

The future of energy politics

Ladies and gentlemen,

It is my honor and pleasure to address you today on such fascinating topic as the future of the European Union. Thank Professor Lehman and Monika for inviting me to deliver a lecture on this seminar. However, I am sure that if someone thinks he knows where the world is headed, he should think again. Founder of the STRATFOR George Friedman in his book “The next 100 years” notices that “when it comes to the future, the only thing one can be sure is that common sense will be wrong”. Factor of uncertainty prevails in the energy sector as well. For instance, many analysts notice that despite of huge investments into intelligence, the most significant events happen as a complete surprise. Oil price could be a good example. Few years ago in six months it dropped from 147 dollars to 35 dollars for barrel and then doubled in another 6 months. Consequences of the increased price came also as a surprise: it was expected that the high prices will lay the rout to political stability and economic growth of the producer states. But contrary to expectations non-democratic regimes in Persian Gulf, West Africa and the same Russia did not fall. Another example - you probably heard the worries that world is running out of oil and other fossil fuels. Just recently I saw warnings from the US State Department that scarcity of oil will appear in 5 years. But the story that oil reserves will be over in 20-30 years is repeated for 70 years already. During all this period world was consuming oil in increasing quantities and the reserves were actually growing because new fields and ways to extract oil were discovered.

Despite the fact, that most of the prognoses fail and the most decisive changes happen by surprise, people love to make predictions about the future. Scientists write books on methodology of future studies, think tanks perform future oriented research and private companies use forecasting for business planning purposes. Therefore, I will also try to make few predictions on future developments in energy sector as well. I will focus on several aspects. In particular, I will discuss the energy resources which world may consume in the future, role of energy resources in international relations and the EU-Russia interaction in energy field.

Some analysts tell that world is headed towards the so called new “energy deal”. Just remember what president Obama declared in his inaugural address. He told something like “we will harness the sun and the winds and the soil to fuel our cars and run our factories”. However, others are less optimistic and think that transition to a sustainable energy future with much smaller rates of fossil fuels is likely to be a very gradual one. In other words, a rapid decline of fossil fuels consumption and replacement of coal and natural gas by wind and solar energy in electricity production is unlikely unless there are dramatic advances in technology development. They say there are several reasons for that. First of all – vast quantities of fossil fuel resources that can be extracted in case the oil price remains at the current level or continue to increase. They notice the possibility to develop new techniques for horizontal drilling and rock fracturing which could increase production of the so called “unconventional” gas and oil from shale formations. These were not developed yet only due to the financial restraints. Besides that, some researchers notice that renewable energy resources are not a panacea for short-term energy security problems. Indeed, focusing attention on renewables at the expense of dealing more directly with stability of consumer-producer relations in international oil markets could be even counterproductive. Finally, the outcome of the Copenhagen climate summit in December 2009 indicates that even with rising oil prices, consumer states, both in the West and in the East, still lack the political determination needed to shift towards a low-carbon economy.

Few words about role of energy in future international relations... Differently from the first and second world wars, today the factor of fuel supply does not determine finalization of military conflicts. But this

doesn't mean that in geopolitics the role of energy resources has diminished. The Arab and Israeli conflicts in 1948, 1967 and 1973, invasions to Iraq in 1991 and 2003 demonstrated the role of oil in the Middle East. These conflicts were not determined by economic motives only, but nobody could deny that many policy-makers expected more favorable oil supply conditions after the intervention. According to American analysts, the oil price exceeding 100 USD/barrel will further push the importers to look for possibilities to reduce import prices, whereas politicians of oil and gas exporting countries will try to increase state control in this sector. Many of energy exporters will use the "oil money" to acquire weapons meant to defend their resources. This accordingly will raise the possibility of military conflicts.

Besides the traditional fights for resources, it is worth to mention terrorism and sea piracy as a new trend of 21st century. Today's most popular target of terrorists' attacks are oil tankers and other energy infrastructure. From 2003 to 2006 the number of attacks directed against these objects has increased 5-6 times (from 50 to 300 attacks per year only against oil tankers and pipelines). In principle, this is not surprising, since most of oil reaches the importing states by maritime routes which actually are unprotected. In the future this tendency will increase, since consumers have started to search for import of liquid natural gas transported by tankers. The question arises: what has to be done in order to protect energy transportation systems and roads, and who should take responsibility for that? Most of the imported oil and gas is consumed by the Western world, therefore it's logical that the West shall be responsible for the security in the Indian Ocean, straits of Hormuz and Malacca and the Gulf of Aden. In this regard I see a growing role of NATO in energy affairs.

Ladies and gentlemen,

If we agree on the assumption that oil reserves are not endless, next logical question is of how long it will be worth for the states to fight over the control of energy fields. In other words, when and how will conflicts over the oil end? Here I would like to quote Mr. Friedman again, who thinks that today strategically important Arabian Peninsula and its oil will lose their significance in the coming fifty years. According to him, the largest energy producer in the world will become the US, which military program will reduce the costs of space-based energy in a form of solar power. Remember computers and Internet which were developed by the US military programs some decades ago. Just listen what Mr. Friedman says: "vast numbers of photovoltaic cells, designed to convert solar energy into electricity will be placed in the orbit or on the surface of the moon. The electricity will be converted into microwaves, transmitted to the earth, reconverted to electricity and distributed through expanded electric grid". Amazing prediction, isn't it? I am sure, that the way he imagines "energy revolution" will differ from reality. Nevertheless, I would agree with the conclusion that in the long term oil and other traditional sources will lose their significance. Future belongs to solar, wind, nuclear, geothermal and maybe some other, today even undiscovered energy resources. The only question is when it will happen.

And still, today Europe consumes huge amounts of traditional energy sources which are mostly imported from external producers. For instance approximately 40% of the whole imported gas is received from Russia and this share is expected to increase in the coming years. Therefore, I would like to tell few words about possible development of EU-Russia energy relations in the future. Talking on this topic I would like to notice that in 2009 Russia withdrew from Energy Charter Treaty regulating investment protection and transit in the energy sector. It is neither a member of the WTO nor a signatory to any other international economic agreement. In other words, there is no international legal instrument limiting Moscow's actions in the field of energy. As a consequence, Russian government, if wanted, may use national energy "champions" for the implementation of its foreign and security policy without obstacles (for instance by streamlining energy resources export and pricing policy). This circumstance determines of why some EU member states insist of building energy relations with Russia on the crucial

principles of “solidarity” and real “reciprocity” in energy affairs. However, the problem is that the EU member states are pretty much divided on what this should actually mean.

Some EU member states in the West perceive “solidarity” first of all as a short term action in time of crises. In other words, this principle is perceived as an ability and willingness to provide support in case of “short term” supply disruptions. But for the countries in the Central and Eastern part of the EU “solidarity” means a strategic long term goal, which includes a “harmonized energy policy” towards external suppliers and transporters, financing of key energy infrastructure projects from the EU budget, and even some type of “collective security” commitments in case of energy attack or blockade. I hope that in the nearest future the EU institutions will succeed in coordinating these different approaches and the “solidarity” will very soon mean not a wishful thinking, but the reality. As a consequence, the common EU energy market will be created as well as Europe’s energy ties with suppliers in Southern Caucasus and the North Africa countries will be strengthened. These quite optimistic conclusions I base on recently ratified Lisbon treaty which in fact allows the European Commission, EU external action service and other bodies to take greater responsibility in the area of energy security.

“Mutual interdependence” in the EU-Russia energy relations is another topic where the EU member states have to find a consensus. On the one hand all of them recognize that Russia supplies around 25-30 % of the total EU oil and gas consumption and therefore serves as an important motor for Europe’s economic growth. Figures also say that as much as 90 % of the Russia’s total natural gas exports are delivered to European countries. When adding oil exports and other raw materials, Russia’s energy exports to the EU account for roughly 75% of Russia’s export earnings and 40 % of Russia’s budget receipts. In other words, the European market is crucial for Russia and neither Asia nor North America will become the main clients of “Gazprom” in the foreseeable future. For many Western experts these circumstances mean “mutual interdependence”. But the Baltic States notice unequal situation of two players. They tell that Russia’s vulnerability comparing to the one of the EU is much lower as it can shift current oil flows easily and the gas exports are relatively unimportant as a source of Kremlin’s revenue. Beside that, relevant Russian actors are capable of acting in unison and strategically, while the EU is internally divided, both structurally and institutionally. This secures Russian companies possibility to penetrate into the EU gas market but the EU-Russia energy relations can not be considered as strategic, predictable and equally beneficial for both parties partnership. It represents nothing else as asymmetrical producer-consumer relations.

I think that this situation very soon will experience considerable changes. Russia does not only lack investments and loose income from oil and gas production. It seems that Kremlin at least partially realized that “Gazprom’s” dominant position (which many believes is its strength) is actually scaring away consumers. It becomes evident that talking from the position of the strength worked in the short term but in the longer “Gazprom” may see consumers shifting away, focusing on LNG, etc. First practical consequences are already there: previously “Gazprom” was telling that it will supply Europe with the 20% of needed gas but now it wants to supply 30%. In other words, “Gazprom” got concerned that it will loose even those 20 % of the EU market. Therefore, many analyst notice, that “U turns” in Russian energy policy are not inconceivable. My forecast would be that even though the state control in the Russian gas sector could increase in the short term, the monopoly position which “Gazprom” enjoys today will vanish. And this will change Russian negotiation position: trying to secure the market share, Kremlin and the Gazprom will become less assertive and more compliant with international framework. In other words, Russia will become more interested in reaching legal agreement with the EU on the strategic level. The EU should not miss this momentum. Thank you for your attention.