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## Rethinking the external dimension of the European Energy Policy

The external dimension of the EU Energy Policy, the question about the challenges regarding the effectiveness of the actions in this field and the search for innovative solutions are now one of the key-issues being raised during European energy policy discussions. The European Commission brought up the issue in the "Energy 2020 - A strategy for competitive, sustainable and secure energy" and questions about the most important directions, goals and tools of the external energy policy are the subject of public consultations announced in December 2010 by DG Energy (the final effect of the consultation and the EC's work in this field is to be published by in 2011). The external dimension of the EU's energy policy is also set to be one of the priorities of the Polish Presidency of the EU Council in the second half of 2011.

On 24 November in London an international seminar, "Rethinking the external dimension of the European Energy Policy" took place, co-organised by the Centre for Eastern Studies (OSW) and the European Council on Foreign Relations (ECFR). The debate was preceded by speeches by Mikołaj Dowgielewicz (Secretary of State at the Ministry of Foreign Affairs of the Republic of Poland) and David Lidington (Minister of State at the British Foreign Office). An introductory speech was given by Ambassador Václav Bartuška. The discussion was moderated by Andrew Wilson of the ECFR. The following speakers took part in the discussion: Dirk Buschle (Legal Counsel of the Energy Community Secretariat), Marcin Korolec (Undersecretary of State at the Ministry of the Economy of the Republic of Poland), Susanne Nies (Eurelectric, Head of Energy Policy & Generation Unit), Jeffery Piper (DG ENER, European Commission) and Shamil Midkhatovich Yenikeeff (Oxford Institute for Energy Studies).

The seminar discussion was on the following three topics:

- the goals of the EU's external energy policy;
- instruments used in that policy;
- the shape of the EU's energy relations with the producer-states, including in particular Russia.

The speakers unanimously stressed the need for the adoption of a market based approach to the issues related to the external dimension of the EU's energy policy. They saw an efficient internal market as a necessary precondition for external actions and as one of the major tools in the relations with third countries (the requirement of accordance with EU energy regulations and law by agreements/ventures with companies from third countries). The experts pointed to the inherent limitations of external energy policy stemming from existing tensions between political goals and tools and those from the economic-market area (the examples of Nord Stream and Odessa-Brody projects were among those mentioned). In particular, a request was expressed for a cautious use of the idea of energy security which is currently too broadly defined and thus is frequently being overused and may happen to be used to limit/suspend the

application of market rules. At the same time, it was stressed that there are cases in the energy sector when the market fails and political assistance is needed. A good example here is the still insufficient number of transborder interconnections – of key importance for enabling alternative supplies. Such investments are not always regarded as an optimal business solution for companies dominating specific markets (in part due to the concurrent opening up of these markets to competition) but could be pushed forward for instance with the support (also financial support) of the EU.

One of the important topics discussed during the seminar was the still unclearly defined function and competence of the EU/EC in the EU's external energy policy. The scope of the EC's competence seems to be expanded mostly in emergency situations (such as during the 2009 gas crisis). The whole range of existing EU energy policy instruments was discussed, including those instruments which serve the policy's external dimension both in the bilateral and multilateral aspect. In this context the need for an increased effectiveness of such tools and for a simplification of the existing solutions/procedures was stressed. It was also noted that no new institutions should be established, as this might have a negative impact on the effectiveness of EU activities.

Another topic in the discussion was the evolving nature of the EU's relations with external partners. Increasing mutual trust was considered one of the main conditions for their strengthening. An insufficient level of trust was observed with regard to EU–Russia relations; it was remarked that this might be one of the reasons for the slow pace of implementation of some of the goals set up in the EU–Russia dialogue or even for the deadlock present in some areas (such as for instance the integration of the power grids). Another factor influencing the EU's relations with producers is the current changes in the European gas market. The oversupply of gas, the greater availability of LNG and the possibility of the emergence of unconventional gas all serve to increase market liquidity and modify the rules of the game (their final form is difficult to predict, though). These factors make the situation particularly difficult for the Russian company Gazprom whose volume of export to the EU and share in the EU market have been going down (as evidenced by data from the 3<sup>rd</sup> quarter of 2010). Due to this, Russia is looking for a new definition of its position in the changing European market.

## 1. GOALS

The common goal of the 27 EU member states is to assure themselves of reliable energy supplies against the backdrop of an increasing dependence on imports. This is particularly important in the context of the existing challenges to the stability of deliveries – among other factors, linked to geopolitical and business disputes (as in January 2009) or failing infrastructure (exposure to external factors such as natural disasters, as in the case of hurricane Katrina in the USA, deficient infrastructure in the EU and in third countries).

In the popular view, one of the main goals of the EU's external energy policy is to guarantee the energy security/security of supplies to the EU. This notion, although indeed sometimes understood as "to guarantee reliable, sustainable supplies", is quite unclear and too broad. During the seminar, the speakers called for it to be defined more precisely or abandoned for good.

In the efforts to guarantee reliable (secure) energy supplies the EU itself must meet two

requirements. Firstly, the proper functioning of the EU's internal market -- by implementing the relevant legal acts and building the necessary infrastructure - is crucial. Secondly, it is necessary to improve the cohesion of the EU's energy policy -- among other methods by creating mechanisms which would enable the formulation and presentation of a joint stance (that is, speaking with one voice). The necessity of adopting a different language than the one used so far in bilateral relations with external partners which would refer to EU law and rules, has become evident, among others, during the Polish-Russian negotiations of the gas agreement (2010).

The EU is trying to assure itself of reliable supplies of energy from third countries by supporting: (a) the diversification of sources/routes of additional fuel supplies; (b) the development of production/export of fuels in third countries; (c) the modernisation of existing infrastructure (e.g. in Ukraine) and the building of new projects (e.g. Nabucco); (d) the improvement of the investment climate (including for EU investments) in third countries; (e) the integration of the infrastructure and/or markets of third countries with the EU market; (f) the promotion of high environmental/security/energy efficiency standards etc.

## 2. RELATIONS WITH THIRD COUNTRIES

According to the strategy Energy 2020 we can divide third countries with which the EU has relations in the area of energy into three groups, according to the shape and goals of those relations:

- Neighbours -- an ever-changing category (due to the enlargement process, having strong links with Privileged Partners.). Usually, the goal of relations with these states in the area of energy is to export the EU *acquis communautaires* to them and to expand the rules of the game observed in the EU energy market. A good example here are the relations of the EU with the Western Balkan states (currently members of the Energy Community), another example is the history of the EU's energy policy towards Ukraine (which, incidentally, has also recently joined the Energy Community). The recent oversupply of gas in the market may lead to an increased role of the market factor in the EU's relations with its neighbours.
- Privileged Partners -- this category includes Russia, Turkey, Ukraine, and should also include the USA and China. The goal of the EU's policy is to maintain good relations with key partners in the energy market (including the producers, the transit states and the consumers) which enable the pursuit of the most important (and in each case different) EU interests.
- Other countries which belong to a broader international context of the EU's energy policy -- the most important goal is to have impact on the developments/directions in which the energy situation is progressing on a global scale. Most likely, one of the major goals adopted by the EU at this level is the promotion of the development of low-carbon economy by the Kyoto-follow up, as well as limiting the CO<sub>2</sub> emission and pursuing climate policy.

### 3. INSTRUMENTS

Various types of instruments already exist in the EU's external energy policy and, due to the very shape of that policy (*in statu nascendi*), new instruments continue to be developed. Some of the existing/developed instruments have been created in connection with new EU documents (Second Strategic Energy Review, strategy Energy 2020, Infrastructural Package which is a potentially powerful instrument to support investments in infrastructure, including transborder links), while others were drawn up in response to concrete events (such as the 2009 Russian–Ukrainian gas crisis which resulted in the SoS Regulation and the Early Warning Mechanism).

In relations with the EU's key partners in the area of energy (Privileged Partners) a number of bilateral agreements were negotiated, individually for each country. The energy dialogue with Russia, launched in 2000, the first initiative of this type with a key exporter of the fuels to the EU, is a good example.

#### **EU– Russia relations**

Russia is the EU's key partner in the area of energy and the most important exporter of energy resources. It is partially for this reason that both the individual member states and the EU as a whole maintain special energy relations with Russia. Russia is the first producer state for the EU to launch an institutionalised energy dialogue in 2000 with the goal of creating a broader framework for comprehensive energy cooperation. Some of the issues discussed during the regular meetings of bilateral working groups have been closed with success (the privatisation of the Russian electrical energy sector, despite the current cooperation deadlock in this area, Russia's adoption of the oil products quality standards required by the EU). Nevertheless, the bilateral energy relations are haunted by several general cooperation problems. Besides its specific tasks/topics the dialogue also aims to rebuild trust between the EU and Russia. The insufficient level of trust and the mutual uncertainty/lack of the sense of security result at least partially from the history of bilateral relations after the collapse of the USSR (the USSR's commitments towards the EU and vice versa after 1991, the enlargement of the EU and NATO). Additionally, the EU and Russia pursue a number of divergent interests in the area of energy. One of the major challenges is the systemic difficulty in combining the EU's goals concerning the security of supplies with Russia's need concerning the security of demand for fuels. The problems with the Energy Charter can be quoted here (Russia refused to ratify the document; the problem of setting the rules of the transit of fuels via Russia). The progressing enlargement of the Energy Community to include Ukraine and Moldova may be another difficulty for Russia, as it most probably means that these states will join the UCTE power system, and by doing so they will need to disconnect from the IPS/UPS system in place in the whole CIS area (including Russia). For the time being, the process of interconnecting the IPS/UPS system with UCTE has been deadlocked and there is no visible will to push it forward.

The security of demand related problems faced by Russia has been particularly evident recently in the context of changes in the European gas market (excess supply, the LNG alternative and, potentially, the unconventional gas alternative) – in the third quarter of 2010 the level of consumption of Russian gas in the EU fell by 25% on average and in the case of some key customers by as much as 50%. The constantly changing rules of the game in the EU energy market (in part related to the liberalisation process) are another challenge for Russia and its energy interests in Europe.

For both sides, these divergent interests result in the need for diversification. In this context, the EU's natural partners are the Caspian states – e.g. Turkmenistan – which are looking for new markets. Notably, for geopolitical reasons, the EU's energy relations with Russia impact upon its relations with other suppliers of energy resources and in particular may hamper relations with the states of the Caspian Sea region.

Since the launch of the energy dialogue with Russia a number of bilateral agreements have been signed, most of them of a declarative nature (Memoranda of Understanding), also with other producers/partners in the area of energy (e.g. the Caspian Sea region, Ukraine). Recent years have seen a revival of the strategic energy partnership between

the EU and the US (EU-US Energy Council). The signed memoranda and agreements, though largely non-binding, aimed first of all at defining the priorities for bilateral cooperation and focusing the activities carried out by EU institutions and the individual member states on the goals listed and directions set out in these documents. The Declaration on the Modernisation of Ukraine's Gas Transit System, signed in March 2009 (as a result of the January 2009 gas crisis), has become an important document and a reference point for further actions to be carried out in the framework of the EU-Ukraine energy cooperation. At the same time, the declaration provides that the EU/EC has assumed the role of coordinator and facilitator of Ukraine's cooperation with foreign donors (in this specific area). The process of the creation of a new instrument in the EU's relations with foreign partners/producers can be facilitated by the experience gained during the Polish-Russian gas negotiations (and the institutional involvement of the EU aimed at guaranteeing the compliance of the agreements with EU law).

In the EU's relations with third countries, multilateral instruments are also used. The most important of these are (a) the Energy Community, which groups together a number of states in the EU neighbourhood and (b) the Energy Charter which has more than 50 member states mainly from Eurasia. They are expected to define formal and homogeneous rules for the EU's multilateral cooperation in the area of energy.

The Energy Charter is expected to introduce transparent rules and methods of solving disputes in international energy relations (e.g. over the issues of transit, investments, energy efficiency). In recent years, however, the effectiveness of this instrument has been repeatedly called into question. The Energy Charter Treaty does introduce additional rules (to complement those which are already in place in the EU and in third countries), and additionally some of its provisions and the difficulties connected with the actual enforcement of the commitments raise certain doubts e.g. on the part of key producer states – Norway and also Russia, which formally withdrew from the Energy Charter Treaty.

The EU plays the central role in the Energy Community – the European Commission coordinates the Community's work and the *EU Code of Justice* is its legal reference. Its *de facto* goal is to export the rules observed in the single EU energy market to the EU's neighbourhood (Western Balkans, Ukraine, Moldova, before 2007 also Bulgaria and Romania, potentially also Turkey and Georgia). In this way the EU is attempting to expand its internal market and to reduce the risk and the transaction costs associated with the operation of EU entities in it. The Community member states, on the other hand, are hoping for more investments, access to EU solidarity mechanisms, and some of them treat their Energy Community membership as a preparatory phase to EU membership (this was the case with Bulgaria and Romania). After the 2010 inclusion of Ukraine and Moldova in the Community the question arises as to whether it would be possible, and if so – on what conditions, to consider opening the path for conceivable Belarus membership in the Energy Community. The main challenge for the effectiveness of the Energy Community - often mentioned in the context of Ukraine's inclusion, and of the slow and incomplete implementation of the internal energy market rules by the EU member states themselves - is associated (just as in the case of the Energy Charter) with the actual difficulties in enforcing the commitments made by the Community member states.

There exist or are being developed instruments (used both in bilateral and the

multilateral cooperation framework) which aim to pursue specific goals or solve specific bi- or multilateral problems. These include the EU–Russia Early Warning Mechanism which is aimed at facilitating the process of information-sharing on possible problems with energy supplies; the Caspian Development Corporation – a concept to create a common platform for the purchase of Caspian gas, coordinated by the European Commission, most importantly offering sale volumes guarantees to Turkmenistan; and the Southern Corridor – an EU-lobbied project which is to enable the creation of the fourth corridor for the export of gas (from the Caspian region and the Middle East to Europe).

#### 4. EFFECTIVENESS

The institutional determinants of the EU's external energy policy are complex at this stage. One of the challenges for the effectiveness of the EU's external energy policy lies in the lack of a clear definition (including in the light of the Lisbon Treaty) of the scope of competence of the EU institutions which are active in this field. The EU's added value and the member states' consent to the increased institutional involvement of the EU manifest themselves usually only as a consequence of crises (cf. the 2009 gas crisis). Meanwhile, new concepts of both the goals and methods of the pursuit of the EU's energy policy start to appear – including the European Energy Community idea put forward by Jacques Delors and Jerzy Buzek. It is feared that complex instruments, new institutions and the involvement of further entities in the energy policy (the Lisbon Treaty, for instance, has increased the involvement of the parliaments of member states in it) might have a negative impact on the effectiveness of EU activities.

During the discussion the following proposals were put forward:

- Instead of creating new institutions/instruments/structures, use the existing ones more effectively (also by adopting a clear definition of their scopes of competence);
- Expand and clarify the scope of competence of the European Commission;
- Develop simple solutions for the complex problems and challenges existing in the field of external relations in the energy sphere;
- Care for the integration and cohesion of work done by the individual EU institutions responsible for energy policy (DG ENER, DG ENLAR and the European External Action Service); between the member states and domestically;
- Better coordination of activities carried out by regional institutions (ENTSO, ACER);
- Ensure employees involved in energy issues in the individual EU institutions have the relevant qualifications – more people with a degree in energy and an industry-specific/expert experience are needed.

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