THE GLOBAL EXPANSION OF RUSSIA'S ENERGY GIANTS

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In any economy, oil and gas companies are tightly linked with the government. In petro-states such as Russia, they are so closely connected that they are sometimes indistinguishable. This symbiotic relationship is particularly strong in the global expansion of Russian energy corporations such as Gazprom, LUKOIL and Rosneft (see table), which is guided by a tangled web of commercial and political motives.

Table 1: Leading Russian Energy Companies in 2008 and 2009

Company	CEO	BoD Chairman	State Stake (%)	Oil Production (in million ton, 2008)	Gas Production (in billion cubic meters, 2008)	Market Value (in $ billion according to Forbes, 2009)
Gazprom	Alexei Miller	Victor Zubkov[1]	50.002%	12.7	550.5	74.55
LUKOIL	Vagit Alekperov	Valery Grayfer	0%[3]	90.2	14.2	26.62
Rosneft	Sergey Bogdanchikov	Igor Sechin[2]	75.16%	113.8	13.0	34.07
Surgutneftegas	Vladimir Bogdanov	Vladimir Erokhin	0%	61.6	14.1	19.65
TNK-BP	Mikhail Fridman	Mikhail Fridman	0%[4]	68.7	10.1	9.45
Gazpromneft	Alexander Dyukov	Alexei Miller	0%[5]	30.7	2.1	n/a

1 former prime minister of Russia.
2 deputy prime minister of Russia.
3 20 percent owned by ConocoPhillips.
4 50 percent owned by BP.
5 55.9 percent owned by Gazprom, 16.9 percent owned by Gazprom Finance BV.

Before 1991

Under socialism, when the petroleum resources of the country seemed limitless, geopolitical considerations drove Soviet energy expansion abroad. The state

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company, Zarubezhneft, established by the Ministry of Oil Industry in 1967, implemented this energy expansion and helped develop oil industries in loyal countries (Algeria, Cuba, Iraq, Iran, Libya, Syria, Vietnam, etc.), thus earning political dividends for the Soviet Union.

Oil exports became a vital source of foreign currency revenues for the USSR, which used petrodollars for domestic and foreign policy purposes. The world's longest export pipeline, Druzhba (Friendship), was built between 1960 and 1964, bringing Russian crude to East Germany, Poland, Czechoslovakia and Hungary. Its second branch was laid between 1969 and 1974, doubling shipments of crude abroad.[1]

The West was worried that the communists would make Europe addicted to Soviet gas.

Oil exports are relatively flexible in contrast to gas exports, where producers and consumers are inextricably linked by a pipeline which can serve as a geopolitical tool. For example, the idea of exporting gas to Western Europe emerged in 1966, but the first negotiations with the Italian firm, Eni, failed as the West was worried that the communists would make Europe addicted to Soviet gas. The first export pipeline, Bratstvo (Brotherhood), therefore, was laid to Czechoslovakia in 1967. Then, in 1968, the Austrian energy group OMV signed a long-term contract for gas deliveries. In 1970, the USSR closed the famous "gas for pipes" deal with the West German company Ruhrgas, and during 1973-1974, Soviet gas reached West Germany, France, and Finland.[2]

The 1990s

Just Business, Nothing Political

Since the Soviet Union's collapse in 1991, Russia has been adjusting economically and psychologically to the loss of an empire and to changed relationships in the USSR's former zone of influence. Russian oil and gas companies that were becoming partially or fully privatized took their first cautious steps abroad, inspired by an uneasy mix of their own thirst for profits and foreign policy considerations.

In the 1990s, LUKOIL, then the biggest and most influential Russian oil company, was the first to embrace the going-abroad policy. Though its CEO, Vagit Alekperov, preferred to position LUKOIL as a Western-style corporation driven by commercial rather than political goals, the company often acted as petroleum ambassador of Russia, and to a certain extent it even determined Russia's policy toward the Caspian region.[3] Alekperov's close ties with Victor Chernomyrdin, Russia's prime minister for most of the 1990s, helped LUKOIL's advances abroad.

Commercially, LUKOIL needed a source of low-cost production and access to solvent customers; in Russia, a non-payment crisis was bleeding dry the energy sector.[4] LUKOIL headed for countries within Russia's traditional zone of interest. Russia wanted to maintain its long-standing political and economic dominance of the Caspian region and launch an energy dialogue with the former republics. This policy was implemented, largely through LUKOIL's efforts, by maximizing Russian involvement in Caspian petroleum projects (where drilling costs were much lower and daily output of wells much higher than in West Siberia) and by controlling export routes out of this landlocked region.[5]

Azerbaijan hosted the bulk of LUKOIL's Caspian operations. This was understandable on a personal level since Alekperov is half Azeri. Politically, this also made sense because LUKOIL was providing a Russian counterweight to the numerous foreign companies involved in the area.

Hydrocarbon-rich Kazakhstan was another target of LUKOIL's upstream expansion during the 1990s. Fully understanding the importance of export pipelines, LUKOIL—through LUKARCO, its joint venture with the American company ARCO—attained a 12.5 percent share in the Caspian Pipeline Consortium[6]. That consortium was in the process of building a 1,500 km pipeline to connect the oil fields of western Kazakhstan with the Russian terminal in Novorossiysk.

Demonstrating its long-term vision, LUKOIL also expanded downstream, buying the Romanian Petrotel refinery, Bulgarian Neftokhim Burgas, and the Ukrainian Odessa refinery.

Other Russian oil companies tried unsuccessfully to follow LUKOIL's example. During the 1990s, the weak Russian government, lacking a coherent energy strategy, often hindered rather than helped their international expansion. This was evident in the Leuna-2000 fiasco: this refinery was built in Germany by France's Elf Aquitaine; Russia's Rosneft, Surgutneftegas and Megionneftegas were to be shareholders and suppliers of crude to Leuna-2000. Russian authorities, however, delayed preparation of documents that Rosneft, Surgut, and Megion needed for so long that they became obsolete. The export benefits that the government provided to the Russian companies were negligible. Negotiations between Elf and the Russians came to an impasse.[7] Leuna-2000 is now refining oil but without Russian oilmen.

Gas Exports are Forever

During the 1990s, gas exports to Europe were essential to the survival of Gazprom, which suffered from low domestic gas prices and rampant non-payments. Shipments to solvent European consumers permitted Gazprom to subsidize its loss-making gas deliveries within Russia and to the former Soviet republics, the latter for political reasons.

Table 2: LUKOIL Involvement in Foreign Upstream Projects during the 1990s

Project/country	Project timeframe	LUKOIL's share	Other participants
Azeri-Chirag-Guneshli (Azerbaijan)	1994-2024	10%[1]	BP (34.1%) Chevron (10.3%) SOCAR (10%) Statoil (8.5%) ExxonMobil (8%) TPAO (6.8%) Devon Energy (5.6%) Itochu (3.9%) Amerada Hess (2.7%)
Shah-Deniz (Azerbaijan)	1996-2036	10%	BP (25.5%) Statoil (25.5%) Total (10%) NICO (10%) SOCAR (10%) TPAO (9%)
Yalama (Azerbaijan)	1998-2035	65% (operator)[2]	SOCAR (20%) GDF SUEZ (15%)
Kumkol (Kazakhstan)	1995-2021	50%	CNPC (50%)
Karachaganak (Kazakhstan)	1997-2038	15%	BG Group (32.5%) ENI Group (32.5%) Chevron (20%)
Tengiz (Kazakhstan)	1997-2032	2.7% through LUKARCO (5%)	Chevron (50%) ExxonMobil (25%) KazMunaiGaz (20%)
Meleya (Egypt)	1995-2024	24%	EGPC (56%) IFC (20%)
West-Kurna 2 (Iraq)	1997-2020	68.5%	SOMO (25%) Zarubezhneft (3.25%) Mashinoimport (3.25%)

[1] LUKOIL sold its 10 percent share to INPEX in 2003.
[2] For the Yalama project, LUKOIL's share was originally 80 percent. Currently, the project is frozen.
Source: www.lukoil.ru/materials/doc/Books/2009/Facts2009/part3.pdf.

Gazprom tried to establish a foothold in Europe, primarily in Germany, creating Wingas—a joint venture with BASF's subsidiary, Wintershall—to deliver gas to German consumers. Wingas owns some 2,000 km of trunk gas pipelines and the Reden underground gas storage facility. In addition to Wingas, Gazprom established another joint venture with Wintershall, WIEH. The alliance with Wintershall was Gazprom's greatest breakthrough in Europe.

By the mid-1990s Gazprom also had several other joint ventures: Fragaz with Gaz de France, Gasum with Neste in Finland, Volta with Edison and Promgaz with SNAM, both in Italy, among others. In February 1995, Gazprom bought 10 percent of the Interconnector consortium that was to lay a 20 billion cubic meters (BCM) per year gas pipeline from Great Britain to continental Europe.

Gazprom delivered gas to Western Europe under long-term take-or-pay contracts and in 1995 the company accounted for 21 percent of the Western European market and 55 percent of the Eastern European market.[8] It offered the lowest-priced gas and delivered gas to consumers without disruptions. Analysts admitted, therefore, that "Gazprom always behaved as a responsible member of the European gas club."[9]

> During the 1990s, gas exports to Europe were essential to the survival of Gazprom.

In contrast to LUKOIL, Gazprom showed only detached interest in the Caspian upstream in the 1990s. When it came to Caspian hydrocarbon transport, however, Gazprom's commercial and political goals dovetailed neatly. Gas industries in landlocked Kazakhstan and Turkmenistan (the latter being the largest gas producer in Central Asia) were tied to Gazprom's pipeline network, meaning that their economies depended on Russia, who could potentially bar them from European markets.

When the USSR collapsed, Turkmen gas was gradually isolated from its main consumers, mainly through the efforts of Gazprom, who used its monopoly on gas pipelines. As a result, exports of Turkmen gas declined. In 1995, however, Gazprom allowed Turkmenistan access to the largely insolvent former Soviet republics. In December 1999, Turkmenistan and Gazprom signed an agreement on the delivery of 20 bcm of Turkmen gas per year, mainly to Ukraine. By that time, Gazprom had discovered to its dismay that it could not produce enough gas in Russia to satisfy domestic demand and meet export commitments, so utilizing Turkmen gas eased pressure on the company.

The 2000s

The Russians are Coming

In the 1990s, when the Russian oil industry was fighting for survival amidst a severe economic crisis, international expansion was not its top priority. The situation radically changed in the new century. Maturing Russian oilmen were striving to become global players, crude production was growing, and oil prices were rising. The much stronger government began to reestablish state control over the oil and gas industries and to restore the global might of the country, using energy for this purpose instead of nuclear weapons. Significantly, the "Energy Strategy of Russia up to 2020", adopted in 2003, declared that, "The role of the country in the global energy markets largely determines its geopolitical influence."[10] The government later tried to moderate this blunt statement and insisted on purely commercial motives for global expansion. The new "Energy Strategy of Russia up to 2030", adopted in 2009, diplomatically says, "The goal of Russia's energy policy is to ensure … strengthening of its global economic positions."[11]

The era of cheap and easy to produce hydrocarbons has ended in Russia.

Global expansion also became necessary for economic reasons because of growing problems with petroleum resources. The era of cheap and easy-to-produce hydrocarbons has come to an end in Russia as new greenfield projects will be implemented in Russia's East Siberia, the Far East and in the Arctic in scarcely populated regions with no infrastructure and extremely difficult geological and climatic conditions. In addition to low-cost production, more favorable taxation regimes abroad became another important motive for the international expansion of oilmen.[12]

Though in the 2000s LUKOIL ceded its status as the Russian oil industry flagship to Rosneft, it continued to lead in international upstream expansion. By the late 2000s, LUKOIL worked in Colombia, Venezuela, Côte d'Ivoire, Ghana, Egypt, Saudi Arabia, Kazakhstan, Uzbekistan, and Azerbaijan. This expansion continues as a LUKOIL (85 percent)-Statoil (15 percent) consortium won a contract for West Kurna-2 in Iraq in December 2009.

LUKOIL continued to help the government establish strategic partnerships abroad, primarily with Caracas. Prime Minister Vladimir Putin, regretting that Russian-Venezuelan economic cooperation was practically non-existent, said that Gazprom, LUKOIL, and Russian Railways could expand business relations with Venezuela.[13] In 2008, LUKOIL extended the 2005 agreement on the Junin-3 block in the Orinoco belt; TNK-BP and Gazprom won the Ayacucho-2 and Ayacucho-3 blocks, respectively. In 2008, LUKOIL, Rosneft, TNK-BP, Surgutneftegas, and Gazprom, prompted by Deputy Prime Minister Igor Sechin, established the National Oil Consortium for Venezuelan operations. In 2009, a memorandum was signed, creating a joint venture between the consortium and Petróleos de Venezuela SA (PDVSA) to develop the Junin-6 block.

It was thought that Russian oilmen could gain valuable experience producing and upgrading extra-heavy crude. Venezuela, however, is inviting national oil companies (NOCs) instead of global majors to the Orinoco belt, being guided as much by Caracas' political agenda as by the promise of upstream expertise or financing. In that context, projects implemented by NOCs, led by Venezuela's financially strained and operationally unsophisticated PDVSA, seem rather risky commercially.

A Tale of Downstream Failure

Compared to an impressive upstream track record, LUKOIL's expansion into the European downstream was stalling. In the 2000s, LUKOIL failed in its attempts to buy the Polish Gdansk refinery, the Lithuanian Mazeikiu Nafta refinery, the Europoort refinery in Rotterdam, and Hellenic Petroleum in Greece.

The Greek case shows that these misfortunes have political origins. Between 2002 and 2003, LUKOIL and the Greek Latsis Group attempted to buy Hellenic Petroleum. The Russian government wholeheartedly supported LUKOIL's expansion; in December 2001, when President Putin visited Greece, much attention was devoted to Russian-Greek petroleum dialogue and Vagit Alekperov was a prominent member of the Russian delegation. In 2002 the LUKOIL-Latsis consortium was the only contender for Hellenic Petroleum, but in early 2003 Athens decided not to sell to LUKOIL, stating that the proposal of LUKOIL and Latsis Group was "unacceptable from the point of view of [Greece's] national interests."[14]

Europeans feared Russian energy companies to be vehicles of Russia's political interests.

The 2008 campaign in the Spanish press, when LUKOIL was negotiating acquisition of 29.9 percent of Repsol, also showed that Europeans feared Russian energy companies to be vehicles of Russia's political interests and did not distinguish between state-owned and private entities. While powerful, these fears are not universal, as LUKOIL acquired 49 percent of the ISAB refinery in Sicily from the Italian ERG in 2008. A year later it bought 45 percent of the Vlissingen refinery in the Netherlands from Total. The Vlissingen transaction, clearly, had political undertones, as the deal accompanied President Medvedev's visit to the Netherlands.[15]

LUKOIL is the only Russian oil company to have entered the United States. In 2000, it acquired control of Getty Petroleum, owner of 1,300 fuel stations. In 2004, it bought another 779 retail outlets from its partner, ConocoPhillips; their relations are based on the principle of "your downstream for our upstream." Nonetheless, since LUKOIL does not yet have its own refinery in the United

States, its business there seems largely a matter of prestige. However, there have been long-standing plans to buy or build a refinery in the United States so as to accommodate its rising oil output in Russia's north. Together with its partner ConocoPhillips, LUKOIL now intends to invest in a new refinery on the U.S. eastern coast that will focus on processing Russian crude blends.[16]

The King is Bankrupt

In the new century, YUKOS, producer of 80.7 million tons (mt) of oil in 2003, emerged as the most dynamic and westernized privately-owned Russian oil company and was actively globalizing. In 2002, it bought 49 percent of shares and managing rights over the Slovak oil transportation company Transpetrol. In the same year, YUKOS gained a blocking interest in Mazeikiu Nafta in Lithuania. YUKOS invited the Hungarian firm MOL to work in West Siberia and, through this alliance, secured a niche in the Hungarian retail market.

YUKOS considered the United States a promising market and planned to export up to 35 mt per year there.[17] In July 2002, as it started trial deliveries of oil to the United States, the Astro Lupus supertanker brought the first cargo of YUKOS's crude to Texas.[18]

YUKOS, having developed major fields in Russia's east, also understood the benefits of exporting East Siberian crude to China. In May 2003, YUKOS and the China National Petroleum Corporation (CNPC) closed a long-term contract to pump 20 mt for the first five years, and 30 mt per year after 2010 through the future Russia-China pipeline. In 2003, however, the YUKOS legal case started: its CEO, Mikhail Khodorkovsky, was arrested and accused by the Russian government of, among other things, tax evasion on a grand scale. The company went bankrupt and its stake in Transpetrol went to Slovakia, while its stake in Mazeikiu Nafta went to Poland's PKN Orlen.

The YUKOS case marked the beginning of the rapid nationalization of the Russian oil sector and aggressive redistribution of assets in favor of state-owned companies. One of the reasons given by the Russian government for expanding the state's role in the economy is that Russia needs mega-companies capable of competing internationally as national champions; Rosneft and Gazprom perfectly fit this category.

Long Live the King

During the 1990s, Rosneft struggled to survive. After purchasing Yuganskneftegaz, YUKOS's main oil producing subsidiary, in 2004 and the lion's share of YUKOS's remaining oil assets in 2007 during bankruptcy procedures, however, Rosneft became a leader of the domestic oil industry. It even aspired to equality with ExxonMobil and BP by 2010.[19] For that, the company would need a significant global presence, which it is currently trying to establish. Rosneft is active in Kazakhstan, where it is developing the Aday zone together with Sinopec, and the Kurmangazy structure in the Caspian Sea with KazMunayGaz.

Its successes abroad, however, are still quite modest. Together with other Russian oilmen, it came to Venezuela. Rosneft also operates in Algeria: in 2001, it signed a contract with Sonatrach for exploration and production in the 245-South Block. Rosneft's leadership said its interest in Algeria was purely commercial, but was it a mere coincidence that the company arrived in the North Africa when Russian-Algerian political dialogue restarted?[20]

Nevertheless, political undertones in the foreign expansion of Rosneft sometimes do it a disservice. In 2003, it wanted to buy a 25 percent share of the Croatian state oil company INA. Of particular interest for Rosneft was INA's 38 percent stake in JANAF, which controls a section of the pipeline between the Croatian deepwater port Omišalj and the Druzhba pipeline. Rosneft hoped that Zagreb would guarantee that it could increase its stake in INA to 51 percent; Croatian officials, however, deemed this demand unacceptable.[21] While in the 1990s the weak Russian government could not help Russian companies to acquire European assets, in the 2000s the strong Russian government sometimes helped too much.

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In addition to YUKOS's assets, Rosneft inherited its vision with respect to China, which increasingly became Russia's military, political, and energy partner. Rosneft's relationship with China flourished after its acquisition of Yuganskneftegaz, for which the Chinese banks lent it $6 billion. During the official visit of President Putin to Beijing in 2006, Rosneft and CNPC signed an agreement of cooperation between Russia and China. A Russian-Chinese joint venture will build a 10 mt per year refinery in China and 300-400 fuel stations. In addition, in 2009, the Chinese Development Bank provided $15 billion of credit to Rosneft and $10 billion to Transneft, the Russian pipeline monopoly, to be repaid by deliveries of 300 mt over 20 years. Igor Sechin, chairman of Rosneft's board of directors and the most influential person in Putin's milieu, helped Rosneft and Transneft get the credit by being personally involved in negotiations with the Chinese. It seems, therefore, that the corporate interests of Rosneft are the key driver of the current energy rapprochement with China.

In December 2009, the first stage of the East Siberia-Pacific Ocean (ESPO) pipeline was launched. Rosneft will be the exclusive supplier of crude to China via the pipeline which Putin has called "a geopolitical project." Indeed, commissioning of ESPO will open the energy door to the Asia-Pacific region. When it began building the ESPO, Russia wanted to show Europe that it had other attractive export opportunities. By pursuing geopolitical goals, however, it sacrificed business considerations: construction costs of the ESPO's first stage grew from $6.6 to $14.5 billion and Transneft's crude deliveries to China will be loss-making due to the pumping tariff established by the state.[22]

Old Boys Network

Other state-owned companies are also expanding their upstream and downstream presence abroad. In November 2009, Gazpromneft signed a memorandum of understanding with the Iranian NIOC, which envisages cooperation in the development of the Azar and Shangule fields in Iran. In December 2009, it won the Iraqi tender for the Badra field jointly with Kogas, Petronas, and TPAO. Gazpromneft, with a 30 percent stake, will be the project operator. Gazpromneft bought 51 percent of the Serbian NIS in 2008, when Russia and Serbia signed a 30-year intergovernmental agreement on energy cooperation. This acquisition is of particular importance as Serbia will be one of the transit countries for Gazprom's South Stream pipeline.

State-owned Zarubezhneft is currently reestablishing relations with countries with whom it had worked before the collapse of the USSR. Under intergovernmental agreements signed in 2002 and 2003, it resumed cooperation with India and Syria; Cuba invited the company to develop the Varadero field. In 2006, during Vladimir Putin's visit to Vietnam, a joint venture with PetroVietnam to work in Vietnam and other countries was established.

Zarubezhneft also opened a motor oil plant in Bosnia and Herzegovina and plans to commission the second phase of the Bosanski Brod refinery and expand its network of fuel stations.

In 2009, Surgutneftegas, a privately-owned company close to the Kremlin, made its debut in Europe: it bought 21.2 percent of Hungarian MOL from Austria's OMV. This step was quite unusual for cash-rich Surgutneftegas, which does not have any production links with MOL. The key assets of MOL include several refineries and 5,000 km of gas distribution networks. Presumably, Surgutneftegas' CEO Vladimir Bogdanov was asked to help Gazprom in trying to obtain distribution assets in Europe.

Transneft also became a powerful foreign policy vehicle. Its Baltic Pipeline System (BPS), a new export direction from Kirishi to Primorsk located on the Baltic Sea which can now transship 75 mt of oil per year, serves as an important tool in regulating relations between Russia and Baltic states dependant on Russian transit.[23]

The saga of BPS had a political sequel. After a Moscow-Minsk oil conflict in early 2007, Russia portrayed Belarus as an unreliable transit partner and decided to build BPS-2 with a potential throughput capacity of 50 mt per year to bypass Belarus.[24]

At the Kremlin's Energy Service

Whereas oil companies are important players, the role of Gazprom in today's Russia is best described by an old cliché: "what is good for Gazprom is good for Russia." While in the 1990s Gazprom and the Kremlin resembled business partners who sometimes disagreed, in the 2000s Gazprom has become the Kremlin's faithful servant and dangerous sword, and the Kremlin has become Gazprom's protector.

The former chairman of Gazprom's board of directors, Russian President Dmitry Medvedev, said, "Gazprom is a business and not an almshouse for satisfying state needs or serving private interests."[25] Gazprom, however, is increasingly acting as a foreign policy tool, and political motives prevail in many business decisions, as evidenced by the vicissitudes surrounding the development of the Shtokman field, with 3.2 trillion cubic meters of gas of reserves in the Barents Sea. Initially, Gazprom planned to commission Shtokman in 2010 and give 49 percent to foreign companies. In 2005, Alexei Miller named the potential participants: Norsk Hydro, Statoil, Chevron, ConocoPhillips, and Total. Suddenly, in autumn 2006, Gazprom announced that it would develop the field itself, as none of the five companies offered assets "that would correspond in terms of quality and volume to Shtokman's reserves."[26] (Statoil, for example, wanted 25 percent of Shtokman but only offered 5 to 10 percent in the development of its Snøhvit field.) Miller also announced a change of priorities: gas from the field would go by pipeline to Europe rather than by tankers to America. Presumably, the United States' tough position on Russia's WTO accession caused this volte-face from America to Europe.[27]

"What is good for Gazprom is good for Russia."

At about the same time, Vladimir Putin proposed to German Chancellor Angela Merkel an offer to direct gas from Shtokman to Germany and to conclude an energy pact. Germany would then become the European hub for distributing Russian gas. Instead of an energy pact with Russia, however, Germany agreed to form an energy alliance with France a month later.[28] It is likely that this agreement contributed to the go-it-alone decision on Shtokman.

Experts doubted that Gazprom could implement such a complex and expensive project by itself, and the concern did invite foreigners. In July 2007, a telephone conversation between the presidents of France and Russia sealed the fate of Shtokman: Total became Gazprom's partner in its development. Making this political choice, Putin hoped that France would oppose the new EU energy directives. In October 2007, StatoilHydro, an Arctic shelf veteran, joined the project. The initial plans were to launch the field in 2013 and to produce 23.7 bcm per year, with half going by Nord Stream to Europe and half to the United States in liquefied natural gas (LNG) form.[29] In September 2009, though, deputy chairman Alexander Medvedev announced that Gazprom might delay the launch of the gas field beyond 2013 should demand in Europe not recover fast enough.[30]

Gazprom's Great Pipe Dreams

Export pipelines enable Gazprom to influence foreign consumers and transit countries, and their construction seems to be number one on the company's agenda, presumably more important than gas field development, probably because Gazprom's internal pipeline lobby is very strong.[31]

Table 3: Gazprom's Key Export Pipelines

Project	Route	Throughput capacity (bcm/yr)	Cost	Project participants
Yamal-Europe	Torzhok - Germany	33	\$5.5-6 billion	Gazprom, EuroPolGas, Wingas
Blue Stream	Black Sea - Turkey	16	\$3.2 billion	Gazprom, ENI
Nord Stream	Vyborg - Germany	55	\$11.64 billion	Gazprom, BASF SE/Wintershall Holding AG, E.ON Ruhrgas, Gasunie
South Stream	Black Sea - Bulgaria; one branch to Italy, another to Austria	63	\$36.5 billion	Gazprom, ENI

The Yamal-Europe pipeline's construction began in 1994 in a reverse mode, from Europe to Russia. Its purpose was to bypass Ukraine, which often pumped out gas from transit pipelines.[32] By 1999, the Polish, German, and Belarussian sections were commissioned and filled with gas from West Siberian fields. What remained was to connect the system to Yamal, the peninsula in the extreme north of Russia with gas resources of some 10.4 trillion cubic meters, but by then Gazprom postponed development of Yamal because of financial constraints and instead decided to use the new system to pump gas bound for Germany—gas that used to go through Ukraine—thus putting pressure on Kiev.[33] In 2006, the first branch of the Yamal-Europe pipeline reached its design capacity of 33 bcm per year.[34] Because gas production in Russia is declining, building a second branch to increase the overall throughput to the intended 65.7 bcm per year would make no economic sense.

Another export pipeline, the Blue Stream, was built under the Russian-Turkish agreement of 1997. In the late 1990s, forecasts of Turkish gas demand were very optimistic and Russia intended to export 364.5 bcm via Blue Stream between 2000 and 2025. A month after commercial deliveries began in 2003, however, Ankara stopped accepting gas, insisting on changes in contract terms. Turkey was a monopoly buyer and had alternative suppliers, so Gazprom was forced to make amendments to the agreement that put it at a financial disadvantage. Blue Stream should reach its full capacity of 16 bcm per year by 2010, but it is uncertain if Turkey will need so much gas. The pipeline, while a commercial disaster, is a geopolitical success; Russia was one of the first movers to Turkey, and Blue Stream slowed down implementation of competing projects. Gazprom is now planning to build its second branch and increase capacity to 32 bcm year.[35]

Nord Stream is Gazprom's most ambitious pipeline project, as it will reduce its dependence on Ukraine as a transit corridor. In 2005, Nord Stream AG was created with Gazprom owning 51 percent, and Wintershall and E.ON owning 24.5 percent each. In 2008, Gasunie bought a 9 percent stake, reducing the stakes of the German partners by 4.5 percent each. Participation by the Dutch company will take Russian gas to Great Britain through the new BBL pipeline.[36]

In autumn 2005, former German Chancellor Gerhard Schroeder was made Shareholders' Committee Chairman of Nord Stream, and Board Chairman of Dresdner Bank Matthias Warnig (who allegedly served with Putin in then East Germany) became its managing director.[37] Explaining its choice, Gazprom said, "Nord Stream is a politically important project for us, and it is essential that people with authority and weight in global community head it."[38]

Expanding on the relationships established with the start of Nord Stream, Gazprom tried to swap some of its shares in Severneftegazprom, license holder for the Yuzhno-Russkoye gas field that was to supply gas for Nord Stream, for foreign assets. In 2007, BASF got 25 percent minus one share in Severneftegazprom, while Gazprom increased its stake in Wingas from 35 percent to 50 percent minus one share and got 49 percent in Wintershall's subsidiary that owned two oil licenses in Libya.[39]

E.ON offered cash and stakes to Gazprom in East European companies. Gazprom, however, was interested in E.ON's assets in Germany and Great Britain. In 2008, after long negotiations, Gazprom only managed to get 49 percent of Gerosgaz, which owned 2.93 percent of its shares, from E.ON.[40]

Nord Stream faced serious political obstacles. Poland and the Baltic states were opposed to its construction across the Baltic Sea, claiming it could hurt shipping and damage the environment. In September 2007, Estonia forbade Nord Stream from laying the pipe along its coast. This decision occurred at the time the 'Bronze Soldier conflict' was raging between Tallinn and Moscow.

In 2008, Nord Stream had to give up construction of the service platform in the middle of the pipeline route in Sweden's economic zone; Sweden feared that Russian intelligence would use the platform.[41]

> It is making gas consumers in the former Soviet Republics pay European, rather than subsidized, gas prices, while retaining discounts for loyal countries.

Russia's leadership personally promoted Nord Stream. To win Denmark's goodwill, Prime Minister Putin promised that Russia would sign the possible climate treaty in Copenhagen in December 2009.[42] In the autumn of 2009, three Nordic countries permitted Nord Stream's construction in their territorial waters—likely persuaded by the breakthrough in Russian-Chinese gas relations.

South Stream is to be built from 2010 to 2015, also with an aim to bypass Ukraine. In 2008, Gazprom successfully signed agreements with Bulgaria, Serbia, Hungary, and Greece—countries through which the pipeline would pass.

Problems, though, began to emerge both with its allies and rivals. South Stream's competitor is the 30 bcm per year Nabucco gas pipeline that was planned to reduce European dependence on Russian gas supplies. Nabucco supporters became more active in early 2009 after the latest Russian-Ukrainian gas conflict. In May 2009, Russia was celebrating: Kazakhstan, Turkmenistan, and Uzbekistan refused to sign the declaration on Nabucco at the EU energy summit in Prague.

This celebration was short-lived, however, as Turkey, Austria, Hungary, Bulgaria, and Romania unexpectedly inked an agreement on Nabucco in 2009, and Turkmenistan revised its position on Nabucco, making its implementation more probable.[43]

Russian diplomatic efforts, however, reversed the situation. Putin played a subtle "Turkish game," and in August the prime ministers of Russia and Turkey signed a protocol on geological exploration in Turkish territorial waters where South Stream will pass. Russia's strategic alliance with Turkey dealt Nabucco a serious blow.[44] To win over Turkey, Russia expressed support for the Samsun-Ceyhan oil pipeline to be built in Turkey by Eni and the Turkish Çalık Enerji.

Love Thy Neighbor

Gazprom is also trying to gain control over the gas transportation infrastructure that used to be part of the Soviet Union's gas supply system. Simultaneously, it is making gas consumers in the former Soviet Republics pay European, rather than subsidized, gas prices, while retaining discounts for loyal countries. To persuade unwilling customers, it switches off gas supplies.

Gas prices grew rapidly, particularly in 2006. In Armenia, the gas price rose from $65 to $70 in 2005 to $110 in 2006. When Yerevan invited Gazprom to participate in the privatization of gas assets, however, the monopoly promised not to raise prices until the end of 2009. Georgia, who refused to cede energy infrastructure to Gazprom, was less lucky. In 2006, it paid $110, up from $60 in 2005; in October 2006, Gazprom raised prices for Tbilisi to $235.

Relations with Belarus and Ukraine, vital transit countries for Gazprom's exports to Europe, are particularly complex, seeing as how Gazprom is the monopoly supplier of gas to its two Slavic neighbors. In 2002, Gazprom suggested that Belarus should pay for cheap gas with gas pipelines, but the Belarussian leadership insisted that assets of Beltransgaz should be sold at market value ($5 billion) rather than book value ($400 million).[45] In late 2003, Gazprom threatened, "your gas pipelines or the price goes to $50."[46] Minsk refused, and on 1 January 2004 Gazprom stopped gas deliveries to Belarus, leaving it and some European consumers without fuel. For the first time since the USSR collapsed, the EU spoke about a new Russian weapon and threat.[47]

Only on 31 December 2006, while promising to cut off gas deliveries again, did Russia sign a five-year contract on gas supplies and later buy 50 percent in Beltransgaz for $2.5 billion. With this deal, Belarus got the lowest gas price among the former USSR republics.[48]

The gas disputes between Russia and Ukraine were the most widely publicized energy conflicts of the decade because European countries became victims of their economic, energy, and political disagreements. One of the "apples of discord" was the issue of the Ukrainian gas infrastructure that Gazprom wanted to control. For Gazprom, which intended to present Ukraine to the global community as an unreliable transit country, one of the most important implications of the gas battles of 2006 and, particularly, 2009, was the reputational loss: the world perceived the company as an unreliable supplier. As a consequence, Gazprom will face greater obstacles to its global expansion.

Gas-Addicted

While raising prices for its customers, Gazprom itself became victim of price hikes initiated by Central Asian gas producers. In 2002, Gazprom signed several long-term contracts with the Central Asian countries on gas purchases and joint implementation of upstream projects. The company faced a shortage of gas, and, until recently, purchasing Central Asian gas was cheaper than developing the Arctic. It also made a huge profit by buying gas at a low price in Asia and selling for a high price in Europe. In 2008, Gazprom purchased 66.1 bcm of gas in Central Asia for $8 billion, including 42.3 bcm in Turkmenistan.[49]

Gazprom, however, became dangerously dependent on Central Asian gas producers who began to dictate their own terms. Turkmenistan was particularly successful in raising prices. In 2003, Gazprom signed a twenty-five-year agreement with Ashgabat to buy 1.8 trillion cubic meters of gas for $44 per 1000 cubic meters.[50] Saparmurat Niyazov, former president of Turkmenistan, quickly renegotiated prices to $100. Gazprom had to agree because Turkmenistan was actively courted by the United States, which proposed to build alternative routes for gas transportation to the West.[51] The new Turkmen president, Gurbanguly Berdymuhammedov, aimed at diversifying export markets. In that context, he grew increasingly discontent with Gazprom's attempts to strengthen Turkmenistan's pipeline dependence on Russia. In 2007 the presidents of Russia, Kazakhstan, and Turkmenistan signed a declaration for the construction of the 30 bcm per year Pre-Caspian gas pipeline, to deliver Kazakh and Turkmen gas to Russia.[52]

In 2009, Turkmenistan, Kazakhstan, and Uzbekistan began to charge European prices for gas sold to Gazprom. As a true monopoly, Gazprom firmly believed in controlling competitors (even at a loss); it expected that if Russia paid European prices for gas, Turkmenistan would forget about exports to other destinations. These expectations were undermined by an explosion on the Turkmen gas pipeline in April 2009, when Gazprom stopped buying Turkmen gas due to its own sales sharply contracting. The pipeline was repaired, but deliveries did not resume because of price disagreements.

Only in December 2009 were amendments signed to the long-term contract on Turkmen gas deliveries: they stipulated a restart on 1 January 2010 at European prices.[53]

Birds of a Feather

Continuing the policies of the USSR, Russia is looking for strategic alliances with kindred spirits, and Gazprom helps it forge political ties with energy producers. The company says it is globalizing to strengthen its international position and increase capitalization. In conquering South America, Gazprom works with Venezuelan PDVSA and cooperates with the Bolivian YPFB. In Asia-Pacific, it works in Vietnam with PetroVietnam and in India with GAIL and ONGC.

In 2006, Gazprom and Algerian Sonatrach signed a memorandum of understanding, leaving many EU leaders afraid that the Russian-Algerian alliance would result in the increase of gas prices, as Gazprom and Sonatrach jointly supply 36 percent of gas consumed in the Europe.[54] This Gazprom-Sonatrach initiative failed, but the potential alliance made Europeans step up efforts to diversify their gas supplies.

After the Algerian fiasco, Gazprom tried its fortunes in Libya. Gazprom won licenses in tenders in 2006 and 2007 and later secured two oil concessions from Wintershall. Gazprom is also negotiating with ENI the purchase of its share in the Elephant project in Libya.[55]

In 2008, Gazprom announced that it wanted to produce gas in Nigeria and participate in the construction of the Trans-Sahara gas pipeline that could become a major source of gas supplies to Europe.[56]

Despite U.S. sanctions, Russia continues to work on energy projects with Iran.

Despite U.S. sanctions, Russia continues to work on energy projects with Iran. In particular, Gazprom might participate in the construction of an Iranian LNG plant using gas from the South Pars field, where Gazprom has been involved since 1997.[57] The Iranian market is of particular importance to Gazprom since Tehran could become its serious competitor as a supplier to Europe. Gazprom also plans to take part in the construction of the Iran-Pakistan-India "Peace Pipeline," thus diverting Iranian gas from the Nabucco pipeline.[58]

In Search of Gas Dorado

Raising the profitability of gas exports to Europe was one of the first tasks that Putin, then Russia's new president, put before Gazprom in 2000. According to Alexander Medvedev, head of Gazpromexport, "the priority of Gazprom's new export policy is to access the end consumer."[59] The company hoped to benefit from European energy market liberalization, but the EU was becoming increasingly worried about its growing dependence on Gazprom.

Gradually, the deterioration of Russian-EU political relations affected their gas cooperation. It could also be argued that Russia's gas policy spoiled Russian-EU political relations. Gazprom's initial attempts to buy assets in Germany, Romania, and Hungary failed. Gazprom has offered Europeans a deal: a share in Russian upstream projects in exchange for access to the European downstream. A certain success was achieved with BASF, and in Austria, where Gazprom received 50 percent in the gas distribution hub in Baumgarten that will become the end point of South Stream.[60]

Despite major efforts by all parties, Russian-European gas relations remain fairly uneven. On the one hand, cooperation between Gazprom and ENI is expanding, helped by the friendship between Vladimir Putin and Silvio Berlusconi.

In November 2006, Eni and Gazprom signed a strategic partnership agreement that gave Gazprom the right to sell 3 bcm per year directly to Italian consumers.[61] Gazprom has also been pursuing stakes in Eni Power, that generates and sells electricity in Italy.

On the other hand, relations with Great Britain are stalling. Gazprom was eager to reach British consumers, who in 2005 paid retail prices of $1200-1500, while Gazprom was selling gas in Europe for $180-200 on average.[62] Soon after Russia's first gas war with Ukraine, information surfaced that Gazprom was interested in increasing its share of the British market to 20 percent by buying a stake in Centrica. It was then that British officials started to worry that Gazprom could be a tool of the Kremlin. The government began to develop amendments to the law that would allow for deals threatening national security to be vetoed.[63] Putin retaliated by warning that Gazprom would head for new markets if it was not allowed to develop its business in the old ones, i.e. Europe. It was then that Gazprom achieved a breakthrough with China and declared the United States to be a priority market.[64]

It was unclear, however, whether Gazprom had enough gas to meet its commitments to Europe, satisfy the growing domestic demand, and supply gas to China.

In March 2006, during President Putin's official visit to China, Gazprom and CNPC signed a "Protocol on Natural Gas Deliveries," which were to begin in 2011 in the amount of 68 bcm per year. The 2006 agreement was an important milestone in Russian plans to diversify gas exports. It was unclear, however, whether Gazprom had enough gas to meet its commitments to Europe, satisfy the growing domestic demand, and supply gas to China.

Gazprom wanted to deliver gas to China with a western route pumping West Siberian gas (the Altai pipeline) and an eastern route pumping East Siberian gas. Altai was not built because of price disagreements with China, but it played its political role as it demonstrated to Europe that Russia was ready to reorient its gas to the East.[65]

In autumn 2009, Prime Minister Putin again visited China. A new agreement was signed envisaging the same two gas pipelines with the same throughput, but with deliveries West Siberia only beginning in 2014-2015, and even later from East Siberia even later. Gazprom lost time bargaining with Beijing; Turkmenistan has already launched its own pipeline to China and thus overtaken it in the Chinese market.[66]

To become a truly global company, Gazprom needs to strengthen its LNG positions. With LNG, Gazprom plans to conquer the markets of North America, Spain, and the Asia-Pacific Rim.[67] The United States seems particularly attractive but it is unclear whether it needs Russian LNG given falling gas demand, stiff competition from other LNG suppliers, and domestically produced shale gas.

Gazprom also wanted to participate in the construction of the 40 bcm per year Alaska gas pipeline to the southern states of the United States, and in October 2008 it made a relevant proposal to BP and ConocoPhillips.[68] Analysts, however, believe that financial constraints and political opposition will reduce Gazprom's chances of participating in the project, leading Valeriy Nesterov from the Troika Dialogue to say that "The U.S. government protects the U.S. market from companies that seem politically untrustworthy."[69]

Commercial realities have recently been forcing Gazprom to moderate its geopolitical ambitions. In May 2008, for example, the company joined the proposed Rabaska LNG regasification project. Using this terminal, Gazprom expected to deliver LNG from Shtokman to Canada. In 2009, however, the company chose not to sign a lease on Rabaska given the global economic situation.

Conclusion

Political and commercial considerations drive the globalization efforts of Russian energy companies, sometimes complementing and sometimes contradicting each other. During the 2000s, with the growing nationalization of the energy sector and attempts by Russia's leadership to reestablish its former global might via its control over energy resources, political aspirations have been gaining importance. Support provided by Russia's leadership to the international expansion of Russian energy companies, however, has sometimes backfired, as even pure business initiatives were perceived as being Kremlin-controlled. As a result, their upstream cooperation with energy producers was generally more successful than their attempts to acquire downstream assets of energy consumers, who feared the growing international influence of Russia. After years of being a seller's market, however, wherein Russian energy companies could dictate their terms to consumers, the global crisis revealed that developed countries did not need Russian energy as much as Moscow thought. This current economic situation will likely make Russian companies rethink their corporate strategy and global ambitions and force the government to revise its energy-based foreign policy, resorting to subtler political maneuvers and an increased awareness of commercial realities.

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