

## The EU gas market and policy and the war in Ukraine

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Neither the ongoing war in Ukraine nor the rising tensions between Russia and the West and the sanctions imposed by the latter have yet translated into disruptions of Russian gas supplies to the EU. However, they are unequivocally deepening the crisis on the EU gas market, which has been evident for more than six months now. This is evidenced by the record high and volatile commodity prices, as well as the nervousness of all the market players who anticipate disruptions in supplies from Russia and react with panic to suggestions of imposing sanctions aimed at Russian gas exports. The aggression against Ukraine has triggered a significant restructuring of the gas policy of the EU as a whole and most of its individual member states. There is a return to thinking in terms of security of supply – which has largely been absent in recent years – and a determination to become independent of gas and other hydrocarbons from Russia. Although at present many EU countries are not prepared to embargo imports of Russian gas, most are reforming their energy policies in such a way as to minimise their dependence on Russian raw materials.

On 8 March, the European Commission presented the *REPowerEU* plan, in which it proposes a series of measures aimed at increasing the EU's resilience in the short term – mandatory gas storage is to be a key element – and at phasing out gas imports from Russia. The EC plans to reduce Russian gas imports by two-thirds (i.e. by 100 bcm) by the end of 2022, and to abandon them completely before 2030 (perhaps even by 2027). Apart from diversifying sources, by means including a surge in LNG imports, the EU's *Fit for 55* package is to be the key instrument to achieve this goal.

The Commission's plan is ambitious, but there are a number of questions about its feasibility. In addition, it is still unclear how it would specifically be implemented. The Commission's proposals were the starting point for a discussion on the EU's dependence on Russian hydrocarbons which took place during the informal European Council in Versailles (10–11 March). However, this is only the beginning of the road to working out a new EU policy on immediate actions, its attitude to Russian gas, and the future role of this fuel in general. Part of the proposals for implementing *REPowerEU* are to be presented by the Commission in the coming weeks and months. The final shape of the EU's policy will depend on how the situation in Ukraine and the EU's relations with Russia develop. It will also – especially in the context of the growing economic crisis – depend on how feasible the proposed actions are, and whether it will be possible to reconcile the member states' various interests, including how ready they will be to bear the costs of the proposed changes.



## The war and the EU gas market

So far the war in Ukraine has not disrupted Russian gas exports to the EU, and there has even been an increase in shipments since the war began. Transit of gas through Ukraine's main lines has risen since 24 February, and remains at around 109 mcm/d, the level of capacity contracted by Gazprom in the transit agreement for 2019–24. Irregular transmission via the Yamal pipeline towards Germany has also resumed. This is largely connected to European companies' concerns about further increases in gas prices and, even more strongly, about possible disruptions or even a halt to supplies. Consequently, everything points to the fact that EU companies are nominating and importing larger quantities of gas, and some of them (from the very beginning of the war, in Poland and Latvia) have also started pumping it into storage facilities.

The war and sanctions against Russia have also translated into large increases and substantial volatility in energy commodity prices. On 7 March, natural gas price on the

TTF hub rose by 75% within a day and temporarily (at 10 am) reached an unprecedented price of €345/MWh (equivalent to approximately US\$3675 per 1000 m<sup>3</sup>); however, after an hour it fell back to €255. The drastic price increases and fluctuations, which are not justified by the market situation, reflect the unprecedented nervousness in the markets, and are linked to the lack of clear prospects for recovery, as well as growing pressure to sanction Russian oil and gas exports. The current increases are not fully reflected in the prices EU consumers are paying to Gazprom. Typically, under long-term contracts they are indexed to the average prices of the previous month. In February the average prices for March were €83/MWh.

” **The increase in Russian gas shipments to the EU since the outbreak of war is related to importers' fears that exports from Russia could be disrupted or halted, and that prices may increase further.**

## Risks for the EU

The EU remains heavily dependent on gas from Russia. According to the International Energy Agency (IEA), in 2021 Russian resources accounted for around 45% of all the EU's imports and almost 40% of its consumption. Meanwhile, in connection with the ongoing crisis in the gas market over recent months, the EU's gas storage sites have only been filled to very low levels. Alternative gas supplies on the global market are also limited in their availability in the short term. Consequently, the escalation of tensions between Moscow and the West poses a serious risk to the stability of the European gas market. With each day of war, the prospect of gas supplies from Russia to the EU being disrupted or interrupted becomes increasingly real.

On the one hand, there is the risk of Russia taking action against stability of supply. It cannot be ruled out that Russia will suspend all or part of its gas exports to the EU as a retaliatory measure against the sanctions imposed by Western countries. Threats of this kind were formulated on 7 March by the Deputy Prime Minister of the Russian Federation, Aleksandr Novak, who suggested that Russia had the right to stop gas flows via Nord Stream 1 in response to the blocking of Nord Stream 2. Although Moscow derives important revenues from exporting its gas to the EU, which are becoming increasingly important during the sanctions regime, it is also apparent that in wartime such economic calculations may take a back seat. Intentional or accidental damage during hostilities to parts of the transit infrastructure on Ukrainian territory, which would affect supplies to the EU, is also likely. Novak also made similar suggestions about possible acts of provocation against Ukrainian gas transmission pipelines.

On the other hand, extending Western sanctions and placing an embargo on Russian oil and gas exports are being discussed. In view of the ongoing aggression against Ukraine, public opposition

to unhindered or even increased gas imports from Russia, worth several hundred million euros a day, is growing. Although there is still no clear-cut solution (a minority of EU countries unambiguously support the introduction of an embargo on imports of Russian hydrocarbons, while a number of them, including Germany, are against it), cannot be completely ruled out that EU countries will suspend or significantly reduce their gas imports from Russia. It is also apparent that certain countries or entities active on the EU market are taking individual actions, and are themselves reducing their purchases of Russian fuels. Regarding natural-gas LNG, trade with Russia seems to be suffering in particular, thanks to spontaneous, sometimes bottom-up activities. Some European terminals have been refusing to accept deliveries of Russian liquefied gas: for example, on 8 March, employees of the Grain LNG terminal on the Isle of Grain in the UK refused to unload two Russian LNG carriers. Similar situations have also allegedly occurred in French and Dutch ports. On 3 March Lithuania announced it was suspending imports of Russian LNG through the Klaipeda LNG terminal.

Record-high natural gas prices are also posing a growing challenge. A series of drastic price increases in the EU have come after six months of already painfully high gas prices,

**” The EC’s ambitious plan to reduce dependence on Russian gas should be achieved by diversifying sources and an accelerated shift away from fossil fuels.**

which translated into increased electricity tariffs on the continent, and led to member states taking a number of measures to relieve the households and businesses suffering most from the price increases. Finally, in view of the multi-level economic and social challenges associated with the ongoing war and sanctions, it may be a serious problem for the EU to get all its member states to maintain a consistent line towards Russian gas trade in the longer term.

## The EU wants to phase out Russian gas

The Russian aggression against Ukraine has fundamentally changed the EU’s perception of its dependence on imports of Russian hydrocarbons, especially gas. The EU and the overwhelming majority of its member states, even including Germany (for more details, see *Niemcy: przygotowania do braku dostaw surowców z Rosji*), see the situation as not only an economic problem, but also a challenge to their own security. Consequently, asserting independence from imports of Russian raw materials and minimising the negative effects of the war and the growing crisis on energy markets have become priority objectives of the EU’s energy policy. Intense discussions are currently taking place in Europe on how to achieve this: this is the subject not only of the work of the European Commission and member states, but also of the meetings of heads of state at Versailles on 10–11 March and discussions in the European Parliament.

In the *REPowerEU* communiqué presented on 8 March, the EC calls for a complete phasing out of the Union’s dependence on Russian gas imports. In the immediate or short-term future, it wants to increase the EU’s resilience to the deepening crisis in the gas & energy market and any possible supply shocks. It envisages two types of action to achieve these ends. The first involves offering further support for EU consumers and economies by helping member states to mitigate using the ‘toolbox’ which the EC presented in October 2021. In addition, the Commission suggests a temporary windfall tax on energy companies’ profits, introducing limits on gas and electricity prices, and revising the current model of the EU’s electricity market. The second, intended to be a key instrument to allow the EU to prepare for the winter of 2022/3, concerns the optimal use of EU storage facilities. The Commission is expected to present a concrete legislative proposal on this subject before the end of March. It is currently calling for a requirement to fill storage sites up to at least 90% by 1 October 2022, and to offer incentives to companies to do so. The European Commission has declared its readiness to coordinate the filling-up of storage facilities, for example through joint purchases of gas. In addition,

the principles of access to storage sites are to be developed, which is particularly important for countries that do not have such infrastructure. Gas storage sites are also to be recognised as critical infrastructure, and their operators/owners (especially those from third countries) will have to undergo certification and assessment in terms of potential risk to security of supply.

At the same time, the EC wants to implement the *REPowerEU* plan, which states that the Union should reduce its dependence on gas im-

**” In the short term, it will be crucial for EU to prepare for the winter of 2022/3 by introducing mandatory gas storage obligations.**

ports from Russia by two-thirds (i.e. around 100 bcm) by the end of this year, and eliminate it completely before 2030. According to the version presented by the EC President in Versailles and supported by the French Presidency, the EU will work to eliminate its dependence on Russian hydrocarbons by 2027. This plan is based on two pillars. The first involves diversifying gas supplies to the EU. According to the Commission’s proposal, by the end of this year and every year thereafter, the EU would import an additional 50 bcm of LNG (from Qatar, the USA, Egypt and West Africa, among others) and some 10 bcm via pipelines (from Azerbaijan, Algeria and Norway). The EC also plans to increase the production of biomethane in the EU and to speed up the production and import of green hydrogen, although the effects of these moves will only become visible in a few years’ time. It may also be necessary to expand both the import infrastructure and the intra-EU interconnectors (including those between Portugal, Spain & France and Greece & Bulgaria), which should also be hydrogen-compatible.

The second pillar of EU measures is to reduce the Union’s dependence on hydrocarbons and speed up the implementation of some of *Fit for 55’s* goals, or even raise some of the package’s targets. According to the EC, the sharp rise in available photovoltaic and wind (onshore and offshore) capacities foreseen in *Fit for 55* could reduce the EU’s demand for natural gas by 170 bcm annually by 2030. The key here would be to speed up and simplify the process of approving/granting permits to individual projects (the EC is to publish the relevant recommendations in May 2022). The Commission also wants to accelerate the installation of heat pumps (every 10 million pumps should translate into a reduction in demand for gas by 12 bcm annually), better thermal insulation of buildings, and increased energy efficiency & energy savings. There are repeated calls for behaviour to change at the household level, turning down thermostats by at least one degree (according to IEA calculations, this alone would enable the EU to reduce gas consumption by 10 bcm per year). Finally, the EC also wants to accelerate the decarbonisation of industry.

Although the Commission does not refer to the role of coal and nuclear energy in the short to medium term in any way in *REPowerEU*, there have also been statements in EU discussions (for example, in the European Parliament) to the effect that, given the scale of the challenge, there should be no taboos in terms of any immediate moves which the member states might choose. During the press conference following the EU leaders’ summit in Versailles, the French President Emmanuel Macron spoke directly about the need for greater use of both renewable energy sources and nuclear energy. On 8 March, EC vice-president Frans Timmermans stated that the question of whether individual countries could extend the operating time of their nuclear power plants (apart from Germany, this could also apply to Belgium or the non-EU United Kingdom) would be left to the discretion of the individual capitals. Similarly, he did not rule out some countries increasing their coal use, provided they accelerate work in parallel on increasing their renewable energy capacity and energy efficiency levels to meet the EU’s 2030 climate targets. According to IEA estimates, a temporary switch from gas-based to coal-based power generation could reduce EU’s gas demand by around 22 bcm this year.

## Doubts about the EC's proposals

At the same time, the Commission's plan raises a number of questions. Among other things, it is unclear whether the planned reductions in the use of gas and in imports from Russia have taken account of the overall growing consumption of energy in the EU. There are also doubts as to whether the member states will actually be able to secure 60 bcm of non-Russian gas, including 50 bcm of LNG, on the global market before the end of this year, and if so, how much this will cost. Given the difficult market situation and the small amounts of uncontracted volumes available, EU customers will most likely have to outbid Asian consumers to attract more LNG. Moreover, European companies would probably also have to compete with each other. Additionally, redirecting larger volumes of LNG to the EU would raise the use of coal in other parts of the world, which would have an immediate impact on coal availability and prices (increases in coal prices are already visible on global markets), and in the longer term would be contrary to the EU's climate goals. Finally, it is unclear at present how the targets and measures proposed by the EC would be implemented at the level of individual member states and companies: what import reduction targets they would translate to, and how those would be implemented. In particular, it is unclear how this would relate to existing contracts for gas supplies from Russia. Questions also arise as to whether the targets the Commission has proposed for increasing renewable energy capacity or producing hydrogen are feasible within the timeframe envisaged, and also to what degree any short-term measures taken by member states and the Commission can protect European societies and economies from rising energy prices. According to the Commission's proposals, we may learn some of the answers in the spring. By the end of March, in addition to legislation on storage facilities, a task force to plan the storage refilling programme and coordinate the related actions would be set up; and emergency measures to limit the impact of gas prices on electricity costs would be developed. By mid-May, the EC plans to have developed a more detailed proposal to phase out dependence on Russian oil, gas and coal.

It is also difficult at present to pre-judge the shape of these proposals and the support for them from individual EU members. Independence from Russian hydrocarbons is

” **There are doubts about how feasible the EC's plan is, as alternative gas volumes are not readily available, and the costs of accelerated decarbonisation will be high.**

a fairly new issue in many countries, and the outcome of the associated discussions is still uncertain. It is primarily those countries that have been seeking diversification for many years – including Poland and the Baltic states (plus Finland and Denmark) – that are advocating an immediate halt to hydrocarbon imports, including gas, from Russia. Individual statements by EU politicians on the timetable and methods for moving away from Russian gas, such as that made by the Italian minister for ecological transition on 8 March, tend to be personal assessments of the situation, not yet reflected in the plans of the individual states' governments, which are still being worked out. Other countries, such as Germany – although ready in principle to change their current gas policy, reduce their dependence on Moscow and diversify their sources further – have not (at least for the time being) openly declared their intention to abandon imports of Russian gas completely.

## Challenges

The European Commission, like the majority of member states, currently rejects the possibility of imposing an embargo on gas imports from the Russian Federation, but its proposed plan and timetable for unequivocally breaking the EU's dependence on gas imported from there seem very ambitious – far more so than the concept presented by the IEA a week earlier. The agency assumed that in 2022 it would be possible to reduce imports from Russia by around a third (over 50 bcm) in a fairly straightforward manner.

In addition to the short-term measures related to the search for alternative sources, the centrepiece of the Commission's plan is to be the EU's climate policy and its move away from the use of hydrocarbons. Thus, security of supply is to be achieved on an EU scale in parallel with reducing emissions, and the crisis in which Europe finds itself may become an opportunity to accelerate decarbonisation. The main challenge in this regard is related to the controversy – which was already visible during the energy crisis in autumn 2021 – over the feasibility of elements of the EC's plans arising largely from the costs of faster and more widespread emission reductions. These costs will be even more difficult to bear as the deep economic crisis intensifies and EU gas & energy prices rise due to the war in Ukraine. This poses a serious challenge and may generate resistance, especially from those member states which are already opposed to some of the proposals included in the *Fit for 55* package, and are fearful of the costs of transition (including those related to the ETS reform and expansion); this includes the central and east European countries most directly affected by the consequences of Russian aggression. There are hopes that EU members will be open, at least in the short term, to using all available sources (including coal and nuclear) in the immediate future to minimise the effects of the energy crisis and their dependence on Russia; this has been suggested during the recent consultations, but was not written down in the EU's formal communiqué. It is all the more important to find common solutions to the current and long-term challenges because the success of the actions related to the war in Ukraine – concerning energy issues as well as all the other matters – depends largely on the unity and solidarity of the EU.