

**ENERGY SECURITY IN TRANSITION:  
COPING WITH ENERGY IMPORT DEPENDENCE IN  
THE CZECH REPUBLIC, SLOVAKIA AND HUNGARY**

By

Andrej Nosko

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Supervisor: Professor Béla Greskovits

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## **DECLARATION**

I hereby declare that no parts of this thesis have been accepted for any other degrees in any other institutions. This thesis contains no materials previously written and/or published by another person, except where appropriate acknowledgment is made in the form of bibliographical reference.

Andrej Nosko

## **ABSTRACT**

In this dissertation I study why countries under comparable international conditions prioritize energy security differently. Why do their domestic responses of coping with structural position of energy import dependence vary over time, and what explains the type of variation and its timing? By answering these questions, this dissertation contributes to the broader research field on temporal and spatial variation of domestic responses to comparable international conditions.

In order to understand the factors of prioritizing security in energy policy, and their facilitating and inhibiting conditions in countries in transition, through case selection, I isolate effects of fundamentals and external factors.

As I observe in the Central and East European countries in transition, policies enhancing energy security are prioritized when three aspects coincide and interact: When popular perception of threat, which can plausibly be connected to the energy supply, is high and concentrated among supporters of ruling parties; when former elites who can draw on personal links with the perceived source of threat, and thus can dampen the effects of threat, are removed from power; and when incumbent industrial interests are de-concentrated and face obstacles in promoting their interests. I also argue that specific timing of change of ownership lowering the control of government over energy assets i.e. privatization, was an obstacle to prioritizing policies aiming to increasing energy security.

The broader theoretical contribution of this dissertation consists of argument for reframing the energy policy debate by bringing back domestic politics, and by contributing to understanding of security policy prioritization during transition. Energy security, albeit important, is only one of the aspects that are being pursued by governments. Through this project I also lay the foundations for broader conceptual model for analyzing energy security, within more inclusive context, as one, but not the only one of the energy policy priorities.

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I dedicate this dissertation to the memory of my late father, Ján Nosko, a tragic victim of transition.

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## ABBREVIATIONS

|         |   |
|---------|---|
| ÁÉB     | Általános Értékforgalmi Bank  |
| ÁFOR    | Hungarian oil product wholesale distribution  |
| AG      | Aktiengesellschaft (Stokholder's company)   |
| ÁPV     | Állami Privatizációs és Vagyonkezelő Rt. – Hungarian Privatization and State Holding Company                  |
| AWP     | Adria – Vienna Pipeline   |
| BC      | BorsodChem – Hungarian chemical company   |
| BDSZSZ  | Hungarian Federation of Mine Workers Unions   |
| BEB     | German gas company  |
| BG      | Bulgaria  |
| BIS     | Bezpečnostní informační služba (Security Information Service) – Czech Intelligence Agency                     |
| BVK     | Borsodi Vegyi Kombinát – Hungarian chemical company   |
| CC      | Crisis Capability   |
| CEE     | Central and Eastern Europe  |
| CEO     | Chief Executive Officer   |
| ČEPRO   | České produktovody a ropovody – Czech oil pipeline operator   |
| CEPS    | Central Europe Pipeline System  |
| ČEZ     | ČEZ České Energetické Závody – Czech electricity company  |
| COMECON | Council for Mutual Economic Assistance  |
| ČPP     | Český plynárenský podnik – Czech gas company  |
| CSFR    | Czechoslovak Federal Republic   |
| ČSL     | Czechoslovak People's Party   |
| ČSS     | Czechoslovak Socialist Party  |
| ČSSD    | Česká strana sociálně demokratická – Czech Social Democratic Party  |
| CZ      | Czech Republic  |
| CZK     | Czech koruna  |
| DÉDÁSZ  | Dél-dunántúli Áramszolgáltató – Hungarian regional electricity company  |
| DÉMÁSZ  | Délalföldi Áramszolgáltató – Hungarian regional electricity company   |
| EBRD    | European Bank for Reconstruction and Development  |
| EC/EU   | European Community / European Union   |
| ÉDÁSZ   | Észak-dunántúli Áramszolgáltató – Hungarian regional electricity company                                      |
| EE      | Estonia   |
| ELMŰ    | Budapesti Elektromos Művek – Hungarian regional electricity company   |
| ÉMÁSZ   | Észak-magyarországi Áramszolgáltató – Hungarian regional electricity company                                  |
| EUR     | Euro  |
| FDI     | Foreign direct investment   |
| FIDESZ  | Hungarian center-right party  |
| FKgP    | Független Kisgazda-, Földmunkás- és Polgári Párt – Independent Smallholders, Agrarian Workers and Civic Party |
| G8      | Group of seven largest industrialized countries and Russia.   |

|                  |  |
|------------------|--|
| GDF              | Gaz de France – French energy company  |
| GDP              | Gross domestic product   |
| GIC              | Gross Inland Consumption   |
| HAG              | Hungary Austria Gas connector  |
| HHI              | Herfindahl–Hirschman Index   |
| HPP              | Hydroelectric Power Plant  |
| HU               | Hungary  |
| HUF              | Hungarian Forint   |
| HZDS             | Hnutie za demokratické Slovensko – Movement for a Democratic Slovakia  |
| IEA              | International Energy Agency  |
| IKL              | Ingolstadt – Kralupy nad Vltavou – Litvínov oil pipeline   |
| INA              | Croatian oil company   |
| IOC              | International Oil Company(ies)   |
| KDH              | Kresťanskodemokratické hnutie – Christian Democratic Movement  |
| KDNP             | Kereszténydemokrata Néppárt – Christian Democratic People's Party  |
| KDS              | Kresťanskodemokratická strana – Christian Democratic Party   |
| KDU-ČSL          | Křesťanská a demokratická unie – Československá strana lidová – Christian and Democratic Union – Czechoslovak People's Party               |
| KISZ             | Magyar Kommunista Ifjúsági Szövetség – Hungarian Young Communist League  |
| KSČ              | Komunistická strana Československa – Communist Party of Czechoslovakia   |
| KÖGÁZ            | Közép-dunántúli Gázszolgáltató – Hungarian regional gas company  |
| LNG              | Liquefied natural gas  |
| LT               | Lithuania  |
| LTO              | Light Heating Oil  |
| LUKOIL           | Russian oil company  |
| LV               | Latvia   |
| MCHZ             | Moravské chemické závody – Czech chemical company  |
| MDF              | Magyar Demokrata Fórum – Hungarian Democratic Forum  |
| MEC              | European intelligence network  |
| MENA             | Middle East and North Africa   |
| MERO             | Mezinárodní Ropovody – Operator of the Czech part of the Družba pipeline   |
| MFA              | Ministry of Foreign Affairs  |
| MFB              | Magyar Fejlesztési Bank – Hungarian Development Bank   |
| MFK              | Mezhdunarodnaya Finantsovaya Kompanya – International Finance Company  |
| MOL              | Hungarian oil company  |
| MSZMP            | Magyar Szocialista Munkáspárt (Hungarian Socialist Workers' Party) – Communist Party in Hungary  |
| MSzOSz<br>/NAHTU | Magyar Szakszervezetek Országos Szövetsége – National Confederation of Hungarian Trade Unions<br>National Hungarian Trade Union Federation |
| MSZP             | Magyar Szocialista Párt – Hungarian Socialist Party  |
| MVM              | Magyar Villamos Művek – Hungarian Electrical Works   |
| NAFTA            | Slovak upstream oil company  |
| NATO             | North Atlantic Treaty Organization   |

|           |   |
|-----------|---|
| NEB       | New Europe Barometer  |
| NGKM      | Nemzetközi Gazdasági Kapcsolatok Minisztériuma – Ministry of Foreign Economic Relations |
| NGO       | Nongovernmental organization  |
| NPP       | Nuclear power plant   |
| ODA       | Občanská demokratická aliance – Civic Democratic Alliance                               |
| ODS       | Občanská demokratická strana – Civic Democratic Party                                   |
| OECD      | Organisation for Economic Co-operation and Development                                  |
| OMV       | Österreichische Mineralölverwaltung – Austrian oil company                              |
| OPAL      | Ostsee-Pipeline-Anbindungsleitung – gas pipeline in Germany                             |
| OVG       | Austria's state oil company   |
| PES       | Primary energy sources  |
| PEW       | Pew Research Center – a public opinion polling and research outlet                      |
| PKN       | Polski Koncern Naftowy – Polish oil company   |
| PL        | Poland  |
| PPC       | Paroplynový cyklus – Slovak combined energy and heat company                            |
| REES      | Risky External Energy Supply (Index)  |
| RES       | Renewable Energy Sources  |
| RO        | Romania   |
| RWE       | German energy company   |
| S/D       | Supply/Demand Index   |
| SDK       | Slovenská demokratická koalícia – Slovak Democratic Coalition                           |
| SDL       | Strana demokratickej ľavice – Party of the Democratic Left                              |
| SE        | Slovenské Elekárne – Slovak Electricity Works   |
| SI        | Slovenia  |
| SITC      | Standard International Trade Classification   |
| SK        | Slovakia  |
| SKK       | Slovak koruna   |
| SMER(-SD) | Center-left political party in Slovakia   |
| SNS       | Slovenská Národná Strana – Slovak National Party  |
| SPP       | Slovenský plynárenský podnik – Slovak gas company                                       |
| SZDSZ     | Szabad Demokraták Szövetsége – Alliance of Free Democrats                               |
| TAKPE     | Társaság a Keleti Piacokért Egyesület – a lobby group                                   |
| TAL       | Transalpine Pipeline – oil pipeline   |
| TARKI     | Társadalomkutatási Intézet (Social Research Institute)                                  |
| TITÁSZ    | Tiszántúli Áramszolgáltató Rt. – Hungarian regional electricity company                 |
| TOE       | Tons of oil equivalent (approximately 41.868 GJ, or 11.63 MWh)                          |
| TÜZÉP     | Trading Company for Fuels and Construction Materials                                    |
| TVK       | Tiszai Vegyi Kombinát – Hungarian chemical company                                      |
| UK        | United Kingdom  |
| UN        | United Nations  |
| US or USA | United States of America  |
| USD       | United States Dollar  |

|      |  |
|------|--|
| USSR | Union of Soviet Socialist Republics                              |
| ÚV   | Communist Party Central Committee (in CSFR)                      |
| VPN  | Verejnosť proti násiliu – Public Against Violence                |
| VSŽ  | Východoslovenské železiarne – East Slovakian Ironwork            |
| ZSNP | Závody Slovenského národného povstania – Slovak aluminum company |

## INTRODUCTION

*"It's always about energy security. Always. It's always about whether the energy security of their country is fully met."*

– Maria van der Hoeven, Executive Director of the International Energy Agency<sup>1</sup>

Two recent incidents reminded citizens and politicians of many EU countries of the importance of energy security for everyday life. In the winters of both 2006 and 2009 number of EU countries experienced what Ukraine,<sup>2</sup> Georgia,<sup>3</sup> Belarus,<sup>4</sup> and Lithuania<sup>5</sup> as individual countries have before: Energy supplies from Russia are subject to unpredictable disruptions, and are not commanded by market logic alone.

On the 1<sup>st</sup> of January 2006, as Russia took over the chairmanship of the G8 with the theme of 'energy security,' pressure on the main gas-exporting pipeline to Europe from Russia decreased. This resulted in supply reductions in France, Germany, Italy, Poland, the Czech Republic, Slovakia, Austria, Hungary and Serbia of anywhere from 20 percent to 50 percent.<sup>6</sup> Three years later, in the January 2009, the same most important import gas pipe from Russia to EU has been completely shut-down, a move unprecedented in peace-time Europe.<sup>7</sup>

As a result of this unmatched situation, number of EU countries was forced to seriously limit their industrial production. Slovakia during this crisis lost an estimated one billion EUR, or 100 million EUR a day.<sup>8</sup> The gas cut related recession in Slovakia was believed to have caused 1-1.5%

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<sup>1</sup> Karel Beckman, "Interview: Maria van der Hoeven, new chief of the IE: We must find mechanisms to strengthen cooperation with the emerging economies", March 15, 2012, [http://www.europeanenergyreview.eu/site/pagina.php?id=3581#artikel\\_3581](http://www.europeanenergyreview.eu/site/pagina.php?id=3581#artikel_3581) (accessed June 7, 2013).

<sup>2</sup> January 2006 cut of gas supplies to Ukraine was a result of a row over transit tariffs and gas prices but also as part of the Ukrainian refusal to hand over its energy infrastructure to Russia.

<sup>3</sup> Both electricity and gas were stopped to Georgia in 2006.

<sup>4</sup> Oil supply cuts from Russia to Belarus in January 2007.

<sup>5</sup> Oil pipeline supplying Lithuanian refinery Mažeikių was shut-down on a pretext of technical reasons after the refinery was sold to Polish and not Russian company.

<sup>6</sup> Stratfor, "EU: Exploring Its Energy Options," *Strategic Forecasting Inc.* (January 03, 2006 18 15 GMT).

<sup>7</sup> S. Pirani, J. Stern, and K. Yafimava, "The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment," *Oxford Institute for Energy Studies* (2009). The shut-down took place during a price-cum-political row between Ukraine and Russia, but affected all other countries downstream.

<sup>8</sup> Alexander Duleba, "Poučenia z plynovej krízy v januári 2009: Analýza príčin vzniku, pravdepodobnosti opakovania a návrhy opatrení na zvýšenie energetickej bezpečnosti SR v oblasti dodávok zemného plynu," *Bratislava* (2009), <http://www.sfpa.sk/dokumenty/publikacie/281>.

decrease in GDP growth;<sup>9</sup> national tax revenues in January 2009 dropped by 40%.<sup>10</sup> Bulgaria was pressed even to impose limits on residential gas consumption, step considered most severe and reserved for the most acute crises.

## **Puzzle**

These two most recent energy cuts have highlighted the interconnection between political sovereignty, economic welfare and energy security, in addition to revealing the large differences among European countries in their ability to cope with energy supply disruptions, and the impact energy cut-off had on their citizens and the economy. Bulgaria and Slovakia, traditionally loyal allies of Russia, have been hit the hardest by these energy cuts. Czech Republic, much stingier in its relations with Russia went largely unaffected. This observed empirical difference in energy security among otherwise similar countries is the source of the puzzle that guides my research.

In search for the explanation why there have been such stark differences in energy security of otherwise very similar countries, I uncover a story which illustrates how policy choices were made in the context of power transition. At the time when both officials formerly in positions of power and those newly empowered faced new reality together with new opportunities – across the whole region. As the former soviet empire crumbled, its former dignitaries and their counterparts in the former vassal countries looked for ways of preserving their influence, not only political but also financial. Having access to both material resources and the information, many of them chose to use the new opportunity to further increase their influence and power, not only in their own countries.

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<sup>9</sup> Monika Poláková, “PLYN: Počiatok:Plynová kríza bude mať na ekonomiku SR dopad v rozpätí 1-1,5 % HDP,” *TASR*, January 20, 2009, <http://www.euractiv.sk/ekonomika-a-euro/clanok/plyn-pociatekplynova-kriza-bude-mat-na-ekonomiku-sr-dopad-v-rozpati-1-15-hdp> (accessed April 6, 2012).

<sup>10</sup> Due to both the gas crisis and the economic recession which was just starting. ČTK, “Ekonomická a plynová kríza znížili príjmy štátu o 40 percent!”, February 2, 2009, <http://www.cas.sk/clanok/104734/ekonomicka-a-plynova-kriza-znizili-prijmy-statu-o-40-percent.html> (accessed April 6, 2012); ČTK, “Podniky ešte nevyšli škody z plynovej krízy - Pravda.sk”, February 6, 2009, [http://spravy.pravda.sk/sk\\_ekonomika.asp?c=A090206\\_092455\\_sk\\_pludia\\_p01](http://spravy.pravda.sk/sk_ekonomika.asp?c=A090206_092455_sk_pludia_p01) (accessed April 6, 2012).

Large countries have higher leverage to face vulnerabilities and face their energy insecurities differently. Smaller countries must look for different options. Small open countries are not interesting only because there are a lot of them, as Katzenstein reminds. The puzzling question is why there are differences not only between large countries and small countries, but also among similar small countries?

All CEE countries faced the threat of supply disruptions from collapsing Soviet Union, and at the same time the risks associated with the crony capitalism emerging both in their own countries as well as in Russia. Nonetheless, the way how they coped with this situation differed from country to country. Russia's resurgence and use of former and new dependencies towards these countries was not given.

Post-soviet state capitalists in Russia tried to establish banks, as well as intermediate companies as vehicles for supplying energy resources to the countries of the former sphere of influence. But it takes two to tango. While we see that Russian approach has been tried across most of the countries which tried to reorient themselves towards the west, there were remarkable differences how much did this strategy work in the individual countries. While Russia was the same for all of her western European partners, there were differences in the moves that her former allies took and how the complex relationship evolved.

In order to study these developments, I choose a sample of three most similar, land-locked central European countries: Czech Republic, Slovakia and Hungary. The Czech Republic diversified sources, routes and contracts for its energy supplies, thus "ticking all the boxes" of mainstream understanding of energy security. Hungary started diversifying its gas supplies but left the process unfinished. Slovakia spoke about it at times, but did not make any significant move to improve its energy security.

While Hungary danced the best in the Russian bank-cum-middle-man couple which consisted of AEB bank and Panrusgáz. Slovakia was second to follow with the pair consisting of Devín bank and SlovRusGas. Czech Republic refused to play according to the Russian conductor, and the

fledgling group of the same arrangement of people around Gas Invest/Chemapol never took hold.

In Czech Republic the fear of Russia, used well by small group of reformist political elites, prevented emergence of this arrangement altogether. Czech Republic also experienced attempts at capturing the state by particular interests, but this specific type of corruption in Czech Republic didn't have negative influence on energy security the way it did in Slovakia and Hungary.

In Slovakia this scheme was stopped by change in government, when the reformist first Dzurinda's government despite being forced to tolerate occasional excesses of its junior coalition partner (an ex-communist SDL) profiteering from the privileged Russia connection, slowed the scheme down and the rules of the game essentially changed from Mečiar era.

The work of this network was brought to perfection in Hungary. The system of front-end companies achieved full scale, not only because it started much earlier, but also because there was much lower popular aversion towards Russians and post-soviets altogether. It was additionally helped by massive privatization which took place much earlier than in either Czech Republic or Slovakia.

What is the source of these differences? Could this be explained by party financing and political corruption, or just plain agenda differences among different political parties? Corruption and illicit party financing has been widespread in the region, and energy sector has been especially entangled in it. Nonetheless, this in itself does not explain the observed differences. According to publicized allegations both the left-wing, as well as the right-wing parties were implicated, although into different extent, in this practice across the region.

Could the differences be explained by different views of the political parties? While political parties have differing views – this does not explain the fact that in Slovakia it was the right-wing party which instigated the type of energy policies which were implemented by a left-wing party in Hungary. So the party-ideological identity does not seem to provide sufficient explanation either.

The small open countries are vulnerable, especially in their energy security, but precise way how this vulnerability is felt is not sufficiently understood. Question how specific threats and their perception affects the political process and influences energy policy choices in small countries in transition remains relevant. Political elites congregating around center-left political parties, many of whom were more or less direct offspring of the soviet-era communist parties, did not see post-soviet Russia as a threat. Political elites on the other side of the spectrum, including former dissent, saw Russia as a direct successor of Soviet Union carrying the historic baggage of intervention and suppression of not only personal liberties, but also freedom of their country – and thus threat to be concerned about in all walks of life including economy and energy.

In the literature, energy security has been presented as an absolute aim which all countries alike strive to maximize. Otherwise they risk being penalized in the reduction of their welfare or sovereignty. As the recent developments in Europe illustrate, similar countries are differently prepared to face precarious energy security situations. This demonstrates that these countries, in externally comparable structural position prioritize energy security into different extents.

What can explain differences in the level of energy security prioritization? The most common explanation of differences in energy policies and prioritization of energy security are based on fundamentals, expecting that energy rich countries will attribute lower priority to energy security than countries with lesser domestic energy resources. Nonetheless, this ‘fundamentals’-based explanation does not provide an answer why we witnessed such glaring differences in energy security prioritizations among relatively similar countries of CEE. To control for the effects of external conditions, and isolate effects of fundamentals; in this dissertation I look at three, in terms of energy structurally most similar cases, Czech Republic, Slovakia and Hungary.

## **Research Question**

In this dissertation I study why countries under comparable international conditions prioritize energy security differently. Why do their domestic responses of coping with structural position of energy import dependence vary over time, and what explains the type of variation and its timing? By answering these questions, this dissertation contributes to the broader research field on temporal and spatial variation of domestic responses to comparable international conditions.

My aim is to understand the factors of prioritizing security in energy policy, and their facilitating and inhibiting conditions. As I observe in the Central and East European countries in transition, policies enhancing energy security are prioritized when three aspects coincide and interact: When popular perception of threat which can plausibly be connected to the energy supply is high and concentrated among supporters of ruling parties, when former elites who can draw on personal links with the perceived source of threat and thus can dampen the effects of threat are removed from power, and when incumbent industrial interests are de-concentrated and face obstacles in promoting their interests.

Security of energy supplies is argued to be part and parcel of security and thus it should be high on the policy agenda for countries across the world. I define energy security by five constituent aspects of level, type and structure of: transit diversification, supplier diversification, import market concentration, energy mix and energy prices. An energy import dependent country has high energy security when its energy import transit routes and suppliers are diversified, the import market is de-concentrated, and its energy mix is diversified – with domestic consumers spread over a number of different sectors, with stable prices at levels comparable to other countries in similar position.

The explanation which I provide applies especially to small open countries in transition, facing an apparent mismatch between their aspired political and economic allies – situation which all but major powers face when former alliances and power relations falter and new ones are in the making. This is the case of most of the Central and Eastern European countries in the early

nineties, as they were looking for their way out of the reins of Soviet Union and its sphere of influence.

The theoretical contribution that I aim to make through this dissertation is in reframing the energy policy debate by bringing back domestic politics, and reminding the students of International Relations and energy policy that energy security, albeit important, is only one of the aspects that are being pursued by governments. I also strive to lay foundations for broader conceptual model for analyzing energy security as one of the energy policy priorities, but not the single one.

This argument is supported by intensive comparative empirical work on three cases of Czech Republic, Hungary and Slovakia. The observed difference among these three otherwise similar countries, I argue, is a result of domestic policy choices: specifically of sequencing and prioritization. This happened as a result of interplay of three most important factors: interests of the ruling elites reflecting effects of powerful domestic interest groups, public perception of threat, and choice of vetting laws at the time of transition which influenced the domestic opportunity structure.

I argue that less consequential and less transparent vetting laws enabled higher participation of former elites, which in case of lower perception of threat towards the source of dependence lead to lower prioritization of security in energy policy. I also argue that change of ownership lowering the control of government over energy assets (privatization) was an obstacle to prioritizing policies aiming to increasing energy security. Therefore security-increasing policies during transition need to be implemented before significant changes of ownership happen. In achieving this I also illustrate how the specific perception of vulnerability influences policy choices in a particular policy area – energy security.

## **Structure of the dissertation and overview of chapters**

This dissertation is divided into two sections. In the first chapter after the introduction I present the empirical and theoretical puzzle, provide overview of the theoretical context of the project, contribution of this dissertation to the existing theoretical discussion in the literature, rival explanations and the research model in detail. The research design that I choose is based on the most similar cases – the Mill’s method of difference.<sup>11</sup> I control for the effects of fundamentals, and external opportunity structure which are comparable across the cases, and point out the differences in the domestic factors which I isolate this way.

The model that I propose to explain variation in prioritization of energy security consists of interplay between three factors: The types, structure and interests of ruling elites with the type concentration and interests of largest domestic industrial consumers of energy, supported or inhibited by the presence of popular perceptions of threat from Russia as the important energy among supporters of ruling political force, and the types of vetting laws enacted.

In the second chapter I offer comparative view of the three selected countries on three main independent variables and how they have influenced the prioritization of energy security. I start with comparing the influence of popular threat perception in the three countries; continue with specific focus on ruling elites’ relations with Russia, and the influence vetting laws had on the type of elites, and the scope for maneuver they had during the transition. Next, I provide the comparison of the industrial structures affecting the energy security prioritization in all three countries.

At the end of the second chapter I provide a detailed comparison of developments in all five constituent aspects capturing the dependent variable of energy security prioritization. I capture the prioritization of energy security through level, type and structure of its five constituent aspects: energy supply diversification, through both 1) transit (pipeline) diversification, and 2) supplier (contract) diversification and 3) import market concentration. I also compare the energy

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<sup>11</sup> John Stuart Mill, *A System of Logic, Ratiocinative and Inductive: Being a Connected View of the Principles of Evidence and the Methods of Scientific Investigation* (John W. Parker, 1843), 455ff.

mix (domestic demand structure) through comparing 4) energy mix type and its structure, and finally offer comparison in the differences of 5) import as well as domestic energy prices.

In this effort I test the following three hypotheses: First, the security aspect of energy policy is prioritized when the perception of external threat, ascribable to specific political or economic actor of relevance to energy supplies, is present and concentrated among supporters of political force in the government. I measure the developments in popular perceptions of external threat using extensive longitudinal data from numerous representative surveys of general public in the CEE countries.

The hypothesis on elite transition that I test is that there is a relation between the vetting laws chosen and the number of former regime exponents in the transition government. The higher the number of former regime exponents in the government, less likely was the government to prioritize security in its energy policy. I operationalize this by measuring the share of former secret service collaborators in the government in case of Czech and Slovak Republics, since the data for these two countries is readily available. I also measure the intensity of relations between the governments through high-level state visits between my case countries' governments and Russia.

What I argue is that, type of coping with the past, as exemplified through the degree and kind of vetting/lustration chosen as part of the transition, has influenced the available and preferred political choices in the energy policy.<sup>12</sup> In cases where lustration has been more thoroughly followed-up and the former members of the regime's security apparatus were excluded from directly and closely influencing policies, the policy choices favored energy security (and were less

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<sup>12</sup> K. Williams, A. Szcserbiak, and B. Fowler, "Explaining lustration in Eastern Europe A post-communist politics approach" (2003); Elizabeth Barrett, Péter Hack, and Ágnes Munkácsi, "Lustration as Political Competition: Vetting in Hungary," *Justice as Prevention: Vetting Public Employees in Transitional Societies* (2007): 260–307; Roman David, "Lustration Laws in Action: The Motives and Evaluation of Lustration Policy in the Czech Republic and Poland (1989-2001)," *Law & Social Inquiry* 28, no. 2 (Spring 2003): 387–439, <http://www.jstor.org/stable/1215775> (accessed August 11, 2010); Lubomír Kopeček, "Creating a New Democratic System and the Problem of Overcoming the Communist Past: The Czech Case" (n.d.); Neil J. Kritz, ed., *Transitional Justice: How Emerging Democracies Reckon with Former Regimes, Volume I: General Considerations* (United States Institute of Peace, 1995)..

Russia-friendly in general, as observed in Czech Republic<sup>13</sup>). In contrast, in countries where lustration was inconsequential, halted or periodically changed, other policy aims were likely to be prioritized (as observed in Slovakia or Hungary) and policies were much more Russia-friendly.

Finally, I hypothesize that presence, type and concentration of energy-intensive industries in the country were additional factors influencing the prioritization of security in energy policy. I hypothesize that when incumbent industrial interests are de-concentrated and face obstacles in promoting their interests, energy security can be prioritized even if it means exerting costs on industry in short-run. If energy-intensive industry is concentrated, energy security is less likely to be prioritized. This is captured also through the timing and sequencing of both energy assets' as well as major energy consumers' privatization and restructuring.

Privatization of energy assets can hinder prioritization of energy security by divesting the costs of provision of public good of energy security and its benefits, which are easier to internalize before the privatization takes place. The effects of the privatization of the major energy consumers play a role as it can be either used to weaken the entrenched industrial interests and the reluctance to transform and increase competitiveness (as was the case in Czech Republic in the earlier period, and partially in Slovakia after 1998) or cement the rent-seeking political privatizers preferring status quo and shielding from the effects of competitive energy pricing, and avoiding economic restructuring.

In the second section of this dissertation, I proceed with three detailed case studies of Czech Republic, Slovakia and Hungary, which I offer in four chapters. Chapter three offers details on the first two important years of Czechoslovak Federation as Czech and Slovak republics started drifting apart. Chapter four is devoted to the detailed analysis of Czech Republic, chapters five and six to Slovakia and Hungary respectively.

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<sup>13</sup> And into certain extent also Poland.

## **Czech Republic**

Public in the Czech Republic was extremely wary of the former regime, and particularly of Russia. As a consequence Czech Republic strove to get rid of the influence of the former security apparatus and former communist party on public affairs in the initial phases of its transition. While the former state secret service officers tried to influence their immunity from prosecution, when they moved into economy they were mostly left untouched. Still, thanks to a number of fortunate coincidences their identity was publicly known and recognized, and while public sensitivity lasted, their ability to directly influence public policies and energy security choices through participation on democratic policy making was seriously curtailed.

The most prominent political argument relating to the prioritization of security in the energy policy in Czech Republic has been between allowing foreign direct investment to take part in the privatization, or to allow the “Czech way” to prevail. Nonetheless, perception has been that the “Czech way” would have been actually a “Russian way.” Two prominent examples of this struggle are the decision not to privatize the Czech refineries in 1994 to the Chemapol, which was seen as being connected with Russian interests, and the decision to build gas connector enabling the import of Norwegian gas rather than further expansion of Russian imports or investments of Russian companies.

The wide-spread popular fear of Russia has helped Czech politicians invest into what seemed to make little economic sense at the time, but provided high energy security premium over time – both oil and gas diversification links. The latter included also a long-term import contract with Norway, which contributed to aggregate lower prices of gas as compared with regional peers – additional benefit only few hoped for at the time decision was made. Also the way how privatization of the energy sector took place reflected high prioritization of security in energy policy agenda. The energy security prioritization was lessened into some degree only during left-wing social-democratic government, which followed in the latter period. The division of interests and the distinction between the “old” and “new” elites became somewhat blurred, as the

“power-sharing” arrangements among both the politicians and their backing financial groups ran across the original division lines.

### **Slovakia**

The situation in Slovakia was much worse than Czech Republic, and even grimmer than in Hungary. In the first phase of its transition people connected with the communist party and allegedly also the security apparatus maintained full control over the parliament and the government. This difference vis-à-vis Czech Republic was also visible in the continuity of Communist elites which was preserved in Slovakia, unlike in Czech Republic until the first free elections.

Only for a short interim period, when a technocratic government was in charge, attempts at somewhat reasonable energy policies could be detected. Mečiar’s governments, which were in power since the first free elections until 1998 (except for the two periods in 1991/1992 and 1994) were more interested in wild “help yourselfisation”<sup>14</sup> a cash-stripping wild-“privatization,” rather than a sustainable energy security policy. During the last months of Mečiar’s rule a middle-man gas trading company SlovRusGas was established, but the company could never assume role equivalent to similar company in Hungary – Panrusgas.

Because of the very wide coalition of anti-Mečiar forces, even Dzurinda’s government, while having cooled the relations with Russia and explicitly steered country towards EU and NATO membership, had a “fifth column” in the government. Dzurinda had to tolerate the junior coalition partner ex-communist party SDĽ, with its ties to Russia through Devín Bank and its main shareholder Apis. Despite this, Dzurinda’s two governments pushed through major energy legislation, as well as 49% privatization of the “strategic“ energy assets, but mainly because of this sequence, prioritization of security was pre-empted.

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<sup>14</sup> Jana Cervenáková, Viktor Niznanský, and Ol’ga Reptová, *From common to private : 10 years of privatisation in Slovakia* (Bratislava: M.E.S.A. 10, 1999).

The case of Slovakia overall illustrates lack of prioritization of security in energy policy and use of energy policy as a means of particularistic benefit to politically connected cronies, with strong alleged links to Russia. When Dzurinda's second government was replaced by ex-communist SMER, the political nominations to energy companies (oil company Transpetrol in particular) as well as policy priorities taken reaffirmed the argument of ex-communist parties in post-transition countries preferring closer connections with Russia and not prioritizing security in energy policy.

## **Hungary**

The public fears of Russia in Hungary were much less widespread than in case of both Slovakia and Czech Republic. The soviet invasion took place only dozen years earlier than in Czechoslovakia, but the communist regime in Hungary allowed its citizens much happier life than "normalization-era" Czechoslovakia, and the economic reforms and internationalization of the economy started earlier. This was also a reason for relatively weak response and isolated and chaotic attempts at transitional justice and lustration legislation. As a consequence of absent fear of Russia especially on the left-side of the political spectrum, energy security was treated as a policy priority only by right-wing political elites. Despite the fact that the perception of fear of Russia, unlike in case of Czech Republic, didn't run clearly along the political party lines.

The first government after the transition, the reformist center-right Antall-Boross government, prioritized energy security by starting energy diversification. Antall-Boross government initiated the construction of gas pipeline to Austria, but it was never followed-up with a contract diversification, as the subsequent socialist-liberal coalition government was more interested in large-scale privatization of energy assets.

On October 1, 1994 in the first months of the socialist-liberal Horn government Russian-Hungarian intermediary company Panrusgáz<sup>15</sup> was set-up and in the 1996 treaty named exclusive vehicle for the long-term intergovernmental gas import. Thus this majority Gazprom controlled

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<sup>15</sup> The "venture" companies used as front companies for Gazprom or its managers mushroomed: TurkmenRosGaz, RosUkrEnergo,

company became the largest importer of natural gas to Hungary. Hungary was also a registration place for a number of other important Gazprom front companies. The first one, Interprocom, was set-up in Budapest already in June 1989<sup>16</sup> by the former top manager of Gazexport Megdet Rakhimkulov. Interprocom, later transferred effectively to the family members of Gazprom officials,<sup>17</sup> became the vehicle for cash stripping of Gazprom and exporting assets from Russia. Interpocom<sup>18</sup> was later joined by Eural Trans Gas headed by former communist official, as well as the seat of one of the Gazprom's foreign banking operation AEB.

During the socialist-liberal government, energy security considerations were mostly absent. Panrusgas gained stronghold and the economic imperium curated by Rakhimkulov family grew. Orbán's first government stopped privatization, and waged an open fight against hostile takeover of BC refinery business, attempted through a number of front-end companies allegedly leading to Gazprom managers.

With the return of socialist-liberal coalition government, privatization was restarted, and more friendly relations with Russia and Russian companies reinstated. The experience of Hungary showed exceptional consistency between policies of the (center)-right and socialist-(liberal) governments. While right-wing governments consistently implemented policies prioritizing security in the energy policy and acted upon "fear" of Russia, the socialist governments had other priorities and fostered intensive relations with Russia facilitating Russia's interests in Central Europe.<sup>19</sup> This is interesting especially given rather weak distribution of fear of Russia along the party lines in Hungary.

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<sup>16</sup> The very same day when Gorbachev met Kohl in Germany.

<sup>17</sup> The sons of Rakhimkulov (Ruslan Rakhimkulov) and former Prime Minister Viktor Chernomyrdin (Vitaly Chernomyrdin), and the daughters of Gazprom boss Rem Vyakhirev (Tatyana Dedikova) and his deputy Vyacheslav Sheremet (Yelena Dmitriyeva) Florian Hassel, "Gazprom Assets A Family Affair," *The Moscow Times*, May 21, 2001, <http://www.themoscowtimes.com/business/article/gazprom-assets-a-family-affair/253518.html> (accessed September 26, 2012).

<sup>18</sup> Followed chronologically in its regional role by Ukrainian Republica, Interhaz, (both Bakai); and Omrania and Itera (Cyprus and Florida, founded by Makarov).

<sup>19</sup> Anita Orbán, *Power, energy, and the new Russian imperialism* (Praeger Security International, 2008); András Deák, "Diversification in Hungarian Manner: The Gyurcsány Government's Energy Policy," *International Issues & Slovak Foreign Policy Affairs* XV, no. 3–4 (2006): 44–55.

# **Chapter 1. THEORETICAL CONTRIBUTION AND REVIEW OF THE STATE OF ART**

## ***1.1. Research Question and Puzzle***

Why do countries in transition under comparable international conditions prioritize energy security differently? Why do their domestic responses of coping with structural position of energy import dependence vary over time, and what explains the type of variation and its timing? By answering these questions, this dissertation contributes to the broader research field on temporal and spatial variation of domestic responses to comparable international conditions.

More specifically, my aim is to understand the factors of prioritizing security in energy policy, and their facilitating or inhibiting conditions. As I observe in the Central and East European countries in transition, policies enhancing energy security are prioritized when three aspects coincide and interact: When popular perception of threat which can plausibly be connected to the energy supply is high and concentrated among supporters of ruling parties, when former elites who can draw on personal links with the perceived source of threat and thus can dampen the effects of threat are removed from power, and when incumbent industrial interests are de-concentrated and face obstacles in promoting their interests.

I define energy security by five constituent aspects of the level, type and structure of: transit diversification, supplier diversification, import market concentration, energy mix and energy prices. An energy import dependent country has high energy security when its energy import transit routes and suppliers are diversified, the import market is de-concentrated, and its energy mix is diversified – with consumers spread over a number of different sectors, with stable and comparable prices to other countries in similar position.

Various countries routinely choose and prioritize different policies; that in itself is not sufficiently puzzling and worth one's attention. Reasons for variation can be multiple, and there is number of theories that capture these either in the individual, domestic or international factors

predetermining the policies.<sup>20</sup> I follow the distinction in the literature<sup>21</sup> and within the nation-state further distinguish between the governmental and societal-level factors, and their interaction in influencing the state-level response to the structural conditions of energy import dependence.

Within the energy security literature, variation of energy security policies is rarely studied, rather the field focuses on definitions of what energy security is, and the actual or hoped for convergence towards achieving it.<sup>22</sup> If the variation in energy security is discussed in the literature at all, it is mostly presented as a stage of a country on its way to *achieving the energy security*. Countries are assumed to *want* energy security and if they do not prioritize it, this is assumed to be because of external factors preventing them from doing so.

This prescriptive view aside, the most common reasons for variation mentioned are: 1) extent to which a country is energy resource-rich or energy resource poor, 2) degree to which market forces are allowed to operate (level of liberalization), and 3) difference in degree to which planning is short-term or long-term.<sup>23</sup>

The first reason explains the difference between energy rich and energy poor countries, and is part of what I call “hard” fundamentals, but it does not explain why variation in the energy security policy occurs *among* energy resource poor countries. I see the degree to which market forces are allowed to operate as a result of regulatory policy choices, and an energy policy tool in itself. The type of the tool itself, nonetheless does not explain why it is being chosen from the available toolbox. The difference in the degree to which planning is short-term or long-term i.e.

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<sup>20</sup> Kenneth Neal Waltz, *Man, the state and war* (Columbia University Press, 1959); James N. Rosenau, *The scientific study of foreign policy* (Nichols Publishing Company, 1980); Jack S. Levy, “The causes of war and the conditions of peace,” *Annual Review of Political Science* 1, no. 1 (1998): 139–165.

<sup>21</sup> Robert Jervis, *Perception and misperception in international politics* (Princeton Univ Pr, 1976).

<sup>22</sup> David A. Baldwin et al., “Evaluating the energy security impacts of energy policies,” in *The Routledge Handbook of Energy Security*, 2011.

<sup>23</sup> Ibid.; David von Hippel et al., “Energy security and sustainability in Northeast Asia,” *Energy Policy* 39, no. 11 (November 2011): 6719–6730, <http://www.sciencedirect.com/science/article/pii/S0301421509005138> (accessed May 21, 2012); *A Framework for Energy Security Analysis and Application to a Case Study of Japan*, Synthesis Report for the Pacific Asia Regional Energy Security (PARES) Project, Phase 1 (Nautilus Institute For Security And Sustainable Development, [http://www.nautilus.org/archives/pares/PARES\\_Synthesis\\_Report.PDF](http://www.nautilus.org/archives/pares/PARES_Synthesis_Report.PDF), 1998), 7.

degree of temporal depth is in my view also a policy choice – be it voluntary or otherwise as I discuss as “soft fundamentals.”

While states have different levels of energy security (also) because they implemented different energy policy choices, this alone does not provide us with an understanding of their policy choices. In sum, I argue that the type of regulation is also a tool which is chosen to implement energy policy, and prioritize security. Thus short-term vs. long-term planning focus is a political choice made as well. Therefore it is important to understand reasons for different energy policy choices and policy tools used to avoid circular explanation.

It is surprising that the energy security and energy policy literature do not offer deeper explanations for the divergence among countries. It is implicitly assumed that energy security is an objectively given absolute aim. In case there is variation observed, the literature suggests that a “different” type of energy security is being pursued. Or these differences are seen to be result of necessary response either to external factors, or to fundamentals, the conditions that are beyond policymakers’ reach and to which they are forced to respond. Natural conditions, climate, availability or lack of natural resources or composition and type of neighboring countries (geopolitical position) are some of these frequently cited conditions. I consider these alternative explanations after I present my working definition of energy security and study possible answers for the policy divergence in other strains of literature.

I claim that energy security is a policy priority as many others and thus important elements of explanations for the variation in policies can be found outside of energy security literature. The main reasons for divergence in energy policy choices are to be found in domestic policy choices which are result of domestic political structure demonstrated through political processes, made in response to the external factors, and in order to pursue political aims, or “national interest” formulated through the interplay of these factors. Level of investments into military, education, or infrastructure and the division and prioritization of these can serve as examples. All of these

policy choices are limited by the scarcity of resources, and opportunities, which influence options for the prioritization among various, and often competing policy goals.

## **1.2. Definition of Energy Security and Theoretical Discussion**

The energy security literature has followed non-academic interest in energy security and it has emerged in waves. The first wave followed the oil crisis in 1973-1974. The second wave followed the end of Cold War, when transition with the ensuing realignment of foreign policy and economic transformation was underway. Not only went these countries through the change of relations with post-soviet Russia as their most important energy supplier, but they also implemented deep economic transformation and integration into west-European political and economic structures.

These two waves can also be seen as a move from traditional understanding of energy security to a more inclusive one reflecting on the changes in trade patterns. Security of energy resources has traditionally been studied in relation to the ability of states to fuel their economies, in order to sustain their armies in case of aggression.<sup>24</sup>

At the pinnacle of the first wave of literature on energy security is the edited volume by Raymond Vernon in 1976,<sup>25</sup> as well as David Deese and Joseph Nye's report of Harvard's energy and security research project five years later.<sup>26</sup> While Vernon's volume focused mainly on the interpretation and reflections of the oil crisis, given that oil at the time was seen as the most important fuel in terms of geo-strategic considerations. The Deese and Nye report went deeper into the issue of energy security. Authors observed that "the relationships between energy,

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<sup>24</sup> Gautam Sen, *The military origins of industrialisation and international trade rivalry* (Pinter London, 1984); Charles L. Schultze, "Economic Content of National Security Policy, The," *Foreign Aff.* 51 (1972): esp. pp. 522–529; Stephen M. Walt, "The renaissance of security studies," *International Studies Quarterly* 35, no. 2 (1991): 221–239.

<sup>25</sup> Raymond Vernon, *The Oil crisis* (New York: Norton, 1976).

<sup>26</sup> David A. Deese and Joseph S. Nye, *Energy and security* (Cambridge, Mass.: Ballinger Pub. Co., 1981). See also Amory B. Lovins and L. Hunter Lovins, *Brittle power: energy strategy for national security* (Andover, Mass.: Brick House Pub. Co., 1982).

economic growth and national security are complex”<sup>27</sup> and Nye explicitly framed “energy as a security problem.”<sup>28</sup> It was already then that authors noted the tensions between stating that energy is a security problem, and reflections of specific policies on this observation, as well as the complexity of “devising a strategy and thinking of energy as a security problem.”<sup>29</sup> The volume focused mainly on the position of major economies (referred to as “key nations”) and mentioned the “energy squeeze” of Central and Eastern European countries vis-à-vis their relation to Soviet Union, although only in passing.<sup>30</sup>

Deese provided five indicators for energy security: “degree of dependence on foreign sources of energy [...] diversification of oil import sources [...] distribution of primary energy sources [...] distribution of final uses of energy.” The fifth indicator that Deese uses is in “differences in government energy policies” which he refers to as the “degree of government intervention in energy markets.”<sup>31</sup> Since government interventions influence all other four energy security indicators, in my view this last indicator, is a self-referencing one, and its inclusion conflates his otherwise helpful classification.

The understanding of energy security in the first wave of literature can be summarized as desire to have foreign policy “molded together [with energy policy] into an effective strategy of energy security” and responding to “three basic threats: the physical disruption of oil supplies, economic and political damage from rapid increases in oil prices, and the foreign policy consequences of [...] energy vulnerability.”<sup>32</sup>

This view of energy security was a clear example of understanding the role of energy as an issue of “hard security.” Nonetheless even these authors recognized that hard energy security is more

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<sup>27</sup> Deese and Nye, *Energy and security*.

<sup>28</sup> Joseph S. Nye, “Energy and Security,” in *Energy and Security*, ed. David A. Deese and Joseph S. Nye (Cambridge, Mass.: Ballinger Pub. Co., 1981), 3–21.

<sup>29</sup> Deese and Nye, *Energy and security*, 6.

<sup>30</sup> Marshall I. Goldman, “The Role of Communist Countries,” in *Energy and Security*, ed. David A. Deese and Joseph S. Nye (Cambridge, Mass.: Ballinger Pub. Co., 1981), 113.

<sup>31</sup> David A. Deese and Linda B. Miller, “Western Europe,” in *Energy and Security*, ed. David A. Deese and Joseph S. Nye (Cambridge, Mass.: Ballinger Pub. Co., 1981), 181–227.

<sup>32</sup> David A. Deese, Alvin L. Alm, and Joseph S. Nye, “A U.S. Strategy for Energy Security,” in *Energy and Security*, ed. David A. Deese and Joseph S. Nye (Cambridge, Mass.: Ballinger Pub. Co., 1981), 391–424.

of a wish and appeal of students of international relations than observed reality. They recognized that the United States considered, and proclaimed energy a security issue for three decades, “in reality, however American policies have tended to address price and economic effects more than energy security.”<sup>33</sup> This observation is in line with my argument that governments prioritize other policy aims than security, and inspires my inclusion of price aspect in analyzing the presence and absence of prioritization of security in energy policy.

The tension between the expectations that governments *ought to* prioritize energy security and observed reality that other policy aims are prioritized calls for re-conceptualization of energy security to include the latter. This gradual “widening” of the concept can be seen in the second wave of the energy security literature.

The second wave of energy security literature followed after the demise of Soviet Union, and the realignment after the end of Cold War. In one way this has been history replayed, as CEE countries were shielded from the effects of the energy crisis in seventies as they received undisturbed amounts of energy at below world market prices.<sup>34</sup> In the second wave we witness two streams of literature – one attempting to maintain the intellectual rigor of the energy security concept by maintaining the narrow understanding of energy as a hard security issue, and a second broader approach attempting to include all those aspects which in fact are prioritized by governments, under the label of energy security.

The Jan Kalicki and David Goldwyn volume<sup>35</sup> followed the path set by the first wave, confirming the dominance of oil, even if recognizing emerging alternative energy sources. The core question of their volume following the wish for coordination between foreign policy and energy security, is how energy can be used to further foreign policy goals. They address two of the related aspects – “how best to conduct relations with established producers [...] to ensure oil

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<sup>33</sup> Ibid., 392.

<sup>34</sup> Goldman, “The Role of Communist Countries,” 115.

<sup>35</sup> Jan H. Kalicki and David L. Goldwyn, *Energy and Security: Toward a New Foreign Policy Strategy*, illustrated edition. (The Johns Hopkins University Press, 2005).

market stability and security of supply. [...] the second is how to develop non-OPEC resources and to ensure that their production also reaches the international market place.”<sup>36</sup>

History seems to be repeating itself, 24 years after the Deese-Nye volume, different authors again observe that, “domestically, the United States has a persistently short attention span when it comes to energy security. It focuses on conservation and stability of supply when gasoline prices are high, in times of war, or when it suffers a disruption in supply for a major producer. Once a war ends, prices drop, electric power is restored, or production resumes, attention fades.”<sup>37</sup>

Kalicki-Goldwyn also observe the complexity that energy security trade-offs, especially domestically, present: “the trade-offs between energy security and national security, energy and the environment and energy and economic security are hard – and the politics of change is formidable.”<sup>38</sup> Authors further analyze the structure of challenges to energy security policies in US, including the division following regional rather than partisan lines or the “bipartisan failure to achieve basic changes” after this analysis authors arrive at a rather surprising conclusion that “the challenge of achieving domestic reform is formidable and makes the need for a new foreign policy approach more urgent.”<sup>39</sup>

The definition of energy security proposed in the Kalicki-Goldwyn volume is the “provision of affordable, reliable, diverse and ample supplies of oil and gas (and their future equivalents) – to the United States, its allies, and its partners – and adequate infrastructure to deliver these supplies to market.”<sup>40</sup> Components of this definition recur in most energy security definitions. Similar to other “comprehensive” definitions, for Kalicki-Goldwyn “affordable energy means the ability to buy supply at relatively stable as well as reasonable prices” they even quote a median range of

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<sup>36</sup> Ibid.

<sup>37</sup> Ibid., 6.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid., 7.

<sup>40</sup> Ibid., 9.

\$18-\$22 per barrel of oil, but emphasize the importance of volatility of prices, rather than their level.

Kalicki-Goldwyn's overall energy security definition nevertheless runs the same problem of complexity and context specificity: "A reliable energy supply means predictable supplies that are less and less vulnerable to disruption." While they recognize that "energy security also means more than oil security – it means security of supplies for natural gas" they see this mainly in "the ability to insulate the global economy from the effects of extreme vulnerability." Their conclusive definition notes that "energy security is an important goal in its own right, but it becomes critical when viewed against the broader canvas of foreign policy and economic development."<sup>41</sup> While trying to account for the observed divergences of priorities and attempting to maintain the conceptual rigor Kalicki-Goldwyn remain trapped in between the hard security view of energy security as an aim in its own right and its broader implications for other policies, but they do not provide a compass to help navigate from this conundrum.

The widening approach to energy security starts with division into different "dimensions," and responses to the globalization of energy trade. As also Harris notes, interconnection in energy development, supply, and use, throughout the world "renders obsolete the traditional energy policy approaches directed towards national autonomy and control," as another dimension of this explanation, she points out that national markets are increasingly integrating with global markets.<sup>42</sup>

Alhajji also joins the wider understanding when he refers to "economic, environmental, social, foreign policy, technical and security" dimensions of energy security.<sup>43</sup> Von Hippel et al. identify "energy supply, economic, technological, environmental, social-cultural and military-security"

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<sup>41</sup> Ibid., 14.

<sup>42</sup> Martha Caldwell Harris, "The Globalization of Energy Markets," in *The Global Century: Globalization and National Security*, ed. Richard L. Kugler and Ellen L. Frost (Washington, D.C.: National Defense University Press, 2001), 272.

<sup>43</sup> A. F. Alhajji, "What is Energy Security?," *Energy Politics. Issue IV. Spring* (2008).

dimensions for which they also provide a laundry-list of energy security policy issues, and complementary energy security strategies, measures/attributes and their interpretation of them.<sup>44</sup>

While energy security is let in through the conceptual open door into virtually any policy area, the conceptual questions of definition remain.

Sovacool and Kruyt et al, both distinguished four dimensions of energy security that relate to the “availability, accessibility, affordability and acceptability of energy.”<sup>45</sup> Elsewhere Sovacool and

Mukherjee offer different five dimensions of “availability, affordability, technology development and efficiency, environmental and social sustainability, and regulation and governance.”<sup>46</sup>

Widening of the understanding of energy security provides also the challenge of sufficiently rigorous conceptualization which would enable quantification of energy security, or at least a proxy measurement. Kruyt et al.<sup>47</sup> have provided comprehensive review of attempts to quantify these concepts,<sup>48</sup> but they only attest to the great diversity of approaches and understandings.

With the advent of wideners in energy security, energy security attracted attention also of students of critical security. Chester points the ‘polysemic nature’ of energy security,<sup>49</sup> and the context-specificity of energy security has been acknowledged also by Yergin<sup>50</sup> and Kruyt et al.<sup>51</sup>

Ciuta provides a critique of the academic *practice* of energy security pointing out the tension

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<sup>44</sup> von Hippel et al., “Energy security and sustainability in Northeast Asia,” 6726.

<sup>45</sup> Bert Kruyt et al., “Indicators for energy security,” *Energy Policy* 37, no. 6 (June 2009): 2166–2181, <http://www.sciencedirect.com/science/article/B6V2W-4VV1BD3-6/2/7dfa92a4c8ec60293f20a099949e871a> (accessed February 8, 2010); Benjamin K. Sovacool, *The Routledge Handbook of Energy Security* (Taylor & Francis, 2011), 6.

<sup>46</sup> Benjamin K. Sovacool and Ishani Mukherjee, “Conceptualizing and measuring energy security: A synthesized approach,” *Energy* 36, no. 8 (August 2011): 5343–5355, <http://www.sciencedirect.com/science/article/pii/S0360544211004294> (accessed May 21, 2012).

<sup>47</sup> Kruyt et al., “Indicators for energy security.”

<sup>48</sup> J. C. Jansen, W. G. Van Arkel, and M. G. Boots, “Designing indicators of long-term energy supply security,” *Energy research Centre of the Netherlands ECN* (2004); Martin Scheepers et al., “EU Standards for Energy Security of Supply-Updates on the Crisis Capability Index and the Supply/Demand Index Quantification for EU-27” (n.d.); J. de Jong et al., “EU Standards for Energy Security of Supply” (2006); J. Bollen, *Energy security, air pollution, and climate change: an integrated cost-benefit approach* (Netherlands Environmental Assessment Agency, 2008).

<sup>49</sup> L. Chester, “Conceptualising energy security and making explicit its polysemic nature,” *Energy policy* 38, no. 2 (2010): 887–895.

<sup>50</sup> Daniel Yergin, “Ensuring Energy Security,” *Foreign Affairs* 85, no. 2 (April 2006): 69–82, <http://www.jstor.org/stable/20031912> (accessed May 12, 2010).

<sup>51</sup> Kruyt et al., “Indicators for energy security.”

between the requirement of homogeneity of security and the observed multiplicity of energy policy priorities.

When the observed diverse objectives of energy policy are forced under the conceptual umbrella of security, they destabilize the security aspect of the definition: As Ciuta points

“no easy fit can be found between energy and existing security theories, precisely because the attempt to find such a fit destabilizes the conceptual scaffolding of these theories. [...] the apparent fit between energy and the traditional approach to security undermines terminally the first principle of this approach, namely, the strict boundaries of the concept and practice of security. Energy security is formulated in patterns that contain jagged fragments and distorted residues of the elements thought essential to many different definitions of security – either survival and existential threats, or emancipation, exception, and distinctions between friend and foe. As a consequence, energy displaces, reshapes and remodulates the definitions of security embedded in these theoretical approaches. [...] In other words, energy apparently confirms that ‘security’ may still have power but does not need to have an obvious meaning. Security is not present in ‘energy security’ in order to explicate what is security-ish about energy, but as a result of a reflex that only seems to confirm both its power and its meaninglessness. Even the absence of conceptual debate on energy security could confirm this inflationary tendency. We may simply not care anymore whether energy is really a security issue, or whether it is wise to put it on the security agenda. Theoretically speaking, the totality of energy may make security total, but not before it makes it banal, a redundant empty signifier.”<sup>52</sup>

This critique of widening approach to energy security is important, as it uncovers the problematic approach to study of energy security. Authors in the search for understanding the variation of importance given to the energy security among various countries in their energy policies rather refitted the definitions to fit the empirical observations. In the absence of observed behavior of governments pursuing narrow energy security, authors instead of finding reasons for this discrepancy and variation pursued the road of changing and widening the definition of energy security to fit the empirical observations.

This has resulted in case of almost every author, and sometimes in each of their publications,<sup>53</sup> in a new definition and redefinition of what energy security is and what it should be. Subsequently this led to almost four dozen of mainstream definitions available in the energy security literature.<sup>54</sup> Literature review on definitions of energy security thus resembles compiling a phone-

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<sup>52</sup> Felix Ciuta, “Conceptual Notes on Energy Security: Total or Banal Security?,” *Security Dialogue* 41, no. 2 (2010): 123.

<sup>53</sup> Sovacool, *The Routledge Handbook of Energy Security*, 3.

<sup>54</sup> *Ibid.*, 3ff.

book. Most of the four-dozen definitions can be classified around logics,<sup>55</sup> policies, or perspectives<sup>56</sup> around which they revolve, or underlying values they represent.<sup>57</sup> Different “logics” offered to-date to explain energy security include “scientific”, “economic”, “ecological”, “social welfare”, and “political”, others include “logic of war, a logic of subsistence and a ‘total’ security logic,”<sup>58</sup> but these logics only represent different analytical perspectives, and further illustrate problems with the widening approach.

Updating or extending the list compiled by Sovacool,<sup>59</sup> is possible – as demonstrated by Tvaronavičienė,<sup>60</sup> - but this might contribute little to our understanding of the matter. Tvaronavičienė also reached the same conclusion that “there is still no unanimous agreement how energy security can be defined and the discussion is ongoing.” She further added that the notion of “energy security” is indefinable universally, as it is in principle context-sensitive perception,” and concluded that the various energy policy targets contradict each other.<sup>61</sup>

The working definition that I use to understand the prioritization of energy security in the context of countries in transition coping with energy import dependency recognizes the limitations and context specificity. In the context of transition countries in Central and Eastern Europe I draw on the work of the first wave of energy security literature and remain within the narrow definition of energy security as sensitivity to energy import dependence. I extend the narrow supply security, which forms first part of my definition and analyze this sensitivity through five constituent aspects: the level, type and structure of a) transit diversification, b)

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<sup>55</sup> Ciuta, “Conceptual Notes on Energy Security: Total or Banal Security?”; Sovacool, *The Routledge Handbook of Energy Security*, 6ff.

<sup>56</sup> Aleh Cherp and Jessica Jewell, “The three perspectives on energy security: intellectual history, disciplinary roots and the potential for integration,” *Current Opinion in Environmental Sustainability* 3, no. 4 (September 2011): 202–212, <http://www.sciencedirect.com/science/article/pii/S1877343511000583> (accessed May 21, 2012).

<sup>57</sup> Sovacool and Mukherjee, “Conceptualizing and measuring energy security.”

<sup>58</sup> Ciuta, “Conceptual Notes on Energy Security: Total or Banal Security?”.

<sup>59</sup> Sovacool, *The Routledge Handbook of Energy Security*, 3–6.

<sup>60</sup> Manuela Tvaronavičienė, “Contemporary Perceptions of Energy Security: Policy Implications,” *Journal of Security and Sustainability Issues* 1, no. 4 (2012): 235–247.

<sup>61</sup> Ibid.

supplier diversification, c) import market concentration, d) energy mix and finally e) energy prices.

Thus for a net energy importing country, I consider high energy security a situation when energy import transit and suppliers are diversified, and the import market is de-concentrated. Energy security is also increased by diversified energy mix – with consumers diversified among a number of different sectors, with stable and comparable prices to other countries in similar position.

As the review of energy security definitions demonstrates, the energy security literature focuses on various aspects of energy policy and security, but is of limited utility in understanding the reasons why prioritization of energy security in energy policies varies across countries and over time. I argue that security is *neither* the main aim of energy policy, *nor* the single driving force of energy policy (re)prioritization. Conflating energy policy with security has minimal analytical value. As I demonstrate in this dissertation, energy policy consists of other policy goals, bundling of which under the label of security is neither desirable nor analytically useful. Additionally, as empirically observed, other policy goals frequently take priority over security, and therefore privileged position of energy security in the academic discourse does not reflect the policy need or attention that it gets with policymakers in reality.

This is not to say that security is absent from the policy prioritization, or that it is not among policy aims, or that it cannot *somehow* be claimed to be delivered through pursuing other policy aims. It is rather to say that security is one among several policy aims, and it is additionally used as a vehicle, signifier supporting and emphasizing argument, to further advance other policy priorities and interests. As Andrews points out, states are involved in the energy sector for various reasons with energy security, being the most voiced “policy driver, of great rhetorical and practical importance.”<sup>62</sup> Energy policy therefore is not only about security, it is about other

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<sup>62</sup> Clinton J. Andrews, "Energy Security as a Rationale for Government Action," *IEEE Technology and Society Magazine* 24, no. 2 (Summer 2005).

policy aims such as welfare, competitiveness, efficiency, environment and general industrial policy as well.

My effort is to understand what the contributing factors to prioritizing the specific aspect of security in energy policy are, and under what circumstances do they facilitate or inhibit prioritization of security on the policy agenda. Therefore I argue that the best analytical approach is to analyze prioritization of specific security aspects in the complex energy policy system. This approach enables us to understand and explain different prioritizations of energy security throughout the studied period, as well as the inter-temporal and interspatial variation across the cases. This approach also enables to understand whether and how countries in fact coped with their structural position and energy import dependence and what were the driving factors influencing different energy security policy choices that are used to tackle the problems stemming from this structural position.

### **1.3. Understanding the Variation in Policy Priorities**

Students of energy security have been striving to provide an ultimate all-encompassing *definition*<sup>63</sup> of what energy security *ought to be*, rather than what it *is*<sup>64</sup> and under what conditions are we expected to see *how much* of energy security and *why*. Also the variation observed across time and among countries received so far only limited attention in literature.<sup>65</sup> Neither does the energy security literature provide answer to the question about the driving factors of its prioritization over other policy goals.

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<sup>63</sup> Alhajji, Chester, Kruyt et al., Scheepers, Le Coq Paltseva, etc. ...

<sup>64</sup> Ciuta, "Conceptual Notes on Energy Security: Total or Banal Security?"

<sup>65</sup> Benjamin K. Sovacool and Marilyn A. Brown, "Measuring Energy Security performance in the OECD," in *The Routledge Handbook of Energy Security*, 2010.

In the literature, energy security is simply expected to raise high on the priority rank of policy agendas.<sup>66</sup> Energy security is considered a legitimate concern of state security,<sup>67</sup> a prime mover,<sup>68</sup> and as such, it is endowed with the possibility to “jump” the policy priority lists and raise on the policy agendas. Scholars of international relations consider energy resources as a “state equivalent of basic human needs,” as an issue, which can *objectively* be seen as legitimate security concern – thus a question of security and a reason for war.<sup>69</sup> The fact that energy can be a security problem is recognized not only in narrow understanding of security, but even by wideners as Buzan, who claims that if national economy needs external resources, access to them “can be clearly and legitimately securitized,”<sup>70</sup> – that is presented and understood as security issue.

The empirically observed reality for both major powers but also for small states is different – states prioritize other policy aims over security and seem to go unpunished for it over decades.

Why is it then that this body of literature provides us with little else than the assertion that energy is a security problem? While the problem of a belligerent neighbor does not require extensive conceptualization to understand the nature of the security problem, understanding energy as a security problem is less straightforward.

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<sup>66</sup> Pierre Noël, “New US Middle East Policy and Energy Security Challenges, The,” *Int’l J.* 62 (2006): 43, [http://heinonlinebackup.com/hol-cgi-bin/get\\_pdf.cgi?handle=hein.journals/intj62&section=11](http://heinonlinebackup.com/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/intj62&section=11) (accessed April 25, 2013); Anatol Lieven, “The Push for War,” *London Review of Books*, October 3, 2002, <http://www.lrb.co.uk/v24/n19/anatol-lieven/the-push-for-war> (accessed April 25, 2013); John J. Mearsheimer and Stephen M. Walt, “The Israel lobby and US foreign policy,” *Middle East Policy* 13, no. 3 (2006): 29–87, <http://onlinelibrary.wiley.com/doi/10.1111/j.1475-4967.2006.00260.x/full> (accessed April 25, 2013); Condoleezza Rice, “Rethinking the national interest: American realism for a new world,” *Foreign Affairs* (2008): 2–26.

<sup>67</sup> Kent E. Calder, *Asia’s deadly triangle : how arms, energy, and growth threaten to destabilize Asia-Pacific* (London ; Sonoma, Calif.: Nicholas Brealey Pub., 1997); Susanne Peters, “Coercive western energy security strategies: ‘resource wars’ as a new threat to global security,” *Geopolitics* 9, no. 1 (March 2004): 187–212; Kenneth Neal Waltz, *Man, the state, and war: a theoretical analysis* (New York: Columbia University Press, 2001); Barry Buzan, Ole Wæver, and Jaap de Wilde, *Security : a new framework for analysis* (Boulder, Colo.: Lynne Rienner Pub., 1998); Michael T. Klare, *Resource wars : the new landscape of global conflict*, vol. 1st (New York: Metropolitan Books, 2001); Sam Nunn et al., *The geopolitics of energy into the 21st century* (Washington, D.C.: CSIS Press, 2000).

<sup>68</sup> Ciuta, “Conceptual Notes on Energy Security: Total or Banal Security?”.

<sup>69</sup> Kent E. Calder, *Pacific defense : arms, energy, and America’s future in Asia*, vol. 1st (New York: W. Morrow, 1996); Peters, “Coercive western energy security strategies: ‘resource wars’ as a new threat to global security”; Klare, *Resource wars : the new landscape of global conflict*, 1st; Waltz, *Man, the state, and war: a theoretical analysis*.

<sup>70</sup> Buzan, Wæver, and Wilde, *Security : a new framework for analysis*.

Given the neorealist paradigm's focus on explaining relations between states mainly from the perspective of primacy of foreign policy and diplomatic bargaining, it falls short of explaining observed variation among countries in transition in central Europe. While theories based on the realist paradigm do not strive for explaining differences, they fail to explain why countries go "unpunished" for not improving their energy security.

The empirical observation of Central and Eastern European countries could be dismissed as too peripheral. Nonetheless, the few existing panel and timeline comparisons of energy security indices demonstrate that countries regardless of their geopolitical importance, or economic power, overtime rarely improve their energy security.<sup>71</sup> It is especially puzzling from the perspective of realism that according to the same study, between 1970 and 2007 out of almost three dozen OECD countries only Switzerland, Belgium, Japan and United Kingdom have improved their energy security.<sup>72</sup> It can be further argued whether this improvement is a result of conscious policy choice (as one could perhaps argue for Japan), or a coincidence of developments outside government policies (as it could be argued for Belgium and United Kingdom).

As Sovacool and Brown point out in larger panel study,<sup>73</sup> few countries act upon observed energy insecurity. This is also confirmed by my own observations in Central and Eastern Europe. Hence the prioritization of energy security is not a function of insecurity, but of something else. Since the effects of international system and structure cannot explain this variation, I propose to look at the impact of domestic factors.

The importance of domestic factors on forming foreign and security policy outcomes is no longer as overseen in the literature as it once was. The available explanations combine both questions of how international system affects the domestic politics as well as how domestic

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<sup>71</sup> Sovacool and Brown, "Measuring Energy Security performance in the OECD," 388.

<sup>72</sup> Ibid.

<sup>73</sup> Ibid.

politics affects the international system. Since the times when Waltz introduced the “second image”<sup>74</sup> and Gourevitch reversed it<sup>75</sup> the perspective of domestic factors have gained legitimate place in the analytical apparatus of both International Relations and International Political Economy. Nonetheless, the understanding of causal impact of domestic factors on prioritizing security policy remains largely under-theorized.<sup>76</sup> As Putnam notes: “Neither a purely domestic nor a purely international analysis could account for this [...]. Interpretations cast in terms either of domestic causes and international effects (“Second Image”) or of international causes and domestic effects (“Second Image Reversed”) would represent merely “partial equilibrium” analyses and would miss an important part of the story, namely, how the domestic politics of several countries became entangled via an international negotiation. [...] we must aim instead for “general equilibrium” theories that account simultaneously for the interaction of domestic and international factors.”<sup>77</sup>

This approach, while highlighting the interaction between the international and the domestic does not provide an answer to what Gourevitch calls “the traditional question: which aspect of domestic structure best explains how a country behaves in the international sphere?”<sup>78</sup> Gourevitch also provides a good review of domestic structural factors that matter for foreign policy.<sup>79</sup> Together with Putnam<sup>80</sup> and Katzenstein<sup>81</sup> he is a source of inspiration for my

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<sup>74</sup> Waltz, *Man, the state and war*.

<sup>75</sup> Peter Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” *International Organization* 32 (Autumn 1978): 881–911.

<sup>76</sup> Robert D. Putnam, “Diplomacy and Domestic Politics: The Logic of Two-Level Games,” *International Organization*, 42, no. 3 (Summer 1988): 427–460.

<sup>77</sup> *Ibid.*, 430.

<sup>78</sup> Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 900. Emphasis added.

<sup>79</sup> *Ibid.*, 901. Gourevitch there also refers to: Jervis, *Perception and misperception in international politics*; J. D Steinbruner, *The cybernetic theory of decision: New dimensions of political analysis* (Princeton Univ Pr, 2002); Michael Brecher, *The foreign policy system of Israel: setting, images, process* (Oxford university press, 1972); Michael Brecher, *Decisions in Israel's foreign policy* (Oxford university press, 1974); R. Harrison Wagner, “Review: Dissolving the State: Three Recent Perspectives on International Relations,” *International Organization* 28, no. 3 (July 1, 1974): 435–466, <http://www.jstor.org/stable/2706301> (accessed April 10, 2011); Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 901.

<sup>80</sup> Putnam, “Diplomacy and Domestic Politics: The Logic of Two-Level Games,” 432.

<sup>81</sup> Peter J. Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978); Peter J. Katzenstein, *Small states in world markets : industrial policy in Europe*, Cornell studies in political economy (Ithaca, N.Y.: Cornell University Press, 1985).

hypotheses on the factors influencing the variation in prioritizing energy security. Although these authors have not studied energy security specifically, their work is very helpful for understanding the importance of elites in politics, economic interest groups, public opinion and elections.<sup>82</sup> Similar to Katzenstein, I see the reason for variation in the policy prioritization and policy choices in the character and functioning of the domestic political structure.<sup>83</sup>

In line with the above, the explanatory (independent) variables of whether states prioritize energy security or not, are to be found mainly in the domestic arena, especially that through my case selection I am able to control for the effect of the international factors. The effects of systemic variables are constant for all of the cases, and thus cannot explain for the observed variation and the lack of “punishment” for states diverging from prioritization of security in their energy policies.

As I observe in the Central and East European countries in transition, policies enhancing energy security are prioritized when public perception of threat which can plausibly be connected to the energy supply is high and concentrated among supporters of political forces in government; when former elites who can draw on personal links with the perceived source of threat and thus can dampen the effects of threat are removed from power; and when incumbent industrial interests are dispersed and thus face collective action problems when promoting their interests.

### 1.3.1. Perceptions of Threat

To understand the link between the variation of prioritization of security among countries in transition and the level of fear of Russia among the citizens I draw on the perceptions literature. The role of fear and perception of threat became more prominent especially with the advent of constructivist theoretical contributions in the literature which built on the seminal work of Jervis.<sup>84</sup> Jervis made the connection from psychology and its applicability in international

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<sup>82</sup> Putnam, “Diplomacy and Domestic Politics: The Logic of Two-Level Games,” 432.

<sup>83</sup> Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, 306.

<sup>84</sup> Jervis, *Perception and misperception in international politics*.

relations,<sup>85</sup> but his contribution remained rather apolitical, emphasizing cognitive biases resulting in misperceptions during decision making. Schelling also recognized that beliefs and perceptions, such as the perceived risk of preemptive military strike, could affect the likelihood of war.<sup>86</sup> While the existing body of literature explains various aspects of decision making and the role of perceptions combining (political) psychology<sup>87</sup>, identity,<sup>88</sup> military<sup>89</sup> and economic theory<sup>90</sup> perceptions got most attention in the non-positivist bodies of international relations literature in which, however, perceptions are rarely fully conceptualized and almost never quantified.<sup>91</sup> An excellent review and critique of the perception literature is also provided by Levy.<sup>92</sup> He criticizes Jervis for failure to distinguish between different types of misperceptions. Yet, Levy's approach is also limited to the understanding of perceptions and misperceptions as causes of war.

I argue that presence of perception of external threat to the economic and national sovereignty of the country, which can be ascribed to particular political or economic actors has a role in influencing the country's prioritization of security in the energy policy. This is especially the case when the threat (or its absence) is perceived by people concentrated among supporters of political forces in the government.

This commonly perceived threat functions by limiting the scope for political choices leading to closer cooperation and maintaining or increasing dependence on those perceived as threat. It allows implementation of economically expensive policies leading to greater independence, and

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<sup>85</sup> Ibid.

<sup>86</sup> Thomas Crombie Schelling, *Arms and influence*, vol. 190 (New Haven: Yale University Press, 1966); Laurence H. Tribe, Corinne Saposch Schelling, and John Voss, "When values conflict. Essays on environmental analysis, discourse, and decision" (1976).

<sup>87</sup> M. W. Watts, "Political xenophobia in the transition from socialism: Threat, racism and ideology among East German youth," *Political Psychology* (1996): 97–126.

<sup>88</sup> Carol Gordon and Asher Arian, "Threat and decision making," *Journal of Conflict Resolution* (2001): 196–215.

<sup>89</sup> B. Fordham, "The politics of threat perception and the use of force: A political economy model of US uses of force, 1949-1994," *International Studies Quarterly* 42, no. 3 (1998): 567–590.

<sup>90</sup> D. Kahneman and A. Tversky, "Prospect theory: An analysis of decision under risk," *Econometrica* 47, no. 2 (1979): 263–291.

<sup>91</sup> Buzan, Wæver, and Wilde, *Security : a new framework for analysis*.

<sup>92</sup> Jack S. Levy, "Misperception and the causes of war: Theoretical linkages and analytical problems," *World Politics* 36, no. 1 (1983): 76–99.

enables political rewards for leaders pursuing them. In cases when government supporters do not perceive a threat from a particular country, or when a threat cannot plausibly be framed and connected with the energy security issue, government has wider scope to pursue policies of cooperation or appeasement.

The existing literature on the role of perceptions in prioritizing energy security is limited. Wionczek in 1983 specifically looks at the problem of misperception in energy security,<sup>93</sup> which is followed by Yergin in 1988 who mentions perceptions of insecurity as a motivation for diversifying energy supplies.<sup>94</sup> From the more recent literature Casier in 2011 follows the discussion in Jervis' terms pointing out that the perception of energy as a security problem is not necessarily reflecting the material situation of how secure the energy supplies are.<sup>95</sup> These arguments further support the hypothesis that prioritization of security follows different logic than objective lack of energy security. I broadly draw on this literature in my hypothesis and the measurement of the effects of perceptions on the prioritization of energy security. I also extend the work of Holsti<sup>96</sup> and others,<sup>97</sup> in understanding the role of perceptions in prioritization of security policy agenda.

The hypothesis that I test related to public perceptions of threat is thus as follows: The security aspect of energy policy is prioritized when the perception of external threat, which can be ascribed to particular political or economic actor of relevance to energy supplies, is concentrated among supporters of political force in the government.

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<sup>93</sup> Miguel S. Wionczek, "Energy and international security in the 1980s: Realities or misperceptions?," *Third World Quarterly* 5, no. 4 (1983): 839–847.

<sup>94</sup> Daniel Yergin, "Energy Security in the 1990s," *Foreign Affairs* 67, no. 1 (1988): 110–132.

<sup>95</sup> Tom Casier, "The Rise of Energy to the Top of the EU-Russia Agenda: From Interdependence to Dependence?," *Geopolitics* 16, no. 3 (2011): 536–552.

<sup>96</sup> Ole R. Holsti, "The belief system and national images: A case study," *Journal of Conflict Resolution* 6, no. 3 (1962): 244–252.

<sup>97</sup> Stuart Oskamp and P. Wesley Schultz, *Attitudes and opinions* (Psychology Press, 2005); Raymond A. Bauer, "Problems of Perception and the Relations between the United States and the Soviet Union," *Journal of Conflict Resolution* (1961): 223–229; Urie Bronfenbrenner, "The mirror image in Soviet-American relations: A social psychologist's report," *Journal of Social Issues* 17, no. 3 (1961): 45–56; Harvey Wheeler, "The role of myth systems in American-Soviet relations," *Journal of Conflict Resolution* (1960): 179–184.

### 1.3.2. Ruling Elites and Transitional Justice

I further hypothesize the interaction between the perception of threat factors, and the ruling elite's preferences. The threat perception interacts and influences the domestic policy preferences and available choices for prioritizing energy security. I draw this hypothesis on the mechanics of the interaction of domestic factors from the combination of international relations and international political economy literature:

Gourevitch proposes “coalitional analysis”<sup>98</sup> to understand why and how specific interests use different tools and institutions to achieve their goals. Putnam adds the structure of important political factor of “identity of the governing coalition.”<sup>99</sup> On the other hand Gourevitch points out the importance of state and politics, emphasizing that “the policy is not simply traceable to the interests of one or another group.”<sup>100</sup> Both Katzenstein and Krasner emphasize the need for the state and decision-makers to be simultaneously concerned with domestic and international pressures. According to Katzenstein, “the main purpose of all strategies of foreign economic policy is to make domestic policies compatible with the international political economy.”<sup>101</sup>

Accordingly, Gourevitch proposes to analyze the conflict among powerful groups,<sup>102</sup> and Katzenstein adds the importance of character of domestic structure.<sup>103</sup> Gourevitch points to interaction among groups and the character of domestic coalitions,<sup>104</sup> emphasizing the political context. I follow the Gourevitch in asking “the traditional question: which aspect of domestic structure best explains how a country behaves in the international sphere?”<sup>105</sup>

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<sup>98</sup> Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 905.

<sup>99</sup> Putnam, “Diplomacy and Domestic Politics: The Logic of Two-Level Games,” 432; Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 903.

<sup>100</sup> Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 903.

<sup>101</sup> Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, 4; Katzenstein, *Small states in world markets: industrial policy in Europe*; Stephen D. Krasner, “United States Commercial and Monetary Policy: Unraveling the Paradox of External Strength and Internal Weakness,” in *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978), 51–87;; Stephen D. Krasner, *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton: Princeton University Press, 1978).

<sup>102</sup> Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 905.

<sup>103</sup> Peter J. Katzenstein, “International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States,” *International Organization*, no. 30 (Winter 1976): 45.

<sup>104</sup> Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics.”

<sup>105</sup> *Ibid.*, 900. Emphasis added.

Alt looks at the question of how much the economy is exposed to the international market when he “models explicitly some ways in which openness affects institutions and ideas and even normal incentives, ways in which structure, institutions and ideas interact to determine economic policy choices and outcomes.”<sup>106</sup> The political argument is also emphasized by Alt, as he points out the need for politicians “to maintain and increase popular support” and thus “gives elected political administrations incentives to make particular economic policy decisions.”<sup>107</sup> The role of ideas and political ideology, which is added by Alt, has been previously formulated by Waltz when he noted that “the practice of politics is greatly influenced by the images the politicians entertain.”<sup>108</sup> Alt proposes the following causal sequence: “structure is prior to institutions and ideas, which precede incentives and strategies, which are the proximate explanations of policy outcomes”<sup>109</sup> Snyder further argues that coalitions reinforce their positions of power and rationalize their policies by exploiting their control over information through the propagation of self-serving myths about their nation, its adversaries.<sup>110</sup>

Katzenstein’s observation is in line with those of Putnam<sup>111</sup> and Gourevitch, and I claim that their general perspective is also applicable to energy policy: “the ruling coalition and policy networks in domestic politics condition strategies of foreign economic policy. The definition of policy objectives is shaped largely by the ideological outlook and material interests of the ruling coalition.”<sup>112</sup>

The divisions between elites within party may play a role,<sup>113</sup> but given the scope of this thesis I use the proxy of using the ruling coalitions in power as a unit, and make the distinction between the internal factions when these were of crucial importance for prioritization of energy security

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<sup>106</sup> J. E. Alt, “Crude politics: Oil and the political economy of unemployment in Britain and Norway, 1970–85,” *British Journal of Political Science* 17, no. 02 (1987): 152.

<sup>107</sup> Ibid.

<sup>108</sup> Waltz, *Man, the state, and war: a theoretical analysis*, 225.

<sup>109</sup> Alt, “Crude politics: Oil and the political economy of unemployment in Britain and Norway, 1970–85,” 152.

<sup>110</sup> Jack L. Snyder, *Myths of empire: Domestic politics and international ambition* (Cornell University Press, 1991).

<sup>111</sup> Putnam, “Diplomacy and Domestic Politics: The Logic of Two-Level Games,” 432; Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” 903.

<sup>112</sup> Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, 306.

<sup>113</sup> Richard Ned Lebow, *Between peace and war: The nature of international crisis* (Johns Hopkins University Press Baltimore, 1981).

(as happened in Czech Republic in 1996-1998). Still the problem of what the ruling coalition really means and who it includes is quite complex, especially in the case of CEE countries in transition. The underlying causal link deserves further scrutiny. The period of transition included the process of forming ideological boundaries, interest groups and political parties. In this context domestic structures and their coalitions have been in flux, and struggled with each other for power and influence. While I use the distinction of right/left ideological “identification”, this should be understood in the local country context, and in the given period – as a short-cut for identifying the ruling government rather than to describe the policies of the given government.

My proposed explanation both focuses on why the different coalition matters, and on the factors of the divergence among different political groups in their outlooks on prioritization of energy security. I see the reason why members of (center)-left governments were less likely to prioritize energy security than members of (center)-right governments in their systematically varied linkages to former security apparatus, and relations to post-soviet Russia. These were much closer in case of members of center-left political formations than in case of center-right. Additionally, supporters of right-wing parties were in general much more threatened by Russia, than their left-wing fellow citizen.

The identity of the governing coalition is important not only because of the ideology that shapes policy preferences. The combination of the transition heritage of personal links which concentrated mainly in post-communist center-left parties (with the notable exception of Hungary), and the concentration of supporters perceiving the main energy supplier as a threat or not along party lines coalesced to increase the importance of ruling coalition’s identity as a predictor of prioritization of energy security.

As the transition progresses, and the importance of threat perception as well as the distinction between the elites fades away, a different phenomenon – state capture – emerges as an important

explanatory factor.<sup>114</sup> As the elites' formation progresses, and the initial advantage that elites connected with the former regime possessed starts to be matched with the connections and power of new elites, their different ideological outlooks under certain circumstances can be overcome through common material interests, as was the case in Czech Republic after 1998, and in somewhat less visible extent in Hungary and Slovakia also in late nineties.

The role of elites and their transition is well covered in literature. Bozoki offers an excellent review of literature on elites in transition in Central and Eastern Europe.<sup>115</sup> Ágh<sup>116</sup> considers a number of questions of elite transition as well. Baylis<sup>117</sup> studied the process of elite transformation and the return of communists into the power in Hungary and Poland. The elite transition literature provides a good source of hypotheses. Yet none of the authors make the explicit connection between the effects of vetting laws and the mechanics of the removal of former elites, neither on energy policy in specific, nor on economic or security policy in general, as I hypothesize in this dissertation. The specific role of effects of elite transition on economic security policy choices is under-theorized and remains rather at a level of anecdotal evidence.<sup>118</sup>

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<sup>114</sup> Joel Hellman, Geraint Jones, and Daniel Kaufmann, "Seize the state, seize the day: State capture, corruption and influence in transition," *World Bank Policy Research Working Paper*, no. 2444 (2000); Joel Hellman and Daniel Kaufmann, "Confronting the Challenge of State Capture in Transition Economies," *Finance and Development | F&D* 38, no. 3 (September 2001), <http://www.imf.org/external/pubs/ft/fandd/2001/09/hellman.htm> (accessed March 10, 2013).

<sup>115</sup> Andras Bozoki, "Theoretical interpretations of elite change in East Central Europe," *Comparative Sociology* 2, no. 1 (2003): 215–247, <http://www.ingentaconnect.com/content/brill/comps/2003/00000002/00000001/art00008> (accessed April 30, 2013).

<sup>116</sup> Attila Ágh, *From Nomenclatura to Clientura: The Emergence of New Political Elites in East Central Europe* (Hungarian Center for Democracy Studies Foundation, Department of Political Science, Budapest University of Economics, 1993); Attila Ágh, "The paradoxes of transition: the external and internal overload of the transition process," *The Journal of Communist Studies and Transition Politics* 10, no. 3 (1994): 15–34; Attila Ágh, "Basic Democratic Values and Political Realities in East Central Europe," *Társadalom és gazdaság Közép- és Kelet-Európában | Society and Economy in Central and Eastern Europe* 17, no. 1 (January 1, 1995): 75–94, <http://www.jstor.org/stable/41468208> (accessed April 30, 2013).

<sup>117</sup> Thomas A. Baylis, "Elite Change After Communism: Eastern Germany, the Czech Republic, and Slovakia," *East European Politics & Societies* 12, no. 2 (March 1, 1998): 265–299, <http://eep.sagepub.com/content/12/2/265> (accessed April 30, 2013).

<sup>118</sup> Vladimír Andrlé, "The Buoyant Class: Bourgeois Family Lineage in the Life Stories of Czech Business Elite Persons," *Sociology* 35, no. 4 (November 1, 2001): 815–833, <http://soc.sagepub.com/content/35/4/815> (accessed April 30, 2013).

Although, an unusual suspect, and largely under-theorized in international relations, the question of transitional justice is important in setting the initial conditions for the path of transition,<sup>119</sup> and structure of domestic elites. It affects the presence and reach to power of former members of the elite, with most intensive links to the Soviet power apparatus. Given that the former security apparatus in post-soviet Russia took control of energy industry, including energy export industry, these personal links were of tremendous importance.<sup>120</sup>

Especially in case of countries in transition, composition of policy community was largely affected by the choice of transitional justice policies. Institutions, coalitions and interests were in the process of their formation. It was of high importance whether and how the lustration/vetting laws were implemented and to what extent the elites and other actors possessing privileged knowledge of the previous regime could participate in the economic and political life of the country.

This is not only important for understanding the policy community and the role of executive officials, politicians and bureaucrats<sup>121</sup> within these networks, but also for grasping who in each of the countries these actors could be. Additionally, the choice of type of vetting laws and their scope influenced the nature of interconnections between politics and business in the formative years which in many cases has had a lasting influence until today.

The hypothesis on elite transition that I test in this thesis is that there is a relation between the vetting laws chosen and the number of former regime exponents in the transition government. I argue that the higher the number of former regime exponents in the government, less likely was the government to prioritize security in its energy policy. I operationalize this by measuring the share of former secret service collaborators in the government in case of Czech and Slovak Republics, since the data for these two countries is readily available. I also measure the intensity

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<sup>119</sup> Kritz, *Transitional Justice*.

<sup>120</sup> Victor Gomez, "What Spy Past? Asks Top Oil Man - The Prague Post", n.d., <http://www.praguepost.com/archivescontent/16693-what-spy-past-asks-top-oil-man.html> (accessed October 22, 2012).

<sup>121</sup> Graham T. Allison, *Essence of decision; explaining the Cuban missile crisis* (Boston,; Little, 1971).

of relations between the governments through high-level state visits between my case countries' governments and Russia.

What I argue is that type of coping with the past, as exemplified through the degree and kind of vetting/lustration chosen as part of the transition, has influenced the available and preferred political choices in the energy policy.<sup>122</sup> In cases where lustration has been more thoroughly followed-up and the former members of the regime's security apparatus were excluded from directly and closely influencing policies, the policy choices favored energy security (and were less Russia-friendly in general, as observed in Czech Republic<sup>123</sup>). In contrast, in countries where lustration was inconsequential, halted or periodically changed, other policy aims were likely to be prioritized (as observed in Slovakia or Hungary).

### 1.3.3. Structure of Industry

I hypothesize that existence, type and concentration of energy-intensive industries in the country are additional factors influencing the prioritization of security in energy policy. The structure of industry is important for understanding the opportunities for interdependence and trade relations. Because of the asymmetries of trade in CEE, and the lack of cross-investment which is seen as necessary for complex interdependence,<sup>124</sup> the concentration of industry and the sensitivities stemming from it are important for understanding the prioritization of security in energy policy.

The argument that trade relations can have asymmetrical benefits for the trading states was already elaborated by Hirschman.<sup>125</sup> Keohane and Nye provide an updated version of this argument. They portray economic relationships as a continuum between perfectly symmetrical

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<sup>122</sup> Williams, Szcserbiak, and Fowler, "Explaining lustration in Eastern Europe A post-communist politics approach"; Barrett, Hack, and Munkácsi, "Lustration as Political Competition: Vetting in Hungary"; David, "Lustration Laws in Action"; Kopeček, "Creating a New Democratic System and the Problem of Overcoming the Communist Past: The Czech Case"; Kritz, *Transitional Justice*..

<sup>123</sup> And into certain extent also Poland.

<sup>124</sup> Harris, "The Globalization of Energy Markets." also Hirschman.and Harris, "Energy and Security.", Yergin, "Ensuring Energy Security."

<sup>125</sup> Hirschman, Albert O. *National Power and the Structure of Foreign Trade*. Expanded ed. Studies in International Political Economy. Berkeley: University of California Press, 1980.

mutual dependence (interdependence) at one extreme point, and absolute asymmetrical dependence on the other. Keohane and Nye define interdependence as a sensitivity, and vulnerability. The sensitivity refers to the speed and magnitude with which costs can be imposed by one state on another, and vulnerability refers to how available are alternative sources of supply.

The fact that levels of sensitivity and vulnerability vary among states, thus provides space for a politics of interdependence in the interstate economic relations, as states strive to manipulate economic interactions to gain economic or political benefits.<sup>126</sup> The sensitivity and vulnerability of states depends on the concentration of energy intensive sectors, as this influences the nature and volume of energy consumption.

The literature on the impact of energy intensive export oriented industry on choices in energy policy and prioritization of security is virtually non-existent. There is a scarce<sup>127</sup> literature analyzing price shocks and adjustment effects of various industries by energy intensity, but more elaboration or hypotheses how energy intensive industry effects prioritization of security in energy policy is absent.

I specifically propose to look at the relation between the concentration of energy-intensive export industrial sectors, as for these the prices of energy matter the most – because of the scale of their energy needs, as well as the pressures of the competition abroad from producers that are able to access cheaper energy inputs. Therefore the presence and concentration of energy intensive export oriented industry provides structural demand for influencing energy policy.

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<sup>126</sup> Keohane, Robert O., and Joseph S. Nye. *Power and Interdependence : World Politics in Transition*. Boston: Little Brown, 1977, pp. 8-19.

<sup>127</sup> Ivan Vera and Lucille Langlois, “Energy indicators for sustainable development,” *Energy* 32, no. 6 (2007): 875–882; Thomas L. Neff, “Improving energy security in Pacific Asia: diversification and risk reduction for fossil and nuclear fuels,” *Project Commissioned by the Pacific Asia Regional Energy Security (PARES) Massachusetts Institute of Technology, Center for International Studies* (1997); Douglas R. Bohi, “On the macroeconomic effects of energy price shocks,” *Resources and Energy* 13, no. 2 (1991): 145–162, <http://www.sciencedirect.com/science/article/pii/016505729190012R> (accessed March 17, 2013); Douglas R. Bohi and Michael A. Toman, *The economics of energy security* (Springer, 1996); Kiseok Lee and Shawn Ni, “On the dynamic effects of oil price shocks: a study using industry level data,” *Journal of Monetary Economics* 49, no. 4 (2002): 823–852.

The issue of timing and sequencing of privatization in general has been discussed in literature, Hellman<sup>128</sup> discusses sequencing and choices in privatization, Kornai and Haggard make the connection between the democratic reforms and the “vulnerability of fiscal and monetary authorities to groups linked to the old planning apparatus.”<sup>129</sup> The role of former communist elites in privatization chosen is elaborated also by Soos.<sup>130</sup>

The timing of the privatization and its sequencing of both energy assets as well as major energy consumers is an important tool which can be used for enabling prioritization of security in energy policy. If privatization of energy assets precedes implementation of energy security policies, security enhancing policies such as supply diversification become much harder to implement because energy sector is unwilling to bear the costs of the public good of energy security unless it coincides with its economic strategy.

Whether the major energy consumers are privatized to domestic well-connected actors or foreign investors influences the industrial preferences for energy policy. In case they are privatized to politically well-connected domestic owners reaping the rents of politically assigned preferential contracts, (as was the case in Slovakia) their preference for status quo is higher, and this works against any security enhancing policies. On the other hand, if the privatization is used to weaken the entrenched interests, as it happened in the Czech Republic, the security is prioritized in energy policy over short-term shielding of industry from real costs of energy. This leads to more sizable increases in efficiency are achieved, which further feeds in and reinforces the security objectives of energy policy.

The power of the industrial sector stems from a number of sources. One set of sources is based on the fundamentals of its contribution to the GDP and employment, as well as its position on the energy market. The other set of sources stems from its structural position, which includes

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<sup>128</sup> Joel S. Hellman, “Winners take all: the politics of partial reform in postcommunist transitions,” *World Politics* 50, no. 02 (1998): 203–234, [http://journals.cambridge.org/abstract\\_S0043887100008091](http://journals.cambridge.org/abstract_S0043887100008091) (accessed March 7, 2013).

<sup>129</sup> János Kornai and Stephan Haggard, *Reforming the State: Fiscal and Welfare Reform in Post-Socialist Countries* (Cambridge University Press, 2001).

<sup>130</sup> Károly Attila Soós, *Politics and Policies in Post-Communist Transition: Primary and Secondary Privatisation in Central Europe and the Former Soviet Union* (Central European University Press, 2011).

level of industrial coordination and competition for policy priorities from similarly positioned industries.

Detailed analysis on how this structural position of power that concentrated industry enjoyed, translated into policy influence, would require further study. The structural power of industries and details of negotiation positions or analyzing the precise coalition building and interest formation processes would make for an independent project in its own right, which is beyond the scope of this thesis.

I take limited quantitative measures of selected sources of industrial structural power throughout the studied period, which I claim to be important for influencing prioritization of security in the energy policy: I focus on the importance of industry as source of national wealth vis-à-vis its position as energy consumer, its concentration, energy intensity, and importance as employer, level of unionization and strike activities.

I argue that energy policy is largely affected by the level of concentration of energy intensive industrial sectors, their exposure to the international market and the way how they were privatized. I argue that interests of those energy intensive industrial sectors that are important in the country's economy because of their high relative share on export output, combined with their relative high energy consumption (input), as are for example metallurgy chemical and petrochemical industries, as compared with other industrial sectors predetermine energy policy choices.

Energy intensity of the export oriented industry influences energy policy especially in case these sectors are concentrated as is the case of Slovakia. Security enhancing energy policies such as supply diversification, become much harder to implement unless they precede privatization of energy assets. This is mainly because privatized energy sector is unwilling to bear the costs of the public good of energy security, unless it coincides with its economic strategy.<sup>131</sup> Additionally, the

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<sup>131</sup> Energy companies are willing to engage in new security enhancing infrastructure developments if they are granted at least partial monopoly benefits from utilizing this infrastructure. (Exceptions from 3<sup>rd</sup> party infrastructure access).

governments during transition do not possess sufficient regulatory capacity to recuperate the full costs of energy security increasing investments from already privatized energy companies.<sup>132</sup>

The industrial preferences for energy policy are further influenced by whether the major energy consumers were privatized to domestic (politically) well-connected actors, or foreign investors. Well-connected domestic owners prefer reaping rents of politically assigned preferential contracts, (as was the case in Slovakia) and their preference for status quo is higher. This preference works against security enhancing policies. On the other hand, privatization can be used to weaken the entrenched interests, as happened in the Czech Republic. The security was prioritized in energy policy over short-term shielding of industry from real costs of energy. This led to larger increases in energy efficiency, and further fed into and reinforced the security objectives of energy policy.

#### **1.4. Rival Explanations**

Could other explanations provide better account for why countries in transition prioritize energy security differently? The available rival explanations could be divided among those seeking the explanation among external conditions and those seeking explanation among internal, mainly fundamentals-based conditions.

The first explanation, especially in large-n panel studies attempts to explain the variation in energy security policies by different external conditions. It is a trivial expectation that countries facing objectively different external conditions have different security needs. Policy needs and opportunities should be different between a country neighboring allies, and a country surrounded by adversaries. It should be also different if it faces structural conditions of unilateral dependence from a country in situation of mutual interdependence. This difference can explain

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<sup>132</sup> This argument is further supported by the developments after 2009 when diversification projects in CEE were enabled only thanks to sizable European Commission's funding program, and determination of governments to prioritize this goal and provide strong economic incentives.

variation between energy dependent and countries with sufficient domestic supplies, but fails to explain observed variation among countries of equivalent external conditions.

The external factors – the external opportunity structure for countries in Central and Eastern Europe have been comparable for the past two decades. Their geopolitical positions are also comparable: the two major external factors influencing these countries was presence of post-soviet Russia to the east, and European Union and NATO to the west. They all strove to “liberate” themselves from the eastern vassal ties, they aspired to join the EC/EU.<sup>133</sup> Concerns over reliability of Russia and other post-soviet suppliers of primary energy sources remained high on the agenda across the region. The numerous minor interruptions in both gas, and oil supplies cross the territory of Russia to Central and Western Europe in the early nineties gave warning signals, and sparked intense policy discussions across the region. Given that the major external factors remained similar for all CEE countries, these cannot be used to fully explain the divergence in their energy policies.

The second, more complex alternative explanation offered to explain divergence in energy policies is difference in fundamentals – the objective circumstances of a given country. Many different aspects are included, and to provide a better distinction I propose to discern two types of fundamentals important for energy policy: Hard fundamentals and soft fundamentals.

The *hard* fundamentals, are for all practical purposes externally given, and are not changeable by policy instruments. The variation observed among countries with different hard fundamentals, same argument applies as for different external conditions. The *soft* fundamentals include those conditions which are given in a “normal” policy cycle, but can be taken as reasonably changeable overtime, if policy agreement and determination exists.

The hard fundamentals include geographical conditions, such as type of climate, proximity to a navigable sea, distance to the sources of energy resources, abundance of natural resources such

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<sup>133</sup> Acknowledging differences in practical implementation of policies leading to integration, the declared political commitments to integrate existed across the region.

as coal, oil or gas. If a country has access to sea, or abundant domestic hydrocarbon resources, this genuinely influences the *costs* of choosing certain types of energy policies over others.

Soft fundamentals, in turn, include structure of domestic energy demand i.e. what kind of energy is consumed within the borders of the country, in what scale, and by whom, as well as domestic energy production. Related to this is energy intensity of industry, its export profile and structure of employment, as well as type of energy regulation. Also the structure of imports, i.e. where do primary energy supplies come from and how. Nature and structure of supply contracts; as well as availability of import infrastructure, such as pipelines, ports, and downstream facilities (refineries, power plants, and storage sites) can be also included among *soft* fundamentals.

The *hard* fundamentals are genuinely predetermining the policies, and could offer explanation for long-term and stable structural differences among countries facing different external conditions. The *soft* fundamentals are results of previous policy choices and thus should be seen as “only” creating predisposition to path dependency. They should not be quickly taken to explain the variation as indicated by the contrast between the Czech and Slovak cases. Even if these two countries started with comparable “soft” fundamentals, the Czech Republic changed the character of its soft fundamentals through a series of policy choices.

Differences in fundamentals have effect on both policy choices, as well as policy outcomes. Fundamentals-based explanations miss a very important difference in the inner workings of the domestic political systems: in particular, it does not provide an explanation why certain countries are able to break out of their policy path dependence, and successfully amend their *soft* fundamentals while others do not.

There are significant differences in *hard* fundamentals across Central and Eastern Europe. One major difference among these countries is in their geographic conditions. While climate conditions are almost the same across the CEE countries, there are differences in abundance of natural resources – with Poland having relatively higher abundance of coal, Estonia having significant domestic supplies of oil shale, and Romania both oil and gas. All CEE countries

except for Czech Republic, Hungary and Slovakia have access to sea.<sup>134</sup> These countries are therefore at least theoretically *able* to tap into the global market of energy supplies and import their energy sources from almost anywhere in the world should a need arise. Czech Republic, Hungary and Slovakia being landlocked countries, would need to negotiate transit route with another country separating them from the sea (plus assure that the necessary importing facilities, including port and the transit infrastructure exists towards their border).<sup>135</sup> Direct access to the sea thus may have more psychological significance and influence on perception of security than actual material presence of importing infrastructure.<sup>136</sup>

There are important differences among *soft* fundamentals, which help to isolate those domestic factors that matter for understanding the variation in prioritization of security in energy policy. When looking at the structure of domestic production, only 6 out of the 10 CEE countries (Czech Republic, Bulgaria, Hungary, Lithuania, Slovenia, and Slovakia) have had nuclear power plants during this period. The presence of nuclear power generation significantly influences the domestic energy landscape. Nuclear energy enables provision of relatively high share of domestic electricity consumption independently of short-term market, as well as political turbulences, for relatively low operational (unit) costs.<sup>137</sup> This industry also both requires, as well as provides access to advanced technology, and a specialized skill-set. In case of the CEE countries it also implies special relations with post-soviet Russia, and need to decide and negotiate the arrangement of fuel supply lifecycle and technical support, since all nuclear reactors built before the end of cold war in CEE countries were of soviet design. Additionally the new fuel for all these reactors was manufactured, and spent nuclear fuel from them processed in Soviet Union.

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<sup>134</sup> While Austria could be included, as a CEE land-locked country, its historical developments, as well as very different structure of domestic energy consumption (high share of oil and renewables) make it unsuitable for this test.

<sup>135</sup> The challenges of negotiating this have been recently demonstrated in the case of Czech Republic negotiating the share on the Germany's oil transit infrastructure TAL.

<sup>136</sup> Especially given the relatively long lead-in time that would be required to construct the importing infrastructure in case of a need, unless it exists previously.

<sup>137</sup> At least during the period in focus, since the market with externalities was not developed yet in this region.

Another important aspect of the domestic energy landscape, and a soft fundamental, is structure of the natural gas market. Unlike the nuclear power, natural gas creates relationships of high (inter)dependence. Production of natural gas requires stable assured consumption, which is ensured through stable and continuous connection to the consumers through long stretches of pipelines, or expensive and technologically advanced, and demanding, liquid natural gas terminals, and underground storage sites requiring geological preconditions. The nature of this connection is reflected in the contractual relationships as well, mainly in the so-called take-or-pay long-term contracts.<sup>138</sup>

I provide an overview of these fundamentals below. Table 1 provides detailed overview of structure of gas and oil sectors – primary energy supplies most frequently quoted in the energy security literature. Presented countries are grouped by hard fundamentals. CEE countries can be broadly divided into four groups of countries according to hard fundamentals and their similar structure of energy consumption (Columns A, B, and G). While there is also variation among these countries, there are groups of countries where the structure of energy market is sufficiently similar.

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<sup>138</sup> Take-or-pay contracts stipulate agreement on the annual volume of gas to be purchased, consumer pays even if the contracted amount is not fully consumed. During the covered period, these contracts additionally prohibited re-sale of gas to third parties.

**Table 1: Share of imported gas and oil on inland consumption**

| Column:   | A       | B   | C   | D                              | E  | F   | G                             | H                                    |                  |
|---|---------|---|---|--------------------------------|--|---|-------------------------------|--------------------------------------|------------------|
| Hard fundamentals and external conditions<br>(Factors to control for)   | Country | Soft fundamentals   |   |                                |  |   |                               |                                      |                  |
|   |         | % of gas on Gross Inland Consumption (GIC) Average 1990-2004 <sup>139</sup> | % of residential consumption of gas on GIC of gas | % imported:                    |  |   |                               | % of oil on final energy consumption | Imports of Oil % |
|   |         |   |   | residential consumption of gas | gas on Gross Inland Consumption (Average 1990-2004) <sup>140</sup> | gas from all (Average 1990-2004) <sup>141</sup> | From Russia Cedigaz 2001 data |                                      |                  |
| Land-locked; consistent and differentiated consumption and use of primary sources of energy                       | HU      | 37.33   | 29.32   | 19.82                          | 25.65  | 67.61   | 79.74                         | 25.9                                 | 76.8             |
|   | SK      | 30.23   | 23.38   | 22.18                          | 28.66  | 94.85   | 100                           | 20.3                                 | 91.9             |
|   | CZ      | 16.25   | 25.10   | 24.61                          | 15.93  | 98.04   | 81.52                         | 25.9                                 | 93.6             |
| Access to sea, high import dependence   | BG      | 16.76   | 0.03  | 0.03                           | 16.65  | 99.30   | 100.00                        | 22.7                                 | 100.2            |
| Access to sea, existing ports, moderate share of imported hydrocarbons on energy consumption, domestic resources. | PL      | 9.85  | 35.35   | 23.65                          | 6.60   | 66.90   | 89.29                         | 30.4                                 | 94.0             |
|   | SI      | 12.40   | 6.93  | 6.84                           | 12.23  | 98.65   | 65.38                         | 48.6                                 | 101.6            |
| Access to sea, small share of imported hydrocarbons on energy consumption   | LV      | 26.39   | 7.36  | 7.44                           | 26.83  | 101.05  | 100*                          | 31.3                                 | 99.2             |
|   | LT      | 24.33   | 7.66  | 7.66                           | 24.34  | 100.03  | 100*                          | 35.1                                 | 94.2             |
| Access to sea, small share of imported hydrocarbons on energy consumption (domestic oil and gas)                  | RO      | 39.42   | 12.59   | 2.80                           | 8.66   | 22.20   | 100                           | 26.0                                 | 86.0             |
| Access to sea, insignificant share of imported hydrocarbons on energy consumption (domestic oil shale)            | EE      | 11.40   | 7.44  | 7.44                           | 11.40  | 99.99   | 100                           | 34.0                                 | 73.8             |

\*Estimate

The share of gas on consumption (column A) is highest in Romania, which is a result of high abundance of domestic gas supplies. Hungary also has very high share of gas on domestic consumption, which similarly to Romania follows (past) presence of domestically produced gas, but compared to Romania, Hungary imports three times as much gas (Column E). The lowest share of gas on consumption is in Poland, relying much more on its domestic coal resources. The second lowest share of gas on consumption is in Estonia because of the abundance of domestic shale oil. The highest residential consumption of gas, which is extremely important because of the high sensitivity to interruptions, is in Poland, Hungary, Czech Republic and

<sup>139</sup> Eurostat and European Commission, “Energy & Transport in Figures 2010: Part 2: Energy,” *Eurostat and European Commission - Directorate-General for Energy and Transport* (2010): [http://ec.europa.eu/energy/publications/statistics/statistics\\_en.htm](http://ec.europa.eu/energy/publications/statistics/statistics_en.htm).

<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

Slovakia. Poland ranks highest because more than a third of all gas is consumed by households. This is nonetheless insignificant in absolute terms given that less than one tenth of energy consumption in Poland is gas based.

Estonia is fully dependent on the imports of gas from abroad, and all of its gas imports come from a single supplier Russia, but the share of gas on its energy consumption is so low (and most of it consumed by industrial sector) that any disruptions in gas supplies would be limited to a small industrial sector, thus decreasing the sensitivity to energy disruptions. Similarly, the country reportedly worst affected by the 2009 gas disruption, Bulgaria, with virtually all gas consumed in the country imported from single supplier Russia, has very low average residential consumption of only 0.03%.

### **1.5. Case Selection**

As Table 1 illustrates, there are differences in fundamentals across the CEE countries. Nonetheless, after taking into account the structure of domestic energy consumption, there are four out of the 10 CEE countries that are the most similar: Czech Republic, Slovakia, Hungary and Poland. While Poland fits the scope conditions, given that Poland has access to the sea, and a much larger energy market compared to the rest of the Visegrad four<sup>142</sup> countries<sup>143</sup>, these differences could be used to deflect the attention away from non-fundamentals explanations. Therefore I decided to not include the Polish case in this dissertation.

When I control for fundamentals, countries that share comparable conditions still exhibit variation in the prioritizations of their energy security policies. In addition to differences in prioritization of energy security observed among Czech Republic, Hungary and Slovakia which form the core of the empirical puzzle of this dissertation, there are observable policy differences within groups of countries where other fundamentals are controlled for. If the fundamentals-

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<sup>142</sup> Czech Republic, Slovakia, Hungary and Poland are referred to as Visegrad Four – based on their membership in the regional grouping of this name, also reflecting on their similarities in many other policy areas.

<sup>143</sup> Roughly twice as big as Czech Republic, 3.5 times as Hungary, and 5 times as big as Slovakia, in 1990

based explanation were to hold, for example all littoral countries with similar structure of their energy market should be seen following similar policies, which is also not the case as differences between Poland and Lithuania or Bulgaria and Slovenia demonstrate.

Additionally, one can find similar policies pursued by countries with significantly different fundamentals. Through this, one can see that the fundamentals-based explanation is insufficient to account for the observed variation. Given both the large variation *despite* the similarities of their fundamentals, *and* similarities despite the differences in the fundamentals, one is compelled to seek a different explanation.

In order to isolate the effects of the fundamentals, and external factors, I choose to study three most similar countries in terms of their fundamentals and external conditions. Three countries that, just like other 7 CEE countries have been part of the “socialist bloc” and have joined the EU and NATO as part of their transition paths.<sup>144</sup> The three most similar countries in this respect are Czech Republic, Hungary and Slovakia.

### **1.6. Puzzle**

While acknowledging that these three, in terms of energy, structurally most similar cases, are not *identical*, they are the most similar cases in CEE.<sup>145</sup> Looking at these three countries, it is puzzling that Czech Republic appears as a case for most consistent prioritization of energy security. The Czech Republic was the first and the only country to completely diversify its energy fuel mix by building *new* oil, as well as *new* gas, import pipelines and signing relevant contracts, in addition to diversifying the supplies of its nuclear fuel.<sup>146</sup>

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<sup>144</sup> Although at different points in time.

<sup>145</sup> Acknowledging higher share of solid fuels (domestic coal) on Czech Republic’s consumption, than in either Hungary and Slovakia.

<sup>146</sup> Having mentioned the relatively low structural dependence of nuclear energy, this point is used just to illustrate the depth of the diversification going beyond the necessary.

Why Slovakia, the country that is fully dependent on a single supplier, Russia, and thus has the highest energy insecurity, has not prioritized energy security and has done little since 1989<sup>147</sup> to diversify its imports of energy resources? How come that Hungary, country with highest share of gas on its primary energy consumption, was the first one to privatize its vertically integrated energy company MOL, and has not followed-up with policies to diversify away from the single foreign supplier?

Although effects of the international opportunity structure remain comparable in these countries, their prioritization of energy security, coping strategies, and the policy tools they chose vary across time, as well as among them. The puzzling question is why these countries prioritized energy security differently, and coped with their structural position under comparable international conditions in varied ways? Why have their coping strategies varied over time and what explains both variation and its dynamics?

The coping position of countries in transition is different from their counterparts in EU which had to cope with their energy glut already in the 70s of the 20<sup>th</sup> century. This happened in the context of the global energy crisis, which caused increases in energy efficiencies. Nonetheless this happened only west of the Berlin Wall. The countries within the orbit of USSR were protected from the effects of energy crisis, by generous Soviet energy subsidies, non-market energy import pricing, and tied together by a complex web of energy infrastructure and trade relationships.<sup>148</sup>

Understanding the energy security prioritization and coping strategies of countries in transition, without any imminent external crisis therefore provides an important insight into effects of domestic policymaking and interplay between the international and domestic opportunity structures. All of these countries had choices to make. The results of their choices and coping strategies from the past nonetheless are not only interesting for understanding the seemingly erratic path they followed during their economic transformation. Understanding of this path is

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<sup>147</sup> Since 1989 until 2009. Nothing has been done during the period of focus for this work (1990-2004).

<sup>148</sup> Intra-COMECON pricing, based on lagged average of world prices, which benefited the CEE countries until early 1980s, when the lagged average price of hydrocarbons was raising in the Soviet Union's benefit (Bucharest price formula).

also informative for other countries in transition, including selected South American Countries, MENA countries, or former USSR countries, some of which even 20 years after the fall of the Berlin Wall, still need to make difficult choices on their transition paths, and can therefore learn important policy lessons.

### **1.7. Research Model in Detail**

The research design that I choose is based on the most similar cases – the Mill’s method of difference.<sup>149</sup> I control for the effects of fundamentals, and external opportunity structure which are comparable across the cases, and point out the differences in the domestic factors which I isolate this way.

To recall, the research question of this thesis is: why countries in transition under comparable international conditions prioritize energy security differently? This difference in countries’ domestic responses of coping with their structural position of energy import dependence varied over time, and I want to understand what explains the type of variation and its timing? I want to arrive at a better understanding what the contributing factors to prioritizing energy security as one of the policy aims are. I aim to understand under what circumstances do these factors facilitate or inhibit prioritization of security on the policy agenda in competition with other important policy aims – welfare, efficiency, and environmental sustainability.

I proceed with comparing the developments in the three cases on three main independent variables and how they have influenced the prioritization of energy security. I capture the prioritization of energy security through level, type and structure of its five constituent aspects:

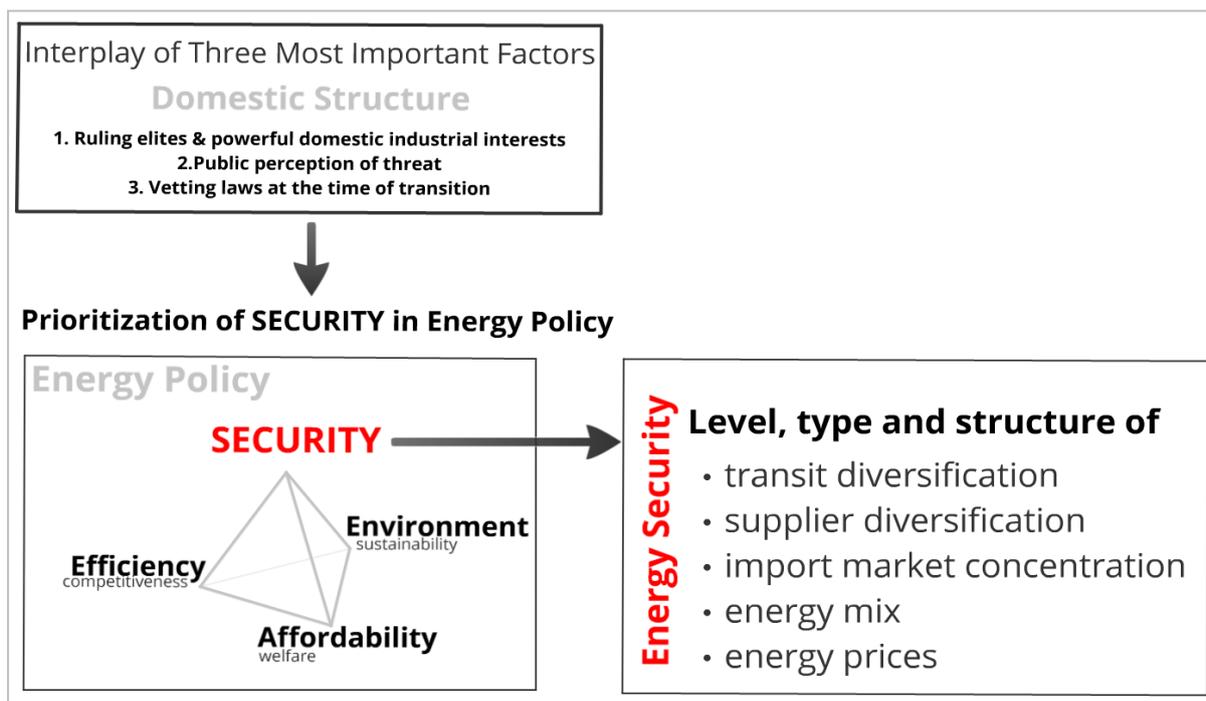
1. transit diversification,
2. supplier diversification,
3. import market concentration,
4. energy mix and
5. energy prices.

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<sup>149</sup> Mill, *A System of Logic, Ratiocinative and Inductive*, 455ff.

In this effort I test the following three hypotheses:

1. The security aspect of energy policy is prioritized when the perception of external threat (ascribable to specific political or economic actor of relevance to energy supplies) is present and concentrated among supporters of political force in the government.
2. When center-left governments are in power energy security receives lower priority on policy agenda than when center-right government's rule.
3. When lustration is thoroughly implemented and followed-up to exclude former members of the regime's security apparatus from directly and closely influencing policies, energy security is prioritized more than when lustration is inconsequential, halted or periodically changed.



**Figure 1: Sketch of the Research Model**

Findings of my comparative analysis corroborate the claim that energy security in transition is prioritized when popular perception of threat which can plausibly be connected to the energy supply is high and concentrated among supporters of the ruling political power, when former elites who can draw on personal links with the perceived source of threat and thus can decrease

the effects of threat are removed from power, and when incumbent industrial interests are de-concentrated and face obstacles in promoting their interests.

Presence of popular perceptions of threat from the important energy supplier country which can plausibly be connected to security of energy contributes to, and enables the prioritization of energy security, especially, when those that perceive this threat are concentrated among supporters of ruling political force. This has been the case more among supporters of center-right governments than center-left governments.

The type of coping with the past, as exemplified through the degree and kind of vetting/lustration chosen as part of the transition has influenced the available and preferred political choices in the energy policy. In case where lustration has been more thoroughly followed-up and the former members of the regime's security apparatus were excluded from directly and closely influencing policies, the policy chosen was security prioritizing, as in the countries where lustration was inconsequential, halted or periodically changed and where other policy aims were prioritized over security. The inconsequential lustration has allowed people with links to the former regime and soviet security apparatus, which maintained control over energy sectors in post-soviet Russia to maintain their links and influence.

The personal linkages to former security apparatus and relations to post-soviet Russia were more present among elites of center-left governments than among the elites of center-right governments. The combination of the transition heritage of personal links which concentrated mainly among post-communist center-left parties (with the notable exception of Hungary), and the concentration of supporters perceiving the main energy supplier as a threat or not along party lines coalesced to increase the importance of ruling coalition's identity as a predictor of prioritization of energy security. My analysis thus corroborates the hypothesis that center-right governments were more likely to prioritize energy security than center-left government.

This hypothesis provides explanation for the transition period, as the time progresses, the importance of ideological differences among the elites is decreased and the effects of systemic

corruption – the state capture are visible in power and spoils sharing among the elites, which influences the prioritization of energy security. In this later stage the structure, concentration and ownership of the energy intensive industry becomes important for understanding prioritization of energy security.

Prioritization of security and the type of energy policy is also affected by the level of concentration of industrial sectors and their exposure to the international market. Presence of concentrated energy intensive industrial sectors with high share of value on country's export creates demand for shielding the sectors from international competition through energy subsidies. This creates incentive for government to avoid restructuring, or introduction of competitive pricing, especially when personal connections between the government and the energy intensive industry exist.

This also factors into the timing and sequencing of both energy assets' as well as major energy consumers' privatization and restructuring. Privatization of energy assets can hinder prioritization of energy security by divesting the costs of provision of public good of energy security and its benefits, which are easier to internalize before the privatization takes place. The effects of the privatization of the major energy consumers plays a role as it can be either used to weaken the entrenched industrial interests and the reluctance to transform and increase competitiveness (as was the case in Czech Republic in the earlier period, and partially in Slovakia after 1998) or cement the rent-seeking political privatizers preferring status quo and shielding from the effects of competitive energy pricing, and avoiding economic restructuring.

If privatization is used to weaken the entrenched interests as happened in Czech Republic, and security is prioritized in energy policy over short-term shielding of industry from real costs of energy, increases in efficiency are realized which feeds in and reinforces the security objectives of energy policy. If the privatization is done according to the preferences of major interest groups as happened in Slovakia, the process of energy market liberalization and prioritization of energy security is delayed or is captive to the interests of few concentrated interest groups. In such a

case policies which would endanger entrenched interests can go forward only if onerous energy or privatization contracts are accepted as a ransom as was the case of Slovakia.

**Table 2: Simplified Summary of Independent Variables**

| Electoral cycles in individual countries vary |             | Ruling government | Popular perception of threat | Vetting / lustration process | Former regime exponents | Intensity of relations with Russia |
|---|-------------|-------------------|------------------------------|------------------------------|-------------------------|------------------------------------|
| Czech Rep.                                    | 1992   1994 | Right             | High                         | High                         | Low                     | Medium                             |
| Slovakia                                      |             | Left*             | Medium                       | High                         | High                    | Medium                             |
| Hungary                                       |             | Right             | Low                          | Haphazard                    | Low*                    | Medium                             |
| Czech Rep.                                    | 1995   1998 | Right             | High                         | High                         | Low                     | Low                                |
| Slovakia                                      |             | Left*             | High                         | Low                          | High                    | High                               |
| Hungary                                       |             | Left              | Low                          | Haphazard                    | High*                   | High                               |
| Czech Rep.                                    | 1999   2002 | Left*             | High                         | High                         | Medium                  | Medium                             |
| Slovakia                                      |             | Cent-Right        | High                         | Low                          | Medium                  | Medium                             |
| Hungary                                       |             | Right             | Medium                       | Haphazard                    | Medium*                 | Low                                |
| Czech Rep.                                    | 2003   2005 | Left              | High                         | High                         | Medium                  | Medium                             |
| Slovakia                                      |             | Right             | Low                          | Low                          | Low                     | Low                                |
| Hungary                                       |             | Left              | Low                          | Haphazard                    | Medium*                 | High                               |

**Table 3: Simplified Summary of Dependent Variables**

|            |             | Transport diversification <sup>150</sup> | Supplier Diversification <sup>151</sup> | Market concentration <sup>152</sup> | Energy Mix <sup>153</sup> | Price <sup>154</sup> |
|------------|-------------|--|---|-------------------------------------|---------------------------|----------------------|
| Czech Rep. | 1992   1994 | <b>Yes</b> (1&1)                         | 57                                      | 863.91                              | 31.10%                    | -24.74%              |
| Slovakia   |             | (1&2)                                    | 37                                      | 2,211.03                            | 45.84%                    | 9.03%                |
| Hungary    |             | <b>Yes</b> (1&2)                         | 49                                      | 1,471.72                            | 62.83%                    | 15.71%               |
| Czech Rep. | 1995   1998 | <b>Yes</b> (1.5&1.75)                    | <b>Yes</b> 64                           | 791.30                              | 37.15%                    | -6.39%               |
| Slovakia   |             | (1.75&2)                                 | 42                                      | 2,201.45                            | 50.82%                    | 0.19%                |
| Hungary    |             | <b>Yes</b> (1& 2)                        | <b>No</b> 49                            | 1,347.52                            | 66.00%                    | 6.20%                |
| Czech Rep. | 1999   2002 | (2&2)                                    | 67                                      | 760.94                              | 39.75%                    | -0.42%               |
| Slovakia   |             | (2&2)                                    | <b>Yes</b> 48                           | 2,165.61                            | 51.21%                    | -0.45%               |
| Hungary    |             | (1&2)                                    | 49                                      | 1,366.42                            | 67.27%                    | 0.86%                |
| Czech Rep. | 2003   2005 | (2&2)                                    | 66                                      | 714.91                              | 38.02%                    | -4.77%               |
| Slovakia   |             | (2&2)                                    | 54                                      | 2,090.93                            | 50.23%                    | -2.28%               |
| Hungary    |             | (1&2)                                    | 49                                      | 1,395.85                            | 69.62%                    | 7.05%                |

<sup>150</sup> Average number of import infrastructure connections for gas and oil.

<sup>151</sup> Average number of trading partners for gas and oil.

<sup>152</sup> HH index\*imported share of combined gas and oil on gross consumption – lower the number the higher the energy security.

<sup>153</sup> Average share of imported gas + oil on Gross Inland Consumption – lower the share higher the energy security.

<sup>154</sup> Difference of Import Price from regional average – lower the price, higher the energy security.

## **Chapter 2. EXPLANATORY VARIABLES COMPARED**

As I discussed in detail in the preceding chapter, the explanatory model that I propose for prioritization of security in energy policy is based on interplay of three major aspects – presence and concentration of public perception of major energy supplier as a threat to their country, choice of vetting laws and its influence on the types and scope for maneuver of elites in domestic politics and economy, together with interests of ruling elites as demonstrated by intensity of relations with major energy supplier – Russia, and finally structure and concentration of energy intensive export industries in the country.

### ***2.1. Influence of Threat Perception on Security Prioritization in Energy Policy***

I see the presence, concentration and intensity of threat perception as one of the explanatory factors interacting with vetting laws chosen, domestic interests as manifested through the intensity of elite relations with Russia, and structure of the energy intensive industry in the overall research model explaining prioritization of security in energy policy. In this chapter I compare differences in the popular threat perception, and the intensity of bilateral relations with Russia, discuss how and into what degree these explain the differences and variation in the prioritization of security in the energy policy choices of Czech Republic, Slovakia and Hungary. I argue that higher threat perception of Russia in Czech Republic, as compared to Hungary and Slovakia enabled reform-minded politicians to channel this fear towards prioritization of security in the energy policy and public acceptance of costs associated with this prioritization.

The popular fear of Russia enabled the country to reprioritize the available resources, shield away from former elites and remove them from direct political influence, for the reason that former elites were seen as complicit with the source of fear – the former regime and the Russia. In this chapter I focus on comparing the threat landscapes of Czech Republic, Slovakia and Hungary and I assess the intensity of relations among the ruling elites in Czech Republic, Hungary and

Slovakia. Finally I discuss the question how the presence of fear of Russia played into prioritization of security in the energy policy. I discuss the internal distribution and concentration of fear among supporters of individual political parties in the country chapters in detail.

The first available regional survey on the perception of threat in CEE at the onset of transition is the *Pulse of Europe: a survey of political and social values and attitudes* (PEW). Although the complete original data from Pew Research is not available,<sup>155</sup> I used both the summaries from the 2009 study, which reported separate headline data for Slovak and Czech Republics, which is not the case for the data reported in the original 1991 report, as well as a copy of data from Hungarian Data Archive TARKI.<sup>156</sup> Second excellent source of data on public perceptions of fear in CEE region are the New Europe Barometer (NEB) surveys.

Since the threat perception of general public in the region can be measured by both the PEW and NEB survey data I rely on these two sources of longitudinal survey data for measuring the popular threat perception in CEE. The most detailed dimensions are available in the NEB surveys, where threat is measured as external (Russia, Germany, USA, neighboring countries) and internal (ethnic minorities, immigrants). The highest threat, in the region of CEE is mostly of neighboring countries – measure capturing the disintegration of Yugoslavia and animosity between Hungary and her neighboring countries hosting autochthonous Hungarian diaspora. There is also a difference between the perception of threat from the eastern and western regional powers of Russia and Germany within the region.

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<sup>155</sup> According to the email from the PewResearchCenter, successor of the Times Mirror Center for the People & the Press, who conducted the 1991 survey, “unfortunately the data and study from 1991 are not available to the public and there is no future plan to make it available.” Katie Holzward Sprehe and Pewresearch, “Pew Global Attitudes Data Request”, December 16, 2009. Times Mirror Center for the People & the Press, *The Pulse of Europe 2009: 20 Years After the Fall of the Berlin Wall* (PewResearchCenter, 2009), <http://pewglobal.org/reports/display.php?ReportID=267>. Top line data available at <http://pewglobal.org/reports/display.php?ReportID=267>

<sup>156</sup> I was able to receive a copy of the original 1991 report on request from MTA Tárki Databank Times Mirror Center for the People & the Press, “The Pulse of Europe: A Survey of Political and Social Values and Attitudes” (Washington, DC: Times Mirror Center for the People & the Press, 1991), TÁRKI Databank, <http://www.tarki.hu/adatbank-e/index.html>. Nonetheless, it is not clear from the original database whether the selection on variable “Region” provides representative samples for both Czech Republic and Slovakia, as the dataset would be distributed by 638 cases in CR, 210 cases in Slovakia and 72 cases were unidentified.

I used the data from NEB II (1992),<sup>157</sup> NEB IV (1996),<sup>158</sup> NEB V (1998),<sup>159</sup> and NEB VII (2004)<sup>160</sup> to measure threat perception. Questions on threat were not explicitly asked at all in the NEB I (1991),<sup>161</sup> and in the NEB III (1994)<sup>162</sup> and the threat question was not asked to Czechs Slovaks and Hungarians I do not use these two surveys. The questions were semi-closed, with the first six countries read to the respondents, with the ability to add countries to the list. The NEB VI (2001)<sup>163</sup> asked the inverse question on alliance affinity (Question C4: “[...W]ith which of the following [countries] do you see our country’s future most closely tied up?”), respondents could have chosen multiple answers, thus sums can be more than 100%.

According to these opinion surveys, there is measured and persistent difference in threat perception between Czech Republic, Slovakia and Hungary towards Russia. Given the similarities between Czechs, Slovaks and Hungarians, and recognizing their different perceptions of threats of their own neighbors,<sup>164</sup> one could expect that they should have comparable external threat perceptions towards major powers.<sup>165</sup> This expectation stems both from the shared

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<sup>157</sup> Christian Haerpfer, Richard Rose, and Centre for the Study of Public Policy (University of Strathclyde), *Adapting to Transformation in Eastern Europe: New Democracies Barometer 2*, Studies in public policy 212 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 1993).

<sup>158</sup> Christian Haerpfer, Richard Rose, and Centre for the Study of Public Policy (University of Strathclyde), *New Democracies Barometer 4: A 10-Nation Survey*, Studies in public policy 262 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 1996).

<sup>159</sup> Richard Rose, Christian Haerpfer, and Centre for the Study of Public Policy (University of Strathclyde), *New Democracies Barometer 5: A 12-Nation Survey*, Studies in public policy 306 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 1998).

<sup>160</sup> Richard Rose and Centre for the Study of Public Policy (University of Strathclyde), *Insiders and Outsiders: New Europe Barometer 2004*, Studies in public policy 404 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 2005).

<sup>161</sup> Christian Haerpfer, Richard Rose, and Centre for the Study of Public Policy (University of Strathclyde), *New Democracies Between State and Market: A Baseline Report of Public Opinion*, Studies in public policy 204 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 1992).

<sup>162</sup> Richard Rose, Christian Haerpfer, and Centre for the Study of Public Policy (University of Strathclyde), *New Democracies Barometer 3: Learning from What Is Happening*, Studies in public policy 230 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 1994).

<sup>163</sup> Richard Rose and Centre for the Study of Public Policy (University of Strathclyde), *A Bottom up Evaluation of Enlargement Countries*, Studies in public policy 364 (Glasgow: Centre for the Study of Public Policy (University of Strathclyde), 2002).

<sup>164</sup> The troubled neighborly relations between the Slovakia and Hungary, since Slovakia has a sizable Hungarian minority as a remnant of the WWI partitioning of Europe plays into the high scoring for the perceived threat from minorities in case of Slovakia and threat from neighboring countries in case of Hungary where fear of Romania in addition plays a role for same reasons.

<sup>165</sup> Bethany Lacina and Charlotte Lee, “Democracy and Culture Matter: A test of threat perception, trust, and foreign policy opinion formation in the US,” *Prepared for the Midwest Political Science Association Conference* (2009).

history, as well as comparable international conditions, as none of these countries fares significantly higher on the foreign policy priority list of any major power.

Both Czechoslovakia (and thus Czech Republic and Slovakia) as well as Hungary have been subjected to Cold War reality of subjugation of their sovereignty by Soviet Union (Russia being popularly perceived as a direct heir to the Soviet Union). Hungary's sovereignty was subdued through occupation in 1956 and Czechoslovakia's through occupation in 1968. In both cases this resulted in permanent stationing of Soviet military units on their national soil. Desire of these countries to realign their foreign policies from being a vassal to Soviet Union towards joining their neighbors to the west in the EU and NATO was shared as well. Slovakia being a late-comer due to detour during Mečiar's government, nonetheless maintained this aspiration even during Mečiar's rule, at least on declaratory level.

This difference in the level of threat perception towards Russia goes also against the expected hypothesis assuming that countries with closer language and cultural affinity will have lower threat perception vis-à-vis each other. Czechoslovakia and its successors are members of the same language family with Russia, nonetheless, their perception of Russia as threat is much higher than that of Hungary, which is culturally more distant from Russia.<sup>166</sup> Perhaps, as the time lapses, the change of generations sanctions less animosity towards past aggressors, and therefore perception of Russia in Hungary is more positive, than in successor states of Czechoslovakia. This nonetheless does not explain the difference between the Czech and Slovak republics. Investigation of the reasons why Russia is seen as threat by Czech Republic and no so much by Hungary and the *sources*, and *formation* or the underlying psychological conditions for the threat itself are questions worth researching, but are beyond the scope of this dissertation.

Throughout the period of 1992 to 2004 when the four available surveys were conducted (Chart 9 in annex) respondents in Czech Republic perceived Russia as the highest threat to their country,

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<sup>166</sup> This hypothesis is popularly used to explain very cordial relations between Bulgaria and Russia, but it does not explain the stark variation since the country with largest fears of Russia is Poland – also linguistically close.

followed by threat from immigrants. Slovak respondents perceived ethnic minorities, followed by Russia as the major threat to their country. Hungarians in the same period saw immigrants, followed by neighboring countries as the major threat to their country, but disproportionately higher than any other threat (Chart 12, Chart 13 in annex).

To understand how threat functioned to influence prioritization of security in energy policy it is important to look at the context of threat. I used two measures to probe the overall ‘feeling of external threat’: The first one is (1) share of those respondents that have not identified any external threat, and the second measure is (2) number of external threats identified by the citizens (neighboring countries, Germany, USA and Russia).

Longitudinal measure of share of those respondents that have not identified any external threat – those that have not identified any of the asked countries, or neighboring countries as a threat – provides general overview of the threat landscape. Initially, in 1992, 45.5% of Slovaks perceived neither their neighboring countries, USA, Germany nor Russia as threats. While only 35% of Hungarians and 37% of Czech had this position in 1992. Hungarians seemed to have overcome their fear of external threats and by 2004 already 84.6% of respondents did not see any of these external factors as threats to their country, while only 43.1% of Czech and 54.9% of Slovak were fearless of external factors by 2004.

When controlled for the effects of fear of neighbors, Hungarians were not worried about the threat from major powers, as 81.9% in 1992 and 89.6% in 2004 did not perceive any threat from these external actors to their country. When the regional affects between the Hungary and its specific neighbors are controlled for, it is clearly visible that Czech Republic has the highest perception of threat out of these three: its citizens are most scared of negative impact of regional powers and particularly of Russia, while Slovaks are less afraid than Czechs. Overall it is Hungarians who have been throughout the studied period least threatened by the external powers.

The second measure is the (2) the number of external threats identified by the citizens (neighboring countries, Germany, USA and Russia) and the share of respondents that have identified at the same time two of the most dominant threats. When analyzing the share of respondents in 1992 who have identified one, two or three threats (with options of Russia, Germany or USA), it is clear that respondents in the Czech Republic had higher perception of threats, and most of them have identified one threat. In case of Czech Republic, about the same number of respondents has identified Russia, as a threat to their country as those that have identified Germany. Nonetheless, Russia has been the dominant threat for all three countries, throughout the most of the studied period.

The difference observed in NEB data is supported also by the PEW data.<sup>167</sup> Already in 1991, before NEB asked the threat question, there has been a significant difference between the threat and positive influence perception (which I refer to as affinity) among the three countries in question. While 41% of Czechs, and 27% of Slovaks considered Russia a threat to their security, only 20% of Hungarians responded to an open question “*What countries pose the greatest threat to the (survey country) in the future?*” by noting Russia. The closed question: “[...H]ow would you rate the kind of influence [Soviet Union is] having on the way things are going in (survey country).” provided even higher percentages of citizens perceiving Russia as negative influence. Russia was seen as a negative influence by 50% of Czechs, 56% of Slovaks and 33% of Hungarians.

In the absence of explicit threat question, this is a useful proxy for threat perception. The reverse question asking about Russia as a positive influence provided inverse results, further corroborating the trend – with 24% of Hungarians, 19% of Slovaks and only 13% of Czechs seeing Russia as a positive influence to their country in 1991. Neutral answer was available as well with 15% Czechs seeing Russia as neither good nor bad, with 17% Slovaks having this balanced view and only 7% of Hungarians taking the neutral view on Russia.

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<sup>167</sup> Times Mirror Center for the People & the Press, “The Pulse of Europe: A Survey of Political and Social Values and Attitudes.” as reported in Times Mirror Center for the People & the Press, *The Pulse of Europe 2009: 20 Years After the Fall of the Berlin Wall*.

While only semi-closed response questions were asked by the researchers of NEB, the findings are consistent with the PEW results. Czech respondents consistently perceived Russia as a threat to their country – with 39%, 54%, 82% and 45% people seeing Russia as a threat in 1992, 1996, 1998 and 2004 respectively. The perception of Russia as a threat to their country by Slovaks was lower with 26%, 50%, 78% and 24% of Slovaks perceiving it as a threat in the respective years. The Hungarians perceived Russia least as a threat when only 13%, 29%, 42% and 6% of them perceived it as a threat to their country in the respective years.<sup>168</sup> These patterns of regional differences are consistent across time, with Czech population being most perceptive of Russia as a threat, and Hungarian population being least receptive to perceiving Russia as a threat to their country.

To check the stability of this regional difference, I look at the inverse question – perception of Russia as a positive influence on the country. I refer to this inverse of threat as affinity. While the threat is a measure of fear and negative attitude, affinity is a measure of positive attitude. This inverse relation also holds true, as PEW data corroborates for 1991, this question can be used as a general trend measure when threat question is not asked.

This trend is constant also in 2001 when explicit question on threat was not asked, as affinities and amities towards other countries display strong preference of Czechs towards EU and USA, followed by high affinity of Slovaks towards nonaligned European countries, neighbors and Russia. This is most likely a result of pre-NATO accession rhetoric of outgoing Mečiar government which has masked its eastern political orientation by using narrative of neutrality. Interesting is the change in case of Hungary. In 1991 almost one fourth of Hungarians (24%) perceived Russia as a positive influence. A decade later, during Orbán government, only four percent of them saw Russia as a positive influence on their country.

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<sup>168</sup> Detailed longitudinal comparison of these results is available in series of charts annexed (Chart 9 – Chart 23).

As can be observed, the affinity towards Russia in 2001 was highest in Slovakia, with one quarter of respondents mentioning Russia, while only 12% of asked Czechs mentioned Russia as a country with which they see their country closely tied up, and only 4% of Hungarians noted Russia for this question.

When drilling deeper into the data, an interesting phenomenon is discovered in both Slovakia and Czech Republic, and into much lesser extent Hungary. In both Slovakia as well as in Czech Republic (unlike in Hungary) the threat perception is visibly distributed according to political party divisions. The highest threat, or unfavorable view perceived by supporters of the most popular mainstream political parties in both countries is clearly identified as Soviet Union. It is also visible that supporters of Communist Party and its successors in both countries did not consider Soviet Union a threat, or had a generally much more favorable view of Russia than supporters of any other party.

Communist supporters in Czech Republic saw highest threat from Germany, and Slovak Communists saw Hungary as the biggest threat for their country. Additionally, those that voiced their unfavorable opinion of Communist party also saw Soviet Union as a threat to Czechoslovakia.<sup>169</sup> Very high popular perception of Russia (and Soviet Union) as a threat to Czech Republic, and the fact that perception of threat from Russia overlapped or became nearly conflated to the threat of former Communist elites,<sup>170</sup> provided a window of opportunity for strict vetting laws but also for desire to decrease dependence on Russia. These public perceptions also enabled prioritization of security in the energy policy which was presented and was credibly seen as emancipatory move away from Russia.

In Slovakia, Russia was persistently seen as a threat by supporters of right-wing Christian Democratic Movement, Democratic Party, and Democratic Union, this division was most clearly

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<sup>169</sup> See Chart 77, Chart 78, Chart 92 for details and distribution by individual parties.

<sup>170</sup> This is visible also on survey responses of those who saw communist party unfavorably saw Russia unfavorably as well.

visible from the 1995 survey. On the other hand supporters of Mečiar's HZDS (partly also SNS and SDE) did not see Russia as a threat throughout the history. Moreover, voters of the opposition to Mečiar (with the notable exception of SDE/Democratic Left) perceived Russia and ex-Soviet Union as a threat to their country. Overall, the perception of threat of Russia in Slovakia was lower than in Czech Republic, but higher than in Hungary.<sup>171</sup>

For Hungarians, Russia did not play such an important role on the security mind-map. In 1992 highest perception of Russia as a threat was among those Hungarians that did not have clear political party identity (44.56% perceived Russia as threat) but majority of this group (55.44%) at the same time did not consider Russia as a threat. The largest fear of Russia was among MDF supporters with 31.98% (but 68.02% explicitly did not see Russia as threat) followed by FIDESZ supporters (31.45%) but 68.55% of FIDESZ supporters did not see Russia as threat and 30.97% of FKgP's supporters saw Russia as threat as opposed to 69.03% who didn't.

In 1995, again the highest share of those who saw Russia as a threat was among voters of MDF (31.98%), FIDESZ (31.45%) and FKgP (30.97%). Nonetheless majority of voters of these parties did not see Russia as a threat (68.02%, 68.55%, and 69.03% respectively), even in 1998 this distribution has not changed dramatically, when only 37.62% of FIDESZ voters and only 35.97% of MDF voters saw Russia as threat to their country while 62.38% and 64.03% respectively have not. The lowest perception of threat from Russia was nonetheless seen in 1998 among the voters of communist Munkáspárt when 77.50% of their voters did not see Russia as a threat.<sup>172</sup> This further illustrates that Russia simply was not on the threat perception map of Hungarian voters. The priority threat for Hungary was mainly seen in the threat towards the Hungarians living outside of the post-world war (Trianon) borders in Romania, Yugoslavia and Czechoslovakia. The motivations for Hungarian Left-wingers to foster more intensive relations

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<sup>171</sup> I further discuss this in the country chapter and detailed illustration is available in annexed charts (Chart 9 – Chart 23).

<sup>172</sup> See Chart 108 in annex for detailed comparison.

with Russia and facilitation of Russia's interests in Central Europe,<sup>173</sup> therefore did not face resistance from the voters.

## **2.2. Ruling Elites' Relations with Russia**

The popular perception of threat is one of the sources of influence on the policy choices of ruling elites, but surely not the only one. Public perceptions of threat provide the ruling elites with an opportunity, which may or may not be used, depending on the interests of these ruling elites and their opposition. I argue that ruling elites with closer relations to Russia are more likely not to prioritize security in the energy policy, as this in all three countries means promoting policies which go against Russia's and Russia's elites' interest. I analyze policies prioritizing security in the energy or lack thereof in the individual country chapters.

To compare the quality and provide a quantitative measure of relationships between the country elites and Russia, I use a proxy. This proxy measure consists of high-level bilateral visits between the country in question and Russia, and number of bilateral treaties. There is a number of ways to measure the quality of relationships between the Russia and a given country elites.<sup>174</sup> Nonetheless, this measure provides most economical way of getting a comparative and quantitative measure to accompany the qualitative assessment which is provided in the individual country chapters.

The quantitative longitudinal data on number of high-level state visits and the number of bilateral treaties corroborates my hypothesis that higher number of visits and treaties occurs during (center)-left government than during (center)-right governments.<sup>175</sup>

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<sup>173</sup> Orbán, *Power, energy, and the new Russian imperialism*; Deák, "Diversification in Hungarian Manner: The Gyurcsány Government's Energy Policy."

<sup>174</sup> I have also conducted quantitative manifest content analysis of parliamentary discussions, nonetheless the value of that analysis for testing the hypothesis on quality and intensity of relations between the elites was very low and therefore I do not provide it here.

<sup>175</sup> No such clear relationship is observed in case of quantitative manifest content analysis, which was used to probe the prominence of Russia in the discourse of the parliaments. These two observations are most likely due to (1) personal background of the different ideological poles in the studies countries, and (2) the measure for the discourse in parliament captures also the oppositional discourse, which has no effect on the number of visits that

### 2.2.1. Bilateral Relations with Russia

The number of treaties between Russia and Czech Republic, and Russia and Slovakia in the period of 1993-1998, illustrates that the executive branch of Slovak government has had much more intensive relations with Russian Federation, than Czech Republic. While in the period of 1994-1998 the Slovak government concluded 40 international treaties with Russia, Czech Republic concluded only 17 and Hungary only 10. The ideological variation also holds true for Hungary, which had higher number of treaties in the periods when the country was ruled by left-wing governments of Horn (1995) and Medgyessy (2002).

What is also interesting is the cumulative comparison between the three countries in question. During the period of 1993-2005 Hungary concluded 24 bilateral treaties with Russia, in the same period Czech Republic concluded 35 treaties with Russia. Slovakia, champion of intensive relations with Russia concluded 67 bilateral treaties. The amount of treaties that Slovakia concluded is almost twice (1.9) as many as Czech Republic and almost three times (2.7) as many as Hungary. This is not only very unusual, as the disproportion among countries with comparable international relations needs clearly indicates more intensive, and above-standard relations.

The cross-temporal variation within the countries further corroborates my argument that center-left governments had more intensive relations than center-right governments. (53:14 for Slovakia between left and right wing government; in Hungary 15:13 for left:right). There is an interesting exception in case of Czech Republic where the relation is inverted (13 during left-wing and 37 during right-wing).

Additional way of measuring the intensity of relations with Russia, and the role of elites is the number of high level state visits. I considered bilateral visits between the head of state

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are conducted by the government (or president/speaker of the parliament) or on the number of bilateral treaties that are conducted between the countries.

(president), head of government (prime minister), head of parliament (speaker, chair), and finally the minister of foreign affairs as high-level state visits. Although it could be interesting analyzing also other government meetings, availability of data for bilateral meetings between ministers from other ministries than MFA is very limited. Additionally, meetings between other ministries or working groups are usually of more technical nature than between the heads of state and government, which have higher token value and are thus better indicator of quality of relationships.

The distribution of visits was more consistent than distribution of treaties. There have been 30 state visits between Russia and Czech Republic, Russian states-people met 29 times with Slovaks and 28 times with Hungarians. So while the absolute number of state visits is very similar, the distribution of visits is of interest. The similar number of bilateral visits points out that there is approximately comparable international agenda conducted through international treaties, nonetheless different governing elites choose different speeds and intensity of dealing with it and cultivating the bilateral relations.

Presidents and Prime Ministers met their Russian counterparts less when right wing governments were in power than when left-wing governments were in power.<sup>176</sup> In Czech Republic the distribution of bilateral visits was four during right-wing government and nine during left-wing. In case of Slovakia it was five visits during right-wing government rule and 11 during left-wing government rule, with two notable high-level visits during the electoral campaign in 1998, when Mečiar went to Moscow both in May, as well as in June 1998 to boost his election prospects.

The Hungarian government and president met their Russian counterparts four times during right-wing governments (with all four meetings during Antal-Boross government, and none during Orbán government) and nine during left-wing government of Hungary (until 2005). Most of the visits (five) happened during Medgyessy rule.

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<sup>176</sup> While president is independent position from the government, it is representative of the executive and until 1999 Presidents of all three countries were elected by the parliamentary majority. Since 1999 Slovak president is elected by citizens directly.

The overall increase of state visits after year 2000 is also interesting. All three countries seem to have converged in the number of visits into two periods when the number of all states visits increased. One peak before 2000, and one after 2000. The existing explanations why this is the case for Czech Republic, which has markedly improved its relations with Russia after year 2000 point towards ‘normalization’ of relations in the development of mutual relations.<sup>177</sup>

The distribution of visits among various ranks of country representatives provides further information on the level of importance that has been attributed to the bilateral relations. Slovakia had highest number of highest level of state visits (16), while Czechs and Hungarians in the same period had only 13 (see Chart 26, Chart 29 and Chart 30 for visual comparison). In the period of 1990-2005, Hungary was developing mutual relations with Russia primarily on the level of Ministers of Foreign Affairs. In the same period, Slovakia relied on the highest level of relations, as its minister of foreign affairs met with its Russian counterpart only seven times.

The overall comparison of the state visits and bilateral treaties supports the hypothesis that the intensity of bilateral relations between the countries and Russia is higher when left-wing government is in power. The notable distinction is Czech government lead by Klaus, who although leading nominally right-wing government was personally very much Russia-friendly. During the period of 1998-2002 when Hungary was ruled by center-right government of Viktor Orbán’s Fidesz, no high level state visits between Hungary and Russia took place.

### **2.2.2. Influence of Vetting Laws Chosen on the Policy Choices**

I argue that the type of vetting laws chosen during the time of transition influenced the domestic opportunity structure in a way which limited possible energy policy choices, thus influencing the prioritization of security in the energy policy. Vetting laws (sometimes referred to as lustration

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<sup>177</sup> Petr Kratochvíl, “Political Relations Between Russia And The Czech Republic: Or There And Back Again?,” in *Paper Presented at ICEG EC Conference*, vol. 5, 2004, 6.

laws) are part of the transitional justice arrangement, when society sets on the path of transition from one regime type to another. Especially when shifting from a totalitarian towards democratic regime, vetting laws enable society to deal with the former perpetrators, members of former power networks and former elites.

If strict and widely applied vetting laws are introduced, this facilitates elite change at the cost of former members of elites who are forced to leave political power, with their privileged knowledge they either retire, or move towards business. If vetting laws are lax, too narrow or weak, former elites and their networks are able to remain wielding both economic, as well as political power in the country.

In case of all three studied countries, but this is applicable in the whole Central and Eastern Europe, former elites had cordial relations with former, and in some cases also with contemporary elites in Russia and post-Soviet Republics. This meant that they had both privileged information about the domestic assets in their country, access to the “old-boys” network<sup>178</sup> of trust within their countries, as well as personal connections and network across the national borders within the old Communist bloc.<sup>179</sup>

The utility of these networks and its effects on energy policy was visible in three specific instances – ability to import energy supplies (import licensing), ability to settle soviet-era debt, and cross-border trade with, and smuggling of non-taxed petroleum products (gasoline bleaching/ light heating oils).

The lustration process and the choice of vetting laws were of paramount importance mainly initially – in the first few years of the transition. With the progression of time, the sensitivity and memory of population diminished, on the one hand, and on the other the difference in the effects of former totalitarian elites and the newly emerging elites faded.

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<sup>178</sup> Mats R. Berdal, *Transnational organized crime and international security: business as usual?* (Lynne Rienner Pub, 2002); James Sheptycki, “Organizational Pathologies in Police Intelligence Systems Some Contributions to the Lexicon of Intelligence-Led Policing,” *European Journal of Criminology* 1, no. 3 (2004): 307–332; Ulrike Schaeede, “The ‘Old Boy’ network and government-business relationships in Japan,” *Journal of Japanese Studies* 21, no. 2 (1995): 293–317.

<sup>179</sup> Mainly to the countries of the former Soviet Union but most prominently to Russia.

The empirical evidence I gathered, suggest that the first 7-10 years are crucial, and if former elite is allowed to continue leveraging power over society, there is a high probability of state capture by former elites. If alternative elites are allowed to emerge, in the later phase a plurality of elites enables competition among the “old” and “new” elites. Similar effects are achieved also if foreign direct ownership (not portfolio investment) which is not allied with the former elites enters strategic industry. In both of these later instances state capture should occurs only if old and new elites (or new foreign owners) ally, which is more unlikely, and even if that happens (as can be argued in the case of Czech Republic after 1998) state capture coalition is more likely to be challenged. The competition of elites happen not only on nation-wide level, but it is even more important on the industrial sector level.

Czechoslovakia started the transition with one of the strictest vetting laws. When the federation split Slovakia did not continue implementing the federal legislation and effectively did not apply vetting process. History of Hungarian vetting is a mix of attempted lustrations, but in the absence of transparency vetting was effectively toothless.

Czechoslovakia had the first lustration law in the post-soviet space.<sup>180</sup> The law was quite strict and required that negative lustration i.e. certification that person has not been member of socialist-era secret service or selected bodies of the communist party was presented by people in a wide number of elected, as well as professional positions to keep (or apply for) their positions. Federal Ministry of Interior was the certifying authority. Positive lustration resulted in an automatic dismissal of the concerned person within 15 days of the lustration certificate being issued. The Czech Lustration law has been prolonged twice, first in 1995<sup>181</sup> until the end of year 2000, and second time in 2000<sup>182</sup> when the validity of the lustration was extended without limit.

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<sup>180</sup> Tomáš Bezák, “Posttranzičná spravodlivosť v regióne stredovýchodnej Európy. Analýza lustrácií a ústavov pamäte národa” 43, no. 4 (2011): 420–446. The law 451/1991 Coll. was accepted by the Federal Parliament already on October 4, 1991.

<sup>181</sup> Law 254/1995 Coll.

<sup>182</sup> Law 422/2000 Coll.

Although there were a number of questions surrounding the lustration process itself, the extent to which the state secret apparatus reached was uncovered for the wide public by the publishing of the leaked<sup>183</sup> (partial) list of former collaborators of the state secret service – ŠTB by Petr Cibulka in 1992. The complete *official* list was published only in 2003 by the ministry of interior.<sup>184</sup>

There have been ample discussions, as well as a number of legal challenges to the reliability, validity, and even legality and implications of one's name being listed in one of these databases. Regardless of the legal implications, and the fact that in a very low number of cases the veracity of these records was successfully disputed at court, it has had an important de-facto impact on the continuity of the elites and privileged individuals from the previous regime in their ability to participate in the political life. Not disputing the legal implications and not attempting to draw moral conclusions, I use this as a proxy measure for continuity of the previous networks and their presence in the political realm.

Thanks to this “transparency” it was possible, and it has been often done throughout the period, to publicly question the motives and connections of individuals implicated by these databases. This has especially happened during larger investment projects and privatization. In case of Czech Republic, because of this strict and early-on implemented lustration law, former elites did not directly influence the energy policy as much as has been the case in Slovakia. Interests of “domestic” elites connected with the previous regime and thus possessing privileged information on the value of assets, and often also the necessary “start-up” capital had much higher influence in both Slovakia and Hungary.

A good example where this pre-existing condition has played a role was building of diversification gas supply route to Czech Republic and negotiating the accompanying contracts

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<sup>183</sup> According to a public interview with Marián Gula director of Slovak Department for The Documentation of the Crimes of Communism, these records, although incomplete, were genuine see SME, “Cibulkove zoznamy sú pravé,” *Www.sme.sk*, May 9, 2002, <http://www.sme.sk/c/537240/cibulkove-zoznamy-su-prave.html> (accessed March 15, 2012).

<sup>184</sup> Based on Law 107/2002 Coll.

with Norway. When the choices of privatization paths were discussed, security argument in connection with former elites was used in Czech Republic, enabling prioritization of energy security and diminishing the influence of elites connected with former regime. The so-called “Czech way” had been successfully dismissed as being a cover for “Russian way” because of the alleged links of Czech business people to former secret agencies, and subsequently security increasing investments took place and important assets were sold to investors from OECD countries rather than to former elites.

While Slovakia inherited functional lustration law from the Czechoslovak Federation, it has not applied it. The main reason, in my view, was that the ruling political leadership of the newly created Slovak Republic themselves would not have passed the lustration. The representative example is the fact that at the time Slovak Prime Minister Mečiar was recorded in the secret service archives as a candidate for undercover collaboration under the code name “The Doctor.”<sup>185</sup> The fact that first government without previous members of communist party was formed in Slovakia only in 2010, illustrates the context in which any idea of transitional justice or lustration could not have received much traction.

The first public attempts at reopening the topic started at the end of first Dzurinda’s center-right government (which was a coalition government with SDE – the direct successor of the communist party). Nonetheless, except for the personal initiative of Christian-democratic minister of interior Čarnogurský to create Department for The Documentation of the Crimes of Communism at his ministry, there was no real progress until 2002. In 2002<sup>186</sup> The Nation’s Memory Institute (Ústav pamäti národa) was set-up with the explicit aim to disclose activities of State Security Authorities during the period of 1939 – 1989. Since this had no legal implication

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<sup>185</sup> Luba Lesná, “Missing secret service files reconstructed,” *The Slovak Spectator*, June 4, 2007, <http://spectator.sme.sk/articles/view/27835/2/> (accessed March 24, 2012).

<sup>186</sup> By the Act of the National Council of the Slovak Republic No. 553/2002 Coll.

on the possibility of former secret service personnel to participate on public life<sup>187</sup> and the transparency came more than a decade after the start of the transition, this is an example of delayed and inconsequential transitional justice which has not prevented people with privileged access and information pursuing their private economic interests and influencing public policies including the energy unhampered at the cost of public interests.

The choice of transitional justice policies of Hungary has been very different from both Czech Republic and Slovakia. The history of lustration legislation of Hungary is a rollercoaster, and in its effects fares similarly to Slovak as mostly inconsequential, with even lower transparency than Slovak one, up until today. The demand for lustration began as early as 1990, but the first lustration law could be passed only three months after Prime Minister Antall's death in 1994. Nonetheless, the Constitutional court rejected implementation of this law and first Hungarian vetting law could only become valid in late 1996.

The delay in passing of the law and the fact that its extent was quite narrow, despite the attempts of liberal political forces to extend it meant the vetting could be restarted only after the major ownership changes in energy sector were already prepared, or even concluded. Subsequent government led by the right-wing, anti-communist Fidesz in coalition with MDF and FKgP expanded the scope of the legislation to also include media and "influential" editorial staff as well as judiciary, prosecutors and other offices that receive state funding. This was to include 7,000-8,000 posts in total, and the parliament extended the validity of law until 2004.<sup>188</sup>

The further spur for tougher lustration regime came in June 2002, when revelation that the new prime minister, Péter Medgyessy of the Communist successor Hungarian Socialist Party (MSZP), had worked for the Communist-era counter-intelligence (Department III/II).

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<sup>187</sup> With the exception of offices and jobs requiring security clearance.

<sup>188</sup> Williams, Szcserbiak, and Fowler, "Explaining lustration in Eastern Europe A post-communist politics approach."

Unlike Slovakia and Czech Republic, Hungary had lacked most of the needed transparency<sup>189</sup> in dealing with the past. Thus the networks of previous regime beneficiaries, and their ability to capitalize on their privileged access and knowledge went mostly unhampered. While in Slovakia and Czech Republic at least the researchers could rely on regulated access to archives and the leaked (partial) database, the list of informers, agents or collaborators in Hungary remains unavailable. What has in effect happened in Hungary at its most can therefore be termed as “*sanctionless*,”<sup>190</sup> or inconsequential lustration.

### 2.2.3. Elites’ Links with the Past

I argue that the vetting laws chosen influenced the presence and power position of former communist elites, who had privileged information and contacts to their peer elites in the countries of the former Soviet Union – particularly Russia.

To get a comparative measure of the extent of presence of these networks, in Czech Republic and Slovakia I use database of former communist secret service personal files. This database was made public first unofficially, later the veracity of the database was confirmed when it was officially published by the ministry of interior. The database included list of names of agents and various levels of collaborators, potential collaborators, confidants and agents. This database also listed enemies of the state and persons of interest to the secret service. Enemies of the state and persons of interest cannot be seen as members of network and having connection with the former regime.

In case there was insufficient transparency in the vetting process and people who were members of the network were not uncovered, their access to the files on enemies of the state provided them with additional leverage over victims of the communist regime. They could draw on the

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<sup>189</sup> The limited dataset of 500-or so ministry employees published on the web does not provide the level of transparency that Cibulka’s list did in Czechoslovakia (“SZT-tisztek”, n.d., <http://szigoruantitkos.hu/szt-tisztek> (accessed March 24, 2012).)

<sup>190</sup> Alexander Mayer-Rieckh and Pablo De Greiff, *Justice as prevention: vetting public employees in transitional societies* (SSRC, 2007), 25.

information collected by the communist regime, often including very personal or private information to blackmail former enemies of the state. Therefore membership of the “enemies of the state” in the positions of political power in the absence of transparent vetting environment created systemic vulnerability and increased power of former regime exponents and their ability to use privileged information. This has happened on a number of cases, in Slovakia especially during Mečiar regime, when incriminating files appeared “overnight” and were “found” on the table to be used in smear campaigns and information games. Since there was insufficient and asymmetric transparency to the files, veracity of these files and the information they contained could not be verified at the time.

To assess the extent of continuity of former elites, I have collected names of all ministers in all governments in Czech Republic and Slovakia until 2005, and I searched their names in the database of secret service personal files. The database allows to search by a combination of given name, surname and date of birth. In most cases I was able to positively confirm whether any particular member of government was recorded in the database or not. In few cases I was not able to find date of birth of a given minister, or the nature of the relation was not clear. And while I found a match on the combination of name and last name, in the absence of confirmed date of birth I recorded such a match as an allegation.

Given the nature of secret service files, I do not have claims about what these people did or did not do for the secret service. In a number of cases conscious collaboration of people recorded has been successfully questioned and dismissed at court. Nonetheless, the problems that exists with the database are equal for records on Slovakia, as well as in Czech Republic, therefore I assume if there is a certain share of the database which recorded people wrongly, this share would be equal for both Slovakia and Czech Republic and cannot be used to explain the difference among the countries and difference among different governments within the country.

The situation in Hungary, for reasons I elaborate in detail in the country chapter, does not allow for a full comparable assessment. First of all, the personnel files of the secret service are simply not accessible.<sup>191</sup> In an attempt to at least provide an intra-country comparison and see whether there is variation among various governments within Hungary I have assessed the number of ministers who have been members of the communist party or the communist youth association. Similarly to Czech Republic and Slovakia, I have collected names of all members of Hungarian governments. I<sup>192</sup> have conducted text search in public domain sources on any mention of their membership in either the Hungarian Socialist Workers' Party (MSZMP) or its youth organization Hungarian Young Communist League (KISZ) as a representative organizations of the communist regime. Since KISZ had approximately 800,000 members and MSZMP 1.2 million (14% of the adult population)<sup>193</sup> the membership in these organizations was much more common than collaboration with the communist-era secret service in Czechoslovakia.

Given both how soft and anecdotal the available evidence is, since it relies only on publicly acknowledged membership of individual ministers in the Communist Party in the two organizations, as well as very different nature of membership in KISZ and MSZMP as compared to communist-era secret service police in Czechoslovakia, this measure cannot be used to compare situation in Hungary with Czech Republic or Slovakia. Some of the most pro-reform ministers or high-ranking members of both center-left, as well as center-right governments in Hungary were allegedly members of either the Communist Party or the Hungarian Young Communist League.

Nonetheless this measure provides crude comparison within Hungary across different governments. Thus, acknowledging that this is by far not the same thing as secret service records

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<sup>191</sup> With the limited exception of few hundred names of highest ranking officials.

<sup>192</sup> With a help of a native Hungarian research assistant.

<sup>193</sup> Data from Gergely Karácsony, "Az előélet utóélete. Az egykori MSZMP-tagságra vonatkozó adatok megbízhatósága," in *Átlás-viszonyok. Tanulmányok Angelusz Róbert 70. Születésnapjára*. (Budapest, 2009), 328–341, [http://www.karacsonygergely.hu/letoltesek/Angeluszkotet\\_Karacsony\\_teljes.pdf](http://www.karacsonygergely.hu/letoltesek/Angeluszkotet_Karacsony_teljes.pdf) (accessed March 11, 2013).

in case of Czech Republic and Slovakia, the results are interesting as they illustrates variation among center-left and center-right governments in Hungary as well.

The difference between Czech Republic and Slovakia are vast. (See Chart 24 and Chart 25 for comparison.) While in Czech Republic during the period 1993-2005 on average only 7.18% of ministers had recorded ties to the former regime's secret service apparatus, in the same period in Slovakia 21.25% ministers were recorded in the secret service database. The right-wing governments in Czech Republic had 5.02% (3.54% during 1993-1998) of ministers who were recorded in the databases, while Czech left-wing governments had 9.96% of ministers recorded in the secret service databases. Slovak right-wing governments had 13.63% of ministers with records in the secret service database, the left-wing governments had 27.18% (27.21% in the period of 1993-1998) of their ministers recorded in the archives of the communist secret service. The crude proxy of manual cross-search performed on biographies and names of members of different Hungarian governments and news articles corroborates, although very weakly, the division observed in both Czech Republic and Slovakia.

Given the nature of the data the division is not that large. Alleged Communist party and communist youth association membership of Hungarian ministers in that period averaged at 47.94%. Nonetheless, the first Hungarian government of transition had minimal personal ties to these two organizations, as I could find only 3.23% of its ministers having been members of MSZMP or KISZ. The following left-wing government lead by the post-communist MSZP had 80.77% of former members of these communist organizations within the cabinet; this is the largest number for any Hungarian government. The right-wing Orbán government that followed had only about half (48.28%) of its ministers with identified ties to MSZMP or KISZ, including a

number of high ranking ministers.<sup>194</sup> The following center-left government had the share between 46.15% and 59.09% averaging at 51.38% of ministers.

### **2.3. Concentration of Energy-Intensive Export-Oriented Industry**

Another aspect that has interplayed with the elites' ties to the former regime and their counterparts in post-soviet countries, I argue, is presence, type and concentration of energy-intensive industry in the country. The literature on the role of energy intensive export oriented industry on choices in energy policy and prioritization of security is virtually non-existent. There is a scarce<sup>195</sup> literature analyzing price shocks and adjustment effects of various industries by energy intensity, but more elaboration or hypotheses how energy intensive industry effects prioritization of security in energy policy is absent.

The presence and concentration of energy-intensive export-oriented sector provides structural demand for influencing energy policy. This both influences choices during the transformation, and energy policy priorities, but also how the industrial restructuring takes place.

The timing and sequencing of both energy assets' as well as major energy consumers' privatization and restructuring is particularly important. Privatization of energy assets can hinder prioritization of energy security by divesting the costs of provision of public good of energy security and its benefits, which are easier to internalize before the privatization takes place. The effects of the privatization of the major energy consumers plays a role as it can be either used to weaken the entrenched industrial interests and the reluctance to transform and increase competitiveness (as was the case in Czech Republic in the earlier period, and partially in Slovakia

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<sup>194</sup> Városi Újság, "A Fidesz azon politikusainak listája, akik korábban a kommunista rendszerben valamilyen funkciót töltöttek be", 2012, <http://www.vujsag.com/cikkek/velemenynk-szerint/241-velemenynk-szerint-ii-evfolyam-8-szam/873-a-fidesz-azon-politikusainak-listaja-akik-korabban-a-kommunista-rendszerben-valamilyen-funkciot-toeltoettek-be> (accessed March 11, 2013).

<sup>195</sup> Vera and Langlois, "Energy indicators for sustainable development"; Neff, "Improving energy security in Pacific Asia: diversification and risk reduction for fossil and nuclear fuels"; Bohi, "On the macroeconomic effects of energy price shocks"; Bohi and Toman, *The economics of energy security*; Lee and Ni, "On the dynamic effects of oil price shocks: a study using industry level data."

after 1998) or cement the rent-seeking political privatizers preferring status quo and shielding from the effects of competitive energy pricing, and avoiding economic restructuring.

If privatization is used to weaken the entrenched interests as happened in Czech Republic, and security is prioritized in energy policy over short-term shielding of industry from real costs of energy, increases in efficiency are realized which feeds in, and reinforces the security objectives of energy policy. If the privatization is done according to the preferences of major interest groups as happened in Slovakia, the process of energy market liberalization and prioritization of energy security is delayed or is captive to the interests of few concentrated interest groups. In such a case policies which would endanger entrenched interests can go forward only if arduous energy or privatization contracts are accepted as a ransom, as was the case of Slovakia.

The power of the industrial sector stems from a number of sources. One set of sources is based on the fundamentals of its contribution to the GDP, its contribution to employment, and its position on the energy market. The other set of sources stems from its structural position, which includes level of industrial coordination and competition for policy priorities from similarly positioned industries. While structural power of industries and details of negotiation positions is interesting enough, its thorough study would make for an independent project in its own right. In this dissertation I only take a limited measure on few of the sources of industrial structural power, which I claim to be important for influencing prioritization of security in the energy policy.

I focus on the importance of industry as source of national wealth vis-à-vis its position as energy consumer. Since all three countries are small open economies, I do this through analyzing the position of the given industry as a contributor to the country's exports. Because of the comparable position of employment in these sectors (see Chart 33 for comparison) in all three countries, and relatively small share of employees in these industries as compared both to the

national economy, as well as the manufacturing sector, these industries do not wield influence based on their direct importance as a source of employment.

Additional aspect which I assessed is the level of unionization in the industries and the number of strikes that has occurred in the given period. The level of unionization is comparable for Czech Republic and Hungary with almost half of the union rates in Slovakia.<sup>196</sup> Comparing the industrial action among the three countries is difficult, as there was very low number of strikes or lockouts in the energy-related industries during the studied period. Between 1991 and 2005 Hungary had only five strikes and lockouts in Mining industry and Electricity, Gas and Water Supply with 27,820 workers participating. In the same period Czech Republic had only two strikes in Mining and Quarrying with 1,800 workers participating and no strikes in electricity sector. Slovakia in the same period had only two strikes also in Mining and Quarrying with only 444 workers participating. (See Chart 31 and Chart 32 in annex for detailed comparison).

For analyzing influence of industrial sectors on the energy policy and whether security can be prioritized, I look at the energy sector itself, but also on industrial sectors for which energy is crucial i.e. energy-intensive industries. The energy sector itself is negligible in terms of export importance, mainly because of the lacking export infrastructure throughout the period.<sup>197</sup> The most energy intensive sectors in Central European Countries are metal producing sectors including both ferrous, as well as non-ferrous, and chemicals industries. All other industrial sectors are much smaller consumers of energy.

In Czech Republic the average industrial energy consumption of four most energy intensive sectors between 1993 and 2005 consisted of iron and steel (28.98%), chemical and petrochemical

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<sup>196</sup> 20.8% for Czech Republic and 19.9% for Hungary, 12.9% for Slovakia (proportion of wage and salaried earners) according to Susan Hayter and Valentina Stoevska, *Social Dialogue Indicators: Trade Union Density and Collective Bargaining Coverage: International Statistical Inquiry 2008-09* (ILO, 2010).

<sup>197</sup> With the notable exception between Czech and Slovak Republics, which used to be part of a single energy system.

(10.61%), non-metallic minerals (9.48%), food and tobacco (6.12%)<sup>198</sup> these altogether accounted for 49.07% of industrial consumption. In Slovakia the four most energy intensive industries accounted for 69.81% of industrial consumption on average between 1993 and 2005, with iron and steel (40.75%), chemical and petrochemical (12.22%), non-metallic minerals (10.77%) and paper, pulp and print (6.07%).<sup>199</sup> In Hungary the three most energy intensive industrial sectors throughout the period have been iron and steel (21.81%); chemical and petrochemical (19.69%); non-metallic minerals (16.54%) and food and tobacco (15.36%). These sectors accounted for 73.39% of industrial energy consumption on average between 1993 and 2005.

In both Slovak and Hungarian cases the share of metallurgy and chemical industry combined is well over 50% of industrial energy consumption, while in Czech Republic, the share of these two sectors on energy consumption has been only between 30% and 46% throughout the studied period. (See Chart 35, Chart 36, Chart 83, Chart 98, Chart 74 and Chart 114 for detailed comparison).

The importance of these high energy consuming consumers stems also from their share on industrial exports. The relation between shares of these sectors on the overall exports of these small open export oriented economies is important for understanding the sensitivity to the concerns of these industrial sectors, given their very high share of energy needs. The measure which provides inside look into the industry is energy intensity – how much energy is needed to produce export value.

The single largest industrial consumer of energy metallurgy and non-metallic minerals (SITC 66+67+68) is also the single most energy intensive sector in all three countries. While in 1993 it took 7.447 tons of oil equivalent (TOE) to produce one million USD of export value in Czech metallurgy, in 2005 it was only 945 TOE per \$M.<sup>200</sup> The numbers for Hungary, for the same

<sup>198</sup> Non-specified Industry consumption accounted on average for 25.66% during 1990-2005.

<sup>199</sup> Non-specified Industry consumption accounted on average for 12.56% during 1990-2005.

<sup>200</sup> Calculated from United Nations Statistics Division, “UN Comtrade”, n.d., <http://comtrade.un.org/> (accessed September 8, 2010); Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy,”

period and same sector are 7,160 TOE per \$M and 1,047 TOE per \$M, the most energy intensive industry in Slovakia was lagging even more with 9,975 TOE per \$M in 1994 and 2.458 TOE per \$M in 2005.

The energy intensity in chemical industry is similar in trend, with Hungary leading the efficiency race moving from 632 TOE per \$M in 1994 to 123 TOE per \$M in 2005. Slovakia's chemical industry improved from 741 to 259 and Czech from 605 to 388 TOE per \$M in the same period.<sup>201</sup> These statistics are interesting especially in light of recorded export decline of Hungarian chemical production exports between 1996, and 1998, which was reversed in 1999. On the other hand the choice of the Horn government to support complex manufacturing rather than chemical industry can be traced as well, as it rapidly took off already in 1996 (see Chart 111 - Chart 116 in appendix).

This high concentration of energy industry in small number of companies in case of both Hungary but mainly Slovakia influenced both the position of these sectors vis-à-vis energy suppliers, but also their interest in energy policy. The export importance of metallurgic industrial sector especially for Slovakia cannot be overlooked. Accounting for 23.23% of all exports, the high energy intensity and low speed of restructuring and increasing efficiency initially influenced and later on became victim of the energy policy choices. The Slovak metallurgic sector – represented mainly by large steel mill in Košice and few other companies throughout the country, were able to shield themselves for a long period of time from the international competition and pressure for energy consumption decreases, through relying on lower costs of energy.

As I discuss in detail in Slovak chapter – a number of individual companies were seeking and received preferential arrangements for energy supplies. Mečiar's government allowed these

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*Eurostat and European Commission - Directorate-General for Energy and Transport (2006):*

[http://ec.europa.eu/dgs/energy\\_transport/figures/pocketbook/doc/2006/2006\\_energy\\_en.xls](http://ec.europa.eu/dgs/energy_transport/figures/pocketbook/doc/2006/2006_energy_en.xls); Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]", n.d.,

[http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nrg\\_100a&lang=en](http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nrg_100a&lang=en) (accessed October 28, 2012).

<sup>201</sup> See Chart 86 and Chart 102 for detail over the whole period.

preferential arrangements, both expecting ability to get energy supplies at a bargain from Russia (which did not materialize in mid-to-long term) and enabling selected politically-well-connected individuals with privileged access to government to reap the rent. Instead of using the temporary shielding of the industry from the competitive pressures to invest and restructure to increase competitiveness, these individuals rather privatized or (often conspicuously) consumed the additional rent. Once restructuring of the industry could not be further avoided, the owners passed the buck to the economy as a whole in form of restructuring loans, or energy costs which had to be distributed among all customers.

What can therefore be observed is that in countries where energy consumption is concentrated in one or very few sectors, and the share of these sectors on exports is high, the sensitivity of government to the needs of these industrial sectors is higher. Depending on the choices of the government, it can either choose to shield the sector in the long run, preventing the pressure to increase energy efficiency, or support the sector in short term but assure that the energy efficiency is increased. In case of Slovakia as I illustrate in the subsequent chapter, the costs of short-term protection of industry has decreased its ability to compete globally, and created costs that had to be paid by successive governments.

## **2.4. Prioritization of Security in Energy Policy Compared**

How much security is prioritized in the energy policies of countries in transition depends on the interplay of three most important factors, public perception of major energy supplier as a threat to their country, choice of vetting laws and its influence on the types and scope for maneuver of elites in politics and economy, together with interests of ruling elites as demonstrated by intensity of relations with major energy supplier – Russia on the highest level – and finally structure and concentration of energy intensive export industries in the country.

I have discussed the conceptualization of energy security together with the literature review in the previous chapter. In this section I provide a comparison of tangible measures of security prioritization for the three countries under study. I provide a comparison of 1) energy supply diversification, through 1a) transit (pipeline) diversification, 1b) supplier (contract) diversification and 1c) import market concentration; I also compare 2) demand structure (energy mix) through comparing energy mix type and structure and 3) energy prices.

How can one measure how much do governments prioritize security in their energy policies and the levels of energy security achieved? In this chapter, I provide comparison of developments in the most important energy security aspects across the period under study. The longitudinal measurement of changes in prioritization of security in energy policy provides a check on how my conceptual model applies. It also enables measure of the extent of impact different choices, and the interplay of factors analyzed in the previous chapter, had on the energy security of the countries I study. I base the measurement on the conceptual model presented in the previous chapter.

This approach to measurement of energy security also captures the inactivity of governments and puts contrast between the rhetoric of government and actual policy developments. It provides an additional measure on how the government choices in energy policy area succeeded

in delivering better policies for their countries in terms of lower prices of energy supplies, and higher competitiveness of their economies.

The existing available measures of energy security provide at best snapshot in time. My study requires dynamic approach to compare both differences among the countries, but also across different periods within the countries. In order to achieve this, I first provide the snapshot in time based on the available measures from the literature, which is the snapshot at the end of the period I study, and then I proceed with presenting my own proxy-measures of security prioritization in the energy policy across the time. I do not proceed with developing an alternative index, but rather provide an in-depth qualitative elaboration for the three countries compared among each other, and comparison for different periods within each of the countries.

#### 2.4.1. Energy Security - Measurements and Indexes

The aggregated indices of energy security and energy policy provide only single snapshot in time, by collapsing many dimensions into a single measurement they gloss over important constitutive aspects.<sup>202</sup> Le Coq and Paltseva's Risky External Energy Supply (REES) Index of Energy (in)security,<sup>203</sup> is a variation of Herfindahl–Hirschman index of market concentration<sup>204</sup>, as such it offers disaggregated measure for different fuels. The picture presented (see Chart 38 and Chart 37) shows that in 2007 Hungary and Slovakia faced highest security risk to their energy policy from all compared countries, with values of combined REES index of 52.2 and 51.1 respectively (51.9 and 50.2 if coal is excluded), in the same index value for Czech Republic was

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<sup>202</sup> Anne Neumann, "How to measure security of supply?", September 9, 2007, <http://www.energypolicyblog.com/2007/09/09/how-to-measure-security-of-supply/> (accessed June 24, 2010); Kruyt et al., "Indicators for energy security"; Lars-Hendrik Röller, Juan Delgado, and Hans Wolfgang Friederiszick, "Energy: choices for Europe," *Bruegel Blueprint Series, Bruegel* (2007); Chloé Le Coq and Elena Paltseva, "Measuring the security of external energy supply in the European Union," *Energy Policy* 37, no. 11 (November 2009): 4474–4481, <http://www.sciencedirect.com/science/article/B6V2W-4WR2C4X-1/2/69e39a771b7e9b2a05ce78ef5be50f60> (accessed April 27, 2010).

<sup>203</sup> Le Coq and Paltseva, "Measuring the security of external energy supply in the European Union."

<sup>204</sup> Albert O. Hirschman, *National power and the structure of foreign trade*, vol. Expanded, Studies in international political economy. (Berkeley: University of California Press, 1945).

17.3 (same value without coal) still above European average of 15.8 (14.2 without measuring impact of coal).

A somewhat different approach to measuring energy security is offered by Röller, Delgado, and Friederiszick,<sup>205</sup> in their Energy Policy Index. This index consists of three aspects: Competitiveness, Security of supply and Environment sustainability. The Security of Supply Index which captures the prioritization of security combines two aspects that are weighted equally: (1) energy net imports divided by gross energy consumption, and (2) generation adequacy. Risks stemming from the distribution and sources of market power are somewhat captured through separate measures of competitiveness and environmental sustainability, but the index overemphasizes the presence of thermal coal generation as a source of energy security. The value of Czech Republic's Energy Security Supply Index was 3.1.<sup>206</sup> The measure is out of maximum value of six, which puts Czech Republic on the fifth best place in Europe after Poland, Denmark, UK, and Estonia. Hungary's value of 2.1 and Slovakia's 1.7 are much worse, and below the European average of 2.25. The overall combined index ranked Czech Republic with 8.7, Hungary with 8.2 and Slovakia with 7.2 on tenth, thirteenth and sixteenth in Europe respectively.

The third index which measures energy security of all of my three cases is offered by Scheepers et al. in the form of Crisis Capability (CC) and Supply/Demand Index (S/D). It offers one of the most comprehensive ways of measuring energy security:

“The S/D index aims at review and assessment of energy security of supply in the medium and longer run. The S/D Index covers final energy demand, energy conversion and transport and primary energy sources (PES) supply. It uses four types of inputs, two objective types and two types of a more subjective nature. The objective inputs concern the shares of different supply and demand types (i.e. for demand: industrial use, residential use, tertiary use and transport use; for supply: oil, gas, coal, nuclear, RES and other) and the values characterizing capacity and reliability in conversion and transport based on the secondary energy carriers (electricity, gas, heat and transport fuels).”<sup>207</sup>

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<sup>205</sup> Röller, Delgado, and Friederiszick, “Energy: choices for Europe.”

<sup>206</sup> Measured out of 6, which put Czech Republic 5<sup>th</sup> best in Europe after Poland Denmark, UK, and Estonia.

<sup>207</sup> Scheepers et al., “EU Standards for Energy Security of Supply-Updates on the Crisis Capability Index and the Supply/Demand Index Quantification for EU-27,” 8.

Nonetheless, as Kruyt et al. note “due to its comprehensiveness, the S/D index suffers from limited transparency as well as an extensive amount of weighing factors, even if these are deliberately made explicit,”<sup>208</sup> in the extensive annex. This index was calculated both for 2005, and for 2020 future scenario.<sup>209</sup> This Index provides values between 0 and 100 with Czech Republic leading the region with the value of 64.4,<sup>210</sup> followed by Hungary with 49.0 and Slovakia with 47.5.

When looking at these snapshots at the end of my studied period, all three countries persistently rate in same order, with Czech Republic having highest energy security followed by Hungary and Slovakia with lowest energy security of them all, despite the different ways of measuring the energy security.

#### **2.4.2. Prioritization of Energy Security – Longitudinal Proxies**

The most widely accepted way of achieving energy security is through diversification.<sup>211</sup> I closely analyze three of its most important aspects: a) transit (pipeline) diversification, b) supplier (contract) diversification and c) import market concentration. Changes in these three aspects offer excellent means for measuring actual prioritization of security in energy policy.

##### **2.4.2.1. Transit Diversification**

Diversification of means of transit – for both oil and gas – this means import pipeline diversification, is perhaps the most difficult element in improving energy security. At the same time, it is the best indicator for prioritization of security in energy policy. In all three cases, in both oil and gas sectors until 2008, there have been only two major diversifications of gas import

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<sup>208</sup> Kruyt et al., “Indicators for energy security.”

<sup>209</sup> The scenario figures provide similar picture with Czech Republic followed by Hungary and Slovakia with 60.9, 49.5 and 47 respectively.

<sup>210</sup> The EU wide best value of Denmark was 64.4.

<sup>211</sup> Zeyno Baran, “EU Energy Security: Time to End Russian Leverage,” *The Washington Quarterly* 30, no. 4 (2007): 131–144; Yergin, “Ensuring Energy Security”; S. Hayden Lesbirel, “Diversification and Energy Security Risks: The Japanese Case.,” *Japanese Journal of Political Science (Cambridge)* 5, no. 1 (2004): 1–22; A. M. Martin Ferguson, “Energy security: the new cold war,” *International Journal of Global Energy Issues* 29, no. 4 (2008): 366–370.

pipelines: one by Czech Republic and one by Hungary. Import oil pipeline was diversified only by Czech Republic.<sup>212</sup>

The gas diversification of Hungary, which was finished in 1995, was started by a right-wing government. The Czech gas diversification which went on-stream in 1996 was also started and promoted by right-wing political forces in the government. The single oil import pipeline diversification of 1995 in Czech Republic was also due to strong preference for security in energy policy by right-wing political forces in the Czech government. The fact that right-wing governments in both Hungary and Czech Republic promoted diversification is no coincidence. It is the right wing governments that in the region in general have had worse relations with the most important supplier – Russia, and it is also right-wing governments that generally prioritized security over other aspects of energy policy.

#### **2.4.2.2. Supplier Diversification**

While infrastructural diversification is much more costly, diversification of suppliers is at least theoretically somewhat more feasible, even in the short run. This expectation nonetheless presupposes that infrastructure is not captured by supplier, as was the case for the import pipeline from former Soviet Union. This is also the primary reason why before meaningful supplier diversification could happen in the region, an infrastructure diversification had to precede it.

To measure the supplier diversification, in the context of highly confidential contracts, when sometimes not even government knows precisely what the contractual situation of energy companies on its territory was,<sup>213</sup> is a genuine challenge. To overcome this challenge and provide for consistency and comparability across the countries I count the number of trade partners for which any traded values are recorded in the UN trade system.

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<sup>212</sup> Both Hungary and Slovakia had alternative oil pipeline importing infrastructure already.

<sup>213</sup> V.B., “Private discussion about Czech Republic’s Energy Security (Telč)”, July 3, 2008.

The number of trading partners has been increasing as time progressed. In this case, there does not seem to be any clear relation between the simple number of gas or oil importing partners, and what type of government is in power. The reason might be that this data captures much higher amount of trading partners than what is realistic for the nature of these markets and physical supplies, and single physical supplier might be recorded as multiple contractual supplier. This could be the case if the financial side of the physical trade is done using more complex business structure involving multiple countries, mainly to provide for confidentiality to the beneficiaries of the trade, and optimize their tax burden. Since the list of gas exporting partner countries for Czech Republic, Slovakia and Hungary contains countries like, Switzerland, San Marino or Andorra, although with relatively small volumes, this may be the case.

Given all of the gas is imported via pipeline, this raises an important questions on the nature of diversification and what this data actually captures. Although there are often so-called swap deals, when the physical amounts of gas are not transferred, and only the ownership rights on the gas which physically does not travel, are moved around, in the absence of alternative supply pipelines, swap deals cannot be considered energy security improving. In these circumstances the right question is whether these are even swap deals, or these are traces of commercial and tax “optimization” vehicles and not genuine means of energy diversification through contract diversification.

Given the exotic list of countries with no pipeline connection to Central European countries, it rather seems to support Kupchinsky’s argument, that these are just “off-shore nameplate companies” linked in one way or another to the existing dominant supplier, the Russia’s Gazprom, while “hiding the names of beneficiaries.” As Kupchinsky further elaborates, “for over a decade the proliferation of so-called “Gas Trading” companies in Europe has destabilized the EU energy market and possibly criminalized it as well. The appearance of such companies as RosUkrEnergo, the Centrex group of companies, Gazprom Germania, YugoRosGas, Eural

Trans Gas, Overgas, and others, all linked in some fashion to Russia's state-owned gas monopoly, Gazprom, have not added any value to gas transactions in the EU.<sup>214</sup>

The sheer numbers, because of the nature of this data, and often negligible amounts accounted for from some of these exotic countries, do not seem to demonstrate any variation based on the type of government in power. Nonetheless, when looking at the market concentration, which captures also the size of the imports and the structural power of the importing countries, a much clearer picture is offered.

#### **2.4.2.3. Import Market Concentration**

Commonly accepted measure of market concentration, used by business as well as regulators is Herfindahl–Hirschman Index (HHI).<sup>215</sup> I calculated the HHI for energy import market by squaring the market share of each supplier present at the market, and then summing the resulting numbers.<sup>216</sup> The HHI takes into account the relative size distribution of the suppliers in a market. The value of the index is close to zero in a very competitive market served by high number of comparably big suppliers. Monopolist market served by a single supplier measures the maximum of 10,000 points on the HHI index. The value of the index increases as the number of suppliers in the market decreases, as well as with increasing disparity in sizes between the suppliers. I offer the detailed charts in the annex (Chart 47 – Chart 52), the comparative analysis follows:

When I calculated the energy import market using this standard index, I found that that Czech Republic in most years outranked both Hungary as well as Slovakia in competitiveness of its import market. The most rapid change is visible in case of Czech Republic since 1997, and in case of Hungary since 1996. This reflects the new import routes for gas from the west for Czech

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<sup>214</sup> Roman Kupchinsky, *Gazprom's European Web* (The Jamestown Foundation, 2009).

<sup>215</sup> Hirschman, *National power and the structure of foreign trade*, Expanded; USDOJ: Antitrust Division, "Herfindahl-Hirschman Index", n.d., <http://www.justice.gov/atr/public/guidelines/hhi.html> (accessed April 6, 2013).

<sup>216</sup> For example, for a market consisting of four suppliers with shares of 35, 30, 20, and 15 percent, the HHI is 2,750 ( $35^2 + 30^2 + 20^2 + 15^2 = 2,750$ ).

Republic and Hungary in the respective years. The real diversification which happened in these two countries is thus reflected also on the noticeable decrease of import market concentration.

The Czech pipeline diversification was immediately reflected in the decrease of market concentration for Russian Federation, in 1996 imports of gas from Germany were already at 7% of value of all gas exports, and in 1997 the share of Russian imports dropped to 83.3% with German and Norwegian imports increasing to 7.2% and 7.4% respectively.

Hungarian gas diversification did not achieve such impressive results as Czech. This is mainly because of the lack of concomitant contractual diversification which did not follow the infrastructure diversification. Nonetheless it still provided for decrease of import market concentration. The first noticeable decrease in Hungarian gas import market was measured only in 1997, two years after the pipeline from Austria was opened, when Russia's share dropped to 85.1% mainly due to imports from Austria and France.<sup>217</sup>

The apparent decrease of market concentration in case of Slovakia in 1995 and 1996 is due to imports which were accounted for as originating in Czech Republic, Hungary and Germany. While these amounts were really negligible in terms of share of Czech imports (0.09% and 0.14% in 1995 and 1996 respectively) for relatively smaller Slovak market these operations reflected in the index.<sup>218</sup>

### **2.4.3. Energy Mix Type and Structure**

The types and amount of energy sources that are consumed in the given country – the specific energy mix – have important effect on the desired types of energy sources which need to be provided. This influences the need for prioritizing the security in energy policy. There have always been and continues to be differences in the energy mix between Czech Republic, Slovakia and Hungary. Nonetheless, the observed changes in the energy mix profile of the countries

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<sup>217</sup> Suspecting these were swap deals, rather than physical deliveries.

<sup>218</sup> I was not able to reliably distinguish whether these statistics capture genuine swap deals, or parts of operation of Slovak gas monopolist SPP under the chairman Ducky when a number of questionable trades happened.

domestically do not seem to vary significantly across different governments. This supports my argument that energy profile in its nature can be treated as a soft fundamental, as changes in the energy profile require long-term determination and policy impetus, which was not visible.

All three countries have high dependence on imported hydrocarbon fuels – natural gas and crude oil. These two combined have provided on average 36% of all energy needs of Czech Republic, 66% for Hungary, and 50% for Slovakia. Average import dependency for these fuels has been 97% for Czech Republic, 72% for Hungary, and 95% for Slovakia.

In the initial period between 1991 and 1994 the share of gas on domestic energy consumption was lowest in Czech Republic with average of only 13.1%, both Hungary (32.3%) and Slovakia (26.9%) had much higher gas consumption.

In the period 1995-1998 share of gas on domestic consumption grew in all three countries by more than four percent, with Hungary's gas consumption growing by 5.18% as compared to the previous period. In the period 1998-2002 share of gas for Czech Republic, Hungary and Slovakia grew to 19.09%, 40.29%, and 33.37% respectively. It reached its peak for Czech Republic in 2001 at 19.3% for Hungary at 44.1% in 2004; and at 34.8% for Slovakia in 2001.<sup>219</sup>

The changes in the share of oil on the energy consumption were similar. Since 1990 the shares of oil on energy consumption were 18.41% in Czech Republic, 30.60% in Hungary, and 20.18% in Slovakia grew to 22.22%, 26.88% and 19.68% respectively (see Chart 53 - Chart 57 in annex). When analyzing changes in the amounts of imported gas and oil, given that these countries do not possess significant amounts of domestic hydrocarbon fuels,<sup>220</sup> these reflect changes in the consumption profiles of these fuels in general.

Additionally, there is a general relationship between the condition of economy, which can be assessed through change in GDP, and the energy consumption. However, as I show in the annexed charts (Chart 75, Chart 90 and Chart 106), this relationship within the countries was not

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<sup>219</sup> My own calculations based on data from Eurostat, "Energy Statistics", 2010, <http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/introduction> (accessed April 7, 2013).

<sup>220</sup> Hungarian gas production has stagnated until 1996 since then it has been in decline for whole period which I study.

constant. In all of the countries, initially, with the GDP contraction at the onset of transition, the contraction in consumption of both oil and gas was much lower.

Whereas between 1991 and 1994 GDP of Czech Republic contracted by average 2.46% the gas consumption in the same period grew 0.87%. Hungarian contraction was even more dramatic with 3.15% of GDP and concomitant increase of 0.64% in gas consumption. In the same period Slovak GDP contracted by 4.7% while gas consumption increased in the same period by average 0.78%. For the remainder of the studied period, GDP on average grew in all countries,<sup>221</sup> gas consumption on average continued to grow in all of the countries except for Czech Republic between 2000 and 2004. In the same period gas consumption in Slovakia stagnated and decreased by 0.2%, while GDP grew by average 3.9%

After the close analysis of the energy mix, no significant variation can be observed in the changes of the amounts of either gas or oil on the energy consumption based on changes in the government. Therefore, no evidence can be found that shaping of the domestic energy mix was used as a tool for prioritizing security in the energy policy. For the detailed visual comparison of all of these aspects please see the annexed series of charts (Chart 53 - Chart 57).

#### **2.4.4. Energy Prices**

Finally, and perhaps most importantly, the different prioritizations of various aspects in energy policy, including security can be observed on the level of energy prices. This enables precisely measure how successful governments are negotiating preferential prices from dominant supplier, or enable competitive market and free pricing to occur. In case of looking at the structure of energy prices this also allows making a distinction between price discrimination among different domestic consumers.

While this aspect is the most interesting, the availability of reliable data to measure it is poor.

There are two main problems with the data for energy prices. First of all, majority of oil and

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<sup>221</sup> With the brief contraction in 1997-1998 in Czech Republic with 0.7%

most of the gas has not been traded on public markets but is priced through long-term contracts, details of which remain mostly secret. Given the potential for monopoly pricing, most of the price information remains highly guarded trade secret. Reliable price data is therefore not available for scholarly use because it is either classified as state, or business secret, or exorbitantly expensive.<sup>222</sup> One of the few publicly available sources of import energy prices is IEA *Natural gas information*.<sup>223</sup> Unfortunately, even this source does not provide sufficient coverage of Central and Eastern countries throughout the period. All of the available data covers only period since 2004 (with break in 2006) for Hungary and Slovakia and the coverage for Czech Republic starts only in 2007. All of the available data is available in annexed chart for review (Chart 58). Since this information should at least theoretically be collected by the national statistical offices, I have also contacted these institutions. Unfortunately, this did not bear much fruit either, according to the response I received; this data is considered commercially confidential and as such is not released to the public.<sup>224</sup> While the situation has improved in the recent years as basic price data is collected by Eurostat, the historic coverage for eastern part of the EU is at the time of writing absent.

The ingenious solution to overcome the problem of missing price data, that I have used and popularized,<sup>225</sup> is a calculation based on the available public data which I used as a proxy. Since the volumes of imported gas are available from European Commission and Eurostat,<sup>226</sup> and the

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<sup>222</sup> Platts flagship product: “European Gas Daily: EMEA Newsletters and Reports - Platts”, n.d., <http://www.platts.com/Products/europeangasdaily/> (accessed September 8, 2010). Which contains one of the best commercially available energy price data is available for individual subscription for \$2,335 in its Basic Version, access to the archives is additional \$405 thus necessary subscription with the archive option is priced at inaccessible \$2,740. Regional data (not containing data for Czech republic) are available through ERRAs ERRAs - Energy Regulators Regional Association, “Products/Tariff Database”, 2010, <http://www.erranet.org/Products/TariffDatabase> (accessed September 8, 2010). Access to this tariff database was EUR 625 for individual subscriber in 2010.

<sup>223</sup> IEA/OECD, *Natural gas information 2009: with 2008 data* (OECD/IEA, 2009).

<sup>224</sup> Zuzana Spolcova and Czech Statistical Office, “Re: Dotaz”, November 24, 2009.

<sup>225</sup> Andrej Nosko et al., *Energy Security* (Visegrad Security Cooperation Initiative, 2010),

<http://www.visegradgroup.eu/download.php?ctag=download&docID=139>.

<sup>226</sup> Eurostat and European Commission, “Energy & Transport in Figures 2010: Part 2: Energy.”

value of imports is available from UN Comtrade database<sup>227</sup> I used following formula to calculate the price as quotient of value and volume:

$$\text{PRICE} = \text{REPORTED TRADED VALUE} / \text{REPORTED TRADED VOLUME}$$

There are limitations of UN Comtrade database, some of which I have previously analyzed.<sup>228</sup> Sometimes there are discrepancies between values reported by exporter and values reported by importer in the same transaction. Occasionally there are numeric discrepancies when the value from one year to another changes by an order of hundreds, without any apparent reason in the trade changes.<sup>229</sup> While I report the value of calculated prices as USD per tons of oil equivalent, this price may not reflect actual purchasing price because of different methods for caloric conversions of gas, and because of difference in reporting values for statistical purposes. Nonetheless, this limitation affects all three countries equally and thus does not affect comparability of the data. Recognizing these limitations of the data, this is still the best proxy readily available to analyze and compare the long term development of import prices.

To check for any inconsistency in the data, I have compared both the calculated as well as the limited available reported data for a narrow period between 2004 and 2007 when both calculated, as well as reported price data are available. I offer these charts for comparison in the annex (Chart 58 – Chart 68). It is visible that there are certain disparities, especially in year 2006 when according to calculated price, Slovakia paid higher unit price for imported gas than Hungary, while according to reported data this was opposite. Nonetheless, in the rest three out of the four years, which are available for comparison, the reported price corresponds with the trend of the

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<sup>227</sup> United Nations Statistics Division, “UN Comtrade.”

<sup>228</sup> Andrej Nosko, “Economic Interdependence of New EU Member States and Russia,” *CEU Political Economy Research Group (PERG) Project 1/2007*, CEU Political Economy Research Group (PERG) Project (2007): 53, <http://www.personal.ceu.hu/perg/file/Nosko.pdf> (accessed September 8, 2010).

<sup>229</sup> For example I was able to identify a number of large numeric discrepancies in the data on values of imported natural gas according to the UN Comtrade for years 1995 and 1996 for Slovakia since the data on values for the respective years were smaller almost 200 times compared to previous and following years (while volumes were not). I was able to fix these upon receipt of partial data from Slovak Statistical Office Zdenka Trlicova and Slovak Statistical Office, “Re: Stredoeuroopska Univerzita”, May 21, 2010. Similarly I was able to fix the data for year 2005 upon receipt of partial data from the Czech Statistical Office when I received partial confirmation or excerpts of data upon my submission of processed data from UN Comtrade from both Czech as well as Slovak Statistical Offices, since the numbers for the given years were in large discrepancy of 35 times lower than the next year without the commensurate drop of imported volumes.

calculated price. Given the general unavailability of data and stating the caveats, I consider this data to be sufficient basis for historic longitudinal comparison.

What would have been interesting, were the historic data available, is checking the price discrimination and preferential treatment among different classes of customers. I was able to obtain only limited sample of data which allows for analyzing this and covers only limited period of time for Hungary and partially for Slovakia.<sup>230</sup> This data indicated that the part of price of gas which is fully domestically determined and government has sovereign control over it – the taxes and other fees, mainly through the regulatory regime, has as a trend been steadily increasing.

Within-country comparison is due to lack of data possible only for Hungary. This additional price component as a share of total gas price for end-users decreased during the left-wing government from 15.1% in 1998-2002 to 12.4% in 2002-2005, nonetheless in subsequent period it again increased to 13.2% on average between 2006 and 2009 (see Chart 69 – Chart 73 for visual comparison).

The comparison across countries is possible only with Slovakia for the period of 2006-2009 when Slovakia had significantly higher taxes and other fees component in gas prices than Hungary for all classes of consumers except for residential sub-class of end-users, where Hungary's additional fees were 16.8% of total price and Slovakia's only 15.9%. The available data is not sufficient to claim whether there is variation based on ideology of the ruling government.

While the general development of import prices follows the same trend – with prices decreasing between 1997 and 1999 and rapidly increasing since 1999 until 2005, there were small differences among these countries. Given the high share of energy costs on GDP and the importance for the overall economy, even small difference makes a sizable impact in terms of comparative

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<sup>230</sup> ERRA - Energy Regulators Regional Association, "Products/Tariff Database."

advantage, especially when energy forms an important part of the manufacturing input for energy intensive export industries.

The available data shows that Slovakia persistently spent highest share of its GDP on imported gas, followed by Hungary. The Czech Republic was able to keep its share of cost for natural gas imports relatively lowest. While in the period of 1994-1997 Czech Republic spent only 1.23% of its GDP on imported gas, Hungary spent 1.56% and Slovakia 2.15% of GDP. In 1998-2001 on average Czech Republic spent 1.48%, Hungary 1.86% and Slovakia's share of expenditures for imported gas increased to 2.35%. In the period of 2002-2005 Czech Republic's share of gas import costs on GDP decreased to 1.38%, Hungary's increased to 1.99% and Slovakia's decreased to 2.17% of GDP.

The fact that country spends more financial resources on imported fuel, in addition to the high share of the imported fuel on its total energy consumption, should mean that the question of energy security would be of higher priority for this country.

While Czech republic would be expected to pay the lowest attention to dealing with its energy import dependence, because of its relatively lowest 'objective' sensitivity, which is given by both the low share of imported fuels on its consumption and by the relatively low share of cost of imported fuel on its GDP, this has not been the case as I discussed in the previous section and further provide details in the empirical chapter covering the Czech Republic.

Czech Republic not only spent lowest amount of money relatively to its GDP, its unit price of gas has been lowest compared to both Hungary and Slovakia, countries that had much better relations with the supplier country – Russia. In the period 1994-1997 during a right-wing government Czech Republic paid 11.2% less per unit of imported gas than average of the three countries. Hungary in the same period, when left-wing government ruled paid 7.6% more and Slovakia also ruled by a left-wing Russia-friendly government 3.6% more.

In the period 1998-2001 when Hungary was ruled by right-wing government the price premium was reduced from the previous period (as compared with itself), and on average Hungary

overpaid only by 3.5%. In the same period Slovakia overpaid by 0.2% and Czech Republic underpaid by 3.79% on unit price of imported gas.

In the period 2002-2005 when Hungary was ruled by left-wing coalition government its price premium, as compared with its neighbors increased. Hungary overpaid its imported gas by 5.1%. Slovakia, ruled by right-wing dominated coalition, in the same period underpaid by 3.5%. The Czech Republic, ruled at the time by left-wing government, but endowed by excellent diversification options from the previous period underpaid its gas imports by 1.5% as compared to the average for the three countries.

This data shows a general trend according to which Czech Republic had lower prices of imported gas than either Slovakia or Hungary since it prioritized energy security. These prices were much lower during right-wing governments (1994 and 1997) and much higher during left-wing government in 2001 and 2002 (acknowledging much lower import prices also in 2004 during left-wing government. Slovakia had higher average unit gas import prices during right-wing governments in 1998-2004 with the exception of 1999 and 2000. Hungary had higher import gas prices than Slovakia and Czech Republic most of the time with the exception of period 1999-2003 when right-wing government was in power. Please see Chart 60 – Chart 68 in the annex for visual comparison.

What this data demonstrates is that countries that invest into higher energy security through improving their supply security are rewarded by lower prices for these commodities. By the comparison of Czech Republic, Slovakia and Hungary, it is visible that higher supply security comes with lower prices. The difference in the prices paid for the least elastic commodity out of the energy mix: piped natural gas, illustrates the differences between the Czech Republic, Hungary and Slovakia. While Czech Republic has paid lower prices during 7 years out of 11, Slovakia has paid lower prices than average only 4 times. Hungary has paid lower prices than the average of the group only twice when right-wing Russia-unfriendly government was in power.

On the other hand, when the left-wing government was in power, according to the data which is available only for Hungary, the variable part of the domestic price for final consumers (taxes and other fees) seemed to have been lower when left-wing government was in power.

The sources of the lower import prices come both from increased negotiation power due to possibility of import alternatives, but also from more competitive market which is enabled when alternative supply routes and supply contracts exists.

## **Chapter 3. CZECH AND SLOVAK REPUBLICS**

### ***3.1. Czech and Slovaks Start Drifting Apart***

What is the source of differences in the way how Czech and Slovak Republics prioritized security in their energy policies? Why is there such a vivid difference between these two countries which once, and for three quarters of a century shared one federation? One could go looking for the answers all the way to the metaphoric Garden of Eden at the very beginning of their histories. The observed difference among these countries, I argue, is a result of domestic policy choices: specifically of sequencing and prioritization of energy policies. This happened as a result of interplay of three most important factors: structure and interests of the ruling elites taking account of effects of powerful domestic interest groups, public perception of threat and choice of vetting laws at the time of transition which influenced the domestic opportunity structure. It is the events which unraveled in the early nineties that created different context and predetermined both available policy choices and the process by which these were predetermined in each of the two countries.

How these events unraveled was obviously not completely immune to the underlying differences in history, demographics and social conditions of these two countries. Nonetheless, the events of the first two years of Czechoslovakia after the “velvet revolution” significantly influenced what was possible in the years to follow in the two Republics.

The first two years after the “Velvet Revolution” in Czechoslovakia have been dominated by questions of constitutional order. Hungary as a unitary state could relatively quickly move over the most contentious parts of its constitution through amendments, having to deal with “only” the differences in political views. Czechoslovakia, especially given that it consisted of two republics with a long heritage of unsettled relations among them, struggled in addition to the political differences also with the question of its own future and mode of “cohabitation” of the

two constitutive republics.<sup>231</sup> The first free elections in June 1990 took place according to the law established in November 1989, soon after the “velvet revolution” which marked the expected beginning of the end of the communist era.

These elections were meant only as a transitory phase – a plebiscite about the transition itself. As until that point members of civic platforms were not elected, but they were coopted into the parliament. It was foreseen that these elections would be followed by regular elections only two years later in June 1992. The two-year short electoral period, combined with a need for a complex negotiations of constitutional order, were not conducive for the continuation of the federation. The first two years were too short to clarify and negotiate the competence arrangements between the Czechs and Slovaks. Already in 1992 as the elections approached, and the tensions in the competence negotiations were used as part of the campaign, it was becoming evident that the federation was about to split.

The first federal government, the so called “Government of National Understanding” consisted of fourteen members of the so-called National Front who were members of the government already during communist rule: ten members of Communist Party of Czechoslovakia (KSČ), two members of Czechoslovak Socialist Party (ČSS), two members of Czechoslovak People’s Party (ČSL). Seven non-partisan ministers were coopted into the government.

The second federal government after the transition, the so-called “Government of National Sacrifice” followed after the first free elections and it was supposed to, together with national governments, negotiate the new constitutional arrangement. Given the short period of time until 1992, and the political complications, explaining of which is beyond the scope of this dissertation, it failed. The last federal government was formed after the 1992 elections, and in October 1992 it received a very limited mandate of de-facto preparing the dissolution of the federation and paving the road for international acceptance of the two new republics.

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<sup>231</sup> PSP Archív, “Volby do Parlamentu České republiky”, n.d., <http://www.psp.cz/docs/texts/elections.html> (accessed July 30, 2012).

In addition to the federal government, each republic had its own national government, which operated in somewhat fuzzy situation – taking part in the trilateral negotiations on both the competences and the constitutional arrangement with its counterpart national government and the federal government. Altogether, Czechoslovakia had 650 members of four legislative bodies (two chambers of the Federal Parliament, and each republic had its own National Council). This institutional arrangement together with complex discussions of constitutional order put additional strain on the capacity of the political system to properly discuss complex policies, including policies concerning energy security.

The Czech government was relatively stable throughout this interim period. Christian-democrat Petr Pithart took over leadership of majority-communist Czech government from the communist Prime-Minister of Czech Federal Republic František Pitra already in February 1990 and his mandate was also confirmed after the June elections. Pithart's government was followed by the government of Václav Klaus after the 1992 elections. On the Slovak side of the border, the communist government under the leadership of Milan Čič continued until the elections in June 1990 when it was succeeded by the first government of Vladimír Mečiar. This is the first major visible difference between the republics: while in the Czech Republic former communist elites had much less time to prepare for, and shield themselves from, the effects of the societal changes, in Slovakia, former communist elites were much less affected by the ensuing transition of the society.<sup>232</sup>

Because of the decision to run the transition in legal continuity, and impose changes through legal amendments, effectively, the former communist elites especially in Slovakia used their knowledge of the policy process and institutional mechanics to maintain power and influence developments in the country.<sup>233</sup> The continuity of political leadership in Slovakia attests to this development with both Mečiar, as the first prime minister, but more importantly the first speaker

<sup>232</sup> Vladimír Ondruš, *Atentát na nežnú revolúciu*, 1.vyd. ed. (Bratislava: Ikar, 2009).

<sup>233</sup> Ibid.

of the Slovak parliament Rudolf Schuster being members of the former communist elites.<sup>234</sup> The difference between the two countries is even more markedly demonstrated by the number of former communist security service collaborators in the two countries taking active part in the political transition. While there were only two members of the Czech government recorded in the communist secret service as alleged collaborators, there were seven names of Slovak government ministers recorded in the communist era secret service database.<sup>235</sup>

The difference in the developments of these two countries is very well illustrated by the case of Vladimír Mečiar, who was extremely worried about the process of lustration and the possibility that his own past involvement with the communist secret service could be uncovered.<sup>236</sup> Also for these reasons he aimed to grasp a closer control over the ministry of interior, which he led during the Čič government. This could be one of the reasons he created a conflict over who the minister of interior in the Slovak government should be, and how the ministry of interior should be organized and controlled. This evolved into a government crisis,<sup>237</sup> which was followed in March 1991 by Mečiar's setting-up his own party HZDS and splitting off from the VPN civic movement.<sup>238</sup> His concern over the impact of lustrations on him and some of his closest cooperatives, led him to ordering of two agents to break into the state secret security archive in Trenčín and steal incriminating documents, allegedly both concerning him, his close associates

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<sup>234</sup> Mečiar less visibly, as a company lawyer and former Communist Party member, while Schuster represented Communist Party in Košice, in November 1989 he became speaker of the Slovak National Council.

<sup>235</sup> While the fact that someone's name is recorded in the Communist era secret service database as a collaborator, can and often was disputed as a reliable evidence of collaboration with the secret service, it provides a proxy for connection with the specific type of social network.

<sup>236</sup> Mečiar's alleged involvement in the communist era secret service was not widely known during transition.

<sup>237</sup> Vladimír Jancura, "Keď premiér odišiel za medved'mi, nastala panika - Pravda.sk", November 6, 2010, [http://spravy.pravda.sk/sk\\_domace.asp?r=sk\\_domace&c=A101106\\_083522\\_sk\\_domace\\_p58](http://spravy.pravda.sk/sk_domace.asp?r=sk_domace&c=A101106_083522_sk_domace_p58) (accessed July 30, 2012).

<sup>238</sup> Civic movement in Slovakia was represented by VPN – Verejnost' proti násiliu (Public against violence).

and his political rivals.<sup>239</sup> This case, despite investigations, which were led by a parliamentary committee, did not receive sufficient public response.

For an interim period, after this government crisis, Ján Čarnogurský's Christian-democratic government was in place in Slovakia until the 1992 elections.<sup>240</sup> Mečiar won these elections and formed a new government. This period came more as a prelude to what followed, and despite of the political system overhaul because of the constitutional crisis, there were also a number of energy policies that were implemented. The developments in energy policy in this period illustrate how the interests of the ruling elites together with the public perception of threat and vetting laws structured the policy discussion, and provided an important basis for future developments in the two countries.

### **3.2. Prioritization of Energy Security in the Federal Policies**

Already throughout the year 1989, when only few would have expected that there is a regime change looming, a number of very slow economic transformation steps started taking place. While in Russia already in August, under the leadership of the Minister of Gas Industry, Viktor Chernomyrdin, the ministry of Energy transformed itself into State Gas Concern Gazprom,<sup>241</sup> in Czechoslovakia seemingly yet another of the few dozen specialized companies for international trade Metalimex<sup>242</sup> was created.

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<sup>239</sup> Altogether 18 files went missing Euba Lesná, "Tisova vila a Gašparovičove spisy ŠTB," *Delet*, April 25, 2009, <http://www.delet.sk/spravy-a-politika/editorial/tisova-vila-a-gasparovicove-spisy-stb> (accessed October 20, 2012).

<sup>240</sup> Its worth noting that deputy speaker of the Slovak national council Ivan Čarnogurský, was brother of the prime minister Ján Čarnogurský. Ján Čarnogurský also active in Christian-Democratic Movement was later allegedly close to the trade between the energy companies and Russian businesses as member of the East-West Economic Club. SME (rf), "Ivan Čarnogurský podľa svojho brata Jána nerokuje s Devín bankou v drese KDH," *SME*, October 1, 1999, <http://www.sme.sk/c/2203259/ivan-carnogursky-podla-svojho-brata-jana-nerokuje-s-devin-bankou-v-drese-kdh.html> (accessed March 4, 2013); SME (dam), "Ivan Čarnogurský rokuje s Devín bankou za KDH," *SME*, September 30, 1999, <http://www.sme.sk/c/2203104/ivan-carnogursky-rokuje-s-devin-bankou-za-kdh.html> (accessed March 4, 2013).

<sup>241</sup> It became the country's first state-corporate enterprise.

<sup>242</sup> Including traditional commodities such as ferro-alloys, aluminium, manganese and iron ores, wolfram and molybdenum concentrates

The significance of this lies in the fact that all international trade until liberalization, which occurred only very slowly and much later, was conducted through specialized companies for international trade. These companies served as “incubators” for economic elites, they had not only the privilege of information, brightest minds, but also a special relationship with the state secret service.<sup>243</sup> Not only for practical reasons, as their staff members travelled and had intensive relations with foreign countries, and thus were source of information about international relations, but they also offered cover for the intelligence officers’ travel abroad.<sup>244</sup> Nonetheless, their major significance for the period of transition was in the fact that people who worked in these companies were much better prepared for economic competition in the new conditions and many of them became very successful throughout transition in both Slovakia, and Czech Republic.<sup>245</sup> Therefore it is worth noting that in addition to Chemapol (in Czech Republic), and Petrimex (in Slovakia) which had initially monopoly on imports of oil, petrochemical goods and gas, this newly created company Metalimex was importing gas directly from Gazprom already a year after its creation.<sup>246</sup>

The import market with energy sources “liberalized” and expanded only very slowly starting in 1991-1992. In 1992 Ministry of Industry issued a number of oil import licenses:<sup>247</sup> to Chemapol Prague, Petrimex Bratislava and a number of smaller limited liability companies (ECE, FDH, ECO-CONSULT engineering<sup>248</sup> and SEZOOZ.<sup>249</sup> Some of these were connected directly to the

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<sup>243</sup> SME (mož), “Podniky zahraničného obchodu mali zvláštny útvar s ľudmi z ŠtB”, May 5, 2003, <http://www.sme.sk/c/886606/podniky-zahranicneho-obchodu-mali-zvlastny-utvar-s-ludmi-z-stb.html> (accessed August 2, 2012).

<sup>244</sup> Michal Miklovič, *Rezidentúra EXPO-67, Paměť a Dějiny* (USTRCR, 2011).

<sup>245</sup> Andrej Babiš,

<sup>246</sup> “FS ČSFR 1990-1992, SL a SN, 9. schůze, část 96/114 (12. 12. 1990)”, n.d., <http://webcache.googleusercontent.com/search?q=cache:R7qcZOhEoVIJ:www.psp.cz/cgi-bin/win/eknih/1990fs/slsn/stenprot/009schuz/s009096.htm> (accessed August 9, 2012). Meanwhile in Russia in autumn 1991 V/O Soyuzgazexport was taken over by Gazprom State Gas Concern as a state-owned foreign trade entity and in December, due to the fact that companies located in the territory of the RSFSR were placed under the jurisdiction of the Russian Federation, this state-owned foreign trade entity (GVP) was named GVP Gazexport supplying the few chosen import license holders in Czechoslovakia.

<sup>247</sup> <http://www.psp.cz/cgi-bin/ascii/eknih/1993ps/tisky/t1315b02.htm>

<sup>248</sup> Set-up by managers of one of the smaller Slovak refineries Petrochema Dubová.

<sup>249</sup> Owned by Roman Zubík, one of the first names later connected with the Ducký bills.

refining operations, or managers of these companies, in this period also the entry of additional foreign traders was enabled.

In February 1992 Wintershall of Germany<sup>250</sup> signed agreements with ČPP and Metalimex to deliver natural gas to the CSFR. Under the agreement Wintershall was to deliver 4.5 bcm of natural gas annually from Russia to the CSFR via the Transgas pipeline. Also transit contracts to Germany were secured in this period.<sup>251</sup> In December 1992, Metalimex, company created just few months before, negotiated a three year contract to cover deliveries in 1993-1995, which was the first gas contract longer than one year negotiated with Russian gas supplier in the region. The importance of connections with the security sector and Russia was publicly acknowledged by Václav Junek, former security operative and executive of Chemapol – energy importing giant and bidder in energy privatization, in an interview when Junek said “that former secret-police connections are a relevant part of the oil-privatization debate.”<sup>252</sup>

Czechoslovakia started discussing, studying and planning alternative supply routes at the time when the stability of Soviet Unions and reliability of energy supplies was not assured. In February 1990 Czechoslovakia signed treaty on the removal of soviet army from its territory, which has been stationed there since 1968. This was a very strong manifestation of political realignment and gaining of political sovereignty.

It was at about the same time, in 1991 when building additional underground gas storage in Slovakia at Láb was started, and Czech Republic built first small gas interconnector at Rozvadov to Bavaria.<sup>253</sup> The same year Transpetrol, a.s., Bratislava, a company operating the transport system of the Druzhba pipeline in the territory of the then Czechoslovakia (until the end of

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<sup>250</sup> Company closely cooperating with Gazprom since fall 1990, it is one of the Gazprom partners in building of the Nordstream pipeline.

<sup>251</sup> The Verbundnetz Gas AG (VNG Boelitz/Ehrenberg) gas company concluded a contract with the Czech Gas Enterprise and the Metalimex Company of Prague on the transit of 7 bcm annually over the Ukrainian-Czechoslovak border.

<sup>252</sup> Gomez, “What Spy Past? Asks Top Oil Man - The Prague Post.”

<sup>253</sup> Karel Hirman, “Diverzifikácia dodávok ropy a plynu do ČR a SR je strategickou otázkou dneška,” *Mezinárodní Politika*, 1995, 19(4), S. 19-21. ISSN 0543-7962., 1995.

1992) was established. A number of alternative supply routes for oil were discussed,<sup>254</sup> nonetheless as Yugoslavia was collapsing in internal wars, and Slovakia was becoming more and more “the weird neighbor in the east,” developing of supply corridor from Adriatic via Croatia and Hungary was rejected, and the one through Vienna was not chosen for technical reasons.<sup>255</sup> The last months of Czechoslovak Federation, the “privatization projects” – plans for the industrial restructuring of a number of companies were being developed. This was in the context of ongoing privatization, be it through the voucher method in the first wave, which started before the federation split, as well as through direct sell-off of few selected companies. The most important ones to note were the Czech Energy Works in April 1992 which paved the way for the establishment of joint-stock company ČEZ a month later, as part of the company’s stocks were offered for purchase in the first wave of the privatization. The decision to offer only 30% of ČEZ into the voucher privatization, which affected Czech energy landscape for years to come, was also made during this period. The discussion on the way how industrial transformation would take place started, with relatively weak voices of Czech energy sector unions, and limited involvement of municipalities – as they were concerned about the distribution companies.

Meanwhile in Russia, the new Russian government, committed to economic reform, began to privatize Gazprom,<sup>256</sup> and started to distribute shares under the voucher method.<sup>257</sup> Gazprom’s political influence increased markedly after the new Russian President Boris Yeltsin appointed the company’s chairman Chernomyrdin as his Prime Minister in December 1992. Rem Viakhirev

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<sup>254</sup> For extensive discussion of alternative oil supply routes and political process surrounding it, please see my MA thesis: Andrej Nosko, *Securitization within Economic Sector: The Case of Diversification of Energy Resources* (VDM Verlag Dr. Muller Aktiengesellschaft & Co. KG, 2008).

<sup>255</sup> Mainly because of inadequate existing throughput of Adria-Wien-Pipeline (AWP) from Italian Trieste to Schwechat refinery.

<sup>256</sup> The company become a joint-stock company according to the Decree of the President of the Russian Federation of 5 November 1992 "Transformation of State Gas Concern Gazprom into Russian Joint Stock Company (RAO) Gazprom" and the Resolution of the Council of Ministers of the Russian Federation of 17 February 1993

<sup>257</sup> Similarly to Czechoslovakia, every Russian citizen received vouchers to purchase shares of formerly state-owned companies.

took Chernomyrdin's place as Chairman of both the Board of Directors and the Managing Committee.

### **3.3. Summary**

Compared especially to Hungary, the voice of unions in the energy policy debate of Czechoslovakia has been very weak<sup>258</sup>. The occasional contribution was limited to the discussion of transformation and setting aside resources for retraining, nonetheless this has not materialized into concrete assurances as was the case of Hungary. The general protests or industrial action did not take on energy topics as happened in Hungary.

The perception of threat stemming from the main supplier – Russia was also different on the two sides of the federation. While 41% of respondents in Czech Republic considered Russia a threat to their country, it was only 27% of Slovak respondents that shared the same view.<sup>259</sup> In the last year of the federation, the perception of threat from Russia decreased to 39% in Czech Republic, and 26% in Slovakia.<sup>260</sup> It is interesting that the perception of Russia as having negative influence was higher in Slovakia than in Czech Republic with 50% of Czech and 56% of Slovaks seeing Russia's influence on their country as negative.<sup>261</sup> (See Chart 9 and Chart 20 for comparison) This might be related to the fact that Slovaks could have in the given period perceived effects of moving of the Russian soldiers through their country much more sensitively, as also those soldiers that were moving from Czech Republic had to move through Slovakia. In both Slovakia and in Czech Republic (unlike in Hungary) the threat perception is visibly distributed according to political party divisions. The highest threat, perceived by supporters of

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<sup>258</sup> In November 1992 there was an isolated demonstration of miners against the restructuring of mining industry, mainly related to the liberalization of coal.

<sup>259</sup> Times Mirror Center for the People & the Press, "The Pulse of Europe: A Survey of Political and Social Values and Attitudes."

<sup>260</sup> Rose, R. and Paul Lazarsfeld Society, "SN 6452 -New Europe Barometer I, 1991-1992" ((Vienna), New Europe Barometer I, 1991-1992 [computer file]. Colchester, Essex: UK Data Archive [distributor], June 2010. SN: 6452, <http://dx.doi.org/10.5255/UKDA-SN-6452-1>, n.d.),

<http://www.esds.ac.uk/findingData/snDescription.asp?sn=6452> (accessed October 24, 2012).

<sup>261</sup> Ibid.

the most popular mainstream political parties in both countries is clearly identified as Soviet Union. It is also visible that supporters of Communist Party in both countries did not consider Soviet Union a threat. Communist supporters in Czech Republic saw highest threat from Germany, and Slovak Communists saw Hungary as the biggest threat for their country. Additionally those that voiced their unfavorable opinion of Communist party also saw Soviet Union as a threat to Czechoslovakia. (See Chart 77 and Chart 79 for details and distribution).

These were the beginnings of establishment of the new economic elites – those who tried to influence politics of the newly independent states of Czech Republic and Slovak Republic. The formation of interests of ruling elites was in flux, and the differences of interests and views on economic policies among the elites in Slovakia and Czech Republic lead to the eventual dissolution of the federation. While it may be a bit of an overstretch to say that federation split because of differences of views on the prioritization of energy security, it is true that there is an overlap between reasons that lead to the difference of prioritization of security in energy policy in Slovakia and Czech Republic and those that lead to the dissolution of Czechoslovakia. Interests of ruling elites were divergent with majority of Czech elites preferring orientation towards “west” and the support for fast reforms was higher in Czech Republic as well. Public perception of threat from Soviet Union/Russia was higher in Czech Republic, which reflected also the orientation of Slovakia more towards the East. Finally the implementation of vetting laws, and the coming to terms with the past, as I discuss in the Slovak chapter were much more lax in Slovakia than in Czech Republic.

## Chapter 4. CZECH REPUBLIC

Czech Republic provides an example of prioritization of security in the energy policy through the combination of policy choices that are different from both Slovakia as well as Hungary. Many of the initial policy choices that were made in the early years of the transition still under the federal government were largely “Czech” choices.<sup>262</sup> The fact that much of the Slovak political elite had different views became apparent after the federation split and there was clear policy discontinuity, and policy divergence between Czech Republic and Slovakia. Therefore, unlike in the case of Slovakia, there is more-less full continuation from the Czechoslovak Federation to the independent Czech Republic.

Czech Republic is the country that has had the highest energy security out of the three studied countries.<sup>263</sup> The country has diversified the primary energy imports of all of its primary energy sources, and it has also de-concentrated its primary energy fuels import markets. Czech government through the energy policy choices and their foreign dimension assured that Czech consumers and companies paid lowest prices for their energy as compared to their neighbors to the east.<sup>264</sup> Czech Republic had lower price of imports of natural gas than either Slovakia or Hungary in nine out of the eleven years (1994-2004) for which there is comparable data (see Chart 60 for comparison).

The positive spill-over of the energy policy can be observed in case of Czech Republic also on the lower unemployment rates when compared with Slovakia or Hungary.<sup>265</sup> Czech Republic also had higher GDP per capita than either Hungary or Slovakia for whole researched period since

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<sup>262</sup> Alena Buchtikova, “Privatization in the Czech Republic,” in *Privatization in Post-communist Countries*, by B. Blaszczyk and R. Woodward (Center for Social and Economic Research, 1996), 75.

<sup>263</sup> Le Coq and Paltseva, “Measuring the security of external energy supply in the European Union”; Röller, Delgado, and Friederiszick, “Energy: choices for Europe”; de Jong et al., “EU Standards for Energy Security of Supply.”

<sup>264</sup> Conditions, and often also cost of import of this commodity especially during the studied period have been subject to bilateral governmental treaties. Thus this provides a good way to measure impact of governmental policies. Given that I measure this comparatively the three countries are in similar position so this should not be explained by other aspects.

<sup>265</sup> Hungary had temporarily lower unemployment than Czech Republic only after 1999 until 2005.

1994. While these aspects should not be attributed to the choices of prioritization in the energy policy alone – especially the unemployment has myriad of other factors that influence it, this comparison provides an important evidence that prioritization of security in energy policy, as was done in Czech Republic, on the long run, does not come at a cost to other policy aims and priorities. As it clearly did not have negative effects on either the GDP or employment.

Reasons behind these positive outcomes is a combination of how different interests which were forming in the Czech political elites got played against each other, with the use of vetting laws and the generally persistent and concentrated fear of Russia in the Czech Republic. The choices which Czech Republic witnessed, particularly the selection and sequencing of policies chosen, prioritized and implemented provided comparatively better outcome not only in terms of energy security but also in terms of the energy policy effects on the overall economy.

The most important division between the elites in Czech Republic was, at least initially, the concentrated public perception of threat, combined with the public view of the former communist regime. The new elites were interested in “cleansing” the society and reforming the country, while former beneficiaries of the regime were interested in preserving their influence in the new conditions. In the later period, this division of interests and the distinction between the “old” and “new” elites became somewhat blurred, as the “power-sharing” arrangements among both politicians and financial groups backing them ran across the original division lines. This was clearly visible in Czech Republic after 1998, when the most ardent reformers were removed from power and a power-sharing arrangement between the left-wing government and right-wing opposition was established. This has set strong foundation for state capture which ensued, and framed much of the energy<sup>266</sup> and security<sup>267</sup> policy processes of Czech Republic since the second decade after the transition.

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<sup>266</sup> ČTK, zep, and jaf, “ČEZ řídí zemi a platí politické strany, říká na nahrávce lobbista - iDNES.cz”, June 19, 2012, [http://zpravy.idnes.cz/cez-elektrarna-prunerov-08i-/domaci.aspx?c=A120619\\_155647\\_ekonomika\\_zep](http://zpravy.idnes.cz/cez-elektrarna-prunerov-08i-/domaci.aspx?c=A120619_155647_ekonomika_zep) (accessed October 27, 2012); Aktuálně (teš, nem, ina), “Schwarzenberg: Všichni víme, že ČEZ financoval strany -

#### **4.1. Choice of Transitional Justice Policies**

Public in the Czech Republic was extremely wary of the former regime, and particularly of Russia. Only supporters of Communist party and partly supporters of Czech Social Democratic Party (ČSSD) which attracted reformed communists had more welcoming position towards Russia (see Chart 78 for details). As a consequence supporters of reformist political forces, who were in Czech Republic against both communist party and perceived Russia as threat, strove to get rid of the influence on public affairs of the former communist party, and the former security apparatus, which was often seen identical with the Communist Party. The former state secret officers, in order to secure immunity from prosecution, moved into economy where they were mostly left untouched.

Still, thanks to a number of fortunate coincidences, their identity was publicly known and recognized. They were at least initially (while public sensitivity lasted) unable to directly influence public policies and energy security choices through public participation on policy making process. Even if they tried to leverage their influence through corrupting politicians, their benefits from policies they were influencing had to remain out of public reach. Otherwise this was used as a case against the policies they lobbied for – as was visible in case of “Czech way” arguments during privatization and diversification.

In this context, it is not surprising that Czechoslovakia had the first and one of the most radical lustration laws in the post-soviet space, and that Czech Republic preserved it.<sup>268</sup> The law was quite strict and required that negative lustration, i.e. certification that person has not been

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Aktuálně.cz”, September 29, 2011, <http://aktualne.centrum.cz/domaci/politika/clanek.php?id=715678> (accessed October 27, 2012); “ČEZ přes Kocourka ovlivňuje legislativu, tvrdí Bursík – Novinky.cz”, n.d., <http://www.novinky.cz/domaci/249927-cez-pres-kocourka-ovlivnuje-legislativu-tvrdi-bursik.html> (accessed October 27, 2012); “ČEZ unplugged : Czech Market Place”, 2010, <http://www.czechmarketplace.cz/en/2518.cez-unplugged> (accessed March 28, 2012).

<sup>267</sup> “Korupční kauza gripeny — Reportéři ČT: 12. 3. 2007 — iVysílání — Česká televize”, n.d., <http://www.ceskatelevize.cz/ivysilani/1142743803-reporteri-ct/207452801240009/obsah/113635-korupcni-kauza-gripeny/> (accessed October 25, 2012); “Gripen - The Secret Deals - Uppdrag granskning | svt.se”, n.d., [http://www.svt.se/2.101059/1.1447173/gripen\\_-\\_the\\_secret\\_deals](http://www.svt.se/2.101059/1.1447173/gripen_-_the_secret_deals) (accessed October 25, 2012).

<sup>268</sup> Bezák, “Posttranzičná spravodlivosť v regióne stredovýchodnej Európy. Analýza lustrácií a ústavov pamäte národa.” The law 451/1991 Coll. was accepted by the Federal Parliament already on October 4, 1991.

member of socialist-era secret service or selected bodies of the communist party, was presented by people in a wide number of elected, as well as professional positions to keep (or apply for) their positions. Federal Ministry of Interior was the certifying authority; investigations were done by independent committees. In case there was a positive lustration, this resulted in an automatic dismissal of the concerned person within 15 days of the lustration certificate being issued. The Czech Lustration law has been prolonged twice, first in 1995<sup>269</sup> until the end of year 2000, and second time in 2000<sup>270</sup> when the validity of the lustration was extended without limit.

Although there was a number of questions surrounding the lustration process itself, the extent to which the state secret service apparatus reached was uncovered for the wide public by the publishing of the leaked partial list of former collaborators of the state secret service – ŠTB by Petr Cibulka in 1992; the complete official list was published only later in 2003<sup>271</sup> by the ministry of interior.

According to an interview with Marián Gula director of Slovak Department for The Documentation of the Crimes of Communism, these initially leaked records, although incomplete, were genuine.<sup>272</sup> There have been ample discussions, as well as a number of legal challenges to the reliability, validity, and even legality and implications of one's name being listed in one of these databases. Regardless of the legal implications, and the fact that in a very low number of cases the veracity of these records was successfully disputed at court,<sup>273</sup> it has had an important de-facto impact on the continuity of the elites and privileged individuals from the previous regime in their ability to participate in the political life. Additionally, thanks to this “transparency” it was possible, and it has been often done throughout the period, to publicly question motives and connections of individuals implicated by these databases. This has

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<sup>269</sup> Law 254/1995 Coll.

<sup>270</sup> Law 422/2000 Coll.

<sup>271</sup> Based on Law 107/2002 Coll.

<sup>272</sup> SME, “Cibulkove zoznamy sú pravé.”

<sup>273</sup> It's important to note that courts and the judiciary in Czechoslovakia remained largely unreformed well into 21st century, staffed with the same judges that passed judgments based on totalitarian communist laws, and ridden with nepotism and corruption.

especially happened during larger investment projects and privatization. In case of Czech Republic, because of this strict and early-on implemented lustration law, which was not the case in either Hungary or Slovakia, interests of “domestic” elites connected with the previous regime<sup>274</sup> did not influence the energy policy as much as has been the case in Slovakia.

The way how former elites were able to participate played into the decisions about energy policy and specifically about the prioritization of security in the energy policy. Perhaps the most prominent political argument relating to the prioritization of security in the energy policy in Czech Republic has been between allowing foreign direct investment to take part in the privatization, or to allow the “Czech way” to prevail. Nonetheless, perception has been that the “Czech way” would have been actually a “Russian way.” Two prominent examples of this struggle are the decision not to privatize the Czech refineries in 1994 to the Chemapol, which was under the control of Václav Junek seen as an example of elite connected with the former secret service network, but rather to investors from various OECD countries.

The fear of Russia has helped Czech politicians invest into what seemed to make little economic sense at the time, but provided high energy security premium over time – both oil and gas diversification links. The decision on building the gas connector enabling the import of Norwegian gas was enabled mostly with the aid of the fear of Russia. The long-term import contract with Norway – a necessity to achieve energy security improvement was also enabled by fear of Russia, and in the situation of Russian politicians exerting explicit pressure on Czech Republic not to pursue this diversification. This contract not only contributed to increased energy security, but also to aggregate lower prices of gas as compared to regional peers – an additional benefit only few had hoped for at the time this decision was made.

The case of choosing US-based Westinghouse to supply fuel for the nuclear power plant in Temelín can be seen as an additional symbol illustrating the fears prevalent in the Czech society and keen desire of Czech politicians to diversify away from Russia. Finally, the way how

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<sup>274</sup> And additionally possessing privileged information on the value of assets, and often also the necessary “start-up” capital –

privatization of the energy sector took place also reflected high prioritization of security in energy policy agenda, lessened into some degree only during social-democratic government.

#### **4.2. Timing and Sequencing of Privatization**

Second important policy choice that has been made in Czech Republic, and which has improved the overall energy security was the choice of industrial restructuring policies, their timing and sequencing. Although it has not been perfect, it has delivered comparatively better results than in case of Slovakia. While Hungary has chosen similar restructuring policies, because of the lack of transparency on connections of people from the previous regime, acceptance of closer relations with Russia, especially during periods when socialist-liberal elites were in power, and unfortunate sequencing of privatization, these policies did not deliver similar positive outcomes in terms of energy security.

Czech elites were more-less united in their views on speedy privatization, and price-liberalization as a way of achieving restructuring of the economy. This speed, however, was not matched in the energy sector, where other considerations including energy security have been visible. The tool of choice for the transformation of Czechoslovak economy, later on followed-up only by Czech Republic was rapid economic and political transition including privatization using the novel “voucher” method, and prompt liberalization of prices.<sup>275</sup> The major down-side of the voucher privatization method was the missing robust legislative environment at the time of privatization<sup>276</sup> and thus wild-capitalism broke-out loose. As a result, number of very rich individuals came out of this transformation, many of them having reaped the benefit of personal connections and privileged knowledge of the economy from their previous careers in foreign

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<sup>275</sup> John R. Nellis, *Time to rethink privatization in transition economies?* (World Bank Publications, 1999).

<sup>276</sup> ČT (duk), “Speciál ČT24: Kuponová privatizace – československý bestseller — Exkluzivně na ČT24 — ČT24 — Česká televize,” *ČT24*, October 31, 2011, <http://www.ceskatelevize.cz/ct24/exkluzivne-na-ct24/141270-special-ct24-kuponova-privatizace-ceskoslovensky-bestseller/> (accessed March 10, 2012).

export, or economic intelligence units of the ŠTB.<sup>277</sup> This is also an important contribution to preconditions of state capture, especially the banking socialism which became rampant in the latter period of Klaus' government.

The privatization which was rapid throughout the economy was not so hasty in case of energy assets. Energy assets were not privatized so quickly, mainly thanks to the explicit decision of right-wing Klaus government in 1995.<sup>278</sup> The Czech government, also thanks to Klaus' specific sort of economic nationalism kept control of the majority of large state industries, also using the tool of voucher method. Subsequently, also as Nellis points out, the government maintained significant ownership in nine out of ten largest companies.<sup>279</sup>

The structure of the ownership, which became mixed, attests to the constant tensions between the competing views of privatization and government control. This has influenced the energy policy choices in providing the counter-argument of the so-called "Czech way" which would have given the way to these newly-rich Czechs instead of foreign investors. Right-wing government decided to keep control of four gas distribution companies, remaining stocks in the refineries and petrochemical companies (Unipetrol), the Ingolstadt and Družba pipeline operators (MERO, České produkty a ropovody / ČEPRO) and electricity monopolist (České energetické závody / ČEZ), and full state ownership of gas company Transgas. This decision was revisited only once the new socialist government came to power in 1998, with the support of the so-called opposition agreement. The 1998 and the way how the government came to power can be seen as a change of paradigm in Czech Republic, when the transition conflict between the "new" and "old" elites was visibly transferred, and these elites agreed on a ceasefire to share power and economic spoils.<sup>280</sup>

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<sup>277</sup> Although different, the most commonly referenced names in this context and energy business in Czech Republic are Václav Junek (Chemapol), and Andrej Babiš (Agrofert).

<sup>278</sup> Eva Munk, "Privatization Remains On Track, With Exceptions," *Prague Post*, September 6, 1995, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YKK0-00BJ-Y2T7&csi=151894&oc=00240&perma=true>.

<sup>279</sup> Nellis, *Time to rethink privatization in transition economies?*, 10.

<sup>280</sup> Erik Tabery, *Vládne, nerušit: opoziční smlouva a její dědictví* (Paseka, 2006); Jiří Pehe, *Vytunelovaná demokracie* (Academia, 2002).

The rapid privatization of energy assets took place after 2000 based on the urgent need of socialist minority-rule government to drum-up its popular support just before the elections through increase in public spending.<sup>281</sup>

### **4.3. Energy Security during Klaus's Two Governments 1993-1998**

The first Czech government lead by Václav Klaus, Cornell University trained economist,<sup>282</sup> focused on the objective of reforming the economy of the country and restructuring of the industrial sectors. Prioritization of security in the energy policy of Czech Republic in this period can be illustrated through developments in three energy sectors – gas, oil/petrochemical and electricity.

To illustrate how specific policy choices influenced the prioritization of security in the energy policy in this period I present following specific examples: Infrastructural developments in building of oil and gas connectors from Germany, policy choices during the restructuring and privatization of Czech refineries and the decision to use United States' Westinghouse manufactured fuel for the newly built nuclear power plant. These three specific cases show how important the security aspect of diversification had been. Choices made during the restructuring of the two largest and most important refineries, related partly to the infrastructure developments but mainly illustrated how Chemapol/Gas-Invest<sup>283</sup> was prevented from becoming what Panrusgáz had in Hungary. I discuss the role of Chemapol in more detail also in relation to the corruption and tax evasion, as it is of crucial importance for understanding the interest of ruling elites and the change from transition to state capture framework.

In case of restructuring of the energy industry, Czech Republic started with restructuring with

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<sup>281</sup> Andrew Schwartz, *The Politics of Greed: How Privatization Structured Politics in Central And Eastern Europe* (Rowman & Littlefield, 2006).

<sup>282</sup> Heike Michelsen (Cornell University), "Foreign Policy Distinguished Speaker Series: Vaclav Klaus, President of Czech Republic," *Cornell*, n.d., [http://events.cornell.edu/event/foreign\\_policy\\_distinguished\\_speaker\\_series\\_vaclav\\_klaus\\_president\\_of\\_czech\\_republic](http://events.cornell.edu/event/foreign_policy_distinguished_speaker_series_vaclav_klaus_president_of_czech_republic) (accessed May 20, 2013).

<sup>283</sup> Jonathan P. Stern, *The Future of Russian Gas and Gazprom* (Oxford University Press, 2005), 115.

the view of eventual privatization as a means of bringing new capital, know-how and access to markets. A decision was made already in the 1994 to diversify the resources and postpone the privatization in the energy sector for minimum five years.<sup>284</sup> The Czech Government studied cases of privatization of energy industries particularly of British Gas of United Kingdom, and in 1993 made a decision to first restructure, unbundle and only subsequently to privatize.<sup>285</sup> The understanding that diversification must happen before privatization was expressly present.<sup>286</sup> The full sequence needed was that of establishing regulation,<sup>287</sup> including liberalization of prices, creation of competition and only subsequently privatization.<sup>288</sup>

In the first years of the federation a number of companies were privatized to foreign investors directly. Right before the two countries split, voucher privatization enabled creation of domestic stock-market, but also created conditions for privatization of assets without capital<sup>289</sup> and selective exclusion of foreign investors which eventually lead to “banking socialism,” (similar cases were observed in both Slovakia and Hungary into different extents) and concentration of wealth in a number of privileged individuals,<sup>290</sup> who tried to influence politics as well.

#### 4.3.1. Transformation of Refineries

The refineries industry is important mostly because of its structural position of power in domestic energy landscape.<sup>291</sup> It can leverage power over the refineries, as well as part of the

<sup>284</sup> Milan Černý, “Cena plynu pro domácnosti se do roku 2000 zdvojnásobí,” *Rudé Právo*, March 21, 1995.

<sup>285</sup> Václava Weignerová and (JB), “Monopoly pod kontrolou,” *Hospodářské noviny*, 1993, 37(115), s. 6. ISSN 0862-9587. (1993); Jan Betheim, “Co přinesla privatizace energetiky?,” *Ekonom*, 1994, 38(26), S. 51. ISSN 1210-0714., 1994.

<sup>286</sup> Vratislav Ludvík, “S privatizací českého plynárenství by se nemělo váhat,” *Hospodářské Noviny*, 1996, 40(207), S. 11. ISSN 0862-9587., 1996.

<sup>287</sup> The first Energy Law was implemented only in 1994.

<sup>288</sup> *Hospodářské noviny* (jaf), “Stát si asi bude chtít v energetice ponechat kontrolu,” *Hospodářské Noviny*, 1998, 42(163), S. 2. ISSN 0862-9587., 1998.

<sup>289</sup> Excellent account of one of the banks IPB which was used by Chemapol is provided in Zdenek Kudrna, “The Rise and Fall of Investicni a Postovni Banka (IPB),” *SSRN eLibrary* (September 10, 2002), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2144277](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144277) (accessed October 25, 2012).

<sup>290</sup> Petr Pithart, “Škoda byla jen jedna, škoda,” *Hospodářské Noviny*, April 15, 2011, [http://www.pithart.cz/archiv\\_textu\\_detail\\_pp?id=489](http://www.pithart.cz/archiv_textu_detail_pp?id=489) (accessed October 21, 2012).

<sup>291</sup> The structure of Czech oil industry, similarly to other countries, combines import, transit and storage facilities, as well as refineries with downstream distribution business. The picture is completed with related petrochemical

petrochemical sector, as was the case in Hungary where the fragile path of reliance between MOL – TVK and BorsodChem was revealed in 2000.

Czech government decided to combine most of the petrochemical industry into a national champion under the Unipetrol brand. The refining operations of two companies - Chemopetrol Litvínov, and Kaučuk Kralupy, were merged into Česká Rafinerská, which was set-up in 1995 as a joint venture of Unipetrol (Czech State owning 51%) and international companies ENI and Shell, the rest of the petrochemical operations remained part of the Unipetrol. The Unipetrol was listed on Prague stock exchange, and the Czech Republic held 67% ownership stake. The ownership relations were extremely complex and opaque. As an illustration of these, often incestuous ownership relationships, exemplifying what became called “privatization through incest,”<sup>292</sup> please see Figure 88 in the annex.<sup>293</sup> This was prepared at a request of one of the members of parliament, trying to understand the relations at the time, as an illustration.

The example of discussions around the privatization of Czech refineries in 1994 serves as a confirmation how the choice between international oil companies’ consortium of Shell, Conoco<sup>294</sup>, Agip and Total<sup>295</sup>, and Czech company Chemapol,<sup>296</sup> played in the prioritization of security aspect and the domestic control with foreign capital and know-how were being combined.

The Czech government initially asked for proposals to modernize the Czech oil refining industry. According to Gert J. de Bruin, manager of Total, several Western concerns responded to this

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industry, which forms a symbiotic relationship with refineries because it provides the only feasible demand for many of the byproducts created in the process.

<sup>292</sup> Jiří Havel, “Akcionářská demokracie „Czech made “,” *Finance a úvěr – Czech Journal of Economics and Finance* 5, no. 9–10 (2005): 441–459.

<sup>293</sup> PSP Archiv, “Odpověď na interpelaci poslance Michala Krause na ministra průmyslu a obchodu Vladimíra Dlouhého ve věci privatizace a transformace (případně restrukturalizace) české petrochemie PČR, PS 1993-1996, tisk 14/94”, March 6, 1995, <http://www.psp.cz/eknih/1993ps/tisky/t1494a00.htm> (accessed October 25, 2012).

<sup>294</sup> ConocoPhilips eventually sold its share in 2007 to Eni (formerly Agip).

<sup>295</sup> Total stepped away from the deal in the last moment and the remaining partners assumed its share.

<sup>296</sup> Svobodné slovo (jaš), “Temelín nelze zpochybnit,” *Svobodné Slovo*, 1994, 50(97), S. 1. ISSN 0231-732X., 1994; Martin R. Myant, *The Rise and Fall of Czech Capitalism: Economic Development in the Czech Republic Since 1989* (Edward Elgar Publishing, 2003).

request.<sup>297</sup> In May 1994 a group of International Oil Companies (IOC), including Italian Agip, French Total, the Dutch-English Shell, and USA's Conoco offered minimum 15 billion CZK (\$520 million) over five years toward restructuring and modernizing for a 49% stake in the Czech oil industry.

The interest of the international oil majors was mainly in the two largest Czech refineries: Chemopetrol in Litvinov and Kaučuk in Kralupy. Western FDI was very much needed not only for the sake of know-how and financial investment into modernization. According to an interview with Dušan Nepejchal, at the time general director Chemopetrol, the most important aspect was in securing access to global markets.<sup>298</sup> These companies played direct role in increasing energy security as they offered also financial support for the diversification pipeline for importing crude oil from Mediterranean port of Trieste through Germany's Ingolstadt to both refineries in Litvinov and Kralupy.<sup>299</sup>

Surprisingly, but consistently, prime-minister Klaus was against this plan. He on the other hand supported questionable and hazy "Czech way." As Klaus said in an interview he "preferred to seek Czech financing for the Chemopetrol Litvinov and Kaučuk Kralupy plants rather than be "dazzled" by the prospect of Western funds," offered by the international consortium.<sup>300</sup>

It is not uninteresting that this "sudden turn" in Klaus' view of restructuring happened just weeks after he returned from Moscow (April 1994), as the Czech Way was also the preferred choice of Russian "businessmen." Klaus' support for Russian interests was returned later on, at a number of occasions when he received support from Russian energy businessmen.<sup>301</sup>

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<sup>297</sup> Ann Marsh, "Western, Czech Interests Compete For Control Of Oil Refineries," *Prague Post*, May 18, 1994, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YY70-00BJ-Y3C0&csi=151894&oc=00240&perma=true>.

<sup>298</sup> Ibid.

<sup>299</sup> Building of which was estimated to cost DM 700 million (\$421 million) Ibid.

<sup>300</sup> Ann Marsh, "Klaus Wants Oil Refineries To Go The 'Czech Way,'" *Prague Post*, May 25, 1994, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YY40-00BJ-Y384&csi=151894&oc=00240&perma=true>.

<sup>301</sup> Markéta Hulpachová, "Klaus' Lukoil ties under scrutiny - News - The Prague Post," *The Prague Post*, March 12, 2009, <http://www.praguepost.com/news/757-klaus-lukoil-ties-under-scrutiny.html> (accessed May 20, 2013); Jiří Leschtina, "Lukoil na Hrad!," *Hospodářské Noviny*, 5 2012, <http://dialog.ihned.cz/komentare/c1-55962350-lukoil-na-hrad> (accessed May 20, 2013).

The discussion over how to privatize the petrochemical industry (i.e. what policy tool to choose) has been difficult. The attempt to find a “Czech way” to privatize the country’s oil refineries has drawn fire from two of the four political parties that made up the ruling coalition. Representatives of the Civic Democratic Alliance (ODA) claimed that the support for the “Czech Way” would prolong country’s dependence on Russian oil. The Christian Democratic Party (KDS) charged that if the “Czech way” plan was to be adopted, the domestic petrochemical industry would not be able to compete with companies from abroad. The Christian Democratic Union-Czech People’s Party (KDU-ČSL), and the Civic Democratic Party (ODS) were more hesitant on taking a clear position.<sup>302</sup>

The Czech Way was mainly represented by Chemapol, the incumbent oil import license holder. Nonetheless privatization to Chemapol would neither bring new capital, know-how, nor access to new markets; the foreign partners could provide all three. The restructuring of the refining business eventually took place in consultation with the international oil companies.<sup>303</sup>

The discussion and planning of the diversification of oil supply started already in 1990, in 1991 the decision for building of a new import oil pipeline from Mediterranean sea through Germany (IKL) was made, the building started in 1994 and the pipeline was commissioned in 1996.<sup>304</sup> Initially the “Czech way” prevailed,<sup>305</sup> also because most of the imports of oil were managed by Chemapol.

The oil transit pipeline – essential upstream part of the petrochemical and refining business in

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<sup>302</sup> Lubomir Sedlak, “Oil Refineries Seek ‘Czech Way,’” *Prague Post*, June 15, 1994, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YXH0-00BJ-Y2XG&csi=151894&oc=00240&perma=true>.

<sup>303</sup> PSP Archív, “Odpověď na interpelaci poslance Michala Krause na ministra průmyslu a obchodu Vladimíra Dlouhého ve věci privatizace a transformace (případně restrukturalizace) české petrochemie PČR, PS 1993-1996, tisk 14/94.”

<sup>304</sup> For detailed account of the political process surrounding the construction of the diversifying oil pipeline to Czech Republic see my MA thesis: Nosko, *Securitization within Economic Sector*.

<sup>305</sup> Olga Skalková, “Výstavba ropovodu z Ingolstadtu se obejde bez účasti zahraničních ropných firem,” *Hospodářské Noviny*, 1994, 38(103), S. 2. ISSN 0862-9587, 1994.

Czech Republic was managed by the state enterprise Benzina, until 1991.<sup>306</sup> The petrochemical product pipelines were managed by ČEPRO, company which split from Benzina, these assets were also excluded from privatization and remained under direct government control.

What is peculiar for the Czech Republic, and neither Hungary nor Slovakia followed this path is the 100% state ownership of both petrochemical product and crude oil transit pipeline system, which was guarded throughout the time, even after the refineries (which were part of the construction project through financing) were privatized.<sup>307</sup>

#### **4.3.2. Building Of the IKL – Diversification of Oil Supplies**

The most important aspect of energy security in the initial period after the transition has been building of the IKL diversification oil pipeline from Bavaria to Northern Bohemia. The details of this policy choice I have analyzed previously in my master thesis.<sup>308</sup> The decision to build this interconnector happened during period of uncertainty about the reliability of Russia as a supplier of oil for Czech Republic in the early 1990s. There were also questions of what will become of Slovakia and whether the transit through Slovakia may not become a security issue in the future. Additionally, the refineries were tailored to process only the heavy-sour type of Russian crude oil. The crude oil to be imported via TAL to IKL would be light-sweet sorts transferred via sea from Middle East or South America. Access to other sorts of crude based on demand would deliver additional competitive advantage, which was already available to other regional refineries. Despite this, from the beginning the project was of questionable short-term economic value,<sup>309</sup> and was seen as primarily a security enhancing measure.

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<sup>306</sup> In 1991 state enterprise Transpetrol in charge of managing the transit oil pipeline on the territory of Czechoslovak federation was founded. When the federation split in 1993, the Transpetrol was divided into Transpetrol, a.s. in Slovakia and Petrotrans a.s. in Czech Republic. Already in November 1993 the 100% of assets of Petrotrans, a. s., were transferred to the Czech National Property Fund (FNM) government body created for managing the state owned assets until they are privatized.

<sup>307</sup> Slovakia bought back the shares of its pipeline operator Transpetrol in 2009, after it was sold in 2002. Hungarian crude oil pipeline is owned by MOL.

<sup>308</sup> Nosko, *Securitization within Economic Sector*.

<sup>309</sup> Blanka Růžičková, "Ropovody: protimluv plný logiky," *Mladá Fronta Dnes*, 1995, 6(27), S. 12. ISSN 1210-1168., 1995.

The reasonableness of this long-term perspective became evident only recently, after the Czech Republic joined the EU, when Russian suppliers on a number of occasions “coincidentally” responded to more assertive Czech foreign policy with “reductions”<sup>310</sup> of oil supplies, which could be flawlessly replaced by IKL imports thanks to existence of the alternative supply route. Additional benefit was delivered also in contract negotiations with Russian suppliers, as Czech Republic was able to negotiate lower prices as compared to its neighbors.

The IKL was financed solely from the participating Czech refinery companies’ sources, and the estimated cost of \$265 million was to be covered by EBRD<sup>311</sup> and commercial loans, with state guarantees.<sup>312</sup> The discussed alternative options for diversification were upgrading of Adria pipeline from Százhalombatta in Hungary to Tupá in Slovakia, connecting to Adria-Wien<sup>313</sup>-Pipeline (AWP) at Schwechat through Slovnaft refinery in Bratislava, connecting to AWP from Czech Republic close to Brno, or building of a new pipeline north to German refinery at Leuna in the existing corridor of ethylene pipeline through the national reserve area in Krušné Hory. Among these possible choices, there was clear security priority given to connection to the western European pipeline system.<sup>314</sup> Leuna was a terminus of northern branch of Družba pipeline and alternative connection was to be delivered only through Polish port of Gdansk (or combination with Rostock) but would mean environmental hazard in drinking water sources from Krušné Hory. Thus preference was given for the TAL connection through Bavaria, and finally the decision was made to build IKL<sup>315</sup> as an extension of TAL. Despite initial attempts of

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<sup>310</sup> An example for all is 2008 supply disruption which followed signing of bilateral treaty between USA and Czech Republic about radar station as part of US missile defense system, what Russia has been vocally opposing. For details see Jiří Pehe, “Americký radar a ruská ropa — Jiří Pehe,” *Americký Radar a Ruská Ropa* (ČRo 6, 15 2008), <http://www.pehe.cz/Members/redaktor/americky-radar-a-ruska-ropa> (accessed March 5, 2013).

<sup>311</sup> Hana Vojtová, *Ropa teče i z jihu. Ingolstadt-Kralupy nejpozději od jara 1994*, n.d.

<sup>312</sup> Vítězslav Kulich, “První kilometry ropovodu z Ingolstadtu už na podzim,” *Hospodářské noviny*, 1993, 37(173), s. 4. ISSN 0862-9587. (1993).

<sup>313</sup> Vienna

<sup>314</sup> Ivo Polišenský, “Žhavé téma: ropovod,” *Lidové noviny*, 1992, 5(175), s. 6. ISSN 0862-5921. (1992).

<sup>315</sup> For the pipeline construction, Chemopetrol Pipeline, GmbH, a company based in Munich, was founded by the Ministry of Industry and Trade of the Czech Republic. The firm oversaw construction of the IKL pipeline in the territory of Germany. A year later, in 1992 Chemopetrol IKL,s.r.o., was founded by the owners of oil refineries Chemopetrol, s.p., Litvínov, and Kaučuk, s.p., Kralupy nad Vltavou, for construction of the Ingolstadt – Kralupy nad Vltavou – Litvínov (IKL) pipeline and the Nelahozeves Central Oil Tank Facility on the territory of Czech Republic and the building of the pipeline started financed through government guaranteed loan.

Bavarian chancellor Edmund Stoiber to link building of the pipeline with resolving the question of Sudeten, this didn't create significant problems for the project,<sup>316</sup> and the only delays were caused by additional state guarantees requested by Bavarian farmers.

Czech Republic made also a fast track priority to build strategic reserves for crude oil. This was a security measure, as well as technical necessity for terminating the new pipeline delivering different sort of crude oil. Therefore the tank farm of one million tons capacity at Nelahozeves was built.<sup>317</sup> In addition to these efforts, as part of the application to NATO, government made request to connect to the NATO Central European Pipeline System (NATO CEPS),<sup>318</sup> but I could not find any public information on the progress of this option.

On the case of oil diversification it was clear, that prioritization was given to the security aspects in the energy policy. From the articles in the contemporary press<sup>319</sup> it was very much visible that the security aspect has been emphasized, and any delays in building of the pipeline were followed with thrilling worries expressed by journalists. Once the project was finalized it was celebrated as an important step towards sovereignty and independence.<sup>320</sup>

#### 4.3.3. Czech Way vs. Norwegian Gas – Gas Interconnector for Energy Security

A clear example of diversification of gas supplies happening *before* privatization<sup>321</sup> is the diversification of gas import infrastructure. While initial transformation of the gas sector started

<sup>316</sup> Ivan Tesař, “Původní termín nebude dodržen,” *Lidové Noviny*, 1993, 6(281). *Finanční Noviny [příloha]*, Č. 57 S. VI. ISSN 0862-5921., 1993; Edmund Stoiber, “Ropovod není podmíněn sudetoněmeckou otázkou,” *Hospodářské Noviny*, 1993, 37(235), S. [1], 20. ISSN 0862-9587., 1993.

<sup>317</sup> Jan Nevyhoštěný, “Strategické zásoby ropy skrývá Česko u Vltavy. Nahlédněte do útrob nádrží?,” June 24, 2012, [http://ekonomika.idnes.cz/mero-skladuje-statni-ropne-rezervy-v-nelahozevsi-fvm-/ekonomika.aspx?c=A120723\\_161913\\_ekonomika\\_neh](http://ekonomika.idnes.cz/mero-skladuje-statni-ropne-rezervy-v-nelahozevsi-fvm-/ekonomika.aspx?c=A120723_161913_ekonomika_neh) (accessed October 25, 2012).

<sup>318</sup> Jaroslav Kmenta, “Praha se nemůže připojit k ropovodu členských zemí NATO,” *Mladá Fronta Dnes*, 1995, 6(64), S. 10. ISSN 1210-1168., 1995.

<sup>319</sup> Ivan Gabal, “Kdo odpovídá za národní bezpečnost?,” *Mladá Fronta Dnes*, 1994, 5(161), S. 6. ISSN 1210-1168., 1994; Hirman, “Diverzifikácia dodávok ropy a plynu do ČR a SR je strategickou otázkou dneška?,” Jana Frančíková, “Diverzifikace na dlouhé lokte,” *Hospodářské Noviny*, 1996, 40(217), S. 3. ISSN 0862-9587., 1996.

<sup>320</sup> Jitka Hanžlová, “Ruská hrozba nás nechromí,” *Lidové Noviny*, 1997, 10(66), S. [1]. ISSN 0862-5921., 1997.

<sup>321</sup> In 1998 in preparation for the privatization, the legal form of the state company Transgas was changed from state enterprise to a joint stock company – Transgas, a.s. this company comprised all international transit gas pipelines, as well as domestic high pressure pipelines and eight underground storage facilities (UGS). (See Law 77/1997 Coll. for details).

already in 1989<sup>322</sup> the diversification was decided only in 1996 by the right-wing Czech government, well before the decision on privatization of Transgas, the gas company, which was made at the end of 2001.

In 2002, during the socialist government power-sharing rule, both Transgas as well as shares in eight regional distribution companies together with the transit infrastructure were sold. Municipalities, except for the capital city of Prague sold their shares to international energy companies as well.

The building of the second gas import connector from Germany, which enabled import of Norwegian gas, is a second important development prioritizing energy security, which took place during this period. Given that Czech Republic, just like Hungary and Slovakia is a land-locked country, geographic conditions dictate that agreement with transit countries was needed. In case of Czech Republic, alternative import infrastructure could come crossing a combination of Germany, Italy and Austria or Poland and Germany. The first connector was built in southern Bohemia already in 1991, and was complemented with an emergency supplies agreement.<sup>323</sup> While it took relatively long to get the ball rolling on significant gas diversification, once the decision was made in 1996, the construction and the ensuing contractual diversification progressed rapidly. Already in May 1997 the first supplies from Norway were purchased.

After the “Czech” version was dismissed, as the ministry pledged not to issue import license to Gas-Invest, a widely-believed front-company representing Russian interests, there was still a number of “choices” or “scenarios” floated with various degrees of energy security improvements which would be delivered through these choices.<sup>324</sup> Even though the most progress was on agreements with Norwegians, the ministry of economy under Dlouhý’s

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<sup>322</sup> The former national enterprise Transit gas pipeline (Tranzitní plynovod; later Transgas) becoming a branch company of a newly established state enterprise Czech gas company (Český plynárenský podnik - ČPP). In 1994 in preparation for the first wave of the voucher privatization, the eight regional gas distributing companies were unbundled from ČPP and also converted into stock companies, at the same time the underground storage was merged into the ČPP. In 1995 independent state-owned company Transgas was founded.  
[http://www.net4gas.cz/cs/media/tiskove-zpravy/N4G-40\\_NGTA-brozura-web.pdf](http://www.net4gas.cz/cs/media/tiskove-zpravy/N4G-40_NGTA-brozura-web.pdf)

<sup>323</sup> Hirman, “Diverzifikácia dodávok ropy a plynu do ČR a SR je strategickou otázkou dneška.”

<sup>324</sup> István Lékó, “Jen aby Rus nebyl nepřítel: Objektívni realita Vladimíra Dlouhého,” *Týden*, 1996, 3(44), S. 52-57. ISSN 1210-9940, 1996.

leadership went on to start preparing four new “alternatives” just before the signature of contract with Norwegian consortium.<sup>325</sup>

There were also a number of questions on prices of Norwegian gas, allegedly floated with Gazprom’s communication’s support, and questions on how the prices of Norwegian and Russian gas would compare.<sup>326</sup> The four scenarios which Dlouhý’s ministry prepared consisted of scenario A which included import of gas only from Gazprom through diversified route via Poland which was in the construction phase. Scenario B recommended by Dlouhý and preferred by Gazprom included contracts with Gazprom’s German-Dutch partners Gasunie and Wintershall for delivering Russian gas via the intermediary companies. This was a solution which Hungary effectively implemented with the HAG (Hungary Austria Gas) connector. Scenario C included purchase from Norwegian producers. This was the alternative which delivered the highest energy security improvement, the Ministry acknowledged that this scenario would go against interests of Gazprom. Scenario D included weakly specified purchases of gas from Western Europe from American Mobil Europe Gas, German BEB and British Gas. This scenario was seen as less preferred as higher number of small suppliers could increase prices; deliver questionable reliability while being seen also as explicitly against Gazprom’s interests.<sup>327</sup>

The Dutch-German-Russian companies (Scenario B), if chosen, would not deliver energy security improvement; it would have ended up as a similar half-solution as Hungarian connector to Vienna which did not deliver actual energy security improvement either. In order for the diversification to become a true energy security policy measure, it was important not only to diversify the supply route (as Hungarians did with HAG pipeline<sup>328</sup>), or only diversify the commercial contracts with the same sources of gas (as the so-called Dutch scenario would have)

<sup>325</sup> Mojmír Hampl, “Česká cesta v plynu: Dovoz z Ruska na věčné časy,” *Respekt*, September 16, 1996, Roč. 7, č. 38 edition; Frančíková, “Diverzifikace na dlouhé lokte”; Lékó, “Jen aby Rus nebyl nepřičetný.”

<sup>326</sup> *Hospodářské noviny* (ja), “Diverzifikace zdrojů plynu nepřinese cenový šok, tvrdí dovozce Transgas,” *Hospodářské Noviny*, 1996, 40(212), S. [1], 2. ISSN 0862-9587., 1996; Jurij Alexandrovič Komarov, “Gazexport: ČR zaplatí za ruský plyn až o 150 milionů dolarů ročně více,” *Hospodářské Noviny*, 1997, 41(58), S. [1], 4. ISSN 0862-9587., 1997.

<sup>327</sup> Lékó, “Jen aby Rus nebyl nepřičetný.”

<sup>328</sup> Týden (il), “Maďarskou metodou?,” *Týden*, 1996, [http://aleph.nkp.cz/F/?func=direct&doc\\_number=00029936&local\\_base=ANL](http://aleph.nkp.cz/F/?func=direct&doc_number=00029936&local_base=ANL).

it was important to also diversify the actual sources of gas, in case the original supplier would cease to supply reliably. This was delivered only by the Norwegian contract (Scenario C), or contract with British suppliers (sub-variant of Scenario D which was not really an option at the time because of insufficient details on sources and contracts).

It was clearly part of the decision as well as public discussions that at the time, those choices of diversification options were related to interests of Russian Gazprom, and the secret services. Václav Junek the chairman of Chemapol, the main proponent of the “Czech Way,” was known to be former secret service agent and he was believed to be well connected with interests in Russia. Junek was the main figure of Chemapol, the communist-era monopolist importer of oil into Czechoslovakia, he had intense relations with important politicians already since the communist regime, and these didn’t seem to falter after the transition either. Junek was member of the Communist Party Central Committee (ÚV KSČ) before the transition. In a public interview Junek acknowledged “that former secret-police connections are a relevant part of the oil-privatization debate”.<sup>329</sup>

Later he employed former federal minister Marián Čalfa, ex-minister Petr Miller or former deputy director of secret service (BIS) Sylva Šauerová. Milan Černý, high-ranking ministry official in charge of regulating gas industry in Czech Republic, also joined Chemapol.<sup>330</sup> Milan Černý was also the chair of the board at Gas-Invest, company seen at the time as a front company of Gazprom in Czech Republic.<sup>331</sup> It is worth mentioning that Chemapol Group also purchased Lucerna palace from the back-than President Václav Havel at a whopping 200 billion crowns, price some considered exorbitant.<sup>332</sup> Václav Klaus was seen with him attending sports events<sup>333</sup>

<sup>329</sup> Gomez, “What Spy Past? Asks Top Oil Man - The Prague Post.”

<sup>330</sup> Hampl, “Česká cesta v plynu: Dovoz z Ruska na věčné časy.”

<sup>331</sup> Lékó, “Jen aby Rus nebyl nepřítel”; Jitka Hanžlová, “Rusko nemusí být jediným zdrojem,” *Idové Noviny*, 1996, 9(258), S. 11. ISSN 0862-5921., 1996.

<sup>332</sup> Petr Casnova, “Muž, který vlastnil první soukromé letadlo v Česku: Jak zbohatl a jak skončil,” *FirstClass*, October 4, 2012, <http://www.firstclass.cz/lode-a-letadla/privatni-letani/muz-ktery-vlastnil-prvni-soukrome-letadlo-v-cesku-jak-zbohatl-a-jak-skoncil/> (accessed October 21, 2012).

<sup>333</sup> Pavel Reisenauer, “Záhada Chemapolu,” *Korupce Po Česku*, n.d., <http://respekt.ihned.cz/korupce/c1-54210570-zahada-chemapolu> (accessed October 21, 2012).

and ČSSD politicians got free gasoline vouchers from his company.<sup>334</sup>

Chemapol was also seen as the core of the high-level organized crime network involving politicians. The network was involved in „trade” with so called “light heating oil” (LTO) which consisted of buying tax-free substance which was chemically nearly-identical to diesel fuel as “heating oil” and selling it on the open market for the price of heavily excise-taxed diesel fuel, while pocketing the price difference. The criminal network most likely involved groups across the borders from Czech Republic, Slovakia as well as Hungary (and potentially further in the former Yugoslavia) and included high ranking politicians. A use of classified Warsaw-pact era military product-pipelines across the borders from the Warsaw pact era was also mentioned.<sup>335</sup>

The involvement of Chemapol was corroborated once government requested that tax-free heating oils be dyed to distinguish them from taxed alternatives. After this decision was passed, Chemapol still received exception to import 150 thousand tons of non-colored LTO,<sup>336</sup> amount much higher than was annual consumption of this fuel for legitimate purposes.

At the time there were even allegations that minister of economy Dlouhý had financial interest colluding with that of Chemapol<sup>337</sup> as was discovered during failed attempt to favor Chemapol during sale-off of aircraft-maker Aero Vodochody.<sup>338</sup> This was also thought to be the reason for delays in signing the contract with Norway<sup>339</sup> which Dlouhý was believed to have caused.

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<sup>334</sup> Jiří Kubík, “Člen vedení Chemapol Transu: ČSSD od nás dostala deset čipových karet - iDNES.cz”, October 1, 1999, [http://zpravy.idnes.cz/clen-vedeni-chemapol-transu-cssd-od-nas-dostala-deset-cipovych-karet-1g1-/domaci.aspx?c=991001\\_114315\\_domaci\\_itu](http://zpravy.idnes.cz/clen-vedeni-chemapol-transu-cssd-od-nas-dostala-deset-cipovych-karet-1g1-/domaci.aspx?c=991001_114315_domaci_itu) (accessed October 21, 2012); Jiří Kubík and Jaroslav Kmenta, “Lídři ČSSD přiznali: Chemapol nám platil benzin - iDNES.cz”, September 30, 1999, [http://zpravy.idnes.cz/lidri-cssd-priznali-chemapol-nam-platil-benzin-fqb-/domaci.aspx?c=990930\\_090553\\_domaci\\_itu](http://zpravy.idnes.cz/lidri-cssd-priznali-chemapol-nam-platil-benzin-fqb-/domaci.aspx?c=990930_090553_domaci_itu) (accessed October 21, 2012).

<sup>335</sup> Pavel Blažek, “Podvody s LTO zřejmě přišly stát na 100 miliard,” *Právo*, September 30, 2004, <http://www.novinky.cz/domaci/40954-podvody-s-lto-zrejme-prisly-stat-na-100-miliard.html> (accessed October 21, 2012).

<sup>336</sup> Ludmila Rakušanová, “Zrod českého kapitalismu: u kolébky tekla nezdaněná nafta a krev,” *Deník.cz*, August 14, 2010, [http://www.denik.cz/z\\_domova/zrod-ceskeho-kapitalismu-u-kolebky-tekla-nezdanena.html](http://www.denik.cz/z_domova/zrod-ceskeho-kapitalismu-u-kolebky-tekla-nezdanena.html) (accessed October 24, 2012).

<sup>337</sup> Vladimír Dlouhý, “Část plynu bude vždy ruská,” *Lidové Noviny*, 1996, 9(275), S. 2. ISSN 0862-5921., 1996.

<sup>338</sup> Brendan McNally, “Klaus: Chemapol not suitable to buy Aero Vodochody - The Prague Post”, October 23, 1996, <http://www.praguepost.com/archivescontent/25024-klaus-chemapol-not-suitable-to-buy-aero-vodochody.html> (accessed October 25, 2012).

<sup>339</sup> Hampl, “Česká cesta v plynu: Dovoz z Ruska na věčné časy”; Frančíková, “Diverzifikace na dlouhé lokte.”

To sweeten the deal, Chemapol and Gas-Invest<sup>340</sup> even tried to offer shares in the gas import company to other industrial companies in Czech Republic and offered to import large quantities of gas from Russia to Czech Republic. The “Czech Way” strategy Chemapol offered therefore was very similar to what happened in Hungary with Panrusgáz and the plan of Devín Bank and SloVRusGas, which was only partially disrupted in Slovakia by Dzurinda’s first government. Russian entrepreneurs and their Czech colleagues were only able to secure friendly considerations of minister of economy and some of his ministry officials towards this plan; the problem was that there was not a sufficient support in the whole government. The dissent originated mainly from the center right ODS and partly from ODA, and assured that the import license was not granted to Gas-Invest, which meant that the company was not able to leverage its influence.

The decisive blow to the “Czech/Russian” alternative was delivered by minister of interior Ruml, a former dissident (ODS), who said he had “conclusive evidence” of connection of a high ranking Chemapol manager to the former communist secret service. Additionally, Ruml questioned Chemapol’s connections in Russia. Both Russian dominance and potential organized crime in the industry were hinted in the messages and were responded sensitively to by the public. Public could have responded sensitively also thanks to the presence of the information on the background of the personalities involved. This in turn was possible only thanks to the publicized information about secret-service connections, which happened in connection with the lustration process.

The second connector which enabled import of Norwegian gas was accompanied with a very difficult political struggle, where the government passed this decision with a margin of single vote. The decisive contribution and vote being delivered by Jan Ruml (ODS) and ODA members of government, and the remaining votes of ODS were cast in favor of the “Russian”

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<sup>340</sup> Other companies occasionally mentioned in this role were RCTd (Russian Czech Trading double) and Gazex.

alternative.<sup>341</sup> Vladimír Dlouhý (ODA) was seen to be in favor of the Russian alternative together with Václav Klaus. Dlouhý's party ODA<sup>342</sup> ordered him to vote in favor of Norwegian alternative threatening his dismissal from government.<sup>343</sup> Additionally, even after the government made the decision, there were further delays in signing the contract with Norway which were attributed to Dlouhý.

The importance of Czech decision was even further illustrated by high level visits from both Norway, as well as from Russia during this period. Both Viktor Chernomyrdin and Rem Viachirev visited Prague and pressured the country to choose Gazprom preferred option.<sup>344</sup> There was even an offer from Gazprom to increase the supplies, and accept Czech goods as part of the payment.<sup>345</sup> Russians tried to pressure, as well as to threaten, nonetheless this only further fueled security rationale for diversifying away from Russian supplies.

As the history illustrates (see Chart 59 and Chart 60) Czech Republic assured through this decision not only higher energy security, but also lower gas import prices than her neighbors to the east. Additional benefit, delivered thanks to this pipeline, was potential for Czech Republic to serve as transit country to the east.<sup>346</sup> This is what happened in 2009 when gas from Russia ceased to flow through Ukraine. Additionally, the existence of both the contract and the real possibility of importing from a new source enabled real price competition which pushed also prices of Russian gas down.<sup>347</sup>

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<sup>341</sup> Čestmír Hofhanzl, "Václav Klaus lze o norském plynu - Český dialog", January 3, 2006, <http://www.cesky-dialog.net/clanek/1681-vaclav-klaus-lze-o-norskem-plynu> (accessed October 22, 2012).

<sup>342</sup> Supporters of ODA were comparatively more worried about Russia than voters of other parties. See Chart 78 in appendix for comparison.

<sup>343</sup> Hofhanzl, "Václav Klaus lze o norském plynu - Český dialog."

<sup>344</sup> Iva Chaloupková, "Plyn - nástroj moci a ovládní konce 20. století?," *Pražské Noviny*, 1997, 2(58), S. 6. ISSN 1210-7794., 1997; Hanzlová, "Ruská hrozba nás neochromí."

<sup>345</sup> István Lékó, "Vláda pod tlakem ruské lobby," *Týden*, 1997, 4(6), S. 26. ISSN 1210-9940., 1997.

<sup>346</sup> Vratislav Ludvík, "K opravdové divarifikaci vede jenom jedna cesta," *Svobodné Slovo*, 1996, 88(303), S. 5. ISSN 0231-732X., 1996.

<sup>347</sup> Alena Adámková, "Sázka na norskou kartu," *Ekonom*, 1997, 41(17), S. 33-36. ISSN 1210-0714., 1997.

#### **4.4. Czech Republic 1998-2006: Socialists' Rule with Opposition Agreement**

After the center-right government of Václav Klaus crumbled in a party-financing scandal it could not explain, interim government of Josef Tošovský led the country towards early elections. The 1998 elections resulted in a close result between the major political forces<sup>348</sup> and because of both personal (center-right), and ideological (center-left) incompatibilities, none of the leading parties was able to put together a government majority. The solution to this situation came out as an unprecedented agreement between the two largest parties – the so called “opposition agreement”<sup>349</sup> effectively a power sharing agreement between ČSSD and ODS.

Through this agreement, two major political forces on the left and right effectively created extra-constitutional wide-coalition government, in which the second strongest partner could pretend that they are an opposition. Since the division of public support was clearly in favor of center-right government, this agreement was widely criticized as non-democratic and anti-systemic. The center-right government was not formed also because of internal power struggles, and personal animosities, but also because of the policy differences, as was visible in the vote on the energy diversification – which was one of the most important breaking points in the previous government.

The power-sharing agreement initially worked, but started crumbling two years before the elections, when ODS started looking for other partners to form new government. While Czech Republic in this period (1999) joined NATO together with Poland and Hungary, banks were privatized and number of foreign investors came to the country, there has been a general distrust towards politicians following the Opposition Agreement. The two leading parties tried to tinker with the electoral law to strengthen their position at the cost of proportionality and smaller

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<sup>348</sup> 32.3% and 27.7% for ČSSD and ODS respectively.

<sup>349</sup> Officially called “Agreement on creation of a stable political environment in the Czech Republic” *Smlouva o vytvoření stabilního politického prostředí v České republice uzavřená mezi Českou stranou sociálně demokratickou a Občanskou demokratickou stranou*, 1998.

political parties.<sup>350</sup> Public outcry against the ruling elites was escalating with a number of civic movements.<sup>351</sup> While it has been already a decade after the beginning of the transition, occasional scandals related to corruption and backdoor deals involving former secret service members occurred. The most publicized was case of Jan Kavan, minister of foreign affairs when it was publicized (again) that he served in the communist secret service as agent with code name “KATO.”<sup>352</sup> It was also in this period (2000–2002) that a journalist uncovered a number of deals involving government officials, and including ministry of foreign affairs property deal in Moscow. A high-level ministry of foreign affairs official ordered assassination of this journalist.<sup>353</sup> During this period three important events took place illustrating how energy security was prioritized in the energy policy of Czech Republic: the privatization of whole gas sector, privatization of petrochemical sector, and attempted privatization of Czech energy giant ČEZ. All of these cases show that prioritization of security and national interest is not an inherent feature of a country, but depends on the interplay between the interest of ruling elites and powerful domestic interest groups. With the change of ruling political elite, and business-people well connected in both former security services networks and the new ruling elites, other priorities than security, were put to the forefront, ignoring the popular demand of majority voters, who were still largely preferring security prioritization as in the previous period.

What were the interests behind choices in energy policy in this period? Why was security suddenly not the highest priority it has been in the previous time? The answer to these questions is that the energy security of Czech Republic improved significantly, and its energy system was covered not only for the short but also for the mid-term risks. Therefore it did not require much to maintain the security, and it was sufficient to focus on only gradual improvements. The main

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<sup>350</sup> The Constitutional Court ruled against the electoral law change.

<sup>351</sup> “Thank you, leave!” Was one of the most vocal ones. As part of the power sharing agreement, ODS even tried to take control of the public TV, which incited further protests of TV employees as well as public.

<sup>352</sup> Evidence zájmových osob StB, “Hledání v seznamu zájmových osob StB - JAN KAVAN”, 2012, <http://www.svazky.cz/test/svazkyMT.php?display=byname&jmeno=JAN&prijm=KAVAN> (accessed October 27, 2012). There was a court ruling that Kavan did not collaborate knowingly with the secret service.

<sup>353</sup> ČTK, “Karel Srba je po osmi letech venku z vězení,” *E15.cz / Zprávy*, September 2, 2010, <http://zpravy.e15.cz/domaci/udalosti/karel-srba-je-po-osmi-letech-venku-z-vezeni> (accessed March 6, 2013).

puzzle for this period is why did Czech Republic privatize its gas sector, including the transit infrastructure – so many times referred to as the chicken laying the golden eggs?

The main precondition for privatization was believed to be regulation. With the energy law enacted and the energy regulator set up in 2001<sup>354</sup> it seemed that it was the time to privatize the remaining energy business. The opposition agreement also called for continuation of privatization. Nonetheless, the way how the privatization was conducted, especially in light of the previous decisions of the Czech government is puzzling. Why did suddenly Czech Government decide to start rapidly selling off strategic assets, when it really went out of its way in the previous period, to keep them under the state control?

The single straight-forward answer I received in an informal off-record discussion, to this question was from a former Czech gas industry (ČPP) official who took part in the company's restructuring, and has been working in the gas sector for more than 30 years. When asked what was the motivation to privatize Czech gas sector so quickly, and in such a way? The response I received off-record was breathtaking: "It was about corruption."<sup>355</sup> The explicit power-sharing agreement between the two major forces of the political spectrum in Czech Republic not only provided 2/3 majority in the parliament,<sup>356</sup> it also effectively removed democratic opposition control of the government. The social-democratic governments are not the first suspects for launching speedy privatizations, nonetheless as is seen in case of Hungary, it is not rare either. Especially when the alleged motivation is not national policy, but private interests of those taking part in it, as has been claimed not only by my interviewee, but also number of politicians in Slovakia, also in the context of gas sector privatization.<sup>357</sup> The cross-party agreement which was in function for the entire electoral period was occasionally witnessed elsewhere as well – as the

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<sup>354</sup> ERU, "Informace o Energetickém regulačním úřadu", 2012, [http://www.eru.cz/dias-read\\_article.php?articleId=52](http://www.eru.cz/dias-read_article.php?articleId=52) (accessed October 27, 2012).

<sup>355</sup> V. Š., "Off-record interview about restructuring of Czech Gas Industry (Budapest)", November 28, 2008.

<sup>356</sup> 137 out of 200 mandates in the lower house and 51 out of 81 in the Senate.

<sup>357</sup> TASR, "Súdny spor Fica s Miklošom stále pokračuje", January 24, 2012, <http://www.pluska.sk/spravy/z-domova/sudny-spor-fica-miklosom-stale-pokracuje.html> (accessed October 27, 2012).

Podolák (MSZP) and Fónagy (FIDESZ) energy law amendment in Hungary illustrated.<sup>358</sup>

What is clear, is that this decision has significantly decreased energy security of Czech Republic and made it nearly impossible for the subsequent governments to take active measures affecting energy security. This was explicitly voiced by Ambassador at large for Energy Security Václav Bartuška in his discussions with US Embassy in Prague as captured by leaked embassy cable message.<sup>359</sup>

Corroborating claims about corruption and state capture influencing the privatization and particular policies is very difficult. This is also evidenced by lack of concluded legal proceeding prosecuting those allegedly connected with these activities. Finding motivations and identifying those that benefited from these policies is more of a role of investigative journalism than academic research. Without slipping into investigative journalism, which could be exciting in itself, the question is how to grasp this analytically? My theoretical model hypothesizes the security prioritization in the energy policy to be the outcome of the interplay between the interests of the ruling elites, including the way how corruption spoils-sharing played out, with the perception of threat and the presence of elites connected with former security apparatus as an outcome of vetting laws. Based on the empirical observation I acknowledge that the prioritization of security in energy policy changes in the context of state capture. Since the structure of elite preferences changes, and this is also captured by my analytical framework. My model reflects on these changes, but the explanatory logic is somewhat different, and its specific spelling out is a task for the subsequent research endeavor.

During the period of Social-democratic party's rule with the support of right-wing ODS, those forces and interests which were held under control in the previous government prevailed.

Former minister Ruml, leading figure in the prioritization of security in the energy policy, ran to

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<sup>358</sup> Corruption Research Centre and Energia Klub, *Government Failures, Rent-Seeking and Risks of Corruption in the Hungarian Electricity Sector* (Budapest, 2010), [http://energiakontrollprogram.hu/sites/energiakontrollprogram.hu/files/ekp\\_report\\_rent-seeking-and-corruption.pdf](http://energiakontrollprogram.hu/sites/energiakontrollprogram.hu/files/ekp_report_rent-seeking-and-corruption.pdf) (accessed March 6, 2013).

<sup>359</sup> Graber/ US Embassy Prague, "US embassy cable - 07PRAGUE313", March 23, 2007, <http://cables.mrkva.eu/cable.php?id=101712> (accessed October 27, 2012).

become chairmen of ODS against Klaus after the party financing scandals in 1998. After he lost to Klaus, together with a number of his supporters they set up new political party Liberty Union (Unie Svobody) main democratic party in the real opposition to ČSSD and ODS power sharing and government. Nonetheless, Ruml and those that shared his view on prioritization of security in energy policy remained without any real power to check on the privatization processes or energy policy choices.

Additional example of the unprecedented speed with which the privatization during socialist government proceeded was the case of privatization of Czech gas and petrochemical sector. This was concluded in May 17, 2002 in the last months of Zeman's government. The winners of both privatization of Unipetrol (refining) and Transgas (gas) were announced on the same day. Unipetrol was privatized to the "Czech" bidder Agrofert for EUR 361 million despite higher offer from a British company Rotch of EUR 444 million. Transgas, company representing the Czech gas sector was purchased by German group RWE AG for EUR 4.1 billion.<sup>360</sup> The price included also the six underground storages.<sup>361</sup>

This meant effectively privatization of the whole gas sector of Czech Republic, and the government lost not only control over the whole gas sector, but effectively also any possible means of influencing types of contracts, as well as access to information from the gas sector vital for accessing vulnerability and security of Czech Energy sector as a whole.<sup>362</sup>

The Unipetrol privatization was extremely puzzling because government surprisingly excluded the highest bid from British Rotch, and chose lower price offer, which came from a Czech business without experience in refining – Agrofert. Pavel Mertlík, a former finance minister and

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<sup>360</sup> Peter S. Green, "Bonanza or Bust? Czech Sale Of Privatized Assets Fizzles," *The New York Times*, December 18, 2001, sec. Business, <http://www.nytimes.com/2001/12/18/business/bonanza-or-bust-czech-sale-of-privatized-assets-fizzles.html> (accessed October 27, 2012). The remaining 3% of shares were kept by state to be able to summon general assembly. Nonetheless even these were sold in 2003. RWE also obtained stakes of between 46% and 58% in each of the country's eight regional gas distributors, with controlling stakes in six of them.

<sup>361</sup> Small gas storage is also owned by Moravské Naftové Doly, Czech Exploration and Production company, which was sold through voucher privatization.

<sup>362</sup> High government official complained about this years after the decision in 2008, when he noted that not only details of gas contracts are not known to the government, but also the government does not have up-to-date information about the status of gas and oil storage. V.B., "Private discussion about Czech Republic's Energy Security (Telč)."

chief economist at Raiffeisen Capital and Investment in Prague said that “it is very difficult to understand why the bid that is 80 million euros lower was chosen as a winner.”<sup>363</sup> This sale was surrounded by numerous corruption allegations and suspicions of contacts between Agrofert director Andrej Babiš and high ranking members of Czech socialist party (ČSSD).

In an attempt to explain this unusual decision to select lower bid, Czech Prime Minister Zeman, said that “Rotch Energy had not persuaded the government that it was a serious strategic investor with a long-term plan for Unipetrol.”<sup>364</sup> This argument rather seemed to have been used as a cover for the less honorable reasons for this awkward choice. A request from socialist politician for a bribe of five million Czech crowns to meet the prime minister at the time was also documented,<sup>365</sup> when Zdeněk Doležel, of socialist ČSSD party was caught on video asking 5 million Czech Crowns from Jacek Spyra, a polish lobbyist allegedly working for rival bidder Seta Invest (Agrofert’s competitor).

According to the interview with former PKN Orlen management member Krzysztof Kluzek, Babiš knew the competing bids for Unipetrol through his connection with the socialist prime-minister Gros. He also pointed out that the bribe which was shared between the Czech and Polish parties was €42 million.<sup>366</sup> The third bidder, consortium of MOL-TVK-OMV was excluded because their business plan included selling off of some of the Unipetrol’s assets. According to some observers, “the government opposed this condition to insure that Agrofert won the tender.”<sup>367</sup> Conoco had an agreement in the bid to take over refining stakes from Unipetrol, as Agrofert was mainly interested in petrochemical part of the conglomerate.

Eventually, this sale to the Czech Agrofert didn’t go through, but not because of the corruption

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<sup>363</sup> Green, “Bonanza or Bust?”.

<sup>364</sup> Ibid.

<sup>365</sup> iDnes, “Lobbista z kauzy „pět na stole“ vysvětluje soudu „deset“ od Babiše,” *iDnes*, January 18, 2001, [http://zpravy.idnes.cz/lobbista-z-kauzy-pet-na-stole-vysvetluje-soudu-deset-od-babise-pb9-/krimi.aspx?c=A110118\\_132549\\_krimi\\_cen](http://zpravy.idnes.cz/lobbista-z-kauzy-pet-na-stole-vysvetluje-soudu-deset-od-babise-pb9-/krimi.aspx?c=A110118_132549_krimi_cen) (accessed March 28, 2012).

<sup>366</sup> Jaroslav Kmenta, “Poláci jedou vyslychat Grosse a jeho ministry”, January 11, 2006, [http://zpravy.idnes.cz/polaci-jedou-vyslychat-grosse-a-jeho-ministry-f44-/domaci.aspx?c=A060910\\_232729\\_domaci\\_ad](http://zpravy.idnes.cz/polaci-jedou-vyslychat-grosse-a-jeho-ministry-f44-/domaci.aspx?c=A060910_232729_domaci_ad) (accessed October 22, 2012).

<sup>367</sup> Sam Cage, “Agrofert-Conoco to Acquire Unipetrol; Czech Republic,” *Chemical Week*, January 2, 2002, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=44W4-3S80-0004-60P7&csi=6940&oc=00240&perma=true>.

allegations, but because of Agrofert's inability to secure loans to finance the operation. Additionally, despite the lower bid, Agrofert was trying to lower the price even further, or sneak in additional foreign partners to chip-in with funding. But Czech government was not willing to allow PKN Orlen to provide the financing to Agrofert's original bid or lower the price.<sup>368</sup> Finally, much later, the sale was reversed and the government sold the refining industry to the PKN directly in June 2004. Agrofert launched an arbitrage against PKN on the basis of previous inter-company agreements. Agrofert had agreement with PKN Orlen based on which once Unipetrol is privatized, Agrofert will take control over some operations of the holding.<sup>369</sup> There were allegations that PKN Orlen joined this agreement, in order to make use of the privileged connection of Agrofert's owner Babiš to the social-democratic government and at the time already Prime Minister Gross.<sup>370</sup>

The failed privatization of Energy giant ČEZ also illustrates changes in prioritization of security in energy policy during the socialist government. The state energy company ČEZ was transformed into a stock company already in May 1992 in the preparation for the voucher privatization. One third of the stocks were available through the voucher privatization. The decision to privatize 30% of the company for CZK 49 billion (approximately \$1.7 billion in 1993) was initially challenged. The challengers were mainly the unions<sup>371</sup> and ecological activists, on the grounds of opposition to finishing of NPP Temelín and needed upgrades to the northern Bohemian coal power plants.<sup>372</sup>

The initial prioritization of security in electro-energy sector can be seen through the decision on

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<sup>368</sup> Sam Cage, "Unipetrol Purchase Unlikely to Proceed," *Chemical Week*, September 25, 2002, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=46WM-SB00-0004-6053&csi=6940&oc=00240&perma=true>.

<sup>369</sup> Agrobchemie, a.s. (50 %). Aliachem, a.s. (38,79 %), Kaučuk, a.s. (100 %), Paramo, a.s. (60 %), Chemopetrol, a.s. (40 %), Bison & Rose Public Relations, "Privatizace Unipetrolu | Chronologie - Privatizace 2004", 2006, <http://privatizaceunipetrolu.cz/page-privatizace-2004-unipetrol-orlen.html> (accessed October 27, 2012).

<sup>370</sup> According to published information, Babiš was allegedly sending Gross money from through his wife. ČTK, "Unipetrol je na prodej. Zájem má Rusko i ČR", August 23, 2009, <http://tn.nova.cz/zpravy/ekonomika/unipetrol-je-na-prodej-zajem-ma-rusko-i-cr.html> (accessed October 27, 2012).

<sup>371</sup> Pavel Hájek and (fl), "Bude privatizace energetiky bolet?," *Sondy odborových svazů*, 1993, 3(14), s. 2. ISSN 0862-7436. (1993).

<sup>372</sup> Jitka Oleárníková, "Spor o projekty trvá," *Noviny*, 1992, 1(60), s. 1 a 16. (n.d.).

finishing of the nuclear power plant Temelin. After the audit of the original project, the decision was made to use Westinghouse fuel instead of Russian fuel.<sup>373</sup> This reflected the wide-spread understanding that whole energy system in Czech Republic including oil, gas and nuclear should be diversified<sup>374</sup> in order to improve energy security.

The socialist Zeman government decided to put the privatization offer for electricity industry in for all or nothing. Government bundled the whole electricity sector together for privatization, including the nuclear power plants. The expectation was that this would provide for a very high return. The decision to bundle production and distribution companies into one package for sale has been criticized by investors and analysts alike, already when the transaction has been in the making in the fall of 2000. As Jan Slabý, equity analyst noted in an interview at the time, government would “get more money by selling the utilities off one by one, if they’re selling such a big thing, they’ll reduce the number of interested investors.”<sup>375</sup>

The sale was scheduled to go through in the early 2002, expecting to bring between \$6-7 billion from the sale, with the sale of the country’s remaining energy assets expected to yield a further \$2-3 billion.<sup>376</sup>

In addition to the extraordinary size of the offer, a number of additional limiting conditions were placed on the prospective bidders. The purchase of energy giant was to happen in whole by a single buyer with a required 10-year minimum ownership term. Additional conditions included that the winning bidder must have nuclear-energy expertise, and needs to limit layoffs and continue with purchases of Czech coal at preferential terms, and agreed volumes. Additionally, there were criteria on maintaining structure of the energy mix for power generation.

Should there be a company willing to accept these conditions, this would create a paradoxical

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<sup>373</sup> Hanžlová, “Ruská hrozba nás nechromí.”

<sup>374</sup> The second nuclear power plant at Dukovany was still using Russian Elektrostal/TVEL fuel under long-term contract.

<sup>375</sup> James Drake, “Prague’s power privatization play,” *Daily Deal*, October 5, 2000, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=45GM-H270-014S-Y159&csi=244689&oc=00240&perma=true>.

<sup>376</sup> “Restructuring; Controversy Over CEZ Privatisation Conditions,” *Modern Power System*, November 30, 2001, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=44MY-VFP0-00HT-22PB&csi=168861&oc=00240&perma=true>.

situation when contract with the Czech government would go against EU regulations on unbundling and emission reduction, as well as forcing the new investors to maintain high energy export levels. Most of the analysts already at the time predicted that the Socialist government's conditions were unrealistic. Despite some bidders threatening to appeal to the European Commission on the basis that the bidding process was unfair, the government eventually went through with the competition.

In early October 2001, six firms were shortlisted: Electrabel of Belgium, Électricité de France International, Italy's Enel, Spain's Iberdrola and British International Power, who formed a consortium with the United States' NRG Energy. Six other candidates have dropped out.<sup>377</sup>

Some opponents have labeled the hurried schedule as a “cynical, politically motivated ploy by the Social Democrats to allow them to claim credit for bringing in the much needed revenue before Czechs go to the polls.”<sup>378</sup> The liberal opposition Freedom Union party was trying to push an amendment to the commercial code which would require investors bidding in privatizations to buy not only the government's controlling stakes, but also the entire equity of companies. This was seen as a way of torpedoing the privatization altogether. Given that part of the ČEZ shares were floated on the stock exchange, this would effectively force the prospective bidders to pay double and thus complicate privatization. The aim was so that the minority-government ruling Social Democrats “can't claim they pulled off these privatization deals.”<sup>379</sup>

The first round of offers yielded single bid from Enel/Iberdrola of about CZK 135 billion (\$3.8bn) for the whole package of assets. E.ON and a consortium of International Power and British Energy bid individually for separate assets. The government has asked Électricité de France and Enel to submit improved offers, with the Prime Minister Zeman, setting CZK 200

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<sup>377</sup> Frantisek Bouc, “CEZ privatization moves forward, but controversy sticks,” *Prague Post*, November 17, 2001, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=4476-Y670-00BJ-Y38X&csi=151894&oc=00240&perma=true>.

<sup>378</sup> Brian Cattell, “Legal change may kill Czech privatizations,” *Daily Deal*, November 6, 2001, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=44CN-5JW0-014S-Y276&csi=244689&oc=00240&perma=true>.

<sup>379</sup> *Ibid.*

billion (\$5.7bn) as the minimum price, saying that “The government of the Czech Republic is nobody’s fool to whom undervalued bids can be submitted.”<sup>380</sup> The only valid bid received in the second round from Enel of 160 billion crowns (\$4.54bn) was not high enough for the government, and the government cancelled the whole tender.

Government later decided to merge ČEZ with the 8 regional distribution companies and no further transformation of electricity sector has been undertaken. The ČEZ is seen by many analysts until today, as an uncompetitive company which benefits mainly from proximity to the political elite than good economic management.<sup>381</sup> ČEZ maintained its position as the national energy champion, and as some say controls the country.<sup>382</sup> According to politicians across the political spectrum ČEZ has financed most of the political parties.<sup>383</sup>

#### **4.5. Summary**

In the period between 1993 and 1998 Czech political elites really strove for sovereignty and independence from Soviet Union and Russia – political as well as economic. High ranking members of communist party and collaborators with the previous regime and its security apparatus have been compromised and largely excluded from the public life. Instead they withdrew to business sector. Economic transformation initially went relatively smooth, with the transformation of energy sector taking slow and well thought-through steps. Privatization was seen as a tool for accessing foreign capital, know-how, and market until the later period when the effects of state-capture appeared. Unions were relatively weak, partly also discredited with their former relation with the communist party and didn’t get involved in the security prioritization of the energy policy, apart from the few industrial actions of coal miners. Industry of Czech

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<sup>380</sup> Brian Cattell, “Czechs choose RWE for gas sector,” *Daily Deal*, December 18, 2001, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=44V2-TSX0-014S-Y4CB&csi=244689&oc=00240&perma=true>.

<sup>381</sup> “ČEZ unplugged : Czech Market Place.”

<sup>382</sup> ČTK, zep, and jaf, “ČEZ řídí zemi a platí politické strany, říká na nahrávce lobbista - iDNES.cz.”

<sup>383</sup> Aktuálně (teš, nem, ina), “Schwarzenberg: Všichni víme, že ČEZ financoval strany - Aktuálně.cz.” ČTK, “Opoziční politik potvrdil Schwarzenbergova slova o tom, že ČEZ skrytě sponzoroval strany”, September 29, 2011, <http://zpravy.ihned.cz/c1-53058290-opozicni-politik-potvrdil-schwarzenbergova-slova-o-tom-ze-cez-skryte-sponzoroval-strany> (accessed October 27, 2012).

republic has been relatively diverse and throughout the period went on to diversify further, with decrease of exports of heavy-basic (high input and energy intensity with low value added) and light—basic (relatively low input and energy intensity with low value added) sectors and increase in both heavy complex and light complex sectors (high input and energy intensity and low input and energy intensity respectably with high value added).<sup>384</sup> Additionally energy intensity of most energy intensive sectors was rapidly decreasing (See Chart 86 for details).

The interests of the ruling elites in Czech Republic in the initial period were in favor of increasing the independence from Russia. This was visible mainly in the presence of small, but very vocal number of ministers of center-right parties in ODS and ODA governments who clearly prioritized security, and explicitly so also in their energy policy preferences. Very high popular perception of Russia (and Soviet Union) as a threat to Czech Republic, and the fact that perception of threat from Russia overlapped or became nearly conflated to the threat of former Communist elites,<sup>385</sup> provided a window of opportunity for strict vetting laws but also for desire to decrease dependence on Russia.

In this context, the early Czech government successfully fended off attempts of Russian businesses with the help of their Czech partners to exert control over energy sector of the country. Government withstood intensive political pressure from Russia and diversified its oil, nuclear as well as gas supplies. These decisions were motivated mainly by the security considerations stemming from the deep mistrust and fear, over economic or business ones. Thanks to these decisions Czech Republic maintained comparably lower energy prices, higher competition on the import market<sup>386</sup> and higher energy security than her neighbors to the east.

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<sup>384</sup> For methodology and distribution of sectors see Béla Greskovits, “Leading Sectors and the Varieties of Capitalism in Eastern Europe,” *Actes du Gerpisa*, no. 39 (2005): 113 – 128, [http://gerpisa.org/actes/39/gerpisa\\_actes39.html](http://gerpisa.org/actes/39/gerpisa_actes39.html). as modified by Lucia Kurekova, *Commodity export structures and the analysis of trends in leading export sectors in the European Union*. (Budapest: Political Economy Research Group, Central European University, October 2007), [http://votcceu.googlepages.com/ExportStructures\\_ResearchNote\\_Kureko.pdf](http://votcceu.googlepages.com/ExportStructures_ResearchNote_Kureko.pdf) (accessed October 28, 2012).

<sup>385</sup> This is visible also on survey responses of those who saw communist party unfavorably saw Russia unfavorably as well.

<sup>386</sup> Please see the comparative chapter and Chart 37 – Chart 40 as well as Chart 60 and Chart 63 for regional comparison.

During the second period situation changed. Social-democratic party formed government with the support of part of the center-right ODS party. Those who were promoting the prioritization of security in the energy, primarily around Jan Ruml, joined the opposition and rapid privatization started. While in the previous period the hallmark of energy policy was improving energy security through diversification and restructuring, the second period was symbolized by speedy and questionable privatization. This privatization was not primarily a tool for promoting energy policy, following the logic of promoting national interest, but it was privatization riddled with corruption scandals and questionable decisions. During this privatization, whole gas sector was sold off to a single investor, thus ridding government any possibility to follow or implement energy security measures in the gas sector, the most sensitive sector of energy. During this privatization oil and petrochemical sector were sold-off. The first major published case of corruption was also recorded during this privatization, which signified political and business corruption in Czech Republic during this period. Finally the transformation of electricity sector took place in such a way, which according to some have created energy giant profiting more from the closeness to politics than from market efficiency.<sup>387</sup>

Additionally, Czech government, seems to have failed regulating the business and using it as a tool of energy policy, but has rather become captive to the energy industry.<sup>388</sup> While energy security has not nominally decreased in this period, this is mainly result of the measures implemented before 1997, as policies implemented between 1998 until 2005 did not lead to improving energy security.

The interplay we witnessed in Czech Republic since 1998, was that of business capturing the state and influencing the decisions when the ČSSD socialist government with the complicity of

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<sup>387</sup> “ČEZ unplugged : Czech Market Place.”

<sup>388</sup> The Economist, “CEZ and Czech energy: No, minister,” *The Economist*, April 8, 2010, <http://www.economist.com/node/15869464> (accessed October 28, 2012); The Economist (K.M.), “State capture,” *The Economist*, November 2, 2011, <http://www.economist.com/blogs/easternapproaches/2011/11/czech-politics> (accessed October 28, 2012).

right-wing ODS took power. The rest of the center-right was bickering over personal issues and its own corruption scandal. Thus government effectively did not have functioning oversight of the political opposition.

The positive lesson from Czech Republic is the sequencing of transformation, which in the initial phase took security-enhancing turn with first diversifying the supplies, supply-routes as well as suppliers. This triple-diversification increased energy security of the country for all future governments. The rapid privatization on the other hand created corruption opportunities, and removed the possibility for the government to assume real responsibility over energy security in the privatized sectors. As a consequence government is left only with regulation, which unfortunately, as we witnessed recently, can be easily captured by those who are to be regulated, and can be a tool of ruling political elites for implementing other priorities than just Pareto-optimal welfare, or increase in energy security.

The more recent developments of Czech Republic, despite the threat of state-capture point towards an example of country which is relatively well covered in the present but does not ignore the possible future security threat. In the recent history Czech Republic, much better positioned in terms of its own energy needs than either Slovakia or Hungary, does not ignore the possible deterioration of its energy security status. Czech Republic has taken active role in reflecting new developments and new realities. These include building of an alternative gas interconnector Gazelle between the undersea Nord stream pipeline (via OPAL) and southern flank of Germany thus maintaining the level of transit through the country even in case should the pipeline through Ukraine and Slovakia cease to be used for transit. The voices from Russia like to remind, might be the case, and in the pipeline for the near future.

## Chapter 5. SLOVAK REPUBLIC

Slovak Republic was, and still remains, one of the most vulnerable countries in Europe in terms of its energy security. The fact that none of its governments have done much to change this situation and prioritize security in their energy policies is puzzling, and interesting as an example to study. The cost of energy security negligence became particularly apparent during 2009 Russia-Ukraine crisis, when Slovakia was one of the most effected countries in Europe. According to multiple available sources overall Slovak economy was losing EUR 100 million a day (1 billion EUR in the whole duration of the crisis).<sup>389</sup> The gas cut related recession was believed to have caused 1-1.5% decrease in GDP growth,<sup>390</sup> national tax revenues in January 2009 dropped by 40%.<sup>391</sup> Some companies, as part of their contingency plans in the response to the energy crisis were preparing to relocate parts of their production to different countries.

How was it possible for a country to end up in a dire situation like this? The path taken, and choices made by successive Slovak governments illustrate a number of mistakes and lack of prioritization, bordering general negligence of security in the energy policy. This created situation where even basic security prioritizing policies were subsequently much more challenging to implement, if not outright preempted by the preceding negligence.

After the 1993, when Slovak Republic entered history as an independent state, serious and complex discussion of energy policy within the country was missing, or at best was inadequate. Importance of energy sector was implicitly understood, as the energy companies were included in the so-called law on strategic assets.<sup>392</sup> This law listed specific companies from almost all industrial sectors of strategic interest, energy companies were listed in the first paragraph. Inventory included in this law was more of a knee-jerk list of potentially profitable companies

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<sup>389</sup> Duleba, "Poučenia z plynovej krízy v januári 2009: Analýza príčin vzniku, pravdepodobnosti opakovania a návrhy opatrení na zvýšenie energetickej bezpečnosti SR v oblasti dodávok zemného plynu."

<sup>390</sup> Poláková, "PLYN: Počiatok: Plynová kríza bude mať na ekonomiku SR dopad v rozpätí 1-1,5 % HDP."

<sup>391</sup> Due to both the gas crisis and the economic recession which was just starting. ČTK, "Ekonomická a plynová kríza znížili príjmy štátu o 40 percent!"; ČTK, "Podniky ešte nevyčíslili škody z plynovej krízy - Pravda.sk."

<sup>392</sup> "Zákon č. 192/1995 Z.z. o zabezpečení záujmov štátu pri privatizácii strategicky dôležitých podnikov.", 1995, <http://www.zbierka.sk/sk/predpisy/192-1995-z-z.p-3305.pdf> (accessed November 2, 2012).

without much strategic thinking. Since country lacked any vision of energy policy or legislation, this excluded energy companies from privatization by default, but the absence of strategic reasoning, and vested interests provided for a number of notable exceptions, which I discuss in detail.

The discussion about the state energy concept existed already from the late 1992 and early 1993, the first discussions of energy *policy* started only in the ‘second’ policy cycle in 1995, resulting in the first high-level mentioning of energy strategy in the fall 1997, four years into the existence of Slovak Republic. This was much later than in cases of both Czech Republic and Hungary. It is only then that the government noted the updated “energy concept” and tasked ministry of economy to produce an “energy strategy.”<sup>393</sup> By then nonetheless, strategic parts of the energy assets were effectively already out of government’s control under the influence of political cronies. The discussions about the energy legislation were seen more of a technical matter than an issue of politics, and the prioritization of security did not enter into the policy discussions at that time in Slovakia, unlike in Czech Republic.

Mečiar’s first government was overly focused on the ‘state-building.’ The primary energy-*relevant* discussion was consumed by the finishing of the hydroelectric power plant (HPP) on Danube – the Gabčíkovo (-Nagymaros) cascade. While having significant energy policy effects, this was handled and promoted more as a “nation-building” or “national-emancipation” project, than energy security project. Additionally, questions around building of the nuclear power plant (NPP) Mochovce emerged. The construction of Gabčíkovo HPP was surrounded by international dispute with Hungary.<sup>394</sup> Construction of Mochovce was suspended due to the lack

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<sup>393</sup> From the wording of the government resolution, it is clear that this step is only one of the necessary conditions in order to fulfill the convergence of national policies with the EU policies, as a part of general accession negotiations. Government of Slovak Republic, *Uznesenie 684/1997 k návrhu aktualizovanej energetickej koncepcie pre Slovenskú republiku do roku 2005*, 1997, [http://www.vlada.gov.sk/uznesenia/1997/0930/uz\\_0684\\_1997.html](http://www.vlada.gov.sk/uznesenia/1997/0930/uz_0684_1997.html) (accessed October 30, 2012)..

<sup>394</sup> In Slovakia, also due to ongoing state-building, finishing of the Gabčíkovo HPP was seen as a major state-building act, while in Hungary stopping of this large-scale ‘megalomaniac’ construction was seen as a part of

of resources in early nineties, and only resumed in 1995. Country applied for loans from EBRD, but there were discussions of financing and finishing of the NPP from French, Russian, and Czech companies. Slovak political elite's preference was for Czech or Russian companies.

While Czech Republic during this time heavily invested into real (and expensive) diversification of oil (1995), gas (1997), as well as nuclear fuel supplies (1996). Slovak political elite was focusing on promotion of 'Carpathian democracy.' This was illustrated by continuous political backwardness, abusing of state intelligence services for political aims,<sup>395</sup> privatization of strategic gas storage capacity,<sup>396</sup> and creation of common Russian-Slovak Devín Bank, as well as gas-trading middle-man company, SloVrusGas to exploit the self-perceived 'privileged' position of Slovakia, as a bridge between Europe and Russia<sup>397</sup> and its 'good relations.'<sup>398</sup> This perception was accompanied by dividing of the national economy among the party cronies, without positive impact on the energy policy of the country and any prioritization of security in it.

The unusually cordial relations between Slovakia and Russia can be traced not only through the numerous high level state visits, but also the highest number of bilateral treaties among the neighbors, which were much higher than either Hungary or Czech Republic.<sup>399</sup> The extent of personal relations especially among the ex-communist SDĽ and various Russian businessmen can be seen in the co-ownership of many companies set-up by people around SDĽ.<sup>400</sup>

During the last months of Mečiar's rule, just before the elections not only that Yeltsin publicly supported<sup>401</sup> Mečiar during his two day official visit to Moscow in May 1998 before the elections.

SloVrusGas a middle-man gas trading company was established just few months before, in

democratization and transitioning towards civic-dialogue based society. These two different perspectives were at the heart of the conflict and tainted the impossibility of reaching a common agreement.

<sup>395</sup> "Správa V. Mitra o plnení úloh SIS," *SME*, n.d., <http://www.sme.sk/c/2179771/sprava-v-mitra-o-plneni-uloh-sis.html> (accessed October 31, 2012).

<sup>396</sup> Slovakia has uniquely privatized the storage *before* the high-pressure transmission. (C.f. Gottweisová, 1998).

<sup>397</sup> Alexander Duleba, "Pursuing an Eastern Agenda," *Transition2 (19)* (1996): 52–55.

<sup>398</sup> Michael Smith, "Ruské spravodajské hry studenej vojny [Russian Cold War Intelligence Games]," *Ejze Špy Magazine*, no. 27 (August 12, 2004), Accessed via Slovak version: <http://www.sis.gov.sk/materials/nazory/n14.html> (accessed June 21, 2009).

<sup>399</sup> Visual comparison is provided in Chart 27 and Chart 28.

<sup>400</sup> Ministerstvo Spravodlivosti Slovenskej Republiky, "Obchodný register SR na Internete", n.d., <http://www.orst.sk/> (accessed November 4, 2012).

<sup>401</sup> Jeffrey Simon, *NATO and the Czech and Slovak Republics: A Comparative Study in Civil-Military Relations* (Rowman & Littlefield, 2004), 173.

March 1998, but the company could never assume role equivalent to Hungarian Panrusgáz as Mečiar's rule was over already in September 1998. Despite the reorientation of the country towards the West in the period after 1998, the particular interests of part of the ruling elites did not correspond with the policy aims of improving or prioritizing security in the energy policy. SDE a junior partner in Dzurinda's governing coalition still went on to capitalize on Russian link through Soviet-era debt recovery using a web of companies around Devín Bank and party influence at the Slovak Electricity Company.<sup>402</sup>

In the first phase of the transition, people connected with the communist party and allegedly also the security apparatus maintained effective control over the Slovak parliament and the government.<sup>403</sup> The high share of people connected with the communist-era secret service is also visible in Chart 94 and Chart 95: in Mečiar's first government ten people were recorded in the secret service's database as having allegedly collaborated into different extents, four recognizably collaborating knowingly. This difference vis-à-vis Czech Republic was also visible in the continuity of communist ruling elites in the high ranks of government and parliament which was preserved in Slovakia, unlike in Czech Republic until the first elections. The higher tolerance for former communist-era officials in Slovakia was visible in all walks of life, from politics, judiciary, culture even in higher education. The cases when those that could not participate in public life in Czech Republic because of their communist past, moved to Slovakia to continue their public careers, were not rare.

Only for a short interim period, when a technocratic government of Jozef Moravčík was in charge, attempts at more reasoned energy policies taking account of security as well, could be detected. Mečiar's governments which were in power since the first free elections until 1998

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<sup>402</sup> SME (dd), "Devín banka sa má k deblokáciám ruského dlhu dostať vďaka stykom so špičkami SDE," *SME*, Autumn 1999, <http://www.sme.sk/c/2181599/devin-banka-sa-ma-k-deblokaciám-ruskeho-dlhu-dostat-vdaka-stykom-so-spickami-sdl.html> (accessed May 20, 2013).

<sup>403</sup> Ondruš, *Atentát na neznú revolúciu*.

(except for the two periods in 1991/1992<sup>404</sup> and 1994<sup>405</sup> when technocratic governments were ruling) were more interested in wild “help yourselfisation”<sup>406</sup> a cash-stripping wild “privatization,” rather than energy policy reflecting public interest, security, or country’s other policy needs. The priority that was detectable was that of supporting the companies, but not for public interests or their higher international competitiveness, but to enable cash stripping and rent seeking.

After the very wide coalition of anti-Mečiar forces led by Dzurinda ousted Mečiar and reoriented the country towards EU and NATO, relations with Russia cooled somewhat. Dzurinda was an acknowledged “Euro-Atlanticist,” and the aim of his government was to explicitly steer country towards EU and NATO membership. Nonetheless, he had a problem in the government. Dzurinda had to tolerate the junior coalition partner, an ex-communist SDĽ, with its personal and business ties to Russia. Minister of justice and then chairman of senior coalition party Christian-Democratic KDH, Ján Čarnogurský, is also known as devoted and often uncritical Russophile.<sup>407</sup>

Effects of these ties were most visible perhaps through Devín Bank and its main shareholder Apis, which combined support of ex-communist SDĽ, but also of Christian Democrat Čarnogurský.<sup>408</sup> In the context of these internal challenges, Dzurinda’s government pushed through major energy legislation, as well as 50-less-1% privatization of the “strategic” energy assets. The outcomes of privatization during Dzurinda’s government nonetheless were mixed. On one hand it provided foreign know-how and improvement in the management of these companies, on the other it solidified the situation without any diversification.

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<sup>404</sup> 1991.05-1992.06 Ján Čarnogurský’s government

<sup>405</sup> 1994.03-1994.12 Jozef Moravčík’s government

<sup>406</sup> Cervenáková, Niznanský, and Reptová, *From common to private*.

<sup>407</sup> Veronika Prušová, “Čarnogurský by ruské pankáčky trestal prísnejšie,” *SME*, 8 2012, <http://www.sme.sk/c/6508167/carnogursky-by-ruske-pankacky-trestal-prisnejšie.html> (accessed May 20, 2013).

<sup>408</sup> *SME* (rek, rk), “Na oslavách v Moskve bol aj Čarnogurský,” *SME*, May 11, 2005, <http://www.sme.sk/c/2212993/na-oslavach-v-moskve-bol-aj-carnogursky.html> (accessed March 7, 2013).

Situation did not change during Dzurinda's second government, neither when it was replaced by ex-communist SMER.<sup>409</sup> Moreover, when first SMER government announced the personnel nominations to governance structures of major energy companies (Transpetrol in particular)<sup>410</sup> some of these political nominations seemed like *Déjà vu* from Mečiar era. The policy and political choices that SMER as a successor of the post-communist SDĽ, and heir of Mečiar's economic supporters made, reaffirm argument of ex-communist political parties in Central and Eastern Europe preferring closer connections with Russia and not prioritizing security in their energy policy. Especially if prioritizing security in the energy policy means decreasing dependence from Russia, and increasing international competitiveness.

### **5.1. Choice of Transitional Justice Policies**

While Slovakia inherited the functional lustration law from the Czechoslovak Federation, after the federation split, the law was not applied. The main reason was that the political leadership of the newly created Slovak Republic themselves would not have passed the lustration process, had it been done properly, as was the case in Czech Republic. At the time Prime Minister Mečiar was recorded in the secret service archives as a candidate for undercover collaboration under the code name 'The Doctor'.<sup>411</sup> The records that testified this were "lost" after Mečiar in January 27, 1990 in his capacity of interior minister personally ordered officers directly reporting to him to deliver records from the secret service archive (Tiso's villa in Trenčín).

This happened in late night hours under bizarre conditions that were revealed in April 1991 by the parliamentary Committee on Defense and Security. While this case should have been a reason for criminal prosecution, the federal general prosecutor Ivan Gašparovič, close associate

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<sup>409</sup> SMER absorbed SDĽ and parts of HZDS and took over its financial supporters, it rebranded to SMER-SD.

<sup>410</sup> Tom Nicholson, "Transpetrol nominations are outrageous - The Slovak Spectator," *The Slovak Spectator*, November 27, 2006, <http://spectator.sme.sk/articles/view/25248/11/> (accessed November 2, 2012).

<sup>411</sup> Lesná, "Missing secret service files reconstructed."

of Mečiar<sup>412</sup> at the time, did not act. Not only for these reasons but also for general incompetence, inaction and lack of independence federal president Havel dismissed him.

The “lost” files were restored only 17 years later,<sup>413</sup> thanks to the fact that much of the missing files were kept in copy in Prague’s secret service archives. Mečiar as minister and subsequently as a prime minister of Slovakia had no access or possibility to destroy files stored in a different country. Mečiar has also promoted individuals that have allegedly been his secret service handlers and contacts. These people were also protected in their positions as long as Mečiar remained in power. The fact that the Slovak secret service during Mečiar era was staffed by former regime exponents with links to former Soviet officials, serving Mečiar, was one of the reasons that Slovakia was excluded from European intelligence network (MEC).<sup>414</sup>

This vivid case, and the fact that first government without previous members of communist party was formed in Slovakia only in 2010, and only for a brief period, illustrates the context in which any idea of transitional justice or lustration could not have received much traction in Slovakia. The first public attempts at reopening the topic started at the end of first Dzurinda’s center-right government (which was a coalition government with SDE – the direct successor of the communist party). Nonetheless, except for the personal initiative of Christian-democratic minister of interior Čarnogurský to create Department for the Documentation of the Crimes of Communism at his ministry, there was no real progress until 2002.

In 2002<sup>415</sup> The Nation’s Memory Institute (Ústav pamäti národa) was set-up with the explicit aim to disclose activities of State Security Authorities during the period of 1939 – 1989. This had no legal implication on the possibility of former secret service personnel to participate on public life.<sup>416</sup> Given that the transparency came more than a decade after the start of the transition this

<sup>412</sup> “FS ČSFR 1990-1992, SL a SN, 20. schůze, část 133/135 (19. 2. 1992)”, February 19, 1992, <http://www.psp.cz/eknih/1990fs/slsn/stenprot/020schuz/s020133.htm> (accessed October 30, 2012).

<sup>413</sup> ÚPN, “Strana: 25, KS ZNB - Správa ŠtB Bratislava (Séria: II)”, n.d., <http://www.upn.gov.sk/regpro/zobraz.php?typ=kraj&kniha=81&strana=25&zaznam=90716> (accessed May 20, 2013).

<sup>414</sup> Smith, “Ruské spravodajské hry studenej vojny [Russian Cold War Intelligence Games].”

<sup>415</sup> By the Act of the National Council of the Slovak Republic No. 553/2002 Coll.

<sup>416</sup> With the exception of offices and jobs requiring security clearance.

can be seen as an example of delayed and inconsequential transitional justice. This policy has not prevented people with privileged access to both information and material resources from pursuing their private economic interests and influencing public policies including in the energy sector at the cost of public interests.

While we could see on Czech case, that business links to politics form even when there are strict vetting laws, the former communist elites-turn-businesspeople had significant time advantage in Slovakia and the fact that they had knowledge of and connections in Russia influenced their “choice of corruptors.” The former security to business-cum-politics nexus is visible in Slovakia in multiple examples” Juraj Široký alleged chief of the Czechoslovak communist-era secret service’s resident office in Washington<sup>417</sup> and his close associates Branislav Králik, Josef Poštulka or Ľubomír Jahnátek,<sup>418</sup> with whom he cooperated in chemical companies Plastika and Chemolak, as well as the in the “Harvard funds”<sup>419</sup> together with the internationally wanted Viktor Kožený.<sup>420</sup>

Another example is of General Alojz Lorenc, who was the last commanding officer of the communist-era secret service and was in charge of shredding of the vast amount of information when the “Velvet” revolution in Czechoslovakia started. Lorenc was sentenced to four years in Czech Republic during Czechoslovakia, but since the country fell apart, and he escaped to Slovakia he successfully avoided prison.<sup>421</sup> In Slovakia he was hired by one of the largest financial groups Penta Group, to serve as chief security officer. Penta which later on went to privatize important industrial sectors including energy and healthcare, was allegedly established with help

<sup>417</sup> Marek Vagovič, “Široký chcel byť tajným aj po revolúcii,” *SME*, June 27, 2007,

<http://www.sme.sk/c/3367764/siroky-chcel-byt-tajnym-aj-po-revolucii.html> (accessed March 8, 2013).

<sup>418</sup> Tom Nicholson, “The spy who prospered - The Slovak Spectator,” *The Slovak Spectator*, November 30, 2009, [http://spectator.sme.sk/articles/view/37237/2/the\\_spy\\_who\\_prospered.html](http://spectator.sme.sk/articles/view/37237/2/the_spy_who_prospered.html) (accessed March 8, 2013).

<sup>419</sup> Privatization deal which amounted to a financial scam of gigantic proportions

<sup>420</sup> Tom Nicholson, “Širokého eštabáci neopustili,” *SME*, 11 2009, <http://www.sme.sk/c/5121686/sirokeho-estebaci-neopustili.html> (accessed November 2, 2012).

<sup>421</sup> ČTK, “Poslední šéf StB zůstane na svobodě,” April 24, 2002, [http://zpravy.idnes.cz/posledni-sef-stb-zustane-na-svobode-d6b-/zahranicni.aspx?c=A001218\\_092324\\_zahranicni\\_mhk](http://zpravy.idnes.cz/posledni-sef-stb-zustane-na-svobode-d6b-/zahranicni.aspx?c=A001218_092324_zahranicni_mhk) (accessed November 2, 2012).

of Vladimír Lexa senior,<sup>422</sup> Deputy Prime Minister of Czechoslovakia in 1989-90 and the last head of Communist-era Economic Planning Commission – a person with vast knowledge of assets in the country and the state of the economy before the transition.

The founding partners of Penta group studied during communist era in Moscow, and became wealthy during Mečiar's era when they were “allowed” to take control over one of the financial funds for a fraction of its market value.<sup>423</sup> When Penta tried to enter privatization of largest Polish arms manufacturer PZL Świdnik, the Polish national security office chair Aleksander Szczygło issued a warning about Penta's connections with Russian secret services.<sup>424</sup>

## **5.2. Timing and Sequencing of Privatization**

The timing and sequencing of privatization of energy assets and development of the diversified infrastructure is of paramount importance. As I demonstrated on the case of Czech Republic, achieving supply security as a public good is possible when the government considers diversification its priority and it is readily achievable when the energy assets are directly owned by the state, or state is able to provide guarantees or other means of support.

The timing and sequencing of privatization in Slovakia was peculiar, it happened before any diversification plans were put in place or even properly discussed. Additionally, the first asset of the energy system which was sold-off was one which made the least sense from the perspective of both the transformation, as well as economic benefit – the most profitable asset – the underground gas storage. This fact illustrates the logic of transformation and the policy choices that Slovak political elites made. The way how the transformation of state ownership happened

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<sup>422</sup> Tom Nicholson, “Penta and Lexa Sr: Mutual business is past,” *The Slovak Spectator*, August 26, 2002, <http://spectator.sme.sk/articles/view/10245/3/> (accessed November 2, 2012).

<sup>423</sup> Bruno Schönfelder, “Courts, credit and debt collection in post-communist Slovakia: Notes about some understudied ingredients of a successful transition,” *Economic annals* 50, no. 167 (2005): 7–53.

<sup>424</sup> Magdalena Božko, “Chętni do kupna PZL: Nic nas nie łączy z rosyjskimi specsluźbami,” *Strefa Biznesu*, August 12, 2009, <http://www.strefabiznesu.dziennikwschodni.pl/artykul/chetni-do-kupna-pzl-nic-nas-nie-laczy-z-rosyjskimi-specsluzbami-19161.html> (accessed November 2, 2012); Piotr Mazurkiewicz, “Skąd Penta ma pieniądze?,” *Ekonomia24.pl*, August 22, 2009, <http://www.ekonomia24.pl/artykul/352311.html> (accessed November 2, 2012).

in Slovakia after the split of the federation affected the transformation of the energy sector and the available choices of policies.

Mečiar's nationalist-populist government stopped the planned second wave of voucher privatization (which went ahead in Czech Republic according to the same laws from the federation) when they came to power just two days before it was supposed to start.<sup>425</sup> The privatization de-facto stopped. Instead of issued vouchers turning into stocks, as was the case in Czech Republic, in 1996 the registered vouchers were transformed into state bonds which were repayable during 2001 by the National Property Fund. This created possibility for Mečiar to go on a giving spree of various companies and industries to his political cronies, whether with or without actual ownership title change. In addition to the bond liability, Mečiar's direct "privatization" to his friends ruined large number of companies and banks, which were handing out loans to "privatize" or support industries based on political ties and friendships not assessment of economic viability.

Many private investors felt "cheated" after the promised voucher method changed into promise of bonds and thus changed the whole rules of the game. As a consequence, many of them sold-off their bonds before their maturity at large discount,<sup>426</sup> enabling small groups of predatory investors (often with privileged access to banks which came with political connection) to collect these bonds at large discounts and buy assets from state in exchange for the bonds (which were accepted at their nominal value by the National Property Fund).

When Dzurinda's government got into power in 1998, they were forced to sell number of assets, both in order to be able to repay approximately one billion EUR worth of bonds to the individual bond holders, as well as to finance the economic reforms and consolidate the banks which were in complete state of disarray also because of Mečiar era's non-performing loans. This

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<sup>425</sup> "Privatizáciu vystriedalo odškodnenie občanov, kupóny sa zmenili na dlhopisy | Slovensko | Ekonomika | eTREND", n.d., <http://ekonomika.etrend.sk/ekonomika-slovensko/privatizaciu-vystriedalo-odskodnenie-obcanov-kupony-sa-zmenili-na-dlhopisy.html> (accessed March 17, 2012).

<sup>426</sup> Although there was a legal limit of about 75% of nominal value, in the crisis of confidence, people sometimes exchanged them for a microwave oven or a TV set.

was one of the reasons for a massive wave of privatization that took place during Dzurinda's government, and which was mostly considering maximization of financial income, and not aims of energy security, as its highest priority.

### **5.3. Mečiar's Eastern Nationalism (1993-1998)**

The examples of missing prioritization of security on the energy policy can be illustrated on the early-Mečiar era privatizations in the energy sector, which were only partially approximated by the socialist Czech and Hungarian governments. Mečiar privatized selectively, maintaining control of nominally state owned companies through politically divided control and nominations. This management was visible in case of gas industry, where a number of “bianco bills” signed by Mečiar-era chairman of SPP emerged, connected with allegations of organized crime reaching to the highest echelons of political power,<sup>427</sup> as well as the fact that the company was economically underperforming.

What followed once second government of Vladimir Mečiar came to power in December 1994 was what IEA experts called “privatization to a selected few,”<sup>428</sup> and others “help yourselfisation.”<sup>429</sup> First, Mečiar stopped majority of the privatization which was already ongoing, on the basis of submitted investment and privatization projects of the previous government, only to later on speed up the distribution of spoils to his loyalists. The political cronyism went so far so as to even change the tax code that the Mečiar's privatizers would not have to pay taxes off of the “gifts” they received from the government.<sup>430</sup>

The fact that this privatization was not a policy tool for transformation and pursuing national interest can be exemplified by a number of cases of clear political privatization of energy assets

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<sup>427</sup> “SPP Wins Another Ducky Bill Case,” *The Daily Slovakia*, August 25, 2011, <http://www.thedaily.sk/spp-wins-another-ducky-bill-case/> (accessed November 1, 2012).

<sup>428</sup> International Energy Agency, *Energy Policies of the Slovak Republic 1997 Survey* (Organization for Economic Co-operation and Development (OECD), 1997).

<sup>429</sup> Cervenáková, Niznanský, and Reptová, *From common to private*.

<sup>430</sup> Anton Marcinčin, “Manažéri a politici: model slovenskej privatizácie,” *Finance a úver* 47, no. 11 (1997), [http://journal.fsv.cuni.cz/storage/2843\\_199711am.pdf](http://journal.fsv.cuni.cz/storage/2843_199711am.pdf) (accessed November 2, 2012).

which happened during Mečiar's rule. The interesting peculiarity of Slovakia is timing and sequencing of privatization: It happened before any diversification plans were put in place, before any regulatory framework was put in place, or even regulatory body established.

In the light of the self-perception of importance and irreplaceability of Slovakia as transit to Western Europe, as well as recognized risk of threatening relations with Russia, Slovak Republic did not dare to pursue any real diversification. In addition to the building of the Gabčíkovo cascade, two important developments which stand out as examples during Mečiar's rule should be mentioned: Privatization of gas storage system and privatization of Slovnaft refinery.

The transformation of gas and oil industry in Slovakia started as part of the federal process, but subsequently it continued in a quite haphazard way lacking overall strategy.<sup>431</sup> The privatization of energy assets in Slovakia started with the gas storage. Not only that privatization of this company made no sense from the energy policy view, it made no sense from the economics point of view either. It was a case of clear political privatization of energy assets. The 45.9% of gas storage and oil mining company NAFTA shares were acquired by previously unknown company owned by Vladimír Poór from Mečiar's circles in 1996, for only a one sixth of the estimated value. President of the National Property Fund during Mečiar's government Štefan Gavorník in an interview described details of the privatization of NAFTA. "If Mečiar attacks Gašparovič on account that he managed privatization, it is otherwise. All of us who were sitting there [special "privatization" coalition meetings], we lobbied on behalf of those who came to us.

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<sup>431</sup> Similarly to Czech Republic, Slovak gas sector was also vertically integrated into Slovak Gas Industry (SPP) after joining the transit part from the split Federal state company Tranzitný plynovod, s.p. and the other assets of the state combine Naftový a plynárenský priemysel. Throughout the initial transformation Slovak gas sector was vertically integrated in Slovak Gas Industry (SPP) and oil sector in Transpetrol. The operation of underground gas storage was split from this state concern and managed by state company NAFTA Gbely. Already in April 1992, during the center-right government of Ján Čarnogurský and while Ivan Mikloš was minister of privatization, this state company was transformed into (state owned) shareholder's company. Just few days after this transformation, a new shareholder's company POZAGAS, a.s. was created as a joint venture of two state companies SPP and NAFTA to develop and build new 4th Underground Gas Storage (UGGS) at Láb close to Austrian border and an important gas trading hub at Baumgarten. In September 1994, during the caretaker center-right leaning government of Jozef Moravčík, French company GdF acquired 30% of shares in Pozagas. The rationale for this green-field FDI was mainly to provide know-how and financing of brand new facility and participate on this long-term investment with the possibility of serving western European market through Austria's gas hub in Baumgarten close to Vienna.

Gašparovič did the same. He was also involved in the discussions. There was a list of what, where goes to whom. About some items [to be privatized] there was discussion, about some there was none because it was clear [to whom they should be privatized].<sup>432</sup>

NAFTA was the fourth most profitable enterprise in Slovakia, and it was also subject to special regime based on the Strategic Enterprises Act of September 1995. The 45.9% of shares had estimated value of three billion SKK (\$97m), according to media information, the company had unpaid dividends worth of SKK 1.075 billion (\$35m) which was more than twice the selling price of SKK 500 million (\$16m).<sup>433</sup> Offers from international companies were ignored, and the privatizing company - previously unknown “Druhá obchodná”<sup>434</sup> was allowed to pay the price in installments, with first one due within 30 days and the remaining within next 10 years. A year later it became known that owner of Druhá obchodná is Vladimír Poór, regional chair of Mečiar’s HZDS in Trnava,<sup>435</sup> nonetheless it was believed that he was just a front-man for one of the HZDS top leaders.<sup>436</sup> After the elections in 1998, when pro-reform government took over the country, this purchase was reverted and the shares were returned to the state and SPP in 2000.

### 5.3.1. Devín Bank

Similarly to Hungary, as I discuss later, in Slovakia a banking institution for facilitating “trade” relations with Russia and post-soviet space was chosen. This institution was Devín Bank in Slovakia.<sup>437</sup> Devín Bank was established in 1992 by three labor unions, Slovak union of

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<sup>432</sup> Roland Kyška and Štefan Gavorník, “Prehovoril!,” *Plus 7 dní*, April 24, 2009, <http://www.pluska.sk/plus7dni/rozhovor/prehovoril.html> (accessed November 1, 2012).

<sup>433</sup> Ibid.

<sup>434</sup> In English the name means “Second trading”

<sup>435</sup> SME (rf), “Kauza Nafta Gbely,” *SME*, 6 1999, <http://www.sme.sk/c/2193013/kauza-nafta-gbely.html> (accessed November 1, 2012).

<sup>436</sup> Kyška and Gavorník, “Prehovoril!”

<sup>437</sup> Alexander Duleba, “From Domination to Partnership: The Perspectives of Russian–Central–East European Relations,” *Final Report to the NATO Research Fellowship Program 1998* (1996): 93, [www.nato.int/acad/fellow/96-98/duleba.pdf](http://www.nato.int/acad/fellow/96-98/duleba.pdf).

cooperatives<sup>438</sup> and Slovenská poisťovňa, an insurance company. In 1995 it was headed by Karol Martinka, well-connected HZDS figure,<sup>439</sup> and former trade representative of communist Czechoslovakia in Austria. This was also the time when Devín Bank started “deblocking” the Soviet-era debt from Russia.

“Deblocking” as it was referred to, was recovery and settling of debts from the COMECON era before 1989. This was tremendously lucrative business, as debts were recovered at below nominal rates and commissions of 20-30% were charged on the recovered debt from the Slovak government. In case of Devín Bank this was even more lucrative as the Bank besides “recovering” the debt charged commission also on handling the debt which was repaid on basis of intergovernmental agreement, and thus without any value added from the Bank.<sup>440</sup> Devín Bank was 31.8% owned by Moscow based Mezhdunarodnaya Finantsovaya Kompanya (International Finance Company – MFK<sup>441</sup>), another Russian company Energija (allegedly associated with people around Viktor Chernomyrdin, former head of Gazprom and prime-minister),<sup>442</sup> and Slovak company Apis owned by people around SDL.<sup>443</sup>

Unsurprisingly, even after the change of government, when Mečiar’s government was replaced by a wide coalition including SDL, Devín Bank without any competition received license to continue recovering soviet era debt. Štefan Košován, associated with SDL, Devín Bank, and Apis company was at the same time executive director of Slovak Electricity Company and on behalf of this state company signed contracts for soviet-era debt recovery to exchange energy-use coal from Russian companies, as well as contracts for used nuclear fuel. Both of these were

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<sup>438</sup> Slovenský zväz výrobných družstiev

<sup>439</sup> His wife Blažena was seen close to Vladimír Mečiar and was his advisor and assistant.

<sup>440</sup> In 1997 Martinka vacated the post as he went off to privatize one of the most important spas in Slovakia – Piešťany.

<sup>441</sup> MFK was created out of the ashes of the former clearing bank for COMECON.

<sup>442</sup> Tom Nicholson, “Getting a green card is no laughing matter in Slovakia,” *The Slovak Spectator*, May 22, 1997, <http://spectator.sme.sk/articles/view/8145/1/> (accessed November 3, 2012).

<sup>443</sup> Sergei Georgievich Gorodkov chairman of the shareholders general assembly pushed through a decision to instate Ľubomír Kanis associated with SDL (and Apis) as the bank’s executive director and another SDL person Štefan Košován (also Apis) as the chair of the supervisory board Marián Leško, “Ako politici zmenili banku na Devín banku,” *SME*, September 3, 2001, <http://www.sme.sk/c/104190/ako-politici-zmenili-banku-na-devin-banku.html> (accessed November 3, 2012).

extremely beneficial for Russian companies<sup>444</sup> and Devín Bank, but not so beneficial for Slovakia or for the state owned electricity company.

The second example of “help yourselfisation” comes from the petrochemical sector.<sup>445</sup> The largest refinery in Slovakia – Slovnaft in Bratislava was privatized in a way which was unduly beneficial to the new owners, but not for the state. The story is similar to the previously discussed privatization of NAFTA. It is yet another example of privatization to the selected, and well-connected individuals and illustrates the lack of “public” policy in the decision.

In August 1995 National Property Fund’s Board, government body in charge of exercising ownership rights, and institution fully politically accountable to the government, decided to sell 39% stake in Slovnaft in favor of a company set-up by Slovnaft managers – Slovintegra and Slovvena.<sup>446</sup> The nominal price was 6.4 billion Slovak crowns (\$220m), nonetheless the contract included a number of provisions which in reality lowered the price to somewhere around 15% of real value. One condition was that Slovnaft itself (not the new investors) had to invest several billions SKK. This lowered the price by three billion SKK, additional condition was on maintaining and increasing the level of profits (these were expected to increase anyways) which was to cut the price by another 2.4 billion SKK (\$83m).

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<sup>444</sup> Miloš Žiak, “Trojský kôň ruských záujmov K zrodu Devín banky (3)”, April 3, 1997, <http://www.sme.sk/c/2070014/trojsky-kon-ruskych-zaujmov-k-zrodu-devin-banky-3.html> (accessed April 7, 2012).

<sup>445</sup> The petrochemical sector in Slovakia consists of Slovnaft – combining refinery and petrochemical plant, a smaller refinery in Dubová and a number of other chemical companies which are not directly connected to the olefins related industry. Petrochemical industry directly connected to the value chain of refining in Slovakia exists only in Slovnaft, unlike Czech Republic or Hungary where the connected petrochemicals existed also in form of separate companies. Other chemical industry represented by NChZ in Nováky, Duslo Šaľa and Istrochem in Bratislava do not form direct strategic link as is in the case of Hungary. They are nonetheless interesting from the perspective of strategic energy consumer and important exporter of goods. These companies had privileged energy supplies for lower than usual prices, and were given under control of groups tied with political leadership. The one cross-border link worth noting is that Duslo and Istrochem ended-up in Agrofert holding of Andrej Babiš (owner of large chemical industry assets in Czech Republic). It is interesting to note that before the transition Duslo was shareholder of one of the few international trade corporations in Czechoslovakia – Petrimex, where Mr. Babiš worked, and allegedly thanks to know-how from this company he built his empire. (Vladimír Bačišin, “RETRO: Duslo Šaľa získala firma Prezam”, August 23, 2005, <http://hnonline.sk/c1-22648145-retro-duslo-sala-ziskala-firma-prezam> (accessed March 29, 2012).)

<sup>446</sup> Slovvena initially company for ordinary rank-and-file employees was liquidated in 2006 after most of the payments from sale of Slovnaft went to Slovintegra. Both companies were effectively controlled by Slavomír Hatina of Slovintegra. Obchodný Register SR, “Výpis z obchodného registra SR - SLOVBENA, a.s. v likvidácii”, 2012, <http://orsr.sk/vypis.asp?ID=21105&SID=2&P=1> (accessed November 1, 2012).

Thus the real price that Slovintegra had to pay was only one billion SKK (\$34m). Additionally, this sum was to be paid in 10 annual installments, with the first installment (covered by a loan from Poľnobanka)<sup>447</sup> due one month after the sale and all subsequent installments due annually (no interest was levied on these postponed installments) with the second one due only the year after the sale in 1997. This way Slovintegra could use dividends from the purchased shares to pay both the loan to the bank (the first year), as well as to the National Property Fund each year, without having to spend any funds of their own.

Slovintegra subsequently increased its share, and in 2002 it swapped shares with Hungarian MOL, cashing in about SKK 3.3 billion (\$83m) for the transaction.<sup>448</sup> The involvement of Slovintegra in Central European refining business ended in December 2005 when it sold all of its MOL shares to BNP Paribas bank and MOL (as treasury shares). Slovintegra received additional SKK 8.7 billion for this transaction (\$280m).<sup>449</sup> This was also the year when Slovintegra paid the last installment to the Slovak Government for the purchase ten years ago.

The smaller refinery Petrochema in Dubová was also privatized by its management<sup>450</sup> in October 1995, its significance was rather in being connected with economic inefficiency and organized crime, as its managers were implicated in a petrol bleaching case.<sup>451</sup> The trans-border dimension of this I already mentioned in Czech Republic chapter in connection with Chemapol. The connections of the criminal activities to the political elites were alleged, but the evidence was hard to corroborate unlike in Czech case of Chemapol. Since this refinery was not connected to the transit or import pipeline and had to rely solely on rail transport, its economic prospects in light of decreasing refining margins across Europe were limited. The start of the end of this small

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<sup>447</sup> Cervenáková, Niznanský, and Reptová, *From common to private*, 136.

<sup>448</sup> Martin Jesný, “Čo robia milióny za Slovnaft | Týždenník TREND | eTREND”, October 11, 2010, <http://www.etrend.sk/trend-archiv/rok-2010/cislo-45/co-robia-miliony-za-slovnaft.html> (accessed November 1, 2012).

<sup>449</sup> Ibid.

<sup>450</sup> SME, “Petrochema Dubová bude sprivatizovaná aj napriek strategickému postaveniu”, August 21, 1995, <http://www.sme.sk/c/2128832/petrochema-dubova-bude-sprivatizovana-aj-napriek-strategickemu-postaveniu.html> (accessed March 29, 2012).

<sup>451</sup> Matej Bučko, “Organizovaný zločin na Slovensku”, 2009, [http://is.muni.cz/th/219334/fss\\_b](http://is.muni.cz/th/219334/fss_b) (accessed March 29, 2012).

refinery started only 10 years after the privatization and the refinery eventually wound up.<sup>452</sup> Occasionally, proposals from unknown Russian businessmen emerged for reviving the refinery, or building a connection from the transit oil pipeline, but nothing materialized.

### 5.3.2. Energy Policy Captured by Mečiar's Cronies

Mečiar's rule was a time of full control of the country by political-criminal nexus with strong links to former communist and ex-soviet political and security apparatus. Public perception of Russia copied the support for the Mečiar's governing coalition (see Chart 92 and Chart 93). Supporters of HZDS<sup>453</sup> (partly also SNS and SDE) did not see Russia as a threat throughout the history, voters of the opposition to Mečiar (with the notable exception of SDE/Democratic Left) perceived Russia and ex-Soviet union as a threat to their country. Overall, the perception of threat of Russia in Slovakia was lower than in Czech Republic, but higher than in Hungary (see Chart 79, Chart 93, and Chart 107 for comparison).

Additional problem in Slovakia was that the metallurgic sectors, as the largest energy consumers were much more concentrated than was the case of either Hungary or Czech Republic. Unlike Czech energy-intensive exporting sectors, the consumption of the Slovak ones remained very high during the whole period until 1997 (see annexed Chart 103), and the real restructuring could be visible only after 2000, with the kick-in of Dzurinda's reforms.

The fact that these energy-intensive sectors were temporarily shielded from real price of energy and thus were not pressured to increase their efficiency is also visible from the annexed chart (Chart 101 and Chart 103). The reason could be an explicit decision to protect the important exporting sector from increasing prices of energy – an important production input. An example

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<sup>452</sup> Gabriel Beer, "Petrochema čaká na vyrovnanie," *Týždenník TREND*, June 6, 2005, <http://firmy.etrend.sk/firmy-nefinancny-sektor/petrochema-caka-na-vyrovnanie.html> (accessed March 29, 2012).

<sup>453</sup> Movement for Democratic Slovakia

of this strategy was seen in case of aluminum producer ZSNP (later SlovAlco),<sup>454</sup> largest single industrial consumer of electricity.<sup>455</sup> ZSNP in 1994 received long term contract with the state owned electricity supplier until 2013<sup>456</sup> for guaranteed low USD denominated prices below market value;<sup>457</sup> this contract was also an issue during the privatization of electricity sector later on.<sup>458</sup>

Shielding of an uncompetitive sector could have some policy rationality, as it could provide important welfare protection and additional time for catching up and realigning and restructuring. Nonetheless, these price differences were in majority cases not used to reform the companies, but rather to postpone facing of the international competition and pocketing of the rents by individuals well connected with the ruling political elites. The real motivation for pressure on lower prices should be sought in the ownership structures of the largest energy consumers in the industrial sector.

The largest Slovak steel-mill VSŽ Košice which was controlled by the Mečiar-connected Rezeš family,<sup>459</sup> and the Chemical producer Duslo Šaľa controlled by Andrej Babiš, Plastika Nitra controlled by Juraj Široký.<sup>460</sup> Both Babiš and Široký lived abroad before the transition and their names appeared in the former communist era secret service databases, although they have both publicly refuted any cooperation with the communist-era secret services.

Given the very high concentration of highest energy consuming industries in the country in the hands of few politically connected individuals who profited from the status quo, and the overall low sensitivity of Slovaks towards the threat from the east, Mečiar's government did not see

<sup>454</sup> Since 1994 was co-owned by EBRD and Hydro Aluminium. Since 2003 Penta Investments eventually purchased all ZSNP shares and thus owned 44.7% of SlovAlco in 2007 the remaining shares are owned by Hydro Aluminium Norway.

<sup>455</sup> 1,3 TWh Fond Pre Alternatívne Energie, "Energeticke rezervy Slovenska", n.d., <http://www.seps.sk/zp/fond/uspory/2.htm> (accessed November 1, 2012).

<sup>456</sup> Martin Jesný, "Napätie v linkách Slovalca," *Týždenník TREND*, March 16, 2011, <http://www.etrend.sk/trend-archiv/rok-2011/cislo-11/napatie-v-linkach-slovalca.html> (accessed November 1, 2012).

<sup>457</sup> Martin Jesný, "Klaster na drôte s megawattmi," *Týždenník TREND*, May 16, 2012, <http://www.etrend.sk/trend-archiv/rok-2012/cislo-19/klaster-na-drote-s-megawattmi.html> (accessed November 1, 2012).

<sup>458</sup> SME, "Nevýhodné zmluvy elektrární," *Www.sme.sk*, August 9, 2005, <http://www.sme.sk/c/2332320/nevychodne-zmluvy-elektrarni.html> (accessed April 5, 2012).

<sup>459</sup> FOAF, "VSŽ akciová spoločnosť Košice", 2012, <http://foaf.sk/firmy/244756#historia> (accessed November 1, 2012).

<sup>460</sup> FOAF, "Plastika, a.s.", 2012, <http://foaf.sk/firmy/15560#historia> (accessed November 1, 2012).

energy security as a priority for the country. Control over the industry, including energy was divided up among the political cronies. And even those companies which were nominally state owned had their political owners, who were pocketing private “dividends” from these public companies.

The political elite believed they could, through their connections in Russia, assure reliable and stable deliveries of energy products, while cashing-in on this connection into their private pockets either directly or through middle-man companies. Nonetheless, as the annexed charts (Chart 60 and Chart 65) and the comparative chapter demonstrates, this delivered only private benefit to those taking part on this scheme and not for the general public. Slovakia paid higher prices for imported energy from Russia than Czech Republic where this scheme was not present in such an extent.

#### **5.4. Dzurinda’s Two Governments of Sell-outs 1998-2006<sup>461</sup>**

Dzurinda’s government was determined to “catch-up” the missed “Euro-Atlantic train.” Both Hungary and Czech Republic were members of NATO by then, and were far ahead on their accessions to the EU. Mečiar’s “Carpathian Democracy” disqualified Slovakia from these processes and therefore Dzurinda rushed to catch-up. Part of this process was rapid privatization and implementation of laws “required” as part of the EU accession process, this included also energy laws. That was one of the reasons there were a number of energy policy documents approved by Dzurinda’s government.

The one passed in 2000 set out a number of strategic legislative goals, which were actually fulfilled. The document explicitly recognized aim of “preparing for integration into the internal

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<sup>461</sup> This section builds on and extends research conducted for my previously published work: Andrej Nosko, “10 Years of Energy Policy in Slovakia,” in *Panorama of Global Security Environment 2009* (Bratislava: CENAA, 2009), 645–658, <http://cenaa.org/wp-content/uploads/2009/11/10-years-of-energy-policy-in-Slovakia.doc> (accessed October 30, 2012). and Andrej Nosko and Peter Ševce, “The Evolution of Energy Security in the Slovak Republic,” *Journal of Energy Security* (October 2010), [http://www.ensec.org/index.php?option=com\\_content&view=article&id=262:the-evolution-of-energy-security-in-the-slovak-republic&catid=110:energysecuritycontent&Itemid=366](http://www.ensec.org/index.php?option=com_content&view=article&id=262:the-evolution-of-energy-security-in-the-slovak-republic&catid=110:energysecuritycontent&Itemid=366) (accessed October 30, 2012).

market of EU”<sup>462</sup> as a strategic motivation. The policy was criticized by NGOs, for being “patchy, imprecise and opaque, and thus failing to fulfill requirements for an Energy Policy of the Slovak Republic.”<sup>463</sup> Besides the criticism, it is nonetheless important to note that it was the Dzurinda’s government that created the energy regulator (2001), necessary condition before the privatization, as well as made a significant progress in the preparation of the necessary legislation towards creating an energy market.

In the energy security respect, it was this government that set out the goals and made a significant progress towards achieving the 90 days of state strategic reserves of liquid hydrocarbons. Unfortunately, this is also the only real improvement in the security aspect that Dzurinda’s government did, at least partly under the pressure of OECD and EU accession negotiations.

Dzurinda’s government, under the influence of speeded-up accession process prepared complex legislation in energy policy area, including the new energy law, regulation law, nuclear energy law, as well as policy-concept of renewable energy use. The rapidity with which reforms in energy policy area have been taken is illustrated by the fact that Slovakia fulfilled the EU legislation conditions for concluding the Energy chapter already in 2001.

The privatization of the transit infrastructure owner SPP, and Transpetrol, during this time, was heavily criticized. Besides the political motivation, the criticism included also corruption allegations, and the parliament dominated by SMER issued investigation which uncovered a number of irregularities surrounding this privatization.<sup>464</sup> The information which was released in

<sup>462</sup> “Energy Concept of Slovak Republic,” *Public Mirror Available via SME*, 1999, [http://www.sme.sk/cdata/1627702/Energeticka\\_politika\\_Slovenskej\\_republiky.doc](http://www.sme.sk/cdata/1627702/Energeticka_politika_Slovenskej_republiky.doc) (accessed October 30, 2012)..

<sup>463</sup> NGOs actually proposed an alternative document ENERGIA 2000, “ENERGIA 2000, Iniciatíva za alternatívne riešenie slovenskej energetiky: Materiál na verejné prerokovanie Energetickej politiky SR”, August 1999, <http://www.seps.sk/pravo/energia/e2000/e2000.doc> (accessed October 30, 2012)., see also Spolocnost pre trvalo udržateľny život SR, “Informacie STUZ/SR”, 1999, <http://web.archive.org/web/20010420071316/http://www.seps.sk/zp/stuz/ii/9943/2.htm> (accessed October 30, 2012).

<sup>464</sup> TASR, “Súdny spor Fica s Miklošom stále pokračuje”; UV SR, “Správa o procese privatizácie SPP”, 2007, <http://www.nrsr.sk/dk/Download.aspx?MasterID=180446&DocID=270042> (accessed November 1, 2012).

December 2011<sup>465</sup> and subsequently<sup>466</sup> further corroborated many of these allegations.

The corruption is not ideological, and is part and parcel of politics, nonetheless the types of “corruptors” and timing of the potential corruption matters for the types of policies which are pursued. While Mečiar era corruption included a full-fledged mutual state and business capture, the allegations of corruption during the subsequent periods were more related to large ownership transfers and commission payments from these transfers.

While many of the Mečiar era policies can be seen as guided by state capture motivations, the decisions after 1998, were taken in haste to catch-up the reform and integration train. While it is hard to corroborate the corruption allegations, there are clear reform results which are visible during Dzurinda’s government. Unfortunately, the haste and the sole financial motivation which guided the energy policy came at the cost to energy security rationale.

The second period is signified by privatization in the gas sector, oil sector and electricity sector. While primary motivations for privatizations of these three sectors was need for financial receipts, the way how security was absent in the energy policy considerations is alarming.

I argue that if diversification of supplies does not precede privatization, the likelihood for the new private owner to invest into the public good of energy security is very low. This is very much illustrated in the case of Slovakia. Government sold off both gas and oil infrastructure, and no diversification took place on these infrastructures until 2009 when the government after the n-1 incident crisis together with EU commission provided sizable public money grants for interconnecting the regional markets.

The rapid transformation of gas sector started in 2001 when the state company SPP was transformed into state owned stock company (a.s.), in preparation for privatization. Already in 2002, 49% of shares, including the full managerial control, were sold to Slovak Gas Holding B.V.

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<sup>465</sup> Obyčajní ľudia, “Leaked wire-tapings ‘Gorila’”, n.d., <http://obycajniludia.com/gorila.html> (accessed November 1, 2012).

<sup>466</sup> Tom Nicholson, *Gorila* (Bratislava: Vydavateľstvo Dixit, 2012), <http://www.martinus.sk/?uItem=122240> (accessed November 1, 2012).

a consortium of E.ON Ruhrgas and GDF Suez (Gazprom, an initial member of the consortium has not claimed its share and eventually stayed out) for \$2,7 billion. The remaining 51% remained in the ownership of the National Property Fund of the Slovak Republic. Unlike in the case of Czech Republic, and similarly to Hungary the gas sector except for the underground storage remained vertically integrated until July 2006, with creation of Eustream and SPP – distribution when *legal* unbundling took place due to requirements imposed by EU legislation.

While there was an attempt to include energy security criteria in the privatization<sup>467</sup> these criteria had only negligible weight in the decision making. The single criteria of relevance for energy security “ability to ensure the diversification of gas *suppliers*” had together with an additional economic criteria of “increasing volume of transit through the Slovak Republic,” and a political criteria of accepting Slovak legislation through “acceptance of the liberalization process and the application of directives” only 15% weight, while the price criteria was 75%. The privatization agreement included a stipulation according to which Slovak Gas Holding had priority purchase rights for additional three per cent of stocks as well as full managerial control of the company despite minority ownership. This was done in hope to increase the purchasing value, which nonetheless was not delivered as expected.

The question which remains unanswered in the privatization of SPP is why Gazprom did not take part in the Slovak Gas Holding and did not take over the 49/3 (16.33) per cent of shares. One view is offered by Anita Orbán, who claims that “the Russian gas giant most likely gave up its shares in SPP to find another way to gain controlling rights”<sup>468</sup> over the transit infrastructure, she further adds that “friendly winds blew in Hungary”<sup>469</sup> at the time. Another alternative explanation I received from a high ranking official at the Slovak ministry of economy was that Gazprom was included in order to distribute kick-backs for the political elite deciding on the

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<sup>467</sup> UV SR, “Správa o procese privatizácie SPP.”

<sup>468</sup> Orbán, *Power, energy, and the new Russian imperialism*, 164.

<sup>469</sup> *Ibid.*, 165.

privatization.<sup>470</sup> Nonetheless, while the source of the information is well-informed and reliable, this does not seem to be plausible, as there were much simpler ways used by the political elites to cash-in kick-backs of privatization, including from the EU companies<sup>471</sup> than would require involving a third party energy company.

Gazprom has really been interested in taking control over the Slovak gas pipelines, and this is also illustrated by the discussion during president Schuster's visit to Moscow in November 2001 when he discussed the issue of privatization of Slovak energy sector with President Putin. Slovakia was also an explicit supporter of the system interconnector, which was supposed to bypass Ukraine through Belarus and Poland, when Gazprom threatened building direct undersea connector bypassing all of the transit countries should they not support the interconnector.

The only plausible gas diversification idea which was briefly mentioned during this period was connection from Norway via Poland to Slovakia; nonetheless it never made it into a serious policy proposal. Security simply was not on the agenda of Slovak energy policy during this period.

Vertically integrated company Transpetrol, which represented the oil sector<sup>472</sup> was privatized in 2002 when Dzurinda's government sold 49% of shares to Yukos Finance B.V.<sup>473</sup> The business, as well as energy security logic of oil pipeline ownership dictates that supply pipelines should be owned by refining companies. These are effectively their captive customers, especially in situation when refining business is concentrated as is case in Slovakia.

The transit oil pipeline in Slovakia is used only for two purposes – to supply Czech Refinery (one of the bidders in privatization) via transit, or supply MOL's domestic Slovnaft Refinery, (the

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<sup>470</sup> M. C., "Off-record discussion with high ranking official at the Slovak ministry of economy (Brussels).", December 2, 2008.

<sup>471</sup> Nicholson, *Gorila*; Obyčajní ľudia, "Leaked wire-tapings 'Gorila'."

<sup>472</sup> Transpetrol was responsible for transit and delivery of oil, and it was created after the split of the federation. Transpetrol, as most of the other energy assets was also included in the 1995 law on strategic assets, and thus was not supposed to be privatized.

<sup>473</sup> The interest was shown by six companies: three refineries Česká Rafinárska, Slovnaft/MOL, and OMV; and three oil suppliers from Russia: Yukos, Surgutneftgaz and Rosneft.

possibility of supplying OMV's refinery would require additional investments). Ownership of pipeline by one of the suppliers, which was allowed by Dzurinda's government, not only limits the possible competition for supplies, decreasing refinery's profitability, but effectively also decreases energy security. This is yet another example how even Dzurinda's right-wing government didn't prioritize energy security consistently.

During the period 2002-2009<sup>474</sup> Slovak government effectively gave up on energy security also in the oil sector. There were discussions on reverse flow of Druzhba pipeline to provide possibility of supplies from Czech Republic in light with the recommendations of IEA and conditions of NATO membership,<sup>475</sup> as well as there was an on-going discussion about extending the oil pipeline from Odessa-Brody in Ukraine to Polish Plock, given that government had neither real means nor willingness to participate in this project, nothing happened on this front either.

Dzurinda's right-wing government, similarly to Hungarian socialist Horn' government, was pressured by external financial needs, and followed rapid privatization. Nonetheless, Dzurinda's government preferred more liberal understanding of market efficiency achieved through market competition, and in this understanding public good of energy security slipped through the cracks. It should be acknowledged thought that the state revenues from these companies after the privatization increased, despite the lower ownership share, mainly as a consequence of effectively missing ownership policy during Mečiar era.

Besides the privatization of SPP and Transpetrol, Dzurinda's government also privatized 66% of the electricity producer Slovenské Elektrárne to Italian energy company Enel.<sup>476</sup> The sale of the electricity industry was the largest privatization of Dzurinda's second government. The most complicated issue surrounding the sale of SE was related to the ownership and further

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<sup>474</sup> In 2009 after the contested bankruptcy of its Russian mother Yukos, which followed incarceration of its CEO Khodorkovsky, and lengthy negotiations Slovak government regained these shares back.

<sup>475</sup> Karel Hirman, "Česi neplánujú predat' prepravcu ropy | Týždenník TREND | eTREND", April 11, 2001, <http://www.etrend.sk/trend-archiv/rok-/cislo-Apr%C3%ADl/cesi-neplanuju-predat-prepravcu-ropy.html> (accessed November 1, 2012).

<sup>476</sup> The transformation of electricity sector in Slovakia started in 1990 when the three regional distribution companies Západoslovenská energetika (ZSE), Stredoslovenská energetika (SSE) and Východoslovenská energetika (VSE) became independent state enterprises after their split-off from the Slovenský energetický podnik, š. p. (SEP).

development of nuclear assets, ownership of the Danube waterworks<sup>477</sup> and a number of unfavorable supplier contracts with major suppliers and consumers of electricity. Initially, a number of international utilities expressed an interest in purchasing the non-nuclear part of SE, but not the SE's nuclear business.<sup>478</sup>

In September 2000, in preparation for the privatization, the government decided on restructuring of the industry.<sup>479</sup> After the initial pre-sale restructuring was done,<sup>480</sup> the government reinforced that the successful bidder had to complete the additional nuclear power plant units at Mochovce. As a result, three bids that fulfilled this condition were received from Czech ČEZ, Russian InterRAO, and Italian Enel. Italian Enel was eventually selected as the “preferred” bidder and contracts were signed in February 2005. The sale of a 66% share of SE to Enel was completed in April 2006, at a price of €839 million. As part of the deal, Enel committed to invest additional €1.9 billion in SE over the next 10 years.<sup>481</sup>

One more case in electricity and heat part of the energy sector in Slovakia is worth mentioning: Paroplynový cyklus, a.s. (PPC) the combined heat and electricity cycle plant. In 2003, during second Dzurinda's government, the tender for the sale of 90% of PPC stock was announced.<sup>482</sup>

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<sup>477</sup> According to the 1977 international agreement with Hungary, Gabčíkovo-Nagymaros waterworks is the joint property of both states additionally the waterworks was subject to international dispute and thus no investor would want to be liable to the outcome of the International Court of Justice ruling (International Court of Justice, *Gabčíkovo-Nagymaros Project (Hungary/Slovakia)* (Contentious Cases 1997)).

<sup>478</sup> PWC, “Privatisation of Slovenské elektrárne (SE)”, n.d., <http://www.pwc.com/gx/en/utilities/privatisation> (accessed March 18, 2012).

<sup>479</sup> Government Resolution No. 758/2000 of the 27th September 2000

<sup>480</sup> The SEP was split into three independent businesses: the power generating utility Slovenské Elektrárne, a.s. (SE), the independent transmission grid operator SEPS (Slovenská Elektrizácia Prenosová Sústava, a.s.), and the heating company in the eastern Slovakia Tepláreň Košice, a.s.. The leftover assets, especially the Nuclear Power Plant Bohunice units, the radioactive waste treatment facilities in Mochovce and Bohunice, and the Gabčíkovo hydro power plant were exempt from the privatization. The nuclear-related assets were transferred to the GovCo (later renamed to Javys) and the waterworks were transferred to other state entities. SE received right to operate the hydro power plant in the Gabčíkovo waterworks for 30 years and receive 65% share of the revenues, the remaining share was to be received by state-owned entity Vodohospodárska výstavba (VVB). SE also had right to operate the first two Bohunice units until their scheduled shut-down in 2006 and 2008 respectively based on the EU accession treaty. In 2001 the regional electricity distribution companies were separated from the heating units which remained in the state ownership, and subsequently 49% of their shares and managerial control was privatized. The 49% of ZSE was sold to E.ON Energie AG., same amount of shares of SSE to EDF and 49% of shares of VSE to RWE. (SEAS, “History - SEAS”, n.d., <http://www.seas.sk/en/the-company/about-us/slovenske-elektrarne/history> (accessed March 18, 2012).)

<sup>481</sup> PWC, “Privatisation of Slovenské elektrárne (SE).”

<sup>482</sup> PPC was established in 1996 by ZSE (Západoslovenské energetické závody, š.p. - 66 %), SPP (Slovenský plynárenský priemysel, š.p. - 24 %) and SE (Slovenské elektrárne, a.s - 10 %), at the cost of 3.8 billion SKK

The problem with this privatization has been related to the long-term contract for electricity with SE, which was exceptionally favorable for PPC but not for SE. This preferential agreement had some rationality while PPC was owned by the SE, but not when the company was privatized. Out of the seven offers, the chosen bid was submitted by Penta Investments Ltd. who offered 2,011 billion SKK (\$54m) for the 90% of shares. The estimated loss for the SE (which had negative impact on the price and sale of SE) and the state was 15 billion SKK (\$405m).<sup>483</sup>

It is not a mere coincidence that investors from Penta have had the luck to land themselves two companies which both had preferential energy supply contracts, as the PPC preferential contract was one of the two most important preferential contracts and matched the extent of Penta's aluminum producing plant's preferential contract mentioned earlier. These two cases illustrate heritage from Mečiar era, which had to be dealt with by Dzurinda's or subsequent governments. Recently information was released<sup>484</sup> which alleges to corruption background of privatization transactions during Dzurinda's government. It is not the role of this dissertation to investigate into detail these alleged corruption cases, nonetheless, this information corroborates the lack of public policy and provides the explanation why security was so low or absent altogether from the energy policy making in Slovakia.

Corruption and state capture by those previously well connected with the security apparatus and former communist era elites, as well as opportunist investors provides factor for understanding the apparently irrational decisions made. The policies in energy sector in Slovakia in the first fifteen years since transition were too often motivated by factors other than security or national interest. The specific benefit from not investing into long term public good of security in energy

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(\$122m). In preparation for privatization 90% of shares were transferred to the National Property Fund and remaining share remained with SE. "PPC Energy Group > About the Company :", n.d., <http://www.paroplyn.sk/index.php?no=347> (accessed March 18, 2012); "Dejiny slovenskej privatizácie - časť 5", January 30, 2008, [http://www.izurnal.sk/index.php?option=com\\_content&task=view&id=2073&Itemid=89](http://www.izurnal.sk/index.php?option=com_content&task=view&id=2073&Itemid=89) (accessed March 18, 2012).

<sup>483</sup> Monika Tódová, TASR, and SITA, "Lipšic chce zrušiť privatizáciu paroplynu," *SME*, March 5, 2012, <http://www.sme.sk/c/6286356/lipšic-chce-zrusit-privatizaciu-paroplynu.html> (accessed March 18, 2012).

<sup>484</sup> Nicholson, *Gorila*; Obyčajní ľudia, "Leaked wire-tapings 'Gorila'."

policy was reaped by well-connected elites. In case of Slovakia mostly with connection to the previous totalitarian regime and later on to political elites across political spectrum.

### **5.5. Summary**

This chapter paints very grim picture of Slovak energy policy as well as general state of affairs in the country. How did the three important factors, which I consider determinant, influence absence of security in the prioritization of energy policy, as well as the haphazardness of the policymaking altogether?

This happened as a result of interplay of three most important factors: relatively low and diffused public perception of Russia in Slovakia as a threat, high continuity of former elites in both politics and energy-intensive businesses, as a result of choice of vetting laws at the time of transition, and high concentration of energy-intensive export-oriented industry. These factors together influenced the domestic opportunity structure.

The ruling elites in power, primarily in the first period, were influenced by the lacking effective exclusion of the former elites from the communist era period. Given that the former communist-era elites successfully transited into the new conditions and grasped and influenced the newly available opportunities, this has shaped Slovak policymaking, as well as business sphere in the first period. Former elites effectively captured the state and controlled important strategic sectors including energy and companies closely reliant on the energy. Their benefiting from the status quo, created an obstacle for prioritizing security in the Slovak energy policy. When the energy assets were privatized, new owners were not interested in investing into public good for the local Slovak market and their commercial strategies did not include increase of energy security for Slovakia.

Low public perception of Russia as threat facilitated further nurturing of existing intensive relations between the ruling Slovak elites and their Russian counterparts, some of whom moved into business sector. Since Russia, which has shaped Slovakia's energy dependence and energy

security the most, has not been widely seen as a threat to the country, political elites could not use this additional impetus to prioritize security in the energy as was the case in Czech Republic. Intensive inter-elite relations between Slovakia and Russia further explain lacking prioritization of security in the energy policy, as there plausibly could be expected higher level of trust based on personal relations. This is specifically documented in case of SDE. Nonetheless these were not used for the public benefit of assuring more beneficial prices or higher reliability (see Chart 62, Chart 65, and chart series Chart 37 – Chart 42) and the preceding comparative chapter), but they were rather used for private benefit of the persons involved. This is vividly illustrated though the case of Devín Bank and the privatization cases I mention. Devín Bank case illustrates the importance of effect of networks and continuity from the previous regime. Thanks to the participation of SDE in first Dzurinda's government this network survived after 1998 and reappeared again during Fico's governments, when SMER-SD effectively took over SDE.

Throughout the modern history of Slovakia, country lacked strategic energy policy vision and security policy planning for the future. In the first period dominated by Mečiar's government the energy policy in Slovakia has been mostly influenced by his take on privatization and the political-business networks that he nurtured. During Dzurinda's government, decisions were less haphazard but mostly motivated by external – NATO and EU accession requirements. When a center-right reform government assumed power in 1998, country was facing other priorities than increasing energy security. Dzurinda's government needed to collect large amount of money to pay back the government bonds from the Mečiar's cancelled second wave of privatization, as well as to finance reforms. This has forced logic of maximization of receipts, speeding industrial transformation and catching up the “train of transatlantic integration” rather than security and national interest rationale as understood by students of international relations.

Also because of the political need for wide coalition to replace Mečiar, SDE joined the anti-Mečiar coalition and thus could maintain its status and politics-business nexus involving cross-

border aspects to Russia. Slovak economy, somewhat similar although less visibly to what happened in Czech Republic after 1998, was divided among the political elites.<sup>485</sup> While gas sector belonged to Dzurinda's SDK at the time dominated by almost libertarian views of market and privatization being the ultimate solutions to the country's ills, the significant part of the energy sector ended up under the control of ex-communist SDE with strong ties to Russia.

The governments that succeeded Mečiar thus could not fully liberate themselves from this security-compromising influence of business-politics nexus. The investment which was required for prioritizing security in the energy policy, and the disruption to the rent-arrangements of some elites would have required additional support and utilization of public fears of Russia as was the case in Czech Republic. Nonetheless, the few politicians that have seen security as important could not rely on the public perception of fear of Russia to deliver the much needed additional impetus for the policy prioritization of security on the energy agenda as happened in Czech Republic.

Additional reason for status quo was the fact that country had been an important transit corridor for Russian gas. This provided certain stability and cushion for future planning which was not utilized to prepare for time when this could change. Among the Slovak policy planners, this was a possibility they turned blind eye to. Whenever there were developments which were endangering this assurance, Slovak government did not take active role in influencing matters, but stood passive or reacted post factum. This was visible in case of Russia-lead discussions on inter-system connector which could have provided additional leverage for Slovakia to continue functioning as a transit country not only east to west, but also east to south, and north to south. This would have provided comparatively higher benefits to Slovakia than to any of her neighbors, yet Slovakia was not seen to take active role in promoting this idea. Even in the more recent history, when discussions on Southern European Corridor happened, Slovakia was more-

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<sup>485</sup> Ján Sopóci, *Zaujímavé skupiny v slovenskej politike v 90. rokoch* (Bratislava, 2002).

less a passive bystander following, rather than trying to steer developments as Czech Republic, Poland and partially even Hungary did. This illustrates lack of vision and strategic foresight, which cursed Slovak energy policy making for the past twenty years.

The lacking public perception of threats stemming from the previous regime, which was also reflected in low public demand for lustration and exclusion of former regime exponents enabled further transformation of these elites and their supporters regardless of the political situation ever since. Their interests are different from the public interests. Ever since these financial groups managed to penetrate most of the mainstream political parties they have effectively captured the state.

Prioritization of security in energy thus happens only if it becomes also their interest, or when it is paid by public money from European Commission, and thus comes for free, as happened after 2009. The important fact remains that these groups could achieve their current power status only because of the public ignorance of threat and risks associated with the former communist party and its links with Russia, which resulted in lax lustration laws and low public support for reform politicians which had to rule with slim governing coalitions.

## Chapter 6. HUNGARY

Hungary is a country which has gone through various stages of energy security prioritizing. While already in 1991. Hungary had an explicit energy policy document prioritizing energy security, the drive started by Antall-Boross<sup>486</sup> government to provide for multifaceted energy policy including prioritization of security was not continued with the same impulse. The socialist Horn government, partly because of the external financial prerogatives, went on a large scale privatization of energy assets. This predetermined the options that future governments had in terms of prioritizing security in energy policy, and made prioritization of energy security more difficult for governments to come.

Additionally, and differently from Slovakia and Czech Republic, unions played more important role in Hungarian energy policy. Energy sector unions were not only much more active and vocal; their representatives were even present in the Hungarian parliament. Energy sector unions were able to negotiate for at least parts of their interests to be taken into account during the privatization, and privatization proceeds to be used specifically for retraining and job transition. Unions have also effectively prevented privatization of the MVM electricity company.

The prioritization of energy security got a break during socialist government. Government focused more on privatization and macroeconomic stabilization. The priority of attracting foreign investors took over the priority of energy security. Security as a priority for energy policy agenda reappeared again when right-wing government won elections in 1998. It is not surprising that economic patriotism has numerous overlaps with prioritization of security in energy policy. Thus it is not surprising that the center-right government with its rhetoric of strengthening the role of state reintroduced the security aspects into the energy policy and returned to some of the policies of Antall-Boross government.<sup>487</sup> These included supporting of the “national” energy

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<sup>486</sup> The first Hungarian government was headed by József Antall, who died in office on December 12, 1993 and was succeeded by Péter Boross, interior minister from Antall's government. I refer to this government as Antall-Boross, mainly because a number of policy decisions of relevance were implemented while Boross was in office.

<sup>487</sup> György Matolcsy, head of Economic Policy Secretariat at Prime Minister Antall's Office, became Minister of Economy in Orbán's first government.

champions and forestalling control of foreign investors with unclear ties from abroad in the energy sector.

After yet another four-year term, the socialist government with liberal support came to power in 2002. The policies of friendly conduct with Russia, as well as downplaying the security aspects of energy policy resumed policy continuity of Horn's socialist government. Few weeks after assuming power, news broke-out that prime minister had served as communist-era secret service agent<sup>488</sup> registered as D-209.<sup>489</sup> This is another similarity with Slovakia, the secret-service experience of prime-minister Mečiar and his policy preference of friendly relations with Russia. Similarly to Slovakia policy of friendly relations with Russia had only questionable benefit to the Hungary's national interest, while it might have delivered private benefits for a number of well-connected individuals, who were at a right place in the right time.

The public fears of Russia in Hungary were much less widespread than in case of both Slovakia and Czech Republic. The soviet invasion took place dozen years earlier than in Czechoslovakia, but the communist regime in Hungary allowed its citizens much "happier" life than "normalization-era"<sup>490</sup> Czechoslovakia. The economic reforms and internationalization of the economy also started earlier. This, in my view, was also a reason for relatively weak response and isolated and chaotic attempts at transitional justice and lustration legislation.

As a consequence of absent fear of Russia, especially on the left-side of the political spectrum, energy security in its most urgent manifestation of high import dependence was treated as a policy priority only by (center-)right political elites. This was the case despite the fact, that the perception of fear of Russia, unlike in case of Czech Republic, didn't run clearly along the

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<sup>488</sup> Andras Gal and Judit Szakacs, "The Spying Game, Continued," *TIME*, August 20, 2002, <http://www.time.com/time/world/article/0,8599,339026,00.html> (accessed April 7, 2012).

<sup>489</sup> David Koch, "Hungary's Prime Minister Exposed as Former Communist Spy", July 25, 2002, <http://www.worldpress.org/Europe/651.cfm> (accessed April 7, 2012).

<sup>490</sup> "Normalization" is the period after 1968 when many liberties were repressed.

political party lines.<sup>491</sup> In case of Hungary, therefore it can be argued that the center-right prioritized security in the energy policy not as a consequence of fear of Russia, but rather as a part of general policy preference for economic patriotism.

The first government after the transition, the reformist center-right Antall-Boross government, started diversification by initiating the construction of gas pipeline to Austria. The supply contract was not negotiated at the time of construction of the pipeline, and thus this was only an imperfect and partial diversification. After the Horn's socialist-liberal coalition government came to power, the pipeline was inaugurated. Since the new government was more interested in large-scale privatization of energy assets, and did not see energy security as a priority for its policies, this infrastructure diversification was not followed with a contract diversification. Thus this necessary move towards increasing energy security remained insufficient and incomplete.

Already in the first months of the socialist-liberal Horn government (October 1, 1994), Russian-Hungarian intermediary company Panrusgáz<sup>492</sup> was set-up, and in the bilateral treaty (1996) it was named the exclusive vehicle for the long-term intergovernmental gas import. This majority-Gazprom-controlled company thus became the largest importer of natural gas to Hungary. The failed case of SlovRusGas Company in Slovakia unsuccessfully followed this example.

Hungary was also a registration place for a number of other important Gazprom (or its managers') front companies. The first one, Interprocom, was set-up in Budapest already in June 1989<sup>493</sup> by the former top manager of Gazexport Megdet Rakhimkulov. Interprocom, beneficial ownership of which was later transferred effectively to the family members of Gazprom officials,<sup>494</sup> allegedly became the vehicle for cash stripping of Gazprom and exporting assets from

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<sup>491</sup> Detailed chart appended.

<sup>492</sup> The "venture" companies used as front companies for Gazprom or its managers mushroomed: TurkmenRosGaz, RosUkrEnergo,

<sup>493</sup> The very same day when Gorbachev met Kohl in Germany.

<sup>494</sup> The sons of Rakhimkulov (Ruslan Rakhimkulov) and former Prime Minister Viktor Chernomyrdin (Vitaly Chernomyrdin), and the daughters of Gazprom boss Rem Vyakhirev (Tatyana Dedikova) and his deputy Vyacheslav Sheremet (Yelena Dmitriyeva)Hassel, "Gazprom Assets A Family Affair."

Russia. Interpocom<sup>495</sup> was later joined by Eural Trans Gas (headed by former Hungarian communist official Andras Knopp<sup>496</sup>), as well as the seat of one of the Gazprom's foreign banking operation Általános Értékforgalmi Bank (ÁÉB) (much more advanced than similar operation in Slovakia through Devín Bank). Panrusgáz gained stronghold in Hungary, and the economic imperium curated by Rakhimkulov family grew, especially well during the Horn government, when the security considerations were mostly absent from the policy agenda.

Center-right Orbán's government stopped privatization, and waged an open fight against hostile takeover of its domestic refinery business, attempted through a number of front-end companies allegedly with ties leading to Gazprom managers. It was also during Orbán's government that the aim of increasing energy security, manifestations of which some could see as economic nationalism, was more apparent. With the return of socialist-liberal coalition government (Medgyessy, Gyurcsány), privatization was restarted, and more friendly relations with Russia and Russian companies reinstated.

The experience of Hungary showed exceptional consistency between policies of the center-right and socialist-liberal center-left governments. While right-wing governments consistently implemented policies prioritizing security in the energy policy. and acted upon "fear" of Russia; the socialist governments had other priorities, and fostered rather lively relations with Russia, facilitating Russia's interests in Central Europe.<sup>497</sup> This is interesting, especially given rather weak distribution of fear of Russia along the party lines in Hungary, as was the case in both Czech Republic and Slovakia.

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<sup>495</sup> Followed chronologically in its regional role by Ukrainian Republica, Interhaz, (both by Ihor Bakai, close associate of Kuchma); and Omrania and Itera (Cyprus and Florida, founded by Igor Makarov).

<sup>496</sup> Kupchinsky, *Gazprom's European Web*.

<sup>497</sup> Orbán, *Power, energy, and the new Russian imperialism*; Deák, "Diversification in Hungarian Manner: The Gyurcsány Government's Energy Policy."

## 6.1. Choice of Transitional Justice Policies

The choice of transitional justice policies of Hungary has been very different from both Czech Republic and Slovakia. The history of lustration legislation of Hungary is a rollercoaster, and in its effects fares similarly to Slovak, as mostly inconsequential, with even lower transparency than Slovak one, up until today.

The demand for lustration began as early as 1990, but both the “*Justitia plan*” submitted by Zétényi-Takács (MDF) and the *Demszky-Hack* bill (SZDSZ) failed. The first law could be passed only three months after Prime Minister Antall’s death in 1994. Nonetheless, the Constitutional court rejected implementation of this law (which relied on the *Demszky-Hack* proposal), and thus Hungarian vetting law could only become valid in late 1996.

Despite SZDSZ attempts at extending the coverage of the lustration law to the whole security apparatus<sup>498</sup> through amendments, parliament, dominated by the Socialist (ex-Communist) party, passed a new law that narrowed the scope of the screening legislation so that it covered only 500-1,000 posts including parliamentarians, ministers and the most senior officials in the public administration, judiciary and state institutions and media.<sup>499</sup> The delay was longer by more than half a year, than what the Constitutional court requested for the rectification of the unconstitutional aspects.<sup>500</sup> Consequently the vetting could be restarted only after the major ownership changes in energy sector were already prepared or even concluded.

Subsequent government led by the right-wing, anti-communist Fidesz in coalition with MDF and FKgP expanded the scope of the legislation to also include media and “influential” editorial staff as well as judiciary, prosecutors and other offices that receive state funding. This was to include 7,000-8,000 posts in total and the parliament extended the validity of law until 2004.<sup>501</sup>

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<sup>498</sup> Departments III/I, III/II, III/III as well as III/IV Barrett, Hack, and Munkácsi, “Lustration as Political Competition: Vetting in Hungary.”

<sup>499</sup> Williams, Szcsérbiak, and Fowler, “Explaining lustration in Eastern Europe A post-communist politics approach.”

<sup>500</sup> Barrett, Hack, and Munkácsi, “Lustration as Political Competition: Vetting in Hungary.”

<sup>501</sup> Williams, Szcsérbiak, and Fowler, “Explaining lustration in Eastern Europe A post-communist politics approach.”

The further spur for tougher lustration regime came in June 2002, when revelation that the new prime minister, Péter Medgyessy of the Communist successor Hungarian Socialist Party (MSZP), had worked for the Communist-era counter-intelligence (Department III/II).

Unlike Slovakia and Czech Republic, Hungary had lacked most of the needed transparency<sup>502</sup> in dealing with the past. Thus the networks of previous regime beneficiaries, and their ability to capitalize on their privileged access and knowledge went mostly unhampered. While in Slovakia and Czech Republic at least the researchers could rely on regulated access to archives and the leaked (partial) database, the list of informers, agents and collaborators in Hungary remains unavailable.

Additionally, in case some bold researcher dares to make a claim based on the limited archival sources available, they are likely to face judicial and financial consequences<sup>503</sup> of extremely harsh libel law in Hungary.<sup>504</sup> Hence even the minimal references to the past, or linkages of business people and politicians to the previous regime or foreign power's security apparatus in Hungary stay on the level of conspiracy theories, and no scholarly or evidence-based discussion about these isolated claims is possible, even 20 years after the transition. The harsh libel law has even prevented this information from appearing in the media, as was frequently case in Slovakia and Czech Republic.

What has in effect happened in Hungary at its most can therefore be termed as “*sanctionless*,”<sup>505</sup> or inconsequential lustration. As David Kemme, analyst of East-West Institute noted in November 1990 “There may no longer be upward mobility through the party, but the *nomenklatura* still

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<sup>502</sup> The limited dataset of 500-or so ministry employees published on the web does not provide the level of transparency that Cibulka's list did in Czechoslovakia (“SZT-tisztek.”)

<sup>503</sup> Eva S. Balogh, “National security documents, the Hungarian case,” *Hungarian Spectrum*, March 18, 2012, <http://esbalogh.typepad.com/hungarianspectrum/2012/03/national-security-documents-the-hungarian-case.html> (accessed March 24, 2012).

<sup>504</sup> Libel is a criminal offence in Hungary, and it has been used to silence attempt at uncovering connections with the past.

<sup>505</sup> Mayer-Rieckh and Greiff, *Justice as prevention*, 25.

dominate every aspect of every enterprise, with insight and knowledge about operations, and political ties and accumulated income to buy companies that are being privatized.”<sup>506</sup>

## **6.2. Timing and Sequencing of Privatization**

The privatization in Hungary started earliest out of the three countries. Since Hungary was facing debt crisis in 1990's, partial privatization of energy assets was seen as a way out of the budget deficit.<sup>507</sup> The government on one hand needed money, but on the other was quite vocal about maintaining the control over the strategic energy assets.

The transformation of energy sector started already in early 1990, in form of transforming the state owned companies into state owned stock companies. The early years of Antall government provided basis for the transformation, enabling private enterprise and granting the companies autonomy through liberalization of prices, wages and imports.<sup>508</sup> Nonetheless, Antall's right-wing reformist government was cautious of rapid privatization. Just year before the elections, in 1993, ruling Hungarian Democratic Forum (MDF) party's congress voiced that “the drive to privatize the utilities and banks must also contend with a heightened political sensitivity about foreign economic domination.”<sup>509</sup> It was also this sensitivity that provided the basis for the policy of majority state ownership. It was also during Antall's government that the explicit objective of energy security and eliminating one-sided energy import dependence as well as diversification of imports was included in the objectives of the state energy policy.<sup>510</sup>

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<sup>506</sup> Amy Kaslow, “Hungary Battered by Energy Costs,” *The Christian Science Monitor*, November 1, 1990, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJB-4NV0-0012-246S&csi=7945&oc=00240&perma=true> (accessed March 11, 2013). Quote by David Kemme, an economist with the Institute for East-West Security Studies in New York

<sup>507</sup> IEA/OECD, *Energy policies of Hungary: 1995 survey* (Organisation for Economic Co-operation and Development, 1995), 19.

<sup>508</sup> Alison Roberts, “EUROPE: Hungary: Do-it-yourself Capitalism Needs A Helping Hand - Long seen as the most westernised of the East European economies, Hungary has been the favourite destination for western investment in the former Communist bloc. But is this reputation justified?,” *Investors Chronicle*, June 7, 1997, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=40PR-34K0-00W3-Y0XH&csi=234036&oc=00240&perma=true>.

<sup>509</sup> Financial Times, “Hungary signals state utilities sell-off this year”, February 4, 1993.

<sup>510</sup> IEA/OECD, *Hungary 1991 survey (Energy policies: )* (OECD/IEA, 1992), 13, and ANNEX 1.

With the arrival of Horn cabinet, energy policy remained unpronounced, and as Hungarian authors remarked in 2000 “The Horn cabinet did not have a declared energy policy, they subordinated everything to a selling-off privatization.”<sup>511</sup> It was during the Horn government that the majority of the privatization legislation was passed.<sup>512</sup> The amendment of June 1995 enabled even wider scope of private ownership including of companies in the energy sector,<sup>513</sup> and the ability of the Hungarian Privatization and State Holding Company (ÁPV<sup>514</sup>) to determine the corporate dividend and development policy of owned companies.

Investors of privatized energy assets had a guaranteed rate of profit on equity of 8%,<sup>515</sup> which was meant to guarantee return on investment in context of not-yet liberalized market and lacking clear price regulation rules. Given that domestic energy prices were based on the inflation this guaranteed rate of return on one hand but price hikes followed the privatization. Orbán’s right-wing government reverted the price formula at the expense of the investors, and used MVM tariff for the benefit of low-income consumers.

Out of the energy assets which were privatized, majority was privatized during the Horn government. The notable exception which remained in state ownership mainly due to industrial action, and opposition’s vocal protests was the integrated electricity sector (MVM). Despite tremendous cash receipts, this money was not used to improve energy security – rather “in a self-propelling process – revenues from privatization were largely spent for (more) privatization: either for preparing firms or banks for privatization by restructuring, reorganization, or bailout,

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<sup>511</sup> Márton Járosi and Ernő Petz, *About the Hungarian energy policy prior to the accession to the EU* (Manuscript, 2000), [www.enpol2000.hu/files/jp\\_priv\\_utan\\_en.doc](http://www.enpol2000.hu/files/jp_priv_utan_en.doc).

<sup>512</sup> The Privatisation Act (XXXIX.) passed in May 1995 and its amendment in June 1995 (LXIX/1995)

<sup>513</sup> Járosi and Petz, *About the Hungarian energy policy prior to the accession to the EU*.

<sup>514</sup> ÁPV is a functional equivalent to the National Property Funds of Czech Republic and Slovakia.

<sup>515</sup> MTI Econews, “No energy price rise in October”, August 22, 1996, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJJ-37R0-004B-W0KN&csi=8279&oc=00240&perma=true>; MTI Econews, “Electricity distributors’ performance shows improvement”, October 1, 1997.

or for creating support for privatization (by restitution and cheap credits), or, finally for attracting foreign investors.”<sup>516</sup>

Exceptional element in Hungarian privatization as compared to other countries in transition was an explicit agreement with unions, which happened just before the elections in May 1998. Ministers of Finance and Privatization (Medgyessy and Csiha) signed an agreement with two main trade unions in energy sector stipulating that HUF 8.6 billion Fund established from five per cent of the privatization proceeds would be used for retraining and redeployment of any displaced workers.<sup>517</sup> According to David Hall, Hungarian unions’ agreement included also a condition that “the observation of the industry collective labor contract would be a contractually binding condition of the share sales [and] employment levels in the privatized companies would be protected.”<sup>518</sup> Despite this, during socialists’ term in office, the employment in the energy sector dropped by 20%.<sup>519</sup>

The center-right government of Viktor Orbán pledged to “stop the privatization of the energy sector to ensure that strategic energy firms remain national property and to create the National Electricity Company.”<sup>520</sup> While Orbán’s rhetoric included protection of consumers and employees in the energy sector, the legislation that his government, especially given the EU pre-accession period passed, was mostly extending the on-going liberalization of the energy sector. While it had militant rhetoric on revisiting the privatization, none of the deals were revoked. Conversely, given how government chilled the relationships with Russia, and staved off attempts at hostile takeovers in BC and MOL, on the grounds of national interest and security, it is possible to argue that Orbán’s government, similarly to Czech right-wing government before, indeed prioritized security in energy policy.

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<sup>516</sup> Béla Greskovits, “Consolidating economic reforms: the Hungarian experience with lessons for Poland,” *CASE-CEU Working Papers*, no. 31 (1999): 29.

<sup>517</sup> MTI Econews, “Agreement on HUF 8.6bn electricity sector fund”, May 8, 1998.

<sup>518</sup> D. Hall, “Restructuring and privatization in the public utilities–Europe,” *London: PSIRU Report* (1997).

<sup>519</sup> MTI Econews, “Agreement on HUF 8.6bn electricity sector fund.”

<sup>520</sup> FIDESZ, “A Fidesz-Magyar Polgári Párt választási negyven pontja”, 1998, para. 6.

Finally, after 2002 socialist-liberal government of Medgyessy-Gyurcsány improved relations with Russia,<sup>521</sup> and in 2006 the state ownership company ÁPV Rt. sold the remaining shares in MOL.<sup>522</sup> This again corroborated argument that left-leaning government in Hungary prioritized other aims than energy security.

## **The four periods in detail: Right-Left, Right-Left**

### **6.3. Bearing Their Best with Creditors at Their Back (1990-1994)**

The prioritization of energy security during the first period of Hungarian transition was influenced by a combination of center-right government in power, need for dealing with economic challenges of transition and transformation, as well as dealing with the interest coordination in the new conditions. The starting point for Hungary in terms of energy landscape was similar as for Czechoslovakia at the time. Hungary had more options for importing oil, but the government was facing challenges domestically and internationally because of difficult macroeconomic situation.

In the early 1990's Hungary, similarly to its neighbors faced problems related to supply of energy sources, both because of the instability in Soviet Union as well as in relation to the nonfunctioning and disintegrating COMECON. The planned energy policy response during the initial period of transition in Hungary was naively idealist. The first energy policy documents were product of the Ministry of Industry and Trade in the form of a policy paper prepared in June 1991.<sup>523</sup> This policy paper was quite liberal – it combined calls for security, efficiency, as well as welfare. It even called for liberalization of imports and creating regional gas market with

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<sup>521</sup> It was Megyessy's government that succeeded in negotiating the return of the Sarospatak library books which were part of the 2<sup>nd</sup> world war spoils.

<sup>522</sup> Mihályi Péter, *A Magyar Privatizáció Enciklopédiája*, 2 vols. (Veszprém – Budapest: Pannon Egyetemi Kiadó – MTA Közgazdaságtudományi Intézet, 2010), <http://econ.core.hu/file/download/privatizacio/ertekeles.pdf> (accessed December 20, 2012).

<sup>523</sup> IEA/OECD, *Hungary 1991*, Annex I.

Czechoslovakia and Austria through cross-border interconnectors to the Austrian hub close to Vienna, and alternative gas supplies through LNG from Yugoslavia or Norway.<sup>524</sup>

The objectives for short term energy strategy included diversification of sources, including preparations and initiations of “the technical opportunities” as well as to “explore opportunities for long-term agreements.”<sup>525</sup> In the imports of oil, the preference was given to the long-term barter contracts with individual Soviet Republics, although 70% of imports were already secured through co-operation in Yamburg and Orenburg fields. In addition to diversification, the policy paper recognized the problem of Hungary in the “bad economic structure focused on the undemanding Soviet market”<sup>526</sup> Therefore the Antall government acknowledged the problem of relations with Soviet Union as a priority: “The most important problem to be solved [was] terminating Hungary’s reliance on Soviet energy deliveries.”<sup>527</sup>

Minister of foreign affairs Jeszenszky saw the Russian risk specifically: “there are new imperialists around, and extremists may get the upper hand in Russia.”<sup>528</sup> It is therefore of no surprise that diversification was at the core of the energy policy, expecting that “In the spirit of diversification, energy supply will be based on several natural resources, and imports obtained from several countries.”<sup>529</sup> At the same time the proposed policy aims were maximalist, not reflecting the necessity for compromise and prioritization.

The drive to transform the economy, including discussion of privatization of utilities and banks took place within context of “heightened political sensitivity about foreign economic

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<sup>524</sup> Ibid., Annex I (Section III).

<sup>525</sup> Ibid.

<sup>526</sup> Ibid., Annex I, section IV.

<sup>527</sup> MTI Econews, “Hungary sets up Energy Strategy Committee”, November 16, 1990, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Hungary+sets+up+Energy+Strategy+Committee&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

<sup>528</sup> Andrew Borowiec, “Hungarian sees danger in Russian nationalism,” *The Washington Times*, March 3, 1994, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJB-3D50-002Y-426W&csi=8176&oc=00240&perma=true>.

<sup>529</sup> MTI Econews, “Hungarian Energy Management in the Nineties” (Budapest, August 25, 1992), <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Hungarian+Energy+Management+in+the+Nineties&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

domination.”<sup>530</sup> The major interest conflict materialized in the context of drive to transform the economy to enable it to compete at the western markets, with the response from the population facing hardship.

### 6.3.1. Interest Coordination

In October 1990, as the Gulf war was in progress and the Soviet oil supplies were cut-back, government attempted to increase the prices of gasoline. Taxi and truck drivers barricaded streets of Budapest in response to the nearly 70% gasoline prices hike. The blockade ended after four days when government agreed to a reduction of planned price increase by half.<sup>531</sup> As a follow-up to the taxi and truck driver’s strike, interest co-ordination council was established. Although the media criticized the council for insufficient transparency and questioned its representativeness,<sup>532</sup> the council followed, though remodeled, the previous tripartite negotiating body the Interest Reconciliation Council.<sup>533</sup> The unions’ hostility towards the government continued, the example in energy policy was the unions opposition to the government’s idea of off-setting the energy price increases.<sup>534</sup>

The largest and most militant of Hungary’s unions, main successor of the former communist regime’s trade union, National Federation of Hungarian Trade Unions (MSzOSz/NAHTU), demanded that at least 15% of the revenues from privatization go towards creating new jobs, and that at least five billion forints (approximately \$38m) are set aside for the energy price

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<sup>530</sup> Financial Times, “Hungary signals state utilities sell-off this year.”

<sup>531</sup> Kaslow, “Hungary Battered by Energy Costs.”

<sup>532</sup> MTI Econews, “Secret Economic Programme - Nepszabadsag, Magyar Hirlap”, December 12, 1990, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJF-WJH0-004B-W09J&csi=8279&oc=00240&perma=true>.

<sup>533</sup> Barnabás Ferenczi et al., “In Focus I. Wages: A Decade Of Transformation,” in *The Hungarian Labour Market 2002*, ed. Károly Fazekas and Jenő Koltay (Budapest, 2002), 54.

<sup>534</sup> Hungarian Radio, “Trade unions ready to call strikes over government inaction,” *BBC Summary of World Broadcasts*, June 6, 1991, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3W37-68C0-002S-W1NK&csi=10962&oc=00240&perma=true>.

compensation.<sup>535</sup> Neither in Slovakia, nor Czech Republic unions had such a specific requests nor had such requests been seriously considered. Besides representing the interest of the workers, unions were seen to be closer to the SZDSZ and MSZP opposition political parties. These parties were sometimes reported as being behind some of the industrial action, even if they were only selectively supportive of the same policy issues.<sup>536</sup> The support from unions and relations between the unions and the opposition was further corroborated in the next electoral period (1994-1998) when 14 members of the MSzOSz leadership were in the parliament as part of the MSZP faction.<sup>537</sup>

Additionally to the industrial action against price hikes, position of mines and miners united in the Hungarian Federation of Mine Workers Unions (BDSZSZ) was important. Járosi and Petz note that mine unions played an important role as they pressured Antall government with recurrent “threats of strike” claiming that their interest was saving the domestic coal mining, but effectively prevented implementation of the restructuring program, while they took part in coal imports.<sup>538</sup>

Government responded partly by following unions’ requests, but “with high oil prices, collapsing exports, drought and a growing budget deficit, political consensus [was] hard to come by.”<sup>539</sup> The government tried to weaken the unions, before “free market policies begin to bite.”<sup>540</sup>

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<sup>535</sup> MTI Econews, “National Strike Called Off”, June 12, 1991, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YFW0-004B-W396&csi=8279&oc=00240&perma=true>.

<sup>536</sup> MTI Econews, “Strike - Background”, June 12, 1991, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YFW0-004B-W395&csi=8279&oc=00240&perma=true>; MTI Econews, “National Strike Called Off.”

<sup>537</sup> Trencsényi Dávid, “Sztrájkőrők,” *168 Óra Online*, December 3, 2007, <http://www.168ora.hu/itthon/sztrajktorok-8901.html> (accessed December 20, 2012).

<sup>538</sup> Vilmos Holló, “Az erőmű-bánya integráció lezárása és értékelése (Closing and evaluating the power plant -mine integration),” *MVM Rt. Közleményei*, April 1993, 1–3; Vilmos Holló, “Az erőmű-bánya integráció II. és III. üteme (The 2nd and 3rd phase of the power plant - mine integration),” *MVM Rt. Közleményei*, March 1994, 37–45. As cited in Járosi and Petz, *About the Hungarian energy policy prior to the accession to the EU*.

<sup>539</sup> Roberts, “EUROPE: Hungary: Do-it-yourself Capitalism Needs A Helping Hand - Long seen as the most westernised of the East European economies, Hungary has been the favourite destination for western investment in the former Communist bloc. But is this reputation justified?”

<sup>540</sup> Seumas Milne, “Europe: Bashing Unions in the East - Governments in Hungary and Poland are busy cutting the increasingly assertive trade union movement down to size before free market policies really bite. Seumas Milne

Additionally given that the National Federation of Hungarian Trade Unions, incumbent ex-communist union, was siding with government's political opposition, it was not a coincidence that it was to be hit the hardest by government's decision to have its assets divided-up among all of the unions.

The requests of miners were met by payment of the miners' loyalty bonus, and the coal allowance for retired miners,<sup>541</sup> as well as an agreement to involve them in discussions over the energy policy.<sup>542</sup> The role of miners in energy policy is important because it influenced the amount of maneuvering space government had to choose domestic energy mix. This was particularly visible in case of Czech Republic, where the amount of domestic coal used by electricity and heat generation utilities remained more-less on par with the production levels and needs of the electricity and heat generators. Even so, the unions' role in Czech Republic never reached the prominence of their Hungarian colleagues.

Partly also due to industrial action which was much more present than in case of either Czech Republic or Slovakia, the liberalization of gas prices was significantly postponed in Hungary. Main reason was because "society's current [limited] burden sharing capability does not make possible the establishment of this [liberalized prices reflecting actual costs] overnight."<sup>543</sup> Additionally, in the context of concern for "whether privatization would threaten the security of consumers and lead to drastic price rises," the Energy Office was promised to "turn into a

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reports on moves to bring workers to heel," *The Guardian* (London, August 9, 1991), <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=40FN-NWW0-00VY-912T&csi=138620&oc=00240&perma=true>.

<sup>541</sup> Hungarian Radio, "HUNGARY; Negotiations on purchase of home-produced coal by electricity board," *BBC Summary of World Broadcasts* (Budapest home service, November 16, 1992).

<sup>542</sup> MTI Econews, "Miners and government reach agreement", January 10, 1992, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJH-YWX0-004B-W2X3&csi=8279&oc=00240&perma=true>.

<sup>543</sup> Hungarian Radio, "Minister submits draft bill on regulating electricity and gas supplies," *BBC Summary of World Broadcasts*, November 8, 1993, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3S51-TCR0-0017-G52F&csi=10962&oc=00240&perma=true>.

licensing authority and in the course of privatization [...] to safeguard special consumer protection rights, [and] ensure the continuity of services.”<sup>544</sup>

The coupling between coal-mines and electricity (together with heat utilities) can be compared to the economic coupling between refineries and ethylene consumers. This coupling therefore offers an excellent negotiation opportunity for interest coordination, beneficial to both sectors. This supportive dependence was partly used during center-right government, when mines that were tied to electricity and heat producers maintained their government support, and those that were not were left in the cold and their subsidies were stopped, which effectively meant their end.

### 6.3.2. Privatization

Initially, privatization started slowly, in 1993 the right-wing reformist Antall government allowed privatization only to the general public in exchange for privatization vouchers (1%) and to the municipalities (7%) whose land was occupied by several MOL Rt. facilities.<sup>545</sup> Privatization of oil and gas energy sector took off with high speed only during the subsequent Horn government.

Antall government started the transformation of energy sector by converting state owned companies into state owned stock companies, but it stopped short of full privatization, as the stated objective was to maintain “majority state ownership for undertakings of strategic importance in the energy sector.”<sup>546</sup>

The economic transformation in the energy sector was mostly visible in case of hydrocarbon<sup>547</sup> and electricity<sup>548</sup> energy industries. Privatization was seen primarily as a tool in transformation,

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<sup>544</sup> Hungarian Radio, “Journalists briefed on plans for privatizing energy companies,” *BBC Summary of World Broadcasts*, December 22, 1994; IEA/OECD, *Hungary 1991* Annex 1, section III.

<sup>545</sup> OECD and International Energy Agency (IEA), *Energy policies of IEA countries: Hungary 1999 review* (Organisation for Economic Co-operation and Development, 1999).

<sup>546</sup> Járosi and Petz, *About the Hungarian energy policy prior to the accession to the EU*; IEA/OECD, *Hungary 1991* Annex 1, section III.

<sup>547</sup> The Hungarian Oil & Gas Company (Magyar Olaj-és Gázipari - MOL) was founded in 1991, as the legal successor to the National Crude Oil and Gas Trust (*Országos Kőolaj és Gázipari Tröszt* - OKGT) by merging nine of the OKGT constituting companies. The remainder of the previously incorporated industry areas, such as the natural gas distribution companies (five regional subsidiaries of OKGT and FŐGÁZ) as well as oil industry

and the cash receipts were not the highest priority, especially as “the participation of foreign capital was subject to capital investments which serve long-term objectives of the energy policy.”<sup>549</sup> Initially, advent of the foreign capital and domestic ownership were seen as compatible.<sup>550</sup> Progressively, however, this connection became more ambivalent. The cash for shares practice of the Antall government received relatively low public support of only about 10%<sup>551</sup> mainly because of the public perception of this being advantageous to the foreign investors.

This happened in the context of talks with the World Bank and the European Bank for Reconstruction and Development (EBRD), which was to be used also for reconstruction program developing energy generation capacity.<sup>552</sup> A number of energy traders of minimal strategic importance including the Trading Company for Fuels and Construction Materials (TÜZÉP), that had a monopoly in the solid fuel market, and ÁFOR, with dominant position on the liquid fuels were slated for gradual privatization. Nonetheless it was clear, that strategic energy assets were to remain under the government control for the foreseeable future.

The elimination of monopolies in the energy sector, and the liberalization of pricing were understood as tools for increasing energy efficiency, which was to be achieved also by tax and credit policies.<sup>553</sup> The transformation of the energy sector already in the first phase was expected

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machinery production firms, became state owned stock companies. “MOL Rt Company Profile, Information, Business Description, History, Background Information on MOL Rt”, n.d., <http://www.referenceforbusiness.com/history/Lo-Me/MOL-Rt.html> (accessed March 24, 2012).

<sup>548</sup> Until 1991 the Hungarian electricity sector comprised of the Hungarian Power Companies Trust (MVMT) which included eight power plant companies (Bakony, Budapest, Dunamenti, Mátra, Paks, Pécs, Tisza and Vértes), six regional power supply companies (ÉDÁSZ, DÉDÁSZ, DÉMÁSZ, ÉMÁSZ, TITÁSZ and ELMŰ), and the company operating the basic network (OVIT). In 1992 MVMT was restructured, and the power plants and supply companies were separated as state owned companies. These companies continued operating in the holding structure under the leadership of MVM Rt. until the privatization of distributors and power plants subsequently during the socialist government.

<sup>549</sup> Járosi and Petz, *About the Hungarian energy policy prior to the accession to the EU*.

<sup>550</sup> Angelusz Róbert - Tardos Róbert, *A piacgazdaság társadalmi megítélése*, Műhelytanulmányok (Budapest: Budapesti Közgazdaságtudományi Egyetem, 1996), 7, [http://edok.lib.uni-corvinus.hu/217/1/MT\\_2\\_Angelusz\\_Tardos.pdf](http://edok.lib.uni-corvinus.hu/217/1/MT_2_Angelusz_Tardos.pdf) (accessed December 20, 2012). page 7.

<sup>551</sup> *Ibid.*, 13.

<sup>552</sup> MTI Econews, “Hungarian Energy Management in the Nineties.”

<sup>553</sup> MTI Econews, “Government draft on privatization of energy sector”, November 15, 1990, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Government+draft+on+privatization+of+energy+sector&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

to decrease both production and employment, but government expected that this would be offset by “the boom in private ventures in the processing industry.”<sup>554</sup>

### 6.3.3. Diversification

Antall right-wing government had optimistic plans for diversification and linking the country to the Western, Mediterranean and regional gas pipeline system. Nonetheless, these plans were gravely hampered by the lack of necessary funds.<sup>555</sup> The first step to diversify gas purchases and deliveries was a pipeline construction contract signed in Vienna in February 1994 by Austria’s state mineral oil company (OVG-AG) and Hungarian MOL on the construction of the Győr-Baumgarten pipeline under a Hungarian government guarantee. This activity by right-wing Antall-Boross government constituted single, but only a partial, diversification of gas undertaken by Hungary until 2010. The actual construction of the \$245-million-project started in March 1994, and three-fifths of the costs were covered by Austrian side.<sup>556</sup> The alternative gas pipeline was operational since October 1996.

While this new pipeline provided an alternative “emergency” connection to the Western Europe, given that the only contracts to supply these pipelines were on a swap basis with Ruhrgas<sup>557</sup> and with GDF<sup>558</sup> it was not a genuine primary energy source diversification. The small capacity and lack of complementary contract with producers did not provide for substantial energy security improvement – neither for the n-1 incident, nor for the price negotiation. Czech Republic had a contract for gas directly from the producer, and the diversification of the gas in Czech Republic

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<sup>554</sup> MTI Econews, “Ministry develops industry and trade policy package for Hungary”, April 16, 1991, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Ministry+develops+industry+and+trade+policy+package+for+Hungary&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

<sup>555</sup> MTI Econews, “Parliament Passes Energy Plan for Hungary”, June 4, 1993, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3SJJ-6TD0-004B-W46B&csi=8279&oc=00240&perma=true>.

<sup>556</sup> MTI Econews, “Gas Pipeline Between Hungary and Austria”, April 12, 1994, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Gas+Pipeline+Between+Hungary+and+Austria%C3%A2%E2%82%AC%C2%9D%2C+April+12%2C+1994.&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

<sup>557</sup> 10 years contract for 0.5bcm

<sup>558</sup> 15 years contract for 0.4 bcm

provided not only technical option to import gas from alternative pipeline corridor in the west, but also for improved negotiation position vis-à-vis Russia – the most important supplier.<sup>559</sup> No further physical pipeline diversification happened in Hungary until the end of socialist-liberal rule in 2010.

#### **6.4. Horn: Cash Receipts over Security (1994-1998)**

Nature of Hungarian energy sector and prioritizations of energy security were affected tremendously by Horn government. What has happened during socialist-liberal Horn government corroborates the hypothesis that left-wing governments in the transition context of Central and Eastern Europe benefit from the linkages to, and lack of fear of post-soviet Russia, and therefore do not prioritize energy security in their energy policies. The supporting evidence can be found across many policy decisions that the Horn government made, but the two examples worth spelling out in detail are privatization choices and relations with Russia as illustrated by the repayment of the soviet-era debt.

While Horn government liberalized economy, government also created opportunities for private interest in energy sector benefiting former nomenclatures, similarly to what happened in Slovakia. An excellent example in point is the distribution of import licenses,<sup>560</sup> the setting up of the Panrusgáz Company and handling of the post-soviet debt. The story of Panrusgáz and handling of the post-soviet debt is one of the most interesting narratives of socialist-liberal Horn government in particular, and of Hungarian energy policy history in general.

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<sup>559</sup> The mocking view of this incomplete “diversification” from 1996 can be seen in the cartoon published in Czech Republic, where this was seen as just another way for importing Russian gas more expensively through a bypass. The copy of the cartoon is annexed as Figure 118.

<sup>560</sup> Mineralimpex, state-owned company supervised by the Ministry of International Relations, was the main foreign trading organization in the oil and natural gas business enjoying the full monopoly before 1991. The company became corporatized in 1992 and in May 1995 the company came under the control of MOL Rt. as a fully-owned subsidiary. Another import license was granted to a newly created company Panrusgáz. Mineralimpex also owned 5% of Panrusgáz before it became a MOL Rt. subsidiary. The subsidiary was renamed and reestablished as MOL Trade-Mineralimpex Rt. in 1996. OECD and (IEA), *Energy policies of IEA countries*, 57. “MOL - Éves jelentés”, n.d., 1997 – 23, [http://www.mol.hu/hu/a\\_molrol/mediaszoba/kiadvanyok/eves\\_jelentes/](http://www.mol.hu/hu/a_molrol/mediaszoba/kiadvanyok/eves_jelentes/) (accessed March 24, 2012).

On October 1, 1994 in the first months of the socialist-liberal Horn government (took office on 15 July 1994) Russian-Hungarian intermediary company Panrusgáz<sup>561</sup> was set-up. This company not only received second gas import license, shortly after it was also named the exclusive vehicle for the long-term gas import in the 1996 intergovernmental treaty. Panrusgáz was the most important Russian company in Central Europe, there was a similar attempt to set-up similar company in Slovakia (SlovRusGas). In case of Czech Republic Gazprom's front company GasInvest was not able to achieve status of Panrusgáz. Companies of similar status and importance existed only in Ukraine (Respublica, Interhaz<sup>562</sup> and Omrania and Itera<sup>563</sup>).

In 1996, Panrusgáz was named a vehicle in a 20-year-long contract with Gazprom export, for the import of 194bcm of natural gas in the period of 1997-2015, thus receiving monopoly on Gazprom originated natural gas imports to Hungary.<sup>564</sup> While Panrusgáz persistently ranked in the top ten of Hungarian companies in terms of revenue, it remained one of the most secretive companies. Three names were seen in the background of Panrusgáz: Megdet Rakhimkulov, Alexey Zaytsev and János Szitó. Zaytsev, a classmate of János Szitó from Gubkin Oil and Natural Gas University in Moscow came to Panrusgáz from Gazprom-Wintershall Company. Szitó worked at MOL before joining Panrusgáz, only to move further closer to Gazprom when in 2004 he became CEO and President of the Board of Directors of Centrex Hungária, a Centrex Group subsidiary created by Centrex Europe Energy and Gas AG on behalf of Gazprom.<sup>565</sup> Rakhimkulov, perhaps the most important manager of Panrusgáz, and often

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<sup>561</sup> Panrusgáz was created as a joint venture between 50% Gazprom's subsidiary Gazexport, and 50% of nominally Hungarian companies. MOL had 30% share, a fully state-owned company in 1994 Mineralimpex had 5% ownership (the company was acquired by MOL a year later) the final 15% was shared by nominally Hungarian company DKG-East (*Dunántúli Kőolajipari Gépgyár* - Transdanubian Crude Oil Machinery Factory). Given that since 1993 DKG-East was 51% owned by Interprocom a Gazprom affiliated company, Panrusgáz the largest importer of natural gas to Hungary since 1996 was effectively 65% controlled by Gazprom. OECD and (IEA), *Energy policies of IEA countries*, 54.

<sup>562</sup> Controlled by a friend and close associate of Ukrainian president Kuchma, Ihor Bakai.

<sup>563</sup> Set-up on the "off-shore" in Cyprus and Florida, by Igor Makarov, gas businessman originally from Turkmenistan.

<sup>564</sup> VG, "Helycsere a Panrusgázban," *VG*, 2006, <http://www.vg.hu/vallalatok/energia/helycsere-a-panrusgazban-147015> (accessed December 20, 2012).

<sup>565</sup> VG, "Gazprom érdekeltség a magyar gázpiacon," *VG*, n.d., <http://www.vg.hu/gazdasag/gazprom-erdekeltseg-a-magyar-gazpiacon-54435> (accessed December 20, 2012).

referred to as resident representative of Gazprom in Hungary,<sup>566</sup> was managing Panrusgáz from the very beginning in 1994 until 2000.<sup>567</sup>

Between 1989 and 1996 Rakhimkulov was also CEO of Interprocom, a Hungarian-Russian gas company he established in 1989, as a partly Soviet state-owned company.<sup>568</sup> It is not only a historical curiosity, that Interprocom was established on June 15, 1989 – the same day former Soviet leader Mikhail Gorbachev in Germany spoke about tearing down the Berlin Wall. Interprocom was a fully Gazprom owned subsidiary in 1997,<sup>569</sup> but in 1998 it was taken over by Horhat (Khor khat), a company belonging to Rakhimkulov, his wife and his friend Oleg Vaynerov's partner Irina Kravtsova.<sup>570</sup> In 1998 Rakhimkulov joined Gazprom's Board of Directors, and it was about the same time, when his wife Galina, and Kravtsova sold their shares in "Horhat" to the "children of Gazprom."<sup>571</sup> In 1996 Gazprombank bought ÁÉB and Rakhimkulov became its president. In the upcoming years, due to Russian legal restrictions on recapitalization of foreign subsidiaries, Gazprombank sold more and more of its shares in ÁÉB Bank to the Rakhimkulov family. By 2005, 100 per cent of the shares were in the hands of Rakhimkulov family. In addition to the finance and energy sectors, the Rakhimkulovs were active in many other important Hungarian companies across different sectors becoming perhaps the single wealthiest family in Hungary.<sup>572</sup>

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<sup>566</sup> FN24, "Rahimkulov, Mihail", November 5, 2001,

[http://fn.hir24.hu/vallalkozas/2001/11/05/rahimkulov\\_mihail](http://fn.hir24.hu/vallalkozas/2001/11/05/rahimkulov_mihail) (accessed December 20, 2012).

<sup>567</sup> VG, "Aki viszi a bankot: Megdet Rahimkulov," VG, November 8, 2005, <http://www.vg.hu/penzugy/aki-viszi-a-bankot-megdet-rahimkulov-104622> (accessed December 20, 2012).

<sup>568</sup> VG, "Visszavenné pozícióit a Gazprom," VG, n.d., <http://www.vg.hu/gazdasag/visszavenne-pozicioit-a-gazprom-15297> (accessed December 20, 2012).

<sup>569</sup> HVG Archívum, "Részvényátruházás a Panrusgáznál", 37 1997, [http://archivum.hvg.hu/article/199737Reszvenyatruhazas\\_a\\_Panrusgaznal.aspx](http://archivum.hvg.hu/article/199737Reszvenyatruhazas_a_Panrusgaznal.aspx) (accessed December 20, 2012).

<sup>570</sup> Marshall I. Goldman, *The Privatization of Russia: Russian Reform Goes Awry* (Routledge, 2003).

<sup>571</sup> Tatiana Dedikova, (daughter of the head of Gazprom Rem Vyakhirev), Elena Dmitrieva (the daughter of deputy chairman of Gazprom, Vyacheslav Sheremet) and Vitaly Chernomyrdin (son of Viktor Chernomyrdin, founder of Gazprom and prime minister of Russia) details in Ibid.

<sup>572</sup> Including 56% in Zalakerámia; 15% in Antenna Hungária; over 6% of MOL; 5.3% in OTP Bank and 20% in BorsodChem. Menedzsment Fórum, "OTP: spekulációkat indított el az ország leggazdagabbjának beszállása - Menedzsment Fórum, mfor.hu", szeptember 2006, <http://www.mfor.hu/cikkek/29956.html> (accessed December 20, 2012).

Members of the Rakhimkulov family also occupied top positions in the management of Panrusgáz directly, and reappeared in different roles and different companies during the attempted hostile takeover of BorsodChem.

Similarly to Panrusgáz, Russians wanted to establish a similar trader vehicle for crude oil imports. This story, in Hungarian media referred to as “Olajgate”, involved the manipulation of Russian oil exports to Hungary and the involvement of businessmen and entrepreneurs affiliated with the ruling socialist government.<sup>573</sup> Members of the socialist party might have allegedly financially benefited in the way how the repayment of the ex-soviet debt towards Hungary was handled.<sup>574</sup>

#### 6.4.1. Repayment of Russian Debt

Repayment (deblocking) of soviet-era Russian debt was an excellent “business” opportunity as was illustrated also in the case of Slovakia. In Hungary, already in 1993 a lobby group was set up, Társaság a Keleti Piacokért Egyesület (TAKPE), to deal with the Russian state debt opportunity. President of the group was Ottó Hujber, at the same time president of the MSZP’s business section.<sup>575</sup> In January 1994, Hujber authorized by Béla Kádár, minister of the Ministry of Foreign Economic Relations (NGKM) negotiated and signed a memorandum of understanding with Russian minister Kuramin, for the benefit of his companies<sup>576</sup> to deliver products to Russia.<sup>577</sup>

A month before the elections, in April 1994 Prime Minister Boross and his Russian counterpart Viktor Chernomyrdin agreed on the principles of the debt settlement which was at that time estimated around \$1.7 billion.<sup>578</sup> Because Russians refused to repay the debt by gas and oil

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<sup>573</sup> Magyar Hírlap, “A Gazprom átvette a Panrusgáz,” *Http://www.origo.hu/*, 21 2002,

<http://www.origo.hu/uzletinegyed/hirek/20020221agazprom.html> (accessed December 20, 2012).

<sup>574</sup> Ószabó Attila-Vajda Éva, “Guruló rubelek I.-III.”, January 1, 2002, [http://www.es.hu/oszabo\\_attila-vajda\\_eva;gurulo\\_rubelek\\_i;2005-07-20.html](http://www.es.hu/oszabo_attila-vajda_eva;gurulo_rubelek_i;2005-07-20.html) (accessed December 20, 2012).

<sup>575</sup> Gábor Juhász, “Nevek az MSZP vállalkozói tagozatából,” *HVG Archívum*, 50 1995,

[http://archivum.hvg.hu/article/199550Nevek\\_az\\_MSZP\\_vallalkozoi\\_tagozatabol.aspx](http://archivum.hvg.hu/article/199550Nevek_az_MSZP_vallalkozoi_tagozatabol.aspx) (accessed December 20, 2012).

<sup>576</sup> Adilet Rt., Agroil Kereskedőház Rt., Intertaverz Rt., Hunga-Rus Rt.

<sup>577</sup> Zsolt Arató, “Az Olaj-gate állása: Kincs, ami nem lesz”, 1996, [http://magyarnarancs.hu/belpol/az\\_olaj-gate\\_allasa\\_kincs\\_ami\\_nem\\_lesz-61512](http://magyarnarancs.hu/belpol/az_olaj-gate_allasa_kincs_ami_nem_lesz-61512) (accessed December 20, 2012).

<sup>578</sup> Ibid.

deliveries, other products and services were included in the deal.<sup>579</sup> The agreement stipulated that Hungarian companies were to deliver goods to Russian companies, with Russian state paying the costs directly to the receiving Russian companies. Supplying Hungarian companies were required to sign contract with Hungarian government and pay at least 58% of the Hungarian claims. Contracts with Hungarian companies did not include sanctions in case Hungarian companies would not pay to the Hungarian government for the settled debt. This complex scheme thus provided similar benefit for those select companies as the arrangement with Devín Bank provided in Slovakia.

In September 1995 inter-ministerial committee was set up to handle the Russian state debt towards Hungary and Hujber was also invited to this committee. This committee reviewed available offers from companies offering to handle the Russian state debt. Offers evaluated included those by Hujber's companies, a clear case of conflict of interest. A month later the interdepartmental committee published results of the selection with winning companies belonging to Hujber<sup>580</sup> and László Máté, former vice President of MSZP.<sup>581</sup> On 5 December the opposition parties Fidesz, KDNP, and MDF requested public hearing of Imre Dunai, the Minister for Industry in the Parliament, based on the package containing information on the Russian-Hungarian gas deliveries and the handling of the Russian debt towards Hungary, which they received allegedly from a journalist.

In light of the public pressure, Horn government acknowledged that the debt-settlement framework agreement had deficiencies, and the Hungarian-Russian trade deficit should be reduced, but no action has been taken. Government report also acknowledged that companies belonging to Hujber received authorization to settlement the Russian debt, nonetheless, the obvious conflict of interest stemming from the fact that Hujber was a member of the inter-departmental government committee dealing with the debt-settlement was not mentioned.

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<sup>579</sup> Products and services included military hardware, machinery and Russian property already in Hungary. Barter trade of oil and gas for agricultural products was not permissible under Russian laws.

<sup>580</sup> Vagon Lízing Rt., Petroltank Rt., Intertraverz Rt. and Agrolízing Rt.

<sup>581</sup> Ples Rt., Lorry Kft.

Additionally, during the December 1995 Parliamentary hearing Dunai was unable to explain his son's András Dunai's position as the Moscow representative of New York based Hungarian oil trader "Hungarian Finance and Trade."<sup>582</sup> While Dunai did not see a conflict of interest stating that "his son needs to work somewhere"<sup>583</sup> later on he was forced to resign. The publicly acknowledged portfolio of companies handling lucrative Russian state debt included also System Consulting, a company which handled estimated \$120 million, controlled by László Kapolyi, a powerful businessman close to MSZP.<sup>584</sup>

The practice was so wide-spread that a parliamentary investigation committee was formed to investigate handling of the Russian state debt, planned oil deliveries, as well as the personal connections and conflict of interest. Nonetheless, the parliamentary committee was controlled by members of the ruling MSZP and SZDSZ majority, who concluded that no irregularities or illegal activities occurred. According to some sources, Hungarian taxpayers lost between \$62 and \$68 million<sup>585</sup> which was channeled into private hands.

Also in Hungary the wide-spread problem of "bleaching" of gasoline was present especially between 1994-1998,<sup>586</sup> allegedly<sup>587</sup> these large-scale scams, similarly to Czech Republic and Slovakia included whole network from local police all the way to politicians across different political parties. The party financing using energy deals was thus not limited to Czech Republic or Slovakia, and as the case of Hungary shows, politicians were at times more busy filling-up party coffers than worrying about prioritization of security in their country's energy policy.

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<sup>582</sup> Richárd Hlavay, "Folytatódik az olajgate-ügy," *Energiainfó*, 2002,

[http://energiainfo.hu/cikk/folytatodik\\_az\\_olajgate-ugy.3246.html](http://energiainfo.hu/cikk/folytatodik_az_olajgate-ugy.3246.html) (accessed December 20, 2012).

<sup>583</sup> Gábor D. Horváth, "Az olajgate és az olajügyek: Adalékok a Horn-kormány felelősségéhez," *Magyarnemzet*, September 25, 2000, [http://mno.hu/migr\\_1834/az-olajgate-es-az-olajugyek-857026](http://mno.hu/migr_1834/az-olajgate-es-az-olajugyek-857026) (accessed December 20, 2012).

<sup>584</sup> Ibid.

<sup>585</sup> Magyar Nemzet, "Olajgate-ügy: lassú nyomozás," *Magyar Nemzet*, August 18, 2004,

<http://mno.hu/migr/olajgateugy-lassu-nyomozas-624597> (accessed December 20, 2012). Horváth, "Az olajgate és az olajügyek: Adalékok a Horn-kormány felelősségéhez."

<sup>586</sup> György Wilde, *Face and faith - The 20 year history of the Hungarian Petroleum Association (HPA) in a nutshell*, n.d., [www.mol.hu/repository/782135.pdf](http://www.mol.hu/repository/782135.pdf) (accessed December 22, 2012).

<sup>587</sup> Hlavay, "Folytatódik az olajgate-ügy."

### 6.4.2. Privatization

The support for privatization during Horn government was relatively low, as 1995 poll showed that more than 47% of respondents desired improvement of the situation of state properties with competent professionals rather than privatization.<sup>588</sup> Despite public support for privatization being low, Horn government aiming at economic liberalization and maximizing the cash receipts in order to stabilize macroeconomic situation and prevent financial meltdown went ahead. The rationale used for privatization nonetheless was a leftist one. As Horn's minister for privatization put it "The reason why we have to privatize fast is not that the state is an inappropriate, or incapable owner in general, but because at the moment it lacks the financial resources to restructure its firms [...] I [Suchman] shall do my best to avoid introducing a new austerity program by claiming that the receipts from privatization are missing."<sup>589</sup>

Privatization was not only unsupported, it was openly opposed. In 1995 the union of electricity workers<sup>590</sup> opposed the privatization concept of privatizing 100% of power stations and electricity distributors.<sup>591</sup> The main argument against the privatization was the perceived threat to job security and price increases in favor of profit of foreign investors. In certain cases the privatization was outright unconstitutional, when Horn government sold energy assets it did not rightfully own – as was the case of local gas distribution networks built previously by municipalities, as was ruled in September 1998 by the constitutional court.<sup>592</sup>

In June 1995, socialist-liberal Horn government passed a new Privatization Act. MOL reincorporated as a stock company and listed its shares on the Budapest Stock Exchange that

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<sup>588</sup> Angelusz Róbert - Tardos Róbert, *A piacgazdaság társadalmi megítélése*, 15–16.

<sup>589</sup> Quoted in György Kocsis, "És ha nyerünk?," *Tallózó*, no. January 11 (1996): 55–57. As cited by Béla Greskovits, "Brothers-in-Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation," *Reforming the State: Fiscal and Welfare Reform in Post-Socialist Countries* (2001): 111–41; Greskovits, "Consolidating economic reforms: the Hungarian experience with lessons for Poland."

<sup>590</sup> Villamosenergia-ipari Dolgozók Szakszervezeti Szövetsége

<sup>591</sup> HVG Archívum, "Magas feszültség", June 1995, [http://archivum.hvg.hu/article/199506Magas\\_feszultseg.aspx](http://archivum.hvg.hu/article/199506Magas_feszultseg.aspx) (accessed December 20, 2012).

<sup>592</sup> Petroleum Economist, "New Government Left Holding the Baby", January 6, 1999, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3W05-JGK0-00GT-Y2SS&csi=318086&oc=00240&perma=true>.

year, with a float of some 67 per cent of its shares.<sup>593</sup> The socialist government decided that only 25% plus one share<sup>594</sup> would be kept in state hands, and the remainder of MOL stocks would be sold off. During the Horn government three waves of selling stocks of MOL took place: First one in November 1995, which also marked first sale of eastern European oil company, in 1997 and shortly before the elections in 1998. Already by November 1995, 29% of MOL Rt. shares were in the hands of foreign (mostly institutional) investors, the Hungarian State Privatization and Holding Company (ÁPV Rt.) held 59% of shares. By 1998 the government's plan was fulfilled and only 25% plus one vote was in the hands of ÁPV Rt.

Between 1995 and 1997, during the socialist-liberal government, large part of the electricity assets were privatized to foreign energy companies. German RWE/EnBW purchased stakes in Mátra power plant, and two of the regional distributors (ELMŰ and ÉMÁSZ), E.ON purchased shares in three regional distributors (ÉDÁSZ, DÉDÁSZ and TITÁSZ) and French EdF got stakes in Budapest power plant and DÉMÁSZ distributor. Government guaranteed return on equity of 8 per cent.<sup>595</sup>

After the privatization, MVM maintained the ownership of nuclear power plant Paks, transmission network and a number of small balancing power generators. Since 2006 MVM functioned as “recognized corporate group,”<sup>596</sup> on the basis of this MVM Zrt., which remained state-owned, operates like a holding<sup>597</sup> encompassing all activities from production, transmission and system operation.

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<sup>593</sup> “MOL Rt Company Profile, Information, Business Description, History, Background Information on MOL Rt.”

<sup>594</sup> This was a special type of share commonly referred to as “golden share”.

<sup>595</sup> Financial Times, “EUROPE: Power groups want access to imported electricity”, February 7, 2001; MTI Econews, “Gas prices should be liberalised in three years, Matolcsy says”, August 4, 2000, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=Gas+prices+should+be+liberalised+in+three+years%2C+Matolcsy+says&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

<sup>596</sup> The concept was introduced by amendment to Companies Act which came into force on 1 July 2006

<sup>597</sup> MVM, “Hungarian Power Companies Ltd.”, n.d., <http://www.mvm.hu/en/organization/history/Lapok/default.aspx> (accessed March 19, 2012).

### 6.4.3. Interest Coordination

The most important interest coordination by unions affecting energy was present from the union of electricity workers<sup>598</sup> who questioned the privatization concept on the basis of jobs security.<sup>599</sup>

A leader of the miner's trade union, Antal Schalkhammer, who was also in the parliament in the colors of governing MSZP advocated for law limiting foreign entities and companies' ability to buying maximum one quarter of shares in electricity producer and distributor MVM and maximum 50% less one share in the electricity utility companies. Schalkhammer also tried to keep Dunamenti, Tiszai, and Mátrai power plants as part of MVM until 1997.<sup>600</sup>

Horn government tried to conclude a "socio-economic pact," an agreement with unions that included a system of guarantees, according to which trade unions were to refrain from nationwide strikes once the agreement was signed.<sup>601</sup> Nonetheless, in early 1995 the negotiations over the pact failed.<sup>602</sup>

Horn managed to weaken Sándor Nagy, a leader of the MSzOSz union and MSZP strongman. The social-economic agreement provided the opportunity for Nagy to put his influence at the table to convince other members of the reconciliation council<sup>603</sup> to accept the budget, and the price increases.<sup>604</sup> Nagy believed that they need to agree to these terms in order to get a bigger share from privatization. However, the discrepancy between his union and governing party position made his situation delicate: he voted "yes" on the Bokros package in 1995, but "no" on the privatization law. Horn proposed Nagy to become a vice-prime minister in charge of what

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<sup>598</sup> Villamosenergia-ipari Dolgozók Szakszervezeti Szövetsége

<sup>599</sup> HVG Archívum, "Magas feszültség."

<sup>600</sup> Eörsi János, "Villamosipari patt | Beszélő," *Beszélő Hetilap*, 16. szám, Évfolyam 7, <http://beszelo.c3.hu/keretes/villamosipari-patt> (accessed December 20, 2012).

<sup>601</sup> Hungarian Radio, "BUDGET AND GOVERNMENT REPORTS; Government draws up draft of socio-economic pact," *BBC Summary of World Broadcasts*, December 16, 1994, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3S51-R5K0-0017-G0SB&csi=10962&oc=00240&perma=true>.

<sup>602</sup> Greskovits, "Brothers-in-Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation," 132.

<sup>603</sup> (Érdekegyeztető Tanács – ÉT) UNIO 2004 Consulting Kft., "A Magyarországi érdekegyeztetés története és helyzetének áttekintése a rendszerváltástól 2010-ig", n.d., <http://www.stratosz.hu/fszh/2010-erdekegyeztetes.pdf> (accessed December 20, 2012).

<sup>604</sup> Kalmár Béla, "Nagy Sándor nehéz napjai | Beszélő", *Évfolyam 7, Szám 13*, <http://beszelo.c3.hu/cikkek/nagy-sandor-nehez-napjai> (accessed December 20, 2012).

was planned to become an economy super-ministry, nonetheless what was essentially a power game<sup>605</sup> aimed to weaken Horn's most prospective rival lead to Nagy giving up his seat in the budget committee in the parliament and resignation as leader of MSzOSz.<sup>606</sup>

Horn could put aside Nagy because Nagy lost his support in MSzOSz and MSzOSz could be kept out from the privatization law discussions.<sup>607</sup> Nagy believed in a greater state presence in the economy and major companies and this could have been a clashing point between him and Horn<sup>608</sup> because the Horn government prioritized foreign investors. Until 1997 86% of all income coming from privatization was of foreign origin, and the rapidity of foreign investors' arrival further sped up during 1994-1995 period.<sup>609</sup>

## **6.5. Orbán Strengthening the "Hungarian Power" (1998-2002)**

Energy policy during Orbán's government was marked with change of priorities as well as approach. This was not by chance; energy policy became one of the most important agendas of the ministry of economy.<sup>610</sup> Government pledged to "stop the privatization of the energy sector to ensure that strategic energy firms remain national property and to create the National Electricity Company."<sup>611</sup> Government made it very clear that the majority ownership and strategic control of energy assets which were not privatized by the previous government were to remain under the government control.<sup>612</sup>

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<sup>605</sup> Greskovits, "Brothers-in-Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation," 136.

<sup>606</sup> "Dr. Nagy Sándor", n.d., <http://www.mkogy.hu/kepviselo/elet/n575.htm> (accessed December 20, 2012).

<sup>607</sup> Tamás Bauer, "1995," *Beszélő*, 2000, <http://beszelo.c3.hu/00/06/10bauer.htm> (accessed December 20, 2012).

<sup>608</sup> Origo, "Tizenhárom éves fenyegetést vált be az SZDSZ," *Http://www.origo.hu/*, April 2, 2008, <http://www.origo.hu/itthon/20080401-koalicios-valsag-1995ben-nagy-sandor-miatt-veszett-ossze-az-mszp.html> (accessed December 20, 2012).

<sup>609</sup> "Privatizáció az 1994. évi kormányváltástól 1997 közepéig," Text, n.d., <http://mek.niif.hu/02100/02185/html/400.html> (accessed December 20, 2012).

<sup>610</sup> MTI Econews, "Minister faces heads in the energy sector", July 29, 1998, <http://www.lexisnexis.com/nl/business/docview/getDocForCuiReq?lni=3T8F-S6V0-004B-W3P4&csi=8279&oc=00240&perma=true>.

<sup>611</sup> FIDESZ, "A Fidesz-Magyar Polgári Párt választási negyven pontja," 6.

<sup>612</sup> MTI Econews, "New power capacity unnecessary in Hungary until 2004", April 8, 1999, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=New+power+capacity+unnecessary+in+Hungary+until+2004&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

Orbán won elections promising to reconsider the privatization, and foreign investors were left uneasy. Government not only started investigating privatization contracts, but also reopened energy price regulation formulas basing the prices not on historic inflation, but on future inflation estimates which lowered the residential prices at the cost of investors,<sup>613</sup> and future investments into the infrastructure. Government explicitly aimed to use the price regulation in order to soften the impact of approximation of prices to the global levels on consumers. The pronounced policy was to “control inflation and protect low-income families.”<sup>614</sup> Minister of economy Chikán already in the first weeks of his tenure pointed out that “rationalizing the pricing system is one of the main tasks.”<sup>615</sup> His successor minister Matolcsy made it even more clear when he emphasized that government “cannot expose Hungarian gas consumers to world market prices” in case it had to it would compensate consumers and “grant [them a] substantial compensation.”<sup>616</sup>

Orbán’s rhetoric included protection of consumers and employees in the energy sector, but the legislation that his government passed in the pre-accession period into the EU, was mostly extending the on-going liberalization of the energy sector. The government had quite a militant rhetoric on revisiting the privatization: the contemporary news included voiced government’s plans to “prosecute members of the previous government for, [...], spiriting away Ft 230 bn [\$2.4bn at end-1995 exchange rates] of privatization income, the bulk of it from energy privatization.”<sup>617</sup> Nonetheless, apart from the strong words, none of the actual privatization deals were revoked.

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<sup>613</sup> MTI Econews, “Minister faces heads in the energy sector.”

<sup>614</sup> Financial Times, “EUROPE: Power groups want access to imported electricity.”

<sup>615</sup> MTI Econews, “Hungary’s Energy Policy Under Preparation”, July 29, 1998, <http://www.lexisnexis.com/nl/business/api/version1/sr?sr=rationalizing+the+pricing+system+is+one+of+the+main+tasks.&csi=237924&oc=00240&shr=t&scl=t&hac=f&hct=f&nonLatin1Chars=true>.

<sup>616</sup> MTI Econews, “Gas prices should be liberalised in three years, Matolcsy says.”

<sup>617</sup> Petroleum Economist, “New Government Left Holding the Baby.”

### 6.5.1. Privatization

Before the elections privatization was not among the priority points of the economic policy.<sup>618</sup> Orbán's government instead of privatization focused on redistribution of assets. According to Voszka, government wanted to “*clear the attic*,”<sup>619</sup> by moving the ÁPV Rt. assets outside of the state budget.<sup>620</sup> In addition to what could have been seen as an election campaign, during the second half of the government's term,<sup>621</sup> frequent changes at the companies' managements together with granting the MFB greater authority to unlimited money transfers put question marks on governments' transparency record, as the circle of selected beneficiaries widened.<sup>622</sup> Energy policy focused on consolidating government control and strengthening the national champions. The increased government control, and support to domestic companies had effects of increasing the energy security. Nonetheless, in this process questions about a clientele network of private and party pockets and the economic nationalism emerged.

While privatization of MOL during Orbán government halted, MOL went on to expand its ownership and control outside of Hungary in the neighboring region and beyond. In 1999, the company attempted acquiring a large stake in Croatia's INA oil company. A year later, in 2000 MOL acquired 36% of Slovnaft refinery<sup>623</sup> and took over full control of Slovnaft in 2002. During Orbán's government MOL expanded also in the upstream market mainly to secure the future oil production.<sup>624</sup> During the right-wing government MOL attempted also to expand by buying further assets in Poland and Czech Republic.<sup>625</sup>

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<sup>618</sup> Éva Voszka, “Privatizáció helyett újraelosztás: Az állami vagyon sorsa 1998 és 2001 között,” *Közgazdasági Szemle* XLVIII. évf. (szeptember 2001): 726, <http://epa.oszk.hu/00000/00017/00074/pdf/Voszka.pdf> (accessed December 21, 2012).

<sup>619</sup> *Ibid.*, 732.

<sup>620</sup> *Ibid.*, 726.

<sup>621</sup> *Ibid.*, 741–742.

<sup>622</sup> *Ibid.*

<sup>623</sup> Initially through stocks swap. For details please see Slovak Case Chapter.

<sup>624</sup> By forming a joint venture with Russia's Yukos, MOL won a major concession in Malobalík, in Siberia, in 1999.

“MOL Rt Company Profile, Information, Business Description, History, Background Information on MOL Rt.”

<sup>625</sup> Downstream assets.

The importance of this expansion within the government's perspective was clearly visible. Prime Minister Orbán in a radio interview pointed out that the acquisition of Slovnaft means a “really strong expansion, [and for his eyes] an image of an even broader, bigger Central European company appears, centered on MOL.”<sup>626</sup> The involvement and support from the government was visible also as Orbán together with his Slovak counterpart Mikuláš Dzurinda as guests of honor celebrated the launch of the strategic partnership between MOL and Slovnaft at the gala night in the Bratislava Opera house.<sup>627</sup> The reason was not only given the MOL-Slovnaft contract ranked at the very top of Hungarian investments abroad at that time.

In addition to refineries,<sup>628</sup> position of which was consolidated and strengthened during Orbán government, additional two important companies linked in petrochemical industry in Hungary are important for understanding energy security: TVK and BorsodChem (BC). The relation between these companies and MOL is that of mutual dependence.<sup>629</sup> The transformation of petrochemical industry in Hungary started in 1991, and the process formally concluded in 1996 during the Horn government when the company was privatized.<sup>630</sup> BorsodChem during Orbán's government went on expanding, when in 2000 it acquired MCHZ Company in Czech Republic. The complex relationship of dependence within the petrochemical industry was governed by set

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<sup>626</sup> Orbán Viktor, “A miniszterelnök a Reggeli Krónikában az árvizekről, MOL-ról, a mezőgazdaságról”, April 5, 2000, [http://2001-2006.orbanviktor.hu/hir.php?aktmenu=3\\_4&id=369](http://2001-2006.orbanviktor.hu/hir.php?aktmenu=3_4&id=369) (accessed December 21, 2012).

<sup>627</sup> MOL, “Ünnep volt Pozsonyban”, February 11, 2001, [http://www.mol.hu/hu/a\\_molrol/mediaszoba/kozlemlenyek/archivum/2001/2001.\\_februar\\_11./](http://www.mol.hu/hu/a_molrol/mediaszoba/kozlemlenyek/archivum/2001/2001._februar_11./) (accessed July 7, 2013).

<sup>628</sup> MOL had control over all refineries in the country: Százhalombatta and two other smaller refineries in Zalaegerszeg and Tiszaújváros (Crude oil processing was discontinued in two small refineries of Nyírbogdány and Komárom in 1983 and 1984, respectively.). Since 2001, when refining at Zala and Tisza refineries was discontinued the Duna refinery in Százhalombatta remains the only refinery in Hungary refining crude oil. MOL also owns 13 out of the fifteen storage facilities for oil and oil products in Hungary.

<sup>629</sup> MOL supplies TVK with the byproduct of the refining process (naphtha) which is raw material for TVK to make ethylene and which MOL would otherwise have to find other use or storage for. TVK sells the ethylene it produces further to BC, which needs it to make PVC and other materials used in plastics and processing. This creates essentially a captive market for MOL, and TVK.

<sup>630</sup> The transformation of petrochemical industry in Hungary started when Borsodi Vegyi Kombinát (BVK) was transformed into BorsodChem (BC) in 1991, and Tiszai Vegyi Kombinát (TVK) was transformed into a state-owned joint stock company on January 1, 1992. The TVK was privatized in 1996 during the Horn government

of long-term contracts.<sup>631</sup> In addition to the intercompany relationships, because of the existence of ethylene pipeline network<sup>632</sup> connecting BC to TVK in Hungary and further with Oriana Company in Ukrainian Kalush, control of these companies had an important strategic role for the energy policy of Hungary. This has been demonstrated by the incident in 2000-2001 when Gazprom through a web of front-end companies controlled allegedly by Rakhimkulov family in Hungary attempted hostile takeover of BorsodChem.<sup>633</sup>

In 2000, an Irish-registered offshore company Milford Holdings acquired a 24.7% stake in BorsodChem, which by that time also owned a stake in TVK, owner of the aforementioned pipeline network. Orbán's center-right government, fearing that a takeover would reduce Hungary's energy security by giving Gazprom a foothold in country's pipeline network and indirect control over MOL, mobilized local companies and banks to fend off the hostile takeover. In response, Milford went on a BorsodChem buying spree on the Budapest Stock Exchange. A further set of obscure firms also started buying, increasing further fears that they too were working with Gazprom. Eventually, in a complex deal between TVK, BorsodChem and MOL, brokered with the support of Orbán's government the Russians were excluded and the balance of relationships and mutual domestic interdependencies among the companies was restored.<sup>634</sup>

The increased state control and government support towards international expansion of Hungarian energy giant MOL, together with clear policy support to strengthen and integrate the position of electricity giant MVM, resulted in what some could see as economic nationalism, and

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<sup>631</sup> In April, 1994 TVK and BorsodChem Rt. concluded a long-term ethylene supply agreement and in March, 1994 TVK and MOL concluded a 10 year feedstock supply agreement

<sup>632</sup> Because of strict regulations and high risk, ethylene can effectively be transported only using pipelines. American Chemistry Council, *Ethylene Product Stewardship Guidance Manual*, 2004, [http://www.lyondellbasell.com/techlit/techlit/Handbooks%20and%20Manuals/ACC\\_Ethylene\\_Manual%203096.pdf](http://www.lyondellbasell.com/techlit/techlit/Handbooks%20and%20Manuals/ACC_Ethylene_Manual%203096.pdf).

<sup>633</sup> Orbán, *Power, energy, and the new Russian imperialism*, 92ff.

<sup>634</sup> Neil Barnett, "From Poland to Hungary, Gazprom takes stealth route to domination," *The Independent*, January 8, 2006, sec. Business Analysis & Features, <http://www.independent.co.uk/news/business/analysis-and-features/from-poland-to-hungary-gazprom-takes-stealth-route-to-domination-522003.html> (accessed March 24, 2012).

centralization of power. These policies of Orbán's center-right government, nonetheless, increased energy security and show prioritization of security in the energy policy.

Orbán, educated at Oxford<sup>635</sup> and being an outspoken critic of the soviet occupation of Hungary, was not known to have Russian connections, or friends from the previous regime.<sup>636</sup> This was also one of the reasons why Orbán's government has also been in favor of prolonging and extending the lustration laws and cutting the ties with the past.<sup>637</sup> Although the lustration was never as thorough as in Czech Republic, which allegedly could be because thorough and transparent lustration process would also affect a number of high-ranking FIDESZ politicians.

During Orbán's government relations with Russia have come almost to a complete freeze, and the publicly perceived hostile takeover attempts and expansion of Rahkimkulovs in Hungary further supported the logic of diversifying away from Russia and strengthening the role of Hungarian energy companies.

## **6.6. Resuming the Sellout, and the Russian Friendship (2002-2006)**

After four years of "economic patriotism", which prioritized security and welfare over other aims of energy policy, Medgyessy socialist-liberal government resumed power. Two aspects characterized this government – notable improvement of relations with Russia and restart of privatization selling out the last remnants of strategic energy assets which were not sold until 1998. The way how relations with Russia and security objectives were handled during this period demonstrates that other priorities were more important for Medgyessy's government than security of energy supplies. The change of the perspective was illustrated by radical replacement

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<sup>635</sup> "Orbán studied the history of British liberal political philosophy in Pembroke College, Oxford, sponsored by the Soros Foundation." "CV of Viktor Orbán", n.d., [http://www.miniszterelnok.hu/in\\_english\\_cv\\_of\\_viktor\\_orban/](http://www.miniszterelnok.hu/in_english_cv_of_viktor_orban/) (accessed March 11, 2013).

<sup>636</sup> Although according to Debreczeni, he has been a secretary of KISZ at his secondary grammar school at the age of 15. József Debreczeni, *Orbán Viktor* (Osiris, 2002).

<sup>637</sup> While SZDSZ as a party was much more supportive of lustration and vetting processes, their all-encompassing ideas were curbed and watered down. Many of SZDSZ's lustration ideas simply were not implemented when they were in coalition government with MSZP.

of bureaucrats and experts including at the helm of independent energy regulatory authority – which was later deemed unconstitutional.<sup>638</sup>

### 6.6.1. Relations with Russia

Relations with Russia improved significantly during Medgyessy government. Medgyessy had a clear links to the former regime, he was Minister of Finance and vice-prime minister for economy in last years of the Kádár regime and member of the Central Committee of the Communist Party.<sup>639</sup>

It was his government that negotiated the return of precious books from Sárospatak Calvinist College Library. Medgyessy government bought back the books which were taken from Hungary as part of the World War II spoils. Economically, Medgyessy government also opened doors to Russians.

Delegation including the Prime Minister, minister of finance László Kovács and minister of economy and transportation István Csillag were present in Moscow in 2002 when MOL and Yukos signed agreement on the development of the Zapadno-Malobalik field.<sup>640</sup> Medgyessy emphasized importance of the Hungarian investment at the time. Hungarian Prime Minister welcomed “Russian investments in Hungary and expressed his delight that an agreement like this could be made in a time when the Russian-Hungarian relations are going on an upwards spiral.”<sup>641</sup> Governments expressed that “neither Hungary nor Russia saw any political obstacle to closer business links” this marked a notable change following “a frosty period under the previous

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<sup>638</sup> Judit Zegnal, “What a gas (law)! Interview with Peter Kaderják,” *Budapest Business Journal*, March 5, 2007, <http://sip-trunking.tmcnet.com/news/2007/03/05/2385256.htm> (accessed December 22, 2012).

<sup>639</sup> Greskovits, “Brothers-in-Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation,” 137.

<sup>640</sup> MOL, “A MOL és a Jukosz a Zapadno-Malobalik olajmezőre vonatkozó szerződést írt alá | MOL-Csoport Befektetői Kapcsolatok”, December 20, 2002, <http://ir.mol.hu/hu/mol-es-jukosz-zapadno-malobalik-olajmezore-vonatkozo-szerzodest-irt-ala/> (accessed December 22, 2012).

<sup>641</sup> “Mol-Jukosz megállapodás Moszkvában | Belföld - Magyarország hírei | Győr-Moson-Sopron - kisalfold.hu”, n.d., [http://www.kisalfold.hu/belfold\\_hirek/mol-jukosz-megallapodas\\_moszkvaban/1035463/](http://www.kisalfold.hu/belfold_hirek/mol-jukosz-megallapodas_moszkvaban/1035463/) (accessed December 22, 2012).

center-right government, when Russian business interests made unwelcome moves into Hungary's petrochemical sector.”<sup>642</sup>

This was in the context of more generally expressed interest from Russian's to enter Hungarian strategic energy assets. Mikhail Kasyanov Russian minister of finance during his 2003 visit in Budapest stated his hopes that “Russian companies could get shares in MOL and also operate gas stations in Hungary.”<sup>643</sup> Kasyanov referred to the long history of Russian gas and oil exports to Hungary and several forms of cooperation including the MOL-Yukos project in Siberia.<sup>644</sup> Nonetheless, these cordial relations with Russia did not translate into lower prices for energy resources, even if compared with neighboring or other comparable countries.<sup>645</sup>

It is hard to measure the effects on the FDI, to assess whether the warming up of the relations resulted in any economic benefit through investments. In the dearth of reliable quantitative data and *modus operandi* of Russian businesspeople this is close to impossible to assess. While OECD provides statistics for FDI between Hungary and Russia since 1999, the reliability and validity of this statistics is questionable. Russian business, and this is particularly true for businesses connected with strategic sectors and energy, do not operate directly under Russian Letterheads and Flag. Because of tax optimization, higher ownership safety and beneficial ownership secrecy, they casually use off-shore heavens. In this context measuring quantitative aggregate impact of these relations in terms of inflows of FDI would require investigative effort which is beyond the point of the current project.

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<sup>642</sup> Eddy Kester, “Hungary to sell stake in Mol,” *Financial Times*, October 17, 2002.

<sup>643</sup> MTI, “Szabad az út az orosz tőke előtt”, September 9, 2003,  
<http://www.origo.hu/gazdasag/hirek/20030909szabad.html> (accessed December 22, 2012).

<sup>644</sup> MTI, “Medgyessy szívesen látja az orosz befektetőket”, September 9, 2003,  
<http://index.hu/gazdasag/magyar/orosz030909/> (accessed December 22, 2012).

<sup>645</sup> IEA/OECD, *Natural gas information 2009*.

### 6.6.2. Privatization

The leftist government announced its plans for resuming the sellout of strategic energy assets. At the time MOL had still been the most important energy asset in Hungary<sup>646</sup> and the structure of its ownership was of high importance for prioritizing security in the energy policy. Istvan Csillag, minister of economy “did not rule out allowing strategic investors to buy into MOL, possibly including Gazprom” the statement was at the time seen as an “apparent shift away from the state’s reluctance to allow a strategic investor into the company, and signals Hungary’s new willingness to strengthen business ties with Russia.”<sup>647</sup>

Concurrently with the improved relations with Russia the sellout pursued. In 2004 ÁPV Rt. sold 10.4% of MOL shares outside of the stock exchange.<sup>648</sup> A year later in 2005, already the first Gyurcsány cabinet allowed MOL a 10% per cent optional right to acquire its own shares.<sup>649</sup> Just before this, head of Gazprom Aleksey Miller hinted that Gazprom and LUKOIL were in negotiation with the Hungarian government for acquiring the remaining 11.7% government shares. After MOL purchased its own shares from the government body ÁPV in 2006 the government controlled shares in MOL dropped to 1.93%. By this time MOL owned 24% of its own shares.

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<sup>646</sup> Until the legal unbundling in 2003 through the Law XLII of 2003 and the implementation decrees which entered into force on January 1, 2004 the sole holder of gas supply license had been MOL through its Natural Gas Division. The new regulatory changes, made because of the EU requirements unbundled the gas trade from the gas system operation (TSO) and opened the gas sector for competition. FGSZ, “Company history | FGSZ”, n.d., <http://www.fgsz.hu/en/content/company-history> (accessed March 24, 2012). The newly created company, 100% owned by MOL was FGSZ Földgázzsállító Zrt. MOL also remained the owner of all gas transit network assets and retained ownership and control of storage facilities, as well as the import and wholesale contracts until 2004. In 2004 MOL sold its gas business (including import licenses, storage and trade) to E.ON. The regional gas distribution companies (DDGÁZ, ÉGÁZ, KÖGÁZ, FÖGÁZ TIGÁZ, DEGÁZ) were all privatized in 1995. The FÖGÁZ was acquired by RWE, DDGÁZ and KÖGÁZ by E.ON, ÉGÁZ and DEGÁZ by GDF-SUEZ, and TIGÁZ by ENI&RWE.

<sup>647</sup> Kester, “Hungary to sell stake in Mol.”

<sup>648</sup> Mihályi Péter, *A Magyar Privatizáció Enciklopédiája*, 27.

<sup>649</sup> *Ibid.*, 28.

According to the MOL's bylaws there was a limit on the treasury shares and therefore 5.5% of MOL shares were moved to Magnolia finance Ltd. a Jersey registered offshore company,<sup>650</sup> and additional 8.2% to French bank BNP Paribas.

The 2006 sale of the remaining 1.74%<sup>651</sup> ÁPV's shares in MOL marked the end of MOL's privatization.<sup>652</sup> Throughout the MOL privatization Hungary received approximately HUF 490 billion (\$2.3bn). According to some, this amount was very low.<sup>653</sup> This view was supported by the fact that (center-right) government paid about the same amount for the repurchase of about a fifth of the company's shares from Russian Surgutneftegas in much more competitive environment, only five years later in 2011.<sup>654</sup>

The stark difference between the left-wing and right-wing governments in their prioritizations of security and welfare in energy policy was visible also by reactions by the opposition. Shortly after the 2002 elections when MSZP-led government launched the privatization process of MOL János Áder, fraction leader of right-wing Fidesz criticized his decision as "unacceptable and irresponsible."<sup>655</sup> Right-wing opposition politician warned that "this move would also lift state control from MOL and the prices would increase drastically."<sup>656</sup> Áder said that the Orbán cabinet also received privatization proposals for MOL but did not proceed in this direction in the interest of the people and the country.<sup>657</sup>

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<sup>650</sup> Napi Gazdaság, "Offshore cégbe kerültek a Mol saját részvényei", March 10, 2006, <http://index.hu/gazdasag/magyar/mol7838/> (accessed December 22, 2012).

<sup>651</sup> Mihályi Péter, *A Magyar Privatizáció Enciklopédiája*, 29.

<sup>652</sup> Origo, "Lezárult a Mol privatizációja," [Http://www.origo.hu/](http://www.origo.hu/), December 11, 2006, <http://www.origo.hu/uzletinegyed/befektetes/20061211lezarult.html> (accessed December 22, 2012).

<sup>653</sup> Mihályi Péter, *A Magyar Privatizáció Enciklopédiája*, 33. András Kósa, "Tanítani való hülyeség a MOL-privatizáció története," *Hírszerző.hu*, June 30, 2007, [http://hirszerzo.hu/hirek/2007/6/30/38885\\_tanitani\\_valo\\_hulyeseg\\_a\\_molprivatizacio\\_to](http://hirszerzo.hu/hirek/2007/6/30/38885_tanitani_valo_hulyeseg_a_molprivatizacio_to) (accessed December 22, 2012).

<sup>654</sup> Origo, "Hogyan nézett ki eddig a Mol tulajdonosi szerkezete?," [Http://www.origo.hu/](http://www.origo.hu/), May 24, 2011, <http://www.origo.hu/uzletinegyed/hirek/20110524-a-mol-tulajdonosi-szerkezete.html> (accessed March 11, 2013); MOL, "MOL-Csoport Időközi Vezetőségi Beszámoló", 2011, <http://bet.hu/newkibdata/107028429/MOL110519QRH01.pdf> (accessed March 11, 2013).

<sup>655</sup> MFI, "Mol-privatizáció: családellenes döntés a nagytőke javára", October 11, 2002, Accessed via: <http://www.fidesz.hu/index.php?Cikk=4941> (accessed March 11, 2013).

<sup>656</sup> Ibid.

<sup>657</sup> Ibid.

Medgyessy/Gyrucsány government successfully brought Hungary into the European Union, and concluded privatization and liberalization of energy sector. Nonetheless, their priorities were not in increasing the security of energy. While not many opportunities during this period were visible, the choices leftist government made at the end of this period, illustrated policy preference consistency. The government preferred energy policy solutions were beneficial more for Russian interests over solutions which were seen more beneficial for Europe in general and I would argue that even for Hungary. An example in point was choice between Russia-sponsored and EU-sponsored Southern Corridor diversification.

This was visible especially when the discussions and choice between gas diversification the “Russian way” or the “European way” were done. The choice was between the Russia-preferred South Stream pipeline over EU-preferred Nabucco which would have improved the security much more than South Stream. The socialist government preferred South Stream, which would instead of increasing security for Hungary mean mainly increase of Russia’s leverage over the transit countries.

## **6.7. Summary**

The experience of Hungary showed exceptional consistency between policies of the center-right and center-left socialist-liberal governments. Right-wing governments implemented policies prioritizing security through and in the energy policy. Right-wing governments acted upon “fear” of Russia, while left-wing governments had other priorities. Left-wing governments focused on increasing competitiveness of the economy through more intensive exposing of it to the effects of global markets and indiscriminate openness to foreign investors. Right-wing governments supported national champions as their economic policy.

Left-wingers also fostered intensive relations with Russia and facilitated Russia's interests in Central Europe.<sup>658</sup> This comes somewhat more surprising than in case of Czech Republic or Slovakia, given that the public support for the right and left wing political parties, unlike in case of Czech Republic and Slovakia, did not follow the division between the perceptions of threat towards Russia (see Chart 108). It is true to the priority threat for Hungary was mainly seen in the threat towards the Hungarians living outside of the post-world war (Trianon) borders in Romania, Yugoslavia and Czechoslovakia.<sup>659</sup> Russia simply did not play such an important role on the security mind-map for Hungarians. In 1992 highest perception of Russia as a threat was among those that did not have clear political party identity (44.56% perceived Russia as threat) but majority of this group (55.44%) at the same time did not consider Russia as a threat. The largest fear of Russia was among MDF supporters with 31.98% (but 68.02% did not see Russia as threat) followed by FIDESZ supporters (31.45%) but 68.55% of FIDESZ supporters did not see Russia as threat and 30.97% of FKgP's supporters saw Russia as threat as opposed to 69.03% who didn't.

In 1995 the highest share of those that saw Russia as a threat was among voters of MDF (31.98%), FIDESZ (31.45%) and FKgP (30.97%). Nonetheless majority of voters of these parties did not see Russia as a threat (68.02%, 68.55%, and 69.03% respectively), even in 1998 this distribution has not changed dramatically, when only 37.62% of FIDESZ voters and only 35.97% of MDF voters saw Russia as threat to their country while 62.38% and 64.03% respectively have not. The lowest perception of threat from Russia was nonetheless seen in 1998 among the voters of communist Munkáspárt when 77.50% of their voters did not see Russia as a threat. (See Chart 108)

While the public perception of threat from Russia in Hungary was much lower than in case of both Slovakia and Czech Republic, many of the similarities with Slovakia reappeared. Unlike in

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<sup>658</sup> Orbán, *Power, energy, and the new Russian imperialism*; Deák, "Diversification in Hungarian Manner: The Gyurcsány Government's Energy Policy."

<sup>659</sup> Details are available in the comparative perception of threat section and particularly in Chart 12.

the case of Slovakia, where the Devín Bank was only thought to be a “Trojan horse of Russian interests in Slovakia”<sup>660</sup> in Hungary Gazprom, and its managers openly had their own bank ÁÉB. The case of settling the soviet era debt is yet another case where similarities between Slovakia and Hungary can be drawn with negative effects for energy policy and the public interest. While in Slovakia the relations between the ruling political elites and beneficiaries of debt settlement had to be inferred indirectly, in Hungary a parliamentary committee for investigations of the conflicts of interests was set-up and relatively ample public information surfaced.

The personal networks linking the ex-communist party to the previous regime were apparent on the highest level, in case of prime-minister Medgyessy, but also on the mid-level as was visible on the example of the involvement of former communist official Andras Knopp<sup>661</sup> in the middleman gas trading company Eural Trans Gas which followed the likes of Interpocom<sup>662</sup> or Itera. Similarly to Slovakia during Mečiar’s era, socialist-liberal political elite prevented investigation when their economic interests were at stake.

Measuring participation of people with links to the former regime is very difficult in Hungary because of the lack of reliable and comparable data.<sup>663</sup> While the personal networks leading to Russia were much more intensive among the post-communist MSZP party, unlike in case of

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<sup>660</sup> Žiak, “Trójský kôň ruských záujmov K zrodu Devín banky (3).”

<sup>661</sup> Kupchinsky, *Gazprom’s European Web*.

<sup>662</sup> Followed chronologically in its regional role by Ukrainian Republica, Interhaz, (both by Ihor Bakai, close associate of Kuchma); and Omrania and Itera (Cyprus and Florida, founded by Igor Makarov).

<sup>663</sup> Using the crude proxy of manual cross-search performed on biographies and names of members of different Hungarian governments and news articles (with a help of native Hungarian research assistant) corroborates, although very weakly, the division observed in both Czech Republic and Slovakia. While the first Hungarian government of transition had minimal personal ties to the Hungarian Socialist Workers' Party (MSZMP) or its youth organization Hungarian Young Communist League (KISZ) as a representative organizations of the communist regime. The following government lead by the post-communist MSZP had majority of its ministers who were members of either of the former communist regime organizations. The right-wing government had about half of its ministers with identified ties to MSZMP or KISZ, including a number of high ranking ministers. (Városi Újság, “A Fidesz azon politikusainak listája, akik korábban a kommunista rendszerben valamilyen funkciót töltöttek be.”)

Since KISZ had approximately 800,000 members and MSZMP 1.2 million (14% of the adult population) (data from Karácsony, “Az előélet utóélete. Az egykori MSZMP-tagságra vonatkozó adatok megbízhatósága.”) the membership in these organizations was much more common than membership in or collaboration with the communist-era secret service in Czechoslovakia.

Given both how soft and anecdotal this evidence is, since it relies on publicly acknowledged membership in the two organizations, as well as very different nature of membership in KISZ and MSZMP as compared to communist-era secret service police in Czechoslovakia, this measure cannot be used as a comparative measure with Czech Republic or Slovakia, and its use is limited only to provide a comparison within Hungary among different government.

Slovakia or Czech Republic, the right-wing also had high-ranking representation of people with links to the previous regime.

The higher representation of these people in left-wing governments provided business opportunities when MSZP was in power.<sup>664</sup> The friendliness of left-wing government towards Russia was visible also through much higher intensity of visits, and clear support for Russian business interests in Hungary, and the statements of highest Hungarian representatives were in general much friendlier for Russia than when right-wing was at power. The Hungarian-Russian companies which were set-up and flourished during this period further illustrate this point.

After the economic reforms in 1994-1995 an increase in complex industrial exports and decrease in basic exports could be seen (See Chart 112 and Chart 113). These radical economic reforms undertaken by the socialist-liberal government can be illustrated on the increase of exports of complex manufacturing (example of SITC 7 in Chart 113) which has been increasing since 1996. The energy intensity of Hungarian economy was steadily decreasing since 1993, with metallurgy remaining the most energy intensive, with largest intensity decrease taking place between 1994 and 1997.

When the right-wing government came to power for the second time in 1998 – this time dominated by FIDESZ, and MDF and FKgP as junior partners, relations with Russia came to an all-time low with no high-level state visits and the international relations dealt with only on the level of ministers of foreign affairs. Right-wing government also revisited the energy price regulation and claimed to examine privatization deals. The government voiced its policy priority of economic nationalism and supporting the welfare provisions<sup>665</sup> of low-income consumers against the needs and previous agreements with foreign investors. At the same time strengthening the national energy champions on their ventures and expansion abroad.

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<sup>664</sup> Examples of Hujber, Máté, Dunai and Kapolyi.

<sup>665</sup> The previous governments provided for the welfare payments through the privatization receipts and loans, making sure not to negatively affect foreign investors and business climate.

Government at the same time staved off important hostile takeover attempt at its petrochemical industry. This policy approach was similar to the Klaus government's one in Czech Republic.

The socialist-liberal government that followed, went back to resume policy approach of the first socialist government after the transition. Rapid privatization, friendliness with Russia and preferring energy projects of lower security value, were policy choices of the socialist Medgyessy and Gyurcsány governments. While leftist government managed to enter the European Union, the stagnation of security priorities in its energy policy left country much more vulnerable than Czech Republic. The socialist government, similarly to its leftist predecessor in 1994-1998 rather focused on maximization of immediate financial gain for the state budget and other policies, rather than long-term investment into the country's energy security.

The energy security of Hungary thus effectively remained unchanged since 1998 until 2010, when right-wing government again resumed the policy of strengthening the national energy giants, resuming government control and radical diversification and investment into the infrastructure in cooperation with its neighbors largely using the public money with the support of the European Union.

## CONCLUSION

When, why, and how much energy security matters for countries has been surprisingly overseen in the recently growing energy security literature. The view of IEA Executive Director, Maria van der Hoeven, that “It's always about energy security. Always.”<sup>666</sup> is too often reverberated in the literature. Since only few countries improve their energy security over time,<sup>667</sup> this shows that primacy of energy security over other policy goals is much less frequently reflected in empirical observations than how much it is discussed in literature.

Governments are in the business of devising policies which take account of a number of issues, priorities and goals. Political and economic transition after the Cold War included shifts in allegiances and threats and provided rare opportunities for rapid policy change. Under these new conditions some countries took active measures to improve their energy security, but other did not. Energy policy during the transition focused not only on security, efficiency, and welfare. It was also a tool of industrial policy, and either an engine of, or a hurdle to industrial restructuring, impacting not only the speed but also the kind of transition in the society and economy.

The politics of energy security was not only politics of competing prioritizations of various aspects of energy policy, but also cases of small countries prompted by requirements of financing their debts, political criteria of Euro-Atlantic integration process, as well as private interest of politically well-connected groups, all of these often at the cost of long-term energy security. The role of personal and interest networks of privileged individuals who had access to information on valuable assets, as well as start-up capital, in combination with fear or absence thereof has played tremendous role in influencing and shaping energy policies of these countries during their paths of transition. Nonetheless these paths played out differently among the countries, but also throughout the time within these countries.

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<sup>666</sup> Beckman, “Interview: Maria van der Hoeven, new chief of the IE: We must find mechanisms to strengthen cooperation with the emerging economies.”

<sup>667</sup> Sovacool and Brown recorded in the past four decades, only four countries out of thirty-four OECD members having improved their energy security. Sovacool and Brown, “Measuring Energy Security performance in the OECD,” 388.

In this dissertation I focused on the puzzle why some countries in transition prioritized energy security while other did not. To uncover the puzzling difference among countries under comparable international conditions prioritizing their energy security differently, I isolated effects of fundamentals and external factors, by choosing Czech Republic, Hungary and Slovakia. These three countries, while sharing effects of similar external conditions and most similar domestic energy systems, have coped with their energy import dependence differently. Czech Republic, country which started its transition with relatively high energy security, has further prioritized energy security and decreased its energy insecurity by diversifying import routes, import contracts and thus de-concentrated the energy import market. Slovakia on the other hand, country with much higher energy insecurity has throughout the transition not prioritized energy security. When the crises of 2006 and 2009 came, Slovak economy paid high price for neglecting energy security. In Hungary energy security was initially prioritized, but the commitment did not last. The prioritization of energy security followed changes in government with right-wing government prioritizing energy security, while left-wing Hungarian governments focused on other priorities.

Besides the differences I identified among the three countries, there were differences across the time within the countries. These were most visible with the changes of governments, as the lustration process, intensity of relations with Russia but also connections with energy intensive business changed as different governments assumed power. Czech Republic started with its first independent right-wing government and diversified energy transport, increased supplier diversification and decreased energy market concentration. After 1998, center-left government pursued a number of policies, especially in change of ownership which decreased energy security, and were clear examples of lack of security prioritization. Similarly in Hungary, the first center-right reform government of Antall-Boross, diversified the energy import infrastructure, but has not diversified the supplier base, nor has it decreased market concentration. The subsequent center-left government has not considered energy security a priority. With the return to power of

center-right government of Orbán, energy security was back on the agenda, and when the rule returned again to center-left government of MSZP-SDSZ energy security again fell out of the priority rank. Hungary thus provides a uniquely consistent variation across the time within a single country. Slovakia was affected by the lack of prioritization of energy security, persistent throughout its history, although for different reasons. While during Mečiar's rule energy security was absent because of the largely friendly relations with Russia, in the subsequent Dzurinda's government it has been lacking because the government was tied up by dealing with policies and reforms of higher urgency.

As I observed in these Central and East European countries in transition, policies enhancing energy security are prioritized when three aspects coincide and interact: When popular perception of threat, which can plausibly be connected to the energy supplier country, is high and concentrated among supporters of ruling parties; when former elites who can draw on personal links with the perceived source of threat, and thus can dampen the effects of threat are removed from power; and when incumbent industrial interests are de-concentrated, not connected to political elites and face other obstacles in promoting their interests. I argued that change of ownership as happened through privatization, which lowered the control of government over energy assets, served as an obstacle to prioritization of energy security as new owners were less interested in bearing the costs of investment into a public good of energy security.

This variation largely followed also left-right political divide, with right-wing parties in government mostly prioritizing energy security, and left-wing parties neglecting energy security. Nonetheless, this variation was guided not by ideological differences, between the right and left, but rather by personal connections of politicians concentrated in these two large ideological camps. More left-wing politicians in CEE came from former communist parties, and had personal history of contacts with post-soviet countries and Russia than right-wing politicians.

Right-wing politicians more frequently perceived Russia as a threat which should be acted upon including by increasing energy security.

### ***Theoretical and Conceptual Contribution***

Findings of my dissertation contribute to two bodies of literature – in the first place to the burgeoning field of energy security literature, and secondly to the literature on policy choices during transition.

Conceptual confusion about what energy security is, how to measure it and analyze, persists in the literature. This is a result of interplay of number of factors. First, energy security is a field where students of international relations and security meet with economists, lawyers and engineers. Second, both energy and security are inherently cross-sectoral concepts relating to human activity across many areas. This has resulted in case of almost every author, and often in each of their publications, defining and redefining what energy security is and what it should be. Subsequently this resulted in almost four dozen of mainstream definitions available in the energy security literature and additional meta-literature on classification of energy security definitions and conceptualizations.

My contribution to the energy security literature in this context is refocusing the attention from prescriptive conceptual approach to energy security which has been preoccupied with finding the right definition, to conceptualization of energy security grounded in empirical observation and guided by descriptive approach. Instead of prescribing what energy security ought to be a trying to fit the empirical observations, I start with empirical observations.

Not everything that governments prioritize and do, which pertains to energy, is energy security. Contrary to the expectations of the literature, governments often prioritize other aims than security, even in the objective absence of sufficient security, and go unpunished for long periods. By calling for more conceptual consistency, I also contribute to laying of foundations for broader conceptual model for analyzing and contextualizing energy security among other policy

priorities pertinent to energy policy, such as welfare and affordability, competitiveness and efficiency, or environmental sustainability.

Conceptually, I introduced the longitudinal approach to assessing historic developments of energy security by introducing a longitudinal and quantified measure of public perceptions of threat into the energy security assessment. To my best knowledge this has not been done before. Additionally, I have enriched the energy security literature by introducing the quantitative measure of links of government officials to the previous regime, linking the problem of transitional justice to energy security, which is particularly pertinent to understanding of security in general, and energy security in particular during times of transition from totalitarian regimes towards more open and pluralistic ones.

The broader theoretical contribution of this dissertation consists of argument for reframing the energy policy debate by bringing back domestic politics, and by contributing to understanding of security policy prioritization during transition.

Energy security, albeit important, is only one of the aspects that are being pursued by governments. By providing explanation for variation and timing of domestic responses to structural position of energy import dependence over time in countries in transition I have also contributed to the broader research field on temporal and spatial variation of domestic responses to comparable international conditions.

### ***Methodological Innovation***

One of the problems that researchers of energy security face, and I experienced the same problem, is extensive scarcity of publicly available data. Information is not available because it is either considered a trade secret, or classified as state secret. This challenge is perhaps hardest when it comes to reliable, longitudinal information on prices, and other details of energy contracts. Even those few commercially available sources that cater to business sector, and are

largely unaffordable for academics, simply do not carry data of sufficient historic depth and geographic breadth, as this is of limited value for business.

Since energy price is part and parcel of most of the definitions of energy security, this poses a serious challenge. In the absence of comparative longitudinal cross-country import energy prices, for this dissertation, I have developed method to calculate longitudinal cross-border import prices. Price can be deduced from two readily available sources of data: by dividing values of energy imports which are reported in the trade databases, with the amounts of energy imports which are available in energy databases. While this approach may suffer from a number of limitations, such as inability to disaggregate prices by individual supply contracts, or supplier companies (if they source the commodity from the same country), it provides comparative assessment for virtually all countries of the world on the country level basis.

Despite this approach being relatively simple, I am not aware of anyone else having applied this approach before to overcome the absence of publicly available pricing data. I have tested validity and relevance of this approach, and popularized it,<sup>668</sup> with results having been referred to by researchers<sup>669</sup> and policymakers in the region ever since.<sup>670</sup>

### ***Applicability of the Explanatory Model***

In order to control for the effects of external factors and elucidate the structure of domestic politics, I have chosen in-depth comparison of three most similar countries. The complexity of

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<sup>668</sup> Nosko et al., *Energy Security*. Although this was a collaborative cross-border international research effort, which I lead and which resulted in a co-authored report, the price calculations, and threat perceptions were both clearly my individual contributions in this collaborative efforts.

<sup>669</sup> Scott Nicholas Romaniuk, “More Power to You: Securing Central Europe’s Future Energy Supply,” *Global Journal of Human Social Science Research* 12, no. 8 (2012); András Rácz, “The Greatest Common Divisor: Russia’s Role in Visegrad Foreign Policies,” *The Polish Quarterly of International Affairs*, no. 4 (2012): 32–51; Nosko and Ševce, “The Evolution of Energy Security in the Slovak Republic”; Andrej Nosko and Petr Lang, “Lessons from Prague: How the Czech Republic Has Enhanced Its Energy Security,” *Journal of Energy Security* (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](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) (accessed May 10, 2011); Petr Binhac et al., *Energetická bezpečnost ČR a budoucnost energetické politiky EU* (Ústav mezinárodních vztahů, 2012).

<sup>670</sup> GLOBSEC 2010: Panel 5: “The Visegrad Four”: *Energized* (Bratislava, September 14, 2010), [http://www.ata-sac.org/globsec2010/uploads/documents/Panel%20Summaries/GLOBSEC\\_2010\\_Panel\\_5\\_summary.pdf](http://www.ata-sac.org/globsec2010/uploads/documents/Panel%20Summaries/GLOBSEC_2010_Panel_5_summary.pdf) (accessed June 7, 2013).

the argument required that I study the cases into great detail; this precludes the possibility to make strong claims about applicability of the explanations developed in this thesis to other countries. Nevertheless, there is no reason why the developed explanatory model would not be applicable to all energy import dependent countries in transition. The acknowledged limitation of this dissertation is that it does not provide the test for the explanatory model beyond the three countries.

I have chosen proxy measure for assessing the linkages of elites in Czech Republic and Slovakia through their records in the former state secret service databases, but already in case of Hungary this measure could not be consistently applied, and I had to develop an alternative measure. This serves as an example that the explanatory model is not dependent on the methodological tools used to corroborate the hypotheses. The absence of particular type of data could be overcome for countries undergoing transition. Even though access to reliable data on connections with previous regime for some countries would be out of question, other means can be devised.

For example, even if the political elite in countries of the former Soviet Union would want to release the information, this is not possible, as the archives of the former secret service are out of their reach in Moscow. With minor adjustments for local peculiarities, and available information sources, my model is applicable to all ten countries of Eastern EU, and most likely for majority of post-soviet energy importing countries.

Coping with the energy dependence, particularly on Russia, can be studied using the explanatory model I propose. The way how other eastern EU countries in transition coped with this structural dependency was affected by the type and presence of elites and perception of threat of Russia. As Steve Blank, noted “Russian attempts to subvert East European governments through economic penetration, corruption of politicians, intelligence penetration, etc., have continued at least since 1997, if not earlier. The evidence from the Czech Republic, Bulgaria,

Hungary, Slovakia, Poland and the Baltic states is overwhelming and points to a strategic decision in Moscow.”<sup>671</sup>

Poland is the only country in the CEE, where more respondents saw Russia as a threat than in Czech Republic. Poland has been extremely careful about its engagements with Russia, expanding its energy options, but also engaging with Russia, but the variation in energy security prioritization of Poland can be also traced. The particular cases that could be studied would include different prioritizations of energy security when looking at the two infrastructural developments – the plans to build Norway-Poland pipeline in 2003, and concurrent negotiation of Russian gas contract extension which cannot be seen as energy security enhancing. Polish position on Odessa-Brody-(Plock) pipeline in 2007 is also an example when energy security has been prioritized.

The importance of previous elites can be traced also in all of the Baltic post-soviet countries.<sup>672</sup>

The 2003 developments around impeachment of Lithuanian president Paksas, or the heavy investment of Russian companies in the energy sector, including choices made during privatization, and allegations of collaboration of high-ranking Lithuanian diplomats with KGB illustrate this in case of Lithuania.<sup>673</sup> Russia even sent former KGB operative, as an ambassador to Lithuania to support its expansive energy policy.<sup>674</sup> Latvia, another Baltic state, is not only a financial center and an entry point for Russian money into the EU. According to a former KGB agent, who worked in Latvia, the country’s geographical position, bridging Russia and the west, and the possibility for Latvia’s residents to travel freely around Europe “made it an ideal entry point for Russian espionage, smuggling and laundering of criminal proceeds. [...] Russia’s

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<sup>671</sup> Stephen Blank, “The Baltic States and Euro-Atlantic Enlargement,” *Sabina A.-M. Anger, The Transatlantic Relationship: Problem and Prospects. Washington: Woodrow Wilson Center For Scholars* (2003).

<sup>672</sup> Agnia Grigas, “Legacies, Coercion and Soft Power: Russian Influence in the Baltic States,” *Chatham House Briefing Paper* (2012).

<sup>673</sup> “MP demands KGB probe,” *The Baltic Times*, January 10, 2007, <http://www.baltictimes.com/news/articles/18932/> (accessed June 8, 2013).

<sup>674</sup> Keith C. Smith, “Current implications of Russian energy policies,” *Center for Strategic and International Studies* 12 (2006).

security services use Latvia like a trampoline, to send their people to Europe and the US.”<sup>675</sup> The importance of former links and the challenge of Baltic states to uncover them was painfully visible in case of “the most damaging” spy in NATO history – Estonia’s defense ministry official Hermann Simm.<sup>676</sup>

Further to the south east, the links of former elites and their influence can be traced also. Although Bulgarians were throughout the transition history the second most friendly in their perceptions of Russia (after Slovenians) as only around five per cent of respondent saw Russia as threat. Still variation in the country’s prioritization of energy security can be traced. The role of the former communist secret service in Bulgaria’s recent political history has been astonishing. Although particular effect on Bulgarian tumultuous energy security policy would need to be further investigated, experts on Bulgaria note that “informal networks that were linked to the repressive communist apparatus continue to lead to corruption, [...and] Personal loyalties determine the [policy] decisions that are made.”<sup>677</sup> The particular two cases that could be studied in case of Bulgaria are construction at the Belene nuclear power plant, and vacillating support for Russia-backed Southern gas corridor. Additional case for study of Bulgarian energy policy is decommissioning of the Kozloduy Nuclear Power Plant, account of which, from a constructivist perspective of competing policy narratives within the context of Europeanization, is offered by Dimitrova.<sup>678</sup>

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<sup>675</sup> Luke Harding, “Latvia: Russia’s playground for business, politics – and crime | World news | guardian.co.uk,” *The Guardian*, January 23, 2013, <http://www.guardian.co.uk/world/2013/jan/23/latvia-russian-playground> (accessed June 8, 2013).

<sup>676</sup> Fidelius Schmid and Andreas Ulrich, “Betrayed and Betrayer: New Documents Reveal Truth on NATO’s ‘Most Damaging’ Spy,” *Spiegel Online*, April 30, 2010, <http://www.spiegel.de/international/europe/betrayer-and-betrayed-new-documents-reveal-truth-on-nato-s-most-damaging-spy-a-691817.html> (accessed June 8, 2013).

<sup>677</sup> DW, “Bulgaria Explores Officials’ Ties to Communist Secret Service,” *DW.DE*, March 14, 2008, <http://www.dw.de/bulgaria-explores-officials-ties-to-communist-secret-service/a-3185229-1> (accessed June 9, 2013).

<sup>678</sup> Gergana Dimitrova, “From Bright Light to Blackout: The Influence of the Europeanization Paradigm on Bulgarian Foreign Policy and Transport and Energy Infrastructure Policy” (Central European University, 2008).

While Romania is much less energy dependent, the linkages of former elites and their role in energy has emerged. Partly as a domestic political struggle, when alleged KGB and Russian energy links of president Iliescu, who studied at Moscow's energy institute, were discussed.<sup>679</sup>

As the test of the applicability would require in-depth research, my claim for applicability of the explanatory model beyond the three countries that I study cannot be evidenced in the current project. Research into elite linkages, availability of proxy data on linkages, and in-depth country research would require intimate knowledge of the countries in question and preferably also understanding of the local languages. Nonetheless, from the personal interviews I have conducted in Estonia, Latvia, Romania and Bulgaria at different occasions, my contacts confirmed high importance of personal linkages of former communist elites, effects of presence, absence and type of lustration implemented, and the way how coping with the past has been done. For both shaping of structural economic reforms in the country, including prioritization of energy security, and the particular ways how corruption played out.

### **Suggestions for Future Research**

There are additional questions generated by this dissertation, which provide opportunity for further study. In this dissertation I have not studied systematically the detailed path from policy priority to policy outcome in energy security. This would be a topic worth pursuing, to further isolate factors of agency, and particular veto players and catalysts in energy security prioritization. I also did not provide details of what is the path of influence and how concentration of energy industries influenced energy security. This topic is worth studying and would potentially contribute not only to energy security literature, but the field of political economy as well.

The costs of trade-offs in energy security prioritization is a question that emerged while I conducted this research and would be of particular interest for future study: Is it more cost-

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<sup>679</sup> Virgil George Baleanu, *A clear and present danger to democracy: The new Romanian Security Services are still watching* (Conflict Studies Research Centre, Royal Military Academy, Sandhurst, 1996); Theodor Tudoroiu, "From Spheres of Influence to Energy Wars: Russian Influence in Post-Communist Romania," *Journal of Communist Studies and Transition Politics* 24, no. 3 (2008): 386–414.

effective for governments to completely expose the industry to pressures of world-market energy prices at the beginning of the transition or rather commit to gradual reform and increase of efficiency and competitiveness? Is the cost paid for “security” commensurate with the benefits received? How should change in energy security be measured, and how can politicians pursue these public-good enhancing policies, that are costly in short run, so that public can see the return on investment similarly as they can see returns on increase in economic efficiency or welfare? I have not attempted precise quantification of both costs and benefits of energy security policies, but this research is worth pursuing in the future, as its policy relevance is especially high. Finally, throughout the study of energy security, the prominence of corruption in the energy sector emerged. Energy industry requires stability of regulatory regime and political environment. It is thus rational, especially during transition, that business interests in energy wield influence also through financial and opaque means if they are available to them. Nonetheless, given both how differently this institutional corruption played out in the countries in transition and the fact that state capture is a risk much more prevalent during transition, it would be worthwhile to study the paths of state capture in detail. Energy sector is only one of the stages where the tragedy of state capture has been played out, but one of the most revealing. Building on this experience and evidence would provide lessons far beyond Central and Eastern Europe.

## APPENDIX: COMPARATIVE ASPECTS

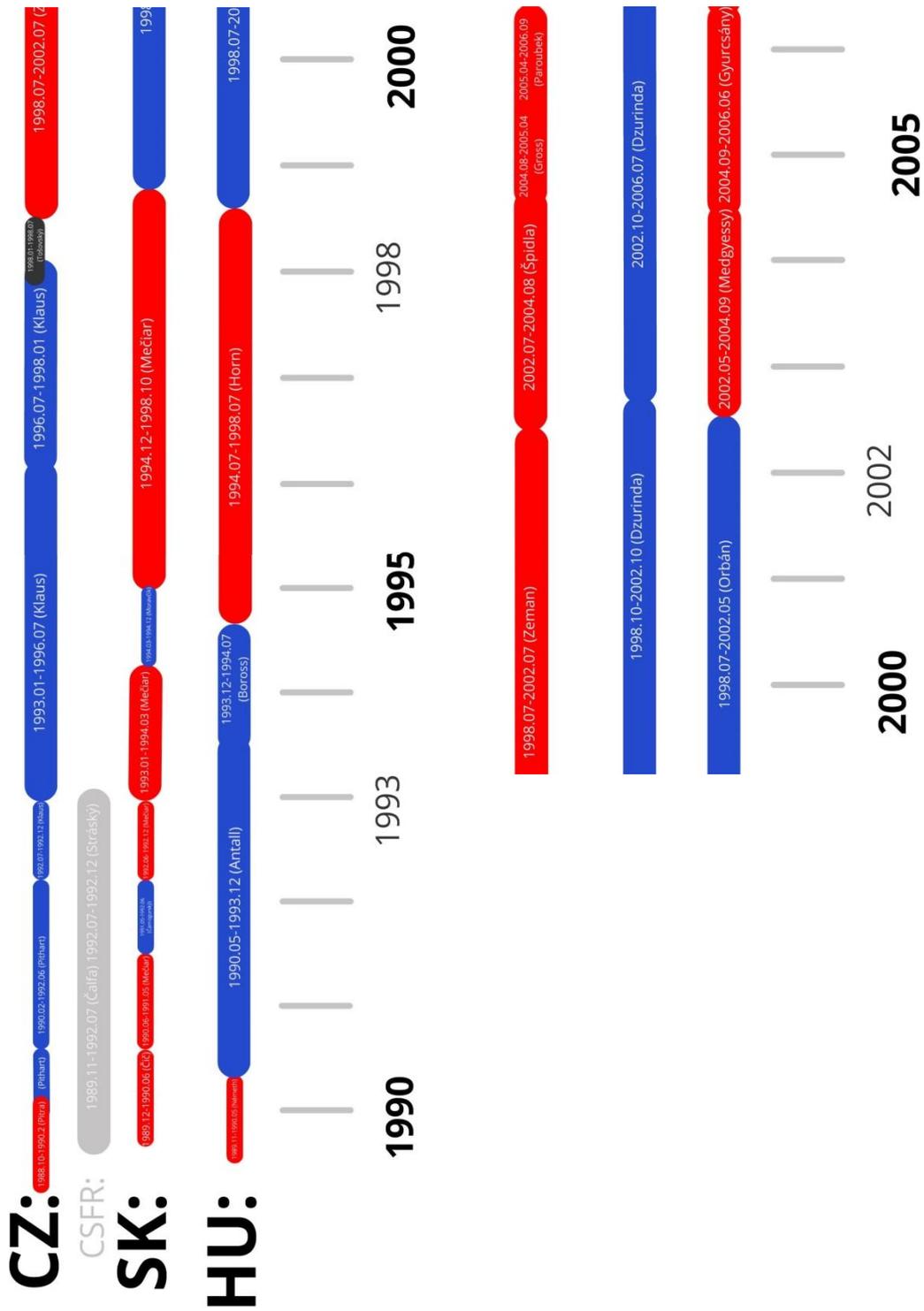


Chart 2: Timeline of changes in governments (Czech Republic, Slovakia, Hungary)

## Fundamentals

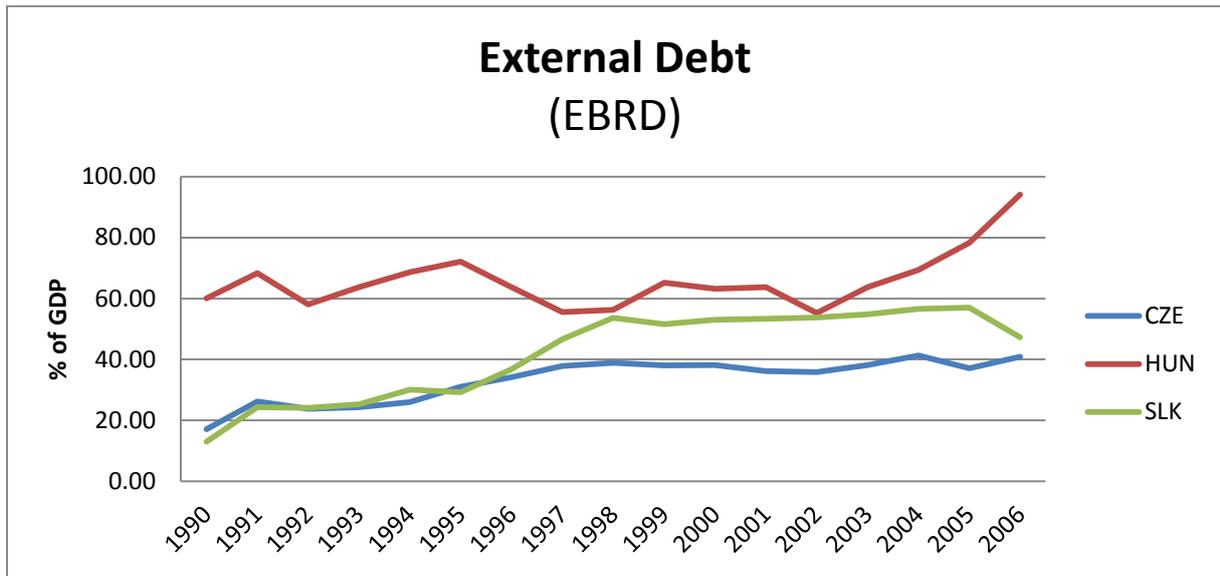


Chart 3: Comparison of external debt

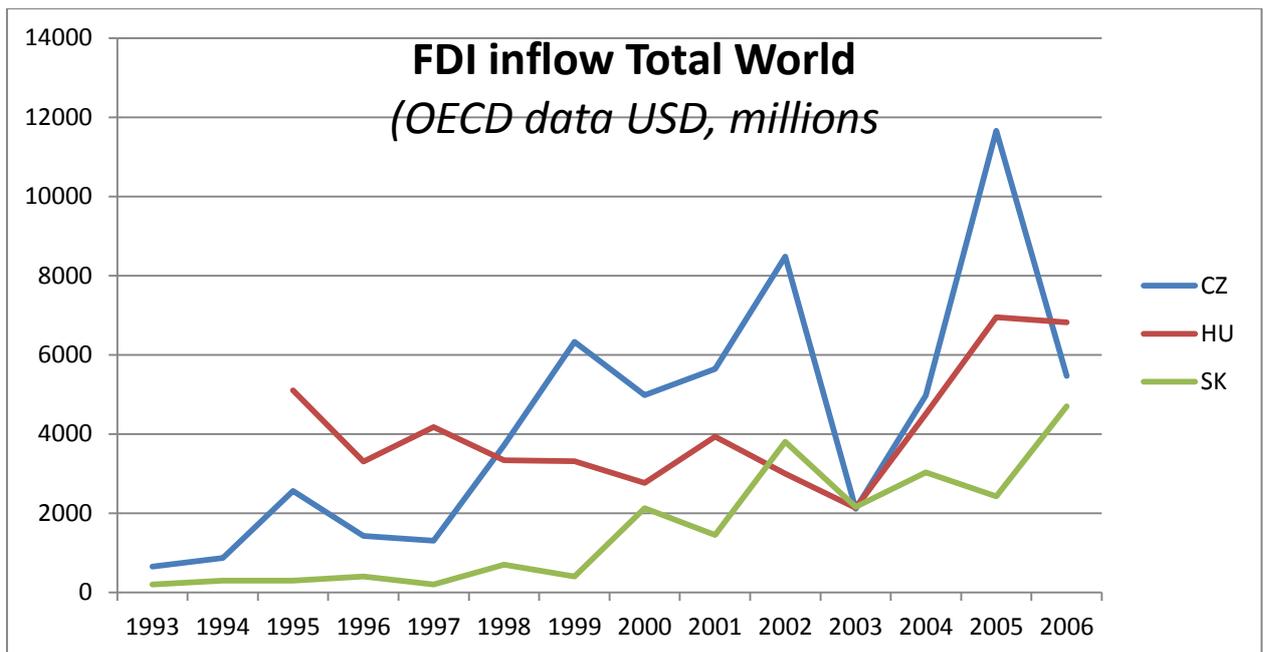
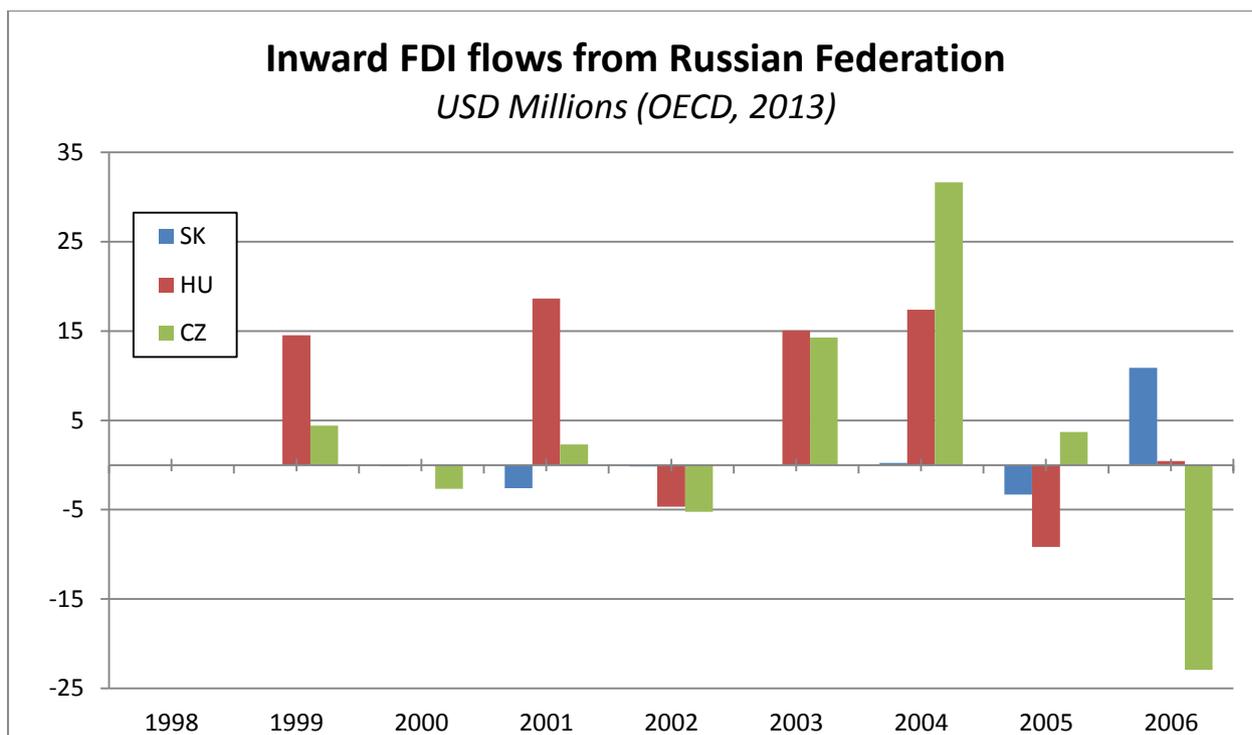


Chart 4: Comparison of FDI inflows



**Chart 5: FDI Inward flows from Russian Federation**

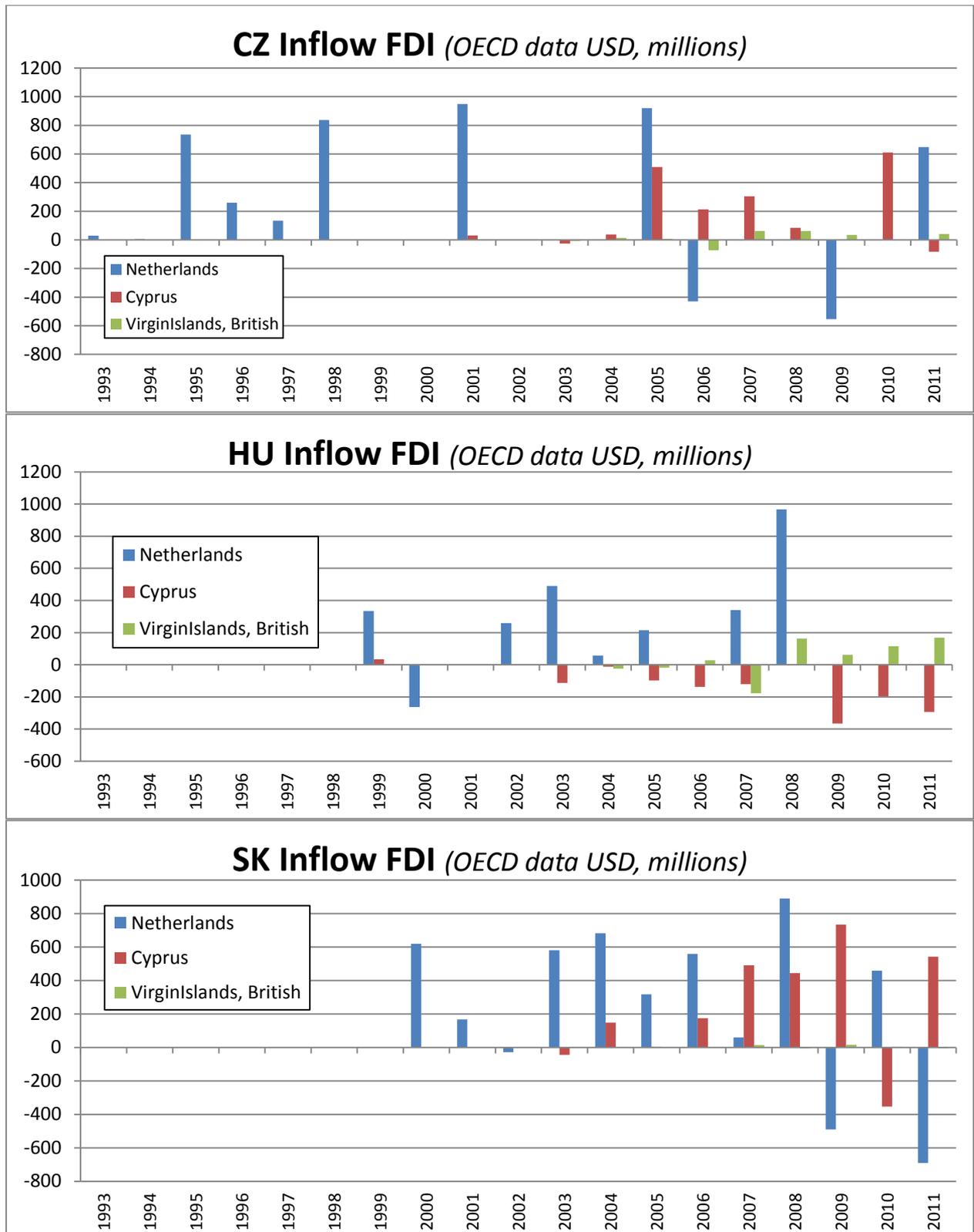


Chart 6: Inward FDI flows to Czech Republic, Hungary and Slovakia from three most popular countries of incorporation for Russian businesspeople.

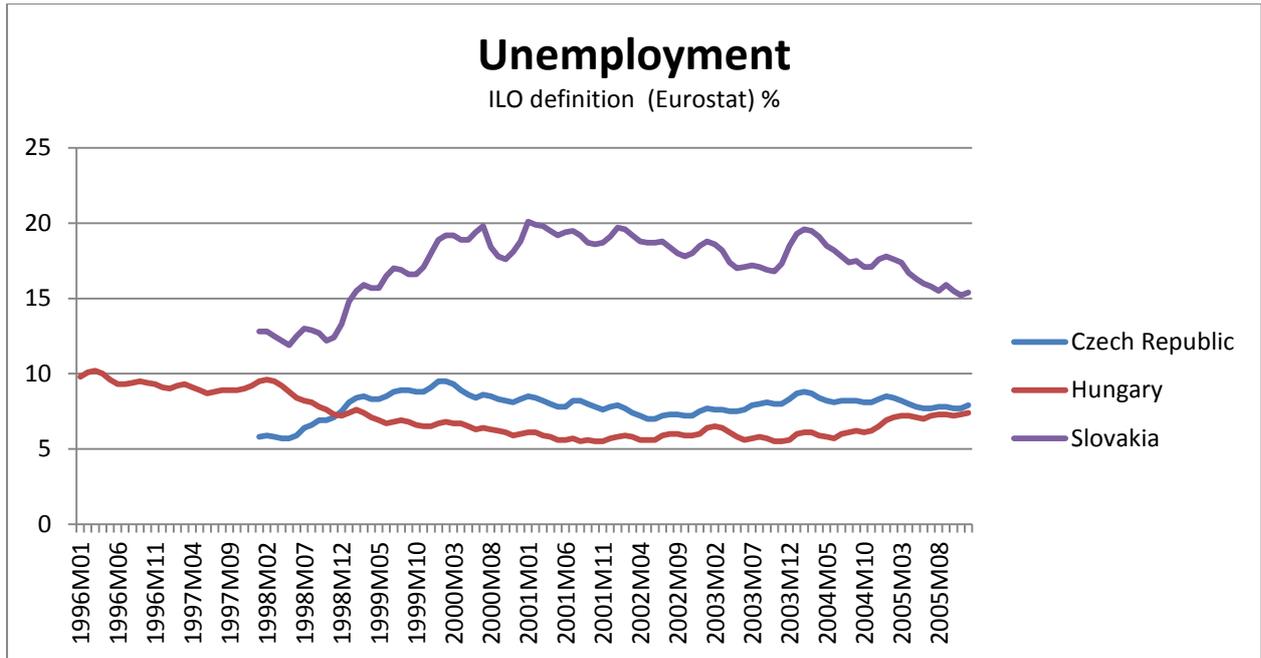


Chart 7: Unemployment data for Czech Republic, Hungary and Slovakia

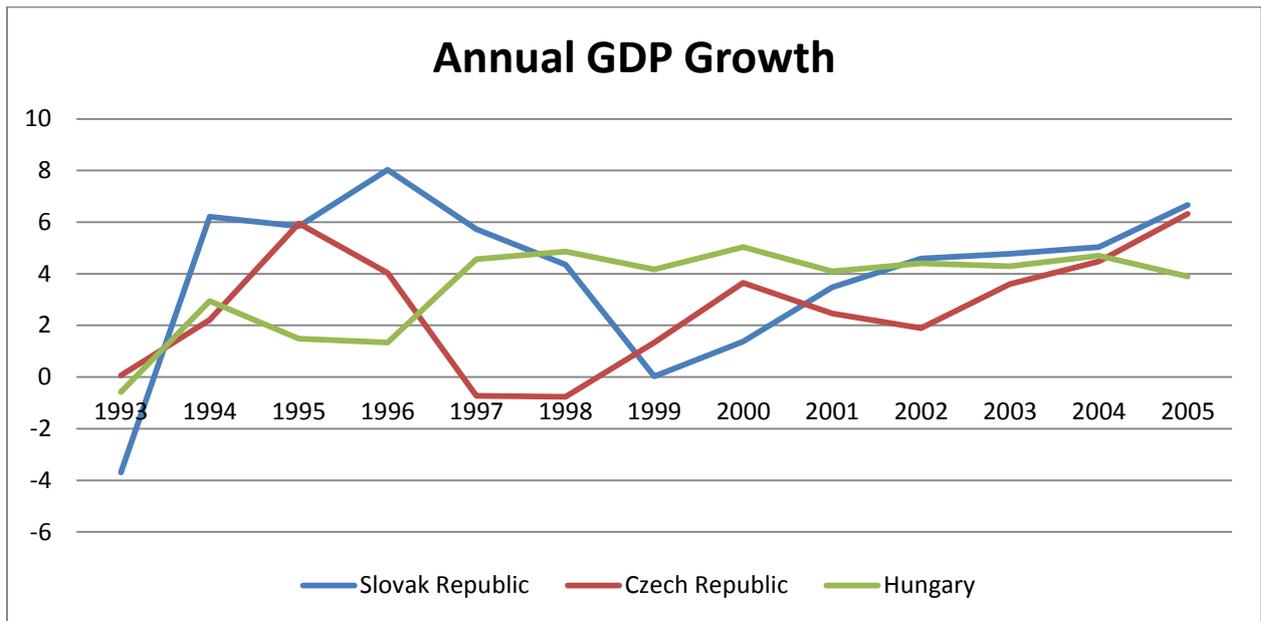


Chart 8: Annual GDP Growth<sup>680</sup>

<sup>680</sup> The World Bank, "Data", 2012, <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD> (accessed April 7, 2013).

### Threat Perception

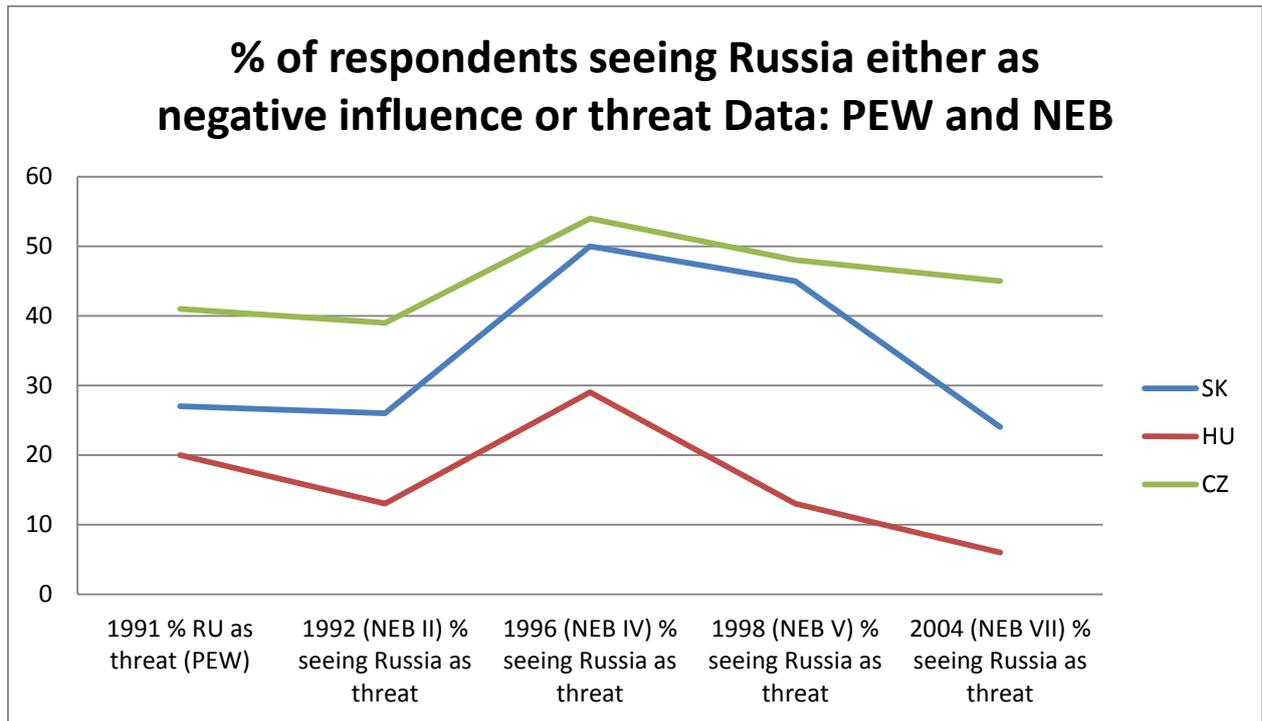


Chart 9: Respondents seeing Russia either as negative influence or threat

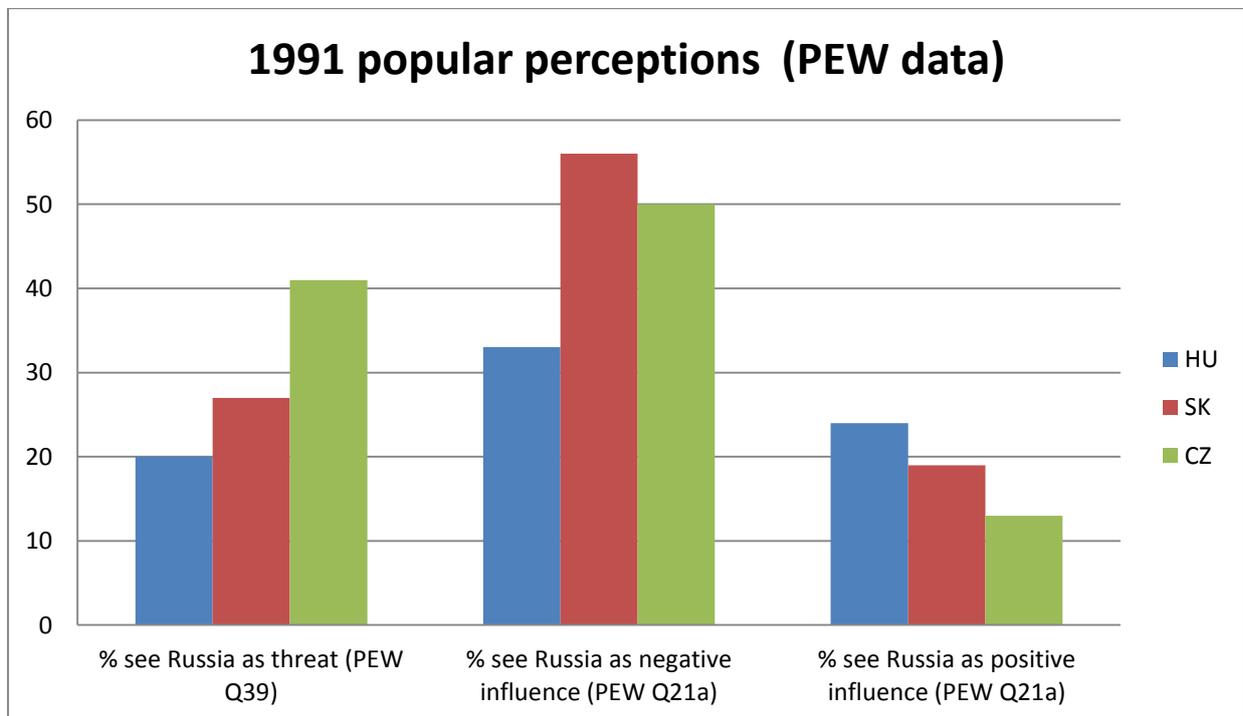


Chart 10: Popular perceptions of Russia in 1991

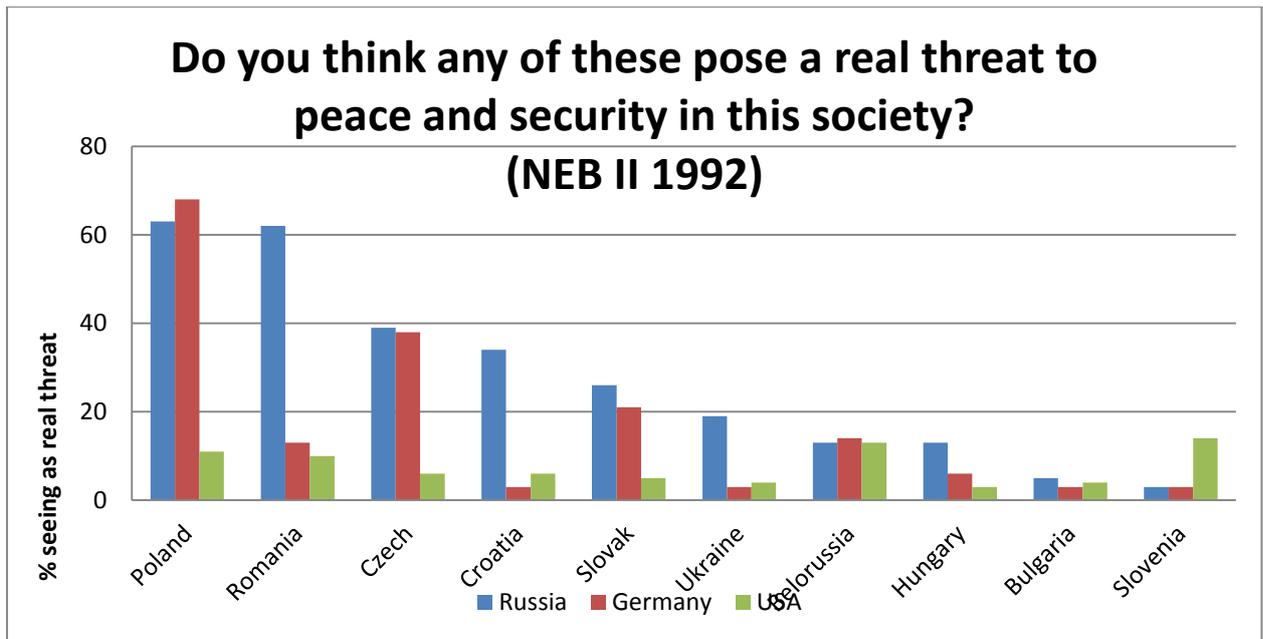


Chart 11: Threat perception in CEE (NEB II 1992)

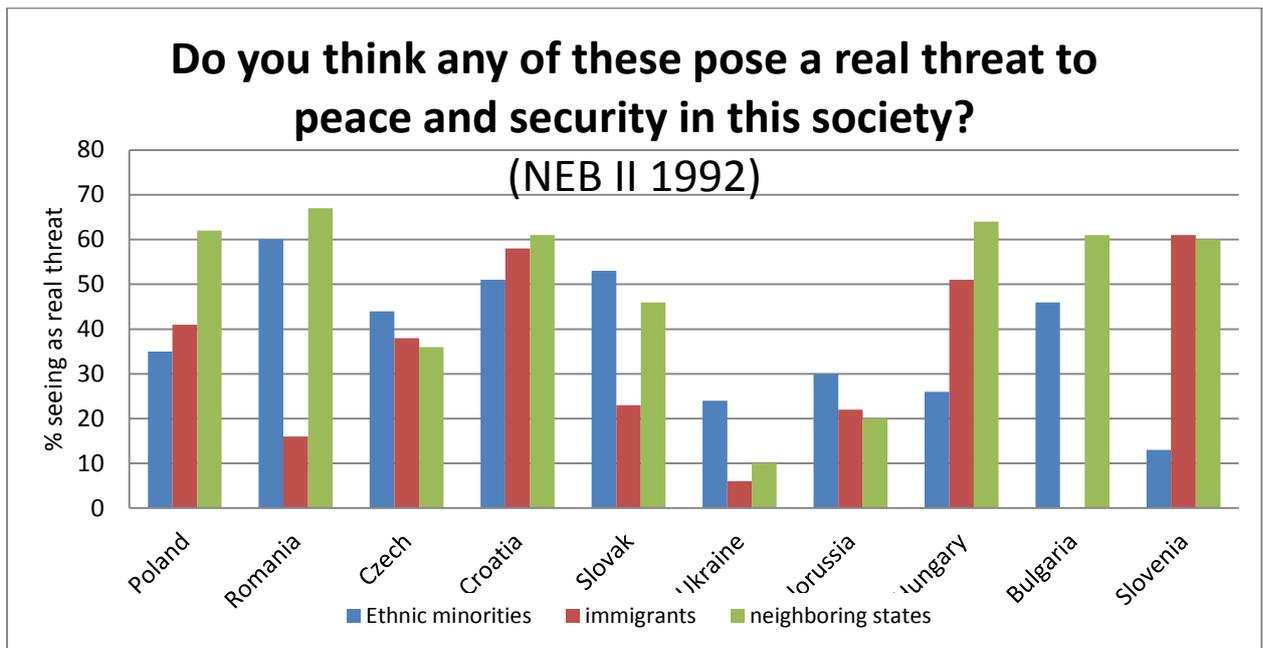


Chart 12: Threat perception in CEE – non-country threats (NEB II 1992)

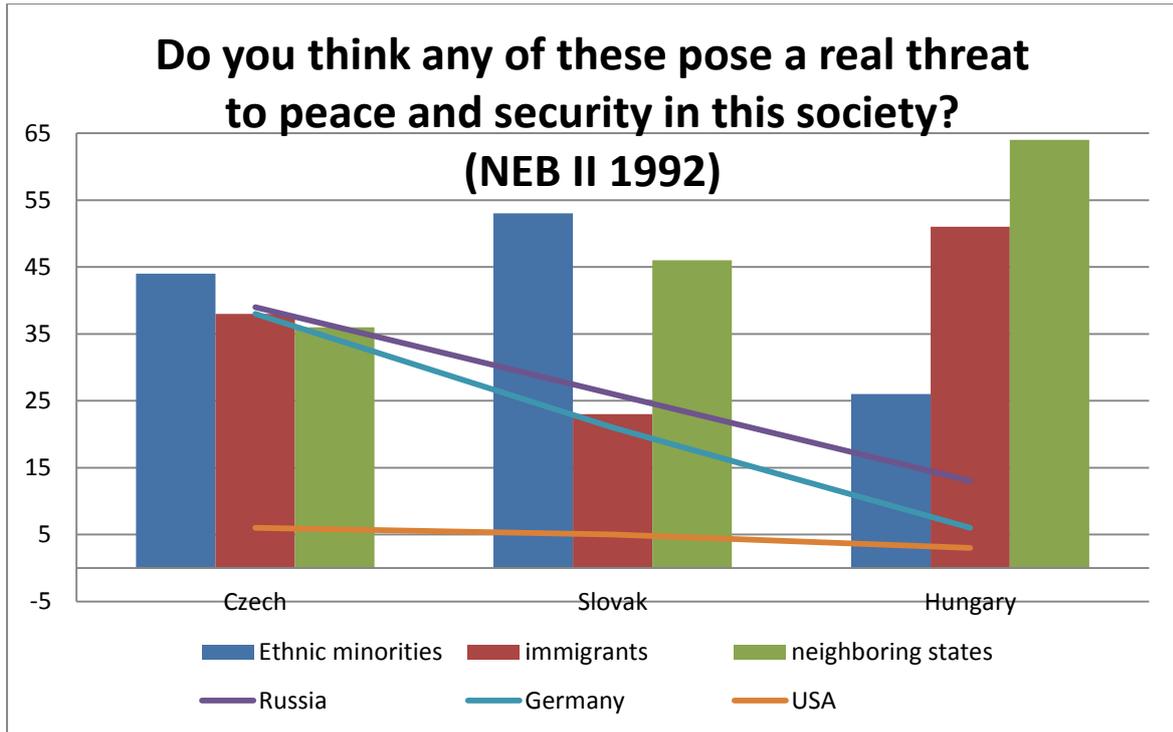


Chart 13: Types of threat perceived in Czech Republic, Hungary and Slovakia

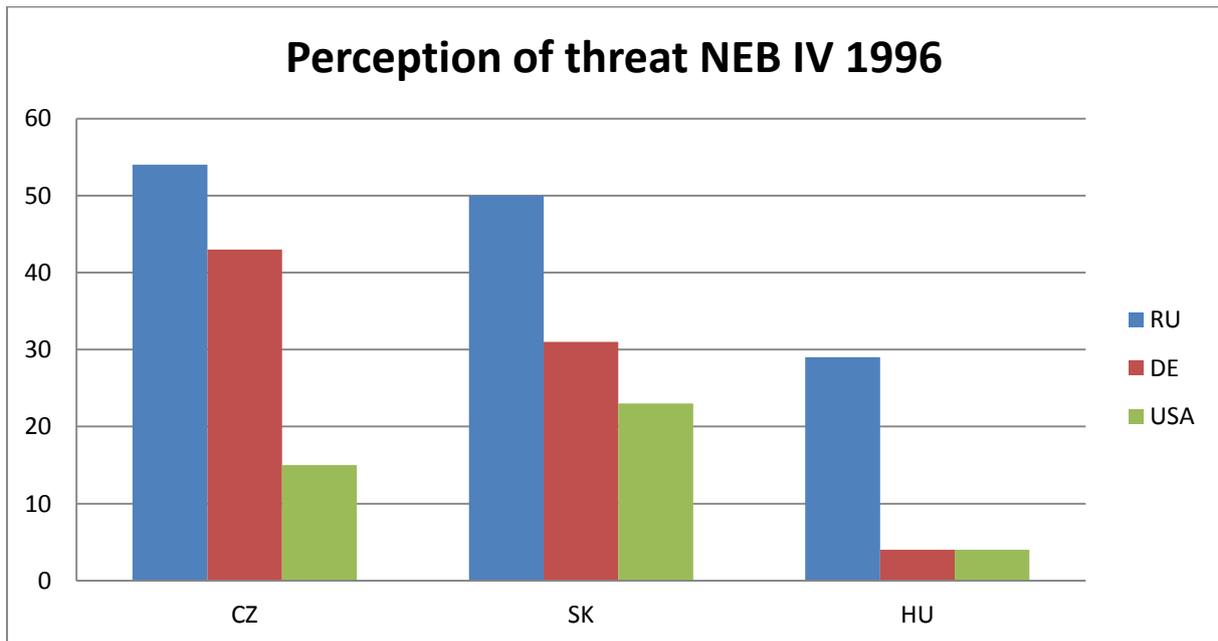


Chart 14: Share of those perceiving named countries as threat in 1996

### Perception of threat NEB V 1998

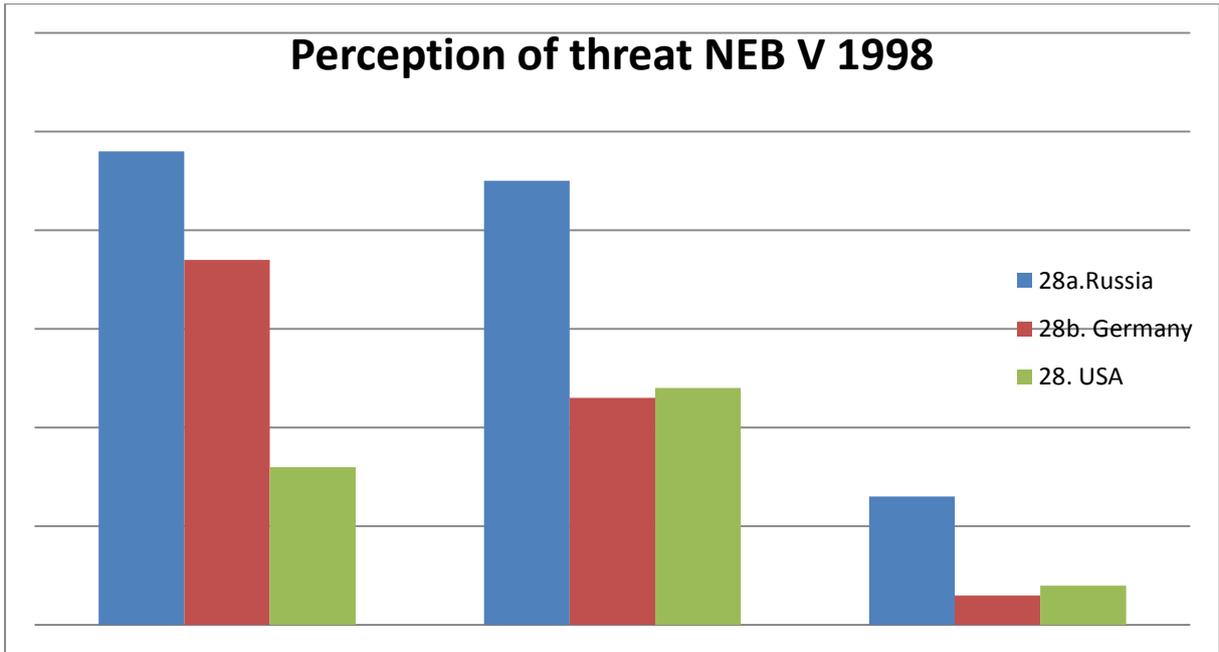


Chart 15: Share of those perceiving named countries as threat in 2004

### No External Threat (neighbors, USA, DE, RUS)

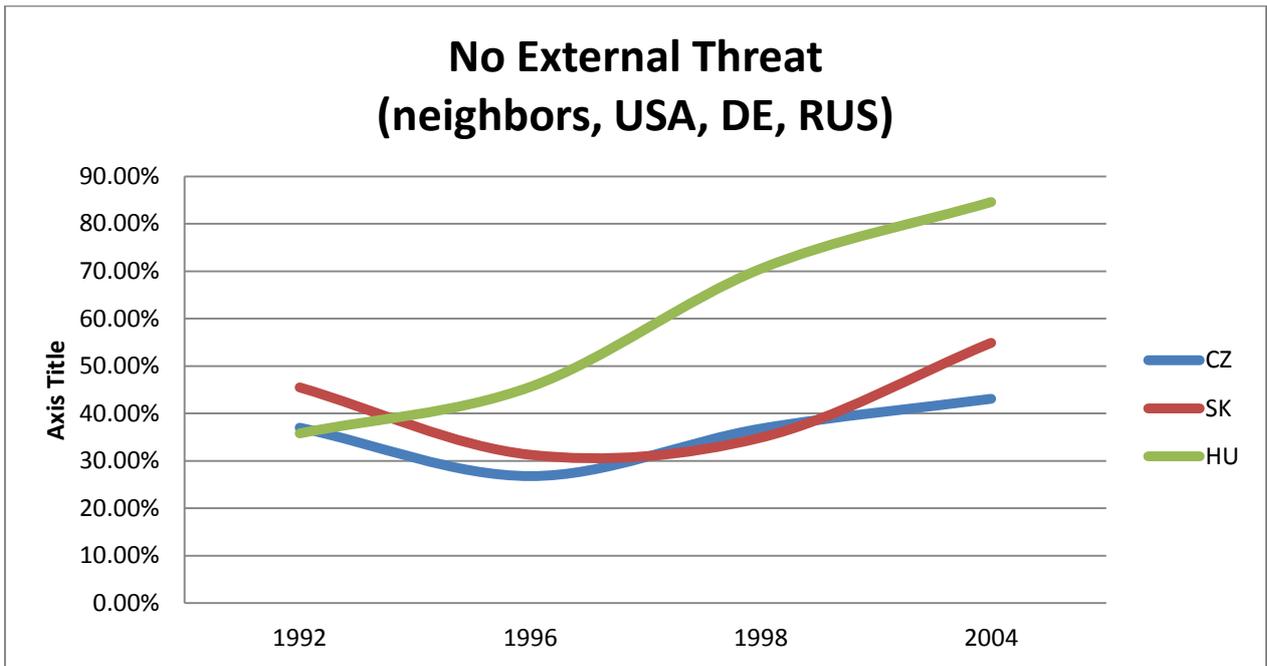


Chart 16: % of those that *do not* perceive external threat from neighboring countries, USA, Germany, or Russia.

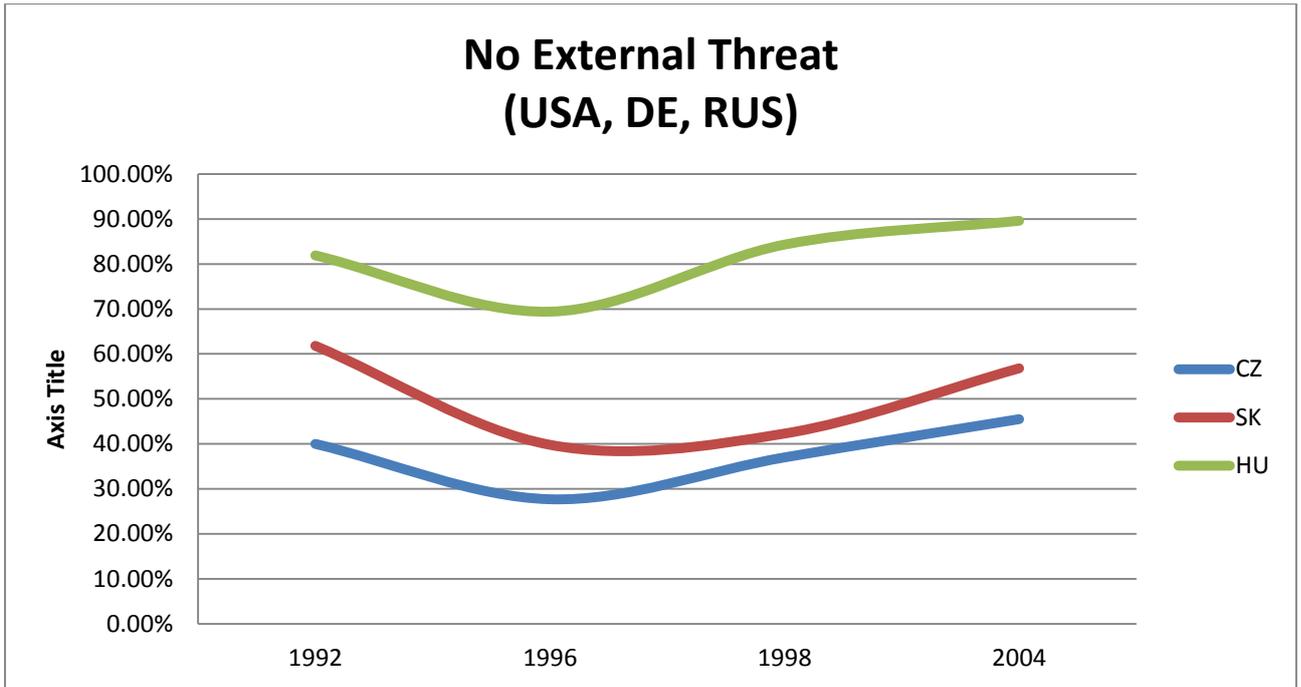


Chart 17: % of those that *do not* see major powers as threat (USA, Germany, or Russia)

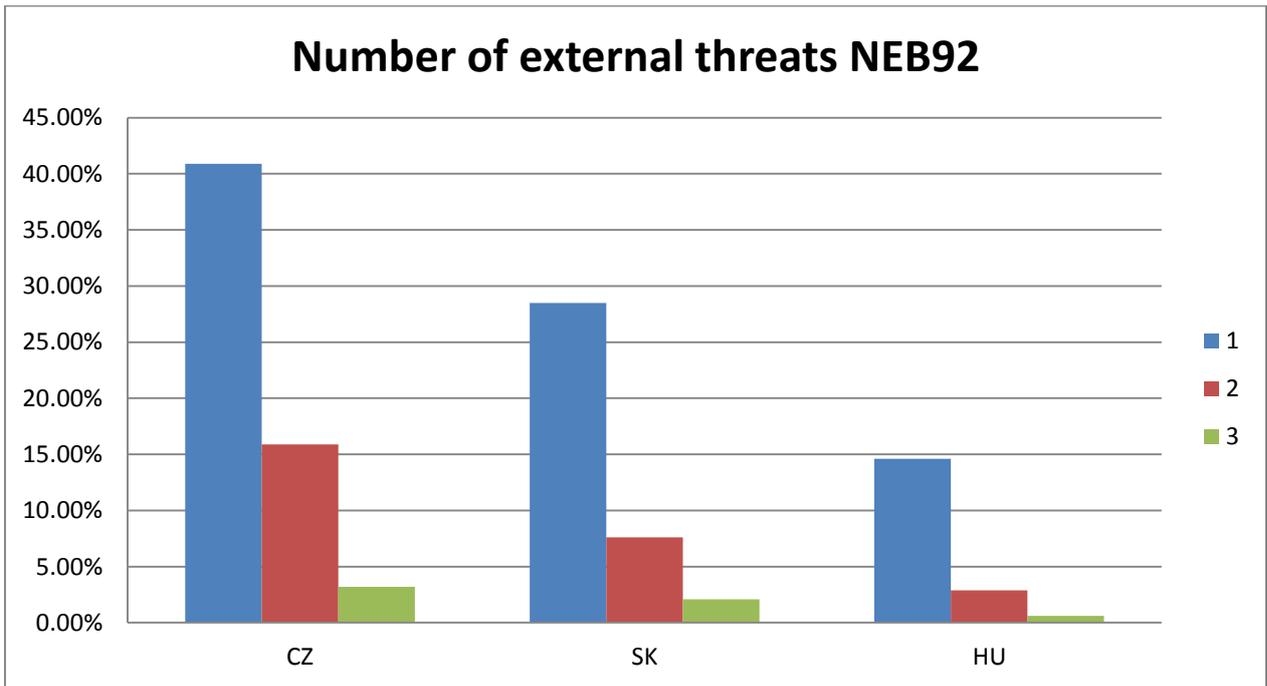


Chart 18: Number of external threats identified (Russia, Germany, USA)

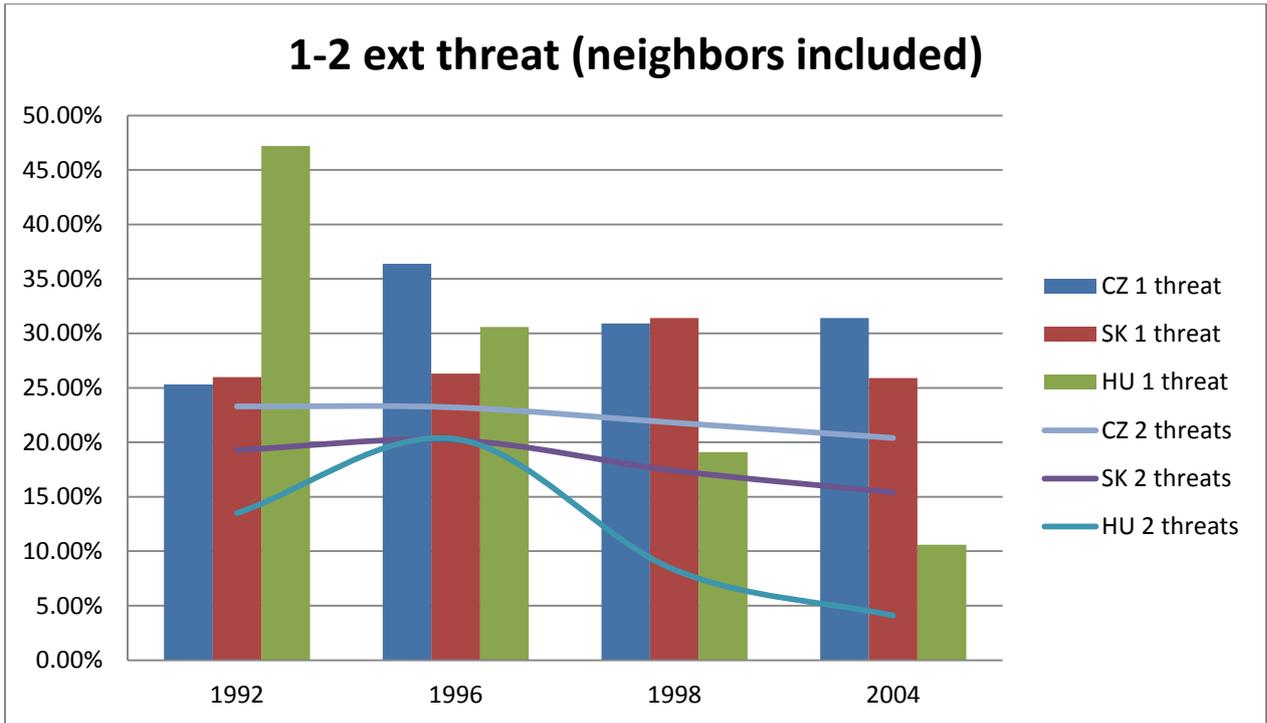


Chart 19: Measure of fear in general (Share of respondents that have identified 1 or 2 external threats)

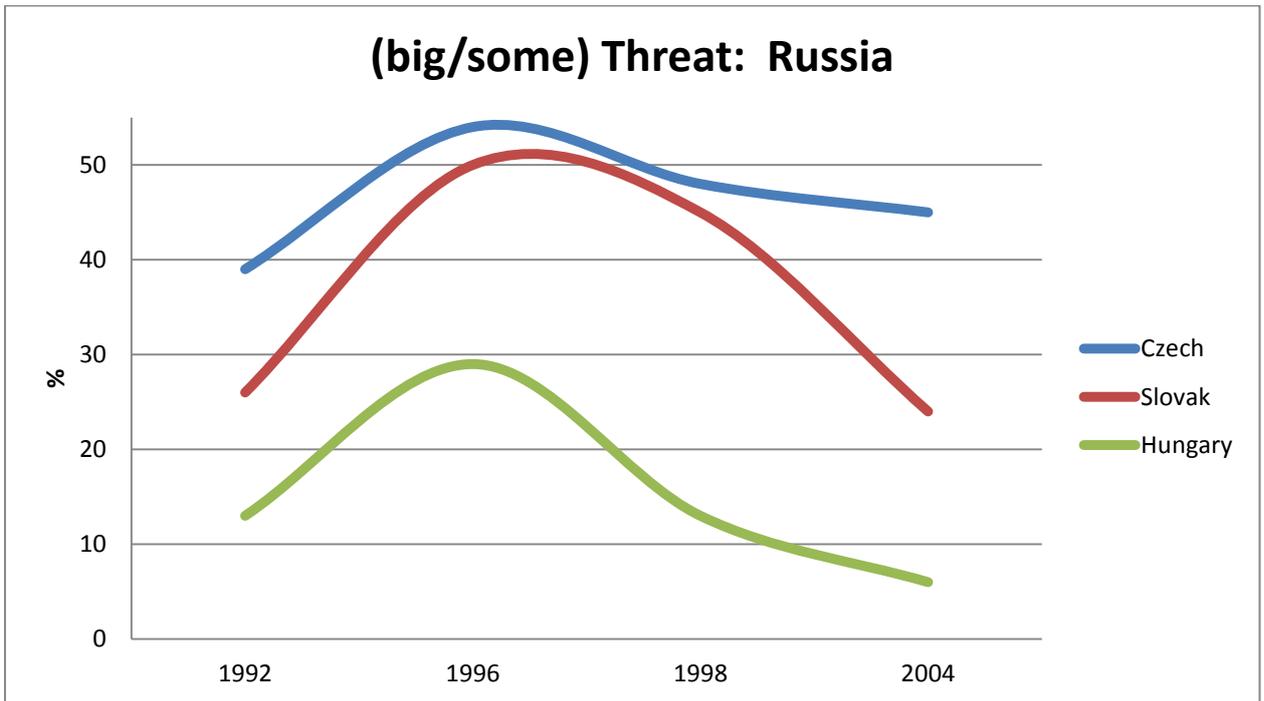


Chart 20: Developments in popular perceptions of threat (NEB data)

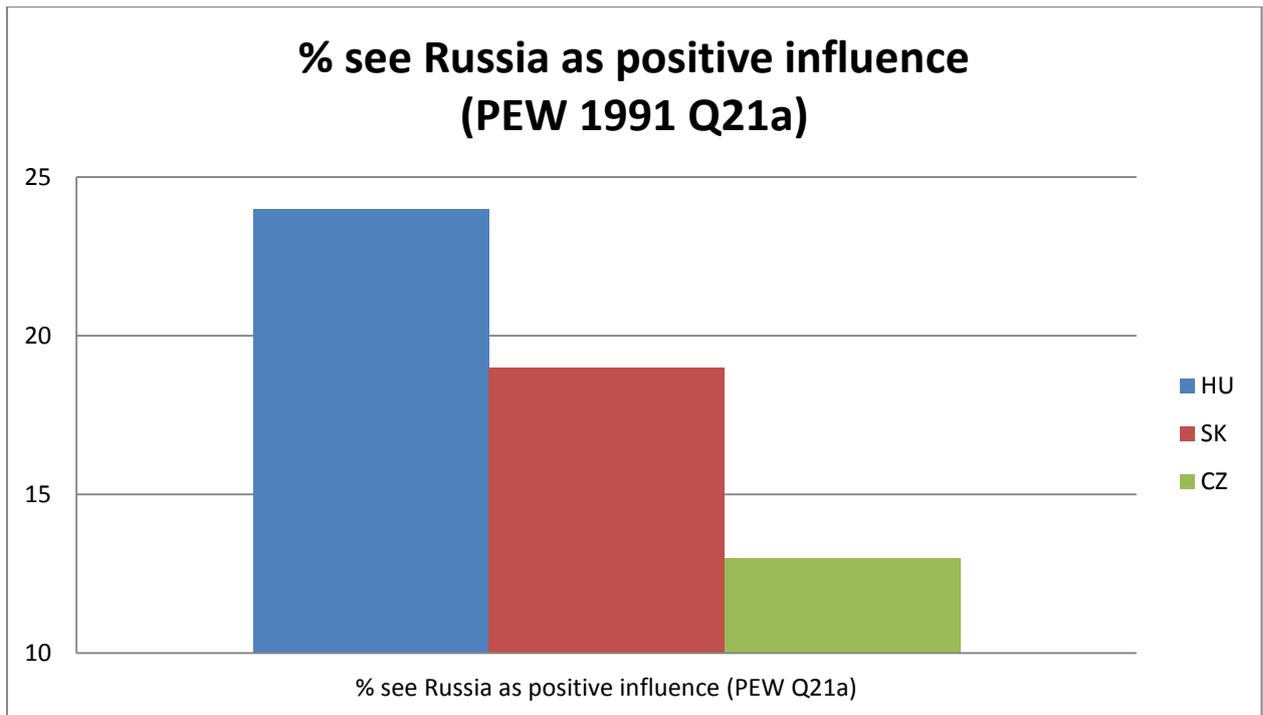


Chart 21: Affinity towards Russia in 1991

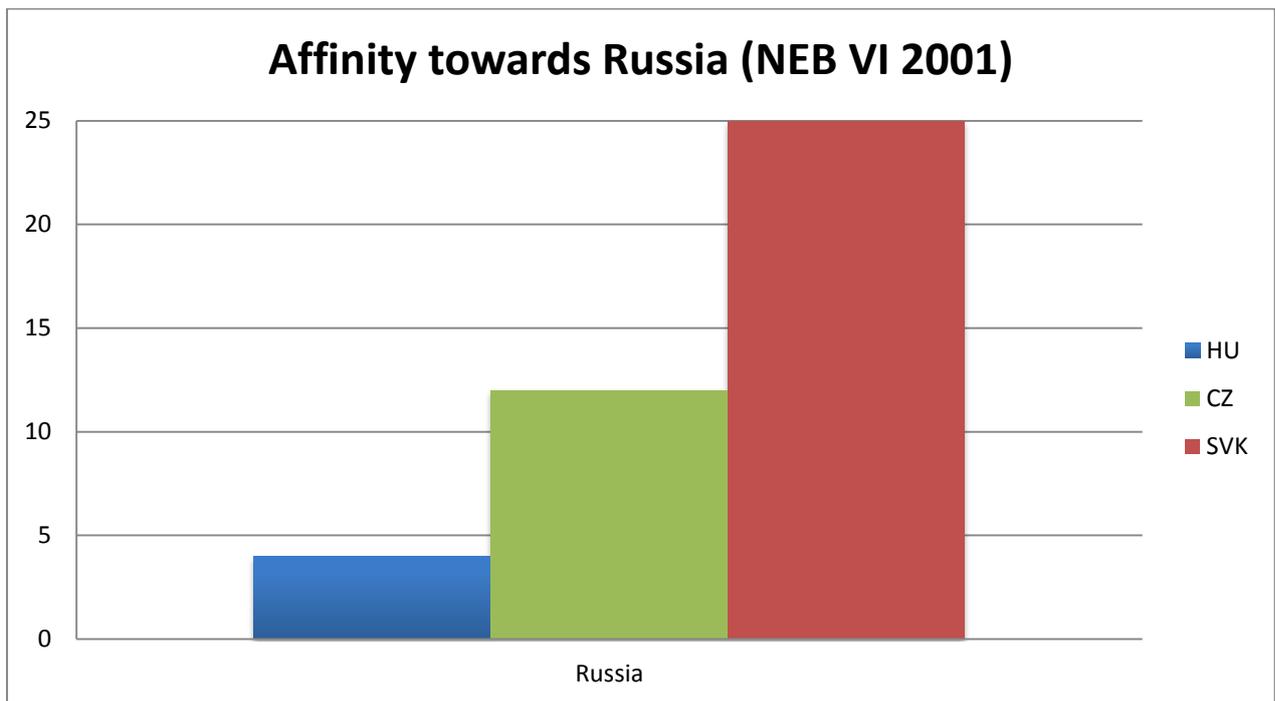


Chart 22: Affinity towards Russia in 2001

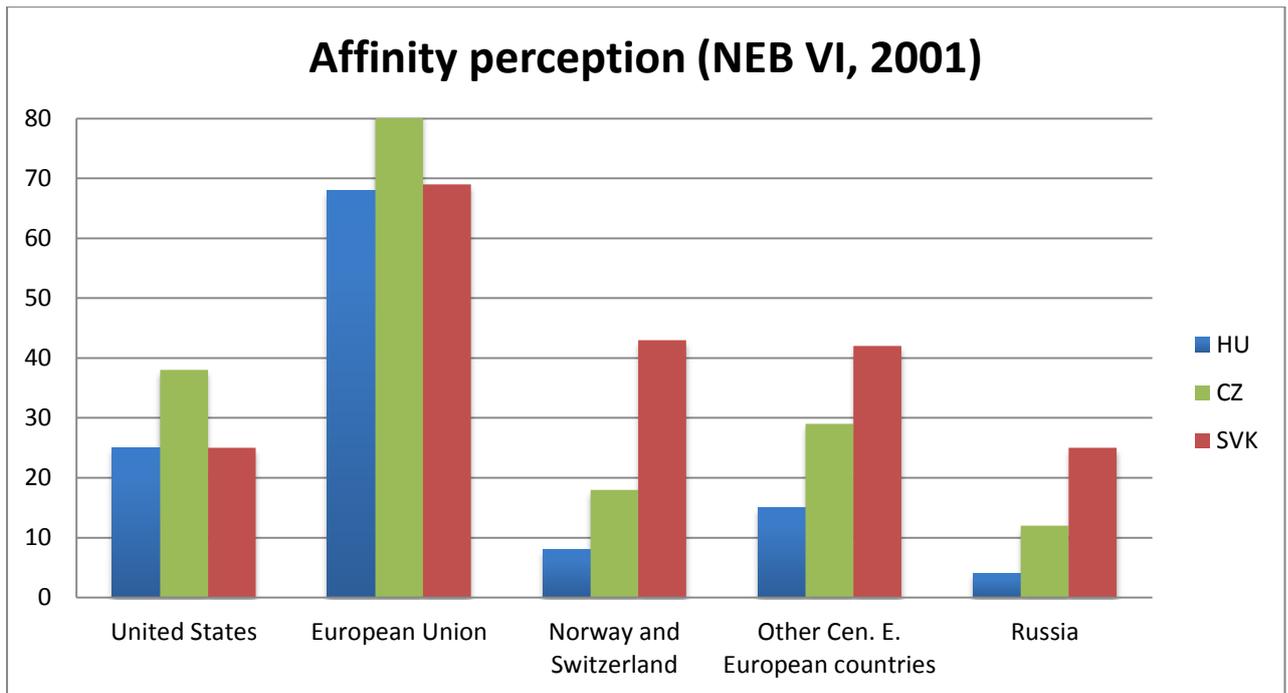


Chart 23: Affinity towards countries in general

### ***Ruling Elites Links with the Previous Regime***

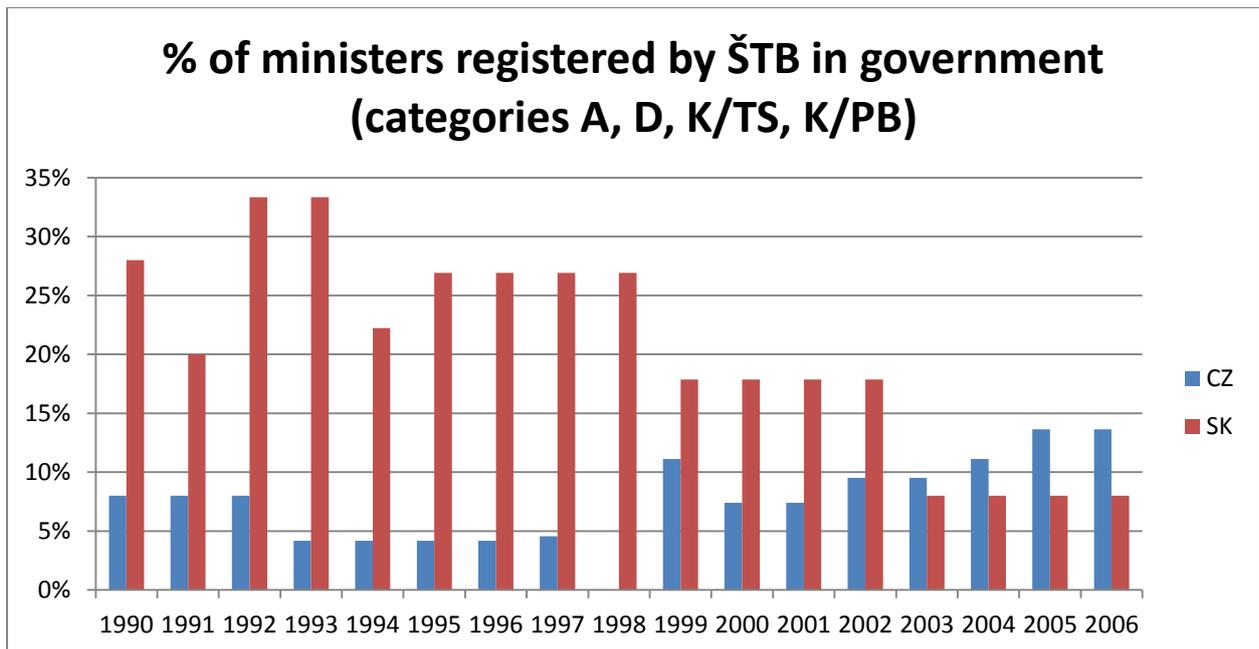


Chart 24: Ministers recorded in the communist secret service databases (A – Agent; D – Confident, K/TS, K/PB – candidates of collaboration or holders of agency apartments).

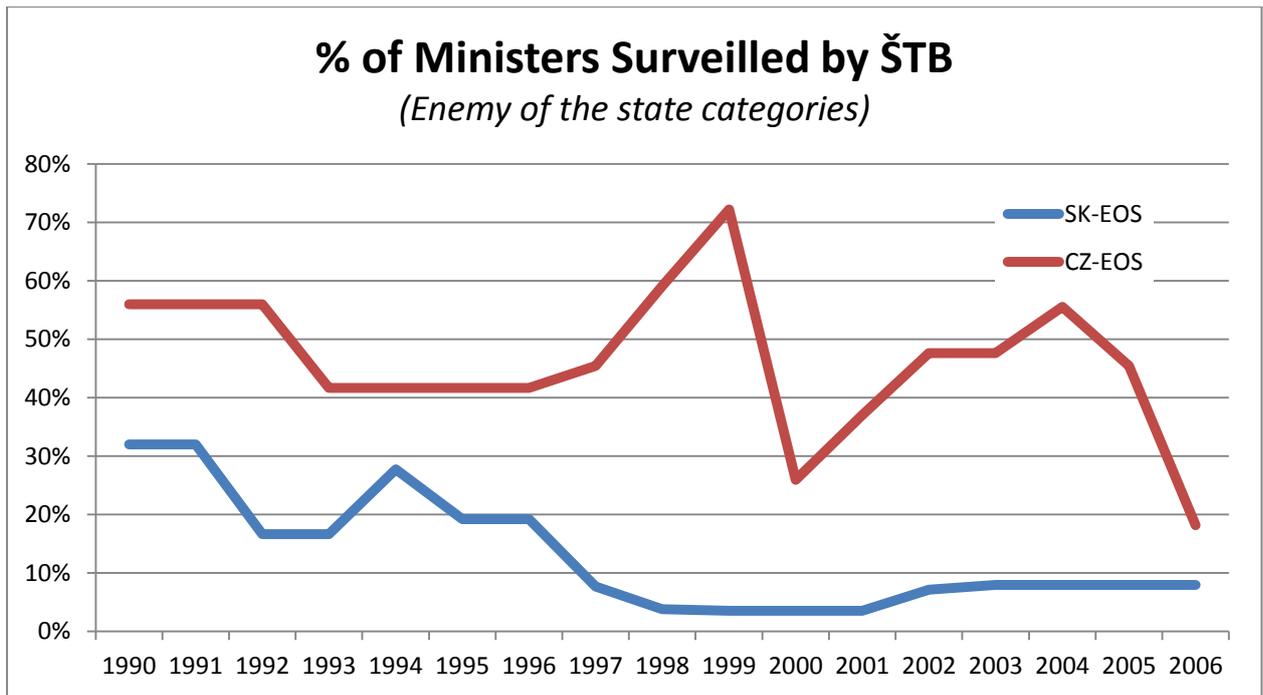


Chart 25: Ministers surveyed by the past communist secret service EOS – enemy of the state categories (people under surveillance).

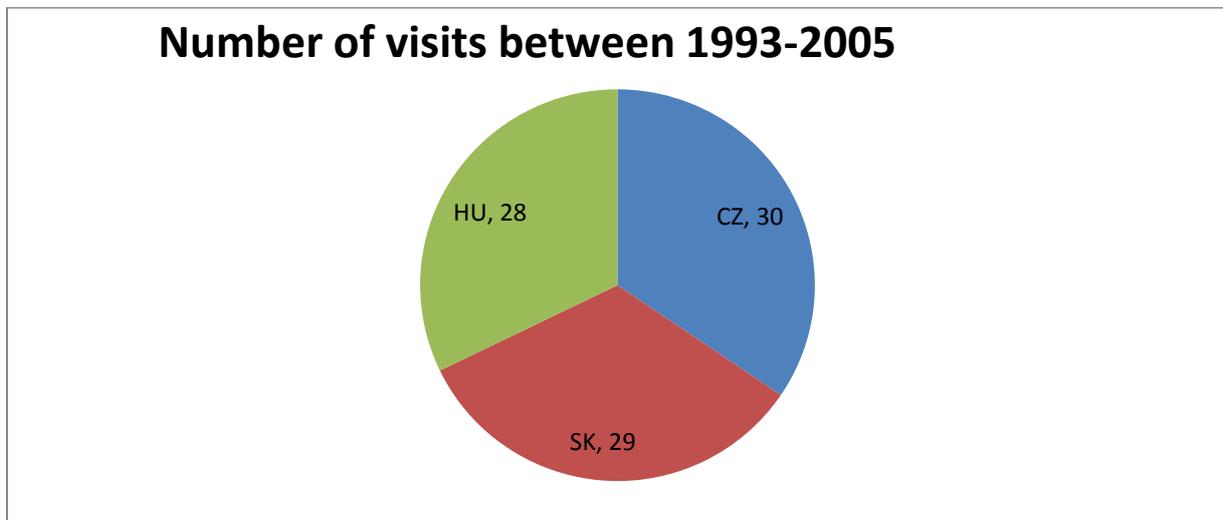


Chart 26: Total number of visits with Russia (1993-2005)

## Total bilateral treaties between Russia and... (1993-2005)

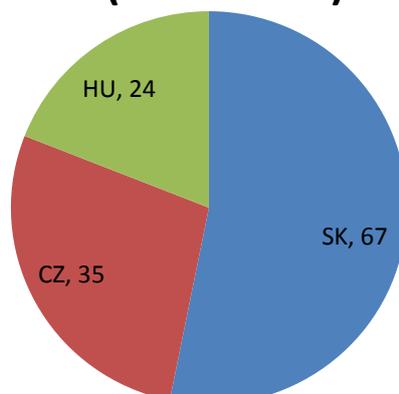


Chart 27: Total number of treaties with Russia (1993-2005<sup>681</sup>)

## Number of treaties between Russia and...

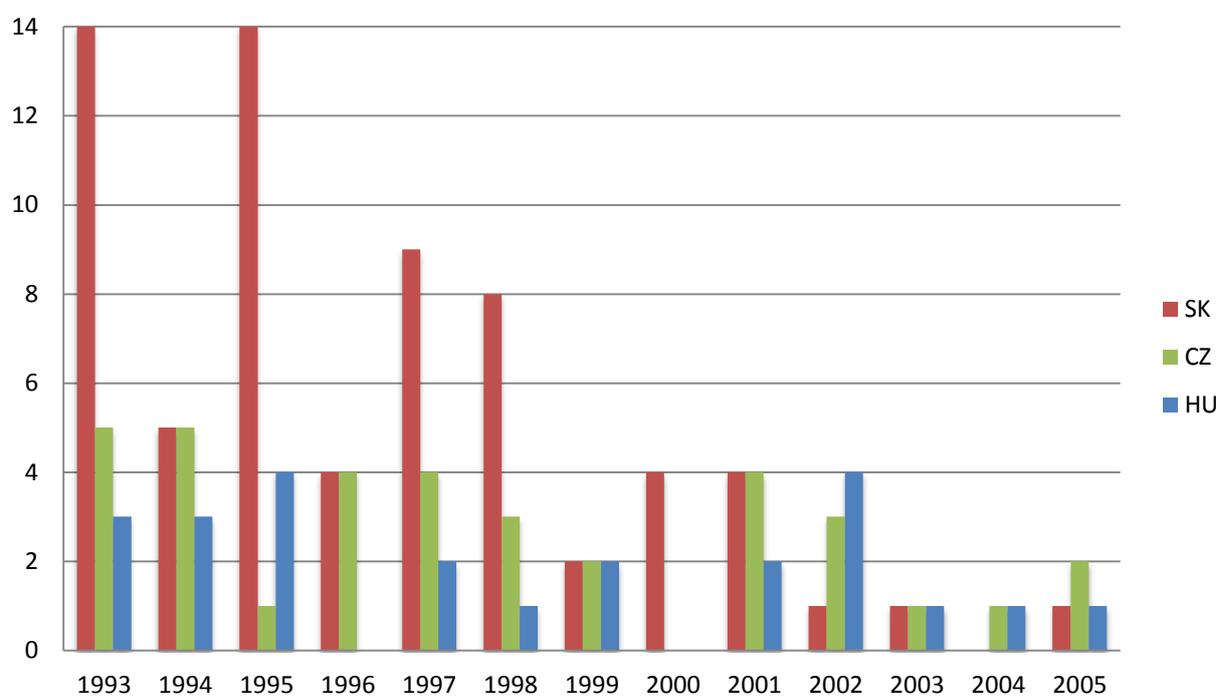


Chart 28: Number of bilateral treaties (compiled from MFAs and public sources)

<sup>681</sup> Data from Ministry of Foreign Affairs of Czech Republic, "Seznam platných mezinárodních smluv s Českou republikou: Rusko [List of international treaties between Czech Republic and Russia]", n.d., [http://www.mzv.cz/jnp/cz/encyklopedie\\_statu/evropa/rusko/smlouvy/index.html](http://www.mzv.cz/jnp/cz/encyklopedie_statu/evropa/rusko/smlouvy/index.html); Ministry of Foreign Affairs of Hungary, "CONTRACT Web: Szerződés-nyilvántartó Rendszer", n.d., <http://www.kulugyminiszterium.hu/szerzodes-nyilvantarto/main.aspx>; and Ministry of Foreign Affairs of Slovak Republic, "Zoznam zmlúv podľa štátov: Rusko", n.d., [http://www.mzv.sk/servlet/content?MT=/App/WCM/main.nsf/vw\\_ByID/zahranicna\\_\\_politika&TG=BlankMaster&URL=/App/WCM/main.nsf/vw\\_ByID/medzinarodne\\_zmluvy-zoznam\\_zmluv\\_podla\\_statov&CSTATE=RUSKO&OpenDocument=Y&LANG=SK&PAGE\\_VSETKYZMLUVY-DWMCEA-7XEM76=4](http://www.mzv.sk/servlet/content?MT=/App/WCM/main.nsf/vw_ByID/zahranicna__politika&TG=BlankMaster&URL=/App/WCM/main.nsf/vw_ByID/medzinarodne_zmluvy-zoznam_zmluv_podla_statov&CSTATE=RUSKO&OpenDocument=Y&LANG=SK&PAGE_VSETKYZMLUVY-DWMCEA-7XEM76=4).

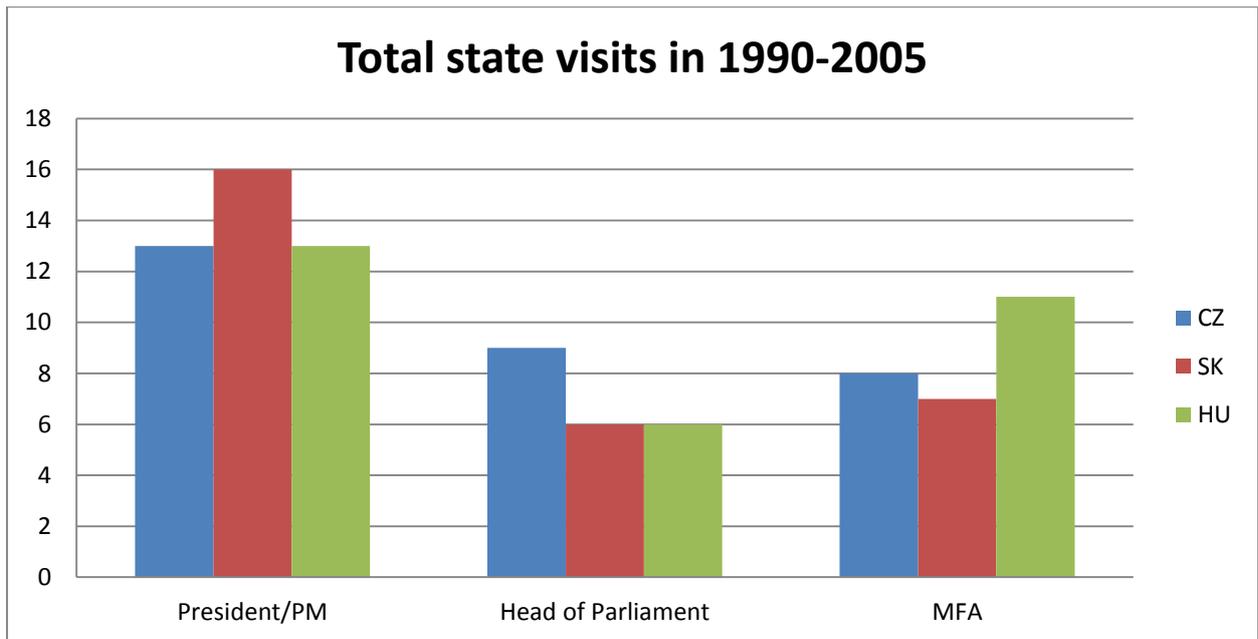


Chart 29: State visits according to level of representation

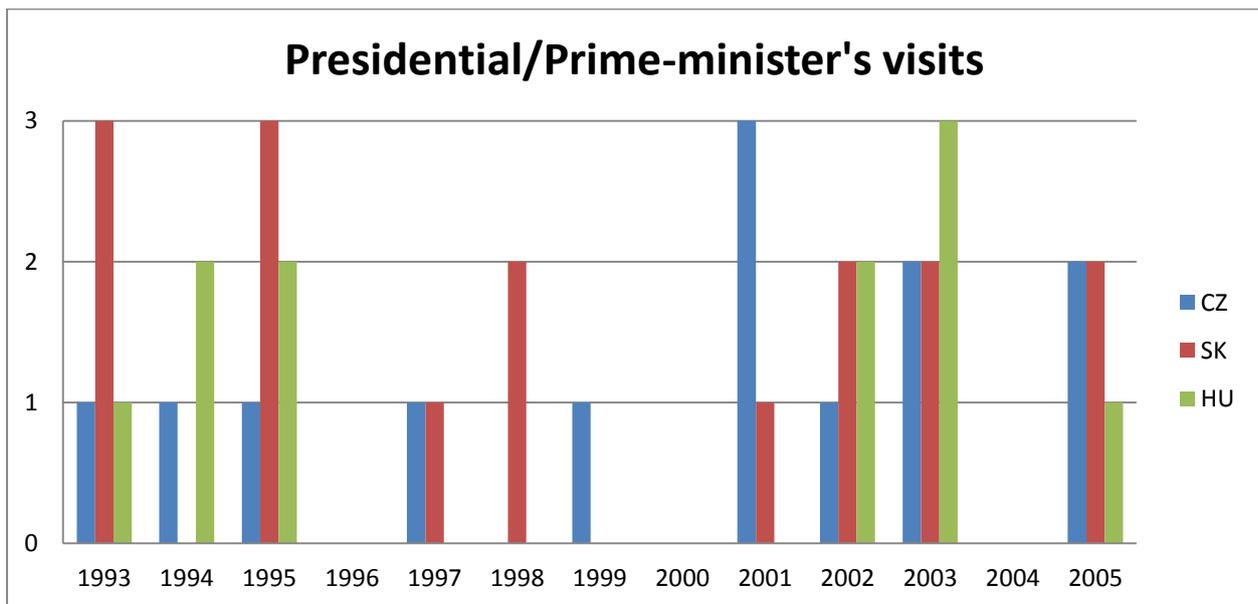
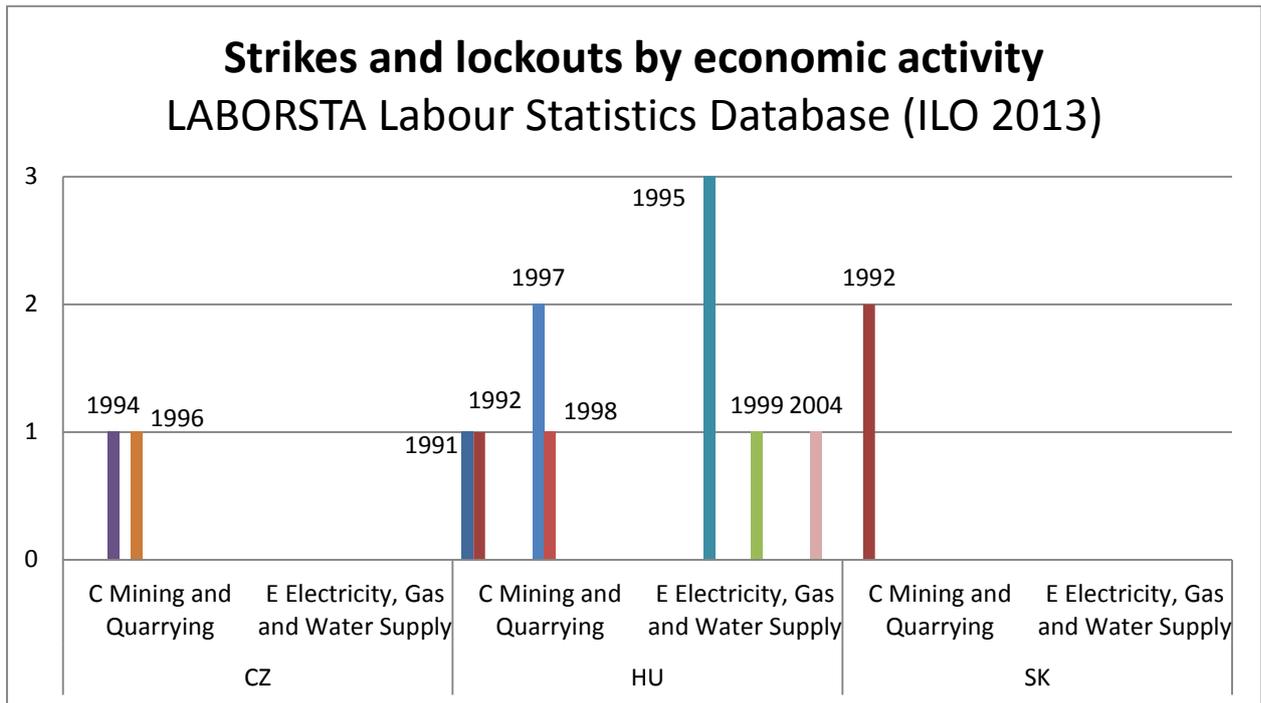


Chart 30: Highest level visits

**Industrial Interests**



**Chart 31: Number of strikes and lockouts by economic activity related to energy**

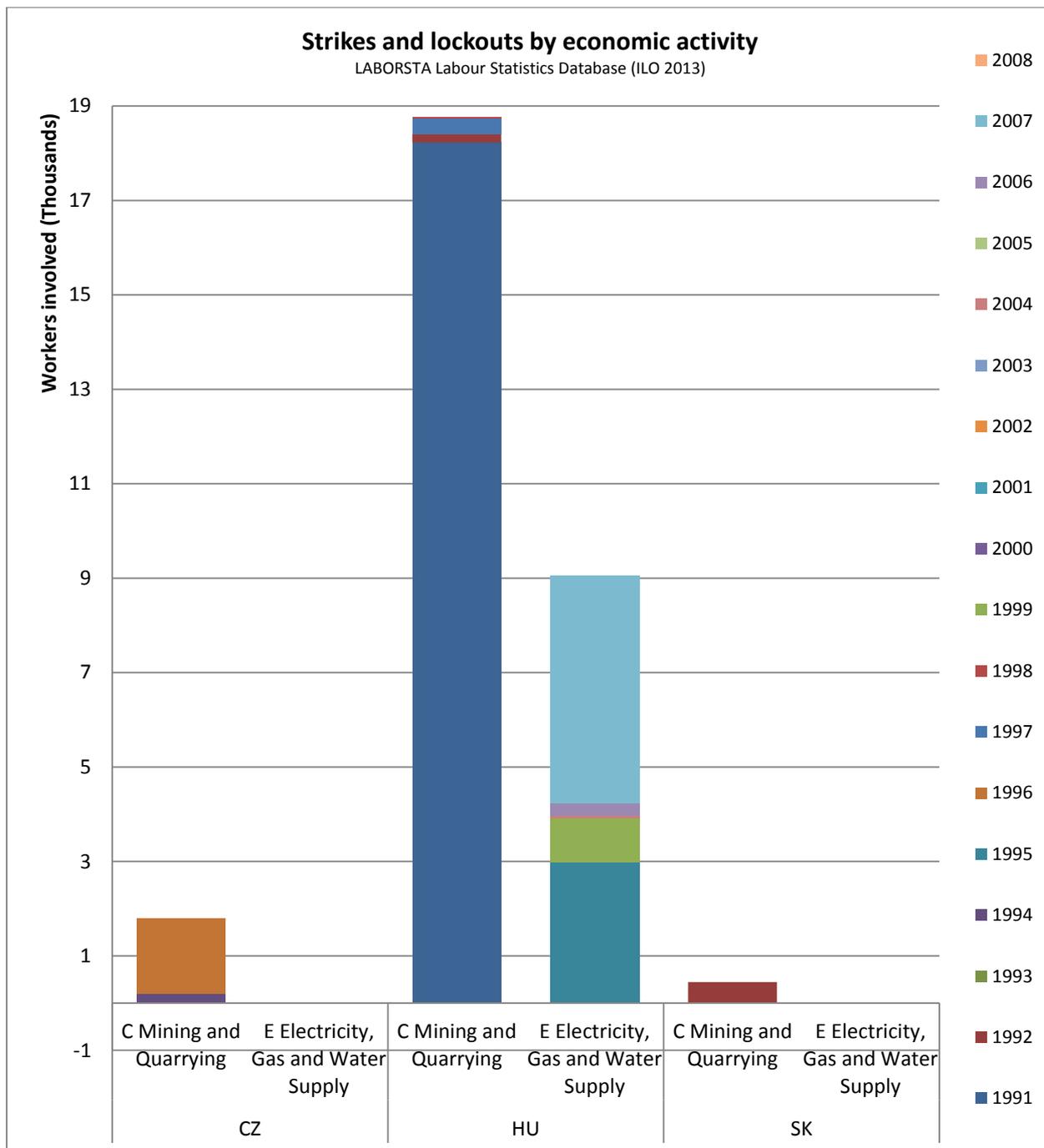


Chart 32: Number of workers involved in strikes and lockouts by economic activity related to energy

## Average paid employment in specific industrial sectors

(% of total manufacturing 1993-2005)

LABORSTA Labour Statistics Database (ILO 2013)

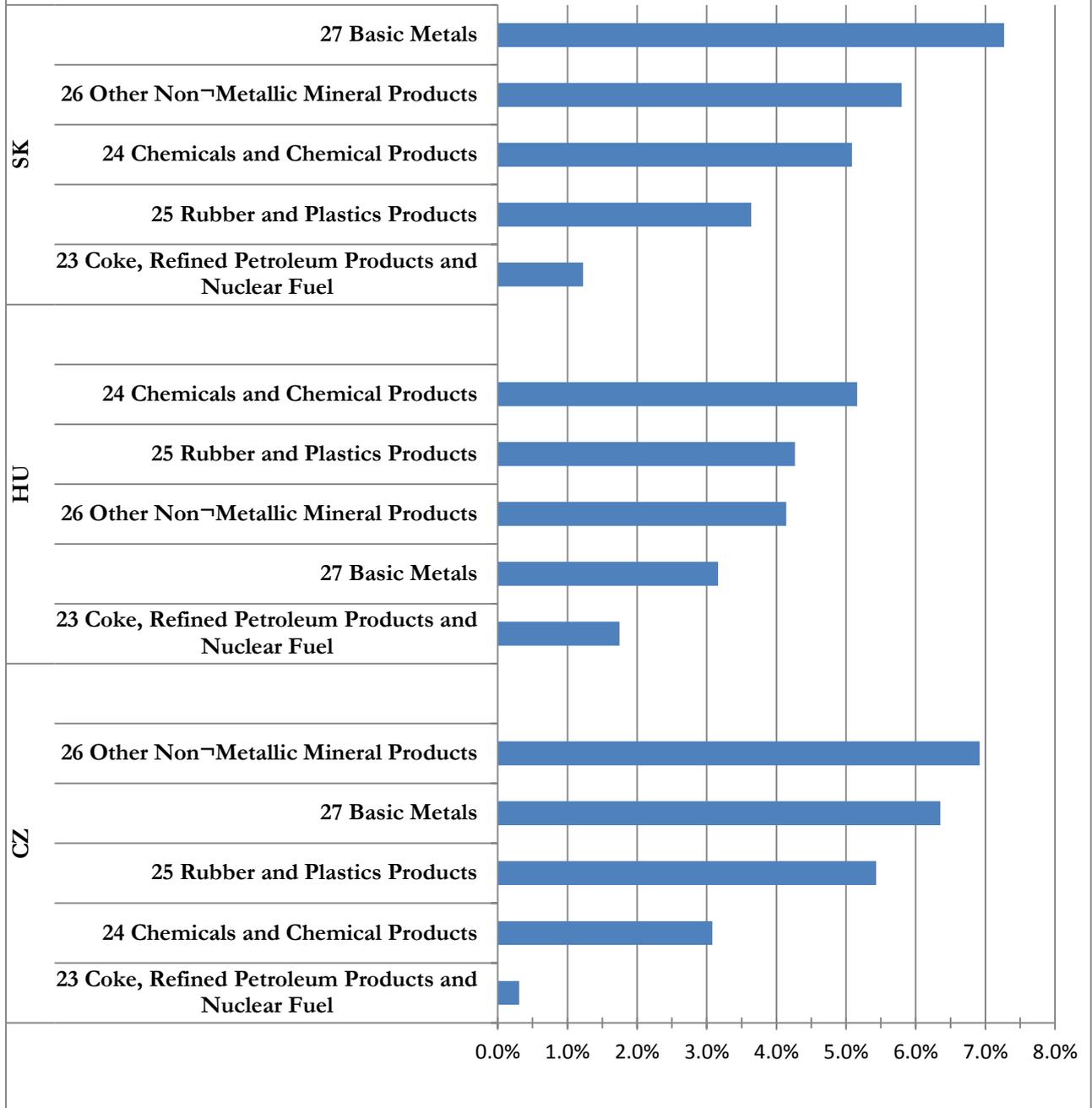


Chart 33: Employment in energy intensive industries as share of manufacturing industries

## Structure of Industry

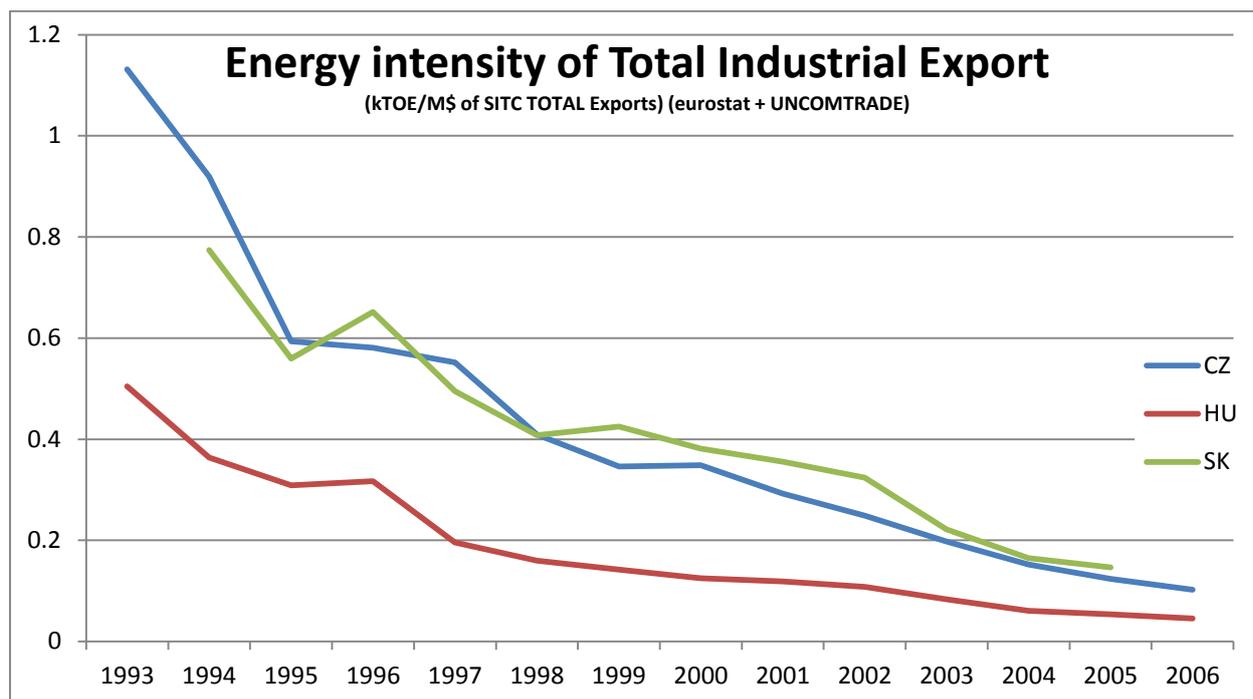


Chart 34: Energy intensity of selected industrial sectors in Slovak Republic<sup>682</sup>

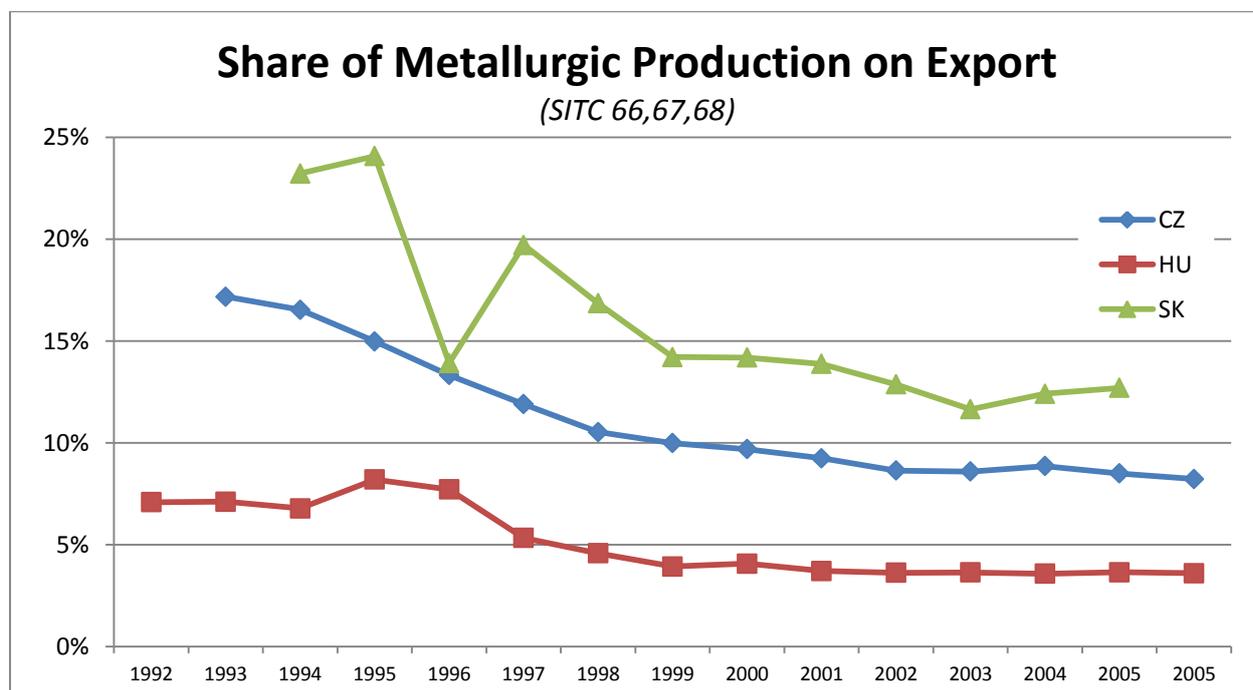


Chart 35: Share of metallurgic production on exports

<sup>682</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; United Nations Statistics Division, "UN Comtrade."

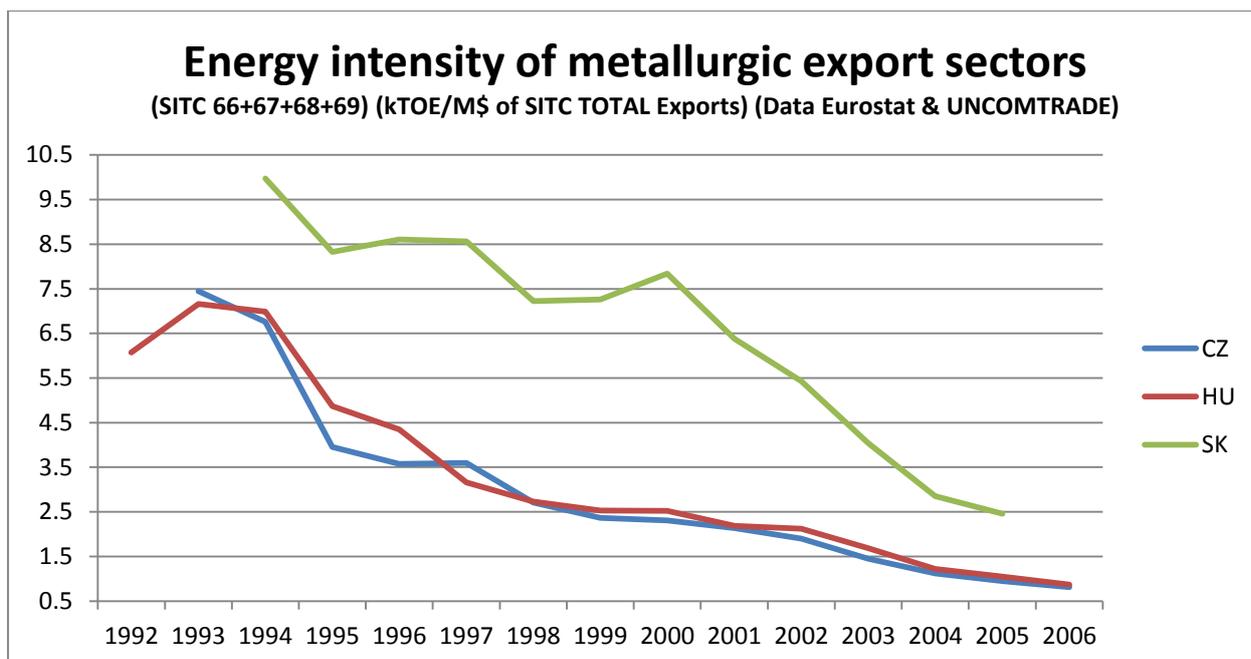


Chart 36: Measure of increase in the efficiency of metallurgic export sectors

### Energy Security Indices

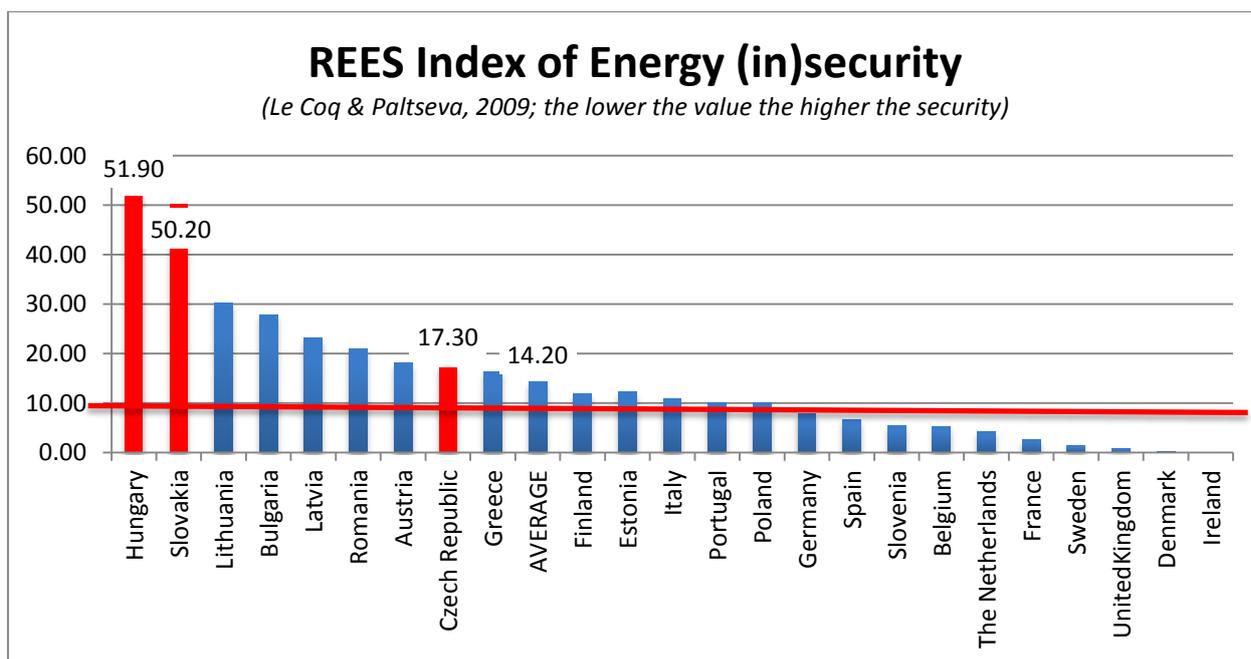


Chart 37: Combined REES Index of Energy (in)security (the lower the value the more secure the country)<sup>683</sup>

<sup>683</sup> Le Coq and Paltseva, “Measuring the security of external energy supply in the European Union.”

### REES Index of Energy (in)security Gas & oil sub-indices

(Le Coq & Paltseva, 2009; the lower the value the higher the security)

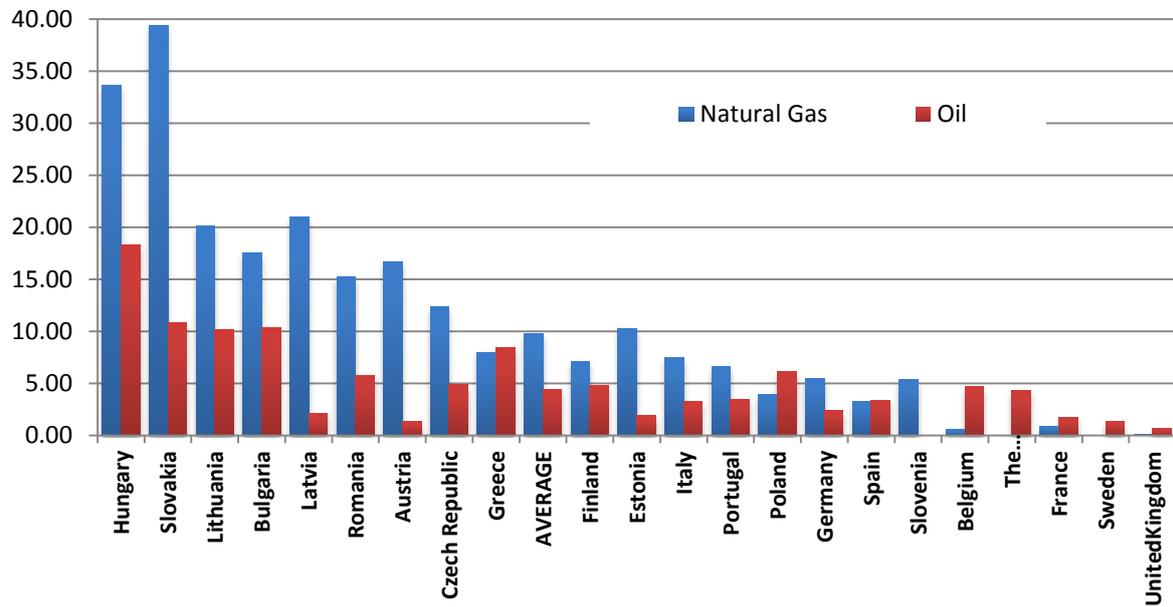


Chart 38: REES Index of Energy (in)security for gas and oil separately (the lower the value the more secure the country)<sup>684</sup>

### Energy Policy Index (combined index)

(Röller & Delgado & Friederiszick 2007).

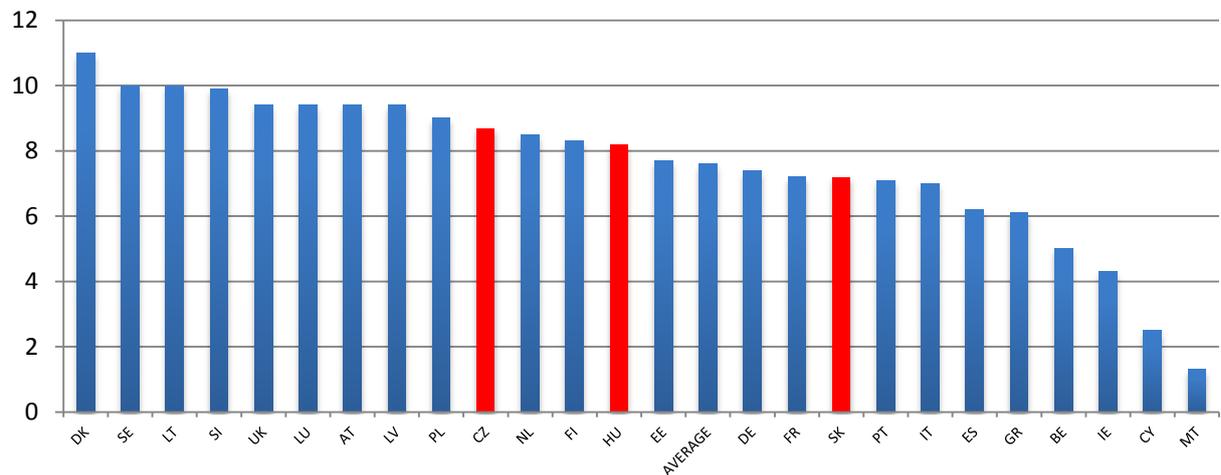


Chart 39: Energy Policy Index (the higher the value the higher the security)<sup>685</sup>

<sup>684</sup> Ibid.

<sup>685</sup> Röller, Delgado, and Friederiszick, "Energy: choices for Europe."

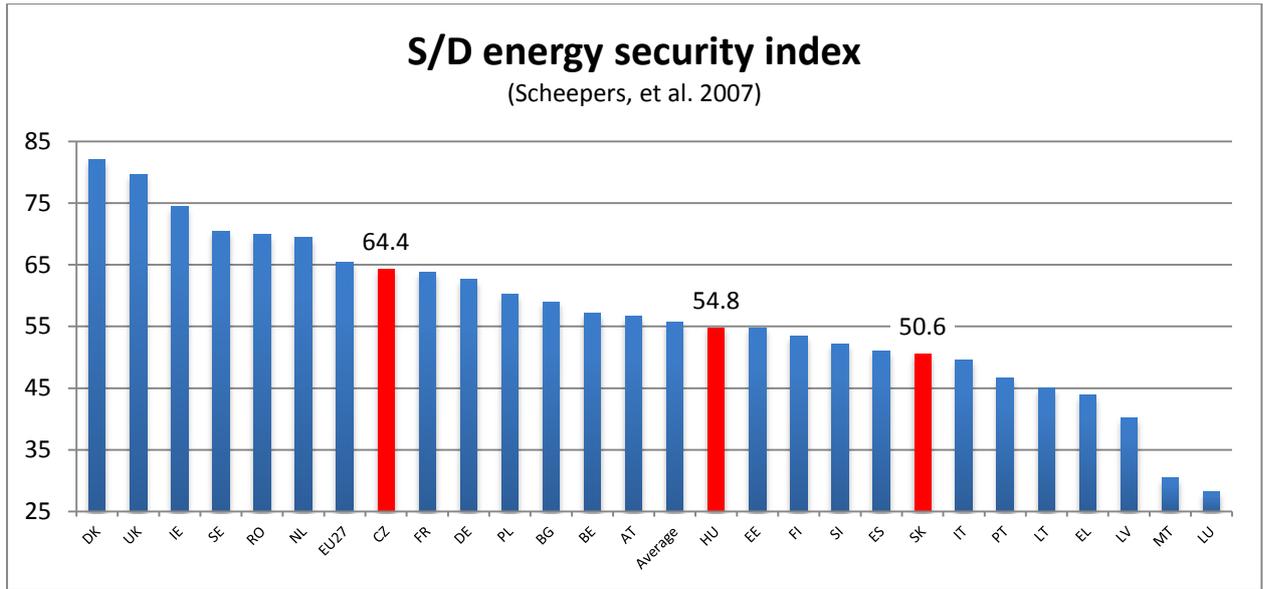


Chart 40: Supply/Demand security index (the higher the value the higher the security)<sup>686</sup>

<sup>686</sup> Scheepers et al., “EU Standards for Energy Security of Supply-Updates on the Crisis Capability Index and the Supply/Demand Index Quantification for EU-27.”

## Asymmetry of natural gas imports BP&Eurostat data 2008

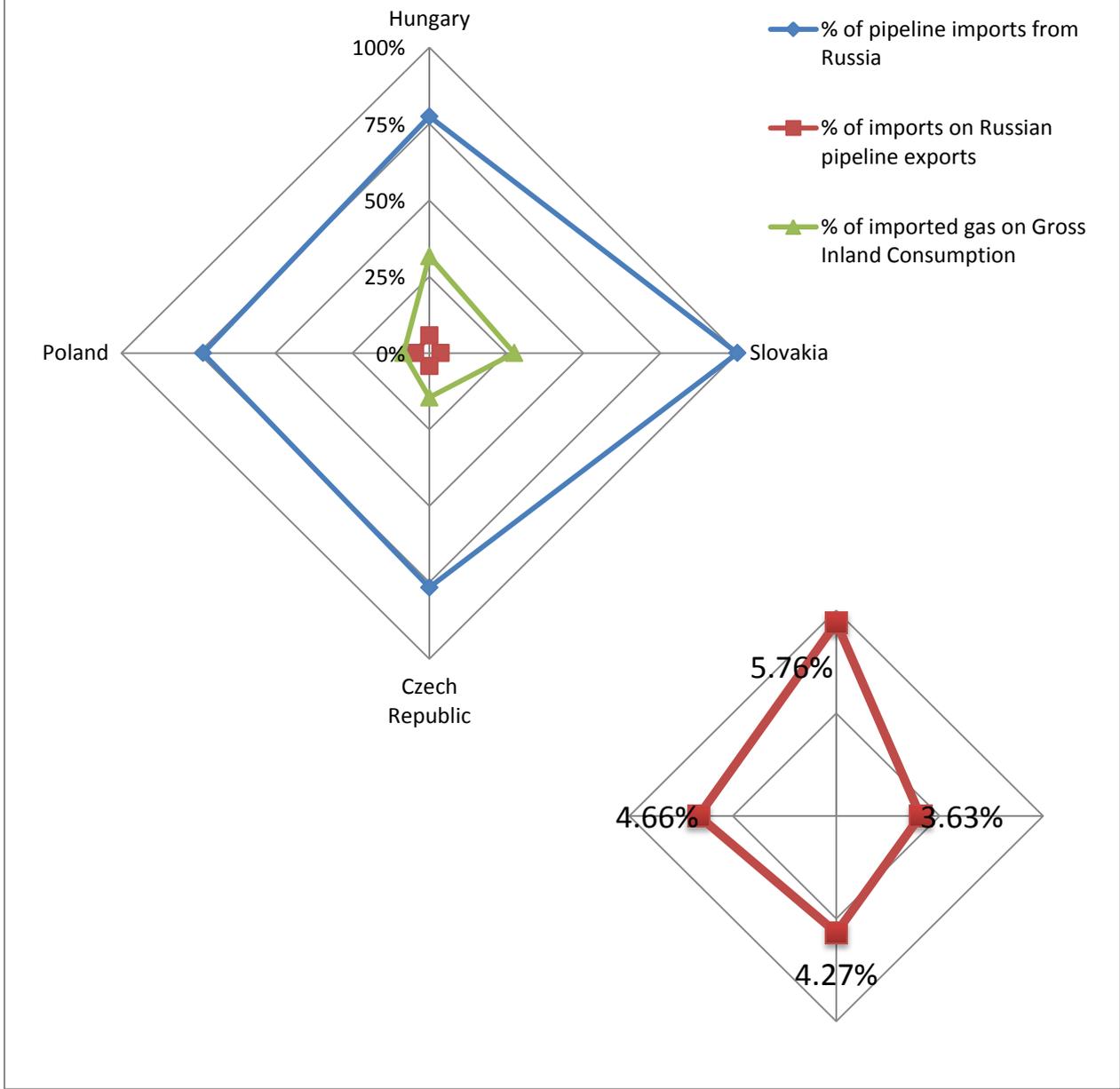


Chart 41: Asymmetry of energy imports<sup>687</sup>

<sup>687</sup> Own calculations based on data from BP, “Statistical Review of World Energy 2010”, 2010, [http://www.bp.com/liveassets/bp\\_internet/globalbp/globalbp\\_uk\\_english/reports\\_and\\_publications/statistical\\_energy\\_review\\_2008/STAGING/local\\_assets/2010\\_downloads/Statistical\\_Review\\_of\\_World\\_Energy\\_2010.xls](http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/2010_downloads/Statistical_Review_of_World_Energy_2010.xls) (accessed June 9, 2010); Eurostat, “Energy Statistics”; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

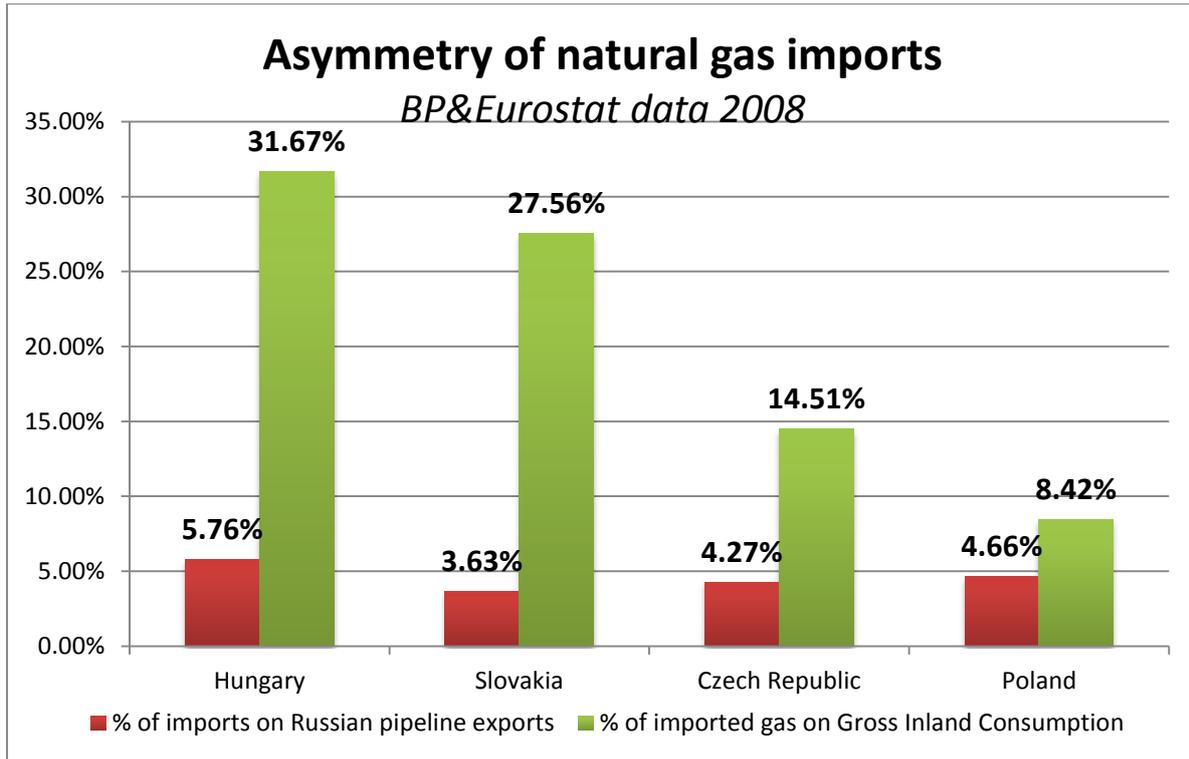


Chart 42: Asymmetry of energy imports<sup>688</sup>

### Transit Infrastructure Diversification

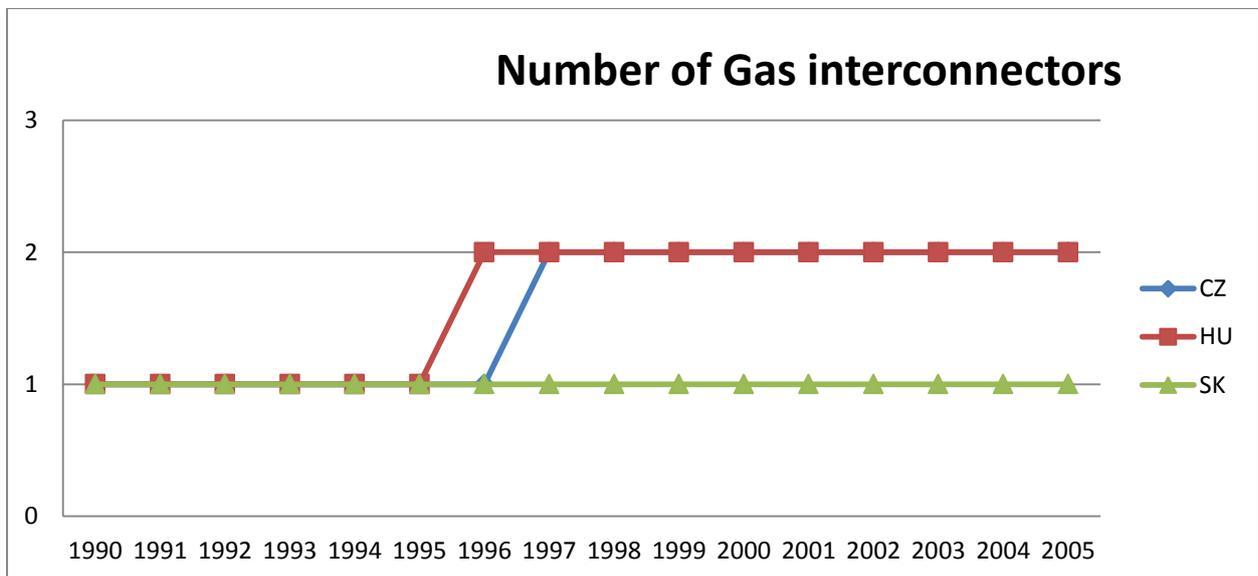


Chart 43: Number of physical gas import pipelines

<sup>688</sup> Own calculations based on data from BP, “Statistical Review of World Energy 2010”; Eurostat, “Energy Statistics”; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

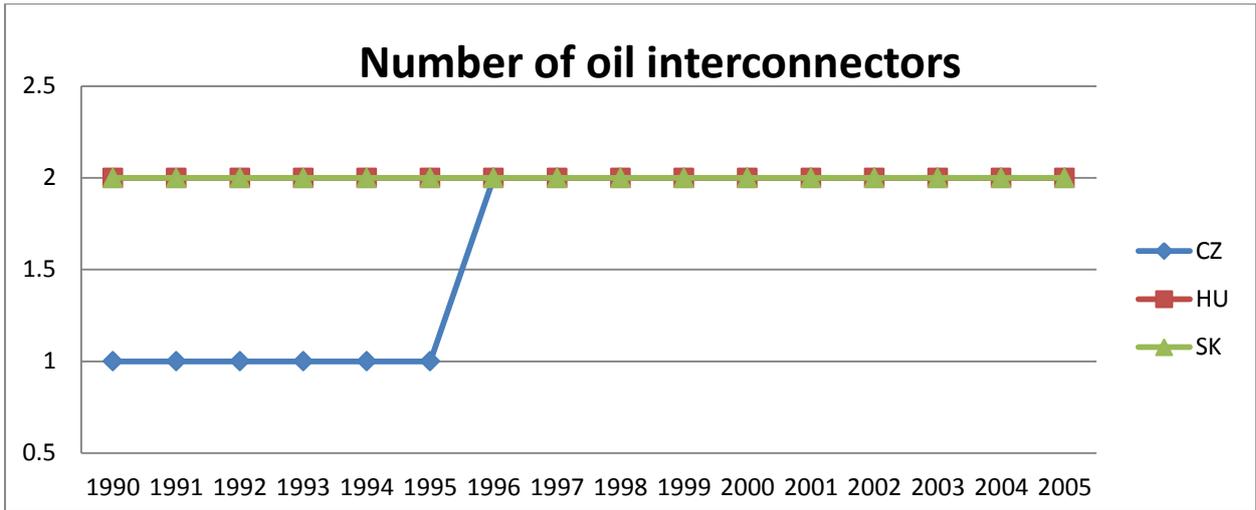


Chart 44: Number of physical oil import pipelines

**Supplier Market Diversification**

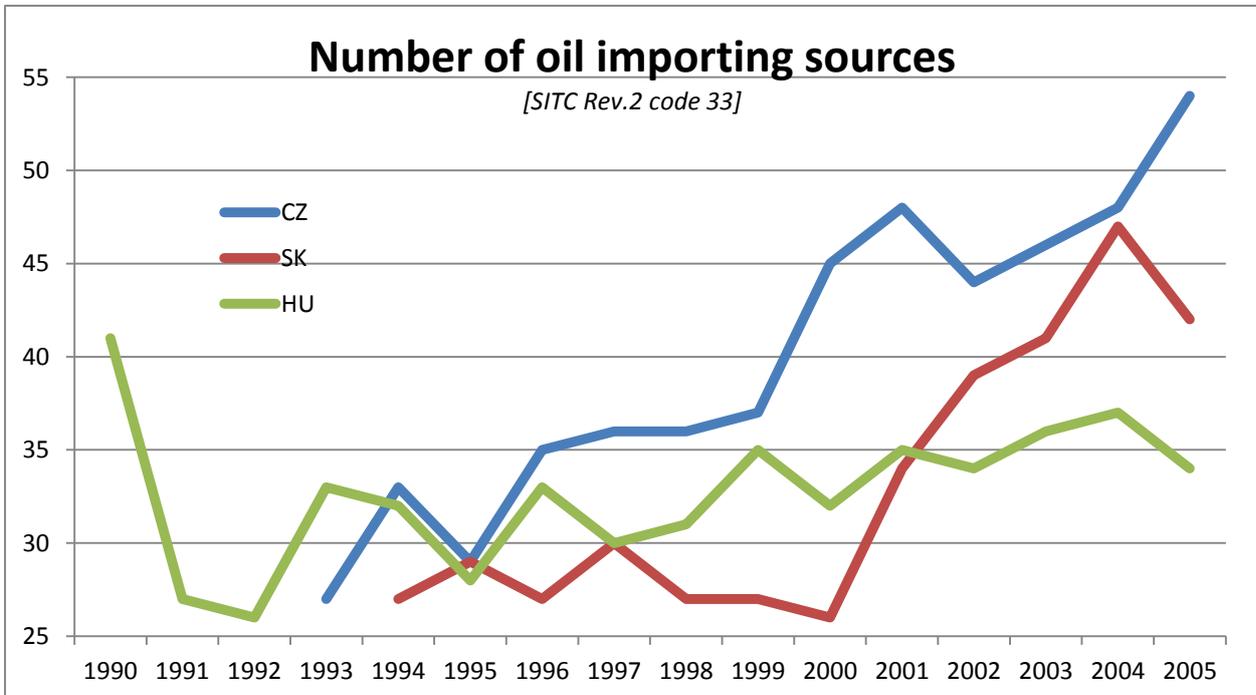


Chart 45: Number of partners for oil imports<sup>689</sup>

<sup>689</sup> Own calculations based on United Nations Statistics Division, "UN Comtrade." Data.

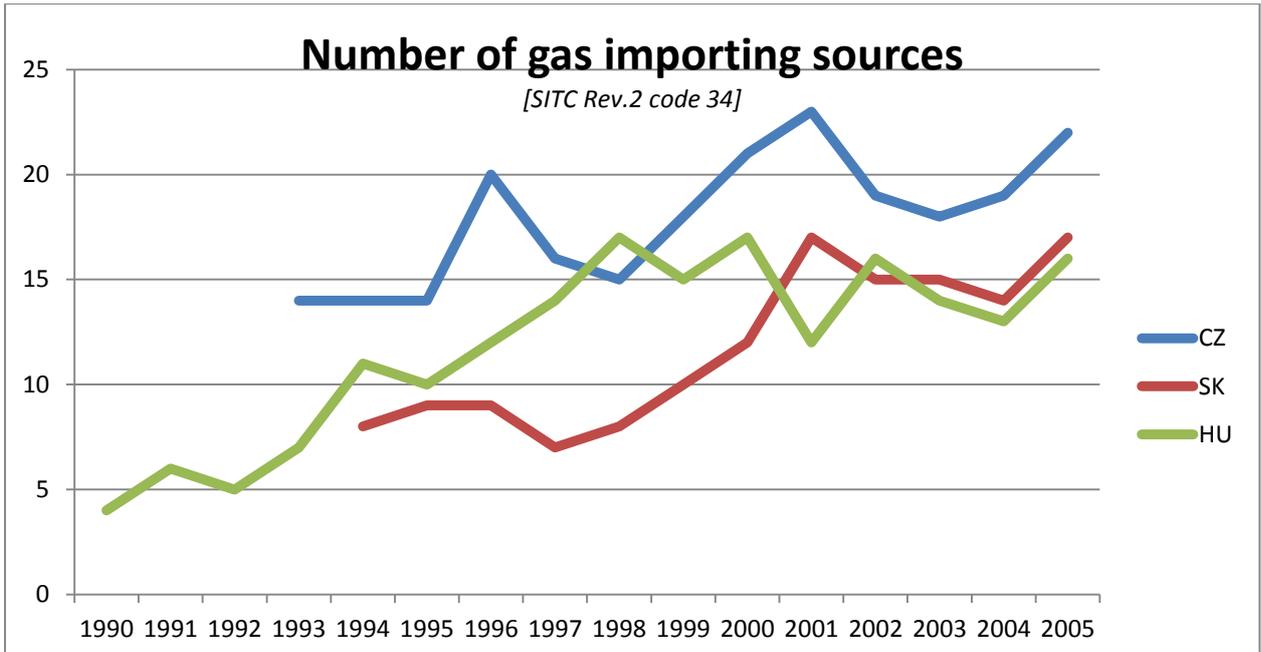


Chart 46: Number of partners for gas imports<sup>690</sup>

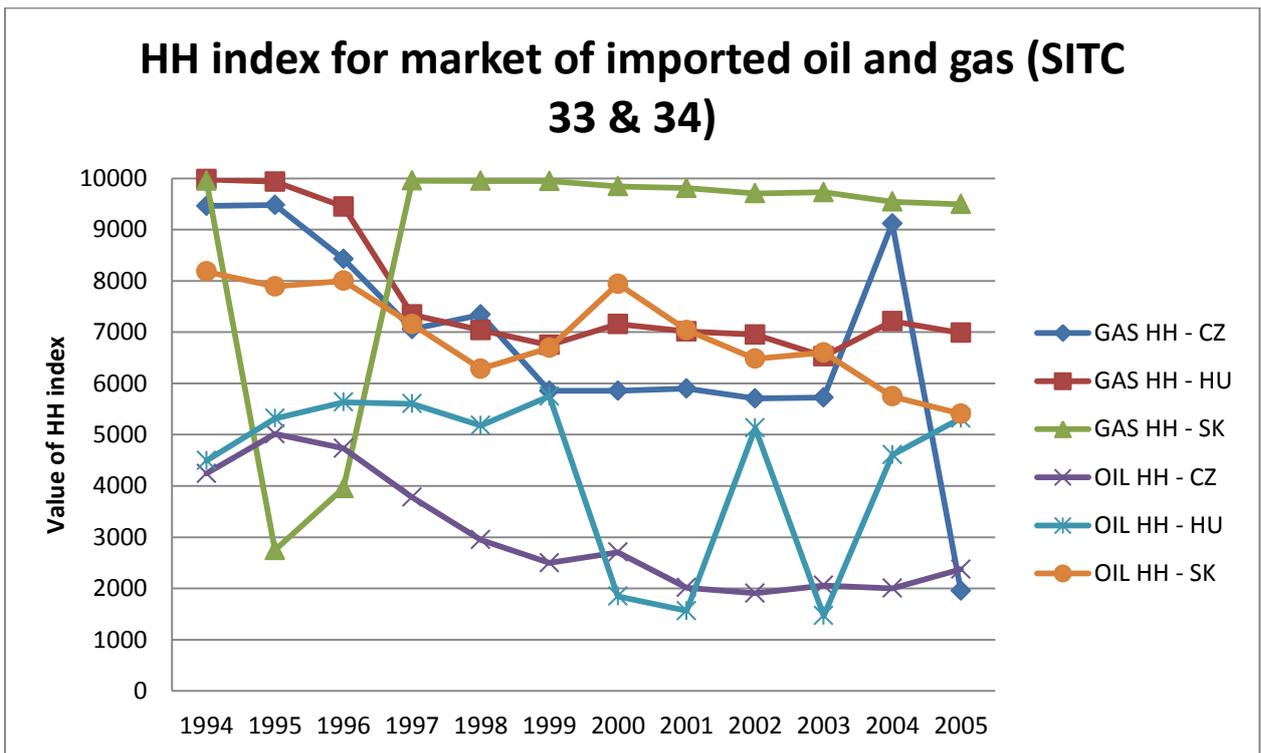


Chart 47: Concentration of gas and oil market compared

<sup>690</sup> Own calculations based on Ibid. data

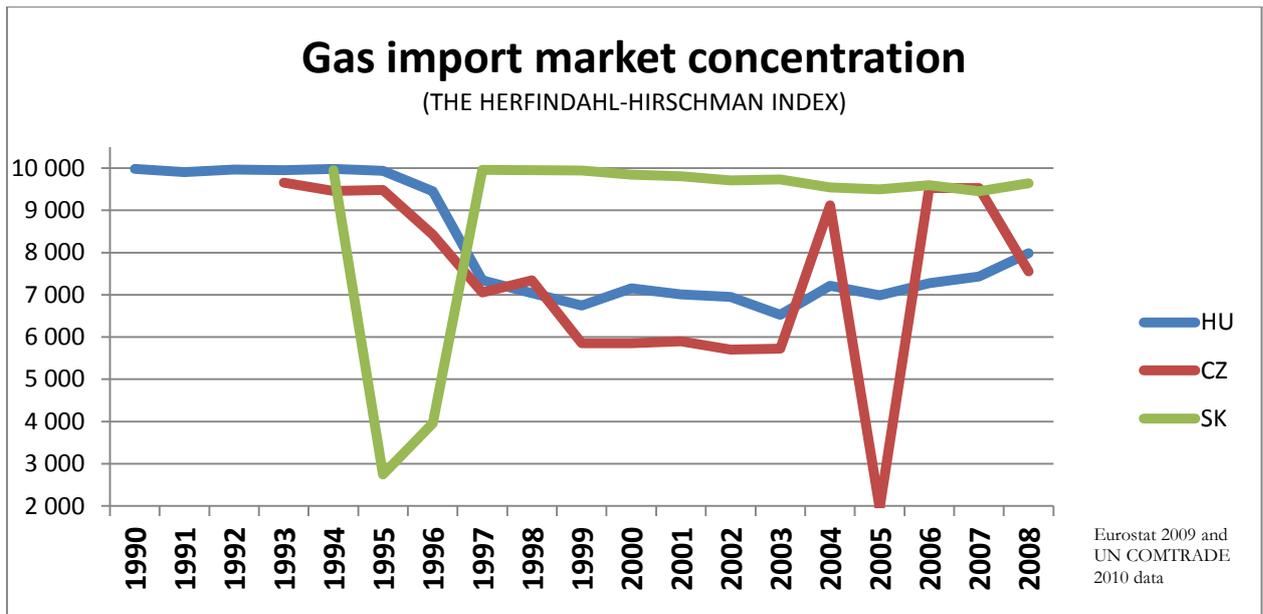


Chart 48: Market concentration for gas imports (higher value means less competition).<sup>691</sup>

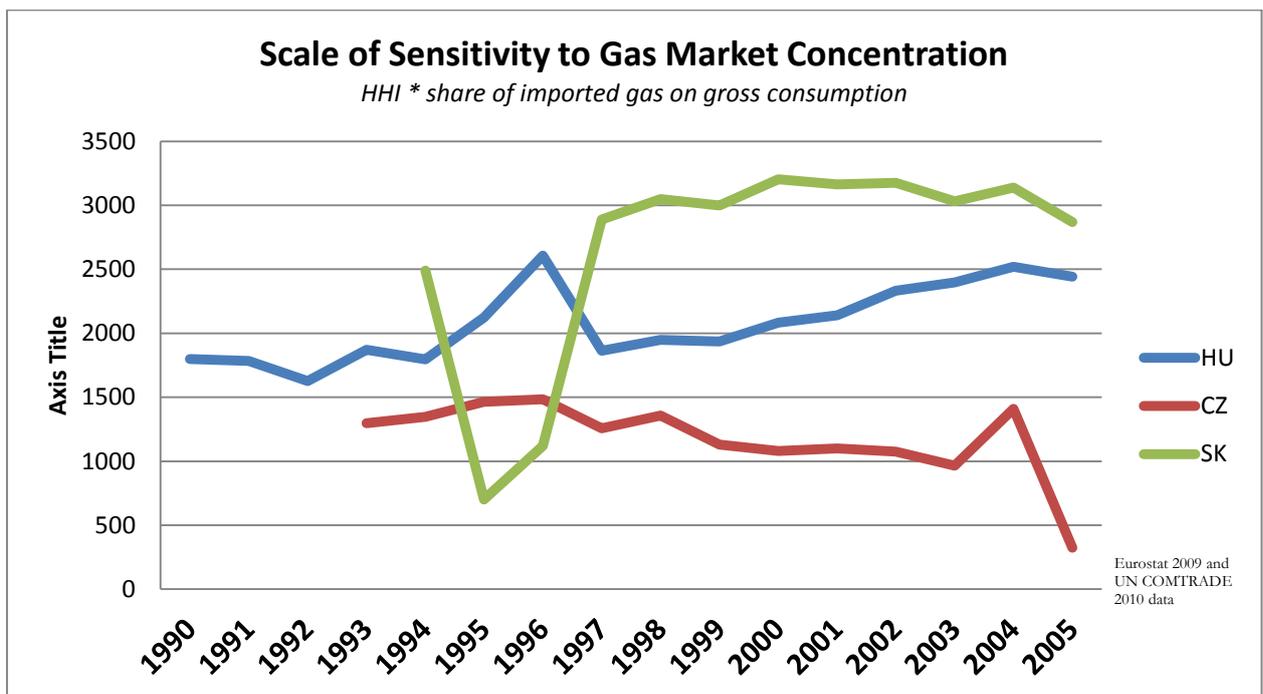


Chart 49: Scale of sensitivity to gas market concentration for gas imports (low value denotes higher energy security)

<sup>691</sup> Own calculations based on Ibid.; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat, “Energy Statistics”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].” Data.

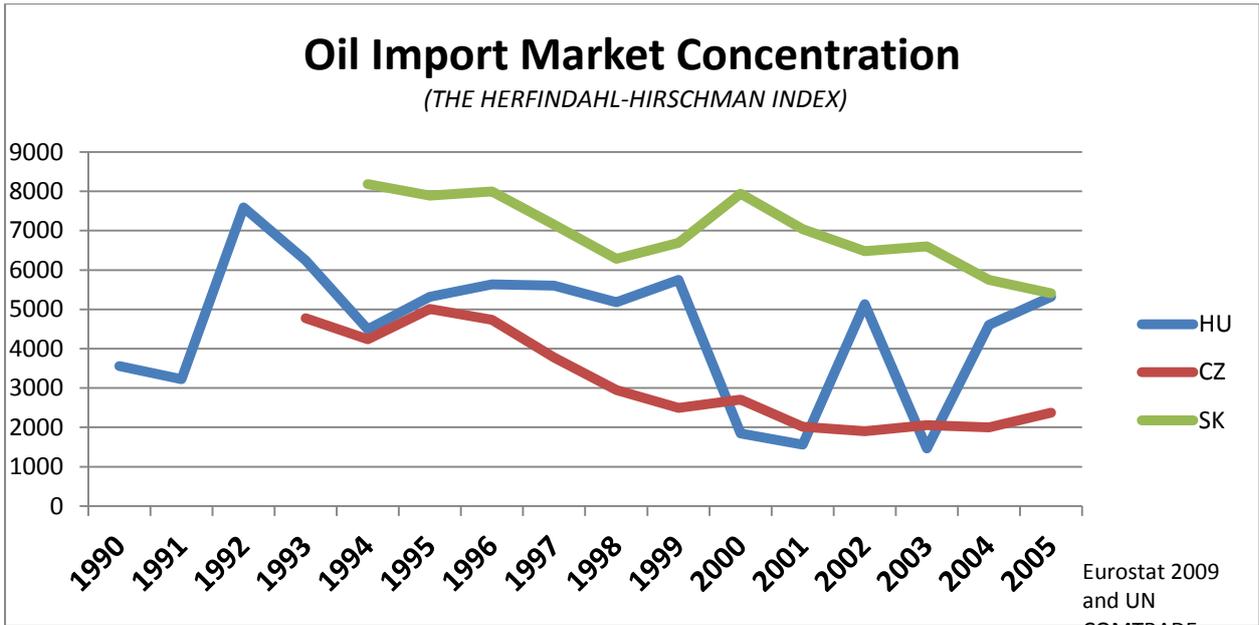


Chart 50: Market concentration for oil imports (higher value means less competition).<sup>692</sup>

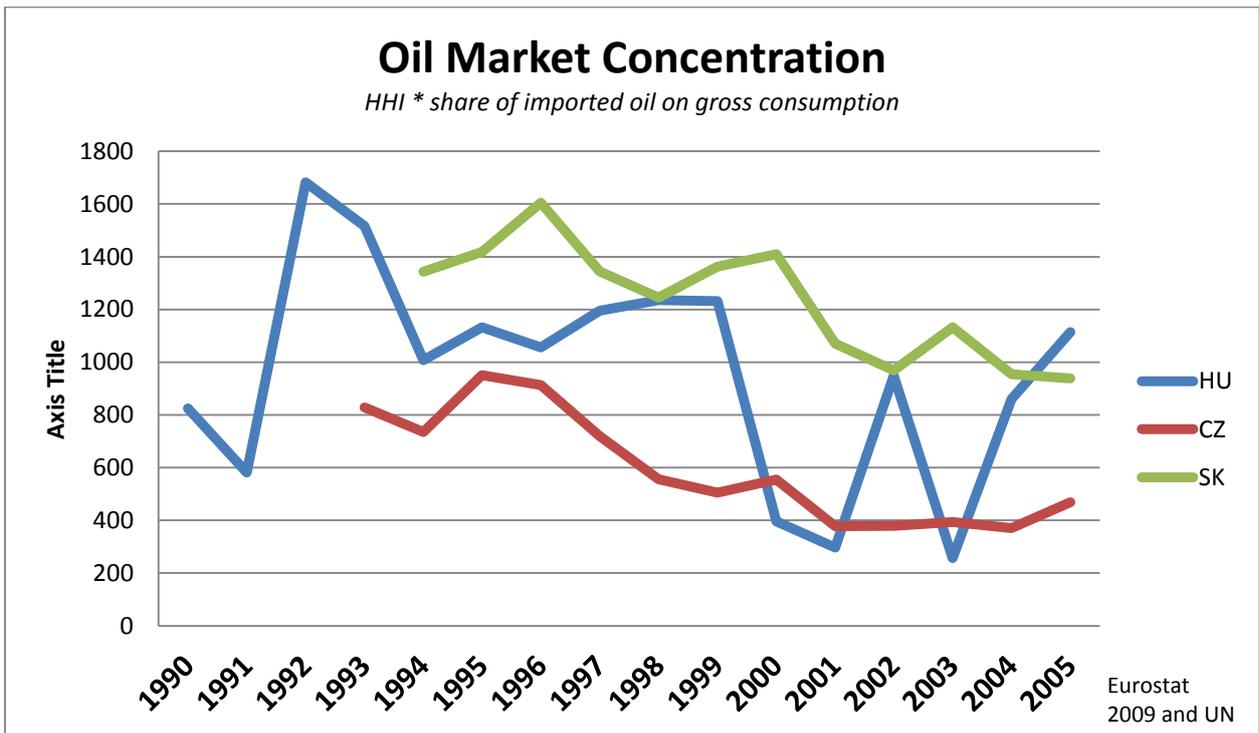


Chart 51: Scale of sensitivity to oil market concentration for gas imports (low value denotes higher energy security)

<sup>692</sup> Own calculations based on United Nations Statistics Division, “UN Comtrade”; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat, “Energy Statistics”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].” Data.

## Comparison of Gas Market Concentration on Energy Security

(% Difference from V3 average of HH\*share)

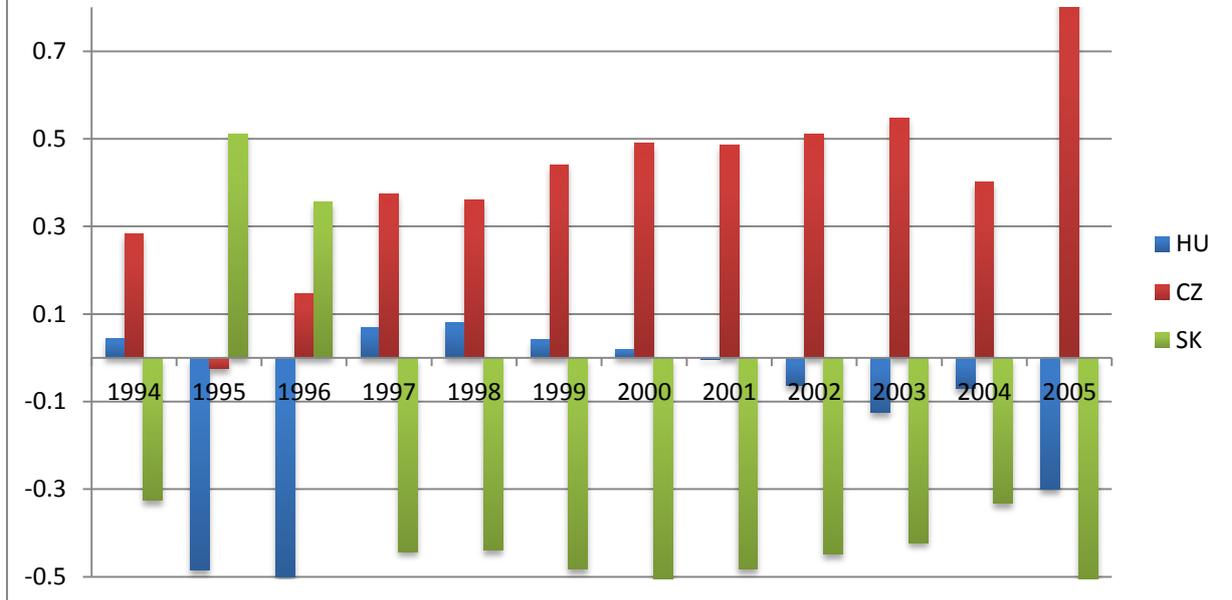


Chart 52: Comparison of gas market concentration factor on energy security HH\*imported share on gross consumption (difference from V3 average)<sup>693</sup>

### Energy Mix

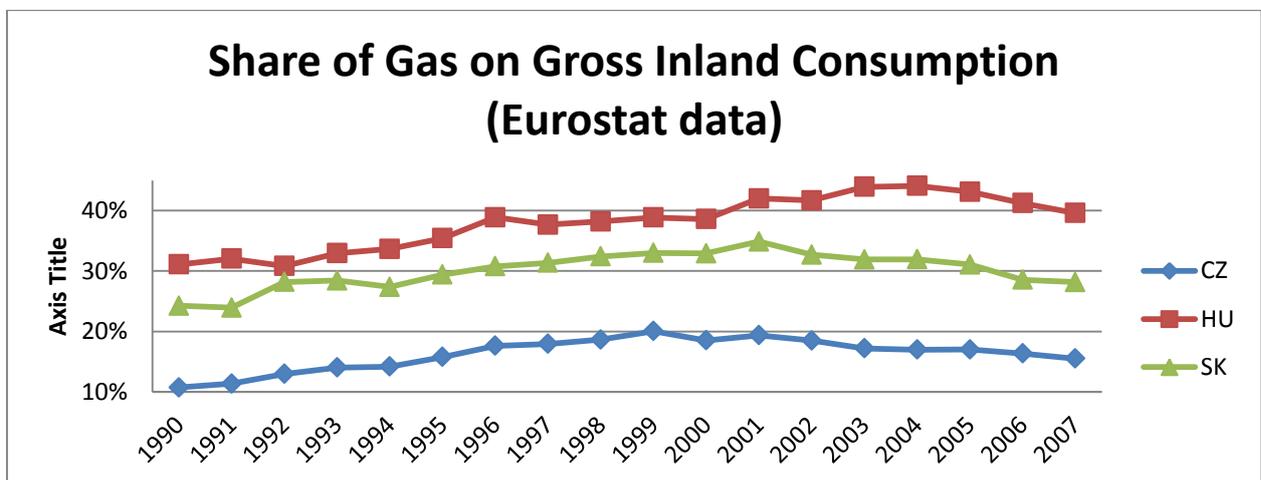


Chart 53: Share of natural gas on inland consumption<sup>694</sup>

<sup>693</sup> Own calculations based on United Nations Statistics Division, "UN Comtrade"; Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat, "Energy Statistics"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]." Data.

<sup>694</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat, "Energy Statistics"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]." Data.

### Share of Imported Gas on Gross Inland Consumption (Eurostat data)

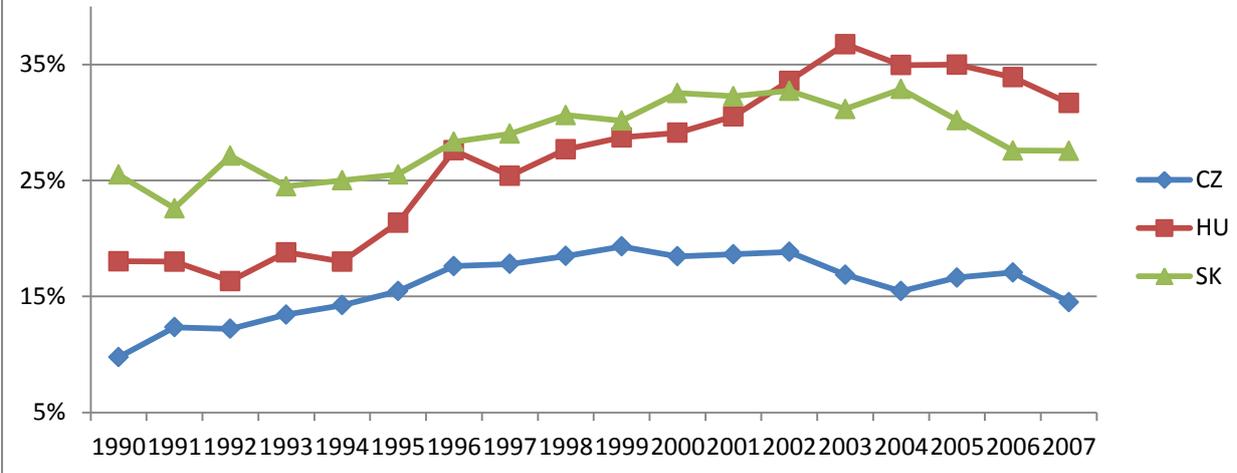


Chart 54: Share of imported natural gas on inland consumption<sup>695</sup>

### Share of Oil on Gross Inland Consumption (Eurostat data)

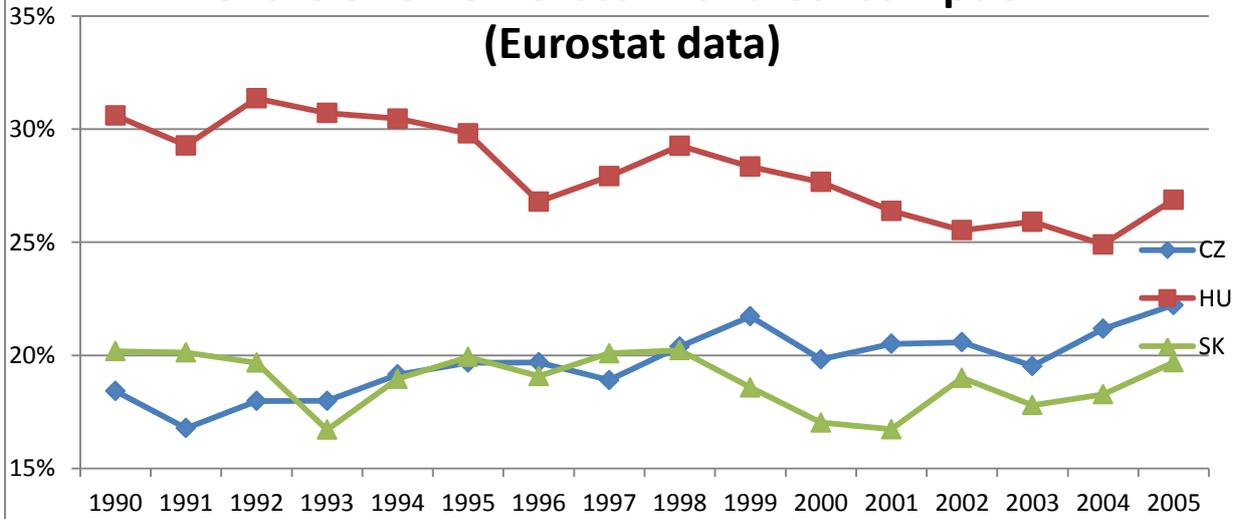


Chart 55: Share of oil on inland consumption

<sup>695</sup> Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat, “Energy Statistics”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

### Share of imported oil on gross inland consumption (Eurostat data)

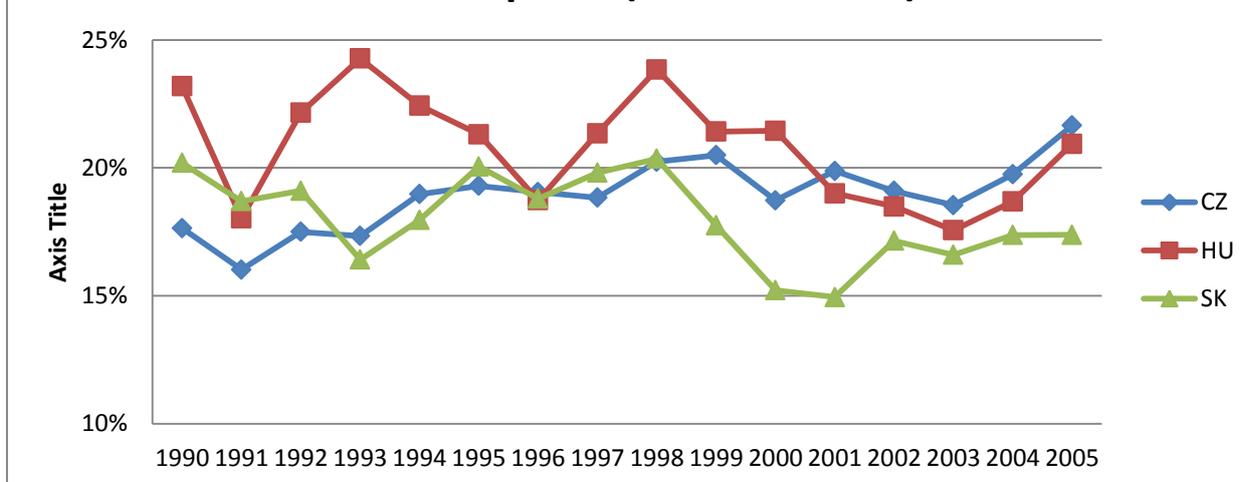


Chart 56: Share of imported oil on inland consumption

### Share of imported gas and oil on gross inland consumption (Eurostat data)

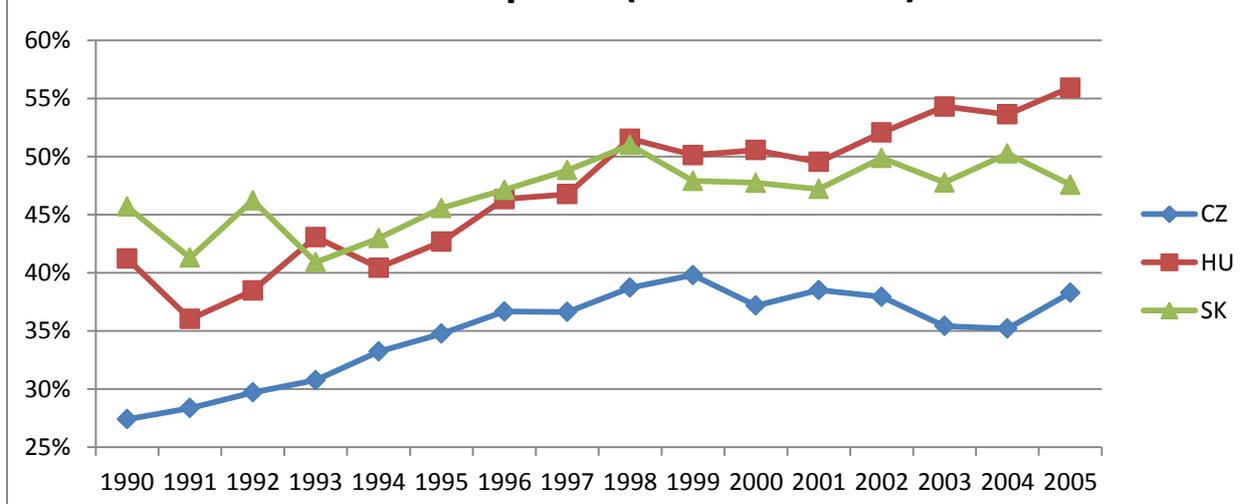


Chart 57: Share of imported gas and oil on inland consumption<sup>696</sup>

<sup>696</sup> Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat, “Energy Statistics”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

## Energy Prices

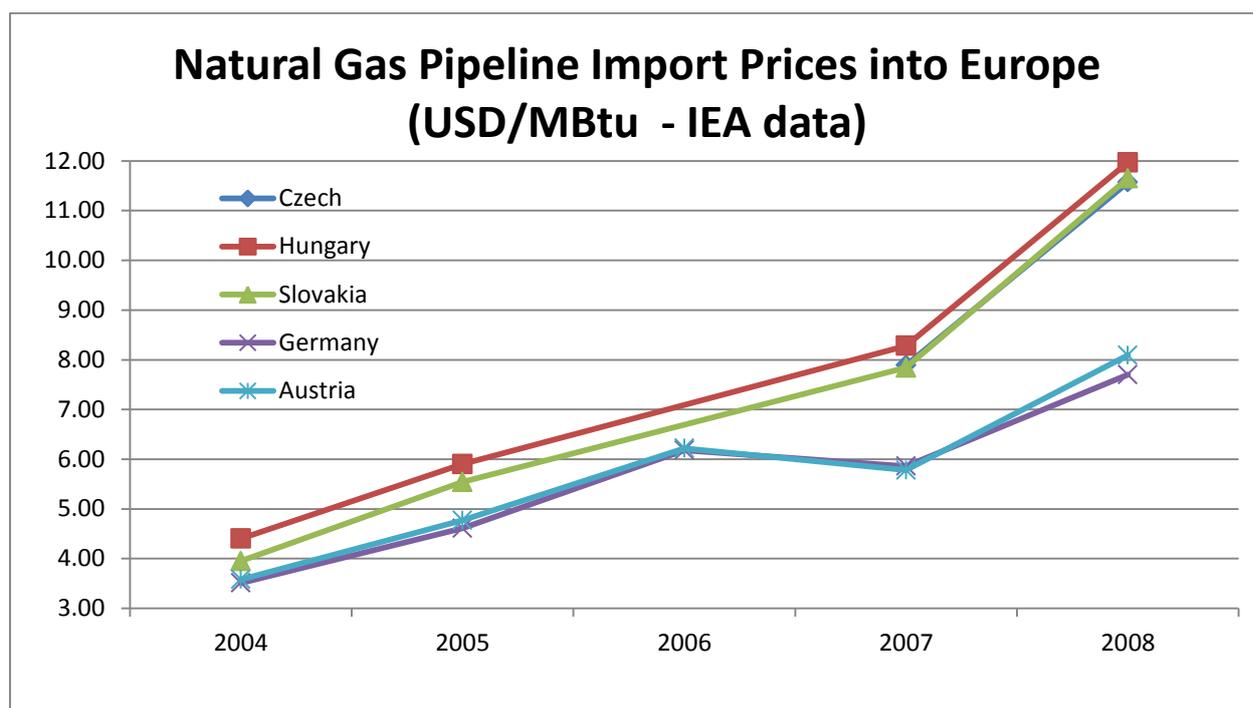


Chart 58: Reported gas import prices 2004-2007 (for methodology)<sup>697</sup>

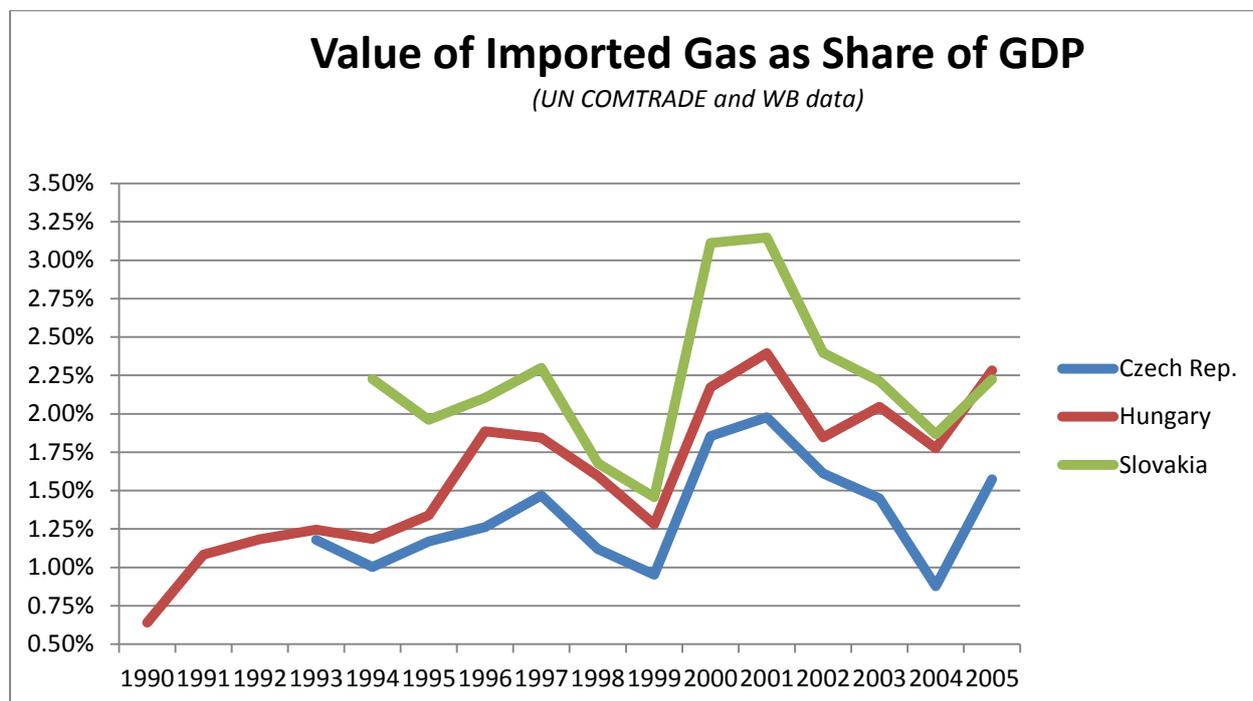


Chart 59: Value of gas imports as share of GDP<sup>698</sup>

<sup>697</sup> IEA/OECD, *Natural gas information 2009*.

<sup>698</sup> Own calculations based on United Nations Statistics Division, "UN Comtrade"; The World Bank, "Data." Data.

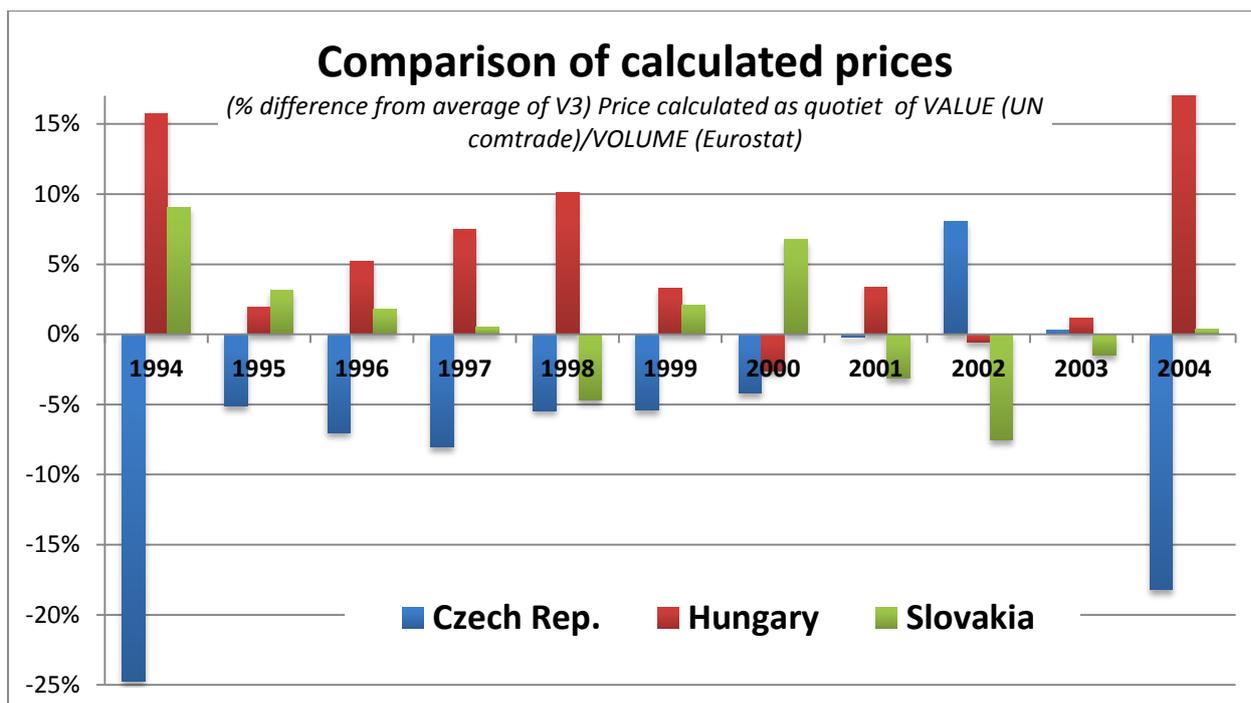


Chart 60: Comparison of import gas prices in Czech Republic, Hungary and Slovakia. My calculations based on UN COMTRADE data.<sup>699</sup>

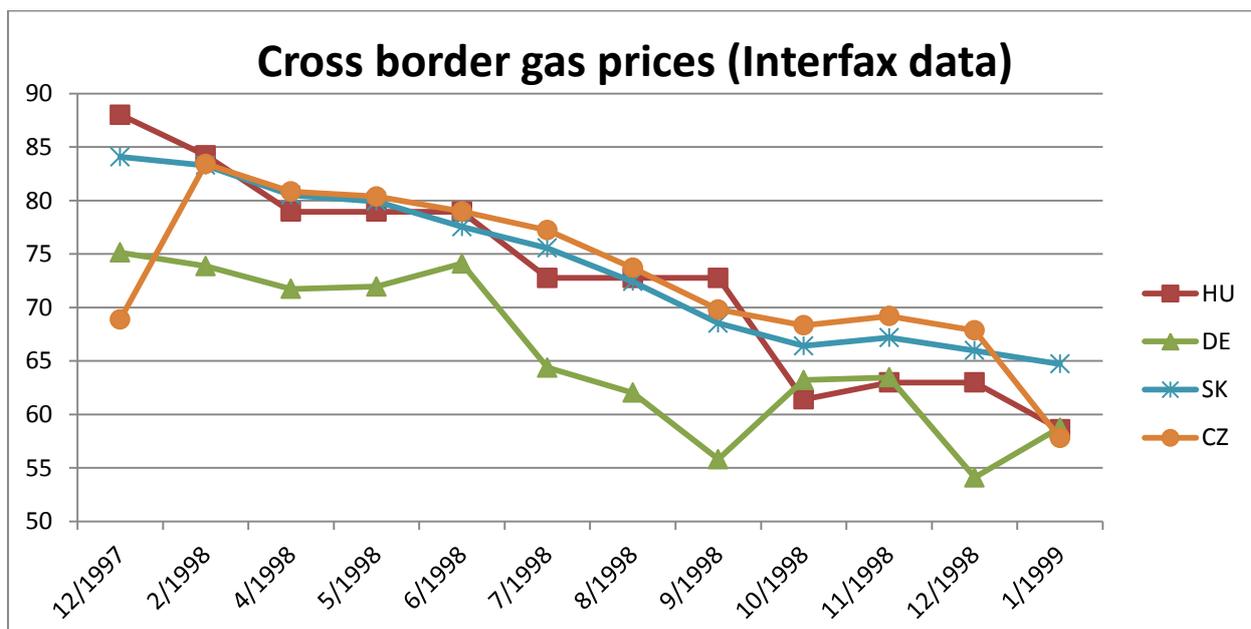


Chart 61: Cross border gas prices<sup>700</sup>

<sup>699</sup> United Nations Statistics Division, "UN Comtrade"; Eurostat, "Energy Statistics"; Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

<sup>700</sup> Interfax, *Gas market data (computer file received from EON Gas Hungary)*, n.d., <http://www.interfax.com/txt.asp?rbr=9> (accessed April 7, 2013).

## Gas Price (value/volume) USD/MTOE averages

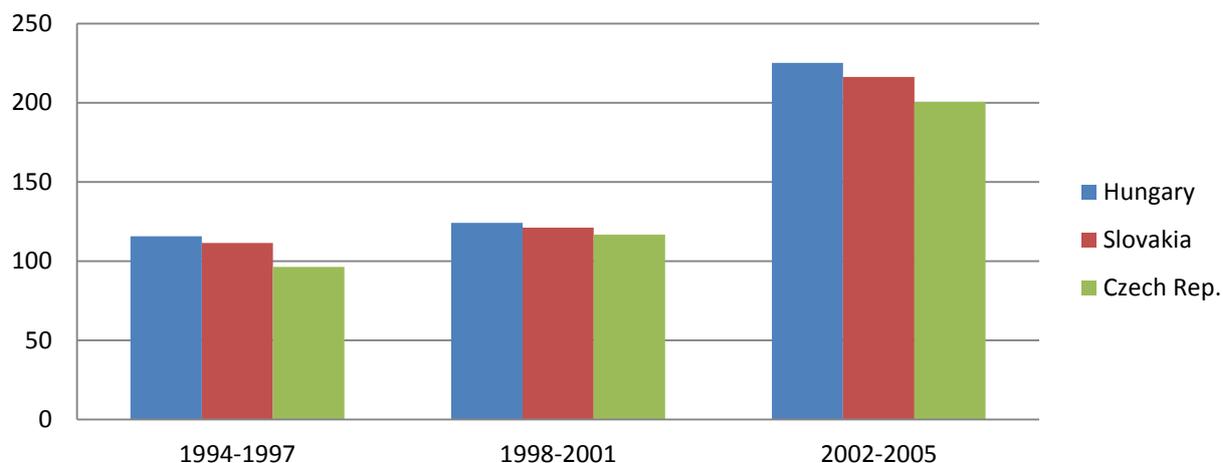


Chart 62: Calculated average gas import prices 1994-2005<sup>701</sup>

## Calculated Gas Price

Calculated as quotient of VALUE (UN comtrade)/VOLUME (Eurostat)  
USD/TOE

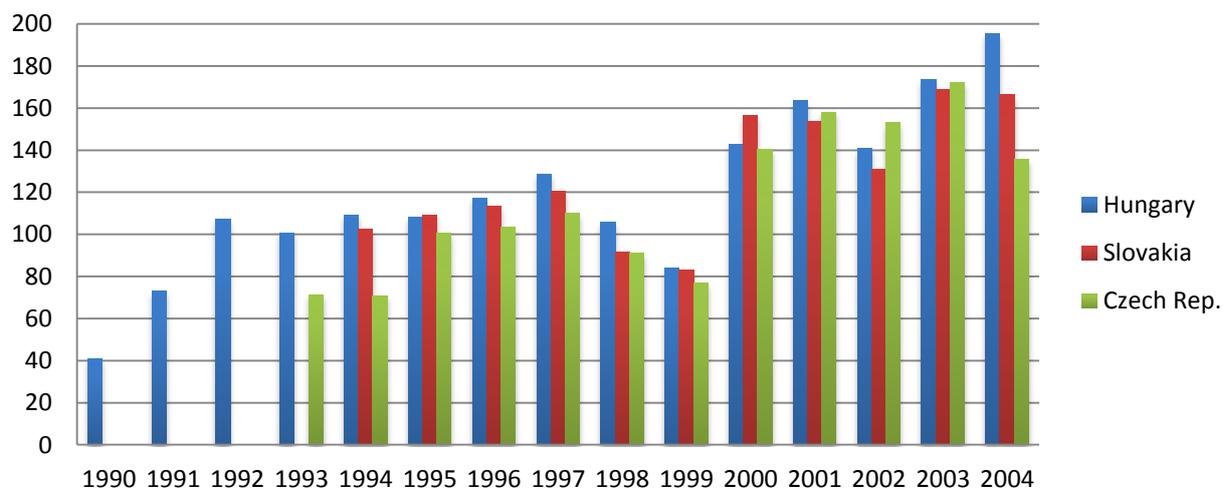


Chart 63: Calculated gas import prices 1990-2004<sup>702</sup>

<sup>701</sup> United Nations Statistics Division, “UN Comtrade”; Eurostat, “Energy Statistics”; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

<sup>702</sup> United Nations Statistics Division, “UN Comtrade”; Eurostat, “Energy Statistics”; Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

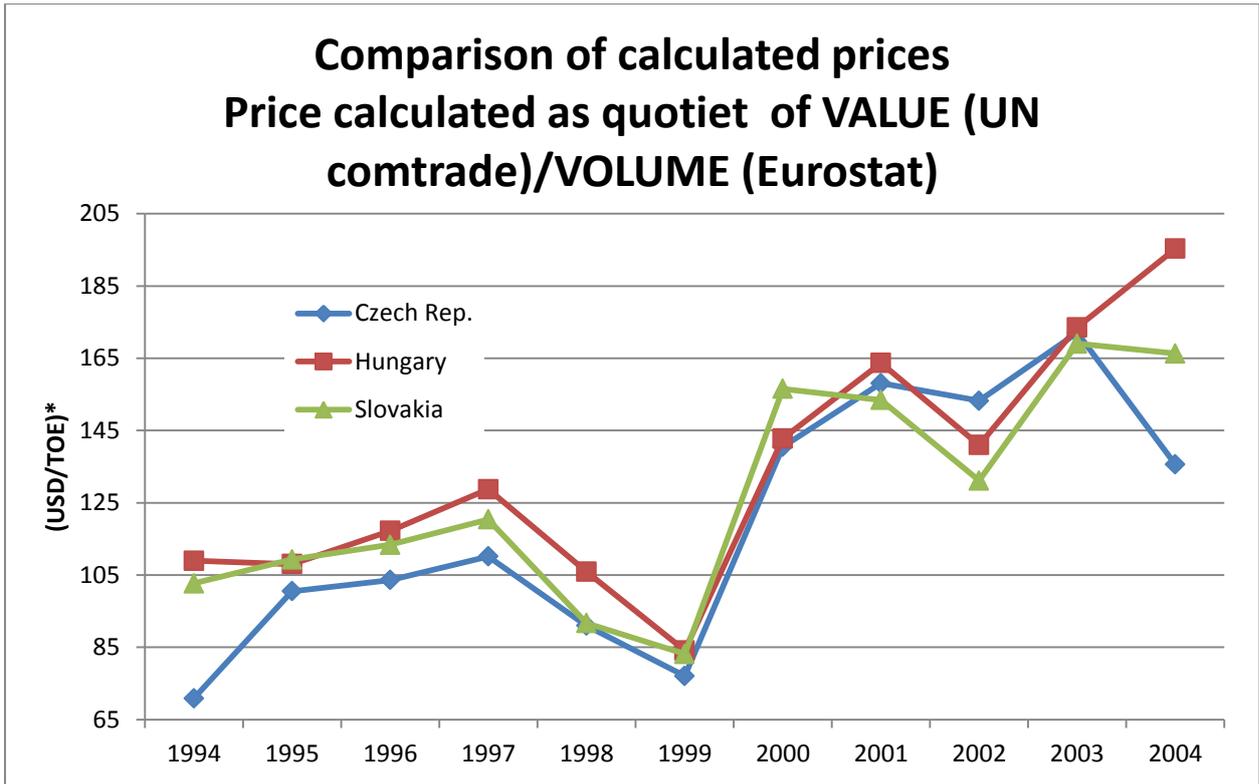


Chart 64: Comparison of calculated price of imported gas

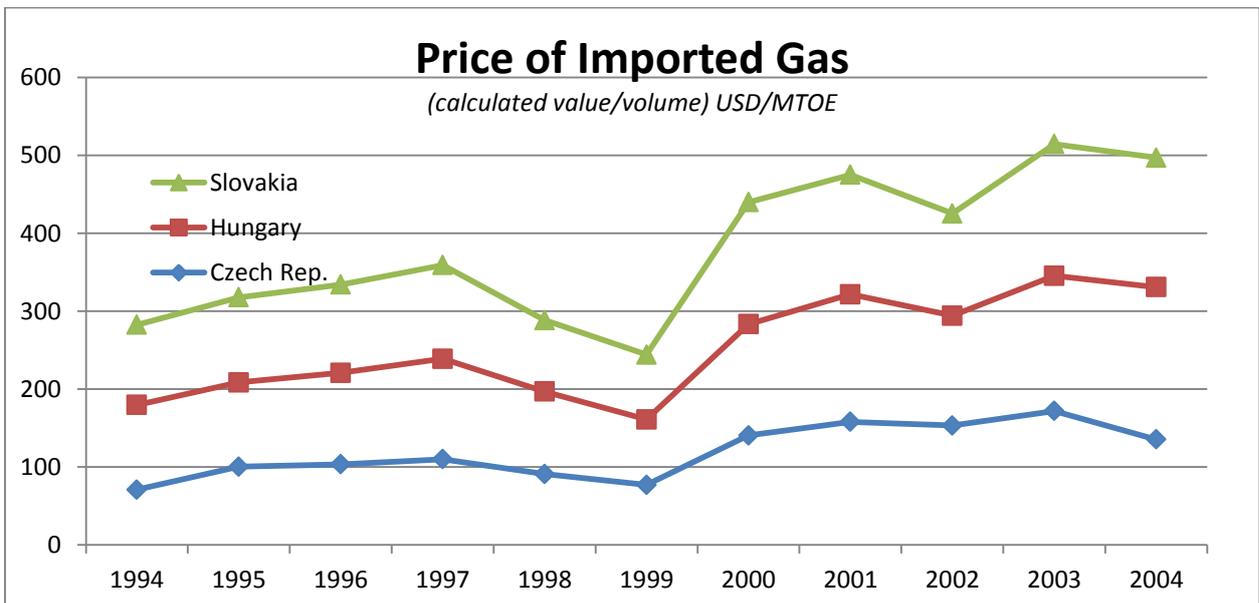


Chart 65: Comparison of calculated price of imported gas (Stacked chart)

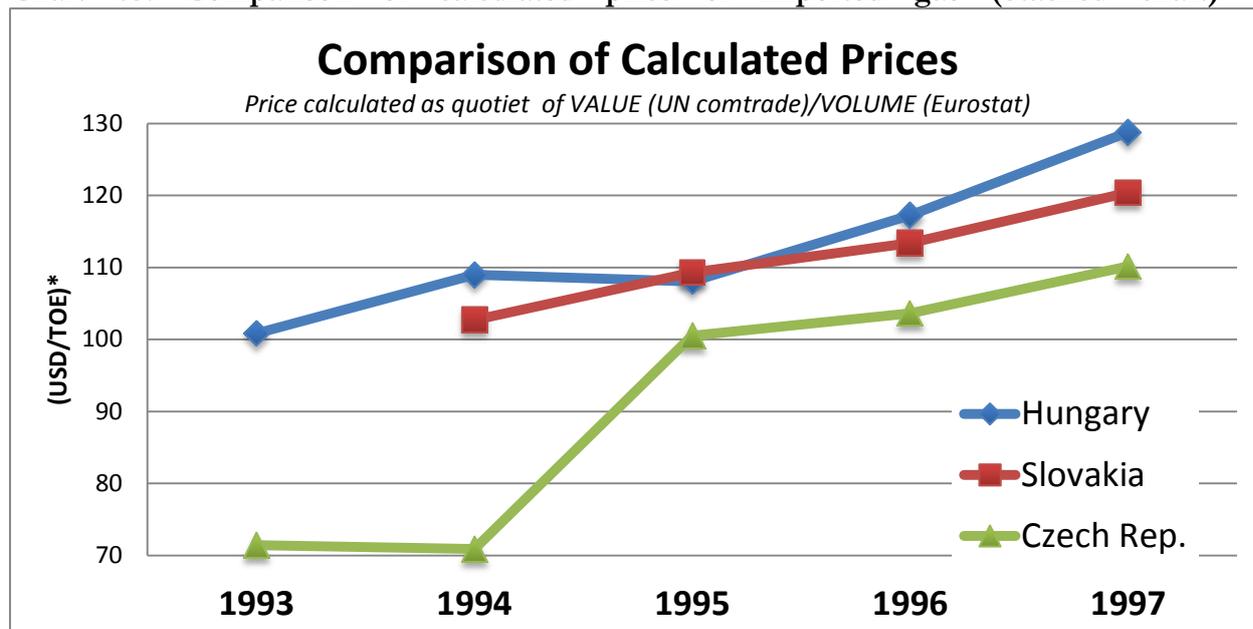


Chart 66: Comparison of calculated gas prices 1993-1997<sup>703</sup>

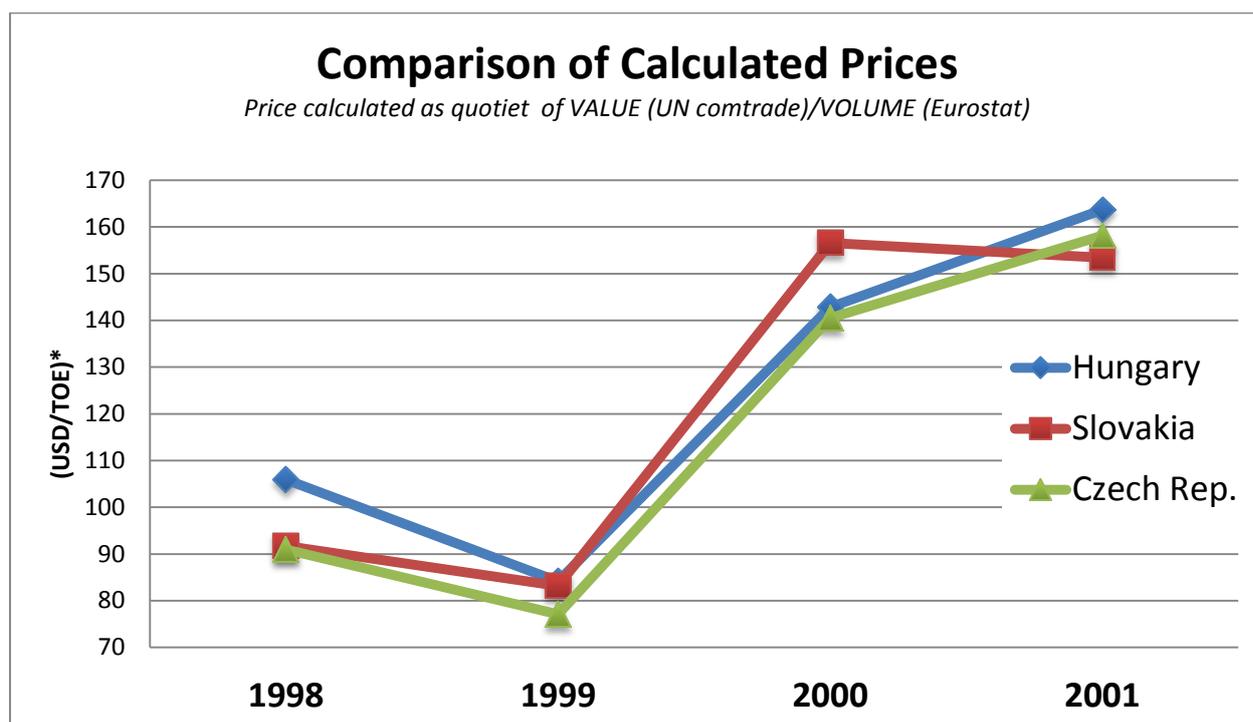


Chart 67: Comparison of calculated gas prices 1998-2001<sup>704</sup>

<sup>703</sup> United Nations Statistics Division, "UN Comtrade"; Eurostat, "Energy Statistics"; Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

<sup>704</sup> United Nations Statistics Division, "UN Comtrade"; Eurostat, "Energy Statistics"; Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

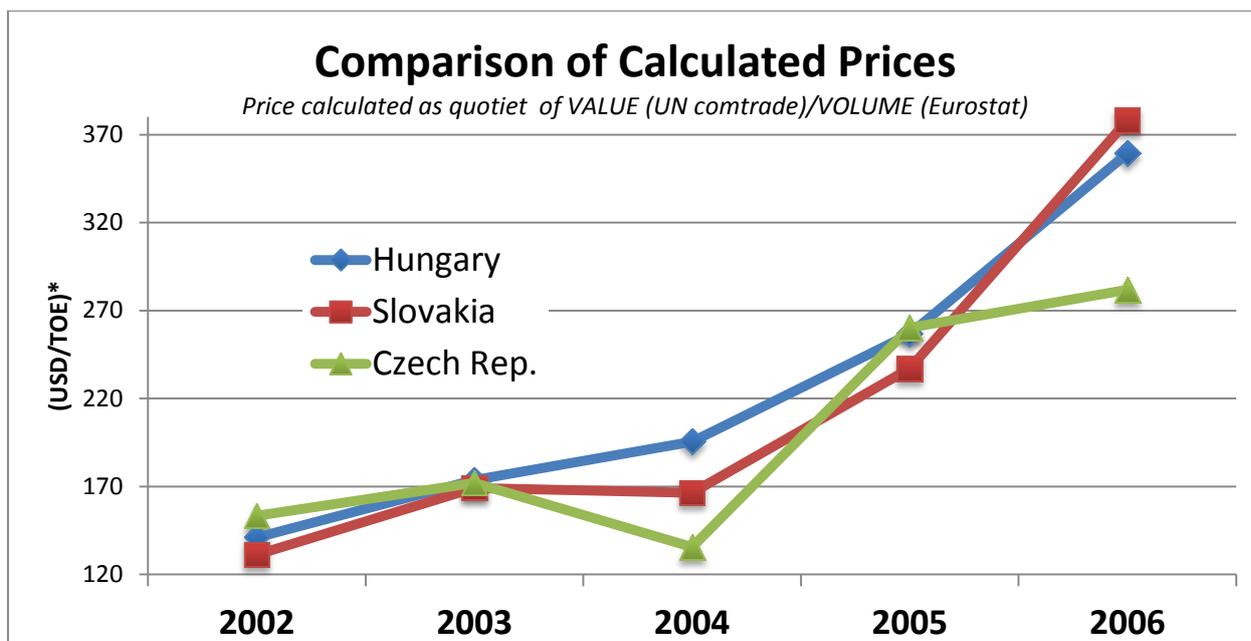


Chart 68: Comparison of calculated gas prices 2001-2004<sup>705</sup>

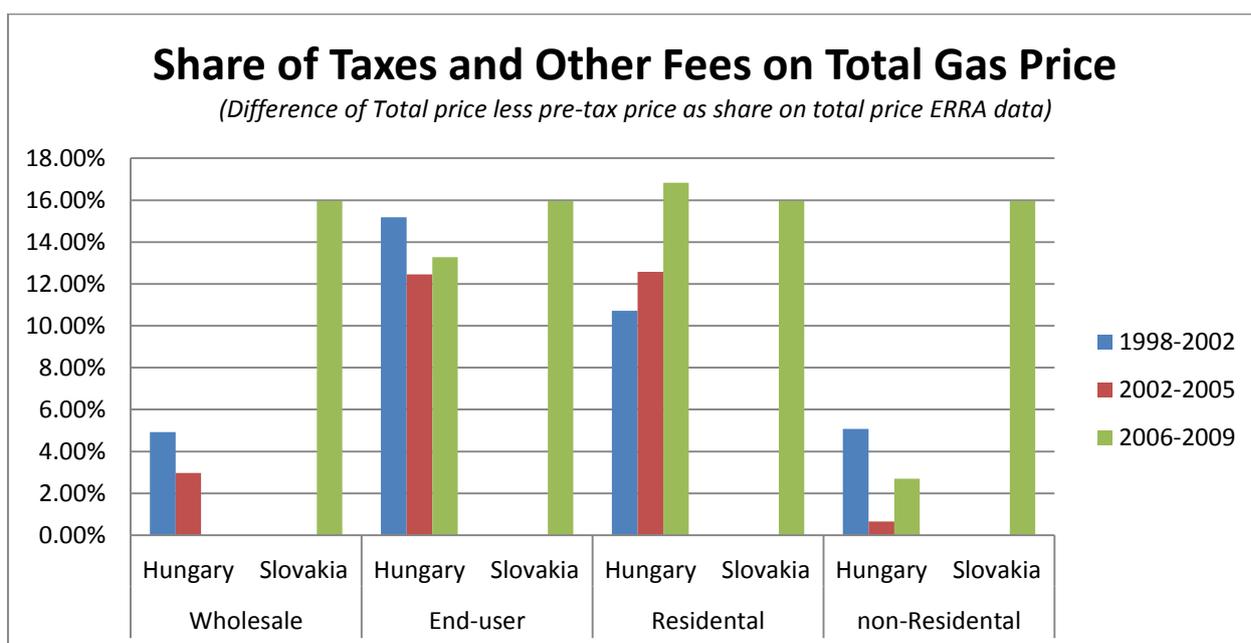


Chart 69: Taxes and other fees on total gas price<sup>706</sup>

<sup>705</sup> United Nations Statistics Division, "UN Comtrade"; Eurostat, "Energy Statistics"; Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

<sup>706</sup> ERRA - Energy Regulators Regional Association, "Products/Tariff Database."

### Natural Gas Wholesale Prices pre-tax, USD / GJ (ERRA)

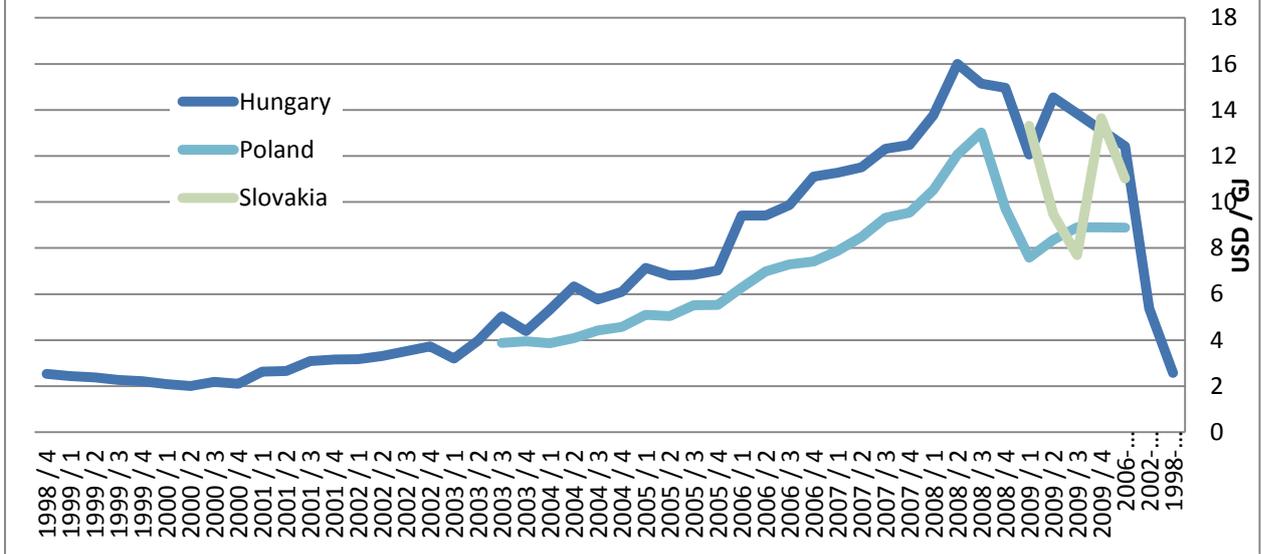


Chart 70: Natural Gas Wholesale Prices (pre-tax)<sup>707</sup>

### Natural Gas Wholesale Prices, total ERRA

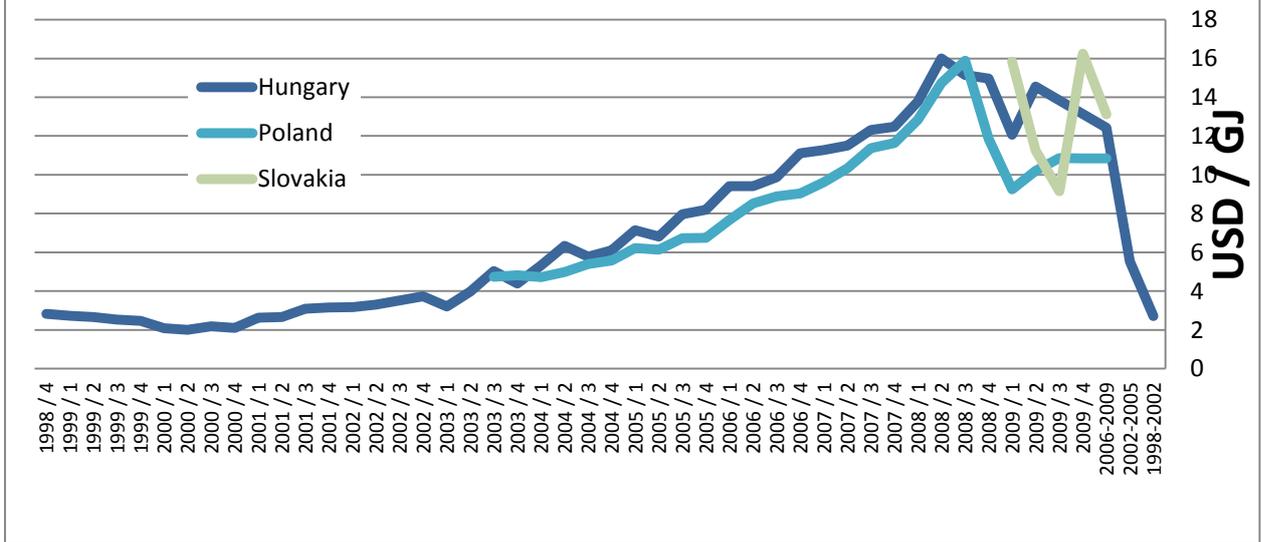


Chart 71: Natural Gas Wholesale Prices<sup>708</sup>

<sup>707</sup> Ibid.

<sup>708</sup> Ibid.

### Gas residential prices (ERRA pre-tax)

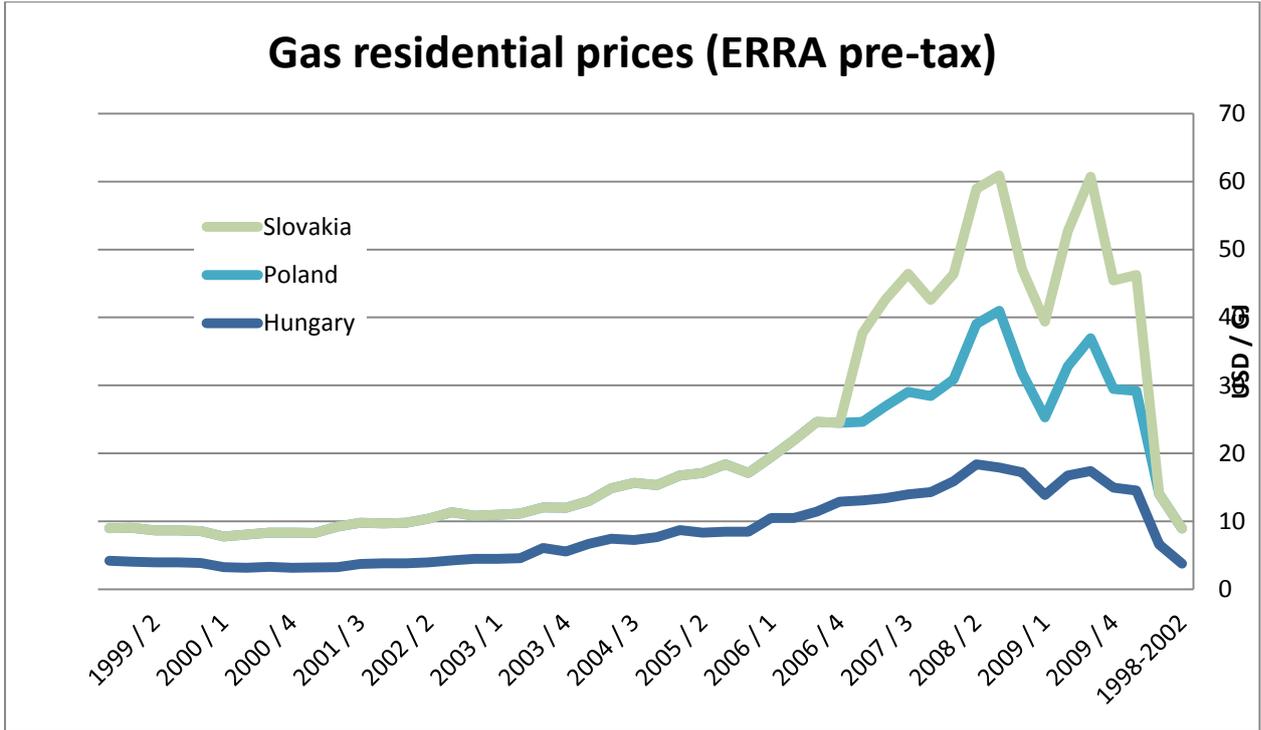


Chart 72: Natural Gas Residential Prices (pre-tax) <sup>709</sup>

### Gas residential prices (ERRA total)

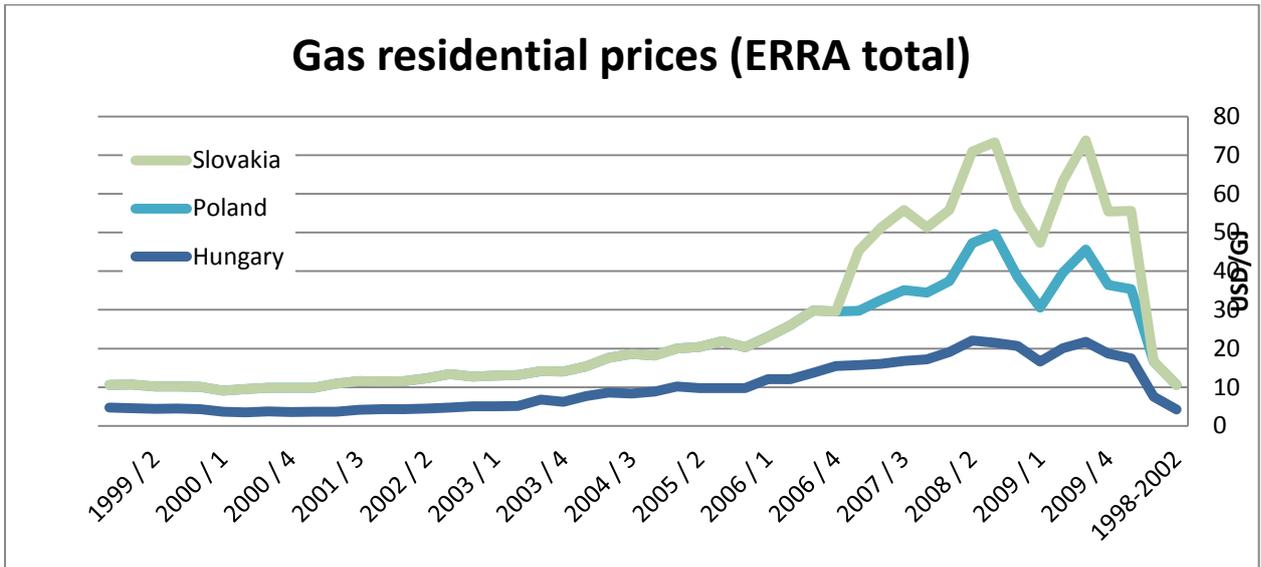


Chart 73: Natural Gas Residential Prices (pre-tax) <sup>710</sup>

<sup>709</sup> Ibid.

<sup>710</sup> Ibid.

## Energy intensity of metallurgic export sectors

(SITC 66+67+68+69) (kTOE/M\$ of SITC TOTAL Exports) (Data Eurostat & UNCOMTRADE)

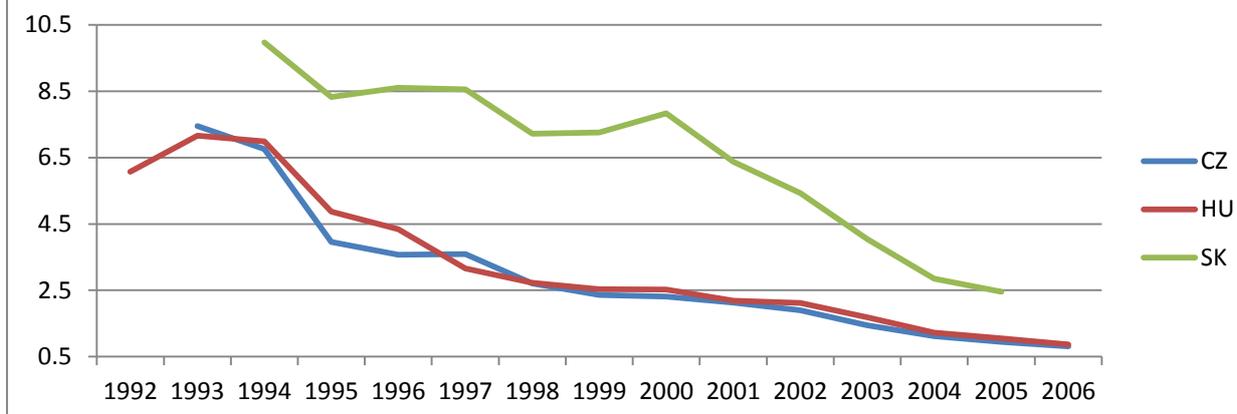


Chart 74: Energy intensity of selected industrial sectors<sup>711</sup>

<sup>711</sup> Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a]”; United Nations Statistics Division, “UN Comtrade.”

## APPENDIX: CZECH REPUBLIC

### Fundamentals

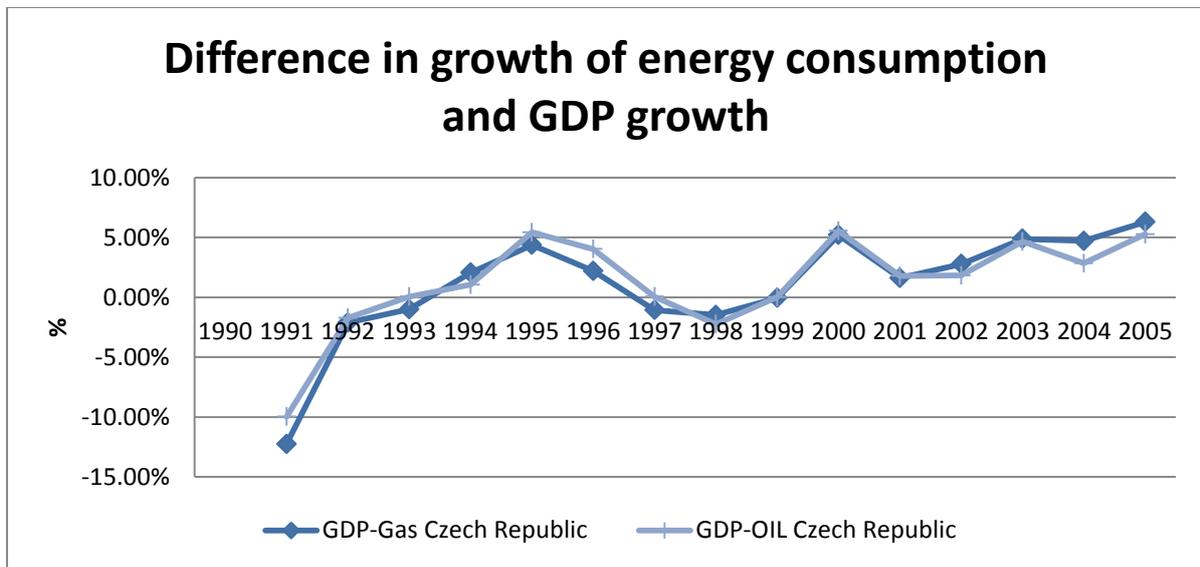


Chart 75: Changes in Energy Consumption and GDP in Czech Republic<sup>712</sup>

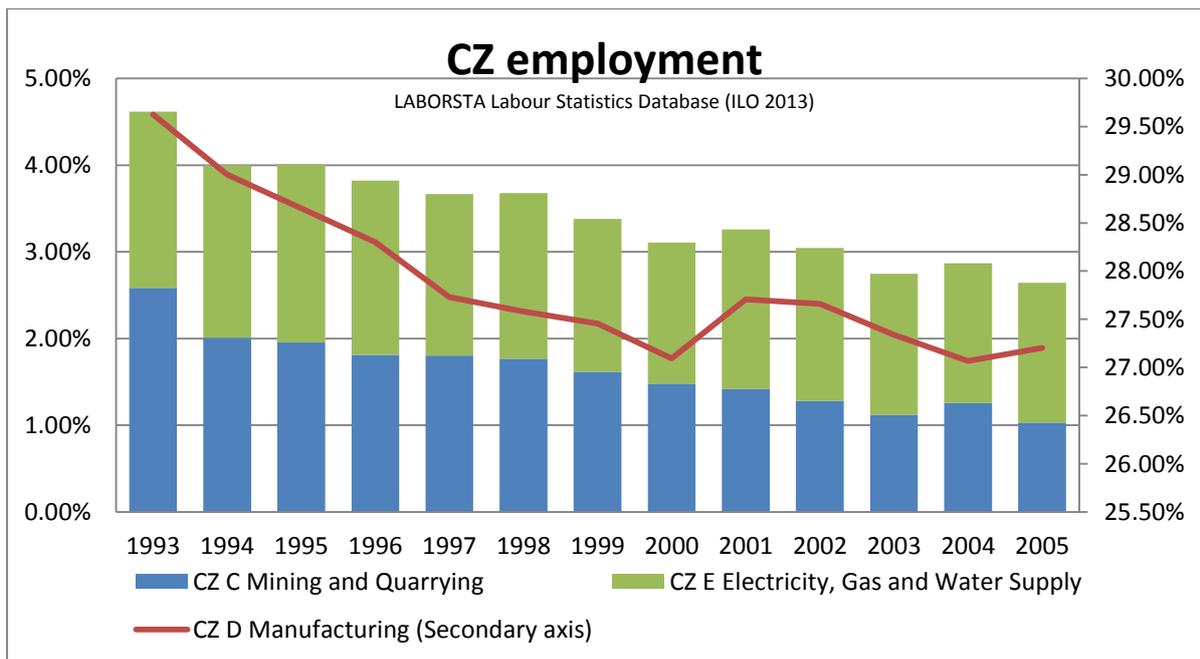


Chart 76: Employment in energy intensive industries as compared to manufacturing industries

<sup>712</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat, "Energy Statistics"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; The World Bank, "Data."

# Threat perception

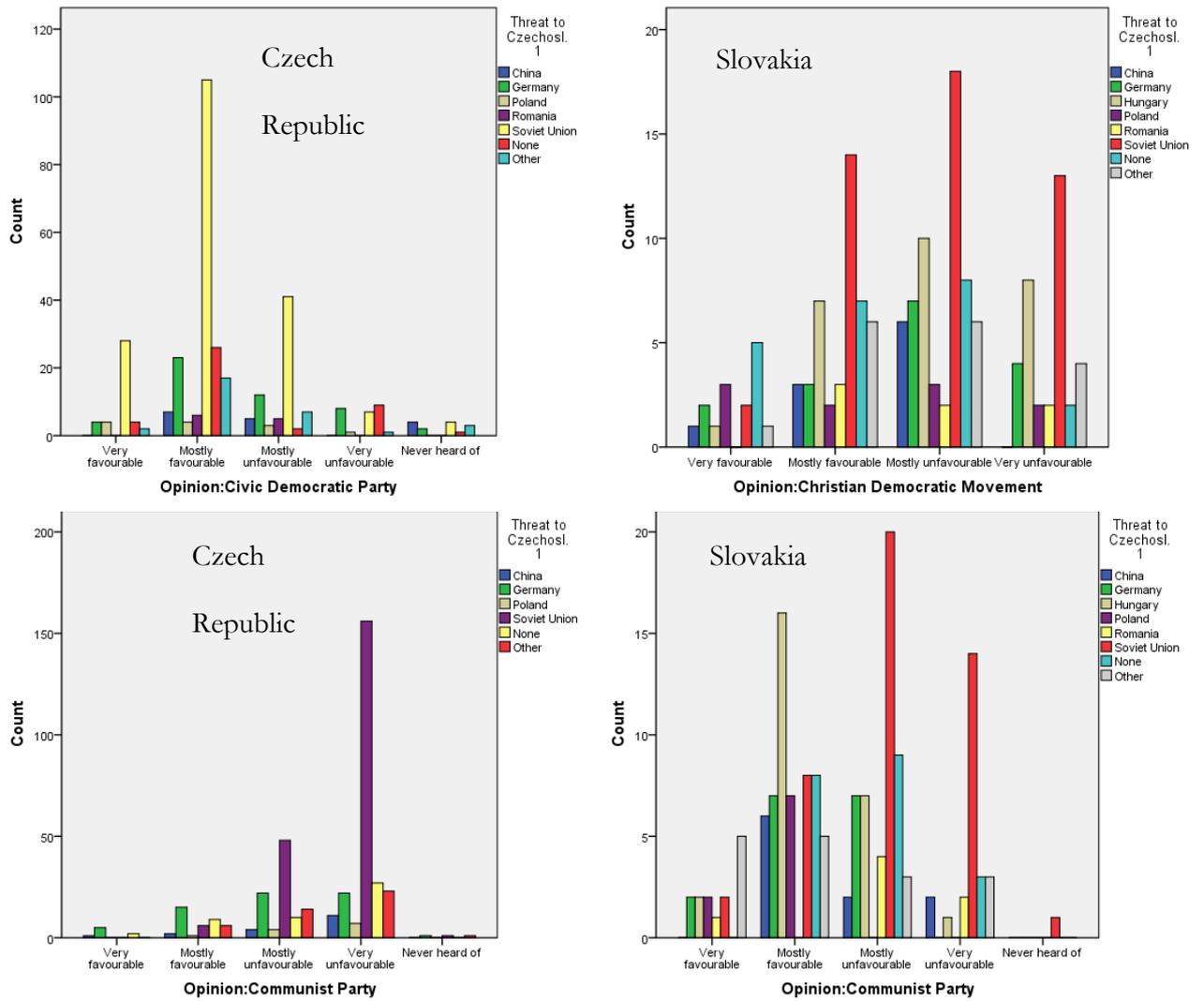
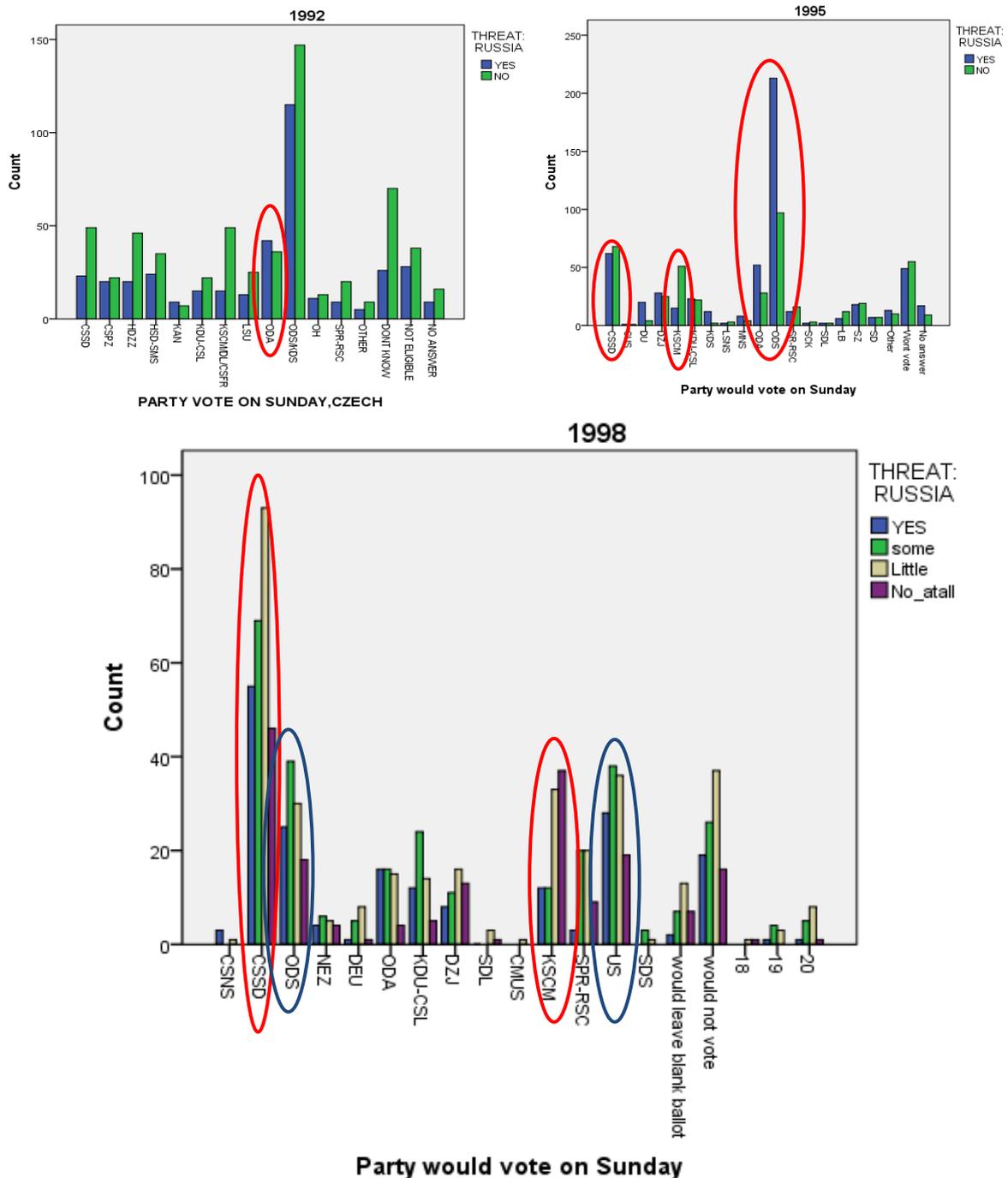


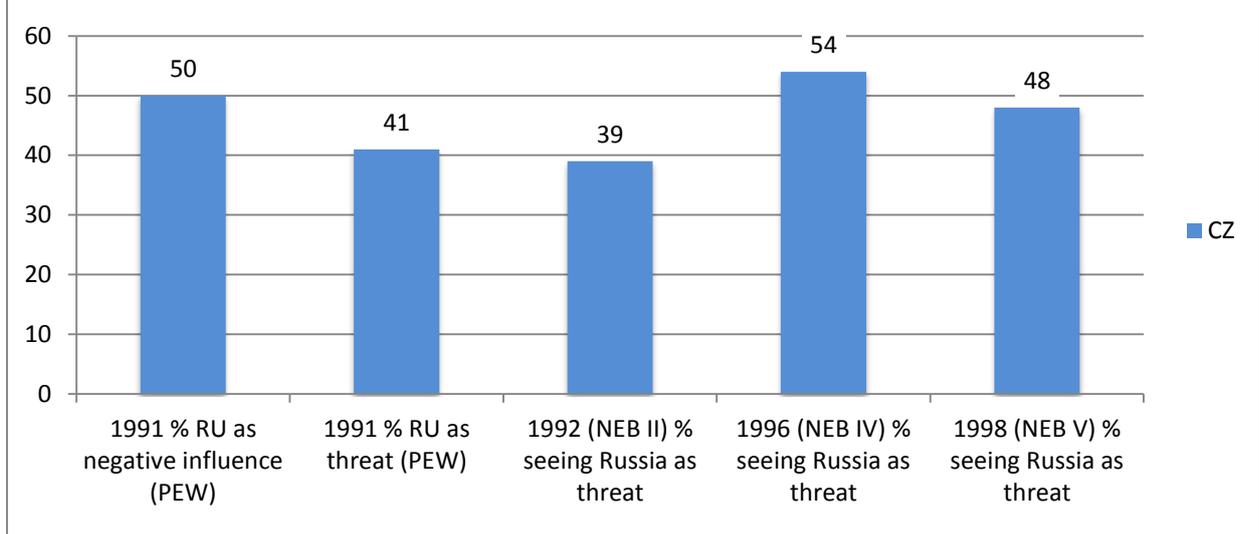
Chart 77: Threat Perception and Party Preferences in 1991



**Chart 78: Threat perception in Czech Republic by political affiliation Russia as threat in 1992, 1996 and 1998<sup>713</sup>**

<sup>713</sup> Rose, R. and Paul Lazarsfeld Society, “SN 6453 -New Europe Barometer II, 1992-1993” (Vienna), New Europe Barometer II, 1992-1993 [computer file]. Colchester, Essex: UK Data Archive [distributor], June 2010. SN: 6453, <http://dx.doi.org/10.5255/UKDA-SN-6453-1>, n.d.), <http://www.esds.ac.uk/findingData/snDescription.asp?sn=6453> (accessed October 24, 2012); Rose, R. and Paul Lazarsfeld Society, “SN 6454 -New Europe Barometer III, 1993-1994” (Vienna), New Europe Barometer III, 1993-1994 [computer file]. Colchester, Essex: UK Data Archive [distributor], June 2010. SN: 6454, <http://dx.doi.org/10.5255/UKDA-SN-6454-1>, n.d.), <http://www.esds.ac.uk/findingData/snDescription.asp?sn=6454> (accessed October 24, 2012); Rose, R. and Paul Lazarsfeld Society, “SN 6455 -New Europe Barometer IV, 1995” (Vienna), New Europe Barometer IV, 1995

## % of respondents seeing Russia either as negative influence or threat Data: PEW and NEB



**Chart 79: Czech's perception of Russia (Soviet Union) as threat or negative<sup>714</sup>**

[computer file]. Colchester, Essex: UK Data Archive [distributor], June 2010. SN: 6455, <http://dx.doi.org/10.5255/UKDA-SN-6455-1>, n.d.),

<http://www.esds.ac.uk/findingData/snDescription.asp?sn=6455> (accessed October 24, 2012).

<sup>714</sup> Times Mirror Center for the People & the Press, "The Pulse of Europe: A Survey of Political and Social Values and Attitudes"; Rose, R. and Paul Lazarsfeld Society, "SN 6453 -New Europe Barometer II, 1992-1993"; Rose, R. and Paul Lazarsfeld Society, "SN 6455 -New Europe Barometer IV, 1995"; Richard Rose and William Mishler, "SN 5243 -New Europe Barometer VII, 2004-2005" (New Europe Barometer VII, 2004-2005 [computer file]. Colchester, Essex: UK Data Archive [distributor], July 2007. SN: 5243, <http://dx.doi.org/10.5255/UKDA-SN-5243-1>, n.d.), <http://www.esds.ac.uk/findingData/snDescription.asp?sn=5243> (accessed October 24, 2012).

## Ruling Elites Links with the Previous Regime

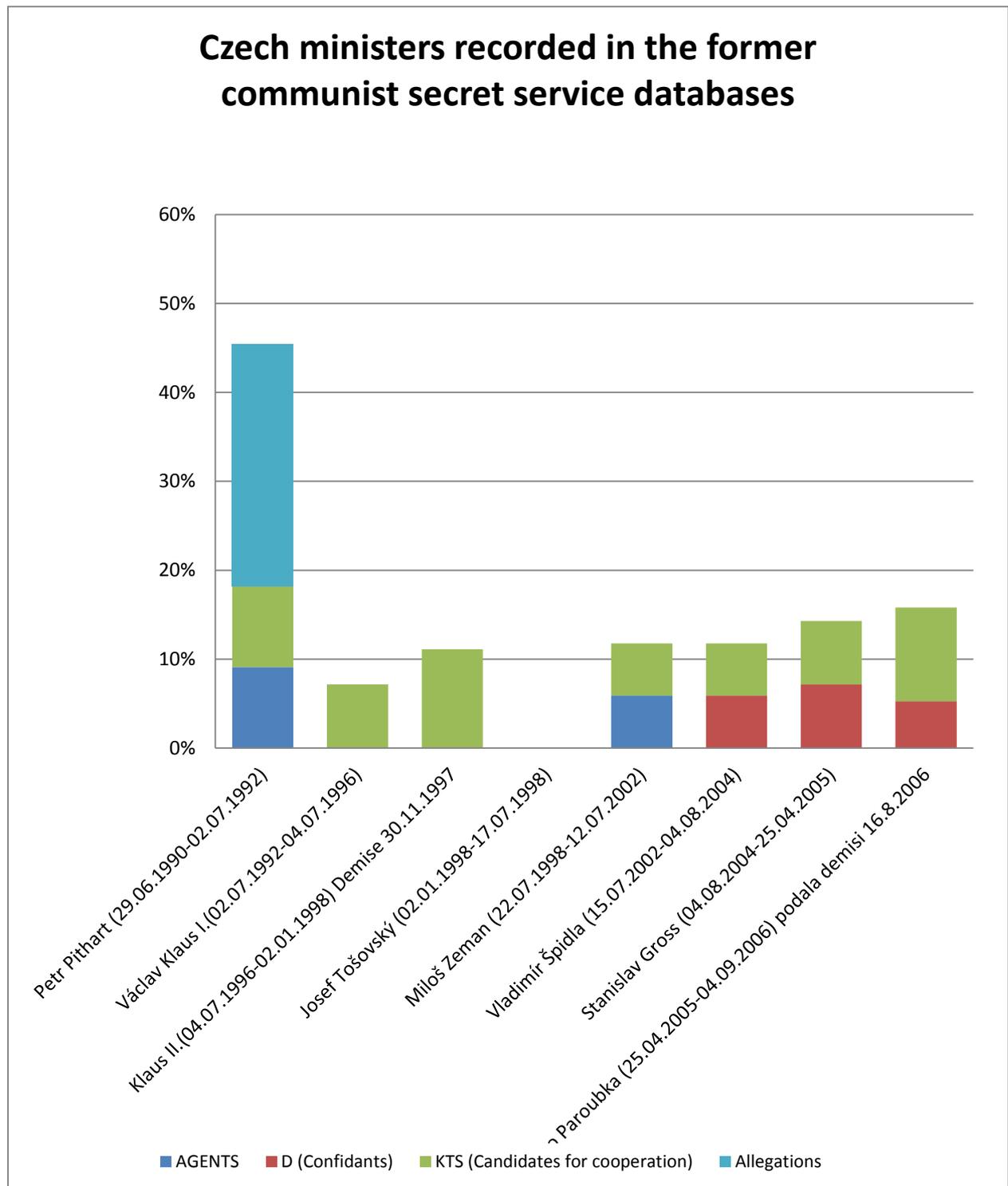


Chart 80: Czech ministers recorded in the former communist secret service databases

## Representation of people of interest to former communist secret service in the Czech government

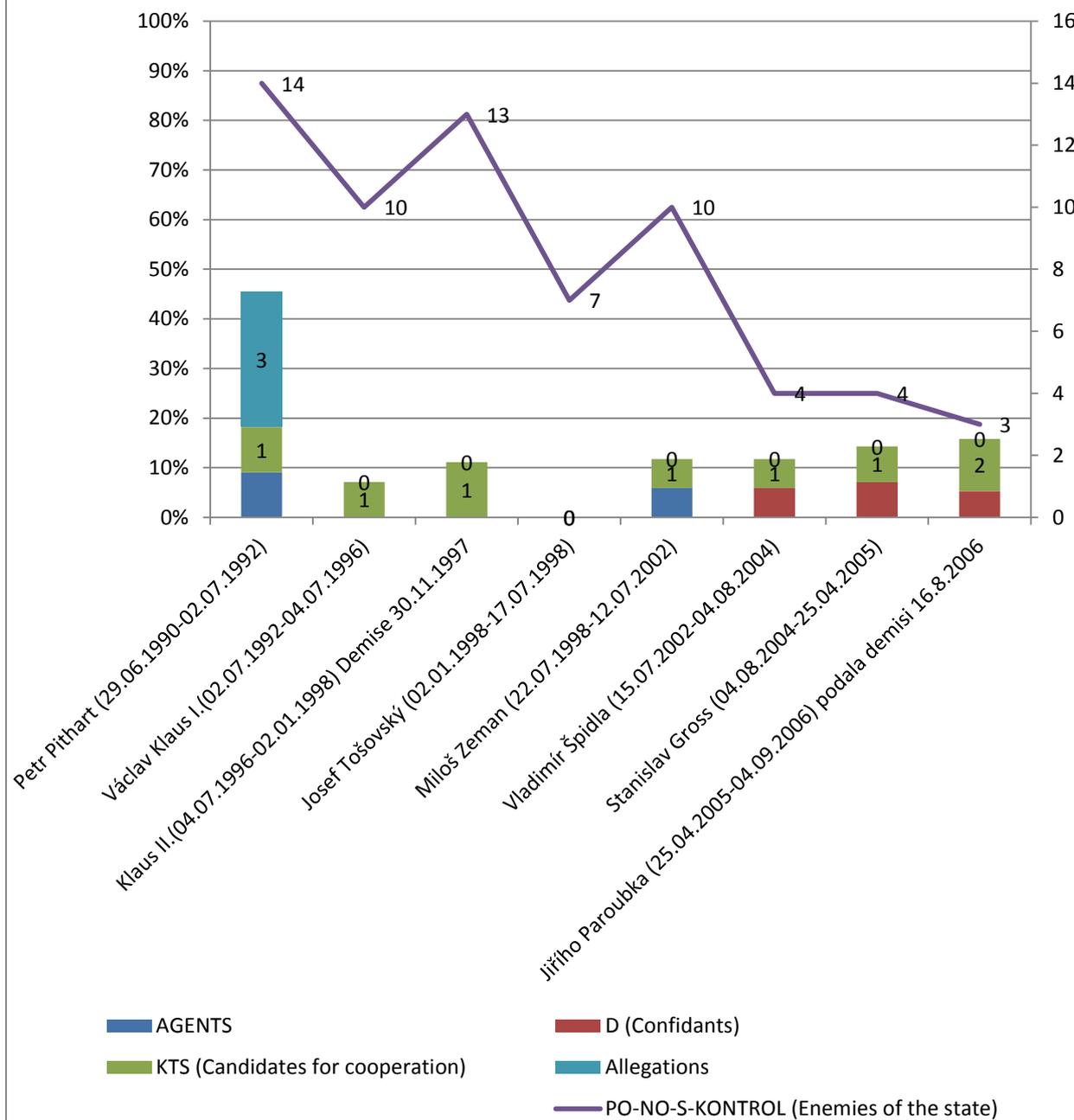


Chart 81: Collaborators and people of interest in the Czech government

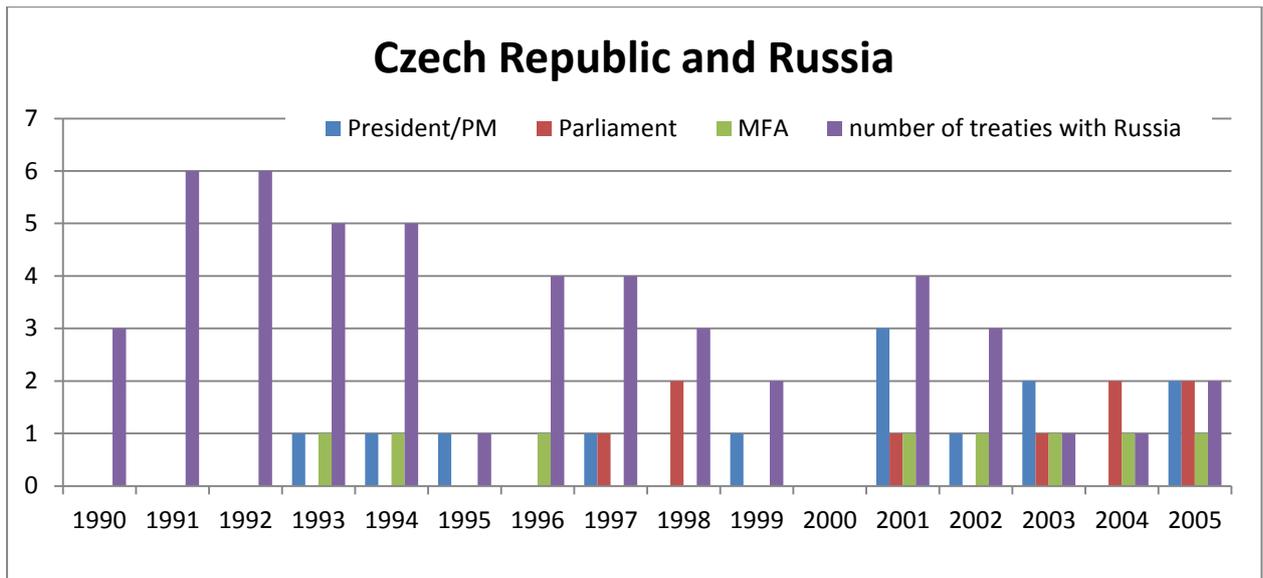
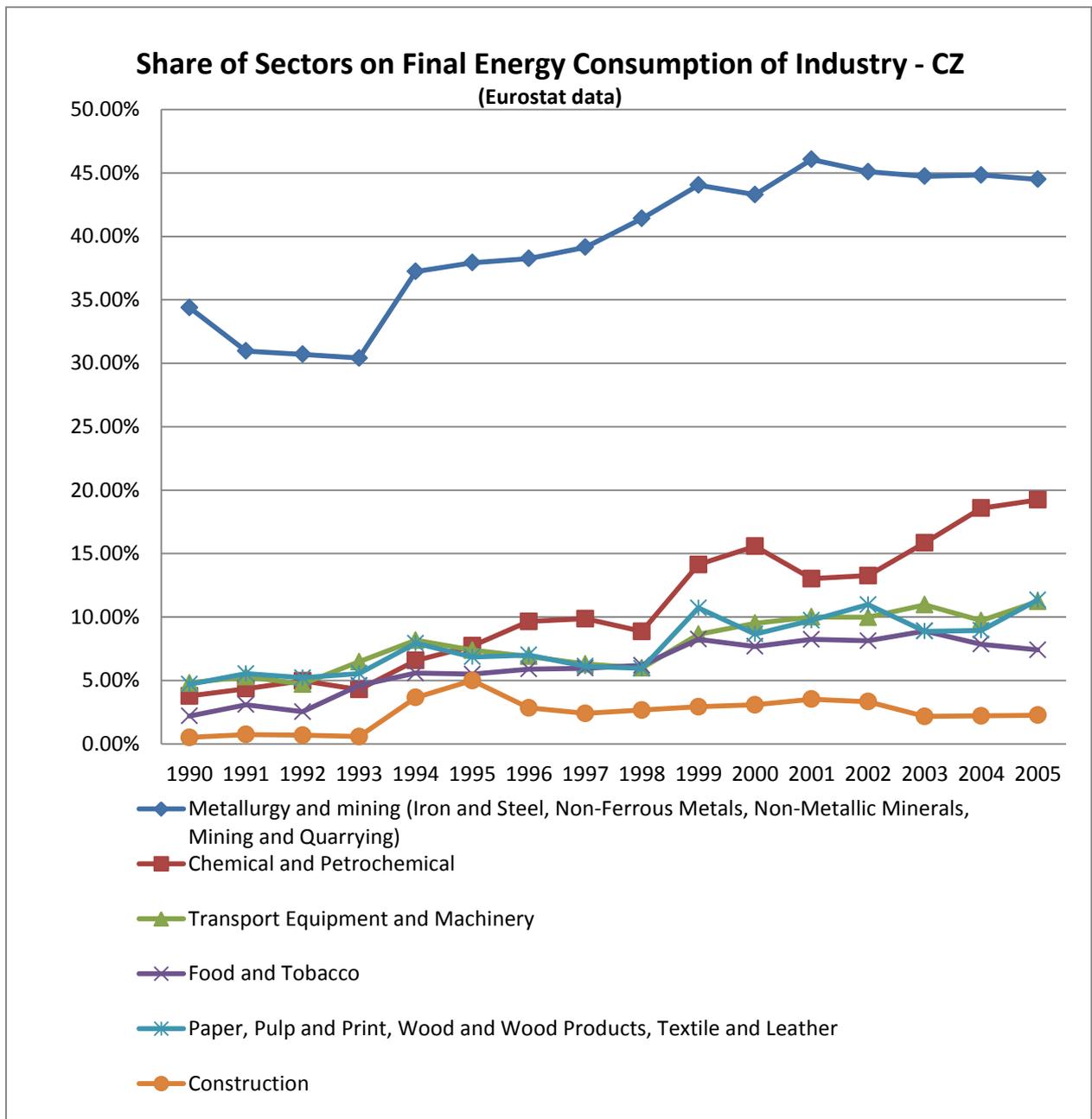


Chart 82: Intensity of official relations between Russia and Czech Republic

## Structure of Industry



**Chart 83: Share of selected industrial sectors on total industrial energy consumption**

### CZ - Share on export by SITC codes

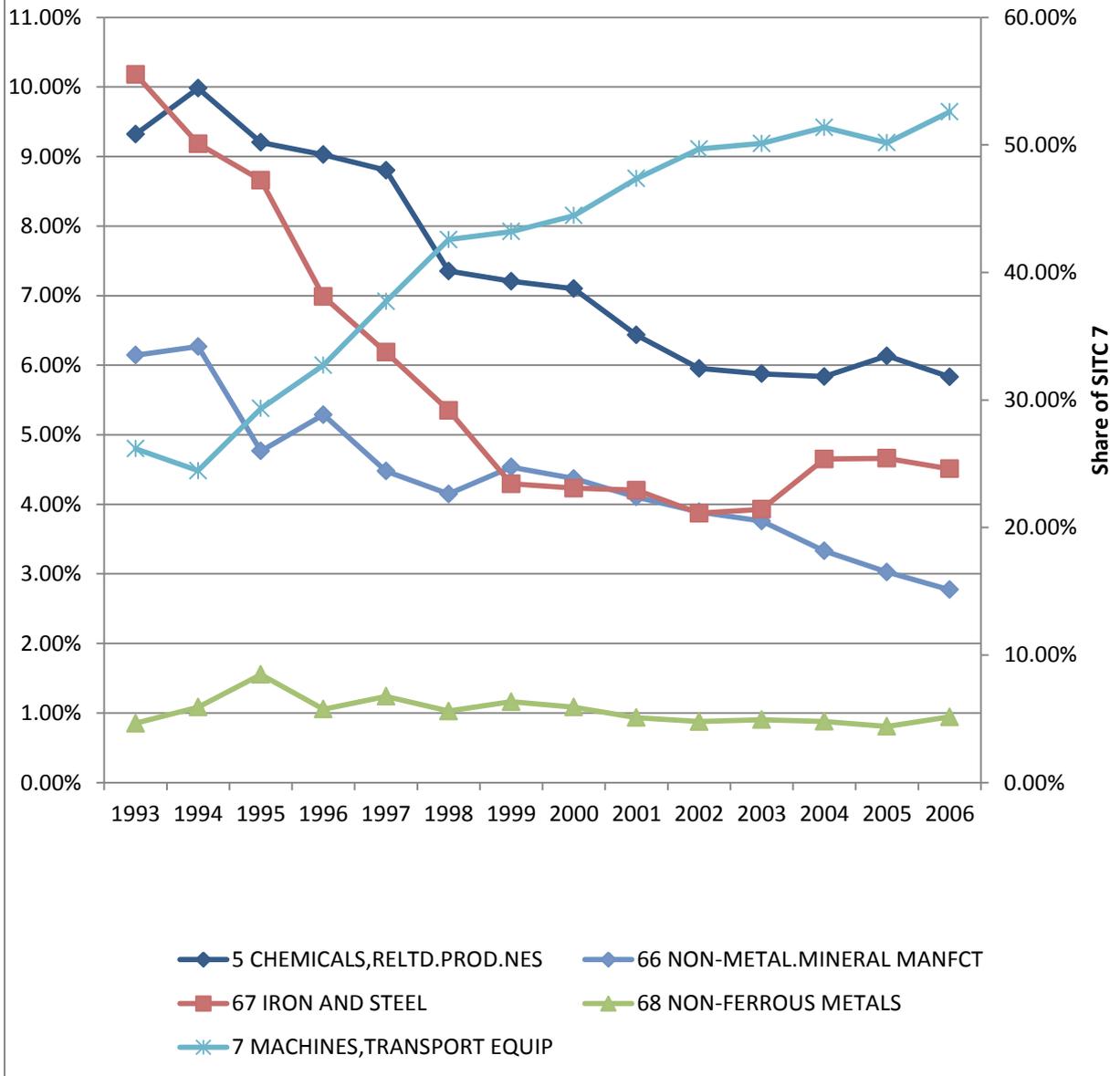


Chart 84: Share of exports of energy intensive manufacturing sectors (SITC 5, 66, 67, 68) on the value of total exports<sup>715</sup>

<sup>715</sup> United Nations Statistics Division, "UN Comtrade."

## Shares of industrial exports in Czech Republic

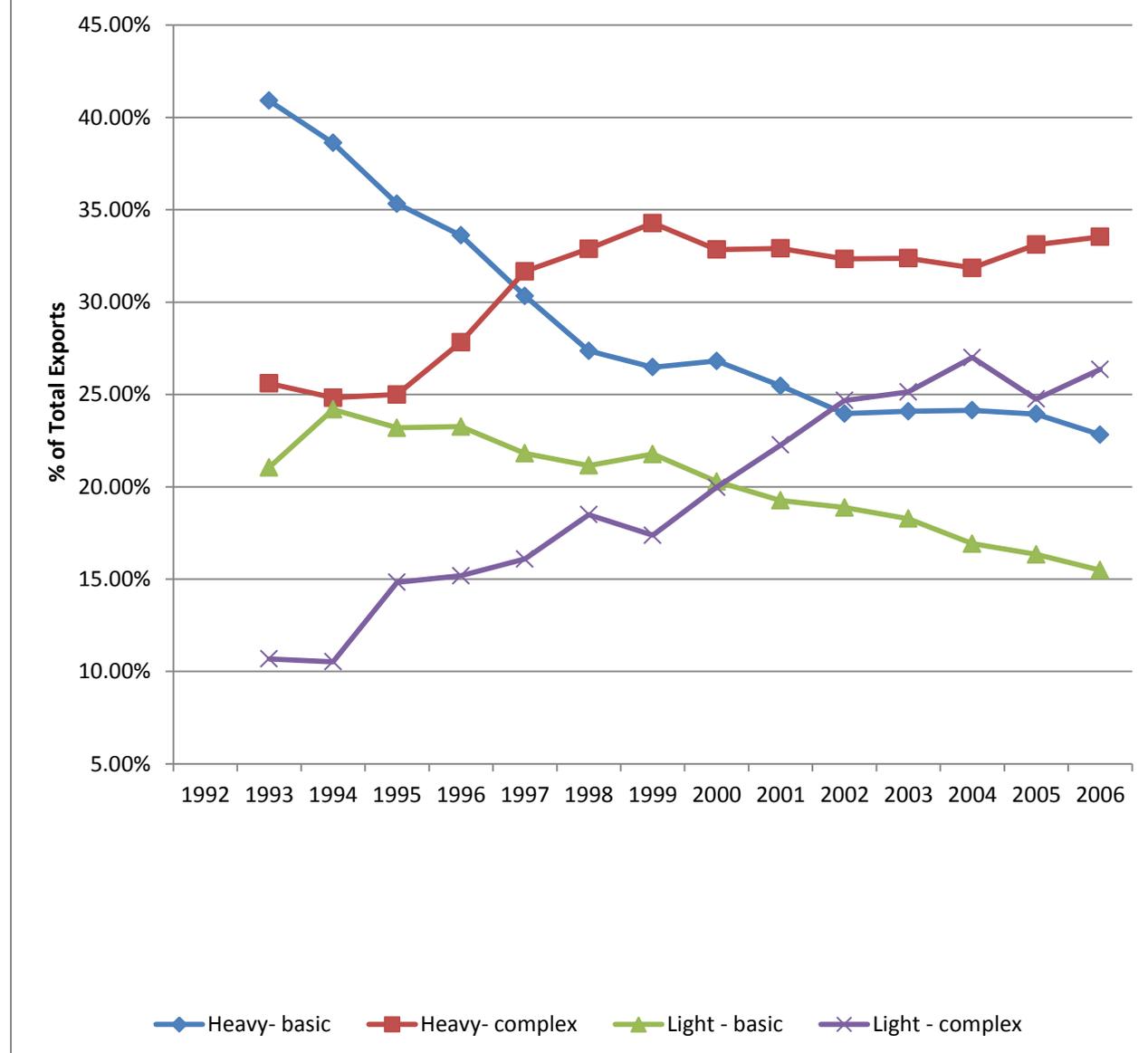


Chart 85: Share of industrial exports by intensity sectors data<sup>716</sup>, methodology.<sup>717</sup>

<sup>716</sup> Ibid.

<sup>717</sup> For methodology and distribution of sectors see Greskovits, "Leading Sectors and the Varieties of Capitalism in Eastern Europe." as modified by Kurekova, *Commodity export structures and the analysis of trends in leading export sectors in the European Union*.

### CZ - Energy intensity of export sectors (kTOE/M\$ of SITC TOTAL Exports) (eurostat + UNCOMTRADE)

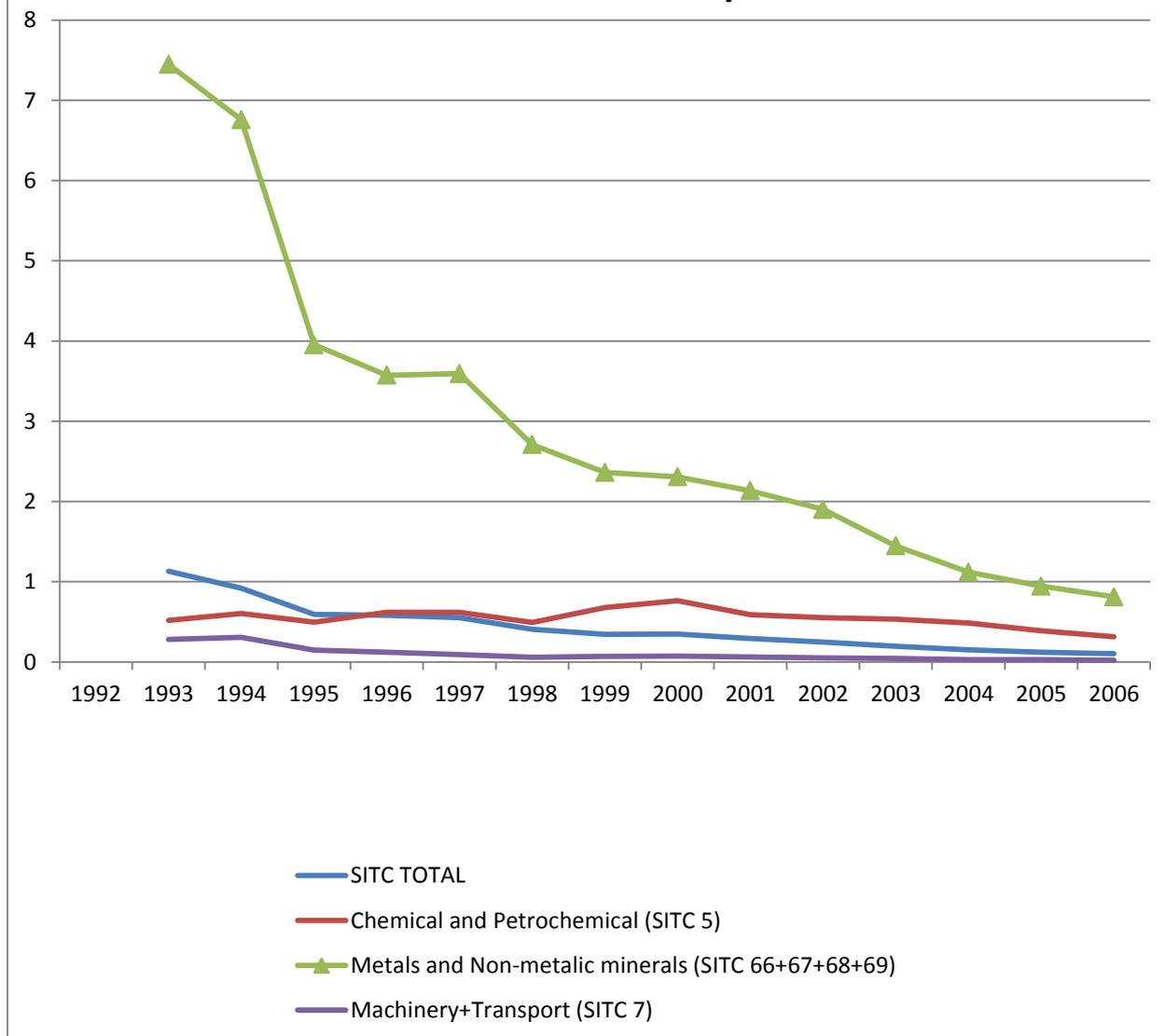


Chart 86: Energy intensity of selected industrial sectors in Czech Republic<sup>718</sup>

<sup>718</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; United Nations Statistics Division, "UN Comtrade."

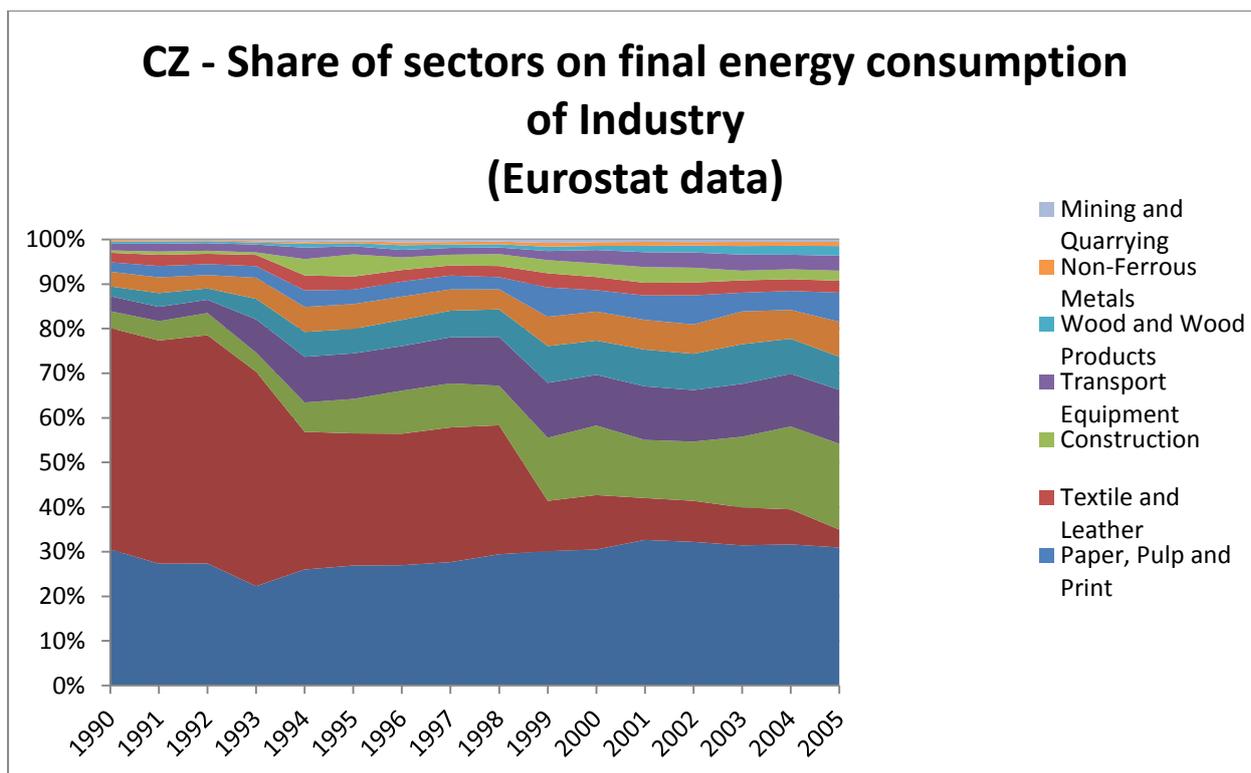


Chart 87: Distribution of Final Energy Consumption in Industry by sectors<sup>719</sup>

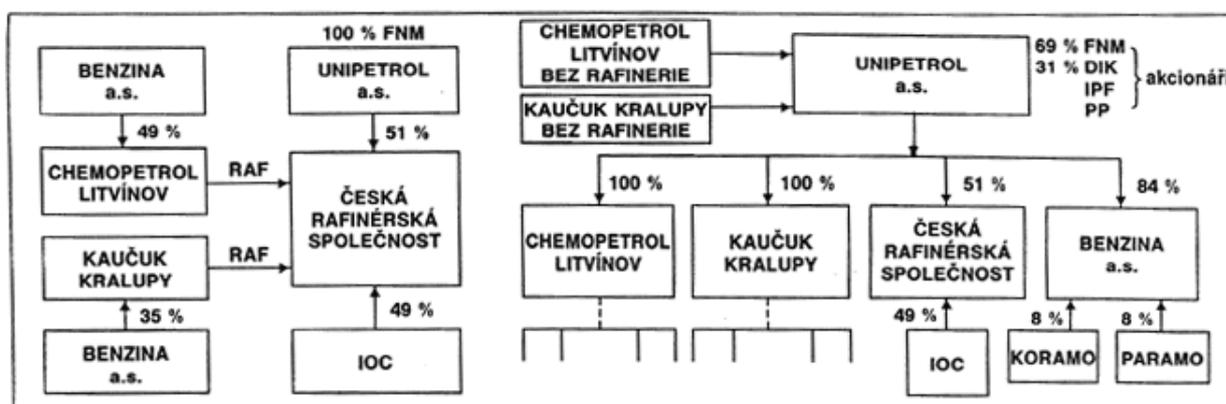
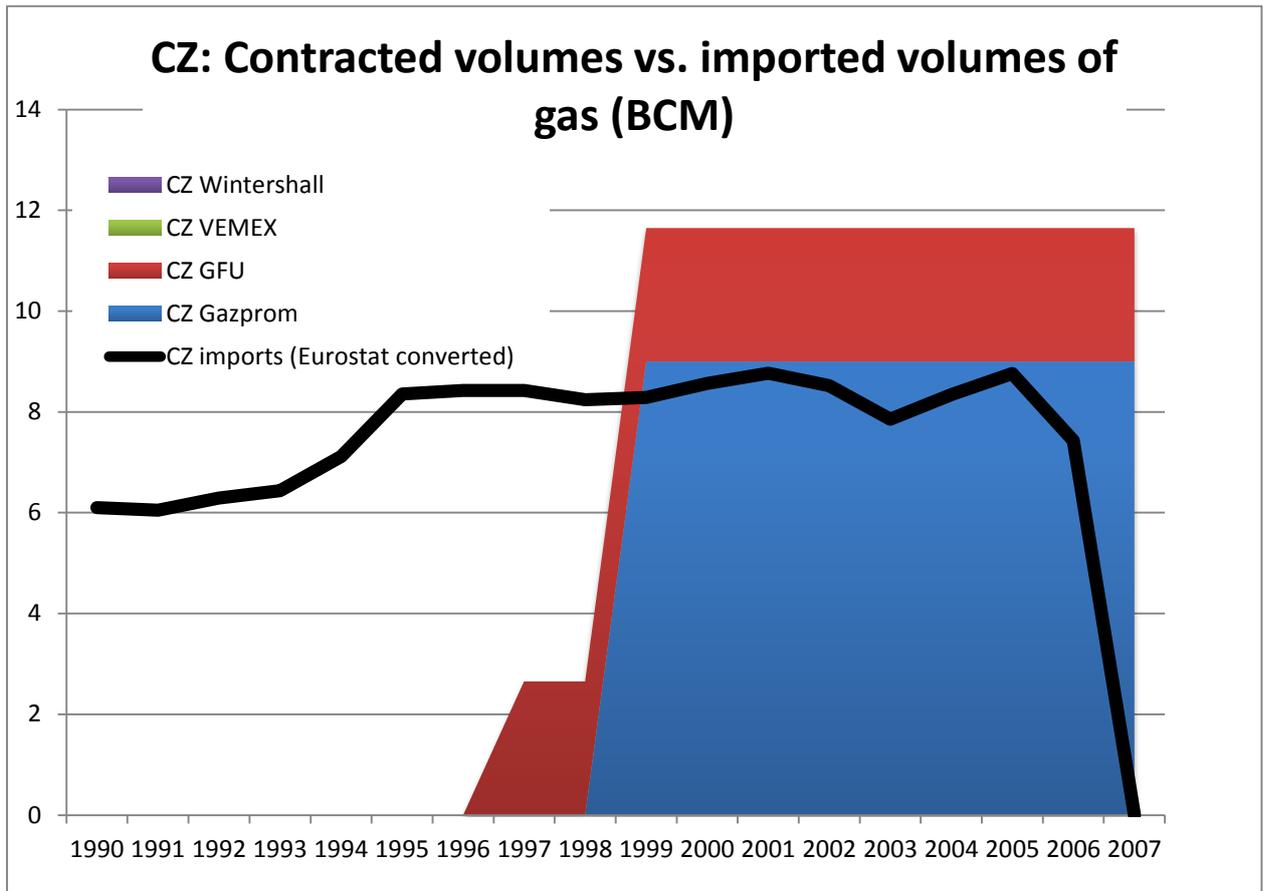


Figure 88: Refinery restructuring<sup>720</sup>

<sup>719</sup> Eurostat and European Commission, “Energy & Transport in Figures 2006: Part 2: Energy”; Eurostat - Data Explorer, “Supply, transformation, consumption - all products - annual data [nrg\_100a].”

<sup>720</sup> PSP Archív, “Odpověď na interpelaci poslance Michala Krause na ministra průmyslu a obchodu Vladimíra Dlouhého ve věci privatizace a transformace (případně restrukturalizace) české petrochemie PČR, PS 1993-1996, tisk 14/94.”

**Supplier Market Diversification**



**Chart 89: Contracted volumes of gas vs. actual imports**

## APPENDIX: SLOVAK REPUBLIC

### Fundamentals

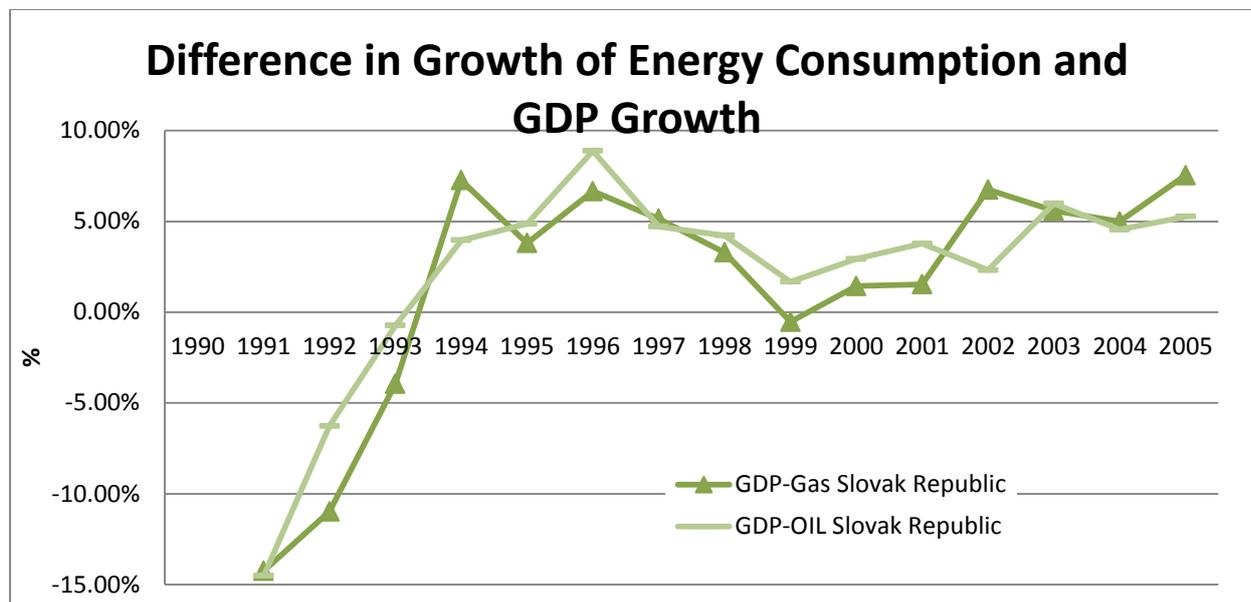


Chart 90: Changes in Energy Consumption and GDP in Slovakia<sup>721</sup>

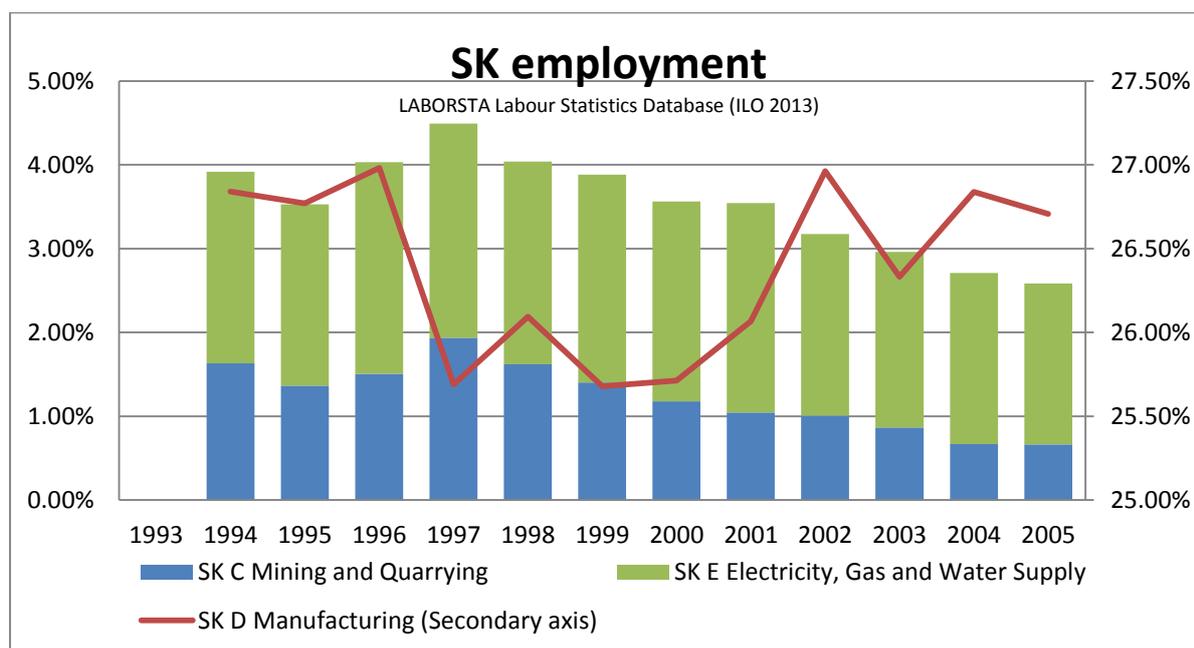
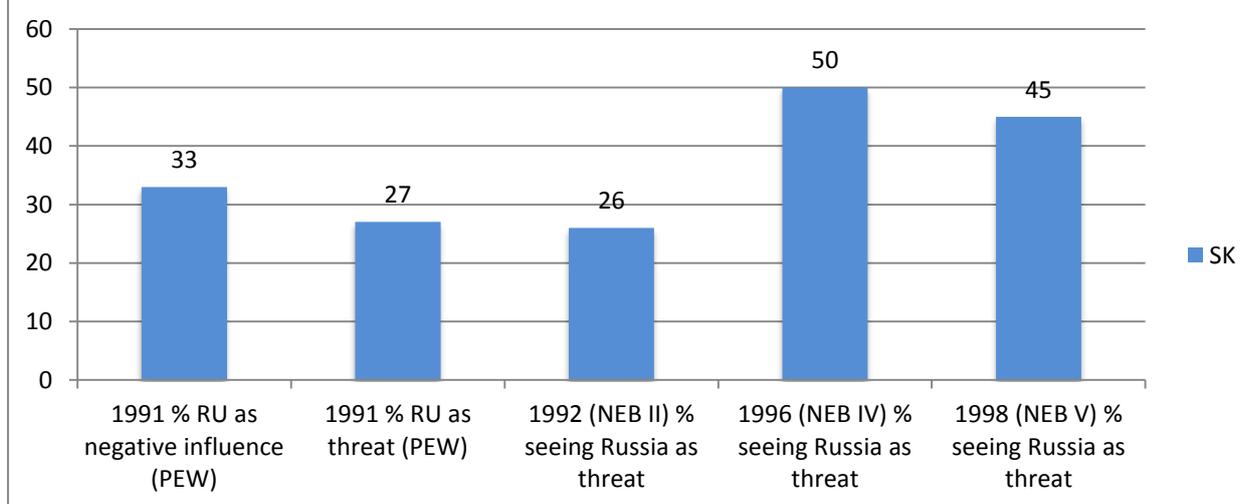


Chart 91: Employment in energy intensive industries as compared to manufacturing industries

<sup>721</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat, "Energy Statistics"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; The World Bank, "Data."



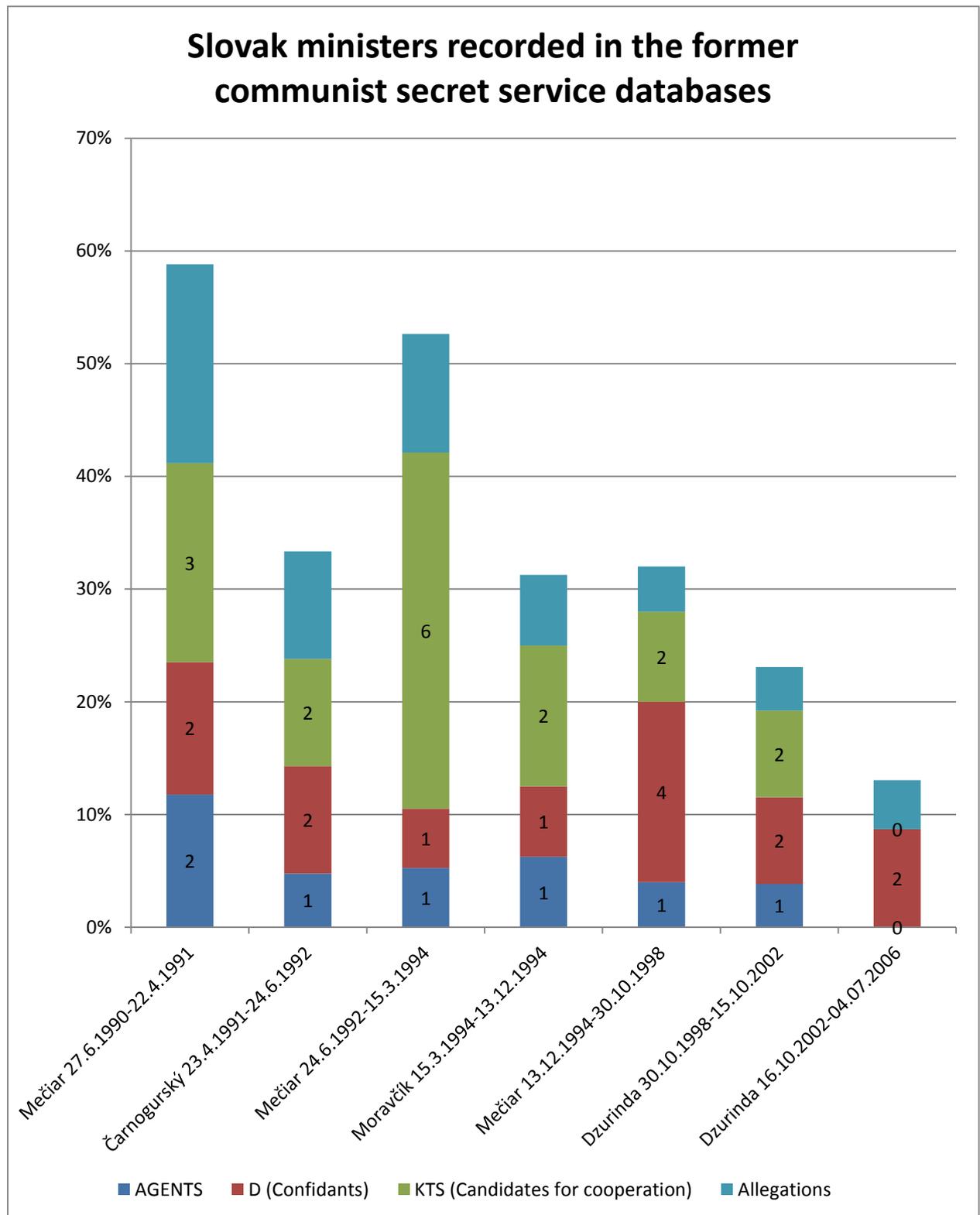
### % of respondents in SK seeing Russia either as negative influence or threat Data: PEW and NEB



**Chart 93: Perception of Russia (Soviet Union) as threat or negative influence in Slovak Republic**<sup>723</sup>

<sup>723</sup> Times Mirror Center for the People & the Press, “The Pulse of Europe: A Survey of Political and Social Values and Attitudes”; Rose, R. and Paul Lazarsfeld Society, “SN 6453 -New Europe Barometer II, 1992-1993”; Rose, R. and Paul Lazarsfeld Society, “SN 6455 -New Europe Barometer IV, 1995”; Rose and Mishler, “SN 5243 -New Europe Barometer VII, 2004-2005.”

**Ruling Elites Links with the Previous Regime**



**Chart 94: Slovak ministers recorded in the former communist secret service databases**

## Representation of people of interest to former communist secret service in the Slovak government

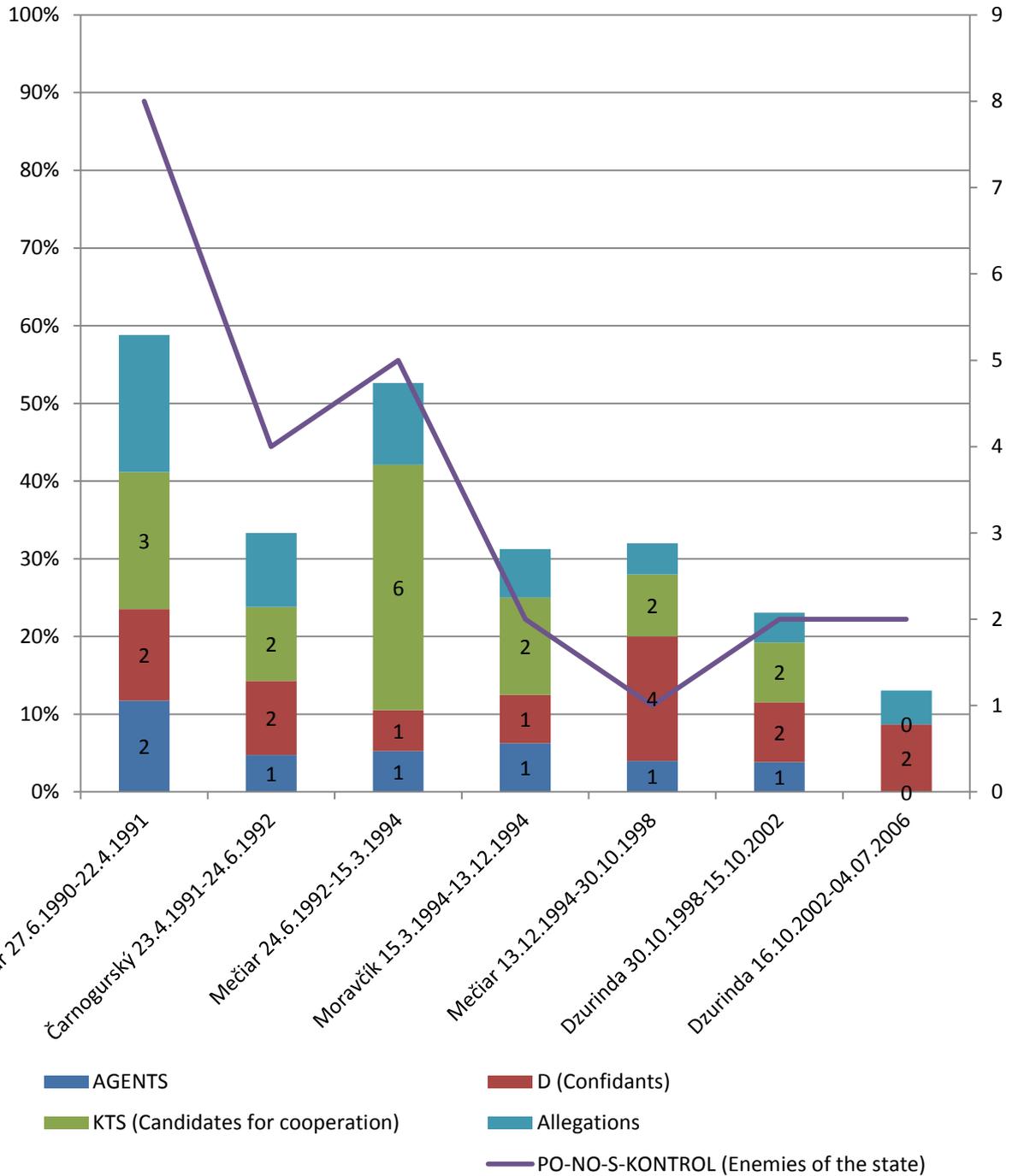


Chart 95: Persons with ties to Former Secret Service in the Slovak Government

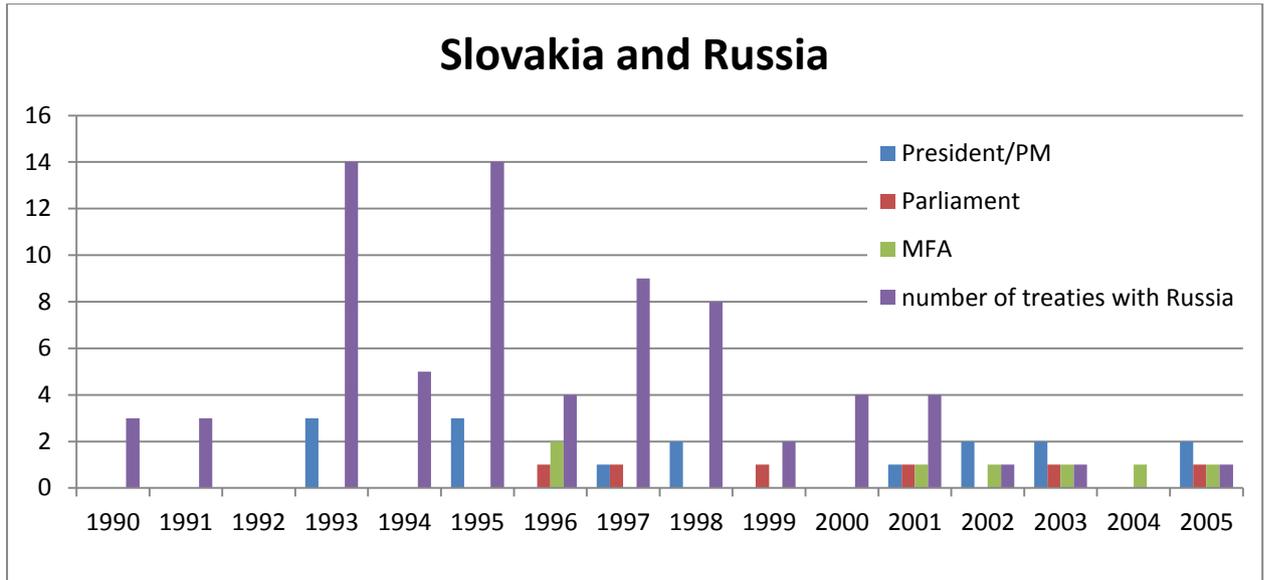


Chart 96: Intensity of official relations between Russia and Slovak Republic

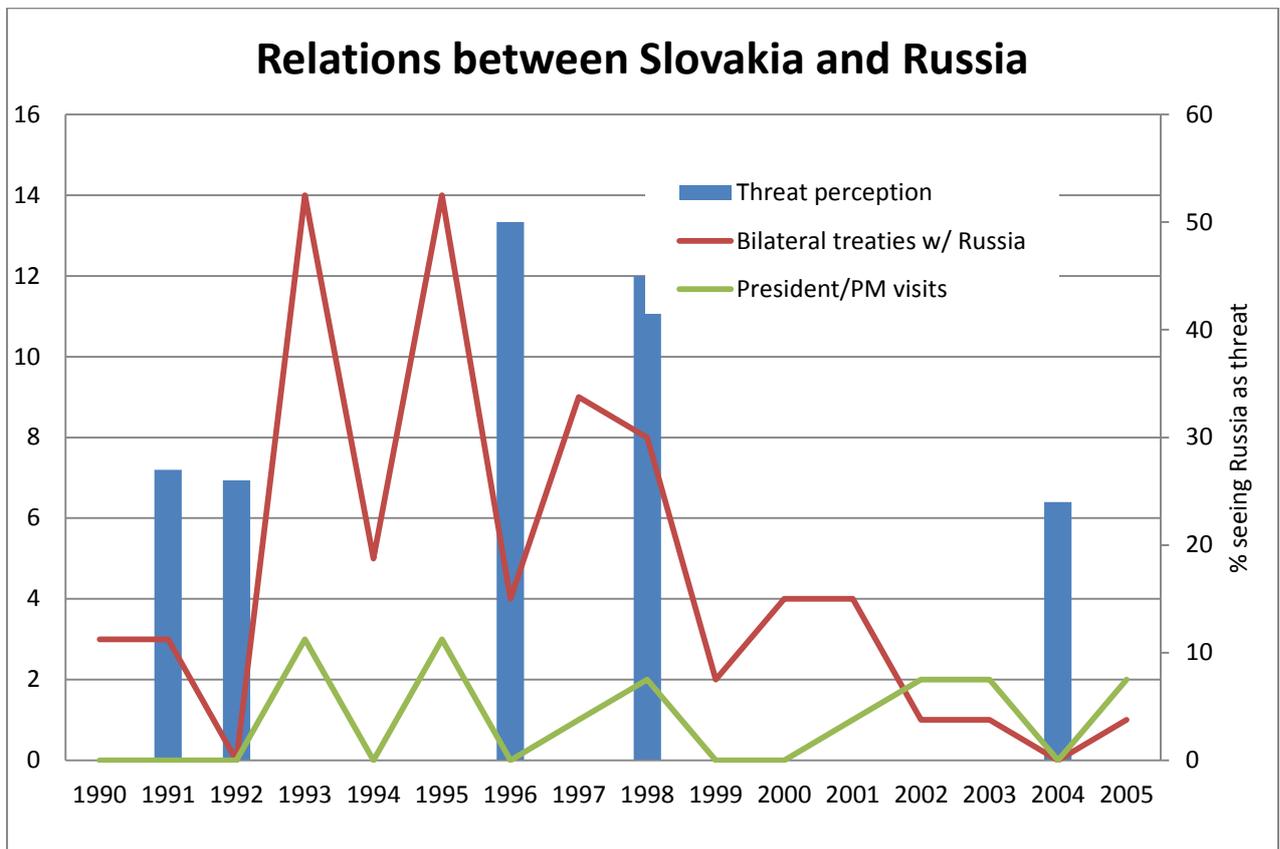


Chart 97: Comparison of variables for Slovak Republic

## Structure of Industry

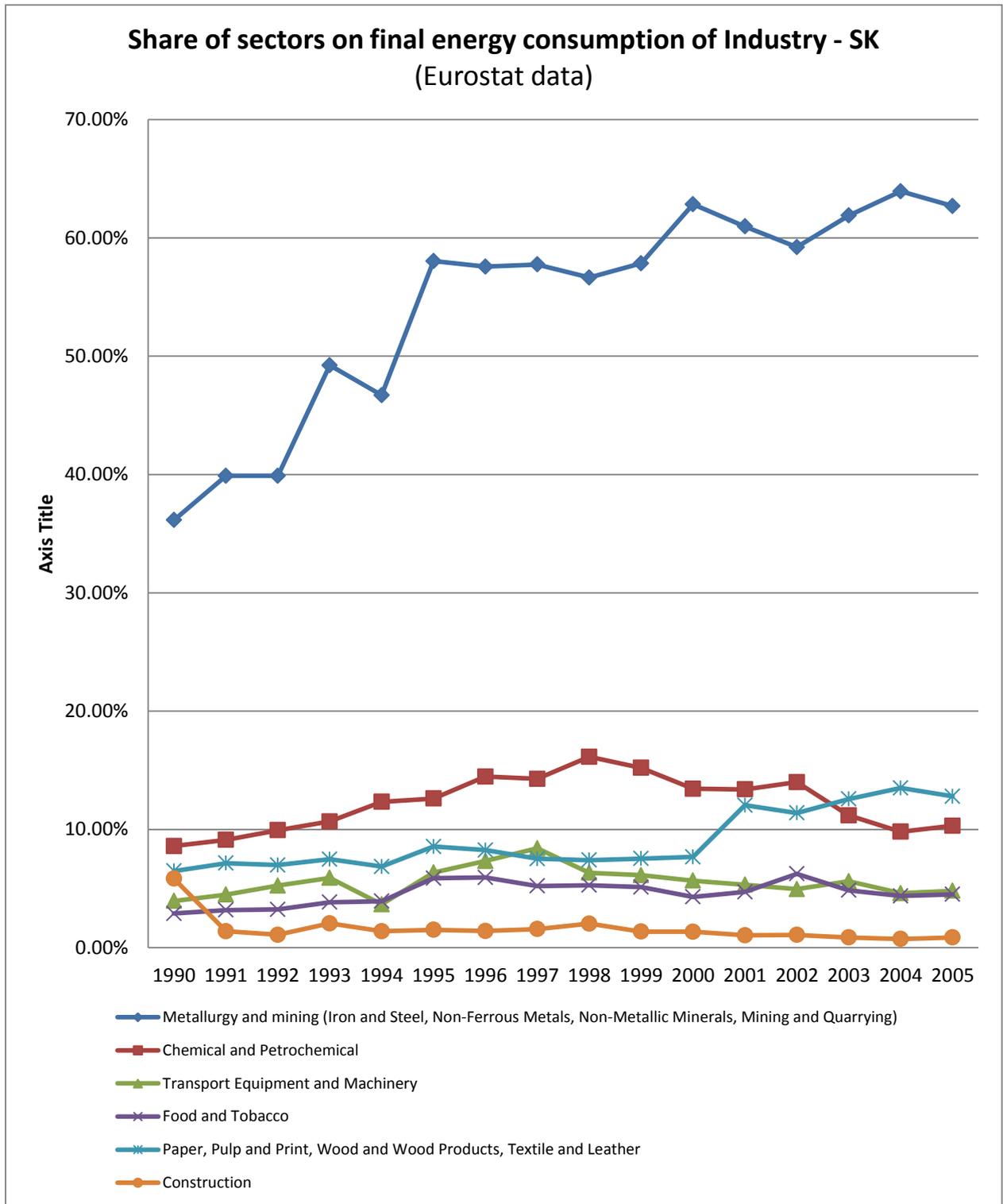


Chart 98: Energy-intensity of different industrial sectors

### Share on export by SITC codes - SK

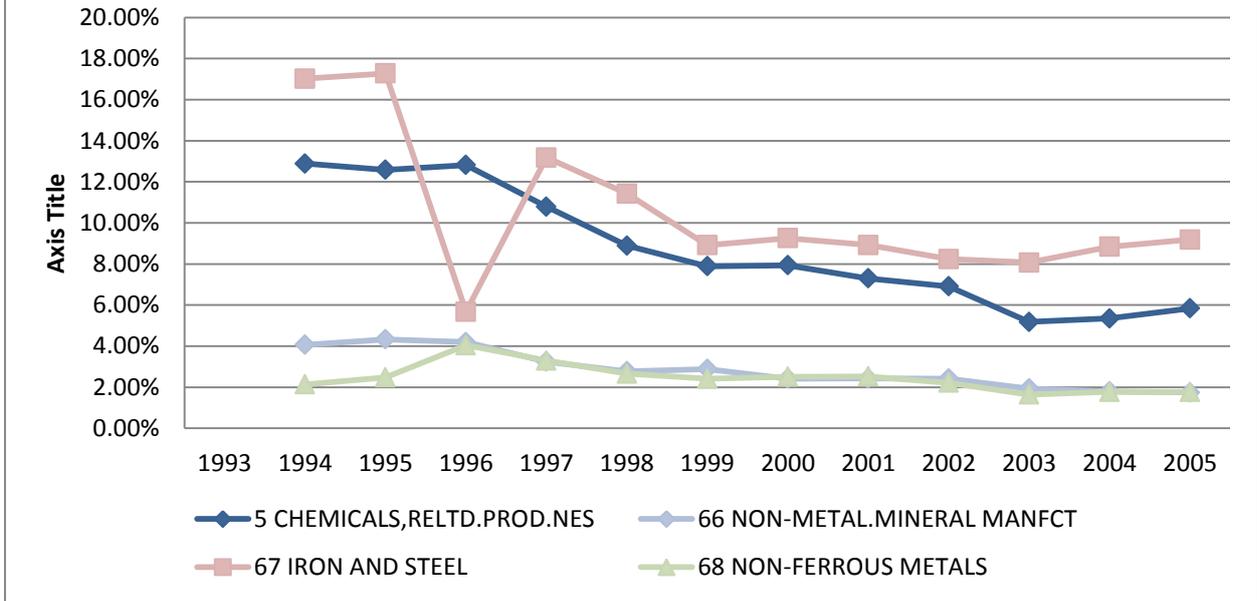


Chart 99: Share of energy intensive sectors on exports (UN COMTRADE Data)

### SK - Share on export by SITC codes

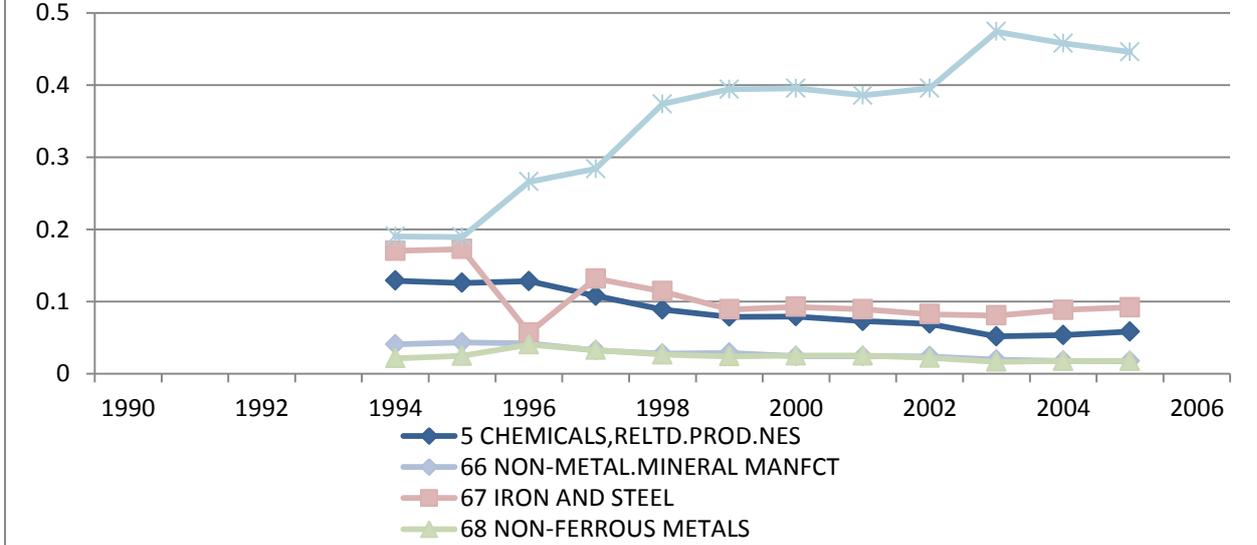


Chart 100: Share of exports of energy intensive manufacturing sectors (SITC 5, 66, 67, 68) on the value of total exports (Slovakia)<sup>724</sup>

<sup>724</sup> United Nations Statistics Division, "UN Comtrade."

## SK - Industrial energy consumption (Eurostat data)

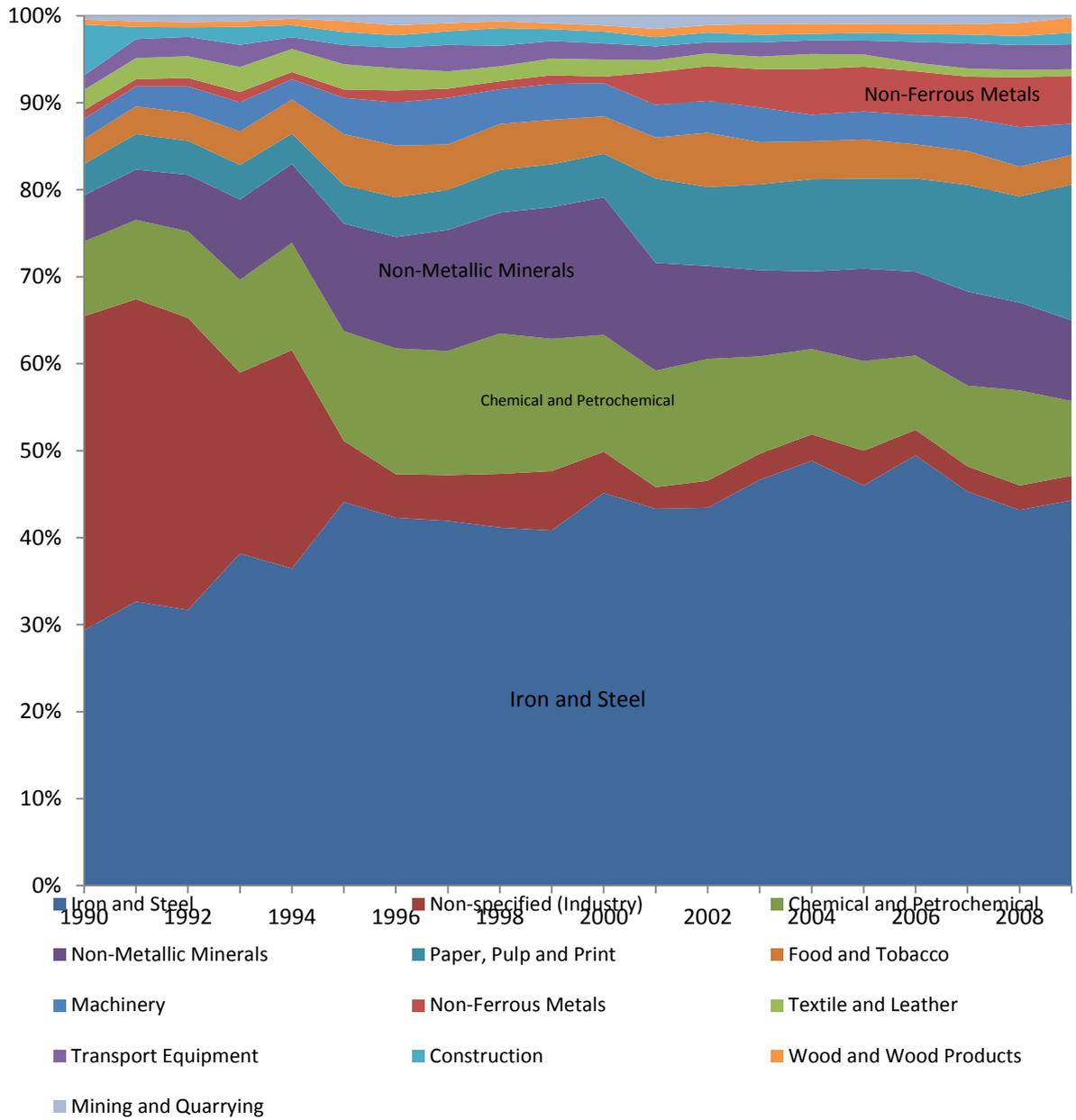


Chart 101: Distribution of Final Energy Consumption in Industry by sectors (Slovakia)<sup>725</sup>

<sup>725</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

## Shares of industrial exports in Slovakia

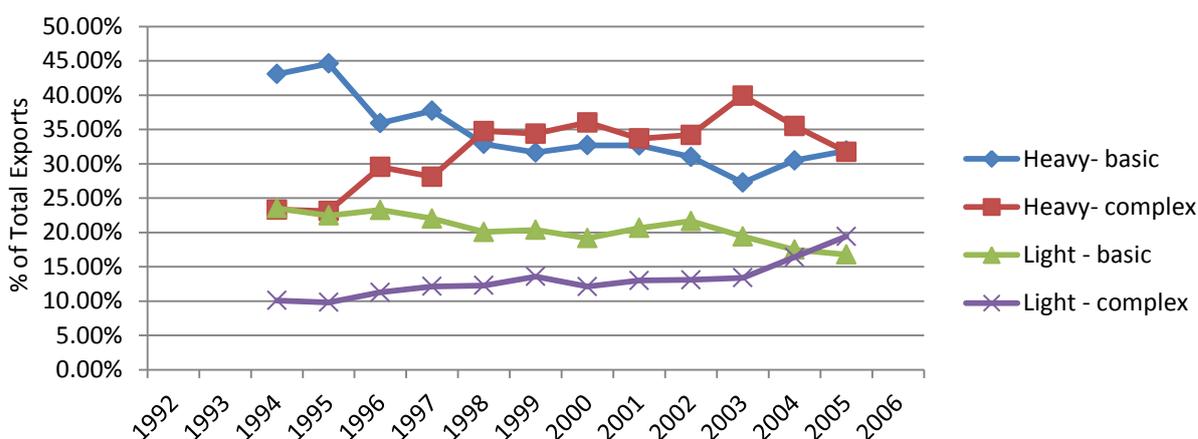


Chart 102: Share of industrial exports by intensity sectors data<sup>726</sup>, methodology. (Slovakia)<sup>727</sup>

## SK - Energy intensity of export sectors

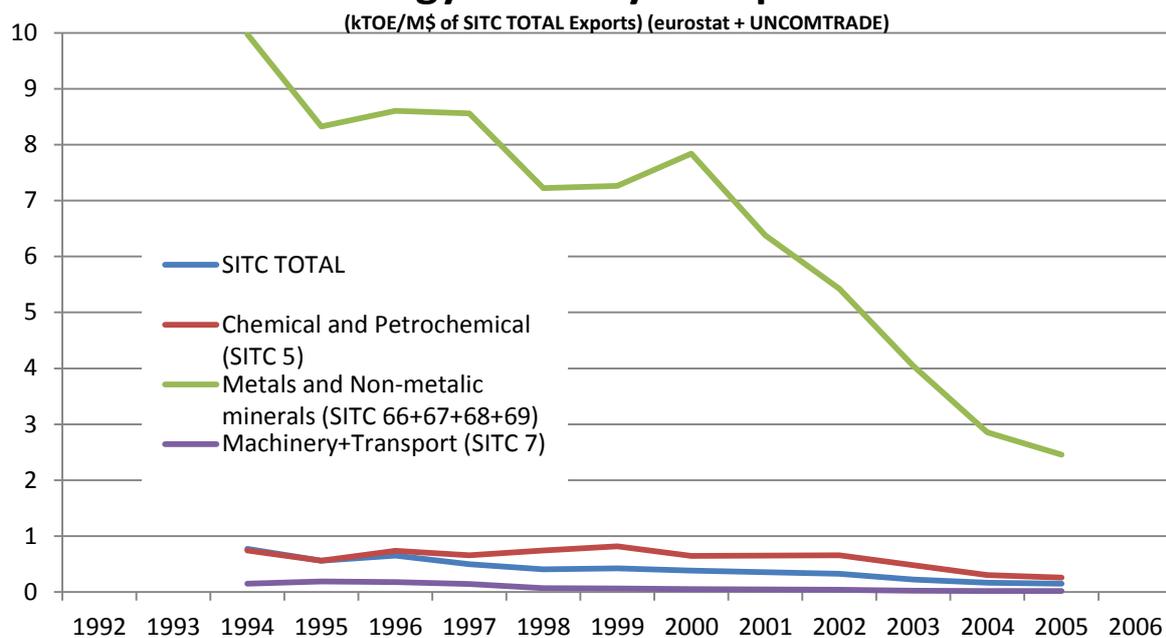


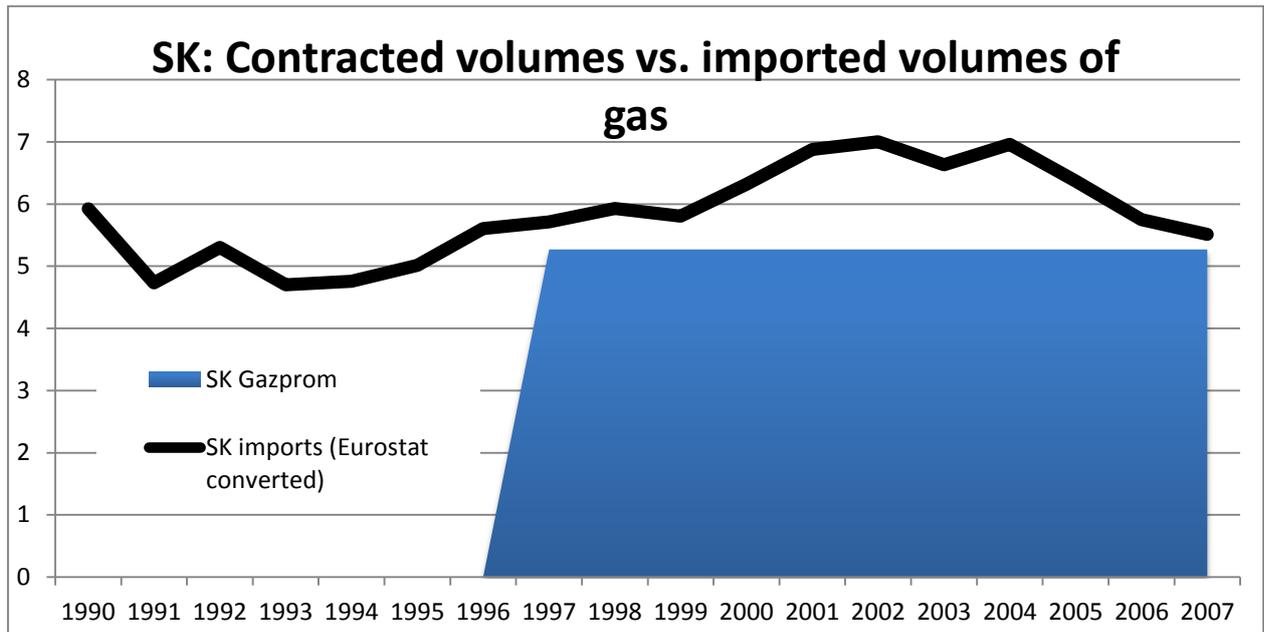
Chart 103: Energy intensity of selected industrial sectors in Slovak Republic<sup>728</sup>

<sup>726</sup> United Nations Statistics Division, "UN Comtrade."

<sup>727</sup> For methodology and distribution of sectors see Greskovits, "Leading Sectors and the Varieties of Capitalism in Eastern Europe." as modified by Kurekova, *Commodity export structures and the analysis of trends in leading export sectors in the European Union*.

<sup>728</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; United Nations Statistics Division, "UN Comtrade."

**Supplier Market Diversification**



**Chart 104: Contracted volumes of gas vs. actual imports (Slovakia)**

## APPENDIX: HUNGARY

### Fundamentals

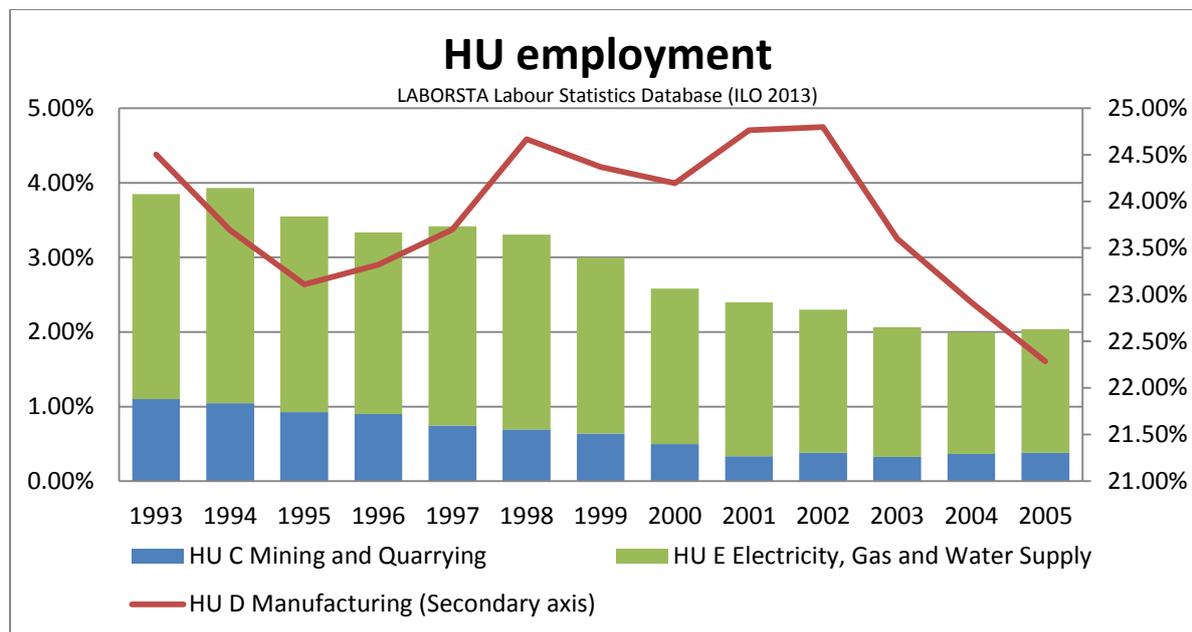


Chart 105: Employment in energy intensive industries as compared to manufacturing industries

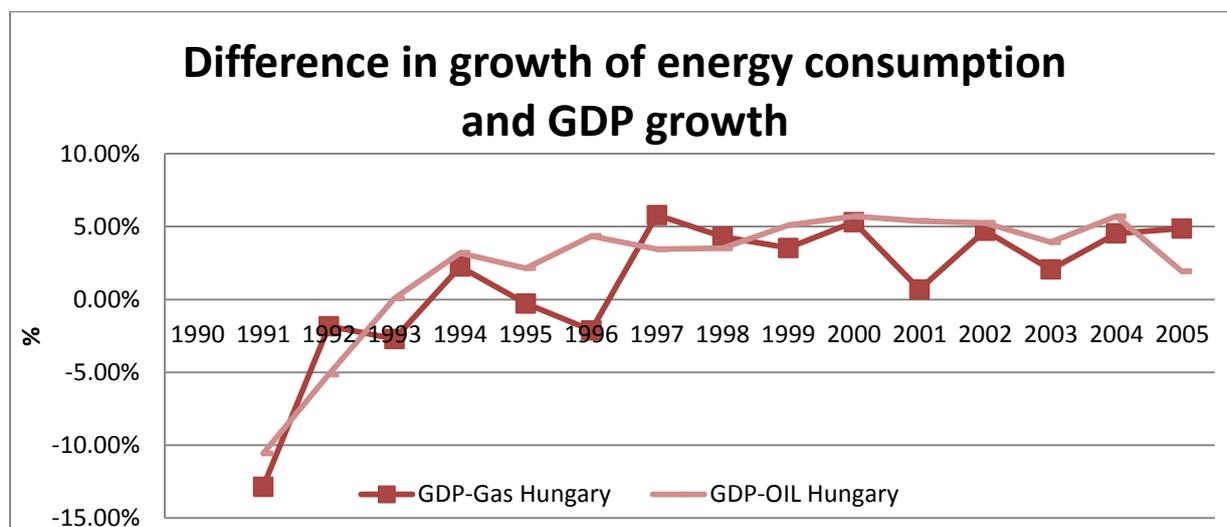


Chart 106: Changes in Energy Consumption and GDP in Hungary<sup>729</sup>

<sup>729</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat, "Energy Statistics"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; The World Bank, "Data."

### Threat perception

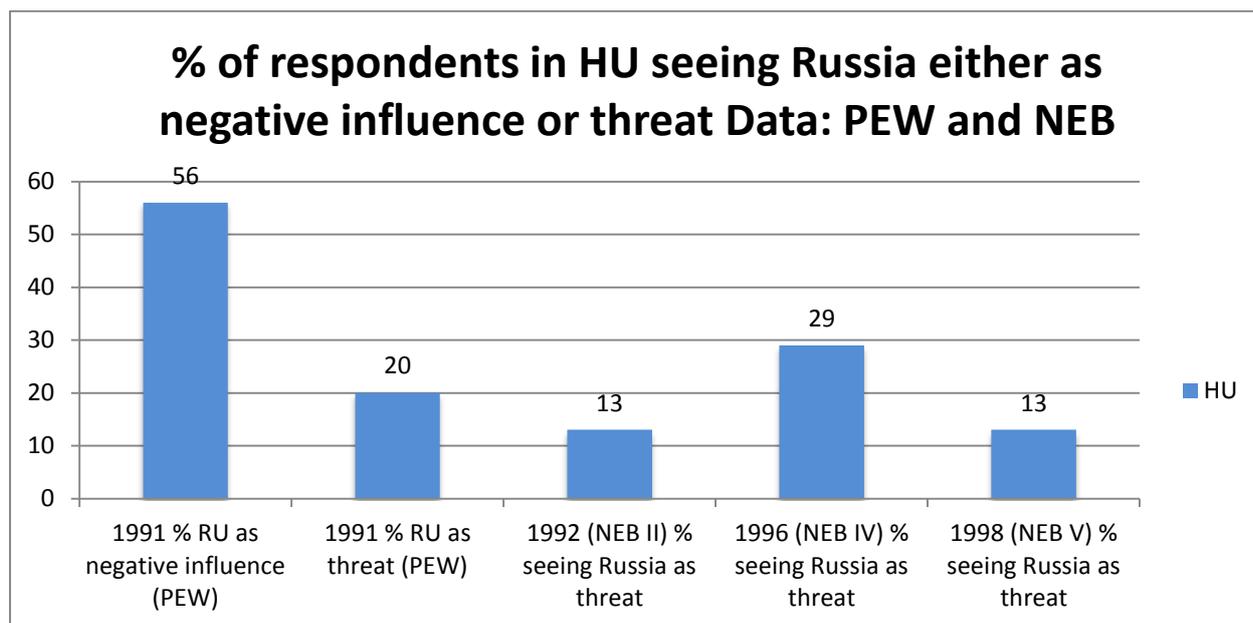


Chart 107: Perception of Russia (Soviet Union) as threat or negative influence in Hungary<sup>730</sup>

<sup>730</sup> Times Mirror Center for the People & the Press, “The Pulse of Europe: A Survey of Political and Social Values and Attitudes”; Rose, R. and Paul Lazarsfeld Society, “SN 6453 -New Europe Barometer II, 1992-1993”; Rose, R. and Paul Lazarsfeld Society, “SN 6455 -New Europe Barometer IV, 1995”; Rose and Mishler, “SN 5243 -New Europe Barometer VII, 2004-2005.”

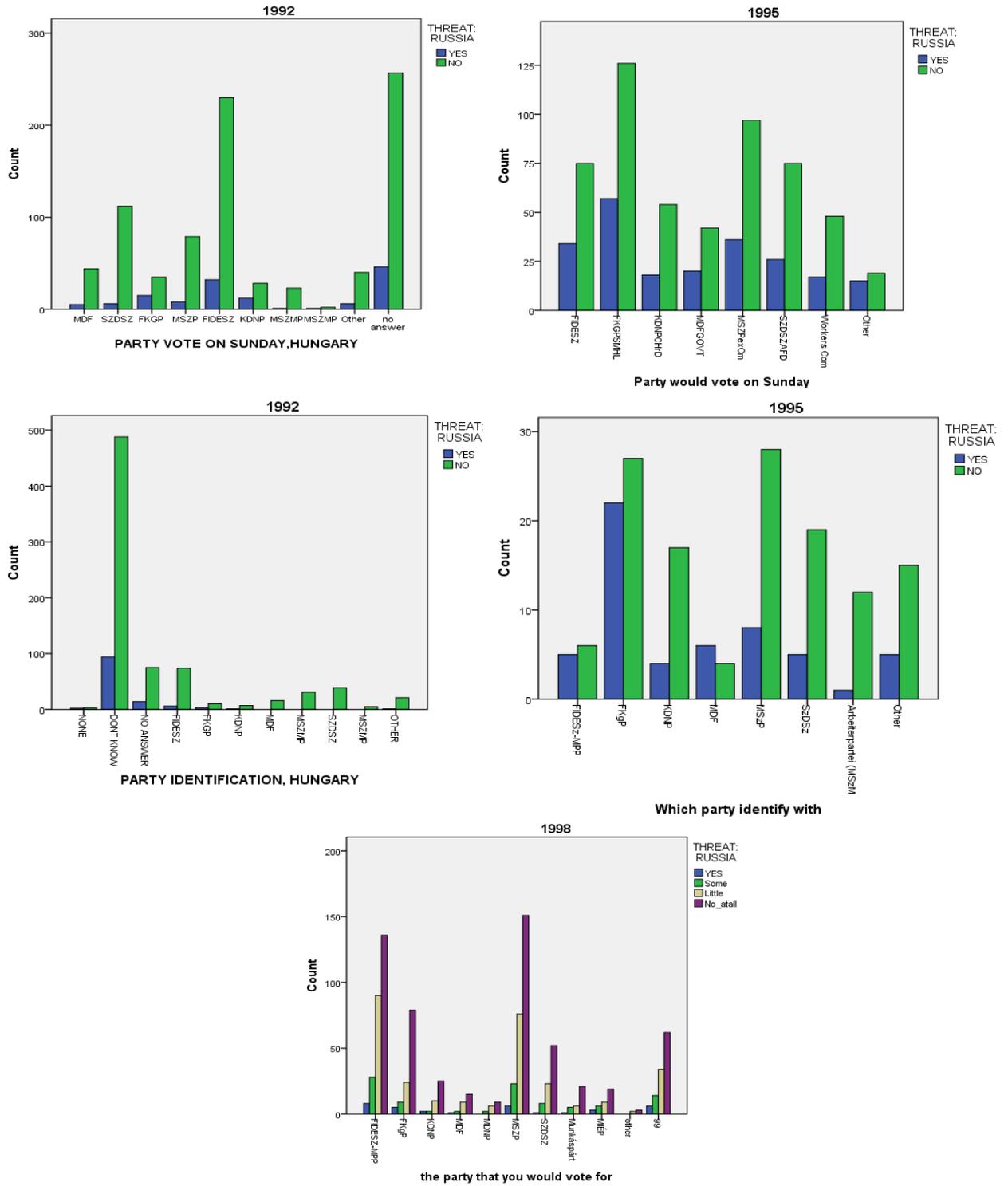
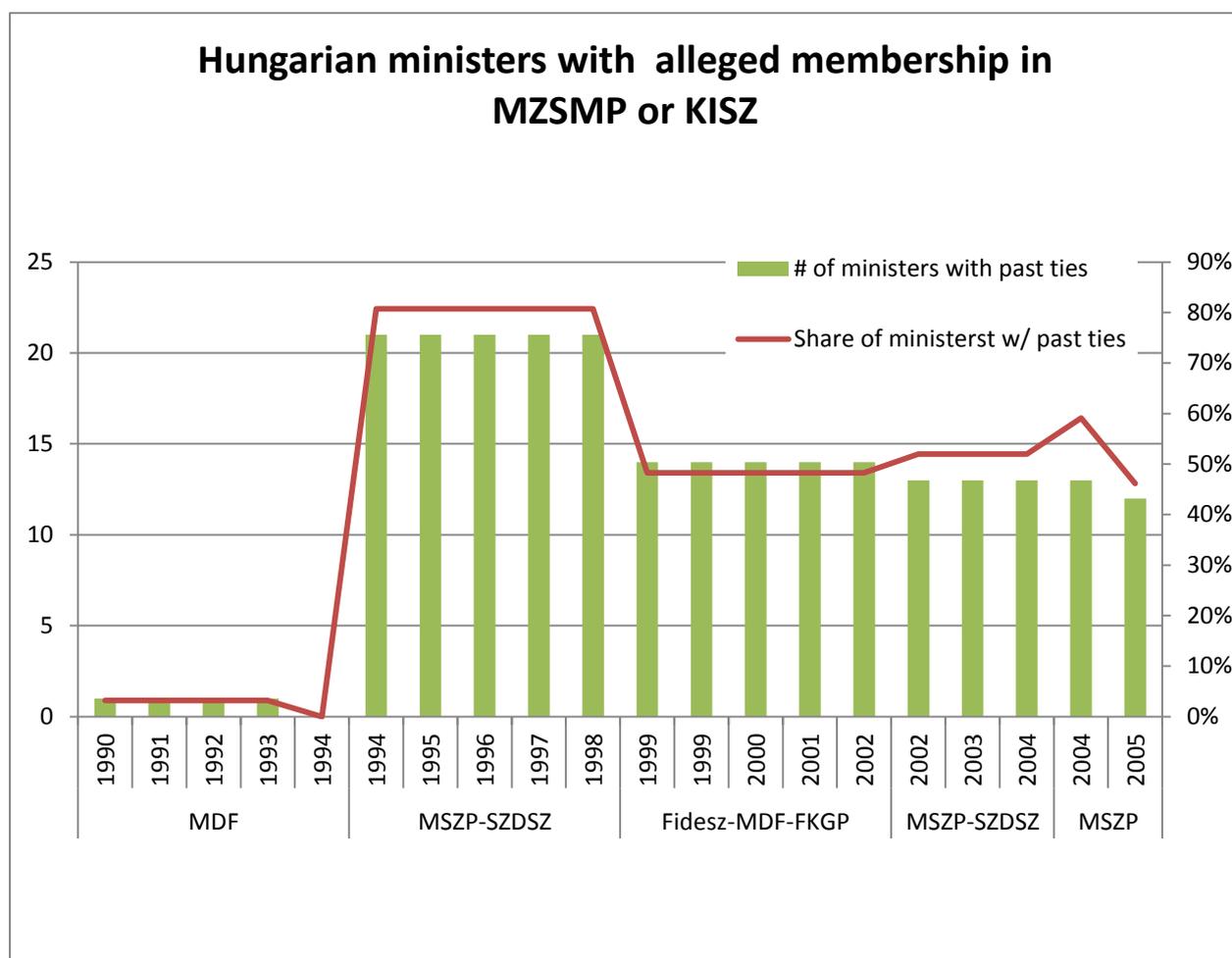


Chart 108: Threat perception in Hungary by political affiliation Russia as threat in 1992, 1995 and 1998

## Ruling Elites Links with the Previous Regime

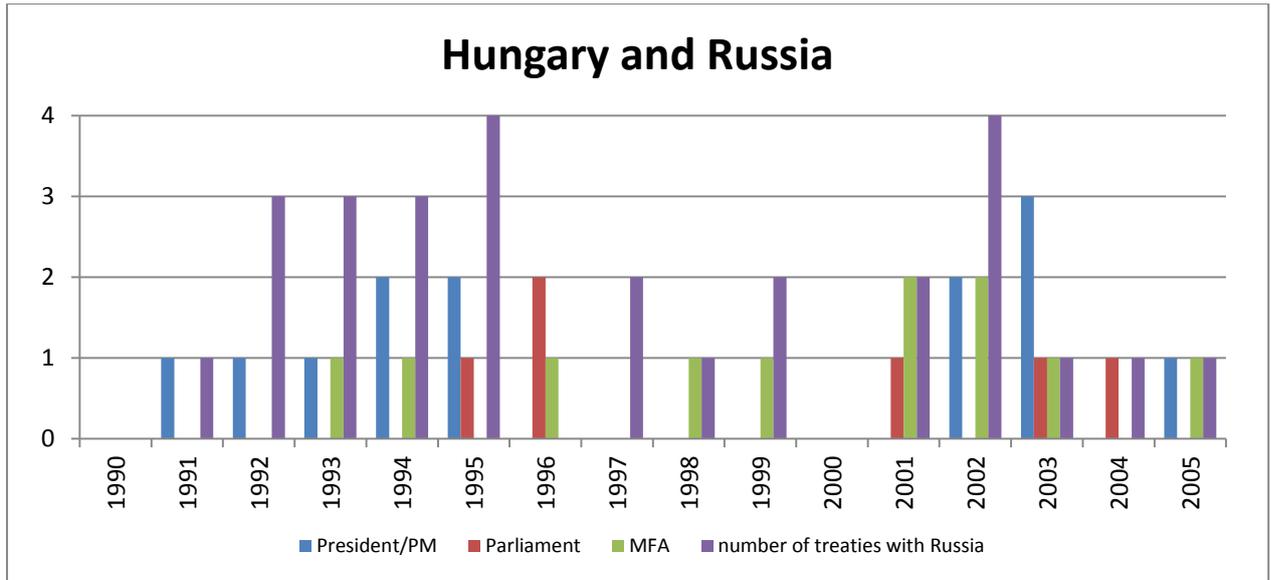


**Chart 109: Ministers with alleged ties to the previous regime (membership in MZSMP or KISZ in Hungary (see footnote for caveats<sup>731</sup>)).**

<sup>731</sup> Using the crude proxy of manual cross-search performed on biographies and names of members of different Hungarian governments and news articles (with a help of native Hungarian research assistant) corroborates, although very weakly, the division observed in both Czech Republic and Slovakia. While the first Hungarian government of transition had minimal personal ties to the Hungarian Socialist Workers' Party (MSZMP) or its youth organization Hungarian Young Communist League (KISZ) as a representative organizations of the communist regime. The following government lead by the post-communist MSZP had majority of its ministers who were members of either of the former communist regime organizations. The right-wing government had about half of its ministers with identified ties to MSZMP or KISZ, including a number of high ranking ministers. (Városi Újság, "A Fidesz azon politikusainak listája, akik korábban a kommunista rendszerben valamilyen funkciót töltöttek be.")

Since KISZ had approximately 800,000 members and MSZMP 1.2 million (14% of the adult population) (data from Karácsony, "Az előélet utóélete. Az egykori MSZMP-tagságra vonatkozó adatok megbízhatósága.") the membership in these organizations was much more common than membership in or collaboration with the communist-era secret service in Czechoslovakia.

Given both how soft and anecdotal this evidence is, since it relies on publicly acknowledged membership in the two organizations, as well as very different nature of membership in KISZ and MSZMP as compared to communist-era secret service police in Czechoslovakia, this measure cannot be used as a supportive evidence in case of Hungary.



**Chart 110: Intensity of official relations between Russia and Hungary**

## Structure of Industry

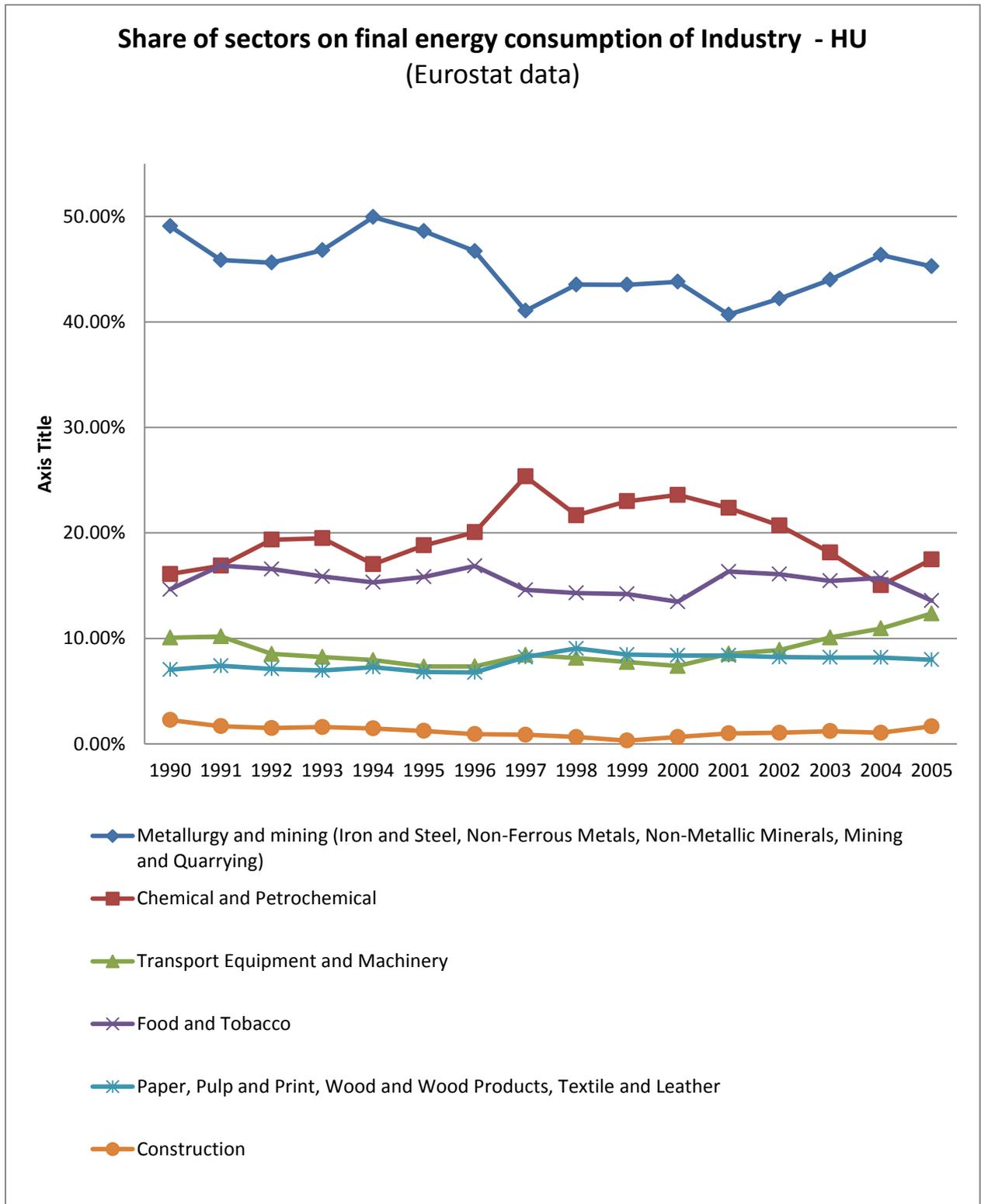


Chart 111: Energy-intensity of different industrial sectors

### Share on export by SITC codes - HU

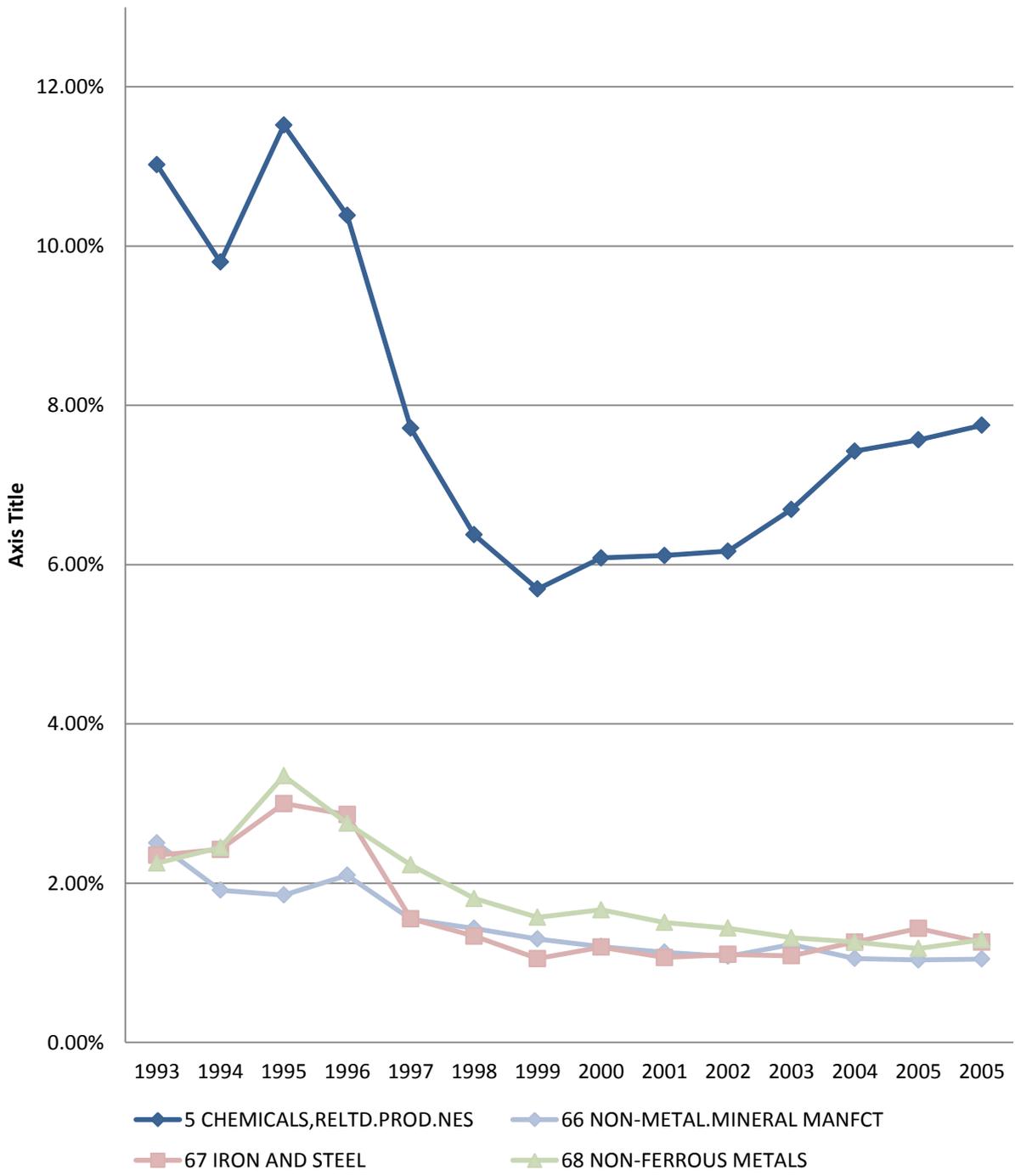


Chart 112: Share of energy intensive sectors on exports (UN COMTRADE Data)

### HU- Share on export by SITC codes

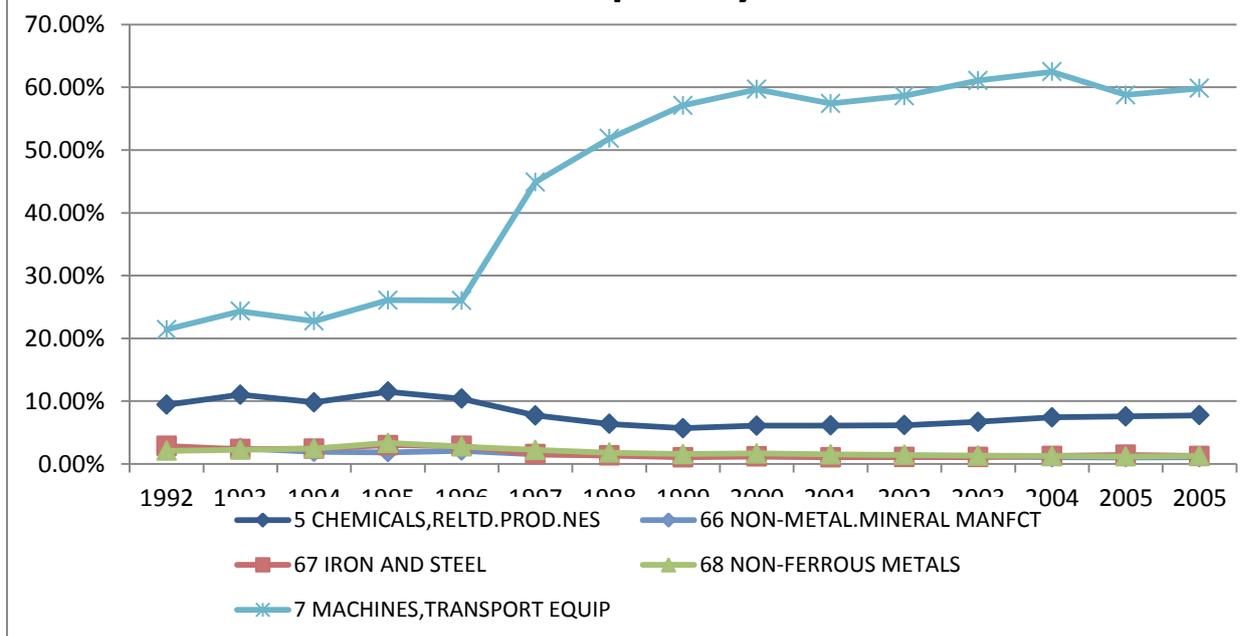


Chart 113: Share of exports of energy intensive manufacturing sectors (SITC 5, 66, 67, 68) on the value of total exports (Hungary)<sup>732</sup>

### HU - Energy intensity of export sectors

(kTOE/M\$ of SITC TOTAL Exports) (eurostat + UNCOMTRADE)

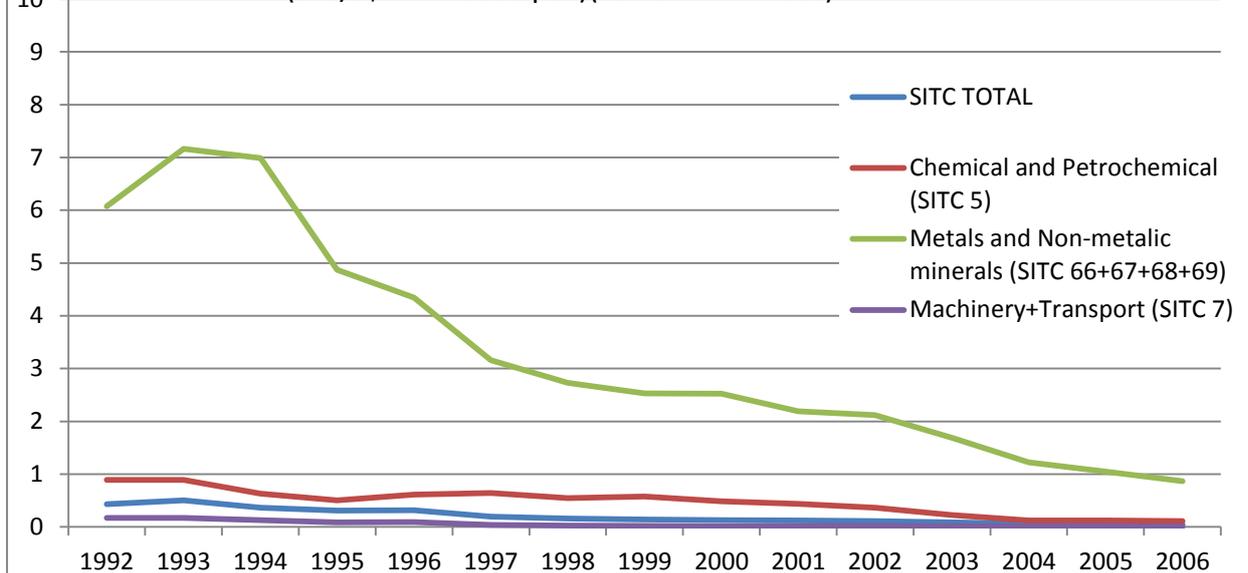


Chart 114: Energy intensity of selected industrial sectors in Hungary<sup>733</sup>

<sup>732</sup> United Nations Statistics Division, "UN Comtrade."

<sup>733</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]"; United Nations Statistics Division, "UN Comtrade."

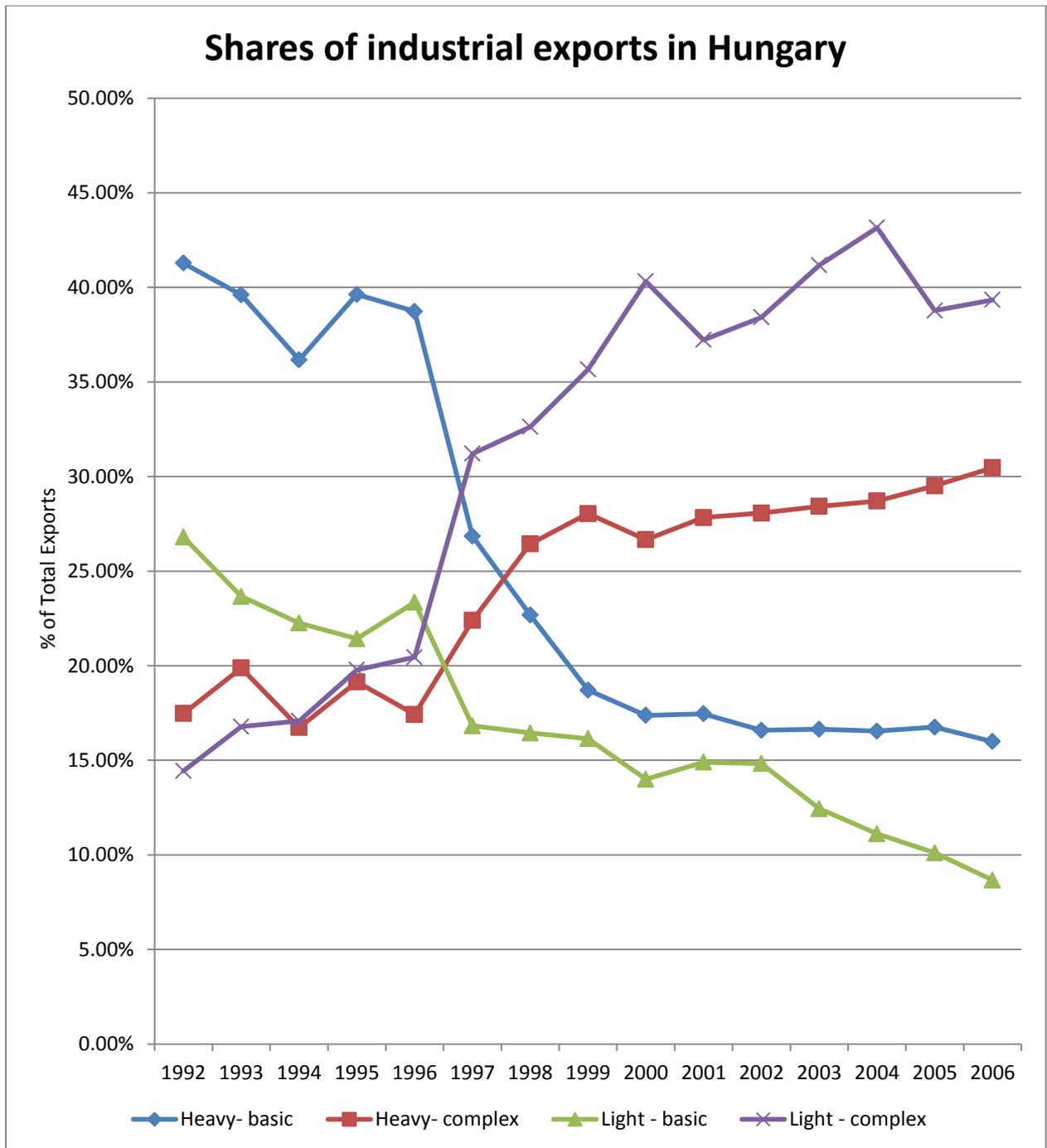


Chart 115: Share of industrial exports by intensity sectors in Hungary (Data<sup>734</sup> methodology<sup>735</sup>)

<sup>734</sup> United Nations Statistics Division, "UN Comtrade."

<sup>735</sup> For methodology and distribution of sectors see Greskovits, "Leading Sectors and the Varieties of Capitalism in Eastern Europe." as modified by Kurekova, *Commodity export structures and the analysis of trends in leading export sectors in the European Union*.

## HU -Share of sectors on final energy consumption of Industry

(Eurostat data)

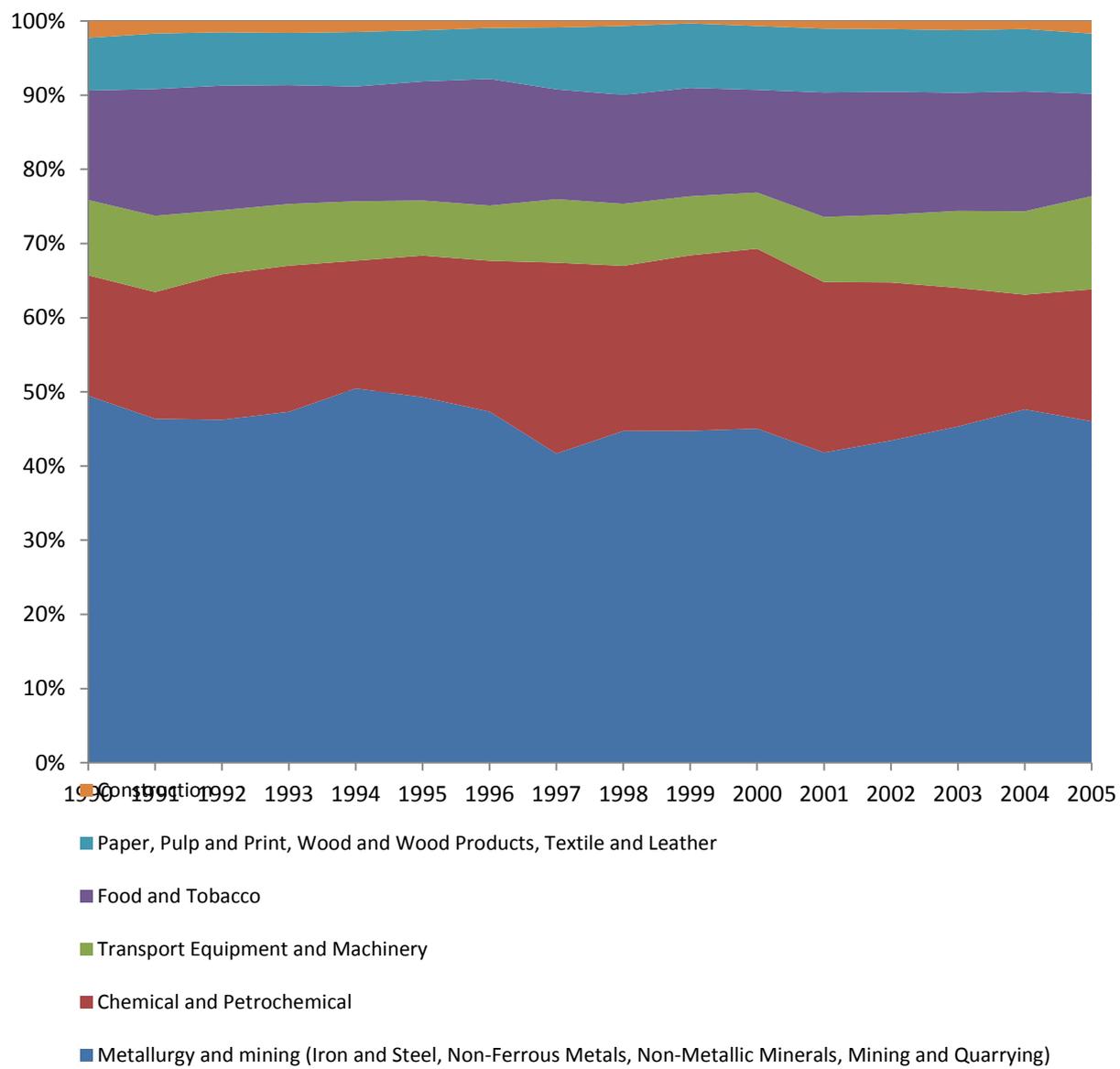


Chart 116: Distribution of Final Energy Consumption in Industry by sectors (Hungary)<sup>736</sup>

<sup>736</sup> Eurostat and European Commission, "Energy & Transport in Figures 2006: Part 2: Energy"; Eurostat - Data Explorer, "Supply, transformation, consumption - all products - annual data [nrg\_100a]."

## Supplier Market Diversification

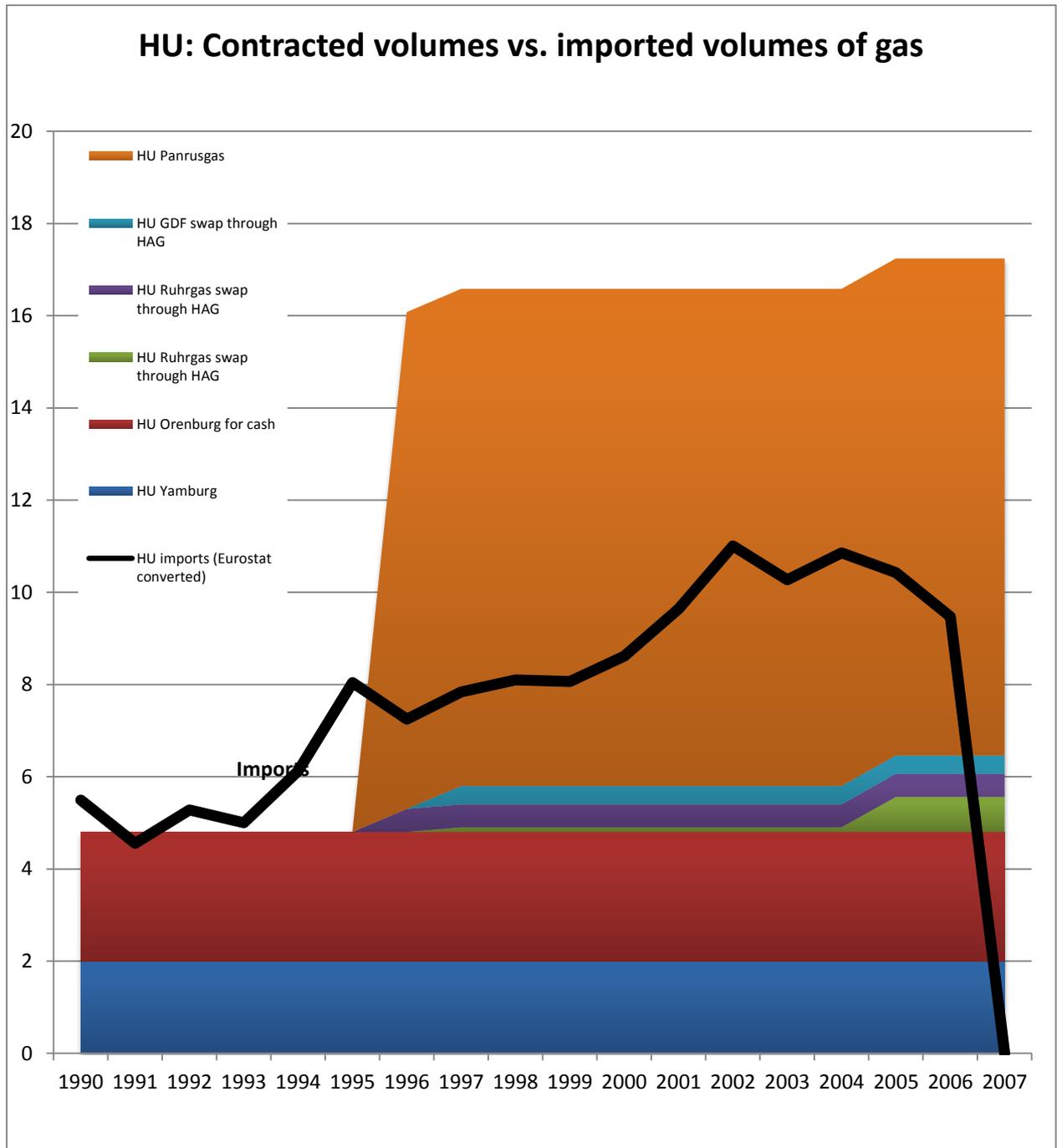


Chart 117: Contracted volumes of gas vs. actual imports (Hungary)

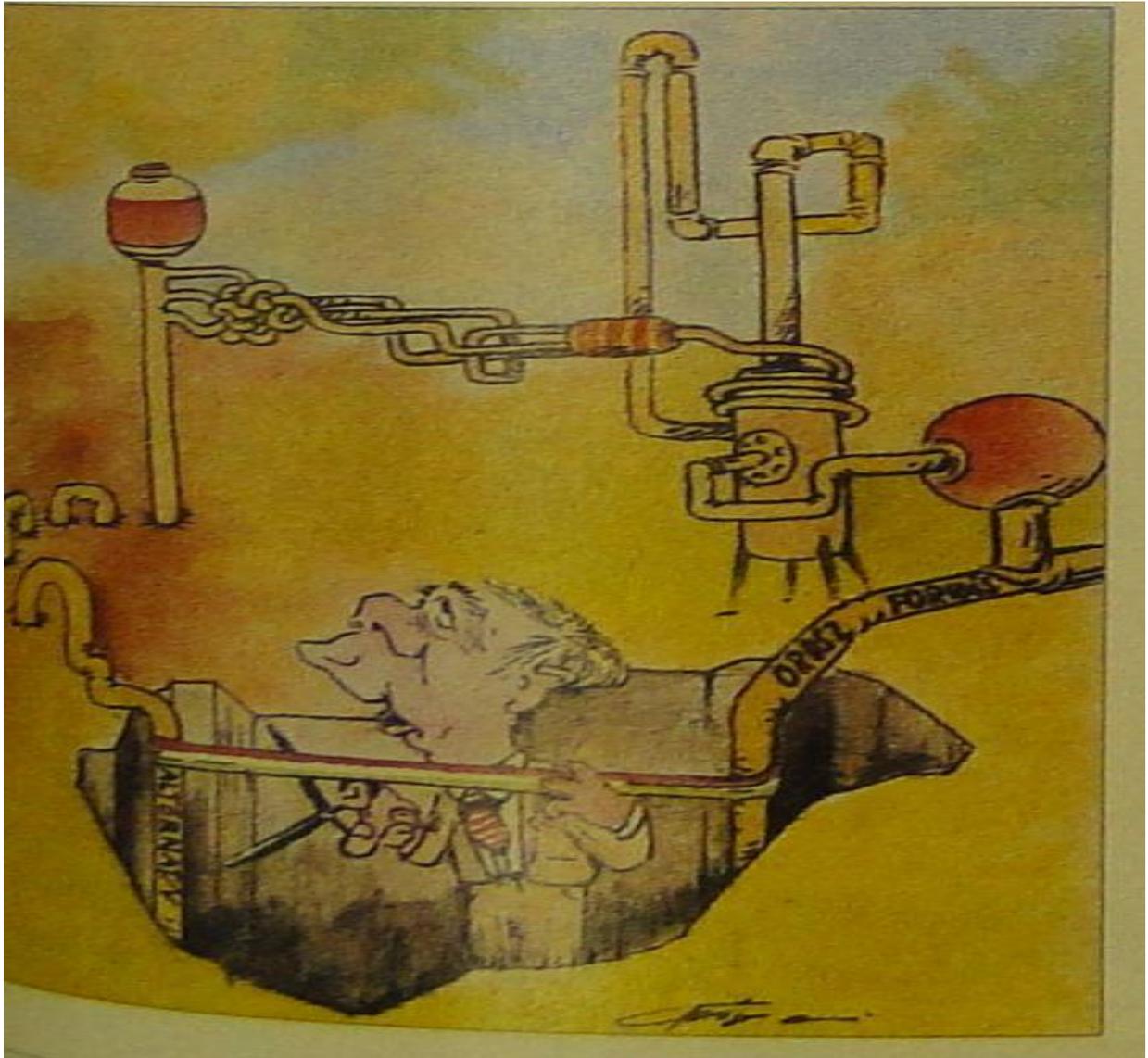


Figure 118: [Diversification] the Hungarian Way<sup>737</sup>

<sup>737</sup> Týden (il), “Maďarskou metodou?”.

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