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Russian Energy Exports and the Conflict in Ukraine: What Options for Italy and the EU?

by Margherita Bianchi and Pier Paolo Raimondi

Putin's war on Ukraine has shaken the European Union to its core. Implications will be long lasting in numerous domains, but it is in the security and energy dimensions that concrete changes are already becoming evident as the EU fast tracks its strategy for energy diversification.

The Russian invasion has drastically changed the European energy paradigm, with the new political absolute being a fast reduction of Europe's overdependence on Russian gas. Diversifying energy supplies away from Russia is a means to tighten the economic noose around Putin, seeking to deprive the Kremlin of billions in energy revenue given that Russia continues to export oil, gas and coal to Europe at very high prices.

For decades, the EU-Russia energy relationship expanded despite previous crises and political tensions. Warnings from some member states about Moscow's use of energy flows to boost its political leverage have often been side-lined by a narrative which separates politics from business and in which energy was considered a means to build peaceful bridges to Russia. Clearly, the war has taken this turbulent relationship to the next level – the EU mindset has shifted, and it is difficult to think the EU will ever feel confident being so dependent on Russian gas, regardless of the course of the war.

Russia's dominant role in the European gas markets was the result of several factors (i.e., clear complementarity between hydrocarbon-rich Russia and the technology and capital-intensive market of the EU). Moreover, Russian gas imports have gained relevance due to a decline in EU domestic gas production. In the case of Italy, domestic gas output fell from 17 billion cubic metres (bcm) in 2000 to slightly below 4 bcm in 2020 compared to consumption needs that hovered

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between 70 and 80 bcm over the same period.[1]

Following the invasion, the EU adopted a series of tough financial sanctions against Russia, yet these have thus far excluded the energy domain. Compared to the US and UK – which have announced an end of energy imports from Russia – the EU is more hesitant due to its overreliance on Russia and fear of further price increases.

In 2021, Russia accounted for around 45 per cent of EU gas imports and almost 40 per cent of its total gas consumption. While the EU also imports around 25 per cent of its oil from Moscow, the bloc is particularly dependent on the gas front given that gas markets are more regionalised vis-à-vis oil markets. Partly for the same reason, as seen from Moscow, an EU oil ban could be absorbed by Russia by redirecting exports to Asia, but the same cannot be said with regards to gas due to the sheer volumes involved.

Yet, one must also consider that an EU ban on Russian oil could easily trigger a Russian retaliation on gas – the Kremlin has already warned it could cut supplies to Europe via the Nord Stream 1 pipeline directly linked to Germany. Nonetheless, pressure to adopt energy sanctions is mounting. Since the beginning of the war, Gazprom has continued to supply its EU buyers through the Ukrainian transit route. This means the EU pours (a lot of) money into the Kremlin's war coffers. According to some estimates, each day European states pay around 800 million euro to Russia for gas and oil imports.[2]

The European response is called "REpowerEU", a strategy aimed at reducing overdependence on Russia by diversifying gas supplies and reducing the use of fossil fuels, seeking to keep EU's green ambitions alive. Yet, such objectives will not be easy – especially in the short term.

The EU imported around 140 bcm of gas by pipeline from Russia and around 15 bcm of liquefied natural gas (LNG) for a total of 155 bcm in 2021.[3] Among those most dependent on Russian energy are Italy and Germany, which rely on Russia for 28.9 bcm[4] and 55 bcm[5] respectively. Through REpowerEU, the EU proposes to replace around 80 per cent of Russian gas by 2022, mainly through LNG (50 bcm), non-Russian pipelines (10 bcm), an acceleration in renewable energy sources (20 bcm) and energy savings in buildings (14 bcm). A gas-to-coal switching could potentially avoid other 30 bcm of Russian gas.[6] In

[1] BP, *Statistical Review of World Energy 2021*, July 2021, p. 36 and 38, https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html.

[2] Kira Taylor and Oliver Noyan, "Stop Financing Putin's War with Energy Imports, Ukrainian NGO Pleads", in *Euractiv*, 3 March 2022, https://www.euractiv.com/?p=1722363.

[3] International Energy Agency (IEA), *A 10-Point Plan to Reduce the European Union's Reliance on Russian Natural Gas*, 3 March 2022, https://www.iea.org/reports/a-10-point-plan-to-reduce-the-european-unions-reliance-on-russian-natural-gas.

[4] It corresponds to 40 per cent of its gas imports in 2021.

[5] It corresponds to 55 per cent of its gas imports in 2021.

[6] European Commission, *REPowerEU: Joint European Action for More Affordable, Secure*

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the longer term, the EU aims to phase out its dependence on fossil fuels from Russia by 2030.

Italy is one of the most exposed European countries to potential disruptions due to its reliance on the Ukrainian gas corridor and the relevant role of gas in the Italian energy mix. Today, 50 per cent of power generation is produced by gas power plants (compared to 37 per cent in 2000). Italy, therefore, like its EU allies, has been working to ensure adequate supply and new and immediate alternatives. This strategy consists of multilevel actions with different timeframes.

While highly exposed, Italy is also potentially better equipped than other member states because it has some alternatives in place, namely its direct infrastructural links with Algeria (TransMed), Libya (Greenstream pipeline) and Azerbaijan (the TAP pipeline) as well as three LNG regasification terminals.[7] Gas pipelines linked to Algeria and Libya are underutilised, currently supplying only 22.5 bcm and 3.2 bcm in 2021, respectively. A higher utilisation of this infrastructure could replace some Russian gas imports, with 11.5 bcm of spare capacity of imports from Algeria and a further 7.8 bcm from Libya.

There are important constraints to increasing supply from North Africa however. Algeria is struggling with growing domestic consumption and a lack of investments that could result in lower gas production, whereas Libya is still suffering from political and security instability which limits the full utilisation of its gas pipeline. TAP's capacity, meanwhile, could be doubled to reach 20 bcm/year by around 2027, but there are some doubts on Azerbaijan's ability to ramp up its production. Lastly, given high energy prices and the need to diversify routes and sources, Italy may end up having to consider other options, including those that would supply gas from the Leviathan Basin in the Eastern Mediterranean.

LNG is part of the EU's and Italy's plans, although the actual feasibility of diversified LNG supplies may be hindered by physical bottlenecks and high prices in the currently tight LNG market.[8] The US and EU have held several meetings with one of the top LNG exporters, Qatar.[9] The Gulf country has offered its political support in the midst of the current energy crisis, thereby gaining newfound political status in the West. Yet, additional LNG supply from Qatar seems difficult in the short-term because there is limited spare capacity and Qatar's LNG exports are already booked through long-term contracts. Nonetheless, the country is working to expand its LNG capacity

and Sustainable Energy (COM/2022/108), 8 March 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52022DC0108.

[7] LNG terminals: Panigaglia (3.5 bcm/year capacity), Adriatic LNG in Porto Levante (8 bcm/year) and OLT Offshore LNG offshore Livorno (3.75 bcm/year).

[8] Gabriele Foà, Antonio Focella and Silvia Merler, "Europe Unplugged: Can We Give Up Russian Gas?", in *The Green Leaf*, No. 2 (February 2022), https://www.algebris.com/?p=12235.

[9] Italian Ministry of Foreign Affairs and International Cooperation, *Diplomatic Mission by Minister Di Maio to Qatar (5-6 March 2022)*, 6 March 2022, https://www.esteri.it/en/?p=73726.

from today's 104 bcm to 171 bcm in 2027.

Should Italy invest in new regasification facilities, it would need to overcome bureaucratic obstacles that have historically prevented the development of other LNG terminals beyond its existing three facilities. Furthermore, Italy should work within European institutions to invest in new interconnector pipelines across the continent in order to boost internal flexibility to redistribute new LNG supplies as well as piped gas. Replacing Russian gas imports with LNG will require significant infrastructural investments and coordination both among European importing countries and other exporting countries.

Lastly, additional LNG supply would also expose the EU to competition with other gas regions, notably Asia, developing countries and emerging economies. Italy could try to ensure future supply through long-term contracts. Otherwise, the risk would entail high potential competition vis-à-vis other gas markets where coal-to-gas switching is needed to reduce CO_2 emissions.

The burden on consumers is real. Europe was already dealing with an energy supply crunch due to low gas inventories, and the conflict has increased commodity prices to record levels. Unprecedented gas prices will deeply affect low-income sectors, exacerbating energy poverty – a condition currently affecting 13 per cent of Italian households. Moreover, several industries will struggle to keep their operations running, such as iron and steel as well as glassmakers among others. The government has adopted several measures to shield Italian consumers and industries.[10]

To further reduce the burden, Italy may decide to partially expand the use of some of its coal power plants, which account for 4 per cent of power generation, even though the government planned to phase out coal by 2025 and Italy currently depends on Russian coal imports (55 per cent). Although turning to coal may contribute to compensate potential gas-power generation losses, it should be seen only as a temporary solution, preventing the potential risk of carbon lock-in.

On the positive side, Italy is in a better condition in terms of gas storage as Italian law prescribes mandatory refill. Italy's gas storage rate is slightly below 40 per cent, compared to a European average of 30 per cent. In this sense Italy has showed other EU countries that it is vital to develop gas storage in order to balance the seasonal gas demand.

This April, the Commission will make a legislative proposal on minimum gas storage, establishing a 90 per cent filling target by 1 October each year, designating gas storage as critical infrastructure and tackling the storage infrastructure ownership risks.[11] The issue here is high gas

[10] Laurence Boone and Assia Elgouacem, "At the Cross-Roads of a Low-Carbon Transition: What Can We Learn from the Current Energy Crisis?", in *ECOSCOPE Blog*, 21 October 2021, https://wp.me/p70nXr-1PX.

[11] European Commission, *Opening Remarks*

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prices which countries need to pay to fill their storages. Crucially, European countries should show solidarity and not compete with each other to fill their gas storages, otherwise the united European front would suffer politically and economically.

The decision of Russia to wage war to Ukraine will predictably redraw the Euro-Russian energy relations as well as the European energy landscape in the longer-term. As the 1973 oil crisis caused a reduction of oil market share in many countries, today's crisis may result in an acceleration of the energy transition in response of high prices and political risks. Increasing renewable energy sources could contribute to achieve multiple goals: decarbonising the economy, reducing vulnerabilities and enhancing strategic autonomy. Nonetheless, Europe and Italy will need time before reducing the relevance of gas imports even if a rapid renewable energy resources deployment would occur.

To conclude, it seems that European efforts to diversify from Russian gas will be less gradual than was originally thought. Today's crisis accelerates the urgency and need to reduce consumption of fossil fuels from Russia. This does not automatically mean that in the future Europe may completely cut energy ties with Russia, but at the moment there is clearly an acceleration in that direction. Secondly, a rapid disconnection will not come without problems or costs. Stronger EU solidarity needs to be in place, alongside effective diplomacy and an orderly plan to find alternatives in order to limit these costs.

Europe will also need more energy savings, and demand-side measures, even if politically challenging. For example, the International Energy Agency (IEA) has shown that turning thermostats down by 1°C could save 10 bcm of gas per year (to put that into context, this is equivalent to the current capacity of the TAP pipeline). Finally, today's crisis could yield a powerful boost to the clean energy transition as countries have reaffirmed their commitment to decarbonise. Hopefully, this crisis will lead to a stronger consensus across the political spectrum on climate policy as well. Conservatives and environmentalists cannot but agree that an orderly transition tackles both insecurity and climate change. Ultimately, investing in clean and efficient technological solutions is a security strategy as well.

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by Executive Vice-President Timmermans and Commissioner Simson at the Press Conference on the REPowerEU Communication, 8 March 2022, https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_22_1632.

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