
Political Pipeline Pressure

By Robert Hodgson
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Energy security and geopolitics

Keith C. Smith of Center for Strategic & International Studies believes corruption, and not dependence, is the threat to Western Europe from Russian energy trade. He criticised the EU for what he sees as its pusillanimous reluctance to stand up to Russia.

Although there has been much talk of global warming and greenhouse gases, the strongest message that came out of a conference on energy security, held in Budapest last week, was this: For now, and for years to come, it remains the question of oil and gas supply will continue to set the international agenda.

The second of three round table discussions on energy organised by the independent, Washington-based pro-democracy think tank Freedom House took place last Thursday at the British Embassy in Budapest. The broad topic was Energy Security and Geopolitics, and talk focussed mainly on the EU and Russia and the complex symbiosis that is their natural gas trade.

Keith C. Smith

Nouveau Riche

Christopher Walker, director of studies at Freedom House observed an apparent correlation between energy price and the corrosion of democracy in developing oil producing states. This not only applies to Russia, but has implications for several other countries, such as Venezuela and Iran, he observed. Freedom House has identified a number of the presumed effects of rising international demand for oil and gas on these and other "energy-rich, democracy-poor petro-states".

As oil and gas become more valuable, runs the theory, state bureaucracy increases, and policy development becomes more opaque and often fails.

The abundance of hard cash means it can be thrown around in the right quarters to consolidate the power of the ruling elite; in other words, "fiscal pacification" is used by government and oligarchs to suppress dissent. Lastly, there is a crackdown on the media to limit access to independent sources of information.

In energy-hungry Western countries that no longer produce enough oil and gas of their own, or never did, a commonly voiced concern is that energy-rich authoritarian states are now using energy supply as a means of applying political pressure. In addition, western multinationals are piqued that they are being refused the opportunity to profit by exploiting huge oil and gas reserves abroad.

The real Russian threat

Keith C. Smith of the Center for Strategic and International Studies (CSIS) clearly believes that Russia, in particular, needs to be brought into line. The CSIS is a corporate- and industry-backed US think tank set up at the height of the Cold War to "to find ways for America to sustain its prominence and prosperity as a force for good in the world". Smith cited several instances where Russia used the threat of cutting off its gas supply to

influence the Baltic states and Ukraine, which, like Hungary, are overwhelmingly reliant on Russia for their natural gas.

Smith - who believes corruption, and not dependence, is the threat to Western Europe from Russian energy trade - criticised the EU for what he sees as its pusillanimous reluctance to stand up to Russia. President Dmitry Medvedev pointed out recently - as some voices in Brussels muttered of punishing Russia for its military intervention and recognition of the independence of Georgia - that sanctions would hurt the EU more than they would Russia.

The CSIS associate responsible for its energy and national security programme sharply criticised the business environment in Russia, Ukraine and other regional petro-states. Referring to "recent media reports" on the presumed wealth of certain prominent Russians, he called for the EU to employ "forensic accountants" to track down the proceeds of oil and gas sales to whatever offshore haven they are lurking in, and find out who is ultimately in control of energy supplies.

Uneasy partnership

In fact, neither Russia nor the EU can afford to snub the other. Andreas Goldthau, assistant professor at the Central European University in Budapest and head of its Energy Security Programme, said that Europe as a whole receives about 50% of its natural gas from Russia. For the EU the figure is about a fifth, with the Baltic states, Finland, and Slovakia all either entirely or heavily dependent on Russian supplies. Hungary, for example, gets over 80% of its natural gas from Russia, with the rest from fairly limited domestic production.

Gas, not oil

And it is largely gas that we are talking about: "There is a global oil market, so that cannot be used as a political weapon," said Goldthau, who believes the question of gas supply is also one of business, not politics. At present, the EU imports 57% of its gas, but this is set to rise to 84% by 2030, much of which will come from Russia, unless the status quo is changed.

For its part, Russia gets 30% of its state budget from the state-owned Gazprom. Within its own borders, the Russian gas market is highly regulated, and 100% of Gazprom's profit comes from the 25% of its output that it sells to higher payers abroad. Goldthau even suggested that one way to tame Gazprom would be to give it access to the European market, thereby exposing it to regulations and accountability that it is not subject to behind the Russian border.

Diversify

The idea of letting Gazprom into the EU would horrify many in Brussels, however. A protectionist instinct was evident when Hungary last year introduced the controversial legislation to prevent a hostile takeover of its largest company MOL, by Austria's regional energy giant OMV. The legality of the "Lex Mol" law is being reviewed by the European Commission, which feels it contravenes the EU principal of free movement of capital within member states.

Although not explicitly aimed at Russia, Lex MOL also prevents a takeover by Gazprom or any other state-owned companies or sovereign wealth funds. Also indicative of a reluctance on the part of states within the community to surrender national industries to the global market is a regulation approved by the German government last month to prevent non-EU owned investment funds from acquiring more than 25% of key domestic energy, telecommunications and banking firms.

So, if the Russian beast cannot be tamed, it must be escaped from - at least that seems to be the general feeling in Brussels. Hence the proposed Nabucco pipeline, which aims to bring natural gas from the Caspian Sea region - notably Azerbaijan and Kazakhstan, possibly the secretive Turkmenistan, and even Iran - into the EU via Turkey.

The new chess board

So the Caucasus and the central Asian countries are now the centre of the energy power game. Russia has been very actively courting the governments of the region in a transparent attempt to maintain its powerful grip on gas supply to Europe. Trade in natural gas does not follow the usual rules of supply and demand. Its price is pegged to that of oil, and to whom it can be sold is dependent on having extremely expensive infrastructure in place. If you are the only one with a pipeline and the sources, you have a automatic monopoly on supply.

South Ossetia in Georgia was only one of several "frozen" conflicts left behind after the collapse of the USSR. It is significant because Georgia was a proposed transit country for Nabucco, and any destabilisation of the region could seriously impede a project which is already proving very slow to get off the ground. Russia's unilateral recognition of the statehood of the breakaway Georgian regions of South Ossetia and Abkhazia increases concerns about re-igniting other frozen territorial disputes.

"The summer conflict in the Caucasus will have severe ramifications for the energy market in the years to come," said Adam Hug, policy director at the UK's Foreign Policy Centre. The de facto state of Nagorno-Karabakh in Azerbaijan is a similar potential flash point, he added. Military spending by the Azeri government surpassed USD 1 billion in 2006, and an attempt to invade - like Georgian President Sakashvili's ill-judged attempt to recapture South Ossetia in August - would seriously jeopardise gas infrastructure. This will undoubtedly make investors think twice.

Turkmenistan, on the eastern side of the Caspian sea, was isolated under the bizarre and autocratic rule of Saparmurat Niyazov from 1991 until his death in December 2006. Although underdeveloped, the country is sitting on perhaps the fifth largest gas reserve in the world - at least 2.3 trillion cubic metres, but possibly as much as 6 trillion. There are clearly ample sources in the Caspian region, but Hug shares the feelings of many western EU states in saying that attempting to access them directly would be a "big gamble".

When Nabucco was announced in 2006, Russia quickly countered with a rival plan dubbed "South Stream", to carry Russian gas - or gas sourced by Russia from central Asia - to the EU. With its backers unhindered by EU foot dragging and not having to set up a consortium of national energy companies, often with competing interests, Gazprom's South Stream has left Nabucco standing. Hungary's prime minister Ferenc Gyurcsány upset Brussels last year by backing South Stream and calling Nabucco "a dream". With Hungary already behind South Stream, Bulgaria signed up and Serbia agreed to the construction of a section on its territory, in January this year. Greece followed in April, clearing the whole route from Russia, under the Black Sea, to Italy.

Also speaking at last Thursday's conference was Milan Simirdic, who represents the European Movement for Serbia and is an advisor to the board of Serbian energy company NIS, of which Gazprom acquired 51% at what many saw as a knock down price in January. Like several countries in the region that are dependent on Russian gas, he feels there is room for both Nabucco and South Stream. He said, however, that Serbian foreign policy is now a "triangle between Brussels, Moscow and Washington". He closed by saying: "I hope that no one will start to describe the Balkans as the natural gas keg of Europe",

a reference to the historical description of the Balkans as a political "powder keg".
Not only about the region

For Richard Youngs, research director at the Madrid-based think tank FRIDE, the principle weakness of EU energy policy is its "lack of recognition of the effect of internal politics in supplier countries". He questioned the EU's ostensible insistence on trading partners demonstrating good governance and respect for such things as human rights. In fact, he said, in energy negotiations with Azerbaijan and Algeria such strictures were not imposed.

The former Fidesz foreign minister János Martonyi was even more expansive on the theme of national differences, de-constructing several tenets which were once received wisdom. Firstly, he dismissed the notion that everything is dependent on the economy. "We learned this in school by reading a famous philosopher. His name was Karl Marx. Now culture matters," he said.

Martonyi also used the current power struggle over energy supplies as proof that globalisation has done nothing to reduce the tendency of large states to vie for control of more and more territory - even if they no longer go so far as to claim other nations as their own. Also turned on its head by the rise of China and Russia is the idea that increasing wealth automatically leads to democratisation, said Martonyi.

For all this, however, the centre-right politician believes Russia is a reliable supplier, and will remain so - something of a contrast to party leader Viktor Orbán's occasional bouts of anti-Russian tub thumping. The idea that Martonyi shared with most speakers is that it is a bad idea to rely too heavily on one supplier regardless of how comfortable the relationship may be.

"If Russia controls oil supply in the Caucasus and central Asia, we will have access to non-Russian gas and oil, but only via Russia," he said. "That is the name of the game," he asserted. Martonyi believes Europe can only be an active player in the energy game if it acts as one. "The reason I and my party support a much stronger EU is because we need each other," he said.

Overall, there was a consensus on one thing: however the great energy game plays out, Europe is going to be reliant on Russian gas to some extent for at least another two decades. Very little was said about renewable energy sources, perhaps because it is not a geopolitical issue, but rather a question of political and civic will in individual states.

Some countries are making strides to reach the EU's 2020 target of boosting the use of renewables by 20%. Spain is now dotted with more windmills than Don Quijote could ever have imagined, and Germans with solar panels are selling surplus electricity to distributors who are legally required by law to pay above the market price for it. Other countries have shown less eagerness. There is no doubt that Europe is going to need gas and oil, and a lot of it, for many years to come. And a good deal of it is going to come from Russia.
