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Options to complete the European ban on Russian fossil fuels

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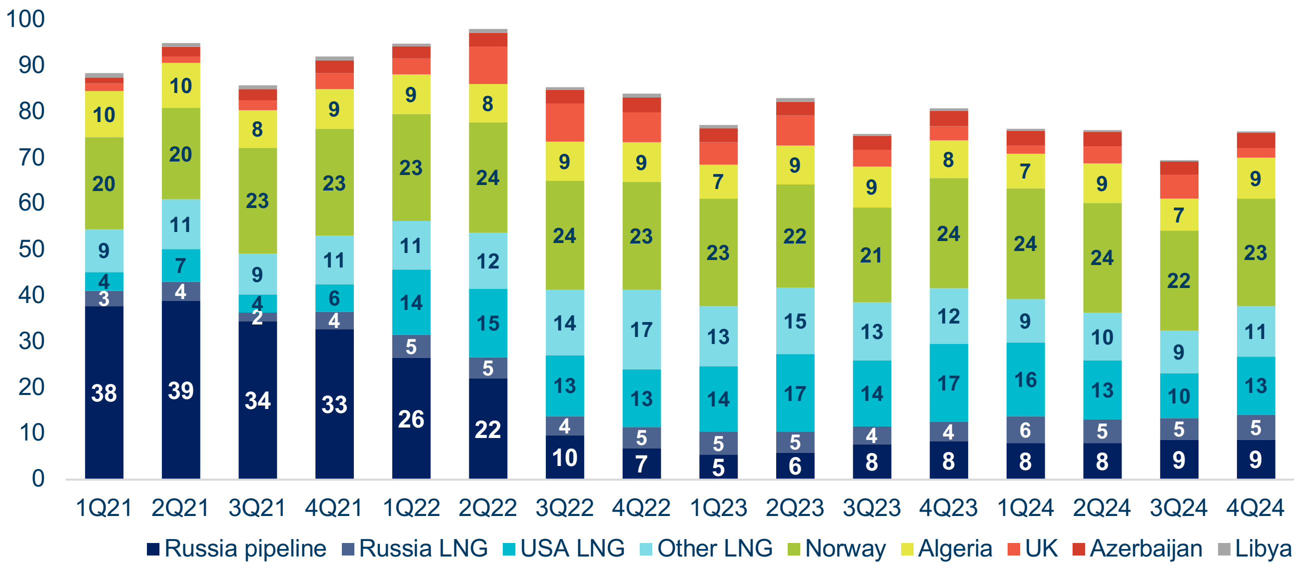
In 2022, in response to Russia's war of aggression on Ukraine, the European Union announced its goal to end purchases of Russian fossil fuels by 2027. Significant progress has already been made in that direction. In 2022, Europe ended purchases of Russian coal. In December 2022, the EU implemented a ban on purchases of seaborne crude from Russia, apart from a temporary exemption for Bulgaria which ended in 2023. In February 2023, the EU introduced a ban on purchases of Russian petroleum products with a limited number of exemptions, including for VGO in Croatia and for LPG, which have now been closed. This left pipeline crude exports via the Druzhba pipeline as the only remaining channel for direct Russian sales of crude oil to Europe. With Poland and Germany refusing to buy Russian crude from the northern Druzhba from 2023, and the Czech Republic ending purchases from the southern Druzhba from December 2024, Hungary and Slovakia remain the only EU countries still purchasing Russian crude via the southern Druzhba. Phasing out Russian oil would be physically straightforward, as there is an existing pipeline from Croatia to Hungary with sufficient capacity to replace Druzhba flows.

The situation with gas is more complex. Although Europe now purchases less than one-third of the gas it bought before the war, and the Nordstream and Yamal pipelines are no longer operational, in 2024 Europe imported approximately 13.4 bcm per quarter from Russia, accounting for 18.2% of EU gas imports (a 4% increase from 2023). Of this volume, roughly 40% was delivered as LNG, mainly to Belgium, France and Spain, with the remaining 60% in the form of pipeline deliveries through Ukraine and Turkey. With Austria no longer receiving Russian gas since late 2024, and Slovakia and Moldova lost an opportunity to buy Russian gas via Ukraine after the Russian gas flows were suspended following the expiry of the Ukraine-Russian gas transit agreement on January 1, 2025, Hungary is the only EU member which continues to buy pipeline gas from Russia.

Additionally, some non-EU countries in the Western Balkans, such as Serbia and Bosnia, also continue to buy Russian pipeline gas.

There is also a concerning trend of increasing Russian gas imports by EU member states in 2024. Despite overall decline in EU natural gas imports by 18.4 bcm year-over-year (YoY) in 2024, imports from Russia increased by approximately 9.5 bcm, or 21% YoY. The EU increased imports of both Russian pipeline gas and LNG exports, with deliveries rising by 5.9 bcm and 3.6 bcm YoY, respectively. The growth in Russian imports came at the expense of declining LNG imports from the USA and other suppliers. As a result, Russia became the EU's second largest natural gas supplier in 2024, overtaking the USA, which held this position in 2023. The additional imports from Russia in 2024 is estimated at \$3.6 bn, while total Russian revenue from natural gas exports to the EU is estimated at \$21.7 bn at market prices, which Russia is using to wage its war in Ukraine. Although Russian pipeline gas exports to the EU will decline in 2025 due to inability to deliver gas via Ukraine and near-full capacity operation of Turkstream, there is a risk that Russia will try to boost its LNG supply to the EU to meet the growing demand for LNG as a substitute to gas previously supplied via Ukraine.

Figure 1. EU quarterly natural gas imports, million cubic meters (mcm)



Source: Bruegel Datasets, KSE Institute

There are two challenges to completing the planned RepowerEU ban on purchases of Russian fossil fuels:

First, gas prices remain relatively high—about twice their pre-war levels. To avoid further upward pressure on prices, many European governments prefer to wait until the significant increase in LNG supply, currently under construction, adds additional volumes to the market, improving global supply and lowering prices. This is expected to occur throughout 2025, as major projects like Plaquemines, Corpus Christi III and LNG Canada projects ramp up. Combined, these projects will supply nearly twice as much gas annually as Russia currently supplies to Europe.

In principle, ending LNG imports is relatively straightforward, as the main European importers of Russian LNG—Belgium, France and Spain—have expressed their support for a ban on Russian LNG. The EU members have already agreed a ban from March 2025 on transshipment of Russian LNG (i.e. injecting Russian gas from a tanker into a storage tank inside the EU for subsequent reinjection into a tanker headed for elsewhere) in the 14^{th} sanctioned package. One potential solution would be to set a future date for a complete ban on Russian LNG in Europe, at a time when the additional volumes of LNG from the new projects in North America are expected. Moreover, since much of the banned Russian LNG will likely flow to other markets—albeit at a substantial discount—the impact on global balances and prices of a Russian LNG ban is expected to be relatively modest. As an immediate step towards the full LNG ban, we propose the EU should confirm a ban on LNG deliveries from Gazprom's small Portovaya LNG plant and from the small Vystotsk LNG plant, which is partially owned by Gazprombank, following their sanctioning by the US in January 2025. Additionally, we recommend imposing a ban on deliveries from the large Yamal LNG plant coming into effect at the the end of Q3 2025, when substantial volumes of LNG from the US and Canada are expected to become available.

Second, and more problematically, the remaining buyers of Russian oil and gas in Europe – Hungary (MVM, Mol) and Slovakia (SPP) – say that they want to keep buying Russian oil and gas, in defiance of the RepowerEU objective. This is unjust, as it is supports Russia's war of aggression on Ukraine and finances the principal threat to European security. It is also unfair, as Hungary and Slovakia gain a competitive advantage by accessing Russian oil and gas at a discount. How can Europe overcome the resistance of the last two countries unwilling to deprive Russia from energy revenues used to wage its war?

We see a menu of options to persuade Hungary and Slovakia to stop buying Russian oil and gas, as following:

EU action: Trade policy. The European Commission has the authority over trade and can therefore impose tariffs and restrictive measures on Russian oil and gas, provided it is supported by a qualified majority—at least 55% of the EU member states, and at least 65% of the EU population. Hungary and Slovakia cannot block such measures on their own and would need support from other member states. For instance, the EU could impose a tariff on Russian oil and gas, similar to the tariffs imposed on Russian grains in July 2024.

EU action: Competition policy. Under EU law, ownership of natural gas pipelines must be separated from the ownership of the gas supplied through them, and third parties must have non-discriminatory access to the pipelines. Building on the OPAL ruling on Nord Stream II, which restricted Gazprom's use of its pipeline and required some capacity to be made available to third parties, the EU could potentially limit Turkstream flows by mandating access for other gas sources. Once again, competition policy falls under EU competence, meaning Hungary and Slovakia would need support from other member states to block such measures.

EU action: Sanctions. The EU could sanction the Russian banks involved in energy trade, as well as Russian energy companies supplying oil and gas. This has become increasingly feasible as EU imports of oil and gas have declined. However, such measures require unanimity and so can therefore be blocked by Hungary and Slovakia.

US action: Sanctions. Another option could be for the US to phase out Russian gas at the European market and replace it with US LNG.

Interestingly, the recent US sanctions on Gazprombank —the payment agent for Russian gas—pose a significant risk to the ongoing supply of Russian gas through the Turkstream pipeline. US sanctions prohibit any US person from dealing with a sanctioned entity and creates risks for any company—such as MoL, MVM, and SPP—that makes payments in US dollars to sanctioned entities. Such entities risk being sanctioned themselves and losing the ability to settle USD payments. In response, the Hungarian foreign minister has visited Moscow lobbying for support[1], which led to Putin signing a decree allowing alternative payment agents to Gazprombank for Russian energy exports and permitting Gazprom to supply gas without payment for a period. The Hungarian foreign minister has also been in Washington lobbying for a waiver for Hungary from the US sanction on Gazprombank.[2] This highlights a vulnerability that could be leveraged to persuade Hungary and Slovakia to wind down their Russian oil and gas purchases. Even if they manage to secure a new payment agent on the Russian side—challenging given most major Russian financial institutions with large balance sheets and international connectivity are already under US sanctions—the US could simply add the new payment agent to the sanctions list. Additionally, the US could offer a waiver to Hungary and Slovakia, similar to the one granted to Japanese companies for continuing to use Gazprombank to purchase gas from the Gazprom-operated Sakhalin-2 project, once they have committed to a credible schedule for ending purchases of Russian oil and gas.

Alternatively, the US could directly sanction the Russian oil and gas companies supplying Hungary and Slovakia, such as Transneft, the owner of the Druzhba pipeline, and Gazprom, the owner of the Turkstream pipeline. Additionally, if the US does not trust Hungarian and Slovak commitment to ending their Russian oil and gas purchases, it could issue the waiver to deal with sanctioned Russian oil and gas companies to a credible third party, such as the European Commission. This authority could then contract Russian oil and gas on behalf of Hungary and Slovakia for a transitional period, ensuring an orderly winddown of purchases by the agreed 2027 deadline.

[1] Euronews, December 12, 2024

[2] Reuters, December 4, 2024