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Liberalized, Monopolized, Fixated

Antinomies of the European Energy Market

In 2006, the trade in energy between the EU and Russia became a focus of public attention and an eminently political topic; the most discussed aspect was the question of security of supply. Step by step, therefore, the European Neighbourhood Policy (ENP) has also become an important instrument of energy policy, since the region plays an important role in the trade in energy. The countries of the region are situated in the common neighbourhood of the EU and Russia, a most important energy supplier. This means that the neighbours are important transit countries for oil and gas from a number of regions, including the Caspian Sea area. The EU's first goal is to improve energy security by means of a common market that will also include the question of transit. Second, the EU hopes that shared infrastructure projects will contribute to a greater diversification of transport routes and sources of supply. Third, co-operation is relevant in terms of structural policy and policy designed to provide order.

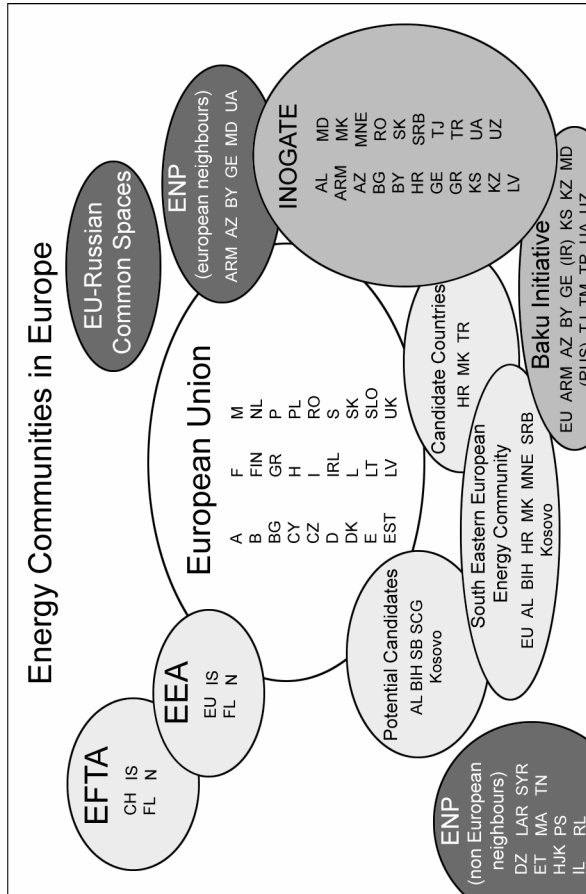
What the EU has basically been trying to do for over 15 years, albeit with varying degrees of intensity, is to establish a multilateral and co-operative set of regulations and rules for international energy relations. Market institutions

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and international law are the most important instruments of this policy. Russia, the EU's most important counterpart in the East, seems to be presenting itself to an increasing degree (at least rhetorically) as an "indispensable power" in international energy relations. This means that Russia has a good deal of potential power as an economic power and provider of political order in regional and international energy relations. And it is indeed the case that international relations are, to an increasing degree, being influenced by questions of resources because the sovereigns' right of disposal over scarce resources has become a decisive power factor and a factor shaping outcomes. Simultaneously, the economic and financial power of countries that produce energy is also growing. The question of where petrodollars and gas dollars are reinvested also has political implications. Above all, however, the liberalization of the electricity and gas market in the EU also makes it possible to invest in those phases of the energy economy that come after extraction: transport, sales, and processing. This has opened up opportunities for Russian firms to expand into the traditional markets of big western companies. In recent years, the Russian firm *Gazprom* has consistently pursued this rational strategy in the European internal market and has profited from the fact that it enjoys a transport monopoly within Russia.

The ENP and energy questions

Energy is a key area within the Neighbourhood Policy. The ENP's Action Plans envisage broad co-operation in the areas of energy dialogue, convergence of energy policy, harmonization of legal frameworks, participation in EU energy programmes, renewable energies, and regional



co-operation as well as nuclear security in the cases of Ukraine and Armenia.¹

The goal is to bring these countries closer to the EU and to open up to the partner countries the possibility of long-term, step-by-step integration into the European internal market for gas and electricity. The Action Plans seek to bring about co-operation on energy policy with the medium-term and long-term goal of bringing the energy policies of the countries of the neighbouring region closer to the contents and to the structural principles and principles of order of the EU. The idea is to implement, step by step, structural reform, in order to bring about market convergence. To achieve this, the idea is that these countries should in the long term accept the principles of the EU internal market and the Union's regulatory mechanisms and in doing so become integrated into the regulation forums responsible for the gas and electricity markets. It is envisaged that they might be able to participate in the Intelligent Energy Europe Programme, the goal of which is a more efficient use of energy. In addition, measures that will reduce price distortions and improve payment practice are supposed to be implemented. The transport networks and their maintenance, repair, and extension are a further field of co-operation, which also includes important questions related to transport regulations. Improving energy efficiency, expanding the use of renewable energy, and the safe use of nuclear energy are further central fields of co-operation.²

In the East, the neighbourhood mechanism's relevance from the perspective of energy policy is greatest for Ukraine and Moldova, Georgia, Armenia, and Azerbaijan.³ For these countries, questions of the diversification of sources of supply, transport routes, and energy sources are the main concerns. The EU plans bilateral co-operation

with energy-rich Azerbaijan, with the goal of aligning Azerbaijan's state-owned fuel energy complex programme step by step with the goals of EU energy policy. Here, too, gradual market convergence is a goal. Finally, the common relationship with Russia is also an implicit issue in the ENP where this concerns regional co-operation, the extension of energy networks, and market convergence.

The ENP and its Action Plans build on existing bilateral and regional initiatives.⁴ It is only one element in a mosaic of dialogues and far-reaching bilateral and multilateral co-operation mechanisms. In the case of Ukraine, for example, a Memorandum of Understanding was signed in December 2005, which is seen as one of the main instruments for Ukraine. There is also a bilateral dialogue with Moldova.⁵ The Baku Initiative (launched in November 2004), on the other hand, is a multilateral mechanism.⁶ It covers the Caspian Sea region, the Black Sea region, and the neighbouring countries. Russia has observer status. At the second conference of the Baku Initiative, held at the end of November 2006, a timetable for the convergence of energy markets, greater energy security, a sustainable energy policy, and investment questions was drawn up.⁷

Both the Baku Initiative and the ENP are closely tied to the TACIS programme INOGATE (Interstate Oil and Gas Transport to Europe), which was developed in 1996-7 and has been in force since February 2001 as an international framework agreement.⁸ The purpose of INOGATE is to tie the resources of the Caspian Sea and Central Asian spaces to the European markets. To date, 21 states have signed the treaty, including the Southeast European states, the countries of the Black Sea and Caspian Sea spaces as well as Lithuania – not, however, Russia. Within the framework of INOGATE, important transport routes to the European markets have been established, feasibility stud-

ies conducted, and repairs to existing networks, storage capacities, and measuring stations financed. INOGATE thus serves to extend the Trans-European Networks (TEN). To get to the heart of the matter: The EU's external relations are characterized by concentric inner and outer circles in which EU norms and regulations apply to different degrees.⁹ This model is also being transferred with increasing emphasis to energy policy. In the inner circles, which consist of countries that are in the process of joining and those hoping to join, together with *European Free Trade Association* and, in particular, the European Economic Space, which came into force in 2004 (to which Norway, an important energy supplier, also belongs), the *acquis communautaire* is accepted either in its entirety or to a large extent (up to around 80 percent). The next circle is the energy community, which came into existence on 1 July 2006 and includes both the EU member states and the Southeast European states. The essential elements here are the extension of legal norms and of free trade in electricity and gas, together with a harmonized regulation of demand according to the principles of energy efficiency and environmental and climate acceptability. There is also the possibility of a common external energy policy. The Energy Community Treaty explicitly envisages the possibility of its extension to include Turkey, Norway, Moldova, and Ukraine. The idea is that the common market should be enlarged, a legal basis in the sense of commercial and ecological norms should be created, and incentives should be put in place that will tie the states of the Caspian Sea space, the Middle East, and North Africa to the European market by means of new infrastructure projects.¹⁰ In the outermost circle, we find the states of the neighbourhood and Russia. Here, legal harmonization and convergence are matters that need to be negotiated. Algeria, as an im-

portant energy supplier, is integrated into the European Neighbourhood Policy and the Barcelona Process. Four common spaces are currently being negotiated with Russia to replace the partnership and co-operation agreement which expires in 2007. The idea is that this colourful mosaic should serve to create, step by step, a stable framework of order and regulation and, in the long term, a common market in energy.

The need for Europe to act in a field of global tension

There can be no doubt whatsoever that action is needed.¹¹ The EU, now a community of 27 states, is the largest net importer of energy in the world. If there is no thoroughgoing reorganization of the EU's energy system, the Union's need for imported oil is predicted to rise from around 82 percent (of oil consumed) today to over 93 percent in 2030 and, for imported gas, from 57 percent today to 84 percent.¹² This is happening against the background of a situation in which world energy needs could rise by over 50 percent in the next 25 years. Even if the energy mix is consistently diversified, the possibilities of substitution for oil and gas mean that diversification has to be pursued not only in regard to supply sources, but also in regard to supplying countries and pipeline routes. At the same time, there is no longer any serious dispute about global climate change; the latest findings show that there is a clear imperative to act for a number of reasons, including the consequences that can be expected for the world economy.¹³ In spite of the numerous challenges that will have to be met if we want a reasonably priced, sustainable, and safe energy supply, it is the question of security of supply that has become the focus of public attention. This is leading to

an increasing politicization of energy relations. Particular attention is being paid to oil and gas, which account for 38 percent and 24 percent of EU energy consumption, respectively.¹⁴ Undoubtedly, this is due to a large extent to the strategic significance these fuels continue to have, but this is not the only reason. Much of this debate feeds on the myth that the “oil and gas weapon” could be used to exert political pressure; however, because there is dependency on both sides, it is doubtful whether this could be effective in the medium and long term. Even so, the short-term effects of interruptions in deliveries, or even the threat of such interruptions, would be devastating. It is to be noted that the trade in energy is increasingly being analyzed and organized in political terms, especially at the international level. As the trade in energy is politicized, neorealist concepts of a zero-sum game and competition for resources that are becoming scarcer are increasingly serving as a guide to action.

Apart from the fact that the energy policy agenda is being analyzed in the categories of security policy and the supply situation is being interpreted as one of growing competition, the general crisis of multilateral co-operation, which is increasingly being replaced by a multipolar (dis)order, also plays a part. The political trend towards a neorealist balance of power has its counterpart in the economic sphere in the turning away from multilateral agreements towards bilateral ones. In this situation of growing competition, exclusive benefits to national actors and specific companies arising from access to resources are the most important considerations.

The EU has its own multilateral model of structure and order, which contrasts with this development. The EU is therefore faced with a challenge: On the one hand, there is a high level of international integration in the energy

sector, and on the other hand, trade must be carried out between markets that are structured in different ways – some liberalized, some highly regulated by the state. The energy trade in the EU's internal market is liberalized (to different degrees), whereas in Russia it is regulated to a high degree by the state, and the Russian company *Gazprom* has an almost complete monopoly on the transport of gas. But this also means that a variety of actors are engaged in the markets, ranging from private multinational companies, via companies that are completely controlled by the state, to the governments of the resource-rich states. The way of price formation also varies. In some cases, the market sets the price, and in others, the price is regulated and subsidized by the state. This means that at the international level the principle of reciprocity, that is to say of reciprocally guaranteed and non-discriminatory access to markets and infrastructure, does not work.

Simultaneously, the energy economy is characterized by certain specific features. Electricity and natural gas are grid- and pipeline bound, that means that they need to be transported with cables and pipelines,¹⁵ there is not much market flexibility in relation to third actors' opportunities to enter or leave the market, and economies of scale mean that a large company may be able to supply a commodity more efficiently than a number of small firms. All these factors favour the formation of a monopoly and vertical integration covering all stages of production.

This means that there is an urgent need for action in European energy policy, a field where responsibilities and competences are divided. However, we must define this requirement within the field of tension that has already been outlined. Russia is the main actor with which the EU has to deal concerning the rules of the game in Europe and in the

space of the former Soviet Union, since the region lies in the area of influence of both the EU and Russia.

The EU and energy policy: Old wine in new bottles?

Energy policy in the EU is a remarkable example of a policy field in which, since 2004 and to an even greater extent since 2006, both deepening and enlargement have been on the agenda. This makes energy policy, as a policy field that is also becoming more important at the global level, an important test case for the gradual process of European integration and the creation of institutions. From the normative point of view, the EU can also act as a role model at the global level, because it is continually striving to strike a balance between the three classical goals of energy policy – security of supply, eco-friendliness, and competitiveness. Up to now, the EU has concentrated on an energy policy that regulates demand. Although there have been problems in the implementation of this policy, it can still serve as a model internationally because it is oriented towards the principles of energy efficiency, sustainability, and the idea that the consumption of energy should not have a negative effect on the climate.¹⁶ The role of political action must be the concrete formulation and implementation of these three goals. It is therefore incumbent upon political actors above all to define the framework of order for energy policy, since in the EU's liberalized market it is predominantly private companies that are active in the energy economy and in the narrower field of the energy trade. However, because there are still considerable differences between the member states in the European internal market for electricity and gas, and because governments and state-owned enterprises are major players in the interna-

tional markets, political actors have to perform very important tasks that cannot be left to market actors alone. In this respect, the EU's more ambitious initiatives on energy policy are a way of catching up with developments that have already taken place, since the creation of an internal market for electricity and gas increasingly also requires that energy policy, internal policy, and foreign policy should be jointly regulated, coordinated, and combined. However, the EU's policy of managing the energy trade by means of market mechanisms, together with international regulation of the trade, also requires that it should be implemented at the *different levels of regulation*: the international, regional, and national levels.

This means that the EU, with its balanced and demand-oriented policy, offers a counterweight to the dominant international trend, which since 2003-2004 has increasingly been focusing on energy security, encouraging speculation about geopolitical conflict scenarios, and thus neglecting the goals of a sustainable and reasonably priced energy supply.

Even so, the gas dispute between Russia and Ukraine in January 2006 alarmed the EU, since pressure also dropped in the pipeline system within the EU market.¹⁷ In the past, the German side had made a point of stressing the reliability of Russia as a gas supplier, but after these events, the EU began to look more closely and critically at oil and gas imports from Russia. The energy dispute between Belarus and Russia in January 2007 reinforced this trend. The Commission had already reacted with a new Green Paper in March 2006,¹⁸ and in January 2007, it published a whole package of far-reaching proposals that had been worked out on the basis of the discussion about the Green Paper.¹⁹ At the press conference where this package was announced, EU Commission President José Manuel Barroso

went so far as to call for a worldwide post-industrial revolution in which the EU should take the lead. The Commission is calling for a comprehensive competition to create a genuine internal market, as a way of bringing down prices, and also for more solidarity between the member states, which in turn is seen as a contribution to greater energy security.²⁰ The extension of cross-border electricity grids and gas networks and of functioning trade make it easier to compensate for possible interruptions in deliveries from other EU countries. In this respect, the EU's new energy policy is not only a contribution to the Lisbon Strategy but also part of the tradition of the construction of the European community as a community of solidarity and as a project designed to ensure peace and stability. Furthermore, the Commission has proposed an external energy policy, the main goal of which should be the creation of a pan-European community in the neighbouring region.²¹ Alongside these aspects of the community of solidarity, which are also legitimising in nature, the strong regional emphasis of this concept also means an important shift of strategic priorities. A new document presented by the Commission and EU High Representative for the Common Foreign and Security Policy Javier Solana, which deals with the requirements for an EU foreign policy designed to serve the Union's energy interests, refers explicitly to the geopolitical dimensions of energy security.²² In this way, the regional dimension, which includes the neighbouring region, becomes a central focus. We have not seen this stated so clearly before.

According to this document, energy security rests on two pillars: diversification and functioning markets. The EU's first goal is to ensure that the principles of transparency and improved multilateral governance are accepted at the regional level, since the Union sees common rules for

trade, transit, and environmental standards, together with harmonized and, ultimately, integrated energy markets as a way of bringing about stability and prosperity in the broader region. In addition, the EU wants to see convergence in regulation systems, which should improve the climate for investment and establish a starting position that is the same for all in relation to opening up the market, competition, and environmental protection.²³

In this way, the EU is pursuing a policy of exporting its own models of order and structure in concentric circles. The plan is to extend the internal market by applying the Energy Community Treaty in the long term to important countries that are part of the European economic space and the Neighbourhood Policy. By doing this, the EU is offering the East European countries an alternative framework of order and integration.

There are two reasons why this is a move of major geo-strategic significance. First, Russia, as the region's largest supplier of energy, structures the space of the common neighbourhood by means of bilateral and exclusive treaties, which, due to the asymmetries of power, are overwhelmingly negotiated to serve Russia's interests. Because of the fundamental differences between the EU and the Russian government in their respective policies designed to provide order with regard to the role of market and state, liberalization and regulation, bilateralism and multilateralism, competing structures and models of order are coming into being. Second, since 2003, there has been a shift of emphasis in EU policy (by comparison with the 1990s), which takes into account developments in the governance structures of international energy relations: the movement away from a market dominated by consumers towards a market structured by the producer countries and the increase in the importance of natural gas. With the

creation of a pan-European energy community, the EU is now pursuing a policy that can be described as geo-energy-economic and geopolitical.²⁴

The reason for the regional orientation, which has now become clear, lies in the fact that the political approach of the 1990s – with its assumptions that the appropriate instruments were market and legal institutions, multilateral co-operation, and the internationalization of the energy markets – was largely a failure. To demonstrate this, one needs only to look at the 1994 Energy Charter Treaty, which entered into force in 1998, the negotiations about the transit protocol, Russia's failure to ratify the treaty, and the fact that the United States and Norway did not sign it.²⁵

The counter-trend towards the formation of regional markets and power-political spheres of influence has also been strengthened by the growing competition for oil and gas resources and the fact that natural gas is transported by pipeline.²⁶ A study commissioned by the EU has, on these grounds, argued that there is a danger of centres and peripheries forming blocs that will compete with other blocs for resources (and markets).²⁷ Against this background, the EU's efforts to improve its market position by creating a pan-European energy community are both strategically and politically problematic, or at least not unproblematic.

The most important question is how a regional energy community can come into existence that is not unilaterally oriented and exclusive, but takes into account the normative idea of a market community and community of solidarity – particularly in relation to equality of opportunity and the social aspects of energy consumption.

Energy policy between Europeanization and national interests

The neighbouring region has an important role to play in the step-by-step creation of a pan-European energy community. At the same time, energy policy is highly valued and has considerable symbolic force and areas of overlap with other policy fields, so there is indeed potential here not only for greater co-operation but also for possible spillover effects. But a glance at the current situation shows that there is a wide gap between aspiration and reality.

The most far-reaching innovations of the last few months are probably to be found in the foreign policy dimension of EU energy policy. It is true that the European Commission continues to recognize the right of every member state to maintain its own external relations in order to secure supplies and to determine its own energy mix, but in the same breath, it calls on the states to improve the coordination and coherence of international energy policy – and there are good reasons why it does this.²⁸ Many member states see energy policy as a national prerogative and are extremely reluctant to cede any sovereignty to the EU in this sphere. So calls for a common energy policy are becoming ever louder in the EU, while the national governments celebrate their state sovereignty and national egoism in this very policy field. These qualifications of market-commonality and solidarity have implications for the Neighbourhood Policy, because they also draw attention to some fundamental problems.

The liberalization of the markets and the creation of competition also imply a change in the role of the state in the energy sector. Since this sector is very important for society and for the economy as a whole, many countries see these changes as a significant loss of national sovereignty.

For this reason, energy policy is a particularly controversial field within the EU.

For example, the EU Commission has criticized the unsatisfactory level of integration of the member states' electricity and gas markets, the excessive degree of concentration in the energy economy, and consumers' reluctance to change suppliers. These factors, says the Commission, are major obstacles to competition. Another reason why there are such significant differences between the member states is the fact that most of them do as little as possible to implement the Commission's directives. Thus the proportion of a country's market supplied by the three largest producers of electricity or wholesale gas suppliers can be anything from 30 percent to 100 percent.²⁹ Many EU governments have put off as long as possible the creation of regulatory bodies responsible for overseeing electricity grids and gas supply networks, the prices charged by these operators, the free access of third parties, and the separation of transport from other branches of the business.

Another factor that helps to explain this is the fact that different member states define the role of the state in the economy differently. This means that the EU is faced with the task of establishing an efficient regulatory system which will make it possible, in spite of the resistance put up by the energy economy and in the member states, to create a functioning market and effective competition. This is a difficult task, because the companies clearly have considerable lobbying power and the states continue to enjoy partial property rights and discretionary power of disposal. The big European energy companies have reacted to this situation of enhanced competition by seeking not only to consolidate their market power through mergers and takeovers but also by moving into new areas of business and expanding their relations with foreign coun-

tries and companies. One part of this strategy has been to intensify their activities in Eastern Europe, North Africa, and Latin America in order to strengthen the company's position in the European market.

On the other hand, in their traditional national markets the energy companies have been successful in their efforts to lobby governments so that they can enjoy the advantages of their protected position for as long as possible. Moreover, the German government under Gerhard Schröder permitted *E.on* to take over *Ruhrigas*, which reflected increased government interest in creating an internationally powerful and competitive energy company. The German government has not been alone in pursuing this policy. At the time when *E.on* was making its takeover bids for *Endesa*, Spanish Prime Minister Rodríguez Zapatero made no secret of the fact that he was interested in creating a "national energy champion".³⁰

The big West European companies have also reinforced their market power in the new member states by acquiring interests in distribution and transport enterprises in these countries. This has led to a noticeable consolidation of so-called downstream activities. These activities include the transport and transmission of energy, sales, and supplies to large consumers and end-users. The consolidation process can be explained in part by the specific features of the energy economy that have already been mentioned, but they are also partly the result of national egoism, inadequate regulation, and the excessively lax implementation of competition policy at the national and EU levels. This creates major problems for the common market and for the idea of a community of solidarity in the energy field, especially in relation to the consequences of how prices are set.

Russia's role as competitor and partner

The consolidation of enterprises in the EU's downstream market has its equivalent on the supply side, in the upstream sphere where four large companies dominate with 87 percent of the market.³¹ Since Russia is the most important oil and gas supplier with 27 percent and 24 percent of the EU's total consumption respectively, the Russian company *Gazprom* is the most important partner for European gas companies.³² This aspect is crucial for the development of market power and the way prices are set.

Russia is also the EU's decisive counterpart on questions relating to political order, pipeline routes, and the goal of diversification, since the EU and Russia have different strategies on the central questions of order. The harmonization of the markets in relation to reciprocity of access to markets, infrastructure, and foreign investment are the central issues that arise, on a regular basis and in a variety of forums. The main bone of contention is *Gazprom's* transport monopoly. This monopoly also affects Russia's relations with the Central Asian countries, which up to now have had very little in the way of alternatives to exporting through Russian territory. Russia has signed long-term contracts with the Central Asian states, and one reason for this is that Russia is thereby able to sell any surplus gas of its own to the EU at a higher price.

Gazprom is protected by the Russian government, and its transport monopoly contradicts both the principles of the market and competition and the idea that the rules of the game should be the same for all. There is no reciprocity of access to the market or networks. While the Russian gas market is only open to western companies in the very limited form of exclusive joint ventures, the European Commission and the governments of the member states

are faced with the paradox that Russian representatives are increasingly complaining about double standards and defence mechanisms whenever the EU takes measures in reaction to Russian business activities.³³ It is indeed the case that these unequal initial conditions cause problems for the regulation of competition. In view of these ongoing developments, there is a need to think about how measures designed to combat monopolies and the formation of cartels can also deal with these aspects of varying market relations and property rights.

Gazprom's clever business strategy has been made easier by the fact that, up to now, it has proved difficult for EU member states to reach agreement with each other and some countries prefer to pursue their own bilateral strategies. The Nord Stream Pipeline through the Baltic Sea has frequently been mentioned as an example of the way exclusive package deals between companies can make multilateral co-operation more difficult, and it also demonstrates that another aspect of the problem is the way European energy companies try to secure their market position in the EU with the help of exclusive deals with *Gazprom* as their main gas supplier.

The history of the Nord Stream Pipeline reveals a number of fundamental problems. The exchange of shares in companies to which *E.On Ruhrgas* agreed in the course of the deal over *Nord Stream* and the *Yuzhnoe Russkoe* gas field has also helped to strengthen *Gazprom's* position in natural gas transit within the EU. In exchange for shares in the gas field, *Gazprom* received from *E.On* shares in the Hungarian companies *Foldgaz Storage*, *Foldgaz Trade*, and *E.On Hungary*. Far-reaching consequences for competition result when downstream enterprises (with consolidated market power) enter into strategic alliances with upstream companies such as *Gazprom*. The strategies of

the enterprises are rational, but the consequences for public welfare and overall prosperity are problematic because rising energy prices have an effect on society and on international competitiveness. These exclusive deals between companies lead to vertical integration covering several stages of production, especially in transport and distribution. This is extremely detrimental to the competition the EU seeks to foster and to the principle of separating the different stages of production, and it also has problematic consequences for gas prices.

Simultaneously, these exclusive deals between companies also have direct practical consequences: It becomes more difficult to finance pipeline projects, because the anticipated market share will be too small. For example, the Hungarian company *MOL* recently signed an exclusive deal with *Gazprom*. This is by no means harmless, especially since Hungary will be a participant in the strategically important *Nabucco* project, which involves an alternative route for gas in transit to Europe. *Gazprom* is using the liberalization of the EU gas market and the networks in order to supply end-users, not only in Germany, Austria, and the United Kingdom, but also – on the basis of long-term contracts – in Italy and France. This strategy is problematic because of its pre-emptive thrust: The more the EU gas market becomes saturated with Russian gas, the less attractive that market becomes for alternative suppliers, partly because the cost of investment in the necessary infrastructure projects is so high. In addition, *Gazprom*'s direct sales to end-users in the EU do nothing to contribute to competition in the European gas market – indeed, they work against competition.

This obviously has implications for the neighbouring space, just as Russian activities in this space affect the EU. The Kremlin and the Russian government's major contri-

bution to supporting *Gazprom* in recent years has taken the form of investment in new export pipelines and the consolidation of the company's market position at home and abroad. In the important transit countries of the common neighbourhood, *Gazprom*'s main goal has been to establish control, either completely or in part, over the important transport routes, and to move into the sale of gas. *Gazprom* used the January 2006 gas dispute with Ukraine to move into sales via the creation of *RosUkrEnergo*. The gas dispute with Belarus in December 2006 ended with *Gazprom* taking over 50 percent of the Belarusian pipeline operator *Beltransgaz*. This means that *Gazprom* has partial control of the important *Yamal* pipeline, through which flow approximately 22 percent of Russian gas exports to Europe. The company had been pursuing this goal for years.³⁴

Gazprom's legitimate business interest in charging higher prices for gas in the post-Soviet space as well falls together with a quid pro quo strategy that aims to get access to transport networks in exchange for still-offered lower gas tariffs. By employing this strategy, Russia has succeeded in maintaining and extending something close to a monopoly over the Europe's natural gas supply from the East.

This means that while the EU is making efforts to break up the transport network as a basic precondition of competition, Russia is pursuing a deliberate strategy of monopolizing the transport sector as well and, step by step, of acquiring control over it. According to the Russian political leadership, there is no likelihood that Russia will ratify the Energy Charter Treaty in the near future.³⁵

And this is not the only problem. Because *Gazprom* has spent so much on investment in strategic projects (the acquisition in December 2006 of 50 percent plus one share in the *Sakhalin-2* project of *Royal Dutch Shell*, *Mitsui*, and

Mitsubishi and of 72 percent of *Sibneft*), there is now insufficient money available for opening up new fields, repairs to the Russian gas infrastructure, and investment in new energy-saving technologies. This will become a major problem in the next few years. The *International Energy Agency* and Russian experts have already drawn attention to the danger of a gas deficit in Russia.³⁶

The EU needs to work hard to catch up in its efforts to organize the energy community, and the relationship with Russia must be a central point of reference.

An energy community between neighbours: Opportunities and limits

The idea of a pan-European energy community is not new,³⁷ but the EU's current conception, with its long-term goals of setting up a common market and an energy community, with its regional orientation and arrangement in concentric circles, contains clear geostrategic elements. The EU is now paying more attention to the neighbouring region, and in doing so, it has corrected the political course of internationalization. The clearest indication of this is that the EU is now once again prioritizing long-term contracts in order to ensure security of energy supplies.³⁸ The EU's co-operation with its eastern neighbours is also important as a way of becoming a unified actor in negotiations and in the market, and of moving forward with the diversification of sources of natural gas and oil.

This strategy is legitimate, but its implementation presupposes an answer to the question of how a regional energy community can come into being that is not one-sided and exclusive, puts into practice the normative idea of a market community and community of solidarity, and includes

Russia. We should not forget that there is not only no consensus in the EU about what kind of relations the Union should have with Russia, but also that Russia and the EU are pursuing antagonistic models of order in energy policy, which is also leading to competition between these models in the common neighbourhood. This makes this issue particularly controversial, as the EU's eastern neighbours are heavily dependent on Russia for their energy supplies. In order to reduce this dependence on Russia, partners are needed for reform and for the reorganization of the energy supply system. This has implications for the expansion of an energy community into the neighbouring space. The two most important implications relate to equality of opportunity and solidarity.

This article has shown that the measures taken by political actors have not always had the desired effects in relation to a functioning internal market. The main factors responsible for this are market distortions, specific features of the energy economy, and failures of regulation, as a consequence of which there has been a strong consolidation of electricity and gas companies in the downstream sector. Simultaneously, the strategic alliances of these enterprises with *Gazprom* have contributed to a situation in which joint ventures control many stages of the value-added chain. This is extremely problematic for the goal of a situation where prices are set by the market. Developments in the EU must therefore be treated as a warning about what can happen if liberalization takes place too quickly and in a forced way in national markets where the state's capacity to act has been weakened by transformation. The EU's experience has shown that politics has an important role to play here, and that there are limits to privatization and liberalization in crucial policy fields that were for many years the concern of the state. Against this

background, there is also a need to think about improved and more effective regulation within the EU, after which it might be possible to “export” these rules.

In countries undergoing transformation, national sovereignty is reconstituting itself in many spheres. Energy, as a strategic sector, plays a crucial role here, especially since political mistakes in energy policy are associated with high economic and social costs. At the same time, there are strong and dominant interest groups in these countries which are frequently clustered around the energy sector and which profit from contracts and general business relations with Russian enterprises.³⁹ Nevertheless, with regard to preserving traditional energy companies, it is important to avoid giving the impression that what is really at stake, behind the instruments of the Neighbourhood Policy, is western corporate interest in takeovers; if the policy is perceived in these terms, it will damage the legitimacy of the project as a whole.

At the same time, there are weighty economic and social arguments in favour of a very slow process of liberalization and movement closer to the European market, since a transnational trade in energy would be likely to lead quickly to higher energy prices. There is a close connection between this argument and the second aspect, solidarity. Energy prices are a focus of considerations related to the economy as a whole and to society. On the one hand, regulated energy prices are not only a sensible political calculation, but also a fundamental social requirement at the level of private households in the countries undergoing transformation. The Action Plans of the Neighbourhood Policy do not say much about this. Here, too, the EU should avoid creating the impression that its main motive for exerting pressure for price liberalization is a desire to do away with competitive advantages for energy-intensive

branches of the economy. On the other hand, higher energy prices create an incentive for more efficient consumption.

These considerations show that the EU's demand-oriented and sustainable energy policy is extremely significant. It manifests the decisive potential for an initial phase of cooperation with the neighbouring region. At present, an almost instinctive fixation on the security of supplies of fossil fuels is blocking alternative paths of development that put more emphasis on greater efficiency, the increased use of alternative sources of energy, and thus on the evolution of a decentralized energy system broken down into smaller units. One can speak of an almost inherent conservatism in the energy economy, which results from the technical features of the system that are grid- and pipeline-bound transport systems and large power stations, which constitute economies of scale.

Politicians have to step in here and, because investment cycles in the energy sector are so long, create a new framework for a transformation of the energy system. This is also where the Neighbourhood Policy has its greatest potential in relation to energy. It is hard to say to what extent integration into the internal market will succeed. The political trick that needs to be pulled off consists not only of avoiding an integration competition with Russia that could lead to conflict, but also of bringing the neighbouring countries closer to the EU in a flexible manner and of exporting the framework for order in energy policy without at the same time offering the countries full membership, something the EU cannot and does not wish to do.

Translated by Gerald Holden, Langen

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