



EUROPEAN POLICY BRIEF



GLOBAL RE-ORDERING: EVOLUTION THROUGH EUROPEAN NETWORKS

The EU's Soft Power with a Hard Edge: Implications for EU
Policy Strategy and Energy Security

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INTRODUCTION

"Soft power is the velvet glove, but behind it there is always the iron fist"

Robert Cooper (2004),

Director-General for external relations and political-military affairs, EU Council Secretariat

The biggest energy policy challenge that the European Union faces besides climate change is security of supply. Policy recommendations on EU energy security commonly either invoke the need for more EU hard power – such as stronger external energy policy, a tougher stance towards Russia, stronger “pipeline diplomacy” with alternative suppliers of oil and gas – or more attractive soft power – primarily a matter of improving the working of the single energy market and persuading non-EU states in the near abroad to adopt similar market-oriented regimes. This brief assesses the EU’s policy tools in the energy sector, and explores whether what might be labelled ‘soft power with a hard edge’ can amount to a consistent and realistic policy strategy.

EU hard and soft power in energy

Hard power rarely works in the EU energy sector, primarily because the EU lacks the will and cohesion to exercise military and economic hard power to secure energy supplies. To be sure, the EU has exercised hard power in the form of counter-terrorist and -piracy operations; but not in order to secure energy supplies. Historical European examples of hard power in this sector include the establishment of the Anglo-Persian Oil Company, later BP. Contemporary US examples include the Fifth Fleet's contribution to keeping the Strait of Hormuz open to international oil trade. Of course the EU has used energy as means and ways of exercising hard power, such as the oil embargo on Iran and sanctions against Russia. However, to the extent that the EU has hard economic power in the energy sector, this is primarily located at the member state level. What is more, it has not used hard (economic) power for energy-related ends. In short, the EU's lack of hard power in the energy sector is not due to an 'expectations – capability gap', but to what might be called an 'expectations – willingness gap'.

Soft power, on the other hand, is problematic for the EU energy sector because it cannot work if the targets (notably Russia) do not find the EU attractive as a model. To be sure, if non-member states do find it important to participate in the European integration project, this can give the EU leverage in terms of energy policy. A good example is Norway joining the European Economic Area, and the European Energy Community (which commits most of the West Balkans states, the Ukraine and Moldova to implementing EU gas rules on a voluntary basis). However, the EU's effort to extend its rule-based regulatory regime for investment, trade and transit to the former Soviet states with the European Charter Treaty failed. Russia did not find it attractive, and the incentives coming with the ECT did not convince other CIS countries either.

However, there is some middle ground, and it stems from the EU being the world's most attractive energy import market, both in oil and, probably more importantly, in gas. This market might give EU soft power a hard edge.

Assessing the EU toolbox: why markets give soft power a hard edge

The most powerful instrument in the European Union's energy policy toolbox is the regulatory rules that govern the Single European Market. This is of utmost importance in gas, the bloc's most vulnerable energy sector. Three sets of directives, issued in 1998, 2003 and 2009, established the internal gas market. Combined with competition law, they provide the EU's *soft power* (the attraction of the Single Market) *with a hard edge* (conditions for third-country firms accessing this market). Important examples include:

- EU competition rules, such as prohibition of companies' abuse of their dominant position, have forced energy firms to change their business practices. In the 1990s and early 2000s, the Commission broke up the Norwegian monopoly exporter GFU and other joint marketing ventures, including plans by Enterprise Energy, Marathon and Statoil to jointly market gas for the Corrib gas field, and the Danish gas supplier DONG's agreement with the country's main gas producers (Shell, A.P Møller and ChevronTexaco) to market their production jointly. The Commission and its network of national competition authorities has vetted and cleared a number of mergers, but their overall approach has been to use this power to impose conditions (usually divestment) for approving mergers and acquisitions, in order to promote competition.
- Since 2000, the Commission's tactic vis-à-vis external suppliers has been guided by pragmatic problem solving. Its investigations of 'destination clauses' in gas contracts (i.e. rules whereby exporters restrict the buyer's freedom to re-sell gas anywhere in the EU or demanded a share of the profits in the case of resale) resulted in the removal of the practice from bilateral supply contracts between Gazprom on the one side and Italy's ENI, Germany's EON Ruhrgas and Austria's OMV on the other, as well as between Algeria's Sonatrach and its European business partners.
- The EU legal requirement that made firms 'unbundle' transport and trade of gas and permit third party access to pipelines, has fostered competition among suppliers. External producers such as Gazprom need to comply with EU and national tariff regulations to the extent that they want to 'come and play' on the EU market. Gazprom has sought, and partially secured exemptions from these rules on the pipelines linked to the Nord Stream project (which runs directly from Russia to Germany under the Baltic Sea, built by a consortium of Gazprom, E.ON, BASF, Gasunie and GDF Suez); but the Commission made clear that there would be no exemptions for South Stream (which runs under the Black Sea to Bulgaria and onwards to Central Europe, planned by a Gazprom-ENI joint venture). The six EU states involved agreed to let the Commission 'assist' with their renegotiations with Gazprom.
- Article 11 of the 2009 directive – the so-called Gazprom clause – allows EU member states to take into account security of supply risks when they vet and certify third-country firms' acquisitions, ownership and operation of gas transportation networks. It is noteworthy that this does not apply to EU-firms. Russia, which joined the WTO in 2012, complained in 2014 that this clause violates the GATS requirement for non-discriminatory treatment of foreign services and service providers. Still, the EU maintains that regulatory practices as applied in the EU need to reflect the goal of supply diversification, in addition to formal legal provisions.

- The EU supports infrastructure projects, which represent a classic 'public goods' problem, as part of its efforts of 'market making'. This is done with a view to enhance diversity of pipeline routes from Russia (until the Nord Stream pipeline was opened in 2012, some 80 % of Russian gas exports to Europe crossed the Ukraine) and to link the EU market to additional suppliers, notably Azerbaijan and Turkmenistan, through the 'Southern Corridor'. The Commission uses three tools to support pipelines: its regulatory tool kit to permit exemptions from single market rules for specific pipelines; its authority and expertise to lend support to any given project; and financial support for pipelines. The Commission's most high-profile initiative was its support for the Nabucco project, which would bring Central Asian gas from Turkey to Austria via Bulgaria, Romania and Hungary. In one case, it even proposed what effectively amounted to a gas buyers' consortium in the shape of the Caspian Development Corporation, a proposal that has seen renewed momentum in the shape of the recently proposed 'Energy Union'. Although the Nabucco and CDC projects both failed, they nevertheless illustrated that the EU's policy toolbox is somewhat wider than merely Single Market regulation.

The EU as a global actor in energy: using market power in a geopolitical game

In international politics, the EU regulatory state is emerging as an actor in its own right. This gives rise to a new and different take on the EU as a soft power: one that relies on attraction, but gives its attractiveness a hard edge. This hard edge is directed at both firms and governments:

- The EU's soft power with a hard edge is directed at firms inasmuch as the Commission can and does oblige third-country firms to play by the rules of the Single European Market if they operate in the EU market. It has forced a number of firms to change their business models.
- The EU's soft power with a hard edge is directed at governments inasmuch as the EU seeks to export its rules and support infrastructure projects. However, this power is conditional on the target states' finding the EU regulatory model attractive, and/or assessing its benefits as outweighing the costs.

The EU's soft power coming with a hard edge is all about making energy markets and making them work. Almost everything the European Commission does in the field of energy policy is designed to complete the Single European Market, to extend it to the field of energy, and to render it more attractive for suppliers and consumers. In other words, the EU's hard power derives from its attempts to mitigate public goods problems. Energy security is one of them – albeit one with a strong strategic dimension. Though often underappreciated, the EU regulatory apparatus, backed

up with European market might, does have impact in fostering energy security, even short of hard power tools.

Nevertheless, the reach of EU tools - and hence its soft power with a hard edge - is clearly limited. It is more pertinent to gas than oil, because it is traded on regional rather than global markets. It is more relevant to the near abroad than more distant countries. And it is more applicable to transit countries than suppliers. The longer the attempted reach (in terms of distance), the more specific the tools need to be – as the Caspian Development Corporation initiative indicates. Finally, the EU's power is often more effective with respect to companies than governments, because its reach depends on how receptive the targets are, and the regulatory toolbox that the EU uses to achieve its policy goals. The EU's real hard edge therefore comes into play when its policies target firms, operators and regulators; not the governments of producer states.

POLICY IMPLICATIONS AND RECOMMENDATIONS

Implications for EU policy

This suggests that EU strategies need to start here. Given the characteristics of its policy toolbox, the EU will need to further sharpen and strengthen its instruments in the areas of competition policy, infrastructure support and market regulation. The EU, the world's largest and most attractive gas import market for decades to come, should invite companies to come, but to come and play according to EU rules. Further empowering the energy market watchdog - the EU Commission - will ensure both smooth market operations whilst competition rules as applied will make sure that external suppliers, as dominant as they may be, are held in check. A 'single voice on energy' will therefore not involve all 28 member states agreeing on a joint Russia policy. Instead, it will emerge through the attractiveness of the world's largest gas import market, its integrated nature ensuring a high level of competitiveness, and a powerful authority guarding market principles - the EU Commission. The 'Single Voice' will articulate the clear message that gas trade is based on the liberal market paradigm and companies supplying the EU market will need to abide by EU rules.

Internally, this crucially requires EU member states to open up their national gas markets, fully integrate them into broader EU frameworks, ensure sufficient interconnectors and reverse flow infrastructure be put in place to allow for physical delivery across borders, and to liberalize their energy sectors to ensure sufficient investment. This will both enhance EU market power and ensure that more than marginal LNG cargos add to the EU's supply structure. EU policies will therefore need to flank the external market-making agenda with efforts to strengthen the operation of the internal market. This is the other side of the coin of the EU strategy to enhance its energy security.

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