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CHANGER AND CHANGES ON THE EUROPEAN ENERGY MARKET AFTER THE UKRAINIAN CRISIS

*Dr. jur. Olena Kotenko,
LL.M*

ТРАНСФОРМАЦИЯ ЕВРОПЕЙСКОГО ЭНЕРГЕТИЧЕСКОГО РЫНКА ПОСЛЕ УКРАИНСКОГО КРИЗИСА

*Котенко Елена Николаевна
к.ю.н., магистр европейского права*

ТРАНСФОРМАЦІЯ ЄВРОПЕЙСЬКОГО ЕНЕРГЕТИЧНОГО РИНКУ ПІСЛЯ УКРАЇНСЬКОЇ КРИЗИ

*Котенко Олена Миколаївна
к.ю.н., магистр європейського права*

SUMMARY

The article is about changes that have taken place on the European energy market after the Ukrainian political and economic crisis. It shows that natural gas is symptomatic of the broader geopolitical issues and the transformational changes taking place on the European (and global) energy market after the current crisis. The article analyzes the problems of energy interdependence on the European energy market, and the possible ways to overcome them.

АННОТАЦІЯ

В статті досліджено зміни, що відбулися на європейському енергетичному ринку після українського політичного і економічного кризи. Показано, що природний газ є симптомом більш широких геополітичних проблем, що лежать в основі трансформаційних змін, які відбуваються на європейському (а також глобальному) енергетичному ринку після подій 2014 року. Проаналізовані проблеми енергетичної взаємозалежності Росії, України і ЄС і можливі шляхи їх подолання.

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Key words: Ukrainian crisis, European energy market, energy interdependence, transit of natural gas, liquefied natural gas.

Ключевые слова: украинский кризис, европейский энергетический рынок, энергетическая взаимозависимость, транзит природного газа, сжиженный природный газ.

Ключові слова: українська криза, європейський енергетичний ринок, енергетична взаємозалежність, транзит природного газу, скраплений природний газ

*What is tango?.. Dance, music, and lyric of course,
but also philosophy, strategy, even controversy,*

vulnerability and empathy...

Like the tango-moves of "give and take", so are the political dancers on the politically stage: pure passion and fight. Similarly it runs on the European Energy Market: all sides are simultaneously vulnerable and empowered, setting the stage for unique tangomoves between all political dancers.

As in tango, so in conflict and its transformation. Connections between the parties can be lost, rejected, or hard to establish. Trust can be broken. Cooperation may falter, empathy be blocked, and communication misunderstood or distorted. A relationship which is healing and creative can turn into a source of frustration, intolerance, judgment and negativity regarding oneself and the other. A conversation which begins so well can lose its way in response to a deliberate or unconscious shift in perceptions of the other.

The complex energy interdependence between Russia, Ukraine and the EU has become a major factor in European politics. But is it possible to dance tango with three partners at the same time?.. No, of course not! Ukraine looks much more like a dancer on the tightrope, walking very careful and fearing to fall on one of the sides.

And after performing for so long, all partners may tire of the other and try to break free from the tango, eying an available replacement partner across the dance floor to enter into a different type of dance with. How long will the EU, Russia and Ukraine dance the tango, can nobody say it exactly... Only time will tell us the answer...

Formulation of the problem. What role does energy play in the Ukrainian crisis? The Ukrainian crisis and Russia's annexation of Crimea is ultimately not about energy, but about power. Nevertheless it has a direct influence on the European (and also global) energy market: Energy is symptomatic of the broader geopolitical issues at the heart of this current crisis. Ukraine's status as an important transit country and a history of high profile and contentious contract negotiations, price disputes, failed payments and supply cut-offs has elevated the strategic importance of energy in the geopolitical context of the region. Several countries in the EU are also very dependent on Russian oil and gas supplies transited through Ukraine – e.g., Slovak Republic and Hungary.

But not to forget: The energy dependency is mutual. More than 90 % of Russian gas exports go to Europe, as does about 80 % of Russia's crude oil exports (revenues from oil and gas exports make up more than 50 % of the Russian budget). Former European Commissioner for energy said once that in energy sector, Russia needs Europe as much as Europe needs Russia. It is a simple but a very good description of the relationship in the energy sector in Europe.

Research Methodology. Methods of the research are primarily discourse-analytical, with particular focus on contemporary assessments of international policymaking on the US and European energy market. Additionally, research includes the theoretical-practical analysis of applications of the US decision to liberalize

the exports of its liquefied natural gas (LNG) reserves to Europe, and thus decreasing European dependence on Russian gas.

Further specialized research includes a combinative analysis of US and European diplomatic policies, procedures, and structural organization; differences in foreign energy policy creation and

modification; chief conflicts between political organization and diplomatic policy-making in the US and Europe regarding to the global energy market.

These information sources basically base on the data from Research Centers with specialization on the global energy policy (such as Oxford Institute for Energy Studies; Center for Strategic and International Studies, Washington), and the interviews with government officials and international organizations. The other sources include books, professors' advices, and other countries' experiment papers.

Analysis of recent researches and publications. Articles assessing the exports of LNG to Europe as tools for political processes are relatively sparse, encouraging the expansion of this topic in international discourse. Supplemental focus includes discussions on foreign energy policy in the US and EU, but also in Ukraine and Russia.

Research Objective. Western economic and energy experts have often claimed a mutual interdependence between the EU and Russia: the EU is dependent on Russian gas and other energy exports; Russia is dependent on the EU as its most important gas export market, European investments and technologies. But Russian experts have always called this an "asymmetric interdependency". This is because, while Russia can live at least one year without any European/Western investments and technologies, Europe cannot survive even 30 days without Russian gas. Is it really true?..

Whether it is right or wrong, appear to be questionable, because the Russian budget is primarily dependent on the energy sector. But the true is that Russia's energy strategy abroad has always aimed to maintain and deepen Europe's dependence on Russian energy supplies. This would help increase its economic and geopolitical influence, as well as decrease risks to its national security.

What exactly is the Russia's calculus? Russia's agenda behind the Ukrainian Crisis entails more than just the wish to annex Crimea: it can be seen as the return of the country's imperial policy. The aim for Russia is to become an "energy superpower" and play a key geopolitical role, by positioning itself as an essential supplier for major global energy markets, and by organizing competition between countries and regions to boost its importance.

Russia wishes to secure the future of European gas demand, while decreasing its own dependence on transit routes through Ukraine, Moldova and Belarus. The reduction in Russian gas delivery, and with it, the risk of temporary supply disruption to Europe, emphasizes the need to build Russian pipelines that bypass the transit

countries. However, the geography of Russia's existing pipeline export infrastructure, with its routes through the Ukraine, Belarus and Moldova to Europe, may not be changed easily.

On the other side Gazprom and the Russian government make no secret of their plans to diversify into exports to various countries in eastern Asia (China and India as major importer countries). Russia is undertaking its own "pivot to Asia" for political and economic reasons. The Putin administration is maybe tired of the Western leaders "lecturing" them about political freedoms and human rights. But this can only be a longterm strategy given the constraints affecting development of new gas fields and installation of the infrastructure required to serve new markets. For the strategy of expansion into Asian markets to be effective, several conditions need to be fulfilled. First, gas pipelines will need to be developed to cover very long distances from the fields in eastern Siberia and the far-east. Secondly, this strategy involves substantial, risk-prone financial commitments, given the considerable uncertainty still affecting the development of gas consumption in China. Thus, in any realistic scenario, the constraints associated with building the pipelines and developing the gas fields associated with the first major contract would push back the first deliveries to beyond 2025 or later.

What does these "pivot to Asia" mean to China's energy market? China and Russia have a strong economic complementarity: China's low-cost manufacturing and Russia's rich natural resource represent mutual assets that can benefit each side. The relationship between Russia and Ukraine has deteriorated in recent years; in contrast, China and Russia are getting closer. Russia should repair the damage done to its interests by the situation in Ukraine, and plug any gaps if foreign investment is withdrawn. Russia has a longterm need for foreign investment which might offer an opportunity for Chinese investors.

Also the structure of China's energy imports can be improved. China relies on importing energy sources from the Middle East, whose transport corridor is the Strait of Malacca – the current limiting factor on China's imports. If it were able to expand energy supplies from north-eastern and north-western channels, it would certainly make China more secure in terms of energy and the current situation impacts on this strategy. The US has begun to consider exporting its gas to Europe as a strategic response to Russian energy exports. This gives Russia leeway in terms of finding new markets for its energy exports. From the perspective of geo-economy and market capacity, China represents an ideal prospect for Russia.

How vulnerable is actually Europe? The

Ukrainian crisis has, for a third time in a decade, reminded Europe of its gas dependency on Russia at a time when Europe's energy demands are increasing.

The EU is trying to establish a strong dialogue with Russia to reach a common interest in this asymmetrical,

yet interdependent relationship. However a full year interruption is the least probable of all scenarios considered. For shorter periods of time Europe has large volumes of gas in storage in addition to alternative Russian routes that can partially compensate nondelivered gas through Ukraine. At the same time the discontinuation of the Ukrainian supply will have a lesser impact than previously due to partial gas transfer via the completed Nord Stream and a network of interconnectors in Central-Eastern Europe. Other fuel sources in Europe consist of local production in, e.g. the Netherlands and the North Sea (Great Britain and Germany).

Over and above that the EU is actively seeking to diversify the sources of its gas supplies in order to keep the share of Russian gas at a certain level in regard to domestic gas consumption. The EU has two alternatives to Russian gas in order to diversify and secure its deliveries. The first is LNG and the second is the Caspian, Middle Eastern and North African gas supplies that could be imported via new pipeline systems.

Thus, the essential question remains: is there a substitute for the Russian natural gas? Events in Ukraine could enhance other global energy trends, primarily affecting the US decision to liberalize the exports of its liquefied natural gas (LNG) reserves to Europe, and thus decreasing European dependence on Russian gas. EU's East European member countries are particularly keen to see these developments occur sooner rather than later.

Therefore LNG is expected to play a strategic role in securing and diversifying the gas supply. Today much more LNG can be imported as a short-term measure, as there are more LNG gas terminals with more new terminals opening in Poland and Lithuania in 2015 and other countries (i.e. Croatia) through 2020. The additional deliveries of LNG are expected to come from the Atlantic Basin or the Middle East (for example Qatar – the world's number-one provider of LNG – is well positioned to play a more influential role in Europe's energy landscape).

Also the Caspian and Middle Eastern countries have gigantic natural gas reserves and are the potential new gas suppliers for the EU. Iran – holder of the world's second-largest natural gas reserves – is the first candidate to sell its gas to Europe. A recent deal brokered by the US could see Tehran eventually re-emerge as a major global supplier at a time when markets are concerned about the reliability of Russia in the wake of the Ukraine crisis. In other words, any energy supply interruption from Russia due to US and EU sanctions could have the unintended effect of undermining the regime of global sanctions against Iran.

The other gas import options are focused on possible pipelines from Azerbaijan, Turkmenistan, Kazakhstan and Uzbekistan in the Caspian region and from Egypt, Syria and Iraq in the Middle-East. In this context the most significant issue is the secure transportation of Caspian and Middle Eastern gas to Europe. The EU aims at interconnecting its network with those of the other Caspian, Middle-Eastern and African gas producer

countries. The EU looks to Turkey to play a key role in a route that has access to the Caspian, Middle Eastern, other Southern and Eastern resources, through which gas could be carried to the West. Turkey may play a very strategic role for the EU's diversification of gas supplies with new gas pipelines transporting gas from the Caspian and Middle East to Europe.

How about coal or nukes? Another option could be to switch from Russian gas to coal or nukes – but obviously this is not great in terms of preventing catastrophic climate change. Currently, 44 % of European reactors are older than 30 years and need to be taken out of operation, since extending their lifetime represents a safety risk and increases costs. And there is another, more fundamental, problem. Russia also exports coal and nukes to Europe (about 27 % of the EU demand).

Can the United States use energy to put pressure on Russia, support Ukraine, or reduce European vulnerability? It would be significant interesting to use the abundance of US natural gas as leverage against Russia, in support of Ukraine, and to reduce European vulnerability. But in the short term the United States has no ability to supply gas to Europe since it does not have any export facilities. The other option some have suggested is to speed up the trade pact between the European Union and the United States (Transatlantic Trade and Investment Partnership, TTIP). For the same reasons that simply calling for LNG exports to Europe is not a solution, expediting TTIP, even if possible, is not a solution.

The only way to extract Ukraine from the immediate payments crisis is to provide money for Ukraine to pay down its debts. However, that does not address the fundamental problems that resulted in Naftogaz indebtedness in the first place: massive corruption, opaque markets, and poor pricing. In the longer-term, the United States could ease Ukrainian and European vulnerability by encouraging reform in the Ukrainian gas sector.

Others have suggested exporting US oil to indirectly hurt Russia by lowering global prices and therefore hurting Russian government revenues. However, the United States government has virtually no control over global oil prices, and attempting to flood the market with US oil would be unlikely to significantly change oil prices or impact Russian government revenue. Another option, a coordinated stock draw among International Energy Agency member countries, may have more impact but there has been very little public discussion of such measures to date.

The best way to put pressure on Russia in the long term and reduce European vulnerability is by encouraging significant structural reforms in Ukraine that result in a vibrant, transparent, and market-oriented energy sector. Pricing reform is a key element of these structural reforms and would encourage domestic production and result in efficiency gains that could boost the Ukrainian economy. Reform – including pricing reform – will require persistence over a number of years,

sustained engagement, a significant infusion of resources (more than a billion dollars), and substantial technical assistance. Nonetheless, the only way to truly lessen dependence in Ukraine – and by extension, Europe – requires a coherent plan that cannot be achieved overnight. Now is a difficult but opportune time to act.

Conclusions. The natural gas issue is the determining factor fostering Russian–EU interdependence, and a predominant concern in their developing relations. On the one hand, the Russians wish to secure the future of European gas demand, while decreasing its own dependence on transit routes through Ukraine and other transit countries. On the other hand, the Europeans seek to improve the security and diversification of their supplies, thereby decreasing their level of vulnerability and dependence on Russian gas.

However, while the EU is not afraid of interdependence, Russia does not tolerate the idea that it itself would be dependent on anyone else in any way. Moreover, Russia prefers a state of affairs where others are dependent on Russia while Russia remains free of any dependencies. As can be inferred from Russia's current predicament, the country has fallen victim to its own policy: multiple threats now face the Gazprom's business model in Europe. Many have been emerging over the past few years, but a combination of warm weather in the 2015 winter, the potential impact of the COP21 discussions in Paris in December 2015, the imminent export of LNG from the US, the continuing expansion of Australian LNG exports, the cheap price of coal, the continued rise of renewable energy in the power sector and the ongoing antipathy towards Russian gas in Europe mean that 2016 could mark a turning point for Gazprom.

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