European Commission

EUROPEAN POLICYBRIEF

GLOBAL RE-ORDERING: EVOLUTION THROUGH EUROPEAN NETWORKS

The European Union, Energy Security and the Ukrainian October 2012 Election: Just another BRIC in the Wall?

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ABSTRACT

The international political economy of energy is undergoing fundamental change. New actors emerge, the global energy gravity centre is shifting eastwards, the state is back with a vengeance, and national energy companies play an increasingly important role. The BRICs – Brazil, Russia, India and China – are often accredited as important drivers of geopolitical change and the shift of political and economic power away from the OECD countries in general and the EU in particular. The EU has taken a broadly liberal, free trade oriented, approach to energy policy in genera, and to energy security – the challenge of securing a stable supply of gas as reasonably prices – in particular. The Ukraine's status as a key transit county notwithstanding, there is little reason to expect the 2012 electio ns to prompt the EU to change its energy policy significantly. Political developments in the Ukraine present a challenge, but this is part of a broader set developments in the international political economy of energy that the EU is presently dealing with.

EVIDENCE AND ANALYSIS

From an EU perspective – whether that of the European Union as a whole or that of its individual member states – the Ukrainian elections of 28 October 2012 is best understood not as a unique political risk event but as just another significant aspects of the changes in the international political economy of energy that the EU faces. It provides several important challenges to the way the EU thinks about energy security.

1. EU Energy Policy

The European regulatory state took a 'public turn' in the 1990s, as EU single market rules were extended to sectors that had been dominated by national monopolies. EU energy liberalisation began as an effort to establish uniform, single-market rules for the gas and electricity sector, but it has resulted in a heterogeneous picture. Although the 1990s and 2000s saw a series of new initiatives liberalising the sector and establishing regulatory agencies, the overall picture remains a mosaic: a more or less coherent picture made up of separate parts rather than a smooth and uniform picture. Liberalisation has been gradual and uneven, there is considerable variation in terms of the legal remit, and the member states' interpretation of and compliance with directives vary considerably.

Three factors that shape the EU's approach to policy making in general and external relations in particular are particularly pertinent:

1. The EU is a plural policy. It is not simply a pluralist polity (i.e. a polity with an open political system, with several points of access), but also a plural polity in the sense that it brings together 27 member states with different policy preferences, administrative traditions; elections cycles and legal systems.

2. The EU is above all a regulatory state. Its principal tools are regulatory (particularly in the shape of competition policy), its legitimacy is derived partly from its technocratic (consensual, non-majoritarian) policy-making and successful policy output (the Single European Market). It was designed in the 1950s, but it was in the early 1990s that the EU regulatory model was, in a sense, and idea whose time had come. This shapes its external policy.

3. The EU operates in a changing international context. The 1990 was the inverse of a perfect storm: a number of factors combined to make the international context benign for the regulatory state. These factors – which range from the end of the Cold War, the 'unipolar moment', and a market-oriented and democratising Russia to low oil prices and economic prosperity in the 1990s – had all been reversed or changed by 2012.

The current debates and policy agendas on energy security and gas dependence in Europe reflect the tension between the depoliticised market-oriented approach that informs the EU Single Market project and the security imperatives that are characteristic of almost all energy policy. EU energy policy has three core dimensions:

1. As far as energy is concerned, the EU is primarily a liberal Single Market project. Competition policy usually trumps industrial policy, gas markets are in the process of being liberalised (albeit with mixed results), and the role of state-owned companies is significant, but not compared to the pre-SEM ear or the EU's eastern and southern neighbours.

2. Since the mid-1980s the environment dimension of EU energy policy has become increasingly important. This has added a non-market dimension to energy security, based on perceptions of gas not simply as a private good, but also as a *public good* and a private good with strong negative externalities.

3. The debate about security of supply in the 1990s included a strong public service dimension to energy – based on the idea that energy is not just and public good and a private good, but also a *strategic good*. Failure of supply can be market failure, but it can also be linked to externalities or geopolitics.

In short, the EU's energy and energy security agenda grew complex during the 1990s: from a focus on the Single Market in energy to a broader agenda that includes a strong climate change dimension and a strategic dimension. The question is whether its policy toolbox is adequate for the new challenges of the twenty-First Century?

2. World Energy Markets

The energy world is in a state of radical change. Each of the drivers that shape global energy markets is in the process of radical redefinition – markets, policy agendas, geopolitics, and actors. The consequence of these changes is a new global setting for energy policy, defined by a fundamental tension between globalization and fragmentation.

1. International energy markets are characterised by increasing demand, drive in particular by developments in the BRICs – Brazil, India, Russia and China. However, data on the main emerging consumer – China – are poor, if at all available.

2. Although the Climate Change agenda is shaping energy markets, the global economic crises has imposed limits on what states can afford to do at the moment.

3. The present trend toward electrification of energy systems beyond the OECD reinforces the role that new consumer heavyweights, notably China and India, play in shaping global energy markets.

4. National Oil Companies (NOCs) play an increasingly important role, particularly outside the OECD, but as consumers and producers.

5. Under Putin's leadership Russia has sought to prevent foreign investors from controlling shares of strategic sectors, including energy. Hence the widespread accusations of resource nationalism

Oil and gas markers are different in two important respects: oil markets are international and fungible, and security of supply in oil markets is therefore a matter of managing price volatility; in the regional and bilateral gas markets characterised by pipeline politics, long-term take-or-pay contracts and destination clauses the main concern is supply risk, i.e. managing or preventing interruptions of supply.

The question is how the EU responds to the failure of its project to extend general trade rules to the energy sector, and what policy tools it has available to address problems of energy security.

3. Energy Security and EU's Policy Tools

Security of supply in the gas sector as discussed by the EU and its member states can be broken down into three analytically distinct questions.

1. A short-term question that concerns possible threats to interruption of supply. In the oil sector this might include price shocks and supply shocks, and the principal policy tool is oil stocks (and excise taxes that in effect cushion the marginal effect on consumers). In the gas sector it includes network regulation, storage and emergency measures to interconnect markets in the event of local shortages (e.g. reverse pipeline capacity).

2. A number of medium-term questions are shaped by the notion that energy security entails steady supply at acceptable prices. This can be extended to include efficient prices (a public goods aspect of energy); prices that reflect social priorities and concepts of equality (cf. the energy poverty debate); and prices that accommodate dominant distributors' duties to supply (the public service provisions much debated in the 1990s). Again the EU's policy tools are strong: competition policy provides a potent regulatory tool for ensuring the efficient operation of the Single Market (and applies to external actors on that market, as Gazprom is experiencing); whereas industrial policy measures (acceptance of state aid and subsidies, NOCs, mergers and acquisitions) cushion the effects of the single market on the industry.

3. Third, energy security includes a long-term dimensions related to sustainable use of energy and its strategic quality. The environment aspect of sustainable energy use is simply the question of the consequences of using fossil fuels and managing what promises to be (at best) a drawn-out a transition process to a low-carbon economy; the strategic aspect concerns the risk that energy may be used as a political weapon in unrelated disputes. The EU's principal policy tools include improving the flow of information in what is a notoriously non-transparent market (contributing to data on supply and demand); regulation of emissions and operating an emissions trading system; promoting (subsidising) renewable energy and compensating the losers in the event of an energy transition. However, the EU is dependent on its member states inasmuch as it lacks the resources to use in non-regulatory policy tools.

4. The Ukraine 2012 Election – just another BRIC in the wall?

The international political economy of energy has been shaped by a handful of fundamental shifts in international oil and gas markets:

1. Until the Tripoli and Tehran agreements of 1971 that nationalised reserves held by international (western) oil companies, the Seven Sisters effectively constituted a consumer cartel that dominated the non-communist market.

2. The following decade saw the OPEC producer cartel dominate markets, and use oil as a political weapon in Middle East conflicts.

3. The combination of non-OPEC production, increased energy efficiency (driven by high oil prices) and the effects of the Iran-Iraq war on OPEC's cohesion and the belligerents' output brought about a liberal age and a buyers' market in oil in the 1980s, which turned into a 'liberal era" in the 1990s after the 1986 'counter-shock' and the collapse of communism.

The question today is how the EU responded to new market developments in what might be labelled a fourth era – with the rapid rise in oil prices, the emergence of 'new consumers', new patterns of international energy trade driven by a combination of mercantilist government policy and the emergence of 'consumer NOCs'.

In this context, the Ukrainian election raises a number of specific questions that, upon close inspection, turn out not so much to be a unique challenge for the EU in terms of energy security as another nail in the coffin of the EU's efforts to extend its rule-based liberal market eastwards and extend it from trade to cover investment and transit.

- To what extent was the election a contest between political alternative that are better described as 'east-of-centre' versus 'west-of-centre' rather than left and right competition affect energy markets? Will the election result enhance Russia's role in Ukrainian energy policy, or in regional energy markets? Or Gazprom's role?
- Will the election result increase/confirm the political dimension of gas markets? Will it make further disputes over pay and transit more likely?
- Will Gazprom re-negotiate its long-term contracts as part of a strategy to secure a dominant position?
- Will the election result make it even more difficult for the EU to pursue its efforts to extend rule-based trade (on terms similar to those that govern its internal market) eastwards?

To the extent that the answers to all these questions are 'yes', the central message in the above analysis is that this is neither unique nor surprising. Markets have become less transparent and predictable over the last decade, and the effect of this is strikingly visible on the EU: it keeps on muddling through, generating policy responses that no longer fully resonate fully in the new environment. The Ukrainian election result may well make the situation somewhat more challenging for the EU, but to the extent that it does, this is part of a broader trend that the EU has already begun to address.

Policy Implications and Recommendations

The EU's approach to the gas sector may be described as 'soft power with a hard edge'. The EU's primary focus is on what Joseph Nye defined as soft power: the EU establishing itself as an attractive model for integration and trade and exporting both its norms and institutions. Hence the EU's efforts to extend rule-based and supranationally regulated energy regimes eastwards. However, the EU's approach is accompanied by a hard edge, which can be found in policy tools such as its use of competition policy vis-à-vis companies that have a dominant position (most recently including Gazprom) and its political, regulatory and financial support for new pipelines designed to increase diversity in supply lines. If anything, the Ukrainian elections of 2012 look set to reinforce the EU's focus on the policy tools that make up the hard edge of its otherwise soft policy.

Project Identity

Project name

Global Re-ordering: Evolution through European Networks (GR:EEN).

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Waseda University
Tokyo, Japan

FUNDING SCHEME

FP7 Framework Programme, Collaborative Project, SSH – Europe facing a rising multi-polar world

DURATION

March 2011- February 2015 (48 months)

BUDGET

EU contribution: 7 944 718 €.

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FURTHER READING

All working papers, policy briefing papers and other publications are available on our website: www.greenfp7.eu/papers