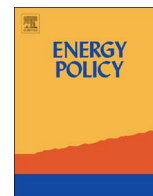




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## Energy Policy

journal homepage: [www.elsevier.com/locate/enpol](http://www.elsevier.com/locate/enpol)

## The Energy Union and security-of-gas supply

Ole Gunnar Austvik<sup>a,b,\*</sup><sup>a</sup> Norwegian Institute of International Affairs (NUPI), BI Norwegian Business School, and Lillehammer University College (HiL), Norway<sup>b</sup> John F. Kennedy School of Government, Harvard University, United States

## HIGHLIGHTS

- Security-of-gas-supply concerns divides the EU between Central/Eastern and Western Europe in the creation of an Energy Union.
- Gas security may be improved by internal measures and better inter-connectedness to and within Eastern Europe, if external relations to Russia will not change.
- More infrastructure may help the functioning of a Single Market for energy and make the Energy Union a unifying project between the East and the West.

## ARTICLE INFO

## Article history:

Received 14 January 2016

Received in revised form

4 June 2016

Accepted 6 June 2016

## Keywords:

Energy Union

Natural gas

Russia

Gazprom

Energy security

## ABSTRACT

This paper discusses and contrasts the proposals for an Energy Union in the European Union and its impact on security-of-gas-supply. Based on an examination of historical East-West gas trade and by revisiting energy security concepts, the paper analyzes how problems with dependency on energy imports can be reduced. The paper discusses how the positions of Central and Eastern European countries (CEEC), where security challenges are especially evident, and the positions of countries in Western Europe, where they are less acute, interact and conflicts in making a common energy security policy as part of the Energy Union. The paper argues that the mainly confederative structure of the EU, and diverging national situations, make it difficult to unify positions into an effective common energy policy. However, with the CEEC in the EU, the EU is also changing, and an increased focus on energy security may be accepted. Extended interconnectivity within and to the CEEC appears to be the central issue that would mitigate, albeit not solve, contemporary security-of-gas-supply problems. As it would also bring the internal energy market closer to reality, it could in addition help the Energy Union to become a unifying project merging the interests in the East and the West despite their different security-of-gas supply concerns with Russian gas.

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## 1. Introduction

In April 2014, Poland's former Prime Minister Donald Tusk, now EU President, proposed the creation of an *Energy Union* to strengthen policy and expand goals and measures to meet security-of-gas supply concerns. The Ukrainian crises had again brought focus on European Union (EU) dependence on Russian gas and

Gazprom. Russia currently accounts for as much as 34% of EU gas

imports (2015) and for many new member states in Eastern Europe the share is much higher.<sup>1</sup> To lose a significant portion of an energy supply overnight in a crisis entails serious social problems. In addition, the long-term implications of being dependent on monopolist, single-supply routes and natural gas as a dominant energy form can be detrimental to a country's welfare and independent policy making. We have seen this especially clearly in

<sup>1</sup> Latvia, Bulgaria, Estonia, Finland, and, until recently, Lithuania import 100% of their gas requirements from Russia. In these countries, Russian gas represents about 20% of the total energy consumption. Other EU countries are less dependent, but Russian gas still plays a significant role in countries such as Austria, Germany, the Czech Republic, Slovakia, Hungary, Poland, Albania, Greece, and the republics of the former Yugoslavia. In each of these countries, Russian natural gas represents over 10% of total energy consumption. In individual sectors the reliance can be far greater.

\* Correspondence address: HiL, P.O. Box 952, 2604 Lillehammer. [www.oga.no](http://www.oga.no).

E-mail address: [ole.gunnar.austvik@kaldor.no](mailto:ole.gunnar.austvik@kaldor.no)

the relations with Ukraine, but also with other Central and Eastern Europe countries (CEEC) left mostly with supply routes from Soviet Bloc times. Many countries in the CEEC consider the one-sided dependency on Russian gas as a security problem that they place on top of the political agenda and as an important element in their relations to Russia. For incumbent EU members in the West the problem of energy security is less acute. Western European countries energy policy is often focused on the completion of the Single Market (SM) and climate change, rather than on energy security and its foreign policy dimensions. The revised Energy Union that was proposed by the EU in February 2015 was heavily influenced by these Western European, and incumbent EU member, countries' priorities. It largely had its focus on realizing existing EU energy and environmental policy in a continued regulative manner, rather than on addressing energy security as its primary objective in internal as well as external affairs, as suggested in a realist manner by Tusk.

This paper discusses and contrasts the two proposals for an EU Energy Union and how they interact and conflict in the making of EU energy security policy when shaping an Energy Union. In which ways may a fragmented EU converge in making the Energy Union a project merging the positions and interests of Eastern and Western Europe? What are the intentional and functional linkages between market liberalization, as both the East and the West want, and security-of-gas supply? Are interventionist supplements to the regulatory efforts aimed at realizing a common market for energy and improve external energy relations needed? To which extent should energy security be part of EU and/or Member States foreign policy in relation to Russia? To contextualize the present situation, the paper first examines the historical European East-West gas trade and conflicts since the Cold War. Second, it revisits energy security concepts to understand when dependency on other countries for a specific good is a problem, and how internal and external measures may reduce problems related to such dependency. Third, the two proposals for an Energy Union are presented and contrasted. Fourth, the challenges in making a coherent energy policy in a fragmented EU is discussed. Sixth, and finally, possible outcomes of the intra-EU East-West debate over energy security and the Energy Union are analyzed.

## 2. Pipeline politics and East-West gas trade

Current East-West gas trade is, to a large extent, based on investments made during the Cold War when the former Soviet Union started its main era as a petroleum producer. Petroleum management in the Soviet system was based on extensive investments targeted to fulfill production plans which were the guiding line for the plan, control, and command economy in all sectors. Producing fields were connected with the major industrial centers of the Soviet republics through the Unified Gas Supply System (UGSS). The UGSS was owned by the Soviet Ministry of Gas, giving it vertical control over all aspects of the Soviet gas industry, from production and transportation to storage. To the neglect of economic efficiency, high production targets requiring extensive resource usage were set. The drop in world oil prices in the mid-1980s and bad resource management, reduced profitability, and affected the Soviet economy negatively as a whole. The economic crises in the late 1980s revealed the insolvency of the plan-and-command economy and contributed to the breakup of the entire union (Austvik and Tsygankova, 2004: 310).

The first East-West gas conflict took place during this period. The Soviet Union was constructing the pipeline to transport gas from the Urengoy field on the Yamal peninsula in Western Siberia to its republics, the satellite states in the CEEC as well as to Western Europe (Gustafson, 1985; Jentleson, 1986; Austvik, 1987;

Closson, 2011). Yamal is about 4000 km from Western Europe, with permafrost and difficult weather conditions. In Western economies the project would probably not have paid off at the time. But since the exports to Western Europe would bring the Soviet Union considerable revenues in convertible currency, while the expenditures were paid for in rubles, the project was assessed as profitable. Western sanctions against the gas pipeline in particular, and against the Soviet economy in general, were imposed. Assistant Secretary of Defense in the Reagan Administration Richard Perle made the arguments against the building of the pipeline clear as a threat to Western security ("Defense" February 1982). First, the exports gave the Soviets vast revenues in hard currency. This enabled them to import technology for military use. It would also release civilian resources, which, in turn, could be used for military purposes. Secondly, Perle argued the project would result in the formation of economic bonds between Western Europe and the Soviet Union. This could widen Soviet influence on U.S. allies, and could, over time, contribute to a Soviet-desired division between the U.S. and Western Europe. Thirdly, in a crisis the Soviet Union could disrupt the gas supplies to injure the West. A fourth argument, which was put forward later, implied that parts of the Western equipment delivered for the construction of the pipeline itself could be used for military purposes. In spite of the prevailing Cold War and long-term dependencies created between East and West, the sanctions were eventually relieved and the pipeline was built.<sup>2</sup> The rise of Soviet/Russian gas production thereafter facilitated a large expansion in the quantity of gas supplied to European markets in the West, as well as in the East of present-day EU.

After the breakup of the Soviet Union, Russia lost control over its republics and satellite states. All the CEEC and the Baltic states became members of both the EU and NATO. On the global stage Russia lost its superpower position; the world went from being bipolar to having U.S. as the hegemon. Russia started a comprehensive economic reorganization of all domestic sectors aiming to move towards a market economy. Restructuring of the oil and gas sectors was a part of these processes. In the gas industry, initially, the state company Gazprom was established on the basis of the former Ministry of Gas. The company took the control and management of all enterprises in the industry. In 1993, Gazprom was converted into a joint-stock company with the government being the main shareholder (at present 50.23%). Gazprom currently controls most Russian gas-producing and processing units; it also owns all high-pressure transmission pipelines and has the sole rights to export gas to Europe. In the domestic Russian gas market, Gazprom with its regional production and transportation units has, practically speaking, a monopoly with strong government involvement in its strategic, political, and economic decisions.<sup>3</sup> Thus, different from many other sectors, the structure of the Russian gas industry and the logic of its organization have not changed much since Soviet times.<sup>4</sup> Gazprom inherited ownership over the UGSS and the various storage facilities and also a pre-dominant position as monopoly supplier to the Russian market

<sup>2</sup> Högselius (2013) investigates how and why governments, businesses, engineers and other actors sought to both promote and oppose the establishment of an extensive East-West natural gas regime that seemed to overthrow the fundamental logic of the Cold War.

<sup>3</sup> See Demakova and Godzimirski (2012) for a review of the relationship between Gazprom and Russian government.

<sup>4</sup> There has been developed a competitive fringe in Russia, albeit still a tiny one, in spite of the great number of companies. IEA (2014) writes: "In total, there were about 260 gas-producing companies operating in Russia on 1 January 2013, including 8 vertically integrated oil companies, 113 oil companies, 14 companies affiliated with Gazprom, 2 affiliated with Novatek, 128 independent companies, and 3 companies operating within the framework of Production Sharing Agreements." Rosneft is also now challenging Gazprom as a gas producer.

and to Europe. Also gas from other Central Asian producers running through Russia is controlled by Gazprom. Central Asian countries selling gas to Europe must make separate agreements with Gazprom for transportation, for example Turkmen gas to Ukraine (Gazprom, 2015).

The energy administrations that had been operative in the Soviet republics and satellite countries turned into national gas companies. Gazprom continued to subsidize gas both domestically and to allies (such as in Belarus and on and off with Ukraine). Countries considered less friendly, for example those that became EU and NATO members, had to enter negotiations where hard currency prices replaced the symbolic prices of the past (Cronshaw et al., 2008:22). R. Newham (2011) notes: “Some states such as Armenia, Belarus and the Ukraine under President Kuchma have been favored with heavily subsidized energy. Others, such as Georgia, Moldova, the Baltic States and the Ukraine under President Yushchenko have been targeted by supply disruptions and punitive price increases.” The UGSS now passes through several independent countries, but are still either owned, controlled, or strongly influenced by Gazprom. Gas to Western Europe that was previously sold at the East-West border now has to transit through a number of independent former Soviet republics and satellite states (Ericson, 2009:33). When these countries became EU members, the UGSS became subjected to the EU energy *acquis*.<sup>5</sup> At the same time the vertical connections to Russia remained through Gazprom ownership of the infrastructure and its long-term supply contracts. Still many countries are left with the same East-to-West infrastructure from Russia to the EU built in Soviet times.<sup>6</sup>

A series of disputes over prices, supplies, transmission tariffs, debts, and political relations arose in the 1990s and thereafter. The most prevalent were those between Ukrainian oil and gas companies Naftogaz and Gazprom. These disputes have grown beyond simple business discussions into transnational political issues involving several countries, caused by their importance to Ukraine's and Russia's energy, economic, and political interests, and Ukraine's role as dominant transit country to the West. Several conflicts took place in the 1990s but the more serious ones occurred in 2005 (Stern, 2006) and 2009 (Pirani et al., 2009: 57). Russia claimed Ukraine was not paying for the gas, and that it diverted to itself gas intended to be exported to the EU. In January 2009, as many as 18 EU countries lost their Russian supplies because of the transit problems in Ukraine. Several economic activities came to a halt, and many people froze to death in these countries. Another climax occurred in 2014 after the Russian annexation of Crimea when supplies to Ukraine were stopped (but supplies and transit to the EU countries maintained). The controversies over this conflict have not yet ended and the outcome is unclear.

With the gradual opening of EU gas markets Gazprom has used the opportunity to invest downstream, consolidated markets and used energy exports as a tool for political power, giving rise to the fear that it will gradually control much of the EU gas industry (Finon and Locatelli, 2007).<sup>7</sup> Russian companies have invested heavily abroad in pipeline infrastructure and storage carrying

Russian oil and gas products (Soderbergh, 2010: 16). The company has pipelines and domestic gas production that delivers to the Nord Stream pipeline in the Baltic Sea, and, with some additional investments, also to new Black Sea projects<sup>8</sup> and is a key player in the market. There has been several attempts to compensate for the lack of EU jurisdiction over the entire gas chain. The EU-Russia Energy Dialogue established in 2000 had as objective to “provide reliability, security and predictability of energy relations of the free market in the long term” (Aalto, 2007). The dialogue comprised a Permanent Partnership Council (PPC) with the Energy Commissioner, with the EU President and the Russian minister for energy and industry as participants. Aspects of confidence-building helped to overcome the 2009 Russia–Ukraine crisis, resulting inter alia with the agreement on an “Early Warning Mechanism”. Attempts to include Russia in the Energy Charter Treaty (ECT) (Belyi, 2009) and the EU-Russian consultations regarding the Third Energy Package were attempts to make Russia play by the rules set by the Western regulatory system. In 2015, the Statement of Objections (SO) from the EU side against Gazprom to abandon resale obligations, market discrimination and unfair pricing (Bershidsky, 2015), and Russia's WTO Dispute Settlement case against the Third Energy Package (TEP) shortly thereafter, are expressions of more negative and conflictual agendas (Austvik and Lembo, 2016:13). Both cases are dealing with the extent to which the EU may regulate Russian energy policy to become more similar to that common in the West. On the Russian side, the formation of the Gas Exporting Countries' Forum (GECF) in 2007, consisting of Russia and countries in Central Asia and the Persian Gulf area, soon led to accusations of being a “gas-OPEC” against consuming countries (Finon, 2007).

The developments in Ukraine has contributed to make the situation into a stalemate. The EU and Russian systems now confront each other both in terms of for whose interest policy should work and how it should be exercised. First, Russia as a manufacturer and exporter of oil and gas on the one side, and the EU as a consumer and importer of energy on the other, do not always share the same economic and political interests of the outcomes; second, Russia has a tradition and desire of stronger and more direct government control of the energy sector than what is proposed in the EU Single Market. Leonard and Popescu, (2007:19) note: “From Russia's perspective, the West has spent the last two decades rewriting the rules that govern their relationship”.. “a process which Russia for a long time had to accept due to its lack of economic and political power in the immediate aftermath of the Cold War.” Russian President Vladimir Putin (2014) argues that it “is an attempt by the West (and the U.S.) to force their rules on other countries.” Mulle-Kraenner (2008:41) states that the “wild privatization” that followed the collapse of the Soviet Union has been replaced by an assertive new policy of “state-monopolist capitalism.” Leonard and Popescu, (2007:19) postulates that Moscow “does not want to become part of the West anymore and it is challenging all the strategic, political and economic agreements that were signed in the 1990s”.

Under President Putin, Russia recovered record high energy revenues and political influence.<sup>9</sup> As in Soviet times, export of oil

<sup>5</sup> The *acquis communautaire*, often referred to as *EU acquis* or just *acquis*, is the accumulated legislation and juridical decisions that constitute the body of EU law.

<sup>6</sup> Leonard and Popescu (2007) studies several dimensions of the links between Russia and the EU, and provide a survey of each Member State's economic, political and military relations with Russia. Högselius et al. (2013) provide a survey of Europe's external and internal critical infrastructure.

<sup>7</sup> This is limited now by the so-called Gazprom Clause of Directive 2009/73/EC (EU, 2009) that does not allow for Foreign Direct Investments (FDI) if the actor threatens security-of-gas supply and does not comply with the energy *acquis*. However, Gazprom managed to establish itself in countries like Italy, Germany, Hungary, Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovakia before the implementation of the directive (Mercouris, 2015).

<sup>8</sup> After South Stream was cancelled Russia is considering a Turk Stream pipeline to Turkey.

<sup>9</sup> Russia has the world's largest natural gas reserves and currently produces ca. 11 million barrels per day (mbd) out of which 7 mbd are exported (EIA, 2015). Reserves of Russian natural gas are even more abundant and estimated to be available for the next 100 years at current productions levels. In 2014 Russia produced 550 Billion Cubic Meters (BCM) of natural gas and is projected to reach at least 680 BCM by 2030 (Soderbergh, 2010:17). The country is one of the three largest oil-and-gas producers in the world along with Saudi Arabia and the U.S. It is the second biggest oil exporter and the biggest gas exporter. The Russian economy is largely dependent on petroleum revenues. According to state-controlled news



and gas has become an important factor in determining Russian policies. Putin managed to take back control over much of the oil industry lost under President Yeltsin in the 1990s (The Guardian, 12.12.2006). State-controlled Rosneft is now the biggest oil company while Gazprom is the dominant gas producer (EIA, 2015). Petroleum revenues, state-controlled industrial structures and, in the gas sector, downstream pipeline control together with high market shares and asymmetric interdependence with purchasing countries, have positioned the Russian state with instruments to use for either economic or political purposes. With its vast geographical territories, located in the “middle of the world,” and enormous natural resource reserves, Russia have considered inevitably it will profit from combining economic as well as geopolitical goals, as in Soviet times. Following the Ukrainian crises, military escalation and elements of a new East-West Cold War, the situation share similarities with the situation during the gas conflicts of the 1980s. The drop in oil prices since 2014 have significantly hurt the Russian economy and the Russian state, being reinforced by Western sanctions, albeit the country appears to be in a much stronger economic situation now than during the break-up of the Soviet Union in the late 1980s.<sup>10</sup> Present Western policy and sanctions have much the same goals as listed by Richard Perle at that time, and should hamper Russia's access to technology and finance, weaken Russian economy, reduce East-West personal and political bonds, and prevent new Russian pipeline projects such as the South Stream (now eventually abandoned) and the second phase of Nord Stream.

### 3. Energy security revisited

In order to guarantee supply for import-dependent countries and ensure stable demand for countries investing heavily in the extraction and export of energy, concern for energy security has been a political preoccupation ever since coal, oil, and gas became a driving force in industrialization and a precondition for modern society. For import-dependent countries in the West, this became particularly apparent during the oil crisis in 1974 when Arab members of the OPEC used oil for political leverage against countries that had supported Israel in the 1973 Arab-Israeli War. Another example is the claim from Russian-gas dependent countries that Gazprom uses its monopoly position over supply and pipeline routes as part of a strategy to interfere in their domestic and foreign policies. Irrespective of the political motivations and results of the 1974 oil crisis and the Ukrainian gas crises, the actions of the exporting countries were instrumental in increasing the price of energy and, thus, revenues from energy exports and/or to get political concessions from importing countries. In the EU, even though energy security gained importance to its Common Foreign and Security Policy (CFSP) during the 2000s, deepening cooperation on external affairs was often rejected by member states (Youngs, 2009:4), as well as on internal energy policy. Correlje and van der Linde (2006) are phrasing the different views on how to address energy security issues as “markets and institutions” and “regions and empires” approaches. Which view to support seems to largely depend on national energy situations and perceptions of Russia's motivations in bilateral relationships. In the CEEC it is often perceived that energy security should be a priority for the CFSP as a geopolitical issue, while in Western Europe it is

thought more to be an issue for the SM, on which EU energy policy largely has had its focus till now.

From the outset, dependency on exports and imports is *the normal state of affairs* in a modern world and a consequence of increased economic integration and mutual dependence. The economic system of the EU is strongly based on specialization and international trade within and outside the Community. Also Russia joined the free trade system in 2012 as a member of the World Trade Organization (WTO). Hence, East-West economic affairs, as for most countries, are dependent on imports across a whole range of commodities, and on exports of fewer commodities (because countries specialize) to pay for the imports.<sup>11</sup> Political concerns arise when dependencies cause short- or long-term problems with significant changes in prices, supply, or market access. A country can lie somewhere on the continuum between *neutral*,<sup>12</sup> *sensitive*,<sup>13</sup> or *vulnerable*<sup>14</sup> in its dependency on a commodity when its price or availability/market access changes. A country's vulnerability dependence can be significantly different from its sensitivity dependence and potentially more costly. As dependency on imports and exports is a normal state of economic affairs, government policy should aim to eliminate or reduce (potential) sensitivity and vulnerability dependence, while neutral dependency from this perspective is optimal. Thus the costs of dependency can be measured in monetary terms as well as by social and political changes in societies and governments. To assess whether a high dependency on trade with another country constitutes a security risk, two points should be taken into consideration: whether relations are (or can become) antagonistic,<sup>15</sup> and the (domestic) ability to adapt to change.

<sup>11</sup> *Import dependency* describes a situation where a country does not possess the capacity to produce 100% of its own needs (Hogan and Mossavar-Rahmani, 1987:8). A producing country has similar concerns about offset and prices for its products when domestic customers are unable to consume 100% of domestic production.

<sup>12</sup> *Neutral dependence* can be defined as a situation in which a country either imports or exports a commodity and always has an alternative if one of the suppliers or customers disappears. This is a situation equivalent to the one that exists in contestable markets; there are numerous suppliers and customers and none of them has any influence on market outcomes. In other words, if a supplier or customer, respectively, withdraws from a relationship there will always be someone in the market to fill the empty place. Supply and demand problems arise, however, when markets are imperfect, when sellers and buyers are to some degree locked together, often in an asymmetric way. A change in price or availability will lead to changes in costs (or revenues for exporters), and/or access to the commodity (or markets). The response must then be to adjust to the new situation rather than just change to another seller (or buyer).

<sup>13</sup> *Sensitivity dependence* is measured by the degree of responsiveness within an existing policy framework. It may reflect the difficulty of changing policy within a short time and/or bindings to domestic or international rules, when price or availability/market access changes dramatically. Sensitivity dependence occurs in “the short run or when normative constraints are high and international rules are binding” (Keohane and Nye, 1977:12–18). Sensitivity dependence need not induce a welfare loss in the long run when circumstances change.

<sup>14</sup> *Vulnerability dependence* is more serious than sensitivity dependence and measures the ability to adjust to changes after policies have been changed (Keohane and Nye, 1977:12–18). In economic terms, vulnerability dependence can be represented as the potential for significant losses of output or welfare. Vulnerability dependence is primarily concerned with long-term supply and demand issues, while sensitivity dependency to a greater extent concerns the risk of disruptions to existing supplies. A vulnerability dependence occurs when “normative constraints are low, and international rules are not considered binding” (ibid).

<sup>15</sup> For example, as an importing country, Ukraine appears to be vulnerable to Russian pressure as they either has to pay a high price for the gas or give political concessions to get a low price. The price of gas was reduced for Ukraine as part of the Kharkov agreement in 2010 to make relations between the two countries more friendly, including the agreement that Russia could use the Sevastopol base on the Crimea for its navy until 2035 (Kremlin.ru, 2010). For Russia, as an exporting country, building the Nord Stream pipeline in the Baltic Sea (expanded or not), from Vyborg near St. Petersburg to Greifswald in Germany, is a way to circumvent the transit country Ukraine which has been considered a security-of-demand problem from their side in relation to EU purchasers (Austvik, 2009).

(footnote continued)

agency Russia Today, more than 50% of the Russian state budget was funded by gas and oil revenues in 2013. The main revenues come from oil reaching \$191 billion while gas revenues reached \$28 billion (RT. COM 17.4.2014).

<sup>10</sup> The significant drop in the value of the rubel has helped the domestic Russian industry against non-sanctioned foreign companies.

Energy security challenges are hence both of an external and domestic political nature, and may be dealt with both by domestic and foreign policy measures. In a situation when security-of-supply- and -demand problems cannot be resolved through foreign policy or external market reorganization, effects of sharp price changes and/or availability, or market access must be addressed by domestic measures. Facing an antagonistic supplier or great market volatility, the ability to domestically adjust to such changes is important in determining the degree of sensitivity/vulnerability in the short and long-term respectively. If a country for example, changes from being inelastic (inflexible) in its demand for imports in both the short and long-term to remain inelastic in the short but elastic in the long-term, the country's dependence on imports may change from vulnerable to sensitive, and the problem is hence mitigated. Domestic and external market and political situations together create the character of dependency on others and to what extent it should be considered a political problem. If an importing country is unable to change the external supply situation, it must turn to domestic measures. Intra-EU measures to mitigate energy security problems can be: one, to build new infrastructure to enhance flexibility and to import gas from other sources and through different channels; two, to enhance energy efficiency to reduce the importance of natural gas in the economy; three, to improve the ability to switch to alternative fuels, or; four, to build Strategic Gas Reserves (SGRs) that can be drawn upon in an emergency situation similar to the Strategic Petroleum Reserves (SPRs) in the oil market to reduce sensitivity (Austvik, 2004:193).<sup>16</sup>

Important to notice is that sensitivity or vulnerability dependency on imports and exports, respectively, may occur even if the access to physical markets are not considered commercial or politically "risky." An exogenous shock in international markets caused, for example, by a war limiting supplies and disrupting pipelines may dramatically change prices also in "secure" markets. This was much the situation following the two oil shocks in the 1970s. In a price shock situation anyone may sell and buy the commodity (unless it comes to a conflict with the country itself involved). The problem is that if prices increase dramatically, parts of demand will switch to other energy sources and push these prices up, as well. Thus, security-of-supply for an energy consuming country is influenced by both the pure physical access to oil or gas, increased economic costs due to a rise in energy prices, as well as the political pressure that can be brought on them by parties controlling supply elsewhere.<sup>17</sup> Making a market more competitive is a measure to reduce sensitive and/or vulnerable dependency to changes in physical volumes for both exporters and

importers, but the price risk may persist and even increase. Demand and supply are two sides of any market, and over time there is no security-of-supply without security-of-demand.

In the European gas market, Russian energy policy has a long tradition of strong state control. In contrast, in the EU the government's role in industrial affairs is ideally considered to be limited as a regulator of economic activities undertaken by private actors. EU energy policy has largely emphasized a market based approach to internal as well as to external energy security issues, including requiring governance reforms in Russia and other producing countries. The EU can be viewed as a weak organization with its intergovernmental structure and absence of financial resources or interventionist measures to address industries and economic policy. In security policy, NATO and the U. S. are the counters to Russian hard power, not the EU. Goldthau and Sitter (2015) argue that EU has power shaped and supported by its market position, determined by both its size and the suppliers depending on it, and the quality and strength of its regulatory power. Harsem and Claes (2012) similarly argue that the EU can compensate for its lack of hard power with other trade related capabilities. On the Russian side, Romanova (2012:39) argues that there are problems connected to Russia's unilateral harmonization with the EU's norms and rules which Russia is not yet ready for. Russia did not sign the ECT and is politically controlling FDIs in the energy sector in Russia, and it is difficult to see that the EU *acquis* can be (fully) expanded to Russia due to diverging views on both policy objectives and methods. As long as different models and interests prevail, and international law not yet work sufficiently well in the field of energy, parties meet today in bilateral arrangements (legal and other) in economic conflicts. If it is not possible to make Russia behave according to Western standards, by force, arbitration or voluntary arrangements, and transit routes remain too unpredictable, energy security problems must be addressed by intra-EU measures.

#### 4. The proposals for an Energy Union

EU energy policy has till now largely been a "markets and institutions" approach. In 2011, former President of the European Parliament Jerzy Buzek and former Commission President Jacques Delors called for a "politicization of EU energy policy". They argued it was an excessive focus on the regulatory issues and wanted to create an European Energy Community with a stronger emphasis on the challenges of supply security in the CEEC (Buzek, 2011). However, neither the Commission nor Member State governments showed much interest in the idea. Part of the reason was that a few years earlier, the EU had made decisions concerning energy and climate targets up to 2020 and introduced a rather comprehensive Third Energy Package<sup>18</sup> and climate policy to address what was considered the most contentious energy policy issues at the time. Slow progress and a partly renationalization rather than a

<sup>16</sup> Similarly, Russia as an exporting country, considering transit countries (especially Ukraine) and EU policy-making a security-of-demand problem, must address the issue by the means it has control over if it is not able to change the situation through foreign affairs. Hence, for Russia improved security-of-demand can be achieved by measures such as:

1. build pipelines and LNG terminals to circumvent the transit problems it has with Ukraine and others (such as the NordStream and the alternatives in the Black Sea);
2. turn to other markets (such as China);
3. diversify the economy to become less dependent on natural resource exports, or;
4. refrain from using revenues as they are earned, instead placing them in a Sovereign Wealth Fund (SWF), as Russia and a number of other countries with large foreign exchange surpluses have done in the past. A large SWF may serve both short- and long-term purposes. A SWF can eliminate short-term domestic economic problems and dependence on prices and markets. The dependency issue may gradually shift focus towards the status and development of the fund itself.

<sup>17</sup> Security-of-demand for an exporting country comprises similarly the risk of a dramatic price drop, economic loss, and adjustments in the economy caused by the loss of revenues and the risk of being politically pressured by parties controlling markets.

<sup>18</sup> With its purpose to further open up EU gas and electricity markets the Third Energy Package (2009) consisted of two directives and three regulations, besides a focus on the realization of the two first energy packages. The First Energy Package (1998) allowed the opening of the electricity and gas markets, the gradual introduction of competition, and imposed broad unbundling requirements to integrated companies. The Second Energy Package (2003) focused on the concepts of unbundling and third party access, defined the need for independent regulatory authorities, and set deadlines for the liberalization of electricity and gas retail markets in 2004 and 2007. The core elements of the Third Energy Package were ownership unbundling to separate companies' generation and sale operations from their transmission networks, the establishment of a national regulatory authority (NRA) for each Member State, and the establishment of an Agency for the Cooperation of Energy Regulators (ACER) to provide a forum for NRAs to work together. The Third Energy Package has yet to deliver fully. See EU (2015c) for an overview of EU energy market legislation.

common-making of EU energy and climate policy took place in the years afterwards.

Poland's Prime Minister Donald Tusk eventually addressed the stalemate in his deliberately provocative article "A United Europe can end Russia's energy Stranglehold" in the *Financial Times* of April 21, 2014. Tusk (2014) argued for a speeding-up of the EU processes and argued that climate and environmental policy were being given too much attention in EU energy policy. For the CEEC, questions of supply security, solidarity between Member States, and concerns over Russian gas imports are more important. He claimed that the imperfect European gas market makes many member states vulnerable to economic pressures and potential disruptions of gas supplies from Russia. Because this is the case within the EU as well as in Russia, he stressed that policy should aim at making both the supply (i.e. Russian) and demand sides more flexible. Until this becomes a reality, however, the EU should have policies to deal with the security-of-gas supply problems and Russia's "stranglehold" on Europe. Tusk suggested the creation of an Energy Union with a focus on energy security, including more interventionist measures beyond regulation to mitigate the security problems faced by the CEEC. The proposal was founded on six "pillars":

1. *Jointly negotiating energy contracts with Russia.* Tusk argued that the EU should "confront Russia's monopolistic position with a single European body charged with buying its gas" and parallel to the European Atomic Energy Community's (EURATOM) role in ensuring EU Member States uranium for nuclear power production. "It would be created in stages. Initially, bilateral agreements would be stripped of any secret and market-distorting clauses; then, a template contract would be created for all new gas contracts; finally, the European Commission would be required to take a role in all new negotiations."
2. *Solidarity Mechanisms.* The Energy Union should guarantee solidarity among member states in case energy supplies are cut off again. Tusk noted: "Europe must be safe in the knowledge that its gas supply is assured, its storage facilities are sufficient and its gas networks are uninterrupted."<sup>19</sup>
3. *Building energy infrastructure.* In countries where the security of supply is most problematic (i.e., dependency on Russia is highest), Tusk argued: "storage capacity and gas links should be built with the help of the EU. Such projects should enjoy the highest permitted level of co-financing from Brussels – 75 per cent" to increase flexibility in the market.
4. *Full use of the fossil fuels available, including coal and shale gas.* Coal shall be considered synonymous with energy security in CEEC. Tusk remarked that "we need to fight for a cleaner planet but we must have safe access to energy resources and jobs to finance it." Energy production within the EU should be increased, including fossil fuels such as coal, and, if possible, shale gas.
5. *Diversification of external suppliers.* More suppliers should come to the European market. In particular, LNG trade should be expanded with the possibility of buying gas from more remote countries like Qatar, the US, Australia.
6. *Reinforcing the energy community.* The EU's internal market for energy should be strengthened through stronger institutions and decisions. The energy community should be enforced and extended eastwards beyond the EU to boost energy security for the whole of Europe, not only for the EU.

<sup>19</sup> The International Energy Agency's (IEA) crisis management system for a disruption in the oil market parallel this element in the proposal (Jakubowski et al., 2011: 17). Such a system does not yet exist for the European gas market.

Leading politicians in the CEEC hoped that Tusk would follow up on the idea of an Energy Union and make it into EU policy when he took over as president of the European Council (Crisp, 2015). His challenge was to transform it from being an Eastern energy security project to becoming a unifying European project with the support of countries also in Western Europe. Western European countries' gas interests diverge, to an extent, from the interests of the CEEC, while, at the same time, they constitute the bulk of EU gas demand. Around 80% of demand originates from major Western countries (predominantly Germany, UK, Italy, France, Netherlands, Spain, and Belgium), and, thus, only a smaller percentage comes from the CEEC. In Western Europe, markets are more developed; they face far less acute energy security problems and dependency on Gazprom; and their relations with Russia are relatively more distant than in the CEEC. In 2014, EU President Herman van Rompuy supported nevertheless Tusk's proposal, stating that the energy challenges of today are of the same kind as the problems faced in the early 1950s that spawned the European Coal and Steel Community (ECSC). However, the Energy Union that was proposed by the EU on February 25, 2015, just a few months after Tusk took over the presidency, had its focus on "secure, affordable, and climate-friendly energy for citizens and businesses" (EU, 2015a) rather than a primacy on security-of-gas supply problems in the CEEC. The proposal was limited to a work package of legislative and non-legislative actions and covered a wide range of policy areas such as competitiveness, climate, transportation, industry, research, the digital economy, and agriculture. It was based on five "dimensions" (EU, 2015a):

1. *Secure energy supplies.* Dependence on energy supplies from outside the EU should be reduced by the means of more efficient use of domestic energy sources while diversifying to other sources and supplies. The proposal stated that a solidarity clause should assure that a reduction in "dependence on single suppliers and fully relying on their neighbors, especially when confronted with energy supply disruptions."
2. *Internal energy market improved.* The proposal argued that "energy should flow freely across the EU - without any technical or regulatory barriers".. "as if it were a fifth freedom." Current rules should be strictly enforced "in areas such as energy unbundling and the independence of regulators – taking legal action if needed".
3. *Energy efficiency increased.* Increased energy efficiency should be considered an energy source in its own right. Reduction in energy consumption would reduce pollution, preserve domestic energy sources, and reduce the need for energy imports.
4. *Emissions reductions.* The target of emitting at least 40% less greenhouse gases by 2030 should be a first step. The proposal postulated that the next step "will be renewing the European emissions trading scheme and investing more in the development of renewable energy sources."
5. *Research and innovation.* The proposal argued that the EU should have the technological lead in the next generation of renewable technology to reduce energy consumption and create export and industrial opportunities and boost growth and jobs.

The EU proposal largely supported existing EU policy for energy and the environment.<sup>20</sup> For energy, its main focus was to realize a

<sup>20</sup> Some of the most important elements for gas trade were:

- A revision of the Gas Security of Supply Regulation (EU, 2010) and increased transparency of commercial gas supply contracts.
- Joint preventive and emergency plans including contracting parties including stress tests.
- An LNG strategy including the need to build transport infrastructure to link LNG access points to landlocked countries.



well-functioning SM, where, in practice, much political competence had remained at national levels with requirements for voluntary cooperation between Member States in cross-border projects. This is typical for much of EU energy policy (Tosun et al., 2015; Schubert et al., 2016). Tusk's desires to alter policy focus towards energy security and to introduce additional interventionist measures to deal internally with the single market, and externally with the economic relations with Russia, were largely omitted.<sup>21</sup> However, in February 2016, the Commission presented an Energy Security Package to address the security-of-supply problems, often called a "Gas Package" (EU, 2016). It had again its main focus on increased internal renewable energy production, diversification of energy sources, routes and suppliers, and to complete the SM. In addition, in an attempt to replace national gas policies with regional ones, it listed a solidarity principle that should be applicable in severe crisis implying that natural gas supplies to households and essential social services entities should be served also by neighboring countries. Most importantly it addressed contracts with external gas suppliers. Natural gas companies should notify member states and the Commission about contracts relevant to security-of-supply upon their conclusion or modification. Such contracts should be longer than one year and when more than 40% of the gas consumption is in the hands of a single third country supplier.<sup>22</sup> The Commission and national authorities may demand to scrutinize contracts if they deem it necessary for security-of-supply concerns. The Inter-Governmental Agreements (IGAs) system should empower the EU Commission to ensure future IGAs' compliance with EU law and to review ex-ante intergovernmental agreements to be signed with non-EU countries. The IGA Decisions should extend its scope to non-legally binding instruments for the assessment. The decarbonization of the heating and cooling sector was also a priority. More LNG and natural gas storage should enhance economic incentives to cooperate with international partners for construction of new liquefaction facilities and regional infrastructure as alternative to pipeline imports. The securitization of member states energy situations should be met by more natural gas pipeline interconnections and cross-border interconnections. A large list of key energy infrastructure projects as Projects of Common Interest (PCI) was made, and an Energy Infrastructure Forum (EIF) to discuss progress on pipelines and electricity interconnectors was proposed. In promoting new gas pipelines and LNG terminals, the EU Commission should establish a Connecting Europe Facility (CEF)<sup>23</sup> and a European Fund for Strategic Investment (EFSI)<sup>24</sup> to bridge the investment gap in private-public financial solutions. In these

arrangements gas infrastructure must compete with infrastructural projects in other sectors. As their funding is only vaguely addressed, both are so far "in the air" for realization.

## 5. EU fragmentation and a common energy policy

The EU strategy for increased import of LNG from a variety of sources, building of more storage and pipeline infrastructure, and for growth in renewable energy production is coherent with both Western and Eastern EU energy policy. All steps taken to diversify energy purchase will help energy security problems of the CEEC. Insights by the Commission and member states on contracts with foreign countries and suppliers considered important to security are expanding SM policy into external relations and will be supplements to the ongoing legal conflicts between the EU and Russia. However, challenges remain as to whether the EU system, and member states in the East and the West will be able to agree and *de facto* implement policies to reach internal and external goals. In the EU, common principles set are usually implemented in a non-politicized regulatory progress and the convergence pressure and policy harmonization thought to follow on MS does not always lead to the same policy. Often, EU rules and regulations become part of national legislation only after long lead-times, they may be translated, interpreted and implemented in different national manners, and compensatory policies may be introduced when national interests diverge with the common policy goals set. There are more reasons for this fragmentation.

First, there are heterogeneous preferences about what the EU is and normatively should be. Different perspectives in regional integration theories largely identify them<sup>25</sup> The CEEC tend to support a supranational and shared EU responsibility to strengthen positions in relation to Russia when energy security is concerned, as in many other security matters, while many Western European countries consider themselves to be better off maintaining policy at the national level. For example, in the West, the UK has spoken out against coal production and simultaneously for the right to develop nuclear power, shale gas, and renewable energy, in line with the UK's own energy policy. Furthermore, borders in the EU are not Europeanized. As Jean-Michel Glachant argued in the Energy Post 24.2.15: "When Spain wants to interconnect with Morocco and negotiates tariffs, investments, rules of access etc., they are doing EU external energy policy but they do it on a national basis. It is the case everywhere in EU." Without more EU power (federalism) in the sector and following institutional change and strengthening the EU also financially, it is difficult to fully realize a common EU energy policy. Glachant (2015) notes that "current institutions and policies are unsuited to deliver an energy system transformation". Hence, if challenges now are as big as Europe had in the 1950s when creating the Coal and Steel Union, as van Rompuy argued, it can only with greatest difficulties be handled

(footnote continued)

- Revision of the Intergovernmental Agreements (IGAs) on gas purchasing to ensure that they are compatible with EU law and to confirm that it is of importance for European energy security before these agreements are signed. The Commission shall be informed about, and be involved in, the negotiation of such contracts.
- Full implementation of the Third Energy Package especially with regard to unbundling and the independence of regulators.
- Strengthening of European Network of Transmission System Operators for Gas (ENTSO-G) to ensure greater cooperation between national TSOs and a "significant reinforcement of powers and independence" of the ACER.

<sup>21</sup> Interestingly, neither of the proposals for an Energy Union suggests the establishment of governmentally owned SGR facilities parallel to SPRs in the oil market to reduce sensitivity dependence, although gas stocks in more general and commercial terms are mentioned in both.

<sup>22</sup> Existing contracts should not be affected by the new rules.

<sup>23</sup> The CEF was launched in September 2014 and will use 50 billion euros of the EU budget to boost transport, energy, and digital cross border network, which, at the same time, will release additional public and private co-financing. The EU contribution will be made in the form of grants, making the co-financing rate between 20% and 85% of a given project (EU, 2013).

<sup>24</sup> The EFSI was launched in January 2015 and should guarantee the mobilization of investments in credible pipeline projects (Gimdal, 2015: 6; EU, 2015b).

<sup>25</sup> In these theories, neo-functionalists generally support the idea and vision of maximizing the benefits for the EU as an entity and expect the integration of individual sectors to lead to spill-over effects to other sectors which further the process of integration. The "Community method" of policy-making through bargaining and consensus building has been predicated upon the behavior of an entrepreneurial Commission, and the expectation that participants agree to reach common goals. A constructivist view supports such an approach by anticipating a convergence of identities and preferences as cooperation evolves. However, every country, company, or citizen may not necessarily be concerned about what is best for the EU as a whole, and may instead choose what is best for themselves. An inter-governmentalist perspective treats states and national governments as the primary actors in the integration process. It considers the Community method to be a refinement of intergovernmental diplomacy, rather than offering excessive power to supranational EU institutions. An institutionalist perspective supports this view, mostly due to the resilience of incumbent domestic institutions (and companies). See, for example, Cini and Borrigan (2010:69).

with the Commission's existing organization, power and market tools. Due to the mainly confederative structure of the EU and diverging national energy situations, political positions and interests, important policy areas may *de facto* remain at national levels, making it more difficult to reach goals considered important for the EU as a whole. The heterogeneous preferences and perceptions on common objectives concerning competitiveness, supply security, and environmental sustainability make a one-policy-for-all difficult (Pointvogl, 2009).<sup>26</sup>

Second, market maturity in the East and in the West but also within the West, differ. As van der Linde et al. (2006:47) points out; the effects of “a straightforward liberalization process can distort necessary evolutionary processes as maturation takes place.” Where the market is still underdeveloped huge investments are necessary and it is a commercial and political desire to secure long-term bindings in contrast to what a free market should look like. Where markets have matured and are more flexible and integrated (mostly in the West), the Transmission System Operators (TSOs) may act more as transporters than as merchants, as expected in a liberalized market. The problem for land-locked CEEC is that they do not have alternative supplies, being Russian gas through other countries, as LNG or gas from other suppliers. These countries need pipelines able to transit gas in sufficient amounts through other countries or other means to make demand more elastic (flexible) such as alternative energy input in power plants etc. Without sufficient infrastructure and flexibility to trade gas between more market participants, it is difficult to create a real liberalized market across the whole EU. Transnational interconnectors needed are not profitable from a business perspective, and will not be realized without some sort and degree of public intervention and support.

Third, economic developments differ between East and West and contribute in creating different preferences in the field of the environment and climate change. Although natural gas is the cleanest of the fossil fuels and is considered preferential to coal and oil, an increase in gas consumption conflicts with the environmental goal of reducing global warming unless emissions are restrained.<sup>27</sup> Tusk's proposal of increased usage of domestic produced energy, including fossil fuels was meant to value improved energy security higher than the environmental problems more fossil fuel production and consumption might create. It is a direct consequence of Tusk's attempt to switch the focus of SM policy towards a priority on energy security. However it is in direct conflict with environmental and climate goals of the richer Western EU countries. If Tusk's proposal had been confined to increased production of renewable energy sources it would have merged with the EU proposal on the issue. However, more renewables would require considerable national, EU, or other support and financing, such as for the *Energiwende*<sup>28</sup> in Germany

which involved substantial amounts of German public finances. For many of the relatively poorer countries in the CEEC this is difficult until renewables become cheaper to produce. Hence, production of more fossil fuels will not be supported by (Western) EU policy. Fossil energy will nevertheless most likely continue to be produced across the EU and especially in the East, and even increased where possible, independent of the lack of EU support.

Forth, Eastern and Western European relations to Russia in general and for Russian gas in particular are formed in a somewhat different sum of hard and soft forces, interests, path-dependent relationships and constraints. Also perception of which policy may work and not work in the relationship differ. Tusk's proposal of jointly negotiated gas contracts (a single buyer) based its logic on meeting Russia's gas sales monopoly with a purchasing monopoly (a monopsony). However, this marks a break with EU's fundamental liberal idea of an internal market with competition, and free movement of goods and services as a premise. In a market context it is also complicated in terms of how providers other than Russia should be handled, such as Norway, Algeria, and LNG exporters. Furthermore, it is uncertain what impact a pooling of purchasing power would have on Russia's market power as long as gas demand is sustained, a country has no access to alternatives and is asymmetrically dependent in favor of Russia. One cannot counteract power with if one has no power. The EU suggested rather a voluntary demand aggregation mechanism for joint gas purchasing when a member state is dependent on a single supplier compliant with WTO and EU competition rules and intended to lead to a greater degree of harmonization of terms and prices, and more transparency. The later Gas Package advised more concretely that the Commission should have direct oversight on contracts with foreign countries and suppliers relevant for security-of-gas-supply. These elements in the Gas Package represent steps to meet Gazprom's power and appears as more relevant in the context, albeit also with a more modest level of ambition, as compared to the single buyer idea, reflecting a somewhat different way of understanding markets in the East and the West.<sup>29</sup>

Fifth, the financing of extended infrastructure and better interconnectedness is based on the premise of a financially strong EU (the EU is not a financial union), a greater degree of supranationality, and more extensive use of the “Community Method”. Boersma (2015) argues that “the novelties in this policy package in terms of stimulating investments in gas infrastructure are at this point not that impressive.” To find the right public-private combination in infrastructural investments will be a most important step both for energy security, as an insurance premium against the effects of a crisis, and for the economic benefits of the completion of the SM in energy that would mitigate, albeit not solve, the energy security problems in the CEEC. Economies of scale and legislation have historically made gas companies in both the East and West, as well as in gas exporting countries, (natural) monopolies.<sup>30</sup> The huge capital costs, large volumes necessary and long pay-back time make investments not profitable for private investors in many of the projects between and to CEEC. Some sort of public co-funding is needed for unprofitable infrastructural cross-border projects that have a net social surplus when supply

<sup>26</sup> The fragmentation is also a concern in relation to EU gas companies. Abdelal (2013:423) suggests that firms rather than countries are in the center of East-West energy trade and these seek sociological conventions on the way on their own rather than following political decisions on national or EU levels.

<sup>27</sup> Natural gas is together with nuclear energy the cleanest non-renewable sources. After the Fukushima accident in 2011, several EU countries reviewed their nuclear policies with a stronger focus on natural gas. In the US, President Obama's proposals and the U.S. Greenhouse Gas (GHG) emissions reduction plan was predominantly based on shifting from coal to natural gas (The White House, 2015). An optimal energy mix focused on energy security must balance the proportion of renewables and non-renewables in its portfolio. On the non-renewables side, natural gas is the best solution available among the fossil fuels.

<sup>28</sup> The German *Energiwende* is changing the German energy situation to become dominated by renewable energy, energy efficiency, and sustainable development. Its final goal is the abolition of coal and other non-renewable energy sources by 2050. Important aspects include 80–95% greenhouse gas reductions, 60% share of renewables, broadly defined as hydro, solar, and wind power, and 50% improvement in energy efficiency. Germany's share of renewables has already

(footnote continued)

increased from around 5% in 1999–22.9% in 2012, surpassing the OECD average of 18% usage of renewables.

<sup>29</sup> The EU has long before Tusk's proposal on a joint purchase mechanisms also seen it as beneficial that large companies in the energy sector maintain a strong position of purchasing power, even if excessive market power in certain regions results and can limit competition in the EU (Finon and Locatelli, 2007:24–28).

<sup>30</sup> On the supply side, in both Russia, Norway and Algeria, national champions produced, transported and sold gas. After 1991, the EU *acquis* expanded to more, but not to all countries participating in the market (most importantly to Norway, but not to Russia and Algeria).



security and other non-business considerations are taken into account. To access private sector capital, cross-border regulation and project-design needs to be stable and sufficiently standardised, and, if still not attractive, public money, whether national or EU, must make up the difference beyond what is suggested through the EIF and the EFSI. It is unclear how transportation tariffs in such projects can be set to determine how much revenues can be expected to be taken from customers in the future. Even with a mature market and suitable related policy packages, regulatory complexity contributes to gaming, and parties' interests and power. Hence, there may be a need for changes in the functionality of the EU system to achieve infrastructural goals. With insufficient economic support from the EU or other financial solutions to build cross-border infrastructure, and proper regulation, the SM for energy may be a reality much later in the CEEC than in Western Europe, with its security-of-supply problems remaining.

## 6. Conclusions

The securitization of energy supply in Eastern Europe heavily colored Donald Tusk's proposal for an Energy Union, much within a "regions and empires" approach and much based on the view of a realist, bilateral and rather conflictual approach in East-West energy affairs. The modified version proposed by the EU was heavily influenced by continued regulatory internal market measures, largely colored by a "markets and institutions" approach, with a primary goal of completing the SM for energy. Within these two main approaches, both sides appear to acknowledge that domestic and external market and political situations together create the character and degree of sensitive and vulnerable import dependence. Tusk gave respect to the importance of "markets and institutions" in supporting the completion of the SM. The EU accepted in the Gas Package that energy security in relations to external suppliers must be helped by more measures than only internal rules and regulations. At the same time, the realization of both internal and external measures are constrained by EU political fragmentation, due different national situations and preferences about EU developments in general and energy situations in particular. The degree of merging of the views into a mutually accepted Energy Union depend on the scale and scope of this fragmentation and EU's ability to adapt.

The SM for energy may not be fully liberalized in the foreseeable future, but most importantly, become *more* liberal and flexible. The external supplier situation may become more competitive in the foreseeable future, but its negative effects on security-of-gas-supply cannot be fully neutralized. One reason is that, the Russian and EU political systems appear to remain unevenly matched. The EU largely wants to create a single energy market decoupled from the dependence on Russia and to repair for the lack of jurisdiction over the whole market through the ECT, various consultations, the Statement of Objections (SO)/court case against Gazprom, etc.<sup>31</sup> Albeit internal and external measures are seen as complementary and necessary parts of a comprehensive approach to address energy security problems, the relationship between SM policy and foreign policy remains not well defined in EU energy policy. It is assumed that internal energy policy will have beneficial effects on the EU's foreign policy and that the extension of

internal rules and regulations to create a foreign policy and external energy strategy in relation to Russia. Russian gas policy is mainly seen as a market failure by the EU. The Energy Union does not define EU geopolitical energy interests or how SM rules and regulation are at interplay with these interests. Legal power is important in the relationship, but the current court cases are basically a question of extension of EU internal rules and regulations and external dimensions of EU energy policy fall short to be part of the CFSP, nor does it include strategic partnerships with Russia or other suppliers (in the Middle East and North Africa). It does not consider energy policy as part of a broader degree of stability neither in MS nor in supplying nations. The single sector consumer oriented approach makes it difficult to help security-of-demand for suppliers which would help security-of-gas-supply from Russia and other more or less autocratic countries heavily dependent on revenues from the petroleum sector.<sup>32</sup> The lack of a holistic internal and external policy is reflected in the relationship between environmental concerns, climate change, market efficiency and foreign and security policy objectives. Far and Youngs (2015) argue that the transition to a low carbon economy is meant to be a security against climate change. Tusk's proposal for an Energy Union valued improved energy security higher than the environmental problems more fossil fuel production and consumption might create. A forward-looking climate policy should be embedded in both internal policies and external actions with third countries at the regional, national and local levels.

Internationalization and global market integration, convergence of economic growth between the East and the West, increased LNG trade, new fossil supplies (such as shale oil and gas), energy efficiency measures, and more renewables, are gradually changing the character of the interdependence between EU economies, and in the longer run also between EU gas importers and Russia. The security-of-gas supply and security-of-gas demand issues will gradually group together, based on whether prices are too high or too low, degrees of price volatility as in the oil market, and regulatory schemes. However, for Eastern countries concerned, Russian energy power is still a threat both in terms of sensitivity and vulnerability dependence. The debate over the creation of an Energy Union may follow the "normal" path of EU integration conflicts. The Commission may compel Member States to agree on it as a principle and then develop a pragmatic and non-politicized regulatory progress for its implementation. Member states will resist the convergence pressures and policy harmonization may become more about formality than reality as often is the case within the EU. A greater similarity in political forms and processes does not always lead to the same degree of similarity in actual political content and, hence, to real political convergence (Austvik, 2015:119). Buchan and Keay (2016) argues that EU policy still falls short of a real Energy Union and "appears as much about preventing the EU's 28 governments from sliding further backwards into national policies as about forward leaps in the Europeanisation of energy policy".. "The hole at the heart of the Energy Union – even as a reform process – is inadequate governance, and the Commission's reluctance to take a strong position in the face of Eurosceptic governments in member states like the UK and the CEEC". With the CEEC inside the EU, the EU is however also

<sup>31</sup> Truly, the soft power exercised by legal, quasi-legal, and institutional instruments as a force to promote Western interests is increasingly more important as alternatives and supplements to economic and military power in international affairs. Nye (2015) claims that soft power will be a main political instrument in addition to economic and military force in the interdependent world of the 21st century. Russia got a lot hard economic and military power in the 2000s, but has still only marginal soft power.

<sup>32</sup> Oil and natural gas differ as non-renewable resources from the renewables in that their supply is limited to a relatively few places in the world. In the EU, the non-renewable nature of natural gas is hardly mentioned. However, in a hypothetical free market extraction and purchase scenario for Russian gas, volatile and lower producer prices may hamper producer investments in large fields and infrastructural projects and in and by itself create a security of supply problem for the EU. Hence it is an industrial desire throughout the gas chain to maintain long term relationships and prices that secure investments in production and infrastructure for large portions of the volumes (albeit not all), which a completely liberalized and more volatile market may threaten.

changing. With a stronger voice from the CEEC, an increased focus on energy security may be accepted also in Western countries with following political, financial and institutional change, especially if a new gas crisis should occur. For the Energy Union, additional and more realist oriented policies to improve access to alternative suppliers and better interconnectedness could bring the internal energy market closer to reality and mitigate, albeit not solve, the effects of a new gas crisis. Some countries may change their situations from being vulnerable to (only) sensitive in their import dependencies. It could hence contribute in making the Energy Union a unifying project merging the positions and interests of Eastern and Western Europe despite their different security-of-gas-supply concerns with Russian gas.

## Acknowledgements

This paper was written as Senior Fellow at Harvard Kennedy School. Thanks to Devjani Roy for comments to and proofreading earlier versions of the manuscript, to Yasir Gokce for checking references, and to Jakub Godzimirski, Paulina Landry, Carolina Lembo, and Zuzanna Novak. Thanks to the editor and anonymous referees for comments to the final text. Any errors that remain are my sole responsibility.

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