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Meeting Summary: Russia and Eurasia Programme

Russia's Position on the Energy Charter

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The issue of energy governance has been discussed in academic literature. International governance depends a lot on domestic governance. Both international and domestic governance are important in the energy sphere. Cross-border trade and investment in energy and other sectors involve governance. Europe's and Russia's dynamics of energy governance are different, which leads to different views on international energy governance.

Russia is not a unique country in relation to energy governance; the notion of state capitalism and resource nationalism is present in many countries. The predominance of the state is a crucial element in the Russian energy governance system. One of the attributes of this system is an unclear definition of property rights. For example, in the UK or Norway licences carry property and investment rights; they cannot be revoked unless it is proven that the holder's activities do not correspond to those covered by the licence. In Russia, licence is also given to operate a business, but the Ministry allocating the licence can revoke it without a court decision. Therefore, relations with regional and federal powers are important for all companies in Russia regardless of their ownership. The gas sector is specific; Gazprom enjoys a predominant role but at the same time it is closely linked to Russia's diplomacy and some of its actions cannot be explained from the economic perspective. State capitalism has consequences for sector competitiveness; Russian oil and gas companies show a low level of profitability despite the resources at their disposal.

Russian companies' initial response to developments in Europe showed a lack of foresight. They, and Gazprom especially, underestimated EU's integration of its energy markets and thought there would be no structural change. The EU is the most profitable market for Russia's natural gas and one of the most interesting for oil and oil products. As LNG began to flow into the European hubs, it began to dawn on Russian companies that gas markets are in transformation. Hence they began to show greater willingness to get involved in the EU regulatory design through EC-established foras only in 2009-10.

Since then, Russia is becoming increasingly interested in multilateral energy governance. At the moment, the Energy Charter Treaty is the only governance framework encompassing both Russia and Europe. However, Russia views the Energy Charter as the main tool of the EU's energy policy, mainly because the EU has given the impression that Russia should accept the Treaty as it is. Declarations by some European Commissioners that Russia should ratify the Energy Charter Treaty and sign the Draft Transit

Protocol (TP) were seen as political pressure and reinforced Russia's opposition to the Charter.

For the EU, the main concern is the security of supply, which can be enhanced by fragmenting a downstream market and hence promoting competition. Consequently, the EU seeks a governance regime to ensure competition on the market. By contrast, for Russia the main issue is the security of demand - long-term access to markets and control of upstream resources. Russian companies would prefer a governance structure that restricts competition and covers security of transit – ensuring, for example, that Ukraine would not take Russian gas and protect companies against mismatch between supply and contracts. Due to these differences, the two sides have as yet failed to agree on an international gas transit regime.

It has been often argued that energy security is not linearly linked to independence; for example, large supplies from Norway to Europe do not constitute a security issue. Since 2006, Britain's dependency on Russian coal has increased, but this is not a security issue either. However, since the Russia-Ukraine energy dispute in 2006, the EU-Russia gas trade has become extremely politicised, which is not conducive to reaching an agreement on international gas transit.

In 2009, Russia stopped the provisional application of the Energy Charter, but never withdrew from the Treaty. Russia would like to increase its role in international energy governance without withdrawing from the treaty or ratifying it. In 2010, Russia proposed a Draft Convention on Energy Security, which emphasised security and proposed an early warning mechanism, but it also included a lower level of investment protection than ECT. This reflects the Kremlin's view on investment protection but it does not correspond to the long-term interests of Russian companies with investments abroad. However, transit provisions of the Draft Convention and ECT are almost identical and Russia might be interested in incorporating the Draft Convention into the ECT negotiation process.

Asked what model of development Russia should follow, the speaker argued that there is no inherent contradiction between the innovative and resource-based model and Canada and Norway provide good examples of this. The Kremlin should think about institutional innovation between companies and the state. There are lively debates on economic policy at a senior level. but most elites do not want to lose control over 'state capitalism'. The Russian government is unlikely to nationalise the gas sector, as it would create large-

scale consternation. Pressure from the public might lead to greater transparency in the gas sector.

The Kremlin wants its energy companies to be more competitive. During the economic crisis in 2008, most energy companies needed financial assistance; the Kremlin does not want this to happen again. Ideally, state capitalism should soften or disappear, but it is unclear how this can happen. Likewise, there are concerns at the government level about attracting investments in smaller fields without reforming the gas export monopoly; independent gas producers would press for greater transparency in the sector.

Russia's entry into the WTO is unlikely to have any bearing on the state's attitude to the Energy Charter. but it may have an impact on issues concerning the oil price. The WTO is not concerned with energy security or investment protection, and it has soft rules on transit. Russia realises that the interests of energy consumers are different from those of the producers. Russia's objections to the ECT are related to its politicisation. The securitisation of diversification of supply is related to Russia's concern over security of demand. Russia is also concerned about the security of the gas price because of the availability of cheap gas from Central Asia. If there is increased liquidity in the market, Russia's position will also evolve. Russia does not object to the investment provisions of the ECT, but Russia's notion of investment is different.

A participant noted that one of Russia's objections to the Charter was that the document is too limited – it should provide for global energy governance. The speaker argued that Russia is indeed interested in a global approach because Russian companies are increasingly investing abroad – in Venezuela, Libya etc.

There is a dialogue over the regime proposed by the EU. Such processes are generally successful if they are not overly securitised; otherwise it is difficult to reach a compromise. This process is likely to take time as the market is evolving. Markets would respond positively to a regional or international governance structure that would clarify access issues and investment protection. Both parties have a strong mutual interest in doing business together.

Pipelines are linked to consumption and the transformation of markets. When Nord Stream is built, Gazprom will need additional suppliers to fill the pipeline. However, if the consumer demand is low, some planned pipelines may not be needed. Therefore, the prospects for South Stream and Nabucco are uncertain.

Russia would like more control over the gas network, but Ukraine's strategy is unclear. South Stream could stop the transit of Russian gas through Ukraine. But as Ukraine has enormous capacity to export and its own gas to develop, it could become a competitor in the commercial context. However, it will not be possible to develop Ukraine's gas resources to fulfil this potential in the near future.