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# Ensuring Energy Security in Europe: The EU between a Market-based and a Geopolitical Approach

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# **Ensuring Energy Security in Europe: The EU between a Market-based and a Geopolitical Approach**

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## Abstract

The question of energy security of the European Union (EU) has come high on the European political agenda since the mid-2000s as developments in the international energy sector have increasingly been perceived as a threat by the EU institutions and by the Member State governments. The externalisation of the EU's internal energy market has in that context been presented as a means to ensure energy security. This approach, which can be called 'post-modern' with reference to Robert Cooper's division of the world into different 'ages',<sup>1</sup> however, shows insufficiencies in terms of energy security as a number of EU energy partners belonging to the 'modern' world do not accept to play the same rules. This consequently poses the questions of the relevance of the market-based approach and of the need for alternative solutions. This paper therefore argues that the market-based approach, based on the liberalisation of the European energy market, needs to be complemented by a geopolitical approach to ensure the security of the EU's energy supplies. Such a geopolitical approach, however, still faces important challenges.

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<sup>1</sup> Robert Cooper, *The Breaking of Nations*, London, Atlantic Books, 2003.

## Introduction

European energy policy, although it has been at the core of European integration with the 1951 Treaty of Paris creating the European Coal and Steel Community (which expired in 2002) and the 1957 Rome Treaty establishing Euratom, has not yet become a truly integrated policy. In the 1980s, energy policy started to be addressed from a liberalisation perspective in pursuit of the European Commission's will to complete the European internal market. Since then, internal energy market liberalisation has continuously been presented by EU officials as the main tool to address European energy security concerns, including the security of supply.

The gas crises between Russia and Ukraine in 2006 and 2009 taught the EU that the traditional economic approach had reached its limits and that new policies in the energy sector were urgently needed. This challenge has been acknowledged at the EU level, as demonstrated by the 2006 Green Paper of the Commission, which recognises the importance of "speaking with the same voice"<sup>2</sup> at the international level. Three years later, the security of energy supply was introduced in the EU treaty following the Lisbon revision, thus giving a legal basis for future developments in this policy field.<sup>3</sup>

The current situation of Europe's energy security can be interpreted through Robert Cooper's framework of different 'ages' in the international system.<sup>4</sup> He claims that Europe, a 'post-modern' political entity which has internally abandoned the 'traditional' methods of international relations based on the Westphalian system between nations, faces a profound difficulty when it has to deal with international partners from the 'modern' world. In order to solve this difficulty, he calls for the development of a double-standard approach. On the one hand, the EU should, with partners accepting the 'post-modern' rules, use tools such as a transparent regulatory framework and open multilateralism. On the other hand, the EU should be able to resort to classical power-based instruments such as pressure, threat and sanctions to effectively defend its interests when engaging with 'modern' partners. Against this background, this paper tries to answer the following questions: First, to what extent does the liberalisation of the EU's internal energy market contribute to

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<sup>2</sup> European Commission, "A European Strategy for Sustainable, Competitive and Secure Energy", *Green Paper*, European Commission, COM(2006) 105 final, Brussels, 8.3.2006, p. 14.

<sup>3</sup> Art. 194.1(b) TFEU

<sup>4</sup> Cooper, *op.cit.*

Europe's energy security? Second, what other policy options besides the market-based approach does the EU have to secure its energy supplies?

This analysis has to be seen against the background of the recent changes in the structure of international energy markets. Up to now, three periods in the energy producer-consumer relationship can roughly be distinguished.<sup>5</sup> The first period which started with the first oil discoveries in the late 19<sup>th</sup> century was characterised by the domination of (notably Western) international oil companies over energy resources and lasted approximately until the 1970s. The second period embodied a greater control of energy-producing countries over their resources, as reflected by the creation of OPEC in 1960 and the oil embargo in 1973. The third, still on-going phase started with the dissolution of the Soviet Union, the spread of liberal values such as democracy and market economy and the empowerment of liberal international institutions. The liberalisation of the energy sector, particularly in the EU, entails that energy has increasingly become subject to the logic of free markets. These last years, however, producing countries have increasingly resorted to political consideration in the management of energy.

The paper is structured in six parts. First, the place of Europe in the international energy system is presented. Second, the paper analyses the complex notion of energy security. The third part applies the concepts of modernity and post-modernity to the energy sector. The fourth and fifth parts analyse the EU's market liberalisation paradigm and its relevance as a tool for the EU's external security of supply policy. Finally, the sixth part presents the challenges of a reinvigorated EU energy policy in the face of changing energy markets.

### **Europe in the international energy system**

Energy is of utmost importance as most modern activity relies on it. An important challenge in that respect is the possible depletion of natural resources. Indeed, future scenarios by the International Energy Agency predict that the global demand for primary energy sources will increase by 36% between 2008 and 2035 "with fossil fuels accounting for over one-half of the increase in total primary energy demand".<sup>6</sup>

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<sup>5</sup> Kirsten Westphal, "Energy Policy between Multilateral Governance and Geopolitics: Whither Europe?", *Internationale Politik und Gesellschaft*, no. 4, 2006, p. 47.

<sup>6</sup> International Energy Agency, *World Energy Outlook 2010*, Paris, OECD/IEA, 2010, Executive Summary, pp. 46-47.

In the EU alone, gas demand is set to increase by 24% between 2005 and 2025.<sup>7</sup> This can partly be explained by international policy commitments to reduce CO<sub>2</sub> emissions, given the favourable attributes of natural gas in relation to environmental concerns, but also by its practical ability to substitute for other fuels in the generation of electricity power.<sup>8</sup> Moreover, the accident at the Fukushima nuclear power plant caused by the earthquake and the tsunami in 2011 is likely to contribute to an increased demand for gas in the EU as sceptics of nuclear energy will push for a switch to gas-powered plants.<sup>9</sup> However, even though there will be a tendency to switch to other energy sources in all sectors for environmental and economic reasons, oil will remain the dominant fossil fuel in the world primary energy mix until 2035.<sup>10</sup>

Europe's need of oil is mainly driven by the transport sector where hardly any substitution is possible. In 2009, Europe's own oil production (mainly in Norway and the United Kingdom) covers about 14% of its consumption; the rest is imported from Russia (around one third), Saudi Arabia (9%), Libya (8%) and Iran (5%).<sup>11</sup> However, dependency rates vary in terms of both source and level among EU Member States. For instance, Slovakia, Poland, Hungary, and Lithuania are almost entirely depended on Russian imports.<sup>12</sup>

Concerning natural gas, the EU's security challenges are different as the gas market presents specific features. Gas is mainly transported through fixed pipelines, which creates direct, long-term interdependence between the producer and the buyer. Consequently, there is no global gas market but rather regional markets, even though the development of liquefied natural gas (LNG) may change the situation in the future.<sup>13</sup> The EU's indigenous gas production peaked in 1996 and started to decline, whereas its consumption grew and still continues to increase.<sup>14</sup> The two main EU gas providers are Russia and Algeria, but potential substantial supplies from Africa,

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<sup>7</sup> Arianna Checchi, Arno Behrens and Christian Egenhofer, "Long-Term Energy Security Risks for Europe: A Sector-Specific Approach", *CEPS Working Document*, no. 309, Brussels, 2009, p. 14.

<sup>8</sup> International Energy Agency, *op.cit.*, p. 50.

<sup>9</sup> "Turkey caught between Nabucco and South Stream", *EurActiv*, 2011.

<sup>10</sup> International Energy Agency, *World Energy Outlook 2010 Factsheet, What does the global energy outlook to 2035 look like?*, Paris, OECD/IEA, 2010, p. 1.

<sup>11</sup> Checchi, Behrens and Egenhofer, *op.cit.*, p. 7.

<sup>12</sup> *Ibid.*

<sup>13</sup> Checchi, Behrens and Egenhofer, *op.cit.*, p. 14.

<sup>14</sup> *Ibid.*, p. 15.

the Middle East, or the Caspian region, imported either as LNG (Nigeria, Middle East) or by pipeline, are seen as important diversification options.

The two tables below illustrate the uneven distribution of fossil resources worldwide. The figures underline Europe's worrying situation as they display an important gap between Europe's oil and gas production and consumption.

Table 1: World oil reserves, production and consumption (2008)

World share (%)	USA	EU	Japan	China	Russia	Middle East	Sum
Oil reserves	2.4	0.5	0	1.2	6.3	59.9	70.3
Oil production	7.8	2.7	0	4.8	12.4	31.9	59.6
Oil consumption	20.9	22.3	6.4	11.4	3.2	3.9	68.1

Source: Gunnar Fernann, "Introduction: Dynamic Frontiers of Energy Security", in Gunnar Fernann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 20.

Table 2: World gas reserves, production and consumption (2008)

World share (%)	USA	EU	Japan	China	Russia	Iran	Qatar	Sum
Gas reserves	3.6	1.6	0	1.3	23.4	16.	13.8	59.7
Gas production	19.3	6.2	0	2.5	19.6	3.8	2.5	53.9
Gas consumption	22	16.2	3.1	2.8	13.9	3.9	0.7	62.6

Source: *Ibid.*, p. 21.

The basic principles of an operational definition of energy security are the "stable, uninterrupted supplies at affordable prices".<sup>15</sup> However, drawing on the institutional literature on energy security,<sup>16</sup> different aspects can be put forward: the need to ensure required investments, the reliability of exporters, or risks linked to transit countries and technical facilities, which can lead to short-term disruptions. This latter element is probably the most referred to when speaking about energy security in Europe after the 2006 and 2009 gas transit crises between Russia and Ukraine which had dramatic consequences on certain EU Member States. Interestingly, the energy

<sup>15</sup> Oystein Noreng, "Energy Security for Europe: A choice of Suppliers and Partners", in Gunnar Fernann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 221.

<sup>16</sup> See for instance Thomas Legge and Christian Egenhofer, "Security of Energy Supply: A Question for Policy or the Markets?", *Report of a CEPS Working Party*, Centre for European Policy Studies, Brussels, 2001, p. 4.



market itself, which is presented as a solution to energy security concerns, can also be part of the risk if its structure turns out to be unfavourable to consumer countries.

## **Energy security: a complex and multifaceted issue**

Energy security is a quite complex notion. Contrary to most of the other traded goods, it entails in itself a strategic dimension. Energy security can be tackled from two main perspectives: geopolitics and economics.

### *The strategic dimension of energy security*

Energy is a strategic issue for two main reasons. On the one hand, energy can be considered as strategic because it is at the core of the way of living of modern societies and has played a crucial role in their evolution. On the other hand, energy also becomes a security issue because it is undergoing a process of 'securitisation'.

The strategic dimension of energy seems to have become obvious when trends towards an increasing consumption of fossil fuels and thus a dependence on these energy sources started to be perceived as a challenge by the West.<sup>17</sup> The 1973 oil crisis and the subsequent OPEC oil embargo put the economic models of several Western countries at risk and triggered strategic reflexions around energy supplies. Energy plays indeed a fundamental role for the smooth functioning of all economies but even more in the developed ones. Modern states rely on energy "to implement key political goals related to the economy at large",<sup>18</sup> which are directly or indirectly linked to almost every aspect of social life. To put it simply, modern life understood in broad economic, political and social terms would be impossible without a considerable amount of energy, particularly from fossil fuels.

Given its central role in the economy, energy is closely linked to economic growth. It has been calculated, for instance, that for one percentage point of economic growth, primary energy<sup>19</sup> consumption increases by 0.5 point.<sup>20</sup> Considering the fact that development is based on economic growth, it is not surprising that energy has come to the forefront of political issues. Therefore, energy can be defined as a

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<sup>17</sup> Gunnar Fermann, "Introduction: Dynamic Frontiers of Energy Security", in Gunnar Fermann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 11.

<sup>18</sup> *Ibid.*

<sup>19</sup> Primary energy is defined as energy "embodied in natural resources prior to undergoing any human-made conversions or transformations". See "Primary Energy", *The Encyclopedia of Earth*, 2007.

<sup>20</sup> Liubou Yavid-Reviron, *Les relations énergétiques entre l'Union européenne et la Russie : Dépendance ou Interdépendance?*, Paris, L'Harmattan, 2008, p. 13.

strategic resource, matching the relevant definition of “resources without which it is almost impossible to conceive socio-economic development within a particular historic era”.<sup>21</sup>

Another way to analyse energy as a strategic resource relates to the theoretical proposals of ‘securitisation’ developed by the so-called Copenhagen School: “Securitization is defined as a specific way of staging the issue on the political arena.”<sup>22</sup> Such a ‘speech act’, whereby declarations and comments on energy security create a political reality and are followed by concrete political decisions, is aimed at getting a specific political issue accepted as a security problem for society and at collecting sufficient support for this definition in order to allow defensive security moves.<sup>23</sup> For example, at least since 1974 and Nixon’s state of the Union address, US Presidents, including Barack Obama, have repeatedly presented US dependency on external oil imports as a major threat to US national security.<sup>24</sup>

In the EU framework, a similar move towards securitisation of energy issues can be observed. As early as 1974, the Commission formulated the notion of ‘energy security’.<sup>25</sup> The main threat identified was that “external actors don’t play the same game as the EU”.<sup>26</sup> The European Parliament too adopted a securitised tone in the energy debate in the 1970s. In the Council, however, the issue was only seriously addressed in 2005 during the European Council meeting at Hampton Court where Member States agreed to tackle important issues related to the internal energy market.<sup>27</sup> Even though the three institutions have pushed in the same directions, they have done so and continue to do so with different arguments. In particular, they have not singled out the same ‘referent objects’, defined in securitisation theory as the elements “that are seen to be existentially threatened and that have a

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<sup>21</sup> Silviu Negut, M.C. Neacsu and L. B. Vlad, “The Geopolitics of Strategic Energy Resources”, *Strategic Impact*, no. 1, 2007, p. 18, cited in Fermann, *op.cit.*, p. 11.

<sup>22</sup> Jakub M. Godzimirski, “Energy Security and the Politics of Identity”, in Fermann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 176.

<sup>23</sup> *Ibid.*

<sup>24</sup> “An Energy-Independent future”, *The Daily Show with Jon Stewart*, Comedy Partners, June 28, 2000.

<sup>25</sup> Michal Natorki and Anna Herranz Surralsés, “Securitizing Moves to Nowhere? The Framing of the European Union’s Energy Policy”, *Journal of Contemporary European Research*, vol. 4, no. 2, 2008, p. 75.

<sup>26</sup> *Ibid.*

<sup>27</sup> Coby van der Linde, “External Energy Policy: Old Fears and New Dilemmas in a Larger Union”, in André Sapir (ed.), *Fragmented Power: Europe and the Global Economy*, 2007, p. 273.

legitimate claim to survival".<sup>28</sup> The Commission's analysis focused on competitiveness and the European integration process itself.<sup>29</sup> The European Parliament mainly focussed on the social dimension of energy policy,<sup>30</sup> whereas the Member States in the Council concentrated on the linkage between "states' energy interdependence and their autonomy in vital economic and political matters".<sup>31</sup>

### *Energy security and geopolitics*

Two main characteristics give fossil fuels a geopolitical dimension. They are highly concentrated in a few regions in the world and they are non-renewable. 80% of the world's oil is located in nine countries representing only 5% of the world's population, whereas 80% of the world's gas resources are found in 13 countries.<sup>32</sup> The Middle East alone possesses 62% of oil and 45% of proven gas reserves.<sup>33</sup>

This situation has geopolitical implications from several perspectives. First, most of the fossil fuels are located in politically unstable regions. For instance, among the seven countries once designated by the EU as sponsoring international terrorism or being 'rogue states', five are energy producers,<sup>34</sup> three are major oil producers (Libya, Iran, and Iraq) and two possess together around 20% of the world's proven oil reserves (Iran and Iraq).<sup>35</sup> Second, problems with access to resources may stem from internal political developments in producing states. Venezuela, a member of OPEC and a major oil producer, has engaged in a nationalisation move after the re-election of Hugo Chavez in 2006, which threatened its supplies to international markets. Russia, which holds around 6% of the world's oil and 23% of the world's gas reserves,<sup>36</sup> has since the election of Vladimir Putin as President in 2000 demonstrated "a growing ability and willingness to use energy as a political tool in order to pursue its political and geopolitical goals [...and] strengthen its international position".<sup>37</sup> This appears to be part of worldwide trends towards a re-nationalisation and politicisation of energy.

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<sup>28</sup> Barry Buzan, Ole Waever and Jaap de Wilde, *Security, A New Framework for Analysis*, London, Lynne Rienner, 1998, p. 36.

<sup>29</sup> Natorski and Surralsés, *op.cit.*, p. 76.

<sup>30</sup> *Ibid.*, p. 78.

<sup>31</sup> *Ibid.*, p. 81.

<sup>32</sup> Benjamin L. Sovacool, "Introduction", in Benjamin L. Sovacool (ed.), *The Routledge Handbook of Energy Security*, New York, Routledge, 2011, p. 21.

<sup>33</sup> Frank Umbach, "Global Energy Security and the Implications for the EU", *Energy Policy*, no. 38, 2010, p. 1233.

<sup>34</sup> Libya, Iran, Iraq, Syria, and Sudan.

<sup>35</sup> Umbach, *op.cit.*

<sup>36</sup> Fermann, *op.cit.*, pp. 20-21.

<sup>37</sup> Godzimirski, *op.cit.*, p. 181.

Whereas in the 1960s the 'Seven Sisters'<sup>38</sup> controlled over 85% of the world's oil and gas reserves, the trend has reversed, and today the 'new Seven Sisters',<sup>39</sup> the main national oil companies hold the majority of the resources.<sup>40</sup> In this context, concerns stem from the fact that an increasing number of energy companies controlled by governments tends to overlook the basic logic of market forces in favour of wider political and ideological ambitions.<sup>41</sup> At the same time, the reluctance of some energy-producing countries' governments to accept foreign direct investments may further complicate the task of securing energy supplies for energy-importing countries.<sup>42</sup>

The geopolitical framework of energy security based on the above-mentioned elements can adequately be analysed through the 'Regions and Empire' scenario developed by Aad Correljé and Coby van der Linde.<sup>43</sup> The scenario foresees the future of energy security issues through a "division of the world into countries and regions, on the basis of ideology, religion and political arguments".<sup>44</sup> The main underpinnings of this vision are the absence of effective international markets combined with highly integrated energy companies operating on a national basis. Foreign policy developments also tend to give credit to such a scenario. The division of the UN Security Council over the war in Iraq in 2003 is a telling example of different states or groups of states having diverging interests in a conflict in which energy considerations were never absent.

### *Energy security and economics*

Energy security analysed from an economic perspective puts the emphasis on the fact that energy is a traded commodity on markets.<sup>45</sup> Besides the challenge of physical availability, the main issue then relates to the level and stability of energy prices. Some authors prefer to avoid the term of 'policy' when speaking about security of energy supplies as it has become a shared responsibility between govern-

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<sup>38</sup> The traditional private energy companies: Exxon-Mobil, Chevron, BP, Royal Dutch Shell, ConocoPhillips and Total (only six after mergers and acquisitions).

<sup>39</sup> Aramco (Saudi Arabia), Gazprom (Russia), CNPC (China), NIOC (Iran), PDVSA (Venezuela), Petrobras (Brazil), and Petronas (Malaysia).

<sup>40</sup> Umbach, *op.cit.*, p. 1232.

<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> Aad Correljé and Coby van der Linde, "Energy supply security and geopolitics: A European Perspective", *Energy Policy*, vol. 34, no. 5, 2006, p. 535.

<sup>44</sup> *Ibid.*, p. 536.

<sup>45</sup> Sovacool, *op.cit.*, pp. 6-7.

ments, firms and customers.<sup>46</sup> From that perspective, the primary responsibility to ensure that all economic actors have access to energy at stable and affordable prices rests in the first place on economic operators.

Such developments are intrinsically linked to the promotion of liberalisation in the energy sector. The belief that free and transparent markets can best guarantee an optimal allocation of energy resources has guided the progressive liberalisation of energy markets worldwide. From that perspective, “free markets are the customers’ first line of defence”,<sup>47</sup> as they are the best means to ensure stability of prices. For instance, well-functioning energy markets should allow the required investments in producing countries in order to secure future oil and gas production and deliveries.

The economic approach to energy security and the subsequent liberalisation paradigm can be usefully depicted by the alternative ‘Markets and Liberalisation’ scenario proposed by Correljé and van der Linde.<sup>48</sup> This storyline assumes that energy flows are regulated by the markets which are themselves framed by international institutions.<sup>49</sup> This vision corresponds quite precisely to the EU’s market-based approach. However, it must be kept in mind that ‘perfect’ liberalisation of energy markets in an economic sense cannot be achieved due to the particularities of fossil energy sources.<sup>50</sup> Particularly on the gas market, prices may not convey the correct signals to govern change in production patterns as the resource is non-renewable. Besides, gas markets are characterised by long time lags between investments and production; gas will have to originate from increasingly remote regions which are either immature (not yet ready to be commercially exploited) or/and poorly integrated into the markets due to political constraints.

### **Modernity and post-modernity: what is at stake in the field of energy security?**

Robert Cooper proposes a division of the world into three categories: the pre-modern, the modern, and the post-modern world.<sup>51</sup> As the question of Europe’s energy security chiefly concerns the modern and the post-modern world, the pre-modern world will be set aside.

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<sup>46</sup> Legge and Egenhofer, *op.cit.*, p. 3.

<sup>47</sup> Pierre Noël, “Time to Challenge the Myths of Energy Security”, *Financial Times*, 2008.

<sup>48</sup> Correljé and van der Linde, *op.cit.*, p. 535.

<sup>49</sup> *Ibid.*

<sup>50</sup> Ole Gunnar Austvik, “EU Natural Gas Market Liberalization and Long-term Security-of-Supply and Demand”, in Gunnar Fermann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 94.

<sup>51</sup> Cooper, *op.cit.*

According to Cooper, the modern world is characterised by the centrality of force and the readiness of nation states to use it in order to defend their interests.<sup>52</sup> Consequently, peace is achieved through a subtle balance of power whose stability is guaranteed by one or several hegemonic powers (if they agree). Another important feature of the modern world is that it entails a clear-cut division between states' domestic and foreign affairs. External interference in domestic affairs in any form is considered prohibited and the best security guarantee remains force.

However, the international system has evolved and since the Second World War a new model of managing international relations has emerged, which Cooper calls 'post-modernity'.<sup>53</sup> One of the best examples that illustrates the features of post-modernity is the Treaty of Rome in 1957 which created the European Communities. The Treaty created a new legal framework in which Member States voluntarily shared sovereignty in an increasing number of fields. Thus, the main characteristic of post-modernity is the commitment of states to engage in a process that blurs the dividing line between domestic affairs and foreign policy.

In the energy sector, such a division between modern and post-modern international actors can be identified, particularly in the interdependent relationship between the EU and Russia. Understanding the modern specificities of Russia's energy policy requires looking at the broader policy developments since the election of Vladimir Putin as president. As amply documented, the Russian government has made a strategic use of national resources in order to restore the country's stature as a world power and also to erase the humiliating image left by the Yeltsin era of Russia as a country not far from delinquency.<sup>54</sup> The state authority has been restored in the name of national interests and the renationalisation of the Russian elites "took the form of de facto nationalisation of the energy sector".<sup>55</sup> Such a movement is visible with the 2006 law establishing a legal monopoly on gas exports for Gazprom.<sup>56</sup> Moreover, the Russian monopoly has developed a tendency to manage energy relations on a strict bilateral basis with Central Asian countries as well as with European companies, following a clear modern logic of agreements respecting the full sovereignty of the parties. Russia's reluctance to develop a framework based on reciprocity for energy investments fits in the same logic.

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<sup>52</sup> *Ibid.*, pp. 21-26.

<sup>53</sup> *Ibid.*, pp. 26-37.

<sup>54</sup> Ivan Krastev, "Russia and the 'Other Europe'", *Russia in Global Affairs*, 17 November 2007.

<sup>55</sup> *Ibid.*

<sup>56</sup> Belyi, *op.cit.*, p. 127.

By contrast, the EU's willingness to develop an open and multilateral framework based on cooperative reciprocity clearly relates to a post-modern logic as the internal market precisely deconstructs the modern logic of sovereignty. In an internal market, the separation between internal and external economic affairs is void as the same rules apply for all economic actors under the same jurisdiction. From this perspective, post-modernity relates to the *supranational* aspects of the EU's internal energy market, such as the integration of Norway in the European Economic Area through its EFTA membership, whereas modernity describes the field in which traditional *international* relations apply as in the case of Russia.<sup>57</sup>

The contrast between a modern Russia and a post-modern Europe is, however, not completely clear-cut. On the one side, Russia joined the WTO with European support. On the other side, it is clear that the EU's external policies are not neutral in terms of self-interests. Furthermore, the fact that energy has not yet become a complete EU competence shows that Member States want to retain some sovereignty in a sector considered strategic and that EU integration is still marked by islets of modernity. Nevertheless, it is possible to argue that what fundamentally matters here is not modern and post-modern differences regarding "what actually is, [but rather] what should be".<sup>58</sup> The EU's choice of policy tools must be adapted to the reality of international energy relations in order to bring about substantial policy outcomes. As Cooper puts it:

For the post-modern state there is [...] a difficulty. It needs to get used to the idea of double standards. Among themselves, the post-modern states operate on the basis of laws and cooperative security. But when dealing with more old-fashion kind of states outside the postmodern limits, Europeans need to revert to the rougher methods of an earlier age – force, pre-emptive attack, deception, whatever is necessary for those who still live in the nineteenth-century world of every state for itself.<sup>59</sup>

Following this recommendation, Europe should not seek to deal with energy producing countries such as Russia or the Middle East – so long as they fail to engage in post-modern practices – in the same way as it deals with Norway, which belongs to the post-modern world.

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<sup>57</sup> Dag Harald Claes, "EU Energy Security Between Internal Market and Foreign Policy", in Fernann (ed.), *Political Economy of Energy in Europe*, Berliner Wissenschafts-Verlag, Berlin, 2009, p. 52.

<sup>58</sup> Mezhuev, *op.cit.*

<sup>59</sup> Cooper, *op.cit.*, pp. 61-62.

## The EU's energy market liberalisation paradigm

The energy market liberalisation has been adopted as a method to regulate the EU internal market internally but also to serve as a tool for external energy policy.

Richard Youngs underlines that within European circles it is traditionally assumed that the internal energy market is the basis for developing an effective external energy policy.<sup>60</sup> European commitments as well as official documents<sup>61</sup> and discourses tend to give credit to the 'market and institutions' rationale, which is based on the assumption of an increasing globalisation of the markets.<sup>62</sup> Therefore, the EU's market-based philosophy should spread towards the EU's energy partners in order to create a common regulatory space in which EU interests are best preserved. An open, norm-based approach building on a liberalised internal energy market is thus seen as the bedrock for a successful EU external energy security policy.

With regard to external security of supply, one main argument for the internal energy market liberalisation relates to the way it would end the division of the European market into national segments. A fully integrated market would be a strong guarantee for the external security of supply, as it would prevent foreign suppliers such as Gazprom from dividing Member States and establishing energy contracts on a bilateral basis with national companies.

The scope for political interference undermining Europe's energy security as a result of the imperfect market liberalisation can be exemplified by the Nord Stream gas pipeline project.<sup>63</sup> The project, depicted by former Polish Minister for Foreign Affairs Sikorski as a new "Molotov-Ribbentrop Pact",<sup>64</sup> is intended to further supply Germany with Russian gas directly by the construction of an undersea pipeline in the Baltic Sea. However, given the extremely high costs of the undersea project compared with a land pipeline, it is possible to argue that it is because of the imperfectly liberalised energy environment that the Russian government is able to sideline historically unfriendly EU Member States such as the Baltic States and Poland. In a fully liberalised environment, the project would be unlikely as it would be very difficult

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<sup>60</sup> Richard Youngs, *Energy Security, Europe's New Foreign Policy Challenge*, London, Routledge, 2009, p. 30.

<sup>61</sup> Such as the 2006 Commission Green Paper: European Commission, *A European Strategy for Sustainable, Competitive and Secure Energy*, *op.cit.*

<sup>62</sup> Correljé and van der Linde, *op.cit.*, p. 535.

<sup>63</sup> Alan Riley, "Nordstream: An Economic and Market Analysis Perspective of the North European Pipeline Project", 2008.

<sup>64</sup> Dicle Korkmaz, "Internal and External Dynamics of European Energy Security", Paper presented at the 5<sup>th</sup> Pan-European Conference on EU Politics, ECPR, 23-26 June 2010, p. 15.



for Nordstream-sourced imported gas to compete with gas transported by land-based pipelines or LNG.

Another argument for the liberalisation paradigm lies in the fact that a liberalised energy environment prevents companies such as Gazprom from having an overwhelming weight in downstream gas activities. Economic changes at the beginning of the 2000s, notably the increase of gas prices, have given Gazprom the necessary resources to develop an internationalisation strategy and conclude merger deals with European companies in Italy, the UK, Denmark, Germany, Austria, Spain, Bulgaria, Hungary and France.<sup>65</sup> These moves are not a threat as such. However, given that Russian political developments tend to make Gazprom more than a commercial player, liberalisation principles such as third party access<sup>66</sup> have also a direct external dimension to the extent that they limit the downstream market power of the foreign supplier and thus strengthen security of supply. It is therefore argued that the liberalisation of the energy market is aimed at securing energy supplies by re-framing the relationship between external energy suppliers such as Gazprom and European monopolies, which needs to be broken up in order to avoid important bilateral deals and dominant positions.<sup>67</sup>

On the other side of the energy supplier-consumer relationship, market liberalisation is also aimed at allowing external suppliers to enter the downstream liberalised market in the form of spot contracts. The entrance of energy supply companies in the downstream market, where activities are generally more profitable than in the upstream market in a liberalised environment,<sup>68</sup> is thus a guarantee that energy will flow to European consumers. In that sense, a liberalised energy market gets through the reconciliation of the imperative of security of energy supply with the commercial interest of foreign energy suppliers.

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<sup>65</sup> Svein Andersen and Nick Sitter, "The European Union Gas Market: Differentiated Integration and Fuzzy Liberalization", in Gunnar Fermand (ed.), *Political Economy of Energy in Europe*, Berlin, Berliner Wissenschafts-Verlag, 2009, p. 79.

<sup>66</sup> This mechanism allows third companies to use the infrastructures of the incumbent monopoly service provider and therefore fosters competition at the gas retail level.

<sup>67</sup> Youngs, *op.cit.*, p. 31.

<sup>68</sup> Catherine Locatelli, "EU Gas Liberalization as a Driver of Gazprom's Strategies?", *Russie.Nei.Vision*, no. 26, Institut Français des Relations Internationales, Paris, 2008, p. 11.

## Market liberalisation and security of supply: a contraction in terms?

Market liberalisation as a means to ensure energy security encounters two types of difficulties. The first kind are of a political nature, whereas the second kind, more intrinsic to the liberalisation phenomena, are of an economic nature.

### *Political limits to liberalisation*

The pan-European energy market that the EU is promoting offers a good example of the political limits. The need for a wide energy market based on European norms and rules has been repeatedly mentioned in Commission documents. The 2010 Communication, for instance, underlines the importance of “strengthening the external dimension of the EU energy market”<sup>69</sup> through the implementation and the extension of the Energy Treaty Community,<sup>70</sup> whereas the 2006 Green Paper emphasises the need to “secure a rapid ratification by Russia of the Energy Charter Treaty [ECT] and [to conclude] the negotiations on the Transit Protocol”.<sup>71</sup>

The ECT was signed in 1994 as the product of negotiations for a European Energy Charter, a non-binding political commitment aimed at East-West energy cooperation after the collapse of the Soviet Union. Replacing 1275 diverse bilateral agreements,<sup>72</sup> it entered into force in 1998 and brought together former Soviet Union republics, Central and Eastern European countries (non-EU members at that time), the EU, Japan, Australia, Norway, and Turkey.<sup>73</sup> Its primary aim is to extend a GATT/WTO-inspired regulatory framework in the energy sector with a major emphasis on transit rules for energy networks.

The main problem faced by the ECT is its non-ratification by Russia, which is particularly concerned with the ECT’s transit regime: signatories are obliged to facilitate the gas transit on a non-discriminatory basis, which would reduce Russia’s ability to resort to political considerations while selling gas. By refusing to be bound by the ECT provisions, Russia retains the power to conclude a network of bilateral transit arrangements, providing it with a *de facto* quasi-monopoly of energy supply for EU

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<sup>69</sup> European Commission, *Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*, European Commission, COM(2010) 639 final, Brussels, 10.11.2010, p. 18.

<sup>70</sup> The Energy Treaty Community will not be addressed here, as it focuses on a specific category of neighbouring states: the accession and pre-accession countries.

<sup>71</sup> European Commission, *A European Strategy for Sustainable, Competitive and Secure Energy*, *op.cit.*, p. 15.

<sup>72</sup> Youngs, *op.cit.*, p. 31.

<sup>73</sup> Westphal, “Energy Policy between Multilateral Governance and Geopolitics”, *op.cit.*, p. 53.

gas imports.<sup>74</sup> It must be mentioned, however, that Russia provisionally applies the ECT rules as long as the provisions do not contradict its own constitution or internal legislation.<sup>75</sup>

#### *Economic limits to liberalisation*

The first difficulty relates to long-term gas contracts. These energy contracts between foreign producing companies and European retailers or distributors have a negative effect from a competition point of view, as they prevent any third company from entering the gas market. Concluded for 20 to 30 years, the European Commission considers them to be an obstacle to a competitive and efficient gas market as they represent vertical foreclosure (anti-competitive behaviour that appears when a company controls the supply and the retail of raw materials).<sup>76</sup> These contracts are, however, necessary for a long-term security of gas supply. They allow for the required upstream investments in the producing country as well as stable prices for consumers. The main feature of these contracts is the take-or-pay clause, which links the producer and the buyer through a mutual guarantee. Under such clauses, the producer is committed to deliver an agreed amount of gas over a certain period of time, whereas the retailer is bound to pay for the agreed quantity. This way, the producer can engage the exploitation investments, as he knows they will be covered by the gas purchaser. On the other side, the buyer can count on access to supplies over a long period of time at a stable price. Therefore, without long-term contracts, the EU's gas supply security could be put at risk as new infrastructures in producing countries would not be financed and the expected demand growth could not be met.<sup>77</sup>

It must be underlined, however, that the academic community is divided on this question. Whereas some scholars argue, in line with the Commission, that liberalisation and the suppression of long-term contracts would not undermine energy security, some defend the idea that liberalisation puts energy security at risk by prohibiting long-term contracts.<sup>78</sup>

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<sup>74</sup> *Ibid.*, p. 55.

<sup>75</sup> Andrei V. Belyi, "Reciprocity as a Factor of the Energy Investment Regimes in the EU–Russia Energy Relations", *Journal of World Energy Law and Business*, vol. 2, no. 2, 2009, p. 126.

<sup>76</sup> Milena Yakimova, *Introducing Competition to the European Electricity and Gas Markets: Between Ambitions and Constraints*, Master's thesis, Bruges, College of Europe, 2007, p. 24.

<sup>77</sup> *Ibid.*, p. 32.

<sup>78</sup> Karsten Neuhof and Christian von Hirschhausen, *Long-term vs. Short-term Contracts: A European Perspective on Natural Gas*, 2005, pp. 4-5.

A second contentious point regarding the compatibility of energy market liberalisation with the security of supply relates to the question of asymmetrical access to energy markets and the principle of reciprocity. The EU has tried to expand its structural reforms of the energy market based on the principle of openness in the form of the ECT, which represents “the most inclusive international legal regime for the investment in the energy sector by creating protection mechanisms for energy investments”.<sup>79</sup> European energy companies, however, have difficulties in profiting from such principles in Russia, where legislation has been used to restrict foreign access to the energy sector. In particular, the Duma voted in 2006 a law establishing a monopoly on gas exports, which contradicts ECT principles.<sup>80</sup>

In this context, the imbalance between the EU’s openness to foreign companies and the relative restriction of European access to Russian upstream markets has been deemed critical for energy supplies. A paradoxical response to such a situation would be the creation of a strong European gas monopoly able to uphold its side in the wrestling with Gazprom.<sup>81</sup> Such a solution would obviously disregard the liberalisation principle, but reveals the structural problem caused by the liberalisation of the internal energy market in conjunction with security of energy supply objectives. It also poses the question of the relevance of the instruments put in place by the EU to mitigate energy security risks.

### **Changing energy markets and challenges to a reinvigorated geopolitical approach**

The changing structure of international energy markets, whereby liberal market mechanisms are subject to growing political interference from energy producers, requires the EU to formulate a credible geopolitical approach. This approach, however, faces important challenges.

#### *The changing structure of international energy markets*

The international energy markets in the 1980s and 1990s were characterised by excess supply and excess capacities as a consequence of economic and energy policies that occurred in Europe after the oil shocks of the 1970s and the subsequent oil price increase which led to a diversification of energy sources in coal and nuclear

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<sup>79</sup> *Ibid.*, p. 119.

<sup>80</sup> *Ibid.*, p. 127.

<sup>81</sup> Robert L. Larsson, *Tackling Dependency: The EU and its Energy Security Challenges*, Stockholm, Swedish Defence Research Agency (FOI), Division for Defence Analysis, 2007, p. 28.

power.<sup>82</sup> It is in that context that the liberalisation process started, first in the US and the UK and then at the European level. However, around the years 2000s, energy markets underwent a profound shift, which made previous policy instruments not suitable anymore. Today, the concentration of resources in a few unstable places highlights the EU's vulnerability; it has been calculated that 70% of the world's gas resources are located in medium and high risk zones.<sup>83</sup> Another important issue relates to ownership access for international oil companies (IOCs) and the behaviour of producing countries.<sup>84</sup>

The well-known cases of resource nationalism in Venezuela, Bolivia, and Russia<sup>85</sup> illustrate a general trend towards an increased control by governments over natural resources in energy-producing countries. Currently only 10% of the world gas resources can be managed by IOCs on the basis of equity access.<sup>86</sup> The 90% remaining are found in countries where governments actively participate in the energy sector through nationally owned companies (NOCs). As such, this situation is not necessarily problematic, given that IOCs and NOCs could have mutually beneficial interests: producing countries could exchange the access to subsoil and resources against skills and technology that the NOCs generally lack. Such partnerships are, however, not always possible, for instance when producing governments use energy in a broader domestic policy framework, such as the recourse to energy subsidies in Russia to satisfy increased national demand at the expense of exported volumes.<sup>87</sup> Fundamentally, however, the relationship between IOCs and NOCs is dependent on their relative bargaining power. Energy prices play a central role in that regard. Whereas low prices in the 1980s and 1990s tipped the balance in favour of Western companies, current high energy prices (gas prices follow the oil price trends as they are fixed according to a formula that includes oil prices) give a strong advantage to NOCs. High energy prices have, for example, strengthened Russia's ability to adopt a bold political stance in the face of its European customers.

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<sup>82</sup> Dieter Helm, *The New Energy Paradigm*, Oxford, Oxford University Press, 2007, p. 3.

<sup>83</sup> Abdelkader Rainaldo Spanjer, *Structural and Regulatory Reform of the European Natural Gas Market*, Leiden, University of Leiden, 2008, p. 37.

<sup>84</sup> It is assumed here that increased access to resources for Western IOCs lowers energy security risks.

<sup>85</sup> In Russia, when Gazprom took majority interests in Shakalin II and Kovykta from Royal Dutch Shell, the sales were considered "forced nationalizations". See A.F.M. Maniruzzaman, "The Issue of Resource Nationalism: Risk Engineering and Resource Management in the Oil and Gas Industry", *Texas Journal of Oil, Gas and Energy Law*, vol. 5, no. 1, 2009, p. 85.

<sup>86</sup> Spanjer, *op.cit.*, p. 39.

<sup>87</sup> *Ibid.*, p. 40.

Put simply, the 2000s have witnessed the emergence of a fourth period<sup>88</sup> in the consumer-producer energy relationship, which "is characterized by a state-driven approach rather than a market-driven one and demonstrates a structural change from a buyers' to a sellers' market".<sup>89</sup> The political answer required from the EU is, however, facing important challenges.

#### *Challenges to a reinvigorated geopolitical approach*

The ability of the EU to be a global and influential energy player rests on two main determinants: its political will to engage in a collective external energy policy and its institutional capacity to support such a move.<sup>90</sup> A clear geopolitical dimension to the EU's nascent energy policy was called upon in the Commission's 2006 Green Paper, which identified the challenges confronting an effective external European energy policy.<sup>91</sup> The Green Paper proposed "clearly identified priorities for the upgrading and construction of new infrastructure necessary for the security of EU energy supplies"<sup>92</sup> and the development of "independent gas pipeline supplies from the Caspian region, North Africa and the Middle East into the heart of the EU"<sup>93</sup> in order to diversify energy sources and ensure security of supply.

The first main challenge in this regard relates to the EU's institutional capacity to develop a coherent external policy. The institutional capacity is of utmost importance to develop an effective energy diplomacy. For example, individual Member States can conduct their external energy relations effectively, as they have full sovereignty and a functioning and coherent diplomatic apparatus for that purpose. When they engage into bilateral energy relations, for example Germany with Russia, or France with Algeria, they do it in a 'modern' framework, based on the mutual recognition of sovereignty. The EU, to the contrary, is unable to develop the same type of relations due to its weak integration in the field of external energy policy.<sup>94</sup> While the EU represents a quite integrated energy community internally, its Member States merely coordinate their external energy policies. The biggest challenge for the EU and its Member States from an institutional capacity

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<sup>88</sup> The three previous periods are mentioned in the introduction.

<sup>89</sup> Korkmaz, *op.cit.*, p. 2.

<sup>90</sup> This division is taken from Claes, *op.cit.*, p. 54.

<sup>91</sup> European Commission, *A European Strategy for Sustainable, Competitive and Secure Energy*, *op.cit.*

<sup>92</sup> *Ibid.*, p. 15.

<sup>93</sup> *Ibid.*

<sup>94</sup> Korkmaz, *op.cit.*

perspective is therefore to proceed towards further integration to develop a full EU competence on energy policy that can be used externally to engage energy partners with 'modern' methods.

Linked to the above-mentioned institutional challenge is the question of a shared political will to address external energy partners in the same fashion. The relationship between EU Member States and Russia shows that discrepancies between various national interests make this unlikely to happen anytime soon. A classification of EU Member States according to their national foreign policy towards Russia and their subsequent positions in EU negotiations when dealing with Russia helps understand this point.<sup>95</sup> First, Greece and Cyprus can be seen as 'Trojan horses' for Russian interests in the EU, as the two countries have regularly adopted a pro-Russian stance in intra-EU discussions. Russia is an important partner for Greece in terms of energy and arms trade as well as diplomatic support on the Turkish issue, whereas Cyprus has become Russia's biggest hub for offshore companies, which makes Cyprus in turn formally the first investor in Russia.<sup>96</sup>

Second, France, Germany, Italy, and Spain can be depicted as 'strategic partners' for Russia. The importance of trade flows explains the bond with the first three countries, whereas the relation with Spain harbours potentials for the future. The third group of countries is called 'friendly pragmatists' and includes the bulk of EU Member States which tend to follow the initiatives of the strategic partners while not being strong supporters of Russian interests (Austria, Belgium, Bulgaria, Finland, Hungary, Luxembourg, Malta, Slovakia, Slovenia, and Portugal). Fourth, the Czech Republic, Denmark, Estonia, Ireland, Latvia, the Netherlands, Romania, Sweden, and the United Kingdom correspond to the category of 'frosty pragmatists': while business-oriented towards Russia, they show particular sensitivity to human rights as well as diplomatic code violations. Fifth, Poland and Lithuania represent the 'new Cold Warriors'. These countries, in addition to being heavily dependent on Russian energy imports, are still profoundly marked by the past and their painful relations with the Soviet Union and regularly express deep concerns over Russia's growing power in Europe's neighbourhood.

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<sup>95</sup> Mark Leonard and Nicu Popescu, "An Audit-Power of EU-Russia Relations", *ECFR Paper*, London, European Council on Foreign Relations, 2007.

<sup>96</sup> *Ibid.*

## **Conclusion**

The aim of this paper was to answer the following questions: first, to what extent does the liberalisation of the EU's internal energy market contribute to Europe's energy security? Second, what other policy options besides the market-based approach does the EU have to secure its energy supplies?

The analysis of the liberalisation paradigm has shown that it remains a useful tool to ensure energy security. A liberalised internal gas market is, for instance, a strong guarantee against the attempts by Russia to divide the Europeans which might lead to the exclusion of some Member States from Russian gas. One important weakness of this paradigm is, however, that it can hardly be applied to the EU's partners, which limits the EU's ability to secure its energy supplies.

With regard to the ineffective partners that do not abide by the 'post-modern' rules of the game, the EU's market-based approach needs to be complemented by a geopolitical approach, whereby the EU would rely on instruments of the 'modern' words such as pressure, threat and sanctions. This claim is supported by the changing structure of international energy markets and the shift from a buyers' to a sellers' market and by the increasing involvement of politics in the management of energy by producing countries.

The advent of such a double-standard approach, however, still faces important challenges. The Member States remain divided by different economic and geopolitical interests and the EU has not yet been given enough competences to implement such a double-standard approach. The EU is therefore an international energy actor in the making. Although the internal energy market can be seen as a convergence of interests among Member States, this integration still does not provide a sufficient basis to clinch a parallel movement on external energy policy aspects.



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