Europe's External Energy Policy: Between Geopolitics and the Market

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Abstract

While energy security has gradually been incorporated into the EU's foreign policy calculus, the declared approach of extending a nexus of 'market-governance' energy norms has been realised only to a limited extent. The EU has eschewed a comprehensively political approach to energy security, with its energy security policy currently hovering ineffectively between market and geopolitical approaches. The EU needs to address more effectively the way in which governance structures in producer states impact upon European energy interests.

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EUROPE'S EXTERNAL ENERGY POLICY: BETWEEN GEOPOLITICS AND THE MARKET

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During the last three years the EU has agreed a series of policy papers and new strategies in the field of energy security. European governments and European Commissioners routinely stress their belief that Europe's energy predicament is acute and cite energy security as a priority issue for the Common Foreign and Security Policy. Policy commitments stress that energy strategy is to move beyond the internal sphere and become systematically a part of EU external relations. The Commission's pivotal 2006 Energy Green Paper promised "a better integration of energy objectives into broader relations with third countries".[1]

And indeed a plethora of new energy agreements, partnerships, dialogues and treaties have been forthcoming. The EU has signed agreements on energy cooperation with Ukraine in December 2005, Azerbaijan and Kazakhstan in 2006 and has offered a similar partnership to Algeria and Egypt. In October 2005, the Energy Community South East Europe Treaty was signed, with the aim of incorporating Balkan states into the European regional market for gas and petroleum products. A Commission-led Black Sea and Caspian Sea energy cooperation initiative is also taking shape. EU-OPEC dialogue has deepened. An EU-Africa energy partnership is being developed. Energy is now a prominent issue in nearly all the EU's external political dialogues, whereas it barely appeared on the agenda five years ago.

But do these new energy initiatives amount to much? Has energy really been fully and coherently integrated into EU foreign policy? Has the EU adopted qualitatively new approaches to energy security or simply piled one formal strategy on top of another without meaningful change?

This paper makes four arguments that follow in sequence. First, the EU's stated approach to energy security can be described as revolving around the concept of a 'market-governance' nexus. Second, European governments and EU institutions espouse this approach while harbouring concerns that in practice a more geopolitical approach is required. Third, such concern is amplified by the increasing resistance to the EU's 'market-governance' model on the part of several key energy producer states. Fourth, despite inching towards a more geo-strategic approach, the EU remains insufficiently engaged with the political issues that impinge upon energy interests in producer states. In sum, the EU currently hovers ineffectively *between* markets and geopolitics, where it needs more effectively to *conjoin* these two necessary strands of energy security.

1. Extending 'market-governance'

It is clear that the internal market is the crucial bedrock of the EU's external energy policies. The EU's stated approach to energy security is predicated on the spread eastwards and southwards of internal European market rules.

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[1] Commission of the European Communities, *Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy*, COM(2006) 105, 8 March 2006, p. 4.

The March 2006 Green Paper argues that energy security can best be achieved through a "pan-European energy community", a "common regulatory space" around Europe. This is said to require "[r]einforced market-based provisions on energy…in the EU's existing and future agreements with third countries".[2] The Green Paper asserts that as a guiding philosophy, "[i]t would be a mistake to pay too much attention to the geographical or national origin of today's oil imports. In reality, the EU depends…on a global oil market".

The Commission asserts that energy security can be achieved "by the EU extending its own energy market to include its neighbours within a common regulatory area with shared trade, transit and environmental rules": "We need to convince non-EU consumer countries that world energy markets can work for them. If they were to conclude that the only route to security lay in bilateral deals, the risk of disruption of the energy system would grow".[3]

The Commission's 2007 Strategic Energy Review stresses the search for international partnerships based on "shared rules or principles derived from EU [internal] energy policy" and the need to promote 'transparent legal frameworks' in producer states.[4] Crucially, in its high-profile September 2007 'unbundling' proposal (to break up the production and distribution of energy) the Commission reiterates the importance of internal market rules facilitating rules-based influence over third country producers. In short, the EU espouses a combination of market and governance principles that might be termed a 'market-governance' nexus.

This is conceived as being more than simply a free market model, but rather an apparently clear example of the EU reproducing its own constituent norms – now widely recognised as central to the EU's international identity. It would be exaggerated to say that the aim is a wholesale export of the internal market, but the logic is to extend as many of its rules as are political and economically feasible outside EU structures.

The overarching aim is said to be the development of inter-connecting energy systems between different geographical areas, based on EU regulatory norms and the *acquis*, as a means of transcending the so far partial technical cooperation pursued separately with individual partner states.[5] The EU's basic goal is to extend the principles of the 1994 Energy Charter Treaty (ECT) successively to the different areas of the EU's periphery, from Russia, through Central Asia and the South Caucasus, Ukraine, the Balkans and into the southern Mediterranean.

The EU's new energy treaties and agreements across the range of different third countries are said to be about 'extending the EU's energy norms and infrastructure' as the main solution to security concerns:

- Following Russia's rejection of the ECT, the EU has sought various alternative avenues to persuade Russia to adhere to at least some of the Charter's market-governance principles. The EU-Russia energy dialogue, which commenced in 2000, has aimed at enhancing infrastructure connections, including through Tacis funding. In 2002 an EU-Russia Technology Centre was created in Moscow, bringing together industry representatives. From 2003 the formal aim was enunciated of extending the internal European energy market to Russia. A focus on practical cooperation, avoiding sensitive political questions, was reinforced by the agreement in 2003 to reorganise EU-Russia relations around four 'common spaces.' The EU linked its support for Russian WTO accession to Moscow's

[2] Ibid., pp. 15-20.

[3] Commission of the European Communities, *An External Policy to Serve Europe's Energy Interests*, Paper from the Commission/SG/HR for the European Council, 2006.

[4] Commission of the European Communities, An Energy Policy for Europe, COM(2007)1, pp. 18-19.

[5] Ibid., pp.15-20.

assent to "favour the growing integration of the continent's energy markets".[6] The focus has recently been on incorporating some ECT principles into any successor to the now-expiring Partnership and Cooperation Agreement (PCA).

- To the south, the Commission's new Mediterranean aid programme for 2007-13 identifies as priority areas for funding the integration of European and Maghrebi gas markets; support for extension of the Energy Community Treaty to the southern Mediterranean; and integration of Libyan energy markets into the broader EMP regional framework.[7]

- Similarly, the Energy Community South East Europe Treaty extends the EU energy *acquis* to the Balkans and coordinates infrastructure linkages, with World Bank financial support.[8] The Energy Community is a process that aims to extend the EU internal energy market to the South East Europe region. It aims to create a legal and economic framework in relation to 'Network Energy'. The main goals are to create a stable and regulatory market framework capable of attracting investment; to create a single regulatory space for trade; to enhance security of supply; to improve the environmental situation and to develop electricity and gas market competition on a broader geographical scale.

- According to Commissioner Benita Ferrero-Waldner, Azerbaijan's inclusion in the European Neighbourhood Policy reflects the country's 'geo-strategic location and energy resources.'[9] Under its energy partnership with the EU Azerbaijan commits itself to adopting an independent energy regulatory authority and independent transmission system operators both along the lines of European market-governance models.[10]

  In 2004, the EU also launched the Baku Initiative, which incorporates the Commission, the Caspian littoral states and their neighbours, with the declared aim of developing regional energy markets and network interconnections in the Caspian and Central Asia. The EU's stated objective is to drive energy sector reform in the region, around EU regulatory standards – once again using Europe's internal market as a template. The Baku Initiative is based on a trade off: European funding and investment for infrastructure development in return for a guarantee of supplies to European markets.[11] New EBRD funds have been offered to Caspian Basin states, along with an increased €500 million of EIB lending, for energy connection and reforms.

  The Commission's new Black Sea initiative similarly aims at the progressive integration of this region into the European energy market. In late 2006 the Commission proposed plans to move towards 'sub-regional energy markets' in the Caspian Basin, Caucasus and Central Asia, through a new EU-Black Sea-Caspian Sea Common Energy House. Policy here will be based on prompting and supporting the convergence of these energy markets with that of the EU, with the ambitious aim of having this whole broader region

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6 EU-Russia Energy Dialogue, Fifth Progress Report, November 2004, p. 2.

7 European Neighbourhood and Partnership Instrument, Regional Strategy paper (2007-2103), pp. 31-32.

8 Charles Grant, *Europe's Blurred Boundaries: Rethinking enlargement and neighbourhood policy*, Centre for European Reform, London, 2006, p. 65.

9 Benita Ferrero-Waldner, speech to the European Parliament, 26 October 2005.

10 Memorandum of Understanding on a Strategic Partnership between the European Union and the Republic of Azerbaijan in the Field of Energy, p. 7.

11 Gawdat Bahgat, "Europe's energy security: challenges and opportunities", *International Affairs*, 82:5, 2006, p. 971.

"functioning on the basis of the EU internal energy market".[12] The Commission has proposed that this initiative have its own secretariat and be funded from the ENPI. The new EU-Central Asia strategy agreed under the German presidency in June 2007 proposed a new formal energy dialogue that would work towards a new 'transport corridor' and the extension of EU internal energy market principles.

- In Africa, energy partnership is understood through the lens of development policy and governance issues. The EU Energy Initiative for Poverty Eradication and Sustainable Development was launched in 2002, aimed at improving access to energy as part of poverty reduction strategies. One instrument agreed under this Initiative is the 220 million euro Energy Facility, to support projects strengthening energy delivery to rural areas. The October 2005 EU Strategy for Africa (p. 5 & 37) attaches priority to the funding of regional energy infrastructure, including links between sub-Saharan and North Africa.

  The 2005 statement on Policy Coherence for Development (PCD) commits the EU to strengthen twinning programmes in the energy sphere, the coordination of regulatory frameworks, regional cooperation and the integration of energy into poverty reduction programmes.[13] In October 2006, energy cooperation was for the first time identified explicitly as a priority focal area for the €23 billion European Development Fund (EDF) budget. An updated review of EU-Africa cooperation issued in April 2007 advocates more efforts in the extension of internal market principles to Africa, as part of an Africa-EU Energy Alliance.[14] In 2007 new dialogue commenced in Brussels between the EU and China on Africa with the declared aim – on the European side – of getting China signed up to market rules. This was judged to be the means to bringing down the energy prices Beijing was offering across Africa which were squeezing medium-sized European companies out of the African market.

Across these varied regions, diplomats insist that the internal market both defines the EU's substantive approach to energy security and (in a classic case of spill-over) ensures that member states' bilateral foreign policies are converging around a unified set of guiding principles. Policy-makers argue that the internal market leaves increasingly little room for market-distorting bilateral deals. Reflecting the EU's unique nature as an (intra-European) international body itself devising an (extra-European) international policy, its 'external' policy extends the nature of 'internal' cooperation already developed between member states.

Internal competition laws have obliged a number of reforms that determine important substance of foreign policy. One example is the scrapping of traditional 'destination clauses' in third country agreements. These clauses enabled producer states to prevent a buyer passing on surplus supplies to other states and thus protect the exclusivity of bilateral contracts – something contrary to the basic tenets of the EU internal market. Their demise permits a more flexible switching of supplies between member states, a contribution to better energy security.[15]

The dispersal of market power is often conceived as integral to security of supply. Market liberalisation is also widely perceived to be the EU's most potent negotiating tool in

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[12] Benita Ferrero-Waldner, Opening address, External Energy Policy conference, 20 November 2006, Brussels.

[13] Policy Coherence for Development, Communication from the Commission, 12 April 2005, COM(2005) 134, p.18.

[14] Presidency-Commission Joint Background Paper on Energy Cooperation between Africa and Europe, 8376/07, 17 April 2007.

[15] John Gault, "EU energy security and the periphery", in Roland Dannreuther (ed.), *European Union Foreign and Security Policy: Towards a Neighbourhood Strategy,* London: Routledge 2004, p. 177.

international energy negotiations. The Commission argues in its January 2007 Strategic Energy Review that it is by opening up its own markets that the EU can best hope to gain FDI access to countries such as Russia. The breaking apart of national energy champions within Europe would make it harder for large non-European firms, like Gazprom, to negotiate their way into dominant positions simply through a small number of bilateral deals.

Moreover, large scale LNG capacities developed in particular by the British and Spanish offer the prospect of huge increases in Algerian, Qatari and Norwegian gas coming in the UK and Spain and then –*assuming* full internal market liberalisation – onto other European markets too, striking at Gazprom's dominant position. In this sense, diplomats frequently concede that completing the internal market is a prerequisite to the EU being able to put in place a common external dimension to its energy policy.

Stressing the market-governance nexus, the internal market's centrality in rooting Europe's international projection is presented as orienting the EU towards energy strategies based on far-reaching rules-based governance reform. Benita Ferrero-Waldner claims that the EU's 'added value' to external energy policies is to ensure that rule of law principles prevail through "enhanced legal framework[s]".[16] The series of new energy partnerships – signed with Ukraine, Azerbaijan and Kazakhstan – represent a familiar EU-style approach of attempting to use contractual agreements to attain adherence to rules-based behaviour on market regulations, transport and safety.

Officials also argue that rules-based governance offers the most promising way to deal with the rise of new energy consumers, such as India and China: European energy strategy seeks to entice these states into an international energy regime based around common regulatory and governance norms, to undercut the ability of such 'rising powers' to resort to untrammeled political deal-making.

Diplomats likewise insist that the Energy Charter is important primarily because of its focus on the rule of law and the role of governments in providing robust frameworks for foreign investment in the energy sector. In this way the Commission argues that the export of European standards and norms is the key to ensuring both consistency with human rights aims and improving conditions for EU investment in producer states.[17] The Director General of DG Relex (External Relations) at the European Commission insists that good governance has become an integral aspect of external energy polices.[18]

The Extractives Industry Transparency Initiative (EITI), launched by then British Prime Minister Tony Blair at the World Summit for Sustainable Development in 2002, is often said to represent a key link between energy security and good governance policies. The EITI aims to gain commitments from multinationals to publish details of their payments in producer states, as a means of reducing the scope for bribery. The EITI has seen an effort to reduce resource-linked corruption in particular in Nigeria, Azerbaijan and Kazakhstan.

European policy-makers see in this market-governance approach a clear difference with US energy security strategy. Many US commentators have highlighted the degree to which the Bush administration has injected a 'hard security' dimension into energy policy. They observe

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[16] Benita Ferrero-Waldner, Opening address, External Energy Policy conference, 20 November 2006, Brussels.

[17] Benita Ferrero-Waldner, "The European Neighbourhood Policy: The EU's Newest Foreign Policy Instrument", EFAR 11/2, 2006, pp. 139-142.

[18] Eneko Landaburu, European Parliament hearing on 'Towards a common European foreign policy on energy', 28 February 2007.

that the US approach is based on the increasing use of military deployments and partnerships to protect and guarantee energy supplies – from West Africa, Central Asia, through to the Middle East.[19] European policy-makers are united in professing a less directly securitised approach to energy. It is notable that energy is not enmeshed within European Security and Defence Policy (ESDP) decision-making.

2. Precarious principles

Such is the declared approach. And the market-governance strategy would certainly seem to have been imbued with sufficient substance to render it more than purely declaratory. But, of course, much recent debate has focused on the well-known divisions that persist within the European Union over the role of market liberalisation. Debates over *internal* market reforms have been extensively covered; this paper is concerned with the degree to which these have impacted upon *external* policies. Crucially, this internal-external spill-over has deepened. At the same time as advocating and proclaiming the market-governance approach, different parts of the EU foreign policy system have in practice reined back efforts to base energy security on the extension of internal market norms. Member state governments and EU institutions harbour two crucial sets of doubts.

First, contrary to formal EU rhetoric, some fairly fundamental doubts persist over market norms. If the internal market is supposed to set the foundations for a rules-based, market-oriented external energy policy, this logic is undermined by the determination of a number of member states to curtail the liberalisation of energy markets within Europe.

In 2006, the Commission criticised all governments except the Dutch for failing to meet market opening commitments they had already signed up to. High-profile cases such as Spain's hindrance of E.ON's bid for Endesa have dominated headlines. Beyond these, analysts lament a broader return to 'economic nationalism' within Europe.[20] While paying lip service to its support for 'completing the internal market', the French government has blocked proposed new EU regulations that would tighten enforcement mechanisms and speed up the implementation of liberalising reforms.[21] After President Sarkozy pushed the controversial Suez-Gaz de France merger to completion, Europe minister Jean-Pierre Jouyet declared that this creation of a new national champion represented a "vision of what could be the energy policy for Europe". At the time of writing, several member states still reject the Commission's flagship 'unbundling' proposal. The internal energy market remains very much less than unified, despite the formal freeing up of internal gas prices in July 2007. Linked to this, basic infrastructural links are still absent between member states.

Significantly for this paper's focus on foreign policy dimensions, this situation has direct ramifications on external strategy. The absence of both pan-European market mechanisms and sufficient physical interconnections prevents the EU from responding as a single entity to external energy shocks. Critics argue that this renders premature expectations of a coherent foreign policy.

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[19] Michael Klare, *Blood and Oil*, London: Penguin, 2004; Lutz Kleveman, (2004) *The New Great Game: Blood and Oil in Central Asia,* London: Atlantic Books; Jan Kalicki and David Goldwyn, "Introduction: The Need to Integrate Energy and Foreign Policy", in Jan Kalicki and David Goldwyn, *Energy and Security: Toward a New Foreign Policy Strategy*, Woodrow Wilson Center, Washington, D.C., 2005.

[20] Sebastian Vos, "Europe's infant energy strategy looks muddled and unclear", *Europe's World*, No. 4, Autumn 2006, pp. 133-137.

[21] Commentaires de la France sur les propositions du Livre vert, available at www.industrie.gouv.fr/energie, p. 3.

Market-doubters also stress the differences between oil and gas markets, reiterating scepticism that the latter can develop the fungibility of international oil flows. They commonly warn that market deepening would mean increased price volatility, to the detriment of energy security.

The French proposal for an Energy Special Representative was openly aimed at the goal of circumventing free market supporters within the Commission in favour of a more government-led, geopolitical approach to energy security internationally.[22] Within most member states foreign ministries have sought to wrest influence from energy ministries for similar reasons.

French, Spanish, Italian and German positions tend not to oppose market principles outright but rather argue that liberalisation should be matched by negotiated reciprocity in producer states. Contrary to much reporting, they insist that their position reflects not an existential rejection of the market but the fact that they start from a different position in terms of the structure of state-firm relations and the vested interests that must therefore be taken into account. It is the condition of reciprocity that has now been formally enshrined in Commission proposals and dubbed 'the Gazprom clause'.

Bilateral deals remain the preferred means of securing such negotiated reciprocity. Most member states, and indeed the Commission, extol the virtues of long-term negotiated contracts. A number of governments admit that if anything their political intervention and backing for such deals is becoming stronger and more overt. They argue that removing the carrot of downstream access within Europe would make it harder for EU governments to win upstream access in producer states. And a number of member states reject even the notion of basic transparency and information-sharing between EU member states on such bilateral deals.

Lithuanian President Valdas Adamkus concurred that while Russia in particular insisted on approaching energy in such an overtly geopolitical manner, the EU needed to respond in kind and drop the 'mantra' that the market would provide for Europe's energy security.[23] In private many member state diplomats opine that while they feel bound to go along with the EU's market rhetoric, such an approach is in practice increasingly unrealistic, in light of a more difficult geopolitical context. In contrast, the UK criticises the demand that liberalisation be reciprocal as a pretext for protectionism.

High Representative Javier Solana has warned that, "we should avoid thinking that enumerating a list of principles is a substitute for a policy" and that there "is no such thing as a single solution" to the complex international politics of energy security. Market liberalisation, he opined, is "only part of the answer".[24] An incipient battle for control over external energy policy between the Commission and Council is described by insiders as one between the competing approaches of 'markets and politics.'

What many take to represent 'the European approach' of extending internal market networks is far from being a rationalised philosophy of energy security, but is simply the area in which the Commission has enjoyed energy-related competence and thus the inevitable focus of Brussels proposals so far. As the Council is becoming more deeply engaged in the geopolitics of energy security, this has already begun to change. The 'energy technocrats' complain that too much alliance-oriented foreign policy is already infecting the coherence of EU strategies.

A **second** set of doubts relates to the balance between the internal and external dimensions of energy security. Despite all the formal rhetoric to the contrary, in private many policy-makers in

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[22] Ibid., p. 1.

[23] Eurasia Daily Monitor, 14 May 2007.

[24] Javier Solana, Address to the EU External Energy Policy conference, 20 November 2006, Brussels.

energy ministries still talk in terms of energy security being a matter of reducing external dependencies, rather than strengthening international market *inter*-dependencies. The foreign policy dimension of energy strategy has been increasingly eclipsed by the focus on climate change and the broader environmental dimensions of energy security.

The 2007 Strategic Review was most notable for the Commission proposal for a 20% unilateral European reduction of carbon emissions by 2020. New European Investment Bank funding available for the development of renewable energy technologies dwarfs external energy funding. Climate change is a more easily definable and identifiable issue that has captured public attention and driven policy changes in a way that the more diffuse external-geopolitical challenges of energy security have failed to do.[25]

To some degree the internal and external dimensions of energy security are quite properly pursued in parallel. But some tension also exists between them. Most notably, the priority attached to reducing external dependencies cuts across talk of 'mutually-beneficial energy partnership' with producer state governments. The latter judge the EU to be increasingly intent on undercutting their influence, when in return for supply commitments to European markets they seek 'energy *demand* roadmaps' from the EU as the basis of predictable interdependence. Security players are right to warn that this risks taking the focus away from the short-term challenges of international geopolitics and fomenting the illusion that investment in renewables can obviate the need to take difficult foreign policy choices.

In short, many member states in practice continue to conceive of energy security as a state-led responsibility both within and beyond Europe. EU governments seek to direct producer governments to increase production capacity for European security, more than they seem willing in practice to trust in market mechanisms.

One European diplomat terms the EU model as one of "regulated liberalisation"; another as "a third way…between markets and geopolitics", predicated upon "political dialogue and cooperation". One of the EU's particularly senior producer-state interlocutors observes that the EU is no less "egotistically geopolitical" than any other international actor, but seeks to dress its geopolitics in the finer cloaks of rules-based discourse.

3. Where the market doesn't reach

A further question is whether the stated approach of norm-based energy governance is accepted by or attractive to producer states. Many argue that it is in the spread of its own regulatory norms that the EU's own most successful influence and comparative advantage lies. But in energy policy this is not demonstrably the case. In fact, resistance has strengthened in many, if not most, of the EU's main energy suppliers to the 'import' of EU energy-pertinent norms. In many places the market-governance approach appears to have little traction.

This is perhaps most conspicuously the case in the Arabian Peninsula, which still accounts for by far the largest share of global oil reserves. The Commission has proposed extending its idea for both an ENP Energy Treaty and the Euro-Med Common Energy House to Gulf Cooperation Council (GCC) states, as well as offering the latter the kind of energy agreement signed with Ukraine, Azerbaijan and Kazakhstan. A small amount of funding is available for energy co-operation projects in such middle-income states under the new 2007-13 EU budget.[26]

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[25] John Gault, *European Energy Security: Balancing Priorities*, FRIDE Comment, Fundación par alas Relaciones Internacionales y el Diálogos Exterior, Madrid, May 2007, (www.fride.org).

[26] Ana Echagüe, *The European Union and the Gulf Cooperation Council*, FRIDE Working Paper, Fundación par alas Relaciones Internacionales y el Diálogos Exterior, Madrid, May 2007.

But EU-GCC free trade area talks have been running for 18 years without conclusion. The EU proposed a Memorandum of Understanding on energy cooperation; the GCC states rejected the idea, insisting that a free trade agreement was the precursor to deepening other areas of cooperation. Even after Saudi Arabia's entry into the WTO at the end of 2005, the GCC remains far from accepting EU-style market and governance norms. Gulf states berate the EU for thinking rigidly in terms of exporting its own model of regional integration, without recognising that intra-regional dynamics are quite different within the GCC.

GCC states complain that the EU has an overly narrow, regulatory-based approach to energy, when they seek energy cooperation that flows from a broader strategic partnership capable of offsetting US power, especially in relation to the Arab-Israel conflict.[27] With the standard EU instruments of technical aid cooperation and regulatory convergence failing to take root in the Gulf, energy cooperation remains limited. British and French bilateral deals and political engagement still predominate. Paris planned to sign a bilateral energy treaty with Saudi Arabia in 2007.

Of course, in two countries – Iran and Iraq – the issue of energy security has clearly been eclipsed by other challenges, with the result that efforts to develop contractual, rules-based energy partnerships have been hesitant or compromised. In Iran the EU has pursued an increasingly tough stance towards non-proliferation despite the country's potential importance as an energy supplier. Energy security might even be seen as being at odds with the EU's nuclear policy in the rather direct sense that if Iran were to develop a nuclear energy capability it would have more gas available for export.

Here there does appear to have been some increasingly joined-up thinking. One part of the incentives offered to Iran in return for abandoning its nuclear programme includes European technological assistance in the energy sector. But, beyond the impressive European unity on WMD, increasing muddle has prevailed over energy policy towards Iran. The British government has discouraged Shell from investing in the Islamic Republic; the French government for a long time offered strong support for Total's desire to invest in Iran (although it appears that this support is being withdrawn under President Sarkozy). Italy and other states have openly backed the Nabucco pipeline project as a means of brining Iranian gas into EU markets; the UK wants no official EU backing for Nabucco. At the time of this writing, new divisions had emerged after the tightening of sanctions against Iran between France and the UK, on the one hand, and Germany and Italy, on the other. The whole viability and desirability of integrating Iran into an EU-led regional energy community are contested within the EU – while the current direction of Iranian foreign policy hardly renders it more propitious anyway.

Even in the EU's immediate periphery the reach of internal market-governance norms sometimes looks distinctly limited. Algeria has rejected the whole edifice of governance norms incorporated into the Neighbourhood action plan offered to it. Spanish officials feel that North Africa has been neglected within overall EU energy security and have pressed Algeria to show Spain 'preferential treatment' in energy supplies over other European consumers and proposed a bilateral 'energy partnership'. Despite this, in September 2007 Algeria revoked its €5 billion contract with Repsol and Gas Natural. The French also admit that the bilateral dimension continues to predominate in relations with Algeria, with Paris signing a new bilateral energy treaty with Algeria in 2006.

Already well covered in analysis of EU policies is the declining place of market-governance norms in strategy towards Russia. Russian officials continue to be resistant to EU efforts to

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[27] Gerd Nonneman, "EU-GCC Relations: Dynamics, Patterns and Perspectives", Journal of Social Affairs, 2007 (forthcoming).

'smuggle in' ECT principles to a new agreement. The growing belief among a majority of member states is that Russia in turn must be approached through an essentially geopolitical lens. One official acknowledges that, whatever the EU's formal language on cooperation and market integration, the primary need is to curtail Russia's power over its neighbours and that this is where 'geopolitics comes in'. Nearly all member states' energy companies have signed bilateral deals with Gazprom. The EU now has more high-level political dialogue with Russia than with any other third country except the United States; in contrast, the depth of 'network' inter-linkages and integration is less than elsewhere in the East as Russia has shown increasing disinterest in adopting European norms and standards. At Russia's behest and unlike ENP action plans, the four common spaces make no mention of the incorporation of EU governance rules and standards. In practice, the EU eventually acquiesced to an exemption for the energy sector in Russia's accession to the WTO. One expert parodies that in terms of extending market-governance the common spaces are "as empty as the word 'space' implies".[28]

Similar trends can be witnessed across the Caspian and Central Asia. In negotiations for its ENP action plan, Azerbaijan only accepted a non-specific and diluted commitment on joining the WTO. The Aliyev government sees market liberalisation as unnecessary due to the country's energy resources – this position resisting a central pillar of the EU's energy security philosophy.

Kazakhstan has resisted an embrace of EU regulatory and market norms while it has no prospect of a place in the ENP. President Nazerbayev's 'multi-vector' foreign policy has recently led him into new strategic, long-term bilateral deals with Russia. As one diplomat notes: Central Asian regimes are increasingly asking Europe for direct and concrete contracts, underpinned by geo-strategic preference, while the EU is asking them "to buy into the more abstract notion of a market distribution system".

With Gazprom offering increased prices for Central Asian gas and new infrastructure investments, the incentives have diminished for Central Asians to buy into a broadly defined 'European market-governance area'. What states in the region want most dearly is first, European support, against the United States, for (more economical) pipeline routes through Iran; and second, a more systematic incorporation into EU policy-making of Turkey, as both a weightier diplomatic player in Central Asia and a potentially vital transit hub for the region's energy experts.

Finally, the extension of internal market norms to Africa is also subject to strong debate and significant doubts within the European Union. If in Africa the approach to energy security is supposed to be consistent with reducing 'energy poverty', the role of market principles in this linkage is contested. Development experts and officials remain concerned that development needs risk being undermined by market reforms aimed in practice at enhancing Europe's access to those energy resources needed within Africa itself. African governments complain that what they want from Europe are long term commitments to buy more significant amounts of oil and gas from Africa, not 'abstract partnerships'.

The Extractive Industries Transparency Initiative is conspicuously not Europeanised. Currently only four member states – the UK, France, Germany and the Netherlands – have signed up to the EITI. Financial support for the EITI has been forthcoming from only the UK ($5.5 million), Dutch ($1 million) and German ($0.5 million) governments. While repeating ritually that EITI is a good initiative, most European governments admit to blocking proposals to exert strong and united EU pressure on states such as Russia, Algeria, Angola, Libya, Qatar or UAE to sign up – at present the EITI only incorporates states accounting for about 5-10% of world production,

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[28] Marius Vahl, *A Privileged Partnership? EU-Russian Relations in a Comparative Perspective*, Danish Institute for International Studies, Working Paper No. 2006/3, p. 9, p. 13 and p. 25.

excluding for example the whole of the Middle East. The EU has resisted the notion of attaching conditionality to governments' performance on the more transparent management of energy revenues.

4. Underplaying politics

There is a connected parallel to this limited reach of market-governance norms, that represents the most serious shortcoming of European policy, namely the almost apolitical flavour of EU energy security strategy.

The Commission has stated that energy security policy "must also be consistent with the EU's broader foreign policy objectives such as conflict prevention and resolution, non-proliferation and promoting human rights".[29] But in practice decisions over European peace support, democracy and human rights policies – where to pursue or not to pursue such values – remain strikingly disconnected from energy policy.

Across different producer regions the mismatch is increasingly evident between Europe's narrowly-delineated approach to energy, on the one hand, and the shifting impact of political factors, on the other hand.

In **North Africa** under the EMP technical cooperation on energy has strengthened and a raft of new energy infrastructure links funded. But EU policy seems to limit itself to such measures and declines to devise a strategy for addressing the way in which North African politics impacts upon security interests. In the summer of 2006, the Algerian government reversed a tentative liberalisation of the energy sector as a means for President Bouteflika to shore up his support with oil clans, amid rumours that he might be pushed out of office.[30] Algeria's March 2007 energy price hike against Spain, as well as the September cancellation of the Repsol-Gas Natural contract, reflects a new assertiveness and 'payback' for the Zapatero government's markedly more pro-Moroccan stance on the Western Sahara. As the Salafist Group for Preaching and Combat launched a new campaign of violence in early 2007 by first attacking foreign oil workers, the illusion has been shattered that Algeria's limited process of political liberalisation had sufficed definitively to resolve conflict. Yet these are issues absent from the energy partnership the EU has offered to Algeria.

Similarly, in the **Arabian peninsula,** officials admit that there has been no debate on how the EU's new energy strategy will impact on the political dimensions of European relations with the Gulf monarchies. European diplomats still commonly suggest that Gulf states are authoritarian but 'well run' and that their internal politics present no concerns for EU energy supplies. The EU has approached energy security in a compartmentalised fashion, divorced from both broader Gulf security issues and any understanding of the way in which Gulf states and societies are fast changing. Diplomats reveal that many in the EU favour developing relations on an EU-OPEC rather than EU-GCC basis precisely because the former is bereft of 'extraneous' conversations on internal politics.

And yet, again, the Gulf's internal politics present real dilemmas, of high and evolving significance for European energy interests. In Saudi Arabia experts argue that the internal

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[29] Commission of the European Communities, *An External Policy to Serve Europe's Energy Interests*, Paper from the Commission/SG/HR for the European Council, 2006

[30] Aurèlia Mañé Estrada, *Argelia: ¿retorno al nacionalismo energético?*, ARI No. 100, Real Instituto, Elcano, Madrid, September 2006, p.5.

politics of the royal family are increasingly the source of unpredictable decision-making.[31] A source of popular anger is precisely the fact that oil revenues flow directly into the royal budget, with no accountability. The regime scaled back its market-opening National Gas Initiative because it feared the political consequences of any significant liberalisation.[32] It is even rumoured that the Saudi National Guard has itself been implicated in attacks on foreign compounds and oil installations. With the intertwining of the Saudi state and Wahhibism persisting, experts argue that international energy interests cannot be divorced from a complex process of internal social and political change.[33]

In **Iran** European diplomats stress that their approach is to 'keep out of politics' and rather try to improve governance conditions to help with oil and gas extraction. Yet the European offer of technical energy cooperation as an incentive to Iran looks incongruous alongside the ways in which an increasingly less pluralistic Iranian political system impinges on the possibility of such cooperation. Iran suffers from an increasing shortfall in energy sector investment that many see as related to the nature of its political system. Iran has been unable to meet its own OPEC oil production quotas since prices rose after 2003. Indeed, it is still a net importer of gas. Despite sitting on 10% of the world's oil reserves, in March 2007 the Iranian government had to ration domestic petrol use. President Ahmadinejad's raiding of the oil investment fund for short-term populist measures draws resources away from the long-term development of the energy sector. One reason for the limited opening of the energy sector is the Revolutionary Guards' determination to sew up energy contracts for their own operators.[34] Despite all this, European support for rule of law and governance improvements has been sacrificed to the effort to keep nuclear negotiations alive. And concerns over Iran's internal political evolution are absent from European energy calculations.

Similarly in the **Caspian and Central Asia,** Commission aid priorities are technical assistance for reform of energy policies; improving the investment climate in the energy sector; and support for pipeline monitoring and other technical energy services. Two formal funding programmes, Traceca and Inogate (Interstate Oil and Gas Transport to Europe), have increased funding for infrastructure and pipeline development, respectively.[35] The Baku Initiative has agreed a new Energy Road Map, with commitments to enhance energy cooperation on both infrastructure and regulatory convergence.

But scepticism prevails in the region over the impact of such projects in the absence of a broader approach to the region's political and security challenges.[36] Some EU programmes in this region have indeed focused on governance, security and trafficking issues. But in general the wider political focus remains limited. Indeed, diplomats welcomed the bilateral energy

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[31] Madawi Al-Rasheed, "Circles of Power: Royals and Society in Saudi Arabia", in Paul Aarts and Gerd Nonneman (eds), *Saudi Arabia in the Balance: Political Economy, Society, Foreign Affairs* London: Hurst and Company, 2005), p. 201 and p. 208; Iris Glosemeyer, "Checks, Balances and Transformation in the Saudi Political System", in Aarts and Nonneman, p. 231.

[32] Ian Rutledge, *Addicted to Oil: America's Relentless Drive for Energy Security,* London: I.B.Tauris, 2006, p. 190.

[33] Iris Glosemeyer, "Checks, Balances and Transformation in the Saudi Political System", in Aarts and Nonneman, op. cit., p. 233¸ Tim Niblock, *Saudi Arabia: Power, Legitimacy and Survival,* London: Routledge, 2006, p. 5.

[34] *Economist,* 21 July 2007, Special Report on Iran, p. 6.

[35] Commission of the European Communities, Strategy Paper 2002-2006 and Indicative Programme 2002-2004 for Central Asia, pp. 15-16 and p. 22.

[36] International Crisis Group, *Central Asia: What role for the European Union*?, ICG, Brussels, April 2006, p. 15.

partnerships offered to Azerbaijan and Kazakhstan because they *delinked* energy from the democracy and human rights strictures of the ENP. Since President Niyazov's death in December 2006 European leaders have been silent about the undemocratic nature of Turkmenistan's transition, with many ministers and officials openly hoping that the long-blocked Partnership and Cooperation Agreement with this potentially major gas supplier can now be implemented and that the new regime will be more amenable to cooperating on energy matters.

The nepotism of Central Asian regimes might sometimes be made to work to the benefit of European oil companies – this is particularly the case in Kazakhstan. But it is also an umbilical cord that works against efforts to delink the region from Russia. In Kazakhstan access conditions have been toughened to allow FDI only in Kazakh-controlled joint ventures.[37] The fact that the oil fund is run by Nazarbayev cronies and used as a patronage fund is increasingly the source of public discontent. Some EU officials express concern that Nazarbayev is increasingly set on emulating Vladimir Putin, using high energy prices as the basis for assertive foreign policy, while attempting to drive wedges between EU member states.

In Azerbaijan the state oil company, Socar, and decisions affecting anything related to oil remain firmly under the control of the Aliyev family, with often unpredictable consequences for European investors. The Commission has allocated funds under the ENPI for governance projects in Azerbaijan. But at the same time the EU has failed to address the broader deterioration of democratic rights in Azerbaijan – as witnessed by a tightly manipulated presidential election at the end of 2005 and the subsequent arrest of many opposition figures. Similarly, while several EU member states seek to remove all post-Andijan sanctions against Uzbekistan, President Karimov increasingly distributes energy contracts and revenues to shore up his regime, and to the disadvantage of Western firms, rather than investing in long-term capacity increases.[38]

As pointed out, there is certainly no lack of political engagement or geo-strategic lead towards **Russia.** But, even here the EU has attempted to separate energy cooperation from concerns over Russia's internal political evolution. Russia's drift into authoritarianism is integrally linked to two developments of profound significance for European energy interests. First, Putin's centralisation of power at home is of a piece with his attempt to re-establish Russian influence abroad. Experts highlight that Russia's assertive energy diplomacy cannot be delinked from the abuse of good governance and market principles internally.[39] Second, the intermeshing of political and economic power has deepened under Putin. While some argue that this has done little harm to EU investors – and indeed has restored stability after the chaos of the Yeltsin era[40] – the effective renationalisation of international energy projects suggests otherwise. In the wake of Shell and BP being forced to cede control over their Sakhalin II and Kovykta investments, respectively, Total has been offered a similar model of limited technical participation in the Shtokman gas field. Many observers link the strengthening of the Kremlin's political control to decreases in oil and gas production. An increasing lack of transparency means that it is not even clear at what levels Russian reserves and production levels actually stand.

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[37] Kleveman, op. cit., p. 85.

[38] International Crisis Group, "Uzbekistan: Europe's Sanctions Matter", Policy Briefing, ICG, Brussels, November 2006, p. 3.

[39] Vladimir Milov, "The use of energy as a political tool", *The EU-Russia Review*, Issue 1, May 2006, Brussels, EU-Russia Centre, p. 20.

[40] Debra Johnson, "EU-Russia Energy Links", in Debra Johnson and Paul Robinson (eds), Perspectives on EU-Russia Relations, London: Routledge, 2005, p. 183.

Despite all this, in practice the EU has kept the political level separate from the slowly accumulating technical and regulatory cooperation between Europe and Russia. The report of the seventh annual round of the EU-Russia energy dialogue, held in November 2006, talks of advances on technical issues, without mentioning any of the high politics contretemps occurring at the very same moment.[41] Detailed work on the integration of Russian and European electricity markets is said to be advancing.

Leading Austria's EU presidency, Wolfgang Schüssel clarified his view at an EU-Russia summit in May 2006 that, "buying and selling oil and gas is a purely commercial activity; it is not politics".[42] A majority bloc of member states has diluted criticism of Putin, as is well known. Governance projects have been scaled down. Those that continue are said to run with the grain of Putin's commitment to rule of law and administrative reform – a judgement that looks, at best, highly charitable. Policy-makers concede that EU-Russia Human Rights Consultations have been ineffective and devoid of meaningful pressure and Russian NGO participation. Officials are even minded to argue that if any form of political engagement is key for energy security it is the need for European governments to join with Russia to push the United States to reduce carbon emissions, not for the EU to join the US to press Russia on democratic abuses. This disconnect is to some extent being revisited after the episodes with Shell and BP. But the EU has still failed to define a common and coherent policy towards Russian internal politics *as part of its energy security strategy*.

In principle the situation in **Africa** would appear to be different. Here European policy-makers lay greater stress than in other regions on energy interests being linked to a broader overall political and security engagement. However, this wider European security engagement in practice remains relatively modest. Indeed, the EU's focus on the foreign policy dimensions of energy within its Africa policies has lagged behind even that of other producer regions.

Nigeria provides perhaps the most striking illustration of the dearth of European political engagement. Despite undergoing democratic transition and being of increasing importance for energy interests, the overall European involvement in Nigeria remains limited. Nigeria is Africa's most under-funded state in terms of its ODA/GNP ratio. The European Commission and the British government are the only two European donors of any meaningful size. Funding that has been forthcoming has been oriented towards support for government institutions. European governments saw President Obasanjo as a guarantor of stability and reform during his two terms in office. For one critic, EU detachment is explained by the fact that the oil illegally bunkered in Nigeria increasingly finds its way to Europe anyway.[43]

This sanguine stance has increasingly been revealed as insufficient. The government of President Obasanjo introduced various schemes to increase investment in infrastructure in the Delta, but resources were siphoned off through corruption and most projects failed. Progress was made on the transparency of energy-related payments under the Nigerian EITI, but the latter became less effective as it was used as Obasanjo's personal political vehicle.[44] Rather than embedding the rule of law, the Nigerian government has sought to buy off militants in the Delta with oil contracts and government positions, providing incentive for a perpetuation of violence.

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[41] EU-Russia Energy Dialogue Seventh Progress Report, November 2006.

[42] At press conference following the 17th EU-Russia summit, Sochi, 25 May 2006, reported in *CEPS Neighbourhood Watch,* Issue 16, Centre for European Policy Studies, Brussels, May 2006, p. 5.

[43] Nicholas Shaxson, *Poisoned Wells: The Dirty Politics of African Oil*, London: Palgrave Macmillan, 2007, p. 202.

[44] For a comprehensive account of the dynamics of conflict in the Delta, see ICG, *Fuelling the Niger Delta Crisis*, Africa Report No. 118, International Crisis Group, Brussels, September 2006.

In his final months in office in 2007, the president doled out licensing offers for 45 oil blocks to political cronies. In the last 18 months of his term, he did not award a single contract to a European oil major. The manipulation of the April 2007 elections, that secured a shoe-in for Obasanjo's ruling-party anointed successor, Umaru Yar'Adua, has inflamed discontent even further. EU monitors did criticise the April poll as the worst they had witnessed. And some European – and especially UK Department for International Development (DfID) – projects have sought to address such governance woes. But overall European policy has barely shifted gear as Nigeria's impact on international energy has intensified and its internal fragility deepened. The European Parliament berates EU governments for resuming 'business as usual' after April's elections.

5. Conclusion

The EU has moved in the last three years to deepen energy cooperation and put in place important new external energy partnerships. Energy security clearly forms part of the foreign policy calculus in a way that it did not five years ago. The notion most strongly espoused has been the (familiar) one of the EU's internal market constituting the basis and principles of Europe's external projection and influence. And this is not entirely without substance, representing a useful foundation from which a more effective energy security policy can be coordinated. But the common 'market-governance' discourse masks persistent and serious doubts and differences, especially over the extent to which the internal market should be guided by states and deployed in a politically conditioned fashion. While policy-makers proclaim a governance-led approach to energy security, in practice the reach of this supposedly basic tenet of external energy strategy remains uncertain.

Differences over internal market liberalisation are well-known and receive wide attention. This paper stresses how such differences have increasingly filtered into debates over the foreign policy dimensions to energy security. If it is true that external 'compliance' is more likely where the internal *aquis* is 'thicker',[45] it is clear how divergences over internal energy policy have undermined external energy strategy. Given the combination of internal differences and producer states' resistance to the market-governance nexus, the temptation has been to fall back on a) apolitical, technical energy cooperation and b) bilateral deals.

The EU needs to move beyond its dichotomised debate over 'market versus geopolitics'. A far more political approach is required, itself to frame market-based policies. In private most policy-makers recognise that the results of the array of EU energy dialogues with producer states have been meagre and progress limited to narrow technical issues. The EU needs to extend its work on technocratic norms to embrace a more holistic focus on the broader political governance of producer state regimes. The need across different regions is to appreciate how the broader politics of energy rebounds on European interests in complex ways. This not only involves realising that backing 'friendly autocrats' rarely optimises energy security in its broadest concept. It also requires policy-makers to question their tendency to consider only a narrow range of governance issues directly within the energy sphere.

At present EU policy does indeed hover ineffectively 'between the market and geopolitics'. It needs instead a means of *conjoining* markets and politics as mutually-conditioned parts of comprehensive energy security. Until this happens, energy policy may extend its reach as a self-contained sectoral policy issue, but will not have been sufficiently and systematically incorporated into European foreign and security policy.

[45] Amichai Magen, "Transformative Engagement through Law: The Acquis Communautaire as an Instrument of EU External Influence", *European Journal of Law Reform*, 9/3, 2007, p. 362.

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