

THE RUSSIAN FEDERATION AS AN ENERGY SUPPLIER

Explaining why Russian authorities are flexing their muscles towards the West and the policy options Russia faces in the energy sector, the author asserts that Turkey is increasingly central in securing Europe's energy supply. He points out that the EU needs a common energy policy that takes diversification into account and that Central Asia needs more options to carry its energy resources to world markets.

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Technological development has gained an enormous impetus during the last 50 years, making the speed of development in this period of time the highest in the whole of human history. Since the developed countries will always be in quest of more prosperity for their peoples and the less developed countries will keep making greater efforts to reach similar socio-economic levels of welfare, the motivation for development will continue to exist, perhaps more fervently each new day than the previous. And the sine qua non for this drive today is, without a doubt, energy.

Sadly, while demand for energy keeps rising, the known resources of energy are in decline. According to the International Energy Agency, the world's energy needs are estimated to be more than 50 percent higher in 2030 than today.¹ Yet under the existing investment programs, "life expectancy" of oil, natural gas and coal reserves are 40, 60 and 200-230 years respectively.

Even this simple calculation shows a clear reality: the 21st century will provide a context for and an environment of competition for the control of limited energy resources. Whereas the 20th century saw the nations compete against one another to exert control over oil resources, the focus of a similar politico-economic struggle in this century is likely to shift to natural gas. Among some of the more obvious reasons for this shift are the following: the continued increase in the price of oil, the environmental friendliness of natural gas compared to coal, and the fact that the use of renewable energy sources is not expected to approach the current levels of use of other major fuels in the immediate future.

The Russian Federation as a Key Natural Gas Supplier

The fact that 58 percent of the world's proven natural gas reserves remain in the hands of three countries, namely the Russian Federation, Iran and Qatar, renders the topic highly interesting for analysts and economic and business planners. But that's not all. The subject becomes more and more striking when one takes into account that the Russian Federation has by far the world's largest proved natural gas reserves - constituting 27 percent of world's total reserves and amounting to 47.8 trillion cubic meters, double the proved reserves of Iran, the second most natural gas-rich country of the world.²

The Russian Federation does not only possess the greatest reserves, but it is also the biggest natural gas producer (612.1 billion cubic meters in 2006) and exporter (180 billion cubic meters a year which is 21.3 percent of the world exports) in the world.³

Against this background, it is perhaps not surprising that the Russian Federation perceives its richness in energy sources not only as an economic factor but

¹ www.worldenergyoutlook.org/summaries2006/English.pdf

² BP Statistical Review of World Energy 2007

³ Ibid

also as an extremely powerful leverage to achieve its foreign policy targets. The Foreign Policy Concept of the Russian Federation approved by President Putin on 28 June 2000 aims, among others, at "achieving firm and prestigious positions in the world community, most fully consistent with the interests of the Russian Federation as a great power, as one of the most influential centers of the modern world, and which are necessary for the growth of its political, economic, intellectual and spiritual potential."

Energy Strategy of the Russian Federation

Some of the recent developments such as NATO's enlargement towards the east, "colored revolutions" in some of the former Soviet republics, the project for the deployment of a missile defense system in Poland and the Czech Republic coupled with the critical approach adopted by the West vis-à-vis the Russian Federation on issues of democratization have been ample reasons for the Russian authorities to begin to flex their muscles.

As a result, the Russian Federation put into practice a strategy based on its comparative advantages, the main pillar of which is the country's rich energy resources. The Russian gas company, or "gas giant", Gazprom plays a very important role in this strategy. As the world's biggest gas company, Gazprom's share in the global and Russian natural gas stocks makes up 17 and 60 percent respectively. Its share in the global and Russian gas production is nearly 20 and 90 percent respectively. The company owns the world's largest gas transmission system through which it exports natural gas to 32 countries.⁴

This strategy of the Russian Federation is further rendered feasible by the present state of affairs in Europe regarding energy supply and demand. The Russian Federation is a key energy supplier to Europe. Currently 44 percent of the EU's total natural gas imports come from the Russian Federation. Moreover, the energy demand in the EU is expected to continue to grow; with demand for natural gas to increase by some 60 percent by 2030; 80 percent of the total demand will have to be covered by imports. As mentioned by the Energy Commissioner Mr. Andris Piebalgs at the EU-Russia Energy Dialogue Conference held in Moscow on 30 October 2006 "this presents significant opportunities for a neighboring gas supplier such as Russia provided, of course, that the gas is competitively priced and the necessary investments are carried out both upstream and in the transportation infrastructure."⁵

However, a closer look at the Russian strategy on natural gas raises questions regarding this optimistic approach. In four stages the Russian Federation is in the process of: securing full control over production process of its natural gas reserves, controlling the whole pipeline network (from the Central Asia to

⁴ www.gazprom.com/

⁵ <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/653&format=HTML&aged=0&language=EN&guiLanguage=en>

Europe), making separate deals with the European countries at the bilateral level in order to prevent them from acting as a bloc, and trying to gain direct access to European consumers. A fundamental question arises: will this not amount to too much dependence on a single country, especially given the same country, in another context, can warn Europe that it may point its missiles at some European countries?

Europe's Conundrum

It is clear that following the Cold War the relationship between Europe and the Russian Federation is no longer one that is based on or defined by hostility. The Russian Federation is the third biggest trade partner of the EU and the EU is the biggest trade partner of the Russian Federation (trade with the EU countries accounts for 52 percent of Russian foreign trade). NATO member states and Russia regularly consult on current security issues and are developing practical cooperation schemes in a wide range of areas of common interest. Last but not least, the Russian Federation has been a part of the G-8 for a decade now.

Despite all this, a careful reading of the stated ambitions of the Russian Federation and its available tools of leverage as well as a look back on the recent Ukrainian, Belorussian, Latvian and Georgian experiences regarding energy crises, suggests that policy makers in the West in particular, would almost feel compelled to consider precautionary counter measures, most particularly in the strategic domain of energy security.

One such obvious precaution would be to diversify energy supply sources and energy supply routes. In the EU, this indeed seems to be the case, with imports of natural gas coming into Europe through different routes. However, the reality is that all the pipelines coming from the east carry the natural gas supplied by the Russian Federation.

Russia's Dilemma

So far, it was the up-side of the story for the Russian Federation, but there is also a down-side. Despite its richness in terms of energy resources and although two thirds of the 13 largest natural gas fields of the world are in its territory, the natural gas production capacity of the Russian Federation is in decline: it can no longer satisfy the existing requirements of foreign markets, nor its domestic consumption which increases by 2.5 percent annually.⁶ This simply means that the Russian Federation needs additional sources of natural gas. It seems to have two main options to overcome this challenge: to make new investments in order to increase production or to provide the necessary additional natural gas from other producers.

⁶ E.O. Ndefo, P. Geng, S. Laskar, L. Tawofaing, and Michael J. Economides, "Russia: A Critical Evaluation of its Natural Gas Resources," in Energy Tribune (www.energytribune.com), 13 February 2007

Given its current level of financial deficit, Gazprom is not in a position to choose what appears to be the most viable but at the same time the more costly option of making more investments in its gas fields. Furthermore, it seems reluctant to invite foreign investments into the country, most likely for the sake of protecting its monopoly.

Under these circumstances, the procurement of the energy resources of the Central Asian countries seems to be the only readily available means for the Russian Federation to continue to play a major role and keep its dominant position in the energy sector. As a consequence, the Russian Federation, largely benefiting from its geography and owing to the existing infrastructure appears to be the only itinerary for the Central Asian republics to export their energy resources to the west; thus, today's not so a-la-mode historical axiom is de facto revisited: Central Asia as Russia's backyard.

Russia's Options

The deal of 12 May 2007 between the Russian Federation, Turkmenistan and Kazakhstan which will significantly increase the amount of natural gas imported from Central Asia to Europe via the Russian Federation may be seen as a great success for Russian foreign policy. This may satisfy the EU countries as well because this will certainly contribute to their continuous access to energy resources. While this is indeed the case one should not ignore the fact that could the EU countries have access to the same resources by bypassing the Russian Federation, they would pay less. This is because the Russian Federation sells natural gas to western countries at the market price, but buys it from the Central Asian countries at much lower prices.

There is another aspect related to the market. Obviously, the EU countries overall constitute an important market in the energy sector. However the Russian Federation might also wish to diversify its natural gas market options. This could enable it to negotiate with the EU countries on the price.

Let's not neglect the newly emerging markets, namely China and India. For the past two decades, China has been growing at an astounding 9.5 percent a year and India by 6 percent. Most economists believe that both these countries possess the fundamentals of a steady growth rate in the 7 to 8 percent range for decades to come. Another common aspect these countries share is the fact that they desperately need significant energy resources to keep this trend going.

The Russian Federation is probably well aware of these energy hungry markets and their potential for future Russian gas exports. There are however certainly a number of other considerations which Russia has to take into account when it comes to managing its multifarious relations with both India and China.

In the Russian-Sino relationship, whether Russia wants or should want to contribute to the further growth of China by providing this economic giant with the energy it so needs will be a policy option shaped by their bilateral relations as well as international dynamics.

However, although the Russian Federation currently seems reluctant to cooperate in general with countries in Asia, the fact that economic dynamism is expected to shift from Europe to Asia in a not too long term may cause a certain switch in Russia's energy policy considerations.

Other Actors: Turkey, EU, US

In such a case, it would be in the EU's best interests to diversify supply of its energy sources and find alternative ways to access natural gas. The Nabucco project and the Turkey-Greece-Italy interconnector are sound alternatives to the current limited number of suppliers. With the Caspian, Iranian, Iraqi and Arab resources, those pipeline options can help the EU countries reduce dependence on the Russian Federation. Turkey has an important role to play in these projects. Turkey is an essential part of the East-West Energy Corridor and already contributes to the energy security of the EU through the Baku-Tbilisi-Ceyhan crude oil pipeline that has been active for more than one year. Upon completion of the South Caspian pipeline Turkey also started to provide Greece with natural gas produced in Shahdeniz field at the Azeri sector of the Caspian.

The Russian Federation attaches utmost importance to being qualified as a reliable energy supplier. Its authorities often refer to the fact that the Soviet Union did not stop supplying the West with energy even during the Cold War days. While this may be correct it is also true that the reliability of the Russian Federation as a consistent and trustworthy supplier is considered questionable by many observers who believe that the Russian old pipeline network may create technical problems and the lack of necessary investments in the fields has the potential to disturb the continuous flow of energy. Above all, they are saying, if the Russian decision-makers tend to perceive energy not purely as an economic but also a political matter, energy bottlenecks due to political risks are always a possibility.

Conclusion

In light of the foregoing, it can be argued with a degree of certainty that the EU has begun to feel the increasing pressure of having to come up with a solid common policy on energy and making real efforts to diversify its energy supplies. The Caspian basin constitutes an important alternative concerning the latter and the EU should find the right ways to explore this option. In this framework, Turkey and the U.S. will certainly be ready to act together with the EU. Moreover, this would also meet the expectations of the Central Asian countries of having more options to open up to world markets.

At this fateful point, the EU in particular and the West in general would do well to reconsider their traditional critical approach towards the Central Asian countries. These countries which are still in transition, would be more willing and indeed more able to adopt western values in a climate of cooperation.

It goes without saying that the West also needs to find ways to make the Russian Federation feel more comfortable in its relations with the West so that it would not be in quest of more influence to reinstitute itself as the power it once was, whether by playing the energy trump card or otherwise.