
„ENERGY PROBLEM” IN THE BALTIC SEA RIM: IS THE REGION PULLED TOGETHER OR PULLED APART?

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The article is based on the results of the research project „Energy: pulling the Baltic Sea region together or apart?” carried out by the Latvian Institute of International Affairs (LIIA) in 2008-2009 with the participation of researchers from nine states of the Baltic Sea Region. Although this article draws heavily on the findings of this project, the opinions and views expressed are author’s own responsibility. The research project and this article would not have been possible without generous financial support of Latvian Ministry of Defence, Nordic Council of Ministers, Friedrich Ebert Foundation, and Soros Foundation-Latvia.

Introduction

The Baltic Sea region (BSR) has recently gained increasing attention due to three main reasons. First, economic cohesion between eastern and western parts of the region does not proceed as it was expected when Poland and the three Baltic states joined the European Union (EU) in 2004. Their faltering economies have recently caused discussions over the possibility of achieving greater economic cohesion within the region in the foreseeable future. Second, in recent years the state of the Baltic Sea has deteriorated despite numerous initiatives aimed at improving the quality of its ecosystem. Third, due to the increasing attention toward energy issues at all decision-making levels – local, national, regional, and global – the importance of the BSR as an energy bridge between Russia (and Norway) and the EU has grown. This article aims to focus on the third issue and will discuss the impact of energy issues on inter-state relations in the BSR.

Energy issues have the potential both for pulling countries apart due to diverging perspectives on national energy policies and for pulling countries

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together in search for solutions to the problems that these states have in common. Both trends can be discerned in the BSR. This article aims to outline the main reasons that facilitate and those that hamper energy cooperation thus pushing countries toward finding individual solutions to their energy problems. At the beginning of the article the author provides a brief overview of the significance of energy issues on a global scale, and then moves on to analyse the impact that energy issues have on cooperation and conflict/competition processes in the BSR.

Global energy trends

Energy is the most important factor that influences growth and economic development in all countries. There is no industrial development and modernization without energy. Although economic growth in the group of developed countries in the past decades has by far exceeded the pace of rise in energy consumption, economic growth and energy consumption are still inextricably entwined, and this link has not yet been broken. In the developing world it is almost impossible to achieve economic growth without a considerable increase in energy production and consumption, and it is evident that energy efficiency in the developing world lags behind that of the developed world.

Global energy trends is a complex phenomenon, which, due to the space constraints, cannot be discussed here in detail. Therefore it will suffice to mention just a few of the most important trends that have impact on the BSR as well. A report released by the World Energy Council in December 2008 outlines several trends observed in the energy sector. First, there is a trend of energy price flaring. Energy prices have been volatile in recent years and have thus created instability and caused concern on both – supply and demand – sides. Second, there is a deep concern among consumers with regard to fluctuations of energy prices. This instability has furthered “anything can happen” type of thinking among consumers. While price increase has caused concern, price decrease has not fully alleviated fears on the part of the consumers (and net importers of energy). Third, price instability (and, especially, price increase) has a potential of economic dislocation in oil and gas importing countries thus causing politi-

cal instability. Higher inflation that comes with rising energy prices can make a botch of considerable development gains achieved throughout the past two decades in the developing world. Fourth, countries have started to pay increasing attention to energy security issues. These concerns range from the possibility of disruptions caused by a major terrorist attack to energy infrastructure and even further to availability of energy *per se* that may be hampered due to lack of investment in energy extraction infrastructure and the possibility of the oil industry already having passed “peak oil”. Fifth, it seems that governments have a greater role to play in relation to energy than previously thought. The magnitude of energy industry and its technological complexity requires much more active government involvement. The scale of required annual investments estimated at around one trillion USD and the necessity to establish adequate international frameworks for fast and efficient energy decision-making cannot be put in place without the support from national governments.¹ One might add that, by empowering oil and gas exporting nations, recent global energy trends have contributed to global power shift.

The international energy industry also faces a number of challenges. The most important ones of them comprise relocation of national and regional energy consumption patterns, a perspective of reaching “peak oil” and “peak gas” in “not-too-distant” future, the impact of energy consumption patterns on global climate, and an increasing awareness that it is necessary to develop low carbon or even carbon-free technologies.² All these trends and challenges have an impact on the BSR as well. Energy consumer nations have raised increasing concerns over energy security. There has been an increasing emphasis on energy security both at the national and the European levels. Awareness has grown regarding the impact of energy consumption on the environment, while concerns on the part of energy consumers about security of supply have been mounting. There is also a growing unease in the EU over the capacity of Norway and Russia to provide the required quantity of fossil fuels. These concerns are addressed in greater detail in the next chapter, which provides a discussion of the main problems of the BSR energy cooperation.

¹ *Assessment of Energy Policy and Practices*. World Energy Council, 2008. p. 4. <http://www.worldenergy.org/documents/assessmentdecember_final_version.pdf> 08.04.2009.

² *Ibid.*, p. 3.

Baltic Sea Region: together apart?

BSR countries are a rather heterogeneous group of actors because of the region's complex history and economic, social, political, economic and cultural parameters. Energy considerably contributes to the heterogeneity of the region. Although the EU enlargement was aimed at ironing out the dividing lines that existed in the region because of the Cold War politics, the arrival of energy issues has exacerbated the old divisions. All of a sudden, the Baltic States had to acknowledge that, despite having achieved political and, to some extent, economic integration in the EU, their integration with other EU member states in terms of energy flows and infrastructure was fairly weak. This has implications for the concept of the BSR being an energy bridge between the EU and Russia. Usually bridges are solid constructions, but unfortunately, the BSR is not a solid region when it comes to energy issues; therefore, the energy bridge concept as such becomes problematic. Various parts of the bridge (countries) have their own interests and security perceptions, while the bridge cannot function properly unless these interests are addressed and their security concerns – alleviated. This chapter addresses some of the most pressing problems that hamper energy cooperation in the BSR and points to several solutions to the existing problems.

1. Lack of shared energy concerns among the BSR countries

It should be emphasized that all BSR countries have their concerns with regard to energy. This also applies to Russia and Norway that are net energy exporters (and regional energy superpowers) because even these countries have their energy-related difficulties. Norway is concerned about depletion of oil reserves and prospects of having electricity shortages during summertime, while Russia suffers from inefficient energy consumption and underinvestment in energy infrastructure and exploration of new gas and oil fields. The Baltic States are concerned about being an “energy island” in the EU. Poland apprehends the possibility of foreign (Russian) companies buying into the Polish energy market and has therefore implemented a rather protectionist energy policy. It has securitized energy policy to the extent that no other BSR country has, but this comes with a price, and Poland's reliance on solid fuels (pri-

marily, coal which makes up to 60% of the country's primary energy's balance) may turn out to be rather costly because of EU's policies aimed at curbing greenhouse gas emissions. Sweden and Finland also have energy concerns that are mostly related to oil and gas consumption, although, when it comes to electricity generation, both countries are largely self-sufficient. Despite the fact that all countries have their own concerns with regard to energy, there is little incentive to facilitate energy cooperation on a truly regional scale because, in essence, countries' concerns are very different, and there is little common ground for cooperation. This, however, does not imply that cooperation is impossible *per se*. On the contrary, some states do share similar concerns, and trade-offs are also possible between those countries whose primary concerns are different. Building grand schemes of *regional energy cooperation* is unlikely, but having *energy cooperation within the region* is very likely.

2. Interests of energy producers, energy consumers and transit countries.

Energy producers are interested in security of demand. While demand is a constantly changing variable, it has been growing over the years, and there is little reason to believe that countries exporting energy are likely to face a considerable fall in energy demand in both Eastern and Western Europe. Energy consumers are interested in stable supplies at affordable prices, and despite recent fluctuations of oil and gas prices supplies have been stable. Russian-Ukrainian “gas wars” have slightly changed perceptions on the part of the EU member states, yet Russia's image as a reliable energy supplier has not been broken. Also, there are concerns that Russia's and to some extent Norway's ability to supply enough gas may decrease over the coming years, but it seems that any disruptions can be avoided with timely action. Transit countries are dependent on producers' and consumers' preferences for transit and are most vulnerable in this sense. There are multiple possibilities for energy transit in the BSR, therefore, vulnerability of transit countries is endemic and cannot be avoided. Exploration of possibilities of transporting gas from Russia through undersea gas pipeline thus avoiding involvement of transit countries is just one such example. However, concerns of transit countries are not shared by consumers and producers because both ends of energy trade are interested in having transit fees as low as possible. In other words, there is a constant friction

between energy producers, energy consumers and transit countries. This conflict is embedded in the nature of the relations between these parties and as such cannot be eliminated altogether. Interests can be reconciled, but conflict as such cannot be eliminated. Roles of the region's countries – energy exporters, energy importers, and energy transit countries – will inevitably have an impact on possibilities for energy cooperation.

3. Energy as one element among other inter-state relations

Part of the problem is that energy issues are becoming part of relations between the countries of the BSR. Energy relations are integrated in the frameworks that currently exist in the region. In theory, there are two options. First, while being integrated in the inter-state relations' framework, energy issues can reinforce the existing framework of relationships. If the existing relations are good, energy issues are likely to reinforce them. Where relations are dire, energy issues are likely to exacerbate controversies. Second, energy issues can change the existing patterns of inter-state relations by becoming part of the regional agenda. In other words, arrival of energy issues on regional agenda may turn out to be a "game changer". In this scenario, on the one hand, energy can improve relations that are dire, and on the other, it may turn sour relations that have been good beforehand. So far there is little evidence that energy has altered the existing patterns of the relations in the BSR. On the contrary, Nord Stream project and Russia's attempts to divert energy transit through the Baltic States and Poland through Russian ports have caused anxiety. There is enough evidence that arrival of energy issues has led to deterioration in relations between the Baltic States and Poland on the one hand and Russia on the other. The process of energy securitization forces countries to act unilaterally since security has traditionally been the responsibility of nation-states. Although there are incentives to internationalize the securitized energy issues, countries are eager first to explore the possibilities for achieving energy security on their own.

4. Internationalization of energy companies

There is no doubt that states are important actors when it comes to energy issues. However, their capacity to act and plan in the sphere of energy is often compromised by commercial logic and internationalization of the en-

ergy sector. First, commercial logic can at times clash with energy security of national governments, and it is very unlikely that private energy firms would pay much attention to security issues arising from implementation of one set of infrastructure projects and non-implementation of a different set of projects. The most likely outcome of this clash of conflicting interests – profits vs national security – is that energy security will be costly and that governments (taxpayers) would have to pay for that. Second, increasing attention has been paid to the simple fact that governments have lost some (or in several cases most) of their leverage with regard to private energy companies: the latter have become internationalized in the sense that their ownership is often determined by market forces rather than national security considerations. In the case of the BSR there is a discrepancy between liberalized downstream energy market in the EU member states and state-controlled upstream market in Russia. This gives rise to concerns in the EU member states over the fact that their energy companies, whose business choices have an impact on national energy security, are actually owned by Russian energy companies controlled by the Russian government. Imbalances in the ownership of energy companies feed security concerns most visibly in the Baltic States, though such concerns have also become pronounced in other BSR countries. Security and business interests may cause friction in the energy debate, as security interests force governments to be more influential in the energy sphere while commercial interests point in the opposite direction and suggest that energy sphere should not become the battle-ground between national governments and should instead be left to business interests.

5. Impact of thinking in terms of relative rather than absolute gains

One of the major discussions in the literature on international relations has been on the importance that countries attach to relative absolute gains that are generated in the process of cooperation. Evidence from the example of the three Baltic States allows one to make a conclusion that states are sensitive towards distribution of even relative gains. Negotiations on constructing a jointly owned Latvian-Estonian-Lithuanian nuclear power plant in Lithuania and talks between Latvia and Lithuania about constructing a Baltic electricity interconnector with Sweden lead to the conclusion that countries are concerned

about the distribution of relative gains even under the pressure of being vulnerable to shortages in electricity supplies. It remains to be seen whether increasing securitization of energy issues has a tendency to result in unilateral actions by involved countries. For now, EU member states in the BSR have displayed the tendency to act unilaterally, but this may change under the conditions of external pressure/incentives. This may also change if current vulnerabilities are increasingly recognized as security threats.

Conclusions

Having pointed out some important problems that may hamper energy cooperation in the BSR, this section will conclude on a more positive note. Until this far, little mention has been made about the EU, yet it is the EU that wields considerable potential for improving energy security of its member states. Much has been written on the EU's inability to speak with one voice vis-à-vis Russia. There is no doubt that EU's common foreign and energy policies should be improved and that this process should start by patient efforts toward creating a common interest among the EU member states. However, when it comes to energy policy, the EU already has tools for improving energy security in the BSR. On the level of external relations the EU should continue to improve its energy dialogue with Russia, but it is the internal aspects of the EU energy policy that are most important. Basically, the EU's "energy presence" in the BSR is beneficial in two ways. First, the EU can provide financial incentives to kick-start a project of regional relevance and act as a facilitator of regional or subregional cooperation. It would be imprudent to expect that the EU would take care of its member states' energy security, but EU's presence can "make things easier to happen". Such incentives are especially important under the current circumstances when economies of the Baltic States' are undergoing a recession.

Second, the EU's energy policy provides a multilateral setting for discussions on energy security of its member states. This can turn out to be very efficient in the long run as energy issues are not something that states would normally be willing to discuss multilaterally. Thus the EU can foster the culture of "energy multilateralism". The most important part of this process is not so much negotiating large-scale energy projects as addressing the concerns of those EU

member states that would be affected by these projects. In this light Nord Stream emerges as a potentially very positive example of the EU's multilateralism. Having taken off as Russian-German bilateral endeavour, this project has provoked harsh reactions from some BSR countries concerned about its implications. Despite the fact that first reactions were mostly negative, discussions have become much more constructive. There is little dispute that the Nord Stream project is important for meeting the EU energy demands, but concerns of Poland, the Baltic States and some of the Nordic states should also be addressed in order to adhere to EU's solidarity requirements. If multilateral cooperation mechanisms are used to the full in order to address concerns of all parties involved, then the EU will have made progress towards forging the common interest among its member states. Thus, important as it is, energy dialogue with Russia should be complemented with (sometimes neglected) internal energy action. The BSR can be a divided place when it comes to energy, but the EU can address at least some of those divisions and turn them into success stories by building on common interests of its member states.