

**Dealing with Russian Gas: Energy Management Dependency Strategies in the Czech
Republic and Hungary from Transition to Present**

By

Cillian O'Donoghue

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Supervisor: Professor Andreas Goldthau

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Abstract

This thesis seeks to explain how two Central European states have dealt with their energy dependency on Russia in the Post Cold war period. Despite inheriting similar path dependencies, Czech Republic and Hungary have followed distinctly dissimilar paths in dealing with their main supplier Russia. This paper identifies two basic hypotheses to be the most likely cause of variation: (a) differing perceptions of Russia and (b) ideological orientation (left-right divide). Utilizing the neoclassical realist theory of international relations, this thesis builds on J.W. Taliaferro's "resource extraction model", applying it to the field of energy security. This research reveals that the Czech Republic's strategy of diversification is the result of a higher perception of Russia as a threat when compared to Hungary. In addition, the left-right political orientation of each country's elites highly correlates with the type of energy policy pursued. This thesis contributes to the literature of energy security by identifying perceptions of foreign policy executives and constraints in the domestic sector to be significant hindrances in the pursuit of an efficient energy policy. The neoclassical model of resource extraction is also applied for the first time to the field of energy and is found to be highly relevant in this issue area. The paper concludes by suggesting most likely future scenarios and offers short-term recommendations to both governments.

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Abbreviations

EU	European Union
NATO	North Atlantic Treaty Organisation
WW2	World War II.
ODS	Civic Democrats
CSSD	Social Democrats
CZ	Czech Republic
HN	Hungary
FPA	Foreign Policy Analysis

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Introduction

Background

In October 2009, 23 current and former Atlanticist Central European leaders sent a letter directly to US President Barack Obama saying “ Central and Eastern Europe is at a political crossroads and today there is a growing sense of nervousness in the region....Europe’s dependence on Russian energy creates concern about the cohesion of the NATO alliance¹”. The signatories of the letter were worried about the region’s dependency on Russian energy which they feared could lead to foreign policy distortion away from Western security architectures eastwards towards their main energy supplier Russia.

The fears about Russian energy and foreign policy distortion in Europe are nothing new and date back to the late 1970s. In 1982 a CIA national intelligence report stated that “ the increased future dependence of West Europeans on Soviet gas deliveries will make them more vulnerable to Soviet coercion and will become a permanent factor in their decision making in East-West issues² ”. In order to address this potential foreign policy challenge the Reagan administration prohibited the sale of American equipment and technology for the construction of a pipeline that would bring Soviet gas to Europe. West European leaders remained undeterred and the pipeline was eventually built although it was unable to supply the amounts of gas contracted originally without American technology³.

Today Central European leaders continue to fear about foreign policy distortion as a result of an overreliance on any one supplier for one’s energy. These leaders fear not just about

¹ ”An Open letter to the Obama Administration from Central and Eastern Europe”, July 16th 2009 http://www.rferl.org/content/An_Open_Letter_To_The_Obama_Administration_From_Central_And_Eastern_Europe/1778449.html

² ”The Soviet Gas Pipelines in Perspective, ” National Intelligence Estimate 3-11-82, September 21, 1982

³ Antony J Blinken. *Ally versus Ally: America, Europe, and the Siberian Pipeline Crisis*. New York: Praeger, 1987. 36. Print.

their Western allies within the EU but also about themselves. With regards their West European allies the worry is that if they are overly dependent on Russian energy they will be less inclined to stand up for their Central European allies in the event of a dispute with Moscow. The fear is strongest with gas as unlike oil there is no fungible global market for gas⁴. In 2006 the Polish foreign affairs minister Radoslaw Sikorski compared the Nord Stream gas project pipeline between Germany and Russia to the Molotov- Ribbentrop deal in which Nazi Germany and Stalinist Soviet Union carved up Poland before WW2⁵.

With regards to themselves they again fear that their foreign policy will be distorted. This fear again is based on the assumption that importers display preferential foreign policy treatment towards suppliers as dependency increases. In the worst case scenario, Russia's dominant position in the Central European energy market could dissuade states from the region from siding with Brussels or Washington on an International issue. In a lesser case it can create incentives to shy away from criticizing Moscow's domestic or International policies. Through a process of "Finlandization" Central European leaders will realize that it is not in their interests to get on the wrong side of Moscow.

Looking from the outside with similar fundamentals as land locked countries, similar energy mixes and timings of transition the countries of Central Europe would be expected to have dealt with their dependence on Russian gas similarly but as Keith Smith former US ambassador the Lithuania states "the biggest obstacle to collaboration and more effective resistance to Russian pressure has been the lack of reform with the CSEE countries"⁶. With regards to energy security for the moment there still remains two Europes. Yet within this New

⁴ Hayes, Mark, "Institutions and Gas Market Security" In *Natural Gas and Geopolitics: From 1970 to 2040*, ed D Victor, A M Jaffe and M Hayes: Cambridge University Press

⁵ Nord Stream a waste of money says Poland, Euroactive.com, January 11th 2010, <http://www.euractiv.com/en/energy/nord-stream-waste-money-poland/article-188727>

⁶ Smith, Keith. "Russian Energy Politics in the Baltics, Poland, and Ukraine: A New Stealth Imperialism (CSIS Report) (9780892064564): Web. 31 March 2011.

Europe, some countries (Czech Republic) have made a greater leap forward than others (Hungary). Why this has occurred is the puzzle on this thesis.

Research Puzzle

Rather than focus on the entire region this thesis looks at two countries which following the collapse of communism inherited very similar circumstances yet have dealt with their dependence on Russian gas in different ways. Both countries were highly dependent on Russian raw materials flowing along a single transmission route yet one of the most puzzling aspects of the post transition period has been their widely variant pursuit of energy security. In the Czech Republic certain governments in power as well as most experts have made reducing dependence on Russian energy a priority and acted accordingly since transition. In 1995 an oil pipeline to Germany was built, in 1997 an expensive decision to import Norwegian gas was made even though it led to higher prices for consumers and through choosing American company Westinghouse for its Temelin nuclear power plant it diversified nuclear fuel supply.

In contrast successive Hungarian governments have responded somewhat differently. Throughout the 1990s the energy security threat posed by an overreliance of Russian energy was not part of the discourse and it was not until the first Ukraine-Russian gas crises of 2005 that energy security considerations became a major factor in the country's foreign policy agenda⁷. In the post Ukraine- Russian gas crises period they have also adopted a different policy than the Czechs. Firstly the ruling Socialist party concluded that energy security could be best increased through the diversification of supply routes, and did not see any need to diversify sources of supply. These contrasting approaches can be seen in their divergent attitudes to the Southern Corridor debate. The Czech Republic has always given its full support to the EU backed Nabucco pipeline project while Hungary originally agreed to establish a company responsible for

⁷ Interview: Orban, Anita, 2011

building the Hungarian part of the Kremlin backed South Stream pipeline. In practice the Socialist government's original strategy meant approaching Russia as a trustworthy supplier and making efforts to benefit from Russia's plans to expand on to EU markets and retain its position as a transit country.

The approach to energy relations with Russia is the crucial differences between Czech and Hungarian energy policies. What *explains this variation* of energy security strategies is the primary focus of this dissertation. Given their similar modern histories (Post WW2), geographical location, material capabilities, economy and path dependencies we would expect very similar policies and initiatives from both sides. Yet this has not been the case. It is a puzzle that this thesis seeks to answer. Additionally, this thesis strives to account for the concurrent variations in each country's energy security over time and space. Why at certain periods do they seem determined to diversify away from Russian energy supplies while at other times not?

Main Argument

This paper seeks to analyze why, despite facing similar energy constraints, have two countries Czech Republic and Hungary, adopted a significantly different approach to energy security over the past decade. Following a Weberian research model, this paper uses the lens of neoclassical realism to argue that the variation in the dependent variable, (energy policy of Czech Republic and Hungary) can be explained by one independent variable (a) the left-right ideological orientation of the political party in power and by one intervening variable (b) "differing perceptions of Russia" by the ruling governments in respective countries. Applying J.W. Taiaferro's "resource extraction model" to the field of energy security for the first time, the study concludes by noting that both domestic constraints and systemic pressures interact in forming energy policy of the respective countries. This in turn contributes to the literature of the

neoclassical realist camp, since its usefulness in successfully analyzing the field of energy security is strongly evident.

Why this study matters?

This research is important for three main reasons, there has been a lack of research into the topic, it adopts an undertheorised International Relations theoretical perspective to energy security and it deals with urgent and topical issues.

In the Central European region there has been a lack of research into the domestic attitudes of governments towards their reliance on Russian energy with the notable exception being a policy brief by Ryan Miller⁸. The value of this research can be seen from the fact that during the elite interviewees many of those interviewed mourned the lack of research into this specific area and highlighted the need for research into the topic.

This thesis will also be a contribution to the literature on a foreign policy analysis of energy dependent importing states as theoretically there has been a lack of research from an International Relations theory perspective into energy security. While the vast amount of literature would indicate that there already exists a strong theoretical underpinning to the subject the opposite is in fact true. As Feliz Ciuta bemoans ”” Energy security has recieved remarkable little conceptual attention, despite an abundant literature in which various meanings of the term proliferate, together with a copious proxy terminology⁹”.

While some authors such as Yergin do adopt a geo-political perspective, these are merely descriptive and do not provide an inclination into what variables one needs to look at in

⁸ Miller, Ryan. *Central Europe's Energy Schism*. Rep. no. ISBN 978-0-9797433-4-4. July ed. Center for European Policy Analysis. Ser. 2009. Web.

⁹ Ciuta, Felix, ” Conceptual Notes on Energy Security: Total or Banal Security?”, *Security Dialogue*, 2010 41:123

order to analyse and to understand energy security in one's foreign policy. At a broader level we know little about the behavior of energy dependent importing states worldwide especially the way domestic conditions and elite perceptions affect their responses to their energy dependency. The analytical framework presented here could be of benefit when applied to other cases within this understudied group of countries. According to Cesnakas the lack of theoretical background in energy security issues has 'created a position where, in most case, the descriptive analysis totally dominates the discussion of the role that energy resources play in foreign policy'¹⁰.

In addition my research is a topical one. Energy security is changing everyday and as of writing big decisions related to Central European energy security are forthcoming. Firstly the decision on the EU backed Nabucco pipeline is expected later this year. The pipeliness projected cost now stands at 14 billion euros and continues to compete with other major gas infrastructure projects such as the South Stream project. While sources of gas and sources of funding have all been major obstacles the divergent responses among Central European states has also been a factor.

Domestically in Hungary and Czech Republic major issues related to the country's energy security are expected very soon. In the Czech Republic a decision on which company to grant the 18 billion Temelin contract to is expected next year and will have major ramifications for the country's energy security. Similarly Hungary is expected to make a major decision in building nuclear reactors later this year. Just lastt month on May 24th the cash strapped Hungary government spent 1.88 billion euro's buying out a 21% share from Russian company Surgut in Hungarian energy company MOL. Such a decision was met with large scale surprise due to the huge amounts of money involved however this thesis aims to provide an aid to an understanding of the dynamics behind such decisions.

¹⁰ Cesnakas, Giedrius. "Energy Resources in Foreign Policy: A Theoretical Approach." *Baltic Journal of Law and Politics* 3.1 (2010): 31. Web. 12 Apr. 2011. <<http://http://cejsh.icm.edu.pl/cejsh/cgi-bin/getdoc.cgi?10LTAAAA086123>>

Chapter 1— Literature Review

Overall there has been a lack of in depth research into the different responses of Central European states to their dependency on Russia gas with much of the literature being policy papers with little academic rigor . These policy papers tend to be written by think tank experts and concentrate on how Central European countries should pursue their interests in energy at the EU level. In addition few studies do a cross country analysis and aim to gauge the diversity of responses that have occurred among the Central European countries. In her book current Hungarian ambassador at large for energy security Anita Orban focuses on why Russia through their energy companies succeeded in moving into Central Europe at certain times but not

others¹¹. However the book while providing an excellent critique of Russian foreign policy does not deal with Central European responses. It focuses only on Russian downstream purchases of Polish, Slovak and Hungarian energy companies. In addition the Czech Republic is not part of the analysis.

The one real exception that has gauged the diversity of responses is Ryan Miller's brief targeted towards the American government¹². In his analysis he identifies 4 reasons why what he refers to as "Central Europe's energy schism" looks the way it does, (1) Russia's policies, (2) EU approach and (3) Regional unity and (4) understanding of the concept of energy security.¹³

The first factor Miller identifies is Russian policy itself. Here the author discusses how the Kremlin offers "sweeteners" to certain countries that they will become an energy hub for Russian gas or an important transit route for proposed pipelines¹⁴. This can be clearly demonstrated in the Kremlin's divide and rule tactics aimed to switch the allegiance of certain countries away from Nabucco towards the Russian backed South Stream pipeline. As Stephan Black notes 'It is typical Russian diplomacy that it promises virtually everyone that if it joins with Russia's plans it will become a hub or major player and rack up hefty revenues from energy trade¹⁵.

Related to this debate are Russia's goals towards the Central European region and its use of energy in its foreign policy. In the later Russia which suffered very badly economically in the late 90s has, buoyed by high energy prices, has experienced an economic resurgence leading to a much more assertive foreign policy in the post Soviet space where Russia has not hesitated to use these countries high reliance of Russian energy as a tool to achieve their foreign policy goals.

¹¹ Orban; op cit

¹² Andrej Nosko a CEU PHD candidate is currently focusing on the topic of how Hungary, Czech Republic and Slovakia coped with their energy dependence in the 1990s. When completed his research will be an important contribution to an underdeveloped field.

¹³ Miller, Ryan. *Central Europe's Energy Schism*. Rep. no. ISBN 978-0-9797433-4-4. July ed. N.p.: Center for European Policy Analysis, n.d. Ser. 2008.

¹⁴ Miller, op cit, 37

¹⁵ Black, op cit, 13

There are two opposing views on whether there is a specific Russian foreign policy towards the region. The first view – one that is held by the majority of academia and foreign policy establishment – is that there is no strategic approach towards Central Europe. The opposing view counters that Russia has a well formulated strategic vision for the region and in the words of main proponent Janusz Bugajski is adopting a policy of new imperialism¹⁶. In his analysis Bugajski summarizes in six points Russia's strategy towards the Central European region, to achieve preeminence over foreign policy orientation and security policy, increasing economic benefits and monopolistic competition, to limit the scope of Western Institutional enlargement in the European CIS, to rebuild a larger sphere of influence, to weaken transatlantic relations and most notable for this research to increase Central European dependence on Russia energy supplies¹⁷. Stephan Black of the US strategic Institute adopts a similar view, for the author Russia's goals are

“to use the energy weapon as to rebuild Russia economically and militarily while also using it to hollow out European membership in NATO and EU so that they are a shell and these organizations are incapable of extending security managing it beyond these present frontiers while Russia has a free hand in its own self appointed sphere of influence can leverage developments throughout Europe and with the US”¹⁸.

Vladimir Putin since coming to power has sought to rebuild Moscow's lost empire, first and foremost by controlling energy resources¹⁹. In his analysis on Russia's use of energy as a “weapon” in the Post Soviet Space Bertil Nygren concluded that “there are ample grounds for suspecting that state controlled energy companies are being used as proxy agents of foreign policy to punish or reward CIS neighbors. Russia's 2003 energy strategy states that ‘Russia

¹⁶ Bugajski, James. "Cold Peace: Russia's New Imperialism (9780275983628): Praeger 2004

¹⁷ Bugajski, op cit,

¹⁸ Black, Stephan. "Russia's Energy Weapon and European Security." Paper Presented at the NATO One Year after Georgia: National Perspectives Conference, Washington DC., 8 Oct. 2009. Web.

¹⁹ Nygren, Bertil. "Putin's Use of Natural Gas to Reintegrate the CIS Region." *Problems of Post Communism* 55.4 (2008): <http://mesharpe.metapress.com/media/7pab6jyvv13ynxxtwc2l/contributions/j/8/2/5/j8252t663188147n.pdf>

possesses great energy resources, which is the basis of economic development and the instrument for carrying out internal and external policy²⁰". While on February 4th 2009 Russian Prime Minister Vladimir Putin stated that "the role of the country on the International energy markets determines in many ways its geopolitical influence"²¹. Such assumptions are backed up by the state's 51% ownership of Gazprom, strong ties between Gazprom and Kremlin elites and by Vladimir Putin's PHD thesis in which he advocates that the state should use its energy resources to advance Russia's foreign policy goals.

With history, political statements and national strategy confirming that Russia has used energy to advance its foreign policy goals the most worryingly for Central European leaders is that Russia's use of energy as a foreign policy tool is not restricted to its "near abroad" where in the words of current President Dimitri Medvedev it has certain "privileged zones of interests". In a study on Russia's use of energy as a foreign policy tool Robert Larsson recorded that Russia had used energy 35 times from the period 1991-2007 to advance foreign policy goals²². The report also added that "NATO and EU membership is clearly not a barrier"²³. In the summer of 2008 just days after Prague signed a Russia opposed treaty on placing a US missile defense system in Central Europe oil supplies along the Druzba pipeline to Czech Republic were cut by half with Russia offering a dubious explanation that they were cut for "technical reasons"²⁴. Indeed a number of incidents listed in the writings of Anita Orban, Janusz Bagajski, Robert

²⁰ 2003 Russian national energy strategy cited in Kupchinsky, Roman. "Energy and Russia's National Security Strategy." *The Progressive Realist*. 19 May 2009.

²¹ 2003 Russian national energy strategy cited in Kupchinsky, Roman. "Energy and Russia's National Security Strategy." *The Progressive Realist*. 19 May 2009.

²² Larsson, Robert. "Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier - Swedish Defence Research Agency." *FOI:s Startida - FOI, Totalförsvarets Forskningsinstitut*. Swedish Ministry of Defense, 2006. Web. 31 May 2011. <http://www.foi.se/FOI/templates/Page_____4889.aspx>.

²³ Larsson, op cit

²⁴ "Russian Oil Supplies to Czech Republic Cut after Missile Defence Deal with US." *The Telegraph* 14 July 2008. Print. <http://www.telegraph.co.uk/news/worldnews/europe/russia/2403798/Russian-oil-supplies-to-Czech-Republic-cut-after-missile-defence-deal-with-US.html>

Larsson, Robert Black and Keith Smith indicate that we are seeing a coordinated action beyond the post Soviet space²⁵.

While it is true that the Kremlin does use energy as a tool in its foreign policy and does seek to deal with countries on a bi-lateral basis rather than deal with the EU as a whole, Miller's analysis does not explain why Russia has been more successful with certain countries than others. It takes two to tango; while Russia's preferential policies of dealing with countries on a bi-lateral basis have been rather consistent, the responses of Central European countries to Russia's advances have varied across time and place thus in order to understand the reactions of Hungary and the Czech Republic we need to look inside the state.

The second factor is the EU's approach where the author states that "the lack of any common EU energy policy contributes to a schism-prone environment"²⁶. He also likens the situation in Europe with regards to energy security as a Prisoners dilemma in which rather than co-operate together states prefer to lock in their own supplies. The strong national interests of member states undermine the collective of the EU as a whole. The actions of several of the large members in Europe exacerbate the problem as the policies of the large member states such as Germany, France, Britain and Italy revolve around the interests of their natural oil and gas companies rather than what is maybe best for the EU as a whole.

In his analysis Rawi Abedal asks why a handful of French, German and Italian corporations have somehow taken responsibility for formulating the energy policy and thus the

²⁵ Smith, Keith. "Amazon.com: Russian Energy Politics in the Baltics, Poland, and Ukraine: A New Stealth Imperialism (CSIS Report) (9780892064564): Keith C. Smith: Books." 28 April 2011.

Orbán, Anita. *Power, Energy, and the New Russian Imperialism*. Westport, CT: Praeger Security International, 2008.

Larsson, Robert. "Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier - Swedish Defence Research Agency." *FOI:s Startida - FOI, Totalförsvarets Forskningsinstitut*. Swedish Ministry of Defense, 2006. Web. 31 May 2011. <http://www.foi.se/FOI/templates/Page_4889.aspx>

Bugajski, James. "Amazon.com: Cold Peace: Russia's New Imperialism (9780275983628): Janusz Bugajski: Books." Web. 31 March 2011

Black, Stephan. Op cit

²⁶ Miller, op cit, 38

Russian strategy for essentially all of Europe²⁷. Germany's privileged relationship based on large scale energy deals has gained the most spotlight and is based on the German vision that Russia is not only a threat but is rather becoming increasingly dependent on Europe creating a relationship of interdependence. Within the EU-Russia gas debate authors such as Pierre Noel and Andrew Monaghan are very skeptical about the idea of Russia "blackmailing" the EU and instead see the relationship as one of interdependence with Monaghan viewing that if anything Russia is the more dependent party²⁸.

Highlighting the divergent attitude among EU member states towards Russia Konstantin Simonov of the Independent National Energy Fund in Moscow points out

"we have three different "Europes" inside Europe, these are Brussels and the Euro-bureaucracy; post-Soviet countries and former satellites of Europe and the so called old Europe led by France, Germany and Italy. With Brussels and this so called New Europe Russia has very difficult relations because of our history and view of the Euro – bureaucracy but our relations and energy relations with Old Europe are usually very, very good and even after the gas war with Ukraine there was no real change in relations²⁹"

The statistics, as highlighted in Figure 1 below, show the two Europe's in energy and just how dependent the region is on Russian gas with the Central European states having an average of 83% of their share of Russian gas imports. Within the EU 27 as a whole the average is much lower and currently stands at 32%.³⁰ Such high dependence, as shown in Figure 1, is a result of the Soviet legacy when Central Europe as part of the communist bloc was connected to the Eastern gas network.

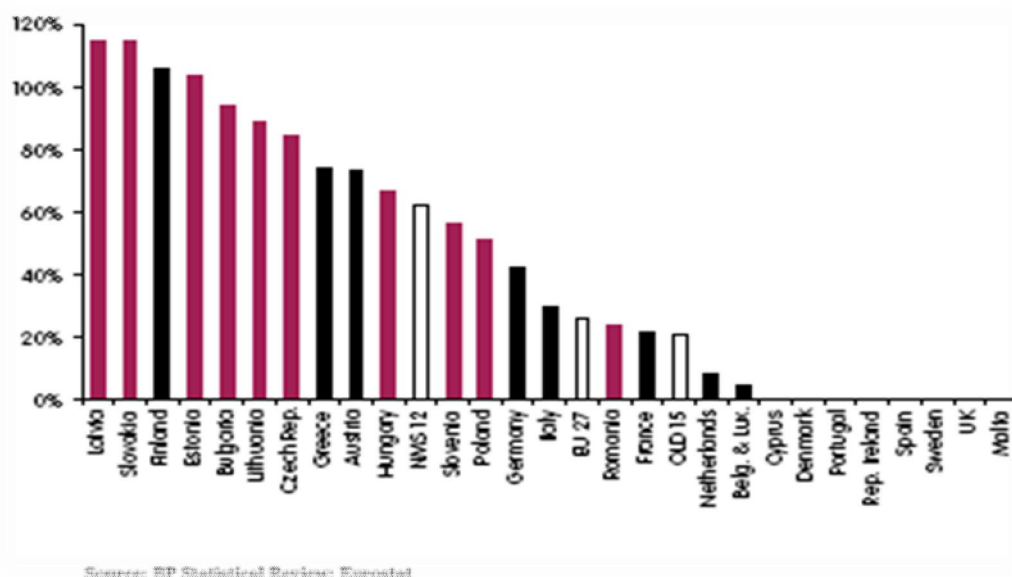
Figure 1 - EU 27 % imports of Russian gas

²⁷ Abdelal, Rawi, "The Profits of Power: Commerce and Realpolitik in Euroasia", March 6th 2011, Working Paper 11-028

²⁸ Monaghan, Andrew, Russia and Security of Europe's Energy Supplies: Supplies Security in Diversity? Defense Academy of the United Kingdom, Conflict Studies Research Centre, Special Series 07/01, January 2007

²⁹ Comments by Konstantin Simonov, cited in Black, Stephan. "Russia's Energy Weapon and European Security." Paper Presented at the NATO One Year after Georgia: National Perspectives Conference, Washington DC,, 8 Oct. 2009. Web. ; 28

³⁰ Eurostat. Consumption figures refer to gross inland consumption.



While it is true that states are very reluctant to give such a strategic competence to the EU, the situation of both countries as part of a weak EU energy policy is the same for both. Through elite interviews it was established that policymakers in both countries see the EU in the same light, they both see a stronger EU as desirable while remaining skeptical about whether it will come about. As Andras Deak, a Hungarian energy analyst with a very pro-EU attitude states “We do not expect very much from the EU, we are alone as far as diversification is concerned, what we have in the EU is that the EU contribution is positive but a very weak one for now, we cannot wait for the EU energy policy”³¹. In addition these countries have only been in the EU since 2004 while this study begins at transition, the different energy policy strategies have existed since the end of the 1990s thus the idea that the different policy strategies could be the result of different attitude to a common EU energy policy is an unsatisfactory one.

The third point the author identifies is that despite efforts to create unity within the Central European energy sphere these attempts have not panned out and regional co-operation remains low. When taking this factor into account it is important to consider that Miller’s brief

³¹ Deak, Andras, “Hungary and Energy Security in Central Europe” in Energy Security in Central and Eastern Europe, published by the Association of International Affairs, Prague 2008

was written in 2008, prior to the Ukraine-Russian gas crises of 2009. Since the gas crises regional interconnectivity has been prioritized as part of the EU's strategy of creating of a North-South energy corridor and the ending of energy islands in Europe by 2015. In seeking to find out why co-operation has been low between Central European member states he says (1) that it is the result of the different parties along the political spectrum with left and right wing parties having various different interpretations but also (2) the strong lobbying efforts of Russian companies in an effort to co-opt certain countries and to tempt them into certain energy deals ³². Balmaceda who analyzed the management of Ukraine's energy relations with Russia concluded corruption and the lack of transparency in the energy to be the central factor behind Ukraine's continued reliance on Russia energy and its inability to escape this dependence³³.

As confirmed by interviews I conducted strong lobbying and corruption while not the scale as exists in Ukraine certainly does exist in the energy industry in Central Europe. Indeed last year in the Czech Republic expelled two Russian diplomats including a defense attaché for spying in efforts to penetrate strategically key sectors of the Czech energy industry³⁴. However, trying to quantify corruption is beyond the scope of this paper and in either case Russia's lobbies equally hard in both countries for its interests to be met. The lack of region unity is again the result of domestic politics with parties on the left and right in each country finding it more difficult to co-operate. Rather than push hard on regional unity left wing parties have tended to seek stronger bi-lateral relations with Russia.

The fourth and final factor Miller identifies is the difference in how elites in Central Europe understand the vague term "energy security". In discussing the different understanding

³² Miller, op cit 38

³³ Balmaceda, Margarita Mercedes. *Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's Power, Oligarchs' Profits and Ukraine's Missing Energy Policy, 1995-2006*. London: Routledge, 2008

³⁴ "Why The Russia Spy Story Really Matters - Radio Free Europe / Radio Liberty © 2011." *Radio Free Europe / Radio Liberty - Free Media in Unfree Societies*. 9 July 2010.

<http://www.rferl.org/content/Why_The_Russia_Spy_Story_Really_Matters/2095515.html

Bilevsky, Dan. "Russian Spy Tale Rattles Czechs." *The New York Times Global Edition* 23 Dec. 2010.

Print.<http://www.nytimes.com/2010/12/24/world/europe/24iht-spies24.html>

of energy security he highlights how for certain countries stable prices in the short term is enough, instead not having enough Russian gas is seen as the real fear. In looking for an answer to the question of what is energy security it is important to take into account that there is no uniform definition of a concept that encompasses the interests of producers, consumers, exporters, importers and transit states alike. While Daniel Yergin offers the simple often quoted definition of energy security as “ simply the availability of sufficient supplies at affordable prices³⁵”, the term energy security remains very vague and contested concept³⁶.

Traditionally energy security for consumers has focused on diversification which is seen as a precondition for the availability of energy at more or less stable prices. In 1913 Winston Churchill stated that “ safety and certainty in oil [...] lie in variety and variety alone³⁷”.

.Diversification in the energy sector has three dimensions

1. Diversification of energy resources which means a variety in a countries energy mix between oil, gas, coal and renewable energy sources
2. The geographical diversification of energy supplies, which takes into account that gas via pipeline often travels a far distance from source country
3. Diversification of transport routes, which is linked to alternative pipeline routes

Yet energy security is far more than just diversification and in the literature we can see that for some energy security is tightly linked to questions of national sovereignty, while for others it is not. In their rather hawkish analysis Luft and Korin break these two perceptions of the energy

³⁵ Yergin, Daniel. "Ensuring Energy Security." *Foreign Affairs*, Mar.-Apr. 2006. Web. 01 Feb. 2011. <<http://www.foreignaffairs.com/articles/61510/daniel-yergin/ensuring-energy-security>>, pg 69

³⁶ Ciuta, op cit; Yergin, op cit; Deese, David A., and Joseph S. Nye. *Energy and Security*. Cambridge, MA: Ballinger Pub., 1981; Kalicki, Jan H., and David L. Goldwyn. *Energy and Security: toward a New Foreign Policy Strategy*. Washington, D.C.: Woodrow Wilson Center, 2005; Baran, Zeyno. "EU Energy Security: Time to End Russian Leverage." *Washington Quarterly* 30.4 (2007): 131-44; Cohen, Gail, Frederick Joutz, and Prakash Loungani. "Measuring Energy Security: Trends in the Diversification of Oil and Natural Gas Supplies." *IMF Working Paper* Feb (2011) Le Coq, Chloé, and Elena Paltseva. "Measuring the Security of External Energy Supply in the European Union☆." *Energy Policy* 37.11 (2009): 4474-481

³⁷ Churchill Winston cited in Yergin, Daniel

security debate down into two broad categories of “realists” and “idealists”³⁸. For realists energy is seen as a subset of global politics and energy commodities have a strategic importance beyond their market price. As the authors note “while realists accept the role of collaboration and interdependencies as a way to enhance the collective energy security, they do insist on weighing these up against other material factors together with an understanding of history, culture and the economics of societies competing in the International system”³⁹. Realists see a role for the state in energy and see energy policy as part of the services of foreign policy and put importance in non markets mechanisms such as government intervention to secure energy resources and strategic stocks. In contrast idealists (or liberalists as they should be referred to) put faith in the power of markets and the idea of “interdependence”. They believe the government should only intervene in case of extreme shocks.

Within this overly dichotomized realist vs. idealist energy security debate tradeoffs are involved with realists arguing that in terms of rationality states are rationale in the sense they prioritize state security aspects while idealists focus more on economic rationality and pricing aspects. It is important to take into account that what is rational for each state is different dependent on *perceptions*. According to Cesnakas “rationalism related to energy resources is defined differently by every state, build on its own *perception* of its own energy security issues”⁴⁰. These different perceptions are very important to take into account when we discuss Czech Republic and Hungary. Here we will see that both states believe they are acting rationally but what is different is their own *perceptions* of what is rational in an energy security sense, some elites focus on economic rationality others security rationality. For Miller the differences in *perceptions* can be traced to historical and structural factors with those who have traditionally had very troubled relationships with Russia more inclined to see energy through a strategic lens. As part of

³⁸ Luft, Gal, and Anne Korin. *Energy Security Challenges for the 21st Century: a Reference Handbook*. Santa Barbara, CA: Praeger Security International, 2009.

³⁹ Luft and Korin, op cit:

⁴⁰ Cesnakas, op cit: pg 35

these different perceptions the author similarly notes how perceptions of energy security are not just different between countries but also between the main political parties in different countries⁴¹. As a general rule of thumb the more right wing the group the more pro –Atlanticist the political party is likely to be in its foreign policy and the more likely to be placed into the category which Miller terms “strategic players” vis-à-vis Russia as opposed to “commercial opportunists”⁴².

Miller successfully identifies four explanations why Central Europe’s energy schism continues to exist. However in each of the four reasons the underlying cause in these explanations is domestic politics of the individual member states which in turn determines how elites react to Russia’s advances, their attitudes to both the EU and the V4 in energy and their understanding of the vague term energy security. In addition Miller uses anecdotal evidence rather than empirics. While the section identifies domestic politics as the most likely cause the need to empirically test for this also arises. In order to do so a theory that acknowledges the strategic importance of energy security but also brings domestic politics and perceptions into the equation is needed.

⁴¹ Miller, op cit, 36

⁴² Miller, Ibid, 36

Chapter 2— Theoretical Framework

2.1. A realist approach to energy security

In the previous chapter I identified that there was a lack of theoretical underpinning into the subject and second that IR theory has not really tackled energy security. This section seeks to fill this gap and move away from a descriptive method of analysis by first identifying the realist framework as the most suitable one to an analysis of energy security and secondly through applying a neo-classical realist framework to foreign policy analysis.⁴³

In general International relations theory is lacking in its analysis of energy security issues. The lack of theoretical analysis can be best accounted for because until recently energy security has not been analyzed as part of IR theory. Instead traditionally IR has focused on military security hard power elements.. For realists power traditionally means military power although in his list of factors that encompass power, Realist Hans Morgenthau does include “national resources” into his analysis⁴⁴. However more recently the concept of power has expanded to include elements that do not belong to this traditional sphere. In today’s world this broader interpretation of what constitutes state power is important as a complete emphasis on military capabilities no longer reflect the realities of the current international environment. As a result energy resources are becoming an increasingly important part of what constitutes power which is the key variable defining the states place in the International system according to the realist theory of International Relations.

⁴³ By support a realist paradigm it rejects both a liberal/idealist paradigm and a political economy International Relations theoretical approach. Liberalism’s weakness is that it downplays the importance of energy resources, and offers an oversimplified view that statesmen are economically rational actors when making decisions on energy resources while a political economy approach is unsuitable for such a strategically important commodity

⁴⁴ Morgenthau, Hans J., Kenneth W. Thompson, and W. David. Clinton. *Politics among Nations: the Struggle for Power and Peace*. Boston: McGraw-Hill Higher Education, 2006. Print

Realism is not one theory but a family of theories incorporating classical realism, neo-realism, offensive realism, defensive realism and neo-classical realism. In realism the idea of a material and objective reality exists. Among the theories three core assumptions are ever-present, (1) states are the primary actors in the International system: they are rational, unitary actors acting in anarchy (2) state preferences are fixed (3) it focuses on the international structure placing emphasizes on material power capabilities.

Realist approaches see the state as the main decision maker, emphasizing it above the level of domestic actors⁴⁵. In realism states are the main actors defining energy relations globally. In her analysis Brenda Schaffer claims that states served energy companies make up 85% of world oil and 80% of world natural gas reserves⁴⁶. This is situation exists in smaller consumer states such as Hungary and Czech Republic too as although privatization of national energy champions has occurred states still very much set the rules of the game. They define exploitation, taxation, privatization as well as environmental regulations. Also as will be shown in the following chapter states are willing to intervene as to prevent take over's of a strategic energy industry if they perceive the takeover to run counter to the national interest⁴⁷. In energy states remain self help actors acting under conditions of anarchy as there are no strong overarching global or regional institutions.

Neo-realism

In the anarchical system of International Relations each country is in a position of risk and uncertainty with each country trying to enhance its energy security⁴⁸. From a realist perspective with energy classified as part of hard power achieving and maintaining energy independence would be part of a state's desire to a state's desire to increase its power and maintain

⁴⁵ Waltz, Kenneth Neal. *Theory of International Politics*. Boston, MA: McGraw-Hill, 1979.

⁴⁶ Shaffer, Brenda. *Energy Politics*. Philadelphia: University of Pennsylvania, 2009. Cited in Luft and Korin

⁴⁷ See LEX Mol Regulation a regulation based by Budapest defending "strategic companies"

⁴⁸ Waltz, op cit

independence more generally as the primary aim of each state is survival⁴⁹. Neo-realism specifically Kenneth Waltz's balance of power theory, holds that the International system provides incentives for states to adopt strategies or risk elimination as entities⁵⁰. The core of neo-realism is the International System which creates incentives for all states to strive for greater efficiency in causing security for themselves. The theory puts structure at the forefront meaning that structural constraints are the primary drivers and not states own priorities. Neo realism assumes that states behave similarly in the structure as the primary motivation of every state is survival⁵¹. It would assume that Hungary and the Czech Republic would both act similarly in their energy dependency situation vis-à-vis Russia as both states are rational actors with very similar power capabilities and would seek to balance constantly vis-à-vis Russia. Thus explaining Czech and Hungarian energy policy strategy vis-à-vis Russia is beyond neo-realism.

The problem with Waltz's theory is that it only seeks to explain broad systemic outcomes and does not explain why and how states choose between different types of internal balancing strategies. As Jennifer Sterling-Folker noted "anarchy does not dictate how states should arrange their domestic processes to achieve that end. States are free to experiment, to emulate one another's practices, or to do nothing. Nonetheless, domestic processes act as the final arbiter for state survival within the anarchic environment"⁵². Explaining this would require a theory that integrates systemic and unit level variables. Neo-classical realism provides a fuller conception of the state by specifying how systemic imperatives will likely translate, through the medium of state power, into actual foreign and security policies. The next section applies a neo-classical realist framework to energy FPA analysis.

⁴⁹ Waltz, *ibid*

⁵⁰ Waltz, *ibid*

⁵¹ Waltz, *ibid*

⁵² Sterling-Folker, Jennifer. "Realist Environment, Liberal Process, and Domestic-Level Variables." *International Studies Quarterly* 41.1 (1997): 1-26, 19

2.2. A Neo-classical realism approach to energy FPA analysis

For neo-classical realists the basic parameters of a state's foreign policy are driven by their relative power capabilities. As noted in Rose "the scope and ambition of a country's foreign policy are driven first and foremost by its place in the International system and specifically by its relative power capabilities" he further adds however that "the impact of power capabilities on foreign policy is indirect and complex because systemic pressures must be translated through intervening variables at the unit level"⁵³. Neo-classical realism differs from neo – realism in that it includes domestic variables into the analysis. According to Colin Elman neo-classical realism suggests that "what states do depends on a large part on domestically derived preferences"⁵⁴. In the analysis 'different state motivations' are also included into analysis thus introducing elements of constructivism. This move away from realism's traditional material approach has been criticized for breaching the 2nd and 3rd level of the realist paradigm⁵⁵. Similarly Bradley Philips talks about "the role played by domestic state ideologies, institutions and shared elite level threat perceptions in explaining international behavior that deviate from neorealist expectations", he further adds that 'one can see more overt evidence of realists recourse to factors that were formerly the preserve of constructivists in developing their elements'⁵⁶.

In neo classical realism statesmen rather than states are the main decision makers. In neo-classical realism the state is referred to as "an organization, composed of numerous agencies led and coordinated by the states leadership that has the ability or authority to make and implement

⁵³ Rose, Gideon, "Neo-classical realism and theories of foreign policy", *World Politics* 51, No 1 (October 1998) 146

⁵⁴ Elman, Colin. Realism 11-20 In Griffiths, Martin. *International Relations Theory for the Twenty-first Century: an Introduction*. London: Routledge, 2007. Print

⁵⁵ Ibid

⁵⁶ Philips, Andrew Bradley, "Constructivism: 60-74 in Griffiths, Martin. *International Relations Theory for the Twenty-first Century: an Introduction*. London: Routledge, 2007. Print

the binding rules for all the people as the parameters of rule making for other social organizations in a given territory, using force if necessary to have its way⁵⁷”.

What matters for neoclassical realists are not just power capabilities but elite *perceptions* about power capabilities. Since individuals are making decisions about the relative power capabilities of states it is necessary to incorporate not only relative power capabilities but also the perception of leaders about relative power capabilities. Neo-realism’s balance of power theory may explain international political outcomes in the long run but in the short and medium term neo-classical realism is a much more suitable theory of analysis as it incorporates leader’s perceptions about International events and how they translate into concrete action⁵⁸. Farheed Zakaria and Thomas Christensen also discuss the importance of perceptual “shocks” meaning that decision makers become aware of “the cumulative effects of long term power trends⁵⁹”. For Hungary this shock came in the 2006 Ukraine-Russian gas crises.

In addition in neo-classical realism statesmen do not have direct freedom to locate their resources as they would desire thus the term “state power” becomes an independent variable. From this it follows that states with different domestic structures but similar relative power capabilities would act differently⁶⁰. As Zakaria notes “foreign policy is not made by a nation but by its government. Consequently, what matters is state power, not national power. State power is the portion of national power that the state can extract for its purposes and reflects the ease at which decision makers can achieve their ends⁶¹”. Consequently states with similar perceptions and relative power may react differently to changes in the International system depending on how much “state power” they can use in their energy policy strategy. Decision makers with high state power are able to react better to changes in the International environment than decision

⁵⁷ Zakaria, Fareed. *From Wealth to Power: the Unusual Origins of America's World Role*. Princeton, NJ: Princeton UP, 1999. Print. 35-36

⁵⁸ Orban, Anita: opt cit: 20

⁵⁹ Zakaria, Fareed. *From Wealth to Power: the Unusual Origins of America's World Role*. Princeton, NJ: Princeton UP, 1999: 9

⁶⁰ Orban, Anita: opt cit: 21

⁶¹ Zakaria, Fareed. *From Wealth to Power: the Unusual Origins of America's World Role*. Princeton, NJ: Princeton UP, 1999: 9

makers with low state power. As Orban notes “for neoclassical realists to explain a state’s foreign policy decision, perceptions are far from enough. It is equally important to incorporate “state power” which decision makers are able to use for their own purposes.⁶²”

In terms of introducing domestic factors into the analysis neo-classical realism allows for a quite simple approach taking into account domestic factors without the need to analyze domestic politics in any really great detail. As a result in addition to changes in perception, changes in a decision making group (change of political party following election) can be used to explain changes in the states interests in the international system and subsequently the state’s foreign policy outcome⁶³. The analysis of domestic factors is not very deep and not too deep to distort outcome. Just like in classical realism, domestic constrains are important factors as well.

To sum up, Neo-classical realism offers the best analysis for Czech Republic and Hungary as it concentrates on material power, underlines the importance of state domestic structure, as well as statesmen’s perception of the International System. What matters with regard to the Czech Republic’s and Hungary’s energy policy strategy is not so much its objective balance of power but rather the Czech and Hungarian leadership’s prevailing perceptions about the balance of power and the resources available to these state to achieve their goals. These aspects allow for a different explanation of the energy strategies in the foreign policy of states with the same relative level of power. It addition it allows for changes in perception and political decision making group when the relative level of power does not change.

2.3. The Central European Resource Extraction Model

In this following section I will present what I refer to as the “Central European resource extraction model” which integrates systemic and unit level variables to explain variation in types

⁶² Orban, Anita: opt cit: 21

⁶³ CesnakasL opt cit

of internal balancing strategies that states will pursue. The model is inspired by J.W Taliaferro's resource extraction model but has been adapted to the situation of energy in Central Europe⁶⁴. Following Taliaferro, it incorporates both neo-realism insights on the constraints of anarchy and the relative distribution of power, while building on the analytical import of classical realism's complex state-society relations.

- *Balancing strategies*

In his model Taliaferro outlines possible internal balancing strategies that states may pursue. According to Taliaferro's when faced with an external threat, a state has a choice of two categories of balancing strategies (1) to continue with the existing political military strategies and technological practices (2) to engage in emulation or innovation. Continuing with existing practices would mean that states by and large continue with the same policies that they inherited from their predecessors. Emulation or innovation is a strategy of change voluntarily undertaken by a state in response to its strategic environment in which they seek to copy the successful practices of the dominant state in the International system. Of the two innovations is far more costly and time consuming.

Applying these possible balancing strategies to the energy policy strategies in the Czech Republic and Hungary the continuation of existing strategies can be seen as continuing with the status quo. This would mean that no efforts would be made to reduce their dependence on Russian energy. Emulation can be seen as diversification of gas supplies while innovation can be seen as active pursuit of energy security in newer ways.

In this model, officials make their policy choices based on their perceptions and calculations of the other's relative power intentions. The result of this is that in the short and medium term different states policies may not be predictable. In addition, states have varying amounts of state

⁶⁴ Taliaferro, J W chapter 7 in Lobell, Steven E., Norrin M. Ripsman, and Jeffrey W. Taliaferro. *Neoclassical Realism, the State, and Foreign Policy*. Cambridge, UK: Cambridge UP, 2009

power, defined as the extractive capability of the government in power in relation to its domestic constraints. As Taliaferro notes “even if states make “accurate” estimates of relative power and power trends they do not always have complete access to the material resources of their own societies⁶⁵”. Indeed this is especially true in liberal democracies where the average citizen lacks the time and expertise to understand concepts such as the balance of power. Similarly, the average citizen tends to discount geographically distant and indirect threats more than foreign policy elites do. As Taliaferro expounds, “citizens have an added incentive to free ride on the efforts of other when called upon to make sacrifices for national security”⁶⁶.

Energy policy of both countries is treated as the dependent variable. In neo-classical realism the international system is one possible independent variable. This is the result of geographic proximity, the offense-defense balance in military technology and the function of the relative power distribution between the Czech Republic/Hungary and Russia. For the Czech Republic and Hungary this variable is the same and thus cannot be a cause for the variation between the two strategies. Geographically both states are located in Central Europe, similar distance away from Russia, the offense – defense balance is very similar with both states being members of NATO and having similar military budgets while the distribution of power taken in its most simple sense of the size of the population figures is the same for both. It is thus clear that the international system cannot explain the dissonance between the cases of energy policy and thus will not be counted as a variable.

The second independent variable is the left-right ideological orientation of the political party in power. This can be seen from Figure 3 below.

Figure 2: Simplified chart of governmental changes from 1990 until 2011

⁶⁵ Lobell, Ripsman, and Taliaferro, op cit 213

⁶⁶ Lobell, Ripsman, and Taliaferro, op cit 218

CZ		ODS							CSSD							1.)	ODS		2.)	ODS		
HU	MDF				MSZP				FIDESZ				MSZP				FIDESZ					
Year	1990	'91	'92	'93	'94	'95	'96	'97	'98	'99	2000	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11

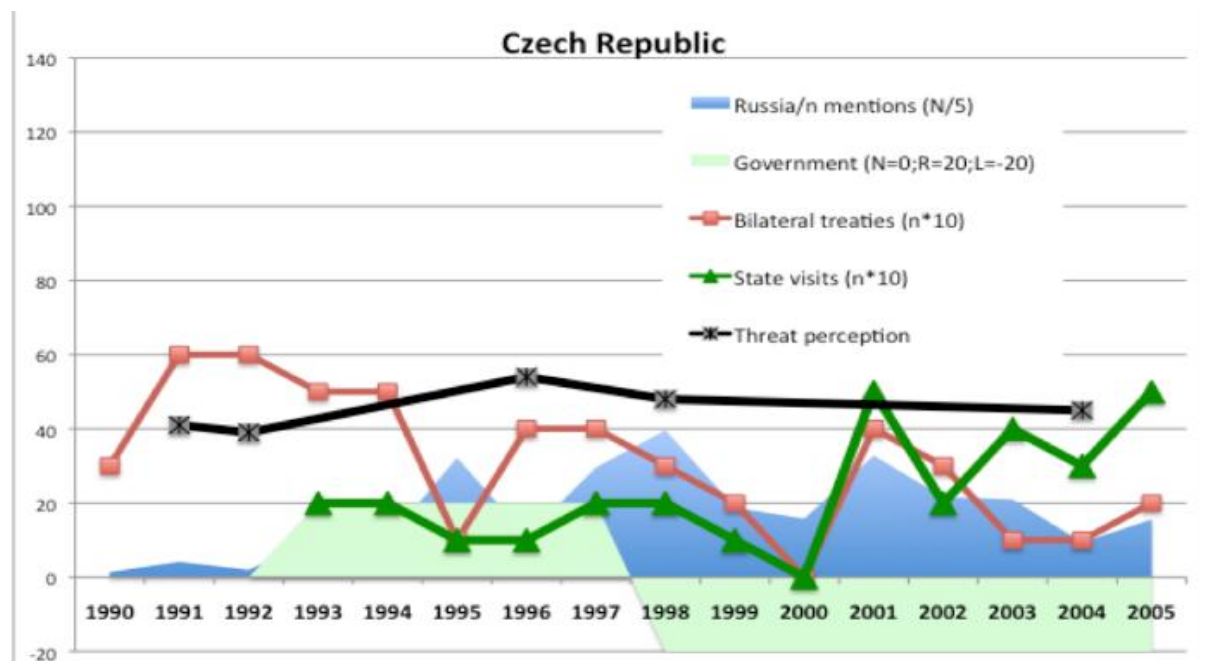
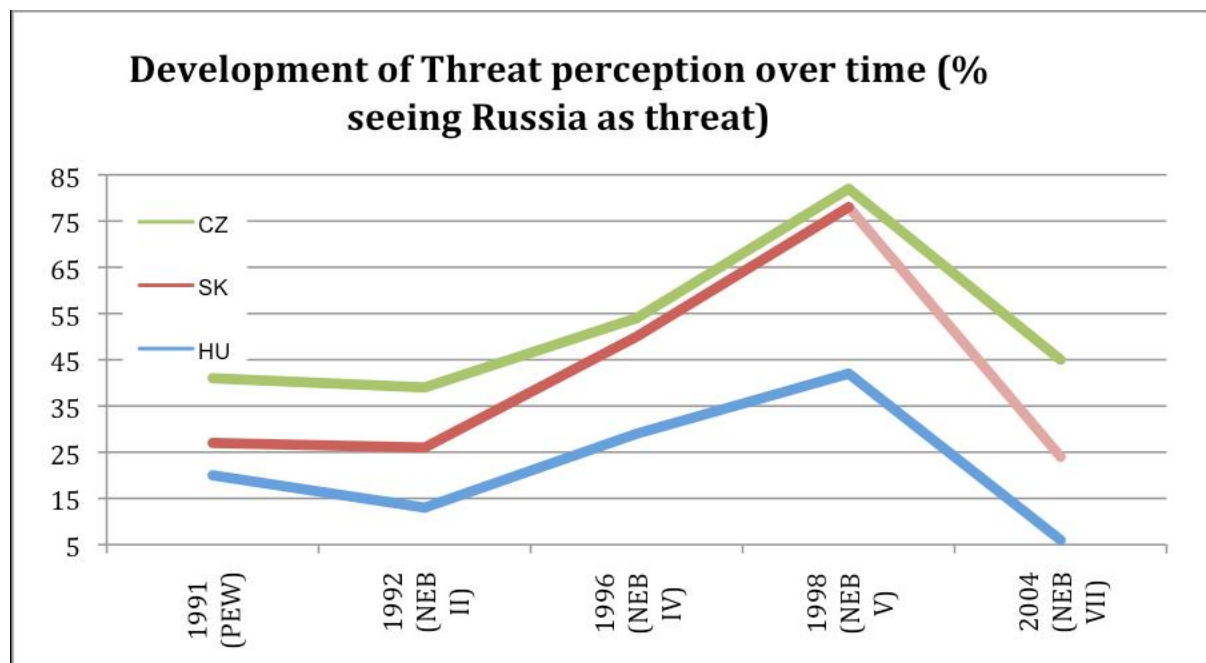
Remarks:

- 1.) A government was formed only 10 months after the elections in 2006.
- 2.) After a non-confidence vote the ODS-government under Mirek Topolánek came to fall and a provisional government under Jan Fischer was established until the new elections in May 2010.

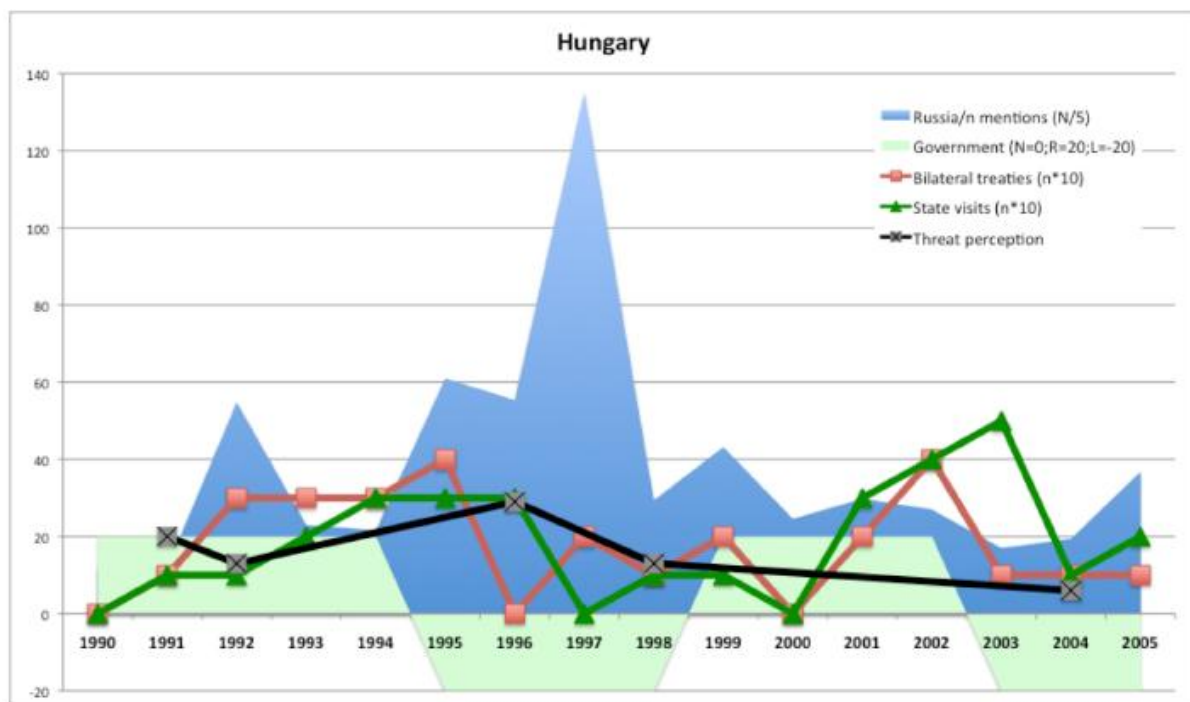
However, the research conducted shows that an intervening variable, perceptions of foreign policy executives distort the correlation of the dependent and independent variables. Thus, for the two countries involved, the threat perception of Russia becomes this intervening variable. Parliamentary transcripts, official state visits by foreign leaders and bilateral treaties provide a wealth of information as a way of measuring this variable. This paper utilizes prior research done by Andrej Nosko in the field⁶⁷. In paper presentation Nosko compared Czech and Hungarian threat perception of Russia as a threat and an ally in Czech Republic, Hungary and Slovakia among both the general population and also at elite level. In his research Nosko used available comparable longitudinal data of frequency of mentions of word formations “Russia/n” in combination with the number of state visits, the number of bilateral agreements concluded in the period of the time under study and through parliamentary transcripts. In his analysis he found a significant difference between Czech Republic and Hungary in their popular threat perception. He concluded that there was a relatively higher perception of Russia as a threat in the Czech Republic than in Hungary. Figure 3 below shows the higher level of threat perception in the Czech Republic than Hungary and the development of this threat perception over time. Figure 4 represents the elite level in Czech Republic while Figure 5 represents the elite level in Hungary.

⁶⁷ Authors permission from author Andrej Nosko Presentation at 5th annual Doctoral Conference 6. April 2010 Budapest "Effects of threat perception on energy security policy choices" (Chapter draft)

Figure 3: perceptions of Russia as a threat amongst the general population⁶⁸.



⁶⁸ Nosko, Andrej, Presentation at 5th annual Doctoral Conference 6. April 2010 Budapest "Effects of threat perception on energy security policy choices" (Chapter draft)



In addition he also discovered a correlation between the ideology of the government in power and the intensity of relations with Russia with centre left governments having more intense power relations with Russia. Based on Nosko's analysis and also the writings of Czech Russia expert Petr Kratochvil and Hungarian-Russian expert Laszlo Poti we can see that the period under study Central- European perceptions of Russia can be loosely divided in three different periods. The first period from transition to NATO accession perceptions were dominant in the region that Russia represented a threat⁶⁹. From the post accession period Russia came to be seen less as a threat and more as a strategic partner. A more reassertive Russian foreign policy began in 2005 in which Russia subsequently came to be viewed as a threat again.⁷⁰

⁶⁹ Kratochvil, Petr, "Political Relations between the Czech Republic and Russia: or there and Back again", Paper Presented at ICEG Conference, Budapest February 5-6 2004

KUCHYŇKOVÁ, Petra. "Between the Return to Europe and the Eastern Enticement: Czech Relations to Russia." *EU-Russian Relations and the Eastern Partnership. Central-East European*. By Petr KRATOCHVÍL. Budapest: Institute for World Economics of the Hungarian Academy of Sciences, 2009. 61-85. Print.

Poti, Laszlo. "Hungarian Foreign Policy and ENP in the East: Energy- (and) Nationality-based Policy", *International Issues & Slovak Foreign Policy Affairs Vol XV.3-4* (2006): 64-75. Print.

⁷⁰ Within these broad categories differences have existed. From 1997 to 1999 perception of Russia as a threat were not as high as the previous 6 years as NATO accession became clear. The highpoint between 2005 and the present was the 2008 war in Georgia

A conditional variable is state power. This will be defined as “the relative ability of the state to extract or mobilize resources as determined by the institutions of the state” and this will be operationalised by assessing whether the government can make the people agree or force them to be willing to spend the funds necessary for energy security. The degree to which state-society relations proves to be a hindrance towards a desirable energy depends on the domestic mobilization hurdles they face.⁷¹ As Taliaferro notes “leaders often encounter difficulties convincing the public to make significant sacrifices for national security, even if such efforts are in the public’s own long term interests”⁷².

In his analysis Taliaferro provides a “resource extraction model” of the state in which he outlines four predictions based on his model. He himself however does not test the model, instead encourages other to apply his model. In the next section I will seek to test an altered version of Taliaferro’s model to the situation in Central Europe.⁷³

Predictions based on this model

1. States that perceive Russia to be a threat and enjoy high state power will implement diversification with relative ease.
2. States that perceive Russia to be hostile but have low state power will constantly strive to implement energy diversification.
3. States which perceive Russia to be a lesser threat and enjoys high state power will seek to ensure further security through innovative diversification.
4. States, which perceive Russia as a lesser threat and have a low state power, will cling on to its status quo energy strategy.

⁷¹ Lobell, Ripsman, and Taliaferro, *opt cit* 218

⁷² Lobell, Ripsman, and Taliaferro, *opt cit* 218

⁷³ Lobell, Steven E., Norrin M. Ripsman, and Jeffrey W. Taliaferro. *Neoclassical Realism, the State, and Foreign Policy*. Cambridge, UK: Cambridge UP, 2009, 199

Figure 6 below builds on Taliaferro's resource model by reflecting on the cases of Czech Republic and Hungary.

Predictions based on my hypothesis

Figure 6- Predictions about Czech Energy Policy Strategy 1990-Present

	Czech Elite's threat perception of Russia	State Power	Predictions on energy policy strategy
1990 – 1992	X	X	X
1992-1998	High	High	Diversification
1998 - 2006	Low	Low	Status Quo
2006-Present	High	Low	Actively search for diversification opportunities

Figure 7 - Predictions about Hungarian Energy Policy Strategy: 1990 - Present

	Hungarian Elite's perception about Russia	State Power	Predictions on energy policy strategy
1990 – 1994	High	Medium	Diversification
1994- 1998	Low	Medium	Status Quo
1998 – 2002	High	Low	Actively search for diversification opportunities
2002- 2006	Low	Low	Status Quo
2006-2010	Low	High	Innovative energy policy strategy
2010-Present	High	High	Diversification will occur

Chapter 3— Testing the model

3.1 Research methods strategy

By combining theory with practice I this chapter will gain a fuller understanding of why the strategies differ. I propose to see if the data is in accordance with my predicted hypothesis as outlined in section 2.3. The predictions deriving from neo-classical realism are clear and in the findings section will answer whether the predictions come true. If the predicted results do occur then neo-classical realism will have been proven an accurate theoretical framework. In order to analyze Czech and Hungarian energy policy I collected data on their main energy policy deals. These mostly involve major moves to diversify sources but also protection of strategic energy industries. A deeper analysis of the main newspaper reports, energy policy strategies, statements by politician and elite interviews will provide a deeper understanding of the motivations behind the deal. By triangulating these sources I will get a range of perspectives allowing me to gain a “thick description” of what I am looking at.

Elite interviews were advantages in that they dealt with the sensitive and often discreet nature surrounding many of the motives for diversification and also allowed me to gain an insight into issues that were difficult to locate in newspaper sources or academic literature. In addition the interviews allowed me to cross check my findings from my document research and triangulate the information with my theoretical approach and data analysis. The open nature of the discussions allowed me to pursue avenues of thought making myself more receptive to alternative explanations that I have not previously considered. By analyzing the explanations provided by the interviewees I was able to cross check if my chosen theoretical approaches was too narrow leaving out important variables, thankfully it was not.

Drawbacks of my approach are that think tanks in Central and Eastern Europe tend to have a right wing bias and in general there is a lack of strong and credible left wing think tanks.

In order to compensate for this the author focused mostly on academics from research Institutes. In addition there was a general lack of experts who really know about energy security, as a result only those interviews with real experts have been incorporated. One drawback in using Nosko's data to analyse perceptions is that his analysis finishes in 2005 while my research continues until the present. However the data is very useful in establishing a pattern between domestic governments and perceptions and although no data is available to analyze the period 2005-present such judging by the different actions of the political parties and the writings of Potl and Kratochvil such patterns continue in a similar format up to the present day⁷⁴.

3.2. Stages and Comparison between Czech Republic and Hungary

3.2.1. Stage 1: 1990-1998

In 1992 following the Velvet divorce the Czech state came into existence. From 1992-1998 a right wing coalition led by Vaclav Klaus was in power. During the period 1992-1998 the Czech Republic was aware of the threat Russia opposed and was able to mobilize its state power to balance accordingly⁷⁵. In the oil realm in 1996 a decision was adopted to build a connection to Germany in a move that would reduce its dependence on Russian oil.

Most significantly in gas a major step in the diversification of gas supply was taken in 1997 when the then state owned Transgas concluded negotiations with Norway and secured a long term contract for the deliveries of 53 bcm of gas for a period of 20 years. The diversification did not come cheap; the public had to pay for it. Speaking back in 1995 when the cabinet made the decision then Czech premier Vaclav Klaus acknowledged that the imports would mean 10-15% higher prices but still he remained determined⁷⁶. The goal of the state

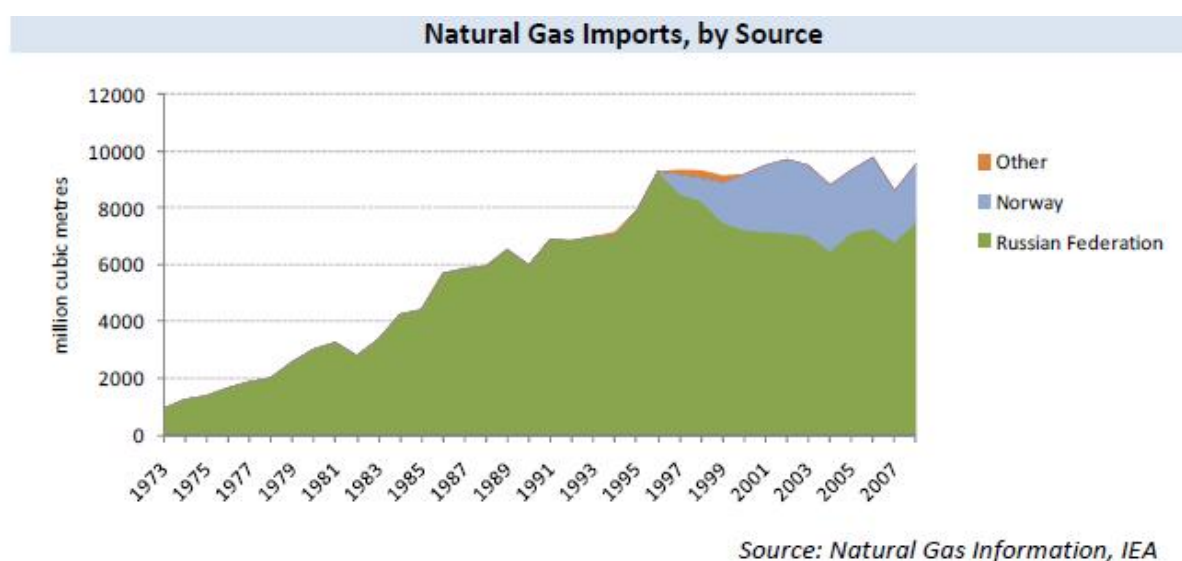
⁷⁴ Kratochvil, op cit; Potl, op cit;

⁷⁵ High perception of Russia as a threat during the 1990s was also confirmed in my Interviews with Andrej Nosko, Petr Lang and Jakub Jaros

⁷⁶ "Gas Monopoly Hoping To End Reliance On Russia." *Prague Post* [Prague] 26 Apr. 1995. Print

owned Transgas at the time was to reduce the amount of gas imported from Russia to roughly 10 billion and to extend the network so it could import from other countries. The cost of extending the Transgas network was one the taxpayers had to pay but one Klaus was willing to make to ensure security “ It is necessary to realize that the price for diversification is not zero”⁷⁷. The result of this, as shown in figure 6 below, was that during period 1997-2002 the Czech Republic increased its share of import of Norwegian gas from 9.7 to 27%⁷⁸.

Figure 8 – Czech Natural Gas Imports, by Source⁷⁹



In the 1995 an important decision was also made to upgrade the original Soviet designed Temelin nuclear power plant with American technology from the Westinghouse Company⁸⁰. The plant was completed in 2002 and today together with Dukovany accounts for one third of Czech energy production. The right wing government also was determined to maintain control of the strategic gas company Transgas and during the period shut the valve on any hopes of the Czech Republic becoming a private company in the near future. Speaking in 1995 then Prime Minister Vaclav Klaus said “ The state will stay in control of Transgas” rejecting plans by them Ministry

⁷⁷ "Gas Monopoly Hoping To End Reliance On Russia." *Prague Post* [Prague] 26 Apr. 1995. Print

⁷⁸ Lang and Nosko, opt cit, 6

⁷⁹ *Energy Policies of IEA Countries: The Czech Republic 2010 Review*. Paris: OECD, 2010. Print

⁸⁰ Lang and Nosko, opt cit, 6

of Trade and industry to sell 30% of Transgas to foreign investors⁸¹. Instead Klaus decided to scrap the original privatization plan and said that Transgas would remain under the direction of the state for the next five years.

Hungary 1990-1998

In Hungary from 1990 – 1994 the Conservative government led by Jozsef Antall perceived Russia as a threat and decided to build the HAG pipeline connecting the Hungarian network to Baumgarten in Austria⁸². This decision on Baumgarten was made instead of increasing capacity from Ukraine⁸³. The effects of the gas connector were minimal as unlike the Czech Republic Hungary did not harmonize the pipeline with long term contracts. In addition it is important to note that while Baumgarten represented a step forward in terms of not relying on one pipeline it did not mean supply diversification. In reality Baumgarten is the same Russian gas, it just comes through a pipeline that avoids Ukraine thus providing backup in case of a disruption from Ukraine⁸⁴. This is more to receive diversity of supply routes rather than diversity of supply and can be best viewed as quasi-diversification than full diversification.

In 1994 the Socialist Horn government came to power. During this period the government did not make any attempt to diversify supplies and through the Hungarian- Russia joint venture Panrusgas a long term gas contract until 2015 was signed. In its relations with Russia it improved economic ties while also managing the NATO enlargement debate⁸⁵. Meanwhile Hungary's dependence on gas grew as a result of the gasification mainly for heating purposes although it was stimulated by regulated natural gas prices that were kept artificially low for end-user consumers and the fact that governments supported the replacement of small

⁸¹ "Gas Monopoly Hoping To End Reliance On Russia." *Prague Post* [Prague] 26 Apr. 1995. Print

⁸² "Gas Pipeline with Austria Agreed as Energy Diversification Needs Increase." *Hungarian Telegraph News Agency* 12 Apr. 1994. Print.

⁸³ Deak, opt cit, 48

Gyor-Baumgarten Gas Pipeline Construction Starts on Sept. 7." *MTI Econews* 05 Sept. 1994. Print.

⁸⁴ The pipeline was barely able to meet its N-1 criteria

⁸⁵ Orban, Anita, opt cit 45

power generations running on heating oil or coal to gas fired ones⁸⁶. As Orban notes back in the 1990s “back in the 1990s there was no debate about energy security, gas was cheap at the time and our dependence grew gradually”. With gas cheap at the time a number of households switched to the fuel during the period with subsidizing from the government acting as a further catalyst. While the Czech’s sought to keep their dependence on Russian energy to a minimum Hungary adopted a policy of ” gasification” in the 1990s which as figure 3 and 4 represents saw the countries share of natural gas in the country’s energy mix rise 31% from 1990 to 2004 representing 40% today, 80% of which is imported from Russia⁸⁷.

Figure 9 - Total Primary Energy Supply, 1973 - 2000

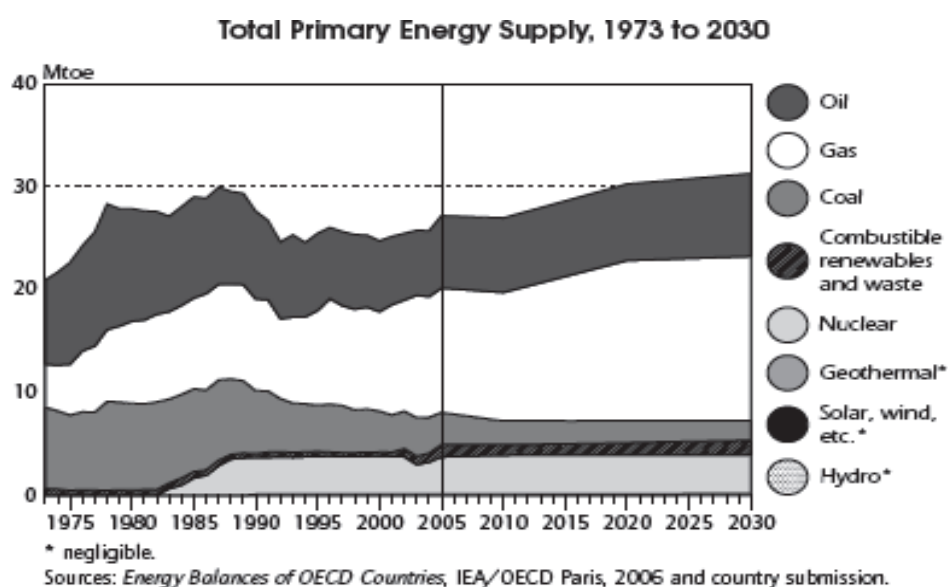
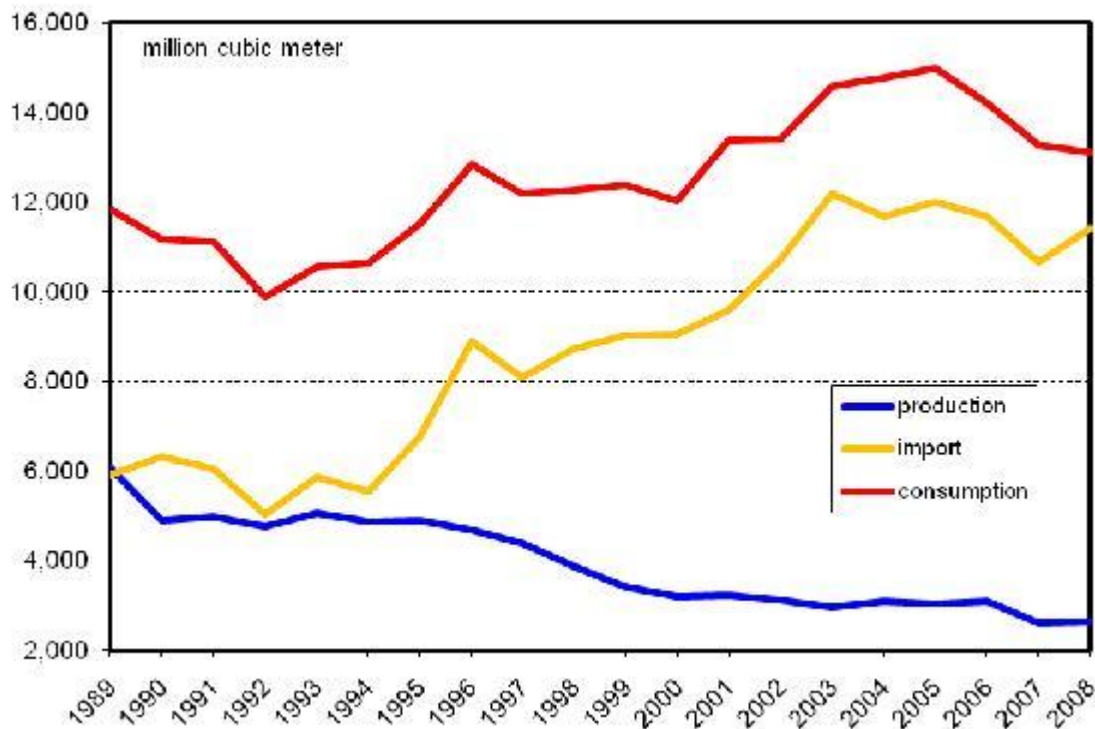


Figure10: Natural Gas Import and Consumption in Hungary

⁸⁶ Andzsans-Balogh, Kornel. "The Road to Hungarian Energy Security." *LAGS Journal of Energy Security* March 15TH (2011)

⁸⁷ OECD, 2010



Result: Czech Republic and Hungary compared 1990-1998

According to the model when States that perceive Russia to be a threat and enjoys high state power will implement diversification with relative ease. This is exactly what occurred in the Czech Republic 1990-1998 where despite the costs of diversification being expensive the government was prepared to pass on the price to the customer. As Czech ambassador at large for energy security Vaclav Bartuska notes “Back in the 1990s, we were the only country in Central and Eastern Europe that did something for its energy security⁸⁸”. The reason for the Czech’s success can be found in the greater capacity of the Czech state to extract the resources necessary for diversification as a result of higher threat perception of Russia as a threat among the right wing ODS. As Orban notes “In the 1990s the Czechs had a totally different attitude to

⁸⁸ ““We’re Strong Enough to Withstand the Blackmail of Suppliers”.” *Europolitics* 25 May 2009, <http://www.europolitics.info/we-re-strong-enough-to-withstand-the-blackmail-of-suppliers-artr234094-10.html> ed. Print.

energy security and had a much stronger sense of energy security than the rest of Central Europe with the possible exception of the Poles⁸⁹”.

In contrast in Hungary the first government was not able to mobilize enough state resources to diversify sources of gas and only managed to achieve diversification of transport routes. Hungary's experience from 1990-1994 corresponds to the situation of H2: States that perceive Russia to be hostile but have low state power will constantly strive to implement energy diversification. Between 1994 and 1998 Hungary made no major effort to diversify away from its reliance on Russian energy as during this period a Socialist party was in power and perceptions of Russia as a threat were low. This is reflective of hypothesis 4 in which: States, which perceive Russia as a lesser threat and have a low state power, will cling on to its status quo energy strategy.

3.2.2. Stage 2: 1998-2005

Czech Republic

The period 1998-2006 saw left wing governments led by the Social Democratic party and also a low perception of Russia as a threat⁹⁰. In 1999 a decision was made to privatize the gas industry with German firm RWE winning the contract in 2001⁹¹. During this period no diversification strategies took place but the government did enjoy the economic benefits of diversification and between 1997 and 1999 Hungary imported natural gas at a cheaper price than the Czech Republic only once in 2003⁹².

Hungary

⁸⁹ Interview, Orban, Anita

⁹⁰ Nosko, Andrej, Presentation at 5th annual Doctoral Conference 6. April 2010 Budapest **"Effects of threat perception on energy security policy choices"** (Chapter draft)

⁹¹ Interview, Petr Strawbawa

⁹² Andrej, Nosko, and Lang Petr. *Lessons from Prague: How Czech Republic Enhanced Its Energy Security*. Issue brief. Journal of Energy Security, July 2010. Web. Nov. 2010. <http://www.ensec.org/index.php?option=com_content&view=article&id=258:how-the-czech-republic-has-enhanced-its-energy-security&catid=108:energysecuritycontent&Itemid=365>

In Hungary between 1998- 2002 a Russian skeptic Fidesz party was in power in Hungary. With Russia weak and perceptions of Russia as a threat low the government was unable to mobilize the state power to support major diversification initiatives. Instead as Deak notes in his analysis during the period 1998-2002 the Hungarian government limited itself to “ searching for diversification opportunities without any political or financial support for the projects”⁹³. Lacking the ability to mobilize the necessary resources for Fidesz energy security became about the perceived fight against Russian takeover of a strategic industry as demonstrated in the 2000 Borsodchem conflict. In 2000 an Irish registered company called Milford Holding acquired a stake a significant stake in Borodchem, Hungary’s primary chemical company and the owner of a pipeline distribution network. Soon after it was revealed that Gazprom was the real force behind Milford Holdings⁹⁴. Fearful that Gazprom or other Russian companies might be behind the move, the Fidesz government successfully rallied local companies and banks to prevent a Russian takeover.

In 2002 the Socialist party led by Medgyessy came to power replaced Fidesz. Interestingly as Orban notes the Russian side made it obvious that it preferred a Socialist victory in the 2002 Hungarian parliamentary elections and during the elections the Socialist party ran on the slogan “ Gaining back the Russian market”⁹⁵. In energy policy the government made major effort to diversify away from Russian energy and in her analysis Orban also notes that the Socialists were more open to Russian investment in their energy sector⁹⁶. The Socialist party’s relationship in energy was reflective of their foreign policy in which they tried to make Hungary a bridge between East and West. They government never criticized Russian foreign or domestic policy and held no public position on developments in Ukraine and Belarus at the time. With the

⁹³ Deak, op cit, 47

⁹⁴ Zeyno Baran, Testimony before the U.S. House of Representatives, Foreign Affairs Committee, “Central and Eastern Europe: Assessing the Democratic Transition,” July 25, 2007, Washington, DC.

⁹⁵ Orbán, Anita. *Power, Energy, and the New Russian Imperialism*. Westport, CT: Praeger Security International, 2008. Print: 67

⁹⁶ Orbán, Anita. *Power, Energy, and the New Russian Imperialism*. Westport, CT: Praeger Security International, 2008. Print: 67- 104

Czech Republic and other countries in the region denouncing the increasing autocracy under Vladimir Putin, Hungary instead adopted a softer approach. ” With regards energy security, the issue of ” safety of gas supply””was the top priority issue in the industry, overshadowing external ” gas supply considerations”⁹⁷.

Comparison: Czech Republic and Hungary 1998-2006

The period 1998 to 2006 can be characterized as a relatively quite one in terms of energy policy strategy. In the Czech Republic perceptions of Russia as a threat dropped dramatically during this period, two successful left wing governments seemed relatively content with the status quo and no major changes to energy policy strategy occurred. This situation is reflective of hypothesis 4 where: States who perceive the International environment to be friendly and have low state power will not make any efforts to diversify supplies.

In Hungary the Fidesz government between 1998-2002 was a Russian skeptic one, it searched for diversification opportunities but did not have the state resources to fully implement one. However it did have the resources to prevent a Russian takeover of Borsodchem in 2000, a move reflective of the Fidesz notion of energy security based on ownership of key industries. This represents the situation in H2 where: States that perceive Russia to be hostile but have low state power will constantly strive to implement energy diversification. From 2002-2005 the Socialist party in Hungary made no effort to reduce their reliance on Russian energy and rather concentrated making the country a bridge between East and West, in turn energy security became about safety of supply with little to no concern over becoming overdependent on Russia. This represents the situation in H4 where: States, which perceive Russia as a lesser threat and have a low state power, will cling on to its status quo energy strategy.

⁹⁷ Deak, opt cit, 48

3.2.3. Stage 3: 2006 – Present

The gas crises felt in Central Europe in January 2006 and 2009 highlighted the regions insecurity. These shortages occurred when Gazprom reduced flow across Ukraine to Europe due to a pricing dispute with Ukrainian gas company Naftogaz. The crises raised vulnerability questions in the region and led to a series of responses which represent the left and right wing divide well. It also raised questions over which party was to blame for the crises with the Czech ODS more critical towards the Russians while the Hungarian Socialist party adopted a more balanced view.

Czech Republic

In elections in 2006 in the Czech Republic the ODS party replaced the Social Democrats. The ODS party proved to be much more publically wary of Russia as a supplier than their Social Democrat predecessors. The party saw energy security in much more strategic terms than the Social Democrats as reflected by then deputy Prime Minister and current Minister for Defence Alexandr Vondra speech at a security conference in Vilnius in 2007 in which he stated that “an unjust manipulation of interruption of energy supplies is as much a security threat as military action. Post Soviet countries have been experiencing this on a daily basis, and Russia’s appetite for using energy as a political weapon is growing”⁹⁸.

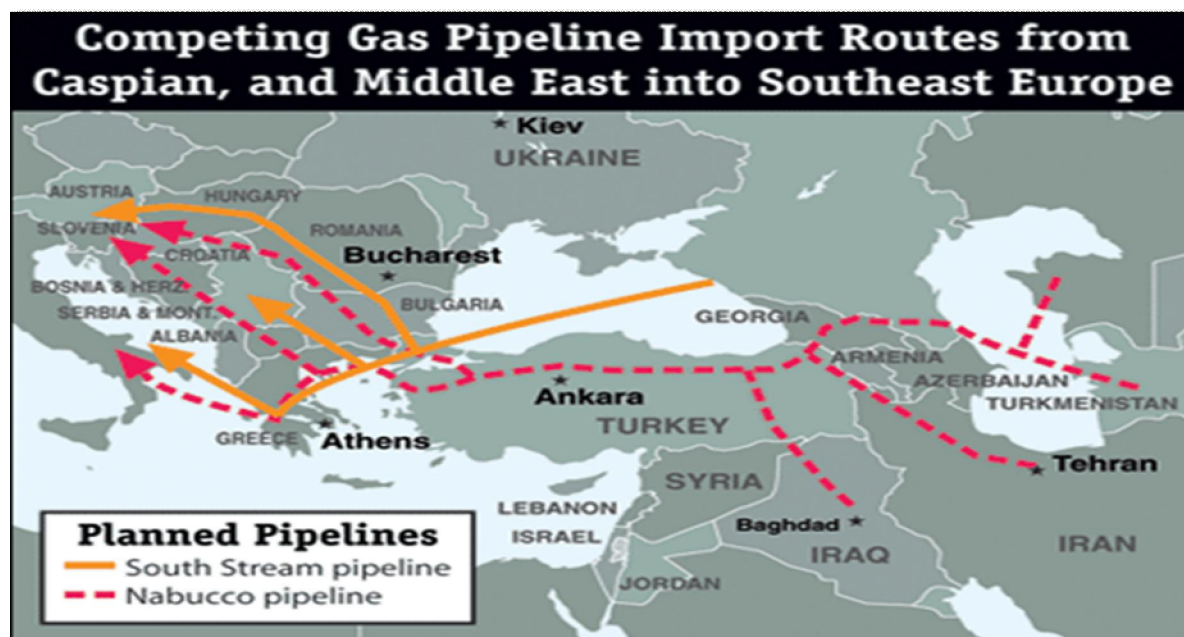
Unlike Hungary for the Czech Republic the 2006 gas crises in the words of Czech energy analyst Petr Binhack “merely reconfirmed the perception of Russia as a latent threat and unreliable partner”. The 2009 Ukraine-Russian energy crises occurred during the Czech EU Presidency. In according blame for the crises the ruling ODS party identified Russia as being at fault although as holder of the EU Presidency it had to tame its public statements. “Within public debate we blame Russia for using energy weapon towards Ukraine to punish their pro-

⁹⁸ From Miller schism – add

Western orientation under Yushchenko.... but truth and public opinion are two different things”

In an effort to reduce their dependence on Russian gas the Czech Republic actively searched for diversification opportunities throwing its weight behind the Nabucco project⁹⁹. The two main competing Southern Corridor pipeline routes are shown in Figure 6 below.

Figure 11 - Competing Gas Pipeline Import Routes



Source: Globalresearch.ca

For the Czech Republic the main reaction to the 2009 gas crises the decision to further reduce Russian gas in its energy mix and it made a decision to invest in nuclear energy.¹⁰⁰ In a deal estimated to be worth \$25 billion it decided to build two nuclear reactors in Temelin, south Bohemia¹⁰¹. Three companies applied for the tender, French company Areva, US company Westinghouse and Russian company AtomStroExport. On June 21st 2010 the caretaker government of Jan Fisher appointed Vaclav Bartuska to the post of government commissioner

⁹⁹ The Nabucco pipeline is a proposed natural gas pipeline bringing gas from Central Asia, the Middle East and the Caucasus to Europe diversifying natural gas supplies and delivery routes for Europe. South Stream is a proposed Kremlin backed gas pipeline to transport Russian natural gas to the Black Sea to Bulgaria and further to Greece, Italy and Austria.

¹⁰⁰ Interview Petr Lang and Jakub Jaros

¹⁰¹ O'Donoghue, Cillian. "Keeping an Eye on Temelin." *The Prague Post* [Prague] 21 July 2010

for the completion of the Temelin nuclear power plant¹⁰². Bartuska is a vocal critic of not allowing too much Russian influence in the energy sector in the Czech Republic and his appointment was seen as a move by the ODS to cloud the chances of AtomStroyExport winning the tender. On July 14th 2010 the Russian daily Kommersant reported that the Czech right wing government would be its utmost to eliminate AtomStroyExport from the tender¹⁰³. Bartuska wanted the Russian company to be expelled from the tender from the beginning and in an interview with the author in July last year he said that "his position had not changed"¹⁰⁴. The announcement of the tender winner was delayed this year and is expected in 2013.

At present the current Czech energy policy strategy still supports the Nabucco pipeline fully but in order to maintain its position as a transit route for German gas it has more become a supporter of the "Gazela" section of the Nord Stream pipeline. RWE is currently planning the construction of a 166 km pipeline that will connect the Czech Republic in the future event of rerouting of gas exports from Russia from the existing pipeline system. The Gazela project would preserve the strategic importance of the Czech position as a transit country. Speaking about the importance of this Bartuska said "It is in our strategic interest to remain a transit state to Germany and elsewhere.... we want to preserve this not just for the income from transit but for the Czech Republic's security of supply; because frankly if there is ever Russian gas switched off going to Europe, the last country where that will happen to is Germany". The Gazela pipeline is expected to become functional in 2012¹⁰⁵. The Czech Republic government has always been a big supporter of diversification projects to reduce dependence on Russian gas so

¹⁰² The appointment was made with the approval of the incoming right wing coalition as it was made after the elections in which it was clear that a right wing government would form the next coalition.

¹⁰³ O'Donoghue, Cillian, op cit

¹⁰⁴ O'Donoghue, Cillian. "ibid

¹⁰⁵ Vlček, Pavel. "Minister Kocourek Launches the Gazela Gas Pipeline Linking the Czech Republic to Nord Stream." *Ministry of Industry and Trade of the Czech Republic*. 14 Nov. 2010. Web. 14 Apr. 2011.

Interview Petr Stawbrawa RWE

as Petr Lang notes “it will be ironic if our security is increased our security by plugging into Nord Stream”¹⁰⁶.

Hungary

For Hungary the 2006 crises proved more of a wakeup call than a reconfirmation of previous conceptions as in the Czech case. “Before the gas crises energy security was not on the agenda and it was only the first gas crises that highlighted our dependency”¹⁰⁷. The Hungarian reaction to the 2006 crises was also interesting. As noted by Deak “Hungary seemed to continue trusting Russian energy supplies, amid widespread fears of the “Russian energy weapon” in Central European countries”¹⁰⁸. The Socialist party blamed Ukraine for the crises and the resulting reaction was a number of diversification attempts but none of which sought to reduce reliance on Russian gas. . The first step the crises triggered the establishment of strategic reserves with an investment of USD 750 million being passed on the general public¹⁰⁹.

The Socialist government’s more pro-Russian stance is perhaps best demonstrated by the Nabucco versus South Stream debate. In 2007 in a move interpreted by many as one that would question Hungary’s commitment to the Nabucco pipeline the Hungary government broke with the bloc of European countries by joining forces with Gazprom to extend the Blue stream pipeline from Turkey¹¹⁰. In addition Socialist PM Gyurcsany criticized the Nabucco project as being a dream, “The Nabucco has been a long dream and an old plan... but we d’ont need dreams we need projects we said”¹¹¹.

The South Stream deal set off a firestorm and was vehemently opposed by the Conservative opposition. In reaction the Fidesz party said that Hungary’s support is a sign of

¹⁰⁶ Interview, Lang Petr

¹⁰⁷ Interview Orban, Anita

¹⁰⁸ Deak, Andras, opt cit 49

¹⁰⁹ Kornel, Andras-Balogh. "The Road to Hungarian Energy Security." *Journal of Energy Security*, March (2011). Print

¹¹⁰ Dempsey, Judy. "Hungary Chooses Gazprom over EU." *The International Herald Tribune* 12 Mar. 2007. Print.

¹¹¹ Dempsey, Judy. "Hungary Chooses Gazprom over EU." *The International Herald Tribune* 12 Mar. 2007. Print.

support by the Socialist government for Gazprom's expanding strategy in Central Europe. The party also called the deal secretive and non transparent and called for a parliamentary resolution saying that Nabucco should be built before South Stream¹¹². The US asked Hungary to give priority to the Nabucco project ahead of South Stream however it refused to do so¹¹³. In February 2008 in Moscow, Gyurcsany officially signed an accord with Putin and praised the Gazprom pipeline "You {Russia} were faster than Nabucco.... It is up to us to determine the tempo of implementing projects in our interest". The Prime Minister also stated "Hungary has realized that it has no alternative to cooperation with Russia"¹¹⁴ According to newspaper reports and elite interviews Hungary's decision to support South Stream was a foreign policy decision and largely Prime Minister Gyurcsany's own project "The issue with Russia and South Stream was rather Gyurcsany private project, Gyurcsany had a very positive attitude towards Russia, Fidesz did not have and that was the main difference"¹¹⁵. In an interview Deak also noted that the energy policy issue of the debate was of "secondary importance".

In December 2007 a new Hungarian energy concept was passed by the Socialist party. With regards to prioritization of infrastructure projects it said that "among the alternatives for diversification (Nabucco, South Stream, LNG terminals from the Adriatic) it is not desirable to give priority to any of these projects"¹¹⁶. In addition for calling for non prioritization the document also called for a strategic partnership with Russia. A revised energy concept was submitted to the Hungarian parliament in 2008. The chairman of the foreign affairs committee, Zsolt Nemeth suggested that they concept openly endorse Nabucco. His proposal was rejected¹¹⁷.

¹¹² Orban, Anita, opt cit, 120

¹¹³ "Energy Issues in Europe: Interview with Matt Bryza." *Hungarian News Agency* 26 Feb. 2008. Print.

¹¹⁴ Socor, Vladimir. "SOUTH STREAM GAS PROJECT DEFEATING NABUCCO BY DEFAULT." *Eurasia Daily Monitor*. 5 Mar. 2008. Web. 01 Apr. 2011

¹¹⁵ Interview, Andras, Deak, MAY 14th 2011

¹¹⁶ Hungarian energy strategy 2007-2020 cited in Orban Anita 154

¹¹⁷ Orban, Anita, opt cit: 154

Since sweeping to in elections in May the Fidesz party has adopted a very different policy to its Socialists predecessors. In the Nabucco South Stream debate it has firmly switched its allegiance to the EU backed Nabucco project. Speaking at a Conference in Budapest one prominent member of the Hungarian government highlighted that Hungary is looking specifically for diversification from one supplier¹¹⁸. He stated that on 8th of June a new Nabucco agreement will be signed in Turkey which he said would be a joint programme of all participants and kickstart the project. Highlighting the need to improve security of supply he further that Hungary had entered "a new phase" and that he hoped the project would be finished by 2015. He also said that Hungary was no longer a supporter of South Stream and that there was a lack of details on the project. "we don't know if it can be taken seriously or not" he stated¹¹⁹.

Similarly since coming to power Fidesz has been determined to purchase back Surgutneftgaz's share in Hungarian energy company MOL. On May 24 they succeeded in buying a 21.2% stake in the country's oil and gas company. The government acquired the stake for \$1.88 billion from OAO Surgutneftgaz, making it MOL's largest shareholder. Speaking about the purpose Prime Minister Orban said "From a national strategic point of view we have managed to place one of the most strategic corporations in safe hands"¹²⁰. The Fidesz government's determination to bring the company into strategic hands can be seen from the fact that it still proceeded with an expensive bailout even though the country was financially stressed. To finance the deal the Hungarian government received a loan from the IMF. Prime Minister described the negotiation process as a "tough struggle"¹²¹. In response the Socialist party

¹¹⁸ Conference proceedings, TransAtlantic Energy Governance Dialogue: The "Shale Gas Revolution", Implications for International Gas Markets and European Energy Security, May 12-13th 2011

¹¹⁹ Conference proceedings, May 12-13th 2011

¹²⁰ "Hungary Buys 21.2% Stake in Oil Producer MOL." *The Wall Street Journal* 24 May 2011

http://online.wsj.com/article/SB10001424052702303654804576343530886058382.html?mod=googlenews_wsj

¹²¹ "Hungary Buys Back 21.2 Pct Stake in MOL Oil Company from Russia's Surgutneftgas for \$2.65 Bln." *The Washington Post* 24 May 2011. Print. http://www.washingtonpost.com/business/hungary-buys-back-212-pct-stake-in-mol-oil-company-from-russias-surgutneftgas-for-265-bln/2011/05/24/AFtRGVAH_story.html

slammed the deal saying it came at a time of high austerity measures and that the government were made paid 40% more than Surgut originally did for the purchase. Tibor Szanyi a member of the party's chief executive said the move was "a borderline criminal and senseless waste of money"¹²². In addition the Fidesz party has adopted a new Hungarian energy concept the most notable being a clause outlining the importance ownership of strategic industries¹²³.

Comparison: 2006 - Present

The third period of analysis best demonstrates just how different the main political parties view energy security. In the Czech Republic the Russia skeptic ODS party viewed the Ukraine-Russian crises as being the fault of Russia and as mere reconfirmation of perceptions that Russia was using energy as a foreign policy weapon. In order to reduce their reliance on Russian gas in its energy mix they decided to build the Temelin power plant and appointed a Russian skeptic ambassador in order to lessen the chances of Russia Company AtomStroyExport being chosen for the tender. Although the right wing party continues to prefer non Russian sources of gas, its decision to build the Gazela/Opal pipeline shows it is not totally opposed to Russian supplies but more represents its determination to remain as a transit route for Russian gas to Germany. In terms of hypothesis the prediction is H2 that States that perceive Russia to be hostile but have low state power will constantly strive to implement energy diversification. The state was determined to reduce Russia's share in its energy mix and decided to spend 26 billion in a new nuclear power plant.

In Hungary the contrasting approaches between both parties can be seen in how they approached the Nabucco versus South Stream debate. For both it was a foreign policy orientation question with the Socialist party seeing their role as something of a bridge between East and West while Fidesz was firmly entrenched to the Atlanticist camp. In addition the

¹²² "Russians Gone." *Budapest Times*. 29 May 2011. Web. 29 May 2011.

<http://www.budapesttimes.hu/index.php?option=com_content&task=view&id=19229&Itemid=219>.

¹²³ Interview Natalia Soczo

difference in energy security strategies can be seen with Fidesz prioritizing ownership of strategic industries and the Socialists non prioritizing major infrastructural projects. The period 2006-2010 States which perceive Russia to be a lesser threat and enjoys high state power will seek to ensure further security through innovative diversification. This innovative diversification can be found in their increase in storage capacities but also in their initial support for the South Stream project. The period 2010 to present represents H4: States which perceive Russia to be a lesser threat and enjoys high state power will seek to ensure further security through innovative diversification.

Findings and Conclusion

From the analysis in Chapter three we can see that the different energy policy strategies of Czech Republic and Hungary in the post transition period is the result of varying elite perceptions of their main supplier (Russia) and ideological orientation of their different governments. Neo classical realism can best explain these two puzzles of why Hungary and the Czech Republic sometimes are determined to diversify their energy supplies while at others seem relatively content (1999-2006). The theory argues that the relative distribution of power in the International system (systemic variable) through elite perceptions of Russia together with domestic factors explains energy policy strategy.

Hungary and the Czech Republic tried to diversify their energy supplies when perceptions of Russia as a threat were high, a right wing government was in power and that government was able to mobilise the necessary resources. When a left wing government was in power and perceptions were low no diversification efforts took place. Czech elites were very uncomfortable with their countries reliance on Russian energy during the period 1990-1998 while for Hungary an overreliance of Russia energy really only become a major issue following the first Ukraine-Russia gas crises . After NATO accession, perceptions of Russia changed as a result of increasing security guarantees and a weak Russian state. As a consequence, between 1998 and 2006, no major efforts of diversification took place in either country. The Ukrainian Russian gas crises of 2006 and Russia's more aggressive foreign policy under Vladimir Putin's second term raised fears of their reliance on Russian energy supplies once again. The different responses of the Czech Republic and Hungary during this time can be explained by the different ideological orientation of their governments at the time. The Socialist government in Hungary saw its role as something of a bridge between East and West while the ODS party was firmly Atlanticist. Hungary's initial decision to support the South Stream project was part of Prime Minister

Gyurcsany's broader foreign policy strategy towards the East. All things being equal diversification attempts and attitudes towards ownership of key strategic energy industry's directly correlates to the ideological orientation (left-right divide) of the government in power . Socialists and Social Democrat governments in both countries tend to be much more accomadating to Russia and make less efforts to diversify. The most likely cause of this phenomenon, although outside the scope of this paper, perhaps depends on the fact that left wing parties of both states tend to have personal ties with Russia.¹²⁴

In general Czech elites recognize that having a high level of dependency on Russian gas represents a national security threat. Through an overview of official statements, interviews and polices applied in the previous section, the paper argues that the Czech Republic recognizes an overdependence on Russia gas is not desirable and has made policies accordingly. During the 1990s it began diversifying its gas imports even though these efforts were largely scoffed at by their neighbors who saw Russia as a reliable supplier and diversification as an expensive mistake. The Czechs realised energy security costs money and that this cost would have to be borne by the taxpayer yet right wing governments during this period remained determined and successfully mobilised the states resources achieving diversification . As Bartuska notes "Many Central and Eastern European countries use energy security as a pretext for asking Europe to pay for projects they should have done themselves. I say - responsibility first, then solidarity. We don't ask anyone to pay for us¹²⁵".

The Czech's energy policy since post accession of keeping dependence of Russian energy to a minimum is likely to persist as perceptions among policymakers remain high. "The stance towards Russia is an import element of our energy policy and that's why we are still trying to

¹²⁴ Most respondent identified the stronger personal relations between left wing parties and Russia as the reason. As Nosko states personal relations "often personal relations overlap between the former communist parties and as a result might not see relations with Russia as a threat", while Natalia Soczo said "They (Socialists) have better personal relationships with Russia"

¹²⁵ "We're Strong Enough to Withstand the Blackmail of Suppliers"." *Europolitics* 25 May 2009, [Http://www.europolitics.info/we-re-strong-enough-to-withstand-the-blackmail-of-suppliers-artr234094-10.html](http://www.europolitics.info/we-re-strong-enough-to-withstand-the-blackmail-of-suppliers-artr234094-10.html) ed. Print.

diversify. We have a very strong feeling towards Russian gas imports and we are trying to keep them low. In Czech Republic we would really mind increasing the share of Russian gas in the energy mix ”¹²⁶. In addition the different perceptions among the political parties are likely to persist ”In some political circles it (dependence of Russia) is perceived as a threat, their main aim is to reduce the dependence of Russia, this is usually people from the centre right and I think they will continue to perceive the growing dependence on Russia as a threat”¹²⁷. Therefore the outcome of future elections is likely to have a major impact of their energy policy strategy. With many in the Czech media predicting that the current dysfunctional centre – right coalition will not see out the year a Social Democrats victory in a possible upcoming election could have a major impact on the Temelin tender. The Social Democrats are likely to focus more on the cost and technological aspects thus favoring AtomStroyExport while the ODS party as always will adapt a more security orientated approach to energy and would likely choose American company Westinghouse.

In contrast, Hungarian case illustrates their consistent strategy of prioritizing costs over security..¹²⁸. This is explained by the major differences that exist between the Socialists and Fidesz in how they perceive and define energy security , which alters their approach towards Russia. In general diversification and strengthening control of key national strategic industries is a rather Conservative topic. For the Socialists prices and short term strategic gains are prioritised ahead of security considerations. These domestic patterns have determined the pattern of energy relations towards Russia from the period 1990 to the present. Perceptions of Russia are a vital factor explaining Hungary’s energy policy and it did not have a serious diversification strategy until the first Ukraine-Russian gas crises. Prior to this the safety of gas supply was the top priority for the industry overshadowing external gas security considerations. In conclusion,

¹²⁶ Interview, Petr Lang

¹²⁷ Interview, Lang Petr

¹²⁸ Interview with Andras Deak

Hungary's lesser perception of Russian threat and its relatively weak resource extraction capability has an absence of energy diversification since coming to power. However since coming to power the Fidesz government has adopted a more security orientated approach more representative of the Czech approach to energy. A sustained period of Fidesz rule would likely see both countries adopting very similar policies in dealing with their dependence on Russia gas and the schism that has existed since transition be replaced by a more concerted approach.

Recommendations

The long term effects of Hungary's reactive energy policy are that they paradoxically end up paying more for their gas than the Czech Republic. Clearly the strategy of sacrificing elements of sovereignty for cheaper prices has not paid off, indeed it is clear that if you want to get a good deal from your dominant supplier you need to demonstrate that you have achieved alternative supplies of gas. In 2015 Hungary's long term gas contract with Russia will run out. As Andras Deak notes "right now the Russian's can come with a piece of paper, say sign now and we cannot do anything because the bargaining position is so bad¹²⁹". Extending the contract on a long term basis similar to Poland did last year need not be a problem however great efforts must be made to ensure that regional interconnectors are in place by 2015 in order to strengthen negotiating position vis-a-vis Russia.

In terms of diversification governments should follow the path of prioritizing diversification of both route and source. The Nabucco project carries with it major advantages over South Stream which is in essence a reactionary project and should be considered as little more than a Red Herring by the Hungarian government. While serious questions still remain with regards the viability of the Nabucco project as long as the project is still on the table the Hungarian government should push *solely* for its completion. The Socialist governments oscillating support for all projects undermined investor confidence and send the wrong signal. It also raised doubts whether Hungary has a clear diversification strategy.

Russian downstream investment in strategic companies cannot be considered as a purely economic matter and elites on both sides of the political divide need to be aware of the national security implications such actions bring. While selling national energy champions may plug the

¹²⁹ Interview Andras Deak

gaping hole in the government's national budget in the short term, in the long term it is disadvantageous. The policies of both the Serbian government in selling NIS its national oil company to Russia's Gazprom is an example strictly not to be followed¹³⁰.

While this thesis has focused predominantly on gas, an overreliance on one country for your nuclear supplies also constitutes a worry. Both countries make big decisions about extending nuclear power plant deals next year and while Czech technological experts in the industry may prefer AtomStroyExport in terms of technology and cost a geo-political factors also need to be considered. If AtomStroyExport are chosen for the Temelin tender the Czech Republic would become heavily dependent on Russian nuclear technology and knowhow. Much of the progress made in the last 20 years will be undermined. Similarly Hungary which will announce the tender for the Paks nuclear power plant next year is in less of a position to increase its reliance on Russian energy.

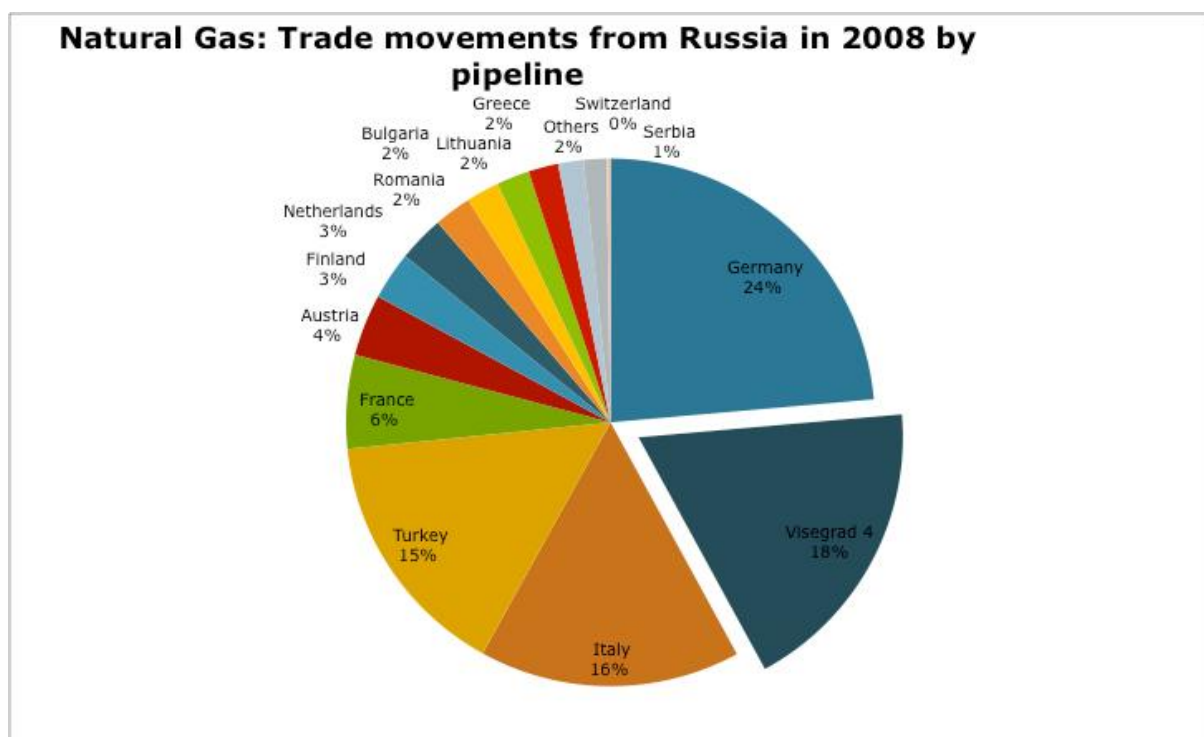
With populations of 10 million people and small market sizes leaders in both countries often bemoan how they are so vulnerable to Russia. However at a regional level a strong platform already exists that has not already been used to its potential, the Visegrad four (V4) . As one Polish analyst reflects "it can be noticed that the Visegrad group has not concentrated on key issues such as: the dissonances in the transatlantic alliance and ways of overcoming it, the policy of energy security and critical infrastructure as well as Russia policy towards the region"¹³¹. Creating a functioning natural gas market is in the interests of all the V4 states. It will lead to greater competition, lower prices and stronger resistance to supply disruptions. In addition by coordinating their positions and acting together wherever possible vis-à-vis both the EU and Russia the countries can have a much larger impact. Taken together the V4's joint share, as

¹³⁰ Socor, Vladimir. "Serbia's Oil Industry: a Christmas Gift to Gazprom." *The Jamestown Foundation*. 29 Jan. 2009. Web

¹³¹ Wagrowska, M. "Visegrad Security Policy: How to Consolidate Its Own Identity." *International Issues and Slovak Foreign Policy Affairs*, International Issues and Slovak Foreign Policy Affairs, Vol. XVIII, No.4, 31-42. Web.

shown in the diagram below, in the Russia's natural gas export market is 18% second only to Germany while their voting power in the European Council exceeds that of France and Germany combined. The EU contains 27 countries with different perceptions and experiences with Russia. The Czech's and the Hungarians can't share their view with Germany and Italy and they can't understand theirs. Instead they must find partners with similar values and fears. In a region with a shared history, perceptions of Russia and many of the same external energy challenges the natural place to start is the V4.

Figure 12 - Natural Gas: Trade movements from Russia in 2008 by pipeline¹³²



Further Research

This thesis is based on the presumption that importers with a high dependency display preferential tendencies to their suppliers. Whether this assumption on gas dependency is in fact really true is one that needs to be empirically tested. Throughout the research and in interviews examples such as Ukraine's black sea fleet deal in exchange for cheaper gas with Russia in 2010

¹³² Energy security policy paper for Visegrad Security Co-operation initiative

were often cited as examples of this but the author could not locate an indepth study of this issue.

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List of Interviewee's

Hungary

- Anita Orban, ambassador at large for energy security
- Andras Deak, CEU Centre for enlargement studies

- Michael La Belle, CEU Centre for Climate change and sustainable energy policy
- Petr, Istvan, Senior Economist MOL
- Natalia Soczo, energy policy expert, MOL

Czech Republic

- Vaclav Bartuska, Ambassador at large for energy security
- Jakub Jaros, Prague Security Studies Institute
- Petr Lang, Prague Security Studies Institute
- Andrej Nosko, Researcher of energy policy and security, PHD candidate CEU
- Petr Binhack, Charles University Prague
- Petr Strabawa, Senior Regulatory specialist RWE, Czech Republic