

EU'S SECURITY OF ENERGY,

*Russia and the negotiations over European Energy Charter
Treaty-a successful two-level game?*

THERESE BALS BORGE



MASTER I STATSVITENSKAP

UNIVERSITETET I OSLO

31.10.2007

TABLE OF CONTENTS

Index.....	2-4
Foreword.....	5
Chapter One- Introduction.....	6
1.1 Point of Departure.....	6
1.2 Three main subjects of study.....	7
1.2.1 The EU.....	7
1.2.1.1 What has been developed in regard to ensure security of energy within the European Union?.....	7
1.2.2 Russia.....	8
1.2.3 Natural Gas Supply.....	9
1.3 Problem of study.....	9
1.3.1 Propositions.....	9
1.4 Line of demarcation in time and place.....	10
1.5 Research design.....	10
1.6 Operational definition of problem.....	11-12
1.7 Collection of empirical data.....	12-13
1.8 Theory; Two –Level Games by Robert D. Putnam.....	13
1.9 The structure of this paper.....	14
Chapter two: ‘Two-Level Game’ Theory.....	15
2.1 Reasons for choice of theory.....	15
2.2 Two- Level Games.....	16
2.3 Win-set Models.....	16-19
2.4 Operationalisation of Two-Level Game Theory.....	20-21

Chapter Three: Empirical Data.....	22
3.1 Introduction.....	22-23
3.2 EU's Energy Policy from the late 1980's and onward.....	24-26
3.3 The Internal Energy Market.....	27-29
3.4 The Gas Directive.....	29-30
3.5 Green Papers of 1988, 2000 and 2006.....	31
3.5.3 Green Paper 1988-"The Internal Energy Market".....	32
3.5.4 Green Paper 2000-"Towards a European Strategy for Security of Energy".....	32-33
3.5.5 Green Paper 2006 on a "European Strategy for sustainable, Competitive and Secure energy".....	33
3.6 Relating events.....	33-34
3.7 Decision making in the EU in the field of trade.....	35-36
3.8 The European Energy Charter.....	37
3.8.1 In General.....	37-38
3.8.2 Four Major Stages in the European Energy Charter Treaty negotiations.....	39-45
3.8.3 From Russia's standpoint.....	46-47
3.8.4 Security of supply issues in the ECT.....	47-48
3.8.4.1 Long-Term VS. Short-Term Security.....	48
3.9 Transit in the European Energy Charter.....	49-50
3.10 Third Party Access.....	50
3.11 Russia's Energy Policy.....	51
3.11.1 In General.....	51-53
3.11.2 Gas Trade and Transit.....	53-54
3.11.3 Gazprom.....	54-55
3.12 The Partnership and Cooperation Agreement (PCA).....	55
3.13 The EU-Russia Energy Dialogue.....	56-57

Chapter Four: Analysis of the negotiations and

outcome.....	58
4.1 Intro.....	58
4.2 EU as a Chief of Government (COG).....	58-59
4.3 The EU as a Two-Level game player.....	59-62
4.4 The different interests of the EU and Russia in the European Energy Charter (ECT).....	63
4.5 The negotiations of the ECT.....	64-65
4.6 Any importance if GATT (WTO)?.....	65-66
4.6.1 Russia's interests in joining the WTO.....	66
4.7 The ratification process.....	67-68
4.8 The Transit Protocol.....	68-69
Chapter Five: FINAL REMARKS.....	70
5.1 An overview.....	70-71
References.....	72-76

FOREWORD

Working with my master thesis has been along and trying time.

I have to thank my guidance council, Svein S. Andersen, professor at BI, Oslo, who was appointed to me for the fall 06/spring 07, as in the early start of my thesis, was a great help with inspiration and a starting point of view. He was also in great help with literature, and giving me the direction I looked for, when I needed to decide on a theory for this paper.

I did not finish, regrettably, within norms set by the University of Oslo, and therefore lost my right to more help from my guidance council. This was in particular difficult, because I could most definitely need the help of a professional advisor.

I also want to give thanks to my nearest family and my closest friends for the enduring and lasting support and belief they have had in me. Without them, this project would have been extremely more difficult to finish.

A thank also to Tommy Nordahl Lund for his help and guidance in the graphical part in my thesis.

And, thanks also to Dag Harald Claes are in order, for enlightening me with his most inspiring lecture given in spring 2006.

Any faults or errors in this paper are most surely and completely my own.

This thesis consists of 18168 words, and are within the limitations rules set by the University of Oslo.

Oslo, October 2007

Therese Bals Borge

Chapter 1: INTRODUCTION

1.1 Point of Departure

In my master thesis, I wanted to study the security of energy supply in the European Union, and EU's relations to Russia regarding this issue.

My interest for this subject was discovered after taking Dag Harald Claes' lecture in International Energy Policy¹ spring 2006 at the University of Oslo.

The subject of Energy is a much talked about, and a discussed topic. It has been so for decades, and it is nor by far over yet. We find it in history books, in economics, political science and environmental issues to mention a few fields where we can find different aspects of energy discussions.

In this qualitative research my intention is to understand and explore this phenomenon of energy security in the EU, and have by no means the will to try to generalize findings over to other areas.

It is a highly descriptive and empirical study, where I want to see what the EU has done to improve or secure their energy supply since mid 1980's in the EU, and since Russia is the biggest exporter of gas to Europe, I want to look at their relations, especially during the European Energy Charter and its negotiations, and (if) any repercussions it has had for the security of supply in Europe.

In the lenses of International Politics genre, I will use Robert D. Putnam's two level games in order to look at this interaction they have with each other.

¹STV 4282b.

1.2. Three main subjects of this study

1.2.1 The EU

EU covers most parts of energy demand through import. Today, approximately 50% of the energy consumption is imported, but the number may increase up to 70% by the year 2020. Security of supply has always been central in the work within the EU. Up until the end of the 1980's this question was dominating in the field of energy.

When concerning questions of energy there are mainly three main goals operating:

1. The community's ability to competition for the industry in general, and for the energy sector in particular, here under the Internal Market, a better competitiveness and increased employment.
2. Safety for energy supply, here under reduced dependence to external sources, and secure on both long and short term.
3. Protection of environment, here under secure that the energy policies merges with the political-environmentalist goals

(http://www.regjeringen.no/nb/dep/oed/dok/rapporter_planer/Rapporter/2004/EUs-energipolitikk.html?id=106083 (own translation.))

1.2.1.1 What has been developed in regard to ensure security of energy within the European Union?

There have been several attempts by the European Union to better and secure energy to the Member States. They (read:the European Commission) have elaborated Green Papers since late 1980's up until today, three of them; 1988,2000 and 2006 are mentioned later in this thesis. The Internal Energy Market, may be a measure in the way of liberalising and

opening the energy market, but is also seen as a way to secure energy. And because of my interest seeing security of energy supply in relation to Russia, the most significant measure is looking at the Energy Charter Treaty.

There have also been a couple of other measures in order to get an agreement with Russia, as The Partnership and Cooperation Agreement, followed by the EU-Russia dialogue.

Because of the Energy Charter Treaty negotiations are most relevant here, it will be the focus of study, when I try to explain the relationship the EU and Russia have had during the course of negotiations with the help of the Two-level Theory, by Robert D. Putnam.

1.2.2 Russia

EU countries dependence of imported energy, in particular gas, is a result of a wanted policy. EU countries have chosen not to cover their own need for energy. This gives a price shock for the consumers, Russia increased political power, and pressure on Norway to deliver more gas.

The failed energy policy does not only create short term domestic political problems inside the EU. In January 2006, the Russians closed down the supply of gas to Ukraine after a argument regarding the price. The reasons behind this can be that Russia disliked at that time, Ukraine government's westerly policy. Ukraine is a transit country for 80% of the Russian gas that is exported to EU. This Russian action reduced the flow of gas to several members of the European Union. The Russian gas was used as a political weapon, something one can threaten with. This example has given the word, security of supply, a new meaning in the EU. Energy is a hot geopolitical topic.

Russia's president Vladimir Putin has himself declared that the country shall use its position as a huge energy producer as a fundament so that the country regains a position as a super power nation (Aftenposten, 13.07.06)

1.2.3 Natural gas supply

In a book by International Energy Agency; Oil, Gas and Coal-supply outlook, they presented an increase in demand of global gas supply, which raised the question of whether, from where and at what cost this demand can be met. Although the global gas resource base is immense and reserves are abundant, gas is not necessarily easily available in any market or at any time. In contrast to the oil market, there is no global market for natural gas, primarily because the transportation of gas is difficult and costly. (1995:69)

1.3 Problem of study

In order to secure the energy supply to the European Union, from one of the EU's most important exporter, namely Russia, have there been several efforts to try to meet this demand. There have been proposals, agreements, and papers in circulations within the EU and between these two, the EU and Russia.

EU's energy security of supply, and Russia's energy policy towards the EU. The negotiations over the European Energy Charter Treaty- a successful two-level-theory game?

1.3.1 Propositions

Have there been successful negotiations between EU and Russia in order to secure energy supply?

Can this relationship be explained through the lenses of two level games, by Robert D. Putnam?

1.4 Line of demarcation in time and place

I have decided that the study of EU's energy security I will concentrate from mid 1980's, when the Internal Market opened for the gas directive discussion, and Energy Charter Treaty started, and up until today.

My main focus for this thesis is goal no 2², safety for energy supply.

Regarding Russia, the focus of study will start after the collapse of the Soviet Union, 1990, and up until today. It will also as mentioned earlier, look at the relationship between the two, especially during the European Energy Charter Treaty and its negotiations.

1.5 Research design

The case study is but one of several ways of doing social science research. Case studies are the preferred strategy when 'how' or 'why' questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context. (Yin, Robert K.1994:1)

I will in this thesis use qualitative case study research study of EU's energy policy, more accurate, energy policy regarding security of supply.

Svein S. Andersen (1997) claims that there is an understanding that case studies only have a limited value, when the intention is to generalize findings (own translation).

Now, my intention with this thesis is not to generalize any of the findings, and do not consider this a challenge nor a problem.

² See paragraph 1.2.1-three main goals operating within the EU.

1.6 Operational definitions of problem

There are some terms that need more specification, an operational definitions of different aspects of my study is important, in order to make the reliability higher. The terms I will elaborate are; Security of supply, and negotiations. I first start by defining security of supply, followed by definition of negotiations.

Security of supply as defined by Bielecki; ‘energy security is commonly defined as reliable and adequate supply of energy at reasonable prices. The meaning of reliable and adequate supply is rather straightforward: it simply means uninterrupted supply that fully meets the needs of the global economy. The interpretation of reasonable prices is somewhat less clear as it changes over time and is perceived differently by energy producers and consumers. In general, however, it means that prices are cost-based and determined by the market based on supply/demand balances. (Bielecki,Janusz, 2002:237)

At the European level, the concept of energy security is defined by the European Commission in a similar fashion. The Commission states:

Energy supply security must be geared to ensuring the proper functioning of the economy, the uninterrupted physical availability at a price which is affordable while respecting environmental concerns. Security of supply does not seek to maximise energy self-stuffiness or to minimise dependence, but aims to reduce the risks linked to such dependence. (Haghighi, S. 2007:15)

Security of supply has long been on the agenda within the EU. Already after oil crises in 1973-74, witch led to the creation International Energy Agency (IEA), has security of supply been on the agenda. And when one look at directives in the period 1973-88, it is clear that much attention was directed towards security of supply, research and storage (Matlary, Janne H.1997:12)

Negotiations; a kind of process where explicit proposals are put forward- and possibly discussed- with the official purpose of arriving at an agreement on some practical matter: the exchange or distribution of certain goods or evils, the establishment of some common good, etc. (Midgaard, Knut:2001:273).

Definition of political bargaining can be said like this by Doron and Sened(2001);

Scarcity shapes the science and practice of politics. Bargaining takes place when two or more players, individuals, organisations, parties, corporations or states- make a tangible effort to reach an agreement over the mode of allocation, distribution or redistribution of scarce resources.

All political bargaining situations are characterized by some common elements. The most important are players, differences of interest, interdependency, time factors, rules of progress, agreed solutions and method of enforcements.(Doron, Gideon; Sened, Itai 2001:2-4)

1.7 Collection of empirical data

I have collected secondary empirical data. I have collected and used literature from mainly books, newspaper, articles and web pages.

The validation includes a critical discussion of the sources ability to give precise information. The books I have used here are open to the public, most of which have been borrowed at University's library, and web pages are also of public information, so I believe that the validity concerning my empirical data are quite high. Literature and books that have been on earlier syllabus, has also been used in this paper. Former exam papers frequent also.

Problems regarding validity, occur when one can't measure the quality one has defined theoretically.

The validity depends on what has been studied, is it of relevance to the thesis and problem put forward (Hellevik, O. (Own translation)).

Since the literature is open to the public, and there would be no difficulty recollecting them, I would be clear that the validity of this thesis can be viewed as high.

The reliability of my operational definitions, such as for the security of energy and negotiations, can also be considered high, this because I have put forward several definitions from different holds, and they are more or less expressing the same, but in slightly different words.

Reliability and validity are important measurements, to see whether or not how accurate and precise the findings of the thesis are. The reliability is decided by how accurate the analysis is done. One can get high reliability by making operational definitions that defines clearly how the subject of study is executed.

1.8 Theory; Two Level Games by Robert D. Putnam

The politics of many international negotiations can usefully be conceived as a two-level game. At the national level, domestic groups pursue their interest by pressuring the government to adopt to favourable policies, and politicians seek power by constructing coalitions among those groups. At the international level, national governments seek to maximize their own ability to satisfy domestic pressures, while minimizing the adverse consequences of foreign developments. Neither of the two games can be ignored by central decision- makers, so long as their countries remain interdependent, yet sovereign. (Putnam,R.D.1988:434)

1.9 The structure of this paper

The first chapter of this paper is an introduction to my master thesis. Here I give a short introduction to the field which will be under study. There are three (four) main strands in this thesis, The EU, Russia and gas, put shortly, and the negotiations between the EU and Russia over the European Energy Charter Treaty.

Chapter two presents my choice of theory for this paper, namely the ‘two-level games’ by Robert Putnam.

I continue with, of course, chapter three, where I go more deeply into the empirical part of this paper. There are as mentioned in the introduction, several agreements, papers and negotiations that have taken place within the EU and in relation with Russia in the past 30 years, which will be covered more or less in this chapter.

In the fourth chapter, the main part, the analysis of the empirical data and theory is presented.

And in the final chapter, number five, I give a summery and some final remarks of the paper.

CHAPTER TWO: 'TWO LEVEL GAME' THEORY

2.1 Reasons for choice of theory

I believe this is the best, of my knowledge, theory which can explain negotiations between two opposing, different sides, states or organizations in international politics, and in this particular case the EU and Russia.

The reason for choosing this specific theory is because I want to look at the relationship that EU and Russia have had since the late 1980's and up until today, and the negotiations over European Energy Charter Treaty that has taken place since the beginning of 1990's. There are certain areas I will have focus on. There have been different agreements or discussions taken place between these two international players, the most significant is The European Energy Charter Treaty.

'Two- level games', was first presented in 1988, in International Organization, under the name 'Diplomacy and Domestic Politics: The logic of Two- Level Games', by Robert D. Putnam.

Explanations of interstate relations have traditionally been categorized according to their 'level of analysis.' The level of analysis tells the investigator where to look for the causes of state behaviour by classifying competing explanations (or independent variables) according to the units in which they are conceptualized.(Moravcsik, 1993-5)

This chapter and my choice of theory are based entirely on Robert D. Putnam article; Diplomacy and Domestic Politics: The logic of Two-Level Games 1988, and Andrew Moravcsik's article in Double- Edged Diplomacy, International Bargaining and Domestic Politics from 1993- which were edited among others, Robert D. Putnam.

2.2 Two- Level Games

The two level games approach begins by assuming that statesmen are typically trying to do two things at once: that is, they seek to manipulate domestic and international politics simultaneously. Diplomatic strategies and tactics are constrained both by what other states will accept and by what domestic constituencies will ratify (Moravcsik, A.1993:15).

The two level games view the relationship between domestic and international politics through the eyes of the statesman (ibid:23).

Putnam decomposes the negotiation process into two stages;

1. Bargaining between the negotiators, leading to a tentative agreement; call level I.
2. Separate discussions within each group of constituents about whether to ratify the agreement; call that level II.

It is important to be aware of the requirements that any level I agreement must, be ratified at Level II imposes a crucial theoretical link between the two levels (Putnam, 1988:436).

2.3 Win-set models

Each state is assumed to have a “win-set”, defined as the set of potential agreements that would be ratified by domestic constituencies in a straight up-or-down vote against the status quo of “no-agreement”.

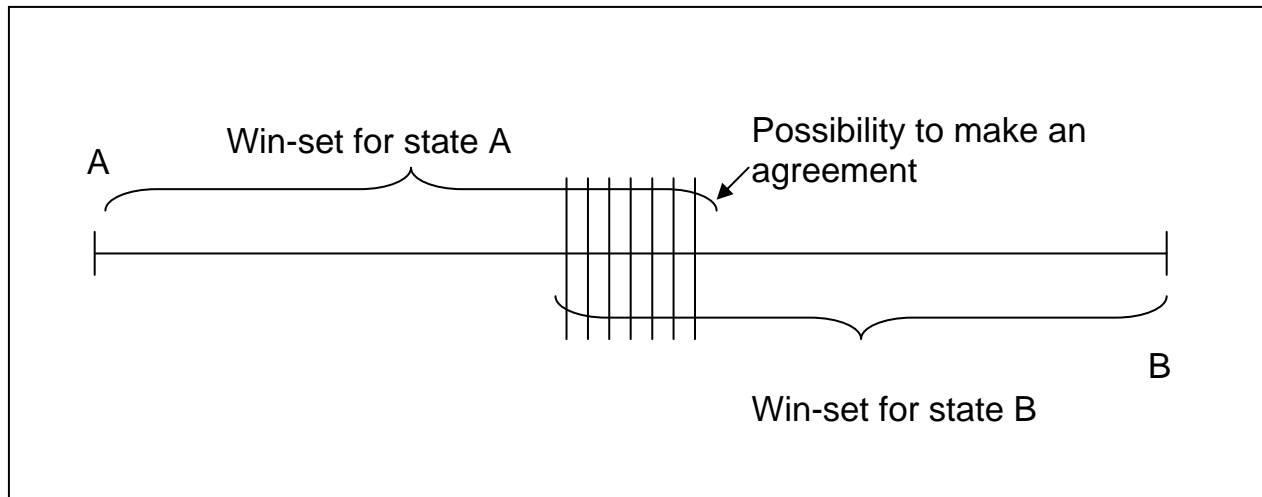


Figure 2.1

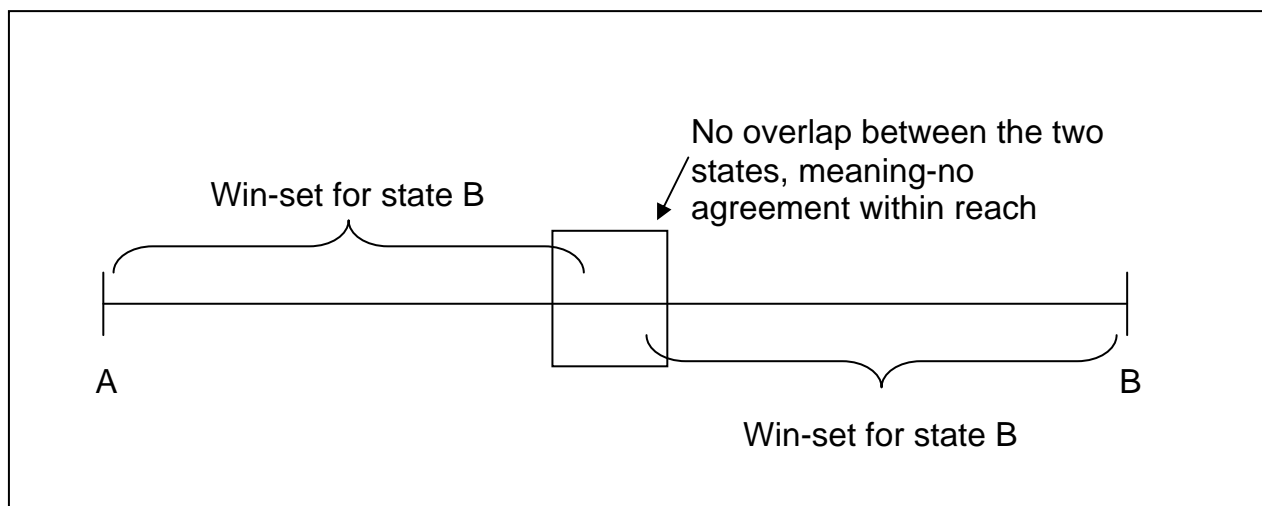


Figure 2.2

Larger “win-sets” make Level I agreement more likely. Any successful agreement must fall within the Level II win-sets of the parties to the accord. As showed in box over, agreement is possible only if those win-sets overlap, and the larger each win-set, the more likely they are to overlap. Conversely, the smaller win-set, the greater the risk that the negotiations will break down (Putnam, R.D. 1988 p.438).

Another reason why the win-set size is important is that the relative size of the respective Level II win-sets will affect the distribution of the joint gains from the international bargain. The larger the perceived win-set of a negotiator, the more he can be ‘pushed around’ by other Level I negotiators. Conversely, a small domestic win-set can be a bargaining advantage (ibid: 440).

Putnam continues to underline the importance of the determinants of the win-set. (ibid: 442)

There are three sets of factors that are important to what circumstances affect win-set size;

1. Level II preferences and coalitions
2. Level II institutions
3. Level I negotiators’ strategies

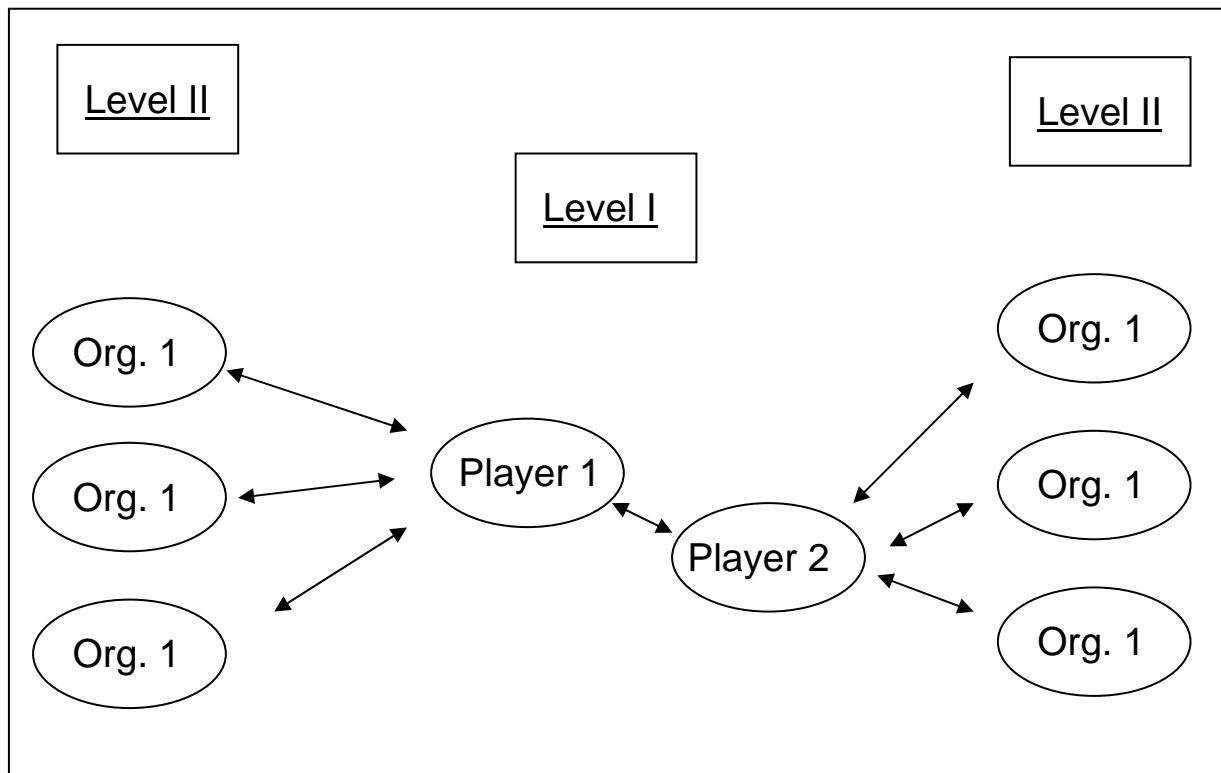


Figure 2.3³

³ This figure was inspired after Ivar Tvede’s Master Thesis in Fall 2006

The chief-negotiator is the only formal link between Level I and Level II. Putnam assumes that the chief negotiator has no independent policy views, but acts as merely as a honest broker, or rather as a agent on behalf of his constituents. This assumption simplifies the analysis of the two-level games.

Because empirically, the preferences of the chief negotiator may well diverge from those of his constituents.

The motives of the chief negotiator include:

- Enhancing his standing in the Level II game by increasing his political resources or by minimizing potential losses.
- Shifting the balance of power at Level II in favour of domestic policies that he prefers for exogenous reasons.
- To pursue his own conception of the national context.

It is reasonable to presume, that in the internationally case of two-level bargaining, that the chief negotiator will normally give primacy to his domestic calculus, if a choice must be made, not least because his own incumbency often depends on his standings on Level II. Hence, he is more likely to present an international agreement for ratification, the less of his own political capital he expects to have to invest to win approval and the greater the likely political returns from a ratified agreement (Putnam, 1988: 456-457).

2.4 Operationalization of Two-Level Theory

How can this two level theory be applied to the empirical data of my thesis?

In a hypothetical model based on two-level game, The European Commission will be the ‘Chief of Negotiator’ (COG), this is because the European Commission work on behalf and in interest of all the European Member States. Head of the European Commission is the formal link between the game players on Level I and Level II.

In this particular case, the Level II, will consist the European Union’s Member States and OECD Countries. The reason why OECD countries are taken in this model is because they are signatories of the European Energy Charter Treaty. They have a say it what can be agreed on in the Energy Charter Treaty as well.

Other large gas companies within the EU must also be taken in account. Although it should be said that, these large European Gas Companies are not mentioned in the further analysis of this thesis.

When the European Union is making new rules and laws there has to be unanimous consent from the Member States. This would mean that the domestic win-set on Level II (Home based level) can be smaller than the opposing side of the game.

On Level I (the international Level), the European Commission meets the Russian Delegation to the European Energy Charter Treaty negotiations as their ‘Chief of Negotiator’.

The Russian Delegation on their Level II must answer to the Russian Government, Parliament and gas companies.

It would be difficult to map out their respective win-sets in this particular (or any) negotiation process. Although it may appear that the European Union is more open to change, than Russia. Meaning, that the win-set of the European Union is larger than Russia's, which are not so eager to make change, especially when it comes to Third Party Access and Transit rules. These themes or rather; obstacles in the ECT negotiation will be covered in chapter four: the analysis.

CHAPTER 3: EMPIRICAL DATA

3.1 Introduction

“We stand before completely new challenges in the energy market. The demand is increasing, Member Countries within the EU’s own production is falling, it invests too little in the energy sector, and we see that the climate is changing. We must face these new realities. EU can no longer have 25 (today 27) uncoordinated political perceptions regarding our energy policy”. (Barroso, Jose M. -Aftenposten 24 of march 2006. Own translation.)

In this important empirical chapter, I will cover some important areas of EU’s energy policy, and its development that has occurred in the European energy policy since the late 1980’s.

On the road to safe security of energy, there are directives and agreements that one has to consider, and take into account.

EU covers most parts of energy demand through import. Today, approximately 50% of the energy consumption is imported, but the number may increase up to 70% by the year 2020. Security of supply has always been central in the work within the EU. Up until the end of the 1980’s this question was dominating in the field of energy.

When concerning questions of energy there are mainly three goals operating;

1. The community’s ability to competition for the industry in general, and for the energy sector in particular, here under the Internal Market, a better competitiveness and increased employment.
2. Safety for energy supply, here under reduced dependence to external sources, and secure on both long and short term.

3. Protection of environment, here under secure that the energy policies merges with the political-environmentalist goals

(http://www.regjeringen.no/nb/dep/oed/dok/rapporter_planer/Rapporter/2004/EUs-energipolitikk.html?id=106083 (own translation.)).

The means to accomplish these goals is liberalising the markets, a sound policy regarding dependence of import from third countries, propose a sustainable development, and support to science and development of technology in the energy field. Common rules are among other developed in the areas of oil, natural gas and electricity.

On the other hand, the general set of rules are also currant in the energy field. This includes rules of competition, government subsidy and monopolies this means the actors in the energy markets must follow the general set of rules for competition, monopolies and government subsidy.

The regulations of the Internal Market and environment, and further development of set of rules, also gets application in the energy sector.

With an internal energy market with increased competition across borders, there is less room for national energy policy that diverges from the framework conditions in other EU member countries.

Formally, the EU does not have a common or joint energy policy. One of the reasons is that the EU member states have wanted to keep energy policy at a domestic level of decision making. Also, it does not exists policies in the energy sector in the EU treaties, like those we can find concerning the common agricultural- and fishery policy.⁴

(http://www.regjeringen.no/nb/dep/oed/dok/rapporter_planer/Rapporter/2004/EUs-energipolitikk.html?id=106083 (own translation.))

⁴ Appeared in an earlier exam paper by me (STV 4230b) in spring 2006.

3.2 EU'S ENERGY POLICY FROM THE LATE 1980'S AND ONWARD

Increased energy security in Europe has influenced EU co-operation from the start in the 1959's. two out of three founding European Community Treaties dealt with the issue of co-operation to ensure sufficient supply of energy. Early EC energy co-operation revolved around enhancing and improving coal and nuclear supplies in Europe.

Security of supply has remained near top of the EU energy agenda, reflecting the general lack of conventional energy resources and dependency on imports from outside the area, and international events threatening to interrupt the flow of energy into the EU.

In 1986, the common objectives established for community energy policy were;

- Maximize security of supply and reduce the risk of sudden fluctuations in energy prices through developing the Community's own energy resources under satisfactory economic conditions;
- Diversify the Community's external sources of supply;
- Improve the flexibility of energy systems and, inter alia, develop, as necessary link-ups;
- Develop effective crisis measures, particularly in the oil sector;
- Create a vigorous policy of energy saving and the rational use of energy, with diversification between the different forms of energy (Eikeland, Per O. 2004:22-23).

In the early 1990's, one could identify three main strands, when the European Community policy acting on the energy industries, security of supply, the environment and the drive for more competition in a free market (Lyons,P.1992:3).

A statement presented at this seminar by Svend Kræmer(Deputy Head of the EC delegation to Norway) ; the European Community wished to play a part in consolidating the democratic changes occurring in Eastern and Central Europe and the effects of

perestroika in the Soviet Union. It was seeking to support the economic and constitutional reforms in progress in the Soviet Union.

The energy sector in Central and Eastern Europe was faced with long-term structural problems, which had been further exacerbated by the Gulf crisis and the collapse of Comecon/CMEA⁵ agreements. Soviet sales of oil and gas to the Eastern bloc countries had become increasingly unreliable, but were now priced at international market rates and paid for in hard currency. Europe wide energy cooperation was therefore very much in the interest of the Central and East European countries. (Energy for Europe- resources, economy, cooperation (report from a Nordic Council seminar 14-15 October 1991:22-23)

As Svein S. Andersen sees it in his working paper for ARENA(2000:2); Energy issues have increasingly been linked to three general perspectives. First, the EU's internal market program where competition policy plays a major role. Second, the EU's attempts to establish a common environmental policy with fiscal measures as key instruments. Third, the European Energy Charter and the Charter Treaty which were attempts by EU to create international market regimes that could support reform in the former East Bloc and thereby secure EU's energy supplies.

⁵ The **Council for Mutual Economic Assistance (COMECON / Comecon / CMEA / CAME)**, ([Russian](#): Совет экономической взаимопомощи - СЭВ), [1949](#) – [1991](#), was an economic organization of [communist states](#) and a kind of [Eastern Bloc](#) equivalent to—but more geographically inclusive than—the [European Economic Community](#). The military counterpart to the Comecon was the [Warsaw Pact](#), though Comecon's membership was significantly wider. The descriptive term *Comecon* was often applied to all multilateral activities involving members of the organization, rather than being restricted to the direct functions of Comecon and its organs. For example, this is the usage in the [Library of Congress Country Study](#) that is heavily cited in the present article. This usage was sometimes extended as well to bilateral relations among members, because in the system of socialist international economic relations, multilateral accords — typically of a general nature — tended to be implemented through a set of more detailed, bilateral agreements. (<http://en.wikipedia.org/wiki/COMECON>)

The adoption of the Single Act⁶ in 1985, brought a new and central priority to much of the Commissions administration, however, it was not until two years later, in 1987, when energy ministers agreed to let the Commission investigate the obstacles to a single market in energy. By 1988, the Commission had published its important communication, Green Paper, entitled ‘The Internal Energy Market’ (IEM) (Lyons,P.1992:7).

In May 1990, the Commission published its first progress report on IEM (COM/90/124). In it the Commission recognized that ‘the Internal Energy Market’ cannot be set up until the notion of security of supply has been defined. The role of the Community’s resources, the optimum degree of diversification of sources or forms of energy, the degree of competition to maintain in the market, the scope of the regulations on the production, distribution and the use of energy and the interconnections of networks all have to be defined(ibid:42).

From 2000 onwards, energy security gained new topicality in EU energy policy, due in parts to fresh energy growth figures showing an increase in import dependencies and other figures showing an aggravation of the situation after the 2000 Nice Summit opened the EU up to new applicant countries from eastern Europe in 2004. The Commission could no longer deal lightly with the security of supply issue, and published in November 2000 a Green Paper in which it announced the introduction of a broad security of supply strategy.⁷

⁶ The EU Council adoption in 1987 of the Single European Act was a pivotal part of a reform aimed at revitalising the general principles guiding Community co-operation- removal of barriers to trade and movement of capital across member states and free competition as means to increase growth and welfare in the region. It strengthen supranational authority in a number of EU policy areas, opening for greater use of qualified majority voting in decisions on EU -wide market rules, thus removing blocking votes of member states sceptical to increased harmonisation of national policies (Eikeland, P.O, 2004:3)

⁷ Green (COM (2000) (769) see own paragraph in same chapter.

3.3 The Internal Energy Market (IEM)

To create a genuine internal market for energy is one of the European Union's priority objectives. The existence of a competitive internal energy market is a strategic instrument in terms both of giving European consumers a choice between different companies supplying gas and electricity at reasonable prices, and of making the market accessible for all suppliers, especially the smallest and those investing in renewable forms of energy. There is also the issue of setting up a framework within which the mechanism for CO² emission trading can function properly. Making the internal energy market a reality will depend above all on having a reliable and coherent energy network in Europe and therefore on infrastructure investment. A truly integrated market will contribute to diversification and thus to security of supply (<http://Europe.eu/cgi-bin/etal.pl>, read date 19.09.07)

Although the Internal Energy Market also includes market of electricity, I will continue to focus only on the natural gas market.

The objective of these common rules for the internal market is to gradually open up national gas markets to competition and to improve security of supply and industrial competitiveness (<http://Europe.eu/cgi-bin/etal.pl>, read date 19.09.07).

The development of 'the Internal Energy Market' which started, as mentioned above, with a package existing of four directives in 1989, continued with a new announcement of content in 1991, and expanded the internal energy market outside EU area in the European Energy Charter⁸ later same year. From 1988-95, the work to improve IEM, despite of extensive opposition from interest within the energy sector, and also governments. Even though the governments from EU member countries supported the idea of IEM, they had strong reservations about parts that directly affected their own national energy sectors. In other words, they supported the general concept, which they

⁸ See own paragraph later in same chapter 3.4..?

saw would bring benefits inside energy trade, but were cautious when it came to secede national control over energy policy. (Matlary, Janne H. 1997: 21-22).

However, a package of proposals for specific energy directives needed for ensuring free and fair competition in the electricity and gas sectors was adopted by the Commission and sent to the Council of Ministers for approval in 1989. The Commission presented the package as a first stage initiative, to be followed up by new directives that would eventually lead up to the establishment of a 'common carrier' system for gas and electricity across member states. A common carrier system would entail a system whereby any consumer could purchase energy from any supplier, regardless of ownership of the intermediary grid structures. This initial package also proposed a less comprehensive system, however, a 'common transit system' that would allow only national grid system operators to purchase electricity or gas across the territory of another member state. Widespread opposition in the council to a common carrier system prompted the Commission to embark on a stage-by-stage procedure.

There has been reluctance from the Member States to accept the idea of pooling their energy markets, particularly gas and electricity, and has been so strong that efforts to obtain their consent were doomed to fail for many years. The energy sector were labelled a 'strategic sector' but concrete policy advances proved difficult. The first success only occurred in 1996 with the creation of the Directive on Common Rules for the Internal Market in electricity followed by the Directive on Common Rules for the Internal Market in Natural Gas in 1998.

This pooling together of energy markets being a new phenomenon, attention was centred on securing an efficient and well-functioning internal energy market. In regulating this market, the discussion of internal security of energy supply came to the fore and dominated various policy initiatives. However, the discussion of external security of supply, namely the design of an efficient framework to guarantee security through relations with energy-producing countries, was overlooked. Demand management issues,

such as energy saving, energy efficiency, stock-holding obligations, climate change issues etc were increasingly addressed at the Community level, but dependence on external sources of energy was left aside or only touched upon en passant for quite some time. This aspect of security remained in the hands of the Member States (Haghighi, S.2007:4-5).

3.4 The Gas Directive

The liberalisation of European gas and electricity industries, by means of creating access to transmission and distribution networks along with the de-monopolisation of markets, and the abolition has been an extremely long process and in 2005 was far from being either complete or successful in many, if not most countries (Stern, J. 2005:129)

Virtually every stage prior to agreement in 1998, key principles of the Gas Directive were fiercely opposed by a majority of gas utility companies- and many important governments of major European Member States and most gas-producing companies.

After lengthy discussion and negotiations, the first EU ‘Common Rules’ Gas Directive was finally agreed by Member States in August 1998.

The Directive required the opening of markets to competition- so called liberalisation or ‘de-regulation’- commencing in August 2000.

The second Common Rules Gas Directive- the Acceleration Directive, was ratified by the European Parliament in July 2003, and provided for complete opening of markets by July 2007, as well as further corporate separation (legal unbundling⁹) of network assets and regulated access to networks.

⁹ Definition of unbundling; separation of accounts for different functions of integrated companies (Stern, J. 1998/9:91)

Transmission, storage, distribution and supply of natural gas were regulated in this directive. The main aim of the directive was to achieve a competitive market in natural gas. Public service obligations could be imposed that gave leeway to Member States in applying the provisions of the directive flexibly for security purposes, only if they are transparent, non-discriminatory and verifiable. Member States could undertake necessary activities to secure their own energy supply. Although the directive stated that the external supply of natural gas was of particular importance for the purchase of natural gas in Member States that were highly dependent on gas imports, no concrete measures to facilitate access to this supply at the external level was mentioned (Haghighi, S.2007:105-106).

This Directive was, as mentioned in previous paragraph, later replaced in 2003. The most important externality in this later directive is found in paragraph (5), where it is acknowledged that ‘in view of the anticipated increase in dependency as regard natural gas consumption, consideration should be given to initiatives and measures to encourage reciprocal arrangements for access to third-party networks and market integration.’ This provision can be said to be directly linked the discussion of security supply and the necessity of considering the dependence of the Community on external sources in internal measures. The directive does not design a framework for such a reciprocal relationship with third countries. It only imposes an obligation on the Commission to produce a general assessment of progress in bilateral relations with third producers or transit countries (Haghighi S. 2007:106)

3.5 Green Papers of 1988, 2000 and 2006

3.5.1 Intro

There have been several Green Papers the last 20 years or so stemming from the EU. The latest edition was Green Paper 2006. Previous is Green Paper 2002, and as early as in the late 1980's. I cannot go into detail in all of these different Green papers here, but I will make room for a short summery from these earlier mentioned, namely the Green Paper 1988, 2002 and Green Paper 2006.

3.5.2 Green paper 1988 “the Internal Energy Market”

The first draft to EU Commission's 'green paper'¹⁰ was put forward in 1988, regarding implementation of an internal energy market in Europe.

In a 1988 green paper entitled 'The Internal Energy Market', the Commission identified four procedures that would be applied in the creation of an internal energy market. The first involve implementing the *general single market provisions* in the energy sector (i.e. harmonisation of rules and technical norms, the opening up of public procurement markets and the removal of fiscal barriers). The second involved the determined application by the Commission of already existing *general EC Treaty Law*, such as the general competition rules. The third involved finding a satisfactory equilibrium between energy and the environment, and the forth, the application of additional, appropriate and specific case-by case means (specific energy directives) to be adopted by the Council (Eikeland, Per Ove-2004:1-5).

¹⁰ 'Green paper' is working paper that the European Commission is putting forward, to the involved parties. Sometimes they are followed up and lead to new laws and regulations. - www.europaveien.no

3.5.3 Green paper 2000 “Towards a European Strategy for Security of Energy”

The Green Paper of 2000 was entitled ‘Towards a European Strategy for Security of energy’¹¹.

This paper was at that time considered ‘the most important document reflecting the major concerns of Europe with respect to this security’ (Haghighi, S.2007:159).

The Green Paper sets the goals of guaranteeing uninterrupted physical availability of energy products on the market, at a price which is affordable for all consumers while respecting environmental concerns and looking towards sustainable development (ibid:159).

The Green Paper sketches the main pillars of a strategy to secure energy supply by focusing on (a) a demand policy, (b) real change in consumer behaviour through taxation measures, (c) the development of new and renewable energies, and (d) the analysis of the contribution of atomic energy (ibid:160).

3.5.4 The Green Paper 2002 (Communication from the Commission to the Council and the European Parliament, Final report)

The Green Paper of 2002 offers a clear strategy based on demand management. It has the merit of pointing out that the EU has little room for manoeuvre with regard to energy supply- due to its low, or in certain cases less competitive energy resources.

The report continues, that the debate on the Green Paper has shown the need to develop a Europe-wide security of supply concept which alone will enable Europe to control its energy future. As emerged from the Paris, Brussels and Moscow summits, the dialogue the EU is entering into with Russia aims to create a new energy partnership. Hopefully, this dialogue will make it possible to determine the best future use off long-term supply agreements and production sharing agreements, on which the representatives of industry

¹¹ COM (2000)

expressed some major concerns in the Green Paper debate (Final report 2002:1-5).

3.5.5 Green Paper 2006 on a European Strategy for Sustainable, Competitive and Secure Energy

The Commission, in spite of progress made with internal energy market since 2000, declared that there is a need to explore further avenues to guarantee energy security, competitiveness and environmental sustainability.

The 2006 Green Paper highlights six priority areas for the Community to focus upon in order to obtain a secure energy environment:

1) Completing the internal European gas and electricity markets, 2) solidarity between Member States, 3) stepping towards a more sustainable, efficient and diverse energy mix, 4) creating an integrated approach to tackling climate change, 5) establishing a strategic European energy technology plan, 6) establishing a coherent external energy policy.

In this 2006 Green Paper, the European Commission claims that in increasingly degree, EU must speak with one voice on the international arena. This in particular in relation to important producer countries, like Russia and Norway (EU-magasinet, 1-2006)

3.6 Relating events

Throughout the entire 1990's the EU have aimed at market relations- within the EU and internationally- in order to gain security of supply. These last years development, with unrest in the central petroleum provinces and increasingly political rivalry between import- dependent states, has created a radical different situation. It is increased importance on political dialogue and cooperation, as supplement and alternative to multilateral institutional and market establishment. Attitudes like these was expressed on EU's informal top meeting in Hampton Court outside London in October 2005. It was followed up by in top meeting in March 2006, with the proposals of a so called Green

Paper on energy. Officials of EU were highly occupied by/with the relationship to energy producing countries, in particular Russia, the largest gas exporter to the EU. Russia is the only one of the G8- countries that is also big exporter of oil and gas. This is a foreign policy card that they have to play. This can be witnessed by the negotiations with foreign companies that wish to participate in the Stochkman field development. At the same time, Gazprom seeks to enhance its position through an active downstream strategy, which would include the acquisition of companies in EU (Andersen, S. 05/06 2006:6).

We could read in a follow up to this discussion in Aftenposten September 20th, 2007- under the headline, 'THE EU will stop Gazprom';

The Russian company Gazprom has bought in eight gas transport pipelines. And now the EU Commission wants to stop this gas giant's raid in Europe. So the day before this article was in print, the EU Commission proposed a suggestion which would entail that gas companies or electricity companies cannot own distribution network. This means gas pipelines or power networks. The Commission wants an ownership dividing line, but is also open to that companies can own pipelines, but their operation are handed over to a independent company. In addition, will this be monitored by regulation authority.

EU's Energy commissioner, Andris Piebalgs said at the press conference, that competition should be equal for those companies that are inside, as well as outside the EU. Therefore the new directives in EU obstruct that a company that is a gas supplier to Europe, also buys in to the gas pipelines. In the proposal to new directives, a company from a third country, prove that it is not connected to a production company. It is not good enough that a subsidiary owns the pipelines. Piebalgs expressed that this was not directives directed towards Russia or Algeria. This was directives that would ensure EU's internal energy market is working. The goal is that this new agreement can be passed under the French presidency in the second half of 2008 (Aftenposten 20.09.07).

3.7 Decision making in the EU in the field of trade.

The legal bases for negotiations with third countries or international organisations are to be found in the treaties establishing the European Community: Article 133 (trade), Article 300 (agreements with a broader scope than trade, or article 310 (association agreements). In all cases it is the Commission that represents the Member States. It does not act autonomously but on a basis of a mandate adopted by the Council. During the negotiations, the Commission and the Council is in continuous dialogue with each other through the Article 133 or other specialised committee. (Hill, Christopher; Smith, Michael. 2005:72-73)

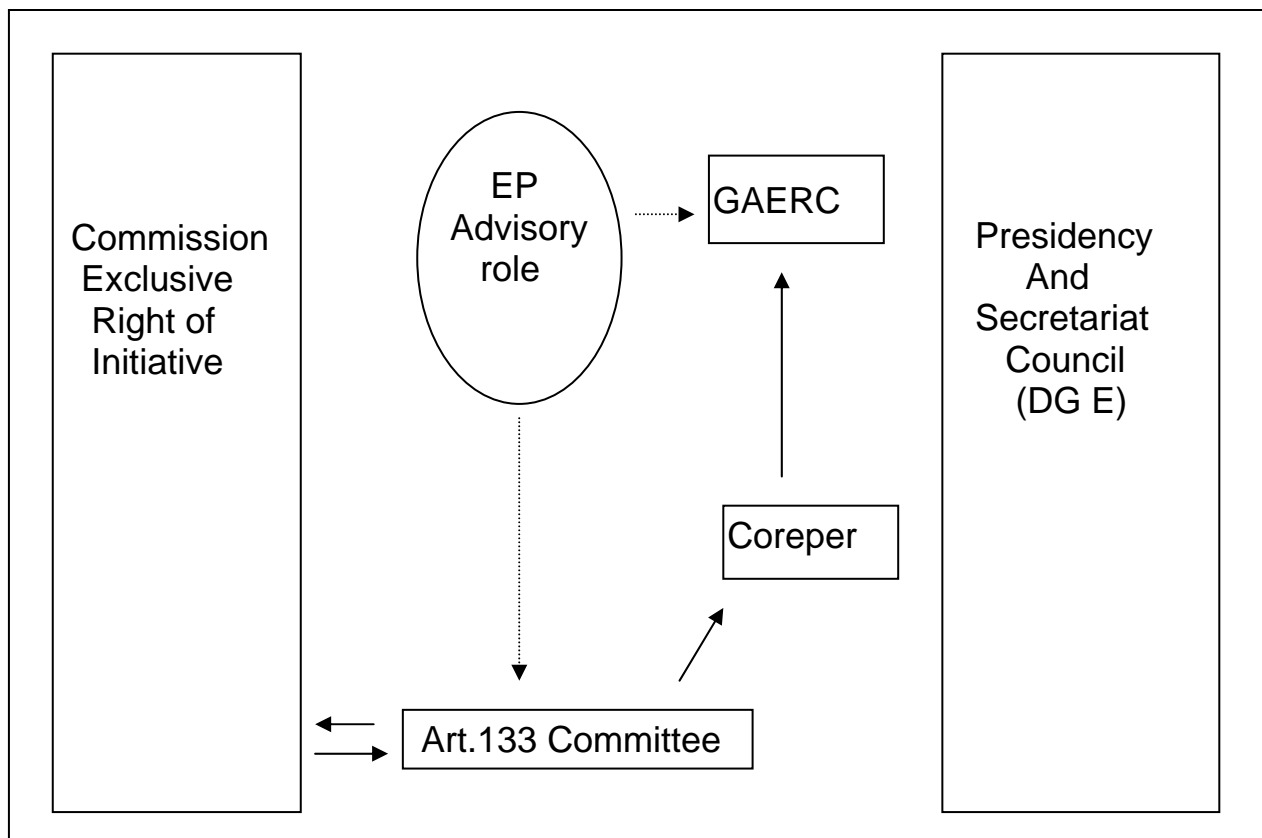


Figure 4.1

(Source; Hill and Smith 2005:72)

It is important to underline the factors influencing the price of natural gas and the nature of demand and supply. Generally large-scale gas consumption entails the installation of capital intensive gas using equipment (storage, gas distribution systems and so on) so that buyers need a guarantee of long-term supply over the period in which these capital costs can be recovered. On the other hand, because gas is costly to transport in liquefied form, suppliers usually need to install bulk supply lines to specific markets centers, and will look for the assurance of long-term contracted demands.

There is therefore a concerted market pressure towards the use of long-term contracts for disposal of new gas finds (Weyman-Jones, T. 1986:128).

These long-term contracts included 'take or pay' conditions which provided the guarantees for the multibillion dollar financing of the facilities. When the contracts and the financing were in place, construction commenced. Thus under the traditional system it was held impossible to build any significant infrastructure in the absence of long-term contracts which guaranteed adequate revenues to the producer and those investing in the facilities (principally the major transmission companies). In addition, the contracts provided a long-term guarantee that the facilities would only be used to transport gas from a specified source (usually, but not always, a particular field) such that the producer could not sell to any other buyer, and the buyers could not buy from any other source. If questioned about this system, the reply from all players was that this was the only way in which major developments could be financed (Stern, J.P. 1998/9:33).

3.8 The European Energy Charter Treaty

3.8.1 In general

In the effort to improve security of supply, maximize the efficiency of production, conversion, transport, distribution and use of energy is the objectives behind the European Energy Charter.

On December 17, 1991, at a conference in the Hague, the European Energy Charter was signed.

The signatories were all members of the European Community, Central and Eastern countries, Russia and all other states in the area of the former Soviet Union, the United States, Canada, Japan, Australia and several others. It embraces countries outside and inside Europe, east and west.

The Treaty was signed in Lisbon on 17 of December, 1994, and was put into effect by 1998.

The Treaty would take legal effect when 30 countries have ratified it, which was expected in 1996 (Martin, Imai and Steeg, 1996:39-44).

However, it was first in April 1998, after the ratification by the thirty countries had taken place, the Energy Charter Treaty (ECT) and its protocol entered into force.

The ECT sought to add protocols on nuclear issues, energy efficiency and hydrocarbons, but a compromise on these issues was difficult to achieve. The protocol on nuclear and hydrocarbons became too contentious and was put aside. Only the text of the ECT , along with the protocol on Energy Efficiency, was agreed upon (Haghighi, S.2007:191).

The conclusion of the ECT and the Energy Charter Protocol on Energy Efficiency by the European Communities and its Member States was deemed 'to help attain the objectives of the European Communities'. These objectives was explicitly revealed as allowing the members of the Common Wealth of Independent States and the Countries of Central and

Eastern Europe to develop their energy potential while helping to improve security of supply. Therefore, the ECT was considered a step in guaranteeing Europe's energy supply (Ibid:192)

The charter is not an operational document and has no compulsory effect. Rather, it sets a political framework for further commitments to be undertaken in specific agreements. The first such agreement, initially called the Basic protocol, was expected to establish only a general framework for cooperation; but the EU Council insisted that this framework should have a legally binding character, establishing precise rules of conduct to be implemented in the national legislation of the participants. This view was accepted by the other partners (Dore and De Bauw, 1995:5)

By 2004, the Treaty had been signed by 51 European and Asian countries plus the European Union. Of those 51 countries, only five had failed to ratify the Treaty. This means that the majority of OECD states and former Soviet republics have ratified with notable exception of Russia and Belarus (Stern,J:2005:136).

3.8.2 Four Major Stages in the Energy Charter Treaty negotiations by Svein S. Andersen

Svein S. Andersen has in an article, or rather a draft, contracted the negotiations into four major stages¹², and I will here try to summarize the most important points to these four major stages in this paragraph.¹³

The future of the Energy Charter Treaty is unclear, but Andersen says that it provides a framework for the international energy sector that is to be used more actively in the present pursuit of increased energy cooperation between the EU and Russia. It also plays an important role in the present discussion about bringing energy into the WTO.¹⁴

The dynamics of the negotiating process and the space for outcomes were governed by contextual factors; political, economic and legal, which provided direction to the process and restricted the possible outcomes.

The Energy Charter and the Treaty represents the first comprehensive *agreements* common to the East and West after the end of the Cold War.

The negotiations over of the Charter Treaty demonstrated that international negotiations may have considerable dynamics of its own. The process takes place in context characterized by overlapping and competing hierarchical principles and rules. Actors invoke, activate, negotiate and reinterpret content and implications of various institutional elements, as well as hierarchical and horizontal relationships between such elements. In this way the process illustrates that the institutionalization of a new order is not only a

¹² I was handed over this article/draft personally, and do not know if this has been published by this time.

¹³ These four stages appeared also in my earlier home exam paper (STV 4230 b) fall semester 2006.

¹⁴ I will not to into the discussions regarding Russia's application to join the WTO here.

question of deducing implications from a higher order institutionalized principles and rules.

The collapse of communism led not only to erosion of traditional state roles in the Eastern European countries, but also inversion of state and market principles. Also in the West market ideology was on the offensive in the energy sector. The coupling between the Energy Charter Treaty negotiations and existing international agreements governing economic exchange reinforced this dynamic and limited the interest that legitimately could be expressed in the negotiations. Such elements provided the context for effective strategies in the negotiations.

Stage 1. Vision and political mobilisation

This stage lasted from the introduction of the Charter initiative in the summer 1990 to the signing of the Charter in December 1991. Andersen, in this draft, continues to distinguish between two different phases in this stage. The introduction of the Charter initiative and the Charter negotiations.

The fall of Berlin wall in 1989 and the development in the Soviet Union created a need for a reorientation in the EU's relationship to the East Bloc countries. The European Energy Charter was conceived by the Dutch prime minister Ruud Lubbers. The EU top meeting in Rome December same year decided that Europe needed a lasting co-operation in energy. The result was a broad invitation to 'all countries concerned' to participate actively in the making of the Charter. In the first round the continuation of the Charter initiative was mainly a question of winning support for a political declaration of principles from other participants outside EU.

The negotiations over the Energy Charter were characterized by a general support for the overarching political objectives. At the same time it was clear that increased economic

integration between East and West had to be anchored in a market perspective. The Commission proposal appeared to be robust. Most proposals and suggestions did not alter the main perspective. The emphasis on a European market as part of a larger international one, and the clarification of the relationship to other international ones, only serve to support the core of the proposal. Attempts to strengthen energy policy state roles and environmental concerns were more problematic. The issues of energy policy and state role reflected a central Russian concern, but also the relationship between a small number of energy exporters on the one hand, and the large majority of import dependent consumer countries, on the other hand.

The signing of the Charter in Haag represented a milestone in the attempt to establish an international framework for energy.

Stage II. From sector regulation to market regime: changing ambitions

The second stage started parallel to the completion of the Energy Charter in the fall 1991, and it lasted until the spring of 1992. It took place in a situation characterized by increased dissolution in the East. Within the Energy Charter negotiations this period can be viewed as a search for a model that could serve as a basis for the institutionalization of international co-operation in the energy sector. For a while there was a tension between adherents of the political cooperation model, and those pushing for a more ambitious and independent market regime.

Two sets of concerns dominated the discussions. One was how an energy regime would relate to other international regimes and established concepts of international law as defined in GATT(now WTO). The other was what such concepts implied for the participating countries, in terms of energy and general political concerns.

A major challenge was to bridge between general market principles and sector problems. Another challenge was to handle the increased conflict potential that would arise when

negotiations shifted from political declarations to legally binding text that should also be consistent and under stable.

Originally the Charter was not supposed to be a legally binding, except when articles were specified through individual sector protocols. This meant that there would be room for negotiations of details on the sector level.

Stage III. Market reform and complexity: From idealism to Realism

Stage III lasted from summer 1992 to December 1993. In this stage the negotiations may be regarded as a collective learning process where increasing complexity pushed towards a simplification. The question was not whether to go for a comprehensive market regime, but how to formulate it and how to deal with special problems of the former East Bloc countries. The fall 1992 was also the start of a comprehensive privatization program in Russia. At the end of this period, the fall 1993, the problems of Russian politics and economy were dramatized through the Ruble crisis and the dissolution of the Russian parliament by military power. Russian oil production fell dramatically. The problem was not only that foreign companies were unwilling to invest in Russia. Also domestic oil companies with available investment capital placed it in other economic activities (in Russia) or abroad.

The Western countries had dominated the two earlier stages. Now, however, the countries from former Soviet and Eastern Europe tended to be more active in formulating their own problems. It became clearer that there was a major difference between the removal of barriers to market forces, on the one hand, and to establish fundamental market institutions, on the other hand. The EU, US and Russia increasingly became the active core in the negotiations.

Early in 1993 three elements increasingly appeared to be underlying the further negotiations that hopefully would be concluded within a few months. First, the agreement should be based on broad, but specific market principles, with little room for sector discussions. Second, it was decided that the Basic Agreement should be renamed the *Energy Charter Treaty*.

The agreement should strive for ambitious market principles as a framework for long-term development. Third, the problems which individual countries might have in relation to the Treaty, particularly in the former East Bloc countries, should be handled through transition arrangements that did not undermine the principles of the Treaty.

Already since the summer 1992 a considerable effort had taken place to map the needs for transition arrangements in the former East Bloc countries.

Originally, it was thought that all countries had to incorporate Treaty standards in their own legislation and regulation by the end of 1998. During the spring of 1993 it became clear that not all countries were able to do this, and, even worse, some countries could not even commit themselves to a specific implementation date.

At the conference plenary meeting (June 28- July 2 1993) Russian representatives expressed their wish to conclude the negotiations before the end of that year. There would be a need for exceptions over a period of time, but it was emphasized that Russia's priority would be to attract foreign investment to assist with modernization and development of their energy sector. The Charter Treaty would be essential to that aim.

In contacts between Russian authorities, the Energy Charter secretariat and the core countries of the negotiations-EU and the US- several possibilities for transitional arrangements were discussed. There were concerns that Russian inability to guarantee that its future legislation will comply with the investment rules of the Energy Charter Treaty, which was also strengthened by Russian parliament members. It was suggested that it could be difficult to gain acceptance for equal treatment between national and foreign companies.

In early October a new concept started to take shape, and in this process EU played an active role. It was a two-step approach. The new proposal gave equal treatment to all countries, but it introduced two stages in the negotiations. All countries should sign the part of the Treaty (T1) which covered trade and post investment. Here the principle should be full GATT rights and full equal treatment of investors. In addition the first treaty should also contain rules for dispute resolution.

The break through for a new two-stage concept reduced complexity and removed the most important obstacle for a conclusion of the ongoing negotiations.

At the same time this development represented another step away from the original objectives of the Charter initiative, namely the short- term reduction of uncertainty regarding access to resources and a stable environment for investment in Russia.

Stage IV: Compromise and holes in the market system

In the last stage it was specification and clarification that dominated within the framework that had been laid down in December 1993. This stage marked an increased weight on the removal of factors blocking trade and competition. Although the two-stage approach had postponed fundamental questions concerning market rules in the pre-investment stage, it still would take a whole year before the first Treaty could be signed. It was particularly four issues that took time, of which three were related to trade.

First, it was the relationship to EU's internal rules which, in certain areas provide exceptions, and which could be affected by the Treaty.

Second, there was the relationship between EU and Russia, where EU in the bilateral agreement wanted exceptions when it came to trade with uranium.

Third, the Americans would not accept that the signing of the Treaty automatically changed Russia's position in relation to the Jackson- Vanik Act.¹⁵

¹⁵ According to the [1974](#) Trade Act of the [United States](#), the **Jackson-Vanik amendment**, named for its major co-sponsors, Sen. [Henry "Scoop" Jackson \(D-WA\)](#) and Rep. [Charles Vanik \(D-OH\)](#),

The fourth problem was the strong opposition from Norway, the major Western oil and gas exporter, to formulation, which could threaten state sovereignty.

After intense negotiations which lasted until the signing ceremony started in Lisbon it became clear that Russia would sign the Treaty. It was particularly important to EU that had initiated the whole Charter (and Treaty) process. Russia did not succeed in making changes to the final text. Instead they were allowed to make 'declarations' in a special document, which the Charter Conference supported. The Russian declarations concerned capital transfers and uranium trade.

The Treaty was signed by a majority of the participating countries at the December 17 meeting.

Russia is still one of the few countries that have not ratified the treaty. This does not mean that the Treaty has no effect. It represents a normative framework that cannot be completely ignored. Presently, the EU wants to push for Russian ratification and an active use of the Treaty as a basis for further energy dialogue and cooperation.

denied [most favored nation](#) to certain countries with non-[market economies](#) that restricted [emigration rights](#). Permanent normal trade relations would be extended to a country subject to the law only if the [President](#) determined that it complies with the freedom of emigration requirements of the amendment. However, the President had the authority to grant a yearly waiver to the provisions of Jackson-Vanik, and these waivers were granted to the [People's Republic of China](#) starting in the late 1970s and later to [Vietnam](#). (http://en.wikipedia.org/wiki/Jackson-Vanik_amendment)

3.8.3 From Russia's standpoint

As we now know, Russia has of today failed to ratify the Treaty, and by the time of December 2006, indicated that this was unlikely due to the provisions requiring Third Party Access(TPA) to Russia's pipelines.

(http://en.wikipedia.org/wiki/energy_charter_treaty).

In retrospect, the Russian delegation hoped that the Energy Charter would encourage investment activity in their energy sectors, an one official stated that ' it is our confident belief that his document will help Russia become a powerful and flourishing country...it will determine areas for development of energy for many years to come'. Delegates were also convinced that Russia needed the Energy Charter Treaty to buttress the short-term survival of the country's oil industry and secure its ability to stabilize exports, thus ensuring the continuance of hard currency earnings(Dore and De Bauw 1995:23)

However, representatives of the Russian Parliament and Russian companies and administrative bodies, were generally less convinced that Western investment would provide the solution to the problems of their energy industry, and were more concerned with protecting Russian economic interest. Opening markets to widespread Western investment in oil and gas was perceived as a danger, since Russia might thereby be forced to loosen control over its most strategic industries. Russian equipment suppliers could also suffer if incoming foreign companies stuck their traditional suppliers and were unwilling to use Russian equipment. Several economist and tax specialist see the necessity for temporary protection of the Russian economy in the oil and gas sectors, and believe that, given time, Russian products will be extremely competitive on the basis of both price and quality.

Given the different position of the liberal minded Russian negotiating delegation and parts of the government on the one hand, and the more conservative Parliament and industrialist on the other hand, the Russian stance towards Energy Charter Treaty was slightly ambiguous.

The negotiating delegation, though in favour of the objectives of the Charter, had to take these different positions into account and to balance the demands of different actors(Dore and De Bauw, 1995:23-24)

Two substantial problems dominate the future of Russian gas exports to Europe, both of which have arisen in the post-Soviet period.

The first of these is Transit; a direct consequence of the break-up of the Soviet Union which will continue to remain unresolved until a multilateral agreement covering Eurasian gas markets is concluded. The Transit Protocol of the ECT is such an agreement but neither Gazprom nor the Russian government has yet to come to view the Protocol as a better answer than bilateral negotiations with transit countries.

The second problem concerns the rapid change in European gas markets, which have been extremely important for Russian gas and Gazprom during the post-Soviet period, but loom even larger in an EU already expanded to 25 (27 today) member states. (Stern, J.2005:167)

3.8.4 Security of supply issues in the ECT

While fully recognizing the sovereign rights of the participating countries over their energy resources, the Charter Treaty carefully avoids dealing with production levels and prices. No explicit reference is made to the need for market stability, a concept and an objective familiar to many in the oil sector even if it proves difficult to achieve. However, in its preamble the Treaty refers to ‘the necessity of a most efficient exploration, production, conversion, storage, transport, distribution and use of energy’, indicating that

the Charter and its Treaty do indeed aim at creating a more stable market.

Article 1 of the European Energy Charter Treaty declares that ‘the signatories desire to improve security of energy supply...on an acceptable basis’. No article of the Energy Charter Treaty echoes specifically this desire. But many, if not all Treaty provisions contribute to its fulfillment, in particular those related to transit, to investment, promotion and protection, and to dispute settlement.

Security of supply is a more important objective to some Treaty signatories than for others, depending on their natural endowment with energy resources. Increasing energy supply security of the ‘have nots’ is beneficial also for the ‘haves’, in so far as it involves, as a trade-off, removing obstacles to trade within a free-market context, increasing foreign investment for the development of domestic resources, and guaranteeing free access to consumer markets. (Dore and De Bauw)

3.8.4.1 Long- term vs. Short- term security

The energy security issues may entail various time dimensions such as short and the long term. Short- term security covers the risks of disruption to existing supplies due to technical problems, extreme weather conditions or political disruptions. By contrast, long-term security focuses on the risks that new supplies may not be brought on stream on time to meet growing demand. This may be due to economic, financial or political factors that inhibit necessary investment in production and transport capacity. (Bielecki, Janusz 2002:237)

3.9 Transit in the ECT

Because of the relevance of the transit negotiations between EU and Russia, it is important to give a short elaboration of the Transit Protocol here.

One of the most controversial articles in the Energy Charter Treaty is the one on transit of energy products, materials and equipments. And the negotiations are still ongoing. The article obliges contracting parties to take ‘necessary measures’ to ‘facilitate transit’.

This means, they shall apply the principle of freedom of transit and they should distinguish between materials, products and equipment as to origin, destination, ownership and, pricing , and they should allow transit without imposing any unreasonable delays, restrictions or charges (Haghighi, S. 2007:323)

The Transit Protocol does not contain any obligation on mandatory third party access to energy transport facilitates for transit. And, there are no provisions codifying a common approach to the public regulation of natural monopolies and only a reference is made to prohibition of the abuse of a dominant position in the transit sector (ibid.2007:325-326).

The second controversial issue was the ‘Regional Economic Integration Clause’, as provided in Article 20 of the Transit Protocol. This Article provides that the ‘Area’ of a contracting party referred to in Article 7(10)(a) (ie where transit take place) shall, as regards contracting parties which are members of a Regional Economic Integration Organisation (REIO), cover the area to which the treaty establishing such a REIO applies.

The obligation on such REIO is that they should ensure that the provisions of their establishing treaty treat energy materials and products originating in another contracting party and in free circulation in its area no less favourable than energy materials and products originating in its constituents Member States.

The European Community will be considered as ‘one Area’ within the definition of Article 20 of the Transit Protocol. Therefore, energy that is originated in a third country, which is passing through the territory of the European Community and is destined for another third country, will be subject to the rules of the Transit Protocol. In this case, the

European Community as a whole is considered as a transit country and subject to the rules of the Transit Protocol. Hence, the constituent members of EU will not be considered as transit countries (ibid.2007:330).

The third controversial issue in the negotiations on the provisions of the Transit Protocol was related to transit tariffs. The Transit Protocol provides rules for the imposition of tariffs by the transit country. Usually the transit country can either impose tariffs on the energy in transit or take some of the energy in transit for its domestic use. The transit tariffs design of the Protocol provides that each state shall take such measures that are necessary to ensure that transit tariffs are objective, reasonable, transparent, and non-discriminatory. Transit tariffs are cost-reflective, and the amount is calculated using objectively determined costs, which include ‘operational and investment costs, and a reasonable rate of return’ (Haghighi S, 2007:333).

3.10 Third Party Access

Energy is a network-bound sector, which means that it has certain characteristics. They are strongly dependent on a fixed network, which represents either a natural monopoly or a de facto monopoly. Within the European Union, competition policy tends to regulate the activities of these network-bound industries and guarantee competition. In the effort to bring the national energy regulatory systems of each Member State into line with principles of the internal market, one important step was to guarantee access to these networks to new market entrants, in other words, third party access (Haghighi S. 2007:326).

3.11 Russia's Energy Policy

3.11.1 in general/intro

The vast energy resources in the area of the old Soviet Union gave energy a central place in its economic and political life. This remains the case for Russia and even more so for some of the Newly Independent States formed out of the old Soviet empire in Central Asia and the Caucasus (Martin, Imai, Steeg.1996:39).

The European Union is Russia's largest trading partner- 50 percent of Russia's trade is with EU countries- although Europe is more important economically to Russia than Russia is to Europe, and Europe is Russia's largest export market. Russia's major economic significance for Europe- one that will grow over the next decade- is as an energy provider (Stent, Angela;2007:425).

Following the break-up of the Soviet Union in 1991, geo-economics and geopolitics moved to the top of the agenda in terms of trade and transit of former Soviet gas. As far as the former Soviet States were concerned, formal commercial relationships needed to be created, where none had existed, in a climate of unrealistic commercial expectations and resentment which had barely submerged in opaque Soviet politics. For the Russian Federation, two distinct markets for gas exports evolved: the 'near abroad' CIS countries or former Soviet republics; and the far abroad countries of Europe.

The break-up of the USSR caused immediate and continuing problems in gas trade between all the republics. The essence of these problems was a demand for gas and transit tariffs to be paid for at prices and in currencies that (with the possible exception of Russia) none of the recipients could afford.

Refusal and/or inability to pay resulted in the amassing of huge debts to suppliers (principally Russia and Turkmenistan) and periodic cutbacks in supply because of non-payment. When Gazprom reduced deliveries because of non-payment, this action caused not only hardship but, in cases where gas has been in transit to European markets, the

diversion of supply intended those markets. For European observers, the most visible manifestation of these problems has been in Ukraine and Belarus, but similar events have been common in trade between Central Asian and Caucasus countries. These transit problems account for Gazprom's repeated attempts to gain ownership and control of the pipeline networks through which its gas travels to Europe (Stern, J. 2005: 66-67).

Up to 1994, Russian trade with CIS countries was handled exclusively by Gazprom. After that date, fragmentation of suppliers presented increased statistical challenges.

It is often said that Gazprom acts as an agent of Russian foreign policy.

It is no accident that all gas trade takes place under the umbrella of intergovernmental agreements, or that all commercial gas agreements are approved and signed by presidents and prime ministers (Ibid:102-104).

The refusal of Russia to ratify the Energy Charter Treaty and its Transit Protocols is, at least in part, a determination to resolve transit at a bilateral level rather than lose control of the process to an international dispute settlement.(Ibid:107)

The first Soviet gas exports to Europe were delivered to Poland in the mid-1940's, but large -scale gas exports to Czechoslovakia began in 1967 with Austria receiving its first gas the following year.

Russia is thus well into its fourth decade as a major gas supplier to Europe, and its second decade as a supplier to post-cold war reunified Europe. (ibid:109)

Gas has strengthened its reputation as an irreplaceable fuel, and there is ever growing demand for it. Russia possesses the largest potential of gas resources (about 40% of the world reserves) which can provide a high gas production level at present and over long-term period. (*Petroleum Economist-the energy sector of the former Soviet Union 1975-1995.- published by the Petroleum Economist Limited in London, 1993*). And even though this was written in 1993, it is still relevant.

These vast energy resources in the area of the old Soviet Union gave energy a central place in its economic and political life. This remains the case for Russia and even more so for some of the newly independent states formed out of the old Soviet empire in Central Asia and the Caucasus. (maintaining energy security in a global context; Martin, Imai and Steeg, 1996:39-44).

The gas industry has largely retained its centralized structure from Soviet times, preventing a disintegration of central investment allocation. The gas sector was in 1995 dominated by one major company, Gazprom. Gazprom was born from the former Soviet Ministry for Oil and Gas and is responsible for all business activities in gas, ranging from securing investment and maintaining production and transportation to contracting exports. Gazprom has maintained a surprising degree of coherence in the industry since the break up of the Soviet Union, and the gas industries of all former Soviet republics save Turkmenistan are still linked through a close network of investment and export coordination (Dore and De Bauw 1995:16)

3.11.2 Gas trade and transit

As I started the third paragraph 3.4.1 with, in the following of the break up of the Soviet Union in 1991, geo-economics and geopolitics moved to the top of the agenda in terms of gas and trade of former Soviet gas. For the Russian Federation, two distinct markets of gas exports evolved: the ‘near abroad’ CIS countries or former Soviet republics; and the ‘far abroad’ countries of Europe.

Transit of gas is a key issue inter-republic trade, and trade with Europe. There are two essential aspects to this transit: (1) All pipelines taking Central Asian gas exports outside the region pass through Russia, putting Gazprom in complete control of those supplies.(2) in the past, virtually all Russian gas exports to Europe needed transit through Ukraine, and around 15 per cent also passed through Moldova.

The break up of the USSR caused immediate and continuing problems in gas trade between the republics. The essence of these problems was a demand for gas and transit tariffs to be paid for at prices and in currencies that (with the possible exception of Russia) none of the recipients could afford. Refusal and/or inability to pay resulted in the amassing of huge debts to suppliers (principally Russia and Turkmenistan) and periodic cutbacks in supply because of non-payment. When Gazprom reduced deliveries because of non-payment, this action caused not only hardship but, in cases where gas has been in transit to European markets, the diversion of supply intended for those markets. These transit problems account for Gazprom's repeated attempts to gain ownership and control of the pipeline networks through its gas travels to Europe (Stern, J; 2005:66-67).

3.11.3 Gazprom

The Gazprom 'kontsern' was created by Victor Chernomyrdin in 1989. He also became its first president and subsequently, a long-serving prime minister of the Russian Federation.

By the end of 1992, Gazprom Kontsern had become Russian Joint Stock Company- a partly privatised joint stock company. In February 1993, the company was registered as Open Joint Stock Company. Gazprom and the government issued licences to the company under the subsoil law of 1992, granting it the right to explore for and produce hydrocarbons. From 1993 to 2004, the ownership structure of the company changed remarkably little, with the Russian government holding 35-40%, Russian legal entities 35-40%, Russian individuals (including Gazprom employees 15-20% and foreigners 10-12% (Stern, J. 2005:170)

In an article in Aftenposten (12.11.06) by Per Kristian Aale, he says that the Russian Gas Giant has become a model for Putin's Kremlin-controlled state capitalism. The opposition in Russia claims that Kremlin actively uses Gazprom as a political weapon in their foreign policy, not least against neighbour countries. Gazprom has been a tool for Kremlin in the

bitter conflicts between Russia and the neighbour countries Ukraine and Georgia. When Kremlin have wanted bigger control over former Soviet republics, Gazprom has followed by threaten to turn up gas prices, if the neighbours don't act as expected.

3.12 Partner and Cooperation Agreement (PCA)

The Partner and Cooperation Agreement came into force in 1997. And it is considered as the legal basis for the relationship between EU and Russia. Its main objective is to create an economic and technical assistance framework, to ultimately establish a free trade area with Russia, and to further facilitate Russia's accession to the World Trade Organisation (WTO).

The agreement took account of the willingness of the EU to provide technical assistance for the implementation of economic reform in Russian and for development of economic cooperation.

Regarding energy relations, Article 65 of the PCA designed the cooperation to include improvement of the quality and security of energy supply.

The cooperation tends to strike a balance between security of energy supply and assisting Russia in overcoming its shortages in the energy sector. (Haghighi, S.2007:343)

The Partnership and Cooperation agreement and the energy dialogue were initiated as economic cooperation and were based on the provisions of the Treaty Establishing the European Community. One may wonder why such separate EU-Russia energy relations were initiated when the Energy Charter Treaty could have been used as the platform for such cooperation (Haghighi, S.2007:348).

3.13 The EU-Russia Energy Dialogue

A high level Energy Dialogue, in a EU-Russia Summit in Paris, October 2000, was created with the following objectives;

- To make progress on the definition of an EU-Russia energy partnership
- To contribute to energy security
- To cooperate on energy savings
- To help rationalise production and transport infrastructure
- To facilitate investments
- To contribute to producer/consumer relations
- To support the Energy Charter Treaty

The institutional background to the Energy Dialogue is the 1994 EU-Russia Agreement on Partnership and Cooperation which covers the period 1996-2006.

From the EU side, the energy dialogue demonstrated the new form of relationship that Brussels intended to create with the Union's major energy suppliers.

The institutional aim of the Energy Dialogue is to develop a long-term Energy Partnership within the framework of the overall Partnership and Cooperation Agreement.

After four years of discussion, the Commission made an assessment of the Dialogue, which was relatively upbeat. In particular it claimed that the intention of the November 2000 Green Paper on security to strengthen competition in the internal energy market, to defend sustainable development and guarantee external security of supply- has been translated into concrete action in the framework of the Energy Dialogue with Russia. It claimed that the Dialogue had made possible investments of the EU Companies in Russia, and Russian companies in the EU, and resolved problems that companies could have encountered. It also claimed that the dialogue had put in place conditions for long-

term energy supplies by supporting building and modernisation of infrastructure and establishing safety rules (Stern,J.2005:134-135)

CHAPTER 4; ANALYSIS OF THE NEGOTIATION AND OUTCOME

4.1 Intro

As we have seen in previous chapter, there have been several attempts by the EU to come to some agreement with Russia, and as especially regarding measures that can help to secure energy supply to the EU.

Especially, the Energy Charter Treaty is highly important and significant here, and will be the focus of this analysis.

Two level games approach is a theory of international bargaining.

Informed by the rational-choice theory, it also offers the analyst guidance as to which domestic 'factors' are likely to be most crucial, and thus seek to move the discussion of the domestic determinants of foreign policy beyond the stage of ad hoc checklists.

Continually, two level games approach recognizes that domestic policies can be used to affect the outcomes of international bargaining, and that international moves may be solely aimed at achieving domestic goals.

The last, and most distinctive element in the two-level games approach is its typology and analysis of strategies for simultaneously exploiting both levels in a bargaining situation (Moravcsik,1993:16-17).

4.2 EU as a Chief of Government (COG)

As Moravcsik starts his paragraph on page 15, in his article, that statesmen are typically trying to do two things at once; that is, they seek to manipulate domestic and international politics simultaneously. Diplomatic strategies and tactics are constrained both by what other states will accept and by what domestic constituencies will ratify.

The chief negotiator is the formal link between level I and level II. It simplifies the analysis that the COG has no independent policy views, but acts as merely as an honest broker, or rather an agent on behalf of his constituents (Putnam,1988:456).

This is highly relevant when one look at the EU in the role of a Chief of Government. The European Commission, is perhaps more accurately as they put forward proposals for their constituents (or rather; the Member States of the EU) to agree on, this being level II, and when they interact on the international level (level I), on behalf of the European community.

That the negotiator is negotiating on behalf of his constituents opens the possibility that the constituents may be more eager for an agreement than he is. It is to believe that it is in the best interest of the European Union to come to an agreement with Russia, in respect the secure the safety of energy to the EU from Russia.

Head of the European Commission would in this case be the Chief of Negotiator, as he is the formal link between level I and level II players. Said in more practical terms, the Head of the European Commission is the link between the Member States of the European Union and the Russian delegation to the Energy Charter negotiations.

4.3 The EU as a two level game player

The negotiation process which is conveniently decomposed down to two stages; Level I, which is bargaining between the negotiators, and Level II; which is separate discussions within each group of constituents. But this is not necessarily descriptive accurate. Because in practice, expectational effects will be different.

As we could witness with EU, and in a prior negotiation process.

The EU delegation was negotiating the Treaty on behalf of the individual member states, a common position on Charter provisions had to be found in advance between all EU

member states. If one state refused to adopt this common position, the EU was incapacitated.

In negotiations, the two level process may be iterative, as the negotiators try out possible agreements and probe their constituents' views.

As the initiator of the charter, the EU would try to avoid such a situation and would seek to integrate all member state positions within its common negotiation stance.

The need for Level II ratification is certain to affect the Level I bargaining, as what was illustrated in the EU above.

Whereas the fundamental problems with accepting the idea of pre-investment national treatment related to Western negotiating parties, the inability of the Central European Countries and the FSU- including Russia- to sign up to national treatment for all stages of investment finally enabled a compromise on national treatment. Despite the explicit support of the Eastern delegations for the main Treaty principles of non-discrimination, national treatment, the prevalence of market forces and national sovereign rights over energy resources, it soon became apparent that many of these states would not be able to sign up to key Charter commitments. Eastern delegations had applied for transitional status on several articles central to the Charter, which would allow their countries to adopt certain provisions at a date to be specified in the Charter Treaty.

This difficulty emerged in the midst of political crisis in the Russian Federation, with relations between President Yeltsin and his conservative Parliament deteriorating rapidly. As the need to signal support for the reform process in Moscow to the Russian Parliament became increasingly urgent, the EU delegation proposed a compromise that could at least enable a conclusion to be reached between the major negotiating parties-the EU, the Russian Federation, and the United States. This proposal, however, foundered because Russia felt unable to sign up to the key article on the promotion, protection and treatment of investment, which enshrines the main Charter principle of non-discrimination.

Although the Russian delegation re-emphasized its support for the national treatment

principle, it did not see itself able to undersign this commitment without sufficient national legislation in place to guarantee compliance with the Charter and without full parliamentary endorsement of the major investment principles. It would have been useless or even counterproductive for the Russian delegation to sign up to a treaty that would not be welcomed, much less ratified, by parliament. The Russian position caused a deadlocked of negotiation over the summer months of 1993. (Dore and De Bauw 1995:31-32)

This process of negotiations can be illustrated by these figures of negotiations between level I and Level II;

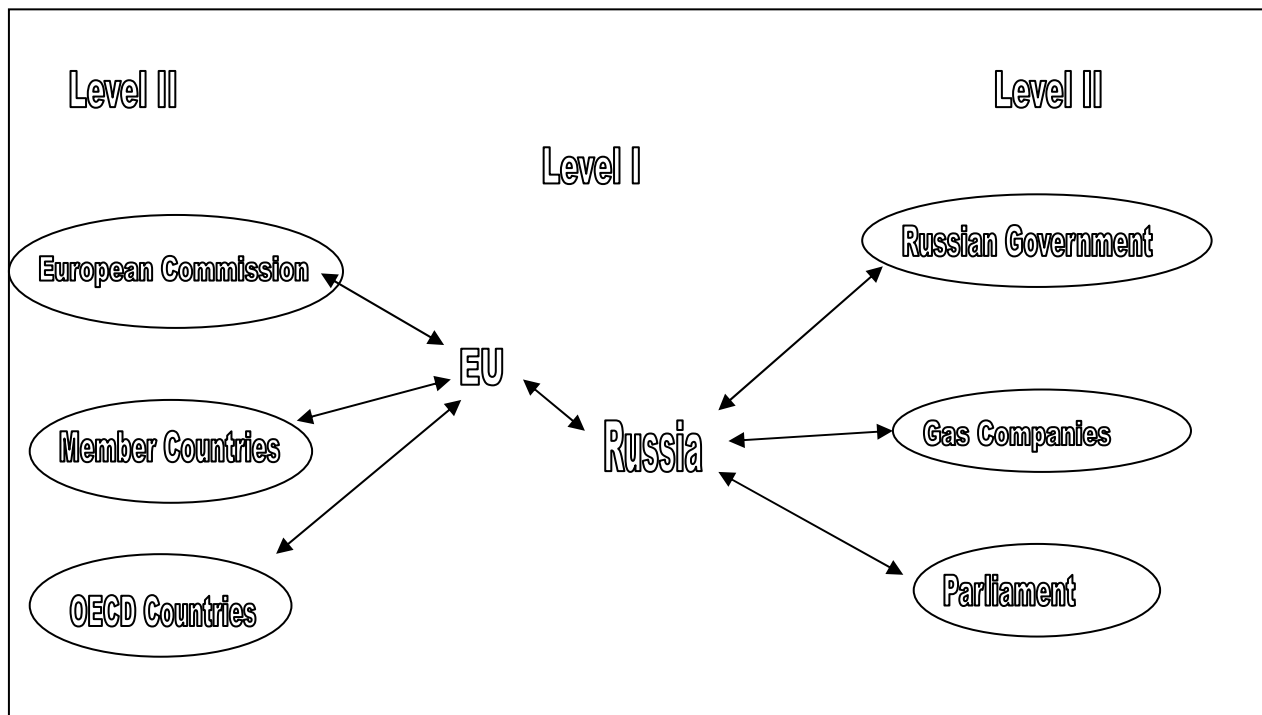


Figure 4.1¹⁶

This iterative process that Putnam speaks of, can be also understood more descriptively by Dore and De Bauw as they continue in their analysis of the Charter negotiations. In a major diplomatic effort to accommodate the difficulties of Russia and other former Soviet

¹⁶ This figure was inspired by Ivar Tvede's Master Thesis of Fall 2006.

republics, the EU delegation then put forward a novel proposal during the plenary session in October 1993, which suggested a new two-stage approach to the signing of the Charter Treaty.

A distinction would be made between the conditions applying to existing foreign investment, for which national treatment would be the rule following the signature of the Energy Charter Treaty, and those applying to the act of making investments, for which national treatment would be postponed for a three-year period until the conclusion of the second treaty.

The Russian delegation greeted this proposal enthusiastically, as the Energy Charter also was being used as a tool in domestic policy arena in Russia.

The delegation negotiating on behalf of the European Union became increasingly interested in bringing the Energy Charter Treaty to a rapid conclusion. On the one hand, it was hoped that the Charter Treaty could support the reform process in Russia at a time when tension was increasing between the reform-oriented Russian government and the conservative Parliament. On the other hand, the European Commission had an interest in completing the Charter negotiations as quickly as possible, in order to maintain its credibility as a leader of international policy initiatives. It was also in favour of rapid conclusion in Russia, as the Russian delegation became more and more interested in using the Energy Charter Treaty as evidence to convince Parliament that pursuing a reform course in Russia was the only way for the country to gain Western support (Dore and De bauw:36).

In order to regard the EU as a successful two level game player, there are certain criteria that have to be in place. Such as the EU, must have control over both Level I and Level II. In addition, there is a question whether the chief of negotiator distances him self from a regular authoritative figure. Is the EU able to achieve results they otherwise wouldn't achieve?

4.4 The different interests of the EU and Russia in the European Energy Charter

Both the EU and Russia had interests to meet an agreement with the Energy Charter Treaty. But one could say that the interests were not alike. One of the objectives to the EU was hoping to achieve through the negotiations of the ECT was furtherance of democratic reform and restructuring in the former communist states. While, the Russian delegation hoped that the Energy Charter would encourage investment activity in their energy sectors. Delegates were also convinced that Russia needed the ECT to buttress the short-term survival of the country's oil industry and secure its ability to stabilize exports, thus ensuring the continuance of hard currency earnings. The political intentions by the EU were coupled with economic interest. Cooperation between the energy sectors of the East and Western Europe was intended to give the states of the European Union the opportunity to gain better access to the vast energy resources of the former Soviet Union. But representatives of the Russian Parliament and Russian companies and administrative bodies, however, were generally less convinced that Western investment would provide the solution to the problems of their energy industry, and were more concerned with protecting Russian economic interests. Opening markets to widespread Western investment in oil and gas was perceived as a danger, since Russia might thereby be forced to loosen control over its most strategic industries.

Given the different positions of the liberal-minded Russian negotiating delegation and parts of the government on the one hand, and the more conservative Parliament and industrialists on the other hand, the Russian stance towards the Energy Charter Treaty was slightly ambiguous.

4.5 The negotiations of the Charter

This paragraph is based mainly on the book by Dore and De Bauw (1995:65-80), a book also used earlier paragraphs.

The negotiations on the European Energy Charter and its Treaty started with high ambitions and expectations of the contents of the agreement, the speed with which it could be concluded and the political impact the end result could have. Negotiating the Treaty took two and a half year longer than hoped, and early ambitions for the content of the document have not been fully realized.

At the starting point of the Charter Treaty negotiations, one of the EU's main objectives was political, namely to reinforce the restructuring of the former Comecon¹⁷ economies and to strengthen political stability in the region. The Energy Charter and its Treaty provide these countries with supportive signals and political opportunities, but other factors, such as an EU commitment towards expansion eastward and the conclusion of the Euro-Agreements to reform their economies.

In economic terms, the EU was hoping to increase the security of Russian oil and gas supplies to Western Europe. Both in 1995, as well as today, the maintenance of Russian export capacity in both oil and gas sectors seems largely to depend on decisions and energy policies adopted of the Russian government.

The Russian delegation was aiming for an agreement that would attract Western capital into Russia and would allow a balanced approach towards opening markets while not provoking the demise of domestic energy companies or loss of Russian control over resources.

¹⁷ European countries and former Soviet republics that were organized within the Council of Mutual Economic Aid: Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic and Slovenia, and the 15 former Soviet Republics (former communist states).

Provisional application of the ECT according to article 45 has given the Russian government the opportunity to implement the Treaty without ratification by Parliament, and thus to circumvent possible parliamentary opposition. This might alienate the Russian Parliament, and contradicts earlier attempts to respect parliamentary powers by avoiding bypassing parliamentary opinion. Such a situation cannot be maintained indefinitely; if Parliament fails to ratify the Treaty after a certain period of time, the Russian government may decide (or be obliged) to terminate provisional application.

During the course of negotiations on the Charter Treaty, observers and officials saw an increasingly urgent the relevance of the Treaty as a document that could provide political support to the reform programs of Russian government. This concern was particularly evident during 1993, as relations between President Yeltsin and his parliament became extremely tense, and the dissolution of Parliament led to early elections in December 1993. Even earlier, officials had expressed concern that had ‘missed the boat’. It is too late, and too complex, but we have to succeed for political reasons. Since then, however, political events have overtaken these aspirations. After the resignation of the most reformist Russian ministers in the Chernomyrdin government, economic reform in Russia is stalling, and political reforms have progressed only sluggishly. The signals of political support emanating from the signing of the ECT are likely to be minimal and in the short term have been overshadowed by the Russian military intervention in the breakaway region of Chechnya in December 1994.

4.6 Any importance of GATT (WTO)?

Did the ECT negotiation process get influenced by the GATT? Did their preferences matter in the Energy Charter Treaty negotiations?

The Community and its Member States are member of the WTO, and WTO law has been fully incorporated into European law. Many trade provisions of the General Agreement on Trade and Tariffs(GATT) are copied in the ECT, and the WTO has been considered as

the relevant body for trade in energy goods and services. (Haghighi, 2007: 188)

This means that, despite the fact that the former Soviet republics and countries of Central Europe are not GATT members, they will respect the multilateral rules on trade based on transparency, non-discrimination and reciprocity. Provisions designed for a purpose to promote trade are deemed to implement the necessary reforms in the energy sector of the ECT members. If these members are not yet members of the WTO, the ECT assists them in carrying out domestic reform in their energy sector and in their subsequent membership of the WTO. (Haghighi, 2007: 319)

One cannot help asking oneself if Russia entered the ECT negotiations with a ‘hidden’ agenda to become a member of the WTO?

4.6.1 Russia’s interest of joining the WTO

Can Putin or former presidents of Russia, have used these different opportunities to enhance Russia’s role in order to enter the WTO?

The interest Russia had when entering the Energy Charter Treaty negotiations, may have altered during the course of negotiations, and as time went by. The ECT negotiations commenced just after the dissolution of the Soviet empire, and the future of Russia was uncertain. By now, the prospect of Russia’s future is more optimistic, as the energy sector in Russia is prosperous. These factors can absolutely change the objectives in a negotiation. This would in any case be difficult to detect, because one player can play the game with his cards close to his chest.

4.7 Ratification process

As we have witnessed, Russia has yet to ratify the European Energy Charter.

Game theoretical analysis should distinguish between voluntary and involuntary defection.

Why did the ratification process fail?

As we already know, the Russian federation signed the Energy Charter Treaty in 1994, but has again, yet to ratify the Treaty.

In a statement by the Deputy Permanent Representative of the Russian Federation to the International Organization in Vienna, Mr. Mikhail I. Kalinin stated following;

When signing the Treaty, Russia expressed its concerns over the issue of trade in nuclear materials and some other issues. These issues still remain unresolved.

He continues, expecting that these issues would be addressed promptly, Russia started, in August 1996, the process of the ratification of the Treaty. The process is not over yet, as a result the Treaty is applied so far on temporary basis. Progress in that direction is hindered by a number of internal and external factors. As to the former, it should be noted that the Treaty has implications for the entire fuel and energy sector accounting for over 40 per cent of the export proceeds of Russia. That is why Russia has to take a very responsible approach to its ratification

(http://www.mid.ru/Brp_4.nsf/arh/D19D4C1F13AFE13943256CBB003095BB?OpenDocument).

It would appear as there is a case of voluntary defection regarding this particular ratification process. Even though Putnam, in his presentation, states that there is difficult both for the other side and for outside analysts, to distinguish voluntary and involuntary defection, particularly since a strategic negotiator might seek to misrepresent a voluntary defection as involuntary (Putnam,1988:439).

The Russian delegation speaks openly of the concerns and issues that need sorting out, before any ratification process can take place.

It appears to be the ‘Transit Protocol’ that is one of the most challenging issues in the Treaty for the Russian Federation to ratify.

As we know from the theory of two level games, in order to meet an agreement on Level II, there has to be within the win-set on level I in order to come to an agreement. Hence, when the Russian companies as Gazprom and Transneft opposed ratification, arguing that it would oblige them to open their network to lower cost gas from Central Asian countries, that became members of the ECT, The Chief of Negotiator has not a large enough win-set in order to make an agreement. It is not within his ‘acceptability-set’.

As illustrated with figure 4.2

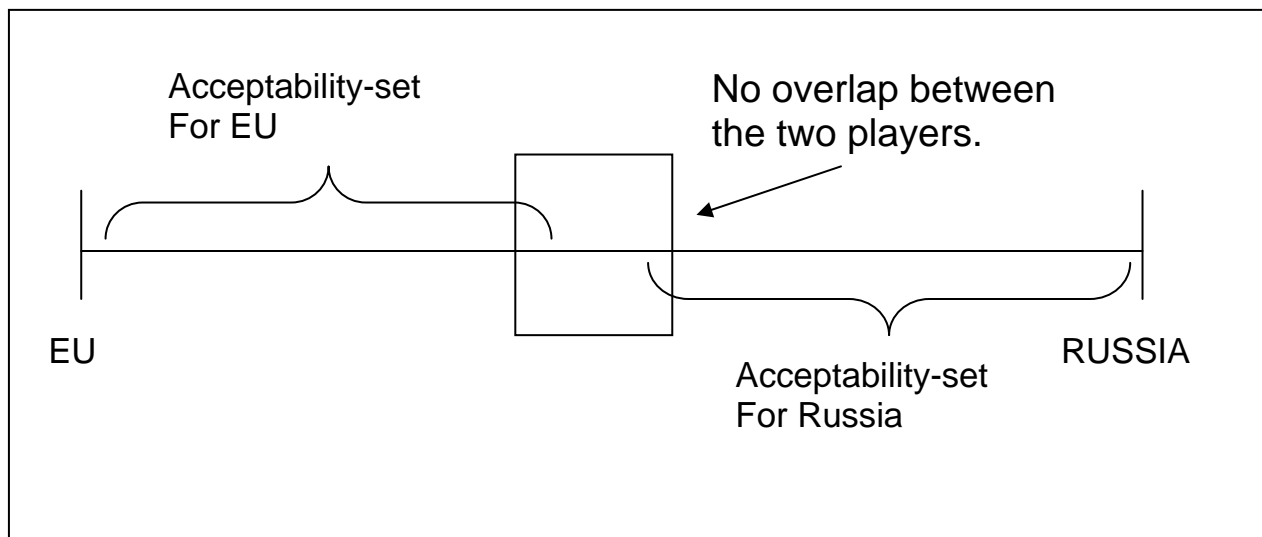


Figure 4.2

4.8 The Transit Protocol and its implications

For Russia, the issue of transit of energy resources for export is more important than for any other energy exporting country. Russia itself is a country of transit.

Therefore, there have been an increased attention on the part of Russia to the transit

Protocol talks. According to recommendations made at the hearings in the State Duma of the Russian Federation, finalization of the Transit Protocol to the Energy Charter is a prerequisite to Russia's ratification of the Treaty. Signing the Protocol could provide a new instrument allowing Russia to defend their interest related to the transit of Russian oil and gas through the territories of the Protocol Participating States. In the process of working out the Protocol Russia managed to reach a compromise on some of its provisions. However, a number of outstanding issues of principle importance for Russia still remain. Two of those are Transit tariff calculations and the right of 'first refusal', when granting access to transit capacities and the settlement of transit disputes. All issues related to transit of energy carriers to the EU will be settled within the framework of the Protocol while the transit of Russian oil and gas to the EU via neighbouring states will be carried out in accordance with the internal EU transport law.

When discussing transit tariffs, Russia proposed that they should be based on capital and operational costs including a reasonable profit rate. As the European Union stands for establishing tariffs by way of auctions, Russia believe that this could pave way for all sorts of speculative games aimed at raising tariffs.

In the statement by the Deputy of Permanent Representatives, he concludes that considering the Treaty as a major multilateral agreement on energy, Russia remains optimistic, in spite of above-mentioned circumstances, about the ratification in the future. Russia is not going to withdraw from the Charter process which, in general, serves their interests. What is important, is to continue joint efforts aimed at eliminating the existing concerns, to pay heed to each other's opinion and to demonstrate the desire to reach a compromise

www.mid.ru/Brp_4.nsf/arh/D19D4C1F13AFE13943256CBB003095BB?OpenDocument).

CHAPTER FIVE: FINALE REMARKS

In the aftermath of the cold war and the collapse of the Soviet Union, gas transit is becoming more important as export volumes, and therefore the costs of transit failure, increase.

It is for these reasons that the transit protocol of the ECT is a unique and essential international instrument with the potential to provide much greater certainty for both participants and investors in gas commerce.

The lack of Russian ratification of the Treaty and the Transit Protocol is therefore a crucial gap in the natural gas and energy relationship between the EU and Russia. While there are many reasons for this failure to ratify, opposition from Gazprom to the Transit Protocol has been important in creating opposition to ratification in the Russian Duma.

During the late 1990's and early 2000's Gazprom opposition was based on an interpretation in which acceptance of the Transit Protocol would require mandatory access to Russian gas pipelines by third parties.

After 2001, its opposition became less strident as the focus of attention on energy transit moved to the government and particularly Russia's application to join the World Trade Organisation. (Stern, J.2005:136-137)

Early in 2007 the European Union proposed a new energy policy as a first resolute step towards becoming a low-energy economy, whilst making the energy we do consume more secure, competitive and sustainable. A common policy is the most effective way to tackle today's energy challenges, which are shared by all the Member States. The policy puts energy back at the heart of EU action, the position it occupied when the European venture first got under way with the European Coal and Steel Community (ECSC Treaty, 1951) and the European Atomic Energy Community (Euratom Treaty, 1957). The aims of the policy are supported by market based tools (mainly taxes, subsidies and the CO²

emissions trading scheme), by developing energy technologies (especially technologies for energy efficiency and renewable or low-carbon energy) and by Community financial instruments (<http://Europe.eu/cgi-bin/etal.pl>).

In an interview¹⁸ with Andrey Kondakov, Director of the Economic Cooperation Department of the Russian Ministry of Foreign Affairs, he states that; in the twelve(today 13) years since the signing, not on one of the issues like nuclear materials, investment protocol nor the transit protocol has there been reached an agreement between these two players of international political system. He finishes by saying that there is no end in sight for them so far

(www.mid.ru/Brp_4.nsf/arh/F09B6AC8715C0E3AC32571B700318BD9?OpenDocument).

Energy can unite countries or divide them one from another. The world has enormous reserves of oil and gas, but to be commercially viable, these resources must often be transported to markets over long distances. The realities of geology and geography make it necessary that some pipelines cross through several countries from source to market. If we are to utilize efficiently the world's energy resources, we must protect against not only economic distortions, but political ones as well (Martin, Imai, Steeg.1996:49).

¹⁸ The interview was published in the Magazine 'Expert' no. 28(522) July 24, 2006, (It is also an unofficial translation)

References:

Aftenposten, 24th March 2006- “*EU- landene går tom for Energi*”. Message from Jose Manuell Barroso- the European Commission’s President to head of Member States in a top meeting in Brussels. Brussels.

Aftenposten, 13th July 2006- “*Russisk makt*”. Article by Ola Storeng.

Aftenposten, 12th November 2006- “*Fra utstyrlik kapitalisme til Kreml AS*”. Article by Per Kristian Aale. Aftenposten.

Aftenposten, 20th September 2007, ” *EU vil stoppe Gazprom*”. Aftenposten

Andersen, Svein S. (1997) *Case studier og generaliseringer: forskningsstrategi og design*. Bergen-Sandviken fagbokforlag

Andersen, Svein S. (2006) *Kampen om energimarkedene i EU- repolitisering og differensiert markedsbygging*. Handelshøyskolen BI,Oslo. Tidsskrift for økonomi og ledelse. MAGMA

Andersen, Svein S. (2006) *EU energy policy: Interest Interaction and Supranational Authority*. Oslo. ARENA, Oslo. Working papers: *Making Policy in Europe*(Coming) Sage London.

Andersen, Svein S. (2006) *Four Major Stages in the European Energy Charter Treaty*. Oslo. Handelshøyskolen BI, Oslo. *Draft*

Bielecki, Janusz (2002) *Energy Security. Is it the Wolf at the Door?* The quarterly Review of Economic and Finance.

COM (2000) Green Paper “Towards a European strategy for the security of energy supply”. Brussels.

COM (2002) 321 Communication from the Commission to the Council and the European Parliament. Brussels. Final report on the Green Paper “Towards a European strategy for the security of energy supply”

COM (2006) Green Paper “European Strategy for Sustainable, Competitive and Secure Energy”. Brussels.

Dore, Julia and De Bauw, Robert(1995) *The Energy Charter; Origins, Aims and Prospects*. The Royal Institute of International Affairs.

Doron, Gideon and Sened, Itai (2001) *Political bargaining: Theory, Practice and Process*. SAGE, London.

Eikeland, Per O. (2004) *The long and Winding road to the Internal Energy Market- Consistencies and Inconsistencies in EU Policy*. The Fridtjof Nansens Institute.

Energy for Europe- *Resources, Economy, cooperation* (1991)

Report from a Nordic Council meeting at Holmenkollen,Oslo, Norway.14-15 October 1991. Report, Oslo.

EU-magasinet, 1-2006 “Mot en ny energipolitikk i EU”.

Haghighi, Sanam S. (2007) *Energy Security*. Hart publishing.

Hellevik, Ottar (2002) *Forskningsmetode i sosiologi og statsvitenskap*. Universitetsforlaget.

Hill, Christopher and Smith, Michael (2005) *International Relations and The European Union*. Oxford University Press.

International Energy Agency (IEA) (1995) *Oil, Gas and Coal-supply outlook*, Head of Publication service, OECD France.

Jacobsen, Dag I. (2000) *Hvordan gjennomføre undersøkelser? Innføring i Samfunnsvitenskaplig metode*. Høyskoleforlaget.

Legvold, Robert (2007) *Russian Foreign Policy in the 21st Century & The shadow of the past; Reluctant Europeans: Three Centuries of Russian Ambivalence toward the West*. Colombia University Press, New York.

Lyons, Paul K. (1992) *EC Energy Policy. A detailed guide to the Community's impact on the energy sector*. Published Financial Times Business information, London.

Martin, William F; Imai, Ryukichi and Steeg, Helga (1996) *Maintaining Energy Security in a Global Context*. The trilateral Commission, New York, Paris and Tokyo

Matlary, Janne H. (1997) *Energy policy in the European Union*. Basingstoke,

Macmillan Press.

Midgaard, Knut (2001) STV 603, *Strategi, politisk kommunikasjon og forhandllinger. Rules and strategy in negotiations:notes on an institutionalist and intentionalist approach*. Kompendium. Unipub. Universitet I Oslo.

Moravsciks, Andrew (1993) *Double-Egded Diplomacy; International Bargaining and Domestic Politics*, University of California Press

Petroleum Economist-*the energy sector of the former Soviet Union 1975-1995* (1993) published by the Petroleum Economist Limited in London

Putnam, Robert.D (1988) *Diplomacy and Domestic Politics; International Organzation* Vol 42. International Organization

Stern, Jonathan (2005) *The Future of Russian gas and Gazprom*. Oxford University Press.

Stern, Jonathan (1998/9) *Competition and Liberalization in European Gas Markets. A diversity of models*. The Royal Institute of International Affairs.

Tvede, Ivar (2006) *Olje og Energidepartementens rolle i gasseksporten til EU. Et vellykket to-nivå-spill?* Oslo: Universitet i Oslo. Institutt for Statsvitenskap.

Masteroppgave

Weyman-Jones, T (1986) *Energy in Europe: Issues & policies*. Methuen London and New York.

Yin, Robert K (1994) *Case Study Research. Design and Methods*. SAGE publications.

<http://Europe.eu/cgi-bin/etal.pl> [read date: 19.09.07]

<http://en.wikipedia.org/wiki/COMECON> [read date: 19.10.07]

www.regjeringen.no/nb/dep/oed/dok/rapporter_planer/Rapporter/2004/EUs-energipolitikk.html?id=106083

“EU’S energipolitikk” [read date: 20.03.2006]

www.mid.ru/Brp_4.nsf/arh/D19D4C1F13AFE13943256CBB003095BB?OpenDocument [read date: 19.10.2007]

www.mid.ru/Brp_4.nsf/arh/F09B6AC8715C0E3AC32571B700318BD9?OpenDocument [read date: 19.10.2007]