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Rethinking Energy Policy in Central and Eastern Europe

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About the Working Papers Series

EUCERS 'Reflections' Working Papers Series (WPS) focuses on promoting an understanding of how use of energy and natural resources affects international relations. The Series seeks to contribute to questions including but not limited to economic competition over energy resources, raw materials and water through multidisciplinary approaches which are academically-rigorous and policy-oriented.

The WPS intends to stimulate debate and exchange of research ideas including those in an early stage of development. The WPS intend to provide a space for scholars and practitioners to present their work to a broad readership and connect with established expert community working on issues related to energy and resource security.

Foreword

A number of issues continue to underpin the international political economy of hydrocarbons. Stalled Paris Agreement, growing role of energy diplomacy, and the rise of protectionism to name a few all add to uncertainty affecting long-term calculus of the industry players and policy makers alike. The innovation continues in particular in the battery storage development holding promise for a more down-top, ‘democratised’ energy policy for the future and a greater say for consumers and communities. Yet, while we are still waiting for the full benefits of the innovative solutions to come to fruition (and possibly interrupt the energy systems as we know them) the ‘knowns’, geopolitical constraints are still on the agenda.

Hence, having in mind the stated objective of this Working Paper Series we welcome four authors who cover three highly topical matters from a policy and academic perspectives.

European Commission’s new regulatory proposal is the most recent development ‘on the radar’. Danila Bochkarev policy paper calls for caution in ‘cracking’ Europe’s ‘energy software’ – the Existing European regulatory framework – due to the effects it may have on the EU’s energy market and the ‘hardware’ (the energy infrastructure, including interconnectors).

Further on, John Roberts takes on board the intertwined politics of Southern Gas Corridor and Turkish Stream projects. The prime focus of his contribution is the long-term development of the Corridor and the role of the Turkish Stream (TurkStream) pipeline in determining the outcome of such a development.

Finally, the paper by Eamonn Butler and Wojciech Ostrowski provide for a critical perspective on the Central and Eastern European (CEE) energy relations. Butler and Ostrowski argue that the economic and political complexities of individual CEE countries remain largely understudied in wider literature and they propose a step beyond a well-established narrative developed around the region’s division into anti-Russian, pro-Russian and neutral bases.

I hope the contents of the fourth volume of our Working Paper Series will be considered useful by our readers. The responsibility of views and opinions expressed in the papers remains with their authors.

Dr Slawomir Raszewski
Editor of EUCERS ‘Reflections’ Working Paper Series

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Let's be cautious about trying to “crack” Europe's ‘energy software’: The new European Energy Governance strategy

Danila Bochkarev

Abstract

We are currently observing a real proliferation of energy regulation and framework strategies (Energy Union, new Gas Directive, etc.) in the EU. This is creating new complex “rules of the energy game” improving Europe's energy security and defending consumers' interests. New regulations run the risk of overregulating markets and increasing the bureaucratic control over the energy market. Does Europe really need these changes? From the natural gas market perspective, Europe is already close to achieving these goals even with the current market design. Existing European regulatory framework (‘software’) and energy infrastructure, including interconnectors (‘hardware’) have already proven themselves to be highly effective means of reinforcing security of energy supplies by providing European customers with diverse, affordable, sustainable and reliable energy. If it is a race for competencies and power, one should remember that an attempt to ‘crack’ energy ‘software’ may result in systemic failures. Furthermore, in case such changes are considered necessary and unavoidable, they should not be made without proper consultation with all stakeholders. The European Commission confirmed itself that implementation of proposals “starts with a good impact assessment and stakeholder consultation”.

Introduction

We are currently observing a real proliferation of energy regulation on the EU level extending the Union's competence into areas which to a larger degree are subject to the level of proficiency in Member States. With this reach for additional power and responsibility the European Commission tries to create a new and complex "rules of the energy game", while creating additional uncertainties for investors. The European Commission has been particularly active in proposing new regulations and framework strategies such as revision of the Security of Supply regulation, Intergovernmental Agreements (IGAs), the proposal for amending the Gas Directive 2009/73/EC, the Clean Energy Package and the Energy Union. This shift of responsibilities from the national governments to Brussels has therefore reached a new quality. An industry commentator rightfully noted that "*EU energy and climate policy has turned into a process exclusively for specialist policymakers, NGO's and lobbyists.*" Furthermore, new regulations "run the risk of *overregulating* markets", increasing the bureaucratic burden for the national regulators and competent authorities under the pretext to "promote 'energy governance', i.e. more EU control over the energy market"¹

¹ Karel Beckman, 'For a kinder, simpler Energy Union', *Energy Post Weekly*, 19 December

New Regulatory Proposals: Hidden Rationale?

What is the real rationale for the Energy Union? What is the Energy Union and why is it so important for the European Commission? On 25 February 2015, the European Commission put forward a proposal for an Energy Union in a document entitled 'A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy.' This 'umbrella strategy' was initially aimed at ensuring Europe's smooth transition to a low-carbon/decarbonised future. The plan was to certify that European citizens would have unrestricted access to secure, affordable/competitive and climate-friendly energy sources. The Energy Union is – at least officially – standing on the three key pillars: secure and reliable energy supplies, competitive sources of energy and affordability/sustainability of Europe's energy supplies.²

Donald Tusk Former Polish Prime Minister and current President of the European Council was one of the founding-fathers of the Energy Union. In his opinion piece 'A united Europe can end Russia's energy stranglehold' published by *Financial Times* on 21 April 2014, Tusk proposed an energy union in order to reduce Europe's

2017. <https://energypostweekly.eu/december-19-2017-watch/>

² For more details on the Energy Union please see:

https://ec.europa.eu/commission/priorities/energy-union-and-climate_en

“excessive dependence on Russian energy”. Tusk’s initiative was based on the key principles – “a mechanism for jointly negotiating energy contracts with Russia”, solidarity between Member States, construction of an adequate energy infrastructure, full use of (domestic) fossil fuels (such as shale gas and coal) and establishing contacts with alternative natural gas suppliers namely Australia and the United States. Tusk also proposed a “European body charged with buying its (Russian) gas”.³ Despite some commonalities, the current “version” of the Energy Union stands quite far from Tusk’s proposal – unconventional gas and coal are not the key pillars of this framework strategy and collective gas is barely mentioned in Brussels. These trends went against the expectations of some Central and Eastern European states. This was a source of many political misconceptions, deceptions and frustrations.

Here we come to one of the Europe’s most important energy question: *does anyone really know what the end goal of the Energy Union is?* Is the EU trying to achieve a single unimpeded internal energy market run solely by EU institutions (regulators, transmission system operators, politicians)?⁴ Unofficially, the Energy Union – as a pan-European umbrella strategy – also might be considered as

³ <https://www.ft.com/content/91508464-c661-11e3-ba0e-00144feabdco>

⁴ The issue was raised by Karel Beckman in his article ‘For a kinder, simpler Energy Union’ <https://energypostweekly.eu/december-19-2017-watch/>

an important tool in a bureaucratic struggle between Brussels and the national capitals for influence on the energy regulation processes in Europe. In fact, there is nothing new and every bureaucratic institution “wants to grab ever more competencies”.⁵

Currently, many important aspects of the national energy policies – such as the choice of the energy mix – still belong to the Member States. Article 194 of the Lisbon treaty state that the “European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary to achieve the objectives in paragraph 1.” These include the functioning of the energy market and security of energy supply in the Union through the promotion of interconnectors, energy efficiency and renewable energy. However, “such measures shall not affect a Member State’s right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply”.⁶

In this context, the importance of Commission’s attempt to obtain a

⁵ Walter Boltz, former deputy chairman of the Agency for the Cooperation of Energy Regulators (ACER) quoted in Kalina Oroschakoff, ‘Tusk’s rude awakening’, *Politico*, 20 April 2015

<https://www.politico.eu/article/tusk-energy-union-hits-eu-reality/>

⁶ See the Lisbon Treaty <http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-the-functioning-of-the-european-union-and-comments/part-3-union-policies-and-internal-actions/title-xxi-energy/485-article-194.html>

mandate from the Council to negotiate an agreement with Russia on Nord Stream-2 and to amend the Gas Directive goes beyond this pipeline project and will have implications on the future direction of the European energy policy. However, this is also counter to the Member States' right to determine the conditions of the general structure of its energy supply.

On 9 June 2017, the European Commission adopted a request from the Council of the European Union for a mandate to negotiate with Russia the key principles for the operation of the Nord Stream 2 pipeline. Commenting on this initiative, the Vice-President for the Energy Union Maroš Šefčovič said: "*Nord Stream 2 does not contribute to the Energy Union's objectives. If the pipeline is nevertheless built, the least we have to do is to make sure that it will be operated in a transparent manner and in line with the main EU energy market rules.*" The Commission argued that Nord Stream 2 should be governed by "a special legal framework, which would take into account fundamental principles (third party access, unbundling, etc.) stemming from international and EU energy law" thus de facto applying the 3rd Package to this project. Commissioner for Climate Action and Energy Miguel Arias Cañete added that "*Nord Stream 2 cannot and should not operate in a legal void or according to a third country's energy laws only*"⁷

⁷ http://europa.eu/rapid/press-release_IP-17-1571_en.htm

A little note is necessary to understand the importance of Nord Stream 2 in the context of the Energy Union. Energy relations between Brussels and Moscow have deteriorated following an investigation into Gazprom's suspected violations of EU antitrust rules and the crisis in Ukraine. Energy rhetoric has deteriorated, whereby the South Stream gas pipeline was one of the casualties of the new political reality in Europe. When the Nord Stream 2 project was launched in September 2015 few months after the 'birth' of the Energy Union, the gas pipeline was immediately seen by the project's opponents as incompatible with the Energy Union's goals. In this context, the Energy Union was presented as a tool to assess various energy infrastructure projects. One should however remember that this 'umbrella strategy' is not a compliance checklist, especially taking into account the fact that it is not - unlike the 3rd Energy Package - a legally binding document and as such is not yet a part of the *acquis communautaire*.

However, the Commission failed to achieve the necessary backing from the Member States and *the opinion Legal Service of the Council of the European Union released on 27 September 2017 saw no "legal void" in relation to Nord Stream 2 and confirmed that Gas Directive 2009/73 do not apply to the pipeline.*⁸

⁸ Opinion of the Legal Service of the Council: Opinion of the Legal Service was published by Politico on 28 September 2017 <http://www.politico.eu/wp-content/uploads/2017/09/SPOLITICO->

The European Commission however did not leave its attempts to assert its powers over the project and the European regulatory process. When the mandate process was stalled, the European Commission decided to amend the Gas Directive to extend it beyond the territory of the EU. Thus, extending the Union's competence into areas, which to a larger degree, lie outside the sovereign territory of Member States.

On 8 November 2017 the European Commission took "steps to *amend* common EU gas rules to import pipelines". It launched an amendment of the Gas Directive in order to apply the Third Energy Package's rules to all import pipelines supplying natural gas to the European Union from countries outside the EU's internal market.⁹

Currently the EU's energy laws for the internal market do not apply to any such import pipelines – a fact currently recognised by the Commission itself.

[17092812480.pdf](#) More comprehensively the issue of mandate and the application of EU energy law to Nord Stream 2 was addressed by Kim Talus and Katya Yafimava. For example, see Talus, K., 'Application of EU energy and certain national laws of Baltic sea countries to the Nord Stream 2 pipeline project', *Journal of World Energy Law and Business*, March 2017; Katya Yafimova, "The Council Legal Service's assessment of the European Commission's negotiating mandate and what it means for Nord Stream 2", *Oxford Institute for Energy Studies*, October 2017 <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2017/10/The-Council-Legal-Services-assessment-of-the-European-Commissions-negotiating-mandate-and-what-it-means-for-Nord-Stream-2.pdf>

⁹ http://europa.eu/rapid/press-release_IP-17-4401_en.htm

New amendments would require the owners of offshore gas infrastructure to achieve effective unbundling and allow third-party access. An official explanation for the proposal to amend the EU Gas Directive is an improvement of the "functioning of the EU internal energy market and enhances solidarity between Member States"¹⁰. Earlier on 13 September 2017 in the context of his State of the European Union Speech, President Juncker announced that, "building upon the solidarity aspect of the Energy Union, the Commission will propose common rules for gas pipelines entering the European internal gas market".¹¹

The European Commission, Directorate for Energy argues the Article. 194 TFEU serves as the legal basis for the proposed changes to the Gas Directive.¹² These envisioned changes would ensure the functioning of the internal energy market and security of supply. What the European Commission and DG ENER however fail to demonstrate is why the internal energy market and security of supply can't be archived if the envisioned changes are not made. No further

¹⁰ Ibid.

¹¹ Ibid.

¹² Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2009/73/EC concerning common rules for the internal market in natural gas, COM/2017/0660 final - 2017/0294 (COD), point 2 "LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY", 8 November 2017 <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2017:0660:FIN>

explanations are given, and it remains unclear if the envisaged changes are suitable or necessary to archive the goals of the Energy Unions cited in Article. 194 TFEU.

The European Commission argues that the lack of EU-wide rules for import pipelines from third countries has a negative impact on the goals of the Energy Union as the EU obtains most of the gas it consumes from third countries. DG ENER argues that by changing the rules, inter alia, the operation of these import pipelines would therefore contribute significantly to the functioning of the internal energy market and security of supply. However, contradicting its own argument of the needed changes deemed particularly relevant for the internal energy market and security of supply, as the respective proposal suggests, that Member States can exempt these pipelines from the regulation. This also implies that the proposed changes do not overcome the existing lack of regulation which is deemed an impairment to the internal energy market and security of supply for the Energy Union.

The European Commission admits that this intended regulation would result in a “conflict of law”, at least with the law of the third country whose companies operate the offshore pipelines. This self-generated “conflict of law” should however be solved by another directive that has just been recently amended: the decision on intergovernmental energy agreements with third countries (IGAs).

Thus, by extending the applicability of the Gas Directive via the proposed

amendment, the European Commission – and DG ENER in particular – are not only trying to create additional internal EU competences, but are also attempting to create the preconditions for an exclusive external Union competently in line with Article. 3(2) TFEU for this area. The draft amendment to the Gas Directive aims to shift what so far has been a Member State competence in the field of international agreements, e.g. regarding the operation of offshore pipelines from third countries, to becoming what will likely be an exclusive European Union competence. Severin Fischer, a Senior Researcher at the Center for Security Studies (CSS) at ETH Zurich suggested that the EC “constructed the problem of a “legal void”, claiming that a conflict of laws on energy regulation were apparent in the Baltic Sea, knowing full well that EU energy market regulation has never been used for comparable import pipelines before, not to mention an application in the offshore Exclusive Economic Zones. To solve this artificially constructed problem, the Commission asked the Council for a mandate to start negotiations on an Intergovernmental Agreement (IGA) with Russia. This IGA should include all important elements of the EU’s domestic approach, namely: third party access to the pipeline, unbundling of ownership and operation of the pipeline, tariff regulation and transparency”¹³ One

¹³ Severin Fischer, ‘Lost in regulation: the EU and Nord Stream 2’, *Energy Post*, 13

should ask if this shift is purely politically motivated as it is unclear how does it contribute to legal certainty or legal harmonization in the European Union.

EU markets are already providing security of supply and competitive pricing

Does Europe really need these changes? From the natural gas market perspective Europe is already close to achieving these goals even with the current market design. Existing European regulatory framework ('software') and energy infrastructure ('hardware') has already proved itself to be a highly effective means of reinforcing security of energy supplies and providing European customers with diverse, affordable, sustainable and reliable energy supplies.

Natural gas prices are finally affordable for the European consumers. The European Agency for the Cooperation of Energy Regulators (ACER) noted that the European gas wholesale market "continued to progress and market dynamics seem to work better and better with gas prices registering a "constant decline ... which is the result of market fundamentals and increased gas-to-gas competition".¹⁴ Overall the European

November 2017. <http://energypost.eu/lost-in-regulation-the-eu-and-nord-stream-2/>

¹⁴ ACER Market Monitoring Report 2015 – GAS, p. 6
https://www.acer.europa.eu/Official_document

energy import bill has decreased by almost 50% in the last 4-5 years. Energy products represented 25% of total EU imports in 2013 and only 15% in the first half of 2017.¹⁵ Global energy played a substantial role in bringing prices down, but EU market mechanisms and increased level of interconnectivity also played a role which should not be neglected.

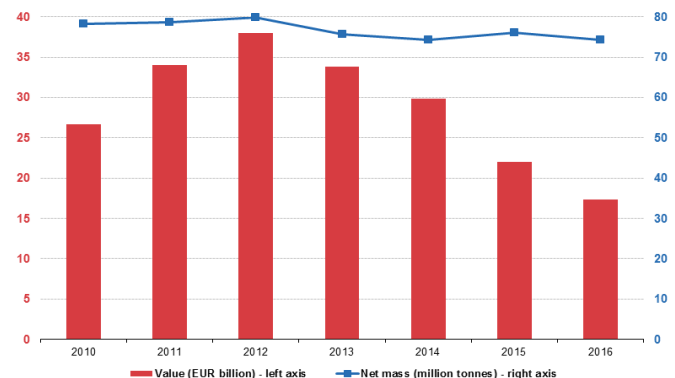


Figure: extra-EU imports of energy products, monthly averages, 2010-16. (C)Eurostat, 2017.

One can argue that gas prices depend on many factors but infrastructure seems to be one of the most important variables in this price equation. The consensus implies that any additional infrastructure guarantees flexibility of supply and has a positive impact on consumers. The increased level of interconnectivity and new reverse flow options that have been created over the last few years, allow the EU countries

[nts/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202015%20-%20GAS.pdf](https://www.acer.europa.eu/Official_document/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202015%20-%20GAS.pdf)

¹⁵ For more details, please see http://ec.europa.eu/eurostat/statistics-explained/index.php/EU_imports_of_energy_products_-_recent_developments#Trend_in_extra-EU_imports_of_energy_products

to source gas from neighbouring countries often situated outside traditional east-west energy supply corridors.

The total Central and East European (CEE) east-west reverse flow capacity currently stands at about 147 bcm/year, while a further 42 bcm/year of new interconnection capacity has been added within Eastern Europe and between Central and Western Europe over the last five years. Poland can now obtain over 90 % of its gas imports from non-Russian sources.¹⁶ This connectivity has helped to reduce the price divergence between the West and the East. For example, in the first half of 2014, the gap between the average wholesale price between the Dutch trading hub TTF (21.58 euro/MWh), the most liquid hub on the European Continent, and the Czech Republic (27.81 euro/MWh) was still quite significant – over 6 euro/MWh. In the third quarter of 2017 wholesale prices at the TTF (16.14 euro/MWh) and the Czech Republic (16.16 euro/MWh) converged.¹⁷ In 2016, Poland's wholesale gas prices fell by 31% compared to 2014, to 15.4 euro/MWh – compared to an EU average of 15.0 euro MWh, while Polish household gas

prices fell by 13.4% from 2013 to 2016, faster than the EU average (10.0%)¹⁸

This connectivity also helped to spread the sense of confidence that exists in the mature markets in Western Europe to the new Member States. Gas is therefore becoming an 'ordinary' source of energy which can be sourced almost everywhere, and its source of origin could no longer a matter of concern for energy importing countries. The feeling of confidence is also being increasingly shared by the EU decision makers. In an interview with *Interfax Natural Gas Daily* published on May 2, 2017 Vaclav Bartuska, Czech ambassador-at-large for energy security said: "we don't get this anti-Russian rhetoric, as the whole logic of the common EU market is that when Russian gas crosses EU border, it's no longer Russian, nor Norwegian nor Algerian. It's simply gas that is measured by its economic value. We find it a safe resource".¹⁹

Security of the supply is therefore made great advances. EU Energy Market has also proven itself as the best system to deliver security of supply. The majority of existing insecurities arise from an incomplete implementation of EU rules and lack of efforts in addressing bottlenecks and infrastructure deficiencies. In its'

¹⁶ For more details please see <http://energypost.eu/quiet-revolution-central-eastern-european-gas-market/>

¹⁷ For more details on prices please see European Commission Quarterly Report on European Gas Markets https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q3_2017_final_20171221finalcover.pdf

¹⁸ For more details please see EC's Energy Union Factsheet Poland (23.11.2017) https://ec.europa.eu/commission/sites/beta-political/files/energy-union-factsheet-poland_en.pdf

¹⁹ <http://interfaxenergy.com/gasdaily/article/25702/czech-ns2-support-tough-luck-for-poland-bartuska>

response to the Commission consultation on an EU Strategy for liquefied natural gas and gas storage, Shell noted that “security of supply issues in some European countries are created or exacerbated by the very slow adoption of the European Regulatory framework”. A well-functioning market is the “best way to deliver security of supply,” – concluded Shell.²⁰ Even the European Commission also confirmed this point of view and stressing the progress achieved in providing the EU Member States with the security of energy supplies. During the State of Union debate at the European Parliament on 1 February 2017 Vice President of the Commissioner Maroš Šefčovič confirmed that energy security has significantly improved in a vast majority of the EU Member States. For instance, Mr. Šefčovič confirmed that “22 out of 28 countries are actually better off (in terms of energy security – note of the author); having better infrastructure and interconnectors with reverse flows is giving us much more confidence; the European market is much more liquid than it ever was before”²¹

Last but not least: increased consumption of natural gas in Europe helps achieving decarbonisation goals.

²⁰

<https://ec.europa.eu/energy/en/consultations/consultation-eu-strategy-liquefied-natural-gas-and-gas-storage>, part 3, file “118 2015 LNG consultation final.pdf”.

²¹

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20170201+ITEM-013+DOC+XML+Vo//EN>

In this context, the United Kingdom shows Europe leads on how the use of gas could reduce greenhouse gas (GHG) emissions without imposing excessive financial burden on industry and population.

EU market dynamics also forced non-European suppliers to change their market behavior. The non-EU companies realised they are running the risk to rapidly losing their market share if they can't effectively adapt to the new market realities. For example, Gazprom accused by the European Commission of breaking EU antitrust rules, accepted to amend its' market strategy and submitted relevant commitments to the Commission. DG COMP positively assessed these commitments. "We believe that Gazprom's commitments will enable the free flow of gas in Central and Eastern Europe at competitive prices. They address our competition concerns and provide a forward-looking solution in line with EU rules. In fact, they help to better integrate gas markets in the region," - said Margrethe Vestager, EU Commissioner for Competition.²² It is somehow surprising to observe the third-country companies willingly playing by the rules established by the Commission, while the EC itself is trying to apply regulatory flexibility, changing regulations according political considerations.

EU regulations and a single market are sufficient to regulate supplies from the third countries and address all relevant

²² http://europa.eu/rapid/press-release_IP-17-555_en.htm

consumers' concerns. It is therefore essential to understand how do these regulations improve the consumer's energy security, choice of supplies and maximise economic benefit for the EU citizens? Do these changes take account of the customer's point of view or this is a part of a political game inside the 'Brussels bubble'?

Attempt to achieve a regulatory flexibility?

Is the Commission trying to achieve regulatory flexibility? In this case, these rules *a la carte* could create a precedent for politicisation of the energy sector and this attitude might have damaging effects. Severin Fischer of the Centre for Security Studies (CSS), ETH Zurich, has rightfully said that "Over-politicisation of natural gas as security problem leads to non-market behaviour... higher prices and increases investment costs."²³ Higher energy prices do not only mean higher energy bills. Increases in energy and in particular natural gas prices will be an imminent threat to hundreds of thousands jobs in Europe and the social welfare of its citizens. Chemical industries, just as an example, are particularly sensitive to the energy prices. According to the European Chemical Industry Council (CEFIC) data this sector alone employs over 1.2 million people in Europe and around 3.6 million if you include related service jobs in the EU Member States.

²³ <https://www.energimyndigheten.se/contentassets/234e2eef49084817a8f6d9dd8b6f9aab/severin-fischers-presentation.pdf>

Amendments to the Gas Directive, if they affect gas transport from third countries to the EU, would effectively be a qualitative expansion of the EU internal market law – certainly not a small technicality which might also have consequences for the Southern Gas Corridor and Europe's relations with the key energy exporters in its' neighbourhood. Europe's partners might also have to ask themselves whether the EU rules – generally seen as an example to follow – can be trusted if they are so easily changed according to rapidly evolving political calculations? If the EC starts to interpret its own rules politically, who will prevent the third countries or even EU member states from doing the same? Regulatory flexibility may create conflict with already existing norms of international law where Brussels might not be always the winner. For example, Russia has challenged the Third Energy Package and the TEN-E regulation in the World Trade Organisation (WTO).²⁴ While the WTO panel report endorses the EU's arguments, to the "astonishment of the European Commission, it also characterises the Projects of Common Interests as discriminatory and directed against third country projects"²⁵

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https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds476_e.htm

²⁵ Presentation by Klaus-Dieter Borchardt, Director, European Commission, European Parliament's Committee on Industry, Research and Energy (11 October 2017); subject: "Negotiation mandate for Nord Stream 2: state of play" (unofficial transcript); Dods EU

Conclusion

The EU energy market is already bringing benefits and one should be cautious about trying to “crack” Europe’s ‘energy software’. All PC users know that unnecessary software changes slow down computers. Similarly to IT equipment EU energy markets may stop running smoothly if the regulatory environment becomes excessively complex. ACER rightfully notes that the “current regulatory model should be allowed time fully to deliver its positive results. Regulatory stability should be encouraged.”²⁶ Furthermore, the regulatory process is too important and proposed changes should not be discussed without proper consultations with all stakeholders. The European Commission in its improved regulation guidelines confirmed that implementation of proposals “starts with a good impact assessment and stakeholder consultation”.²⁷

About the author

Danila Bochkarev specialises in Eurasia energy and natural resources issues with a particular focus on the natural gas. Before joining the EastWest Institute, Danila was an Inbev visiting scholar for EU-Russia relations at the at UCL/KUL universities in Belgium. He also worked on China and Central Asia affairs at the European Parliament and the Energy Charter Secretariat and advises private sector companies.

provides a full transcription of the ITRE Committee Meeting.

²⁶ http://www.acer.europa.eu/Events/ACER-CEER-Market-Monitoring-Report-Launch-Event-2017/Documents/MMR%20Launch%20Event%20Persentation_Final.pdf, slide 6.

²⁷ <https://ec.europa.eu/info/sites/info/files/better-regulation-guidelines-preparing-proposals-implementation-transposition.pdf>



The Relationship between the Southern Gas Corridor and Turkish Stream

John M. Roberts

Abstract

As of December 2017, the main Southern Gas Corridor (SGC) elements are generally close to completion, so that the physical infrastructure should be in place for gas from Azerbaijan's giant Shah Deniz field to reach Turkey in the second half of 2018 and destinations in the European Union from the start of 2020.

But while upstream field development and the laying of physical pipe proceeds apace from Azerbaijan all the way to Albania, there are three issues that have the potential to cause serious repercussions for the SGC, thus affecting the SGC's long term impact on European gas supplies and European energy security. Two concern the physical development or operation of the pipeline. The third concerns its long-term development, and it is this issue – and the role of TurkStream in determining the outcome of such development – which is the prime focus of this paper.

Introduction

The Southern Gas Corridor (SGC) is the collective term for more than US\$40bn worth of projects which will initially bring Azerbaijani gas to Europe and which are eventually intended to carry gas from other Caspian and Middle Eastern suppliers as well.

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But while upstream field development and the laying of physical pipe proceeds apace from Azerbaijan all the way to Albania, there are three issues that have the potential to cause serious repercussions for the SGC, thus affecting the SGC's long term impact on European gas supplies and European energy security. Two concern the physical development or operation of the pipeline. The third concerns its long-term development, and it is this issue – and the role of TurkStream in determining the outcome of such development – which is the prime focus of this paper.

The first issue concerns the landfall in Italy of the Trans-Adriatic Pipeline (TAP) and whether local politics might yet cause delays in developing the final leg of the SGC's 3,500-km pipeline system, the eight-km section from the

Italian coast to a new connection with the country's existing gasline network, thus delaying – or in a worst case scenario, aborting – the delivery of some 9 bcm of gas to Italy.

The second issue concerns the overall security situation within Turkey and the possibility that increasing political tensions might lead to prolonged instability threatening both foreign and domestic investments, including oil and gas pipelines.

It is worth emphasising that those involved in ensuring a successful SGC landfall in Italy, namely the developers of TAP, continue to stress that they expect to complete their work in time to enable the first gas to reach Italy via the SGC in early 2020, and that, while there is indeed continued local political opposition in Italy's Puglia region to the project, at present it looks as if the worst that can happen is that the start of key construction works is delayed, possibly prompting a subsequent delay to first deliveries.

It is also important to stress that the danger posed by potential internal instability in Turkey is not necessarily a threat directed particularly at the SGC, but relates to the increasing polarisation of political and social attitudes. In particular, it relates to the increasing alienation of the country's Kurdish community at a time when the Turkish Government is not only engaged in open warfare with PKK fighters in south-eastern Turkey but is imprisoning some important Kurdish members of parliament and is also

conducting a widespread purge – including civil servants, teachers and military personnel – in response to a failed coup in July 2016. So far, there is little sign that the Kurdish-related violence in the southeast is extending to the rest of the country, but bombing attacks in major cities attributed to Islamist militants and the ferocity of the government’s post-coup crackdown have prompted serious concerns in the western business community about the country’s internal security situation.

The challenges posed by both these issues are beyond the scope of this paper. They are noted simply to make the point that the challenge posed by Russia’s TurkStream project is not the only issue capable of impacting dramatically on the future of the SGC. Moreover, while all these issues possess the capability of damaging the development or operation of the SGC, what really counts is the likelihood that they will occur. At this stage, suffice it to say that it is quite likely that TurkStream (as the Russians now officially call Turkish Stream) will indeed significantly impact on second stage development of the SGC, hence this paper. But the possibility that the TAP might not be able to make landfall in Italy – a concern that in early 2017 prompted at least some contingency planning from TAP partners – is negligible. As for averting any delay due to regional political objections, a recent change in TAP management, which has seen a greater role for personnel from Italy’s SNAM gas group, should help to overcome these, since SNAM is not only a 20 percent

stakeholder in TAP but because the final point on the TAP line will be its connection to the SNAM-operated Italian distribution system.

The TurkStream Challenge

The SGC has to be considered in two ways, as a set of projects that require a commercial rationale and as an element in the European Union’s drive to diversify sources of supply and thus reduce its vulnerability regarding supplies from Russia, though not necessarily to reduce actual import volumes from Russia. The SGC projects are intended, in their first stage, to deliver 6 bcm/y of Azerbaijani gas to Turkey and a further 10m bcm/y to European customers beyond Turkey. Deliveries to Turkey are expected to start in the second half of 2018 and to customers beyond Turkey. The second stage would see the installation of additional compression to enable these volumes to be doubled. For its part Gazprom envisages TurkStream as a system that will consist of two sets of 15.75 bcm/y capacity pipes – called “strings”. The first 15.75 bcm/y capacity string would be essentially dedicated to providing a replacement route for gas deliveries to Turkey once Russia discontinues transit (or it least much of its transit) across Ukraine at the end of 2019 and, in effect, ceases to use the Trans-Balkan Pipeline through Moldova, Romania and Bulgaria for routine deliveries of some 12-14 bcm/y to Turkish customers. The second 15.75 bcm/y capacity string would be used to

deliver gas to European customers beyond Turkey.

The SGC projects include upstream field development in Azerbaijan, onshore pipeline construction across Azerbaijan, Georgia, Turkey, Greece and Albania, and a subsea connection from Albania to Italy. First stage development is collectively expected to cost around €40bn, while second stage development will cost much less, since other producers would be responsible for upstream development, the physical pipe has already been laid, and so, essentially, all that is required is extra compression to push the gas through the existing pipes. With regard to the first stage, the overwhelming bulk of the work to be carried out in developing the upstream and shipping the gas to and through Turkey has already been completed, and though work on the final section, the TAP, is only half-completed, it is only due to start operation more than a year after the earlier sections to Turkey.

So long as the TAP line is completed successfully, then, according to the consortia of companies developing this integrated system, there is little reason to doubt the commerciality of the venture. Azerbaijan's SGC company, which represents Azerbaijan's interests in the various SGC projects, in August 2017 described the SGC in a statement to the local Trend news agency as a 'chain of interlinked projects comprising one value chain' and that its commerciality was based upon the delivery of the initial contracted

deliveries of 6bcm/y to Turkey and 10 bcm/y beyond Turkey.

'The profitability and economy of all Southern Gas Corridor projects were based on these volumes of gas, thus are independent from gas supply from third parties', Trend quoted the statement as saying.

The challenge posed by TurkStream concerns second stage development of the SGC: the planned doubling of the system's capacity so that as much as 32 bcm/y would be able to reach Turkey, with 20 bcm/y of this available for delivery beyond Turkey, notably to Italy. Apart from one section in Georgia, this would not require the laying of any fresh pipe but would rely on the addition of extra compressor plant. This challenge potentially takes two forms. The first is outright competition through the laying of a completely new pipe across Southeastern Europe to reach either the Italian market or a major European hub such as Baumgarten in Austria. The second is by seeking to utilize the projected second stage expansion capacity of the TAP to ensure the delivery of Russian gas to customers in Italy or served through Italy.

No less a person than Russian Prime Minister Dmitry Medvedev demonstrated that Russia is at least paying nominal attention to the first option when, while discussing TurkStream in Istanbul, he stated on 23 May 2017 that:

'Altogether, two lines of the gas pipeline are expected to be laid.

One of them will be completely oriented toward the Turkish market. The second is aimed at supplying European countries. Right now, we are holding talks with a number of European countries to determine where the best place is to enter Europe. There are various proposals. Negotiations are under way with a whole range of European countries, including Greece and Bulgaria. But the corresponding developments could vary somewhat'.¹

A landfall in Bulgaria would seem to imply a resurrection of the aborted South Stream project, and would require the development of connections through Bulgaria and the Balkans to markets in central, northern and Western Europe. Moreover, Russia is clearly keeping its options open with regard to what kind of a route it might seek to develop to reach market hubs in Italy or Austria.

As of late 2017, Gazprom had reached agreements concerning potential development of both a southern route to Italy via Greece – the so-called ‘Greek Stream’ approach – and also a more northerly route – which might be termed ‘Son of South Stream’ – via Serbia and Hungary, aimed at either the monitoring station at Tarvisio in northeastern Italy or at the Baumgarten hub in Austria.

¹ Talks under way on extending Turkish Stream to EU – Medvedev, Interfax, Natural Gas Daily Europe, May 23, 2017.

However, the agreements concluded in connection with both options appear to be preliminary and are more akin to initial Memoranda of Understanding (MoUs) than to the the kind of Final Investment Decisions (FIDs) that Gazprom signed in the autumn of 2012 with Bulgaria, Serbia, Hungary and Slovenia for the original South Stream project.

In terms of actual pipeline construction, Russia appears to be keeping its options open. As of late November 2017 Gazprom was saying there was “a total of over 520 kilometers of pipes laid along the two strings by now” and that TurkStream would be completed by end-2019.² But that may not be quite the full story. Gazprom routinely refers to TurkStream as constituting two “strings” – with one intended to serve the Turkish market and the other to supply other customers in Europe. However, whether the vessel hired to lay TurkStream, the massive *Pioneering Spirit*, is laying both strings simultaneously is not so clear. The author understands that the vessel is indeed laying two physical pipelines simultaneously, but that each of these is just 32 inches in diameter, and thus would only be expected to have a routine capacity of around 8 bcm/y. With regard to pipelaying during the winter of 2017/18, it thus seems likely

² See <http://www.gazprom.com/press/news/2017/november/article382429/> for the 520-kms report and <http://www.gazprom.com/press/news/2017/november/article382429/> for the completion date.

that it was only the first 15.75 bcm/y string, the one intended to serve Turkey, that was being laid in the final months of 2017 and that while there may have been some initial laying of the inshore section of the second string, major offshore pipelaying has yet to start.

This would be in line with the lack of absolute confirmation concerning the location of the second string's landfall on the eastern coast of the Black Sea; in particular, whether it will copy the first string in landing at Kiyıköy in Turkey or whether, perhaps, it will diverge from the first string for about 100 kilometers in order to make land near the Bulgarian port of Varna, the original landfall for South Stream.

The 'Greek Stream' option

Agreements concluded in connection with a potential 'Greek Stream' project include an MoU signed on 24 February 2016 in Rome by the CEOs of Russia's Gazprom, Italy's (French-owned) Edison SpA, and Greece's DEPA 'on natural gas deliveries across the Black Sea from Russia via third countries to Greece and from Greece to Italy in order to establish a southern route to deliver Russian natural gas to Europe'.³ On 2 June 2017, the CEOs of the same companies (though with a different head at DEPA) signed a

³ <http://www.gazprom.com/press/news/2016/february/article267671/>

further cooperation agreement specifying that the gas would come via Turkey.

The 'Greek Stream' option effectively constitutes a revival of the Interconnector Turkey-Greece-Italy (ITGI) / Poseidon project, first envisaged more than a decade ago. This sought to ensure the development of a two-element system. The first would be a 613-km line across Greece from Komotini to Florovouni, just inland from the Ionian Sea. This would constitute the main Greek section of the original ITGI concept. The second would be the onward 210-km subsea connection from Florovouni to a landfall near Otranto in southern Italy, known as the Poseidon project.

However, the prospects for such a system being built in time to serve Gazprom's export interests remain remote. On 7 November, Elio Ruggieri, CEO of the IGI-Poseidon group, told the European Autumn Gas Conference in Milan that a final decision on constructing ITGI/Poseidon would be made in 2019 – and that the ITGI/Poseidon system could be built by 2023.⁴ Even this, however, appears to be a somewhat optimistic schedule.

⁴ <http://georgiatoday.ge/news/8253/Project-Poseidon%3A-Europe-Starts-the-Fight-for-Russian-Gas-from-Turkish-Stream>. The IGI-Poseidon company, which was founded in 2008, takes its name from a project first contemplated at least six years earlier for the development of the Interconnector-Greece-Italy (IGI) and the subsea component of such a system, Poseidon. Thus it is the IGI-Poseidon company that would like, over the next several years, to develop the full ITGI/Poseidon system.

In October 2017, Italy's SNAM Group – which operates much of the Italian gas transport, storage and regasification facilities – published a consultation exercise aimed at testing the interest of shippers to use an ITGI/Poseidon system for gas transit between Greece and Italy. It concluded that costs to develop IGI/Poseidon would be reasonable, between €2.5 bn (around US\$3 bn) for a 7.3 bcm capacity system and €4.0 bn (US\$4.7 bn) for a 13.7 bcm/y system, but cautioned that in either case “the duration of the activities to build the new capacity ... will take approximately 6 years after the positive outcome of the economic test” – with the outcome of the test not expected until the end of 2019.⁵

The ‘Son of South Stream’ option

In November 2017, Interfax reported that Gazprom had asked its own NIIgazekonomika institute to perform a pre-investment study of scenarios in connection with the possible extension of TurkStream through the Balkans to the Baumgarten hub in Austria. Interfax cited Gazprom itself as the source for this report and appeared to be citing Gazprom directly as the source for a statement that the purpose of the study was “to choose the optimal

⁵ http://www.snamretegas.it/export/sites/snamretegas/repository/file/en/business-services/Online_Processes/Allacciamenti/procedure-module/incremental-capacity/Public_consultation_incremental_capacity_Greece_and_Italy.pdf

configuration for projects to create new and expand existing gas transportation capacity in the territories of Bulgaria, Serbia, Hungary and Austria necessary for the supply and transit of Russian gas to these countries.”⁶

In June 2017, Hungarian Foreign Minister Peter Szijjarto had stated that ‘Hungary, Russia and Serbia have resumed talks on the construction of the South Stream gas pipeline, but with a smaller capacity than it was initially discussed’.⁷ This would seem to indicate that what was being discussed was a pipeline of perhaps 10-20 bcm/y capacity, in contrast to the 32 bcm/y capacity system envisaged for the onshore South Stream project when supposed FIDs were being taken in late 2012. Even so, this would still be a very expensive project indeed. In 2012, judging by contemporary accounts of the various individual country sections, the costs involved in laying some 1,200 kms on onshore pipeline from landfall at Varna in Bulgaria through Serbia, Hungary and Slovenia to Tarvisio in northeastern Italy, were estimated at around US\$7.5 bn.

The costs for constructing an admittedly smaller ‘Son of South Stream’ line should be a little less than

⁶ <http://www.interfax.com/newsinf.asp?id=792772>

⁷ <https://sputniknews.com/business/201706101054507360-south-stream-future/>

this, but precision remains impossible at this stage for various reasons. The size of the pipe has not been disclosed, so pipe acquisition costs cannot be estimated. The terms under which Right of Way might be granted and landowners compensated are not known. Above all, it is not clear whether any such line would start in Bulgaria with one of the TurkStream strings diverted to a landfall in Bulgaria (a proposal naturally favored by the Bulgarian authorities), or in Turkey, at some onshore connection with TurkStream, or in Greece, where it might constitute an element in a broad regional project to create a corridor from the Aegean to Central Europe.

Booking space in TAP

The problem confronting both a route from Bulgaria and a revival of ITGI/Poseidon is the cost, particularly at a time of relatively low gas prices. On the other hand, if Gazprom were to bid for capacity in TAP, the only real issue it would face is whether anybody else would be able to compete with it.

When the TAP group signed its Resolution To Construct, the equivalent of a Final Investment Decision, in November 2013, it was agreeing to develop a line in accordance with EU regulations that would ensure it had an exemption from third party access rules for the first 10 bcm/y of gas, but that any gas carried as part of the second stage expansion would be on the basis of competitive third party access. This

means that any prospective supplier wishing to use TAP's second stage capacity can ask for an open season and that, if a bidder is successful in booking space on commercial terms, the bidder has to be accommodated. At the time, there was an implicit assumption that Azerbaijani gas would possess a sufficient competitive edge to ensure it would be the most likely source of gas for second stage transportation.

This is no longer the case. Since the fall of international gas prices in 2014, the ability of Azerbaijan to secure the kind of upstream investment necessary to finance its planned 'Next Wave' of gas production has been strictly limited. Moreover, in practice, almost all competition from other producers can also be eliminated from the start: Turkmenistan because of its inability to conclude an agreement with Azerbaijan and cross-Caspian supply; Iran because of its disinclination to pursue gas exports and its determination to focus on oil; the Kurdistan Region of Iraq because of the financial woes of the companies operating there; and the Eastern Mediterranean for a plethora of commercial and political reasons. In the long run, offshore Romania might prove a potential source of supply, but, unless there are some dramatic new discoveries in the next year or so, not in time to challenge Gazprom's ability to make gas available for prospective insertion into TAP from as early as 2020.

The bottom line is that, under current conditions, Gazprom is by far the most

commercial prospective source of gas for any second stage TAP expansion. In addition, on grounds of cost, it would seem far more likely that Gazprom would opt to ship gas to Italy through an expanded TAP rather than by building a successor to South Stream.

Officially, sources in both TAP and Gazprom have told the author as late as September 2017 that there has been no official or unofficial approach by either side concerning possible Gazprom input into TAP.⁸ But that this is indeed under consideration was made clear in January 2017, when Gazprom Deputy Chairman Alexander Medvedev, for the first time mentioned TAP:

‘We have installed available capacity ready to produce more than 100 bcm of gas today, so we don’t need any additional investment to produce more than 100 bcm. But in order to bring this gas to Europe we need additional infrastructure which we are working on with our European partners – NordStream 2 and Turkish Stream. This capacity will not be sufficient to bring all this to Europe. So this is why we are talking to use available capacity on Poseidon project, (the

⁸ A report in Russia’s *Kommersant* newspaper on 5 June 2017 that SNAM CEO Marco Alvera had suggested during talks in St. Petersburg with Gazprom CEO Alexei Miller that the Russian giant should consider shipping TurkStream gas to Italy via TAP, in which SNAM is a 20% shareholder, was immediately denied by SNAM.

studies for) which will be ready soon – or maybe TAP’.⁹

Perhaps more importantly, on 19 September 2017, Turkey’s Official Gazette announced that the Turkish cabinet had formally ratified an intergovernmental agreement with Greece allowing for the development of the ITGI/Poseidon natural gas transit system between Turkey, Greece and Italy.

This was a somewhat peculiar development, since this constituted ratification of an agreement that was actually concluded more than a decade earlier and which had already led to its principal concrete conclusion, the opening of a direct gas pipeline between Karacabey in Turkey and Komotini in Greece, in 2007.

As a result, initial Turkish and international reports on this long-delayed ratification naturally focused on the ITGI/Poseidon element and saw the ratification as clearing the way for Russian gas to flow through Turkey to enter an ITGI/Poseidon system.¹⁰

⁹ Medvedev, comments at European Gas Conference in Vienna, 24 January 2017. According to the interpreter, and therefore as heard by most of the audience, Medvedev referred to ‘the Poseidon project, which will be ready soon’. He told the author immediately afterwards that he had said, in Russian, that it was the studies for the Poseidon project which would be ready soon.

¹⁰ See Natural Gas World, 19 September 2017, *Turkey clears ITGI to Greece, opens way for TurkStream*.
<https://www.naturalgasworld.com/turkey-approves-itgi-poseidon-link-with-greece-paving-way-for-link-with-turkstream-55400>

Moreover, since most of the elements of the ITGI/Poseidon system still have to be built, it was natural to conclude that this was an indication that Turkey was clearing the way for Russian gas to enter an ITGI/Poseidon system and, as a logical consequence, that it would be for Gazprom to finance or arrange financing so that the ITGI/Poseidon system could be developed.

This is almost certainly a major misunderstanding of the situation.

What the ratification does is that it clears the way for *any* connection from Turkey to Greece. In the current context this means it clears the way for the onshore section of TurkStream, which is already slated to end at the same Ipsala/Kipoi border crossing from Turkey to Greece as the SGC, to connect within Greece – in or around Kipoi – to the TAP section of the SGC rather than having first to connect within Turkey – in or around Ipsala – to the TANAP section of the SGC. In effect, it enables Gazprom to contemplate having to build only a few kms of connecting pipeline in Greece in order to access TAP.

and Daily Sabah, Turkey, 19 September 2017, *Agreement to bolster gas transfer between Turkey, Greece and Italy*.
<https://www.dailysabah.com/energy/2017/09/19/agreement-to-bolster-gas-transfer-between-turkey-greece-and-italy>

Conclusion

The challenge posed by TurkStream to the prospective expansion of the SGC remains key to any consideration of the medium- or long-term development of the SGC. Prospective Russian input into the SGC, by means of a request to use the expansion capacity of the TAP, can only be denied if the European Union changes its regulations regarding third party access, or some other producer is able to make a better offer for available capacity than that any offer that Gazprom might make.

No matter how much political posturing there might be, it seems unimaginable that the European Commission would abandon its support for open access. This should therefore be ruled out. Unless there is a dramatic upsurge in both European demand for gas and of gas prices – a highly unlikely combination – it seems equally improbable that Gazprom would either be interested in funding the development of expensive new pipelines which would have to operate in accordance with EU regulations or that it would be able to find partners willing to make the necessary investments.

But Gazprom will have gas available for input into an expanded TAP, and therefore as a guide to Gazprom's likely course in this respect one should not look to Dmitri Medvedev's comments concerning 'talks with a number of European countries' but to Alexander Medvedev's tantalising hint that 'maybe' TAP offered a suitable

solution to the conundrum posed by TurkStream's second string.

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Rethinking Energy Policy in Central and Eastern Europe

Eamonn Butler & Wojciech Ostrowski

Abstract

This paper provides an overview of an upcoming book which seeks to do just this by asking the questions, what role does Russia play in the Central and Eastern Europe (CEE) energy sector and how did the Russian-CEE energy relationship develop since the early 1990s? One of the central thesis outlined here argues that in order to fully understand Russian involvement in the regional CEE energy complex, the Russian-CEE energy relationship should be analysed in the context of the political and economic transition that both Russia and the CEE states underwent following 1989. It is asserted that questions on which energy security analysis normally center—such as a country's energy mix, its transport system, and energy vulnerabilities—have to be considered along with questions related to the post-communist transformation, interactions between emerging post-socialist elites in Russia and the CEE region, as well as general governance structures.

Introduction

Central and East European (CEE) energy policy and security debates have in recent years been primarily viewed through a realist lens. This emphasises the geopolitics of energy, with focus placed on security of supply and the vulnerability of the CEE region stemming from its dependency on Russian energy imports (specifically natural gas) and Russia's perceived willingness to use energy as a political tool to advance its foreign policy aims.¹ Such interpretations also extend beyond academic analysis and are often to be found in national policy. A cursory glance at any of the national security strategies from the region highlights how energy has become securitised as a policy matter. This was most clearly seen in the 2007 Polish National Security Strategy, published in the aftermath of the 2006 Russia-Ukraine gas crisis and which noted how, 'The Russian Federation, taking advantage of the rising energy prices, has been attempting intensively to reinforce its position on a superregional level'.² 'The dependence of the Polish economy on supplies of

¹ See for example: Newman, R. (2011). 'Oil, carrots, and sticks: Russia's energy resources as a foreign policy tool', *Journal of Eurasian Studies*, 2(2), pp.134-143. Slobodian, N. (2016). 'Russia, Ukraine and European Energy Security', *New Eastern Europe*, 26 May 2016. Available at: <http://www.neweasterneurope.eu/interviews/2007-russia-ukraine-and-europe-s-energy-security>, accessed 19 August 2017.

² Polish Government (2007). *National Security Strategy of the Republic of Poland*. Warsaw. Page 6.

energy resources – crude oil and natural gas – from one source *is the greatest external threat to our security*' [author's emphasis].³

The legacy of such thinking has continued to inform understanding of and attitudes towards Russia's role within the CEE region's energy landscape. Ongoing political conflict between Russia and Ukraine and the promotion of pipeline projects, such as Nord Stream 2, which reinforce perceptions of continued Russian dominance of the European energy supply market, do little to move the debate away from Russia. While a geopolitically driven analysis is not without merit, an overtly Kremlin-centric analysis may overstate the strength of the leverage that Russia has had over these countries and potentially overlooks other nuances, including the national interests and power politics, at play within the CEE states. Therefore, while we should acknowledge that Russia is and will remain an important actor which cannot be dismissed, we must try to better understand the extent of its role.

This paper provides an overview of an upcoming book⁴ which seeks to do just

³ Ibid. Page 8.

⁴ The co-edited book by Ostrowski, W. and Butler, E. (eds) is entitled *Understanding Energy Security in Central and Eastern Europe: Russia, Transition and National Interest* and will be published by Routledge. It will be available from the spring of 2018. Contributors to the book include: Dimitar Bechev, Eamonn Butler, Giedrius Cesnakas, Terry Cox, Milos Damnjanovic, Roland

this by asking the questions, what role does Russia play in the CEE energy sector and how did the Russian-CEE energy relationship develop since the early 1990s? One of the central thesis in the book and outlined here argues that in order to fully understand Russian involvement in the regional CEE energy complex, the Russian-CEE energy relationship should be analysed in the context of the political and economic transition that both Russia and the CEE states underwent following 1989. It is asserted that questions on which energy security analysis normally center—such as a country’s energy mix, its transport system, and energy vulnerabilities—have to be considered along with questions related to the post-communist transformation, interactions between emerging post-socialist elites in Russia and the CEE region, as well as general governance structures.

Why is this important?

Rebalancing the energy actor debates to include specific reference to the role played by CEE governments and national actors (including national champions) since the collapse of communism offers potential new avenues of enquiry. The contemporary CEE energy landscape has evolved over more than 25 years and cannot be assumed to be simply a Soviet-era legacy quirk, which locked the

countries of the region into a Soviet and later Russian sphere of energy influence, where pipeline infrastructure, and to a lesser degree, nuclear technology, dictated the direction of energy policy.

This is not to say that close political and economic connections between Moscow and the various CEE capitals did not exist. Certainly, for some of the newly independent states of the region, specifically the Baltic States and those Central European states with higher dependence on Russian gas imports, the ties that bound them to Moscow were more than just the physical infrastructure. However, from the beginning of the post-communist era, governments across the region also started to develop their own policy positions and inaugurate moves to shift themselves out of that sphere or at least to distinguish themselves within it. It is important to recognise that these moves were not necessarily due to any inherent fear of Russia and the potential for it to use energy as a political tool, but rather they reflected the broader political and economic sentiment of the time, which saw the CEE countries orientate themselves more towards the liberal market economy structures of western Europe. The ‘return to Europe’ mantra that swept across the region and which underpinned most of the early transition government policies enabling political, economic and social transformation, was an important driving force for change, in the energy sector. It was to Europe that the countries of CEE primarily looked when undertaking this process,

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particularly with regard to liberalisation and privatisation.

The privatisation processes that were established during the transition of the early to mid-1990s helped to set the scene for evolution of the CEE-Russian relationship to the current day. It is important to recognise that the transition did not occur in an institutional vacuum and that the paths followed by countries before the transition started matter a great deal for the final outcome. This point is particularly significant in the case of energy systems and its operations which are based on long-term projects, arrangements and links cannot be easily broken. However, many of the decisions taken at this time, at national level, dictated the extent to which Russia and its own newly established national energy corporations were able to benefit from privatisation processes in CEE. When we look at this in detail what we find is that the capability of Russia to gain traction in the region's energy sector was actually quite limited, and it is only when expressly invited, as in the early stages of the privatisation process in the Baltic States or in the more recent case of Serbia, that it was able to consolidate and strengthen its involvement and influence.

In the book that informs this paper, it is argued that instead of concentrating solely on the Kremlin and the geopolitics of post-Soviet Russia, we should pay much more attention to broader economic drivers. This is reinforced by other examples within the book which emphasises the

political-economy of the privatisation era. This may help to explain why Russian companies—in particular, Lukoil—to a large degree failed to establish themselves in the CEE energy sector. At the same time, Rosneft, the number one Russian oil company, remained more or less absent from the CEE downstream market. For most of the CEE states, privatisation of the energy sector was intended to help establish strong, market orientated economies with efficient and effective national actors and opportunities for domestic and foreign investment via ownership of business and infrastructure commodities. It was believed that the new owners would transform the sector through injecting both operational business knowledge and the necessary financial capital to enable development. There was also clear preference for western rather than Russian foreign investors, in part driven by the attractiveness of western capital and business best practice knowledge. There was also the fact that for some states the sell-off of the energy sector offered quick and easy access to financial capital needed to help pay off Soviet-era debts, including those held by western states. Finally, the preference for western investors was also heavily influenced by the belief that opening up their energy sector, alongside other strategic sectors—such as telecommunications and transport—would benefit the CEE states by reinforcing the 'return to Europe' ideal and that it would represent a first major step for their longer-term European integration.

Russia's greatest success reflects its continued role as an energy supplier, and it is in this context that partnership has often proven most fruitful—despite growing concerns and vocalisations about dependency. It is economic or rather, commercial, rationales that have traditionally dictated the willingness of CEE states to purchase Russian energy. Russia is a very attractive supplier of gas to the CEE region due to the proximity of these markets and the relatively low production and transport costs. Despite everything that has been said regarding diversification of energy supply for the CEE region, the simple reality is that Russian gas is extremely competitive for a number of countries. It is only in the Baltic States—specifically Lithuania and to a lesser degree Latvia—where we see recent geopolitical attitudes towards Russia override longer standing commercial considerations. For most of the other states, specifically those with a higher percentage use of natural gas within their overall energy mix, such as Hungary, commercial benefit and value for money continue to directly inform decisions to buy energy, specifically natural gas, from Russia. This is all the more relevant in light of a wider failure to invest in meaningful, alternative pipeline infrastructure to support new, cost effective supply routes.

When we look in closer detail at the specifics of Russian gas in the CEE region we see that the region has a varied landscape. Overall, gas plays a much smaller role in the CEE regional energy mix than has often been

assumed within general discourse. An examination of the gas market highlights differences in attitude towards Russia, the openness of CEE to engage with Russia and the extent to which Russia has been able to access the sector across the various countries of the region. The book that informs this paper shows how in the case of Romania, political elites, supported by the local population, firmly rejected any involvement of Russian companies in the country's energy sector both prior to and after the collapse of the communist regime. Other CEE countries, began devising projects aimed at diversification from solely purchasing Russian gas, in some cases as early as in the 1990s. The Czech Republic was most successful at adopting this strategy while others followed its footsteps in the 2000s with the help of the European Union.

In the case of Bulgaria, Poland, and more recently, Hungary, the corrupted nature of the transition led to the creation of environment for the involvement of Russian energy actors who in tandem with local political elites established rent-seeking, intermediary companies. The presence of those companies is often viewed as part of the Kremlin's strategy aimed at dominating the CEE energy complex, but there is a lack of evidence to show that this was generally the case.

In the case of the Baltic Republics and Serbia, the Russian energy companies managed to penetrate the energy system to a much greater extent than in other states in the CEE regions, albeit, for very different reasons. The

Baltic Republics due to their historic Soviet ties and relative isolation from the European energy system did not have much choice but to actively engage with Russian companies. Serbia, which until the mid-2000s, followed similar trajectories to Poland or Bulgaria, began collaborating with Russian companies in a more intensive manner only after the Russian state actively supported Serbian efforts aimed at blocking Kosovo's independence.

This suggests that there are 3 main blocs of states in the CEE region reflecting differing attitudes to Russian energy relations and some states have moved fluidly across or between these blocs in recent years. The first bloc is represented by the resisters and includes Romania, the Czech Republic, and more recently the three Baltic states. These countries have actively resisted and opposed where possible Russian influence. The second bloc is represented by what we term the hesitant partners and this includes Poland, Hungary and to a lesser extent Bulgaria. These states recognise the need to work with and partner Russia in terms of energy supply, but are wary of completely opening up access to their energy sector and will actively oppose Russian investment when not deemed to be in their national interest, but will be more willing to explore partnership opportunities. The third bloc is the collaborator and this includes Serbia, but we also find increasing evidence of Hungarian and Bulgarian movement towards this bloc in recent times. The collaborators have essentially opened their energy sector

to Russian influence and complete penetration. The following section outlines three examples, one from each of the blocs to show how the legacies of their communist past and the transition era have informed their attitude towards Russia.

Bloc One: 'The Resistor'

The key to understanding the dynamics governing the Russian-Romanian energy relationship is the legacy of Ceausescu's policies, which aimed at gaining economic and political independence from Moscow during the Communist era. In the post-1991 period the old Communist policy was continued in the actions of Romanian elites who blocked not only Russian but also Western capital from entering the country, including to the energy sector, with the Romanian public largely supportive of the policy. Thus, the state remained a dominant actor in the energy sector, while local elites captured key areas of the sector and engaged in rent-seeking activities. The limited Russian investments that did get through, were not driven by any political agenda, they were rather aimed at making a quick profit, predominantly via asset stripping. There is also no proof that Russian businesses held privileged relations with political parties or decision makers. Ironically, the outcome of this is that the various protectionist measures, which initially shielded the country from Russian penetration, have led to a clash with liberally oriented EU institutions and Romania may yet find itself forced to be more

open to Russian investment and engagement within its energy sector.

Bloc Two: ‘The Hesitant Partner’

In the case of Poland, energy security was never threatened directly by Russia because the state retained primary control over the energy sector and because coal plays a key part in the country’s energy mix, reducing the need for extensive natural gas imports. When we consider domestic politics, including that emanating from the transition era it is possible to shine a spotlight on the corrupted environment of the 1990s and early 2000s, which allowed Polish and Russian political, commercial and private actors to engage in rent seeking activities. The collusion between the two sets of actors had a detrimental effect on the way in which the debate concerning Polish energy security has developed and on the broader political and economic relationship between Russia and Poland. Interestingly, it is possible to see how the division and infighting between the ‘anti-Russian’ post-solidarity camp and the ‘pro-Russian’ post-communist camp, coupled with corruption scandals that brought to the murky dealings between the Russian oil and gas sectors and Polish political actors, have kept generating interest about the country’s energy security and further fueled concerns about Russia’s real intentions. The Ukrainian-Russian ‘gas wars’ in the mid-2000s entrenched a negative view of the Russian oil and gas sectors and gave the energy security debate a truly geopolitical

dimension, which has shifted the country more towards the resistor end of the hesitant partner spectrum. Since the late 2000s the EU, similarly to other countries in the CEE region, has played an important dual role in the Polish-Russian relationship, facilitating reconciliation between two parties, whilst also aiding Polish efforts aimed at diversifying away from Russian oil and gas supplies.

Bloc Three: ‘The Collaborator’

Since the late 2000s, Serbia has increased its energy insecurity by essentially ‘handing over’ its oil and gas sector to Gazprom. This move was due to special political circumstances which were not replicated in other countries. Having said that, until the late 2000s, the story of the Serbian-Russian energy relationship, despite Serbia’s international isolation in the 1990s, was not that different to other countries in the region. The post-communist evolution of the Serbian energy sector was accompanied by the presence of Russian intermediary companies, involved in the sale of natural gas, and an increase in the prevalence of corruption scandals in the energy sector. As with other states in the region, the energy sector also largely remained in the hands of the state. Yet, the relationship between the Serbian and Russian energy relationship moved to a different level after 2007. Moscow’s attempts within the United Nations (UN) and other international organisations to block recognition of Kosovo’s independence changed the political dynamics

between the countries. The provision of this vital support from the Serbian perspective coincided with an intensification of the energy relationship between Russia and Serbia which led to the 2008 deal with Gazprom. As a result of the agreement, the Russian company now controls Serbia's oil and gas extraction, as well its oil refining capacities and much of its oil retail sector. In addition, the Serbian energy sector depends on a single pipeline through which Russian gas is piped. Consequently, towards the end of the 2010s, Serbia which traditionally enjoyed a high degree of energy security—with coal accounting for over half of its energy mix—found itself exposed to pressures from Russia which now possessed very strong leverage. In short, Serbia has trodden a diametrically opposite path from the other countries in the region under discussion here.

Conclusion

This paper, nor the book that it is drawn from, assumes to explain every aspect of CEE energy relations. It does, however, acknowledge that we cannot view the region as a single unit of analysis and that explanations for the CEE countries' diverging approaches to the issue of energy policy and security in relation to Russia have, on the whole, to date, followed a well-established narrative developed by a range of scholars who divide the region into groups of actors representing anti-Russian, pro-Russian and neutral bases. We take the line that these explanations view energy security

predominately through a realist lens with energy used as a geopolitical tool for the Russian state. This means that the economic and political complexities of the individual countries remain largely understudied in wider literature and that without engaging with these issues we cannot possibly come to a fuller understanding of the region's energy security including its relations with Russia and the European Union.

The book's contributors have sought to provide nuanced studies of a range of country cases, three Baltic states (Estonia, Latvia and Lithuania), three central European states (Poland, Hungary and Czech Republic) and three south-east European states (Romania, Bulgaria and Serbia). These studies were tasked with moving beyond a simple realist type of analysis. This proved challenging because realism does have a role to play in understanding the national interest-led choices made by states. However, the book's authors do show, through their analysis of different governance structures within the CEE energy sector, how conducive environments for Russian presence and influence emerged or were resisted. Discussion of the post-communist transition, the emergence of post-socialist elite, politics of private and state-owned energy companies in the CEE states and the move to respond to the liberalisation agenda of the EU was scrutinised. This provides a better understanding of the dynamics governing approaches to energy security and policy in the CEE region.

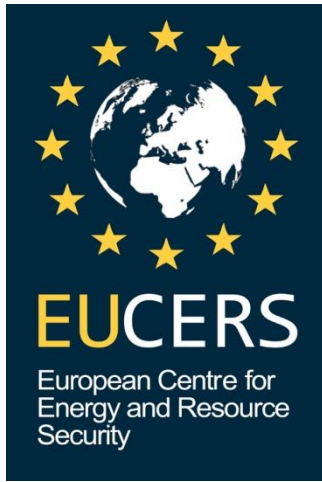
It also allows us to open discussion on new emerging areas of interest. For example, not all future engagement on the energy front will be with Russia. Increasingly, Brussels is holding the CEE states accountable for failing to implement EU law appropriately. This potentially will bring Brussels and CEE states into possible conflict, albeit not the same type of conflict often assumed to exist with Moscow. As EU member states, the CEE countries are able to inform EU energy policy, but if common policy is to work effectively then all participants need to follow the rules. If these do not benefit the national interest of the CEE state, then we can expect attempts to push the acceptable boundaries of non-compliance. Only by fully accepting that CEE states have agency and that their decisions will be grounded in not only current affairs but often past affairs will we be able to navigate and understand the politics underpinning Central and Eastern European energy policy and approaches to security.

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