

## Getting energy diplomacy right: a challenge starting at home

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In July 2015 the European Commission, together with the High Representative (HRVP), presented the EU Energy Diplomacy Action Plan. This will be an integral part of the EU's efforts to build up an Energy Union, felt as increasingly urgent in light of mounting political turmoil in the whole European neighbourhood, affecting both supply and transit countries. This commentary argues that the Action Plan is, in principle, a strategy for gas imports and pins too much hope on the diplomatic dialogue with alternative producers for gas, whilst neglecting that an essential pre-condition for an effective energy diplomacy starts with removing the misalignments in member states' preferences for their external energy relations. It is further argued that completing the internal market is the key to remove these misalignments.

Energy diplomacy refers to any diplomatic activity designed to enhance access to energy resources. The Foreign Affairs Council, along with the Commission and the HRVP will – according to the Action Plan – strengthen their support to the external aspects of the Energy Union within the Treaty mandate. Notably, the Action Plan mentions the enhancement of political dialogue with producers and transit countries both in the neighbourhood and in the rest of the world, prioritising those initiatives aimed at diversifying the gas supply to Europe, with a specific focus on the Caspian region, the Eastern Mediterranean and liquefied natural gas (LNG) supplies. Second, it calls for added support to multilateral governance frameworks, explicitly mentioning institutions and instruments such as the Energy Charter, the association initiative of the International Energy Agency, the reform of the Energy Community, and other initiatives at the UN level. In addition, efforts will be made to ensure open and competitive markets.

The overall assumption is that a more active external engagement by the EU would contribute to the continent's energy security. But can such an effort succeed when the house is not in order yet?

The EU's normative approach has been partly successful in changing the dynamics of EU-Russia gas relations. By implementing the Third Energy Package, the EU is forcing Gazprom to abandon a policy of unfair and differentiated pricing schemes and attempts to foreclose markets. However, these achievements do not seem to be enough to deter Russia from using energy as a political tool. The recent agreement on the Nord Stream II pipeline – allowing Russia to expand its export capacity to the EU and circumvent Ukraine – gives Moscow a stronger hand in its Ukrainian policy.

The reason why Russia scored this point is that the member states involved apply a national – instead of European – understanding of energy security. The Action Plan seems to suggest that the Russian ability to exploit the member states' diverging ways of framing energy security is due to dependence in itself, and that diversification – as an answer – failed in the past due to a lack of external political engagement by the EU. But this assumption is not entirely correct. Whilst the plan focuses on diversification, it should not be forgotten that just increasing external political engagement will not be enough, as serious measures will be needed within the EU as well.

First, dependence in itself is not the reason for the misalignment of member states' preferences, which gives so much leverage to Russia. Simply reducing the gas dependence rate will not change the member states' energy security preferences and the Russian attempts to exploit their conflicting interests. This is seen with oil imports:

dependence on Russian oil is not a particularly divisive issue. The reason is that the oil market is globally integrated, and entry points, hubs and transit are not considered as a national security issue. This demonstrates that the role of market integration in reducing the political sensitivity of import dependence is often overlooked.

Second, the reason why diversification for routes and suppliers of gas showed a dismal record in the past can hardly be attributed to a lack of external political engagement by the EU. The commercial rationale of several pipeline diversification projects was called into question, and should be even more now that demand is on a negative trajectory and the EU intends to decarbonise its economy. As for LNG, it can only flow to Europe when prices become attractive – and if this is not the case, it is because market segmentation does not allow LNG to compete in those parts of the EU market that are most exposed to the monopoly of a single supplier.

To reduce gas market segmentation, more needs to be done to remove remaining physical, regulatory and licensing barriers. The evolution of internal market liquidity exposes the insufficient depth and size of hubs, insufficient interconnection – especially in the North-South corridor in Eastern Europe – capacity hoarding, and local monopolies and oligopolies creating obstacles to trading. These persisting barriers drive flows in the opposite direction of the one normally suggested by zonal price spreads, preventing the price mechanism from playing a role in ensuring collective security, and therefore raising national security concerns. National regulators, whose mandates do not take into account the European interest, are part of the problem. As such, above all, robust and independent European regulatory oversight should be ensured. Ideally, this would imply the empowerment of the Agency for Cooperation of Energy Regulators (ACER). Once gas will be able to freely flow continent-wide, driven by prices able to re-allocate gas instantaneously in case a shock occurs, individual entry points will not be so nationally sensitive and national interests will be more easily driven towards convergence. In such a situation, Russia will no longer be able to extract political gains from EU member states' conflicting preferences. This is a fundamental pre-condition for effective energy diplomacy, which is needed in several areas – especially in the EU neighbourhood.

Once the home is in order, priority should be given to projecting the internal market beyond the EU's jurisdiction. The expansion of the Energy Community Treaty – notably to Turkey – would be of paramount importance. However, the EU should pay attention to Ankara's use of energy as a bargaining chip for regional power objectives, and make sure it will abide by common rules now that the Southern Corridor is politically 'owned' more by Turkey than by the EU. Also, continuous effort should be put into keeping a transit role for Ukraine during the trilateral negotiation between the EU, Ukraine, and Russia, as successfully done on the occasion of the latest Winter Package.

Energy diplomacy can be an important tool for enhancing the EU's energy resilience – but its pre-conditions remain at home. Completing the internal market will be necessary to unleash its strategic dimension *vis-à-vis* third powers.

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