

Transit Protocol progress

Bilateral negotiations between Russia and the EU over Russia's accession to the WTO took place in Moscow in May. The energy agenda between the two parties was, as always, at the top of the list, writes Andrei Konoplyanik, deputy secretary-general, Energy Charter Secretariat

CO-OPERATION between Russia and the European Union (EU) continues to build, but nowhere is the need to co-ordinate policy more pressing than in the energy sector. Mutual dependence – Europe is Russia's main gas market, while Russia is Europe's main gas supplier and an important source of oil – is likely to result in a more rapid process of policy alignment than in other areas.

Over time, the EU's dependence on Russia is set to increase, with natural gas imports set to rise particularly fast. Russia – even with high prices for its energy exports – needs huge investment to maintain and develop effectively its energy resources. This investment will come mostly from international capital markets – either through Russian or international energy companies. But without a robust legal framework for energy transactions, this investment is unlikely to be forthcoming.

Compatible approaches

Policy alignment requires common rules, or at least compatible approaches to regulation. Based on the principles of transparency and non-discrimination, they must be oriented towards market solutions, and reflect the interests of the contracting parties and the state of development of their energy markets. This is the role performed by the Energy Charter Treaty (ECT), which has been signed by Russia, the EU and 25 other European and Asian countries.

The ECT is one of the few sets of common rules that bind the EU and Russia together and is the only piece of the EU's *acquis communautaire* – the laws governing the operation of the EU – to which Russia (which has yet to ratify the Treaty, although it applies ECT rules provisionally and participates actively in the Energy Charter process) and the countries of eastern Europe, the Caspian region and Central Asia (another group of prospective energy suppliers to Europe) subscribe.

Nonetheless, the ECT represents a foundation of essential common rules (or minimum-standard rules) necessary to build an integrated energy relationship between Russia and the EU within a broader geographical area – an emerging Eurasian energy market.

The multilateral approach of the Energy Charter rests on producer, transit and consumer countries agreeing common rules, based on the minimum-standard principle, for investment, trade and transit, energy efficiency and related environmental issues in

the energy sector. Each ECT member country can go further, compared with what ECT rules demand, in applying more liberal regulations to their domestic energy markets. That can be done, of course, when the state of market development in a country – including development of energy infrastructure – would allow, both technically and economically, the implementation of more liberal rules.

The Energy Charter also recognises that some energy-sector issues, particularly cross-border energy flows, cannot be regulated adequately through bilateral channels alone. The ECT is the most developed multilateral mechanism that can tackle this strategic question. The issue of energy transit is crucial for the future of European and, in broader terms, Eurasian energy markets. It will not be possible to develop the energy resources of Russia, the Caspian and Central Asia unless there are reliable and binding rules on the use of the existing or future pipeline networks.

A grey area

Important issues in the energy sector, including those related to transit, have been discussed for some time in the negotiations over Russian accession to the World Trade Organization (WTO). At May's Moscow Summit, bilateral discussions between the EU and Russia on Russia's accession were concluded, but energy-transit-related issues were not. It seems the EU is confident that the WTO's rules of transit (Article V of GATT Freedom of Transit) covers the grid-bound energy-transit issues, but Russia does not agree. The issue of energy transit remains a grey area in WTO talks.

However, Energy Charter member states – including the EU countries and Russia – have developed the Transit Protocol. This multilateral mechanism establishes, in detailed, legally binding form, the general principles of international energy transactions.

The Protocol would clarify, under international law, some key concepts that would facilitate energy transit. It would implement the WTO principle of freedom of transit. It would oblige network operators to hold negotiations in good faith on access to available capacity in the pipeline networks (defined as taking into consideration the realities of energy markets, when in some ECT states energy companies might be involved in production and at the same time own the transportation grids). The Protocol also specifies that the tariffs paid for transit should be non-discriminatory, cost-based and provide a reasonable rate of return.

The Protocol provides a realistic and balanced solution to transit issues and protects the legitimate interests of both the EU and of Russia (including those of Gazprom, the Russian gas monopoly), as well as those of the other Energy Charter member states. Russia and the EU can go no further on transit issues in WTO negotiations than the provisional agreement they have reached on the Energy Charter Transit Protocol, because the latter adequately reflects the state of development of the energy markets, both in the EU and in Russia, as well as in other ECT countries. The draft Transit Protocol is the basis for a sustainable compromise.

The outstanding issues that have prevented finalisation of negotiations can be clarified in bilateral consultations between Russia and the EU in the form of joint declarations or understandings. None is insurmountable. The Transit Protocol presents a unique situation where the legal demands of the EU adequately correspond to the valid economic interests of Russia and Gazprom.

Political commitment

The other Energy Charter member states have indicated their willingness to proceed with the Protocol, it would be appropriate for Russia and the EU to renew their political commitment to finalising these negotiations by the end of the year. Transit Protocol negotiations were suspended in December.

Finalisation of the Protocol would promote Russian ratification of the ECT. During parliamentary hearings in 2001, the Duma made its consideration of ECT ratification contingent on the finalisation of the Transit Protocol negotiations. So the government may have an opportunity to present the Protocol to the Duma as early as 2005 – if negotiations are concluded at the December 2004 Energy Charter Conference.

By reducing the risks associated with energy investment and cross-border energy flows, full implementation of the ECT and its protocols would enhance Russia's ability to compete successfully with other energy-producing states on international energy and capital markets. It would also represent a major step forward in securing a firm legal foundation for energy co-operation across Eurasia, promoting both Europe's security of supply and further integration of Russia into the world economic system. □

Draft text of Transit Protocol is available at www.encharter.org under Transit section