



Seminar Summary

Transparency in Russia and Eurasia and Energy Security in Europe

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Panel One – Europe and Eurasia: The Extent and Limits of Energy Interdependence

Russia

Mutually assured energy dependence exists only up to a point. Russia needs to be able to sell its gas and oil, and Europe needs the hydrocarbons. However, Russia is basically a unitary actor whereas the European Union is not. The EU has alternative sources of energy for everything except gas.

44 per cent of Russia's oil output and 24 per cent of its gas output goes to non-CIS countries. 29 per cent of the EU's oil consumption and 30 per cent of its gas usage comes from the Russian Federation. The latter figure is rising. More than half of the Russian Government's budget revenues come from the oil and gas sectors.

What are the risks associated with Russia as the major energy supplier to Europe? The Government could cut supply for political objectives. Gazprom faces no domestic competition and is deeply inefficient. There are questions over Gazprom's supply capability. The Russian government's energy strategy to 2030 envisions output rising at less than 1 per cent per annum and prices remaining at about \$60 per 1000 cubic metres. The Government is seeking to develop an eastern gas programme which would send a significant amount of gas from Eastern Siberia and Sakhalin to Asia.

How can Russia cover Europe's increasing gas demands? It could reduce deliveries to the CIS; increase supplies from Central Asia; reduce domestic consumption by increasing prices; improve domestic industry energy efficiency; reduce domestic gas consumption by fuel-substitution (i.e. increasing the number of coal, nuclear or hydroelectric power stations).

The Russian government had planned to increase the domestic gas price up to the European level by 2011. Domestic prices *are* rising slowly, but are still a long way from true market cost. At present, one of the most effective ways to reduce domestic consumption is thus not being deployed. The grand plans to substitute gas with coal and nuclear power stations are probably not possible.

What are the prospects for Russia as an energy supplier? Long-term gas contracts are here to stay. The Russian Government will not ratify the Energy Charter, though it has signed it, but the EU should ensure that Gazprom complies with standard EU competition rules. There needs to be a united EU policy on energy, including issues such as power grids, energy stocks and gas reservoirs.

Kazakhstan

Rule of law in Kazakhstan is virtually non-existent. Regulatory control is poor and deteriorating. It is essentially a one-family government. Nazarbayev has not yet learned to play it clean. He may no longer keep his money in Switzerland, but it is certainly in other off-shore bank accounts.

Nazarbayev's political strategy is no longer about enrichment of himself and his family, but about maintaining control. The regime is not changing but stagnating.

The West's approach is extremely problematic. The West should adopt the line that transparency is important not only because it is morally desirable, but because it improves the business environment. The European Union's position is embarrassing. There is no way the EU will get the amount of gas from Kazakhstan and Turkmenistan that it claims.

There are huge obstacles to increasing the supply of oil and gas from Kazakhstan to Europe. Russia has control over energy exports. The Kashagan project is being delayed further. There are ways to get Kazakhstan's oil out by sea, through Baku, but this depends on Azeri capacity. Shipping oil from Batumi would be very expensive. The Kazakh government has said that they should concentrate on exporting hydrocarbons through Russia. Expansion of the pipeline network will take years and one has to question whether it is worth the investment.

Corruption in Kazakhstan is a major worry, but little is being done internationally to put pressure on the country. There needs to be proper audits of foreign currency reserves. The European Union should not adopt a smash-and-grab approach to Kazakhstan's energy resources. A recent Kazakhstan-Turkmenistan Memorandum of Understanding didn't mention transparency. Kazakhstan will hold the chairmanship of the OSCE in 2010 – is this appropriate?

Turkmenistan

Berdymukhamedov's approach to political challenges is not structural reform but simply the replacement of cadres. There are some indications of change here but no progress on making the government more pluralistic.

There have been some limited changes to the banking system and relaxation of the rules on investment. Subsidies have been reduced and greater price freedom allowed.

Turkmenistan's core energy relationship is still with Russia, although there is concern in the latter that Turkmenistan is working too closely with Kazakhstan. Aleksei Miller has visited Ashgabat frequently to try to hold the partnership together. Turkmenistan's increasing dialogue with Kazakhstan over energy suggests a new national champion may emerge.

The Chinese relationship is also crucial. The China pipeline is now being built. China is the only country to hold a PSA with Turkmenistan. Plans for the Afghanistan/Pakistan/India pipeline are also continuing. Berdymukhamedov visited Kabul recently and announced that the pipeline should be built by 2015.

Turkmenistan is aiming to produce 250 billion cubic metres of gas a year and 2.2 million barrels of oil a day. Current production of gas is 70 billion cubic metres a year. Gas production is currently just two-thirds of the Soviet level.

Real gas reserves are probably much below what members of the government have claimed. We cannot be sure how much gas there is in Turkmenistan. Although Berdymukhamedov seems to be more open to the West, there are big risks involved for any investor.

How does corruption relate to Turkmenistan's energy sector? Corruption is a contested concept, it is not necessarily always harmful. Under Niyazov, for example, corruption blunted some of the worst excesses of the regime,

allowing enterprises to cut through red tape and impossible bureaucratic demands.

Corruption in Turkmenistan is of a very specific kind. The main form of corruption in Turkmenistan is nepotism and cronyism. There is generally little business capture, or overregulation for material gain. Officials do not demand kickbacks. Judges are incompetent but not generally corrupt. Corruption in Turkmenistan is not investor centred – it doesn't threaten foreign operations. The investment climate is thus in some ways more certain than in Kazakhstan. There is no prominent class of wealthy oligarchs in Turkmenistan and corruption is generally centred on the state.

Downstream diversification will alter the patterns of corruption. People will start to use corruption more tactically to remove rivals and competitors. New corruption networks may form. As the business situation gets more complex in Turkmenistan, corruption may increase.

Supply and Demand of Energy Flows

Transparency for NATO has traditionally been about developing integrity in the defence industry.

Possible security risks associated with energy supply include resource competition and demography, terrorism, climatic and geological instabilities, inadequate energy conservation and diversification, instabilities in the economic and political environment, weaknesses in critical energy system infrastructure protection.

NATO's relationship to energy security is much more problematic. The debate about NATO's involvement was kick-started in 2006 by a leaked report on energy security which appeared in the *Financial Times*. This inspired a heated discussion and was the unwanted baby at the Riga NATO summit, at which it was confirmed that NATO would start to take into account energy security. NATO had not wanted to discuss this topic. NATO is not a unitary

organisation, it comprises 26 states and there are lots of factors in play, including potential clashes between 'old-Europe' NATO and 'new-Europe' NATO.

Nonetheless, NATO now has a mandate to engage in energy security. It committed itself to engage in the following fields: information and intelligence fusion and sharing; projecting stability; advancing international and regional cooperation; developing effective mechanisms to deal with new challenges; supporting the protection of critical energy infrastructure. The NATO Council in Permanent Session was tasked with preparing a consolidated report on the progress achieved in the area of energy security for consideration at the 2009 summit.

Pipeline security is a very sensitive issue and consensus is very difficult to achieve. Some countries believe NATO has no part to play in this area.

Energy is giving the Russian Federation increasing bargaining power in Europe. At the same time, European states are becoming increasingly dependent on Russian energy exports. NATO is a forum in which the exchanges and discussion which needs to occur could take place. There is however a fear that it could lead to the militarisation of energy security which could undermine discussion.

NATO is aware that energy price shocks are a major concern to Alliance members, but its main principle is that price fluctuations are determined by market forces and do not require action.

Discussion

Whilst there is a monopoly on upstream production, liberalisation of downstream delivery companies is misguided. The situation with Gazprom and a liberalised downstream market is similar to that of Microsoft and computer manufacturers. It does not create market security.

Is this a fair comparison? Angela Merkel said recently that Gazprom should be flattered to be compared to Microsoft. Gazprom does not have a global dominance. There is potential for diversifying upstream supply. Moreover, sovereign regulatory regimes can have an influence over Gazprom's activities, provided they are properly implemented.

The issue is reciprocity – Europe should insist that the payoff for Gazprom's entry into downstream markets is an equal access to Russia's production sector. A more integrated system of regulation would be of interest to everyone involved.

Liberalisation is coming to Europe, and this has important implications for Russian elites. People are starting to realise that unbundled companies are more valuable. Putin would be much richer if Gazprom were to be unbundled. The successful de-monopolization of the electricity sector in Russia is raising questions for Gazprom.

However, if you look at Gazprom's statements, it is quite clear there is no desire to break up the company.

There is a great deal of anxiety in Central Europe over unbundling. Reciprocity can partly settle this. There is a danger that unbundled companies will be resold to Russian state energy companies.

The EU does not want to touch the issue of corruption in the energy sector. Perhaps NATO could make up for the EU's lack of engagement, and push it in that direction?

A rational Gazprom will seek to keep the price low enough to maintain foreign contracts but high enough for a good profit. Unbundling will make it easier to diversify supply and undermine Gazprom's strategy.

What should the EU do about Central Asia. Is it worth courting these states? The EU is putting a lot of effort into building relations with central Asian states. There is a fixation on the Nabucco pipeline. It might be more helpful to explore other routes.

Russia is a net importer of gas from Turkmenistan. If it were not, Russia would not meet its domestic requirements. Getting gas from the 'near-abroad' instead of creating investment incentives is a deliberate policy.

Panel Two – The Distribution System: Cross Investment and Political and Financial Reward

Risks for the Investor in Central and Eastern Europe

The biggest danger in Europe's energy relationship with Russia is not over-dependence but the spill-over of corruption. Western energy companies which are trying to do business in Russia, Ukraine, or Central Asia confront constant pressure to consider issues of transparency when making investment decisions.

No one at the European Commission is looking at the issue of dummy companies and the dangers posed by their dubious practices. Western energy companies engage in practices which would not be acceptable in the West, and their governments turn a blind eye because they do not want to do anything to jeopardise the energy supply. Elite cartels are trying to build trans-national alliances with the aim of enriching high-level elites.

Corruption levels in the energy sector have increased in Russia. Why should we in the West assume that the increase in business corruption in Russia has not already spilled over into the activities of these same state-directed firms when they operate in the EU? The dominance of state companies in the energy sector, which pursue extremely dubious and non-transparent practices, reduces possibilities for investment. According to Anders Aslund, 50 per cent of the money Gazprom invests in development simply disappears. Western firms need to ask why significant profits are lost each year by

Gazprom to murky intermediaries for no apparent value gain. Some Western firms have reportedly called off negotiations with Eurasian energy firms rather than funnel profits through off-shore accounts or to intermediary firms.

Corruption and re-nationalisation have also weakened the bargaining position of Western firms using best practices when engaging in East-West energy trading. This increases the pressure on Western firms to engage in corrupt and non-transparent practices.

The feeble reaction on the part of Western governments to non-transparent behaviour leads to the continuation of dubious business practices. For example, the West responded weakly to the energy disruptions in East Central Europe by Transneft and Gazprom, and accepted monopoly and anti-trust practices by Russian companies. These anti-trust and anti-competition practices are a clear violation of Article 82 of the EC Treaty and of Article 45 of the Energy Charter Treaty. How many Western leaders can really negotiate well with the seasoned KGB-ers who make energy policy?

The governments of Central Europe have been relatively passive in dealing with transparency and corruption issues. This could be explained by the large number of political and economic leaders who are holdovers from the communist period. Low transparency in Central Europe facilitates the formation of new alliances between East European elites and the former communist/intelligence elite in Russia who dominate major energy companies. This makes it very hard for Western companies to compete for facilities or pipeline construction contracts.

There is a lack of due diligence in the West, indeed, it is often very hard for Western firms to conduct due diligence reports on potential partners. There is a lack of reliable information and in some cases it is impossible for Western firms to know if those conducting the due diligence are objective agents.

There are a number of specific recommendations which would improve the situation:

- The EU Parliament adopted a common energy policy on 26 September 2007. They should work to implement it.
- Western firms should petition the EU and national governments to enforce existing anti-trust and competition policy, particularly with regard to Russian state companies.
- The European Council and Parliament should consider an independent regulatory committee to monitor (but not veto) energy deals with companies based outside the EU. It would report to the Commission regarding the likely effect of the proposed agreement on the broader EU energy market. The agency could enforce a minimum level of revenue transparency in international energy contracts, extending to all companies that do business within EU member states.
- There should be a uniform reporting requirement for member governments to notify the Commission at the start of negotiations with foreign entities regarding the construction of new energy pipelines, the offering of tenders for energy contracts and when conducting talks for the sale of existing facilities within their border.
- All energy firms operating within the EU should be obliged to report their revenue flows for their operations at home and abroad. This would weaken the present advantage held by firms from countries with high levels of business corruption and an unwillingness or inability to enforce existing contracts.
- The EU Commission should take more concerted action to defend member states from politically-motivated disruptions in energy flows from Russia.

Dummy Companies

In the 1990s, there was a legitimate reason for intermediary companies. During a period of high financial turmoil, it was extremely difficult for companies to guarantee payments. Much payment was made in barter, which often created opportunities for corruption.

The intermediary companies remained after barter payments disappeared. What function do they fulfil? They don't own facilities or pipelines. They claim to have 'local knowledge' which expedites supply and payment. Is this worth Gazprom surrendering 50 per cent of its business? Big sums are involved. RosUkrEnergo made \$750 million in 2005 and paid \$730 million in dividends.

Yulia Tymoshenko pledged that RosUkrEnergo would be dismantled. A preliminary agreement was signed with Russia, but no timetable was set. On April 11 2008 RosUkrEnergo retained its contract as an intermediary energy supplier. However it was no longer allowed to operate on Ukrainian territory. Tymoshenko blamed Russia for the perpetuation of RosUkrEnergo, but Victor Yushchenko remained curiously silent, fuelling speculation he was involved in keeping the company alive. Russia wanted to keep RosUkrEnergo operating – one of the most senior figures in the company is now a senior advisor of Dmitri Medvedev. There appeared to have been a deal made whereby the price of gas will remain relatively low in return for the continued operation of RosUkrEnergo.

RosUkrEnergo has now been replaced by a fully-owned subsidiary of Gazprom which has direct access to the Ukrainian domestic market. Despite high-level discussions on removing intermediary companies, it appears that whilst Ukraine's debt to Russia remains, dummy companies will continue to exist. Both sides have stated that they would like to sign a long-term gas supply agreement. However, whilst there is no transparency in the system it is likely that the yearly haggling over price will continue. Ukraine is currently paying \$179 per 1,000 cubic metres. This is still well below the European market price and it is unclear whether Ukraine could cope with a jump to European rates. Given this, it is likely that intermediary companies will continue to exist in the Russo-Ukrainian energy market.

The Latvian Energy Distribution System: Cross Investment and Political and Financial Reward

Latvia's monopolist transmission and distribution company, Latvijas Gaze, is controlled by Russian companies. Gazprom holds a 34 per cent stake, Itera 16 per cent. The other big stakeholder is E.ON Ruhrgas, which since 2005 has been sidelined from the management and is attempting to sue Latvijas Gaze and Itera-Latvija.

Latvijas Gaze has a monopoly in distribution until 2017, as provided by the privatisation agreement. Itera is the key interlocutor in Russian-Latvian energy deals. Itera used to be a Chernomyrdin slush fund which has adapted to the Putin system. The company is represented by former business associates of Putin.

Gazprom and Itera act as intermediaries in energy negotiations with Moscow.

In the 1990s Latvijas Gaze was helpful in communicating with Russia, providing an acceptable price for gas. The price for this, however, was that Itera and Gazprom took a majority in Latvijas Gaze when the company was privatised.

Itera and Gazprom used their leverage to maintain a monopoly position in the Latvian energy market. They successfully lobbied to delay any government decisions on alternatives to Russian gas until the point when pressure for increased capacity forced the government to permit construction of a Gazprom-owned power station. They played off energy security against environmental concerns to argue the case for continued reliance on gas over coal.

What we see is the Gazpromization of Latvia's energy market through 'Schroderisation'. Where Gerhard Schroeder became head of Nordstream after being Chancellor, Latvian Premier Kalvitis became head, and a key shareholder, of Dinamo Riga hockey club, which was established in April

2008 with a three million Euro share capital. Former President Ulmanis also received a 10 per cent stake.

There is no public funding for political parties in Latvia. The opportunities for companies such as Gazprom to buy influence are therefore very high. Gazprom and Iтера are also able to exert leverage over politicians by offering them lucrative positions, shares etc.

How can Russian monopoly control over the Latvian energy sector be undone? In 2017 Latvijas Gaze's distribution monopoly will end. The network could then be unbundled or nationalised. Europe should be more involved in energy policy. Political and business ownership need to be separated. There needs to be party funding reform. A stronger and depoliticized regulator must be created. More transparency is required from both politicians and utility companies. At present, many politicians seem to be of the view that since they are trapped in this monopolistic system until 2017, they may as well take personal advantage.

Discussion

There is a line of thinking in Ukraine that if only we could eliminate the intermediary companies, the two sides could split the difference and reduce costs. But prolonging the life of intermediaries may be the only way to keep the price at an affordable level in the short-term. When Yushchenko came to power he promised to remove intermediaries in the energy sector. Russia immediately declared it would introduce European prices.

Why was the 2006 gas crisis between Russia and Ukraine resolved so quickly? Putin and Yushchenko reached an agreement to keep RosUkrEnergo. Medvedev claims that Russia has no desire for intermediaries. This is not the case.

If intermediary companies are removed in 2009, the price of gas in Ukraine may double, and that would have disastrous implications for the economy.

It would be very valuable to conduct a study of what impact of the imposition of European energy prices would have on CIS countries. Who would suffer? How would the problems be overcome?

Would some of the transparency issues in the energy sector which are currently unregulated become regulated if Russia accedes to the World Trade Organisation? Is this worth exploring?

Could the cooling off of Russia's ambitions to join the WTO be linked to the impact membership might have on energy deals?

The European Commission has too small a staff; they don't have the capacity to monitor energy deals. But evidence of malpractice is mounting, which will change people's views on energy companies.

The fact that the US is not a signatory to the Energy Charter is a serious hindrance when European states try to put pressure on Russia to ratify.

It is true that the US's stance may complicate negotiations with Russia, but most elements of the Charter already exist in US law.

A key problem in Ukraine is that those who are committed to transparency know a lot less about the energy sector than those who are not committed, or actively oppose it.

Weak political elites in Central and Eastern Europe need to be protected against bribes from Gazprom and other energy companies. Transparency International seeks to achieve transparency on party funding – where do political parties get their money and what do they do with it?

Panel Three – The Investor’s Perspective

The Energy Industry in Russia

Despite the high oil price, there has been a slowdown in production in Russia. Sechin has announced that oil production will grow this year so expect a statistical fudge. Tax breaks for the energy sector have been promised by both Sechin and Putin, but this is not certain. Russia has one of the least favourable tax regimes in the world for oil and gas. The export revenue per barrel is 90 cents a dollar.

The most important reason for the slow down in production has been taxation policy. Export duty on oil has increased four-fold while mineral extraction has increased nine-fold.

The overall environment has been one of the consolidation of oil and gas extraction companies under the state. The level of debt of these state companies has become huge. Gazprom is trying to restructure this debt through a loan from Deutsche Bank.

A Gazprom-Rosneft merger still cannot be ruled out, though there are strong inter-personal differences. Gazprom and Rosneft will divide Arctic exploration between them. It will cost ‘Russia inc.’ \$2.62 trillion.

The possibility of falling production is not yet perceived as a political danger in Russia. It is an issue of prestige. It is also not a major problem for Europe. Europe can switch to other producers. But it is a long term problem for Russia.

Investors' Prospects

There is a toxic cocktail in Russia of high rents and a bureaucracy which is increasing its influence not least due to high rents from commodity prices and an expanding bureaucracy. Medvedev has set up a Council for combating corruption headed by himself. Putin set up a similar council at the start of his presidency, which met twice! Meanwhile, the 'corruption budget' has increased fifteen-fold over the past eight years. Start-ups must still pay bribes to controlling industries.

The risks for international energy companies include the high cost of investment, possibility of political unrest/terrorism etc., contract repudiation, the manipulation of excessive environmental requirements to force concessions or seize assets, expropriation, restrictions on the removal of assets, nepotism. Of these, the most common are demands for bribes or special payments or 'charitable donations'.

Investors have a strong stomach for such things, however. They have seen it before and they factor it in. Business is about calculated risk; taking any opportunity comes with risk – subsoil risk and political risk in all its manifestations. Other business factors to be considered are: contract repudiation; welfare obligations; tax fines; a political justice system and nepotism.

Investment requires a local partner who can help to navigate you through relations with local government and federal representatives in the region. However, finding a reliable local partner demands a great deal of due diligence.

To manage risk you need strong financial governance, good financial reporting and a simple, transparent structure. It is not possible to close exposure to risk in these environments, but you can limit it. A relative risk rating will determine whether the price of investment is worth paying.

Experience shows that a big company that insists on transparency and refuses to be drawn into dubious practices will not be subject to corruption. This requires a strict ethics code and ethics training for all employees. IOCs look hard at such things.

If corruption spreads it will negatively effect the whole energy market. As long as the oil price stays high, it's hard to see how corruption will be tackled.

Day-to-Day Business Practices

There is no doubt that companies are highly preoccupied with 'risk' and the consequences of failing to take account of it are exposed. Once you get to a certain level of risk, companies will decide not to proceed.

That said, French companies, for example, are not held by the same criteria and so they have a greater chance of winning contracts.

The best solution is to get projects financed – that way all parties are held to loan agreements.

Insurance companies are vital – they act as a tool. Insurance is all about risk and may be a factor of change in the near future.

Everyone is vulnerable to risk and companies exist in a state of constant tension.

Discussion

International service companies are being replaced by Russian ones. Due diligence and disclosure are vital but there is always the risk of not receiving payments. In the world of competitive advantages versus competitive disadvantages, IOCs have to be careful and creative.

The situation surrounding TNK-BP is finely balanced. But one thing is certain: this deal has worked extremely well for five years. Even if it all folds now, it

will have been an excellent deal for BP. Putin himself warned about the dangers of joint ownership – he said it would not be easy. Things have to be done by consensus in a partnership but the frictions between the two sides are well known (it has been widely covered in the media). Probably the shareholders will thrash out a deal in the end. If not, this will have a very negative effect on the investment environment. This *is* an element of energy security. If this is impossible to settle amicably, BP will not expand further into Russia. The question remains as to why BP made the same mistake again, but they have fought a tough battle and they did at least get their assets back. BP decided it was a risk worth taking. Overall, this is a deal that has worked well and should provide grounds for optimism.

The absence of a legislative framework leads to a reliance on the regional administration. You are dealing not with Moscow, but with cash-strapped regional companies.

Getting consent from governments is a huge deal for companies buying shares.

The reluctance to disclose *and* not to disclose both contain risk.

The licensing laws were amended last year (but are still movable). All sorts of extra-legal 'exemptions' are needed – and that means a bribe.

There are limits to Russian power in Central Asia. But nonetheless, Turkmenistan is largely to blame for awarding contracts solely to the Russian government. Can Turkmenistan escape this dependence? It does not have much room for manoeuvre.

Panel Four – Building Transparency: The Energy Charter Treaty, EITI and Future Strategies

The Link between Transparency and Security

Is there really a link between transparency and security? It is not clear there is. Energy security has many different aspects to it, many different definitions, and it is important not to conflate them. This is also true of transparency. It is important not to confuse things which are similar but definitely different.

It should be stressed that all the issues discussed are not unique to Russia and Eurasia. The region is not remarkable or unique in this respect.

The energy sector as a whole, including in Western Europe, is one of the least transparent sectors you could imagine. In fact, we know a lot more about gas transit pricing in Russia than in Europe. Western energy companies impose powerful confidentiality agreements on their employees within the EU. Russians regard a lack of transparency as normal business practice in Europe. And they are right. One should therefore be careful about condemning it.

We should not assume there is a link between greater transparency and greater security. There are two views on energy liberalisation. The UK view holds that it leads to transparency which is good for security. The continental view is pretty much the opposite, reflecting the view articulated earlier today that it is dangerous to liberalise downstream distribution whilst upstream production is monopolistic. There are thus strongly divergent views on energy security and little prospect of consensus.

What do we really think is threatened in security terms by a lack of transparency? We need to have a better perspective on this issue. Will the EU really speak with one voice on this issue now if it was unable to do so when it was an association of nine countries, never mind 27? If Russia called the EU's bluff and declared that it would ratify the Energy Charter, Brussels would find a way to delay its implementation. There are big legal issues relating to the Charter.

The truth is, if there is going to be reciprocity in energy deals, it is the EU, not Russia, which will have to make concessions. The EU utility market is a closed shop, Gazprom can't get in. We own more of Russia than Russia owns of our energy sectors.

The EU shouldn't pretend it has leverage it doesn't. Russia holds all the cards.

Transit Pipelines

Transit pipelines are inherently unstable. Politics intervenes, neighbours have histories, and there are frequently disputes over transit fees.

This is related to the concept of the 'Obsolescing Bargain'. Negotiations between states (and energy companies) result in a deal to produce and transport oil or gas on certain terms. However, once production has begun and the pipeline is in place, the relative bargaining power of the two sides shifts markedly. The transit company now has the power to negotiate.

What is a transit fee for? Why should a country receive money simply for allowing hydrocarbons to pass over its territory? Transit pipelines and fees are about sharing in the benefit of the deal. However, whilst oil and gas prices are subject to change, no transit agreements have progressivity built into the fee.

The Energy Charter Treaty seeks to manage this problem, changing relative bargaining positions, shifting negotiations, and all the while keep the energy flowing. The Charter was drawn up in a hurry, and like most rushed legislation, it is bad law. Where the parties involved couldn't reach consensus, they left the issue vague.

The Energy Charter Treaty could help transparency by forcing countries and companies to make the terms of transit pipeline agreements public. The more deals made public the better. It could also create a framework which would allow for progressivity in transit fee agreements to take into account changing prices.

Transparency, Energy Security, and Transparency International

The link between transparency and security is corruption. Corruption in the energy sector is huge. Corruption increases instability, it undermines attempts to establish an efficient, reliable energy supply. There will be greater security, for example, if we know how large the hydrocarbon reserves are in different regions. How can firms invest with any confidence in such an opaque and difficult environment?

There is a wide variation in disclosure practices. Companies tend to act in a similar manner in different parts of the globe. If they employ corrupt practices in one place, they are likely to export these when investing abroad. Companies generally act with more integrity domestically than internationally.

There needs to be increased voluntary disclosure by companies. Regulations introduced in one jurisdiction will have positive effects in other jurisdictions, partly because many companies are registered abroad, for example on the New York Stock Exchange.

We have to overcome the most common excuses for avoiding transparency, such as the claim that operating difficulties necessitate corruption

Extractive Industries Transparency Initiative (EITI)

The assumption that transparency is important in the extractive industries is a relatively recent one. So far there has not been a great deal of progress in this area. Transparency is low.

The key tenet of EITI, originally promoted by Global Witness and TI, is to get companies to 'publish what you pay' and to get governments to publish what they receive, with an independent audit of payments and receipts. However, when companies like BP decided to report payments unilaterally, they quickly found that it was extremely hard to go it alone. It became clear that collective action was needed.

This led to a coalition of governments coming together to propose a joint solution, out of which came EITI. EITI aims to overcome the 'resource curse'. A lot of countries do not benefit from their natural resources, and a significant reason for this – though not the only one – is corruption.

EITI is a coalition of governments, companies, civil society and investment organisations. It has developed a robust yet flexible methodology for monitoring compliance by participating governments and companies.

How does EITI work? Both companies and governments disclose their payments and revenues, respectively; this process, which involves an independent audit, is overseen by multi-stakeholder groups in countries and an international Board. The key is to create ownership of these figures. Transparency is not an end in itself; it is a means to improving public knowledge of governments' revenues and making markets fairer and more competitive.

It is hard to establish conclusively how effective the scheme is. Direct causality is difficult to prove, but the anecdotal evidence is very positive. Credit rating agencies are improving the score of countries which implement EITI. Efforts are being made to get a UN endorsement.

The constraints on EITI include the limited political will to implement the EITI in some areas, a lack of leverage and a lack of awareness. To improve performance, the capacity of the organisation needs to be expanded, and awareness of its work needs to be increased.

The Link between Revenue Transparency and Energy Security

There is a link between revenue transparency and security. Anything you do to improve governance may improve levels of security. The fear of corruption may threaten the willingness to access energy reserves and invest in a country's energy sector.

The EITI has been a valuable tool in improving revenue transparency; Kazakhstan represents the high watermark of efforts to improve revenue transparency.

The EU could do a lot more. It could refuse to conduct business with companies which won't reveal their ownership structures. It could follow the example of legislation under consideration in the US and consider a Directive which required all IOCs to report to their shareholders all payments to Governments in their investee states. As far as Central Asia goes, there is definitely a (small) window for demanding better governance, particularly through incorporating the anti corruption issues in 'Neighbourhood Agreements'

However, an initiative like the EITI is never going to work in a place like Turkmenistan where there is little or no civil society. How does one operate in such a high risk environment, then? Perhaps one could create an 'EITI-lite', comprising companies which agree to work together to formulate a common framework for transparency and disclosure.

The EU has to look both inwards and outwards. There is a need to focus on the effectiveness of competition rules to promote unbundling. It should

consider introducing an independent regulatory authority to examine all energy deals for their consistency and anti corruption provisions. Likewise stock exchange regulators should be requiring all IOC's to disclose fiscal and royalty payments to the same standards.

EU companies are signing very corrupt deals with companies and governments in Eurasia. The EU and the UK need to adopt a much clearer anti-corruption agenda.

Discussion

If we are talking about energy relations between Russia and the EU as a whole, then the link between transparency and security of supply is not clear at all.

When we talk about a lack of transparency, this does not necessarily mean corruption, or breaking the law. There is more data available in Russia about energy than in the EU.

There certainly could be more opportunities for foreign investment in Russia, but if you get those opportunities, they are very profitable.

The transparency/security relationship is about the ability to deliver on projects. Without transparency there is a danger projects could collapse – this is the security danger.

It is an anomaly that as a member of the G8, Russia is not involved in EITI, which has been endorsed by the G8. Pressure could be put on Russia through this channel.

The interest shown by NATO in energy security, and its recognition of the significance of the corruption dimension, should push the EU Commission into taking these questions on board in a more effective manner.