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WIDER ENERGY PERSPECTIVES FOR BALTIC COUNTRIES

Debates on energy policy in the EU and the Baltic countries in particular have been characterized by at least two important features: first, a gap between the political rhetoric and practical action, which could be called ‘a delivery gap’, and, second, a gap between talking about the need for a common EU energy policy and practical action, which show persistence of national perspectives and the intergovernmental way of acting, or ‘an integration gap’. Most of Baltic States’ energy policy issues are directly linked to the existence of the delivery and integration gaps, therefore better understanding of their origins can help in identifying and resolving the energy issues, that have been at the top of Baltic States’ political agenda since their EU accession.

This article discusses the key energy policy issues faced by the Baltic States since joining the EU by presenting and analyzing them through the lenses of ‘the delivery gap’ and ‘the integration gap’. First, how important is the gap between political rhetoric and actual implementation in the field of energy policy and is it different from other areas of the Baltic States’ and EU public policies? How can the existence of this gap be explained? Second, how much progress has been made in integrating Baltic countries’ energy markets into the EU market and in general, how much progress has there been towards integrating EU energy market? How can we account for the limited integration in this policy field, which has received lots of attention

in the EU and the Baltic States in particular? Finally, what conclusions about the possibilities to narrow ‘the delivery gap’ and ‘the integration gap’ can we draw from this analysis?

The persistence of ‘the delivery gap’ in the Baltic States’ energy policy

The studies of policy process in democratic political systems have concluded a long time ago that every political decision is likely to suffer from implementation problems¹. Institutional structure, interests groups, resources available, external environment and other factors are likely to influence the policy process and complicated the delivery of policy objectives. Imperfect information, changing behavior and shifting preferences can further constrain the implementation of political decisions. Even regimes with a high degree of control and probability of sanctions do not assure perfect implementation.

Therefore, according to examples from other policy areas and strategic projects, energy policy does not seem very different from other policies in this respect. For example, the experience of the EU with the Lisbon Strategy, adopted in 2000, has often been presented as an example of ‘a failure to deliver’². The Single Market of the EU – the Union’s key achievement – has also been recently described as being ‘far from completed’ despite the fact that the end of 1992 has been popularly known as the date of its completion³. In fact, the lack of energy integration can be seen as a part of this diagnosis, and it is the subject of the next section of this paper. Finally, the evidence of non-compliance with the EU’s Stability and Growth Pact, when absolute majority of euro zone members do not observe its rules and have excessive deficit procedures initiated against them, is yet another evidence of the difficulties to implement policies even when they are agreed at the EU level.

Similar evidence can be found in national politics of EU countries. For example, if we look into the public policies of the Baltic States’, we can find

¹ There is a tradition of writings on policy implementation problems that dates back to 1970s and in particular the study of Pressman, J., and A. Wildavsky on Implementation first published in 1973 (see Pressman, J., A. Wildavsky, Implementation, University of California, Berkeley, 2nd edn., 1984). For the review, see Vilpišauskas, R., V. Nakrošis, Politikos įgyvendinimas Lietuvoje ir Europos Sąjungos įtaką [Policy Implementation in Lithuania and the influence of the EU], Eugrimas, Vilnius, 2003.

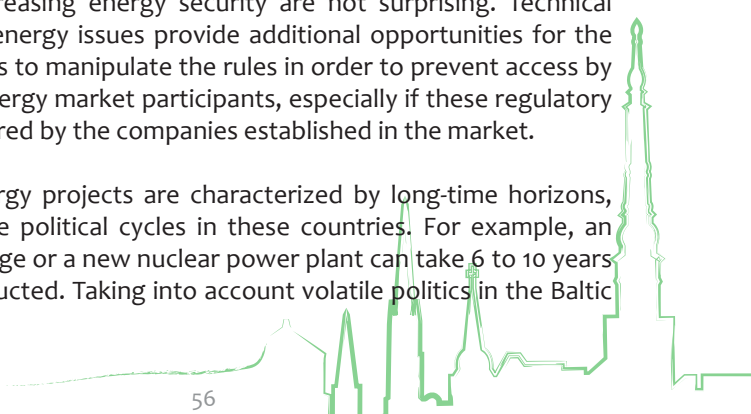
² See, for example, Vilpišauskas, R. Does Europe 2020 represent learning from the Lisbon Strategy, a paper to be presented in the bi-annual EUSA conference, Boston, 3-5 March, 2011.

³ See Monti, M. A New Strategy for the Single Market. At the service of Europe’s economy and society. Report to the President of the European Commission J. M. Barroso, 9 May 2010, p. 10.

ample evidence of non implementation. Structural reforms, or rather a lack of them, in the fields of health care, social support and education, which first come to one's mind. To be sure, in this respect there are differences between Estonia, Latvia and Lithuania, as well as divergences in actual implementation (the higher education reform in Lithuania probably being the most recent example of actual delivery, although with still uncertain results). But the fact is that the difficulties of turning rhetoric into actual decisions, enforced in order to deliver the outcomes set by policy makers, are present in many public policies. Still, it is argued here that the energy policy provides a particular case, which could be characterized by a combination of factors making the delivery of policy objectives (introduction of competition and construction of interconnections, more efficient use of resources, changing the balance of energy consumption) extremely difficult.

The delivery of policy objectives is particularly challenging when policy makers intend to reform the whole system, when there are interest groups and other actors stand to lose from policy change, when the institutional structure of decision-making and implementation is complicated with many veto players present. The energy policy in the Baltic States is characterized by all of these factors, which are usually associated with difficulties in implementation. The goal of integrating Estonia, Latvia and Lithuania into the EU energy markets, first of all into the Nordpool, and later possibly into the UCTE system, as well as the intention to reduce the asymmetries of dependence on a single supplier (in particular, of natural gas) represent a change of systemic nature. The introduction of competition and the choice of supply sources into the energy market can be seen as a transformation of a similar magnitude to the other systemic reforms which the Baltic countries introduced in the early 1990s. Even though consumers would benefit from such a reform, a number of interest groups are likely to lose in the short-term. Therefore, the persistent difficulties in delivering the most important energy projects targeted at increasing the choice of suppliers, introducing competition and increasing energy security are not surprising. Technical complexity of most energy issues provide additional opportunities for the regulatory institutions to manipulate the rules in order to prevent access by new suppliers and energy market participants, especially if these regulatory institutions are captured by the companies established in the market.

Moreover, most energy projects are characterized by long-time horizons, usually exceeding the political cycles in these countries. For example, an electricity power bridge or a new nuclear power plant can take 6 to 10 years or more to be constructed. Taking into account volatile politics in the Baltic



States and shifts in governing coalitions, it is often the case that newly formed governments review the instruments and strategies of implementing previously agreed national energy policy goals. Thus, even though the main energy policy priorities, such as the construction of interconnections and the creation of a regulatory framework for the development of renewable energy sources, are agreed in parliaments by all major parties, once a new government is formed, it is likely to review the previous policy, in such a way delaying the delivery of the policy objectives. For example, a closer look at the National Energy Strategies of Lithuania since 1999 (renewed in 2002, then in 2007 and again in 2010) very visibly shows how the key objectives and strategic priorities (construction of the electricity linkages to Nordic countries (Sweden) and to Poland, construction of the new nuclear power plant, increasing the efficiency of heating systems in the communal houses and others) have been repeated in every new strategy with the deadlines for their implementation being postponed yet again and again. Probably the best illustration of non-implementation is provided by the project of constructing the new nuclear power generating capacities to replace the old Ignalina Nuclear Power Plant, which were discussed in the Strategy of 1999 with a deadline of 2009 foreseen for their construction. However, in 2011 the perspectives for this project are as unclear as a decade ago, with speculations of competing nuclear energy projects in Kaliningrad Region and Belarus creating even more uncertainty about the Visaginas nuclear power plant project.

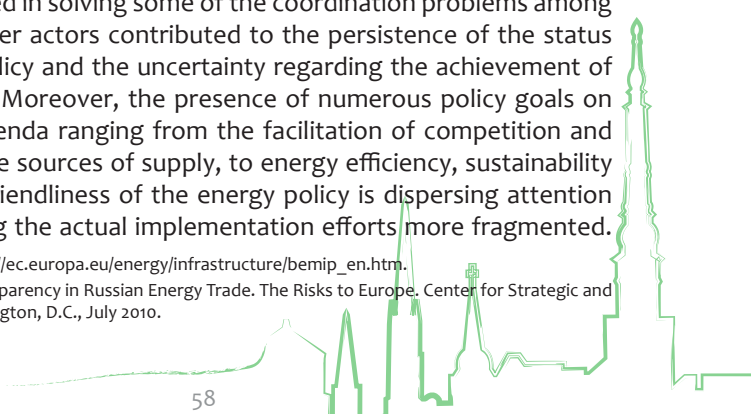
Finally, there is one more factor that makes the practical delivery of the energy policy objectives of the Baltic States particularly complicated, namely, collective action problems when the projects involve a group of countries, increasing the transaction costs of reaching agreements and their actual implementation. Again, the project of Visaginas nuclear power plant, where Estonia, Latvia, Lithuania and Poland are the participating parties and possibly some private investors could also be attracted is an example of such a group. Although politically (and possibly economically) the participation of such a group of countries is justified, this is likely to make the decision-making and administration process very complicated, if the project finally gets off the ground. A dispute, which took place in 2008-2009 between Latvia and Lithuania on the issue of where the electricity power bridge from Sweden to the Baltic States should be constructed to, is also an example of such collective action problems. After having delayed the project for more than a year, it was solved mostly as a result of EU involvement and provision of EU funding for the domestic electricity infrastructure in Latvia.

It should be noted that the role of the EU, namely, the European Commission, can be important in solving such collective action problems. Although usually the input of the EU is associated with funding of the feasibility studies of energy projects and co-financing the implementation of some projects, the adoption of the Baltic Energy Market Interconnection Plan (BEMIP) is a good example of how the EU can contribute to solving collective action problems by facilitating an agreement among the partners in the Baltic regional projects and by monitoring the implementation of the projects⁴. Such monitoring arrangements are also likely to have a positive effect on the continuity of the project implementation amidst the political cycles and changes in the governments of the participating countries. Therefore, it is quite understandable that recently some policy makers in the Baltic States, namely, Lithuania, have underlined the need for strengthening the co-ordinatory work in the area of natural gas interconnections, where the situation may be still characterized by a complete absence of alternative sources of supply. Although the integration of natural gas markets also forms a part of the BEMIP, the progress in this area has been more limited than in the electricity market. Political uncertainty linked to diverging views among the Baltic States as for where the LNG terminals should be built and increasing competition for EU funding to energy projects from other member states (including Visegrad countries) complicates the use of EU resources in advancing interconnections of natural gas.

To sum up, the energy policy in the Baltic countries has been characterized by numerous failures of implementation and large delivery gaps. The need for a systemic reform causing resistance from the interest groups and veto players, technical complexity of the projects and regulatory policies, long time horizons characterizing the projects and frequent political changes resulting in regular reviews of policy instruments, complicated mechanisms of implementation and large groups of participating actors have all contributed to the presence of delivery gaps. While some external actors, mostly the EU, assisted in solving some of the coordination problems among the Baltic States, other actors contributed to the persistence of the status quo in the energy policy and the uncertainty regarding the achievement of energy policy goals⁵. Moreover, the presence of numerous policy goals on the energy policy agenda ranging from the facilitation of competition and opening of alternative sources of supply, to energy efficiency, sustainability and environmental friendliness of the energy policy is dispersing attention and resources making the actual implementation efforts more fragmented.

⁴ For more on BEMIP see http://ec.europa.eu/energy/infrastructure/bemip_en.htm.

⁵ See Smith, K. C. Lack of Transparency in Russian Energy Trade. The Risks to Europe. Center for Strategic and International Studies, Washington, D.C., July 2010.



Clear prioritization of energy policy objectives, for example, by making the introduction of competition by regulatory policy changes and construction of infrastructural links, a clear priority could be an example of concentrating resources and making policy more effective.

Still not-so common EU energy market and the Baltic States

‘The EU needs a fully functioning, interconnected and integrated internal energy market’: this is not some old declaration but a very recent statement of the European Council of February 4th, 2011⁶. It shows both the importance of the common EU energy policy for the Union and the absence of a functioning common energy market. Energy has been the field where the European integration was advanced first more than half a century ago. However, the EU energy market has remained fragmented due to national regulatory differences and a lack of infrastructure links until now. Despite the efforts of the European Commission to advance the integration of national electricity and natural gas markets in the EU, the market is still far from being common with the deadline of 2014 set up for gas and electricity ‘to flow freely’⁷.

Even this new deadline might prove to be too optimistic. Although the energy policy issues have been high on the EU’s agenda since its enlargement in 2004 and 2007, in particular in recent years, the divergent views of its member states towards the common energy policy provide grounds for caution in relation to the prospects of energy integration. It should be remembered from the history of European integration that integration initiatives in the EU have been implemented when Germany and France were among the key drivers of those initiatives. As the debates on ‘the third package of electricity and gas directives’ showed, these two Member States remain quite cautious regarding the integration of the EU energy market, at least on the basis of the regulatory model initially proposed by the European Commission. There is another element missing in the field of energy, namely, the push of the economic interest groups supporting EU-wide energy market integration. The consumers of electricity and natural gas have been quite passive in this respect in most EU Member States. Moreover, companies from the energy sector in some EU countries have been opposed to a common regulatory framework and opening of the national market to competitors from other EU countries. Thus, the absence of economic interest groups lobbying their governments for more integrated energy markets, the presence

⁶ European Council Conclusions, EUCO 2/11, Brussels, 4 February, 2011, paragraph 3.

⁷ European Council Conclusions, EUCO 2/11, Brussels, 4 February, 2011, paragraph 4.

of established energy producers skeptical of market integration and the reluctant attitude of some EU Member States all point to the difficulties of energy market integration in the EU.

At least for some time to come the EU is likely to remain a place with several energy markets separated by differences in regulatory environment and a lack of infrastructural connections. In this context, the Baltic States have been rightly focusing their attention on joining the closest regional electricity market of the Nordic countries (Nordpool). It should be noted that support for an integrated common EU energy policy has been one of the European policy priorities for the Baltic countries since they joined the EU. This policy based on the need to reduce perceived vulnerabilities due to asymmetrical dependence on one source of supply and on the assumption that a common EU energy market is a precondition for a common EU external energy policy has been quite effective in terms of getting the issue acknowledged by EU institutions. This has been evidenced by the inclusion of a provision on energy security into the Lisbon Treaty, the adoption of a number of statements regarding the need to integrate isolated Baltic energy markets and, in particular, the adoption of the BEMIP in 2009. It is mostly a result of these policies that led the EU to claim in February 2011, that ‘no EU Member State should remain isolated from the European gas and electricity networks after 2015 or see its energy security jeopardized by lack of the appropriate connections’⁸.

On the other hand, the actual effects of translating political declarations into EU actions have been quite limited, as illustrated by the continuous closure of Druzba pipeline. Therefore, the focus on the Baltic-Nordic (and Baltic-Polish) regional energy integration seems to be appropriate on both economic and political grounds. The electricity power bridge (Estlink 1 with the capacity of 350MW) functioning since 2007 between Estonia and Finland (with Estlink 2 with a capacity set to be doubled by 2014), is an important first step in this direction. The Lithuanian-Swedish connection of 700 MW, foreseen for 2015, should provide another major step in integrating Baltic-Nordic electricity markets⁹. The gradual opening of the Baltic electricity exchange, which was started in 2010 and is based on the Nordic electricity exchange (Nordpool) model, is yet another important development in this respect. An integrated Nordic-Baltic and later Polish electricity market (LitPollink with first 500 MW electricity link to be completed by 2016, the second one of the same capacity by 2020) with regulatory policies facilitating exchange, trade and entry of

⁸ European Council Conclusions, EUCO 2/11, Brussels, 4 February, 2011, paragraph 5.

⁹These are the deadlines set in the most recent Lithuanian National Energy Strategy adopted by the Government of Lithuania in October 2010, see http://www.enmin.lt/lt/activity/veiklos_kryptys/strateginis_planavimas_ir_ES/NES_projektas_2010_2050.pdf.

new market participants is a priority for the Baltic States, in particular if integration of the EU energy market continues to be slow and restricted to smaller groups of member states with converging regulatory regimes. Provided that the BEMIP is implemented according to the schedule, the Baltic States might be integrated into the Nordic-Baltic electricity market by 2015.

The situation in the field of natural gas is somewhat more complicated with difficulties extending beyond simply translating policy objectives into concrete actions and projects. Estonia, Latvia, Lithuania and Finland are the only EU Member States that remain isolated from the integrated EU gas transmission system. Despite the discussions on potential sources and routes of supplies of natural gas through pipelines (for example, a connection between Poland and Lithuania and some other projects planned to implement by 2014) as well as possibilities for LNG terminals, the prospects for these plans are still unclear and will depend on the factors mentioned above¹⁰. Although an increasing EU attention to the energy issues is a welcome development for the Baltic States, it also implies more intense competition for EU resources from other infrastructural projects in other EU regions. This might encourage the Baltic States to find a common position on the prioritization of LNG sites and gas interconnections, but so far it remains uncertain.

The situation is also complicated by divergent regulatory regimes chosen by the three Baltic States on implementing the provisions of the EU's third package. The presence of other countries' shareholders in the main national Baltic natural gas companies adds to the complexity of opening the Baltic gas market. Although high prices and uncertainty might encourage the development of the new sources of energy to replace natural gas (and oil), it depends on the regulatory environment, which has not facilitated the emergence of competitive new resources of energy so far.

In the place of conclusions

The energy policy in the Baltic States and the EU in general has been characterized by a persistent gap between the official rhetoric and practical actions aimed at achieving policy objectives, as well as a gap between the statements on the need for a common (integrated) EU energy policy and continuation of the diverging national Member States' policies. This article has discussed the possible reasons for these trends and possible ways

¹⁰For the discussion of the natural gas projects in the framework of the BEMIP see Rambol, Future Development of the Energy Gas Market in the Baltic Sea Region, Final Report, June 2009, available at http://ec.europa.eu/energy/infrastructure/doc/2009_bemip_rambol_bemip_final_report.pdf.

of reducing these gaps. Better prioritization of numerous energy policy objectives and strategic projects, consistency between national and EU level policies as well as consistency over time when political cycles result in government change, involvement of the European Commission to assist in coordinating energy projects with regional partners, focus on the Baltic Sea region (first of all, Nordic-Baltic) energy market integration, and, finally, regulatory policies facilitating trade, entry of new market participants and technological innovations are among the key measures allowing to better deliver energy policy objectives and integrate the still isolated Baltic energy markets.

