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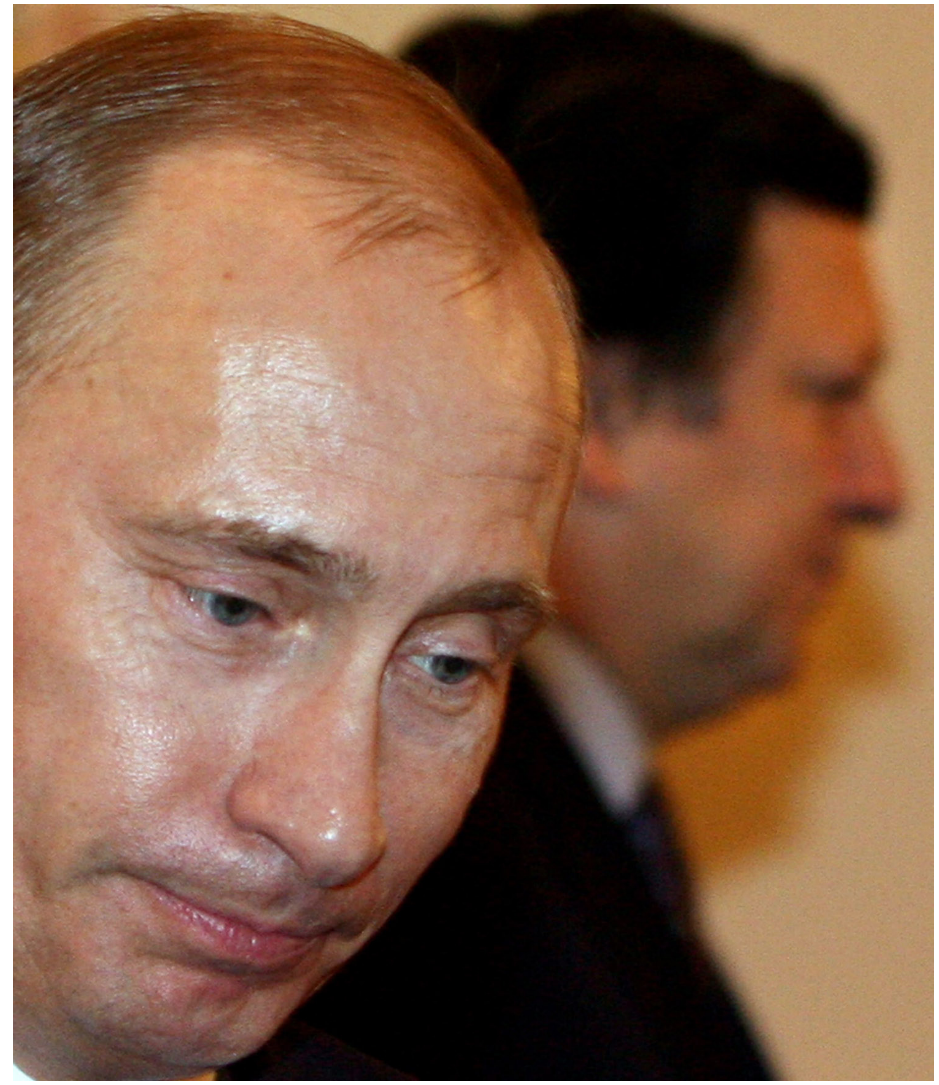
Brussels without Muscles?

Exploring the EU's Management of its Gas Relationship with Russia

DAVID HARRIMAN



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David Harriman

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Sammanfattning

EU är på många områden en stark aktör, t.ex. inom frihandel, klimat och krishantering. I gasrelationen med Ryssland har dock EU:s politiska kapacitet varit begränsad. En del av problemet ligger i bristen på enighet men detta är snarare ett symtom än en orsak.

En central orsak återfinns i samspelet mellan externa och interna faktorer. De externa faktorerna, dvs. intressekonflikter mellan EU och Ryssland och det europeiska politiska systemets struktur, förstärker EU:s interna styrningsproblem. Detta är en effekt av att gasfrågan faller under olika politikområden (energi, externa relationer och säkerhetspolitik) inom vilka Kommissionen och medlemsstaterna har olika ansvar. Ett annat problem är att energi förvisso är Kommissionens ansvar men att den verkliga kompetensen finns hos medlemsstaterna. En förklaring är att den nuvarande multipolära strukturen i europeisk politik minskar utrymmet för samarbeten som gynnar EU som helhet; i det här fallet dess energisäkerhet.

Dessa omständigheter förvärras bl.a. av att Kommissionen i förhållande till medlemsstaterna och medlemsstaterna sinsemellan har olika syn på rysk energipolitik. Andra nyckelfaktorer är bristen på transparens och konkurrens i gassektorn (vilket passar både Gazprom och stora företag inom EU) samt att vissa EU-länder är mer beroende av rysk gas än andra. Även relationerna mellan Frankrike, Tyskland och Ryssland är viktiga. Tyskland och Frankrikes är centrala aktörer för EU:s energisäkerhet och deras stöd för gasledningen Nord Stream, motstånd mot ägarskapsåtskillnad i gassektorn (s.k. unbundling) och relativt varma Rysslandsrelationer har inte gynnat EU i gasrelationen med Ryssland. Genom Lissabonfördraget får Frankrike och Tyskland dessutom utökad makt. Detta i kombination med att EU:s och Rysslands intressekonflikter, strukturen i den europeiska politiken, den fortsatt delade synen på rysk energipolitik kvarstår, gör att utsikterna för att fördraget ska stärka EU:s maktposition mot Ryssland är begränsade.

Nyckelord: EU:s politiska kapacitet, Ryssland, gas, externa och interna faktorer.

Summary

In many respects, the EU is a strong player on the world stage, for example, in trade, climate change issues and crisis management. In its relationship with Russia over gas supply, however, the EU's political capacity remains limited. Part of the problem lies in the lack of EU unity, but this is more a symptom than an actual cause.

A key explanation is the interplay between external and internal factors. The external factors – that is the EU's and Russia's conflicting interests and the structure of the political system – reinforce the EU's internal problems. This is an effect of that the gas issue falls under different policy areas (energy, foreign relations and security policy) within which the European Commission and the member states have different responsibilities. Another problem is that energy is the Commission's responsibility, but the real competence lies with the member states. The current multipolar structure of European politics reduces the scope for cooperation that favours the EU as a whole – in this case its energy security.

The fact that the Commission and member states, and the member states among themselves, have different views on energy policy vis-à-vis Russia exacerbates these circumstances. Other key factors are the lack of transparency and competition in the gas sector (which suits both the Russian company Gazprom and large EU companies) and the unbalanced dependence of EU countries on Russian gas. Relations between France, Germany and Russia are also important. Germany and France are key players for the EU's energy security, and their support for the gas pipeline Nord Stream, their resistance to unbundling in the gas sector and their relatively warm relations with Russia have not strengthened the EU's position in its gas relationship with Russia. Besides, the Lisbon Treaty increases France's and Germany's powers inside the EU. Combined with the conflicting interests of the EU and Russia, the structure of European politics, and different views on Russian energy policy, this limits the room for hopes that the Treaty could strengthen the EU's power position vis-à-vis Russia.

Keywords: EU political capacity, Russia, gas, external and internal factors.

Contents

Preface

Russia's relations with the European Union are impossible to analyse without taking into account the pivotal role of the energy trade between Russia and the EU member states. The image of this conveyed in newspapers usually centres on how different member states champion different positions on how best to build relations with Russia. Quite frequently, the member states are divided into the 'new' and the 'old', but this notion was challenged when the European Council on Foreign Relations published its policy paper, *A Power Audit on EU-Russia Relations*, in November 2007. The dynamics have proved to be complicated and multi-layered, and the present report contributes to the ongoing process of understanding the many mechanisms inside the EU that regulate and, at times, also complicate the Union's energy relationship with Russia.

In this report, David Harriman, an intern at FOI during the period September 2009–March 2010, analyses the EU's multifaceted energy relationship with Russia, and then specifically the gas relationship. He concludes that the EU's limited political capacity in dealing with Russia is explained by both internal and external factors. Among the external factors he singles out the conflicts of interest that underpin the EU-Russia relationship – not least the competition for influence in countries such as Ukraine and Azerbaijan. Furthermore, he identifies the effects of that the gas relationship straddles two major policy areas inside the EU, namely energy and security policy, as another root of the problem.

The report has been written within the project on Russian Foreign, Defence and Security Policy (RUFS) at FOI, which is financed by the Swedish Ministry of Defence. The RUFS Project aims to study Russia's military development in a very broad context, of which the general economic situation is a key part. The present report, however, was written during David's internship at FOI and was not formally commissioned by the Ministry of Defence.

Carolina Vendil Pallin

Head of the RUFS Project at FOI

March 2010

Abbreviations and Acronyms

bcm	billion cubic meters
CIS	Commonwealth of Independent States
CFSP	EU Common Foreign and Security Policy
DG Tren	EU Directorate General for Transport and Energy
DG Relex	EU Directorate General for External Relations
ECT	Energy Charter Treaty
ENP	European Neighbourhood Policy
IEA	International Energy Agency
LNG	Liquefied Natural Gas
NESCO	Network of Energy Security Correspondents
OIES	Oxford Institute for Energy Studies
QMV	Qualified Majority Voting
RUE	RosUkrEnergo
SES	Single Economic Space
SG/HR	Secretary-General of the Council of the European Union/High Representative for the Common Foreign and Security Policy
tcm	thousand cubic meters
WTO	World Trade Organization

1 Introduction[1]

In many ways the EU is an influential actor on the world stage. Today it consists of 27 member states and more states aspire to membership. Over the years the EU has made substantial contributions to world politics in areas such as climate change, trade and crisis management. This has contributed to creating peace and prosperity on the European continent and elsewhere.

Within the energy field the EU has also been very active in terms of promoting reductions in the demand for energy as well as increased sustainability and competitiveness. However, when it comes to Russian gas supplies, the EU remains weak despite several attempts to deal with this seriously (e.g. the proposal for measures to safeguard the security of gas supply and the strategy to diversify by gas supplier and import route). The 2009 Russo-Ukrainian gas crisis, during which several member states suffered from gas shortages, made this clear. Among other things, it demonstrated the EU's vulnerability to Russia and Ukraine, and, more importantly, how difficult it was for the EU to do something about it. Instead of the EU, it was European gas and utility companies, with the backing of national governments, which played the main role in handling and resolving the dispute.[2]

The consensus is that the most pressing problem is that the EU lacks an effective common energy policy, a Russia strategy shared by the member states and an external energy policy. Moreover, the member states' differing national energy interests pose a considerable problem. Given that gas will be a key energy source in the transition from oil and coal to renewables (e.g. wind and solar energy), that the EU's dependence on imported gas is expected to rise by 2030 and given the possibility of a Russian supply squeeze, the EU-Russia energy relationship is and will continue to be increasingly crucial. As the European Commission's Directorate General for Transport and Energy (DG Tren) put it:

> Russia and the European Union are natural partners in the energy sector. Russia has been a reliable supplier of energy into the European Union for

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[1] I am most grateful to the Head of the FOI RUFS project, Carolina Vendil Pallin, and all my colleagues at FOI for important comments during the process of writing this report. Madelene Lindström, analyst at FOI, provided me with important remarks and suggestions on how to develop the report at a FOI seminar on 26 January 2010. I am also obliged to Michael Fredholm for detailed comments on the text. The responsibility for any remaining errors is my own.

[2] Pirani, Simon et al. (2009b) *The Russo-Ukrainian Gas Dispute of January 2009: A comprehensive assessment*, Working Paper, Oxford Institute for Energy Studies (OIES), February 2009, pp. 46-49.

> many years, despite periods of internal difficulties. Likewise, the European Union continues to be the dominant market for Russian energy exports. This strong mutual interest and interdependence means that energy is an ideal sector in which relations can be progressed significantly – a kind of test case – for the further development of an EU-Russia strategic partnership. Success in the energy sector could then serve as a model for other areas of common interest.[3]

Given that the energy relationship is a test case for further development of an EU-Russian strategic partnership, it is worrying that it reveals severe tensions and conflicts between the parties. The numerous gas conflicts (with Belarus in 2004 and 2007 and Ukraine in 2006 and 2009) and Russia's use of energy resources as a foreign policy tool are just some examples of issues that have put strains on the energy relationship. If further cooperation cannot develop within the energy field, how is it going to develop elsewhere? This is crucial with respect to other pressing issues that the parties need to manage in their relations, for example, EU-NATO expansion in the former Soviet states, the future status of South Ossetia and Abkhazia, and nuclear weapons in Europe and Russia.

In view of the immense number of pressing issues, not least over gas, it is disturbing that the member states disagree on how to manage the Russia issue. For one thing, it has practical implications for how other actors perceive the EU and its ability to act cogently and cohesively in international affairs. Second, it raises doubts about whether the EU can create an energy policy that effectively safeguards gas supplies to all the member states. The question, then, is how the EU – an influential actor on matters like promoting democracy and trade liberalization – can be so weak in the gas relationship with Russia.

1.1 Purpose/Research Questions

Analyses often point to the lack of unity as being behind the EU's weakness in its energy relations with Russia, expressly so where the gas supply issue is concerned. But lack of unity is arguably the symptom of the problem rather than the actual cause. This study therefore seeks to go beyond the lack of unity and analyse in more detail the factors that account for the EU's limited political capacity in the gas relationship with Russia. The study directs its attention to the pipeline issue since it lies at the very core of the EU-Russian gas relationship. More specifically, it looks at three current gas pipeline projects, namely Nord

[3] European Commission (2010a) 'International Relations – Russia', on the Internet: http://ec.europa.eu/energy/international/bilateral_cooperation/russia/russia_en.htm (retrieved 27 January 2010).

Stream, Nabucco and South Stream (see the map in Appendix I). These cases illuminate crucial aspects – such as the issue of Ukraine and the coordination between EU institutions – that relate to the Union's limited political capacity. Second, the study investigates how the EU can work to strengthen this political capacity.

As a result of the above discussion I pose the following research question:

- What factors can account for the EU's limited political capacity in the gas relationship with Russia?

The main conclusion of the study is that a number of internal and external factors together contribute to the EU's limited capacity. More specifically, the internal EU dimension, that is, the competences of the European Commission and the member states and their coordinating capacities, interplay with existing conflicts of interests with Russia and the multipolar structure of the European political system to limit the Union's political capacity. The conflicts of interests centre on the EU's and Russia's different views on economic and political reform in the Black Sea and Caspian Sea regions, on the character of interaction in the gas sector and on how to do business. These conflicting interests all come into play in the cases of Nabucco, Nord Stream and South Stream. The core conflict of interest revolves around the absence of common values. This does not mean some 'fuzzy' values – which Russia sometimes accuses the EU of. Rather it means rules (e.g. rule of law and transparency) that are crucial for enabling predictable gas cooperation.

The study also concludes that the EU could weaken such values by supporting Nord Stream if it fails to safeguard the implementation of key policies like the Third Energy Package. Among other things, the package includes an important third country clause, the so-called anti-Gazprom clause, which constrains non-EU companies' access to the EU's internal market. If implementation is insufficient, Nord Stream could become an example of EU-Russia energy cooperation that builds on common interests rather than common values, which puts the EU on the losing side. In addition, the fact that security policy aspects are not being taken into account with respect to Nord Stream indicates that the coordination between institutions (the Commission and the member states) is limited. The fact that the EU member states' are not united on Nord Stream and Nabucco reflects the fact that energy is the policy area of the Commission but the real competency lies with the member states. The analysis also shows that Germany and France are crucial for the EU's gas relations with Russia. These two states have fairly friendly relations with Russia, have resisted further European integration in the gas sector, and will increase their influence inside the EU due to the Lisbon Treaty. These factors combined will limit the extent to which the Treaty can increase the EU's political capacity in the gas relationship with Russia.

1.2 Point of Departure

The first thing that to note about the EU-Russia gas relationship is that it touches upon the EU's energy policy as well as its external energy policy and the Common Foreign and Security Policy (CFSP). This is important since these policies fall under different EU pillars and thus refer to different decision-making procedures and competencies of the respective institutions, that is, the European Commission, the member states and the European Parliament.

The EU's energy policy falls under the first pillar which is supranational (the European Communities) and thus a core competency of the Commission. This means that it has responsibility to initiate legislation while the Council of the European Union, alone or together with the Parliament, decides on the approval of new laws. The EU's energy policy is a broad concept which focuses on creating 'a competitive internal energy market offering quality service at low prices, on developing renewable energy sources, on reducing dependence on imported fuels, and on doing more with a lower consumption of energy'.[4]

Relations with Russia fall under the second pillar, the CFSP, which is intergovernmental and thus a core competence of the member states (through the Council of the European Union). Here the Commission and the Parliament have limited roles. However, the Commission and its Directorate General for External Relations (DG Relex) do have an important role in the EU's relationship with Russia. They contribute to policy formulation and manage relations with countries outside the EU (here Russia), as well as the wider enlargement process.

The external energy policy is basically a mixed-pillar issue which falls between the above two pillars[5] since it includes both energy policy (gas supplies), and the CFSP (security policy) and relations with third countries. The fact that the 2006 document on 'An External Policy to Serve Europe's Energy Interests' was a joint venture between the Commission and the Secretary-General of the Council of the European Union (SG/HR) clearly indicates this. An

[4] European Commission (2010b) 'Energy Policy for a Competitive Europe', on the Internet: http://ec.europa.eu/energy/index_en.htm (last retrieved 29 January 2010).

[5] The third pillar, which is not dealt with here, centres on the EU's cooperation on justice and home affairs.

additional example is the Network of Energy Security Correspondents (NESCO). Its purpose is to facilitate early exchange of information on issues of importance to the EU's external energy policy and to serve as a forum for sharing assessments of external factors impacting on Europe's energy supply. NESCO consists of representatives of the Commission, the Council Secretariat and the member states.[6]

However, with the coming into force of the Lisbon Treaty on 1 December 2009 the pillar structure was abolished. But, since this study focuses mainly on the period leading up the initiation of the Treaty and also argues that many of the fundamental problems in the EU's gas relationship with Russia still remain after its initiation, it is instructive to discuss the pillar structure.

1.3 Definitions

Political Capacity

This study builds on a specific definition of political capacity as the EU's ability to act effectively and achieve a desired outcome (energy security) for the member states.

Capacity to act effectively basically refers to the internal dimension of power (the external dimension refers to the ability to influence other actors' behaviour). In the case of the EU it entails that it has strategies and policies that are strong both on principles and on specifics. It also implies that it acts in accordance with these strategies and policies since they are what guide action and give it legitimacy.

In this regard the EU's limited political capacity refers to the area of energy, specifically the gas supply issue. With respect to the above reference to the EU's influence in many areas, such as promoting democracy and market-based trade policies, this specification is important to make. It underlines the puzzle of this study, namely the question why the EU has limited political capacity in one specific area but not others.

6 EU (2007) 'European Commission to Launch EU Network of Energy Security Correspondents 10th May', Press release, 9 May 2007, on the Internet: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/629&format=HTML&aged=0&language=EN&guiLanguage=en (retrieved 8 February 2010).

Energy Security

During the 2000s, energy security has become another buzz word in the political sphere, often used without closer clarification. This is a serious deficiency, since energy security means different things to different actors: it is context-dependent. For producers it means access to markets and security of demand whereas for consumers it means security of supply. For states like China and India it concerns how to satisfy their soaring energy consumption needs on an increasingly volatile world market.[7] However, since energy also connects with geopolitics, strategy, security policy and economic factors, it has a foreign relations dimension as well. This study adopts a broad definition which includes the EU's own energy security elements, namely sustainable development, competitiveness and security of supply. It also includes the security policy aspects connected with energy issues (i.e. supply of Russian gas to the EU). This is a logical definition to use given that the EU's gas relationship with Russia intersects with its energy policy, CFSP and external energy policy (see above).

1.4 Data/Sources

The sources used in the study mostly consist of policy analyses made by European and American academics, speeches by EU and Russian officials, official EU documents (directives, proposals etc.) and statistical data on energy, in particular those produced by the International Energy Agency (IEA) and the Oxford Institute for Energy Studies (OIES).

With respect to official documents, as well as policy analyses, it is important to keep in mind the question of the evidentiary value of such data. Since they are official one needs to think about who is speaking, to whom, for what purpose and under what circumstances. In turn, this connects with the larger question of what purpose a document is designed to serve, how it fits into the policy-making process and how it relates to other communications and events. This is not a problem in itself but is rather a suggestion for how the analyst ought to read the texts. The use of literature from multiple sources has helped me put official documents into a broader strategic policy perspective.

[7] Petersson, Bo and Plewa-Törnquist, Barbara (2008) 'Introduction: Energy Security in Europe', in Bo Petersson and Barbara Plewa-Törnquist (eds) (2008) *Energy Security in Europe*, Proceedings from the Conference 'Energy Security in Europe', Lund, 24–25 September 2007, CFE Conference Papers Series no.2 (Lund, Centre for European Studies at Lund University), pp. 7-8.

1.5 Limitations

First, since this study primarily focuses on the EU side of the equation it will not deal with Russia's internal political dimension. Even though such a perspective is important in order to understand the general configuration of EU-Russia energy relations, it is less important here due to the EU perspective of the study.

Second, the analysis mainly covers the EU's limited political capacity in the light of trends and scenarios on gas consumption prior to the economic crisis of 2008–2009 and the subsequent recession. The crisis has led to decreasing demand in Europe for Russian gas as well as lower gas prices. Consequently, the power balance between the EU and Russia could be affected by this and thus produce effects for the EU's political capacity during the coming few years which are currently uncertain. Still, the observations made in the analysis are highly relevant since they relate not only to the amount of gas imported into the EU but also to the wider ramifications of the EU-Russian gas relationship.

1.6 Structure of the Study

Chapter 2 deals with specific issues related to the EU's political capacity in the case of Nord Stream. It focuses on Ukraine as a key issue in the EU-Russian gas relationship, asymmetric dimensions in the relationship, value incompatibility and the impact of the relationship between Russia and Germany.

Chapter 3 deals with specific issues related to the EU's political capacity in the cases of Nabucco and South Stream. It focuses on the Black Sea and Caspian regions as a key area for the EU and the Russian gas supply issue, control and dependency as crucial variables for Nabucco and South Stream, and lost opportunities for cooperation.

Chapter 4 deals with different external factors that intervene in the EU-Russian gas relationship. Together with the EU's internal workings – the relationship between the member states and between the Commission and the member states – these factors account for some interesting explanations for the limited political capacity the EU has in its gas relationship with Russia.

In chapter 5 the main conclusions of the study are sketched out accompanied by some remarks regarding the results.

2 The EU's Limited Political Capacity – the Case of Nord Stream

This chapter deals with essential issues that relate to the EU's limited political capacity in the case of Nord Stream.

2.1 Ukraine – a Key Issue for the EU-Russian Power Balance

Russian-Ukrainian gas relations have been a key topic during the 2000s due to several disputes over the supply and transit of Russian gas. In late October 2009, Russian Prime Minister Vladimir Putin warned the EU of a new possible gas dispute with Ukraine – due to fears that Ukraine would be unable to pay for its gas.[8] Gas disputes between Russia and Ukraine are not a new phenomenon: sales and transit problems existed already in the early post-Soviet period.[9] Even so, it is well established that the Orange Revolution in 2004, which brought pro-Western politician Viktor Yushchenko into power, accentuated political tensions in the relationship between Russia and Ukraine.

Russo-Ukrainian relations are crucial to the EU's gas situation and thus to its relations with Russia and Ukraine. For one thing, Russia is dependent on Ukraine as a transit country for its European gas exports (80 per cent of the EU's gas imports from Russia transit through Ukraine). Second, Ukraine's gas transport network is one of the largest in the world. It has an input capacity of 280–290 billion cubic meters (bcm) per year and an output capacity of 175.0–178.5 bcm per year.[10]

During 2003–2006, gas transit through Ukraine to Europe averaged 117 bcm per year and transit revenues contributed substantially to its economy.[11] Apart from those revenues, gas transit is important to Ukraine since it is strongly dependent on imported gas for its own consumption and receives

[8] 'Putin warns Ukraine over Gas Crisis', *New York Times*, 30 October 2009, on the Internet: http://www.nytimes.com/reuters/2009/10/30/world/international-uk-russia-ukraine-gas.html (retrieved 30 October 2009).

[9] Mitrova, Tatiana et al. (2009) 'Russia, the CIS and Europe: Gas trade and transit', in Simon Pirani et al. (2009a) *Russian and CIS Gas Markets and Their Impact on Europe,* Oxford Institute for Energy Studies (OIES) (Oxford, Oxford University Press), p. 419.

[10] Pirani, Simon (2009) 'Ukraine: A Gas Dependent State', in Pirani et al. (2009a) *Russian and CIS Gas Markets*, p. 109; Tsarenko, Anna (2007) *Overview of Gas Market in Ukraine,* Center for Social and Economic Research, CASE Ukraine, Working Paper no. 2, p. 7.

[11] Pirani (2009) 'Ukraine: A Gas Dependent State', p. 113; Pirani, Simon (2007) *Ukraine's Gas Sector*, Oxford Institute for Energy Studies (OIES), June 2007, p. 28.

part-payment in gas.[12] Some estimates state that in 2005 Ukraine received 23 bcm from Gazprom for its transit services.[13] Nord Stream, projected to bring about 55 bcm/year of gas to EU countries, could substantially reduce those transit benefits and mean that gas relations between Russia and Ukraine become mainly bilateral relations: Russia can deal with Ukraine on energy issues without affecting deliveries to the EU.

At the same time, some uncertainty exists as to how serious the economic effects of Nord Stream would be for Ukraine. For example, Ukrainian President Viktor Yanukovych has said that Nord Stream will not have major negative economic consequences for Ukraine. Instead, he has suggested that Ukraine should participate in the Nord Stream (and South Stream) project. He has also suggested that an international consortium, led by the Russian gas giant Gazprom, should be put together to manage Ukraine's gas transit network, in return for discounted prices on Russian gas supplies. Some sources[14] see vote-catching and/or potential financial interests on the part of Yanukovych as being behind this move. However, given declining gas demand in Europe and decreasing prices, Yanukovych's argument may have bearing since it is uncertain how much gas actually will transit through Ukraine in the next few years.

Nonetheless, it is still highly relevant to look at the possible political effects of the Ukraine issue on the EU-Russian gas relationship. For example, could Nord Stream affect the political configuration of Wider Europe, and, if it did, to what extent would it do so? In particular this has to do with the direction of EU-Ukrainian relations, since this relates to the EU-Russian power balance and, in turn, the Union's limited political capacity. That is, Russia with Ukraine on its side is stronger politically vis-à-vis the EU than it is without. Hence, the question is whether Nord Stream can bring Ukraine closer to the EU and increase the Union's political capacity in the gas relationship with Russia.

Given that transit revenues constitute an important part of the Ukrainian budget, any loss of these could lead to significant budget shortfalls. This would affect the maintenance of the energy sector, the well-being of society and, in turn, the legitimacy and stability of the state. If Nord Stream were to put Ukraine into a more vulnerable position, it could give it larger incentives to open up to economic and political reform – which by definition means strengthened ties with the EU. Such a rapprochement could serve as a way for Ukraine to

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[12] Pirani (2007) *Ukraine's Gas Sector*, p. 28.

[13] Tsarenko (2007) *Overview of Gas Market in Ukraine*, p. 7.

[14] Korduban, Pavel (2010) 'Yanukovych, Tymoshenko Hold Opposite Views on Russian Gas', *Eurasia Daily Monitor*, vol. 7, issue 18 (27 January 2010), on the Internet: http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=35958&tx_ttnews%5BbackPid%5D=7&cHash=58180d4fa1 (retrieved 2 February 2010).

diversify away from its dependence on Russian gas by reducing energy demand and its debts to Russia. This is not an unlikely scenario when we take into account that the EU and Ukraine have developed a close relationship – notably through the Partnership and Cooperation Agreement, the Memorandum of Understanding on Energy, and the European Neighbourhood Policy (ENP) Action Plan, and that the relationship may be strengthened through the Eastern Partnership in the future.

Apart from being an important energy actor, Ukraine is seen by some (e.g. the European Parliament) as a potential key partner in the management of migration flows and border security.[15]

Previous Russian-Ukrainian gas disputes have reinforced EU-Ukrainian relations. In this regard it is important to note the less than transparent connections between companies that exist in the gas sector, which have also been a source of tension between Russia and Ukraine. For example, RosUkrEnergo (RUE) is a company officially co-owned by Russia and Ukraine but with diffuse owner relations on the Ukrainian side. Even the Russian side says it does not know who the Ukrainian owners are.[16] RUE serves as an intermediary between the Ukrainian gas company Naftohaz Ukrainy and the Russian gas giant Gazprom. By virtue of this position, it was a central cause of the 2009 gas crisis in the sense that gas money from Naftohaz Ukrainy was to be sent via RUE to Gazprom.[17] But Gazprom did not get its money. Due to the lack of transparent legal and technical gas transit agreements, the conflict escalated and European customers had to freeze in the middle of the cold winter. In the light of possible new gas conflicts and the possible economic and political consequences for Ukraine which Nord Stream presents, these are important circumstances.

What would further rapprochement with Ukraine mean for the EU's limited political capacity and for Russia? First, it would enable a more secure and stable Europe because of Ukraine's geostrategic position regarding both energy and security policy. It would strengthen the possibilities of expanding the EU's common market to the Black Sea region, where Ukraine could serve as a precursor for other countries in the area. To some extent, there are already precursors given Bulgaria's and Romania's accession to the EU. But, since Ukraine is fundamentally more important, given its special historical-

[15] Bengtsson, Rikard (2009) *The EU and the European Security Order: Interfacing security actors*, (London, Routledge), p. 69.
[16] Fredholm, Michael (2008a) 'Natural-Gas Trade between Russia, Turkmenistan and Ukraine: Agreements and disputes', *Asian Cultures and Modernity*, Research Report no. 15, November 2008, pp. 22-23; Kupchinsky, Roman (2009b) 'Gazprom's European Web', Jamestown Foundation, February 2009, pp. 26-27.
[17] Kupchinsky (2009b) 'Gazprom's European Web', pp. 26-27.

cultural relationship with Russia and its role as a key transit country to the EU, it holds a stronger symbolic value to the EU-Russian power balance. Second, it would be counterproductive to Russia's ambition to regain control over its 'near abroad'. Third, it would reduce the risk of Ukraine joining the customs union with Belarus, Kazakhstan and Russia. This could have economic consequences for Russia. If all these factors came into play it would put the EU in a stronger position relative to Russia and thus make it better able to act in the gas relationship with Russia.

However, the EU's unclear and ambiguous behaviour in the relationship with Ukraine has complicated matters, and this connects with its limited political capacity regarding the gas supply issue. The following paragraphs examine why this is so.

Basically, perceptions are central to international politics since they are often what actors act upon rather than reality. The question here concerns whether the EU perceives Ukraine or Russia as the problem for its gas imports. A closer inspection of the 2009 Russo-Ukrainian gas crisis is instructive since it reveals a great deal about Europe's image of Russia as energy supplier and Ukraine as transit country. Accordingly, if the EU perceived the central cause of the crisis to be Ukraine's actions and the inability of both Russia and Ukraine to manage their bilateral relationship, transit avoidance pipelines like Nord Stream would be part of the solution. For one thing, they would substantially reduce the significance of Russia–Ukraine relations for European gas imports. If, on the other hand, the EU perceived Russia's actions as the major problem, then projects like Nord Stream would be irrelevant. At least officially, the EU took the middle way and blamed both sides (and endorsed Nord Stream). Ukraine, on the other hand, felt abandoned in what it perceived as a Russian 'gas attack' designed to undermine its economy and its pro-Western leadership, whereas Russia accused Ukraine of stealing gas. Even though both sides were responsible,[18] the crisis itself had wide political implications and went beyond the mere question of who did what. For the EU it was a matter of choosing the direction of its external energy policy, while for Russia and Ukraine it was a matter of showing their (un)reliability as supplier and transit country respectively. In the aftermath of the crisis, the EU and Ukraine agreed to work together on the modernization of Ukraine's gas transit system. The March 2009 agreement on this was criticized by Vladimir Putin, but constituted a step towards further integrating EU–Ukrainian relations and thus an implicit way of taking sides in the gas conflict between Russia and Ukraine.

[18] According to some sources both Ukraine and Russia bore responsibility for the conflict. See e.g. Pirani et al. (2009a) *The Russo-Ukrainian Gas Dispute of January 2009*, …p. 63.

At the same time, the Commission proposed a regulation on how to secure Europe's gas supply internally in order to avoid future crises. In April 2009 the Parliament gave its final approval to the Third Energy Package. In large part the package is an attempt to create an integrated, competitive EU gas market. It also includes a third country clause, the so-called anti-Gazprom clause, which constrains non-EU companies' access to the EU's internal market. Clearly, these actions indicate doubts about Russia's reliability as an energy supplier. However, the facts that the EU and Russia continue to jointly support Nord Stream and that the Commission sees it as a common European project indicate that the EU as a whole has yet to decide whether Russia is the problem or the solution to its gas imports.[19] As Jonathan Stern of the Oxford Institute for Energy Studies (OIES) puts it, 'Europe is fundamentally confused. It doesn't know whether it wants more Russian gas because it can't rely on other people, or less because it can't rely on Russia'.[20] Clearly, solutions exist to the (undefined) problem, such as the Third Energy Package as well as the strategy to diversify energy supply (by source, supplier and import routes/transport), to manage demand and to work towards sustainability. But before solving the problem you need to define it. The difficulty in defining it basically comes down to different views on Russia and Russian energy policy inside the EU, (a) as between the member states and (b) as between the member states and the Commission. Mark Leonard and Nico Popescu of the European Council on Foreign Relations (ECFR) have drawn up an excellent categorization of the member states' different policy approaches to Russia.[21]

The first category is the 'trojan horses', Cyprus and Greece. These states often defend Russian interests within the EU system, and are willing to veto common EU positions. However, even if Greece and Cyprus have often taken the lead in defending Russia's position on issues such as energy, the overall effect of their policy positions has been limited.

The second is the 'strategic partners', that is, France, Germany, Italy and Spain. These states enjoy a 'special relationship' with Russia which occasionally has undermined common EU policies. France's approach to Russia

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[19] See e.g. EU-Russian Energy Dialogue 10th Progress Report, November 2009, p. 7, on the Internet: http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/progress10_en.pdf (retrieved 24 November 2009); European Parliament (2009b) Parliamentary Questions to the European Commission and Commissioner Andris Piebalgs, 5 October 2009, on the Internet: http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=P-2009-4296&language=EN (last retrieved 24 November 2009).

[20] Jonathan Stern, quoted in Elder, Miriam (2009) 'Russia Faces Problems Home and Abroad', *Financial Times*, 3 October 2009, on the Internet: http://www.ft.com/cms/s/0/627f555e-aeea-11de-96d7-00144feabdc0.html (retrieved 8 February 2010).

[21] Leonard, Mark Popescu, Nico (2007) *A Power Audit of the EU-Russia Relations*, Policy Paper, European Council on Foreign Relations (ECFR), November 2007.

connects with its wish to strengthen its own position in international relations. Germany has a special relationship to Russia with respect to close trading ties (it is Russia's biggest trading partner) as well as historical ties. The Russo-German relationship and the role of France and Germany inside the EU are dealt with in depth below.

The third category is the 'friendly pragmatists' – Austria, Belgium, Bulgaria, Finland, Hungary, Luxembourg, Malta, Portugal, Slovakia and Slovenia. These states maintain a close relationship with Russia and tend to put their business interests above political goals. They rarely try to set the agenda and prefer to follow a mainstream policy which is largely shaped by the big states (notably Germany and France – whose support is crucial for any coherent EU policy on Russia). In practice, this means that even though these states are not active promoters of Russian interests within the EU system, they tend to oppose actions which they fear might irritate Moscow.

The fourth category is the 'frosty pragmatists' – the Czech Republic, Denmark, Estonia, Ireland, Latvia, the Netherlands, Romania, Sweden and the United Kingdom. These states also focus on business interests but are less afraid than others to speak out against Russian behaviour on human rights or other issues. The factor uniting the frosty pragmatists is that most of them have had bilateral disputes with Russia. As a result of a number of incidents with Russia the last few years, the UK has gone from being a strategic partner of Russia to seeking a more unified EU position on Russia. Hence, there are two rival great powers in the 'strategic partner' category, with highly national agendas, and one great power in the 'frosty pragmatists' category that proposes a more common stance on Russia.

The fifth and last category is the 'new cold warriors' –Lithuania and Poland. These states have an overtly hostile relationship with Moscow and are willing to use the veto to block EU negotiations with Russia.

The Commission, on the other hand, sees Russia as a natural partner for the EU in the energy sector. Due to the parties' interdependence, energy is an ideal sector for further development of an EU-Russia strategic partnership. Thus, the Commission's view is not in line with those of a majority of the member states on Russia and Russian energy policy. This discrepancy is reflected in the Commission's support for Nord Stream, which is shared by France and Germany and opposed by (for example) the Baltic states and Poland. On a level of principle, it is a reflection of the Commission's general energy strategy which contributes to putting some member states as well as other states (here Ukraine) at risk in the sense that it would put them in an unfavourable power position relative to Russia. Nord Stream strengthens Russia's ability to deal with transit and consumer countries bilaterally. If anything, this indicates the effects of energy policy being the responsibility of the European Commission whereas foreign relations and security policy are mainly the concern of the member states. The issue of which actor was ‘at fault’ for the January 2009 gas crisis is therefore not a secondary one. Rather it connects directly with the EU institutions’ different views of Russia as energy supplier, that is, whether it is a problem or a solution to the Union’s dependency on gas imports. The fact that the EU did not take sides in the 2009 gas crisis was not just a reflection of indecisiveness and a missed opportunity to tie Ukraine closer to itself; it was also an indication of the EU’s limited political capacity in the gas supply issue.

Instead, as it happens, the more pro-Russian stance of the current Ukrainian President, Viktor Yanukovych – compared to that of his predecessor, Viktor Yushchenko – means that stronger relations between Russia and Ukraine are a risk that has to be taken into account. If Russia were to reinforce its influence over Ukraine this would increase the EU’s vulnerability and strengthen Russia’s ability to divide the Union even further. However, because both the EU and Russia are important to Ukraine, not least economically, and given Ukraine’s own fragmented domestic political situation, it is likely that Ukraine will turn towards a multi-vector policy once more. Even though this policy lost ground with the Orange Revolution, it is still very much alive. Moreover, to some extent Mr Yanukovych represents such a policy direction.[22]

Thus, even though the EU’s actions in the crisis and its aftermath indicated a limited political capacity, it will continue to be a crucial actor for Ukraine. But a Ukrainian multi-vector policy could make the intentions, motives and behaviour of the EU, Russia and Ukraine more unpredictable and thus increase insecurity among the parties. This, in turn, could make it even more complicated for the EU to decide where the problem for its gas imports lies.

[22] Yermolenko, Volodomyr (2009) ‘Ukraine’s Return to a Multi-vector Policy’, *EUobserver.com*, 11 November 2009, on the Internet: http://euobserver.com/9/28650 (retrieved 24 November 2009).

2.2 Asymmetry despite Interdependence

The EU, and the EU and Russia together, have on numerous occasions[23] stated the importance of ensuring trust between the parties. Trust-building requires actors to take risks in the sense that successful risk-taking is a foundation for generating trust. The premise for any such trust-building is that actors are mutually dependent. Academics, researchers as well as the EU itself (e.g. the Commission, the Parliament and the former High Representative for the CFSP, Javier Solana[24]) and Russia have repeatedly said that the relationship between the EU and Russia is one of mutual dependence. In many ways this is correct: the EU area is Russia's most important trading partner – in 2008 the EU countries accounted for 55.2 per cent of Russia's exports and 45.4 per cent of its imports;[25] and the EU countries are dependent on Russian gas imports – even though Russia's share has declined, roughly from 80 per cent to 40 per cent since 1980 (see figures 2.1 and 2.2).[26] With this is in mind, Nord Stream can be seen as a risk-taking endeavour to generate trust between the parties. Successful risk-taking would mean extended and intensified interaction and thus closer cooperation. This is also how we could interpret the EU's and Russia's joint support for Nord Stream within the Energy Dialogue, given that the dialogue itself centres on strengthening energy cooperation between the parties.[27]

[23] See e.g. European Commission (2008a) *Second Strategic Energy Review: An EU energy security and solidarity action plan*, COM(2008) 781 Final, 13 November 2008, p. 8; EU-Russian Energy Dialogue 8th Progress Report (2007) p. 2; EU-Russian Energy Dialogue 9th Progress Report (2008), p. 2.

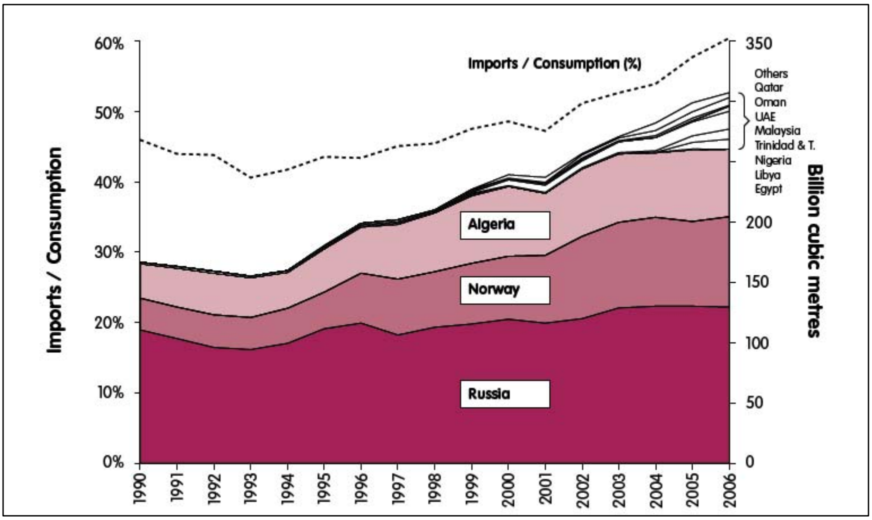
[24] European Commission (2008b) *Review of EU-Russia Relations*, COM(2008) 740 Final, 5 November 2008, p. 3; European Parliament (2009a) Report with a proposal for a European Parliament recommendation to the Council on the new EU-Russia agreement, 2008/2104(INI), 16 March 2009, p. 19; Solana, Javier (2008) *Where is Russia Going? A new attempt for an all-European security order*, S055/08, 10 February 2008.

[25] Eurostat (2009) *Russia–EU Bilateral Trade and Trade with the World 2008*, on the Internet: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf (retrieved 5 November 2009).

[26] Noël, Pierre (2008) *Beyond Dependence: How to deal with Russian gas*, European Council on Foreign Relations (ECFR), Policy Brief, November 2008, pp. 3-5.

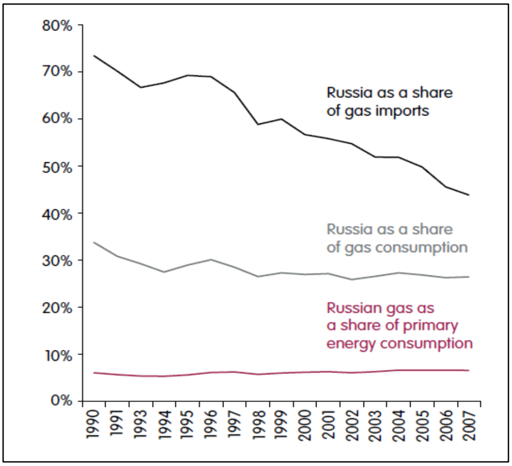
[27] See EU-Russian Energy Dialogue 7th Progress Report (2006), p. 4; EU-Russian Energy Dialogue 8th Progress Report (2007), p. 4; EU-Russian Energy Dialogue Synthesis Report.

Figure 2.1 EU 27 Gas Imports 1990-2006



Source: Noël, Pierre (2008) *Beyond Dependence: How to deal with Russian gas*, European Council on Foreign Relations (ECFR), Policy Brief, November 2008, p. 4

Figure 2.2 EU 27 Dependence on Russian Gas, 1990-2006



Source: Noël, Pierre (2008) *Beyond Dependence: How to deal with Russian gas*, European Council on Foreign Relations (ECFR), Policy Brief, November 2008, p. 4

Such a view, however, excludes some important factors that create asymmetry in the overall relation of mutual dependence. These factors are well known.

First, within the EU there are different degrees of dependence on Russian gas: Latvia, Slovakia and Poland, for instance, are heavily dependent whereas Sweden imports almost nothing (see figure 2.3). To the first mentioned states, gas also represents a substantial share of their total energy demand, which exacerbates the dependence. Second, Europe lacks interconnected infrastructure, especially where gas is concerned. Third, companies from individual EU countries sign long-term bilateral supply deals with Gazprom (e.g. ENI of Italy and E.ON Ruhrgas of Germany). Fourth, gas prices are often non-transparent since currently there is no official accounting for gas prices in Europe in the way that there is for oil prices. This is due to the fact that commercial agreements in most cases are not made public. Among other things, this helps Russia to strike deals with European companies without other companies being aware of what they are paying. This creates a risk that companies increasingly make concessions to Russia and Gazprom, for example concerning corruption and vested interests, in return for subsidized gas prices. In turn, it preserves the incentives to strike bilateral deals with Russia and thus works against the development of a common European energy policy.[28] In this regard it is interesting to note that the Commission and Europol have drawn attention to Gazprom's not-always-transparent company connections in the European gas sector, for example, in Austria, Cyprus, Switzerland and Ukraine.[29] Even though too much should not be read into such observations, it is fair to say that this contributes to insecurity and to imbalance in the EU-Russian gas relationship.

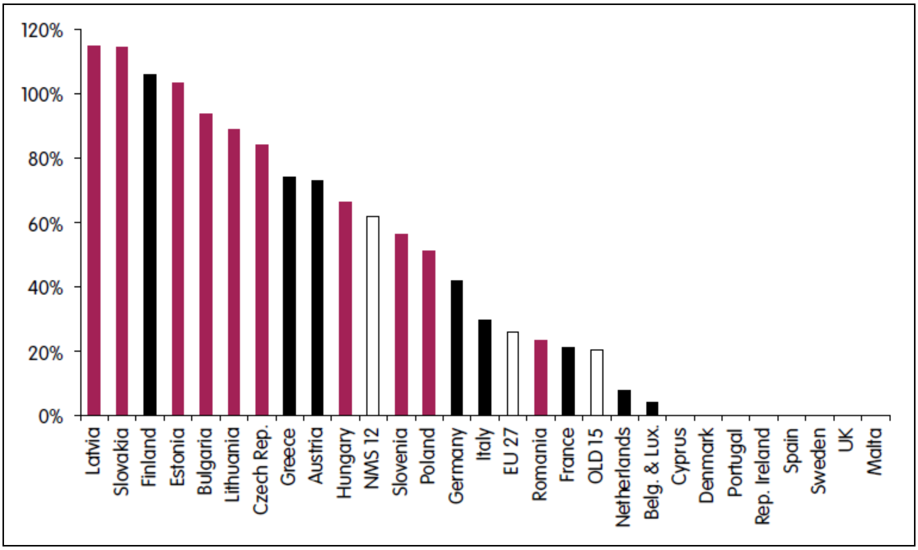
With respect to Nord Stream's possible strategic implications, these factors distort the interdependence in the EU-Russian gas relationship and give Russia leverage over Europe's energy security. Nord Stream's strategic implications primarily concern the fact that the pipelines will bypass (for example) Poland and the Baltic states and make Russia's relations with these states, and the EU as a whole, more asymmetrical.[30] Thus, Nord Stream will make it easier for Russia to deal with the EU member states bilaterally. There are also strategic implications stemming from the fact that Russia will secure control of gas flows to a number of countries, including Germany, Netherlands and the UK, through Nord Stream.[31] This will contribute to sustain the bilateral

[28] This point was suggested to me by Dr. Susanne Oxenstierna at FOI. See Kupchinsky (2009b) 'Gazprom's European Web', p. 30, for a similar view.
[29] Kupchinsky (2009b) 'Gazprom's European Web', pp. 13-21.
[30] Larsson, Robert (2007) *Nord Stream, Sweden and the Baltic Sea Security,* Base Data Report, March 2007, FOI-R--2251--SE (Stockholm, FOI), pp. 40-41.
[31] Ibid.

relationship between these states and Russia, and accentuate Germany's existing position as one of Russia's closest strategic friends within the Union.

In other words, since the EU's and Russia's mutual dependence contains asymmetric dimensions, the relationship does not satisfy the basic preconditions for successful risk-taking and, eventually, trust-building. As a result, the opportunities to strengthen ties through Nord Stream are at best limited. Rather, there is a risk that the Nord Stream issue will become an example of the way in which the EU disregards the position of some member states while favouring others. This, in turn, could further encourage the member states to prioritize their national energy interests and thus reduce the chances of building a common energy policy. Thus, the EU and Russia are mutually dependent on an overarching level but, given the different views on Russia as energy supplier and the asymmetry among the member states, it is difficult to talk about mutual dependence when the relationship is broken down and analysed at a member state level vis-à-vis Russia.

Figure 2.3 Russian Gas as a Share of Primary Gas Supply (2006)



Source: Noël, Pierre (2008) *Beyond Dependence: How to deal with Russian gas*, European Council on Foreign Relations (ECFR), Policy Brief, November 2008, p. 10

In many ways the member states' differing views on Nord Stream demonstrate the fragmentation within the EU in the energy field, most notably between the Commission and the member states. At one end, the Commission (represented by the former Commissioner for Energy, Andris Piebalgs[32]) has promoted Nord Stream as a project that favours Europe as a whole:

> The European Commission has always been favourable to Nord Stream. With the progress being made in this project, and the recent signing of the Inter-Governmental Agreement on Nabucco, the EU is taking crucial steps towards securing energy supplies for the future. These projects have the full support of the European Commission.

At the other end, Polish Foreign Minister Radek Sikorski[33] has compared the Russo-German deal on Nord Stream to the Molotov-Ribbentrop Pact ahead of World War II – a pact which set out to divide Poland between Nazi Germany and the Soviet Union. Likewise, smaller member states (e.g. the Baltic states) have criticized the project on the grounds that it threatens their energy security and carries environmental risks.[34] There is also a security aspect to it given the possible presence of Russian military forces on the Baltic Sea.[35] Certainly, the third country clause, contained in the Third Energy Package, could ease Nord Stream's strategic implications. The clause offers protection to the member states from non-EU company investments if they deem that such investments threaten their energy security.

Still, the split in the ways in which the Commission and some of the member states perceive Nord Stream speaks for itself. Moreover, it does not accord well with the Commission's assumed role as the small[36] member states' best friend. As a best friend, the Commission would show:

[32] Piebalgs, Andris (2009) Nord Stream, Press Release, 16 July 2009, on the Internet: http://www.nord-stream.com/en/press0/press-releases/press-release/browse/1/article/nord-stream-and-eu-energy-commissioner-reaffirm-importance-of-new-gas-supply-routes.html?tx_ttnews%5BbackPid%5D=24&cHash=b6db8a9067 (retrieved 24 November 2009).

[33] Traynor Ian (2006) 'Poland Recalls Hitler-Stalin Pact amid Fears over Pipeline', *The Guardian*, 1 May 2006, on the Internet: http://www.guardian.co.uk/world/2006/may/01/eu.poland (retrieved 28 October 2009).

[34] 'Baltic States Still Worry about Nord Stream Pipe', Reuters, 6 November 2009, on the Internet: http://uk.reuters.com/article/idUKL636662820091106 (retrieved 3 February 2010).

[35] Larsson, Robert L. (2008a) *Security Implications of the Nord Stream Project*, FOI Memo E12706, February 2008 (Stockholm, FOI), pp. 12-13.

[36] Poland is not a small member state but has joined forces with other new and/or small member states (notably the Baltic states) on e.g. Nord Stream.

- Greater sensitivity than other actors to the need to safeguard the principle of 'equality between states' in the EU and prevent the big states dominating; and
- Greater sensitivity than other actors to small states' national interests and alliance-building efforts in their pursuit of their interests within the EU.[37]

At the same time, the Commission has supported the so-called solidarity principle, for example, in the Second Strategic Energy Review. In short, this principle means that member states are to help other member states in need (e.g. in the event of gas shortages).[38] This demonstrates how the Commission supports member states, notably the small ones and those heavily dependent on gas, in terms of helping them to spread risk within the EU. However, in practice documents such as the Second Strategic Energy Review have had only limited effect. Simon Pirani, Jonathan Stern and Katja Yafimava of the Oxford Institute for Energy Studies argue that it made little difference in the 2009 Russo-Ukrainian gas crisis during which many member states suffered from gas shortages. They argue, inter alia, that the Commission's limited political credibility and leverage with Ukraine and Russia and its inability or unwillingness to provide financial resources worked against a resolution of the crisis.[39] It is therefore questionable what the principle of solidarity on energy policy really can guarantee when it comes to it. In addition, even though the solidarity principle is included in the Lisbon Treaty it contains no binding obligation which forces member states to act. Certainly, in July 2009 the Commission launched a proposal concerning measures to safeguard security of gas supply, which was a direct reaction to the crisis.[40] The main part of the proposal centred on strengthening crisis management between the member states and the Commission and on coordinating measures at European Community level. However, this is chiefly a temporary solution since it does not deal with the actual problem, namely the EU's long-term import dependence and the gas relationship with Russia.

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[37] Bunse, Simone et al. (2005) *Is the Commission the Small Member States' Best Friend?*, Swedish Institute for European Policy Studies (SIEPS), 2005:9, p. 7.
[38] European Commission (2008a) *Second Strategic Energy Review*, p. 3.
[39] Pirani, Simon et al. (2009a) *The Russo-Ukrainian Gas Dispute of January 2009*, pp. 47-49.
[40] European Commission (2009a) *Proposal for a Regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC*, COM(2009) 363 Final, 16 July 2009.

How, then, are we to understand the Commission's simultaneous support for the solidarity principle and Nord Stream with respect to the strategic implications and the 2009 crisis? Judging from the position of Andris Piebalgs,[41] Nord Stream is only one part of a more general energy strategy which includes:

- Diversification of energy by source (renewable, clean fossil fuel and nuclear), and by supplier as well as method of transport, distribution and import routes;
- Lowering energy demand; and
- Creating an external energy policy.

In large part this strategy mirrors the objectives of competitiveness, security of supply and sustainability outlined in the 2006 Green Paper on Energy and in energy chapter in the Lisbon Treaty.[42] The support for Nord Stream can also be explained because the third country clause, if applied effectively, would reduce the project's strategic implications. The Commission's proposal for a regulation on measures to safeguard security of gas supply in the EU also points in this direction. The regulation states that:

> In the event of failure of the largest gas supply infrastructure and/or supply source of a Member State (entry point, production field, LNG terminal, storage, etc.), **sufficient** capacity should exist in the remaining gas infrastructure to meet demand (at least for domestic consumption) [bold in original].[43]

Sufficient capacity refers to the member states' ability to ensure a supply of gas for 60 days based on a worst-weather scenario (a goal to be reached by March 2014).[44] In other words, if the EU countries manage to make energy savings, use energy more efficiently, create storage capacity and implement the Third Energy Package effectively, Nord Stream would not necessarily pose an imminent threat to the EU's energy security.

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[41] Piebalgs, Andris (2008) *European Energy Security Policy*, 21 February 2008, p. 3.

[42] European Commission (2006) *Green Paper A European Strategy for Sustainable, Competitive and Secure Energy*, COM (2006)105 Final, 8 March 2006, p. 3; The Lisbon Treaty, Article 194.

[43] EU (2009) European Commission's Proposal for a Regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC, COM(2009)363, ERGEG Comments, p. 7.

[44] European Commission (2009a) European Commission's Proposal for a Regulation, p. 13.

These are tough endavours by themselves and, as Andris Piebalgs has emphasized,[45] the Baltic nations face the biggest challenges in meeting the capacity standards: that is, those EU countries (together with Sweden) that have been most worried about Nord Stream with respect to its effect on their position vis-à-vis Russia. The risk that Nord Stream could increase the vulnerability of the EU countries and reinforce the asymmetrical interdependence between the EU and Russia is thus still a relevant factor to take into account. It is also fair to say that Nord Stream does not automatically favour the EU as a whole, since it does not guarantee security of gas supply to all of the affected member states. Nord Stream thus demonstrates that the Commission may have shown greater sensitivity to the small member states' interests, but in practice it has not succeeded in preventing the dominance of the big states (here France and Germany). On a level of principle, it demonstrates how difficult it is for a supranational organ to act within a field where individual states' competence is strong and where national interests often diverge – even if it is a supranational policy area.

At the same time, it is important to point out the new and/or small member states' own responsibility regarding their dependence on Russian gas. Truth to tell, even though these states have searched for options to diversify their energy supplies away from Russia, the results have been very modest. Instead their reliance on Russian gas has continued to be high. For example, the share of total primary energy supply covered by imports of Russian gas for the twelve new member states is 15 per cent, whereas the figure for the 'EU 15' is 5 per cent.[46] These circumstances thus underline that Nord Stream's strategic implications have become more prominent than they need be. It is therefore crucial that these states work harder for a rapid change in their energy mix. Thus, EU solidarity should not exclude these states' own responsibility. But until they do achieve a different energy mix the asymmetry in gas dependence within the Union is likely to continue to be a factor in the EU-Russian gas relationship.

So far the analysis has not focused on the economic arguments about the legitimate business interests for Russia in the case of Nord Stream. One such argument centres on the effects of gas price disparities in the Commonwealth of Independent States (CIS) region, which is a contentious issue. Since 2004–2005, Russia and Gazprom have worked to implement European 'netback' prices on gas, which would mean significantly higher prices in this area.[47] Here it is important to mention that the gas disputes between Russia and

[45] EurActive.com (2009) *Commission Tables EU Winter Gas Storage Plan*, 17 July 2009, on the Internet: http://www.euractiv.com/en/energy/commission-tables-eu-winter-gas-storage-plan/article-184199 (retrieved 25 November 2009).
[46] Noël, Pierre (2008) *Beyond Dependence*, pp. 13-14.
[47] Mitrova et al. (2009) 'Russia, the CIS and Europe', pp. 395-397.

Belarus, and Russia and Ukraine in the 2000s in large part had to do with the European netback principle and payment discipline.[48] Russia's dependence on these countries for transiting gas to Europe and their resistance to increased prices (due to their highly gas-dependent economies) could put Gazprom in an unfavourable position. For instance, it could force Gazprom to buy Central Asian gas at prices equivalent to European prices and then sell it to western CIS countries at lower prices. This, in turn, would be a guarantee that gas supplies to Europe transiting these countries are not disrupted. Hence, Nord Stream (and South Stream) would largely relieve Russia of such pressure.[49]

However, since alternatives, such as onshore routes via the Baltic states or extension of the existing Yamal-Europe pipline, have not been fully explored, it is clear that political motives constitute an integral part of the Nord Stream project. Among other things, Nord Stream indicates Russia's interest in sustaining the asymmetries of the EU-Russian gas relationship. With respect to its negative effects on the EU's position vis-à-vis Russia hitherto, Nord Stream could make the creation of a common external energy policy more difficult.

2.3 Common Interests but Not Common Values

The EU's and Russia's different positions on how to do business clearly come into play in the Nord Stream case. Most notably this has to with the principles that lie behind the parties' respective interests in the project. One such principle concerns the issue of ownership unbundling. Basically, unbundling has to do with the principle that energy companies should not own both gas supplies and gas transmission networks. The Commission has promoted full ownership unbundling or, alternatively, a system where the operation of the network is transferred to an independent operator (ISO). The Council of the European Union, however, has promoted a model with an independent transmission operator, which in practice means that a company can continue to own both production and supply via affiliated companies.

The issue of unbundling has been of key importance to the EU since the European gas market remains rather rigid and closed, despite advances towards liberalization. It was a crucial part of the EU's Third Energy Package, launched in 2007 and finally approved by the Parliament in April 2009. The Russian side, however, have had serious doubts about unbundling. For example, Sergey Yastrzhembsky, the Russian President's special envoy for relations with

48 Pirani, Simon (2009) 'Conclusions', in Pirani et al. (2009a) *Russian and CIS Gas Markets*, p. 445.
49 Mitrova, et al. (2009) 'Russia, the CIS and Europe', pp. 431-433.

the EU until May 2008, has stated that it looks like an EU attempt to regulate the operation of national energy companies in the domestic Russian market.[50] With respect to Nord Stream, unbundling is a crucial issue since the project entails a risk that Gazprom could increase its control of gas (production) and the transmission network and at the same time it will own half the pipeline. Clearly, this is not in line with the idea of unbundling.

The issue of unbundling also divides the EU internally. Countries such as France and Germany as well as Austria, Bulgaria, Greece, Latvia, Luxembourg and Slovakia have opposed it. All these countries (except for Latvia) have good or fairly good relations with Russia. Among other things, Austria, Bulgaria, Luxembourg and Hungary (as well as Belgium) hope to become gas hubs for Gazprom in the EU. However, it would be unfair to connect opposition to unbundling solely with good relations with Russia. For example, Spain (a strategic partner to Russia) supports unbundling, whereas Latvia and Lithuania (highly dependent on Russian gas and strong critics of Russia) do not. Moreover, unbundling would effectively force large European gas companies like the German E.ON Ruhrgas, the French Gaz de France and the Italian ENI to split, which is clearly not in the interest of any of these state-owned companies. In other words, states that oppose unbundling tend to be dependent on Russian gas, or to want to become gas hubs, or to have a national interest in maintaining the current state of affairs. Luxembourg is the exception.

Reciprocity, which relates to the issue of unbundling, is another principle on which the EU and Russia have opposite views:

> In Russia, it means equality in end results, that is to say, asset swaps of equivalent financial or commercial value; for the EU, it means commonly agreed principles and access to markets and investments – a level playing field, with the end result being left to free competition.[51]

Added to this is the issue of pipeline control. Russia is keen on maintaining the structure of state majority-controlled companies that have the monopoly on gas exporting pipelines.[52] The Nord Stream case should definitely been seen in the light of these examples of the parties' different views on crucial principles, since it connects with the way in which they do business. In this

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[50] Yastrzhembsky, Sergey (2008) 'Trust, Not Double-standards: What Russia expects from the EU', in Katinka Barysch (ed.) (2008) *Pipelines, Politics and Power: The future of EU-Russia energy relations*, Centre for European Reform (CER), October 2008, p. 36.

[51] Cleutinx, Christian and Piper, Jeffrey (2008) 'The EU-Russia Energy Dialogue', in Barysch (ed.) (2008) *Pipelines, Politics and Power*, p. 28.

[52] I am indebted for this point to Michael Fredholm at the Department for Central Asian Studies, Stockholm University.

respect it interesting to note that in its resolution on the environmental impact of Nord Stream, the European Parliament has emphasized that 'the reciprocity principle must be fully respected as regards investment if the interdependence between the EU and Russia is to develop into a partnership'.[53] In addition, it noted that 'third countries benefit to a great extent from Europe's open market, but also that European investors in Russia are not accorded similar advantages'.[54] From this perspective, the EU's support for Nord Stream looks unsound since it does not symbolize support for such crucial principles that mean the same thing for both parties.

At the same time, the EU's Third Energy Package and the Energy Charter Treaty (ECT) provide some important clues here. The third country clause, the anti-Gazprom clause, contained in the package enables national governments to deny a non-EU company entry into the EU's internal market if it is deemed to threaten the energy security of the member states. The clause forces third countries to unequivocally comply with the same requirements as EU companies. Also, the package and the ECT include mechanisms that can be applied retroactively, which can compel non-EU companies to sell existing investments in the EU's internal market.[55]

Thus, the Third Energy Package and the ECT could make it more difficult for Russia to ignore principles such as unbundling. This means that Nord Stream would not automatically give Gazprom access to European markets. At the same time, Gazprom's not always transparent company structure and possible diffuse business affiliations in countries like Austria, Italy and Hungary[56] complicate matters. If it is hard to establish who really owns the companies, it will be more difficult to ensure that companies that are responsible for production and supply respectively really are independent from one another. In turn, it could lead to difficult situations in cases where it is not possible to establish that a company really is independent. This, in turn, necessitates detailed and complex legislation on unbundling. Given that only a minority of EU countries have indicated that they are interested in full ownership unbundling, the implementation of this principle involves substantial difficulties.

Furthermore, the degree to which a relationship is institutionalized or regulated reveals something important about the nature of that relationship, namely that bigger divergences necessitate more detailed regulation

[53] European Parliament (2008) *European Parliament Resolution of 8 July 2008 on the Environmental Impact of the Planned Gas Pipeline in the Baltic Sea to link up Russia and Germany*, P6_TA(2008)0336, 8 July 2008, p. 7.
[54] Ibid.
[55] Again, I am indebted to Michael Fredholm for pointing this out.
[56] Kupchinsky (2009b) 'Gazprom's European Web', pp. 13-21.

in order for it to work. Compare, for instance, EU-Russian relations with the EU's relations with the US. Even though they disagree on many things, the EU and the US can cooperate without detailed regulation since they share some common values (e.g. rule of law). Less regulated relations are by no means devoid of problems, but with common values there exists a ground for predictability between the parties. If anything, common values have a practical dimension, especially on energy trade, in the sense that clear rules of engagement can reduce sources of geopolitical tension and insecurity. As former EU Commissioner for Trade, Peter Mandelson, put it:

> Clearer bilateral, regional or international rules would improve predictability for transit and supply of energy, open the door for producer and consumer countries to invest in each other and therefore deepen interdependence and stability and help channel domestic and foreign capital for exploration and extraction.[57]

With respect to Nord Stream, it is therefore troublesome that the EU and Russia disagree on central business principles for gas trade like unbundling and reciprocity.

More to the point, in the EU-Russian relationship in general, and the gas relationship in particular, an inherent tension exists between the low degree of consent on common values and the need to regulate cooperation. That is, without common values increased regulation is necessary. But as long as Russia continues to be anxious about such values it will be difficult to achieve that. When the EU tries to impose legal principles unilaterally it is met with suspicion from Russia, as was the case with unbundling. Nord Stream may be a project of common interest, but it is not based on common values. This means that the ground for predictable EU-Russian gas cooperation is limited, and thus the tools for reducing insecurity among the parties, in particular among the member states that are heavily dependent on Russian gas, are limited. Clearly, this could exacerbate the EU's internal divisions on its Russian energy policy further as well as accentuating the perception that energy is the Commission's policy responsibility but the concern of the individual member states. If the goal is to create a common EU energy policy this is not favourable. Nord Stream is thus a case when a cooperative endeavour is favourable to Russia rather than the EU. It demonstrates that projects based on common interests rather than common values (i.e. interaction despite value incompatibility) complicate the EU's position vis-à-vis Russia in the gas relationship.

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[57] Mandelson, Peter (2007) 'Energy Security and Climate Change: What role for trade policy?', 9 February 2007.

2.4 Russo-German Relations

The role of Germany and its relationship with Russia are key factors in gaining a full understanding of Nord Stream, the EU-Russian gas relationship and ultimately the EU's limited political capacity in the gas supply issue.

Generally, Germany has long been crucial to the structure of European politics since it is:

> The fulcrum of the European balance of power, and the lodestone of its institutional architecture. Because of its central geographical location in the heart of the continent – its *Mittelage* – Germany is Europe's *Zentralmacht*, strategically located on the cross-roads of Europe: between the Gaullic West and the Slavic East, and between the Scandinavian North and Latin South. Its *Mittellage* means that Germany has more neighbours than any other European country, and consequently how it acts on the international stage has far-reaching implications for the regional balance of power [italics in original].[58]

From a political perspective, this is exactly what Nord Stream symbolizes – a growing economic and political relationship between Moscow and Berlin (amplified by strong personal ties[59]) leading to a deepening of Russia's access to Europe *with possible implications for the regional power balance*. The EU was founded as a construct to counter any potential hegemony of a single state on the European continent, which had characterized Europe for the preceding centuries. The Commission was a crucial element of this vision of the EU as an anti-hegemonic project, with its mandate primarily lying in pursuing the common good and mitigating pure power politics in Europe.[60] In view of the project's great power connotations, it is therefore striking that the Commission has supported Nord Stream. Certainly, it is evidence that great power behaviour is very much alive within the EU in the sense that none of the larger powers are likely to subordinate their relations with other great powers (in this case Russia) to a common energy policy. As such, it is an example of the pressure that cooperation between great powers can put on supranational institutions.

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[58] Hyde-Price, Adrian (2007) *European Security in the Twenty-First Century: The challenge of multipolarity* (London, Routledge), p. 117.

[59] In the case of Nord Stream it is fair to say that personal ties between influential individuals (notably Prime Minister Putin's connections with the former Chancellor of Germany, Gerard Schröder, and the Managing Director of Nord Stream AG, Mathias Warnig) played a role in realizing the project. See Larsson (2007) *Nord Stream, Sweden*, p. 29 for such a view.

[60] Bunse et al. (2005) *Is the Commission the Small Member States' Best Friend?*, p. 45.

Europe has long felt the impact of Russo-German relations, notably since around the time of World War II. During this time Germany has served as a balancer between the East and the West and the important question has always been where in Europe the Germans belong – to the East? To the West? Or wandering between East and West? To smaller states (e.g. the Baltic states and Poland) Russo-German relations exemplify the well-known proverb that the grass gets trampled whether the elephants fight or make love. As a result, these states tend to be suspicious of Russo-German relations when they are good and worried when they are bad.[61] This goes in particular for Poland as it is

> Located on the eastern borders of the European Union and serves as a conduit for trade between the EU and Russia, Ukraine and the CIS. The main oil and gas pipelines also transit through Poland. Poland has extensive and growing economic relations with Ukraine, and shares a border with the Russian exclave of Kaliningrad, which is now surrounded by the EU's Schengen borders. For all these reasons, Poland has a systemic interest in acting as a hinge state in the gateway region bridging the EU and Russia.[62]

It is from this perspective that one should see Poland's opposition to Nord Stream, since the Polish state sees obvious economic, strategic and symbolic implications of the project. More important, even with less close Russo-German relations (due to the less warm approach to Russia of the current Chancellor, Angela Merkel) Nord Stream raises some interesting questions for the future. For example, how will Germany balance its role as Europe's *zentralmacht*? That is, how will it manage its relations with Central and Eastern Europe, France, Russia, the UK and the US all at once without creating tensions between them? In particular, balancing its growing economic interests in East–Central Europe with good relations Russian will be a delicate matter.

Germany's foreign policy choices have been and will continue to be crucial to the EU, especially with regard to the change in the power balance within the Union as a result of the Lisbon Treaty. The Lisbon Treaty, which entered into force on 1 December 2009, changes the power balance within the EU in favour of the big states (notably Germany and France). For example, Germany's share in the Council of the European Union on votes with qualified majority (QMV) will increase from 8.4 per cent to 16.4 per cent, and France's will increase from 8.4 per cent to 12.9 per cent (see table 2.1). Also, the bloc led by Germany and France will be in a better position to block legislation, while the ability of the EU-sceptical states (red on the table) and states wary of France and

[61] Hyde-Price (2007) *European Security in the Twenty-first Century*, pp. 132; 135-136; 161.
[62] Ibid., p. 160.

Germany (yellow on the table) to block legislation will decrease.[63] In essence, Germany and France support a strong EU which they control.[64] Given the effects of the Lisbon Treaty, it is possible that France and Germany will be able to put even more pressure on supranational institutions like the Commission in the years ahead. The result could be a more energetic and stronger EU. But it would be a Union which France and Germany could dominate.

This would not favour the possibilities of creating a common EU energy policy. For one thing, France and Germany have fairly friendly relations with Russia and a relaxed view of Russia as energy supplier. More important, however, France and Germany are crucial for further integration of the EU's gas market; if they do not fully embrace such an endeavour, it will not be realized. Currently, both have large national energy companies that gain from the de facto monopolistic market structure. There is therefore a strong risk that the EU will have a hard time effectively implementing (for example) the Third Energy Package and thus getting the benefit of the package's technical merits. This means that Nord Stream's strategic implications and the fears mentioned above regarding the EU's political capacity in its gas relations with Russia still constitute a considerable risk.

Given these conditions, and in the light of diverging interests and views on Russia as energy supplier, it is not likely that the EU will be able to increase its coordination capacity between the institutions and balance between the competencies of the member states in the energy field. At the same time, it is important to point out that in order to achieve a stronger EU, France and Germany must put disagreements demonstrating their different interests aside (their dispute in 2008 over the Mediterranean Union is a good case in point since it revealed their different priorities). Currently, it is highly uncertain whether they will be able to do so, but their history of disputes indicates that it will be difficult.

[63] To block a proposal, a minimum of four member states (which must comprise more than 35 per cent of the EU population) is required. The EU-sceptical states together with the states that are wary of France and Germany barely reach that number (approximately 36 per cent for the combined populations of the 14 states). Consequently, these states will have to exercise perfect discipline and not let a single member back out in order to block proposals.

[64] Stratfor Global Intelligence (2009c) *EU and the Lisbon Treaty, Part 3: Tools for a strong union,* 16 October 2009, on the Internet: http://www.stratfor.com/analysis/20091015_eu_and_lisbon_treaty_part_3_tools_strong_union (retrieved 19 January 2010).

Table 2.1 The Shifting Balance of Power in the EU

COUNTRY	QMV VOTES AS % OF TOTAL UNDER NICE TREATY	QMV VOTES AS % OF TOTAL UNDER LISBON TREATY	BLOC SHARE OF NICE VOTES	BLOC SHARE OF LISBON VOTES
Germany	8.4	16.4	29.9	43.6
France	8.4	12.9		
Italy	8.4	12.0		
Belgium	3.5	2.2		
Luxembourg	1.2	0.1		
Spain	7.8	9.2	25.9	20.7
Romania	4.1	4.3		
Greece	3.5	2.3		
Hungary	3.5	2.0		
Bulgaria	2.9	1.5		
Slovakia	2.0	1.1		
Cyprus	1.2	0.2		
Malta	0.9	0.1		
Netherlands	3.8	3.3	22.7	12.9
Portugal	3.5	2.1		
Sweden	2.9	1.9		
Austria	2.9	1.7		
Finland	2.0	1.1		
Ireland	2.0	0.9		
Lithuania	2.0	0.7		
Latvia	1.2	0.5		
Slovenia	1.2	0.4		
Estonia	1.2	0.3		
United Kingdom	8.4	12.3	21.7	23.1
Poland	7.8	7.6		
Czech Republic	3.5	2.1		
Denmark	2.0	1.1		
Total	100.0	100.0		

- To pass under the Nice Treaty, the proposal needs to be supported by 14 countries and reach 74 percent of QMV votes (countries supporting the proposal should represent 62 percent of EU population).
- To pass under the Lisbon Treaty, the proposal needs to be supported by 15 countries and reach 65 percent of EU population.

- Favor strong EU
- Can be swayed to support strong EU
- Open to support strong EU, but wary of Franco-German dominance
- Skeptical of EU

Source: Stratfor Global Intelligence (2009c) *EU and the Lisbon Treaty, Part 3: Tools for a strong union*, 16 October 2009

3 The EU's Limited Political Capacity – the Cases of Nabucco and South Stream

This chapter deals with essential issues that relate to the EU's limited political capacity in the cases of Nabucco and South Stream.

3.1 The Black Sea and Caspian Sea Region – A Key Area

Much of the discussion on Nabucco and South Stream hinges on whether the projects are competitors and whether there will be enough gas to fill the pipelines, given China's future need for gas.[65] So far, a major obstacle to both projects has been the ability to attract sufficient gas supplies – which according to some estimates is unlikely to happen prior to the late 2010s.[66] The Nabucco consortium projects operation in 2014, whereas for South Stream it said to be around 2015.[67] Currently, the reliability of such projections is uncertain: the International Energy Agency (IEA) has pointed out that gas demand is falling (by around 3 per cent for 2009) and that there will be a gas glut as a result of the economic crisis during 2008. At the same time, assuming that the global economy begins to recover in 2010, the IEA has forecast average growth in gas demand of 2.5 per cent per year between 2010 and 2015.[68] Nonetheless, it is important to mention a couple of implications, apart from the mere political ones, in realizing Nabucco and South Stream.

First, South Stream is technically demanding since it will run under the Black Sea and needs to connect with the existing Blue Stream pipeline running from Turkey to Russia (see the map in Appendix I). Nabucco, on the other hand, with a projected cost of €7bn, would run completely onshore. But the

[65] For an analysis on China's gas needs see e.g. Atarodi, Alexander and Hellström Jerker (2009) *Säkerhetspolitiska aspekter på ökat externt beroende av olja och gas: EU och Kina som exempel* [Security Policy Aspects on Increased External Dependence on Oil and Gas: the Examples of the EU and China], User Report, November 2009, FOI-R--2837--SE (Stockholm, FOI).

[66] Mitrova et al. (2009) 'Russia, the CIS and Europe', p. 426.

[67] Nabucco Gas Pipeline Project, on the Internet: http://www.nabucco-pipeline.com/project/project-timeline/main-page-project-timeline-20090126.html (last retrieved 24 November 2009); South Stream, on the Internet: http://south-stream.info/index.php?id=14&L=1 (last retrieved 24 November 2009).

[68] International Energy Agency (2009) *World Energy Outlook 2009: Executive Summary*, p. 10, on the Internet: http://www.worldenergyoutlook.org/docs/weo2009/WEO2009_es_english.pdf (retrieved 19 November 2009).

proposed Trans-Caspian pipeline will be critical to the workings of Nabucco. Also, the idea of attracting gas from (for example) Iran looks unrealistic from a wide range of perspectives, not least due to the strained relations between the US and Iran (the US is a co-supporter of Nabucco) and Iran's own ambitions in the region.

Pipelines can serve as a basis for closer relations between actors as well as for division. Building pipelines is by its nature an integrating factor: it includes producers and consumers while it excludes others. With this in mind, and due to the strategic location of the Black Sea and Caspian Sea regions, Nabucco and South Stream are not just about gas; they are about the political and economic direction of these regions. It is therefore important to see the competitive aspects of the two projects. In a sense, they materialize the EU's and Russia's competing interests of drawing the Black Sea and Caspian Sea states closer to themselves. In this regard, a number of factors point to the idea that South Stream could be seen as a Russian attempt to counter further EU rapprochement with states in the Black Sea and Caspian Sea area. First, South Stream is an expensive project in itself (€25bn) as well as compared to lower-cost alternatives, like expanding the existing Blue Stream pipeline.[69] Second, with the Georgian energy transport infrastructure threatened by tensions between Moscow and Tbilisi, not least after the Georgian War in 2008, Azerbaijan's only other real option is to transport gas via Russia. Nabucco would change this. Third, under a new gas deal between Azerbaijan and Russia, Russia will pay $350 per thousand cubic meters (tcm) for its Azerbaijani gas. This means that Russia is willing to pay more for that gas than Europe pays to Russia – in 2009 the price Europeans pay is expected to average just above $280 per tcm.[70] Thus, Russia is willing to incur a financial loss in order to confine Azerbaijan's gas exports in the future. Such confinement could endanger the future of Nabucco, since gas from Azerbaijan (as well as Turkmenistan, from which Russia imports large quantities) is crucial to the project. It is important not to overstate the difference in price, since European gas prices are connected to the oil price and thus rise (and fall) accordingly. Also, Russia's and Azerbaijan's new gas deal concerns rather small volumes of gas (0.5 bcm per year). But, given Gazprom's long term ambition to tie all Azerbaijan's gas to itself, and Azerbaijan's increasing export capacity,[71] it is a relevant consideration. Fourth, doubts exist as

[69] Mitrova et al. (2009) 'Russia, the CIS and Europe', p. 425.

[70] Stratfor Global Intelligence (2009a) *Russia: Moscow's Grip on Caucasus Energy Tightens,* 30 June2009, on the Internet: http://www.stratfor.com/analysis/20090630_russia_moscows_grip_caucasus_energy_tightens (retrieved 23 November 2009). Note, however, that this exact figure of what Europeans pay for their gas calls for some caution given generally declining gas prices during 2009.

[71] 'Gazprom Says Prepared to Raise Azeri Gas Purchases', Reuters, 11 January 2010, on the Internet: http://uk.reuters.com/article/idUKLDE60A1YY20100111 (retrieved 15 February 2010).

to whether Russia will be able to provide the declared amounts of gas through Nord Stream, Yamal, via Ukraine, Blue Stream and South Stream all at once.[72] Even though demand for gas and gas prices both fell during 2009, such doubts still hold for the long term given that global gas consumption is forecast to increase continuously up to 2030.[73] Fifth, for a number of states (e.g. Azerbaijan and Turkmenistan), South Stream would mean continued interconnectedness with Russia. This could potentially constrain these states' opportunities and/or willingness to pursue an independent energy policy and continue their Western path of development. South Stream would be a continuation of the continental pipeline system inherited from Soviet times, directed at Moscow, and would thus preserve Russian control in the area. All these factors mirror Russia's concern for control of energy as a crucial variable for its ability to be a strong sovereign state, outlined in the latest version of Russia's *National Security Strategy of the Russian Federation up to 2020*.[74]

Russia's ambition to tie the Black Sea and Caspian Sea regions to itself also has historical roots and geopolitical connotations that go beyond the gas issue. As a result of past experiences, Russia has seen these regions as buffers to keep foreign invaders out.[75] Even though invasion is not a likely threat today, talk of NATO expansion in this area and the involvement of NATO in Europe's energy issues[76] connect with this historical strategic concern.

If Russia gets South Stream on track while Nabucco is further delayed it would strengthen Russia's control over the region, which could make it harder for the EU to promote political and economic reform in the area. Nabucco would fill a missing link between Europe and the Black Sea and Caspian Sea regions by extending the EU's common market into the area. It would be an important strategic step in the EU's efforts to create a ring of well-governed states. At the same time, the fact that the EU has been divided in the Nabucco process (e.g. by Italy's support for South Stream) indicates the

[72] Socor, Vladimir (2008) 'Sourcing the Nabucco Pipeline to Prevail Against South Stream', *Eurasia Daily Monitor*, vol. 5, issue 25 (7 February 2008, on the Internet: http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=33365 (retrieved 15 December 2009).

[73] International Energy Agency (2009) *World Energy Outlook 2009*, p. 10.

[74] Korsunsky, Sergiy (2009) 'Russian Energy Security Policy: A challenge, an opportunity or a threat?', in Andrew Monaghan (ed.) (2009) *The Indivisibility of Security: Russia and Euro-Atlantic security*, NATO Defence College Non-paper, December 2009, pp. 73-74, on the Internet: http://www.ndc.nato.int/download/downloads.php?icode=143 (retrieved 10 December 2009).

[75] Friedman, George (2008) 'The Geopolitics of Russia: Permanent struggle', *Stratfor Global Intelligence*, 15 October 2008, on the Internet: http://www.stratfor.com/analysis/20081014_geopolitics_russia_permanent_struggle (retrieved 24 November 2009).

[76] Korsunsky (2009) 'Russian Energy Security Policy', pp. 75-76.

difficulties it has in trying to unite on things that would benefit the Union as a whole, and to do it rapidly. If anything, it indicates that political capacity is not only about the ability to act and achieve a desired outcome; it is also about the ability to come to decisions swiftly and implement them effectively. The EU's size, differing views on Russian energy policy, split policy responsibility on the gas issue and long-drawn-out decision-making procedures make this hard. In turn, all this gives Russia a realpolitik advantage in that it can act more quickly and forestall the EU on crucial issues relating to gas, which the South Stream project indicates. At the same time, since 2009 Russia and Gazprom have had problems convincing Bulgaria to join South Stream. The previous Bulgarian government supported the project while the government which took office last year has been more sceptical of it.[77] Bulgaria is also pivotal for South Stream's gas flows to Europe. This indicates that both Nabucco and South Stream currently are viable projects and that the competition between the EU and Russia to launch their respective pipelines is not decided.

3.2 Dependency and Control

According to the former Commissioner for Energy, Andris Piebalgs, the Nabucco project would be an embodiment of an existing common European energy policy. From this perspective, Nabucco would fill a missing link between the so far disparate energy policies of the member states. As such, it is an opportunity to give legitimacy to the EU's energy policy and empower its external gas relations.

In this regard, it is interesting to note that the project has demonstrated quite the contrary. One the one hand, certain member states such as Hungary, Italy and Slovenia have signed bilateral deals with Russia on South Stream. An agreement between Austria and Russia may also be on the way. On the other hand, Austria, Hungary, Romania and Turkey have signed an intergovernmental agreement on Nabucco. All these countries have an interest in becoming energy hubs and Austria and Hungary in particular have fairly friendly relations with Russia. In the case of Austria, some sources state that during Vladimir Putin's presidency it became a hub for numerous corporate entities connected to Gazprom, for example, the Centrex Group, CentraGas Holding, Zangas, Centrex Energy Italian Gas Holding AG, Ostchem Holdings and Ukrinvest Holdings, which has strengthened Gazprom's position in Austria's

[77] Socor, Vladimir (2010) 'Bulgarian Government Skeptical on South Stream Project' *Eurasia Daily Monitor*, vol. 7, issue 33 (18 February 2010), on the Internet: http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=36057&cHash=4cbbb0ae04 (retrieved 15 March 2010).

domestic gas distribution network.[78] In this regard, it is interesting to note that 'the Austrian financial sector can legally refuse to disclose the identity of the principles of companies whose owners want to remain anonymous'.[79] With respect to the Third Energy Package and principles like unbundling, this could make it more complicated for the EU to implement such policies effectively.

The above factors are important to consider given that:

> South Stream could position Russia to control the entry of pipeline-delivered gas to Europe from Central Asia and other producer countries. On top of its role as unwanted middleman, Russia would also become the gatekeeper of Europe's southern corridor for energy supplies.[80]

Thus, South Stream could be a way for Russia to sustain the relationship of asymmetrical interdependence with the EU. Some analysts[81] say that in order to achieve this goal Russia is trying to play off the Nabucco consortium's countries and their neighbours against each other by offering pipeline extensions and storages, gas supply quotas, and the position as important regional hubs to multiple countries at the same time. This deviates substantially from Russia's official position, which is that South Stream is beneficial to all of Europe since it strengthens energy security.[82] Still, South Stream's strategic implications – for example, sustained asymmetrical interdependence relative to the EU and increased Russian control of gas flows – cannot be ignored.

Nabucco and South Stream demonstrate the EU's difficulties in keeping a common position on Russia in the light of diverging national interests, which is a reflection of the member states' diverging dependence on Russian gas. This indicates how different perceptions of Russian energy policy play out within the EU. It also illustrates the effects of the fact that the EU's energy strategy is the Commission's policy area, but that the real competence lies with the member states. Even though the intergovernmental agreement on Nabucco is a milestone for the EU, recent talks between Russia and (for example) Croatia and Romania on South Stream[83] serve to undermine this symbolically important agreement.

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[78] Kupchinsky (2009b) 'Gazprom's European Web', pp. 17-18.
[79] Ibid.
[80] Socor (2008) 'Sourcing the Nabucco Pipeline'.
[81] Ibid.
[82] South Stream, on the Internet: http://south-stream.info/index.php?id=29&L=1 (last retrieved 21 January 2010).
[83] In October 2009 the Bulgarian Minister for the Economy, Energy and Tourism, Traycho Traykov, met with the Russian Energy Minister, Sergey Shmatko, to discuss the development of South Stream; see e.g. 'Russia, Bulgaria to Speed Up Work on South Stream', Reuters, 18 September

3.3 Lack of Common Interests and Common Values

The fact that the EU and Russia do not adhere to common values de facto constrains the possibilities of finding ways to cooperate on matters that would produce mutual benefits. The example of getting access to Central Asian gas is a case in point. In a generally asymmetric power relation with the EU and Russia, the only real leverage that countries like Azerbaijan and Turkmenistan have is their access to resources. This, in turn, increases the level of uncertainty regarding how they will behave in the face of increased competition for the region between China, the EU and Russia (and Iran). Some sources[84] argue that China, rather than Russia (or the EU) is increasingly the pole around which Central Asian states are trying to position themselves. The best way to secure access to Central Asian gas, and more generally to increase control over the region, would therefore be for the EU and Russia to cooperate on the basis of common principles – notably those outlined in the ECT and those of the World Trade Organization (WTO).

The ECT is a legally binding multilateral instrument and the only one of its kind that specifically deals with intergovernmental cooperation in the energy sector. The fundamental aim of the ECT is to strengthen the rule of law on energy issues and its trade provisions are in line with WTO rules and practice (e.g. non-discrimination, transparency and commitment to the progressive liberalization of international trade).[85] It is thus an arrangement that could help Russia to modernize its energy sector and at the same time guarantee demand for its energy. At the same time, it would secure gas supply to the EU. But, since Russia has rejected these principles, the chances of such cooperation are currently at a dead end. Instead, the EU and Russia are competing with each other and with China for Azerbaijan’s and Turkmenistan’s gas. The fact that Russia has agreed to buy Azerbaijani gas for a higher price than it earns from European customers indicates that economic rationales are partly secondary to political (value-based) ones. This strengthens the assumption that Nabucco and South Stream are not just about who gets the gas; they are about two different ways of doing business.

2009, on the Internet: http://in.reuters.com/article/oilRpt/idINLI19666420090918 (retrieved 24 November 2009).

[84] See e.g. Haukkala, Hiski (2009) ‘From Zero-Sum to Win-Win? The Russian challenge to the EU’s eastern neighbourhood’, *European Policy Analysis*, Swedish Institute for European Policy Studies (SIEPS), issue 12 (November 2009), p. 7.

[85] Energy Charter Treaty (ECT) and Related Documents, pp. 13-15, on the Internet: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (retrieved 10 December 2009).

Not only is it working against the ability of the EU and Russia to secure supply and demand, respectively, but the lack of agreement on common values is prolonging the process of turning the non-transparent and discriminatory CIS gas market into a functioning market. This, in turn, reduces the opportunities to depoliticize the energy issue since it strengthens the incentives to favour political considerations rather than economic ones. It is imperative that the energy issue be depoliticized since this would assure the relevant actors that gas supply is first and foremost a business relationship between producer and consumer. As a consumer, the EU will always strive for greater investments in supply in order to ensure that demand is met and abundance created so that prices are kept down. As a producer, Russia and Gazprom will always strive for a balanced investment strategy that maximizes profits. Thus, there will always be diverging interests and tensions between the EU and Russia. Currently such tensions are obscured by the lack of clear rules of engagement and the lack of transparency in the gas sector which has created insecurity. This has accentuated the EU’s diverging views on Russian energy policy and the problems connected with the fact that gas supply issues fall under different policy fields inside the Union. Taken together, these factors have not favoured the EU’s political capacity in its gas relationship with Russia.

4 Explaining the EU’s Limited Political Capacity

At this point we can make some general remarks regarding the factors that account for the EU’s limited political capacity in its gas relationship with Russia. The first point to make is that conflicting interests between the EU and Russia in at least three areas seem to accentuate the tensions in the Union’s internal workings – the relationship between the member states, and between the EU institutions (notably the Commission) and the member states. The second point to make is that the current European political systemic structure (balanced multipolarity) also accentuates these internal EU factors. It is in the interplay between the EU’s internal workings and external influences that we find the nexus of the Union’s limited political capacity. The following sections look at the external factors and explain why.

4.1 Conflicting Interests

Based on the above analysis it is possible to discern three particularly essential conflicting interests between the EU and Russia that help explain the Union’s limited political capacity, namely their dispute on

- values
- the development of the European neighbourhood
- the role of dependency and sovereignty

The following sections each deal with a specific conflicting interest. The primary purpose is to provide an overarching explanation of their importance to the EU’s limited political capacity in the gas relationship with Russia.

4.1.1 Value Incompatibility

The EU primarily stands for values such as market liberalization, transparency and competition. These values are the very foundation on which the EU’s market-oriented profile and bureaucratic and judicial system builds. This has implications for EU-Russia relations in the sense that the EU sees legal frameworks (e.g. membership of the World Trade Organization, a Partnership and Cooperation Agreement and the ECT) as the foundation for a working partnership. The EU’s emphasis on such frameworks does in fact make it harder for the energy relationship to progress, since Russia has doubts about subjecting itself to them. On the other hand, legal principles like the ECT (and the Third Energy Package) are also the EU's strongest tool in managing Russia in the gas relationship since they enable the EU to safeguard its internal market. As mentioned earlier, this has irritated Moscow and made it difficult to get Russia to comply with such principles.

Russia's doubts are partly due to the fact that it connects such frameworks with reduced autonomy (sovereignty) and increased dependence on foreign states. This, in turn, is due to Russia's economic nationalism and the fact that it gains leverage by keeping the EU legally bound by its own rules while Russia itself stays out of such arrangements. For example, Russian companies have been rather aggressive in acquiring small European energy companies and buying shares in large companies with the aims of securing a customer base, increasing profits and maintaining control over consumer markets. These are all legitimate business interests. But, while the Russian state supports national companies' exploiting loopholes in the EU system in order to gain access to the inner market, it does not offer equal openness of access to European companies on Russia's producer markets (see the discussion on the EU and Russia's differing views on reciprocity above).[86] Furthermore, the fact that the 60-day notification period of Russia's provisional application of the ECT has come to an end[87] means that new European investments in the Russian energy sector will have to rely on the goodwill of the Russian state. In view of Russia's explicit ambition to use energy as a foreign policy tool, this is worrying. At the same time, Russian investors will continue to enjoy safeguards and legal protections under European law, which also means that they will have to comply with principles like unbundling. However, Gazprom's not always transparent company structure and its diffuse business connections in European countries could make it harder for the EU to enforce such rules.

There are also vested interests among the Russian political elite which favour a continuation of a corrupt and non-transparent system, especially in the gas sector.[88] The basic problem is thus that 'the people who run Russia are now the same people who own it; this makes it harder to disentangle Russia's

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[86] Larsson, Robert L. (2008b) *Energikontroll: Kreml, Gazprom och rysk energipolitik* [Energy Control: The Kremlin, Gazprom and Russian Energy Policy], User report, January 2008, FOI-R--2445--SE (Stockholm, FOI), pp. 69-70.

[87] Clark, David (2009) 'Russia's Unsustainable Energy Model', *Financial Times*, 16 October 2009, on the Internet: http://www.ft.com/cms/s/0/8d5be452-b987-11de-abac-00144feab49a.html (retrieved 16 October 2009).

[88] Kupchinsky (2009b) 'Gazprom's European Web'; Shevtsova, Lilia (2007) 'Models of Succession', *Kremlin Survivor Series 3*, Discussion at the Center for Strategic and International Studies (CSIS), 5 June 2007, p. 2, on the Internet: http://csis.org/files/media/csis/events/070605_ruseura_sumshevtsova.pdf (retrieved 10 December 2009).

national interest from the private interests of elites'.[89] Adherence to rule of law, transparency and democratic principles (e.g. freedom of the press, free and fair elections and free debate) and other such principles would threaten these people's influence and security. At the same time, the Russian economic system and Russia's foreign policy profile currently enjoy public support, largely thanks to unprecedented economic growth during the Putin years. Consequently, the prospects for engaging Russia to agree voluntarily to (for example) the ECT appear bleak.

Apart from being ideological, common values include principles (e.g. reciprocity and unbundling) that have practical implications for the possibility of deepening relationships, for instance, in terms of concluding trade agreements and expanding cooperation on pressing issues.

The EU's dilemma is that, since it believes the common market to be the best way to ensure secure and affordable energy supplies,[90] it would appear soft if it abstained from this conditionality. By and large it is what the EU stands for and compromising on the principle would thus undermine the EU itself. If it pursues such a path without being able to include Russia in legal arrangements and/or to apply its own principles (e.g. the Third Energy Package and the solidarity principle) effectively, it will find itself on the losing side – as the January 2009 gas crisis demonstrated. If, on the other hand, the EU pursues a more realpolitik path it will risk undermining its role as promoter of common market principles and anti-monopolist policies. Currently, Russia's realpolitik approach means that it is better able to act quickly than the EU with its preoccupation with common value-based legal frameworks and its rigid decision-making procedure – as Nord Stream and South Stream indicate. These circumstances are made worse by the fact that the gas supply issue connects with policy areas that fall under different EU pillars which lack effective coordination. The fact that Gazprom has increased its cooperation with a number of countries inside the EU whereas the EU itself has not been able to create a transparent and competitive European energy market proves the point. Thus, there is a temporal dimension here which helps explain both the advantage Russia has gained by not agreeing to common values and the EU's limited political capacity.

At the same time, Russia's dilemma is that it wants to be a sovereign great power that controls its environment and safeguards its natural

[89] Dmitri Trenin, referred to in Leonard and Popescu (2007) *A Power Audit of the EU-Russia Relations*, p. 55.

[90] See e.g. Kesteris, Andris, Head of the Office of Commissioner Andris Piebalgs of the European Commission (2006) 'EU Energy Policy Towards the Caspian and Black Sea Regions', Speech at the International Conference on 'Building Energy Security: Cooperation among the Baltic, Black and Caspian Sea Regions', Vilnius, 5 December 2005, p. 20.

resources. Simultaneously, it needs to be a reliable business partner and supplier of energy since it is dependent on energy revenues from Europe. In this regard, it is instructive to say something about the state of Russia's economy[91] which is an important variable given its connection with Russia's behaviour in international affairs.

Russia's economy is unstable, as the financial crisis in 2008 indicated. Among other things, it demonstrated that relying on a resource-based economy and high oil prices makes Russia very vulnerable to international fluctuations in prices. Russian decision makers are well aware of the fragile nature of the economy, and President Dmitri Medvedev has made modernization of the economy one of his top priorities.[92]

Russia's general international economic position is also comparatively weak and is projected to remain so for a long time. As Charles Grant of the Centre for European Reform has put it:

> Its [Russia's] economy is less than 3 per cent of world GDP (on a purchasing power parity basis) and is forecast (by the Economist Intelligence Unit) to remain below 3 per cent in 2030. By then, the EIU predicts, China will be at 23 per cent of world GDP, the US at 17 per cent, and the EU-27 at 16 per cent.[93]

Furthermore, because existing gas and oil fields will reach exhaustion in the next few years, the Russian energy sector is in great need of investment and technology transfer in order to access the country's great reserves. In the gas industry alone, some Russian sources forecast that investments of $565-590 billion (in 2007 prices) between 2008 and 2030 are needed.[94] The heavily indebted state-controlled company Gazprom cannot generate these funds on its own. Certainly, the recent drops in demand for gas

[91] For detailed analyses on Russia's economy see earlier FOI reports, e.g. Oxenstierna, Susanne (2009a) *Russian Economy in 2009: Steep decline despite crisis management*, User Report, December 2009, FOI-R--2853--SE (Stockholm, FOI); Oxenstierna, Susanne (2009b) *Russia in Perspective: Scenarios of Russia's economic future 10 to 20 years ahead*, User Report, June 2009, FOI-R--2774--SE (Stockholm, FOI).

[92] 'Russian Bear Must be Modern to be Attractive: Medvedev', 26 July 2009, Reuters, on the Internet: http://www.reuters.com/article/newsMaps/idUSTRE56P0G520090726 (retrieved 15 December 2009).

[93] Grant, Charles (2008) 'How to Handle the New Russia', Centre for European Reform (CER), *CER Bulletin*, issue 62 (October/November 2008), on the Internet: http://www.cer.org.uk/articles/62_grant.html (retrieved 10 December 2009).

[94] Gromov, Alexey (2009) 'Energy Strategy of Russia: Approaches, priorities and reference points', 23 October 2009, on the Internet: http://www.energystrategy.ru/ab_ins/source/Gromov_MGIMO-23.10.09.ppt#538,21,Bild 21 (retrieved 29 January 2010).

and gas prices reduce the danger of a possible Russian gas supply squeeze in the short term, but the need for foreign investments in the long term still holds. Consequently, there are strong incentives to let European investors into the Russian energy sector, and depoliticization of the energy issue is therefore imperative.

In this regard, it is interesting to note that Russia's rejection of (for example) the ECT, and President Medvedev's own energy proposal from April 2009, are basically a message that Russia wants its voice to be heard.[95] In many ways the proposal – termed the 'Conceptual Approach to the New Legal Framework for Energy Cooperation' – overlaps with the ideas of the ECT. But, importantly, it represents a Russian initiative and thus has a symbolic value in that it demonstrates that Russia matters to international politics. Even though the prospect of success for the proposal is limited, and the rejection of the ECT is a way for Russia to show its independence, the possibility cannot be excluded that it could open up the space for discussions on foreign investments in the Russian energy sector. At the same time, the closed and non-transparent gas sector serves vested interests among the Russian elite. The chances that Russia will open up voluntarily to investments, agree to EU market principles, and thus lose some of its autonomy, therefore remain bleak. For these reasons, it is likely that the value incompatibility between the EU and Russia will continue to characterize the gas relationship in the years to come. For the EU it is crucial that it implements policies like the Third Energy Package effectively and sticks to crucial Community principles, for instance, on anti-monopoly and competition. The possible strategic risks surrounding Nord Stream (see above) indicate the situation in which the EU could find itself if it fails.

4.1.2 Influence over the European Neighbourhood

The primary concern here is the security competition between the EU and Russia over the European neighbourhood. The European neighbourhood basically refers to the countries outside the EU and means broadly the countries covered by the EU's Neighbourhood Policy, notably Azerbaijan, Belarus, Georgia and Ukraine. But it also includes Central Asian countries like Kazakhstan and Turkmenistan due to their importance to the EU-Russian gas relationship.[96]

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[95] Bochkarev, Danila (2010) 'Redrawing the Global Energy Blueprint', *EuropeanVoice.com*, 12 February 2010, on the Internet: http://www.europeanvoice.com/article/2010/02/redrawing-the-global-energy-blueprint/67151.aspx (retrieved 15 February 2010).

[96] European Commission (2009b) 'European Neighbourhood Policy', on the Internet: http://ec.europa.eu/world/enp/partners/index_en.htm (last retrieved 17 November 2009). These countries are part of the EU's Central Asia Strategy and not included in the ENP, but are referred to in the analysis due to their relevance for the discussion on gas deliveries to the EU.

The core of the conflict between EU and Russian interests is that the EU is eager to create a buffer zone of well-functioning states (well-functioning by virtue of being liberal democracies) in its immediate proximity. To the EU, it is about exporting *stability* or importing *instability*.[97] This ambition connects directly with the EU's security identity and refers to the survival of the continent:

> One of the key implications of the European Union Security Strategy of December 2003 is the need for the EU to promote a ring of well-governed countries surrounding the EU with whom close and cooperative relations can be enjoyed. If the regions adjacent to Russia are not stable, this will have consequences for the security of the EU itself.[98]

The EU's ambition to create a ring of well-governed countries around its borders by promoting liberal reform (both economic and political) clearly connects with the concern for energy security: well-governed states are more likely to have a functioning market climate and thus be open to transparent and predictable energy cooperation. This is particularly important when it comes to gas given the rather rigid and non-transparent market that currently exists. Nabucco, Nord Stream and South Stream by definition affect the development of the common market since they relate to the role of supply and transit countries like Azerbaijan, Belarus, Georgia, Kazakhstan, Turkmenistan and Ukraine. The pipeline projects are thus embedded in the wider context of political and economic reform. For example, the Commission's 2004 *European Neighbourhood Policy Strategy Paper* stated that 'enhancing our strategic energy partnership with neighbouring countries is a major element of the European Neighbourhood Policy'.[99]

Russia, on the other hand, is also eager to create a geographical buffer zone in its near abroad consisting of states which support Moscow. Such states are not the kind of liberal democracies (i.e. ex-Soviet states turned pro-Western) that the EU wants. Russia's ambition connects with its regional power status and the goal of securing its sphere of influence, and thus its national security.[100] Just like the EU, Russia is reliant on a number of neighbouring states for its energy security, such as Belarus and Ukraine for the transit of gas to Europe and the Central Asian countries for gas imports. Nord Stream and South

[97] Bengtsson (2009) *The EU and the European Security Order*, p. 48.
[98] European Commission, DG for External Relations (2007) *Country Strategy Paper 2007–2013*, p. 5.
[99] European Commission (2004) *European Neighbourhood Policy Strategy Paper*, COM (2004) 373 Final, May 2004, p. 17.
[100] Hyde-Price (2007) *European Security in the Twenty-first Century*, pp. 144-145; 147.

Stream clearly would reduce that reliance. Given that South Stream would strengthen Russia's role as middleman for Europe's southern energy corridor, it would also increase Russia's ability to influence countries in the European neighbourhood, at the expense of the EU.

However, Russia's interest in the European neighbourhood is not solely a question of defending and/or extending its sphere of influence. It also involves economic factors. The former Soviet republics are almost the only ones that import commodities such as groceries and processed products from Russia. To other countries, Russia mainly exports weapons and natural resources. Consequently, Russia has tried to create a customs union within the CIS and a Single Economic Space (SES) focusing on the free movement of goods, services, capital and labour.[101] Currently, Belarus and Kazakhstan are the only states that have agreed to form a customs union with Russia.[102] In November 2009 the parties reached a deal, setting the date for the start of the customs union at 1 July 2010.[103] The importance of such an initiative should not be disregarded. For example, if Ukraine decides to join, it would reduce its possibilities to obtain a free trade agreement with the EU which, in turn, could enhance Russia's power position relative to the EU. At the same time, Ukraine's accession to the WTO in May 2008 is a constraining factor regarding the chances that it actually will enter into any such union with Russia.

In other words, the EU's and Russia's ambitions in the European neighbourhood are mutually exclusive since by definition they envisage opposite trajectories for the same states in their immediate proximity. Nabucco and South Stream in particular are therefore two politically essential projects in terms of the EU's and Russia's ability to extend their respective buffer zones. In this light it is disturbing that the Nabucco project has been constantly prolonged (compared to South Stream) and that the EU has a rather weak role relative to Russia (and China) in Central Asia. Arguably, this indicates how the conflicting views of the EU and Russia about their interests on their 'outer boundaries' amplify the effects of the Union's internal difficulties regarding the gas supply issue.

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[101] Leijonhielm, Jan et al. (2009) *Rysk militär förmåga i ett tioårsperspektiv – ambitioner och utmaningar 2008* [Russian Military Capability in a Ten-Year Perspective – Ambitions and Challenges 2008]¸ User Report, January 2009, FOI-R--2707--SE (Stockholm, FOI), pp. 75-78.

[102] Clover, Charles and Williams, Frances (2009) 'Russia Returns to Lone WTO Accession Path', *Financial Times*, 16 October 2009, on the Internet: http://www.ft.com/cms/s/0/e95c1836-b9ea-11de-a747-00144feab49a.html (retrieved 16 October 2009).

[103] EUBusiness, 'Russia, Belarus, Kazakhstan Agree on Customs Bloc', *EUBusiness*, on the Internet: http://www.eubusiness.com/news-eu/russia-summit-wto.1o2 (retrieved 15 December 2009).

4.1.3 Differing Views on Dependency and Sovereignty

The primary concern here is that the EU and Russia have different views on how to build working relationships in international politics. The EU, on the one hand, sees interdependence as a solid ground for building functioning long-term relationships. This would mean that Russia is to be at least as dependent on the EU as the EU is on Russia. The rationale for such a relationship, and the EU's raison d'être is that states agree to reduce their sovereignty[104] in exchange for an enhanced potential to achieve prosperity, for example, economic growth, energy security or national security. Russia, on the other hand, is keen on maintaining its sovereignty. The basic logic is that interaction is a zero-sum game where economic dependence opens up to political dependence, and thus privileges.[105] Accordingly, reducing dependence as much as possible in order to preserve autonomy is believed to be the best way to deal with this. To Russia it is the best way to increase its economic growth and national security. Russia's 2009 *National Security Strategy of the Russian Federation up to 2020* reaffirmed this as a central Russian goal.[106] Clearly, this is what Nord Stream and South Stream symbolize in the sense that they would enable Russia to maintain its autonomy by controlling gas flows to Europe and to continue to deal bilaterally with EU member states. Nabucco, on the other hand, works against this since it would help reduce the asymmetry of the EU-Russian gas relationship.

Moreover, Russia's energy resources show clear tendencies of being a foreign policy tool rather than a tool to build win-win relations between producers and consumers. However, until the mid-twentieth century Europe and the US resorted to similar behaviour in order to influence domestic politics in resource-extracting countries, in particular in the Middle East and Africa.[107] Thus, perceiving energy as a foreign policy tool is not a feature exclusive to Russia. But Russia's approach is crucial here, since it explains its preference for

[104] Some sources say that it is more appropriate to talk about reducing autonomy than sovereignty, since sovereignty points to something absolute (i.e. a state is either sovereign or not – sovereignty cannot be divided). If one talks about autonomy it is possible to talk about more or less autonomy. This is because 'the cost of infringements on a state's authority varies between issue areas and over time' (i.e. it is not absolute). This study therefore uses the term 'autonomy'. See Fägersten, Björn (2009) *European Intelligence Cooperation: Drivers, interests and institutions,* Swedish Institute of International Affairs, SIIA Papers, no. 6, p. 20.

[105] Trenin, Dmitri (2007) 'Russia Redefines Itself and its Relations with the West', *Washington Quarterly*, vol. 30, no. 2, p. 97.

[106] Kupchinsky, Roman (2009a) 'Energy and the Russian National Security Strategy', *Eurasia Daily Monitor*, vol. 6, issue 95 (18 May 2009), on the Internet: http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=35006&tx_ttnews%5BbackPid%5D=27&cHash=1b344dfc35 (retrieved 24 November 2009).

[107] See e.g. Smith, Keith C. (2008) *Russia and European Energy Security: Divide and dominate*, Center for Security and International Studies (CSIS), October 2008, p. 1.

dealing with the EU member states bilaterally: it retains the asymmetric interdependence in EU-Russian energy relations. This also explains Russia's resistance to the EU's proposal for a Regional Economic Integration Organisation (REIO) clause in the ECT Transit Protocol. Such a clause would treat the EU as a single entity rather than as national entities.[108]

Russia's position on dependence and sovereignty is not unique. Most states (if possible) prefer to be less dependent on other states than these other states are on them – which goes for the EU member states as well. The difference with the EU (especially the Commission) is that it works to make dependence less problematic by imposing certain legal frameworks that are intended to reduce vulnerability costs. In their very essence, this is what Nabucco and South Stream are about. Nabucco symbolizes an EU initiative that builds on the Community logic of creating a common market and deepening cooperation, in this case increasing interdependence between the member states and between the member states and Azerbaijan, Turkey and Turkmenistan. South Stream, on the other hand, symbolizes a Russian initiative that serves to maintain its sovereignty by single-handedly controlling the gas flow from (for example) Azerbaijan and Turkmenistan to Europe.

4.1.4 Some Remarks

If anything, the EU's and Russia's values incompatibility demonstrates the consequences that lack of agreement on the basic rules of engagement could have on relations in international politics in terms of creating predictable relationships. This conflicting interest is basically a core category since it captures the essence of the other two conflicts of interests. It captures the underlying logic to why the EU and Russia anticipate and hope for the opposite development of the states in the European neighbourhood. It also captures why the EU and Russia view the costs of dependency differently: it is a matter of viewing relations as a positive-sum or zero-sum game.

Thus, what is the point of analysing three conflicting interests if, in essence, there is only one? Even though no sharp dividing lines exist between them, the fact remains that they shed light on different aspects of the EU-Russian gas relationship. They are different colours on the spectacles with which we look at the topic at hand: we use the same theoretical glasses but with different perspectives. For example, the competition for influence over the European neighbourhood directs attention to the wider geopolitical ramifications in which the gas supply issue is embedded. The conflicting interests regarding views on dependency and sovereignty, on the other hand, shed light on how the EU and

[108] Mitrova et al. (2009) 'Russia, the CIS and Europe', p. 430.

Russia look at interaction in international politics (positive-sum vs zero-sum). Lastly, the value incompatibility illustrates how principles such as reciprocity and unbundling mean completely different things to the EU and to Russia. These are all essential aspects to look at in order to fully understand the EU's problems and there is therefore a point in separating them analytically. But, as mentioned above, all these conflicts derive from the fact that Russia is not interested in having clear shared rules of engagement and that the EU currently has too many internal weaknesses to effectively do something about it.

4.2 The Structure of European Politics – Balanced Multipolarity

The primary concern here is the structure of European politics, and it relates to the kind of polarity that both enables and constrains Europe's political system. The precursors of the EU were built on a bipolar power constellation (during the Cold War) but with the break-up of the Soviet Union and the political fragmentation of the West, a multipolar order emerged in Europe, with five great powers – the US, Russia, Germany, the UK and France.[109] In the case of the US, it has functioned as a European great power for a long time (mainly since World War II), despite the geographical distance. This is due to its role as an 'offshore balancer' with the aim of mitigating conflict on the European continent. During the 2000s, however, the US role as a transatlantic ally has weakened.[110]

There are two kinds of multipolarity – balanced and unbalanced – and the current European order, as presumed here, is one of balanced multipolarity.[111] Basically, balanced multipolarity exists

> When there are three or more states with broadly comparable power capabilities [i.e. economic, military, political and technological capabilities]. In this situation none of the great powers can make a feasible bid for regional hegemony, and hence states tend to emphasise security maximisation over power maximisation. In this context, great power cooperation becomes possible, and can assume the form of the nineteenth-century 'Concert of Europe'. Concert diplomacy involves great power cooperation in collective milieu-shaping and for the joint pursuit of second order interests.[112]

The structure of the political system provides clues to how to understand the gas relationship between the EU and Russia, and between Russia and other great powers. In the case of the EU it helps explain why its energy policies are often based on agreement on the lowest common denominator. The reason is that balanced multipolarity favours a complex mix of cooperation and competition which, in turn, arises from the fact that in this structure relative gains matter more than they do in a bipolar one (since there are more states with

[109] Hyde-Price (2007) *European Security in the Twenty-first Century*, pp. 4; 94.
[110] Ibid., p. 70.
[111] For a detailed account of multipolarity see Hyde-Price (2007) *European Security in the Twenty-first Century*, p. 43.
[112] Ibid., p. 43.

roughly the same capabilities).[113] It is therefore also likely that the EU will continue to be limited as a union by the great powers' priorities and the member states' diverse interests. Hence, the Commission will continue to find it difficult to ensure equality between the member states and act as the small member states' best friend in the energy field.

It is also likely that we will see continued cooperation between France, Germany and Russia accompanied by disagreements. This said, it is questionable whether France and Germany will be able to set their differences aside and minimize disagreements even if the goal is to build a strong EU which they could dominate. For these reasons, EU energy cooperation is likely to continue to be of an intergovernmental rather than a supranational character. This is all the more likely given that the Lisbon Treaty mainly urges the member states to act in a spirit of solidarity and includes few binding obligations. In turn, coordination across policy areas will continue to be hard despite the EU's intentions with the Treaty to increase its ability to speak with one voice. Balanced multipolarity as such favours 'De Gaulle's limited version of a Europe of nation-states rather than Jean Monnet's vision of an ever closer union'.[114]

[113] Ibid., p. 115.
[114] Ibid.

5 Conclusions

In essence, Nabucco, Nord Stream and South Stream are not just about gas supplies to the EU countries; they are embedded in the wider context of conflicting interests between the EU and Russia regarding economic and political reform in the Black and Caspian Sea regions, differing views on the character of interaction in the gas sector and diverse ways of doing business. Fundamentally, these conflicting interests come down to the lack of clear rules of engagement in the EU-Russian gas relationship. Apart from keeping the gas market rigid and non-transparent, this weakens the EU's position vis-à-vis Russia in the gas relationship and has made it more difficult for the EU to achieve energy security.

Added to this is the impact of the current structure of the European political system, balanced multipolarity. For one thing, it helps explain the EU's difficulties in coordinating across the fields of energy, security and external relations. It also helps explain why the member states' national competence in the energy field undermines the Commission's formal policy responsibility for energy issues. In balanced multipolarity states are preoccupied with security maximization rather than power maximization. Relative gains become more important and thus supranational cooperation becomes harder. This, in turn, reduces the scope for cooperation that favours the EU as a whole – in this case the Union's energy security. Thus, the EU's limited political capacity in the gas relationship with Russia is due to a mix of external and internal factors, where the former accentuate the effects of the latter.

The Third Energy Package and the ECT include important mechanisms which will mean that Nord Stream will not automatically give Gazprom increased access to European markets. For example, the third country clause, contained in the package, enables EU states to say no to Gazprom entering their market. At the same time, it means that the principle of unbundling – owner separation – will apply to Russian and European investors alike. From this perspective, the EU's support for Nord Stream is reasonable. However, Gazprom's not always transparent company structure and allegations by various parties of connections with organized crime will make it more difficult to confirm independence between energy companies. This complicates the implementation of unbundling and creates uncertainty as to how it will work in practice. Meanwhile the asymmetric dependence on Russian gas inside the EU (i.e. some member states are more dependent than others) as well as the lack of interconnected gas infrastructure and transparency on gas prices will continue to weaken the EU's position vis-à-vis Russia.

In addition, since the EU and Russia do not share similar views on crucial concepts such as reciprocity, Nord Stream is not a project that favours predictability and clear rules of engagement, and thus trust-building, between the parties. Closer interaction presumes that they share common principles on how to do business since it lays the ground for transparent and predictable cooperation. For the Baltic states and Poland, which have been wary of Nord Stream, the lack of common principles increases their sense of exposure. Nord Stream could therefore become a project that demonstrates that energy is the responsibility of the European Commission, but is the main concern of the member states. This is not likely to favour the creation of a common EU energy policy. Thus, Nord Stream may be a common interest to the EU and Russia (since they support it jointly), but it is not based on common values.

Given these circumstances, Nord Stream is more favourable to Russia than the EU. Still, Nord Stream's strategic implications could have been much less if the above factors had not been present. To some extent, this is the member states' own responsibility but it affects the EU as whole in the gas relationship with Russia.

A further exacerbating factor is the differing views on Russia as energy supplier between the Commission and the member states, and between the member states. In effect, the result is that the EU as a whole has had difficulty defining where the problem with its gas imports actually lies. This was made clear in the January 2009 gas crisis and its aftermath with respect to the EU's ambiguous treatment of Russia and Ukraine. Thus, before solutions can be effective the problem must be explicitly sketched out.

The role of Germany and France is also an important variable in explaining the EU's limited political capacity in the gas relationship with Russia. These states are crucial for enabling a common energy policy and if they do not embrace it a common integrated EU gas market will be hard to realize. The fact that both states have large national energy companies that gain from the current market structure further calls into question the EU's ability to effectively implement the Third Energy Package. So far France and Germany have supported Nord Stream and opposed unbundling, which has not helped the EU's position in the gas relationship with Russia. Furthermore, these states will gain increased powers in the EU with the Lisbon Treaty in place. This could result in a stronger union but one which would be dominated by France and Germany, if they manage to settle their differences. If they do, the EU would be steered by two states which have more friendly perceptions of Russia as an energy supplier than many of the new member states (notably the Baltic states and Poland). Given these circumstances, France and Germany will continue to be crucial for the EU's energy future.

The cases of Nabucco and South Stream clearly demonstrate the lack of convergence between the EU and Russia. For one thing, neither of the projects is jointly supported by the parties as (for example) Nord Stream is. Underlying this absence of joint support is the fact that Nabucco and South Stream represent two different ways of doing business, relate to different courses of development for countries such as Azerbaijan and Turkmenistan, and illustrate that the EU and Russia cannot cooperate in an area for which they are in competition. Instead, China is getting a chance to meet its gas needs and strengthen its power position in the area, notably in Central Asia. In essence, legal frameworks create a ground for predictable cooperation on the transit and supply of energy. The lack thereof has favoured neither the EU's nor Russia's quest for securing supply and demand of gas, respectively.

The EU's limited political capacity is not likely to change substantially in the next few years. Certainly, the Lisbon Treaty is an attempt to increase coordination inside the EU and currently it is too soon to say anything substantial about its effects. But, given that the EU's and Russia's conflicting interests, the structure of the EU's politics, the conflict between the EU's trade policy and energy policy, and diverging views on Russian energy policy all remain, the chances that the Treaty will strengthen the EU's political capacity are limited. Falling demand for gas and declining gas prices could temporarily reduce the impact of the EU's weakness in the gas relationship with Russia. This would be positive for the EU given the problems linked to its political capacity, but it is not a long term solution.

The key to strengthening the EU's political capacity in the gas relationship with Russia, therefore, does not primarily lie in constitutional changes. Rather the Third Energy Package and the EU's existing antitrust laws, that is, laws that promote competition and hinder monopolies, constitute tools that could enable the EU to strengthen its position vis-à-vis Russia. During 2009, for example, the Commission launched a number of antitrust cases against French, German and Italian energy companies. Similar cases could certainly be launched against Gazprom (for example) in the Baltic states where the company has substantial influence over the energy sector. Such principles, if applied effectively, would thus force Gazprom – as well as large EU companies – to comply with union rules on the European gas market. This is arguably where the EU's path towards a common energy policy starts. The fact that Russia illuminates the EU's flaws like no other actor on the world stage should hence not be seen as ruining the EU's chances of becoming a strong actor in the energy field. Rather it serves as a crucial case for how it can develop.

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Appendix I

Nabucco, Nord Stream and South Stream

Below follows a short introduction to the respective pipeline projects that are analysed in this study.

Nord Stream stretches from Vyborg in Russia to Greifswald in Germany, which means that the pipeline will run 1,220 kilometres. Its projected capacity is 55 bcm and the projected cost is €7.4bn.[115] The project is a joint venture between Gazprom, the German companies E.ON Ruhrgas and BASF SE/Wintershall Holding AG and the Dutch company Gasunie.

Nabucco stretches from Turkey to Bulgaria, Hungary, Romania and Austria. The pipeline runs 3,300 kilometres. It has a projected capacity of 32 billion cubic meters (bcm) and a projected cost of €7.9bn.[116] The EU is the main promoter of the project. On 13 July 2009 Austria, Bulgaria, Hungary, Romania and Turkey signed an intergovernmental agreement on Nabucco.

South Stream stretches from Russia through the Black Sea to Bulgaria, Serbia, Hungary, Greece, Italy and Austria. The pipeline will be 3,700 kilometres long and the projected cost is €25bn.[117] The project is a joint venture between Gazprom and the Italian company ENI.

[115] Nord Stream, on the Internet: http://www.nord-stream.com/en.html?no_cache=1 (last retrieved 23 November 2009).
[116] Nabucco Gas Pipeline, on the Internet: http://www.nabucco-pipeline.com/ (last retrieved 23 November 2009).
[117] East European Gas Analysis, on the Internet: http://www.eegas.com/southstream1.htm (last accessed 23 November 2009); Mitrova et al. (2009) ‘Russia, the CIS and Europe’, p. 425.

Figure A1. Gas Pipeline Routes of Nabucco, Nord Stream and South Stream

Source: http://www.energy.eu/images/pipelines_nabucco_nord_south_stream.gif

Blue Stream

Figure A2. Gas Pipeline Route of Blue Stream

Source: http://eng.gazpromquestions.ru/uploads/pics/gl_09_img_02_eng.jpg

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