ADVISORY LETTER

THE EU'S DEPENDENCE ON RUSSIAN GAS

HOW AN INTEGRATED EU POLICY CAN REDUCE IT

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AIV

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Foreword

The crisis in Crimea and Ukraine has focused attention on the energy dependency of the countries of the European Union (EU) on Russia. On average, they import about a quarter of their gas from Russia and some eastern member states depend on Russia for 50% or more of their gas. This dependency makes the EU as a whole vulnerable to political pressure. In the opinion of the Advisory Council on International Affairs (AIV), it also prevents the EU from responding adequately to the violations of international law committed by Russia during the current crisis involving Ukraine.

The purpose of this advisory letter, issued on the AIV's own initiative, is to identify action that can be taken in the near term to increase the energy security of the EU as a whole and so contribute to the Netherlands' input into the European Council of 26 and 27 June 2014. The European Commission issued its new energy strategy on 28 May 2014, while this advisory letter was being written. In view of the parallel circumstances, the AIV was unable to familiarise itself with the strategy until the closing stages of preparing this advisory letter. The main elements of the Commission's strategy, which will be discussed at the European Council in June, are summarised in the annexe.

This advisory letter focuses on the geopolitical dimension. The AIV addresses the following questions:

- What has to be done to establish an effective and efficient common EU energy policy?
- Does the solution lie in an increase in strategic stocks and the construction of pipelines between the EU member states?
- Is the Polish prime minister's recent proposal for a solidarity mechanism feasible?
- Does the solution lie in further diversification of gas suppliers? Should the EU look to Central Asia and North Africa or should its preference be for Norway and the United States?
- To what extent should the Netherlands subordinate its energy relationship with Russia to a sanctions policy (potential or otherwise)?

In view of the short period in which this letter was prepared, the AIV does not consider the construction of nuclear power stations and the extraction of shale gas in Europe.

Following consultation with the European Integration Committee (CEI) and the Peace and Security Committee (CVV), this letter was prepared by Dr A.R. Korteweg (CVV), Professor A. van Staden (AIV/CEI) and C.G. Trojan (CEI). The Executive Secretary was Ms P.H. Sastrowijoto, assisted by Ms E.A.M. Meijers (trainee).

The AIV adopted this advisory letter at its meeting of 6 June 2014.

I Geopolitical aspects

The EU's overdependence on Russian energy exposes it to undesirable political influence. The risk should be seen in the light of Russia's ambition to create a sphere of influence that roughly coincides with the former Soviet Union.[1] An important means of doing so is to establish a Euro-Asian Union as a counterweight to the EU. Russia has exerted strong pressure on Ukraine to join this new Union. In effect, the willingness of the deposed president, Viktor Yanukovich, to succumb to the pressure rather than sign an association agreement with the EU was the direct cause of the protests in Maidan Square. For the EU an essential principle was at stake: the right of the Ukrainian people to freely choose their own political future. In the AIV's opinion, the EU must be capable of standing up for that right without Russia's being able to retaliate by turning off the gas.

In March 2014, Gazprom threatened to stop supplying gas to Ukraine if it did not pay its outstanding debts promptly. It also changed the price from the reduced level agreed with the former pro-Russian government of Ukraine. This threat was a clear wake-up call for the EU and prompted the European Council to ask the Commission in June 2014 to present an energy plan to reduce the EU's dependence (on Russia).[2]

Gazprom is a major player in Russia, with hundreds of subsidiaries, and is now extending its operations to Europe (Gazprom's Dutch subsidiary aims to supply 15% of the Dutch business gas market within five years)[3] and has holdings in the United Kingdom, Ireland, France, Germany and elsewhere. It is investing not only in gas suppliers but also in storage facilities (Gazprom owns 42% of the Bergermeer storage facility in the Netherlands) and gas transporters.[4] Gasunie, the Dutch gas infrastructure company, owns 9% of the Nord Stream pipeline. Gazprom is the majority shareholder of this pipeline, which transmits Russian gas via the Baltic Sea to Germany and the Netherlands.

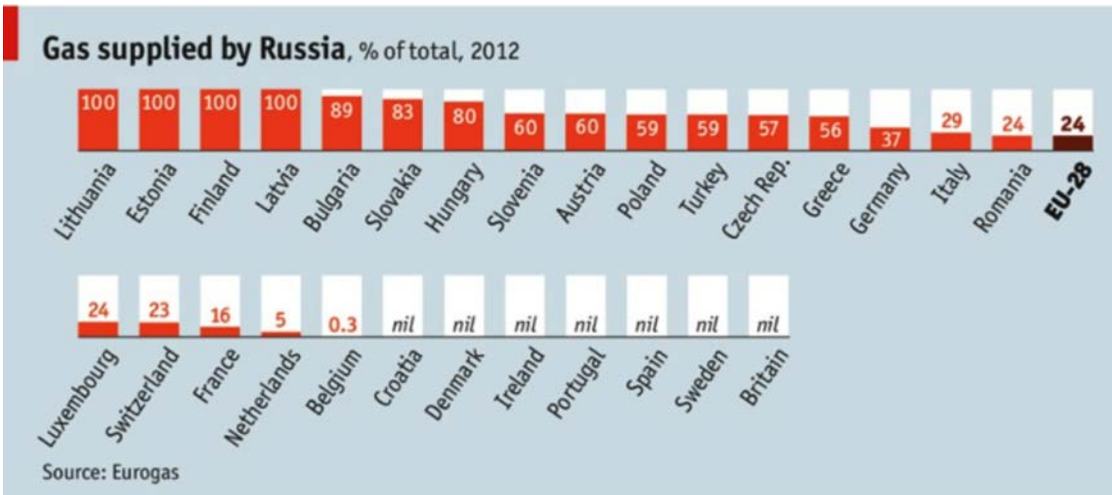
European countries depend on Gazprom's gas to differing degrees to satisfy their energy requirements, as illustrated by the map below.

1 Advisory Council on International Affairs, Cooperation between the European Union and Russia: a Matter of Mutual Interest, advisory report no. 61, The Hague, July 2008.

2 European Council (2014), Conclusions of the European Council (20/21 March 2014), EUCO/7/1/14 REV1, section 20.

3 *De Volkskrant*, 'Russische Gazprom begeeft zich op zakelijke market in Nederland' (Russia's Gazprom enters business market in the Netherlands), 29 June 2012.

4 H. de Zeeuw (2013), 'Eerst het gas, dan de moraal' (First the gas then principles), *De Correspondent*, November 2013. See: https://decorrespondent.nl/299/eerst-het-gas-dan-de-moraal/32952491-c7e501ab.



Some EU member states, such as the United Kingdom, import little if any Russian gas. Others, such as Finland, the Czech Republic, Bulgaria and the Baltic states, depend almost entirely on Russian imports. Gazprom exports about 50% of its gas to Europe via pipelines that run through Ukraine, chiefly to southeast Europe (see table below). Seven EU member states are completely dependent on the Ukraine pipeline for their gas imports.

Country	Imports via Ukraine in March 2013 (mcm/day)	Total gas imports in March 2013 (mcm/day)	Share of Ukrainian transit in imports
Austria	14.30	14.30	100%
Bulgaria	7.90	7.90	100%
Croatia	3.96	3.96	100%
Hungary	21.48	21.48	100%
Romania	4.96	4.96	100%
Slovakia	14.84	14.84	100%
Slovenia	3.16	3.16	100%
Greece	6.56	9.44	69.5%
Italy	83.87	172.74	48.6%
Poland	13.83	31.53	43.9%
Czech Republic	11.19	27.59	40.6%
Average	16.91	28.35	82.1%

Source: based on IEA Gas Trade Flows in Europe; Nord Stream website.[5]

5 J. Sharples and A. Judge (2014), 'Bulgaria and Macedonia would be hardest hit by a suspension of Russian gas exports through Ukraine', London School of Economics and Political Science Blog. See: http://blogs.lse.ac.uk/europpblog/2014/03/13/bulgaria-macedonia-and-romania-would-be-hardest-hit-by-a-suspension-of-russian-gas-exports-through-ukraine/.

This enables the Russian government, Gazprom´s major shareholder, to use energy as leverage for political ends and to play power politics in order to exert pressure on the EU.

The ominous language President Putin used in a letter to 18 heads of government in April 2014 about the impact on the EU of stopping or reducing the gas supply to Ukraine spoke volumes: *'However, the fact that our European partners have unilaterally withdrawn from the concerted efforts to resolve the Ukrainian crisis, and even from holding consultations with the Russian side, leaves Russia no alternative'*.[6]

Attempts to break Gazprom's monopoly as a producer, network owner and supplier seem, for now, to be beyond the EU's power, despite the Commission´s efforts. The coherence of the Union's energy policy is also compromised by the involvement of multiple members of the Commission in one way or another (President, High Representative for Foreign Affairs and Security Policy, and the Commissioners for Energy; Industry and Entrepreneurship; Internal Market and Services; Trade; Climate Action; Competition; Environment; and Research, Innovation and Science). There is no overall vision that takes account of the geostrategic implications.

The crisis has prompted the European Commission to prepare an energy plan and, paradoxically, individual member states to speed up the conclusion of contracts with Gazprom. To give some recent examples, in May 2014 the Austrian gas company OMV and Saipem of Italy signed agreements with Gazprom for the construction of South Stream pipelines. Siemens of Germany recently won a contract to supply the electrical system for the section of South Stream under the Black Sea, and the Bulgarian parliament recently agreed to South Stream's designation as an extension of an existing pipeline, which in effect circumvents the internal market. Such an arrangement does not require the separation of production, supply and network ownership, as laid down in the Third Energy Package.[7]

This gets to the heart of the problem: the AIV observes that the member states, despite being well aware of Gazprom's policy of divide and rule, are yielding to temptation in the interests of their own national markets. Cooperation is therefore difficult to establish at EU level but it is necessary in view of the member states' common long-term economic interests. Furthermore, the AIV thinks geopolitical concerns now play second fiddle to economics in both EU and national energy policies.

The EU member states do not fully realise that Gazprom's monopolistic position could seriously hinder the completion of the Third Energy Package and thus the liberalisation of the energy market.[8] Some claim that a cold war is being waged on the gas market among the member states on the one hand and between Gazprom and the European Commission on the other. The Energy Commissioner, Günther Oettinger, makes no secret of his exasperation and the Directorate-General for Competition is investigating

6 V. Putin, (2014), 'Message from the President of Russia to the leaders of several European countries', 10 April 2014. See: http://eng.news.kremlin.ru/news/7002.

7 *Het Financieel Dagblad*, 'Gazprom voert Koude Oorlog over gasmarkt' (Gazprom wages Cold War over gas market), 7 May 2014.

8 The main elements of the Third Energy Package are green energy, greater choice and lower prices, and unbundling ownership, production and network operation.

whether Gazprom is guilty of dictating terms and prices to its customers, obstructing free transmission and preventing diversification. One consequence of the investigation is that Gazprom is considering submitting a complaint about EU policy to the World Trade Organisation (WTO).[9] The EU has instructed the five member states through which South Stream runs to renegotiate the contracts in accordance with the Third Energy Package.

For Ukraine itself, the uncertainties regarding gas supplies have led to tripartite talks between the EU energy commissioner, the International Monetary Fund (IMF) and the energy ministers of Russia and Ukraine. The main topic has been the price of gas and the outstanding debt. The EU is in an awkward position: by promising aid to Ukraine (including aid to alleviate its energy debt) it is indirectly strengthening Russia's negotiating position (the negotiations had not resulted in a final agreement when this letter was prepared). [10]

The Russian government earns more than half its revenue by exporting oil and gas to the EU. The International Energy Agency (IEA) has projected that the EU will become more dependent on foreign gas supplies. Despite the modest economic growth, the relatively mild winters and the associated limited increase in gas consumption, all forecasts indicate that gas imports will increase until 2035. There is therefore a great deal of interdependence.

In the meantime, Russia is diversifying its sales markets. The lengthy negotiations (since 1997) with China seem to have borne fruit. A multi-billion dollar contract to supply gas was signed at the summit of Central Asian nations in Shanghai on 21 May 2014. Russia will supply 38 billion cubic metres (bcm) of gas per annum as from 2018 with an option to supply 60 bcm in total.[11] Russia is thus reducing its dependence on the EU as a customer and suggesting that it can ignore Western pressure regarding Ukraine. For its part, China has made the most of the situation by demanding a lower gas price from Russia.[12]

The AIV also notes that Russia could make geostrategic use of the considerable gas reserves under the Russian sector of the Arctic Ocean. The AIV will issue an advisory report on the Arctic Ocean later this year.

The Dutch position

The Netherlands has long pursued an active gas policy. Since the end of the 1990s such policy has been directed at cooperation with Russia, for example by storing Russian gas in the depleted Groningen gas fields and actively participating in the Nord Stream pipeline. Shell is partnering with Gazprom on the Sakhalin II project in the northeast of Russia. Furthermore, Rotterdam is the main transit port for the export of

9 *Het Financieel Dagblad*, 'Gazprom voert Koude oorlog over gasmarkt' (Gazprom wages Cold War over gas market), 7 May 2014, and *EU Observer,* 'Russia to file WTO lawsuit against EU energy laws', 1 May 2014. See: http://euobserver.com/news/123984.

10 *Trouw*, 'Stijgende gasprijs kan Kiev opbreken' (Rising gas price could tear Kyiv apart), 2 May 2014.

11 *NRC Handelsblad*, 'Gasdeal met China "strategisch" voor Poetin' (Gas deal with China 'strategic' to Putin) and 'China stelt geen moeilijke vragen' (China doesn't ask difficult questions), 17 May 2014.

12 Although the exact price is unknown, insiders suggest it is about USD 350 per 1,000 cubic metres.

fuel oil from Russia to Asia. The Netherlands has the ambition of becoming northwest Europe´s leading gas storage, trading and transit country (the 'Gas Roundabout' project). Eight billion euros have already been invested in this project.[13]

There is no doubting the importance of trade with Russia: in 2012, the Netherlands imported goods worth EUR 20.3 billion from Russia (chiefly oil products) and exported goods worth EUR 7.1 billion. This made Russia the Netherlands' third-largest trading partner outside the EU (after the US and China), regarding both imports and exports.[14] The investment relationship with Russia is considerable.[15]

The IEA wrote in a recent country analysis that, owing to the decline in its gas production, the Netherlands will by 2025 have turned from a net exporter to a net importer of gas. It recommended that the Dutch government actively continue its participation in the northwest European electricity and gas market.[16]

The Netherlands and the EU have so far exercised restraint as regards imposing sanctions on Russia, so as not to jeopardise the supply of oil and gas (and related contracts). Although the Netherlands consumes very little Russian gas, its trade relations mean it would be affected more than other EU countries if sanctions were to be imposed on a wide scale. In the AIV's opinion a balanced policy is required that takes account of Dutch-Russian trade interests as a whole, the need to de-escalate the tensions between Russia and the EU and the desire for an integrated EU energy policy aimed at reducing dependence on Russian gas.

13 The Court of Audit has issued a critical report on this subject. Court of Audit (2012), 'Gasrotonde: nut, noodzaak en risico's: Nederland als Europees knooppunt van gastransport' (The Gas Roundabout: the benefit, need and risks – the Netherlands as the European gas transmission hub). See: http://www.rekenkamer.nl/Publicaties/Onderzoeksrapporten/Introducties/2012/06/Gasrotonde_nut_noodzaak_en_risico_s. In the Court's opinion the State has not assessed in all cases whether this investment is in the public interest, i.e. whether it will help make the supply of energy cleaner, more reliable and more affordable. The government did not agree and responded by pointing to a statutory task of Gasunie Transport Services.

14 See: http://www.nlrf2013.nl/relatie-nederland-rusland/economie/.

15 Including Special Financial Institutions, in 2012 Dutch investment in Russia exceeded EUR 53 billion and Russian investment in the Netherlands came to nearly EUR 29 billion. Source: De Nederlandsche Bank (Dutch central bank), 2012.

16 IEA (2014), Energy Policies of IEA Countries: the Netherlands, 2014 country analysis. See: http://www.iea.org/textbase/nppdf/free/2014/Netherlands2014SUM_dutch.pdf.

II Common EU energy policy: the sum of national interests?

The EU has its roots in the European Coal and Steel Community (ECSC) and introduced energy legislation in the context of the internal market and the environment, but real strides towards a common energy policy were not taken until the informal European Council at Hampton Court in 2005, when the EU heads of government recognised that a wide-ranging EU energy policy was needed. This led to a green paper in 2006 and a first series of legislative proposals in 2007. The Treaty on the Functioning of the European Union (TFEU) then provided the legal basis for a common energy policy; article 194 considers the functioning of the energy market, security of energy supply, energy efficiency and the promotion of energy networks' interconnectivity. The TFEU included a solidarity clause for the first time. Article 222 stipulates that the Union and the member states will act jointly in a spirit of solidarity if a member state is the object of a terrorist attack or the victim of a natural or man-made disaster. At least some member states will probably interpret this article flexibly in the case of a gas crisis.

Gas crises in Ukraine in 2006 and 2009 – triggered by a payment dispute between Moscow and Kyiv which even then may have been politically inspired – had repercussions in several European countries. The 2009 crisis in particular gave new impetus to European diversification, interconnectivity, the development of the Southern Gas Corridor and decision-making on the Third Energy Package. The Third Energy Package had been proposed in 2007 and was adopted by the European Council in July 2009.

Why has an EU energy policy not been successful so far?
Has the EU actually pursued a common energy policy since the summit in the United Kingdom? There is good reason to doubt this. A number of common goals have been set (such as the climate targets to reduce CO_2 emissions by 2020) but since each member state has its own competences, there are in effect still 28 national energy strategies. The liberalisation of the gas market proposed in the Third Energy Package should have been completed in 2014 but by no means all member states have implemented it. Moreover, the protection of national energy markets is a source of friction among the member states. To give some examples, France, a major nuclear energy generator, refuses to admit surplus renewable energy from the Iberian Peninsula onto the French market. The generous subsidies to encourage renewable energy in, for example, Denmark and Germany have forced gas power stations out of the market elsewhere and weakened the competitiveness of heavy industry (for example the company Aldel in north Groningen). The link between climate and energy targets, furthermore, stymies negotiations among the member states. As a coal producer, Poland will probably agree to a reformed and stricter Emission Trading System (climate goals for 2030) this autumn only if it receives support in return for further energy diversification and greater connectivity.

As noted above, significant contradictory national interests are at play. Member states in a relatively favourable position do not want to share their competences at EU level. The Treaty of Lisbon (specifically the TFEU) may have provided a legal basis for a common energy policy but it also contains an important restriction. Article 192, paragraph 2, subparagraph 2 stipulates that European or framework laws do not affect a member state's right 'to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply'. Liberalisation of the gas market is a long and difficult process and investments in interconnectivity will be a long time coming or are currently inadequate. Given their interests in domestic operators, national governments are anxious about more foreign competition brought about by pipelines with other countries. The anxiety is probably strongest among national oil and gas companies, which – as noted above – are often wholly or partially owned by national governments.

III Pathways to reduce the EU's dependence on Russian energy

The European Council of June 2014 will have to consider short- and long-term goals to reduce dependence on Russian gas, as the Commission proposed in its Strategic Plan published on 28 May 2014. As the member states that import Russian gas exclusively through Ukrainian pipelines are at the most acute risk, the AIV recommends for the short term that countries that import more than 50% of their gas from Russia via Ukraine be given priority in the EU's plans, for example by increasing strategic stocks, interconnectivity and reverse flows and importing more gas from non-Russian sources (such as Qatar, Norway and Algeria).

Strengthening the European gas market: interconnectivity and reverse flows
After the previous gas crisis in Ukraine, in 2009, the EU gave priority to reducing dependence on Russian gas supplied through the Ukraine. As mentioned above, the Commission sought solutions in strengthening interconnectivity between member states (pipelines) and increasing reverse flows in the networks. The latter entails piping gas in both directions so that member states can supply each other if the need arises. Good results in this area have already been achieved within the EU but a lot still needs to be done before all member states are connected. Slovakia and Ukraine signed a reverse flow agreement in April 2014.[17]

The European Commission made several interconnectivity proposals in its Projects of Common Interest. Certain interconnectors are of strategic importance (such as the North-South corridor).[18]

Strategic stocks
Since the 2009 crisis, a directive has obliged each member state to hold strategic oil stocks in underground storage corresponding at the very least to 90 days of average net imports or 61 days of average daily inland consumption, whichever is the greater.[19] It is far more difficult to hold similar strategic stocks of gas. Not every country is able to fill old gas fields with imported gas like the Netherlands. A regulation of 2010 on gas supply security lays down that member states must complete a risk assessment and prepare an emergency plan, but their form and presentation are left totally open. Cross-border cooperation, however, is encouraged.[20] These measures, it is reported, have somewhat reduced the former Eastern Bloc countries' vulnerability but it is not a structural solution for the long term. Governments must realise that there are commercial and physical limits to gas storage.

17 Reuters (2014), 'Slovakia reaches reverse gas flow deal with Ukraine', 26 April 2014. See: http://www.reuters.com/article/2014/04/26/ukraine-crisis-slovakia-gas-idUSL6N0NI0HU20140426.

18 See: http://ec.europa.eu/energy/infrastructure/pci/doc/2013_pci_projects_country.pdf and http://ec.europa.eu/energy/infrastructure/north_south_east_en.htm.

19 European Council (2009), Council Directive imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products, 2009/119/EC, 14 September 2009.

20 Regulation no. 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC.

In response to the Russian dominance of the European gas market and in anticipation of this month's European Council, the prime minister of Poland, Donald Tusk, has proposed an energy union for the collective purchase of gas, and a solidarity mechanism for member states in difficulties. The European Commission would play a key role.[21] Sweden, Denmark and the UK have also published their energy policy priorities, with the first two countries emphasising energy efficiency and renewables and the UK shale gas.[22]

Another short-term option would be to import more gas from established non-Russian suppliers. In addition to the available capacity (how much extra gas can Norway and Algeria supply?), the main concerns are price (especially of liquefied natural gas (LNG)) and the political stability of the producer.

Proposals must also be made to reduce the entire EU's dependence on Russian gas in the longer term. Besides addressing the points mentioned above, the European Commission will have to turn its attention to further diversification (including shale gas, although it divides opinion – see foreword), increased LNG import capacity, further development of the Southern Gas Corridor, renewables and energy saving measures. It should be noted that there is a tension between ambition and feasibility. Linking interconnectivity to diversification depends on the technical and economic feasibility and the political willingness to promote, for example, sustainable energy by means of interconnectivity.

LNG terminals
To reduce their dependency on Russian energy, several member states have decided to build LNG terminals. Worldwide, the scope for LNG exports is increasing. In addition to established LNG exporters such as Qatar, new producers such as Australia, Mozambique, Indonesia and Canada are entering the market. In the US, too, the shale gas revolution has enabled the production of LNG for export. The map below shows the location of current and planned LNG import terminals (for gasification) in Europe. A liquefied gas terminal will be opened in Klaipėda, Lithuania, at the end of the year. This is a very important project for the Baltic states given their current dependence on Russia.[23] Exports of liquefied gas to the EU, however, have recently declined owing to the fall in international coal prices and high gas prices in Asia. Another factor that must be taken into account is that the US's LNG export capacity is currently very small owing to the lack of adequate export facilities. Calculations by the IEA indicate that US exports of liquefied gas will not reach 66 bcm per annum until 2018-2020, while the entire volume traded on the world market will be 540 bcm per annum.[24]

The construction of LNG terminals also takes time. LNG will not represent a substantial

21 D. Tusk (2014), *Financial Times*, 'A united Europe can end Russia's energy stronghold', 21 April 2014.

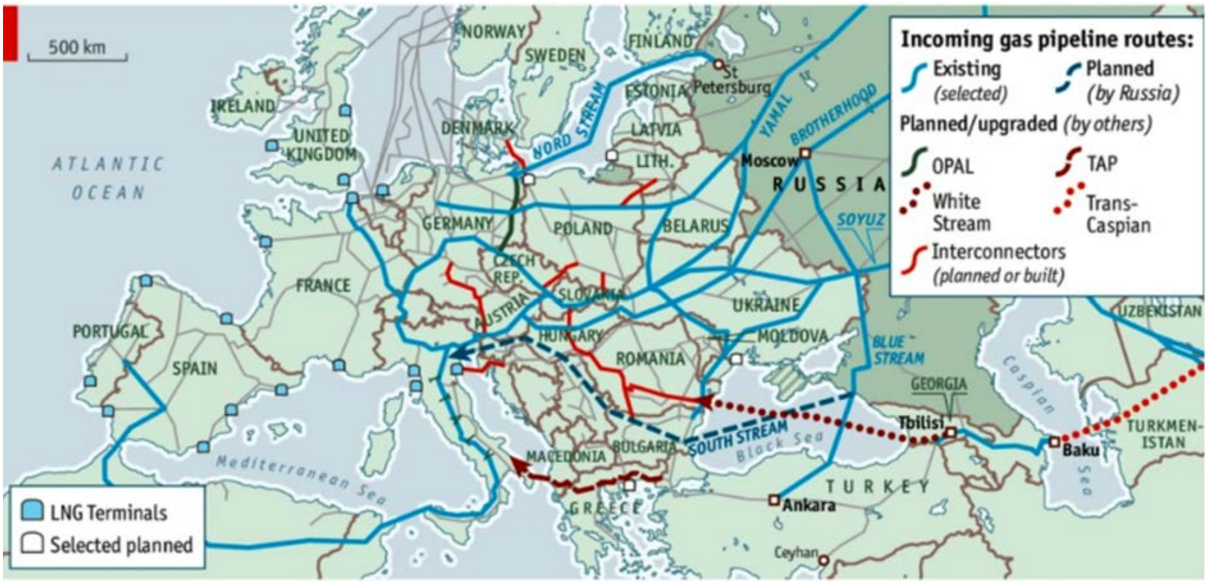
22 M. Lidegaard and C. Bildt, *European Voice*, 'How Ukraine should change EU energy policy', 17 March 2014, and *Euractive* (2014), 'EU warms to shale gas in the wake of Crimea crisis', 26 March 2014. See: http://www.euractive.com.

23 European Parliament, 'Power to the People: Lithuania plugs into the European network', 2 May 2014. See: http://www.elections2014.eu/en/news-room/content/20140430STO45880/html/Power-to-the-people-Lithuania-plugs-into-the-European-network.

24 *The Economist*, 'Briefing: European energy security', 5 April 2014, p. 32.

proportion of European gas consumption for several years. Furthermore, the location of LNG terminals is problematic. Most terminals are located (or planned) in western Europe and along the Mediterranean coast. This might be economically attractive to those European coastal states but poor interconnectivity within Europe will not solve the problem of dependence. LNG must be transported from the terminal to the rest of the EU. Interconnectivity and more terminals therefore go hand in hand.

By themselves, therefore, more LNG terminals are not the solution to the problem of dependence. More research is required into electricity generation by source (involving less coal to reduce the carbon footprint and an increase in the proportion of other energy sources).



Source: *The Economist* (2014), ‘European Energy Security Briefing’, 5 April 2014.

Pipelines, alternative routes, other sources

There are several alternative routes from Russia that avoid Ukraine. The Yamal pipeline runs to Poland via Belarus, which has relatively close political ties with Russia, and the Nord Stream pipeline has been transmitting gas to Germany via the Baltic for the past 18 months. The latter is a joint venture involving Russian, German, French and Dutch companies.[25] The planned South Stream pipeline, running from the Black Sea via Bulgaria, Serbia, Hungary and Slovenia to Italy and Austria, is expected to become operational in 2015.

To increase EU imports of non-Russian gas, progress must be made with the Southern Gas Corridor. This project will enable gas to be imported from Azerbaijan via Turkey (via the Trans-Anatolian pipeline; TANAP) to Italy (via the Trans-Adriatic pipeline; TAP). In the longer term, the corridor could be extended to open up new gas sources in, for example, Turkmenistan and Kurdish Iraq. If agreement were to be reached with Iran on its nuclear programme, the EU would also have access to Iran’s substantial gas reserves. Serious thought should also be given to gas extraction in the eastern Mediterranean, particularly in the waters around Cyprus and Israel, although these sources have their own security

25 Gazprom, Wintershall, E.On, GDF Suez and Gasunie.

and political problems. To benefit from the gas potential of Cyprus a political solution based on the proposals made by the former Secretary-General of the United Nations, Kofi Annan, must urgently be sought to the division of the country. Gas production in North Africa, especially in Algeria, is also of strategic importance, although this is an uncertain source as the region's instability has led to a decline in production and exports to southern Europe in recent years.

Investment and research
The European Commission uses the Connecting Europe Facility (CEF) to award grants and funds for energy infrastructure. It is an important source of funding for interconnectors. Some EUR 9.1 billion has been earmarked for energy projects in 2014-2020. A project qualifies if it satisfies certain criteria and if it is covered by one of the Commission's 12 larger regional plans.[26] In the AIV's opinion, the criteria should also consider the geostrategic importance of investment projects. They currently do not. The Commission's plans should explain whether the CEF is adequate given the urgency of the problem or whether additional funds should be provided from the regular EU budget or from the member states.

The CEF is aimed at EU member states only but the European Investment Bank (EIB) has an energy mechanism that can be deployed more widely. It also awards loans to non-EU countries. Closer coordination of EIB and CEF funding would increase the effectiveness of investment projects, especially those involving partnership countries to the east and south of the EU. The Commission should also include the Research and Development Budget in its plans for the European Council. Are the research funding criteria for energy innovation sufficiently flexible to ensure full use of the budget? Two research areas that require particular attention are the storage of renewable energy and the conversion of energy in gas.

Sustainable energy/renewable sources
Given the importance of renewables in future energy policy, it is appropriate to consider national support schemes that distort the market, as noted above. In this respect, the AIV notes that the current EU directive on renewable energy (Directive 2009/28/EU) gives member states the right to set territorial limits on national support schemes for renewable energy and reject applications from foreign companies. This might be changed, however, by a case currently before the European Court of Justice brought by a small Finnish energy company, Ålands Vindkraft, against the large Swedish Energy Agency. In the Advocate General's opinion, the Renewable Energy Directive is contrary to the free movement of goods. Moreover, article 34 TFEU prohibits discrimination against foreign suppliers. As the European Court's judges rarely diverge from the Advocate General's opinion, it is expected that the Court's judgment will take the same view.[27] If so, the Renewable Energy Directive will have to be revised and national support for

26 Such as isolated location, maturity of a project and commercial significance of a market party.

27 K. Beckman, *Energy Post,* 'The end is near – for national renewable energy subsidy schemes in the EU', 26 February 2014. See: http://www.energypost.eu/end-near-national-renewable-energy-subsidy-schemes-eu/.

renewable energy must be opened up to all suppliers in the EU.[28] Once the Court has given its verdict, the directive should be revised without delay. A revised directive is likely to increase cooperation and coordination in the area of European funding.

Regional cooperation

Regions within the EU work closely with each other on energy platforms such as the Pentalateral Energy Forum in northwest Europe (consisting of the Benelux, France and Germany), the Danube/Visegrád Group and the cooperation around the Mediterranean as part of the Barcelona Process. These forums are important in learning about each other's needs and requirements but they involve no binding commitments. Nonetheless, they can help dispel national fears and highlight the need for cross-border cooperation to increase countries' capacity to act jointly.[29]

28 H.G.J. Kamp, Minister of Economic Affairs, '*Beantwoording vragen over nationale subsidies voor hernieuwbare energie*' (Answers to questions on national renewable energy grants), The Hague, 6 May 2014.

29 For more details see: J. de Jong and K. Groot (2013), 'A Regional EU Energy Policy?', Clingendael International Energy Programme paper, 2013/06.

IV Conclusions and recommendations

The EU needs to introduce an integrated EU energy policy as quickly as possible. The crisis in Ukraine could provoke the necessary sense of urgency among the heads of EU governments. Petro Poroshenko was elected Ukraine's new president on 25 May 2014, and the next few months will show whether Ukraine's elected representatives can solve the country's constitutional and economic problems without external involvement. Russia must not be allowed to present the eastern provinces with *faits accomplis* by means of 'fifth column' activities as it did in Crimea – activities to which the EU member states are unable to respond adequately, given their fear of economic reprisals. The need for the EU to take action soon is also underlined by the relatively short time available to take measures in anticipation of possible disruptions in the supply of Russian gas this winter.

The EU leaders must be convinced that the EU's capacity to act as a trade and political bloc would be strengthened by close cooperation, especially in such a vital field as energy, not only in word, during this month's summit, but also in deed, when measures have to be approved in October 2014. In the AIV's opinion, delay is not an option: there is now a window of opportunity. The ambition remains a liberalised energy market. The EU will have to go to great lengths to create this market – by connecting networks efficiently (interconnectivity and reverse flows) and making the necessary investment in the transport of non-Russian gas, the storage of liquefied gas and the diversification of gas suppliers, wherever they are located.

Reducing EU dependence on Russian gas will require considerable financial investment. The member states must realise that while not every business case will be commercially feasible some may be necessary for strategic reasons. The Netherlands has a longstanding trade and investment relationship with Russia. It would not be realistic to subordinate it entirely to the imposition of sanctions in response to the Ukraine crisis. Nevertheless, the EU must seek smart measures that exert pressure and perhaps have other positive side effects. The EU could apply its competition instruments, for example, to bring Gazprom's activities into line with EU legislation.

On the basis of the above, the AIV has arrived at the following conclusions and recommendations.

1. In the AIV's opinion, the EU should urgently introduce an integrated energy strategy. The strategy should not only be based on economic and climate considerations, but also give geopolitical interests greater prominence than in the past. The Ukraine crisis has shown Europe's political vulnerability owing to its dependence on Russian gas. It has also shown that Russia will not eschew energy when playing power politics.

2. Before the winter of 2014-2015, the European Council must consider with priority the countries in Central and Eastern Europe that import more than 50% of their gas from Russia via Ukrainian pipelines. In the AIV's opinion, the key areas of consideration should be interconnectivity and reverse flows, gas from non-Russian sources and strategic storage.

3. The AIV does not favour a centralised purchasing mechanism to strengthen solidarity among the member states, as proposed by the prime minister of Poland. Such an instrument would rob the system of its flexibility, impede the liberalisation of the EU energy market and probably diminish market efficiency. In the interest of solidarity, a certain proportion of strategic stocks could be held for unforeseen shortages elsewhere. It is doubtful, though, whether this would enjoy the support of market parties in a liberalised market. The AIV is fully aware of this but it believes the final decision should be based on geopolitical considerations. The AIV recommends that the Commission study the regulations necessary for such a mechanism.

4. In view of Ukraine's heavy and ongoing dependence on Russian gas and its function as a transit hub for gas imports to the West, the EU and the IMF must persuade it to introduce a strategic and coherent energy policy. It must not use gas pipelines to force Gazprom to lower its prices; it must reform gas pricing, tackle corruption and lack of transparency in the Ukrainian gas industry and dramatically improve the industry's energy efficiency. This will entail a difficult support operation requiring large-scale action and substantial funding. As well as the EU and IMF, Russia will also have to show political will. The AIV doubts that it will do so in the near future. At the same time, the EU must not close its eyes to the fact that gas transmission is an important source of revenue for Kyiv. In the AIV's opinion, the EU (and the IMF) must follow up on the Deep and Comprehensive Free Trade Agreement (DCFTA) by supporting the diversification of the Ukrainian economy. Diversification could make up for the loss of EU demand for Russian gas piped through Ukraine.

5. To reduce dependence on Russian gas in the longer term, the AIV would propose greater diversification of oil and gas imports (pipelines to other areas, increased LNG capacity and interconnectivity, and higher storage and reverse flow capacity). The AIV is aware that this will require deep and long-term investment. Economic feasibility, however, may not be the only driver of interconnectivity. Geopolitical considerations must also be taken into account. The EU can commit itself to increasing diversification and so achieve the desired political impact on Moscow in the short term. The increase in reverse flow capacity offers the most expedient solution in areas with dense networks. The EU should also examine the scope for deepening gas relations with established suppliers such as Norway and Qatar, as well as completing alternative gas supply routes from Azerbaijan (Tanap and TAP) and connecting Iraq and Iran to those routes after the sanctions imposed on the latter are lifted.

6. Serious thought should also be given to the gas connection with North Africa, even though the countries in this region are a source of uncertainty as regards security and political instability. This will seriously influence the conclusion of long-term agreements. Furthermore the feasibility of producing gas in the eastern Mediterranean and imports of LNG from the US in the longer term should be studied.

7. The European Commission (through the CEF) and the EIB have the funds necessary to support these proposed steps. The CEF funding criteria were recently revised but should be aligned even more closely to the EU's needs and perhaps linked more strongly to the EIB instruments. Criteria such as 'maturity of the project' must not be applied rigidly.

8. The AIV recommends that renewable energy grants be coordinated at EU level in keeping with the agreements applicable to the European Semester. Financial support for sustainable energy distorts competition between countries, which is at odds with the creation of a level playing field. As in the case of financial governance (compare the European Semester mentioned above), national competences (the awarding of grants) will remain intact; they will just be underpinned by a common sustainable energy policy. The common policy, including the margins within which renewable energy grants can fluctuate, should be indicative.

9. In the AIV's opinion, geopolitical considerations are incorrectly given secondary billing in both EU and national energy policies. The EU should consider giving the High Representative for Foreign Affairs and Security Policy and the European External Action Service power to agree the energy policy and the criteria for awarding funds from the CEF to energy projects. Furthermore, there should be a clear link with neighbourhood policy. It is also advisable that, when allocating the portfolios in the Commission and possibly establishing policy clusters, the incoming President of the European Commission take account of the High Representative's position in the energy cluster. In the Netherlands, too, energy policy is determined primarily by economics, and thus primary responsibility for it lies with the Minister of Economic Affairs. To a large extent, however, energy policy is also a matter of foreign policy.[30] The Minister of Foreign Affairs should have a prominent voice in strategic investment decisions.

10. Finally, the AIV is aware that an integrated EU energy policy cannot be introduced overnight. It will affect the member states' competitiveness, but, as in financial and economic policy, European governments must realise that long-term close cooperation will increase all the member states' capacity to act. The AIV therefore recommends that the Third Energy Package be actively implemented in full in all member states, especially when it comes to the construction of vital infrastructure.

30 The AIV made the same recommendation in a joint report with the Dutch Energy Council in 2005, Energised Foreign Policy: Security of Energy Supply as a New Key Objective, advisory report no. 46, The Hague, December 2005.

European Commission's Strategy to reduce energy dependence (published on 28 May 2014)[31]

The Commission's strategy is based principally on short-term measures to increase the EU's capacity and deal with a serious supply disruption in the winter of 2014-2015 by:

- conducting a stress test of the EU's energy supply;
- developing back-up mechanisms, gas stocks and emergency infrastructure and reducing gas demand as a matter of urgency;
- coordinating risk assessments and national emergency plans at EU and regional level;
- pooling parts of the existing stocks at EU or international level.

Medium-term measures are directed at:

- strengthening emergency and solidarity mechanisms, with a direct focus on the countries on the EU's eastern border;
- completing the internal market (particularly transposing internal market legislation by the end of 2014);
- strengthening regional cooperation among member states;
- active cooperation in projects of common interest and interconnectivity.

For the long term, the Commission proposes:

- reducing demand for energy;
- increasing EU energy production. The member states must continue to use renewable energy sources and deploy hydrocarbons, including non-conventional sources such as shale gas, and clean coal while respecting the decarbonisation priorities;
- diversifying external supplies;
- increasing the transparency of gas supply at EU level by means of periodic reports on new gas contracts;
- working out the options for a mechanism to bundle demand voluntarily in order to strengthen the buyers' negotiating position;
- supporting the development of gas infrastructure with Norway, the Southern Gas Corridor and the Mediterranean;
- coordinating national policy measures and speaking with one voice where external energy policy is concerned;
- member states informing each other of important national decisions on energy policy before approving them. Furthermore, the Commission proposes that it be informed at an early stage in the negotiation of intergovernmental agreements that have a potential impact on security of supply.

31 Source: European Commission, 28 May 2014. See: http://europa.eu/rapid/press-release_IP-14-606_en.htm.

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