CENTER FOR THE STUDY OF DEMOCRACY

EU AND NATO'S ROLE IN TACKLING ENERGY SECURITY AND STATE CAPTURE RISKS IN EUROPE

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Introduction

The Crimean crisis and the continuing instability in Eastern Ukraine have turned into a rude wake up call for Europe's energy security vulnerabilities.[1] Russia has demonstrated its capacity to yield political and economic influence on the countries in the CEE and the Black Sea regions by leveraging its dominant position on their energy markets. Russia has pressured governments to support its flagship project, South Stream, at the expense of the countries' long-term strategy to diversify their natural gas supply and in defiance of EU's strategy for building a liberalised common market.[2] Since the beginning of the crisis the EU and NATO have scrambled for finding the right measures to a balanced response to Russia's growing assertiveness, while striving to alleviate the most acute energy security risks for their members.

The high energy dependence of many countries in the Central and Southeastern Europe and the Black Sea regions coupled with fragile democracies and

KEY POINTS

- Despite the efforts in increasing its expertise in energy security matters, NATO remains a military alliance. Yet, it could cooperate with the EU on solving some of the most critical energy security risks for its member-states. NATO can facilitate dialogue by implementing solidarity-building measures in times of energy crises.
- While in the past decade Europe had primarily focused on the competitiveness and environmental (or sustainability) components of its energy strategy, recently the EU has decided to rush in some long-delayed solutions, related to the security of supply issue, such as the creation of an Energy Union amid growing instability along the main European energy routes.
- The most critical energy security challenges, faced recently by Central and Eastern Europe and the Black Sea countries are the overreliance on one energy source, the lack of adequate measures for supply diversification and limited involvement in the development of the domestic production. On the demand side, these countries are characterized by large pockets of energy poverty, high energy demand and low energy efficiency.
- The negative influence of the traditional energy security risks in Central and Eastern Europe and the Black Sea region is amplified by bad governance and state capture in the sector, which impedes the formation of a common and coherent regional energy strategy. These have been skilfully used by Russia who has engaged state-owned energy complexes in large, inflated deals, which largely outweigh the administrative and financial capacity of the national industries, leaving national monopolies exposed to increased risk of financial dependence.

[1] *This policy paper is the outcome of the presentations and discussions during the International conference "Energy Security and State Capture Risks in Europe", organised by the Southeast Leadership for Development and Integrity (SELDI) and NATO's Public Diplomacy Division on 27 October, 2014 in Sofia, Bulgaria. More information about the event and the presentations of the speakers could be found at: http://www.csd.bg/artShow.php?id=17111*

[2] Vladimirov, M., and R. Stefanov. (2014) "Bulgaria and the South Stream Pipeline Project – At the Crossroads of Energy Security and State Capture Risks". Südosteuropa Mitteilungen, 05, no. 06: 54-72.

NATO OTAN

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economic stagnation calls for concerted NATO – EU efforts to shore up the most vulnerable countries from resurgent Russian influence and capture. Both alliances need to strengthen their involvement in the political dialogue behind regional energy markets. This seems to have started to gradually happen. The European Commission's has taken a firm stance on not granting exclusion from the Third Energy Package to the South Stream project, which led to the Russian president declaring its suspension in December 2014, despite continuing strong pressure on member-states along the route, such as Bulgaria and Hungary. Then during the final summit of the EU Council for 2014, member-states agreed in principle for the need of creating an Energy Union to improve EU's bargaining power vis-à-vis foreign suppliers. In January 2015 the United States through its State Secretary has reiterated its strong commitment to Bulgaria's overall security and to helping the country diversify its energy flows.

NATO and EU's Roles in Energy Security in Europe

The EU is clearly better equipped to take on the energy security challenges in Southeast Europe and the Black Sea region, and it should take on the bulk of the responsibility in addressing the challenges to its energy security, as well as that of its immediate neighbourhood. While in the past decade Europe had primarily focused on the competitiveness and environmental components of its energy strategy, in 2014 it had to rush in some long-delayed solutions, such as the Energy Union in the wake of the Crimean crisis. It also needs to focus more intensively on improving the governance of the energy sector across the EU, as past experience has shown Russia has successfully exploited governance loopholes and its soft power in the region to tie member-states to long-term contracts of sizable proportions. NATO on the other hand seems better prepared to act swiftly, and needs to reinvigorate its security engagement by incorporating energy security risks in the overall commitment of the alliance to the European strategic security architecture. Thus there seems to be good scope for synergies and mutual reinforcement between the two organisations in Europe.

The Energy Union initiative could be an important tool for guaranteeing uninterrupted energy resource imports on reasonable prices. The idea for a common bargaining mechanism comes on the back of EU's effort to significantly revamp its focus on energy security amid growing instability along the main European energy routes. This is crucial as the EU's dependence on energy imports keeps growing. In 2013, the member-states depended on natural gas imports for 65.8 % of the domestic consumption. For the countries in Central and Eastern Europe, the dependence rate is even higher at more than 80 %. The EU would need to strengthen their efforts to diversify their energy supply, including through making good on their pledges to intensify their domestic approaches to energy security improvement, such as the construction of reverse-flow interconnectors and the expansion of gas storage facilities.

In accomplishing its energy security goals, the EU can work with NATO on designing a coherent energy strategy. For NATO, energy has come to the forefront of the security policy debate during the organization's 2010 Strategic Concept, which formed the alliance's approach to energy security by prioritizing transport and transit routes. Energy infrastructure security for the existing and new transit routes through Central and Eastern Europe and the Black Sea region is also part of the focus of the Science for Peace and Security (SPS) program. The policy focus was deepened in 2013 when NATO founded the Energy Security Centre of Excellence (ENSEC COE) in Vilnius, Lithuania. Its overall goal is to train and educate leaders and specialists from NATO member and partner countries about specific energy security threats and to assist in the development of a common doctrine, and to improve the interoperability and of the alliance to cope with these new threats. The Centre of Excellence aims at providing energy security expertise to the Strategic Command in countries such as Lithuania, Estonia, France, Italy, Latvia and Turkey, as well as other international energy stakeholders.

Despite its efforts in increasing its expertise in energy security matters, NATO remains a military alliance.[3] Yet, it could cooperate with the EU on solving some of the most critical energy security risks for its member-states. One way NATO can facilitate dialogue is by implementing solidarity-building measures in times of energy crises. One area of immediate cooperation among NATO's member states is on energy efficiency in the military, where energy savings could significantly optimize costs' operations.

In addition, NATO members have pledged to increase the alliance's role and competence in energy security issues. The priority of guaranteeing the security of supply, nonetheless, remains the prerogative of member-states. NATO could facilitate a dialogue between member-states and among international organizations. As an area of immense geostrategic importance in regards to competition of major energy infrastructure projects linking oil & gas producing countries with consumers in the European Union and beyond, the CEE and Black Sea regions could become a focal point for the future energy cooperation.

In the few years before the NATO summit in Newport many have started questioning the relevance of the North Atlantic Alliance. However, Russia's forceful annexation of Crimea in March gave NATO a new impetus to return to its original role – ensuring the collective security of its members. The concentration of Russian forces on the Ukrainian borders has raised security concerns among the Eastern and Northern members of the Alliance. The Article 5,[4] contained in the Washington Treaty, has again become a relevant tool not only for the preservation of collective defence in Europe, but also for a containment policy aiming at the prevention of a major military conflict in Ukraine. The challenges in Ukraine are closely related to other, emerging security challenges for NATO's members. One of the most critical threats stemming from the conflict in Ukraine is contained in the immediate security of energy supply to Europe. The leaders concluded during the Newport summit that a stable and reliable energy supply, the diversification of routes, suppliers and energy resources, and the interconnectivity of energy networks remain of critical importance for the overall security of the EU.

The NATO leaders pledged to increase their role in maintaining the security of critical energy infrastructure such as pipeline, storage facilities and refineries. The Strategic Concept from the 2008 Bucharest Summit on tackling energy security risks will be augmented to include a closer cooperation with the EU especially on pending crises such as the current Russia-Ukraine gas dispute. In that sense, the long-term resolution of the conflict in Ukraine cannot be limited to a peace agreement in Eastern Ukraine but should include a broader effort to stabilize the Russia-EU energy dialogue without compromising the economic development of Ukraine. Even though NATO is a military alliance, it could cooperate with the EU on solving some of the most critical energy security risks for its member-states. One way NATO can facilitate dialogue is by implementing solidarity-building measures in times of energy crises.

Energy Security Risks in the CEE Region

When discussing energy security risks, we cannot place all EU-28 and NATO members under one umbrella. More accurately, energy security issues are more acute for Central and Eastern Europe (CEE) and the Black Sea regions. Among the most critical energy security challenges that these countries face, are the overreliance on one energy source, the lack of adequate measures for supply diversification and limited involvement in the development of the domestic production. On the demand side, the CEE and Black Sea regions are characterized by large pockets of energy poverty, high energy demand and low energy efficiency. Hence, policy-makers often face a dilemma

[3] Speech by Mr. Michael Ruehle, Head of the Energy Security Section in the NATO Emerging Security Challenges Division, on NATO's role in Europe's Energy Security Architecture, during the international conference "Energy Security and State Capture Risks in Europe".

[4] Article 5 of the North Atlantic Treaty Organisation provides that in case of an attack against an Ally, the other members of the alliance should consider this an attack against all members and should take actions in assisting the attacked country.

Table 1. Russia's role in the CEE and Black Sea Energy Markets

Country	Gas Import Dependency	Share of Russia in gas imports	Share of Russia in gas consumption	Total Gas Consumption (bcm)	Average Gas Price ($ per 1000 cubic meters)
Slovenia	100.0 %	60.2 %	60.2 %	0.87	485
Greece	100.0 %	55.6 %	55.6 %	3.6	476
Slovakia	98.4 %	83.5 %	82.2 %	5.4	429
Czech Republic	98.0 %	58.6 %	57.5 %	8.4	503*
Bulgaria	90.0 %	100.0 %	90.0 %	2.6	417
Austria	78.9 %	76.1 %	60.0 %	8.5	379
Hungary	78.2 %	100.0 %	78.2 %	8.6	435
Poland	72.0 %	81.3 %	58.6 %	16.7	403
Romania	24.3 %	100.0 %	24.3 %	12.5	399
Turkey	99.0 %	56.0 %	56.0 %	45.6	406
Ukraine	55.0 %	100.0 %	55.0 %	45.0	385
Moldova	100.0 %	100.0 %	100.0 %	3.25	400
Macedonia	100.0 %	100.0 %	100.0 %	0.16	460
Serbia	82.4 %	100.0 %	82.4 %	2.91	457
Average	81.0 %	81.0 %	63.0 %	11.13	431

Source: *BP, Eurogas, CSD, European Geopolitical Forum.*
* *Data for 2012.*

of ensuring uninterrupted flow of energy supply, and at the same time, maintaining energy prices low. The nature of the policy choices is further complicated by the common EU drive to foster sustainable economic growth that takes into consideration climate change and resource efficiency.

First and foremost is the regional dependence on natural gas supply from Russia. On average, the share of Russian gas in the total consumption of the countries in the CEE and Black Sea regions has hovered around 63 % in 2013. However, natural gas dependence in terms of share of total imports is even more alarming at 84 %. The majority of Russian gas supply to the CEE and SEE region flow through two pipelines transiting Ukraine. In March 2013, the dependency on Ukraine as a transit route reached 82 % for Central and Eastern European countries. Meanwhile, Austria, Bulgaria, Croatia, Hungary, Romania, Slovakia and Slovenia remain 100 % dependent on the Ukrainian transit route for gas imports. In case of a natural gas crisis similar to the one in 2009, the region will be severely exposed to supply disruptions, heating shortages and fuel deficits for industrial consumers.

The 2009 gas dispute showed in practice how dependent some states in Central and South-Eastern Europe are on Russian-Ukrainian relations. The response to the crisis was mixed with some countries using swap deals for importing Norwegian and Algerian gas, while others changing to heavy fuel for heating or increasing their domestic production. Overall, the region was unprepared to sustain the cut in gas supply in the long term as the capacity of underground gas storage facilities was not enough to handle a winter gas demand. Similarly, the crisis proved that the gas interconnectors linking the different national grids in the EU are underdeveloped preventing countries from balancing their markets.

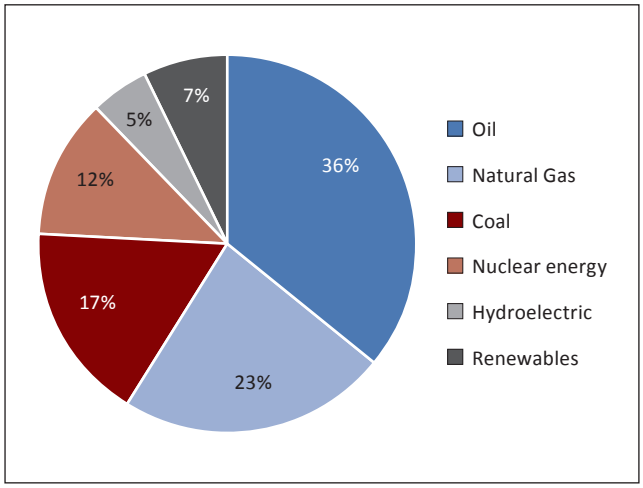
The fragmented approach to improving the security of supply has left the region exposed to future disruptions amid a continuing turmoil in eastern Ukraine. Russia's halt of natural gas supply to Ukraine

in early July, 2014 has increased the prospects that Ukraine will cut the gas transit to the EU sometime in the winter of 2014/2015. While this scenario has been averted through intensive EU involvement, it cannot be ruled out altogether. Although the halt in gas transit will not have a severe effect on consumers in Western Europe due to diversified sources of gas and import routes, the CEE & SEE regions would be able to sustain a gas supply disruption for no more than 110 days using both gas storage facilities and reverse flow gas links. Moldova, Bulgaria and the countries in the Western Balkans (with the exception of Slovenia, Serbia and Croatia with limited access to Hungarian and Austrian gas supply) will be hit hard as they are almost fully dependent on Russia, have limited production capacity and have not developed their gas storage infrastructure. While, the good news is that the economy of these countries is relatively less dependent on natural gas – for example natural gas constitutes only 17 % of the total energy consumption in Bulgaria – switching to alternative fuels is both very polluting and costly.

Energy Security Risk: Towards Common EU Governance Framework

Having a secure supply of energy is a key priority to the EU and is vital for the European economic development. The EU focuses its efforts on making sure that energy supplies are not interrupted and energy prices remain stable. Still, energy dependency of the Union, especially of some member states, is a major issue, which requires serious attention. Data shows that currently more than half the EU's energy consumption comes from imported sources. Energy imports are worth close to $400 billion per annum weighing heavily on an already sluggish economy.[5] Dependency rates vary from one energy source to another, being highest when it comes to uranium imports (95 %) and crude oil imports (88 %). 66 % of the natural gas consumed within the EU is imported, while the Union is least dependent on solid fuels imports (coal, for example) – 42 % only. The fall in oil prices in the second half of 2014 and the beginning of 2015 will alleviate some of the pressure on European economies but will not remove the very low price elasticity of demand in Europe.

Figure 1. EU Energy Demand by Type of Fuel (2013)



Source: *BP Statistical Review of World Energy 2014.*

The common EU energy policy is undermined by the geographic, economic and political differences of the member-states. The latter have a very different structure of their energy supply, which complicates the building of a coherent and consistent strategy for dealing with energy challenges. On average in 2013, the total energy needs of the EU, in terms of gross inland consumption, were covered by the following sources: 36 % oil, 23 % gas, 17 % solid fuels such as coal, 12 % nuclear power, 12 % renewable sources such as hydropower, solar or wind energy.[6] This mix varies widely across countries and evolves over time as a result of their geographical conditions, such as the availability and access to natural resources, national policy choices (e.g. the decision to make use or not of nuclear power, allow shale fracking, participate

[5] European Commission. (28.05.2014). Communication on European Energy Security Strategy from the Commission to the European Parliament, accessed from http://ec.europa.eu/energy/doc/20140528_energy_security_communication.pdf

[6] European Commission, "Europe 2020. A strategy for smart, sustainable and inclusive growth", accessed from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF

in different international projects, etc.), changing financial incentives, progress in technologies, decarbonisation requirements and the development of the internal market.

In spite of differences, EU MSs have three common policy objectives:

- reducing energy costs for households and businesses ("competitiveness"),
- ensuring a reliable and uninterruptable supply of energy ("security of supply") and
- limiting the negative environmental impact of energy production, transport and use ("sustainability").

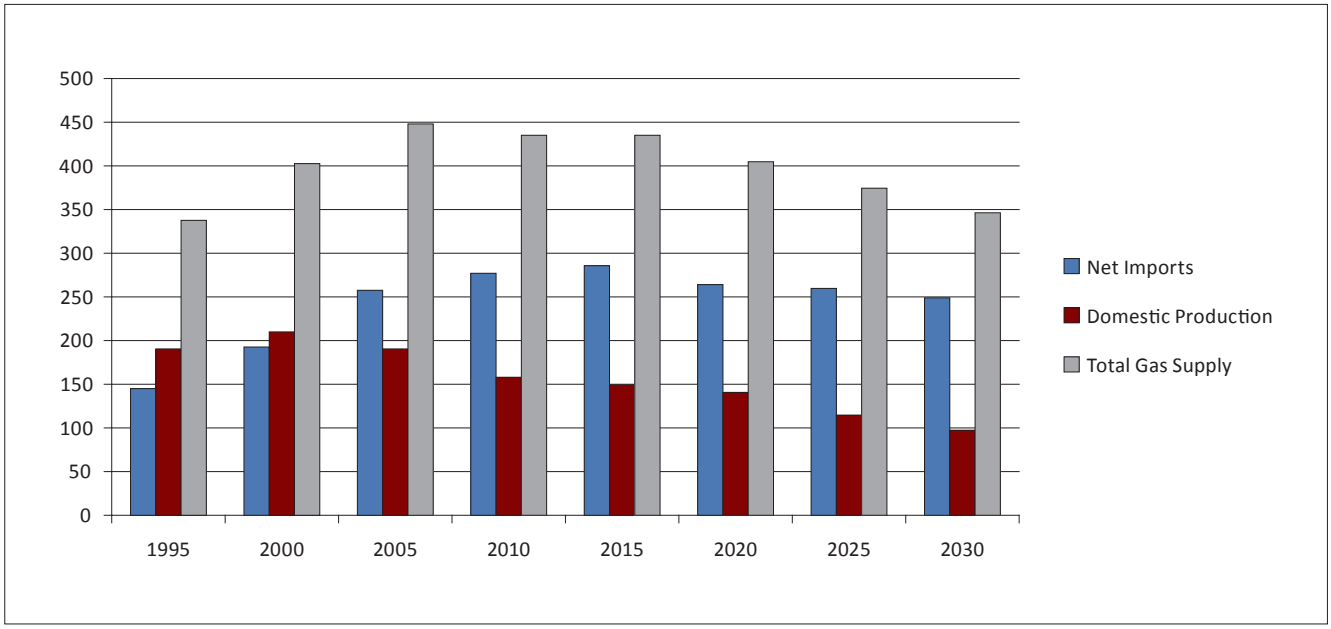
That is why three headline targets to be achieved by 2020 were agreed by Heads of State or Government (often referred to as "20/20/20 by 2020"): "to reduce CO_2 emissions by 20 % compared to 1990 levels, to raise the share of renewable sources as part of the overall EU energy mix to 20 % and to increase energy efficiency by 20 %". These goals are also at the core of the Europe 2020 strategy for smart, sustainable and inclusive growth.

Part of the efforts for ensuring a reliable and uninterruptable supply of energy has been the diversification of energy sources away from depending on natural gas imports, the increase of the renewable energy sources in the power generation mix, and the fostering of domestic energy supply sources including the development of unconventional fossil fuels and the construction of new nuclear capacity. The latter has been more successful despite safety fears after the Fukushima incident in 2011. At least 13 EU members are considering the development of nuclear energy either by building new reactors or extending the life of old ones. With the start of the economic crisis in 2008 though no irreversible new commitments have been made financially in this respect.

Energy supply dependence is also strongly related to the development of grid infrastructure to link energy consuming with energy producing regions. The lack of regional balance between power generation sources and demand centres implies the need for significant expansion of the grid and the construction of power storage and balancing systems. While hydro-power provides one of the few known systems for the storage of power capacity, increasingly RES and gas-fired power plants are able to cover gaps in the energy supply.

The energy security challenges are most clearly exposed in the CEE and Black Sea regions. The policy-

Figure 2. EU-28 Gas Demand Projections – bcm/year (1995 – 2030)



Source: *European Commission, May 2014.*

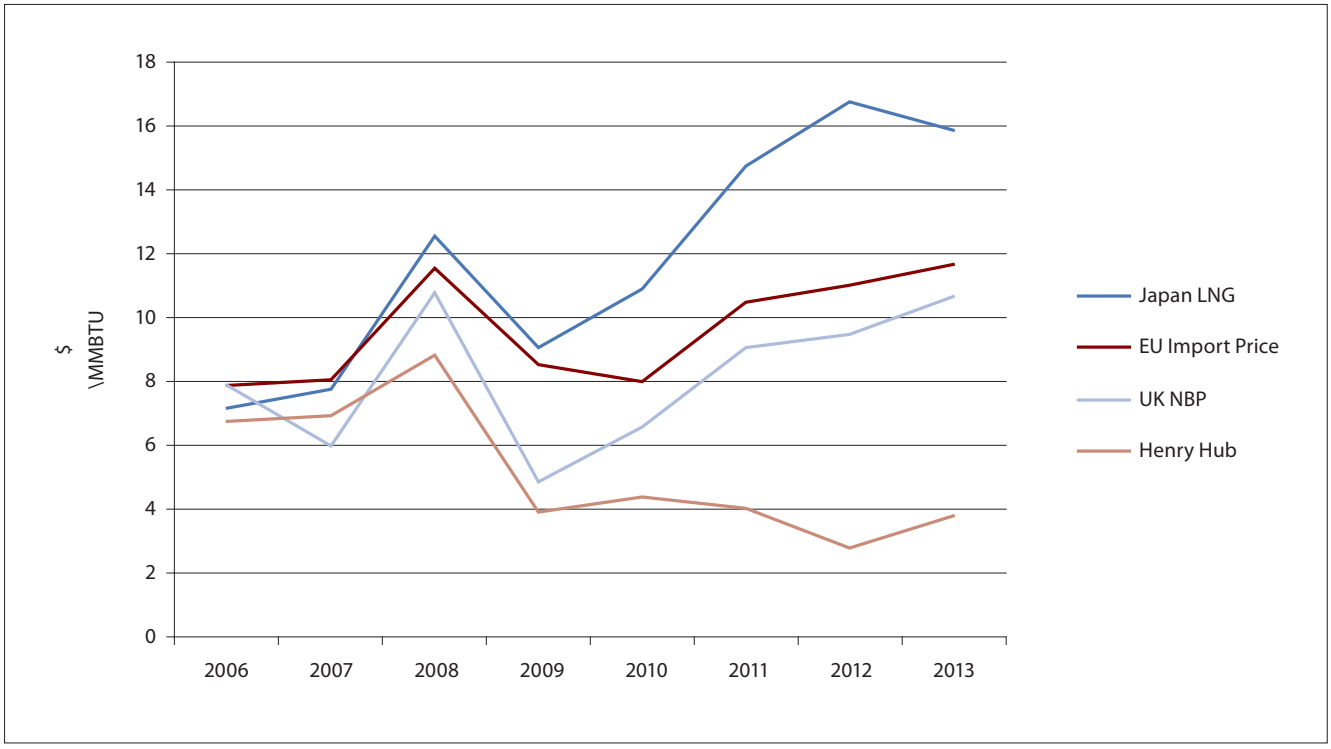
makers there face an energy security trilemma, namely which two of the three conflicting elements of the energy policy paradigm to choose – efficiency, affordability or sustainability. Governments can follow only two out of three policy priorities. By making this choice, there will always be losers in the process. In this dilemma EU members in the East and Southeast have been unable to prioritize energy security issues partially due to state capture, the vested interests of third parties close to government circles.

In attempt to solve the trilemma, at least on the issue of natural gas security, the EU has revamped significantly its focus on gas supply strategy, and has stepped up efforts to set up a European energy union. Although the creation of a common European energy policy has been prevented by many obstacles, the demands of the more energy dependent country-members make this policy direction irreversible. The main challenges include: the huge need of investment resources; the need for cross-border connections the different levels of energy poverty and hence ability to pay in member-states, etc. The latter applies directly to the regions under study, where a large share of the population is energy poor.

The main goal of the energy union will be to guarantee uninterrupted energy resource imports on reasonable prices. Currently, the countries in Central and Eastern Europe pay close to USD100 per 1000 cubic meters more than the average gas price in Western Europe. An energy union will aim to limit such large price discrepancies by insisting that the international market will set prices, rather than bilateral political agreements. This aims at limiting the use of energy leverage by large suppliers, such as Gazprom for achieving political impact in the region of South East Europe and the Black Sea region.

The EU is also trying to improve the functioning of its domestic energy market by creating mechanisms for reaction in case of energy crises. One option is to formulate spare quotas for member countries according to the levels of their vulnerability in cases of supply disruptions. Another option is to increase investments in the European gas and electricity network and to expand gas storages and construction

Figure 3. Regional Natural Gas Prices by Hub



Source: *BP Statistical Review of World Energy 2013.*

of liquefied gas ports, which would allow access to alternative gas sources. In any case, Common Energy Strategy is needed so that it could be coordinated at the supranational level, which will help in overcoming member-states' instinct to pursue their personal energy interests only.

A potential framework for a European energy union has been presented by the former Polish PM, Donald Tusk. The proposal has a 6-pillar structure including:[7]

1. Priority infrastructure development
2. EU-level solidarity mechanisms
3. Strengthen the bargaining power of Member States and the EU vis-à-vis external suppliers
4. Development of indigenous energy sources in the EU
5. Diversification of energy supply to the EU – gas and oil in particular
6. Reinforcing the Energy Community

The most ambitious idea is contained in the third pillar regarding the strengthening of the bargaining power of EU member-states vis-à-vis the external energy suppliers. The goal will be for the European Commission to provide direct support during the negotiations of intergovernmental agreements (IGAs) and ex ante verification of the contracts. There will also be an IGA template containing restricted trade clauses and compulsory provisions on the terms of the natural gas contract. The energy union also envisions the formation of a reporting mechanism that will publish aggregated contract data through market monitoring.

There will also be a dedicated gas purchasing agency that will evaluate the gas demand structure of all interested companies in the EU. This could lead to the efficient streamlining of demand for new gas supplies from external upstream suppliers via regional exchanges/platforms, thereby allowing market forces to play a greater role in price formation and leading to increased economy-of-scale benefits. According to estimates by Poland's energy ministry, the current welfare loss for the EU due to gas market inefficiency could reach EUR 30 billion per year, most of which is borne by customers in the CEE region.[8]

The successful creation of a European energy union will not be possible without the acceleration of the building and financing of projects of common interest, such as natural gas interconnectors, oil and gas storage facilities, and LNG regasification plants with a crucial focus on the CEE and Black Sea regions. In essence, to overcome the threats to the regional energy security, the EU should promote more practical approaches to common external energy strategy. Market solutions are out there but their implementation hinges on the political will of European governments to work together. Unfortunately, the efforts for the establishment of an internal energy market have stalled, which has pushed many energy companies to seek ways to improve their security of supply on their own. Strategic long term partnerships with the major external suppliers has undermined market transparency and has encouraged the encroachment of private interests over the consumer welfare.

The Polish idea for the creation of a common energy union comes after a meeting of the European Council on 20-21 March 2014, which concluded that the EU has to take measure to reduce the high gas dependence of the Union, especially for the most dependent member-states, most of which are located in Central and Eastern Europe. The strategy consists of both short-term and long-term measures, which were explicitly mentioned in the Communication by the European Commission on Energy Security Strategy published at the end of May, 2014. In the short-term, the Commission proposes to launch energy security stress tests in order to simulate gas supply disruptions in the upcoming winter. The aim of these tests is to prove

[7] Adam Janczak, Deputy Director of the EU Economic Department in the Polish Ministry of Foreign Affairs, Presentation on Energy Union for Europe - a policy proposal by Poland, during the international conference "Energy Security and State Capture Risks in Europe".

[8] Ibid.

Table 2. Natural Gas Demand Projections in bcm/year for Countries Highly Dependent on Russian Gas (2013 – 2030)

Country	Gas Demand in 2013	Gas Demand Projections			
		2015	2020	2025	2030
Austria	8.53	8.53	7.54	7.6	7.11
Czech Republic	8.47	8.08	8.69	8.68	9.94
Slovakia	5.81	4.72	4.86	6.19	7.66
Poland	18.31	15.73	17.08	19.49	21.07
Hungary	9.28	10.65	11.12	10.37	9.79
Estonia	0.68	0.34	0.38	0.41	0.43
Latvia	1.73	1.83	1.93	2.05	2.13
Lithuania	2.71	3.24	3.47	3.75	4.03
Finland	3.48	2.33	2.35	2.72	3.06
FYROM	0.16	0.12	0.12	0.12	0.12
Bosnia/Herzegovina	0.19	0.26	0.27	0.29	0.3
Bulgaria	2.59	2.89	3.03	3.14	3.29
Serbia	2.52	2.3	2.3	2.3	2.3
Greece	3.84	4.32	4.1	3.85	3.64
GRAND TOTAL	68.3	65.33	67.25	70.95	74.86
Turkey	45.64	49.56	59.26	65.58	70.62

Source: *IEA Medium-term Natural Gas Report (2014). Tables 3 and 8, pp. 8-9, 16-17. Ralf Dickel et. al, Reducing European Dependence on Russian Gas: Dstinguishing Natural Gas Security from Geopolitics, Oxford Institute for Energy Studies, October, 2014.*

whether the European energy system is able to deal with potential supply disruptions.[9] In case the stress tests have proven unsustainable natural gas dependence, the EU suggests as possible solution the increasing of gas stocks, the development of emergency infrastructure (such as reverse flows), the reduction of short-term energy demand and the shift towards alternative fuels.

The long-term solutions are defined in five key areas of energy security management, such as increasing energy efficiency and reaching the 2030 climate goals. The moderation of the energy demand, especially in the residential sector, could be crucial for achieving the 20 % target for energy savings by 2020. Currently, the residential sector is responsible for over 40 % of the total energy demand in the EU.[10] Renovation of buildings can bring residential energy consumption down by 75 % if member-states follow through with their energy efficiency plans, financially supported by the EU regional development fund.

The second long-term option is to accelerate work on the energy Projects of Common Interest (PCI), implemented according to the Regulation on the Guidelines for trans-European energy networks and the Connecting Europe Facility (CEF).[11] On 21 November, 2014, the European Commission reached a decision to allocate EUR 647 million to 34 key energy projects. The total budget of the energy

[9] European Commission. (28.05.2014). Communication on European Energy Security Strategy from the Commission to the European Parliament, accessed from http://ec.europa.eu/energy/doc/20140528_energy_security_communication.pdf

[10] Ibid.

[11] European Parliament and Council, (17.04.2013), Regulation (EU) No 347/2013, on Guidelines for Trans-European Energy Infrastructure and Repealing Decision No 1364/2006/EC and Amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009.

section in the CEF mechanism amounts to EUR 5.85 billion until 2020.[12]

The final long term goal is the completion of the internal energy market by abolishing anti-competitive practices on European level that abuse the market or political power of single suppliers as it is often the case with Gazprom. The practical accomplishment of the internal market design depends on the creation of liquid spot markets and liberalized trading mechanisms in the gas market mimicking existing practices in the crude oil and coal markets. Enhanced cross-border exchanges will diminish the role of the single supplier in setting regional gas prices and will create the preconditions for regional gas hubs. As the gas stress tests showed in October, 2014, regional gas hubs based on diversified supply are most badly needed in Southeastern Europe and the Black Sea region. The CEE, Baltic and Black Sea regions were identified as the most severely exposed to disruptions to natural gas deliveries. It is likely that in these countries gas suppliers will have to curtail the deliveries to non-protected customers after a potential medium-term (6 month) disruption.

While some of the countries under consideration would be able to replace the cut gas supplies with LNG deliveries or alternative fuels, countries such as Bulgaria, Romania, Moldova, Serbia, Macedonia, and BiH would not have a longer-term supply option. The delay in the implementation of the Romanian-Bulgarian interconnector, the Greek-Bulgarian, Bulgarian-Serbian interconnector and the Romanian-Moldovan interconnector have made the region extremely vulnerable. The European Commission has identified that there is a need for cooperation and short-term coordination of gas supply strategy, in which unilateral policy is avoided. Hence, sharing of the EU gas storage capacity and transfer of natural gas supply from the more saturated to the more needed markets are key preconditions for the development of a common European energy security strategy.

Defining and Measuring Energy Security Risks

When discussing the energy sectors with vital national security significance, the analysis cannot be limited to economic considerations, but has to also encompass considerations about the nature of decision-making both on the domestic and international arena. The fact that energy security is the product of two distinct fields of study – politics and economics – the concept has remained vague and hardly sustainable under positivist assessment. The common definition of energy security includes four dimensions that relate to the availability, accessibility, affordability and sustainability of energy.

In a world of ever scarcer and more expensive energy resources, countries have begun looking for alternative, unconventional hydrocarbon reserves in order to expand their domestic reserves. The concept of reliability, on the other hand, pertains to the protection of energy services from interruption.[13] Most commonly, countries strive to enhance energy reliability through:

1) diversifying the supply sources and the supply chain;
2) stockpiling on additional reserve capacity and emergency stocks;
3) reducing the demand for energy;
4) increasing domestic production including in the renewable energy sector.[14]

This is one of the most critical areas, where the countries in the CEE and Black Sea regions have to implement reforms in order to improve their energy security.

According to another definition, the energy security concept has three aspects: reliability, affordability and environmental friendliness. They pose a policy

[12] European Commission. (29.10.2014), Description of Projects of Common Interest, Memo.

[13] Pascual, C. and Elkind, J. (2010). Energy Security: Economics, Politics, Strategies, and Implications. Brookings Institution Press, Washington, D.C.

[14] Ibid.

dilemma, for policy-makers as it is possible to achieve only two out of three at any given moment in time. States increasingly have to face the policy dilemma of dealing with security of energy supply, and at the same time ensuring affordability of energy prices. The residents of the countries in Southeastern Europe, for example, use disproportionately high amounts of environmentally damaging coal and wood, as well as costly electricity to heat their homes, and pay substantial portion of their incomes for energy bills, while also not being able to keep their homes adequately warm. The limited reach of certain types of networked energy infrastructures (particularly gas) means that, in addition to affordability issues, energy deprivation is also predicated upon the spatial and technical limitations associated with switching towards more affordable fuel sources in the households.

To the affordability/reliability nexus, one should add the determined strategy of many European governments, to guarantee the environmental friendliness of energy supply. While it the affordability, availability and even reliability can be somewhat objectively measured, the sustainability of energy supply is "possible" to only a limited extent.[15] However, in the CEE and Black Sea regions, environmental security is often trumped by other priorities including the immediate availability of energy supply at affordable cost consistent with the stage of the country's economic development. Paradoxically, government have to often take policy decisions that improve the overall energy security position of the country but at the same time lead to environmental degradation.

Albeit the disagreement on the "correct" definition of energy security, most analysts agree that energy security is very difficult to quantify. One practical way to assess the security of energy supply is to calculate the energy security risk by multiplying the share of the fuel on the total consumption (import dependence) by the probability of disruptions to the supply of this fuel.[16] While the dependence rate is easier to calculate, the probability of disruption could be determined both by a historical analysis of past disruptions and a weighted basket of supply risks including origin of the fuel, probability of transit disruptions and contract frustration. Providing an objective way of measuring the risks to the security of energy supply could provide policy-makers with a practical tool for designing the most sustainable energy strategy for tackling energy policy challenges. Furthermore, it should be emphasized that energy security measurement should be refined and enhanced on EU level, which will help the development of a coherent European strategy that takes into consideration the complexity of contradictory energy security policies.

Options for Supply Diversification in Europe

The Russo-Ukrainian gas dispute has serious repercussions for the EU energy policy as it led to a serious reconsideration of the EU-Russia energy partnership. The risk for the security of gas supply gave fresh momentum for the EU drive at supply diversification with a renewed focus on Southern Gas Corridor (SGC). Both the conclusions of the EU Council meeting in March, 2014 and the European Energy Security Strategy of the Commission in May, 2014 emphasized on the need to pursue further action on the completion of the SGC.

The current working strategy is to take advantage of the giant natural gas reserves (1.3 trillion cubic meters) in the Shah Deniz field in offshore Azerbaijan. Around 16 billion cubic meter of natural gas will reach European consumers via two major pipelines, the Transanatolian Pipeline (TANAP) passing through Turkey to the Greek and Bulgarian borders, and the Trans-Adriatic Pipeline (TAP) crossing Greece, Albania and reaching Italy via a subsea pipeline across the Adriatic Sea.[17] The project received a major push on

[15] Nosko, A. (2013). Energy Security in Transition: coping with energy import dependence in the Czech Republic, Slovakia and Hungary. Doctoral Dissertation. Central European University. Department of Political Science.

[16] Ibid.

[17] Cunningham, Nick. (03.12.2013). Trans-Adriatic Pipeline Takes Step Forward. *OilPrice.com*

28 June, 2013 when the Shah Deniz Consortium (SDC) announced its choice of the TAP pipeline for gas to be linked with TANAP in Turkey, dealing a heavy blow to the EU-Flagship Nabucco project, and effectively halting it. This choice is expected to have far reaching implications for the structure of CEE and SEE energy security in the short-and medium term. Although the quantities of potential gas deliveries from Shah Deniz are too small to directly challenge Russian gas dominance, they could tilt critical gas market balances in SEE with a multiplier effect across Central and Eastern Europe.

However, overall, the decision for the Shah Deniz consortium to name TA P as the priority pipeline for the deliveries of new gas supply from 2017 to Europe does not fulfil the strategic purpose of EU agenda for diversification. The TAP gas pipeline, instead would cross countries, whose dependence on monopoly gas exporters, including Russian, is far lower than the one facing the CEE region and is due to drop further in line with emerging into the prospective timeline alternative gas sources. The reliance of Greece on Gazprom gas has come down from 83 % in 2005 to 51 % in 2011. Italy's gas market is one of the most diversified in Europe and dependence on Gazprom gas is less than 38 %. Over the same period Bulgaria's dependence on Russian supplies, for instance, has remained at the same high level well above 85 %.[18]

It seems that the selection of TAP over Nabucco West is indicative of a broader trade-off, in which South Stream scraps the southern leg of the pipeline, which allows TAP to be the only gas link between Greece and Italy, in exchange for the Consortium's dropping of the alternative Nabucco West route.[19] Such an agreement was meant to effectively put an end to the Nabucco West project forcing the shareholders to write off substantial losses well in excess of 100 million euro, leaving a yawning gap for alternative gas supplies in SEE and CEE. The choice of TAP coincided with the buying by Azeri national oil company, SOCAR, of the Greek gas transmission company, DESFA. Gazprom, which also took part in the bid, at the final stage decided to withdraw from the competition. The latter raised concerns that there has been a behind-the-scenes market-sharing agreement between the members of the Shah Deniz consortium and Gazprom. The goal is that the Shah Deniz partners will not promote a competitive pipeline to the Russian-led South Stream, and Gazprom will not meddle in Greece's natural gas market.

The outcome of such a deal for the security of gas supply of the SEE and CEE regions is not solely associated with the availability of physical alternative gas flows but would decrease the CEE importers' bargaining power in on-going negotiations with Gazprom on prices, revision of the re-export ban, oil-indexation and other critical contractual terms. In effect, the result of a successful construction of the South Stream pipeline instead of Nabucco-West would further strengthen the ability of Gazprom and other Russian economic interests to directly influence political life in the region, largely ignoring the local interests of the countries.

For the Southern Gas Corridor to fulfil its geostrategic role of natural gas diversification, the EU has to consider promoting additional sources of natural gas in the Caspian and Middle East regions. Currently, there are four options under consideration:

- Natural gas supply from Turkmenistan via a TransCaspian Pipeline
- Iranian LNG or deliveries via the Turkish pipeline network
- Kurdistan Region of Iraq via a pipeline link with Turkey
- Direct LNG link from Israel or via a pipeline to Turkey

The Iranian and Turkmeni options are unlikely to materialise due to significant geopolitical, legal and economic obstacles. Although Iran is the second largest gas reserves holder in the world (34 trillion cubic meters) for the country to become a major

[18] Statistics based on Eurostat data on energy dependence levels in the EU.

[19] CSD (2014), "Energy Sector Governance and Energy (In)Security in Bulgaria".

natural gas supplier to Europe, it would have to develop its massive untapped potential in the South Pars supergiant field in the Persian Gulf. Key barriers to the reserves development are the continued international sanctions that prevent foreign oil & gas companies to service the E&P market. Another problem is that Iran is currently a net importer of natural gas as its domestic demand sucks up most of the new production capacity coming online.

Turkmenistan is also an unlikely EU gas partner as the viability of its gas supply hinges on the construction of a TransCaspian pipeline or an LNG link with Azerbaijan. The successful commissioning of the two projects has been prevented by the lack of a decision on the Caspian legal status. The issue depends on whether the Caspian basin is deemed a sea or a lake. If it is a sea, according to the International Law of the Seas, each country would have a 200 mile stretch off its coast to use for national exploitation. On the other hand, if it is recognized as a lake, the five states would be entitled to an equal share of the territory of the basin.[20] Iran is pressing for a "lake status" in order to acquire additional exploration space. Russia has firmly backed the Islamic republic on this issue, even threatening the other littoral states with military actions if new infrastructure is built without the legal permission of each one of the five littoral countries.

As a more likely alternative, the Kurdistan Region of Iraq (KRG) could become a potential future gas supplier to Europe.[21] The prospects were strengthened in 2013 when Turkey and the KRG signed a gas sales agreement in 2013 for the supply of up to 10 bcm per year starting in 2020. Yet he pointed out that the viability of Kurdish gas exports will depend on the ability of the regional government to reach an agreement with the central government in Baghdad on autonomous natural gas contracts.

Israel is also a potential supplier after the discovery of the giant Leviathan field in the eastern Mediterranean. However, a pipeline project with Turkey would be difficult as the latter has been wary of strengthening energy relations with Israel due to different foreign policy approaches to the Gaza conflict. According to a recent report by the Oxford Institute for Energy Studies (OIES), Israeli production could increase to 8-10 bcm/year by 2016/2017, and further rise to 10-15 bcm by 2020 depending on export markets.[22] A more viable export solution for the Israeli gas would be the LNG option. For the Israeli government there are two LNG options: one is to take advantage of existing LNG facilities in Egypt or to construct its own terminal on the Mediterranean coast. The viability of both options will depend on the structure of the European gas market in the next decade. A tight market would provide more incentive for foreign investors to build up the Israeli gas capacity. Some European gas experts in Europe claim that the demand for natural gas in Europe is bound to decline over the next decades due to a significant shift in the structure of Europe's energy mix.[23]

LNG as a Potential Option

The demise of the Nabucco-West project has been seen as a failure of the Common European External Energy policy in the face of increasing dependence of the Central and Eastern European countries on Russian natural gas imports. However, the abandonment of a cross-Balkan gas link connecting the energy-rich Caspian basin with the gas hubs in Central Europe did not dissuade efforts for diversification

[20] Five states debate division of Caspian Sea. (30.09.2014). accessed at http://www.worldbulletin.net/haber/145438/five-states-debate-division-of-caspian-sea

[21] Presentation by Dr. Simone Tagliapietra, Researcher at Fondazione ENI Enrico Mattei in Italy, on The EU-Turkey Energy Relations After the Ukraine Crisis, during the international conference "Energy Security and State Capture Risks in Europe".

[22] Dickel, R. et. Al. (October, 2014). Reducing European Dependence on Russian Gas: distinguishing natural gas security from geopolitics. The Oxford Institute for Energy Studies (OIES). Paper 92.

[23] Presentation by Dr. Frank Umbach, Director of the European Centre for Energy and Resource Security, on Good Governance and the Example of the South Stream Gas Pipeline Project, during the international conference "Energy Security and State Capture Risks in Europe".

along the Southern Corridor. A relatively new idea is to foster the construction and expansion of LNG facilities on the Mediterranean Sea. Recently built interconnectors between Hungary, Slovakia, Ukraine and Romania as well as introducing reverse flow options in almost all transit pipelines in the region, allows for an immediate and scalable growth in gas supply from indigenous or external sources – LNG and pipeline. The North –South Gas Corridor framework allows for integrating potential new LNG facilities as entry points for alternative gas supplies to the region and resides within the immediate grasp of the CEE governments. These efforts address immediate synergies and set the fundament for a more efficient mode of accommodating regional gas markets dynamics, individual countries' policies.

Existing LNG terminals in the region and planned new ones such as in the Gulf of Saros (Turkey), Alexandroupolis-Kavala (Greece) and Krk (Croatia) could significantly boost the resource base, increase the entry points from global gas; enhance gas market integration and trigger gas demand growth in the region.

The North-South gas corridor has been further enhanced by the completion of the Klaipeda Floating LNG terminal off the coast of Lithuania. With a projected regasification capacity of around 3 billion cubic meters, Klaipeda will not only improve Lithuania's immediate energy security, but will also diversify the energy supply of the whole Baltic region. The main supplier will be Norway, which will be selling LNG volumes at spot prices reducing the impact of paying high oil-indexed natural gas volumes from Gazprom. The latter already decreased the price of its exports to Lithuania by 23 % in May, 2014 in anticipation of the new market dynamics. Another LNG terminal at the Polish port of Świnoujście to be commissioned by the end of 2015 could further buttress the viability of the North-South corridor bringing up to 5 bcm per annum of Qatari LNG. Although the project had experienced cost spikes and the supply contracts will be based on oil-indexation, the alternative route will provide Central Europe an outlet to global gas markets that are bound to become much more competitive in the next decade.

LNG gas would not necessarily contribute in the short term to a significant reduction in gas prices but would enhance the security of supply, promote energy source diversification hence independence and improve the economics of new and existing projects in interconnectors, gas storage and pipeline transport. Even without full physical gas market integration a coordinated use of the free capacities at LNG terminals for direct or virtual gas swaps in the region could trigger immediate diversification of gas supplies even before the completion of planned interconnectors and the physical entry of alternative gas supplies.

The New Dimension of Energy Security Risks: State Capture

The negative influence of the traditional energy security risks is amplified by bad governance and state capture in the sector, which impedes the formation of a common and coherent energy strategy in South East Europe, and the Black Sea region. The countries in the region have been unable to improve their energy security partially because their energy sectors remain dominated by poorly managed state-owned enterprises characterized by widespread corruption and abuse of public funds. These have been skilfully used by Russia who has engaged state-owned energy complexes in large, inflated deals, which largely outweigh the capacity of the host industry to handle them properly, leaving national monopolies exposed to increased risk of financial dependence and subsequent loss of control over assets. The energy dependence of most of the countries in the CEE and Black Sea regions has been used by Russia as a political tool to influence the governments' decision-making. This considerably increases the threat of backsliding in democratic achievements in the region.

Recent examples of such strategy have been Bulgaria and Hungary's engagement in new nuclear facilities financed through loans from Russia. The increase of Russia's involvement in the regional energy sectors has translated in a powerful financial and political influence that decrease the countries' opportunities to diversify and liberalize their energy supply in

order to become more independent and to make the energy sector more profitable. This has effectively torpedoed EU's drive for better internal market energy integration, liberalization, and diversification as major drivers of energy security. Russia's strategy has been somewhat successful because the economic crisis in Europe provided the necessary environment for the growth of bilateral relations between countries in the CEE region and Russia. Moreover, with the decline of Russia's ability to exert military pressure, Moscow would try to expand its presence in strategic economic sectors in the region, such as the banking and energy sectors.

Part of the explanation for the strong influence of Russian private and state interests in the formation of energy decision-making are the close ties between energy companies. This historical relationship is perceived as vital to the well-functioning of the state and crucial to the overall economic development. Russia's influence on the domestic energy sector is revealed via past collaborations in energy infrastructure, long-term supply contracts and ongoing technology transfer. Overtime, these factors have influenced not only the inner structure of the economies but also the formation of domestic political elites. Such economic dependencies have grown very strong in the oil, gas and nuclear sectors based on rigid infrastructure, inflexible contractual obligations and partitioned market. In addition, Russian technological design and source of capital predetermine strategic policy choices and constrains the development of market-based solutions.

The prevalence of state capture mechanisms often leads the government to suboptimal decisions that side-line its own planning and investment needs that benefit the improvement of energy security, the minimization of energy losses, and the management of natural gas and power exchanges. The essence of the state capture practices in the energy sector is that the national energy policy is the product not of a consistent strategy based on a cost/benefit analysis but is designed to benefit private local or foreign, including state, interests. The loss of policy independence is the result of the systemic corrupt practices at all levels in the energy sector, the bad corporate governance of the state-owned energy enterprises, as well as the violation of all rules of market competition in the implementation of large energy infrastructure projects.

The existence of state capture practices is often the result of governance failure. The latter is preconditioned on the lack of effective and timely policies. Policy deliverables are usually ad-hoc in nature and are not executed on the basis of clear objectives. In addition, energy policy in many countries in the region are not coherent or easily understood by the general public. The lack of transparency in decision-making gives the impression of background dealings in the energy sector. The non-transparent nature of natural gas talks is most visible in the negotiations over long-term gas supply contracts.[24] Transparency, in his opinion, is crucial for the overall energy security of the region and the improvement of the bargaining position of consumer countries.

In order to counter the impact of bad governance practices, European researchers unite behind three main governance pillars to be constructed in the future:[25]

- openness of EU institutions;
- participation throughout the policy chain;
- accountability of legislative and executive processes.

The overcoming of state capture practices depends on the systematic development of both participatory decision-making mechanisms and awareness of the socio-economic impacts of energy strategies, as well as on alignment of social costs and indicators to economic and environmental state of the art, backed by an EU-wide energy dialogue.

[24] Speech by Mr. Traicho Traikov, Minister of Economy, Energy and Tourism of Bulgaria (2009 – 2012), during the international conference "Energy Security and State Capture Risks in Europe.

[25] Presentation by Andrea Ricci, Director of the Institute of Studies for the Integration of Systems in Italy, on Good governance and social sustainability indicators of energy systems during the international conference "Energy Security and State Capture Risks in Europe".

The improvement of energy sector decision-making comes also through the introduction of international standards for corporate governance in the state-owned energy enterprises such as the OECD principles. Some of the most urgent needs for the corporate governance of the energy sector in CEE and the Black Sea region but also in Europe as a whole include:

- the creation of an effective legal and regulatory framework for SOEs;
- a clear, consistent ownership policy so that the State acts as an informed and active owner;
- the ensuring of a mechanism for the state and the SOEs to recognize the rights of all stakeholders and treat them equally allowing for equal access to corporate information;
- the recognition of stakeholders' rights and their inclusion in the decision-making process;
- high standards of transparency and the development of consistent reporting on SOEs, with the publication of annual management review.

Their active implementation will benefit the formation of measures against the widespread management deficiencies in the energy sector. The problems with the non-transparent and inefficient corporate governance structure of the energy state-owned enterprises in CEE are exacerbated by the inconsistent legislation, which undermines the predictability and sustainability of decision-making in the sector. The current opaque system of corporate governance of state-owned enterprises is prone to abuses of public funds and serious neglect of the companies' and national interests. Sufficient public scrutiny over a consistent reporting mechanism are, thus, necessary to increase the transparency of governance and improve the management of state-owned enterprises.

In response to the state capture challenges, the role of the non-governmental sector in denouncing corruption and making sure international standards for good governance are implemented in the sector in the CEE and the Black Sea regions is key to improving the European energy security. The lack of comprehensive and in-depth process of monitoring the development of energy policy because of its innate technical complexity and notorious lack of transparency in the region has undermined the ability of the civil society sector to have an effective impact on decision-making in general, and as concerns anti-corruption and good governance, in particular. One has underlined the importance of civil society anti-corruption reports as tools for unearthing the potential harm of state capture processes to the public interest.[26] He concluded that the civil society should be given a more prominent role in both the monitoring and evaluation of anti-corruption strategies.

Southeastern Europe can be seen as a case study for the dominant role of corrupt practices in the management of the state-owned energy companies and the development of a consistent energy strategy. Countries in the region face common issues in tackling corruption: legislation on financing of parties not arranged or with no impact; dissatisfactory or problematic cooperation and coordination between institutions; low investigative capacity and weak prosecution; weak public procurement legislation and law enforcement; low administrative capacity of public financial inspection; lengthy or suspended trials, few final judgments, inconsistent or dissatisfactory sentences; weak monitoring mechanisms for anti-corruption policies, etc. All of these issues converge into one of the most important sectors of the regional economy – energy. Such issues have proven very potent in destabilising Ukraine and the lack of progress in democratic transition there. They can lead to similar processes in the ethnically divided and economically backwards countries in Southeast Europe.

[26] Presentation by Mr. Radu Cotici, Head of Secretariat of Regional Anti-Corruption Initiative, Bosnia and Herzegovina, on Public-Private Partnership for Countering Corruption in the SEE Region during the international conference "Energy Security and State Capture Risks in Europe".

State Capture Case Study: South Stream in Bulgaria

The risks of capture of Bulgaria's energy policy and its implications for the energy security of the country are most visible in the management of the Bulgarian section of the Gazprom-led South Stream gas pipeline project. With a varying degree of willingness, Bulgaria has subscribed to the project from its very beginning despite an increasing number of warning signs for its viability.[27] Negotiations on the project have been opaque, characterized by pressure exertion from the Russian side through a number of unexpected visits at the highest political level and Gazprom top management.

At the cost of EUR 3.8 billion, the financing of the project remained unclear until President Putin's announcement. A number of other questions have also been raised about the viability of the project including the lack of publicly available cashflow, demand projections, agreement on gas transit fees, as well as compatibility issues with the existing gas transit arrangements of Bulgartransgaz with Turkey, Greece and Macedonia. From a security perspective, the project would have only worsened the overall natural gas dependence of the country as the new route does not provide an alternative supplier of gas, despite improving the energy security position of the country in the short run. Regulatory issues have also been at stake as South Stream is violating the unbundling rules of EU's third energy liberalization package.

Despite the red flags raised by Brussels, the South Stream partner countries proceeded with the implementation of the project. In the case of Bulgaria and Hungary, the national parliaments even tried to amend their energy laws to circumvent EU legislation after the European Commission (EC) began reassessing the IGAs, voicing concerns that the EU member-states have not negotiated their decision to join South Stream without first consulting with the EC. The culmination came in the summer of 2014 when the Commission also began an infringement procedure

Figure 4. South Stream Route

Source: *Gazprom.*

[27] The South Stream case study is based on: Vladimirov, M., and R. Stefanov. (2014) "Bulgaria and the South Stream Pipeline Project – At the Crossroads of Energy Security and State Capture Risks". Südosteuropa Mitteilungen, 05, no. 06: 54-72.

against Bulgaria for violating the rules of the public procurement procedure for the choice of an EPC contractor. The government tried to accelerate the start of the pipeline's onshore construction in late July, 2014, by issuing construction permits to South Stream Bulgaria but had to ultimately backtrack amid growing public opposition to the project.

Overall, the continued attempts by consecutive governments to accelerate the construction of the South Stream pipeline despite objections from the EC increased fears that it is not (solely) the national public interests that drive the energy decision-making of the government. This was confirmed by the declassification of official documents and written correspondence between senior officials in BEH, the Gazprom management and the Bulgarian energy minister revealing how the Russian side had been instructing the local authorities in changing the domestic energy legislation.[28] Similar attempts at manipulating the national decision-making have been also observed in the management of the public procurement procedures and the definition of the final investment agreement terms. All of the above have demonstrated again that allowing third-party interests to drive a country's energy strategy removes policy-makers' ability to accurately and consistently define the key priorities in the sector and improve the country's energy security.

Conclusions and Policy Recommendations

Amidst the crisis in Eastern Ukraine, the new EU members and the Southeast Europe and Black Sea region countries are not prepared to adequately deal with a new energy crisis, as EU stress tests published in 2014 have shown. The lack of an EU Common Energy Policy, the failure of the energy dialogue with Russia, and the governance deficits in the energy sector are among the key energy security risks in the CEE and Black Sea regions. The high energy import prices and the over-dependence on one energy source and one transit route for imports of gas and oil are among the factors that influence energy security levels the most.

Apart from the four energy security dimensions (availability, reliability, affordability and sustainability), one should take into consideration the horizontal aspect of good governance, and the detrimental effect of state capture on the determination of the individual energy policy. Despite the activism of international organizations, the countries in the region still pursue mostly a bilateral approach to energy security, which is insufficient for the development of a strategic regional energy system. The latter erodes efforts for a comprehensive, multilateral (pan-regional) approach to the region's energy challenges, and puts at stake Europe's opportunity to diversify its energy supply. The consequences for countries in Central and Eastern Europe are that they remain victims of political pressure from the largest energy suppliers, which leverage their quasi-monopoly status on European energy markets to promote specific political objectives. In that sense, there is a need for developing a common understanding for the constraints stemming from the current segmented approach to energy security issues in the region and the identification of the multilateral mechanisms that can be utilized to strengthen the overall energy security architecture.

The latter requires the deeper engagement of NATO on a regional and European level in promoting a political dialogue between the different stakeholders to find a common ground on how to best improve energy security. The unfolding of the Crimean crisis has starkly demonstrated how Russia has managed to leverage the energy dependency of its neighbours in Europe to corrupt and capture political elites and ultimately change the balance of power in the region. The crisis has also demonstrated the lack of progress in EU and NATO efforts in reducing members' energy security risks.

[28] Bulgarian National Radio. (04.09.14). "Министър Васил Щонов разсекрети документите по проекта "Южен поток", accessed from http://bnr.bg/horizont/post/100456668/ministar-vasil-shtonov-razsekreti-dokumentite-po-proekta-ujen-potok

The EU in particular should revamp significantly its focus on energy security and step up efforts to set up the European energy union. In this respect, there are many challenges the EU faces in establishing the energy union this policy direction is irreversible, especially if the energy interests of countries in the CEE and Black Sea regions are defended. The main challenges include: the huge need of investment resources; the need for cross-border connections the different levels of energy poverty and hence ability to pay in member-states, etc.

Policy Recommendations

Improving the energy security and the governance of the energy sector in the CEE and Black Sea regions entails, at a minimum, the implementation of the following actions:

- Enhancement of EU efforts to form an energy policy based on a common mechanism for energy trade bargaining.
- Expansion of the regional natural gas and power interconnectors in Europe increasing the liquidity and competitiveness of the market.
- Construction of new gas storage facilities and the expansion of existing ones in Central and Eastern Europe.
- Natural gas diversification away from pipeline trade, and development of LNG capacity to tap world markets.
- Improving overall governance of the energy sector of CEE and SEE member-states and candidate countries through the introduction of transparent regulation and management of the state-owned companies and competitive public procurement processes.
- Consider all options for Introducing shale gas exploration under scrutinized procedures, in line with the highest EU environmental standards.
- Introduce prioritization and selection of large investments projects in the decision-making process, based on clear and transparent procedures and fact-based analyses, synchronized with the EU priorities.
- CEE and SEE governments should focus on energy poverty reduction and energy efficiency improvement, while leaving large scale infrastructure projects to be decided at EU level.

Related Publications

CSD Reports:

Energy Sector Governance and Energy (In)Security in Bulgaria, CSD Reports No 30, 2014
Energy and Good Governance in Bulgaria. Trends and Policy Options, CSD Reports No 22, 2011
Green Energy Governance in Bulgaria at a Crossroads, CSD Reports No 24, 2011

CSD Occasional Papers:

Anti-Corruption in Public Procurement: Balancing the Policies, CSD, 2011
The Energy Sector in Bulgaria: Major Governance Issues, CSD, 2010

CSD Policy Briefs:

Bulgaria's Energy Security Risk Index, CSD Policy Brief No 40, 2013
The Bulgarian Economy: Competitiveness 2013, CSD Policy Brief No 39, 2013
The Green Element in the Sustainable Energy Policies of Europe, CSD Policy Brief No 25, 2010

Other CSD Publications:

Policy Tracker: Economic Governance and Performance of the State-owned Energy Sector, CSD, 2014
Policy Tracker: Key Challenges for Energy Efficiency Policies in the Domestic Sector, CSD, 2014
Green Growth and Sustainable Development for Bulgaria: Setting the Priorities, CSD, 2012

Publications by CSD Staff:

Vladimirov, M., and R. Stefanov. (2014) Bulgaria and the South Stream Pipeline Project – At the Crossroads of Energy Security and State Capture Risks. In: Südosteuropa Mitteilungen, no 05-06, pp. 54-72.

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