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# Russia: energy policies and carbon markets

Russia's importance for international energy and climate policies  
Prepared by WWF and Allianz



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## Russia: risks, responsibilities and opportunities in future carbon and energy markets

At the beginning of the 21st century, energy supply and energy security are among the most dominant themes in world politics. With fossil fuel incineration being the major source for releasing anthropogenic greenhouse gas (GHG) into the atmosphere, the issues of energy supply and climate change are inseparably linked. Energy policy and climate policy are actually two sides of the same coin and present a unique challenge for establishing the foundations for a sustainable future energy supply.

Due to its high volume of natural resources, Russia plays a fundamental role in the global energy market. At the same time, it has an important potential role in supplying the global carbon market with emission reduction certificates for Russian GHG reductions. Under the legislation to the Kyoto Protocol, known as the 'Kyoto Protocol Flexible Mechanisms', certificates can also be generated via domestic emission reduction projects. These need to follow the criteria established in the Flexible Mechanism known as Joint Implementation (JI), where every emission reduction project is eligible to receive credits (called Emission Reduction Units or 'ERUs'), which can be traded on the global carbon market.

With Russia's ratification of the Kyoto Protocol in late 2004, the most important global policy instrument at the interface between climate and energy policies entered into force in February 2005. Under the Kyoto Protocol, industrialised countries have committed to stabilising GHG emissions below 1990 levels by the years 2008-2012, on average a -5 per cent commitment in reductions. The Kyoto Protocol is breaking new ground with the establishment of a global carbon market that incorporates innovative market-based mechanisms<sup>1</sup> that can assign a concrete financial value to each tonne of GHG emission. This global carbon market will provide incentives for achieving a more sustainable and less resource-intensive energy supply on a global level.

For Russia, the Kyoto Protocol Flexible Mechanisms, International Emissions Trading (IET) and Joint Implementation (JI), seem to be promising opportunities for improving energy efficiency and utilisation of renewable energy sources. These Flexible Mechanisms are principally designed to optimise the cost-effectiveness of mitigating climate change and enabling the eligible parties to cut emissions where it is cheapest. This is an attractive provision because the net effect of mitigation in the atmosphere is the same no matter where it takes place.

International climate policies with the Kyoto Protocol at its core are inevitably linked with global energy policies – and both tackle the challenge of building sustainable energy supply systems for the future. Clearly, Russia is among the most important key players.

However, as the start to the Kyoto commitment period for 2008-2012 nears, so does the start of possible trading for the ERUs from JI projects. Many potential investors are concerned that the Russian government may be preparing too slowly to develop the domestic policies necessary to allow investors to participate confidently in the IET and JI flexible mechanisms. In order to receive a 'green light' from the United Nations for the start of carbon trading, the Russian government must build up the domestic infrastructure in such a way that emission projects can be accounted for and verified as GHG-friendly investment projects according to the Kyoto Protocol Flexible Mechanism. This process has been moving forward slowly due to long-lasting disputes between ministries and government agencies. For similar reasons, Russia still lacks a concrete long-term energy strategy that will enable it to participate in the international agreement on emission reduction after 2012, thus falling short of its environmental responsibility and diminishing investor confidence in the opportunities available for emissions reduction projects.

<sup>1</sup> Market-based mechanisms under the Kyoto Protocol are the following Flexible Mechanisms: International Emissions Trading (IET), Clean Development Mechanism (CDM) and the Joint Implementation (JI), which in turn create the tools, supplies and currencies for the global carbon markets.

## Russia is one of the largest players in building sustainable energy for the future

- **Large energy resources:** Currently the largest share of the European Union's (EU) oil and gas imports come from Russia.<sup>2</sup> Gas imports from Russia will further increase as natural gas is the least carbon intensive fossil fuel, making it increasingly important as a bridging fuel while the EU makes the transformation to a low-carbon economy.<sup>3</sup> Russia and the EU need to reach agreement on a joint long-term strategy for access to each others' markets if secure energy supplies are to be ensured.
- **Large greenhouse gas emitter:** Even after the breakdown of the former Soviet economy, in 2006 Russia was still the world's third largest GHG emitter in absolute terms.<sup>4</sup> Among Russia's total GHG emissions, energy and transport related carbon dioxide (CO<sub>2</sub>) emissions constitute the major share with 84 per cent (2004).<sup>5</sup> However, there is a vast potential for energy efficiency and GHG reductions in the fields of energy generation and industrial energy use. As Russia's gas reserves are projected to last only another half century,<sup>6</sup> a more efficient domestic use of energy resources is necessary to meet domestic demand and maintain gas exports in the longer term. The development of carbon intensity in the Russian energy sector will be key to whether the projected future growth of the Russian economy can be realised in a sustainable way.
- **Large energy investment needs:** To modernise and realise options for increased energy efficiency in the Russian energy sector, Russia has a projected annual investment need of between US\$30-40 billion for the next ten years.<sup>7</sup>
- **Large carbon credits volumes:** In the course of Russia's economic transition starting in the 1990s, Russia's GHG emissions have collapsed far below the emissions quota target that was assigned to it under the Kyoto Protocol. Russia potentially has the largest emissions quota surplus in the international carbon markets. Furthermore, in the frameworks of JI and a so-called Green Investment Scheme (GIS), which link the selling of surplus quotas allocated to Russia under the Kyoto Protocol to domestic emission reduction activities in Russia, foreign investment can be attracted into environmentally friendly projects that reduce the carbon footprint of the Russian energy sector in turn for trading of emissions quotas. Many companies in Russia and Western Europe are preparing for the implementation of investment projects under the Kyoto Protocol Flexible Mechanisms.

## Recommendations by WWF Russia and Allianz

WWF and Allianz recommend the following schedule of milestones for implementation of the Kyoto Protocol Flexible Mechanism in Russia, which should be started as soon as possible and fully finalised by the end of 2010.

### Schedule of milestones for implementation of the Kyoto Protocol Flexible Mechanism in Russia 2007-2010

Compliance with requirements for participation in Kyoto Trading, including putting in place a complete and reliable GHG inventory and a transparent, robust and ecologically integral JI procedures (2007)

Definition of a clear, economically based but ecologically sound negotiating position for a post-2012 international GHG reduction scheme as a basis for long-term carbon business (2007)

Practical development of GIS and bilateral cooperation with focus on project-based GIS (2007-2008)

Wide involvement of Russian regions in international cooperation within the framework of GIS and JI (2007-2009)

Development of a voluntary domestic emission trading system to facilitate energy efficiency of Russia's economy, which in future could be linked with other systems (e.g., EU ETS) (2008-2010)

<sup>2</sup> European Commission (2006). The EU-Russia Energy Dialogue: Towards an EU-Russia Energy Partnership –The EU perspective. Presentation by Paul Vandoren, Deputy Head of Delegation to the Russian Federation; <sup>3</sup> European Commission. Moscow, March 2006; <sup>4</sup> United Nations Framework Convention on Climate Change (UNFCCC), www.unfccc.int (2006); <sup>5</sup> Ibid, 4th Russian National Communication; <sup>6</sup> According to Bushuev et.al., reserves amount to 47 trillion cubic meters. At the current level of production, about 600 billion cubic meters, this extends out to 78 years. Bushuev, Vitaly, Makarov, Alexey, & Mastepanov, Alexey, eds. (2003) Energy of Russia: Strategy of Development – Scientific Background of the Energy Policy. Moscow, "IATs Energy" Publishing House, 799 pp. (in Russian) <sup>7</sup> Korppoo, Anna, Karas, Jacqueline, & Grubb, Michael (2005), Russia and the Kyoto Protocol – Opportunities and Challenges, London, Royal Institute of International Affairs, Chatham House, 174 pp.

# Conclusions and recommendations

The analysis of Russia's role in international energy and climate policies comes to the following conclusions.

**Russia, an energy and emissions giant, has great potential to benefit from energy and climate policies under the Kyoto Protocol Flexible Mechanisms and is a key player in the areas of energy and climate policies that are shaping international energy supply.**

Russia is amongst the world's five largest GHG emitters. With the ratification of the Kyoto Protocol, Russia has formally taken a large step towards leading its growing economy on the path towards sustainable development. Under the Kyoto Protocol, Russia will be equipped with a large surplus of emission reduction credits that can be sold to those European and international buyers who need such credits to comply with their own reduction targets. When bound to climate-friendly investment projects in Russia under the Kyoto Protocol Flexible Mechanisms of the JI or a GIS, carbon trading offers the chance to spur energy efficient development and open up new investment opportunities in the Russian economy by attracting foreign investment into emission reduction projects that realise solutions superior to business-as-usual projects. If Russia successfully realises future economic growth in an energy-efficient, and therefore emission-efficient way, this could have a substantial influence on global emissions as well as on the long-term supply of Russian natural gas to international buyers.

The development of international energy market openings will allow Russia to move down the supply chain in other European markets and also allow foreign partners to co-operate in domestic Russian emission reduction projects. This will play a crucial role in developing the future energy market structures while in parallel enabling natural gas to take a more central role in today's economies and the transition toward reducing carbon intensity.

**Russia needs to give priority to developing its domestic prerequisites to participate fully in the Kyoto Protocol Flexible Mechanism. This would facilitate an immediate start on related domestic investment activities.**

To get the United Nations' 'green light' for participation in the flexible trading mechanisms of the Kyoto Protocol, Russia must speed up developing its domestic infrastructure and

approval process for GHG-friendly investment projects as required under the Protocol. The establishment of a high quality GHG inventory is needed, potentially leading up to a domestic trading system and ultimately a possible link to the EU ETS and JI mechanisms. Compliance with the eligibility requirements for Kyoto Trading and operational project approval procedure are also needed. Priority should be given to reassuring investors as the window of investment opportunity narrows with the approach of the first trading period of the Kyoto Protocol in 2008.

**Developing a national climate policy in Russia must be embedded in an environmentally sound, long-term, national energy strategy that enables Russia to take part in the international negotiations for future international climate policies. This would also provide potential investors with the assurances they need to seek out the opportunities available in Russia.**

Although a number of short-term measures on energy efficiency are planned, these are intended to be in place only for a couple of years – they are merely expedient, tactical measures.<sup>8</sup> Part of these are domestic scenarios on the developments of individual sectors, reducing energy capacity and achieving energy savings. However, there is no coherent and comprehensive prognosis on the development of energy and climate scenarios. A consistent climate policy should be an integral part of Russia developing a long-term energy strategy, until at least 2030, and the first developments of this are already being observed. This will finally be of outmost importance for investors in Russia who seek a stable investment environment alongside such an interesting spectrum of investment opportunities.

<sup>8</sup>Sharonov, Andrew (2006). "On the implementation of the UNFCCC Kyoto protocol in the Russian Federation". Presentation of Russian Ministry of Economic Development and Trade. Moscow Carbon Market Forum 2006, Moscow 3-4 April, 2006, (in Russian). Third Russian National Communication to the UNFCCC, 2002, [www.unfccc.int](http://www.unfccc.int)



## The WWF and Allianz Partnership: co-operation to combat global climate change

In 2005, Allianz and the World Wide Fund for Nature (WWF) joined forces to advance the public debate on climate change and to propose recommendations and solutions. Allianz and WWF published the report "Climate Change and the Financial Sector – An Agenda for Action" in June 2005 outlining steps to tackle the global problem of climate change and to develop actions to turn the risks related to climate change into opportunities. The cooperation between Allianz and WWF is a milestone towards raising the awareness of climate change within the finance industry and towards a broader dialogue aimed at improving the management of climate change-related risks. This brochure is a special additional study to the report jointly developed by the WWF and Allianz that focuses on Russia's important role in the international arena in combating climate change.



WWF is one of the world's largest and most experienced independent conservation organizations, with a network active globally.

WWF's mission is to stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.

WWF sees climate change as the biggest threat for nature and humanity in the 21st century. WWF works with politics, businesses, consumers, and conservationists, to find solutions to keep global warming below the danger threshold.

Since climate change is a worldwide problem, WWF sees it as imperative to have binding international agreements between the key contributors to this problem. WWF also works with national and regional governments to ensure that policies and measures are designed and implemented.

WWF is partnering with global companies that are prepared to take climate change seriously under the Climate Savers programme. Our team can help identify strategies to address climate change – the WWF Climate Savers companies will have reduced their collective CO<sub>2</sub> emissions by over 10 million tons by 2010. So far, the work with the Allianz Group resulted in a series of reports on climate change and the financial sector.



Allianz SE is one of the world's largest financial services providers. Allianz Group provides its more than 60 million customers in over 70 countries with a comprehensive range of services in the areas insurance, banking and asset management. Allianz is listed in the FTSE4Good Index and has been listed in the Dow Jones Sustainability Index as the most sustainable insurance company.



**Dresdner Kleinwort**

Dresdner Kleinwort is the investment banking division of Dresdner Bank AG and a member of the Allianz Group, offering commercial and investment banking services to European and international clients. Dresdner Kleinwort has been pivotal in the development of the emissions trading market. In 2001, Dresdner Kleinwort became involved in a pilot project aimed at trialling emissions reduction and establishing political support for the Kyoto Protocol. These successes have firmly established Dresdner Kleinwort as a leading and experienced partner in the emissions trading area.

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