TURKEY'S ENERGY AMBITIONS CLASH WITH RUSSIAN SUCCESSION POLITICS

The Caspian Basin is increasingly at the center of international energy competition. Turkey aspires to enhance its chances of joining the European Union and increase its credentials as a regional power by making itself into a critical energy hub for oil and gas flowing from the former USSR to world markets. Russia, Europe's major energy supplier and in control of major transport networks, is raking in huge profits and using its dominance in the international energy sector to increase its clout in international politics. Moscow has carefully moved to limit Ankara's influence over the energy politics in the region. Russia's behavior in the Caspian, however, has as much to do with competition within the Kremlin for control over the country's major energy firms as it does with geopolitical calculations. This competition is likely to intensify as Russia's presidential transition approaches and make Russian firms increasingly unreliable energy partners.

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The Caspian Basin has become a focal point for international energy politics. For the five Central Asian nations and Iran, the area is a critical transit route for shipping their energy to foreign markets. Since the infrastructure left after the collapse of the Soviet Union was inadequate, moreover, numerous new pipelines and pipeline expansions have been proposed and several have been constructed. Four main pipelines – the Baku-Tbilisi-Ceyhan (BTC), the Baku-Novorossiysk, the Baku-Supsa, and the Caspian Pipeline Consortium (CPC) now carry or will carry the bulk of the region's oil and gas resources to markets in Europe and elsewhere. Meanwhile, Europe and the United States pay special attention to the development and transport of energy reserves in the area as a way to diversity the sources of their imports.[1]

Russia, the largest supplier of oil and gas to Europe and the main route to the West for energy from Central Asia, is playing an increasingly central role in this mix. The Russian company Lukoil began exploring the North Caspian in 1995 and is working to produce natural gas by 2008. Lukoil announced in 2006 that it had found oil at the offshore V. Filanovskogo field. It plans to bring six fields in the Russian section of the Caspian online with production starting at the Y. Korchagina field in 2008. Lukoil expects its fields to reach a maximum of 140,000 barrels per day in 2016. The firms Rosneft and Gazprom are also involved in joint ventures with Kazakhstan's state oil MunaiGaz.

Turkey, also a central player in the region, hopes to boost its chances of joining the European Union by transforming itself into a critical energy hub for oil and gas flowing from the former Soviet Union and the Middle East to world markets. The BTC pipeline, which delivers some one million barrels of Azeri oil per day to the Turkish port of Ceyhan, considerably raises Turkey's standing as a transit route for oil. In July 2007, Turkey concluded, over U.S. objections, several deals with Iran, including one designed to develop three gas fields in Iran's South Pars field. Another agreement would ship an estimated 30 billion cubic meters of Iranian and Turkmen gas to Turkey for further resale to Europe. Iraq is also preparing to resume oil shipments through Turkey. An Iraqi pipeline that will ship 500,000 barrels of oil per day through Turkey was recently completed and is undergoing final tests.

Turkey has tried to diversify its energy sources away from Russia, which provides two-thirds of the country's natural gas, but achieving this goal has been difficult. Turkey's state-owned Bota pipeline corporation is part of a consortium led by Austria's OMV Group to build the Nabucco pipeline, which would carry gas from the Caspian and Central Asia but avoid Russia. Moscow countered the BTC pipeline by raising the price for the oil it sold Azerbaijan, which relies on Russia for almost all its supply. The Russian move forced Azerbaijan to use more of its own gas, and left it unable to fill the Turkish pipeline, which was idle until

[1] Energy Information Administration, *Country Analysis Briefs:* Caspian Sea, January 2007, p. 1.

July 2007. The Blue Stream natural gas pipeline connects the Russian transport system to Turkey. Moreover, Russia, together with the Italian company Eni, plans to extend Blue Stream from Turkey to Southern Europe. However, Russia has also announced a 50/50 joint venture with Eni known as South Stream, which will bypass Turkey entirely. These developments make it unlikely that Turkey will able to carry out its plan to extend a recently completed pipeline from Greece to Germany by 2011. In 2007, Moscow demanded a controlling interest and tax privileges for Russian companies before it signed an agreement with Greece and Bulgaria for a pipeline from Burgas to Alexandropoulos. The project would be a direct rival to BTC and also bypass Turkey.

Turkey also has misgivings about the ability of the Bosporus and Dardanelles, already major chokepoints for oil tankers, to handle additional traffic, since most of Russia's oil export pipelines terminate at the Black Sea port of Novorossiysk – where they are load onto tankers. These include environmental concerns about a possible collision in the Straits as a result of the increased tanker traffic from the launch of the CPC pipeline. To Russian displeasure, Turkey has imposed restrictions on the size and quantity of tankers passing through the Bosporus and Dardanelles.[2]

The Politics of Russian Business

Russian officials often state that Moscow bases its decisions in the energy sector on market considerations.[3] President Putin has branded as parasites the energy transit states that have benefited from shipping fees and cheap energy and said Russia should stop subsidizing them. Indeed, Russia's relations with countries through which it has shipped energy – including Belarus, Ukraine, the Baltic republics and Turkey – have been marked by frequent disputes over prices. Ukraine has long haggled with Russia over how much it pays for gas. In January 2006 the row came to world attention when Gazprom halted supplies to Ukraine entirely on the grounds that Ukraine refused to pay world market rates. However, Moscow's policies have at least as much to do with geopolitical as economic calculations. Foreign Minister Lavrov admitted recently that it "would be fair to say that we see our role in the global economy as a means to safeguard our independence in foreign affairs."[4] Control over energy prices and pipeline networks enable Russia to project power well beyond its borders.

The Business of Russian Politics

Russia's assertiveness in the region's energy issues is also the result of its domestic politics. The Russian leadership realizes that an assertive foreign policy

[2] Energy Information Administration, *Country Analysis Briefs:* Caspian Sea, January 2007, p. 4.
[3] Aleksey. Arbatov, "Is a New Cold War Imminent?" in *Russia in Global Affairs,* July-September 2007, in Johnson's Russia List, www.cdi.org/russia/johnson, 16 August, 2007.
[4] Sergey.V. Lavrov, "Containing Russia: Back to the Future," Ministry of Foreign Affairs of the Russian Federation, 15 August, 2007.

plays well with voters in the months leading up to the elections.[5] The Russian government has also aggressively consolidated its control over the entire energy sector. In a recent article, Lavrov claimed that such centralization is "in line with the global trend toward establishing state control over natural resources."[6] Energy is indeed viewed by the Kremlin as one of the strategic sectors of the Russian economy. Putin has replaced the dominance of the energy sector by oligarchic capitalists, a hallmark of the Yeltsin era, with an equally corrupt system of presidential-bureaucratic capitalism, a fusion of power and money largely inside the executive branch. A web of Kremlin staffers and government ministers are in charge, or on the boards of, the largest state-owned energy companies. Several of these firms have energy interests in the Caspian and Black Sea regions. (The Kremlin has also centralized under state control other key sectors such as arms production and aircraft manufacturing. Today, five high officials lead firms controlling at least on-third of Russia's GDP) even as they carry out their official duties).[7]

This situation, however, is highly unstable, since property rights are weakly protected by the state. In fact, the constant distribution and redistribution of property among competing interests is an important strategy the Kremlin uses to govern. Although one-time independent energy giants Yukos and Sibneft have been formally integrated into the state structures, informal coalitions of businessmen, bureaucrats and intelligence officers form and reform as they jockey for the wealth and political power that flow from control over the key energy assets. This political infighting shapes in a major way the behavior of Russia's energy companies, both at home and abroad. There is some evidence as well that organized crime groups are active as semi-independent players that lobby on behalf of their business interests and occasionally help the government implement oil and gas policy.

Although Putin's influence varies considerably by issue, in the energy sector he usually acts as a balance among competing coalitions and to preserve his freedom of maneuver. These groups, in turn, constrain his ability to act with a free hand. Putin sometimes promises things he is unable to deliver, is forced to compromise or even abruptly chances his mid due to external pressures. Additionally, Putin himself almost certainly has business ties in the energy industry and these probably play a role in his decisions. The result of this ever changing political milieu is the sometimes unpredictable behavior by Russian companies or abrupt changes in these firms' policies.

Two alliances have especially significant influence. The first, led by First Deputy Prime Minister Dmitry Medvedev, often mentioned as Putin's successor, and Deputy Head of the Presidential Administration Vladislav Surkov, dominates Gazprom, Russia's natural gas monopoly. The second, headed by Igor Sechin (also a deputy chief of the Presidential Administration) controls Rosneft, the state's major oil firm. (Aleksey Miller and Sergey Bogdanchikov, formally the CEOs of these rival firms, generally stay out of the political fray). Neither group has a track record of reinvesting profits to improve their firm's performance. Instead, they use their political connections to expand operations by mergers, takeovers, and sometimes coercion of rival firms. Their opponents can either succumb and collaborate or resist and risk disembowelment.[8] While there are some differences between these two groups over political and economic policies, both favor limits on foreign investment in the strategic sectors of the Russian economy and using Russian firms to pursue the country's foreign policy interests (which they often see as synonymous with their personal enrichment).

The coalition led by Medvedev and Surkov, which controls Gazprom, holds many of the assets of Sibneft, the oil company once run by oligarch Roman Abramovich. Abramovich, who helped the Kremlin ruin his rival Mikhail Khodorkhovsky, sold Sibneft to Gazprom before moving to London on a part-time basis to run his Chelsea soccer club. The Medvedev-Surkov team includes presidential aide Igor Shuvalov, Procurator General Yuriy Chaika, Minister of Health and Mikhail Zurabov. This group also controls key media assets, including those owned by Gazprom. But this group also has serious political weaknesses. Though he frequently appears in the media, significant portions of which Gazprom controls, Medvedev comes across as a weak leader and has been losing ground to Sergey Ivanov, his chief presidential rival, in recent months. Additionally, the group's hold on Gazprom is not as tight as that Sechin wields over Rosneft. Finally, Gazprom's aggressive stance on several recent deals, including the Ukrainian gas dispute and a dispute with BP over exploitation of the Kovykta oil field, has hurt its image as a moderate firm with whom foreign investors could do business. In the past two years Gazprom has also taken a controlling stake in the Sakhalin II oil and gas fields away from Royal Dutch Shell and Japanese interests.

The coalition led by Sechin controls Rosneft, including most of the refineries, oil fields and assets formerly held by jailed oligarch Mikhail Khodorkhovsky (which are now on Rosneft's books). The Alfa Group conglomerate also tends to back Sechin and the alliance is able to undermine some of rival Gazprom's power through its control of Gazprombank. Key figures in the group include Justice Minister Vladimir Ustinov, Prime Minister Mikhail Fradkov, Interior Minister Rashid Nurgaliev and Duma Chairman Boris Gryzlov. While some members of this group hope Putin will stay for a third term (and thereby protect their property interests), others would likely back Sergey Ivanov or Deputy Prime Minister Sergey Naryshkin. In recent months the influence of the Sechin forces has grown, despite strained ties between Putin and Sechin in the autumn 2007. According to several Kremlin sources, Putin disapproved of some of Sechin's activities regarding Russia's planned Baltic pipeline to Germany.

[5] Anatasiya Samotorova, "Hold That Course: Citizens Approve of the Kremlin's Hard-Line-Policy in Europe," in *RBC Daily*, 4 September 2007, p.1.
[6] S.V. Lavrov, "Containing Russia: Back to the Future," Ministry of Foreign Affairs of the Russian Federation, 15 August, 2007
[7] Robert Skidelsky, "Putin's patrimony," in *Prospect Magazine*, Issue 132, March 2007.
[8] "Russian Energy: Grabbing the Ring," in Stratfor.com, 29 May 2007.

Despite the dominance of Gazprom and Rosneft, the two coalitions still do not control the entire energy sector. Competition between them for the remaining independent firms is fierce and other oligarchs are involved as well. In the summer of 2007, the owner of the independent oil firm Russneft, Russia's seventh largest producer, yielded to state harassment to sell his company to oligarch Oleg Deripaska. While some sources reported that Deripaska would transfer Russneft to Sechin and Rosneft, with Putin's blessing, other experts speculated that Deripaska was not actually the middleman in the deal and intended to keep the firm for his Basic Element business empire. In the meantime, some sources suggested that Gazprom might also be interested in acquiring Russneft.

Two firms which play a significant role in Russian energy policy toward the Caspian and Black Sea regions remain independent and are likely to be tempting targets for acquisition in the coming months: The first is Transneft, Russia's state-run oil transport monopoly, (which controls 50,000 miles of oil and oil product pipelines, but is so far independent of both Gazprom and Rosneft). The second is Lukoil, which produced about one-fifth of the country's oil before the incorporation of Yukos into Rosneft.

Gazprom owns the world's largest natural gas pipeline system and uses that control to generate huge profits from foreign sales and for the Medvedev-Surkov coalition which controls it (Gazprom makes little money on domestic business since prices at home are regulated). By maintaining its monopoly on gas exports, Gazprom can prevent other Russian energy firms from providing competition and cutting into its foreign profits. Rosneft, Gazprom's bitter rival, owns no pipeline system, which puts it at a political and commercial disadvantage with its great adversary. If Putin wishes to continue to balance competing Kremlin factions in the run-up to the elections, his preferred style of governing, the chances are good that he will transfer Transneft to Rosneft.

The other possible takeover target, Lukoil, in contrast to other Russian firms, acts much like a true commercial company. It is the only Russian firm with a strong international portfolio and the only Russian company that has spent significant resources on diversifying its technological skill base. Lukoil is not only active throughout the former Soviet Union, but holds a number of transport, refining, and retail assets in Europe, and the United States as well as some production efforts in the Middle East and the Caspian basin, as we have seen . Additionally, while Rosneft and Gazprom have grown quickly due to appropriations and takeovers, Lukoil's growth is more the result of astute purchases, technological advances and actual investment. The leadership of Lukoil by oligarchVagit Alekperov, Russia's sixth richest man, has been particularly impressive. He is the only Russian oligarch with whom the European Bank for Reconstruction and Development will work. His working relations with leaders in Europe and the Caucasus countries has been highly professional and Alekperov is the only oligarch who owns a major business in the United States (the Getty Oil Company).[9]

[9] "Russian Energy: Grabbing the Ring," in *Stratfor.com,* 29 May 2007

Whether Putin will continue to allow Lukoil to retain the independence it has shown under Alekperov's leadership is unclear. On the one hand, Lukoil's relatively good reputation helps raise Russia's generally dismal international image for corporate management. On the other hand, Lukoil's activities in areas such as the Caspian have significant implications for Russian foreign policy that the Kremlin is unlikely to ignore. In a rare sign of public discord within the energy sector, Alekperov recently expressed "concern" at the growing clout of state-owned companies. That may soon be his firm's fate.

Fueling Succession Politics

A firm's commercial success in the energy industry and the rough-and-tumble politics associated with that sector, best exemplified by the aggressive behavior of Gazprom and Rosneft, is a measure, above all, of its political clout at the top. The contending coalitions that control these firms, therefore, are not just business rivals in charge of adversary state companies. They are also factions struggling to advance their favored candidates. Since the transfer of power in the Russian system requires not just the replacement of one group of politicians by another but the transfer of property and patronage, business competition between Gazprom and Rosneft has intensified as the prospect of a presidential succession looms. If and when Putin leaves, his cronies face the prospect of losing much: not only their positions but their lucrative income streams. Putin's balancing role has so far helped him avoid becoming a lame duck and is intended to make sure neither Gazprom nor Rosneft, nor the Kremlin insiders who control them, are dominant when he steps down.[10]

Putin is under conflicting pressure from Kremlin forces, however, and it is too early to predict the outome of the succession struggle. While all the major players are in agreement that Russia's energy firms will continue to play critical roles in projecting power, what is at issue is which firm will take the lead and who will control the money flows.

At present four scenarios are most likely:

First, Dmitry Medvedev succeeds Putin. This would mean that Gazprom would gain the upper hand in Russian energy politics and might well take over Lukoil and try to marginalize Rosneft or take over its assets.

Second, the Rosneft team succeeds in securing a successor to Putin who would protect its business interests and marginalize Gazprom. This would likely be Ivanov or Naryshkin.

Third, Putin stays in power for a third term. While many members of the Rosneft-Sechin team favor this variant as a way to protect their interests, in a third term Putin is more likely to continue the current system of multiple centers of power in the energy sector.

[10] "Robert Skidelsky, "Putin's patrimony," in *Prospect Magazine,* Issue 132, March 2007.

This competition puts the reliability and transparency of Russia's domestic and foreign commercial relationships in the energy sector, including for Turkey and the other countries of the Caspian Basin, in considerable doubt. The Russian Natural Resources Ministry sent a delegation to the United States in August 2007 to calm American investors concerned in the wake of the Russneft takeover that they did not understand the rules the government uses to regulate the energy sector. That confusion is unlikely to end anytime soon.

RUSSIA AS A BLACK SEA POWER

The author highlights Russia's determination to exploit its advantages in the sphere of energy for increased global power and argues that the West needs to match this determination with clear support for countries like Ukraine and Georgia that are vulnerable. He points out that offering such countries clear prospects for membership in NATO and the EU would render Russia with no choice but to integrate with Europe. Without increased involvement of the EU in the Black Sea region, he warns, threats could grow to be intractable.

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