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Soft power with a hard edge: EU policy tools and energy security

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# Soft Power with a Hard Edge: EU Policy Tools and Energy Security

## ***Abstract***

International security debates surrounding the European Union energy supply challenge commonly invoke the need for more EU hard power – e.g. getting tough on Russia or engaging directly with other exporters. This article investigates whether what might be labelled ‘soft power with a hard edge’ instead amounts to a consistent policy strategy for the EU. The central argument is that the EU has turned a weakness into a strength, and developed a set of tools that sharpen the way soft power is exercised in the energy sector. The article explores how soft power affects companies that ‘come and play’ on the EU market: the rules of the Single European Market and how they affect external firms. It also assesses the long reach of the SEM: both the gravitational ‘pull’ the SEM exerts in the ‘near aboard’, and the EU’s ‘push’ to facilitate the development of midstream infrastructure and upstream investment. The conclusion is that the EU regulatory state is emerging as an international energy actor in its own right. It limits the ways states like Russia can use state firms in the geopolitical game; and it exports its model into the near abroad thus stabilizing energy supply and transit routes.

***Keywords:*** soft and hard power; energy security; Single European Market; EU regulatory state; EU competition policy; external energy governance

***Word count:*** 11.000

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"Soft power is the velvet glove, but behind it there is always the iron fist"  
Robert Cooper (2004),  
(then) Director-General for external relations and political-  
military affairs, EU Council Secretariat

## 1. Introduction<sup>1</sup>

The European Union (EU) is usually described as a civilian – or soft – power: an economic giant but a military dwarf. The reason for this lies in the EU's lack of 'hard power' policy tools: it does not have sizeable armed forces under joint command, a substantial federal budget or direct control of firms. Its ability to use 'hard power', by means of coercion and payment (Nye 2004), are limited. Indeed, very little power is centralised at the EU-level. However, the present article argues that the EU's soft power comes with a hard edge. The EU's ability to exert more than mere soft power is a consequence of its attractiveness as a USD 17.3 trillion economy and the world's largest single market; and it is brought to bear by a policy entrepreneur with a well-stocked regulatory toolbox: the European Commission. Indeed, although its international military and economic power may be limited, the EU features a formidable regulatory state. Its Single European Market (SEM) operates on a liberal, rule-based model. In EU competition policy, the European Commission has a powerful tool to enforce this model, albeit directed as much at firms as at governments. The central point here is that this tool reaches well beyond the borders of the EU.

The SEM exerts soft power inasmuch as it attracts non-EU companies to 'come and play' on the EU's turf and accept its rules as the price for access, or when neighbouring states voluntarily choose to adopt EU rules and regulations as their own. However, to the extent that the European Commission – the EU's SEM watchdog – uses these rules purposefully to target external firms, this soft power acquires a hard edge. By these means, the EU can

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<sup>1</sup> The authors would like to thank the participants of discussions, panels and workshops at the 55th ISA Annual Convention 2014, the Harvard Belfer Center and the Centre for European Studies of Australian National University, and three anonymous reviewers for valuable input and feedback.

and does use its regulatory toolbox to foster strategic goals in the near abroad and at the global level.

We use energy security as a critical case for testing the 'hard edge' argument about the EU's power on the international stage, and its role in the international political economy of energy. For one, energy security is one of the key policy challenges that the EU faces today. The problem is not so much that the EU imports more than 50 per cent of its primary energy (Eurostat 2012), but rather that, unlike the USA, its energy imports do not come in the shape of reliable supply at affordable prices (Yergin 2006). Even before the 'revolution' in unconventional oil and gas put the USA on a trajectory towards net import independence, the country imported much of its oil and gas from Canada (with significant additional imports coming from Mexico), thus having a much higher share of secure energy supply than that which the EU achieves through imports from neighboring Norway. The prospect for remedies by way of unconventional oil and gas in the EU are far slimmer than public debate suggests, for reasons of local politics, geology, technological feasibility and regulatory frameworks (Stevens 2010). An additional, 'midstream', challenge for the EU lies in the management and operation of transit pipelines (Stulberg 2012).

As a series of 'gas disputes' between Russia and the Ukraine has vividly demonstrated, conflict involving the owner of crucial supply infrastructure can present great risk for European consumers. The fact that many of the third-country firms involved are state-owned gives the EU's company-targeted power a political dimension that is stronger in the energy sector than in the case of non-strategic industries. Besides bringing Europe's import dependence back into political debates, the 2014 Ukraine crisis unfolding in conjunction with Russia's annexation of the Crimea once again highlighted Europe's exposure to supply risks relating to Eastern transit routes.

Second, although energy is a private good, and traded as such in the EU, it is not a commodity like any other. Not only does it have public goods dimensions; some of its public goods characteristic are also of a strategic nature. Like almost no other commodity, energy has therefore been at the center of power struggles, international conflict and *realpolitik* (Abdelal 2013; Colgan 2013). For an import dependent economic bloc such as the EU, reliable energy supplies are vital for military security, economic prosperity and human welfare. Unlike the market for shoes, the market for molecules cannot be allowed to fail. This makes energy policy a good case for studying the external nature of the EU regulatory state, and for investigating whether what might be labelled 'soft power with a hard edge' can amount to a consistent and realistic policy strategy. Critics who call for a more proactive 'hard power' approach to energy security (Youngs 2009) tend to see the Commission's perception of security of supply as a question of market failure as a weakness and a source of its inability to address the energy security concerns of its eastern member states. We suggest that the Commission's approach to this question is linked to the EU's nature as a 'regulatory state', and that the 'hard edge' of its policy tools is derived from its ability to target third-country firms.

The article is organized in three parts. The first part extends the debate on soft and hard power to the EU, and operationalizes this for energy security. Although the EU's quest for energy security includes important internal dimensions in the shape of reduction of demand (improved energy efficiency) and increased domestic production (more nuclear or renewable power), we focus on the more pressing question of managing external security of supply in oil and gas in the face of geopolitical instability. The second part of the article explores the nature of 'soft power with a hard edge': the rules of the SEM, how they are applied, how they affect external actors, and how they take into account the 'strategic good' aspect of energy. The third part discusses the long reach of the SEM: the gravitational 'pull' as the SEM regime influences policy making in the 'near aboard' as well as the EU's 'push' to improve midstream transit infrastructure and upstream investment.

The final section returns to the question of what this means for the EU as an international actor.

## **2. Soft and Hard Power, Policy Tools and Energy Security**

The EU's toolbox is primarily defined by its nature: the EU is a 'regulatory state'. Although the European Economic Community was established after the Second World War as part of a wider set of West European institutions designed to promote security, democracy and prosperity, the organisation's mandate was to pursue these goals largely by economic integration. More to the point, this would be *rule-based* economic integration: governance by regulation rather than direct intervention in the industry or the economy. Accordingly, the Commission's main policy tools are regulatory (Lodge 2008; Majone 1996; Moran 2002). They are designed to make economic agents alter their behavior, in order to correct market failures and to ensure proper market functioning (Begg 1996). This comes with the clear notion of regulation as a precondition of capitalism, with states (and their regulatory actions) creating markets at first place (Wilks 1996). In short, as a regulatory state the EU seeks to create markets and to make them work efficiently. Most states have a wider set of policy tools at their disposal. These include not only the authority to make rules, but also the financial resources needed to provide incentives or subsidise production of goods and services, and organisational resources in the shape of bureaucracies, armies and nationally owned industries and public services (Hood 1983; Solomon 2002). As a regulatory state, the EU has the former, but lacks the latter two.

Because of its focus on markets – and, as a corollary, as a result of its (limited) policy toolbox – the EU is typically boxed into the category of an actor that almost exclusively exerts 'soft power'. In the realm of 'hard power', by contrast, the EU level is usually diagnosed with an 'expectations-capability gap' (Hill 1993), a function of both lack of tools and lack of political will or consensus. More specifically, the EU can deploy hard power only if all states agree (or agree to not block this), and a few of the big states – in effect

the UK or France – will provide the necessary hardware. The crisis brought about by Russia's 2014 annexation of the Crimea illustrated the point: the EU agreed on sanctions, but required time to build consensus on this and started with more modest steps than the USA. However, the EU has one policy tool that can be wielded by a single actor, without the need for cross-member state agreement on every action: the Commission's enforcement of the rules of the Single European Market in its capacity as the executive arms of the EU's regulatory state. Much of the focus in this article is therefore directed at the Commission's use of the available policy tools.

The distinction between hard and soft power in international relations, elaborated by Joseph Nye (2004), is based on the contrast between coercion used by a state and backed by the threat of military or economic force one hand, and the way a state influences world politics because of the attractiveness of its culture, values and even the very legitimacy of its foreign policy on the other. In Nye's own words: "simply put, in behavioral terms, soft power is attractive power" (Nye 2004), 6); or, focusing on the policy tools used, "the ability to affect others to obtain the outcomes one wants through attraction rather than coercion and payment" (Nye 2008), 95). Nye's work builds on a sociological tradition of thinking about power as more than mere direct use of force. For example, in the 1960s Schattschneider (1960) and Bachrach and Baratz (1962) elaborated on the importance of the power to structure alternatives. A decade later Lukes (1974) added ideological power in these sense of the ability to shape or influence what other actors want and desire. His distinction between tools (coercion, payment, attraction) and resources (military and economic, and culture, values and legitimacy), allows Nye to note that the military and economic resources normally associated with coercion and payments can also be used to attraction.

This article is far from the first to explore the grey areas between hard and soft power. Indeed, Nye himself emphasises that hard and soft power is a continuum, not a dichotomy (2004). The spectrum of behaviour thus runs from command, coercion, and inducement

on the hard side, to agenda-setting, attraction and co-optation on the softer side, but also includes a range of options in between and through combining different tools. Likewise, all three 'faces of power' come in both hard and soft varieties (Nye 2011). The related 'smart power' debate (Armitage and Nye 2007; Nye 2009; Wilson 2008) explores the room for combining hard and soft power, with the 'smartness' entailing integrated strategies that combine the tools and resources of both, and require 'contextual intelligence' (Nye 2011; Nye 2008). For the case of the US this means to focus on international institutions, development, public diplomacy, free trade and US leadership in combating climate change and energy insecurity (Armitage and Nye 2007).

These notions clearly also resonate in both political and academic debates on EU power. Catherine Ashton, then the EU's High Representative for Foreign Affairs and Security Policy put it succinctly: "the EU is not a state or a traditional military power. It cannot deploy gunboats or bombers. It cannot invade or colonise. It can sign free trade agreements or impose sanctions only when all 27 states agree. [...] the EU has soft power with a hard edge – more than the power to set a good example and promote our values. But less than the power to impose its will" (Ashton 2011). Robert Cooper, the EU Council's former Director-General for external relations and political-military affairs, saw the EU as a civilian power, but with its exercise of soft power dependent on a track record of protecting its member states and successfully achieving its goals: "Hard power and soft power are two sides of the same coin. [...] There is no soft power without hard power" (2004), 1749-180). Pointing to a broad range of soft or 'civilian' instruments for projecting international influence, some scholars also allude to the EU as 'smart power' (Moravcsik 2010) and 'normative power' (Läidi 2008; Sjursen 2006; Whitman 2011) (see also (Hyde-Price 2006).

In order to further theorize about the notion of soft power and its possible 'hard edge', we draw on Barnett and Duvall's (2005) insights about power in international relations and the application of this type of analysis to the EU. Emphasizing social relations, Barnett

and Duvall note that power involves the ability to shape the capacities of other actors, and that this can be done both directly (compulsory power) and indirectly. A direct exercise of power comes closest to Nye's classic form of hard power. Indirect forms include the ability to shape the settings in which actors operate (institutional power), the very identity of social actors (structural power), or even the way global politics is interpreted and given meaning (productive power). For example, the EU's use of conditionality for applicant states can be considered institutional power: it is indirect and works only because of the EU's overall power of attraction. By contrast, the EU's use of its trade power (Meunier and Nicolaidis 2006) comes closer to Barnett and Duvall's compulsory power: here power is a function of the EU's sheer economic strength that can be directly targeted at states or other actors. An important point with respect to the debates about the EU's power therefore is that power can be used actively and directed at given targets, but also used passively without a designated target.

The EU's trade power ranges from solely exporting goods, to exporting the very rules based upon which these goods are traded. As Meunier and Nicolaidis' (2006) argue, "[t]he EU speaks the language of shared norms developed through consensus and co-operation. [...] trade power is about using 'carrots' and 'sticks' to enforce such norms on trading partners" (Meunier and Nicolaidis 2006): 920). As Zielonka (2008) has argued, this makes the EU an 'empire by example' partly because of its ability to exercise economic power for political ends, an approach which "seems most effective when its power is overwhelming and its norms are shared" (Zielonka 2008):482); (see also Lavenex (2014): 886). This is soft power, where trading partners agree to operate under certain rules or norms. However, the EU can also direct its economic power at specific target, when it demands compliance with its own rules as the price of access to the Single European Market. Importantly, it is not only governments and international organizations that present themselves as a target of the EU's economic power, but also other actors such as firms (Damro 2012): 690).

In light of this, Damro (2012) coined the term 'market power Europe', to capture the way the EU "exercises its power through externalization of economic and social market-related policies and regulatory measure" (Damro 2012): 682). As a concept 'market power Europe' emerges an alternative to the – in Barnett and Duvall's categories 'structural' or even 'productive' – argument of the EU as a 'normative power'. Similar to Meunier and Nicolaidis, Damro conceptualizes the EU as an international actor whose power derives from its explicit efforts to use its sheer economic weight in order to extend its own liberal principles to the international stage, notably through regional and global trade. Following Daniel Drezner (2007), Damro notes that countries have also chosen to align with EU regulatory regimes and standards, even absent any direct EU pressure. This is a function of EU market size. Examples include the GSM mobile telephony standard (cited by Damro, see also (Pelkmans 2001). Similarly, Sweden's decision in the early 1990s to adopt EU competition policy rules to an extent that went beyond requirements for the run-up to EU membership followed a dialogues between the government and industry about the benefits of a single set of rules for the national and EU level (Sitter 2001). This is what Lavenex (2014) labels a form of passive use of power, or structural power in Barnett and Duvall's typology, as "third countries adopt rules not because the EU asks them to but because they fear the costs from not doing so" (887).

The mechanisms of rule diffusion at work here are indirect and comprise learning, socialization and technocratic cooperation in policy networks, as well as emulation and competition. As the Swedish case shows, it can also include an element of bottom-up pressure from industry on a non-member state (or applicant state) to adopt the EU's rules and procedures at home to reduce transaction costs. Yet all mechanisms serve the EU's overall purposes in foreign policy and trade more generally, and its sectoral preferences more specifically. Importantly, market might coupled with transactions costs and the ability to sanction non-compliance with EU regulatory requirements (notably through the Commission), allows the EU to also exert direct influence in crucial global policy areas. Bradford (2012) therefore argues that the EU has acquired 'unilateral power to regulate

global markets' (3), i.e. the ability to export its laws and regulations beyond its borders by way of market mechanisms. The EU disposes of significant 'extraterritorial regulatory capacity' (Bradford 2012), 22), notably with a view to foreign companies whose economic actions may have impact on EU market affairs or functioning.

In short, the EU's economic power can result from the EU's mere existence and the size of its market, and work through less coercive mechanisms; but it can be also directed at specific targets, involve conditionality and exert extraterritorial impact through regulatory and sanctioning authority. This finding stands in contrast to the hard/ soft power debate, even if 'hard and soft' is not understood purely as a dichotomy. Essentially, hard power involves a situation marked by conflict of interest, in which one actor coerces or induces the other to act (or not) in a particular way, by means of economic or military resources. By contrast, in the case of soft power, an actor gets its way by way of the attraction of its values, institutions or ideology. Neither of the two ideal-types obviously captures the way the EU exerts external (economic) power. The EU exerts hard power when it makes other countries or foreign firms adopt EU rules or standards, even though it does not do so in a direct and targeted way. At the same time, the EU's economic power may prevent another actor from exercising hard power through economic tools. This situation may involve a conflict of interests and be of coercive nature, but clearly the exercise of power is indirect or passive. On the other hand, the EU can also exert targeted influence on companies or governments based on the overall attraction of the EU market and its rule-based model. The costs of non-adoption are a case in point: third parties may decide to resist EU regulatory diffusion (and the policy agendas coming with it), but this may come with direct effects on their ability to operate within or with the EU. This extends to conditional access to the Single Market: unless companies or governments have a viable alternative to becoming part of or operating in the EU market, conditionality becomes a direct (and hence targeted) way of exerting soft power.

In order to account for the distinct way the EU exerts power in international energy politics and markets it therefore becomes imperative to differentiate both between power that is based primarily on coercion and attraction, and whether this power is directed at a given target or not. That way all attributes of the power debate can be combined in new ways, thus shedding more light on the grey area between hard and soft power. In Figure 1 we therefore suggest two additional analytical notions: 'passive hard power', i.e. hard power that is not directed at a given target; and 'soft power with a hard edge', i.e. power based on attraction that features some degree of conditionality.

**Figure 1: Soft Power with a Hard Edge**

	<b>Coercion</b>	<b>Attraction</b>
Targeted and intentional	Hard Power (target: governments)	Conditional Soft Power, aka Soft Power with a Hard Edge (target: governments and firms)
Non-targeted	Passive hard power (target: none)	Soft Power (target: none)

The upper left and lower right cells in table 1 are the classic cases of hard and soft power. The central, defining, feature of hard power is coercion. This can come in the shape of outright commands, or work through economic incentives. Hard power can also be exerted by depriving the targets of economically viable policy alternatives. In the standard version of hard power, this involves one actor (usually a government) telling another what to do or to refrain from doing. By contrast, the key to soft power is its element of attraction. Here, voluntary behaviour drives the choices of the target actor who is at the receiving end. Moreover, whereas coercion involves a specific target, attraction can apply across the board without a single, designated, target. For example, US values (notably democracy) and products (Rock 'n' Roll and Coca Cola), derive their attractiveness from

their universal character, and from the fact that they resonate with societies and individuals across the globe.

Hard power has long been the most common type of power exerted in the international energy sector. Cases in point include the establishment of the Anglo-Persian Oil Company as a means to safeguard British dominance over Middle Eastern energy reserves; Western support of the cartel of the 'Seven Sisters' to secure control over oil producers and rents (Yergin 1991); the First Gulf War (whose link to oil remains debated); and the American presence in the Persian Gulf in the shape of the Fifth Fleet, with a view to keeping the Strait of Hormuz open to international crude trade (Noreng 2006), xv). For the EU, hard power in the energy sector lies with the member states, rather than at the 'federal' level. To the extent that bilateral energy deals qualify as hard economic power, these are concluded between EU countries and third suppliers. More unambiguous forms of hard economic power include EU member states maintaining national oil companies (NOCs) or backing private companies (national champions), and lending them government support for commercial activities. For example, strong diplomatic ties with the Gaddafi regime allowed ENI to develop large scale upstream activities in Libyan oil and gas (Willey 2012). Moreover, 'state flanking' can be a form of hard power when national 'energy champions' 'go out' and acquire energy assets in third countries. A case in point is China's controversial 'energy diplomacy' in Africa (Alden, Large, and Oliveira 2007; Evans and Downs 2006). Finally, some armed interventions in the Middle East and Africa have been motivated by more than purely humanitarian rationales. For instance, critics have linked France's military engagement in the Central African Republic to energy interest, more specifically to Areva's interest in uranium mines there.<sup>2</sup>

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<sup>2</sup> This has been dismissed as conspiracy theories by observers. Hibbs, Mark. 2013. Uranium in Saharan Sands: Carnegie Endowment for International Peace. Available at <http://carnegieendowment.org/2013/01/22/uranium-in-saharan-sands/f4ej>. Accessed on 27 February 2014.

Moving to the lower left quadrant, this represents a situation where hard power resources, by their mere existence, provide a shield against an adversary's ability to use hard power. This is why it is labelled 'passive hard power'. In the energy sector, a striking contemporary example is the shale oil and gas 'revolution'. The surge in domestic hydrocarbon production, resulting in lower import needs, has lowered US' exposure to the risk of external suppliers using oil or gas as a (hard power) policy tool. With the possible exception of Norway few, if any, European states enjoy a similar shield from hard power in the petroleum or gas sector. As a corollary, potential US energy exports resulting from a domestic oil and gas glut may check dominant energy exporters such as Russia, without the US exercising targeted hard power. Still, this type of power is passive: even if US policy makers acknowledge that lower oil prices put pressure on Iran, and might help negotiations over that country's nuclear program, this is a fortuitous effect and not the reason for increased US production.

The upper right cell, finally, is the most interesting one, both theoretically and empirically. This cell depicts a situation where attractiveness (e.g. of the EU's large market) is coupled with a targeted and conditional policy that controls or restricts access (e.g. the Commission's regulatory governance). In fact, this can be observed empirically both in the EU and the USA. Both require third countries or their firms to comply with a given set of rules that allows them to gain full access to their (large and attractive) market. In this case, they exercise soft (economic) power in ways that are targeted and conditional. Importantly, however, whereas the US government has a diverse toolbox at its disposal, including soft *and* hard power tools, for the EU, this kind of conditional soft power is usually its main policy tool. By necessity, therefore, the European Commission seeks to explore and perfect the various types of soft power instruments, including the type of soft power that comes with conditions and requires third parties comply with EU rules and regulations. This approach is backed up by the Commission's clear and strong enforcement capacity. In the European energy sector, rules that force external supplies

of gas to comply with EU competition law when they sell to the SEM is a good example of this.

As a big market – indeed the biggest integrated market in the world – the EU is a mighty economic player in its own right. By simply existing, it influences the behaviour of firms in other countries that want to sell goods on the EU market – from Indonesian palm oil producers who need to comply with EU bio-fuels standards, to the Chinese aviation sector which recently became subject to European carbon taxes. This attractiveness comes close to classic soft power. In this, it surely is passive power. However, economic soft power can also be directly targeted at specific actors, particularly firms. For instance, US law can require foreign firms to comply with US rules in order to gain market access. The Iran-Libya Sanctions Act precluded firms that did business with the two named regimes from operating in the USA while the US Foreign Corrupt Practices Act requires US firms to comply with good governance standards even when operating in foreign jurisdictions. Foreign firms and governments may even be obliged to comply with US law in their own countries, e.g. the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates the US Securities Exchange Commission to enforce compliance with respect to ‘conflict diamonds’, bribes and even mine safety standards in the Republic of Congo and elsewhere. This is not hard economic power in the sense of coercion, let alone the exercise of economic power backed up by gunboat diplomacy. It is a matter of giving soft power a hard edge, because compliance can only be forced on firms that want access to markets.

As the guardian of the Single European Market, the European Commission uses a similar type of soft power that is conditional and targeted. Firms that want to come and play on the EU market are subject to the full range of the EU’s regulatory powers. The Commission can, and does, demand that foreign firms alter their behaviour, and not just their products, as the price of accessing the SEM. Still, the EU’s soft power, stemming from its economic might, remains passive and, as Gray (2011) reminds us, can hardly be

strategically deployed. The key point here is that the Commission can also give its soft power a hard edge, the effect of which can be observed in the shape of behavioral change against the targeted actors' own preferences.

At the 'federal' EU level, hard power can hardly be observed in the energy sector for the simple reason that the EU lacks the cohesion to exercise military and economic hard power to secure energy supplies - a frequent point of criticism among security scholars and analysts (Youngs 2009); see also contributions in (Birchfield and Duffield 2011). To be sure, the EU has exercised hard power, in the form of counter-terrorist and -piracy operations in the Horn of Africa (Operation Atalanta), but not in order to secure energy supplies. The EU has also used energy as *means* and *ways* of exercising hard power, such as the oil embargo on Iran (effective of July 2012) aimed against the latter's nuclear weapons programme, but it has not used hard power for energy-related *ends*, which would point to energy as part of EU grand strategy (O'Sullivan 2013). In short, to the extent that European countries use hard power in the energy sector, it is not usually mandated or coordinated by the EU; and to the extent that it is EU power, it is rarely hard power.

The EU's soft power, on the other hand, can be effective also with regard to energy security. The problem is that it has been most effective where it is least needed, but has had a less impressive effect on Russia. If non-member states find it attractive to participate in the European integration project, this can give the Commission leverage. A good example is Norway joining the European Economic Area, and thus effectively becoming a quasi-member of the EU, not because of hard power or inducement specifically related to energy but because of the attractiveness of the SEM (Eliassen and Sitter 2003). Although this did have an effect on *how* Norwegian gas was sold to the EU, it hardly affected the Norwegian government's or firms' willingness to sell gas to the EU or the implausibility of a security of supply crisis. Obviously, however, this approach may be problematic if the 'target' (e.g. Russia) does not find the EU model attractive. A case in

point is the EU's effort to extend its regulatory regime for investment, trade and transit to the former Soviet states in the shape of the European Charter Treaty. The treaty provides a legally binding framework covering all commercial activities in the energy sector and featured a multilateral dispute settlement mechanism, based on the liberal trade and regulatory blueprint (Bamberger and Waelde 2007). It eventually failed because Russia regarded it as informed by a generally unattractive model, and as imposed at a moment of relative geopolitical weakness (Belyi 2009). So whilst Moscow signed the treaty in 1994 it never ratified it and pulled out altogether in 2009.

The central argument in the two sections that follow is that the EU has turned a weakness into a strength, and developed a set of tools that sharpen the way soft power is exercised in the energy sector – both at home and in the 'near abroad'.

### **3. Soft power with a hard edge and the regulatory state: the external effects of the Single European Market and EU competition policy on firms**

The most powerful tool in the European Union's public policy tool box when it comes to governing the SEM – and indeed the energy sector – is competition policy. McGowan and Wilks (1995) memorably described competition law as the EU's first supranational policy, and the Commission's Directorate General for Competition (or DG IV, as it then was) as effectively a supranational independent regulator. Indeed, DG Competition has emerged an agent of further market integration and continuously kept on pushing for deepening the SEM. Yet, whilst important sectors such as telecommunication or postal services were subject to liberalization measures in the early 1990s, energy remained an exception until the end of the decade and well into the 2000s. To be sure, this proved less of a problem in oil, which has effectively been traded on an international, fully fungible, market since the 1980s. Gas markets, by contrast, continued to be characterised by national champions, long-term bilateral contracts, take-or-pay arrangements, and until recently, a dominant oil-price-peg and even destination clauses that prevent re-sale of gas.

In fact, until 1992, European gas markets were effectively national. Three sets of directives, the key legislative act of the EU, were designed to open the EU market gradually: the 1998 directive (European Parliament and the Council 1998) allowed states to define 'eligible costumers (i.e. who could access the competitive market)', limited initial opening to 20% of national markets, allowed different regimes for third party access to gas pipelines (negotiated or regulated TPA), and accepted a series of derogations and exemptions. Take-or-pay contracts – the standard practice in bilateral gas relations with non-EU suppliers – were permitted upon decisions by states or their regulatory authorities subject to Commission review, as were derogations for emergent markets or markets with only one external supplier. The directives of 2003 (European Parliament and the Council 2003) and 2009 (European Parliament and the Council 2009) extended liberalisation: all states were to adopt a regulated access tariff, establish independent regulators, strengthening legal and ownership unbundling of transport from trading services, and established a new EU regulatory agency – ACER – from 2010.

The three 'energy packages' had wide ranging consequences for companies that operate in the EU downstream market. Now, they must abide by a set of rules made up of the general single market regulation, competition law and the three liberalisation packages. The key general rules and principles include the EU Treaty's rules that ban agreements between companies that restrict competition (article 101), prohibit the abuse of a dominant position (art. 102), promote market opening to competition and dismantling national monopolies (art. 106), and restrict state aid (art. 107). They also include regulations and case law that operationalize the EU's rules on mergers and acquisitions, non-discrimination, and free movement of goods and services. The Commission enforces these principles in the gas market: by the early millennium, it had initiated a number of cases initiated against Germany's E.ON Ruhrgas, Spain's Repsol and Gas Natural, and Romania's Distrigaz based on allegations of anti-competitive behavior. This marked the

end of the traditional model in the European downstream natural gas market (De Hauteclocque 2008).

Although SEM rules primarily apply to EU firms and third country firms that operate within the EU, the Commission's power of enforcement also reaches companies that export to the single market. In other words, the energy 'packages', coupled with SEM rules and competition policy gave the European Commission a powerful means also to address challenges to European energy supplies, i.e. in the upstream market segment. A major case in point was the Commission's ruling that broke up the Norwegian Gas Negotiation Committee – the country's gas export monopoly – in 2001. To be sure, this was an intermediary case because of Norway's quasi-membership of the EU since 1994. But the Commission did not shy away from turning its regulatory big guns also on external suppliers such as Russia or Algeria. In the 2000s the Commission had already stopped restrictive internal cross-border trade that limited buyers' freedom to re-sell gas by way of territorial restriction clauses, through cases against amongst others Statoil, ENI, and Gaz de France. Now it targeted destination clauses and similar mechanisms that had been part of bilateral gas contracts with non-EU companies and prevented gas-on-gas competition on the EU market. By 2007 major bilateral supply contracts between Gazprom on the one side and Italy's ENI, Germany's EON Ruhrgas and Austria's OMV on the other, as well as between Algeria's Sonatrach and its European business partners were stripped of destination clauses through a mixture of regulation and negotiation (Talus 2011; Talus 2012).

Coupled with the provision that a company must not simultaneously be involved in gas supply and transmission, this meant that the traditional way external suppliers operated in the European market had come to an end. What is more, in doing so the Commission effectively went against the core of a business model that had cemented the dominant role external suppliers enjoyed in their gas relations with individual European countries and allowed them to apply what observers have termed 'divide and rule' tactics (Smith

2008). EU companies that imported gas (e.g Italy's ENEL which imports Nigerian LNG) had to comply with this ban as well. This reflects both the Commission's interpretation of security of supply as a matter of market failure, and the actual policy tools at its disposal.

In September 2011, the Commission took the next step and carried out a dawn raid on Gazprom's German, Czech, Polish, Bulgarian and Austrian subsidiaries and partners, on the grounds of suspicion of breaches of EU Treaty articles 101 and 102 in the form of non-transparent pricing, obstacles to network access, market partitioning and other abuse of its dominant position to hinder the liberalisation of EU energy markets (New York Times 2011). This was followed by an antitrust investigation against Gazprom, launched by DG Competition, on 4 September 2012 (European Commission 2012). In 2013, the Commission started preparing charges against the Russian monopolist for violating EU antitrust laws by hindering the free flow of gas across the EU, operating unfair pricing practices and linking the price of gas to the price of oil (Reuters 2013). The focus of attention here was on Central Eastern Europe, traditionally the region mostly affected by lopsided import dependence and Russian energy politics. Whilst the final ruling is pending, observers have noted that this anti-trust case is likely to severely impact on Gazprom's ability to maintain a commanding role in European gas supply security (Riley 2012).

Finally, in order to ensure that the functioning of the internal market is not unduly distorted by external NOCs, the EU's third energy package included a clause targeted specifically at third-country firms – the so-called 'Gazprom clause' (European Parliament and the Council 2009), art. 11). The measure is in fact not only directed at the Russian energy giant, but designed to allow national regulators to take security of supply risks into account when certifying third-country firms' acquisition, ownership and operation of transmission networks, and ultimately to withhold certification (Cottier, Matteotti-Berkutova, and Nartova 2010). As SEM rules require all non-EU gas companies that operate in the SEM to register with a local regulator, this effectively amounts to an

instrument for excluding certain suppliers from market access. For governments that are concerned about Russian use of energy as a 'weapon' (Smith 2006), this provides a tool for dealing with Gazprom's asymmetric power.

In all, the finding is that the SEM certainly constitutes soft power for the European Union with respect to external companies that want to operate on the attractive EU market, whether directly or through subsidiaries and partners. This soft power clearly comes with a hard edge in the shape of competition law, which is applied on a case by case basis, i.e. in a targeted way. It is complemented by special scrutiny applied to potential threats to security of supply. That way, the EU forces external suppliers such as Gazprom to change their business practices and thus limits the ability of those actors to operate energy deals on grounds of broader foreign policy considerations. The very fact that many of these firms – notably Gazprom and its counterparts in other former Soviet states and in Algeria – are state owned, means that the effects of the EU's regulatory power is felt by state actors too. So whilst it is unlikely that the attractiveness of the EU energy market will trigger domestic business lobby against their governments' overall strategy in these countries – an effect observed in EU accession states – the Commission's approach certainly limits third-country governments' ability to use their energy companies as policy tools in a broader geopolitical contest (which, indeed, is one threat to security of supply).

To be sure, the EU typically communicates its actions in terms of its market integration narrative, rather than in geopolitical terms. But clearly the EU's SEM rules – as applied – have a strong external dimension; they affect non-EU actors, and often in a targeted way rather than across the board. This exercise of EU power is about more than influencing what other want (Nye's ideal-type soft power); it is also about deterring actors from a particular course of action and even compelling them to do certain things that is in the EU's specific interest - notably supplying the European gas market at terms the EU sets.

#### **4. The long reach of the single market: soft power with a hard edge and policy regimes in the near abroad**

The SEM also casts a long shadow, and influences energy markets and energy policy far beyond its borders. This is predominantly a matter of classic soft power. For example EU rules on certification of bio-fuels have a long reach (foreign firms must comply with these rules to sell their goods at the EU market). This soft power acquires a hard edge – targeted at governments and firms – once the EU manages to export its own rules to the near abroad and make a specific region 'play according to its rules'. That way its soft power remains limited in geographical reach, and somewhat targeted in outlook. This is far from the classical imperialist exercise of hard power, as the EU remains far from sending gunboats. Instead, it sends regulators. And only when they are invited. This is the long arm of the regulatory state: it primarily influences through attraction – particularly in the form of lower transaction cost for firms if third-country governments can ensure that their firms face the same rules at home and in the EU – rather than through coercion. At the same time, a targeted export of the EU's rule-based sector regulation makes third countries and their firms subject to EU policy tools, including their enforcement mechanisms.

The Energy Community is a prime example of the EU's attempts to export its rules to the near-abroad. This agreement, which dates back to 2005, extends the EU's internal market regulation for energy to South East Europe and the Ukraine. It represents a sector-by-sector approach to extending the reach of the EU regulatory regime, by way of the contracting parties agreeing to implement the relevant part of the EU *Aquis Communautaire* and liberalise their energy markets accordingly. In other words, signatory states are obliged to transpose past and future EU directives and regulations into national law, including the 2009 Third Energy Package. Unlike the SEM and EEA, it is not subject to supranational enforcement. In other words, it is a binding agreement, but without sanctions other than suspending a state's rights under the Community Treaty (Buschle

2011). To the extent that the assumption is that its signatories will comply in their own interest, this is soft power par excellence.

The main narrative used by the EU is again essentially one of market-making: the Energy Community exerts a stabilizing effect on the EU's immediate near-abroad which will improve the investment climate, attract capital and thus enhance energy security in the region. Yet, there is more. For the EU, the Energy Community gains particular importance in natural gas, which in both market and geopolitical terms is primarily a regional game. It is particularly the transit countries that have become key targets of the EU's approach to selective rules export. To date, signatory country Ukraine is home to more than 50 percent of Russian gas exports to Europe.<sup>3</sup> Fully transposing the Third Energy Package into Ukrainian law by the 2018 deadline would therefore make a crucial transit corridor subject to EU rules (assuming the 2014 political crisis can be resolved without long term civil or regional war). The EU has also started official negotiations with Georgia to join the Energy Community, another important transit country in the context of the Southern Corridor bypassing Russia controlled pipeline infrastructure (European Commission 2014). This, in turn, stands in stark contrast to the interests of Russia's Gazprom. Gazprom is eager to retain unhindered access to the Ukrainian gas network, as it remains vital for its gas exports to Europe (Shapovalova 2010). It is also interested in limiting the ability of the EU to project its regulatory power onto alternative routes of gas supplies, as this would undermine its still dominant position in the European market. Moreover, Energy Community signatory states are obliged to implement EU regulation on cross-border networks and Third Party Access provisions, which will limit the ability of Gazprom to partition markets in South-Eastern Europe and the Balkans and to exclusively service them on what some would call arbitrary contractual terms. The obligation to liberalize energy markets for all customers by 2015 will give consumers choice, which will likely

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<sup>3</sup> Calculations for 2012 based on export data from OAO Gazprom. 2013. *Gazprom in Figures 2008—2012. Factbook*. Moscow. and transit flow data from Naftogaz of Ukraine ([http://www.naftogaz.com/www/3/nakweben.nsf/0/3375A8575C8884D0C22571010035B9D2/\\$file/big4.jpg](http://www.naftogaz.com/www/3/nakweben.nsf/0/3375A8575C8884D0C22571010035B9D2/$file/big4.jpg), accessed 26 February 2014).

further add to turning the balance of (energy market) power away from the incumbent Russian monopolist. In short, by installing and supporting the Energy Community, the EU exerts strong regulatory impact on non-EU countries and their dominant supplier – Gazprom. Its effect amounts to a direct security gain in a region that for both parties – the EU and Russia – has again come to be geopolitically contested.

When it comes to fostering transit security the EU also has more robust policy tools at its disposal. The Commission contributes to the organisation, finance and regulation of energy infrastructure and external pipeline projects (for an overview see Hirschhausen (2011)). It has allocated EUR 5.85 billion to support trans-European energy infrastructure for the period 2014-20, which includes projects enhancing energy security (European Commission 2013). Its financial commitment to the planned (and now abandoned) Nabucco pipeline included a grant for a feasibility study and EUR 200 million from the European Economic Recovery Programme. More significantly, the EU-owned European Investment Bank and the EU-supported European Bank for Reconstruction and Development were prepared to provide loans to the tune of some EUR 4 billion (EBRD 2010).

The Nabucco project has to be seen in the broader context of the Southern Corridor. Its explicit aim was twofold: to improve security supply of gas through upstream and midstream diversification to Central Asian gas, and to strengthen the SEM by fostering gas-to-gas competition at home. In Nye's terms, this is a matter of exercising hard economic power. From the EU's point of view, however, its participation in and regulatory support of pipeline projects constitutes an effort to solve the public goods dimension of energy infrastructure, as "some projects [...] would be [...] unable to attract enough market-based finance" (European Council 2011). It therefore serves the purpose of making its single (energy) market more attractive, to enhance its competitiveness and to provide for consumer choice. As is often the case in European public policy, external action involved a combination of EU states, non-EU states, the EU as an international

organisation, and other IOs (Sitter 2005). The support of gas pipelines therefore rests on the mobilisation and voluntary participation of market actors. This clearly qualifies as soft power.

Importantly, however, the Commission has not supported the constructions of additional pipelines per se, but instead has adopted a targeted approach: it has exclusively financially supported projects in the realm of the Southern Corridor. Moreover, it has exempted the Nabucco pipeline and (partially) the Nord Stream pipeline between Germany and Russia under the Baltic Sea from some Single European Market rules. In turn, it has announced that the bilateral deals underpinning the Russia-sponsored South Stream pipeline project through the Black Sea – rivalling the Southern Corridor projects – were in breach of EU law (Keating 2013). Our assessment therefore is that these initiatives represent soft power being given a hard edge.

Finally, the Commission has recently begun to explore a wider range of policy tools that come closer to the grey zone between hard and soft power, partly as a consequence of the limited reach of its soft power. More specifically, the failure of the Energy Charter treaty prompted the Commission to explore alternative routes to export its rules and regulatory regime to important upstream and transit countries and/or to cope with the strategic goods dimension of gas. On the softer end of the spectrum, the Commission has begun to support and coordinate external action in the energy sector, for example by sitting on bilateral negotiations between Poland and Gazprom. This officially comes with the goal to enhance market liquidity and to help ensure that their deal fits EU rules and policy (Bloomberg 2010). Effectively, however, the Commission thus helps the Poles to use their economic power, by lending its weight to the negotiating team. On the harder end, the EU has started to experiment with new tools such as pooling purchasing power vis-à-vis supplier countries, in order to help provide long term security of demand. In Nye's terms, such use of economic muscle to alter the behavior of others lies at the harder end of the soft – hard power spectrum. Yet the Commission presents initiatives such as

the Caspian Development Corporation (CDC) not so much a matter of using monopoly buyer strength (monopsony power) to get a better deal from suppliers, but rather as an effort ensure that sufficient upstream and pipeline project secure sufficient long-term investment (IHS CERA 2010). This addresses a key challenge in the gas sector: for investment to take place, security of demand is needed. The CDC has effectively been planned as a take-off vehicle – the functional equivalent of a take-or-pay contracts on behalf of several EU states, which – in theory – ensures the EU gas market remains attractive for suppliers. Moreover, this was a long way from an ‘offer that the target countries could not refuse.

In all, the finding is that the gravitational ‘pull’ of the EU single market regime influences national governments’ policy making in the ‘near aboard’, while the EU’s ‘push’ to facilitate or contribute to securing midstream infrastructure and upstream investment rests on a market making agenda. This is what we term the long reach of the EU regulatory state. Therefore, and in contrast to Nye’s suggestion that economic power is usually hard power (payments, sanctions and bribes designed to compel or deter action), the Commission’s approach to energy security demonstrates that in the EU’s case, economic power can also be the source of soft power (designed to overcome public goods problems) – whether this is targeted or not. Importantly, because policies are deliberately targeted at key issues and actors pertaining to natural gas markets – both firms and governments – this soft power can come with a harder edge. The central point here is not that the Commission (or even the EU) lacks the tools of exercise hard power – to a large extent they do – but rather that even when the EU exercises harder forms of economic power this is done within a very specific legal and normative context. The legal context is shaped by the single market tools of the regulatory state; the normative context is that the EU is a political system essentially designed to overcome public goods problems.

## **5. Conclusion**

In international politics, the EU regulatory state is emerging as an actor in its own right. Although the EU member states struggled to agree a common strategy towards Russia over the 2014 Ukrainian crisis, the Commission – in its capacity as the regulatory watchdog of the Single European Market – comes across as a relatively unified actor with a considerable policy toolbox at its disposal. This gives rise to a new and different take on the EU as a soft power: one that relies on attraction but gives its attractiveness a hard edge. This hard edge is directed at both firms and governments, but through different mechanisms. As our investigation shows, this external dimension of the EU regulatory state is a rather underappreciated aspect of the nature of the EU, and of its 'actorness' in the international political economy of energy (see also (Kuzemko et al. 2012).

First, the EU's soft power with a hard edge is directed at firms inasmuch as the Commission can and does oblige third-country firms to play by the rules of the Single European Market if they operate in the EU market. In the case of gas, this has forced some firms to change their business models, and may have a considerable impact on Gazprom depending on how the Commission's 2013-14 investigation is concluded. When it comes to security of supply – and particularly the concerns that the EU government may act through Gazprom to threaten EU's eastern member states – the Commission's policy tools and action only allows it to address part of the challenge. The EU can address the threat that Gazprom's dominant market position constitutes to security of supply; and it can limit the ways the Russian state can use their state-owned firm as a policy tool in the geopolitical game. But it cannot alter the geopolitics behaviour of, let alone the preferences of, the Russian government as such.

Second, therefore, the EU's soft power with a hard edge is directed primarily at governments inasmuch as the EU seeks to export its rules and support infrastructure projects. In the case of gas, this power is conditional on the target states' finding the EU regulatory model attractive, and/or assessing its benefits as outweighing the costs. In terms of security of supply on gas markets, this policy tool can address some of the

challenges, particularly those that are ultimately a question of inadequate supply of public goods, whether in the form of regulation, infrastructure or diversity of supply routes.

Third, the EU's soft power coming with a hard edge is all about the market making narrative, and about making the internal market work. Almost everything the European Commission does in the field of energy policy is designed to complete the Single European Market, to extend it to the field of energy and to render it more attractive for suppliers and consumers. Consequently, even when dealing with geopolitical challenges such as energy security, the European Union primarily exercises soft power (both conditional and unconditional), or at most a passive (and rather mild) form hard power. It can prepare for emergencies at home, e.g. by regulating for spare storage capacity and supporting reverse-flow interconnecting pipelines. It can limit the market power of third-country firms, and thus limit the ways governments can use them. It can export its regulatory rules. And it can support pipeline diversity. Rule export, support of crucial infrastructure and transit corridors as well as a steady push for expansion of the EU energy regime into its near abroad not only enhances the investment climate in upstream projects; it also deprives monopoly suppliers of opportunities to use their dominant market position for economic or political purposes. This is undoubtedly a significant achievement of the EU as an international energy actor.

Fourth, and as a consequence of the above, the EU cannot, through its regulatory tools, address its member states' vulnerability to politically driven supply interruptions, let alone engage in a geopolitical contest with Russia on the latter's terms. The 2014 crisis in the Ukraine forcefully drove home this message, and thus illustrated the limits to the EU's power. Regulatory power can directly force firms to change their behavior (or pull out of the EU markets); but if a government does not aspire to join the EU's rule-based regime, the EU can only affect that government indirectly. The EU can reduce its own vulnerability to others powers' use of energy as an instrument of hard power, by improving its own infrastructure. It can limit Moscow's ability to use its state-owned energy NOCs as a tool

of hard power vis-à-vis EU states, by prosecuting firms for discriminatory pricing and abuse of dominant position. But the reach of the EU's regulatory power is not sufficient to alter Russia's behavior in the Ukraine, whether in the form of using gas prices to extract political concessions or actually annexing a part of the country. In geopolitical conflicts, the EU's regulatory power is no substitute for the hard military power held by the EU's own member states and by NATO. To the extent that the EU can contribute to this game, it is by the use of its own hard-power tools such as economic sanctions, not by its regulatory power.

All said, the European Union's soft power with a hard edge extends further than the classic post-Cold War hard vs. soft power debate might suggest. Nevertheless, its reach is clearly limited. It is more pertinent to gas than oil, because it is traded on regional rather than global markets. It is more relevant to the near abroad than more distant countries, and more applicable to transit countries than suppliers. The longer the attempted reach (in terms of distance), the more specific the tools need to be – as the Caspian Development Corporation initiative indicates. Finally, the EU's power is often more effective with respect to companies than governments, because its reach depends on how receptive the targets are. The EU's real hard edge comes into play when its policies target firms, operators and regulators; not the governments of producer states.

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