

THE FEATURES
OF EU ENERGY
STRATEGY
IN THE BALTIC
REGION

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This article analyses the issues of EU energy policy in the 1990s-the beginning of the 2000s in order to identify the features of energy supply and energy safety of the Baltic region countries. The research and practical significance of the work lies in the stepwise description of actions taken by EU leaders and EU member states in order to formulate a common European energy policy. The 2004 EU enlargement posed the problem of taking into account the features of energy supply of Eastern European countries and, especially, the Baltic States. The energy industries of Lithuania, Latvia, and Estonia, as well as other Eastern European and CIS countries, are closely related to the energy industry of the Russian Federation. Trying to allow for this circumstance, EU leaders and energy structures took a number of organisational measures aimed, on the one hand, at an increase in energy independence of new members of the EU and, on the other hand, at taking into account the recent trends in the energy market development. The research shows that most of the initiatives do not take into account the perspective and interests of Russia, which has a strong presence in the energy market.

The analysis conducted will help the assessment of prospects of further development of the Baltic States' energy industry and its interaction with that of the Russian Federation.

Key words: energy, market, strategy, sources, European Union, Russia, Baltic region, guideline, safety, energy resources, diversification, integration

Despite the fact that the energy problem is of crucial importance to the EU, it was long considered a prerogative of nation states. The community did not have a unified energy strategy. In the 1990s, the energy policy started to be considered as a factor of sustainable development of the European Union. Its formulation was facilitated by a number of documents, which

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took into account the interests of Western European countries. First of all, one should mention the 1991 adoption of the European Energy Charter (EEC) — a system of international agreements relating to energy markets. The EEC presupposed free access of the European countries to Russian resources and pipelines, whereas it remained closed for the Russian energy investment.

Gradually, the European energy market players tried to escape the regional European framework giving the EEC an international character. It was renamed the Energy charter. 1994 saw the formulation of the Energy Charter Treaty, which came into force in 1998.¹

At the same time, experts emphasize that, at the turn of the 20th century, the formation and implementation of the EU long term energy policy was influenced by a number of problems. Firstly, it is fiscal issues, particularly those relating to the internalisation of negative externalities in order to create equal conditions for the development and application of different energy sources. Secondly, market problems accompanied by calls for thorough and detailed monitoring of market processes, the extension of long-term planning practices in the private sector, and the creation of mechanisms adjusting the market situation. Thirdly, it is the technological issues, including those of commercialisation of environmentally friendly but initially unprofitable technologies [2].

Back then, it seemed that these problems can be solved through the formulation and implementation of a relevant energy strategy. As European politicians and energy experts believe, an instrument such implementation requires is the so called *Green Paper* (subheading: *A European strategy for sustainable, competitive and secure energy*) [3].

However, the central idea of the strategy presented in the *Green Paper* was that the EU has rather limited opportunities in the field of energy supply, first of all, as a result of insufficient resources or their low competitiveness in the modern world (coal, for instance). Thus, the EU was forced to pay special attention to the management of demand for energy carriers. At the same time, the generation of this demand resulted in a new energy situation and new problems.

First of all, throughout the first decade of the 21st century, the EU could not accomplish the liberalisation of energy markets, nor create internal markets. A clear and rather low diversification of import was established in Europe: three countries accounted for almost a half of gas supply. An important factor affecting the demand for energy carriers was a significant, almost two-fold, increase in gas prices. And high prices have a tendency to remain at that level.

¹ Russia signed the charter and partially applied it — on a temporary basis before the ratification of the document. However, the Charter was never ratified. The Charter was believed to contradict the interests of the RF, since it grants European companies access to Russian resources, but limits the opportunities of Russian power, oil, and gas companies to penetrate the European market; on August 6, 2009, Russia finally refused the EEC membership due to the disagreement over energy efficiency issues and corresponding environmental aspects (see [1]).

The most peculiar process of the European energy market development is trade in natural gas. Specialists emphasize that, just several decades ago, this fuel accounted for a smaller share in the European energy compared to coal and oil. However, gradually its technical and economic advantages — high calorific value, easy burn control, high equipment efficiency, absence of cinder, etc. — became evident, thus, it rapidly rose to the leading position in the world balance of fossil fuel consumption.

The EU had to turn to legislative activity regulating the functioning of the European gas market, which resulted in the formulation of the first EU gas directive — the underlying document of the liberalisation of EU energy markets; on June 26, 2003, the second directive aimed at the accomplishment of liberalisation process and the opening of markets until July 1, 2007 was adopted (it came into force on July 1, 2004). The opening of EU national gas markets granted consumers a free choice of a supplier. The second directive also included the measures relating to the separation of transport infrastructure of vertically integrated companies into individual legal bodies and giving them certain independence from parent companies.

However, the implementation of the second directive was suspended due to the insufficient competition in gas markets. Then, on September 19, 2007, the European Commission offered the market players either complete unbundling of energy companies or an introduction of independent operators of gas transporting infrastructure. These provisions became the key elements of the so called “third package”. The EC measures aimed at the change of ownership most negatively affected the transit regime and the rights of foreign investors.

The “third package” initiatives were opposed by a number of leading EU countries (France, Germany): they believed the distribution of assets of the largest national energy monopolies to be inefficient and undesirable. Moreover, the initiatives of the “third package” were announced, while the requirements of the second directive were still being pursued. A certain overlapping of requirements took place: against the background of an insufficient international transport infrastructure, the actions of regulators and operators of gas transporting networks were not harmonized; the development of regional markets fell short of the desired. All this gave rise to a logical question about the relevance of further, more radical steps towards the market liberalisation. In view of the fact that the markets of EU member states were at different stages of development, complications in reaching an agreement between the parties were becoming clear. Naturally, the leading European states proposed a way out (the so called “third way” put forward by France and Germany, which aspired to take into account the features of national energy markets). Russia faced most difficult problems relating to the implementation of the third energy package in Europe, especially, the Baltics.

Finally, there emerged a need for the search for compromise decisions in the RF-EU framework. Russia was one of the most important gas suppliers to the EU countries (according to some estimates, Russian accounts for more than a quarter of the total volume of natural gas imported to the EU countries) [4]).

These features of the generation of demand for energy carriers in the EU significantly affect its energy security. Energy security, in accordance with the third directive, is estimated on the basis of a number of parameters such as the dependency on the network operator, the degree of dependence of the EU and EU members on import from third countries, the regime of national and foreign trade and investment into the energy industry by a certain third country. Energy security was traditionally assessed in each case in the context of the factual situation in view of international trade liabilities, in particular those stipulated by international agreements concluded by the EU with third countries. The third country operators, in their turn, must hold certification from EU member states and the EU Commission [5].

At the same time, energy security of gas importing countries can be ensured through encouraging the sustainable use of energy and application of its alternative sources (internal factors), as well as the reduction of dependence on importing energy carriers from one source. Taking into account that Russia accounts for up to 40 % of gas import to the EU, the latter criterion should be classed as external factors (Gazprom), can pose an obstacle to the company's action on the EU market.

Different European regions, independent of their EU membership are of vital interest for the EU in terms of politics, economy, and security. Naturally, Brussels pursues those interests through different strategic initiatives and programmes, such as new Mediterranean policy or the neighbourhood strategy, etc.

In January 2009, the Committee on Industry, Research, and Energy of the European Parliament approved a draft recommendation on the EU energy policy in the context of the recent gas crisis. This draft document, as Anne Laperrouze mentioned in her report, was drawn up on the basis of the Second Strategic Energy Review of the European Commission. Alongside the conceptual problems of the energy future of Europe, members of the European Parliament emphasised the importance of further development of nuclear energy, which should be used at the highest technological security level, as well as the opportunities for the revision of the 2004 EU directive on the security of natural gas supply aimed at pursuing a common energy supply policy and solving other problems. Of special importance were the Baltic and Caspian regions, which were identified by the members of the European parliament as areas in need of further integration and called for the development of gas supply through Central and South-Eastern Europe along the North-South axis. The inclusion of the Baltic states into the orbit of a different form Russian gas network was based predominantly on the development of the Nabucco pipeline. However, some members of the European parliament did not agree with the way the problem was formulated and demanded that negotiations on new cooperation and partnership with Russia be resumed [6].

As the further developments in Central Asia, Asia Minor and Transcaucasia showed, the idea of using Nabucco is far from reality [7]. The pipeline,

whose major problem is filling its capacity, is meant for supplying gas to the countries of Southern and Central Europe. The hopes of supplying “Southern” gas to the Baltics were of political rather than economic nature. One cannot exclude that this is why the European Commission — whose actions fit in general the framework of the Second Strategic Energy Review — initiated on June 10, 2009 a Strategy for the development of the Baltic region, which unlike other strategies is aimed only at the EU member-states. The creators of the Strategy pay attention to the fact that many problems of the Baltic region can be solved only in the conditions of effective cooperation with external partners in the region, in particular, Russia [8]. However, they emphasize that this Strategy cannot serve as a guideline for the third countries; it rather identifies the areas where cooperation is desirable and proposes holding forums where cooperation will be discussed [8].

The independence of the EU initiatives in the Baltic was stressed by the member of the European Commission, Danuta Hübner, when presenting the document: “The EU Strategy for the Baltic Sea Region is a major step as it marks a new way of working together in the Union. It does not imply new laws or institutions but is rather based on the will of governments and citizens in the Member States and regions to meet urgent, shared challenges. The Commission is proposing a comprehensive action plan, based on a thorough consultation with national and regional governments, business, NGOs and academia: the EU is well placed to coordinate the work that needs to be done in order to make the most of available resources to save the Baltic Sea, boost trade and improve the quality of life of everyone in the region” [8].

In the framework of the strategy proposed, nine countries (Denmark, Estonia, Finland, Germany, Lithuania, Latvia, Sweden, Poland, and Norway) signed a Memorandum of Understanding on the Baltic Energy Market Interconnection Plan. A common energy market shall be created in 2009—2015 [9]. As experts stress, the Strategy for the Baltic Sea region is indeed a large project, or as it is often called, Action Plan covering 15 priority areas, within which 80 different projects will be implemented. The estimated cost of these projects has also been announced — the Baltic region was supposed to receive more than 50 bln euros investment from different EU funds (including 27 bln Euro for providing better access to the region and almost 10 bln for environmental protection, 6.78 bln for increasing competitiveness, and 697 mln Euro for ensuring security and risk prevention). The basic point of the Strategy is that eight EU countries constituting the Baltic region — Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland, and Sweden — home to almost 100 mln people — will be able to plan their activities and identify priorities knowing that their neighbours contribute both efforts and funds to the development of the region [10].

One cannot but notice that the Strategy does not take into account the interests of another member of the Baltic region — Russia, whose position in the region is quite influential and, in some cases, the implementation of projects planned is impossible without its participation. In particular, experts emphasize that the ecological state of the Baltic Sea is constantly deteriora-

ting as a result of an excessive discharge of nitrates and phosphates, and its biological diversity is threatened. The level of these threats can be lowered only through joint efforts. In its turn, Russia (also in order to avoid excessive tank load on the Baltic routes) constructed the first stage of the pipeline on the seafloor. However, it will yield minimum results because of the aspiration of a number of Baltic States to build liquefied gas terminals, which will lead to the use of additional large-capacity vessels. Finally, without taking into account Russian interests, there will be significant complications to the implementation of energy supply programmes.

The developers of the Strategy classed such actions under “improving the access to, and the efficiency and security of the energy markets” [11]. Their estimation of the situation, especially from the EU perspective, is far from positive. According to European experts, energy markets (electricity, gas, oil) in the Baltic Sea region lack an infrastructure; moreover, they are overly focused on the internal needs of the countries and are poorly connected and coordinated. In some EU member states, the openness of markets and the competition level are insufficient for encouraging investment. This results in a high risk of rise in prices and a threat to energy security. In particular, Estonia, Latvia, and Lithuania are insufficiently integrated into larger energy networks of the European Union², hence, these countries turn out to be sort of isolated when it comes to energy.

The implementation of the developed energy strategy in the Baltic region, according to its creators, will face significant complications due to the fragmentation of power markets, poor access to generating capacities in the region relating to differences in power standards. Emphasizing the on-going almost 15-year campaign for the liberalisation of energy market and the resulting lack of competition, they identify as major problems a rise in energy prices, a limited number of incentives and opportunities for investment in the infrastructure, especially in the field of renewable energy resources. The absence of cooperation between the three Baltic States is most pronounced in the gas sphere. The “sore spot” is the lack of gas links to the other countries of the region, which, in its turn, results in the insufficient transborder trade turnover, low market liquidity, and rising prices against a decrease in the level of energy source diversification.

The development of an energy strategy is based on all EU/EEA member states of the Baltic region being part of the internal electric power and gas market. Since, in the early 2000s, the energy markets were at different stages of liberalisation and their infrastructures had significant flaws, the physical integration of Lithuania, Latvia, and Estonia lacked a near-term outlook against the background of the planned closing of the major power source — the Ignalina NPP.

Experts emphasized that the diversification can be increased, for example, through renewable energy sources, but this way is long and cost-inten-

² The only energy link is the Estlink cable set between Estonia and Finland; however, it has a low capacity (see [12]).

sive, thus the use of fossil fuels seems to be inevitable. So, the regional integration of energy systems is an absolute necessity.

The main conclusion of the strategy developed was a proposal to create an integrated and functioning energy market. The formation of a common EU energy market should result from the implementation of the Baltic Energy Market Interconnection Plan — BEMIP. A common energy market should be established in 2009—2015 [9].

BEMIP will naturally affect the generation and consumption of energy by the Baltic region states having different sources of energy supply. First of all, it is the countries lying on the eastern shores of the Baltic Sea (Finland, Estonia, Latvia, and Lithuania), which almost completely depend on the import of natural gas from Russia, although they have a small (for Russian suppliers) energy market. It is the countries of the southern coast (Germany, Poland), which are less dependent on Russian supply, although they are more attractive for Russian producers from the export perspective, as well as the countries of the western part of the region (Denmark, Sweden, and Norway), which do not depend on Russian energy at all.

The model of the Baltic states energy market is based on the Nordic model and is aimed at ensuring the power exchange so that power between the two regions, market management of overloading, and the creation of common reserves and energy market balance become possible.

Moreover, a number of infrastructure projects, which are of significant importance from the perspective of market integration and identification of potentially reliable companies, have been developed. These are NordBalt connecting Sweden and Lithuania, Estlink 2 between Estonia and Finland, and LitPol between Poland and Lithuania. Together they shape the so called “Baltic energy ring”. Some of the proposed BEMIP infrastructure projects were chosen to be financed through the European economic recovery plan.

The BEIMP plan does not include the Kaliningrad region of the Russian Federation, since Russia is a member of neither the EU, nor the European Economic Area.

A number of the plan’s provisions have undergone significant changes over the recent two-three years, especially, in terms of the implementation periods. The background reasons were the world economic crisis, the relations between EU member states, the changes in the general situation on the world energy markets, etc. In particular, in spring 2011, Lithuanian energy experts started discussing the launch of Visaginas NPP in 2020 instead of the earlier scheduled 2018 (or even earlier announced 2016).

One should emphasize that BEIMP has a similar project package for the provision of gas supply to the Baltic region. However, most gas projects concern the provision of Russian raw materials; however, a significant part of project initiatives has not been agreed on by the Russian party, therefore, they remain “virtual”. Moreover, the third energy project, which significantly complicated the relations between the Russian suppliers and Baltic consumers of natural gas, came to force in 2011.

As to the pipeline and network, the countries of the southern and western coasts of the Baltic Sea seem to enjoy the most favourable conditions; hence, the study of their participation in the common European energy market constitutes an individual research task.

Therefore, the problem of formation of a common Baltic energy market in the eastern sector of the region remains unsolved. The Baltics, which aspire to become energy independent states, try to solve it individually. The Baltic unity, which was characteristic of the region in the 1980s—1990s, became a matter of the past. However, the individual opportunities of these countries are rather limited, whereas the EU cannot provide practical help due to certain objective reasons (the repercussions of the world crisis, the events in North Africa, etc.). Turning to Russia for help seems to be a logical necessity. However, it seems to be unlikely in the near future.

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