



ENERGISED FOREIGN **POLICY**

**SECURITY OF ENERGY SUPPLY
AS A NEW KEY OBJECTIVE**

GENERAL ENERGY COUNCIL

ADVISORY COUNCIL ON INTERNATIONAL AFFAIRS

DECEMBER 2005

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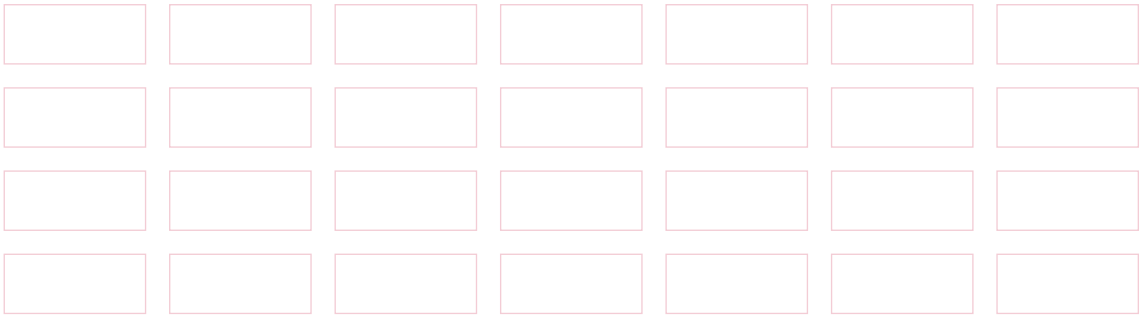
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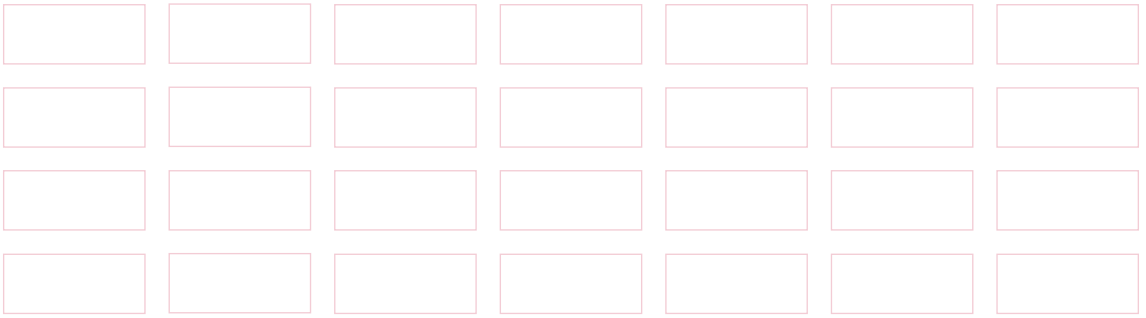
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FOREWORD

In May 2005, the government requested the Advisory Council on International Affairs (AIV) and the General Energy Council (AER) to prepare without delay an advisory report on energy and foreign policy (see annexe 1 for the request for advice).

The report was prepared by a joint committee – the Energy and Foreign Policy Committee – which consisted of several members of the AER and the permanent committees of the AIV. The committee was chaired by G.H.B. Verberg (AER). The other members of the joint committee were: Dr W.F. van Eekelen (AIV European Integration Committee), T. Ety (AIV Human Rights Committee), Dr P.P. Everts (AIV Peace and Security Committee), Professor C.J. Jepma (vice-chair, AIV Development Cooperation Committee), Professor J.G. van der Linde (AER), H.C. Posthumus Meyjes (AIV European Integration Committee) and Professor M.P.C. Weijnen (AER).

P.J.T. van Strien and Dr R. Vos (Ministry of Foreign Affairs) and G.K. Roukens (Ministry of Economic Affairs) acted as civil service liaison officers. The post of executive secretary was held successively by P.W. Broekharst and E. Janssen (AER) and P.J.A.M. Peters and P.A. Ramaer (AIV).

The AER and the AIV adopted this report on 1 and 2 December 2005, respectively.

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INTRODUCTION

1

THE REQUEST FOR ADVICE

The Ministers of Foreign and Economic Affairs requested the Advisory Council on International Affairs (AIV) and the General Energy Council (AER) to prepare a joint advisory report on the question whether, and if so how, the foreign policy of the Netherlands and the European Union can contribute to security of energy supply in Europe and, in particular, the Netherlands. For the sake of brevity, readers are referred to annexe 1 of this advisory report for the full text of the request for advice.

This question is motivated in part by the increasing dependency on oil and gas imports from a small group of countries and regions, including Russia, the Persian Gulf countries and the Caspian Sea region. The European Union and other major consumers, such as the United States and emerging economic powers like China and India, are also becoming increasingly dependent on energy imports. This is leading to fiercer competition between these countries.

Following the collapse of the Soviet Union and the emergence of countries like China, India and Brazil as important powers within their own regions and beyond, global relations have changed dramatically. These changes have also had implications for relations in the various energy markets. As a result, security of energy supply has become an important issue on the agenda of consumer countries. Many countries are reviewing the instruments they use to secure energy supplies, partly in view of the changes in market organisation that have taken place in many consumer countries. In the coming years, the combination of changing geopolitical relations, economic factors in energy markets and the environmental agendas of many governments will place different demands on the implementation of supply security policy than in the past.

Treating security of energy supply as a foreign policy issue is in keeping with the analysis presented in a recent policy document entitled *Nu voor later*¹, which states explicitly that the current and future energy situation requires an approach that affords a role to Dutch foreign policy. Other recent relevant publications, which also served as sources for this advisory report, include the explanatory memorandum to the Ministry of Foreign Affairs' 2006 budget (September 2005), the General Energy Council's advisory report *Gas for tomorrow*², *World Energy Outlook* (2004 and 2005)³, *Saving Oil in a Hurry*⁴ and the study of the relationship between security of energy supply and geopolitical changes carried out by the Clingendael International Energy Programme (CIEP) in the context of this advisory report.⁵

ENERGY AND FOREIGN POLICY

Global demand for energy is rising and will continue to do so in the coming

1 Ministry of Economic Affairs, *Nu voor later. Energierapport 2005* (Now for later. Energy report 2005), July 2005.

2 AER, *Gas for tomorrow*, January 2005.

3 IEA, *World Energy Outlook 2004 and World Energy Outlook 2005*.

4 IEA, *Saving Oil in a Hurry*, April 2005.

5 The advisory councils were glad to make use of this study. See Femke Hoogeveen and Wilbur Perlot (eds.), *Tomorrow's mores. The international system, geopolitical changes and energy*, Clingendael International Energy Programme, 2005.



decades. It is expected that energy needs will still be satisfied largely by means of fossil fuels in 2030 (although renewable energy is the fastest growing sector in relative terms). However, this fossil energy (in particular oil and gas) will come from an ever-decreasing number of countries and regions. Regions where political stability is not an established fact. This will lead to a sharp increase in the European Union's dependency on natural gas imports and a continuation of its heavy dependency on oil imports.

Oil prices have risen sharply since January 2004. For a long time, the price of oil fluctuated between \$22 and \$28 per barrel. Given the underlying causes of these developments in the global oil market, it is likely that the price of oil will remain high for the foreseeable future.⁶ Prices reached \$50-70 per barrel in recent months. In real terms, this is close to price levels during the oil crises of the 1970s.⁷ The underlying price rise is mainly an expression of the growing demand for energy – especially oil – in countries like China and India, but also the United States and the European Union, for example. In addition, growth of oil supply and refining capacity remains inadequate, while the supply of LNG (liquefied natural gas) is hampered by setbacks whose impact is expected to last until 2009-2010.

For the past five years, China and India, which together account for a third of the world's population, have managed to maintain their economic growth at a level well above that of other large countries. On this basis, it is reasonable to assume that, in the coming decades, the world's economic centre of gravity will largely shift away from the United States, the European Union and Japan towards China and India.⁸ Their rapidly growing energy imports, which are needed to fuel this economic development, have a significant impact on the global energy market.

In recent years, concerns have arisen regarding the ability of the oil-producing countries to meet this growing demand. Investments in the oil and gas sectors are clearly trailing behind the anticipated rise in demand. The International Energy Agency (IEA) shares this concern, because access to oil and gas reserves is limited. International oil and gas companies only have access to one-third of all proven reserves.⁹ The remaining two-thirds are accessible only to state-owned enterprises, which may or may not grant a minority stake to foreign parties.¹⁰ Even in countries where foreign companies are able to invest the investment climate is not ideal, which means that not all opportunities can be exploited on time. Examples of problems affecting investment include corruption and conflicts with local or national (as in Bolivia) movements that harbour serious doubts about the expediency of producing and exporting oil and/or gas. The state-owned enterprises in the producer countries often have to compete with other vital areas of

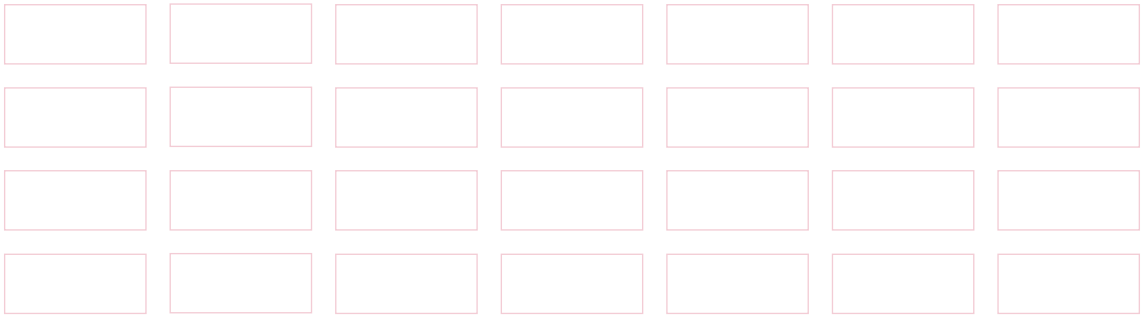
6 In *World Energy Outlook 2005*, the IEA predicts that the average oil price will be \$35 per barrel in 2010 and will rise to \$39 per barrel in 2030 (at 2004 constant dollar prices).

7 See <<http://www.eia.doe.gov/emeu/steo/pub/fsheets/petroleumprices.xls>>.

8 See Goldman Sachs, *Dreaming with BRICs: the Path to 2050*, Global Economics Paper no. 99, October 2003.

9 IEA, *World Energy Outlook 2005*.

10 IEA, *World Energy Investment Outlook 2003*.



government expenditure (e.g. social welfare) and do not always possess the knowledge needed to exploit less accessible oil and gas reserves, although increasingly they do. On the whole, various economic and political factors are making it impossible to adequately increase supply.

Geopolitical, regional and national problems, as well as a greater reluctance with regard to free energy markets, also contribute to the changes that are taking place in international energy markets. There are developments that, at the very least, cast doubt on the precept that says 'the market should be allowed to determine where oil and gas go'. Examples of these developments include:

- For political reasons, Venezuela may prefer to sell oil to China rather than to the United States, even if this results in slightly lower revenues.
- Minister Mani Shankar Aiyar of India has stated publicly that the gas in Asia should be for Asia.
- The United States advanced national security as a reason for preventing the takeover of Unocal, a US oil company, by China's state-owned oil company CNOOC.
- In the European Union, Denmark, Germany, France and Austria, for example, are attempting to help 'national champions' into the saddle, or keep them there, for reasons of national interest.
- In a growing number of countries, in particular the United States, the United Kingdom, China and Russia, security of energy supply is regarded as an issue of national security. In India, energy is even regarded as the second most important issue of national security, after food security.

Recent measures by President Putin's government have led some observers to doubt whether the Russian economy will continue to progress towards transparency and legitimate market mechanisms. Compared to the situation under the first Putin government, the current government has significantly strengthened its control over the energy sector.

Problems are also arising on the supply routes for oil and liquefied natural gas. Capacity problems and security risks present a growing problem. The threat of terrorist attacks has had a substantial impact on the global oil and gas markets. In 2004, Minister Khelil of Algeria observed that he assumed a 'terrorism premium' of \$7-10 per barrel in the price of oil.¹¹

In various producer and exporting countries, tensions exist between the government and the local population. Corruption in many countries, as well as the poor human rights reputation of certain regimes, harms the legitimacy of the local authorities. A lack of transparency in the implementation, maintenance and enforcement of national legislation has a negative impact on the investment climate. This ultimately has implications for the supply of oil and/or gas to the market.

Much has been done within the OECD to develop norms and principles of good conduct for multinational enterprises. The OECD Guidelines for



Multinational Enterprises are regularly revised (most recently in 2000) and are endorsed by a growing number of countries. However, the truth is that these guidelines are not consistently observed by all enterprises and some countries are more forthcoming than others. This can lead to disparities at international level regarding access to energy sources.

The results of scientific research are constantly bringing climate issues into sharper focus. The need for consistent action, especially at international level, can no longer be reasonably denied. This is also apparent from the recent climate declaration of the G8 summit in Scotland in mid-2005 and the partnership between the United States, China, India and Australia, among others, which was concluded around the same time. Unlike the Kyoto Protocol, the partnership does not include any binding agreements on emission ceilings, but in a sense it signifies a recognition of the climate issue. The two agreements nevertheless differ substantially. Kyoto has a more developed framework that even includes a form of sanctions, although it is still unclear how they will be implemented in practice. It is also still unclear whether there will be a post-Kyoto policy and, if so, what it will encompass. This is becoming an increasingly serious problem, given the many decisions and large investments that need to be made in the energy sector during the next ten years.

The above-mentioned developments stand in sharp contrast to the views and images that held currency during the 1980s and early 1990s. At that time, the expectation was that the world would increasingly follow the path of globalisation in all areas of economic development. Governments would increasingly take a back seat to market forces and limit themselves to setting boundaries, especially in the fields of competition and the environment. Guided by an invisible hand, the logic of the market would take effect. This was expected to also apply to energy supply, which consequently underwent a process to expand the role of market forces, especially in the European Union.

In light of this discrepancy, it is necessary to reassess the best way to guarantee the security of energy supply in the future. This applies to medium and long-term energy supply as well as to acute energy crises as a result of disruptions in supply. Such disruptions can be caused by several factors, including natural disasters (e.g. hurricanes), terrorism or technical failures. The present advisory report aims to provide a framework for this reassessment.

APPROACH

For the purposes of this advisory report, the AIV/AER ('the advisory councils') define the security of energy supply as 'the long-term and continuous availability of enough energy to safely meet the needs of society in accordance with as many – preferably market-oriented – conditions as possible and in a way that causes the least possible harm to the environment. All this within the parameters set by the government.' The advisory councils note that the security of energy supply is not only a long-term issue but also a short-term one. Short-term security usually concerns acute disruptions of the energy supply that could lead to an energy crisis.

Chapter 2 analyses the world energy situation for the next 20 to 30 years. The advisory councils believe that a brief analysis suffices, as on most issues it is possible to refer to existing publications (see above). Following this, chapter 3 examines Dutch energy interests relating to supply security. Chapter 4 translates these interests into foreign policy objectives. Chapter 5 concludes with a summary and recommendations.

In their work, the advisory councils have avoided focusing on the field of energy policy in its narrowest sense, which also includes international components, in favour of a focus on foreign policy and energy – in particular from the perspective of Dutch interests – in accordance with the request for advice. This is because these interests are meant to provide the motive and the justification for policy in this area.

ENERGY IN A CHANGING WORLD

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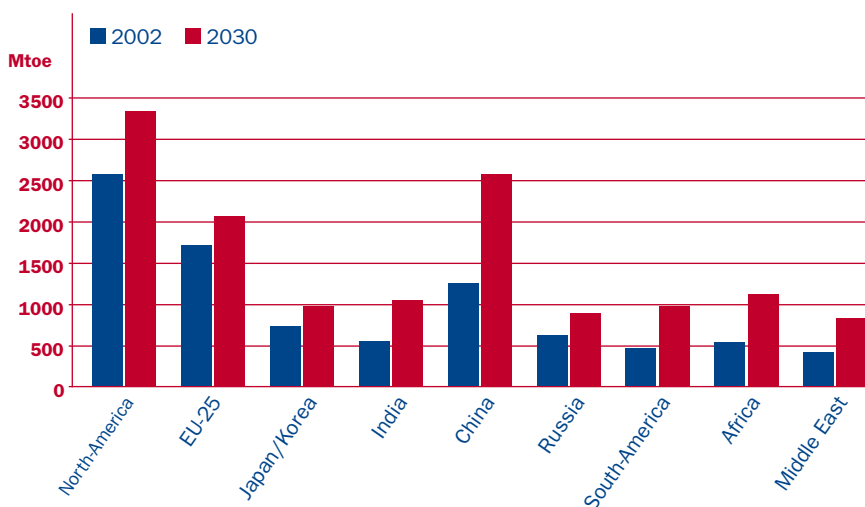
This chapter starts by examining developments in the various global energy markets. It devotes detailed attention to oil and gas, not only because these are the most sought-after fuels but also because the markets in question are confronted by the most uncertainties and risks. Following this, it looks at geopolitical developments in the field of energy. This is important for understanding the political orientation of regimes in countries that are relevant from an energy perspective, so that the Netherlands and the European Union can tailor their approach accordingly.

2.1 ENERGY DEMAND AND SUPPLY: GLOBAL DEVELOPMENTS

DEMAND

The demand for energy continues to grow and is expected to rise by 60% over the next 25 years, at an average of 1.7% per year (see figure 2.2). As figure 2.1 shows, the rise in demand will come mainly from developing countries and rapidly growing economic powers such as Brazil, Russia, India and China (the so-called BRIC countries),¹² but demand is also on the rise in OECD countries (in particular the United States).

FIGURE 2.1 TOTAL ENERGY DEMAND BY REGION, 2002 AND 2030



Source: IEA, *World Energy Outlook 2004*.

China's role is particularly striking. The expected continuation of the country's strong economic growth will be accompanied by a sharp rise in the demand for energy. This is partly due to the fact that the Chinese economy is very energy-intensive, which means that for the time being it requires

12 According to the IEA's reference scenario, the developing countries' share of global primary energy demand will rise from 39% in 2003 to 49% in 2030 (in 1971 it was just 22%). The share of the OECD countries will thus decline. See IEA, *World Energy Outlook 2005*, p. 87.

13 Energy intensity is the total energy consumption (in tonnes of oil equivalent) divided by GNP. China (0.90), India (1.04) and Russia (1.32) have a much poorer score than, for example, the EU countries (0.20) - including the Netherlands (0.19) - and the United States (0.25). See further IEA, *Key World Energy Statistics 2004*, p. 48-57.



much more energy than Western economies in order to grow.¹³ According to the IEA's projections, China will account for 21% of the rising energy demand by 2030. Since it is a net importer, this will increase pressure on the oil market.

Fossil fuels are expected to still account for the largest share of energy demand in 2030. Although the volume of renewable energy is rising fastest in relative terms, in absolute terms its share of the total remains modest.

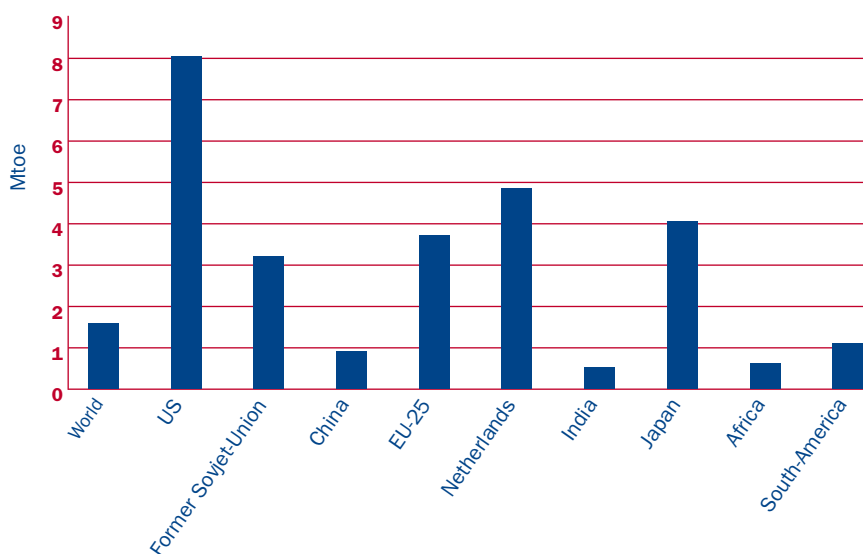
FIGURE 2.2 GLOBAL ENERGY DEMAND BY FUEL (MTOE)

	2002	2030	Annual rise, 2002-2030 %	2030 Alternative scenario*	Annual rise, 2002-2030 %
Coal	2.389 (23%)	3.601 (22%)	1,5	2.744	0,5
Oil (excl. bunkers)	3.530 (34%)	5.604 (34%)	1,6	4.995	1,2
Gas	2.190 (21%)	4.130 (25%)	2,3	3.701	1,9
Nuclear	692 (7%)	764 (5%)	0,4	868	0,8
Hydropower	224 (2%)	365 (2%)	1,8	367	1,8
Biomass/Waste	1.119 (11%)	1.605 (10%)	1,3	1.648	1,4
Other renewable	55 (0.5%)	256 (2%)	5,7	330	6,6
Total	10.345	16.487	1,7	14.654	1,3

Source: IEA, *World Energy Outlook 2004*, pp. 59, 416.

* The alternative scenario presupposes the introduction of stricter environmental controls, resulting in a larger growth of alternative energy sources; investment shifts from energy production to energy-efficient equipment.

FIGURE 2.3 ENERGY CONSUMPTION PER CAPITA (2004)



Source: IEA, *Key World Energy Statistics 2004*.



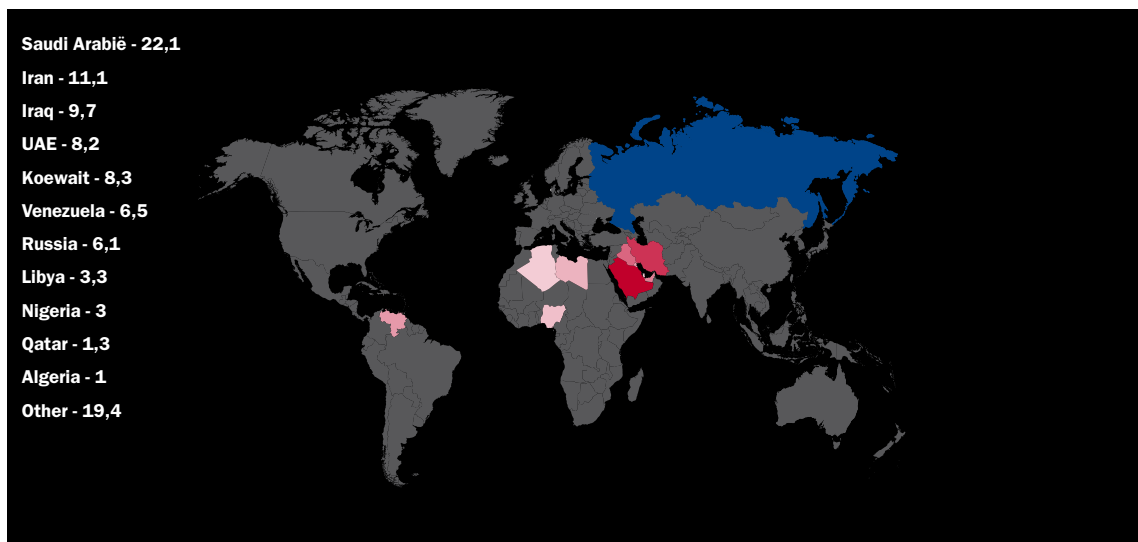
SUPPLY

OIL

The remaining oil reserves are heavily concentrated in a limited number of OPEC countries (see figure 2.4).¹⁴ Five countries bordering the Persian Gulf (Saudi Arabia, United Arab Emirates, Iran, Iraq and Kuwait) control almost 60% of the remaining proven oil reserves.¹⁵ The share of these countries in oil production is much lower (35%) but will rise in the future. The amount of oil produced in non-OPEC countries will continue to rise until 2010.

After that, it is expected that rising production in a number of countries and regions (such as Russia, the Caspian region and Africa) will no longer make up for falling production in other non-OPEC countries (such as the countries bordering the North Sea and the Alaskan oil fields, for example). Non-OPEC countries will see their share in total oil production decline after 2010, while OPEC's market share will rise from 37% in 2002 to 53% in 2030, just above the historical peak reached in 1973. Thus, oil consumption will rise, and this oil will come from fewer source countries.

FIGURE 2.4 WERE ARE THE OILRESERVES?



N.B. The countries in red are OPEC members. Values represent the share of reserves in percentages.

Source: BP, *Statistical Review of World Energy 2005*.

- 14 OPEC stands for Organisation of Petroleum Exporting Countries. Its members are Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.
- 15 The exact size of the remaining global oil reserves is difficult to establish for a number of reasons (different definitions, lack of transparency, lack of access to and/or reliability of data). Nevertheless, there are various generally accepted estimates (for example by BP) which indicate that there are sufficient reserves to meet demand for the next 25 years. This is the assumption on which the advisory councils have based their analysis.



Moreover, substantial investments are needed to facilitate the exploitation of these reserves. The IEA predicts that \$3,000 billion in replacement and expansion investments will be needed between now and 2030. At present, only one-third of all proven oil reserves are accessible to direct foreign investment. The remaining two-thirds are reserved for the state-owned enterprises of the oil-producing countries.¹⁶ At current oil prices, it will be easier for these enterprises to obtain the necessary investment capital from their governments, although spending in oil-producing countries is rising to such an extent that they need the real price of oil to keep on rising in order to balance their budgets. Nevertheless, the need for investment often exceeds the willingness of many oil-producing countries to make the necessary funding available, given that they also have other priorities. Attracting foreign capital could provide some relief in this regard. However, the earlier prediction, namely that the oil-producing countries would open their doors to foreign investors, has proved correct to only a limited extent. They appear keen to maintain the current division of ownership. They favour other ways of mobilising capital or are willing to accept a policy that pursues revenue optimisation on the basis of current production capacity or merely a slow increase in that capacity.

FIGURE 2.5 GLOBAL OIL SUPPLY
(IN MILLIONS OF BARRELS PER DAY)

	2002	2030	Difference 2002-2030
OECD	21,0	12,7	- 8,3
Former Sovjet Union	9,5	15,9	+ 6,4
Developing countries	14,6	14,8	+ 0,2
o.w. China	3,4	2,2	- 1,2
Africa	3,0	4,4	+ 1,4
Brazil	1,5	4,0	+ 2,5
OPEC	28,2	64,8	+ 36,6
o.w. Middle East	19,0	51,8	+ 32,8
Unconventional oil	1,6	10,1	+ 8,5
Total	77,0	121,3	+ 44,3

Source: IEA, *World Energy Outlook 2004*, p. 106.

GAS

The proven natural gas reserves are more than sufficient to meet the expected demand during the period covered by this report. However, the number of gas-producing regions is also in decline. The centre of gravity is moving to the Gulf region, North Africa and Russia (see figure 2.6). Russia will probably continue to be the world's largest exporter of gas in 2030.



FIGURE 2.6 WERE ARE THE GASRESERVES?



Values represent the share of global gas reserves in percentages.

Source: BP, *Statistical Review of World Energy 2005*.

Substantial investment is also needed in the gas sector. The IEA predicts that \$2,700 billion will be needed between now and 2030 for the entire value chain (from oil well to gas cooker or power station). Whether or not this materialises depends in part on the attitude of the governments of the gas-producing countries. Approximately 64% of current proven natural gas reserves are managed by state-related or state-controlled companies. It remains to be seen whether the countries concerned have sufficient investment capital and the necessary technical capabilities at their disposal.

COAL

There are still vast reserves of coal. Compared to oil and gas, moreover, they are spread out over a wide area; 40% of the reserves (enough for 200 years at current exploitation levels) are in OECD countries. China is still the world's largest coal producer. However, the fact remains that using coal harms the environment.

NUCLEAR ENERGY

Although demand for nuclear-generated electricity will rise in absolute terms, its relative share in electricity generation is expected to drop from 17% at present to 9% in 2030 if current policies prevail. The geopolitical problem is that nuclear energy involves enriching uranium and reprocessing plutonium, and these materials can also be used to manufacture nuclear weapons. The issue of proliferation is a continuous source of international tension, especially – at present – in relation to North Korea and Iran. Moreover, nuclear waste storage is regarded as an environmental problem.

RENEWABLE ENERGY

The volume of renewable energy is rising fastest in relative terms, but for the time being remains modest in scope. The share of hydropower, biomass and other sources of renewable energy amounts to approximately 13% in both 2002 and 2030 (see figure 2.2). It is striking that biomass has such a large



share in this category, and much of it is traditional biomass (wood, dried manure, et cetera).

DEPENDENCY ON OIL AND GAS

Domestic production is declining in consumer countries, which means that their dependency on imports will increase. This is reflected in the international energy trade. The OECD countries account for a quarter of the rise in demand, but for only 3% of the rise in production. Exports from non-OECD countries to OECD countries will therefore increase by 80% by 2030. At present, 46% of the global demand for oil is traded between these regions, and this will rise to 63% in 2030.¹⁷ In the case of gas, the figure will rise from 15% to 26%.¹⁸ The European Union's dependency on oil imports is expected to rise from 76% to 94% in 2030. Its dependency on gas imports will rise from 49% to 81%.¹⁹ In spite of this, the market share of the European Union and the United States in terms of total consumption will decline, mainly due to rapidly growing demand in Asia, Africa and South America. In the coming decades, the economies of these regions are expected to grow faster than those in the West. For the producer countries, the emerging countries are an interesting growth market alongside the traditional large consumer countries. In the future, an increasing number of parties will be competing for energy exports from a limited number of countries.

FUEL TRANSPORTS

Fuel is transported all over the world via land-based or sea-based pipelines and ships. The Netherlands is involved in both types of transport. When natural gas is transported via pipelines it usually has to cross many national frontiers before reaching its final destination. Moreover, the distances that have to be bridged between Russia's gas fields and the Middle East and Europe are becoming greater, because the centre of production is slowly moving eastwards.

The sea routes also provide cause for concern. The logistical capacity of the main sea routes is limited, and they are increasingly acting as a bottleneck. It is by no means certain that they will be able to handle the expected increases in the transport of oil and gas. This relates in particular to the Strait of Hormuz, Bab el-Mandab, the Suez Canal and the Bosphorus. These routes all contain narrow passages (straits) or other problematic stretches (such as canals or shallows). Piracy (especially in the Strait of Malacca) and terrorism also present an increasing risk. These routes are already plagued by problems, and the risk of further problems is growing due to the increasing concentration of trade flows from the regions concerned.²⁰

17 IEA, *World Energy Outlook 2004*, p. 71.

18 Ibid.

19 IEA, *World Energy Outlook 2004*, pp. 117 and 140.

20 See <<http://www.eia.doe.gov/cabs/choke.html>>.

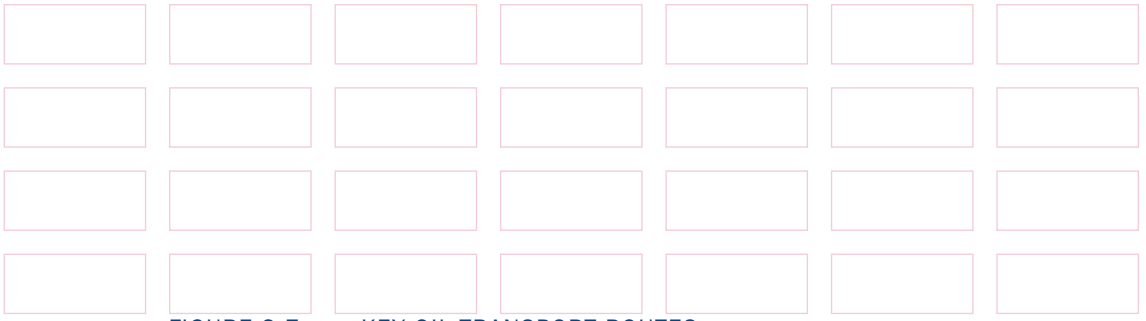
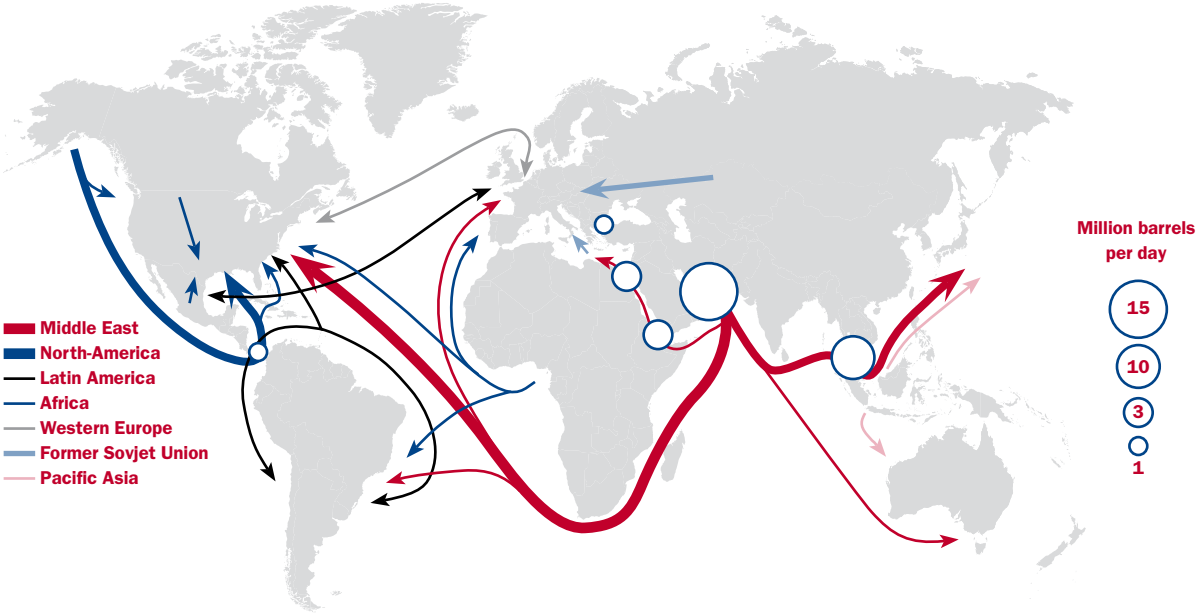


FIGURE 2.7 KEY OIL TRANSPORT ROUTES



Source: Hofstra University, see people.hofstra.edu/geotrans/eng/ch5en/appl5en/ch5a1en.html.

FIGURE 2.8 OIL AND LNG TRANSPORT VIA STRATEGIC SEA ROUTES

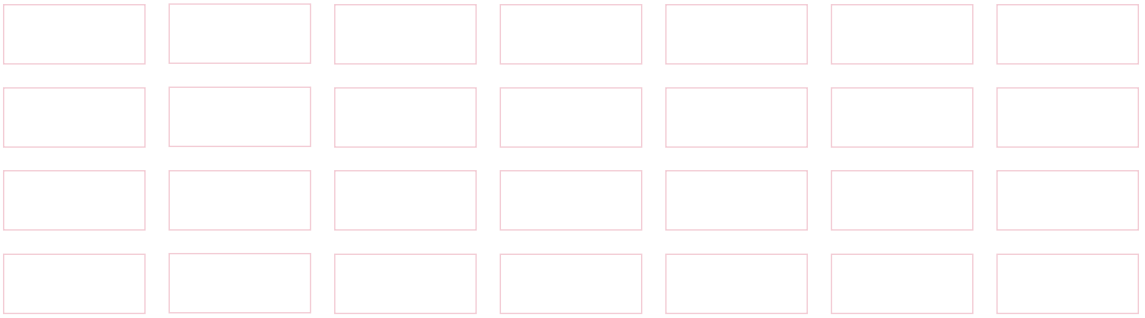
		2002		2030	
		Volume of Oil (mbd)	Share of interregional trade (%)	Volume of Oil (mbd)	Share of interregional trade (%)
		Gas (bcm)		Gas (bcm)	
Strait van Hormuz	Oil tankers	15	44	43	66
	LNG tankers	28	18	230	34
Strait van Malacca	Oil tankers	11	32	24	37
	LNG tankers	40	27	94	14
Suez Canal	Oil tankers	1	4	3	4
	LNG tankers	4	3	60	9

Source: IEA, *World Energy Outlook 2004*, p. 119.

ACCESS TO ENERGY

Energy is a prerequisite for economic development. At the same time, economic progress increases the demand for energy. Many countries are currently in a promising phase of economic development. In the world's poorest countries, though, this process has not yet gained momentum. The IEA formulated an Energy Development Index (EDI) in its *World Energy Outlook 2004*.²¹

21 The IEA's EDI is based on three factors: commercial energy consumption per capita, the share of commercial energy in total energy consumption and the proportion of the population with access to energy (IEA, *World Energy Outlook 2004*, p. 342).



It turns out that this EDI is strongly correlated to the UN Human Development Index.²² What is striking is that it appears to make no difference whether or not a country has access to indigenous energy reserves. The countries with the lowest scores are mainly from South Asia and Sub-Saharan Africa. The IEA predicts that the countries with the highest energy poverty will still be far below the OECD level in 2030, at roughly half the level enjoyed by OECD countries 30 years ago.

The correlation between economic development and energy development in the world's poorest regions justifies devoting attention to energy in the framework of development policy. The millennium development goal of eradicating extreme poverty – to reduce by half the number of people living on less than \$1 a day by 2015 – would be well served by a significant improvement in access to energy. However, this depends on a number of factors, for example good governance of the country and the local energy sector (for the purpose of attracting investment) and efficient energy markets. As noted by the IEA, industrialised countries can advance their own economic, political and security interests by assisting the poorest countries with their energy development, as these countries will remain susceptible to social and political instability and humanitarian disasters as long as poverty, hunger and disease continue to reign there. The cost of helping these countries to secure an adequate energy supply could ultimately be lower than that of fighting the instability and lack of security resulting from poverty.²³

Improving the energy poverty situation that currently exists in China and India will simultaneously intensify climate problems and place an increasing burden on energy supplies.

2.2 GEOPOLITICAL DEVELOPMENTS: A MODEL APPROACH

For the purpose of this advisory report, the CIEP analysed the relevant geopolitical developments in relation to the energy markets and organised them according to a model approach. The model distinguishes two dimensions of the politico-economic orientation of the key actors in the energy field. This makes it possible to identify four different types of national orientation.

The horizontal axis indicates the extent to which a state is driven by market economics or political economics. A state driven by political economics is characterised by a state-controlled economy that serves strategic political goals.

The vertical axis reflects the different national orientations towards international cooperation. The two extremes are a unilateral or bilateral focus, on the one hand, and a multilateral focus, on the other. Countries can move in different directions both horizontally and vertically.

The geopolitical landscape has changed dramatically since the collapse of the Soviet Union in 1991, when the earlier bipolar system, in which the United States and the Soviet Union maintained the balance of power in their role as superpowers, was replaced by a unipolar system. The United

22

IEA, *World Energy Outlook 2004*, pp. 343-346.

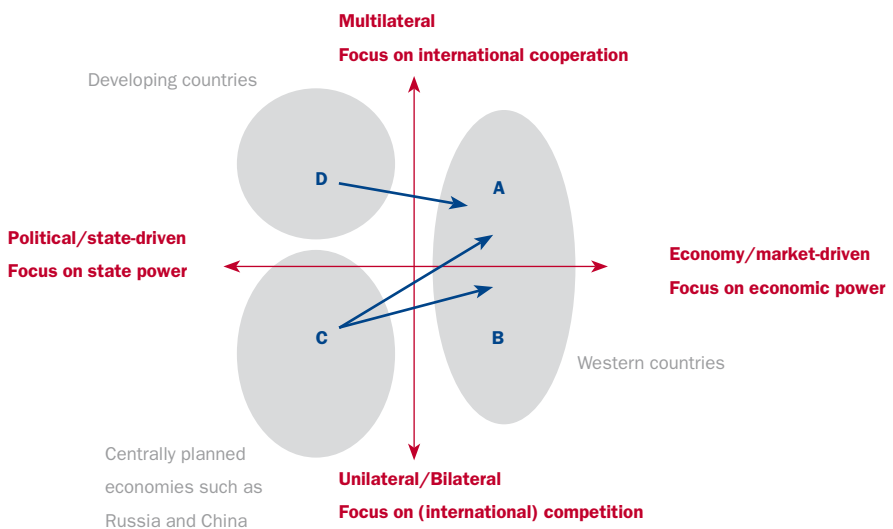
23

ibid., p. 355.



States is regarded as the only remaining superpower. This manifests itself mainly in terms of military superiority, but also through the scale and resilience of the US economy. As a result of its power, the United States was able in the past to determine the character of the global economic market system. The country traditionally supports free trade, market forces and relatively limited government involvement in the economy. During the Cold War, the United States was able to integrate most of the Western world into this market-oriented global system. After the fall of the Soviet Union, it was generally expected that the former planned economies, such as Russia and China, would also opt for the market and integrate into the economically driven multilateral global system, instead of staying the course of a state-led or political economy and unilateralism. Under this scenario, economic integration was expected to lead automatically to political and social integration and democratisation.

FIGURE 2.9 THE EXPECTED DEVELOPMENT OF THE WORLD IN 1991



In 2005, it appears that this expectation has not yet become a reality. The economies of Russia and China remain relatively closed, there are many obstacles to trade and both countries are still more politically than economically driven. They regard further globalisation and the trend towards economic integration as a threat to their national security and sovereignty. They therefore allow strategic national political interests to dictate their actions at international level, but have nevertheless avoided exclusion from important capital and trade markets. This approach to international relations, also known as weak globalisation, is winning increasing support.²⁴ As a result, both Russia and China focus more on bilateralism than multilateralism for the purpose of concluding economic agreements.



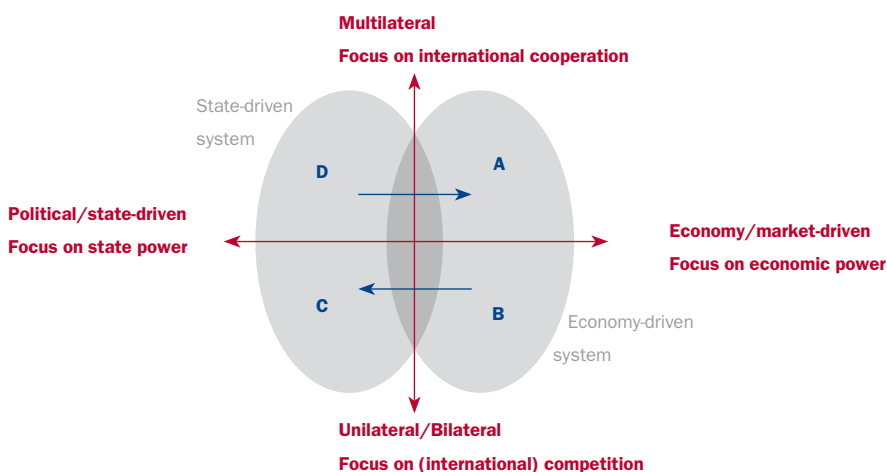
At the same time, it should be recognised that the present unipolar world, characterised by the economic supremacy of the United States, will not remain unchallenged. The relatively rapid economic growth of countries with large populations, such as China and India, which has been going on for several years, cannot fail to have an impact on geopolitical relations during the period covered by this advisory report (until 2030). The actions of Russia (opening up towards China and India with regard to energy exports, the participation of Chinese and Indian companies in the exploitation of Russian energy interests, as well as the recent joint military exercise with China) indicate that the country has understood these developments.

These developments have important implications for the future of the global energy markets. While the European Union and the United States have opted for an economic system that is largely controlled by the market, key geopolitical players such as Russia and China are moving towards a state-driven economic system. The main oil and gas-exporting countries are also more inclined towards a state-driven economy. This is an important observation that is fundamental to the future organisation of the international economic order in general and the global energy market in particular. The key question is how international cooperation between the United States, the European Union, Russia and China will develop. They are located in different parts of the four quadrants, which is indicative of differences in political and economic orientation. Moreover, it remains to be seen which countries will emerge as major powers alongside the United States in the medium and long term.

WHICH SYSTEM DOMINATES?

The dominance of the state-driven economic system (quadrants C and D; the direction chosen by China, Russia, India and most producer countries) would present a major challenge for the current market-oriented economies (the United States and the European Union). Under this scenario, oil and gas acquire a 'nationality', as trade chiefly takes place between states and/or national oil companies.

FIGURE 2.10 WHICH SYSTEM WILL DOMINATE?





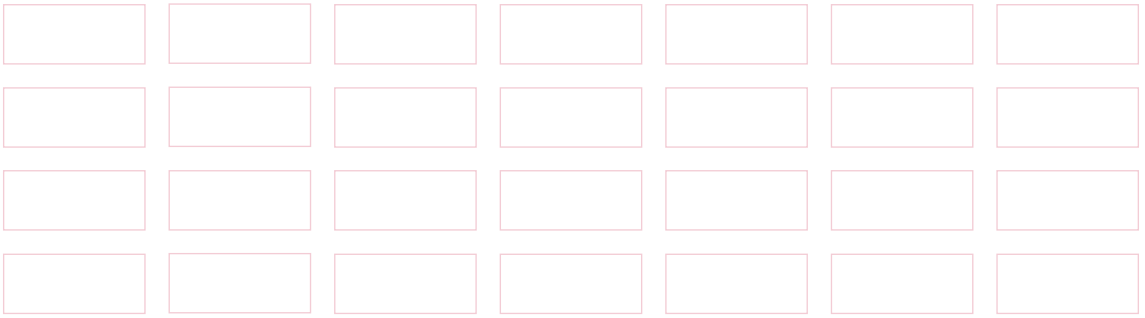
In this world, even the economically-driven countries will be unable to avoid adopting a more politically strategic policy. Any adaptation of supply security policy will consequently have to focus more on bilateral relations. The focal point of decision-making in the energy sector will shift from companies to governments. Under this system, governments will not only be more facilitative and supportive but will also play a greater role in the areas of coordination and leadership. Increasing state control over relations also has implications for the oil companies. If their access to reserves continues to diminish, they may gradually transform into oil-refining and trading companies (downstream), as exploration and exploitation (upstream) move increasingly into the hands of state-owned oil companies under this system.

It is important to bear in mind that increasingly often state-owned companies are majority partners in joint ventures with Western oil companies to trade and sell oil and gas. It is clear that this facilitates a certain amount of state control in this part of the chain. A state-driven system reduces the need for producer countries like Russia, Iran and Saudi Arabia to make far-reaching political, social and institutional changes. Countries like China and the producer countries still prefer weak globalisation because it guarantees national strategic interests more effectively than globalisation, which requires them to implement far-reaching political, judicial and social reforms, in addition to economic reforms, in order to integrate fully into the system.

In contrast, the dominance of the market-driven system will chiefly benefit the current economically driven countries (quadrants A and B; the United States, the European Union and Japan among others). Under this scenario, supply security is achieved via market forces and the mechanisms of the international oil and gas market. Energy flows will remain relatively predictable in this case. Producers will sell their oil and gas to the highest bidder. In addition, the market's self-regulating mechanism will ensure a balance between supply and demand. In this world, the identity of the investors and producers is barely relevant, as long as the gas and oil find their way to market. Under this scenario, oil and gas are stripped of their nationality. The role of companies and governments will remain the same.

Before this system can become a reality, however, the most important politically driven actors that currently fall outside it (China, Russia and India) will have to become convinced that their energy supply is best served by market forces and free trade. For the time being, however, they are very reluctant to liberalise their economies any further, fearing that further openness will come at the expense of control over domestic industry.

Deeper integration into the international market system also requires far-reaching political and social reforms. China and India consequently prefer to conclude bilateral supply agreements with producer countries. Russia's position is also significant. It too is a politically driven state, but in contrast to China and India it is a net exporter of energy. A politically driven global system appears to offer the Russian state more scope to engage in geopolitics.



2.3 ENERGY AND GEOPOLITICS

SELLERS' MARKET

In recent years, the global market for oil and gas has developed into a sellers' market, in contrast to the situation that existed for most of the Cold War (with the exception of the years 1973-1984). At that time, the abundant supply and the large quantity of reserves ensured that there was a buyers' market. Switching between different exporting countries became easier after 1980, because production was spread out over a large number of countries and regions. In addition, due to the abundant supply and the relatively small number of disruptions of supply (with the exception of the oil crisis), supply security was almost never a problem. OPEC assigned itself the task of regulating quantities, which ensured a sufficiently large market buffer. However, this meant that maintaining unexploited capacity was the sole responsibility of the OPEC countries (in particular Saudi Arabia, where the costs involved also happen to be lowest).

The combination of a sharp rise in demand and insufficient expansion of production capacity around the world has led to tension in the oil market. Production capacity is concentrated in just a small number of countries, of which only Saudi Arabia and the United Arab Emirates have enough flexibility to vary supply. This could give rise to geopolitical competition between consumer countries to secure future energy flows, especially under a system of weak globalisation.

POLITICISATION²⁵ OF ENERGY

Market forces alone will not automatically solve the problem of energy acquisition. At present, countries like China and India not only choose to buy on the open market, but chiefly opt for politically motivated agreements with producer countries. They conclude long-term contracts to guarantee future oil and gas supply, in exchange for investments in a wide range of sectors in producer countries. In this regard, the Chinese and – to a slightly lesser extent – Indian state-owned companies can count on the support of their governments. Supply security is the key issue, and it has priority over financial attractiveness and environmental concerns. Chinese state-owned companies can often rely on low-cost government loans. In addition to concluding agreements on prices and purchase quantities, moreover, the Chinese government is willing to grant development aid or other supplementary aid to producer countries. China has already concluded such agreements, for instance with other politically oriented countries like Russia, Iran and Sudan, and is also willing to do so with Venezuela.

Such agreements are very attractive to producer countries, because they offer a long period of demand security in rapidly expanding markets. In exchange for supplying oil, for example, Saudi Arabia could acquire shares in Chinese refineries, which would enable it to establish a direct interest in the expanding Chinese market. For China, such an agreement has the

25 In this advisory report, politicisation is understood to mean: the increasing influence of governments in global energy markets. It is the opposite of the situation under free trade and globalisation, which is subject to market forces. The present use of the term politicisation therefore differs from its use in other AIV advisory reports, where it is more likely to mean 'turning something into a political issue'.



advantage that Saudi Arabia will wish to continue supplying oil to its own refineries, thus guaranteeing supplies to the Chinese market. Providing producer countries with a market also provides them with the confidence to invest in infrastructure and expanding production at home.

It is difficult for the economically driven consumer countries – first and foremost the United States and the European Union – to compete with such agreements. Such direct state assistance to business violates the market principles that apply there. Nevertheless, it is conceivable that the large international oil companies will enter into vertically integrated joint ventures with state-owned companies in producer countries. For example, the way in which the North European gas pipeline and the exploitation of the Russian Shtokman gas field are managed bears certain characteristics of such an arrangement. Russian gas company Gazprom will probably enter into a joint venture with one or more companies from the United States, France or Norway.

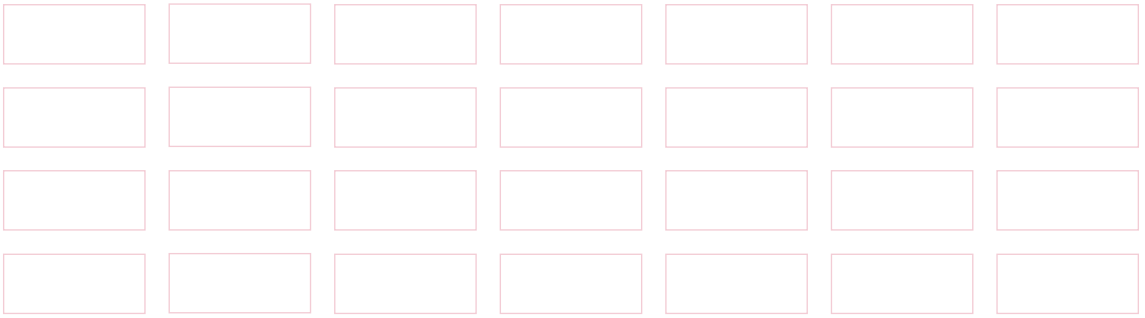
Such an agreement will require a substantial change in strategy by the international oil companies. In recent years, they have come under increasing pressure to purchase shares in oil and gas projects, and some of the agreements with state-owned companies do not provide this option. The producer countries increasingly want to generate and control at least part of their own revenues from oil and gas exploitation in the market.

The United States and the European Union rely mainly on private international companies for their oil and gas supplies. In a world focusing on further globalisation and market forces, the appropriate strategy is to make the market attractive for a large number of providers. This policy was successful due to the possibility of establishing oil and gas reserves in the OECD countries. It produced efficient and financially strong companies that largely controlled the market until the 1990s.

INVESTMENT CLIMATE

It remains to be seen whether the international oil companies will be able to stand their ground in an oil and gas market increasingly dominated by government players. These companies have a profit motive (influenced by private shareholders) and therefore want a certain return on their investments. In principle, they cannot rely on the kind of facilities that state-owned enterprises, which are able to conclude international energy contracts, have at their disposal. It is thus possible to speak of an unlevel playing field in this area of the global oil market.

To limit the risks involved, international oil companies often wish to obtain full or partial ownership of the projects in which they invest. This is becoming increasingly difficult, however, as many producer countries – especially in the Gulf region, Venezuela and partly also in Russia – have closed their oil sectors to majority holdings by international investors. These countries regard their reserves as a strategic asset and as the property of the state or the nation. The sale of these reserves is not open to discussion, as it would encroach on national sovereignty. Moreover, the recent rise in oil prices is producing higher revenues for producer countries, enabling them to meet their own investment requirements. The need



for foreign investment is therefore falling. In order to ensure government control, the oil sector in each country is controlled by a state-owned oil company.

SHOULD MARKET ORIENTATION SIMPLY BE RECONSIDERED?

International oil contracts concluded at government level and diminished access to reserves are both forcing importing countries to seek a new balance between market orientation and government intervention in their economic relations with producer countries.

This is particularly relevant in relation to Russia, which is home to two of the world's largest combined oil and gas reserves and located between two major importing regions: the European Union and East Asia (China and Japan). Russia is well aware of its comfortable position and plays its energy trump card as much as possible in its foreign policy. It regards energy as a strategic means to achieve its geopolitical ends. In order to strengthen state control over the energy sector, President Putin has tightened his government's grip. He is increasingly abandoning the path towards a more economically driven state that was cautiously adopted by former President Yeltsin. Foreign investors are no longer permitted to own majority interests in the Russian energy sector. Large energy companies – Gazprom, Yugansk and Sibneft – are firmly back in state hands.

Because until now Russia has directed almost all its energy exports towards the European Union, the Russian government is looking to diversify. The country has taken concrete steps to supply China and India. Russia will simultaneously try to strengthen its influence in East Asia and reduce its dependency on Europe. The European Union's liberalised energy market has played a role in this decision. Russia is concerned about the uncertain future of European demand for Russian gas. It is therefore more than happy to conclude long-term, high-volume contracts with the Chinese and US markets. At the very least, this provides Russia with demand security and helps it to spread its risks.

The oil-producing countries of the Gulf region (Saudi Arabia, United Arab Emirates, Kuwait, Iran and Iraq) play a key role in the geopolitical energy game. However, they are also regarded as politically unstable, which means that there is a significant risk of the oil supply from these countries being disrupted for economic or political reasons. The countries in this region are integrated into the international economic system only to a limited extent. Their ruling elite are fearful of institutional changes of a political, social and economic nature, which are necessary for further integration into the global economy. Those in power are afraid to lose their political and social (religious) influence at national level.

2.4 CONCLUSION

The international political and economic environment of energy markets is changing. The likelihood that producer countries will fully liberalise their oil and gas sectors is limited. In the future, they will be better able to serve their own national political and economic interests if they can prevent over-investment in production capacity and avoid being pushed into

the role of marginal producers. Energy contracts with countries like China and India offer the prospect of demand security and access to markets in the manufacturing industries of these countries. This increases the revenue security of producer countries, enabling them to manage their domestic political and social stability more effectively. The adjustment of expectations concerning globalisation and the energy markets should also have implications for the foreign policy and energy policy of the Netherlands and Europe, which have so far focused primarily on realising the globalisation agenda. In the new geopolitical climate – in which it is uncertain whether the United States will be willing or able to defend European energy interests, because its interests in Asia outweigh its interests in Europe – a strategic reorientation of the energy policy of both the Netherlands and Europe will be required.

DUTCH ENERGY INTERESTS

3

In every society, maintaining security of energy supply is a prerequisite for responsible development. In today's complex society, in particular, a substantial shortfall in supply can have serious consequences.

The Netherlands traditionally focuses on developing and perfecting international free trade. This policy orientation meshes well with the nature and structure of the Dutch economy. In the energy sector, too, it is apparent that the Netherlands has interests that can flourish better under conditions of free trade than under protectionism or other types of barriers, provided that there is a level international playing field. As noted in the previous chapter, however, there is a real danger that energy flows are becoming increasingly politicised, especially in the case of oil and gas. To gain a better picture of the foreign policy that should be pursued in response to this development, a brief examination of Dutch energy interests is appropriate. The advisory councils distinguish between two types of Dutch interest:

- 1 Dutch interests that are non-interests of other states (in cases where the Netherlands or Dutch companies compete with others)
- 2 Dutch interests that are shared by others (common interests).

In principle, serving common interests signifies a common approach. The joys and burdens must be shared equally between all interested parties. This requires a multilateral approach to prevent free-riding. However, it can only succeed if all the interested parties are convinced of a problem's urgency. Examples of common interests include the security of transport routes and prevention of cross-border terrorism. It is a Dutch interest to put problems on the agenda and participate actively in multilateral fora like the European Union, the IEA, the United Nations and the OSCE.

Multilateral fora are not the first option for safeguarding purely national interests. The question is therefore whether – and if so to what extent – the Netherlands should enter into bilateral relations with the partner countries concerned. This might be relevant, in particular, with regard to access to exploration sites or establishing transport routes to or via the Netherlands. The Netherlands would not be alone in this: Germany has also conducted bilateral negotiations with Russia, for example, concerning the North European gas pipeline. With this route, Germany has secured a long-term supply of Russian gas. However, other interested EU member states (e.g. Poland) were not involved in these negotiations and feel passed over. France also has a strong bilateral orientation.

3.1 DUTCH INTERESTS

Although crisis management measures in the energy field are often only effective in an international context – and should therefore be discussed in the next section – there are also some purely Dutch aspects to this issue. The advisory councils have therefore chosen to briefly examine supply security and crisis management with regard to each fuel type in this section.

GAS

Compared to most European countries the Netherlands has the advantage of possessing substantial gas reserves of its own. From the moment it started



exploiting the large Groningen gas field, the Netherlands has always sought and found an international market. Gas has attained a prominent position in the Dutch fuel mix. The vast majority of homes can be heated only by means of gas. In addition, electricity generation in the Netherlands is largely based on gas. For a long time, the Groningen gas field provided the Netherlands with a 'guarantee' in these areas that was taken for granted. Since the introduction of the small fields policy in 1974, when Ruud Lubbers (then Minister of Economic Affairs) published his policy document on energy, securing energy supplies has been a near-permanent feature of Dutch energy policy, although it has not always enjoyed the same degree of attention. The small fields policy ensured that the gas from the Groningen field could be exploited much more slowly than would have otherwise been the case.

The transport of gas via the Netherlands, which started with the transport of substantial amounts of Norwegian gas to Belgium and France, is showing clear signs of growth potential with the construction of a large pipeline to the United Kingdom. The Netherlands' role in gas transport is expected to receive a further boost if the highly developed gas network in the east of the country is connected to the North European gas pipeline (also known as the Baltic pipeline). In that case, a substantial increase can be expected in the amount of gas transported via the Netherlands, due to the transport of Russian gas to the United Kingdom or other related transports.

The gas sector has undergone a number of important structural changes in the past ten years, with an acceleration in activity in the past five years. The European Union's ambition was to liberalise the internal European energy markets in order to encourage competition. It envisaged the creation of a level playing field across the European Union. Following a demanding transformative phase, this liberalisation obviously links up directly to the policy principle of promoting world trade that is so important to the Netherlands and vital for European and global economic development. This promotion of world trade should take place within the policy framework laid down by the relevant international institutions (e.g. WTO, IMF, World Bank) and, at European level, by the European Union.

Security of energy supply deserves a prominent place on the policy agenda. Due to a number of factors, this issue currently requires detailed attention from a policy perspective, as also noted in the AER's recent advisory report *Gas for tomorrow*.

- More than half the gas in the Groningen field has now been exploited.
- During energy crises, the Netherlands cannot suddenly reserve for Dutch consumption Groningen gas that is contractually destined for export to other EU countries: it must comply with the principle of non-discrimination.
- The European Union is rapidly becoming dependent on imports for its supply security.



In its recent advisory report, the AER referred to the importance for European supply security of having a player of European calibre, like Gasunie Trade & Supply, which has close ties to Maatschap Groningen.²⁶ A suitably large player is also important because it can guarantee that the deployment of imported gas, gas from small fields and Groningen gas is balanced and geared to market potential.

The liberalisation of the market and the resulting competition between gas companies in both Europe and the Netherlands are simultaneously leading to an increase in the supply/import of gas to the Netherlands. The establishment of an LNG terminal in the Netherlands, as advocated in *Gas for tomorrow*, would further stimulate this intensification of the international gas trade in the Netherlands. It appears that the Dutch gas industry is seizing this opportunity.

In light of the above, it can be concluded that the Netherlands still occupies a relatively comfortable position as far as gas is concerned, but that this position will deteriorate steadily in terms of dependency. In the framework of Dutch energy policy, the Minister of Economic Affairs, Laurens Jan Brinkhorst, has established a production ceiling for the Groningen gas field. This will slow down the field's depletion rate, enabling the Netherlands to maintain a strategic buffer stock for a longer period. However, the advisory councils note that the Groningen field cannot produce extra gas at any given moment to compensate for inadequate imports from other countries, as this depends on the field's production capacity at the time in question. It can be assumed that production capacity will be kept in line with contractual obligations and not much higher. This is because maintaining production capacity becomes progressively more expensive as the pressure of the remaining gas in the field decreases.

There is no worldwide crisis management system for disruptions in the gas supply as there is for oil and oil products in the framework of the IEA. This is because the gas market is not yet a global market, but in fact a collection of regional markets (North America, Europe, Japan, et cetera). Mutual assistance and actions to reduce consumption are not effective in the gas market at global level. Even the rapidly expanding LNG market will not be able to do enough to change this in the coming decade, due to its relatively small market share.

One of the key features of the gas market is that a majority of all gas deliveries are still transported by pipeline. An advantage of this is that the producer and the consumer are 'riveted' together. This makes it harder to change the destination of gas, affording the consumer the benefit of supply security. At the same time, however, the consumer is dependent on the supplier concerned, which limits the scope for diversification.

26 Maatschap Groningen was established to exploit the gas in the Groningen field. Shell and ExxonMobil each hold a 30% interest in the company, while the Dutch state holds a 40% interest through Energiebeheer Nederland (EBN). The Nederlandse Aardolie Maatschappij (NAM), a joint venture of Shell and ExxonMobil, performs the operational tasks.



The Netherlands should promote the availability of gas by establishing good links with producer countries, in particular Russia, without delay. In order to ensure that it continues to receive gas from Russia, the Netherlands will have to push for a better connection to the Russian gas transport network. In doing so, it may be able to take advantage of its current position in the gas market. The Netherlands should focus on its role as a transit country for gas (for example to the United Kingdom) and as a provider of flexibility²⁷ and strategic storage, since it has the option of storing gas in largely depleted gas fields.

For example, it would considerably strengthen security of gas supply if Gazprom and the rightholders of the comparatively large – and largely depleted – Annerveen gas field concluded a contract to turn the field into a strategic gas reserve. The Annerveen field has the capacity to hold approximately 100 bcm of gas.

This would nevertheless require some robust energy diplomacy. The Dutch gas market is highly liberalised. This is an advantage for a provider of flexibility but less advantageous for acquiring gas. It is harder to conclude long-term contracts with producer countries in a liberalised market, which is partly due to the constant pressure by regulators to suppress long-term transport contracts.²⁸ This is an unattractive proposition for producer countries, however, which need long-term supply and transport contracts to fund exploration and exploitation, pipelines and LNG infrastructure.

Constructing an LNG terminal is an important step towards reducing the Netherlands' dependency on a small number of suppliers, as this will enable it to switch between different gas providers. In the coming decades, however, it is expected that LNG will also be supplied mostly by means of long-term contracts. During the next ten to twenty years, the share of spot-market LNG is expected to rise to 20-25% of the entire LNG market. (Incidentally, long-term contracts are becoming more flexible with regard to volume commitments, and the price formulas in these contracts occasionally include references to spot-market prices.)

OIL, REFINERIES AND THE PETROCHEMICAL INDUSTRY

Traditionally, the security of European energy supply has been largely guaranteed by the international oil companies. Although hardly any of the large international oil companies are recognisable as such today because their activities span the entire globe, they are originally American or European. In fact, the European home market still features strongly in the activities of BP, Total and Shell. A significant part of their downstream activities (refining and trade) are carried out in EU countries. As a result, a

27 Storing gas underground makes it possible to respond to market demand in a faster and more flexible manner. The stored gas can be used, for example, as a buffer. When demand unexpectedly peaks, for example due to a sharp frost, gas can be quickly 'produced' from storage. Stored gas can also be used to meet demand in the case of interruptions in production. The Netherlands is a European leader in gas storage.

28 European Commission, *Energy Sector Inquiry - Issues Paper*, 15 November 2005.



large portion of their output is processed and sold in these home markets. Although the oil market, in particular, is becoming increasingly internationalised, the vertical integration of the oil companies provides a certain degree of guaranteed supply to Europe.

All this could change dramatically, however, if international oil companies' access to reserves continues to decline, as explained in chapter 2. It is therefore important that some of the Netherlands' efforts in the field of foreign policy focus on ensuring that private companies also have access to concessions. The technical and managerial knowledge of the international oil companies could work to their advantage in this regard, although state-owned companies increasingly appear to have this knowledge at their disposal as well (e.g. Petronas and Petrobras).

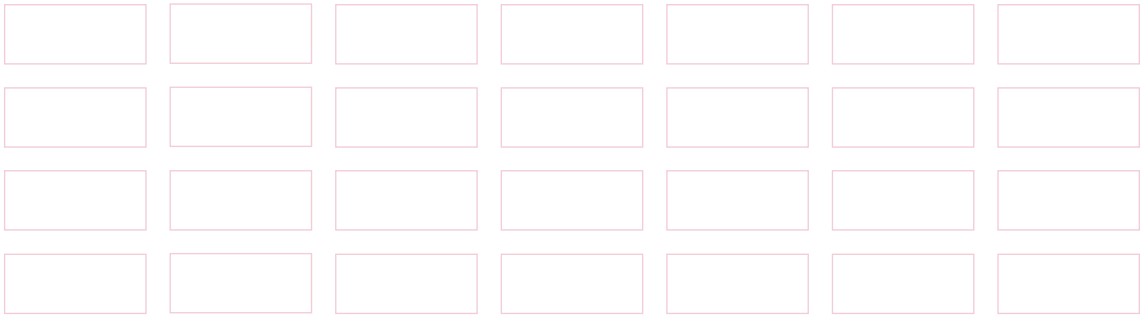
One of the largest international oil companies, Shell, has its roots and a large share of its activities in the Netherlands. The Rijnmond area boasts a concentration of refineries – and a related petrochemical industry – that is matched or surpassed in only a few other places around the world. Activities have also developed elsewhere in the Netherlands (Moerdijk, Terneuzen, Vlissingen, Delfzijl/Eemshaven and Limburg) that can survive only in a free trade context because the Dutch market is too small to ensure continuity. Together import and export are the pulse of healthy economic development. Free trade – and with it the policy goal of achieving and maintaining a level playing field at international level – is of vital importance here. In this context, the advisory councils consider it important that companies from oil or gas-rich countries are actually willing to invest in industrial installations in the Netherlands, like Kuwait Petroleum in the Rijnmond area and Sabic in South Limburg, because interwoven interests promote mutual understanding and policy coordination (e.g. with respect to protecting investments).

Although there are clear indications that the global oil market is becoming increasingly politicised, it is reasonably liquid, which also benefits the Rijnmond area (and the other Dutch business locations). In order to deal with supply shortages on the global oil market – i.e. oil crises – the OECD countries have established a crisis management mechanism that is managed by the IEA. This mechanism is effective, as was recently proven again when oil products were released from the 90-day crisis stock in several European countries to cover the shortages that developed in the United States as a result of the damage to refineries caused by hurricanes Katrina and Rita.

Because oil is traded on the global market, the Netherlands and other countries have consistently declined to grant the European Union similar powers with regard to an oil crisis management system. This would not be effective precisely because of the market's global nature. In effect, the European Union is thus a free-rider within the IEA.

COAL

The Netherlands has a comparatively modest role as regards coal. Coal consumers are limited in number and are relatively large market players (power stations and blast furnace plants). Coal is imported from a wide variety of countries. The global coal market is not characterised by an oligopolistic market structure or the concentration of suppliers in countries that pose a



danger in terms of security or ‘democracy’. The best way to look after Dutch interests regarding the coal market is therefore to continue promoting free trade. That is also the best environment in which to market clean coal technology, an area in which the Netherlands (Shell) has a vantage ground for playing an important role at international level. The Netherlands represents an attractive business location for the coal sector because of the ports of Rotterdam and Amsterdam, which are well-placed for the transport and/or supply of coal to other parts of Europe.

Regardless of the Netherlands’ relative position in the coal market, it is clear that no short or long-term supply disruptions need to be expected. It is therefore understandable that there is no specific energy supply policy concerning coal. In practice, aside from the associated environmental problems many countries regard coal in itself as a welcome diversification that increases overall security of energy supply.

NUCLEAR ENERGY

In international terms, the importance of Dutch policy in the field of nuclear energy can be described as limited. This is not only because of the limited size of the nuclear energy sector in the Netherlands but also because nuclear energy has thus far been a sensitive issue in Dutch politics and society, although this appears to be changing. Incidentally, due to its one-third stake in the uranium enrichment activities of URENCO, the Netherlands occupies a special position that it might be able to develop. If it succeeds in doing so, the Netherlands would also find a more willing audience for its policies in the relevant fora and gain greater prominence in the field of energy in general and nuclear energy in particular.

URENCO’s ultracentrifuges represent the best available uranium enrichment technology in the world. It is thus not without reason that a major nuclear energy power like France recently decided to enter into a joint venture with URENCO (through AREVA) in the field of centrifuge development and production. A special treaty was drafted for this purpose between France and the three countries of the troika (the Netherlands, the United Kingdom and Germany) to ensure the safety of supervision and use.

URENCO has now managed to corner 20% of the global uranium enrichment market and has plans to build a factory in the United States. Expectations are that its market share will continue to rise. The Netherlands thus occupies a key position in a vital section of the nuclear energy chain. This position will only gain in importance in the future, given the upturn in the use of nuclear energy. The reasons for this upturn include the price of fossil fuels, the difficulty of supplying them in a prompt and reliable manner and environmental considerations.

Like coal, nuclear energy is regarded as an opportunity to diversify in order to increase the general security of energy supply. It has various advantages over fossil fuels. Nuclear energy does not lead to an increase in CO₂ emissions. Several countries neighbouring the Netherlands regard nuclear energy at the very least as an additional way of securing their energy supply. However, a lack of public acceptance has so far stood in the way of widespread use.



The advisory councils note that in practice there are no energy options without disadvantages. The government should examine what role the Netherlands can play in the field of nuclear energy, in cooperation with others and under the strictest conditions, while recognising the problems of waste and proliferation. It seems appropriate to reconsider this issue at regular intervals in order to determine whether the sum total of developments (improved technology and security in the field of nuclear energy, greater risks in the field of gas and oil, etc.) continues to lead to the same conclusion.

BIOMASS

The Netherlands is in a good position to secure a key role in the field of processing and, in particular, utilising biomass. The ports of Rotterdam and Eemshaven provide the necessary infrastructure for the transshipment, conversion and marketing of biomass. Wageningen University has expert knowledge on improving crops used for the production of biomass. Furthermore, the Energy Research Centre of the Netherlands (ECN) and various other organisations know how to transform biomass into energy. The Netherlands can best capitalise on this favourable position in an open, global biomass market. It goes without saying that, as this market develops, adequate attention should be devoted to the implications for sustainability and specific biomass-producing developing countries.

As a source of liquid fuels, biomass is regarded as one of the few options for diversifying transport away from oil and oil products and thereby increasing security of energy supply. On 8 May 2003, the European Union issued Directive 2003/30/EC, according to which 20% of conventional fuels should be replaced by alternative fuels by 2020. At that point in time, 8% of the total fuel supply should come from biomass.

ELECTRICITY GENERATION AND DISTRIBUTION

Achieving and maintaining a level playing field at European level has become more important as a result of the liberalisation of the energy sector. It is vital for electricity producers, which are increasingly feeling the pressure of competition due to continuing liberalisation, that a level playing field is also achieved in adjacent policy areas, such as environmental policy. This is sometimes also referred to as the harmonisation of policy and policy provisions. If the level of harmonisation is inadequate, this may be expected to have an unfavourable impact on activity in the sector as well as on the relative price levels of energy and electricity.

As in the case of the Dutch gas sector, it appears that it is not the aim of the Dutch government to establish a company of European calibre in the electricity distribution sector. The advisory councils note that this does appear to be the aim, for example, of the German, Danish, Austrian and French governments, which are focusing on establishing (or maintaining) large-scale, more vertically integrated companies. The aforesaid governments expect that these companies will consequently have more negotiating power in relation to fuel suppliers, especially in cases where they grant them policy-related and political support in the developing balance of geopolitical forces. In addition, they will gain a stronger position vis-à-vis competitors in the European market.



Electricity is not as easy to transport over long distances as oil, gas and coal. Transport losses are significant, and technically it appears to be a complicated and relatively vulnerable process, while the means of transport (power lines) are also unpopular. In practical terms, moreover, it is still almost impossible to store electricity without using water reservoirs.

It is therefore reasonable to assume that the practice of locating power stations as close as possible to markets will continue. This means that security of energy supply in the field of electricity comprises two aspects. Firstly, there is the principle of assisting each other as much as possible in the case of acute supply shortages. In this context, most European electricity companies have already agreed to provide mutual assistance. In addition, the Minister of Economic Affairs, Laurens Jan Brinkhorst, has made an effort to encourage the countries that make up the North-West European market and the electricity companies in those countries to conclude agreements to comply with supply contracts as much as possible, even in the case of supply disruptions. This essentially reflects what was noted earlier, namely that the Netherlands cannot disregard its gas export contracts in the case of a disruption in the gas supply to the Netherlands.

Secondly, electricity generation in any country (e.g. the Netherlands) is essentially only as reliable as its fuel supply. Given that the Dutch generating system is highly dependent on natural gas, it should be clear that a certain vulnerability will also develop here.

SUPPLY INDUSTRY

Numerous supply companies operate in the various energy sectors in the Netherlands, including wind and solar energy. These companies will have a better chance to develop in terms of size and quality if they are given a fair chance in the international energy sector. Promoting a level playing field and eliminating protectionism (by progressively internationalising standards) is also of key importance for their activities.

3.2 COMMON INTERESTS

TRANSPORT ROUTES

In all the aforementioned sectors, transport routes should be open and secure. This applies to both sea routes and land routes (which consist primarily of pipelines). Both types of route are subject to specific international treaties, although those concerning the use of the sea appear to be more developed than those concerning transit routes over land. The Secretariat of the Energy Charter is trying to make progress on land routes, but this appears to require more time than anticipated in 1990 at the launch of the basic concept by the then Prime Minister of the Netherlands, Ruud Lubbers.

Terrorist attacks are a realistic possibility on both types of route. In the case of land routes, the views and requirements of the individual countries that must serve as transit countries are often problematic. In these areas,²⁹ foreign policy



is by far the best way to advance Dutch interests. The realisation of collective interests such as these has its own dynamic and can only be achieved by means of international cooperation.

At a certain point, military resources may have to be deployed to protect these routes in order to ensure that supply is not interrupted. The Netherlands should declare now that it is willing to contribute to such operations, provided that they are legitimised by a clear international mandate, preferably from the UN Security Council. NATO should also devote more explicit attention to this issue.

POLITICAL STABILITY

Another collective interest is the existence of political stability in producer countries and countries involved in the transport of energy, as well as in the large new consumer countries. This is important for multinational enterprises as well as national state-owned oil and gas companies. In countries like Nigeria and Sudan, ethnic conflict and civil war regularly interrupt production. Oil and gas projects have a long-term character and therefore benefit from predictability and certainty.

However, it would be short-sighted and cynical to interpret this collective interest exclusively in terms of the uninterrupted production of fuels. Both the governments and the populations and business sectors of the countries concerned have an interest in factors that promote stability. These include respect for fundamental human rights, including fundamental international labour standards regarding the rights of employers and employers' organisations, employees and trade unions. The latter, enshrined in ILO Conventions 87 and 89,³⁰ lay down important conditions for a well-ordered system of labour relations, an issue to which many of the countries concerned still devote scant attention. Certain multinational enterprises have, so far, attached limited importance to this issue, and the efforts they have undertaken to help establish such a system are correspondingly poor.

Time and again, it has proved essential to ensure that exploration, exploitation and export of energy take place within the framework of a widely accepted policy that serves the interests of the producer countries as well as interests in the local and regional vicinity of the actual exploitation activities. Although the authorities in question obviously bear responsibility for this, the active and conscientious cooperation of the oil and gas companies is also vital here. Corruption is a well-known phenomenon that is hard to eradicate and frequently undermines political stability and local support. Fortunately, it appears that companies, mindful of the OECD guidelines, are generally aware of this.³¹ The fact that this often leads to substantial delays in the development of projects is the price that has to be paid in order to achieve

30 ILO Convention 87 concerns the freedom to establish trade unions; ILO Convention 98 concerns the right to organise and collective bargaining.

See also <<http://www.ilo.org>>.

31 See, *inter alia*, OECD, *Annual Report on the OECD Guidelines for Multinational Enterprises 2003: Enhancing the Role of Business in the Fight Against Corruption*, the 'Publish What You Pay' campaign and the work of organisations like Transparency International.

and maintain long-term cooperation that is effective and productive for both parties.

EFFICIENT AND SUSTAINABLE ENERGY

Focusing on the 'greening' of energy – increasing sustainability of energy supply and energy efficiency – is not only a Dutch interest but can benefit the whole world. The Netherlands' potential role in this area involves the export of knowledge and technology in the fields of cleaner energy generation (gas technology, clean coal technology, wind energy, solar energy, biomass and CO₂ storage), energy efficiency/conservation and energy transport management. This fits in with the Dutch policy of seeking support in international and multilateral frameworks for the sustainable use of fossil fuels, the use of renewable energy and the achievement of greater energy efficiency.

FOREIGN POLICY WITH A VIEW TO SECURING THE DUTCH ENERGY SUPPLY

4

4.1 A NEW KEY OBJECTIVE

In recent decades, due to the relative tranquillity on the energy markets and the existence of substantial gas reserves in the Netherlands, there was no cause for concern regarding supply security. Ever since the first oil crisis (1973), moreover, Dutch energy policy has been targeted at securing a reliable energy supply. However, the analysis presented so far indicates that the Netherlands – and even more Europe – will now also become increasingly dependent on energy imports, at a time when a state-driven scenario of energy flows is more likely than the continuing market-oriented globalisation of energy markets.

The advisory councils believe that a turning point has now been reached. The implications of a threat to the energy supply are so severe that security of energy supply clearly warrants policy attention in the current global energy situation. Energy shortages affect every citizen and, depending on their scale and duration, can even disrupt society. The mere threat of physical shortages leads to price rises that are so sharp they can damage the economy, as occurred in the United Kingdom at the end of November 2005.

Supply security can no longer be taken for granted. A proactive and coordinated approach is needed to secure the future of the Dutch energy supply. Given the increased importance of the international dimension of security of energy supply, domestic energy policy, which focuses on reliability, should be complemented by foreign policy.

The advisory councils welcome the increase in attention devoted to energy in the Explanatory Memorandum to the 2006 Budget of the Ministry of Foreign Affairs. In their view, however, classifying security of energy supply under the key objective of promoting peace and security does not go far enough,³² as it fails to emphasise the public interest nature of the issue and, moreover, may lead to negative connotations.

The advisory councils believe that security of energy supply should become a new, independent, key foreign policy objective, alongside existing key objectives.³³ The advisory councils are aware that in practice objectives must always be weighed against each other and carefully combined in real-life situations.

32 See Explanatory Memorandum to the 2006 Budget of the Ministry of Foreign Affairs, policy Article 2, Operational Objective 8: Promoting security of energy supply, pp. 38-40.

33 See the eight policy articles of the Explanatory Memorandum to the 2006 Budget of the Ministry of Foreign Affairs: 1. Strengthening the international legal order and respect for human rights; 2. Promoting security and stability, effective humanitarian assistance and good governance; 3. Strengthening European cooperation; 4. More prosperity, less poverty; 5. Promoting human and social development; 6. Protecting and improving the environment; 7. Promoting the welfare and safety of Dutch nationals abroad and regulating the movement of persons; 8. Raising the Netherlands' cultural profile and helping create a positive image, in the Netherlands and abroad.



The specific details of foreign policy aimed at securing energy supplies depend to a large extent on the general development of the global energy markets in the long term. If this development clearly points towards a continuation of free trade, with the market as the central allocation mechanism, the foreign policy contribution will remain relatively limited. However, if it moves in the direction of increasing government intervention and the erosion of the freely available part of the energy supply – and this possibility should be explicitly taken into account – additional demands will have to be placed on foreign policy. The government therefore needs to consider whether its bilateral and multilateral relations require new instruments that focus specifically on securing energy supplies.

Before examining in detail the potential implications of such a reorientation in various policy areas, the advisory councils wish to make it clear that introducing energy as a key objective does not have to come at the expense of other objectives in most cases. In general, there will be no zero-sum game. Three situations are possible:

- 1 No interaction: securing energy supplies takes place independently of other key objectives.
- 2 Synergy: securing energy supplies also serves other foreign policy objectives, and vice versa.
- 3 Conflicting interests: securing energy supplies comes at the expense of other key objectives.

In the first two situations no problems arise. Promoting peace and security, for example, is not just a prerequisite for uninterrupted energy supplies, but usually also for successful trade relations, economic development and preventing humanitarian crises. In a similar manner, safeguarding the investments of companies with close ties to the Dutch economy will also benefit the energy supply. Improving the quality and effectiveness of Dutch trade and investment promotion is an operational objective under policy article 4 ('More prosperity, less poverty') of the Ministry of Foreign Affairs' budget. In general, policies aimed at eradicating poverty, in combination with policies promoting sustainable development, will ultimately also be favourable from an energy perspective, even where this leads to increased demand for energy in developing countries.

The third situation, however, is clearly different. Where conflicting interests exist, clear choices have to be made. Examples of this include the deployment of what happen to be limited military resources for the purpose of protecting transports or for peace operations. How is it possible to prevent efforts to secure energy supplies from undermining certain aspects of Dutch and European human rights policy? This is a problem because some competing consumer countries have no trouble doing business with producer countries with poor human rights records. In certain cases, efforts to secure energy supplies can also clash with environmental policy or development cooperation policy, for example.

The advisory councils are not expressing an opinion on the relative importance of energy in relation to other key objectives. The main issue is that



supply security will henceforth be one of the key considerations of foreign policy as a whole. The advisory councils have already drawn attention to the complementarity of foreign policy and energy policy with regard to securing energy supplies. These policies should consequently be coordinated and determined at the highest official and political level.

The fact that different objectives can sometimes conflict with one another and that certain interests must prevail over others is nothing new. What is new is that in future security of energy supply will be placed on the agenda more clearly and that it will be given full weight.

What is also new is that the advisory councils explicitly advise the government to adopt a **'both/and'** approach with regard to securing energy supplies. In other words, it should pursue policies focusing on multilateral fora and institutions, starting with the European Union, as well as policies aimed at developing bilateral relations.

The reason for this is that the advisory councils are unable to say whether the increasing politicisation of the energy markets described earlier in this report will continue or whether it will prove to be a temporary intensification, following which the global energy market will return to the more attractive path of free trade and globalisation. An approach that provides a robust response to both situations is therefore appropriate.

The remainder of this advisory report will also demonstrate that the Netherlands should focus on a number of countries, regions and international institutions for the purpose of securing energy supplies and that this can go hand in hand with the development of broader economic ties with the energy-exporting countries concerned. This applies, in particular, to Russia and countries in the Gulf region and North Africa. Countries south of the Sahara can be effectively approached from the combined perspective of securing energy supplies – including specifically for the local population – and development cooperation. It is precisely because there are encouraging signs in this region that the authorities really want to tackle corruption and bribery that the Netherlands should not let this opportunity pass.

When formulating policies, the government should remember that several of the above-mentioned countries understand and accept that the real trade takes place between companies but still prefer to package and support it in some kind of bilateral treaty or memorandum of understanding concluded between the two governments. The advisory councils support this, particularly when it provides an additional opportunity to extend the trade relationship beyond oil and gas. The importance of achieving support in these countries for the export of oil and gas should not be underestimated. It is achieved more readily if the populations of producer countries actually see that their own economic development is strengthened in the broadest sense. The Netherlands should certainly understand and in fairness accept the desire of countries to be cautious – or even frugal – about exporting their own mineral resources. After all, our own gas policy has also always been based on maintaining a balance between export and domestic development.



4.2 REVIEW OF KEY FOREIGN POLICY OBJECTIVES, WITH A FOCUS ON ENERGY

EUROPEAN UNION

Within the European Union, energy policy has developed with difficulty and is still far from complete. There is a conspicuous gap, in particular, in the field of securing energy supplies. This painstaking development is explained by the significant differences (or perceived differences) of interest that exist between the various member states with regard to energy. Several EU member states hold the view that a national policy offers more opportunities to promote objectives such as securing energy supplies and access to oil and gas reserves in favour of their 'own' companies. Another explanation is the separate handling of economic issues in the first pillar and foreign policy issues in the second pillar.

As a result, the European Union has so far been unable to demonstrate that it is capable of taking firm joint action to secure energy supplies. The Netherlands, too, has thus far not been among the proponents of a Community energy policy, at least not where security of energy supply is concerned. We understandably prefer to remain in sole charge of the Groningen gas field.

Due to the European Union's rapidly increasing import dependency, security of energy supply has found its way onto the agenda. Given the lack of political will among the member states, however, this has not led to allocation to the European Commission of competences and instruments that could be used to shape an effective external EU policy. In fact, external policy remains limited to dialogues with producer countries (Russia and OPEC).

The advisory councils note that in key areas the European Commission has also played an unfortunate part in selecting potential competences and instruments for an EU policy on supply security. Thus, its fairly persistent attempts to bring the IEA's competences relating to the oil crisis management mechanism to Brussels underestimate the need to pursue and maintain a global approach with regard to oil. The Netherlands and other countries have therefore rightly rejected these attempts.

With regard to gas, the proposals of the previous Energy Commissioner, Loyola de Palacio, proved too superficial to inspire enthusiasm among the member states, which in any case are still largely focused on national policies. So far, there are few signs indicating a real change in this position. The Constitutional Treaty would also have provided little in the way of new perspectives on this issue, aside from the fact that it would have explicitly classified energy policy as an area of mixed competence.

As a result, European energy policy has to date focused primarily on the internal market (liberalisation of internal markets, competition, sustainable energy policy, energy conservation and CO₂ emissions trading). A common external European energy policy has not yet been developed. Furthermore, the advisory councils note that, insofar as there has been policy with an external focus, particularly in the aforementioned dialo-



gues with energy-exporting countries, the European Commission once again played an unfortunate part. With the benefit of hindsight, the advisory councils note that in two areas, in particular, the European Commission approached the gas exporters and, to a lesser extent, the oil exporters with less understanding than would have been appropriate.

Firstly, the European Commission's actions were largely determined by its attempt to export EU attitudes regarding energy market liberalisation, in the context of improving relations with the above-mentioned exporters. This also placed a heavy burden, for example, on the conclusion of a working Energy Charter. The Commission ignored the fact that one of the main objectives of the energy market liberalisation desired by the European Union is to reduce energy costs. However, this primarily implies 'offering' less state revenue to countries that are highly dependent on energy exports (monocultures). Obviously, these countries will be less than enthusiastic as long as they are not granted sufficient advantages in return.

Secondly, a certain arrogance can be observed on the part of the European Union, or at least that is the perception of some energy-exporting countries. It was thus not without reason that, during his recent state visit to the Netherlands, President Putin described the basic terms for a further improvement in the relations between Russia and the European Union (and the Netherlands) as equality, mutual understanding and reciprocity. Regarding reciprocity, he was probably not only referring to trade issues.

Nevertheless, the European Union and the Netherlands will have to face up to the changing situation in the energy markets and the increase in international political influences in this area. It is significant that the United Kingdom, for example, has published a policy document on security of energy supply and the role of UK foreign policy in this context.³⁴ The document was recently 'ratified' in the position voiced by Prime Minister Blair and his call for an EU energy policy focusing on supply security.

The advisory councils consider it essential for the Netherlands to send a clear signal to Brussels and other EU capitals that the time has come for an EU policy with an external focus. This will not be easy. The member states will first have to determine which interests in this area can be regarded as common interests before they can formulate a common external policy on this basis. The Netherlands will primarily be able to play an agenda-setting role in the initial process, while the chances of establishing an effective alliance with countries such as the United Kingdom are considered favourable.

In the advisory councils' view, it is also clear that the policy in question can be effective only if the European Union ensures that it consists of two well-integrated elements, namely the EU foreign policy that needs to be developed for this purpose and an appropriate EU energy policy. Both



advisory councils consider it essential that the member states are open to providing the European Union with the necessary instruments, primarily in the field of foreign policy, so that it can actively promote security of energy supply in the framework of its geopolitical relations. Examples of areas of common interest to EU member states include demand management, crisis policy, strategic stocks and access to energy reserves.

The advisory councils regard an external EU energy policy, aimed at guaranteeing supply security, as indispensable. The Netherlands should therefore strive towards developing and deploying Community instruments where common interests are at stake.

To avoid misunderstanding, the advisory councils note that effectiveness should remain a key criterion for action. It is therefore not the intention that the oil crisis management mechanism should be taken out of the hands of the IEA. As noted earlier, any approach to the oil market needs to take place at OECD level if it is to be effective. In the case of gas, the European Union is relevant, as there is no global market for gas, but several regional markets. Only when LNG has secured a larger share of the global gas market – say over 20% – can intercontinental coordination also be effective.

The advisory councils point out that their advocacy of the formulation of an external EU energy policy, aimed at securing energy supplies, is a logical consequence of the fact that it can no longer be taken for granted that Europe will be supplied with enough energy, in particular gas.³⁵ The global market, in which Europe will increasingly have to compete with other large energy-importing economic blocs, is supplied by a relatively small number of players (as noted in the analysis in previous chapters of this report). This situation clearly deviates from the assumption that the European Union justifiably entertained while formulating policy on the internal European energy market during the 1980s and 1990s. As argued in the AER's recent advisory report *Gas for tomorrow*, all this means that the European Union should take this changed situation firmly into account in its liberalisation policy.

The development of EU liberalisation policy will therefore also have to take account of – or even be geared towards – issues in the sphere of supply security. This implies, for example, that there should be room in this policy for: a permanent, healthy source of revenue for private energy players of sufficient size and weight to operate effectively in the energy supply market; those characteristics of long-term contracts that are favourable to supply security; and non-discriminating access to and use of European networks.

In connection with the changed energy situation in Europe, the common foreign and security policy (CFSP) should also play an important role. It should take explicit account of issues relating to energy.³⁶ As in other cases, however, the European Union can take action only if the member states are able to align their views.

At any rate, the Netherlands should ensure that the European Union continues to develop its energy dialogues with OPEC, Russia and any other producer countries. Participation in multilateral organisations and active diplomacy aimed at placing Dutch interests on the European agenda are essential.

It follows from the above that it would be risky for the Netherlands to focus its foreign policy exclusively on or towards Brussels while there is no European policy. A 'both/and' policy could prevent the Netherlands from being left empty-handed.

UNITED STATES

It is a fact that a good relationship between the Netherlands (and the European Union) and the United States is one of the core values of Dutch foreign policy. In cases where energy is an issue of strategic interest on the world stage, and is also regarded as such by the United States and other major players, the Netherlands should give due consideration to American views in this area. When these views promote a free international energy market with as much unrestricted access to sources as possible, they are compatible with Dutch and European preferences. In the bilateral consultations and the regular EU-US consultations, as well as in consultations with the IEA, of course, energy should therefore feature regularly as a topic of common interest. Moreover, both the United States and the European Union have an interest in greater energy efficiency, stock management and a favourable investment climate, and could undertake joint actions in these areas.

Nevertheless, it is important not to overlook the fact that the United States basically approaches this issue from a strictly national perspective. There may now be less sympathy for European interests and views, compared to the situation at the time of the 1973 oil crisis. This situation is exacerbated by the fact that the United States' strained relations with various population groups in Arab countries and Venezuela appear to limit its opportunities to exercise political influence and will increase its dependency on a small number of producers. In future crisis situations, it appears that the Netherlands stands to gain the most from action in the framework of the IEA (and, if necessary, NATO), also given the expectation that, when it really matters, the European Union will be unable to take effective joint action for the time being. This does not alter the fact that, where possible, the Netherlands would be well advised to raise and keep alive the issue of supply security with the United States. A related issue to consider is that the United States ought to promote energy conservation precisely with a view to increasing the security of its energy supply.



Although it is definitely not an alternative to Kyoto, the recent climate partnership concluded by the United States with China and Australia, among other countries, can be described as a positive development for two reasons: firstly, because in a sense it also contains a recognition by the United States that there is a climate problem, and, secondly, because the emphasis on improving energy technologies is actually very important. The countries concerned are large coal consumers and also possess large stocks of coal. It can therefore be expected that they will focus a lot of effort on establishing clean coal technology and CO₂ sequestration (deep geological storage of CO₂) with greater success. Applying modern energy technologies, especially in developing countries, should be an objective of both the climate partnership and the Kyoto treaty. Precisely because much remains to be achieved in these countries in terms of infrastructure and energy supply, it is important that the most modern technologies are applied there as much as possible, in order to ensure the highest possible energy efficiency.

RUSSIA

It is important for the Netherlands and the European Union to maintain good relations with Russia. The European Union is Russia's foremost trade and investment partner. It supports Russia's ambition to join international fora such as the WTO and regional investment banks. Russia's ratification of the Kyoto Protocol is a positive step. Relations are based on the Partnership and Cooperation Agreement (PCA) between the European Union and Russia that entered into force in 1997 and expires in 2007. Many of the activities in the European Union take place within the framework of the PCA, the TACIS programme and other programmes for Russia.

As explained above, however, current relations in the energy field – at least with the European Union – can be described as difficult. The Commission's approach is too paternalistic in nature. European legislation became the measure of all things in the negotiations on the Energy Charter, the EU-Russia energy dialogue and the Common Economic Space.³⁷ Furthermore, the European Union would like Russia to liberalise its gas sector and is interested in establishing a pan-European energy market (in the process of which Russia would have to be integrated into the European energy markets). So far little progress has been achieved in these areas, as the two sides continue to have fundamental differences in outlook. The European Union has been unable to convince the Russian government of the need to carry out major institutional and economic reforms.

The European demands are unacceptable to Russia, because it is expected to make all kinds of major concessions without knowing what it stands to gain. In Russia's view, the liberalised European internal market has no advantages. This is one of the reasons why it is increasingly turning to China, India and the United States. They provide the kind of long-term market security needed to fund expensive energy projects. To Russia energy is not just of vital economic importance, but also an instrument through which it can

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At the EU-Russia summit of 10 May 2005, the European Union and Russia signed a Road Map for a Common Economic Space. Energy is a key objective in this regard. See, inter alia, <http://www.eu.int/comm/energy/russia/joint_progress/doc/progress6_en.pdf>.



once again become a global player. Besides commercial considerations, strategic considerations (playing large customers off against each other) will probably play a large part in determining Russian policy.

The advisory councils therefore advocate a reorientation of policy towards Russia. The issue is not so much the instruments or the channels but the general approach. The Netherlands and the European Union will have to accept Russia as an equal partner more than they have done in the past. The key issue is to give substance to and make more intensive use of the four agreed 'common spaces' in the areas of the economy; freedom, security and justice; external security; and research, education and culture. The government should examine whether significantly more advanced forms of cooperation are possible between the European Union and Russia. For this purpose, it should give greater consideration to Russian interests and views.

With regard to energy, the government should examine ways to incorporate more long-term security for both sides.³⁸ The prominent Dutch role in the EU-Russia energy dialogue should be maintained, but this does not disqualify the Netherlands from undertaking bilateral initiatives if this contributes to the security of the Dutch energy supply.³⁹ A 'both/and' policy is therefore appropriate in this case too, given the great uncertainty as to whether a multilateral approach (e.g. at EU level) will produce prompt results.

38 This corresponds to the conclusions and recommendations of AIV advisory report no. 44, *The European Union's New Eastern Neighbours*, July 2005. See, inter alia, recommendation 14 on p. 47: '...Finally, it is crucial for the Union's long-term energy security that the EU as a whole regard these issues from a strategic standpoint and accord them a high priority in developing the agreed economic space with Russia.' In their response to the advisory report, Parliamentary Letter DZO-183/05 of 8 November 2005, the Minister of Foreign Affairs and the Minister for European Affairs write, inter alia, as follows: The Government concurs that that the four common spaces need to be fleshed out further. This is a 'work in progress', and along with the PCA will be the framework for cooperation between the EU and Russia in the coming years. Giving substance to the four spaces will be financed on the EU side from TACIS, and starting in 2007 from the ENPI. The Government does not see anything to be gained by creating new consultative structures outside the structure of the PCA; the PCA provides enough possibilities for exchanging thoughts and taking decisions on different subjects at different levels. In the opinion of the advisory councils, the government pays too little attention here to prioritising energy supply security.

39 During the recent state visit of President Putin to the Netherlands, the two countries signed the new Dutch-Russian Joint Action Programme (GAP) (2 November 2005). It contains a short section on energy: 6.4 Energy and energy conservation

- a. Both parties attach great importance to their bilateral cooperation in the fields of energy and energy conservation, they are considering the conclusion of a bilateral agreement in the field of energy efficiency and will continue to promote this cooperation by various means, including regular consultations in the framework of the Joint Committee for Economic Cooperation.
- b. Both parties regard the International Energy Forum as a key instrument in the international energy debate.
- c. The parties will continue their regular contacts on energy issues at political, senior official and expert level in both bilateral and multilateral frameworks.



TURKEY

Turkey is an important transit country for Europe and its importance in this regard will probably only increase in the future. As far as is known, however, this barely played a role in the decision on Turkey's application for EU membership. Now that the accession negotiations have started, there is little to do other than to await their outcome. Nevertheless, it seems certain that there are still important decision-making moments on the horizon, especially given the expected length of the negotiations, and on these occasions considerations relating to energy politics should figure in the decision-making process. In this context, the advisory councils are referring primarily to the transit role that Turkey will be able to perform in respect of gas from the Gulf and the Caspian Sea region. Planned pipelines such as the Turkey-Greece-Italy pipeline and the Nabucco pipeline, which will run from Turkey to Austria via Greece, Bulgaria, Romania and Hungary, are very important in this regard. As soon as these pipelines have been built, it will become more difficult for other large importing countries, such as the United States and China, to attract gas to their own markets. This will be easier in the case of liquefied natural gas (LNG).

GULF REGION

The complex and sensitive political, economic and social problems in this part of the world will for the time being remain a fact for the European Union and the Netherlands. It is not the responsibility of the advisory councils to delve deeper into these issues and indulge in speculations in this advisory report, but where appropriate considerations relating to supply security will also have to be taken into account.

The advisory councils do wish to draw attention to the importance of achieving a more balanced form of economic development in the countries concerned. It is not advisable for them to continue basing their economies exclusively on the extraction and export of oil and gas. This raises a lot of money, but does not provide sufficient employment opportunities for their young and growing populations, with all that this entails. Where possible, both the Dutch government and Dutch businesses should actively help to diversify local economies. Developing tourism and the necessary associated infrastructure is a recent and – to all appearances – good example of such efforts. Promoting investment in the Netherlands by companies from the Middle East has the different but equally welcome effect of promoting common interests.

NORTH AFRICA

North Africa, in particular Algeria and to a lesser extent Libya, is an increasingly important region for the European Union. Egypt is particularly important as a transit country, due to its control over the Suez Canal. OPEC member Algeria has estimated oil reserves of 11.8 billion barrels (approximately 1% of global reserves). It occupies eighth place on the list of the world's largest gas reserves and supplies approximately 20% of the European Union's gas imports (the main customers being Italy, Spain and France). With the removal of international sanctions and the change of course by Colonel Gaddafi, who is clearly seeking rapprochement with Europe, Libya has also firmly entered the picture as an energy supplier.

Due to the intensification of the exploration and exploitation of oil and gas fields in these countries, and given their geographical position in relation to Europe, this region will become more important to the European Union in the near future with regard to diversification. The Netherlands should continue to support the European Union's policy of helping the region to improve economic development in other areas.

SUB-SAHARAN AFRICA

The global weight of the countries of sub-Saharan Africa in terms of oil production is modest (approximately 6%). Many countries on the west coast of Africa have large oil fields, and some also have gas reserves. Nigeria is the largest oil producer in Africa and the eleventh largest in the world. Other key countries include Angola, Gabon and Equatorial Guinea. In East Africa, Sudan has potential.

Given the increasing demand in the global market, oil and gas production in African countries is expected to rise sharply in the coming years. The United States (good supply route by sea) and now also China are very interested in this region. Europe is less interested in Africa. The large oil companies all have a presence in Africa, partly because access is relatively easy. It is important, however, to take instability, corruption and poor governance into account. Since the energy sector is dependent on foreign investors, this is of crucial importance for further developments.

The advisory councils wish to point out that the Dutch government should do more to facilitate broader economic development, including greater attention to energy issues, in developing countries. In principle, it should also be possible to use instruments of development policy (including funds) for this purpose. It should not be forgotten that the Millennium Development Goals implicitly assume a substantial improvement in access to energy (in particular electricity), as this is a prerequisite for achieving success on a wide range of issues (education, the economy, etc.).

The government could examine whether development cooperation resources can potentially be deployed in developing countries where there are Dutch or European exploration interests. This would obviously have to take place in accordance with current policy, that is, in a way that clearly benefits several parties, including the local population, and contributes to political and economic stability. In addition, the government could actively promote sustainable energy models in developing countries. Development policy can also be used to improve energy generation and its associated infrastructure in developing countries. Finally, the government could devote much more attention in its development cooperation policy to large-scale biomass production for sustainable energy purposes. Obviously, all initiatives of this kind must be accompanied by the reinforcement at local level of the required knowledge infrastructure.

MULTILATERAL ORGANISATIONS

As far as the Netherlands is concerned, the IEA, together with the OECD, and the IEF will remain the preferred fora for international consultations on energy issues in general and crisis management (mainly regarding oil)



in particular. In addition, our country will actively participate in other consultations in the same broad area, either in a global framework or in ad hoc consultation structures in which non-OECD members can also participate. In principle, the Netherlands should support and promote all consultations with producer countries.

The IEA also conducts consultations with countries that are not OECD members, including important players such as China and India. It is primarily an organisation of consumer countries and as such occupies the demand side. The IEA's strength would therefore be greater if these future major consumer countries were to be involved in the IEA in a more formal manner, as this would increase the effectiveness of demand management and crisis policy (establishing and managing strategic stocks). The stability of the oil market, which is global, is a common interest. China and India are becoming increasingly dependent on oil imports. A form of associate membership for China and India would increase the effectiveness of the IEA's oil crisis management mechanism. This could be expected to lead to a reduction in short-term price fluctuations on the global oil market, because the countries in question would also be building up reserves. Less volatile oil prices are good for the economy.

4.3 FOREIGN POLICY INSTRUMENTS

The advisory councils have examined the need for specific new policy instruments. Assuming that securing energy supplies becomes a key policy objective, the advisory councils believe that in theory all existing foreign policy instruments thereby become available. The advisory councils see no need for the specific addition of new instruments. The key issue is to tailor the available policy instruments to the situation at hand. In practice, for example, the UK White Paper on foreign policy and security of energy supply also stops short of introducing new policy instruments.⁴⁰

This advisory report does not consider existing instruments. For this, the reader is referred to the aforementioned publications. Much has already been initiated in this area. The advisory councils have preferred to highlight the foreign policy issues to which the Netherlands should devote more attention in the coming years and the areas in which policy orientations need to be adapted or changed.

In the context of this advisory report, moreover, foreign policy instruments are also understood to include the deployment of manpower and resources to achieve the objective of securing energy supplies. This involves a more intensive use of Dutch diplomatic missions in foreign countries and an active stance on the part of Dutch delegations in the various international fora, which in turn requires reliable information on developments in the energy field. The information collected on the basis of analyses and reports provides an important contribution to the policymaking efforts of the ministries concerned.



Examples of ways to implement policy at bilateral level include frequent consultations at political and official level, concluding agreements and treaties, for example concerning the construction of pipelines, mutual investment protection and technology transfer. Examples at multilateral level include initiating or acceding to international agreements and treaties, for example on promoting and protecting infrastructure (transport routes).

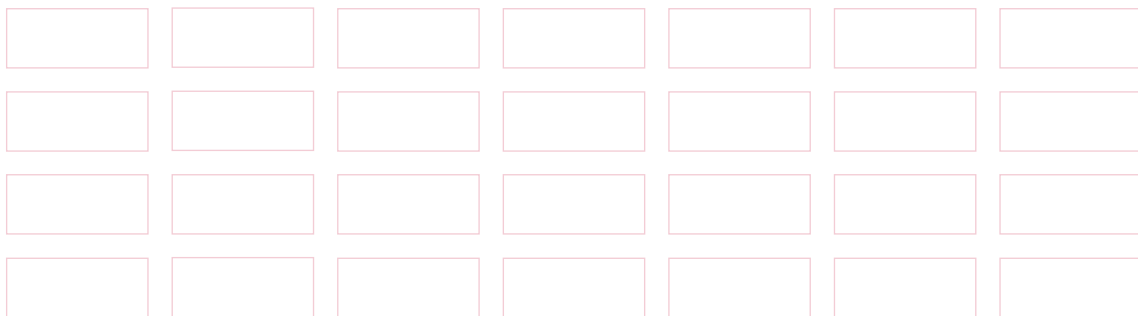
As noted above, the preferred international forum for developing external energy policy is the European Union. The European Union has taken initiatives towards energy-related cooperation with third countries. Thus, for example, it has used TENs resources and TACIS funding for feasibility studies concerning projects such as pipelines. Mention may also be made of the MEDA resources that have been made available in the framework of the Barcelona Process to support the construction of pipelines to and from North Africa. In addition, mention may be made of the energy dialogues with OPEC and Russia and the Energy Charter. Other fora that lend themselves to energy consultations include the United Nations, WTO, OECD, IEA, IEF, IMO and ICAO.

In order to pursue a coherent foreign policy aimed at securing energy supplies, the Netherlands must ensure that its internal affairs are in even better order than in the past. The Explanatory Memorandum to the 2006 Budget of the Ministry of Foreign Affairs mentions the possibility of establishing an interministerial consultation structure to improve coordination on energy-related international issues.⁴¹ The advisory councils endorse the need for such fixed consultations between the Ministries of Foreign Affairs, Economic Affairs, Housing, Spatial Planning and the Environment and Defence on the formulation and implementation of policy aimed at securing energy supplies. Given the importance of this subject matter, these consultations should, as already noted, take place at senior official (director-general) level. In addition, the topic should appear more often on the agenda of the Cabinet Committee on European and International Affairs (REIA).

The Ministry of Foreign Affairs has already started using its network of Dutch diplomatic missions in foreign countries more intensively in the context of the energy dossier. More attention is now being devoted to reporting on energy issues and supporting Dutch business.

The Ministry of Economic Affairs will be responsible for shaping the substance of the energy policy issues that the Ministry of Foreign Affairs, often together with the Ministry of Economic Affairs, will present as part of Dutch foreign policy. The Ministry of Foreign Affairs will also be responsible for providing continuous feedback, with the assistance of the missions. This will enable the Ministry of Economic Affairs to evaluate the situation in relevant countries more effectively and develop ways to improve it.

In addition, the Ministry of Economic Affairs, in particular, will be responsible for shaping the substance of short-term energy supply policy



(crisis policy) – especially in relation to gas. This will prove a difficult task, as prices rise rapidly and the scope for extracting additional gas from Dutch gas reserves (e.g. the Groningen gas field) at short notice is limited.

Diversifying gas flows to Europe and the Netherlands is generally regarded as the least expensive way to increase security of energy supply. In order to achieve this, however, governments are highly dependent on the gas companies concerned, which in turn are responsible for their own profit and loss accounts.

Given that the advisory councils consider it useful to view the issue of energy deliveries from the Gulf region, Africa and Russia in a broader economic context, it would be advisable to conduct regular consultations with the business sector. The government could use such a foreign energy consultation platform (BEOP) to explore the needs of companies as well as to inform them of significant developments in specific countries that they should take into account. It speaks for itself that environmental issues (in cooperation with the Ministry of Housing, Spatial Planning and the Environment) and, where relevant, corruption, bribery and human rights are also topics that need to be discussed. To guarantee the effectiveness of the BEOP, the advisory councils recommend using a sunset clause (automatic dissolution after four years, for example, unless decided otherwise). In addition, the platform can be used to discuss whether new technologies are suitable for developing countries and to what extent the Dutch business community is willing and able to be involved in their introduction.

4.4 A 'BOTH/AND' POLICY: A BILATERAL AND MULTILATERAL FOCUS

Energy supply is such a big issue that a relatively small player like the Netherlands cannot operate alone in this environment. The government should not refrain from concluding bilateral agreements with partners where possible, but in all other cases the Netherlands will have to internationalise its energy policy. First and foremost, it should do so through the European Union. The realisation that the EU member states have a common interest, especially in the long term, must become stronger. The steps taken by the European Union in the field of external energy policy, in particular the energy dialogues with Russia and OPEC, should contribute to a more positive approach⁴² and be expanded. In general, security of energy supply should play a more important role in the CFSP. The Netherlands can definitely contribute here. Where it is still unfeasible to act within an EU framework, the Netherlands can exert influence independently or through ad hoc coalitions in fora such as the IEA-OECD, the WTO and the United Nations. NATO should also devote explicit attention to the issue.

At this stage, the Netherlands should try to keep all its options open by selecting a 'both/and' approach, as it is still not sufficiently clear in what direction the policies of the various relevant countries will develop. The analysis conducted by CIEP demonstrates that, for analytical purposes, it

is useful to distinguish the relevant countries in accordance with the four quadrants and then track whether and how they move within these quadrants. In that sense, this approach is similar to using different scenarios. In both cases, the Netherlands should opt for policies and instruments that provide a robust response to the various conceivable developments. With regard to tracking countries from a policy perspective, it should focus not only on key producer countries but also on key transit countries (including countries bordering important straits). In addition, it should examine with which countries it can establish coalitions, partly for the purpose of promoting its preferred policies in international fora such as the European Union and the IEA. The European Union should be regarded as an international entity in which the Netherlands should not adopt a wait-and-see attitude, but should try to win acceptance for its policy views in an effective manner. In doing so, it should strive towards developing and deploying Community instruments. Forming alliances will prove useful in this regard.

SUMMARY AND RECOMMENDATIONS

5

In recent years, global energy markets have been characterised by shortages, in particular the oil and gas markets. Due to a strong rise in demand and insufficient supply, which is largely the result of a lack of investment in the oil and gas sectors, it is likely that energy-importing countries and regions (in particular North America, Europe, China, India and Japan/Korea/Taiwan) will have to compete more fiercely to acquire energy. This development is expected to dominate the period covered by this advisory report (until 2025-2030). The competition for energy forms the backdrop against which the security of energy supply, which has hitherto been taken for granted in the Netherlands because of the Groningen gas field, is eroding. In fact, the remaining Dutch natural gas reserves are so limited that the Netherlands will become dependent on imports even before the end of the period covered by this report.

At the same time, disruptions to the energy supply (in particular the electricity supply) have demonstrated in recent decades how vulnerable modern society has become. Depending on its size and duration, an energy shortage can seriously disrupt society. It is thus not without reason that many countries designate the security of their energy supply as a key policy priority and often even regard it as a matter of national security.

The advisory councils have opted for a broad approach. The analysis of the global energy situation and the relevant geopolitical trends in chapter 2 and the assessment of the energy interests of the Netherlands in chapter 3 reveal that security of energy supply is no longer guaranteed, even in the Netherlands.

The interests and risks associated with a good energy supply transcend the field of energy policy. The issues at stake here, which concern the medium and long-term security of energy supply as well as acute disruptions of that supply (energy crises), require government involvement and a broader range of policies. This need is even greater due to the substantial increase in global energy consumption and the environmental problems (especially climate change) that this has caused. Dutch foreign policy priorities in particular will have to be adjusted so that efforts to guarantee a secure energy supply are afforded sufficient importance in the overall policy package.

To gain a better understanding of potential geopolitical developments relating to the global energy situation, the advisory councils asked the Clingendael International Energy Programme to study the issue. Partly on the basis of this study, the advisory councils believe that, in principle, two future scenarios need to be taken into account. Under the first scenario, the world economy will become increasingly globalised and integrated – also in relation to energy – and the watchword will be free trade (the economically driven world). This implies that energy will flow to the consumer via market mechanisms and that the role of governments will be relatively limited and more facilitative in nature.

Under the second scenario, countries will operate in a more politically strategic manner, based on their national interests, at least in so far as energy is concerned. Energy flows will be politicised, and the energy trade will be conducted mainly by means of government action. Under this scenario, the



ultimate source of decision-making on important issues related to energy flows is the government (the politically driven world).

The advisory councils advocate that the Netherlands formulate a policy on securing energy supplies that is effective and robust under both scenarios, as it is still unclear which of them will turn out to be dominant during the period covered by this report. Dutch interests are located primarily in the field of promoting global free trade. This implies that the Netherlands should pursue a multilateral approach. In parallel, however, the Netherlands will also have to focus on bilateral relations in order to secure energy supplies. At this stage, the Netherlands should keep its various options open as much as possible and opt for a both/and approach.

THE ADVISORY COUNCILS HAVE ISSUED THE FOLLOWING RECOMMENDATIONS

RECOMMENDATION 1

Securing energy supplies should be a separate, new, key foreign policy objective, alongside existing key objectives.

The fact that different objectives can sometimes conflict with one another and that certain interests must prevail over others is nothing new. What is new is that in future the security of energy supply will be placed on the agenda more clearly and that it will be given full weight.

Energy requires more attention at policymaking level. It is clear from the analysis contained in this advisory report, as well as from other authoritative publications which served as sources, that the security of energy supply can no longer be taken for granted. Moreover, the security of energy supply, including that of the Netherlands, is increasingly determined by foreign and geopolitical developments.

Due to the increased foreign policy component of securing energy supplies, energy policy, which falls under the responsibility of the Ministry of Economic Affairs, should be complemented by incorporating the options and instruments used by the Ministry of Foreign Affairs.

RECOMMENDATION 2

Policy coordination between the Ministries of Foreign Affairs and Economic Affairs, and where relevant with the Ministry of Housing, Spatial Planning and the Environment and the Ministry of Defence, should always take place at the highest official and political level.

The security of energy supply should feature as a policy theme in regular inter-ministerial consultations at the highest official (director-general) level and should be placed on the agenda more often at ministerial level, for example in the Cabinet Committee on European and International Affairs (REIA).

RECOMMENDATION 3

Make the entire range of instruments in the field of foreign policy, including development cooperation policy, available for the purpose of securing energy supplies.

The advisory councils are of the opinion that the existing range of foreign policy instruments can also be used to promote the security of energy supply. The key issue at present is to do so in the near future. Until now, energy interests have played only a limited role in foreign policy.

RECOMMENDATION 4

Focus primarily on establishing an external (common) European energy policy, but without neglecting bilateral policy: a both/and approach.

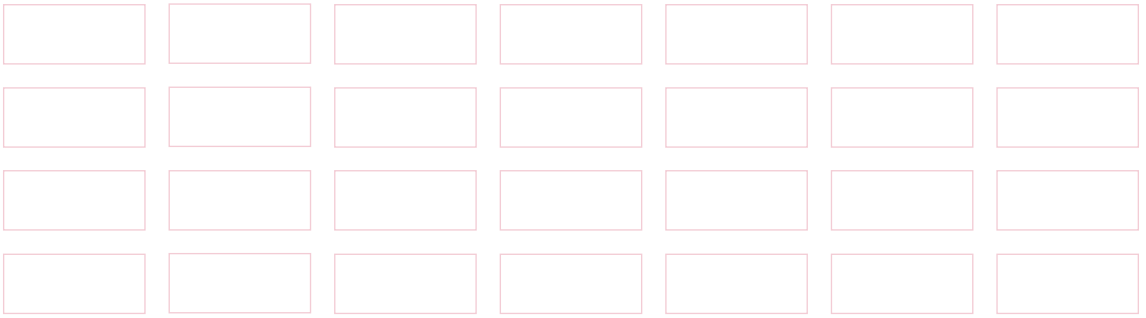
The development and implementation of Community measures is a precondition in this regard. In addition, the member states must be willing to transfer competences to the European Union. This means that the various EU member states will have to adopt the same line and formulate common interests in areas such as demand management, crisis policy, strategic stocks and exploration and production rights. The advisory councils point out that this should not take responsibility for oil crisis policy away from the IEA, in order to maintain its effectiveness. This is because oil plays a role on the global market and is not limited to a regional market such as the European Union. This is different in the case of natural gas, for which the European Union does constitute a regional market. In connection with the above, the advisory councils consider it important, in the context of the both/and approach, for the Netherlands not to focus exclusively on Brussels. When appropriate, it should be able to select other fora or partners. This definitely applies in the intervening period until a common external policy for the EU has become a reality.

RECOMMENDATION 5

Promote Dutch energy interests more robustly in multilateral fora.

Where it is still unfeasible to act within an EU framework, the Netherlands can exert influence independently or better yet through alliances in fora such as the IEA-OECD, the WTO and the United Nations. In future crisis situations, it appears that the Netherlands stands to gain the most from action in the framework of the IEA and, if necessary, NATO. In addition, it is possible to consult with countries that are not OECD members through the IEA, including important players such as China and India. The IEA's strength will be even greater once these future major consuming countries are involved in the IEA in a more formal manner, as this will increase the effectiveness of demand management and crisis policy (establishing and managing strategic stocks). The stability of the oil market, which is a global market, is a common interest.

With respect to the United States, energy should feature regularly as an issue of common interest. This could be achieved in the framework of the bilateral consultations and the regular EU-US consultations, as well as in the framework of the IEA consultations, of course. The European Union and the United States both have an interest in greater energy efficiency, stock management and a favourable investment climate and could undertake joint actions in these areas. At the same time, it is important not to overlook the fact that the United States basically approaches the issue of supply security from a strictly national perspective and that there may now be less sympathy for European interests and views, compared to the situation at the time of the 1973 oil crisis, for example.



RECOMMENDATION 6

If necessary, be prepared to contribute to the military protection of international transport routes.

The advisory report points out that the security of energy supply can be threatened by the increased vulnerability of supply routes (sea lanes and pipelines). At a certain point, military resources may have to be deployed to protect these routes in order to ensure that supply is not interrupted. The Netherlands should declare now that it is willing to contribute to such operations, provided that they are legitimised by a clear international mandate (preferably from the UN Security Council). In order to prepare for such action, NATO should also devote more explicit attention to this issue.

RECOMMENDATION 7

Reformulate the relationship with Russia on the basis of ‘equality’, ‘mutual understanding’ and ‘reciprocity’ and try to achieve the same at EU level.

Europe’s relationship with Russia is more troubled than necessary or expedient. Given the significant geopolitical and energy interests involved, the Netherlands should focus on improving the relationship between the European Union and Russia. In view of the relatively good relationship that exists between the Netherlands and Russia, it should be possible to find support for this in Brussels. It should be examined whether significantly more advanced forms of cooperation between the European Union and Russia are possible. Given the parties’ mutual energy interests, they have a common interest in incorporating more long-term security into their energy relationship. Under such a scenario, the European Union will have to be more attentive to Russian objections, especially in the energy field.

RECOMMENDATION 8

Maintain good relations and enter into consultations with producer countries. Where possible, expand the area of interest to include issues relating to broader economic and social development and promote reciprocal investment.

In its relations with other countries, the Netherlands should attach more weight to the importance of securing energy supplies. This means that the Netherlands has a special interest in producer countries, in particular Russia and countries in the Middle East, North Africa and south of the Sahara. In order to safeguard the common energy interests that it shares with other countries, the Netherlands can make use of alliances, partnerships and other forms of cooperation. It should take independent initiatives in this area.

In addition, the ‘give and take’ of the trade relationship will become more genuine once the Netherlands is in a position to devote more attention to the broader economic and social development of the countries concerned. This includes respect for fundamental human rights and international labour standards. The oil and gas-exporting countries are overly dependent on the proceeds of their oil and gas exports, and this creates imbalances that hinder the proper development of their labour markets, for example.

RECOMMENDATION 9

Focus on increasing national and local support for the responsible exploration and exploitation of oil and gas reserves; help to create the conditions for increased access to energy (electricity) where relevant and promote the use of sustainable energy.

The Netherlands could play an independent role in this field, for example through its development cooperation policy. One of the aims of this policy is to increase the access of poor population groups in countries with which the Netherlands maintains a bilateral aid relationship to modern methods of energy generation. One option is to examine whether more development cooperation resources can be deployed in countries where there are Dutch or European exploration interests. This would obviously be done in accordance with current policy, that is to say, in a way that clearly benefits the local population and contributes to political, economic and social stability.

In addition, the Netherlands could promote sustainable energy models more actively and utilise its development cooperation policy to reinforce energy generation and the related infrastructure in developing countries, with a view to making them less dependent on dwindling gas and oil reserves. Finally, in the framework of development cooperation policy, the Netherlands could devote much more attention to large-scale biomass production for sustainable energy purposes. It speaks for itself that all these policy initiatives should be accompanied by the reinforcement of the necessary knowledge infrastructure at local level.

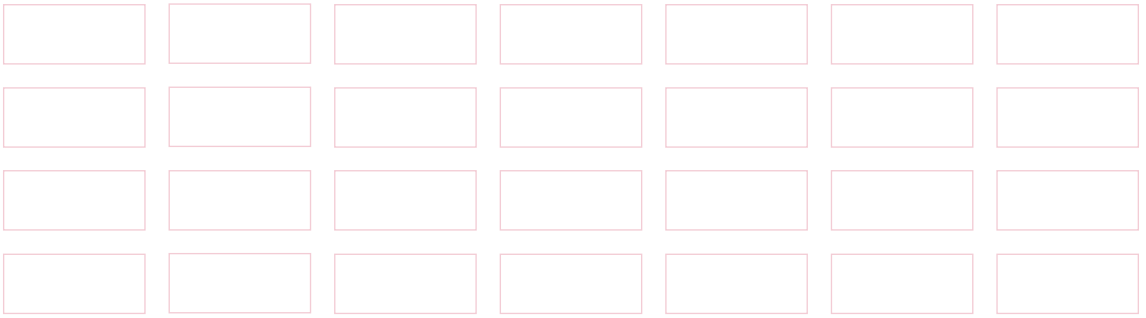
The Netherlands could use its existing knowledge and technology in the field of cleaner energy generation (gas technology, clean coal technology, wind energy, solar energy, biomass production and CO₂ storage) and energy efficiency/conservation for export purposes. It thus has something extra to offer, which could be useful in negotiations with oil and gas-producing countries. Every efficiency gain achieved reduces the pressure on the market and therefore has a beneficial impact on prices, the environment and relative availability.

In order to implement the above-mentioned activities, the government could conduct closer consultations with the companies operating in the countries concerned.

RECOMMENDATION 10

Assist Dutch energy-related companies and help them to act in a socially responsible manner at local level. Establish a Foreign energy consultation platform (BEOP) in which the Ministries of Foreign Affairs and Economic Affairs, and where relevant the Ministry of Housing, Spatial Planning and the Environment, can meet with representatives from the business sector to see whether there are problems or opportunities that require a policy initiative.

The Netherlands is a significant player in international energy markets. It possesses a large amount of specialised energy knowledge and is home to a number of powerful companies. In terms of the security of energy supply, it is important to support these companies in their activities. It is also important that the Netherlands maintains its competitive position at international



level and that a level playing field is established. In the context of the more general promotion of economic and social development in energy exporting countries, however, there should also be opportunities for Dutch companies from other sectors to become or remain involved in the development of trade relations.

It is also very important, especially for ensuring good long-term relations, that the government assists – and where necessary urges – companies to act in a socially responsible manner at local level. Key issues in this regard include good governance, transparency, a refusal to give in to corruption and responsible environmental behaviour.

RECOMMENDATION 11

Promote investment in infrastructure so that the Netherlands remains an energy hub, which benefits the security of energy supply, and promote an extensive infrastructure to facilitate supply flexibility and competition.

If the Netherlands wishes to remain an important transit country and a provider of flexibility, it is important to invest in the necessary infrastructure. The Netherlands is a leader in the field of gas storage and as a provider of flexibility services. In order to ensure that energy continues to flow to third countries via the Netherlands, the Netherlands has an interest in constructing one or more LNG terminals and, in particular, underground gas storage systems (see the AER's advisory report '*Gas for tomorrow*'). This will also increase the Netherlands' own ability to switch between different gas providers and thus enable it to avoid becoming overly dependent on just one supplier or a small number of suppliers.

RECOMMENDATION 12

When formulating foreign policy and energy policy, especially at European level, keep a close eye on the Dutch negotiating position towards producer countries and parties with a view to optimising the energy supply.

ANNEXE 1 REQUEST FOR ADVISE

Ministry of
Foreign Affairs
P.O. Box 20061
2500 EB The Hague
Telephone 070 348 6486

Ministry of
Economic Affairs
P.O. Box 20101
2500 EC The Hague
Telephone 070 379 8911

TO

The Chairman of the Advisory Council on International Affairs (AIV)
The Chairman of the General Energy Council (AER)
P.O. Box 20061
2500 EB The Hague

The Hague, 14 May 2005

RE

request for advice from AIV/AER regarding energy and foreign policy

In the coming years, the EU member states will be more and more dependent on imported oil and gas for their energy supply. Indigenous European energy sources are gradually being depleted, and despite energy conservation programmes and the development of sustainable energy, our energy will increasingly come from a small group of countries and regions: the Middle East, Russia, the countries bordering on the Caspian Sea and West Africa. Rapidly growing economic powers like China and India will also be competing more heavily for oil and gas.

Although there are no serious problems with oil and gas deliveries from producer countries today, political and security risks caused by instability, war, organised crime and the possibility of terrorist attacks are a cause for concern.

Although securing energy supplies does not qualify as an objective of Dutch and EU foreign policy at present, the Government considers that this must change because of the above-mentioned developments and the findings of analyses by the International Energy Agency, the Clingendael International Energy Programme and the AER advisory report on gas. Against this backdrop, we would appreciate advice from your Councils about whether, and how, Dutch and EU foreign policy can help to secure energy supplies for Europe and, more specifically, for the Netherlands.

GENERAL QUESTIONS:

- Can Dutch foreign policy, including security and development cooperation policies, complement existing energy policy pursued by the Ministry of Economic Affairs and Ministry of Housing, Spatial Planning and the Environment through a rational, structural contribution to securing energy supplies for the Netherlands and the EU?
- Should securing energy supplies be a separate foreign policy objective?

- How can foreign policy, in the broadest sense of the term, help to ensure:
 - that the political, economic and social conditions in the oil and natural gas producing countries are such that development there remains stable and medium and long-term oil and gas production and export levels meet Dutch and EU energy requirements;
 - that the investment climate in producing countries is promoted in a way which ensures a sufficient level of investment in oil and gas extraction and production;
 - that delivery of oil and gas in particular is not interrupted by disruption of the supply routes, particularly sea lanes and pipelines;
 - that the rapidly increasing worldwide demand for energy is met in the most secure and sustainable way which takes account of climate issues (e.g. through clean coal technologies, energy efficiency and renewables) along with security concerns (nuclear proliferation, transport security);
 - that the necessary investments are made in developing countries with a view to guaranteeing poor people's access to energy and promoting the most sustainable supply of energy possible?

FURTHER QUESTIONS

DIALOGUE AND COALITIONS

In order to improve the way the world energy market operates, what instruments of foreign policy in the broad sense can be used to help develop a constructive, worldwide energy dialogue and effective international coalitions? In this connection, the role of producer, consumer and transit countries and international business must be considered.

ROLE OF BUSINESS

In guaranteeing a secure energy supply, what instruments of foreign policy in the broad sense can help to promote the interests of Dutch and European business?

What can be done to support Dutch and European business so that it can be effective in helping to guarantee a secure energy supply for the Netherlands and the EU?

How can the worldwide market position of Dutch and European companies which deliver energy-related products, services and technologies be strengthened while contributing to sustainable energy policy in third countries, including rapidly growing developing countries and economies?

CHOICE OF CHANNELS AND PARTNERS

In which areas would it be possible for the Netherlands to act alone and in which areas would action by the Netherlands be more effective in a multilateral/European framework?

By presenting an overview of how other countries incorporate energy into their foreign policies, for example, could AIV/AER indicate the producer, consumer and transit countries with which closer bilateral or multilateral cooperation is called for in order to achieve energy security?

INTERNATIONAL FORA

Within the framework of which worldwide international and European fora and organisations can the Netherlands achieve its energy-related foreign policy objectives most effectively? The fora and organisations which play a role here include IEA, WTO, IEF, Energy Charter, OSCE and NATO as well as international companies like Extractive Industries Transparency Initiative and MIGA.

How well is the EU equipped to ensure that the security of its energy supply (in view of inter alia the Union's competences, including the competences provided for in the Constitutional Treaty, and the objectives of the CFSP) is promoted and in which contexts (the Commission or the High Representative for the CFSP, for example) can this be done?

How can the Netherlands maximise its contribution to establishing a European external energy policy in order to ensure a secure supply of energy (through the EU-RF Energy Dialogue and EU-OPEC dialogue, for example)?

In the light of developments in and between relevant departments regarding energy and foreign policy, a prompt advisory report from the AIV/AER is desirable. It would be appreciated if the advisory report were received in November and published in December 2005 so that it can provide maximum support for the various policy developments in the ministries concerned.

The request to your Councils is also being made on behalf of the Minister for European Affairs.

(Signed)

Bernard Bot
Minister of Foreign Affairs

(Signed)

Laurens Jan Brinkhorst
Minister of Economic
Affairs

ANNEXE 2 LIST OF ABBREVIATIONS

AER	General Energy Council
AIV	Advisory Council on International Affairs
Bcm	billion cubic metres
BEOP	Foreign energy consultation platform
BP	British Petroleum
BRIC	BRIC Countries (Brazil, Russia, India and China)
CEB	Energy and Foreign Policy Committee
CFSP	Common Foreign and Security Policy
CIEP	Clingendael International Energy Programme
CNOOC	China National Offshore Oil Corporation
CO ₂	Carbon dioxide
DZO	Southeast and Eastern Europe and Matra Programme Department, Ministry of Foreign Affairs
ECN	Energy Research Centre of the Netherlands
EDI	Energy Development Index
ENPI	European Neighbourhood and Partnership Instrument
GAP	Dutch-Russian Joint Action Programme
GNP	Gross national product
ICAO	International Civil Aviation Organisation
IEA	International Energy Agency
IEF	International Energy Forum
ILO	International Labour Organisation
IMF	International Monetary Fund
IMO	International Maritime Organisation
LNG	Liquefied natural gas
Mbd	Millions of barrels per day
MEDA	Euro-Mediterranean Partnership Programme
MTOE	Million tonnes of oil equivalent
NATO	North Atlantic Treaty Organisation
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
OSCE	Organisation for Security and Cooperation in Europe
PCA	Partnership and Cooperation Agreement
REIA	Cabinet Committee on European and International Affairs
TACIS	Technical Assistance to the Commonwealth of Independent States
TENs	Trans European Networks
URENCO	Uranium Enrichment Corporation
WTO	World Trade Organisation

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