

Policy Brief #6

May 2008



INTERNATIONAL CENTRE FOR BLACK SEA STUDIES (ICBSS)

Black Sea Regional Policy Approach:

A Potential Contributor to European Energy Security

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Introduction

The January 2006 gas row between Russia and Ukraine rekindled the energy debate with a particular accent on the need for diversification. The situation characterized by a double monopoly – Russian monopoly on gas supply and Ukrainian monopoly on transit system – was not sustainable. Europe's vulnerability on natural gas, accentuated by the Ukrainian gas crisis and the increasing skepticism emanating from the European Union's (EU) new members, has brought about the need to reassess Union's energy situation.

In January 2007, the European Commission tabled a comprehensive package of ambitious proposals for a 'New Energy Policy for Europe'. As evidenced by the European Council Conclusions of 9 March 2007 based on the Commission's Communication 'An Energy Policy for Europe', Europe has entered into a new energy era.

Following the adage that energy security lies mainly in diversity, a new quest for alternative energy resources that could alleviate some of Europe's dependence on Russian energy has developed. The Black Sea region plays a critical role in the European energy security. Geographically located in close proximity to the world's greatest proven gas and oil reserves, the Black Sea region forms a natural energy bridge between the supplier countries and important consumer markets of the EU. It draws attention to how oil and gas from further afield should reach Europe's major consumer markets. This paper addresses the issue of whether a Black Sea regional approach is able to enhance European energy security and contribute to the diversification strategies by promoting the common good of all the three elements of the energy chain: supplier countries, transit countries and consumer countries.

The views expressed in this Policy Brief are personal and do not necessarily represent those of the ICBSS.

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**A more detailed version of this text was published by the European Parliament, Policy Department External Policies.



Considering the EU Energy Security within the Global Energy Market: The EU is Highly Dependent on Russia

The largest share of oil and natural gas comes from countries that do not apply OECD or WTO rules, for example by subjugating investment to political control. The consequence is an underdevelopment of production capacity.

Both the world oil and natural gas markets are not functioning as competitive markets on the supply side. The market has become very favourable to producers: domestic production is declining in absolute terms in major consumer regions, resulting in higher import dependency, and the development processes in Asian countries have caused a surge in demand that has in turn generated distribution problems. Consequently there is a high need to foster the competition on the supply side by aiming at a diversification of supply sources as well as by supporting the construction of infrastructure that enables diversification of transit routes. Currently 62% of oil reserves are concentrated in the Middle East.¹ Not only are reserves in the Middle East immense but production costs are much lower than in other regions.² China was still a net exporter in 1992 but by 2005 it already became the third largest importer in the world. India is moving towards a similar growth pattern. The world oil market is relatively fragmented into regional sub-markets. The Middle East delivers two-thirds of its oil to Asia, the oil suppliers in North and South America (Canada, Mexico and Venezuela) deliver 75% of their exports to the United States (US) alone, Russia and the Caspian region ship 82% of their exports to Europe alone and North Africa is bound to the European market with 64% of its exports.

Natural gas is more difficult to transport. Pipelines are used to connect at regional hubs near demand centres. Natural gas is a network-bound commodity. There is a preference for long-term take or take-or-pay contracts between buyers and suppliers where the latter are usually assured of a guaranteed market for their natural gas. The pipeline connection imposes a far greater regionalization of the world market for natural gas than for oil, since pipeline of a length of over 4000 km can hardly be regarded as profitable. It is therefore impossible to speak about global natural gas market. A larger and a larger proportion of the natural gas trade has been supplemented by trade with liquefied natural gas (LNG). In 2005, 26% of natural gas trade took part place via LNG shipments. However three-fifths of this quantity was used to supply Japan, Korea and Taiwan, which are too far away from the production sites. The increase of the share of the LNG shipments will contribute to the diversification of supply possibilities.

The international gas market is composed of strict bilateral infrastructure arrangements and long term delivery contracts. The price of natural gas is contractually pegged to the price of oil to the detriment of consumers in OECD countries. In 2005, Gazprom set country-specific prices that differed from each other as much as 400%.³

¹ BP Statistical Review of World Energy, June 2006.

² International Energy Agency (IEA) World Energy Investment Outlook: 2003 Insights, p. 113. Available on <<http://www.iea.org/textbase/nppdf/free/2003/weio.pdf>>

³ Roland Götz. *Nach dem Gaskonflikt*. Berlin: Stiftung Wissenschaft und Politik, January 2006.



The EU, in its Green Paper on Energy Security published in 2002, anticipated a 45% increase in gas demand for the then 15 member states between 1998 and 2030.⁴ The International Energy Agency (IEA) has estimated that the EU's primary gas demand is expected to grow by 2.9% per year from 2000 to 2010 and by 1.6% from 2010 to 2030.

Europe is by far the largest natural gas importing region. Europe is not only currently importing more natural gas than all other importing regions combined, but this situation will remain unchanged by 2030 according to the projections of the IEA.⁵

Russia, the largest natural gas supplier worldwide, ships its exports, outside of the Commonwealth of Independent States (CIS) region, exclusively to Europe. Europe draws 64% of its natural gas imports from Russia. During the late 1970s and early 1980s, the construction of the infrastructure for Russia's natural gas trade was regarded as a harbinger of a policy of détente. The drawback of the mutual dependency associated with this sort of trade relationship emanates from the suppression of the competition and from the asymmetrical nature of the dependency.

Attempts at Bridging the EU through the Black Sea to the Caspian Resources Leads to the Acknowledgment of the Importance of Iranian Resources and Diversification of the Transit Routes for Russian Gas

The centrality of the Caspian oil and gas to the problem of diversification away from the dependency on Russia is frequently highlighted. A strategy for supply diversification can aim to link the EU with the transit and producer countries in the Black Sea and Caspian basins. Turkey is being connected to Azerbaijani Shah Deniz gas field via the Baku-Erzurum pipeline, or the South Caucasus Pipeline (SCP).⁶ In coming months, with the commercial start of the SCP, Azerbaijan will be able to send gas to the West. Still with only one major foreign investment focusing primarily on natural gas, the region will need considerable investment in upstream projects and export infrastructure.

The Trans-Caspian Gas Pipeline (TCGP)

Planning for the TCGP began back in 1998 when the US funded a feasibility study for the project, but last year's supply worries have reinvigorated the plan. If constructed, the TCGP pipeline would take Turkmen and possibly Kazak gas across the Caspian to feed into existing transit routes to Turkey.

Meanwhile, the collapse of the TCGP Project prevents access to the Turkmen gas and in the absence of oil pipeline linking Azerbaijan and Kazakhstan, the Kazakh oil is being shipped to Novorossisk.

⁴ European Commission. Communication from the Commission to the Council and the European Parliament. Final Report on the Green Paper 'Towards a European Strategy for the Security of Energy Supply', COM0321 Final, Brussels, (2002).

⁵ IEA World Energy Outlook 2004. Available on <<http://www.iea.org/textbase/nppdf/free/2004/weo2004.pdf>>

⁶ Azerbaijan is to deliver 70 bcf of natural gas to Turkey, rising to 177 bcf in 2007 and around 223 bcf per year from 2009 through 2020.



With regard to most Caspian and Central Asian gas producers, Russia still retains the ability to use its monopoly power to lock up long term contracts for the import of

Central Asian gas at relatively low prices while simultaneously holding out for much higher prices with regard to its own sales to European customers.

Presidents Vladimir Putin of Russia, Nursultan Nazarbaev of Kazakhstan and Gurbanguly Berdymuhammedov of Turkmenistan signed a trilateral deal for the construction of a pipeline on 12 May 2007 in the Caspian port of Turkmenbashi. The presidents had tentatively agreed to sign a formal treaty by September to build the pipeline which is expected to run along the Caspian shore from Turkmenistan through Kazakhstan, with a goal of delivering about 10 bcf of natural gas per year to Russia's existing gas delivery grid within three years. Gazprom has a deal in place that commits Turkmenistan to increase its exports to reach 90 bcm by 2028.⁷

While the Russian-Kazak-Turkmen agreement is an important development, it does not signal the end of other proposed pipelines. Nevertheless the Turkmen authorities – who presumably would wish to reduce the Russian stranglehold on gas exports and pricing – have indicated that the construction of alternative routes remains feasible. They leave open the possibility that the TCGP might still be built, along with potential pipeline projects to Iran, China, Afghanistan, India and Pakistan. In April 2006, President Niazov signed an agreement to construct a pipeline to China that carried an obligation to sell 30 bcm annually once it is up and running.

In this context, the Nabucco pipeline can contribute to the diversification of supplies if filled with Iranian gas, while the European Gas Ring linking Turkey and Greece is more likely to contribute to the diversification of the transit routes for the transportation of the Russian gas to the EU.

Southern Europe Gas Ring: Diversification of Transit Routes

Turkey is engaged in the Southern Europe Gas Ring Project, which aims at bringing natural gas from the Caspian Sea, Middle East and Southern Mediterranean countries to Europe through Turkey and Greece. The first phase of the project, which connects Turkey and Greece, was completed in 2007. Feasibility studies were financed by EU funds.

In April 2002, after two years of planning, Turkey and Greece signed a memorandum of understanding for a gas pipeline linking the two countries: the Ankara–Dedeagac link, which forms part of the EU's INOGATE.⁸

An economic feasibility study for the project, conducted by Société Générale, was funded equally by DEPA (Greek national gas company) and the European Commission. The incorporation of Turkey's energy network with that of the EU was realized with the conclusion of the Intergovernmental Agreement on the Turkey-

⁷ See International Herald Tribune, 'Moscow gets Central Asian agreement on pipeline to Russia', 13 May 2007.

⁸ Interstate Oil and Gas Transport to Europe (INOGATE) is a technical assistance programme of the EU covering Central and Eastern Europe, including the newly independent states that seek to integrate the hydrocarbon transport networks between the Caucasus, Central Asia, as well as Central and Eastern Europe.



Greece Interconnector signed in February 2003 and the Sale and Purchase Agreement between BOTAS (Turkish national gas company) and DEPA in December 2003.

Turkey-Greece Natural Gas Pipeline Project was developed as a result of the studies undertaken for the interconnection of natural gas grid of Turkey and Greece and creation of South Eastern Gas Ring. The Turkey-Greece pipeline is a 296 km long natural gas pipeline, which connects Turkish and Greek gas grids.

Natural gas delivery to Italy has also become an important agenda item. Italian gas company Edison-Gas and DEPA has signed a memorandum and BOTAS is involved in this agreement upon an invitation. The pre-feasibility study of the project was completed with feasibility funding from the EU TEN Programme.⁹ DEPA and Edison-Gas have also launched a tender for the feasibility study of the project.

In the aftermath of the Russian-Ukrainian gas crisis, Russia openly expressed its willingness to export gas to EU countries via Turkey. Alexei Miller, Gazprom's chief executive, offered during a recent visit to Athens to invest in tripling the capacity of the Greek-Turkish pipeline and to provide long-term supply agreements. Russia is considering Turkey as a potential transit point for Russian natural gas exports to EU. At present the only gas pipeline system connecting Turkey and Europe is a network extending through South Eastern Europe, which delivers Russian natural gas to Turkey. The Commission has recommended that certain volumes of Russian natural gas could also be transported to Europe through the South Eastern Gas Ring connecting Turkey with Greece. Turkey will probably first re-sell and re-export to Europe Russian natural gas previously contracted to the Turkish market.

The Nabucco Pipeline Project Can Contribute to the Diversification of Supply if Filled by Iranian Gas

The Nabucco pipeline will establish a link between the Black Sea region and the Middle East. The Nabucco project represents a new gas pipeline connecting the Caspian region, Middle East and Egypt via Turkey and with Bulgaria, Romania, Hungary, Austria and further on with the Central and Western European gas markets.

The pipeline length is approximately 3,300 km starting at the Georgian/Turkish and/or Iranian/Turkish border respectively, leading to Baumgarten in Austria. According to market studies the pipeline has been designed to transport a maximum amount of 31 bcm/y. Estimated investment costs including financing costs for a complete new pipeline system amount to approximately € 5 billion.

⁹ The idea of Trans-European Networks (TEN in the EU jargon) emerged at the end of the 1980s in conjunction with the proposed Single Market. It made little sense to talk of a big market, with freedom of movement for goods, persons and services, unless the various regions and national networks making up that market were properly linked by modern and efficient infrastructure. The Trans European Energy Networks are integral to the EU's overall energy policy objectives. The EU supports electricity and gas transmission infrastructure projects of European interest, mainly by financing feasibility studies. Most of the projects cross national borders or have an impact on several EU Member States. 'Projects of European Interest' should be mature projects on priority axes with a cross-border component or with significant impact on cross-border transmission capacity.



In November 2002, five companies signed an agreement to carry out a joint feasibility study on the construction of a natural gas pipeline from Turkey to Austria via Bulgaria, Romania, and Hungary. Participants in the project are BOTAS (Turkey), Bulgargaz (Bulgaria), Transgaz (Romania), MOL (Hungary) and OMV Erdgas (Austria). The study received approval from the EU in July 2003. The EU's TEN Programme has accepted to fund a part of the feasibility study.¹⁰ Natural gas is planned to be supplied by the planned pipeline to the emerging market countries like Bulgaria, Romania, Hungary, Slovakia, Czech Republic and later on to the other European markets through Austria. In June 2004, project partners founded Nabucco Company Pipeline Study GmbH in order to engage in project finance and pipeline capacity marketing studies. According to a preliminary time schedule the development phase¹¹ is foreseen to last until the end of 2008. The construction of the Nabucco Pipeline is planned for 2009 with an envisaged start up of transportation of gas in 2012.

Iran is interested in using the Nabucco pipeline to pump gas through Turkey towards the EU. Approximately 30 to 50 percent of the capacity of the pipeline might be allocated to Iran for its gas exports. The Iranian Oil Minister Kazem Vaziri-Hamaneh, during his visit to Ankara in August 2006, announced his country's intention to increase the capacity of Iran's pipeline, which is connected to the Turkish pipeline, and export gas to Europe jointly with Turkey. Iran and Turkey agreed on a joint scheme to export Iran's natural gas to Europe via Turkish pipelines.¹²

Measured in terms of its reserves, Iran occupies the second place behind Saudi Arabia, with 11.5% of world oil reserves and the second place behind Russia, with 15% of world natural gas reserves.¹³

Iran is geographically closer to Europe than the West Siberian gas fields and will share a common border with the EU with the accession of Turkey. The Nabucco Project is only sensible if this pipeline is supplied with natural gas by Iran in addition to Azerbaijan.

In the long term, this project should contribute to the establishment of a broader scheme to provide Europe with natural gas from the South Pars field shared by Qatar and Iran.

The Diversification Strategies will not Diminish the Importance of Russia

However, diversification strategies ignoring Russia are doomed to failure or low efficiency. Gazprom has developed a broad control strategy along the gas chain that

¹⁰ In December 2003 a grant agreement was signed between OMV Gas, the other four partners as associated beneficiaries and the European Commission. With this agreement, the Commission awarded a grant in the amount of 50% of the estimated total eligible costs of the study phase, i.e. feasibility study including market analysis, technical, economic and financial studies.

¹¹ During this development phase, all technical, legal, commercial and financial issues will be covered. Regarding technical issues, in principle the basic and detailed engineering analysis will be performed to meet all requirements for environmental impact assessments in all Nabucco Countries and to obtain all approvals by the respective authorities so as to start construction according to time schedule above.

¹² Reuters, 'Iran agrees to pipe gas to Europe via Turkey', 19 August 2006.

¹³ BP Statistical Review of World Energy, June 2006, pp. 6 & 22.



directly conflicts with diversification routes. Russian companies, such as Itera and Eural Trans Gas established offshore schemes in Hungary, Poland and Slovakia before these countries' accession to the EU. This jeopardizes transparency in gas sales. Gazprom has purchased transit lines in various European countries, notably in Poland, Slovakia, Ukraine and Belarus. Gazprom and other Russian companies have purchased distribution companies in Georgia, Turkey and Bulgaria.

Furthermore, even if the diversification strategies are successful, the importance of the EU-Russian energy relationship will not lessen. In order to avoid a greater dependency on the Middle East, the EU must seek to maintain a special relationship with Russia - currently the primary oil supplier to the EU - even if in the long term Russia allocates greater shares of its exports to China and Japan. In the decades to come, Russia and the EU are to remain respectively the largest exporter and the largest importer of natural gas in the world. The supply stream from Russia to the EU will continue to represent the largest bilateral trade volume despite efforts of diversification. Russia is projected to stay the biggest individual import source for Europe. The process of enlargement has brought the EU at the borders of the largest world reserves, production and export volumes of natural gas.

Energy security cannot be ensured only by diversification of sources of supplies. The Black Sea regional approach has to focus on market reforms in the energy sector by engaging with Russia. Energy market reform in Russia is a pre-requisite for Russian and European energy security.

The IEA in its World Energy Investment Outlook 2003 considers that the cumulative investment needs in the Russian gas sector are projected to total just over \$ 330 billion, or \$ 11 billion per year over the period 2001-2030. Gazprom will have to struggle to secure larger investment to carry on its expansion and increase supplies to foreign markets. A new aspect of energy security is stirring up concerns: Gazprom's rather dark production outlook combined with Russia's lack of market reform, is putting into question Russia's capacity to deliver the quantities of natural gas it has committed.

As former Russian Deputy Minister of Energy Vladimir Milov has observed, Russia 'faces an investment crisis, especially in gas', and has 'done nothing' to invest in infrastructure that would enable it to increase production substantially, particularly on the important Yamal peninsula.¹⁴

Indeed, Gazprom has consistently failed to invest in new field infrastructure, relying on large Soviet-era fields for the bulk of its production. Gazprom is facing decline in production rates in its gas fields that have traditionally made more than 75% of its total production. A new giant field, Zapolarnoye was integrated into production in 2001. However, most studies show the decline rates will exceed the new production from 2008 onwards.¹⁵ Significantly more fields have to be explored and invested in. In addition, Russia is facing an increase in the internal gas demand that Gazprom is

¹⁴ Vladimir Milov. 'How Sustainable is Russia's Future as an Energy Superpower?'. Summary of presentation at Carnegie Endowment for International Peace, 16 March 2006. Available on <<http://list.carnegieendowment.org/t/80287/192304/42757/0/>>

¹⁵ Claude Mandil. 'Securing the Russian-European Energy Partnership'. IEA, 2005. Available on <<http://www.iea.org/textbase/papers/2005/russian.pdf>>



obliged to satisfy at below costs. Gazprom's forecast is mainly relying on imports of cheap Turkmen gas that are redirected to Europe.

The question is how Gazprom will seek to balance its investment needs with the maintenance of near monopoly powers with regard to both its Central Asian and European neighbours. Gazprom holds the pipeline infrastructure under strict monopoly control. Independent gas producers and oil companies with associated gas production have no access to the export infrastructure. The third country access to the export infrastructure would raise incentives for investments. This should give the EU a considerable leverage in its negotiations with Russia for the opening up its pipeline networks to Central Asian oil and gas producers on a transparent and non-discriminatory basis. Once again this signifies the importance of market reforms in Russia for Russian and European energy security.

Resolving the Transit Issue: Giving a New Momentum to the Ratification Process of the Transit Protocol of the Energy Charter with a Regional Black Sea Approach

The decision of Gazprom to reduce supplies across the Russian-Ukrainian border on 1 January 2006 has severely undermined its reputation as a reliable supplier of gas to Europe. Gazprom's two-day reduction in gas supplies, aimed at Ukraine alone, also affected such customers as Italy, France, Germany and Turkey. The EU has started pressing Russia to resolve the issue of the transit of third country gas from Central Asia via Russia to customers in Ukraine and elsewhere.

The basic confrontation between Russia and Ukraine was the complete lack of institutionalized or legalized dispute settlement. Other than non-transparent and closed-door negotiations without procedural certainty, apparently no dispute settlement agreement had been in place between the two parties. Neither Russia nor Ukraine has ratified the Transit Protocol of the Energy Charter Treaty.

This Protocol explicitly states rules for settling international disputes between transit, producer or consumer countries or respective companies. Governments have a major role to play in reducing companies' transit risks to manageable levels, including pre-empting and settling disputes. By its very nature, energy transit is undertaken through a chain of countries, no stronger than its weakest link. A reliable transit regime in a large geographical area is therefore a question of finding common denominators. Different legal and regulatory regimes and different industry structures may hamper investments in energy transit infrastructure.

The priority is to secure an agreement with Russia on the core issue of transit. Russia itself has to secure the transit of its energy resources to world markets. Its credibility as a supplier is tightly linked to the issue of transit. An improved investment climate as well as a more harmonized set of transit rules focusing on specific conditions for the modernization and use of international energy transit networks are likely to facilitate long term investor confidence by reducing risk and uncertainty.

In this respect, the ratification of the Energy Charter Treaty and the consent to the Energy Charter Secretariat's Transit Protocol would open up Russia's pipeline system to third parties on a transparent and non-discriminatory basis. The roots of the Energy Charter date back to a political initiative launched in Europe in the early 1990s, when



the end of the Cold War offered an unprecedented opportunity to overcome the previous economic divisions in Europe. Nowhere were the prospects for mutually beneficial cooperation between East and West clearer than in the energy sector. Russia and many of its neighbours were rich in energy resources but needed major investments to ensure their development, whilst the western European states had a strategic interest in diversifying their sources of energy supplies. Therefore there was a recognized need to ensure that a commonly accepted foundation be established for developing energy cooperation between the states of the Eurasian continent. On the basis of these considerations, the Energy Charter process was born. Negotiations on a Transit Protocol were launched in 2000, and aimed to build on the existing transit-related provisions of the Energy Charter Treaty by developing an enhanced set of operational rules under international law governing energy transit flows across national borders. Agreement was reached on the bulk of the Protocol's text at the end of 2002. However negotiations had to be suspended in December 2003 and June 2004, in recognition of the fact that energy issues, including transit, were also a subject on the bilateral agenda for the EU and the Russian Federation in the context of Russian negotiations for accession to the WTO.

Regional Energy Market Initiatives Based on the Internal Energy Market Principles

The EU is surrounded by almost 80% of the world's hydrocarbon resources. The aim is to create a wide network of countries around the EU, acting on the basis of shared rules and principles derived from the internal market. Thus it is important to build up relations with strategically important neighbours of the Union.

Member states need to support the ongoing bilateral and regional energy cooperation partnerships with the main EU energy partners, including the gradual extension of the principles of the internal energy market. A well-functioning market is the best way to ensure safe and affordable energy supplies. They create a resilient and responsive world energy supply and facilitate investment decisions. However, markets need physical and legal infrastructure, as well as information and transparency. Any transit system, by its very nature, requires multilateral agreement to ensure that national transit rules and regulations result in a multilateral framework for unhindered transit investment and commercial operation.

The EU has to continue its support for cooperation initiatives aiming at creating predictable and transparent energy markets by extending the application area of the *acquis* beyond the borders of the Union. Integration of energy markets will stimulate investment and economic growth as well as security of energy supply for all. Only the development of the appropriate legal and financial framework permitting fair and transparent transit conditions will enable the Black Sea countries to play a major role as gas transit countries to the EU. The EU should be a key driver in the design of international agreements, including the extension of the Union's energy regulatory framework to neighbours (the Energy Community).

The Baku Initiative

The Baku Initiative is a policy dialogue on energy cooperation between the EU and the littoral states of the Black Sea, Caspian Sea and their neighbours. The initiative



was announced on 13 November 2004 at the Energy Ministerial Conference in Baku. A second ministerial conference was held in Astana on 30 November 2006. It was the lack of fair and objective energy trade standards between the EU, Russia and the newly independent Caspian region countries that was calling for such an initiative. However, Russia refused to be a full-fledged member preferring only an observer status instead.

Originally, both the TRACECA and the INOGATE programmes were designed as technical assistance programmes. The lack of a regional political dialogue affected the efficiency of the technical projects. The TRACECA initiative started in 1993, aimed at promoting a European-Caucasus-Central Asian trade and transport web of infrastructures along an east-west axis, rather than north-south. In the field of energy, Brussels launched the so-called INOGATE Programme in 1995, a TACIS line of finance aimed at addressing some supply security issues in participating INOGATE countries such as infrastructural deficiencies, regulatory standard requirements and possibly the improvement of the investment framework especially for downstream projects. While the TRACECA had limited impact on trade routes, the INOGATE, though conceived merely as a technical assistance tool for energy, has provided the suitable environment to foster regional cooperation.

The Energy Ministerial Conference of the Baku Initiative that brought together the EU countries and the governments of the Caspian and Black Sea regions was held in Astana, Kazakhstan, on 30 November 2006 and led to the formulation of the Energy Road Map setting out a long term plan for enhanced energy cooperation between all partners and pave the way for a comprehensive legal and regulatory framework governing an integrated EU-Black Sea-Caspian Sea common energy market based on the EU acquis. This road map sets as a long term objective the creation of integrated regional energy markets and their progressive integration with the EU internal energy market. The regional cooperation has to ensure an open and non-discriminatory access to energy resources and networks.

The priority areas for action are defined as promoting the development of the energy sector based on the principles of security of supply, competitiveness and environmental sustainability and the building up of a stable, sustainable energy policy framework in all beneficiary countries.

Even though the Baku Initiative will not bring any significant change in the pattern of energy production and trade between European countries and their Caspian partners, thus not altering the current pattern of energy trade in the Eurasian space, it will help in the long run to build a more market-oriented energy relationship between the EU and Caspian energy producers. This energy policy dialogue can be expected to galvanize the countries of the region to tackle shared challenges in cooperation with the EU and help boost new supplies from central Asia to the EU.

The value added aspect of this strategy lies on its goals, which are the establishment of institutions and the pursuit of market-building initiatives. In this respect, the EU can play a role and share its experience with new partners that have already demonstrated their willingness to have access to EU consumers on a fair market basis.



The Energy Community

The Energy Community is a process that aims to extend the EU internal energy market to the Southeast European region. The Energy Community Treaty entered into force on 1 July 2006 and extended the relevant EU energy acquis to the Western Balkan countries. The implementation of the treaty will improve energy security, create a regional energy market and encourage vital investments.

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.

One of the challenges ahead is to ensure Norway, Ukraine and Turkey's full integration into the Energy Community Treaty. As far as Turkey is concerned, only the development of the appropriate legal and financial framework permitting fair and transparent gas transit conditions will enable it to play a major role as a gas transit country to the EU.

Turkey's strategic position and its role as a key country for energy transit would necessitate a correct implementation of the internal market acquis on gas and electricity.

Turkey's participation in the Regional Energy Market for Southeast Europe (REMSEE), covering also Western Balkans, Romania and Bulgaria, is to ensure that its legislation will be in line with the relevant acquis well in advance of its accession.

However, the Turkish government has been reluctant in joining the Energy Community Treaty. The construction of the Southeast Energy community has gone indeed hand in hand with the EU enlargement process. The size of the Turkish energy market, its strategic geographical location and the fact that Ankara had not yet begun negotiations on energy policy as part of its EU accession talks are among the reasons for holding back. Some in Turkey started doubting the EU's interest in admitting Turkey once it gained unfettered investment access to its energy sector through the treaty. Some others felt Turkey should extract more concessions in its EU accession process as a price for joining the community, fearing it would face unequal pressure from Brussels if it signed the treaty without a firm prospect of EU membership. This aspect raises the issue of whether the extension of the EU energy market can be disconnected from the enlargement process.

EU's Action in the Black Sea Region for Enhancing Energy Security

The EU's action has to focus primarily on how to manage interdependence in energy relations in developing, when possible, multilateral governance frameworks for energy transfer and investments. The prospect is that the institutionalization of transparent, mutually agreed rules and procedures will render the interdependence relationship more certain, as norms tend to stabilize behaviours. In limiting possible behaviours to a corridor of legally permitted actions and in setting up a dispute settlement procedure the governance approach tries to minimize arbitrary, unexpected actions by withdrawing opportunities for politically motivated action through its transfer to the domain of law.



The realization of the internal energy market in the EU will foster investment and innovation and contribute to the security of supply. Member states should promote the principles of the internal energy market in bilateral and multilateral fora, enhancing the Union's coherence and weight externally on energy issues. The EU should help to create the environment for private capital flows and offer political and financial support to economically feasible projects, as appropriate. The EU has to continue its support for cooperation initiatives aiming at creating predictable and transparent energy markets by extending the application area of the *acquis* beyond the borders of the Union. Integration of energy markets will stimulate investment and economic growth as well as security of energy supply for all. The Black Sea countries will be able to play a major role as a gas transit corridor to the EU only if the development of the appropriate legal and financial framework providing fair and transparent transit conditions is achieved.

The EU should use all its weight in current and future bilateral negotiations and agreements, offering balanced and market-based solutions with the Black Sea region, including both suppliers and transit countries. The EU and Russia should see mutual long term benefits from a new energy partnership, which would seek a balance between expectations and interests of both sides. Russia seeks ways to secure energy demand presented by the EU market. The EU needs Russian resources for its energy security. There is a clear interdependence.

Russia wants a stronger presence in the EU's internal energy market, ensured long term gas supply contracts, the integration of electricity grids and free trade for electricity and nuclear materials.

It also wants the acquisition and control of downstream EU energy assets (gas and electricity) and EU investments and technology for the development of the Russian energy resources. The EU wants non-discriminatory and fair treatment from Russia in their energy relationship, in terms of supply from Russia and in terms of access to the Russian market for EU investors, a level playing field in terms of market conditions, investment and acquisitions in the upstream and downstream Russian energy infrastructure and resources, third party access to pipelines within Russia, including those for transit of energy products from the Caspian region and Central Asia, respect for competition rules as well as high levels of environmental security and safety. The foreseen negotiations on a new comprehensive framework agreement within the post-Partnership and Cooperation Agreement (PCA) offer an opportunity to agree on the objectives and principles of energy cooperation in a balanced and mutually binding manner.



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ISSN 1791-6658

ISBN 978-960-89927-9-5

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