Locking Horns over Natural Gas:

The EU and Russia's Discussion on Energy Security

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Resumé

Energipolitik i en europæisk sammenhæng har levet en omflakkende eksistens. Energiresourcer havde så stor betydning under Anden Verdenskrig, at man valgte at oprette to fællesskaber målrettet energi: Den Europæiske Kul- og Stålunion og Det Europæiske Atomenergifællesskab (EurAtom). Det tredje fællesskab, Det Europæiske Økonomiske Fællesskab (EØF), havde til formål at styrke handel og samarbejde mellem medlemslandene. Mens Kul- og Stålunionen langsomt mistede aktualitet og atomenergi blev mere omdiskuteret, udviklede EØF sig til det moderne EU. Energipolitik i EU har længe været omstridt. Indtil Lissabon-traktatens vedtagelse var energi ikke en del af EUs traktatgrundlag. Ønskede Kommissionen at foretage sig noget på området, måtte man ty til miljø- og konkurrencereglerne.
De første direktiver så dagens lys i 1996, elektricitet, og 1998, gas, men baggrunden ligger mere end tyve år tidligere. I 1973 indførte Organisationen af Petroleum Eksporterende Lande (OPEC) en embargo mod Vesten som følge af en krig i oktober 1973 mellem Israel på den ene side og Egypten og Syrien på den anden. Embargoen betød at Europas energiforsyningssikkerhed var alvorligt truet, for størstedelen af den olie Europa brugte blev importeret fra Mellemøsten. Europa havde behov for at sprede risikoen for lignede afbrydelser af energiforsyningerne ud over flere energikilder og flere leverandører. Det gav Sovietunionen mulighed for at trænge ind på de europæiske markeder. Soviet havde længe udvundet naturgas og havde oprettet et vidtspredt rørledningsnetværk igennem Sovietunionens republikker. Man kunne med relativ lethed udvide dette netværk ind i Europa. Umiddelbart viste Soviet sig at være en mere stabil leverandør end OPEC-landene.
De første tegn på ændringer i samhandlen viste sig efter Sovietunionens fald i 1991, og Vladimir Putin blev russisk præsident. I soviet-tiden havde styret i Moskva jævnligt brugt gas som et pressionsmiddel til at tvinge sovietrepublikker med oprørstrang til at makke ret uden det gik ud over gasleverancerne til Europa. Sovietunionens sammenbrud betød at en række nye lande så dagens lys. De resourcer og faciliteter der befandt sig på de nye landes territorium blev national ejendom, mens Rusland overtog størstedelen af Sovietunionens gaskontrakter. De turbulente år fra Sovietunionens fald og til Vladimir Putin blev præsident betød at Ruslands politiske betydning på den internationale scene blev formindsket. Samtidigt var Ruslands muligheder for at øve indflydelse over de tidligere sovietrepublikker mindsket betragtligt. Et af de få tilbageværende midler var, og er stadig, naturgas.
De russiske gasfelter er forbundet med de europæiske markeder via rørledninger der går gennem ukrainsk og hviderussisk territorium. Rusland er altså afhængig af at de to transitlande tillader at gassen strømmer uhindret. Samtidigt er begge lande afhængige af at importere gas fra Rusland. Det gamle rørledningsnetværk er konstrueret sådan at der ikke er nogen adskillelse mellem gas til de ukrainske og hviderussiske forbrugere og gas til de europæiske forbrugere. I de tilfælde hvor

der har været uenighed mellem det statslige russiske gasselskab Gazprom og et af transitlandede, har de to parter kunnet bruge to pressionsstrategier: Rusland har kunnet true med at lukke for gassen til det pågældende land, og har også gjort alvor af truslen. Transitlandets mest effektive træk har været at true med at stoppe, eller begrænse, mængden af gas i transit. Begge midler blev taget i brug i 2006, 2007 og 2009. Indtil 2005 nød Ukraine og Hviderusland gavn af meget lave gaspriser sammenlignet med de europæiske gaspriser. Gazprom ønskede at maksimere og konsolidere sit overskud, og meddelte at mellem 2006 og 2011 ville gaspriserne stige så de nåede det europæiske prisniveau. Transitlandene nægtede at acceptere prisstigningerne. Gazprom lukkede for gassen, mens transitlandene tappede gas af fra de europæiske leverancer.
Under gaskonflikterne oplevede Europa stop for leverancerne. 20-20-20-aftalen fra 2007 var et forsøg på at imødegå fremtidige uregelmæssigheder i gasleverancerne og optimere det europæiske energisystem, så det er bedre rustet til fremtiden. EUs bestræbelser på at mindske afhængigheden af energi fra tredjelande har både haft betydning for energisammensætningen indenfor EUs grænser og har haft betydning for forholdet til Rusland. Både EU og Rusland taler om energisikkerhed, men de mener noget forskelligt med udtrykket. EU taler om forsyningssikkerhed. Rusland taler om efterspørgselssikkerhed.

1. Introduction

The European Union (EU) has influenced the daily lives of European citizens both living in Member States and in non-Member States. The creation of a Common Market has greatly affected the European economy since the European Coal and Steel Community (ECSC) was established after the Second World War (WWII). The EU is the offspring of the cooperation in the ECSC, the European Atomic Energy Community (EurAtom) and the European Economic Community (EEC). The EEC later developed into the EU of today but the original trinity of Communities led to an interesting division of policy areas. Two communities dealing with energy and one dealing with economic development and trade. While the EU has had a long, public development, characterised by stops and starts, into the political entity it is today; the ECSC and EurAtom have lived relatively quiet lives in the public eye until the expiration of the ECSC in 2002. The division of policy areas has meant that energy has had a weak presence in EU policy making until the political turmoils onset by the Yom Kippur war in 1973 and the oil embargo imposed by OPEC on the West as a consequence. New and reliable energy sources were necessary and these were most readily found in the Soviet Union (USSR).

1.1. Research Question and Delimitation

The weak presence of energy in the EU's common policies is at the core of my curiosity. Before the first Ukrainian-Russian conflict over the price of gas and the price of gas transits to Europe in 2006, energy had a low awareness in the public eye, while the General-Directorates had striven to liberalise the European energy markets on the quiet. These developments, as well as the two Ukrainian-Russian and the one Belarusian-Russian gas conflicts, have led me to ask the research question of this thesis:
How has the relationship between the EU and Russia, in particular around the issue of natural gas, affected the development of a Common European Energy Policy?
The evolution of the EU's energy policy is a large and complex area. This is why I have chosen to limit the topic by looking at two things: the developments that have taken place within the EU institutions from the 1970s and until 2013 prior to the current instability in Ukraine, and the relationship between the EU and Russia. Noting the role played by third countries in European energy policy this thesis also has a foreign policy aspect. I have chosen to look at energy and foreign policy from two perspectives: A supranational and a national. A country's national attitude towards energy, and that country's attitude towards external energy suppliers, influence the EU's institutional attitude towards energy and vice versa. Looking at the attitude of all 28 Member States, however, is too ambitious for the purposes of this thesis. In stead I have chosen to look at the division between Member States that view energy as a question of high politics of such great

importance that direct state control is considered indispensable, and the Member States that consider energy to be a commodity that need some regulation but not direct political control. There are some aspects of energy policy which I will not address, or which I will only touch upon briefly. These are: energy usage in the transport sector, nuclear energy production, alternative energy suppliers, renewable energy sources and measures to improve energy efficiency. These aspects are all highly relevant in any discussion of a common European energy policy but would be too extensive to deal with in depth in this thesis.

2. Method

The EU has been described in a number of ways: quantitative descriptions in the form of statistics and other numerical data, and qualitative descriptions based on empirical and historical data. The reliability of statistics depend on the reliability of the national agencies providing data, the means and methods of collecting data and the methods of processing the collected data. This thesis is focusing on the development and implementation of a common European Energy Policy. Using the inductive approach on the area of energy policy may provide information on the practical effects energy policy may have on EU Member States' economic development, the choices national governments make when making investments in the national energy structure and the possible types of energy sources available. Statistics may also provide data on energy decisions made at the EU level and the effects of these decisions both in the Member States affected by the decisions and the EU as a whole. A substantive analysis cannot be conducted without these data. However, the reasons behind policy decisions are not always based on numbers and statistics only. History, geopolitics, political climate, and domestic energy resources play major roles in the policy making process in the Member States. To comprehend these, the deductive approach combined with theories of integration is necessary. The primary approach in this thesis will be deductive while using the inductive approach when needed.

2.1. Literature

The topic has a direct influence on the literature and sources used in this thesis. Saunders, Lewis and Thornhill (2012, p. 82) divide literature into three general categories: Primary sources consisting of original texts presenting ideas or data for the first time e.g. reports, theses, emails, some government publications et cetera. The texts may have accessibility issues either because they may be difficult to read and interpret which may be the case with legal texts, or because they are confidential or private. Secondary sources consists of books, articles and some government publications. These texts develop and expand on primary sources, and while they are not as detailed in general as primary sources, their strength is in their readability and their ease of

access. The tertiary sources are described by Saunders et al. (2012, p. 82) as catalogues, indexes, databases, encyclopaedia. What defines these is the relatively low level of detail.
In this thesis primary and secondary sources dominate with a greater emphasis on secondary sources. The primary sources used are either documents published by an EU institution describing a policy area or a treaty texts. The secondary sources fall into three main groups: Texts published by think tanks, primarily the Center for European Policy Studies (CEPS), articles from peer reviewed journals and books.

3. Theories

The thesis will be dealing with two political entities. The first, and most complex, is the European Union (EU), and the second is the Russian Federation. The main difference between the European Union and the Russian Federation is their structure. The Russian Federation has a classic federal structure with geographical areas that excise varying degrees of self governance in accordance with the guidelines and orders from the federal level. This means that the political structure is reasonably well defined, and policies involving other countries are defined and implemented in one single place. In the case of the Russian Federation, that place is the Kremlin. While the Russian Federation constitutionally is a democracy, Freedom House's annual Freedom in the World 2014 report on Russia ranks the country as not free (Freedom House, 2014b). The EU on the other hand is not a federation but an organisation consisting of independent democratic states (Freedom House, 2014a). There is no word for what the EU is. The EU is an unidentified political object. It is an UPO. This was of little consequence when the Union dealt with policy areas that were either exclusively the domain of the Union or the Member States. With the introduction of shared competences in article 4 in The Treaty on the Functioning of the EU (TFEU) this division has become blurred. Energy and foreign policy are areas where the EU's institutions and the national governments share responsibility and competences. US Secretary of State Henry Kissinger famously asked who he should call when he needed to speak to Europe. To address this, the EU created the position of High Representative of the Union for Foreign Affairs and Security Policy, embodied by Baroness Catherine Ashton until November 2014. However, each Member State maintains the right and privilege to formulate their own foreign policies. So while Mr Kissinger might be able to call Europe by dialling lady Ashton, he would still need to call the German, French et cetera foreign ministers. This creates a duality in European foreign affairs that may in some cases simplify and in other cases complicate coherent European foreign policy responses. This also applies when foreign policy is exchanged with energy policy, or rather the complexities are compounded as energy policy is developed both locally, nationally, and on the Union level, as well as the foreign policy aspects of energy imports from third countries e.g. Russia, Norway, Middle Eastern countries, North African countries, the United States and Canada. The energy dependence, political, and economic relations all have an effect on the

Union's, and the Member States', attitudes towards international relations and the formulation of energy policy. The conflicts between Russia and Ukraine/Belarus in 2006, 2007 and 2009 illustrated the need for greater coordination and cohesion in the European energy markets, energy and foreign policies.
Traditionally the EU has been analysed by means of neo-functionalism or intergovernmentalism. Both these theories have shown their merits in describing and analysing aspects of the functioning of the EU system and the integration process. However, the political system is affected by the way the political actors, in this case the Member States, act within the system. Some areas, such as energy policy, are determined by the national governments, but the domestic policies are affected by supranational decisions concerning CO2 emissions, binding targets on the use of renewable energy sources, targets for energy efficiency et cetera. This places policy areas like energy in an interesting "in between" place that neither the supranationalism of neo-functionalism nor the domestic domains of intergovernmentalism have the tools to analyse.

3.1. Alternative Theories of Integration

There are other theories that attempt to address the gap between the two old grand theories. Two of these are Multi-Level-Governance and Europeanisation. Both these may perhaps be better characterised as concepts rather than rather than theories.

3.1.1. Multi-level-governance (MLG)

MLG looks at the complexities involved in policy making. While the EU institutions are powerful, they are still dependent on national governments and parliaments to adapt and implement common rules in much the same way national politicians depend on regional and municipal institutions and politicians. Policies are developed and tested on all levels, from the very local to the union level. Neo-functionalism and intergovernmentalism do not take sufficient notice of this reality (Rosamond, 2010, pp. 115-116). While MLG is excellent when looking at the actual workings of policy making, it lacks the tools to predict future developments. I have chosen not to use MLG in this thesis for two reasons: 1) The complexity of the concept would too easily move the focus on the thesis from policy developments in the EU institutions to the policy making in the national assemblies. 2) MLG has developed a number of interesting concepts and highlights the deficiencies of both neo-functionalism and liberal intergovernmentalism, but at the moment of writing this thesis, MLG seems too loosely defined.

3.1.2. Europeanisation

Europeanisation is divided into five schools: 1) National adaptation - Member States adapt to the developments in the EU’s institutions, 2) National projection - Member States project their policies to the EU’s institutions attempting to transfer national policies to supranational institutions and

other Member States, 3) Identity reconstruction - Shared values and norms emerge among policy making elites, common ground is sought and promoted, 4) Modernisation - Reforming and modernising the political, legal and economic systems of prospective Member States to ensure compliance with EU standards, 5) Policy isomorphism - Direct and indirect national adaptation, direct adaptation is the transfer of competences to the EU, while indirect adaptation is the emulation of policies among Member States (Wong, 2011, pp. 150-158). Europeanisation is a sprawling collection of concepts that allows its theorists to view the development of the EU in more varied and complex ways than both neo-functionalism and liberal intergovernmentalism. I have chosen not to use Europeanisation because of its complexities. Energy policy and foreign policy are both complex areas of study, and compounding these complexities with the complexities of Europeanisation would be deeply interesting and likely highly informative, but my reasons for excluding MLG applies to Europeanisation as well: namely that this thesis would become too focused on minute details rather than the overall picture, and that the concept of Europeanisation is too loosely defined.

3.2. International Relations Theories

3.2.1. Realism

Realism is the first empirically based theory on the behaviour of states and political leaders. It is based on a rather pessimistic view on human nature. This pessimism is followed by an assumption that all international relations must by nature be conflictual and that war is an inescapable fact of international politics.The perceived conflictual nature of international politics dictates that the security of the nation and the survival of the state is the primary goal of any government. The pessimistic view on human nature also means that realists tend towards scepticism with regard to progress in international politics (Jackson & Sørensen, 2013, p. 66). Realism is an old theory dating back to ancient Greece. The first to evolve realism as a theory based on empirical evidence was the historian Thucydides, who wrote of the Peloponnesian War (431-404 BCE). The theme was developed by Machiavelli in Il Principe (The Prince), Hobbes in his Leviathan and later by Morgenthau in Politics among Nations: The Struggle for Power and Peace. Central to these theoretics is the belief that the acquisition and possession of power, and the utilisation of power is at the core of political activities. The pessimistic perception of human nature and the power politics of international relations leads to the assumption that the international system of states is anarchistic where power and the willingness to deploy that power defines a state's position in relation to other states'. In this kind of system there is little room for non-state influence. International organisations, NGOs and individuals have limited or no power to influence the balance of power between states.

Key Points

The basis for realism is the assumption that human nature is conflictual in its natural state. In order to overcome the disadvantages of nature states are formed and given the authority to impose internal order and external security. The conflictual natural state then moves up to the state level creating an anarchistic international political system where conflicts ultimately are resolved through war. Realists call this the security dilemma; To ensure security the state is created, but the creation of states eventually leads to war thereby endangering the sought security.

The survival of the state, the strengthening of the state and the position of the state in the international anarchy depends on the power and abilities of the state's leader, its “prince”. The leader must both possess the brute strength and courage of the Lion and the agility and deviousness of the Fox as described by Machiavelli (Jackson & Sørensen, 2013, p. 69). The leader must also posses foresight, prudence, caution and good judgement to succeed in ensuring his own power, the well being of his population and the survival of the state (Jackson & Sørensen, 2013, p. 68). Power and the nature of power is contingent on both the perceived willingness to utilise it and the manner in which power is used. Thucydides and Machiavelli both point out that there is a distinction between the personal morality expected by a private citizen in a state and the moral of a state. Political ethics allow some actions that would not have been tolerated in the private sphere, if those actions are taken to ensure national security, or may be of benefit to the society in question (Jackson & Sørensen, 2013, p. 70).

As mentioned, the international system is anarchistic in the realist's perception, however it is not chaotic. There is some kind of order; The great powers may seek to balance the influence of their opponents, there is a "balance of power" that is meant to diminish the likelihood of long, destructive wars. The Cold War between the US and the USSR is an example of the balancing of power in international politics. The Cold War has been described as a bipolar system i.e. a system of two hegemonic powers that are roughly equal in strength, but the end of the Cold War has increased the complexity of the international system (Jackson & Sørensen, 2013, p. 80). After the Cold War it has been suggested by Waltz that the international system was multipolar i.e. a system of many powers, or at least a number of regional hegemonies contesting with each other. Huntington and Ole Wæver have suggested that the term unimultipolar might more accurately describe the current world order. Wæver explains the term as a situation where one great power, the US, sees the world as unipolar while the other great powers see the world as multipolar (Wæver, 2010). In a realist perspective the most stable balance of power is the bipolarity, while the more complex kinds of polarity are difficult to predict.

3.3. Liberalism/EU Integration Theories

The EU integration theories, neo-functionalism and liberal intergovernmentalism, are part of the group of liberal international relations theories. Unlike realism's zero-sum game, liberalism acknowledges the possibilities of political win-win situations and the options provided by greater interdependence and cohesion for the benefit of the individual state.

3.3.1. Neo-functionalism

Neo-functionalism was the first attempt at theorising the burgeoning European cooperation after WWII. It was formulated by Ernest Haas and published in 1958. Originally, Haas' theory was not meant to explain today's multifaceted European cooperation. Haas' objective was to provide analytical tools to comprehend the founding and workings of the European Coal and Steel Community (ECSC) (Jensen, 2010, p. 72). It is worth noting that the first supranational cooperation in European history was based on coal, the dominant energy source at the time. It should also be noted that until the Lisbon Treaty, energy was almost non-existent in the EU's legal framework, not because it was considered unimportant, but because it was considered to have such importance that it merited two separate communities, the ECSC and EurAtom.

Spillover

Haas' original theory had three main characteristics: spillover, elite socialisation, and supranational interest groups. Spillover is both the best known and the most fundamental concept in neo-functionalism. It refers to the process of political cooperation in one area, which leads to cooperation in other related areas. An example is the free movement of workers. The original goal was to ensure that workers from one Member State could find employment in another Member State. However, education and certification/authorisation from one Member State might not be accepted by another Member State because of differences in educational systems. This was an obstacle to the original goal of free movement of workers. The Member States needed to establish cooperation in a new policy field i.e. education, to achieve the original goal. In this example there is a spillover from free movement of workers to educational policy (Jensen, 2010, p. 75). Simply put, the wish to achieve one specific goal will generate new goals, which in turn will generate new goals, etc. Spillover may be divided into three types: functional, political and cultivated spillover (Jensen, 2010, p. 76). The example above is a case of functional spillover. The functionality of one policy area creates a pressure for cooperation in another related policy area. Political spillover is a more deliberate process used when actors, these may be national governments, supranational institutions, political parties or NGOs, see a benefit in arguing for European solutions rather than national. Neo-functionalists consider environmental protection, climate change and social dumping to be areas where national solutions cannot adequately address the cross border aspects of the issues. The last type of spillover, cultivated

spillover, is when a supranational actor e.g. the European Commission, uses intergovernmental negotiations to promote further integration. The Commission may do this by offering bargains focusing on Member States' special interests. France may have an interest in maintaining the current agricultural policy, while the UK may have an interest in liberalising the EU's financial policy. By linking these unrelated policy areas in a "package deal" benefiting the two Member States, the Commission may persuade them to support further integration on a third policy area e.g. equal pay or environmental policy. Lindberg and Scheingold point out that this type of integration is based on Member States accepting delegation of sovereignty on specific issues, and this delegation leading to the need to delegate further (Jensen, 2010, pp. 76-77). Neo-functionalism predicts that the process of integration is likely to become less political and more technocratic over time. The integration process grounded almost to a halt during the 1970s showing that the automatic process envisioned by Haas had little foundation. This failing led to the decline in popularity of neo-functionalism among scholars (Jensen, 2010, p. 81).

Elite Socialisation and Supranational Interest Groups

The last two concepts, elite socialisation and supranational interest groups, are closely connected. They are based on the idea that certain groups e.g. parties, interest groups and elites, become more Europeanised over time if they perceive supranational solutions as favouring their specific interests. Neo-functionalists focus especially on the EU's bureaucratic elite i.e. the EU officials. The EU's officials are expected to take a European rather than a national view on policy issues. Because of this neo-functionalists expect them to shift their loyalty from the narrow national perspective to the broader supranational perspective of the EU institutions and thereby promote further integration both nationally and supranationally. Interest groups are expected to unite across borders to promote certain policy development within the EU. The focus of these groups might be political e.g. environmental issues, or economic e.g. agriculture and financial services.

Critique of Neo-functionalism

Haas' original theory has been criticised by a number of scholars: Haas himself, Andrew Moravcsik, Robert Keohane and Joseph Nye (Jensen, 2010, p. 79). The original prediction of neo-functionalism was that EU integration would gradually increase and become less political and more technocratic. This attitude, along with the elite focus, has caused both the EU and neo-functionalism to be dubbed undemocratic. The most striking critique of neo-functionalism was formulated by Moravcsik in 1993. He points out that the neo-functionalists' focus on the autonomy and influence of supranational officials neglects the importance of national leaders and the role of nation states in the European Union (Jensen, 2010, p. 80).
Moravcsik's critique strikes at the core of what neo-functionalism can and cannot do with regard to explaining the workings of the European Union. Its excellence at explaining the workings of the supranational institutions, and its failure to explain the role and authority of the national

governments renders the analyses of the concept of "shared competences" described in TFEU's article 4 incomplete at best. To ensure a more complete grasp of the workings and significance of the new shared competences, the intergovernmentalist aspects of the EU's organisational structure must be taken into consideration.

3.3.2. Intergovernmentalism

While neo-functionalism was the first grand theory, intergovernmentalism has been the dominant theory in the twenty-first century (Cini, 2010, p. 87). There are a number of variants of intergovernmentalism, but the most significant was formulated by Andrew Moravcsik as a response to Haas' neo-functionalism. Moravcsik's intention was to create a theory that bridged the gap between neo-functionalism and intergovernmentalism.
Intergovernmentalism is characterised by its state-centrism contrasting Haas' supranationalist institution-centrism and in its most fundamentalist form intergovernmentalism considers European integration as a zero-sum game which is limited to areas that do not encroach on national sovereignty. The driving force behind integration in intergovernmentalist theory is the national interest and actions championed by the Member States (Cini, 2010, p. 87). Many of the conceptual ideas behind intergovernmentalism are drawn from one of the oldest theories in international relations: realism. The basis of realism is that the international political system is anarchistic and lacking a global hegemon capable of securing order in the system. In such an environment nation states must act rationally to ensure their own self-interest. By contrast intergovernmentalism works within a political system with a relatively high degree of order e.g. the EU and its formalised negotiation framework.
Intergovernmentalism is often used to analyse EU politics, but most international organisations i.e. the UN, the Organisation of American States (OAS), the Association of Southeast Asian Nations (ASEAN) etc, are intergovernmental bodies. These organisations offer a forum for negotiations between the governments of sovereign states. Their power is based on the willingness of the member states to comply with decisions made within the organisation's framework. Should a member state refuse to comply the organisation has little or no power to enforce compliance (Cini, 2010, p. 88). A final characteristic of international organisations is that they have no power over taxation and rely on contributions from their member states. The EU does not have to authority to lay taxes on the Member States. Here the EU resembles the UN. It has an institution acting as a negotiation forum for the Member States' governments in the European Council. The EU digresses from the classic intergovernmentalist theory by having distinctly supranational institutions, the Commission and to some extent the EU Parliament.

3.3.3. Liberal Intergovernmentalism (LI)

Moravcsik's brand of intergovernmentalism is an attempt to bridge the dichotomy between neo-functionalism and traditional intergovernmentalism, while staying in the intergovernmentalist camp.
Moravcsik bases his theory on the assumption that states behave in a manner that utilises "the most appropriate means of achieving their goals" (Cini, 2010, p. 97). LI makes the assumption that states are rational actors and European cooperation is based on the preferences and powers of the participating states. This means that any bargains reached within the EU are limited to being agreements of the lowest common denomination.

Two Dimensions of LI

Moravcsik operates with two dimensions: supply and demand. The logic is that there is a demand for cooperation coming from the national political scene, and a supply of integration derived from intergovernmental negotiations. In other words, there is a domestic push for cooperation and a regional pull towards integration. Moravcsik explains the connection between supply and demand by using three steps. Each of these steps are explained by a different set of factors that draw on a variety of theories (Cini, 2010, p. 97). The first step, economic interests, focuses on national preference formation. Rather than considering national interests as something derived from a Member State's geopolitical concerns, Moravcsik sees national interests and thereby also the national preferences as something derived from domestic politics. In other words, national policy preferences are highly dependent on the interests of dominant groups within society. The second step, relative power, focuses on strategic bargaining between states and the importance of governmental elites in the shaping of international relations. The negotiations are generally a two-stage process. First, the governments strive to resolve the policy issues in question, and second, the governments strive to agree on institutional mechanisms that allows the implementation of the decisions made in the first stage. The outcome of these negotiations are dependent on the power of the participating Member States in relation to each other. Large powers e.g. France, Germany and UK, hold relatively more negotiation power than smaller or poorer Member States and they are therefor more likely to sway negotiations to their benefit.
The third step, credible commitments, deals with the institutions set up to facilitate and improve the efficiency of the interstate negotiations. The European institutions' purpose is to create links and compromises bridging issues where it might be tempting for Member States to avoid complying with a decision. The institutions reflect the need for "credible commitments".

Critique of LI

Moravcsik's theory has been subjected to a number of critiques. The most common critique is that LI is not a theory of European integration but one of intergovernmental negotiation. Its choice of empirical references are too selective to be representative of the aspects of the EU that are not

clearly intergovernmental (Cini, 2010, p. 99). The strength of LI is in its application to decisions that shape history. Moravcsik chose five cases to demonstrate his theory in his book The Choice of Europe (Cini, 2010, p. 99): 1) the negotiation of the Treaty of Rome, 2) the consolidation of the Common Market and the Common Agricultural Policy, 3) the set up of the European Monetary System, 4) the negotiation of the Single Market Act and 5) the negotiation of the Treaty on European Union. However, LI runs into trouble in the everyday small scale politics (Cini, 2010, p. 100).

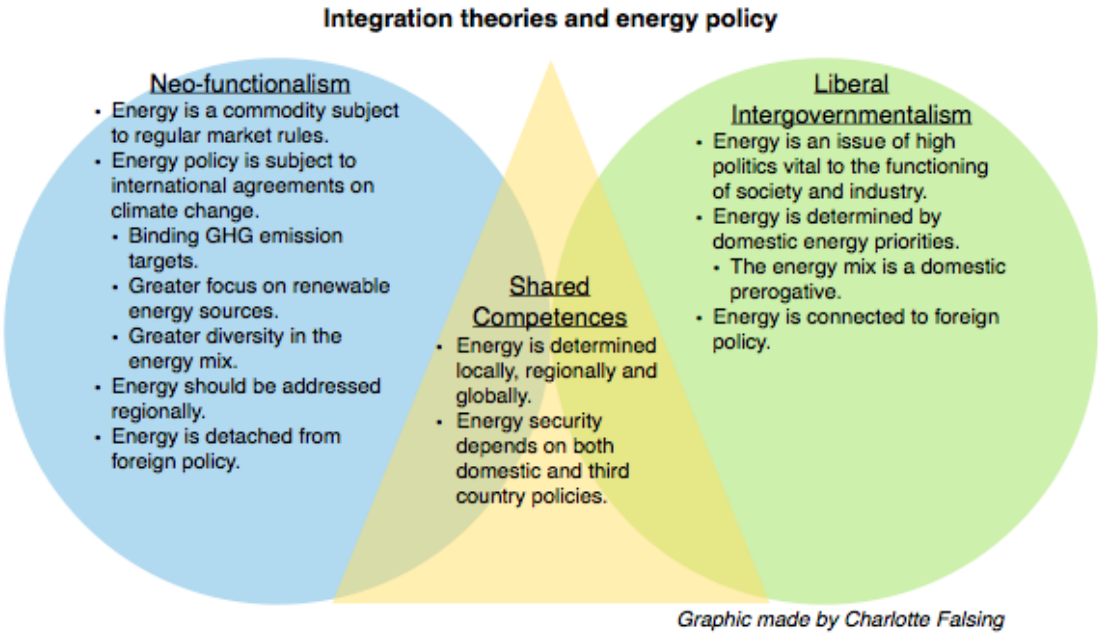
Another critique of LI is the way national preferences are formed. Moravcsik's liberal view focuses mainly on economic interests, but in reality the range of influences that determine a state's national preferences is huge and divers. He is also criticised for being too simplistic in his depiction of EU politics. He basically argues that there are two levels, the national and the international, but the realities of EU politics are such that the structure of European politics is multi-level, local, regional, national, international and global (Cini, 2010, p. 100).

LI has also been criticised for underestimating the importance of supranational actors, specifically the European Commission and the European Court of Justice. According to Moravcsik, the Commission is little more than a facilitator and mediator when significant decisions are made. The empirical data suggests that the Commission and the Court of Justice exercise greater influence and independence than allowed for in LI. The EU institutions are not only underestimated, so is the influence of non-state actors e.g. multinational companies, interest groups and NGOs. These may not exercise direct transparent influence over policy making, but they may exercise indirect influence through a variety of lobbying activities (Cini, 2010, p. 101).

3.4. Shared Competences

Neo-functionalism and intergovernmentalism have each shown their qualities in providing analytical and predictive tools to understand the complex organism known as the European Union. The difficulties in applying these two theories lie in the aspects of the Union that are neither clearly supranational nor clearly intergovernmental. As mentioned in the introduction article 4 of the TFEU introduces a new type of competence. Competences can be divided into exclusive competences held by the EU, supporting competences held by the Member States, and shared competences which fall between the two. The two grand old theories, neo-functionalism and intergovernmentalism, do not take this innovative development into account. The topic of this thesis is one of the shared competences i.e. energy policy. Energy is linked to domestic energy policy, domestic environmental policy and foreign policy, but energy is linked to the EU's various commitments on climate change, through the Kyoto Protocol, environmental protection, through the EU's ambition to be global leader on environmental protection, and the complexities of EU foreign policy at the same time. This web, with energy at it's centre, branches out across the local, regional, national and supranational levels of decision making and implementation. It leads to a

joining of two otherwise contradictory theories; neither the supranational decision making level, neo-functionalism, nor the domestic decision making level, intergovernmentalism, can be said to have sovereignty over or be subordinate to the other. Energy is at the one and the same time a purely domestic policy area and a policy area strongly influenced and controlled by the European institutions.



Graphic made by Charlotte Falsing

In this thesis I intend to use both neo-functionalism and intergovernmentalism to explain the development of the common European energy policy. Neo-functionalism will be utilised in explaining the aspects of energy policy dictated by the European Commission and to some extent the EU Parliament whereas intergovernmentalism will be used to explain the aspects of energy policy that are under domestic control.

4. Energy's Historical Importance

The first pillars of European cooperation after WWII were coal and steel. The two most important commodities needed when preparing for and making war. In 1951 the ECSC was established and seven years later, in 1958, the energy dimension was extended to include nuclear energy in EurAtom (McCormick, 2005, p. 63). The ECSC and EurAtom both illustrate that energy was considered an area of high politics by the original Member States.

4.1. War and Peace

When France, Germany and the Benelux countries created the ECSC they agreed to secure the free movement of coal and steel between the Member States (McCormick, 2005, p. 61). By

removing the Member States', especially France and Germany, means to impose trade barriers on the two most important industrial resources, the financial and political means to resume warmongering after the WWII was significantly reduced. At that time in Europe's history, coal was the main source of energy and for that reason it was paramount to ensure formalised cooperation between the two former adversaries i.e. Germany and France.
The importance of coal diminished up through the 1950s and the 1960s while Middle Eastern oil and Soviet gas increased in importance, primarily due to the versatile nature of oil. Energy policy led a very quiet existence until the energy crises in the 1970s. In 1973 the Organisation of Petroleum Exporting Countries (OPEC) imposed an oil embargo on the West. The embargo helped open the eyes of the European Community to the dangers of single supplier dependence. The 1973 oil crisis was less a case of single supplier dependence but rather a dependence on supplies from a single region acting jointly to raise the price on oil (Goldman, 2008, p. 46). In Denmark the 1973 crisis led to innovations such as car-free Sundays and a heightened focus on energy efficiency. The same tendency could be seen in the rest of Europe, but as the embargo was abandoned by OPEC some of the urgency for utilising energy efficient measures was diminished.
In the following two decades, energy became less important from a regional perspective and moved into a more national sphere. Energy was still important from a societal point of view, but moved from being an issue of high politics to becoming more of a low politics issue. Energy was not considered to be a commodity suffering from scarcity. Coal as an energy source decreased in importance while oil and gas became increasingly more important. After WWII, Western Europe was in great need of energy to ensure economic growth and the versatile usage of oil especially ensured this. Oil and gas were both easy substitutes for coal in electricity production and gas became a more widely spread household commodity for heating and cooking. Europe was not without options; in 1965, British Petroleum discovered natural gas in the Southern North Sea (BP, 2014). Denmark, Norway and the Netherlands also found oil and gas reservoirs within their maritime borders.

4.2. Geopolitics

By the time of the oil crises in the late 1960s and early 1970s, gas from the Soviet Union (USSR) was an integral part of the national energy mixes in a number of European countries. A country's energy mix is a composition of energy sources. It depends on the energy sources available, both domestically and imported; it depends on domestic energy demands, and it depends on economic, environmental, social and geopolitical choices. The decision to buy Soviet gas was originally taken with great caution. The European countries, and the US, were worried that the USSR might use gas to put Western Europe under political pressure and the US was worried that the trade in gas might economically strengthen the USSR, thus shifting the balance of power in

the Cold War; Western Europe agreed to avoid large scale dependency of Soviet gas (Goldman, 2004, p. 46). It is worth noting that the USSR did not use gas to put political or economical pressure on EU Member States, the USSR did use gas to put pressure on Yugoslavia under the rule of Josip Broz Tito, Israel in 1956, Finland in 1958 and China in 1959 (Checchi, Egenhofer, & Behrens, 2009, p. 19; Goldman, 2008, p. 49). The confidence in Soviet gas deliveries increased, and Germany imported 45% of its total gas consumption from Russia by 2004; while several Eastern and Central European countries imported between 80% and 100% from Russia (Goldman, 2004, p. 166).
Trade between the USSR and the West had suffered since WWII and the USSR needed foreign currency to finance activities in Western Europe. Millions of dollars moved from Western Europe to the USSR and back again. After 1991 and the collapse of the USSR, the use of gas as a political and economical weapon became more common. Examples may be seen in Belarus, Ukraine and Georgia to name a few. While gas has not been used as a weapon aimed directly at EU countries, it has been used against the two key transit countries, Ukraine and Belarus, and the effects have been strongly felt in the EU (Goldman, 2004, p. 49).

5. Main Actors

There are a number of actors that exert influence over the development of the EU's energy policy and the measures taken to ensure a free and fair competitive market. Some of these actors are the European institutions and the Member States. Others are energy enterprises and the various lobby groups employed to influence national governments and the EU institutions. The following will primarily focus on actors within the EU.

5.1. Member States

The EU’s Member States have transferred part of their sovereignty on a wide range of policy areas to the supranational institutions in the EU. The transfer of power forces the governments, the executive branches, to abide by decisions made outside the national legislative branch of government. This arrangement has the drawback from the EU’s point of view that national governments may put the blame for unpopular measures on the EU, as has been seen in resent years in connection with the crisis in the Euro Zone, while taking credit for the successes that originate in the EU’s institutions.
While some areas of sovereignty has been given over to the EU, others have not. The Member States have maintained power over the most strategically important sectors e.g. energy and foreign policy (Proedrou, 2012, p. 49). The EU does affect national decision making regarding energy through directives and regulations. These are often legally based on areas that are closely

related to energy such as environmental protection or competition regulations. It is possible, and even likely, that this will change in the near future due to the Lisbon Treaty.
There seems to be a dichotomy between the Member States' wish to maintain control over their energy policy and the EU's wish to create a cohesive EU-wide Common Energy Policy supervised by the Commission. Agreeing on a Common Energy Policy is difficult for several reasons. Some of these reasons are the differences in supplier dependency and the usage of energy as a foreign policy tool in each of the Member States. Some Member States are entirely dependent on Gazprom to cover their gas consumption e.g. many of the former USSR member states, while others are largely self-supplying due to nuclear power production e.g. France, or domestic oil and gas production e.g. Denmark, UK and the Netherlands (Proedrou, 2012, p. 56). The formulation of a Common Energy Policy is further challenged by the differences in the energy mix between the Member States and to what extent the Member States each use energy as a foreign policy tool.
The clearest case of an EU Member State using energy in connection with foreign policy is Germany. Jonas Grätz (2011, p. 70) explains that former German chancellor, Gerhard Schröder, took the goal of energy security to a new level by adding a geopolitical dimension to the formulation of energy policy. Schröder’s reasoning was that further Russian-European integration is essential in order to compete with the US and the emerging powers such as China both economically, politically and culturally. This policy towards Russia seems to have been beneficial for Germany, however it does not seem to be in accordance with the interests and attitudes of the newest members of the European Union. These countries have striven to strengthen integration with Western Europe and distance themselves from Russia. Considering that many of these countries have been unwilling members of the Soviet Union this attitude is not surprising.

5.2. The EU Commission

Energy was one of the cornerstones in the formation of the ECSC and EurAtom. While the EU may be called an extension of these two communities, energy has been conspicuous by it's absence until the Lisbon Treaty. Prior to the Lisbon Treaty, the Commission issued a number of directives aimed at reforming and liberalising the gas and electricity sectors based on the competition and environmental regulations. This has changed with the adoption of the Lisbon Treaty (Proedrou, 2012, p. 51). The Commission's objective has been to create a single internal European energy market governed by centrally regulated rules in place of the fragmented national markets. These markets were often dominated by monopolistic energy enterprises with a high degree of vertical integration i.e. a company owning both gas fields, refineries, distribution networks and sales to consumers and industries.
The Commission's task is to ensure that EU-wide competition regulations are correctly observed both by public and private companies and enterprises. It also monitor market penetration by external actors i.e. Russian Gazprom, Algerian Sonatrach, and US-Norwegian Statoil, and

supervise how these companies meet the terms to operate on the European market (Proedrou, 2012, p. 51). Besides its monitory and regulatory obligations the Commission participate in international forums on behalf of the Union e.g. WTO. The Commission also participates actively in institutional structures whose purpose is to secure dialogue and cooperation between the Union and external partners. An example to the point is the EU-Russia energy dialogue. The Commission's participation in the EU-Russia energy dialogue enables the EU to make suggestions or apply pressure with regard to the construction of new pipelines and energy facilities. It should be noted at this point that while the Commission holds formal power to act, it cannot do so effectively without the backing of the EU Council, the European Council, the EU Parliament and the Member States. While these actors do not work in concert to achieve a specific goal, in this case a Common Energy Policy, the full potential of the Commission's policy making competences is unlikely to be fully realised. The ratification of the Lisbon Treaty has moved energy from a national policy area to an area of shared competency. A consequence of this is that the Commission's role in the formation of a Common Energy Policy has greatly improved (Proedrou, 2012, p. 51).

5.3. Energy Enterprises

Many of the dominant European energy companies, such as DONG in Denmark and Centrica in Britain, were originally owned by the respective states and were often used as an extension of the national strategies and interests. Prior to the liberalisation process which began in the early 1990s, these companies held a monopolistic position on the national markets. The three energy packages and the EU led liberalisation process has changed this in the last decades (Eikeland, 2011, p. 13). The liberalisation process has forced national governments to privatise or at least semi-privatise their monopolistic energy companies and to some degree break them up. The change in status has meant that the energy companies now operate more in accordance with market conditions than the national interests of the government in question. While energy companies could be used as foreign policy and energy policy tools before the implementation of the liberalisation measures, this option has been greatly limited following the energy packages. Liberalisation has created a much more complex relationship between the energy enterprises, the national governments and the external suppliers. In stead of being extensions of the government, energy companies now must be considered independent and equal partners in securing sufficient energy supplies and in the implementation of political decisions involving changes in the national energy mix. To quote Filippos Proedrou (2012, p. 50):
"*[The energy enterprises] operate in the energy field, sign supply contracts, form joint ventures, invest money on exploration and transportation schemes, and provide energy to industries and households.*"

In this post monopoly reality energy security is more dependent on the performance of the energy enterprises rather than on the performance of the government. The gas conflicts in 2006, 2007 and 2009 put energy security into an interesting perspective: The national energy enterprises were unable to provide sufficient quantities of gas to cover household and industry consumption during the conflicts over gas prices between Gazprom and Ukraine, in 2006 and 2009, and Belarus, in 2007. In all three cases the fall in gas supplies were not due to energy companies underperforming; the disruptions were caused by political and economic disagreements that lay outside the companies' sphere of influence. The energy companies' performances must be seen in the light of the political decisions determining a country's energy mix; Member States with a low degree of supplier diversification, as well as a low degree of transit route diversification, are more vulnerable to disruptions due to technical issues or political/economic disagreements between the exporting and transit counties. This illustrates that the decisions made by energy companies, in conjunction with the energy and foreign policy dispositions made by the national governments, affects the country's energy security when there are instability in the exporting or transit countries (Proedrou, 2012, p. 50). Most energy trading e.g. coal and oil, takes place on international markets and is therefore influenced by international politics. The energy enterprises are dependent on forming alliances with suppliers, as well as exercising behaviour designed to avoiding upsetting or alienating governments, that are essential in terms of securing sufficient supplies. Here foreign policy may affect the performance of the private and semi-private energy companies and that may cause problems not only for the companies in question, but also for their home countries.

6. The Development of the EU's Energy Policy

The EU Council adopted the Single Market Act in 1987. The Single Market's purpose was to revitalise the general principles guiding the cooperation within the European Community. It sought to increase the growth and welfare in Europe by liberalising the markets, removing trade barriers and easing the movement of capital across the Member States' borders. Originally, energy was not part of the reform programme, but as the internal energy market slowly began to form there was a shift among the actors. The energy market actors, end-user customers, businesses, national regulatory authorities and Member States, were becoming increasingly active in redefining the terms of traditional energy policy issues. However, before the implementation of the Single Market, it had been suggested that it might be beneficial to let the energy marked become part of the Single Market. Before this could take place there were several issues that had to be addressed first. Unlike other goods and services, energy, in particular natural gas, is tied to a

relatively fixed structure. The vulnerabilities of an energy network whether it is a pipeline network or an electrical grid depend on the number of alternative routes. If the grid or pipeline network resembles a finely meshed net, the flexibility is increased while the risk of disruption is minimised. When the grid or network resembles a coarsely meshed net, the structure becomes more rigid and more vulnerable to disruptions. The problem facing both national governments and the EU is the cost. Grids and pipeline networks that allow for a high degree of flexibility are expensive and cumbersome to build and they require some kind of long term security of demand and supply (Eikeland, 2011, p. 17). Flexibility, as well as energy efficiency, has become cornerstones in the EU's efforts to increase competition in the European energy sector and develop a Common European energy policy. The last four decades have introduced three energy packages each attempting to address issues arising from energy matters.

6.1. Three Energy Packages

The EU Council strove to revitalise the general principles that guide EU cooperation by adopting the Single Market Act in 1987. The purpose was to strengthen cross border trade by removing trade barriers and easing the movement of capital as a means to improving the region's growth and welfare. The Council did this by strengthening the supranational institutions' authority in a number of policy areas. The changes resulted in an increase in decisions made by qualified majority voting and limited the ability of disgruntled Member States to block policy harmonisation across the Member States (Eikeland, 2011, p. 17).

6.1.1. The First Package

Energy was not originally part of the reform introducing the Single Market, but the dynamics of the national energy market actors e.g. private consumers, businesses and enterprises, National Regulatory Authorities and Member States, were in a state of transition largely due to the drive towards a Common Internal Market. The changed dynamics in the energy market meant that traditional energy policy issues had to be redefined in order to meet the new circumstances. One suggestion in favour of a Common Internal Energy Market was that by deepening the integration between national energy markets, energy supplies might be utilised more efficiently, prices would be lowered due to increased competition, and the European industries would improve their global competitiveness due to the lower energy costs (Eikeland, 2011, p. 17).
The Commission took the first steps towards making the energy markets part of the Single Market in 1988. The vision was to create a "common carrier system" and thereby ensuring that the energy markets were liberalised and providing consumers with the option of buying energy from any supplier across the Union regardless of electrical grid or gas pipeline network ownership at reasonable prices (Eikeland, 2011, p. 17). The European energy markets were dominated by national monopolies with a high degree of vertical integration i.e. national energy companies

would own or manage the extraction of energy sources, typically fossil fuels, refinement facilities and distribution channels. The Commission perceived the dismantling of such monopolies, naming it unbundling of ownership, as pivotal for ensuring free and fair competition in the visioned common internal energy market and allowed the Directorate-General for competition (DG-COMP) to start up proceedings against import and export monopolies of gas and electricity. DG-COMP notified the Member States that they would be asked to justify their use of monopolies in the energy sector and that the Commission would use drastic actions to enforce compliance with the creation of a single European energy market (Eikeland, 2011, p. 18). These steps were met with intense lobbyism by the national governments, the European Parliament, and the industry to keep the EU out of the national energy markets.

The Commission could make use of two decision procedures: The first was to apply EU competition rules, then article 85 and 86 in the European Economic Community (EEC) now article 101 and 102 in the Treaty on the Functioning of the European Union (TFEU). These article require Member States to dismantle any undertakings, agreements or practices that prevent, restrict or distort competition. The second option was to start infringement procedures against the Member States that were unwilling to comply with the Commission's interpretation of the treaties according to article 169 in the EEC, now article 258 in the TFEU. A second aspect of the Commission's ambition to form a common internal energy market was the basis for formulating directives regulating the electricity and gas sectors. The Commission could formulate directives unilaterally based on article 90 (3) in the EEC (now article 106 (3) in TFEU). Alternatively, the Commission could issue directives based on consensus between the Commission, the EU Parliament and the EU Council using article 100a in the EEC (now article 115 in TFEU) (Eikeland, 2011, p. 18). The first option of unilateral directives on gas and electricity would be the quicker option, but would potentially lack the political backing of key Member States. The second option of a consensus based procedure would ensure political support from the Member States, but would also be likely to result in directives with the lowest common denominator restricting the Commission's vision of an effective common energy market. The Member States and the Parliament expressed their preference for the latter option and in 1996 the Electricity Directive was adopted. Two years later the Gas Directive was also adopted. These energy directives were heavily watered down versions of the Commission's initial vision, from 1988, of a common carrier system. Neither of these contained measures that would really make them effective in liberalising the energy markets (Eikeland, 2011, p. 19).

6.1.2. The Second Package

There was an awareness of the inadequacies of the two new energy directives. To counter these deficiencies the Commission was instructed to report on further needs to harmonise or change the directives to ensure that barriers to trade and the physical flow across national borders were removed. The first report by the Commission was on the Electricity Directive in 1998. The report

focused on the need to ensure that energy goals and environmental goals did not counteract or lead to trade distortions. The Commission concluded that there were environmental policies that would lead to such distortions e.g. the various schemes to promote renewable energy (RE), and that there was a need to harmonise the various national schemes to rectify further and prevent future trade distortions due to these RE favouring schemes. The initial report on the Electricity Directive was follow by a report in 1999 on the Gas Directive and a new report on the Electricity Directive in 2000. These reports concluded that the variations in transmission prices, the congestion management systems and the insufficient cross border capacities in the physical grids and pipelines networks were hampering further energy trade between the Member States (Eikeland, 2011, p. 20). A benchmark report from 2001 concluded that there were large asymmetries across the Union in the implementation of the two energy directives and that these asymmetries were jeopardising the creation of a free and fair competitive internal energy market. The asymmetries were caused by the various attitudes towards energy i.e. energy as high/low politics. Striving to correct the failings of the first energy package, the Council adopted revised versions of both the Electricity Directive and the Gas Directive in 2003 (Eikeland, 2011, p. 21). The revised directives required that the energy markets were fully opened to commercial consumers by July 2004 and to all consumer by July 2007.

Full ownership unbundling of vertically integrated energy enterprises had been a part of the Commission's original vision for a competitive internal energy market, but the initiative had failed to enter into both the directives in the first energy package as well as the revisions of the two directives in spite of having been proposed by a number of agents and interest groups (Eikeland, 2011, p. 21). To remedy some of the consequences of the failed ownership unbundling, and to ensure greater transparency on the national energy markets, the directives required the Member States to set up national regulatory agencies with clearly defined functions and responsibilities.

6.1.3. The Third Package

The Commission launched gas and electricity sector inquiries in 2005 after energy consumers complained of increases in the tariff levels as well as vertically integrated energy enterprises constraining access to the grid and pipelines for independent energy producers. The inquiries resulted in a preliminary report in 2006 which concluded that the energy infrastructure in many Member States was flawed, leading to energy prices at unnecessarily high levels. Open competition was further hampered by vertically integrated energy producers holding back on new investments in the infrastructure. By doing this the vertically integrated energy producers effectively prevented independent producers from offering their services to the general public (Eikeland, 2011, p. 21). The same difficulties were experienced by RE producers.

In 2006 the Commission proposed, with the approval of the European Council, a new European energy strategy focusing on creating greater coherence between the national strategies of the Member States and the common energy and environmental goals of the Union. The new

strategy's objectives were 1) to ensure competitive energy for the European consumers, 2) to improve the energy supply security and 3) to making the European energy systems more environmentally sound (Eikeland, 2011, p. 22). Following the Commission's inquiries on the electricity and gas sectors, the 20-20-20 goals were agreed to in 2007. The essence of the 20-20-20 agreement was that the EU would unilaterally reduce greenhouse gas emissions by 20 percent, raise the percentage of energy produced by renewable energy sources and improve the EU's energy efficiency by 20 percent - all to be achieved by 2020 (Eikeland, 2011, p. 22). There are two things worth noting in the timing of the 20-20-20 agreement: 1) Consensus was reached after Gazprom had had disruptive disputes over gas prices with the two most important transit countries between EU territory and Russian territory i.e. Ukraine in January 2006 and Belarus in January 2007. 2) The agreement was made before the international financial crises started, and there may be some doubt as to the agreement's success due to the economic set backs experienced by the Member States.

The inquiries were accompanied by a strategic energy review which concluded that in spite of the Commission's attempts to establish a common internal energy market, the European energy market continued to resemble a collection of national energy markets only loosely connected with each other. The fragmented nature of the European energy market and the challenges posed by the dominant positions of the national energy enterprises lead the Commission to propose a third legislative package amending the short falls of the Electricity Directive and the Gas Directive (Eikeland, 2011, p. 23). As in the first and second energy package the Commission stressed the benefits of ownership unbundling, but again the suggestion was blocked. However, unlike earlier negotiations the Member States blocking the proposal acknowledged the necessity of creating de facto seperation of these enterprises' production and distribution branches but rejecting de jure separation (Goldirova, 7/6/2007). In stead of approving ownership unbundling, the blocking majority suggested that an independent regulatory body might be created. The body's task would be to regulate the energy networks while allowing energy companies to maintain full ownership.

In July 2009, after almost two years of negotiations, the third energy package was adopted. The new energy package comprised new Electricity and Gas Directives, regulations harmonising cross border electricity and gas trade, and the establishment of the Agency for the Cooperation of Energy Regulators (ACER) tasked with overseeing and improving cross border regulatory cooperation between the Member States. The new directives did not include the ownership unbundling, but they provided two other models: an Independent System Operator (ISO) and an Independent Transmission Operator (ITO). The ISO allowed the energy companies to retain ownership, but required them to hand the management of the networks over to a separate operator not sharing any stakeholders with the parent company. The ITO also allowed retention of ownership, but in this case the managing operator can be owned by the parent company under the proviso that top management is prevented from moving easily between a company's

production and transmission wings. The operators' development and investment plans must be supervised by a national regulatory body with the authority to demand changes in both development and investments (Eikeland, 2011, pp. 24-25).

7. Energy Security

Energy security is generally understood as security of supply in Europe; in Russia, energy security is understood as security of demand. The concept of energy security has become an increasingly more important topic and the solutions under discussion are varied. Some solutions, like the implementation of renewable energy (RE), are expensive to implement and suffer from the paradox that RE may have general public support, but meet with strong opposition whenever a location, typically for new wind turbines, needs to be decided upon. Others, such as energy efficiency, are difficult to implement on an EU-wide scale due to disagreements among the EU Member States as to the necessity and the de facto gains. Mats Nilsson (2007, p. 542) argues that any improvements in energy efficiency due to energy saving technologies will be short term. The argument behind this rebound effect is simple: An energy saving item e.g. a car, a vacuum cleaner, a refrigerator etc will have a lower energy cost pr. unit. Initially this leads to a reduction in energy consumption which is consistent with the EU's stated goals in the 20-20-20 agreement. However, such a reduction carries two implications: 1) The usage of energy saving household appliances might increase because they become more efficient while the cost of using them falls. This will likely offset some of the benefits of energy saving technologies. 2) The reduction in energy consumption implies that consumers' real income will increase as they will use, and therefor pay less, for energy. The improvements in income is likely to offset greater demand for consumer goods i.e. more cars, computers etc which in its turn will increase energy consumption (Nilsson, 2007, p. 542). Energy efficiency cannot be the only measure utilised to enhance energy security. The EU's talk of reducing energy dependence from third countries by reducing imports has a worrying ring in the ears of countries dependent on energy exports to Europe e.g. Russia, Algeria and the Middle East. These exporters' primary objective is to ensure the security of demand. Decreases in demand will cost revenue and is likely to lead to decreasing gas prices, which will affect the national budgets. As a result, energy security is both security of supply and security of demand.

7.1. Gas Dependency and Security of Supply

Gas and gas dependence invite discussion on numerous topics. One of these is the definition of security of supply. It is one of those terms which are instantly defined when seen. However, the

definitions vary greatly depending on political and economic viewpoint, and knowledge of the topic.

Looking at security of energy supply from an economic point of view, Arianna Checchi, Arno Behrens and Christian Egenhofer (2009, p. 1) describe it like this:

"*[T]he majority of economists consider the expression meaningless, since they believe that energy matters are subject to market rules only, leaving political and hard power factors aside."*

From a strictly economic point of view this simply means that market forces will insure that there is an equilibrium between gas demand and gas supply. This will ensure that there are sufficient gas supplies available to meet the demands of those who can pay the price asked and that the asking price is reasonable. This view makes perfect sense if politics play no part in the setting of supply availability and price.

The economic perception on energy security is simply that EU is not in immediate danger of short term disruptions of the energy supplies. In the mid and long term, the challenges become more complex as easily accessible reservoirs of fossil fuels are depleted and the cost of exploring and developing new gas and oil fields increase (Checchi et al., 2009, p. 2).

Looking at security of supply from a more political viewpoint, an other complexity appear. Checchi et al. (2009, p. 1) state it like this:

"*[...]the market alone is not able to deal with the mounting and multi-faceted challenges that energy-consuming countries have to face in a globalised world. Energy security therefore requires international cooperation, government intervention and military control."*

Unlike the purely economic take on energy security, this view has a much broader focus. Richard Youngs (2009, p. 1) uses the dispute between Iran and the West with regard to the Iranian development of nuclear facilities to show the complexity involved in securing energy supplies. Iran claims that the facilities and the production of nuclear material are purely for medical purposes, while the West claims that the facilities are a cover for enriching nuclear material sufficiently to be used as part the military programmes. Iran has threatened to close the Hormuz Strait if the West should decide to tighten the oil embargo already imposed on the country due to the nuclear controversy. Quite a large percentage of the oil consumed in the West is transported through the Hormuz Strait and a disruption of this route would likely lead to rising oil prices and a general scarcity of oil supplies until the Strait is reopened or an alternative route has proven itself to be equally efficient. Should Iran choose to carry out its threat the West will be in a position where the supplies will be insufficient to cover the demand. If energy is a commodity, as the economists would have it, the balance will simply shift until a new equilibrium is reached. In theory this might be acceptable but the economic consequences could be devastating. The worst case scenario would be severe reductions in the transport sector depending on gasoline and diesel, reductions in the production industries dependent on oil derived components in their products, reductions in general energy supplies used for heating households et cetera. Europe could potentially see a

repetition of the problems experienced since 2008. In all likelihood a new crisis due to a closure of the Hormuz Strait would not be allowed to develop as catastrophic as just described, but it would be damaging to the European economy. This type of disruption to energy supplies would be difficult to address without using political tools and initiatives because it illustrates that while energy might be a commodity, it is also potentially a powerful political tool.

7.2. Types of Disruptions

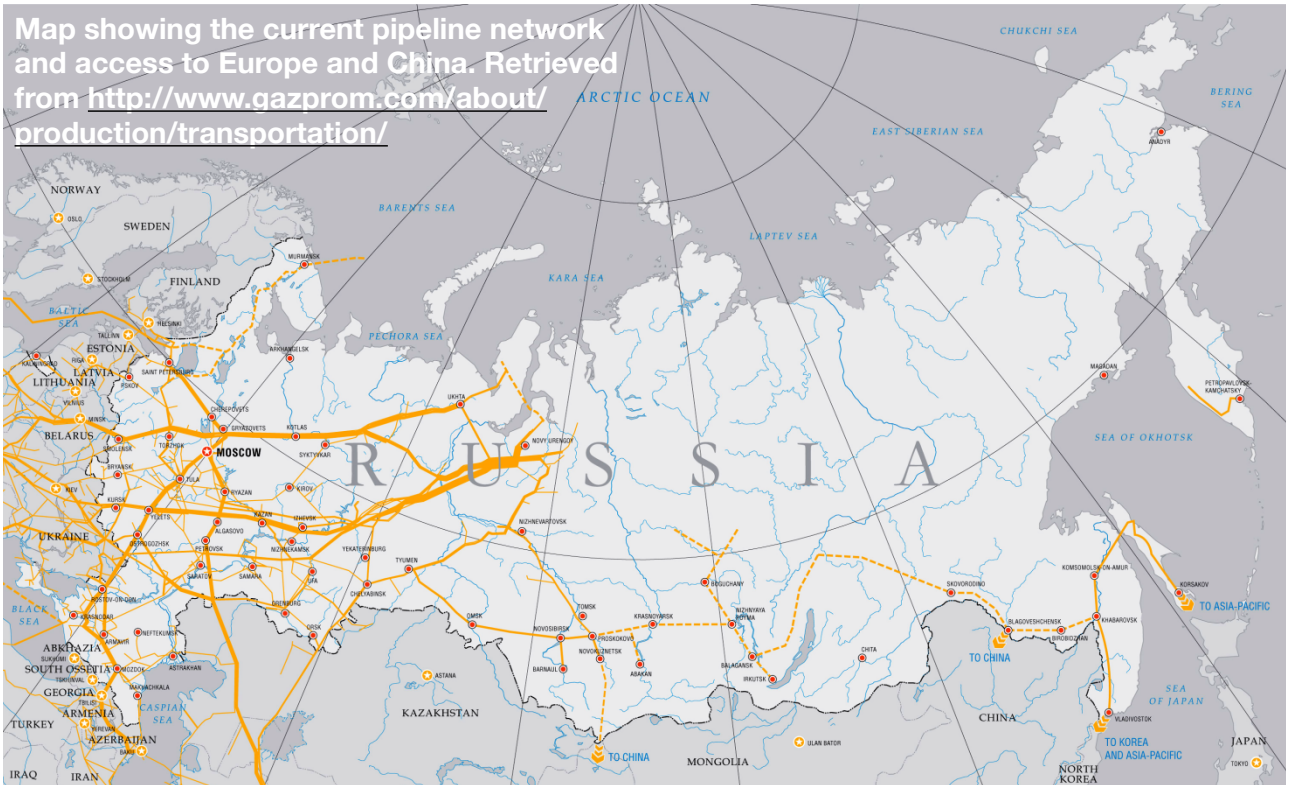
Aad Correljé and Coby van der Linde (2006, pp. 537-538) distinguishes between two types of supply disruptions: 1) sudden disruptions, often the result of political decisions, military conflicts or technical/operational issues , 2) slowly emerging supply gaps, typically the result of inadequate investments in production/transit/storage capacity.

7.2.1. Sudden Disruptions

The effect of sudden disruptions in gas supplies depend on the scale of the disruption, the layout of the infrastructure in question and the regions involved, and the availability of alternative production and transport facilities that allows for deliveries to be rescheduled (Correljé & van der Linde, 2006, p. 538). When gas trade is regulated by rigid, typically long term, contracts the system's ability to adapt to new situations is hampered, while prices, primarily regulated in the contracts, are subject to only limited effects of collective coordinating price mechanisms. The preference for long term contracts and the fragmented nature of the European energy market mean that the Member States preferring these contracts are obliged to maintain relatively large stocks depending on the country's size, gas' prevalence in the energy mix and the likelihood of receiving supplies through interconnecting pipelines from neighbouring countries (Correljé & van der Linde, 2006, p. 538).

7.2.2. Slowly Emerging Supply Gaps

Emerging supply gaps tend to happen in regions and countries that have experienced low economic growth or recession over longer periods of time. The weak investment climate leads to fewer or no investments in new pipelines and modernisation of existing pipelines. A supply gap is unlikely to appear due to depleted gas reservoirs in the foreseeable future, but gaps may appear if the trust between producers, transit countries and consumers deteriorates (Correljé & van der Linde, 2006, p. 538). In a climate characterised by distrust importers tend to seek alternative suppliers and alternative energy sources, while producers tend to seek alternative markets. The EU has done this by increasing the emphasis on implementation of RE into the national energy mixes and by demanding improvements on energy efficiency. Russia and Gazprom has chosen to seek out new markets. The most immediately attractive markets are China and India. Both countries have an almost unquenchable thirst for energy in their industries as well as from the steadily growing middle class. A number of things has been preventing an agreement between



Map showing the current pipeline network and access to Europe and China. Retrieved from http://www.gazprom.com/about/production/transportation/

Russia and China: The majority of Russia's gas pipelines are connecting gas/oil fields and refineries to the former Soviet republics and Europe. China is connected to the Russian pipeline network, but only in a few places. Russia and China has attempted to reach a trade agreement several times since the early 2000s. The stumbling block every time has been the gas price. In 2006 Gazprom signed an agreement with China. The plan was to build a new pipeline transporting gas from the Eastern and Western Siberian fields to China. The pipeline was never built because Russia and China failed to reach an agreement on the price of the gas. Even though the Russian-Chinese agreement came to nothing in the end, it did play a role in showing Europe that Russia was willing and capable of reorienting its gas exports to the East (Poussenkova, 2010, p. 120).

7.3. The Exporter's Perspective

Proedrou (2012, p. 3) adds another perspective to the debate related above. He notes that most literature on energy security has focused mainly on the needs of the importing countries. Proedrou describes energy security for importing countries as the state where a country strives to secure stable energy supplies by means of diversifying energy sources, energy suppliers and supply routes. The opposite of energy security is energy poverty. Proedrou quotes (2012, p. 4) the International Energy Agency's definition of energy poverty: "*The condition where large swaths of a country's population has inadequate access to energy supplies, suffering in particular by*

insufficient and unreliable access to electricity that would deprive them of the ability to service basic household needs."

This occurs rarely within the EU but during the gas conflicts between Russia, Belarus and Ukraine something resembling this definition did happen. The exporting country has no interest in causing energy poverty. The main concern for exporting countries is security of demand at competitive prices that will ensure a satisfactory revenue. Besides the main concern, exporters also have an interest in avoiding recession in the importing countries that would reduce the demand for energy, and avoid giving the importing countries occasion to seek alternative energy sources and diversifying suppliers.

8. The Internal Dimension

Security of gas supplies, like energy security in general, consists of an internal and an external dimension. The external dimension is concerned with the relations to third countries or companies based in third countries e.g. Russia/Gazprom, Ukraine and Belarus. The internal dimension focuses on national, intergovernmental and supranational measures taken to ensure a well functioning internal gas market.

The EU's liberalisation measures towards establishing an internal energy market follows three parallel tracks: 1) Deregulation, 2) Privatisation and 3) Liberalisation (Proedrou, 2012, p. 60). The purpose is to eliminate, or failing that at least seriously weaken, monopolies and oligopolies, promote competition, increase energy efficiency and lower prices. Deregulation: removing rigid regulations set by national governments; allowing market dynamics to determine gas volumes and prices. Privatisation: increasing efficiency by privatising national energy companies. While liberalisation: providing public and private actors with equal opportunity to operate freely on the energy market. By granting equal access the possibility of create monopolies is limited greatly, however, a sufficiently vertically integrated company or rather a group of companies might still manage to achieve a semi or quasi monopolistic status.

The liberalisation process has been facilitated by the first two energy packages adopted between 1996 and 2003. These as well as the third energy package are dealt with elsewhere in this thesis. The first two energy packages initiated and partly implemented the creation of a Single Energy Market. As the Member States began to implement the legal framework some of the weaknesses of the first two energy packages were highlighted making the EU-wide implementation uneven and patchy. The third energy package was adopted in 2009 to address the implementation issues and remedy the shortcomings in the measures meant to ensure competition. The market reforms in the three energy packages were based on the idea that the free market forces are efficient and conductive to energy security. The theory has been tested on several sectors within the EU with a reasonably high success rate e.g. telecommunication. The key differences between

telecommunication and the energy sector, especially natural gas, are firstly the rigid supply chain and secondly the limited nature of the gas resources and their geographical location.

8.1. Internal Controversies

The various crises in resent years have illustrated the divide between especially the northern and southerns Member States with regard to liberalisation on a number of policy areas. Most obvious is the discussion on the EU's Common Agricultural Policy (CAP). Denmark, in this context representing the Northern Member States, and France, representing the Southern Member States, illustrate the dichotomy within the Union on subsidised agriculture. Denmark favours reducing the subsidies while France favours maintaining the current system. The same may be seen when it comes to energy. The Northern Member States have embraced the liberalisation measures and have gone quite far with the implementation while a number of Southern Member States are more reluctant (Proedrou, 2012, p. 61).

The last couple of years have seen a change in gas supplies on the market. One of the main reasons for this is the production of shale gas in the USA (Crooks, 2014). Since 2008 there has been an increase in readily available energy supplies while there has been a decrease on the demand side primarily caused by the financial crisis and the Euro crisis. One of the reasons is long-term contracts. The liberalisation measures adopted by Northern Member States have limited the use of long-term contracts with external suppliers as well as making it easier to renegotiate parts of a contract if conditions on the gas spot market changes to such a degree that it becomes less favourable for one of the parties. A recent example of this is the 1 billion Euro rebate Poland managed to negotiate with Gazprom in 2012 (Buckley, Cienski, & Chaffin, 2012). While the implementation of the liberalisation measures in Northern Europe has benefited these countries by reducing the gas prices during the recent years' financial turmoils the situation is different in those countries that have chosen to slow the implementation. In the southern Member States the maintaining of long-term contracts with oligopolistic energy enterprises has kept the price level for gas higher than in the North. In other words: The Southern Member States appear to be suffering from the drawbacks of the financial crises, but are not reaping the benefit because of rigid long-term contracts (Proedrou, 2012, p. 61). There are a number of reasons why some Member States have shown a certain amount of reluctance with regard to embracing liberalisation on the energy market. The Baltic States' reluctance is based on a fear of Russia gaining too much political leverage over them. This fear is based on historic actions first by Tsarist Russia and later by the USSR. Other Member States consider energy to be a public good of strategic importance both domestically and in the foreign policy. These states prefer to retain strong state control over national energy enterprises as a means to ensuring energy security as well as a means to prevent dramatic price fluctuations.

The liberalisation measures adopted since the mid 1990s have created a number of medium-sized energy companies with a low degree of vertical integration. These companies are obliged to negotiate with energy giants with a high degree of vertical integration i.e. Russian Gazprom and Algerian Sonatrach (Proedrou, 2012, p. 50). The asymmetry in size between internal and external energy suppliers also mean that medium-sized European energy enterprises are dependent on backing, both political and financial, from their national governments in order to negotiate with state-backed external companies, such as Gazprom, on an equal ground. The asymmetrical relationship between internal and external energy companies is an other reason why opponents to the liberalisation process favour the idea of national monopolies. The notion is that with sufficient state-backing the national monopolies are capable of attracting contracts as well as regulating the supplies to the domestic markets. This approach works well to ensure reasonably stable supplies, but a side effect tend to be that consumer prices are higher than in Member States with a higher degree of liberalisation on the gas market.

8.2. Bottlenecks

Most of the Commission's efforts on the energy market in the last couple of decades have been focused on making a legal regulatory framework while the physical network of pipelines has been somewhat neglected. The gas supply problems experienced by a number of the newer Member States as recently as in 2009 brought this aspect of energy security to the surface. The liberalisation process has given the task of operating the energy network over to the energy companies, but it is still unclear who is to initiate and finance modernisation of old pipelines or invest in new. Proedrou (2012, p. 62) mentions several possible scenarios: 1) The energy companies invest on their own or as joint ventures. Either way the result is private pipelines. 2) The energy companies and the governments join in a public-private partnership to finance changes and upgrades in the energy network. The result could be privately owned pipelines with the governments as large, if not majority, share holder. 3) The last scenario is that the energy enterprises choose to do nothing and leave any investments to the governments, making any resultant pipelines state-owned. The pipeline network existing today has been initiated and financed by governments or state-owned energy enterprises. The question in future will be how to guarantee that these large investments are done.

8.2.1. The Tragedy of Nabucco

As mentioned above, the political focus has primarily been on regulation while the physical pipelines have been somewhat neglected. The most publicised European pipeline project has been the Nabucco pipeline. The purpose of Nabucco was to increase supplier diversification by connecting Middle Eastern and Caspian gas suppliers to Europe through Turkey. The new pipeline would serve both to lessen the EU’s dependency on Russian gas and the transit risks posed by

Ukraine. A key feature of the pipeline was that it would bypass Russia and by doing so increase supplier diversification (Freifeld, 2009, p. 122). Such a bypass would be a blow to Russian plans to maintain, and preferably expand, Gazprom's dominant position on the European gas markets and the company responded by proposing the South Stream pipeline as an alternative southern energy corridor.

Nabucco represents a divide in European energy politics. When it was first proposed it was merely a business opportunity to gain access to new gas supplies for the Caspian Sea and the Middle East, and allow Turkey, Bulgaria, Romania, Hungary and Austria to earn lukrative transit fees for allowing transit across their territories. But realising that the pipeline could be used to break what former German foreign minister, Joschka Fisher, called "Moscow's divide-and-conquer politics." (Freifeld, 2009, p. 122), Nabucco gained moral support from Russia sceptics in Central and Eastern Europe, who had historic reasons for being wary of Russia's intentions. The pipeline did not gain support from the large, strong economies in Western Europe; firstly, these were less dependent on Russian gas, and secondly they were less willing to antagonise Moscow by bringing gas into Europe from former USSR satellite states, and thereby encroaching on what Russia has named its "near abroad" (Freifeld, 2009, p. 124). Russia's near abroad consists of former Soviet republics that gained independence in the aftermath of the disintegration of the USSR.

Hard vs Soft Power

Dominique Finon (2011, p. 49) describes the EU-Russian relationship in terms of hard power vs soft power. The EU may have considerable economic and political power, but the Union lacks the ability to act as one united geopolitical entity. When Nabucco was suggested in 2005, the EU consisted of 24 geopolitical entities with widely divergent interests. Each of these Member States have its own degree of hard power depending on the country's size, economy, military strength etc but the EU cannot draw directly on the national hard power of its Member States. Traditionally the EU has focused on wielding soft power to persuade third countries to agree to or comply with EU regulations and guidelines. The Union has striven to lead the rest of the world by its example rather than by force. By comparison Russia has had a tendency to use its hard power to achieve the intended goal. Russia managed to break the alliance between the Nabucco transit countries by notifying Bulgaria and Hungary that abandoning their agreements with Gazprom in favour of the Nabucco pipeline would mean higher gas prices and lower transit fees in future. If Bulgaria and Hungary refused to comply "the gas would be cut off." (Freifeld, 2009, p. 125). Bulgaria and Hungary receive the great majority of their energy from Gazprom placing them in a position similar to that of Ukraine.

To make an expensive pipeline project like Nabucco viable a number of factors must be taken into consideration: 1) Is the importing market large and wealthy enough to make the investment worth while? In this case, the simple answer is "yes". Central and Western Europe is dominated by

reasonably healthy economies. 2) Where is the gas going to come from? The initial answer to that question is Azerbaijan (Freifeld, 2009, p. 126). Azerbaijan is in a precarious situation. Like the two other gas and oil producing countries on the shore of the Caspian Sea, Kazakhstan and Turkmenistan, Azerbaijan sells most of its gas to Gazprom, or is dependent on Gazprom to transport it across Russian territory to Europe. The Nabucco pipeline would offer the Caspian oil and gas producing countries the opportunity to diminish their reliance on Russia and Gazprom, and would offer the opportunity to penetrate the lukrative European gas market. The down side is that such an opportunity might damage these countries' relationship with Russia. Since president Putin's ascent to power, Russia has striven to regain the political and economic power of previous eras. Vladimir Putin has shown time and again that he considers the loyalty and deference of Russia's neighboring countries, the "near abroad", as a zero-sum game (Freifeld, 2009, p. 123). If the Nabucco pipeline should become a reality the Caspian countries would have greater room to maneuver both politically and economically. Russia has been able to buy gas from Kazakhstan and Turkmenistan cheaply since the collapse of the Soviet Union. The cheap Caspian gas has allowed Russia to sell gas extremely cheaply on the domestic market and sell gas cheaply to loyal countries in the near abroad, particularly Belarus and Ukraine. Nabucco would jeopardise Gazprom's access to cheap Caspian gas. In a successful attempt to deprive Nabucco of the gas supply needed to make the pipeline viable, Russia signed an agreement with Azerbaijan laying claim to a significant part of the Azeri gas available for sale "at well over market rate" (Freifeld, 2009, p. 127). The Russian threats against Bulgaria and Hungary and insufficient access to gas supplies ment that the project died.

8.2.2. Interconnecting Europe

The Russian-Ukrainian/Belarusian conflicts made two things clear for the EU: 1) The EU's security of gas supply is heavily dependent on the relations between the exporing countries and the transit countries. These relations may be somewhat influenced by the EU, but probably not to the extent where deteriorating relations might not pose a risk in future. 2) The fragmented nature of the European energy market pose a significant risk for Member States with low diversity in their energy mix and low diversity of transit routes. In an attempt to remedy the lack of interconnectors between the European pipeline networks, and prevent any future recurrence of European citizens freezing in their homes due to conflicts outside of the Union's borders, the European Energy Programme for Recovery (EEPR) was established in 2009 (European Commission, 2014. p. 1). The purpose of the EEPR was to establish a well-interconnected European market by 2014, and ensuring that there were interconnectors between all Member States (Proedrou, 2012, p. 66). The goal of a regional pipeline network is to be achieved by modernising and enhancing the existing European gas infrastructure to include more reversible pipelines or dual pipelines, and building more pipelines connecting neighbouring countries. Reversible pipelines allow the gas flow to be reversed, while dual pipelines allow the gas to flow in two directions at the same time. This new

regional pipeline network is meant to mitigate the consequences of gas disruptions regardless of the reason for the failed deliveries. The EEPR has generally focused on three types of projects: Infrastructure concerning gas and electricity, off shore wind, and carbon capture and storage. The Commission reports annually to the EU Council and the EU Parliament on the EEPR's progress. The latest report from 28 Oct. 2014 state that the EEPR has supported 44 infrastructure projects focusing on gas and electricity. 27 of the projects have been completed while the remaining 13 projects are progressing according to schedule and will be complete in 2015 at the latest, but 4 projects will be terminated by the end of 2014. Three of these projects, Nabucco being one of them, failed due to unsuccessful negotiations over gas supplies, while the fourth could not be implemented due to technical difficulties (European Commission, 2014, p. 4).

9. Challenges to the EU's Energy Security

The EU is challenged by a number of factors. Domestic energy production is not capable of keeping up with the demand. Oil and gas production in the North Sea seems to have peaked and any ambitions of maintaining or improving the current production levels would require implementation of new extraction technologies. According to the Commission's Directorate-General for Energy the EU's energy mix is quite divers. Approximately 35% of the energy consumption is oil, 25% is gas, coal accounts for 16%, nuclear power for 13% and RE 10% (European Commission, 2012, p. 19). The 20-20-20 Agreement reached in 2007 proposes an increase in energy produced using renewable technologies from the 10% in 2012 to 20% in 2020. The likelihood of achieving this goal can be debated. It is also debatable if an increase will suffice if the general energy demand rises as well. The DG Energy's numbers cover substantial differences between the Member States and different attitudes toward achieving energy security and the means that can be used to this end.

9.1. Energy Security and Foreign Policy

There is something of a dichotomy between the Commission's attempts at creating a common energy market and the Member States' wishes to maintain maximum control over the energy production. Grätz, (2011, p. 69), points out that energy distribution traditionally has been an industry of monopolies, or National Champions. These monopolies would negotiate deals with suppliers, often Russia, Algeria, Norway and the Netherlands. Their main purpose was to act as gatekeepers ensuring national control with market access and negotiating long-term energy deals.

The Commission and the Directorate-Generals for Energy and Competition worked to increase liberalisation and privatisation of the EU's gas market. This changed the nature of many of these monopolies. Through both vertical and horizontal integration these monopolies essentially became national champions. The agenda changed from one of servicing national demands to one of taking advantage of the new possibilities offered by the liberalisation. The result was that the EU Member States were eager to make good use of these new markets while attempting to limit competition on their own national markets (Grätz, 2011, p. 70).

9.1.1. Import Dependency

According to Proedrou (2012, pp. 41-42), the EU's dependency of oil and gas imports is quite high. The union is required to import approximately 85% of the oil needed and about 65% of the gas. This dependency is not particularly problematic as long as suppliers are reliable and the global energy market is working smoothly. However, a majority of oil and gas producing countries struggle with poor governance structures and corruption that increase the level of instability on the global markets for fossil fuels.

A further aspect of the import dependence is that the importance of the West for the exporting countries has decreased due to the economic development in countries like China and India. At the moment Russia's most valuable market is Europe, but Europe is under continual threat that Russia might build gas pipelines to China and, start exporting natural gas on a much larger scale than is the case today (Stratfor Geopolitical Diary, 2010). It is not only a question of the quantities available, but a consequence might be higher European gas prices and pressure to give geopolitical concessions in exchange for stable energy supplies. Europe is not under any such pressure at the moment. However, taking the means Russia has used on it's smaller neighbours it seems possible that this might change as gas production peaks and heavy investments in exploration, production and transportation are needed. Mert Bilgin (Bilgin, 2011, p. 122) points out that according to Gazprom’s own estimations $20 billion of investments in gas field exploration, transit pipeline etc will be needed annually until 2030 to meet the growing domestic demands as well as meeting export commitments.

9.1.2. The Missing Link - External Energy Policy

The EU has attempted to export its internal regulatory model to the countries surrounding the Union. The Union has little hard power to forcefully impose the values and norms that the EU is built on, on the neighbouring countries. The EU has striven to lead the way by its example. The strategy is basically that these third countries will recognise and acknowledge the Union’s leadership and emulating the good example will implement the principles guiding the EU’s internal energy market. The idea is very similar to the neo-functionalist notion of functional, and to some extent cultivated, spill-over. The spreading consensus on energy policy envisioned would help solidify the cooperation between the exporting and the importing countries as well as the transit

countries. It would also reduce the risks to the EU's energy supply security emanating from third countries' divergent interests and values (Proedrou, 2012, p. 70). The strategy has yet to prove itself. While some neighbouring countries e.g. Norway and Switzerland have chosen to mostly comply with EU regulations others, particularly Russia, Belarus and Ukraine, have not. Russia might be considered a special case because of its predominance as external European energy supplier and its status as a great power in the international political system. But the success of programmes such as the Eastern Partnership, indicate that countries that are unlikely to become members of the Union are less likely to be swayed by the EU's proposals, while countries with realistic prospects of future membership are more likely to comply with the Union's wishes (Proedrou, 2012, p. 72).

The strategy has two levels, the regional described above and a global. The global strategy focuses on the international fora that are connected to trade e.g. the World Trade Organisation (WTO) and economy e.g. the G8. The idea is to integrate the EU's energy policy into its trade policy to create "a more holistic framework" and bring the new take on energy and trade policy into the WTO (Proedrou, 2012, p. 70). The G8 might serve as a platform for the EU to enhance the global deliberations on energy, the environment and climate change. The forum might lead to deeper mutual understanding of the interconnected challenges posed by energy and environmental damage to the world. The Commission's intention is to ensure the success of a regional issue by taking it to the global level (Proedrou, 2012, p. 70).

9.1.3. Shortcomings and Policy Proposals

The idea of spreading the EU's views on energy and energy regulation suffers under the reality that many of the peripheral countries' attitudes toward energy run counter to the EU's market bias. While the EU's institutions consider market forces and liberalisation to be the best means to ensure energy security, the countries bordering the Union have a tendency towards considering energy a public good and as such energy should be under strong national control (Proedrou, 2012, p. 72). This attitude is mirrored in a number of EU Member States.

Foreign affairs policy may be used to illustrate what kind of issues an EU energy policy faces. Both policy areas are intergovernmental. Both policy areas have a top level representative, Günther Oettinger, Commissioner for Energy, and Catherine Ashton, High Representative for Foreign Affairs and Security Policy. The dichotomy between the intergovernmental nature of these two policy areas and the supranational representative creates an unclear, and at times even contradictory, decision making process. The dichotomy also appears to result in the Union speaking with 28 voices in fora, where greater benefits might be achieved by speaking with one united voice (Proedrou, 2012, p. 73).

The greatest external obstacle to achieving a holistic energy framework, both within the Union and in the peripheral countries, might be the EU and the Member States' failure to integrate economic, political and development policies into the energy policy. Third countries that suffer

from instability in one or more of these policy areas are less likely to be reliable and stable partners (Proedrou, 2012, p. 73). Ukraine in particular is an example to the point. The country's economic development has been badly neglected by the political elite since it gained independence in 1991. At times the neglect has developed into kleptocracy and corruption, the latest example may be read in the records left by former President Viktor Yanukovich when he fled Ukraine to seek refuge in Russia in February 2014 (McHugh, 2014).
The EU's energy policy goals might be more readily achieved by promoting democracy, human rights, peace making and good governance in third countries that have the potential to influence European energy policy and security. The majority of the world's energy rich countries are subject to poor economic, political and social governance; the EU could strengthen its global soft power, and external energy security, by boosting the performance of these economies, help improving the living standards of the general population without appearing to oppose the traditional hard power "bears", Russia and the US (Proedrou, 2012, p. 74).

10. EU Energy Policy and Russia

The production of natural gas in the European union is declining. However, Russia has some of the largest reservoirs of gas in the world. The close geographical proximity between the EU and Russia creates a clear interdependence between the two. The relationship between Russia and the European Union, however, is not always tranquil. This is partly due to differences in the perception of geopolitics and gas. These views may be analysed in a variety of ways, but looking at the historical background of both the EU and Russia, two things spring to mind: The EU was founded on trade. In resent years, the financial crisis and the euro crisis has evoked much talk of the peace making aspect of the original cooperation, ECSC, but looking at the mechanisms used to promote the peace project you find that trade and interdependence is at the core. This may be called a liberal "markets and institutions" approach (Grätz, 2011, p. 62). Russia on the other hand follows a realist "regions and empires" approach derived from its historical background as an empire (Grätz, 2011, p. 62). While the Soviet Union cannot strictly speaking be called an empire, the union did retain certain aspects of the Russian Empire. One of these is the idea of Russia as a world power. After 1991, Russia lost most its international political and economic power and not until president Putin came into power in 2000 did this state of affairs change. Vladimir Putin implemented the concept of National Champions, changing key companies from being private or semiprivate actors into instruments that could be used to strengthen or enhance the political power of the Kremlin, home of Russia's central administration, (Goldman, 2008, pp. 98-99). To quote Jonas Grätz (2011, p. 62):

[...], current Russian energy policy is based on the conception of oil and gas resources as strategic goods, requiring the reliance on direct influence of state actors rather than on market forces to regulate their extraction and distribution.

This perception of Russian foreign policy is somewhat simplistic, at least where the EU is concerned, but there are examples of Russia using gas debt to gain key control over gas pipelines, specifically a deal from 2011 which gained Gazprom the controlling share of Beltransgaz, Belarus' national gas transit company (Kramer, 2011).

10.1. Gas Transit Risks

The conflicts between Russia and the two largest transit countries i.e. Belarus and Ukraine, have, to some degree, been due to unresolved issues occurring after the disintegration of the USSR. These issues were often to do with ownership of gas pipelines and associated facilities, control over national gas companies, gas prices, and transit fees. While these are clearly commercial issues, they may be eased or complicated by the good or bad political relations between Russia and the transit country in question. A transit county's power is in the potential capability of interfering with the gas crossing its sovereign territory. The likelihood of such interference is increased if the transit country also relies on buying gas from the exporter (Yafimava, 2011, p. 139). In cases where the transit country either cannot pay or is unwilling to pay the price demanded by the exporter, crises similar to the ones from 2006 to 2009 occur.

In 2012 Le Coq and Paltseva introduced a transit risk index (, p. 642). The purpose of the index is to evaluate the risks of importing natural gas through pipelines. The article also looks at the effects of introducing new pipelines, specifically the Nord Stream (NS) pipeline.

10.1.1. The Influence of Gas Transit

Le Coq and Paltseva (, p. 642) mention two ways gas transit may influence security of a country's energy supplies: 1) The effects of a disruption depends on the availability of alternative transit routes, or the availability and versatility of alternative energy sources. 2) The geographical and technical configuration of a pipeline may influence the bargaining power, as well as the political power, of an importing country.

The Transit Risk Index (TRI) focuses on alternative transit routes available for a given external supplier, the risk of technical problems with the pipelines e.g. ruptures, the level of political stability in the transit countries, and lastly, the power balances for each transit route (Le Coq & Paltseva, 2012,p. 642). The TRI increases exponentially with the level of gas dependency, the level of political instability in transit countries, and the likelihood of ruptures on the pipeline in question. The TRI decreases equally exponentially with the number of alternative transit routes available, and the bargaining strength of countries served by transit routes.

Le Coq and Paltseva place the EU Member States into three groups (Le Coq & Paltseva, 2012, p. 643): The first group are the countries directly connected to the NS pipeline (NS-countries). Initially these countries' TRI is low. They are served by several pipelines lowering their exposure to transit risks. However, this depends on how much of the pipeline's capacity is used. If the full capacity is used, Le Coq and Paltseva claim that the TRI of the countries directly served by NS would increase due to the fact that the allocations along the transit routes would change. There is insufficient empirical evidence to verify or falsify this claim, but it is likely that such a scenario would resemble that of the 2009 Russian-Ukrainian conflict. Gazprom cut back on the amount of gas sent through the Ukrainian gas pipeline network. Ukraine continued to siphon off gas from the pipelines resulting in gas shortages in Hungary and Romania among others (Yafimava, 2011,p. 183). The second group consists of EU Member States that do not have a connection to NS, but do share older transit routes with the Member States directly connected to NS (Indirect NS). The second group of countries' TRI is increased, not because they experience any physical changes in the infrastructure providing the gas, but because the countries directly connected to NS are likely to be less willing to exert political pressure toward Russia in case this might damage their relationships. This leaves the second group of countries in a weakened position in case of disputes between Russia and the transit country in question (Le Coq & Paltseva, 2012, p. 643). The third group of countries consists of countries that buy natural gas from Russia, but do not receive gas from NS nor from any pipelines serving the second group of countries (No-NS).

10.1.2. Three Scenarios

Le Coq and Paltseva (2012, p. 646) use three scenarios to illustrate the possible impact of Nord Stream. The first scenario (No-NS) is one where the pipeline is left incomplete or not facilitated. The pipeline would have no impact what so ever in this scenario. Le Coq and Paltseva use this scenario as their benchmark case. The assumption in this scenario is that any increases in imports of gas from Gazprom corresponds proportionally with increases in gas consumption within the EU. The second scenario (Conservative NS) also assumes that consumption and import are proportionally correlated. In this scenario NS is not fully utilised. The third scenario (Full NS) is one where NS is used to its full capacity. Unlike the first two scenarios, the assumption is that consumption is unchanged while the import through NS is increased. In this case there is a likelihood that the countries served by NS would increase their dependence on NS while making the older transit routes superfluous to national gas security. This situation would in all likelihood have two consequences: 1) The bargaining power of countries served directly by NS would either stay stable due to an unchanged bilateral relationship between the importing country and Russia, or the bargaining power might increase slightly because the importing country would be in position where the needs of neighbouring countries served by other pipelines than NS would carry less weight in negotiations. This is directly connected to the second consequence: 2) The countries not served by NS, but by the older pipelines, would see their bargaining power

decrease. If the NS-countries cannibalise the older transit routes available in favour of utilising the full capacity of NS, their interest in showing solidarity with and offering political support to the Indirect NS countries would decrease. This scenario would also decrease the likelihood of the EU exerting joint political pressure on Russia in case of conflicts between the Russian energy supplier and a given transit country. As a result the bargaining power of the Indirect NS countries would fall (Le Coq & Paltseva, 2012, p. 646).

No-NS vs Conservative NS

When comparing the first and the second scenarios, Le Coq and Paltseva find that there are three effects. The first is that NS will provide greater diversification of transit routes. The lowered vulnerability to disruptions due to technical problems with the pipelines, and the decreased impact on the stability of energy supply in case of conflicts between Russia and a transit country combine to lower the TRI for countries directly connected to NS. The second is that the countries not connected to NS, but sharing other transit routes with the NS-countries will see their TRI increase as a result of their diminished bargaining power. These countries may be able to use NS as a backup for gas deliveries if gas supplies through their regular transit routes are disrupted. However, this is only viable as long as NS is not used to its full capacity. The third is that NS will have no impact on countries that are neither directly connected to NS nor share transit routes with any NS-countries (Le Coq & Paltseva, 2012, pp. 646-647).

Conservative NS vs Full NS

The conservative utilisation scenario lowers the TRI for the NS-countries, because it allows for greater transit route diversification. The full utilisation of NS, and the assumed cannibalisation of the older transit routes, would reduce that diversification. Rather than receiving gas from several pipelines lessening the impact of disruptions, full utilisation would markedly increase the impact of disruptions. The loss of bargaining power of the countries indirectly connected to NS would be compounded further compared to the conservative scenario due to a decreased interest in the discarded transit routes by the NS-countries (Le Coq & Paltseva, 2012, p. 647).

11. Russian Geopolitics and History

The Russian political mindset is somewhat different from the EU's. The reasons are to be found both in historical factors, the Soviet regime and the tsarist empire, and geographical factors. Peter the Great (1672-1725) and Catherine the Great (1729-1796), inspired by the Enlightenment, reformed and modernised the Russian society; and oriented it towards Europe. Their political and military efforts placed Russia in a position of power in the European political system (Riasanovsky, 2005, p. 76). Following the October Revolution in 1917 the picture changed from a primarily European political and cultural system to the Soviet system. Communism may have been

developed in Europe, but the practical development of the system in Russia diverged greatly from European traditions and cultural norms.
The idea of a Strong Man as the leader of the nation is old and probably one of the most deeply rooted ideas in Russian culture going back to the civil wars (1598-1613), named the Time of Troubles, and the establishment of the Romanov dynasty (Riasanovsky, 2005, p. 49). The idea of the Strong Man was taken up by the Communist Party and personified first in Vladimir Lenin and later in Joseph Stalin. Most recently this idea has been manifest in Vladimir Putin, and the way he has managed to promote his own image as a Strong Man, both physically, mentally and politically.

11.1. The Near Abroad

After Mr. Putin's ascent to power, there have been several crises between Russia/Gazprom and the Commonwealth of Independent States (CIS) countries who harbour the transit routes of Russian gas to Europe. The CIS consists of eleven former Soviet republics. All of the member states, as well as the three Baltic states and Georgia, are described by the Kremlin as Russia's near abroad. This is also why Russia perceives EU initiatives in these countries as a European encroachment upon Russia's sphere of influence. The best known crises are the so-called price wars with Belarus and Ukraine. Most of these crises seem to peak in January, making it vitally important for the populations that solutions to the disagreements between the host countries and Gazprom/Russia are found quickly. However, the Ukrainian and Belarusian leverages are vastly different. According to Bertil Nygren (2008, p. 5) one of the main differences is that until the construction of Nord Stream, Ukraine has handled approximately 80% of Gazprom's export to Europe, while Belarus has handled about 20%. This creates an interesting political situation when it comes to negotiations over prices, transit fees and amounts.

11.2. The Means to an End

There are two means of exercising pressure used both by Gazprom and the transit countries. These are could be called "the tap weapon" and "the transit weapon" (Nygren, 2008, p. 5). Both weapons are quite simple but very effective. The tap weapon may be expressed in two simple demands; "Pay me the price I demand for my gas or I'll turn off the tap!" and "Do as I tell you or I'll turn of the tap!". Many of the CIS countries are almost entirely dependent on Russia for their gas supply due to the infrastructure left after the collapse of the USSR. Creating a new infrastructure of gas pipelines is costly and many of these countries simply do not have the financial backing for such a solution. The tap weapon has been used successfully by Gazprom when it comes to Georgia and Kazakhstan. In these cases the tap weapon has been used to reward or punish a trades partner (Nygren, 2008, p. 9).
The transit weapon may be expressed in these demands: "Give me the price pr. cubic meter I want, or I'll disrupt deliveries!" or "Pay me the transit fee I require, or I'll disrupt deliveries!".

Russia has attempted to use the tap weapon against both Ukraine and Belarus. However, these two countries have had the means to counter the Russian demands by using the transit weapon and have succeeded to a greater or lesser extent (Nygren, 2008, p. 5).

11.2.1. Belarus

Russia and Belarus have been negotiating the formation of a union since the collapse of the USSR. The original agreement between the Belarusian president Alexandr Lukashenko and Russian president Boris Yeltsin was one of two equal, sovereign states working within a common legal framework (Yafimava, 2011, p. 221). When Vladimir Putin took over as Russian president, the Russian attitude changed. His opinion was “that unification must proceed ‘unconditionally’ on the basis of a single state with a single parliament and a single government.” (Yafimava, 2011, p. 221). President Lukashenko was furious, calling the change an attempt to strip Belarus of its sovereignty.

Gazprom had always wanted to gain control over the Belarusian pipeline network either as a result of the political union or failing that by buying it outright (Yafimava, 2011, p. 254). In response to the failed negotiations, president Lukashenko withdrew a promise to allow Gazprom to buy Beltransgaz. He realised that without a political union with Russia, selling Beltransgaz would lose Belarus its most powerful protection against Russian use of the tap weapon as blackmail (Nygren, 2008, p. 6). On the other hand, Gazprom’s wish to gain control over the network is an attempt to protect both the company itself as well as its end-users from Belarusian use of the transit weapon.

11.2.2. Ukraine

Looking at Ukraine, the case is different. While Belarus and Russia have striven to create a political union, Ukraine is divided into a pro-Russian bloc and a pro-west bloc. This divide has lead to an uncertain political strategy towards both the EU and Russia. Part of the reason for this divide is the ethnic mix of the population. Taking the Crimea as an example 58% of the population is ethnic Russians (Larrabee, 2010, p. 42). The remaining population consists of approximately 25% Ukrainians and 15% Crimean Tatars.

Both Belarus and Ukraine have received gas at heavily subsidised prices from Russia in the past. This changed in 2006, when Gazprom chose to eliminate subsidies to the CIS countries (Yafimava, 2011, p. 323). With the subsidies, the Ukrainian and Belarusian gas prices were close to the domestic Russian prices. In 2008 the domestic gas prices in Russia were approximately $50 per million cubic metres (mcm) gas (Nygren, 2008, p. 5). Considering that the European price at the time was at $250 for 1000 cubic metres the subsidies both domestically and in Ukraine and Belarus were substantial. It is reasonable to assume that Russia originally used the tap weapon politically to ensure that the CIS countries stayed compliant towards Russia’s political wishes. The economic crisis from 2008 and onwards changed that picture. In Europe the demand for gas was

going down and with it the profits of Gazprom. The fall in European demand paired with the CIS subsidies and Belarusian and Ukrainian tendencies towards non-payment and late payment led Gazprom to announce that the subsidies would be abandoned and that prices would be brought to European levels by 2011 (Yafimava, 2011, p. 323). It is not unreasonable to imagine that Gazprom might attempt to compensate for the loss of revenue in Europe by increasing the price for some of the CIS countries.

12. The Gas Weapons

When looking at the pipeline network one thing catches the eye; Russia is the geographic centre of the Soviet era pipeline network giving it power to cut off Turkmen, Uzbek and Kazakh gas exports to European consumers in case of disagreement between Russia and either of the three countries. This threat is what Nygren (2008, p. 5) calls the transit weapon.

12.1. The Transit Weapon

The transit weapon has been used by Gazprom to gain de facto control over prices on Turkmen, Uzbek and Kazakh gas. The European transit countries, Belarus and Ukraine, utilised the transit weapon against Russia during the gas conflicts in 2006, 2007 and 2009 (Nygren, 2008, p. 5). Looking at the way these conflicts were resolved, Russia used two different strategies; in Ukraine's case, Gazprom managed to counter the Ukrainian transit weapon by effectively changing the origin of the gas imported by the country. The 2006 gas dispute resulted in an agreement where Ukraine was to import all its gas from Uzbekistan, Turkmenistan and Kazakhstan. The price would be $130 per mcm. The mechanics of the agreement mean that Gazprom has managed to neutralise the Ukrainian transit weapon by exchanging its own tap weapon with a transit weapon against Ukraine (Nygren, 2008, pp. 5-6). Russia has cut gas deliveries to Ukraine several times according to Checchi et al. (2009, p. 18). It is worth noting that after the Orange Revolution in 2004, Gazprom chose to increase the gas price from $50 to $160 per mcm (Nygren, 2008, p. 6). The argument forwarded by Gazprom was economic and quite reasonable, however the timing was somewhat suspicious. The pre-2004 Ukrainian president, Leonid Kuchma, had shown a pro-Russia attitude, while the leaders of the Orange Revolution were showing a more western bias (Nygren, 2008, p. 6). The connection between the price increase and the change in the political leadership is speculative, but looking at the timing in Ukraine, as well as Belarus and the other CIS countries not dealt with in this paper, a connection does suggest itself.

Belarus is an entirely different case. No other former Soviet country has moved closer to a de facto and de jure union with Russia than Belarus (White, McAllister, & Feklyunina, 2010, 348). After Belarus declared itself independent in 1991, the political elites in Minsk and Moscow initiated an

integration process meant to strengthen both countries politically, economically and militarily. The military integration proceeded rapidly but the political and economical integration did not. The political integration slowed to a standstill, while economic integration suffered serious setbacks (Yafimava, 2011, p. 220). This was the political background for the 2004 conflict between Gazprom and Belarus. The economical background was that the relationship between Russia and Belarus is one of asymmetrical interdependence favouring Russia (Yafimava, 2011, p. 253).

12.2. The Tap Weapon

The tap weapon has been used in two different ways according to Nygren (2008, p. 5). The positive or generous usage of the tap weapon is to reward importing countries for behaving in accordance with Russian wishes. The reward might be that the importing country pays a price for gas that is below world market prices. The negative usage is to threaten importing countries with price hikes as a punishment for unwillingness to comply with Russian wishes.
Threatening to increase prices only works if the importing country is capable of paying the demanded price. In case of countries that are incapable of this, the tap weapon is much less effective, at least from an economic perspective, and may cause long term damage to the political and economic relationship between the exporting and the importing countries. The relationship between Russia and the importing country must also be considered. When the relationship is mostly symmetrical, as is the case in the Russia-EU relationship, the importing country may seek alternative energy sources and routes. If the relationship is asymmetrical benefiting Russia, as is the case with Belarus and Ukraine, and the importing countries do not possess the economic resources needed to change import routes in the short and medium term, the tap weapon gains in potency. Russia may use the tap weapon to compel these countries into complying with Russia's foreign policy (Nygren, 2008, p. 11).

13. The Importance of Gazprom

Russia, under the rule of Vladimir Putin, has striven to improve the economy and Russia's political position. One of the most powerful means to these ends has been Gazprom. In reality, president Putin's goal has been to reassert Russia as a superpower, or more precisely an energy superpower after the collapse of the USSR in 1991 and the Russian economic crisis in 1998. He placed siloviki in key positions in state-owned companies like Gazprom to ensure that the companies' policies were in accordance with that of the central government (Goldman, 2008, p. 192). Siloviki are former employees and colleagues from Vladimir Putin's years in the KGB and later the Federal Security Service (FSB) and his political allies. The best know example is perhaps the replacement of Viktor Chernomyrdin, the former Soviet energy minister, with Dmitry

Medvedev, future Russian prime minister and president, as chairman of Gazprom (Goldman, 2008, p. 104).

13.1. Gazprom's Transition into a National Champion

Gazprom's origins are noteworthy when striving to comprehend the company's position in Russia's economy and politics. Viktor Chernomyrdin was minister of the Gas Industry from 1985-1989. In 1989 he took the initiative to transform the Ministry of Gas into a state owned corporation, naming it Gazprom and assuming the post of corporate president (Goldman, 2008, p. 100). Between 1989 and 2000 Gazprom became first a joint stock company and later an open stock company. By 2005 the Russian government held 40% of the shares in Gazprom (Goldman, 2008, p. 100). The collapse of the Soviet system opened the way for both foreign and private Russian investors to buy stocks in Gazprom. At one point German Ruhrgas either owned or controlled more than 5% of Gazprom's stocks, while approximately 61% of the stocks were owned by primarily Russian investors. The Russian government was the largest stockholder, but foreign investors like Ruhrgas could in theory accumulate enough stocks to take control over Gazprom. Aiming to prevent such a take over president Putin arranged for the state-run oil company Rosneft to buy up almost 11% of the stocks ensuring that the Russian government had direct control with 51% of the stocks in Gazprom (Goldman, 2008, p. 83).
In 1997 Mr Putin handed in his dissertation at the Saint Petersburg Mining Institute (Ciprian-Beniamin & Cosmin, 2010, p. 46). In the dissertation he introduced the concept of National Champions into Russian politics. The idea behind National Champions was that the Russian government should reassert its control over the country's natural resources and raw materials. The effect of regaining control over these resources would be that the government could control domestic energy prices, and would provide the government with the means to suspend deliveries of gas and oil to countries that showed themselves to be less than compliant with or supportive of the Kremlin's foreign policy (Ciprian-Beniamin & Cosmin, 2010, p. 46). President Putin realised that some companies would chafe at following the dictation of the Kremlin and described two kinds of measures to handle such companies: the "gentle" nudge, replacing oligarchs in powerful positions with siloviki, and leave the company alone to a greater or lesser extent, or the stick, sending tax auditors or inspectors from environmental agencies to search for any kind of failure to abide by the law (Goldman, 2008, p. 99). This is one of the ways president Putin managed to regain control over most of the Russian gas and oil production.

13.1.1. Mismanagement and Asset Stripping

Boris Yeltsin initiated the privatisation of an economy that had been centrally planned and state owned to win political support for his vision of a Russian liberal democracy (Goldman, 2008, p. 58). He saw the need to transform the Soviet era's planned economy into a modern capitalist economy. The government issued vouchers worth 10,000 rubles each to every Russian citizen. These vouchers were intended to be exchanged for stocks in the newly privatised companies. The challenge was that after seventy years of communist rule few Russians understood the mechanisms of capitalism. The Russian economy was in recession; the market value of the companies under privatisation was falling, and the value of the vouchers dropped. Many Russians opted for selling their vouchers for a handful of rubles or a bottle of vodka (Goldman, 2008, p. 58). A dismal economic outlook combined with a flawed privatisation programme along with corruption meant that a small group of investors managed to control the majority of the newly privatised companies. These newly minted oligarchs fell into two groups: former government officials, who were ill prepared to operate in a market economy, and former black market operators, who had learnt to maneuver in a shortage economy. The problem was that the oligarchs were not necessarily capable managers in the new economic reality, and a number of the companies take over by former officials ended up suffering losses due to mismanagement, corruption, embezzlement and asset stripping (Goldman, 2008, p. 58).

13.1.2. Gazprom Being Stripped

When president Putin removed Viktor Chernomyrdin from Gazprom's chairmanship in 2000 and Gazprom's CEO, Rem Vyakhirev, in 2001 it was not only to ensure government control over Russia's largest gas company. Chernomyrdin and Vyakhirev had allowed many of Gazprom's active gas wells, pipelines and distribution entities to be parcelled out to the family and friends of some of Gazprom's executives. The largest of the assets parcelled out were transferred to ITERA (Goldman, 2008, p. 61). The assets transferred to ITERA were so productive that at one point the company was Russia's second largest gas producer. Further transference of Gazprom's assets was stopped when Dmitry Medvedev was instated as chairman and Alexey Miller became CEO. The first task, preventing further asset stripping, was achieved. The second task was to reclaim the assets. Alexey Miller did this by simply denying ITERA access to Gazprom's pipeline network. Without the means to transport gas from its gas wells to its end-users, primarily in Belarus and Ukraine, the company's finances quickly deteriorated. By 2004 ITERA was on the brink of bankruptcy. To avert that ITERA's management agreed to sell the company's 51% interest in Sibneftegaz to Gazprom (Goldman, 2008, p. 142).

13.2. Yukos as an Example

While Boris Yeltsin held the Russian presidency, the Russian economy developed into a kind of Klondike. Those with connections, and a sense for business opportunities, acquired potentially very productive companies for a fraction of their value. An example of this is Mikhail Khodorkovsky's acquisition of Yukos Oil. According to Marshall Goldman (2008, p. 64), Khodorkovsky and his associates paid $309 million for Yukos. This price is quite low especially considering that a couple of years after the takeover the market value had risen to $15 billion. The idea that companies should support state-interests was put under pressure by Yukos. In 2003, Khodorkovsky signed a major oil deal with China. A 20 year contract obligating Yukos to deliver 20 tonnes of oil a year by 2005 and 30 tonnes a year by 2010. President Putin considered this an encroachment on the powers of the government calling it foreign policy making made by private companies (Goldman, 2008, p. 111).

Khodorkovsky is an ambivalent figure in the Russian business world. On the one hand he created his fortune in ways that were not always strictly by the law. A number of Yukos employees have been accused and sentenced for murder and violating legal contracts (Goldman, 2008, p. 115). Whether these alleged crimes were done at the behest of Mikhail Khodorkovsky or not is unclear. One thing is clear: Vladimir Putin took no interest in Khodorkovsky before the oligarch started to do international business, and thereby encroached upon the domaine of the president, and generally criticising the political elite.

In 2000 president Putin held a meeting with twenty-one of the Russian oligarchs. He told them that he would take little interest in their businesses as long as they refrained from acting politically (Goldman, 2008, pp. 102-103). Two oligarchs did not heed the president's warning: Khodorkovsky, released in 2013 after ten years in prison (Herszenhorn & Myers, 2013), and Boris Berezovsky, former majority stock owner in Sibneft, living in exile in the UK. Khodorkovsky and Berezovsky's crimes were that they criticised the new president. When the nuclear submarine Kursk sank, drowning all aboard, ORT, a tv network controlled by Berezovsky, criticised both the accident itself as well as the government's response to it. ORT asked what the president was doing since he did not appear to be taking the situation personally in hand. The answer was that president Putin was holiday making by the Black Sea (Goldman, 2008, p. 103). The situation resembles the critique experienced by US president George W. Bush in 2005 after Hurricane Katrina devastated New Orleans. Unlike the critics of the US president, Berezovsky experienced severe repercussions: he was forced to surrender his media assets as well as Sibneft to his junior partner Roman Abramovich. Abramovich put both the media assets and Sibneft at the president's disposal (Goldman, 2008, p. 104).

There are many similarities between the machinations of Khodorkovsky and other Yeltsin-era oligarchs. Many of the charges laid against Khodorkovsky such as fraud, tax-evasion and murder,

or attempted murder, could with equal justification be laid against other oligarchs. The fundamental difference was that Khodorkovsky was beginning to show political involvement.

14. The Belarusian-Russian Relationship

The political, social and economic ties between Belarus and Russia are perceived to be much closer than those of Russia and Ukraine (White et al., 2010, p. 348). The cooling of the Russian-Belarusian relationship can be said to have started shortly after Vladimir Putin's accession to the presidency. Russia and Belarus had agreed to form the Community of Sovereign Republics (CSR) in 1996. The new Union was meant to emulate the structure of the EU. However, when Vladimir Putin became Russian president in 2000 he suggested that Belarus should be incorporated into the Russian Federation; forming a single parliament and a single government. Belarusian president, Alexander Lukashenko, saw this as an attempt at stripping Belarus of its sovereignty (Yafimava, 2011, p. 221). Furthermore, the Belarusian economy has seen little reform since Belarusian independence making it vulnerable to price increases on imported goods, specifically natural gas (Yafimava, 2011, p. 253).

14.1. Gas Debt and Unfinished Business

The growing political uneasiness between the two countries brought the accumulating Belarusian gas debt to Gazprom's attention. It also shone a light on the possible implications the gas debt might have on the security of the gas deliveries transported through the Belarusian transit routes. In April 2002, Belarus and Russia signed an agreement allowing Gazprom to buy 50% of the Belarusian pipeline network. Gazprom and Beltransgaz were to form a joint venture, Beltransgaz JV, that would operate the Belarusian network. Beltransgaz JV was a way of allowing Belarus to settle its gas debt of $120 million to Gazprom. The joint venture combined with a Customs Union agreement from 1998, where Russia, Belarus, Armenia, Kazakhstan, Kyrgyzstan and Tajikistan agreed to trade all goods at the domestic prices of the manufacturing country, meant that Belarus would receive gas at domestic Russian prices. The agreement ensured that Belarus could buy Russian gas for $17-18 per mcm from July 2002 onwards, while other CIS countries paid about $50 per mcm and Europe paid $100-124 per mcm (Yafimava, 2011, pp. 224-225). The 2002 joint venture agreement stranded because the Belarusian government considered the offered price of $0.6 million, in 2004, to be too low. Three years later, in 2007, Gazprom agreed to pay $2.5 billion and the offer was accepted (Yafimava, 2011, p. 255). When joint venture negotiations were concluded in April 2002, Russia and Belarus were in agreement on the principles of the deal, but no agreement had been reached on the mechanism for the valuation of Beltransgaz. Gazprom's

frustrations over the lack of progress in the establishment of the joint venture led the company to end the price discounts in January 2004. In stead of the domestic prices agreed upon in 2002, Gazprom began demanding $30 pr mcm. When the supply contract for 2003 expired, the price in the 2004 contract was increased to $50 mcm. Belarus refused to sign the new contract, and Gazprom responded by cutting off deliveries to Belarus (Yafimava, 2011, p. 226). Belarus was forced to buy gas on short term contracts from independent suppliers paying about $50 per mcm. On 18 February 2004 the last of the short term contracts expired, and the independent suppliers would not agree to any new contracts. With no other means of attaining sufficient gas supplies to cover domestic consumption, and a disinclination to agree to pay $50 per mcm, Belarus began to siphon gas off the European deliveries. Gazprom's answer was to divert the European deliveries through Ukraine, and completely cut off the gas flow through Belarus (Yafimava, 2011, p. 228). The Russian-Belarusian relationship was at its lowest point ever.

14.2. Disputes over Prices and Fees

Gazprom and Beltransgaz did eventually manage to reach an agreement in June 2004, but no long term contract was made. The negotiations over the 2005 contract were equally tough. Gazprom wished to increase the gas price to $50 per mcm, and Belarus countered by threatening to increase the transit tariffs. In the end, the prices and transit tariffs were allowed to continue unchanged in both the 2005 and the 2006 contracts (Yafimava, 2011, p. 229). The 2004 dispute had badly damaged Gazprom's reputation as a reliable gas supplier to Europe, and the desire to avoid new confrontations that would further damage Gazprom's image led to the 2005 and 2006 contracts. It is also likely that Gazprom chose to avoid a conflict with Belarus in 2006 so that the company would not have to deal with simultaneous conflicts in its two most important transit countries (Yafimava, 2011, p. 232).

In the negotiations over the 2007 contract, Gazprom announced that it would harmonise the gas prices demanded in the CIS countries with the European gas prices by 2011. The company therefore suggested that Belarus should pay $200 per mcm in 2007 (Yafimava, 2011, p. 230). The reasoning behind the drastic increase in the gas price is to be found in the financial crisis that ravaged the Russian economy in 1998. During the crisis, Gazprom's finances were jeopardised by two things: the "chronic nonpayment by western CIS countries" (Yafimava, 2011, p. 323), and the large gas price subsidies to these same countries. Gazprom's response was to insist on cash payments on time, and to threaten to reduce supplies in case of tardy payment or nonpayment; or, alternatively, demand shares in the CIS countries' transit networks. The European gas prices are linked to the oil prices; as the oil prices began to skyrocket from 2006 onwards, the discrepancy between Gazprom's actual CIS revenue and the potential revenue should the CIS countries pay European prices became starkly clear (Yafimava, 2011, p. 323). Gazprom's goal

was, and still is, to depoliticise its relationship with the transit countries, and maximise the company's profits ensuring that it would not experience a repeat of the financial woes of 1998. A repetition of 2004 was only avoided in the very last minutes of 2006. Belarus and Gazprom signed a new five year supply and transit contract. Half of Beltransgaz would be sold to Gazprom for $2.5 billion. Belarus would pay $100 per mcm in 2007 increasing the price annually, and pay European prices by 2011. The transit fees would be increased to $1.45/mcm/100km (Yafimava, 2011, p. 232). There were two points in the contract that opened up for new conflicts: firstly, the increase in gas prices was calculated as an increasing percentage of the European price, but did not stipulate which location in Europe nor which point in time Gazprom would use in its calculations. Secondly, Belarus assumed that the transit fees would follow the increases in gas prices; Gazprom stated that the transit fees would not change (Yafimava, 2011, p. 233).

15. The Ukrainian-Russian Relationship

While the Russian-Belarusian relationship might be compared to an on-off love affair, the Ukrainian-Russian relationship might better be compared to a threesome, or perhaps even a foursome depending on what aspect of Ukraine you look at. Politically, the Ukrainian-Russian relationship is a triangle between Russia, Ukraine and EU. In theory this would place Ukraine in a position similar to that of Belarus by utilising a strategy of divide and rule to manipulate Russia and the EU into positions benefiting Ukraine. This is not the political reality of Ukraine. Looking at the Ukrainian economy and Ukraine's place in the Great Energy Game, the political triangle is extended to a foursome consisting of Ukraine, the EU, Russia and Turkmenistan.

15.1. The Political Triangle

Ukraine was in a strong position after the collapse of the USSR. Compared to Belarus and Moldova, the two other western CIS countries transiting Russian gas to Europe, Ukraine had a relatively high degree of national cohesion. The political and economic interdependence between Ukraine and Russia was less asymmetrical than the Belarusian-Russian or the Moldovan-Russian interdependences (Yafimava, 2011,p. 141). The difference between the Belarusian, the Moldovan and the Ukrainian stances is, that while Belarus chose to direct its political compass towards Russia in exchange for economic support and security; Moldova chose to focus on joining Europe and in time become a member of the European Union. Ukraine chose neither path. A major goal after gaining independence was to avoid coming under Russian influence. Ukraine's problem was that its economy, infrastructure and industry were either outdated, insufficient or inadequate. To help mediate these shortfalls, Ukraine sought assistance from the West e.g. from the International

Monetary Fund (IMF) and EU. The assistance was conditional on Ukrainian efforts towards liberalising the economy. The IMF required that Ukraine relaxed constraints on large scale privatisations. These requirements placed significant constraints on the Ukrainian government's ability to determine economic policies, and allowed Russian investors to penetrate Ukrainian industries that had been restricted to domestic investors until then (Yafimava, 2011,p. 141).
The relationship between Russia and Ukraine was never warm after the break up of the USSR. Initially the Russian population's attitude towards Ukrainian independence was mixed, but with the stated Ukrainian desire to join NATO and EU, the Russian public opinion towards Ukraine has since deteriorated to problematically low levels. The fact that the Russian population and Russia's political elite have never fully come to terms with Ukrainian independence has influenced Russia's foreign policy towards Ukraine significantly (Yafimava, 2011, p. 142). The first hitch in the political relations between Russia and Ukraine took place when the Russian government realised that it had very few means of exercising influence over Ukrainian politics. The most readily accessible channel was the Ukrainian dependency on Russian natural gas. In 1993, Russia attempted to facilitate Ukraine's gas needs, and the Ukrainian gas debt, in an effort to keep the Russian Black Sea Fleet on the Crimea. To further induce Ukrainian complaisance, the Russian government threatened to cut off gas supplies should no agreement be reached (Yafimava, 2011, p. 142). This heavy handed attempt to sway the Ukrainian government into accepting Russian hegemony failed dismally, and one of the consequences was that Ukraine realised that the gas transit network could be used as a strategic asset. The power the transit network gives Ukraine is one of the main reasons why Gazprom has expressed a desire to gain control over the pipelines. The political relations between Russia and Ukraine are now at a historical low requiring intense long-term diplomatic efforts to reestablish the most basic levels of trust between the two countries.

15.2. The Great Energy Game

The Ukrainian gas corridor consists of a widespread network of gas pipelines. Gas enters the network either directly from Russia, or through pipelines from Russia via Belarus. Gas exits to Russia, Poland, Slovakia, Hungary and Romania (Yafimava, 2011, p. 144). The network is a part of the great pipeline network constructed by the USSR and because of this, there is no separation between the pipelines that transit gas to Europe and the pipelines that carries gas for domestic use. This gives Ukraine the leverage over Russia that Nygren names "the transit weapon" (2008, p. 5).
The original gas transit arrangement between Russia and Ukraine was relatively straight forward. Gazprom would pay with gas for the privilege of transporting natural gas over Ukrainian territory, and through Ukrainian pipelines. Russia supplies natural gas to the majority of CIS countries. Of these markets, Ukraine is the largest, consuming approximately 75 billion cubic metres (bcm) annually. Ukraine has a small domestic production reaching 20 bcm annually, making it necessary

to import the remaining 55 bcm from Russian and Central Asian, primarily Turkmen, suppliers (Yafimava, 2011, p. 150). Until early 2006, Gazprom supplied about half of Ukraine's import requirements as payment for transit. The remaining half was supplied and/or shipped by a number of intermediary companies: Itera from 1998 to 2002, EuralTransGaz (ETG) form 2003 to 2004 and RosUkrEnergo (RUE) from 2005 to 2008 (Yafimava, 2011, p. 151). The Central Asian gas must be transported across Kazakh/Uzbek and Russian territories. The transit of gas needed for domestic consumption in Ukraine is dependent on the willingness of Russian, Kazakh and Uzbek authorities to allow gas transit without obstacles. The restrictions and obstacles placed on gas transit from Turkmenistan to Ukraine therefore determine the security of Ukraine's gas balance, and indirectly determine the likelihood of disruptions of Russian gas transited through Ukraine to Europe. One transit threesome e.g. Russia, Ukraine and EU, is dependent on another transit threesome, Ukraine, Russia and Central Asia. Russia and Ukraine are central to both trilateral transit relationships underpinning the importance of the two countries being, at the very least, on neutral terms.
The old pipeline network's lack of separation between gas in transit to Europe and gas meant for domestic consumption in Ukraine places all three parties in an interesting situation in case of legal disputes or technical disruptions. Prior to Nord Stream, Gazprom might reduce the export through Ukrainian pipelines, but the capacity in Belarus and Moldova was insufficient to compensate for large reductions. The nature of the Ukrainian pipelines means that any reductions can be taken out of the gas meant for the European markets; this is what happened in the 2006 and 2009 crises.

16. Gazprom's Challenges

Grätz (2011, p. 63) lists a number of areas that are challenges to Gazprom's future development. These areas can roughly be boiled down to two topics: revenue and political leverage. These two topics deal with underinvestment in exploration, development and gas production, expanding penetration on the European markets and preventing large scale energy and supplier diversification, and maximise economic and political gains in the CIS countries.

16.1. Revenue

It has been suggested that the nationalisation of Gazprom led to underinvestment in exploration and productions: Whether this is the case is a difficult question to answer as the company has an interest in keeping information on investments scarce to increase price-setting power by simultaneously driving a strategy of higher market penetration (Grätz, 2011, p. 63).
Gazprom generates approximately 60% of its revenue on the European Market, while the domestic Russian market is the largest when looking at volume. While the European market

invites a strategy to expand Gazprom's share of the market and thereby the profits, the Russian market has a substantial potential to reduce domestic gas demand through measures aimed at energy efficiency (Grätz, 2011, p. 63). Nygren (2008, p. 5) points out that in early 2008 domestic and CIS prices were substantially below EU prices; The CIS/domestic price per thousand cubic metres was approximately $50, while the EU price was approximately $250, making it about 80% more expensive for consumers and industry in Europe to buy gas compared to consumers and industry on Gazprom's domestic market. Checchi, Behrens and Egenhofer (2009, p. 19) add another point to the debate on energy security and potential Russian monopoly on the European market. The EU-Russian interdependence is asymmetric; the EU imports 6,5% of the Union's total primary energy supply from Russia while Gazprom rely on Europe for 60% of the company's revenue.

As mentioned above, Europe is not Gazprom's largest market looking at volume. There is a large potential to reduce domestic demand on the Russian market. However, increasing prices as an inducement to lower domestic demand on gas would likely lead to civil protests (Nygren, 2008, p. 5). Improvements in the building mass, similar to what has taken place in northern Europe, might help to reduce demand, but such measures are expensive and would require political and financial aid from the Kremlin to succeed.

16.2. Divide and Rule

The high price on gas in Europe has made an expansion strategy highly attractive for Gazprom. By increasing market shares and attaining a higher degree of market penetration, the company is likely to succeed in maximising profits on the European market. As part of the expansion strategy, the company may increase profits by creating or raising barriers against competitors to prevent decreases in gas prices due to supplier diversification. These barriers may then be used to fragment the common European market into national markets. If Gazprom manages to succeed in the mentioned expansion strategy, there might be a danger to the EU's aim of diversification of gas suppliers; this could lead to decreased energy security and higher consumer prices (Grätz, 2011, p. 63).

The likelihood of success depends on the EU Member States' national energy policies, and how energy is allowed to affect the national foreign policies. In Germany under the Chancellorship of Gerhard Schröder (1998-2005), there was a strong connection between energy policy and foreign policy. Chancellor Schröder used national German energy policy and energy security to justify a renewal of the Ostpolitik. He argued that integration of Russian and European capital, exemplified by German capital, would eventually lead to better mutual understanding, greater political integration and peace (Grätz, 2011, p. 70). Gerhard Schröder further argues that in competition with the US and China, the EU needs to pursue political, economic and cultural integration with Russia. In an ideal world, Mr Schröder might be right; Europe and Russia have plenty to offer

each other, but that would require a higher degree of convergent political and economical interests and objectives than is the case currently.
The German-Russian relationship under Gerhard Schröder's chancellorship was mostly congenial; however, Russia's relationship to a number of the former USSR republics were, and still is, not. Gerhard Schröder's vision of future peace and understanding is built on the assumption that Germany is a faithful representative of the European countries. The divergent interests, political objectives and histories offers Russia an opportunity to exploit the weaknesses in the European cooperation, and utilise a divide and rule strategy to maximise Gazprom's market penetration and profit Russia's political interests.

16.3. The Pipelines

In recent years, the media have discussed three pipelines Nord Stream, Nabucco and South Stream. There are several means of transporting natural gas. One is by liquifying the gas (LNG). This method makes it possible to transport gas in much the same way oil is transported: by ship. While oil only require refinement once, depending on the end usage, and is then ready to be used; LNG must go through three stages: firstly, LNG requires facilities to liquify the natural gas. Secondly, it requires bulk transport facilities e.g. LNG optimised tankers and carriers, and thirdly, LNG needs to be re-gasified before it can be used by consumers. The specialised facilities needed for LNG are costly to establish and according to Goldman (2008, p. 138) the price is almost as high as the price for building pipelines. The other more traditional and rigid way of transporting gas is through pipelines.
Large parts of the pipeline network used today to transport gas from Russia, Turkmenistan, Uzbekistan and the Caspian Sea to Europe was built in the Soviet era. This explains why the wast majority of the gas is transported through only two countries, Belarus and Ukraine. At the moment approximately 90% of Russian gas exports to Europe go through Belarus or Ukraine (Checchi et al., 2009, p. 20). These two countries buy almost 100% of their gas consumption from Gazprom, placing them in an uneasy interdependence. Belarus and Ukraine need Russian gas to function, and Russia is dependent on two main pipelines to Europe, Druzhba (Friendship) and Yamal-Europe; these go through Ukraine and Belarus respectively.
The pipeline network in use today was built by the Soviet Union as mentioned above, and this adds another aspect to Gazprom's pipeline challenges. Russia is not the only country in the region with oil and gas reserves. Turkmenistan, Uzbekistan and Kazakstan all have sizeable gas reserves. These countries are connected to Russia and Europe through the Soviet era pipeline network, but do not have any other means of exporting gas even though Kazakstan and Turkmenistan both border the Caspian Sea (Nygren, 2008, p. 9). This provides Gazprom with several options; if the domestic gas supply suffers from technical problems or domestic demand

increases, Gazprom may buy additional supplies relatively cheaply in the countries mentioned (Nygren, 2008, p. 8).

17. Conclusion

Energy has been a contentious topic for many years. The discussions have run along two related lines: energy as a commodity vs energy as a public good and energy supply security.
The destruction and desolation left by the fighting in WWII, and the deeply felt wish never to something similar again led to the creation of the European Coal and Steel Community (ECSC). Energy as a means to make war had to be curtailed. While the ECSC was based on coal other fossil fuels were beginning to emerge; oil's versatility was proved under the war while gas emerged as an alternative in the 1960s and 1970s. Until the 1970s and the OPEC embargo on the West, energy was not considered a problematic resource. Oil, the dominant energy source, was plentiful on the international markets; coal was, and still is, a reasonably readily available domestic European energy source, and gas was of little importance. The commodity vs public good and supply security discussions were not yet wide spread.

17.1. The First Game Changer

The first great game changer came in 1973. The West chose to support Israel in the Yum Kippur war which angered the Middle Eastern OPEC countries. The OPEC countries launched an embargo on Western Europe; the US had its own oil resources, but Europe was completely dependent on oil imported for the Middle East: the discussion about energy supply security is initiated. Without the oil deliveries from the Middle East, Europe was forced to seek alternatives; energy diversity emerges in the discussion. The options were limited; few countries outside of OPEC produced sufficient amounts of oil to substitute the Middle Eastern oil. Domestic European energy resources consisted mostly of coal while oil and gas fields in the North Sea were in the early stages of development. The nearest supplier, capable of deliverieng sufficient energy supplies, was the USSR. The Soviet Union already has a pipeline network within the Union's borders, and extending it to provide Europe with a steady supply of gas was relatively easy.
The end of the oil embargo and the Soviet penetration of the European energy markets meant that the energy security debate was allowed to slip into the background.

17.2. The Second Game Changer

The second time European energy policy changed was when the EU Commission attempted to create a single European energy market. In the 1980s and early 1990s, the national energy markets were dominated by national monopolies, National Champions. These champions' task was to provide sufficient amounts of energy supplies to meet the national demand; they acted as

gatekeepers to prevent uncontrolled market penetration from third countries, and they implemented energy policy decisions made by the national governments. The system of monopolies was stable, but it was also expensive for the consumers. The Commission initiated a liberalisation process primarily through the Directorate-General for Competition. However, the Commission's long held bias in favour liberal market mechanics collided with the perception of energy as a common good. The first skirmishes in the commodity vs common good debate were a reality.

In the proposal for the first Gas and Electricity Directives, the Commission argued that the most efficient way of reforming the European energy market was to dismantle the vertically integrated national monopolies: separating the ownership of the distribution networks from the ownership of production and refinement facilities, ownership unbundling. Unbundling was meant to allow independent energy providers access to the transit networks, and increase competition between the various energy providers. The Gas and Electricity Directives have been updated twice: the first energy package introduced them, while the second and third energy packages were attempts to patch up the deficiencies of the first and second energy packages respectively. The Directives have been subject to long difficult negotiations, both in the EU Council and between the Member States and the Commission. Many of the stumbling blocks in the EU negotiations have their origins in the discussion of energy as a commodity or a public good.

The EU's energy policy suffers from two other challenges: the implementation of the various energy Directives is unevenly distributed in the Member States, and while the Commission has succeeded in adopting rules and regulations these have been based on competition and environmental regulations. Energy was not mentioned in the various EU treaties until the Lisbon Treaty was adopted. While all parties agree that energy is important there has not been made any strategic decisions as to the future of European energy security.

17.3. The Third Game Changer

The third time the EU's energy policy became the subject of change was when Gazprom and the Russian government utilised their transit and tap weapon, and the effects could be felt in Europe. Gazprom had no intention of targeting European consumers, but neglected to consider all the implications of using power politics to sway the Belarusian and Ukrainian governments to comply with Russian wishes. Russia's relationships with Belarus and Ukraine deteriorated; the same thing happened to Gazprom's image as a reliable energy supplier to the European market.

In the European discussion of energy security, focus has been on security of supply; the European countries needed to be guaranteed that gas supplies would be delivered regularly and reliably. The Russian perspective on energy security is security of demand.

In an ideal world the Russian security of demand and the European security of supply should be able to find an equilibrium with relative ease. In an ideal world energy would be an apolitical

commodity. In the real world Russia, the other exporting countries and the transit countries, exploit gas' political potential to attain political or economic goals.

17.4. The Trust Game Changer

The EU has worked hard to become a world leader on environmental protection and climate change since the Kyoto Protocol. Energy became part of the EU's framework of treaties with the Lisbon Treaty; in the absence of energy as an exclusive competence, the Commission used its competences regarding environmental and competition regulations to develop a de facto EU energy policy. The competition regulations were applied to establish a single internal European energy market in place of the national energy markets; while the environmental regulations were used to reduce energy consumption by increasing energy efficiency. The targets in the Kyoto Protocol as well as the environmental regulations were used to boost the implementation of renewable energy reducing the need to import energy for third countries. From a European point of view decreased energy consumption would mean less dependence on external energy suppliers, particularly Gazprom. Reduced European energy consumption combined with greater reliance on renewable energy would threaten Russia's security of demand.
Europe is Gazprom's most profitable market, but the Russian-Ukrainian and Russian-Belarusian conflicts and the EU's measures to decrease dependence on Russian gas has damaged the trust between Russia and Europe. The Russian economy is highly dependent on gas revenue. Gazprom's economic dependency on the European region may be compared to Europe's dependency on Middle Eastern oil. Russia's only choice is to diversify its markets; China is the most obvious choice. The country shares a border with Russia and is a major energy consumer. The stumbling block so far has been agreeing on the gas price. While the Chinese market is a plausible alternative to the European, Russia may also use China to downplay Gazprom's dependency on European revenue.

17.5. The Pipeline Failure

The Russian conflicts with Belarus and Ukraine illustrated that clear trade agreements and strict adherence to these agreements are vital in securing European security of energy supply. However, the gas conflicts illustrated something else about the EU's energy policy: an internal market cannot function optimally unless the various national markets are efficiently connected to each other. The insufficient presence of European cross border interconnectors made it difficult for the EU to respond to reports of gas disruptions. The missing interconnectors not only limited cross border gas trade within the Union; they also meant that Member States dependent on gas from pipelines transiting through a country in dispute with Gazprom and Russia had a higher transit risk than anticipated prior to the first gas conflict in 2006.

In 2009, after three winter conflicts and the start of the European financial crisis in 2008, the Commission launched the European Energy Programme for Recovery (EEPR). The EEPR's task was to facilitate and partly finance projects modernising, enhancing and extending the European energy networks. Most of the EEPR's gas and electricity projects dealt with cross border interconnectors, but a few were more ambitious. The most notable example, the Nabucco pipeline, failed.

Nabucco was envisioned as a means of diversifying transit routes into Europe and a way to diversify gas suppliers. If natural gas is understood as a commodity, the rationale behind Nabucco is impeccable. The pipeline would allow gas from Azerbaijan to bypass Russian territory, reducing European dependency on Russian gas and Europe's vulnerability to disruptions in Belarus and Ukraine. However, gas is not merely a commodity. Nabucco could potentially reduce Gazprom's position on the European market. Allowing that to happen would harm Gazprom and Russia in a number of ways: reduced sales on the European market would reduce Gazprom's revenue; allowing Azerbaijan to sell gas directly to Europe would reduce Gazprom's transit fees on Azeri gas. Nabucco would also limit Russian usage of the transit weapon against Azerbaijan. A transit pipeline from the Caspian sea bypassing Russian territory could conceivably also change Russia's relationship with Uzbekistan and Turkmenistan. Gazprom purchases relatively cheap gas from both countries on the Caspian Sea, and the gas sold to Ukraine, or other Western CIS countries, most cross Russian territory. The pipeline infrastructure connecting the countries on the Caspian Sea with Russia and the Western CIS countries dates back to the USSR. These countries lack the resources to build new pipelines tying them to the existing infrastructure and the power the infrastructure gives to Russia.

17.6. Answering the Question

In the beginning of this thesis, I asked: How has the relationship between the EU and Russia, in particular around the issue of natural gas, affected the development of a Common European Energy Policy? The answer is that the EU's energy policy has been affected by the European-Russian relationship due to diverging perceptions of the term energy security, and the EU's goal on climate change and environmental policy. However, the most clear cut effects on the development of a European energy policy may be seen in Russia's relationships with Belarus and Ukraine. The asymmetrical relationships between the transit countries and Russia, and the political means employed by both transit countries and Russia, has cast the weaknesses in the European energy infrastructure and energy policy into stark relief. If the EU is to create an effective internal energy market, the Union must address the Member States' diverging attitudes towards liberalisation, perceptions of energy sources and both the Union and the Member States' attitudes towards the Russian bear.

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