

The Energy Dialogue EU-Russia

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European Commission
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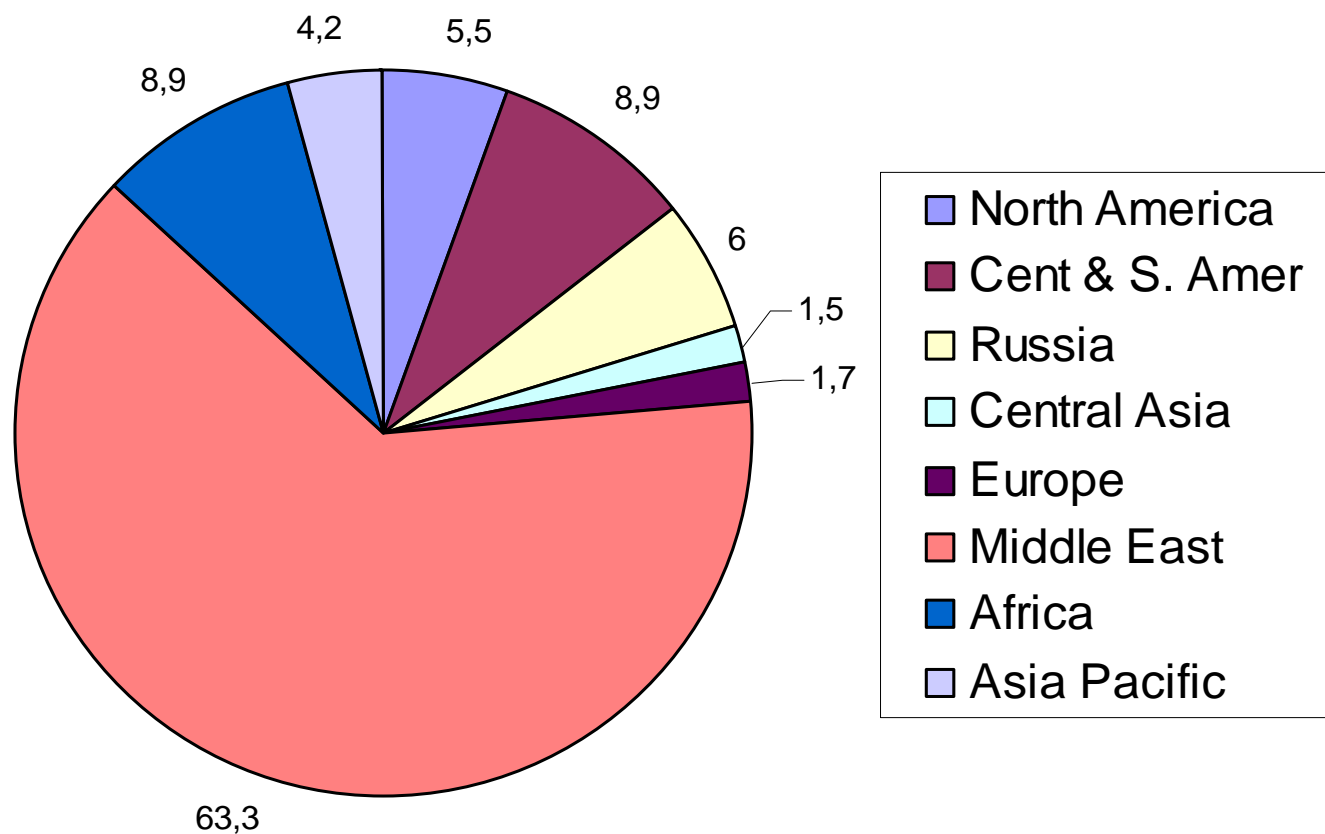
Russia

- A huge country: 2 x China, 31 x France, 17 mio km², 11 time zones
- South to North : 4000 km, West to East : 9000 km, 1/8 of the world earth surface, getting colder from west to east....
- 143 million inhabitants, out of which:
 - 75% are in the European part of Russia which covers about 25 % of the territory
 - 25 % in Asian Russia which covers about 75 % of the territory
- Composed of 89 subjects : 49 regions (oblast), 21 autonomous republics, 6 territories (krai), 1 autonomous oblast, 10 autonomous districts(okroug), two federal cities (Art 65 of the Russian Constitution)
- From the administrative point of view : 7 federal districts to ensure the exercise by the president of the Russian Federation of his constitutional powers, to raise the effectiveness of the activity of federal bodies of government and to improve the system of control of their implementation of their decisions.
- State Council : advisory body composed of the governors and chaired by the President of the RF
- Federal Assembly : - upper chamber : the Federal Council
- - lower chamber : The Duma
- More than 100 nationalities and ethnic groups
- Over 100 minority languages
- Russian spoken by 120 million inhabitants
- Is Russia Eurasian ? : represented in Asia (Russian Far East) with a ratio of 1 to 200 as compared to China.
- The region East of the Urals (Asian Russia) is about as large as China and India combined, with about 30 million inhabitants and with a yearly average temperature below freezing

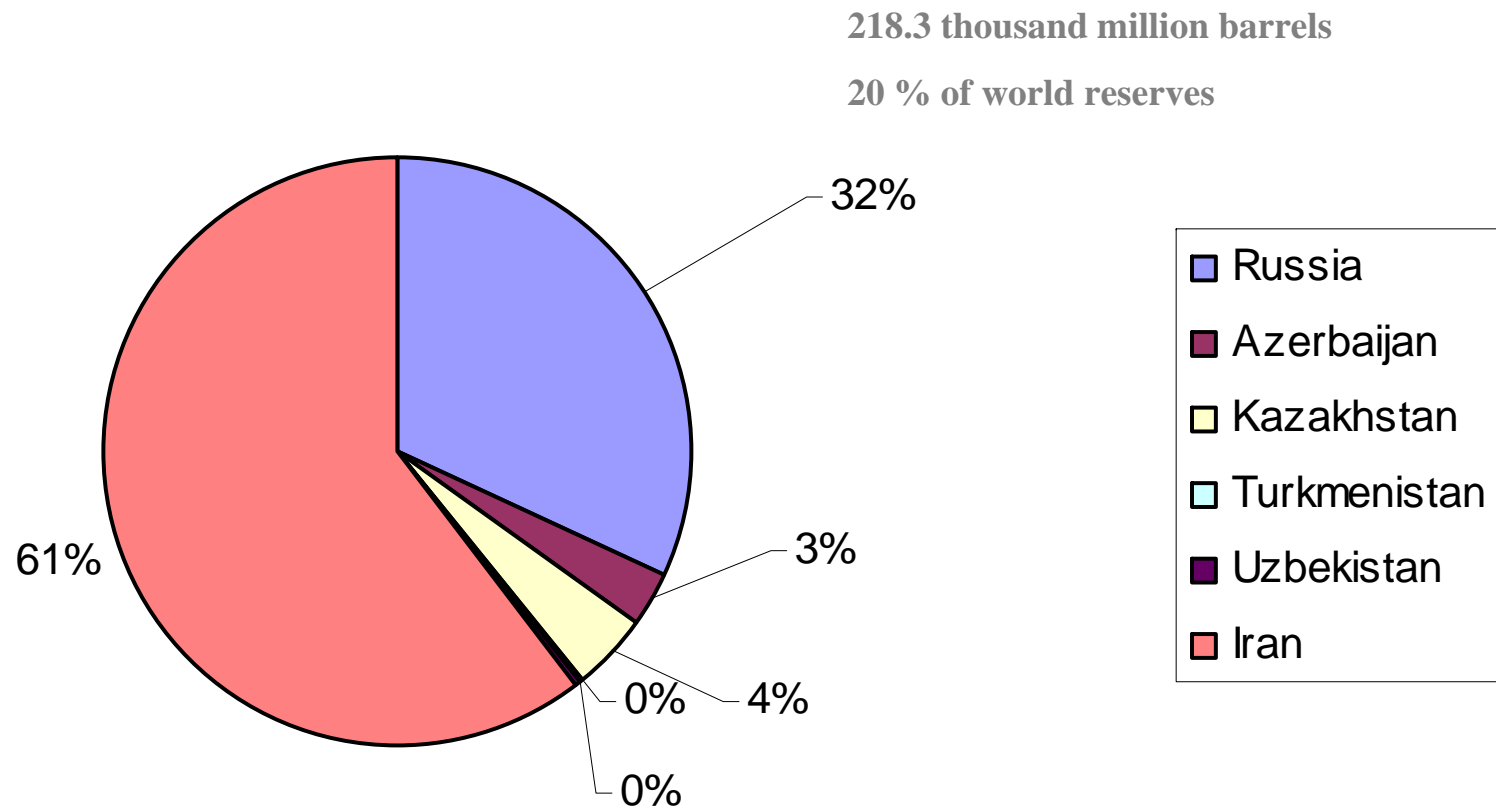
The Global Energy Context

Oil : World Proved Reserves (%)

1 148 thousand million barrels



Oil Proven Reserves: (Caspian region countries)

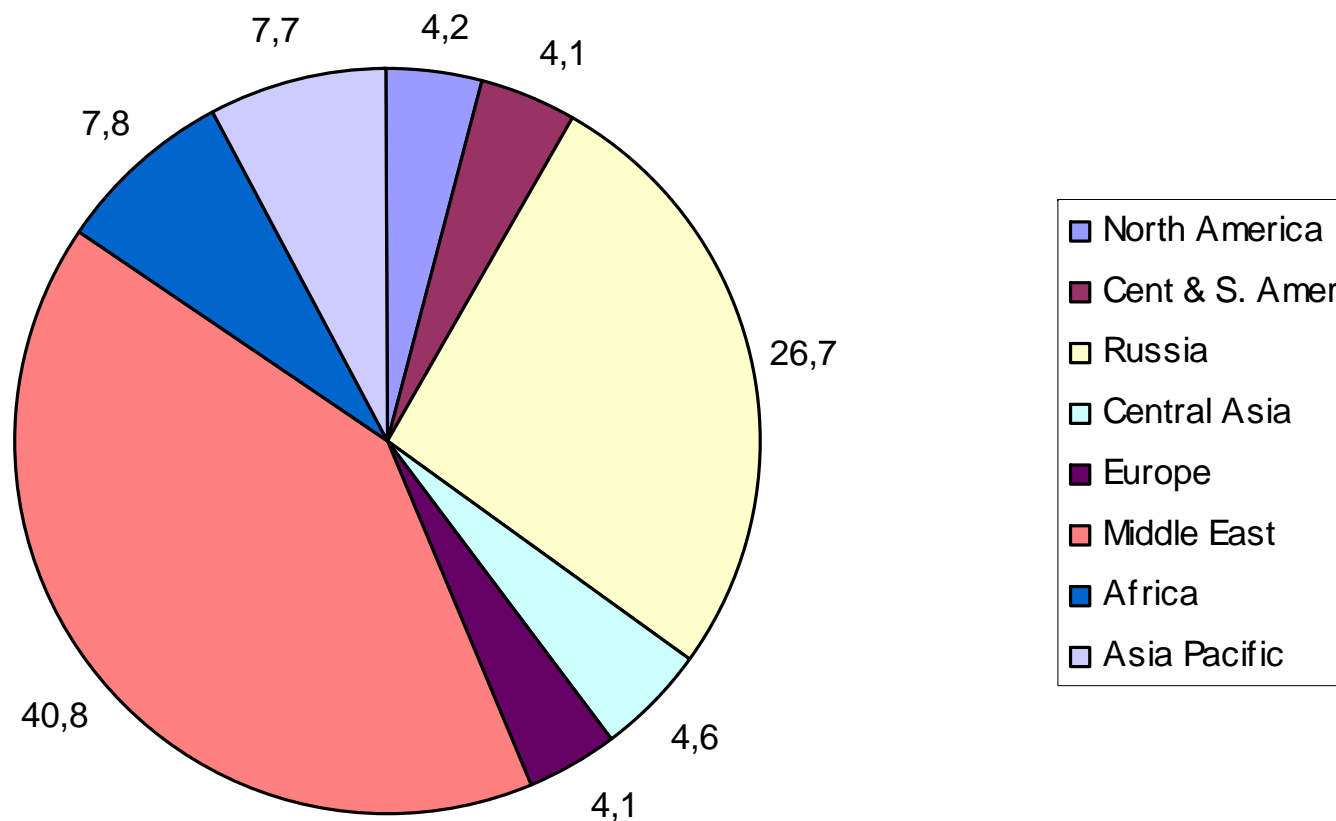


BP Statistical Review of World Energy, 2004

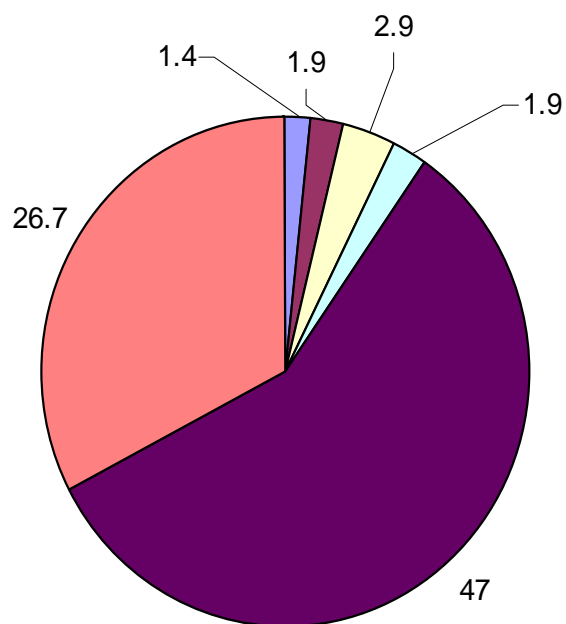


The Global Energy Context: Natural Gas : World Proved Reserves (%)

176 trillion M3

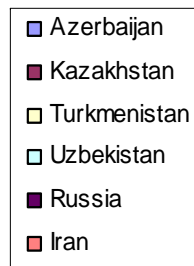


Natural Gas Proved Reserves (trillion cm) (Caspian region countries)



81,5 trillion cm

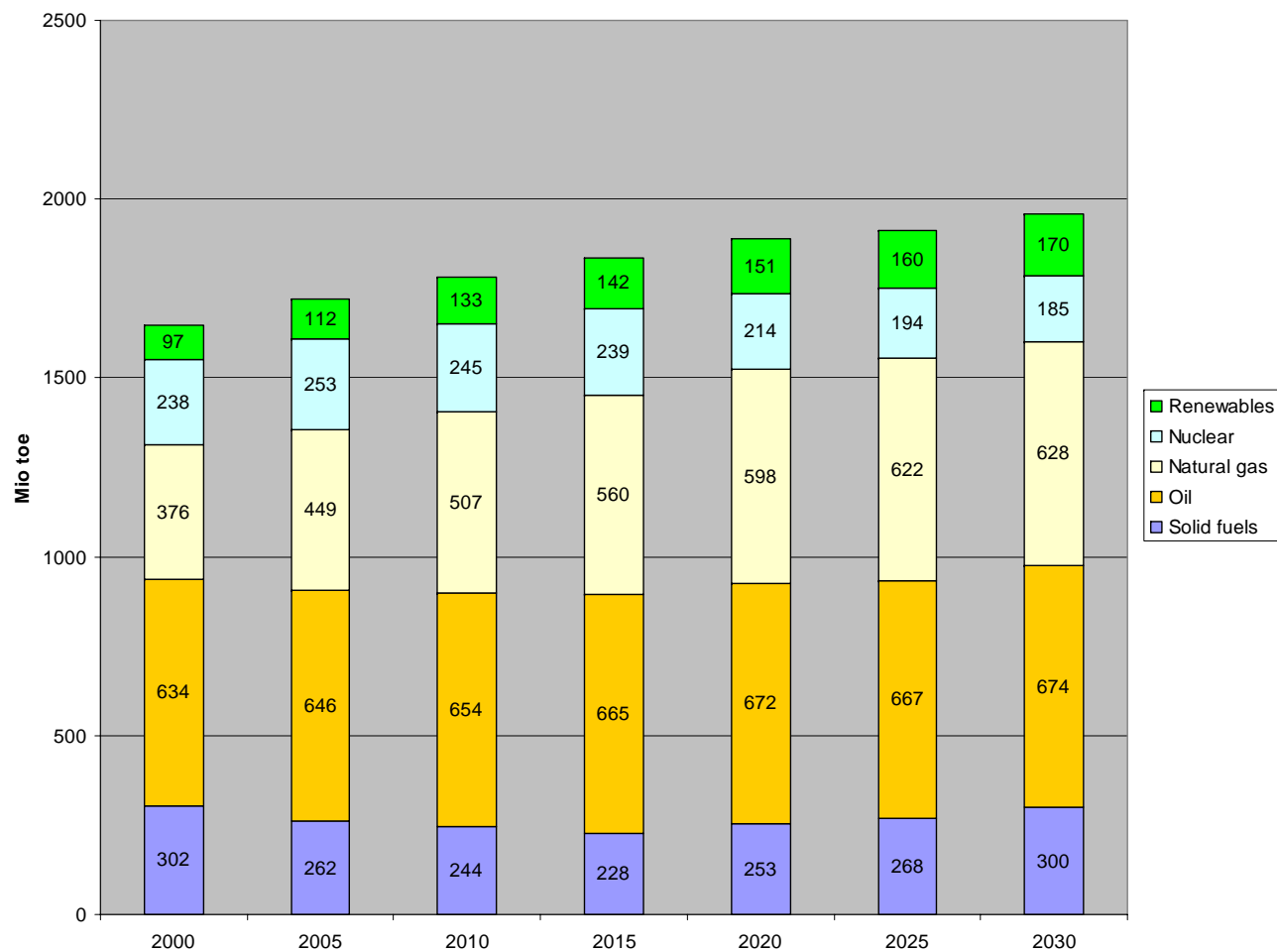
47 % of world reserves



BP Statistical Review of World Energy, 2004



EU 25 Gross Inland Consumption



Sources : European Commission, Scenarios on Key Drivers, Brussels, sept. 2004



Extending the Internal Energy Market beyond the EU

- *Commission Communication*

on «The development of energy policy for the enlarged EU, its neighbours and partner countries » (May 2003) to enable « The progressive creation of an integrated European internal market, not a market simply limited to EU Member States » in order to create « an area of shared prosperity and stability in and around Europe »

- *Objectives*

- Enhance the security of energy supplies of the European continent
- Strengthen the Internal Energy Market of the enlarged EU
- Support the modernisation of energy systems in partner countries
- Facilitate the realisation of major new energy infrastructure projects.

- *Conditions*

- A level playing field in terms of market opening, fair competition, environmental protection and safety, including nuclear safety.
- Some common rules and standards in the energy sector.
- Additional infrastructure.



EU Actions to match policies

- *South-East Europe*

Development of an Energy Community between the EU and the countries of South East Europe, including Turkey.

- *Mediterranean*

Objective of developing a Euro-Mediterranean energy market.

A number of significant sub-regional projects being pursued (including the progressive integration of the Maghreb electricity markets and integration of gas markets in the Mashreq region)

- *Caspian Basin*

EU-Caspian Basin Ministerial Conference on Energy of November 2004 and the creation of four working groups

- *Ukraine*

Agreement in February 2005 to intensify energy co-operation. Draft memorandum of understanding to be approved on the occasion of the Summit EU-Ukraine.

- *Russia*

EU-Russia Energy Dialogue.

- *Other countries and organisations* : Dialogue with Opec and energy cooperation with China

- *Israeli-Palestinian Energy Co-operation programme* : electricity, renewables, gas cooperation



Importance of EU-Russia energy relations

Data: Russia

- energy sector contribution to GDP : approx 25%
- oil exports to the EU-25: 63% of oil exported
- gas exports to the EU-25 : 65% of gas exported

Data: EU-25 today

- 30% of oil imports from Russia
- 50% of gas imports from Russia



The Russian economy (1)

- Robust economic growth (6.5% on average 1999-2004) but economy over dependent on energy and metals (account for well over 50 % of exports). GDP growth rate in 2004 : 7.1 % but 1 \$ decrease in oil prices (Ural crude) might mean 0.15 % decrease in GDP growth rate. Decrease in GDP growth rates foreseen for the next couple of years even with increasing oil prices. Revised estimate for 2005 : 5.2 %. Baseline forecast 2006-2008 : 4.5-4.6 %. Optimistic scenario 2006-2008 : 5.9% - 6.2%;
- Good management of public finances with large surplus of the federal budget;
- Stabilisation fund at 20 billion € on August 1 2005 after Russia reimbursed in July the Paris Club creditors €12 billion on an accelerated schedule;
- International reserves multiplied by 10 since 1998 : 145 bn \$;

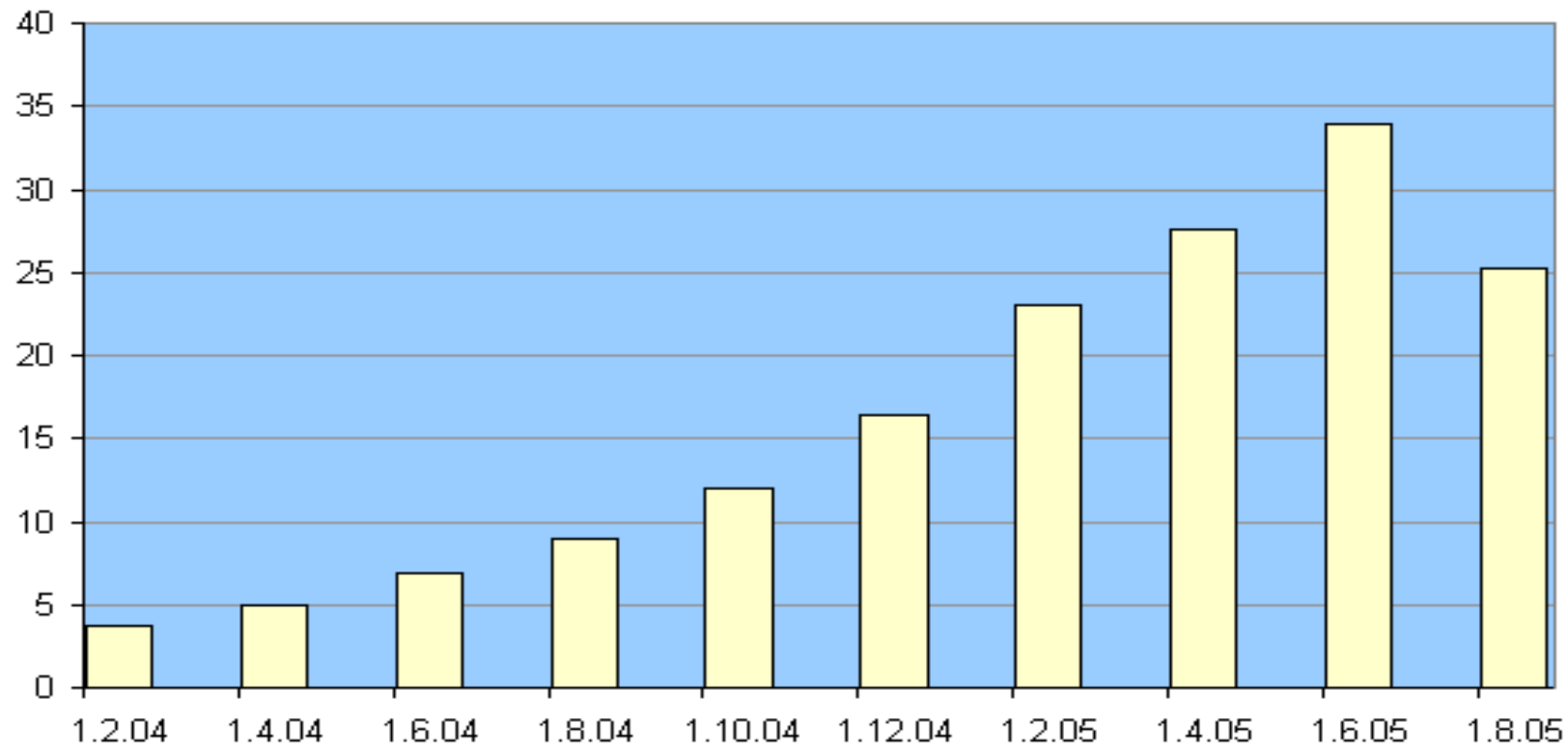


The Russian economy (2)

- Lowest income tax in Europe : 13 % for residents and one of the lowest corporate profit tax at 24 %;
- Increase in real terms of nominal average monthly wage in 2004 by 11 % (6 655 roubles) and increased consumer confidence, but 20 % of the population is still living below the poverty line of 2 400 roubles per month;(1 \$ = 28 Rb, 1€= 35 Rb)
- Economic fundamentals are improving : stable exchange rate, inflation under control even if higher than expected for 2004 (12.4 %), but demographic trends cause a downward pressure on productivity. On average Russian women live 10 years less than women in Western European countries, and Russian men live a whole 16 years less on average. Around 40 000 people a year die from alcohol poisoning;



Stabilisation fund assets (000 million US \$)



Sources : Russian Ministry of Finance. August 2005

European Commission : DG TREN



Functioning of the Stabilisation Fund

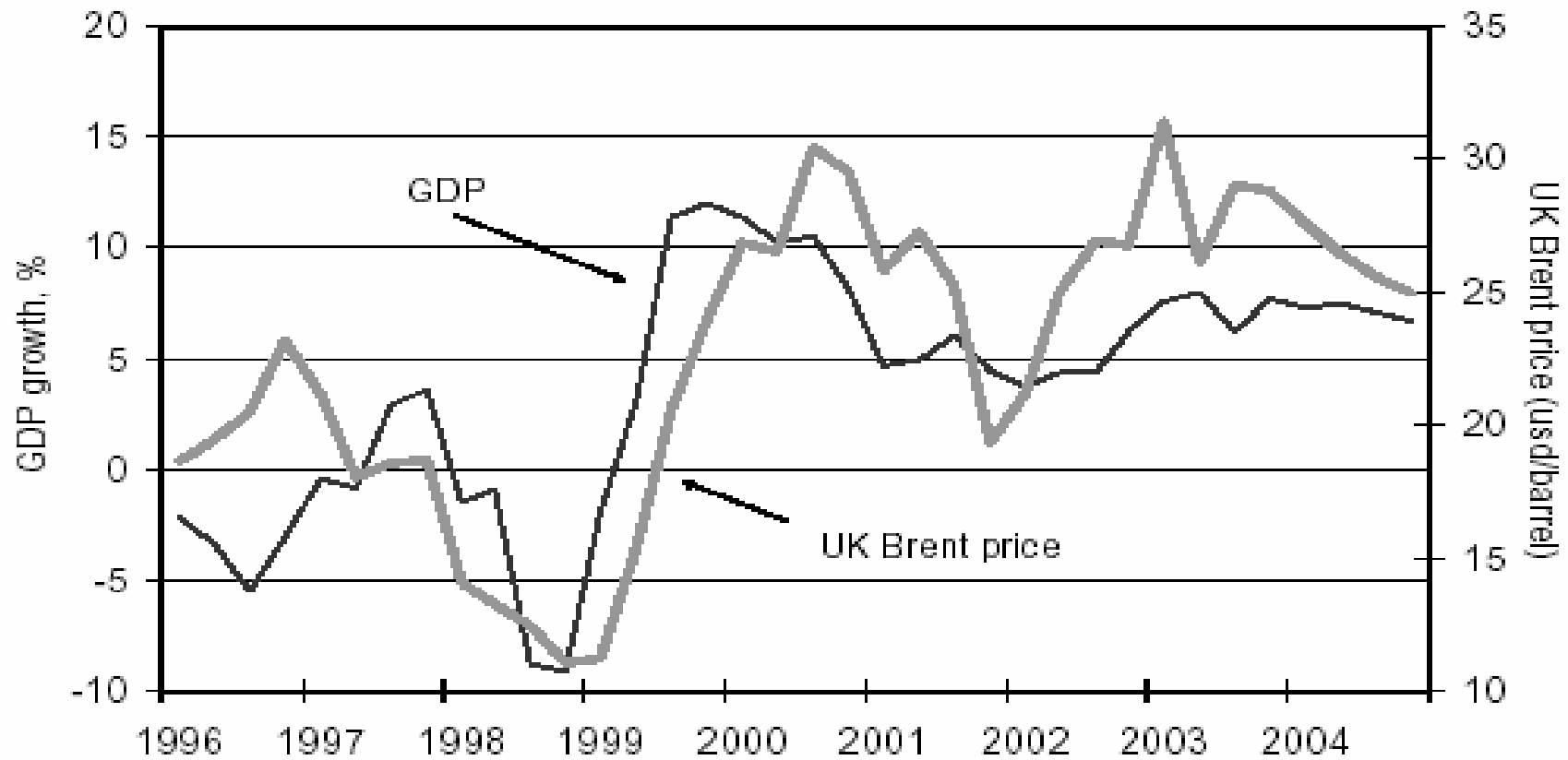
- Created in 2004 to insure the federal budget against oil price volatility (financial crises of 1998)
- Surplus revenue from relatively high oil prices are accumulated automatically in the Fund ie : all the revenue from the natural resource extraction tax and the crude oil export duty above that which would accrue at an oil price of \$ US 20.
- When the Fund exceeds 500 bn RB (18 bn US\$), additional revenue can be used for unspecified other purposes, but must be foreseen in the federal budget. It will for example feed the

proposed *investment fund*

To attract private investors to joint public-private investment projects, the government has agreed in principle on the establishment of an investment fund. The fund is expected to contribute to stable economic growth and diversification of the Russian economy. Its resources would come from oil export revenues and interest savings from early repayment of foreign debt. The financial plan for 2006–2008 allocates about RUB 70 billion (\$2.5 billion) yearly to the fund. The fund is designed for infrastructure projects and projects related to institutional reforms and innovation systems. Fund resources may also be used for fixed capital investments in enterprises or for state guarantees. This fund would contribute to « liberate » GDP from its too high dependency on oil prices. WHY



Correlation between oil prices and GDP growth



Russia's foreign investment policy

Annual Address of President Putin to the Federal Assembly. 25 April 2005

« Russia is extremely interested in a major inflow of private, including foreign, investment. This is our strategic choice and strategic approach. »

« In practice, investors sometimes face all kinds of limitations, including some that are explained by national security reasons, though these limitations are not legally formalized. This uncertainty creates problems for the state and investors. »

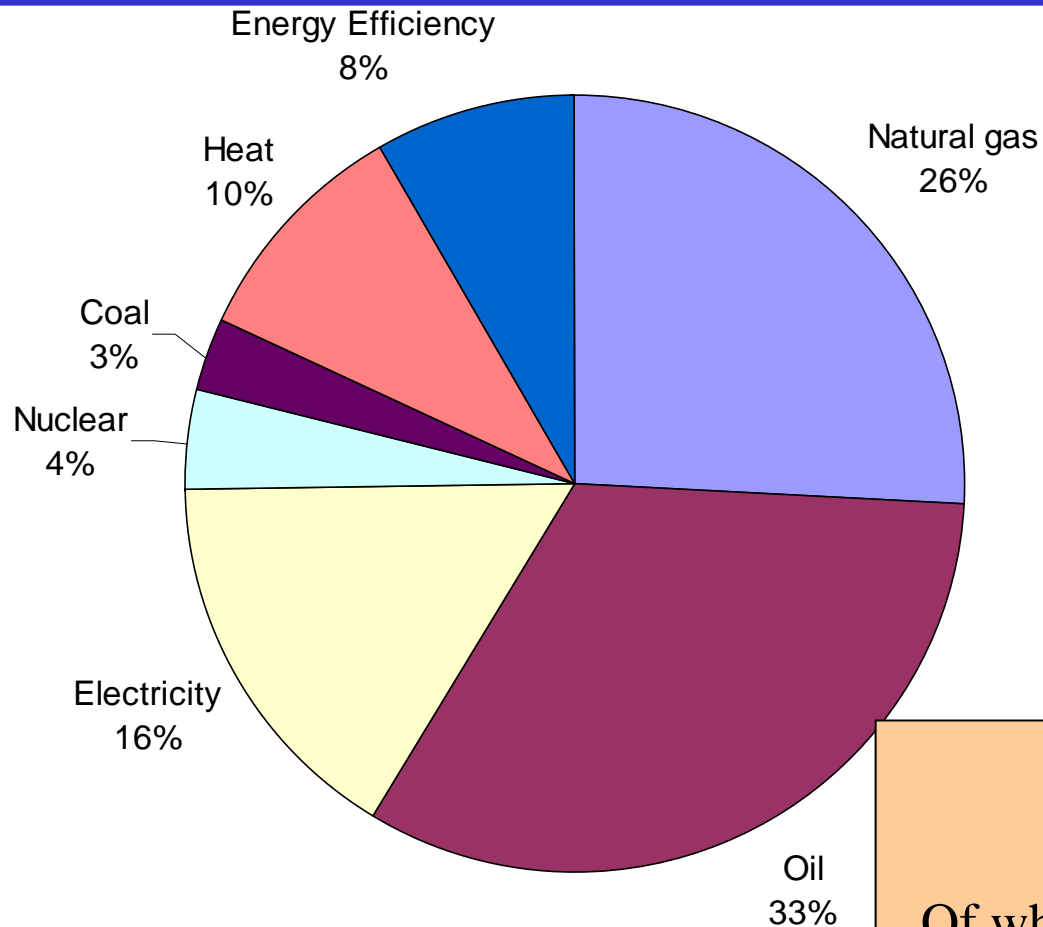
« We should draft and legally formalise a system of criteria to determine the limitations on foreign participation in (certain) sectors of the economy. »

« While maintaining such control and limitations in some economic sectors, we should create favourable conditions for the inflow of private capital to all the other attractive sectors. »

« The goal of these measures is apparent: investors do not need riddles and charades. They will invest their money only in a stable economy with clear and comprehensible rules of the game. And this approach will be fair to both society and the state, which should protect its prospective interests and take care of the country's development for years and decades to come. »



Russia Energy Sector Investment requirements



Total requirements 2003-2020
\$ 735 thousand million
Of which at least 25 % foreign investment

Sources : Russian Federation : Russia's Energy strategy
until 2020 and European Commission.



Investment climate

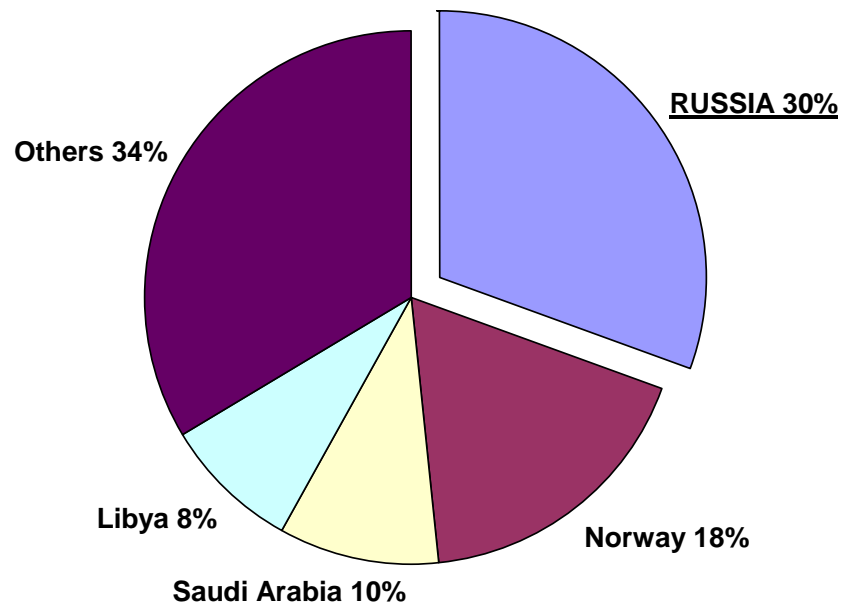
- Oil and gas investors, well-adapted to tough business environments, ranked Russia their second most attractive market in the world, behind Australia according to A.T. Kearney 2004 FDI Confidence index, even if according to AT Kearney, on the global Russian FDI Confidence index, Russia dropped nevertheless from an all time high in 2003 as number 8 to the 11th most attractive market globally as the result of the “likely role played by the events surrounding the Yukos affair, violent terrorist attacks over the past year as well as limited progress on reforms and lack of clarity about the role of the State in the economy”.
- FDI increasing rapidly : \$ 9.4 bn in 2004 but still low when aggregated over the 1990-2004 period : \$ 40 bn.
- International **rating** of Russian bonds raised to “investment grade” but banking system is still in the middle of restructuring; number of banks falling but still about 1 300.
- **Corruption remains a problem.** various anticorruption bodies : (2003) Council for the struggle against Corruption, (2004) Special Commission for the struggle against Corruption, (2004) Reorganisation of the Federal Financial Monitoring Service.



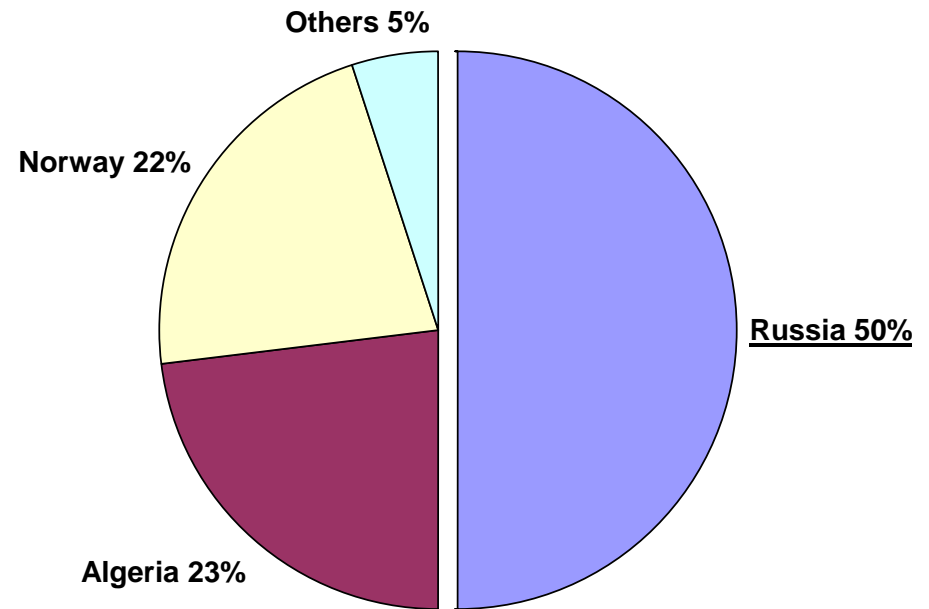
Energy Security: Russia: a major & reliable supplier of hydrocarbons

The origin of imports into the EU 25

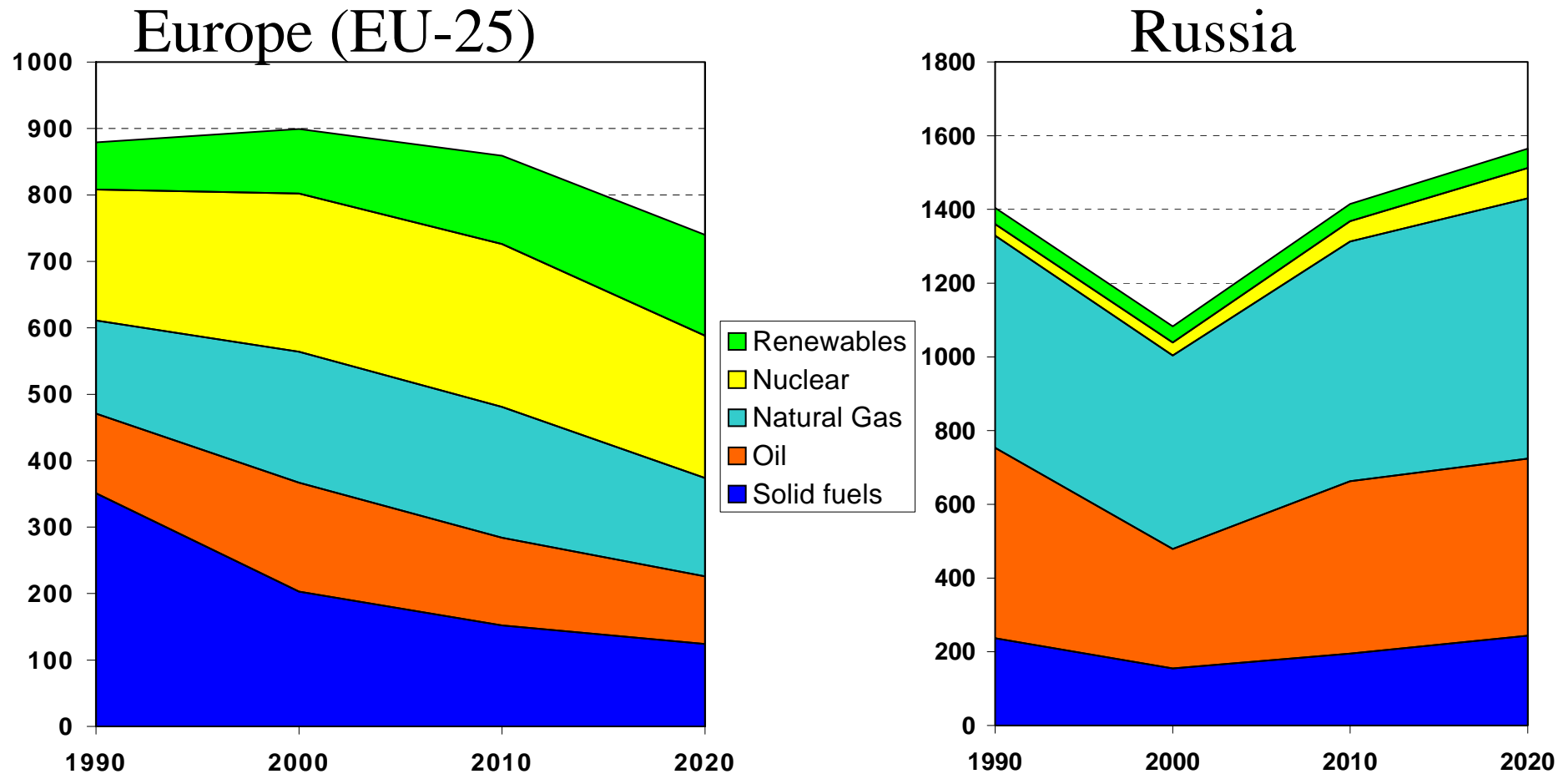
Oil (crude & products)



Natural gas



Importance of EU-Russia energy relations: Indigenous energy production (Mtoe)



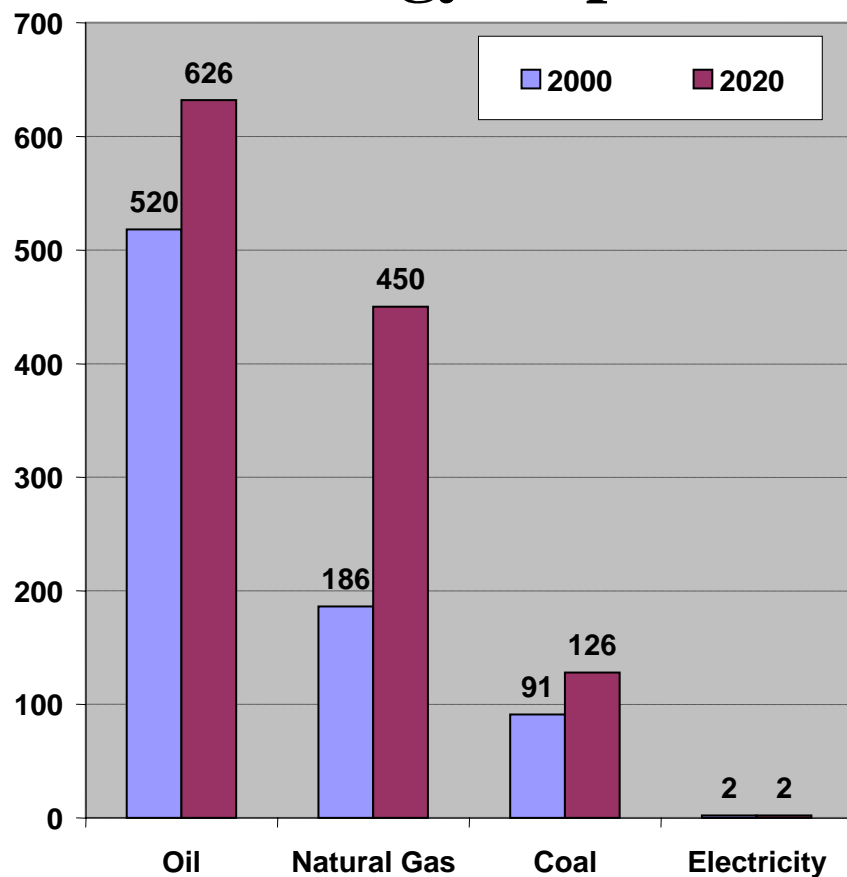
70% EU-30 external energy dependency by 2030!

Sources: Russian Federation : Russia's strategy until 2020, European Commission : trends to 2030

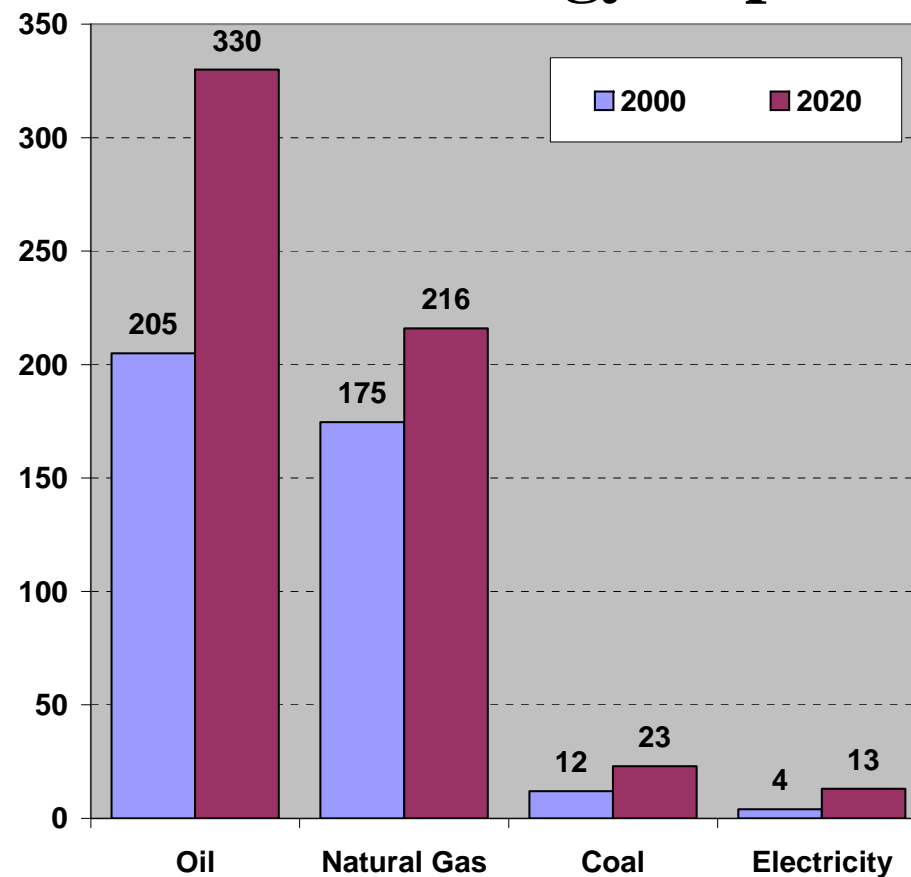


Importance of EU-Russia energy relations: Energy imports and exports (in mtoe)

EU Energy Imports



Russian Energy Exports



Sources: Russian Federation : Russia's strategy until 2020, 2003. European Commission, : Scenarios on key drivers, 2004



Trans-European Networks

- TEN-Energy policy aims at
 - encouraging effective operation of the internal energy market
 - reinforcing the security of energy supplies
- Revised set of guidelines for TEN-Energy projects includes
 - priority projects which enjoy priority in Community support

❖ for natural gas

NG 1 : Northern European Gas Pipeline, Yamal-Europe

NG 2 : Algeria-Spain-Italy-France-Northern continental Europe

NG 3 : Caspian Sea Countries-Middle East-European Union

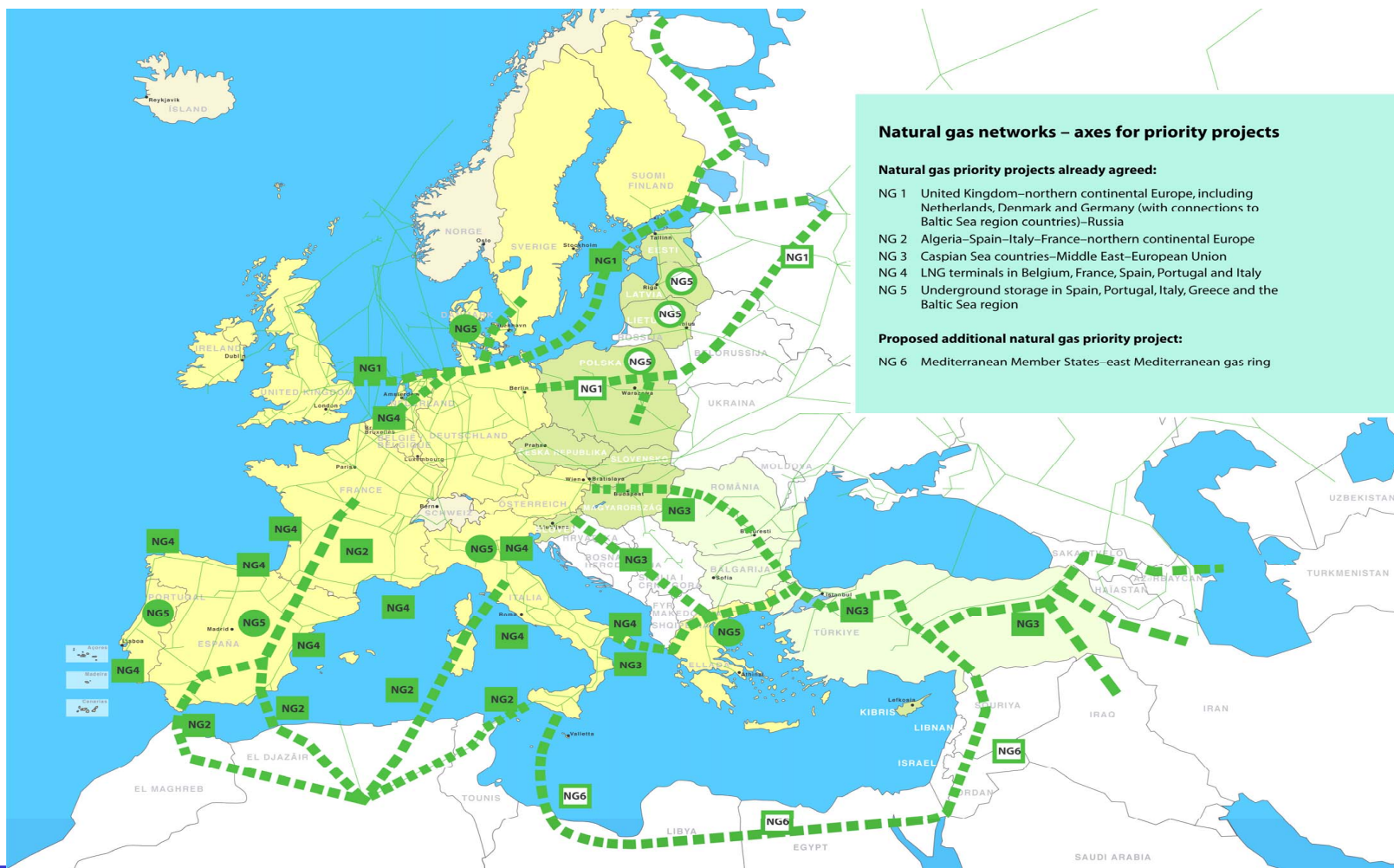
NG 4 : LNG Terminals in Belgium, France, Spain, Portugal, Italy and Poland

NG 5 : Underground storage in Spain, Portugal, Italy, Greece and the Baltics

NG 6 : Mediterranean Member States-East Mediterranean Gas Ring.



Trans European Networks Gas priority projects



EU-Russia partnership :The four Spaces

EU-Russia Summit of 10 May 2005

-
- **Common Economic Space** : The objective of the common economic space is to create an open and integrated market between the EU and Russia. Work on this space will bring down barriers to trade and investment and promote reforms and competitiveness, based on the principles of non-discrimination, transparency and good governance.
 - **Common Space of Freedom, Security and Justice** : The underlying principles of the common space of freedom, security and justice are democracy, the rule of law, respect for human rights and fundamental freedoms, including free and independent media and the effective application of common values by independent judicial systems.
 - **Common Space of Co-operation in the Field of External Security** : The road map for the Common Space of External Security underlines the shared responsibility of the EU and Russia for an international order based on effective multilateralism, their determination to co-operate to strengthen the central role of the United Nations, and promote the role and effectiveness of relevant international and regional organisations, in particular the OSCE and the Council of Europe.
 - **Common Space of Research and Education** : Work to create the common space of research and education, including cultural aspects, aims to capitalise on the strength of EU and Russian research communities and cultural and intellectual heritage.
-



The Energy Dialogue

- ➔ Where : The EU-Russia Summit in Paris
- ➔ When : 30th October 2000
- ➔ Nomination of two sole interlocutors : Mr François Lamoureux, Director General of the European Commission and Vice-Prime Minister of the Russian Federation, Viktor Khristenko
- ➔ Objectives
 - **progress in the definition of an EU-Russia energy partnership,**
 - **contribute to the security in energy supply as well as in energy demand,**
 - **cooperation on energy efficiency and saving,**
 - **rationalisation of production and transport infrastructures and importance of electricity interconnections,**
 - **facilitate investments,**
 - **contribute to the relations between producer and consumer countries.**



Energy dialogue: Results to date (1)

- *No quantitative restrictions on EU imports of fossil fuels;*
 - *Solutions found to ensure the compatibility of Russian long term gas supply contracts with the EU internal market rules by the elimination of « destination clauses »;*
 - *Contributed to the ratification by Russia of the Kyoto Protocol ;*
 - *Promotion of energy efficiency projects : pilot projects Astrakhan, Arkhangelsk, Kaliningrad;*
 - *Contributed to the bilateral agreement of May 2004 between the EU and Russia on Russia's accession to the WTO with relation to the price of gas to industrial users in Russia and export duties on energy products;*
 - *Feasibility studies on mechanisms to cover non commercial risk for energy investment projects;*
 - *Maritime Safety : support provided by Russia to the EU at the IMO concerning the phasing out of single hull tankers;*
-



Energy dialogue: Results to date (2)

- *Confirmation of supply contracts for nuclear material concluded by Russia before enlargement;*
- *Free transit of energy products including electricity to Kaliningrad;*
- *Continuous comparison of analysis, scenarios and strategies;*
- *Setting-up in December 2003 of an « Energy Industry Steering Group » to identify more clearly the industrial and business issues to be tackled;*
- *Setting-up in November 2004 of four Thematic groups comprising Russian and European experts from the private and public sectors on the themes of investment, infrastructures, energy efficiency and trade;*
- *Constitutes a path for European companies seeking to enter Russian markets. Has made it possible to resolve certain problems which European companies could have encountered.*



Energy dialogue: **Results to date (3)**

Interconnection of the electricity grids

On 19 April 2005, Boris Ayuev, CEO of the System Operator of the « United Power System of Russia –UPS » and Martin Fuchs, President of the European « Union for the Coordination of Transmission of Electricity – UCTE » and CEO of E.ON Netz, kicked of a three year study that should lead to the synchronous interconnection of the UPS/IPS and the UCTE creating an installed generation capacity of some 800 GW, spanning 13 time zones and serving about 800 million people



Energy dialogue: Results to date (4)

Projects of Common interest

The Shtokman gas field

- Reserves : 3 200 million M3
- Yearly production : 60 000 - 90 000 million M3
- Production to start in 2010
- Duration : 50 years
- Yearly production would represent **15 %** of yearly EU 25 gas consumption
- Capex : 15 to 20 000 million €
- Western Companies shortlisted by Gazprom on 16/9/2005
 - Statoil (N), NorskHydro (N), Total (F), Chevron(US)
 - ConocoPhillips (US)

Gazprom will keep 51 % of the consortium. Contract to be signed in 2006 with the shortlisted western companies that could be brought down to 2 or 3.

First stage of production will be liquefied natural gas (LNG) for the US and Europe. NLG plants being probably build by 2010 in **Ust Luga** in the Gulf of Finland (7 000 mio M3) and in **Murmansk** oblast (Capacity : 15 000 mio M3)



Energy dialogue: Results to date (5)

Projects of Common interest

The Northern European Gas Pipeline

- Vladimir Poutine : *“The capacity of the pipeline is about 20 billion cubic metres a year and it will be increased up to 55 billion cubic metres a year by the year 2011. The first part of the project will amount to about two billion US\$. The total cost is 5.7 billion U.S. dollars. We hope that the project will give a powerful impetus to the energy dialogue between Russia and the European Union,”*



8/9/2005 : Signing of a tripartite agreement for the creation of a joint-venture between Gazprom (51 %) and BASF and E-ON (each 24.5 %) to build the NEGP.



Energy dialogue: Results to date (6)

The EU-Russia Energy Dialogue Technology Center



Технологический центр

The EU-Russia Energy Dialogue -

Technology Centre is a project co-funded by the European Union and the Russian Federation which aims to enhance co-operation between the EU and Russia on new energy technologies and facilitate the attraction of investment for technology projects of common interest.

Last Update: 20/05/2005

Inauguration of the Center by

V Khristenko and F. Lamoureux 5/11/2002



<http://www.technologycentre.org/>

European Commission : DG TREN



The Energy Dialogue : Priority Actions for the future (1)

Conclusion of the EU-Russia Summit of May 10 2005 in Moscow on the Energy Dialogue (Roadmap for the Common Economic Space) :

« Particular emphasis on addressing issues related to the sustainability and continued reliability of the production, distribution, transportation and use of energy, including energy efficiency, energy savings and the use of renewable energies.

In order to reach these objectives, it is important to promote and protect investments in the energy sector, to facilitate the improvement of the investment climate, promote regulatory convergence and a high standard of environmental protection »



The Energy Dialogue : Priority Actions for the future (2)

- **Contribution by 4 thematic groups by the end of 2005**
- **Convergence of EU and Russian energy strategies, policies and regulatory measures**
- **Conclusion of negotiations on an agreement on trade in nuclear materials**
- **Cooperation on energy infrastructure projects of common interest (Significant progress on Northern European gas pipeline, Gas field Shtokman (Barents sea) and further development of Yamal Europe gas pipeline**
- **Evaluation of mechanisms to cover non-commercial risk of energy projects**
- **Cooperation in the field of safety of transport of energy products**
- **Implementation of the work programme of the EU-Russia Energy Technology Centre**
- **Launch of a full scale energy business dialogue between EU and Russian companies**
- **Cooperation to facilitate fair trade and transit of energy products**
- **To move in the direction of an energy community between Russia and the EU**



The Energy Dialogue : Priority Actions for the future (3)

- **Cooperation in the field of nuclear energy (safety and nuclear material safeguards)**
- **Examination of the feasibility of the integration of electricity markets**
- **Observe the gradual and progressive reform of the Russian gas sector**
- **Implementation of the work programme of the EU-Russia Energy Technology Centre**
- **Launch of a full scale energy business dialogue between EU and Russian companies**
- **Cooperation to facilitate fair trade and transit of energy products**



The End : Thank you

