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Article

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EU – RUSSIA AND THE ENERGY DIMENSION OF THE EASTERN PARTNERSHIP

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Abstract: *The Energy Union Strategy, launched in February 2015, is a vast project aiming at identifying a set of common responses to a series of present and future challenges in the field of energy. The question of energy security occupies a central position in EU's relationships with its neighbours. In this context, economic and political ties with the Russian Federation in its role of major supplier of energy resources to EU member states are of crucial importance. Acquiring a higher degree of independence from the Russian supply of natural gas has been proclaimed as a national priority by several ex-Soviet republics. Moldova, Ukraine and Georgia have recently signed Association Agreements with the EU. We look into the early stages of the implementation of AA's and analyse their consequences on the EU – Russia relations in the energy field. A series of common characteristics and possible developments in the field of energy are analysed.*

Keywords: EU-Russia; security of energy supply; diversification of energy supply; 3rd Energy Package; Energy Community; Eastern Partnership

JEL Classification: Q2; Q3; Q4 (main) F10; F13; F41; F55; H70; L71; L72; L78

Introduction

Association Agreements have recently been signed between the EU and three former Soviet republics – Moldova, Ukraine and Georgia – as an outcome of the Eastern Partnership agenda. Each one of these documents contains extensive provisions regarding the reformation of the national energy sector. Ensuring the energy security, raising the energy sector competitiveness and introducing the elements of a genuinely free and diverse energy market - are among the main objectives of the above-mentioned Agreements. How will the implementation of the energy compartment of the AA's impact the EU – Russia relationships, that are already in a state of advanced deterioration in the context of recent developments in Ukraine? What are the main regional geo-political factors capable to play a role in Russia's degree of resilience on the question of energetic freedom of its former satellite states? What are the most effective methods for the three former Soviet republics to attain their European integration objectives, while maintaining Russia's geopolitical ambitions within reasonable limits?

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In the current paper, we look into the early stages of the implementation of AA's and analyse their consequences on the EU – Russia relations in the energy field. While the purpose of this article is not to provide a deep and comprehensive study of the energy sector in each of the 3 ex-Soviet republics, a series of common characteristics and possible developments will be analysed. Ukraine, Moldova and Georgia have signed commitments on energy reform, as part of AA's. Nevertheless, their energy sectors are very different: Moldova's gas sector is "Gazprom-owned" and dominated; Ukraine's natural gas transmission operator is nationally owned, but has a highly complex web of interdependence, but also corrupt links, with Gazprom; Georgia is buying most of its gas from Azerbaijan and has a relatively high share of own hydropower in the energy mix. Despite similar commitments to reform the energy sector, the state of play of the 3 countries in the field is very different. Our article will analyse the most urgent needs and challenges in implementing AA's and relating to the Energy Community obligations. The role of the newly-forged European Energy Union in EaP member states' path towards European integration (with a focus on Moldova, Ukraine and Georgia) will be discussed.

The European Commission installed in 2014 defined the establishment of a resilient European Energy Union as one of its top priorities. Its main goal is to give consumers secure, sustainable, competitive and affordable energy (European Commission Press Release on Energy Union, 2016). The most important challenge in achieving this goal is to construct an open, liquid and competitive European internal energy market, allowing the EU to act and to speak as one unique organism in its relations with external energy suppliers. In an Energy Union, cooperation of member states with their neighbours when implementing their energy policy is of vital importance. Transparency of member states regarding their energy relations with third countries and compliance to internal EU market regulations are key requirements for the well-functioning of a resilient and efficient internal energy market. International relations based on the realities of the global energy market and trade are no longer a matter of pure economic or financial policy. In the last several decades, they have acquired a political dimension, and become a powerful tool of foreign policy in the hands of major energy supply and energy transit countries. The European Union needs to make use of its economic and political weight on the world scene, and to project its principles, views and interests on the global energy market. In doing so, the EU must act in a stronger way in order to engage in a more constructive and ambitious dialogue with its major energy partners, including Russia. Better global governance of energy markets will lead to a more competitive and transparent energy system, for the mutual benefit of all parties. EU-Russia energy aspects form the very basis of the relations between the two economic and political spaces. Eastern Partnership countries are situated at the confluence of

regional interests of both EU and Russia, and the energy dimension of the EU-Russia relations influences and orients the action taken in the direction of these six former Soviet republics. In this article, we discuss the implications of the EU-Russia energy relations on the three Eastern Partnership member states that have recently signed Association Agreements with the European Union: the Republic of Moldova, Ukraine and Georgia. Among them, Ukraine's role as a major transit country for energy resources (especially pipeline gas) imported from Russia is predominant, especially in the light of the most recent developments in this country since the end of the year 2013. Indeed, internal political turmoil followed by Crimea's annexation (2014) and the military Russian aggression in the Eastern part of Ukraine cannot remain without consequence on EU-Russia energy relations. Although in a completely different manner, Moldova has also undergone internal turbulences during the last 18 months, steering popular unrest related to giant fraud in the country's financial system. Georgia's geographical position in close proximity to Azerbaijan is an important asset in EU's search of alternative energy sources. Before going into more details in relation with each of these three countries' position and perspectives in the EU-Russia big picture, we will analyse several issues concerning the existent state of the energy relations between the two major dialogue partners.

1. Energy as a component of the EU – Russia relations in the past decades

Immediately after the breakdown of the Soviet Union in 1991, the Russian Federation acknowledged its potential as a major energy supplier to European countries. During the 1990's Russia used its dominant position on the European energy market (Noël, 2008)¹ in order to set up new frameworks of economic, but also of political co-operation with the EU15, and after 2004 and 2007, with the EU27 Member States. Russia's economic position on the energy market and its role as a major energy supplier to the European Union was confirmed in the Partnership and Cooperation Agreement signed between the Russian Federation and the European Union in 1994. Russia is still considered today to be a major supplier of energy resources to the European Union, especially when it comes to gas and oil. The public's perception in respect to the share of the Russian gas in the European Union's energy mix is often exaggerated. As a matter of fact, the Russian gas as a share of primary energy consumption is stabilized at approximately 6.5% over the last 25 years (BP Statistical Review of World Energy, 2015). Since 1990, Russia's share of gas imports to EU27 has significantly dropped, from 75% to roughly 45%, demonstrating on the European side a successful implementation of a diversification of supply strategy during the past quarter of a century. In 2013, 33.5 % of total

¹ In 1990, 75% of the imported gas in the EU27 countries originated from Russia

EU's crude oil imports and 28.8% of total EU coal imports originate from the Russian Federation (Eurostat, 2013). At the same time, the European Union is by far Russia's most important trade partner: 47% of all Russian imports originate from EU, and about 75% of the foreign investments in Russia come from EU investors.

Since the beginning of the EU – Russia economic relations in the early 1990's, the Russian Federation privileged the signature of long-term supply energy contracts directly with member states. Two major EU economies of the EU15, Germany and Italy, are nowadays dependent on a larger scale on imports of Russian gas (BP Statistical Review of World Energy, 2015; Eurostat, 2013). The accession of new member states to the European Union in 2004 and 2007 did not produce a great change in the EU – Russia energy relations. As a matter of fact, a number of the new member states were in a long lasting relationship of dependence on Russian energy resources at the moment of the accession to the European Union (Noël, 2008). Their accession to the European Union did not change the state of play in respect to their dependence on Russian gas, crude oil or coal. At present, the European Union is constructing and implementing a joint approach to the need for ensuring security of supply of energy resources. It is only with the approval of the Third Energy Package in 2009 that the EU started to address the real hurdles in the process of building a common energy market. Until recently, the lack of a coherent internal EU policy on energy led to a situation in which external energy suppliers, especially Russia, disposed of a specific “leverage” in the field of energy – bilateral negotiations with suppliers from individual EU-member countries often raised to the level of political negotiations. Thus, during the past decades, Russia did not hesitate to make use of its dominating position on the energy market of several EU member states in order to promote its own interests, including those deriving from purely political considerations. While it appears clearly that considering Russia as having a dominating position on the energy market of the EU as a whole is an exaggeration, one must recognize its divisiveness on a certain array of issues, including European Union's foreign policy. In the short term, a possible European answer to Russia's divisive strategy on the energy market could imply the identification of demand aggregation mechanisms, allowing for the instalment of collective purchasing procedures in times of crisis. The implementation of such instruments would put the Russian Federation in a position of taking into account EU-level interests when negotiating energy supply contracts, and would automatically limit the possibilities to impose long-term contracts to member states (Framework Energy Union Strategy, 2015).

Another way to limit third countries' (mainly the Russian Federation, relevant to the case of energy supply) interference with EU member states internal matters would be to ensure the transparency of energy supply procedures. First and foremost, this leads to the necessity of setting up

procedures of legal compliance of commercial energy supply contracts concluded between EU member states and third countries to EU internal rules. Intergovernmental Agreements (IGA's) governing at present the vast majority of gas supply contracts with third countries, are subject of a post factum compliance assessment process by the European Commission, as provided by the IGA's Decision (2012). The practical impact of these assessments is limited, especially when it comes to sensitive, confidential provisions included in the supply contracts. As a matter of fact, the compliance checks are undertaken after the clauses have been negotiated and agreed upon by the signatory parties. Evidently, any further eventual modification of the contract implies obtaining both parties' principle agreement, thus it involves introducing new conditions and eventually modifying the very essence of the supply conditions. Very often, in such cases, bilateral EU member state – supplier country considerations prevail. Therefore, political pressure originating from the supplier country's will to defend its positions on the EU energy market is difficult to avoid. One way to ensure IGA's compliance with EU internal market rules and security of supply criteria would be to ensure the European Commission's participation in the process of negotiation, and to set up a list of standard contract clauses. The European Commission will review in the near future the IGA's Decision, in order to ensure the EU speaks up with one voice in its relations with third countries (Framework Energy Union Strategy, 2015). The proposed revised text of the Decision contains a number of obligations for member states, to inform the European Commission in a pro-active manner, at every step up to the ratification: entering a negotiation process, draft of the agreement for an ex-ante Commission assessment, amendments, ratification. The member state must take into account Commission's opinion prior to the final ratification of such an agreement (IGA's Decision, 2012).

Since its launch at the 6th EU – Russia Summit in 2000, the EU – Russia Energy Dialogue is a permanent instrument of communication and cooperation, based on the idea of energy interdependence between both sides, therefore on the existence of a set of common interests and goals. A decade later, the paramount *raison d'être* of the EU-Russia Energy Dialogue, as identified by Paul Magette, the Belgian Minister for Climate and Energy, is the mutual willingness to develop and to promote “the pragmatic and equitable principle of security of supply and security of demand”².

² Paul Magette, Belgian Minister for Climate and Energy, Welcome Address at the 10th Anniversary Conference of the EU – Russia Energy Dialogue, Brussels, 22 November, 2010

2. EU's new energy policy: unbundling the Russian geopolitical mix

During the past decade, the European Union forged itself into adopting a new approach in the energy domain, aiming at affirming its role as a major and, foremost unique player on the European continent. An important step forward in this direction is the entering into force of the Lisbon Treaty in 2009, conferring the EU explicit competences in the field of energy. The underlying principle of this Treaty in its energy section is that of a spirit of solidarity, responsibility and transparency among all Member States, when it comes to dealing with the main challenges related to the establishment of a common European energy policy. The Treaty marks the genuine start of the process of Europeanization of the energy policy, favouring the creation of a unique EU energy market. This should allow the European Union to speak with one voice in its relations with the main energy suppliers (Russia among them, but not the only one), and therefore contribute to “the introduction of transparent and market based relations between producers, transit countries and the consumers”.³

As it has been stated on numerous occasions by EU decision makers – urgent action at national and European level is needed, in order to provide for reliable, secure, environmentally sustainable and affordable energy for European citizens. Evidently, attaining these goals appears almost impossible without the establishing a close cooperation with the main energy suppliers, among which the Russian Federation plays a very important role. Today, Russia's main interests in the EU-Russia Energy Dialogue theoretically should derive from the country's urgent needs to ensure the security of demand of its energy resources, and to modernize its energy sector. The development of the Russian energy sector includes large-scale importation of technologies available in the West. The implementation of large infrastructure projects aiming at ensuring new extraction, transportation and storage capacities are vital for maintaining Russia's positions on the European energy market. Also, as a tributary to large-scale Soviet-type infrastructure (especially in the household and industrial sectors), Russia is interested in the implementation of energy efficiency measures. While attaining the above-mentioned objectives demands the implementation of an energy policy based on an open-minded approach and concerted actions with its European partner, Russia seems adopt a different logic, which is not in every point convergent with its theoretical interests, as stated in this paragraph. Thus, the diversification of the EU energy supply is seen as a sign of “mistrust”⁴ in the EU-Russia relations. European Union's search for new energy sources and for new, alternative routes to supply

³ Gunther H. Oettinger, European Commissioner for Energy, Keynote Speech at the 10th Anniversary Conference of the EU – Russia Energy Dialogue, Brussels, 22 November, 2010.

⁴ Sergey I. Shmatko, Minister for Energy of the Russian Federation, Keynote Speech at the 10th Anniversary Conference of the EU – Russia Energy Dialogue, Brussels, 22 November, 2010.

energy to its consumers is seen by Russian officials as a major risk for the decades to come. From Russia's viewpoint, diversification of energy supply leads to additional costs, paid by the consumers, and thus "lowering the competitiveness in the sector"⁵. While it is difficult to argue against a short and middle-term increase in the expenditures caused by the diversification of energy supply, the collective gains of EU member states in the long run consist mainly in the identification of a resilient answer to situations of energy shortages or disruptions, and therefore in the limitation (aiming complete elimination) of Russia's "political leverage" bias from the Energy Dialogue. It is important to add that while Russia is resilient towards EU's efforts aimed at diversification of natural gas supply routes, Russia itself is pushing a number of projects aimed at bringing gas to EU via alternative routes. These projects are not so much aiming to increase Russia's presence on EU natural gas market, but rather to reduce the role of traditional transit countries (particularly Ukraine) and therefore gaining additional leverage in the Russia-Ukraine relations.

Diversification of energy supply implies urgent need for new, complex and expensive infrastructure, both outside and inside the European Union. For this, the efficient use of all available funding instruments (including the future European Fund for Strategic Investments – EFSI) is of crucial importance. Limiting external suppliers influence on EU internal energy matters passes also through identification of infrastructure solutions. For example, the instalment of reverse flows, allowing to supply the gas networks from several alternative sources is the an efficient measure to ensure security of supply in times of temporary shortages, or in case of regional issues that might impact the flow of gas on a regional level. In cases of temporary disruptions of gas flows, tight cooperation between EU neighbours is necessary, as stated in the 2014 European Commission's Report on short-term resilience in the gas sector (Com. on gas resilience, 2014). For the oil sector, the Oil Stocks Directive (2009) contains a series of obligations for EU member states, to install in the nearest future the infrastructure needed for stocking crude oil and oil products. This measure is another step forward in ensuring EU energy market resilience in times of oil supply disruptions. Increasing the share of Liquefied Natural Gas (LNG) supplied by third partners: Algeria, Nigeria, Egypt, Trinidad, Qatar (Noël, 2008) in the internal energy mix is another way to ensure diversification of energy supply and decrease dependence on energy imported from the Russian Federation. Today, due to high liquefaction, transportation and re-gasification costs, LNG prices on the world market are higher compared to pipeline gas. Nevertheless, significant increase of LNG storage capacities in Europe and efficient connections linking LNG with the European internal energy network will

⁵ Sergey I. Shmatko, Minister for Energy of the Russian Federation, Keynote Speech at the 10th Anniversary Conference of the EU – Russia Energy Dialogue, Brussels, 22 November, 2010.

contribute to a fall of LNG price. The European Commission's comprehensive LNG strategy aims to increase Europe's LNG storage capacities and to adapt the regulatory framework (Framework Energy Union Strategy, 2015). Currently, EU's total LNG import capacity can meet 43% of the European gas demand (2015) (European Commission Press Release on LNG, 2016). Nevertheless, the access to LNG in south-eastern, central European and Baltic states is very limited due to the lack of adapted infrastructure. The LNG strategy is oriented towards reducing these disparities at the European level, and granting Eastern and Central European countries an access to a wide range of supply sources, through a regional gas hub. The costs for the new LNG infrastructure will be paid through end-user tariffs; in some cases gas companies will bear a part of the construction costs. Also, EU funds available through the Connecting Europe Facility (Projects of Common Interest – PCI's) (CEF Energy, 2014) or EIB loans or EFSI might fill in the gaps. A number of EU member states heavily rely on nuclear energy; therefore they are dependent on the import of nuclear fuel and related services (especially storage of nuclear waste) on Russia. Diversification of supply in the field of nuclear fuel and services is a very important matter, even for member states that have adopted strategies to considerably diminish the share of nuclear energy in their energy mix over the next decades.

Increasing domestic energy production is a way to decrease EU's dependence on imported energy. This goal can be achieved mainly through the development of renewable energy sources, thus complying with the environmental objectives fixed by the European Union: attaining a share of 20% of renewables by 2020, or of 27% by 2030. On a longer term perspective, the European Union's objectives related to the implementation of the energy transition and to the achievement of a Low Carbon Society by 2050 are very relevant when it comes to increasing the share of renewables in the European energy mix.

Enhancing energy efficiency measures allows a constant decrease in energy needs and therefore leads to lowering energy dependence on external suppliers. According to the most recent estimations, half of the energy used in the European Union serves to heat and cool buildings, both in the residential and in the public service sectors (European Commission Press Release on Heating and Cooling, 2016). Moreover, 75% of the energy used for this heating and cooling cycles is of fossil origin. Therefore, in the medium and long term, strengthening the implementation of energy efficiency measures is a sure method to reduce the energy dependence. The new Heating and Cooling Strategy proposed by the European Commission sets up a series of measures to facilitate renovation of buildings, promote energy efficiency models (especially in the public owned buildings), and revise a number of existing legislative documents (the Energy Efficiency Directive, the Energy Performance of Buildings Directive, etc.) in 2016.

A unified and coherent internal EU energy market cannot be conceived without a proper level of interconnectivity of national energy networks. At present, the EU faces a situation of insufficient cross-border connectivity between member states. This state of play does not favor the gradual disappearance of the so-called “energy islands” within EU borders. A minimum interconnection target of 10% of the installed electricity production capacity by member states has been set up for 2020 (Framework Energy Union Strategy, 2015). This target will be revised to reach minimum interconnection of 15% by 2030, as it should be communicated by the Commission during the year 2016. An integrated energy system needs consequent investment in order to function in a secure and sustainable way. The investment needs for major infrastructure projects is estimated at 200 billion euros annually over the next decade (Investment Plan, 2014). A number of instruments are available to provide the necessary financial support for major projects, such as the European Investment Bank, the Connecting Europe Facility and European Structural and Investment Funds. In the near future, these are to be completed by the European Fund for Strategic investments that will concentrate its activity on projects of European importance, such as energy networks, renewable energy and energy efficiency. The European Commission will ensure a transparent access to the information on the existing funding schemes, in order to contribute to a better orientation of the existing investor capacities, and to maximize the impact and the coherence of the investments in the energy sector.

The creation of a genuinely free, open and competitive internal EU energy market is impossible without a strong legal and regulatory framework. A series of policy instruments in this respect is contained within the 3rd Internal Energy Market Package. In recent years, the European Commission is monitoring the implementation of the provisions of the 3rd Energy Package. Unbundling (separation of major energy companies upon the functional principle) and coherent, EU-oriented functioning of national energy regulatory bodies are at the core of the 3rd Package. Regulatory agencies of member states are still too often oriented towards the defence of national companies. Also, they need to set up an efficient cooperation with energy transmission system operators in order to contribute to the emergence of a truly integrated EU energy system. The 3rd Energy Package institutes the Agency for Cooperation of Energy Regulators (ACER), whose main role is to assist national regulator bodies. Nevertheless, ACER has a very limited decision-making power, acting mainly through recommendations and opinions. Therefore, it needs to be strengthened and allowed to carry out regulatory functions at the EU level, and have prerogatives on cross-border issues. The new European energy system’s degree of integration will depend upon the efficiency of the European Networks of Transmission System Operators for Electricity and Gas (ENTSO-E/G), established by the 3rd Energy Package (Framework Energy Union Strategy, 2015).

3. EU's energy policy in the Eastern neighbourhood countries

3.1. *Energy Community*

During the past 15 years, the European Union fully acknowledged the fact that securing energy supply from Russia goes hand in hand with deepening the cooperation in the field of energy with its Eastern neighbours. The EU has undertaken an ambitious agenda of extending its energy *acquis* Eastwards, by setting up an international organization – the Energy Community (formerly called the Energy Community of South-East Europe), composed of the European Union and 8 third Contracting Parties (Western Balkans countries and two of the six members of the Eastern Partnership: Moldova and Ukraine). Currently, the main goal of this organization is to contribute to the accession of the Contracting Parties to the integrated European energy market through the transposing of the 3rd Energy Package. Ensuring diversification of energy supply, enhancing the implementation of energy efficiency measures and stimulating the development of the renewable energy sector in the neighbouring countries – these are the concrete directions set up for the members of the Energy Community. The complexity of achieving the Energy Community's tasks makes it an ambitious endeavour, as it is for the first time since the creation of the European Community more than half a century ago, that the European Union is practically “reproducing” its own institutions and procedures outside its own borders (Renner, 2009).

Moldova and Ukraine expressed their political will to join the Energy Community in 2008. After a period of negotiations, and assuming among other commitments a profound reform of the national gas system by the compliance to the EU's Gas Directive, the two EaP countries became members of the Energy Community in May 2010 (Moldova), and, respectively, in February 2011 (Ukraine). Georgia is at present one of the observers to the Energy Community.

3.2. *Ukraine*

Ukraine is a major transit country for the Russian gas reaching the European Union. It is also one of the major clients of the Russian state-owned Gazprom. Half of the total volume of the pipeline gas sold annually by Russia to the European Union transits the Ukraine. Although Ukraine produces more electricity from its nuclear and coal sectors, according to the Oxford Institute for Energy Studies, its outdated, Soviet-type industry and municipal infrastructure “is highly dependent on gas” (Pirani *et al.*, 2014). Before 2014, more than 50% of the total volume of the gas consumed in Ukraine originated from Russia (Turkmenistan was the second major gas supplier). Ukraine-Russia energy

disputes are not a novelty. The first “gas war” between the two countries escalated at the beginning of 2006, when Russia and Ukraine failed to identify a consensus concerning a long term supply contract for pipeline gas. The consequences of these worsened relationships have immediately been felt in EU member states, some countries having immediately reported a drop of about 30% of pressure in their national gas (Hotten *et al.*, 2014). The second “Ukraine-Russia gas war” occurred exactly 3 years later, when a new gas supply cut from Gazprom turned into more than two weeks of shortages for several EU member states (especially Slovakia and Bulgaria) in the middle of a particularly harsh winter period. It needs to be noted, that in both cases Gazprom’s actions have been politically oriented, as these “sudden gas cuts” occurred during political tensions between Moscow and Kiev. When the more Russian-friendly president Viktor Yanukovich came into power in 2010, Gazprom seemed to have put aside the economic arguments (Ukraine’s “historical” debt to Russia for the unpaid gas bill, amounting to approximately 4.5 billion USD (Dickel *et al.*, 2014)), and a settlement of the gas dispute has been identified. Meanwhile, within the EU-Russia Energy Dialogue, an Early Warning Mechanism (EWM) has been instituted as means of preventing negative impacts of eventual problems of energy supply⁶.

After the February 2014 revolution in Ukraine and the signature of an Association Agreement with the European Union, the country’s energy sector is included in the long list of domains that need rapid and profound reforms and modernization. The energy sector modernization in Ukraine reposes on two pillars: re-building the infrastructure and implementation of energy market reforms, with a strong focus on reducing corruption in the sector. Ukraine is in need of serious upgrades of its gas and electricity national networks. Also, energy efficiency measures need to be implemented, especially in the household and public sectors, as a method of reducing the country’s need for energy and therefore its energy dependence upon imported energy. On the other side, the country’s energy regulatory framework needs to be reformed, adopting the principles of ownership unbundling and effective independence of the national regulatory body.

Although officially owned by the Ukrainian government, the national gas operator Naftogaz has long been under the influence of the Russian giant Gazprom, not least because Ukrainian politicians sought to obtain corrupt profits from the energy sector and links with Gazprom. Thus, Ukraine was not able to efficiently defend its national interests during the “gas wars” with Russia in 2006 and 2009. The question of the historical multi-billion gas bill remained on top of the political agenda between the two countries. Since the 1990’s, Russia agreed to “freeze” this question in exchange for the long-term lease of the Sevastopol infrastructure for the Russian Black Sea military

⁶ Report of the 10th Anniversary Conference of the EU-Russia Energy Dialogue, Brussels, 22 November 2010

fleet. Even so, the long-term lease contract to host the Russian Black Sea fleet in Sevastopol until 2042 resulted in a slight “discount”, of 100 USD per 1 thousand cubic meters of gas, sold by Gazprom to Ukraine. Taking into account this discount, the price of the Russian gas delivered to Ukraine was of 420 USD per 1,000 m³ (mid 2013), still higher than the price of the gas delivered to European consumers, which was of approximately 370 USD per 1,000 m³ of gas at the same period. The military annexation of Crimea by the Russian troops in 2014 eliminated this variable from the Russia – Ukraine gas relations. In the context of serious deterioration of EU – Russia relations following the events in Ukraine in 2013 – 2014, the subject of the gas bill has a considerably increased weight, introducing yet another non-negligible element of political pressure.

Recent changes in the European regulatory framework, resulting mainly from the implementation of the 3rd Energy Package, have had an impact on Ukraine’s gas supply. While negotiating long-term supply contracts with major European consumer, Gazprom introduced a series of “take-or-pay provisions”, forcing EU consumers to pay even for the unused volumes of delivered gas. The economic crisis in European countries led to a decrease of gas consumption, a situation in which a surplus of gas supply occurred in several countries, notably in Germany. In conjunction with these factors, gradual elimination of destination clauses from long-term supply contracts with Gazprom allowed European countries to re-sell their unused volumes of purchased gas to third parties, mainly to Ukraine. The construction of a number of new compressor stations permitted the reverse of the gas flow from the West to the East, and since November 2012 the German energy giant RWE sells directly to Ukraine billions of cubic meters of “Russian” gas annually (Popescu, 2013) that flows through Slovakia, Poland and Hungary. In response to Gazprom’s insistent protests over these new practices, RWE argues that it sells to Ukraine surplus gas out of its general energy mix, and that once the negotiated price has been paid to the supplier, it decides on its own what to do with this gas. By applying this strategy, Ukraine’s EU partners manage to undermine Gazprom’s ‘market partitioning’ (i.e. selling gas at different prices to different countries, as part of a larger geo-political approach), and to limit Russia’s energy leverage over its neighbours. Today, Ukraine has almost completely ceased imports of natural gas from Russia. Following the conflict in Eastern Ukraine, the natural gas consumption plummeted, together with industrial consumption of gas. Presently Ukraine is relying on its own gas, as well as natural gas imported from the West (in reverse mode). In response to this new state of play, Russia has been pushing for alternative routes of supplying natural gas to EU markets (North Stream – 2, South Stream, then Turkish Stream) primarily to be able to avoid (or at least minimize) the role of Ukraine as a transit country and thus gain additional leverage in their relations with Ukraine.

The share of EU gas in Ukraine's energy mix is constantly increasing. Nevertheless, in a scenario of possible economic boost in EU economies in the years to come, available gas surplus might decrease in European countries. Therefore rendering once again Ukraine's gas supply secure, stable and independent of internal evolutions in other countries – is up to date a question still unanswered.

3.3. *Moldova*

In its natural gas sector, the Republic of Moldova is in a situation of almost complete dependence on Russia. Close to 100% of its gas originates from the Russian Federation, and only an insignificant quantity of gas flows in through the Iasi-Ungheni pipeline that has been inaugurated in 2014. Moreover, 50% of the national gas company MoldovaGaz is owned by Gazprom (and 13% of shares owned by the Transnistrian authorities, but offered in trust management to Gazprom (Nutu *et al.*, 2016)). The 50% share in MoldovaGaz has been conceded by the Moldovan government in 1997 as a retribution for the country's "historical debts". At present, MoldovaGaz's role on the Moldovan market is twofold: it is the main importer and supplier of natural gas, and serves as a holding company which owns the main Moldovan Transmission System Operator (TSO) and DSO's (Distribution System operators, in process of merging into one national-wide DSO). The situation in the electricity sector is quite similar as it comes to the degree of dependence upon external supply, as only 18.3% of the electricity is produced on the right bank of the Dniester river, the rest of it being supplied from the separatist left bank of Dniester, uncontrolled by the country's constitutional authorities (Morcotilo, 2015).

Moldova's obligations to reform the energy market are mentioned in the Association Agreement, with direct references to the country's commitments assumed as an Energy Community contracting party. In a foreseeable future (end of 2017), security of energy supply can be granted by diversification of supply through the construction of a large capacity gas pipeline Ungheni-Chisinau (Nutu *et al.*, 2016). The completion of this infrastructure project would make the Iasi-Ungheni pipeline genuinely useful for Moldova and would effectively tackle Gazprom's role of monopolist on the Moldovan internal energy market. Transposing the provisions of the 3rd Energy Package would bear a series of profound changes in the current state of play, allowing for an unbundling and a liberalization of the energy market. This would create a more understandable and predictable environment, facilitating the entering of foreign investors, so much needed for the implementation of large infrastructure projects. One efficient way to reduce Moldova's energy dependence upon Russia

is to favour an efficient inter-connection of its electricity grid with the Romanian national network (Dusciac, 2015, p. 133). Energy interconnection with Romania will also lead to a decrease of end-user tariffs, as Romania is producing excess electricity which is cheaper than in Moldova. The implementation of the 3rd Energy Package will also stimulate the energy efficiency sector and will allow for the adoption of a Renewable Energy Law, thus contributing to lowering the degree of energy dependence on Russia.

Gazprom's uncontested reign over the Moldovan energy landscape is nowadays a major factor that contributes to the stagnation of the country's energy sector development. In the present state of play and in the light of recent regional developments related to Ukraine, foreign investors are simply not willing to penetrate the Moldovan energy market. One of the most important specific reasons is that the own electricity generators (CHPs) accumulated huge historical debts (mainly in the period 2000 – 2009) towards MoldovaGaz, which, in turn is indebted to Gazprom. Attracting any investment in these energy generation facilities is impossible without solving the "debt-to-Gazprom" issue. Moreover, partial and hesitant implementation of 3rd Energy Package provisions, especially those related to the energy market liberalization, shows that nowadays Moldova's credibility in the field is subject to a very weak, almost absent political will to undertake serious and effective transposition of the EU energy acquis.

3.4. Georgia

Situated at the interface between major energy supplier countries (Azerbaijan, Turkmenistan, etc.) and major energy consumers (European Union), Georgia is taking advantage of its geographical position, striving to affirm and maintain its role as a transit country for energy resources. As an observer to the Energy Community since December 2007, the country is currently undertaking a series of profound reforms of its internal energy market that are expected to grant accession to the EnC by 2017 (Sumbadze *et al.*, 2014).

Georgia has one of the world's largest share of hydro power per capita. Nevertheless, close to 70% of the country's energy needs are imported, mainly in form of fossil fuels. As part of its commitments stated in the Association Agreement, Georgia is implementing a series of reforms aiming to build an open, competitive and transparent energy market. As Moldova and Ukraine, Georgia is implementing a series of legal provisions of the 3rd Energy Package. The Georgian Electricity Market Model 2015 (GEMM 2015) adopted in 2012 sets forward a series of new developments of the electricity sector, directed towards the introduction of competitive market

principles, in compliance with EU regulations. GEMM 2015 favours the increase of the share of private investment in the hydropower sector and aims to decrease the dependence on imported fossil fuels. The Electricity Trading Mechanism, another fundamental strategic document, establishes a modern set of rules governing the electricity market in Georgia stimulating the development of cross-border electricity trade instruments and exports of electricity to neighbouring countries. The implementation of ETM is expected to reduce total electricity system costs by 10% annually, leading to gradual decrease of end-user tariffs (Sumbadze *et al.*, 2014).

The development of the Georgian energy sector is one of the main priorities defined in the Socio-Economic Development Strategy Georgia 2020 (Government of Georgia, *n.d.*), adopted in June 2014. Thus, Georgia will maximize its transit potential and further ameliorate the investment environment in order to stimulate foreign direct investments in the field of energy. Ensuring a higher degree of energy independence is achievable, according to the Strategy, through the support of the local hydropower potential and the implementation of energy efficiency measures. Georgia views accession to the Energy Community as a way to boost its energy exports. The electricity production capacity of Georgia is intended to almost double by 2020.

Conclusions

EU-Russia relationships represent a two-ways road. The concept of “interdependence” is very present in the diplomatic discourse employed by both parts. Trying to summarize this concept, one can say that interdependence means supply and transportation of hydrocarbon energy resources from Russia to EU, in exchange for economic investment and transfer of modern technology from EU to Russia. In this sense, security of energy supply and of energy demand are central issues, underlining the wide array of EU – Russia relations. Nevertheless, in a number of ways, these concepts are not understood in the same way by each of the partners of the Energy Dialogue. While EU puts forwards and deals with the economic aspects of Russia’s presence on its energy market, the Russian side traditionally mixes economic and political aspects of the energy question. Basing its actions on somewhat “old-fashioned” principles of the overwhelming importance of fossil fuels and neglecting modern-times deep and long-term structural changes in the energy realm (as introduced by the presence of renewable energy, energy efficiency and energy transition), Russia is missing on the goal of true modernization and liberalization of its internal energy structure. In spite of a growing global energy demand, Russia’s share in the EU energy mix is shrinking over the past years.

In the past decade, the European Union has implemented a series of reforms, leading to a common, free, open and competitive energy market within the Union's borders. At present, EU is striving to achieve an Energy Union, strengthening its role as a single actor, speaking up with one voice in its relations with major energy suppliers, including Russia. Whilst promoting principles of an open energy market functioning upon a transparent set of fair rules, the EU managed to institute a new reality in the state of play in the energy sector in the countries of its Eastern neighbourhood (Western Balkans and part of the Eastern Partnership countries). Transposing the European energy *acquis communautaire* is beginning to show the first results, notably in Ukraine, Moldova and Georgia. Compliance with the 3rd Energy Package (within and outside EU) allowed a temporary solution to the Ukraine's security of gas supply problem. Gazprom's dominant position and market partitioning strategy has been efficiently turned around, allowing the EU to demonstrate the implementation of its solidarity principle towards an Eastern neighbour in a state of danger and serious internal turmoil. For Moldova, an efficient implementation of the 3rd Energy Package, although subject of the political will of the government, will lead to a more open market, suitable for liberalization, modernization and ready for foreign investments. Interconnection of the Moldovan electricity grid to that of Romania would stimulate the country's exit from the present state of energy dependence upon Gazprom. In the years to come, Georgia will increase its role of transit country between alternative suppliers (mainly Azerbaijan) of energy resources to the EU. The implementation of the 3rd Energy Package will adapt the country's hydropower sector for modernization and will open it for foreign investors.

So far, regarding the energy market as what it really is – a market ruled by economic and financial supply-and-demand rules, fair competition and transparent regulation – has proven the most efficient strategy to uphold geopolitical meddling from major energy suppliers, including Russia. Compliance to the EU regulatory framework is the best way for Ukraine, Moldova and Georgia to regain energy autonomy, and thus to minimize Russia's political leverage.

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