

## Working Group on Energy

Comments of the EU Ukraine Business Council (EUUBC)\* in response to the European Commission's Green paper: "**European Strategy for Sustainable, Competitive and Secure Energy**".

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### EUUBC Remarks:

EU-Ukraine energy relations are important for achieving many goals of the EU Green Paper on Energy, especially those related to energy security and efficiency.

European energy markets are in transition and face the longer-term challenges of balancing supply and demand. 2006 has been a dramatic year so far in the European gas market. It has seen at its very outset a high profile disruption in supply between Russia and the Ukraine. This has been followed by a volatile debate extending from Moscow through to Brussels and London, and even reaching as far as Washington, about the security of future gas supplies internationally.

Attention has also been drawn to the stresses becoming evident in the gas infrastructure across Europe, both in terms of pipeline capacity and underground storage.

And lastly, tensions have been raised about alleged corporate and political power playing around all these issues.

In the Ukraine as well as other Former Soviet Union states, there is a painful but necessary move towards a fully market related pricing mechanism, based on a cash settlement system, and away from the non-transparent, previously prevalent barter-based system. This was the backdrop to the New Year dispute between Russia and the Ukraine.

In the EU, there is recognition of dwindling EU production and a corresponding need to focus on the provenance and assuredness of future supplies both from the East and further afield in the Middle East, either conventionally or through Liquefied Natural Gas (LNG).

Even in the corporate arena there are wide-ranging pressures for change and/or consolidation. The leading supplier in Eurasia, namely Gazprom, is alone responsible for circa 25 per cent of gas supply to Europe, which under existing contracts will go up to circa 30 per cent. It is having to demonstrate, as it increasingly engages with the international financial markets, a more commercial, competitive and transparent approach to its business. At its most basic level this has meant difficult discussions with its geographical neighbors about moving gas prices towards the much higher levels prevalent in the West. Whilst these prices rises are having a short-term impact on GDP growth in the affected countries, they are also have the longer-term benefit of encouraging them to restructure their economies to become more energy efficient.

The main existing pipeline network from the gas fields of Turkmenistan, Uzbekistan, Kazakhstan, Russia and Ukraine, to Central and Western Europe is close to full capacity, carrying circa 190 Billion Cubic Metres per annum. The lines through the Ukraine are scheduled for upgrading by Russian and the Ukrainian authorities, and there is the new 1200km North European Gas Pipeline that is to run under the Baltic Sea from near St. Petersburg to Greifswald in Northern Germany. However, the fact remains that more pipeline capacity will be necessary in due course across Europe in a 10- 25 year time-frame, and greater capacity will also hopefully enable a freer, more secure and more competitive market.

There are some very clear structural problems in the current European gas market that lie at the heart of the situation. These are creating pressure points in the gas supply system that in turn raises political and strategic tensions. The two most important issues are firstly the limited capacity of the existing gas pipeline network, going from East to West, thereby providing limited options both in supply competition and in redundancy; and secondly, the very limited installed capacity of underground storage across Europe, notably again in the EU, in turn restricting both commercial and strategic options when there are any interruptions in supply.

Looking at the storage issue, Russia and the Ukraine at this point in the time possess by far the largest proportion of the underground storage capacity in Europe; EU member states lag far behind.

The challenge of increasing pipeline and storage capacity is that they not only demand substantial capital investment, but also require long-term strategic vision, political and corporate partnership and, more than anything, mutual trust and understanding. Aside from the investment in the facilities of pipelines or storage, the cost of simply filling them can also be significant. With such large capital sums required, these projects need long-term horizons of 20-25 years in order to cover their costs and make a return. Those companies who would invest in them need to feel comfortable that there is a certainty of custom over such periods or else they will not invest. Alternatively, EU governments will need to commit to and subsidize such investments in the wider public and strategic interest.

The challenge is to ensure stability and security of gas supply, diversity of origin of such supply and to foster competition to assure reasonable market-based prices to consumers. This will require a concerted approach by all parties concerned and can only be fostered through co-operation between governments, policy makers and commerce through the development of closer links and a transparency of interests.

### EUUBC Recommendations:

1) The EUUBC supports the idea of elaboration of the EU External Energy Policy that would give the EU a common voice as opposed to a set of sometimes diverging energy policies of the different member states. With a common voice, the EU will have stronger leverage in relations with its partners, in particular in its energy dialogue with Russia.

2) The EUUBC supports the EU in its stated intention to diversify sources and routes of energy supplies. Ukraine is a natural candidate to be involved in the development of new routes for oil and gas supplies, in particular, from the Caspian Sea region.

3) Energy security is a matter of national security for Ukraine. The operation of its industry, the welfare of its citizens and the fate of its democracy - all depend on the country's energy security. But, as witnessed at the beginning of 2006, Ukraine's energy security is also inextricably linked with that of the European Union. For this reason, the EU should take a more active position in helping Ukraine meet and resolve its energy challenges, primarily by facilitating long-term strategic energy-related investments and projects.

4) The EUUBC also recommends that the EU should more pro-actively encourage more efficient energy use in Ukraine. Ukraine is one of the most energy inefficient countries in the world, and under free market energy prices its industries become uncompetitive. This translates into energy dependency and nurtures different schemes to avoid market relations in the energy sector. The EU can make energy efficiency a condition for provision of its financial assistance to Ukraine. Moreover, investment into energy efficiency in Ukraine may bring high returns for private investments. EU companies can also benefit from JI projects with Ukraine. We recommend that EU initiatives should be undertaken to explore investment opportunities in energy efficiency in Ukraine and to facilitate private investment by EU companies in energy saving projects in Ukraine.

5) Many of the above suggestions could be implemented by integrating Ukraine into the European energy market. This will also contribute to the achievement of Priority #1 of the Energy Green Paper, which is completion of single European electricity and gas markets. Transparency, market relations and environmental safety in the energy sector should become preconditions for Ukraine's integration into these markets.

The EU will benefit from integration of Ukraine in these markets because of:

- greater security of supply thanks to better access to Ukrainian energy infrastructure and greater leverage over Ukrainian energy policy;
- better emergency management due to access to large Ukrainian gas storage facilities;
- greater trade opportunities thanks to access to the Ukrainian energy market, in particular, in the electricity sector;
- opportunities to satisfy EU Kyoto obligations through carbon trading with Ukraine.

EUUBC Conclusion:

To conclude, the EUUBC sees energy cooperation as one of the most important and promising areas in EU-Ukraine relations, and urges that Ukraine should be given a key role in helping to translate the Green Paper proposals into policy and action.

Achieving energy liberalization and security in Europe will require ongoing dialogue leading to concrete steps to be agreed by producing, transiting and consuming nations, to depoliticize the debate and focus on the long-term issues to provide for the open, secure and transparent market in gas that Europe requires.

\* The EU-Ukraine Business Council is an independent CEO-level forum for European and Ukrainian business leaders. It is set up in Brussels as a non-profit making organization in order to promote trade and investment between the EU and Ukraine, to assist companies to develop business opportunities, to promote dialogue between governments and companies to help solve market access difficulties and overcome regulatory obstacles both for Ukrainian businesses in the EU and EU businesses in Ukraine. For further information on the Council please go to [www.euubc.com](http://www.euubc.com).