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INTEGRATION OF THE BALTIC STATES INTO THE INTERNAL ENERGY MARKET OF THE EU

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TABLE OF CONTENTS

ABSTRACT
LIST OF ABREVIATIONS
INTRODUCTION 1
1. THEORETICAL APPROACH 9
1.1. Integration and the role of energy resources in this process 9
1.2. Key aspects of the theory of neo-functionalism 10
1.3. Economic regional integration 12
1.4 Neo-functionalists' view on the first energy communities in Europe 14
1.5 The value of energy in the Post-industrial and Information society 18
1.6. Energy resources in the contemporary world 19
2. METHODOLOGY 22
2.1. The Meaning and Determination of Capabilities 22
2.2. The Concept of Project 23
2.3. Evaluation of Projects Feasibility 24
3. INTERNAL ENERGY MARKET OF THE EU 27
3.1. The Concept and the Goals of the Internal Energy Market of the EU 27
3.2. Challenges in the Construction of the Internal Energy Market 29
3.3. Role of the European Commission towards the Baltic States Joining the Internal Energy Market 32
4. THE ENERGY POLICY OF THE BALTIC STATES 35
4.1 The First Steps of Energy Integration for the Baltic States 35
4.2 The Energy Sector of the Baltic States 36
4.3 The Plan of the Baltic Sea States Integration into the Internal Energy Market of the EU 39
4.3.1 The Main Aspects of the Baltic Energy Market Interconnection Plan 39
4.3.2. The Energy Projects of the BEMIP 40
4.3.2. Implementation of the Projects in the Baltic States 44
5. THE RUSSIAN FACTOR IN THE BALTIC STATES' INTEGRATION INTO THE INTERNAL ENERGY MARKET 47
5.1. Energy Partnership between Russia and the Baltic States 47
5.2. Russian Reaction toward the Baltic States' Integration into the Internal Energy Market of the EU 50
5.3. The Role of Gazprom in the Energy Market of the Baltic States Development 54
CONCLUSION 56
BIBLIOGRAPHY 62
APPENDIX 1 69

ABSTRACT

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In the thesis I study integration of the Baltic States into the Internal Energy Market of the EU. The object of the study is the Baltic States. Latvia, Lithuania and Estonia which are isolated from the energy system of the EU and cannot create a free and open energy market.

The theory of neo-functionalism helps me to understand the main principles of integration. The key concept of the theory is the spillover process. The sectoral spillover process explains the interdependence of political and economic integration while the geographic spillover process shows the principles of regional integration. Renowned neo-functionalist Ernst Haas, theorizes that states which are excluded from the integration process actually influence its process. This concept explains the Russian influence on the energy integration of the EU which is important for the study.

To understand the problem I use the textual analysis of some select documents. I compare the progress reports of the Baltic Energy Market Interconnection Plan and analyze the implementation of the energy projects. A systematic approach helps me to understand the cooperation of different systems such as Russia and the EU.

The main problem is that the EU and the Baltic States do not have enough money to construct the infrastructure. Russian Gazprom offers to finance some projects but not enough that will allow the Baltic States to sufficiently decrease its dependency on Russian energy, therefore nullifying the Baltic States' main goal to integrate into the EU energy market. Therefore, the main goal of the Internal Energy Market will not be achieved.

Key words: Baltic States, neo-functionalism, spillover process, resources, energy islands, integration, project, energy market, Gazprom

LIST OF ABREVIATIONS

BEMIP - Baltic Energy Market Interconnection Plan

BRELL agreement - Agreement among transmission system of Belarus, Russia, Estonia, Latvia and Lithuania

BPS - Baltic pipeline system

CIS - Community of Independent States

EC - European Commission

EERP - European Economic Recovery Programme

ECSC - European Coal and Steel Community

EU - European Union

Euratom - European Atomic Energy Community

IPS/UPS - Integrated Power System/ Unified power system of Russia

LNG - Liquefied natural gas

TEN-E - Trans-European energy networks

INRTODUCTION

Energy integration is an important aspect of international relations. Distribution of energy resources in Europe causes a lot of disagreement and conflicts. Since the end of the Second World War, several European states have decided to integrate their energy systems to avoid possible conflict with one another. Regulation of the usage of energy resources was driven to the supranational level. The energy organization operated successfully and European states became members of the European Coal and Steel Community and the European Atomic Energy Community.

Today, the process of energy integration in the region is continuing. The members of the EU accept the common energy legislation to establish a single gas and electricity network. Energy systems of the member states should be linked to one other and the countries should follow a common energy policy. An integrated energy market should help to decrease energy prices, regulate management of energy resources, decrease the energy dependence from third countries and ensure security of supplies.

The other important step in the energy market construction is the creation of the common energy legislation for EU members. The first Energy Legislative Package was accepted at the end of 1990s, while two other legislative packages were accepted later. Therefore the process of the Single European Energy Market creation has been continuing for a long time. The legislative packages are aimed at achieving free and open energy market. Each following package has included the necessary aspects of energy policy legislation which were not considered in the previous packages. The main goal of the Third energy legislative package accepted in 2007 was the Internal Energy Market construction. One of the aims of the package is the restriction of the role of third countries in the EU energy market. The EU plans to finish the Single Energy Market construction by 2014. The members should have energy connection to the other countries and follow the common energy legislation. Additionally, the members of the EU should have equal rights and possibilities in the energy sphere. Although a great success in the energy integration in Europe is evident the main desirable outcome has not been achieved yet.

The Internal Energy Market creation faces a number of problems. Some members of the EU identify themselves as “energy islands” or “energy isolated states”, because they don’t have energy links with the rest of the EU. The goal of the EU is to avoid energy isolation and include all the EU members in the Internal European Energy Market. All the EU members should accept energy legislation and follow the common energy policy.

The problem of the Baltic States’ integration into the Internal Energy Market of the EU is relevant. According to the plans of the EU, all regions should be integrated into the Internal Energy

Market by 2014. It is necessary for assurance of energy security in the region. But not all EU countries are ready to participate. Integration of the Baltic States has taken a lot of time and effort. This problem is on the agenda of the European Commission. The EC has undertaken a number of measures to integrate the Baltic countries since 2009 but the goal has not yet been achieved. Today, the Baltic States are in a difficult situation. They would like to be part of the Internal Energy Market of the EU, follow the European legislation and diversify energy suppliers, but the states don't have enough capabilities to be integrated. The European Commission has created a special program which is aimed at the Baltic States' integration, the Baltic Interconnection Plan. But there are problems with its realization.

The problem of energy cooperation in Europe is well illustrated in literature. The most important aspects highlighted in the articles are energy legislation of the EU, the role of the third countries in the energy policy of the EU and energy supply conflicts. The problems of the Third energy package acceptance and coordination of the EU and Russian energy legislation are well illustrated by associated professor of St. Petersburg State University T. Romanova. In his works, ""The Third Package" and the future of "Gazprom"" T. Romanova describes the Third legislative package's influence on relations between the EU and Russia and its positive and negative effects. The main provisions of the Third energy package are highlighted in the article. A special meaning is given to vertical energy integration. This part includes the problems of acceptance of the documents and disagreements of several countries with some points of the new energy legislation.[1] T. Romanova gives special attention to the political aspects of energy cooperation. In the article "Russian – EU Relations: problems and perspectives" T. Romanova describes the role of Russia in the energy policy of the EU. First of all T. Romanova stresses the wish of the EU to spread its energy legislation on Russia. The other problems are differences in understanding the correlation on the macro and micro levels in the sphere of energy and differences in the state and private sectors in Russia and the EU. The role of the European Commission regarding energy integration is discussed in Tomas Matby's article: "European Union Energy Policy Integration: A Case of European Commission Policy Entrepreneurship and Increasing Supranationalism". The author concentrates on energy cooperation in the sphere of natural gas. The aspect of energy cooperation with Russia is also highlighted in this work.

The role of Russia in EU energy policy is very popular in the literature on energy integration. Sometimes Russia is understood as a threat for energy security in Europe. The EU – Russian energy cooperation is highlighted in the works of Pami Aalto, Professor and Director of the Jean Monnet Centre. The book "the EU Russian Energy Policy" includes some problems of

[1] Романова 2007.

cooperation with special attention given to northern Europe. This Problem is illustrated in the article, "Actors in Russia's Energy Policy towards the EU" by Stanislav Tkachenko, "Energy Dialogue and the Future of Russia: Politics and Economics in the Struggle for Europe" by Viatcheslav Morozov.[2]

It is necessary to consider the literature concerning energy policy of the Baltic States and their energy cooperation with Russia. One of the main scientists studying energy situation in the Baltic Sea Region and energy cooperation with Russia and Baltic States is N. Mezevich, a professor of St. Petersburg States University. In his work, "Energy Aspects of the Economic Diplomacy of Russia: Baltic Direction" the energy cooperation of the Baltic States and Russia in the sphere of transit of natural resources are highlighted. Mezevich has a lot of articles concerning the development and role of atomic energy in the Baltic Sea region, with a special meaning given to the problem of Visagina power station construction. Eiki Berg, professor of Tartu University in his article, "Identity and Foreign Policy: Baltic-Russian Relations and European Integration", describes relations between the Baltic States and Russia after integration of Latvia, Lithuania and Estonia into the EU. Berg describes the problem of the Baltic States' independence stressing the role of national and supranational identity.

Professor of St. Petersburg States University I. Zeleneva also writes about energy cooperation between Russia and the Baltic States. In the article "Russian Geostrategy in the Sphere of Energy in the Baltic Sea Region" I. Zeleneva concentrates on the problem of the Baltic States energy dependence on Russia. In the work the author considers the role of the Third energy package in the energy relations between the Baltic States and Russia. The other important aspects highlighted in the article are Gazprom participation in the energy structure of Latvia, Lithuania and Estonia and the problem of energy price regulation.

The Single Energy Market should be fully constructed in a year but the situation in the Baltic States is still complicated. That is why the research question is to define what the main problem of energy integration of the Baltic States is and if they are able to be fully integrated into the Internal Energy Market of the EU. To answer the main question it is necessary to understand why the Baltic States, despite being members of the EU since 2004, are still isolated from the EU energy system. Other important questions that will be answered include: When is the energy isolation supposed to be finished for these states? How does the new energy policy of the EU affect the Baltic States? All these issues force me to study this problem. In the thesis I concentrate on the problem of the BEMIP realization in the Baltic States and the role of the EU and third countries in the energy integration of Latvia, Lithuania and Estonia. I would like to understand how this integration process is implemented and what has slowed down the integration.

[2]Aalto 2012.

In this work I try to compare the problem of the Baltic Energy Market Interconnection Plan implementation with Russian energy pressure on the Baltic States. I would like to trace the interdependence of the infrastructure projects and Russian participation in the energy market of the EU. Therefore the main aspects of the work are to analyze the implementation of the Action Plan and the construction of the energy infrastructure in the Baltic States and estimate the role of Russia in the energy system of the region. I try to understand who has invested money in the energy projects and how the realization of the projects depends on the third-country resources. There is also a need to study the efforts of Latvia, Estonia and Lithuania to become a part of the energy market. Furthermore, I will estimate the coordination of actions of these countries. The acceptance of the new energy legislation in the Baltic States is also considered in the work. This fact is examined considering the role of Russia. It is interesting to estimate the changes in the Baltic States energy legislation and the consequences of the new energy legislation acceptance.

The main hypothesis of the thesis is that the investment of Russian Gazprom is an important source of the new energy infrastructure construction in the region. If the Baltic States don't accept the financial assistance from Gazprom several infrastructure objects will not be constructed in the region. Gazprom is willing to finance the process of the Baltic States' integration into the Internal Energy Market to not lose its influence in the region. If the hypothesis is proved correct, receiving full energy independence and security of supplies in the states will be questionable.

The object of research is the Baltic States, while the subject of research is the process of the Baltic States integration into the Internal Energy Market of the EU.

The goal of the thesis is to define the main problems of the Baltic States' energy integration into the Internal Energy Market of the EU and estimate the possibility of future integration.

To achieve the goal I set the following tasks: To understand the concept of the Internal Energy Market of the EU and consider the main challenges on the way of its construction; to study the energy systems of the Baltic States; to analyze the Baltic Energy Market Interconnection Plan, its implementation and financing in particular; and to consider the Russian factor in the energy policy of the Baltic States and its role in the realization of BEMIP.

The research is based on the documents of the EU concerning energy integration and the creation of the Internal Energy Market. First of all, the documents of the Third energy package have been considered: gas and electricity directives and three regulations. Studying these documents helps to understand the new energy legislation of the EU. The analysis makes it possible to determine what action should be undertaken by the members of the EU to follow the new energy rules. The third energy package was adopted in 2007, but began operation in 2011. The analysis of the document is still relevant, because there have been problems with its acceptance.

The essential documents the work is based on are the documents dealing with the Internal Energy Market creation. The main aspects of cooperation between the European Commission and EU members are considered in the document: "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee of the Regions, Making the Internal Energy Market Work". Another essential document for the thesis is "Investment Projects in Energy Infrastructure". This document includes analysis of the existing infrastructure in Europe and future plans for infrastructure construction. Financial aspects are also included in the documents. This document is especially important for the "isolated regions".

The main document in the work is the Baltic Energy Market Interconnection Plan. This plan is aimed at Latvian, Lithuanian and Estonian integration into the Internal Energy Market of the EU. The memorandum of understanding was signed in 2009. The three main aspects of the plan are electricity market integration, electricity interconnections and generation, gas internal market and infrastructure. The BEMIP represents an Action Plan, the plan of the infrastructure construction in the Baltic Sea region and reconstruction of the energy market according to the energy plans of the EU. The first progress report of the BEMIP was created in 2009. There are five progress reports. The final report was presented in 2012. In these reports the main aspects of the progress of the Baltic States' integration are observed. It also includes the timeframes of the projects implementation.

The main sources of information concerning the energy situation of Latvia, Lithuania and Estonia are their energy reports. These reports describe the energy sector of the countries including the information about the main energy companies and their shareholders, the energy infrastructure of the countries, prices for energy resources and other aspects. Some documents concerning energy cooperation of the Baltic States and Russia are also considered.

The other research material has different news including information concerning Gazprom participation in the energy market of the Baltic States. In these works, Russian and Baltic States' sources were analyzed. The information dealing with Gazprom participation in the energy market of the Baltic States was also taken from the official website of Gazprom.

The main theory of the thesis is the theory of neo-functionalism. The theory of neo-functionalism studies economic integration. A special meaning of the theory is given to integration on the regional level which is important for the thesis. The neo-functionalism theorists study energy integration in Europe. The neo-functionalists point that economic integration generates political integration. The main aspect of the theory is the snowball effect or the spillover process. The spillover process can be sectoral, political or geographical. Neo-functionalism explains energy integration in Europe. The theory of neo-functionalism originated from the theory of functionalism. Functionalists stress the importance of natural resources and confirm that resource shortage leads to

conflict between nations. In this case it is important to transit some authority to the supranational level.

One of the main theorists of neo-functionalism is Ernst Haas, the author of the book "The Uniting of Europe". Haas emphasizes an important role of international institutions in the integration process, but there are a lot of challenges on the way of integration and this process costs a lot of money. The aspect of the problems of integration is considered in the thesis and one of the main issues is the cost of energy integration.

An important subject considered in the thesis is cooperation between the states and international organizations. Neo-functionalists note that countries should have common economic interests, identical economic systems and interconnections to cooperate with each other. The other aspects that neo-functionalists stress are political pluralism and similarity of elite circles. This information is important for the thesis. It helps to understand what the Baltic States should achieve to be integrated into the internal energy market.

According to the theory of neo-functionalism, energy integration leads to conflict. The result of energy conflicts on the regional level is delegating some powers to international organizations. Consequently, economic integration leads to political integration. This aspect is also important for the thesis because now the EU is not just an economic, but a political organization as well. In neo-functionalism there is a concept of excluded states. According to Haas this concept means that the states excluded from the integration process influence the integration. This concept explains the Russian influence on the energy integration of the EU.

Mitrany and Monnet's strategy of the European Coal and Steel Community was made on the basis of neo-functionalism. Establishment of the ECSC launched the process of integration in Europe, which emphasized the role of energy integration and cooperation. The second international organization regarding energy in Europe was Euratom. Establishment of this organization confirmed the spillover process of neo-functionalism. A lot of researchers note that integration in the sphere of energy will continue. But not all governments would like to delegate all their powers to supranational organizations. Sometimes the interests of the union of some countries supercede the interests of one country. In some cases it is better for states to conducts bilateral energy policy.

Neo-functionalists point out that energy integration is the process leading to progress. They mention that establishment of the EU community was the result of spillover process and that integration in one sphere always leads to integration in other spheres. Neo-functionalists stress the role of energy resources in the process of integration. There are scientists who do not support such a point of view. For example, Daniel Bell notes that the most important resource is theoretical knowledge. Progress is a result of the appearance of with new technologies and opportunities in a post-industrial society. Furthermore, in a post-industrial society, natural resources are not that

important and their integration does not influence economic progress. Protection of the environment is very important in post-industrial society. The problem is the limitation of natural resources and their role in the industrial sector. Cobb Kurt notes that there is a need to change energy policy and develop a "sustainable information society".

This thesis is based on the research of documents. The aim is to understand if the Baltic States have the capability to be part of the Internal Energy Market of the EU. Having these capabilities helps to reach the goal. At the same time the state can achieve the goal if it has sufficient capabilities. There is a capability approach which helps people to cooperate and attain objectives. The capabilities are freedom and functioning. Estimation of capabilities helps to create the strategy of the country.

To understand the capabilities it is important to study the energy projects' realization in the Baltic States. If the projects are well realized, the state has enough capabilities to achieve the aim. The project is a complex of actions that should solve the assigned task. The projects have goals, resource potential, time frame, and the final result. The project includes financial information and information about existing resources, of which all these factors help to understand a state's capabilities. There are different classifications of the projects, dealing with the duration, size and structure.

In the thesis I study cooperation of the different systems. To analyze the cooperation I use systematic approach. It is particularly essential in the case of international cooperation. Great importance is given to the Russian factor in the integration of the Baltic States into the Internal Energy Market of the EU. This approach helps to understand the energy cooperation of such systems as the EU, the Baltic States and Russia.

Concerning the Baltic States' integration into the Internal Energy Market of the EU, it is important to estimate the energy projects realization in the region. These energy projects are described in the Action Plan for the Baltic States and the process of its realization is described in five progress reports. I will use comparative analysis to estimate the progress in the projects implementation.

The thesis consists of five chapters. The first chapter is a theoretic part. This part includes the main principles of the energy integration. In the first chapter I describe the theory of neo-functionalism and neo-functionalists' view on the energy integration in Europe. The theories about Post-industrial and Information society are considered as contrary views on the role of energy. The last paragraph is about the role of energy resources in the contemporary world. I write about the consumption of energy resources and importance of energy resources in EU – Russia relations.

The second chapter is the methodological part of the thesis. In this part I describe the meaning and concept of capabilities. I try to explain how capabilities influence the energy

integration of the Baltic States. The other important aspect of the chapter is describing the concept of a project because the thesis is based on the analysis of the energy projects implementation in the region. I describe classification and main characteristics of projects. I also consider the systems analysis of Kenneth Waltz in this part of the thesis.

The third chapter includes information about the Internal Energy Market of the EU. This part describes the concept of the Internal Energy Market and its main goals. A special meaning is given to the stages of energy integration in Europe and the energy legislation of the EU. The third chapter comprises the problems of the Internal Energy Market creation and the role of the European Commission in the process of energy integration. I try to explain which instrument the EU uses to force members to accept the new energy legislation.

In the fourth chapter I write about the energy situation in Latvia, Lithuania and Estonia and the process of the Baltic States' integration into the Single Energy System of the EU. First of all I study the steps which the Baltic States made in the sphere of energy to become part of the EU. The essential aspect is the energy policies of Latvia, Lithuania and Estonia and the energy sector of these countries. The other important point is the Baltic Interconnection Plan implementation in the region. I analyze the progress reports and try to explain the effectiveness of the plan realization.

In the fifth and final chapter, I examine the role of Russia in the integration of the Baltic States into the Internal Energy Market of the EU. Energy cooperation of Russia and the Baltic States is essential for integration and that is why this aspect is also considered. In the chapter the participation of Gazprom in the energy market of the Baltic States is described. Essential meaning is given to the role of Gazprom in the energy infrastructure construction in the region.

1. THEORETICAL APPROACH

1.1. Integration and the role of energy resources in this process

Energy is an important element of international relations. Energy resources have special meaning in the process of integration and cooperation between states and regions. As early as the 50th anniversary of the integration of the European countries, the unification of the energy sector of the economy has taken place. At the time Haas, Mitrany and Monnet emphasized that energy resources cause all main conflicts in Europe. Unification of the energy sector could help to avoid such conflicts. Therefore the European Coal and Steel Community and Euratom were established. These organizations laid the foundation of the European Union. Haas confirmed that integration in one sector of the economy will lead to integration in the other sectors and then bring political integration. Today we can see that the European Union is not only an economic, but also a political organization.

However in the 70th new approaches denying the leading role of energy came into existence. In post-industrial and information society, major importance is given to information and scientific knowledge. Bell noted that the main element of economy became scientific researches.

Nowadays there are different points of view on the role of energy in economy and society. However such scientists as Tatyana Romanova and Pami Aalto attach great importance to the energy issues. The role of energy in the EU-Russian relations has essential meaning in their writings. Energy resources are very important today. The demand for them increases every year. Energy resources play a special role in the process of cooperation of states and regions.

In the contemporary world economic integration has special meaning. It deals with certain political and economic transformations in the world. In this regard it is necessary to define which problems face the region during the integration process and on which principles the integration process is based. The other essential element is cooperation. Usually states start cooperation with interaction in several sectors of the economy and then such cooperation influence future relations. The issue is defining the role of energy in the integration and cooperation processes. Is energy the basis of integration or it is just a part of the economic process? Economic integration in Europe is a key aspect of the theory of neo-functionalism. The theory gives attention to such aspects as interdependence of economic and political integration. Neo-functionalism studies integration at the regional level which is important for this research. That is why it is necessary first of all estimate the main principles of neo-functionalism and then examine the role of energy in the integration process according to the theory.

1.2. Key aspects of the theory of neo-functionalism

Neo-functionalism is macro-level theory, which describes the process of integration in international relations. It is the most elaborate theory of regional integration. This theory studies regional integration and, in particular, European integration. Neo-functionalism argues that economic integration will lead to political integration. It was formulated in the late 1950s and early 1960s as a result of the establishment of the European Community.

The theory of neo-functionalism is based on the theory of Functionalism. It is difficult to understand neo-functionalism without understanding the theory of Functionalism. The key idea of Functionalism in International Relations is the importance of cooperation. But functionalists concentrate on cooperation in the political fields which are not very big and important. They argue that, first of all, a solid foundation of cooperation should be constructed. The theory of Functionalism was represented in the writings of David Mitrany. As early as 1940, Mitrany pointed out that functional links are much more important than all international treaties of peace and security. Functional links according to Mitrany are the links between non-state members of international relations such as trade-economic relations, counteraction of non-governmental organizations and private connections.[3] Mitrany confirms that international organizations can be established if states have common interests which are beyond their territories. This fact is called natural selection of interest. The priority in the theory of functionalism is given to human needs and public interests. Functionalists doubt if states can fill the needs of the society. Furthermore, a part of common resources should satisfy the requirements of this state. That is why international organizations can be more effective than national states.[4]According to Mitrany's theory there are two areas: political and technical. Sharp conflicts and challenges are absent in the technical area, which is why the necessity of cooperation is the basis for establishing an international organization. It is important that technical control should be out of a state government's power. Any process of cooperation will lead to cooperation in other spheres. Functionalists argue that such cooperation entails a limitation of the states' sovereignty, eventually leading to the emergence of a society without states.[5]

The basis of neo-functionalism and its main deductions are defined in Ernst B. Haas's "The Uniting of Europe" and Leon N. Lindberg's "The Political Dynamics of European Economic Integration". There are special differences in these works but at the same time Haas and Lindberg form common conclusions. These conclusions compose the theory of neo-functionalism. It is possible to say that neo-functionalism poses as the functionalist's methods to attain federalist

[3]Ланко 2010, стр. 2.

[4]Дульский 2010, стр.4

[5]Кутейников 2010, стр. 5.

objectives.[6] Jean Monnet should also not be left unmentioned when we talk about neo-functionalism. His idea was taken as a basis of the Shuman Plan which led to the foundation of European integration. It is possible to observe the basic thesis of neo-functionalism in Shuman's declaration.

The main actor of the theory is supranational organization instead of the state like in realism. Non-states members in the theory of neo-functionalism are intended to solve the conflicts between member-states. The other actors are interests groups which should negotiate with the same groups of the other states. Neo-functionalism emphasizes the importance of non-states actors in international relations. In the case of Europe, such an important body is the European Commission.[7]

Functionalists argue that cooperation is more profitable than competition and that conflict is a result of the shortage of economic recourses. Haas takes the position that cooperation is a natural character trait of people and that human interest should be integrated at a higher level. Haas suggests four "separate" notions in the theory of functionalism. First of all, functionalism separates power and welfare, which comprise the goals of state and humanity. Secondly governmental tasks consist of separate elements. However, these divisions are temporary. Eventually all tasks will be combined into one – to achieve welfare. The key division is between the political and technical spheres. Finally, functionalists separate the types of loyalty of political actors. From the functionalist's point of view, the types of loyalty will be given to international organizations. For Haas and Lindberg integration is a process. At the same time integration includes building institutions in the new center. Neo-functionalism is not only an explanation of theory but also a prescription of strategy.

The main idea of neo-functionalism is that integration in one sphere will lead to integration in other spheres, thereby resulting in a snowball effect. Haas and Lindberg give an important role to central institutions which realize common interests. Both Haas and Lindberg consider that integration in some sectors of the economy is expensive and there are a lot of processes which can interrupt the process of integration.

Although neo-functionalism was created on the basis of the theory of functionalism, neo-functionalists criticize functionalism. One aspect of the criticism is the impossibility of economy existing without policy. In contrast to functionalists, neo-functionalists have developed principles of cooperation between states and international organizations. Also, neo-functionalists consider it unreasonable to separate policy from the economy. National states, especially in the case of regional integration, are really important for neo-functionalists. It is essential for the theory that

[6]Tranholm –Mikkelsen 1991, p. 3

[7]Theories of European Integration 2003, p. 9.

some sets of non-state actors promote the process of integration. These are, first of all, social movements and interest associations which operate in the regions and secondly the secretariat of the organization. Some aspects, such as exclusive determination of the elaboration and direction of the international agreement within an organization or the pace of change are not under control of the member states, but they may offer the terms of a treaty or control its implementation.

1.3. Economic regional integration

Integration is a natural process in Europe. The functionalists' theory was taken as a basis of European integration after the Second World War. The requirement for integration appears when national states are ready to give some of their powers to the center and when states cannot resolve certain problems without supranational organization. Haas identifies economic factors as indicators of the process of integration which help to understand the integration progress.[8] Neo-functionalists pose the theory that cooperation between national states in some spheres of economy influence the wider political and economic cooperation in Europe.[9]

There are a lot of definitions of economic integration. The most exact definition was given by Livinzew. He argues that international economic integration is the development of deep steady interrelations and divisions of labor between the national farms, leading to the gradual binding of the reproduction structures of a number of countries.[10] Haas argues that economics has promoted European integration the most. The biggest progress in economic integration has been achieved in Europe. The European Union is an example of regional integration. Theories and practical models have been established on the basis of the EU. Functionalists confirm that modern society has created new technical problems. That is why it is important to create a new model of cooperation. Integration is a process of the creation of new structures to which will be given new authorities. According to neo-functionalists, to achieve integration states should have common economic interests, identical economic systems, interconnection, political pluralism and similarity of elite circles.[11]

Haas compared regional integration with political integration and political integration as,

…the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities to a new centre, whose institutions possess

[8]Haas 1961, p. 367.

[9] Theories of European integration 2003.

[10] Воронина 2010, стр. 214.

[11]Воронина 2010, стр. 210-212.

or demand jurisdiction over pre-existing national states. The end result is a new political community, superimposed over the pre-existing ones.[12]

According to Haas, regional integration represents a "discontinuous process". Also Haas argues if regional integration spreads beyond the bounds of Europe other regions will follow the example of Europe. Integration according to Haas is a process which results in changes at the macro level.

The theory of regional integration was based on the early experiences of the European Community. Neo-functionalism represents its new concept of European Integration. Neo-functionalists connect regional integration with conflict. However national states facing problems and pressure on the regional level will delegate their authority to regional organizations. The handover of more and more power to regional organizations will lead to the passage of economic-social integration to political integration at the regional level. Neo-functionalists call the transition from economic integration into politic integration the spillover principle. Moreover Haas pointed out the existence of not only sector or political spillover process but also a geographical spillover process. What is meant by "spillover processes"? Lindberg understood spillover process in such a manner: "'spillover' refers to a situation in which a given action, related to a specific goal, creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and anteed for more action, and so forth."[13] The political spillover process is an influence of international organizations political activity on the political actors of the member-states. Sectoral spillover process is regarded as a connection between spheres of cooperation. It means that cooperation in one sector of economy will lead to cooperation in the other. Geographical spillover results in other states joining the community. The states which are not in the organization understand the benefits of cooperation and try to become members. Haas talked about the effect of excluded states. States which are not included in the process of cooperation influence integration. Geographical spillover process actually takes place in the European Union. Currently, it is the wish of many countries to be a member of the organization. Geographical spillover process was first displayed in the 1960s as member-states of the European Free Trade Association started to join the European Economic Community. Political spillover was also displayed in the creation of the Common Agricultural Policy. Haas argued that European integration would have political aspects and would be finished even earlier than the transition period.[14] At the present time, the EU has a lot of political authority.

Explaining the process of regional economic integration, Haas pointed to the spillover process. It means that integration in economic spheres should pass like a snowball effect from one

[12]Soren 2010, p. 4.

[13]Theories of European Integration 2003, p. 9.

[14]Richardson 2003, p.59.

economic field to another. Moreover, economic policy areas will be also integrated. Haas argued that political interest would be the main reason for the integration process. When individuals are satisfied with the work of the supranational organization they will decide to give more authority to such international actors - both economic and political powers. Schmitter notes the reasons which could lead to the spillover process. These reasons are:

- Growth of interdependence between members of the organization
- Bureaucratic problems in the regions
- Establishment of new regional interest organizations[15]

It means the transition of powers from the national states to the center. Economic regional integration can be considered as the process of overcoming discrimination between the economic systems of the national states.[16] In creating a new super-national organization, national governments give way some part of their sovereignty.

1.4 Neo-functionalists' view on the first energy communities in Europe

Energy policy is one of the aspects on which neo-functionalism became popularized. Haas's neo-functionalism examines the development of the theory of neo-functionalism of Mitrany and Monnet's strategy of the European Coal and Steel Community. It is evident that energy resources cause a lot of conflict in Europe. The French economist Jean Monnet's attempts to avoid the next war involved integrating the coal and steel sectors. Then the European Coal and Steel community headed by a supranational Secretary-General was established. Its creation goes back to the year 1950. The goal of the European Coal and Steel Community was supranational control of combined German and French coal and steel. The establishment of the ECSC provided the basis for European integration. This first step of integration led to political integration, as Haas predicted. It is an attempt for politics to exist without national states.

Energy integration is an important point of the European integration at large. Already in 1922, France and Germany tried to create a coal and steel trust, which failed. However, after the war, these states continued negotiations regarding coal and steel cooperation. Regarding history of the establishment of the ECSC, it should be mentioned that Germany's industry was under international control. But by the year 1949 it became clear that soon Germany would be free of this control. That is why a new way of controlling the German steel industry and therefore Ruhr coal control was invented – the establishment of an international organization. The other European states were afraid that Germany could prevail in the market and that the economies of other states would

[15]Schmitter 2005, p. 258.

[16]Soren 2010, p.5.

suffer. Potential members of the ESCE didn't want to coordinate their industries. It was a difficult time for each state and they needed recourses to restore their private economies after war. According to such a situation, it was significant to create an independent international government and a Council of Ministers to control the High Authority (HA).

Eventually Germany, Italy, France, Belgium, the Netherlands and Luxembourg signed the Treaty of Paris. Decisions were made under the principle of majority. Such institution as the European Court of Justice and common assembly enabled the work of organization. To make the work more effective additional rules were added. First of all prices should be transparent. This was achieved by publishing prices and avoiding price discrimination. Secondly, money insertion into industry should be legal. To avoid market dominance cartels, were banned. Labor policy was transformed to make it clear and legal. This organization was a diplomatic element, so it could negotiate with other states under its competences. Finally steps were taken to prevent crises and production quotas were set up.[17]

The realization of the plan started in February 1953 with the opening of the market of resources. However, in practice, this market did not work. The main tasks of the European states were to give work places to their people and facilitate industrial growth. In these circumstances European states were not interested in taking down trade barriers and blocked any efforts of the High Authority to do so. The policy of price transparency failed, according to the report of the HA in the year 1954. Despite the efforts of the High Authority, firms fixed prices themselves. Another attempt to regulate prices was the establishment of "Monnet margin". Price deviation of 2,5 % was acceptable. These policies of the ECSC were considered incapable by William Diebold, but at the same time, Hass called it flexible politics. At the same time the "Monnet margin" policy was not accepted by the states. Germany and Italy, for example, considered it illegal. The other aspect was cutting prices for transportation, as a result France could buy American coal. All these moments show the nonproductiveness of the ECSC. Therefore the plans' realization differed from Monnet's expectations. In 1959 the European coal sector faced a crisis, dealing with the overproduction of coal in Europe. Still, Germany, France and Italy did not want to accept the help of the ECSC.

Despite all problems the ECSC completed two main tasks. First it represented a forum where firms or governments could make adjustments to their policies and discuss important issues. Its other function was representation of the European countries on the international arena and the conduct of negotiations for example with United States. It should be mentioned that the United States was the first non-European state that recognized the ECSC and conducted negotiations with it in the field of coal and steel. In 1973 the United Kingdom, Denmark and Ireland joined the ECSC

[17] Alter 2007, p. 5.

and in 1981 so did Greece, which allowed this organization to control about 90% of steelmaking, around 100% of coal mining and 50% of ironstone production in Western Europe.

By 1980, the ECSC tried to achieve Haas's expectations of such integration: setting prices and targets at the European level. Many experts predicted the continuation of European integration and saw it as a prospective process. But the government's support of the organization was clear. They didn't want to give a lot of powers to the organization. New steel crises in the 1990s led to the decision that the ECSC would go out of business together with the Treaty of Paris. The ECSC was phased out in 2002 and its duties were given to the EU.

The view of the productivity of the work of the organization differs greatly. There are some negative points of view. For example, the French scientist Gilbert Mathieu argued that any changes in the steel and coal production in the "changing world" were not a result of the work of the ECSC. It was the separate politics of each of the six members and they were not concerned with their neighbors. He confirms that the increase in production of steel from 42 million to 107.3 million was not a result of the ESCS's activity. In Russia and in Japan the progress was greater. At the same time Gilbert Mathieu notes several important advantages. At times of crisis the ECSC helped member states to avoid cutbacks and in the period of growth promoted receiving supplies. The ECSC spent a lot of money on welfare issues. It financed thousands of flats, and created a lot of job places. This organization spent about 100 million dollars on job creation in particular for coal and steel workers who lost their work places.[18]

In 1955 the ministers of foreign affairs of the state-members of the ECSC decided to spread the principles of the ECSC to the other spheres of economy and create a united Europe.

From the neo-functionalists' point of view the creation of the Treaty of Rome was a result of the spillover process. This treaty was accepted by the same six member-states. In such a manner two new international organizations – the European Economic Community and the European Atomic Energy Community – were established. In 1967 these communities together with ECSC formed the European Community.[19]

The European Atomic Energy Community comprises the role of nuclear energy cooperation in Europe. The goal of the European Atomic Community is the peaceful use of nuclear energy. Euratom guarantees regular supplies of nuclear resources. The tasks of the organization are: the promotion of nuclear research, protection of the health and safety of workers, and the promotion of the development of nuclear energy in the EU.[20] At the beginning of its existence the organization could take part in negotiations and represent the interest of its state members at the international

[18]Gilbert 2012, p. 3.

[19]Kaarbo - Ray 2011, p. 435.

[20]Treaty establishing the European Atomic Energy Community (Euratom) 2007.

level. Now Euratom is under the control of the EU. Some points of the treaty were changed in 2008. Currently this organization includes 28 members – all members of the European Union.

Although this organization has a lot of authority in nuclear energy regulation, national governments play a key role. Member-states can suggest additional standards of nuclear energy or decide whether they should use nuclear energy or not. The main achievements of the organization were nuclear protection after Chernobyl and the maintenance of nuclear standards by Eastern European countries. The Euratom treaty promotes nuclear safety regime for all participants, despite the presence of nuclear power plants in the state.[21]

According to the neo-functionalists' approach, the creation of Euratom was the result of the spillover process – the main idea of the theory. Haas argued that it is impossible to separate one sector from the economy, because of the cooperation and interdependence of all economic sectors. Haas notes "Economic integration – with its evident political implications and causes – then became almost a universal battlecry making complete the "spillover" from ECSC to Euratom and its promise of independence from oil imports, from sector common markets to the General Common Market"[22]

Nuclear cooperation became confirmation that ideas of neo-functionalism work. The urgency of the theory confirms not only cooperation in the new sphere, but also delegation of new powers to the supranational organizations and the joining of new members. The new neo-functionalists Burley and Mattli argued that international organizations are only interested in their own interests and try to overcome national ones. The scientists argue that the supranational government of nuclear energy tried to reinforce its power using the laws of Euratom. This comes from the fact that a lot of judges at the national and supranational level don't know the law of Euratom and cannot regulate its policy. Euratom has a lot of authority in the field of energy but individuals or firms will not complain about Euratom regarding energy or nuclear issues because they don't exactly know its duties and authorities. At the same time national states give more and more authority to such organizations. However, according to the EU's justice system Euratom has hardly any capability to pursue its own interests contrary to national interests.[23] It is possible to call the spillover process a key process of European Integration. Now Euratom includes 28 members – all members of the European Union.

[21]Wolf 2011 p.12.

[22] Richardson 2005, p. 56.

[23]Wolf 2011, p. 16.

1.5 The value of energy in the Post-industrial and Information society

There is another point of view regarding energy value. According to Daniel Bell in the years 1945-50, the post-industrial society phase began.[24] In the post-industrial society the most important strategic resource is theoretical knowledge. Bell argues that if in an industrial society the transforming resource is energy notably electricity but also oil, gas, coal and nuclear power, then in the post-industrial society the transforming resource is information specifically the computer and data-transmission system.[25] In an industrial society fabricated nature exists and humanity has used energy to transform the world. The central issue of the post-industrial society is that the relationship between persons and nature is not important, it is excluded.

There is a new correlation between science and technology in the post-industrial society. This combination leads to the more progressive results. In an industrial society, such links were absent. Energy and the other big industry sectors such as metallurgical engineering and automobile manufacturing began in the 19th century. These economic sectors have been created by the craftspeople without using special theory. William Kelly and Henry Bessemer, the founders of the oxidation process who promoted the transition to mass production of steel did not know Henry Clifton Sorby who was theirs contemporary and discovered steel microstructure.[26]

One of the important aspects of the post-industrial society is recreation. In this regard post-industrialists point out the damage of the energy industry. They emphasize that the nuclear energy commission increased usage of nuclear energy, but failed to take into account that it leads to water pollution. In the post-industrial society there is the new idea of environmentalism. According to post-industrial environmentalism, people are part of nature and their actions, including pollution are natural.

In post-industrial society the strategic role of energy and natural resources has been changed. Post-industrialists point out the limitations of these resources and emphasize that the limitation of natural resources and energy can influence all industrial sectors. The "economics of goods" has been changed to the "economics of information". Science based industries and information play key roles in the new society.[27]

In the 1990s the idea of the information society appeared as a result of new information and communication technologies. The information society points at new economic values. The growth of the economic value of information activities leads to the establishment of a new social order.[28]

[24] Bell 1976 p. 30

[25] Bell 1976, p. 47.

[26] Белл 2001, p. 130.

[27] Bell 1976 , pp. 211-214.

[28] Webster Frank Economy 2002, pp. 25.

Supporters of the information theory in the information society note that world energy resources will be sufficient only for several decades. In this regard there is a need for a transition to the new energy economy.[29]Information becomes more important than raw materials or energy.[30] Within the theory of the information society there is a concept of the "sustainable information society" which describes a new approach to the problem of the environment and natural resources. According to the followers of such an approach the development of the "sustainable information society" should be based on social innovation and action planning. At the same time, there is a need to create the "green information society".[31]

In the information society such phenomena as "hidden faces" takes place. One of the negative effects of the use of energy is "hidden face". Today people understand the importance of energy issues. According to the supporters of this approach we should control the use of energy and cut emissions. The wrong consumption of energy resources can cause environmental and social crises. In the information society energy problems take place generally in the context of the protection of environment. It should be mentioned that during the work of the World Summit on the Information Society in Geneva in 2003 energy issues were not a cause of great interest.[32]

1.6. Energy resources in the contemporary world

There are different points of view on the role of energy resources in the world. It is a fact that energy resources are limited and one day they will not play an essential role in the economy and social spheres. However, today we cannot contest the role of energy.

According to forecasts world demand for energy resources will increase. Today the growth of world demand for primary energy resources comprises 1,6%. Fossil fuels prevail in general power consumption. This tendency will continue and in 2030 fossil fuel consumption will comprise 80%. The share of coal in the world energy demand will be 29%. According to the forecast, demand for natural gas will increase and the share of its consumption will reach 22%. Universal stocks of energy resources are capable to satisfy a great demand. Experts consider that, according to growing demand, oil reserves will be large enough for more than for 40 years, and gas reserves more than for 60 years.[33]

[29]Cobb 2009.

[30]Gouveia 2003, p. 1.

[31]Karvalics 2007, p. 19.

[32]Souchon 2007 p. 124.

[33]World Energy Outlook, 2008.

It is important to note that in the contemporary world energy is the basis of relations between Russia and the European Union. Deputy Head of the Ministry of the Foreign Affairs Alexandr Glushko notes that energy cooperation between Russia and the EU has been a centerpiece of relations during the last ten years.[34] The president of the Center of energy diplomacy and geopolitics, the main adviser of the Department of Economic Cooperation of the Ministry of Foreign Affairs of Russia S. Zhiznin points that the situation in the world energy markets and access to the main energy resources influence living standards and the welfare of society. In these conditions cooperation between states in the energy sphere is especially important to provide reliable deliveries of fuel and energy resources and to avoid conflicts in this sphere.[35] According to Zisnin, energy plays a key role in the socio-economic development of states. Today, all countries are in the general world energy space and energy policy takes an important place in policy of each state. Such new concepts as "energy security", power policy" and "gas diplomacy" have become important and popular. These concepts are often mentioned today by politicians and economists. Specialists notice the growth of competition in the world energy market. That is why there is a need to enhance intergovernmental cooperation and regulate a normative basis.

The other important aspect is international economic cooperation on the regional level. A positive example of such cooperation is the European Union. Now legislation and rules of law which regulate the energy process in Europe are developed within the EU. The institutional basis for the control of energy policy has been created. It should be mentioned that the work on energy integration proceeds.

Romanova T., candidate for political science associate professor of St. Petersburg State University notes that energy is the most important field of relations between Brussels and Moscow.[36] The activity of the energy central institutes of the European Union began in practice in 1990 together with appearance of Jacques Delor's idea of the creation of the united energy market in Europe. The basis of this energy market is the trans-European energy networks. The aim was the creation of a united system with a universal regulatory system.[37] The Energy Charter and the Energy Charter Treaty should become a basis of relationships with Russia in the energy sphere. Then Energy dialogue has been started. A key aspect is the increase of energy efficiency and the development of infrastructure to deliver energy resources.

Pami Aalto, Jean Monnet Professor and Director of the Jean Monnet European Centre of Excellence at the University of Tampere, also points out the importance of energy in the

[34] Голос России. 25.09.2012.

[35] Жизнин 2007, стр 86.

[36] Романова 2010.

[37] Романова 2011, pp. 52-53.

contemporary policy agenda. The EU – Russian energy relationship in the energy sphere is the main issue of the European Energy Policy. The goal of energy dialogue between Russia and the EU is the development of energy cooperation.[38]Pami Aalto notes that Russian energy policy is an important element of world energy policy. At the same time the importance of Russian energy resources for Europe is emphasized.[39]

Currently, energy is an important aspect of economic relations and integration. Several countries place a priority on energy. There is a spatial meaning of energy in EU-Russian relations. At the same time, energy integration within the EU and the establishment of united energy market is essential. One day energy will be not so important. However, today, the importance of energy resources for economy and society cannot be denied.

[38]Aalto Pami 2008.

[39] Aalto Pami 2012.

2. METHODOLOGY

2.1. The Meaning and Determination of Capabilities

To achieve any goal the actor should have a wish and capabilities. Capabilities are essential in that elements exist in all spheres, including economic and political spheres. Often the problem appears because of the lack of capabilities to achieve a desirable outcome. There is a capability approach. Sabina Alkire notes that a capability approach makes the goals clearer and helps to realize it in a definite sphere.[40] This approach helps people to cooperate and reach their aim. The existence of capabilities brings progress and development. Capabilities represent greater freedom.

Nussbaum emphasizes that, "the community of nations should reach a transnational overlapping consensus on the capabilities list, as a set of goals for cooperative international action and a set of commitments that each nation holds itself to for its own people."[41] Sen and Nussbaum mentiones people have capabilities when they can achieve something. It is a possibility to have what people want. Philipp Charles and Phil Turner also define capabilities as the ability to achieve the result by carrying out a number of steps. To understand how to solve the problem, it is important to estimate capabilities which are necessary for the desirable outcome.

Capabilities consist of two main factors freedom and functioning.[42] Functionings help to create more comfortable living conditions. Freedoms assist in achieving goals. The tools together with the integrated process can ensure capabilities. Each project and plan begins with the estimation of capabilities. The existence of capabilities influences the strategy of countries and communities.

The role of capabilities is demonstrated in Kaplan's balance of power system. One of the main principles of the balance of power system is the increase in capabilities. To achieve that goal the actors should negotiate rather than fight, and fight rather than pass the possibility to increase its capabilities. K. Waltz notes that states have different size, power and wealth. All the new processes in states lead to the changes of these aspects. The states are usually included in a single group in accordance with the tasks they face. Often the capabilities to complete these tasks are not taken into consideration, although in many cases the states use their own means to satisfy the requirements of the consumers.[43] States should have great capabilities to complete difficult tasks. Waltz mentions that only a few states have capabilities to achieve energy independence. At the same time, the states with the greatest capabilities can use them to influence other states.

The integration into the Internal Energy Market is not the issue of the wish but the issue of capabilities. The countries should be able to operate together with other countries. If the states

[40]Alkira 2003, p. 2.

[41]Nussbaum 2000, p. 104.

[42]Sen 1992, p. 40.

[43] Waltz 1979, p. 103.

would like to be part of the internal energy market they should have enough capabilities to follow the legislation and communicate with the rest of the EU. At the same time the citizens of the states should be able to pay high rates for electricity or gas. That is why it is important to study capabilities. The capabilities of the Baltic States can be estimated analyzing the documents. The most important documents in this case are each country's energy reports. The energy sectors of the Baltic States are presented in these reports and the capabilities of integration can be determined.

It is necessary to study that the Baltic States need to be integrated into the energy market of the EU and if the states and the EU have essential capabilities to implement integration. The main factor inhibiting integration into the market is the absence of the necessary energy infrastructure linking the isolated countries with the other EU states.

Estimation of the existing capabilities to reconstruct the energy market in accordance with the energy system of the EU is important for the study. To understand the capabilities of the states I also use the countries' reports about their energy markets. The method of this research is theoretic analysis of the repots. It is essential to determine which infrastructure is presented in the states and which additional facilities are needed. The second step is to study the main supplier of energy resources and the owners of the main energy companies.

The next step is an analysis of the necessary infrastructure construction process, to understand what infrastructure should be built and what the obstacles of the infrastructure construction are. There is a need to use the documents of the EU and study the energy projects in the definite region. A special meaning should be given to the implementation of the projects.

2.2. The Concept of Project

Reconstruction of any system usually begins with the creation of the action plan including some projects which should be implemented to achieve the positive results. In this research paper it is important to study the projects and especially its implementation in accordance with the plan.

Project represents a proposal including organization of its implementation and the actors which will implement it. According to Mintzberg, "a project is an organizational unit that solves a unique and complex task".[44] It is a way to organize peoples work. At present, the concept of the project is extended. Sergey Potapov explains the project as "change or reforming of the existing system. This change has goals, resource potential, time frame, expectation of the eventual result and

[44]Mintzberg 1983, p.30.

demands to this result".[45] Each project has its result and this result is unique. The Project Management institute defines project as a set of operation aimed at achieving the result.[46]

The project has special characteristics. First of all the project has a goal which should be achieved. It is important to denote the goal clearly to provide its implementation. The second important characteristic is the date of the start and finish. The time frame should be adhered. If there is no time frame in the project it is another type of activity – procedure. The time of procedure realization is not limited. Project includes a number of activities, information about resources and budget. It is essential for projects to be well structured. Correct structure makes the implementation of the project more productive.

There are technical, economic, social, organizational and mix projects.[47] Projects are classified by duration: short-term, middle-term and long-term. There is classification according to the structure, size and frame of reference. The process of a project creation includes several definite steps: the beginning stage, development, implementation and the final stage. The beginning stage involves the collection of necessary data and analysis of the information. Then the decision concerning the project and the general concept are made. The action plan is developed on the second stage. The second stage includes financial and technical resources. The process of implementation is important. This stage foresees the realization of the point of the plan to achieve the desirable outcome. This phase also includes signing of contracts and treaties regulating the management of resources and other issues. At the last stage the project should be finished and tested.[48]

There are national and international projects. Kenneth N. Waltz notes that national projects mostly prevail over international projects. There countries create common projects to achieve success. It is hard to realize international projects because of difficulties in cooperation and reaching agreements.[49] It is necessary to cooperate in solving some common problems. The importance and amount of common international projects have increased. Usually it is difficult to solve the problem alone. The countries should cooperate and create common projects.

2.3. Evaluation of Projects Feasibility

Project analysis means study of definite points of the project and designation of the main threats. In this research the most important aspect is the definition of reality of projects. The basis of

[45] Потапов 2013.

[46] What is project management? Project Management Institute 2013.

[47] Сооляттэ 2013.

[48] Потапов 2013.

[49] Waltz 1979, p.197.

the analysis is the study of the documents, including the description of the necessary projects. It should be documents comprising specification of the project and reports concerning the projects implementation.

First of all, the action plan should be examined because the main energy project is clearly described in it. The action plan includes the documents on the preparatory stage, but it is possible to define the goals which should be achieved at the final stage.

To analyze the feasibility of the project it is necessary to use comparative analysis and compare five progress reports. The progress reports describe the current situation of the projects implementation. The essential characteristic in this case is time frame. This aspect can be estimated comparing the time frame of the projects in the first progress report for 2009 and the final progress report for 2012. The method of the research is comparative analysis. Comparing the dates of finishing the project in the four reports it is possible to understand if the time frame is stable. If the dates are the same it means that the progress is evident and the project will be realized on time. If the dates are changed the project will not be realized on time and can be closed.

To understand the reason of the time frame compliance or non-compliance, there is a need to classify the projects according to financial sources. Therefore, the third phase is determination of the financial sources of the projects based on the fact whether the projects keep the time frame or not. The method is the theoretic analysis of the documents, the action plan and the progress report. The objective is to find the financial sources and understand the influence of financing on the project realization.

Kenneth N. Waltz in his work "Theory of International Politics" also writes about the study of the government financing of the projects. The goal of these projects was getting independence from the import of natural resources. The governments do not want to allow an increase in the price of supplies and resources. It is necessary for the states to have an access to the resources and be independent from the other countries. Waltz pointed out that the main challenge of the common project realization is the defining of the source of financing.

The common economic projects influence the political relations between affected countries. It is explained in the systems theory of K. Waltz. It is possible to compare analytic analysis with the system approach. Usage of systemic analysis is essential in understanding different system cooperation and that of international systems in particular. Systems approach explains two levels interconnection. Systems approach explains the role of the structure in the cooperation of different systems.[50] In this thesis it is important because special attention is paid to the Russian factor in the integration of the Baltic States into the internal energy market of the EU, and how the new energy structure of the EU influences the cooperation of the Baltic States and Russia. The conflict is a

[50]Waltz 1979, pp. 38-60.

predetermining factor of the appearance of infrastructure. The different systems should interact with each other in order to reconcile their actions in the projects realization.

3. INTERNAL ENERGY MARKET OF THE EU

3.1. The Concept and the Goals of the Internal Energy Market of the EU

The European Union would like to create the Internal Energy Market for the Member-States. The Internal Energy Market of the EU represents an integration of the energy systems of the all EU members into a single system with common energy rules, connecting the EU states transportation grids and conducting a united energy policy. The goal of this integration is insurance of the security of energy supplies and implementation of competition of the suppliers in the market. This allows them to receive better kinds of natural resources and more qualified services. A single energy market will be a system without any barriers, and should conform to the energy standards of the EU. The internal energy market should protect the rights of consumers and ensure interconnections of energy systems of the member-states. The EU will use its tools to ensure compliance of the rules by the member states.

The other aim of energy integration is price regulation. According to the European Commission, the competition of the suppliers will help to achieve the lowest possible costs.[51] Scientists note that in a liberalized energy market, the prices should be lower than in a non-liberalized energy market. However, it is impossible to guarantee low prices as prices depend on world fuel costs.

Suppliers should represent their conditions for consumers and the consumers should decide which company to cooperate with. Scientists note that if the consumers choose the cheapest operator in the sphere of electricity, for example, the population can save about 13 billion Euros a year.[52] The EU wants to achieve diversification of suppliers. There are common energy rules for the members of the EU and the countries should follow the legislation. The EU plans to fully construct the integrated energy market by 2014. In 2014, all members should follow the legislation, and the market should be free and secure. The members of the EU are included into the single energy market if they follow the energy legislation of the EU and have access to the EU energy system.

There are three stages of energy integration in the EU and there are three packages of the energy legislation. In the late 1990s, the first energy package was adopted. This package included two directives of common rules in the sphere of gas and electricity. The second energy package was accepted in 2003. The second energy package included the main goals of the energy policy such as security of supplies and an open energy market. According to the second package, the consumers were given the possibility to choose their own energy supplier. However, it is impossible to achieve some goals of the package without new energy rules.

[51] Questions and Answers on the third legislative package for an internal EU gas and electricity market 2013.

[52] European Commission press release 15.11.2012, p.1.

All changes in energy legislation should help to construct a more profitable energy market for EU members. The most important benefit is the possibility to choose an energy supplier. However, this goal was not achieved and there was a need for new rules. That is why the European Commission has decided to make a new package of energy rules.

In 2007, the European Commission accepted the Third Energy Package. This package of rules consisted of five documents of gas and energy market regulation: two directives and three regulations. These documents represent the structure of the Internal energy Market. The Third energy package is aimed at the Internal Energy Market construction. The three main goals of the package are the separation of operators and suppliers in the sphere of gas and electricity, protection of consumers' rights, and independence for regional authorities to act. To make the process more successful the EC has offered some innovations. For example according to the new energy rules supplier of energy resources cannot regulate the transition of the power. There is a new definition in the energy market – a so called "independent system operator". The integrated companies can be the owners but theirs assets should belong to independent actors. Such measures are aimed at restricting energy activity of third countries. Such rules are not profitable for companies from third countries but they can remain investors and energy suppliers.

The other aspect is the establishment of the Agency for the Cooperation of National Energy Regulators. This agency should help to construct a single energy grid of Europe and operate in the energy sphere as one network. In 2011, the European Agency for the Cooperation of Energy Regulators started to operate. The agency should assist the development of cooperation at the regional level, help to realize the 10 year network development plans and coordinate the development of the Internal Energy Market of gas and electricity. The agency will control the work of national energy regulators and assist in energy trade between members.[53]

The Third Package was admitted by the European Parliament and the European Council. The proposal of the Third Package rules was made by the European Commission. It is obligatory for the EU member states to implement it into their national legislation. But there are different forms of acceptance. The third energy package started to operate in March 2011 but there are a lot of members of the EU which have not accepted those rules. In September 2011, seventeen infringement proceedings were sent to the states which did not adopt the legislation.

This energy policy of the EU should prevent any crisis regarding energy supplies, because the energy systems of the member-states will be connected to each other. The EU could diversify energy suppliers and be more confident in energy negotiations.

[53] Europa Press Release Rapid 2011.

3.2. Challenges in the Construction of the Internal Energy Market

The Internal Energy Market should be fully constructed by 2014. This decision has been made by the member states of the EU. The members should implement legislation and follow the rules. In 2014, cross-border trade should be developed and all parts of the EU should be linked. At this time, the EU Energy market with modernized infrastructure should start to operate.

There are a number of challenges that counteract the construction of the internal energy market by 2014. First of all, to ensure the work of the energy market the countries of the EU should implement the third energy package. The implementation is obligatory and delay in implementation will cause problems for the realization for the project. If the state does not implement the new legislative package, the EU commission has organized an infringement procedure. In 2011, there were 19 cases and in 2012, twelve of them were closed.[54]

The task of the Commission is to ensure equal conditions for energy companies in the EU. First of all, it is important for countries to have strong historical operators and suppliers with long-term energy agreements. The main energy operators in the EU are traditional energy companies.[55]

Each region and each country of the EU should be integrated into the Internal Energy Market. The European Commission should help the regions with one energy supplier which are isolated from other member countries. However, the new legislation should be accepted in such regions anyway. The energy systems of the countries should be modernized to speed up the process. The Commission asks the EU members to make an action plan including measures on the energy system recovery. Some countries especially in Eastern Europe need more pipelines to diversify energy suppliers and cut the dependence from one supplier.

Some states estimate themselves as energy isolated because they don't have energy connection with the other EU members. These countries for example are Latvia, Lithuania, Estonia Finland, and the countries of the Iberian Peninsula. The isolation of these states deals not only with technical but also with political aspects. There are geographical and political "energy islands". Political "energy islands" depend on an external energy exporter. Countries such as the Baltic States and Finland have only one gas supplier.[56] Energy isolation is determined by economic and political links with third countries. The energy isolation of Iberian Peninsula differs from the isolation of the Baltic States. Spain and Portugal do not have enough internal energy resources and connectors linking the countries with the rest of the EU. The energy isolation of the Baltic States deals not only with the technical aspects but also their lack of power. The Baltic States are dependent on Russian

[54] Making the internal energy market work 15.11.2012, p. 8.

[55] Making the internal energy market work 15.11.2012, p. 1.

[56] Communication staff working document 15.11.2012 2012, p. 5.

energy. Latvia and Lithuania import 62% of their energy from Russia while Estonia imports 30%.[57] It is a problem because the members of the EU do not have the benefits of the Union and have to coordinate their actions in the energy sphere with Russia. The result of this dependence is unstable energy prices, insecurity of energy supplies, and problems with the protection of environment. Dependence on external suppliers may have a negative impact on economic relations between the EU and these states.[58] According to the gas directive of the European Parliament the countries dependent on one natural gas exporter for over 75% of their energy needs may not follow some provisions of the directive.[59] The aim of the EU is the diversification of the sources of suppliers and ensuring security of supplies. However, a visible result has not been achieved yet.

The other problem is the cost differential of energy between Western and Eastern Europe. The gap between prices continues to grow. A lot of EU members have regulated energy prices. For example, in the sphere of electricity, controlled prices cover 57% of households in Europe.

An important problem of the Internal Energy Market construction is the absence of necessary infrastructure. In the third energy package this issue is considered. According to the rules the new infrastructure can be owned by a natural or legal person but at the same time that person cannot be the system operator.[60] In 2011, the Energy Infrastructure Package was accepted. This package includes the infrastructure that should have been built by 2020 to promote the construction of the Internal energy market of the EU. The project also includes financial issues. The other essential infrastructure project is a Ten-Year Network Development Plan.

To achieve the goal and create the Internal Energy Market, the EU should invest a lot of money into to the infrastructure development. Investment is the most important aspect in the internal energy market construction. The EU needs a trillion Euros to reconstruct the energy system. 540 billion Euro should be invested in the sphere of power generation and 210 billion Euro should be spent on the development of the gas and electricity sector. However, it is impossible to invest this amount of money today. The investments are represented through such programs as the European Energy Programme for Recovery, the future Connecting Europe Facility, the EU Cohesion Policy and Horizon 2020. Unfortunately, these investments are not big enough to recover the infrastructure and create a new energy system.

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[57] Reinis 2011, p. 4.

[58] Getting EU energy islands connected , 13 December 2012. p. 6.

[59] Article 49 // Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC // Official Journal of the European Union. 14.08.2009.

[60] Article 36 // Directive 2009/73/EC of the European Parliament and the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC. p. 26.

Most of the money is invested in renewable sources of energy. Renewable source is an important object for investment in the EU. It was reported in the Investment project of energy infrastructure of the European Commission from 2005 to 2010 that a lot of money was spent on the development of renewable sources, especially on wind, solar and hydro energy. In the sphere of electricity the first countries to receive investment for nuclear capacity development were Bulgaria, the Czech Republic and Finland. Lithuania takes the fifth place in this list.[61] In the Ten-Year Network Development Plan it was mentioned that investments in of some projects will be delayed because several projects have not been approved. The economic situation influences project investment and because of the European financial crisis, there is not enough money to fund all projects. Likewise, in the case of the reconstruction of the electricity market, the EU should spend 70% more than in previous years and 30% more in the gas market. It is emphasized that the Baltic States need investments for infrastructure that would connect them with the other EU states and promote energy trade in the region. At the same time, most investments on the cross-border gas transmission pipelines construction should go to Germany, the Czech Republic, Italy, the Netherlands and Greece.[62]

To receive investment for energy project development, member-states should notify the commission that they need a definite infrastructure and are planning to build it. Then the Commission would research these notifications. Several countries including the Baltic States receive Recommendations from the Council in accordance with the "Europe 2020 strategy". It is necessary for Latvia, Lithuania and Estonia to be linked with the rest of Europe to be part of the Internal energy market. But the Council emphasizes that projects such as gas transmission linking Estonia and Lithuania with the Baltic-Connector pipeline have risks of implementation.

The EU also gives a priority to other infrastructure projects in the Baltic Sea Region such as the East Gas and Baltic Market interconnection. The EU notes that it is important to build a LNG terminal in Lithuania and later in Latvia and Estonia. Lithuania is included in the investment plan. The essential part of the investment should be given to electricity network development. Priority is given to renewable integration and to Latvian, Lithuanian and Estonian integration into the electricity market of the EU because the countries have interconnected energy links and links with third countries – Russia and Belarus. In the investment project of the energy infrastructure, it is noted that it is impossible to invest in all projects to finish the construction of the internal energy market. There is not enough money to achieve that goal. The investment issue should be discussed in the EU to decide the plans concerning the development of the energy market.

[61] Communication staff working document, Brussels, 15.11.2012. SWD(2012) 367 , p. 4

[62] Ibide.p.17.

It is important to develop fair competition and extend the rights of consumers. There is a need to enhance the efficiency of the energy network and ensure access to the transportation systems for consumers.

Some EU member-states cannot follow the full legislation because of infrastructure problems. Those countries are not able to follow definite points of the directive until their energy systems are connected to the other parts of the EU. For example Estonia, Latvia and Finland are permitted not adhere to articles 4, 9, 37 and 38 of the Gas Directive. These isolated states should ask the Commission about temporary non-compliance with definite articles. The countries should receive the derogation from the EC. One of the reasons of giving the derogation is a lack of investment for infrastructure development.

To finish the construction of the energy market the objectives of the EC are to establish new energy rules in order to ensure reliable energy trade between members of the EU, protect the rights of consumers and provide the lowest possible energy prices, to cooperate with the national governments in case of consumer rights implementation, and control the energy price policy of members.

3.3. Role of the European Commission towards the Baltic States Joining the Internal Energy Market

The main initiator of the Baltic States energy integration is the European Union. What are the goals the EU wants to achieve by promoting integration? There is an opinion that some countries can estimate integration through several dimensions including political and infrastructural.[63] Through energy integration, the EU renders assistance to third countries which cannot integrate themselves. At the same time, the EU is sure that the integrated countries will accept the energy legislation of the EU. The process of integration will step by step lead to the creation of a united energy market. There are some countries in the EU that see integration into the EU energy system as a means for energy stability. Several countries do not want to integrate but according to the political situation they should. Currently, there is no opposition in the energy integration process. The European Commission composes recommendations for the Baltic States. For example, according to the recommendations in the case of infrastructure, Latvia, Lithuania and Estonia should end their energy isolation, create new transport links, and renovate the operation of their energy markets.[64]The EU is the source of financing of these projects.

[63]Mariusz 2012.

[64]Schymic - Crumrey 2009, Berlin. pp. 8.

In 2007, the third legislative package of the EU was signed. The European Commission wants all member states to adopt the package. However, Latvia, Lithuania and Estonia did not accept some of the Third package rules in the electricity and gas sphere. The EU has to make certain notes in some provisions to help the Baltic States to notify this package. Lithuania and Latvia have had discussions with the EC concerning their energy law and accepted provisions of the electricity sphere.[65]

According to the Lisbon Treaty, the European Commission is responsible for taking measures in respect of the EU members which do not follow the legislation of the EU. First of all, the Commission sends formal notice to the country which the government should reply to the request in two months. When the EC has not complied with the request of the country, it asks for "Reasoned Opinion". The "Reasoned Opinion" is a report including measures which the state undertakes to improve the situation. If the Commission is not satisfied with the report it can appeal to the Court of Justice.[66]If the Court decides to punish the state, it is supposed to correct its legislation in accordance with the EU legislation or the Court of Justice can make the Member of the EU to pay financial penalty.[67] However, most of the countries try to follow the EU legislation after the first or second request and there is no need to apply to the Court.

Initially Estonia did not accept the gas directive because the country was isolated from the EU energy grids and could not follow some provisions of the gas directive. In February 2012 Estonia received the "Reasoned Opinion" from the EC. After two month the Commission had to apply to the Court. There are several difficulties for Estonia in order to accept the Third legislative Package in the gas area. According to the third package Eesti Gaas, the main natural gas company in the country, should sell the transportation infrastructure to decrease its dependence on Russia. In June 2012, Russian Gazprom had 37.3% of Eesti Gaas shares, which is the largest share.[68]According to changes in the natural gas legislation in Estonia, if the company does not sell their pipelines by 2015 it should pay sanctions, about 1.2 million Euros per year.[69]There is a similar situation in Latvia and Lithuania. In Latvia, according to the agreement on Latvias Gaze, privatization only the shareholders can make a decision to sell the infrastructure. If the terms of the agreement are violated Gazprom can bring an action against the Latvian government. To diversify the energy suppliers, the Baltic States need financial and legal assistance which they can receive

[65]Baltic Energy Market interconnection Plan 3rd progress report. June 2011. p. 8.

[66]Internal energy market: national legislation in 5 Member States is still not fully in line with EU rules. European Commission – Press release. 24.04.2013.

[67]Eugene 2012.

[68] The Baltic Times. 13.06.2012.

[69]Вардуль 2012.

from the European Union. The EU promises to support the Baltic Sea countries in Court when they protect their interests for example in the cases against Gazprom.

The European Union is interested in the Baltic States' integration into the Internal Energy Market because the Internal Energy Market will work only if all the members are integrated. To be part of the Internal Energy System the Baltic States should adopt the new energy legislation and follow the common energy policy of the EU. Currently, the energy grids of Latvia, Lithuania and Estonia are isolated from the Internal Energy Market of the EU. The Baltic States depend on the external energy supplies. On the one hand the Baltic countries cannot enjoy the benefits of EU membership in the sphere of energy. On the other hand, the dependence on third countries for energy has negative impact on relations between the EU and external energy suppliers. The European Commission would like to integrate the Baltic States as fast as possible to achieve its goals in the sphere of energy.

4. THE ENERGY POLICY OF THE BALTIC STATES

4.1 The First Steps of Energy Integration for the Baltic States

The first attempt to establish the united energy market in the Baltic Sea region was undertaken in May 1998 by the Baltic Ring Electricity Cooperation Committee establishment. The members of the committee were Belarus, Germany, Denmark, Latvia, Lithuania, Norway, Poland, Russia, Finland, Sweden, and Estonia[70] The goal of the states was to create the Baltic Ring, which would promote cooperation in the energy sphere. In 2001, an agreement was signed between energy companies in Belarus, the Russian Federation, Estonia, Latvia and Lithuania concerning electricity interconnection of their electricity systems. The Baltic States together with Russia and ISC (without Armenia and Turkmenistan) were included into the IPS/UPS synchronous area. At the Russia – EU summit in 2001, Russian President Putin and Chairman of the European Commission decided to join the electricity networks of Russia and Europe: IPS/UPS and UCTE synchronic areas.[71]

The three Baltic States mostly use energy from external sources. It was in 1999 when Latvia, Lithuania and Estonia set a goal in the Baltic energy strategy to decrease their dependence on external energy resources. The other reason for energy reorganization was the joining of the three Baltic States to the European Union. In Estonia, renovation of the energy sphere began in 1998, while in Latvia and Estonia it began later in 2001. In Latvia, the energy company of Latvenergo possesses a monopoly in the energy sphere. In 2004, 95% of its energy was regulated by the state. According to the energy law in Estonia only 51% of shares can belong to the state. However, in practicality, in 2004 pro state Eesti Energia controlled 98% of power in the country. Private capital has essential meaning only in the sphere of energy distribution. In Lithuania, the energy company of Lietuvos Energija and Ignalina nuclear power station was under the state control. In 2002, break down of the monopoly in the country began. The energy reforms in the Baltic States before joining the EU covered: introduction of divided financial accounting, development of private sector, limited privatization (besides Latvia).[72] However, all these arrangements did not lead to the restriction of state influence on energy system; it was just an attempt to satisfy minimum requirements of the EU.

Ascension to the EU has a particular meaning for the energy systems of the Baltic States. The EU requires closing the Ignalina power station, the source of cheap energy for Lithuania and the other Baltic States. The principles of energy security, diversification of energy resources, and integration to the EU energy market were on the agenda of the three Baltic States since their

[70] Зверев 2010.

[71] Проект объединения энергосистем ЕЭС/ОЭС и UCTE, 24.02.2013.

[72] Шульга 2005.

entrance to the EU. The closure of the Ignalina nuclear power station should speed up the integration process.[73]

After joining the EU there was a need to expand energy cooperation and implement its energy requirements. In 2005, the treaty on the construction of the electricity connector linking Finland and the three Baltic States, EstLink, was signed. This cable was launched in 2006. The same year, reconstruction of the Riga heat electric generation plan started. It was an essential investment project for the region. The main energy companies of Latvia, Lithuania and Estonia created an organization of electricity cooperation by the name of the BALTSO. There were a lot of treaties between energy companies of Latvia, Lithuania and Estonia concerning cooperation of the electricity systems of the countries. In 2006, Latvenergo became the first member of the Scandinavian energy exchange, Nord Pool Spot AS. In 2007, the free electricity market for all consumers was opened in Latvia, while Latvenegro started to establish its sub companies in the other Baltic States to promote energy interconnection.[74]

After the USSR had collapsed, the Baltic countries started to reconstruct their energy systems. The states cooperated with both Russia and the EU. Latvia, Lithuania and Estonia signed energy agreements with Russia and reformed their energy market in accordance with the requirements of the EU. This energy policy let the Baltic States buy cheap energy resources in Russia and join the EU at the same time.

4.2 The Energy Sector of the Baltic States

The closure of the Ignalina Nuclear power station in 2009 influenced the energy situation in Lithuania and in the Baltic Sea region as a whole. These circumstances have led to the rise in the import of other energy resources and increased energy dependence on Russia. The Russian Federation is the only external supplier of gas to Lithuania. From 2009 to 2010, the import of energy resources in the country increased from 4% to 56%. In 2011 the situation in the energy sector of Lithuania was even worse.[75] Currently, Lithuania imports 80% of its power needs. Lithuania plans to construct a new power station to solve its energy problems.

The electricity system is controlled by the main companies: INTER RAO Lietuva UAB and Lietuvos Energija AB. Since 2012, the main performer in the sphere of electricity in Lithuania has been the Nord Pool Spot. Electricity operation in Estonia operates in accordance with the rules of Nord Pool Spot.

[73] ЮРгис 2010.

[74] Gaismas Gadi 2013.

[75] Dudzinska 2012, p. 2.

Today in Lithuania natural gas is one of the most important resources of energy and its use increased by 0.77 million cubit meters from 2009 to 2011. However, the Lithuanian gas system is not integrated into the united energy system of the EU. It has only one link with Latvia (Kiemenai). Natural gas goes to Lithuania from Russia through Belarus. The gas operator in Lithuania is Lietuvos Dujos with the main part of shares of the company owned by Gazprom, E.On and Lithuanian Government.[76] Finally, Lithuania adopted the Third energy package of the EU in the gas sphere. It means that Gazprom cannot be a gas supplier and shareholder of the Lituvos Dujos since simultaneously.

In June 2012, Nord Pool Spot began operating in the country. Today it plays an essential role in the electricity system of Lithiania. One of the goals of Lithuania is Baltic regional electricity market construction. The NordBalt interconnections to Poland and Sweden should be established. In the gas sphere there are two main projects: construction of the Lithuanian-Polish and Latvian-Lithuanian interconnectors. The other project is LNG terminal implementation. There is a conflict of interests because each Baltic State wants to build the terminal on its territory. Lithuania as a shareholder of the Nord Pool Spot now has the right to take part in the Internal energy market construction. The problem is that electricity connections on the border of Latvia and Estonia are not very developed so it is difficult to get access to cheaper Estonian gas. energy.[77] Lithuania has to choose between Russian, Polish and Scandinavian energy systems which have different prices. Litgrid Stalunis, a Lithuanian electricity operator, mentioned that energy prices in the Scandinavian electricity market should be a reference point for the Baltic States. However, in reality it is difficult to estimate which factor would be determinative.

Priority in the energy structure of Latvia is given to renewable energy resources. That makes Latvia one of the most "green" countries in the EU. In 2010, renewable energy covered 34.6% of energy consumption inside Latvia. In Latvia natural gas is an important source of energy while it continues to grow annually. In 2010, the share of gas in the energy system of the country was 32.2%.[78] After the closing of the Ignalina power station, Latvia has become the most gas-dependent state of the Baltic States. However, the situation with gas suppliers is still rather stable there. Currently, there is no nuclear electricity generation in the country. The essential part in the energy system belongs to oil and petroleum usage. Latvijas Gaze is the natural gas operator in Latvia. Its major shareholders are Gazprom (34%) and E.ON. In 2011, all the gas consumption in Latvia ensured import from Russia. The gas system of Latvia is isolated from the EU. The goal is the integration of the region into the internal energy market of the EU. The most important aspect of

[76]Country report: Lithuania, Energy Markets in the EU in 2011, 2012. p.107.

[77]Сапеткайте 2013.

[78]Country report: Latvia, Energy Markets in the EU in 2011 2012, p. 103.

integration is construction of a LNG terminal. Inčukalns underground gas storage plays an essential part in the energy system of the country. There are several trade companies in the electricity sector of Latvia and the operator is JSC Augstsprieguma.

The main electricity producer in Latvia is Latvenergo, which generated 72% of energy in 2012.[79] One quarter of electricity in Latvia was imported and the other part was produced in the country. There were no stable prices, since prices were regulated by bilateral agreements. In the sphere of electricity Latvia has links with Russia, Belarus, Estonia and Lithuania. This energy cooperation is regulated by BRELL ring agreement. Today the European Commission conducts negotiations with Russia and Belarus concerning this electricity cooperation in the Baltic States. If the BalticConnector pipeline, linking Estonia and Finland is constructed, gas from Latvia could go to Estonia and Finland. State energy company of Latvia, Latvenergo Linkevich noted that Latvia considers the possibility of coal-steam plant construction or hydro-electric power station reconstruction if Visagina power plant project would be frozen. According to Linkevich Latvia is aimed at building a liberal energy market by 2016 and decreasing energy dependence on third countries by 50 % in 2030.[80]

Estonia is the smallest country of the Baltic States. Solid fuels are the main source of electricity and heat in Estonia. It covers about 64% of consumption in the country. Estonia holds one of the first places in the world in oil shale production. In 2011 production of renewable sources in Estonia energy system was 24.3%.

The central electricity TSO in the country is Elering AS, while the main producer of electricity in Estonia is Easti Energia. In 2010, 89% of produced electricity in the country was produced by this company.[81] In this regard the Nord Pool Tallinn power exchange was established to diversify the sources of electricity in the country. The main gas company in Estonia is AS Eesti Gaas. An essential part of its shares are owned by Russian Gazprom, the main gas supplier in Estonia. Currently, Estonia has links in its gas sector with only two neighbors: Russia and Latvia. There is no competition between companies in the country and that is why it is difficult to control gas prices. From 2010 to 2011, Russian gas prices rose by 6.8%. There is a contract with Russia on gas delivery until 2015 and Estonia is going to prolong it. The country covers its own main energy demand itself and exports electricity to Latvia and Lithuania. Over the last few years export of electricity in Estonia has increased by more than 20%. The problem is that using solid fuels pollutes the environment. In this regard the country tries to increase its use of renewable sources of energy. In 2011, 12.7 % of electricity in Estonia was produced from renewable sources of energy. Demand

[79] Economic development of Latvia Report // Ministry of economic republic of Latvia 2012, p. 101.

[80] Сапеткайте 2013.

[81] Country report: Estonia, Energy Markets in the EU in 2011, 2012. p.77.

for natural gas in Estonia is rather low compared to Latvia and Lithuania. Estonia plans to develop its gas network and at the same time explore new sources of supplies. K. Kukk, representative of the electricity operator Elering notes that construction of the Baltic States energy market limits the possibility of using energy resources as a political tool.

In the electricity system Estonia has links with the EU. The country cooperates with the EU members by the EstLink and Nord Pool Spot. Thus Estonia can develop electricity trade with the EU and control energy prices. However, the electricity infrastructure should be extended to provide free energy trade. Such projects like EstLink 2 connecting Estonia, Finland and the third line Est-Lat are being implementing now. EstLink 2 should be launched in 2014 and the third line of Est-Lat in 2020.

In the sphere of gas, Estonia should extend its energy links with other EU members. The EU has an aim to integrate Estonia into the internal gas market of the EU. The plans of interconnection include the construction of a LNG terminal and pipelines to link Estonia with Poland. However, Estonia needs a great amount of investment to implement these projects.

The energy systems of the Baltic States have strong links with the Russian energy system: Russia is the lead energy supplier (Appendix 1) and the Russian Gazprom partly regulates the Baltic States' energy companies. The Baltic States have lack of energy connectors with the rest of the EU and the energy systems are separated from each other. Currently, Latvia, Lithuania and Estonia do not have enough capabilities to be integrated into the Internal Energy Market of the EU. There is a need to construct the energy infrastructure in the region and diversify their sources of energy supplies.

4.3 The Plan of the Baltic Sea States Integration into the Internal Energy Market of the EU

4.3.1 The Main Aspects of the Baltic Energy Market Interconnection Plan

The Baltic energy market interconnection plan was accepted by the Baltic States' governments in June 2009. This project was initiated by the European Commission and the goal of the project is the Baltic States' integration into the Single energy system of the EU to put an end to the energy isolation of the Baltic Sea States. The European Commission together with Latvia, Lithuania and Estonia decided to improve the energy security situation in the Baltic Sea Region. The plan comprises a lot of actions and projects to include this energy isolated island in the united EU system. The author of the idea of a Baltic energy market interconnection plan was President

Barroso. The main areas of the BEMIP are electricity market integration, electricity interconnections and generation and gas internal market and infrastructure.

It is impossible to construct Internal Energy Market of the EU without Baltic States integration into the single system. This plan should attract investment into the region and control the development of infrastructure. The other goal is the implementation of energy trade and natural resources conservation. The project should help to regulate energy communication between the Baltic States and the non-EU countries as well as help to follow the Third energy package of the EU. The plan mainly includes infrastructure projects in the sphere of gas and electricity which should be realized in the region to achieve full energy integration.

The goal of Latvia, Lithuania and Estonia is the diversification of its energy supplies. Today, the countries together with the EU work to achieve that goal. In October 2008, the High Level Group was created which should work on creating an Internal Baltic Sea energy market and integration of the Baltic Sea States to the Internal EU energy system. The members of the Group are Finland, Estonia, Latvia, Lithuania, Poland, Germany, Denmark, and Sweden, with Norway being an observer. The Integrated Baltic Sea energy market is an energy market for the Baltic Sea Countries. The aim of its creation is the integration of the states into the EU energy system and assurance of EU energy legislation implementation, especially in the case of trade with third countries. The European Commission should regulate the implementation of the plan and the activity of the High Level Group. The project of the realization of the strategy is the Baltic Energy Market Interconnection Plan.

The BEMIP includes several energy projects which are also in the European Economic Recovery Programme.[82] This means that the Baltic States should receive additional assistance. The assistance should be approximately half a billion Euros. As with the other financial sources the EC defines the cohesion fund, TEN-E programme and others. Now the goal is to implement the Action Plan for the Baltic States. This plan should help to implement the EU energy market rules in the Baltic States and provide fair competition in the EU energy market.[83] According to the joint Declaration which the Prime Ministers of Latvia, Lithuania and Estonia signed in Vilnius on April 27th, the countries should assure open market and promote integration in the electricity area.

4.3.2. The Energy Projects of the BEMIP

[82] The Baltic Sea Region States reach agreement on the Baltic Energy Market Interconnection Plan. 17 June. 2009.

[83]Memorandum of understanding on the Baltic Energy Market Interconnection Plan. June 17. 2009.

The spheres of the BEMIP operation are the electricity and gas energy systems of the Baltic States.

In the sphere of electricity the three Baltic States should be integrated into the Nordic electricity market model and operate in accordance with the EU rules. The TSO should be separated.

The electricity infrastructure plan consists of three sets of projects. The first is the Nordic master plan which includes the interconnection of the Nordic countries. The other project covers links between Poland and Germany. The last is about cooperation of the Baltic area with the Nordic countries, as well as Poland. The electricity link projects in the field are NordBalt or SwedLit between Sweden and Lithuania, EstLink – 2, connecting Estonia and Finland and LitPol linking Poland and Lithuania. The other goal is the reconstruction of the electricity grid in Latvia. These projects are aimed at strengthening the electricity network in the Baltic Sea Region.

The gas sector projects include the diversification of sources and suppliers. The projects on gas cover the development of gas storages and the implementation of the reverse flow. Today, the three Baltic countries depend on one source of gas supplies. This project should help in diversifying gas suppliers and developing new gas routes.[84] All these measures will contribute to the energy integration of the region into the internal energy market of the EU. In the sphere of gas Baltic Pipeline and pipelines connecting Latvia and Lithuania should be constructed. In the gas system of the Baltic States the most important projects deal with the construction of infrastructure in the East Baltic Sea region. Special attention is given to the EU – Russia energy dialogue. The most important projects in the Baltic States are the Polish – Lithuanian gas interconnection, BalticConnector (Estonia – Finland), and a LNG terminal.

First of all there is a need to create a common energy market between the Baltic Sea States and the Nordic Countries. The Baltic Member States should correspond to the Nordic energy market and to the EU Directive 2003/54/EC.

In February 2011, the European Council concluded that after the year of 2015 all the EU states should be connected to the European gas and electricity networks and have implemented the legislation of the energy market. The 4th progress report of the Baltic energy market interconnection plan, signed in May 2012, emphasizes that the internal market is the main priority. Special emphasis is given to wind generation. The Agreement on the regulation of the electricity system in the region between Russia, Belarus and the EU has been signed. Special focus in the document is given to the

[84]Communication from the commission to the European Parliament, the council, the European economic and social committee and the committee of the regions. Making the internal energy market work {COM(2012) 663 final. {SWD(2012) 368 final} 15.11.2012. p. 5.

plan of constructing two electricity interconnections, which will link the Baltic Sea region and the Scandinavian Peninsula.[85]

The infrastructure projects should be introduced in the gas system. Today new gas projects are GIPL connecting Poland-Lithuania and the BalticConnector between Finland and Estonia. But there is a need for investments to develop the system.

The European Energy Programme for recovery includes such projects as EstLink2, NordBalt and the development of the Latvian network in the field of electricity. Gas projects such as the gas network consolidation in Denmark and Poland, and the development of the Swinoujscie LNG terminal reverse flows between Lithuania, Latvia and Poland.[86]

The main priority in energy integration in the Baltic Sea region is given to electricity and gas integration. Energy integration consists of four steps. The first step is the adoption of political and business decisions on electricity integration. Political decisions include agreement on electricity integration and the cancellation of regulated tariffs for eligible customers in Latvia and Estonia. Business plans involve the run-up to the opening of the EstLink price area, and the regulation of actions of EstLink shareholders. First step projects have already been implemented.

The second step represents the implementation of demands for opening the market. These demands are the implementation of transparency rules (NordPool rules), the unification of Latvian, Lithuanian and Estonian in the electricity sphere following the common energy policy concerning Russian and Belarus TSO's, joint ITC treatment of the border countries for the Baltic States and Finland, rejection of license and tariff in Latvia, Lithuania and Estonia, and the establishment of the Nord Pool Spot price area for EstLink. In 2010, the Nord Pool Spot price area for EstLink was established. Latvia and Estonia joined the Nord Pool Spot and the relevant rules were taken into consideration. The other aspect was the detachment of TSO activities. This project is still being worked on.

Step three begins the process of market functioning. According to this project, the three Baltic States and Finland should follow the joint position towards third-party states. It is important to keep the balance of prices and establish an intraday market. The Baltic States should follow basic transparency rules according to the Northern European electricity regional initiative. The plan should be finished by the end of 2013. Implementation of the third step deals with the realization of the Third package of the EU, which includes the separation of TSOs. Latvia and Lithuania accepted all conditions of the Third package concerning electricity market by May 2012. Estonia adopted only part of the third package rules. The fourth step suggests full market integration; the electricity

[85]Baltic Energy Interconnection Plan, Progress Report. June 2012. p. 4.

[86]European Energy Programme for recovery (EEPR), Baltic Energy Interconnection Plan. Progress Report. June 2012. p. 5.

market should be open for retail trade, common rules for trade in the Nordic and Baltic area should be implemented and construction in place for financial products.[87]

The Baltic States electricity system has strong links with the energy systems of Russia (especially the Kaliningrad region) and Belarus. Norway and the Ukraine also deal with the Baltic Sea electricity system. The Baltic Sea region with the surrounding states is known as the extended Baltic Region. The problem is the determination of the status of the Baltic Sea Region electricity market, estimation of abidance to EC directive 2003/54/EC and the regulation of financial aspects. The interconnection of the Russian Federation and the Republic of Belarus on the one hand and Latvia, Lithuania and Estonia on the other is based on the BRELL agreement. This is the main problem for the Baltic States integration. There is misunderstanding between one side and the other and negotiations on this issue are still not constructive. According to the plan, energy integration should be finished by the end of 2015. The electricity market in Latvia, Lithuania and Estonia has specific structure and a different level of market opening. In Estonia Esti Energia is the main electricity company. The production capacity of the company is 97%. Therefore there are no independent suppliers in the Estonian electricity market. In 2009, the opening of the energy market in Estonia was 35%, but the market opening project should be completed by 2013. In Latvia the electricity market is free from any restrictions. The electricity market in Lithuania operates according to the directive 2003/54/EC. This directive contains some general rules for the electricity market for the EU member states. Latvia, Lithuania and Estonia have the lowest electricity prices among the members of the EU in the Baltic Sea region. These regulations provide free access to the electricity system for producers and consumers; customers should have a right to choose their electricity supplier, any important information in the sphere should be publicly available, and liquidity of the market should be implemented. In the document concerning electricity market integration in the Baltic Sea region it is mentioned that in the Belarus and Kaliningrad region there are no free electricity markets.[88]

An important nuclear project in the region is the construction of the Visagina power station in Lithuania. The Baltic States are interested in its realization. In 2010 the High Level Task Force on "Nuclear Power Generation" (HLTF) was established to assist in the realization of the project. The HLTF should also help with financial problems. EU Financing of the Visaginas power plant is very important as it can support promotion of the project.

[87]Electricity Market integration // Baltic Energy Interconnection Plan. Progress Report. June 2012. pp. 10-11.

[88] Electric Markets Description, Report CEIC A9017215, pp. 4-5.

Latvia and Lithuania adopted the Gas Directive of the Third Package of the EU. Estonia has not accepted the provision of the Energy Package Directive, as it has its own Gas Law. The common goal is to search additional sources of gas.

The European Commission presents a number of recommendations for the Baltic States. According to these recommendations Estonia should finish construction of Estlink2 and connect its electricity sector with the Finnish electricity sector. Latvia has strong links with Russian and Belorussian electricity grits and it is necessary for the country to get electricity from Finland, Sweden and Poland. Lithuania needs to link its electricity network with Sweden and Poland with the interconnections of the electricity grids should be finished by 2016. Essential part of recommendations is devoted to security of energy supplies. One of the steps to achieve this goal is the construction of additional LNG terminal.[89]

4.3.2. Implementation of the Projects in the Baltic States

Almost all of the energy projects in the Baltic Sea Region are long-term and complicated. All these problems can lead to delaying the project or its closing. To understand the implementation of the Action Plan and define the construction of the infrastructure, it is important to research the Progress reports of the BEMIP.

Some projects started being realized in 2009. The Baltic States began integration of the electricity market. In 2010, great success in the open price area construction was achieved. The TSO started separating from the owners of the companies. The shareholders of the Estlink1 achieved an agreement on the capacity purchase change. Nord Pool Spot started operating in Estonia and in Lithuania. Restrictions regulating prices is processing in Lithuania and Estonia. In the sphere of electricity the progress is more visible. The plans are being implemented and the projects realized. The electricity market integration should be completed by 2015. The third energy package in the sphere of electricity was fully accepted by Latvia and Lithuanian and partly in Estonia.

In the sphere of electricity the project LitPolLink was at the preparation stage in 2009 and it should be finished in accordance with the initial plan by 2015. In 2012 it was still at the preparatory stage.

Other grids linking Lithuania and Poland Alytus-Kruonis is on the preliminary stage and should be constructed in 2015. In 2012 it is noted in the progress report that the documents concerning the project are completed and territory preparation is finished. Realization of the project

[89] Country specific recommendations, Electricity Market integration, Baltic Energy Interconnection Plan, Progress Report, June 2012, p. 29

is still in process. The project for the grid connecting Visagina and Kruonis is still under discussion. In 2012 it was reported that development of the project depended on the Visagina power station construction.

The EU plans to build the first NordBalt network between Klaipeda and Telsiai in 2013. However, in 2012, the landowners did not reach an agreement on the legislation and therefore the project realization was postponed till 2014. NordBalt should be fully constructed in 2015. The Latvian grid should be reconstructed at the period of 2012 – 2016. In 2010, the time frame was 2012 – 2018. In the fourth report it is pointed that the problem of realization is lack of financing. Estlink2's construction began in 2009 and should be completed in 2014. In 2010, some steps were undertaken. An issue concerning investment was solved and environmental studies were finished. The project is being realized in accordance with the plan and should be finished on time.

In the sphere of nuclear power the most important project in the Eastern Part of the Baltic Sea Region is the Visagina power plant. In the first progress report it is noted that the nuclear plant will be constructed in 2018. In the second project it is noted that there is a lack of investment. In 2012, the project was delayed until 2020-2022. The Visagina power plant is an unsuccessful example of the Action Plan realization. The referendum on it has shown that this station is not a reliable energy source in the region and the project realization is questionable. The EC pointed that it was necessary to negotiate with regional partners concerning the project.

All the wind energy projects should be implemented in 2020. Latvia, Lithuania and Estonia are attempting to increase wind capacity and a project is being implemented.

The third energy package in the sphere of gas has been accepted by Latvia and Lithuania. In the progress report concerning gas infrastructure there is no concrete dates when the projects should be realized. Polish-Lithuanian gas interconnection in 2009 was discussed at the meetings. The meeting showed small interest of the participants in the project. There was a possibility of Latvian inclusion in the project. The BalticConnector project in 2009 was under research and a decision concerning its implementation was not made. There was no certain decision regarding the LNG terminal construction, which should be discussed. The EU estimated the Baltic States' energy market is too small for such a terminal and each of the three countries in the region would like to build it on its territory. In the fourth progress report it is pointed that all the three Baltic States should support the LNG terminal and it should be a big regional project. There is also a financial problem. The countries should determine shortly the location where the terminal will be situated. If the Baltic States do not achieve an agreement the project will be not invested by the EU.[90]

[90] Final project report // Analysis of costs and benefits of regional liquefied natural gas solution in the East Baltic Area, including proposal for location options under the Baltic Energy Market interconnection Plan. 20.11.2012. p. 18.

However, all these gas infrastructure projects were estimated by the Commission as priority projects.

Other obstacles in the realization of the Baltic Sea energy strategy are the fragmentation of electricity markets, difficulties in gaining access to the electricity power stations in the region and different electricity standards. The main problem for the Baltic States is a rise in prices. Absence of energy interdependence of the Baltic States is especially noticeable in the case of gas trade. There is a deficiency in the number of gas pipelines connecting Latvia, Lithuania and Estonia. The BEMIP should help to overcome these problems. However, some points of the plan have already been changed especially in terms of several projects' realization.

The Kaliningrad region and Russia in general are not included in the BEMIP. However, for the most part, the main energy supplier is Russia. It should be mentioned that some provisions concerning Russian energy supplies are not negotiated. The Russian aspect is defined in the progress report as an obstacle on some project realization, especially projects dealing with electricity and nuclear power**.** The Baltic States have strong links with Russian and Belarusian electricity systems. In the sphere of nuclear energy, Russia has constructed the power station to export energy to the EU. The Third Legislative Package has aggravated the situation. The three Baltic Sea States in many cases try to solve the problem of integration into the internal energy market separately. The most favorable situation in the energy sphere is in the Southern and Western parts of the Baltic Sea Region.[91]

The chief executive of the Latvian Institute of International Relations Andris Spruds notes that there is a risk from the Russian side. First of all, the Baltic energy market is monopolized and there is a platform for manipulation. However, at the same time he estimates Russia as an important energy partner for the Baltic States.[92]

[91] Энергетическая стратегия ЕС в Балтийском регионе, 23.01.2013.

[92] Амелюшкин 2013.

5. THE RUSSIAN FACTOR IN THE BALTIC STATES' INTEGRATION INTO THE INTERNAL ENERGY MARKET

5.1. Energy Partnership between Russia and the Baltic States

Cooperation in the sphere of energy is very important for Russia and the Baltic States. After the USSR collapsed, around 90% of Russian energy terminals on the Baltic Sea remained in the Baltic States. Russian ports on the Baltic Sea were not able to transit oil fuel so Russia became dependent on the Baltic States as transit countries. However, tariffs on the transit of energy resources were rather high and relationships between Latvia, Lithuania, Estonia with Russia were difficult. In many cases, such relations were a result of the soviet history. Russia decided to reconstruct its own infrastructure and transport oil through the Russian ports on the Baltic Sea. The first branch of the Baltic pipeline system, Yaroslavl-Kirishi-Primorsk, was launched in 2001. The third and the last part started to operate in 2006. From 2003 to 2007, the transit of energy resources through the Russian port of Primorsk increased by 53.2 million tons while the Baltic States' ports decreased by 17.6 million tons.[93] Nevertheless, the Baltic direction is important for Russian export. 20% of Russian oil exports are transported through the Baltic Sea Area.[94] The role of the Baltic Region as transit a territory is increasing. The Baltic Region is essential for transit of energy resources from Russia to the EU.

Later the northern part of the Druzba pipeline went through the Baltic States but due to the emergency in 2006 the northern part of the pipeline was closed and oil did not go to the Baltic States through Druzba.

Russia is an important investor in the economy of the Baltic States. For example Russia has invested in big energy companies like Latvijas Gaze and Lukoil Baltija. Usually foreign investors consider Latvia, Lithuania and Estonia as one region and invest in all the three countries simultaneously.[95] But the Baltic States are skeptical to investors like these, especially in the sphere of transit and trade.

In 2009, Ignalina power station was completely closed. The closure of the station was a great loss for the Baltic States. Lithuania decided to construct a new power station called Visagina. The final solution concerning the construction of the Visagina power station has not been adopted yet. Vydas Gedvilas, Chairman of Lithuanian Parliament noted that the country did not plan to build the new power station. According to Gedvilas, this project is not profitable for the country. Prime Minister of Lithuania, Algirdas Butkevičius pointed out that Lithuania should develop renewable

[93] Зверев 2010, стр. 2.

[94] Межевич 2007, стр. 119.

[95] Павук 2012.

sources of energy and that the country would not construct the power plant. [96] In 2009, Lithuania signed a 10-year electricity supply agreement with Russia. The supplier is Inter RAO Unified Energy System of Russia, while the main shareholder of the company is Rosatom. The country should receive 2,5 kilowatt an hour. In 2011, Lithuania together with Finland was the main importer of electricity from Russia. The export to Lithuania marks 24.4 % of all imported electricity.[97]

In 2009, Putin signed an agreement on the Baltic power station construction. The station will be situated in Kaliningrad region. The Baltic power plant is aimed at supplying not just Russia but the Baltic States, Poland and Germany as well. The first unit will start operating in 2016-2017. The former president of Lithuania, Algirdas Mykolas Brazauskas noted that the country should participate in this project. However, at the same time the country is cautious toward the project. Lithuania claims that the project is not open and is not secure enough. The Chairman of the committee of natural resources Valerij Yasev emphasizes that Russia acted in accordance with the Espoo convention although not being a member of it. Germany, Poland, Denmark, Norway, Sweden, Finland, Estonia, Latvia and Belarus agree with the project. Yasev notes the Lithuania has received the documents including the reasons of the region's choice and the results of seismology research but the country does not want to negotiate with the Russian government and discuss the problems.[98]

The main aspect of gas cooperation between Russia and the Baltic Sea states is to guarantee security of gas supplies. The gas market of the Baltic States is monopolized by the main Russian energy company.[99] In 2009, Gazprom increased gas prices for the former USSR states including the Baltic States by 17%. It was a strategy of transition to the contract system of payment like in other European countries.[100] This policy was caused by the Baltic States joining the EU. In 2012, gas supplies to the Baltic countries and the CIS decreased by 9.4% and amounted to 64.42 cubic meters.[101] However, it is expected that in 2013 Gazprom will increase its supplies to the Baltic States and ISC by 15.7%. Cooperation in the sphere of gas is developing. There is an agreement on the gas supplies to Latvia until 2030 but Russia promised to decrease the prices by 15%.

[96] REGNUM Belarus. 21.11.2012.

[97] Анализ итоговой деятельности электроэнергетики за 2011 год, прогноз на 2012 год // министерство энергетики Российской Федерации. 2012. стр. 25.

[98] Пресс-центр атомной энергетики и промышленности.14.03.2013.

[99]Kisel 2008 – 2009, p. 62.

[100] СНГ и Балтия , 1.03.2013.

[101] Вести, 20.04.2013.

AndrisSpruds, the Latvian political scientist notes that Latvia has energy links and pipelines with Russia and there is no other infrastructure to diversify the gas sector in the country.[102]

In the sphere of gas the Baltic States are important transit countries for Russian gas. Natural gas goes from Lithuania and Latvia to the Kalinigrad region. However, sometimes the Baltic States are not reliable energy partners. In 2005, Lithuania threatened to close the supply of gas to the Kaliningrad region if Russia increased gas prices. Now Russia plans to construct an additional part of the Nord Stream pipeline to Kaliningrad region to prevent such risks. It should be mentioned that the Kalinigrad region is a member of the Baltic Ring and this joint energy system is reliable.[103]

A successful example of cooperation between the Baltic Sea states and Russia was a project on interworking the energy systems of the countries in a synchronous operation. Currently, these energy systems are working together, constructing united energy area. This project is aimed at developing transportation routes, supplies of energy resources and supplies of natural gas from Russia to the Baltic States.[104]

In energy relations between Russia and Lithuania, the most important problem is natural gas prices. Lithuania wants to diversify energy suppliers and escape energy dependence on Russia. Indeed, Lithuania pays one of the highest prices for gas in Europe. Russia is the only source of their natural gas imports. There is an opinion that such high prices are a Russian reaction to the unfriendly policies of Lithuania or adoption of the Third energy package which is unfavorable for Russia. According to the rules, Gazprom cannot own shares of Lituvos Dujos. The real cause of high prices is an agreement on gas supplies which the Lithuanian government has signed with Gazprom. This agreement contains a clear explanation of the gas price assessment. Russian Gazprom invests a lot of money to Lituvos Dujos. Now, it is not quite clear how Lithuania can buy the shares of its energy company from Gazprom. In February 2013 the conditions concerning Lituvos Dujos' division was confirmed. Lituvos Dujos will be a gas supplier and the new company will regulate the transit of natural gas and own the pipelines.[105] By increasing the prices, Russia wants Lithuania to change its unfriendly energy policy towards them. If Lithuania is not able to buy Russian energy resources due to the high prices the country will likely negotiate with Russia and fulfill Russian conditions.

Lithuania intends to construct a LNG Terminal to diversify its gas suppliers but it might be too expensive for its economy. The terminal will rent ship-to-store from Norway while Lithuania will pay the rent for it about 60 million dollars a year. The other problem is the source of liquefied

[102] Амелюшкин 2013.

[103] NewsBalt, 02.11.2012.

[104] Министерство энергетики Российской Федерации, 25.03.2013.

[105] News TTS LT, 1.03. 2013.

natural gas and its transportation. Thus it is questionable that gas from the other sources will be cheaper than Russian gas.

In 2010, Estonia signed a law that energy prices should be regulated by the state only. This law limits energy supplies from Russia and increases control of the energy suppliers. Russian Gazprom is the main shareholder of the Estonian energy company Eesti Gaas. The Parliament of the country wants to separate gas routes from the company by 2015 which will lead to competition in the energy market.[106] Estonia also hopes that the new LTG terminal will be a reliable source of gas and an alternative to Russian gas. However, in the country there are worries that Russia will hinder the construction of the terminal, or buy it if it is situated in Latvia.

The head of the department for the Baltic States and its research and information center of Moscow State University S. Rekeda mentioned that energy cooperation was the most important issue in the relations between Russia and Latvia, Lithuania and Estonia. Problems in the energy cooperation influence political relations with the EU. The other problem is the energy plans of the Baltic States which can be dangerous for the energy dependent economy.[107]The energy partnership of the Baltic States and Russia has a political impact. Russia as well as the three Baltic countries uses different instruments to influence the energy policy of their partners. Russia builds energy infrastructure to consolidate its influence in the region and increases energy prices to force the Baltic States to agree with the Russian terms in the sphere of energy. The Baltic States intend to leave the unified power system of Russia and join the EU energy system in response.

5.2. Russian Reaction towards the Baltic States' Integration into the Internal Energy Market of the EU

Latvian, Lithuanian and Estonian electricity systems historically operate jointly with the electricity systems of Belarus and Russia. This cooperation is based on the BRELL ring agreement. The exit of the Baltic States from the current electricity system and its transition into the European system will cause major problems in the functioning of these electricity systems. The Minister of Energy of the Russian Federation, A. Novak criticizes the decision of the Baltic States to exit the IPS/UPS synchronic system and join the European electricity system. He mentions that if Latvia, Lithuania and Estonia exit the current energy synchronic system Russia and the Baltic States have to invest a lot of money to reconstruct the system to ensure energy security. Novak notes that the EU has violated its commitments on the issue and that the Baltic States should inform Russia 5-10 years beforehand.[108]

[106] REGNUM, 27.04.12.
[107]Павук Ольга, 19.03.2012.
[108] ИноТВ, 14.12.2012.

The Third energy package, ratified by the Baltic States, violates Gazprom's rights since Gazprom is one of the main shareholders of the Baltic States' energy companies. Such an energy policy will lead to the rise in gas prices and a negative reaction from Russia. The shareholders of Latvijas Gāze are against the third energy package because Latvijas Gāze should sell its transportation infrastructure. However, in compliance with the agreement on Latvijas Gāze privatization any decision concerning changes to the company's structure should be accepted by its shareholders. Gazprom owns 34% of the shares. The agreement concerning Latvias Gaze privatization was signed in 1997 and the agreement is in action until 2017. The head of the Gazprom in Latvia E. Roldugin reports that the energy company can increase gas prices and appeal to the court if Latvia follows the provisions of the third energy package before 2017. The head of Itera Latvija, Y. Savizkis reports that the lawsuit with Gazprom will cause an increase in prices. There is no official statement from Gazprom concerning gas prices because the issue is under discussion.[109] If Latvia deprives Gazprom of its right on gas storage, the Russian energy company will claim a refund of the money spent on the reconstruction.

Edgars Rinkēvičshas, the minister of foreign affairs of Latvia, emphasizes that it would be better to make an agreement with Gazprom without dealing with the court. Otherwise this situation will cause high central heating prices for the people of Latvia. There is an opinion that Gazprom will start formal construction of the open energy market and a newly established Russian energy company will buy the shares of Gazprom in the Baltic Sea energy companies. Consequently the requirements of the Third energy package will be followed. The president of the Estonian AS EG Vorguteenus reports that gas prices will increase by 2 to 3%.[110]

The most complicated situation with the adoption of the Third energy package is in Lithuania. Gazprom made a complaint against the Ministry of Energy of Lithuania because the shareholders' agreement on the energy company Lietuvos Dujos had been violated. The Russian energy company as a main shareholder and investor requires refunding the loss of money. However, in March 2011, Lithuania was the first to apply to the court. Lithuania demanded to stop the activity of the Lietuvos Dujos and dismiss some representatives of the management of Lietuvos Dujos. Lithuania claims that the management acts in the interests of Gazprom. The problem is that Gazprom decreases natural gas prices for Latvia and Estonia, but not for Lithuania.[111] In response, Gazprom filed to the arbitration committee in Stockholm because according to the agreement of the shareholders, all controversies should be considered in the Stockholm Arbitration Institute of the Stockholm Chamber of Commerce. But the court in Stockholm refused to block the proceedings at

[109] REGNUM, 15.10.2012.

[110] DzD.ee, 25.02.2013.

[111] Палов 2013.

court concerning the energy company Lietuvos Dujos. At the same time the judge mentioned that Gazprom would be able to win that lawsuit.[112]

In 2012, the court concluded that the actions of Lithuania were a partial violation of the rights of the Lietuvos Dujos' shareholders. In accordance with the decision of the Arbitration Court, Lithuania cannot apply to the courts trying to change the provisions of the agreement on transit and supplies of energy resources. But the government of Lithuania denoted that such decision of the Arbitration Court violated the rights of the government of Lithuania and restricted the right to apply to the court in accordance with the New York Convention. The government of Lithuania is not going to change the decision. In two years Russian Gazprom will not be able to own the shares of the energy company Lietuvos Dujos.

In the beginning of 2012, there were negotiations concerning the implementation of the Third energy package in Lietuvos Dujos. The main participants of the negotiation were the head of Gazprom, A. Medvedev, A. Kubilius, Prime Minister of Lithuanua, and the director of the EC of energy P. Law. They decided to make the list of problematic issues and created a "Road map". However these decisions were not realized.[113] Nevertheless, the head of Gazprom A. Medvedev hopes that the sides will be able to reach an agreement without applying to the court.

In March 2012, Gazprom appealed to the International Court of Arbitration UNCITRAL and pointed that Lithuania did not follow the investment treaty. Now the natural gas price in Lithuania is 11% more expensive than in Estonia and 20% more than in Latvia. For the rest of Europe natural gas from Russia is not as expensive as for Lithuania.[114] In January 2013, Alexander Medvedev visited Lithuania and negotiated with the Minister of Energy of Lithuania, Jaroslav Neverovich. According to unofficial data, Gazprom suggested that Lithuania should abandon the gas sector reforms and in response the Russian energy company would decrease gas prices. Besides this, the Russian side would like to reach an agreement with Lithuania on the long-term gas supplies and wants Lithuania to abandon a claim currently in the court.[115] However, Lithuanian Prime Minister Algirdas Butkevičius has declared that Lithuania would not make any concessions to Gazprom. Butkevičius added that the transit of Russian gas to Kalinigrad region went through Lithuania and that transit prices could be reviewed.

The Russian government is also concerned about the rules of the Third Legislative Package. President of Russia V. Putin called this energy policy of the EU "robbery". Prime Minister D. Medvedev emphasized that the EU energy legislation complicated relations between the consumer

[112] РБК. 13.08.2011.

[113]Кривошапко 1.03. 2012.

[114] Взгляд. Деловая газета, 1.03.2012.

[115] Росбалт, 1.02.2013.

and the supplier. The former Minister of Energy S. Shmatko declared that Russia might decide to oppose the Third energy package indicating that the agreements on energy supplies had been singed regardless of the new energy legislation.[116]

The head of the national energy security fund K. Simonov mentioned that Gazprom would not suffer from such a policy of the Baltic States, because Latvia, Lithuania and Estonia did not have any alternative energy supplier.[117] Gazprom declared that energy trade was carried out in accordance with the energy law of consumer rights. However, changes in the energy law of the EU influenced the agreements on energy supplies and activity of the company. Following the new energy legislation, Gazprom companies rejected the conditions of reselling Russian natural gas. Gazprom supports the development of the open energy market but emphasizes that gas should be sold on the basis of long-term agreements. The energy company hopes that the EU member states keep to the same opinion because long-term agreements make energy cooperation safer and more reliable. Gazprom invests money into different energy projects. That is why some provisions of the new legislation such as forbidding supply companies to own big energy projects, cause great concern. Gazprom points out that such a policy could lead to a funding gap and increase transportation costs. These circumstances can have a negative impact on the reliability of energy supplies.[118]

Russian economist and politician Vladimir Milov calls the actions of Gazprom self-defensive. Milov thinks that Gazprom will have to decrease gas prices. He estimates the reaction of Gazprom on the new energy policy of the Baltic States as one of panic. Putin signed an act enacting that Gazprom and other state companies cannot disclose information without permission from the state. This act should decrease opportunities for international companies to get a hold of confidential information because it would have a negative impact on Russian companies. V. Milov points out that the Russian Energy Company uses its primary position on the energy market to achieve its goals. But Gazprom should be more competitive. He emphasizes that Gazprom should modernize its energy policy by becoming more flexible. Energy prices are not stable and long-term treaties are not competitive today. According to the current situation, Gazprom has to change its agreements and regulate prices. Some states have tried to influence Gazprom policy judicially. For example, Poland managed to decrease its gas prices. Construction of an LNG terminal in one of the Baltic States will make Gazprom implement its policy in accordance with the new environment.[119]

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[116] Newsland, 11.01.12.

[117] Топалов А. 2012.

[118] Газпром в вопросах и ответах, 23.03.2013.

[119] *Delfi*.18.09.2012.

5.3. The Role of Gazprom in the Energy Market of the Baltic States Development

Gazprom is an important investor in the Baltic States energy system due to the fact that it is one of the biggest shareholders of the main energy companies in all three states. In the case of adopting of the new energy legislation the role of Gazprom should change. However, the Baltic States take the view that Gazprom is not going to lose its influence in its energy market and tries to use other mechanisms to remain an important energy player in the region.

Construction of a LNG terminal in the Baltic States is doubtful now. The European Commission does not want to invest in the project pointing out that first; all of the Baltic States should come to an agreement on the project and define where the terminal should be situated. There is an opinion that a sub-company of Gazprom will construct the LNG terminal in the Baltic States. The representative of the Parliament Committee of Estonia, Ceslovas Stankevicius noted that in this case Gazprom would be the owner of the terminal and the countries would not have an alternative gas supplier. The other problem is that the role of the terminal building will be gas export since it corresponds to Gazprom energy policy.

There is a disagreement between the Baltic States as to which country is the best to construct the terminal. Each country would like to build it on its territory. But the countries cannot construct the terminal using just their own resources. There is a need for investment. It has not been officially declared which company will be the main investor of the project. For example, in Latvia, the company of Itera Latvia is one of the possible investors and is interested in the project. Inter Latvia is a sub-company of Gazprom and a shareholder of Latvijas Gaze. The government of Latvia emphasizes that Latvia is the best place for the terminal. A well-developed gas pipeline network and the existence of gas storage can make gas transportation more efficient and cheaper. At the same time Latvia and Estonia does not want Gazprom to finance the project because they intend to achieve diversification of energy suppliers. The minister of economics of Latvia Pavluts mentioned that the goal of the LNG terminal construction was getting a new energy supplier in the region and that Latvia would support alternative suppliers.[120]

The alternative place of the LNG terminal situation was proposed by the Finnish company Gasum and Estonian company Vorguteenus. That place is the Finnish city of Inkoo. It should be mentioned that Gazprom is a shareholder of these two companies.

An important aspect of Russian-Lithuanian energy cooperation is their mutual reconstruction work on the Inčukalns Underground Gas storage. Gazprom has invested between 191 and 380 million Euros.[121]

[120] Телеграф. Новости Украины и мира, 22.02.2013.

[121] Информационный портал русской общины Латвии, 4.04.2013.

Since 2003, Gazprom has owned the Kaunas thermal electric power station. However, in March 2013, the Russian energy company sold its assets and the current owner is unknown. According to Gazprom, the company received small benefits from the station.

The Baltic States energy market is very attractive for the Russian investors. For example "Gazprom oil" plans to construct an oil production plant in Estonia. Eesti Päevaleht estimates the amount of the investments between 30 and 40 million Euros.[122]

Gazprom do not want to lose its energy consumers in the Baltic Sea region and continues invest energy projects in the Baltic States. Financing of the infrastructure projects in the three Baltic countries helps Gazprom to spread its influence in the region and conduct its energy policy.

[122] Postimees, 21.03.2013.

CONCLUSION

The EU wants to finish the construction of the Single Energy Market by 2014. This means that in a year the Baltic States should be fully integrated in the single energy system. Latvia, Lithuania and Estonia should accept the new energy legislation of the EU and follow the common European energy policy. To achieve these goals the countries should reconstruct their energy systems. The Baltic States integration has already been in process for a long time. The progress is visible but a lot of things should be done to complete the integration process. In the process of the reconstruction of the energy systems, the countries face a lot of problems.

The Baltic States decided to be a part of the EU at the end of 90s. The countries reformed their energy systems to correspond to the rules of the EU and these changes also affected the sphere of energy.

New aspects such as financial accounting, development of the private sector, and limited privatization have been introduced into the energy system of the countries. In 2004, restriction of state control of the energy companies was an important aspect for the Baltic States because the energy sector was monopolized. However, state role in the sphere of energy has remained essential until now. Eventually the Baltic States satisfied minimum requirements in the energy sphere to become part of the EU.

Some aspects of joining the EU influenced the energy system of the Baltic States. In Lithuania the Ignalina power station was closed. The Baltic States lost the main source of cheap energy and therefore, the import of energy resources increased. Closing the power station was an additional impetus to speed up the integration process and connect the energy grids of the Baltic States with the rest of the EU. In the early 2000s, some electricity connectors were constructed and a lot of treaties concerning energy cooperation were signed.

The natural gas system is the most isolated energy system in the Baltic States. Estonia has a gas connection only with Russia and Latvia. Latvia and Lithuania gas systems are also isolated from the EU. Lithuania is only connected with Latvia. However, natural gas is an important source of energy for the countries, in particular Latvia and Lithuania. A lack of alternative sources of gas leads to uncontrolled gas prices in these countries. There is no rivalry between companies in the region. The problem of energy prices in the Baltic States is very important. Usually prices in Latvia, Lithuania and Estonia are regulated by bilateral agreements.

All the states want to construct a liberal energy market and decrease energy dependence on third countries. At this time, Latvia, Lithuania and Estonia still do not have enough infrastructure to connect with the rest of the EU. The absence of the necessary infrastructure is one of the main problems of integration into the Internal Energy Market of the EU. The lack of the necessary energy

connectors linking the Baltic States and the EU also causes problems in adopting the new energy legislation.

The countries have a lot of projects for new energy constructions which should be built in the region. First of all, Latvia, Lithuania and Estonia do not have enough money to finance the infrastructure. The actions of the Baltic States are not coordinated. Each country would like to construct the infrastructure on its own territory and it complicates the problem of financing. The energy market of the Baltic States is not big enough and it would be unreasonable to build similar energy objects in each country. In spite of this all the countries have their own plans concerning new energy constructions.

The EU is interested in the integration of the Baltic States into the Internal Energy Market. The market construction will be completed only with the participation of all the EU members. The EU wants to ensure competition of the suppliers on the market. The European Commission thinks that the Internal Energy Market will help to receive a better kind of service and achieve the lowest possible costs of energy resources. Today the Baltic States are isolated from the energy grids of the EU, but the countries should accept common energy legislation anyway. There is an infringement process for the countries which have not accepted the EU legislation. The Baltic States should accept the new legislation and follow the EU rules in the sphere of energy but it is impossible for them because they do not have the necessary infrastructure and energy networks linking them with the rest of the EU. The European Commission understands the difficulty of integration for the states and tries to help them be part of the European Internal Energy Market.

Lack of the energy infrastructure inhibits the countries from integration. There are several documents of the EU concerning construction of the new infrastructure. But the new infrastructure needs a lot of money. The Baltic States are just one of the regions where new infrastructure should be built. The Baltic States do not have enough funds to finance the project and the European Union does not have the capacity to finance the entire energy infrastructure in Europe. The European Commission points out that the economic situation in Europe is difficult today due to the lack of money. There are several European programs which give financial assistance for the energy projects. However, these investments are not large enough to recover the infrastructure and create a new energy system. A great amount of money should be spent on the development of the renewable sources of energy. At the same time, the new legislation makes the energy market unattractive for investors from third countries. The infrastructure can belong to companies from third countries but the owner cannot be an energy supplier at the same time.

In 2009, the Baltic States Interconnection Plan was created to help the Baltic States in the integration process. The aim of the plan is the improvement of energy security in Latvia, Lithuania and Estonia. The plan presents a number of energy projects aimed to control the infrastructure

development and regulate energy communication between the Baltic States and third countries. The Action Plan mostly covers the energy spheres of electricity and gas. Realization of the plan should promote integration into the Single Energy Market of the EU.

Implementation of the Action Plan has a lot of difficulties, dealing with the financing and coordination of actions. In the sphere of electricity implementation, the projects are more successful than in the sphere of gas. Some electricity projects have already been realized and for the most part the time frame has been adhered to. But there are some projects which are on the stage of preparation or under discussion. Most of the projects should be finished by 2015. For example in the first progress report the time frame of electricity grids reconstruction in Latvia is 2012-2016, but in the second report the same is 2012-2018. In the fourth report, it is raised that the problem of some projects' realization is a lack of financing. There is a problem of electricity market fragmentation and introduction of the new electricity standards. The Baltic States electricity systems operate together with Russia and Belarus and it is necessary to coordinate the countries' electricity systems with the EU.

In the sphere of nuclear power the situation is worse. It is clear that the main energy project in the region, the Visagina power station construction, will be not realized on time. Initially the station was supposed to be constructed in 2018 but in 2012 the realization of the project was delayed until 2020-2022. The EC points out that there is a need to discuss the project with the region partners. Russia has already started building the power station in the Baltic Sea region. The station is intended to transport energy to the EU. The Visagina power station construction in the region is questionable and it is an unsuccessful example of the Action Plan implementation.

The worst situation is in the sphere of gas. There is no time frame for the gas infrastructure project realization in the Action Plan. At the same time these projects are of great importance for the energy systems of the Baltic States and necessary for cooperation with the EU. These projects are costly and difficult. A lot of gas infrastructure projects are under research now and there is no decision concerning their realization. The EC mentions that Latvia, Lithuania and Estonia should coordinate their actions and that the energy market in the region is too small for several LNG terminals. In the final progress report there is information that if the Baltic States do not achieve an agreement the project will not be invested by the EU. However, it should be mentioned that the EU gives a priority to all the gas infrastructure projects in this plan.

The role of Russia is considered in all the progress reports because Russian influence is estimated as one of the main problems of the Baltic States integration into the Internal Energy Market. The Baltic States still have strong links with the energy system of Russia. This interdependence has historical associations.

Russia is the main gas supplier for the Baltic Sea states. The gas market of the Baltic States is monopolized by Russian Gazprom, because there is no other alternative for the three Baltic countries. These circumstances allow Gazprom to set energy prices in the region. In the last several years the energy prices in Latvia, Lithuania and Estonia have considerably increased. For example, Lithuania pays one of the highest prices in Europe. The rise in the energy costs deals with the Baltic States participation in the EU and the new energy policies of Latvia, Lithuania and Estonia. Gazprom points out that the prices of the energy resources established in the region are legal and regulated by the agreement on gas supplies signed between the states and Gazprom. Despite the problems the forecasts shows that the supplies of energy resources from Russia to the Baltic States will increase. The demand for gas in these countries increases and there are no alternative sources for it.

In the sphere of electricity the Baltic States and Russia are included in the single synchronous area, IPS/UPS. The Baltic States have increased consumption of Russian electricity since the Ignalina power station was closed. There are bilateral treaties on Russian electricity supplies. In 2009 Estonia signed such agreement for ten years. Lithuania is also the main importer of Russian electricity. The Baltic States have connections with the electricity systems of Russia and Belarus and there is a BRELL agreement between countries.

It is clear that the role of Russia in the energy sphere of the Baltic States is essential. Russia has instruments to influence energy policy, regulate prices and affect the energy integration of the Baltic States. However, the energy policies of Russia and the Baltic States are interdependent while the reconstruction of the energy markets in Latvia, Lithuania and Estonia has a negative effect on the energy sector of Russia. The exit of the Baltic States from the current electricity system and transition into the European system influences the functioning of the Russian electricity system. The Russian electricity system works together with the Baltic States and the transition will lead to an essential failure of operation. After all these changes it will be expensive to reconstruct the system and ensure security. The reconstruction will take a lot of time.

Adoption of the Third energy package by Latvia, Lithuania and Estonia violates the rights of Gazprom. According to the new energy legislation Gazprom lost its transportation infrastructure in the region despite agreements between Russia and the Baltic States**.** Gazprom is one of the main shareholders in the lead energy companies in Latvia, Lithuania and Estonia. This fact complicates the process of share redistribution. Russian energy policy is a response on the energy policy of the Baltic States. The Baltic States and Russia cannot reach an agreement and coordinate energy policy in the region.

Gazprom is an important investor in the energy sphere of the Baltic States. A lot of big energy companies in the Baltic States receive money from Russia. Gazprom is ready to finance

energy projects in the region such as the construction of the LNG terminal in Latvia. Thus, the Russian Energy Company will own the energy infrastructure in the region. However, the Baltic States would like to have an alternative energy supplier and the government of Latvia points out that the country will support alternative suppliers only. As a result, Gazprom will invest in the construction of the LNG terminal in Finland. Russia spent a lot of money on reconstruction of the Gas Storage in Latvia. But now Gazprom wants to return the money due to the policies led by the Baltic States. The energy policies of Latvia, Lithuania and Estonia and adoption of the new energy legislation could lead to the reduction of investment into the energy sphere.

The theory of neo-functionalism is very important in understanding the integration of the Baltic States into the Internal Energy Market of the EU. Considering the energy integration of Latvia, Lithuania and Estonia, it is possible to observe the spillover process. Economic Integration of the Baltic States is strongly linked with political integration. It is a sectoral spillover process. Constructing the infrastructure is not enough for the Baltic States integration. Latvia, Lithuania and Estonia should accept the new energy legislation of the EU and follow the European energy policy. However, the countries cannot follow the new legislation without energy networks connecting them with the rest of the EU. First of all the Baltic States should diversify their energy suppliers. This fact proves the interdependence of different sectors that Haas talked about. The geographical spillover process is visible in the case of the Baltic States integration. The energy integration in Europe involves all EU members. Some regions have already been fully integrated into the system but the rest of Europe still wants to be part of the Internal Energy Market.

Haas notes that the process of integration costs a lot of money. This issue was also proved in the thesis. Energy integration is impossible without financing. Without investments the desirable outcome cannot be achieved. Haas noted that the countries should have common economic interests, identical economic systems, interconnections to cooperate with each other to be successfully integrated. The proof of the statement was demonstrated in the thesis. The Baltic States should coordinate the work of their energy systems with the EU to accept the legislation and continue the process of integration.

The connection of integration and conflict is shown in the thesis. On the one hand it is possible to observe the reaction of the EU on the Baltic States refusal to accept some aspects of the Third energy package, and on the other hand the reaction of Russia on the changes in the energy policy of the Baltic States. Neo-functionalists write that there are excluded countries which influence integration. The role of Russia in the Baltic States integration is a great example of this.

The thesis proves the neo-functionalists' statement that sometimes national interests prevail over the interests of international organizations. In the case of Latvia, Lithuania and Estonia, the process of energy integration led to the rise in energy prices. According to the researchers, the

energy costs would not decrease. The changes are essential for consumers. The economic situation in the countries does not correspond to energy prices. In some spheres the bilateral energy policy is better for the Baltic States than the common energy policy of the EU to meet the requirement of the consumers.

I would like to come to the conclusion and answer the research question, what main problem of energy integration of the Baltic States is and if they are able to be fully integrated into the Internal Energy Market of the EU. The problem is that the Baltic States strongly depend on Russia in the sphere of energy and especially on natural gas. The dependence is the result of the lack of necessary energy infrastructure. In the sphere of gas Russia is the only supplier. That is why the Baltic States should coordinate their energy policy with Russia. Many infrastructure projects are not realized because neither the EU nor the Baltic States have enough money for projects implementation. The EU funds the energy projects. However, Europe does not invest in gas or nuclear infrastructure projects in the Baltic States and refers to the non- coordinated actions of the countries. But in reality, the economic situation in the EU is difficult and there is not enough money to realize these projects. At the same time, Gazprom understands that it cannot lose a very important energy market and tries to reinforce its position in the region. Gazprom is ready to finance the energy projects in the region and offers its help to the Baltic States. Thus, if the Baltic States accept Russian help, Gazprom will continue to regulate the energy market in the region but if the Baltic States refuse to accept the money from Gazprom the infrastructure in the region will not be built and Russia will still be the main energy supplier.

Today, it is virtually impossible for the Baltic States to achieve one of the main goals of the Internal Energy Market and get rid of the energy influence of the third countries. It will be possible in the future but it will take a lot of time and money. It is unlikely to lead to a decrease in the energy prices, another important goal of the Internal Energy Market. If it is cheaper for them, the Baltic States might finally decide to cooperate with Russia in the energy sphere.

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APPENDIX 1

Energy and Gas Pipeline Infrastructure in the Baltic Region[123]

[123] Grigas Agnia p.7.