

1<sup>st</sup> Transatlantic Energy Security Dialogue

# Energy Dragons Rising

Global Energy Governance and the  
Rise of China and India

## *Conference Report*

Schloßhotel Cecilienhof, Potsdam, January 18-19, 2007

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# 1. Introduction

On January 18-19 2007, the Global Public Policy Institute (GPPi) convened the first “Transatlantic Energy Security Dialogues” conference entitled *Energy Dragons Rising: Global Energy Governance and the Rise of China and India* at the Schloßhotel Cecilienhof in Potsdam. The conference was made possible by a generous grant from the German Marshall Fund of the United States (GMFUS) and additional sponsorship from E.ON Ruhrgas.

Until now, EU and US discussions on energy security have been running in parallel. It is, however, important to integrate European and American debates more closely in order to weave a genuine transatlantic strategic dialogue on energy security. For two reasons, such an exchange would be beneficial for both sides: First, we stand to learn from comparing the energy policy experiences and strategies on both sides of the Atlantic. And second, dialogue and cooperation between Europe and the US is essential to devising joint strategies for effectively dealing with the increasingly global challenges of energy security.

In this context, the conference brought together more than 30 decision-makers and professionals representing all relevant sectors (government, NGOs, business, the media, think tanks and universities) from both sides of the Atlantic for a strategic debate on one key emerging energy security issue – the consequences of rising energy demand from China and India for the institutions and mechanisms of global energy governance. To promote a lasting transatlantic dialogue on energy security, participants were mainly highly qualified young professionals concentrating on these issues.

In focusing on the role of governance institutions in achieving energy security, the conference attempted to fill a critical gap in the current public debate and addressed questions such as:

- Why is it that the two biggest emerging economies, one of them a democracy, find it necessary to circumvent the established framework of world energy markets to secure upstream energy investments?
- How should the rest of the world – and in particular the transatlantic alliance – deal with the consequences of their defection for good governance and economic development in Africa, the global regulation of climate change, and the need for rapid and substantial investment in energy production?
- How can the system of global energy governance be changed to better integrate China and India, and satisfy everybody’s needs in a reliable way?
- What would a constructive transatlantic strategy to this end look like and what roles would the G8 and the European Union play?

Starting with an opening speech outlining the challenges put forward by the rapid growth of emerging economies like China and India, the conference explored these themes by addressing (i) the rationale behind China’s and India’s current energy strategies, (ii) their consequences for issues of global energy governance, and (iii) common transatlantic policy options for adjusting the global framework for energy governance to meet the needs of all market participants. Small working groups were formed to tackle specific aspects of each

question. In each working group, a participant with particular expertise on the topic was asked to give a short introductory presentation while another led the discussion. In preparation for the final session of workshops, a panel discussion was conducted to solicit additional input on policy options.

Rather than providing a summary of each of the panel sessions and working groups, this conference report traces some of the key red threads that structured the discussions during the two-day meeting. These threads include (i) the operability of global oil markets in light of the “challenge” from China and India, (ii) economic growth and climate change and (iii) the “good governance” question in leading African nations. Within the context of these red threads, this report takes into account conference discussions on the main questions and themes listed above.

## **2. Operability of global oil markets in light of China's and India's international energy strategies**

As a first step toward a better understanding of China's and India's foreign energy policies, conference participants reviewed and discussed some key features of today's global oil market. In this context, discussions identified domestic pressures on energy demand in India and China, as well as policies being implemented to cope with these pressures. Looking at the structure of energy markets and their entanglements with the political systems of China and India provided key insights into the motives behind these countries' strategies at the international level, their implications on the global oil market and potential transatlantic strategies to cope with the changing environment.

### **2.1 Key features of the global oil market**

A general consensus among conference participants highlighted the increasing inclination of producers and consumers to base their policy decisions with regard to energy security on strategic and political grounds. There was agreement that this development has induced a climate of supply-side resource nationalism and demand-side resource mercantilism, particularly in the cases of China and India where suspicion of energy markets due to historical control and leverage by Western economies has created a mood of "catch up". In this respect, the rise in demand for oil (and also natural gas) in the coming decades, coupled with the lag of supply-side growth and decreasing concentration of non-OPEC reserves has created a mercantilist environment based upon the desire for insurance and diversification of energy supplies.

In addition, it was pointed out that oil market security is a global public good and, naturally, free-riding is a key issue. The protection of transportation routes is a case in point: Today, the military security of sea lanes is mostly provided by the US military and future challenges will include securing critical transportation bottlenecks such as the Straits of Malacca. Participants also identified the importance of a stable Saudi Arabia, the world's largest oil producer, as a necessary condition to ensure market flexibility in case of major disruptions in world oil supply. In addition, participants pointed out that the weakness of the emergency governance of the world oil market remains problematic. Moreover, it was emphasized that the existence and expansion of western strategic oil stocks is a stark indicator that OECD countries themselves lack sufficient trust that the market will ensure adequate supplies in the event of a major supply disruption.

Furthermore, in contrast to general assumptions regarding the global oil market, some participants argued that a veritable oil market does not, in fact, exist. Roughly 40 percent of oil production is bound in long-term contracts and only the remaining 60 percent is actually traded on spot markets. In addition, it remains clear that in the long-run oil prices will continue to exceed the marginal costs of production and tendencies of restricting access and drilling licenses of additional private companies to new exploration projects will further exasperate gaps in efficiency, investment and, potentially, supply.

While the above issues certainly contribute to higher prices, some participants maintained that the market itself is not likely to disappear nor would the costly challenge of resource nationalism fundamentally transform the existing system. Despite imperfections, it was argued, the positive relationship between the oil market and security of supply remains inextricably linked. Integrating fully into the existing market can better help countries to respond to unexpected short term supply disruptions. Good examples of this include the response to Hurricane Katrina and the 2002/2003 strike in Venezuela which were mitigated by reliance on the open oil market. Following that, one could argue that precisely because the oil market is of such high strategic relevance, governments should not intervene and should rather be left to market forces. The freer the oil import regime, the more rapidly players can adapt to crises and effectively overcome them. Moreover, any form of price control would be detrimental and would potentially harm consumers, as illustrated by long lines at gasoline stations during the 1973/1974 oil crisis.

## **2.2 Energy strategies in China and India**

A good understanding of the impact of rising demand for energy from China and India on the institutions and mechanisms of global energy governance needs to be based on a thorough appreciation of the fundamentals of energy markets and strategic energy policy in both these countries.

### **China's domestic energy markets and the need for rising imports**

Experts on Chinese energy policy pointed out that the two dominant sources of China's energy consumption in 2004 were coal (66 percent) and oil (24 percent) while gas made up only 3 percent. Due to limited domestic oil resources, China faces a tremendous gap to fuel its current oil demand and policy makers are desperately scrambling to meet growing oil import needs. Figures for 2006 estimate China's total oil consumption at around 7 million barrels per day. In addition, to somehow mitigate vulnerability towards high oil market prices, Beijing has made an effort to enlarge its domestic nuclear energy production. Nevertheless, China's import portfolio is still highly diversified, though the fraction of oil from Saudi-Arabia, Russia, and Iran has increased over the last few years.

A main issue of concern revolves around the development of Chinese National Oil Companies (NOCs) and the odds that their engagement overseas, together with the gradual market liberation in China, would result in an enlarged role of the market in the Chinese Energy Sector. Some voices have noted the dilemma of China's NOCs striving for both market engagement and preferential treatment, for instance, by support through cheap loans from domestic state banks. Furthermore, due to their historic evolution from Chinese ministries, most Chinese NOCs are headed by former officials appointed by the Beijing ruling elite who are dedicated to maintaining state control over the oil companies. In addition, while subsidiaries of some Chinese NOCs are publicly listed, government control over the parent company remains firm and major engagements need approval by the government. As a major stakeholder, it controls the NOCs' financial resources. As a result, Chinese NOCs operate, at most, in a partly market-based environment.

Lastly, it was noted that while overseas engagements by major Western energy companies such as Shell, BP, or Exxon Mobil are rarely considered to be primarily motivated by their “home” countries’ supply needs, this motive is consistently ascribed to the Chinese. In reality, however, most Chinese oil produced out of equity investments abroad is also sold abroad rather than shipped to China. By one estimate, more than 90% of “equity oil” has been sold internationally in recent years.

### **The energy market, import priorities and governance in India**

India also has an energy-intensive growth paradigm that has witnessed 6.0-6.5 percent growth of GDP over the last 25 years. The Indian economy is fueled primarily by hydrocarbons, accounting for roughly 40 percent of commercial energy demand. The transportation sector has seen an 8-9 percent growth in 4-wheeled traffic and a 12 percent growth in 2-wheeled traffic which contributes highly to India’s import intensive policy that includes about 2.4 million barrels of daily consumption, three-fourths of which are imported, and a USD 43 billion energy bill in 2005 which undercut roughly 40 percent of export earnings. Approximately 68 percent of Indian oil and virtually 100 percent of its natural gas comes from the Middle East.

In addition, it is important to note that the energy sector in India is administered by five different ministries, including a full-fledged ministry dedicated to the production of energy from renewable energy sources. However, India has liberalized its petroleum industry and 100-percent foreign ownership of extraction and refining is now possible, although minimum investment costs remain quite high and the amount of investment has been relatively small despite the active encouragement of private sector participation in the market. The general industry feeling is that not much more oil will be found in India, but the discovery of additional gas reserves remains a possibility. Overall, the experts present agreed that India’s energy strategy is poorly coordinated.

## **2.3 Implications for global energy markets**

Despite the numerous internal weaknesses surrounding both Chinese and Indian energy policies, there was broad agreement among participants that their effect on global energy markets has become profound, especially in the context of not only finding new sources of supply to accommodate the rapid increase in demand, but also securing proper levels of investment.

In this respect, the rise of oil and natural gas prices has, in fact, been accompanied by annual double digit increases of Exploration and Development (E&D) budgets of oil companies; some participants noted, therefore, that the general notion of an existing problem of under-investment is no longer correct. Rather, it was argued that the underlying problem today is that service industries are over-stretched. For example, the fabrication of LNG ships currently includes a waiting time of about 10 years. In addition, the visible trend of resource nationalism not only drives up prices, but also makes projects for foreign investors more complex, as foreign upstream investment is increasingly hard to achieve in times of growing domestic government control. Therefore, finding creative financing instruments for the huge investment needs will be of major importance in the future.

But participants also pointed out that oil demand will continue to rise faster than future supply. Since the most accessible and prospective oil areas have already been explored, one key future supply-side challenge will be to increase the recovery factor in mature areas. Moreover, oil companies face exorbitant prices for their equipment coupled with a rather dramatic lack of skilled personnel, further exasperating the situation. Lastly, some participants noted that there is a perceived degree of increasing mutual interdependence between China and India as a demand heartland on one hand and the Middle East supply on the other. This could play a large role in the future as the oil-exclusive economies of the Middle East require new clients as western countries try to diversify away.

While the internal and external energy policies of China and India vary on a number of different levels, the above symptoms have created similar response mechanisms in respect to energy security. Active oil diplomacy and the forging of strategic partnerships, financing for national energy companies, soft loans and aid tied to infrastructure projects in supplier communities, and particularly in the case of China, cross-investment for preferential supply access and “influence exhibitions” in the UN Security Council are observable and create a number of issues. First, the situation heightens already existing uncertainties in the global oil market and further instigates geopolitical tension. Second, they weaken the efforts of the West to promote transparency and accountability. Lastly, the economic growth and corresponding increase in energy consumption in China and India further exasperates the pressing need for combating climate change trends.

However, while it is often easier to paint negative pictures of the operability of oil markets, especially when taking into account the prospective consequences of China’s and India’s economic growth and energy consumption, the often observed phenomenon of “resource nationalism” can also be perceived as a normal way to ensure energy security. Western powers have done the same for much of the 19<sup>th</sup> and 20<sup>th</sup> centuries and it would be hypocritical to condemn China and India for wanting to secure upstream investments. In addition, while recent trends of resource nationalization might threaten the commercial prospects of the international oil majors, some participants noted that supplier countries with nationalized oil industries have acknowledged that their own economic security depends on a stable market in energy resources.

## **2.4 Challenges for global oil market governance and transatlantic policy options**

The market developments discussed in the previous section must also be considered with respect to the institutions with a mandate to govern global energy markets, particularly the international market for oil. The Organization of the Petroleum Export Countries (OPEC), an oil producer’s club founded in 1960, is a product of the decolonization era. Its objective is to coordinate and unify oil policies among its member countries in order to secure “fair and stable prices” for petroleum producers on the global market. The International Energy Agency (IEA), on the other hand, exists as the OECD’s oil consumer’s club and was a product of the oil crisis in 1973. Considering to what extent these institutions are capable of adapting to the new realities of the global energy market, conference discussions focused primarily on consumer collaboration in the IEA.

## **The changing energy environment and challenges for the IEA**

Beyond its original role to further the energy supply-related interests of its members, the IEA has been taking a more comprehensive approach through its International Energy Program (IEP). The program conducts research on fuels like coal and gas and has recently shed some light on formerly more neglected issues such as environmental aspects and energy efficiency. In this respect, the IEA of today is far more advanced than only an oil consumer's club.

However, many participants highlighted various shortcomings of the IEA and argued that the organization will be required to adapt itself if it is to maintain a functional role, especially in light of the challenges discussed above. For instance, the IEA tends to overestimate production figures and underestimate demand. Despite efforts of the IEA and the International Energy Forum Secretariat (IEFS) to establish a Joint Oil Data Initiative, accumulating comprehensive and accurate demand figures to better adjust supply remains elusive.

Furthermore, the high reluctance within the IEA to enlarge membership – for example to include major new consumers such as India and China – is problematic due to the fact that this would require sharing data with any new members. Additionally, while the current limited membership includes 26 nations, the IEA requires cooperation with a wide range of non-member countries to ensure the accuracy and comprehensiveness of their energy statistics. Furthermore, as a non-profit organization, the IEA is dependent on the revenues of its publication. For this reason, the range of freely accessible publications has to be limited to publications more than two years old.

In addition to inconsistencies in data compilation and sharing, it is also important to note some of the fundamental institutional flaws of existing governance mechanisms within the IEA. Voting shares in the IEA are based on 1974 GDP ratios, hence, there are no voting shares for potential newcomers. At the same time, voting shares of the US (45 percent) exceed the veto margin in the IEA (41 percent). While the question of an IEA membership outreach has gained considerable attention during the past few years, the question of how this outreach should actually happen still needs further inquiry.

However, there does appear to be an interest in China and India to collaborate with the IEA on strategic stocks and the ongoing debate is mainly concentrated on reasons why the IEA should enlarge its group of members. In this respect, it is worthwhile to focus on whether China and India have fulfilled the necessary preconditions for IEA membership and the question of whether these countries have the political willingness as well as the administrative structures and financial resources to fulfill IEA membership obligations is essential. Especially with regard to India, participants voiced concern that the country is unable to effectively participate in IEA work because of a lack of coherent domestic energy institutions. At the very least, the highly selective structure of IEA membership should not inhibit entering into a close dialogue with both China and India.

On the other hand, some participants voiced more fundamental skepticism and questioned whether the global oil market really needs governance at all. They argued that the existing global oil market is a well-functioning and sufficient governance mechanism. In simultaneously coordinating millions of consumer and producer decisions by price signals,

the market fulfils a critical function; duplicating or managing this kind of mechanism by any form of centralized government is difficult or perhaps even unfeasible. It is in the industries' best interest to focus on putting up transparent and predictable framework conditions to ensure sufficient investment. Overall, the involvement of the international energy industry is paramount to secure necessary developments, both in technological breakthroughs or in risky investments and in this respect the role of energy governance institutions is still ambiguous.

### **Transatlantic strategies for global energy governance**

The challenges facing the transatlantic community are numerous. However, the effectiveness of any course of action hinges mainly on effective cooperation and depends on the availability of accurate analyses of both the internal energy policies of China and India as well as the development of global energy markets in general. World spare production capacity of oil has become dangerously low and, traditionally, OPEC has paid for spare capacity and thus provided security of supply (which it no longer does). At the same time there will be “no new North Sea” bailing out western consumer countries and the strategic value of oil is affecting the way the West perceives China and India, namely as competitors. Moreover, Chinese acquisitions are seen as more of a threat than those of other countries because perceptions of China are different. Due to India's government and political system (it is the world's largest democracy) it is not perceived as much of a threat, at least not yet. Nevertheless, it is important to realize what exactly the transatlantic community is threatened by: Is it climate change policies or governance mechanisms in supplier countries? Or that China and India will develop very powerful companies that are state-backed and competing with “us” for resources?

Some have suggested that the inclusion of China and India in the IEA consumer's club would demonstrate reciprocity while continuing to encourage the leaders of Chinese and Indian NOCs, who are essentially “allies” to the West, to continue to look internationally and adopt a market-based regime autonomously from domestic government policy. In addition, the sharing and cooperative development of technology between the US, EU and emerging economies would promote both increased standards of energy production/consumption and the professed reliability of the market.

Above all, constructive dialogue between all parties is seen as essential in overcoming misunderstanding and disagreements that occur from a lack of (a) proper definitions and reliable data, (b) accurate interpretation of internal energy policies and (c) a long-term strategic plan. A true, continuous dialogue between producers and consumers can improve security of oil and gas supply and demand by taking China and India out of the “black box” and incorporating them into a constructive global energy framework.

### **3. Climate change: opportunities and challenges for a post-Kyoto climate regime**

As demand for energy increases, both China and India have naturally reverted to using the resource which both have in abundance: coal. India, as the third largest coal producer, currently holds roughly seven percent of all global reserves. In this respect, coal currently provides about 56 percent of India's commercial energy supply and will continue to be a major source in the future. China, on the other hand, is the world leader in burning coal, which accounts for 67 percent of China's primary energy consumption. High oil prices have led to an increase in the "carbonization" of energy production and energy use has grown faster than GDP in the last four years. In terms of electricity generation, the government has approved the construction of an additional capacity of approximately 50 gigawatts per year, a number that does not include the boom in the construction of illegal power plants. It is estimated that China will need roughly USD2.5 trillion over the next 25 years to finance its growing energy appetite.

Coupled with this pace of growth also comes an increasing level of carbon dioxide emissions. Within the next thirty years, greenhouse gas emissions from vehicles could rise 3.4 times in China and 5.8 times in India. It is also predicted that China will overtake the US in greenhouse gas emissions by 2009. In fact, effects are already visible. In China, 30 percent of the nation's land has been eroded and twenty Chinese cities are among the thirty most polluted cities in the world. In addition, air pollution and congestion will rise and will increasingly hamper the ability to move people and goods effectively. Particularly vulnerable sectors will include the agricultural and coastal fishing sectors as well as forest-dwelling communities who are extremely vulnerable to shifts in weather systems.

Such effects will be difficult to prevent unless major efforts are undertaken to bring Chinese and Indian energy production plants up to reasonable efficiency standards. It has been calculated that the technical potential to reduce emissions by 2020 range from 1 percent to 43 percent in China and from 4 percent to 45 percent in India, calculated relative to 2020 unabated emissions. The relatively large reduction potentials (43 percent for China and 45 percent for India) are projected for end-use efficiency improvement, replacement of coal by renewable energy and natural gas, as well as electrical efficiency improvement of power plants in both countries and the reduction of electricity losses during transmission and distribution.

However, looking ahead it is evident that coal will continue as the mainstay of power production in both China and India unless energy prices converge on actual calorific values. In addition, shifting to other fuels like gas and renewables will be difficult to achieve, specifically in China since federal government control over local governments in China is generally weak. Moreover, environmental authorities are weak as well, and, rather exceptionally, there is no energy ministry in China, which hampers the ability to effectively enforce mechanisms even if they were put in place. In the case of India, a lack of coordination among energy ministries has inhibited a coherent long-term policy on emissions reduction. In addition, India's nuclear agreement with the US has the potential to meet India's medium- to long-term energy needs by opening the door to nuclear investment, a

sector notorious for large, prohibitive up-front costs. However, many critics charge that the agreement is superficial and is fundamentally a weapons deal in civilian guise.

### **3.1 Recommendations for China and India**

So what can be done? In the case of India, recommendations highlighted by participants include: promoting a boost in biofuels and natural gas, effective energy efficiency measures, active promotion of solar, wind and hydroelectric power (through the responsible ministry) and continued development of these renewables with effective policy measures. While India currently ranks fifth in the world for wind energy production, it must be noted that wind power generation is 100 percent subsidized, thus leading to skewed figures and overall unsustainability. Therefore, a functioning market in renewables would be highly beneficial. Additionally, trapped in a situation of coal endowment, India needs to proceed with effective measures to reduce emissions resulting from coal exploitation.

China, on the other hand, does in fact have rather ambitious efficiency goals and emissions targets, for example the target of creating 12 percent of its power generation capacity from renewables by 2020. The challenge is meeting these goals, which seems unlikely without effective enforcement mechanisms. Nevertheless, China should promote a policy that decouples economic growth from energy use and provides reliable and transparent data.

In this respect, a number of specific steps can be taken to reduce the possibility of serious consequences related to climate change in the future: Funding for environmental education programs, public awareness and advocacy campaigns, government funds to promote new technologies, directing foreign investment towards clean technologies through the removal of market barriers and the provision of low-cost loans. In addition, policy mechanisms should be put in place such as enforcement of efficiency standards, the establishment of fair and predictable pricing, creating price incentives for fuel-switching and the creation of long-term policies for sustainable transport, grid connections and distribution of renewable energies.

However, for much of this to take place, strengthened governance institutions and implementation capacities must be put in place in conjunction with the formation of independent regulatory agencies and data transparency. On a general level, recommendations include the formation of competent ministries in both China and India to address issues of energy security and climate change in a manner that couples both issues into one unified policy. At the same time, a legitimate pricing structure needs to be implemented before any institutional changes can be expected to take place.

### **3.2 Transatlantic climate change strategies**

The issue of climate change is international in scope and the environmental and economic costs could be high without concerted action. The rise of China and India and their consequences for climate change further heightens the pressure to act. However, because the sources of pollution tend to be distant from the effects, coupled with the assumption that these effects will only manifest themselves in the distant future, the issue has remained touchy. Nevertheless, we are aware of what needs to be done to achieve the desired solution, but questions remain as to how go about doing it.

Cooperation between the EU and the US on issues of climate change is essential, though up until now effective collaborative efforts have previously been hindered by hard-line US opposition. However, recent developments have placed the US climate change agenda at a crossroads. While US states increasingly implement unilateral emissions caps and large corporations compose their own strategies, a federal policy is still lacking and the role of the newly elected democratic congress, while encouraging, remains uncertain.

To begin, a number of different possibilities have the potential for combating climate change on an international level, such as soft loan programs, subsidy and promotion schemes from International Finance Institutions, the Global Environment Facility (GEF), renewable energy programs, emissions trading schemes and carbon financing, to name a few. China and India, however, can not reasonably be expected to adopt ambitious emissions measures if two of the largest polluters (the US and Australia) are not participating.

In addition, Europe's role must be consolidated into a single voice with a common agenda, as opposed to differing EU member state interactions with China and India. The EU should also focus on helping China and India realize existing goals and not continue to push further demands. In addition, while intellectual property concerns remain a sensitive issue regarding the exchange of technology, it is also important to understand that China and India are not as much insistent on charity as they are on productive technological cooperation.

While widespread cooperation between the EU, US and other industrialized countries regarding climate change strategies should be pursued, the role of international governance institutions should also be considered. First, it is essential that governance institutions couple energy production issues with strategies of mitigating climate change. It is evident that while the Kyoto protocol and EU Emissions Trading Scheme are a good first step toward combating climate change, these mechanisms are not nearly enough to make a significant impact. In addition, while China and India currently dominate the Clean Development Mechanism market, the CDM is measured by a double standard and overall has very little actual impact despite being an important step in formulating a more effective and encompassing future policy. A post-Kyoto (post-2012) regime is a critical issue and one of the main challenges is to integrate China and India (as well as the US) into these compliance regimes. However, there is reluctance on the part of Chinese and Indian policymakers to send signals that would suggest the willingness to adopt emission reduction targets.

Regardless, any future energy governance and climate change outreach must not be governed by a "one-size-fits-all" approach, but should rather be tailored towards individual countries needs. It should also include cooperation with the business community and multilateral organizations relevant in the respective areas such as the Association of Southeast Asian Nations (ASEAN). A potential shift in the development paradigm could add another perspective to the current debate by integrating discussions on development policy with that of energy governance and climate change strategies.

## **4. Challenges for good governance in Africa and the record of transparency initiatives**

Rising energy demand from China and India also has consequences for good governance efforts in Africa. Participants pointed out that China and India have in recent years started to go head-to-head in competing for African energy resources. China, however, has thus far exhibited the more aggressive strategy, frequently overbidding for stakes in African oil and gas fields. In addition, Chinese (and in some respects Indian) disregard for transparency, development or stability in supply countries emphasizes not only a mercantilist strategy, but also a stark reminder that China and India are late in the game and “rogue” countries that the West avoid for political reasons are an attractive, if not the only, option for securing adequate resources.

However, it was also pointed out that governance problems in Africa are not new. Looking back at the history of oil development in Africa, prospecting and production began at the beginning of the 20<sup>th</sup> Century. By the 1950s, Angola and Nigeria were already world class producers. Dependence on western oil companies deepened in the 1990s due their technological advantage, notably in new deep water off shore technologies. The key western actors (including Elf, Eni, Chevron, Exxon and Shell) maintained generally close ties with the African governments in a mutually beneficial network that brought together the local elites, oil companies and the governments of importing countries. Only in the 1990s, the issue of governance and corruption came to the fore as NGOs started looking at the implication of oil on local populations. Participants pointed out that corruption related to oil revenues didn't change existing structures, but rather aggravated existing pathologies such as bad institutions, self serving leadership and undiversified economies. The contribution of the resource curse to these pathologies in Africa should therefore not be overstated.

Since 2002, initiatives such as Publish What You Pay and the Extracting Industries Transparency Initiative (EITI) have begun to address corruption, human rights violations and other negative consequences of oil extraction in Africa on a much wider level. In addition, after considerable NGO lobbying, the World Bank started to link financing to governance issues. However, these initiatives were not enough to make all Western oil companies change their business practices.

Therefore, when looking at Chinese and Indian activities in the region, many of the problematic issues often underlined today by Western observers are no more than the insertion of these countries into a political and business landscape that is largely predefined.

### **4.1 China in Africa**

China's competitive advantage is that it is willing to engage in unstable countries, which jeopardizes Western efforts to promote good governance. For example, while it appears that Chinese diplomacy is attempting to adopt a more proactive stance on the Darfur issue, commercial activities have been maintained and are even being accelerated by the Chinese NOCs. However, participants pointed out that Western countries maintain similar

partnerships, for example in Equatorial Guinea, therefore criticism of China's Sudanese stance should be limited.

Angola and Zimbabwe are two further problematic cases. In both countries, Chinese partnership provides a lifeline to these regimes and exacerbates the situation by strengthening the local elites. Chinese "package deals" such as investments in infrastructure, aid and construction of big projects linked to the extraction industry remain highly symbolic and are underpinned by political reasoning, but the question is will they actually bring China commercial reward?

China is engaged in a wide variety of industries, not just the extractive industries, but its impact is felt mainly in labor intensive industries. In this respect, the key relationship to maintain in order to gain access to industries remains with the African decision-makers and elites, and in this, the Chinese have been successful. However, the issue still remains of whether China can meet growing popular African pressure against the flooding of African markets with both Chinese goods and labor.

Some participants argued that Chinese investments do not improve the situation in Africa, but neither do they lead to new or greater erosion of business practices on the continent. Furthermore, in the current situation of high oil prices and tight global energy supply, it may be exceptionally difficult to address the situation in African producer states because of the inability of Western consumer countries to exert pressure. Moreover, it is difficult to uphold the conditionality of financial aid when investors are not all attached to good governance, especially when it is in everyone's interest to keep resources flowing. Chinese "no-strings attached" investments are more favorable to African decision-makers than the generally smaller and more conditional loans from the World Bank.

## **4.2 The role of EITI**

The Extractive Industries Transparency Initiative (EITI) was launched in September 2002 at the World Summit on Sustainable Development in Johannesburg. The main goal of EITI is to improve governance in resource-rich countries through the verification and full publication of company payments and government revenues from extractive industries, namely oil, gas, and mining. In order to promote economic growth and poverty reduction, the Initiative works to build multi-stakeholder partnerships in developing countries to increase the accountability of governments and improve transparency. In this respect, EITI aims to avoid the so-called "resource curse" of resource rich countries.

Since its launch, EITI has generated some significant achievements. Thus far, twenty-one governments of resource-rich countries in Africa, Asia and Latin America have joined the initiative and many of the necessary guidelines, criteria and governance structures have been formulated. In addition, awareness of the importance of transparency, accountability and multi-stakeholder interaction in the extractive industries has improved and has laid the foundation for future progress.

However, a number of problems exist that must be addressed for EITI to have any worthwhile and lasting impact on revenue transparency and good governance in resource-rich countries. The main problem is lack of implementation. EITI today is often seen to represent

a free-rider problem where many countries or companies who participate want to gain the reputational or political benefits without changing their practices. Moreover, country-level leadership to effectively push EITI goals is lacking in most cases. While a validation system to counteract this problem was approved at the EITI meeting in Norway in October 2006, it remains to be seen how effective this will be in pushing full-fledged implementation.

Thus far, only Nigeria and Azerbaijan are considered compliant as they are the only ones to have fully reported and audited their accounts. Countries such as Ghana and Botswana have shown progress and EITI is seeking to expand into Latin American states such as Peru and Bolivia. It has been much easier to bring the least developed countries into EITI because of the value of reputation with regard to aid conditionality, however, the question remains how to involve China and India, or more generally, how to bring more middle-income countries on board. In this respect, there is still a long way to go to succeed in getting the top tier of Middle East oil producers involved in transparency regimes.

The current work done by EITI is only the first step in addressing the problem of resource consumption. The knowledge of how much money the government is receiving from resources is the necessary first step to beginning a debate on how those resources should be used. The next step would be to create a protected space for civil society to talk with the governments about revenues.

### **4.3 Strategies for good governance in Africa**

So where do we stand? Are China and India really a threat to good governance in Africa and initiatives such as EITI? On one hand, participants argued that over time Chinese and Indian companies that do business in Africa will be much more prone to reputational risks as they increasingly compete with established western players. With trends towards increasing internationalization, some argued, further interaction with other players in the oil industry is likely to lead to more familiarization with social responsibility and appeal to them on the issues of image and diplomacy.

On the other hand, this is not where we are today. Chinese companies are still 90 percent state-owned. If the Chinese accept to play on the Western-defined playing field, they lose their competitive advantage which is based upon three factors which distinguish them from other companies: an uncritical view towards corruption, package deals with host countries (including preferential loans and/or security cooperation) and a willingness to go places the West will no longer go.

The key challenge for advocates of good governance is therefore to convince China and India that investing in stable countries is more lucrative in the long-term. In this respect, transatlantic policies should focus on further improving the effectiveness and implementation of initiatives such as EITI and bringing China and India on board. At the same time, the West needs to realize that China's and India's "late start" in securing energy resources inevitably leads them to countries scorned by the West for political reasons. With this in mind, a mid- to long-term transatlantic strategy for promoting Chinese and Indian good governance compliance in Africa is more realistic than expecting immediate change.

## 5 Conclusion

The 1st Transatlantic Energy Security Dialogue emphasized that the rise of "new consumers", namely China and India, is fundamentally transforming the global energy landscape. The discussions in Potsdam clearly highlighted the need for the transatlantic alliance to work in partnership with China and India to adapt and modernize the existing institutions and mechanisms of global energy governance so as to close emerging gaps. That includes, among other things:

- transforming existing mechanisms for consumer coordination - most notably the IEA - to accommodate the increasing significance of India and China
- including the new consumers in a dialogue on "good governance" in Africa and to provide initiatives such as EITI with more teeth
- a systematic and consistent attempt to bring in India and China into a post-Kyoto action strategy to tackle climate change.

In addition to political action and leadership, there is also a need for more thorough, policy-oriented research. With regard to consumer coordination in energy markets, there is a need to further examine:

- the role of the IEA and to develop a functional framework for adapting to the changing energy environment. Should China and India be brought in? What preconditions should they fulfill? What role should they play in consumer-producer forums such as the IEF?
- the development paradigms of China and India need to be examined more thoroughly within the context of the good governance debate, especially as to how these may clash with the existing efforts of established donors but also the extent to which they can contribute to positive development and poverty reduction in Africa.
- the potential of technology sharing and cooperation with the aim of maximizing both the efficiency of China and India's power production and minimizing the damaging effects of carbon emissions in order to combat climate change.

GPPi is committed to pursuing this important research agenda in the months and years ahead. We believe there is an urgent need to look at global energy governance in a more comprehensive fashion. Traditional conceptions of global energy security often focus on narrow analysis of supply and demand, defining energy security as the reliable supply of energy at a reasonable cost. This remains a concise, but dangerous and short-sighted definition. We believe that the concept of energy security has to be increasingly understood in a more comprehensive fashion. As such, the conception of "reasonable cost" to the energy consumers should not only include the actual market price being paid, but also external costs such as environmental costs (e.g. climate change), societal costs (e.g. social impacts of oil extraction in producer countries), or security costs (e.g. costs for protection of transportation routes).

This is an ambitious and demanding agenda and it requires rethinking of many deeply held beliefs and practices. The linking of previously non-linked issues and actors is necessary to address the issues of energy security, climate change and energy market governance in a concerted manner. Only in this way can we develop effective and sustainable solutions to contemporary and future energy challenges.

## Annex I: Conference Program

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### DAY 1: THU, 18 JANUARY

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**12:00pm**      **Arrival and Registration**

**12:30pm**      **Lunch**

**02:00pm**      **Welcome**

- *Jörg Himmelreich, Senior Transatlantic Fellow, German Marshall Fund of the United States*
- *Jan Martin Witte, Associate Director, Global Public Policy Institute*

**02:30pm**      **OPENING SPEECH & PANEL DISCUSSION**  
***Old rules, new players: Why the interests of emerging economies clash with the established rules of the game***

Speaker: *Flynt Leverett, Senior Fellow and Director, Geopolitics of Energy Initiative, New America Foundation*

Further panelists:

- *Jean Laherrère, Independent Consultant and Deputy Director of Exploration, TOTAL S.A., retired*
- *Markus Ederer, Head of Planning Staff, German Foreign Office*

**Q&A**

**04:00pm**      **Coffee Break**

**04:30pm**      **WORKING GROUP SESSION (I)**

***Asia's rising import needs: Domestic pressures and foreign policy implications***

The first set of working groups will discuss the current energy policies of India and China. Two working groups will examine both countries' domestic policy options while a third will explore the record of both countries' upstream acquisitions: Which energy choices are China and India confronted with? Why do they pursue sometimes aggressive or mercantilist foreign energy policies? How effective are these policies in securing their stated goals, i.e. in increasing security of supply for China and India?

- **WORKING GROUP A**

***Hard choices: The energy mix in China and resulting foreign policy priorities***

To examine China's energy policy options, it is useful to first look into the structure of its existing domestic fossil resources, evolving patterns of consumption, as well as the larger political constraints that make the smooth supply of energy a critical priority for the Chinese political leadership. In this context, the working group will discuss the relative merits of various sources of energy and Chinese interests toward the

governance frameworks for global and regional energy markets.

Introduction: *Janet Xuanli Liao, Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee*

- **WORKING GROUP B**

***The energy market in India: Domestic conditions, import needs and challenges for the security of supply***

Taking the country's scarce oil and gas resources as a starting point, this working group will discuss India's evolving pattern of consumption and the state of deregulation in domestic energy markets. What is the structure and scale of India's energy needs in the coming decades? What is the state of its domestic energy infrastructure, in particular in terms of investment to tap into the large coal reserves? Which problems and tensions limit energy imports? How does nuclear energy fit in, given the strategic nuclear partnership with the US?

Introduction: *Sudha Mahalingam, Senior Research Fellow, Centre for Policy Research, New Delhi*

- **WORKING GROUP C**

***The race for upstream acquisitions: How does it affect security of supply?***

Looking into the political economy of Chinese and Indian equity acquisitions in foreign oil and gas fields, this working group will discuss the strategy's cost-benefit structure to identify its rationale and track record. Why are Chinese companies often overpaying for oil fields? What benefit are China and India expecting from their security of supply? What effect does the increasing role of international partners in oil joint-ventures have on these expectations?

Introduction:

- *Llewelyn Hughes, Center for International Studies, Massachusetts Institute of Technology*
- *Thomas Geisel, Director Gas Supplies North, E.ON Ruhrgas AG*

**05:30pm Presentation of Working Group Results & Discussion**

Moderated by *Jan Martin Witte*

**06:00pm Break**

**06:30pm Dinner**

**09:00pm Night Cap**

***Changes in the world energy market and challenges for the future***

Speaker: *António Costa Silva, Chairman of the Management Commission, PARTEX Oil & Gas*

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**DAY 2: FRI, 19 JANUARY**

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09:00am

## WORKING GROUP SESSION (II)

### **International consequences of the new ‘resource scramble’**

The new importers’ energy hunger and their neomercantilist strategies have crucial consequences for global governance in a number of areas, including good governance in supplier countries, most crucially in Africa; rapidly rising greenhouse emissions, as well as continued under-investment into the expansion of production. The working groups in this session provide a forum to discuss some of the problems that we are confronted with. These working groups will provide the basis for a discussion of policy options during the next session.

- **WORKING GROUP A**

#### ***African oil states, corruption and economic development***

China’s equity investments in African oil states such as Sudan, Angola and Nigeria provide these regimes with a way to bypass Western conditionality. Mindful of the link of such developments to regional and global security, this working group will focus on the domestic effects on the ground. How do oil exports promoting corruption and underdevelopment in Africa? How does the “China factor” relate to other sources of bad governance in the states affected?

Introduction: *Ricardo Soares de Oliveira, Fellow, Global Public Policy Institute and Research Fellow, Sidney Sussex College, Cambridge University*

- **WORKING GROUP B**

#### ***Commerce and climate: How to promote low-carbon growth in emerging economies?***

China’s and India’s rapid economic growth comes with unsustainable levels of carbon emissions. Given the level of poverty and inequality in both countries, any ‘solution’ that would slow down economic expansion is not an option for their governments. What domestic institutional changes would be necessary to promote energy conservation and low-carbon technologies? How can the international community encourage the reduction of greenhouse emissions (e.g. through investment, technology transfer)?

Introduction: *Charlotte Streck, Vice Chairwoman, Global Public Policy Institute and Director, ClimateFocus B.V.*

- **WORKING GROUP C**

#### ***Why is supply not keeping pace with demand? Sources of the investment gap in fossil fuels***

While the investment problem in oil and gas production is not new, the rapid increase in demand from emerging economies has made it much more urgent for consumers. What respective role do the lack of information in markets, substitution strategies to ‘break the oil addiction’,

the lack of expertise on the parts of national oil companies and the political interests of producer governments play for the investment gap? How effective are existing producer-consumer institutions like the *International Energy Forum* in enabling more investment?  
Introduction: *Harry Aas, Director, Hydro Oil & Energy*

**10:00am Presentation of Working Group Results & Discussion**

Moderated by *Jan Martin Witte*

**10:30am Coffee Break**

**11:00am PANEL DISCUSSION**

***Institutional gaps and remedies in the current governance of global oil markets***

Panelists:

- *Dagmar Graczyk, Manager for South Asia, Office of Non-Member Countries, International Energy Agency*
- *Pierre Noël, Research Fellow, Judge Business School, University of Cambridge*
- *Gregory Austin, Director for Policy Innovation and Acting Director, Global Security Program, East-West Institute*

**Q&A**

**12:30pm Lunch**

***Germany's G8 agenda: Development cooperation and the African resource scramble***

Speaker: *Manfred Konukiewicz, Director, Global and Sectoral Tasks, German Ministry of Economic Cooperation and Development*

**02:00pm WORKING GROUP SESSION (III)**

**The agenda for the US, Europe and global public policy**

Falling back on traditional unilateral strategies or the illusion of “energy independence” is no solution for the challenges ahead, in particular for resource-poor countries in Europe. What other options are available? Looking into three specific issues – the ‘resource curse’, climate change and cooperation among importing countries in the oil market – the final working groups will discuss institutional solutions to some of the key problems examined in the previous session. The goal of the working groups is to develop a set of concrete policy recommendations for the European and US governments, the European Union or the Group of Eight to reshape the framework for global energy governance.

- **WORKING GROUP A**  
***Banning the resource curse? The role of transparency initiatives***  
Multi-stakeholder initiatives such as the *Extractive Industries Transparency Initiative* (EITI) have been launched with the intent to undercut opportunities for corruption and the misuse of funds in resource-

rich developing countries by increasing transparency and therefore accountability for the revenues from resource exploitation. What are the implications of increasing investment of Chinese and Indian companies – many of which are state-owned – for voluntary initiatives such as the EITI? How can voluntary instruments be developed further to adapt to such challenges?

Introduction: *Diarmid O’Sullivan, Oil Campaign, Global Witness*

- **WORKING GROUP B**

***Matching security of supply with a post-Kyoto greenhouse regime?***

With the end of the Kyoto commitment period in 2012 looming, the world is facing the daunting challenge to bring together the energy security imperatives of emerging economies with the equally pressing needs of climate protection. What role can the EU, the US, emerging economies, as well as business play in the development of a successful post-Kyoto and long-term sustainability regime? How can emerging economies, specifically India and China, be persuaded to participate?

Introduction: *Jennifer Morgan, Climate Change Programme Director, E3G*

- **WORKING GROUP C**

***Oil market governance: How to get the new consumers on board?***

Initially set up as one response to the 1973 oil shock, the *International Energy Agency* (IEA) is an institution of the OECD world. As such, it no longer adequately represents all important oil importers. Both to increase confidence among consumer countries and to effectively pursue common interests vis-à-vis exporters, the US and Europe need to work together with China and India. How can the network of governance institutions be changed to bring them back into the system? What can the US and the EU put on the table to facilitate such institutional adjustment?

Introduction: *Enno Harks, Senior Expert, Energy and Resources, German Institute for International and Security Affairs (SWP)*

**03:00pm Presentation of Working Group Results & Discussion**

Moderated by *Jan Martin Witte*

**03:30pm CONCLUDING DISCUSSION**

***Where to go from here for our transatlantic strategic community?***

Moderated by *Jan Martin Witte*

**04:15pm Farewell**

## **Annex II: Participant Contact Information**

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## Annex III: Organizer Information

### The Global Public Policy Institute

The Global Public Policy Institute (GPPi) is an independent think tank based in Berlin and Geneva. Our mission is to develop innovative strategies for effective and accountable governance and to achieve lasting impact at the interface of the public sector, business and civil society through research, consulting and debate.

#### *Our approach:*

- **We are an independent and non-profit institute.** We receive project funding from foundations as well as our project partners and clients from the public and private sectors. We re-invest profits from consulting activities into our research work.
- **We build bridges between research and practice.** Our international team combines research and public policy expertise with management consulting skills. We foster the exchange of knowledge and experience between researchers and practitioners.
- **We promote policy entrepreneurship.** Our work strengthens strategic communities around pressing policy challenges by bringing together the public sector, civil society and business.

### The German Marshall Fund of the United States

The German Marshall Fund of the United States (GMF) is a nonpartisan American public policy and grantmaking institution dedicated to promoting greater cooperation and understanding between the United States and Europe.

GMF does this by supporting individuals and institutions working on transatlantic issues, by convening leaders to discuss the most pressing transatlantic themes, and by examining ways in which transatlantic cooperation can address a variety of global policy challenges. In addition, GMF supports a number of initiatives to strengthen democracies.

Founded in 1972 through a gift from Germany as a permanent memorial to Marshall Plan assistance, GMF maintains a strong presence on both sides of the Atlantic. In addition to its headquarters in Washington, DC, GMF has six offices in Europe: Berlin, Bratislava, Paris, Brussels, Belgrade, and Ankara.

# Acknowledgments

First and foremost, we would like to thank the German Marshall Fund of the United States (GMF) and E.ON Ruhrgas for their generous financial support.

We would also like to thank all the participants for helping to make the 1<sup>st</sup> “Transatlantic Energy Security Dialogues” conference a success. In addition, we would like to kindly thank the speakers as well as those participants who acted as group moderators and kept discussions on track. Lastly, a special thanks to the rapporteurs (Michael Dempsey, Andreas Goldthau, Michal Meidan, Amber Poroznuk) without whom this conference report could not have been possible.