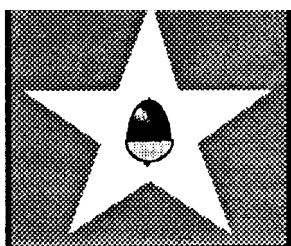


Conflict Studies Research Centre

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Russia's Energy Diplomacy

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Particularly in Europe Russia's importance as an energy supplier could enable her to make concrete her aspirations to be, and to be recognised as, a great power in the international arena.

In recent years the Russian leadership became increasingly aware of the importance of energy as a factor in Russian foreign policy. In May 2001, Foreign Minister Igor Ivanov called for closer government support for Russian energy companies. He said that the Russian leadership was paying exceptional attention to the advancement of the energy sector and, in a broader sense, to the strengthening of Russia's energy security and its role as a great energy power. An Institute for the fuel and energy complex was set up at Moscow's prestigious foreign policy body, MGIMO, in 2000, so highlighting the increased importance that the energy factor was now playing in Russian foreign policy thinking. The Institute (MITEK) was set up in order to provide Russian oil companies with the necessary specialists in the fields of international law, world economy, finances and management, so that these companies can effectively defend their interests in forums such as OPEC, the International Energy Agency IEA, and the International Association of oil and gas producers. Ivanov said that in addition to MITEK, a centre for strategic studies and geopolitics will be created. Ivanov commented: "We hope that these two structures will make interaction between diplomatic missions and major Russian companies abroad even more effective".¹

It is highly likely that this importance will increase following the launch of the anti-terrorist operation by the USA in September 2001. Putin said in Germany on 26 September 2001, that faced with the possibility of a war against terrorism, Europe might find itself short of energy carriers. He went on to say that Russia is ready to support Europe during these times with its energy supplies and "Russia is keen to develop further its cooperation with Europe as far as Europe's energy security is concerned."²

Russia is important to world energy markets as she holds the world's largest natural gas reserves, the second largest coal reserves and the eighth largest oil reserves. She is the world's largest exporter of natural gas, and the second largest oil exporter (after Saudi Arabia). She is also the world's second largest energy consumer. If oil and gas exports are added together, Russia is the world's largest energy exporter. Energy accounts for 40 per cent of Russia's exports and 13 per cent of GDP.³

Oil

In the 1990s oil production declined, but has been rising since 1998, when Russia's oil production stood at 6.07 million barrels per day (bbl/d). It increased to 6.71 million in 2000 and was projected to increase to 7.12 million bbl/d in 2001. In 2000 Russia's new oil exports were 4.37 million bbl/d. Of this total, 3.8 million bbl/d went to countries outside the former Soviet Union. Russia has estimated oil reserves of 49-55 billion barrels. Russia is not a member of OPEC, but has in recent years attempted to coordinate its export strategy with OPEC. However in 2001 Russia increased production whilst OPEC cut it.⁴

Russia's export capacity is hindered by limited pipeline capacity. Transneft, the state oil transport monopoly, has taken steps to modernize the pipeline system. The Baltic Pipeline System has been completed and there is interest in building a pipeline to China. Transneft is also interested in acquiring oil from Kazakhstan and Azerbaijan to transit Russia.

Gas

Russia has the world's largest supply of natural gas, with over 1,700 trillion cubic feet (tcf) in proven reserves. Gazprom produces nearly 94 per cent of Russia's natural gas, operates a 90,000 mile pipeline grid and holds nearly one-third of the world's natural gas reserves. Gazprom is also Russia's largest hard-currency earner, and its tax payments account for around 25 per cent of federal government tax revenues. Russia is the world's largest exporter of natural gas, exporting 6.8 tcf in 1999. Gazprom currently supplies Europe with 25 per cent of its natural gas, and with the construction of new pipelines, Russia hopes to increase this percentage in the next decade. The Blue Stream pipeline to Turkey is almost complete, which will supply Turkey with 565 billion cubic feet of gas. Russia is also interested in building a new gas pipeline to Europe which will bypass Ukraine. Russia may also build new gas pipelines to China and Japan.

Electricity

The Russian electricity monopoly United Energy Systems, UES, is seeking to export electricity. In October 2000 UES began to supply electricity to Europe as part of an international project to create an "East-West" energy bridge. UES is participating in an energy ring with power companies in the Baltic states, and has signed contracts to export power to Turkey via Georgia. In August 2001 the Ukrainian and Russian electricity grids were reconnected, allowing Russia to export electricity to Ukraine and Moldova. Among countries in the far abroad which import Russian electricity are: China, Mongolia, Latvia, Poland, Finland and Norway.⁵

Russia-European Union Energy Relations

The European Union is likely to become Russia's most important customer for its energy exports. Russia envisages a partnership with the EU in which the two partners become organically linked. As Putin put it in Germany in September 2001:

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*Nobody doubts the great value of Europe's relations with the United States. However, I simply think that, certainly and in the long-term, Europe will better consolidate its reputation as a powerful and really independent centre of international politics, if it combines its own possibilities with Russia's human, territorial and natural resources, with Russia's economic, cultural, and defence potential.*⁶

An important part of this process is the development of a close energy relationship between the EU and the Russian Federation.⁷ The EU imports 53 per cent of Russia's oil exports and 62 per cent of Russia's gas exports. Russian exports account for 16 per cent of the EU's oil consumption and 20 per cent of the EU's gas consumption. At the sixth EU-Russia summit in Paris in October 2000, it was agreed to institute an energy dialogue on a regular basis between the EU and Russia in order to make arrangements for an EU-Russia energy partnership. The Joint Declaration of the sixth summit stated that the energy partnership "will provide an opportunity to raise all the questions of common interest relating to the sector, including the introduction of cooperation on energy saving, rationalisation of production and transport infrastructures, European investment possibilities, and relations between the producer and consumer countries. The planned ratification of the Energy Charter treaty by Russia and the improvement of the investment climate will be important aspects in this context." Russian deputy prime minister Viktor Khristenko and Director-General of the EU Commission directorate of Energy and Transport, Francois Lamoureux, were appointed interlocutors.

Europe's need for a secure energy supply, and Russia's need to earn export revenues and for investment in its energy sector are a basis for a closer relationship between the EU and Russia. Instability in the Middle East enhances Russia's importance as a source of energy for Europe. It has been estimated that the Russian energy sector will require between \$460 and \$600 billion in new capital investment up to 2020. The energy partnership aims at improving investment opportunities in the Russian energy sector by upgrading infrastructure, promoting efficient and environmentally friendly technologies and enhancing energy conservation within Russia.

The EU desires that Russia undertake concrete commitments in terms of fiscal stability, improvement of production and protection of investment. It also aims to improve the legal framework in which European firms operate. Access to Russian transport infrastructure will be part of the EU's concerns. The European Commission's role is to facilitate discussions between the parties involved. Four thematic groups have been set up to deal with the following issues:

- Energy strategies and balances
- Investment
- Technology transfer and energy infrastructure
- Energy efficiency and environment

The development of cooperation in the energy sector between Russia and the EU will prove to be one of the most important aspects of the Russia-EU relationship, and the need of the EU for a reliable source of energy, and of Russia for investment in modernising her energy sector provide the basis for a natural partnership that could bind the two partners closely together. Russian entry into

the World Trade Organisation (WTO) and the development of closer economic ties with the EU are likely to create pressures for a reform of Gazprom in order to end its monopoly position in the Russian gas market.

The Geopolitical Implications

On 2 February 2002, Vladimir Putin's economic adviser, Andrey Illarionov, said that the size of Russia's energy exports is changing the traditional view of the world energy market, which has grown up since the end of World War Two and the role which Russia itself is playing in it. He said the world "has suddenly realized that Russia is becoming not only the second largest oil supplier in the world after Saudi Arabia, but also, if one takes into account its gas exports, the world's leading exporter of energy resources."⁸ Indeed, if "one combines Russia's proven oil and gas reserves, it is already the world's energy nation, with about 15 per cent more proven reserves than Saudi Arabia."⁹ Russia could therefore dominate the world's energy industry.

If instability in the Middle East increases, then Russia's importance as a supplier of oil and gas to Europe is likely to grow. Russia may not just become a more important source of energy to Europe, but also to other regions if the reliability of Middle East oil supplies becomes questionable. Russian prime minister Mikhail Kasyanov has talked of the possibility of supplying oil to the USA, and Japan may also find Russia a more attractive source of energy if such a situation develops.¹⁰ The inflow of hard currency and of western technology to modernise the fuel energy complex may in the long-term contribute to a significant strengthening of the Russian economy and possibly therefore of the Russian military. In the long-term therefore, Russia's importance as an energy supplier could enable her to make concrete her aspirations to be, and to be recognised as, a great power in the international arena.

In the 1990s, western oil companies were deterred from making significant investments in Russia because of an uncertain investment climate. If Russia does become a member of the WTO and/or succeeds in developing a common economic space with the EU, then in the long-term, the investment climate for foreign oil companies may improve. Such a development would probably increase economic interdependence between Russia and the industrialised world (ie the West). This could potentially bring Moscow both advantages and disadvantages: advantages in that it would enhance Russia's importance as an energy supplier; disadvantages in that it may make Russia excessively dependent on foreign multinationals as a source of investment and technology. Balancing these opportunities and challenges may become a major task of Russia's new energy diplomacy.

It is also likely that the energy dependence on Moscow of countries such as Ukraine and Moldova will increase, and Russia may be in a position to reverse the decline in her influence over the former Soviet Union that she was forced to endure in the 1990s. The change in western attitudes towards Russia since September 2001 has increased the prospects for close Russia-NATO and Russia-EU security cooperation, which could give Russia a much bigger say in the management of security in Europe, particularly if the USA diminishes her own role in Europe. Russia's importance as a supplier of energy to Europe could increase Russia's role as a European security manager yet further, and possibly enable her to play a leading role along with some of the major West European powers, such as Germany and France, in developing the post-Cold War security order in Europe, possibly in a

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non-Atlanticist direction. If Russia does become Europe's main source of energy in the next few decades, then the temptation to use the supply of energy to influence European states to pursue foreign policies conducive to Moscow may become quite strong.

There is currently a strong desire in Moscow to see the development of a Russia-EU foreign policy axis. In 2000, Vasily Likachev, Russia's ambassador to the European Union, wrote that:

*The further and deeper EU-RF ties are, the more voluminous and realistic are the potentialities of both sides for conducting themselves in the capacity of mutually interlinked poles of the contemporary world order.*¹¹

In discussing Russia-EU relations, Likachev advocated "the development of a Russia-EU political dialogue that moves from just exchanging information to making joint decisions and undertaking joint actions". The development of the Russia-EU energy relationship could facilitate this, and make Russia a much more important player not just in Europe, but in other areas where both Russia and the EU feel they have a role to play, such as the Middle East.

ENDNOTES

¹ BBC Summary of World Broadcasts (SWB), 25 May 2001, SU/4164. See also Anatoly Torkunov 'MGIMO widens,' in Nezavisimaya Gazeta, 21 June 2001, DIP'KURER, No 10. Torkunov is the rector of MGIMO.

² SWB, 28 September 2001, SU/4290.

³ See US Department of Energy website for information on the Russian energy sector, <http://www.eia.doe.gov/emeu/cabs/russia.html> This paper relies heavily on the information from this website.

⁴ See the discussion of the Russia-OPEC relationship by Jonathan Eyal, 'Russia and OPEC: The Confrontation', RUSI Newsbrief, Vol 22, No 2, February 2002.

⁵ See UES website <http://www.rao-ees.ru/ru/>

⁶ SWB, 27 September 2001, SU/4289.

⁷ See EU website section on the Russia-EU energy relationship. http://europa.eu.int/comm/energy_transport/library/pres_russie.pdf
http://europa.eu.int/comm/external_relations/russia/summit_10_01/dc_en.htm#nrg

⁸ SWB, 4 February 2002, SU/4419.

⁹ See Jonathan Eyal, fn 4; Edward L Morse & James Richard 'The Battle for Energy Dominance', Foreign Affairs, March-April 2002, pp16-31.

¹⁰ See fn 8. Russian prime minister Mikhail Kasyanov spoke of the possibility of Russia supplying the USA with oil.

¹¹ V Likhachev, 'Rossiya i Yevropeisky soyuz v strategicheskoy perspektive', Mezhdunarodnaya Zhizn, No 1, 2000, p.40.

APPENDIX**Russia's Energy Overview¹**

Proven Oil Reserves (1/1/01E): 49-55 billion barrels (estimates vary)

Oil Production (2000E): 6.71 million bbl/d; (2001E): 7.12 million bbl/d (of which 6.89 million bbl/d is crude)

Oil Consumption (2000E): 2.34 million bbl/d; (2001E): 2.38 million bbl/d

Net Oil Exports (2000E): 4.37 million bbl/d (of which 3.8 million bbl/d go outside the FSU); (2001E): 4.74 million bbl/d

Major Oil Customers: Europe, Commonwealth of Independent States

Crude Refining Capacity (1/1/01E): 6.6 million bbl/d

Natural Gas Reserves (1/1/01E): 1,700 trillion cubic feet (tcf)

Natural Gas Production (1999E): 20.8 tcf

Natural Gas Consumption (1999E): 14.0 tcf

Net Natural Gas Exports (1999E): 6.8 tcf

Coal Reserves (1/1/99E): 173 billion short tons

Coal Production (1999E): 276.3 million short tons (mmst)

Coal Consumption (1999E): 268.3 mmst

Electric Production Capacity (1999E): 204 gigawatts (68% thermal, 21.5% hydro, 10.5% nuclear)

Electricity Production (1999E): 798 billion kilowatt-hours (bkwh)

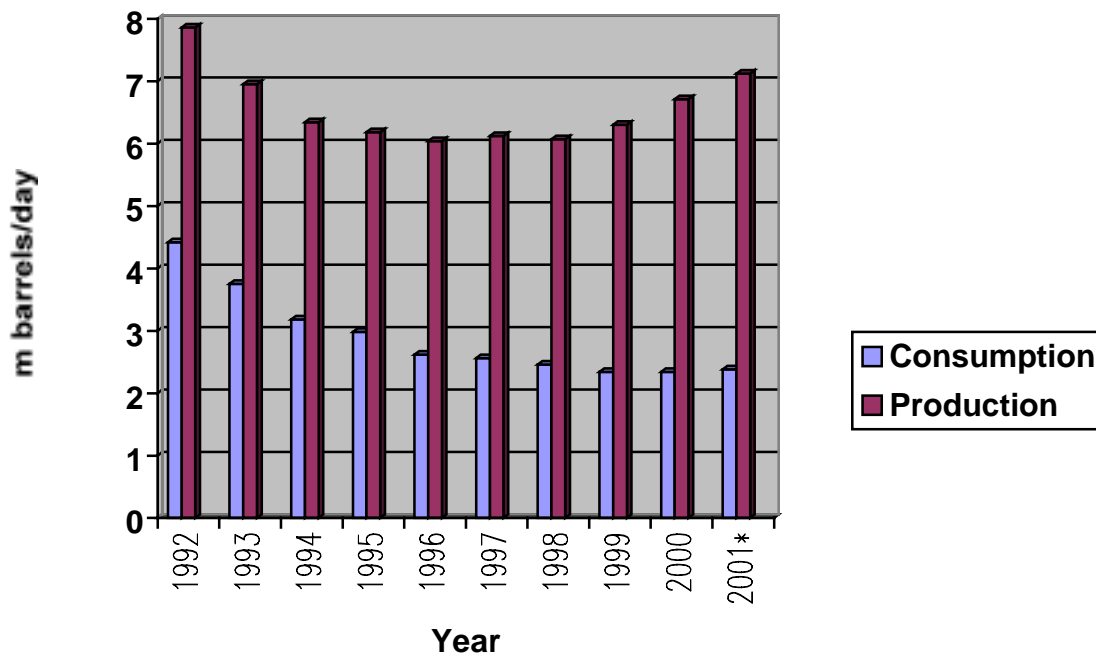
Electricity Consumption (1999E): 728 bkwh

Net Electricity Exports (1999E): 70 bkwh

¹ See US Department of Energy website
<http://www.eia.doe.gov/emeu/cabs/russia.html>; e = estimate.

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Russian oil production & consumption, 1992-2001*



* Projected
Source: EIA

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