

Conflict Studies Research Centre



**The Russian Energy
Strategy & Energy Policy:
Pipeline Diplomacy or
Mutual Dependence?**

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Key Points

1. The Russian energy policy was until mid-2003 determined by many disparate actors, within the state structures and the private sector. Energy policy has since been centralised and put under the control of the Russian President, Vladimir Putin.
2. Until spring 2003, energy company executives took part in the decision-making process at government level. This trend has since been reversed, and Putin is placing his own men as chairmen and chief executive officers of important energy companies.
3. Russia is financially dependent on the export of energy.
4. Russia's leaders have a fundamental awareness of Russia's strategic needs with regard to the energy industry (such as pipelines, export ports, and refineries) and this is reflected in the country's successive energy strategies.
5. However, this does not mean that the Russian government is, or was, able to use energy deliveries as a foreign-policy instrument with regard to what might be termed important countries (such as those in Western Europe and the EU) for reasons of credibility and mutual dependence - and the Russian government early on realised this.
6. The Russian government cannot in any case use the major oil companies as foreign-policy instruments, since they have been privatised. However, it can to some extent use gas and electricity companies as foreign-policy instruments, since they remain government-controlled - but even then the credibility and dependence aspect enters the picture and precludes such uses towards important countries such as those of the EU.
7. Countries such as Latvia and Georgia have used Russia as a scapegoat and exaggerated the threat from Russian energy blackmail to gain favours from NATO and the EU.
8. The Russian government therefore formulated an energy strategy during the first half of 2003, in which the foreign policy significance of energy exports was elaborated.

9. Russia has since used energy deliveries as a foreign-policy instrument against one country only, Belarus, which is formally united to Russia in a two-state union.

10. Unfortunately for Russia, available economic data indicate that the state monopolies are unable to run the energy industry in a way that increases economic growth and labour productivity. They cannot then assure the state of sustained and lasting revenues from the energy sector.

11. Domestic as well as export energy infrastructure projects suffer from a lack of funds. This causes export and transportation bottlenecks.

12. The key energy projects, but by no means the only ones, in which increased Russian attention and activities can be expected in both economic and geostrategic sense are:

- * Northern oil pipeline
- * Eastern Siberian oil pipeline
- * Sakhalin oil and gas fields
- * North European Gas pipeline
- * Yamal-1 gas pipeline
- * Central Asia-Centre (CAC) gas pipeline
- * Bukhara-Urals gas pipeline restoration
- * A new CAC-3 gas pipeline
- * Trans-Caucasus gas pipeline restoration
- * Kovykta-Pacific gas pipeline
- * A Gazprom-led joint venture with Belarus, based on Beltransgaz
- * A 25-year agreement with Kazakhstan on strategic co-operation in the gas sphere
- * Further strategic partnerships in the electricity sector with the remaining CIS states and UES investment in these states.

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The Russian Energy Strategy & Energy Policy: Pipeline Diplomacy or Mutual Dependence?

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Introduction

The energy needs of the world are growing fast, and competition for energy is on the rise. Not only hydrocarbon (crude oil and natural gas) resources are at stake, but also the means of electricity production and indeed most other sources of energy. China and India may both need to double their oil requirements in the period up to 2030, while Europe will need to import increasingly more natural gas.¹ Even the United States, despite hopeful political speeches on energy independence, will need outside sources of oil and gas, with net energy imports being expected to rise from approximately 27% of total consumption to 38% of consumption in the next twenty years.² With the Middle East in seemingly permanent turmoil, much of this will have to come from Russia. The outside world has in the 21st century come to regard Russia and the Commonwealth of Independent States (CIS) as increasingly important sources of energy for other countries, particularly in the West (here loosely defined as Europe and North America), for reasons of energy security and energy diversification if no more.

Russia's oil production in 2004 totalled 458.8 million tonnes.³ Sergei Oganessian, head of the Russian Federal Energy Agency, expects the 2005 crude production in Russia to reach 480 million tonnes, while crude exports will reach 285 million tonnes.⁴ The Russian Ministry of Industry and Energy expects that the extraction of oil until 2015 will increase to 530 million tonnes per year.⁵ Even according to more conservative scenarios, Russian oil production will be substantial in the near future.⁶ Russia in 2004 ranked second (after Saudi Arabia) among world oil producers.⁷

With the expected peak in world oil production, variously estimated to occur at some point between 2015 and 2033, natural gas is becoming increasingly important for the world's energy needs.⁸ Russia's position in the production of natural gas is even more important than in oil extraction. Russia controls an estimated 31% of the global gas reserves, which makes Russia more important for gas than Saudi Arabia is for oil (Saudi Arabia has an estimated 25% of the global oil reserves).⁹ Russia has little competition in this market. There are other producers of gas, in particular among the CIS countries and in Iran and Iraq. But to compete with Russia, they must first learn to co-operate among themselves.¹⁰

In 2004, Gazprom alone exported 140.5 billion cubic metres (bcm) of gas,¹¹ out of Gazprom's total production of 545.1 bcm.¹² In 2005, Russia expects to produce a total of 640 bcm of gas (of which 547 bcm by Gazprom),¹³ and by 2015, no less than 740 bcm per year.¹⁴ Russia currently supplies Europe with 26.1% of its gas needs.¹⁵ Of the total EU gas imports, about half comes from Russia.¹⁶ Some analysts expect that Europe in the future, perhaps by 2020, will depend up to 70% on Russian gas

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supplies.¹⁷ In marked contrast to the situation with oil, where Russia is an important producer but not the leading one, Russia will be able to influence gas prices on export markets by increasing or curtailing exports.¹⁸ This has caused some anxiety in Europe. Can one rely on Russia as an energy supplier? Will there be co-operation or confrontation between Europe and Russia?

Russia is also becoming an important energy trading partner for the United States. While the European interest in Russian energy primarily lies in natural gas, the chief initial US interest is expected to be in oil. However, projected US natural gas consumption in the period up to 2020 (and no doubt beyond) will far exceed current rates of production. The United States will soon need gas as well.¹⁹

While Russia seems to show all the signs of becoming an increasingly reliable trading partner at least for the major countries in the West, to depend on Russia for energy supplies is to move from the field of pure business relationships into the field of politics. The global energy scene, and especially when it comes to oil and natural gas, is not a purely business environment. Energy is not decoupled from international politics and geostrategy. Politics and in particular geopolitics introduce distortions in business activities. While economists and industrialists are good at basing business decisions on number crunching, they are often less cognisant of political, and in particular geopolitical, issues, even when these have a direct effect on the conditions of business. Political commentators and diplomats, on the other hand, understand politics but not always the restraints imposed by business conditions and the technical demands of oil and gas extraction and transportation or electricity generation. This paper attempts to shed some light on a few key political and technical issues that are not readily apparent to all those who debate the developments within the Russian energy sector. In particular, this paper attempts to answer the question of whether relations with regard to energy between Russia and the West will become a confrontational one of pipeline diplomacy or a harmonious one of mutual dependence. The emphasis will lie on an investigation into the existing and planned infrastructure projects, since the proper functioning of the energy sector demands an intricate network of production sites and transportation means, all of which take time and funds to develop and none of which can subsequently be easily removed to another location. Without a sufficient export infrastructure, there can hardly be any relations between Russia and the West within the field of energy, so any policy discussion needs to take infrastructure questions into account.

The Russian Energy Strategy

To understand the Russian view of the world's energy resources, one must first understand the Russian energy strategy. This strategy is based on how Russia regards its own and the world's need for energy.

Soon after the dissolution of the Soviet Union, the Russian government began work on a new energy policy. In September 1992, the government approved the main provisions of the 'Concept for Energy Policy under New Economic Conditions' which aimed to look out to the year 2010.²⁰ The energy policy was formulated to provide Russia with a reliable supply of energy, to ensure the independence and security of Russia, and to support its potential to export energy. It also emphasised the need to develop a raw materials base, increase efficiency, and develop renewable energy resources.²¹ In November 1994, the Ministry of Fuel and Energy circulated a document entitled the 'Energy Strategy for Russia'. The subsequent 'Energy

Strategy of Russia (Major Provisions)' was approved by the Russian government on 7 December 1994.²²

On 7 May 1995, President Boris Yeltsin confirmed the first post-Soviet Russian energy strategy: 'On the Main Directions of Energy Policy and Restructuring of the Fuel and Energy Industry of the Russian Federation for the Period up to the Year 2010'.²³ On 13 October 1995 the Russian government followed up by approving a document known as 'Main Provisions of the Russian Energy Strategy'.²⁴ The turn then came to the natural monopolies. On 28 April 1997, President Yeltsin confirmed the 'Main Provisions of Structural Reform in the Field of Natural Monopolies'.²⁵ On 7 August 1997, the government approved the 'Programme of Means for Structural Reconstruction, Privatisation and Reinforcement of Control in the Field of Natural Monopolies'.²⁶

Under the presidency of Vladimir Putin, the first changes came on 23 November 2000, when the Russian government approved a document known as 'Main Provisions of the Russian Energy Strategy to 2020'.²⁷ This was on 28 May 2002 followed by an 'Elaboration on the Main Provisions of the Energy Strategy of Russia to 2020' by the Russian Ministry of Energy.²⁸

These documents were superseded by the latest published Russian energy strategy, approved on 23 May 2003 and confirmed by the Russian government on 28 August 2003.²⁹ This document, which carries legal status, explains much of what goes on within the Russian energy sector. The energy strategy expresses key goals for Russia. The results of its prescriptions can be seen in several infrastructure projects since 2003 carried out within the state-controlled Russian energy firms. In addition, Russia, as a state, tends to take legislation such as the energy strategy seriously and tends to follow official policy expressed therein.³⁰

Parts of the conclusions of the energy strategy, primarily those concerned with foreign markets, sound faintly alarming to Russia's neighbours. Yet, it should in all fairness be pointed out that the energy strategy devotes the bulk of the text to domestic Russian concerns. In addition to several references to energy security, the strategy also, for instance, indicates the need for environmental security, in particular with regard to the oil and gas fields on the shelf of the Arctic Ocean, Sakhalin, the Caspian, and the Baltic.³¹

The Russian energy strategy concludes that the goals of the Russian energy policy with regard to foreign countries include the need to strengthen the position of Russia in the global energy market and maximise the efficiency of the export possibilities of the Russian energy sector, and to ensure that Russian companies have equal access to foreign markets, technology, and financing.³² The export infrastructure must be sufficiently diversified to allow exports in all directions as well as for use within the domestic market.³³ Russia must use its unique geographical and geopolitical location. The energy factor is a fundamental element within Russian diplomacy, for the foreign policy realisation of the energy strategy, diplomatic support to the interests of the Russian energy companies abroad, and an active dialogue within the field of energy with the CIS states, the Eurasian Economic Community,³⁴ North-East Asia, the European Union (EU), as well as the United States and other states and international organisations. The energy strategy occasionally uses language reminiscent of military strategy: the state must support the Russian companies in the struggle for resources and markets. It is also necessary to have a long-term programme for the development of the export of energy resources.³⁵ The energy strategy also mentions the need for a programme of

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modernisation and construction of port terminals for the loading of energy resources.³⁶ The integration of Russia with the global economy demands attention to not only the tactics of the Russian energy companies, but of those of the entire Russian government. The government will support Russian companies in financially sound investments abroad.³⁷

What Else Does the Russian Energy Strategy Conclude?

A key goal for Russia is to ensure energy security, which is described as the most important factor of Russia's national security. The energy strategy singles out foreign threats (geopolitics, macroeconomics and business conditions) but also domestic problems such as the functioning of the national energy sector.³⁸

The Russian energy strategy lists the objective to secure Russia's political interests, in Europe and the neighbouring countries and within the Asia-Pacific region with natural gas, and through the entire world with oil.³⁹ However, it also contains the objective to remain a stable and reliable partner for the European countries and for the whole world community with regard to the export of energy.⁴⁰

Decisions on which directions will be used when it comes to hydrocarbon transport infrastructure developments will, according to the energy strategy, be taken by the Russian government. Russian ports will be favoured, and the state will support projects that aim to transit oil from the CIS countries through Russia.⁴¹ The energy strategy also indicates the need to have export port terminals not under the control of foreign powers.⁴² The energy strategy indicates that Russia must develop its pipeline infrastructure further.⁴³

The international activities of Russia within the energy sector should, according to the energy strategy, be (1) the export of energy resources, (2) exploitation of energy resources in other states, (3) increased participation in the domestic energy markets abroad, and taking control over energy resources and energy infrastructure in these countries, (4) attraction of foreign investments to the Russian energy sector, (5) work with neighbouring energy firms, (6) transit of energy exports, and (7) international technical and legal co-operation.⁴⁴

Russia wishes to establish a common energy space among the participating CIS states. Not only would this confirm Russia's leading role in such a fuel and energy system, it would also make economic sense since the fuel and energy industry of Russia and the CIS states was developed as a single system. At present, the goal is to strengthen, promote, and improve the integration of the common fuel and energy system for the benefit of its participants.⁴⁵ While this would seem advantageous also for the CIS countries, many independent economists point out that there is little economic profit to be gained by retaining old infrastructure, since a new one is needed.

The energy strategy points out in no uncertain terms that Russia will need to rely on the hydrocarbon resources (and in particular natural gas) of the Central Asian CIS states. This would allow Russia not only to save the gas deposits in the north for future generations and to avoid the need for immediate capital investments to exploit them, but also to alleviate the strains on resources that represent the strategic interests of Russia.⁴⁶ Interestingly, Russia at present does not have sufficient volumes of available gas to supply the full needs of Europe. Russia derives a large share (in 2002, 43%)⁴⁷ of its electrical energy from gas-fired generators. Russia therefore hopes to increase the export of gas by substituting coal (Russia's coal reserves are expected to last far longer than its natural gas reserves) for domestic energy production. Power station coal consumption has been

projected to increase by 1.5 to 2 times in the period up to 2020.⁴⁸ Another way of looking at the issue is that more coal is needed to ensure energy security if goals for increased gas and nuclear production are not met.⁴⁹ Russia also hopes to acquire and re-export gas from the CIS countries to Europe.

It is in Russia's interest that Russian companies participate in projects to broaden the energy transport infrastructure within the CIS countries. Most important in this aspect will be the establishment and development of a unified electricity system (that is, to restore the unified grid that was broken up at the time of the dissolution of the Soviet Union), but the exploitation of oil and gas fields also remains a key concern.⁵⁰

The energy strategy points out that the development of the means to export electricity is a strategic task for Russia.⁵¹ Russia must preserve the completeness and develop the single energy system of the country, and to integrate it with other energy firms on the Eurasian continent.⁵² As for gas export, Russia's main market is perceived to be in Western Europe, followed by Central Europe.⁵³ The United States has the potential to become a long-term market for Russian oil. The United States is also a prospective market for the nuclear energy industry, and will in the future become a market for Russian liquefied natural gas (LNG) as well. In the Asia-Pacific region and South Asia, Russia envisages useful markets in China, Korea, Japan, and India for all types of energy. The markets of the Near East, South America, and Africa are primarily regarded as potential customers of Russian experience and technology and equipment.⁵⁴

As for production, the energy strategy notes the development of the hydrocarbon resources of East Siberia and Yakutia as a key issue, as well as the implementation of a system of delivering these resources to the markets of the Asia-Pacific region.⁵⁵ Another key issue will be the exploitation of the Yamal peninsula fields.⁵⁶ The most important areas for gas extraction are East Siberia, the Far East, the Yamal peninsula, the Barents Sea, and the Kara Sea.⁵⁷ Hydrocarbon resources are located in West Siberia, the Lena-Tungus basin, and the Timan-Pechora region. The shelf of the Arctic Ocean and the Far East are most important. In the north, the Barents and Kara Seas are of key importance together with the Sea of Okhotsk, near Sakhalin, while there is gas on the Caspian shelf. Important reserves are in the basins of Pechora, Gorlovsky, Kansk-Achinsk, Minusinsk, Irkutsk, and South Yakutia.⁵⁸

As for domestic developments, the energy strategy indicates that those regions with high cost of energy resources and low supply or availability, such as the Far East, the Baikal region, North Caucasus, Kaliningrad, Altai, and so on, will be given priority.⁵⁹ Energy resources will also be earmarked for socially important consumers and strategic objects,⁶⁰ euphemisms for cash-strapped domestic consumers and, among others, the military.

This much can be deduced from the energy strategy. There have also been other important policy documents for the Russian energy sector. In 2000, for instance, the Russian government adopted a new nuclear power strategy.⁶¹ This sought to increase the efficiency and reduce the cost of nuclear generation, modernise and extend the life of existing reactors, and pursue new construction in Russia as well as abroad.⁶² Russian nuclear power generation is wholly owned by the Federal Agency of Atomic Energy, and nuclear power plants are with one exception (the independently operated Leningrad nuclear power plant) operated by the state company Rosenergoatom.⁶³

On 11 November 2003, Putin approved changes to the federal law 'On State Secrets' with effect that henceforth, the quantity and volume of oil reserves, and the methods, locations, and amounts of extraction, production, and consumption of Russia's strategically valuable fossil fuels would be classified. The list of classified natural resources, which included oil, had already been spelled out in a Russian government decree of April 2002. The new amendment came into force three months after its official publication, that is, in February 2004.⁶⁴ In a related but technically unconnected issue, the state-controlled oil pipeline monopoly Transneft in 2002 took the decision to become less, not more, transparent, when it ceased publishing its full financial reports, instead only issuing an abbreviated balance sheet and an abbreviated profit and loss statement.⁶⁵

One should also consider that more than a thousand enterprises currently under state ownership until recently were on the list of Strategic Enterprises and Strategic Joint Stock Companies. These are considered to have "strategic significance for ensuring the defence capability and security of the state and the protection of morality, health, and the rights and legitimate interests of citizens". While most belong to the defence-industrial complex, the list also includes state-controlled energy companies such as Transneft, Transnefteprodukt and Gazprom.⁶⁶

Russian Energy Dominance - or Mutual Dependence?

There is no doubt that Russia in the future will occupy a dominant position with regard to energy supplies in particular to the European Union. However, the dependence will be mutual. While the European Union will not be able to forego Russian energy deliveries, Russia will for reasons of export infrastructure not be able swiftly to divert its energy exports elsewhere, in case the two parties cannot agree. And Russia will need the revenues from gas exports as badly as the European Union will need Russian energy. Russia is dependent on the incomes from gas and oil. No less than 37% of federal budget revenues and 20-25% of the Russian GDP derive from oil and gas.⁶⁷ In other words, Russia and the European Union will be mutually dependent, the European Union on energy imports, Russia on export revenues. There is thus no need to exaggerate the risks of a Russo-European mutual energy dependence. Russia is increasingly becoming a rational trading partner.

This is all the more evident for energy moved through fixed infrastructure such as pipelines. In this case, mutual dependence will also safeguard those EU and CIS countries through which the pipelines pass on their way to western Europe. Russia cannot cut deliveries to Belarus without also ceasing deliveries to Poland and consequently Germany. Likewise, Russia cannot cancel deliveries to Ukraine without also ceasing deliveries to Slovakia and Hungary and in extension much of western Europe. With the present pipeline grid, Russia (or Ukraine) could not even cease deliveries to little Moldova (or for that matter, the unrecognised Moldovan breakaway republic of Transnistria, in which the firm OOO Tiraspoltransgaz controls the same transit pipelines that Russia needs to reach Moldova)⁶⁸ without also cutting pipeline-based deliveries to Romania, Bulgaria and Greece. Even if Russia for political reasons felt obliged to take such a drastic step, disregarding the negative political fallout with the EU, the decision would drastically reduce revenues from export and thus be counter-productive to the Russian ability to go it alone.

Russia has independent, commercial energy companies, especially within the oil sector. However, Russia also has a state energy policy, formulated by the Russian government. State policy is limited to the formulation, and occasionally imposition, of strategic priorities by means of control over infrastructure, tariff systems and taxes. The energy companies act independently in response to the market situation although within the framework of these state powers.

Few governments wish to be dependent on forces outside their control, even if the dependence is mutual. When possible, Russia certainly strives, through its energy policy, to avoid dependence on other states and at the same time to dominate its domestic market as well as, when possible, the international market. Russia sees a particular strategic need to control the export and transit means for its exports to the international market. Russia thus works to create export infrastructure on Russian territory that will eliminate the need to transit energy deliveries through other states. Russia for this reason also sees a need to re-integrate energy infrastructure in the countries of the former Soviet Union by mergers, acquisitions, and investments. Here the interests of the independent energy companies meet those of the Russian government. A re-integration along these lines makes both commercial and security sense for these actors.

Energy as Russian Natural Monopoly

Russia regards energy as a natural monopoly to be kept under state control. To fulfil this ambition, as well as the desire to re-integrate the energy infrastructure in at least the CIS countries, the Russian state primarily works through three companies: Gazprom, Transneft and Unified Energy Systems of Russia (UES).

Gazprom, a joint stock company with foreign participation but under state control, has almost total control over natural gas transport within and out of Russia and furthermore controls most gas production. Gazprom is also, as will be shown, indicating an interest in diversifying its activities into oil production, electricity generation and the construction of nuclear power plants. Transneft, in which the state owns a controlling stake, has a virtual monopoly over Russian oil pipeline transport (private companies are allowed to build and own pipelines but only if used solely for their internal needs)⁶⁹ and substantial influence over other modes of Russian oil transport infrastructure. UES, of which a majority share is owned by the state, dominates Russia's electricity sector and is also active within several other CIS countries.⁷⁰

There are no signs that the Russian state plans to reduce its control over these monopolies, since they provide the Russian government with a convenient way of regulating the energy industry and safeguarding strategic objectives. Yet most energy companies in Russia are independent and motivated by commercial reasons far more than state policy. These companies often resent the exclusive role played by in particular the monopolistic Gazprom and Transneft, since they find that their ability to export is less dependent on the willingness of foreign buyers to pay than by the pipeline operator's ability and willingness to move their product. UES remains a virtual monopoly as well, but since its commodity is electricity, it does not directly control or compete with independent commercial energy companies in the oil or gas sector.

Developments within the Russian energy sector as a whole, and the energy sectors of those CIS countries that are dependent on the Russian energy sector, are therefore driven by commercial reasons - but some developments (that do affect the

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independent companies) are governed by the state energy policy. The explanation for this has less to do with political pressure on the boards of directors of these companies than the demands of the existing infrastructure (export ports, oil and gas pipelines and refineries). The infrastructure, and in particular new infrastructure projects, remain under the control of the Russian government. The implication is that Russian energy companies are commercially motivated, but especially in pipeline and other transport infrastructure-related strategic issues, the Russian state does attempt to use its monopolistic position.

State Control over Infrastructure

The present Russian leadership's views on energy policy form but the latest chapter in a long history. Russia's policy towards oil in particular and, at present, energy in general has been characterised by two fundamentally contradictory schools of thought. In the early 1900s, there was a Russian policy dispute between Sergei Witte (1849-1915), minister of finance 1892-1903, and an aristocrat named Kuzminsky. Witte, the son of a businessman, was strongly in favour of trade. He promoted Russia's industrial development through, among other means, protective tariffs, foreign investments, and increased taxes, and saw a need for the presence of foreign enterprise to maintain Russia's position in the international oil market. Kuzminsky, however, a conservative from the group that despised Witte because they felt that he was moving Russia towards liberalism, wished to see the entire oil industry nationalised and exports put under strict state supervision to "secure Russia's national interests from being usurped by foreign monopolists," as he described it to the imperial court.⁷¹

A similar dispute seems to have divided the Yeltsin government in the early 1990s. On 21 July 1994, encouraged by former Foreign Minister Andrei Kozyrev and foreign intelligence service director Yevgeny Primakov, President Boris Yeltsin reportedly signed a secret directive 'On Protecting the Interests of the Russian Federation in the Caspian Sea' which postulated that Russia should maintain its "sphere of influence" there through a policy to prevent involvement from foreign companies in the development and export of oil from the CIS states. This view was reportedly opposed by other government members such as Prime Minister Viktor Chernomyrdin and several oil-industry officials, who instead regarded foreign participation in the development of the oil resources as a means to ensure access to capital investment and advanced technology. The latter believed that Russian oil companies should participate in foreign consortia to establish themselves on the world market, improve their technology base, and to share in the profits from developing the oil fields. When the much-touted Azerbaijani "contract of the century" for the development of the Azeri, Chirag, and Guneshli oil fields was signed on 20 September 1994, with the Russian oil company LUKoil as a signatory, a representative of the Russian Ministry of Fuel and Energy (Stanislav Pugach, Chief of the Main Department of the Ministry) participated in the signing ceremony, while the Russian Ministry of Foreign Affairs instead held an official press conference in which its spokesman condemned the deal as illegitimate since the legal status of the Caspian Sea had yet to be determined.⁷² Indeed, LUKoil eventually felt it had to withdraw from the project so as not to damage its standing with the Kremlin.⁷³

The policy dispute continued for almost a decade. Until at least mid-2003, Russian energy policy remained the composite product of many disparate actors, both within the state structures and the Russian private sector. Until at least the spring

of 2003, energy company executives even took part in the decision-making process at government level.⁷⁴

Policy has since been settled in favour of state control. Vladimir Putin on 29th April 2004 stated that “At the moment I consider that there are no grounds for the state to give up its control over pipeline transportation. But this does not hinder private investment, which will be welcomed.” He continued that “private investment is possible with continued state control and state ownership of pipeline transport”.⁷⁵

Putin’s opinion on this matter was known since at least the previous year. Already in October 2003, Putin reportedly told visiting German Chancellor Gerhard Schroeder in Yekaterinburg: “The gas pipeline system is the creation of the Soviet Union. We intend to retain state control over the gas transportation system and over Gazprom. We will not divide Gazprom. And the European Commission should not have any illusions. In the gas sector, they will have to deal with the state.”⁷⁶

However, the issue has since gone beyond the realm of pure state control and caused repercussions in the investment climate for Russian business to an extent that the YUKOS affair never did. Ostensibly to further ensure continued state control, Putin has introduced a number of means to limit foreign participation in industrial sectors of strategic importance, that is, those sectors that “ensure the security of the state, objects of infrastructure, defence suppliers, natural monopolies, and development of resources of strategic importance”. Bills to this effect are expected to come into force in late 2005. In addition, Russian legislation still limits foreign capital in Gazprom to 20%.⁷⁷ Russia’s ministry of natural resources in February 2005 banned foreign companies and companies over 49% owned by foreigners, including the Russo-British TNK-BP (in which BP holds 50% of the equity), from entering the 2005 auctions on a number of Russia’s largest oil fields, since these were regarded as fields of strategic importance.⁷⁸ Then the government approved changes in the legislation ‘On Subsoil’ to the same effect so as eventually to put the decision on a legal basis.⁷⁹

Putin’s Men

The natural monopolies are not only falling under state control, they are also being put under the personal authority of representatives of the Russian state in the form of members or chairmen appointed to the boards of directors. Since these representatives are generally regarded as Putin’s men and come from Putin’s own staff, the Presidential Administration, it is clear that not only is Putin strengthening state control over the natural monopolies, he is also strengthening direct presidential control. This is true for the energy sector as well as other strategic sectors.

It is, of course, by no means certain that the appointment of a close aide of the president automatically leads to increased presidential control, and a full inquiry into the relationships between the Putin administration and the upper echelons of these companies is beyond the scope of this study. Even so, the sheer number of appointees to important companies within strategic industrial sectors in recent years with close ties to the Presidential Administration is telling.

Table 1 - Members of the Putin Administration Appointed to Influential Business Posts

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| Name | Official Post | Business Post | Date of Appointment |
|--------------------|--|---------------------------------|-------------------------------|
| Dmitry Medvedev | Head, Presidential Administration | Chairman, Gazprom | June 2002 ⁸⁰ |
| Vladislav Surkov | Deputy head, Presidential Admin | Chairman, Transnefteprodukt | August 2004 ⁸¹ |
| Igor Sechin | Deputy head, Presidential Admin | Chairman, Rosneft | 27 July 2004 ⁸² |
| Yevgeny Shkolov | Former aide to Medvedev | Board of directors, Transneft | August 2004 ⁸³ |
| Arkady Dvorkovich | Head, Presidential Experts' Directorate | Board of directors, Transneft | August 2004 ⁸⁴ |
| -" | -" | Board of directors, Sukhoy | September 2004 ⁸⁵ |
| Sergei Vyazalov | Deputy head, Presidential Foreign Policy Directorate | Board of directors, RZhD | 24 October 2003 ⁸⁶ |
| -" | -" | Board of directors, Svyazinvest | September 2003 ⁸⁷ |
| Igor Shuvalov | Aide to the President | Board of directors, RZhD | July 2004 ⁸⁸ |
| Viktor Ivanov | Aide to the President | Chairman, Aeroflot | 23 October 2004 ⁸⁹ |
| Sergei Prikhodko | Aide to the President | Chairman, TRV | April 2003 ⁹⁰ |
| -" | -" | Board of directors, Sukhoy | September 2003 ⁹¹ |
| -" | -" | Chairman, TVEL | 23 October 2004 ⁹² |
| Mikhail Lesin | Advisor to the President | Board of directors, Channel One | 30 June 2004 ⁹³ |
| Aleksei Gromov | Press-secretary to the President | Board of directors, Channel One | 30 June 2004 ⁹⁴ |
| Aleksandr Anoshkin | Aide to Medvedev | Board of directors, Svyazinvest | September 2001 ⁹⁵ |
| Aleksei Miller | Friend of Putin from St Petersburg | President, Gazprom | May 2001 ⁹⁶ |
| Igor Yusufov | President's Special Representative | Board of Directors, Gazprom | June 2005 ⁹⁷ |

In politics and business, friends and allies naturally come and go. So was, for instance, Putin's first deputy head of the presidential administration from November 2003, and head of the administration from 9 March 2004, Dmitry Kozak,⁹⁸ chairman of Russia's state-owned shipping operator, Sovcomflot, which among other assets controls many oil tankers, until he on 13 September 2004 was removed from this post and instead appointed presidential plenipotentiary envoy to the Southern Federal District.⁹⁹ Since this put him in charge of developments in Chechnya, some believe that the appointment was an invitation to failure and demotion.¹⁰⁰ Likewise, Viktor Kalyuzhny, who was minister of fuel and energy from 1999 to 2000, on 31 May 2000 was appointed Special Representative of the President on the Caspian Basin. He was also elected chairman of the board of the Russian Federation representatives of Transneft. However, following his failure to prevent the US-led coalition of politicians and industrialists under Ambassador Steven Mann, US State Department Special Representative, Caspian Basin Energy Diplomacy, from pushing through the Baku-Tbilisi-Ceyhan (BTC) pipeline, Kalyuzhny on 12 July 2004 was instead appointed ambassador to Latvia. He was replaced by Igor Yusufov (in a slightly modified role) on 29 July 2004.¹⁰¹

The Export Infrastructure

The monopolistic position of a few Russian state-controlled companies has already been described, together with the relationship of these companies with the Putin

administration and the perceived Russian need for state control over infrastructure and in particular pipelines. So which infrastructure is currently available for export purposes?

There are three main oil export routes from Russia towards the West: the Central European (or continental), the Black Sea, and the Northern (Baltic). Each is served by existing pipeline routes and dedicated alternative forms of transport such as rail and internal waterway. The last two routes depend on Baltic and Black Sea ports.¹⁰²

The Central European or continental route is served by the old Soviet Druzhba main pipeline. Problems for Russia with this route are both a need for increased capacity and dependence on transit through third countries.¹⁰³

The Black Sea route depends on port terminals in Novorossiysk and Tuapse in Russia and Odessa and Pivdenny in Ukraine. To reach these terminals, the oil is transported through the old Soviet system of pipelines and the comparatively new Tengiz-Novorossiysk pipeline of the Caspian Pipeline Consortium (CPC) that began shipments in October 2001.¹⁰⁴ A bottleneck is formed by the Turkish Straits, through which oil tankers must pass to reach the Aegean and Mediterranean Seas. There is also some uncertainty with regard to transit dependence on Ukraine. In addition, the port of Novorossiysk frequently suffers from unsuitable weather conditions.¹⁰⁵

The Northern (Baltic) route depends primarily on the Baltic Pipeline System (BPS) relying on the new export terminal in Primorsk, which first came into operation in December 2001. While this route avoids transit dependence, a bottleneck is formed by the Danish Straits. Besides, Primorsk is not an ice-free port.¹⁰⁶

A further complication is that the existing pipeline system in Russia was designed to mix low quality crude oils like the Urals blend grade with high-grade oils like Siberian Light. The only exception is a separate pipeline for transport of unblended Siberian Light directly from the Tyumen region to the export terminal at Tuapse, used by Sibneft. This means that the oil exported through the existing system of main pipelines is less competitive than non-Russian sources of oil.¹⁰⁷

There are three large routes for transport of gas through Russia. The northern route, which has the highest load, delivers gas from the Nadym-Pur-Taz gas production area (where 80% of Russian gas is produced, and which is expected to remain the main resource base until at least 2010) to consumers of north-western Russia as well as facilitates exports to the Baltic countries, Belarus and western Europe. The central route provides gas (again from the Nadym-Pur-Taz area) to consumers in central Russia and facilitates export to Europe by way of Ukraine. The southern route, which is the least loaded, delivers gas from the same area but also from Turkmenistan, Kazakhstan and Uzbekistan to consumers in southern Russia and adjacent countries including Ukraine and (through Blue Stream) Turkey.¹⁰⁸ Most Russian gas exports to Central Europe transit through an export network often known from the old Soviet name of one of its components as Bratstvo ("Brotherhood"), which consists of several routes through Ukraine, namely through Ukraine and Poland; through Belarus and Ukraine to Slovakia and Hungary; and through Ukraine and Moldova to Romania, with an extension to Bulgaria and Turkey (known as the Russia-Turkey pipeline), and with another extension from Bulgaria to Macedonia and Greece.¹⁰⁹ There is also a pipeline route through Belarus and Poland known as Yamal-1. A second such pipeline known as Yamal-2 is

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planned, but will probably not be built, having been superseded by the plans for the North European Gas Pipeline (see below).¹¹⁰ Before the completion of the Yamal gas pipeline through Belarus (the project was decided in November 2000 after having been under discussion for ten years, but is not expected to be fully operational until 2006),¹¹¹ 90% of the Russian exports to Europe had to pass through Ukraine. Ukraine thus gained considerable leverage over Russia, which allowed Ukraine to build up a major debt to Russia. Ukraine also siphoned off significant amounts of Russian gas from the pipeline. Ukraine no longer has this option, as Gazprom can route its gas through Belarus instead.¹¹² The gas export infrastructure also includes Blue Stream, a gas pipeline across the Black Sea, built with the aim of exporting natural gas from Russia to Turkey.¹¹³

As for electricity, UES holds a virtual monopoly of production and distribution. UES has since October 2000 also supplied electricity to Europe, works with power companies in the Baltic states, and exports electricity to Turkey, Poland, Finland, Norway, China and Mongolia.¹¹⁴

The YuKOS Affair: Private Sector Foreign Policy versus State Control

On 25 October 2003, the head of the oil company YuKOS, Mikhail Khodorkovsky, was arrested.¹¹⁵ Thus culminated the YuKOS affair, the incident in Russian business and politics that since has received arguably most media attention. Just days before, an insightful observer commented as follows: “There is, for instance, the opinion that the Kremlin hit YuKOS because it financed first [opposition political party] Yabloko, then the Communists. Ridiculous. When have parliamentary elections nowadays decided anything important in Russia? But here YuKOS led the movement of oil companies towards construction of their own export pipelines, independent of the state - to the West with a terminal in Murmansk and to the East in China - it is a sad fact but such acts of ‘breaking the rules’ are punishable with severe means.”¹¹⁶

YuKOS had proposed two privately owned pipelines. One, first proposed in the mid-1990s (with an agreement signed in March 2003), was the construction of a pipeline from Angarsk in Siberia to Daqing in China.¹¹⁷ This was anathema to the Putin administration for strategic reasons, since it would have tied up scarce export infrastructure to a single customer, China, a customer who also formed a potential military threat to Russia. Yet YuKOS to this end had entered into a contract with China, in effect behaving as if it, not the Russian president, decided Russian foreign policy. The other, initiated in late 2002, was a projected pipeline from West Siberia to the ice-free, deep-water port of Murmansk on the Barents Sea. A terminal there would, unlike the export terminals in the Baltic and Black Seas, have been able to accept tankers of a sufficient size for it to make economic sense to export oil to North America. The proposed project would have had an export capacity of up to 80 million tonnes per year and would chiefly have served exports to the United States, which supported the project.¹¹⁸ Indeed, Khodorkovsky had engaged in discussion with US officials on the construction of this pipeline.¹¹⁹ Besides YuKOS, LUKoil, Sibneft and TNK also expressed their interest, signing a memorandum of understanding in November 2002 and (together with Surgutneftegaz, which by then had joined the four) a joint declaration of intention in April 2003.¹²⁰ In July 2003, a US business delegation led by Deputy Energy Secretary Kyle E McSlarrow arrived in Murmansk to display the American interest in the project.¹²¹ In this project, too, YuKOS had attempted to formulate foreign policy, even though the company then at

least followed what at the time was official Russian government policy with regard to the United States, that is, to export oil there. The Murmansk project was for this reason approved by the Russian government on 17 April 2003, when the Russian government under Prime Minister Mikhail Kasyanov and Energy Minister Igor Yusufov in a cabinet meeting no doubt dominated by the business entrepreneurs reversed its position on state ownership of pipelines and gave YuKOS a green light to build an oil pipeline from the fields of West Siberia to the port of Murmansk.¹²²

However, the year 2003 was a watershed in Russian foreign policy. Hitherto foreign policy had been made by many actors, as when in Azerbaijan in 1994 the ministers of fuel and energy and foreign affairs had found themselves on opposing sides. Henceforth, foreign policy would be the prerogative of the Russian President.

The approval to build a privately owned pipeline to Murmansk therefore fell through. This is the context in which one should see the subsequent YuKOS affair. The affair became serious on 26 May 2003, when a Kremlin insider named Stanislav Belkovsky, general director of the National Strategy Institute, had a report published in the newspaper *Utro*, accusing the oligarchs headed by Khodorkovsky of plotting a political coup by bankrolling certain political parties in an effort to gain a majority in the Duma during the December 2003 legislative elections.¹²³ The timing of the disclosure suggests a close relationship between the Murmansk pipeline approval and the subsequent accusations, since the report was apparently first issued in early May on the web site of the National Strategy Institute. Indeed, Belkovsky had on 6 May 2003 published many of his arguments in a article in the nationalist newspaper *Zavtra*.¹²⁴ Yet it is perhaps more correct to locate the beginning of the YuKOS affair on 22 May 2003, when the draft Energy Strategy of the Russian Federation was endorsed by the cabinet.¹²⁵ Decisions on hydrocarbon infrastructure developments are, according to the energy strategy, to be taken by the Russian government, not individual companies.¹²⁶ Khodorkovsky clearly thought otherwise, but the powers of the state prevailed.

Escape from Transit Dependence

The question of whether Russia is a reliable long-term business partner and whether mutual dependence is something to welcome, or indeed is possible at all, is often tied to the potential use of energy export as a foreign-policy instrument. In the present work, this will be narrowly defined as a means to impose one's will on a foreign government, whether for political or economic gains. The fixing of oil prices within OPEC springs to mind, which would seem to make oil the prime candidate for such uses. However, the Russian government is no longer in a position to use the country's major oil companies as foreign-policy instruments under its full control, as they in all cases but one have been fully privatised. What the Russian government, at least to some extent, could do if it wished to use energy as a foreign-policy instrument, would be to rely on the gas and electricity companies, since these remain government-controlled - although even then the credibility aspect and the mutual dependence on energy supplies and revenues enter the picture. Yet the question remains, does Russia use, or intend to use, its gas and electricity exporters in this way?

This is not an idle question. Countries such as Latvia and Georgia have found it convenient, rightly or wrongly, to paint a picture of Russia as a scapegoat and immediate threat in order to gain favours from NATO and the EU. There is thus no

doubt whatsoever that the Russian government has become aware of the possibility to use energy deliveries as a foreign-policy instrument.

Partly in response to these accusations, the Russian government during the first half of 2003 formulated its energy strategy, in which the foreign policy significance of energy export was elaborated. Yet, from the Russian point of view, it was Russia, not the EU or CIS states, that was vulnerable to foreign policy pressure in the energy field. This was intimately linked to Russia's role as an exporter, because Russia itself depended on transit routes to move the energy to its destination. In other words, Russia regarded itself as suffering from transit dependence. This expressed itself in the energy strategy, which singles out foreign threats (geopolitics, macroeconomics, and business conditions) to Russian security, and furthermore indicates the need to have export port terminals not under the control of foreign powers.¹²⁷ Transit dependence means dependence on a foreign power, thus making Russia vulnerable not only to swings in business conditions but more importantly, to economic or political blackmail - making Russia the victim of precisely the policy of which others have accused Russia.

To get out of this dependence, Russia finds it of vital importance that energy exports go through Russian ports and Russian-controlled pipelines. Semyon Vainshtok, president of Transneft, on 23 June 2004 made it clear that Russia saw an urgent need to "get rid of transit dependence ... Russia has a unique opportunity not to depend on anyone in oil shipment. We have access to the Pacific, the Arctic, the Black Sea and the Baltic Sea. Then why use transit?"¹²⁸

Russia has since at least mid-2000, when the BPS project began, worked to use its own ports to avoid depending on those of the Baltic states (as was the case in Soviet times, when they belonged to the Soviet Union).¹²⁹ Several export terminals for oil have been or will be built in the Gulf of Finland in addition to the existing ports at St. Petersburg and Vyborg: two in Primorsk (the BPS terminal operated by Transneft, which is already in operation, and Transnefteprodukt's project Sever - "North"), one in Vysotsk (a new oil products terminal operated by LUKoil), and one in Batareynaya bay (operated by Surgutneftegaz). The Primorsk terminal operates in conjunction with the BPS which was built for exporting Timan-Pechora and West Siberian oil deposits. The dry-cargo port in Ust'-Luga is also in the process of being refurbished as an oil transfer centre, in part operated by TNK-BP, and Gazprom have plans there for a production and export terminal for LNG.¹³⁰ There are plans for connecting Ust'-Luga by pipeline - not tanker - across international waters to Kaliningrad; construction of this reportedly began in spring 2004.¹³¹

In 2002, the Russian government reportedly took the formal decision that as a matter of principle, pipelines not under the control of Russian capital and ports that abused their monopoly position would be used only as a last recourse.¹³² These sentiments were later echoed in the energy strategy.¹³³

Oil from the Yamal peninsula and the Prirazlomnoye deposits can in principle be transported by way of the Arctic Sea, a route that some argue can reach from the Atlantic to the Pacific Ocean, by railway if not by ship.¹³⁴ Transneft may make use of the western reaches of this route in a project known as the Northern pipeline (an oil pipeline from the northern Urals to an ice-free Barents Sea port such as Murmansk). In February 2004, Transneft announced that it was considering five possible locations for an export terminal in the Nenets autonomous area, the most promising of which were Indiga and Cape Svyatoy Nos (or Cape Bolshoy Rumyanichnyy, both on the Barents Sea coast). Transneft and the Ministry of

Transport then favoured a pipeline from Surgut to Indiga.¹³⁵ Transneft was expected to present its feasibility study on the Northern pipeline in August 2005. The pipeline was also mentioned by Putin in his annual speech to the Russian Federal Assembly on 26 May 2004.¹³⁶

The same pattern can be seen in other regions. There is an emphasis on the development of new freight routes, primarily with regard to crude oil from Kazakhstan, Turkmenistan and Azerbaijan. New or improved export terminals for petroleum products in Novorossiysk, Tuapse, and Makhachkala (oil from Kazakhstan and Turkmenistan transits through Makhachkala) will be developed to replace ports on Ukrainian territory. Temryuk is to be developed as an export port for coal, while there are also plans for the shipping of LNG from ports in Zhelezny Rog and the North Caucasus.¹³⁷ Corresponding port facilities will also be developed in conjunction with the Sakhalin oil and gas fields.¹³⁸

The perceived need to avoid transit dependence can also be seen in other parts of the transport sector. For instance, Russia is working on the international North-South Transport Corridor, which is ultimately expected to connect Europe to India by way of Russia, the Caspian Sea, and Iran. As part of this project, Russia is constructing a railway to the Caspian port of Olya, in the Volga estuary.¹³⁹ The port is currently being expanded. The railway component of the North-South Corridor was inaugurated on 28 July 2004, with an access railway to the port.¹⁴⁰ From Olya, a railway ferry will connect Russia with Iran.¹⁴¹ In autumn 2003, a new container transit terminal was ready for use in the Iranian port of Bandar Abbas on the Persian Gulf - the most modern such terminal in the Middle East.¹⁴² For certain goods, the new route thus becomes a potential replacement for the current route through the Suez canal.

Repercussions on the CIS States

What repercussions can be expected of the Russian policy to avoid transit dependence, and which can already be observed?

First, Russia will continue to aim to export its own oil and gas resources, and if possible also those of the Caspian region, to the outside world through Russian pipelines or in Russian keels. This is not wholly bad even for the producer states; to export through the Russian system is still, in most cases, cheaper than to build completely new infrastructure. However, some CIS states would prefer to establish their own ties with the West rather than to continue exporting through Russia. This inevitably leads to rivalry.

Second, Russia will aim to acquire Central Asian and Caspian energy, in particular gas, in order to re-export it. This could be perceived as a negative development for the CIS states concerned in so far that they cannot themselves control the exploitation of their energy resources. Turkmenistan is an important example. Russia has tied up the Turkmen natural gas production for several years through a series of contracts, even though these do allow Turkmenistan higher gains from the sale than were previously earned. On 10 April 2003, Russia and Turkmenistan signed a 25-year agreement on gas co-operation that stipulated a gradual increase formula for the purchase of Turkmen gas, with purchases in 2004 beginning at 5-6 bcm, rising to 10 bcm in 2006. Delivery volumes will significantly increase from 2007 (when coincidentally, the 2001 Turkmen-Ukrainian agreement expires; Ukraine being a major market for Turkmen gas). By 2009, Russia will in effect be

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buying virtually all of Turkmenistan's gas, amounting to an expected 70-80 bcm by 2028. Moreover, Russia will retain the exclusive right to re-export the gas elsewhere.¹⁴³

The relationship between Russia and the energy-producing states may eventually lead to mutual dependence, with prices and export access set by negotiations, although it could admittedly also make certain smaller states dependent on Russia. In addition, Russian energy companies have aimed to improve their profitability by investment in downstream operations in neighbouring states. Some would argue that for political reasons it would be better for these states to get investments from Western energy companies, to tie them to the West rather than to Russia. On the other hand, it is investment and technological know-how that are needed, and the independent Russian companies are no less adept than their American and European equivalents. And to depend on the West is merely another form of dependence, and not necessarily a better one.

Besides, co-operation is possible. On 21 January 2002, Putin proposed a "single export channel" for all gas exports from Central Asia and suggested that Russia, Kazakhstan, Turkmenistan and Uzbekistan form a Eurasian Gas Producers' Alliance.¹⁴⁴ These words were later echoed in the Russian energy strategy, which also insists on the need to preserve a "single channel of export of natural gas" and the use of long-term contracts with regard to exports to Europe.¹⁴⁵ As a consequence of Putin's initiative, the presidents of Russia, Kazakhstan, Turkmenistan and Uzbekistan on 1 March 2002 signed a joint statement on co-operation in the energy sphere, and on protecting the interests of the countries that produce natural gas.¹⁴⁶

Third, Russia will aim to promote Russian investment in the energy infrastructure of neighbouring states. This in particular concerns electricity and natural gas, since these remain state monopolies. However, the same development occurs within more independent parts of the energy sector as well. LUKoil, Russia's largest oil company, has made substantial investments abroad, not only in the Caspian but as far away as Saudi Arabia (the LUKoil Saudi Arabia Energy Ltd (LUKSAR) joint venture with Saudi Aramco, initiated on 8 April 2004, 80% owned and thus controlled by LUKoil) and Colombia.¹⁴⁷

In July 2004, Putin recalled the Russian ambassadors to Moscow for a special meeting to review Russia's foreign policy priorities. During this meeting, Putin emphasised that the priority tasks of Russian foreign policy were "to protect national economic interests, raise the investment attractiveness of Russia, and resist discrimination in foreign markets" but he also indicated the key importance of the CIS countries and pointed out that "relations between CIS states and Russia should be made as attractive as possible not only for us but also for them."¹⁴⁸ That the energy sector would play a role in this was shown when Putin in the same week appointed Viktor Khristenko, Russian energy minister, new envoy to the CIS countries. Khristenko has a reputation as an economist who sees economic integration of the CIS region as a key issue.¹⁴⁹

This development should not necessarily be interpreted as an attempt to gain political control over these countries. Russia is, however, right that it makes economic sense for the CIS states to co-operate in production, distribution and export of the available energy resources. The key word is re-integration, not political control.

However, these two concepts are for historical reasons often misunderstood among Russia's neighbours. Problems of history and geopolitics will cause problems for Russian investments in central Europe. The new EU members Estonia, Latvia and Lithuania were forcibly annexed by the Soviet Union during the Second World War and only regained independence in 1991. The Czech Republic, Slovakia, Hungary, Romania, Bulgaria and Poland were placed under Marxist rule by the Soviet Union, and Poland has a long history of annexation by Russia. Many in these countries still resent their past oppression and are quick to see Russian tendencies to resume political control. This is understandable. On the other hand, some in leading positions in these countries might also doubtlessly find these sentiments useful tools in the creation or fanning of populist resentment and scaremongering to advance individual political agendas, in both domestic and foreign policy. For them, even the Russian intention to avoid unnecessary transit fees can be seen as outright aggression.

Energy Export as a Foreign-Policy Instrument

So, does the Kremlin use energy diplomacy as a means to exercise economic pressure on foreign states? Does the Kremlin, for instance, use threats of the suspension of energy exports as a means to impose its will on other countries? There are numerous unsubstantiated rumours to this effect, most of which do not hold water upon closer inspection. Disregarding those, there have been a few limited cases when threats and ultimatums based on energy deliveries as a lever of state power have been used by representatives of the Russian government. These occasions should furthermore be distinguished from the numerous times when commercially independent Russian operators have temporarily suspended energy supplies for technical reasons due to faulty infrastructure or because of non-payment. The actual cases of Russian attempts at energy diplomacy, not surprisingly, all seem to date from the stormy years of the Yeltsin administration immediately after the collapse of the Soviet Union. More surprising is perhaps that these attempts did not bring the expected results to the Russian side, nor did much, if any, good in other ways. Indeed, considering the inability, and in many cases unwillingness, of many CIS countries to pay for energy deliveries, it is more surprising that energy supplies were not halted more often, and permanently so.

In 1991, soon after Lithuania's declaration of independence, Russia ceased all energy deliveries. This gained the Kremlin nothing, and energy supplies were eventually resumed. In 1993, when Estonia adopted its 'Law on Aliens', which affected the ethnic Russians in the country, gas deliveries temporarily ceased. Again the Kremlin gained nothing.¹⁵⁰

In 1993, the Kremlin cut 25% of Ukraine's gas supply, officially due to non-payments, a week before an important meeting during which the two sides would discuss a Russian ultimatum on the surrender of nuclear weapons and the Black Sea Fleet. If Ukraine gave in, it was understood, the energy debt would be written off. Ukrainian President Kravchuk agreed to comply but later changed his mind. Russia had gained nothing. In 1995, the Kremlin made another attempt to use energy diplomacy. Russia raised its export price on gas for Ukraine while proposing that Ukraine join the CIS Customs Union. Again, the attempt to use energy as a foreign-policy instrument brought no result.¹⁵¹

In 1998, Gazprom threatened to cut gas deliveries to Moldova, reportedly just before scheduled negotiations with Russia over the deployment of Russian troops in the break-away region of Transnistria. Earlier in the year, however, Moldova had in a

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similar way threatened to cease deliveries of Russia's transit gas destined to Bulgaria, Turkey and Greece. It is doubtful whether the Kremlin gained anything from its actions, if there indeed was a connection between the gas deliveries and the political demands. There is little doubt that Moldova was unable to pay off its debt to Gazprom.¹⁵²

These incidents show that although Gazprom undeniably has taken advantage of its customers by allowing them to run up debts that in the end only could be exchanged for equity in infrastructure and energy companies (although some would say that by running up impossible debts, the customers had taken advantage of Gazprom), there are no known cases in which the Russian government successfully used the energy sector as a lever to force unwelcome political decisions onto neighbouring countries. Yet, the common perception of the Russian energy policy as an instrument for political pressure has no doubt encouraged some countries, for instance Georgia, to wield this imagined weapon against Russia itself, by loudly complaining to the United States and the European Union that they were under threat from Russian bullying and thus needed a fast track to membership in NATO and/or the EU. After all, political actions are as often based on how events are perceived by those with the power to influence decisions as on the real situation.¹⁵³

There is one exception to this general pattern. Russia has since the 2003 formulation of its energy strategy used energy deliveries as a foreign-policy instrument against one particular state, Belarus.¹⁵⁴ This is perhaps not surprising. First, Belarus is a state that since the signing of a treaty on 8 December 1999 envisioning greater political and economic integration is formally united to Russia in a two-state union. Second, Belarus has for domestic political reasons no support whatsoever to expect from the West, even if it cries foul.

The Activities of State-Controlled Energy Companies Abroad

Transneft, the Russian oil pipeline monopoly, is the legal successor to the Soviet Oil Ministry's Central Production Department for Oil Transport and Supply. The firm, which was established by presidential decree in 1992,¹⁵⁵ for obvious reasons chiefly operates on Russian territory. This constraint does not apply to Gazprom and UES.

Gazprom

Gazprom is the largest gas producing company in the world, according to its own estimate responsible for about 20% of world gas production and employing nearly 300,000 people either directly or through its numerous subsidiaries. The firm exports gas to a large number of countries, including Germany, France, Italy, Britain, Austria, Switzerland, Netherlands, Turkey, Hungary, Czech Republic, Slovakia, Poland, Finland, Bulgaria, Romania, Yugoslavia, Slovenia, Croatia, Greece, Bosnia, Macedonia, Ukraine, Belarus, Moldova, Lithuania, Latvia and Estonia.¹⁵⁶ Gazprom is a vertically integrated monopolist. Although organised as a joint-stock company and despite having some limited foreign ownership (in particular the German firm E.ON Ruhrgas AG, a part of E.ON Energie AG) which owns 5.7% of Gazprom), Gazprom in many ways operates as a government agency. It combines commercial and regulatory functions and retains tight control over information flows within the gas sector which impedes transparency within the sector as a whole.¹⁵⁷ Gazprom suffers from large-scale inefficiency and low labour productivity. Substantial reform will be needed to reverse this trend.

However, Gazprom is controlled by the Russian state. It is for this reason unlikely that President Putin would propose its far-reaching reform. He would, however, be in favour of reforms to increase income from the energy sector while retaining or increasing state control. The Russian energy strategy does mention the need to make Gazprom more efficient.¹⁵⁸ The perceived need to escape from transit dependence in itself does not rule out increased transparency or indeed gradual de-monopolisation. A division of, for instance, Gazprom into distinct and independent entities for the transport of gas through pipelines and the supply and distribution to customers could be envisaged. The key aspect will remain the government's ability to control Russia's natural resources.

Instead of initiating a thorough reform, Putin has taken steps to increase his control over Gazprom. In May 2001, Putin replaced the president of Gazprom, Rem Vyakhirev, with an old friend, Aleksei Miller. This appointment, and Miller's subsequent management reshuffle, brought Gazprom in line with Putin and his administration.¹⁵⁹ German Gref, Minister of Economic Development and Trade, had from June 2000 onwards proposed a reform plan for Gazprom. This plan, occasionally (most recently in 2002) changed in details, would fundamentally have divided Gazprom into several independent entities for the production, distribution and sales of gas. However, President Putin on 26 December 2002 stopped this by pointing out that the firm was an important strategic resource that should not be divided.¹⁶⁰ On 17 February 2003, Putin gave a speech at a reception commemorating the 10th anniversary of the founding of Gazprom: "Gazprom, as a strategically important company, should be kept, and has been kept, as a single organism ... Gazprom is a powerful political and economic lever of influence over the rest of the world."¹⁶¹

In this context, it should be emphasised that the head of the Federal Energy Agency, Sergei Oganessian, on 11 August 2004 had indicated that the state should control 15-20% of crude production in Russia.¹⁶² This conclusion was echoed in the results of a survey among the top managers within the Russian oil sector, held from November 2004 to January 2005. Most, including the presidents of all major companies, agreed that about 10 to 30% of production should be under state control.¹⁶³ However, even with the acquisition of Yuganskneftegaz, the Russian state would only control some 16% of Russia's total oil production. More acquisitions can therefore be expected, most likely from the disintegrating YuKOS.

But oil was not the end of the matter. Gazprom bought a share in UES. As of June 2004, Gazprom was estimated to hold around 13% of UES.¹⁶⁴ On 6 October 2004, Miller also announced that Gazprom had acquired a "significant" share in the power utility Mosenergo, the electricity-generation company of the city of Moscow (presumably in addition to the 19% share Gazprom already controlled; Gazprom now has a blocking stake in the firm).¹⁶⁵ And on 18 October 2004, Federal Atomic Energy Inspectorate Director Andrei Malyshev announced that Gazprombank, Gazprom's wholly owned subsidiary bank, had purchased a more than 50% share in Atomstroyeksport, a key Russian company involved in the construction of nuclear powerplants, including two in China, two in India, and the controversial one in Bushehr in Iran.¹⁶⁶

It should again be emphasised that these moves were all related to the question of state control, not prevention of gas sector reform as such. A careful reform to increase income while at the same time retaining, or increasing, state control would no doubt be welcome and may even be quietly underway. At the end of May 2004,

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Gazprom announced that its gas distribution assets would be combined in a single, wholly owned subsidiary, OOO Mezhregiongaz.¹⁶⁷

The lack of transparency within Gazprom has encouraged a number of murky or outright dubious deals with regard to domestic consumption as well as export of gas. In 1994, Gazprom somehow assisted the company Itera in taking charge of the selling of Turkmen gas to other CIS countries. Itera had been founded in 1992 by Igor Makarov, a Russian born in Turkmenistan and a former cycling champion who began trading food for Turkmen oil in the early 1990s before he founded Itera. In 1994, Itera opened an office in Jacksonville, Florida, in a failed attempt to secure guarantees from US officials. The company has since at least 1998 supplied gas to Ukraine, Armenia, Georgia, Belarus and Moldova, known as problem clients since they paid seldom if at all for gas deliveries. The rapid rise of Itera came amid suspicions that the firm was nothing but a front for Gazprom executives in what some believed was a scheme to siphon off profits.¹⁶⁸ However that may be, following the 2001 appointment of Aleksei Miller as new president of Gazprom, Itera and Gazprom became fierce competitors. This seemingly did not change the apparent need for a middleman in Gazprom's export activities, however. From 4 December 2002, Gazprom's new managers allowed, for a while, the (not at first even registered) offshore gas trader Eural TransGas to take over Itera's role in handling the supply of gas from Turkmenistan to Ukraine and Europe. Eural TransGas, eventually registered in Hungary, has allegedly been connected to a variety of criminal activities. However, Eural TransGas was on 29 July 2004 made superfluous by the signing of documents by the heads of the two state monopolies laying out rules for cooperation between Russia and Ukraine in the sphere of transport and delivery of natural gas up to 2028. This entailed the establishment of yet another new entity, Swiss-registered SP RosUkrEnergo, which will buy Turkmen gas for the Ukrainian market, and operate as a transit operator as well as investor in the gas-transport infrastructure needed for subsequent deliveries. RosUkrEnergo is owned, on an parity basis, by Gazprombank and Austria's Raiffeisenbank. The Ukrainian firm NAK Naftogaz Ukraini will henceforth serve only as the ultimate gas consumer.¹⁶⁹

Gazprom regards Europe as its main market and, whenever possible, makes every effort to prevent other gas producers from making substantial inroads into Europe. Gazprom supports, for instance, the proposed Iran-Pakistan-India gas pipeline.¹⁷⁰ There are several reasons for this. First, its successful completion would be a further nail in the coffin of the American-supported, proposed Turkmenistan-Afghanistan-Pakistan gas pipeline, which in any case would not be commercially viable as long as Gazprom acquires all or most Turkmen gas. Second, the Iran-Pakistan-India project would also deflect Iranian gas from Europe to Asia, thus depriving Gazprom of an important competitor.

Gazprom does not expect actually to produce any LNG before 2010 (in Ust'-Luga or on the Barents Sea). Meanwhile, Gazprom instead hopes to swap its pipeline gas in Europe for LNG in for instance Qatar from companies such as BP, Ruhrgas, Statoil and Norsk Hydro, in order to gain experience dealing with and selling LNG on the US (and possibly UK) market. The first such LNG cargo belonging to Gazprom arrived in the United States in early September 2005..¹⁷¹

Gazprom has successfully negotiated agreements on strategic co-operation with a number of other former Soviet states.¹⁷² Gazprom has also succeeded in acquiring shares in major segments of the energy infrastructure in these countries, even in the Baltic states, where equity has been acquired in several important firms.¹⁷³

Gazprom's successes abroad can be summarised as follows (primarily based on information disclosed by the companies concerned):

Table 2 - Gazprom Assets in the CIS and Baltic States

| Country | SCA | Company | Activity | % owned |
|--------------|------|-------------------|------------------------|----------------------|
| Kazakhstan | - | ZAO KazRosGaz | Gas extraction | 50% |
| Uzbekistan | 2012 | - | - | - |
| Kyrgyzstan | 2028 | AO Kyrgyzneftegaz | Gas & oil exploitation | 85.16% held in trust |
| Tajikistan | 2028 | - | - | - |
| Turkmenistan | 2028 | - | - | - |
| Georgia | 2028 | - | - | - |
| Armenia | - | ZAO ArmRosgazprom | Gas exploitation | 45% |
| Azerbaijan | - | - | - | - |
| Belarus | - | - | - | - |
| Ukraine | 2028 | SP RosUkrEnergo | Gas pipeline operator | 50% |
| Moldova | - | AO Moldovagaz | Gas pipeline operator | 50% + 1 share |
| Estonia | - | Eesti Gaas | Gas distribution | 37% |
| Latvia | - | Latvijas Gaze | Gas distribution | 34% |
| Lithuania | - | Lietuvos Dujos | Gas distribution | 25% |
| -"- | - | Kaunas CHP | Power plant | unclear |

* SCA = Agreement on strategic co-operation, in force until the year mentioned in the table.

Unified Energy Systems of Russia - UES

Russia is the world's fourth-largest electricity producer, after the United States, China and Japan. Of the total production, thermal generation accounts for 66%, hydro-electric for 17%, and nuclear for 16%.¹⁷⁴ Russia's electricity sector has since 1992 been dominated by UES; in Russian known as RAO YeES Rossii, of which 52.6% is owned directly by the state (a further 10-13% is owned by Gazprom and 4% by the state-controlled National Reserve Bank).¹⁷⁵ However, unlike Gazprom, UES realises almost all its revenues on the domestic market.¹⁷⁶

The head of UES, Anatoly Chubais, has openly declared his ambition that Russia should expand its influence through the neighbouring countries through business relations and acquisitions. On 25 September 2003, he coined the expression "liberal empire" for his vision of Russia as a country in which the state would support an aggressive economic expansion abroad to make Russia the leading regional power and a democratic and peaceful successor to the Soviet Union. Russia should exert its influence abroad through business rather than foreign policy.¹⁷⁷ To make good this vision, UES has since at least 2001 but in particular from 2003 onwards expanded aggressively in the CIS countries (Table 3, primarily based on information disclosed by the companies concerned). UES has also participated in almost all privatisation tenders in Slovakia, Romania, Bulgaria, Poland, and Moldova, although the firm has been unsuccessful in these tenders so far.¹⁷⁸

Table 3 - UES Assets in the CIS and Baltic States

| Country | Company | Activity | % owned |
|------------|---------------------|--|-----------------------------|
| Georgia | AO Telasi | Electricity distribution | 75% |
| -" | OOO Mtkvari | Power generation | 100% |
| -" | OOO AES Transenergy | Electricity export | 50% |
| -" | AO Khramesi | Khrami-1/-2 hydroelectric power plants | Right to run ¹⁷⁹ |
| Armenia | Sevan-Hrazdan | Hydroelectric power plant | 100% |
| -" | ZAO Hrazdan TPP | Thermal power plant | Management control |
| -" | Metsamor NPP | Nuclear power plant | Management control |
| Kazakhstan | Ekibastuz | Hydroelectric power plant | 50% ¹⁸⁰ |

In addition, UES has managed to re-connect several countries to the single energy grid originally shared by Russia, the CIS and the Baltic states. In December 2004, it was announced that Iran too would join the single energy grid in 2006, together with Azerbaijan.¹⁸¹ Russia and Belarus agreed to unify their power systems on 22 November 1999. In 2001, Kazakhstan and Russia restored the simultaneous operation of their electricity systems. The Russian and Ukrainian energy grids were reconnected in August 2001, following a deal struck in February 2001. UES exports electricity to Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Ukraine and Latvia. UES imports electricity from Kazakhstan and Lithuania (it also exports a small amount to the latter). UES has since October 2000 also supplied electricity to other European countries, works with power companies in the Baltic states, and has signed contracts to export electricity to Turkey by way of Georgia. In addition to Turkey, UES exports electricity to China, Mongolia, Poland, Finland and Norway. In the field of electricity export and import, UES since 2004 works through the subsidiary ZAO Inter RAO UES, 60% owned by UES and 40% by Rosenergoatom.¹⁸²

On 5 April 2003, Putin signed a package of six items of new amending legislation that aimed to reform the industry by unbundling its various activities. The goal of the reform is to introduce competition into electricity production and supply, while leaving dispatch, transmission and distribution as regulated natural monopolies with non-discriminatory third-party access to the networks. Tariff rates on the domestic markets will be liberalised on a date set by the government (at the earliest on 1 July 2005, according to the reform package, but since postponed), and UES itself is scheduled to be liquidated and split up by 1 April 2006. The firm is likely to be restructured into a number of independent power generating companies united by a federally controlled power distribution network, the Federal Grid Company, thus overcoming any conflict of interest between power generation, transfer and sales. While the firm's generation and distribution facilities are thus expected to be privatised, the transmission grid will remain under state control.¹⁸³

As part of the reform process, the board of directors of UES on 17 March 2005 decided to liquidate the UES branch in Georgia, and on 24 May 2005 those in Ukraine and Kazakhstan.¹⁸⁴ This concerned the local branches of UES of Russia, and did not affect any other companies in these countries in which UES held equity.

The implication is that UES is on the path of reform. Even so, UES has substantial problems with ageing infrastructure. Annual construction of new generating capacity has fallen by more than three-quarters since the dissolution of the Soviet Union. Replacement and expansion of generating capacity will thus be a serious issue as demand for electricity grows.¹⁸⁵

Strategic Threats as Perceived by Russia

State control over much of the energy infrastructure also means that Russia finds its energy policy a vital part of various issues of national security policy. The Russian wish to avoid dependence, for instance, makes its leaders preoccupied with a wide range of perceived strategic threats in the same way that many CIS and EU countries instead perceive Russia as a threat.

Russia is, for instance, sensitive to what its leaders see as American attempts to prevent Russia from realising certain energy export opportunities. Some (in the West), for instance, promote the East-West Energy Corridor Project, which includes the Baku-Tbilisi-Ceyhan (BTC) and the South Caucasus Gas Pipeline (also known as the Baku-Tbilisi-Erzurum, BTE, which possibly will be extended to Europe). Russia believes this to be a purely geopolitical move.¹⁸⁶ Considering the economic facts behind the projects, it is hard to disagree with this conclusion.

American policy towards the Caspian and Central Asia shows a number of idiosyncrasies that makes it hard to disassociate it from geostrategic power projection in order to check Russian, Iranian, and Chinese economic, political, and military influence in the region. By the late 1990s, the Clinton administration had developed a policy that, regardless of an outspoken emphasis on the promotion of democracy, human rights, and beneficial economic development, primarily aimed to (1) contain Russia, (2) isolate Iran, (3) reward old and new allies (Turkey, Georgia, and Azerbaijan), (4) develop alternative energy sources to reduce reliance on sources in the Middle East, and (5) project US influence into what by then seemed to be a regional power vacuum.¹⁸⁷ The stated aim of the BTC project was to build a crude oil pipeline that could move Caspian oil from in particular the three oilfields of Azeri, Chirag, and Guneshli from Azerbaijan to the United States and its NATO allies. A route through Russia or Iran was never acceptable to the United States for political reasons, and a route through Armenia was unacceptable to Azerbaijan due to the Nagorno-Karabakh dispute. Turkey did not accept an additional pipeline to the Black Sea, as this would put further pressure on the already crowded Bosphorus Strait, and besides, the United States believed that any new Black Sea routes might become subject to Russian pressure. It was for these reasons eventually decided to run the pipeline from Baku in Azerbaijan through Tbilisi in Georgia to the deep-sea Mediterranean port of Ceyhan in southeast Turkey.¹⁸⁸ American interests are clearly better served by moving oil from the Caspian through Georgia and Turkey than through Iran and Russia. The reasons for the BTC were thus clearly political, not economic. To make the pipeline commercially viable, the United States would probably need to influence the government of Kazakhstan (and possibly also that of Turkmenistan) to construct a new pipeline under the Caspian to connect to the BTC, something that seems not yet realised.¹⁸⁹ Whilst the Bush administration proved somewhat more accommodating to Russia, it has not shown any inclination to change these policy objectives with regard to the Caspian region.

Yet another strategic threat is the Turkish demand to stop the Russian oil tanker transit traffic from the Black Sea to the Mediterranean. For Russia, this is not only a question of oil tankers. By forcing a stop to the tanker traffic, one would also tear up the Montreux Convention of 1936, which gives Russia and the other Black Sea states the right to regard the sea route through what in practice is the commercially most important city of Turkey as an international waterway - which also gives Russia the right to move naval forces in and out through the same route. This makes the transit issue a serious threat to both Turkish and Russian security

policy concerns and national interests. Any change in the terms of the Montreux Convention would bring implications for Russia's naval strategy. This has occasionally caused diplomatic rows between Turkey and Russia, for instance when Russia planned to sell S-300 Zenit surface-to-air missiles to the Greek Cypriot government in 1998,¹⁹⁰ and during an oil and gas conference in Istanbul in February 2004, when the Russian representative, among other comments, pointed out that "alarmism of Marmara straits transit is being deliberately built up for political reasons" and that such "alarmism is dangerous, and may get out of hand". The Russian side also pointed out that the straits transit was still at only half capacity, according to the preliminary results of a Novorossiysk State Maritime Academy study, and that the key problem was the need for an improved traffic control and onshore navigation system, not the present transit volume.¹⁹¹

There is of course no denying that the Straits form a bottleneck, and that weather also causes delays. According to some calculations, one oil tanker passes through the Bosphorus every twelve minutes (in daytime; the Straits are closed to large ships at night).¹⁹² Furthermore, Turkey expects terrorist attacks aimed at the transit traffic.¹⁹³ The Montreux Convention stipulates two rights, the right of freedom of navigation and the right to dispel congestion in the Straits, but the question remains how to balance these two rights, since the Montreux Convention does not allow the imposition of tolls in the modern sense. Turkey has therefore proposed an international, UN-led convention to protect the Turkish Straits.¹⁹⁴ However, since a new convention would result in the tearing up of the Montreux Convention, Russia would probably oppose this. There is no question that the entire issue has been politicised; Turkey appears, for instance, far less keen to reduce the number of its own chemicals tankers passing through the Straits, even though any leaks from them would be significantly more dangerous than oil spills and this traffic poses dangerous targets for terrorism in its own right. However one chooses to regard this question it remains a challenge, but the geostrategic threat perceived by Russia makes the problem particularly difficult to resolve.

The Straits issue also highlights the possibility to use environmental aspects as at the same time a worthy cause and a powerful means for exerting political pressure in negotiations concerning energy exports. In the media-driven world of today, no government that wishes to be seen as modern can afford to neglect environmental concerns. However, they tend to surface wherever an oil pipeline or tanker port is to be built.

The United States and Turkey are not the only geostrategic rivals of Russia. China as well is regarded as a potential strategic enemy. Russia cannot accept the construction of an oil pipeline that would lead only to China, such as was negotiated by YukOS. In case of future conflict, to build such a pipeline now would be a tremendous waste of resources. Although China and Russia signed a framework agreement in March 2003 to build an oil pipeline from Angarsk in East Siberia to Daqing in Heilongjiang province, northeastern China, the Russian leadership has realised the political risk in such a solution. Far better is then to build the oil pipeline from Siberia along a route as proposed by Japan, which offered to finance part of the project, that will bypass China and terminate at Russia's Far East port of Nakhodka or somewhere nearby. While a pipeline terminating in Daqing in effect would be a hostage to Russo-Chinese relations, a pipeline to Nakhodka or thereabouts could be used to export Russian oil by tanker not only to Japan but also to other foreign buyers in the Asia-Pacific region, including even China - as long as a sufficient volume of oil is available. In June 2004, the director of the Russian Federal Energy Agency, Sergei Oganesyanyan,

suggested that the Angarsk-Daqing pipeline might eventually be built, but only as long as the Nakhodka pipeline was constructed first and then only in parallel with this pipeline.¹⁹⁵

Oil deliveries to China can of course still take place by rail (there are also rail connections between China and Kazakhstan),¹⁹⁶ and Putin has expressed his support for larger deliveries by this means.¹⁹⁷ Indeed, by January 2005 not only YuKOS but also LUKoil and Rosneft supplied West Siberian oil to China by railway. According to an agreement from November 2004, the two sides hope to increase railway supplies of Russian oil to China to 60 million tonnes per year by 2010, which would then equal more than 10% of Russia's total production.¹⁹⁸ In the final analysis, the Russian leaders may well regard rail deliveries as a first-stage solution to China's needs.

The perceived threat from a pipeline terminating in China was not only geostrategic but also economic. To invest money in a pipeline leading to a single customer makes the supplier vulnerable to demands from the customer to re-negotiate the price of energy or cease sales, after the investments have already been made and the project is committed. This was the lesson Russia learnt with regard to the Gazprom-sponsored gas pipeline to Turkey known as Blue Stream. This pipeline only began operations in December 2002, but in March 2003 the Turkish side suspended imports (reportedly because of recession) in order to re-negotiate the agreement in its favour. That geopolitical factors complicated the deal, because of Turkish support for the American-sponsored BTE pipeline, did nothing to ease Russian concerns.¹⁹⁹

Perceived geostrategic threats were also apparent in the construction of the Chechnya bypass pipeline. The 312 km long pipeline skirts Chechnya by passing through Dagestan to Khasavyurt, then runs towards Stavropol Kray, ending at Terskoye in North Osetia.²⁰⁰ The idea of building a bypass pipeline was reportedly first raised in September 1997, as a means to facilitate negotiations with the Chechen government with regard to transit fees when moving oil in the existing pipeline from Baku to Novorossiysk via Chechnya's capital Grozny. Russia's then first deputy prime minister Boris Nemtsov announced that this bypass pipeline would take only nine months to construct, and as a result of this pressure an agreement was signed with Grozny on 9 September 1997.²⁰¹ Even so, it seemed clear to the Russian side that the existing pipeline through a de facto independent Chechnya beyond its control was not an optimal solution. Work on the bypass was therefore set to begin in February 1998 after an agreement between Transneft and Rosneftegazstroy, which would construct the bypass.²⁰² However, money was lacking, and little work actually took place.²⁰³ In addition, further arguments between Grozny and Transneft soon followed with regard to transit fees, who should pay for the protection of the existing pipeline, and the fact that oil from time to time was diverted from the pipeline while in transit. On 7 June 1999, just weeks before the present war in Chechnya began, Transneft suddenly ceased using the pipeline, instead organising a system by which oil was moved from Makhachkala to Tikhoretsk by rail. In September 1999, then prime minister Putin ordered the new president of Transneft, Semyon Vainshtok (appointed a few days earlier) to complete the bypass in the shortest possible time. Work re-commenced in late October 1999 and was concluded in April 2000, when the pipeline was finally ready for operations.²⁰⁴ However, the Chechnya bypass was solely the result of a government decision and its continued use is in question.²⁰⁵ In June 2000, Baku re-oriented its oil export towards Supsa, although oil transit has since been resumed through Makhachkala.²⁰⁶

The Energy Sector & The Russian Military

From the point of view of the Russian state, energy infrastructure is not only a source of geopolitical or geostrategic worries. It is also a possible target of enemy action, regardless of whether the enemy is another state or a terrorist group. In addition, the dissolution of the Soviet Union brought tensions between the military and the energy companies, since the military henceforth had to pay for its energy supplies, in particular electricity, and each unit suddenly faced being cut off if it did not pay its bills. This situation, which is not yet completely resolved, explains the emphasis in the energy strategy on the need to earmark energy for strategic objects.

However, the Russian state can also gain occasional, purely military benefits from its energy companies. The latter also recognise the need for military protection from possible sabotage or terrorist attacks. This has in places developed in what can only be compared to a state of symbiosis. So will, for instance, the Russian Baltic Fleet instal a radar station on an oil platform at the Kravtsovskoye deposit (known as D-6), located 22 km offshore from Kaliningrad on the Baltic shelf and owned by LUKoil-Kaliningradmorneft. This has been announced as the Baltic Fleet's first sea-based radar station and will be a significant addition to its surveillance capability.²⁰⁷ On 27 September 2004, LUKoil and the Ministry of Defence even signed a broad co-operation agreement on the provision of technical and financial assistance to a range of defence establishments, including the Rear Services and Transport Military Academy in St Petersburg, the military hospital in Khimki outside Moscow, and the main personnel department of the Ministry of Defence. LUKoil would, in addition to continuing to supply the armed forces with fuel and lubricants, also attempt to find employment for those who were discharged from military service.²⁰⁸ Similar joint enterprises can be expected elsewhere, when the energy companies and the military forces find themselves sharing common needs and concerns. Indeed, Gazprom is developing a co-operation programme with the Russian Navy, in which navy vessels and infrastructure will be used in the development and transportation of LNG in the Barents Sea, and naval co-operation will be sought in the preparations for the construction of the North European Gas Pipeline.²⁰⁹

There are also regular joint conferences between the leaders of the companies of the Russian oil and gas complex and the defence industrial complex. The latest was the seventh, being held in Moscow on 24 May 2005.²¹⁰

The Export Infrastructure Remains a Bottleneck

Gazprom has made substantial investments in European, in particular German, gas companies (and E.ON Ruhrgas AG has invested in Gazprom). However, unfortunately for Russia, Gazprom does not, it seems, have the capital for the necessary investments in anticipation of future domestic operations, that is, exploration, gas-field development and infrastructure. This would be needed to meet both domestic as well as anticipated foreign demand.²¹¹ Russia remains dependent on gas for domestic use, for households and in industry. As a legacy of the Soviet period, the monopoly is not allowed to charge more than a fraction of the value of the gas consumed. The price of domestic gas is for political and practical reasons still determined by what people can afford to pay, not what the gas would cost on the international market. Indeed, the energy strategy indicates that energy resources will be earmarked for socially important consumers and strategic

objects,²¹² euphemisms for cash-strapped domestic consumers and, among others, the military. This is a key problem for Gazprom, since Russia consumes the major share of the gas it produces.²¹³ Domestic prices are far too low to cover more than present production costs and do not allow investments in exploration, gas-field development and domestic infrastructure. Should this situation continue, it would seem to indicate that Russia could not use its gas supplies as a “lever of power” even if Putin, or his successor, would wish to do so. Gazprom has worked on a mechanism to open up a free market of natural gas for industrial consumers, while retaining fixed prices for, among others, municipal infrastructure and ordinary consumers. This limited liberalisation could take place from 2007.²¹⁴

In addition, the export infrastructure remains a bottleneck for the entire gas industry. The transport and distribution networks are in urgent need of investment. Over 70% of Russia’s high-pressure gas pipelines were commissioned before 1985, the average age of the Gazprom trunk pipelines being nearly 22 years, and an estimated 14% of the pipelines are beyond their anticipated lifespans, causing substantial losses in transport as well as increased power consumption. In addition, worn out equipment prevents the system from working above 90% of its capacity. Gazprom has embarked upon a modernisation programme scheduled for 2002-2006, among other improvements increasing the internal pressure throughout the entire gas transport system.²¹⁵ The outcome remains to be seen when, and if, the programme is fully implemented. According to some estimates, Gazprom will by 2008 not be able to pump all gas extracted due to the limited capacity of the firm’s pipelines.²¹⁶

There is also a bottleneck in the existing export infrastructure for oil, and the overall picture is similar to that of the gas industry. Oil pipeline capacity in particular is often insufficient. Exports are then being made by rail.²¹⁷ The implication is that even should output increase, the additional oil cannot be exported, unless substantial investments are made in transport infrastructure. The export infrastructure thus remains a serious bottleneck for the Russian oil industry. Oil output growth indeed outperforms export capacity. By the end of 2003, Transneft pipeline utilisation reached 97%. Yet, oil exports by rail in 2003 increased by 109%, and by river by 52%. Oil output continued to grow in 2004. According to some estimates, if this trend continues, Russia may by 2010 be short of about 115 million tonnes per year of export capacity.²¹⁸ Besides, the service wear of the the existing main oil pipelines is over 70%, and the pipelines are often old (Table 4).

Table 4 - The Pipeline Network²¹⁹

| Age (years) | Percentage of main oil pipelines |
|--------------------|---|
| <10 | 7% |
| 10-20 | 25% |
| 20-30 | 34% |
| 30+ | 34% |

Transneft has countered the complaints from oil companies by stating that for the first time in years, there is in fact capacity to spare. Transneft blames the oil companies, which often fail to meet their shipping schedules. This argument, however, has been countered by the explanation that since shipment schedules must be prepared in advance, the oil producers have to make their calculations on pipeline usage based on estimates only. While bureaucracy and red tape no doubt play a role, pipeline capacity remains insufficient, since some regions in Russia,

where crude output is growing rapidly, currently lack pipelines.²²⁰ According to some assessments within the industry, as much as one quarter to one third of Russia's oil exports (70 million tonnes) are moved along alternative (and thus more expensive) routes such as railways, waterways, and in small tankers instead of by pipeline.²²¹ In addition, transport costs are rising. Even rail transport suffers from some bottlenecks.²²²

The bulk of Russian oil exports go by the Druzhba pipeline or terminals on the Baltic and Black Seas. The oil from West Siberia and Volga-Ural is primarily exported via pipeline to Novorossiysk and Tuapse on the Black Sea and onwards, primarily to Europe, by tanker, or via pipeline through Belarus and Poland or Ukraine to Western Europe. The oil from Timan-Pechora is primarily exported by tanker across the Baltic Sea, although there is since 2000 also the export oil terminal known as Northern Gateway in Varandey on the Barents Sea (with a current capacity of 1 million tonnes per year, to be upgraded to 5-15 million tonnes),²²³ and Rosneft's Belokamenka floating trans-shipment terminal, a converted VLCC²²⁴ tanker, in Kola Bay near Murmansk, which has been in place since February 2004.²²⁵ The BPS terminal at Primorsk near St. Petersburg has the capacity to transport about 50 million tonnes per year, a capacity achieved in October 2004.²²⁶ Primorsk thus took over from Novorossiysk the role of Russia's leading oil export terminal.²²⁷ By the end of 2004, Transneft indeed asked the Russian government to cut the projected further addition to throughput capacity since further expansion beyond the already achieved 50 million tonnes per year was not regarded as cost-effective.²²⁸ The oil from Sakhalin is exported directly to Asia. There is no transport infrastructure between the Russian Far East and Siberia. The latter region is only connected to the westward infrastructure.²²⁹

The Baltic and Black Seas lead into the Atlantic via narrow and shallow straits that limit tanker size to 110,000 deadweight tons (dwt) for the Baltic and 145,000 for the Black Sea. This makes exports to North America uneconomical, since the consensus view is that this would require VLCC tankers of 300,000 dwt (key American oil terminals built to handle VLCCs are in Louisiana and on the Atlantic coast). Such supertankers require deepwater ports and when fully loaded cannot use existing Russian export routes through the Turkish or Danish Straits. They can be used in the Mediterranean. However, neither the VLCCs nor the smaller Suezmax tankers²³⁰ are used in the Baltic Sea because of the constraints of the straits. Only tankers with a capacity of no more than 80-100,000 dwt, such as the smaller Aframax tankers,²³¹ customarily pass through the Baltic Sea.²³² Suezmax tankers are being used in the Black Sea, but even there the most common large tanker is the Aframax.²³³ In addition, the transport capacity of the straits is limited. Oil tanker traffic through the Bosphorus has risen by 45% since 1999, and Turkey introduced restrictions on tanker traffic through the Bosphorus in early 2004. This has slowed passage time and forced ships to queue. While the Turkish restrictions are in part politically motivated (in support of the BTC pipeline), there are genuine environmental concerns as well. Such also exist in the Baltic, with environmental organisations in Denmark and Sweden exercising pressure on the EU and Baltic Council to restrict oil traffic via the Baltic Sea.²³⁴

Russia's Strategic Infrastructure Projects

The many bottlenecks have made Russia embark upon an ambitious series of infrastructure projects. These are the fields in which increased Russian attention and activities can be expected in both economic and geostrategic senses.

With regard to oil, Transneft is actively promoting a number of projects. On the Northern (Baltic) route, the main project is the further development of the BPS that allows the export of oil through Primorsk and several other ports in the Gulf of Finland.²³⁵ However, negotiations are still going on with regard to the Northern pipeline from West Siberia to Murmansk or thereabouts. For Russian interests, this option would be far more favourable than either of the Black Sea or Central European (continental) projects and alternatives with regard to transit costs, avoidance of transit dependence, and political risk in transit countries. In addition, the possibility of an ice-free deepwater port on the coast of the Barents Sea would allow the use of not only VLCCs but also large ULCCs²³⁶ with a capacity of 500,000 dwt. Murmansk can at present handle tankers with a capacity of 300,000 dwt. Besides, a dedicated pipeline to this terminal would not need to be connected to the existing main pipeline system, which would allow the export of a higher grade of oil than the Urals blend. However, so far Transneft has favoured another pipeline route, from Surgut or preferably Khariaga to Indiga, which would be connected to the existing Transneft system for Urals blend. Such a decision would disregard the fact that Indiga, unlike Murmansk, may not be an ice-free port (although Transneft says it is) and does not have as deep water as there is in the region around Murmansk. The maximum capacity of tankers in this region would be only 200,000 dwt.²³⁷ While a pipeline to the Barents Sea eventually no doubt will be constructed (the project was mentioned by Putin in his annual speech to the Russian Federal Assembly on 26 May 2004), its location therefore remains to be decided. A pipeline from West Siberia to Murmansk was first suggested by a consortium of several Russian oil companies (YuKOS being one) in 2002. The consortium applied to the federal government for approval, and Transneft was named general contractor.²³⁸ One possible 2,000-km route runs from the northern Urals through the city of Ufa, to transport oil from West Siberia, the Zapolyarnoye Urals deposits, and the Timan-Pechora oil and gas fields. A capacity of about 50 million tonnes of oil per year is being projected, about 60% of which will be Siberian.²³⁹

However, Transneft president Semyon Vainshtok on 15 June 2005 declared that he in fact was against the entire project, citing a perceived lack of demand for Russian crude on the US market and a lack of interest among Russian oil companies in guaranteeing orders. Rosneft, for instance, has already developed its own transport scheme for the region.²⁴⁰ A less favourable assessment could be that Transneft was running out of funds due to its commitments in East Siberia. On 21 June 2005, in response to a direct question he elaborated further on the project. At first all went well, he said, but then the oil companies had not given guarantees of volumes to be pumped through the system. Yet, Vainshtok pointed out that he believes the northern route to be necessary for Russia's oil industry. Besides, he noted that the Timan-Pechora or Komi-Pechora oil would be a new type of oil and would therefore be marketed separately from Urals blend.²⁴¹

As for Rosneft, the firm in late 2004 announced that it would construct a 750-km oil export pipeline from its Vankor field in Krasnoyarsk Krai to an oil export terminal to be built near Dikson on the Kara Sea. Rosneft already has a shipping subsidiary, Rosneftflot, which it plans to develop further for use in the Arkhangelsk and Murmansk region, among others in the form of a fleet of ice-breakers and 70,000 dwt tankers.²⁴² From Dikson, crude oil will be shipped to Rosneft's Belokamenka floating trans-shipment terminal. This facility accumulates crude oil moved from the White Sea ports of Arkhangelsk and Vitino. The oil is then reloaded into Aframax-type tankers for shipment to Northwest Europe.²⁴³

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Rosneft is even planning a new marine terminal, Belokamenka-2, near Arkhangelsk.²⁴⁴

As for LUKoil, there is the already mentioned Northern Gateway terminal in Varandey on the Barents Sea. LUKoil is the only vertically integrated oil company in Russia that already has its own fleet of tankers, managed by the subsidiary LUKoil-Arktik-tanker (LAT). There were, however, rumours in 2002 that LAT would be sold to an outside buyer, or perhaps transferred to LUKoil-Kaliningradmorneft due to internal disputes.²⁴⁵

On the Black Sea route, the main projects for increasing pipeline capacity have been completed. Azerbaijani oil still transits through the Baku-Tikhoretsk-Novorossiysk pipeline. Kazakhstani oil transits through several export routes: the Atyrau-Samara section to Druzhba (controlled by Russian Transneft) and the Baku-Tikhoretsk-Novorossiysk pipeline to which the oil can be moved by tanker to the Dagestani port of Makhachkala. Scarce pipeline capacity is thereby taken up by non-Russian oil, which annoys some Russian oil company executives.²⁴⁶ But the Russian state considers it a strategic interest to retain a modicum of control over the oil exports of these countries. There is also the privately owned CPC pipeline from Kazakhstan to Novorossiysk.²⁴⁷ The Druzhba-Brody-Odessa connection, launched on 29 September 2004, will also be a considerable Russian asset, as long as the new Ukrainian government does not reverse the decision on its use.²⁴⁸ The Odessa-Brody pipeline was originally built to run from Odessa to Brody, that is, to carry Caspian (or any other) oil via Odessa up towards Poland, or to supply Ukraine itself. It was built and funded by and is owned by the Ukrainian state, following a political decision that did not take the needs of the industry into account. However, the pipeline remained fundamentally idle following its completion in August 2001, since insufficient oil was available. The pipeline has therefore been reversed so as to better meet Russian export needs.²⁴⁹

On the continental (Central European) route, Transneft will continue to rely on the existing Druzhba pipeline, for which Belarus, Ukraine, Poland and to some extent Hungary are vital transit countries. Transneft's main interest was the integration of the Druzhba pipeline with the Adria pipeline (which would then be reversed) and its export terminal in the Croatian deepwater port of Omisalj on the Adriatic, since this would allow Russian exports a port in the Adriatic.²⁵⁰ Transneft planned to export at least 5 million tonnes per year through the Adria pipeline via Belarus, Ukraine and Hungary to Omisalj. By mid-2004, the Croatian side had still not completed the necessary infrastructure for completion of the project because of a lack of funds, and in early 2005 Croatia expressed environmental concerns. It seemed clear that the project had no future.²⁵¹ The first stage of the project was to be executed in 2005-2006.²⁵² However, although the use of a deepwater port such as Omisalj would allow access to the North American market, this project would only add throughput capacity of 5 million tonnes per year with the prospect of 15 million tonnes per year in the future. These volumes, as well as the low-grade Urals blend of oil in the Druzhba, would prevent it from being a decisive means to enter the North American market, even had the Croatian side been more eager to participate.²⁵³

The export route to the east is another matter. The Eastern Siberian Oil Pipeline from Taishet to the Pacific (at present likely to be a terminal in Perevoznaya Bay near Nakhodka, which according to Transneft would become an ice-free port able to receive tankers of 300,000 dwt)²⁵⁴ is being projected by Transneft, with an estimated capacity at about 80 million tonnes per year, primarily from the East Siberian oil fields. According to Transneft's President Semyon Vainshtok, the

project could start in summer 2005 and take 3-4 years to complete. The route will follow the Baikal-Amur Magistral (BAM) railway as far as Tynda.²⁵⁵ Vainshtok has since noted that the pipeline, which he described as having been decided as early as in 1994, will be in operation in 2008.²⁵⁶ The first stage would be a pipeline to Skovorodino, from which crude oil can be transported by rail either to China or to the new terminal to be built on the Pacific at Perevoznaya for export by sea to Japan and other countries.²⁵⁷ Russia's prime minister, Mikhail Fradkov, signed an order for the project on 31 December 2004.²⁵⁸ This project could also serve for exports to the United States. Even China may eventually need to rely on this project. Although China has displayed a substantial interest in Kazakh oil to promote competition between Kazakhstan and Russia, Moscow believes Kazakhstan will by 2010 probably not have a sufficient volume of oil to fill all existing export pipelines, not to mention any new projects.²⁵⁹ However, at present there are no oil producers or developers with strategic plans for the exploitation of the East Siberian oil resources.²⁶⁰

This apparent lack of interest highlights another issue. Under normal business conditions, the energy and in particular the oil industry at most times tends to be characterised by the existence of a plethora of transport infrastructure projects. In most cases, not all will be realised, and the volumes of oil might even be insufficient for all projects under discussion. In the end, only the truly profitable projects will be realised, unless a state steps in to support a particular project. Then funds will be made available for political reasons, regardless of business prospects. This, as noted, was the case with the Odessa-Brody pipeline, and it might well be true for the Eastern Siberian Oil Pipeline.

A summary of the key Russian oil export infrastructure projects can be found in Table 5.

Table 5 - Key Oil Export Infrastructure Projects

| Project | Status |
|--|--------------------|
| Druzhba pipeline | Existing but aged* |
| Baltic Pipeline System (BPS) | Existing* |
| Northern pipeline | Under discussion* |
| Druzhba-Adria integration | Not yet realised* |
| Baku-Tikhoretsk-Novorossiysk pipeline | Existing |
| Atyrau-Samara pipeline | Existing* |
| Caspian Pipeline Consortium (CPC) | Existing* |
| Novorossiysk and Tuapse ports | Existing* |
| Druzhba-Brody-Odessa | Existing |
| Eastern Siberian pipeline to the Pacific | Under discussion* |
| Sakhalin-1 and Sakhalin-2 | In progress* |

* Mentioned as especially important in the 2003 Russian energy strategy.²⁶¹

In addition, there are several ongoing gas infrastructure projects. While the Bratstvo pipeline system retains its importance, several new projects are equally needed.

Restoring and increasing the transit capacity of the Central Asia-Centre (CAC) gas pipeline system (from Turkmenistan through Uzbekistan and Kazakhstan to Russia) must be accomplished to retain the capacity to move gas from this region into Russia. The CAC is a network of five separate pipelines chiefly used for gas from the southeastern gas fields of Turkmenistan. The first line was built in 1966 and

the last in 1987. The pipeline system was laid in two major corridors: a main branch consisting of four pipelines (CAC-1, -2, -4 and -5) that passes through Uzbekistan, and which accounts for the bulk of the system's capacity, and a smaller branch consisting of only one pipeline (CAC-3) that runs only through Kazakhstan. The earliest parts of the system are already beyond their projected exploitation limit of 33 years. The initial design capacity of the system was 90 bcm per year and capacity occasionally reached 120 bcm per year. At present, its maximum annual capacity is less than 50 bcm: about 45 to 48 bcm per year according to Gazprom and no more than 40 bcm per year according to Uzbek experts. Because of these problems as well as lingering rivalry between Uzbekistan and Turkmenistan, there have been Turkmen proposals to increase the capacity of the existing CAC-3 pipeline through Kazakhstan.²⁶² In addition, a new CAC-3 pipeline along the Caspian coast from Turkmenistan through Kazakhstan to Russia is under consideration and will almost certainly be needed if the full stated export potential of Turkmen gas is to be realised.²⁶³

Restoring and increasing the transit capacity of the also quite old Bukhara-Urals gas pipeline is another project that needs to be resolved.²⁶⁴ There is also an existing Trans-Caucasus gas pipeline from Tbilisi to Russia, which the Russian side would like to see in more efficient use.²⁶⁵

The North European Gas Pipeline (approved by the Russian government in January 2004) will dramatically increase Russia's gas export potential.²⁶⁶ The project, at first called North TransGas, originated in 1997, when Gazprom and the Finnish firm Fortum agreed on the need for such a pipeline.²⁶⁷ The pipeline, which is being built by Gazprom in co-operation with the German firm Wintershall AG (a fully owned subsidiary of the BASF AG concern; Gazprom will own 50% minus one share, while BASF AG will own 49%), is currently expected to be in operation by 2010. Construction is expected to begin in autumn 2005.²⁶⁸ The pipeline will run under the Baltic from Vyborg. The final terminus of the pipeline will be Britain, accessed through the Zeebrugge (Belgium) - Bacton (UK) Interconnector pipeline. Project financing is partially available from the EBRD and the European Investment Bank.²⁶⁹ The project may also include branches to Finland, Sweden and the Russian enclave at Kaliningrad.²⁷⁰ The construction of a gas pipeline - the North European Gas Pipeline - from the deposits in the Yamal peninsula, which at least for now is being seen as the main resource base for export through this pipeline, has in an agreement between the European Union and Russia been designated a "common interest" energy project.²⁷¹ However, any exploitation of the Yamal gas deposits will need large-scale investment, which so far has deterred Gazprom.²⁷² Some suggest that exploitation of the Yamal deposits can begin from 2011, although starting dates in 2013 or 2015 cannot be ruled out.²⁷³ The North European Gas Pipeline is expected also to rely on the Shtokmanovskoye prospective gas field in the Barents Sea, which can be reached via Murmansk. The development of the Shtokman gas deposits (which are expected to be in production by 2012)²⁷⁴ has also been designated a "common interest" energy project between the European Union and Russia.²⁷⁵

There have been plans for a new 10,000-km Yamal-Europe gas pipeline to connect the Yamal Peninsula to the European pipeline grid (through Kessler, Germany). From the Yamal peninsula, the pipeline would run to Ukhta, where it would connect to the existing gas pipeline known as Northern Lights that runs to Europe through Belarus. Part of this project has been completed; an export pipeline known as Yamal-1 currently connects Russia to Poland by way of Belarus. A second one known as Yamal-2 is planned along a different route, although it would not really

be needed after the construction of the North European Gas Pipeline and may be cancelled.²⁷⁶

The Russian gas transport system is scheduled to be extended to the east from 2011.²⁷⁷ The Ministry of Industry and Energy has projected a gas pipeline from the Kovykta gas condensate field in Irkutsk Oblast to the Pacific coast of Russia. There may be an extension to South Korea via North Korea.²⁷⁸ There are also projected gas pipelines from Sakhalin to Japan and Vladivostok.²⁷⁹

Gazprom has already gained control over Turkmen natural gas, and has expanded its influence throughout the gas producing states in Central Asia. The most pressing remaining issues in what some regard as Moscow's plan to build up a liberal empire based on natural gas - if indeed this is the plan - would seem to be the following:²⁸⁰

1. A Gazprom-led joint venture with Belarus, based on Beltransgaz.
2. A twenty-five-year agreement with Kazakhstan on strategic co-operation in the gas sphere.

Both have been expected since 2004, but neither has yet taken place. For a summary of key Russian gas export infrastructure projects, see Table 6.

Table 6 - Key Gas Export Infrastructure Projects

| Project | Status |
|------------------------------------|---------------------------------|
| Bratstvo pipeline system | Existing but aged |
| North European Gas Pipeline | Projected |
| Yamal-1 | Existing, but needs expansion |
| Yamal-2 | Projected, but may be cancelled |
| Blue Stream | Existing |
| Central Asia-Centre (CAC) pipeline | Existing but aged |
| Bukhara-Urals pipeline | Existing but aged |
| A new CAC-3 pipeline | Under consideration |
| Trans-Caucasus pipeline | Existing |
| Kovykta-Pacific | Projected |
| Sakhalin-1 and Sakhalin-2 | In progress |

While the export infrastructure attracts most attention and will be vital for Russia, one should not forget the need for domestic infrastructure projects where major investment will be needed. Recent investment to improve existing production facilities has been comparatively small and may be insufficient to safeguard future growth.

In addition, the oil sector in particular suffers from lower profit margins of oil exports and production growth in times of high oil prices, because of the additional tax load imposed on the oil industry when international oil prices rise above a certain level, at present \$20 per barrel (Urals, which is somewhat cheaper than Brent which is the benchmark for oil prices); the additional taxes go into a fiscal stabilisation fund for government use.²⁸¹ The Russian government is in effect milking the oil industry of its profits by taxation when times are good. This paradoxically means that profits do not increase, or increase but marginally, even when oil prices are high, thus giving companies no incentive to increase production and export volumes, thus making infrastructure investments undesirable in times of both high and low oil prices.²⁸²

As for Transneft, the company does not appear to be making sufficient profits to finance all of its currently more or less favoured infrastructure projects (such as the BPS expansion, the East Siberia-Pacific pipeline, the Trans-Thracian Pipeline (for transit through European Turkey from Kiyiköy to Ibrihaba (Ibrice)), the Druzhba-Adria integration, and the Surgut or Khariaga-Indiga pipeline). This is at least the conclusion one can draw from Transneft's own calculations, which imply that its projects are conspicuously expensive in terms of cost per km. There are speculations that Transneft will finance its infrastructure projects in conjunction with the Russian government with a special tax (investment tariff) on oil companies, over and above the increase in taxes in 2004.²⁸³ In addition, Transneft in early 2005 requested tax privileges of about \$11.5 billion from President Putin for the duration of the construction and payback period of the East Siberia-Pacific pipeline.²⁸⁴ Transneft's President, Semyon Vainshtok, on 21 June 2005 in response to a question mentioned that Transneft will benefit from a new tariff system to make oil exports eastwards more attractive.²⁸⁵ Vainshtok on the same occasion also indicated that Transneft will borrow some funds for the project. This confirms the general view that at least the new export infrastructure projects will be mainly financed by international loans.²⁸⁶

In addition, there is a need for further domestic prospecting and production. West Siberia still shows a high potential for oil exploration. The Russian Arctic coast has hitherto seen little exploration but shows high potential for oil finds, as does the Lena delta. There is also a high potential for exploration for oil in Kazakhstan, in particular in the pre-Caspian, which is shown by the supergiant Kashagan offshore oil field, the only new supergiant oil field found in the last twenty-five years.²⁸⁷

Medvedev versus Sechin: The Struggle Between Gazprom & Rosneft

Until recently, Gazprom seemed to be the chosen tool for the Kremlin to re-acquire a sufficient share of ownership, and therefore control, over the oil industry. This ambition coincided with the intention of Gazprom President Aleksei Miller to transform Gazprom into a diversified energy company, involved in both oil and natural gas production as well as electricity generation. As part of this development, Gazprom on 2 November 2004 formally established OOO Gazpromneft, registered in St. Petersburg with 30 million rubles (USD 1 million) in capitalisation, as a wholly owned Gazprom oil subsidiary. All Gazprom oil assets were expected to be consolidated within the company. Rosneft President Sergei Bogdanchikov was appointed general director of the new company.²⁸⁸ A few days later, on 11 November 2004, the Kremlin gave its formal approval for Gazprom to take over the state-owned oil company Rosneft. This deal would also increase the state's share in Gazprom ownership from 38.37% to 50% plus one share, which of course meant that the Russian state henceforth would become the majority owner of Gazprom.²⁸⁹

This move, when it took place, was no particular surprise. President Putin's approval of the plan was first reported on 14 September 2004, and rumours of such a move had indeed been circulating since at least July 2004.²⁹⁰ Kremlin insider Stanislav Belkovsky on 5 July 2004 posted a prediction on the National Strategy Institute's Agency of Political News (APN) web site that the Kremlin would implement a plan by presidential administration deputy head Igor Sechin to create a new holding based on the two state-controlled energy companies, Gazprom and Rosneft, which together would acquire about one-half of the assets of the oil

company YuKOS. Belkovsky added that the new holding would be headed by Sechin, who by then was widely expected to be named chairman of Rosneft soon.²⁹¹ Sechin was indeed soon after elected chairman.²⁹²

As if wishing to confound speculators - but more likely to evade complications due to the actions of YuKOS in a US court - Gazprom on 17 December 2004 (two days before the controversial Yuganskneftegaz auction, see below) sold Gazpromneft to an unknown buyer. There are suspicions that the sale was actually decided upon after the auction, but that the date was shifted back so as to shield Gazprom from the possible fall-out of US court action in favour of YuKOS.²⁹³

On 19 December 2004, the main asset of YuKOS, majority ownership in Yuganskneftegaz, was auctioned to Baikal Finance Group (BFG).²⁹⁴ On 23 December 2004, BFG in its turn sold its equity in Yuganskneftegaz to Rosneft. Gazprom announced that the deal would not prevent Gazprom from acquiring Rosneft.²⁹⁵ In other words, even without Gazpromneft, Gazprom would still create an oil subsidiary and the state would still acquire a majority share in the firm. Belkovsky had again proved the credibility of his inside information on the view from the Kremlin.

Or had he? On 17 May 2005, Gazprom chairman Dmitry Medvedev suddenly declared the expected merger dead. Rosneft would remain independent of Gazprom. Sechin, who reportedly had campaigned fiercely against the proposed merger, had perhaps triumphed in the end.²⁹⁶ His influence is no doubt considerable. Sechin is reportedly the only official whom Putin has taken with him to every new job.²⁹⁷ This makes the outside observer wonder whether the rivalry indeed was a political one between Medvedev and Sechin, or a commercial one between Gazprom and Rosneft.

In late May 2005, both Gazprom and Rosneft, independently of each other, reportedly carried out negotiations on the possible acquisition of the oil company Sibneft.²⁹⁸

But the need for the government to acquire a majority stake in Gazprom still remained unfulfilled. According to a new plan, which was then presented, the government would instead borrow capital from Western banks to buy the required 10.7% stake in Gazprom, by buying shares from Gazprom subsidiaries for cash at market value (at first estimated to be almost \$13 billion but on 16 June 2005 fixed at \$7.15 billion).²⁹⁹ The government would then probably need to sell 49% or less of its 100% stake in Rosneft to repay the loan.³⁰⁰

On 30 May 2005, the Federal Agency for the Management of Federal Property (Rosimushchestvo) declared that it in the coming week would surrender all equity in NK Rosneft (thus privatising the firm) into the new temporary holding company OAO Rosneftegaz.³⁰¹ This happened on 1 June.³⁰² Rosneftegaz would thereby absorb Rosneft. Furthermore, the new Rosneftegaz would buy the Gazprom shares from subsidiaries needed by the government to gain a majority stake in Gazprom. Afterwards Rosneftegaz would reportedly be liquidated. The end result would be two privatised, but government-controlled, energy companies with equity in which the state in both cases held a majority stake: Rosneft and Gazprom.³⁰³ If the Russian state had abandoned its wish to create a more powerful Gazprom, what did it want instead? So far, it seems that the current plan is to have several major state-controlled entities at the disposal of the state. These would surely include Gazprom and Rosneft, but others would also seem eligible, including Zarubezhneft,

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an oil firm that previously primarily operated abroad, but recently has begun to take part in domestic projects as well.³⁰⁴

Even so, this is not likely to be the last chapter in the Gazprom-Rosneft saga.

The Other Side of the Medal

Despite high Russian hopes for the country's energy resources, not all is well in the state of Russia - and certain systemic errors begin to show up within the state-controlled entities of the Russian energy sector.

Even in the time of Witte and Kuzminsky in the early 1900s, the private segments of the Russian oil fields were operated far more efficiently than the state-owned enterprises, and the government made little or no effort to develop those oil fields that lay idle.³⁰⁵

In recent years, Russian GDP growth has been derived from industrial exports in general and the export of hydrocarbons in particular. The GDP growth has primarily been driven by oil, and in particular the major independent oil companies such as YuKOS, Sibneft and TNK-BP, which have seen both output and export of crude and condensate grow substantially more than in the state-controlled part of the sector. The fact that growth has primarily been driven by oil, however, is not solely, or even primarily, an effect of the increasing price level. Despite the rising oil prices, Russia has in recent years seen a decrease in total growth. In addition, labour productivity has decreased in the Russian gas industry. To a lesser extent, this also holds true for electricity production. It appears that the customary high level of bureaucracy and nepotism is reasserting itself in the state-controlled monopolies. While the major independent oil companies have done well, the state-controlled companies are doing far less well. Productivity within Gazprom and UES is particularly poor. In other words, the state-controlled monopolies are not contributing to economic growth.³⁰⁶ Yet it is clearly through the state sector that Putin and his friends wish to run the Russian energy industry.

To maintain a sustained economic growth in Russia will require strong export growth, which means the export of natural resources and in particular hydrocarbons. A sustained hydrocarbon export growth in its turn demands more pipelines and, judging from the poor performance of Gazprom, substantial energy sector reform.³⁰⁷

If the Russian state released its monopoly on oil and gas pipelines, it is likely that the energy companies would make substantial new infrastructure investments. Many additional oil and gas pipelines would be built, and the domestic and export prices could in theory converge (if the Russian consumers could take it without another revolution - and domestic prices raised to levels that would cover long-term production costs form a part of the published energy strategy).³⁰⁸ Export prices would yet remain higher, since the great distances would entail transportation costs, but the end result might be that the energy sector would bring increased incomes to the state coffers.

However, this is not likely to happen, since the state under Putin is very unlikely, to say the least, to release its grip on strategic natural resources.

This is also unfortunate for the Russian oil industry. Transneft is, together with the Russian state, in the process of deciding the export infrastructure strategy with which Russia will have to live in the near future. Yet Transneft has no interest per se in the selling of oil, which is the core business of the oil companies that are supposed to rely on the Transneft infrastructure, and Transneft has therefore shown precious little ability to understand the economics of oil exports. Besides, Transneft has shown itself, like other state monopolies, an inefficient and often unnecessarily expensive constructor of infrastructure. The Transneft monopoly therefore may not be in a position fully to understand the present and future requirements of the Russian oil industry. Its decisions may well be based on what on the surface appears to be rational reasons for the Russian state, but which in the end will not result in increased oil exports and therefore will decrease rather than increase the revenues of oil companies and state alike.

At present, the foreign loans to Russia (private sector borrowing) are roughly compensated by the level of Russian capital flight. The volumes more or less correspond. This suggests that the two volumes of capital in fact may consist of the same money.³⁰⁹ If so, this is not a very efficient way to make full use of capital. And in either case the investment volume is insufficient.

As for Russia's energy customers abroad, in the short term, the mutual dependence between Russia and especially the EU ensures that Russia will not use its dominant position in the energy sector to exercise political or economic pressure under normal operating conditions. However, mutual dependence remains mutual only as long as both parties perceive a need for the other. In times of real crisis in the relationship, for instance if a weak Russia felt increasingly isolated from Europe, all bets are off. Mutual dependence is based on rough parity, or it will no longer be mutual. Alliances, formal or informal, are never formed as a matter of principle. They are formed for specific contextual reasons. Alliances arise out of communities of interests. Existing alliances may collapse when conditions change, for instance when one party is growing in power and the other is not, or even diminishes. He who has nothing to lose will not hesitate to break a relationship of mutual dependence. This is equally well known in tribal societies as in the political science departments of modern universities. "Men ally with their equals."³¹⁰

ENDNOTES

¹ Norio Ehara, "IEA Collaboration with India and China on Oil Security", presentation during Workshop on Oil Supply Disruption Management Issues, Cambodia, 6 April 2004. See also, eg, International Energy Agency (IEA), *China's Worldwide Quest for Energy Security* (Paris: IEA, 2000), 18-22; Vladimir Saprykin, "EU-Ukraine-Russia: Further Gas Dialog As a Guarantee of Europe's Energy Security", *Central Asia and the Caucasus* 17 (2002), 159-68.

² Justin Swift (Deputy Assistant Secretary of Energy), presentation, 12th International Caspian Oil & Gas Conference, Baku, 7-10 June 2005. See also *Economist*, 30 April 2005; National Energy Policy Development Group, *National Energy Policy* (Washington, DC: National Energy Policy Development Group, 2001), xv. It should be emphasised that the figures mentioned by Justin Swift are projections only. The reader should note that most figures cited in the present paper are projections, and any capacity or throughput calculations are likely to depend on the companies building or running the relevant transport infrastructure. Oil and gas reserves are also often subject to revision.

³ ITAR-TASS, 7 February 2005.

⁴ *Nefteryok*, 2, 2005.

⁵ Vladimir Sayenko (Head of Division for State Energy Policy, Department for Fuel and Energy Complex, Ministry of Industry and Energy), presentation, 3rd International

Conference on Mergers, Acquisitions and Licences in the Russian Oil and Gas Industry, Moscow, 30-31 May 2005.

⁶ See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh razvitiya infrastruktury po transportirovke rossiyskoy nefti* ("On the Possible Directions for Development of Russian Oil Transportation Infrastructure"), November 2004 (www.csr.ru). The centre was founded by the Minister of Economic Development and Trade, German Gref. See also Igor Tomberg, "Oil Pipeline in the Far East: Economics and Geopolitics", *Central Asia and the Caucasus* 25 (2004), 110-18, on 117.

⁷ *BP Statistical Review of World Energy*, June 2005.

⁸ See, eg, presentations by Francis G Harper (Senior Executive, Exploration, BP) and Kjell Aleklett (Uppsala University; president of the Association for the Study of Peak Oil and Gas), Seminar on Oil Reserves, Stockholm, 14 December 2004. Not all would agree that there will be a peak in oil production.

⁹ William Tompson & Rudiger Ahrend, *OECD Economic Surveys: Russian Federation* (Paris: OECD, 2004), 144; Energy Information Administration, US Department of Energy, *Saudi Arabia Country Analysis* (Washington, DC: Energy Information Administration, January 2005; www.eia.doe.gov). *BP Statistical Review of World Energy*, June 2005 offers different figures but shows a similar relationship.

¹⁰ John Roberts (Energy Security Specialist, Platts), "Potential of Caspian Oil and Gas and Export Options Via the Black Sea Region and Balkans; Overview of Export Options from Central Asia and the Caspian Region to the Middle East and Asia", Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004.

¹¹ *Gazprom* 5, (May 2005), 6. The journal *Gazprom* is, as the name implies, published by Gazprom.

¹² *Novosti TEK* 557, (Tsentr politicheskoy kon'yunktury Rossii, 13-19 June 2005); *Petroleum Argus FSU Energy* 10:22 (10 June 2005).

¹³ Interview with Rudolf Ter-Sarkisov, General Director of Gazprom's scientific institute OOO VNIIGAZ, *Oil & Gas Eurasia* 6, 2005, pp54-8.

¹⁴ Sayenko, presentation.

¹⁵ Olga Vinogradova, "Gaz Rossii: Otrazlevoy obzor", *Neftegazovaya Vertikal'* 8-9, 2005, pp96-103, on 99.

¹⁶ Torsten Wöllert (EU Co-director of the EU-Russia Energy Dialogue Technology Centre, Moscow), presentation, 3rd Russian Petroleum & Gas Congress, Moscow, 21-23 June 2005.

¹⁷ Roberts, "Potential of Caspian Oil", *Gazprom* 5, (May 2005), 6.

¹⁸ Tompson & Ahrend, *OECD Economic Surveys: Russian Federation*, 163.

¹⁹ Justin Swift (Deputy Assistant Secretary of Energy), presentation, 12th International Caspian Oil & Gas Conference, Baku, 7-10 June 2005; National Energy Policy Development Group, *National Energy Policy*, x.

²⁰ *Osnovnyye polozheniya Kontseptsii energeticheskoy politiki Rossii v novykh ekonomicheskikh usloviyakh*.

²¹ Robert Ebel (Center for Strategic and International Studies), in Bill Lahneman & Timothy R Gulden, *Conference on the Geopolitics of Energy in 2015: Russia* (College Park, Maryland: National Intelligence Council Project, University of Maryland, 10 May 2002).

²² The full text is published in International Energy Agency (IEA), *Energy Policies of the Russian Federation* (Paris: IEA, 1995), pp269-323.

²³ *Osnovnyye napravleniya energeticheskoy politiki Rossiyskoy Federatsii na period do 2010 goda*, Presidential Decree No 472, 7 May 1995. The text is published in eg IEA, *Energy Policies*, 265-8.

²⁴ *Osnovnyye polozheniya Energeticheskoy strategii Rossii*, Protocol No 1006, 13 October 1995.

²⁵ *Osnovnyye polozheniya strukturnoy reformy v sfere yestestvennykh monopoliy*, Presidential Decree No 426, 28 April 1997.

²⁶ *Programma mer po strukturnoy perestroyke, privatizatsii i usileniyu kontrolya v sferakh yestestvennykh monopoliy*, Protocol No 987, 7 August 1997.

²⁷ *Osnovnyye polozheniya Energeticheskoy strategii Rossii na period do 2020 goda*, Protocol No 39, 23 November 2000. Published in Moscow by Institut energeticheskoy strategii (IES), 2001. Also available on the websites, <http://energo-cis.org>; and

www.nice.nnow.ru/Ru/dbs/document/noadopt1.htm. This document briefly summarises the contents of the previous laws and documents.

²⁸ *Ob utochnenii osnovnykh polozheniy Energeticheskoy strategii Rossii na period do 2020 goda*. Russian official website, www.government.ru.

²⁹ *Energeticheskaya strategiya Rossii na period do 2020 goda* ("Energy Strategy of Russia to the Year 2020"), Government of the Russian Federation Decree 1234-r, 28 August 2003.

³⁰ See, eg, Michael Fredholm, "Russia and Central Asian Security", Birgit N Schlyter, (ed), *Prospects for Democracy in Central Asia* (Istanbul: Swedish Research Institute in Istanbul Transactions Vol 15, 2005), 97-116, on the Russian National Security Concept and Foreign Policy Concept, pieces of legislation enacted for similar reasons.

³¹ *Energeticheskaya strategiya*, 26.

³² Ibid. 40-41.

³³ Ibid. 61.

³⁴ The Eurasian Economic Community came into force in 2001, following a treaty signed in 2000. Its members are Russia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan.

³⁵ *Energeticheskaya strategiya*, 42-3. It is not only the energy strategy that occasionally uses language reminiscent of military strategy. At the 3rd Russian Petroleum & Gas Congress in Moscow on 21-23 June 2005, the President of the Russian oil pipeline monopoly Transneft, Semyon Vainshtok, quoted the famous Russian general Suvorov to make a point.

³⁶ *Energeticheskaya strategiya*, 45.

³⁷ Ibid, 51, 53.

³⁸ Ibid, 17.

³⁹ Ibid, 61, 71.

⁴⁰ Ibid, 41.

⁴¹ Ibid, 70.

⁴² Ibid, 68.

⁴³ Ibid, 69.

⁴⁴ Ibid, 50-51.

⁴⁵ Viktor Kalyuzhny, Deputy Minister of Foreign Affairs of the Russian Federation and Russian Special Presidential Envoy for the Caspian Sea, Statement at the Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, 26 February 2004.

⁴⁶ *Energeticheskaya strategiya*, 52.

⁴⁷ International Energy Agency(IEA), *Russia Energy Survey 2002*(Paris: OECD/IEA 2002), *Russian Electricity Reform: Emerging Challenges and Opportunities* (Paris: OECD/IEA, 2005), 95. This was a slight increase from 42% in 1999. IEA, *Russia Energy Survey 2002*, 194.

⁴⁸ IEA, *Russia Energy Survey 2002*, 55-6. Cf. *Energeticheskaya strategiya*, 89.

⁴⁹ IEA, *Russia Energy Survey 2002*, 161.

⁵⁰ *Energeticheskaya strategiya*, 53.

⁵¹ Ibid, 94.

⁵² Ibid, 85.

⁵³ Ibid, 54.

⁵⁴ Ibid, 55.

⁵⁵ Ibid, 45, 46.

⁵⁶ Ibid, 45, 46.

⁵⁷ Ibid, 57.

⁵⁸ Ibid, 59-60.

⁵⁹ Ibid, 37.

⁶⁰ Ibid, 39.

⁶¹ 'Strategy of Nuclear Power Development in Russia in the First Half of the 21st Century', approved by the Russian government on 25 May 2000 (Protocol No 17). See, eg, the Rosenergoatom website, www.rosatom.ru.

⁶² Oleg Bukharin (Princeton University), in Lahneman and Gulden, *Conference on the Geopolitics of Energy*.

⁶³ IEA, *Russian Electricity Reform*, 31; Rosenergoatom's website, www.rosatom.ru.

⁶⁴ Alexander Sutyagin, Monitoring BTS/Bellona, St Petersburg, 6 May 2004, (www.bellona.no).

⁶⁵ See, eg, Tsentralnaya strategicheskaya razvitiya, *O vozmozhnykh napravleniyakh*. The Transneft documents released to the public can be seen on the Transneft website, www.transneft.ru.

⁶⁶ This list, the last version of which does not appear to have been published in its entirety, appears in different versions in different decrees and laws. Earlier versions were published in 1998 and on 9 January 2004. One of the 1998 lists also included oil companies such as LUKoil, Slavneft and Sibur, as well as the electric power monopoly UES. On President Putin's Edict 'On Approving the List of Strategic Enterprises and Strategic Joint Stock Companies', see, eg, *Vremya Novostey*, 6 August 2004. Some legislative acts that listed these companies have since been cancelled. *Interfax Oil & Gas Report*, 6 October 2004.

⁶⁷ GDP figures from 2000. World Bank, *From Transition to Development: A Country Economic Memorandum for the Russian Federation* (Poverty Reduction and Economic Management Unit, Europe and Central Asia Region, March 2005), 8-9; World Bank, *Russian Economic Report No 7*, February 2004 (www.worldbank.org.ru), 14. According to data from the Russian Audit Chamber, Gazprom, which accounts for a quarter of the world's gas output, in itself contributes a 7% share to Russian GDP and 10% of all federal tax incomes. ITAR-TASS, 7 February 2005.

⁶⁸ Vinogradova, "Gaz Rossii", 99.

⁶⁹ *Oil & Gas Eurasia* 6, 2005, p65.

⁷⁰ See, eg, the websites of these companies, www.gazprom.ru; www.transneft.ru; and www.rao-ees.ru.

⁷¹ Charles van der Leeuw, *Oil and Gas in the Caucasus & Caspian: A History* (Richmond, Surrey: Curzon, 2000), 68, 86-7.

⁷² Rosemarie Forsythe, *The Politics of Oil in The Caucasus and Central Asia: Prospects for Oil Exploitation and Export in the Caspian Basin* (London: Oxford University Press/IISS, Adelphi Paper 300, 1996), 15-16, 39-40; with regard to the secret directive referring to Robert V Barylski, "Russia, the West, and the Caspian Energy Hub", *Middle East Journal* 49: 2 (Spring 1995).

⁷³ See, eg, Pavel Baev, "Russia's Happiness in Multiple Pipelines", *Central Asia Caucasus Analyst* (www.cacianalyst.org), 16 June 2004.

⁷⁴ See, eg, Interfax, 20 December 2002, on the Russian president's regular contacts with top Russian businessmen. An earlier example is provided by the 1995 energy strategy, which was drafted by a number of commissions that included, in addition to various government appointees, A F Dyakov, president of UES; V D Chernyayev, president of Transneft; V I Ott, vice-president of Rosneft; R I Vyakhirev, president of Gazprom; V Yu Alekperov, president of LUKoil; and V A Fedorchenko, president of the East-Siberian Oil and Gas Company.

⁷⁵ Interfax, 29 April 2004.

⁷⁶ Pavel Felgengauer, "Oborona neftegazovoy truby", *Novaya Gazeta* 76, 13 October 2003, <http://novayagazeta.ru>.

⁷⁷ *Nefterynok* 5, 2005.

⁷⁸ *Nefterynok* 2, 2005.

⁷⁹ *Nefterynok* 3, 2005.

⁸⁰ www.gazprom.ru. Medvedev was chairman of the board of directors of Gazprom also in 2000-2001, as well as deputy chairman of the board of directors of Gazprom from 2001 to June 2002. See the official website, www.kremlin.ru.

⁸¹ *Nefterynok* 8, 2004. Surkov, it should be noted, is also reputed to maintain close links with and function as a lobbyist for Alfa-Bank, his employer in 1997. *Alexander's Gas & Oil Connections* 6: 23 (6 December 2001; www.gasandoil.com). Surkov's colleague and fellow aide to the President, Aleksandr Abramov, also worked for Alfa-Bank in the period 1997-1999. See the official website, www.kremlin.ru; and Transnefteprodukt's website, <http://transnefteprodukt.ru>.

⁸² RFE/RL *Russian Political Weekly* 4: 29, 29 July 2004. On Sechin, see also *Upstream* 10:24 (17 June 2005), 26; and www.rosneft.ru.

⁸³ *Nezavisimaya Gazeta*, 10 September 2004. Shkolov was on 16 March 2005 also appointed Vice-President of Transneft. *Kommersant*, 17 March 2005; www.transneft.ru.

⁸⁴ *Nezavisimaya Gazeta*, 10 September 2004; www.transneft.ru.

- ⁸⁵ OAO AKhK Sukhoy is involved in military aircraft production. Sukhoy website, www.sukhoi.org. Dvorkovich was on 2 February 2005 also nominated to the board of directors of OAO Svyazinvest, a telecommunications conglomerate that controls among others Rostelecom, but elections (scheduled for August 2005) have not yet taken place. *Ekonomicheskaya Politika* 6 (538), www.ancentr.ru. See also Svyazinvest's website, www.svyazinvest.ru.
- ⁸⁶ Vyazalov is deputy head of the Presidential Foreign Policy Directorate. OAO Rossiyskiye zheleznye dorogi (RZhD) is Russia's state-owned railways operator. See the firm's website, www.rzd.ru.
- ⁸⁷ www.svyazinvest.ru.
- ⁸⁸ *Nezavisimaya Gazeta*, 10 September 2004; www.rzd.ru. Shuvalov was in 2005 also nominated to the board of directors of Gazprom (Prime-TASS, 1 February 2005) but was not elected.
- ⁸⁹ Mosnews, 5 November 2004 (www.mosnews.com); Aeroflot's website, www.aeroflot.ru. Ivanov was previously (from June 2002) the chairman of Almaz-Antey. *Nezavisimaya Gazeta*, 10 September 2004. OAO Kontsern PVO Almaz-Antey belongs to the Russian defence industrial complex and is involved in air defence weapons production. See the firm's website, www.raspletin.ru.
- ⁹⁰ *Nezavisimaya Gazeta*, 10 September 2004. TRV, OAO Takticheskoye Raketnoye Vooruzheniye (Tactical Missile Armament Corporation) is involved in missile production.
- ⁹¹ *Kommersant*, 23 October 2004.
- ⁹² Ibid. OAO TVEL produces nuclear uranium fuel. See the firm's website, www.tvel.ru.
- ⁹³ *Nezavisimaya Gazeta*, 10 September 2004. OAO Pervyy kanal (Channel One Russia) is a television station. See the firm's website, www.1tv.ru. Lesin was in January 2005 nominated to the board of directors of Svyazinvest, but he was within two weeks replaced by Dvorkovich as the Presidential Administration's candidate. Corporate Governance in Russia website, www.corp-gov.org.
- ⁹⁴ *Nezavisimaya Gazeta*, 10 September 2004.
- ⁹⁵ www.svyazinvest.ru.
- ⁹⁶ *Upstream*, 17 June 2005, p32.
- ⁹⁷ Prime-TASS, 1 February 2005; www.gazprom.ru. Yusufov, who from 16 June 2001 to 24 February 2004 was energy minister of Russia, on 29 July 2004 was appointed Special Representative of the President of the Russian Federation on international cooperation in the energy sector, with the rank of ambassador.
- ⁹⁸ See, eg, RFE/RL *Russian Political Weekly* 3: 48 (5 December 2003); 4: 9 (12 March 2004).
- ⁹⁹ RFE/RL *Russian Political Weekly* 4: 36 (16 September 2004). On Sovcomflot, see the firm's website, www.sovkomflot.com.
- ¹⁰⁰ *St Petersburg Times*, 10 December 2004.
- ¹⁰¹ On Kalyuzhny's career, see, eg, his official CV presented to the Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004. The more fortunate Steven Mann, who had not even bothered to show up at this, the reportedly last public debate between the two, a few months later participated in the triumphant ceremony of connecting the Azerbaijani and Georgian sections of the BTC pipeline on 16 September 2004. Faris Ismailzade, "BTC Enters the Final Stage as Azerbaijan and Georgia Connect the Pipeline at the Border", *Central Asia-Caucasus Analyst*, 20 October 2004. On Kalyuzhny's appointment to Latvia, see RFE/RL *Newsline*, 14 July 2004. On Yusufov, see www.gazprom.ru.
- ¹⁰² See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.
- ¹⁰³ See, eg, *ibid*.
- ¹⁰⁴ See, eg, *Nefteryok* 8, 2004.
- ¹⁰⁵ Several possible bypass routes have been proposed by various parties to avoid transit through the straits. Unfortunately, the straits transit can only be relieved, not entirely bypassed, through pipelines, since the capacity needed is simply too great. The cheapest bypass pipeline would be a trans-Turkish pipeline (the so-called Trans-Thracian Pipeline) from Kiyiköy on the Black Sea to Ibrihaba (Ibrice) on the Aegean. This project has been promoted by Transneft. The second cheapest alternative would be a bypass pipeline from Burgas in Bulgaria to Alexandroupolis on the Greek coast of the Aegean. During a

trilateral meeting in Athens on 4-5 November 2004, Russia, Greece, and Bulgaria initialed a memorandum on a project to construct such a pipeline, and a further memorandum of cooperation was signed on 15 April 2005. However, the sides have been negotiating the project since 1994, and no firm timetable has yet been established. *Nefteryok* 10, 2004; 4, 2005. Unfortunately, the overhead costs of any alternative pipeline remains higher than the increased costs for tanker transit even with a twenty-day hold-up. See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*. On the costs and alternatives, see also Adolf H Feizlmayr (ILF Consulting Engineers), presentation at the Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004; and (on Transneft's participation) Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.

¹⁰⁶ See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.

¹⁰⁷ See, eg, *ibid*.

¹⁰⁸ Interview with Rudolf Ter-Sarkisov, *Oil & Gas Eurasia* 6, 2005, pp54-8.

¹⁰⁹ See, eg, IEA, *Russia Energy Survey 2002*.

¹¹⁰ *Neft' i kapital* 10, 2004, p117.

¹¹¹ *Jane's Foreign Report* 2617, 16 November 2000; *Neft' i kapital* 10, 2004, p117; Vinogradova, "Gaz Rossii", 100.

¹¹² Matthew Sagers (Cambridge Energy Research Associates), in Lahneman and Gulden, *Conference on the Geopolitics of Energy*.

¹¹³ See, eg, Nadir Biyikoglu (Deputy General Manager, BOTAS), "An International Cooperation Project in the BlackSea: Blue Stream", *BlackSea Trend Review* 1: 1 (Summer 2002), 86-9.

¹¹⁴ UES website, www.rao-ees.ru.

¹¹⁵ *International Herald Tribune*, 27 October 2003.

¹¹⁶ Felgengauer, "Oborona neftegazovoy truby".

¹¹⁷ Tomberg, "Oil Pipeline in the Far East", 110-18.

¹¹⁸ YuKOS, *Murmansk Pipeline* (3 March 2003; www.yukos.com). Others expected a capacity of from 60 to as much as 120 million tonnes per year. See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.

¹¹⁹ Fiona Hill, *Energy Empire: Oil, Gas and Russia's Revival* (London: Foreign Policy Centre, 2004), 35-6.

¹²⁰ See, eg, RFE/RL, 28 November 2002; *Neft' i kapital* 10, 2004, p165; Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.

¹²¹ *Moscow Times*, 23 July 2003.

¹²² Rosbalt News Agency, 17 April 2003; Reuters, 17 April 2003. See also the website, www.rusenergy.com, 21 April 2003.

¹²³ "V Rossii gotovitsya oligarkhicheskiy perevorot", *Utro*, 26 May 2003 (www.utro.ru). Many researchers of the National Strategy Institute subsequently protested against the report. See, eg, "Politologi ssoryatsya iz-za oligarkhov", *Utro*, 30 May 2003.

¹²⁴ Stanislav Belkovsky, "Oдиночество Putina," *Zavtra* 19 (494), 6 May 2003 (<http://zavtra.ru>). The report is no longer available on the website of the National Strategy Institute, Agency of Political News (www.apn.ru). On Belkovsky, see also Victor Yasmann, "The Mysterious Herald of National Revanche: Stanislav Belkovskii", *RFE/RL Russian Political Weekly* 4: 13 (7 April 2004); Victor Yasmann, "What's Next for Yukos?", *RFE/RL Russian Political Weekly* 4: 27 (15 July 2004).

¹²⁵ Tomberg, "Oil Pipeline in the Far East", 111-12.

¹²⁶ *Energeticheskaya strategiya*, 70.

¹²⁷ *Ibid*, 17, 68.

¹²⁸ RIA-Novosti, 23 June 2004.

¹²⁹ *Neft' i kapital* 10, 2004, p50.

¹³⁰ Pankrashkin, Nikolay, "The Baltic Azimuth", *Oil of Russia* 2, 2005, pp31-33. *Oil of Russia* is published by LUKoil. On Transnefteprodukt's project Sever, see also *Neft' i kapital* 10, 2004, p200. The state-controlled, and 100%-state-owned, OAO AK Transnefteprodukt (TNP) is one of the world's largest companies in the transport of oil products such as diesel fuel, gasoline and kerosene. Transnefteprodukt is active throughout Russia as well as in Ukraine, Belarus, Latvia and Kazakhstan. "Neft' Rossii: Otravnyy obzor", *Neftegazovaya Vertikal'* 8-9, 2005, pp62-9, on 69. On the LNG project in Ust'-Luga, see Alla Sapun, "SPG Ust'-Lugi: Zapasnoy parashiut?", *Neftegazovaya Vertikal'* 8-9, 2005, pp140-141. Gazprom has indicated that it by 2009 wants its own LNG terminal in Ust'-Luga. Reuters, 25

February 2005. This LNG terminal may in fact be put in operation before Gazprom's LNG efforts on the Barents Sea and the Shtokman field, although there may be delays since standard LNG tankers cannot use the Gulf of Finland in winter because of the ice. Igor Meshcherin (Gazprom), presentation, 3rd Russian Petroleum & Gas Congress 2005, Moscow, 21-23 June 2005. LNG is gas cooled to minus 162 degrees Celsius, which produces a liquid that occupies less than 1/600 of its original volume. LNG is transported by special tankers to re-gasification terminals, where it is returned to a gaseous state and fed into regular gas pipelines.

¹³¹ AK&M Information Agency, 9 June 2004.

¹³² See, eg, Aleksandr Yershov, "Baltiyskiy tranzit: Rossiya nashla upravu na svoikh sosedy", Internet newspaper www.pravda.ru, 10 December 2004.

¹³³ *Energeticheskaya strategiya*, 70.

¹³⁴ On the Arctic Sea route (severnnyy morskoy put'); SMP), see, eg, *Neft'gazpromyshlennost'* 4 (16), 2005, pp20-24.

¹³⁵ See, eg, *Nefterynok* 10, 2004; Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.

¹³⁶ Interfax, 26 May 2004. Putin's corresponding speech in 2005 (on the official website, www.kremlin.ru) dealt with other issues.

¹³⁷ Novorossiysk and Tuapse are major existing ports. On Makhachkala, see, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*. On Temryuk, see AvtoTransInfo, 7 December 1999 (www.avtotransinfo.ru). On Zhelezny Rog, see, eg, the logistics portal, www.logistics.ru, with regard to the firm ZAO Taman'neftegaz.

¹³⁸ See, eg, Interfax, *Energy News Service*, 12 April 2004; WPS *Russian Oil & Gas Report*, 14 April 2004, on the construction of industrial infrastructure as part of the Sakhalin-1 project, operated by a consortium which also includes Japanese interests. There are five offshore oil and gas projects for Sakhalin, consequently named Sakhalin-1 to -5. All involve both oil and gas reserves, and a variety of Russian and foreign companies take part. See, eg, ITAR-TASS, 22 November 2004.

¹³⁹ On the North-South Corridor, see, eg, Alexander Mukhin & Vladimir Mesamed, "The North-South International Transportation Corridor: Problems and Prospects", *Central Asia and the Caucasus* 25 (2004), 123-6.

¹⁴⁰ RIA-Novosti, 28 July 2004.

¹⁴¹ WPS *Russian Business Monitor*, 14 May 2004.

¹⁴² *DVZ: Deutsche Verkehrszeitung*, 20 March 2004.

¹⁴³ Soglashenie mezhdru Rossiey i Turkmenistanom o sotrudnichestve v gazovoy otrasli, Moskva, Kreml', 10 aprelya 2003 goda (at the Ministry of Foreign Affairs website, www.ln.mid.ru). See also Veniamin Ginsburg & Manuella Troschke, "The Export of Turkmenistan's Energy Resources", *Central Asia and the Caucasus* 24 (2003), 108-17.

¹⁴⁴ *Pipeline & Gas Journal*, March 2002.

¹⁴⁵ *Energeticheskaya strategiya*, 78-9.

¹⁴⁶ See, eg, Ekspress-K (Almaty), 20 April 2002; Vladimir Saprykin, "Gazprom of Russia in the Central Asian Countries", *Central Asia and the Caucasus* 29 (2004), 81-93, 82.

¹⁴⁷ LUKoil website, www.lukoil.com.

¹⁴⁸ Vladimir Putin, "Address at the Plenary Session of the Russian Federation Ambassadors and Permanent Representatives Meeting", Foreign Ministry, 12 July 2004 (www.kremlin.ru).

¹⁴⁹ RFE/RL *Newsline*, 14 July 2004.

¹⁵⁰ Jan Leijonhielm & Robert L Larsson, *Russia's Strategic Commodities: Energy and Metals as Security Levers* (Stockholm: FOI, 2004), 126. The Estonian Law on Aliens was amended in 2002.

¹⁵¹ Ibid, 122-3.

¹⁵² Ibid, 127.

¹⁵³ See, eg, ibid, 130-31.

¹⁵⁴ See, eg, IWPR's Belarus Reporting Service 53, 2 March 2004.

¹⁵⁵ Presidential Decree No 1403, 17 November 1992. On this decree, see, eg, *Neft' i kapital* 10, 2004, p8. Transneft was also established through Government Protocol No 810, 14 August 1993.

¹⁵⁶ www.gazprom.com.

¹⁵⁷ See, eg, Tompson & Ahrend, *OECD Economic Surveys: Russian Federation*, 143.

- 158 *Energeticheskaya strategiya*, 31.
- 159 *Upstream*, 17 June 2005, p32.
- 160 RFE/RL, 5 February 2002, 17 January 2003.
- 161 *Moscow Times*, 17 February 2003 (www.moscowtimes.ru).
- 162 *Financial Times*, 12 August 2004.
- 163 *Mestorozhdeniya: Zhurnal po nedropol'zovaniyu i toplivno-energeticheskomu kompleksu* 1, 2005, p23.
- 164 IEA, *Russian Electricity Reform*, 95.
- 165 *Finansovyye Izvestiya*, 4 August 2004; reprinted in *Vestnik TEK: Obzor pressy* 6 (39), 31 July-6 August 2004, 38-9; *Alexander's Gas & Oil Connections* 9: 21 (28 October 2004), based on Mosnews, 7 October 2004. See also www.gazprom.ru.
- 166 *Moscow Times*, 18 October 2004 (www.moscowtimes.ru).
- 167 See, eg, *Vedomosti*, 5 August 2004; reprinted in *Vestnik TEK: Obzor pressy* 6 (39), 31 July-6 August 2004, 26-29.
- 168 R Hrair Dekmejian & Hovann H Simonian, *Troubled Waters: The Geopolitics of the Caspian Region* (London: I B Tauris, 2001), 158; David Hoffman, "Itera: Mystery Player in Russia's Natural Gas Market", *Washington Post*, 21 May 2000, p11. See also IEA, *Russia Energy Survey 2002*, 116-17; Roman Kupchinsky, "Naftohaz Ukrainy: A Study in State-Sponsored Corruption", *RFE/RL Organized Crime and Terrorism Watch* 3: 25 (18 July 2003); 3: 26 (5 August 2003); 3: 28 (15 August 2003); 3: 29 (21 August 2003); 3: 30 (28 August 2003).
- 169 Eural TransGas Kft. was registered in Hungary on 6 December 2002 at an address in the city of Csabdi (Szabadsag u. 24), with an account at Raiffeisenbank, and a capital listed as the equivalent of \$12,000. On Ukrainian gas exports, see, e.g., *Economist*, 12 June 2004; *RFE/RL Central Asia Report* 4: 30 (10 August 2004); referring to Prime-TASS Energy Service, 29 July. On Eural TransGas, see also *RFE/RL Organized Crime and Terrorism Watch* 3: 21 (19 June 2003). See also *Upstream*, 7 March 2003 (www.upstreamonline.com); Kupchinsky, "Naftohaz Ukrainy", *RFE/RL Organized Crime and Terrorism Watch* 3: 25 (18 July 2003); 3: 26 (5 August 2003); 3: 28 (15 August 2003); 3: 29 (21 August 2003); 3: 30 (28 August 2003).
- 170 See, eg, *Kommersant*, 20 December 2004.
- 171 Reuters, 25 February 2005.
- 172 See, eg, Marika S Karayianni, "Russia's Foreign Policy For Central Asia Passes Through Energy Agreements", *Central Asia and the Caucasus* 22 (2003), 90-96.
- 173 Lembit Vali (Technical Director, Management Board, Eesti Energia AS), presentation on "Development and Problems of Baltic Energy Market," conference on Political and Financial Tools to Promote Sustainable and Secure Energy Supply, Oslo, 10-11 December 2004.
- 174 IEA, *Russian Electricity Reform*, 21.
- 175 *Ibid*, 50.
- 176 Tompson & Ahrend, *OECD Economic Surveys: Russian Federation*, 182.
- 177 WPS Russian Media Monitoring Agency, 26 September 2003. See also Chubais' personal website, www.chubais.ru.
- 178 Vali, Political and Financial Tools to Promote Sustainable and Secure Energy Supply.
- 179 Control for 25 years beginning from 1999.
- 180 First agreed in an inter-government agreement in 2000. See, eg, RFE/RL, 17 October 2000. A deal was eventually concluded in September 2004. See, eg, Gregory Gleason, "Financing Russia's Central Asian Expansion", *Central Asia Caucasus Analyst*, 3 November 2004.
- 181 IRNA, 11 December 2004.
- 182 UES website, www.rao-ees.ru; CIS Electric Power Council website, <http://energo-cis.org>; Igor Tomberg, "Energy Policy in the Countries of Central Asia and the Caucasus", *Central Asia and the Caucasus* 22 (2003), 71-81, on 80.
- 183 See, eg, Tompson & Ahrend, *OECD Economic Surveys: Russian Federation*, 180-82, 188-95, 208-15; and in particular IEA, *Russian Electricity Reform*. See also the Federal Grid Company's website, www.fsk-ees.ru.
- 184 *AK&M News*, 24 May 2005.
- 185 IEA, *Russian Electricity Reform*, 22.

- ¹⁸⁶ Kalyuzhny, Statement at the Caspian and Black Sea Oil and Gas Conference, Istanbul, 26 February 2004.
- ¹⁸⁷ See, eg, Dekmejian & Simonian, *Troubled Waters*, 138; Hooman Peimani, *The Caspian Dilemma: Political Games and Economic Losses* (Westport, Connecticut: Praeger, 2001), 103.
- ¹⁸⁸ See, eg, Colin Sutcliffe, “The Baku-Tbilisi-Ceyhan Project: Bringing Caspian Oil to the World’s Markets”, *BlackSea Trend Review* 1: 1 (Summer 2002), 77-81. See also “Construction Begins on the Baku-Tbilisi-Ceyhan Pipeline”, *BlackSea Trend Review* 2: 4 (Summer 2003), 46-8.
- ¹⁸⁹ See, eg, Hakki Akil (General Director - Economic Affairs, Ministry of Foreign Affairs, Turkey), “Potential of Caspian Oil and Gas and Export Options Via the Black Sea Region and Balkans”, Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004.
- ¹⁹⁰ See, eg, Reuters, 6 May 1998.
- ¹⁹¹ Kalyuzhny, Caspian & Black Sea Oil & Gas Conference 2004.
- ¹⁹² Osman Saim Dinc (General Manager, TPAO), “Upstream and Downstream Oil and Gas Industry Potential in Turkey”, Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004.
- ¹⁹³ Dr Mehmet Özkanli (President, Turkish Association of Petroleum Geologists), Caspian & Black Sea Oil & Gas Conference 2004, Istanbul, Turkey, 26-27 February 2004.
- ¹⁹⁴ Akil (Ministry of Foreign Affairs, Turkey), Caspian & Black Sea Oil & Gas Conference 2004.
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- 225 *Upstream*, 17 June 2005, p38-9.
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- 227 *Ibid*, 3, 2005.
- 228 *Ibid*, 11, 2004.
- 229 See, eg, IEA, *Russia Energy Survey 2002*.
- 230 Suezmax tankers can pass through the Suez Canal and have a capacity of from 125,000 to 200,000 dwt.
- 231 Aframax (American Freight Rate Association) tankers have a capacity of from 80,000 to 125,000 dwt.
- 232 Tankers capable of entering the Danish Straits are sometimes referred to as Baltmax tankers.
- 233 Tankers capable of entering the Turkish Straits are sometimes referred to as Bosphorusmax tankers.
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- 241 Semyon Vainshtok, 3rd Russian Petroleum & Gas Congress, Moscow, 21-23 June 2005.
- 242 *Petroleum Argus Nefte Transport* 4:4 (April 2005), 5; *FSU Pipeline Advisory* 23, 2004 (Centre for Global Energy Studies (CGES), 15 October 2004; www.cges.co.uk).
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- 246 See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*. There is currently no oil being shipped into Makhachkala, but plans are underway. *Petroleum Argus Nefte Transport* 4:4 (April 2005), 4.
- 247 See, eg, *Nefteryok* 8, 2004. A second, parallel pipeline has been commissioned and was initially projected to be ready by summer 2005. A third pipeline has been planned. See, eg, Baev, "Russia's Happiness". However, the CPC can also be expanded by adding pump stations and other facilities. Ian MacDonald (General Director, CPC), presentation on the Caspian Pipeline Consortium, 3rd Russian Petroleum & Gas Congress, Moscow, 21-23 June 2005. The Russian state would like to re-assert control over this pipeline, one of very few privately owned oil transport infrastructure projects in Russia, but it remains unclear how far it is prepared to go. The CPC has been exposed to criticisms from the Russian government, which no doubt would prefer to see the project deemed a natural monopoly under full state control. See, eg, *Nefteryok* 8, 2004. The CPC also suffers from a shaky legal foundation. An agreement was signed by the Russian government in 1996, but this was not an official intergovernmental agreement, "only" a private contract. See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*.
- 248 *Nefteryok* 9, 2004.
- 249 See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*; *Nefteryok* 5, 2005.
- 250 See, eg, Tsentr strategicheskogo razvitiya, *O vozmozhnykh napravleniyakh*. The Adria pipeline, completed in 1974, was originally built to move Middle Eastern oil from Omisalj northwards to Yugoslavia and on to Hungary.
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- 262 Kalyuzhny, Caspian & Black Sea Oil & Gas Conference 2004.
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- 264 See, eg, Energy Information Administration, US Department of Energy, *Caspian Sea Region: Natural Gas Export Options* (Washington, DC: Energy Information Administration, July 2002; www.eia.doe.gov).
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