



## CONTACT GROUP ON RUSSIA-WEST RELATIONS

### Climate, the Green Deal and Russia-EU relations<sup>1</sup>

17 September 2021

Our meeting aimed to 1) discuss the implications of the energy transition and the EU's Green Deal for Russia; 2) identify areas of mutual interest and potential joint activities between the EU and Russia on climate-related subjects; 3) debunk common misperceptions about the EU Green Deal (and the Carbon Border Adjustment Mechanism (CBAM) and other measures).

#### **Context**

Energy trade is one of the last major fields of EU-Russia cooperation. Russia's economy is highly dependent on hydrocarbon exports while the EU's market remains the main destination for Russian exports of oil, coal, gas and uranium.

In 2019, the European Commission presented the European Green Deal – a set of policy initiatives with the overarching objective of making the EU climate neutral by 2050. The European Climate Law of July 2021 made the EU's 2050 climate neutrality goal legally binding for all member states.

The European Green Deal has two main implications for Russia. First, European demand for Russian fossil fuels is set to decrease. This will initially affect coal, then oil, and finally gas imports after 2030. Second, the European Commission intends to introduce a CBAM – a so-called 'carbon tax' – by 2023. This is to ensure that greenhouse gas emissions reductions at home are not offset by carbon embedded in imports from countries such as Russia that do not put an equivalent price on carbon. The tax will affect imports of Russia's energy-intensive products, such as steel and fertilisers.

Until 2015, there was a dedicated EU-Russia Energy Dialogue and roadmaps for cooperation. In 2014, all dialogue was frozen. As yet, there is no dedicated Russia strategy within the Green Deal. Dialogue is needed for the two sides to work out actionable priorities that could be pitched to decision makers when the political environment becomes more favourable.

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<sup>1</sup> This was the Contact Group's 12<sup>th</sup> meeting. As usual, this summary note was prepared by the European Leadership Network secretariat and does not necessarily represent the views of any individual Contact Group member or any member of the European Leadership Network.

## **Incentives for Russia to decarbonise**

The Green Deal gives Russia an incentive to decarbonise its economy. Until now, Russia's green policies have mostly been declaratory. Formally, Russia participates in international climate efforts. It has ratified the U.N. Framework Convention on Climate Change, the Kyoto Protocol and the Paris Agreement. And during the Leaders' Summit on Climate this April, President Putin emphasised that Russia has halved its emissions compared to 1990 levels and is set to "substantially limit" net emissions by 2050. In practice, these targets are easy for Russia: Moscow could expand fossil fuel production while still meeting its international commitments. However, this July President Putin signed a law introducing mandatory carbon reporting for large greenhouse gas emitting companies starting from January 2023. This has been welcomed as a first step towards carbon regulation in Russia.<sup>2</sup>

Technology is another reason to decarbonise. Transition to green technologies today would prevent Russia facing a technology gap in the future. Finally, decarbonisation would give Moscow access to EU climate finance and improve Russia's international image as one of the biggest polluters.

## **Moving beyond myths and misperceptions**

### ***Myth 1: CBAM is a protectionist tool***

The EU carbon tax is a contentious topic, widely discussed not just in Russia but also in the U.S. and China. Some regard it as a protectionist tool that will hit EU trading partners hard. But as decarbonisation efforts grow, so does the price that European companies have to pay for each tonne of CO<sub>2</sub> emitted (the carbon price on the EU Emissions Trading System (ETS)). CBAM's primary objective is to mitigate the risk of 'carbon leakage'<sup>3</sup> and get EU industry and reluctant policymakers on board with more stringent industrial decarbonisation policies. Rather than a direct tool to reduce emissions, CBAM should instead be viewed as a tool to unlock the political potential to pursue more ambitious decarbonisation efforts. Although not a protectionist tool, one guest speaker clarified, CBAM can probably be used as a (geo)political one that gives the EU leverage over countries that are reluctant to decarbonise. Whether and to what extent this geopolitical tool will be applied depends on how the EU's trading partners react to CBAM and what their policies will be.

### ***Myth 2: CBAM is incompatible with WTO rules***

Last year, Russia's economic development minister Maxim Reshetnikov warned that the EU's carbon tax would contravene WTO rules.<sup>4</sup> According to one of our guest speakers, the current proposal is broadly aligned with WTO rules.<sup>5</sup> It includes a very narrow sectoral scope (targeting only energy and carbon intensive sectors), it has no waiver for less developed countries, nor any double protection of EU installations (by phasing in the CBAM in parallel with the phasing out of ETS free allowances). It does not include export rebates either. The only "open" issue is how CBAM revenues will be used:

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<sup>2</sup> "Russia's Putin signs law to curb greenhouse gas emissions," *Reuters*, 2 July 2021, <https://www.reuters.com/business/environment/russias-putin-signs-law-curb-greenhouse-gas-emissions-2021-07-02/>.

<sup>3</sup> Carbon leakage refers to a situation when polluting industries from one country simply relocate to places with weaker climate policies/lax environmental standards, and overall emissions stay much the same.

<sup>4</sup> "Russia warns EU against carbon border tax plan, citing WTO rules," *Climate Change News*, 28 July 2020, <https://www.climatechangenews.com/2020/07/28/russia-warns-eu-carbon-border-tax-plan-citing-wto-rules/>

<sup>5</sup> For more detail, see Adrien Assous et al., "A Storm in a Teacup," E3G, August 2021, <https://9tj4025o153byww26jdkao0x-wpengine.netdna-ssl.com/wp-content/uploads/E3G-Sandbag-CBAM-Paper-Eng.pdf/>.

they are not clearly earmarked for climate action in the current draft. Separately, given the weakening of the WTO, it is unclear what implications a theoretically incompatible CBAM design would have.

### ***Myth 3: CBAM targets will massively affect the Russian economy***

CBAM will affect five carbon-intensive sectors: cement, fertilizers, iron and steel, aluminium and electricity.<sup>6</sup> Exporters to the EU of such goods are a mix of large producing countries and smaller states neighbouring the EU (these goods are not transported over long distances). Although CBAM will inevitably affect Russia – a neighbouring country with developed logistics and supply chains to deliver goods to Europe – it is not targeted *at* Russia. Moreover, across six major EU trading partners,<sup>7</sup> the total net CBAM cost will barely reach €1.0bn in 2026 and €1.6bn in 2035.<sup>8</sup> So CBAM's geopolitical potential to feed into worsening EU-Russia relations is much higher than any actual economic damage. In fact, as our guest speaker concluded, the EU's decarbonisation efforts (i.e., the shift away from fossil fuels) will be more destabilising for the Russian economy than CBAM, given Russia's high levels of hydrocarbon exports. The expected decrease in EU demand for hydrocarbons necessitates restructuring of EU-Russia trade relations.

### ***Myth 4: China/Asia is an alternative market for Russian fossil fuels***

As the EU decarbonises and its market becomes less relevant, it is generally assumed that Russia could switch to Asian markets, especially China. But even though Russian exports to China increased between 2010-2020, they remain lower than exports to the EU. When it comes to natural gas, additional infrastructure investment would be needed to enable the reorientation of gas exports away from the EU. What is more, just like the EU, Asian countries are adopting more ambitious energy transition goals, with China aiming for carbon neutrality by 2060. Accordingly, Asia's demand for fossil fuels is set to decline in the medium to long term. One guest speaker nevertheless believed it was plausible that energy trade between Russia and China will increase in the coming decades.

## **Possible areas of EU-Russia cooperation**

According to our guest speakers, EU sanctions do not impact climate cooperation directly. Three examples were provided: the Italian company ENEL is building wind farms in the Murmansk, Stavropol and Azov regions; Germany's Siemens Energy has signed a strategic partnership and cooperation agreement with Russia-based natural gas producer Novatek on hydrogen and more sustainable LNG production; and Novatek and Germany's Uniper have signed a hydrogen MoU. The following areas of possible 'green' EU-Russia cooperation were identified during the meeting:

- Renewables
- (Green) Hydrogen production
- Energy efficiency
- Rare earths and minerals
- Methane
- Sustainable finance

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<sup>6</sup> Adrien Assous et al., "A Storm in a Teacup," E3G, August 2021, <https://9tj4025ol53byww26jdkao0x-wpengine.netdna-ssl.com/wp-content/uploads/E3G-Sandbag-CBAM-Paper-Eng.pdf>.

<sup>7</sup> U.S., Turkey, Russia, Ukraine, South Korea, and China.

<sup>8</sup> Adrien Assous et al., *Op. cit.*

- Carbon pricing
- Power trade and connectivity

Several obstacles continue to inhibit prospective cooperation. These include different regulations and taxonomy (i.e., defining what is 'green'), Russia's green policies being mostly declaratory for now, and broader political tensions in EU-Russia relations.

### **Discussion Summary:**

In our discussion, one member asked whether CBAM revenues might be reinvested into the economies of countries that pay them (namely Russia). It was suggested that Russia would be better off avoiding these revenues being collected in the first place by incentivising polluting industries to reduce emissions and directing the (tax) revenues into its own economy.

Russia's efforts to develop and implement carbon capture, utility and storage (CCUS) technologies have the potential to decarbonise hydrogen produced from natural gas and coal – also known as *blue hydrogen*. But so far, CCUS has proved too costly to be commercially viable. Moreover, the pilot projects have been unable to capture 100% of emissions, which raises the question whether producing blue hydrogen is a good use of electricity. Using existing gas pipelines to transport blue hydrogen is considered inefficient and additional energy would be required for its liquefaction. Given the global trend towards decarbonisation and falling renewable generation costs, it was suggested that it would be a safer bet for Russia to produce green hydrogen, from both an economic and a political point of view. However, Gazprom's business model and the government strategy differ in this regard.

Ukraine recently signed a partnership with the EU on raw materials. Germany has been in talks with Ukraine over investments in hydrogen infrastructure. So how competitive might this track be to EU-Russia green energy cooperation? According to our guest speakers, the potential for green cooperation is difficult to assess because Russia is not just a market for developing renewable energy, but also affects every important neighbour in security terms. In theory, there could be competition for EU funding, but it would not be advisable for the EU to foster it.

Discussion also addressed the growing trend for fuel theft, smuggling and fraud, as energy prices grow. An area that merits closer attention is cybersecurity of European power grids and the potential that malign actors may target and sabotage the energy sector in Europe. We lack a frank discussion about how such efforts might jeopardize decarbonisation efforts and how to tackle this effectively.

It was argued that Russia is both worried and cares about the economic implications of the EU's Green Deal. As evidenced by the shifting public discourse, Moscow also acknowledges that global warming presents a serious problem for the country.

We concluded that EU-Russia cooperation on decarbonisation could be stabilising. It would also give the Russian economy more stability and resilience. Cooperation on renewables was identified as the priority to be pursued to lessen mutual dependence on Russian gas. The UK was identified as a country that could push Europe-Russia climate dialogue forward. As the UK prepares to host COP26, there is space for open conversation about how both countries can cooperate on clean energy solutions.

## **Reading Suggestions**

Adrien Assous et al. ["A Storm in a Teacup: Impacts and Geopolitical Risks of the European Carbon Border Adjustment Mechanism,"](#) Sandbag and E3G, August 2021.

Marco Siddi, ["What does the European Green Deal mean for EU-Russia relations?"](#) The European Leadership Network (ELN), 6 October 2021.

Marco Siddi, ["The European Green Deal and Future Prospects for EU-Russia Energy Cooperation,"](#) Valdai Discussion Club, 17 March 2021.

Jussi Lassila & Marco Siddi, ["Russia Meets Climate Change: The Domestic Politicization of Environmental Issues and External Pressure to Decarbonize,"](#) *Briefing Paper*, Finnish Institute of International Affairs (FIIA), March 2021.

Tatiana Mitrova, ["Is Russia Finally Ready to Tackle Climate Change?"](#) *Carnegie Moscow Centre*, 27 July 2021.

Danila Bochkarev, ["Green Burden: How Global Climate Policies Could Impact Russia,"](#) *Russia Matters*, 4 August 2021.

Natalia Piskulova, ["The European Green Deal: Risks and Opportunities for the EU and Russia,"](#) *RIAC*, 21 April 2021.

Elena Alekseenkova, ["Can the 'Green' Dialogue Become a Driver for Restoring the Dialogue between Russia and the EU?"](#) *RIAC*, 28 July 2021.

Bobo LO, ["The Adaptation Game: Russia and Climate Change,"](#) *IFRI*, March 2021.

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