OBSTACLES BEHIND A COMMON EUROPEAN ENERGY POLICY:
CASE STUDIES OF GERMANY, HUNGARY AND RUSSIA

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A thesis submitted to the faculty of the University of North Carolina at Chapel Hill in partial fulfillment of the requirements for the degree of Masters of Arts in the Department of Political Science, Concentration Transatlantic Studies.

Chapel Hill, 2008

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ABSTRACT

ALBERTO SERRANO: Obstacles Behind A Common European Energy Policy: Case Studies of Russia, Germany and Hungary

(Under the direction of Gary Marks)

This thesis explains the obstacles constraining the development of a coherent Common Energy European Policy (CEEP). It hypothesizes that the full implementation of a CEEP has been slow because it is not in line with the national energy interests of all European Union (EU) member states. The crux of the problem is that the interests of some EU members like Germany and Hungary have slowed down the implementation of a common energy policy to get special benefits from producers like Russia.
ACKNOWLEDGEMENTS

To my Father Jesus.

Djekuji Father!

Special thanks to Lulu, Paps, Dan, Majo, Melo, Sylvia, Alex, Sam and Sarah H.

To my Alma Mater, Wheaton-Massachusetts, UNC-Chapel Hill, Uni-Regensburg, Sciences Po-Paris, and Humboldt-Berlin and their distinguished professors.

To my unmentioned yet cherished friends.

To Goethe, who once said: Divide and rule, a sound motto; Unite and lead, a better one.

Thank you!
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<td>CEEP</td>
<td>Common European Energy Policy</td>
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<td>EPE</td>
<td>Energy Policy for Europe</td>
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Skeptics insist that the enactment of a Common European Energy Policy is practically an impossible feat. They suggest that it is simply too difficult to integrate the interests of different European countries under one voice. They argue that the energy sector is simply too strategic and vital for EU member states to entrust to Brussels. Moreover, they insist that even if Europe were to enact one, they believe it is too difficult to envision its shape. Finally, they insist that because the EU is not a political federation, they are not entitled to give up such vital assets away.

As an entity, however, the EU has given up various strategic and vital assets in order to “gain the strength and world influence none of them could have on their own”\(^1\). The fact that European countries, sometimes-former archenemies like Germany and France, have pooled their interests means that EU member states want to exert more influence on the larger world\(^2\). In fact,


\(^2\) Ibid EU Institutions (2007).
equally vital areas such as national currencies, migrant controls and monetary policy have already been entrusted to Brussels. Energy policy, therefore, deserves equal attention by EU policy makers given the numerous challenges affecting Europe’s energy markets. The events in Georgia last August and the cut offs to the Ukraine in 2006 make it imperative for Brussels to start envisioning a Common European Energy Policy (CEEP).

Although skeptics maintain that a CEEP is an unrealistic policy because European energy markets operate better without government intervention, energy companies often go under the political umbrella of their respective governments when their interests seem threatened. As Geden, Goldthau and Noetzel accurately note, energy companies are the ones taking the most important investment decisions. In addition, awkward and ineffective political meddling can hinder the growth of private companies. Thus, it is only reasonable that the companies making the bulk of the investments should be the ones making the majority of the decisions.

Most European markets, however, operate to a greater or lesser extent under the umbrella of their national governments. In other words, responsible government intervention seems appropriate in Europe’s energy markets given the uncertain ambitions of energy suppliers to the EU like Russia. Furthermore, European governments have lately employed political maneuvering to repel unwanted foreign intervention. For instance, when Italy’s Enel wanted to takeover France’s Suez, Paris explicitly prevented the acquisition by merging it with GDF.

In addition, when Spain’s Endesa wanted to repel Germany’s EON takeover attempt, Endesa sought Madrid’s protection despite repeated calls from the Commission for Spain to

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approve the merger. Moreover, when Berlin formally entered negotiations with Moscow on the North Stream pipeline, Germany’s former chancellor Gerhard Schroeder chaired the consortium leading the project. All of which leads to the conclusion that in Europe’s energy market business and political interests often intercept.

Most importantly, pooling energy sources under one European voice has already taken place in Europe. After a devastating World War II, Europeans started the continent’s new course precisely by integrating energy capabilities. Even the framework of the EU was based on the 1951 European Coal and Steel Community. It was under the integrationist ideas of Robert Schumann and Jean Monnet that post-war France and Germany were able to unify, or Europeanize, their coal and steel assets to ensure peace in Europe. Not only were Germany and France the largest competing economies of continental Europe, but they were archenemy states that were able to unify their energy capabilities even after three wars.

It was precisely through the Monet Method that pooled energy resources to integrate Europe’s common economic interests that Paris and Berlin started coining the principles that dominated Europe’s foreign policy for the second half of the 20th Century

4. In other words, the origins of the EU precisely come from European countries pooling their energy capabilities. This leads to the conclusion that the strength of the current European Union depends on the EU’s energy capabilities. The submissive behavior from Brussels and other European capitals towards Russia with the events in Georgia exemplify such conclusion.

Finally, when Italy, Belgium, the Netherlands, France, Luxembourg and Germany established the European Coal and Steel Community (ECSC) of 1952, they were cognizant that

Europe needed a common market and an atomic energy community to harmonize post-war Europe. Thus, the six founding members subsequently established the European Economic Community (EEC). Consequently, the six members formed the European Atomic Energy Community (EURATOM) to tackle the general shortage of conventional energy of the 1950’s focusing on nuclear energy in order to achieve energy independence. They recognized that the costs for investing in nuclear energy capabilities could only be met if individual countries joined efforts and expertise, which is very similar to Europe’s current situation\(^5\).

Currently, the EU’s energy security is low due to its high dependency on Russia, Europe’s largest supplier and a country that is lately using energy cut offs (or the threat of one) as a foreign policy tool with its neighboring countries in Eastern Europe. Despite being the world’s second largest economy, the EU has not devised a common energy policy to tackle such risks. This weakness in securing gas and oil supplies, however, makes it imperative for Brussels to device a strategy that also strengthens the Union’s energy security. Thus, this thesis revolves around the following central question: how can one explain the constraints of developing a coherent Common European Energy Policy (CEEP)? To answer this question, the thesis will explain energy policy at the European and national level and focus on the cases of European consumers such as Germany and Hungary and producers like Russia.

The thesis will explain that the crux of the problem remains in the bundled-nature of the EU’s internal energy market, which is influenced by a country’s resources, economic situation, and energy needs. Specifically, the EU energy market operates under the lead of strong National Champions. These champions are difficult to integrate under a common energy policy because

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they act as protectors of the strategic assets of their countries. National champions, in turn, perpetuate Europe’s *Resource Nationalism*, which refers to the way governments keep a country’s strategic energy assets exclusively under domestic control.

Therefore, this thesis hypothesizes that the most glaring obstacle in implementing a CEEP is that common energy policy is not in line with the national interests of all EU member states. Notably, the cluttered internal market is slowing the full implementation of a CEEP because countries like Italy, Germany, Spain, France, Britain and the Netherlands protect their powerful National Champions (a term that describes the energy companies within the European countries) to safeguard their strategic energy assets.

Russia is also a contending player in terms of the CEEP. Moscow is aggressively seeking to solidify its presence in the European markets. Thus, a common European energy policy will meet resistance from Russia. Clearly, it is in Russia’s interests to continue being Europe’s most important energy provider since the EU’s demand for energy imports will increase from 50% to 65% in two decades and Europe remains Russia’s most lucrative market. Amid these circumstances, it is in Russia’s interests to trample any EU-joint effort to unify Europe’s internal markets.

This explains why Russia is enticing single member states like Germany and Hungary to drop out of the EU consensus through the construction of pipeline projects in strategic geographic points like the North Sea and the Black Sea so Moscow continues increasing the EU’s dependence on Russian energy supplies. Lastly, the Kremlin’s emboldened energy policy is the result of Vladimir Putin’s vision of a strong and vociferous Russia whereby energy policy

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serves fundamental political and economic objectives. Consequently, this thesis would illustrate the cases of two countries that are challenging the implementation of a common policy.

The first is Germany with its North Stream pipeline project stemming from Russia. This Russian-Dutch-German project would make Germany a major energy distribution center for Europe. Berlin’s move, however, circumvents the EU proposal that supports energy diversification away from Russia. The second case is Hungary, which is negotiating the extension of the Blue Stream Pipeline in its soil with Russia. By doing so, Hungary is turning its back at the EU-backed Nabucco pipeline project, which seeks to reduce the EU’s dependency on Russia by importing gas from non-Russian sources in the Caspian Sea region. By allowing Blue Stream’s extension in Hungary, Budapest’s stance has endangered Nabucco’s conclusion given way for Europe’s growing dependency on Russian gas.

Since Russia is Europe’s most important energy supplier, a portion of this work will be devoted to Russia. Russia is an integral part of European energy policy because at least in the middle run Russia is an essential partner to the EU. Firstly, Russia has a splendid geographical comparative advantage in relation to other producers in the Middle East and Africa. Secondly, Russia possesses the most important existing energy transportation networks to Europe. Thirdly, Russia’s lofty reserves make it an extremely attractive energy supplier not in only in Europe, but in Asia as well, where developing economies are desperately searching for energy sources to supply their energy-hungry industries.

Finally, a slew of global factors have affected energy markets such as drying oil wells, America’s credit crisis, political unpredictability in producer States like Iran and Venezuela, unforeseeable natural catastrophes like Katrina, high investor speculation due to active terrorist
activity and unresolved wars in the Middle East (Iraq). As a result, analysts like Kraener believe that the United States, the EU, Russia, China, India and Japan are in a stage where these actors are competing for the last sources of oil. For that reason, the following thesis presents the energy issue as an indispensable one to assess in order to strengthen the EU’s security.
2.1 Assessing Energy Security

Energy security, which depends on physical reserves, price and market structure, is one of the major challenges that Europe will confront in the next decades. According to Nicolas Lefèvre, possible short-term solutions that decrease the risk of energy supply shortage include strategic reserves, coordinated emergency oil stocks, and contingency plans to reduce consumption on the side of governments. Long-term solutions, however, seem more complicated to enact given the complexities they bring about. For example, the two most important causes of energy shortage are the following:

1. Regulatory failures: Governments establish market rules to create effective markets, but are unable to ensure market quality.

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2. Concentration of energy resources: Fossil fuels’ exploration and production is concentrated in certain regions of the planet such as the Middle East and Russia.\(^2\)

In regards to regulation, the countries belonging to the Organization of Economic Cooperation and Development (OECD) have tried to liberalize their energy markets in the hopes of spurring efficiency.\(^3\)

However, as Lefèvre suggests, the shift remains complex due to the lengthiness of firms and regulators to learn the process.\(^4\) For example, Lefèvre notes that England’s and Wales’ market was fundamentally changed eleven years after the regulatory policy was launched (1990/2001). Moreover, once market structures are liberalized, new challenges arise, such as skepticism from national governments to participate in the liberalization efforts. For example, although the EU Commission approved the takeover, Spain refused to sell its energy company Endesa to Germany’s EON in 2006 and 2007.

Another challenge to energy security is the uneven concentration of carbohydrates, which Lefèvre described as the most long-lasting cause of energy insecurity.\(^5\) For example, 62% of the world’s oil is in the Middle East.\(^6\) Furthermore, the Organization for Petroleum Exporting Countries (OPEC) holds 75% of the world’s oil reserves. On the other hand, the heaviest energy consumers, namely the OECD counties, hold only 7% of the world’s oil reserves. Not only is this


\(^3\) Ibid Lefèvre (2007): Pp.34.


visible in the oil sector, but also in the gas market as well. Lefèvre demonstrates that only three countries hold half of the world’s proven gas reserves; Russia with 27%, Iran with 15%, and Qatar with 14%.

Similar to the oil picture, the OECD countries hold only 8% of the world’s gas reserves while they consume over half of the world’s total. Amid these contradictions, the energy market is a struggle between swiftly drying supply and ever-growing demand. Lefevre maintains that due to the easy access and low costs of extracting oil in the Middle East and North Africa, OECD countries have ‘significantly relied on these region’s oil imports.’ That is to say, that 59% of the OECD’s oil needs were covered through imports; OECD Europe imported 40% of its gas needs and OECD Pacific 69%. The OECD countries are in simple words ‘heavily dependent importers.’

The underlying problem for Lefèvre is that producer countries have extremely sensitive political climates. Since 1957, most oil crises including the Six Day War (1967), the Arab-Israeli War (1973-1974), the Iranian Revolution (1978-1979), and today’s war in Iraq were politically motivated. Not only have these crises produced significant supply shortages, but they have also altered the economic progress of OECD countries. For example, the 1973-1974 OPEC-produced shortage altered the stability of the world’s economy. The EU has also witnessed the consequences of political instability in the gas sector. In 2006, the Russian-Ukrainian dispute over transit fees cut off Western Europe’s gas supplies, which is the main source of energy for the majority of European households.

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7 Ibid Lefèvre (2007): Pp. 36
Although it is difficult to speculate about the future, it is certain that as long as the OECD’s energy needs are dependent on oil and gas, these producer countries in Africa, Asia and the Middle East will continue being of vital importance. The International Energy Agency (IEA), the entity that measures future energy trends, estimated in 2006 the world’s remaining reserve-to-production-ratios (R/P). R/P ratios represent the length of time that those remaining reserves would last if production were to continue at that level. These estimates show that the Middle East has an R/P of 81 years while the OECD of only 11 years.

Even though these ratios are subject to change since reserves are a dynamic quantity due to changes in price, technology, and demand, Lefèvre believes that the OECD will more than likely increase its reliance on Middle Eastern oil in the near future. In the gas sector, the OECD’s dependency is even more likely because reserves are found in a handful of countries. Lefèvre shows that Russia has an R/P of 81 years and both Iran and Qatar of 100 years. The OECD, however, has only an R/P of 14 years, which hints that the OECD gas dependency is very likely to increase.

Consequently, Lefèvre suggests that the policy response from the OECD should seek to “minimize exposure to concentration risks.” He believes that this is extremely important since the unequal concentration of energy supplies is a “long-term driver of energy security.” Furthermore, these common policies should seek to diversify the sources of supplier countries, trade means and routes. Finally, Lefèvre suggests that in order to curtail these risks, the OECD should foster dialogue with producer states.

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2.2 Challenges for the EU

One of the biggest challenges the EU Commission faces, however, is that they lack the ability to influence the inner market of the EU members in order to pursue more energy-cooperating policies. Although in environmental protection and monetary policy the EU Commission is very powerful in regulating the Members’ strategies, they are extremely weak in energy policy. The Commission, nonetheless, has enacted working policies to try to coordinate the member’s energy policy.

In the 1992 Maastricht Treaty, the EU adopted the Common Foreign and Security Policy (CFSP). One of the goals the CFSP was to promote sustainable development. In addition, one of the goals of 2003 EU Security Strategy was that the EU would actively pursue common climate protection and energy policies. Furthermore, in 2007 the EU adopted “An Energy Policy for Europe” seeking to decrease the EU’s import dependency.

The Commission’s source of concern is that the members’ dependency will increase in the coming decades. Moreover, the Commission believes that a European energy policy is necessary to prevent that the possible energy shortfalls of one member affect others. Since the EU will become more dependent on energy imports, the Commission believes that the business-as-usual approach is no longer sustainable.

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The EU will certainly face critical challenges. The Commission, for example, estimates that energy imports, currently 50%, will peak to 65% in the next twenty years. Its gas imports will increase 33% (to 84% from 57%) and oil imports 11% (to 93% from 82%) in this period.\(^{14}\)

Another source of concern is that the world’s energy resources are under pressure. The 2006 World Energy Outlook, which gives thoughtful insights into the future of the energy markets, believes that there are new players exerting pressure in the competition to secure their own sources of energy, notably India and China. These two countries, in addition to having the world’s populations, have reached notable economic growth at the turn of this century. This growth, however, has not reached the entirety of its population.

This is why Joachim Bitterlich believes that the OECD and the emerging economies of India and China will engage themselves in a ‘supply war’.\(^{15}\) Presently, the EU consumes 17% of the world’s energy, the United States 29% and Asia 20%. However, just India consumes 4% and China 11%. The source of alarm, however, lies in the new entrants. Since China and India have not fully developed their economies, there are still low-income sectors of their populations that are not energy consumers.

China’s per capita consumption exemplifies this. China’s population consumes on average 17% more energy per person than that of the US and 29% more than Europe.\(^{16}\) China is currently growing between eight to ten percent a year. For Bitterlich, therefore, the most important question is, what will the energy situation look like for China in the next 10 years, when more consumers come into the energy market? Although one ignores how the energy

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market will look like in 10 years, it is likely that energy demand will continue to increase given that these energy-hungry countries are net energy importers. It is worthwhile to mention that the food prices have already increased because of the growing demand in China and India.

Thus, there are great political and economic risks to be taken into account, if an energy supply war comes to being. The International Energy Agency’s 2007 Energy Outlook estimates that if the governments of the world continue espousing the current energy policies in place, the world’s energy needs will increase by 50% in 2050\textsuperscript{17}. For all of the above, it seems urgent that the EU actively pursues a Common Energy European Policy (CEEP) so that the EU members do not engage in a supply war among themselves, which might in turn considerably erode the European integration links.

2.3 Russia: Understanding the EU’s Most Important Energy Producer

“The more other countries are nervous about their energy security, the better Russia is geopolitically.”

- Peter Halloran, CEO of Moscow-based Pharos Financial Group\textsuperscript{18}.

Dialogue with Russia is an essential component for the successful implementation of a common energy policy. Russia is for many reasons the EU’s most important neighbor. Firstly, Russia is in many ways one of the world’s most important energy suppliers due to its gigantic energy potential. Secondly, Russia will possibly remain Europe’s most important source of energy in the future. Often considered an energy superpower, Russia holds about 26.6% of the


world’s gas and 6.2% of its oil reserves. In other words, Russia has enough gas for 80 years and oil for 21 years. Moreover, Russia holds comparative advantage as supplier in relation to other energy suppliers due to its massive territory, which extends itself from Europe, throughout Asia until it borders the American continent at the Bearing Strait. Finally, one of Russia’s major strengths is its low prices in relation to other producers. This is specially true for Europe.

Russian producers have lower costs due to its extensive pipeline system that covers most of Europe, unlike other producers in the Middle East and Africa, which have to ship their oil to Europe\(^\text{19}\). For Götz, as long as Middle Eastern and African producers ship their oil, Europeans will continue favoring Russian imports since these remain more cost efficient. Therefore, Russia’s lofty energy reserves and comparative advantage in logistics posits Russia as one of the EU’s fundamental partners.

### 2.3.1 The Origins of European Mistrust: The Ukrainian-Russian Dispute

In 2006, Moscow cut-off supplies to the Ukraine, making European capitals nervous that Russia would use energy supplies as an intimidation instrument of their foreign policy. Some suggested that behind the dispute was a Kremlin warning to Kiev for warming itself too much to Brussels and Washington. The case, moreover, exemplifies the difficulties that countries face when they have few energy suppliers.

On one hand, those countries belonging to the Commonwealth of Independent States, namely the Eastern European countries controlled by the Soviet Union, receive subsidized oil prices. Furthermore, the countries that serve as transit countries for Russian pipelines receive lucrative energy fees. The Ukraine, however, owed $1.3 billion to the Russian energy company Gazprom\textsuperscript{20}. This certainly strained Kiev’s position vis-à-vis Moscow.

Since earlier this decade, the Ukrainian-Russian relationship has been icy. A series of incidents including the Orange Revolution, in which Ukrainians demonstrated against the Russian-backed Presidential candidate that rigged the elections, have dampened the Kiev-Moscow relationship. Furthermore, when Kiev applied for a membership to the North Atlantic Treaty Organization (NATO), an entity created during the Cold War to contain the Soviet influence, Moscow became weary.

Moreover, the Ukraine possesses few energy supply alternatives, which makes it prone to price manipulations, given that Russia is the country’s single-most important energy supplier. From the Ukrainian-Russian dispute, one learns that Europeans should aim at a diversification of their energy suppliers. This is a classic case of a market being dependent on a single supplier, which enables the supplier to manipulate freely prices and supply. The Ukraine is not alone. Several EU countries are dependent on Russian energy. Der Spiegel estimates that the Russian gas behemoth Gazprom is a supplier to about 30 European countries. Estonia and Slovakia, for example, depend 100% on Gazprom, Greece 80%, Hungary 84%, Poland 60% and Germany 36% respectively\textsuperscript{21}. This makes Russians extremely powerful when dealing with the EU. The


latest Russian-Georgian conflict illustrates this, whereby most European capitals were unable to pressure Moscow to leave Georgia in the aftermath of Russia’s crushing offensive. Furthermore, the conflict evidenced how most Europeans countries could not criticize Russia, Europe’s main energy provider.

Russia’s current hawkish behavior, nonetheless, is understandable. When Russia’s economy fumbled in the early 1990’s, the country’s GDP catastrophically fell 60%22. The former superpower’s decline in the 1990’s brought social instability, anemic economic growth, the collapse of the rubble (Russia’s currency) and widespread discontent. The collapse of Soviet Union and its humiliating effects in Russian society, analysts suggest, left Russia yearning for stability and its past superpower glory. Debilitating processes in Russia such as the corrupt privatization of its energy assets deeply resented even Russia’s most staunch transatlanticists. The sour taste of these events left Moscow thirsty for power, which became accustomed to be the world’s most belligerent capital with Washington DC after 1945.

2.4 Russia: Understanding the Energy Giant

Vladimir Putin’s Presidency meant the end to an ailing Russian economy. In addition to Putin’s strong and efficient handling of the country’s internal politics and finances, earlier this decade Russia started enjoying unseen levels of prosperity largely due to strong domestic

consumption and spiking energy prices. As crude prices soared, Russia paid off its international debt by 2006, such as the $19.8 billion they owed the International Monetary Fund (IMF)\textsuperscript{23}.

Ever growing energy demand has unquestionably allowed Russia to augment its confidence in the international stage. Some pundits suggest that it is precisely Russia’s continued economic growth what legitimizes Putin’s continuity at the Kremlin despite the country’s questionable democratic development\textsuperscript{24}. Simply put, Putin’s popularity depends on the overall health of Russia’s economy. This might explain why is it so important for Putin to renationalize Russia’s gas and oil fields and bring the windfall of energy exports to State coffers.

Russia’s economic backbone is its energy revenues. Energy exports account for about 20 percent of the Russian economy, 55 percent of their export earnings and 40 percent of their tax revenue\textsuperscript{25}. The IMF and the World Bank estimates that each dollar spike in the price of oil increases the Russian GDP by 0.35 percent\textsuperscript{26}. Moreover, Russia’s renewed success did not occur by accident.

As Putin earned his PhD from the St. Petersburg Mining Institute, his thesis explained how Russia’s energy resources were crucial to restore the country’s might. Explaining that the massive state privatizations during the 1990’s were a mistake, Putin’s thesis calls for a renationalization of Russia’s hydrocarbons and the creation of large state vertically-integrated

\begin{itemize}
\item 26 Ibid Szrom and Brugatto (2008).
\end{itemize}
companies able to compete on global markets. Russia’s gas titan Gazprom epitomizes Putin’s emboldened energy vision.

With a market capitalization of $348 billion, Gazprom represents 8 percent of the Russian GDP. It pays taxes equal to 20% of the Russian budget. Gazprom is the world’s third largest company by market value and the Russian State is its major stakeholder. It is poised to become the world’s market-juggernaut because it controls 17% of the world’s gas, which is believed to be the future’s most important energy resource. As oil world reserves (as a percentage of known) dry up, the world’s demand for gas, a more abundant and greener energy source, will increase by 67% until 2030.

Analysts believe “Gazprom’s extensive natural gas reserves may allow it to overtake Exxon Mobil’s throne as the world’s largest energy company,” a goal espoused by Dmitry Medvedev, Russia’s current president and former Gazprom executive. Russian supply cut offs to neighbors accomplishes two mutually enforcing goals for Gazprom and the Kremlin: Cut offs (1) bolster Gazprom’s revenues and (2) reminds Russia’s neighbors (including Western Europeans) of its economic and foreign policy power. Russian foreign minister Sergey Lavrov said in relation to this, “it would be right to say that we view our role in global energy supply as means for ensuring our foreign policy independence.” Although Putin explicitly denies that

energy has been a political tool, a series of events implicitly evidence the opposite, such as the supply cuts to Belarus, Ukraine and Georgia earlier this decade. These cuts intended to reassert the Kremlin’s influence over its former Soviet sphere of influence.

Some analysts suggest that Russia is not in the position to threat its western European partners in the same manner. The thesis that Europe has an asymmetrical dependence, which states that Western Europe is asymmetrically dependent on Russian energy, is arguable. On one hand, energy decisions are market-driven. On the other hand, Russia’s energy exports are the main engine of its economy. As Roland Götz suggests, Moscow cannot hit their western partners in the knees because they would hurt themselves.\(^{32}\)

President Medvedev, Gazprom’s former Chairman, believes that Gazprom could become the world’s largest company by market value if it starts raising domestic prices.\(^{33}\) Russia’s rock-bottom domestic prices induce wasteful practices and shrink profits. As a result, Gazprom generates the bulk of its revenue in Western Europe.\(^{34}\) Thus, to becoming number one, Gazprom faces serious challenges ahead. Only 25% of its total production reaches Western Europe. In addition, Russia has subsidized its former Soviet neighbors for 15 years. Meanwhile, Russians only pay 17% of what EU-12 pay for gas prices in 2006, a consumption pattern that fosters wasteful consumption. For instance, Russia uses 3.2 times more energy per unit of GDP then the EU-25.

\(^{32}\) Ibid Götz (2008): Russia as…

\(^{33}\) Ibid Kramer (2008)

Furthermore, Russia’s energy infrastructure remains heavily underinvested. For example, the Yamburg, Urengoy and Medvezh’ye fields, which account for 60 percent of Russia’s total production, are drying up, spurring the need for exploration and investment in new projects\(^\text{35}\). Most of these projects, however, are in the far Arctic, which due to climatic and geographical challenges have dramatically boosted costs. Just the Russian gas sector plans to spend $17 billion a year until 2030 in exploration and production (E&P) projects and mending the current fields to meet domestic and external demand\(^\text{36}\).

Additionally, the IEA forecasts that Russia will need $400 billion to cover its future oil E&P costs. Thus, Russian energy producers cannot afford to cut off consumption as suggested by skeptics. Specifically, the Western European market is too lucrative for Russians to be scrappy dealers. Furthermore, Putin’s renationalization strategy restricting foreign investment in the energy sector hinders foreign investment in new E&P projects in an already underinvested Russian energy infrastructure.

Putin’s re-nationalization of energy companies is his attempt to revamp revenues for the State coffers and bolster its voice in the world stage. In 2006, for example Shell ceded Gazprom the Sakhalin-2 fields\(^\text{37}\). That same year, Gazprom snagged a bid for the Shtokman gas field, the world’s third largest, in a competition with the foreign companies of Chevron, Statoil, and Total\(^\text{38}\). As of early August of 2008, a 50-50 Russian-British joint venture of TNK-BP is facing shareholder disputes, which suggests that the venture will not succeed further in its current form.

\(^{35}\) Ibid. Goldthau (2008)  
\(^{36}\) Ibid. Golthau (2008)  
\(^{38}\) Ibid Hooper (2006).
Although TBK-BP is the “only oil company with partial foreign control, TNK-BP may be excluded from developing new fields under national security rules”39.

Putin’s nationalistic energy policy is not entirely uncommon in the EU as well. Although Western European energy conglomerates are not State-run companies, they are “National Champions.” When the Spain’s Jose Luis R. Zapatero government shrewdly prevented an acquisition by Germany’s EON in 2006, Madrid was worried about its national energy resources in the hands of foreigners. Enel, Italy’s conglomerate, followed suit by trying to take over Suez, a Franco-Belgian conglomerate that same year. Paris, however, cunningly protected Suez by merging it with GDF, the French State gas monopoly, five days later. The problem with these resource nationalism tendencies, however, is that altercations between two States might affect third parties. The cut offs from Russia to Belarus and Ukraine, for instance, evidence how such politically charged actions affected third parties in Western Europe.

2.4.1 The Georgian-Russian War: Cutting Europe’s Silk Road

Early this August, the former Soviet republic of Georgia invaded two of its separatist territories, South Ossetia and Abkhazia. After the fall of the Soviet Union, these territories belonged to Georgia. These two provinces, however, had been struggling for independence from Georgia. Russia, moreover, supports the sovereignty of these provinces. Some of its citizens even possess Russian passports and their leadership has built an alliance with Russia.

As a result, Georgia’s surprise attack deeply angered Russia. Moscow responded by sending a full-armed attack to defend South Ossetia and Abkhazia. After six days of fighting, Russia’s military crushed Georgia’s troops in South Ossetia and Abkhazia and then penetrated deep into Georgian soil to seize its Black Sea port of Poti and the country’s main transportation routes. Georgia, as a result, surrendered and asked Moscow for a cease-fire. Nevertheless, even after western leaders including George Bush and Nicolas Sarkozy called for a reestablishment of Georgia’s territorial integrity, Moscow refused to pull out its troops.

The Georgian-Russian relationship provides insights into the dense politics of Europe. Under Mikhail Saakashvili’s Presidency, Georgia became a staunch US ally trying anxiously to become a NATO member. Georgia and the Ukraine even applied to enter the alliance in the last NATO meeting in Bucharest, but met resistance by some of its members. Members such as Germany refused their accession possibly fearing a downturn in Berlin’s strategic relationship with Moscow. Moreover, Saakashvili’s salty rhetoric towards Russia alienated him in Muscovite political circles. He has conspicuously criticized Vladimir Putin’s government in ways that no other former Soviet country has. Now, with the invasion Russia sees itself as taking its rightful place as a leader in Eastern Europe.

After Georgia was defeated, Brussels was powerless to restore Georgia’s territorial integrity due to deep divisions within the EU on whether or not to pressure Russia. Marc Champion et al. summarizes the conflict in the following way:

The EU pledged to help Georgia recover from Russia’s continuing military intervention, but fears over Europe’s dependence on Russia for energy and of splitting the EU prevented moves to pressure Moscow.40

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Given that Russia supplies one fourth of Europe’s gas needs, it is not surprising that some countries remain weary about criticizing the Kremlin. The EU’s decision not to pressure Moscow until the EU-Summit takes place in November of 2008 evidences Brussels’ divisions on the matter.

For France’s Foreign Minister Bernard Kouchner, it is unquestionable that Brussels’ restrain “represents energy, gas and oil." Although EU members like Poland see Russia’s presence in Georgia as an ‘immediate threat’, Kouchner believes that due to the EU’s reliance on Russian crude it was unrealistic for the EU to “adopt a confrontational approach towards Russia." Such divisions, however, should be a wake up call for European policy-makers. The fact that Russia can exercise its muscle freely in the Caucus can undermine the stability of an extremely important region for the EU’s energy ambitions.

Russia’s insistence to remain in Georgia kills the Nabucco project. By doing so, Dan Fisher believes Russia is placing a lid in a vital transit country for oil and natural gas for western companies like Britain’s BP, which is competing with Russian energy companies to win extraction contracts in the Caspian Sea region. Furthermore, Georgian territory is extremely important to break away Russia’s monopoly over the rich oil and gas resources of the Caspian Sea region.

41 Ibid Champion, Marc, John W. Miller, David Gauthier-Villars and Alessandra Galloni (2008).
Russia’s next move is to lure Azerbaijan to sell its gas to Gazprom. By buying Azerbaijan’s gas, Heidi Brown argues that Russia would achieve three things. It would (1) gain a larger share of Europe’s gas market, (2) increase its pricing power, and (3) immobilize its two rival western pipelines, BTC and Baku-Sipsa, which already run through Georgia. Therefore, Russia’s control of Georgia is extremely important for them to monopolize Europe’s energy capabilities.

On the other, when dealing with Russia, Washington and Brussels are caught. Most EU members dependent on Russian gas (including Germany) have avoided grievances with the Kremlin. Germany, which sees itself as Russia’s most important European trading partner, refuses to endanger its strategic alliance with Moscow over third party disputes. They avoided uttering the harsh criticism that other EU members like Poland and the Baltic States made to the Kremlin. The White House, on the other hand, needs the Kremlin’s help in its war against terrorism and halting Iran’s nuclear projects. Ultimately, this suggests that Russia’s emboldened energy strategy and cunning alliances are proving effective in curtailing the EU’s diversification efforts.

2.5 The Baku-Tiflis-Ceyhan Pipeline

The Baku-Tiflis-Ceyhan Pipeline (BTC) carries oil from the Caspian Sea port of Baku, Azerbaijan through Georgia up to the Mediterranean port of Ceyhan, Turkey. BTC was

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constructed to elude Russia, Iran and Armenia. Kraener describes the Caspian Sea as an oil rich region since antiquity. For instance, since the times of ancient Greece, Baku was famous for the oil that rose up to the surface. In the 19th Century, oil magnate families like the Rockefeller and the Rothschild invested in the region\(^{47}\). Therefore, Kraener calls the southern Caucus a “vital energy point for international relations\(^{48}\).”

Although Azerbaijan, Armenia and Azerbaijan are participants of the European Neighborhood Policy (ENP), Brussels had practically forgotten this region until the Russian-Georgian conflict erupted\(^ {49}\). The United States recognized this region’s potential as energy runway immediately after the fall of the Soviet Union due to Azerbaijan’s oil and gas reserves. BTC’s construction, though actually initiated by the US, it was mostly funded by Britain’s BP\(^ {50}\).

BTC was beneficial for the EU, Azerbaijan, Georgia and the US. With BTC, the EU decreased its oil dependence from Russia, which greatly pleased Washington DC. Azerbaijan had a market for its oil exports. Georgia, in turn, profits from the transit fees\(^ {51}\). Kazakhstan, in addition, had expressed interest in exporting its oil through BTC. For Russia, however, BTC represented a loss in its near oil monopoly in the region\(^ {52}\).

Russia wants to continue monopolizing the gas market of Armenia and Georgia. In the 2005 winter, for example, sabotaged the pipelines going to those countries were greatly affected.

\(^{49}\) Ibid Kraener (2007): Pp.139
\(^{50}\) Ibid Kraener (2007): Pp. 139.
\(^{51}\) Ibid Kraener (2007): Pp. 139-140.
those countries’ heating infrastructure and industries\textsuperscript{53}. As a result, Russia’s presence military presence in Georgia effectively sabotages the alternative runway that BTC provided the EU in regards to oil supplies. This in turn, increases Russia’s control of hydrocarbons in the region and threatens to kill Nabucco.

\textbf{2.6 European Commission’s Strategy}

The EU Commission is the organ in charge of drafting proposals for new European laws, which it presents to the EU Parliament and Council\textsuperscript{54}. The Commission has 27 Commissioners, or one per EU member. The Commissioners are regarded as officials acting on the benefit of EU interests as whole that disregard the national interests of their respective States. Andris Pielbags is the Energy Commissioner since 2004. Under Pielbags’ leadership, the Commission proposed to the Council an \textit{Energy Policy for Europe} (EPE).

The EPE’s goal is to make the EU a low consumption economy based on a more secure, more competitive and more sustainable energy policy, where members worked together to tackle the challenge as opposed to single-member strategies\textsuperscript{55}. The EPE was endorsed by the Council in March of 2007. It focuses on seven priorities: (1) achieving a true internal market, (2) increasing energy efficiency and (3) renewable energy, (4) augmenting investments in technology and (5) the prospects of safe nuclear energy, (6) raising energy solidarity among members, and (7)


developing external energy policy relations. Finally, the EPE strives to “ensure efficiency and coherence” by implementing a common international energy policy so that the EU Member states are able to speak with a single voice on energy matters. Pielbags maintains that market liberalization is driving force of the EPE.

By breaking national borders and eventually creating a single-market for 480 million users, Pielbags intends to increase competition to benefit consumers with freedom of choice and open new energy investment opportunities for energy companies. Pielbags believes that the current rules companies controlling the energy market make it difficult for new entrants to use their pipelines or high-tension cables, thereby hampering competition and liberalization. With the unbundling of these rules, the EPE expects to open up these markets to these new entrants. Pielbags concludes that there are still significant barriers in order to unbundle the internal market, achieve a competitive and interconnected market, and implement a common international energy market to speak on a single voice on energy issues.

2.6 Challenges to an Energy Policy for Europe

Significant barriers to unify energy interests at the European level include resource nationalism and national champions. The barriers date back to the time when European

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governments created National Champions to safeguard their energy assets\(^{59}\). In its origins, National Champions were state-run energy companies that were an essential part of the government’s national interests.

Moreover, the internal markets of the EU Members are difficult to homogenize due to the country’s different energy assets. For example, Kraener explains how the state-owned French concern Electricité de France (EDF) specialized in nuclear energy during Charles De Gaulle’s presidency because the country had little coal reserves. The sources of Polish electricity and heating power, furthermore, come considerably from coal while the Czech Republic mostly works with brown coal.

For Kraener, there are also extremely different approaches in relation to energy such as the ones related to geographical location. Baltic States, which depend almost entirely from Russian imports, are searching for energy alternatives that circumvent Moscow while Germany and the Netherlands are strengthening their partnership with Russia\(^{60}\). Britain, on the other hand, blocked the acquisition of its Gas concern Centrica by Russian investors. Kraener explains that Britain can afford to block Russian imports because the bulk of their gas imports come from northern Africa and the North Sea. Similarly, Spain’s geographic location allows it to import energy from northern Africa and remain less concerned with Russian-European relations\(^{61}\).

Another obstacle to achieve an energy policy for Europe is the competitive character of the EU, Kraener explains. Since the existing monopolies zones have been gradually abolished, European energy companies, private or state-owned, are forced to compete with each other.


Therefore, members like Italy, Germany and France built their former state-owned companies as National Champions using an Offensive-Defensive strategy.\textsuperscript{62} They act on the offensive because they seek to takeover other National Champions when they can and on the defensive when another company seeks to take over them.

Kraener mentions how National Champions become defensive by refusing to lend out their physical infrastructure to foreign companies or preying unwanted takeovers through legislative tricks\textsuperscript{63}. For example, it is practically impossible to compete with National Champions like EDF in France and EON and RWE in Germany. France’s EDF owns practically all the country’s power supply networks. Thus, foreign suppliers wanting compete in their internal market can only do so in the periphery of France. In Germany, EON and RWE, which were formed by the mergers of a series of companies with formerly state-owned companies, have practically maintained their monopoly zones intact. Foreign companies like Sweden’s Vattenfall managed to enter the German market, but only after making some political concessions and deliberately choosing to operate in Eastern Germany, where the monopoly zones were less solidified.

Even inside the EU, Kraener explains how mistrust still prevails. Although the Commission approved the takeover, Spain rejected the acquisition of Endesa by Germany’s titan EON through legislative tricks in 2006. First, Madrid attempted to merge Endesa with its domestic competitor, Gas Natural. EON responded by offering a higher bid then Gas Natural. Spain, nonetheless, rejected this second offer even when EON incessantly tried to lure Endesa’s


shareholders with more attractive bids. In the end, Spain merged did not take the offer despite the repeated calls from the Commission to allow the EON takeover.

Kraener explains how EON was also formed by *defensive* practices on the side of Germany. EON acquired Ruhrgas even when Germany’s cartel authorities recommended preventing the takeover. Germany’s Economics Ministry, however, supported EON’s move. This defensive strategy evidences how Germany’s government explicitly strengthened EON to solidify its presence abroad. In addition, Spain’s protection of Endesa and Germany’s offensive move with the EON-Ruhrgas merger evidence how that the powerless the Commission is to prevent the protectionism of EU member states in the energy market\(^64\).

The EU is mostly dominated by the German giants EON, RWE, and ENBW, France’s EDF and its gas company Suez and the Italian company ENEL. Rather than operating in a peaceful coexistence, these companies see themselves as competitors fighting to expand their EU market share to increase profits\(^65\). In short, these European energy companies see their own survival intrinsically related to the strength of their balance sheets by increasing the number of customers, which means they have will eventually have to fight themselves in the process.

As a result, it is unlikely for them to cooperate with other European companies. For instance, when Italy’s ENEL wanted to acquire France’s Suez in 2006, Paris cunningly prevented the acquisition by merging Suez with Gas de France (GDF) five days later. Hence, any EU Commission effort to integrate the energy market under an EU umbrella is very difficult to


achieve since national governments are firmly maintaining the monopoly zones intact for their National Champions.
SECTION 3
ENERGY POLICY AT THE NATIONAL LEVEL

3.1 German Case

Although Germany is one of the founding members of the EU and its foreign policy is pro-European, in the realm of energy it has pursued different interests. Enno Harks and Andreas Pointvogl believe that German energy policy is more pragmatic than its pro-EU foreign policy suggests. This is probably because Germany is in a tight position regarding energy needs. Although they are one of Europe’s major players due to the size of their economy, they are not on par with other major western European countries in the energy sector. Europe’s major players of the Great Game (the Rudyard Kipling-coined term to describe the fierce competition for energy supplies since turn of the 20th Century) are France, Britain, Italy, the Netherlands, and Spain.

The governments of the major European players, Harks and Pointvogl insist, are vying to protect their respective oil and gas producers and to maintain their State influence to make

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provisions for their nation’s future energy supply and consequently perpetuate their companies’ stronghold abroad. As Harks and Pointvogl explain, Germany is for historical reasons the only major European economy without an oil or gas company with significant extraction and access capabilities abroad. Since Germany is not a major player in terms of production and access to gas and oil reserves overseas, it is highly susceptible to the function of the market, Harks and Pointvogl conclude. This makes Germany essentially more dependent on market allocation than other major European economies, which can allocate supplies based on national needs because of their considerable foreign extraction capabilities.

In addition, not all States follow the Commission’s regulations. When Germany’s EON attempted to acquire Spain’s Endesa in 2006, Spain repeatedly defied the Commission’s requests for Spain to lift up its obstructions to EON’s bid. Although EU regulators approved the deal, Spain has been flagrantly protectionist of its energy assets and an illustrative example of how EU governments resist the Commission’s proposals. To brush off EON’s 18-month standing offer, Spain ultimately resolved in April of 2007 Endesa’s future by favoring the bid from Acciona, a Spanish construction company, and Enel, Italy’s strongest energy company.

This made EON’s takeover impossible and even left lingering questions regarding the validity of Enel and Acciona’s bid. Spain’s top stock market regulator Manuel Conthe resigned immediately after Enel’s offer citing that their last minute bids broke the rules of Spain’s stock

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market\textsuperscript{5}. Lastly, the deal shows how Madrid shied away through tricks for 18 months from Germany’s EON bid only to let Italy’s Enel carve up Endesa in a last minute proposal.

Harks and Pointvogl suggest that it was in Italy’s interests to water down the takeover because the deal would give EON control over Endesa’s Italian subsidiary company Endesa Italia, Italy’s third largest electricity company. After Europe saw active attempts for mergers and acquisitions in 2006, the governments of Spain (Endesa’s takeover by EON), France (Suez’s takeover by Enel), Italy (Enel’s marriage with Endesa) and Germany (EON’s unsuccessful Endesa bid) have enacted a slew of barriers to brush off unwanted takeovers. According to Harks and Pointvogl, these governments are enacting such laws to protect their National Champions, which ultimately erodes any effort from the Commission to pass a common energy policy.

Even though Germany has two of the largest energy companies in Europe, EON and RWE, they are net importers of gas. German companies such as Wintershall (a subsidiary from BASF), Wingas, and EON Ruhrgas produce gas and oil, but their influence in the international energy market is minimal\textsuperscript{6}. For instance, in 2005 RWE produced 2.4 billion cubic meters of gas per year and Wintershall 7.4 billion barrels while France’s Total produced 49.6 billion barrels and Britain’s BP 87.5 billion barrels\textsuperscript{7}. In oil, the picture does not change for Germany. While RWE and Wintershall are producing 0.08 and 0.18 million barrels of oil per day respectively, Total is producing 1.62 and million barrels and BP 2.60.


3.1.2 Making for the Pitfall: The North Stream

One of the ways by which Germany is trying to make up for this comparative
disadvantage is with the construction of the North Stream pipeline in partnership with Russia and
the Netherlands. This pipeline, which would stretch under the North Sea from Vyborg, Russia to
Greifswald, Germany, is intended to meet Europe’s future growing energy demands. The major
stakeholders are Gazprom with 51% ownership of the project and EON and Wintershall with
24.5% each.\(^8\)

This 12,000-Kilometer project would start pumping 27.5 billion cubic meters of gas
yearly to Western Europe by 2010. The former German Chancellor Gerhard Schroeder and
former Russian President Vladimir Putin (currently Prime Minister) coordinated the project.
Schroeder, however, caused controversy in Europe because he chaired the consortium while
acting as Germany’s Chancellor. Furthermore, Europeans had lingering questions of Germany’s
bilateral negotiations with Russia since other important European governments did not take part
in the negotiations aside from the Dutch.

In other words, Germany’s project goes against the EU Commission’s goal to divert away
from a gas mono-supplier and the establishment of a multi-vector energy policy. According to
Kraener, Germany’s move fulfills its self-interests since it would become a hub for Russian gas
in Western Europe.\(^9\) Berlin, nonetheless, argues that the pipeline is the beginning of a closer


privileged partnership between Moscow and Brussels, since the project would not only benefit Germany and the Netherlands, but other EU Members like the Czech Republic.

In realistic terms, the pipeline does affect other European Union members, notably Poland and the Baltic States. This pipeline would explicitly circumvent these countries and solidify Western Europe’s dependency on Russia. Since Russia is Europe’s largest energy supplier, Brussels is reasonably becoming skeptic. The EU aimed for Nabucco, a pipeline that seeks to circumvent Russia by bringing gas supplies from the Caspian Sea through Turkey, Romania and Hungary. The North Stream pipeline, however, slashes Brussels’ effort to negotiate with new energy producers in Central Asia to weaken the EU’s dependency on Russia. As a result, other EU members have questioned Germany’s position.

The North Stream pipeline, nonetheless, is very beneficial for both Russia and Germany. Russia’s Gazprom, the project’s major stakeholder, is purposely circumventing the Baltic States and Poland. Firstly, they would cut costs by avoiding the payment of transit fees. Secondly, they would avoid complications due to possible political instability in Eastern Europe10. Thirdly, Gazprom would have direct access to Germany, the EU’s largest market, and Russia would solidify its foothold in the EU market, which is Gazprom’s most profitable market. Lastly, the bilateral partnership would make this pipeline Russia’s most reliable gas vein11.

Germany would also benefit from the Russia’s risk reduction seeking strategy behind the North Stream pipeline. Firstly, Germany would make up for some of the ground it lost due to its low gas production capabilities in relation to Europe’s major players. Secondly, by becoming a


new energy hub for the EU, Germany would strengthen the competitiveness of its national champions EON and Wintershall in Europe.

Thirdly, Germany would become one of Russia’s closest trading partners and thereby have preferential access to Russia’s juicy energy resources. Finally, Germany would have more reliable gas deliveries since it would avoid cut offs due to third party disputes such as the Russian-Ukrainian dispute of 2006. The most glaring obstacle for the pipeline’s construction is that thousands of bombs lying in the North Sea’s seafloor since World War I could destroy machinery and the pipeline’s infrastructure. It is also unknown were the bomb traps lie.

Nevertheless, these physical challenges will not dampen the strong support this project enjoys from Russia’s and Germany’s business and political circles. In addition, it sheds some light in the complications of creating a Common European Energy Policy (CEEP). Berlin’s move to bypass the Commission’s proposals evidences the difficulties of implementing a solid and comprehensive CEEP. Given the lucrative gains from such pipeline and the disadvantaged energy trajectory from Germany in relation to Europe’s major players, it is difficult to convince Berlin of pulling out of the project. Since Germany lacks the foreign exploration and access oil and gas capabilities that other European nations have, Germany sees itself in a deadlock in terms of energy policy.

Germany, which has the largest population in the EU, depends too much on the market in comparison to Spain, France, Italy, Britain and the Netherlands, which have considerably larger foreign exploration and access capabilities to meet their nations’ energy demands and smaller populations in comparison to Germany. This German weakness makes Berlin thirstier to secure

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energy supplies then to follow the Commission’s proposals. Simply put, Germany sees its strategic partnership with Russia as a means to secure its continued economic expansion and compensate for the shortcomings from its energy companies. Furthermore, the delays from the frequent disputes arising between Russia and transit countries like the Ukraine and Belarus make this project a win-win for both Russia and Germany.

In conclusion, Germany’s temptation to secure its access to Russia’s attractive energy reserves evidences how the full implementation of CEEP remains slow because is not beneficial to the national energy interests of all the EU Members. Although the Commission recommends drifting away from a mono-supplier and building a common energy front, Germany’s deal with Russia has solid gains for both members. Russia needs to consolidate its presence in Germany because they are Gazprom’s largest customer\textsuperscript{13}. Germany, moreover, sees itself as country unable to reject such an offer given the advantages North Stream promises, the market complications Germany faces by its small production capabilities of gas and oil, and its population size.

Finally, Germany is due to its aforementioned weakness, is the only major European player that cannot take part in the ‘Uncooperative Strategy’ that others such as Britain, Spain, and France can employ\textsuperscript{14}. For Harks and Pointvogl, Germany’s way to secure energy supplies is not through the reduction in energy imports, diversification of energy suppliers, sources, routes or increasing its energy efficiency, but rather through the function and creation of a liberalized


market\textsuperscript{15}. Hence, Germany adheres to the EU’s liberalization energy proposals. This is exemplified on EON’s incessant attempts to take over Spain’s Endesa and Germany’s move to become a new energy distributor by collaborating with Russia’s Gazprom on the North Stream project, which makes this a classic case of a country acting to further its self-interests.

\subsection{3.2 Hungarian Case}

In 2007, the occasional meetings of Vladimir Putin and Hungary’s Prime Minister Ferenc Gyurcsány leveled the eyebrows of European capitals. Since the fall of the Soviet Union, Severin Fischer notes that most of the Eastern European governments have had icy relations with Russia\textsuperscript{16}. Polish, Czech, and Baltic relations with Moscow, for example, have been frictional. Hence, most European capitals were surprised when Gyurcsány and Putin suddenly started warming up. This is in part because EU countries that underwent Soviet oppression see Russia with a sort of resentment and mistrust. Therefore, the sudden warmth of the Russian-Hungarian relationship was the exception that broke the rule.

At the core of their new warmth was energy policy. Hungary is an EU member, but its pragmatic energy foreign policy is somewhat similar to Germany’s North Stream case. Hungary

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is not a heavyweight like Germany, which places Budapest on the receiving end of the EU. Hungary is due to economic and political reasons a less assertive member than Germany inside the EU.

This did not prevent Hungary, however, from meeting with Russia on an energy project that goes against the EU’s intended strategy. By meeting with Putin, Gyurcsány was opening its territory to Russia to compete against the EU strategy aiming to divert away from the EU’s dependency on Russia. Hungary’s geographical position is extremely important for both Brussels’ and Moscow’s energy strategies. To understand Hungary’s importance, one has to delve what is driving both Moscow and Brussels in terms of their energy strategies.

### 3.2.1 The EU’s Current Problem: Energy Diversification

Fischer notes that the root of the EU’s problem is that its consumption needs will increase from the current 400 billion gas cubic meters per year to 600 billion by 2020. To make up for the 200 billion gas cubic meters per year, the EU can count on the North Stream pipeline, which will pump 55 billion cubic meters per year. The EU, nonetheless, still ignores how to make up for the other 150 billion cubic meters. Some suggest that although Algeria and Libya are important alternatives, their production is still insufficient to meet the EU’s future growing consumption, which leaves Russia, with the world’s bulkiest gas reserves, as the EU’s major option to alleviate its gas needs at least in the middle-run.

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The EU’s dependence on Russian gas is certainly a challenge for its decision makers. As Fischer notes, the EU is searching for alternatives in the Caspian Sea to divert away from depending on a mono-supplier as assertive as Russia. As a result, when searching for alternatives, the EU is more focused on a country’s logistical acumen then its production capabilities.

This is specially true for gas producers. Although both gas and oil are indispensible commodities for all the EU members with the possible exceptions of France and Denmark, gas seems to pose the greatest challenge in terms of transportation\(^\text{18}\). Oil, for example, can be shipped, trucked, and carried by plane. This makes oil in the event of a crisis a relatively easier commodity to substitute. Gas, nevertheless, can be transported only through pricy LNG terminals (also known as pipelines). Therefore, Fischer concludes that a diversification from oil is, at least in the short-term, more feasible than gas. Consequently, Russia’s geographical location and existing pipeline network facilities will make it an indispensible partner for the EU at least in the short term mainly due to four major factors benefiting Russia.

Firstly, Russia has enough gas reserves for approximately 80 years. Secondly, Russia already covers 60 percent’s of the EU’s gas needs. Thirdly, the other countries with the world’s largest reserves are Iraq and Iran, which due to their unstable political course are not yet reliable producers\(^\text{19}\). Fourthly, as oil reserves dry up, the utilization of gas as an energy supply will dramatically increase. These factors in turn give Russia the upper hand vis-à-vis the EU, which has propelled Brussels to find alternatives for its gas consumption.


3.2.2 The Pipeline Competition: Russia’s Blue Stream vs. EU’s Nabucco

The EU is developing an alternative runway for new gas supplies that seeks to circumvent Russia in a project called the Nabucco pipeline. The largest gas companies from Hungary, Romania, Austria, Bulgaria and Turkey have joint efforts in Nabucco. This 3,300-kilometer pipeline would start in Azerbaijan going through Turkey, Romania, Hungary and end up in Vienna, Austria\(^20\). Planned to be concluded between 2011 and 2013, Nabucco should reach its peak capacity by 2017 and financed by the different consortiums from the participating countries at a cost of 4.6 billion Euros.

Nevertheless, Russia’s gas behemoth Gazprom is vying to win over Budapest to weaken Nabucco’s capabilities. Gazprom’s rationale is simple. By extending Blue Stream from the Turkish section of the Black Sea to Hungary, Russia significantly hampers Nabucco’s raison d’être in Europe and considerably strengthens Gazprom’s control of Eastern Europe’s energy market. As aforementioned in the section devoted to Russia, Gazprom’s purpose is to become the world’s leading energy company. Therefore, by overpowering the Nabucco pipeline, Russia is trying to embed its control of the EU’s gas market\(^21\). Moreover, Gazprom has a strong


comparative advantage over its competitors. It is already the continent’s most important gas supplier delivering in 30 European countries\textsuperscript{22}.

Fischer also suggests that Hungary benefits more from Blue Stream’s extension then from Nabucco. In fact, the benefits are similar to the one Germany attains from North Stream\textsuperscript{23}. Firstly, Hungary would become an energy hub for Europe. Secondly, it would shovel up considerable earnings by negotiating contracts and fees with third parties\textsuperscript{24}. Thirdly, Blue Stream would strengthen Hungary’s gas company MOL. Fourthly, due to the lack of a long-term energy storage infrastructure to cover its needs in the event of a crisis, Hungary would benefit from a continued flow of gas because Blue Stream’s extension would continuously distribute gas to Western Europe\textsuperscript{25}.

Currently, Hungary imports 80\% of its gas from Russia, which is also a worrisome factor for a portion of Hungary’s population. Specifically, Hungary’s conservatives want to reduce its dependence from Russia\textsuperscript{26}. They support Nabucco because they estimate it could reduce Hungary’s dependency down to 60\%. In addition to Hungary’s conservatives, its Eastern European neighbors such as Poland vehemently support Nabucco. But Nabucco possesses serious logistical shortcomings\textsuperscript{27}.

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Nabucco, for example, is not a comforting alternative to the Gyurcsány government because it will be finished approximately by 2014. Prime Minister Gyurcsány is interested in a project that would bring gas as fast as possible to Hungarian consumers to avoid a gas deficit in the coming years. With this goal in mind, Blue Stream appears to be the safest bet for Hungary because it will bring in supplies in the short-run\(^{28}\).

Furthermore, some of Nabucco’s potential gas producers are uninterested in the project. Only Azerbaijan has shown interest, but its gas reserves are insufficient to allow the pipeline to start deliveries\(^{29}\). The other Central Asian gas producers like Kazakhstan, Uzbekistan, and Turkmenistan are at least in the short-term uninterested in participating in Nabucco because Gazprom cunningly consolidated their grip on this market earlier than the Nabucco group did. Other potential producers like Iran and Iraq are still in doubt due to their unstable governments\(^{30}\). Finally, it is unclear how the five countries participating countries in the project are going to finance an already expensive project.

Blue Stream, in contrast, is an extension project, which means that is a step ahead in logistical infrastructure in comparison to Nabucco. For example, Blue Stream’s extension will be entirely financed by Gazprom and depend solely on Russian gas\(^{31}\). Fischer also notes that Moscow has strong interests in extending the pipeline because, as evidenced in its North Stream project with Germany, they want to circumvent the Ukraine and Belarus.

In addition to this, Fischer suggests that Hungary might have doubts about embracing Nabucco when it comes to its interests as a nation. For instance, Austria’s energy company OMV, which heads the Nabucco group, is interested in taking over Hungary’s energy company MOL once the pipeline starts delivering. By negotiating with Austria, Fischer believes that Hungary can affect its own interests. A possible OMV takeover MOL might send shock waves to Budapest that Nabucco might go against Hungary’s energy interests and leave, therefore, few enticements for Budapest32.

For pragmatists, the Blue Stream extension makes sense because it is a bilateral deal, which allows Hungary’s interests to be better represented. Thus, Blue Stream is a kingmaker project for Budapest that makes Hungary an energy distributor and allows it to shore up negotiation fees and contracts. Not surprisingly, Gyurcsány announced his readiness to continue negotiating with the Russians in 2007. Amid this controversy, Brussels’ political circles labeled him as a ‘traitor to Europe33.’ Fischer explains, however, that Hungary is only playing its best hand. Budapest, Fischer goes on, is in an unpleasant position. Although it is anchored politically to Brussels, Hungary depends 80% on Russian gas, which is an extremely high percentage in relation even in relation to other Eastern European EU Members34.

Gyurcsány started supporting the Nabucco project because of a considerable segment of Hungary’s population was starkly against lending their soil Russia’s pipeline. But because for the pragmatist Gyurcsány government it was equally important in the short-term to guarantee a secure gas supply, he became adamant about rejecting Russia’s offer. Gyurcsány’s social liberal

ruling party stood for short-term earnings and remained goal oriented. They believed that Hungary could not afford an abrupt price increase to its consumers in the future thereby leaving Budapest’s doors open to Moscow.

In stark contrast to Gyurcsány’s party, Poland and Gyurcsány’s largest opposition party FIDESZ staunchly opposed the Russian extension project. FIDESZ, which was also largely supported by many of Hungary’s Eastern European neighbors, wanted Hungary to shy away from the Kremlin and force the government to create a long-term strategy to reduce the country’s dependence on Russian gas\(^{35}\). This strategy enjoys widespread support in Eastern Europe because a large portion of Eastern Europeans became Russo-phobian after undergoing Soviet control. Fischer also believes that this dispute is not only related to national pride, but also evidences the problems of Europe’s energy policy.

On one hand, the EU is expecting Hungary to support Nabucco, but does not concretely have measures to help the country strengthen its weak gas reserves. In other words, the EU expects its members to adhere to its energy proposals, but does not have concrete energy solidarity measures to help ailing members confront future crisis despite it is mentioned in the reform contract of energy solidarity from Article 19 of the Mandates for Government’s Conference\(^{36}\). On the other hand, most of the Western European governments have enacted a slew of laws that go against the Commission’s energy proposals.

Therefore, any attempt to forge a CEEP would have to take into consideration the Government’s self-interests of each EU member. As seen in the German and Hungarian cases,


these nations stepped out of the Commission’s recommendations to look out for their interests thus making the creation of a CEEP an arduous process, which implies that the EU should rethink its energy strategy.
SECTION 4
WHY THE EU SHOULD RETHINK ITS ENERGY POLICY

Even though Europe underwent massive European interstate unification, the continent remained dormant in devising a unified strategy that increased the EU’s energy security. As the Nabucco example evidences, countries such as Russia have been many steps ahead of Europe in the energy game. The fact that Central Asian producers like Kazahkstan, Turkmenistan, and Uzbekistan are giving preferential access to extract their energy to Russia rather then the EU members is making analysts like Richard Youngs call for changes in Europe’s energy strategy.

Youngs explains that the EU hovers ineffectively between markets and geopolitics. Currently, the EU energy strategy is based on spreading eastward and southward exporting the EU’s market rules\(^1\). The EU operates by expanding its market-governance model. Nonetheless, as Youngs and Fischer explain, the EU should rethink the market-governance model for three reasons.

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Firstly, the Commission proposed that the internal market would set the foundations for “a rules-based, market-oriented external policy.” However, for Youngs there is a group of EU members preventing the liberalization of the EU’s energy markets due to one-sided interests from some EU members. For example, in 2006 the Commission criticized all governments except the Netherlands for not meeting the market-opening commitments they had already signed.

When Spain hindered Endesa’s takeover, the EU was unable to persuade Madrid to trust Germany’s EON. In addition, France has blocked new proposed regulations that would “tighten enforcement mechanisms and speed up the implementation of liberalizing reforms.” These examples essentially show how EU governments are only paying ‘lip service support’ to the EU’s energy strategy.

As Youngs explains, many EU diplomats even feel unconvinced that the EU strategy works. He says that many of them confess that they have to go along with the EU’s pro-market rhetoric, but know that the EU’s strategy is ‘unrealistic due to geopolitical complications of energy trade’. If even EU diplomats are not convinced with the European energy strategy, then it is very unlikely that the strategy will thrive in the cutthroat-natured markets of Asia, Africa, and the Middle East.

This leads to a second point. The EU has supported a market-governance strategy that remains unattractive to producer countries. Although the EU has of successfully exported regulatory norms in many areas such as environment protection and democracy promotion, their

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energy strategies remain insipid to most producer states. As Youngs argues, most producer states remain weary of implementing the abstract energy conditionality norms of the EU because they habitually adhere to geo-politic realities\textsuperscript{5}.

The EU Commission supports an energy policy consistent with the EU’s foreign policy goals such as the promotion of human rights, peace support, democratization and conflict resolution and prevention\textsuperscript{6}. In addition, they stress the market-governance strategy to ensure that the ‘rule of law’ prevails to compete with new energy consumers like China and India. By adhering to market-governance, Europeans are trying to “undercut the ability of such rising powers to resort to untrammeled political-deal making\textsuperscript{7}.” Moreover, Youngs explains that the market-governance also provides a strong framework to attract foreign direct investment for EU investors. There are certainly commendable and extremely useful aspects of the EU’s energy policy.

Producer states, however, are not yet enticed by this strategy. For example, Youngs explains how the EU has been unsuccessful in convincing the Gulf Cooperating Council (GCC) of the Arabian Peninsula to adopt a free trade agreement with the EU for about 18 years. Gulf States, nonetheless, are not comfortable with the EU-Style market and governance norms\textsuperscript{8}. In fact, Gulf States criticize EU attempts to export its regional integration model to the region.

They argue that the EU fails to recognize that the gulf’s intra-dynamics differ even within the GCC\(^9\). This limits the GCC’s energy cooperation with the EU and results in the bilateral decision-making between producers and individual EU countries that always has watered down the EU efforts to achieve single-voice negotiations. As a result, Youngs concludes that the EU’s common government strategy presents serious shortcomings that should be solved a priory with technocracy and pragmatic decision-making\(^{10}\). Simply put, the EU’s strategy should stick to its principles, but guided by practical consequences and results.

Thirdly, Fischer suggests that the EU strategy needs energy solidarity followed by concrete and solid measures. Fischer suggests that the EU’s strategy should be a solid, frank, and responsible dialogue with Russia. In realistic terms, Fischer thinks that the EU will depend on Russian energy at least until next century\(^{11}\). Thus, Brussels should elaborate a common policy towards Russia.

Brussels can only win because Russian energy companies and its physical infrastructure will be equally dependent on the lucrative European energy market for the coming decades. Since Russia is eager to enter the EU retail market (as Gazprom evidenced when it sought to takeover Britain’s gas provider Centrica), Europeans should introduce reciprocity clauses in exchange for retail and distribution enticements in Russia. On one hand, the EU needs Russia since Russia has the largest pipeline networks in Europe and it possesses immense crude reserves. Europe, on the other hand, has the best paying market.

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The Russian-European relationship, however, is still mistrustful despite the large volume of trade between them. On one hand, Russians resent the waste and corruption brought by privatization of their energy assets during the 1990’s. Europeans, on the other hand, fear that Russians can use crude as a political tool and restore to strong-arm tactics once they control the distribution and retail. Therefore, the French Presidency’s *Reciprocity Clause* seems to be a feasible and fair solution.

Reciprocity would “force companies buying EU energy transmission assets to abide the same open market rules that govern EU” businesses. The clause intends to level the business conditions for European operators and would hinder large sell-offs of strategic energy assets once the new EU unbundling rules take place. Since Gazprom has openly expressed interested in acquiring assets in Europe, Europeans can give up these assets in exchange for other Russian strategic assets where the EU has comparative advantage (such as research and development and financial services). By following reciprocity, Europeans would avoid feeling threatened by the Russia’s uncertain energy ambitions.

Nevertheless, Brussels is still facing skepticism on the part of one member. Germany is against reciprocity citing that the clause is endangering its interests; Germany had “secured upstream gas and oil gas rights in Russia in return for retail rights.” Unfortunately, this is another example of a feasible EU proposal that would level the field for EU members against Russia, but that cannot go through due to the bilateral interests between Russia and single EU members.

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Clearly, Germany is in its right to protect its strategic investments in Russia and other foreign countries. Nonetheless, the EU (and for that matter its single member states) cannot remain vague and static in its perceptions of Russia. As Gary Marks suggests, there is “clearly no EU legislation concerning Russian energy supplies.” The latest conflict in Georgia is a reminder of how Brussels should enact energy policies that will prepare the EU in the event of an energy cut off.

The Russian-Georgian conflict even demonstrates that the EU’s democratization efforts in Eastern Europe will remain sluggish if the EU does not achieve energy independence. At the time of the conflict, some EU members such as Poland vehemently supported Georgia but others such as Germany abstained due to their energy partnerships with Russia. Therefore, Brussels should elaborate a strong and definite strategy towards Russia to prevent the Kremlin from playing off EU members against each other. The failure to pass the reciprocal clause is just one of those cases.

4.1 Denmark’s Energy Policy: Achieving Energy Independence

The most significant strategy the EU can employ to raise its energy security is achieving energy independence. Denmark’s energy policy epitomizes the case in point. After being economically crushed by the 1973 oil shocks, Copenhagen devised an energy policy that
drastically reduced its dependency on Middle Eastern energy imports from 99% to zero\(^{15}\). By imposing itself an array of “gasoline and carbon dioxide taxes and building-and appliance efficiency standards,” Denmark sunk its energy consumption and spurred one of the most competitive clean power industries in the world, which in turn strengthened its economy and placed Danish *know-how* on the forefront of various industries\(^{16}\).

Far from crumbling the economy due to energy prices as high as $10 per gallon, Denmark forced itself to innovate. Their bold energy policy strengthened Danish job creation and spurred new sources of employment such as wind energy. As a result of such policies, Denmark now produces “one-third of the world’s terrestrial wind turbines…[and its] exports of energy efficiency products have tripled\(^{17}\).” Thomas Friedman notes that thanks to such policies, Denmark has broken its addiction to oil and considerably strengthened its economy. For example, Denmark is selling energy efficient technologies at a time when the world is yearning for new sources of energy.

Although skeptics might suggest that Denmark is small country of only five million people and high standards of living, Denmark’s results demonstrate that energy independence is possible through smart policies, political will and innovation. Denmark’s Prime Minister Anders Fogh Rasmussen even plans to increase taxes on energy to cut personal income taxes and improve the country’s energy innovation\(^{18}\). The challenges that larger EU economies (and thus


\(^{17}\) Ibid Friedman (2008): “Flush With Energy.”

larger consumers) face should make them re-evaluate their current energy strategy since the ones in place have not broken their gas and oil dependence.

The costs of being large energy consumers on more politically charged producers such as Iran, Iraq, Libya, and Russia are too high and risky. In addition, the costs of high-energy prices drain the economies of developed countries, as the latest 2007-2008 oil bubble demonstrated. Therefore, a possible CEEP might start introducing the Danish idea of smart taxes on energy and subsidizing clean energy producing industries. This idea will eventually force countries to innovate and make European countries even more environmentally friendly than they are already.

4.2 Energy Solidarity: A Possible Basis for a Common Energy Policy

Denmark has demonstrated that energy independence is possible given the appropriate government policies and proper innovation. Another idea to strengthen Europe’s common energy policy is Severin Fischer’s idea of an energy solidarity system that looks out for the smaller states in Eastern Europe. Since smaller countries are the ones with the starkest energy dependence from Russia, a common energy policy should be a tangible and reliable energy resource alternative that provides solidarity to them.\(^\text{19}\)

Fischer notes that Hungary’s case demonstrates that EU members can walk away from the EU consensus if they are threatened by severe energy shortages; Hungary’s gas reserves are

\(^{19}\text{Ibid Fischer (2007): Pp. 9.}\)
too feeble to confront a crisis. Therefore, Fischer believes energy solidarity is a key aspect that
the EU should build upon\textsuperscript{20}. Lip service, Fischer says, is not enough to convince countries like
Hungary to follow the EU consensus when there are no existing concrete measures to aid these
countries if a crisis hits them. He proposes the creation of a community organ responsible for
administrating the EU’s energy resources that would look out for the security of the smaller EU
states and act as a unitary actor to handle the EU’s energy needs.

In addition to this, Fischer concludes that the EU should subsidize its transnational gas
networks and finance inter-pipeline systems to make ‘European energy policy’ a physical reality.
A system of interconnected energy networks would give way to an energy solidarity system that
would make the EU a stronger entity that is capable of looking out for its weakest members\textsuperscript{21}. It
would also give Brussels a stronger voice when dealing with energy producers. One can expect
that the smaller countries due will unify because they face because the highest pressures in the
energy market. If the group shows some success, others would be enticed to join. Perhaps therein
lais an attractive alternative to begin enacting a common energy policy.


The two most important reasons why the EU lacks a common energy policy are Resource Nationalism on the part of influential EU Members and the competitive nature of National Champions. Resource nationalism refers to the nationalistic policies that most western European countries adopt in regards to their energy assets. Examples of resource nationalism include Spain’s refusal in 2006 to sell their energy company Endesa to Germany’s EON. Another is France’s move to merge Suez with GDF to impede a takeover by Italy’s Enel that same year.

Thus, resource nationalism inhibits the necessary fruitful relationship among different EU members to liberalize their strategic energy assets. Furthermore, it fosters a tendency for governments to pursue energy policy their own way. Take the positions of France and Spain. Although Italy’s Enel and Germany’s EON takeover attempts fulfilled European trade laws, Spain and France decided to repel the foreign takeovers through State-sponsored tricks. Specifically, the Spanish government obstructed Endesa’s takeover despite repeated calls by the EU Commission for Madrid to approve the merger.
Another aspect that increases resource nationalism is that EU members have divergent goals and objectives due to their different geographic locations and energy resources. For example, the EU members from the Baltic States want to find new supply alternatives since they are entirely dependant on Russian energy supplies. Other members such as Poland have called for an Energy NATO among Transatlantic powers to ensure a continued energy supply from producers. Poland’s objective, however, is to create a counterweight organization that prevents Russia’s strong-arm tactics such as the cut offs they employed against the Ukraine and Belarus.

Other EU members such as Germany and Hungary, however, remain more comfortable with increasing their energy trade with Russia. A few members such as Spain can remain less interested in Russian energy due to their vicinity with northern African producers. Similarly, Britain can refuse a Gazprom takeover offer because the bulk of its gas imports still come from northern Africa and its own North Sea reserves. Moreover, different conceptions prevail within EU members on how to achieve energy security. For instance, coal-starved France has placed a strong emphasis on nuclear energy while Germany remains unwilling to implement it. Thus, the creation of a CEEP remains an arduous process.

Furthermore, the objectives of producer countries can pose obstacles for the creation of a CEEP. As the case studies of Russia, Germany and Hungary suggest, the crux of European energy policy is that it is in the interest of some individual countries to deal bilaterally with Russia and get deals that are more advantageous than if they were dealing multilaterally. Russia, for its part, reaps out better deals by dealing bilaterally with

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European countries. Thus, when the EU tries to shift away from a mono-supplier, Russia gives lucrative incentives to geographically or economically advantageous EU members such as Germany and Hungary to continue strengthening Europe’s dependency on Russian energy. Berlin and Budapest, in turn, accept Russia’s offers because they shore up substantial earnings by becoming European energy hubs.

The Netherlands, France, Britain, Italy and Spain (Europe’s major players) also evidence resource nationalism. As Harks and Pointvogl suggest, these major players are vying to protect their respective oil and gas producers by blocking unwanted foreign takeovers to safeguard their nation’s energy supply and consequently perpetuate their companies’ stronghold abroad. Linked to the major players’ resource nationalism is the competitive character of the EU’s *National Champions*.

The EU governments created the National Champions to safeguard their strategic energy assets domestically and abroad. Due to the only partial abolishment of existing zone monopolies, Kraener explained that National Champions are forced to compete with each other in an *Offensive-Defensive* fashion. On one hand, European National Champions try to *offensively* takeover other assets abroad. They act *defensively* when they feel that a foreign takeover is looming or a foreign company wants to enter their domestic market.

Germany’s actions are usually *on the offensive* (like EON’s bid for Endesa and the North Sea pipeline construction) because they are the only major European economy without an oil or gas company with significant extraction and access capabilities abroad². Thus, the construction of North Stream tries to make up for Germany’s pitfall by making it

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Germany’s defensive side is its monopoly zone, which remains practically impenetrable for non-German companies.

For example, Berlin allowed foreign companies such as Sweden’s Vatenfall to operate in Germany, but only after Vatenfall made political concessions. Specifically, Vatenfall agreed to operate only in Eastern Germany, a region with less solidified monopoly zones. Such tactics make it nearly impossible for foreign companies compete with EON and RWE in the more lucrative regions of western Germany. Similarly, EDF owns practically all of the France’s power supply networks, which successfully repels foreign competition.

Hungary’s case is similar to Germany’s North Stream example. Hungary is allowing the extension of Russia’s Blue Stream pipeline in its territory over the EU-supported Nabucco pipeline to become an energy hub. Although Hungary remains an EU member strongly anchored in Brussels, its strategic energy partnership with Moscow sheds considerable benefits to Budapest. For example, Budapest would shore up substantial earnings by negotiating lucrative energy contracts and fees with third parties. In addition, the deal would ensure a continued gas flow to a country with weak gas reserves.

Russia, for its part, has adopted a hawkish energy policy after finding in crude exports a potent foreign policy tool. After the 1990’s left the former Superpowers’ economy in shambles, contemporary Russia renewed its strength due to the world’s ever-growing energy thirst. Due to its immense energy export revenues and strong domestic consumption, Russia has enjoyed at the turn of this century unseen levels of prosperity. Europe,

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moreover, has become overly dependent on Russian energy, which has unquestionably allowed Moscow to increase its confidence in the international arena. For example, Moscow swaggeringly entered Georgia this August in front of a shocked yet submissive Brussels.

Clearly, high-priced energy exports have been the source of Putin’s swagger. Firstly, crude exports have propped up Russia’s economy, which in turn strengthens Putin’s popularity in Russia. Secondly, by renationalizing energy assets and ensuring that the energy windfall benefits the Russian State, Putin revamps his image as a leader that fights for the interests of the Russian people. Finally, Russian energy serves as a potent foreign policy tool with which the Kremlin gains allies and dissipates criticism.

For pundits, nevertheless, the toll that the credit crunch recession has taken on energy prices will be the first test that the Putin government will endure. Economists suggest that Russia’s growth rates will dive by the end of 2008. Putin’s government remains confident that its $531 billion in international reserves will cushion the economy. It remains to be seen, however, what will happen to Putin’s popularity and Russia’s economy and foreign policy if energy prices continue their downward spiral. It is quite clear, however, that Moscow’s goal is to continue monopolizing Europe’s energy markets.

Finally, Russia seems to be steps ahead in the European energy markets. They successfully play EU members to against each other. For example, Moscow played

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5 Ibid White (2008): “Oil’s Drag…”

6 Ibid White (2008): “Oil’s Drag…”
Germany against France on the reciprocity clause and Hungary against Brussels on the Nabucco project. Thus, it remains imperative that the EU develops a solid and pragmatic policy towards Russia.

Some suggest that Brussels should not fear Moscow. They believe that Russia is simply too dependent on energy exports to hit Europe on its knees with unprofitable cut-offs. Russia is certainly dependent on energy exports in order to sustain its economy and overhaul its rusty energy infrastructure. Nevertheless, Europeans face larger challenges than Russia. In the event of a cut-off, the effects on Europe are immediate while for Russia the effects would be short or medium term. Thus, it is urgent that Brussels develops a policy to deal with Russia. Only this way will Brussels avoid that Moscow shrewdly plays off EU countries against each other. If former archenemy European countries were able to unify in coal, steel and nuclear capabilities after two devastating wars in less than a quarter century, then a common energy policy under an EU flag is not an impossible feat.
FIGURES

Figure 1.1 Baku-Tibly-Ceyhan Pipeline.  
Source: British Petroleum
Figure 1.2 North Stream Pipeline
Source: Gazprom.

Figure 1.3 Nabucco Pipeline
Source: Nabucco Pipeline Gas Pipeline International GmbH.
REFERENCES


