Rethinking Energy Policy in Central and Eastern Europe

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Abstract

This paper provides an overview of an upcoming book which seeks to do just this by asking the questions, what role does Russia play in the Central and Eastern Europe (CEE) energy sector and how did the Russian-CEE energy relationship develop since the early 1990s? One of the central thesis outlined here argues that in order to fully understand Russian involvement in the regional CEE energy complex, the Russian-CEE energy relationship should be analysed in the context of the political and economic transition that both Russia and the CEE states underwent following 1989. It is asserted that questions on which energy security analysis normally center—such as a country's energy mix, its transport system, and energy vulnerabilities—have to be considered along with questions related to the post-communist transformation, interactions between emerging post-socialist elites in Russia and the CEE region, as well as general governance structures.

Introduction

Central and East European (CEE) energy policy and security debates have in recent years been primarily viewed through a realist lens. This emphasises the geopolitics of energy, with focus placed on security of supply and the vulnerability of the CEE region stemming from its dependency on Russian energy imports (specifically natural gas) and Russia's perceived willingness to use energy as a political tool to advance its foreign policy aims.[1] Such interpretations also extend beyond academic analysis and are often to be found in national policy. A cursory glance at any of the national security strategies from the region highlights how energy has become securitised as a policy matter. This was most clearly seen in the 2007 Polish National Security Strategy, published in the aftermath of the 2006 Russia-Ukraine gas crisis and which noted how, 'The Russian Federation, taking advantage of the rising energy prices, has been attempting intensively to reinforce its position on a superregional level'.[2] 'The dependence of the Polish economy on supplies of energy resources – crude oil and natural gas – from one source *is the greatest external threat to our security*' [author's emphasis].[3]

The legacy of such thinking has continued to inform understanding of and attitudes towards Russia's role within the CEE region's energy landscape. Ongoing political conflict between Russia and Ukraine and the promotion of pipeline projects, such as Nord Stream 2, which reinforce perceptions of continued Russian dominance of the European energy supply market, do little to move the debate away from Russia. While a geopolitically driven analysis is not without merit, an overtly Kremlin-centric analysis may overstate the strength of the leverage that Russia has had over these countries and potentially overlooks other nuances, including the national interests and power politics, at play within the CEE states. Therefore, while we should acknowledge that Russia is and will remain an important actor which cannot be dismissed, we must try to better understand the extent of its role.

This paper provides an overview of an upcoming book[4] which seeks to do just

[1] See for example: Newman, R. (2011). 'Oil, carrots, and sticks: Russia's energy resources as a foreign policy tool', *Journal of Eurasian Studies*, 2(2), pp.134-143. Slobodian, N. (2016). 'Russia, Ukraine and European Energy Security', *New Eastern Europe*, 26 May 2016. Available at: http://www.neweasterneurope.eu/interviews/2007-russia-ukraine-and-europe-s-energy-security, accessed 19 August 2017.

[2] Polish Government (2007). *National Security Strategy of the Republic of Poland*. Warsaw. Page 6.

[3] Ibid. Page 8.

[4] The co-edited book by Ostrowski, W. and Butler, E. (eds) is entitled *Understanding Energy Security in Central and Eastern Europe: Russia, Transition and National Interest* and will be published by Routledge. It will be available from the spring of 2018. Contributors to the book include: Dimitar Bechev, Eamonn Butler, Giedrius Cesnakas, Terry Cox, Milos Damnjanovic, Roland

this by asking the questions, what role does Russia play in the CEE energy sector and how did the Russian-CEE energy relationship develop since the early 1990s? One of the central thesis in the book and outlined here argues that in order to fully understand Russian involvement in the regional CEE energy complex, the Russian-CEE energy relationship should be analysed in the context of the political and economic transition that both Russia and the CEE states underwent following 1989. It is asserted that questions on which energy security analysis normally center—such as a country's energy mix, its transport system, and energy vulnerabilities—have to be considered along with questions related to the post-communist transformation, interactions between emerging post-socialist elites in Russia and the CEE region, as well as general governance structures.

Why is this important?

Rebalancing the energy actor debates to include specific reference to the role played by CEE governments and national actors (including national champions) since the collapse of communism offers potential new avenues of enquiry. The contemporary CEE energy landscape has evolved over more than 25 years and cannot be assumed to be simply a Soviet-era legacy quirk, which locked the countries of the region into a Soviet and later Russian sphere of energy influence, where pipeline infrastructure, and to a lesser degree, nuclear technology, dictated the direction of energy policy.

This is not to say that close political and economic connections between Moscow and the various CEE capitals did not exist. Certainly, for some of the newly independent states of the region, specifically the Baltic States and those Central European states with higher dependence on Russian gas imports, the ties that bound them to Moscow were more than just the physical infrastructure. However, from the beginning of the post-communist era, governments across the region also started to develop their own policy positions and inaugurate moves to shift themselves out of that sphere or at least to distinguish themselves within it. It is important to recognise that these moves were not necessarily due to any inherent fear of Russia and the potential for it to use energy as a political tool, but rather they reflected the broader political and economic sentiment of the time, which saw the CEE countries orientate themselves more towards the liberal market economy structures of western Europe. The 'return to Europe' mantra that swept across the region and which underpinned most of the early transition government policies enabling political, economic and social transformation, was an important driving force for change, in the energy sector. It was to Europe that the countries of CEE primarily looked when undertaking this process,

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particularly with regard to liberalisation and privatisation.

The privatisation processes that were established during the transition of the early to mid-1990s helped to set the scene for evolution of the CEE-Russian relationship to the current day. It is important to recognise that the transition did not occur in an institutional vacuum and that the paths followed by countries before the transition started matter a great deal for the final outcome. This point is particularly significant in the case of energy systems and its operations which are based on long-term projects, arrangements and links cannot be easily broken. However, many of the decisions taken at this time, at national level, dictated the extent to which Russia and its own newly established national energy corporations were able to benefit from privatisation processes in CEE. When we look at this in detail what we find is that the capability of Russia to gain traction in the region's energy sector was actually quite limited, and it is only when expressly invited, as in the early stages of the privatisation process in the Baltic States or in the more recent case of Serbia, that it was able to consolidate and strengthen its involvement and influence.

In the book that informs this paper, it is argued that instead of concentrating solely on the Kremlin and the geopolitics of post-Soviet Russia, we should pay much more attention to broader economic drivers. This is reinforced by other examples within the book which emphasises the political-economy of the privatisation era. This may help to explain why Russian companies—in particular, Lukoil—to a large degree failed to establish themselves in the CEE energy sector. At the same time, Rosneft, the number one Russian oil company, remained more or less absent from the CEE downstream market. For most of the CEE states, privatisation of the energy sector was intended to help establish strong, market orientated economies with efficient and effective national actors and opportunities for domestic and foreign investment via ownership of business and infrastructure commodities. It was believed that the new owners would transform the sector through injecting both operational business knowledge and the necessary financial capital to enable development. There was also clear preference for western rather than Russian foreign investors, in part driven by the attractiveness of western capital and business best practice knowledge. There was also the fact that for some states the sell-off of the energy sector offered quick and easy access to financial capital needed to help pay off Soviet-era debts, including those held by western states. Finally, the preference for western investors was also heavily influenced by the belief that opening up their energy sector, alongside other strategic sectors—such as telecommunications and transport—would benefit the CEE states by reinforcing the 'return to Europe' ideal and that it would represent a first major step for their longer-term European integration.

Russia's greatest success reflects its continued role as an energy supplier, and it is in this context that partnership has often proven most fruitful—despite growing concerns and vocalisations about dependency. It is economic or rather, commercial, rationales that have traditionally dictated the willingness of CEE states to purchase Russian energy. Russia is a very attractive supplier of gas to the CEE region due to the proximity of these markets and the relatively low production and transport costs. Despite everything that has been said regarding diversification of energy supply for the CEE region, the simple reality is that Russian gas is extremely competitive for a number of countries. It is only in the Baltic States—specifically Lithuania and to a lesser degree Latvia—where we see recent geopolitical attitudes towards Russia override longer standing commercial considerations. For most of the other states, specifically those with a higher percentage use of natural gas within their overall energy mix, such as Hungary, commercial benefit and value for money continue to directly inform decisions to buy energy, specifically natural gas, from Russia. This is all the more relevant in light of a wider failure to invest in meaningful, alternative pipeline infrastructure to support new, cost effective supply routes.

When we look in closer detail at the specifics of Russian gas in the CEE region we see that the region has a varied landscape. Overall, gas plays a much smaller role in the CEE regional energy mix than has often been assumed within general discourse. An examination of the gas market highlights differences in attitude towards Russia, the openness of CEE to engage with Russia and the extent to which Russia has been able to access the sector across the various countries of the region. The book that informs this paper shows how in the case of Romania, political elites, supported by the local population, firmly rejected any involvement of Russian companies in the country's energy sector both prior to and after the collapse of the communist regime. Other CEE countries, began devising projects aimed at diversification from solely purchasing Russian gas, in some cases as early as in the 1990s. The Czech Republic was most successful at adopting this strategy while others followed its footsteps in the 2000s with the help of the European Union.

In the case of Bulgaria, Poland, and more recently, Hungary, the corrupted nature of the transition led to the creation of environment for the involvement of Russian energy actors who in tandem with local political elites established rent-seeking, intermediary companies. The presence of those companies is often viewed as part of the Kremlin's strategy aimed at dominating the CEE energy complex, but there is a lack of evidence to show that this was generally the case.

In the case of the Baltic Republics and Serbia, the Russian energy companies managed to penetrate the energy system to a much greater extent than in other states in the CEE regions, albeit, for very different reasons. The

Baltic Republics due to their historic Soviet ties and relative isolation from the European energy system did not have much choice but to actively engage with Russian companies. Serbia, which until the mid-2000s, followed similar trajectories to Poland or Bulgaria, began collaborating with Russian companies in a more intensive manner only after the Russian state actively supported Serbian efforts aimed at blocking Kosovo's independence.

This suggests that there are 3 main blocs of states in the CEE region reflecting differing attitudes to Russian energy relations and some states have moved fluidly across or between these blocs in recent years. The first bloc is represented by the resistors and includes Romania, the Czech Republic, and more recently the three Baltic states. These countries have actively resisted and opposed where possible Russian influence. The second bloc is represented by what we term the hesitant partners and this includes Poland, Hungary and to a lesser extent Bulgaria. These states recognise the need to work with and partner Russia in terms of energy supply, but are wary of completely opening up access to their energy sector and will actively oppose Russian investment when not deemed to be in their national interest, but will be more willing to explore partnership opportunities. The third bloc is the collaborator and this includes Serbia, but we also find increasing evidence of Hungarian and Bulgarian movement towards this bloc in recent times. The collaborators have essentially opened their energy sector to Russian influence and complete penetration. The following section outlines three examples, one from each of the blocs to show how the legacies of their communist past and the transition era have informed their attitude towards Russia.

Bloc One: 'The Resistor'

The key to understanding the dynamics governing the Russian-Romanian energy relationship is the legacy of Ceausescu's policies, which aimed at gaining economic and political independence from Moscow during the Communist era. In the post-1991 period the old Communist policy was continued in the actions of Romanian elites who blocked not only Russian but also Western capital from entering the country, including to the energy sector, with the Romanian public largely supportive of the policy. Thus, the state remained a dominant actor in the energy sector, while local elites captured key areas of the sector and engaged in rent-seeking activities. The limited Russian investments that did get through, were not driven by any political agenda, they were rather aimed at making a quick profit, predominantly via asset stripping. There is also no proof that Russian businesses held privileged relations with political parties or decision makers. Ironically, the outcome of this is that the various protectionist measures, which initially shielded the country from Russian penetration, have led to a clash with liberally oriented EU institutions and Romania may yet find itself forced to be more

open to Russian investment and engagement within its energy sector.

Bloc Two: 'The Hesitant Partner'

In the case of Poland, energy security was never threatened directly by Russia because the state retained primary control over the energy sector and because coal plays a key part in the country's energy mix, reducing the need for extensive natural gas imports. When we consider domestic politics, including that emanating from the transition era it is possible to shine a spotlight on the corrupted environment of the 1990s and early 2000s, which allowed Polish and Russian political, commercial and private actors to engage in rent seeking activities. The collusion between the two sets of actors had a detrimental effect on the way in which the debate concerning Polish energy security has developed and on the broader political and economic relationship between Russia and Poland. Interestingly, it is possible to see how the division and infighting between the 'anti-Russian' post-solidarity camp and the 'pro-Russian' post-communist camp, coupled with corruption scandals that brought to the murky dealings between the Russian oil and gas sectors and Polish political actors, have kept generating interest about the country's energy security and further fueled concerns about Russia's real intentions. The Ukrainian-Russian 'gas wars' in the mid-2000s entrenched a negative view of the Russian oil and gas sectors and gave the energy security debate a truly geopolitical dimension, which has shifted the country more towards the resistor end of the hesitant partner spectrum. Since the late 2000s the EU, similarly to other countries in the CEE region, has played an important dual role in the Polish-Russian relationship, facilitating reconciliation between two parties, whilst also aiding Polish efforts aimed at diversifying away from Russian oil and gas supplies.

Bloc Three: 'The Collaborator'

Since the late 2000s, Serbia has increased its energy insecurity by essentially 'handing over' its oil and gas sector to Gazprom. This move was due to special political circumstances which were not replicated in other countries. Having said that, until the late 2000s, the story of the Serbian-Russian energy relationship, despite Serbia's international isolation in the 1990s, was not that different to other countries in the region. The post-communist evolution of the Serbian energy sector was accompanied by the presence of Russian intermediary companies, involved in the sale of natural gas, and an increase in the prevalence of corruption scandals in the energy sector. As with other states in the region, the energy sector also largely remained in the hands of the state. Yet, the relationship between the Serbian and Russian energy relationship moved to a different level after 2007. Moscow's attempts within the United Nations (UN) and other international organisations to block recognition of Kosovo's independence changed the political dynamics

between the countries. The provision of this vital support from the Serbian perspective coincided with an intensification of the energy relationship between Russia and Serbia which led to the 2008 deal with Gazprom. As a result of the agreement, the Russian company now controls Serbia's oil and gas extraction, as well its oil refining capacities and much of its oil retail sector. In addition, the Serbian energy sector depends on a single pipeline through which Russian gas is piped. Consequently, towards the end of the 2010s, Serbia which traditionally enjoyed a high degree of energy security—with coal accounting for over half of its energy mix—found itself exposed to pressures from Russia which now possessed very strong leverage. In short, Serbia has trodden a diametrically opposite path from the other countries in the region under discussion here.

Conclusion

This paper, nor the book that it is drawn from, assumes to explain every aspect of CEE energy relations. It does, however, acknowledge that we cannot view the region as a single unit of analysis and that explanations for the CEE countries' diverging approaches to the issue of energy policy and security in relation to Russia have, on the whole, to date, followed a well-established narrative developed by a range of scholars who divide the region into groups of actors representing anti-Russian, pro-Russian and neutral bases. We take the line that these explanations view energy security predominately through a realist lens with energy used as a geopolitical tool for the Russian state. This means that the economic and political complexities of the individual countries remain largely understudied in wider literature and that without engaging with these issues we cannot possible come to a fuller understanding of the region's energy security including its relations with Russia and the European Union.

The book's contributors have sought to provide nuanced studies of a range of country cases, three Baltic states (Estonia, Latvia and Lithuania), three central European states (Poland, Hungary and Czech Republic) and three south-east European states (Romania, Bulgaria and Serbia). These studies were tasked with moving beyond a simple realist type of analysis. This proved challenging because realism does have a role to play in understanding the national interest-led choices made by states. However, the book's authors do show, through their analysis of different governance structures within the CEE energy sector, how conducive environments for Russian presence and influence emerged or were resisted. Discussion of the post-communist transition, the emergence of post-socialist elite, politics of private and state-owned energy companies in the CEE states and the move to respond to the liberalisation agenda of the EU was scrutinised. This provides a better understanding of the dynamics governing approaches to energy security and policy in the CEE region.

It also allows us to open discussion on new emerging areas of interest. For example, not all future engagement on the energy front will be with Russia. Increasingly, Brussels is holding the CEE states accountable for failing to implement EU law appropriately. This potentially will bring Brussels and CEE states into possible conflict, albeit not the same type of conflict often assumed to exist with Moscow. As EU member states, the CEE countries are able to inform EU energy policy, but if common policy is to work effectively then all participants need to follow the rules. If these do not benefit the national interest of the CEE state, then we can expect attempts to push the acceptable boundaries of non-compliance. Only by fully accepting that CEE states have agency and that their decisions will be grounded in not only current affairs but often past affairs will we be able to navigate and understand the politics underpinning Central and Eastern European energy policy and approaches to security.

About the authors:

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