

# ENERGY POLICY IN THE BALTICS: A STUDY OF REGIONAL COOPERATION

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## **ABSTRACT**

Jessica Annette Parks: Energy Policy in the Baltics: A Study of Regional Cooperation  
(Under the direction of John Stephens)

Regionalism, especially in the form of macro-regions, has emerged as a force of cooperation and integration within the European Union. The Baltic states, who have cooperated more closely since acceding to the EU, provide an effective case study for testing the unifying power of regionalism. As small states that have shared a damaging dependence on Russian energy imports, the three Baltic states share the incentive to cooperate as a region and develop their internal gas, oil, and electricity capacities. The Baltic states have displayed uneven tendencies of cooperation when it comes to energy, however. After presenting an overview of regionalism in the EU, this paper examines EU policy regarding energy in the Baltics, energy ties between the Baltics and other countries, and specific energy projects in the Baltics to show that while the Baltics do not yet have a strong tradition of cooperation in the energy sector, they have laid the groundwork to strengthen future ties.

## TABLE OF CONTENTS

LIST OF FIGURES.....	v
ABBREVIATIONS.....	vi
Introduction.....	1
1. Regionalism, the European Union and the Rise of Macro Regions.....	6
1.1 New Regionalism.....	6
1.2 The Significance of the Macro-Regional Level in the EU.....	9
2. Case Study: The Baltic Countries.....	15
2.1 The Role of the EU in Baltic Energy Policy.....	15
2.1.1 Energy Policy at the EU Level: The Third Legislative Package.....	15
2.1.2 Baltic Energy Market Interconnection Plan.....	19
2.2 Baltic Energy Projects and Regional Relations.....	25
2.2.1 The Russian Relationship and Pipeline Politics.....	25
2.2.2 Nordic and Polish Energy Ties.....	27
2.2.3 Baltic Energy Projects.....	29
3. Conclusion: What Future Prospects?.....	33
REFERENCES.....	35

## **LIST OF FIGURES**

Figure 1 - Energy Dependency Rate, EU-28 (% of net imports).....	19
Figure 2 - Current and Proposed Energy Linkages in the Baltic Sea Region.....	22
Figure 3 - Capacity of EU Member States to Withstand Supply Disruptions.....	26

## **LIST OF ABBREVIATIONS**

BEMIP: Baltic Energy Market Interconnection Plan

BSS: Baltic Sea Strategy

CoR: Committee of the Regions

LNG: Liquefied natural gas

MLG: Multi-level governance

MRS: Macro-regional strategy

PCI: Project of Common Interest

TFEU: Treaty on the Functioning of the European Union

## **Introduction**

In the post-Cold War multipolar world, regional networks have played an important role in policymaking and governance. Scholars have long focused on the region as a geographic unit within a country, but regional networks have come to exist beyond the sub-national. Regions can also consist of country groupings, many of which have solidified into official organizations. Labeling this phenomenon, Mario Telo argued that the world has entered “post-hegemonic regionalism” with the proliferation of organizations such as ASEAN, NAFTA, and the EU (Telo 2014a:5). Certain member countries may have already had an established pattern of political and economic cooperation, but these organizations—the European Union in particular—have further shaped the connections between these countries, extending cooperation into new areas and strengthening interstate relationships.

During its more than six decades of evolution, the European Union has created and influenced various layers of governance in its defined area (now consisting of twenty-eight member states). Geographically-based regional groupings, such as the Benelux countries, the Višegrad group, and the Baltic states<sup>1</sup>, have emerged as political and economic forces in the EU. However, as will be discussed later on, a ‘region’ can be defined in different ways, and a region

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<sup>1</sup> This paper considers the countries of Estonia, Latvia and Lithuania as the main ‘Baltic states’ based on their shared political and economic characteristics as post-Soviet nations. Other countries such as the Scandinavian states, Germany, and even Poland are certainly a part of the geographic Baltic region based on their proximity to the Baltic Sea. Besides their shared modern history, though, Estonia, Latvia and Lithuania also possess unique cultural and linguistic traits that form a distinct area of Baltic heritage, setting the three nations apart from Western Europe and Scandinavia.

(however it is defined) may experience different levels of integration and fragmentation among its actors. Regions form around shared characteristics and/or shared interests, so it is expected that the actors in a region will behave in a unified way. The question is, to what extent do regions behave as unified actors? The Baltic states provide an effective test case for this particular question. As Daunis Auers pointed out, the Baltic states have historically been more disunited than united, but EU accession has changed this (2015:215). The shared history of the three countries, as well as their accessions to the European Union, shaped their general development as a regional bloc. European Union integration policies, especially those in the energy sector, have sought to support this development.

This paper seeks to examine the energy policies of the Baltic states after 2007 in order to determine how unified this particular region has become and how the EU has impacted this process. Energy policy provides a valid basis of measurement from a regional perspective. Lithuania, Latvia and Estonia share equal structural energy conditions, with a 90% dependence on Russian oil and an almost 100% dependence on Russian gas (Grigas 2013:39). All three states share a common interest in reducing this dependency, which has had harmful political and economic consequences and thus remains a major source of concern. The Baltic states also remain poorly integrated in broader EU electricity grids and energy networks. More than two decades have passed since the disbanding of the Soviet Union, and the common goal of a return to Europe via EU accession helped stir the first vestiges of cooperation among the Baltic states. Daunis Auers pointed this out in the introduction to his volume *Comparative Politics and Government of the Baltic States*, writing, “Brussels, Strasbourg and the domestic legislatures shape the Baltic states more than does the communist experience that ended a quarter century ago” (2015:3).



However, the communist experience very much remains imprinted on the energy infrastructure of the Baltics, whose electricity grid remains more connected with Russia and Belarus than fellow EU members. In addition to providing all of their oil and gas, the Soviet Union also heavily relied on the Baltics for transit and so did not greatly invest in their internal energy capabilities (i.e., energy connections *between* the three nations). This is not to say that the Soviet Union completely neglected energy; Soviet scientists did develop the Ignalina power plant in Lithuania, upon which all three Baltic nations relied for their electricity. However, the EU mandated the closure of the plant by 2009 and has left the Baltics struggling to find foreign investors to back the Visaginas NPP project (Kretinin 2013:34). The Russian gas monopoly Gazprom also continues to hold a controlling share in all three national Baltic gas companies-- Eesti Gas, Latvijas Gas, and Lietuvos Dujos (Auers 2015:223).

Various EU bodies have expressed concern over energy security and interconnectedness in the Baltic states. In the 2014 European Union Energy Security Strategy, the European Commission identified “strong dependence from a single external supplier” as the most pressing problem facing both gas and electricity supplies, and indicated the Baltic states in particular as a “less integrated and connected region” (European Commission 2014a). As mentioned, the Baltic states, while having made efforts to diversify their gas supply and integrate into the EU energy market, still suffer from the Soviet legacy of limited energy diversification and problematic economic ties to Russian companies. In short, between a common interest in reducing energy dependency and top-down support from the EU, the conditions exist for the Baltic states to cooperate to develop their regional energy capabilities.

To specifically address unification in energy policies in the Baltic states, the goals of the EU’s Third Energy Package will serve as a measuring stick. This package, introduced in 2007,

established the groundwork for a common gas and electricity market. Even in light of more recent developments concerning energy in the EU, this third energy package continues to provide a foundation for member states. Based on Commission recommendations in a working document detailing the progress of this package, Estonia, Latvia, and Lithuania face the following key challenges (and have introduced the following responses):

a) Diversifying the gas supply, by establishing a regional liquefied natural gas (LNG) terminal and completing the Balticconnector pipeline between Estonia and Finland. To fulfill this end, it would also help to establish relationships with more suppliers. To explore this first challenge, the chapter on Baltic Energy Projects will examine the floating LNG terminal established at Lithuania's Klaipeda port and the early effects it has had on Lithuania's oil supply.

b) Improving (through diversifying) electricity security and connectedness both within the Baltic region and in the larger EU network (European Commission, 2014b, p.62). As this paper will later explore in the chapter on Baltic Energy Projects, all three Baltic states have already established gas and electricity links with neighboring countries such as Sweden, Finland, and Poland. The Council has set the specific target of 10% interconnection within the whole EU by 2020 (in other words, electricity cables in each country should have the capability to transport at least 10% of its electricity to neighboring EU countries).

This study's methodology will look at regional and EU projects in the context of these two major goals. This will indicate to what extent a Baltic energy community has truly emerged. This approach using specific EU benchmarks does pose potential analytical limitations in that certain projects (such as the failed Visaginas nuclear power plant project) did not have EU

involvement, financial or otherwise. (However, as later analysis will discuss, the project exemplifies the political obstacles faced by the Baltic states when the EU or other external partners do not provide political support or financial impetus for an energy project).

The following chapters of this paper will delve deeper into this question. First, an examination of new regionalism as proposed by Mario Telo (2014a:9) will establish the multilayered nature of governance today and how it relates to previous forms of regionalism. This section will also introduce the macro-region as the unit of study for this paper, focusing on the rise of macro-regions and macro-regional strategies (which the EU pioneered with the creation of the Baltic Sea Region in 2009). The following sections will focus on the impact of EU policy, including Macro-Regional Strategies, the Third Energy Package introduced in 2007, and the Baltic Energy Market Interconnection Plan which remains a major guiding force for further regional integration. Discussion on the Baltic states' internal development of their energy supply, as well as links with other countries such as the Nordic countries and Poland, will show the dynamics behind projects such as the Klaipeda LNG (liquefied natural gas) terminal and the Visaginas nuclear power plant. Finally, a third subsection will provide at the three countries' relationships with Russia and problematic pipeline politics. While dependency on Russian gas and oil has not proven recently problematic, it has shaped the countries' energy development. Finally, the conclusion will provide a brief outlook on energy prospects for the Baltic states.

## **Regionalism, the European Union and the Rise of Macro-Regions**

Discussing the origins of the European Union Strategy for the Baltic Sea Region, Leonas Zitkus asserted that this Macro-Regional Strategy (MRS) did not apply to any past form of cooperation within the EU (2013:145). While Macro-Regional Strategies represent a new policy tool for the EU, they have not signaled a complete departure from previous cooperation strategies. From a multilevel governance perspective, the development of Macro-Regional Strategies has simply continued the tradition of different but interacting layers of policymaking within the EU. Scholars of EU integration have not always accepted the significance of the regional level in EU politics. Multilevel governance theory recognized the limited perspective of prior state-centric approaches to EU integration and instead emphasized as an alternative “[...] the existence of overlapping competencies among multiple levels of governments and the interaction of political actors across those levels” (Marks et al. 1996:41). Multilevel governance theory has thus provided the foundation for exploring the role of regional processes in the EU (notably, the theory did initially focus on the region as a subnational body). The study of regions has gained even more traction in the twenty-first century. With this context in mind, exploring regionalism as it relates to the EU—including the theory of new regionalism proposed by Mario Telo and the growth of macro-regions—will show that macro-regions and Macro-Regional Strategies enhance existing patterns of cooperation by bringing them to a new level.

### *New Regionalism*

In the twentieth and twenty-first centuries, governance has acquired a multilayered, overlapping character that has impacted policy and cooperation among nations. Regionalism has

played a significant role in perpetuating a multilayered system of governance, especially in the EU. Defining a region and regionalism depends on the specific circumstances, because regions exist in relation to a larger body. Furthermore, as a 2009 study on macro-regions in the EU stated, regions “[...] are formed and framed through specific practices. They can be considered as products of intended actions by a set of stakeholders” (Dubois et al. 2009:17). Thus, regions can consist of more than a subnational geographic or cultural area in a state. In this paper, a group of countries (the Baltic states) count as a region in a broader context (the European continent). Regionalism can thus refer to a collection of actors located in geographic proximity acting with a common purpose. Mario Telo identified the EU, on a broader level, as a part of “new”—post-hegemonic—regionalism in the volume *European Union and New Regionalism: Competing Regionalism and Global Governance in a Post-Hegemonic Era*. These post-hegemonic institutions have impacted regional cohesiveness; the Baltic states lacked a strong historic tradition of working together, but post-Cold War NATO and EU membership enhanced cooperation between the three nations (Dubois et al. 2009:13). Telo proposed three waves of regionalism: the imperial regionalism of the interwar period, economic regionalism in the 1950s and 1960s, and post-hegemonic regionalism characterized by the growth of interstate organizations such as NATO, ASEAN, NAFTA, and the EU (2014a:2-5). The EU as an organization has developed over the latter two waves. The European Community, founded by the Benelux countries, France, West Germany, and Italy in 1957, built on the foundation of the European Coal and Steel Community by expressing the intent to strengthen economic bonds between member states. Over the following decades, the European Community expanded to other areas of cooperation, solidified in three pillars in the Treaty of Maastricht in 1993 that also renamed the body the European Union.

More than any act or treaty preceding it, the Maastricht treaty marked the EU's entrance into the post-hegemonic phase of regionalism. As the free market system appeared as the "victor" in the post-Cold War era, more and more nations acknowledged the value of cooperation in trying to maximize the benefits of globalization. More than ever, nations looked to institutionalized cooperation to further their agendas, with "new regionalism" playing a larger role. As Telo defined it, "New regionalism can be seen as an attempt by states to react by strengthening regional control when traditional centralized national sovereignty no longer functions as before and to bargain collectively with extra-regional partners" (2014a:9). Compared to the plethora of other organizations that transitioned into the post-Cold War era, however, the EU remained a *rara avis*. The three pillars under Maastricht formally established the EU as concerned not just with economic cooperation, but also with integration in areas such as currency, judicial and police affairs, the environment, and foreign and security policy. Of course, the Lisbon treaty eliminated these pillars in 2009 in favor of simply clarifying the role of the EU in various policy areas. The Lisbon treaty amended the TFEU with Article 194, specifying a legal role for the EU in energy policy (Treaty of Lisbon: Energy 2015) While the treaty specified that energy is a shared competence between the EU and member states, it also recommended member states consider a "spirit of solidarity" when implementing energy policies (Treaty of Lisbon: Energy 2015). While the EU does not have the power to dictate energy policies at the national level, it can remind member states in this way to keep the good of the whole Union in mind, as more integrated electricity networks and flexible gas supplies benefit all.

In short, the EU has proven a trailblazing institution in its scope; in comparison, others have a more targeted mission (NATO), remain firmly centered on trade and economics (NAFTA

and ASEAN), or have followed the EU's example but have yet to match its level of overall success (the African Union and the Russia-led Eurasian Economic Union). Thus, the EU has provided—and continues to provide— “[...] the most complex, rich and elaborated workshop of regional cooperation/integration in the world [...]” (Telo 2014b:323). Because of its nature as an organization that has sought “ever closer union” among its member states, the EU has naturally introduced innovative methods of bringing together stakeholders at all levels to further integration in different policy areas. Macro-regions and their associated strategies are the newest of these strategies, and significant when it comes to energy policy in the Baltics.

#### *The Significance of the Macro-Regional Level in the EU*

As previously discussed, new regionalism shows that actors can cooperate based on a common goal and retain cultural and linguistic diversity. Due to their multilevel nature, macro-regions can preserve this diversity while encouraging political and economic cooperation. Macro-regions play an important role in the EU, and the Baltic states played a role in their beginnings. The Council approved the Strategy for the Baltic Sea Region in 2009, which “[...] constitutes an integrated framework to address common challenges, i.e. the urgent environmental challenges related to the Baltic Sea, and to contribute to the economic success of the region and to its social and territorial cohesion, as well as to the competitiveness of the EU” (Council of the European Union 2009). The Baltic Sea Strategy includes the three Baltic states along with Germany, Poland, Denmark, Sweden, and Finland, and also welcomes cooperation with neighborhood partners not in the EU (such as Norway). This diversity exemplifies a macro-region. While the Baltic states have not implemented all energy projects through the macro-regional level, the EU has targeted this level in providing support and funds, so an examination of the increasing importance of macro-regions will later clarify EU involvement.

Macro-regions occupy a unique space in terms of regions. Stefan Ganzle and Kristine Kern placed macro-regions on a spectrum between territorial regions (based on geography) and functional regions (based on a common policy). Macro-regions also involve both horizontal and vertical networks of policymaking; they seek to engage stakeholders across all involved states, at all levels down to subnational. Notably, macro-regions take advantage of existing structures in their functioning. The Commission termed this the “three no’s” (no new funding, no new legislation, no new institutions) and stated that MRS “require specific action rather than new policy initiatives” (European Commission 2016:2). In other words, macro-regions should enhance and solidify existing project-driven cooperation among stakeholders. Macro-regions involve a broad array of actors for focusing on specific initiatives, which has proven a weakness in the area of energy policy.

Despite their unique nature, macro-regions have strong roots in existing European initiatives. Exploring this history is vital to understanding the role that regionalism has played in the EU and how it continues to shape cooperation in different policy areas. Since the European Union has grown over the decades in scope and size, it makes sense that its approach to its internal regions would change. The European Union has always recognized the many regions within Europe, though. The Treaty of Rome in 1957 first referenced the goal of the signatories “to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favored regions” (Treaty of Rome 2002). Of course, this referred to regions at the subnational level. The EU focused on providing financial support to bring regions up to the same economic level. Macro-regions can draw on EU funds for projects, but cannot create new funding sources themselves. The strategy falls in line with the self-sustaining approach of the MRS, but puts a large burden on the states involved, as the EU



may not decide to dispense funding for a particular project. In its first MRS progress report published last year, the Commission expressed annoyance at the apparently weak involvement of member states in the strategies: “The benefits would be much greater if the Member States who initiated these processes of cooperation would retain greater responsibility” (European Commission 2016b:9).

Starting in the 1990s, the EU began to focus on regional governance as well as economic cohesion. The EU increasingly tied the subnational regional level to its democratic legitimacy. For example, the Committee of the Regions (established by the Maastricht treaty in 1993) brings together elected regional and local representatives to provide consultations on legislation to the Commission and the Parliament. This is in keeping with the principle of subsidiarity, which dictates that policy issues should be addressed at the lowest level possible (close to the population) in order to ensure efficient implementation as well as the preservation of democratic legitimacy. Macro-regions can co-exist with subsidiarity because it dictates that policy should be addressed at the lowest level *possible*, which will obviously differ across policy areas.

Macro-regional strategies in the EU have also built upon existing institutionalized cooperation. Depending on the perspective, these overlapping webs have the potential to enhance cooperation, but they also can make the process slower and less efficient. As Pertti Joenniemi observed regarding the Baltic Sea, “There has been a considerable proliferation of region-specific bodies and yet it appears difficult to get them to work in a coherent and target-specific manner” (2010:41). These bodies include the Council of Baltic Sea States, Baltic Cooperation, and the Nordic Council. In addition, the CoR has a series of interregional groups, one of which is the Baltic sea regions.

Despite the newness of macro-regions as a level of governance within the EU, they link into existing structures and funding sources well and it is unlikely they will disappear. If anything, macro-regions have such a unique approach—blending the geographical with project-driven objectives—that they will become more of a force in the future. This holds particularly true for smaller states within the EU such as the Baltics, who may find it easier to pool resources to achieve certain policy goals and EU-wide objectives rather than going it alone. Macro-regions can also provide smaller states with more influence; Franziska Sielker argued that stakeholders choose to get involved in macro-regions for the purpose of agenda-setting (2016:2001). The Baltic Sea Strategy has certainly taken advantage of this opportunity, developing the Baltic Energy Market Interconnection Plan in order to assist the Baltic states in meeting EU energy targets.

However, it does not follow that states and stakeholders then choose to *follow* these agendas. As with other forms of cooperation within the European Union, macro-regional strategies can help build relationships among stakeholders and host important discussions regarding cooperation in a policy area. But macro-regions lack an enforcement mechanism, and the self-sustaining approach still places a large burden on national governments despite the multilevel involvement of different stakeholders. The government also does not have to choose to listen to all expert opinions. The Baltic national governments in particular tend to consult with experts who reinforce their pre-determined course of action, not to gain another perspective (Molis 2011a:72).

The legitimacy of the macro-regional approach comes from the fact that it does involve a variety of stakeholders à la MLG, but as mentioned before this can also weaken results. The multiplicity of actors means that, as Sielker pointed out, domestic actors can get involved to

further their individual agendas (2016:2001). Macro-regions, then, run the risk of free riding (as with any large cooperative effort). Additionally, each actor at each level needs to commit fully to implementing the agreed-upon priorities, and national governments need to ensure that their policies also exist in accordance with macro-regional objectives (Roggeri 2015:155). The EU has always struggled internally with balancing inclusivity in policy-making with the need for an efficient and effective process. Macro-regions are still a relatively new strategy, and it is natural that these difficulties have arisen. Nevertheless, for the Baltics, cooperating within a macro-region presents the best opportunity to meet EU interconnection targets and diversify their gas supply. This is because the macro-regional level can effectively address energy policy, due to its cross-border nature. Such cooperation reduces costs for all concerned; since energy diversification is expensive, “regional integration of energy systems is an absolute necessity” (Kretinin 2011a:76). In fact, cooperation not only saves money over the long term, but can also result in gains; a 2015 European Parliament report, ‘Mapping the Cost of Non-Europe,’ estimates that 12.5 to 40 billion euros could be gained annually upon full integration of the EU energy market (51).

New regionalism and macro-regions, at first glance, may not appear to have anything to do with energy policy. However, in a broad context, new regionalism helps explain the proliferation of post-hegemonic organizations—especially the EU—that contain heterogeneous actors uniting for one or more common purposes. New regionalism means that regional cooperation can occur at different levels—including at the state level—and for different reasons. In the context of new regionalism, states, subnational regions, and nonstate actors can work together on policy areas such as energy that do not fall within “traditional” political or economic areas (energy occupies both). Macro-regions, a new development rooted in older structures,

bolster this goal-driven cooperation. The Baltic Energy Market Interconnection Plan, which will be explored more in-depth in the following section, was created through the Baltic Sea Strategy, and it has provided the major framework for interregional energy policy in the Baltics. Despite their unwieldy nature involving an overwhelming amount of stakeholders and overlapping layers with other regional organizations, macro-regions occupy a unique position and can helpfully address interregional energy policy as this section has discussed.

## **Case study: The Baltic Countries The Role of the EU in Baltic Energy Policy**

As previously expressed, the EU has concerned itself with the energy security of the Baltic states. This concern taps into larger EU goals regarding energy, as the EU has introduced a goal of a fully integrated energy market. The goals the EU has set towards this end matter for not only the EU, but also the Baltic states. Since they have a vested interest in reducing oil and gas dependency and strengthening their connectedness with the EU electricity grid, the directives laid out by the EU in the energy sector can help the Baltics. The third legislative package concerning energy, introduced in 2007 and passed in 2009, has continued to play an especially major role in developing the internal energy market by introducing directives to improve competition and interconnectedness in the electricity and gas sectors. The second major plan that also applies to the Baltic states is the Baltic Energy Market Interconnection Plan, introduced through the BSS. Even though the BSS continues to prioritize environmental concerns (namely, the maintenance of the Baltic Sea), the BEMIP has provided the most targeted guidance to the Baltic nations concerning reform of their internal energy infrastructure.

### *Energy Policy at the EU Level: The Third Legislative Package*

As this paper has previously touched upon, the European Union has only recently concerned itself with energy at the European level. The European Union has passed a plethora of past initiatives targeting the energy sector. However, the third package passed by the Parliament and Council in 2009 differs from previous initiatives in that it represents the first time the EU has made a concerted effort to fully implement a union-wide energy market. Article 194 of the

Lisbon treaty, granting the EU shared competency in energy with member states, serves as the legal basis for the third energy package. The package consisted of two directives setting common rules, one for the electricity market and one for the gas market. These directives do build on previous regulations introduced in the EU (but as noted, this is the first attempt to standardize energy regulations across the board for every member state).

In the area of electricity, Directive 2009/72/EC makes market competitiveness and flexibility a priority. It requires the unbundling of providers (and ideally owners) from networks, to avoid monopolies. It also stated member states should promote “interruptible” contracts, make clear supply information available to consumers, allow independent regulators to check on member states’ unbundling processes, and (in Article 6 of Chapter 2) should cooperate *on a regional level* to integrate their markets (European Parliament 2009). The directive on natural gas also prioritizes unbundling; unlike the electricity directive, however, Article 6 of Chapter 2 focuses more explicitly on security of supply. It calls for “regional solidarity” and suggests the coordination of national emergency measures in case of a supply disruption (European Parliament 2009). This vague language can lead to different understandings of what is actually expected. For example, different member states interpret the term “solidarity” as either providing intensive short-term support to fellow members in times of crisis, or pursuing long-term strategic goals in the name of cohesion (Molis 2011b:84). As a result, not all member states may display the same level of commitment in pursuing “regional solidarity.” The EU can only encourage cooperation, through creating forums or suggesting it in legislation; it does not have the legal power to mandate that states work together.

In macro-regions, regional cohesiveness depends first and foremost on *cooperation* among members. While these directives in the third energy package do not mandate regional

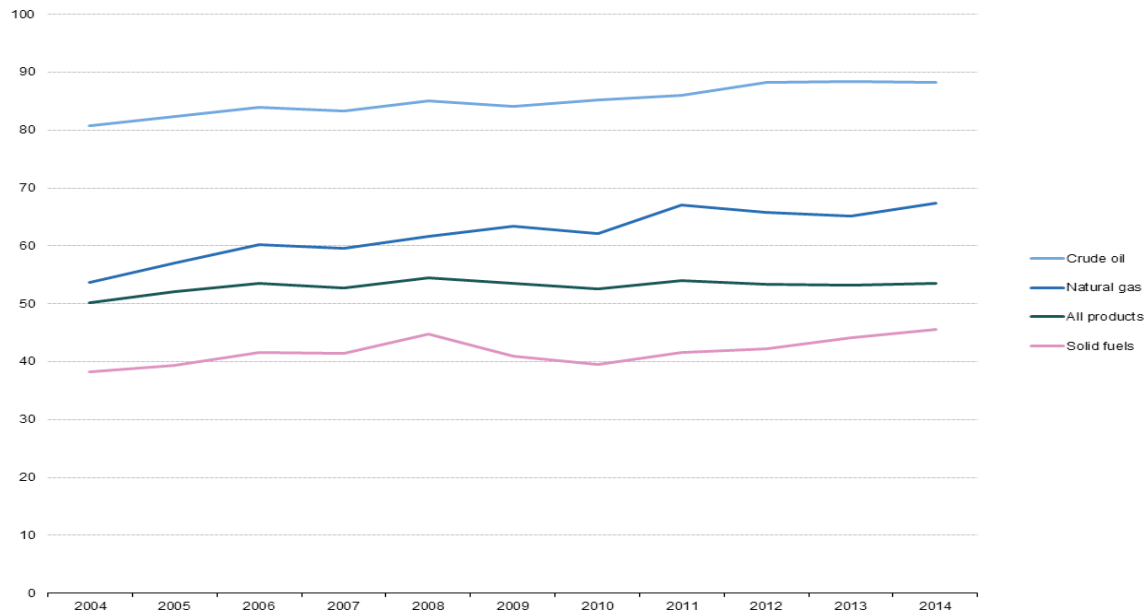
cooperation, their language clearly links its importance to an integrated energy market. Implementation of these directives has benefited the Baltic nations in terms of diversification, but has not led to increased cooperation between them (in terms of electricity connections between the three states). Estonia and Lithuania have fully implemented the third package; Latvia is exempt from the gas directive and only began to reform its electricity market in 2015 (European Commission 2014c). Estonia's 2014 country report, published by the Commission, states that Estonia successfully unbundled its electricity sector, has at least 5 independent suppliers, and has established connections with Finland via the Estlink and Estlink 2 projects (European Commission 2014d). Lithuania and Latvia's reports note their electricity markets are less advanced in the EU grid integration process (European Commission 2014e, 2014c).

All three reports emphasize that while external cooperation has occurred, interBaltic electricity connections remain almost nonexistent. Estonia's cooperation with Finland certainly has helped to diversify their energy sector, as well as the NordBalt cable between Lithuania and Sweden. The EU even funded the latter project along with the LitPol link between Lithuania and Poland, using a substantial Commission loan as well as EU structural funds (Auers 2015:210). However, electricity links *between* the countries are also vital to improving the region's self-sufficiency and integration. If any one of the three countries experiences a disruption in service, it would be much more convenient to be able to procure electricity from an immediate neighbor. Furthermore, solid interregional integration of electricity could enhance infrastructure projects. For example, the Baltic states lack a quality regional passenger train system. Electricity projects could have a positive impact for the proposed *Rail Baltica* that would connect cities in all three countries with Poland and Finland (Kuznetsov and Olenchenko 2013:13).

The three countries remain uneven when it comes to the directive on gas. In general, the oil and gas sector has the greatest absence of cooperation in the Baltics (Kretinin 2011:75). As mentioned, Latvia is exempt from the third energy package gas directive. Lithuania and Estonia continue to import Russian gas--though the completion of the floating LNG terminal at Lithuania's Klaipeda port has already had promising effects on oil supply for Lithuania. Though the terminal has only been operating for a short period, it has contributed to a drop in LNG import prices for Lithuania and a sharp rise in LNG demand in the country (Jacikas 2016). Lithuania (which has experienced past pipeline closures and gas supply disruptions from Russia in the past) also used the unbundling requirement of the gas directive to force Gazprom to sell back its shares in the Lithuanian gas industry (Shaffer 2015:194). The EU emphasized unbundling in the third energy package for exactly this reason, to help states liberate themselves from a single supplier. It seems to have helped in Lithuania's case. It is worth noting as well that the EU-28 also still has an overall high dependence on crude oil and gas as shown by Figure 1 below from Eurostat. The development of a competitive and transparent gas market would benefit all members, not only the Baltic states.



Figure 1 - Energy Dependency Rate, EU-28 (% of net imports)



Source: Eurostat (online data codes: nrg\_100a, nrg\_102a and nrg\_103a)

Source: Eurostat, 2016, available from: [http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy\\_production\\_and\\_imports](http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_production_and_imports)

### *Baltic Energy Market Interconnection Plan*

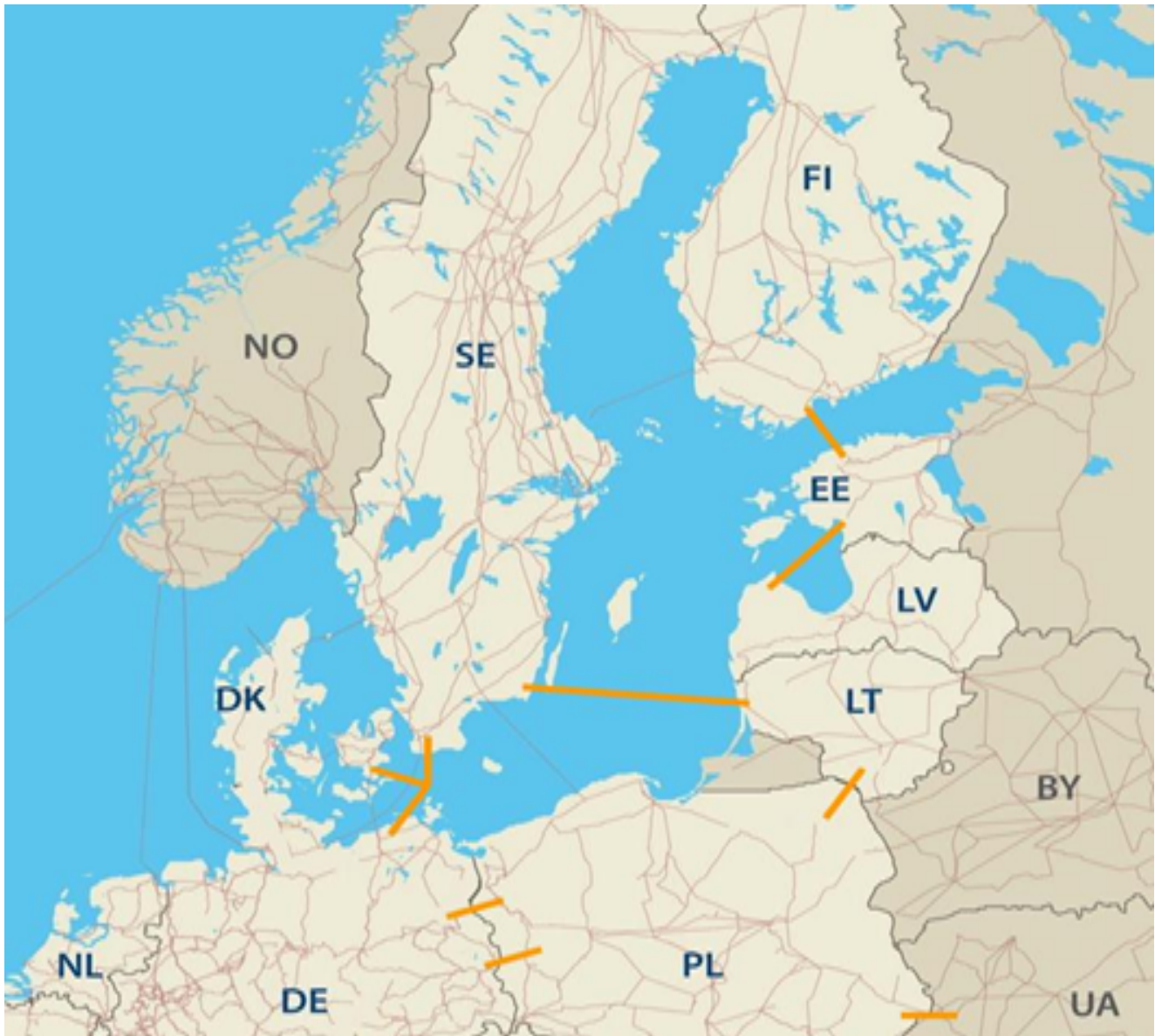
The Baltic Sea Strategy laid out the BEMIP in 2015, as a region-specific plan for BSS members to follow. The BEMIP explicitly mentions the full implementation of the third energy package as one of its goals, and its goals regarding electricity and gas mirror those of the package (BEMIP Memorandum of Understanding 2015:7). The Plan seeks open and fully integrated energy markets, as well as strengthened energy security. It outlines strategies for the signatories to implement, including establishing high-level and technical working groups involving member states' Ministers for Energy Policy (including Norway's, though it is not an EU member), Commission energy representatives, and other senior officials (2015:5). This dynamic exemplifies a macro-region, in that both technical and political experts from all countries (and even one outside the EU) can shape the direction of the plan for the entire region. The memorandum essentially recognized that the entire Baltic region—including Estonia, Latvia,

and Lithuania—had unique concerns that a separate but related strategy had to address. The EU has given the BEMIP its blessing in the form of Commission technical experts and access to structural funds for projects (since the BEMIP falls under a major macro-regional strategy). The BEMIP, therefore, has provided Estonia, Latvia, and Lithuania with the opportunity for advancement in building interregional energy ties.

The BEMIP, however, has a downside; it does not seem to emphasize projects linking the three main Baltic countries. The Memorandum establishing the project referenced the need for integrating the Baltic states' energy markets (2015:8). As Figure 2 shows, though, current and proposed linkages connect the Baltic states to every surrounding country in the BSS, but not to each other (with the exception of a single link between Latvia and Estonia). The main webpage of the BEMIP provides a clue: in a section describing different electricity projects planned for the region (including strengthening ties with the Nordic countries), it specifies that the projects are meant to align the Baltic states with the EU grid (European Commission BEMIP 2017). The section does mention strengthening electricity connections between the three Baltic states, but it appears almost as an afterthought and does not include any details on what such projects might be or when they would happen. This does not mean a lack of will exists, though; national governments are still considering projects in this sphere. In her Lithuania case study on energy policy tools for single-supplied states, Brenda Shaffer noted that Lithuanian officials are working on an electricity connection with Latvia—cited from a 2015 briefing given by senior government officials (195). Based on this information, this effort appears to be bilateral cooperation rather than anything implemented through the BEMIP (but still quite beneficial for the region if the unspecified project comes to fruition). Additionally, a Commission document listing Projects of Common Interest designated the BEMIP a “priority corridor” and listed several smaller

electricity projects connecting specific cities in Latvia and Estonia (2016c:19/11). The BEMIP, then, has made provisions for interregional energy connections. They just do not appear to be at the forefront of BEMIP strategy.

Figure 2 - Current and Proposed Energy Linkages in the Baltic Sea Region



Source: BEMIP, 2017, available from: <https://ec.europa.eu/energy/en/topics/infrastructure/baltic-energy-market-interconnection-plan>

As the Commission has involved itself in the BEMIP, the EU-centric approach in the BEMIP does make partial sense. This fits with the EU's goal of bringing the "energy island" of the Baltic states into the wider energy market and reducing the states' enduring energy ties to Russia and Belarus. It also drives home the fact that the EU has established macro-regions not only to boost regional development, but also to enhance integration overall. As Pertti Joenniemi stated, "[...] macro-regions are being viewed as important instruments for the EU to achieve its own internal grand objectives" (2010:40). Naturally, since the Commission has committed technical expertise and opened up the possibility of funding to BEMIP projects, it has an interest in furthering an EU-friendly agenda. Energy connections *between* the Baltic states would also benefit the EU, though. After all, all three Baltic states are members, and the EU wants to see all member states integrated into the European energy network. While the BEMIP does include projects targeting Estonia, Latvia, and Lithuania, the plan should make those projects more of a priority considering the area's status as an "energy island." While this status is changing, prioritizing energy projects targeting the three main Baltic regions will help speed their way to deeper integration.

The BEMIP also places a large share of project implementation on national governments. This makes perfect sense; national governments have the proper capacities for implementation and enforcement. The most recent Action Plan lists specific objectives next to their implementing bodies, of which national ministries and project promoters form an overwhelming majority (2015). The document also reiterates the objective to tie the Baltic states into the European gas market as well as the Finnish market, also stated in the original memorandum (2015:6). These objectives include greater electricity connectedness using the EU target of 10% interconnection and an interconnected gas grid (including diversifying sources) (2015:3). While

macro-regions make a point of involving state and non-state actors, national governments still take responsibility for the actual implementation of goals. In this context, domestic politics matter greatly. As Ramunas Vilpišauskas argued, the effectiveness of EU policies in small countries such as the Baltics depends on the consistency of their domestic policy and how they implement it (2011:16). In turn, the consistency of domestic policy depends on how politics unfold and which interest groups speak up regarding a proposed policy. In the Baltics, Vilpišauskas observed a lack of strong interest groups supporting EU energy integration (2011:16). In addition, Agnia Grigas indicated the presence of a lobby linked to Russian commercial interests as one of four main reasons the Baltic states have not diversified their energy (2015:43). As the section on Russian relations will explore in more detail, though, these groups seem to have exerted more of an influence on gas policies in the Baltics.

While the EU has taken many actions regarding energy in the last decade, the third energy package introduced in 2007 and the Baltic Energy Market Interconnection Plan introduced in 2009 apply most directly to the Baltic states. The third energy package not only sought to build an integrated energy union, but also introduced specific unbundling requirements for member states to implement in order to reduce single-source dependency and increase market competitiveness. The BEMIP further supported these initiatives, applying them to the unique regional context of the Baltic Sea and acknowledging the particular concerns of that area (such as energy security). The BEMIP focuses more on projects that will increase the entire Baltic Sea region's connectivity to the EU rather than enhance connections between the three Baltic states, but smaller projects targeting their electricity grids do exist. Of course, the BEMIP remains broadly important for Baltic energy as it has developed a specific plan with objectives for the countries to follow.

## **Baltic Energy Projects and Regional Relations**

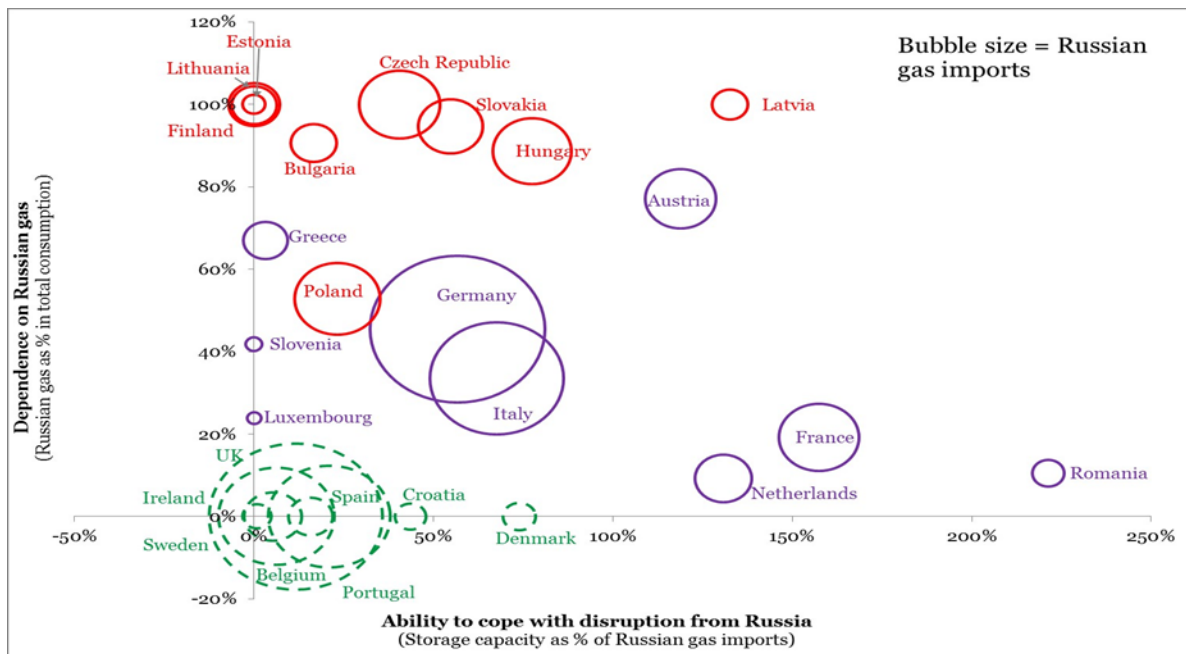
The Baltic states have involved themselves in several large projects in order to diversify their energy and reduce dependence on Russian oil and gas. While it has not presented as much of a problem in the past few years, this dependence has very much shaped the energy policies of Estonia, Latvia, and Lithuania. The three countries have leaned on existing ties to more friendly regional neighbors, including the Nordic countries and Poland, to develop projects such as the NordBalt grid and Balticconnector pipeline. The Baltic states have also tried to strengthen their own internal capabilities with two large projects, the Klaipeda LNG terminal and the still nonexistent Visaginas nuclear power plant. All of these projects reveal the complicated dynamics of cooperation in the region.

### *The Russian Relationship and Pipeline Politics*

The often contentious political and economic relationship between the Baltic states and Russia has particularly manifested itself in the energy sphere, as policymakers and scholars have already recognized. This relationship has in fact impacted regional energy cohesion, as the Baltic states have chosen to approach relations with Russia in different ways rather than presenting a united front. The relationship contains two troubling factors from an energy perspective: high dependence, but low security. Figure 3 provides a visual representation of this relationship for EU countries. According to the European Council on Foreign Relations, who developed and published the figure, bubbles in red represent insecure (dependent) member states, purple represents “secure” member states, and green represents neutral member states (those who do not import Russian oil and gas). As the diagram shows, importing gas and oil from Russia does not pose problems in itself. Germany, along with many countries in Central and Eastern Europe, imports significant amounts of Russian gas and oil. The size, colors, and positions of the circles

in Figure 3 represent the real issue: the ability of an importer to withstand shocks or disruptions in supply. Germany, while a large importer, can withstand disruptions relatively well, as its large purple circle shows. On the other hand, Lithuania, Estonia, and Latvia (all in red) depend on Russian gas and have lacked the capacity to withstand supply disruptions. The countries can import oil via their terminals on the Baltic Sea, but only pipelines can transport natural gas (Grigas 2015:77). As the subsection on the Klaipeda LNG terminal will later explore, LNG can change this by adding flexibility to supply.

Figure 3 - Capacity of EU Member States to Withstand Supply Disruptions



Red: Insecure, Purple: Secure, Green: Neutral

Source: European Council on Foreign Relations, March 2015, available from: [http://www.ecfr.eu/page/-/dependence\\_on\\_Russian\\_gas.jpg?v=1426599314503](http://www.ecfr.eu/page/-/dependence_on_Russian_gas.jpg?v=1426599314503)

Studies have already explored the machinations of Russia’s “pipeline politics” -- manipulating its widespread energy network in the post-Soviet space to punish states for



unfavorable decisions. This occurred in Lithuania in 2006 with the closure of the Druzhba pipeline, as Lithuania chose to sell its refinery Mazeikiu Nafta (which had already gone through a complex round of privatization after the fall of the Soviet Union) to Polish rather than Russian investors. Russian authorities claimed the pipeline needed maintenance work, but Lithuanian leaders ascribed the disruptive shutdown to political motives. In reality, it is difficult to separate political and economic motives since energy occupies both spheres (Grigas 2015:44). Until recently, Russia depended on the Baltics as transit states, to transport oil supplies to Baltic Sea ports for shipping. Russia has since opened its own ports that provide more convenience, but the Baltic states still rely on gas imports to fuel their energy.

The responses of the Baltic governments to Russian energy interference have varied, even after their accessions to the EU. The EU has served as a political buffer between the Baltic states and Russia, though often walking a fine line since many EU states also have energy relationships with Russia. Agnia Grigas noted that the Baltic governments have behaved differently towards Russia, by placing them on axes of cooperative/adversarial and pragmatic/principled (2015:49). Lithuania has proven the most adversarial and has defended its interests within the EU, threatening to use its veto power in EU-Russia agreements (which Latvia has not tried to do) (Grigas 2015:55). The Baltic states have never presented a united front towards Russia, and have only recently begun to reduce their energy dependency with the guidance and goals provided by the BEMIP and the third energy package.

#### *Nordic and Polish Energy Ties*

The Baltic Sea MRS has encouraged stronger ties between the Baltic states and their regional neighbors. These ties existed before the MRS came into being in 2009, but the Nordic states and Poland have recently begun to play a more significant role in Baltic energy networks.

The MRS has undoubtedly enhanced these preexisting ties. These relationships do exist partly due to historical and cultural ties (while a macro-region centers on stakeholder-based cooperation, it also still includes a territorial element as discussed earlier). Estonia, for example, identifies more with Finland, and Lithuania shares a close relationship with Poland. The Baltic states formed the NB6 coalition with Sweden, Finland, and Denmark in 2004; the Baltic Sea MRS would later incorporate this group (Ruse 2013:238). The Nordic states in particular have provided an effective example of regional cooperation for the Baltic states to follow (Auers 2015:216). Furthermore, the BEMIP website mentions the Nordic electricity grid as a model for the Baltic states to follow (2017).

The Baltic states have undertaken multiple projects involving their regional partners, supported by the BEMIP. These projects focus more on electric connections, though the Nordic states (especially Norway) are playing a larger role in the Baltics' gas markets than ever before. Estonia and Finland share Estlink and Estlink 2, two underwater electricity cables. The Estlink project, launched in 2007, marked the beginning of the Baltics' energy reorientation towards northern Europe; Lithuania and Latvia occasionally use Estlink services (Kuznetsov and Olenchenko 2013:12). Estonia and Finland have also developed a plan for a gas pipeline, for which construction will start this May (European Commission Balticconnector 2017). The EU is providing 75% of the funding—nearly 188 million euros—for the project, though the plan does not specify the exact EU source for the loan (Balticconnector 2017). Lithuania is also working on the LitPol electricity grid with Poland and the NordBalt underwater cable with Sweden (both of which are still under construction). These projects emphasize that a macro-region can contain overlapping areas, with uneven levels of connectedness. In other words, while the Baltic states

still have to work on energy integration within their immediate region (the three main countries), these projects under development will increase their connectivity with the wider Baltic Sea area.

### *Baltic Energy Projects*

#### **Klaipeda LNG Terminal**

In late 2014, after years of acknowledging the need for a regional LNG terminal, a floating terminal opened in Klaipeda, Lithuania's main port city. According to a Commission communication on LNG terminals, the EU already has multiple terminals, concentrated in the Mediterranean region (although a few also exist in the UK, Sweden, and the Netherlands) (2016:6). The Klaipeda floating terminal is the first LNG terminal in the three Baltic states. The Baltic states do not lack ports; two, Riga and Tallinn, are also capital cities. LNG terminals are expensive, but open up the opportunity for states to import and export natural gas from a wide variety of suppliers, making them desirable for dependent states. Thus, it is not entirely surprising that the countries could agree on the vital importance of having an LNG terminal, but could not agree on where to locate it. The location issues seemed to be the main source of the bickering that slowed the implementation of the project (Auers 2015:214).

For energy-dependent countries, LNG provides crucial flexibility in supply that can reduce dependence. Flexibility also helps the market to respond better to shocks and disruptions--a vital consideration for countries dependent on a single source (Jacazio 2017). Only pipelines can transport natural gas in its original form, but at very cold temperatures, it can turn into a liquid easily transported by ship. An LNG terminal contains the necessary facilities for receiving shipments of LNG. All LNG terminals in the EU focus on importation, since none of the member states produce gas for export (Wilson 2016:2). The EU recognized the positive implications of

the terminal project, providing funding for its construction along with the Nordic Investment Bank (who contributed 34.8 million euros) (Nordic Investment Bank 2014).

The LNG terminal has operated for over two years, and has had positive effects on the gas market. Norway is poised to become Lithuania's top gas supplier; the Norwegian Statoil company signed a contract with two importers, and volumes of LNG imports are expected to triple (Adomaitis 2016). This is also significant because the Norwegian shipments will cover the minimum needed for the terminal to pay for its operation (Nordic Investment Bank 2014). The terminal has not completely changed market conditions; Lithuania will also continue to import gas from Gazprom. The terminal also offers only limited flexibility. For example, imports from the US are not likely to happen for a while, as American LNG does not currently have the right chemical composition required by the Klaipeda terminal (Sytas 2016). Nevertheless, the successful completion of the LNG terminal signifies a major step in the Baltic energy market.

### **Visaginas Nuclear Power Plant**

Unlike LNG terminals, nuclear power has proven much more controversial throughout the EU. The EU's approach to nuclear power has a significant history, starting in 1957 with the foundation of EURATOM. The EU does not oppose the use of nuclear energy, but has laid out specific and strict guidelines governing all aspects of its use, including the construction of power plants. In addition to EU directives, national governments also have to take into account segments of their populations that may oppose the construction of facilities for providing nuclear power. Nevertheless, 130 NPPs exist across the EU and supply almost 30% of its electric power (European Commission: Energy 2017). The Soviet-era Ignalina NPP, located almost on the border between Lithuania and Belarus, provided power for electricity to all three Baltic nations.

However, the EU mandated the closure of the plant's main reactors by 2009 (Grigas 2015:41). In keeping with promoting the safe use of nuclear energy, the EU most likely ordered this decommissioning due to outdated technology and safety standards. The closure of the plant impacted Lithuania's gas market; by 2010, energy dependence on Russia had increased even compared to their pre-accession years (Vilpišauskas 2011:28). Estonia and Latvia have not relied as much on nuclear power; Estonia mined its unique deposits of shale oil, and Latvia continued to rely on gas imports as well as hydro power. According to 2014 Eurostat data, renewable energy in the form of this hydro power generates over half of Latvia's energy, vastly outpacing Lithuania (13.7%) and Estonia (14.6%).

Since the EU has not offered support for an alternative to the Ignalina plant, Lithuania, Latvia, and Estonia drew up a plan for a replacement (Ignalina 2/Visaginas) as early as 2006. They later included Poland as well. Eleven years later, the plant remains on paper, having run into numerous obstacles. The states disagreed over how to distribute the energy from the plant, and the 2008-2009 economic crisis further complicated project finances (Zverev 2010:5). In the absence of EU funding, the states attempted to find foreign investors for the Visaginas NPP; as noted before, these efforts did not meet with success. The willpower behind the project became fragmented as Latvia and Estonia developed their own plans for NPPs; to seal the plan's demise, the Lithuanian population rejected the project in a 2012 referendum (Kretinin 2013:34-35). Since Estonia and Latvia did not depend on nuclear power to the extent of Lithuania, they most likely did not prioritize cooperation over the construction of the plant. A 2016 Eurasia Daily article quoted the former minister of energy Arvydas Sekmokas, on the plant's failure: "The first conclusion is that the regional model does not work for projects of such scale and complexity, it is simply not suitable."

In practice, the Visaginas proposal has failed and there do not seem to be prospects for a new Baltic NPP any time soon. Zverev argued that Lithuania, Estonia, and Latvia would most likely build their own NPPs in light of the Visaginas failure (2010:5). Given the results of the referendum in Lithuania, though, this appears unlikely. Moreover, given the enormous cost, time, and technical expertise needed to construct an NPP, a smaller country does not possess the necessary resources to pour into such a large project. The EU will not offer access to structural funds in this type of a situation, as those funds are meant to boost development in a region and not to fulfil an individual country's goals. In contrast to the former energy minister's dismissal of regional cooperation, a project of this magnitude clearly displays all the reasons why cooperation is necessary. This failure in the Visaginas project, though, emphasizes the most significant quality of successful macro-regional cooperation—all stakeholders must have equal will to participate in and fully implement the project. In the case of the Visaginas NPP, that will was never present to begin with.

## **Conclusion: What Future Prospects?**

This paper has discussed energy in the three core Baltic states (Lithuania, Latvia, Estonia) from the perspective of regional cohesion—judging how much the three countries have begun to form an energy community. The EU continues to focus on energy integration as a priority, for the Baltic states in particular but also for the EU as a whole. The Baltic states have gained a reputation as an “energy island,” dependent on Russian gas supplies even after joining the EU. The EU has encouraged cooperation in the region with its macro-regional Baltic Sea Strategy, connecting the three countries to their Nordic, Central, and West European neighbors. The strategy, and its Baltic Energy Market Interconnection Plan, has helped the Baltic nations diversify their energy markets. Borisas Melnikas wrote, “[...] the Baltic region must be understood as the *whole* together with characteristic differences and signs of internal conflict” (2008:56). In light of the evidence examined previously, is this statement true?

This paper posited in its introduction that using EU targets can measure how cohesive the region has become, including how integrated it has become with regards to the rest of the EU. According to these targets, the Baltic states certainly no longer remain disconnected from the rest of the EU. The states have not yet met the 10% interconnection target, but the BEMIP website notes that Baltic interconnectivity with the EU is at 22% (2017). Moreover, smaller energy projects listed as PCIs indicate that the will exists to improve interregional electric connections. In terms of gas, construction on the Balticconnector pipeline has not yet started—but Klaipeda gained a floating LNG terminal in 2014, which was an EU recommendation for the Baltics. Interregional use of the terminal is not equal among the three states—it has had the most

significant impact on Lithuania's gas market—but the presence of the terminal provides much needed supply flexibility. Lack of cooperation led directly to the failure of the Visaginas NPP project, but the three states did not appear to share equal willpower to see it through.

Stakeholder interest forms the glue holding macro-regions together. Macro-regions are formed around a common interest, and all parties must be willing to implement projects advancing its goals. In its 2016 MRS progress report, the Commission noted that long-term strategic thinking must remain the basis for macro-regional cooperation (3). The Baltic states have shown that, while they disagree in certain areas, they recognize the importance of working with themselves and their neighbors to improve energy integration. They have made progress in the past few years, reducing dependency on Russian gas and extending regional electricity links. The Baltic energy market is still not fully integrated, but if future projects are completed and successful cooperation continues, it will not be a distant prospect.



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