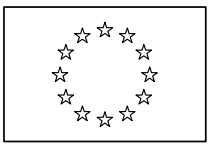

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

The Energy Dialogue between the European Union and the Russian Federation between 2000 and 2004

1. INTRODUCTION

The energy dialogue launched at the summit between the European Union and the Russian Federation in October 2000 arose from the notion that the European continent constitutes a broad geopolitical area linked culturally, historically and economically and that the complementarity in terms of energy between the eastern and western parts of the continent should be developed in a sustainable way in the future. The Russian Federation not only is our most important supplier of fossil fuels and uranium, it could also to a certain extent play a moderating role in international markets, being in some ways the most promising - and geographically the closest – alternative to the Middle East as energy supplier to Europe. At the same time, the EU is particularly interested in having economic stability in a partner and neighbour like Russia and thus continues to underline the importance for Russia to diversify its economy and trade in order to assure sustainable economic development in the long term[1].

The Partnership and Cooperation Agreement[2] (PCA) (signed in 1994 and in force since 1997), general in its design, set up institutional structures for the establishment of cooperation on all subjects of common interest. Despite the existence of the Agreement, some specific questions related to energy which have arisen in the course of the last ten years, or which have been suspended since 1994, as in the case of trade in nuclear materials, remain unresolved, , causing dissatisfaction to both sides. It has not been possible to find solutions through the Energy Charter Treaty – a multilateral treaty signed by 51 countries, including non-Europeans – as Russia has stalled ratification of the Treaty since signing it in 1994.

The sudden change in the international energy situation in 1999, the development of the internal energy market in Europe, Russia's bid to join the WTO, enlargement of the EU by 10 Member States, of which 8 from central and eastern Europe, have increased the economic interdependence of Russia and the EU, as well as the number of energy-related questions which need urgent resolution, such as long term contracts or destination clauses. A bilateral dialogue was deemed complementary to the PCA in order to resolve concrete energy questions between the EU and Russia.

The energy dialogue set out above all to resolve "all questions of common interest relevant to this sector"[3]. Among the priorities of the dialogue was cooperation in order to improve the investment climate in the energy sector, including Production Sharing Agreements (PSA).

The dialogue, as a sui generis bilateral initiative, has focussed on the resolution of problems. In four years, it has developed into a true partnership which today offers wider prospects which go beyond the narrow questions of energy trade, extending to transport-related problems and to the environmental impact of the energy sector.

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1 On this point, certain commentators believe that trade relations between the EU and Russia could be defined in two words: « energy and asymmetry" (The EU and Russia - Strategic Partners or Squabbling Neighbours?" Centre for European Reform, 2004)

2 PCA = Partnership and Cooperation Agreement

3 Joint Declaration adopted at the close of the EU-Russia Summit of October 2000

2. A UNIQUE STRUCTURE FOR THE ENERGY DIALGOUE: INVOLVING ALL THE ACTORS

As a bilateral dialogue, the energy dialogue has developed around concrete themes of interest to both parties and calling for shared "win-win" solutions. To succeed, such a dialogue must take into account all the stages of decision making. All relevant parties should be involved. Thus, the working structures put in place revolve around a flexible organisation and a permanent dialogue between actors from both the political and industrial areas.

2.1. The "political" motor for a successful dialogue

The impulse for an energy dialogue was launched by Presidents Putin, Chirac and Prodi during the EU-Russia summit of October 2000. Subsequent summits have been regularly informed of the state of development (progress reports[4]) and have given guidance for future work. Two sole interlocutors designated by President Putin and President Prodi respectively have had the task of taking the dialogue forward[5]. These personal nominations have helped to assure continuity in the dialogue. Member States have been regularly consulted and informed in Council by reports from the Commission services (working documents). The interest shown by the majority of Member States in the evolution of different dossiers and the desire of the current Council Presidency to give priority to the energy dialogue demonstrates the importance and usefulness of this exercise, as underlined in 2001 when Commissioners (Patten and Lamy) suggested that the dialogue serve as a "pioneer for wider relations"[6]. The Dutch Presidency proposed a "non-paper"[7] to Member States including recommendations related to the institutional organisation and future priorities of the dialogue. These have been incorporated into the 5th report of the interlocutors which has been presented to the EU-Russia Summit in November 2004.

2.2. The full participation of industry

From the start of the energy dialogue, industrial representatives were invited to take part in bilateral thematic groups on the themes of strategies, technology transfer, investments, environmental questions and energy efficiency. These groups, comprising Russian and European experts from the private sector and national administrations, were charged with examining common areas of interest and defining priority sectors for cooperation. Their work has led to conclusions and recommendations, included in the synthesis report presented by the two interlocutors at the EU-Russia Summit of October 2001. These groups are committed to meeting again in the future to make progress on more specific subjects, as requested by the Dutch Presidency. Four themes have been identified for the thematic groups: investments, infrastructures, energy efficiency and trade flows.

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4 To date, five joint progress reports by the interlocutors have been sent to the EU-Russia Summits – to the 8th Summit of 3 October 2001, the 9th of 29 May 2002, the 10th of 11 November 2002, the 12th of 6 November 2003 and the 14th of 25 November 2004.

5 The Russian Federation nominated Victor Khristenko (Deputy Prime Minister, then minister for energy and industry). From the Commission, the Director-General of the Directorate-General for Energy and Transport, Mr Francois Lamoureux, was nominated.

6 Financial Times, 5 December 2001

7 Non-paper adopted by the Council (COREPER), 26 October 2004

The EU-Russia Industrialists' Round Table is a useful complement to these thematic working groups. Industry has taking the initiative of participating actively in the integration of markets within a "pilot group on energy"[8] (created in December 2003[9]), comprising senior representatives of European and Russian companies. This structure will be the central core and coordinating body of a wide participation mechanism for companies within the energy dialogue. Industrial participation is one of the ways of guaranteeing the long term success of the energy partnership. A meeting of the pilot group and the sixth meeting of the Industrialists' Round Table was held on 10 November 2004, attended by the two sole interlocutors and the Dutch Presidency (Mr Zalm, Deputy Prime Minister and Finance Minister of the Netherlands). Among other things, it was agreed that the four thematic groups would each make a report to the pilot group which would synthesise them. .

2.3. Structures for implementing the dialogue

The working method put into place since October 2000, based on the personal commitment of the sole interlocutors, the organisation of the round table and brainstorming conferences involving all stakeholders has been demonstrated to be fruitful. Support structures have recently been created which enrich and give a new impulsion to the dialogue. These support structures complement those of the PCA, that is, the EU-Russia Permanent Partnership Council (which can treat energy questions), the Cooperation Committee and subcommittees which can treat energy issues at the technical level.

a) A flexible working method

– **regular meetings between interlocutors**

The two parties meet regularly to discuss the evolution of current questions. A coordination cell made up of interested Commission services has had 36 meetings since the dialogue began. The members of this cell have regular meetings with their Russian counterparts on various topical subjects covering gas and uranium trade or electricity exchanges.

– **round tables**

A number of round tables on topical issues have been organised bringing together European and Russian partners from the public and private sectors at the highest level. A conference on natural gas was held in Brussels on 10 December 2003, and one was held on electricity in Moscow on 16 October 2002. These brought together the principal actors from the private sector, various Russian ministries, Commission services as well as Commissioners de Palacio and Monti and the Council Presidency.[10]

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8 Among the active members of this group are Messrs Tchubais (CEO, RAO UES), Miller (CEO, Gazprom), Vekselberg (BP-TNK), Bernotat (CEO, E.ON), Sutherland (BP) and Verberg (GasUnie)

9 EU/Russia Industrialists' Round Table, Moscow, December 2003 http://www.europa.eu.int/comm/energy/russia/reference_texts/industrialists_en.htm

10 Other round tables at the technical level held or about to be held are: conference on a comparative analysis of energy strategies (Moscow 17 October 2003), round table on the quality of petroleum products (2004), seminar on energy efficiency (2004)

Finally, a continuous comparison of analyses, scenarios and strategies takes place at the highest level with the participation of European and Russian industry. Industrialists such as A. Tchubais, president of the Russian electricity giant RAO UES and A. Miller, president of Gazprom, are very active in the dialogue.

b) Support structures

Two concrete structures support the work of the dialogue – a joint energy technology centre and a market observatory.

– **the Russia-EU Joint Energy Technology Centre**

A joint Energy Technology Centre[11] was set up in Moscow on 5 November 2002. It is managed by two co-directors, one Russian and one European. The centre is a platform aimed at promoting advanced energy technologies in the sectors of oil, gas, coal, electricity , new and renewable energy sources and energy savings. It works in partnership with industry and seeks to facilitate investments in priority projects.

With the purpose of fulfilling this task, the Centre:

– Promotes the necessary conditions for exchange of information about advanced energy technologies and organises and co-ordinates activities which will facilitate contacts between EU and Russian energy sector actors, including in research and technology development;

– Identifies, evaluates, facilitates and assists in promoting concrete, large-scale, technology co-operation projects in the above-mentioned energy sectors;

– Liaises and co-ordinates joint activities with other Russian and EU energy centres, and promotes the creation of a common information space for disseminating energy technologies.

In order to do all this, the centre has organised various round tables and proposals for mutually beneficial energy technology projects are starting to come forward.

The activities of the centre will help to attract mutually beneficial investments in the areas in which it is active.

– **market observatory**

In order to facilitate and speed up the integration of Europe's energy markets and to assure security of energy supply, the observatory system for the energy market will make it possible to monitor data and issues crucial to the proper functioning and security of supply of the internal energy market, acilitate the completion of necessary infrastructure projects and identify potential risks to internal and external energy supply to the EU. . The observatory mechanism will cover notably the oil, gas and electricity sectors.

[11] For more details see http://www.technologycentre.org/

This internal service of the Commission will provide a central and reliable source of quantitative and qualitative information. It will help the Commission, Member States, industry and other interested parties to take decisions relating to energy policy and new investments. It will thus help to improve the EU's energy supply security in the short, medium and long term. The support of competition and the need to ensure energy supply in good cost-benefit terms are in line with the strategy defined by the European Council at Lisbon (23-24 March 2000).

Given the mutual interests of the EU and Russia in improving security and stability in energy supply, as well as the importance of Russia as a supplier of energy to the EU, the Commission intends to associate Russia in the work of this observatory as soon as possible and to establish a link with the hydrocarbons observation system which the Russian Federation plans to create.

3. RESULTS OF THE ENERGY DIALOGUE

The three-pronged approach announced in the Green Paper "Towards a European strategy for the security of energy supply" adopted by the Commission on 30 November 2000 – to strengthen competition in the internal energy market, to defend sustainable development and guarantee external supply security – has been translated into concrete action in the framework of the energy dialogue with Russia.

It has been possible to resolve difficulties faced by Russian companies in the internal energy market by establishing clear and predictable rules for companies operating in the single market. It has created a path for European companies seeking to enter Russian markets. During this period, companies such as BP, Shell, Total or ENI have made significant investments. The dialogue has made it possible to resolve certain problems which European companies could have encountered. Likewise, Russian investments in the EU have forthcoming, essentially through stakes which Gazprom has bought.

Finally, the dialogue has put in place the conditions for long term energy supplies in Europe by supporting the building and modernisation of energy transport infrastructure and establishing safety rules.

Such results would not have been possible without the mutual interest of the parties to produce them. Russia and the EU are broadly interdependent in the energy area. For the EU of 25 Member States, Russia is the EU's main supplier of energy products: half of EU gas imports, one quarter of oil imports, one third of uranium imports. For Russia, the EU is its principal economic partner. It is the natural destination for its energy exports (all its export infrastructure is directed towards Europe – oil and gas pipelines, waterways, railways and road routes). Sales of its raw materials provide foreign currency and almost 40% of the federal budget.

At the same time, the EU will continue to underline the importance for Russia to diversify its economy and trade in order to assure sustainable economic development.

3.1. The energy dialogue as an instrument of the single energy market

As the internal energy market is intended to rationalise the European energy sector for the benefit of consumers, it should as a consequence have an impact on preexisting links with international markets for energy products. It is impossible to dissociate the two, given the certain rise in coming years in the EU's dependence on imported fuels. Russia can help the EU to diversify its fossil fuel supplies. It is therefore inconceivable that the EU should impose quantitative restrictions on its imports. Market transparency and healthy competition are what will secure stable supplies into Europe.

In this respect, the gas sector, on which the EU economy will become most dependent in the future, appears particularly vulnerable. Russia should remain the EU's principal external supplier[12]. It is therefore important that exporting countries do not distort the rules of the internal market by contracts which are inconsistent with Community law.

Indeed, internal market rules needed to be clarified in view of long term contracts which included territorial restriction clauses running counter to EU rules governing free movement and competition. Thanks to the dialogue, these questions have been discussed and solutions have emerged. The principle of long term contracts has been quite rightly upheld. They can help security of supply by improving investment planning for production or infrastructure projects necessary for EU supplies. On the subject of destination clauses incompatible with internal market rules, an agreement was reached on 6 October 2003 between ENI and Gazprom. This should be followed in the near future by agreements over contracts with Germany and Austria.

3.2. The energy dialogue as an instrument of sustainable development

Since the start of the energy dialogue with Russia, the Commission has underlined the importance which it attaches to commitments under the Kyoto Protocol on climate change. In the framework of the dialogue, the Commission has insisted on raising the question of Russian ratification of the Protocol, without which the Protocol could not come into force[13]. Russia's implementation of the Kyoto Protocol should help Russia move towards a more efficient use of its energy resources.

Sustainable economic development in Russia depends on putting in place key reforms, among others in the energy sector, and notably regarding the structure and management of natural monopolies, pricing structures and the taxation of natural resources. On the one hand, these reforms should promote trade stability in the future as they will have a positive effect on future investments and the improvement of energy efficiency. On the other hand, they should contribute to the diversification of

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12 The share in the EU economy of gas, a fuel with wide applications, is growing noticeably. Between 2000 and 2030, its share will rise from one fifth to one third of total energy supply, and from one third to one half of electricity. 80% of our gas needs could be covered by imports in 2030. The volume of gas imports from Russia is bound to increase, even if the 50% share is maintained.

13 In October 2004, the Duma approved the ratification of the Kyoto Protocol, allowing the Russian Federation to take benefits from the Kyoto Protocol. The European Commission will provide technical assistance through the TACIS programme (2 Meuros) starting in early 2005.

the Russian economy by promoting restructuring and the development of sectors other than that of energy.

The modernisation of the Russian economy, support to its high rate of growth (around 7% p.a.) makes it all the more essential that Russian industry adopts efficient energy practices in order to increase capacities for export, including towards the EU. Energy transport (by land or sea) between the EU and Russia will become more intense, which is another cause of environmental concern for EU countries.

a) a more environmentally conscious use of energy

Increasing energy efficiency is one of the priorities of the Russian Federation's energy strategy. In this area, industrial cooperation between Russia and the EU, notably through exchange of good practice and technology, could be fruitful. A round table on energy efficiency in buildings took place in Moscow in October 2004 and a second at Nizhny Novgorod with a view to agreeing projects which could be developed with the support of the Energy Technology Centre.

Joint pilot projects on energy efficiency have been launched in the north and south of Russia: Arkhangelsk, Astrakhan and Kaliningrad. The last is of particular political importance for energy cooperation due the city's character as a Russian enclave within the territory of the EU.

For Kaliningrad, estimations of energy savings as a result of an energy efficiency programme are in the order of 35-40%.This potential is significant considering that 90% of the enclave's primary energy comes from Russia (gas pipeline) and 95% of its electricity comes from the Russian network IPS/UPOS. Now that the Baltic states are EU Member States and as they integrate in due course into the European electricity network, this will raise a necessity to look for technical solution regarding Kaliningrad's electricity system.. This calls for a mutual solution to be found between the EU and Russia in this area.

Energy efficiency programmes should be accompanied by the development of renewable energy sources. A round table on renewable energy organised by the Energy Technology Centre was held in Moscow non 22 June 2004[14]. This aimed to encourage the establishment of a framework favourable to renewable energy development in Russia. A work programme for 2004 was adopted jointly by the Commission and the Russian Ministry for Industry and Energy. More focussed seminars on fuel cells, CO2 sequestration and biomass have been organised with a view to Russian participation in the Community Research Framework Programme.

With the ratification of the Kyoto Protocol, the EU/Russia Technology Centre should explore opportunities for EU private sector investments under the project-based mechanism called Joint Implementation. The existing projects in Archangelsk, Astrakhan and Kaliningrad could serve as pilot areas for such an exercise.

[14] For more information http://www.technologycentre.org/

b) a less polluting transport system

The physical security of transport networks is another important area of cooperation. The energy dialogue has studied the feasibility of a regional surveillance system by satellite to prevent accidents and detect leaks in oil and gas infrastructure. It was decided to provide technical assistance under TACIS 2004 to evaluate the need for rehabilitation and investment to improve the security and effectiveness of Russia's hydrocarbon export network.

Marine pollution is a serious concern for all the countries bordering the Baltic Sea and the North Sea. Recent maritime accidents and the growing density of traffic along the EU coast give maritime safety a special significance in the EU's cooperation with Russia. The Commission has had reassurance from Russia that she will reinforce controls on tankers unloading in its ports and that she will support the EU's efforts within the International Maritime Organisation (IMO), in particular to eliminate single hulled tankers. On this last point, a compromise was accepted in the IMO on December 4th 2003, which will come into force in April 2005. In the meantime, many meetings with Russia are being organised by the EU to encourage the rapid implementation of IMO standards. Particular emphasis is also being given to the role that should be played by land transport (oil pipelines and rail transport).

Transport, as an energy consuming sector, should not be ignored in the energy dialogue. Transport accounts for about one third of Russian CO2 emissions. Greater efficiency, particularly of urban transport, could significantly improve the environmental impact of the sector. Closer cooperation in this field could be profitable for both parties. A first seminar on transport took place in Moscow in May 2004. It helped to define areas for co-operation in coming years. A second seminar looking at urban transport was held in October 2004.

3.3. The energy dialogue as an instrument of stable and predictable supply

As stated in the Green Paper on security of energy supply, European energy supply policy is aimed less at maximising energy autonomy or reducing dependence on imports, more at reducing the risks associated with the latter. Thus, with regard to Russia, on which dependence is inevitably going to rise, cooperation must aim to establish a relation of constructive interdependence: establish predictable trade rules, improve networks and encourage investments by promoting a more stable and transparent legal framework and encourage key reforms in the Russian energy sector.

a) trade in energy products

Trade in hydrocarbons has been one of the primary subjects for clarification in the energy dialogue. Following long discussions with the Russian partners, particularly at the time of the recent enlargement, a Joint Declaration on EU enlargement and relations between Russia and the EU stated that there were no longer any restrictions on imports of gas and oil into the EU.

In the framework of the bilateral agreement in May 2004 between the European Union and Russia on Russia's accession to the World Trade Organisation (WTO), the two parties reached agreement on certain questions in the energy sphere. Russia made WTO commitments related to the price of gas to industrial users and export

duties on energy products. In addition, the two parties agreed to intensify their cooperation on questions relating to energy infrastructure.

In parallel, the agreement on trade in nuclear materials, currently at the negotiation stage, aims to establish transparent, stable and predictable trade rules in the interests and for the viability of the nuclear industry of both parties. The new agreement will take into account not only the new market conditions in the newly enlarged EU, but also the need to maintain the viability of the nuclear industry of both parties.

Trade relations in the area of nuclear material between Russia and the new Member States represent more than $200 million per year to Russia, and correspond to 80% of the market in the new Member States (or 12% of the market in EU 25). Russian export companies had concluded long term agreements to supply the nuclear reactors in the new Member States, some of which went well beyond May 2004. A diplomatic exchange of letters between the two interlocutors, signed in April 2004, made it possible to define rules which would apply in this area, to confirm the validity of these contracts in accordance with Euratom Treaty (Article 105) and thus to avoid complications involving the new Member States.

It is therefore important that general rules and principles covering energy trade should be predictable and transparent, such as, on the one hand, the rules of the Partnership and Cooperation Agreement and the World Trade Organisation and, on the other hand, in the future, arrangements to facilitate trade and the protection of investments in the framework of the European Economic Area.

b) Transeuropean Energy Networks

The reliability of energy transport is one of the pre-conditions for a stable and continuous energy supply in the EU. Hydrocarbons coming from Russia pass either by land route (oil or gas pipeline) or by sea route (see above). If land transport is to be preferred, networks must be reinforced.

In 2001, the Russia-EU Summit identified a list of priority projects, on which feasibility studies could be co-financed by the European Union in the framework of the Trans-European energy networks programme.

The revised guidelines for the Trans-European energy networks, adopted on 26th June 2003, include a number of electricity and gas infrastructure projects involving the Russian Federation. The new guidelines[15] have designated as a priority axis the gas pipeline project connecting the United Kingdom and continental northern Europe with Russia..

The importance of cooperation in infrastructure development must be underlined given the interest of oil pipelines as an alternative to maritime transport in the Baltic. Both Scandinavian and Baltic countries are particularly concerned by the growing number of tankers crossing the Baltic, multiplying the risk of an oil spill for countries with a coastline.

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15 Proposal for a decision of the European Parliament and of the Council laying down guidelines for trans-European energy networks and repealing Decisions No 96/391/EC and No 1229/2003/EC

The energy dialogue does not replace the private sector in carrying out the projects, which are based on commercial and economic considerations. Projects are labelled "common interest" only to ease their implementation, notably in the light of reticence on the part of investors to invest in Russia, given the degree of commercial risk.

Other ways should be explored for oil transport to avoid overuse of the Baltic Sea and further congestion in the Bosphorus. One of the solutions would be to develop transport by rail, particularly given the current upward trend in oil prices. It could also contribute to improving interoperability between the railway systems.

3.4. The energy dialogue smoothes the way towards market harmony across the continent

The energy dialogue has enabled the two parties to move closer and set the scene for closer relations in the future. It has opened the way for the convergence of strategies in the Russian and EU markets. The principles of the internal energy market, such as energy efficiency, reform of internal industrial structures, reform in the electricity sector and unbundling, could provide part of the reference framework for the restructuring of Russia's energy sector. Even if the two markets are separate, they should be inspired by shared principles.

a) an interconnected electricity network

Discussions on the reform of electricity systems are being pushed most strongly. Indeed, consideration should be given to involvement of the Russian electricity supply industry in the Community electricity market, given forecasts of European electricity needs[16]. Thus the synchronous interconnection of the Russian electricity network with the EU continental network was entered on the list of "common interest" projects agreed on at the EU-Russia summit of October 2001.

To achieve this, many related issues will need to be resolved, notably those relating to the respect of environmental standards, nuclear safety in Russia and reciprocal access to electricity markets with due respect to relevant international obligations incumbent on each party.

[16] According to IEA and Eurelectric forecasts, between now and 2030, the EU could need to invest in new electricity capacities of almost 600GW in order to cover consumer needs.

A Round Table held in Moscow in October 2003 analysed the conditions which would be necessary to move towards a common electricity market. Among the difficulties which were cited are:

– The absence of a sufficient regulatory framework in Russia was observed in a report from March 2004. Accordingly, in September 2004, Russian representatives were invited to take part in the Florence Forum of electricity regulators. A greater understanding of the system which the internal market puts in place will enable an integration in due course of both markets.

– There is a need to adopt similar environmental and safety standards for electricity production, such as clean coal combustion rules and the guarantee of nuclear safety[17].

– The effective integration of markets requires the putting in place of necessary infrastructure for the joint use and synchronisation of the electricity systems of Russia and of Member States. A working group on network interconnection has been charged with analysing the current situation in this area. A feasibility study of the synchronous interconnection of the UCTE and IPS/UPOS systems is being carried out, financed by the European Commission and RAO-UES. It should be completed by 2007.

The adoption of a financial guarantee scheme could ease the reform process in both the electricity and hydrocarbon sectors.

b) reinforcing the security of infrastructures

Energy is one of the principal fields that will benefit from satellite navigation. Its use in the sector includes the whole activity chain: exploration, construction, transport, and including site monitoring. Russia is carrying out an ambitious programme of modernisation of its GLONASS system, which it plans to open up for civilian purposes. The European programme GALILEO aims to set up by 2008 the first global satellite navigation system specifically designed for civilian and commercial applications.

The joint use GLONASS and GALILEO is an objective pursued since 1999. The complementary use of the two networks will significantly reinforce the safety of energy transport infrastructures and energy production.

The energy dialogue has helped to revive negotiations over the interoperability of the two systems. Progress to date suggests that an agreement on this matter is likely to be adopted by the end of 2005. Apart from discussions about the technical compatibility of GLONASS and GALILEO, co-operation covers the joint development of receivers, as well as specific applications in the energy field (exploration, construction and maintenance of transport infrastructure).

[17] The setting up of an independent nuclear safety control system should be welcomed.

c) Providing investment guarantees

The general investment climate in Russia must become more transparent, stable and predictable. The EU continues to encourage Russia to put in place the necessary reforms to this end.

Russia's accession to the World Trade Organisation will have a beneficial impact in this regard. Moreover, the objectives and action to facilitate trade and the protection of investments already underway in the framework of the European Economic Area should also make a positive contribution to improving the investment climate in Russia.

The issue of the improvement of the financial framework for energy relations between the EU and Russia has stimulated a range of initiatives. During the first phase (2002), the idea arose for a "guarantee fund for international arbitral awards". This idea sought to remedy the latent insecurity of European companies faced with the possibility that Russian courts would not transpose international arbitrational sentences made in the context of trade disputes between European and Russian companies. A Commission-funded feasibility study concluded that there was a real problem, but that the idea would be financially extremely heavy for the Community budget (in the order of 500 million euros), even without giving the funds the necessary critical mass to cover adequately the projects envisaged. From the legal point of view, ratification by 25 Member States and by Russia would be necessary, and, moreover, providing such a guarantee would only prolong the poor functioning of the Russian legal system.

Given the lack of viability for this system, an alternative initiative was developed, one which would be cheaper and in accordance with market rules, in the framework of a study the European Investment Fund carried out on behalf of the Commission. This approach was based on the observation that Russian operators - even at a time of crude oil price rises - do not have satisfactory access to international monetary markets and particularly to very long term financing. The development of eligible projects, with estimated costs of around 200-300 billion euros, would require access to financing beyond the current typical 5 year terms. Ideally, terms should extend up to 10 to 15 years, even more. To make this possible, a new mechanism was envisaged which would put in place an "**Energy Desk**", possibly associated with an international development bank, which would have a special status to serve the energy dialogue. In particular, it would play an active role in setting up **banking syndicates**. The aim would be to bring in resources for developing projects in Russia over the longer term and at a lower cost by sharing the risk among several syndicated banks.

The costs for this "Energy Desk" for the EU would be limited to start-up costs. Russian companies and authorities would not need to contribute. The initiative would form part of the PCA. This idea would have to be developed in more depth with banks and companies active in the energy area to ensure its full complementarity with their activities.

Other initiatives could be developed in parallel, notably an **investment or guarantee fund for energy efficiency**, which would seem justified given the size of energy

losses (around 40%) in Russia. This fund could be focused on targeted support for European companies active in this field in Russia. In any case, the design of such an instrument requires a detailed assessment including a market analysis prior to its launching. It would require however a significant input from the Community budget, though it could be linked to the implementation of the Kyoto Protocol by Russia.

Following the ratification of Kyoto, as well as preparing an investment guarantee fund for energy efficiency, synergies could be considered to be achieved by putting in place flexible mechanisms linked to the Kyoto Protocol.

4. CONCLUSIONS

The dialogue has demonstrated its usefulness through concrete and commendable results. The strategies and policies of both parties are leading to a closer relationship which is to be welcomed.

The Community acquis could become a reference framework for a reform of the energy sector to be implemented in Russia. This reference framework is more sensitive for the electricity sector than for the gas sector. The EU considers that this reform should be a priority for Russia as it is necessary in order to enable sustainable development not only in the Russian energy sector, but also in the whole of the Russian economy.

Nevertheless it remains the case that many questions still need to be resolved to enable a better integration of both markets. In the future, it will be necessary to emphasise such priority subjects as:

– encouraging the process of reform in the Russian energy sector;

– developing energy efficiency, technology exchange, the environment and the implementation of the Kyoto Protocol;

– promoting and protecting investments;

– establishing a pan-European natural gas market;

– reinforcing the transport of oil over land (by pipeline and rail rather than by sea).

The achievement of these objectives will contribute decisively to the creation of a large continental market.

Growing economic interdependence between the EU and Russia calls for more intense cooperation, particularly in the energy sector. The energy dialogue and those aspects specifically related to the implementation of the Kyoto Protocol contribute to the Common Economic Space and fall within the framework of the Partnership and Cooperation Agreement.

ANNEX

	Russian Federation		EU 25	
	2000	**2020**	**2000**	**2020**
Population (million)	146	120 à 125	453	462
PNB (billion €)	220	/	8 940	14 460
Growth p.a.	6,3 %		2 %	2,4%
Demand (Mtoe)	586	900	1650	1895
Demand per capita (toe/h)	4	7,2	3,6	4,1
Oil : Reserves	65 billion brl	/	6, 5 billion brl	/
Production	323 Mtoe	500 Mtoe	164 Mtoe	102 Mtoe
Export + /Import -	+ 205 Mtoe	+ 330 Mtoe	- 518 Mtoe	- 632 Mtoe
Trade EU/Russia	+ 126 Mtoe	:	- 126 Mtoe	:
	or 60 %		or 25 %	
Gas Reserves	47 trillions m3	/	3 trillions m3	/
Production	490 Mtoe	600 Mtoe	197 Mtoe	147 Mtoe
Export + / Import	+ 175 Mtoe	+ 216 Mtoe	- 186 Mtoe	- 450 Mtoe
Trade EU/Russia	+ 90 Mtoe		- 90 Mtoe	:
	or 36 %		Or 50 %	
Carbon Reserves	157 billion ton	/	100 billion ton	/
Production	116 Mtoe	190 Mtoe	203 Mtoe	124 Mtoe
Export + / Import	+ 12 Mtoe	+ 23 Mtoe	- 91 Mtoe	- 128 Mtoe
Trade EU/Russia	+ 4 Mtoe	:	- 4 Mtoe	:
	or 33 %		or 5 %	
Uranium Reserves	158 000 ton	/	15 000 ton	/
Production	2 500 ton	5 000 ton	711 ton	0
Export + / Import	+16 000 ton	-	-15.800 ton	-
Trade EU 15/Russia	4.200 ton	-	- 4.200 ton	-