

EaP CSF Position Paper: Energy

Prepared for: Platform 3 meeting on connectivity, energy efficiency, environment and climate change

Prepared by: Ana Otilia Nutu, Expert Forum, EaP CSF WG3 Coordinator

Contributions from: Ruslan Surugiu, Denis Cenusă, Murman Margvelashvili, Sergiu Tofilat, Anton Antonenko, Giorgi Mukhigulishvili, Elchin Sultanov

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Executive Summary

- Speeding up interconnections, with EU financial, technical and institutional support, is critical to enhance energy security in the EaP.
- In countries with the AA/DCFTA (Georgia, Moldova, Ukraine), the consistent application of the EU rules is the most effective instrument to solve the main energy issues.
- Understanding energy challenges in the EaP region is essential not only to support the EaP, but also to learn valuable lessons for the EU and for the future of the Energy Union.
- The EU can support improvements in the governance in the energy sector in the EaP countries, through conditionality for financial support (general budget support or grants for investments); and through technical assistance, e.g. in the EU4Energy framework.

Introduction

The EaP CSF is a strong supporter of EU's priorities on the energy sector in the Eastern Partnership countries. We see our role in several ways. First, we seek to build a local buy-in from our societies for the implementation of the EU policies in the region. Second, we share information with the EU counterparts about the actual implementation of our countries' commitments towards the EU on the ground, beyond legal transposition or formal compliance with the conditionality for financial support. Third, we also share with the EU counterparts the lessons learned in our region, e.g., the Russian use of the energy sector as a political weapon, are critical to inform the EU's understanding of the real challenges for energy security and abuse of monopoly power affecting the new EU Member States (Poland, Latvia, Lithuania, Estonia, Bulgaria etc.) and threatening the prospects of the Energy Union.

Arguments

In our view, the points below are the top priorities for energy in the EaP.

1. **Speeding up interconnections, with the EU financial, technical and institutional support, is critical to enhance energy security in the EaP.** Funding for interconnections, such as grants or loans from EIB or EBRD must be conditioned on governance reforms and consistent policies, as well as on full, effective implementation of the Energy Union principles, both in the EaP countries with the AA/DCFTA, but also inside the EU itself, without derogations. The finalisation of interconnectors and their actual operation require broader reforms in the energy sector, such

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as the full implementation of the Third Energy Package, a level playing field for new market entrants; conditioned additional financial support; strong methodology and criteria for project prioritisation, which are developed in the EU4Energy framework; and the full implementation of the Energy Union. It must be noted that the implementation of the EU values in the EaP countries requires zero tolerance for exemptions from the EU rules inside the Union. For example, the controversies surrounding the North Stream 2 project or OPAL pipeline, involving substantial derogations from the Energy Union principles inside the EU itself, send a disastrous signal to decision-makers in our region and weaken our voice as civil society. It is difficult to defend that, for instance, Moldova, must implement the unbundling of the gas transmission network by 2020, though it is critical for the country's energy security, if the EU Member States give the contrary example, deepening their dependence on a single source of gas and undermining the EU's common energy policy.

The EU could also help the region by supporting regional approaches for the most contentious issues of energy policy. For example: Moldova and Ukraine have diverging interests concerning the construction and operation of the hydro power plants on the Dniester river, which affects the environment, threatens the supply of water for 80 per cent of Moldova's consumers and does not increase Moldova's energy security. Also, the uncertainties on Ukraine's time of joining the European electricity system ENTSOE affect Moldova's enthusiasm to connect (asynchronously) with Romania. The EU can facilitate dialogue and condition financial support to both countries on reaching an agreement on these issues that would meet both countries' needs and the EU energy and environment *acquis*.

- 2. In countries with the AA/DCFTA (Georgia, Moldova, Ukraine), the consistent application of the EU rules is the most effective EU instrument to solve energy issues**, such as the diversification of supply, energy efficiency improvements in industry and households, and improving the environment to attract investments in new technologies (e.g. renewables) as well as foreign suppliers to domestic markets, once interconnectors are built and operational. We strongly advocate at the level of national and local governments, as well as the EU level for the application of these rules in our countries and seek to raise awareness to facilitate the adoption of difficult reforms.

These EU rules include the Third Energy Package, with its requirements for regulatory governance and unbundling; and the EU competition policy with the requirements for competitive procurement and elimination of state aid. While all three AA countries, also members of the Energy Community, are on the right track for the legal transposition of the Energy *acquis*, a lot remains to be done. For example, Moldova's energy regulator, despite recent reforms, is not fully independent and accountable, as can be observed from its recent decisions on tariffs¹. Ukraine and Georgia are in the process of overhauling their electricity and gas models from single-buyer models to bring them in line with the EU's competitive model. The Georgian energy regulator lacks essential functions for market opening and development, which remain with the Government (Energy Ministry)².

Probably the most important barrier for energy efficiency in the region is the low price for energy, not only for households, but also for industry. Liberalisation of energy prices and markets would put significant challenges for affordability and a social safety net must be carefully put in place to avoid a rapid escalation of energy poverty. However, regulated prices

¹ <https://www.europalibera.org/a/interviu-sergiu-tofilat-valentina-ursu/29014094.html>

² <https://expertforum.ro/en/national-energy-regulators-a-comparative-assessment/>

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and tariffs are applied in the region as political measure, as previously in the new EU member states, to justify the delays of energy market reforms, while benefiting more the large industrial consumers, such as oligarchs in the fertilizer industry, metal industries etc. In the absence of market-based energy prices, these have little incentives to improve their energy efficiency³. We are advocating for liberalisation of energy markets in our countries with introduction of social safety nets and effective consumer protection.

There is also a significant potential for renewables in the region. Investments in renewables can be stimulated not through state aid schemes, but primarily through solving the general governance issues in the energy markets, liberalising energy prices and ensuring a level playing field with incumbents, by independent and competent regulators.

Thus, the best potential for the wind power is in the Caucasus region with strongest winds – Absheron peninsula and adjacent areas. The location of this peninsula provides not only direct wind from the North (Russian Plain, West Siberia, West Kazakhstan), but also cross wind from the North-Eastern slopes of the Greater Caucasus, that double the power and number of wind days (up to 200). Currently, less than 0.1 per cent of the potential is used. The shallow waters of the Caspian Sea with a lot of old oil platforms also provide very good conditions for offshore wind farms. The Black Sea coast in Georgia and some high mountain regions in all the South Caucasus countries could have significant potential as well. Solar panels are particularly suitable for the in regions with dry and sunny climate (the plains of Azerbaijan, mountains of Armenia, Nakhchivan Autonomous Republic, Mountain and Karabakh Plain). Ukraine and Moldova are in the process of developing their energy markets in general and the support schemes that would attract renewables.

- 3. Understanding energy challenges in the EaP region is essential not only to support the EaP, but to learn valuable lessons for the EU and for the future of the Energy Union.** The EaP is the learning ground for the EU to understand Russia's "political weaponising" of energy, which is valid also, at a lesser scale, for the EU's new Member States⁴. In the EaP, as we expressed in our joint Civil Society Declaration in 2017, Russia "exercises political and economic control through energy production and supply chains, abuse of dominant market positions, and control over critical energy assets and infrastructure through questionable deals and corrupt cross-border networks. It seeks to influence decision-makers to oppose or delay the implementation of EU supported policies, such as the Third Energy Package. Russia encourages extortion and unpaid use of energy resources by separatist regions, creating artificial debts, which are then later turned into a powerful political instrument to pressure companies or the whole countries"⁵.

Example: Moldova currently owes over 90 per cent of its GDP to Gazprom according to the historically accumulated gas debts. Most of the debt is generated by the Transnistria's industry, owned by Russian companies and subsidised by Gazprom by allowing these companies to default for their gas consumption. About a third of Transnistria's budget consists of non-payments to Gazprom. However, because of how the gas is contracted and delivered, Gazprom, which controls 50 per cent of the gas transport in Moldova, could always push Moldova's government to delay the gas sector unbundling with a threat to cut supplies. It was even able to demand from Moldova's government to repay the full overdue amount or else execute the debt

³ <https://expertforum.ro/en/energy-russian-influence-and-democratic-backsliding-in-central-and-eastern-europe/>

⁴ <http://dixigroup.org/eng/publications/russian-fairy-tales/>

⁵ http://eap-csf.eu/wp-content/uploads/Civil-Society-Declaration_EN-2.pdf

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by gaining control over other energy assets. That is why we also support as civil society the acceleration of the interconnection with Romania and advocate Transgaz to speed up both the investments on Romania's territory and the construction of Ungheni-Chisinau pipeline as soon as possible. With Transgaz as owner of the Moldovan pipeline, it would be more difficult for Gazprom to take over the pipeline by executing the historical gas debts than if the Moldovan government remained the owner. We also believe that the EU grant originally intended for the Moldovan government to finance a share of the pipeline cost should be viewed as a grant for energy security, regardless of who builds the pipeline, and should be made available, conditioned on energy sector reforms (particularly, strong regulator, unbundling, third party access and proper tariff methodologies). We also advocate locally with our governments to strengthen regulators and to reform the market to allow the entry of alternative supplies from Romania. For the actual construction of the pipeline, information should be made publicly transparent for the civil society on the construction timeline, so that we can react timely if the project goes off-track.

In Georgia, a major energy security concern is related to Enguri hydro power plant (HPP), which provides about 40 per cent of country's electricity needs. The location of the powerhouse and the switchyard of Enguri HPP is in Abkhazia occupied by Russia, while the dam and reservoir are on the territory controlled by the Georgian state. The plant is operated and maintained by Georgian engineers, but over 40 per cent of output is consumed on the Abkhazian side without any payment and participation in capital repairs or operation costs.

Similar twisted situations, which de facto allow Russian companies such as Gazprom, Rosatom, Inter RAO and others to exercise various forms of control, can be observed in the other EaP countries⁶.

Given the behaviour of the Russian companies in the EaP, companies such as Gazprom or Rosatom should be closely monitored also in the EU Member States, to avoid attempts at market foreclosure, opaque deals, de facto control over infrastructure. Attempts at breaking the EU rules inside the EU should be penalised promptly and consistently. For the EaP, it would be essential to create regional early warning systems, with the support of civil society, to rapidly identify the risks of the Russia-led energy corridors, such as North Stream 2 and Turkish Stream. For example, if Gazprom would indeed bypass Ukraine completely for the gas transit, this would not only cause a drop of 2.5 billion USD or 3 per cent of the Ukraine's GDP, but could leave Moldova without any source of gas. Understanding the implications and pressuring national governments to accelerate critical energy security projects is essential.

- 4. The EU can support enhanced governance in the energy sector in the EaP countries, through conditionality for financial assistance (general budget support or grants for investments); and through technical assistance, e.g. in the EU4Energy framework.** It is critical that energy strategies and action plans should be realistic and feasible, with sustainable projects, accurate analysis of environmental, social, economic and security impacts. The preparation, approval and implementation of energy strategies in the region should include cross-sectoral cooperation, proactive approach, more effective planning and shorter time span between planning and implementation. Transparency is crucial. There must be more emphasis on developing robust country energy strategies harmonised with their strategic environmental assessments and climate action plans, and on the cooperation and coordination between countries on these issues. Moreover, stronger transparency and consultations with

⁶ <https://expertforum.ro/en/energy-russian-influence-and-democratic-backsliding-in-central-and-eastern-europe/>

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stakeholders, their effective involvement are equally important. Countries should be supported to develop their Sustainable Development Strategies and action plans in compliance with the Paris agreement and other international obligations. Governance reforms are needed for the energy regulators, to ensure their independence and quality of regulations, particularly in tariffs; and for the state-owned companies in the energy sector, to ensure full commercialisation and elimination of soft budget constraints. These are essential to ensure a level playing field with new market entrants, such as investors in renewables or suppliers of gas and electricity from the EU and neighbouring countries, once the interconnectors (Southern Gas Corridor, Romania-Moldova gas and electricity, Georgia-Armenia back-to-back electricity interconnection etc.) are finalised. These cannot compete if state owned companies or incumbent actors play by different rules, allowing arrears or subsidies. We are actively advocating for transparency of state owned companies, corporate governance reforms, and independence of the regulators, with the leadership selected transparently and on merit.

Conclusions:

The top issues to be observed by the EU institutions in 2018 and 2019 to facilitate the energy priorities for the EaP are as follows:

- Support (institutional and financial) for regional dialogue among countries whose energy markets will be interconnected. For example, support for Moldova-Ukraine dialogue, with involvement of civil society, to reach an agreement on Dniester HPP and on the issue of timing of Ukraine's joining ENTSOE, so that the electricity interconnection of Moldova and Romania can be pushed forward
- Support for Transgaz (institutional, previous grant for Ungheni-Chisinau) to finalise the gas interconnection Romania-Moldova on both sides
- Support civil society with information for the regional early warning mechanisms on Russian-driven pipelines (North Stream 2, Turkish Stream) and their effects on the EaP's energy security
- Full implementation of the EU rules both in the EU and AA/DCFTA countries without derogation and with understanding the real implications and behaviour of the Russian companies
- Conditioning of support on actual implementation of energy reforms in the EaP countries

More Information

The Eastern Partnership Civil Society Forum (EaP CSF) is a unique multi-layered regional civil society platform aimed at promoting European integration, facilitating reforms and democratic transformations in the six Eastern Partnership countries - Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Serving as the civil society and people-to-people dimension of the Eastern Partnership, the EaP CSF strives to strengthen civil society in the region, boost pluralism in public discourse and policy making by promoting participatory democracy and fundamental freedoms.

For more information, please visit the EaP CSF website at www.eap-csf.eu