

Master Thesis

**The Internal Energy Market and Latvia**

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## **Abstract**

Secure energy supply is like an engine of almost all actions in modern world. Energy is necessary for businesses and for each of us in everyday lives. Supply has to be without interruptions, and price of the energy also matters - it impacts the whole economic situation, growth and the overall development. Secure supply and better price is in the interests of the European Union (EU) to ensure that, it is necessary to complete the internal energy market (IEM) for gas and electricity. The IEM is a long project and the development of it is still on the way, with expectations to be completed by the 2014. Completed IEM has a lot to offer for the EU and Latvia too.

For Latvia the IEM is crucial because of the idea about the connectivity between the EU, of course, possible better prices, security, and other gains are important. Latvia has to face, historically occurred, specific situation being a part of “energy islands”. Right now there is only one connection with Finland for electricity, besides with two other Baltic States and Russia. Gas can be supplied only from Russia. This means that Latvia is highly dependent on one supplier and large energy dependency is considered as dangerous, especially in the circumstances with one supplier.

To complete the IEM and to get all promised gains, implementation of the Third IEM package is necessary. Officially Latvia has agreed to implement necessary legislation to liberalize markets but the process has been complicated, postponed several times. It provoked a scientific interest to research why the process has been so long and complicated when provided gains are desirable.

The research is conducted through the three levels: the EU, regional, and national level. At first the development of the IEM, obstacles for it, are analyzed. Further analysis goes to the regional level to envisaged common problems in the way towards real market liberalization for gas and electricity markets. Final level, is specific Latvian case where attention is paid to complicated processes in domestic arena which affect the market opening processes.

To explain why the process has been slow two theories are used: liberal intergovernmentalism (LI) and historical institutionalism (HI). Approaches were chosen because, the first one, puts emphasis on the role of the member states, formulation of their national interests and the role of those in the international arena. The second one was

chosen because besides all political games and influences governments have to follow to previous accepted decisions and policies.

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## Introduction

As it is known, energy is vital to our everyday lives. It is important to have a reliable and affordable energy supply because the price of all other goods and services depends on the price of energy. No matter what is being produced energy is necessary in the process and the price of it is included in the final costs of every product or service we buy. Besides that, energy price affects the European Union (EU) competitiveness on the global stage. Businesses cannot be as competitive as other states where the price for energy is lower. Estimations show that by 2035 the price of electricity in the EU will be 50% higher than in the USA and for 300% higher than in China!<sup>1</sup> Those risks must be taken in to consideration and changes must be done to ensure the EU competitiveness and wealth in the future.

The price of energy is not the only problem that the EU faces. The list can be continued with incompatibility between national grids which creates problem of energy islands leaving some states dependent from one supplier, and not giving the chance to choose to buy energy for better price. Also increased clarity of offers is necessary for the consumers to be able to make a choice between suppliers, where it is possible.<sup>2</sup> Improved connections between the member states (MS) are crucial for energy security issue which is important for the whole EU. Permanent and secure supply is integral part of everyday life and for economic development. Recent problems with energy supply made this issue more actual. In January 2006 supplies of natural gas to Ukraine and Georgia were cut,<sup>3</sup> in January 2009 it happened again. Those interruptions highlighted energy dependency problem. The import of gas in the EU reaches around 60% and the prognoses are that by 2030 it will increase till 70% - 80%. That would require around 700 euro per year from each citizen in the EU.<sup>4</sup>

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1 Jerzy Buzek, „The Internal Energy Market is Now!”, <http://www.buzek.pl/en/node/7557>

2 Jerzy Buzek, „The Internal Energy Market is Now!”, <http://www.buzek.pl/en/node/7557>

3 D. Warner North, „Energy Security for the Baltic Region,” in *Global Risk Governance: Concept and Practice Using the IRGC Framework*, eds. O. Renn and K. Walker (Springer, 2008)  
[http://irgc.org/wp-content/uploads/2012/04/Chapter\\_12\\_Baltic\\_Energy\\_Security\\_final.pdf](http://irgc.org/wp-content/uploads/2012/04/Chapter_12_Baltic_Energy_Security_final.pdf) 1

4 European Commission, Video „Energy Security in Europe,” European Commission  
[http://ec.europa.eu/energy/fpis\\_en.htm](http://ec.europa.eu/energy/fpis_en.htm)

Previously mentioned supply cut in 2009 left many people without possibility to heat their houses in the middle of winter. To avoid that in the future it is crucial to not to rely on one supplier, that is a threat to energy security. To ensure stability and to solve previous explained problems the internal energy market (IEM) for gas and electricity is necessary with improved interconnections between states and other benefits.

The EU is on the way to make the IEM for more than 20 years, now the aim is to complete creation of it until the end of 2014. Common energy market has many advantages to offer for the MS, like, better prices for consumers, also it would provide the EU with a stronger common voice in the energy sector in the world, and of course increased energy security. There are more gains beside stated ones, however, the process towards the IEM has been long and complicated and still faces obstacles.

After Enlargement energy security got extra attention because of the new MS and the huge dependency from one supplier, Russia, like it is in the case of the Baltic States. These countries are isolated (called as isolated islands) in energy field from the rest of the Europe- dependent largely on one supplier- that complicates the situation of the Baltic States even more, especially knowing that relations with Russia is not stunning. In Latvia's situation dependency from Russia's supply in energy is around 63%<sup>5</sup> (gas is delivered only from Russia). The IEM is necessary for the Baltic's energy security, but creation of it is slow and complicated, hindered by the MS (being slow in implementation of necessary legislation). In words all MS support it but actions and postponed deadlines do not reaffirm those claims. To improve situation of the Baltic States help from the other MS is necessary in unite attitude and also as financial support because supply infrastructure building is very expensive process.

It can be seen there are many problems that must be solved in energy sector to gain from united energy market in Europe. Through the years a lot of things have been done from the Commission side. It has claimed the meaning of the IEM, developed proposals for energy packages, which as will be explained further in the text, was not approved in their ambitious forms for long time. Proposals were made weaker from the initial ones because they did not get support from the MS side. They under the pressure of influential domestic groups did not allowed to develop liberalization processes as fast as it was wanted by the

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<sup>5</sup> Krišjānis Kariņš, „Konkurence enerģētikas tirgū- izaicinājumi un iespējas,” [Competition in the Energy Market- Challenges and Possibilities], Krišjānis Kariņš Deputy of the European Parliament, <http://www.karins.lv/raksti/energetika/konkurence-energetikas-tirgu-%E2%80%93-izaicinajumi-un-iespejas/>

Commission. With the last energy package it is finally expected to liberalize energy market by 2014.

**Problem formulation:** Situation when everybody are aware of all gains of the IEM, agrees and officially states that it is necessary, also in Latvia, but knowing that the process of implementation has been so long and still continues, raises the question: Why the energy market liberalization for gas and electricity have been slow and complicated in Latvia despite of, generally agreed, promised gains from the IEM? The main idea is to look on political level: to decisions and actions to investigate why the processes have been slow and why the legislation has not been developed in time. To find the answer the EU level will be analyzed, role of other MS, and of course domestic problems in Latvia, dedicating attention to the lack of technical solutions and the role of politicians for that, and impact on their decisions.

### **Methodology and Research Design**

The main purpose of this project is to find the answer to that why the development of the IEM has been slow and complicated in Latvia. To do that at first the IEM history is viewed to understand the idea, necessity, and also the problems of the IEM at general level. So at first the whole EU level is viewed, next the Baltic region and its problems. At the end specific Latvia's case will be analyzed. So the analyses starts with the general level of the processes, than turns to regional level, till finally goes to specific case study in Latvia. The structure was made so to see all factors and the situation from various sides. It is necessary to look on the EU level to understand the idea of IEM and the history of development. An analysis of regional level was included because mostly situation in energy sector, issue of energy islands, is heritage from the Soviet times which is common for all Baltic States. To find answers various EU documents, speeches and interviews of the EU and national officials, and also books were used.

In the first chapter Liberal Intergovernmentalism will be explained and used to analyze why the process of the development of the IEM has been so slow. This theory has chosen because it is useful to explain the role of the states and other players, like powerful national companies with impact on the end decisions and positions of governments in the international bargaining in the EU. As it will be further explained in the chapters, MS was

those who under the pressure of strong national companies hindered the liberalization of the energy market in the EU. Also Historical institutionalism will be used to explain how decisions/ agreements made in the past impact actual situation now.

The second chapter provides general explanation of the development of the IEM and all expected benefits from it in the EU to prove the statement from the problem formulation that the creation process has been long and complicated.

In the third chapter historical situation of the Baltic region will be analyzed to show and explain why it is called as isolated islands in energy sector. The energy system in the Baltic States mainly is heritage from the Soviet time; of course improvements through the years have been made but still those states, because of historical development stay, highly dependent from Russia. Dependency in energy sector is perceived as threat. The situation in the Baltic States is more complicated because of the relations between those states and Russia.

As it was stated above than the analysis was started with general level and moved till the specific case study. The forth chapter is dedicated to Latvian problems. At the beginning aims in Latvia's energy policy will be viewed to understand they compatibility with the EU's ones. Further analyses of the development of the gas and electricity markets liberalization in Latvia, decision making, and involved interest groups will be provided.



## **1. Liberal Intergovernmentalism and Historical Institutionalism Explanations for Energy Market Liberalization Problems**

Both theories, Liberal intergovernmentalism (LI) and historical institutionalism (HI), asserts the role of MS in the process of integration. LI states that countries are the main ones in this process, HI assumes that states are leading the integration process but they can lose controlling leverages because of the bargains and decisions made earlier.<sup>6</sup> Those specific theories are chosen because LI can explain why integration (cooperation) in energy policy, including issue of IEM creation, has been so complicated. This theory claims that at the time of making national preferences, decision makers are influenced by other interest groups and their parties. This explains that governments were reluctant towards further integration because of the pressure of other interests groups, what made the process slow and complicated. To explain why integration has developed HI is useful. This approach states that earlier decisions will impact actions in future- governments will have to deal with that on what they, or previous governments, have agreed earlier.

### **1.1.Liberal Intergovernmentalism**

Starting from early 1990s Liberal intergovernmentalism (LI), developed by Andrew Moravcsik, has become one of the most important approach to explain European integration.<sup>7</sup> In this specific theory it is assumed that behavior of the states are rational- which means to act according to their goals. Statesmen represent national preferences in the EU, which are constrained from the strongest domestic interest groups. All accepted decisions in the EU are the result of bargaining. In the process the power of the state is important to achieve their preferences.<sup>8</sup>

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6 Craig McLean, Tim Gray, „Liberal Intergovernmentalism, Historical Institutionalism, and British and German perceptions of the EU’s Common Fisheries Policy,” *Marine Policy* 33 (2009) p. 459 , DOI: 10:1016/j.marpol.2008.10.002

7 Michelle Cini, „Intergovernmentalism,” in *European Union Politics* third edition, Michelle Cini, Nieves Perez- Solorzano Borraran (NY: Oxford University Press, 2010), 96.

8 Michelle Cini, „Intergovernmentalism,” in *European Union Politics* third edition, Michelle Cini, Nieves Perez- Solorzano Borraran (NY: Oxford University Press, 2010), 97.

Government preferences in foreign policy are changed under the pressure from some domestic interest groups, political institutions aggregate those interests. States preferences are not fixed or common for all, they differ in the one state, even concerning one issue, and so they can differ between states.<sup>9</sup>

National preferences arise from state and society interactions. Politicians that lead governments set them but they are constrained by society. Important role has that what the society wants and it reflects in foreign policy. Also identity of important groups, core of their interests, and the relative power has affect to domestic policy matter. Groups have preferences and they articulate them to the government. A. Moravcsik offers an explanation for government and society relations, it meaning to the decisions:

The primary interest of governments is to maintain themselves in office; in democratic societies, this requires the support of a coalition of domestic voters, parties, interest groups and bureaucracies, whose views are transmitted, directly or indirectly, through domestic institutions and practices of political representation. Through this process emerges the set of national interests or goals that states bring to international negotiations.<sup>10</sup>

Three main elements of the LI are: “the assumption of rational state behavior, a liberal theory of national preference formation, and an intergovernmentalist analysis of interstate negotiation.” National preferences primary are set by the estimations of the costs and benefits of economic interdependence.<sup>11</sup>

The EU IEM is definitely a benefit in economic terms- being connected in single electricity and gas market provides a lot of advantages. Competition that arises from open market should keep prices as low as possible because suppliers would be interested to gain more consumers for their supply and of course main criteria is a cheaper price. So it is rational to open markets and connect them with necessary infrastructure. It seems that with time governments has totally understood the meaning of provided benefits when finally agreed on Third energy package.

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9 Frank Schimmelfenning, „Liberal Intergovernmentalism,” in *European integration Theory*, edited by Antje Wiener, Thomas Diez. (New York: Oxford University Press, 2004), p.77.

10 A. Moravcsik, „Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach,” *Journal of Common Market Studies* Volume 3. No. 4 (December 1993), 483.

11 A. Moravcsik, „Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach,” *Journal of Common Market Studies* Volume 3. No. 4 (December 1993), 480.

LI is a two step model of preference creation, Moravcsik made it from liberal theories and international political economy and international bargaining (made from Putnam's two level game approach and bargaining theory). In the first step national leaders set national preferences, in the second step those preferences are brought to the EU for bargaining process. Results shows how strong the state is according to other states. By this approach it is accepted that the role of supranational institutions in those processes is not influential.<sup>12</sup>

Institutions, made in the bargaining process, are necessary to ensure MS with information and reduce transaction costs.<sup>13</sup> For A. Moravcsik the EU is a successful intergovernmental regime, made to administrate economic interdependence.<sup>14</sup>

A. Moravcsik states that most important intergovernmental bargains, like for Maastricht Treaty, were not led by supranational power. He argues that it happened: "by gradual process of preference convergence among the most powerful Member States, which then struck central bargains amongst themselves and offered side-payments to smaller, reluctant Member States." <sup>15</sup>

As the central piece to explain European integration A. Moravcsik, in his book "The Choice for Europe. Social Purpose and State Power from Messina to Maastricht" puts:

...European Integration can best be explained as a series of rational choices made by national leaders. These choices responded to constraints and opportunities stemming from the economic interests of powerful domestic constituents, the relative power of each state in the international system, and the role of international institutions in bolstering the credibility of interstate commitments.<sup>16</sup>

Partial gas market liberalization will start with April 2014, although, there is contract with Latvian Gas which expires only in April 2017. It was stated that with this

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12 Marck A. Pollack, „International Relations Theory and European Integration,” *Journal of Common Market Studies*, Vol. 39, No. 2 (2001), 225.

13 Marck A. Pollack, „International Relations Theory and European Integration,” *Journal of Common Market Studies*, Vol. 39, No. 2 (2001), 226.

14 Andrew Moravcsik, „Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach,” *Journal of Common Market Studies* Volume 3. No. 4 (December 1993) 474.

15 Marck A. Pollack, „International Relations Theory and European Integration,” *Journal of Common Market Studies*, Vol. 39, No. 2 (2001), 226.

16 Andrew Moravcsik, *The Choice for Europe. Social Purpose and State Power from Messina to Maastricht* (UCL Press, 1998), 18.

step, and without having a real competition prices will increase, however, it was decided to develop this process further, besides warnings from the Latvian Gas boss about Gazprom preparations to bring the country by the court and higher prices. Using Moravcsik integration concept (cited above), this decision can be explained as rational calculations for a long-term because gas market liberalization and integration in the EU IEM should be economically beneficial for the society and states security further. Prices for energy in the future will only grow and open market will help to hold them at the possible lower stage. Alternative gas suppliers and connections are necessary to increase energy security because high dependency on one supplier is considered as dangerous.

Answering the question why the energy market liberalization has been slow and complicated must note on the lack of will of the politicians to forward this process because it was against the interests of the big national energy companies. LI intergovernmentalists note that state position in international arena is influenced by strong national economic interest groups, as it happens in reality for a long time and process was hindered. Speaking about Latvian situation, there are more specific obstacles besides the influence of the strong interest groups, corruption, using political power for own business interests, and being as “an energy island” because of the lack of interconnection for energy supply with the EU. All together influences Latvian position in the international arena. Country had to agree on Second energy package with accessing the EU. Next package was adopted when was already the MS of the EU. After the evaluation of the official national priorities in energy sector is absolutely rational that Latvia implements Third energy package. Therefore the way how politics is made in Latvia impacts the development of the energy market liberalization.

Looking at the regional level, process also have been hindered by the inability to come to an agreement with other Baltic Sea region states were to build those missing connections. For gas market liberalization as important obstacle has been and remains the agreement with Latvian Gas (expires only in April 2017) promising to keep the company as one unit until that day.

Although according to conclusions, the governments and politician have a crucial part in the development of the implementation of the IEM completion rules in Latvian case there can clearly be seen that previous accepted agreements has influence on the processes now on energy market liberalization. This agreement with Latvian Gas from one side and agreement with the EU, with accession new MS has to invent the communities laws, shows how previous taken decisions impacts situation now. However, there are some derogations

from the directive, and Commission does not mind taking into account specific situation. To explain the influence of previous decisions HI is relevant to explain energy sector problems.

## 1.2. The Historical Institutionalism

The main idea of HI is ‘path dependency’, it means that policy choices made at the beginning while creating institutions, or when some policy is proposed, will at large extent influence policy in the future. When governments initiate and start some path it is hard to change it. Alterations are possible but for that it is necessary strong political pressure.<sup>17</sup>

To ensure surviving, in a case if the first choices made by policy makers or institutions are<sup>18</sup> inappropriate, they have to be able to adopt or they will stop to exist. Although there are some ‘permanently failing organizations’ but they still exist. It is perceived that most likely the initial path will be followed if there will be no pressures. Under pressure changes will occur but they will be constrained by the modeling period of the institutions.<sup>19</sup> The most accepted definition of institutions is rules. However it differs between scholars, some concentrates on formal rules and organizations, while other on informal norms and rules.<sup>20</sup>

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17 B. Guy Peters, „The Legacy of the Past: Historical Institutionalism,” in *Institutional Theory in Political Science. The New Institutionalism*, B. Guy Peter (Ashford Colour Press Ltd, 2005), p. 71.

18 B. Guy Peters, „The Legacy of the Past: Historical Institutionalism,” in *Institutional Theory in Political Science. The New Institutionalism*, B. Guy Peter (Ashford Colour Press Ltd, 2005), p. 73

19 B. Guy Peters, „The Legacy of the Past: Historical Institutionalism,” in *Institutional Theory in Political Science. The New Institutionalism*, B. Guy Peter (Ashford Colour Press Ltd, 2005), p. 74

20 Sven Steinmo, „Historical Institutionalism” in *Approaches and Methodologies in the Social Sciences: Pluralist Perspective* edited by Donatella Della Porta and Michael Keating (Cambridge University Press, 2008) pp. 123-124  
[http://www.hse.ru/data/2012/11/03/1249193115/Donatella\\_Della\\_Porta\\_Michael\\_Keating\\_Approa.pdf](http://www.hse.ru/data/2012/11/03/1249193115/Donatella_Della_Porta_Michael_Keating_Approa.pdf)

With HI it must not be perceived that preferences of the MS are totally influenced by the EU, however, previously accepted decisions seriously impacts new governments, limiting their space for manoeuvre. HI scholar Pierson acknowledges that LI emphasis the role of the MS as the main actors. He does not reject that but notes that LI does not take in an account the role of the EU institutions and that those seriously limit the MS. The EU institutions were made by the MS, but during the time, with more decisions, institutions have gain power through agreed things in the past because of the unintended consequences. It is hard to prevent this path dependency.<sup>21</sup> Of course must remember that general decisions about the overall directions are made by the state or government leaders in the European Council (intergovernmental in character), were the states decide. EU institutions can use previous accepted, even in other spheres, to influence processes in present. In Latvian case, it just had to approve the liberalization and other rules with accession to the EU and further also Third energy package, already being as the part of it. Although there derogation from some points were provided, while being under specific circumstances, still requirements must be fulfilled and it is strongly encouraged by the EU institutions through reports, conclusions, politician statements, and also with financial support to end the isolation situation. Although there are obstacles in the way to gas market liberalization in Latvia, government acknowledges necessity to implement requirements of the directives because there is agreement on that made earlier.

In next chapter the overall development process of the IEM in the EU will be explained as the first level of analyses to investigate why the implantation of energy liberalization has been slow and complicated.

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21 Craig Mclean, Tim Gray, „Liberal Intergovernmentalism, Historical Institutionalism, and British and German Perceptions of the EU’s Common Fisheries Policy,” *Marine Policy* 33 (2009) 458-465, p. 460 DOI:10.1016/j.marpol.2008.10.002

## **2. The Development and the Meaning of the Internal Energy Market for the EU**

The EU aim is fully integrated energy market by 2014. It is necessary to increase competence, to ensure energy supply, and also to improve the services and products in the energy sector. A lot of things have been done- in some part of the MS it is possible to choose suppliers and they must explain terms and conditions; however, there is still what to do with the issues of network operation rules and infrastructure.<sup>22</sup> Despite already reached through the years there is more to gain with completing this long development of the IEM to finally deal with problems which can be solved by completion.

Essence of the problems in energy sector has been known for more than 40 years, the IEM as solution has been seen since mid 1980s, however, it is not completed and the deadlines for introduction have been postponed several times. In this chapter analysis of the development of the IEM further will be provided to prove that process has been long and complicated, as it is stated in the problem formulation. This chapter includes general explanations of the IEM- starting from the beginnings.

As stated before, the process of the IEM has been long; it can be found in the documents that the completion of it has been a central priority already in 1985 when the Single Act was adopted.<sup>23</sup> After Single Act, the European Council decided to dedicate resources to implement the idea of it for completed European internal market for energy. In 1988 the Commission made document on the implementation of the IEM for Europe. At the beginning of this document there is a quote from the communication from the Commission to the Council, made in 1968, where it was stated that barriers to trade of energy still exists and if it that will not be changed soon, achieved integration can be jeopardized. In 1968 first guidelines for a common energy policy were made. In Commission's working document about the internal energy market in 1988, twenty years after communication from 1968, it was stated that for this period progress towards

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<sup>22</sup> European Commission, „Single Market for Gas & Electricity,” (accessed. 06.11.2013.), [http://ec.europa.eu/energy/gas\\_electricity/index\\_en.htm](http://ec.europa.eu/energy/gas_electricity/index_en.htm)

<sup>23</sup> Commission of the European Communities Directorate-General for Energy, „Energy in Europe. The Internal Energy Market,” (Luxembourg: Office for Official Publications of the European Communities, 1988), 3.



common energy market has been little.<sup>24</sup> In this document was explained why common energy market is essential, including that it would reduce energy costs because of greater competitiveness, foster economic growth and reduce unemployment, it would be better for energy companies making them more able to compete at the international level, and will secure supply.<sup>25</sup> So it can be clearly seen how far in the history the roots for the IEM and acknowledge of provided benefits of it can be found, and still the EU is on the way to reach that. Further the main legal basis of the IEM, development of the IEM packages, will be provided.

### **2.1. The Internal Energy Market Three Packages and the Problems with Implementation**

The legal base for the IEM is set in the three energy packages. To fight against conservative national markets with strong monopolies first liberalizing packages were laid out in 1996 and 1998 (directives 96/92/EC and 98/30/EC). They created first opening for the IEM. Need to add that first initiatives from the Commission to those directives were laid out in 1989.<sup>26</sup> Many offers were given by the Commission because of opposition from the MS it has to review its proposals. Complex negotiation continued and finally first package directives were adopted in 1996 for electricity and in 1998 for gas. The final documents were “heavily watered-down versions” comparing to initially offer by the Commission. MS had to open their electricity market for free competition at least for 25.3% by 1997 (further for 32% by 2003). For gas MS could decide in what extent and speed to liberalise the market. Comparing to strict initial offers from the Commission this package at the end was more like framework for further liberalisation. MS saved pretty big freedom of choice in all processes. Commission was forced to accept requirement by France for the possibility to choose one buyer system where one firm would have the control over

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24 Commission of the European Communities, The Internal Energy Market (Commission Working Document), COM(88) 238 final, p. 2. <http://aei.pitt.edu/4037/>

25 Commission of the European Communities, The Internal Energy Market (Commission Working Document), COM(88) 238 final, p. 3. <http://aei.pitt.edu/4037/>

26 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> p.8



imports. As Peer Ove Eikland noted this package had “only modest results in terms of legislative pressure on national governments to open electricity and gas markets.”<sup>27</sup>

The Commission had to accept that at the ambitious plans for common carriage system and harmonised national system of third- party access was not approved. It just could hope that in future the MS will change their position in questions for open market and directives will further it.<sup>28</sup> Here clearly appears the view of the LI as states about the main players in international bargains, made institutions can not develop processes if the states are against.

The Commission in 2001 benchmarking report notified that the IEM implementation faces deep problems because of different implementation of legislation and also about obstacles in cross-border transmission systems. Diverse market conditions were the result of asymmetrical implementation of directives between the MS. Some of the MS even had not set the deadline for market opening. In 2001 Gothenburg Summit the European Council assented that the first package failed to make working IEM, and decided that the next package has to be made.<sup>29</sup>

In 2003 problems still were deep. It was clear that the first package did not succeed to create the IEM, amendments were necessary; they were made and laid out as Second Internal Energy Market Package. With it was asked to totally open energy market for all consumers by July 2007. Changes also included requirement for legal unbundling of network actions; requirement for regulator with clearly set functions; published network tariffs.<sup>30</sup> Need to add that this Second package was made in 2003 and included directives 2003/54/EC and 2003/55/EC. With these package consumers got more possibilities to choose retailers and generally affordable prices. Even though a lot of things were improved, important issue stayed unsolved- competition was hindered by big producers

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27 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> p. 10

28 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> pp. 10-11

29 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> pp. 12-13

30 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> p13

who also owned transport networks. This situation allowed big energy players to exclude, from the access to the market, other players.<sup>31</sup> Second legislation package did not provide the desired goal of the EU – market liberalization. To finally conclude the processes and unite Europe in one energy market one more legislation package for energy was adopted.

In 2009 the Third Internal Energy Market Package was made to totally remove barriers to free competition and trade in the energy market. To ensure all suppliers the ability to access to energy networks, it was required to implement ownership unbundling. It means that national companies have to sell their energy network businesses.<sup>32</sup> It consists of two directives 2009/72/EC for electricity and 2009/73/EC for gas. It includes also Regulation (EC) No 713/2009 to establish an Agency for the Cooperation of Energy Regulators; (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity, and (EC) No 715/2009 on conditions for access to the natural gas transmission networks. With this package the second was replaced.<sup>33</sup> As Radu Dudau and Teodora Simionel (from Romania Energy Center) states, the Third package for liberalizing energy market in the EU faces with the dissatisfactions of influential economic and political interests groups.<sup>34</sup> It was meant to be implemented by March 1, 2011. As it is known it is not done yet. Till that 4 countries fulfilled only some part of requirements. Planned changes had made dissatisfaction in countries and companies because of the historical system or deals with big companies like Gazprom (“whose business model runs fundamentally against TEP’s grain”).<sup>35</sup>

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31 Radu Dudau, Teodora Simionel, „The Politics of the Third Energy Package,” (2011) Romania Energy Center, p. 3. <http://sar.org.ro/wp-content/uploads/2013/01/The-Politics-of-the-Third-Energy-Package.pdf>

32 Per Ove Eikeland, „The Third Internal Energy Market Package: New Power Relations among Member States, EU Institutions and Non-state Actors?,” Journal of Common Market Studies, Volume 49 Number 2. (2011): 243, accessed October 25, DOI:10.1111/j.1468-5965.2010.02140.x

33 European Commission, „Single Market for Gas & Electricity,” [http://ec.europa.eu/energy/gas\\_electricity/legislation/legislation\\_en.htm](http://ec.europa.eu/energy/gas_electricity/legislation/legislation_en.htm)

34 Radu Dudau, Teodora Simionel, „The Politics of the Third Energy Package,” (2011) Romania Energy Center, p. 3. <http://sar.org.ro/wp-content/uploads/2013/01/The-Politics-of-the-Third-Energy-Package.pdf>

35 Radu Dudau, Teodora Simionel, „The Politics of the Third Energy Package,” (2011) Romania Energy Center, p. 4. <http://sar.org.ro/wp-content/uploads/2013/01/The-Politics-of-the-Third-Energy-Package.pdf>

Development of the IEM, as it was noted by the Commission in 2000, was hindered because of the lack of consensus between MS. They were reluctant to give necessary power to the Commission- it lacked necessary capacity to regulate process. This problem rose from the incompatibility between national energy interests and the EU goals in energy sector. This problem caused asymmetries between the MS in implementing the IEM legislative, which is important obstacle for moving to the goal in the whole EU.<sup>36</sup> LI has clear vision about that why integration happens or it does not. Also here, according to the Commission report, integration depends on the MS. As there has been disharmony between the goals of the EU and national interests -as it can be understood from previous stated, under the influence of big business interests- process just did not developed as smooth as expected.

Looking on the situation now- EU Commissioner for Energy Gunther Oettinger, in his speech in 17 May 2013 in Ljubljana at ACER Conference, noted that in general the EU is well in the way of completed IEM by 2014. He also emphasized that the MS are those who can do a lot to make it complete and also they can do many things to make it fail if the rules are not taken in the right way or some measures undermine the market possibility to function. He pointed that energy sphere is highly political because it affects questions at the highest national level (like energy mix). Commissioner said that it also directly impacts the interests of the big companies and of course daily lives of each of us.<sup>37</sup> He emphasized that because of national-centric thinking: “national first, community-wide second,” which appears as taken measures that creates situation when the benefits from cross-border cooperation are not gained. He noted that some discussed and even implemented measures threatens the gains of the IEM and even reverse the development process. Commissioner G. Oettinger emphasized in Ljubljana that gains from open market are obvious, and in words (at least) this idea is supported from everyone. Completion is dependent of MS, from their readiness to look for compromises to make common rules. It might be necessary to refuse from some national practices to introduce necessary changes to the IEM, in his

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[Energy-Package.pdf](#)

36 Per Ove Eikland, „The Long and Winding Road to the Internal Energy Market – Consistencies and inconsistencies in EU Policy,” FNI Report 8/2004 <http://www.fni.no/doc%26pdf/FNI-R0804.pdf> p.33

37 Gunther Oettinger, „EU Energy Policy Beyond 2014,” Speech/13/432 (17 May 2013), [http://ec.europa.eu/commission\\_2010-2014/oettinger/headlines/speeches/2013/05/doc/20130517-eu\\_energy\\_policy\\_beyond\\_2014.pdf](http://ec.europa.eu/commission_2010-2014/oettinger/headlines/speeches/2013/05/doc/20130517-eu_energy_policy_beyond_2014.pdf) p.3

eyes this is the greatest risk for the project.<sup>38</sup> Again here clearly LI views confirms, following to commissioner stated, the processes depends from the MS decisions, their national interests. Successful implementation depends on the level of harmony between the EU and national levels.

Although, the IEM is not completed and the end result depends on MS will, a lot have been reached. In 2012 in Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work (further Communication making the IEM work) it was noted that around 14 energy companies worked in more than one state; in 2/3 of the MS consumers have ability to choose between suppliers giving the possibility to get better price for energy.<sup>39</sup> Through all efforts also competition has increased, cross border trade and the market has become more integrated. This all has been promoted by the EU legislation. Besides mentioned, MS have understood the necessity to coordinate external relations related to energy issues, seeing the benefits from the energy market going beyond the borders, this is necessary to extend the market, and also to improve more situation of the energy security.<sup>40</sup> Besides reached, there is more to gain from completed IEM, to emphasize more the necessity for it, further benefits and the meaning will be explained at broader extent.

## **2.2.Benefits from the Completed Internal Energy Market**

As stated above a lot of things have been achieved but still it is necessary to move forward to ensure this liberalisation in the whole EU. Completed energy market is necessary to: make network for gas and electricity flow in the necessary place; to fight the

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38 Gunther Oettinger, „EU Energy Policy Beyond 2014,” Speech/13/432 (17 May 2013), [http://ec.europa.eu/commission\\_2010-2014/oettinger/headlines/speeches/2013/05/doc/20130517-eu\\_energy\\_policy\\_beyond\\_2014.pdf](http://ec.europa.eu/commission_2010-2014/oettinger/headlines/speeches/2013/05/doc/20130517-eu_energy_policy_beyond_2014.pdf) p. 4

39 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” COM(2012)663 final (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p.3

40 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p.4

climate changes; to ensure affordable energy supply-reliable supply for lowest cost; ensure energy security;<sup>41</sup> increase possibility to choose between suppliers (estimations shows this could help to save around € 13 billion per year); with investments it is planned to reduce energy consumption; improved access to transmission grids to all players in the market;<sup>42</sup> improved effectiveness in using and developing of grids that would simplify access to infrastructure (also to renewable energy producers).<sup>43</sup>

In June 2013, parliament's rapporteur on making the IEM work, Jerzy Buzek encouraged MS to introduce the third energy package. He said that: "Completing the European energy market is our exit strategy from the crisis."<sup>44</sup> The prices of energy increases, according to Eurostat it is because of the higher tariffs and environmental surcharges which are the reasons for the hindered growth in the EU.<sup>45</sup>

European Heads of the State or Governments noted that the IEM is not an end in itself. The IEM is crucial part in achieving the most of the aspirations of the citizens: "economic growth, jobs, secure coverage of their basic needs at an affordable and competitive price, and sustainable use of limited resources."<sup>46</sup>

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41 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 2

42 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 6

43 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 7

44 Kayleigh Lewis, „Internal energy market is EU's 'exit strategy' from the crisis, says senior MEP,” The Parliament.com, <http://www.theparliament.com/latest-news/article/newsarticle/internal-energy-market-is-eus-exit-strategy-from-the-crisis-says-senior-mep/#.UkGxZj-BadI>

45 Kayleigh Lewis, „Internal energy market is EU's 'exit strategy' from the crisis, says senior MEP,” The Parliament.com, <http://www.theparliament.com/latest-news/article/newsarticle/internal-energy-market-is-eus-exit-strategy-from-the-crisis-says-senior-mep/#.UkGxZj-BadI>

46 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 2

Failing to complete would mean not stable and more expensive energy system. Besides that the competitiveness of the EU would be lower and also decarbonisation process would decline.<sup>47</sup>

To avoid the failure and get all possible benefits the IEM must be completed. To do that it is necessary to implement the third energy package on time, delaying causes bad effect on everybody.<sup>48</sup>

In many MS price regulation exists, this situation does not encourage to make better offers for consumers and also is not attractive for new players. Besides that price regulation in the future can cause huge costs for consumers. MS should stop to regulate prices.<sup>49</sup> Changes to liberal market and necessary system are costly but it must have been done because market will provide more effective and cheaper supply than any central planning.<sup>50</sup>

In Communication making the IEM work it was noted that more investments are necessary in generation, transmission and infrastructure. Estimated price is high for that- a trillion euro. Besides that it was emphasised that improvements in efficiency measures, and in competition are necessary.<sup>51</sup> Required from the MS in legislation introducing and

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47 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 2

48 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 7

49 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p.10

50 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 12

necessary costs for infrastructure are high but it has to be done to ensure better conditions for the citizens of the EU in the future.

Although now, as written before about the statement of G. Oettinger, the IEM is moving on the right way, recently still doubts about it were expressed whether it will be done till chosen deadline. In Communication Making the IEM work it was noted that still in 8 MS around 80% of power generation was controlled in historical way. Attention was paid that investments should be directed accordingly to market not subsidies and also to the lack of transparency, and openness to the new players in the energy markets.<sup>52</sup>

In 2012 it was noted that the EU is not on the right track- the goals will not be reached by the deadline without improvements. It was stated that MS are slow in adjusting the national legislation and creation of competitive markets, besides that, it was stated that they need to “move away from, and resist the calls for, inward –looking or nationally inspired policies.”<sup>53</sup> It even threatens reached progress. To avoid that, Commission emphasized benefits provided by the complete IEM.<sup>54</sup> To gain results it was stated that the IEM is a priority for the Commission that it will start infringement procedures towards MS that have not transported Third energy package or have not done it in an inappropriate way.<sup>55</sup>

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51 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 2

52 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 3

53 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p. 2

54 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions- Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p.3



J. Buzek in his speech in 2009 in Opening Ceremony College of Burges stated that the EU needs a common energy policy to reduce gas emission and to increase the energy security, emphasising the necessity for solidarity in the field of energy, saying that all MS have to work together because the security and lower carbon emissions are necessary and all have to work together because it cannot be done alone. He also acknowledged that energy is issue of sovereignty and that is why that not all MS wants to start to do it. He said that at the beginning it is necessary to start with those states that are ready to join. He noted that it is time to think about pooling sovereignty over energy production. Europe must be related to avoid energy cut crises as some states have experienced recently noting that it can happen to everyone.<sup>56</sup>

According to stated everything above the IEM must be completed but obstacles still remain to be overcome. In interview Jerzy Buzek answering the question what are the Challenges to the completed IEM till 2014, said-there a lot of challenges but the most important task is to ensure true competition in energy market, providing consumers possibility to choose between suppliers.

In interview he was asked about how there can be competition if the tariffs are regulated, adding that regulated tariffs are cheaper for consumers than liberalized. Mr. Buzek confessed that is true that liberalisation will make energy more expensive but it is necessary to that to ensure security of the supply, sustainability, stability and affordable prices. He said that consumers do not understand geopolitics but they know if they do not have electricity or other kind of energy, to avoid it, consumers must understand the necessity of liberalized market, even with higher prices. To exit from the crises also the IEM completion is crucial part for that. Governments must to implement third energy package and after that it will be possible to create investments and further development.<sup>57</sup>

Secure energy supply is vital for Europe, the IEM would ensure that gas crisis, as experienced in recent history in 2009, would not surprise again. As the market is not

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55 European Commission, „Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee and the Committee of the Regions-Making the Internal Energy Market Work,” (15.11.2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0663:FIN:EN:PDF> p.8

56 Jerzy Buzek, „Opening Ceremony College of Europe Burges, 4 November 2009 Speech by Me Jerzy Buzek, President of the European Parliament,” <https://www.coleurope.eu/speeches>

57 The EU Policy Broadcaster, „Completing the European Internal Energy Market, rapporteur Jerzy Buzek MEP (EEP).” Interview video (16.04.2013) <http://www.vieuws.eu/citizens-consumers/completing-the-european-internal-energy-market-rapporteur-jerzy-buzek-mep-epp/>



completed, and the EU is not totally connected, and there are not possibility to choose between suppliers in the all EU, concerns about new energy crisis are open. At the beginning of November 2013 Dragomir Stoynev (Bulgarian Economy and Energy Minister) said that we could experience new crisis because of the disputes between Russia and Ukraine. Those concerns are raised because of Ukraine's debt to Gazprom around € 666 million. D. Stoynev also noted to the real reason for possible gas crises, which is Ukraine's wish to sign association agreement with the EU at the end of November during the Vilnius summit. However, it is mentioned that D. Stoynev has raised those concerns because of other interests, particularly using it to favour Bulgaria's decision to build South Stream gas pipeline, implementation of this project would mean that gas would be delivered evading Ukraine. Need to add that this project likes to Gazprom.<sup>58</sup> On my opinion, concerns about possible cuts could be real because it is not nothing new that Russia is using its energy power for political games, to show its dissatisfaction with some decisions or actions, and try to influence other countries and change their behaviour. Although, according to the latest news, seems that supply cuts should not be experienced any soon because of the sudden Ukraine's u turn.

As approval that Russia use energy power to gain political influence may use case with Ukraine. As it is known, Russian undesirable association agreement between Ukraine and the EU was not signed during the Vilnius summit. In December 17, 2013 there came news that Russia has agreed to reduce the price of the gas to Ukraine about one third.<sup>59</sup> Russia also will buy \$15bn of government bonds. Ukraine's decision to postpone oncoming to the EU and sign aid agreement with Russia has saved it from bankruptcy.<sup>60</sup> The lesson for the EU, from Ukrainian example, should be that it is necessary to develop the IEM to not to allow Russia influence Europe with the price for energy. To avoid that real competition in an open energy market and diversification of suppliers are necessary.

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58 Georgi Gotev, „Bulgaria Warns of New Gas Crisis,” EurActiv.com EU news& policy debates-across-languages [http://www.euractiv.com/energy/bulgaria-warns-new-gas-crisis-20-news-531560?utm\\_source=RSS\\_Feed&utm\\_medium=RSS&utm\\_campaign=EurActivRSS](http://www.euractiv.com/energy/bulgaria-warns-new-gas-crisis-20-news-531560?utm_source=RSS_Feed&utm_medium=RSS&utm_campaign=EurActivRSS) (seen 12.11.2013.)

59 Delfi, „Ukrainas premjers aizstāv vienošanos ar Krieviju; opozīcija sauc par nodevību [Ukrainian Prime Minister Defends the Agreement with Russia; Opposition Calls it as Betrayal],” (published December 17, 2013), <http://www.delfi.lv/news/world/other/ukrainas-premjers-aizstav-vienosanos-ar-krieviju-opozicija-sauc-par-nodevibu.d?id=43953886> .

60 BBC, „Russia Deal Saved Ukraine from Bankruptcy- PM Azarov,” British Broadcasting Corporation, (published 18.12.2013), <http://www.bbc.co.uk/news/world-europe-25427706> .

Concluding the chapter it can be stated that there are no doubts that the process of the IEM have been complicated and long. In general it can be said that that the main reason for slow and complicated development is the reluctance of MS to forward power in the energy sector. Because of limited powers, the Commission's proposals for many times were rejected and the end result differed a lot from the initial plans. Also with implementation MS in general did not succeed to good, they were different a lot in the extent what the legislation was implemented. Differences in that how fast and in what extent energy packages were implemented between the MS mattered a lot for failure to reach this goal in the EU. Here again must use explanation of the LI about the role of the MS and their national interests in the process of integration. From one side MS acknowledges necessary to develop this project but from other side there are strong economic interests and incumbents in domestic arenas which had not been in harmony with idea of liberalized energy market. MS were reluctant to implement requirements of directives. Offcourse each case of the MS is different but it is the general conclusion. Further, in next chapter, specific Latvia's case will be analysed as it is chosen for the case study for this paper.

### 3. The Situation in Energy Sector in Baltic States

All three Baltic States: Estonia, Latvia, and Lithuania, at first sight, seems similar because they all are small and have analogous recent history, Soviet times, has forced them to develop under the same ruling. After regaining independence all three states have moved to the West- joining the NATO and the EU. But when starting deeper analyses meaningful diversities appears. In energy policy they cannot be evaluated totally similar because in energy mix situation diverges, however, there is uniting factor- all of them are called “isolated islands” because of lack of infrastructure to be connected with the rest of the EU for gas supply, and only with one other connection for electricity with the EU. Joining factor in energy sector is also being a part of the EU – all three states have to follow the EU requirement to implement Third energy package to introduce the IEM for the EU. In this chapter, general situation in energy sector in the Baltic States, common/uniting problems will be explained. In the next chapter, Latvia’s specific case, as it is the main purpose of this thesis, will be analysed. Estonia and Lithuania will not be researched in depth because those countries are not chosen as the focus in the thesis.

As stated before, liberalisation is targeted for electricity and gas markets in the EU. Liberalisation process has been more successful in electricity sector than for gas market. In Lithuania and Estonia electricity markets have been opened since the beginning of 2013. From one side it is absolutely necessary to make the liberalization, but in the Baltic States this move may not provide the most desirable promised gain for consumers- lower prices. This situation has emerged because of the lack of real competition.<sup>61</sup> Gas sector liberalisation faces more problems because of the Gazprom. The Company has the ownership over the transmission and distribution pipelines.<sup>62</sup> In gas sector the Baltic States remains isolated till now.

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61 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 75

62 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 76

### 3.1. "Energy Islands"

Baltic States are totally dependent from Russian gas supplier Gazprom. This situation is a heritage from the Soviet Union times. There are simply no connections with the rest of the Europe- only with Russia. Need to add that common for the Baltic States is being as energy islands but each case is different because of energy mix and internal diversities.<sup>63</sup> I will not go in deep analyses with each of the states, only with Latvia, in the next chapter, as it is chosen as case study for the thesis. Here I will turn to common situation of energy islands.

Baltic States have exclusive dependence on Russia's gas supply and also huge part of electricity is received from there. Besides that, there is lack of connection with other countries in the EU. All this causes threats to energy security, and makes the Baltics vulnerable, and affects energy prices.<sup>64</sup> Dr. Agnia Grigas states that energy sector is the weakest sector of all Baltic States, calling it as "Achilles heel" of them, because of previous mentioned isolation and dependency. Energy affects economy, development, and everyday lives. A. Grigas claims that inflation during 2000s, global crisis in 2008 was at some extent reinforced by fast increasing costs of gas and oil delivered from Russia.<sup>65</sup> As it is known crisis hit these countries very hard, especially Latvia.

Energy island issue is crucial, as Latvian Minister of Economics stated, to end monopoly situation is not just in the interest of consumers but also in the interests of the state security.<sup>66</sup> Alternative supplier is necessary for greater energy security and lower prices, and to not to allow Gazprom to use its near or total monopoly to get more for its gas

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63 „Baltic Energy Security and Shale Gas Development in Europe,” Natural Gas Europe, (accessed 28.11.2013) <http://www.naturalgaseurope.com/baltic-energy-security-shale-gas>

64 „Baltic Energy Security and Shale Gas Development in Europe,” Natural Gas Europe, (accessed 28.11.2013) <http://www.naturalgaseurope.com/baltic-energy-security-shale-gas>

65 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 1 (vai 65)

from Europe. Gazprom, being very important supplier, has strong bargaining power towards Europe.<sup>67</sup>

Situation is improving and the Baltic States are moving forward. As professor Andris Spruds has written: “Baltic states transform gradually from Europe’s energy “island” into “peninsula”, all three are still heavily integrated with Russia’s electric power grid”<sup>68</sup> There are more planned connections to end Baltics vulnerability in energy sectors. For electricity sector first steps are done but for gas market liberalization a lot of changes have to be introduced. The European Council has reaffirmed that it is necessary to complete energy market liberalization by 2014, and end the situation that some states are isolated from gas or electricity networks by 2015.<sup>69</sup> There are plans to build several connections for gas and electricity in a few years and there is also promised financial support from the EU.<sup>70</sup>

### **3.1.2. Energy Security Issue and Relations with Russia as Energy Supplier**

It is perceived that too big energy dependency from one supplier is not good at all- it is a threat to energy security and state security. The Baltic’s are largely dependent on

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66 Magda Riekstina, „Pagaidām gāzes tirgu varam atvērt tikai uz papīra [At Present situation We Can Open the Gas Market Only on the Paper],” Newspaper *Diena [Day]* November 4, 2013.

67 „Baltic Energy Security and Shale Gas Development in Europe,” Natural Gas Europe, (accessed 28.11.2013) <http://www.naturalgaseurope.com/baltic-energy-security-shale-gas> Magda Riekstina, „Pagaidām gāzes tirgu varam atvērt tikai uz papīra [At Present situation We Can Open the Gas Market Only on the Paper],” Newspaper *Diena [Day]* November 4, 2013.

68 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010) <http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> p. 13

69 European Council, „Conclusions,” 23 May 2013, p.2. <http://register.consilium.europa.eu/pdf/en/13/st00/st00075-re01.en13.pdf>

70 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, North Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 79

Russia. Relations between each Baltic State and Russia cannot be evaluated as too stunning. Russia is using its energy power to influence those small states on through such strong tool as energy prices (threats to raise them). Of course there are potential threats about secure supply, knowing situation what occurred in 2009 in Europe after gas supply cut to Ukraine.

Baltic States are not the only ones depending on gas import only from Russia. This is also an issue for Finland, Romania, Bulgaria, and Slovakia despite similarity with dependency, as A. Grigas, noted, Baltic States are more vulnerable because of a dependence on a “potentially hostile source” and existing infrastructure, built during the Soviet times, and now pipelines owned by Gazprom. She states also that Russian interests are dominant in the gas sector in this region because Gazprom has a considerable amount of shares in national gas companies in all Baltic states -Estonia Gas (Eesti Gaas 37%), Latvian Gas (Latvijas gāze) 34%, Lithuanian Gas (Lietuvos Dujos 37%).<sup>71</sup>

Must agree to A. Grigas stated, that internal political processes has had influenced from powerful energy interest groups. With existing corruption and the lack of transparent financing parties system and through that there has been important influence from energy business sector. Most influential interest groups include national gas companies and also gas distribution company Itera with subsidiary companies in Latvia and Estonia, and local gas distributors as Lithuanian Dujotekna, Vikonda, and Stella Vitae. Ownership of those companies has links with Gazprom. She also notes that, to direct to concrete influence is difficult because of the lack of documents about that. Existing situation make it difficult to be coherent in energy policy or foreign relations towards this big neighbour. This situation has been tried to solve with greater involve of the EU, but consequences was just more bad relations with Russia. Lithuania tried to solve the problem of different energy prices for Baltic States- they are politically made rather than based on the market.<sup>72</sup> That prices have political roots, it approves with this compare between prices:

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71 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 67

72 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 73

“The Directorate General for Competition has compared the prices other consumers of Russian gas pay for it and deemed Lithuania’s complaint justified,” its press-service told *The Ukrainian Week* in Strasbourg. “Lithuania is buying gas at a price that is 13% higher than Estonia’s and 20% higher than Latvia’s. It pays EUR 403 per cu m, which is EUR 90 more than Germany is paying.”<sup>73</sup>

Lithuanian opinion is that those prices diverge because of its stronger effort towards energy market liberalization.<sup>74</sup> As mentioned before, energy policy is not “clear” and it is influenced by the interests of the business group. There is no official documentation for that, but situation when Lithuania is harder lined in implementing third energy package and it has to pay more than in Estonia and Latvia, note on that. There is also unofficial information that exists an offer to Riga from Gazprom to gain a discount for gas- in an amount of 20% -for delayed introduction of the Third energy package.<sup>75</sup> The liberalization process has been the slowest between the Baltic States, In Latvia, this could be one of the reasons why there is lower price for the energy. Latvian minister of economics Pavluts said that price differences between the Baltic States means something. As it is the most benevolent to Latvia leads to think that it is awarded already for something. He also noted that historically Latvia has been the weak link towards being against the influence of Gazprom.<sup>76</sup>

However, this legislation has to be implemented in the Baltic States according to directives and regulations that must be applied in the MS. Those requirements have not been in the interests of Russia that has complicated relations. The EU has helped the Baltic States, involving in talks. There are even frameworks for dialogue.

Energy Dialogue between the EU and Russia was established on 30 October at the sixth EU- Russia Summit with aim to ensure secure and reliable energy relations based on the

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73 Alla Lazareva, Alen Guillemoles, „Brussels Against Gazprom,” *The Ukrainian Week* (26.09.2012) <http://ukrainianweek.com/World/60925>

74 Alla Lazareva, Alen Guillemoles, „Brussels Against Gazprom,” *The Ukrainian Week* (26.09.2012) <http://ukrainianweek.com/World/60925>

75 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 74

76 Anita Brauna, „Pavļuts: Pāri enerģētikas celmiem, pret superrentablajiem, [Pavlut: Over the Energy Strains against Super-profitable],” *ir.lv* <http://www.ir.lv/2013/3/21/pavluts-pari-energetikas-celmiem-pret-superrentablajiem>



free market. Through this dialogue confidence for both sides has increased and that helped to solve the dispute in 2009.<sup>77</sup>

As A. Grigas states EU involvement in the Baltic – Russia relations in energy sector is crucial, if there would be no support, it would much harder for the Baltic States to implement requirements from the EU energy liberalization packages.<sup>78</sup>

Referring to different prices for gas between the Baltic States, Ukrainian example it is obvious that actions according to Russia's desires (slower energy market liberalization or delayed signing of the accession treaty) proceeds benevolent attitude from it. Russia uses its energy power in relations with other states. It is necessary to get secure alternative supplier to increase the security and stability, all MS has to be joint to reach that.

### **3.3. Solidarity between the Member States**

The necessity to end the Baltic States vulnerable situation is an acknowledged problem in the EU, and there have been and are support from other MS to solve this problem; however, can be found also bad examples from recent history when in words other states gave support but not in actions. In this section some of good and bad examples will be analysed; also relations between Baltic States will be analysed.

It cannot be said that other MS and the EU as a whole are not interested in solving this issue. There are specific interest from the EU, which reflects in documents and stated emphasise on the Baltics situation. One example is in 17 June 2009 signed Memorandum of Understanding on the Baltic Energy Market Interconnection Plan (BEMIP) between eight Baltic Sea states and Commission.<sup>79</sup> In this project are involved Latvia, Lithuania, Estonia, Poland, Denmark, Sweden, Germany, Finland, and Norway as observer. This High

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<sup>77</sup> European Commission, „EU-Russia Energy Dialogue,” (accessed 2.12.2013)  
[http://ec.europa.eu/energy/international/russia/dialogue/dialogue\\_en.htm](http://ec.europa.eu/energy/international/russia/dialogue/dialogue_en.htm)

<sup>78</sup> Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 85

<sup>79</sup> „Memorandum of Understanding on the Baltic Energy Market Interconnection Plan,”  
[http://ec.europa.eu/energy/infrastructure/doc/2009\\_bemip\\_mou\\_signed.pdf](http://ec.europa.eu/energy/infrastructure/doc/2009_bemip_mou_signed.pdf)



Level Group (HLG) delivered this plan. Commission has to monitor the development of the implementations of this plan and report to the HLG. In Baltic Energy Market Interconnection Plan 4<sup>th</sup> progress report, released in June 2011-May 2012, as main objectives were outlined to fill the Council Conclusions made on 4<sup>th</sup> February 2011- to not to allow any MS stay as isolated island because of lack of connections; energy market legislation implementation.<sup>80</sup>

The Commission, in the framework of the European Energy Programme for Recovery (EEPR)- gives resources for two electricity interconnections Estlink2 (connecting Finland and Estonia) and NordBalt (connecting Lithuania and Sweden). Latvia is supported to strengthen internal transmission grid.<sup>81</sup> Together with this good example of being joined towards the necessity to reduce vulnerability of the Baltic States, there is an example in recent history when two projects were not supported. EU donor states refused to finance electric cable setting between Latvia and Sweden. In words the rest of the Europe give support, but in the 2009 as there was necessity to provide with financial sources old MS- Great Britain, Netherlands, France and Germany decided against the projects Swedlink (Sweden- Latvia) and Estlink-2 (Estonia- Finland). It was expected to finance those projects from the saved budget money from 2008.<sup>82</sup> Need to add that there is Estlink connection between Estonia and Finland since January 2007.<sup>83</sup>

Speaking about gas sector, than in February 2011 European Energy Council concluded that to solve Baltics energy isolation problem investments are necessary as new interconnections: “(GIPL- Poland- Lithuania, BalticConnector-Finland-Estonia), upgrade and development of the intra-Baltic gas networks and a regional LNG terminal.”<sup>84</sup> It seems

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80 Baltic Energy Market Interconnection Plan-4th progress report- June 2011-May 2012  
[http://ec.europa.eu/energy/infrastructure/doc/20121016\\_4rd\\_bemip\\_progress\\_report\\_final.pdf](http://ec.europa.eu/energy/infrastructure/doc/20121016_4rd_bemip_progress_report_final.pdf) 3

81 Baltic Energy Market Interconnection Plan-4th progress report- June 2011-May 2012  
[http://ec.europa.eu/energy/infrastructure/doc/20121016\\_4rd\\_bemip\\_progress\\_report\\_final.pdf](http://ec.europa.eu/energy/infrastructure/doc/20121016_4rd_bemip_progress_report_final.pdf) 4

82 Dienas bizness, „Eiropa negrib maksāt par Latvijas energodrošību {Europe Does Not Want to Pay for Latvian Energy Security},” db.lv biznesa portāls <http://www.db.lv/citas-zinas/eiropa-negrib-maksat-par-latvijas-energodrosibu-190153>

83 Paul Newton, „Nordic-Baltic Energy Market under Pressure from Divergent National Interests,”(02.06.2009.) <http://www.utilityweek.co.uk/news/Nordic-Baltic-energy-market-under-pressure-from-divergent-national-interests/800232#.Up3F2-IiydI>

84 Baltic Energy Market Interconnection Plan-4th progress report- June 2011-May 2012  
[http://ec.europa.eu/energy/infrastructure/doc/20121016\\_4rd\\_bemip\\_progress\\_report\\_final.pdf](http://ec.europa.eu/energy/infrastructure/doc/20121016_4rd_bemip_progress_report_final.pdf) 5

now that dedicated attention and resources to the Baltic States situation will finally end the isolation in the following years. The EU has prioritized this issue and money is dedicated and promised for problem solving. As there are some financial solutions for problems, those three states have to end their disagreements to finally ensure secure supply and other benefits.

Liberalization process has not been hindered only by the historical situation, or lack of money. As another reason has to mention disagreements between the Baltic States about in which country some energy facilities will be built. Several years Nordbalt project was delayed because of Latvia's and Lithuania's inability to agree which state will receive the cable from Sweden.<sup>85</sup>

Building of liquefied natural gas (LNG) terminal would be an important step towards increased energy security for the Baltic Sea states. There are no political agreement between Latvia, Estonia and Finland where to build it. Estonia is insisting that it must be located there because the building and maintenance costs would be the lowest, and the project is developed further than the one of competitors.<sup>86</sup> Finland arguments: its gas consumption is higher than in all three Baltic States together, and is the most vulnerable from the view of energy security.<sup>87</sup>

In September the Commission published the list of potentially supporting energy projects, mentioning that the LNG terminal could be built in any of those countries. In earlier reports Finland was considered as the best place. Because of disputes between the countries the Commission hired consultant Booz&Company to evaluate that. They noted on a lot of advantages to have LNG terminal in Estonia, although a lot of similar

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85 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 79

86 Db.lv, „Igaunija, Latvija un Somija aizvien nespēj vienoties par to, kur būvēt LNG terminālu [Estonia, Latvia and Finland cannot Agree Where to Build LNG Terminal],” db.lv [business portal] <http://www.db.lv/razosana/igaunija-latvija-un-somija-aizvien-nespej-vienoties-par-to-kur-buvet-lng-terminalu-403197>

87 Karl Sorri, „Baltic Dependence on Russian Gas About to End,” oilprice.com <http://oilprice.com/Energy/Natural-Gas/Baltic-Dependence-on-Russian-Gas-About-to-End.html> (accessed 13.12.2013.)

preferences for Finland was identified.<sup>88</sup> This question has been under debates for a few years without solution. This terminal would be funded by the EU and it would provide some benefits for the hosting country that is why states are disputing for that so long. The hosting state would have direct access to global markets because it could store gas and that would also lower transaction costs. As benefits can also be mentioned increased employment. States have given rights to choice about the place to the Commission. It is known that it will be not Lithuania because it is chosen to build smaller terminal, and because of that decision Latvia is not the most attractive place to build it because of the short distance in between. The main fight remains between Finland (city Inkoo) and Estonia (Muuga/Paldiski).<sup>89</sup> Also Latvia has been trying to get this project to be implemented in its territory. Now it is known that Latvia is not in the game anymore and the fight goes between Finland and Estonia. As one of the reasons why Latvia is excluded Minister D. Pavluts mentions the influence of the Gazprom – the way how their interests are being directed. Minister said that on this obstacle it was noted in Brussels when he started to bargain about the possibility to have LNG terminal in Latvia.<sup>90</sup>

Acknowledging how beneficial this project would be for involved states in terms of energy security it seems unreasonable that the decision of building LNG terminal has not been taken for several years. Here the explanation of the LI is in place because it clearly shows how national preferences (benefits from hosting this terminal) make compete for their gains, international bargains are hindered because of national preferences.

It can be concluded that the uniting in energy sector for all Baltic States is the historically developed situation of being as isolated islands. It is necessary to work together to develop necessary infrastructure but this process is delayed because of the inability of MS to reach an agreement about where to build necessary facilities. Of course support

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88 Db.lv, „Igaunija, Latvija un Somija aizvien nespēj vienoties par to, kur būvēt LNG terminālu [Estonia, Latvia and Finland cannot Agree Where to Build LNG Terminal],” db.lv [business portal] <http://www.db.lv/razosana/igaunija-latvija-un-somija-aizvien-nespej-vienoties-par-to-kur-buvet-lng-terminalu-403197>

89 Karl Sorri, „Baltic Dependence on Russian Gas About to End,” oilprice.com <http://oilprice.com/Energy/Natural-Gas/Baltic-Dependence-on-Russian-Gas-About-to-End.html> (accessed 13.12.2013.)

90 Anita Brauna, „Pavļuts: Pāri enerģētikas celmiem, pret superrentablajiem, [Pavlut: Over the Energy Strains against Super-profitable],” ir.lv <http://www.ir.lv/2013/3/21/pavluts-pari-energetikas-celmiem-pret-superrentablajiem>

from other MS and the Commission is necessary for economic solutions and also in relations towards main supplier Russia.

After the analysis of the regional, Baltic level, part of most important obstacles has been discovered, however, there are more issues that has affected situation in Latvia which will be explored in the next chapter.

#### 4. Electricity and Gas Markets Liberalization Issues in Latvia

In liberalization processes Latvia has been more compromised in relations with Russia, being slower in those processes, than Lithuania and Estonia. But it has been more active in renewable targets, not just between the Baltic's but in the EU, which is also important because of more diverse energy sources.<sup>91</sup>

As explained in previous chapter, looking to energy issues through the Baltic's prism, Latvia belongs to those countries with a high level dependency from imported energy. In 2011 it was estimated that only 33,1% of total energy consumption is ensured from local sources. Oil, solid products and electricity are received from several countries but natural gas has only one supplier and it is Russia.<sup>92</sup> Situation is made more complicated by the fact that Latvia is also a part of 'energy island', it means that historically situation has developed so that the country is connected only with one supplier (now in gas supply) and in this case with Russia.<sup>93</sup>

In the EU, Latvia is on the highest positions in dependency from energy import. Basically all oil and gas is delivered from Russia. Electricity sector looks better because also neighbors are suppliers, and important part is produced in Latvia from renewable sources, however, relying on import of 30% is too big.<sup>94</sup>

Becoming a MS of the EU Latvia has to implement the Third energy package rules to complete the making of the IEM in the EU. It is required to liberalize gas and electricity

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91 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 66

92 Latvijas Republikas Ekonomikas ministrija [Ministry of Economics of the Republic of Latvia], „Latvijas enerģētika skaitļos. Latvian Energy in Figures,” [http://www.em.gov.lv/images/modules/items/Brosura\\_Latvijas\\_energetika\\_skaitlos\\_2013%281%29.pdf](http://www.em.gov.lv/images/modules/items/Brosura_Latvijas_energetika_skaitlos_2013%281%29.pdf) p. 4

93Latvian Association of Local and Regional Governments, „'Enerģētikas salas' iemītnieki joprojām gaidās [Inhabitants of the 'Energy Islands' Still are Waiting],” (accessed 27.10.2013), [http://www.lps.lv/Darbiba\\_Eiropa/?task=view&article\\_id=3132](http://www.lps.lv/Darbiba_Eiropa/?task=view&article_id=3132).

94 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Developmnet: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010) <http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> p. 13

energy markets to gain different kind of benefits from open market. Liberalization processes have been long and complicated in the EU, as it can be concluded from analyses in the first chapter of this thesis. Now I will turn to specific Latvia's case- to the opening process of the electricity and gas markets. Liberalization has not been smoothly, and even in electricity sector Latvia is behind other two Baltic States.

In following chapter compatibility between the aims of the EU and Latvia's stated one for energy sector will be analyzed to understand if they match. This first step is necessary to reassure if Latvia, at least in official level, wants/needs the same as the EU.

#### **4.1. Compatibility in Energy Policy Goals between the EU and Latvia**

At first, before looking for other reasons for the slow development of the energy liberalization market in Latvia, must view compatibility between the EU goals and Latvian stated ones for the energy sector. This step is necessary to be sure if Latvia's vision for energy policy, at least at the official level, is in connection with the EU's one.

The Ministry of the Economics of Latvia (responsible for energy policy in Latvia) has noted that main objective of successful energy policy is to ensure positive effect on the economy of Latvia. To do that, increased energy security is necessary, diversification of the sources, appropriate energy efficiency measures and new interconnections to avoid isolation.<sup>95</sup>

According to Latvian Energy Law, purposes are to ensure secure and reliable supply for reasonable prices from diverse resources while observing necessary requirements for environmental protection. Also to ensure rights to choose between energy suppliers, encourage competition, use of renewable, efficiency and others.<sup>96</sup> As it can be deduced, taking account written in previous chapter about the EU level aims, content of this law basically ensure the same what the EU legislation with the IEM introduction wants to reach.

Sustainable Development Strategy of Latvia until 2030 (the highest level planning document) aim is to ensure independency through increased self-sufficiency of resources

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95 Latvijas Republikas Ekonomikas ministrija [Ministry of Economics of the Republic of Latvia], „Latvijas enerģētika skaitļos. Latvian Energy in Figures,” [http://www.em.gov.lv/images/modules/items/Brosura\\_Latvijas\\_energetika\\_skaitlos\\_2013%281%29.pdf](http://www.em.gov.lv/images/modules/items/Brosura_Latvijas_energetika_skaitlos_2013%281%29.pdf) p. 4

96 „Enerģētikas likums [Energy Law],” Legislation of the Republic of Latvia <http://likumi.lv/doc.php?id=49833> (accessed 19.11.2013.)

and integration in the EU networks. It is stated that Latvia, as the MS of the EU with its own specific interests, supports harmonized EU energy policy and common aims of it.<sup>97</sup> After the review of those sources, it can be concluded that, officially set goals of Latvia's energy policy are in harmony with EU visions for energy policy, and with benefits which the completed IEM can provide.

Integration in the EU energy market is a priority for Latvia, and also the aim of the Baltic Energy Market Interconnection Plan (BEMIP) to ensure connections between countries.<sup>98</sup> Moving to the EU IEM is not only Latvian aim but to reach that there are plans, forums and cooperation between Baltic States, in the regional level and through the EU institutions.

Knowing that aims in energy sector between Latvia and the EU are not in contradictions, further development in market opening for electricity and gas sectors will be analyzed to view the process and outline obstacles for liberalization.

#### **4.2. Development of the Energy Market Liberalization in Latvia**

The process of liberalization diverges for electricity and gas markets. Further, in subchapters, development of the liberalization process for both sectors will be analyzed. After that, issues related with decision makers will be analyzed.

Liberalization process has been complicated and long and still continues. In March, Minister of Economics refused from idea to direct proposal in government for opening Electricity market totally from September 1, 2013<sup>99</sup>, term was postponed and now it finally will be done in April 1, 2014. In the gas sector the situation more complicated and

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97 Latvijas Republikas Ekonomikas ministrija [The Ministry of Economics of the Republic of Latvia], „Enerģētikas stratēģija 2030 [Strategy for Energy 2030],” [http://www.em.gov.lv/images/modules/items/14122011\\_Energetikas\\_strategija\\_2030%281%29.pdf](http://www.em.gov.lv/images/modules/items/14122011_Energetikas_strategija_2030%281%29.pdf) p.5

98 U.S. Energy Information Administration, „Latvia,” (last modified May 30, 2013), <http://www.eia.gov/countries/country-data.cfm?fips=LG&trk=m>.

99 'Enerģētikas salas' iemītnieki joprojām gaidās [Inhabitants of the "Energy Islands" Still are Waiting],” Latvian Association of Local and Regional Governments (accessed 27.10.2013), [http://www.lps.lv/Darbiba\\_Eiropa/?task=view&article\\_id=3132](http://www.lps.lv/Darbiba_Eiropa/?task=view&article_id=3132)

liberalization is expected to reach in six years, although, the EU states that there will be no isolated states by 2015. As situation for gas and electricity markets diverges, further liberalization for both will be explained deeper.

#### **4.2.1. Liberalization of the Electricity Market**

In November 6, 2013 the government of Latvia approved that the electricity market will be liberalized in 1<sup>st</sup> April 2014. With this decision almost 85000 households will gain possibility to choose supplier with best deal. As main benefits, stated in the web page of the Ministry of the Economics of Latvia are: increased competition between suppliers and choice of offers, transparency and more clear and competitive price for electricity.<sup>100</sup>

The opening of the electricity market in Latvia was started in July 1, 2007 with aim to ensure more convenient and easier process of liberalization. This action theoretically gave rights to all users to switch suppliers of electricity. Actually, the free market started to function in 2008 when the first agreements for the trade of electricity were made, mostly this opportunity is used by the big companies with big energy consumption. Next opening stages were in 2012 in 1<sup>st</sup> April and 1<sup>st</sup> November. Now, as stated before, it is approved to liberalize electricity market totally in April 2014, giving chance to involve in the market all households. Need to add that this opportunity was available for households since July 1, 2007, and it is used in around 3000 individuals, including some merchants.<sup>101</sup>

Latvia's priority is to end the situation of being an energy island and the process towards it begun few years ago with the Baltics linking with Finland. There are further plans to make more cables with Sweden and Poland.<sup>102</sup>

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100 Latvijas Republikas Ekonomikas ministrija [Ministry of Economics of the Republic of Latvia], „Atvērts elektrības tirgus dos iespēju patērētājiem izvēlēties sev izdevīgāko piedāvājumu,” Ministry of Economics of the Republic of Latvia, last modified November 16, 2013, <http://www.em.gov.lv/em/2nd/?lng=lv&id=33602&cat=621>

101 Latvijas Republikas Ekonomikas ministrija [Ministry of Economics of the Republic of Latvia], „Par elektroenerģijas tirgus atvēršanu 2014.gada 1. Aprīlī [About the Opening of the Electricity Market in April 1, 2014],” <http://www.youtube.com/watch?v=T46OSrcrvPc&feature=c4-overview&list=UUvutkrvJPHyvEhCFwIIYzRA>

102 Krišjānis Kariņš, „Konkurence enerģētikas tirgū- izaicinājumi un iespējas,” [Competition in the Energy Market- Challenges and Possibilities], Krišjānis Kariņš Deputy of the European Parliament, <http://www.karins.lv/raksti/energetika/konkurence-energetikas-tirgu-%E2%80%93-izaicinajumi-un-iespejas/>



As stated in previous chapter, Baltic States with liberalization process might not gain the most desirable gain for consumers- lower prices. Opposite is stated- that prices will rise.<sup>103</sup> In the last years prices (since 2011) have stayed the same but factors that influences price has changed. Even if there would be no decision about the electricity market liberalization it was expected that Latvenergo could ask for higher prices.<sup>104</sup> In July official of the Public Utilities Commission and Regulator Roland Irklis said that even without liberalization price could rise because right now they are below market tariff.<sup>105</sup> Till November 2013 the price for electricity and gas was the sixth lowest between the EU MS.<sup>106</sup>

As stated, electricity market liberalization will happen in 1 April, 2014 it was expected to do that already earlier, also starting with 1 September 2013. D. Pavluts explained this decision saying that after deeper analyzes he is not ready to open the electricity market until there is a solution how to reduce the amount of the mandatory procurement components.<sup>107</sup> This postponing came soon after the doubts, raised by media, about increased price after market liberalization, need to add that local elections were in front in June 2013, and general elections will be held next year; however, soon there were news that in anyway prices will be increase. There are no clear prove that nearby elections were a reason for postponed liberalization date but according to LI assumptions it could be so because politicians are highly interested to save their chairs and the successfulness of their decisions is important for that.

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103 Arnis Kluinis, „Valdība tuvina elektrības sadārdzināšanu [The Government Brings Closer Towards Higher Electricity Prices], ” (accessed 04.12.2013) <http://nra.lv/latvija/102513-valdiba-tuvina-elektribas-sadardzinasanu.htm?view=comments>

104 Delfi, „Elektroenerģijas tirgus liberalizācijas risinājumu apspriešanu atliek uz nedēļu,” [http://www.delfi.lv/bizness/biznesa\\_vide/elektroenerģijas-tirgus-liberalizācijas-risinājumu-apspriesanu-atliek-uz-nedelu.d?id=43538191](http://www.delfi.lv/bizness/biznesa_vide/elektroenerģijas-tirgus-liberalizācijas-risinājumu-apspriesanu-atliek-uz-nedelu.d?id=43538191)

105 Delfi, „Esošās elektrības cenas vairs neatbilst tirgus situācijai; pieaugums teju neizbēgams .” <http://www.delfi.lv/news/national/politics/esosas-elektribas-cenas-vairs-neatbilst-tirgus-situacijai-pieaugums-teju-neizbegams.d?id=43433813>

106 LETA, „Latvijā sestā zemākā elektrības un gāzes cena ES,” <http://www.db.lv/razosana/energetika/latvija-sesta-zemaka-elektribas-un-gazes-cena-es-405380>

107 LETA, „Pavluts viars nav gatavs atvērt elektroenerģijas tirgu mājsaimniecībām no 1. Septembra [Pavut is not Ready Anymore to Open the Electricity Market for Households from September 1],” <http://nra.lv/latvija/91690-pavluts-vairs-nav-gatavs-atvert-elektroenerģijas-tirgu-majsaimniecibam-no-1-septembra.htm>

In previous chapter it was mentioned that energy policy in the Baltic States is lead by the big energy companies. Although for that is not any official documents even Latvian Minister of Economics D. Pavluts said that energy policy related with electricity has been lead by the Latvenergo but according to his thoughts it is not like that anymore. He also noted that other sector (gas) has been de facto lead by the big company.<sup>108</sup> Such statements from so high officials erase any doubts that there are more than strong influence from interested powerful businesses, and they can influence political processes and decisions of the policy makers.

#### 4.2.2. Liberalization of the Gas Market

In June 2013 it was stated that the process of the gas market liberalization has been started to develop by announced amendments, which must be approved by parliament, in laws which are necessary to start to implement liberalization. As Latvian Minister of Economics noted, the issue of the natural gas liberalization has been difficult and through the time of previous governments it was not developed further than just talks. Handing in of proposed amendments for coordination has brought Latvia closer to liberalization than ever before.<sup>109</sup> Liberalization in gas market has been more complicated than in electricity sector, and it is expected to take some years before liberalization will be possible. Latvia can have slower liberalization because of provided derogation in directive. Already in 2009 gas market liberalization was postponed to 2015.<sup>110</sup> According to last prognosis real liberalization is possible around 2019-2020.<sup>111</sup>

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108 Anita Brauna, „Pavļuts: Pāri enerģētikas celmiem, pret superrentablajiem, [Pavlut: Over the Energy Strains against Super-profitable],” ir.lv <http://www.ir.lv/2013/3/21/pavluts-pari-energetikas-celmiem-pret-superrentablajiem>

109 Delfi.lv, “Sakustas gāzes tirgus liberalizācija Latvijā; to plāno īstenot divos posmos [Latvian Gas Market Liberalization Starts to Move],” (published July 4, 2013), [http://www.delfi.lv/bizness/biznesa\\_vid/sakustas-gazes-tirgus-liberalizacija-latvija-to-plano-istenot-divos-posmos.d?id=43456419](http://www.delfi.lv/bizness/biznesa_vid/sakustas-gazes-tirgus-liberalizacija-latvija-to-plano-istenot-divos-posmos.d?id=43456419)

110 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010) <http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 16

111 Financenet.lv, „Pavļuts: Latvijas gāzes tirgu varētu liberalizēt sešos gados [Pavlut: Latvian Gas Market Might Be Liberalized in Six Years],” (accessed 18.11.2013)

With Directive 2003/73/EC for gas Article 49 Latvia has got some derogation from requirements and also before with previous energy package. Taking into account Latvia's situation in gas market, with second energy directive for gas 2003/55/EK, there was provided possibility for slower market liberalization. With Article 28, about new and isolated market, second point was said that MS which is considered as emerging market can have derogation from several articles.<sup>112</sup> Latvia was recognized as emerging market in period from April 5, 2004 till April 5, 2014. Because of that it was possible to postpone gas market liberalization.<sup>113</sup>

With Third energy package Directive for gas market 2009/73/EC derogation for Latvia and other states from some articles was provided:

Articles 4, 9, 37 and/or 38 shall not apply to Estonia, Latvia and/or Finland until any of those Member States is directly connected to the interconnected system of any Member State other than Estonia, Latvia, Lithuania and Finland.<sup>114</sup>

Articles that Latvia can implement later are about: article 4 is for "Authorization procedure" -give permission to build some gas facilities when it is necessary; no discrimination criteria; ensure objective reasons in the case of refusal to give permission for some projects.<sup>115</sup> Article 9 about "Unbundling of Transmission Systems and

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[http://financenet.tvnet.lv/viedokli/475894-pavluts\\_latvija\\_gazes\\_tirgu\\_varetu\\_liberalizet\\_sesos\\_gados](http://financenet.tvnet.lv/viedokli/475894-pavluts_latvija_gazes_tirgu_varetu_liberalizet_sesos_gados)

112 Eiropas Parlamenta un Padomes Direktīva 2003/55/EK (2003. Gada 26. jūnijs) par kopīgiem noteikumiem attiecībā uz dabasgāzes iekšējo tirgu un par Direktīvas 98/30/EK atcelšanu [European Parliament and the Council Directive 2003/55/EC of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC], <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:176:0057:01:LV:HTML>

113 Latvijas gāze [Latvian Gas], „Dabāsgāzes pārvades sistēmas operatora ikgadējais novērtējuma ziņojums par 2012. Gadu,” (2013) p. 3  
[http://www.em.gov.lv/images/modules/items/zinojums\\_2012.pdf](http://www.em.gov.lv/images/modules/items/zinojums_2012.pdf)

114 The European Council and Parliament Directive 2009/73/EC of 13 July 2009 Concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC in the Community (2009)OJ L 211/94. P. 129 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:en:PDF>

115The European Council and Parliament Directive 2009/73/EC of 13 July 2009 Concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC in the Community (2009)OJ L 211/94. P. 104 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:en:PDF>

Transmission System Operators”.<sup>116</sup> Article 37 about Market opening and reciprocity and Article 38 “Direct Lines”.<sup>117</sup>

Latvia has derogation rules concerning the access to natural gas networks. According to those exemptions, Latvia does not have to separate transmission system and transmission system operators and the market opening can be postponed until there will be necessary connections.<sup>118</sup>

While Lithuania from the beginning took the harder way of Third package implementation, the other two Baltic states decided to go most favorable way for Gazprom. Estonia and Latvia chose ITO (Independent transmission operator) option, it means that energy companies can keep the ownership of the transmission networks but it was required to make “the transmission subsidiaries legally independent stock companies operating under their own brand name different management and strict regulatory oversight.” In 2012 Estonia started to move towards ownership unbundling, passing legislation that requires Estonia Gas by 2015 to sell its pipeline part.<sup>119</sup> In Latvia process is slower and political is highly connected with the business interests. In February 2013 almost was accepted Gazprom directed proposal to postpone the gas market liberalization. In Economic, Agricultural, Environmental and Regional Policy Committee it was agreed to amend Energy law to delay liberalization. It was asked to the Commission to give comments on

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116 The European Council and Parliament Directive 2009/73/EC of 13 July 2009 Concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC in the Community (2009)OJ L 211/94. p. 106 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:en:PDF>

117 The European Council and Parliament Directive 2009/73/EC of 13 July 2009 Concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC in the Community (2009)OJ L 211/94. p. 121 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:en:PDF>

118 Latvijas gāze [Latvian Gas], „Dabāsgāzes pārvades sistēmas operatora ikgadējais novērtējuma ziņojums par 2012. Gadu,” (2013) P. 3 [http://www.em.gov.lv/images/modules/items/zinojums\\_2012.pdf](http://www.em.gov.lv/images/modules/items/zinojums_2012.pdf) The European Council and Parliament Directive 2009/73/EC of 13 July 2009 Concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC in the Community (2009)OJ L 211/94. P. 129 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0094:0136:en:PDF>

119 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 77

this decision. The answer was in favor to liberalization, noting else than open market with real competition provides fair gas prices.<sup>120</sup>

At the end of August 2013, Daniel Pavluts, Minister of Economics of the Republic of Latvia, stated that the gas market in Latvia could be liberalized in next 5-6 years. It is expected to implement liberalization in two stages. At that time proposal for the parliament was made, and the minister said that approval should not face any problems. He added that the only trader of the gas “Latvian Gas” has to obey to requirements of EU directives. The company must separate accounting, ensure clear rules for third parties, and implement ownership unbundling. Second stage will happen according to Latvia’s specific situation because of the privatization treaty with “Latvian Gas” which expires in 2017. Minister added that actual market opening can happen when there will be other suppliers. It all together can take up till six years, noting that this time must be used to make appropriate legal base.<sup>121</sup>

Situation in gas market liberalization is complicated because of the contract with Latvian Gas. It says that this company must be as united whole and that it has exclusive storage, separating realization rights in the natural gas sector until 2 April 2017.<sup>122</sup>

It is expected to realize first stage in April 2014 requiring “Latvian Gas” to make separate units for gas transportation and storing from supply and trading. Besides that it is required to grant access to network for new players in the market. Need to add that “Latvian Gas” has asked to postpone those actions.<sup>123</sup>

Turning to Latvia’s only gas supplier, company “Latvian Gas”- shareholders are E.ON Ruhrgas International GmbH (Germany) with 47,23%, Gazprom (Russia) with 34%

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120 Ir.lv, „EK Latvijai atgādina, ka gāzes tirgus ir jāliberalizē [The EC Reminds to Latvia that the Gas Market Has to Be Liberalized],” <http://www.ir.lv/2013/2/28/pavluts-saeimas-komisija-parsteidzas-ar-lemumu-par-gazes-tirgu>

121 Finanzenet.lv, „Pavļuts: Latvijas gāzes tirgu varētu liberalizēt sešos gados [Pavluts: Latvian Gas Market Might Be Liberalized in Six Years],” (accessed 18.11.2013) [http://financenet.tvnet.lv/viedokli/475894-pavluts\\_latvija\\_gazes\\_tirgu\\_varetu\\_liberalizet\\_sesos\\_gados](http://financenet.tvnet.lv/viedokli/475894-pavluts_latvija_gazes_tirgu_varetu_liberalizet_sesos_gados)

122 Magda Riekstina, „Pagaidām gāzes tirgu varam atvērt tikai uz papīra [At Present situation We Can Open the Gas Market Only on the Paper],” Newspaper *Diena [Day]* November 4, 2013. P.4

123 Finanzenet.lv, „Pavļuts: Latvijas gāzes tirgu varētu liberalizēt sešos gados [Pavluts: Latvian Gas Market Might Be Liberalized in Six Years],” (accessed 18.11.2013) [http://financenet.tvnet.lv/viedokli/475894-pavluts\\_latvija\\_gazes\\_tirgu\\_varetu\\_liberalizet\\_sesos\\_gados](http://financenet.tvnet.lv/viedokli/475894-pavluts_latvija_gazes_tirgu_varetu_liberalizet_sesos_gados)

and ITERA Latvia with 16% and 2,27 % belongs to other shareholders.<sup>124</sup> Despite that the gas supply comes from Russia, and Gazprom holds around 1/3 part of shares in Latvian Gas, recently there appeared news that biggest shareholder E.ON will leave the Baltic's gas market, so opening the question that who will get those shares. Latvian government considered to purchase those shares.<sup>125</sup>

As it was explained in the previous chapter, the gas is received only from Russia. High level dependency is considered as threat to security but in Latvia's case it is absolute. Situation is more complicated because of the not too great relations with this country and knowing that it can use this power for political reasons.

Need to add that Latvia has one advantage or insurance for some time if there would be some interruptions in gas supply- the gas storage facility Inčukalns, It serves also for other Baltic States, and northwest Russia. Inčukalns could ensure supply if Latvia would face with some supply cuts as it has happened to several times to Ukraine, and because of that in 2009 some countries in the EU had to suffer from that, and Belarus in February 2004.<sup>126</sup>

In 2012, when finally the first steps were taken towards gas market liberalization, in October the process was hindered by the lack of approval for that who owns the this gas storage facility Inčukalns. State perceived that Inčukalns is only rented to Gazprom for time, while the company considered that facility belongs to it.<sup>127</sup>

Good news came in November 19, 2013 with the approval of the EU's 7 year budget- in the framework of it money is dedicated to reduce energy dependency from

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124 Latvijas Gāze [Latvian Gas], „Akcionāri [Shareholders].” Latvian Gas <http://www.lg.lv/?id=94> (accessed 23.11.2013)

125 Līva Melbārdze, Māris Ķirsons, „E.ON aiziešana ‘uzspridzina’ Baltiju [The Leaving of E.ON. ‘Blows Up’ the Baltics],” <http://www.db.lv/razosana/energetika/e-on-aiziesana-uzspridzina-baltiju-404282>

126 Agnia Grigas, „Energy Policy: the Achilles Heel of the Baltic States,” in *Baltic States in the EU: Yesterday, Today and Tomorrow*, Studies & Reports No 98, Norte Europe- Jacques Delors Institute, authors: Agnia Grigas, Andres Kasekamp, Kristina Maslaukaite, Liva Zorgenfreja, foreword by Jerzy Buzek, (July 2013) <http://www.notre-europe.eu/media/balticstateseu-energypolicy-grigas-ne-jdi-july13.pdf?pdf=ok> 68

127 Līga Greiškane, „Valstsvīriem nav skaidrs, kam pieder Inčukalna gāzes krātuve [Officials are not Sure who owns the Gas Storage Facility Inčukalns]” <http://www.aprinkis.lv/ekonomika/uznemejdarbiba/item/5316-valstsviriem-nav-skaidrs-kam-pieder-incukalna-gazes-kratuve>

Russia.<sup>128</sup> In November 26, 2013 the government approved amendments in Energy law that supposes to start natural gas liberalization first stage. With this decision market for gas would be open partly. With this decision it means that till 1 January 2014 Latvian Gas will have to separate enterprise which provides natural gas distribution system maintenance. The chairman of the board of Latvian Gas, Adrian Davis, said that the ministry made law wrongly is transported in to the law and the requirement will lead to higher prices. He also said that Gazprom, because of this law, will bring Latvia by the court, stating that the company already has contracts with lawyers that would challenge this decision to force to separate Latvian Gas, that is against the privatization agreement, which is valid until 2017. Mr. Davis tried to gain that this law proposal would not be approved, but this time it did not succeed for him, but in the past gas market liberalization was postponed after his requirements.<sup>129</sup>

Previous stated about higher prices for electricity after market opening is actual problem also in gas sector. Experts have stated that with liberalized gas market price for electricity and gas will increase. There are no real competition in Latvia, even after market opening, that is the reason. Experts say that liberalization of gas market is necessary in the future but not before the end of the Latvian Gas monopoly agreement and without existing alternatives of gas supply. Experience of other two Baltic states shows that hurry in gas market liberalization leads to higher prices. Infrastructure and other sources are necessary to gain real openness of gas market.<sup>130</sup> Minister of Economics thinks that prices can go up and also down, it is hard to make some prognoses about the gas price. He said that according to his expectations competition will turn prices down, if there will be real and fair competition.<sup>131</sup>

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128Latvijas sabiedriskie mēdiji [Latvian Public Media], „Panorāma [Panorama],” Latvijas televīzijas video [Latvian Television video], November 19, 2013, <http://www.ltv.lv/lv/raksts/19.11.2013-panorama.id20735/>

129 Delfi, „Valdība aizslēgtām durvīmnolemj daļēji atvērt dabasgāzes tirgu [Behind Closed Doors, the Government Decides to Open the Gas Market Partly], ” (published November 26, 2013), [http://www.delfi.lv/business/biznesa\\_vide/valdiba-aiz-slegtam-durvim-nolemj-daleji-atvert-dabasgazes-tirgu.d?id=43849324](http://www.delfi.lv/business/biznesa_vide/valdiba-aiz-slegtam-durvim-nolemj-daleji-atvert-dabasgazes-tirgu.d?id=43849324)

130Financenet. „Vai gāzes tirgus liberalizācija sadārdzinās apkuri un elektrību? [Will the Liberalization of Gas Market Increase the Price for Heating and Electricity?],” Financenet, (accessed December 4, 2013), [http://financenet.tvnet.lv/viedokli/462172-vai\\_gazes\\_tirgus\\_liberalizacija\\_sadardzinās\\_apkuri\\_un\\_elektrību](http://financenet.tvnet.lv/viedokli/462172-vai_gazes_tirgus_liberalizacija_sadardzinās_apkuri_un_elektrību)

131 Financenet. „Vai gāzes tirgus liberalizācija sadārdzinās apkuri un elektrību? [Will the Liberalization of Gas Market Increase the Price for Heating and Electricity?],” Financenet,



For real gas market liberalization, as D. Pavluts noted, two main things has to change. It is necessary to bring to order legislation, ending Latvian Gas monopoly, and to have some other gas supplier. For that investments are necessary to develop necessary facilities.<sup>132</sup> According to future projects BEMIP alternative source for gas supplier is not possible before 2019-2020.<sup>133</sup>

### **4.3. Decision Making in Latvian Energy Sector**

According to Energy law the governance of energy sector is conducted by the government and implemented by the Ministry of Economics, and the minister who has responsibility over energy sector. Responsible minister has to lead the crating of proposals for the implementation of energy policy; also must encourage attraction of investments, and must encourage efficient using of supplied energy to consumers.<sup>134</sup>

Besides previously explained- historically built infrastructure of supply, agreement with Latvian Gas, also policy makers and influential interested parties has meaningful role in the market liberalization processes in Latvia, as it already was drawn up in previous and this chapter. To understand totally implementation problems of the IEM in Latvia it is necessary to analyze involved parties and their interests in energy policy.

Above the aims of Latvia for energy sector were explained to see whether they are compatible with the EU ones. It was concluded that aims are in harmony and provided gains by the completed IEM are those one what Latvia's energy policy is tended to. So in official papers and words international and national level policy for energy sector

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(accessed December 4, 2013), [http://financenet.tvnet.lv/viedokli/462172-vai\\_gazes\\_tirgus\\_liberalizacija\\_sadardzinās\\_apkuri\\_un\\_elektribuh](http://financenet.tvnet.lv/viedokli/462172-vai_gazes_tirgus_liberalizacija_sadardzinās_apkuri_un_elektribuh)

132 Finanenet, „Vai gāzes tirgus liberalizācija sadārdzinās apkuri un elektrību? {Will the Liberalization of Gas Market Increase the Price for Heating and Electricity?},” Finanenet, (accessed 04.12.2013.) [http://financenet.tvnet.lv/viedokli/462172-vai\\_gazes\\_tirgus\\_liberalizacija\\_sadardzinās\\_apkuri\\_un\\_elektribuh](http://financenet.tvnet.lv/viedokli/462172-vai_gazes_tirgus_liberalizacija_sadardzinās_apkuri_un_elektribuh)

133 Latvijas gāze [Latvian Gas], „Dabāsgāzes pārvades sistēmas operatora ikgadējais novērtējuma ziņojums par 2012. Gadu,” (2013) P. 14  
[http://www.em.gov.lv/images/modules/items/zinojums\\_2012.pdf](http://www.em.gov.lv/images/modules/items/zinojums_2012.pdf)

134 „Enerģētikas likums [Energy Law],” Legislation of the Republic of Latvia  
<http://likumi.lv/doc.php?id=49833> (accessed 19.11.2013.)



concedes, however, as it is known, process has been complicated; deadlines for liberalization have been postponed. Those actions make to think about what changes the minds of governments, what is the role of other influent players in the field. On the report the European Parliament has dedicated critique towards MS in which, under the pressure of lobbies, implementation of the Third energy package was postponed. As the EP deputy Robert Zile has noted, this situation is also actual in Latvia. He said that proposals made by relevant commission in Saeima (parliament) and the Ministry of Economics hinders liberalization of gas market.<sup>135</sup> As it is was mentioned in previous chapter- to find evidence for the influence from interest groups within some official document is hard but some actions just indicates that influence come from. This statement from R. Zile serves as evidence that interest groups can lead the processes.

As it is stated in „Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector” in article written by Andris Spruds, director of Latvian Institute of International Affairs, the role of natural gas is huge because of the historically built infrastructure for this source, and because of the missing infrastructure for energy gained from renewable sources. He stated that there are no doubts that: “the use of gas is also related to the role of powerful interest groups play in the Latvian energy policy.”<sup>136</sup>

According to A. Spruds, interests groups has influence on decisions in energy policy. The big companies Latvian Gas and Latvenargo have important role on processes over decision making in energy sector. He added that it must be kept in mind that those companies provide government with the information about energy sector and also with possible offers for solution of some problems.<sup>137</sup>

Energy sector is crucial for economy and that is why it is attractive to business groups and political parties. As A. Spruds claims, ruling parties involves in important

135 „Roberts Zīle: Eiropas Parlaments nepārprotami mudina dalībvalstis uz ātrāku gāzes tirgus liberalizāciju,” European Conservative and Reformist Group, <http://ecrgroup.eu/lv/?p=4763> (accessed

136 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010) <http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> p. 12

137 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010) <http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 15

decision making process, according to their interests sectors, to support some businesses, even despite with all influence and requirements of the EU :

Despite some European influences in both the content of energy policy and the form of its implementation, on the whole, transparency and accountability remain limited and the room for behind-the-scenes business dealings still exists. The decisions taken by the state suggest that, when it comes to the energy sector, the principles of political and financial bargaining and the desire to maintain the profitability of political businesses prevail and strategic planning and strategic choices are put aside.<sup>138</sup>

In the report also other problems are mentioned like lack of transparency and efficiency of institutions involved in processes related to energy issues.<sup>139</sup> A. Spruds also outline the problem of lack of transparency in policy making for energy, saying that for a long time it has been made between few experts in related big companies, to ensure its serving for the interests of big companies. In recent time situation has gradually improved, discussion has become more open.. Also interest from society has increased.<sup>140</sup>

Andris Spruds notes that decision making in energy sector is directed from two cultural sides. First one is the heritage from the Soviet Union (lack of transparency, present of strong influence from corporative interest groups, political power is used to develop interests of some business, and importance of supplier (Russian) money presence). On the other side there is the influence of the EU requirements in market liberalization what indisputable directs towards liberalization of energy sector.<sup>141</sup> Here HI assumption about

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138 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010)  
<http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 15

139 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010)  
<http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 15

140 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010)  
<http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 16

141 Andris Spruds, „Sustainable Energy Sector Policy in the Context of Latvian Political and Economic Development: Prospects and Limitations,” in *Research Latvian Energy Policy: Towards Sustainable and Transparent Energy Sector*, edited by Andris Spruds (2010)  
<http://lai.lv/site/attachments/17/01/2012/LatvianEnergyPolicy.pdf> 17

the effect of formal and informal institution on the processes, in long term, clearly appears. On the one hand political decisions in Latvia are influenced from informal way of doing things. This manner is a heritage from the Soviet times. On the other hand there are rules of the EU that urges to develop process. On these rules state is earlier agreed and now it just has to follow to that what those institutions provide.

In previous chapter already was written about the statements of D. Pavlut that the policy has even lead by the companies, and opinion from the EU institutions about too powerful lobbying impact on the liberalization process (postponing) can be considered as important evidence that energy policy has been heavily influenced by interests of businesses.

Concluding it can be stated that the energy policy, also the liberalization processes has been strongly influenced by the business interests. Energy policy in Latvia has been complicated and liberalization process, especially for gas sector - still faces obstacles and way till open market, with real competition, seems long. While electricity market will be open in April 2014 the process also was postponed. As reasons specific arising from Latvian situation for slow market liberalization is the agreement with Latvian Gas which expires in 2017, lack of interconnections, and also influence from big players in energy sectors with meaningful influence on decision makers.

## **Conclusions**

The main aim was to investigate: Why the energy market liberalization for gas and electricity have been slow and complicated in Latvia despite of, generally agreed, promised gains from the IEM? The aim was to look for the political level reasons for delayed implementation of the necessary legislation for energy market liberalization. Answer for the problem question must look through all levels: the EU, regional and national level.

It can be concluded that the liberalization in electricity and gas market was long and complicated in the EU, and the process still continues. The aim to create the IEM was set long time ago, in documents some commencements can be found in mid of 1980s. The Commission made ambitious proposals to faster reach the aim and get all possible gains from the completed IEM. The legal basis is embedded in three energy packages, and now the implementation of the last one is in progress. First energy package was finally approved eight years after initial offer, and at the end it was much less ambitious than the initial Commission proposal which was rejected by the MS. There are a lot of gains, acknowledged for many years, like lower prices for consumers, increased energy security, possibility to choose best supplier, reliable supply when necessary, improved infrastructure, increased economic strength. It is even claimed as the strategy to exit the crisis because of the energy meaning in almost all producing processes. The IEM is perceived as crucial part of the processes to reach wealth overall the EU. However, knowing all that, the MS hindered the process because of the strong national monopoly energy companies. In the interests of the companies were to save that position. According to Commissions conclusions, the process was hindered because of the disharmony between the EU energy goals and the interests of the national interests. Even now, when there is an agreement on the Third energy package, and the process has been developed much further, with expectations to finish it by 2014, recently the EU institutions expressed condemnation to countries which are passive in the implementation of it under the pressure of the big energy companies. Here LI explanation of two level game is useful to understand how preferences, made at the national level (influenced by the strong economic groups) affects state behavior in international bargains, at the EU level. How pressure from strong economic groups about their interests effects decisions of the governments. It took very long time to get approved first energy package, but with creation of that further processes

developed to complete/improve previously accepted decisions. HI can provide explanation why the situation developed further. Institutions want to survive. To not to stop exist because of the lack of appropriateness changes/development is necessary. If there would be no further packages (they replaced previous ones and introduced new measures) process would not be developed.

Further it is necessary to view the regional level- Baltic States. Situation is more interesting here because of specific circumstances- being as “energy islands”. Processes slowly but is moving. At least in one sector, now having an electricity cable between Estonia and Finland, energy security has been increased. Need to add that more connections are planned. In gas sector situation is more complicated- Baltic States are connected between themselves and the only supplier-Russia. This situation is like that because of the heritage of the Soviet times. For network development financial resources are necessary, Baltic States need to cooperate and also the EU must, as it is doing, involve. To answer the question why the development of the market liberalization in the Baltic States has been slow and complicated (question is partial answer to the Latvian specific case) must emphasize disagreements about that in which country some connections or facilities will be built. Here again LI explanations can be used because it clearly shows how national interests, potential economic benefits from having LNG terminal or connection points from electricity cables at the country, affects international bargaining. Countries, lead by national benefits, economic calculations, does not allow to processes develop.

Turning to final, national level of analysis, specific Latvian case, it can be concluded that the level of market liberalization between sectors differs. Electricity market will be open in April 2014. In the gas sector is expected to do that in next six years. The partial liberalization will start in April 2014 but it will only be on paper because of lack of real other supplier, market does not function as it should if there is no real competition. Of course it is also necessary to make in order legislation that new players could join the energy market and to improve this environment, making more desirable for investors. Real action towards liberalized gas market started only in 2012, before than politicians did not get any further than talks. There are no doubts that liberalization is against the interests of incumbents and they have tried to hinder the process. One more specific aspect for Latvia is the contract with Latvian Gas. It provides the company monopoly situation, and to keep it as one unit until 2 April 2017. From the EU level, there are directives on which Latvia has agreed. So on the one hand there is agreement with Latvian Gas and threats to be

brought by the court, in a case of earlier liberalization, on the other hand there are legislative form the EU to liberalize energy market on what Latvia has agreed before. Politicians decided to start to liberalization first stage although there are threats from Gazprom to bring the country by the court. This situation can be explained with the help of HI- It is clearly can be seen how previous decisions affect politician action at present- Latvia just has to implement the last package, as the minister Pavlut has noted. Although the gas market liberalization directive provides derogations for Latvia, minister considers that it is rational to go the liberalization. LI in this case can be used to explain why decision was taken using the concept that the states are rational, meaning they act according to their interests. Calculations of costs and benefits are under the interests, apparently in this case it was decided that in long term liberalization will be more beneficial.

Answering the problem question through the prism of LI, must agree to assumption about the influence of the powerful economic group on the decisions of government concerning the energy sector. Benefits from faster market opening probably would be more beneficial but the government opted to use possibilities to postpone processes. After analyses, conducted in previous chapter, it can be deduced that energy companies has been strong influence on the processes. Latvia faces more problems because of its domestic political environment. There is lack of transparency, in energy sector decisions were made in small, mostly closed groups. Isolation also matters a lot, legislation on itself, without real competition does not create real open market, and does not provide all benefits.

Summing up Latvian case the reasons of slow energy market liberalization has been the influence of the big energy companies, which affected political decisions. At the EU level there is agreement on the necessity of the IEM and required actions from Latvia to its part to complete market. Latvia acknowledges the meaning of having open market but in reality process was hindered and opening dates postponed. In the official documents aims between Latvia and the EU are in harmony, and the country has agreed to work on liberalization, acknowledging provided benefits in the future. From other side there are internal political games were big energy companies are involved. Based on the different prices between the countries for gas supply it can be understood that they are politically made, and as D. Pavluts said Latvia has been rewarded for something already from Russia because of the lowest price for gas between the Baltic States. Need to add that in liberalization processes this country has been the slowest one. As written previous, there is some information about unofficial agreement between Gazprom and Riga to have discount

for delayed liberalization. Besides that, in spring 2013 some information wandered that postponing is necessary to ensure that Latvian prime minister can have a meeting with D. Medvedev.

At the official level there is agreement on the necessity of the energy market liberalization, calculated gains are desirable and at the international level the government has agreed to implement Third energy package. As it can be seen after real actions from one side there is direction towards the aim but still process delays because of the domestic situation which is influenced by the infrastructure, strong business interests, and other factors.

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