

EU-Russia energy relations: a critical analysis

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Abstract

This paper examines EU/Russia energy relations in the aftermath of the 2006 gas crisis. It analyses the political dynamics and interests which underpin this supposedly 'strategic partnership' on both sides, as well as the theoretical frameworks through which these are predominantly explained in academic literature. By deconstructing the EU's approach to energy relations with Russia through social constructivist theory, and by assessing the Russian perspective through a neo-realist theoretical framework, the shortcomings of these theoretical perspectives in portraying the multifaceted nature of EU/Russia energy relations will be highlighted. This critique of the aforementioned theories forms the basis for the argument of this paper: though conflicting visions of and interests in their energy diplomacy seem to render EU/Russia energy relations inherently asymmetric, it will be argued that their uneasy relationship is held together by an interdependency which is acknowledged by both parties and likely to persist for some time to come.

Keywords: EU-Russia energy relations; energy security; realpolitik in energy trade; normative power critique; energy interdependence



Introduction

The functioning of the European economy and the everyday life of European citizens is virtually unthinkable without sufficient availability of energy. The EU, however, excessively depends on Russian natural gas to satisfy its internal energy needs. While this certainly makes the EU vulnerable, Russia's perceived reliability as a supplier has been severely undermined by its apparently political use of gas exports during the 2006 gas dispute with Ukraine, which left European customers cold in the middle of winter. The gas crisis not only alarmed Europeans about their vulnerability to supply disruptions and Russian 'energy blackmailing', but also sparked the question whether a normative Europe can sufficiently assert itself against aggressive Russian geopolitics. Despite these uncertainties, it is believed the EU's dependency on gas imports will increase considerably within the next decades, making this energy relationship a long-term strategic challenge for the EU.

Taking the 2006 gas crisis as starting point, this paper presents a critical analysis of EU/Russia energy relations, by examining what interests and dynamics underpin gas relations between the EU and Russia on both sides, and to what extent the theoretical frameworks employed within prevalent academic literature (social constructivism and neo-realism) adequately reflect the complexity of this relationship. In doing so, the paper will also address the following questions: to what extent are the respective interests in and understandings of energy relations between the EU and Russia compatible? In what way are the EU's and Russia's stances in energy relations embedded in their respective self-understanding within international politics? How should their energy relationship be described? How is the term 'reciprocity' used and understood within EU/Russia energy relations?

It will crystallise that there are two main strands within academic literature on this topic, those arguing from a constructivist perspective that the EU is attempting to project its liberalised, rules based agenda onto energy matters with Russia, yet remains internally divided (e.g. Haukkala 2007; Hughes 2007; Keukeleire & MacNaughtan 2008; Westphal 2006); and those arguing that Russia operates in a neo-realist fashion, using energy exports for political purposes (e.g. Barysch 2007; Light 2008; Lucas 2008; Smith 2004). While these theories bear explanatory value for the different approaches taken to energy relations by the EU and Russia, it will be argued that they fail to portray the complexity of energy and power relations between these actors. In depicting the EU's and Russia's rationale within their energy



relations as diametrically opposed, these scholarly analyses often lead to the conclusion that the EU/Russia energy dialogue is inherently asymmetric or even doomed to failure. This paper, however, argues in line with a third strand of authors, which has adopted a more nuanced approach, and emphasises the persisting interdependence between the EU and Russia (e.g. Aalto 2009; Goldthau 2008a; Youngs 2009). Overall, while the EU's and Russia's approaches to their relationship *are* conflicting, it will be argued that their relationship is held together by a substantial interdependency, which is unlikely to vanish in the short to medium-term future.

The paper is structured as follows: a background chapter will firstly present the nature of gas cooperation between the EU and Russia. In light of the EU's heavy dependency on Russia for its natural gas imports, the regional dimension of gas trade and the political predicament of the 'shared' eastern European neighbourhood, the monopolistic position of state-controlled Russian gas giant Gazprom and the different understandings of 'energy security' will be presented as the main predicaments. Finally, the background chapter will briefly outline the 2006 gas crisis, arguing that this event presented a watershed in European perceptions of Russia as a reliable supplier of gas.

The second chapter analyses the EU's perspective of EU/Russia energy relations. The Commission's attempts to frame energy relations according to a rules-and market based approach, internally (through the struggle for fully competitive European gas and electricity markets), as well as externally with Russia (through the Energy Charter Treaty or ECT, the energy dialogue and their Partnership and Cooperation Agreement PCA) will be assessed through the lens of social constructivist theory, and embedded in the context of the EU's nature as a normative foreign policy actor. It will, however, be demonstrated that the EU's energy relations are more complex than suggested by this theory, by putting forward the argument that the EU does not merely project its identity onto Russia as an end in itself, but uses this within the rational aim of changing the rules of energy cooperation to its benefit, thus also acting in a quasi-realist manner (Hyde-Price 2006; Zielonka 2008). This criticism of the constructivist argument on the one hand aims to highlight the multifaceted nature of EU/Russia energy relations, and on the other hand demonstrates that both parties depend on this cooperation (while trying to shape it to their benefit), although it constitutes a challenge for both.



Subsequently, the member state (MS) perspective on energy relations with Russia will be examined, highlighting the heterogeneity of national interests and the difficulties this implies for forging a coherent European energy policy vis-à-vis Russia.

Finally, the second chapter will analyse the EU's attempts to enhance energy cooperation with its wider neighbourhood, focussing on the energy-rich Caucasus region, which could allow for more European independence from Russia through alternative gas and transit routes. In doing so, the strategic importance of this region will be highlighted, as well as the predicaments which European engagement in the Caucasus presents for its (energy) relations with Russia.

The final chapter of this paper engages with the Russian perspective. Through a neo-realist framework the chapter will explore the geopolitical approach taken to energy matters by Moscow. Thus, the increased state control over the Russian energy sector (notably the intertwined relationship between gas monopolist Gazprom and the Kremlin) as well as the use of energy as Moscow's foreign policy tool will be discussed. While this blurred boundary between energy economics and political ends highlights why the EU's rules and market-based approach is at odds with Russian interests, it will be demonstrated that the neo-realist framework is reductionist in other respects: an analysis of the domestic context of Russia's external energy policy reveals that, contrary to what Moscow's realist rhetoric suggests, (relatively) positive energy cooperation with the EU is virtually indispensable for Russia, due to its loss-generating internal gas and electricity market and a substantial investment gap in its upstream sector. It will hence be concluded that while the EU and Russia may be difficult partners, they are indispensable to one another and will be for some time to come.

1. Background

1.1 European energy poverty and dependence on Russia

For the EU, energy is central to its economy and wealth and consequently to the high standard of living of its citizens, making its increasing energy poverty a critical issue for the Community. At present, the EU depends on external suppliers for more than 50% of its energy requirements, while natural gas is even imported to 64% (European Commission 2011b: 24). Significantly, this import dependency for natural gas is expected to increase



further: because the depletion of internal European sources of natural gas coincides with increased domestic demand for this relatively ‘clean’ source of power, the International Energy Agency (IEA) estimates that the EU will have to import up to 84% of its natural gas requirements by 2030 (IEA 2004: 252). This trend towards heavy reliance on external actors for the internal good is rendered particularly problematic by the fact that one supplier, Russia, provides for the bulk of the EU’s gas imports (55% in 2008 according to Kirchner & Berk 2010: 861). Though this makes the EU vulnerable, and seems to afford Russia an asymmetrically powerful position, it is expected that European dependency on Russia for gas imports will remain substantial for some time, due to a number of reasons.

Firstly, although diversification efforts in recent years have slightly reduced Russian shares in the EU’s gas imports, the geographical proximity and the sheer scope of Russia’s gas reserves mean that other gas imports “can only at best complement Russia and reduce its relative weight” to some extent, but not replace it (Aalto 2009: 164). The much used term ‘*alternative sources*’ of gas is therefore somewhat deceiving in the context of Eurasian energy relations.

Secondly, while the technology of Liquefied Natural Gas (LNG) allows for the transportation of gas on a global scale (via the sea) and could hence substitute Russian gas with imports from, *inter alia*, Latin America, LNG is too cost-intensive and requires special infrastructure, and is therefore not feasible on a large scale at present (Mandil 2008: 18).

Thirdly, absence of short-term effects also characterises the European Commission’s efforts to reduce gas import dependency by targeting the demand side: attempts to increase energy efficiency, such as the ‘Europe2020 Strategy’, which aims at reducing energy consumption by 20% until 2020, can afford more independence from external gas suppliers if long-term goals are met (European Commission 2012c). However, such initiatives do not change current levels of dependency. Hence, while the Commission certainly has a range of longer-term options, Russia’s overall weight in the EU’s gas imports remains an uncomfortable reality at present, and is likely to persist as such in the near future.

Yet, to fully understand why this dependency on Russian gas constitutes a threat for the EU, a number of issues must be noted: the effect of the EU’s eastern enlargement, the regional dimension of gas trade and conflicting understandings of the concept of ‘energy security’.

The rate of the EU’s overall reliance on Russian gas imports obscures that for several individual member states, dependency on Russian gas (and hence their vulnerability) is substantially higher: with the eastern enlargements of 2004 and 2007, the EU now includes



several central and eastern European states which depend up to 100% on Russian gas imports as a result of former Soviet links, while being politically antagonistic vis-à-vis Moscow¹. Consequently, the EU has deepened its dependence on Russian gas with this enlargement, while expanding into the Russian sphere of influence over former Soviet countries, adding non-negligible geopolitical conflict potential to their energy relations (Hughes 2007: 86).

EU-Russia energy relations are furthermore affected by the regional dimension of gas trade. While oil is traded in a virtually global market, gas is dependent on transport through inflexible pipelines, affording consumer and supplier countries little flexibility and alternatives in terms of trade routes and partners. Therefore, any supply disruptions are likely to have an almost instant impact on energy availability in the consumer country (Kirchner & Berk 2010). This reliance on regional transport infrastructure renders the role of the Russian gas giant Gazprom problematic for the EU: Gazprom owns and controls over 90% of Russian gas reserves and infrastructure, hence occupying a “virtual monopoly over ownership, production, processing and transportation” of Russian gas and its exports (Kirchner & Berk 2010: 864). Significantly for our analysis, Gazprom is 51% state-owned, which means that its action is hardly distinguishable from the will of the Kremlin (Light 2008: 16).

Finally, it seems clear that for the EU, the quest for its energy security *of supply* is at the heart of its gas relations with Russia. For the purposes of this paper, the EU’s energy security will hence be understood as the “availability of energy[...], in sufficient quantity and at affordable prices, delivered in an environmentally friendly, sustainable manner which is also free from serious risk of major disruptions of service” (Kirchner & Berk 2010: 864). For Russia however, the aim of energy relations with the EU is to ensure its energy security *of demand*, which will here be understood as a “quest for a market for [...] energy exports which correlates to increased (government) revenues” (Kirchner & Berk 2010: 864). Therefore, while the pursuit of energy security drives energy relations between the EU and Russia, the very different dimensions of their respective energy securities form the basis of their conflicting interests in their energy cooperation.

¹ Baltic States’ disputes with Moscow over Russian-speaking minorities and Russian military installations on their territory reflect historical conflicts about the USSR’s annexation of Baltic territory and the Baltic States’ struggle for the right to independent statehood. Poland’s uneasy relationship with Moscow also relates back to the Soviet Union’s imposed hegemony over political and economic affairs in Poland (see Mouritzen 1998; Raszewski 2012).



Hence, the EU's substantial dependency on Russian gas imports, the political predicament of the shared sphere of influence in Central and Eastern Europe and Gazprom's monopoly position as an 'extended arm of the Kremlin' are highly problematic against the backdrop of the regional characteristics of gas trade, which leave no alternative to Russian gas supply in the case of inflow disruptions. The fact that these issues make cross-border gas cooperation with Russia a serious energy security challenge was, however, not sufficiently acknowledged by the EU until the 2006 gas crisis (Hughes 2007; Stern 2006; Westphal 2006).

1.2 The 2006 turning point

The 2006 gas crisis between Gazprom and Ukraine, its most pivotal eastern European transit and customer country, resulted from a dispute over transit fees for gas transported to EU markets via Ukraine, and Russia's decision to raise gas prices for Ukraine from previously highly subsidised price levels to European prices. As a result of failed negotiations, Russia cut off gas supplies to Ukraine on 1st January 2006. As almost 80% of the EU's Russian gas imports were channelled through pipelines crossing through Ukraine, the cuts had an instant effect on the EU: by January 2nd, Hungary had lost 40% of its Russian gas supplies; Austria, Romania, Slovakia and France about 30%; Poland's gas inflow fell by 14%; and Italy lost about 25% of its supplies between 1st and 3rd January. (Aalto 2008a: 38; Stern 2006: 8). The gas dispute crudely revealed the perils of European import and transit dependencies and was thus a 'wake-up call' for EU members to the geopolitical dimension of energy relations with Russia (Westphal 2006: 45). Whereas Russia had been perceived as a reliable supplier of natural gas ever since the Soviet Union's first gas imports in the 1970s, the 2006 dispute raised substantial questions about Russia's trustworthiness (Hughes 2007: 89; Monaghan 2007: 38). The sense of alert, articulated by numerous MS, was caused by Moscow's apparent readiness to resort to political 'energy blackmailing', i.e. in the impression that the gas cuts had been used by Moscow as a retribution for Ukraine's 'European choice' in the Orange Revolution. (Bahgat 2006: 962; Feklyunina 2008: 130). Though it cannot be established with absolute certainty whether economic or political reasons primarily underpinned the 2006 gas dispute, (Ukraine also contributed to its escalation²), the gas crisis indisputably became politicised in that "any cuts in Russian gas supplies to CIS (let alone the EU) countries will be

² See Stern (2006) for a detailed discussion.



interpreted in Europe [...] as being politically motivated, irrespective of the cause of reduction” (Stern 2006: 16). This change in attitude, from obliviousness to heightened awareness of European vulnerabilities and geopolitical dynamics in EU/Russia energy relations forms the basis of the analysis carried out in this dissertation.

2. The EU perspective: between multilateral identity and realpolitik

This chapter engages with the EU’s approach to energy cooperation with Russia. In examining both the Commission’s vision of this cooperation, as well as the MS perspective, the difficulties of forging a coherent multilateral approach in energy relations with Russia will be illustrated. The chapter will first examine the Commission’s strategy of multilateral energy governance through the prevalent theoretical framework of social constructivism, by considering its internal, external and foreign policy dimension, subsequently evoking the shortcomings of this theoretical strand in portraying EU/Russia energy relations. The MS perspective will be examined in the second part, highlighting the heterogeneity of interests which exist behind the multilateral façade of the EU, before addressing EU attempts to engage its Eurasian neighbourhood in closer energy cooperation and the predicaments this presents for its cooperation with Russia. While overall, the EU’s approach will be found to be conflicting with Russian interests, neither of them seem to be able to afford abandoning their energy diplomacy.

The EU’s multilateral perspective

In its 2006 green paper “European Strategy for Sustainable, Competitive and Secure Energy”, the European Commission states that Europe has “entered into a new Energy era” (European Commission 2006: 3), hence acknowledging the need for a clear EU response to the events of January 2006. Yet while this statement was made with concern to a perceived threat which is external in nature, there is remarkably little emphasis on external policies in the green paper, with five out of six proposed measures concerning the Community level. The predominant aim crystallising from the document is the achievement of an internal energy market.

2.1 The internal dimension

With the aim of developing fully liberalised and competitive internal gas and electricity markets, the European Commission seeks to utilise the considerable potential of the EU's internal market for its energy security: encompassing almost 500 million consumers, substantial leverage can be exercised in negotiations vis-à-vis external actors, if internal fragmentations are overcome. Within liberalised EU markets, enhanced competition and diversification between suppliers would boost infrastructure investments, making (emergency) gas stocks easier to move around the EU. This would considerably diminish the impact of supply disruptions and, crucially, build energy solidarity on the Community level, thus laying the basis for a common external energy policy according to a 'spill-over effect'³ (Youngs 2009: 29).

The Commission has therefore since the 1990s tried to promote the liberalisation of European energy markets through several 'packages of directives', setting out a common legal framework. It did so with the First Package in the mid-1990s (mainly concerned with gas and electricity transit through Europe) and with the Second Package in the early 2000s (attempting liberalisation of energy supply and production). In response to the events of 2006, a Third Energy Package was introduced in 2007, taking liberalisation significantly further with the concept of 'ownership unbundling'. While unbundling can be defined as the "separation of production, transportation and distribution functions in a vertically integrated company"⁴, usually one distinguishes between three types of unbundling: ownership, operational and financial. This logic is also reflected in the EU's three energy packages (Energy Charter 2007: 236). Under the ownership unbundling requirement, energy companies are forced to sell supply networks or to place them under entirely independent management. Significantly, a reciprocity clause has been introduced into the Third Energy Package (Buchan 2010). This clause stipulates that companies of non-MS are only authorised to operate in EU markets if abiding by the same unbundling principles - dissociating ownership of production, transport and sales of gas - within the internal market (Closson 2009: 99; Dasseleer 2009: 126). From

³ The 'spill-over' refers to Ernst Haas' (2004) [1958] classic integrationist theory neo-functionalism, according to which EU-cooperation in one policy area facilitates (or even necessitates) cooperation in further areas, creating an integrationist dynamic.

⁴A vertically integrated company operates in the whole energy value chain comprised of production ('upstream'), transportation ('midstream') and distribution ('downstream') of energy. Hence, a vertically integrated company is the opposite of the unbundling notion (Energy Charter 2007: 236).



the Russian perspective, the reciprocity principle is therefore viewed extremely critically (Mandil 2008: 20; McGowan 2008: 101): seen as a specifically designed ‘anti-Gazprom clause’, it poses an obstacle to Gazprom’s access to European markets, since Gazprom works as a vertically integrated company. Importantly, the unbundling requirement challenges Gazprom’s pronounced strategic objective in EU markets: acquiring more downstream assets, thus directly controlling sales to European customers (which it already does to some extent in a number of MS, including Germany) (Pleines 2009: 79; Romanova 2008: 68). The Third Energy Package could thus mean that the conditions of some of Gazprom’s long-term contracts with EU MS need to be renegotiated where dispositions run counter to the competition envisaged by the Commission’s liberalisation measures: *inter alia*, where Russia has acquired downstream assets, and where it enforces the ‘take-or-pay principle’ and ‘destination clause’. These oblige customer countries “to pay for a certain volume of gas irrespective of whether it is taken or not”, and prohibit the re-selling of gas which is not used by a customer country (Energy Charter, 2007: 229 & 236).

The Third Energy Package therefore seems to constitute an EU attempt to curb its energy relations with dominant Gazprom and Russia, or at least to narrow Gazprom’s room for manoeuvre. Yet it will crystallise in our analysis that, on the contrary, a mutual commitment to long-term cooperation between the EU and Russia persists.

To date, however, problems of implementation reveal that the Commission’s multilateral logic is not shared by all MS. Although in recent analyses, Kirchner and Berk (2010) as well as Umbach (2010) conclude that substantial energy cooperation on the community level is likely to develop over the next five to ten years, as a result of liberalisation measures in the energy sector, the perceived urgency of a common energy policy and as by-product of environmental legislation, today genuine cooperation remains wanting. In its sector inquiry (published in 2007), the Commission’s Directorate General for Competition revealed substantial short-comings in the implementation of European gas and electricity markets, as did the Commission’s report on the implementation of the Third Energy Package (European Commission 2011d). This state of affairs, while it undermines the Commission’s objectives, provides an insight into the heterogeneity of national interests within the EU itself.

Some governments are keen to liberalise energy markets as this suits their domestic framework: for instance, Spain’s energy sector is privatised, so vested interests in oligarchies from the state are absent. In the United Kingdom, where the energy market is largely



liberalised, market operators would profit from seeing this framework expanded to the rest of the Single Market. States with a high import dependency on Russia would also profit from further market liberalisation (Belyi 2009: 123; Youngs 2009: 33). For other governments however, national champions remain a valuable asset, and allow for negotiations ‘on equal terms’ with exporters like Gazprom (Barysch 2007: 6; McGowan 2008: 101). This explains, for example, why in France the merging of Gaz de France and Suez was backed by the Elysée and it receives preferential political treatment (Youngs 2009: 36).

The problems of implementation thus illustrate that there is a sensible reluctance by some MS to leave energy matters to market forces alone: as business interests are often guided by the aim of short-term economic profits, with measures of privatisation and liberalisation no one actor takes on responsibility for long-term security of gas supplies (Umbach 2010: 1230). This distrust of markets is likely to have hardened against the backdrop of severe global financial and economic crisis since 2008, and the market failures associated with it (see e.g. The Economist 2010).

The paradox of finding both market liberalisation and its refusal in the name of energy security is hence indicative of the multiplicity of interests behind the multilateral façade of the EU’s approach to energy matters, and helps understand the complexity of forging a common policy, an issue which will be further touched upon throughout this chapter.

2.2 The external dimension

Despite the abovementioned weaknesses of the internal approach, its extension to the external sphere appears to be seen as logical by the European Commission (see e.g. European Commission 2011c: 2). This commitment to export internal structures of multilateral governance to relations with external partners is in academic literature often explained from a social constructivist perspective (Haukkala, 2007; Hughes 2007; Keukeleire & MacNaughtan 2008; Westphal 2006). According to social constructivism, actors cannot be seen in isolation from the environment in which they act: this environment, and its “collectively shared system of meanings”, or “culture”, defines the identity and hence the preferences of actors (Christiansen et.al. 1999; Pollack 2010: 24). Consequently, interests are endogenous rather than exogenous to institutions, meaning that they are essentially social constructs and not pre-determined (Wendt 1999). For the European Commission, the principle underpinning the



(internal) approach to energy policy is that of multilateral cooperation and solidarity, based on a clearly defined set of rules (Westphal 2006). From a constructivist perspective, this preference is conditioned by the Commission's central role in the project of European integration, which is built on the belief that the advantages of cooperation exceed the disadvantages (Nugent 2006: 353). Through EU treaties and the *acquis communautaire*, relations between MS could be clearly defined and managed, in that "mutual oversight was designed to resolve, or at least contain, the tensions and conflicts arising between MS, enhancing the predictability of behaviour and promoting mutual understanding" between formerly deadly foes (Keukeleire & MacNaughtan 2008: 13). Hence, the Commission holds an endogenous belief in cooperation based on rules and sustained by shared norms, which is seen as beneficial to all. This logic is thus not only applied internally, but also argued to define the overall energy strategy of the Commission (Hughes 2007; Keukeleire & MacNaughtan 2008; Westphal 2006).

Although this theory contributes to our understanding of why the EU attempts to frame energy relations with Russia within EU principles, it suffers from a major weakness: "the almost total neglect of power" within their energy relations (Hyde-Price 2006: 218).

Importantly, the Commission certainly knows itself to be in a powerful position vis-à-vis Russia: the EU's heavy dependency, when considered from a different perspective, ensures an important and virtually indispensable market for Gazprom, on which Russia today heavily depends for 70% of its gas exports (European Commission 2012b). This importance of EU markets for Russia suggests that the Commission is in a position where it can exert pressure, and is able to insist on a framework of cooperation which rationally suits EU interests the best. Therefore, attempts to engage Russia in core European principles through the ECT, the energy dialogue and even their PCA are maybe best understood not as a purely identity-based choice, but likewise as a rational attempt to change the rules of energy cooperation with Russia to its advantage, which effectively engages Russia and the EU in plays of power. Such power struggles reveal themselves, as the following chapters will argue, not only in their direct energy cooperation (ECT, energy dialogue and PCA), but likewise in projects aiming to diversify energy sources and markets, as well as Russia's tactic of 'divide and rule'. All of these endeavours aim at strengthening the respective power positions within energy negotiations between the EU and Russia.



Although the ECT is not an EU-initiative *per se*⁵, it was used as an attempt to link Russia into EU principles (Kirchner & Berk 2010: 872). As a binding treaty under international law it provides rules on investment, transit and trade in the energy sector, its central aim being “to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments” (Energy Charter 2012a). This would increase the reliability and predictability of energy flows to the EU and lessen the likelihood of price-cartels and of non-economic factors putting steady energy supplies at risk. Hence, the EU’s interest in Russia’s signing of the treaty is to de-politicise energy relations with Russia in order to create a level playing field, which would enhance the EU’s energy security of supply (Aalto 2009).

While the ECT could have provided a suitable framework for this objective, and its most important target country Russia signed the treaty in 1994, subsequently it neither ratified the ECT nor any of the additional protocols on gas transit, only applying the treaty provisionally (Energy Charter 2012a). Indeed, Russia had good reasons not to do so, as the EU’s motives for its signing the treaty are hardly compatible with Russian interests. Most problematic were the treaty’s provisions on pipeline grids and transit. As the ECT would subject Russia’s pipeline network to multilateral regulations, and it promotes “the principles of freedom of transit and of non-discrimination” (Energy Charter 2012b), the existing transit provisions of the ECT would oblige Russia to facilitate gas transit through its pipelines, regardless of “origin, destination or ownership, at non-discriminatory pricing” (Aalto & Westphal 2008: 12). Furthermore, as the attempt from the late 1990s onwards to establish a Transit Protocol defining more precise rules on energy transit indicates, the EU sought to utilise the ECT platform to de-monopolise the EU’s energy trade with Russia, and to push for third-party access to Russian transport infrastructure (see Energy Charter 2012c). Hence, under the ECT, Russia’s pipeline system could be used for outside interests, including the establishment of a ‘transit corridor’ channelling gas from the Caspian region through Russian territory, but beyond Gazprom’s control (Belyi 2009: 121; Hughes 2007: 89). Ratifying the ECT therefore would have meant ceding an extremely favourable position for Russia: without the ECT, Gazprom is, given its pipeline monopoly, able to largely control alternative energy transit from Central Asia, thus reinforcing its position as Europe’s key supplier of gas. Hence, as

⁵ The ECT is based on a Dutch initiative, from 1990, with the objective to set out a legal framework for energy-related investments in and trade with former Soviet states (Buchan 2010: 371).



Umbach (2010: 1237) emphasises, liberalised energy markets with multilateral regulations “threaten Russia’s monopoly policies, market shares in the EU and long-term contractual prices” which Russia can currently enforce in European markets. None of this is in Russia’s interest. Not surprisingly therefore, Russia officially declared in August 2009 that it had no intention of becoming a contracting party to the ECT and terminated the provisional application of the treaty in October 2009 (Energy Charter 2012 a). Yet it seems plausible that Russia has been able to ‘safely’ do so because the ECT was not the only channel of energy diplomacy with EU and this dialogue could hence be maintained.

Given the meagre results from the ECT, in 2000 the energy dialogue was set up between Russia and the EU. The energy dialogue is a diplomatic platform designed to facilitate EU-Russia energy relations and investments by creating a favourable political and institutional framework, for example, through regular expert group meetings and annual summits (Aalto & Westphal 2008: 13). From a more cynical point of view, the energy dialogue can be seen as merely an alternative channel to convince Russia to commit to (at least some) ECT principles (Youngs 2009: 81), which reveals the stubborn insistence of the EU to incorporate “allegedly joint goals” that had already been rejected by Russia as part of the ECT (Morozov 2008: 47). This corroborates, as Romanova notes, that Russia and the EU “have a mutual interest in the dialogue, but each pursues its own agenda” (2008: 76). Their divergent interests in this cooperation are well illustrated by the term ‘reciprocity’, a principle which both state to pursue through the energy dialogue, however interpreting it fundamentally differently. For the EU, reciprocity signifies a “mutually agreed legal framework that facilitates two-way investment”, and hence effectively an instrument for assimilation and market opening (Barysch 2007: 5; Romanova 2010). For Russia, however, reciprocity means “swapping assets of similar value or utility”, and is thus a means of acquiring profitable downstream assets in European markets (Barysch 2007: 5; Belyi 2009: 128), a vision which clearly conflicts with the EU’s aim of market liberalisation.

Regular exchange within the energy dialogue has thus produced no quantum leap in EU/Russia energy relations, failing to prevent further supply disruptions, as illustrated by the 2009 gas dispute between Russia and Ukraine which again “left millions of East Europeans without heating in the middle of winter” (EurActive 2011b)⁶. Although the

⁶ See Pirani et al. (2009) for a detailed discussion.



dialogue has in the meantime been strengthened by an early warning mechanism - supplying notifications for likely interruptions in gas and electricity - and by the establishment of an EU-Russia Gas Advisory Council (European Commission 2009), agreements are limited to issues of technical order and the articulation of abstract long-term goals, e.g. the creation of a common energy market between the EU and Russia, without specifying when and how this would be achieved (Romanova 2008). Disagreement, however, prevails on key issues such as pipeline grids, contracts of gas transit and electricity pricing as well as ‘reciprocity’ (European Commission 2011c: 8). Hence the most significant issues of energy relations between the EU and Russia remain to be tackled, and the results of the energy dialogue are seen as of little added value: as pointed out by a Russian energy executive, “Russia did not need dialogue, but a clearer roadmap of the EU of what it would get in return for strategic energy cooperation” (Youngs 2009: 154). The EU, however, is unable to sign the deals which Russia aspires to, as these would mean “compromising its own principles of open markets, transparency and a level-playing field”, which illustrates that the interests of Russia and the EU clearly are at odds (Barysch 2007: 5).

Meanwhile, Russia’s continued commitment to the energy dialogue despite its frustration corroborates that the EU is able to insist on its multilateral preference for cooperation with Gazprom, as it seems that Russia cannot afford to abandon this energy relationship. Therefore, despite their conflicting visions about the goals of the energy dialogue, the active engagement in EU/Russia energy diplomacy is a mutual acknowledgement of their interdependence (Aalto 2008b: 193). The willingness for a longer-term commitment is further reflected in the 2011 signing of the “Common Understanding on the Roadmap of the EU-Russia Energy Cooperation until 2050” (European Commission 2011a) and in energy cooperation at the regional level, which is actively sought, pursued and indeed mutually beneficial, for example, as part of the Northern Dimension regional cooperation scheme (Romanova 2008).

2.3 The foreign policy dimension

Although energy matters are decoupled from political questions since the 2000 Feira European Council meeting, the wider nature of EU foreign policy allows the situation of external energy relations in the ‘bigger picture’ of the EU’s international behaviour, further



illustrating the shortcomings of a purely constructivist understanding of the Commission's approach to external energy relations.

The EU has been argued to largely act as a civilian power in the international realm, resorting not to coercion, but to 'softer' tools for persuasion and influence, such as economic incentives, while it also weighs on the basis of its norms and ideals (Diez 2005; Haukkala 2007). As the EU can be seen to have an impact internationally through the values it embodies, shaping what is perceived as 'normal' in the international sphere, it has been qualified as a "normative power" (Manners 2002). Importantly, as Haukkala points out, the Union's civilian influence is not a choice which is "merely practical, reflecting the lack of [military] means, but it also stems from the Union's self-conception (or identity) as a new and qualitatively different international actor that shuns away from traditional models of 'power politics' and seeks to promote a 'rule-based international order' in its stead" (2007: 133), which seems to corroborate the above social constructivist argument. From a normative perspective, EU foreign policy is consequently "in essence about transforming the identity of other entities" (Keukeleire & MacNaughtan 2008: 334), i.e. striving for convergence of third parties to Community norms (Prozorov 2006: 162).

Yet as the 'normative power' concept tends to be seen positively due to the values it represents, critical distance to *why* the EU exerts influence, and *how*, often remains wanting (Hyde-Price 2006; Zielonka 2008). Meanwhile, these elements strongly suggest that not only ideals, but also interests shape the EU's external policies.

Significantly, it must be noted that the EU greatly benefits from spreading internal standards and norms beyond its borders, when cooperating economically and politically with non-MS, which makes it utterly difficult to dissociate values and utility in the EU's foreign policy (Zielonka 2008).

While one-sided convergence to EU norms may be a normal *modus operandi* with candidate countries for accession, critics note that the EU seems to have difficulties formulating alternative external policies, as an integrationist logic is applied persistently, even when



accession is neither an option, nor desired (Monaghan 2007: 47)⁷. Non-candidate external actors, however, have no prospect of gaining access to EU decision-making processes, despite their obligation to implement EU decisions (Zielonka 2008). Therefore, it can certainly be argued that the EU's approach to energy relations with Russia is in line with a foreign policy pattern that is characterised by a perceptible "subject-object asymmetry" (Prozorov 2006: 161) - which in itself is hardly compatible with the principles the EU is said to promote, notably solidarity and democracy, but from which the EU arguably benefits.

Coherently, the PCA with Russia is drawn up according to an EU-centred normative doctrine to which Russia is supposed to be subject (Prozorov 2006: 161). Since 1994, the PCA is the main institutional framework for EU-Russia relations, the aim of PCAs being, according to the Commission (2012a), "to strengthen democracies [...] and develop their economies through cooperation in a wide range of areas and through political dialogue". However, while the EU promotes the idea of a level playing field with Russia, EU laws and norms are seen as the suitable basis for cooperation: according to article 55 of the PCA, "the parties recognize that an important condition for strengthening the economic links between Russia and the Community is the approximation of legislation. Russia shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community" (cited in Romanova 2010: 76). Consequently, Russian officials feel that European principles are being imposed on them, without regards to Russian identity and tradition, and without regards to Russian interests. The Russian notion of "sovereign democracy" (promoted by Putin's chief of staff) is indicative of the "conviction that Russians should define their own democracy and *protect themselves from values exported from outside*" (Light 2008: 22, emphasis added). Hence, while the EU and Russia constitute two rather different ideational models, the EU does not acknowledge this and continuously attempts to "reform Russia despite itself" (Mandil 2008: 2; Morozov 2008: 161). Therefore, the normative argument is (like the constructivist perspective on which it is based) misleading due to its exclusive focus on values as an end in itself rather than as a means to an end. Considering the Commission's behaviour exclusively through the lens of constructivism fails to portray the EU as an actor who actively pursues a goal, namely that of shaping the 'rules of the game' to the EU's own benefit. Hence,

⁷ E.g. within the European Economic Area (EEA) and the European Neighbourhood Policy (ENP), assimilation of laws and administrative practices to EU norms usually is the basis for functional cooperation in certain policy areas with the EU (Lavenex & Schimmelfennig 2009).



it seems that the Commission itself resorts to *realpolitik* and can do so because Russia also depends on their energy cooperation. Although, as the following section will demonstrate, Russia is currently able to make use of disunity within the EU to resist EU principles, it is aware that the EU has several ‘aces up its sleeve’, especially for the longer term. These include, as discussed above, the prospect of increased energy efficiency, the development of fully liberalised internal gas and electricity markets and further diversification of the EU’s external energy suppliers, which altogether strengthen the Commission’s power position (Mandil 2008). This insight refutes the perspective, adopted by a strand of literature, that EU/Russia relations are inherently asymmetric (e.g. Hughes 2007; Lucas 2008) and instead corroborates the view, taken by a recent strand of authors, that energy relations between the EU and Russia are difficult, but indispensable to Russia just as much as to the EU (Aalto 2009; Goldthau 2008a; Mandil 2008; Youngs 2009).

2.4 The member states’ perspective

While the European Commission thus tries to engage Russia in a common framework, Russia is able to resist this multilateral logic also because MS undermine it.

Although overall, MS may agree with the Commission’s energy agenda, they remain reluctant to concede sovereignty in energy matters, which is perceived as a sensitive, security-related policy area and hence seen at the core of nation states’ competences (Aalto 2008b: 199; Natorski & Herranz-Surralsés 2008; Romanova 2008: 66). Energy policy has therefore so far only been pushed by the EU through competences relating to environmental policy, technology and the internal market/competition, where the Commission has been able to make use of its political entrepreneurship (Westphal 2006: 52): in these policy areas, decisions are largely made by qualified majority voting in the Council of ministers, whereas decisions “significantly affecting a Member State’s choice between different energy sources and the general structure of its energy supply”, require unanimity (art. 192, Lisbon Treaty).

There is some irony in the absence of Community-level competences in energy matters, given that with the European Coal and Steel Community, energy was at the very basis of the European project. In the recently agreed Lisbon Treaty, the concept of ‘energy solidarity’ was included in a Community Treaty for the first time. The treaty, however, also stresses the principle of subsidiarity, and hence, MS still decide over their respective energy supply, as argued above (Buchan 2010).

On a practical level, different national preferences concerning the respective national ‘energy mix’ make supranational competences and decision-making in the energy field difficult (Kirchner & Berk 2010: 867-68; Schmidt-Felzmann 2008: 67): for example, while some MS heavily rely on nuclear energy (e.g. France, the UK and Finland), others are very apprehensive about this source of energy (e.g. Austria, Denmark and recently Germany). Similar differences can be found for, *inter alia*, the national reliance on renewable sources of energy. This heterogeneity of energy production leads to different levels of vulnerability vis-à-vis external suppliers, and notably to different levels of dependence on imports of Russian gas. Youngs (2009: 79-80) categorises MS into three groups: those with the lowest dependence on Russian imports, including those countries which import no Russian gas at all. Italy, France and Germany make up the second group, that of countries with medium dependence (although importantly, these are the largest importers of Russian gas in absolute terms). The third group encompasses MS with a high dependence, and includes Finland, Estonia, Latvia, Lithuania, Slovakia and Romania which depend 100% on gas imported from Russia.

Member State	Percentage of Total Gas Imports that come from Russia
Austria	70
Belgium	8
Bulgaria	100
Czech Republic	76
Estonia	100
Finland	100
France	23
Germany	57
Greece	84
Hungary	81
Italy	36
Latvia	100
Lithuania	100
Poland	68
Romania	100
Slovakia	100
Slovenia	60
Other EU Member States (Cyprus, Denmark, Ireland, Luxembourg, Malta, Netherlands, Portugal, Spain, Sweden, UK)	0

Table 1: EU member states' import dependency on Russian natural gas. Source: House of Lords 2008



While this illustrates that the perception of Russia as a potential threat is not consistent between MS, some MS have considerable leverage in negotiations with Gazprom due to their market size, whereas other MS do not. Furthermore, for bigger MS, energy often is part of their bilateral foreign policy towards Russia, so that energy deals of national champions may be linked to other foreign policy agreements (Buchan 2010: 370), which brings out the importance of good personal ties between European politicians and the president of the Russian Federation; a legacy of the Putin presidency (Light 2008: 25; Westphal 2008: 93). Gerhard Schröder, Silvio Berlusconi and Jacques Chirac are prime examples of politicians who developed a personal relationship with Putin to the detriment of unity within the EU (Barysch 2007: 2). Hence, as the dependence on Russian imports, the perception of Russia as a potential threat to energy security and individual MS' (political) relations with the Kremlin vary substantially, not all MS see the need to protect themselves with a common external energy policy (Kirchner & Berk 2010: 868; Umbach 2010: 1237). Russia is hence able to agree long-term contracts in bilateral deals with individual MS, notably between Gazprom and the respective national champions of the European main net importers: Germany's EON Ruhrgas (until 2035), France's Gaz de France Suez (until 2030) and Italy's ENI (until 2035) (Kirchner & Berk 2010: 868). These agreements give Russia an advantage in negotiations with the EU, and (at present) allow Gazprom to maintain energy cooperation with the EU largely at its own terms.

The 'North Stream' pipeline serves as a case in point for this predicament. 'North Stream' (an initiative of the Schröder government in Germany, on stream since early 2011) transports gas from Vyborg in Russia to Greifswald in Germany through a submarine pipeline, circumventing all transit countries (Westphal 2008: 209). Although the pipeline is supported by the EU at the strategic level, due to its diversification of transport routes for Russian gas to Europe (Romanova 2008), it indisputably reinforces the EU's reliance on gas from Russia and is furthermore highly problematic at the regional level. 'North Stream' was built despite environmental concerns articulated by both Finland and Sweden, which has produced conflict between Germany and these states (Light 2008: 19). The pipeline also circumvents Poland and the Baltic States, causing them a loss in transit revenues. Moreover, while these countries try to enhance their energy security through Russian dependence on transit through their territory, they have lost a central bargaining asset when negotiating gas prices with Russia in the future (Romanova 2008: 87; Westphal 2006: 57).



Hence, bilateral agreements heighten the EU's reliance on imports of Russian gas while fragmenting attempts at creating competitive internal energy markets. Externally, they significantly undermine the possibility of establishing a coherent European policy vis-à-vis Russia and damage EU solidarity, leaving individual MS in an increasingly vulnerable position. Therefore, in a vicious circle, while states need to ensure their respective energy security in the absence of a functional European energy policy, such unilateralism currently undermines the very development of a common approach.

While the EU's approach to energy relations with Russia can hence be described as multilateral, it encompasses a multiplicity of actors and interests, which means that a coherent European energy policy is difficult to put into practice, both internally and externally. Nevertheless, as argued above, there remains potential for a more coherent common energy policy in future, as 'spill-over' from internal energy policies, as by-product of environmental legislation, and due to the urgency attributed to the development of energy solidarity (Kirchner & Berk 2010; Umbach 2010). This potential for more leverage, as well as Russia's *de facto* reliance on European markets for its exports reveal the strong position the Commission finds itself in. The Commission therefore appears as a rational, goal-driven actor rather than merely the incarnation of European values, and although engaging with each other in power games, the EU and Russia hold a mutual interest in their energy relations.

Having considered EU approaches to Russia on the Community and the MS-level as well as the internal divergences that weaken the EU's overall approach, it is necessary to take a closer look at an alternative EU attempt to respond to the strategic challenge of heavily depending on Russian gas.

2.5 Engaging with the shared neighbourhood: Central Asia

With increasing dependency on gas imports and continuing difficulties in forging a common European energy policy towards Russia, the strategic importance of the EU's Central Asian neighbourhood (notably Kazakhstan, Turkmenistan and Uzbekistan) increases. The gas reserves in the Caucasus region offer an opportunity to lessen the EU's energy dilemma with Russia, both in terms of production and transit of gas. EU engagement in this region, however, also holds significant conflict potential with Russia.

The strategic value of the Caucasus is recognised in the Commission’s first communication on external energy relations since 2006, “The EU Energy Policy: Engaging with partners beyond our borders” (2011c). While this document is not legally binding, it provides a snapshot of EU perspectives and strategies, the aim of which it is to enhance energy cooperation with the EU’s neighbouring region, notably by also offering a political and normative agenda⁸.

The Commission’s communication provides suggestions for how the energy-rich Caucasus region can potentially lessen dependency on gas imports from Russia, emphasising two priority projects in the region. The planned (not yet signed) Trans-Caspian pipeline project, which could channel gas from Turkmenistan and Azerbaijan to the EU through a submarine pipeline, would circumvent both Iran and Russia as transit countries, and is therefore a main concern for the Commission. In an attempt to speak with one voice in this region, the Commission has been asked to negotiate this project on behalf of the EU (European Commission 2011c: 4), a mandate which could be seminal for further common projects. The prospect of the pipeline being realised remains, however, unclear as Russia has taken on legal endeavours (relating to the legal status of the Caspian Sea) in order to prevent the construction of the pipeline (Closson 2009).

Secondly, the Commission advocates the ‘Southern Corridor’ project, an initiative for gas supplies running through a number of pipelines from the Caspian (and Middle Eastern) region to the EU and which according to estimates could satisfy 10-20% of the EU’s gas import needs by 2020 (European Commission 2011c: 5). This European energy diplomacy, as will be argued, conflicts with Russia’s interests in the region.

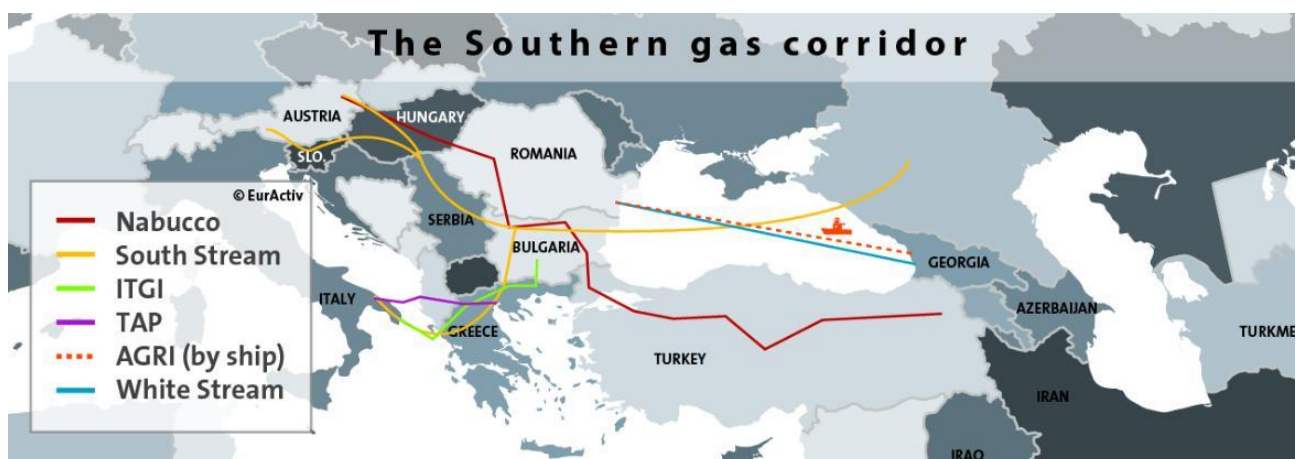


Figure 1: The Southern gas corridor. Source: EurActive 2011a

⁸ Although the communication covers the EU’s neighbourhood more broadly, we will here focus on proposals for the Caucasus, as it is a region of pivotal importance, offering both ‘alternative’ production *and* transit.



The ‘Nabucco’ pipeline is arguably the ‘Southern Corridor’s flagship project: it would allow Azerbaijan, Kazakhstan and Turkmenistan (and potentially Iran) to export their gas without relying on Gazprom’s pipeline grid. Channelling gas from Turkey to Austria, it is designed to lessen the EU’s dependence on Russia. Importantly however, it must be noted that there remain serious uncertainties regarding the availability of sufficient gas to operate this pipeline as gas reserves in the three abovementioned Caspian states are limited, and because Russia attempts to secure access to these resources as well (Mandil 2008: 22).

The fact that the ‘Nabucco’ pipeline is strongly supported by the EU and (most of) its MS, considering the uncertainty, reveals that this project bears a strongly political dimension, not only as a power signal to Russia, but also as a political gesture to the Caucasus region (EurActiv 2011b; Mandil 2008: 23). Accordingly, the EU’s plans to engage with its neighbours for energy cooperation also include a significant claim to normative and political influence. The document states that “the EU should also consider offering comprehensive bilateral partnerships to those countries interested to engage towards further integration” and “demonstrate that it is prepared to engage with the Caspian [...] region on a long-term basis, *both politically and economically*” (European Commission 2011: 5 & 7, emphasis added). Given the region’s historical ties with Russia, a comprehensive agenda seems necessary if the EU wants to convince these countries to co-operate in the long term (Nanay 2009: 128). At the same time, European interests significantly underpin this approach, as economic and regional stability is crucial for predictable relations between consumer and supplier countries, and hence for dependable energy supplies (as the events of the Georgian War in 2008 highlighted, where oil pipelines were targeted in attacks) (Umbach 2010: 1237). Stahl therefore emphasises that “the EU’s energy, security and normative interests are closely intertwined in the Southern Caucasus region: [...] the EU strives to integrate the [region] not only economically, but also politically and ideationally in order to enhance its (energy) security” (Stahl 2009)⁹.

Increased European involvement in the region, however, presents a predicament with Russia. Moscow is increasingly sensitive about EU engagement in the Caucasus, as Russian control over the Caspian region *directly* determines European dependence on Russia (Feklyunina

⁹ Original text: “Energie-, Sicherheits- und normative Interessen der EU sind im Südkaukasus eng miteinander verflochten: [...] Die EU möchte den Südkaukasus nicht nur wirtschaftlich, sondern auch politisch und ideell an sich binden, um ihre (Energie-)Sicherheit zu erhöhen.”



2008: 131; Nanay 2009: 109), and as Russia itself also depends on Turkmen gas to satisfy its enormous domestic energy demand (Feklyunina 2008: 134). Furthermore, as will be explored in more detail in the next chapter, the countries of the Caucasus are part of a region which Russia still sees as its 'natural sphere of influence' and where it wants to maintain a constitutive muscle (Rumer 2007). It seems, therefore, that the EU's and Russia's (energy) objectives in the Caspian region are not only conflicting but almost incompatible. With this in mind, it must again be underlined that gas from the Caspian region can only complement and lessen, but not entirely substitute Russian gas imports to the EU (Aalto 2009: 164). The Community consequently has a strong interest in maintaining cooperative rather than conflicting relations with Russia. Monaghan (2006), for example, argues that excessive European diversification efforts could undermine the EU's perceived dependability as a consumer and thus encourage increased Russian endeavours to diversify its export markets away from the EU. Endeavours in Central Asia hence remain a precarious undertaking for the EU, attempting to find a difficult balance between energy policy, neighbourhood policy and its approach to Russia.

3. The Russian perspective: between power politics and interdependency

This chapter engages with Russia's vision of energy cooperation with the EU. While presenting the political and economic dynamics in which Russian energy policy is rooted, it will be argued that a simple focus on geopolitical realism belies the complexity of factors which determine Russia's energy policy vis-à-vis the EU. In a first part, a neo-realist framework will be applied to analyse Russia's state control over and geopolitical use of energy resources. Subsequently, the importance of energy policy for Russia's recovery after the economic downturn in the late 1990s and its importance for Russia's self-image today as a power pole in the international sphere will be examined, while maintaining that this seems to make any commitment to the EU's suggested framework for energy cooperation rather unlikely. The shortcomings of a realist reading will, however, become evident within an analysis of the domestic dimension of Russia's external energy policy. Russia's dependency on revenues from the EU will be highlighted, and further examined in the final section, notably with regards to Russia's investment gap in the upstream sector. It will be concluded that, contrary to what Moscow's realist rhetoric suggests, Russia heavily depends on positive energy relations with the EU.



3.1 Russian power politics

Russia's refusal to commit to a rules-based approach to energy cooperation and its rejection of multilateral regimes such as the ECT suggest an exclusive focus on national interest in an environment which Russia seems to perceive as hostile to its interests, and is hence often seen through the lens of neo-realist theory (Barysch 2007; Emerson 2006; Light 2008; Lucas 2008; Smith 2004).

According to neo-realism, states are the main actors in an international realm characterised by a state of anarchy, i.e. no central authority enforces rules and order. The international system therefore is a competitive one; a self-help system in which states struggle for survival (Waltz 1979). The main aim of states is to gain power and to ensure their national interest, minimising the loss of power and influence through rational behaviour. Within this anarchical system, uncertainty and instability can be limited by achieving a "balance of power" according to Waltzian neo-realism (Waltz 1979: 117): as hegemony is perceived as a danger in the international sphere, it is essential to balance against states with a potential claim to hegemony. Accordingly, it has been argued that "Russia views itself as a pole in the multi-polar world, characterized by interest-based interaction and the necessity to balance the other poles to ensure that none of them becomes too strong" (Romanova 2008: 192). The Russian rejection of the EU's approach to energy cooperation can consequently be interpreted as a zero-sum approach to energy politics in the Eurasian region (Tkachenko 2008: 192). There seems to be a strong geopolitical dimension to Russian energy politics, which the EU's market-based approach fails to undercut: the use of energy as a foreign policy tool, enabled by state control of the gas sector.

Vladimir Putin's presidency (1999-2008) is particularly associated with geopolitical realism (Feklyunina 2008: 130; Light 2008: 15; Rumer 2007: 23). Whereas the liberalisation of gas and energy markets is pushed in the EU, notably after the turning point of 2006, this process has been halted and even reversed in the Russian Federation (Belyi 2009: 122). With Putin's declared aim of establishing Russia as an 'energy superpower' in the international sphere, state influence and control over the energy sector have been strengthened through a range of legislative initiatives reversing much of the energy sector privatisation of the 1990s. This was sometimes achieved in an extremely dubious manner, for which the case of the oil company



Yukos¹⁰ may be the most infamous example (Morozov 2008: 51). Under Putin, the leadership of Russia's largest energy companies were staffed with "prominent figures of the presidential administration" (Tkachenko 2008: 167), which is indicative of the intertwined relationship of the Kremlin and the Russian energy sector. In 2007, Russian anti-monopoly regulations were removed, which enabled the Kremlin to also acquire substantial shares in the main remaining private gas producers, notably Itera and Novatek, through Gazprom (Smith Stegen 2011: 6507). Therefore, while the gas sector in Russia indisputably involves a wide range of actors, including different "ministries of the [...] Federal Government, regional administrations [...] and legislative assemblies, [...] energy companies, and other business and financial actors", it is the presidential administration which has established a dominant control over both the exploration and transport of gas through Russian territory and that of its immediate surroundings (Tkachenko 2008: 163).

It has been able to do so mainly through the energy giant Gazprom. While Gazprom claims to be purely commercial, it is described by critics as something similar to a Foreign Ministry, "a parallel government" (Tkachenko 2008: 186) or even as "synonymous with the Kremlin" (Light 2008: 18). An offspring of the former Soviet Ministry of the Gas Industry, Gazprom was privatised after the demise of the USSR. In 2004/05, however, the Kremlin bought 51% of the company's shares, effectively bringing it under total state control. While routine management of Gazprom and its estimated 170 subsidiary companies remains with managers rather than bureaucrats, strategic decisions of Gazprom are determined at the highest political level in Russia (Westphal 2006: 54). Putin furthermore changed the leadership of Gazprom, appointing Aleksey Miller - a personal friend and a former member of the St. Petersburg administration - as chief executive officer (Tkachenko 2008: 185).

This political control over Gazprom, and the company's monopoly over both extraction and transport of gas, seems to provide the Kremlin with an effective foreign policy tool.

Whereas the EU insists on a de-politicised approach to energy relations, the Russian Ministry of Energy bluntly states that energy resources are an "instrument for domestic and foreign policy", which crudely highlights how poorly compatible European and Russian approaches

¹⁰ Yukos, at the time the biggest petroleum company in Russia, was acquired by state-controlled Rosneft in 2004/05 under dubious circumstances involving the arbitrary taking into custody and trial of Mikhail Khodorkovsky (then head of Yukos) (see also Tkachenko 2008).



to the gas sector *de facto* seem to be (cited in Smith Stegen 2011: 6506). The Kremlin has arguably used gas exports as a means to assert itself in its near neighbourhood at several occasions since the end of the USSR, even before the 2006 crisis (Umbach 2010: 1230). Reductions of gas supply to the Baltic States were used by Moscow to assert pressure during a dispute about Russian-speaking minorities and Russian military installations on Baltic territory in 1992/93; in the early 1990s gas disruptions were also used during a conflict with Ukraine about the Black Sea Fleet. When settling the issue, Ukraine obtained price reductions of 30% on its gas imports (Smith Stegen 2011: 6509). Overall, there seems to be a direct correlation between the gas prices paid by the states in Russia's immediate neighbourhood and the political (more or less pro-Russian) orientation of the respective governments (Smith Stegen 2011: 6509). Russian energy policy can thus, at least in part, be seen as an attempt to preserve power within a perceived 'natural sphere of influence', encompassing countries of the former USSR and the Warsaw Pact (Rumer 2007; Ševcova 2007; Smith Stegen 2011). Against this background, the Russian perception of the EU's involvement in Eastern Europe is that of an increasing conflict over its influence in this region, notably since the Orange Revolution in Ukraine (Feklyunina 2008: 137). Effectively, the EU has over the past two decades cut into a sphere where Russia previously dominated politically and economically: as a result, all of the former Warsaw Pact and Baltic satellite states are today incorporated into NATO, and the EU, or its neighbourhood policy framework (Rumer 2007: 29). Russia has hence lost substantial weight in this region. While Moscow's 'hard power' of economic and military strength declined in the 1990s, it had little to offer in terms of 'soft power' which could compete with the economic gains and security offered by "Euroatlanticism" (Lucas 2008: 131). The EU's attempts to convince countries in the Caucasus region to sign up to its economic and normative agenda (discussed above) hence run counter to Russia's regional ambitions. As Michael Margelov (a member of the Federal Russian Assembly) states, the South Caucasus and Central Asia are "historic zones of Russian interest" and should therefore not become "strategic 'black holes' or lost to other states' geopolitical influence" (cited in Smith Stegen 2011: 6507). Developments in the shared neighbourhood thus seem to be perceived according to zero-sum logic, meaning that "any increase in EU influence is perceived to cause a diminution of Russian influence" (Light 2008: 15).

It must, however, be noted that the EU itself has at times, quite actively, fed into this impression: some of the tough rhetoric surrounding the 'Southern Corridor' project overly

framed this endeavour, and notably the ‘Nabucco’ pipeline, as specifically designed *against* Gazprom (Mandil 2008: 22). The EU’s diversification endeavours have therefore yielded an increased Russian commitment to a tactic commonly referred to as ‘divide and rule’, which undermines unity within the EU through the signing of bilateral deals with individual MS (Umbach 2010: 1237). One example of this, the ‘North Stream’ pipeline deal with Germany, has been discussed above.

In response to the ‘Southern Corridor’ project, Russia launched its ‘South Stream’ project, a pipeline directly competing with Nabucco and, importantly, committed Italy’s national champion ENI as contracting partner in 2007. ‘South Stream’ would channel Russian gas to the EU, targeting the same consumer countries in Central Europe as ‘Nabucco’ while envisaging similar completion dates (both around 2015), which translates into directly overlapping and competing projects (EurActive 2011a).



Figure 2: ‘Blue Stream’ and (parts of) ‘South Stream’ pipelines. Source: Gazprom 2012

Both Bulgaria and Greece have signed deals with Gazprom in order to ensure their energy supplies through a part of ‘South Stream’, a Trans-Balkan pipeline channelling gas from the Russian Black Sea. This pipeline will be the first to be controlled by Gazprom on EU territory (Youngs 2009: 86). Similarly, in March 2007, Russia agreed a bilateral deal, according to which Hungary ensures its national energy needs for the medium term through Gazprom’s



'Blue Stream' pipeline, another competitor project to 'Nabucco' (Kirchner & Berk 2010). In response to criticism on the part of the EU of this deal, Hungary responded that in absence of genuine solidarity or genuine commitment to a common energy policy it had to secure its vital energy supplies unilaterally, which sums up how Russia's 'divide and rule' tactic is able to work (Youngs 2009: 86).

The boundaries between Russian energy policy and political interests are hence blurred and at times seemingly non-existent, negating almost by definition a commitment to the EU's de-politicised and market-based approach.

Yet a sole focus on geopolitics does not do justice to the complexity of dynamics inherent in Russian energy policy, as energy economics seem inextricably linked to the Kremlin's political ambitions.

The sheer importance of the energy sector for Russia's economic recovery and the Russian state makes the full application of market rules to this sector by Russia highly unlikely. After the financial meltdown in 1998, energy revenues were key to the recovery of the Russian economy and hence allowed for Russia's newly confident and assertive stance in the international sphere (Barysch 2007: 5; Engelbrekt & Nygren 2010: 13; Perovic 2009: 1). Energy earnings enable the Russian state "to pay back all Soviet and post-Soviet foreign debt, to enlarge the country's stabilization fund and the currency reserves of the Central Bank of Russia [and] to maintain a non-deficit budget for many years", which allows for independence from foreign lenders and their conditionality (Tkachenko 2008: 164). Therefore, "in one way or another [...] the whole Russian population, its business community, and federal and regional authorities benefit from the national energy sector" (Tkachenko 2008: 164), which highlights why energy resources are not viewed as an ordinary commodity which can be dealt with according to market dynamics. Putin and his Energy Minister therefore emphasise with regards to the ECT that Moscow signed the treaty at a time when Russia was economically weak, but that the ECT is today no longer an option as it is "one-sided" (i.e. based on EU internal rules) (Monaghan 2007: 40). While in the late 1990s, Russia had to accept the "didactic, smug and often patronizing" tone of the EU (for example in the PCA), today with its new assertiveness, the Kremlin consciously rejects attempts to entice Russia into an alien framework (Keukeleire & MacNaughtan 2008: 316). Russia's monopolistic energy policies are thus as vital for Russia's material profits as for its self-image as a power pole in the international realm, which suggests that the EU has little to offer Moscow to encourage them



to sign up to a framework which would directly undermine the energy hegemony defining Russia as ‘energy superpower’.

However, Russian external energy policies are not only the product of deliberations of international power politics, as the realist argument would suggest. It is necessary to appreciate their domestic context, which highlights some of the shortcomings of this theory.

Energy matters are politicised in Russia: internally, this is due to the commitment of supplying gas at highly subsidised prices. While gas makes up more than half of domestic energy consumption, Gazprom is bound, by federal legislation, to ensure supplies for the consumption of domestic households and industries. Therefore, more than two thirds of Russia’s annually produced gas is used domestically by, *inter alia*, households, industry, transport and heating (Goldthau 2008b; Pleines 2009: 81). Due to a dual pricing system, domestic manufacturers and households are heavily subsidised, effectively only paying one fifth of European prices (Goldthau 2008b; Pleines 2009: 80). This policy is rooted in the perception of gas as a right rather than as a commercial good within the Russian Federation (Belyi 2011: 2) and therefore, cheap gas to a certain extent buys “social peace” in many regions of Russia (Dasseleer 2009: 50).

However, domestic subsidies are a very costly obligation for Gazprom, which is aggravated by Russia’s highly energy-intensive economy and domestic consumption¹¹ (Belyi 2011: 7; Hanson 2009: 38). As a result, energy policy is also highly politicised externally, where Gazprom needs to earn revenues which can compensate for its loss-generating domestic market (Goldthau 2008b). This situation is likely to persist for some time to come, as attempts to reform the internal gas and energy market in Russia haven proven difficult (Belyi 2011). Russia’s external policies are thus also determined by Gazprom’s need to balance its losses in the domestic market.

3.2 Interdependency

While Russia’s politicised and assertive energy policy, and its relatively successful dividing of EU MS (allowing it to circumvent EU principles) may at first sight seem to portray EU/Russia power relations as asymmetric (Emerson 2006; Hughes 2007; Lucas 2008), the above analysis of Russia’s domestic market suggests otherwise by highlighting that Russia

¹¹ Russia uses three times more energy per unit of GDP than the EU-25 (Goldthau 2008b).



heavily depends on revenues from the EU market, and will do so for some time in the future. The argument that Russia, despite its realist rhetoric, therefore has a strong imperative to frame energy relations with the Community in a relatively cooperative manner will be explored in further detail in the following sections.

Russia's strategic use of energy exports can be seen as self-defeating. It has led, from early on, to a tendency to over-invest in export capacity while underfunding its own production (Baev 2008; Morozov 2008; Pleines 2009). The effect of this neglect has been worsened by a systematic lack of earnings in the 1990s (due to non-payments during the economic downturn), which further limited the scope of investments in transport and production capacities (Belyi 2011: 7). Furthermore, with increased state-control over the Russian energy sector, and no legislative framework protecting private actors from arbitrary state-intervention, private companies have been marginalised, causing a significant loss of productivity within the Russian energy sector (Pleines 2009). The issue of gas flaring constitutes an illustrative example of this problem. Due to Gazprom's monopoly over extraction, sales and exports of natural gas, oil companies in Russia are mostly unable to sell gas which is associated with oil deposits, instead resorting to flaring (Belyi 2011: 3; Mandil 2008: 21). According to a World Bank report (2007: 17), flaring of gas therefore annually amounts to 38 billion m³ in Russia (in comparison: annual exports to the EU for the same time frame are 120-150 billion m³). This figure reveals the inefficiency the Russian energy sector suffers from, due to monopoly policies, as close to one third of Russia's potential export capacity is wasted annually. Furthermore, due to the discrimination against private companies and the absence of a reliable legal framework, not only Russian private actors, but also foreign businesses are reluctant to invest in the Russian gas sector (Goldthau 2008b; Morozov 2008: 52; Perovic 2009: 7). Therefore, Russia may face serious challenges in the medium and long term future.

Although Russia owns the world's largest reserves of natural gas, its most important gas fields, (located in Western Siberia: Yamburg, Urengoy and Mdzvezh'ye), which together account for about 60% of Russia's total gas production, have started depleting, while production at a fourth major gas field (Zapaloyarnoye) has also peaked (Goldthau 2008a; Goldthau 2008b). Therefore, new gas fields, notably Shtokman (off-shore in the arctic Barents Sea) and the gas fields of the arctic Yamal peninsula need to be developed urgently and taken on stream. This, however, is an extremely costly and difficult endeavour, since these fields are



located in geographically rough areas in the far North, and are thus hostile to technology and equipment, while requiring long stretches of pipeline transport (Hanson 2009: 42; Perovic 2009: 7). The development of new gas fields will therefore constitute a considerable financial burden on Gazprom (Pleines 2009). In light of these prospects there is increasing concern whether Gazprom will actually be able to meet its contractual commitments (while satisfying its domestic demand) in future (Barysch 2007: 5; Hanson 2009: 40; Perovic 2009: 7). While the IEA estimates that Gazprom needs to invest US\$ 17 billion per year until 2030 in extraction and production undertakings as well as in maintenance of current pipeline infrastructure for this purpose, some even argue that the development of new gas fields is “impossible on the basis of Russia’s resources alone” (Poussenkova 2009: 152). This judgement seems especially plausible when bearing in mind that most other sectors of the Russian economy are not competitive internationally, and can hence not sufficiently fund the development of Russia’s energy sector (Hanson 2009: 29). These findings corroborate that Russia heavily depends on EU demand to maintain and increase the production of its energy sector and to modernise the rest of its economy (Barysch 2007: 8; Nanay 2009: 128; Perovic 2009: 7). Currently, an overwhelming 70% of Russian gas exports go to the EU (European Commission 2012b). The Community thus generates up to two thirds of Gazprom’s annual earnings, although it only accounts for 25% of its total production (Belyi 2011: 3; Goldthau 2008b).

In this connection, it must be noted that Gazprom is of enormous economic importance to the Kremlin: it is Russia’s most important earner of hard currency, and its tax payments make up one quarter of federal annual revenues of the Russian state (Tkachenko 2008: 185). Contrary to neo-realist interpretations, focussing on energy as Russia’s foreign policy tool, it therefore seems that Moscow has strong economic incentives to avoid conflicting (energy) relations with the EU, to avoid putting vital government funds at risk.

While Moscow repeatedly articulates plans to export more of its gas eastwards when energy cooperation with the EU is uneasy (e.g. with the prospect of EU restrictions on Russian downstream investments), its pipeline infrastructure currently binds it to Europe (Closson 2009: 96; Monaghan 2007: 39; Perovic 2009: 2). As pipeline grids take many years to construct and require substantial additional investments, new pipelines going eastwards are unlikely to be an immediate priority for Gazprom given its current investment challenge (Goldthau 2008b; Light 2008: 16; Poussenkova 2009: 151). Furthermore, the prospects for



exports to Asian markets, notably to China, still seem less attractive than current relationships with the EU, as Beijing is to date not willing to pay European prices (Aalto 2008b: 194; Barysch 2007: 6). Consequently, despite the existence of considerable conflict potential and inherently different approaches to their energy relation, it seems that “it is hardly possible for Russia to replace Europe as the main destination of Russian exports of natural gas”, at least for some time to come (Tkachenko 2008: 170). It can, therefore, be concluded that for Russia just as for the EU, their energy relations can be described as difficult, but nevertheless essential, and hence it is likely that they will remain bound together for better or worse in the short to medium term future.

4. Conclusions

This paper has engaged with EU/Russia energy relations, while arguing that the theories applied within two predominant strands of academic literature on this subject, social constructivism and neo-realism, do not do justice to the complexity of (power) relations between the EU and Russia. It has been suggested that an exclusive reliance on these theories conveys a simplified image of the EU as an idealistic actor guided purely by values and its multilateral identity, and of Russia as a realist threat to multilateral cooperation; both of which have here been challenged. It has instead been argued that the EU’s behaviour likewise exhibits quasi-realist elements and that for Gazprom, cooperative terms with the EU remain indispensable although Russia’s rhetoric suggests otherwise. This critique of the abovementioned theories has been underpinned by the argument (in line with a third strand of authors) that gas relations between the EU and Russia are not sustained by the EU’s asymmetric dependency on Russia, but by a strong interdependency, and therefore ought to qualify some of the alarmist tendencies which have shaped European debates about energy cooperation with Russia.

The second chapter has argued that the European Commission attempts to curb the risks of its growing gas import dependency by the promotion of rules- and market-based multilateral energy governance. Internally, attempts to establish fully competitive gas and electricity markets are intended to enhance European energy security and to yield increased energy solidarity, forming the basis for a common external energy policy vis-à-vis Russia. Externally, the European Commission has coherently attempted to apply its rules- and market-based logic to gas relations with Gazprom in order to create a level playing field (through the ECT, the



energy dialogue and the PCA). While this multilateral preference is in most literature seen from a constructivist perspective, as a choice rooted in European values and its multilateral identity, this paper has suggested that the constructivist argument overlooks the strong position the Commission finds itself in, representing Russia's most pivotal gas export market. Therefore, it has been suggested that multilateral energy governance seems to be a rational choice in the EU's best interest, and one that the EU can afford to insist on. On the MS level, however, the difficulties of putting a coherent multilateral approach to Russia into practice have been exemplified with problems relating to the implementation of competitive domestic gas and electricity markets, and with unilateral endeavours to sign long-term contracts with Gazprom. It has hence been found that distrust in a common European energy approach has enabled Gazprom to pursue a tactic of 'divide and rule', which in turn further undermines prospects of European energy solidarity, as reflected in the EU's 'Southern Corridor' project.

The third chapter has assessed Russia's approach to gas relations with the EU, with critical attention to realist interpretations. It was found that Russia's refusal of multilateral energy regimes and of the EU's approach to energy cooperation seem to be in line with a realist interpretation. Overall the Russian energy sector seems inextricably linked to political aims of the Kremlin: in contrast to European liberalisation endeavours, state control over the Russian gas sector remains a distinct reality, ensured through state-controlled gas giant Gazprom. The apparent use of Russian gas exports as a foreign policy tool furthermore suggests that geopolitical considerations motivate Russia's energy policy, which appears irreconcilable with the EU's attempts to de-politicise gas relations with Russia. With energy forming the basis of Russia's newly assertive stance in the international sphere, energy policy is not only vital for material ends but also reflects Russia's new self-image as an 'energy superpower', further highlighting the blurred boundary between energy economics and politics in Russia. Yet this paper has suggested that despite its aggressive rhetoric, economically Gazprom is highly dependent on revenues from European markets, and hence on cooperative terms with the EU. This is due to Gazprom's need to make up for the losses generated within its domestic market, the investment gap in Russia's upstream sector, and the improbability of Gazprom reaching out to Asian markets within the near future, which reveals the shortcomings of the realist argument.

While the EU's multilateral vision of energy cooperation at first seems poorly compatible with that of Russia, as the failed attempt to incorporate Russia into the ECT, the lack of



substantial results of their energy dialogue and their different understandings of ‘reciprocity’ suggest, it has been demonstrated that neither the EU nor Russia are able to abandon their difficult energy relationship as both indisputably depend on it. It can therefore be concluded that EU/Russia energy relations are certainly complex; including elements of both conflict and cooperation, of dependency and interdependency between the EU, individual MS and Russia, as well as changes to these elements over time. Eurasian gas relations also involve strategic games of power as both partners continuously attempt to shape this vital energy cooperation to their benefit (the EU through multilateral regimes as well as diversification efforts; Russia through ‘divide and rule’, threats to focus exports on Asian markets, and attempts to thwart EU endeavours in Central Asia). This complexity of power relations, however, is not adequately portrayed within the use of constructivist and neo-realist theory.

On a more practical level, the above findings of interdependency suggest that fears of Russian ‘pipeline politics’ appear somewhat exaggerated, as any actions that would severely undermine Russia’s credibility as a supplier of gas (e.g. direct ‘energy blackmailing’ of the EU, or further conflicts affecting its gas supplies) would prove harmful to Russia’s own energy security (of demand) and hence seem rather unlikely at present. How the relationship between the EU and Russia will evolve in the longer term depends on numerous factors, including possible reforms in the Russian internal gas and electricity market, its ability to attract investors for its upstream sector as well as potential pipeline developments towards Asian markets; the EU’s future energy efficiency and the implementation of liberalisation measures, enhanced European energy solidarity; and on developments in the shared neighbourhood, notably Central Asia. While these variables make any long-term predictions difficult it seems clear from the above analysis that at present and in the near future, interdependency binds the EU and Russia together as uneasy, but essential partners.

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