

Doc. 11139
22 January 2007

Peril of using energy supply as an instrument of political pressure

Opinion¹

Committee on the Environment, Agriculture and Local and Regional Affairs

Rapporteur: Mr Ivan IVANOV, Bulgaria, Group of the European People's Party

A. Conclusions of the committee

1. Mr Mihkelson's report on the peril of using energy supply as an instrument of political pressure deals with a very important question, which is currently the subject of heated debate in various Council of Europe member states. The Committee on the Environment, Agriculture and Local and Regional Affairs congratulates the Political Affairs Committee on bringing this question before the Assembly, having first examined and discussed it thoroughly

2. The Committee on the Environment, Agriculture and Local and Regional Affairs refers to its own recent work on energy in Europe, including the report on energy systems and the environment which it produced two years ago. In Resolution 1435 (2005), the Assembly invited member states to take urgent action to reduce the environmental impact of energy production, transport and use, in particular by gradually reducing dependence on fossil fuels and ensuring a secure and sustainable energy supply, through options such as further developing renewable energies. It particularly invited central and eastern European countries to further enhance their energy efficiency, safety and industrial restructuring, to diversify and decentralise their energy sources and to reduce their energy consumption.

3. Renewable energy sources (solar power, wind power, hydroelectricity, tidal power, biomass, bio fuels, etc.) make for increased energy independence and security, and make it possible to produce more energy without endangering the environment. This is why clean and renewable energy sources must find their place on energy markets. Reservations still attach to the use of nuclear energy, both for safety reasons and because the problems of processing and storing nuclear waste remain unsolved. An active policy on energy efficiency also offers an optimum return on investment and reduces energy waste, thus improving quality of life.

4. The European Commission has just presented a comprehensive package of measures for a new European energy policy, aimed at combating climate change and improving energy security. It suggests that attention should focus on increasing energy efficiency and giving renewable energy a bigger share of the energy market. But a reliable and lasting solution to this problem requires a joint pan-European strategy, involving all the Council of Europe's member states.

¹ See Doc 11116 presented by the Political Affairs Committee.

5. However, the Committee on the Environment, Agriculture and Local and Regional Affairs notes that the Political Affairs Committee says nothing in its report about energy savings and hopes that the motions for a recommendation which were referred to this Committee in March 2006 will in future receive the attention they deserve. The Committee on the Environment, Agriculture and Local and Regional Affairs intends, for its part, to tackle the question of protection of the environment through energy savings in its own work.

B. Amendments to the draft resolution proposed by the Committee

Amendment A:

In paragraph 5, second sentence, replace the words “both for supplier and consumer countries”, with the following words: “producer, supplier and consumer countries”.

Amendment B:

In paragraph 8, last sentence, after the words “Georgia, Moldova, Ukraine”, insert the following word: “Belarus”.

Amendment C:

In paragraph 9, first sentence, after the words “systems for the”, insert the following words: “transport and”.

Amendment D:

In paragraph 11, last sentence, after the words “which reflect”, insert the following words: “production and transport costs”.

Amendment E:

In paragraph 14, second sentence, before the word “under-utilised”, insert the following words: “under-estimated and”

Amendment F:

After paragraph 14, insert the following new paragraph:

“The Assembly insists on the importance of improving energy efficiency in European countries. This is vital for transport, the building industry and high energy-consumption products. It is also important to reduce energy losses on energy transport and distribution lines. The Assembly is consequently pleased that the European Commission intends, in its action plan for energy efficiency, to reduce its energy consumption by 20% by 2020.”.

Amendment G:

In paragraph 15.2, after the words “construction of infrastructure and”, insert the following words: “improved energy efficiency”.

C. Amendments to the draft recommendation proposed by the Committee

Amendment A:

In paragraph 2.2, after the words “construction of infrastructure and”, insert the following words: “improved energy efficiency”.

Amendment B:

In paragraph 2.3, replace the words “a common pan-European-Strategy”, with the following words:

“a pan-European-Strategy to promote a new common policy, speaking with a single voice on energy questions”.

Amendment C:

After paragraph 2.5.1, insert the following new sub-paragraph:

“not to use energy supply as an instrument of political pressure”.

Amendment D:

After paragraph 2.5.4, insert the following new sub-paragraph:

“to encourage the use of renewable energy on their national energy markets;”

Amendment E:

After paragraph 2.5.4, insert the following new sub-paragraph:

“to do more to develop measures aimed at increasing energy efficiency in industry, transport and services “.

Amendment F:

After paragraph 2, insert the following new paragraph:

“The Assembly is aware that securing real competition and establishing a genuine energy market in Europe depend on diversifying imported energy sources, which in turn helps to reduce the danger of energy supply’s being used as an instrument of political pressure. In this connection, the Assembly asks the European Union and the European Investment Bank to promote, and give priority to, European projects which pursue this aim, as was done for the NABUCCO gas pipeline”.

D. Explanatory memorandum
by Mr Ivan Ivanov, Rapporteur

1. One of the main aims of any democratic country is to provide secure, competitive and sustainable energy, for the purpose of developing its economy, producing goods and services, and meeting the general public’s needs.
2. At the start of this 21st century, energy plays a decisive role in all our countries’ development, as a result of rapid industrial growth and the constant increase in consumption of all types of energy.
3. Growing energy consumption faces the problem of a shortage of natural energy resources in some countries, which are thus highly dependent on imported oil, natural gas and coal.
4. The cost of extracting natural resources has not really increased, but their price on the international markets has risen dramatically, mainly for geopolitical reasons, e.g. the crisis situations in countries with plentiful energy resources, such as Iran, Iraq, Nigeria, etc.
5. After the financial crisis of the mid-90s in the Russian Federation, which ended when the rouble was sharply devalued, Russia’s oil and natural gas exports increased steadily, while its output rose considerably, with the result that it is now the world’s largest producer of oil and natural gas, taken together.
6. The Russian Federation chiefly exports energy to European countries, unlike other major traditional oil and natural gas producers, such as the countries of the Middle East (Saudi Arabia, Iran, Iraq, Kuwait and Qatar) whose exports are regularly divided between various parts of the world.
7. The end of the cold war, the enlargement of the European Union and the disappearance of the threat of military confrontation in Europe were accompanied by a decline in solidarity, and European countries reduced their co-operation on economic issues, including energy, considerably. This allowed the Russian Federation, by concluding a series of “strategic” bilateral co-operation contracts in the energy field, to extend its influence to a point where it could dictate prices for the supply and transport of oil and natural gas to certain former Soviet, and central and east European countries.

8. EU countries with which Gazprom has signed contracts include Germany (whose contract runs until 2030), Italy (until 2035), France (until 2030), Finland (until 2025), Austria (until 2027), the Netherlands (until 2019), Poland (until 2022), the Czech Republic (until 2020) and Hungary (until 2015). In the long term, however, these contracts do not give Gazprom a monopoly as supplier to these countries, since they nearly all have guaranteed supplies from alternative sources, chiefly Norway and Algeria.

9. The countries of eastern Europe are in a totally different situation. For historical reasons, they are highly dependent on energy supplies from Russia. This dependence is primarily embodied in the oil and gas pipelines which were constructed, and became operational, in the old COMECON days, and still connect Russia with the former Soviet republics and the countries of central and eastern Europe. In technological terms, these countries' oil refineries are another aspect of their dependence, since they are principally designed to process Russian oil, which has a high sulphur content. Finally, their nuclear power stations use Russian nuclear fuel almost exclusively.

10. This concentration of energy supplies, and the fact that they are effectively monopolised by a single state, create conditions favourable to their being used as an instrument of political pressure. The reduction, and indeed complete breakdown, in supplies from certain Arab countries to the United States and the Netherlands after the Middle East war in 1973 provide an eloquent example. Although action of this kind does not usually achieve its purpose, it does create economic and social problems for the countries concerned.

11. In 2006, Russia gave the impression that it was using its position as a supplier of natural gas, which is a vital energy source, to exert pressure on certain countries in the region. This was reflected in the determination of the Russian giant Gazprom, which is very close to the Kremlin leadership, to introduce rapid and disproportionate increases in the price of natural gas, coupled with threats that it would stop supplies if its partners refused to pay. This, alas, was no isolated initiative, but a political strategy applied to various countries.

12. Ukraine was the first country to face a sudden price increase from Gazprom. From 1 January 2006, the price of natural gas was increased unexpectedly from 50 US\$ to 230 US\$ per 1000m³. By mixing Russian gas with gas from central Asia (at 60 to 65 S\$), Ukraine has arrived at a consumer price of 96 US\$ per 1000m³ of natural gas.

13. According to Gazprom's estimated budget for 2007, which was published recently, the price paid by Georgia for natural gas will increase from 110 US\$ to 230 US\$ per 1000m³. In Armenia, the price is still 110 US\$, but it will remain at this level for only two more years. Russia accepts this price, because Armenia has sold its largest thermic power plant. Moldova, which bought natural gas from Russia at 80 US\$ per 1000m³ in 2005, was paying 160 US\$ per 1000m³ in 2006. The Moldovan President, Vladimir Voronin, has declared that this is not a fair market price, and has asked for a reduction, on the strength of Moldova's co-operation with Gazprom on gas distribution. Gazprom has refused to agree unless ownership of the Moldovan pipeline network is transferred to it. The Georgian President, Mikhail Saakashvili, has called Russia's price for natural gas a "political price". In fact, Gazprom's prices are clearly not market prices, but serve political purposes.

14. The price of natural gas exported by Gazprom to Romania through intermediaries is twice as high as that in Moldova – 325 US\$ per 1000m³. It should be noted that Romania covers two-thirds of its natural gas requirements (12,000 million m³) from its own output. Referring to the latest price increases, the Romanian President, Traian Basescu, recently said: "There is a danger that Gazprom may be used, at some time in the future, to put political pressure on the European Union". He added: "Finding an alternative to Russian gas must be the European Union's number one priority, since Gazprom may eventually say 'Unless you play ball, we'll sell only to China'." It should be noted that the Romanian Government is one of those which favour a joint EU policy on energy.

15. In 1998, Bulgaria signed a 12-year contract for the supply and transit of natural gas, running until the end of 2010, with Gazprom in Moscow. Starting in January 2006, Gazprom put pressure on Bulgaria to terminate this contract and conclude a new one, insisting that the old one was no longer in the company's interest. In open violation of the "pacta sunt servanda" (contracts must be honoured) principle, and of the agreement it had signed, it finally compelled Bulgaria to break the contract and sign a new one, running until 2030, on 18 December 2006. Russia's failure to respect the original contract will cost Bulgaria over 1.2 billion dollars.

16. In the last few days of 2006, a very serious conflict - similar in all respects to that which had arisen at the beginning of the year with Ukraine - developed between Gazprom and Belarus. In spite of Russia's very close ties with Belarus, Gazprom insisted on increasing the price of natural gas from 47 US\$ to 200 US\$ per

1000m³. Every year, 45,000 million m³ of natural gas - 20% of Russian supplies to western Europe - pass through Belarus, with the remaining 80% passing through Ukraine. With considerable difficulty, Belarus and Gazprom finally agreed a compromise two minutes before the new year began: the price was fixed at 100 US\$ per 1000m³, but Gazprom acquired 50% ownership of the natural gas distribution network in Belarus for 2.5 billion US\$. Regardless of the price finally agreed with Belarus, our study shows that Gazprom's prices for Russia's neighbours range from 95 to 325 US\$. These discrepancies make it hard to claim, as Gazprom does, that it charges market prices.

17. In the first few days of 2007, a further conflict broke out between the Russian Federation and Belarus – this time over oil prices. Russia started by doubling the price of oil to Belarus, which responded by levying a 45 US\$ customs tax on every tonne. On 6 January, Russia cut oil supplies through the Druzhba pipeline, affecting not only Belarus, but also Poland, Germany and other European countries. The German Chancellor, Angela Merkel, declared that this action had “put an end to trust”. Russia and Belarus finally resolved the dispute – but it had, all the same, halted oil supplies through the main pipeline to Europe for several days.

18. Behaviour of this kind has very negative effects on the countries concerned. Firstly, the sudden increase in the price of natural gas makes their goods and services less competitive, slows down their economic development and reduces their living standards. Secondly, natural gas supplies remain a monopoly for decades to come, creating a real danger that they will be used as an instrument of political pressure. Bulgaria is a perfect example of total dependence on Russia for energy supplies: 100% of its oil and natural gas supplies come from Russia, and it is obliged by contract to buy Russian nuclear fuel for the Kozluduy reactor until 2025, i.e. until it is taken out of service. The same scenario may well recur if plans for the new reactor at Belene, which is to be built by Russia, go ahead. Other countries – Belarus, Ukraine and Moldova – are in the same situation, which threatens to turn their past political dependence on the Soviet Union into total energy dependence on Russia.

19. This means that European countries, and particularly those in central and eastern Europe, including members of the old Soviet Union, must – to avert the danger of energy's being used as an instrument of political pressure - find an optimum solution to the problem of energy security.

20. The European continent's means of achieving energy security fall into two categories: technological and political. Making use of them requires the political will to assess the seriousness of the problem for each country's national security.

21. There are four main technological means of ensuring energy security:

- Using local energy resources
- Increasing renewable energy sources
- Boosting energy efficiency
- Diversifying energy supplies from third countries.

22. Local resources are unfortunately limited by natural distribution, which varies from one country to another. The European continent has few oil and natural gas deposits, apart from the deposits on the Norway/United Kingdom continental plate, where production will nevertheless start to dwindle in the coming decades. Coal is a major energy source which most European countries possess. The technologies developed to obtain satisfactory coal and lignite output and ensure almost complete retention of the CO₂ emitted during combustion afford encouraging prospects for the long-term use of coal as an essential energy source in Europe.

23. Renewable energy sources are by definition local sources, which increase a country's level of independence and energy security. They also serve to increase energy production without endangering the environment. They already rank third (after coal and natural gas) among the energy sources used for electricity production worldwide. The share of electricity produced from renewable energy sources in the European Union's consumption is expected to reach 12% by 2010. Also by 2010, biofuels should account for at least 5.75% of all petrol and diesel oil consumption. Some countries have already exceeded these targets. In Denmark, for example, 25% of the country's electricity is produced by wind farms. Given the scale of initial investment costs, efforts must be made to encourage research, demonstration and initial commercial application projects in order to help clean and renewable energy sources gain a foothold on the markets. These sources include hydroelectricity and tidal power, but also the use of biomass and biofuels such as bioethanol and biodiesel. Technologies for producing solar energy and wind power are already highly developed.

24. An active energy efficiency policy serves to make cost-effective investments and curb energy waste, which results in a better quality of life. Formerly, for political reasons, central and east European countries used high energy consumption technologies and machinery from the Soviet Union. They must now be encouraged in their efforts to improve energy efficiency – a slow and difficult process. By way of example, according to European Commission estimates, Bulgaria's energy efficiency rate is eight times lower than the EU average. The situation is even more serious in the former Soviet Union countries. It is imperative to mount a long-term campaign in favour of energy efficiency in transport, in the building industry, including the public sector, and in the main groups of high energy consumption products (appliances, vehicles, industrial facilities). It is also important to reduce energy loss along electricity transport and distribution lines, which exceeds 25% in some east European countries. The Energy Efficiency Action Plan unveiled by the European Commission on 29 October 2006, which proposes to save 20% of the energy used by the European Union by 2020, can provide the basis for the measures to be taken.

25. The use of nuclear energy has remained a matter for caution since Chernobyl, both for nuclear safety reasons and because of the unresolved problems surrounding the processing and storage of long-life radioactive nuclear waste. Bearing in mind the world's future generations, the construction of new nuclear plants must meet very strict international criteria guaranteeing that the use of civilian nuclear energy involves no humanitarian, ecological or economic risks. The future of nuclear energy will be clearer after fusion power has been produced industrially. The first plant of this type will start to operate in France as part of the international ITER project.

26. For the time being, establishing real competition and a genuine energy market in Europe means diversifying energy import sources, which in turn will reduce the danger of using energy supply as an instrument of political pressure. Energy supply can be diversified by means of direct contracts with oil and natural gas producing countries in the Caspian Sea region (Azerbaijan), central Asia (Kazakhstan, Turkmenistan) and the Middle East (Iran, Iraq, Qatar), and transport via the Caucasus and the Balkans. Steps have already been taken in this direction. The Baku-Tbilisi-Ceyhan oil pipeline has already been built and is in operation. The Shah-Deniz (Baku)-Tbilisi-Erzurum gas pipeline is scheduled to come into operation in the near future. Erzurum is in fact the starting point of the trans-European gas pipeline NABUCCO, which runs through Turkey, Bulgaria, Romania, Hungary and Austria and is to be brought into operation in early 2011, carrying natural gas supplies from Azerbaijan and Iran. The European Commission has declared it a "priority energy project" and funds part of it. Another major project is the Liquefied Natural Gas (LNG) pipeline from Algeria and Libya to southern Europe. The gas pipeline being built in Egypt, Jordan, Syria and Turkey has a capacity of ten billion m³ per year and can also feed into the NABUCCO gas pipeline at Erzurum.

27. The second group of means of achieving energy independence is based on international legal instruments which guarantee liberalisation of the energy market and free competition between suppliers. Setting up a framework of this kind and ensuring that all Council of Europe member states comply with it should permanently remove the danger of using energy supply as an instrument of political pressure. This framework is firmly grounded in the European Energy Charter (The Hague, 1991), a declaration of political intent, and the Energy Charter Treaty (ECT), a multilateral document defining intergovernmental co-operation in the energy sector. Unfortunately, although both Russia and Norway have signed it, they have not yet ratified it: Russia disagrees on the issue of natural gas and oil from third countries transiting through its pipeline network.

28. The Protocol on Transit will be of crucial importance for free trade in energy products. Negotiations on its content have reached a very advanced stage, but if it is to be valid for all European countries, the Russian Federation must be involved in its preparation. The main principle embodied in the protocol will be oil and natural gas suppliers' free access to national pipeline networks. This is the principle that has been established in European countries for electricity transport, telecommunications services and rail transport.

29. Unlike other countries, the Russian Federation systematically denies third countries access to its pipeline network for natural gas and oil transport, and compels Kazakhstan and Turkmenistan to sell their natural gas to the monopoly company Gazprom on their border with Russia. This hampers direct negotiation between the European countries and the central Asian countries, which would allow the latter's natural gas to compete with that of Gazprom in terms of price, quantity and delivery times. There are two possible solutions: either the Russian Federation liberalises its pipeline network or alternative pipeline networks are built, bypassing the Russian Federation to the south. The second would take longer and cost more, but may prove the only possible solution if the Russian Federation does not alter its position.

30. In negotiations with other countries, Gazprom applies double standards. On the one hand it does not allow gas to transit directly through its pipeline network across Russian Federation territory, while on the

other, the long-term contracts that it signs with central and east European countries for their natural gas supplies always include clauses guaranteeing that Russian gas will be transported across the corresponding countries to more distant destinations.

31. On 10 January 2007 the European Commission presented a comprehensive package of measures for a new European energy policy, particularly to combat climate change and increase energy security. The mainstay of the new policy is a core energy objective for Europe: the EU should reduce greenhouse gas emissions from its energy consumption by 20% by 2020. With this objective in view, the EU will be able to measure progress in redirecting the energy economy towards a system that will fully meet the challenges of sustainability, competitiveness and security of supply. To do so, the Commission proposed concentrating on specific energy measures including improving energy efficiency, increasing the share of renewable energies in the energy mix and placing renewed emphasis on nuclear safety and security.

32. A stable and sustainable solution to the problem might be to devise a common pan-European strategy for energy security, based on the principles of liberalising the market and ensuring free competition between producers, suppliers and users. Setting up a strategy of this kind would require the involvement of all the Council of Europe member countries, and consideration of their national interests, to ensure that it was a fully European instrument.

33. The principle of reciprocity is an important part of such a future strategy for energy security in Europe. It is not acceptable that Gazprom should own pipelines in other countries (Moldova) and should not allow other foreign companies to own network segments on Russian territory.

34. Transparency should also be a basic principle of the future outline document on natural gas supply and transit: transparency in terms of contracts, prices and the subsidiaries conducting the various activities. The fact that Gazprom can in some cases double the price of natural gas casts doubts on its price-setting methods and instils a belief that its motives are basically political.

35. Several points are completely unclear, including the status of the subsidiaries imposed by Gazprom when contracts are signed with the various countries, the reasons for setting them up and their financial relations with Gazprom itself.

Reporting committee: Political Affairs Committee

Committees for opinion: Committee on the Environment, Agriculture and Local and Regional Affairs and Committee on Economic Affairs and Development

Reference to committee: Reference No 3231 of 29 May 2006

Opinion approved by the committee on 22 January 2007

Secretariat of the committee: Mr Sixto, Mr Torcatoriu, Mrs Trévisan