EUROPEAN ENERGY SECURITY: TRANSPARENCY AND ENFORCEMENT OF EU RULES

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Summary

A major challenge to the new democracies of Central Europe is the corruption and lack of transparency in importing oil and natural gas from Russia and other energy producing states once part of the Soviet Union. This situation threatens to undermine good governance and ethical business practices throughout the European Union. It is a mistake to believe that there will be a major shift in the near term toward more openness in Russian foreign economic and political relations. Change will have to come through stricter EU enforcement policies and the adoption of stronger anti-corruption measures within the importing states. Unconventional gas production in Europe can help provide greater energy security in the medium term, but will not by itself reduce corruption or bring greater transparency.

EU membership provides only limited energy security to the EU's newest member states. The European Union lacks a common energy market and needs strong enforceable transparency and competition policies regarding energy imports. Nor does it have a common energy strategy concerning accountability by large importers, such as the Russian state monopolies Gazprom and Transneft.

Wealth accumulation from the energy trade is often used by powerful groups in the East to buy support in Western countries for Russian economic and security policies. This situation is facilitated by the lack of legal reporting requirements in Europe, including within the EU, concerning outside funding of political and business groups. Major Russian energy firms are busy financing large public relations efforts, university research and "independent" think tanks in Europe. This is one area where Europe could adopt laws to increase transparency, such as the U.S. Foreign Agents Registration Act.

The most serious threats come from the danger of intervention at any point in the commercial process on the part of elite cartels that dominate the energy trade, particularly in Russia, Ukraine, and Central Asia. These cartels are composed of governmental leaders, intelligence officials, and favored business oligarchs. Lawsuits by these elites designed to silence Western critics have been a standard tactic up to now, including some oligarchs with close ties to Russian organized crime.

Courageous steps are needed by EU and Central European political leaders in order to bring about greater transparency and competition. Reformers too often pay for making the tough decisions by being turned out at the next election. After adopting badly needed improvements in legal and judicial systems they face well-funded opponents who are backed by nebulous firms representing energy importers. Real reformers would benefit from increased business transparency and from faster implementation of EU law concerning monopolies and accounting standards. The energy security concerns of the newer and more

vulnerable member states have taken a back seat to the interests of the wealthier, but more energy secure countries in Western Europe.

Corruption and Non-transparency

Western energy firms too often confront demands from governmental officials and Eastern energy companies to engage in shady business practices when considering investment decisions, long-term sales contracts, and accounting procedures. Lack of a common energy policy and of strong antimonopoly enforcement regarding energy importers, have over the past 20 years increased opportunities for non-transparent state companies to secure influence among Western governments and with political and economic elites in Europe.

Dubious or outright corrupt business practices are distorting the energy decision making processes in both consumer and supplier countries. According to Russian economists, the business climate within the Russian energy sector has become less transparent and more corrupt in recent years. Why should one assume that this increase in Russian corruption has not spilled over into Europe, particularly into countries heavily dependent on oil and gas imports from, or through, Russia?

Many businessmen in former Communist states engage in what people in the West refer to as corrupt practices as a result of having grown up in a culture that considers bribery and coercion to be normal methods of conducting business. Some other influential individuals have close economic and personal ties that go back to the Soviet period. In addition, Western leaders are often at a significant disadvantage in negotiations with a highly trained former Soviet or Warsaw Pact intelligence officer. It is worth noting that both Rosneft and Transneft have hired "sleeper agents" recently expelled from the U.S. for spying.

Elite Beneficiaries

Corruption and tight Kremlin control of Russia's energy companies have weakened the bargaining position of Western firms that normally use "best practices" when engaging in East-West energy trading. The domestic monopoly power and designated export privileges of Russia's state-controlled energy companies have led to a marked reduction of alternative investment possibilities for Western companies. This further intensifies the pressure on Western firms to agree to demands by Eastern energy suppliers that they engage in behavior not acceptable when dealing with other Western firms. In addition, this fuels the temptation for Western governments to ignore questionable business practices by their own domestic energy firms engaged in trade with Russian suppliers.

Western firms are already at a disadvantage when making business decisions in the former Soviet area. The absence of a win-win business concept in the East, combined with the absence of impartial judicial systems to enforce internationally recognized contracts between business firms, gives nontransparent firms an advantage in negotiations. Western businesses are usually compelled to work with partners favored by elite cartels. The existing systems appear to be designed to enrich networks of higher-level elites and/or their political parties, making it even more difficult for reform elements in some EU member states to bring about political and economic change.

Weak Western Reaction

The ineffective reaction of Western governments and the European Union to non-transparent business practices by Moscow only encourages the Kremlin to believe in the effectiveness of its aggressive energy policies and in its own ability to circumvent the "unbundling" and "third party access" rules of the EU.

The EU's blessing of the Nord Stream gas pipeline and what now appears to be its acceptance of South Stream, only facilitates continuation of monopoly and antitrust practices on the part of Russian companies. These antitrust and anti-competition practices are a clear violation of the original EC Treaty, the Energy Charter Treaty and now of the Lisbon Treaty. The EU's granting of "opt-outs" from its own rules only further encourages Russian firms to demand exemption from EU anti-monopoly rules.

Western governments continue to be reluctant to investigate and enforce the anti-bribery laws and regulations of the European Union and the Organization for Economic Co-operation and Development (OECD). The lack of a common EU approach to Russian and Central European energy policies allows Moscow to carry out a "divide-and-conquer" strategy that plays to the particular vulnerabilities of each European state.

Most EU member countries do not require their national firms that accept payments from foreign governments or that companies report this information to official government agencies and make the details concerning such payments available to the public. This makes it virtually impossible for governments, the media, or private researchers to know who is behind foreign-directed public relations campaigns or political influence peddling.

The problem is particularly pronounced in countries where the media is either unable or unwilling to engage in aggressive investigative reporting. Many newspapers and television stations in the new democracies are in precarious financial positions and are vulnerable to offers of help from well-financed foreign companies or their intelligence services.

The EU organizations in Brussels are particular targets of Eastern intelligence services that in many cases are charged with promoting the interests of their country's energy companies. Lobbying and public relations firms in Brussels are frequently hired directly and indirectly to further the interests of Gazprom and other Russian companies. Russian nationals are regularly employed by the European Union, some of whom then go on to lobby EU bodies on behalf of their country's energy firms.

Competition and Transparency

The new democratic states of Central and Southeastern Europe have too often been relatively passive in dealing with transparency and anticorruption issues. One reason for this could be that there are large numbers of political and economic leaders in the region who are holdovers from the Communist period. In the chaos resulting from the collapse of the Soviet Union and the Warsaw Pact, many former officials were able to gain control of the Communist Parties' assets and/or purchase large domestic industries cheaply. Not surprisingly, the business ethics of most former Communist officials did not significantly change with the fall of the old system.

Of course, the leaders of the new democracies are already faced with many problems, not the least of which is implementing the multitude of laws and regulations required for EU membership. Reformers find it difficult to curb the activities of the old-new business elite, particularly when these people already possess much of the countries' wealth and influence and often control large parts of the media.

Murky Alliances

The weak state of transparency in Central Europe aids the formation of new alliances between East European elites and former Communist Party and intelligence officers in Russia who dominate the major energy companies. This again puts Western firms at a clear disadvantage when negotiating for facilities acquisition or pipeline construction. With the renationalization of Russian energy assets, negotiations with the West are often carried out by top Kremlin officials. Fewer agreements are carefully negotiated at

the company level. It is fair to ask whether there are many Western political leaders who can negotiate effectively with the seasoned intelligence officers in the Kremlin who determine Russia's energy policies.

Western leaders rarely have the skills or the ability to fully mobilize the state's resources in order to negotiate on an equal basis, and they often lack good intelligence regarding the tactics of the other side. Russia's top leadership is directly involved in energy sector deals with other countries. Prime Minister Putin devotes more time and attention to promoting his country's energy interests than does any leader from a Western country. Putin knows how to effectively use the Russian intelligence services to promote pipeline projects and downstream acquisitions.

In sum, corruption in the East-West energy trade will only end or diminish significantly when the large import countries decide that it is in their collective interests to abandon the practice of looking past non-transparent practices. They must be persuaded to stop attempting to give their own countries' energy firms a competitive edge at any cost. If they demand "best practices" by their own commercial interests and closely monitor the activities of government officials engaged in energy transactions, the more vulnerable "new democracies" will be more inclined to follow. When the large and more prosperous countries of Europe ignore corruption in the energy trade, they indirectly facilitate coercion of the new and smaller states of the region by more nontransparent, state-directed energy importers and foreign investors.

Saved by Unconventional Gas?

No doubt, the unconventional gas "revolution" that started in the U.S. is already having an effect on the natural gas market in Europe. The U.S. no longer needs LNG imports. This frees up LNG supplies to compete with piped gas from Russia. Prospects are good that significant quantities of shale and methane gas will be produced in Poland and the UK. Gazprom, however, is actively attempting to dampen enthusiasm for this new technology, and the company's export head, Alexander Medvedev, has warned Europeans of the alleged environmental dangers of unconventional gas production. Of course, Gazprom's leverage will be weakened by larger domestic gas production in Europe. However, the nuclear disaster in Japan will likely slow or stop the construction of new nuclear plants, thereby preserving the market for Gazprom exports to Europe over the medium term.

Environmental opposition to halt unconventional gas exploration, however, has sprung up in France and Germany. In many cases, it is difficult to trace the funding sources of these groups. A stop has been imposed on "fracking" efforts in those two countries, and a moratorium may be imposed on other countries, possibly by the EU's own environmental directorate. An official at DG Environment has even claimed that unconventional gas is "dirtier" than Arctic gas that will go through Nord Stream. This could be an attempt to dampen enthusiasm for increased exploration efforts within the EU. Europeans and Americans should carefully study the relative risks posed by the various forms of energy production. Unfortunately, too often frightening media headlines and poor science are utilized by various groups for their own political agenda. These scare tactics are encouraged by domestic coal producers and by foreign business interests, including Alexander Medvedev, the Director of Gazprom Export.

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