

## IN QUEST OF A NEW EMPIRE - THE RUSSIA'S ENERGY POLICY IN THE WIDER BLACK SEA REGION (1991-2010)\*

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**Abstract:** The evolutionary principle the leaders of this country place, at least in theory, at the core of their action, cannot hide the fact that Russia is in full process of building a new type of state. Stability, preventing sudden changes, security and a peaceful shifting of power are the most important attributes of contemporary Russia. Being convinced they are meant to innovate in matters of political organisation and social construction and especially frightened by the West's intention to quarter them to the periphery of the world system, the Russians channel a large part of their national energy to trying to avoid classical routes of development. By putting in circulation the concept of 'sovereign democracy', Russia, in reality, is building a new type of authoritarianism, exercised in democratic forms but with authoritarian content.

Living a fortunate moment as an energy supplier, Russia sees the Black Sea Greater Region, (including not only Europe but also the Caspian Sea area), as a territory it is qualified to manage. At the beginning of the millennium Russia bet on energy, given its vast territory crossed by virtually all major trade flows and transport routes. To Russia, oil and natural gas are the ideal ingredients able to transform it into a modern economy and a power of a new type, one that carefully manages energy flows in Europe, Asia and the Far East. Trying to act at the same time as Europe's main supplier, unique transporter and exclusive distributor of gas produced by Central Asian states, Russia wants to be the master of the huge trade hub connecting Europe to Asia. Determined to merge into a single hand extraction, transport, processing and distribution of fossil fuels in Europe, Russia is playing its intense game the best it can, its only contenders being time and various world economic circumstances.

**Keywords:** Russia, oil, gas, politics, foreign policy, trade, Black Sea, Central Asia, Europe, CIS

**Rezumat:** Strategiile energetice reprezintă pentru Rusia cel mai bine structurat și mai puternic instrument de politică externă, aflat la baza eforturilor sale de transformare în centru mondial de putere. În absența unei organizații politico-militare eficiente pe care să o controleze, precum și a unei economii diversificate care să-i permită să influențeze pe termen lung conjuncturile economice mondiale, transformarea politicii energetice în principal registru al evoluției sale internaționale este o consecință a unei stări structurale și mai puțin o alegere strategică. În perspectivă medie, adică aproximativ spre 2030, obiectivul strategic intermediar al Rusiei în

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această direcție este aceea de a asigura premisele unei politici energetice libere de orice constrângeri imediate, așa cum sunt "captivitatea" creată de țările de tranzit și capacitatea țărilor din Asia Centrală și regiunea Mării Caspice de a genera modificări importante ale prețului resurselor energetice, prin posibilitatea de a-și livra independent producția de hidrocarburi către consumatorii din Europa și regiunea Asia-Pacific.

Politica energetică a Rusiei urmărește și obiective interne, așa cum este structurarea unei piețe naționale pe principii capitaliste, însă nonconcurențiale, de natură să permită companiilor rusești să obțină o marjă considerabilă de independență față de consumatorii externi. În plan extern, obiectivele secundare, după conectarea directă la marii consumatori europeni, reprezintă canalizarea exclusivă a traseelor energetice din Marea Caspică și Asia Centrală pe teritoriul rus, precum și o mai bună interconectare cu țări precum China, Coreea de Sud și Japonia. Pe termen scurt, intenția evidentă a Rusiei este aceea de a forma un "coș" variat de consumatori externi, care în combinație cu o creștere accelerată a pieței interne, prin renunțarea treptată la prețurile preferențiale și gazeificarea întregii țări, va da conducerii sale politice posibilitatea să negocieze extrem de dur pentru impunerea unor prețuri avantajoase pe termen lung, de natură să crească previzibilitatea încasărilor externe de valută, atât de necesare amplului program de modernizare etatistă.

**Cuvinte cheie:** Rusia, petrol, gaz, politica, politica externă, comerț internațional, Marea Neagră, Asia Centrală, Europa, CSI

### **Intoduction**

The evolutionary principle the leaders of this country place, at least in theory, at the core of their action, cannot hide the fact that Russia is in full process of building a new type of state. Stability, preventing sudden changes, security and a peaceful shifting of power are the most important attributes of contemporary Russia. Being convinced they are meant to innovate in matters of political organisation and social construction and especially frightened by the West's intention to quarter them to the periphery of the world system, the Russians channel a large part of their national energy to trying to avoid classical routes of development. By putting in circulation the concept of 'sovereign democracy', Russia, in reality, is building a new type of authoritarianism, exercised in democratic forms but with authoritarian content. Energy is the sector that dictates Russia's pace. It is in keeping with the international oil price, length of transport pipelines or capacity of gas liquefying plants that economic, social and foreign policies are conceived.

Living a fortunate moment as an energy supplier, Russia sees the Black Sea Greater Region, (including not only Europe but also the Caspian Sea area), as a territory it is qualified to manage. At the beginning of the millennium Russia bet on energy, given its vast territory crossed by virtually all major trade flows and transport routes. To Russia, oil and natural gas are the ideal ingredients able to transform it into a modern economy and a power of a new type, one that carefully manages energy flows in Europe, Asia and the Far East. Trying to act at the same time as Europe's main supplier, unique transporter and exclusive distributor of gas produced by Central Asian states, Russia wants to be the master of the huge trade hub connecting Europe

to Asia. Determined to merge into a single hand extraction, transport, processing and distribution of fossil fuels in Europe, Russia is playing its intense game the best it can, its only contenders being time and various world economic circumstances.

The association of the economic successes of the Putin administration with an unexpected crude and gas price rise is a common fact. The promotion of an aggressive energy policy designed to make gas a Russian monopoly is also a widely spread statement. Another unanimous view is that Putin has no merit in the rise of energy prices. The meaningful fact is how the money obtained on oil is spent and what type of economy is building the administration headed by the ex-intelligence officer turned into Russia's unchallengeable master in a record time.

With a state that is massively engaged in the sectors it deems strategic, such as energy, shipbuilding, aerospace and pharmaceutical industry, Russia's leaders are speedily developing a corporatist regime. The new corporatist Russian state operates on capitalist principles in relation to the foreign market; as regards the domestic market, it is based on protectionist rules, some of which are legalised, while most of them are implicit, as it results from the discriminatory treatment of foreign capital by authorities. At the core of the capitalist state there is a new class of capitalist managers who have replaced 'the red directors' and who control huge properties without actually owning them; they report directly and exclusively to the political leaders. Based on simple decision-making mechanisms, a little caged by red-tape rules, but effective at times of crisis and reconstruction, the Russian statist-corporatist capitalism is still in its heyday. Hence the general feeling that it is a functional model that, in spite of its various flaws, has successfully dealt with some of the major issues of Russian economy. The heyday because, after the anarchy of the first post-communist decade, the task of a statist-corporatist system is just to create economic forms similar to those used by developed Western countries and restore order in dismembered sectors, in brief to restart the economy. Assisted by the state via direct investment and/or protectionist legislation, the new economic system is far from having shown its true capabilities. Lacking competition and the natural vitality of the struggle for survival characteristic of an open, classical capitalism, the statist-corporatist capitalism is still a lab product whose primary sponsor is the political power.

The Russian regime keeps an intact public attachment to democratic formalism, managing to have a parliament without an opposition, elections without contenders and independent courts of law whose judgments never contradict the opinions expressed by the power. The democratic formalism of the new authoritarian regimes that have infested Eurasia after the 'Cold war', also called 'competitive authoritarianism'<sup>2</sup>, is less related to the wish of the respective leaders to legitimate themselves by saving democratic appearances and more to the need to preserve a

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<sup>2</sup> For explanation to length see [S. Levitsky, L. A. Way](#), *Competitive Authoritarianism: Hybrid Regimes after the Cold War*, Cambridge University Press, 2010

shade of democracy in those states. The existence of considerable energy resources in countries such as Russia, Azerbaijan, Kazakhstan, Uzbekistan and Turkmenistan, all ruled by authoritarian regimes, makes Western leaders to considerably lower political standards, and settle for the staged pseudo-elections.

Before labelling developments in Russia as a return to the past, we need to know the reasons why the alliance between the ‘siloviki’ and the Liberal statist reformers pursued a policy of restricting individual and economic freedoms, and other freedoms. The collapse of the state machine in the 1990s, of the tax system, the proliferation of organised crime, corruption and the installation of a general state of insecurity prevented the state from fulfilling its basic functions. Unfortunately for the Russians, the condition as such overlapped with a period of relative political and individual freedom which led, in the public awareness, to confusion between democracy and anarchy. The baseline functions of a capitalist state – provide an operational legal framework and guarantee private property – were not fulfilled in Yeltsin’s Russia, which supports the conclusion that the former president’s regime had failed in that respect; it only managed to obtain an oligarchy whose majority was insensitive to the idea of common welfare. As regards the concentration of the energy sector in the hands of the state, the situation should not be absolutised. Even with the two big state- owned companies, the Russian energy sector still has an important private component; actually, it is much bigger than the one to be seen in other countries that enjoy a positive perception in the West, such as Saudi Arabia, Kuwait or Mexico, where the energy sector is fully state-owned. What disturbed democratic states was the disregard for the private property of private investors and the state’s image campaigns stigmatising those investors as criminals *apriori*. The advocates of the strong corporatist state, the ‘siloviki’, are not as powerful and active in all economic areas, as they do not oppose the liberalisation of other industries such as telecommunications or infrastructure. All this makes contemporary Russia a much more diverse landscape than one may expect to see at a first glance. Fears shared by a majority of the population, stringent needs of the state, fortunate chains of circumstances, strategic visions and re-visited great power’s egos are all ingredients to a diverse Russian landscape where the imperial past, Soviet experience and capitalist relations are organically intertwined into a heteroclitic present..

### **Russia toward a new type power using old methods?**

The European energy policy is, first and foremost, a sum of contradictions primarily generated by the fact that countries involved are trying to solve a European issue starting from strictly national prerequisites. This characteristic is further enhanced by the more than uneven distribution of oil and gas resources, which makes political ambitions extremely difficult to separate from economic objectives, with the latter being at least just as important as the former. The rather fluid political agendas of participating states – big powers and regional powers alike – make energy policies

as well as resource extraction and transport projects often resemble genuine dramas, unfolding at fast pace and dotted with many reversals of situation. What seems an extremely certain thing today, tomorrow may easily turn into a little probable fact, meaning that in a short run, that thing will become totally unadvisable..

At the basis of the instability of the various energy projects stand a few factors that can be counted on to manifest themselves at least in a foreseeable future of roughly 20 to 25 years.

The first of them is the fluctuating economic context which allows the generally optimistic estimates to be often contradicted, especially when it comes to the use of energy and resources. The most illustrative case in that respect is Turkey, a country deemed to experience a galloping rise of the use of resources between 2005 and 2020, with an annual growth rate of roughly 10-15%. In reality, in the context of the world economic crisis, Turkey's energy consumption not only did not go up, but actually dropped by about 10 per cent from 2008 to 2010 and is not expected to return to the rate prior to 2008 before 2013-2014<sup>3</sup>. The Turkish example is not accidental, as many of the projects for the transport of resources from the Caspian Sea and Central Asia regions – be they natural gas or oil – were actually counting on Turkey, seen at the time not only as a crucial transit country, but also as a major consumer.

A second element that induces instability to energy projects is the volatility of political interests servicing these projects and the often changes of regime. The absence of political strategies in the countries that own resources as well as in those that are crucial to transit makes them prone to sudden shifts of political attitude according to the circumstances offered by the hydrocarbon market. All these factors are supplemented by the particularities of local cultures, too little attached to democratic principles and extremely difficult to frame in a long-term international context. The most relevant case concerns the relations between Turkmenistan and Russia, the two countries being engaged in a 30-year agreement for the acquisition of Turkmenistan gas by Gazprom; Ashhabad unilaterally rescinded that contract for the pretext of technical difficulties, when the price of gas paid by Russia, imprudently tied to international rates, had started to fall<sup>4</sup>.

The multitude of political and territorial conflicts that mine strategic regions. We have in view the separatist regions in Georgia or Azerbaijan, both crucial to the extraction and transit of resources, the extended dispute over the status of the Caspian Sea separating Azerbaijan from Turkmenia, Russia and Iran and the border conflicts between Turkmenistan, Uzbekistan and Azerbaijan; in all cases, the political tension

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<sup>3</sup> *Toplevno-energheticeskii kompleks Rossii, 2000-2010, Spravocino-analiticeskii obzor*, Institut Energheticeskoi Strateghii, ZAO „GU IES”, Moscova, 2011, p. 25

<sup>4</sup> S.G.Luzianin, *Vostocinaia politika Vladimira Putina, Vozvrašenie Rossii na „Bolšoi Vostok” (2004-2008), Haracteristika sovremennogo vnešnepoliticskogo kursa v otnošenje vseh vostocinih regionov mira-ot Cevero-Vostocinoi Azii do Blijnego Vostoka i arabskih stran Magriba*, Izd. Vostok-Zapad, Moscova, 2008, p.254

generated by territorial conflicts not only makes big investors extremely cautious, but it also hampers the implementation of large-scale prospecting work to determine the approximately accurate amount of gas and oil on which a whole range of energy projects are based.

Contradictions between the objectives of energy policies and those of local policies also seriously undermine the consistency of energy projects. Perhaps the most relevant case in this respect concerns the relations between Russia, Ukraine and Belarus. Based not only on Gazprom's intention to come into contact with major European consumers<sup>5</sup>, but also on its plan to by-pass the transit countries Ukraine and Belarus, the alternative Russian projects South Stream and Nord Stream have collided with Moscow's policy of setting up a new unitary economic space, made up of the former Soviet republics. Therefore, the founding of the Russia-Kazakhstan-Belarus Customs Union or Ukraine's entry to that organisation was conditioned by Kiev and Minsk on Russia' giving up the above mentioned projects and renouncing to the exemption of petroleum goods and natural gas from the common customs policies, as Russia wanted. One can state without fear of being wrong that virtually all gas and oil pipelines are governed by too much politics and too little economy for the system to be able to operate without major syncope.

### **Why Russia cannot separate energy from politics**

In Russia's case, things are complicated by the fact that the objectives of energy policies are tightly related not only to foreign policy plans, but also to a series of domestic aims pertaining to the planned modernisation of the state. In its essence, the country's energy policy is part of a much more comprehensive effort of integration of its own territory via transport networks and of securing multiple exits to warm seas; this priority came back on the agenda of the Russian state after the dismantling of the USSR. To the Russian energy system, the dismembering of the USSR came with the loss of a significant number of maritime terminals while a major part of its transport network, especially the one making the connection to Europe are now owned by the new independent states. For that reason, seeking to regain its major influence on the Eurasian Continent, Russia is trying to integrate to a single system the territory lying between its current borders and the Eurasian aquatorium, using political as well as economic tools of which the transport of hydrocarbons is one of the most important. Russia's intermediary objective is the setting up of a single resource extraction, processing and transport system designed to cover the entire continent<sup>6</sup>. This goal entails specific requirements related, on the one hand, to the territorial distribution of transport networks and of processing centres and on the other hand, to the modes of

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<sup>5</sup> K.C. Smith, *Russian Energy Policy and its Challenge to Western Policy Makers*, Center for Strategic and International Studies, Washington DC, March 2008, p. 5-15

<sup>6</sup> *Energheticeskaia Strateghia Rossii na period do 2030 goda, Utverjdjena Rasporiajeniem Pravitelstva Rossiiskoi Federacii ot 13 noiabria 2009 g. 1715-r*

distributing processed and by-products. That kind of Russian expansion is rather a secondary product of the transition from socialism to capitalism. The uncontrolled transfer of state assets into private property, most often down illegal ways, followed by the restoration of the authority of the state and of the central administration, a process beginning in 2000, has paved the way to what is called managed capitalism.<sup>7</sup> While the results of post-communist privatisation were never formally reconsidered, the reinstatement of central administration control over society, politics and economy has led to a dissipation of the full character of private ownership of such assets. A special category thus emerged – the state managers of private assets, people who act on behalf of the central administration in relation to the big private property. The state, led by politicians attached to the idea of respect for democratic appearance, is not changing the regime of property for tactical considerations; however, the public owners of such assets have long lost their prerogative of deciding on the development strategies of their own companies. Formally, the Russian state only owns parts of the assets of such companies, as is the case with Lukoil or Sibneft, Gazprom being the exception, but nonetheless, it has absolute control over the policies they pursue.<sup>8</sup> In that way, the Russian state operates the strategic management, while former owners have been downgraded to executive positions. Russian energy companies are built according to Western entrepreneurial principles; they often have high-profile western companies among their shareholders, being sometimes headed by foreign executives; their role in Russia's foreign economic policy is similar to the one played in the past by international communist organisations. Implementing the strategy of the state, faithfully pursuing the policy lines set by Russian leaders, the country's energy companies trigger the responsibility of the government only marginally, and enjoy the important advantage of remaining credible when reconsidering public statements or dropping already announced plans.

To Russia, energy strategies are the best articulated and most powerful foreign policy tool, the main pillar of its efforts to become a global centre of power. Russia has neither an efficient political-military organisation it could control, nor a diversified economy allowing it to influence world economic circumstances on a long term; therefore, changing the energy policy into the main score of its international performance is rather the consequence of a structural state than a strategic choice. On a medium term, approximately by 2030, Russia's midterm strategic objective is to

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<sup>7</sup> Ledeneva A.V, *How Russia Really Works : The Informal Practices that Shaped Post-Soviet Politics and Business*, Ithaca, Cornell University Press, 2007

<sup>8</sup> In Gazprom, the Russian state holds 50.1% of the shares and in Gazprom Neft – 74.3%. As far as Rosneft is concerned – that being the biggest oil company that has also taken over most of the Yukos assets - the state holds 84.6% of the shares. Although it may not look that impressive, the direct state shareholding becomes more relevant when looked at in the context of the general capitalisation in Russia, where the federal government and local municipalities hold as much as 40% of the capitalised assets on the domestic capital market. (Carsten Sprenger, *State-Owned Enterprises in Russia*, ICEF, Higher School of Economics, Moscow, October 27, 2008)

ensure the premises for an energy policy free of any immediate constraints; such constraints may be for instance, the 'captivity' created by the transit countries and the capacity of countries in Central Asia and the Caspian Sea region to drive significant changes of the price of energy resources, through independently supplying its hydrocarbon production to consumers in Europe and the Asia-Pacific area.<sup>9</sup>

In its energy policy, Russia also pursues domestic objectives, such as the structuring of a national market based on capitalist, yet uncompetitive principles, allowing Russian companies to obtain a considerable margin of independence from foreign consumers. At a foreign level, second to the direct connection to major European consumers, other goals are an exclusive channelling on the Russian territory of energy routes from the Caspian Sea and Central Asia, as well as a better interconnection with countries such as China, South Korea and Japan. On a short term, Russia's obvious intention is to set up a varied 'basket' of foreign consumers; in combination with the fast growth of the domestic market, through phasing out preferential prices and supplying gas to the entire country, this will give its political leadership the possibility to negotiate toughly in order to impose advantageous prices on a long term; thus, it will be possible to improve the predictability of foreign currency entries so necessary to the comprehensive programme of statist modernisation.<sup>10</sup> The reformation of the domestic market and an increased presence of Russia on the Asian- Pacific markets are trends generated by objective structural phenomena and do not generate major political complications. Gazprom and other Russian energy companies' attempt to surround Europe from the South and North directions and to cut the independent access of Caspian Sea and Central Asian countries are to a large extent economic plans with a powerful political inlay; they are prone to major international complications, being also in strong contradiction with the policies Russia implements in its European 'close neighbourhood'.

Given the Russian concept of concentrating extraction, processing and distribution of hydrocarbons in a single decision-making centre, Moscow has managed to come into conflict with Brussels rather soon, as the European Union is in a full process of regulation and liberalisation of its common energy market. All the more so as, in 2008, the EU has adopted the Energy Security Charter that stipulates not only the decrease of hydrocarbon consumption by 20% in 10 years, but also the diversification of gas production and liberalisation of gas supply.<sup>11</sup> A symptomatic moment for the situation confronting Russian plans occurred in April 2009: in a matter of days, Russia received the EU refusal to declare the South Stream 'a European priority project', during an energy forum in Sofia, and Gurhan

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<sup>9</sup>Şmelov N.P., Guseinov V.A., Jazykova A.A., *Sredizemnomore-Cernomore-Kaspii: mejdu Bolşoi Evropoi i Bolşim Blijnim Vostokom*, Izdatelskii Dom 'Graniţa', 2006

<sup>10</sup> Mitrova T, *The role of Russian gas in Europe's energy future*, Vienna, 27 January 2011

<sup>11</sup> *Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network, On conditions for access to the natural gas transmission network.*



Berdâmuamedov's Turkmenia declared its support for the Nabucco project during a meeting with Russian officials. All happened after the European Parliament had adopted 'the third package' of legislation banning monopolies on the European energy market. The regulation in question allows any EU member state to prohibit the entry to their national market of a company not complying with the rule of separation of extraction and transport, as by that the EU energy security is under threat.

The answer Russia gave, true enough, a continuation of the tactic shaped some years before<sup>12</sup>, was to stimulate the decision-making polycentrism inside the EU, with the purpose to create resistance to the implementation of the supra-national legislation in the field of energy. A first reaction was to accelerate bilateral negotiations with countries crucial to the transit of the alternative pipelines Nord Stream and South Stream, the results being spectacular, as it became apparent at a later stage. The second reaction was to have major energy companies of Germany, France and Italy engaged in those projects. Under agreements with Berlin, Paris and Rome, national energy companies joined the project shareholding as owners of minority stakes of up to 10%. The third move was to launch, (conjointly with major European companies operating in the field, but also in the context of the European policy aimed at a better security of supply), proposals to increase the „responsibility” of the countries crucial to transit and prohibit them, under the threat of huge fines, from taking gas from international pipelines.

It was not by chance that Russia chose Germany as the main starting point in its attempted mining of common energy policies. The Russian vision in the field is seductive, as it starts from the assumption that harmony can be reached sooner and in a more sustainable way through interdependence. However, both harmony and interdependence apply solely in relation to Germany.

In a column published by *Suddeutsche Zeitung* at the end of 2010, 'Russia and Europe: from a reflection on lessons of the crisis to a new partnership agenda', Russian PM Vladimir Putin launched the idea of a common European energy system, based on the commissioning of the two new transport systems that would have put Gazprom in closer contact with the big European consumers: South Stream and Nord Stream. Aside from the idea embryo it contained, the published material was nothing but an attack at the third European legislation package; it claimed that, in reality, the concentration of transport, distribution and extraction of gas in a single entity would have been a way of ensuring the security of gas supply. Practically, Putin was

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<sup>12</sup> In 2000, Russia commenced its policy of 'energy dialogue' with the Balkan countries for the implementation of which it concluded strategic partnership agreements with Croatia (2002), Bulgaria (2003), Hungary (2007) and Greece (2008). Starting from such partnership that was sketching out the most cost-effective resource transmission routes, three major projects were launched: the Burgas Alexandropolis and Trieste-Constanța oil pipelines and the South Stream/Jujnii Potok gas pipeline, the purpose being to mine the EU strategy of bringing the gas from Central Asia and Caspian region into Europe by-passing Russia via Turkey, Bulgaria, Romania and, from there crossing Central Europe, through the Nabucco gas pipeline.

proposing to drop Brussels' philosophy and embrace the Russian one; however, he did not specify the exact way in which the Russian system could have become a European one, apart from the willingness to call it like that. Much more subtle in its attempt to change what were to become European rules of access to the common market, the German party is trying to dilute them into apparently generous initiatives.

Apart from its spectacular appearance, at closer examination, Russia's energy policy is full of contradictions. Lacking more complex and more efficient means, Moscow is using political manipulation of energy supply to solve modernisation issues. The massive investment in 'diversion routes', economically ineffective and also technically difficult, is done to the detriment of a coherent programme of investment in the national extraction and transport infrastructure. That is augmented by the considerable reduction of prospecting work to identify new major reserves of resources and by the technological stagnation in the process of extraction; all that has led to the development of a difficult situation in the Russian energy industry<sup>13</sup>. A telling example in this respect is that a majority of Russian gas deposits in Siberia and the Ural, on which Russian expansion is greatly based, have already reached 50% of their extraction capacity, the usage of a reservoir standing, according to depth and geological structure, at approximately 60-70%.<sup>14</sup> The underdevelopment of the petrochemical sector that existed during the Soviet age and is still a reality nowadays because of the massive choice of exporting raw materials explains why, while the Russian Federation now holds approximately 24% of gas reserves and approximately 6% of oil reserves, it still has less than 1% of the world market of petrochemical goods.<sup>15</sup> This accounts for the considerable difference between Russia and industrialised countries with respect to the processed to extracted gas ratio: approximately 78% in the USA, almost 90% in Canada and Iran with a special note in the case of Iran, 47% in Algeria and only 10-11% in Russia.<sup>16</sup>

In this context, Russia does not present a special constancy in the use of energy pressure. Even if Russia continues to sell gas to Belarus at 192 USD/m<sup>3</sup>, and to Ukraine at USD/m<sup>3</sup>, the two countries, alongside Poland and the Baltic States, are obviously targeted by the direct routes, which make them partners difficult to satisfy in the matter of the customs union. Things are not any better in the case of the European Union. Seeking to convince Europeans to collectively let go of Nabucco and other projects outside Russian influence and support the two political-energy

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<sup>13</sup> N. Pusenkova, A. Bessonova, *Blesk i nişeta rossisskoi nefteperobotki*, Rabocie materialâ 2/2008, Carnegie Endowment for International Peace

<sup>14</sup> C. Tonjes, *Perspectives on Security of Supply in European Natural Gas Markets*, Working Paper, August 2007, Clingendael International Energy Programme, p. 4

<sup>15</sup> V. Feigin (coord), *Issledovanie sostoiania i perspektiv napravlenii pererabotki nefiti i gaza, nefte i gazohimii v RF*, Institut Sovremennogo Razvitia, Institut Energetiki i Finansov, 17 maia 2011, p. 20

<sup>16</sup> V. Feigin (coord), *Op. Cit.*, p 11

projects it pursues, Russia keeps cutting the supply of natural gas through Ukraine and Belarus, while permanently claiming to be a reliable supplier.

It is equally true that, nowadays, most of the Russian gas is distributed to Europe via the system of main pipelines developed in the 1960s-1970s, as well as through the Yamal-Evropa gas pipeline crossing Belarus and Poland and inaugurated in mid-1990s. Russia is dependent on transit states, and in the relations with these countries, it adopted the philosophy of pushing conditions rather than negotiating; this fact is in contrast with the strategic importance Moscow attaches to the hydrocarbon trade.

### **The Big Russian-German Alliance: Objective Needs and Subjective Risks**

What calls for a closer analysis is not so much the Russian energy policy - obviously expansive and with a substratum - but rather the expansion of the Russian model of action to Europe. Against the existing competition, but most of all against the already applicable regulations in the EU, Gazprom's expansion carries on almost unhindered; it is also fuelled by the absence of any geopolitical agenda of the European Union<sup>17</sup>, being equally based on the alliance with Germany, a genuine pact of economic expansion. Thus, both Russia and Germany have gradually and surely increased their political weight by means of energy policies, while claiming that their action is strictly economic. The beginnings of this alliance, without taking into account historical precedents, are to be found in the end period of the Soviet Union, when the political conditioning of the supply of fossil resources had already become, as far as the Soviet leaders were concerned, the last decision-making lever they still had in relation to Eastern Europe<sup>18</sup>.

It also became the source of a growing Russian influence in Europe. After the collapse of the German Democratic Republic and the reunification of Germany, German corporations in the chemical industry - BASF, and energy industry - Wintershall, spotted the prospect of a certain future prosperity, in the context of a vigorous German economic growth. In 1990, Wintershall and former USSR gas export company Soiuzgazexport - currently Gazprom Export - signed a long-term agreement for the supply of natural gas in cooperation on third markets. It was at that time that joint ventures were also set up to operate both on the German market and on third markets - Wintershall Erdgas Handelshaus GmbH (WIEH) and Wintershall Erdgas West GmbH (in 1992 it became Wintershall Gas GmbH - WINGAS), with the former signing the contract for the acquisition of Russian gas<sup>19</sup>. The new partners

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<sup>17</sup> D. Finon, C. Locatelli, *Russian and European gas interdependence. Can market forces balance out geopolitics?*, Cahier de Recherche LEPII, Série EPE, N° 41 bis, janvier 2007

<sup>18</sup> A. Bessonova, *Neftedobîcia v Rossii, Gossudarstvennaia politika i inovaïionnîi perspektivî*, Rabocie materialî, 1/2009, Carnegie Endowment for International Peace, p.6-11

<sup>19</sup> John M. Letiche, *Russia Moves into the Global Economy*, Routledge, London and New York, Routledge Studies in the Modern World Economy, 2007, p.25

embarked on a large-scale programme for the development of their own gas transport and underground storage infrastructure in Germany; this fact gave them access to both Russian and European energy resources, with a view to obtain a significant share of the domestic German market and to gain markets in neighbouring countries. Another joint venture was set up in 1993 - Wintershall Erdgas Handelshaus Zug AG (WIEE), the purpose of which was to supply gas to South-Eastern European countries, primarily Romania and Bulgaria<sup>20</sup>. However, the management of both Wintershall Erdgas Handelshaus GmbH (WIEH) and Wintershall Erdgas Handelshaus Zug AG (WIEE-Romania and Bulgaria) was based on a parity principle and, today, the Gazprom assets linked to operations in Germany, including WINGAS, are managed through GAZPROM Germania GmbH. In a relatively short period of time, WINGAS built in Germany a 20,100 km long pipeline system, with the following main pipelines having been built: STEGAL (bringing Russian gas from the East, from the Czech and Slovak borders to Central Germany), MIDAL (connecting the North Sea to South Germany), WEDAL (running from the Belgian border to MIDAL, which secured the interconnection with the Belgian network as well as with the INTERCONNECTOR pipeline connecting the Continent to Great Britain, JAGAL (the one connecting the German national system to the Jamal-Europa pipeline) and RHG (the Reden-Hamburg main pipeline, one of the MIDAL ramifications which crosses Germany from South to North). Apart from those, in the place of a former depleted gas reservoir operated by Wintershall, WINGAS built the biggest underground gas storage facility (UGS) in Western Europe, at Rehden, with a capacity of 4.2 bn m<sup>3</sup><sup>21</sup>.

At present, E.ON Ruhrgas is one of the biggest partners of the Gazprom Group. In 2004, E.ON (the result of a merger of companies VIAG and VEBA) became the single shareholder of the company that owns the largest gas distribution network measuring a total of 11,300 km, with 12 UGS (5.1 bn m<sup>3</sup>), providing approximately 50% of the German gas demand<sup>22</sup>. Gas is imported from Russia, the Netherlands, Norway and Denmark. The Russian gas supplied to Germany and Switzerland by E.ON. Ruhrgas is provided by Gazprom export, under seven long-term agreements, four of which have been extended from 2020 till 2035, with a total annual volume of approximately 20 bn m<sup>3</sup>. Apart from these, there is also an agreement in place for the transit of Russia gas to the Netherlands and Belgium through the German territory, concluded with E.ON Gastransport GmbH.

The gas supply to WINGAS and WIEH is done under three long-term agreements (cca.22 bn. m<sup>3</sup>/year), plus an agreement with WIEE for the supply of gas

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<sup>20</sup> *Toplevno-energheticeskii kompleks Rossii, 2000-2010...*p.36

<sup>21</sup> *Gazovaia i gazopererabatvaušaia promišlenost Rossii, Itogi 2009-2011. Prognoz na 2015, Info Line, 2012, p 14*

<sup>22</sup> *Toplevno-energheticeskii kompleks Rossii, 2000-2010...*p.37

to Romania (cca. 5 bn m<sup>3</sup>/year). The agreement between Gazprom and WIE has been already extended, stipulating a minimum volume of 15 bn m<sup>3</sup>/year until 2043. There is also a close cooperation between WINGAS and Gazprom on the British market, with an agreement being already in place for the supply of approximately 5 bn m<sup>3</sup> of Russian gas/year, for now only valid until 2028. Based on 2008 data, Gazprom exports via WINGAS and WIEH, around 23 bn m<sup>3</sup>/year to Germany, Belgium and Great Britain. Another noteworthy fact is the tight cooperation Gazprom has with the former gas supply company of East Germany Verbundnetz Gas (formerly owned by E.ON, but sold to another company under the German anti-monopoly law), going through WIEH. An agreement was signed by those in 1999, for a period of 20 years, for the annual supply to East Germany of cca. 7 bn m<sup>3</sup>. Today, 15.79% of the Verbundnetz Gas AG stock is held by Wintershall Holding AG, and 5.26% by Gazprom Germania GmbH.

Long-term contracts agreements are, in fact, Gazprom's main asset in Germany. At the same time, the company is trying to use all options for strengthening its positions in the region, both in cooperation with its partners and through own projects. Together with Verbundnetz Gas, Gazprom set up a joint venture for the construction of new underground gas storage (UGS) facility in Germany, "Katerina", with a volume set to reach 600 M m<sup>3</sup> in 2022. As part of the exchange of assets between Wintershall and E.ON Ruhrgas the exploiting of the Iujno-Ruskii deposit with documented reserves of over 800 bn m<sup>3</sup> started being planned. On the other hand, the Russian party received parity in the holding of energy assets of German partners, including the European ones. Gazprom Germania increased its participation in the WINGAS GmbH&Co.KG registered capital to up to 50% minus one share (49.98%), and the procedures for the entry of E.ON Ruhrgas to the concern to exploit Iujnâi Ruskii are now being finalised. The most important joint project to which Gazprom participates with 51% and E.ON Ruhrgas and Wintershall with 20% each is Nord Stream/Severnii Potok, which is an offshore natural gas pipeline system with a yearly transport capacity of 55 bn m<sup>3</sup>, that would run from Russia to Germany through the Baltic Sea. Ahead of the project, WINGAS and E.ON Ruhrgas are already building new main pipelines on the German territory - OPAL and NEL, designed to be the continuation of Nord Stream. The first pipelines system will transmit Russian gas to the South, down to the Czech border, and the second one to Northern Germany to the UGS in Rehden. The development of the German gas infrastructure also opened Gazprom's way to other markets. For example, in 2007, WINGAS, Gazprom Export and the Austrian RAG (Rohoel Aufsuchungs AG) company have commissioned the UGS in Haidach, Austria. On a short term, the underground storage facility will become the second largest in Central Europe, with its capacity being set to grow from 1.3 bn m<sup>3</sup> to 2.6 bn, which stands for one third of Austria's annual gas consumption.

Such a close business cooperation between German energy companies and the Russian company has both objective rationales and subjective risks.

The first rationalisation is that, according to BP Statistical Review, Germany's prospected gas reserves amounted to approximately 120 bn m<sup>3</sup>. A total of roughly 18% of the gas necessary for domestic use - cca. 15 bn m<sup>3</sup> - is extracted every year, but the national gas demand has, however, reached 85 bn m<sup>3</sup>. The annual quantity of natural gas entering the German market is 112 bn m<sup>3</sup>, which indicates that major German companies invest in the procurement of Russian gas which they resell for a profit on third markets. Germany's gas shortage is, however, considerable. Based on AG Energiebilanzen e.V. (German Energy Association) data, cca. 37 per cent of the total gas quantity – 41 bn m<sup>3</sup> - is imported from Russia. The rest comes from Norway - 26% and the Netherlands - 19%.<sup>23</sup> With a growing gas deficit, it is evident that Germany is headed to a total dependence on imports from Russia and on the partnership with that country. In reality, it is interdependence. Germany is Gazprom's main foreign partner. In 2007, Germany imported 40 bn m<sup>3</sup> of gas, standing for over 1/3 of Gazprom's total export to Europe. The Russian-German strategic partnership and Berlin's energy dependence on Moscow may be also interpreted as a consequence of the long standing energy dispute in Germany. It has created a genuine fault between German politicians, one that, apart from many other considerations, divides Social-Democrats from Christian-Democrats, with a grey, trans-party area being caught in the middle. Both the chief of the Nord Stream Board, Gerhard Schroeder, and the main Nabucco adviser, Joschka Fischer, come from Germany, alongside the German companies engaged in both projects<sup>24</sup>.

The 2000 decision of the German government, at the time led by Chancellor Gerhard Schroeder, to close down all Germany's nuclear power stations by 2022 placed the country in front of some strategic choices. Besides the considerable raise in the CO<sub>2</sub> emissions the return to coal and gas-based energy technologies would have entailed, the German political spectrum also faced the issue of compensating for the gas deficit. The already shaped option of a strategic partnership with Russia and Gazprom was chosen. A change of nuance intervened once Chancellor Angela Merkel came to power. Following an already customary war of oil transit between Russia and Belarus in 2007, the Chancellor said it was unacceptable that a supplying or transit state stops fuel supply without prior consultations and that the plan for closing down nuclear power stations would need to be reconsidered from the point of view of its consequences.<sup>25</sup> Before the Japan catastrophe – the nuclear accident at

<sup>23</sup> D. Kirillov, *Strateghia ekspansii*, NG-Energhia, 10.11.2009, www.ng.ru

<sup>24</sup> A. Stent, *Russia and Germany Reborn, Unification, the Soviet Collapse and the New Europe*, Princeton University Press, 1998, p. 204-233

<sup>25</sup> S. Bendik, *Nord Stream: Not Just a Pipeline, An analysis of the political debates in the Baltic Sea region regarding the planned gas pipeline from Russia to Germany*, November 2008, Fridtjof Nansen Institute, p. 14

Fukushima, the plans for closing nuclear facilities were not revised, given the electoral risk that would have come with the initiative; from now on, such a revision seems even more improbable. Another consideration is the strong German lobby for a strategic partnership with Russia. The huge revenue and intoxicant shares on the domestic market from the supply of cheap Russian gas compared to Norwegian or Dutch gas cause German companies to put constant pressure on the German political system towards deepening cooperation with Russia. The tremendous investment those companies have made in Russia as well as on third markets, as they counted on a long term access to Russian gas, push them to try to keep relations between Moscow and Berlin far from any possible conflicts.

The main subjective risks are two. The first one, important to Germany, is the mounting dependence on Russian gas. The second one, important to Europe, is the European legislation and policies in energy matters being torpedoed by facilitating Gazprom's expansion, along with a de facto instauration of the practice of concentrating extraction and transport in one place, although the European law expressly prohibits it.

It was not by chance that Russia chose Germany as the main starting point in its attempted mining of common energy policies. The Russian vision in the field is seductive, as it starts from the assumption that harmony can be reached sooner and in a more sustainable way through interdependence. However, both harmony and interdependence apply solely in relation with Germany.

In a column published by *Suddeutsche Zeitung* at the end of 2010, 'Russia and Europe: from a reflection on lessons of the crisis to a new partnership agenda', Russian PM Vladimir Putin launched the idea of a common European energy system, based on the commissioning of the two new transport systems that would have put Gazprom in closer contact with the big European consumers: South Stream and Nord Stream. Aside from the idea embryo it contained, the published material was nothing but an attack on the third European legislation package; it claims that, in reality, the concentration of transport, distribution and extraction of gas in a single entity would have been a way of ensuring the security of gas supply. Practically, Putin was proposing to drop Brussels's philosophy and embrace the Russian one, without specifying the exact way in which the Russian system could have become a European one, apart from the willingness to call it like that.

Much more subtle in its attempt to change what were to become European rules of access to the common market, the German party is trying to dilute them into apparently generous initiatives. That is the case of the conference '*Private Sector Initiative for Security of Gas Supply in Europe*', launched by the German Economy Ministry in the autumn of 2010, during which a concept was launched into the debate of the expert community: that the responsibility for the security of gas supply should belong to private companies, entitled to set up international arrangements of

cooperation much more versatile than those of the states<sup>26</sup>. The conference set up an action programme for private companies that could be the foundation for identifying a happy way of interaction between state priorities and needs of private capitals in energy.

The first is a combination of the various suppliers' long term agreements with the setting up of centres that would organise and uphold buyer's requirements, oversee the optimal operation of the infrastructure and act towards a better international cooperation.

The second is to identify crucial regions for the European transit not only of gas, and set up regional and international cooperation systems. It also consists of recording and quantifying transit system operation difficulties, turning them into criteria for appreciating the security of transit routes and making national authorities take responsibility for the security of supply. The third way is to set up international mechanisms for crisis management by relevant European production and transport companies. In this context, it is proposed to embrace a new type of philosophy in the matter of energy security, where all three major gas transport projects - Nabucco, South Stream and Nord Stream – are equally supported by European countries and implemented without further delay.

The message such a conference is trying to propose is that states and companies should share equal responsibility for the supply and transit of gas; the role of the state is to offer a flexible framework that should foster cooperation among companies, while the latter should take care of concrete aspects. In reality, however, the initiative belongs to a broader process of releasing decision-making in energy matters from the international constraints a country adheres to.

### **By-pass routes and marketing policies - an expression of energy imperialism?**

Costly, complicated with regard to the route followed and carrying an evident baggage of political plans, alternative Russian routes are first of all meant to release Moscow from the captivity of transit countries. It is there that both the strength and the main weakness of such projects resides, as long as Russia pursues contradictory policies in relation to those countries. On the one hand, Russia tries to engage transit countries in a system of understandings, treaties and a series of economic and political projects designed to anchor them, at least on a medium-term, in its sphere of influence; on the other hand, it exits the energy interdependence of a nature to 'condemn' it to reaching a reasonable compromise.

While it can be said that, in the early 1990s, Ukraine and Belarus gained their political independence from Russia, they remained, however, in a deep state of economic dependence. Energy parameters are the most relevant in this respect. In 2009, the national oil and gas extraction was 3 M tons of oil and 20 bn m3 of gas in

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<sup>26</sup> P.Engstefeld, *Novîe formî organizații postavok gaza*, "Nezavisimaia Gazeta", "NG Energy", 10.11.2009, [www.ng.ru](http://www.ng.ru)



Ukraine and 2 M tons of oil and 2 bn m<sup>3</sup> of gas in Belarus. With their little revamped economies, the domestic production of the two states meets approximately 1/10 of their need for energy resources. Obviously, in the context of the extended economic crisis as well as of market practices in force in the CIS, the two countries enjoyed special conditions for the procurement of short energy products. Apart from that, Kiev and Minsk fully capitalised on Russia's interest in using their transit infrastructure to Europe as well as the main port oil terminals in the territories of Ukraine and Belarus.

Detour routes under Russian control - Nord Stream, South Stream for gas or Burgas-Alexandropolis for oil – as well as the marketing policies applied by Russian companies in Central Asia and the Caspian Region best highlight Russia's wish to put a drastic control on the European energy market. The type of control it promotes makes Russia's energy domination very easily convertible to political control. Pressed by US energy projects in Central Asia, such as the Trans-Caspian System, with its two ramifications for oil and gas, as well as by the Nabucco project, Russia has been forced to implement a mix of policies in the Caspian Sea region, combining military pressure, economic offers for the modernisation of transport and extraction systems and the diplomatic game.

In the matter of the legal status of the Caspian Sea – actually one of Russia's main levers of influence in the field of energy – Moscow has shown a consequent inconsistency, having radically changed its position a few times already. While initially it suggested the approach of a condominium of coastal states, starting from the national limit of the 45 nautical miles, Russia has subsequently changed its position, now advocating an equal distribution of the sea starting from a median line. Obviously, the new Russian position has received the endorsement of Azerbaijan and Kazakhstan, while Turkmenistan and Iran still plead for the condominium, starting from national sectors; the latter countries have declared the agreements made by the three countries lying north of the Caspian Sea illegal.<sup>27</sup> In sheer contrast to the usual Russian diplomacy standards, the new Moscow position seeks to block both Turkmenistan and Azerbaijan's alternative projects, which do not start from the premise of resources transiting the Russian territory; in fact the two countries are engaged in a host of conflicts related to the sovereignty of important gas reserves. Hazar (Azeri), Osman (Chirag), Altin Asir (Şarg) and Serdar (Kiapaz) are fields lying along the median line invoked by Russia, with Ashabad accusing Baku of illegally exploiting resources found there. Iran strives with Azerbaijan for the Araz-Şark field and Russia and Kazakhstan fight over the Kurmangazâ field, yet they jointly exploit resources reserves at Khavalinsko and Ťentralnoe.

Alongside the ambitions of other countries, the result of that policy was a genuine naval armament race in the Caspian Sea; it has prevented Russia, the main

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<sup>27</sup> Larsson R, *Russia's Energy Policy, Security Dimensions and Russia's Reliability as an Energy Supplier*, FOI-Swedish Defence Research Agency, 2006, p.237

investor, from being able to share its risk with any other partner and it has especially facilitated China's encroaching on Central Asia. In the case of Kazakhstan, (a country with which Russia has had an agreement on the transport of its gas to Europe since 2005) and Turkmenistan, Moscow has succeeded in controlling their hydrocarbon trade, making it dependent on its economic and political interests; however, it was only a matter of time before leaders of the countries in that region started looking for alternative ways of selling their resources. That is because Central-Asian leaders, who control their respective states through authoritarian regimes, based on clan rivalry and conditional access to resources, see in the multiplication of national resources dispatch markets a real strategy for consolidating their own power and discretion of action in international relations. Russia counts on the argument of predictability by offering advantageous commercial conditions to concerned countries such as removing the price it charges from the context of fluctuating international markets; however, the enthusiasm with which Russia's closest partner in the region, Kazakhstan, engaged in common projects with China shows that two selling modes instead of one makes leaders in the region feel more comfortable.<sup>28</sup>

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<sup>28</sup> The Atirau-Atasu (Kazakhstan) pipeline, running to the border with Xianjiang – with its first Atirau-Kenkiak segment in 2004, followed by a new Kazachstan-China agreement in May 2004 on continuing the pipeline all the way to the Chinese border, covering a total distance of 1,240 km, without crossing the Russian territory. Another grand project planned to connect Central Asia to the Eastern Coast of Chin, also using the territory of Uzbekistanului, with a total length of 11,000 km, is under construction. The Kazakhstani segment has been completed and the Chinese one is still in progress. Anotehr symptomatic fact is the aquisition by China of 33% of the state-owned company PetroKazah.