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## **TRANSATLANTIC DIPLOMACY IN SECURITISATION OF SHALE GAZ'S POLITICAL RISKS**

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*The late changes in energy resources markets are connected with new norms of protection of nature, deficit of raw material, rise of prices, exploitation of unconventional gas and oil. It influenced immensely on states' and firms' strategies. It looks like installing new rules of game in energy resources' world and regional markets after 2008 global financial crises. In 2013 some illustration of this process we can see in Transatlantic talks between and US and Canada with EU.*

During Transatlantic talks between and US (Transatlantic Trade and Investment Partnership) and Canada (Comprehensive Economic and Trade Agreement) with EU were raised a lot of problems. Some of them are connected with different corporations' interests lobbying. In Canada are placed headquarters a lot of natural resources companies. ExxonMobil and Chevron some of them and their interests in promotion of unconventional gas and oil projects in European region and began exploring shale gas reserve in European particular in Poland. In EU country—members' point of view on unconventional resources programs predominate environmental protection policy.

Unconventional gas exists in nature in form of shale gas, tight gas, and coal—bed gas. Unconventional gas refers to methane (CH<sub>4</sub>) gas deposits considered to be unrecoverable and economically nonprofit. Deposits of shale gas exist in shale rocks and coal — bed formations. Its extractions require new technologies. One of them is the fracking process, which considered being dangerous for the environment.

Process of the Transatlantic Trade and Investment Partnership and Canada Comprehensive Economic and Trade Agreement's negotiations depend from perspective of friction and safety risks information. Now we have results of the safety risks analysis done for the Great Britain Parliament's order:

1) The hazard of friction projects require changes of law in order to access not only the risks above ground and those associated with sub surface aspects of the operations; 2) Some controversial experience of US, where fracking of unconventional gas as phenomenon of energy self—sufficiency started in 2000—s, have received media attention and resulted in friction ban in the State of New York; 3) In US used chemicals which include such benzene as carcinogen, diesel which are harmful for health [1]. Now practice of industrial production of unconventional natural gas extraction is used in US, Canada, Australia, and New Zealand. US produced 21 bil. Cubic feet in 2010. This amount not achieved since a period of high production 1970—1974—s.

Some countries like France, Bulgaria banned it, while Romania, Ireland, Czech Republic, Denmark, North—Rhine and Netherland, the UK, Switzerland suspended until assessment are done.

The problem is that US firms and administration began to demonstrate shale gas projects as way out of energy crises, as strategy of changing rules of energy market and “exis” of new geopolitics.

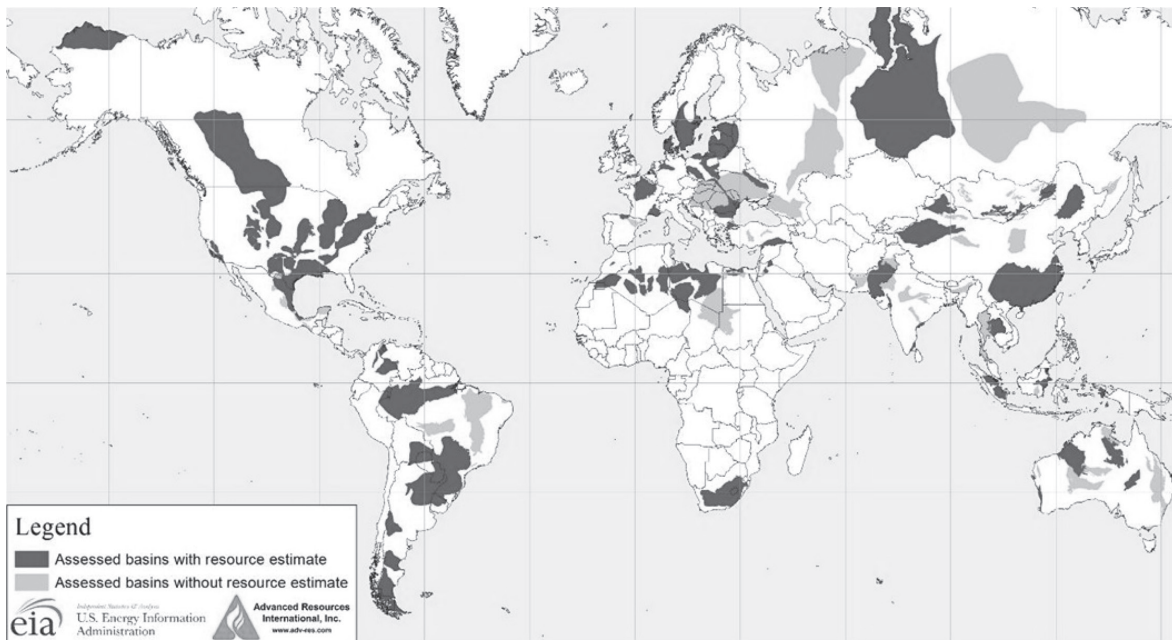
Under influence of the conception large group of counties began unconventional natural gas extraction: Taiwan, Vietnam, India, China, Poland, Germany, Ukraine, Italy, South Africa,

Algeria, Brazil, and Mexico. In Poland were granted 100 licenses to international companies. Chevron before moratorium on fracking in Romania had there Barlad Shale concession, 50 % stake in an exploration in Lithuania, biggest shale gas fragment with Ukraine (2013 – 10 bil dol.). ExxonMobil in 2011 had agreement with Ukrainian Naftogaz.

Our opinion is that in cases of exploring new business frontiers necessary to think over situation from point of view of international political risk management, role of diplomacy, character of behavior persons who make important decision. Necessary to bring together the assessments and experiences of leading academics and practitioners from the international investor, lender, and insurance communities.

In the Oil and Gas Financial Journal. – 2013. – June 10. [26] – wss made estimation of shale oil and shale gas resources. The estimation is that “in the United States and in 137 shale formations in 41 other countries represent 10 % of the world’s crude oil and 32 % of the world’s natural gas technically recoverable resources, or those that can be produced using current technology without reference to economic profitability, according to a new EIA-sponsored study

(see Table 1) released today (June 10, 2013). Resources International (ARI) based on data from various published studies. Unlike an earlier EIA-sponsored study that focused exclusively on natural gas, the new world shale assessment includes shale oil, which has recently been produced in significant volumes in the United States. In addition, more and better geologic information has become available for shale formations located outside the United States, in part because the earlier report stimulated new work on shale resources in many countries (e. g., Algeria, Argentina, and Mexico). These shale oil and shale gas resource estimates are highly uncertain and will remain so until they are extensively tested with production wells. This report’s methodology for estimating the shale resources outside the United States is based on the geology and resource recovery rates of similar shale formations in the United States (referred to as analogs) that have produced shale oil and shale gas from thousands of producing wells. Because they have proven to be quickly producible in large volumes at a relatively low cost, shale / tight oil and shale gas resources have revolutionized US oil and natural gas production” [26].



**Table 1. Shale oil and shale gas resources are globally abundant. — Source: US basins from US Energy Information Administration and United States Geological Survey; other basins from Advanced [26]**

Shale oil (billion barrels)			Shale gas (trillion cubic feet)		
Rank	Country		Rank	Country	
1	Russia	75	1	China	1,115
2	U.S. <sup>1</sup>	58 (48)	2	Argentina	802
3	China	32	3	Algeria	707
4	Argentina	27	4	U.S. <sup>1</sup>	665 (1,161)
5	Libya	26	5	Canada	573
6	Venezuela	13	6	Mexico	545
7	Mexico	13	7	Australia	437
8	Pakistan	9	8	South Africa	390
9	Canada	9	9	Russia	285
10	Indonesia	8	10	Brazil	245
<b>World Total</b>		<b>345 (335)</b>	<b>World Total</b>		<b>7,299 (7,795)</b>

<sup>1</sup> EIA estimates used for ranking order. ARI estimates in parentheses.

**Table 2. Technically Recoverable Shale Oil and Shale Gas Resources estimates [26]**

Examination of the transformations in the political risk insurance market in the 1990–2000-s was done at Symposium on International Political Risk Management (MIGA) Georgetown University, held at the World Bank on 2000.

In this materials experts mentioned that “... with the global financial crisis largely behind, foreign direct investment flows to developing countries have begun to pick up. In this environment, demand for political risk insurance has been increasing rapidly, and was likely to continue to grow further in the coming years. Faced with the possibility or the prospect of sudden, recurring financial crises, many investors and lenders would continue to actively seek political risk insurance for their long-term investments. According to an anonymous survey of 152 investors conducted recently by MIGA, approximately 50 % expressed the view that political risk was more of a concern 2000 than five years ago. Indeed, despite spectacular growth of 30 to 40 % per annum in the private political risk insurance market in the past two years (to the extend that private insurers now have more than 50 % of the political risk investment insurance market), only a small percentage of foreign direct investment is covered by political risk insurance from any source. This is partly

because some investors choose to use alternative risk mitigation instruments” [2, 1–2].

The current supply and demand of energy resources has challenges in the political risk insurance marketplace. Some of its practices waked the financial crises of the late 1990-s and 2008. Most important to think over future directions in political risk management with regard to many of the most difficult issues: breach of contract coverage for firms with large fixed investments in sectors such as infrastructure and natural resources; securitization of political risk exposure; pricing and capacity in the political risk insurance industry; multiple pledge of shares between investors and lenders; and cooperation among private and public insurers, among other important topics. Solving some of these problems – or at least clarifying the issues so that practitioners have a common understanding of the challenges involved – will be key to continue and expanded political risk insurance coverage for projects in emerging markets. That coverage, in turn, is vital for promoting the continued economic growth of developing countries throughout the world.

In MIGA materials “the term “political risk” has a wide range of definitions in practice. The term is often used in a general fashion, with the result that it is not always clear exactly what risk elements are included. In practice, commer-

cial and political risks are often difficult to distinguish, as for example when the host government has guaranteed payments for electricity under an off-take contract and refuses to make payments because it alleges that the power company breached the contract. Is this risk political, or is it really commercial?" [2]

Specialist of PricewaterhouseCooper, LLP Finnerty John [3] said that "political risk was best thought of as the corporate exposure to the risk of a political event that diminishes the value of an asset. Political risks should be distinguished from commercial and economic risks. It is possible to distinguish political risks as those risks relating either to a specific government action, such as a law or regulation, or to instability in a jurisdiction's political or social system, such as a war or an abrupt change in government. He defines political risk as the "probability of the occurrence of some political event that will change the prospects for the profitability of a given investment Finnerty John thinks that political risk can be measured at either the macro level or the micro level. At the micro level, political event risk is specific macro level, whereas most parties who desire political risk cover purchase it at the micro level through the conventional political risk insurance market.

Insuring an investment against political risk requires a precise specification in the insurance contract of the political risk events that are covered under the insurance policy. The insurance policy must clearly spell out the covered events in sufficient detail to enable the parties to the insurance contract to agree on whether a covered event has occurred, and if so, to determine whether it occurred during the period when insurance coverage was in force and the amount of the insurance recovery to which the insured is entitled.

Exist derivative financial instruments, called credit derivatives that can be used to hedge country political risk. They provide imperfect coverage against project political event risk, however, because they generally cover political risk in the macro sense. This paper describes how securities and derivatives, including credit derivatives, can be crafted to provide the sort of micro political event risk coverage currently

available through conventional political risk insurance" [3].

The consultant of The World Bank Moran Theodore H. [4] observed that "the growing interest in the potential to securitize political risk insurance derives from the same factors that drove the efforts to securitize property catastrophe insurance: the desire to diversify risk exposure and reallocate risk exposure to those market participants best equipped to handle them, thereby spreading the risks across a broader market and tapping a deeper pool of risk capital.

To make the securitization of political risk insurance feasible several conditions have to be met. As in the case of reinsurance, primary insurers must retain some substantial loss exposure to mitigate problems of adverse selection, asymmetric information, and moral hazard. At the same time, however, the probability of loss and corresponding premiums must be high enough, and the size of the issue large enough, to pay for the transaction costs of the securitization. Finally, the loss trigger must be exogenously determined, out of the control of the insurer, and symmetrically transparent to all participants in the securitization. The market instrument might then be designed like a credit derivative, with a notional principal amount, a strike spread, and an option expiration date.

Important benefit from the securitization of political risk insurance is the potential for reducing credit risk. There are property casualty insurance securitization structures that insulate the insurer from exposure to reinsurer credit risk, put simply, the risk that the reinsurer lacks sufficient funds to pay off on a claim. Removing credit risk eliminates the possibility that the insurer might discover ex post that it has not reduced its overall risk exposure, but rather has only transformed it from property casualty risk to credit risk exposure" [5].

The 2012 MIGA report of the World Bank about World and investment and political risks [5] is mentioned that exists expectations about jump to 70 % compared with 52 % short terms agreements in developing countries with 11 % of them planning to decrease investments over the medium terms. Firms continue to adopt a "wait-and-see" approach over the next three

years more than halved to 15 % from those with a cautious stance over next year. It is expected the current economic uncertainty to decline in the medium term, thus removing one of the reasons that has held back additional flows [5, 7].

Such position influence upon recommendation about dispute settlement mechanism of investor – state in both negotiations (Canada Comprehensive Economic and Trade Agreement; Transatlantic Trade and Investment Partnership). They suggested idea about the public debate about fracking risks. EU specialist and public are against adding to Comprehensive Economic and Trade Agreement regulations that can raise risks and limit environmental and consumer protection.

Example is that Canadian economy diplomat suggested idea about investor–state disputes settlement give an opportunity for Cana-

dian investor to go to law outside of the regular court system. Such investor – state dispute settlement can be used mining and energy firm for challenging environmental, public health, government measures, in their terms, indirectly lower their profit expectations. In other words, run counter to their financial interest. Such investment protection provision will enable raw material companies which have an office in Canada to challenge fracking bans and nature protection standards of fracking in US. It means large sums of money to be paid to the companies. Such types of challenges have had already precedents in America. The precedents with US Lone Pine Inc. was done according to analog provision in the North America Free Trade Agreement by challenging a moratorium on fracking in the Canadian province of Quebec.

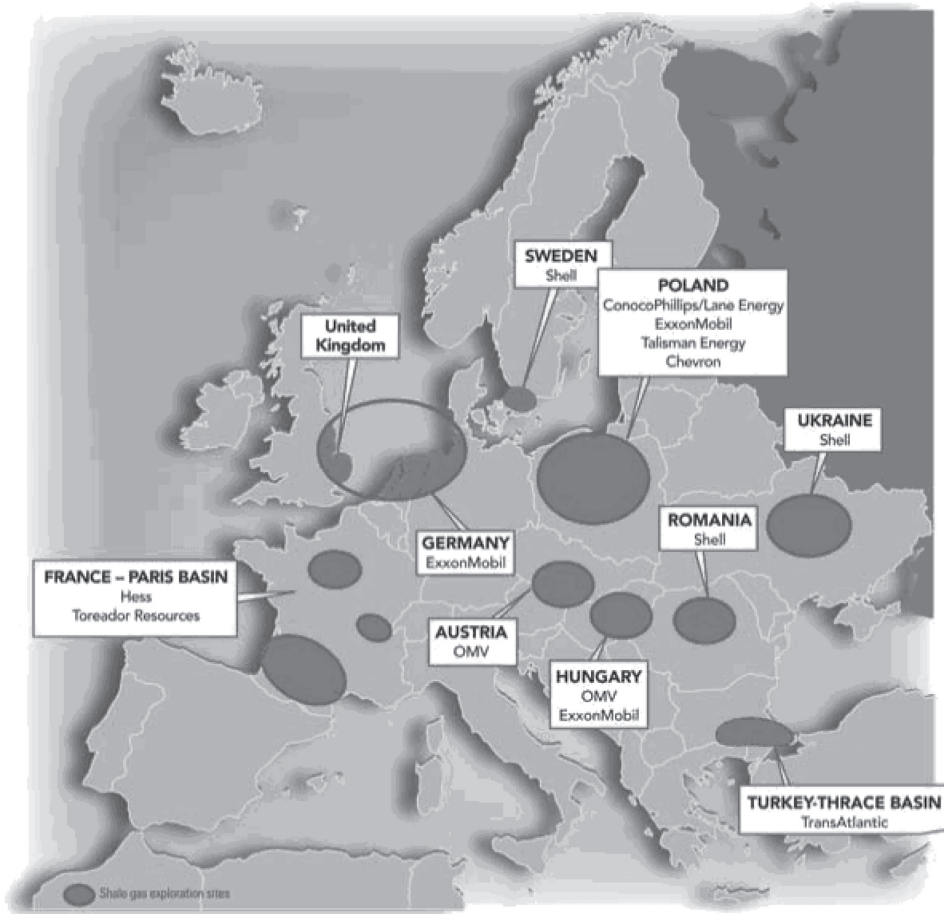


Table 3. Shale gas in Europe [27] Bart J. A. Willigers, Palantir Solutions Ltd., Aberdeen

Such rules of game in the resources market and concentration of gas and oil production in control of few producing countries and firms has led to concern that global system may not remain competitive and be challenged or compromised by universal norms [6].

The Italian political theorist Gaetano Mosca noted in “The Ruling Class” (1939) [7] that universal peace and universal norms are something to be feared, because it could come about only if all the civilized world were to belong to a single social type, to a single religion, and if there were to be an end to disagreements as to the ways in which social betterment can be attained. When granting that such a world could be realized, it does not seem to us a desirable sort of world. Of course, there is often nothing worse than war and violent death. But a truism that bears repeating is that peace, as a primary goal, is dangerous because it implies that you will sacrifice any principle for the sake of it. A long period of peace in an advanced technological society like ours could lead to great evils and the ideal of a world permanently at peace and governed benignly by a world organization is not an optimistic view of the future but a dark one.

In Europe are now against universal peace and universal norms and particular Technical Barriers to Trade and Regulatory Cooperation rules proposed by Canada. It looks like response to previous dispute with European seal product ban. The disputed claimed an illegal trade’s technical barrier according to the law of World Trade Organization. In their turn Canada diplomats came forward against European Quality Directives at World Trade Organization. The Directives labels tar sands’ fuel as polluting. In this case exploitation of Canadian largest deposits of tar sands in province Alberta appeared to be non-profitable [8–15].

Difference of interests and lobbying practice resulted in conspiracy of talks at Transatlantic Trade and Investment Partnership and Canada Comprehensive Economic and Trade Agreement with EU. The public EU, Canada and US

know about talks from the side or throw the leaked documents in Internet.

Bernadette Ségol being general secretary of the European Trade Union Conference said that in these days of democracy transparency the secretive approach was not acceptable [12].

The same point of view has American informational specialist E. Snowden, who opened to public American practice of industrial espionage against ally and got political refuge in Russia in summer 2013. In this context appeared to be problem of secret diplomacy from point of view of WikiLeaks and energy diplomacy.

Energy diplomacy has thus emerged as a powerful concept in public discourse. European scientist Andreas Goldthau [16; 17] asked questions about correctness common perceptions energy diplomacy, its effect. His point of view on the diplomatic means is pessimistic because it cannot effectively secure supply or access to resources. While energy diplomacy certainly is important but its impact strongly moderated structure of market. Energy diplomacy disturbs the effective allocation of capital and decreases transparency in energy markets. In history energy resources have been both cause and a proxy for foreign policy and military actions. The British–Russian rivalry over the control of Persia is believed to depend upon oil resources. Italy invaded Abyssinia 1935 targeted by access to energy resources. US embargo against resource–poor Japan, aimed at forcing the country to withdraw its troops from occupied China, is widely portrayed as a primary cause for Japan’s actions of 1941. Germany’s import dependency on overseas mineral resources of Soviet Union’s dependency on Caspian reserves are believed to have been a core cause Berlin’s decision [18] in order to seize control of Caspian energy. And recent projects such as the Baku–Tbilisi–Ceyhan pipeline, built to provide (Western) access to Caspian oil reserves, would not have been realized without Washington’s strong diplomatic backing [19]. Hence link energy and diplomacy or even military action is not a recent phenomenon.

The nexus of energy, foreign policy, and supply security, there is no consensus on what exactly the term energy diplomacy means. A review of current debates on energy diplomacy reveals an assumed strong issue linkage, particularly between energy policy, bilateral relations, military aid, and foreign relation. The main geopolitics task of diplomacy is ensuring to natural resources access, secure a country's energy supplies.

But when we speak only for market rules it means to forget sociology rules. Polanyi Karl in his work "Great transformation" mentioned such possibility. He established substantivist economic school, claiming importance of social institutions. He called the idea of independent economical rationality and "self-regulating" utopian [20; 21].

Sahling Marshal [22] prominent American anthropologists used K. Polanie's term "reciprocity" in diplomatic conception of primitive trade. Traditional diplomacy became social institute of dispute regulation before forming law rules and was built on principle of social equality. Now diplomacy protects market relations principle.

American annalist Baer Robert, who spent 21 years for CIA on Middle East exposed information that in competition for natural resources there were not market relations [23]. Secret service analyst details American and Saudi Arabia diplomacy like hypocritical and corrupt relationship. Particularly damning are his details regarding Saudi Arabia's support of militant Islamic groups, which are active now in North Africa. Now he mentioned about changing of American interests on Middle East because the shell gas' provision. Now cheap energy from shale will reshape America's position. It looks like end of American reliance on despot Gulf.

In MIGA materials are mentioned that in this context the political risks are rising. By following MIGA [5], the capital investment projects of "long-term assets whose political risk exposure is consequently long-term in nature (i. e., more than one year) are not developing.

International trade also involves political risk, but these transactions are short-term in nature and their risks are consequently short-term. The interest in securitizing political risk insurance pertains to long-term insurance contracts of the type used by project sponsors to insure their investments against political risks that jeopardize asset values.

Political risk insurers, both public and private, provide expropriation coverage to investors on the assumption that if the insurers are required to pay compensation, they will then have a legal basis to pursue recovery against the host government. To provide such a legal basis, the insurers typically require that the equity investor turn over its shares, free and clear of liens, as a condition of receiving compensation. The insurers are thus in a position to make a claim against the host. Multilateral and national political risk insurers usually have formal agreements with developing countries that the latter will honor claims of this kind.

Lenders that provide project finance support to these same investors generally require, at the same time, that all assets associated with a given project, including equity shares, be pledged as collateral for the loans. Possession of the shares may enable the lenders to make their own claim against the host, or they may be sold as part of liquidating the project company's assets.

With the growing use of project finance to raise capital for major private investments in the developing countries, this leads to a dilemma: both insurers and lenders would like to require that the shares of the project be pledged to them in the event of an expropriation".

Energy professional and managerial elites now do not think about strategy and continue to adopt a "wait-and-see" approach. Over the next three years more than halved to 15 % from those with a cautions stance over next year. In shale gas practice more countries adopted same practice of the "wait-and-see" approach too. Securitizing political risk investment insurance, if it is to be successful, will have to strike a balance among the insurer's exposure to basis risk

and the investors' exposures to moral hazard, adverse selection, and liquidity risks.

What wrong with diplomacy, elite, democracy? Christopher Lasch [24] as social historians asked to himself this question. He makes his most accessible critique yet of what is wrong with the values and beliefs of America's professional and managerial elites. He argues that democracy today is threatened not by the masses, as Jose Ortega y Gasset (*The Revolt of the Masses*), but by the elites. These elites, mobile and increasingly global in outlook, refuse to accept limits or ties to nation and place. As they isolate themselves in their networks and enclaves, they abandon the middle class, divide the nation, and betray the idea of a democracy for all America's citizens. This is Christopher Lasch's clarion call for a return to the virtues of community, responsibility, and religion. Thanks to the decline of old money and the old—money ethic of civic responsibility, local and regional loyalties are sadly attenuated today. The mobility of capital and the emergence of a global market contribute to the same effect. The new elites, which include not only corporate managers but all those professions that produce and manipulate information — the lifeblood of the global market— are far more cosmopolitan, or at least more restless and migratory, than their predecessors. Advancement in business and the professions, these days, requires a willingness to follow the siren call of opportunity wherever it leads. Those who covet membership in the new aristocracy of brains tend to congregate on the coasts, turning their back on the heartland and cultivating ties with the international market in fast—moving money, glamour, fashion, and popular culture.

Christopher Lasch mentioned that “Democracy requires a more invigorating ethic than tolerance. Tolerance is a fine thing, but it is only the beginning of democracy, not its destination. In our time democracy is more seriously threatened by indifference than by intolerance or superstition. We have become too proficient in making excuses for ourselves—worse, in making excuses for the “disadvantaged.” We are

so busy defending our rights (rights conferred, for the most part, by judicial decree) that we give little thought to our responsibilities. We seldom say what we think, for fear of giving offense. We are determined to respect everyone, but we have forgotten that respect has to be earned. Respect is not another word for tolerance or the appreciation of “alternative lifestyles and communities.” This is a tourist's approach to morality. Respect is what we experience in the presence of admirable achievements, admirably formed characters, natural gifts put to good use. It entails the exercise of discriminating judgment, not indiscriminate acceptance” [24, 89].

Another American scientist Kaplan Robert D. [25] said that now we observe rules of authoritarian or hybrid regime. No matter how illiberal they are will still be treated as legitimate if they can provide security for their subjects and spark economic growth. And they will easily find acceptance in a world driven increasingly by financial markets that know no borders.

Kaplan Robert D. mentioned that a new debated elite problem has been emerging — the world government. We observe the increasingly dense ganglia of international corporations, diplomacy and markets that are becoming the unseen arbiters of power in many countries. Of the world's hundred largest economies, fifty— one are not countries but corporations. While the two hundred largest corporations employ less than three—fourths of 1 % of the world's work force, they account for 28 % of world economic activity. The five hundred largest corporations account for 70 % of world trade. Corporations are like the feudal domains that evolved into nation—states. They are in the forefront of real globalization while the overwhelming majority of the world's inhabitants are still rooted in local terrain, corporations will be free for a few decades to leave behind the social and environmental wreckage they create — abruptly closing a factory here in order to open an unsafe facility with a cheaper work force there.





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*Unconventional gas projects are promoted as an geoeconomical strategy from the energy crisis and a potential geopolitical “game changer” for some countries. But European Union member states consider environmentally risky shale gas development programs and obstacle to the negotiations with Canada for Comprehensive Economic and Trade Agreement (CETA) and trade deal between the US and the EU — the Transatlantic Trade and Investment Partnership (TTIP).*

*Проекты з видобутку сланцевого газу позиціонуються як геоекономічна стратегія подолання енергетичної кризи і потенційної геополітичної можливості “змінити правила гри” для деяких країн. Але держави — члени ЄС вважають програми розвитку видобутку сланцевого газу ризикованими щодо збереження довкілля, і як перешкоду на шляху переговорів з Канадою щодо всеосяжної економічної і торгової угоди (CETA) і трансатлантичної торговельної угоди з США (TTIP).*

*Проекты по добыче сланцевого газа позиционируются в качестве геэкономической стратегии преодоления энергетического кризиса и потенциальной геополитической возможности “изменить правила игры” для некоторых стран. Но государства — члены ЕС рассматривают программы развития добычи сланцевого газа рискованными в отношении сохранения окружающей среды, и как препятствие на пути переговоров с Канадой о всеобъемлющей экономической и торговой сделке (CETA) и трансатлантическом торговом соглашении с США (TTIP).*

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