

**Tugce Varol**

# **THE RUSSIAN FOREIGN ENERGY POLICY**

European Scientific Institute



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Tugce VAROL

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## TABLE OF CONTENTS

### CHAPTER I: THEORIES OF INTERNATIONAL RELATIONS AND RUSSIAN FOREIGN POLICY

1. INTRODUCTION .....	2
1.1. Realism .....	3
1.2. Liberalism.....	7
1.3. Constructivism.....	9
1.4. Imperialism.....	11
2. FOREIGN POLICY ORIENTATIONS OF THE POST-SOVIET PERIOD.....	14
2.1. Westernists (Atlanticists).....	15
2.2. Eurasianists.....	22
2.2.1. Evolution of Eurasianism in Russia.....	22
2.2.2. Eurasianism in 21 <sup>st</sup> Century Russia.....	24
2.2.3. Neo-Eurasianism.....	25
3. RUSSIAN FOREIGN POLICY AND SECURITY CONCEPTS.....	27
3.1. 1993 Military Doctrine.....	28
3.2. 1993 Foreign Policy Concept.....	29
3.3. 1997 National Security Concept.....	30
3.4. 2000 National Security Concept.....	31
3.5. 2000 Military Doctrine.....	34
3.6. Putin's Millennium Speech.....	35
3.7. Foreign Policy Concept of 2000.....	36
3.8. Foreign Policy Concept of 2008.....	37
3.9. National Security Strategy of Russian Federation Until 2020.....	38
3.10.2010 Military Doctrine.....	39
4. PERSPECTIVE OF RUSSIAN FOREIGN POLICY.....	41
4.1. Russian Foreign Policy During USSR.....	41
4.2. From Dissolution to the First President of Russian Federation.....	45
4.3. Andrei Kozyrev as Foreign Minister.....	48
4.4. Yevgenii Primakov as Foreign Minister and Prime Minister.....	50
5. PERSPECTIVES OF RUSSIAN FOREIGN	

POLICY FROM PUTIN TO MEDVEDEV.....	54
5.1. Putin’s First Term.....	55
5.2. Putin’s Second Term.....	60
5.3. Medvedev as the 3 <sup>rd</sup> President of Russian Federation.....	63
CHAPTER II: ECONOMY OF RUSSIAN FEDERATION	
6. BEGINNING OF THE TRANSITION PERIOD.....	67
6.1. Shock Therapy.....	71
6.2. Privatization.....	73
6.3. The August Crisis – Black Monday.....	76
7. PERIOD OF POST-AUGUST CRISIS.....	79
7.1. Evolution of Russian Economy After 1999.....	79
7.2. Stabilization Fund.....	85
7.3. Oil and Gas Sector in Russian Economy.....	89
7.4. WTO Accession.....	98
7.5. Dutch Disease.....	102
7.6. Re-Nationalization Policy.....	105
8. THE IMPACT OF THE 2008 CRISIS AND TODAY.....	110
9. ENERGY STRATEGY DOCUMENTS.....	113
9.1. Energy Strategy for Russia for the Period up to the Year 2020.....	113
9.2. Energy Strategy for Russia for the Period up to the Year 2030.....	116
CHAPTER III: RUSSIAN FEDERATION ENERGY SECTOR	
10. Introduction.....	120
10.1. CRUDE OIL.....	120
10.1.1. Classification of Crude Oil.....	121
10.1.2. Oil Production and Reserves.....	122
10.1.2.1. Western Siberia.....	126
10.1.2.2. Eastern Siberia (Yakutia) and Sakhalin Islands.....	127
10.1.2.3. Volga-Urals Region.....	128
10.1.2.4. Timon-Pechora Basin.....	128
10.1.2.5. Caspian Sea and North Caucasus.....	129

10.1.2.6.	Arctic Ocean.....	129
10.1.3.	Major Oil companies.....	131
10.1.3.1.	Gazprom Neft (Sibneft).....	132
10.1.3.2.	Rosneft.....	133
10.1.3.3.	Lukoil.....	134
10.1.3.4.	TNK-BP.....	138
10.1.3.5.	Surgutneft.....	139
10.2.	NATURAL GAS.....	142
10.2.1.	The Geology of Gas Basins.....	143
10.2.1.1.	Cenomonian Gas.....	143
10.2.1.2.	Neocomian Gas.....	144
10.2.2.	Natural Gas reserves and Production.....	145
10.2.2.1.	Nadym Pur Taz.....	146
10.2.2.2.	Yamal Peninsula.....	149
10.2.2.3.	Shtokmanovskoya (Shtokman) Field.....	150
10.2.3.	Major Natural Gas Companies.....	151
10.2.3.1.	Gazprom.....	151
10.2.4.	Private Gas Companies.....	154
10.2.4.1.	Itera.....	155
10.2.4.2.	Novatek.....	156
10.2.4.3.	Northgas.....	156
10.3.	PIPELINES.....	157
10.3.1.	Gas Pipelines.....	160
10.3.1.1.	Existing Pipelines.....	161
10.3.1.1.1.	The Yamal-Europe Gas Pipeline.....	161
10.3.1.1.2.	Blue Stream.....	162
10.3.1.1.3.	Central Asia – Center Gas Pipeline System.....	163
10.3.1.1.4.	Kasimovskoye UGS – Voskresensk CS.....	164
10.3.1.1.5.	Minsk – Vilnius – Kaunas – Kaliningrad.....	164
10.3.1.2.	Under Construction.....	164
10.3.1.2.1.	North European Gas Pipeline (NEGP) – Nord Stream.....	164
10.3.1.2.2.	Sakhalin – Khabarovsk – Vladivostok Pipeline.....	166

10.3.1.2.3.	Bovanenko – Ukhta and Ukhta – Torzhok Gas Pipelines....	167
10.3.1.2.4.	Gryazovets – Vyborg Gas Pipeline.....	167
10.3.1.2.5.	SRTO – Torzhok Gas Pipeline.....	168
10.3.1.2.6.	Pre-Caspian Gas Pipeline.....	169
10.3.1.2.7.	Dzhubga – Lazarevskoye – Sochi.....	170
10.3.1.2.8.	Dzuarikou – Tskhinvali.....	170
10.3.1.2.9.	Poshinki – Gryazovets.....	171
10.3.1.3.	In Progress.....	171
10.3.1.3.1.	Eastern Gas Program.....	171
10.3.1.3.2.	South Stream.....	173
10.3.1.4.	Under Discussion.....	174
10.3.1.4.1.	Murmansk – Volkhov Gas Pipeline.....	174
10.3.1.4.2.	Blue Stream II.....	174
10.3.1.4.3.	Yamal-Europe Gas Pipeline II.....	175
10.3.2.	Oil Pipelines.....	175
10.3.2.1.	Existing.....	175
10.3.2.1.1.	Druzhba Pipeline.....	175
10.3.2.1.2.	Baltic Pipeline System.....	176
10.3.2.1.3.	Baku – Tikhoretsk – Novorossiysk Pipeline.....	177
10.3.2.1.4.	Atyrou – Samara Pipeline.....	178
10.3.2.1.5.	Caspian Pipeline Consortium (CPC).....	179
10.3.2.1.6.	Sakhalin I.....	180
10.3.2.1.7.	Sakhalin II.....	181
10.3.2.1.8.	East Siberia – Pacific Ocean (ESPO).....	181
10.3.2.2.	Under Construction.....	182
10.3.2.2.1.	Baltic Pipeline System II.....	182
10.3.2.2.2.	Purpe – Samotlar Project.....	183
10.3.2.3.	In Progress.....	184
10.3.2.3.1.	Burgas – Alexandroupolis Oil Pipeline.....	184
10.3.2.3.2.	Samsun Ceyhan Oil Pipeline.....	185
10.3.2.4.	Under Discussion.....	186
10.3.2.4.1.	Druzhba Pipeline and Adria Reversal Project.....	186

10.3.2.4.2.	Kharyaga – Indiga and Murmansk Oil Pipelines.....	187
10.4.	Conclusion.....	187

## CHAPTER IV: RUSSIAN FOREIGN ENERGY RELATIONS WITH WEST

11.	RUSSIAN FEDERATION-EU PROXIMITY.....	190
11.1.	Important Documents Between Russia and EU.....	190
11.1.1.	The Partnership and Cooperation Agreement (PCA) Between Russia and EU.....	190
11.1.2.	The Common Strategy Paper of EU.....	191
11.1.3.	The EU-Russia Energy Dialogue.....	192
11.1.4.	Energy Charter Treaty.....	193
11.1.5.	Russian Federation Middle Term Strategy Towards EU(2000-10).....	194
11.2.	Russian Foreign Energy Affairs with EU-27.....	195
11.2.1.	Low Dependent.....	198
11.2.1.1.	France.....	198
11.2.1.2.	Italy.....	200
11.2.1.3.	Spain.....	202
11.2.1.4.	United Kingdom.....	203
11.2.2.	Moderate Dependent.....	204
11.2.2.1.	Germany.....	204
11.2.2.2.	Netherlands.....	207
11.2.2.3.	Austria.....	208
11.2.2.4.	Greece.....	209
11.2.2.5.	Latvia.....	210
11.2.3.	Dependent.....	210
11.2.3.1.	Czech Republic.....	210
11.2.3.2.	Estonia.....	211
11.2.4.	High Dependent.....	212
11.2.4.1.	Bulgaria.....	212
11.2.4.2.	Hungary.....	213
11.2.4.3.	Poland.....	214
11.2.4.4.	Lithuania.....	215

11.2.4.5. Slovakia.....	216
11.3.    Interdependence Between Russia and the European Union.....	217
11.3.1. Divide and Rule.....	223
11.3.2. Nord Stream, South Stream and Nabucco.....	226
11.3.2.1. Nord Stream.....	227
11.3.2.2. Nabucco Versus South Stream.....	230
11.4.    Ukraine Gas Crisis and Their Impacts on Relations	
Between Russia and the EU.....	234
11.4.1. Ukraine Gas Crisis in 2006.....	234
11.4.2. Ukraine Gas Crisis in 2009.....	236
11.5.    Conclusion of the Russian Foreign Policy and	
Energy Strategy Towards EU.....	239
12. RUSSIA – US COMPETITION ON ENERGY.....	242
12.1.    Russian Foreign Policy Towards US	
After the Dissolution of USSR.....	242
12.2.    Energy Relationship Between Russia and the United States.....	245
12.3.    Grand Game for Central Asia.....	251
12.4.    Foreign Policy Crossroads.....	254
13. RUSSIA AND TURKEY - ENERGY COOPERATION OR RIVALRY.....	259
13.1.    Blue Stream Pipeline.....	261
13.2.    Blue Stream Pipeline II.....	262
13.3.    Nabucco Gas Pipeline.....	262
13.4.    Samsun-Ceyhan Oil Pipeline.....	264
13.5.    Impacts of Georgia Conflict to Russia and Turkey Relations.....	265

CHAPTER V: RUSSIAN FOREIGN ENERGY RELATIONS  
WITH NEAR ABROAD AND CHINA

14. RUSSIAN ENERGY RELATIONS WITH UKRAINE, BELARUS AND MOLDOVA.....	270
14.1.    Russia-Ukraine Energy Relations.....	270
14.1.1. New Neighbor, Ukraine.....	271
14.1.2. Russia, Ukraine and West Triangle.....	276

14.2.	Russia-Belarus Energy Relations.....	279
14.2.1.	Friends or Partners.....	284
14.3.	Russia-Moldova Energy Relations.....	290
15.	RUSSIAN ENERGY RELATIONS WITH CAUCASIA.....	293
15.1.	Russia-Georgia Energy Relations.....	293
15.2.	Russia-Azerbaijan Energy Relations.....	299
15.2.1.	Pipeline Diplomacy.....	301
15.2.1.1.	Baku-Tbilisi-Ceyhan Oil Pipeline, BTC.....	303
15.2.1.2.	Baku-Supsa Oil Pipeline.....	305
15.2.1.3.	Baku-Novorossiysk Oil Pipeline.....	306
15.2.1.4.	Baku-Tbilisi-Erzurum Gas Pipeline.....	306
15.2.2.	Growing Potential of Azerbaijan’s Gas Sector.....	307
15.2.3.	Russia and the Importance of the Caspian Sea.....	310
15.3.	Russia-Armenia Energy Relations.....	311
15.3.1.	Isolation Problem of Armenia.....	313
16.	RUSSIAN ENERGY RELATIONS WITH CENTRAL ASIA.....	315
16.1.	Russia-Kazakhstan Energy Relations.....	315
16.1.1.	Energy Sector of Kazakhstan.....	317
16.1.1.1.	Oil Sector of Kazakhstan.....	318
16.1.1.1.1.	CPC – Caspian Pipeline Consortium.....	321
16.1.1.1.2.	Atyrau-Samara Oil Pipeline.....	322
16.1.1.1.3.	Kazakhstan – China Oil Pipeline.....	323
16.1.1.2.	Natural Gas Sector of Kazakhstan.....	324
16.1.1.2.1.	Central Asia – Centre Pipeline.....	326
16.1.1.2.2.	Pre-Caspian Gas Pipeline.....	326
16.1.1.2.3.	Kazakhstan-China Gas Pipeline.....	327
16.2.	Russia-Turkmenistan Energy Relations.....	328
16.2.1.	Russia in Turkmenistan Again.....	329
16.2.2.	Pipeline Diplomacy.....	333
16.3.	Russia-Uzbekistan Energy Relations.....	338
16.4.	Russia-Kyrgyzstan Energy Relations.....	341
16.4.1.	Energy and Security Challenges in Kyrgyzstan.....	343

16.5.	Russia-Tajikistan Energy Relations.....	346
16.5.1.	No Gas Neither Oil But Water and Location.....	347
16.6.	Russia-China Energy Relations.....	349
16.6.1.	Energy Strategy of China.....	349
16.6.1.1.	Oil Sector of China.....	352
16.6.1.2.	Natural Gas Sector of China.....	354
16.6.2.	Russia-China and the Grand Strategy.....	356
16.6.3.	Nuclear Aspect Between Russia and China.....	358
16.6.4.	The Role of Shanghai Cooperation Organization.....	360

#### PROJECTIONS FOR RUSSIAN FOREIGN ENERGY POLICIES

FOR THE FUTURE.....	364
Short Term for 1-5 Years.....	364
Medium Term for 5-10 Years.....	368
Long Term for 10-20.....	372
CONCLUSION.....	378

APPENDIX.....	386
BIBLIOGRAPHY.....	392
BOOKS.....	392
JOURNAL ARTICLES.....	404
NEWSPAPERS AND BROADCASTS.....	440
WEB RESOURCES.....	452

## LIST OF ABBREVIATIONS

<b>ACG</b>	Azeri, Chirag, and Guneshli oil fields
<b>AIOC</b>	Azerbaijan International Operation Company
<b>Bbl/d</b>	Barrels per day
<b>Bcm</b>	Billion cubic meter
<b>Bil</b>	Billion
<b>BTC</b>	Baku-Tbilisi-Ceyhan
<b>BTE</b>	Baku-Tbilisi-Erzurum
<b>BTS</b>	Baltic Pipeline System
<b>CAC</b>	Central Asia – Center Gas Pipeline System
<b>CAGP</b>	Central Asian Gas Pipeline
<b>CFE</b>	Conventional Forces in Europe
<b>CFR</b>	Council of Foreign Relations
<b>CIS</b>	Common Independent States
<b>CNPC</b>	China National Petroleum Corporation
<b>CPC</b>	Caspian Pipeline Consortium
<b>ECT</b>	Energy Charter Treaty
<b>EES</b>	European Economic Space
<b>EIA</b>	Energy Information Administration
<b>ESPO</b>	East Siberia – Pacific Ocean
<b>EU</b>	European Union
<b>EurAsEc</b>	Eurasian Economic Community
<b>FDI</b>	Foreign Direct Investment
<b>FSU</b>	Former Soviet Union
<b>GATT</b>	General Agreements on Tariffs and Trade
<b>GDP</b>	Gross Domestic Product
<b>GUUAM</b>	Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova
<b>IEA</b>	International Energy Agency

<b>IMF</b>	International Monetary Fund
<b>IR</b>	International Relations
<b>Kb/d</b>	Thousand barrels per day
<b>KGB</b>	Komitet Gosudarstvennoy Bezopasnosti
<b>LNG</b>	Liquefied natural gas
<b>M/bbl</b>	Million barrels
<b>M/t</b>	Million Tonnes
<b>M/toe</b>	Million Tonnes of Oil Equivalent
<b>MFN</b>	Most-Favored Nation
<b>Mn.</b>	Million
<b>MoU</b>	Memorandum of Understanding
<b>MRD</b>	Motor Rifle Division
<b>NATO</b>	North Atlantic Treaty Organization
<b>NEGP</b>	North European Gas Pipeline
<b>NPT</b>	Non-Proliferation Treaty
<b>NRC</b>	NATO-Russia Council
<b>NSC</b>	National Security Concept
<b>OPEC</b>	Organization of the Petroleum Exporting Countries
<b>OSCE</b>	Organization for Security and Co-operation in Europe
<b>PCA</b>	Partnership and Cooperation Agreement
<b>PSA</b>	Partnership Share Agreement
<b>RSFSR</b>	Russian Soviet Federalist Socialist Republic
<b>RUB</b>	Russian Rubbles
<b>SCO</b>	Shanghai Cooperation Organization
<b>SCP<sub>a</sub></b>	Samsun-Ceyhan Pipeline
<b>SCP<sub>b</sub></b>	South Caucasus Pipeline
<b>SF</b>	Stabilization Fund
<b>SOCAR</b>	State Oil Company of Azerbaijan Republic
<b>SOE</b>	State-Owned Enterprises
<b>SPE</b>	Society of Petroleum Engineer

<b>SRTO</b>	Northern Tyumen Regions
<b>T/bbl</b>	Thousand Barrels
<b>TAPI</b>	Turkmenistan-Afghanistan-Pakistan-India
<b>Tcf</b>	Trillion cubic feet
<b>Tcm</b>	Trillion cubic meter
<b>TPAO</b>	Turkish Petroleum Corporation
<b>UN</b>	United Nations
<b>US</b>	United States
<b>USD</b>	United States Dollar
<b>USSR</b>	Union of Soviet Socialist Republics
<b>VEB</b>	Vneseconombank
<b>WTO</b>	World Trade Organization

## LIST OF TABLES

- Table 1:** The Spectrum of Russia's Post-Soviet Foreign Policy Thinking
- Table 2:** A General Ideas and Stated Views Which Formed Foreign Policy Orientations
- Table 3:** Liberal Democrat and Other Elite Assessment of East-West Relations: US-Russian Security
- Table 4:** The Russian Economy in Transition: Basic Statistics
- Table 5:** Russian Industrial Production, 1992 – 1999 (% of previous year)
- Table 6:** The Process of Privatization in Russia, 1992-1995
- Table 7:** Gross Domestic Product Rates, 1995-2010
- Table 8:** Major Russian Internal Economic Indicators, 1999-2007
- Table 9:** Reserve Fund and National Reserve
- Table 10:** Hydrocarbon (Oil and Gas) Exports
- Table 11:** Oil and Gas Sector: % of GDP Growth
- Table 12:** Oil Prices: 2000-2010 (January \$/barrel)
- Table 13:** Exports of Russian Crude Oil for 2000-2010
- Table 14:** Exports of Russian Natural Gas for 2000-2010
- Table 15:** Crude Oil Production and Export Forecasts, Selected Years, 2010-2030
- Table 16:** Russian Natural Gas, Selected Years, 2010-2030 (billion cubic meters)
- Table 17:** Ownership of the federal government; Unitary Enterprises, Stakes in JSCs and their size, golden shares
- Table 18:** The Ten Largest Companies Controlled by the State according to the Expert making of Russian Companies by Market Capitalization, 2004 and 2008
- Table 19:** Russian Energy Production and Exports
- Table 20:** Comparative Classification of Oil Reserves; Russia and Former Soviet Union – USA and Saudi Arabia
- Table 21:** Estimates of Russian Oil Production (Million bbl/d)
- Table 22:** Estimated by Reserves, by Different Sources
- Table 23:** Production of Russian Oil Companies in 2009
- Table 24:** Lukoil Interim Consolidated Financial Statements (Million of US Dollars)
- Table 25:** Proved Oil Reserves of Lukoil (end of year) m/bbl)
- Table 26:** Surgutneftegaz Key Operating Results

- Table 27:** The Forecast of Phase by Phase Gas Production Development for the Period up to 2030 (bcm)
- Table 28:** Gazprom's Foreign Subsidiaries and Affiliates
- Table 29:** Russian Federation Gas Pipelines' Status
- Table 30:** Russian Federation Oil Pipelines' Status
- Table 31:** EU-27 Import and Dependency Number of Oil and Natural Gas from Russia in 2009.
- Table 32:** Dependency Model for EU-27
- Table 33:** Gas Transit Volumes through Ukraine to Europe + Turkey (2000-2009)
- Table 34:** US Imports From Russia of Crude Oil and Petroleum Products (Thousand Barrels)
- Table 35:** Turkey's Natural Gas Supply and Demand Forecast (bcm)
- Table 36:** Gas prices paid by Ukraine, Moldova and Belarus in 2006–2007 (in \$/tcm)
- Table 37:** Azerbaijani Oil - Proved Reserves at the end of 2009
- Table 38:** Oil and Gas Sector of Azerbaijan
- Table 39:** Main oil and gas export pipelines in the South Caucasus
- Table 40:** Kazakhstan's Oil and Gas Proven Reserves
- Table 41:** Kazakhstan's Oil and Gas Production
- Table 42:** International Oil Pipelines of Kazakhstan
- Table 43:** International Natural Gas Pipelines of Kazakhstan
- Table 44:** Natural Gas Sector of Turkmenistan (bcm)
- Table 45:** Pipeline Plans of Turkmenistan
- Table 46:** China's Production, Consumption and Import of Crude Oil, 1980-2004 (m/t)
- Table 47:** China's Oil and Gas Sector in 2009 in BP Report
- Table 48:** Deliveries of Russian Crude Oil to China (1999-2008), in million tones
- Table 49:** Chinese Actions in Central Asia

## LIST OF FIGURES

- Figure 1:** Oil Prices Between 1990-2009
- Figure 2:** Export Performance of Main Sectors: 2000-2004
- Figure 3:** Real Exchange Rate of the Ruble
- Figure 4:** Stabilization Fund and Reserves
- Figure 5:** Real GDP growth and Oil prices
- Figure 6:** Energy Accounts of Russian Export 2010
- Figure 7:** Russia's Economic Development in 2007-2009 and the September 2010 Bank of Finland Forecast for 2010-2012, %
- Figure 8:** Evolution of Russian and OECD GDP, 2000 and 2009-10.
- Figure 9:** EU-27 Development of Import Dependence up to 2030 (Baseline Scenario)
- Figure 10:** US-Russia Trade Reaches New High
- Figure 11:** US Imports From Russia
- Figure 12:** US Exports to Russia
- Figure 13:** Monthly US Imports from Russia of Crude Oil and Petroleum Products
- Figure 14:** Natural Gas Transit Via Ukraine
- Figure 15:** Oil Transmission Volumes in Ukraine
- Figure 16:** Energy Consumption in Belarus 2005-2020
- Figure 17:** Dynamics of prices for gas imported by Belarus, 2001 – Early 2008
- Figure 18:** USD per 1000 m<sup>3</sup> of Natural Gas Paid Russia to Turkmenistan
- Figure 19:** Russian Gas Supply Outlook to 2020

## LIST OF MAPS

<b>Map 1:</b>	Major Russian Oil Basis
<b>Map 2:</b>	Russian Natural Gas Reserves
<b>Map 3:</b>	Nadym Pur Taz
<b>Map 4:</b>	Shtokman Field
<b>Map 5:</b>	Russian Gas Pipeline System
<b>Map 6:</b>	Yamal-Europe Pipeline
<b>Map 7:</b>	Blue Stream Pipeline
<b>Map 8:</b>	Central Asia – Center Gas Transmission System
<b>Map 9:</b>	North European Gas Pipeline
<b>Map 10:</b>	Sakhalin – Khabarovsk – Vladivostok Pipeline
<b>Map 11:</b>	Bovanenko – Ukhta and Ukhta – Torzhok Gas Pipelines
<b>Map 12:</b>	Gryazovets – Vyborg Gas Pipeline
<b>Map 13:</b>	SRTO – Torzhok Gas Pipeline
<b>Map 14:</b>	Pre-Caspian Gas Pipeline
<b>Map 15:</b>	Eastern Gas Program
<b>Map 16:</b>	South Stream Project
<b>Map 17:</b>	Murmansk – Volkhov Gas Pipeline
<b>Map 18:</b>	Druzhba Pipeline
<b>Map 19:</b>	Baltic Pipeline System
<b>Map 20:</b>	Baku – Tikhoretsk – Novorossiysk Pipeline
<b>Map 21:</b>	Atyrou – Samara and CPC Pipeline
<b>Map 22:</b>	Sakhalin Island Pipelines
<b>Map 23:</b>	East Siberia – Pacific Ocean Pipeline
<b>Map 24:</b>	Baltic Pipeline System II
<b>Map 25:</b>	Bourgas – Alexandroupolis Oil Pipeline
<b>Map 26:</b>	Samsun-Ceyhan Oil Pipeline
<b>Map 27:</b>	Adria Pipeline Reversal
<b>Map 28:</b>	Nord Stream, Nabucco and South Stream Pipelines
<b>Map 29:</b>	Alternative Onshore Routes – Yamal II and Amber
<b>Map 30:</b>	Situation in Ukraine After the Gas Cut to EU on 7 January 2009

- Map 31:** Gas Pipelines of Turkey
- Map 32:** Samsun-Ceyhan Pipeline
- Map 33:** CIS Oil Export Infrastructure
- Map 34:** CIS Gas Export Infrastructure
- Map 35:** Energy Resources, Production and Transportation Lines on Belarus
- Map 36:** Caucasian Pipelines
- Map 37:** BTC Pipeline
- Map 38:** CPC – Caspian Pipeline Consortium
- Map 39:** Oil Transportation Routes of Kazakhstan
- Map 40:** Kazakhstan-China Pipeline Project
- Map 41:** Russian Existing, Under Construction, In Progress and Under Discussion  
Oil Pipelines
- Map 42:** Russian Gas Pipelines

## **Dedication**

First of all, I would like to dedicate my study to my incredible father, Eyyüp VAROL.

Secondly, I would like to thanks my wonderful grandma Fatma ÖZÜÇER.

Finally, I owe special thanks to Prof. Mesut Hakkı CAŞIN.

## ABSTRACT

After the dissolution of the USSR and the Cold War at the beginning of 1990s, the international system has evolved to another system in the Post-Cold War era, namely “Unipolar hegemony of the United States”. New state Russian Federation had revealed from the long-time socialist state as a liberal and democratic state in 1991. Afterwards, new question arose in international arena in order to analyze the future of Russian Federation and power capacity. Since the independence of Russian Federation, twenty years past and during this process Moscow has challenged with many conflicts as well as successes many priorities. When the transformation period of Russian Federation from closed economy to liberal economy commenced, it was understood that the main indicator of Russian economy will be the energy resources and their production. For that reason, inevitably “the concept of energy” revealed as a both weapon and a vulnerability of Russia. In this context, Russia formed a new kind of diplomacy that is called “Foreign Energy policy”;

“The Strategic objective of the foreign energy policy is the maximum efficient use of the Russian energy potential for full-scale integration into the world energy market, enhancement of positions thereon and gaining the highest possible profit for the national economy.”

In this study it was aimed to analyze the way that Russia uses its energy privilege either hard or soft power. After picturing the Russian oil and gas reserves, pipelines, main companies and strategy documents, in order to research the Russian foreign energy policy actions, the two directions East and West of Russian energy connections have been analyzed concerning the period of last decade. Furthermore, it was observed that Russia may use energy weapon anytime it feels a threat against its national interest or regional strategy. Yet, Russia did not directly cut any supplies to Germany and Turkey is a way to establish it demand. Moreover, there are many instances that Russia uses energy card as a weapon against former Warsaw Pact and USSR states. Finally, according to the Russian analytical documents, Russian economy will maintain to depend on energy export commodities in the long term. Consequently, it is expected that Russia will continue to employ its energy privilege in case of requirement regarding to its foreign energy policy.

## CHAPTER ONE

### THEORIES OF INTERNATIONAL RELATIONS AND RUSSIAN FOREIGN POLICY

#### 1. INTRODUCTION

The purpose of this study is to find the answers of some questions regarding Russian foreign policy integration with the energy aspect. As a part of this new phenomenon, main indicators of Russian economy highly depend on energy export orientation. Therefore, the basic question here is whether or not Russian economy will remain to be dependent on energy exports in short, medium, and long term? Other than that, due to reason of new type of Russian foreign policy priorities, what is “foreign energy policy”? It is a concept written on the Energy Strategy Paper up to 2030 including with certain explanation. Hence, does Russia capable of achieving this goal? And finally, it is aimed to analyze whether Russia use its energy card as a hard or soft power against its neighbors, markets, or sometimes allies by some certain cases. Regarding to West and East directions of Russian Federation, the aim of this study is to analyze the Russian approach of energy strategy in its foreign affairs.

As a result of the dissolution of the Soviet Union, the distribution of international capabilities in the post-Cold War era was fundamentally changed and raised many questions about the “New World Order”. One of the Cold War’s challenger US’ analysts responded to these questions particularly regarding the United States as the only super power.<sup>1</sup> However, there were also contrary arguments from the Atlantic side such as Mearsheimer.<sup>2</sup> While proclamations of unipolar world were rising, Mearsheimer underlined the potential risks of this sort of world order. Simultaneously, in Asia, world witnessed the newly born country, namely the Russian Federation. By 1993, Russia had realized that the distribution of power had undergone enormous shift through United States which is known as Unipolarity. As opposed to this new world order, Russian policy makers began to speak that Russia needs to take action to create multipolarity. When Vladimir Putin came to power, the multipolarity intention rose with close diplomatic

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<sup>1</sup> Yannis A. STIVACHTIS: (2008) “Power in the Contemporary International Society: International Relations Meet Political and Social Theory – A Critical Appraisal of US Foreign Policy”, *Journal of Political and Military Sociology*, 36:1, p.90.

<sup>2</sup> John I. MEARSHEIMER: (1990) “Why Will Soon Miss The Cold War”, Atlantic Monthly Online.

actions such as “European troika” of France, Germany, and Russia; the special relationship between Germany and Russia, the “strategic triangle” of Russia, China, and India; and, most important, the “strategic partnership between China and Russia.”<sup>3</sup> Under these new circumstances scholars started to make comments about the post-Soviet period of international theories.

Although Russian foreign policy is in favor of “Multipolarity” against US “Unipolarity”, Moscow designs all its foreign policy strategies in accordance with its energy weapon capacity. Therefore, since the rise of Vladimir Putin to the Presidency, Russian economy benefitted from high oil and natural gas prices. This made Russian economy highly dependent on export of energy commodities and pipelines. In this context, Russia cut off supplies to many former Warsaw Pact and Soviet Union states as in the cases of Ukraine, Belarus, Lithuania etc. As long as many countries are dependent on Russian energy exports, Russia at the same time is ultimately dependent on the incomes of hydrocarbon commodities. It is significant to analyze Russian foreign energy policy regarding Moscow’s priorities that are being a regional power, clearing Central Asia and Caucasia away from US military existence, connecting as many as states and their resources as to Russian energy monopoly. Although Central Asia, Caucasia are Russian substitute energy reserves, Western powers are also eager to reach these reserves. Consequently, there is a new “Great Game” in Eurasia and Russia is the main player of this game.

### **1.1. Realism**

The basic assumptions of realism are: First, the primary objects of study are unitary actors, pursuing goals including, above all, their own survival in an anarchic system. Second; the goals pursued by these political units are naturally in conflict with the goals pursued by other units. Third, these goals are primarily material, and the resolution of conflict between units are linked to material capabilities.<sup>4</sup> Shakleyina and Bogaturov argue that since the 1990s, realism has gained the status of leading intellectual movement in Russia. According to them, Russian realists mainly focused on the characteristics of the newly emerging world order and the best strategy for

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<sup>3</sup> William C. WOHLFORTH: (2004) “Revisiting Balance of Power Theory in Central Asia”, in T.V. Paul, James J. Wirtz, and Micheal Fortmann (ed.) “*Balance of Power: Theory and Practice in the 21st Century*”, Stanford Uni. Press, p.219.

<sup>4</sup> Thomas S. MOWLE and David H. SACKO: (2007) “Balancing and Bandwagoning in a Unipolar System”, *Paper for APSA*, August 30, p.16.

Russia to pursue in its international behavior. While Russian liberals view democratic institutions and norms as the pillar of the world order, realists put emphasis on power center, poles, using the perspective to describe the forming international system.<sup>5</sup> Contrary to Shakleyina and Bogaturov, MacFarlane states that in the first half of the 1990s, Russia's foreign policy did not mainly support the idea of balance of power in international relations; and realism was not the dominant impulsion among the foreign policy elite concerning both Russia's and world future, either. From 1993 to 1999, Russia's relations with the West gradually deteriorated while Russia reasserted itself at the expense of the other independent states on the territory of the former Soviet Union.<sup>6</sup>

Subsequently, in the second half of the 1990s the idea of balance of power reemerged in foreign policy discussions. Russia's role and strategy were re-defined in terms of supporting a multipolar balance of power in the world. Contrary to many American realists, the majority of Russian realists view unipolarity of the international system as problematic.<sup>7</sup> Lebedeva, on the other hand, says that, Russian realism influenced by the American IR literature; "The mixture of realism and Marxism-Leninism, with realism predominating was a very important feature of the Soviet understanding of IR, and even today it continues to have strong influence on both the study and practice of IR".<sup>8</sup> And also Lebedeva adds that "the manipulation of polarity in the world politics is typical of the realist tradition. Russian IR scholars were, and remain, influenced mainly by the American IR literature."<sup>9</sup>

According to Russian realists, Russia's national security came first, with the point of departure being the real potential of the state and its ability to take into consideration internal, as well as external, aspects of people's life. Hence, Russian realists accept two kinds of threats to Russia's security: external and internal. For instance; Sergunin says that the external political threats included attempts to challenge the territorial integrity of the Russian Federation, blocking of integration in the CIS, political stability in neighboring countries, and efforts to weaken Russia's

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<sup>5</sup> Tatyana A. SHAKLEYINA and Aleksei D. BOGATUROV: (2004) "The Russian Realist School of International Relations", *Communist and Post-Communist Studies*, 36, 1, p.37-8.

<sup>6</sup> Neil MACFARLANE: (1999) "Realism and Russian Strategy After the Collapse of the USSR", in Ethan B. Kapstein and Micheal Mastanduno (ed.), "*Unipolar Politics: Realism and State Strategies After the Cold War*", p.218

<sup>7</sup> SHAKLEYINA and BOGATUROV, p.38

<sup>8</sup> Marine M. LEBEDEVA: (2004) "International Relations Studies in the USSR/Russia: Is There a Russian National School of IR Studies?", *Global Society*, Vol.18, No.3, p.270

<sup>9</sup> Ibid, p.276

role and position in international organizations.<sup>10</sup> Furthermore, internal threats are; the potential disintegration of the Russian Federation as a result of inter-ethnic and regional conflicts, economic decline, organized crime, cultural and spiritual degradation, degradation of environment and lack of information security.<sup>11</sup>

At the end of 1999, when Putin came to power, he developed a new approach to foreign policy that combined Russia's traditional orientation towards *realpolitik* with a recognition of interdependence and international economic integration. Moreover, the problem of world order came into the core of the foreign policy discussions. The neorealist theory, founded by Kenneth Waltz, claims that it is the system which determines the behavior of the actors, not the motivations of the actors themselves. And peace could be achieved when the balance of power is reached by the most powerful states in the system.<sup>12</sup> Waltz first claimed that the international system of states is a “self-help” system. Therefore, there is nobody to look after a state’s security than the state itself. Secondly, according to Waltz, “the number of states that are a serious threat to each other’s basic survival” determines the balance of power in international relations. And thirdly, power in neo-realist terms is limited to hard currency, that is, strong military and great economic capabilities.<sup>13</sup>

Regarding to Waltz’ argument of gaining great economic capabilities, when Russia was dealing with the internal conflicts both politically and economically, Putin saw the solution in attempting to integrate into the world of developed Western countries.<sup>14</sup> While integrating it into the world community with the framework of new realism, Putin sought to craft a policy that asserted Russia's national interest. According to Sakwa, various approaches such as realism, idealism and instrumentalism reflects the tension in Putin’s new realism. While Russia's foreign policy remained within the broad neo-realist tradition, Putin insisted that Russia must join the Western community, but should pursue its own way.<sup>15</sup>

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<sup>10</sup> Alexander A. SERGUNIN: (2004) “Discussions of International Relations in Post-Communism Russia”, *Communist Post-Communist Studies*, 37, 1, p.24

<sup>11</sup> Ibid.

<sup>12</sup> Kenneth WALTZ: (1979) *Theory of International Politics*, Boston, McGraw Hill.

<sup>13</sup> Ilya EBELEV: (2011) *Neo-Realism Meets Neo-Liberalism: Nord Stream and Its Implications for EU-Russia Energy Relations*, GRIN Verlag, p.5.

<sup>14</sup> SHAKLEYINA and BOGATUROV, p.43

<sup>15</sup> Richard SAKWA: (2008) “New Cold War on Twenty Years’ Crisis? Russia and International Politics”, *International Affairs*, 84:2, p.244-45

As an example of Putin's neo-realism, Sakwa cited the press conference of President Putin on 18 July 2000: "*We do not consider NATO an enemy organization or view its existence on a tragedy, although we see no need for it. It was born as the antipode to the Warsaw pact, no Soviet Union, but NATO exists and is growing.*"<sup>16</sup> Sakwa divided the foreign policy of Putin's leadership into two periods, early Putin accepted and lived with American unipolarity, in the belief that America's voluntaristic application of hegemonic power would not last long. Later Putin realized that the invasion of Iraq demonstrated not only that unilateralism would continue but it would also be intensified.<sup>17</sup> Jackson explains the logic of Russia's positioning in terms of neorealist theory as follows:<sup>18</sup>

- Favoring a policy of bandwagoning with or otherwise accommodating a preeminent West;
- Seeking to encourage the emergence of a countervailing coalition of the rest versus the West or the transformation of the unipolar structure into a Multipolar power structure;
- Pursuing the former strategy in the short term and the latter strategy in the long-term.

Moreover, neo-classical theory synthesizes classical realism and neo-realism. Neo-classical theory states that domestic variables between the systematic factors and the particular state's foreign policy decision. In addition to that neo-classical realists distinguish between power and foreign policy interests as opposed to classical realists, for whom power is an end in itself.<sup>19</sup> Finally Orban claims that neo-classical realist paradigm is best suited to explain the object of the analysis, Russian energy companies' expansion into Central Europe. What really matters with regard to Russian energy companies' prosperity to expand into Central Europe are the Russian foreign policy leadership's prevailing perceptions about the country's status in the balance of power and the resources for the Russian state.<sup>20</sup> Above all these discussions, Russia expresses "multipolarity" concept against unilateral acts of US in order to achieve balance of power as well as gaining super power status again. Indeed, Russian main aim to establish great economic

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<sup>16</sup> Ibid, p.257

<sup>17</sup> Ibid, p. 249

<sup>18</sup> William D. JACKSON: (2001) "Imagining Russia in Western International Relations Theory", Paper presented at the Imagining Russia Inaugural Symposium at Miami University March 22 2001, <http://www.units.muohio.edu/havighurstcenter/publications/documents/Jackson.pdf>

<sup>19</sup> Anita ORBAN: (2008) *Power, Energy and the New Russian Imperialism*, Praeger Security International Press, p.20.

<sup>20</sup> ORBAN: (2008), p.23.

capacity in the 21<sup>st</sup> century by its huge energy export numbers. Therefore, using energy is a matter of Russian realist foreign policy.

## 1.2. Liberalism

After the dissolution of the USSR, Russia withdrew its military force from Eastern Bloc; however, the lack of force in the region was fulfilled by NATO and US in a short time. In early 1990s, during the transition period of Russian economy, Russia could not achieve to become an attractive place in terms of ideological and economical parameters. Moreover, Russia has lost its competitiveness against economic superiority of EU. In addition to that, the newly emerging Far East Pacific market, particularly Chinese, enforced Russian position in the world economy. The lack of functional modern economy pushed Russian officials to construct a new market economy and introduce country with new implementations of liberal economy such as privatization. As a subject of this study, particular energy companies, such as Gazprom and Lukoil were privatized. Following the rise of Vladimir Putin to the Presidency of Russia, the re-nationalization of these companies revealed which was criticized by liberals, saying that preventing competitiveness in the economy.

In terms of the theoretical approach; liberals are the supporters of the values of freedom, tolerance and democracy in the world. However, liberalism may be evaluated differently in different social and cultural contexts. Thus, Russian liberalism is different from Western or other sources of the ideologies. Russian liberals mainly ask three questions; *Which world order is emerging after the Cold War and which one is the most preferable for Russia? How are the state, its sovereignty, and national interests affected in the new era of globalization? What kind of foreign policy strategy should Russia adopt to adequately respond to the new world's challenges and conditions?*<sup>21</sup> According to Tsygankov and Tsygankov, these debates have two distinct stages: from the dissolution of the Soviet Union to the mid-1990s, and from the mid-1990s to the present. The September 11, 2001 terrorist attacks against the US have changed the context in which these debates progress. Russian liberal international relations theory remains

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<sup>21</sup> P.A. TSYGANKOV and A.P. TSYGANKOV: (2004a) "Dilemmas and Promises of Russian Liberalism", *Communist and Post-Communist Studies*, 37, 1, p.54

heavily shaped by Western approaches.<sup>22</sup> The concepts and theories that seem dominant in Russian liberal international relations are the same concept and theories which are well familiar to Western, particularly American academia.

Tsygankov and Tsygankov categorize Russian liberals into three groups as modernizers, institutionalists and national democrats.

The disagreements between them can be illustrated by comparing their attitudes toward Putin's method of approach to the US after September 11, 2001. Modernizers supported Putin's decision to side with the US after September 11, and they argued that Russian alliance with the West should go beyond solving some tactical purposes and create the development of a common identity and common cultural values. On the other hand, the attitude of institutionalists and national democrats was a more complex and cautious one. While being supportive of Putin's decision and being sympathetic toward the West, the group cautioned that the US' unilateral use of power and the narrowly chosen pro-American model of globalization was one of the causes of the spread of terrorism.<sup>23</sup>

The debate between realists and liberals about diplomacy was especially noticeable on two issues: CIS integration and European security. According to liberals Russia's real dilemma was not disintegration versus integration of the CIS but rather the challenge of successfully completing democratic and market reforms in the region.<sup>24</sup> Concerning the European security, the liberals support that the Russia's major interest in Europe should be the strengthening of multilateral institutions which would serve as a guarantee against the return to balance of power politics. For instance; many liberals considered NATO as the main guarantor of stability in Europe and as an alliance of democracies that has defensive rather than offensive intentions. The realists and liberals, therefore, disagreed on the nature of the post-Cold War order.<sup>25</sup> As a result of the liberalist wind; the leaders of the new Russia had very high expectations about joining Western international organizations. They expected loans or assistance for debt restructuring and currency stabilization including high Western investments. However, the West had no intention to launch some program similar to Marshall Plan for the post-communist Russia.<sup>26</sup> In order to be

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<sup>22</sup> A.P. TSYGANKOV and P. TSYGANKOV: (2007c) "A Sociology of Russian Liberal IR", *Paper presented at the Annual Meeting of International Studies Association*, San Diego, February 28, p.4

<sup>23</sup> P.A. TSYGANKOV and A.P. TSYGANKOV: (2004a), p.61

<sup>24</sup> SERGUNIN, p.26-27.

<sup>25</sup> Ibid, p.27.

<sup>26</sup> Andrei P. TSYGANKOV: (2010) *Russia's Foreign Policy: Change and Continuity in National Identity*, Rowman&Littlefield, p.70.

part of West, Russian initiatives to be a member of G-8 and WTO are examples in a liberalist approach.

Russian liberals also argued in favor of state withdrawal and surrendering “state sovereignty to transnational corporations and international organizations. They even proposed to transfer parts of Russian territory to foreign states – the Kuril Islands to Japan in exchange for economic credits and Kaliningrad to Germany and Scandinavian nations.<sup>27</sup> Finally, many Russian liberalists also believe that Russia should give up the illusions of a great power and accept its current status by agreeing to some limitations upon its independent foreign policy behavior.<sup>28</sup> For instance; Trenin believes that Russia is a fundamentally European, not a Eurasian, country and therefore its “pro-European choice” should be quite natural. He also supports the idea that Russia should address the problems of Eurasia through the direct involvement of the West, particularly the US.<sup>29</sup>

In terms of the economics, Russian transition period experienced a neo-liberalist period according to those days’ western advisers of Russian economy. First of all, as Campbell and Pedersen stated, neo-liberalism is itself a heterogeneous set of institutions consisting of various ideas, social and economic policies and a ways of organizing political and economic activity that are quite different from others. Therefore, it includes formal institutions, such as minimalist welfare state, taxation, and business-regulation programs; flexible labor markets and decentralized capital-labor relations, and the absence of barriers to international capital mobility.<sup>30</sup> Thus, Russian neo-liberal reform program of 1990s has contributed to future prospects for growth. Liberalization, stabilization, and privatization were undertaken with the idea that the efficiency gains would lead to growth.<sup>31</sup> According to the neo-liberalist strategy, Russia first lifted state price controls and reduced state spending. Then, Central Bank of Russia began to follow an extremely tight monetary policy to stop the inflation provoked by the state

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<sup>27</sup> A.P. TSYGANKOV and P. TSYGANKOV: (2007c) “A Sociology of Russian Liberal IR”, *Paper presented at the Annual Meeting of International Studies Association*, San Diego, February 28, p.6.

<sup>28</sup> TSYGANKOV, and TSYGANKOV, (2004a), p.63.

<sup>29</sup> Ibid, p.65.

<sup>30</sup> John L. CAMPBELL and Ove Kaj PEDERSEN: (2001) *The Rise of Liberalism and Institutional Analysis*, Princeton University Press, p5.

<sup>31</sup> Zoltan D. BARABY and Robert G. MOSER: (2001) *Russian Politics: Challenges and Democratization*, Cambridge University Press, p.159.

controls.<sup>32</sup> Finally, the ideology of neo-liberalism survived for a short term in Russia because the main goals of active development of Russian state institutions and other market-supporting institutions necessary for successful market-oriented reform and creating the conditions of investment could not be achieved.<sup>33</sup> And the supporters of neo-liberal ideas have lost their support among the political elite.

### 1.3. Constructivism

Constructivism assumes that the identity of a state is a dependent variable determined by the historical, cultural, social and political context. Constructivism focuses not only on the political elites' construction of the identity of the state as an actor, but also on the construction of national identities by elites, as well as the self-construction of individual political identities.<sup>34</sup> In other words, the central category of the constructivist approach to foreign policy is "identity". National identity therefore is a system of meaning that expresses the Self's emotional, cognitive, and evaluative orientations toward its significant Other.<sup>35</sup>

According to constructivists' international relations theory in general – and its contemporary structural variants, neo-realism and neo-liberalism, in particular – are poorly equipped to explore normativity in international politics.<sup>36</sup> Realism views foreign policy as a reflection of the structure of the international system. Neo-realists, on the other hand, focused on emphasizing the centrality of the international system. And liberals concentrated on multiple foreign policy advances. While rejecting the anarchy-based perspective as inaccurate, liberals produced the vision of an international system that is restrictive in its own way.<sup>37</sup> According to Tsygankov, there are two problems with realist and liberal understandings of foreign policy. First, both theories tend to emphasize one aspect of the international system at the expense of others. Secondly, both realism

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<sup>32</sup> David Michael KATZ and Fred WEIR: (2007) *Russia's Path From Gorbachev to Putin*, Routledge, p.234.

<sup>33</sup> BARABY and MOSER, p.159.

<sup>34</sup> Nikita LOMAGIN: (2005) "Forming a New Security Identity in Modern Russia", in Hønskov, Jakob, Konrad, Vilhelm, Nygren, Bertil, Oldberg, Ingrid, and Pursiainen, Christer (ed.) *Russia as a Great Power, Dimensions of Security Under Putin*, BASEES, Routledge Series on Russian and East European Studies, USA and Canada, p.257

<sup>35</sup> Andrei P. TSYGANKOV: (2005b) "Do Rationalists Have a Theory of Foreign Policy? Understanding Russia's Geostategic Chances After the Cold War", *Paper presented for the Annual Meeting of the International Studies Association*, Hawaii, March, p.12

<sup>36</sup> Paul A. KOWERT: (2001) "The Peril and Promises of Constructivist Theory", *Ritsumeikan Journal of International Studies*, 13:3, p.158

<sup>37</sup> TSYGANKOV: (2005b), p.4-9

and liberalism are ethnocentric in the sense that they view Russia's foreign policy through similar Western culture and do not sufficiently pay attention to Russia's indigenous history and system.<sup>38</sup>

Neither realism nor liberalism is fully satisfactory in explaining the identified changes in Russia's international strategy. Therefore, from the perspective of the constructivist theory, Yeltsin and Kozyrev are great examples, who were thinking in terms of priority of cooperation and engagement with the world, rather than preserving or reviving Russia's material power.<sup>39</sup> Russia remained strongly interested in enlargement and deepening economic ties to the West. However, their main reason for that was not so much related with globalism. As the Foreign Policy Concept of 1993 put it in; “*Without economic rebirth, Russia cannot become a full-fledged member of the club of great powers at the end of the 20<sup>th</sup> and beginning of the 21<sup>st</sup> centuries.*”<sup>40</sup> In conclusion, Russia finds itself in the position of seeking legitimating from Western authorities privileged by the fall of Soviet communism.<sup>41</sup>

#### **1.4. Imperialism**

The character of progressive imperialism was set forth by Britain's political philosopher, John Stuart Mill. Mill defended the capitalist imperialism and feared the far greater evils of a state socialist, regressive imperialism. Following that, Karl Marx was the one of the first figure who began to criticize imperialism.<sup>42</sup> Afterwards, Lenin envisaged a final stage in which imperialist countries finally had degenerated into parasitic, functionless aggregates. Moreover, Rosa Luxemburg thought that the imperialist countries were like predators who finally destroy their prey so utterly that, no further fresh support of prey being available, the predators themselves must perish.<sup>43</sup> According to Thornton; an imperial policy is one that enables a metropolis to create and maintain an external system of effective control. The control may be exerted by political, economic, strategic, cultural, religious, or ideological means, or by a combination of some or all of these.<sup>44</sup> Cohen rightly asks the question of “will Russia for the first time in history since the 15<sup>th</sup> century, abandon attempts to become a universal empire or a dominant state –one

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<sup>38</sup> Ibid, p.11

<sup>39</sup> Ibid, p.25

<sup>40</sup> MACFARLANE, p.234

<sup>41</sup> KOWERT, p.164

<sup>42</sup> Lewis Samuel FEUER: (1989) *Imperialism and Anti-Imperialist Mind*, Transaction Publishers, p.9-10.

<sup>43</sup> Ibid.

<sup>44</sup> A. P. THORNTON: (1978) *Imperialism in the Twentieth Century*, University of Minnesota Press, p.3.

that, in various ideological guises, incessantly strives for imperial domination of a known political universe?”. Cohen wrote in 1998 that a new page in East-Central Europe, Central Asia, and world history could be opened to include the participation of Russia in a Multipolar and hopefully cooperative international political system by expecting no more imperialist approach of Kremlin in the new century.<sup>45</sup>

Although political scientists expected Russia to be non-imperialist in the 21<sup>st</sup> century, the rise of Vladimir Putin once again raised the question of whether Russian imperialism will re-emerge or not in the international arena. In order to be a superpower again, when Vladimir Putin first came to power, his priority was to strengthen the Russian state, develop the economy while paying foreign debt, and restoring Russia's international status which are the pillars of Russian foreign policies in recent years. On the other hand, Orban suggests that Russia gained an empire before it became a state and a coherent nation. That is the reason why Russia have claims on the identity and territory of various neighbors and why the former Soviet Republics were not considered fully sovereign entities but classified as the “near abroad”.<sup>46</sup> According to Wallender, Putin's foreign policy is not in favor of integration or liberalization.

In Russia's international economic strategy, the state plays a central role in managing the domestic economy and society as well as in interacting with the outside world. Energy has become the single most important issue in Russian foreign policy, occupying the place of importance and emphasis that military relations used to have in Soviet foreign policy and creating speculation about Russia as an energy superpower. Thus, energy dominates Russia's relations with almost every important country or region, namely its post-Soviet neighbors, Europe, China, and Iran.<sup>47</sup>

Wallender asks the question of “how can Moscow deal with the international context of globalization and yet sustain “patrimonial authoritarianism” at home?” and answers to this question with the theory of Transimperialism.<sup>48</sup> Wallender criticizes imperialism and post imperialism theories, because she emphasizes that post-imperialism is not capable of explaining Russia's refusal to accept international rules of the liberal economic order, including contracts and private investment in the energy sector. For instance, Russian government has refused to ratify the European Energy Charter, which it signed in 1994, because implementation of the

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<sup>45</sup> Ariel CHOEN: (1998) *Russian Imperialism: Development and Crisis*, Greenwood Publishing Group, p.163.

<sup>46</sup> Anita ORBAN: (2008) *Power, Energy and the New Russian Imperialism*, Praeger Security International Press, p.11.

<sup>47</sup> Celeste A. WALLENDER: (2007) “Russian Transimperialism and Its Implications”, *The Washington Quarterly*, 30:12, p.110

<sup>48</sup> *Ibid*, p.117

charter would require transparency and competition in Russia's pipeline systems, currently monopolized by the state companies Gazprom and Transneft.<sup>49</sup>

On the other hand, Goldman underlines that once Russia and its industries recovered enough economically to do without such help, the state authorities either disregarded contractual agreements or found environmental loopholes or instances of tax evasion that they used to claim contractual violations such as Sakhalin (Shell) and Kovykta (BP).<sup>50</sup> By doing so, Goldman thinks that Russia displays imperialistic methods behind these actions. And regarding Kremlin's Asia policies, former President Putin repositiones Russia in the region with its neo-imperial ambitions, and sees it as a power-balancer and a legitimate and though contender in its own rights for political influence and economic benefits in any power vacuum situation left open by the US.<sup>51</sup>

## **2. FOREIGN POLICY ORIENTATIONS OF THE POST-SOVIET PERIOD**

Foreign policy orientation mainly shifted from East to Western democratization during the transition period from Gorbachev to Yeltsin. However, the side-effects of the neo-liberalist implementation in the economy enforced Russian people to live under worse conditions than the USSR. Therefore, dissatisfaction and disappointment rose among the society in Russia. During the Yeltsin period, there is no doubt that Chechnya events also affected the Kremlin foreign policy approach. Although, Russia was challenging with harsh economic conditions, still managed to secure its territorial integrity and prevented the separation of Chechnya. Moreover, during Presidency of Putin (2000-08), as the man actor of the designation of the Russian foreign policy, he emphasizes that Russian path is through Westernization, but with its own way. Then, after the events of 9/11 in 2001, Putin allowed US existence to expand in Central Asia and showed support of Kremlin against terrorism such a Western country. However, during the second term of Putin, US military existence in Central Asia, NATO expansion and colorful revolutions in "Near Abroad" of Russia, provoked Russian foreign policy statements to be against unilateral acts of US. Then, Russia demanded from some Central Asian states to

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<sup>49</sup> Ibid, p.113

<sup>50</sup> Marshall I. GOLDMAN: (2008) *Petrostate, Energy, and the New Russia*, Oxford Uni. Press, p.172.

<sup>51</sup> Alexandre Y. MANSUROV: (2005) "Mercantilism and Neo-Imperialism in Russian Foreign Policy During President Putin's 2<sup>nd</sup> Term", *The Korean Journal of Defense Analysis*, Vol. XVII, No.1, Spring, p.151.

terminate their military base contracts with US sometimes by diplomatic affairs and sometimes by using its energy card. Due to reason that Russian economy has healed itself thanks to high incomes from energy exports, Russian self-reliance improved in the first decade of the 21<sup>st</sup> century.

When Dmitri Medvedev was elected as the 3<sup>rd</sup> President of Russian Federation, he was only 42 years old. The western bloc has expected that he would be much more pro-western than Vladimir Putin. However, whole world was shocked when Russia used of force against Georgia in August 2008, only after five months of the election. Thus, Russia showed that the expansion of NATO through Ukraine or Georgia will not be tolerated according to Russian national priorities. In this context, entire process has led Russian foreign policy to follow neither Atlanticist nor Eurasianist, but a different way which is called “third way” by Putin himself. Furthermore, during the 1990s and 2000s main political groups affected Russia foreign policy regarding to the developments in the world.

Domestic political groups in Russian Federation, with various foreign policy orientations influenced the foreign policy decision making process. There were a wide range of political approaches that endeavored for the possible foreign policy directions through 1991-96.<sup>52</sup> While Pursiainen and Patomaki describes contemporary trends in Russian political thought in eight different approaches; Romantic Liberal, Neo-liberal, Authoritarian, Conservative, Moderate and Orthodox Marxism-Leninism, the New Left, Anarchism and Eurasianism (Slavophilism, National Patriotism Romantic Nationalism),<sup>53</sup> Duncan diversifies these approaches into three groups; Westernism, Eurasianism and Pragmatism<sup>54</sup>, Smolansky on the other hand divides only two groups as Atlanticists (Westernists) and Eurasianists<sup>55</sup> each which tries to answer the questions of the foreign policy orientations and seeks the best way for Russia.

## **2.1. Westernists (Atlanticists)**

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<sup>52</sup> Nicole J. JACKSON: (2003) “*Russian Foreign Policy and the CIS, Theories, Debates and Actions*”, Routledge, London, p.27.

<sup>53</sup> Christer PURSIAINEN and Heikki PATOMAKI: (2004) “The State and Society in Contemporary Russian Thought”, in E. Reindzeviciute (ed.) “*Contemporary Change in Russia: In from the Margins?*”, Baltic & East European Studies 3, BEEGS: Hundinge, p.35-6.

<sup>54</sup> DUNCAN.

<sup>55</sup> Oles M. SMOLANSKY: (1997) “Russia and the Asia-Pacific Region: Policies and Polemics”, in Blank, Stephen J., and Rubenstein, Alvin Z. (ed.) “*Imperial Decline, Russia’s Changing Role in Asia*”, Duke Uni. Press, London, p.7.

The Atlanticists were led by former Foreign Minister Andrei Kozyrev and embraced many former followers of Mikhail Gorbachev's New Thinking, advocated the incorporation of the Soviet Union in a "common Europe home".<sup>56</sup> According to Atlanticists; it is a term reflects a commitment to close relations with the West, "the return to civilization", integration into the world economy, while at the same time maintaining Russia as a post-imperial power.<sup>57</sup> The Atlanticists think that Russia itself was far too weak to attempt to form an economic role of its own and believe that Russia's security problems are strictly a result of the USSR's confrontation with the West, therefore, the collapse of the USSR and the end of Cold War has abolished any serious security challenges.<sup>58</sup> The argument between Atlanticists and Eurasianists essentially focused on what is Russia, is it a European state such as Poland or Romania, should we consider its isolation from Europe, its Orthodox Christianity, or does Russia belong to a class of its own?<sup>59</sup> Tsygankov conceptualizes the political traditions as Westernism, Statism, and Civilizationism. While Tsyngankov's Westernism resembles to the other scholars' analysis, Statists desires a strong independent state and Civilizationists deals with the issues from cultural perspectives.<sup>60</sup>

**Table 1: The Spectrum of Russia's Post-Soviet Foreign Policy Thinking<sup>61</sup>**

School of Thought	A Vision of Russia and Its External Threat	Principal Proponent
<b>WESTERNIZERS</b>		
Liberals	Russia is a part of the West and should integrate with Western economic and political institutions; the main threats to Russia come from non-democratic states.	Andrei Kozyrev

<sup>56</sup> Ibid, p.7.

<sup>57</sup> Richard SAKWA: (1996) *Russian Politics and Society*, Routledge, Second Edition, p.42.

<sup>58</sup> Ilya PRIZEL: (2004) *National Identity and Foreign Policy – Nationalism and Leadership in Poland, Russia and Ukraine*, Cambridge Uni. Press, p.244-52.

<sup>59</sup> Andrey KORTUNOV: (1999) "Russian National Interests: The State of Discussion", in (Ed) Kurt R. Spillmann and Andreas Wenger, "Russia's Place in Europe: A Security Debate", *Studies in Contemporary History and Security Policy*, Vol.1, Peter Long, Bern, p.39.

<sup>60</sup> A. P. TSYGANKOV and P. TSYGANKOV: (2008d) "National Ideology and IR Theory: Three Incarnations of the Russian Idea", *Paper Presented at the Annual Meeting of the International Studies Association*", San Francisco, March 26-30, pp.1-17.

<sup>61</sup> Andrei P. TSYGANKOV: (2006) *Russia's Foreign Policy, Change and Continuity in National Identity*, Rowman & Littlefield Pub, p.61.

Social Democrats	Russia is an independent part of international society; it has its own specific interests, but also shares some common interests with others; the main threats to Russia come from the violation of basic human rights and disrespect for cultural pluralism.	Mikhail Gorbachev
<b>STATISTS</b>	Russia is a sovereign state and a great power with its own specific interests in maintaining the stability of the international system; the main threats to Russia come from state-revisionists seeking to change the existing balance of power.	Yevgenii Primakov
<b>CIVILIZATIONISTS</b>		
National Communists	Russia is an independent socialist civilization and a great power/superpower; its interests are incompatible with those to the West and include the restoration of a balance of power between socialism and capitalism and the spread of the influence of Russian civilization; the main threats come from the West and its imperialist intentions.	Gennadi Zyganov
Hard-line Eurasianists	Russia is a land-based geopolitical empire; its interest are mutually exclusive from those of sea-based powers and include the preservation and expansion of Russia's geopolitical sphere of influence, the main threats come from sea-based powers.	Vladimir Zhirinovski

In order to structure the foreign policy proposals, basic challenge for the Russian ruling elite was to the definition of the national identity.<sup>62</sup> It was an empire almost 80 years ago and it should not be underestimated that over a night Russia lost many lands and a property. First step to find the answer for national identity was to define the “who the Russians are”. According to Jackson;

One way was in terms of language, so that Russia includes all “Russian speakers” in the former Soviet states. Second way was to define Russia ethnically, third way was to define it as a Slavic entity, fourth way was the reintegration of Russia with northern Kazakhstan, Belarus and Ukraine and fifth way was to design a civic state that members are all Russian citizens without any discrimination.<sup>63</sup>

Regaining the great power status was the common argument among many political groupings, although a small group was in a position of rejecting the old imperialistic methods. The main questions were how Russia should become a great power again? Should Russia follow the Western economic and political path of development or go its own unique way?<sup>64</sup> Extreme pro-Westernists of the political elite asserted that the liberal reforms should be established both in domestic politics and finance in addition to develop good relations with the West. They advocated integration with Western institutions such as the EU and the NATO. Kovadiayev, as today’s supporter of this idea, mentioned that “*to avoid the worst, Russia must look westwards. Russia's readiness to join the West's two major structures, NATO and EU, will attest to its earnest intentions. Since joining the EU would inevitably be a dragged-out process for many reasons, NATO remains the only choice, at least its political wing.*”<sup>65</sup>

On the other hand, anti-Westernists were against marketization and democratization. Because, they believed that possible integration with Western institutions would mean the control of the Russia. A moderate position revealed and advocated the third way which is unique for Russia. During the mid-1990s, the Eurasianist idea became attractive because according to Jackson, it fit with the reality of the eastward movement of Russia's borders and justified a focus on the renewal of ties with the CIS states as well as Russia's Eastern neighbors.<sup>66</sup>

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<sup>62</sup> JACKSON, p.28

<sup>63</sup> Ibid, p.29

<sup>64</sup> Ibid, p.31-2

<sup>65</sup> Fyodor-Shelov KOVADIAYEV: (2005) “Torn Between Two Choices”, *Russia in Global Affairs*, Vol.3, No.4, October-December, p.40

<sup>66</sup> JACKSON, p.32

As an advocate of the Eurasianism, for Dugin, Russia “is not a European country. Russia is a Eurasian country...a synthesis of Eastern, Asian and West European characteristics” that should be compared with Europe itself or with India as a civilization”. The United States, in Dugin’s view had evidently ended its unspoken agreement not to intervene on the territory of the former Soviet Union declared a “geopolitical jihad”; it was currently moving into the Northern Caucasus and the Volga, using the same “orange” methods that had been perfected elsewhere the region.<sup>67</sup>

Main elite opinions of Russia;

- i. **Liberal Westernist Ideas:** Russia's identity should be defined as a civic state. They believe in close relations with EU and NATO and active cooperation with international institutions. Although they want good-neighborly relations with the other successor states, they believe Russia should abandon its historical great power ambitions. They think that Russia is a part of Europe concerning its history, culture and mentality. <sup>68</sup> They rejected the idea of Eurasia supported the principles of equality of states, including non-interference in other states’ (near abroad) domestic affairs.<sup>69</sup>
- ii. **Fundamentalist Nationalist Ideas:** They believed in an ethnic or Slavic definition of Russia. West was to blame for the collapse of the Soviet Union. They wanted to recreate the great Russia either in Soviet Union way or Tsarist Empire.<sup>70</sup> They have desire to re-establish Russian hegemony in the former Soviet Republics. They interpret Eurasianism in both geography and economic terms that Russia should imply a third way in politics and economics.<sup>71</sup> Finally, they give more emphasis to Russia's relations with Asian powers and Central Asia.<sup>72</sup>

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<sup>67</sup> Stephen WHITE: (2007) “Elite Opinion and Foreign Policy in Post-Communist Russia”, *Perspectives on European Politics and Society*, Vol.8, No.2, p.155

<sup>68</sup> Ibid, p.149

<sup>69</sup> JAKCSON, p.34

<sup>70</sup> Ibid, p.35

<sup>71</sup> WHITE, p.149

<sup>72</sup> Ibid, p.154

- iii. **Pragmatic Nationalist Ideas:** They understood the Russian identity definition linguistically as regards they required for the defense of Russian speakers in the near abroad. Most importantly, the country’s former prestige must be restored.<sup>73</sup> They do not think that it is realistic to attempt the reconstitute of the USSR, but support the fullest possible reintegration of its former members.<sup>74</sup>

**Table 2: A General Ideas and Stated Views Which Formed Foreign Policy Orientations<sup>75</sup>**

Categories of Ideas	Liberal Westernism	Pragmatic Nationalism	Fundamentalist Nationalism
Identity (who are the Russians?)	Civic: Russians in Russia	Linguistic: Russian – speakers in Former Soviet Union(FSU)	Union: Ethnic Russians or Slavs in FSU or Ethnic: Ethnic Russians in Russia or FSU
History	No use	Important	Crucial
Collapse of the Soviet Union	Positive	Negative	Negative/ blame West
Russia’s borders	Russian Federation	Russia (and parts of the FSU)	Russia and parts of FSU/Russian Federation
Worldview	Peaceful, unantagonistic	Balance of Power	Hostile, surrounded by enemies
Geography	West	Eurasia	Eurasia
Self perception	“Normal” power	Great power with own interests	Great power usually with empire
Mission (Russian idea)	No mission	Unique, geopolitical mission	Historical, divine mission
Domestic politics and economics	Liberal democracy and market reforms modeled on west	Liberal democracy and market reforms, taking Russian conditions into account	Anti-democratic and anti-marketization
Foreign policy direction	West	Own path	Expansionism or isolationism
Threats	Communism	Any which threatens FSU interests (Diaspora, NATO expansion)	West/pan Turkic
Relations with FSU	Not significant	Crucial	Crucial

<sup>73</sup> JACKSON, p.35

<sup>74</sup> WHITE, p.150

<sup>75</sup> JACKSON, p.36

Broad proposals towards FSU	policy towards	Support sovereignty, equality of states, non-interference	Protect Russian interests/support rights of Russians in near abroad	Future re-incorporation of certain FSU areas isolationism
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Diverse from other scholars, Menon wrote in his article that the elites of Russia displayed Neo-Imperialist policy actions. According to him, they were in four types;

- i. Those whose preferences are institutional, deriving primarily from their positions in national security bureaucracies, mainly the armed forces, the intelligence and security services.
- ii. Those who have influential positions in society such as intellectuals, journalists, and political leaders who wishes to turn back to the nostalgia for empire and superpower status.
- iii. Those who focus on Russia's southern periphery which is called Eurasia.
- iv. Those who favor reforms to democratize the policy and marketize the economy but whose strategic orientations emphasize Russian preeminence in the former Soviet Republics.<sup>76</sup>

According to Menon, both Yeltsin and Kozyrev displayed neo-imperial attitudes:

“Russia's right to use its power to safeguard [geopolitical positions that took centuries to conquer], the necessity of protecting the rights of ethnic Russians in the near abroad, by using force if it is needed the importance of granting Russian in Central Asia dual citizenship; the support for mobile rapid-deployment forces, they claim that Central Asia’s external borders are Russia's as well, as the portrayal of Central Asia as a region of domino states that, absence of Russian military force, could fall before on Islamic fundamentalist wave.”<sup>77</sup>

On the contrary, the “Concept of Russian Federation Foreign Policy” that circulated in the Supreme Soviet by Kozyrev in 1993 maintains Westernist approaches despite Menon’s analysis.<sup>78</sup>

- i. The ideologically motivated struggle between the “two systems was over, rendering a “large proportion of aims accumulated in the era of confrontation unnecessary”.

<sup>76</sup> Rajon MENON: (1998) “After Empire: Russia and the Southern ‘Near Abroad’”, in Micheal Mandelbaum (ed.) “*The New Russian Foreign Policy*”, Council on Foreign Relations, p.156

<sup>77</sup> Ibid, p.159

<sup>78</sup> Oles SMOLANSKY, p.13

- ii. “The chief threat to world stability today comes from the countries of the third world”. This made it necessary for Moscow and Washington to cooperate in efforts to maintain international security. “For these purposes, we should reorient our military potential toward ensuring global stability and creating in conjunction with the US reliable guaranteed of our safety”.
- iii. “Russia is a democratic rule-of-law state sharing “a general understanding of the fundamental values of world civilization”.

During the first decade of the Russian Federation, although the Russian Federation did gain access to such important organizations as the World Bank, IMF, and GATT, Moscow became a requester that expecting assistance from the West. Smolansky thinks that the most damaging outcome of Atlanticist diplomacy was based on the Kremlin’s failure to address the fact, in addition to being unwilling to admit Moscow to some of the institutions created during the Cold War and as well the West has been gradually pushing Russia out of Europe.<sup>79</sup>

## **2.2. Eurasianists**

### **2.2.1. Evolution of Eurasianism in Russia**

The question of Russian identity has been on the agenda of Russia ruling elite since the days of Peter the Great’s (1672-1725) Westernizing policies and it is essential for today’s Russia. According to some scholars, Eurasianism could be accepted as the most defining element in Russian foreign policy. Eurasian idea born out of the necessity to incorporate the territory won during his war with Charles XII of Sweden, Peter the Great decided to have a new geographic outline written that would include the newly won territory, moving Russia's place on European maps of the day from the Asian continent into Europe.<sup>80</sup> Moreover, in the 19<sup>th</sup> century Nikolai Danilevsky (1822-1885), was the first to define Eurasia as a distinct geographic entity separated from both Europe and Asia.

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<sup>79</sup>Ibid, p.35

<sup>80</sup> Matthew SCHMIDT: (2005) “Is Putin Pursuing a Policy of Eurasianism?”, *Demokratizatsiya*, Vol.13, Issue 1, p.88

Danilevsky defined Eurasia as the vast unbroken landmass bounded on its edges by the high mountain ranges of the Himalayas, Caucasus and Alps, and the large bodies of water to make up the Arctic, Pacific, and Atlantic Oceans, and the Black, Mediterranean, and Caspian Seas.<sup>81</sup>

The term Eurasia meant not the combination of Europe and Asia, as the term is commonly understood, but rather as a separate entity. Eurasia as conceived by Savitskii, Trubetskoi and their peers, was neither Europe nor Asia, but a different “geographical world” altogether, distinct from the first two.<sup>82</sup>

Afterwards Eurasian ideology was developed again in the early 1920s among Russian intellectual figures that immigrated to Western Europe after the October revolution and the civil war.<sup>83</sup> It was the Russian version of Western currents known as the “third way” but stressed its differences with them by upholding Russian cultural distinctiveness.<sup>84</sup> Soviet émigrés in the 1920s who were Count Nikolai Trubetskoi and Petr Savitsky were accepted as the first self-conscious “Eurasianists”. They heavily influenced by geopolitical theorists such as Halford Mackinder, Alfred Mahan, and Karl Haushofer, and aware of Russia's distinctiveness from Europe, they envisioned Russia as a sort of bridge between East and West, pursuing a spiritual and geopolitical “third way”.<sup>85</sup> Eurasianists argued that the peoples of Soviet Union, be they Slav and Orthodox or Turkic and Muslim, had melded together over the centuries of Russian rule and now shared the particular characteristic which laid the basis for political unity.<sup>86</sup>

The idea of “third way” can be found in many actions and speeches of Putin in 21<sup>st</sup> century's Russia. “*The main point for today is; Russia must be an empire, ruling over the former Soviet space and beyond.*” However, Putin and others from this school typically are not chauvinistic nationalists. Instead of displaying extreme nationalism, they tend to emphasize on Russia's diversity and a multi-cultural “Eurasian empire” that would unite Slavic and Muslim/Turkic communities.<sup>87</sup> Eurasianists perceived the USSR as a continuation of the empire and regarded ethnic nationalism, including Russian ethnic nationalism, as extremely dangerous to the future

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<sup>81</sup> Ibid, p.89

<sup>82</sup> Ilya VINKOVETSKY: (2007) “Eurasia and Its Issues: The History of an Idea and the Mental Geography of Post-Soviet Space”, *SOYUZ Symposium*, p.4 <http://www.sfu.ca/history/vinkovetsky/> (Accessed on August 2008).

<sup>83</sup> Marlène LARUELLE: (2008) “Russia's Central Asia Policy and the Role of Nationalism”, *Central Asia-Caucasus Institute & Silk Road Studies Program*, p.33.

<sup>84</sup> Ibid, p.34, Gordon M. HAHN: (2002) “The Rebirth of Eurasia”, *The Russia Journal*, July 12-18, <http://www.cdi.org/russia/215-14.cfm> (Accessed on 31 July 2008).

<sup>85</sup> Paul KUBICEK: (2004) “The Evolution of Eurasianism and the Monroe Doctrine Under Vladimir Putin”, *Paper for ISA*, Montreal, March, p.4.

<sup>86</sup> Peter J.S. DUNCAN: (2002) “Westernism, Eurasianism and Pragmatism: The Foreign Policies of Post-Soviet States, 1991-2001”, *Working Papers Series in Political Paper*, Uni. College of London ,No.2, p.6

<sup>87</sup> KUBICEK, p.5

integrity of the common state.<sup>88</sup> They as well believed that the government paid too much attention to the Western direction of its foreign policy while Russia's most vital needs were in the South and in the East. They argued that, Moscow should deal with 'the arc of crisis' developing on Russia's Southern borders and with the problems which had arisen in relations with its own sizeable Muslim population. According to Eurasianists, these threats and challenges are inevitably important than to create close dialogues with the West and trans-Atlantic.<sup>89</sup>

### 2.2.2. Eurasianism in 21<sup>st</sup> Century Russia

Rangsimaporn divides Eurasianism into three groups as Pragmatic Eurasianism, Neo-Eurasianism, and Intercivilizational Eurasianism. Rangsimaporn identifies Putin as Pragmatic Eurasianist due to his balanced policy between East and West. So, according to pragmatic doctrine, Putin does not reject the importance of the West and Russia's cultural connection with Europe.<sup>90</sup> However, Shlapentokh suggests that Putin is pursuing Neo-Eurasianist approach. Shlapentokh indicates that; "While 'neo-Eurasianism' plays a variety of roles in rhetoric, Putin's Russia, its major role is clear: to provide ideological justification for Russia as a multi-ethnic state, one that is still pre-modern in many ways."<sup>91</sup>

On the other hand, Rangsimaporn's understanding of Neo-Eurasianism is dealing with geopolitics rather than politics. While rejecting the common points with West, Neo-Eurasianism gives an importance to similar political and social values with Asia, particularly with Central Asia. Rangsimaporn mentions that the idea of "civilizational" Eurasianist identity and geopolitical position of Russia as the foundation for Russia's economic development and integration into East Asia and also for its political and strategic relations with the region.<sup>92</sup> Titarenko suggests that; "...the Eurasian character of Russian civilization opens the possibility of

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<sup>88</sup> Michail ALEXANDROV: (1999) *Uneasy Alliance: Relations Between Russia and Kazakhstan in the Post-Soviet Era 1991-1997*, Greenwood Press, p.28.

<sup>89</sup> Vinay Kumar MALHOTRA and Alexander A. SERGOUNIN: (1998) *Theories and Approaches to International Relations*, Anmol Pub., New Delhi, p.348

<sup>90</sup> Paradorn RANGSIMAPORN: (2006) "Interpretations of Eurasianism: Justifying Russia's Role in East Asia", *Europe-Asia Studies*, Routledge, Vol.58, No.5p.375-376

<sup>91</sup> Dmitry SHLAPENTOKH: (2007b) "Putin's Neo-Eurasianism, or Models of the Construction of a New Russian Identity on Their Implications", *Prague Watchdog*, January 16, [www.watchdog.cz](http://www.watchdog.cz) (Accessed on 28 May 2008)

<sup>92</sup> RANGSIMAPORN, p.384

new Intercivilizational and international relations founded on the principles of co-development and mutual influence, allowing to solve the problems of ... preserving civilization diversity.”<sup>93</sup>

As Shlapentokh has mentioned, during the first years of Putin, there were high hopes among Eurasianists that he would direct Russia through Eurasian way. However, after the events of September 11, Putin pursued a balanced and pragmatic foreign policy. Simultaneously, Russia watched the expansion of US forces in its near abroad until 2005. As a turning point, in 2005, when US experienced a sudden geopolitical reversal in Central Asia, Russia has rushed to fill the geopolitical vacuum in the region and rapidly strengthening bilateral ties over the past years. Eurasianist accepts that as Russian diplomatic success in Central Asia and raised hopes that Putin’s Kremlin will press a broad geopolitical offensive to push American forces out of Central Asia, entirely, and virtually eliminate Washington’s influence in the region.<sup>94</sup> Consequently Putin has displayed evidence that he is again respecting the Eurasian approach. As an example for the rhetoric of the Eurasian theory, during on August 26 celebration of the city of Kazan’s 1,000<sup>th</sup> anniversary, Putin publicly praised Lev Gumilev, the historian and philosopher who is recognized as a founder of the modern Eurasianist movement.<sup>95</sup> For the memory of Gumilev, Putin said that “*the ideas of Lev Gumilev, who founded Neo-Eurasianism based on the idea of a united Eurasia in opposition to the transatlantic West*”.<sup>96</sup>

### 2.2.3. Neo-Eurasianism

Neo-Eurasianism takes its inspiration from nationalist tradition and advocates a new form of sovereignty, both for the ethnic groups and nationalities of the Russian Federation and the peoples of the former Soviet Republics.<sup>97</sup> Although Eurasianist position allowed underlining the disappointment felt towards Western cautiousness regarding to Moscow’s adhesion to its institutions and the granting of massive financial aid. The slavophiles or neo-Eurasianists, on the

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<sup>93</sup> Aleksandr V. LOMONOV: (2005) “On the Periphery of the Clash of Civilizations? Discourse and Capabilities in Russo-Chinese Relations”, in Pal Nyiri and Joana Breidenbach (ed.) “*China Inside Out*”, Central European Uni. Press, p.75-76

<sup>94</sup> Dmitry SHLAPENTOKH: (2005) “Russia’s Foreign Policy and Eurasianism”, 9 February, Available on site <http://www.eurasianet.org/departments/insight/articles/eav080205a.shtml> (Accessed on 28 May 2008)

<sup>95</sup> Ibid.

<sup>96</sup> Igor TORBAKOV: 24 June 2004, “Russia’s Eastern Offensive: Eurasianism Versus Atlanticism”, CDI Russia Weekly, <http://www.cdi.org/russia/312-13.cfm> (Accesses on 31 July 2008)

<sup>97</sup> Dider CHAUDET, Florent PARMENTIER, and Renoit PELOPIDAS: (2009) *When Empire Meets Nationalism: Power Politics in the US and Russia*, Ashgate Pub., p.49.

other hand, were less interested in the national geopolitical situation than its profoundly unique or somewhat imperial character. They were against western assistance to interference and refused to adhere to its economic, political or military institutions.<sup>98</sup> Szaszdi claims that all form of neo-Eurasianism advocate social and economic reform to drive the development of modernization of the Russian Federation, a goal linked to its notion of Russia as a strong and stable state. In addition, the use of military power is regarded as a legitimate instrument at the disposal of the Russian state for the achievement of foreign policy objectives.<sup>99</sup>

The two best-known doctrinaires of neo-Eurasianism to this day are Alexander S. Panarin (1940-2003) and Alexander G. Dugin (1962). Both thinkers hold the same beliefs:

“that there exists a cultural unity and a community of historical destiny that is shared by Russians and the peoples of the post-Soviet space, if not also by other peoples of Asia; that the geographic centrality of the so-called Eurasian space in the old continent entails an unavoidable political reality, namely, empire; and that there are cultural invariants which can explain the deeper meaning of contemporary political events.”<sup>100</sup>

Dugin insists upon a categorically different basic definition, which identifies Eurasia in terms of neither a distinctive geographical region nor a singular civilization, but rather in terms of a political and ideological principle. The most important historical task of Eurasianism, he observes, is to provide the world with a common platform for the struggle against Atlanticism.<sup>101</sup> Consequently, Neo-Eurasianism stands against American global hegemony in order to sustain the regional empires or multipolarity.<sup>102</sup>

Dugin’s Eurasianist party doctrine states that:

“in the place of Nation States, new political forms must emerge, to combine the strategic unification of the large continental zones with the multi-dimensional complex system of national, cultural and economic autonomies. Some characteristics of such an organization of zones and peoples can be observed in former empires (for example of Alexander the Great, the Roman Empire; etc) and the in the more recent political structures (EU, CIS).”<sup>103</sup>

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<sup>98</sup> Ibid, p.54.

<sup>99</sup> Lajos F. SZASZDI: (2008) *Russian Civil-Military Relations and the Origins of the Second Chechen War*, University Press of America, p.16.

<sup>100</sup> LARUELLE, p.37

<sup>101</sup> Mark BASSIN: (2008) “Eurasianism ‘Classical and Neo’: The Lines of Continuity”, *Slavic Eurasian Studies*, No.17p.286

<sup>102</sup> Florent PARMENTIER: (2008) “The Rising Influence of the Neo-Eurasianist Project in Putin’s Russia”, *ISA*, p.9

<sup>103</sup> Ibid, p.3-4

In essence, Dugin updated the Eurasian perspective to reflect the essential global shifts of the world after 1945 and 1991, and in so doing, shifts the center of gravity of the West across the Atlantic to North America. It is the US that now represents Eurasia's anti-thesis and chief opponent. On the other hand, classical Eurasianism was a radically isolationist doctrine.<sup>104</sup> Dugin's, Neo-Eurasianism advocates an entirely different vision of Russia's place in the world. It is to begin with a genuinely perspective, which has at its center Dugin's own version of a Eurasian New World Order.<sup>105</sup> According to Dugin, "*A confrontation between the West and East is inevitable*". He says that; "*I was the first to state this. I was the first who made this clear even in the beginning of the Yeltsin era, when everyone was confident that Russia would become a part of the West.*"<sup>106</sup>

### **3. RUSSIAN FOREIGN POLICY AND SECURITY CONCEPTS**

The most important single difference between today's Russia and the "old" one in terms of security policy lies in the availability of nuclear arms and options. Because Cold War foreign policy orientation was shaped by the nuclear armament race between US and USSR. Nonetheless, in today's world security can no longer be based on control of territory by large forces and a central authority imposing its rule. The quality of forces and command structures, central authority, organization and planning, immediate availability of reserves and war stocks and the efficiency of rapid mobilization and reinforcement are more important than ever before.<sup>107</sup>

#### **3.1. 1993 Military Doctrine**

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<sup>104</sup> BASSIN, p.290

<sup>105</sup> *Ibid*, p.292, Aleksandr DUGIN: (2005) *Rus Jeopolitiği, Avrasyacı Yaklaşım*, Küre Yayınları, p.3; "...Russia is neither East nor West, but independent and special third way."

<sup>106</sup> Dmitry SHLAPENTOKH: (2001a) "Russian Nationalism Today: The Interview with Alexander Dugin", *Contemporary Review*, July, p.2.

<sup>107</sup> Lothar RÜHL: (2004) "The Historical Background of Russian Security Concepts and Requirements", in Vladimir Baranovsky, (ed.) "*The Russia and Europe – The Emerging Security Agenda*", SIPRI, Oxford Uni. Press, p.29

The 1993 Military Doctrine<sup>108</sup> gives the impressions that rely on the historical experience and predicts forward deployment of Russian troops as “stationed forces in allied countries” and Russian military installations outside the Russian Federation. The basic existing and potential sources of external military danger for the Russian Federation are:<sup>109</sup>

- i. The territorial claims of other states on the Russian Federation and its allies,
- ii. Existing and potential local wars and armed conflicts, particularly those in the immediate vicinity of the Russian borders;
- iii. The possibility of the use (including the unsanctioned one) of nuclear and the other types of weapons of mass destruction which a number of states have in service;
- iv. The proliferation of nuclear and other types of weapons of mass destruction, their delivery systems, and the latest military production techniques in conjunction with the attempts by certain countries, organizations, and terrorist groups to realize their military and political aspirations;
- v. The possibility of strategic stability being undermined as a result of the violation of international accords in the sphere of arms limitation and reduction and of the qualitative and quantitative buildup of armaments by other countries;
- vi. Attempts to interfere in the internal affairs of and destabilize the internal political situation in the Russian Federation;
- vii. The suppression of the rights, freedoms, and legitimate interests of citizens of the Russian Federation in foreign states;
- viii. Attacks on military installations of the Russian Federation Armed Forces sited on the territory of foreign states;
- ix. The expansion of military blocs and alliances to the detriment of the interests of the Russian Federation’s military security;
- x. International security

Factors which help to transform a military danger into an immediate military threat to Russian Federation:<sup>110</sup>

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<sup>108</sup> The Basic Provisions of the Military Doctrine of the Russian Federation, Available on site <http://www.fas.org/nuke/guide/russia/doctrine/russia-mil-doc.html>

<sup>109</sup> Ibid.

<sup>110</sup> Ibid.

- i. The buildup of groupings of troops on the borders of the Russian Federation to the point where they disrupt the prevailing correlation of forces;
- ii. Attacks on facilities and installations on the state border of the Russian Federation and on the borders of its allies and the launching of border conflicts and armed provocations;
- iii. The training of armed formations and groups on the territory of other states which are intended to be transferred to the territory of the Russian Federation and its allies;
- iv. The actions of other countries which hinder the functioning of Russian systems for the support of the strategic nuclear forces and of state and military command and control of above all, their space component;
- v. The introduction of foreign troops in the territory of neighboring states of the Russian Federation (if this is not connected with measures to restore or maintain peace in accordance with a decision of the UN Security Council or a regional organ of collective security with the agreement of the Russian Federation)<sup>111</sup>

### 3.2. 1993 Foreign Policy Concept

First of all, the national tradition of the unchallenged domination of national security and foreign policy priorities over domestic economic, political and social development was reversed. On behalf of the Kremlin, economic progress and democratic stabilization emerged as the key objectives by which Russia's external activity was to be defined.<sup>112</sup> While Russia was being introduced with new concepts, Yeltsin was involved in a struggle for power with the legislature.<sup>113</sup> Second, the Russian state, whose emergence had coincided with colonial conquest, was decoupled from the Russian Empire after more than four centuries during which the two were inseparable. Third, also gone was the Messianic component “(the Third Rome, pan-Slavism and world system) which for centuries had been a guiding principle of foreign policy making.<sup>114</sup>

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<sup>111</sup> Ibid.

<sup>112</sup> LOMAGIN, p.264

<sup>113</sup> Marcel de HAAS: (2003) “The Development of Russian Security Policy 1992-2002”, *BASEES Annual Conference*, p.6, <http://www.clingendael.nl/cscp/staff/mhaas/0303-BASEES-RF-security-policy-92-02.pdf> (Accessed on 20 June 2008).

<sup>114</sup> Igor IVANOV: (2001) “The New Russian Identity: Innovations and Continuity in Russian Foreign Policy”, *The Washington Quarterly*, 24:3, p.11; “...contemporary Russia has given up the global messianic ideology that was practiced by the USSR and that prompted a demonstration of the Soviet presence in the remotest parts of the

According to the 1993 Foreign Policy Concept;

Russia is a great power with several foreign policy priorities: ensuring national security through diplomacy; protecting the sovereignty and unity of the state, with special emphasis on border stability; protecting the rights of Russians abroad; providing favorable external conditions for internal democratic reforms; mobilizing international assistance for the establishment of a Russian market economy and assisting Russian exporters; furthering integration of the CIS and pursuing beneficial relations with other nearby foreign states, including those in Central Europe; continuing to build relations with countries that have resolved problems similar to those that Russia faces; and ensuring Russia an active role as a great power.<sup>115</sup>

### 3.3. 1997 National Security Concept

The link between economics, foreign and security policy and social transformation was of the greatest importance for the new Russian national grand strategy. Russia's grand strategy was to secure the country's territorial integrity and its international status, and different ways of achieving those two goals have been tried since 1992.<sup>116</sup> Therefore, Russian internal threats took the priority in terms of the national strategy. Russian National Security Concept of 1997 not only repeated the main provisions of the Foreign Policy concept of 1993 but put even more emphasis on Russia's internal conditions as the major source of threads to Russian security.<sup>117</sup>

According to the 1997 National Security Concept document, the period of 1992-1997 was characterized as instability, both internal (the fight between the president and the legislative power in 1993; the first Chechen conflict 1994-1996) as well as external (civil wars in neighboring CIS states such as Moldova, Georgia, Tajikistan; crisis in the Balkans). Therefore, document says that the Russian government had to pay a lot of attention to these internal and external events, which was at the same time an obstacle for further development of the Russian Federation security policy into a National Security Concept.<sup>118</sup>

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planet.”, Leon ARON: (1998) “The Foreign Policy Doctrine of Postcommunist Russia and Its Domestic Context”, in Micheal Mandelbaum (ed.) “*The New Russian Foreign Policy*”, Council on Foreign Relation, p.29

<sup>115</sup> Martin NICHOLSON: (2001) “Putin’s Russia: Slowing the Pendulum Without Stopping the Clock”, *International Affairs*, Vol.77, No.4, p.35

<sup>116</sup> Jakub M. GODZIMIRSKI: (2000) “Russian National Security Concepts 1997 and 2000: A Comparative Analysis”, *European Security*, 9:4, p.74-5

<sup>117</sup> Nikita LOMAGIN, p.265

<sup>118</sup> HAAS, p.4

“...The Russian Federation’s national interests in the international sphere require the implementation of an active foreign policy course aimed at consolidating Russia's positions as a great power... one of the influential centers of the developing multi-polar world.”<sup>119</sup>

### 3.4. 2000 National Security Concept

When Vladimir Putin became President in 2000, Russia released three important documents under his leadership, each emphasizing the fact that Moscow considered international terrorism a major threat to its security, which in fact means the Chechen problem. These documents were the *National Security Concept* (January 2000), *Military Doctrine* (April 2000) and the *Foreign Policy Concept* of June 2000. The new National Security Concept signed by President Putin on January 2000 and provided a serious shift of understanding the security in Russia. First of all, the sum of threats and risks to Russia's national security reached its highest point after the dissolution of the USSR. Secondly, all spheres of life were viewed as a part of the security. The difference between the former national security concepts is the list of external threat.<sup>120</sup>

Important points of the 2000 National Security Concept;<sup>121</sup>

- i. The striving individual states and inner-state associations to lower the role of the existing mechanisms of ensuring international security, above all the UN and the OSCE;
- ii. The danger of weakening the political, economic and military influence of Russia in the world;
- iii. The strengthening of military-political blocs and unions, above all the eastward enlargement of NATO
- iv. The possible appearance of foreign military bases and large military contingents in direct proximity to the Russian borders;
- v. The proliferation of mass destruction weapons and their delivery vehicles;
- vi. The weakening of the integration processes in the CIS;
- vii. The appearance and escalation of conflicts close to the state borders of the Russian Federation and the external borders of countries members of the CIS;

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<sup>119</sup> Russian National Security Blue Print

Available on site <http://www.fas.org/nuke/guide/russia/doctrine/blueprint.html>  
(Accesses on 21 June 2008)

<sup>120</sup> LOMAGIN, p.267

<sup>121</sup> National Security Concept of the Russian Federation

Available on site <http://www.fas.org/nuke/guide/russia/doctrine/gazete012400.htm>  
(Accesses on 21 June 2008)

- viii. The claims to the territory of the Russian Federation.

The new list of external threats shows that Kremlin identifies the “Other”. As well as accepting the enlargement of NATO as a threat, both USA and West becomes the “Other”.<sup>122</sup> Another important point is the declaration of the importance of the integration process in the CIS. However, some of points has challenged after the unexpected September 11.

The significance of both these documents (1997 and 2000 National Security Concept) was that they highlighted Russia’s security dilemma as an important issue as Russia moved on from its earlier threat perceptions and identified several new sources of threat, by mentioning that “many actions will pose not only potential challenges but also actual threats to Moscow’s security.”<sup>123</sup> In many respects the 2000 version can be accepted as a copy of the original 1997 document, only modifications reflect the experiences and conclusions of the two years and separating the two texts. In these two years, Russia went through tribulations which obviously led to a rethinking and redefinition of Russia's place in the world and the strategies for ensuring the country’s security. The main events which affected Russian thinking on security in these two years were:<sup>124</sup>

- i. The enlargement of NATO, interpreted by the Russian leadership as a geopolitical setback for Russia.
- ii. The 1998 economic collapse in Russia, which revealed the weakness of Russian economy, its exposure to global trends and to a certain extent its dependence on Western financial institutions.
- iii. NATO’s intervention in Kosovo, which was interpreted that only as an unjustified assault on an historical Balkan ally, but also as a sign of a new emerging international order which the traditional idea of sovereignty could be suppressed in defense of human rights.

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<sup>122</sup> Blank, Stephen J. (2000) “Threats to Russian Security: The View From Moscow”, p.12; “...These documents’ threat assessments also portray the United States and NATO as threats in and of themselves”. [www.strategicstudiesinstitute.army.mil](http://www.strategicstudiesinstitute.army.mil) (Accessed July 2008).

<sup>123</sup> Amina AFZAL: (2005) “Russian Security Policy”, *Strategic Studies*, [http://www.issi.org.pk/journal/2005\\_files/no\\_1/article/4a.htm](http://www.issi.org.pk/journal/2005_files/no_1/article/4a.htm) (Accessed 07 July 2008).

<sup>124</sup> GODZIMIRSKI, p.78, LOMAGIN, p.266, BLANK, p.3

- iv. Russia's armed intervention in Chechnya, which directly resulted in the restoration of confidence of the Russian army and in the allocation of new funding for the military and the military – industrial complex.

As a disappointment example, when the Kosovo conflict emerged in the international agenda, Army General Makhmut Gareyev stated that NATO's strategy, following the security policy of the US, was no longer directed at defensive but pre-emptive use of force, including the possibility of deploying outside the territory of the alliance's treaty, the emphasis being more on the use of military force rather than diplomatic.<sup>125</sup> For that reason, while NSC 1997 was relatively optimistic with regard to the country's international situation in all its assessments, the description of Russia's international and domestic situation in NSC 2000 is more pessimistic.<sup>126</sup>

### 3.5. 2000 Military Doctrine

The Military Doctrine, which Russian President Vladimir Putin approved on 21 April 2000, is the conclusion of several years of work and countless revisions. This long-awaited document, which was assured several times since early 1997, replaced the earlier document "Main Provisions of the Military Doctrine," which Boris Yeltsin approved in November 1993.<sup>127</sup> In Military Doctrine of 2000, there is an important development concerning the nuclear weapons, written that "The Russian Federation for itself the right to use nuclear weapons in response to the *use of nuclear* and other kinds of *weapons of mass destruction* against it and its allies, and in response to wide-scale aggression using weapons in situations critical to the national security of the Russian Federation and its allies".<sup>128</sup>

The new Doctrine details the provisions concerning to the limited use of nuclear weapons that were set out four months earlier in the National Security Concept and in this regard marks a qualitatively new stage in the development of Russian nuclear doctrine. The first post-Soviet

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<sup>125</sup> BLANK, p.3

<sup>126</sup> GODZIMIRSKI, p.84

<sup>127</sup> Nikolai SOKOV: July 2004 "Russia's 2000 Military Doctrine", <http://www.nti.org/db/nisprofs/over/doctrine.htm> (Accesses on 20 June 2008)

<sup>128</sup> Draft Russian Military Doctrine

Available on site <http://www.fas.org/nuke/guide/russia/doctrine/991009-draft-doctrine.htm> (Accesses on 21 June 2008), Asem Nauşabay HEKİMOĞLU: (2007) "*Rusya'nın Dış Politikası I, ABD, AB, Çin, Hindistan, Orta Asya*", Vadi Yay., p.83

improvement in nuclear policy was recognized in the 1993 Doctrine, which permits the first use of nuclear weapons. (Until then, the official Soviet policy, which was set in the 1970s and confirmed in 1982, allowed for the use of nuclear weapons only in response to a nuclear attack.) Nevertheless, previous document assigned only one mission to the nuclear weapon: deterrence of a significant attack that threatened the sovereignty and the survival of the country.<sup>129</sup>

In the 1993 Military Doctrine, for the first time attention was given to internal conflicts, most likely as a result of internal conflicts in CIS states. on the other hand, the 2000 Military Doctrine signed by President Putin was opposed to West and the consequences of the second Chechen war. Haas underlines that in the 2000 Doctrine “allies” were left out of the text. Russia has considered Serbia as its ally due to reason of the Kosovo air campaign of the NATO in 1999 and left “allies” out. Therefore by the early years of the 2000s, according to Kremlin, the weakening of the mechanism of international security considered to be major destabilizing factor.<sup>130</sup>

### 3.6. Putin’s Millennium Speech

On 29 December 1999, Prime Minister Putin made the speech of “Russia at the turn of the Millennium-Millennium Speech”, and later in order to send an open letters to voters, published on 25 February 2000. The declaration gives a picture of the principal directions of and priority areas for the future President.<sup>131</sup> One of the important aspect of that Putin has underlined in the document was; “Russia's westernization must be a westernization of Russia's own choosing and carried out in Russia's own way which is generally called as the “Third way”.<sup>132</sup>

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<sup>129</sup> SOKOV: (2004).

<sup>130</sup> Marcel HAAS: (2004) *Russian Security and Air Power, 1999-2002*, Routledge, p.46-51.

<sup>131</sup> K.P. NALECZ: (2006) “Counter-Reforms in Times of Prosperity”, *Centre for Eastern Studies*, Warsaw, September, p.27 Available on site [http://www.osw.waw.pl/sites/default/files/PUNKT\\_WIDZENIA\\_12.pdf](http://www.osw.waw.pl/sites/default/files/PUNKT_WIDZENIA_12.pdf) (Accessed on 02 January 2011)

<sup>132</sup> Inver B. NEUMANN: (2005) “Russia As a Great Power”, in Hendskog, Jakob, Konnander, Vilhelm, Nygren, Bertil, Oldberg, Ingnor, and Pursiainen, Christer (ed.) “*Russia as a Great Power, Dimesions of Security Under Putin*”, BASEES, Routledge Series on Russian and East European Studies, USA and Canada, p.14; “...the main thing is that Soviet power did not let the country develop a flourishing society which could develop dynamically, with free people. First and foremost, the ideological approach to the economy caused our country to lag increasingly behind the developed states. It is bitter to admit that for almost seven decades we traveled down a blind alley, which took us away from the main track of civilization... the experience of the 1990s vividly shows that genuine and efficient revival of our Fatherland cannot be brought about a Russian soil simply by dint of abstract models and schemata extracted from foreign textbooks. Mechanically copying the experiences of other states will not bring progress. Every country, Russia included, has a duty to search for its own path of renewal. We still have not made much

“...Moreover, “Russia was and will remain a great power. It is preconditioned by the inseparable characteristics of its geopolitical, economic and cultural existence.”<sup>133</sup>

Important points behind the speech were: restoring order under a strong state; overcoming Russia's backwardness through a market economy; and reviving a sense of nationhood in post-Soviet Russia. Which also means that Putin will give primacy internal policy over external policy; pursuing national, particularly economic, interest in foreign policy; achieving integration into the world economy, in particular the WTO; and emphasizing Russia's European destiny.<sup>134</sup> On searching the “Third Way”, he stated that “...We can hope for the future if we can organically synthesize the universal principles of market economy and democracy with the Russian reality.”<sup>135</sup>

### **3.7. Foreign Policy Concept of 2000**

The elements of the Foreign Policy Document of 2000 positions Russian foreign policy in contrast to its historical pattern is the use made of multilateral institutions. The document also poses institutions, particularly UN Security Council, as a constructive alternative to a unipolar world in which US power created hegemony.<sup>136</sup> Important points of Foreign Policy Concept of 2000;<sup>137</sup>

“...New challenges and threats to the national interests of Russia are emerging in the international sphere. There is a growing trend towards the establishment of a unipolar structure

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headway...Society has been in a state of schism...Russia will not soon, if ever, become a replica of, say, the United States or Great Britain, where liberal values have deep-seated traditions. For us, the state, with its institutions and structures, has always played an exclusively important role in the life of the country and its people. For the Russian, a strong state is not an anomaly, not something with which he has a struggle, but, on the contrary, a source and a guarantee of order, as well as the initiator and main moving force of any change. Contemporary Russian security does not a mistake a strong and effective state for a totalitarian one.”

<sup>133</sup> Richard SAKWA: (2004b) “*Putin: Russia’s Choice*”, Routledge, p.257.

<sup>134</sup> Martin NICHOLSON: (2001) “Putin’s Russia: Slowing the Pendulum Without Stopping the Clock”, *International Affairs*, Vol.77, No.4, p.870-71

<sup>135</sup> Sergei PROZOROV: (2004) “Russian Conservation in the Putin Presidency: The Dispersion of a Hegemonic Discourse”, *DIIS Working Paper*, 2004/20, p.9

<sup>136</sup> Robert LEGWOLD: (2007) *Russian Foreign Policy in the Twenty-First Century and the Shadow of the Past*, Columbia University Press, p.319.

<sup>137</sup> The Foreign Policy of the Russian Federation

Available on site <http://www.fas.org/nuke/guide/russia/doctrine/econcept.htm>

(Accesses on 02 May 2008)

of the world with the economic and power domination of the United States. In solving principal questions of international security, the states are being placed on Western institutions and forums of limited composition, and on weakening the role of the UN Security Council.”

“...Russia shall seek to achieve a *multipolar system* of international relations that really reflects the diversity of the modern world with its great variety of interests”.

“...NATO’s present-day political and military guidelines do not coincide with security interests of the Russian Federation and occasionally direct contradict them. This primarily concerns the provisions of NATO’s new strategic concept, which do not exclude the conduct of use-of-force operations outside of the zone of application of the Washington Treaty without the sanction of the UN Security Council. Russia retains its negative attitude towards the expansion of NATO.”

In the Foreign Policy Concept of 2000, Russia for the first time has made an open claim to the need to dominate its neighbors which means the former republics. The Foreign Policy Concept adopted by presidential decree on June 28, 2000, calls for the establishment of a belt of good neighbors around Russia's perimeter. As “the strongest Eurasian power,” Russia asserts in the Concept that “the [U.S.] strategy of unilateral action may destabilize the world, because the use of force represents the basis for international conflict.”<sup>138</sup> As a result, President Vladimir Putin declared that Kremlin will not accept the hegemonic power in the international order.

### **3.8. Foreign Policy Concept of 2008**

On 12 July 2008 President Medvedev signed a new edition of Foreign Policy concept. The new document described Russia as a great power with a full-fledged role in global affairs. Regarding to Euro-Atlantic security, document says Moscow’s desire to create a different regional collective security and cooperation system than the West has. Moreover, document rejects further expansion of NATO, especially concerning Ukraine and Georgia which means NATO in Black Sea. And finally it emphasized the Moscow’s opposition to the planned US missile shield

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<sup>138</sup> Ariel COHEN: (2007) “Domestic Factors During Russia’s Foreign Policy”, *Executive Summary Backgrounder*, Heritage Foundation Pub., No.2984, <http://www.heritage.org/research/reports/2007/11/domestic-factors-driving-russias-foreign-policy> (accessed July 2008),.

in Europe.<sup>139</sup> Kosyrev believes that the old concept covered a very limited range of challenges, whereas the new one spotlights the current task of forming a new world order.<sup>140</sup>

“The need for the international community to develop a common vision of our era is becoming ever more urgent, which could only be achieved through open and honest substantive discussions of the problems confronting the mankind. What is needed is to provide favorable conditions for scientists to carry out their professional work with a view to establishing the historical truth and preventing historical issues from becoming an instrument of practical policy.”<sup>141</sup>

“Russia will continue to seek the strengthening of principles of multilateralism in international affairs, development of an architecture of international relations that would be based on the recognition by the international community of the principles of security indivisibility in the modern world and would reflect its diversity.”<sup>142</sup>

### **3.9. National Security Strategy of Russian Federation Until 2020**

On 12 May 2009 Medvedev signed a decree approving the “National Security Strategy of the Russian Federation until 2020”. The document replaced the previous one and includes the developments in international security, national interests, priorities and threats, ensuring national security in the field of military security and defense, social security, the welfare of citizens, the economy, science-technology-education, healthcare, culture and the environment.<sup>143</sup> The most important phrase of the document underlines the Russia's ability to defend its national security depended above all on the country's economic potential. And another important point is the protection of Russian citizens in near abroad. As a key object in the evolving multipolar system of international relations, Russia aims to play a dominant role together with the CIS, China and other great powers. Finally document assigns a high priority to economic development and support the idea that only an increase in economic output will give Russia the means to substitute its claim to great power status.<sup>144</sup>

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<sup>139</sup> Marcel DE HAAS: (2009) “Medvedev's Security Policy: A Provisional Assessment”, *Russian Analytical Digest*, No.62, 18 June, p.2.

<sup>140</sup> Dmitry KOSYREV: (2008) Foreign Policy: Medvedev Taking Inventory”, RIA Novosti, 15 June <http://en.rian.ru/analysis/20080715/114049494.html> (Accessed on 05 February 2011).

<sup>141</sup> The Foreign Policy Concept of the Russian Federation (2008) Available on site <http://www.mid.ru/ns-osndoc.nsf/0e9272bfa34209743256c630042d1aa/cef95560654d4ca5c32574960036cddb?OpenDocument> (Accessed on 05 February 2011)

<sup>142</sup> Ibid.

<sup>143</sup> DE HAAS, p.3

<sup>144</sup> Berlin SCHRÖDER: (2009) “Russia's National Security Strategy to 2020”, *Russian Analytical Digest*, No.62, 18 June, p.6.

Article 6 of the document describes the basic concepts;<sup>145</sup>

“[National Security] – the state of security for the individual, society and state from internal and external threats, which allows for constitutional rights, freedoms, decent quality and standard of living citizens, sovereignty, territorial integrity and sustainable development of the Russian Federation, the state defense and security;”

### **3.10. 2010 Military Doctrine**

The new doctrine was published on February 5, 2010, composed of four chapters: general provisions; military dangers and military threats to the Russian Federation; military policy of the Russian Federation; and military-economic support for defense. According to Haas;

“Russian national interests were designed in the document as; first, the desire to expand the circle of partner states on the basis of common interests, second, for the participation of the interests of Russia and its citizens and maintaining international peace and security, formations of the Russian Federation Armed forces might be used operationally outside Russia (as in Georgia), and third, the creation and training of special formations and armed forces and other troops for use in the interests of Russia's economy.”<sup>146</sup>

Chapter two of the Document underlines the military dangers and military threats to the Russian Federation;<sup>147</sup>

- i. World development at the present stage is characterized by a weakening of ideological confrontation, a lowering of the level of economic, political, and military influence of certain states (groups of states) and alliances and an increase in the influence of other states with ambitions for all-embracing domination, multipolarity, and the globalization of diverse processes.

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<sup>145</sup> The National Security of the Russian Federation Until 2020 (2009) Available on site <http://www.scrf.gov.ru/documents/99.html> (Accessed on 05 February 2011)

<sup>146</sup> Marcel DE HAAS: (2010) “Russia's Military Doctrine Development”, in (ed) Stephen J. Blank, “*Russian Military Politics and Russia's 2010 Defense Doctrine*”, Strategic Studies Institute”, March, p.39-42.

<sup>147</sup> The Military Doctrine of the Russian Federation, Approved by Russian Federation Presidential Edict on 5 February 2010, [http://www.sras.org/military\\_doctrine\\_russian\\_federation\\_2010](http://www.sras.org/military_doctrine_russian_federation_2010)

- ii. Many regional conflicts remain unresolved. There is a continuing tendency toward a strong-arm resolution of these conflicts, including in regions bordering on the Russian Federation. The existing international security architecture (system), including its international-legal mechanisms, does not ensure equal security for all states.
- iii. That said, despite the decline in the likelihood of a large-scale war involving the use of conventional means of attack and nuclear weapons being unleashed against the Russian Federation, in a number of areas military dangers to the Russian Federation are intensifying.

And more importantly Article 8 states the main external military dangers for Russia;<sup>148</sup>

- a) the desire to endow the force potential of the North Atlantic Treaty Organization (NATO) with global functions carried out in violation of the norms of international law and to move the military infrastructure of NATO member countries closer to the borders of the Russian Federation, including by expanding the bloc;
- b) the attempts to destabilize the situation in individual states and regions and to undermine strategic stability;
- c) the deployment (buildup) of troop contingents of foreign states (groups of states) on the territories of states contiguous with the Russian Federation and its allies and also in adjacent waters;
- d) the creation and deployment of strategic missile defense systems undermining global stability and violating the established correlation of forces in the nuclear-missile sphere, and also the militarization of outer space and the deployment of strategic nonnuclear precision weapon systems;
- e) territorial claims against the Russian Federation and its allies and interference in their internal affairs;
- f) the proliferation of weapons of mass destruction, missiles, and missile technologies, and the increase in the number of states possessing nuclear weapons;

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<sup>148</sup> Ibid.

- g) the violation of international accords by individual states, and also noncompliance with previously concluded international treaties in the field of arms limitation and reduction;
- h) the use of military force on the territories of states contiguous with the Russian Federation in violation of the UN Charter and other norms of international law;
- i) the presence (emergence) of seats of armed conflict and the escalation of such conflicts on the territories of states contiguous with the Russian Federation and its allies;
- j) the spread of international terrorism;
- k) the emergence of seats of interethnic (interfaith) tension, the activity of international armed radical groupings in areas adjacent to the state border of the Russian Federation and the borders of its allies, the presence of territorial contradictions and the growth of separatism and violent (religious) extremism in individual parts of the world.

#### **4. PERSPECTIVES OF RUSSIAN FOREIGN POLICY**

Russia had existed in the 18<sup>th</sup> and 19<sup>th</sup> century as Russian empire, and then as USSR in the 20<sup>th</sup> century and finally survives as Russian Federation in the 21<sup>st</sup> century. In this sense, it was aimed to give a brief foreign policy turning points and different approaches of the USSR period in order to enlighten contemporary foreign policy approach of Russia. Today's ruling elite of Russia has born in USSR and experienced a different kind of adolescence than what they are trying to structure now. In other words, first Russian Federation born President will have to wait for at least two decades to be elected.

##### **4.1. Russian Foreign Policy During USSR**

According to former official of Soviet Union, all diplomatic activities were based on a Marxist-Leninist evaluation of the world situation, understanding the laws of social development in combination with concrete knowledge of particular countries as well as understanding their historical and national characteristics.<sup>149</sup> Therefore the language of policy and decision was ideological in Soviet Union. In terms of the decision making process, Politburo was the main

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<sup>149</sup> Richard Felix STAAR: (1991) *Foreign Policies of the Soviet Union*, Hoover Press, p.69; (N.I. Lebedev).

actor for the Soviet foreign policy and Ministry of Foreign Affairs was responsible of the implementation of the decisions taken by Politburo. The Politburo was the group of dozen or top leaders elected by the Communist Party Central Committee (several hundred members) to control and manage affairs of the party and government. And the Central Committee also had its own apparatus devoted to international affairs that was International Department.<sup>150</sup>

The Soviet Union was established in December 1922 by the leaders of the Russian Communist Party who were known as Bolsheviks after the revolutions against Tsarist Russia. Although it has lost some lands due to the World War I, it was still an enormous multinational country which was located in Europe and Asia. The main characteristic of Soviet foreign policy was its differentiation. Soviet Union was ruled by five leaders and their personal control over foreign policy from 1922 to 1991; V. I. Lenin's (1917-24) "dual task – dual policy", Joseph V. Stalin's (1922-53) "socialism in one country", Nikita S. Khrushchev's (1953-64) reinterpretation of "peaceful coexistence", Leonid I. Brezhnev's (1964-82) "détente", and Mikhail S. Gorbachev's (1985-91) "new political thinking".<sup>151</sup> "The Soviet leadership has always sought national security, economic growth, and political stability at home; dissemination of its ideology and social institutions abroad; territorial expansion, and increased influence over non-Communist governments and parties, ruling and non-ruling Communist parties, and revolutionary movements."<sup>152</sup>

At the beginning of the young Soviet state history, Lenin seemed a practical leader and convinced that socialist revolution would not break out in other countries in the near future. Moreover, he realized that Soviet Union required normal relations with the Western world for its survive.<sup>153</sup> Therefore, Lenin introduced a series of legal and political reforms to attract Western businessmen and to facilitate Russia's recovery.<sup>154</sup> Lenin's formalized his foreign policy according to decisive convictions: that World War I was an imperialist war and that a socialist revolution in one and more advanced industrialized countries was necessary for the survival of the Bolshevik government. As a result of these points, Russia withdrew from the war and linked

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<sup>150</sup> Geoffrey K. ROBERTS: (1999) *The Soviet Union in World Politics: Coexistence, Revolution, and Cold War, 1945-1991*, Routledge, p.10-11.

<sup>151</sup> Eric P. HOFFMANN: (1991) "Soviet Foreign Policy Aims and Accomplishments From Lenin to Brezhnev", in (ed) Frederic J. Fleron Jr., Eric P. Hoffmann and Rabbin F. Laird, *Classic Issues in Soviet Foreign Policy – From Lenin to Brezhnev*, Walter de Gruyter Inc., p.49.

<sup>152</sup> Ibid, p.50.

<sup>153</sup> Glenn E. CURTIS: (1998) *Russia: A Country Study*, Federal Research Division, p.69.

<sup>154</sup> Gabriel GORODETSKY: (1994) *Soviet Foreign Policy, 1917-1991: A Retrospective*, Routledge, p.12.

its “national interests” with expanding revolutionary activity abroad.<sup>155</sup> It was an element of Soviet dual policy because when the Treaty of Rapallo signed in 1922, Soviet side promised to reduce Comintern activities in Germany; however, in the summer of 1923, Moscow began to financially support German communists.<sup>156</sup>

When Stalin rose to power after Lenin’s death, he began to dictate his own foreign policy motives. Hence, Soviet foreign policy concentrated on strengthening its power and defense system against foreign dangers as well as Nazi Germany in West and Japan in the East. Stalin’s foreign policy goals between 1931-39 were; 1) stay out of war 2) alliance with the winning side, if it erupted 3) avoidance of simultaneous various by Germany in Europe and by Japan in Asia 4) avoidance of any battles fought on Soviet territory 5) territorial expansion 6) support of Communist takeovers in other countries. Therefore, Stalin tried to postpone the German attack and to generate preparation time for the armed forces.<sup>157</sup> At the end of the World War II, Soviet Union revealed as one of the world’s two great military powers, and by the early 1950s, there were numerous countries ruled by Communist governments from Adriatic to Pacific Ocean. Stalin realized the importance of the oil during the World War II and the development of oil field in Iran became his priority, along with the development of Soviet oil reserves beyond the Urals, as oart of the Soviet Union’s postwar economic plans.<sup>158</sup> The era from 1947 until the dissolution of Soviet Union in 1991 called “the Cold War to describe the international tensions between the Soviet Union and the major Western countries such as US.<sup>159</sup>

According to Khrushchev, Stalin had deviated from Leninism and confirms a Soviet commitment to “peaceful coexistence” with capitalism. Khrushchev wanted peaceful coexistence with the West, not only to avoid nuclear war but to permit the Soviet Union to develop its economy.<sup>160</sup> Khrushchev declared that the balance of forces in the international arena had shifted as a result of the transition from “socialism in one country” to a powerful socialist world system. Khrushchev designed the major task of Soviet foreign policy as; pursuing a policy of peaceful coexistence, building stronger relations among the socialist states, strengthening friendship and

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<sup>155</sup> Walter G. MOSS: (1997) *A History of Russia – Volume II: Since 1855*, McGraw Hill Pub., p.268.

<sup>156</sup> HOFFMANN, p.53.

<sup>157</sup> Ibid, p.55.

<sup>158</sup> Vladislav M. ZUBOK: (2007) *A Failed Empire: the Soviet Union in the Cold War From Stalin to Gorbachev*, Uni. Of North Carolina Press, p.41.

<sup>159</sup> MOSS, p.268.

<sup>160</sup> CURTIS, p.89.

cooperation with neutralist and peace-loving states is Europe and the Third World, pursuing closer relations with the US and its allies, and finally strengthening the USSR's defense potential and exposing the activities of the enemies of peace.<sup>161</sup>

Brezhnev's major concern was to reestablish Soviet primacy in the community of communist states by undermining the influence of China. The new Brezhnev leadership sought to define the boundaries of an independent policy within the socialist alliance on the basis of ideological orthodoxy.<sup>162</sup> The period is called *détente* which determines the relaxation of tensions between the United States and Soviet Union.<sup>163</sup> In some respect *détente* was continuation of Khrushchev's policy, however it was differed in two ways. First *détente* was more comprehensive and wide-ranging in its aims. Second, it was based on essential military equivalence between the two superpowers. In addition to that during Brezhnev's term in Kremlin, the number of troops rose to 5 million as well as enhancing its air and naval capabilities as a result of the oil incomes.<sup>164</sup> When Brezhnev was at power, during the years between 1973-81 the world witnessed with the escalation of energy prices. And finally with the expanding petroleum production made the USSR (1974) the world's largest oil producer. However, poor farming weather in 1985-87, the Chernobyl disaster of 1986, and the Armenian earthquake all hurt the Russian economy. Due to reason that the USSR was the world's largest oil producer, declining world petroleum prices worsened the economic problems and produced large budget deficits.<sup>165</sup>

"New thinking" was Gorbachev's slogan for a foreign policy based on shared and ethical principles to solve global problems rather than an Marxist-Leninist concepts of irreconcilable conflict between capitalism and communism.<sup>166</sup> According to Sestanovich, the idea of "new thinking" included: a devaluation of ideological precepts, a more satisfied assessment of outside threats, a re-examination of national interests and a heavier stress on global common interests, a cop on resource commitments, a search for less expensive policy instruments, a more flexible

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<sup>161</sup> Robert H. DONALDSON AND Joseph L. NOGEE: (2009) *The Foreign Policy of Russia: Changing Systems, Enduring Interests*, M.A.Sharpe, p.75.

<sup>162</sup> Matthew J. OUINET: (2009) *The Rise and Fall of the Brezhnev Doctrine in Soviet Foreign Policy*, UNC Press Books, p.9.

<sup>163</sup> CURTIS, p.93-95.

<sup>164</sup> Mike BAWKER: (2002)"Brezhnev and Superpower Relations", in (ed.) Edwin Bacon and Mark Sandle, *Brezhnev Reconsidered*, Palgrave Macmillian, p.90-91.

<sup>165</sup> MOSS, p.420.

<sup>166</sup> CURTIS,, p.103.

and less demanding stance in negotiations...etc.<sup>167</sup> Tsygankov argues that the policy of “new thinking” has failed because “new thinking” did little to improve living standards at home, and it did not result in the expected active participation of the West in reforming the bureaucratic economy. Furthermore, as a result of the collapsing economy, Gorbachev was increasingly perceived abroad as weak and unable to sustain his foreign policy course.<sup>168</sup>

#### **4.2. From Dissolution to the First President of Russian Federation**

During the Cold War, Soviet foreign policy was highly centralized and hierarchical. The Central Committee of the Communist Party was in charge of foreign policy. The collapse of the Soviet Union created an entirely new situation. The Russian political elite were not only forced to develop a new “Russian” foreign policy but also to create new institutions to carry out that policy.<sup>169</sup> Before the dissolution of the Soviet Union, both social and economic situation was going under crisis. In terms of the economic problems, the decline had begun under Gorbachev. Despite the fact that he intended to reform the state with the new policies of perestroika and glasnost (Restructuring and Openness), could not stop the declining trend. Inflation continued to increase and reached an annual rate of over 2,000%. After the demise of the Soviet Union, the state was no longer an empire because it had withdrawn almost to the frontiers of 1700 in Asia and of 1600 in Europe, and its population was now no more than 150 million. Boris Yeltsin appeared to restore and rebuild the country according to a new model.<sup>170</sup> According to Rasizade, the fundamental difference between the civil wars in the Russian Empire and the quiet demise of the USSR was the issue of property. In the 1917-1922 civil war Russia's ruling class was defending its concrete property. When Yeltsin was destroying the Soviet Union and his *nomenklatura* (the ruling elite) was privatizing the state assets, because nobody had the same concern for the communist state and no personal asset.<sup>171</sup>

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<sup>167</sup> Stephen Sestanovich: (2009) “Gorbachev’s Foreign Policy: A Diplomacy of Decline?”, in (ed.) Frederic J. Floron Jr., Eric P. Hoffmann and Rabbin F. Laird, *Contemporary Issues in Soviet Foreign Policy – From Brezhnev to Gorbachev*, Transaction Publishers, pp.574-93, p.577-78.

<sup>168</sup> Andrei P. TSYGANKOV: (2010) *Russia's Foreign Policy: Change and Continuity in National Identity*, Rowman&Littlerfield, p.50-51.

<sup>169</sup> Stephen F. LARRABEE and Theodore W. KARASIK: (1997) “Foreign and Security Policy Decision Making Under Yeltsin”, *RAND* p.1

<sup>170</sup> Philip LONGWORTH: (2006) *Russia – The Once and Future Empire from Pre-History to Putin*, St. Martin’s Press, New York, p.302

<sup>171</sup> Alec RASIZADE: (2008) “Putin’s Mission in the Russian Thermidor”, *Communist and Post-Communist Studies*, 41, p.15

When the Soviet Union collapsed, crowds were on the streets of Moscow and St. Petersburg to greet the new era. They would be ruled by democracy instead of tsars and commissars, and join the global economy.<sup>172</sup> The Russia that emerged as “the continue state of the former Soviet Union inherited a society disarray, a demoralized, dispirited people, and a deteriorating, quasi-anarchical economy and political system.<sup>173</sup> On June 1991, Yeltsin became President of Russia for the first time in history that a ruler chosen by a popular vote. However, Russia was still operating under the old Soviet constitution which did not mark a clear division in the balance of powers between the legislative and executive branches of government. On 21 September Yeltsin announced that he was dissolving parliament.<sup>174</sup>

The Supreme Court declared that it was illegal, and demonstrators, some of them armed, gathered in the parliament building. Yeltsin had won the struggle and a constitution which increased Yeltsin’s powers as president was imposed.<sup>175</sup> The final schedule of organizations and candidates contesting the election was determined on November 12. This allowed Yeltsin one month for the actual campaign.<sup>176</sup> After the December 1993 election Duma remained dominated by those who opposed Yeltsin’s radical reforms and the government’s early liberal Westernist foreign policy.<sup>177</sup> Adranik Migranyan a member of Yeltsin’s Presidential Council termed the results of the previous three years of Russian foreign policy as “catastrophic”.<sup>178</sup>

In December 1993 President Yeltsin approved a new coat of arms for Russia. Therefore Russia recognized the form of a Byzantine eagle with two heads surmounted by three crowns. It might seem interesting that Yeltsin, who had played a key role in dissolving the Soviet Union, should have adopted this imperial symbolism for the new Russia.<sup>179</sup> After the failed coup of August

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<sup>172</sup> LONGWORTH, p.301

<sup>173</sup> Alvin Z. RUBINSTEIN: (1997) “The Transformation of Russian Foreign Policy”, in Karen Dawisha (ed.) “*The International Dimension of Post-Communist Transitions in Russia and the New States of Eurasia*”, M. E. Sharpe, p.33

<sup>174</sup> Robert VINCENT: (1998) *Russia’s Transformation: Snapshots of a Crumbling System*, Rowman & Littlefield Pub, p.183

<sup>175</sup> LONGWORTH, p.305

<sup>176</sup> Jerry F. HAUGH, Evelyn DAVIDHEISER, and Susan Goodrich LEHMANN: (1996) “The 1996 Russian Presidential Election”, *Brookings Occasional Papers*, Washington D.C., p.27

<sup>177</sup> JACKSON, p.52-4

<sup>178</sup> LARRABEE and KARASIK, p.2

<sup>179</sup> LONGWORTH, p.304-5; “Between the dates of January 1992 (beginning of the market economy) and June 1994, the death rate in Russia rose over 30%.”

1991, Yeltsin had first formulated and pursued the idea of Westernizing without the republics as a matter of international strategy. The idea had three key components.

First, Yeltsin and Kozyrev advocated a strategy of radical economic reform, which is so-called “shock therapy”, that Russia's transition to a Western-style system would be both fast and irreversible. Second was the joining international organizations and strategy of integration with the West. Since the US and other Western countries were now “natural allies”, Russia should gain a full-scale status in transatlantic economic security institutions, such as the EU, NATO, IMF, G-7, and so on. Finally the new foreign policy assumed that Russia's integration with the West would take priority over the relationship with the ex-Soviet republics.<sup>180</sup>

American free-market theory provided the framework of the new way of the Russian economy and *shock therapy* was given as a name. On 2 January 1992, the day after Russia began its separate existence, most prices were freed from state controls – though those for oil and other national resources were kept so low that vast quantities were sold on abroad for profit. To make the new, higher, prices in the shops more affordable wages were raised, which meant further increases in the money supply. As a result of the urgent financial needs, auctions of state enterprises took place. However, which huge enterprises would go to whom and at what prices was to a great extent determined by a small group of officials and businessmen in advance of the auctions, and the auction process was disputable.<sup>181</sup> According to Yeltsin, the economic basis for statehood had to be sought through land reform, privatization and the market and said that: “We have defended political reform? Now we have to give economic freedom”.<sup>182</sup>

#### **4.3. Andrei Kozyrev as Foreign Minister**

During the Kozyrev's Foreign Ministry period, who is known as Westernist, the political opposition did not organize and develop foreign policy positions. The liberal capitalist model was advocated by politicians such as Prime Minister Yegor Gaidar (15 June 1992) and Anatoly Chubais (Chief of Privatization 1 November 1991) who considered the Russia's economic interests should be centered on the West. Westernist politicians most supported the idea of Russians to abandon the old Soviet belief of a hostile West and reject the idea of Russian moral on cultural superiority, and instead to join the new global economy and benefit from Western

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<sup>180</sup> TSYGANKOV: (2005b), p.16-7

<sup>181</sup> LONGWORTH, p.306

<sup>182</sup> Richard SAKWA: (1996) “*Russian Politics and Society*”, Second Edition, Routledge, p.39

investors and international financial institutions.<sup>183</sup> As a Westernist, Kozyrev was a radical supporter of Gorbachev's "new thinking" in foreign policy, which promoted international co-operation and interdependence instead of confrontation with capitalism.<sup>184</sup> Moreover, Kozyrev also hoped to join organizations such as the IMF, GATT, to make the G-7 the G-8, and to win from the West large amounts of aid, investment and market access.<sup>185</sup>

Kozyrev wrote in *Izvestia* that the Russian foreign policy must be based on "common sense". This meant the rejection of "messianic ideas" and their replacement by "practical concerns about the spiritual and material revival of Russia as a democratic state".<sup>186</sup> Kozyrev states that "Our aim is to become a full member of the international community, and to be viewed as a democratic, peace-loving state that poses a threat neither to its own citizens nor to other countries".<sup>187</sup> Therefore, Russia's task was not to serve as some mythical "bridge" but "to join in the process of synthesis between Europe and Asia that was already going on".<sup>188</sup> While Kozyrev himself maintained that Russia's interests lay in patiently seeking co-ordination within the CIS, including a common army and an interconnected economy, pro-Western analysts advised that the "the CIS should be seen as a temporary institution, the main aim which to regulate the process of disintegration of the former USSR."<sup>189</sup>

The first opposition among the democrats about the questioning Western orientation of Russian foreign policy was voiced by Sergei Stankevich, who was a former presidential adviser. Stankevich argued that since Russia had already been Europeanized, the extreme Eurasian views of the 19<sup>th</sup> century were no longer applicable. Afterwards Stankevich created an idea of modified Eurasianism maintain a balance of Western and Eastern orientations.<sup>190</sup> Later on in the early 1990s the democrats around Yeltsin tried to avoid discussion of a Russian return to great power

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<sup>183</sup> JACKSON, p.55

<sup>184</sup> DUNCAN, p.8

<sup>185</sup> *Ibid*, p.13

<sup>186</sup> SMOLANSKY, p.10

<sup>187</sup> Alvin Z. RUBINSTEIN: (1997) "The Transformation of Russian Foreign Policy", in Karen Dawisha (ed.) *The International Dimension of Post-Communist Transitions in Russia and the New States of Eurasia*, M. E. Sharpe, p.34

<sup>188</sup> SMOLANSKY, p.11

<sup>189</sup> Margot LIGHT: (1996) "Foreign Policy Thinking", in Neil Malcolm, Alex Pravda, Roy Allison, Margot Light (ed.) *Internal Factors in Russian Foreign Policy*, Clarendon Press, Oxford, p.46

<sup>190</sup> *Ibid*, p.47

status for fear of being criticized for “new imperialism” or “great-power syndrome”.<sup>191</sup> Yet, at the 6<sup>th</sup> Congress of People’s Deputies, the political opposition loudly attacked Yeltsin’s government. They began to criticize the one-sided Westernist foreign policy and proposed various measures to strengthen Russia’s position in international arena.<sup>192</sup>

From the adoption of the November 1993 Military Doctrine to the June 1996 Presidential elections, there was a decline of many liberal Westernist ideas in the foreign policy debates on the constitution of fundamentalist nationalist ideas.<sup>193</sup> It was Kozyrev’s unwillingness to let “national interest” and “security” translate into what came to be known as the “Monroviski” doctrine for the abroad as an exclusive sphere of Russian influence that led to his dismissal as foreign minister.<sup>194</sup> Despite his (Kozyrev) alignment with “pragmatic nationalists”, Kozyrev remained commitment to a constitutive relationship with the West, refusing to accept that the latter remained the threat it had been during the Cold War.<sup>195</sup> The replacement of Andrei Kozyrev by Yevgenii Primakov as Foreign Minister in January 1996 was widely mean as signaling a shift in Russian diplomacy from a Western oriented to a Eurasian-oriented foreign policy.<sup>196</sup>

#### **4.4. Yevgenii Primakov as Foreign Minister and Prime Minister**

According to Tsygankov, there are three factors that why the great power coalition was able to defeat liberal Westernizers: relative status of the great power identity, behavior of the West, and weakness of the new liberal state. The great power identity had powerful historical roots and symbolic memory that goes back to the pre-Soviet eras. The West –“Other”- strengthened the great power coalition by making a decision to expand NATO eastward and excluding Russia from the process.<sup>197</sup> While much of the criticism for the failures of Russian foreign policy was

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<sup>191</sup> Lena JOHNSON: (2004) “*Vladimir Putin and Central Asia, The Shaping of Russian Foreign Policy*”, I.R. Tauris, New York, p.5.

<sup>192</sup> JACKSON, p.60

<sup>193</sup> Ibid, p.69

<sup>194</sup> Mette SKAK: (2005) “The Logic of Foreign and Security Policy Change in Russia”, in Hendskog, Jakob, Konnander, Vilhelm, Nygren, Bertil, Oldberg, Ingnor, and Pursiainen, Christer (ed.) “*Russia as a Great Power, Dimensions of Security Under Putin*”, BASEES, Routledge Series on Russian and East European Studies, USA and Canada, p.84

<sup>195</sup> SAKWA: (1996), p.280

<sup>196</sup> Allen C. LYNCH: (2001) “The Realism of Russian Foreign Policy”, *Europe-Asia Studies*, Vol.53, No.1, p.9

<sup>197</sup> TSYGANKOV: (2005), p.30

directed at former Foreign Minister Andrei Kozyrev, a large part of the problem can be attributed to Yeltsin’s own foreign policy style and the decision making process he established.<sup>198</sup>

Although foreign policy is a presidential the change of ministers inevitably changed the direction of the foreign policy. For many Western scholars, the changing of the Russian trend toward the West began, in advance of Primakov’s rise to Foreign Minister in early 1996.<sup>199</sup> According to Primakov, while seeking to maintain good relations with the West, Russia should re-establish its relations with the East, meaning China, Far East and Middle East. Primakov’s four priority missions for Russian foreign policy were to create the external conditions to strengthen Russia's territorial integrity, to support integrative tendencies within the CIS, the stabilize regional conflicts, and to prevent the spread of weapons of mass destruction.<sup>200</sup> Primakov has argued that;

Russia, like any great power, needs a “*diverse*” foreign policy – one that, in addition to promoting good relations with the US and countries of Europe, also should seek to cultivate strong ties with China, India and Japan, and “the countries of the Near and Middle East”. Primakov insisted that its purpose is to restore a degree of “balance” to Moscow’s policy.<sup>201</sup>

**Table 3: Liberal Democrat and Other Elite Assessment of East-West Relations: US-Russian Security<sup>202</sup>**

<b>Issues</b>	<b>1993</b>	<b>1995</b>	<b>1999</b>
Agreed: US threat to Russian Security	17%	46%	52%
Liberal Democrats	56%	70%	79%
Others			
<b>Very important goal balancing power of the West</b>			
Liberal Democrats	-	37%	58%
Others	-	70%	81%
<b>Great or greatest threats to Russian Security:</b>			
Growth of US military power			

<sup>198</sup> LARRABEE and KARASIK, p.2

<sup>199</sup> Coit D. BLACKER: (1998) “Russia and the West”, in Micheal Mandelbaum (ed.) “*The New Russian Foreign Policy*”, Council on Foreign Relations, p.178

<sup>200</sup> SAKWA: (1996), p.280

<sup>201</sup> BLACKER, p.183

<sup>202</sup> William ZIMMERMAN: (2002) “*The Russian People and Foreign Policy: Russian Elite and Mass Perspectives, 1993-2000*”, Princeton Uni. Press, p.158-159.

Liberal Democrats	10%	40%	49%
Others	48%	78%	82%
<b>NATO expansion in Eastern Europe</b>			
Liberal Democrats	-	58%	52%
Others	-	80%	70%
<b>NATO intervention in international conflicts</b>			
Liberal Democrats	-	-	56%
Others	-	-	77%
<b>Military spending: increase or keep some</b>			
Liberal Democrats	35%	73%	94%
Others	57%	87%	96%

Johnson thinks that it was Yevgenii Primakov (Foreign Minister 1996-1998 and Prime Minister 1998-1999) who turned Russia towards a more pragmatic and low-profile and former Soviet territory in order to narrow the gap between policy declarations and actual capacity, although he was viewed by the West as anti-Westernism and an old-style Soviet thinker in his Western policy.<sup>203</sup> Primakov introduced the name of Alexander Gorchakov into the Russian debate – the tsarist Foreign Minister and who had structured Russian policy after the Russian defeat in the Crimean War and the severe terms of the 1856 Treaty of Paris. It is an important detail because Gorchakov is an historical figure who combined an agenda reform with a long-term foreign policy aim of a return to great power status.<sup>204</sup> Former Foreign Minister Igor Ivanov (1998-2004) also wrote that “Russia's foreign policy should be based on national interest rather than political ideology. This change was inspired by the great Russian diplomat, Chancellor Alexander Gorchakov, who first introduced the notion of Russia's national interests into the foreign policy debates.”<sup>205</sup>

Primakov, with deep roots in the Soviet foreign policy and intelligence bureaucracies, focused on securing for Russia the status of global power within Eurasia. Contrary to liberals (Westernists), Primakov had on several occasions declared that Russia should pay the economic price for reintegrating the old empire, directly or indirectly; great power status did not come cheaply and

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<sup>203</sup> JOHNSON, p.6

<sup>204</sup> Ibid.

<sup>205</sup> I. IVANOV, p.8

was worth the cost.<sup>206</sup> Trenin says that Primakov, who tirelessly promoted the idea of multipolarity, had to manage the consequences of Russia's double devaluation, first of the ruble and of Moscow's international diplomatic and military weight. In a spectacular gesture of protest over the NATO air attack against Yugoslavia, Primakov turned his phone back over the Atlantic.<sup>207</sup> On the other hand, Primakov concentrated on CIS integration in order to restore Moscow's influence in the former USSR; however, former Soviet republics were in favor of acting independent both politically and economically. In addition to that Primakov faced with a Western-oriented coalition of GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova) becoming more consolidated.<sup>208</sup>

Yevgenii Primakov pointed that;

“...in the absence of any active foreign policy, it is difficult, or even impossible for Russia to effect any fundamental domestic transformations or preserve its territorial integrity. Russia is far from indifferent about the manner and capacity in which she enters the world economy: as a mistreated appendage useful as a source of raw materials, or as an equal participant. In many ways, this also relates to the junction of foreign policy.”<sup>209</sup>

Furthermore he wrote in an article that “...The peoples on both sides of the “iron curtain” rid themselves of the policy confrontation by their common efforts. The ‘leaders-and-followers’ mentality will inevitably trigger a drift to a [unipolar world]. The great majority of the world community will today not accept any such model of global order”.<sup>210</sup> He remained the only senior minister on whom Yeltsin and the communist leader Gennady Zyuganov continue to agree.<sup>211</sup>

Boris Berezovksy appointed as deputy secretary of the National Security Council on October 1996, meant that the birth of a new category of institutional actor at the heart of the Russian policymaking. He answered to some question about the NATO's expansion as “I can assure you

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<sup>206</sup> LYNCH, p.9.

<sup>207</sup> Dmitri TRENIN: (2003b) “After the Empire: Russia's Emerging International Identity”, in Gabriel Gorodentsky (ed.) “*Russia Between East and West – Russian Foreign Policy on the Threshold of the Twenty First Century*”, Frank Cass Pub., p.34.

<sup>208</sup> Ibid, p.35.

<sup>209</sup> I. IVANOV, p.14.

<sup>210</sup> Yevgenii PRIMAKOV: (2005) “International Relations on the Eve of the 21<sup>st</sup> Century: Problems and Prospects”, in Andrei Melville and Tatiana Shackleina (ed.) “*Russian Foreign Policy in Transition, Concept and Realities*”, CEU Press, p.209.

<sup>211</sup> ARON, p.29.

that the enlargement of NATO to the East will be more than compensated for the enlargement of Gazprom to the West”.<sup>212</sup> Boris Berezovsky was one of the brains behind then-President Yeltsin’s re-election campaign in 1996, when Yeltsin’s approval rating was in the single digits. His famous interview became as a manifesto to explain what a Oligarch is;

“we, Russia's seven leading businessmen, hired Anatoly Chubais as presidential campaign manager, invested colossal money and ensured Boris Yeltsin’s election. Now, we have the right to join the government, take top posts there and enjoy the fruits of our victory”.<sup>213</sup>

Aron suggests that “as Primakov himself put it in early 1997, his was a “middle course” between the “extremes of Soviet anti-Westernism” and Kozyrev’s pro-Westernism romantic approach.<sup>214</sup> As a decisive moment, in July 1997 Yeltsin approved the profit-sharing decree which allowed foreign investment in several oil, gas, iron, and gold mining sites in exchange for a percentage of the resources extracted in the future. Simultaneously, foreign investors were permitted to bid for up to 25% of major privatized enterprises, with the share of foreign ownership promised to increase in future auctions.<sup>215</sup>

Garnett assumes that without Yeltsin there would have been no NATO – Russian Founding Act.<sup>216</sup> However, Moscow’s hesitation to NATO enlargement in May 1997 came with a renewed statement of its opposition to NATO membership for the Baltic States and any other state of the former USSR.<sup>217</sup> Conversely, while Primakov has proven to be a more skillful Foreign Minister than Kozyrev, he could not succeed to ensure that the Russian government speaks with one voice on foreign policy. The different voices especially appeared over NATO enlargement issue. Alexander Lebed<sup>218</sup> directly challenged Primakov’s direction of foreign policy. As head of the Security Council, Lebed made a number of opposing statements that undercut Primakov’s effort to maintain a clear and consistent line on NATO enlargement.<sup>219</sup>

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<sup>212</sup> Ibid, p.46.

<sup>213</sup> Andrei PIANTKOVSKY: (2003) “A Berezivsky Disappointment”, in Ajay Goyal (ed.), “*Uncovering Russia*”, Norasco Pub., Moscow, p.223.

<sup>214</sup> ARON, p.30.

<sup>215</sup> Ibid, p.45.

<sup>216</sup> Sherman W. GARNETT: (1998) “Europe’s Crossroads: Russia and the West in the New Borderlands”, in Micheal Mandelbaum (ed.) “*The New Russian Foreign Policy*”, Council on Foreign Relations, p.67.

<sup>217</sup> Ibid, p.70

<sup>218</sup> Appointed as Secretary of Russia’s Security Council in 1996.

<sup>219</sup> LARRABEE and KARASIK, p.8

## 5. PERSPECTIVE OF RUSSIAN FOREIGN POLICY FROM PUTIN TO MEDVEDEV

Two days after the article of “Russia at the Turn of the Century” published Yeltsin resigned from Presidency.<sup>220</sup> As Charap stated, when Vladimir Putin was appointed President of the Russian Federation on December 31, 1999, international community was worried about his impressive rising and somewhat nervous about the implications of his career in KGB.<sup>221</sup> Solzhenitsyn<sup>222</sup> who is a significant figure in Russia, commended for Putin that; “he is in many ways a puzzle. We do not know how he will act as president. He stands at cross-roads. Either he can give in to his sponsors and lead the country inevitably to its ruin – and him with it – or he can break with clan loyalty and pursue his own policies”.<sup>223</sup>

Alexander Solzhenitsyn defended the regime of former KGB colonel Vladimir Putin, and actively supported Putin’s assertive foreign policy. Besides that Solzhenitsyn accepted a state prize from Putin, while he rejected similar awards from Putin’s predecessors Mikhail Gorbachev and Boris Yeltsin.<sup>224</sup> Putin’s original strategy rested on the pragmatic goal of fighting for Russia's survival. Ultimately he understood from the very beginning that a serious modernization in every area of the state was needed. Therefore, for Putin, Russia's main strategic goal should be to become a modern great power that would be economically strong, technologically advanced, socially developed and politically influential.<sup>225</sup>

### 5.1. Putin’s First Term

Under Primakov, Russian foreign policy emphasized economic development as a means of providing the state with resources to act independently. The rise of Putin to the presidency in

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<sup>220</sup> Vyocheslov NIKONOV: (2005) “The Putin Strategy”, *Russia in Global Affairs*, Vol.3, No.1, January-March, p.68-9

<sup>221</sup> Samuel CHARAP: (2004), “The Petersburg Experience: Putin’s Political Career and Russian Foreign Policy”, *Problems of Post-Communism*, Vol.51, No.1.

<sup>222</sup> Solzhenitsyn won the Nobel prize in 1970 and then expelled from USSR. He returned to Russia in 1994 and died in 2008.

<sup>223</sup> SAKWA: (2004), p.35

<sup>224</sup> Flemming ROSE: (2007) “*Solzhenitsyn Defends Putin’s Regime*”, Pajamas Media, July 29,

Available on site [http://pajamasmedia.com/flemmingrose/2007/07/29/post\\_4/](http://pajamasmedia.com/flemmingrose/2007/07/29/post_4/) (Accessed on August 2008)

<sup>225</sup> NIKONOV, p.70

January 2000 helped to consolidate this approach to foreign policy into something like a grand strategy.<sup>226</sup> Putin's first priorities were; challenging the power of Russia's oligarchs, invading the increasingly terrorist-ridden Chechnya, tightening internal security, and reining in quarrelling parliamentarians and pursuing economic liberalization.<sup>227</sup>

Putin's millennium article<sup>228</sup> was showing the coming future themes as; restoring order under a strong state; overcoming Russia's backwardness through a market economy; and reviving a sense of nationhood in post-Soviet Russia.<sup>229</sup> Putin argued that Russia could take its rightful place in the world only restoring its economic strength. This meant internal policy primacy over external policy; pursuing national, particularly economic, interests in foreign policy; achieving integration into the world economy, in particular the WTO; and emphasizing Russia's European destiny.<sup>230</sup> In order to achieve Russia's economic interests, Putin has stressed the need for Moscow to integrate itself into Western institutions and to attract Western investment. He wrote in his article that;

“Without [integration into international economic structures], we simply can't raise ourselves to the level of economic and social progress, which developed countries have achieved. . . . Only this path, as experience the world over shows, opens a real perspective for dynamic economic growth and improvement in quality of life. There is no alternative to it.”<sup>231</sup>

Trenin affirms that Putin has abandoned Yeltsin's foreign policy agenda, with its desire to play an oversized role in world affairs, its old-fashioned quest for multipolarity to balance America. Likewise, to Putin, economic concerns were not only superior to state geopolitical schemes; they constituted the master key to the Russian state's position in the international arena.<sup>232</sup> Building and maintaining strategic relations with key Western powers and institutions was regarded as one of the highest priorities for the first Russian president. One of the many directions in Russia's

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<sup>226</sup> Jeffrey MANKOFF: (2006) “Vladimir Putin and the Re-Emergence of Russian Foreign Policy”, Yale University, *International Security Studies Certificate Paper Series*, Number 06-02, p.6-7.

<sup>227</sup> Micheal RYWKIN: (2003) “Russia and the Near Abroad Under Putin”, *American Foreign Policy Interests*, 25, p.9.

<sup>228</sup> Clifford G. GADDY and Andrew C. KUCHINS: (2008) “Putin's Plan”, *The Washington Quarterly*, 31:2, p.121; “...One of the major themes of Putin's Millennium Statement was the need for the unity and cohesion in Russian society if the nation's destiny was to be fulfilled and the objectives met.”

<sup>229</sup> Martin NICHOLSON: (2001) “Putin's Russia: Slowing the Pendulum Without Stopping the Clock”, *International Affairs*, Vol.77, No.4, p.868-69; “...The ongoing crisis in the Chechen Republic provided the context in which to present Putin as a quite different leader from Yeltsin.”

<sup>230</sup> Ibid, p.871.

<sup>231</sup> CHARAP.

<sup>232</sup> TRENIN: (2003), p.2-3.

self-pronounced “multi-vector” foreign policy; it was the West that had achieved the greatest significance.<sup>233</sup> Putin’s era on the other hand, has focused on conducting an independent and active multi-vector policy of a pragmatic “father of the nation” who is concerned, at the same time, about the greatness of his nation.<sup>234</sup> Thus for Putin, Russia no longer needs any Western support or advice and should follow its own interests as a sovereign actor in international politics. The era of the “West first” foreign policy character has gone and “Russia first” foreign policy that the Kremlin leadership began to aspire.<sup>235</sup>

After the attacks of 11 September 2001 Putin was quick to point out the alleged connections between Osama bin Laden and the rebels in Chechnya, identifying a radical Muslim fundamentalism as the core threat to the West.<sup>236</sup> The 9/11 attacks provided a further impetus for Putin to seek a pragmatic relationship with Washington, free for the most part from the overheated rhetoric and bluster that often characterized the Primakov/Yeltsin era. Putin was the first foreign leader<sup>237</sup> contact Bush in the hours following the attacks on New York and Washington.<sup>238</sup> Despite the opposition of the Russia's Security Council, he supported Washington’s anti-terrorist campaign without preconditions and accepted the American deployment in Central Asia. Those decisions allowed Putin to gain better Western understanding of his policies and to sell his military campaign in Chechnya as a purely anti-terrorist enterprise.<sup>239</sup>

In the first period of Putin’s presidency there appeared to be a shift from an American-centered foreign policy towards a greater European orientation. This was in part because Clinton was in the last year of his presidency in 2000, and in early 2001 the Bush newcomers reassessed policy towards Russia. In his speech to the Bundestag in 2002, Putin insisted that;

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<sup>233</sup> Vadim KONANENKO: (2008) “Russia in 2008 and Beyond, What Kind of Foreign Policy?”, The Finnish Institute of International Affairs, *Briefing Paper 17*, p.4.

<sup>234</sup> NIKONOV, p.78-9.

<sup>235</sup> KONANENKO, p.4.

<sup>236</sup> SAKWA: (2004), p.173.

<sup>237</sup> Jill DOUGHERTY: (2002) “9/11 a ‘Turning Point’ for Putin”, CNN World, Foreign Policy, 10 September [http://articles.cnn.com/2002-09-10/world/ar911.russia.putin\\_1\\_russian-president-vladimir-putin-dmitri-trenin-moscow-carnegie-center?\\_s=PM:WORLD](http://articles.cnn.com/2002-09-10/world/ar911.russia.putin_1_russian-president-vladimir-putin-dmitri-trenin-moscow-carnegie-center?_s=PM:WORLD) (Accessed on 22 October 2009).

<sup>238</sup> MANKOFF, p.17.

<sup>239</sup> RYWKIN, p.10.

Russia's destiny is a European one, and this was borne out later when a fundamental choice had to be made between the European and the American versions of the West during the Iraq crisis of 2003.<sup>240</sup>

Johnson explains the foreign policy shift of Putin by four components. The first is the international structure explanation which was focused on preventing third countries engagement in Central Asia. The second is the instrumental explanation which means the great power dream is alive. The policy turn of 2001 has to be understood in the context of Russia's search for a strategy to enable it to make its return as a great power. The third is the institutional rivalry of security institutions of the Russia. In spite the fact that Putin was met with strong resistance from among the military and the security sector, he persuaded the opposition voices and allowed US forces access to Central Asia. Finally, Putin's policy turn in September 2001 can be interpreted as the result of a socialization process-Russia had entered a common value system with the West and wanted to join the USA to combat what was perceived a common threat.<sup>241</sup>

Regarding to China foreign policy of Putin, Trenin emphasizes that it was heavily influenced by his concerns about the capability of the Russian Far East and Siberia. Early in his presidency, Putin dropped the multipolar struggles of China as a potential ally in an American-balancing exercise. In 2000, Russia signed a formal treaty of friendship with China and soon afterward acted to transform the Shangai Forum into a regional security organization.<sup>242</sup> After their first summit, Putin and Jiang Zemin issued a strong condemnation of US plans for missile defense shields stating that the US plan was 'to achieve unilateral superiority in military and security matters'.<sup>243</sup>

In the situation of the economy, Putin launched a new market reforms, which could not completed during the Yeltsin term. He focused on reducing taxes, opening the economy for global competition in order to meet WTO membership criteria, and for carrying out social, pension and public utilities reforms in far beyond the intentions of the reformers from the early Yeltsin times.<sup>244</sup> When Putin appointed as Prime Minister in August 1999, Russia was in a

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<sup>240</sup> SAKWA: (2004), p.211.

<sup>241</sup> JOHNSON, p.177.

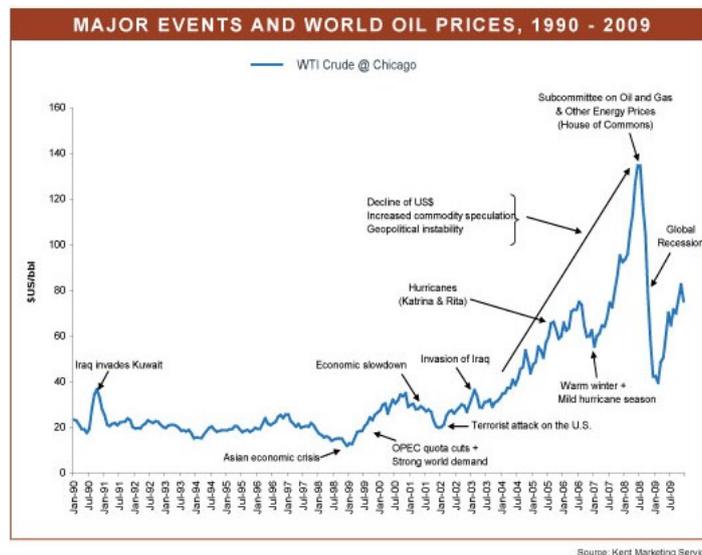
<sup>242</sup> TRENIN: (2003), p.10.

<sup>243</sup> Natasha KURT: (2007) *Russian Policy Toward China and Japan: The Yeltsin and Putin Periods*, Routledge, p.111.

<sup>244</sup> NIKONOV, p.72.

bankruptcy. The nation owed \$16.6 billion to the IMF alone, while its foreign currency reserves were under \$8 billion and shrinking. Putin has initially benefited from a jump in oil prices since the beginning of his term.<sup>245</sup> The price of oil in August 1999 was \$20.17 bbl/d (August 1998 \$11.88). The rising trend continued was \$25.48 in December 1999, \$27.47 in May 2000 and \$32.52 in November 2000. Finally Putin was concentrating on the second presidential election at the end of the year 2004; oil price was almost \$40 bbl/d.<sup>246</sup>

**Figure 1: Oil Prices Between 1990-2009<sup>247</sup>**



It is beyond dispute that the economic recovery of the early 2000s has underpinned Putin's policy of strengthening the state by keeping government reserves full. The funds have been heavily spent on strategic initiatives such as reducing Russia's foreign debt and modernizing the military. Putin has used the revenues from oil to pay off Russia's international debt burden early, reducing foreign leverage over Russian policy. Moscow's debt payments to both the IMF and the Paris Club of sovereign creditors have proceeded ahead of schedule.<sup>248</sup> The Russia's public debt reached its peak in 1998 which was 146.4% of the GDP. As of January 2000, Russia's foreign debt made up \$158.7 billion. The home and foreign debts totaled 84% of GDP. Putin set a goal and schedule during his presidency to decrease the amount of Russia's debt. As a result, Russia

<sup>245</sup> GADDY and KUCHINS, p.123.

<sup>246</sup> Index Mundi Available on site <http://www.indexmundi.com/commodities/?commodity=crude-oil-brent&months=180> (Accessed on 05 February 2011).

<sup>247</sup> Canadian Petroleum Products Institute, Available on site [http://www.cppi.ca/index\\_e.php?p=69](http://www.cppi.ca/index_e.php?p=69) (Accessed on 05 February 2011)

<sup>248</sup> MANKOFF, p.13.

managed to paid \$22.5 billion to Paris Club by the end of 2005, and the country's state debt amounted to \$53 billion afterwards (9% of the GDP).<sup>249</sup>

## 5.2. Putin's Second Term

First year of the second term was a tough year for Putin because of Chechen terrorist attack, the Beslan school massacre and as well as Ukraine turned against Russia due to Western-Oriented Orange Revolution.<sup>250</sup> In terms of the Central Asia policies, Taliban was largely defeated and concerns about a long-term American presence in the region rose among Kremlin policy makers. One of the most serious anti-American presence action occurred and as a result Moscow joined the Uzbek and Chinese governments in calling for the US to leave the Khanabad airbase in Uzbekistan (as well as the Manas Facility in Kyrgyzstan) in mid-2005.<sup>251</sup> This action could be accepted as the practice of the multipolarity policy understanding rather than theory.

Two big powers' competition came clear in the international arena, identified the two different approaches between them. Nation says that while Russia recognizes the US expansion efforts in the Central Asia as a strategy of unipolarity and hegemony, US think that the Russian blocking the US interests in the region as the imperial revival.<sup>252</sup> Due to this reason, Washington has consistently opposed Moscow's interference in the affairs of the new independent states on its borders and sought to resist any kind of imperial revival.<sup>253</sup>

Concerning the Russia-NATO relations, post-Soviet relations between Russia and NATO reached their lowest point in the last months of Yeltsin's presidency, after the Western alliance ignored Russian objections and bombed targets in Serbia to stop the ethnic cleansing of the Kosovo Albanians. The problem grew by the adoption of NATO's new Strategic Concept in March 1999 that proclaimed the alliance's willingness to intervene anywhere in Europe in order

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<sup>249</sup> Pravda.Ru (2009) Putin to End Debt History of USSR This Year, 6 August, <http://english.pravda.ru/russia/economics/06-08-2009/108653-debt-0/> (Accessed on 05 February 2011).

<sup>250</sup> Anders ASLUND: (2007) *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed?*, Peter G. Peterson Institute for International Economics, p.244

<sup>251</sup> Ibid, p.17-24.

<sup>252</sup> Craig R. NATION: (2007) "Russian Security Strategy Under Putin. US and Russian Perspectives", US Interests in the New Eurasia, November, p.5, <http://www.strategicstudiesinstitute.army.mil> (Accessed on December 2007) "...Blocking Russian imperial revival is a foundation of US Eurasian policy, but it is important to think systematically about the consequences of success."

<sup>253</sup> Ibid, p.4.

to uphold stability and human rights.<sup>254</sup> Enlargement raised major problems over access, the visa regime and other issues concerning the Kaliningrad exclave, separated from Russia by Lithuania and Belarus.<sup>255</sup>

On February 10, 2007 Putin gave a speech in Munich that some experts perceived as the start of a “New Cold War” between Russia and the US. Speech confirmed that the Russian elite thinks that Washington is using “slogans of democratization” to get access to Russia's natural resources.<sup>256</sup> In other words Russia takes issue with US “attempts to construct a unipolar world”, by NATO enlargement, US missile defense deployments in Central Europe, and the official US policy of democracy promotion.<sup>257</sup> Therefore, it was a warning for US that it should not attempt to create a world “of one boss, one sovereign”, and it should stop interfering in Russian domestic politics.<sup>258</sup> Putin’s speech, delivered in Munich is commonly held to have opened a new chapter in Russian foreign policy. In reality, it marked a turning point that had been signaled some three or four years earlier.<sup>259</sup> According to Brzezinski, it signaled to many Russians that their leader was no longer the protector of the US president but his global challenger and that the end of Russian subservience to the US marked Russia's return to the days of global prominence.<sup>260</sup>

Russia's difficulties in forming a stable relationship with China showcase the major problem with the foreign policy vision being pursued by Putin. Geopolitics has been at the center of Russia's China policy, with the content of Russo-Chinese relations centering on power (economic and military) and a struggle for influence, principally in Central Asia. Russia views China as a potential partner in constructing a multipolar world order even as a rising China is seen with a certain amount of concern in Moscow.<sup>261</sup>

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<sup>254</sup> MANKOFF, p.22

<sup>255</sup> SAKWA: (2004), p.212

<sup>256</sup> Lilia Fedorovna SHEVTSOVA: (2007) *Russia Lost in Transition: the Yeltsin and Putin Legacies*, Carnegie Endowment for International Peace, p.243-45

<sup>257</sup> Dmitri TRENIN: (2007) “Russia’s Strategic Choices”, Carnegie Endowment for International Peace, *Policy Brief* 50, May, p.2

<sup>258</sup> O. OLIKER, K. CRANE, L.H. SCHWARTS, and C. YUSUPOV: (2009) “*Russian Foreign Policy – Security Implications*”, Rand, p.86

<sup>259</sup> Dmitri TRENIN: (2008) “Russia’s Coercive Diplomacy”, *Carnegie Moscow*, Briefing Vol.10, Issue 1, January, p.1

<sup>260</sup> Zbigniew BRZEZINSKI:(2008) “Putin’s Choice”, *The Washington Quarterly*, 31:2, p.96

<sup>261</sup> MANKOFF, p.36

In terms of domestic affairs, during Putin's presidency between 2000 and 2008, the Russian GDP grew almost 7% thanks to high income from energy exports. The economic recovery led Putin to stabilize economy and social life compare to 1990s catastrophic years. Another domestic policy of Putin is "rise of silovikis" (it is a Russian word for politicians from security and military services such as KGB) in critical sectors of the state. The mission of siloviki is to reestablish, preserve and extend the authority and influence of the state. For instance, five of seven people selected to serve as regional "super-governors were siloviki."<sup>262</sup> The election of Vladimir Putin on 26 March 2000 led to renewed efforts to tackle the federation's problems. The federal government sought to impose a greater degree of centralized control on the regions. Additional reforms were introduced to tighten central control. Moreover, the new reforms included; the creation of seven federal districts, the appointment of federal inspectors, control of federal appointments, weakening the political influence of governor, and etc. By these reforms, the main aim was to monitor the raising of taxes in the regions and also exercise greater control over the redistribution of the revenues.<sup>263</sup> And finally, the conflict of "oligarchs", new class appeared in the 1990s, was handled by Putin himself. On July 2000, Putin held a meeting with 21 oligarchs in the Kremlin. Putin's message to the oligarchs was quite clear: "You stay out of politics and I will not revise the results of privatization". According to Aslund; his unspoken point was that the Russian state was back and that the era of oligarchs was over.<sup>264</sup>

As a result of the Putin's eight years in Russian Presidency, Russian Federation became a serious rival against the United States. Cohen's advice to US foreign policy makers as; "Congress and the Administration should understand that Russia is resurging as an assertive autonomous international actor poised to challenge American leadership, particularly in Central Asia, the Caucasus, Eastern Europe, and the Middle East."<sup>265</sup> Furthermore, Russia's foreign policy is still driven by former Soviet military and security elites who view Russia as the direct heir to the autocratic Russian Empire and the Soviet Union and who cherish Russia's self-appointed role as America's counterbalance on the world stage.<sup>266</sup>

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<sup>262</sup> Harold ELLETSON: (2006) *Baltic Independence and Russian Foreign Energy Policy*, GMP Pub., p.17.

<sup>263</sup> Neil MELVIN: (2003) "Russia's New Federalism", in *Eastern Europe, Russia and Central Asia*, Vol.4, Routledge, p.36-38.

<sup>264</sup> ASLUND: (2007), p.226.

<sup>265</sup> COHEN, p.15

<sup>266</sup> *Ibid*, p.17

### 5.3. Medvedev as the 3<sup>rd</sup> President of Russian Federation

It was one of the biggest even in 2008 that Putin will change the constitution in order to expire his term or will there be successor, if yes, then who? The question was answered in December 2007 with the announcement of Dmitri Medvedev as Putin's choice for the next presidency. 42 years old, law-educated and long time loyal friend of Putin was elected as 3<sup>rd</sup> President of Russian Federation in March 2008. Most reports in the West depicted him as pro-western in his foreign policy and liberal in his economic policy. However, the first visit of the newly elected President was not to the West, instead to Kazakhstan and then China.<sup>267</sup>

On August 2008, after being elected 5 months, Medvedev did not hesitate to invade some parts of the Georgia and shocked the world. Shevstova thinks that August War with Georgia showed that Medvedev was not only still working with a autocratic framework, he was also continuing the Putin model of diplomacy with the West.<sup>268</sup> Although there are still arguments that Putin is brain behind this intervention, but either that or another, Medvedev was the President and says the last word. While US and Western authorities were strictly criticizing Russia, Medvedev said after the August War that; "the future relations depended on "our friends and partners" that "have a choice" to recognize Russia's privileges.<sup>269</sup> In the meeting with the Valdai Club on September 12, 2008 Medvedev told to Western experts that "Russia was no longer weak and defenseless" and would "no longer tolerate" the West's "unfair and humiliating policy in its neighborhood. Afterwards, on 8 October 2008 Medvedev made a speech at the World Policy Conference in Evian and condemned the "NATO-centric approach" and emphasized on multipolarity and a system equal for all states."<sup>270</sup>

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<sup>267</sup> Robert H. DONALDSON and Joseph L. NAGEE: (2009) "*The Foreign Policy of Russia: Changing Systems, Enduring Interests*", M.E. Sharpe, p.137

<sup>268</sup> Lilia Fedorovna SHEVTSOVA: (2010) "*Lonely Power: Why Russia Has Failed to Become the West and West is Weary of Russia*", Carnegie Endowment for International Peace, p.79.

<sup>269</sup> Roman MUZALEVSKY: (2010) "The War in Georgia and Its Aftermath: Russian National Security and Implications for the West", *USAK Year Book of International Politics and Law*, Vol.3, p.340-41.

<sup>270</sup> James SHERR: (2009) "The Implications of the Russia-Georgia War For European Security", in Svante E. Cornell and S. Frederick Starr (ed.) "*The Guns of August 2008: Russia's war in Georgia*", Central Asia-Caucasus Institute and Silk Road Studies Program, p.206-208.

On 31 August 2008, Medvedev announced of five points of Russian foreign policy which is known as “Medvedev Doctrine”,<sup>271</sup>

First, Russia recognizes the primacy of the fundamental principles of international law, which define the relations between civilized peoples. We will build our relations with other countries within the framework of these principles and this concept of international law.

Second, the world should be multipolar. A single-pole world is unacceptable. Domination is something we cannot allow. We cannot accept a world order in which one country makes all the decisions, even as serious and influential a country as the United States of America. Such a world is unstable and threatened by conflict.

Third, Russia does not want confrontation with any other country. Russia has no intention of isolating itself. We will develop friendly relations with Europe, the United States, and other countries, as much as is possible.

Fourth, protecting the lives and dignity of our citizens, wherever they may be, is an unquestionable priority for our country. Our foreign policy decisions will be based on this need. We will also protect the interests of our business community abroad. It should be clear to all that we will respond to any aggressive acts committed against us.

Finally, fifth, as is the case of other countries, there are regions in which Russia has privileged interests. These regions are home to countries with which we share special historical relations and are bound together as friends and good neighbors. We will pay particular attention to our work in these regions and build friendly ties with these countries, our close neighbors.

President Medvedev visited United States on November 2008 and was invited by CFR-Council of Foreign Relations in Washington to make a speech with the presence of former US Secretary of State Madeleine Albright as the moderator. When Albright asked that what he had meant when he referred to Russia's sphere of “privileged interests, Medvedev replied that;

“...when I formulated the five current principles of Russia's foreign policy. One of them is the principle for developing relations with nations which traditionally have been connected with the Russian Federation... But those are nations which are very important for us, with which we have lived side by side for decades or centuries, with which we are connected by the same roots. I am referring to the states that one point were part of the USSR”.<sup>272</sup>

Lukyanov interprets that the political focus on values, which was the basis of relations with the West, has clearly ended and there are some factors for this development. Firstly, Russian leaders

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<sup>271</sup> George FRIEDMAN: (2008) “The Medvedev Doctrine and American Strategy”, Stratfor, 2 September, Available on site [http://www.stratfor.com/weekly/medvedev\\_doctrine\\_and\\_american\\_strategy](http://www.stratfor.com/weekly/medvedev_doctrine_and_american_strategy) (Accessed on 17 September 2009)

<sup>272</sup> SHEVTSOVA: (2010), p.89.

are disappointed with the results of the last 15 years with the West. Secondly, shift in the global economic balance was weakened the West's monopoly on the world's modernization reservoir. And the third factor is historical.<sup>273</sup> Consequently, President Medvedev is a quite different character than former Russian leaders. He speaks much more open and looks less authoritarian although he continues the way which Putin began to construct. As an example of Medvedev's point of view for the future of Russia, on 23 January 2010, current President wrote an important article to reach all citizens of Russia and to inspire them a optimistic future that is "Go Russia".

In the future, Russia will be an active and respected member of the international community of free nations. It will be strong enough to exert a significant influence on the formulation of decisions that have global implications. It will be able to prevent anyone's unilateral actions from harming our national interests or adversely affecting our internal affairs, from reducing Russians' level of income or damaging their security.<sup>274</sup>

For these reasons, along with other countries we are trying to reform the world's supranational political and economic institutions. The aim of this modernization is the development of international relations in the interests of as many peoples and countries as possible. We want to establish rules of cooperation and dispute settlement, in which priority is given to modern ideas of equality and fairness.<sup>275</sup>

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<sup>273</sup> Fyodor LUKYANOV: (2010) "Russian President Dmitri Medvedev Shows a Very practical Approach to the West", Telegraph, 04 June (First published in Moscow Times)  
<http://www.telegraph.co.uk/sponsored/russianow/opinion/6932170/Russia-President-Dmitry-Medvedev-shows-a-very-practical-approach-to-the-West.html> (Accessed on 05 February 2011)

<sup>274</sup> Dmitri Medvedev's Article: Go Russia Available on site  
<http://www.moscowtopnews.com/?area=postView&id=1546> (Accessed on 5 February 2011)

<sup>275</sup> Ibid.

## CHAPTER II

### ECONOMY OF RUSSIAN FEDERATION

#### 6. BEGINNING OF THE TRANSITION PERIOD

At the end of the 1991, Soviet Union disintegrated and a new economic phenomenon appeared in this former communist and centralist country, named transition.<sup>276</sup> At first, the collapse of the communism in the Soviet Union created high hopes for the integration of Russia into the global economy. Russian economists in 1991 saw some reasons to predict that transition to a market economy would be followed by sustained economic growth in Russia.<sup>277</sup> When the Soviet Union collapsed, advocates of democracy and reform optimistically put their faith in liberalism, market principles, and the “invisible hand of God”. They believed that since the Communist dictatorship disappeared, a democratic order and stable market economy would naturally come about in Russia, even if people acted solely in pursuit of self-interest.<sup>278</sup> According to Robinson, engagement with the global economy was seen by Russian reformers as the end of communism and the beginning of European Civilization. On the other hand some claimed that integration of Russian economy into the world economy is fundamental aspect of Russia's national interest”, and believed that Russia would achieve membership of all major international economic

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<sup>276</sup> Antonio SANCHEZ-ANDRES and Christina GARCIA-TESTAL: (2008) “Post-Soviet Studies and the Transition: The Case of the Russian Economy”, *Post-Communist Economies*, Vol.30, No.2, p.133

<sup>277</sup> Sergey BRAGUINSKY and Roger MYERSON: (2007) “A Macroeconomic Model of Russian Transition, the Role of Oligarchic Property Rights”, *Economics of Transition*, Vol. 15(1), p.78

<sup>278</sup> Shigeki HAKAMADO: (1999) “Factors Behind the Russian Crisis”, *Asia-Pacific Review*, Vol.6, No.1, p.36

agencies within a short time and form links with Europe so as to take part in the “single monetary system”.<sup>279</sup>

The First Program of Russian Economic Reforms which was a strategy document for achievement of economic independence of Russia was prepared in September – October 1991 at the Russian Soviet Federalist Socialist Republic (RSFSR) Council of Ministers state dacha.<sup>280</sup> Ulyukaev distinguishes November 1991 – April 1992 as the first (revolutionary romantic) period of Russian economic reforms. Actual working on the new version of the program of Russian economic reforms thus began in April 1992.<sup>281</sup>

**Table 4: The Russian Economy in Transition: Basic Statistics**<sup>282</sup>

	1992	1993	1994	1995	1996	1997	1998
GDP (% change)	-14,5	-8,7	-12,7	-4,2	-3,5	0,8	-4,6
Gross fixed investment (% change)	-45	-25,8	-26	-7,5	-18,5	-5	-6,7
National saving ratio (% of GDP)	29	29,4	27,9	24,8	25,4	21,9	19,3
Budgetary balance (% of GDP)	-10,3	-7	-9,8	-5,4	-7,9	-7,1	-5
Balance of trade (\$ billion)	5,5	10,8	17,8	20,8	23,1	17,5	6,6
Balance of payments, current account (\$ billion)	4,2	6,4	8,9	7,9	12	3,6	-5,6*
Rate of inflation (Annual average %)	1,353	876	307,4	197,4	47,6	14,6	27,8

\*First nine months

Regarding to the basic statistics of the transition period, Dyker criticizes that one of the outstanding characteristics of the Russian economy over the years of transition period has been the lack of structural change, whether in terms of the structure of production, of investment of

<sup>279</sup> Neil ROBINSON: (1999) “The Global Economy, Reform and Crisis in Russia”, *Review of International Political Economy*, Vol.6, No.4, p.533

<sup>280</sup> Aleksei ULYUKAEV: (1996) “*Reforming the Russian Economy 1991-1995*”, Centre for Research into Post-Communist Economies, p.11

<sup>281</sup> Ibid, p.37

<sup>282</sup> David A. DYKER: (2000) “The Structural Origins of the Russian Economic Crisis”, *Post-Communist Economies*, Vol.12, No.1, p.6

exports, or of key institutions like banks.<sup>283</sup> The first years of Russia's transition from the Soviet central planned economy (1991-1998) were not easy at all. During this period, Russia lost close to 30% of its real GDP, a decline reminiscent of the Great Depression of the 1930s in the United States.<sup>284</sup> In addition to that Russia experienced a dramatic inflation numbers between 1992 and 1996 and could not reduce to less than 10%. Moreover, the GDP of Russia constantly decreased and led to Russia to have worst economic statistics.

**Table 5: Russian Industrial Production, 1992 – 1999 (% of previous year)<sup>285</sup>**

	1992	1993	1994	1995	1996	1997	1998	1999	1999 as % of 1991
Total of which	82	86	79	97	96	102	95	108	54
Extractive industries	89	90	90	99	98	103	n.a.	n.a.	n.a.
Manufacturing industries	81	85	76	96	95	102	n.a.	n.a.	n.a.
Electricity	95	95	91	97	98	98	98	100	75
Oil extraction	94	91	93	96	98	101	99	100	75
Gas	97	95	94	100	99	98	101	104	88
Ferrous metals	84	83	83	110	98	101	92	114	66
Non-ferrous metals	75	86	91	103	98	105	95	109	64
Engineering and metal-working	85	84	69	91	95	104	93	116	48
Light industry	70	77	54	70	78	98	89	120	17

<sup>283</sup> Ibid, p.5

<sup>284</sup> William H. COOPER: (2008) "Russia's Economic Performance and Policies and Their Implications for the United States," *CRS Report For Congress*, Order Code RL34512, May 30, p.3  
<http://www.fas.org/sgp/crs/row/RL34512.pdf>

<sup>285</sup> Michael ELMAN: (2000) "The Russian Economy Under El'tsin", *Europe-Asia Studies*, Vol.52, No.8, p.1423.

Food industry	84	91	83	92	96	99	98	108	59
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The political and economic situation in Russia by the end of 1991 can be described with no exaggeration as catastrophic. In one year national income had fallen by more than 11% GDP by 13%, industrial production by 2.8%, agricultural output by 4.5%, oil and gas production by 11%, pig iron by 17%, and the output of the food industry by more than 10%.<sup>286</sup> The fall in national income went back to the last years old Soviet rule, but several years after the dissolution no recovery was witnesses. In addition to that official numbers had never been satisfactory especially when a group of senior officials at the statistical office was arrested in 1998 and charged with bribe-taking.<sup>287</sup> The foreign currency position deteriorated sharply. Gold and foreign currency reserves fell steeply, and for the first time in the entire period of existence of the Soviet state gold reserve was less than 300 tons (289.6 tons on 1 January 1992).<sup>288</sup> Foreign debt amounted to 97\$ billion in 1992 to 152\$ billion in 1998. Russia's share of the world trade had fallen from 2.5 to 1.3% and ranked twelfth by the World Banks in 1997.<sup>289</sup>

Rising subsidies to back controlled prices, falling production and collapsing tax discipline pushed the budget deficit above 16% of GDP. As this deficit could only be financed by printing money, the money supply ballooned, and the system of price controls totally damaged.<sup>290</sup> During 1992-94, Russia's budget deficit was largely financed by an expansionary monetary politics, with resulting high inflation. Afterwards, between 1995 and mid-1998, monetary policy based on maintain a stable exchange rate helped in controlling inflation.<sup>291</sup> However, it was still hard to talk about stable economy. On the official data, real GDP fell by around 32% during 1992-1994, continuing the sharp contraction of the previous two years.<sup>292</sup> As an important pillar of the economic transition, Russia should have to restructure international banking system. Government of independent Russia first created the new Central Bank of Russia (founded 13

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<sup>286</sup> ULYUKAEV, p.3-4 .

<sup>287</sup> Stephen WHITE: (2000) *Russia's New Politics – The Management of Post-Communist Society*, University of Cambridge, p.133-34.

<sup>288</sup> ULYUKAEV, p.3-4 .

<sup>289</sup> WHITE: (2000) p.134.

<sup>290</sup> Rudiger AHREND and William THOMPSON: (2005) "Fifteen Years of Economic Reform in Russia: What Has Been Achieved? What Remains to Be Done?", *Economics Department Working Papers*, ECO/WKP/2005/17, No.450, p.6

<sup>291</sup> Alexander KURA: (2001) *Russia's Transition, International Help of Meddling*, Nova Science Publisher, p.51.

<sup>292</sup> AHREND and THOMPSON, p.11.

July 1990), which was to operate strictly as a central bank on the Western model. New legislation paved the way for the information of new, privately owned, commercial banks. In the event, private banks sprang up like mushrooms, and by September 1994 there were 2500 of them.<sup>293</sup>

## 6.1.Shock Therapy

In 1991 President Yeltsin invited prestigious foreign advisors particularly from West and listened them to a surprising degree. They insisted radical, comprehensive, and consistent reforms for Russian economy restructuration. Yeltsin and his economic team followed what they recommended between 1991-93.<sup>294</sup> One of the invited Professor Jeffrey Sachs from Harvard University, who was the main adviser to the Russian government until January 1994, insisted that the Western financial aid was essential for the successful economic transformation of Russia, and saw “economic integration with Western Europe” as “the primary engine of economic growth” for Russian transitional economy. In order to get the Western money, Russia lifted barriers to make the country available for as quickly as possible, so that foreign capital could rapidly enter the economy and help consolidate the state efforts at economic transformation.

The neo-liberal ideas on radical economic reform sponsored by Western governments and International Financial Institutions and designed by the Gaidar team as “*shock therapy*” offered solutions to all these problems and engaging with the global economy.<sup>295</sup> Gaidar’s program for economic reform called for immediate liberalization of prices and trade while at the same time achieving macroeconomic stabilization through control of the money supply and government spending. Gaidar’s plan was consistent with his neoliberal approach to markets and market development; the less the state intervened in the market better.<sup>296</sup> Furthermore, these efforts were backed by the G-7 and its agencies (such as IMF) and by the international business community.<sup>297</sup>

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<sup>293</sup> DYKER, p.14.

<sup>294</sup> ASLUND: (2007) p.119.

<sup>295</sup> ROBINSON, p.533-36.

<sup>296</sup> Micheal MCFOUL: (2001) *Russia's Unfinished Revolution: Political Change From Gorbachev to Putin*, Cornell Univeristy, p.143.

<sup>297</sup> ELMAN, p.1417.

Yeltsin outlined his programme (written by Gaidar) to the Russian Parliament on 28 October 1991.<sup>298</sup>

- Economic stabilization based on tight monetary and credit policy, strengthening of the ruble up to the creation of a separate Russian currency to protect the economy.
- Price liberalization
- Privatization and the introduction of a mixed economy with a growing private sector, accelerated land reform.
- Reorganization of the financial system, tight control of budget expenditure, reform of the tax and banking system.

It was an optimistic scenario presented by Yeltsin, who promised the economy would stabilize and life would improve within six months also played an important role in gathering political support.<sup>299</sup> Under this optimistic scenario, it was expected to achieve economic freedom for the people and build on efficient business system on this base, which is capable of providing for the dynamic progress of the national economy, and the sufficient welfare of the citizenry, overcoming the logging position with respect to other countries.<sup>300</sup>

In economics, shock therapy refers to the sudden release of price and currency controls, withdrawal of state subsidies, and immediate trade liberalization within a country.<sup>301</sup> The Gaidar team saw their first task as controlling inflation and stabilizing the ruble and the budget deficit by liberalizing prices and cutting state spending. This pattern of reform price liberalization and financial stabilization before the privatization of industry – was social engineering designed to alter the entire fabric of industrial production and make privatization a more attractive option to outside investors.<sup>302</sup> An attempt to reduce monetary financing by creating a market for short-

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<sup>298</sup> Richard SAKWA: (2008b) *Russian Politics and Society*, Second Edition, Routledge, 4<sup>th</sup> Edition, p.290

<sup>299</sup> Graene GILL and Roger D. MARKWICK: (2000) “*Russia’s Stillborn Democracy? From Gorbachev to Yeltsin*”, Oxford University Press, p.138.

<sup>300</sup> G. YAVLINSKY, B. FEODOROC, and S. SHATALIN: (1991) *500 Days Transition to the Market*, St. Martin’s Press, p.13.

<sup>301</sup> Economic Expert.Com, Available on site <http://www.economicexpert.com/a/Shock:therapy:economics.htm>; “According to Prof. Jeffrey Sachs, shock therapy traces its roots from the economic liberalization program undertaken by post-war West Germany in the late 1940s”.

<sup>302</sup> ROBINSON, p.536, SAKWA: (2008b) p.118

term government debt seemed quite successful at first. However, due to amount of huge debt, domestic savings were unavailable. Hence, the government soon had to stimulate foreign participation in the market. By doing so the risk of a speculative attack was strongly increased.<sup>303</sup> The acute result of the shock therapy was seen in the middle of the 1994. As a result of the price liberalization in January 1992, a sharp jump in the price level was emerged and the subsequent large increase in the money supply fuelled very high inflation. The nominal exchange rate fell sharply as the ruble supply expanded. In mid-1994, the Central Bank began intervening to slow the nominal depreciation, but it quickly ran through its reserves and on 11 October 1994, the ruble dropped 30% against US\$.<sup>304</sup> The crisis was caused in part by commercial banks speculating on leaked information about government plans to realign the ruble against the US\$ in the hope that this would enable it to finance some of the budget deficit, and in part by the buildup of inflationary pressures in the Russian economy caused by the growth of that deficit. Consequently, the crisis caused high inflation.<sup>305</sup>

## 6.2.Privatization

Yeltsin government had launched on a massive program of privatization in order to establish shift from central economy to market economy. Therefore, Russia had to privatize its state companies to get foreign direct investment and competitiveness for modernizations of the sector. Tkachenko divides privatization into two separate programs. The first is the “mass privatization” program that was started by the Russian reformers almost immediately upon the establishment of Russia as an independent state, and largely completed by the mid-1990s. It is often termed a “voucher privatization”, and initiated by Yegor Gaidar’s government in 1991.<sup>306</sup> For instance; the majority of the Gazprom’s shares went to its managers. Soon after that the Russian Government, headed by the former Minister of Gas Victor Chernomyrdin, signed an agreement with Gazprom. It passed all government’s shares to a trust ownership of the new leadership of

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<sup>303</sup> Niko GABBIN and Bruno MERKEVEDE: (2000) “The Russian Crisis: A Debt Perspective”, *Post-Communist Economics*, Vol.12, No.2, p.161

<sup>304</sup> Daniel TREISMAN: (2006) “Evaluating Exchange Rate Management” in Timothy T. Colton and Stephen Holmes (ed.) “*The State After Communism – Governance in the New Russia*”, Rowman&Littlefield Pub., p.190.

<sup>305</sup> ROBINSON, p.547-48.

<sup>306</sup> Stanislav L. TKACHENKO: (2008) “Political Economy of Energy Policy of Russian Federation Towards USA and European Union”, *Paper presented at the ISA Panel*, California, March, p.2.

Gazprom with Rem Vyahirev as the CEO. As a result, the state lost transparent and public control over its most powerful company.<sup>307</sup>

The second strategy, pursued in parallel with the first, was to sell off strategic Russia's industry to Russia's emerging business class in less-than transparent status. The most famous of these sell-offs was the “Loans for Shares” between 1995-96 when the Yeltsin government had put up shares in key enterprises that hitherto remained state-owned as collateral for loan and from private Russian banks.<sup>308</sup> Tkachenko says that it was a “loans for shares” deal between the Kremlin and its close allies in the national business community.<sup>309</sup> Tompson says that the banks-driven loans-for-shares privatization in reality best understood as simply a further stage in the process of privatization to insiders that began with the asset of the Soviet period and continued during the voucher phase until 1994.<sup>310</sup>

The great financial-industrial media groups were formed in Russia during the period of privatization between 1992-97. Yeltsin's reformers were not opposed to the creation in principle but wanted them to improve competitiveness in their industries rather than to protect monopoly rents.<sup>311</sup> Many of these groups established business consisting of firms, plants and enterprises which were acquired at random and in an accidental fashion from different sectors, banks and so on. Nevertheless, many of these loans provided for them, were sponsored by the state.<sup>312</sup> Small group of tycoons who won the president's consent to the plan exploited the government's desperate need for operating revenues as the parliamentary election campaign season was approaching.<sup>313</sup> However, the process of distributing federal property after Boris Yeltsin's re-

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<sup>307</sup> Ibid.

<sup>308</sup> Mark SCHAFFER and Anna SHABUNINA: (2004) “The Great Transformation: Russia's Return to the World Economy”, *Centre for Economic Reform and Transformation*, Heriot-Watt University, p.5.

<sup>309</sup> TKACHENKO: (2008) p.2.

<sup>310</sup> William TOMPSON: (2006) “Russian Banks and Russian Diplomacy: Occasionally Rather Embracing”, in Andreas Wenger, Jeronim Perovic, and Robert W. Ortung (ed.) “*Russian Business Power – The Role of Russian Business in Foreign and Security Relations*”, Routledge, p.182

<sup>311</sup> Thomas F. REMINGTON: (2006 “Democratization, Separation of Powers, and State Capacity”, in Timothy T. Colton and Stephen Holmes (ed.) “*The State After Communism – Governance in the New Russia*”, Rowman&Littlefield Pub., p.274.

<sup>312</sup> Eva PASZYC and Iwona WISNIEWSKA: (2002) “Big Business in the Russian Economy and Politics Under Putin's Rule”, EES Studies, Centre for Eastern Studies, p.2,  
Available on site [http://pdc.ceu.hu/archive/00002224/01/big\\_business.pdf](http://pdc.ceu.hu/archive/00002224/01/big_business.pdf)

<sup>313</sup> REMINGTON, p.275

election did not motivate most of the new owners, who were interested in fast and easy profit, to invest in the development of the enterprises they had so cheaply obtained.<sup>314</sup>

**Table 6: The Process of Privatization in Russia, 1992-1995<sup>315</sup>**

Date	Privatization Applications Submitted	Privatizations Executed	Value of Property of Privatized Enterprises	Number of State Enterprises Transformed into Joint-Stock Companies in which shares were issued for sale
01.01.1993	102330	46815	193	2376
01.01.1994	125492	88577	648	14073
01.07.1994	137501	103796	958	20298
01.01.1995	143968	112625	2357	24048
01.07.1995	147117	117406	3401	25816
01.01.1996	147795	118797		27040

In 1995, the government auctioned off to local banks shares in 29 of the most potentially lucrative firms, including major oil companies and mineral producers. The twelve companies sold included five oil companies (Yukos, Sibneft, Sidanko, Lukoil and Surgutneftegaz), Norilsk Nickel, two steel corporations (Novolipesk and Mechel), two shipping companies, and the oil products trade Nafta Moskvo.<sup>316</sup> The auctions were the bids. They obtained the shares at a fraction of their market value and were able to keep them when the government failed pay back the loans. The government did not challenge their control of these assets because their owners, who became known as oligarchs, financed Yeltsin's reelection as president in 1996.<sup>317</sup>

Krasnow says that one who opposed to shock therapy was Joseph Stiglitz. After chairing Clinton's Council of Economic Advisers, he replaced shock therapy iconoclast Larry Summers as World Bank's Chief Economist. Krasnow commends Stiglitz words (Making Globalization Work, 2006) that "Shock Therapy" failed in Russia". And privatization was done in Russia

<sup>314</sup> PASZYC and WISNIEWSKA, p.2.

<sup>315</sup> ULYUKAEV, p.129

<sup>316</sup> ASLUND: (2007) p.162.

<sup>317</sup> COOPER: (2008), p.4, TKACHENKO: (2008) p.2

before adequate systems of collecting taxes and regulating newly privatized enterprises were put in place.<sup>318</sup>

### 6.3. The August Crisis – Black Monday

The August crisis has significant importance in Russian transition period, because in one day the country became poor and inadequate to pay its debts. Several factors contributed to the crisis in the Russian financial system that began on “Black Monday” in August 1998.<sup>319</sup> The crisis culminated in August 1998, when the government abandoned its defense of a strong ruble. It also defaulted on official domestic debt forcing its restructuring and imposed a 90-day moratorium on commercial external debt payments.<sup>320</sup> By the end of 1998, Russian GDP fell by 40%, a third of population found itself suddenly impoverished while oil production, the backbone of the economy seriously declined.<sup>321</sup> Beginning in 1997 and into 1998, a number of forces came into play that placed Russia in a financially vulnerable position: First; world prices for oil and other commodities, putting downwards pressure on foreign currency reserves and ruble. Second was the Asian financial crisis.<sup>322</sup> According to Oppenheimer and Maslichenko; the key point behind the August 1998 defaults and devaluation was the Federal authorities’ failure to match government spending commitments with tax revenues.<sup>323</sup>

On 29 April 1996, the Paris Club rescheduled Russia's \$40.4 billion of debt inherited from the Soviet Union with 25 years repayment period. Afterwards, another agreement was signed with the London Club on 6 October 1996 and \$33 billion of Soviet era debt to commercial banks rescheduled.<sup>324</sup> By late March the political and economic situation had become terrible, and on March 23, Yeltsin fired his entire government, including Prime Minister Victor Chernomyrdin.

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<sup>318</sup> George W. KRASNOW: (2008) “Did Shock Therapy Help Russia? About Anders Aslund’s Capitalist Revolution”, 06 May Available on site <http://www.cdi.org/russia/johnson/2008-88-39.cfm>, Elaine SCIOLINA: (1993) “US is Abandoning Shock Therapy For The Russian”, *The New York Times*, December 21, Available on site <http://query.nytimes.com/gst/fullpage.html?res=9F0CEED91F39F932A15751C1A965958260>

<sup>319</sup> Shigeki HAKAMADO: (1999) “Factors Behind the Russian Crisis”, *Asia-Pacific Review*, Vol.6, No.1p.35

<sup>320</sup> COOPER: (2008) p.3

<sup>321</sup> Pavel EROCHKINE: (2005) “Russia and Its Oil Friends or Foes”, in Jennifer Moll (ed.) *Blueprint for Russia*, FPC, London, p.13

<sup>322</sup> COOPER: (2008) p.5

<sup>323</sup> Peter OPPENHEIMER and Sergiy MASLICHENKO: (2006) “Energy and The Economy: An Introduction”, in Michael Ellman (ed.) *Russia’s Oil and Natural Gas, Bonanza or Curse?*, Anthem, p.21

<sup>324</sup> Jeffries, Ian (2002) *The New Russia – A Handbook of Economic and Political Developments*, Routledge Curzon, p.279.

In a move that challenged investor confidence even further because Yeltsin appointed 35 year-old Sergei Kriyenko, a former banking and oil company executive who had been in government less than a year, to take this place.<sup>325</sup>

Russia's main problems during the 1998 crisis were; lack of capital flow, lack of capacity to collect taxes (during the Soviet era individuals did not pay taxes), short-term bonds and the flight of capital from Russia. In addition to that Russia's biggest export commodities oil and weapons was also hit by the drop in oil prices from around \$25 bbl/ to \$13.70 bbl/d in January 1997.<sup>326</sup> And finally the oil prices even dropped to under \$10 in December 1998 (\$9.80).<sup>327</sup>

On 17 August 1998 the Russian authorities announced some drastic policy measures that had a strong impact upon the Russian economy. The fluctuation had in which the ruble mourned against the dollar was widened.<sup>328</sup> Subsequently, there was no certainty either in Russia or abroad in the ability of the government to service its debt or to implement reform measures that would enable it to again confidence. As a result of, the IMF held back US\$ 800 million of the extra aid that it had granted Russia to support the ruble. The price of Russian debt plummeted once more and the stock market began to sink to new lows (between October 1997 and devaluation the market lost 81.9% of its value). Sergei Kriyenko, Russia's thirty-five-years-old Prime Minister,<sup>329</sup> announced that the ruble would be allowed to float in a wider band so that it could be devalued by over a third by the end of the year. A moratorium on payment of foreign commercial debts and a freeze on domestic debt repayment were also announced.<sup>330</sup>

Tabata thinks that the only responsible was not Russian government and adds that it was the complete failure of policies recommended by the IMF, characterized by global liberalism, including complete liberalization of currency markets, adoption of the corridor system, issuing a great amount of short-term domestic bonds and liberalization of state bond markets for non-

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<sup>325</sup> Abigail J. CHIADO and Miceal T. OWNYANG: (2002) "A Case Study of a Currency Crisis: The Russian Default of 1998", The Federal Reserve Bank of St. Louis, November-December, p.11-12, Peter RUTLAND: (2005) "Putin and Oligarchs", in Dale R. Herspring (ed.) *Putin's Russia, Past-Imperfect, Future Uncertain*, Rowman&Littlefield Pub., p.164-65

<sup>326</sup> HAKAMADO, p.39-40, Niko GABBIN and Bruno MERKEVEDE: (2000) "The Russian Crisis: A Debt Perspective", *Post-Communist Economies*, Vol.12, No.2, p.141.

<sup>327</sup> Index Mundi Available on site <http://www.indexmundi.com/commodities/?commodity=crude-oil-brent&months=180> (Accessed on 05 February 2011)

<sup>328</sup> GABBIN and MERKEVEDE, p.141

<sup>329</sup> Thane GUSTAFSON: (1999) "*Capitalism Russian Style*", Cambridge Uni. Press p.2

<sup>330</sup> ROBINSON, p.555, AHREND and TOMPSON, p.15.

residents.<sup>331</sup> The crash of August 1998 provides a dramatic symbolic close to the period that began with the launch of market reforms in January 1992.<sup>332</sup> Additionally, much of the decline of the 1990s might be welcomed because it marked the overdue restructuring of the Russian economy toward producing goods and services that met consumers' demands rather than planners' preferences.<sup>333</sup>

After freeing the whole prices on January 2, 1992, consumer prices increased by 2,509% that year. People's saving lost their value and caused catastrophe in the society. Monetary and fiscal policies brought annual inflation down from 840% in 1993, to 215% in 1994; to 131% in 1995; to 22% in 1996; and to 11% in 1997. With the economic meltdown of August 1998, inflation rebounded to an annual rate of 84.4%, and then subsided to 36.5% in 1999.<sup>334</sup> Gaddy says that in 1998, Russia was a country so impoverished and a country whose meager finances had been so mismanaged that it was essentially bankrupt. It was so depleted of foreign reserves that denial of a bailout by the IMF to the tune of \$15 billion or so could effectively bring down a government.<sup>335</sup>

While most of the experts were criticizing the August crisis from different perspectives, Uegaki thinks different than the others regarding the consequences foreign policy August crisis. According to Uegaki's analysis;

Although the economic crisis was reported as a shock in Russia and abroad, the details of the crisis remain unclear today. It is noteworthy that the facts indicate that the crisis did not seriously affect the Russian economy. Furthermore, it appears to have triggered the subsequent economic growth. For example, although the monthly index of real consumption of goods and services of Russia declined during the crisis from 107.4 in August 1998 to 75.5 in February 1999. The trend in the unemployment rate was the same. It was between 11.3% and 11.7% until the end of August 1998, and it increased to 14.1% at the end of January 1999. However, it declined steadily to 12.9% at the end of November 1999.<sup>336</sup>

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<sup>331</sup> Shinichiro TABATA: (2006a) "Dependent on Oil and Gas: Russia's Integration into the World Economy", *21st Century COE Program Slavic Eastern Studies*, No.11, Slavic Research Center, p.6-7.

<sup>332</sup> GUSTAFSON, p.3.

<sup>333</sup> Keith BUSH: (2008) "Russian Economic Survey", *US-Russia Business Council*, December, p.9 Available on site <https://www.usrbc.org/>

<sup>334</sup> Ibid.

<sup>335</sup> Clifford G. GADDY: (2006) "The Future of Russian Energy Policy", The Brookings Institution, Washington D.C., November 30, p.4, Available on site <http://www.brookings.edu/~media/Files/events/2006/1130russia/20061130.pdf> (Accessed August 2009).

<sup>336</sup> Akira UEGAKI: (2006) "Capital Flight From Russia", in Tabata Shinichiro (ed.) "*Dependent on Oil and Gas: Russia's Integration into the World Economy*", 21st Century COE Program Slavic Eastern Studies, Slavic Research Center, No.11, p.52

## 7. PERIOD OF POST-AUGUST CRISIS

### 7.1. Evolution of Russian Economy After 1999

After the August 1998 crisis Russia's economy started to recover quickly. Since the second quarter of 1999, in addition to the cheap ruble, Russia's trade surplus continued to strengthen due to on oil price-led export rise, which contributed to growth by providing liquidity constraints in the economy.<sup>337</sup> According to Shevtsova; the main cause of the economy's success is high oil prices, along with protection from foreign competition in key areas of industry and trade.<sup>338</sup> Moreover, Hanson says that two developments joined the economy into growth after the crisis: a five hold devaluation of the ruble in the course of a few months and, a little later, an upturn in oil prices in 1999 and 2000.<sup>339</sup> And Thompson says that when Putin was appointed Prime Minister in 1999, less than a year after the August financial collapse, a surprisingly robust economic recovery was already under way, driven by a combination of ruble devaluations, very low real wages and domestic energy commodities.<sup>340</sup> Initially, the economic programme of the Putin period outlined by German Gref on 28 June 2000 was permeated by a liberal spirit and openness to the world economy. The aim was to establish the conditions for stable economic growth to restore Russia to the ranks of the world's major industrialized nations.<sup>341</sup>

The Russian economy has grown impressively since 1999 and, by some measures, has been one of the fastest growing economies in the world. The growth has brought an improvement in the standard of living of the average.<sup>342</sup> Merlevede, Aarle, and Schoors identify that since Putin became acting President in 2000 after surprising new year's eve resignation speech of President Yeltsin and after having won Duma support in the December 1999 elections, refer to this as the

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<sup>337</sup> Jouko RAOTAVA: (2002) "The Role of Oil Prices and the Real Exchange Rate in Russia's Economy", BOFIT Discussions Papers, No.3, p.7.

<sup>338</sup> Lilia SHEVTSOVA: (2007) "Post-Communist Russia: A Historic Opportunity Missed", *International Affairs*, Vol.83, No.5, p.895.

<sup>339</sup> Philip HANSON: (2007a) "The Russian Economic Puzzle: Going Forwards, Backwards or Sideways?", *International Affairs*, 83:5, p.870.

<sup>340</sup> William THOMPSON: (2004) "The Russian Economy Under Vladimir Putin", in Cameron Ross (ed.) "*Russian Politics Under Putin*", Manchester Uni. Press p.117, Fiona HILL: (2004) "Energy Empire: Oil, Gas and Russia's Revival", The Foreign Policy Centre, September, p.10.

<sup>341</sup> SAKWA: (2008b) p.260.

<sup>342</sup> COOPER: (2008) p.1.

“*Putin effect*”.<sup>343</sup> Putin took power at a time when the country was enjoying a little rise. Although poverty was widespread, wage arrears endemic and the debt crisis permanent, the economy circumstances, and Russia was a major beneficiary of the commodity price increase of the early 21<sup>st</sup> century.<sup>344</sup> According to Aslund, when Putin became President in 2000, he continued the “second generation” market reforms that had been formulated in 1996-1997, and thanks to his newly won parliamentary majority he could them as Yeltsin never could. Due to these reasons, the three years from 2000 to 2002 were characterized by progressive economic reforms.<sup>345</sup>

During the Putin’s presidency, cumulative number the Russian GDP between 1998 and 2008 is 6.94. Bush argues that this recovery after more than a decade of virtually uninterrupted decline, was primarily attributable to the high world prices for Russia's oil, gas and other commodity exports; the import substitution effect after the devaluation of August 1998, market-oriented restructuring; and sound fiscal and monetary policies.<sup>346</sup> In other words, Putin modified the close and detrimental relationship between the state and the economy that had developed under Yeltsin. This was mainly because of the privileged various business and commercial structures evolution such a “state within the state” with their own media empires, house politicians, television channels and security services.<sup>347</sup>

**Table 7: Gross Domestic Product Rates, 1995-2010**<sup>348</sup>

Year	Gross Domestic Product, Constant Prices	Year	Gross Domestic Product, Constant Prices
1995	-4.1	2003	7.3

<sup>343</sup> Bruno MERLEVEDE, Basvan AARLE, and Koen SCHOORS: (2007) “Russia From Bust to Boom: Oil, Politics or the Ruble?”, William Davidson Institute, *Working Paper*, No.722, April, p.3 Available on site [http://www.feb.ugent.be/nl/Ondz/wp/Papers/wp\\_07\\_461.pdf](http://www.feb.ugent.be/nl/Ondz/wp/Papers/wp_07_461.pdf) (Accessed on May 2008)

<sup>344</sup> SAKWA: (2008b) p.243

<sup>345</sup> Anders ASLUND: (2008) “An Assessment of Putin’s Economic Policy”, *CESInfo Forum*, 9, 2, p.17

<sup>346</sup> BUSH, p.5, Evgeny GAVRILENKOV: (2004) “Growth in Russia and Economic Diversification”, in Tabata Shinichiro and Akihiro Iwashita (ed.) “*Slavic Eurasia’s Integration into the World Economy and Community*”, Slavic Eurasian Studies, No.2, Sapporo, Japan, p.96

<sup>347</sup> SAKWA: (2008), p.240

<sup>348</sup> Index Mundi, Russia GDP-Real Growth Rate Available on site [http://indexmundi.com/russia/gdp\\_real\\_growth\\_rate.html](http://indexmundi.com/russia/gdp_real_growth_rate.html) (Accessed on 20 January 2011)

1996	-3.6	2004	7.2
1997	1.4	2005	6.4
1998	-5.3	2006	7.4
1999	6.4	2007	8.1
2000	10	2008	6.8
2001	5.1	2009	-7,9
2002	4.7	2010	4

Russian growth in 1999-2003 averaged considerably above 6.5% per annum. Annual growth rates, partly driven by changes in the terms of trade, changed between 6.7% and 10%.<sup>349</sup> As a result of the crisis, the main contribution to growth came from net exports. However, domestic demand took over as the dominant drive by mid-1999.<sup>350</sup> Economic growth in the first half of the 2003 stood at 7.1%. Under the presidency of Putin, the federal budget showed a surplus, and the Russian government managed to pay its international debts as well as pensions and wages to its citizens.<sup>351</sup> Ahrend says that the most important economic policy choice underlying the expansion since 1998 has been the adoption of a prudent fiscal policy. Since 2000, federal budgets have been drafted to aim for surpluses based on conservative oil price assumptions. However, Ahrend underlies that simulations allowed that the federal budget would have remained in rough balance even with oil prices unchanged at USD 19/bbl (Urals) throughout the period.<sup>352</sup> Furthermore Grigoriev summarizes the Russian economic recovery in 2000-03 as a result of the four main factors: devaluation of the ruble, spare capacity in many industries; a devaluation (or writing off) of enterprise debt; and the growth in oil prices.<sup>353</sup>

Russia, as a large commodity exporter, benefitted from healthy terms of trade during 2000-2004. The current surplus, however, was not driven by high oil and commodity prices alone. Given that

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<sup>349</sup> Goregin ASLANYAN, Sergey MALADSTSOV, and Vitali LAKABTSHOUK: (2005) "Monitoring The Sustainability of Russia's Energy Development", *National Resources Forum* 29, p.335; "Russia's economic performance since the financial crisis of August 1998 has been marked by impressive GDP growth, peaking at 10% in 2000, with an average annual growth rate of 6%."

<sup>350</sup> Rudiger AHREND: (2004) "Accounting For Russia's Post-Crisis Growth", *Economics Department Working Papers*, No.404, ECO/WKP/2004.27, 30 September, p.5.

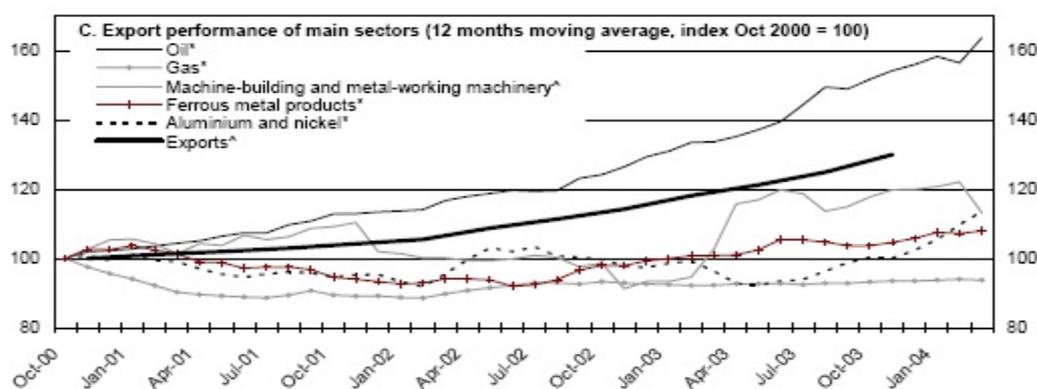
<sup>351</sup> Eugene B. RUMER and, Celeste A. WALLENDER: (2003) "Russia: Power in Weakness?", *The Washington Quarterly*, 27:1, p.59, Stefan HEDLUND: (2008) "Such a Beautiful Dream: How Russia Did not Become a Market Economy", *The Russian Review* 67, April, p.193.

<sup>352</sup> AHREND: (2004) p.14.

<sup>353</sup> Leonid GRIGORIEV: (2006) "Growth with Energy and Energy Security", in "European Energy Security: What Should It Mean? What to do?", *Center for European Policy Studies*, October, p.15.

import volumes increased by an average of 21% per year between 2000 and 2003, both strong oil prices and sharply increasing oil export volumes were vital in keeping the current account in surplus.<sup>354</sup> Russian merchandise export has driven the country's high economic growth. In only nine years, they increased six times from a low of \$76 billion in 1999 to \$472 billion in 2008. The share of exports in GDP contracted from 38% in 1999 to 27% in 2007 which means that the Russian economy is quite open even twice open than US economy.<sup>355</sup>

**Figure 2: Export Performance of Main Sectors: 2000-2004<sup>356</sup>**



One of the pushing factors behind the recovery was the tax reform. Greater simplicity has increased the efficiency of taxation while decreasing complicated economic activity. Many tax rates were significantly reduced, while tax bases were broadened. This has diminished both incentives and opportunities for tax evasion.<sup>357</sup> Tax collection was centralized into the tax ministry which eliminated tax collection competition among several collection agencies. These reforms have largely improved the business climate.<sup>358</sup> The oil sector also remained an important input to Russian GDP, with oil-related tax revenue occupying an extremely important place in the Russian government's total tax revenue.<sup>359</sup>

<sup>354</sup> Rudiger AHREND: (2006) "How To Sustain Growth in a Resource Based Economy? The Main Concepts and Their Application to the Russian Case", *OECD Economies Working Paper*, No.478, February p.17

<sup>355</sup> Anders ASLUND and Andrews KUSHINS: (2009) *The Russia Balance Sheet*, Peter G. Peterson Institute, p.70.

<sup>356</sup> Ibid, p.24

<sup>357</sup> AHREND: (2004) p.15

<sup>358</sup> COOPER: (2008) p.11-12

<sup>359</sup> Ken KOYOMA: (2004) "Reorganization of Russian Petroleum Industry and Its Effect on Business Strategy", (*The Energy Dimension in Russian Global Strategy*), The James A. Baker III Institute for Public Policy of Rice University, October, p.1.

**Table 8: Major Russian Internal Economic Indicators, 1999-2007**<sup>360</sup>

<b>Year</b>	<b>Real GDP Growth</b>	<b>Consumer Price Index</b>	<b>Average Real Wages</b>	<b>Real Personal Disposable Income</b>	<b>Unemployment Rate</b>
1999	6,4	85,7	-23,2	-8,8	12,6
2000	10	20,8	18	11,3	10,5
2001	5,1	21,5	19,9	8,7	9
2002	4,7	15,8	16,2	9,8	8,1
2003	7,3	13,7	9,8	13,5	8,6
2004	7,2	10,9	10,3	8,6	8,2
2005	6,4	12,7	12,6	11,5	7,6
2006	6,7	9,7	14,4	10,2	7,2
2007	8,1	9	16,2	12	6,2

In spite of obvious advantages, high oil price and capital inflows create a number of macroeconomic problems and challenges at the same time.<sup>361</sup> Increased taxation of the oil industry since mid-2004 also contributed to weakening ties between the current account and growth. In spite of the fact that economic growth depends largely on export revenues, this growth is balanced because consumption and investment are also both growing. Moreover, export revenues are crucial for economic growth and diversification.<sup>362</sup> On the other hand, massive foreign exchange inflows and appreciation of the ruble created an extremely favorable environment for the restructuring of the economy.<sup>363</sup>

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<sup>360</sup> COOPER: (2008) p.7.

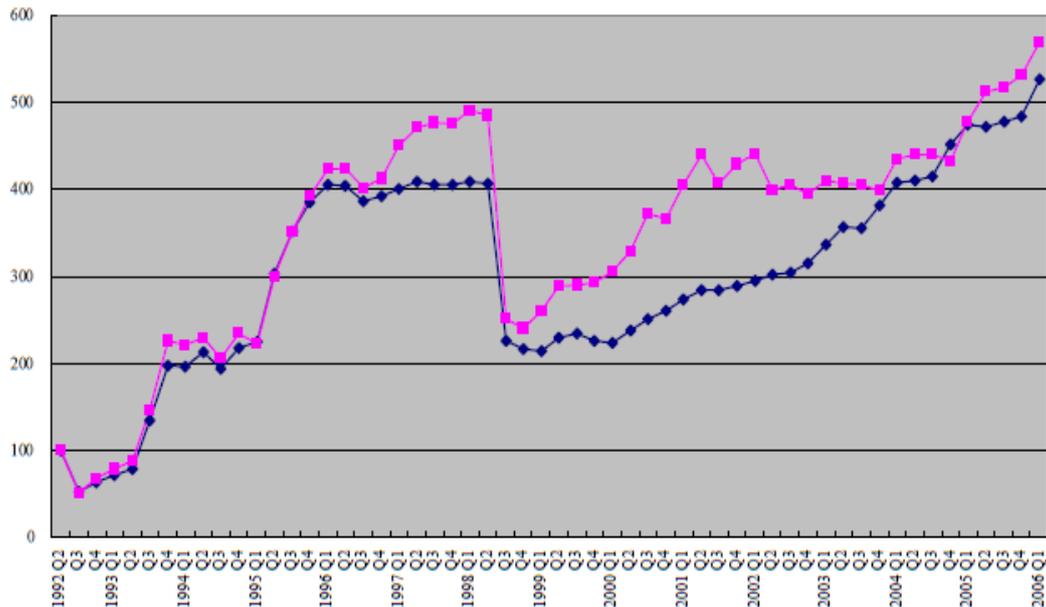
<sup>361</sup> GAVRILENKOV: (2004) p.109.

<sup>362</sup> Evgeny GAVRILENKOV: (2006) "The Road to Spontaneous Diversification", in Michael Ellman, (ed.) *"Russia's Oil and Natural Gas – Bonanza or Curse?"*, Anthem, p.129-132.

<sup>363</sup> GAVRILENKOV: (2004) p.109.

**Figure 3: Real Exchange Rate of the Ruble**<sup>364</sup>

In relation to dollars – In relations to Euros



As a result, Russia has accumulated one of the world's largest foreign reserve holdings that have skyrocketed from \$12.5 billion in 1999 to \$476.4 billion in 2007.<sup>365</sup> According to Rosstat, Russia's GDP grew by 8.1% in 2007 to RUB32.988,6 bio (\$1.35 trio) compared to 7.4% in 2006. The total assets of Russia's banking system rose by 43% in 2007 and reached RUB 20.08 trio.<sup>366</sup> The decline in global demand, the fall in commodity prices, and the tightening of credit have accelerated Russia's economic slowdown since the fourth quarter of 2008. Strong growth during the first three quarters of 2008 (7.7% on average) ensured solid overall growth of 5.6% for the year<sup>367</sup>, but lower than the 8.1% in 2007. Growth in industrial production dropped to 2.1% in

<sup>364</sup> Shinichiro TABATA: (2006a) "Dependent on Oil and Gas: Russia's Integration into the World Economy", *21st Century COE Program Slavic Eastern Studies*, No.11, Slavic Research Center, p.14.

<sup>365</sup> COOPER: (2008) p.9.

<sup>366</sup> Andrey P. GOLOBEV: (2008) "Strong 2007 – Deceleration in 2008. New Amendments to the State Budget", Credit Europe Bank, <http://www.crediteurope.ru/files/research/CEBrueconAG04022008.pdf> (Accessed on 28 April 2009).

<sup>367</sup> RIA Novosti (2009), "Russia's GDP Grew 5.6% in 2008 Statistics", 3 February Available on site <http://en.rian.ru/russia/20090203/119949215.html> (Accessed on 23 April 2009); "Russia's GDP grew 5.6% year on year, in 2008, the country's top statistics body said on Tuesday. Russia's Economic Development Ministry earlier revised its 2008 GDP growth from 6.0% to 5.6%. Russia's economy grew 8.1% in 2007 and the government expected GDP to grow 7.8% in 2008 but had to lower its forecast to 6.0% due to the global financial crisis. Russia's GDP growth will be close to zero and budgetary revenues could decline 40% in 2009 amid the ongoing global financial crisis, Financial Minister Alexei Kudrin said on Friday. "Budgetary revenues will decline by 4.4 trillion rubles (about \$133 billion), or more than 5.4% of GDP", he added, suggesting Russia's budgetary revenues could decline from 10.9 trillion rubles (\$321 billion) to 6.5 trillion (191.5 billion). He said

2008 from 6.3% a year earlier. December 2008 industrial production fell 10.3% relative to December 2007. It then dropped 16% year on year in January and 13% in February 2009.<sup>368</sup> (Appendix 1)

## 7.2. Stabilization Fund

The Stabilization Fund (SF) was established in 2004.<sup>369</sup> The original idea behind the Stabilization Fund was to accumulate money when oil prices are high and set them aside for time when prices are low.<sup>370</sup> Due to reason that the oil prices are not stable, in case of cash need for the Russian economy, Putin did not want to turn back to West to receive foreign loan. Therefore, a portion of revenues from export duties and severance taxes on oil were to be transferred into this fund, when world market prices on oil were above the base price (initially \$20 per barrel). Resources from this fund were to be used, when they exceeded 500 billion rubles, for the financing of the deficit of the state budget when world market prices of oil fell under the base price. In 2004, SF resources were 37.8 billion rubles, and then it tripled to 106.4 billion rubles in 2005.<sup>371</sup> Additionally, Stabilization Fund, in turn, has been in part to pay off government debt.<sup>372</sup> According to World Bank reports;

The Stabilization Fund is no longer just insurance for the federal budget against oil price fluctuations. It is becoming an increasingly important part of the wealth of the country. If the price of oil does not fall dramatically in the near future or medium term, as most experts now project, the size of the fund will expand quite rapidly. The Stabilization Fund is currently held as a ruble account at the Central Bank. Fears that some Russian assets abroad could be frozen in legal disputes have delayed the investment of the Stabilization Fund in foreign assets. The current law permits only investment in safe and highly liquid foreign government bonds.<sup>373</sup>

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Russia would have to spend a significant portion of its reserve funds to cover the 2009 budget deficit, and increase borrowing in 2010-2011.”

<sup>368</sup> Russian Economic Report (2009), No.18, March, p.3,

<http://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/rer18eng.pdf> (Accessed on 30 November 2009)

<sup>369</sup> Clifford G. GADDY: (2007) “The Russian Economy in the Year 2006”, *Post-Soviet Affairs*, 23:1, p.39; Gaddy prefers to say “Oil Stabilization Fund”.

<sup>370</sup> EROCHKINE, p.28, Peter RUTLAND: (2006) “Oil and Politics in Russia”, *Paper Presented at the Annual Meeting of the American Political Science Association*, Philadelphia, August 31, p.18

<sup>371</sup> Schinichiro TABATA: (2006b) “Price Differences, Taxes and Stabilization Fund”, in Michael Elman (ed.) “*Russia’s Oil and Natural Gas – Bonanza or Curse?*”, Anthem, p.46, Schinichiro TABATA: (2008) “Influence of the Oil Price Increase on the Russian Economy: Comparison with Saudi Arabia”, *Paper Prepared for the 10th Bi-annual EACES Conference*, European Association for Comparative Economic Studies, Moscow, August 29, p.6

<sup>372</sup> HANSON, p.870

<sup>373</sup> World Bank Moscow Office Economics Unit, April 2006, p.13

Available on site [http://ns.worldbank.org.ru/files/rer/RER\\_12.2\\_eng.pdf](http://ns.worldbank.org.ru/files/rer/RER_12.2_eng.pdf) (Accessed on 12 August 2008)

Barnes says that some observers fear the government will submit populist pressures for inflationary spending of the fund, while other argue the money should be invested or saved, but now it provides a safety net for the economy as a whole, presumably increasing confidence and underpinning growth.<sup>374</sup> Many experts unite on the common idea that the Russian government's ability to maintain prudent fiscal balances is due in part to the establishment in January 2004 of a Stabilization Fund. About two-thirds of oil export revenue, at mid-2007 prices under 2007 rules, goes into the government's SF. Some of that non-sterilized revenue, mainly from oil products and gas, was taxed; but if it did not go into the SF, it was tax revenue that could feed government spending.<sup>375</sup> On January 30, 2008, the fund held an aggregate amount of 3.9 trillion rubles. The Russian government has used these funds to pay off partially its IMF and Paris Club debts and to finance a deficit in the government – operated pension fund.<sup>376</sup>

From the beginning of 2008 the treatment of hydrocarbons export revenue has changed. The tax base for what had been the SF was extended from the mineral extraction tax and export duties on crude oil only to cover oil products and gas as well. The SF itself was also divided into two funds: a Reserve Fund and the National Welfare Fund.<sup>377</sup> By the time of the split Russia's SF amounted to RUB 3.852 trillion (\$157.38 billion) as of January 30, 2008 with the balance of the Fund's accounts amounting to USD 66.85 billion, EUR 50.95 billion, and GBP 7.7 billion. After the split was done, the Reserve Fund and National Welfare Fund amounted to RUB 3.069 trillion (\$125.37 billion) and RUB 782.8 billion (\$31.38 billion) as of January 31, 2008.<sup>378</sup>

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<sup>374</sup> Andrew BARNES: (2005) "Oil and the Russian Political Economy: Is Russia and the Red Sox or the Cub?", *Paper prepared for presentation at the conference on "Post-Soviet In/Securities: Theory and Practice"*, Mershon Center, Columbus, OH, October 7-8, p.1

<sup>375</sup> Philip HANSON: (2007b) "The Sustainability of Russia's Energy Power: Implications For the Russian Economy", *Economics Working Paper*, No.84, December, p.4

<sup>376</sup> COOPER: (2008) p.11

<sup>377</sup> HANSON: (2007b) p.5.

<sup>378</sup> Andrey P. GOLOBEV: (2008) "Strong 2007 – Deceleration in 2008. New Amendments to the State Budget", Credit Europe Bank, p.3, <http://www.crediteurope.ru/files/research/CEBrueconAG04022008.pdf> (Accessed on 28 April 2009).

Figure 4: Stabilization Fund and Reserves<sup>379</sup>

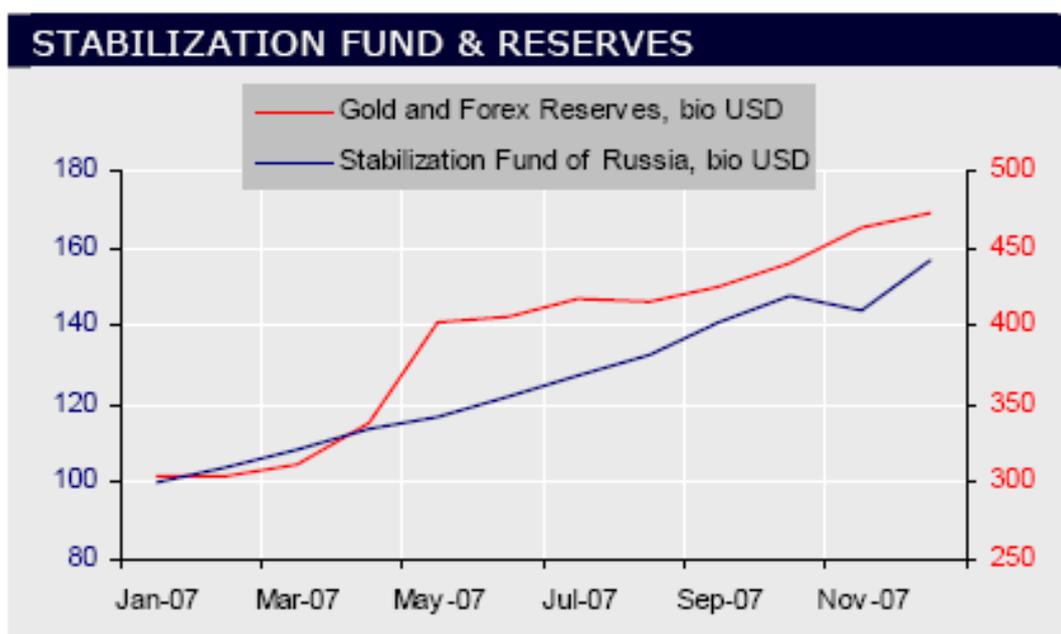


Table 9: Reserve Fund and National Reserve

Reserve Fund		
Operation Date	Balance in currencies	
18.01.2011	Rubles	46.038.951.264,70
26.01.2011	Dollar	11.076.524.377,83
26.01.2011	Euro	9.035.380.822,92
26.01.2011	GB Pounds	1.579.149.350,39
01.10.2011	Aggregate	25,85 US\$ and 823,87 RUB
National Fund		
Operation Date	Balance in currencies	
27.04.2011	Rubles	3.042.897.205,67
26.09.2011	Dollar	28.196.110.620,52
26.09.2011	Euro	24.554.374.173,26

<sup>379</sup> Ibid, p.2.

26.09.2011	GB Pounds	4.462.490.551,43
01.10.2011	Aggregate	88,69 US\$ and 2.827,10 RUB

Source: Ministry of Finance of Russian Federation Available on site <http://www1.minfin.ru/en/reservefund/> (Accessed on 18 October 2011)

Given the importance of ensuring fiscal balance across the commodity-price cycle, the creation of a SF is generally a very important issue. Such a SF accumulates windfall government revenues.<sup>380</sup> First of all it facilitates to smooth government revenues. Then, it serves for balancing government expenditures. Finally, it serves to reduce exchange –rate fluctuations. This arises from the fact that the investment and spending pattern of the Stabilization Fund set up to contribute to capital outflows when commodity prices are high and capital inflows are low.<sup>381</sup> Finance Minister Alexei Kudrin summarized the main goal behind the foundation of these funds as: *“Currently we are investing these funds, but as they grow we are preparing mechanisms which will allow us to invest them like the Norwegian fund. At a conservative estimate we expect the return from investing in the world markets to be from 4 to 6%”*.<sup>382</sup>

### 7.3.Oil and Gas Sector in Russian Economy

During the preparation of this study Russia left the second rank status in the middle of 2010 and achieved to be the leading oil producer in the world after Saudi Arabia.<sup>383</sup> Along with Russia is the largest producer of natural gas in the world. The abundance of these and other resources has been a key determinant of Russia's economic evolution for decades. Throughout its modern history, the country's political economy has centered on the transfer of value created in the resource sector to other parts of the economy.<sup>384</sup> Changes in oil prices have been associated with major developments in the world economy, and are often seen as a trigger for inflation and

<sup>380</sup> AHREND: (2006), p.5.

<sup>381</sup> Ibid, p.6.

<sup>382</sup> RT (2008) *National Welfare Fund to Invest for Longer Term and Better Return*, 10 September <http://rt.com/business/news/national-welfare-fund-to-invest-for-longer-term-and-better-return/> (Accessed on 07 February 2011).

<sup>383</sup> BBC News (2010) *Russia Becomes Leading Oil Producer, BP Says*, 9 June <http://www.bbc.co.uk/news/10275183> (Accessed on 9 June 2010)

<sup>384</sup> Clifford G. GADDY and Barry W. ICKES: (2005) “Resource Rents and the Russian Economy”, *Eurasian Geography and Economics*, 46, No.8, p.559

recession. The increase in oil prices in 1974 and then again in 1979 were important factors in producing a slowdown in the world economy at a time when inflation was rising.<sup>385</sup> Before the collapse of the Soviet Union, oil has been the backbone of the Russian economy. About 60% of Russia's exports are tied to oil prices and more than 30% of the government revenues usually came from the oil sector.<sup>386</sup> In Soviet mythology, the health of the country's economy, national power, and influence in the world are directly linked to the performance of its oil and gas industry. It is ironic then, that peak oil and gas production in the USSR was reached in the late 1980s just as economic collapse brought political disintegration.<sup>387</sup>

Tkachenko says that;

Public and private energy companies play a very important role in the economic transformation of many Russian regions to oil and/or gas fields located on their territories and their control of transportation means via their territories to export terminals...The huge inflow of hard currency into the state budget due to energy exports gives Moscow the opportunity to pay back all Soviet and post-Soviet foreign debts, to enlarge the country's SF and the currency reserves of the Central Bank of Russia, to maintain a non-deficit budget for many years, and guarantee the stability of the ruble's exchange rate. In one way or another, it can be said that the whole Russian population, its business community, and federal or regional authorities benefit from the national energy sector.<sup>388</sup>

Not only Tkachenko, Barnes also states the same idea by saying that; "*there is no doubt that the Russian economic recovery of the past several years has been driven hydrocarbons, especially petroleum.*"<sup>389</sup>

At the time of Soviet Union energy sector was a huge and imperfect industry but it was also very professional, competent and innovative. Its greatest impediment was the imposition of central planning (Gosplan) production directives and investment constraints. What they lacked after the dissolution of the USSR was technology, capital and international contacts.<sup>390</sup> As a result, one of the biggest problems in the 1990s was; Russia was not able to attract the foreign investment to develop the new oil fields that were and still are essential for the sustainability of its oil

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<sup>385</sup> Ray BARREL and Olga POMERANTZ: (2004) "Oil Prices and The World Economy", London, SWIP 3HE, December, p.2, <http://www.niesr.ac.uk/pubs/dps/dp242.pdf> (Accessed on 28 August 2008)

<sup>386</sup> EROCHKINE, p.18

<sup>387</sup> Edward C. CHOW: (2004) "Russian Pipelines, Back to the Future", *Georgetown Journal of International Affairs*, Winter/Spring, p.27

<sup>388</sup> TKACHENKO: (2008) p.2, COOPER: (2008) p.17.

<sup>389</sup> BARNES, p.1.

<sup>390</sup> Fiona HILL and Florence FEE: (2002) "Fueling The Future: The Prospects for Russian Oil and Gas", *Demokratizatsiya*, Vo.10, No.4, p.484.

production.<sup>391</sup> Although, government tried to dazzle foreign investment for the resources, it was still not sufficient and not to mention the instability of the economic situation.

Beck, Kamps, and Mileva worked on empirical study to indicate that oil prices have a considerable impact on GDP growth in Russia. According to these estimates a permanent 10% increase in oil prices would, in the long run, lead to a 1.5-2% growth in GDP.<sup>392</sup> Moreover, Cukrowski suggests that in the long run a 10% permanent increase (decrease) in international oil prices are associated with a 2.2% growth (fall) in the level of Russian GDP. Thus low oil prices in international markets may reduce the impact of the sector not only on total output but also on fiscal revenue.<sup>393</sup> As a result, Russia's GDP has become increasingly dependent on oil but that the growth dampening effect of an appreciating real exchange rate has also increased. The cumulative effect of a 1% increase in oil prices on GDP, which takes into account the endogenous reaction of all the either variables, is estimated to be around 0.2%.<sup>394</sup>

**Figure 5: Real GDP Growth and Oil Prices**<sup>395</sup>

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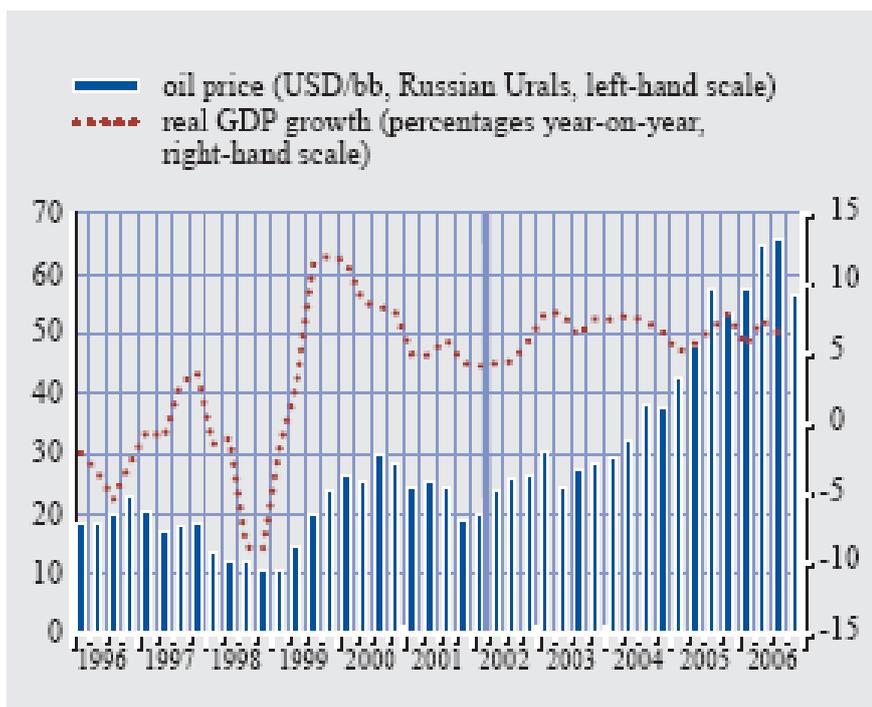
<sup>391</sup> Oksan BAYULGEN: (2006) "Foreign Investment, Oil Curse, and Democratization: A Comparison of Azerbaijan and Russia", *APSA Meeting*, Philadelphia, September, p.13.

<sup>392</sup> Roland BECK, Annette KAMPS, and Elitza MILEVA: (2007) "Long-Term Growth Prospects For the Russian Economy", European Central Bank, *Occasional Paper*, No.58, March, p.9

<sup>393</sup> Jacek CUKROWSKI: (2004) "Russian Oil: The Role of the Sector in Russia's Economy", *Post-Communist Economies*, Vol.16, No.3, p.286, Raotava, p.18

<sup>394</sup> BECK, KAMPS, and MILEVA, p.10

<sup>395</sup> *Ibid*, p.9



On the budgetary side of things, Federal Budget revenues from oil rose from 9.1% of GDP 1998 to 20% in 2002.<sup>396</sup> Undoubtedly, oil sector has a huge importance in the development of revenue. This occurred initially through the effect of devaluation in raising the ruble value of oil exports – which indeed had constituted the major prior case for ruble devaluation irrespective of the august financial crisis. Subsequently the high level of international oil prices had an equal effect. Over the years between 1998 to 2003 oil and gas production has maintained its 20-25% of GDP.<sup>397</sup>

**Table 10: Hydrocarbon (Oil and Gas) Exports<sup>398</sup>**

	1998	1999	2000	2001	2002	2003
Oil and Gas Exports (USD bil)	27.9	31.0	52.8	52.1	56.3	74.0
Share of total exports	32.2	36.6	46.1	46.1	46.4	49.2

<sup>396</sup> BARNES, p.11

<sup>397</sup> OPPENHEIMER and MASLICHENKO, p.22.

<sup>398</sup> Ibid, p.17.

%						
Ratio to GDP %	10.4	15.8	20.3	17.0	16.3	17.1

**Table 11: Oil and Gas Sector: % of GDP Growth**<sup>399</sup>

	2000	2001	2002	2003	2000-2003
Oil Sector	9,7	13,2	47,9	34,9	24,8
Gas Sector	-3,6	-9	1,7	5,9	-0,8
Oil and Gas Sector	6,1	4,2	49,6	40,8	24

According to OECD paper, from the first recovery of oil prices in 1999 until the end of 2004, Russia's broadly successful macroeconomic strategy rested on the assumption that high oil prices were a temporary phenomenon. It is important to recognize that the adjustment to sustained high oil prices creates problems of its own, with respect to both monetary and fiscal policy.<sup>400</sup> On the other hand Hill and Fee says that thanks to large part to high oil prices, at the end of 2001, the Russian economy had experienced a major rise, increasing state funds and enabling the government to balance its budget, pay wages, and pensions, and meet its international debt repayment obligations.<sup>401</sup> Although one of the problems of the transition period was the lack of investment, oil sector investment jumped from roughly 25% of industrial investment before the crisis to around 35% from 2000 onwards. Particularly, the growth of oil-sector investment was led by companies controlled by the state or by oil industry insiders: by 2000 their investment was already 70% above 1998 levels.<sup>402</sup>

**Table 12: Oil Prices: 2000-2010 (January \$/barrel)**<sup>403</sup>

Year	Price	Year	Price
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<sup>399</sup> Ibid, p.23.

<sup>400</sup> Economic Survey of the Russian Federation (2006), *OECD Policy Brief*, November.

<sup>401</sup> HILL and FEE, p.465.

<sup>402</sup> AHREND: (2006) p.19.

<sup>403</sup> Index Mundi Available on site <http://www.indexmundi.com/commodities/?commodity=crude-oil-brent&months=300> (Accessed on 18 October 2011)

2000	25,22	2006	63,57
2001	25,64	2007	54,3
2002	19,49	2008	91,92
2003	31,29	2009	44,86
2004	31,18	2010	76,37
2005	44,28	2011	96,29

**Table 13: Exports of Russian Oil for 2000-2010<sup>404</sup>**

Year	Total (m/t)	Value million USD	CIS (m/t)	Non CIS (m/t)	Average Price of Export USD/bbl
2000	144,4	25271,9	16,9	109,8	23,94
2001	164,5	24990,3	23,7	110,4	20,78
2002	189,5	29113,1	33	111,1	21,02
2003	228	39679	37,2	121,9	23,81
2004	260,3	59044	40,1	115,5	31,02
2005	252,5	83438	38	97,3	45,21
2006	248,4	102282,9	37,3	98,5	56,32
2007	258,6	121502,8	37,3	104,8	64,28
2008	243,1	161147	38,2	92,6	90,68
2009	247,5	100593,2	36,5	103	55,61
2010	256,7	135799,3	26,6	106,2	74,11

**Table 14: Exports of Russian Natural Gas for 2000-2010<sup>405</sup>**

Year	Total (bcm)	Value million USD	CIS (bcm)	Non CIS (m/t)	Average Price of
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<sup>404</sup> Export of Russian Crude Oil for 2000-2010 (According to the Russian Federal Customs Service and the Federal State Statistics Service) Updated September 26, 2011  
[http://www.cbr.ru/eng/statistics/print.aspx?file=credit\\_statistics/crude\\_oil\\_e.htm&pid=svs&sid=vt1](http://www.cbr.ru/eng/statistics/print.aspx?file=credit_statistics/crude_oil_e.htm&pid=svs&sid=vt1) (Accessed on 18 October 2011).

<sup>405</sup> Russian Exports of Natural Gas For 2000-2010 (According to the Russian Federal Customs Service and the Federal State Statistics Service) Updated September 26, 2011  
[http://www.cbr.ru/statistics/print.aspx?file=credit\\_statistics/gas.htm](http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/gas.htm), (Accessed on 18 October 2011).

					<b>Export USD/ 1000 cm</b>
2000	193,9	16644,1	134,0	59,9	85,84
2001	180,9	17770	131,9	48,9	98,25
2002	185,5	15897,3	134,2	51,3	85,69
2003	189,4	19980,9	142,0	47,3	105,51
2004	200,4	21853,2	145,3	55,1	109,05
2005	209,2	31670,5	161,7	47,5	151,36
2006	202,8	43806,2	161,8	41,0	216
2007	191,9	44857,4	154,4	37,5	233,66
2008	195,4	69107,1	158,4	37,0	353,69
2009	168,4	41971,4	120,5	47,9	249,27
2010	177,8	47739,3	107,4	70,4	268,48

According to the IMF, the Russian federal government budget enjoyed a fiscal surplus equivalent to 7.4% of GDP in 2006; however, if oil-related revenues are excluded, the budget would have been in a deficit equivalent to 3.8% of GDP.<sup>406</sup> The significance of oil and other natural resources to the Russian economy is perhaps no more evident than in Russian foreign trade.<sup>407</sup> As an oil exporter in a period of rocketing oil prices, Russia has managed very large balance of payments and surpluses. The resulting inflow of currency has boosted the ruble money supply. During 2007 that particular inflow declined, but a sharp increase in inward investment kept the total currency inflow high.<sup>408</sup> As Putin stated “energy is, at least today, the most important motive force of world economic progress. The present and future prosperity of Russia depends directly on the place we occupy in the global energy context.”<sup>409</sup>

<sup>406</sup> COOPER: (2008) p.18.

<sup>407</sup> Ibid, p.19.

<sup>408</sup> HANSON: (2007a) p.870.

<sup>409</sup> Robert LEGVOLD: ( 2008) “Russia’s Strategic Vision and the Role of the Energy”, *NBR Analysis*, Russian Energy Policy and Strategy, Vol.1, No.2, p.14, Lukoil, Annual Report 2008, p.14 Available on site [http://www.lukoil.com/materials/images/Refining/AR\\_2008\\_ENG\\_44-51.pdf](http://www.lukoil.com/materials/images/Refining/AR_2008_ENG_44-51.pdf) (Accessed on August 2009); “There was a sharp correction in the oil price in 2008, following the steady growth of the previous even years. In the course of half a year the price fell from a record high to a four year low amid the crisis in the world economy. Main factors behind oil price growth in the first half of the year were weakening of the dollar to other main currencies, OPEC’s policy of limiting supply, slower rates of production growth by independent producers, and significant growth of demand from countries in the Asia-Pacific region and the Persian Gulf. As a result, prices for oil reached a historical peak in July 2008, when the Brent price

The Ministry of Economic Development and Trade released its plan on August 6, 2008, which called for a general crude oil slowdown in the years out to 2030 that would be out placed by the domestic oil consumption. Basic scenario for the oil and the natural gas sector is set out in the following:<sup>410</sup>

**Table 15: Crude Oil Production and Export Forecasts, Selected Years, 2010-2030<sup>411</sup>**

Million barrels/day		
Year	Production	Exports outside CIS
2010	10	4.28
2015	10.6	4.58
2020	10.7	4.5
2025	10.7	4.42
2030	10.6	4.42

**Table 16: Russian Natural Gas, Selected Years, 2010-2030 (billion cubic meters)<sup>412</sup>**

	2010	2015	2020	2025	2030
Natural gas production	701	800	880	910	935
Natural gas exports	181	237	279	310	310

Natural gas is another important export object for Russian economy however it needs special attention in comparison to oil exports, because Russia has less diversified ways to export natural gas and dependent to pipelines and transnational boundaries.<sup>413</sup> According to Paltsev, in the mid-2000s, there were predictions of a potential shortage of Russian gas exports due to inadequate

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approached \$145 per barrel. However, oil prices fell dramatically in the second half of the year as the world economy entered the crisis. Brent prices had fallen to \$26.5 per barrel by the end of the year as a result. Despite the abrupt decline of prices in the second half of the year, the average price for Brent crude in 2008 was \$97.3 per barrel, which is 34.4% more than in 2007.”

<sup>410</sup> Robert E. EBEL: (2009) “The Geopolitics of Russian Energy, Looking Back, Looking Forward”, CSIS, July, p.42, Available on site [http://csis.org/files/publication/090708\\_Ebel\\_RussianEnergy\\_Web.pdf](http://csis.org/files/publication/090708_Ebel_RussianEnergy_Web.pdf) (Accessed on August 2009)

<sup>411</sup> Ibid, p.44

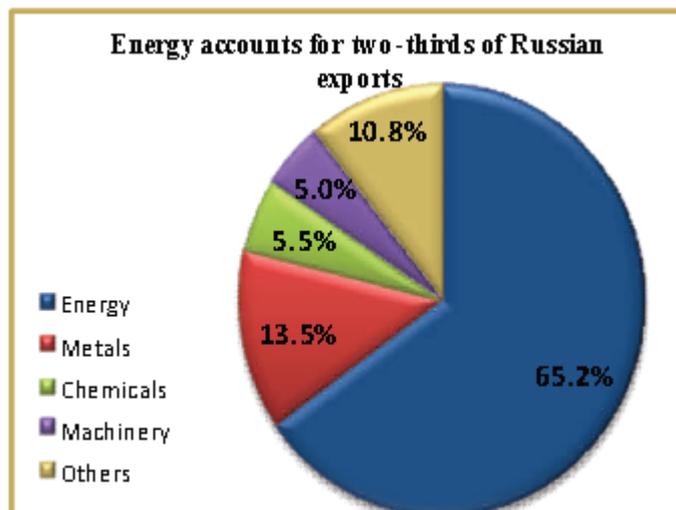
<sup>412</sup> Ibid.

<sup>413</sup> Sergey PALTSEV: (2011) “Russia's Natural Gas Export Potential Up to 2050”, MIT Center For Energy and Environmental Policy Research, *CEEPR WP*, 2011-012, July, p.2.

investments in infrastructure. Nevertheless, there are now new predictions on excess of gas exports due to LNG and shale gas competition.<sup>414</sup> Hence, during the period of 1998-2005, the Russian industrial gas sector was transferred from a commercially loss-making nightmare to a modestly profitable business for Gazprom selling at regulate prices.<sup>415</sup>

Thanks to Putin’s energy strategy Gazprom grew tremendously and even became a foreign policy actor for the Moscow. The stability of gas sectors not only an important aspect for export revenues also for the consumption and the social needs. Natural gas impact for the Russian economy is different from the oil, because gas has no obliged to organization such as OPEC. Therefore, Russia is almost independent to decide the price for every customer. Due to this reason, Russia managed to receive great income from natural gas trade in the last decade. Gazprom accounts for about 8% of Russia's GDP, one-fifth of its exports and one-fifth of its market capitalization.<sup>416</sup> Russia is today’s top natural gas exporter in the world with more than 220 bcm in 2010 and followed by Norway (99 bcm), Canada (95 bcm), Algeria (60 bcm) and Qatar (57 bcm) in top five countries.<sup>417</sup>

**Figure 6: Energy Accounts of Russian Export 2010**



Source: Oil & Natural Gas in Russia: Fueling Growth, BRIC Spotlight, January 2011, p.3, <http://www.thomaswhite.com/explore-the-world/bric-spotlight/2010/russia-oil-and-gas.aspx>

<sup>414</sup> Ibid, p.2-3.

<sup>415</sup> Jonathan P. STERN: (2005) “*The Future of Russian Gas and Gazprom*”, Oxford University Press, p.205

<sup>416</sup> Ander ASLUND: (2010) “Gazprom: Challenged Giant in Need of Reform”, in ed. Anders Aslund, Sergei Guriev and Andrew Kuchins, “*Russia After the Global Economic Crisis*”, Peterson Institute for International Economics, p.152.

<sup>417</sup> Index Mundi – Natural Gas Exports <http://www.indexmundi.com/map/?t=10&v=138&r=xx&l=en>

Concerning both oil and gas, it is a fact that Russia is extremely dependent on energy sectors for its economic growth. If you managed this situation, it is an advantage; otherwise, it can be a boomerang for a country. The problem is confirmed by the authorities, for example by Mikhail Kasyanov in January, 2004 when he was then Prime Minister stated that “in spite of numerous changes in the Russian economy, Russia is still too dependent on primarily commodity exports”.<sup>418</sup> It is an empirical fact that hydrocarbon exports, basically oil and gas are major driver of Russia's economy over the years as a result of the increasing production and prices. However, the dependence on oil and gas exports (65%) made the country vulnerable to economic crisis in case of low demand and reduction on prices.<sup>419</sup> The transition period of 1990s experienced a decline of hydrocarbon reserves’ production and prices simultaneously. Nevertheless, as a result of the privatization of energy sector, decision-making of energy sector also shifted from state companies to private companies. Thus, private companies often disregarded the interest of Russia and pursue its own goal of strategy as a rule of liberal economy. However, from the very beginning of his tenure, Putin intended to restore the Russian economy using the energy industry as well as taking into consideration Russian national interest first.<sup>420</sup>

#### **7.4.WTO Accession**

The World Trade Organization (WTO) was established in 1995 as the successor to the General Agreements on Tariffs and Trade (GATT) signed by the first members as long ago as 1948. The WTO provides the legislative basis for international commerce as well as the dispute settlement process for resolving conflicts in trade issues.<sup>421</sup> In terms of this engagement, the crucial point for Russia, will it be possible to carry out reasonable protectionist measures within the limits of

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<sup>418</sup> Robert L. LARSSON: (2006) “Russia’s Energy Policy: Security Dimensions and Russia’s Reliability as an Energy Power”, *FOI, Swedish Defense Research Agency*, FOI-R-1934-SE, March, p.53, Available on site <http://www2.foi.se/rapp/foir1934.pdf> (Accessed on 10 April 2009)

<sup>419</sup> Oil & Natural Gas in Russia: Fueling Growth, BRIC Spotlight, January 2011, p.3, <http://www.thomaswhite.com/explore-the-world/bric-spotlight/2010/russia-oil-and-gas.aspx>

<sup>420</sup> Adrian DELLECKE and Thomas GOMART: (2011) *Russian Energy, Security, and Foreign Policy*, Routledge, p.3.

<sup>421</sup> Heli SIMOLA: (2007) “Russia Getting Closer to WTO Membership – What are the Practical Implications?”, Bank Of Finland, *BOFIT*, 3, p.4

its formal obligations under future membership in the WTO.<sup>422</sup> The WTO agreements are based on a number of general principles. Members usually have to apply the principle of Most-Favored Nation (MFN) in their foreign trade. The MFN implies that countries on imports from any member country. The most important matter is that domestic and imported products and producers should be treated equally after entering the market.<sup>423</sup>

Russia is the largest economy and the largest country<sup>424</sup> in the world that is not a member of the WTO, and, as of early 2008, it was among 30 countries in the long process of negotiating its accession to the WTO. Russia applied for membership in the GATT in June 1993 and the GATT Working Party was transformed into the WTO Working Party in 1995.<sup>425</sup> When Putin became President in 2000, he promised that Russia would join the WTO by 2003, but has not accomplished this goal yet until the end of 2011.<sup>426</sup> Main subjects of the Russian WTO accession are (i) liberalization of barriers against multinational providers of business services, (ii) a 50% reduction in tariffs on goods; and (iii) on improvement in market access for Russian exports to WTO member country markets.<sup>427</sup>

The Working Party on accession of the Russian Federation to the WTO was established June 16, 1993. The WTO Working Party on Russia's accession comprises 60 countries and is the largest such Working Party in the history of the WTO.<sup>428</sup> WTO accession will impact on a wide range of policies and institutions, including tariff policy, customs administration, standards, and rights of foreign investors, agricultural policy, intellectual property and possibly government procurement.<sup>429</sup> Rutherford, Tarr and Shepotylyu says that despite the significant gains [we] estimate from WTO accession during a transition period it is likely that many households that displaced workers will lose as they are forced to seek new employment. [We] estimate that there will be a decline in employment in light industry, the food industry, mechanical engineering and

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<sup>422</sup> Yuriy BORKO: (2004) "Economic Transportation in Russia and Political Partnership with Europe" in Vladimir Baranovsky (ed.) *Russia and Europe, The Emerging Security Agenda*, SIPRI, Oxford University Press, p.485.

<sup>423</sup> Ibid.

<sup>424</sup> COOPER: (2008) p.13

<sup>425</sup> David G. TARR: (2008a) "Russian WTO Accession: Achievements, Impacts, Challenges", p.4, Available on site [www.oecd.org/dataoecd/28/4/40747249.pdf](http://www.oecd.org/dataoecd/28/4/40747249.pdf) (Accessed on 14 August 2008)

<sup>426</sup> Anders ASLUND: (2008) "An Assessment of Putin's Economic Policy", *CESinfo Forum*, 9, 2, p.17

<sup>427</sup> TARR: (2008a) p.6.

<sup>428</sup> TARR: (2008b) "Russian WTO Accession: What Has Been Accomplished, What can Be Expected?", p.2, Available on site [www.docstoc.com/docs/1003558/Russian-WTO-Accession-What-Has-Been-Accomplished-What-Can-be-Expected](http://www.docstoc.com/docs/1003558/Russian-WTO-Accession-What-Has-Been-Accomplished-What-Can-be-Expected) (Accessed on May 2009)

<sup>429</sup> Ibid.

metalworking and construction materials.<sup>430</sup> And finally the most important impact of WTO accession is expected on Russia is the liberalization of barriers against foreign direct investment in business services.<sup>431</sup>

During the accession negotiations, main question arose whether Russia should change the same price for the exports of its natural gas as its changes in its home market. This issue was highly controversial in Russia and was a major issue in the bilateral market access negotiations between the European and Russia.<sup>432</sup> In 2006 Russia's Trade Minister German Gref stated that *one of the most important problems resolves so far in the multilateral negotiations is gas prices. Russian domestic gas prices for industrial users will be lifted to a level that covers production costs*<sup>433</sup>

Domestic prices for Russian energy are regulated by the government while exports of energy products are related to world prices. Generally, domestic prices are lower than world prices. The European and the United States have pointed out that the gap between the world price for natural gas and the Russian domestic price has been as large as six to one, for electricity – five to one, and for oil – four to one. The “dual pricing”<sup>434</sup> is partially a result of a policy of providing affordable heating and electricity to residential customers regardless of ability to pay and providing favorable fuels rates to enterprises and to government agencies, such as the military.<sup>435</sup> Although WTO is complaining about some problems, Russian side has some objections too. For instance; in 2007 Putin made speech and called them (WTO and IMF) archaic, undemocratic and awkward and complained that the US, the EU, and Japan run the organization as if it were a privileged private club.<sup>436</sup>

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<sup>430</sup> T. RUTHERFORD, D. TARR, and O. SHEPOTYLU: (2005) “The Impact on Russia of WTO Accession and the Doha Agenda: The Importance of Liberalization of Barriers Against Foreign Direct Investment in Services For Growth and Poverty Reduction”, *World Bank Policy Research Paper 3725*, October, p.4.

<sup>431</sup> *Ibid*, p.13.

<sup>432</sup> TARR: (2008a) p.10.

<sup>433</sup> SIMOLA, p.5.

<sup>434</sup> For detailed information, David TARR and Peter THOMPSON: (2003) “The Merits of Dual Pricing of Natural Gas”, The World Bank, July 19, Available on site [http://siteresources.worldbank.org/INTRANETTRADE/Resources/Tarr&Thomson\\_DualPricingGasRussia.pdf](http://siteresources.worldbank.org/INTRANETTRADE/Resources/Tarr&Thomson_DualPricingGasRussia.pdf) (Accessed on 18 August 2008)

<sup>435</sup> William H. COOPER: (2006) “Russia’s Accession to the WTO”, *CRS Report For Congress*, Order Code RL31979, July 17, p.10 Available on site <http://www.usembassy.it/pdf/other/RL31979.pdf> (Accessed on 8 May 2009).

<sup>436</sup> Marshall I. GOLDMAN: (2008) “*Petrostate, Putin, Power and the New Russia*”, Oxford Uni. Press, p.207-08.

Progress during the Yeltsin era was slow. This was attributable in part to the huge task of building new institutions, the resistance of the sluggish and sometimes venal bureaucracy, the autocracy of Russia's regions, and the lack of commitment for the top.<sup>437</sup> When Putin came to power in 2000, one element of the economic programme announced by his Economy Minister, German Gref, was a renewed commitment to accelerate Russia's negotiations with WTO, with a view to securing agreement to early accession for the country.<sup>438</sup> Russia's entry into WTO, which Gref nearly succeeded in negotiating in late 2006 and from which Moscow retreated in 2008 when it became clear that other states would use the conflict in Georgia to block Russian entry.<sup>439</sup>

Due to reason of the Abkhazia and South Ossetia regions, Russia and Georgia have serious problems. These problems increased with the intervention of the Russian army into Georgia on early August 2008. Moreover, Prime Minister Putin said that he saw “no advantages” and “only burdens” to joining the WTO, after warnings from the West about its conflict in Georgia. And the decisions to formally recognize Abkhazia and South Ossetia has heightened tensions with the West-promoting some WTO members to warn that they will not allow Russia to join until it pulls out of the region.<sup>440</sup>

Within Russia itself there have been mixed feelings over the prospect of WTO membership. Some fear that the obligations related to membership will shrink many domestic sectors both in production and services.<sup>441</sup> On the other hand, Putin's emphasis on economic integration with West (WTO) runs directly counter to the Eurasianists' call for regional consolidation within the CIS and rejection of the global capitalist order.<sup>442</sup> Therefore, Russian government is not challenging only with external actors, but also internal ones. Putin and other Russian officials many times voiced their complaining about requirements for Russia's accessions have been raised higher than for previous applicants.<sup>443</sup>

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<sup>437</sup> BUSH, p.16

<sup>438</sup> SCHAFFER and SHABUNINA, p.18

<sup>439</sup> Jeffrey MANKOFF: (2009a) *Russian Foreign Policy, The Return of Great Power Politics*, Rowman & Littlefield Pub, p.84.

<sup>440</sup> BBC News (2008), “*Doubts Grow on Russia's WTO Plans*”, August 26, Available on site <http://news.bbc.co.uk/2/hi/business/7582079.stm> (Accessed on 8 May 2009).

<sup>441</sup> SIMOLA, p.4.

<sup>442</sup> MANKOFF: (2009a) p.81.

<sup>443</sup> BUSH, p.16.

Past last months, the ices between Russia and WTO have melt down and observed a great progress. Firstly, Prime Minister Putin said on September 19, 2010 that Russia is unlikely to join the WTO by the projected date of January 1, 2011. He said that “we want to join the WTO and are doing everything we can do to achieve this...But, in all honesty, I do not believe it will happen by January 1.”<sup>444</sup> It was understood from this statement that Prime Minister has a strong desire for accession. Only nine days later this time Putin said that “Russia will be ready to accept restrictions imposed by the WTO only after it has joined it.”<sup>445</sup> It seems that these words are accepted as kindly by the WTO side. On January 29, 2011, WTO Director-General Pascal Lamy said that “Russia has high chances to joining the WTO this year.” He continued that “for the first time in 10 years [17 years of accession process] since I have been dealing with the issue of Russia's accession to the WTO, I believe indeed that the chances that Russia will join the WTO are real”.<sup>446</sup> And finally on December 16<sup>th</sup>, it was announced that Russia is accepted as the member of WTO at the end of December 2011.<sup>447</sup>

### 7.5.Dutch Disease

In the Netherlands, which in the 1960s began the exploitation of the large Groningen natural gas field, the initial experience of these riches was wholly favorable. It removed the balance of payments constraint on growth, the income constraint on public expenditure, and provided abundant cheap energy. However, experience soon showed that there were also negative effects.<sup>448</sup> The discovery generated a resource boom that led to an appreciation of the Dutch guilder and a drop in manufacturing output and employment. Since this event, the combination of booming resource sector, a rising currency and a resulting decline in the competitiveness of

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<sup>444</sup> RIA Novosti (2010) “*Russia Unlikely to Join WTO by 2011 – Putin*” 21 September <http://en.rian.ru/business/20100921/160673783.html> (Accessed on 07 February 2011).

<sup>445</sup> RIA Novosti (2010) “*Russia Ready to Accept WTO Restrictions Only After Joining Says Putin*”, 30 September <http://en.rian.ru/russia/20100930/160778773.html> (Accessed on 07 February 2011).

<sup>446</sup> RIA Novosti (2011) “*Russia Could Become WTO Member in 2011 – Organization’s Chief*”, 29 January <http://en.rian.ru/world/20110129/162369292.html> (Accessed on 07 February 2011).

<sup>447</sup> BBC News: (2011) “*Russia Set to Become WTO Member After 18 Years of Talks*”, 16 December <http://www.bbc.co.uk/news/business-16212643> (Accessed on 16 December 2011).

<sup>448</sup> Roland GÖTZ: (2005) “*Russian Economic Security in a Medium-Term Perspective*”, in Hendskog, Jakob, Konnander, Vilhelm, Nygren, Bertil, Oldberg, Ingnor, and Pusiainen, Christer (ed.) *Russia as a Great Power, Dimensions of Security Under Putin*, BASEES, Routledge Series on Russian and East European Studies, USA and Canada, p.245.

non-resource sectors has been referred to as “Dutch Disease”.<sup>449</sup> However, when oil prices fell, the budget came under great tension and these programmes became difficult to finance. Since natural gas production employs very few people, this had the effect of reducing employment and increasing unemployment.<sup>450</sup>

There is a common argument among scholars that diagnosing “Dutch disease” is not easy. Concerning the Russian case, scholars are divided into three groups that Russia showing “Dutch disease”, not showing “Dutch disease” and developing “Dutch disease”. Götz claims that the first symptom associated with the Dutch disease was an overvalued currency. Other symptoms are big fluctuations of world market prices for raw material, creating exchange rate volatility and instability of export earnings.<sup>451</sup> The original nation of “Dutch disease” refers to the negative effect of natural resource discovery on the development of other tradable goods sectors within the economy.<sup>452</sup> Algieri is one of the analysts that claim the risk of Dutch Disease exists in Russian economy. And Algieri also proposes two preventive thrusts of action in order to reduce its threat: diversify the economy and to hold back the appreciation of the exchange rate through fiscal and monetary policies.<sup>453</sup>

Beck, Kamps and Mileva also claims that Russia showing “Dutch disease” symptoms;

The prominent role of raw material in Russia's exports and the significant real appreciation of the Russian ruble, may lead to concerns about the competitiveness of the non-oil industrial sector. The high importance of mineral extraction for Russia's economy makes the country susceptible to the Dutch disease phenomenon. The term Dutch disease refers to a situation in which new discoveries of natural resources or, as in the case of Russia, sharp rise in commodity prices lead to an increase in the equilibrium real exchange rate, thus undermining the competitiveness by the other tradable sectors in the economy. As suggested in the academic literature, the Dutch disease is associated

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<sup>449</sup> Ryan MACDONALD: (2007) “No Dutch Disease, Its China Syndrome”, Insights on the Canadian Economy, Analytical Paper, Canada, August, p.5 Available on site [http://dsp-psd.pwgsc.gc.ca/collection\\_2007/statcan/11-624-M/11-624-MIE2007017.pdf](http://dsp-psd.pwgsc.gc.ca/collection_2007/statcan/11-624-M/11-624-MIE2007017.pdf) (Accessed on 05 February 2011)

<sup>450</sup> Micheal ELLMAN: (2006) *Russia's Oil and Natural GAs, Bonanza or Curse?*, in Micheal Elman (ed.) Anthem, p.4, Rudiger AHREND, Donato de ROSA, and William THOMPSON: (2008) “Russian Manufacturing and the Treat of ‘Dutch Disease’, A Comparison of Competitiveness Developments in Russian and Ukrainian Industry”, *Economics Department Working Papers*, No.540, EKO/WKP (2206), 68, 25 January, p.6.

<sup>451</sup> GÖTZ: (2005) p.245.

<sup>452</sup> Volchkova, Natalia (2006) “Is Dutch Disease Responsible for Russia's Energy Dependent Industrial Structure?”, *The World Bank*, Vol.4, Issue 38, p.2 Available on site [http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/Day\\_2\\_Session\\_5\\_Eng.pdf](http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/Day_2_Session_5_Eng.pdf) (Accessed on 09 May 2009).

<sup>453</sup> Bernardina ALGIERI: (2011) “The Dutch Disease: Evidences From Russia”, *Econ Change Restruct* 44, p.243.

with four main symptoms; a slowdown in manufacturing output, a booming non-tradable sector, an increase in real wages and real exchange rate appreciation.<sup>454</sup>

On the other hand, Tabata argues that Russian economy is immune to “Dutch disease” by saying that one of the most significant causes of the great depression of the 1990s in Russia was the high exchange rate of the ruble maintained by the competitive exports of fuels. By this high exchange rate, imports of consumer goods and manufactured goods were promoted, resulting in a reduction in the production of domestic manufacturing industries. The phenomenon is usually called Dutch disease.<sup>455</sup> However, due to increase in oil export revenues, the ruble has been gradually appreciated in real terms since 1999. Therefore, it is one of the reasons that shows that Russian economy is immune from Dutch disease.<sup>456</sup>

Oomes and Kalcheva are also supporters that diagnosing is not easy. They concluded that “although we find evidence of real appreciation a declining manufacturing sector, an expanding service sector, and rapid real wage growth, more research is needed to determine that these symptoms are not caused by other factors. Nevertheless, the risk of Dutch disease exists and warrants close monitoring.”<sup>457</sup> Whereas Borko says that there is a developing “Dutch disease” phenomenon in Russia; “especially after 2003 Russian economic data develop reflecting the symptoms of Dutch disease; real exchange rate has accelerated, the prices of services increased relative to tradable prices, the manufacturing growth slowed down, while the service sector performed well, the employment shifted to service sector.”<sup>458</sup>

Ahrend, de Rosa and Thompson accept that the most immediately visible “symptom” of Dutch disease is the rapid appreciation of the real exchange rate that is often connected with natural resource booms.<sup>459</sup> But they added that in any case, diagnosing a case of Dutch disease is not easy. The shift of employment from manufacturing to services is a common structural trend and is particularly pronounced in transition economies owing to the communist system’s tendency to

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<sup>454</sup> BECK, KAMPS , and MILEVA, p.14.

<sup>455</sup> TABATA: (2006a), p.3.

<sup>456</sup> Ibid, p.5.

<sup>457</sup> Nienke OOMES and Katerina KALCHEVA: (2007) “Diagnosing Dutch Disease: Does Russia Have the Symptoms?”, BOFIT Discussion Papers, 7, April, p.27.

<sup>458</sup> Tamas BORKO: (2007) “The Suspicion of Dutch Disease in Russia and the Ability of the Government to Counteract”, *ICEG Working Paper*, No.35, December, p.15.

<sup>459</sup> AHREND, de ROSA, and THOMPSON, p.6

neglect services and over-develop industry.<sup>460</sup> As a result while there is no significant evidence in favor of “Dutch disease” effect spreading across Russian economy the danger of resource dependence negative effect on Russian economic development still remains because of underdeveloped market and governmental institutions.<sup>461</sup>

## 7.6.Re-Nationalization Policy

As we have seen in the previous chapter of this study, many policy documents are underlining three important aspects: promoting economic growth, extending Russia's international influence, and ensuring Russia's economic independence.<sup>462</sup> In his first presidential term, Putin focused on the strengthening of the state's role in energy companies by consolidating the blocks of the government's shares. Putin's slogan of “an equal distance between the oligarchs and the government”, as well as the very definite steps taken against some of them, proved that even the most influential “sharks” in Russian business.<sup>463</sup> And his second term, which started in May 2005, his clear priority in the energy sector became the creation of large public companies able to function and compete with currently existing private companies.<sup>464</sup> Cooper says that “If Putin's first term of office was marked by achieving economic stability and launching some critical reforms, the second term was largely characterized by the government's re-establishing control over critical sectors of the Russian economy.”<sup>465</sup>

The Putin administration was using the method of re-nationalizing companies directly by taking control of assets or indirectly through supposedly private sector companies in which the Russian government has substantial ownership. The first conspicuous step for the re-nationalization was the attack on the Yukos oil company and its president, Mikhail Khodorkovsky. On October 25, 2003, Khodorkovsky was arrested and charged with tax evasion.<sup>466</sup> Before the crisis between Yukos and the administration, Yukos was openly pursuing negotiations with the Chinese

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<sup>460</sup> Ibid, p.7

<sup>461</sup> VOLCHKOVA, p.21

<sup>462</sup> LARSSON: (2006) p.50

<sup>463</sup> Eva PASZYC, and Iwona WISNIEWSKA: (2002) “Big Business in the Russian Economy and Politics Under Putin's Rule”, EES Studies, Centre for Eastern Studies, p.57 Available on site [http://pdc.ceu.hu/archive/00002224/01/big\\_business.pdf](http://pdc.ceu.hu/archive/00002224/01/big_business.pdf) (Accessed on 12 August 2008)

<sup>464</sup> TKACHENKO: (2008) p.7

<sup>465</sup> COOPER: (2008) p.14

<sup>466</sup> Micheal FREDHOLM: (2005) “The Russian Energy Strategy and Energy Policy: Pipeline or Mutual Dependence?”, *Conflict Studies Research Centre*, Russian Series 05/41, p.12

government for the construction of the pipeline from Angarsk to Daqing. Concurrently, Khodorkovsky had engaged in discussions with US officials on the construction of a new pipeline to the Russian deep-water part of Murmansk<sup>467</sup>, which would facilitate increased exports of Yukos-produced oil to the United States. Yukos also publicly announced a series of crude oil shipments to the Port of Houston in the United States in the summer of 2002, to showcase its potential to meet future US energy needs.<sup>468</sup>

As a result, the government seized Yukos's assets to pay tax penalties and sold them at below market value prices to Rosneft, a state-owned oil company.<sup>469</sup> Larsson quotes to Milov that Putin has a "psychological barrier" of a maximum share of foreign ownership. He states that Putin believes that foreign enterprises should not be allowed to own a larger share than 20% of a Russian energy company. As an example, it can be stated that when Yukos and Khodorkovsky in 2003 tries to sell a 25% share of YukosSibneft to ExxonMobile, Putin blocked the deal as it was market driven and beyond his control.<sup>470</sup> On 22 December 2004, the Baikal group was acquired by Rosneft, giving the government over Yukos and overnight tripling Rosneft's oil output.<sup>471</sup> Afterwards, as a certain aspect of the re-nationalization, in February 2005, Russia's Natural Resource Ministry announced that foreign companies would be banned from bidding for large strategic oil and metal deposits. According to this new regulation, foreign participation will be permitted only for ventures in which a Russian particular has at least a 51% shareholding.<sup>472</sup>

Putin changed the leadership of Gazprom in spring 2001 and consolidated into the hands of its leadership at least half of its assets, which had been trusted to "friendly companies" by the previous generation of Gazprom's managers.<sup>473</sup> While Gazprom was becoming a giant in the natural gas sector, Rosneft was rising in the oil sector which is the only state controlled oil

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<sup>467</sup> Julia NANAY: (2009) "Russia's Role in the Eurasian Energy Market", in Jeronim Perovic, Robert W. Orttung, and Andreas Wenger (ed.) *Russian Energy Power and Foreign Relations*, Routledge, p.112

<sup>468</sup> HILL: (2004) p.36

<sup>469</sup> COOPER: (2008) p.15

<sup>470</sup> LARSSON: (2006) p.52.

<sup>471</sup> Richard SAKWA: (2009) *The Quality of Freedom, Khodorkovsky, Putin and the Yukos Affair*, Oxford Univeristy Press, p.186.

<sup>472</sup> BAYULGEN, p.40.

<sup>473</sup> Vladimir MILOV: (2006) "The Future of Russian Energy Policy", The Brookings Institution, Washington D.C., November, p.11 Available on site <http://www.brookings.edu/~media/Files/events/2006/1130russia/20061130.pdf> (Accessed on 22 July 2007)

"...the surprise was the telegram that the CEO of the Russian power monopoly RAO UERS, Anatoly Chubais, had received from Gazprom the day before the cold temperatures about the occur. The telegram was saying that there was going to be no gas supplied to power stations in Central Asia, so they have to get on somehow wiThout it".

company among the other companies in Russia. It also remains within the Presidential Administration's powers to allow entry for multinational energy companies in the Russian market. In the subject of the transportation of oil and gas; state institutions (Kremlin – *emphasis added*) are the sole responsible units for deciding the routes of new pipelines and locations of new part terminals for expanding oil and oil products as well as for selection of partners (investors and contractors) among foreign governments and foreign private companies.<sup>474</sup>

From 2005-2007 the government increased its stake in the oil industry through Gazprom, the state-controlled company that has a monopoly on Russian gas exploration and production. It bought controlling shares in Sibneft, a once private company. It also bought Sakhalin Energy Company, which had been led by Shell Oil and TNK-BP, a joint venture between BP and a group of private Russian companies. The latter two acquisitions occurred after the Russian government cited projects by these companies for environmental regulation infringements and licensing issues. As a result of these acquisitions, state control of the oil industry increased from around 18% to over 50% between 2004 and 2007, according to one estimate.<sup>475</sup>

The draft of the proposed New Subsoil Law was submitted by government in 2005 which was prepared according to the energy security strategy. Arbatov, Belova and Feygin says that;

This seemed to be a new strategy of the Russian authorities, as “controlled foreign involvement”. This strategy is based on providing state-supported national companies with exclusive rights to control a majority stake in the field operator companies, and offering foreign investors an opportunity to buy a minority stake in such companies (the so-called 51/49 concept). Under such a regime, foreign participation is tolerated, because international investors would bring the necessary capital, technologies, knowledge and personnel to ensure proper development of the fields.<sup>476</sup>

This development represents that Kremlin does not need to own 100% of shares in order to fully control the subordinate enterprises. Yet still, privatization of minority stakes is an important way of attracting foreign capital to Russia. For instance, in July 2006 the authorities received nearly US\$ 11 billion by selling 15% of Rosneft shares in an initial public offering.<sup>477</sup> The re-

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<sup>474</sup> TKACHENKO: (2008) p.4.

<sup>475</sup> COOPER: (2008)p.15

<sup>476</sup> Alexander ARBATOV, Maria BELOVA, and Vladimir FEYGIN: (2006) “Russian Hydrocarbons and World Markets”, *Russia In Global Affairs*, Vol.4, No.1, p.120.

<sup>477</sup> Iwona WISNIEWSKA: (2007) “The Invisible Hand of the Kremlin Capitalism a la Russe”, *Center for Eastern Studies*, Warsaw, February, p.41 Available on site [http://www.osw.waw.pl/sites/default/files/PUNKT\\_WIDZENIA\\_14.pdf](http://www.osw.waw.pl/sites/default/files/PUNKT_WIDZENIA_14.pdf) (Accessed on 7 February 2009).

nationalization and privatization formed a new type of companies in Russia, which are called State-Owned Enterprises (SOE's) where the state has significant control, through full, majority, or significant minority ownership. The policy of the state property management of the Russian government aimed to consolidate existing state participants into holding companies beyond the fuel and energy sectors, to increase the state in strategic enterprises to a controlling level, and to privatize minority stakes of firms in non-strategic sectors.<sup>478</sup>

**Table 17: Ownership of the federal government; Unitary Enterprises, Stakes in JSCs and their size, golden shares**<sup>479</sup>

	2001	2002	2003	2004	2005	2006	2007	2008
Number of Federal State Unitary Enterprises	n.a.	9394	9860	9222	8293	7178	6533	5709
Number of JSCs* with a stake of the federal government	3524	4407	4205	3905	3524	3481	3816	3674
Of which with size of the stake in %								
Less than 25%	49,5	51,5	51,1	49,9	38,8	30,5	24,4	21
From 25% to 50%	34,4	31,8	31,8	30,3	31	25,4	21,3	17,6
More than 50%	14,4	14,7	14,3	12,8	13,5	11,4	9,6	7,3
100%	1,7	2	2,8	7	11,7	32,6	44,6	54,1
Number of firms where the federal government owns a golden share			118	251	259	243	181	n.a.

\*Joint Stock Company

**Table 18: The Ten Largest Companies Controlled by the State according to the Expert making of Russian Companies by Market Capitalization, 2004 and 2008**<sup>480</sup>

2004 (September 1)				2008 (September 1)			
Rank	Company name	Market capitalization million \$	State share %	Rank	Company name	Market capitalization million \$	State share %
1	Gazprom	46660	38	1	Gazprom	236187	50,1
7	RAO UES	10884	53,8	2	Rosneft	92968	84,6
9	Sberbank	7431	60,6	4	Sberbank	51058	60,6
15	Mosenergo	3220	95,3	9	Gazprom Neft	22787	73,7

<sup>478</sup> Carsten SPRENGER: (2008) "The Role of State-Owned Enterprises In the Russian Economy", *ICEF Working Paper*, International Research Laboratory in Financial Economic, Moscow, December 4, p.2.

<sup>479</sup> Ibid, p.6.

<sup>480</sup> Ibid, p.13.

21	Rostelekom	1469	50,7	12	Vneshtorgbank	18823	77,5
22	Uralsvyazinform	1153	57,8	15	Rushydro	16738	60,4
23	Aeroflot	1142	51,2	22	Rostelekom	8349	50,7
25	Rosneft- Purneftegaz	1015	82	23	UES	6377	77,7
33	Volga Telecom	679	51	26	Bank of Moscow	5531	44
34	Bashneft	664	63,7	32	Mosenergo	4043	60,5
Market capitalization of ten largest SOEs		74317		Market capitalization of ten largest SOEs		462861	
Total market capitalization		237014		Total market capitalization		975098	
Share of ten largest SOEs %		31,4		Share of ten largest SOEs %		47,5	

In order to analyze Russian economy and its re-nationalization period, it should be noted that former President Putin had an academic degree with the PhD thesis of “Mineral Resources Reproduction of a Region in the Process of Establishment of Market Economy”<sup>481</sup> In his thesis; Putin presented his idea of the raw material concern supporting the development of the Russian economy. According to Putin full state control over this sector would guarantee the most effective management of Russian natural resources. The state should regulate this market closely and stimulate its development by creating “national leaders”, holdings, associated with the state, which would be large enough to successfully compete on the international arena.<sup>482</sup> By judging the uncontrolled privatization period of 1990s, he thinks that the country would be best served by establishing vertically integrated companies encompassing whole industries that could compete in world markets.<sup>483</sup> And Russia's natural resource base will not only secure the country's economic development but will also serve as the guarantee of the country's international position. Because Putin believes that Russian ownership of Russia's resource base is critical to Russia's economic recovery and to the country's reemergence as an important international actor.<sup>484</sup>

Consequently, the state concerns and private companies which are controlled by the Kremlin not only actors in economics other than serve as important instruments of pressure in Russian

<sup>481</sup> TKACHENKO: (2008) p.7

<sup>482</sup> WISNIEWSKA, p.44

<sup>483</sup> Richard SAKWA: (2004) *Putin: Russia's Choice*, Routledge, p.12.

<sup>484</sup> Martha Brill OLCOTT: (2004) “Vladimir Putin and the Geopolitics of Oil”, (*The Energy Dimension in Russian Global Strategy*), The James A. Baker III Institute For Public Policy of Rice University, October, p.16

foreign policy. As long as Moscow has a capability to control over the economy, it will allow the authorities to manipulate the amount of energy resources supplied, their transit routes and their prices.<sup>485</sup> During the 1990s, the privatization process evolved into a depredation throughout Russian state. Yet, re-nationalization policy turned the process upside down and estranged Oligarchs from vital sectors as well as Kremlin. As a result, after almost a decade Putin has shifted the centre of energy coordination and decision-making back towards the state, away from the private business sector as he wrote in his thesis.<sup>486</sup>

## 8. THE IMPACT OF THE 2008 CRISIS AND TODAY

Russia has succeeded to obtain 5% annual real economic growth rate between 2000-08; however, the high dependence on the revenues from energy exports was also one of the major factors during the global crisis of 2008-09 effects on Russian economy.<sup>487</sup> The impact of the economic crisis on the Russian economy was stronger than any other G-20 economy. Not only was the 8% Russian GDP contradiction for 2009 the largest among G-20 countries, but also the change in the growth rate between 2008 and 2009.<sup>488</sup> As oil prices in 1998 plunged in response to the Asian crisis of the previous year, and Russia suffered a financial crisis, including a twofold real devaluation and a default on domestic debt.<sup>489</sup> The 1998 crisis is not remembered only a financial crises but also a political crisis.<sup>490</sup> The crisis affected Russia from three ways, first is the oil price which was peaked at almost \$150 bbl/d in summer 2008 and then fell below \$40 bbl/d just half a year later. Secondly, Russian financial system suffered greatly during the 2008-2009 crises because it is highly dependent on the price of oil and the international financial markets.<sup>491</sup> And finally the export and import numbers fell down.<sup>492</sup>

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<sup>485</sup> WISNIWESKA, p.39

<sup>486</sup> Erik JANSSEN: (2005) "Can Russian Oil Growth Be Sustained?", Clingendael International Energy Programme, October, p.7 Available on site [http://www.clingendael.nl/publications/2005/20051000\\_ciep\\_briefing\\_russian-oil.pdf](http://www.clingendael.nl/publications/2005/20051000_ciep_briefing_russian-oil.pdf) (Accessed on August 2009).

<sup>487</sup> PALTSEV: (2011) p.1.

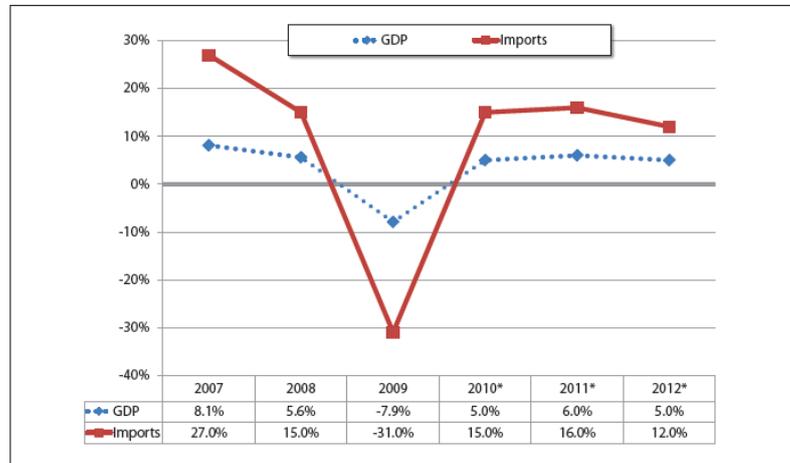
<sup>488</sup> S. GURIEV and A. TSYVINSKI: (2010) "Challenges Facing the Russian Economy After The Crisis", in Ander Aslund, Sergei Guriev, and Andrew Kuchins (ed.) "Russia After the Global Economic Crisis", Peter G. Peterson Institute for International Economics, p.17.

<sup>489</sup> Cliffer G. GADDY and Barry W. ICKES: (2010) "Russia After the Global Financial Crisis", *Eurasian Geography and Economics*, 51, No.3, p.281.

<sup>490</sup> Stephen SESTANOVISH: (2008) "Russia and the Global Economic Crisis", *CFR Expert Brief*, 25 November Available on site <http://www.cfr.org/economic-development/russia-global-economic-crisis/p17844> (Accessed on 07 January 2001)

<sup>491</sup> Laura SOLONKO and Zuzuna FUNGOCOVA: (2010) "The Russian Banking Industry After the 2008-2009 Financial Crisis-What Next?", *Russian Analytical Digest*, No.74, 3 March, p.2.

**Figure 7: Russia's Economic Development in 2007-2009 and the September 2010 Bank of Finland Forecast for 2010-2012, %**<sup>493</sup>



Rosstat numbers indicate that total gas production was reduced 20%, and Gazprom produced 25% less gas in the first half of the 2009 compared to the same period in 2008. Meanwhile, Russian domestic gas consumption decreased about 10% in addition to 17% in industrial production.<sup>494</sup> The outflow of capital in 2008 October was \$50 billion and the Russian stock market had down 70% during the crisis. And the government spent more than 20% of its foreign-exchange reserves.<sup>495</sup> By the end of 2008, total number which had been pulled out from Russia was about \$130 billion.<sup>496</sup> However, Russian administration prevented the collapse of the banking system. They injected a massive liquidity to ensure that no major bank collapsed.<sup>497</sup> On the one hand global recession was going on and on the other hand Russia threatened Georgia and sent troops to some parts of the Georgia and as a result it triggered large flight of foreign investment from Russia in the second half of 2008. In order to arrange the Ruble value, Moscow spent \$200 billion from the Reserve Fund.<sup>498</sup>

<sup>492</sup> Pekka STUELA: (2010) "Forecasting the Russian Economy for 2010-2012", *Russian Analytical Digest*, No.88, 29 November, p.2.

<sup>493</sup> Ibid, p.4

<sup>494</sup> Daniel Buikema FJAERTAFT: (2009), "Russian Gas – Has the 2009 Economic Crisis Changed Russian Gas Fundamentals?", *BOFIT*, 10/2009, p.16.

<sup>495</sup> SESTANOVICH.

<sup>496</sup> Jeffrey MANKOFF: (2010a) "Internal and External Impact on Russia's Economic Crisis", *IFRI*, Russia/NIS Center, March, p.7.

<sup>497</sup> GURIEV and TSYVINSK, p.22.

<sup>498</sup> Jeffrey MANKOFF: (2010b) "The Russian Economic Crisis", *Council on Foreign Relations Special Report*, No.53, April, p.4-5.

According to Gaddy and Ickes, compare to past, Russia was better prepared this time. Today's Russian leaders have learned lessons from the past. Its foreign exchange reserves, which grew to become the third largest in the world, played a critical role in protecting Russia's financial sovereignty and the welfare of its citizens.<sup>499</sup> Mankoff is also agree with Gaddy and Ickes that Kremlin's intervention to cope with the crisis has been successful in preserving social peace and preventing a return to the worst moments of earlier crisis.<sup>500</sup> Finally, the return of high oil prices had important implications for the Russian economy; the markets believed that the global crisis was over and demand for oil was higher, and growth in Russia resumed.<sup>501</sup> Even only few months after the crisis, Russia announced that it would lend \$2 billion to Belarus, \$500 million to Armenia, \$500 million to Moldova, and \$2.1 billion to Kyrgyzstan.<sup>502</sup>

Today the most important element that explains the Russia's medium-term growth is the productivity. After the crisis of year 2008, Russia achieved to maintain \$10.521 GDP in 2010, and between the 2000-09 periods achieved a GDP growth rate of 5.5% compare to whole OECD countries 1.7%.<sup>503</sup> And according to IMF report, growth in Russia is projected to reach about 4.3% for 2011 and 4.1% for 2012, including the oil production of 10.6 million bbl/d in 2011.<sup>504</sup> Russia has completed the year 2010 Leading Exporter Countries in rank 12 and the Leading Importer Countries in rank 18. More importantly, Russian export fuel of share in economy was 60.8% in 2005 and rose to 63.3% in 2010 while merchandise exports' share was 21.7% in 2005 and shrunk to 20.2% in 2010.<sup>505</sup>

**Figure 8: Evolution of Russian and OECD GDP, 2000 and 2009-10.**<sup>506</sup>

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<sup>499</sup> GADDY and ICKES: (2010) p.308.

<sup>500</sup> MANKOFF: (2010a) p.7.

<sup>501</sup> GURIEV and TSYVINSK, p.28.

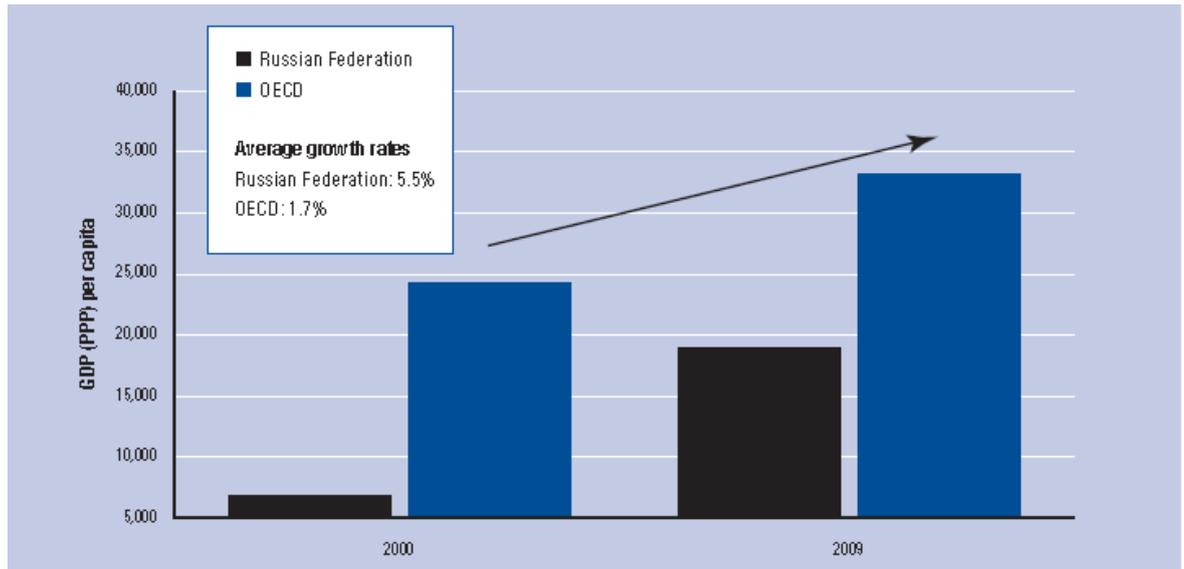
<sup>502</sup> MANKOFF: (2010b) p.12.

<sup>503</sup> Margareta DRZENIEK and Alexey PRAZDNICHNYKH: (2011) "The Russia Competitiveness Report 2011", *Eurasia Competitiveness Institute*, World Economic Forum, p.3.

<sup>504</sup> IMF, World Economic Outlook 2001, September, p.81.

<sup>505</sup> WTO, Internaitonal Trade Statistics 2011.

<sup>506</sup> DRZENIEK and PRAZDNICHNYKH: (2011) p.4.



## 9. ENERGY STRATEGY DOCUMENTS

### 9.1. Energy Strategy for Russia for the Period up to the Year 2020

On 7 May 1995, President Boris Yeltsin confirmed the first post-Soviet Russian energy strategy: “On the Main Directions of Energy Policy and Restructuring of the Fuel and Energy Industry of the Russian Federation for the period up to the year 2020”. On 13 October 1995 the Russian government followed up by approving a document known as “Main Provisions of the Russian Energy Strategy”.<sup>507</sup> Under the presidency of Vladimir Putin, the first changes on 23 November 2000, when the Russian government approved a document known as “Main Provisions of the Russian Energy Strategy to 2020”.<sup>508</sup> In September 2003, it was enlarged for the period up to 2020. It’s a very detailed and technical document oriented on the growth of energy production.<sup>509</sup>

Two scenarios of social and economic development of Russia lie at the heart of the energy strategy: Moderate and Optimistic. Optimistic scenario is characterized by the growth of GDP 3,3 times more of the level of 2000 by 2020, by a seven times increase of physical investment into the fixed capital for this period, by high world prices for Urals oil (up to 30\$bbl in 2020 and gas (138\$ thousand cm in 2020. The moderate scenario is characterized by the GDP growth 2,3

<sup>507</sup> FREDHOLM, p.2-3

<sup>508</sup> Ibid, p.3

<sup>509</sup> TKACHENKO: (2008) p.5

times more to the level of 2000 by 2020, the increase of physical investment fixed capital 3,6 times more for the concerned period, fixed prices for Urals oil at the world market on the level of 18,5\$ bbl, average contract prices for gas which are no more than 118,5\$ thousand cm. This scenario foresees the decrease in the power intensity of GDP by 2020 by 42-4% compared to 2020.<sup>510</sup> According to document of the national energy strategy for the period up to 2020, natural gas production is expected to increase from the 598 bcm in 2005 to 730 bcm under the optimistic and to 680 bcm under the pessimistic scenario by 2020. And it forecasts to supply 450 m/t of oil under pessimistic scenario and 520 m/t under optimistic scenario.<sup>511</sup>

The main goals of the energy policy are to;<sup>512</sup>

- Export energy resources
- Attract FDI to the national energy sector
- Transport energy
- Promote the exploration and production of activities of the Russian fuel-energy sector abroad
- Increase the presence of Russian companies in foreign markets (both in upstream and downstream sectors).

According to Leijonhielm and Larsson, Russia states that it aims to utilize energy policy for security purposes. This idea connects to the general notion of security and strives, by non-military means, to extend Russia's influence abroad, to secure its independence.<sup>513</sup> Main goal of the Putin government's energy strategy until 2020 is to use Russia's substantial energy resources and strong fuel-energy industry as a base for expanding Russian political power. Therefore, the document confirms that the "energy resources" are crucial for the country's geopolitical

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<sup>510</sup> The Summary of the Energy Strategy of Russia for the Period of up to 2020 (Resume), Ministry of Energy of the Russian Federation, 2003, Moscow, p.6

Available on site [http://ec.europa.eu/energy/russia/events/doc/2003\\_strategy\\_2020\\_en.pdf](http://ec.europa.eu/energy/russia/events/doc/2003_strategy_2020_en.pdf) (Accessed on 13 July 2007)

<sup>511</sup> Tuuli JUURIKALA and Simon-Erik OLLUS: (2006) "Russian Energy Sector – Prospects and Implications for Russian Growth, Economic Policy and Energy Supply", *BOFIT*, 4, p.13-15

<sup>512</sup> Danila BACHKAREV: (2006) "*Russian Energy Policy During President Putin's Tenure: Trends and Strategies*", GMB Publishing, p.8, Ivanov, Igor (2001) "The New Russian Identity: Innovations and Continuity in Russian Foreign Policy", *The Washington Quarterly*, 24:3, p.1

<sup>513</sup> LEIJONHIELM and LARSSON, p.11

influence and the foreign policy.<sup>514</sup> As a result, document advances the basic idea that Russia's resource endowment is essential to its domestic energy security and to sustained economic growth.<sup>515</sup>

**Table 19: Russian Energy Production and Exports<sup>516</sup>**

	Production		Exports, US\$billion	
	2002	2020	2002	2020
Oil (million tons)	380	450-520	184	140-310
Oil Products (million tons)	135	146-166	75	30-50
Natural Gas (billion m3)	590	680-730	185	235-245
Coal (million tons)	253	375-445	47	55-60
Power Generation (billion kWh)	892	1.215-1.365	14	30-75

## 9.2. Energy Strategy for Russia for the Period up to the Year 2030

After adopting the energy strategy up to year 2020, Russian Federation needed to replace that document with the new one. The main initiative behind this policy is the economic crisis of the 2008. Due to reason of the financial crisis of 2008, Russia's all production, exploration and investment forecasts were affected. During the crisis both domestic and consumption and energy exports reduced and not only the crisis hit the budget also had an impact on the energy strategy for the 10 years. Therefore in order to recover its energy sector as soon as possible government adopted this new strategy document.

The objective of the energy policy of Russia is to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population and promote strengthening of foreign economic positions of the country.<sup>517</sup>

Document basic goals are;

<sup>514</sup> Keith C. SMITH: (2004) *Russian Energy Politics in the Baltics, Poland and Ukraine, A New Stealth Imperialism*, The CSIS Press, December, p.17.

<sup>515</sup> GADDY, HILL, DANCHENKO, and IVANOV, p.21

<sup>516</sup> Vladimir I. IVANOV: (2003) "Russian Energy Strategy 2020: Balancing Europe with the Asia-Pacific Region", *ERINA Report*, No.53, August, p.13 Available on site <http://www.erina.or.jp/en/Research/db/pdf2003/03081e.pdf> (Accessed on 8 August 2008)

<sup>517</sup> Energy Strategy of Russia For The Period Up To 2030 (2010), p.10.

- Improvement of the efficiency of reproduction, extraction and processing of energy resources to meet domestic and external demand for them;
- Modernization and construction of a new energy infrastructure on the basis of large-scale technological updating of the country's energy sector;
- Establishment of a stable institutional environment within the energy sector;
- Improvement of the energy and environmental efficiency of the Russian economy and energy sector, including through structural changes and activation of technological energy saving;
- Further integration of the Russian energy sector into the world energy system.

Document concentrated on three phases for the Russian energy strategy up to 2030. In the first phase of years 2013-15, the consequences of the 2008 crisis will be overcome while building a foundation for the future development. It is also envisioned that critical tendencies in the energy sector such as decreasing production are to be overcome, and conditions will be created for faster development and modernization of the sector. During the second phase of 2015-22, the fuel-based sector is to be made top efficient, modern innovative technologies will be introduced for the energy sector, and most importantly the new oil and gas production centers in Far East, Eastern Siberia will be developed and maximized. Finally, in the period of the 2022-30, the economy will be turning towards the use of alternative sources of energy and the dependence on export of hydrocarbons in Russian economy will be reduced by half.<sup>518</sup>

Concerning the oil sector, it is envisioned that reserves will be increased to 5,122 m/t in 2030. Western Siberian resources will increase to 1,205 m/t to 2,500 m/t and Eastern Siberian resources will increase to 165 m/t to 1,200 m/t in 2030. Moreover, oil production is estimated to grow up to 530-35 m/t at the end of phase three. And finally, the investment plan for the oil sector is forecasted \$609-25 billion. With regard to natural gas sector, the estimated reserves for the year 2030 is 6,500 bcm including Western Siberia 3,000 bcm, Eastern Siberia 1,200 bcm and Seas of Russia 2,000 bcm. According to the document, the share of new regions in the total gas production will be %15 in 2030. And the gas production development is estimated at 885-940 bcm.<sup>519</sup>

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<sup>518</sup> Barents Observer (2009) "Russia Adopted New Energy Strategy", 28 August <http://www.barentsobserver.com/russia-adopted-new-energy-strategy.4625792-116320.html>, (Accessed on 08 February 2011), Russian-American Business (2009) "Energy Strategy 2030", 3 November [http://russianamericanbusiness.org/web\\_CURRENT/articles/545/1/Energy-strategy-2030](http://russianamericanbusiness.org/web_CURRENT/articles/545/1/Energy-strategy-2030) (Accessed on 08 February 2011), Robin PAXTON: (2009) "Russia Unveils \$2 Trillion Energy Growth Plan to 2030", Reuters, 26 November <http://www.osw.waw.pl/en/publikacje/eastweek/2009-09-02/russias-new-energy-strategy> (Accessed on 08 February 2011), Eastweek (2009) "Russia's New Energy Strategy", Centre For Eastern Studies, 2 September, <http://www.osw.waw.pl/en/publikacje/eastweek/2009-09-02/russias-new-energy-strategy> (Accessed on 08 February 2011).

<sup>519</sup> Energy Strategy of Russia For The Period Up To 2030 (2010).

One of the subtitles of the document is the “foreign energy policy” road map for the Russia up to 2030; *“The objective of the foreign energy policy is the maximum efficient use of Russian energy potential meaning oil and gas export with high prices, secure Russia's position in these markets and finally the gaining of highest possible profit for the national economy.”* In order to implement this strategy markets are vital issue for Russia. Russia envisions stable relations with traditional consumers, meaning Europe and stable relationships with the new markets, meaning Asia. Hence, for Russia, the basic point will be maintaining good quality relations with its big customers.

- Active participation in international negotiation processes on energy issues, provision of balance between interests of importers, exporters and transistors of energy resources in international treaties and international organizations;
- Commonwealth of Independent States, Eurasian Economic Union, North-Eastern Asia, Shanghai Cooperation Organization, and European Union as well as with other international organizations and countries;
- coordination of activity on world oil and gas markets with the countries-members of the Organization of Petroleum Exporting Countries and the Gas Exporting Countries Forum;
- Assistance in developing the united European-Russian-Asian energy area;
- assistance in provision favorable and non-discriminatory environment for domestic energy and service companies (as well as for foreign companies with Russian share holders) on world markets, including their access to productive and distributive segments of foreign markets;
- Assistance in foreign investments attraction, primarily for technically sophisticated and risky projects, on mutually beneficial basis;
- Provision of Russian energy companies with access to the resources of world financial markets and advanced energy technologies;
- Stimulation of Russian energy technologies and services development and export; promotion of transport infrastructure construction in the east, south, north-west and north of the country aimed at diversification of sale markets and export destinations for Russian energy resources;
- Stimulation of the growth in the share of highly processed energy resources in the overall structure of the Russian energy export; rational development of transit energy flows through the territory of Russia;
- Development of new forms of international cooperation (including technological one) in the energy sector;
- Provision of the Russian energy policy transparency and coordination of its energy strategy with prospective plans and energy strategies of other market players;
- Active participation of Russia in international cooperation on development of the energy of the future (hydrogen, thermonuclear, tidal energy, etc.).<sup>520</sup>

Energy Strategy Document up to 2030 is the handbook of Russian foreign energy policy. The document not only includes energy sector priorities but also social and economic requirements in order to improve competitive functional economy. By doing that, it is written in the document that the incomes from energy exports provides the main finance resource for improvement of

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<sup>520</sup> Energy Strategy of Russia For The Period Up To 2030 (2010), p.53-54.

standards of life in Russia and explore and production of new areas. Due to reason of the depletion of some resources, new resource areas should be integrated to the sector. And finally, the role of Russian pipeline policy is being underlined according to implementation of Russian foreign energy policy. It is observed in the document that one of significant objective of Russia is to construct direct pipelines to both west and East direction and bypass transporter countries.

### **CHAPTER III**

#### **RUSSIAN FEDERATION ENERGY SECTOR**

##### **10. INTRODUCTION**

In this chapter, it is aimed to describe firstly, main Russian oil production and reserve areas, secondly, main natural gas production and reserve areas including different estimates of various resources, thirdly significant energy companies of Russia, and fourthly, pipelines with different

categories. As a part of Russian foreign energy policy, pipelines play a significant role. Therefore, first pipelines of both oil and natural gas has divided into four categories according to the year 2011 data as; existing, under construction, in progress, and under discussion. Their capacities, length and international status are being explained including their maps.

## **10.1. CRUDE OIL**

Russia occupies 13% of the world's land but has less than 3% of the world's population. Russia boasts 35% of the world's natural resources and has 15% of the proven world's reserves of hydrocarbons.<sup>521</sup> Russia's discovered and estimated undiscovered oil resource bases are among the very largest on the planet.<sup>522</sup> After 13 years (1987), Russia is again number one oil producer in the world after Saudi Arabia, including the number one natural gas exporter, which makes Russia "the energy superpower". On November 2010, Russia pumped more than 10 m/bbl and completed the construction of new oil pipeline in the Far East, which will increase Russian crude oil export in the short term. Oil's strategic character is derived from the fact that it is essential for industrialized countries. In addition, the armed forces and military-industrial complex must have access to oil.<sup>523</sup> It is a reality that the world is run by energy-not by money. Every living organism needs to convert energy to a useful form to stay alive.<sup>524</sup>

### **10.1.1. Classification of Crude Oil**

Soviet decision makers created a classification system that defined reserves as proven if they could be produced under prevailing technological standards. The Russian system divides reserves into the following categories in a descending scale of geological certainty. The levels

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<sup>521</sup> Pavel EROCHKINE: (2005) "Russia and Its Oil Friends or Foes", in Jennifer Moll (ed.) *Blueprint for Russia*, FPC, London, p.14-15.

<sup>522</sup> John D. GRACE: (2005) *Russian Oil Supply, Performance and Prospects*, Oxford University Press, p.213.

<sup>523</sup> Jan LEIJONHJELM and Robert L. LARSSON: (2004) "Russia's Strategic Commodities: Energy and Metals as Security Levers", Swedish Defense Research Agency FOI-R-1346-SE, November, p.32 Available on site <http://www.foi.se/upload/english/reports/foi-russias-strategic-commodities.pdf> (Accessed on 10 August 2008).

<sup>524</sup> Aram MAKIVIERRIKKO: (2007) "Russian Oil, A Depletion Rate Model Estimate of the Future Russian Oil Production and Export", University of Uppsala, October, p.15.

go from A, as highest to D2, the lowest.<sup>525</sup> The Russians define their proven reserves as the sum of categories A+B+C1 and report their reserves using this system.<sup>526</sup>

According to SPE/WPC (Society of Petroleum Engineers and World Petroleum Council) Proved reserves are;

those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given data forward, from known reservoirs and under current economic conditions, operating methods and government regulations. Proved reserves can be categorized as developed or undeveloped.<sup>527</sup>

Unproved reserves are;

based on geologic and/or engineering data similar to that used in estimates of proved reserves; but technical, contractual, economic, or regulatory uncertainties preclude such reserves being classified as proved. Unproved reserves may be further classified as probable reserves and possible reserves.<sup>528</sup>

A geologically examined reserve currently in production;

B geologically examined reserves, which are the unused producing capacity

C1 geologically examined reserves, which according to engineering data show partial recoverability.

C2 reserves that are presumed to exist based on geological and geophysical data analogous to that of verified reserves.

C3 reserves are potential reserves but undrilled reservoirs;

D1 speculative reserves, presumed to exist on basis of geological analogy of reference area;

D2 where demonstration has not been made and less evaluated.<sup>529</sup>

## **Table 20: Comparative Classification of Oil Reserves; Russia and Former Soviet Union – USA and Saudi Arabia**<sup>530</sup>

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<sup>525</sup> GRACE, p.260.

<sup>526</sup> Erik JANSSEN: (2005) “Can Russian Oil Growth Be Sustained?”, Clingendael International Energy Programme, October, p.3 Available on site [http://www.clingendael.nl/publications/2005/20051000\\_ciep\\_briefing\\_russian-oil.pdf](http://www.clingendael.nl/publications/2005/20051000_ciep_briefing_russian-oil.pdf) (Accessed on August 2009).

<sup>527</sup> DEGOLYER and MACNOUGHTON Report: (2006) “Oil, Condensate, and Natural Gas Reserves Owned by OAO NK Rosneft in Certain Fields in Russia”, *Appraisal Report*, December 3, p.7.

<sup>528</sup> DEGOLYER and MACNOUGHTON, p.9.

<sup>529</sup> JANSEN, p.3, GRACE, p.260-66.

<b>Russia and Former Soviet Union</b>	<b>USA and Saudi Arabia et. All</b>
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Reserves	Proven	A	Identified	Showed	Drilled	Proven
		B			Unused	
		C1			Indicated	Probable
	Estimated	C2		Calculated		
Assets	Expected	C3	Possible			
	Foreseen	D1	Hypothetical			
		D2	Speculative			

### Units

1 barrel: 0.1591 m<sup>3</sup>: 42 US gallons<sup>531</sup>

1 m<sup>3</sup>: 6.285 barrel

1 metric tonnes: 1000 kg

1 metric tonnes: 1.165 m<sup>3</sup>: 7.33 barrel

### 10.1.2. Oil Production and Reserves

Russian oil production peaked in 1986-1988 when it produced 570 m/t a year on average (20% of the world). After the collapse of the Soviet Union, oil production was in a free fall until the 1990s. By 1995, the production levels had fallen to only 307 m/t a year (10% of the world).<sup>532</sup> While Buccelloto and Mickiewicz characterized transition period as inefficiency in oil management, Grace thinks that Yeltsin administration managed to transform Russia's oil producers from total dependence on state budgets to compete reliance on selling oil in the domestic and export markets for their revenues.<sup>533</sup> On the other hand, the strong reduction was accused by a number of reasons including:

- A collapse in industrial production, resulting in lower demand for oil;

<sup>530</sup> LEIJONHJELM and LARSSON, p.43.

<sup>531</sup> MAKIVIERRIKKO, p.10.

<sup>532</sup> Tulio BUCCELLOTO and Tomasz MICKIEWICZ: (2009) "Oil and Gas: A Blessing For the Few Hydrocarbons and Inequality within Regions in Russia", *Europe-Asia Studies*, 61:3, p.387.

<sup>533</sup> GRACE, p.3.

- The destruction of organizational structures and established distribution for oil;
- Insufficient investments in the industry;
- Old and physically crumbling equipment and infrastructure;
- Declining production rates of some major basins.<sup>534</sup>

A turnaround in Russian oil output began in 1999. The privatization clarified incentives and increased less expensive production.<sup>535</sup> In fact, production has increased by over 50% since 1999. Since the end of 2004, however, the production growth has slowed down. In 2005, Russia's oil production was 9.6 million barrels per day (bbl/d), which was still less than during the peak years of the Soviet era, and it grew by less than 3% year on year.<sup>536</sup> (Appendix 2) As a non-OPEC country, Russia has increased its oil production significantly during the last decade. During 1998-2005, Russia's oil output growth accounted for almost 40% of the increase in world oil supply. After Saudi Arabia, Russia was the second largest oil producer in the world. In 2005, Russia accounted for 12.1% and Saudi Arabia for 13.5% of total world oil production.<sup>537</sup> Afterwards, Russia's oil producing trend increased since 2005. Only in 2008, due to reason of the financial global crisis, the oil production has dropped, but later on it recovered and reached more than 10 m/bbl per day at the end of 2009. There are different estimates concerning the future production of oil Russia.

**Table 21: Estimates of Russian Oil Production (Million bbl/d)**<sup>538</sup>

		2003	2007	2010	2015	2020
Russian Oil Companies	TNK	8.5	10.0	11.1		
	YUKOS	8.5	9.0 (2003)	11.0		11.0
Long-term Energy Plan: 2003	High scenario	8.5		9-9.8	10.17	9-10.4
	Low scenario	8.5		7.2		6.3
Long-term Energy Plan:2000		8.5		6.1-6.7	6.1-6.9	6.1-7.2

<sup>534</sup> EROCHKINE, p.16.

<sup>535</sup> Energy Strategy of Russia, (1996) International Energy Agency, p.2.

Available on site <http://www.iea.org/textbase/nppdf/free/1990/rusinrus96.pdf> (Accessed on 10 August 2008)

<sup>536</sup> Tuuli JUURIKALA and Simon-Erik OLLUS: (2006) "Russian Energy Sector – Prospects and Implications for Russian Growth, Economic Policy and Energy Supply", *BOFIT*, 4, p.4.

<sup>537</sup> Ibid, p.4.

<sup>538</sup> Sadek Boussena and Catherine Locatelli: (2005) "Towards a More Coherent Oil Policy in Russia", *OPEC Review*, 29:2, p.89.

Ministry of Energy: 2004					8.0	
Ministry of Economy: 2004	Optimistic scenario		9.14 (2006)			
	Pessimistic scenario		5.6 (2006)			
Ministry of Natural Resources: 2002		8.5				5.0
Ministry of Foreign Affairs: 2002		8.5	9.0	5.6	5.6	
Independent Experts	Troika Dialogue	8.5	10.2	10.9		
	Laherrere	8.5	7.7 (2008)			5.0
	OWEM Model (2002)	8.5		8.2		8.7
	ASPO (2003)	8.5		9.34		4.85
	Khartulov (2003)		9.8-10.0	11.8-12.1		
	CGES (2004)		10 (2006)	12.0	13.0	
	Woodmac basic scenario			10.38	9.09	7.41
	Woodmac high scenario			12.04	10.66	8.69
International Agencies	IEA, WEO (2004)			10.40		10.60

In terms of oil reserves in Russia, today almost 70% of Russian reserves are located in Western Siberia and more than 10% is located in Volga-Ural region. Timon-Pechora region is also known as big oil reservoir in North-West Russia.<sup>539</sup> In addition to these places Russia is also concentrated on exploring new reserves in Caspian Sea, East Siberia, Russian Far East and also Arctic region in the north. Although Russia is not announcing its official numbers of oil reserves

<sup>539</sup> LEIJONHJELM and LARSSON, p.43, Russia: Country Analysis Briefs (2010) Energy Information Administration, November Available on site <http://www.eia.doe.gov/cabs/Russia/pdf.pdf> (Accessed on December 2010).

but in 2010 Resource Minister Yuri Trutnev said that Russia discovered a new large oil deposit with estimated reserves of over 1.1 billion bbl in East Siberia.<sup>540</sup> There are various reserve estimates from various resources.

**Table 22: Estimated by Reserves, by Different Sources**<sup>541</sup>

WHO?	Reserve, billion barrels
Oil & Gas Journal	60 (proven SPE**)
World Oil	69 (proven SPE)
BP	72 (proven SPE)
10 Largest Russian Oil companies combined	82 (A+B+C1)
E. Khartukov (Russian oil expert)	110 (A+B+C1)
United States Geological Survey	116 (proven SPE)
Wood Mackenzie	120 (proven SPE)
M. Khodorkovsky (former CEO of Yukos)	150
Brunswick UBS (consultants)	180 (proven, probable, possible SPE)
Russian government*	322 (A+B+C+D)

\* The Russian government still regards reserves as a state secret and does not publish official figures, although they do speak of prognised reserves of 44 billion tonnes (322 billion/barrels).

\*\* SPE: Society of Petroleum Engineer classifications 'proven and probable'.

### 10.1.2.1. Western Siberia

It boasts the second largest volume of discovered oil in the world and planet's richest concentration of discovered natural gas.<sup>542</sup> West Siberia is by far Russia's most important oil-producing province, accounting for roughly three-quarters of its recoverable oil reserves. Most of Russia's 60-74 billion barrels of proven oil reserves are located in Western Siberia, between the

<sup>540</sup> RIA Novosti (2010) "Russia Discovers Massive East Siberian Oil Field", 27 January <http://en.rian.ru/russia/20100127/157696641.html> (Accessed on 07 February 2011)

<sup>541</sup> JANSSEN, p.4.

<sup>542</sup> GRACE, p.34.

Ural Mountains and the Central Siberian Plateau.<sup>543</sup> In the 1980s, the Western Siberia region (2.2 million km<sup>2</sup>), also known as the “Russian Core”, made the Soviet Union a major world oil producer, allowing for peak production of 12.5 m/barrels per day in total liquids in 1988.<sup>544</sup> According to Ulmishek study:

Three total petroleum systems are identified in the West Siberian basin. Volumes of discovered hydrocarbons in these systems are 144 billion barrels of oil and more than 1,300 trillion cubic feet of gas. The assessed mean undiscovered resources are 55.2 billion barrels of oil, 642.9 trillion cubic feet of gas, and 20.5 billion barrels of natural gas liquids. The largest known oil reserves are in the Bazhenov-Neocomian Total Petroleum System that includes Upper Jurassic and younger rocks of the central and southern parts of the basin. Oil reservoirs are mainly in Neocomian and Upper Jurassic clastic strata.<sup>545</sup>

During the period 1987 to 1994, it produced some 69-73% of Russia's crude oil which means two of every three barrels of Russian oil come from the basin. However, its major fields are now in a large stage of depletion. Between 1988 and 1993, crude oil production in West Siberia fell, from a peak of 420 m/t to 235 m/t, a decline of 44%. The supreme decline in West Siberia alone represented 85% of the overall decline in Russian crude oil production between 1988 and 1993.<sup>546</sup> By the boom of oil prices, the flood of money over the years has led to better science and engineering in the basin.<sup>547</sup> The West Siberian oil and gas province will remain as the country's key oil resource. Oil production in this region will increase until the years 2010-2015, after which it will decline slightly and be in the range of 230-315 m/t in 2020.<sup>548</sup> And finally, it is indicated in Russian Energy Strategy for the period up to 2030 that Western Siberian oil reserves will be 1.205 m/t (Phase 1), 2500 m/t (Phase 2), and 2.500 m/t (Phase 3).<sup>549</sup>

#### **10.1.2.2. Eastern Siberia (Yakutia) and Sakhalin Islands**

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<sup>543</sup> Robert PIROG: (2007) “Russian Oil and Gas Challenges”, CRS Report For Congress, Order Code RL33212, June 20, p.1.

<sup>544</sup> Russia: Country Analysis Briefs (2010).

<sup>545</sup> Gregory F. ULMISHEK: (2003) “Petroleum Geology and Resources of the Western Siberian Basin, Russia”, USGS- US Geological Survey, *Bulletin 2201-Government*, Available on site <http://pubs.usgs.gov/bul/2201/G/> (Accessed on 08 February 2011).

<sup>546</sup> Energy Strategy of Russia, (1996) International Energy Agency, p.110-111.

Available on site <http://www.iea.org/textbase/nppdf/free/1990/rusinrus96.pdf> (Accessed on 10 August 2008)

<sup>547</sup> GRACE, p.55.

<sup>548</sup> Oleg ANTONOV: (2003) “Russian Upstream”, *OPEC Review*, Vol.27, Issue 3, p.251.

<sup>549</sup> Energy Strategy of Russia For The Period Up To 2030 (2010) Moscow, p.139 Available on site [http://energystrategy.ru/projects/docs/ES-2030\\_\(Eng\).pdf](http://energystrategy.ru/projects/docs/ES-2030_(Eng).pdf) (Accessed on 05 February 2011)

Considerable hydrocarbon potential also exists in East Siberia and Yakutia, a vast area comprising 7.2 million km<sup>2</sup>, or 42% of total Russian Federation territory. Eastern Siberian platform is extended between Yenisey river to the west and Lena river to the east. Because of the region's still largely unconfirmed oil potential, its inherently high production costs (associated with reliance on deep drilling, the complexity of the geological structure and harsh physical-climatic conditions) and undeveloped infrastructure to transport the product to markets.<sup>550</sup> According to Nakoshima's study, the ultimate oil reserves of the 39 fields are about 4.000 m/bbl in total.<sup>551</sup> However, as mentioned earlier Russian government announced new discovered vast oil reserves.

The islands' North Sakhalin Basin has on onshore and offshore areas of approximately 24.000 km<sup>2</sup>. Oil has been produced on Sakhalin since 1928, but before World War II output was concentrated around Okha on the northern tip of the island.<sup>552</sup> Recoverable oil reserves around Sakhalin Island are estimated between 7 billion bbl and 14 billion bbl. International consortia have entered into production sharing agreements (PSAs) to develop the resources. Even though all of the consortia have extensive export plans (including to the United States) via LNG terminals and export pipelines to the mainland, there has been little progress except on the first two parts of Sakhalin Island: Sakhalin 1 and Sakhalin 2.<sup>553</sup>

### **10.1.2.3. Volga-Urals Region**

Oil-production region encompasses an area of approximately 500.000 km<sup>2</sup> on the western flank of the Ural Mountains and extending across the Volga River Basin. Oil production began here in the 1930s, but did not really pick up until the 1950s with the development of the supergiant Romashinko and Arlan fields.<sup>554</sup> Romashinko's 17 billion barrels not only made it the world's largest field when it discovered, its two decades of production fuelled the Soviet economy.

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<sup>550</sup> Energy Strategy of Russia (1996), p.115.

<sup>551</sup> Keishi NAKOSHIMA: (2004) "Petroleum Potential in the East Siberian Region, *IEEJ*, June, p.25.

<sup>552</sup> Energy Strategy of Russia (1996), p.115.

<sup>553</sup> EIA Sakhalin Island (2008), May <http://www.eia.doe.gov/emeu/cabs/Sakhalin/Background.html> (Accessed on 07 April 2009)

<sup>554</sup> Energy Strategy of Russia (1996), p.115.

Today, the Romashinko field is the heart of Tatneft and the Tatar Republic of Russia.<sup>555</sup> More than 2000 t/bbl per day was produced in 2009.<sup>556</sup>

#### **10.1.2.4. Timan-Pechora Basin**

Region is located in northern European Russia in the Komi republic and the Nenets Autonomous Okrug. The Timan-Pechora Basin is a significant hydrocarbon-producing region, whose offshore extension in the Barents Sea may also represent a prospective area of some 800.000 km<sup>2</sup>.<sup>557</sup> Area remained relatively undeveloped compare to Western and Eastern Siberia. However, Timan Pechora basin has good remaining exploration potential. Since Lukoil has moved into the basin at 1990s, they claim to have discovered several hundred million barrels of new oil.<sup>558</sup> In 2007, Gazprom Neft and Lukoil established a joint venture called Development of Regions in order to maintain of joint projects in Timan-Pechora.

#### **10.1.2.5. Caspian Sea and North Caucasus**

Comparing to the other Caspian states, Russia is holding a very small part of the offshore in North Caspian basin. However, Russian has super-giant Astrakhan gas and condensate field, much more gas than oil.<sup>559</sup> On the other hand, North Caucasus is the oldest producing area in Russia. Production began before the turn of the century around Grozny, the capital of the Chechen Republic. Because much of the area's oil has already been produced, and due to the high degree of social unrest and political instability in the area, the oil resources of the Northern Caucasus have not attracted much attention from the major international companies.<sup>560</sup> Oil production is especially well-developed in Stavropol Territory, Chechnya, and Dagestan. These three subjects of the Federation provide 97% of the region's income in the sphere of oil production. 0.6% of the total amount of the oil.<sup>561</sup>

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<sup>555</sup> GRACE, p.22-3.

<sup>556</sup> Russia: Country Analysis Briefs (2010).

<sup>557</sup> Energy Strategy of Russia (1996), p.116.

<sup>558</sup> GRACE, p.32.

<sup>559</sup> Ibid, p.197.

<sup>560</sup> Energy Strategy of Russia (1996), p.116-117.

<sup>561</sup> Vestnik Kavkaza (2010) "*The Strategy of Social Economic Development of the North Caucasus Federal District (NCFD) Until 2025*", 7 October <http://vestnikkavkaza.net/analysis/society/6671.html> (Accessed on 08 February 2011)

#### 10.1.2.6. Arctic Ocean

The US Geological Survey has estimated that the Arctic seabed could contain 20% of the world's oil and gas resources and Russia's Ministry of Natural Resources says that the Arctic territory claimed by Russia could be home to twice the volume of Saudi Arabia's oil reserves. Trenin says that if Russia's diplomatic efforts; by 2020 the Arctic will become one of the Russian Federation's leading strategic resource bases.<sup>562</sup> Recently, BP has signed a joint venture with Russian biggest oil company Rosneft to exploit Russia's Arctic shelf. According to the deal, Rosneft will take 5% of BP's shares in exchange for approximately 9,5% of Rosneft's shares. Companies will explore in three areas as EPNZ 1, 2, and 3 –on the Russian Arctic continental shelf. The area covers 125.000 km<sup>2</sup> in area of the South Kara Sea.<sup>563</sup>

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<sup>562</sup> Dmitri TRENIN: (2010) "The Arctic: A Front For Cooperation Not Competition", in Dmitri Trenin and Pavel Baev (ed.) *"The Arctic: A View From Moscow"*, Carnegie Endowment for International Peace, p.9

<sup>563</sup> BBC News (2011) *"BP and Rosneft in Arctic Ocean Deal"*, 14 January <http://www.bbc.co.uk/news/business-12195576> (Accessed on 08 January)

**Map 1: Major Russian Oil Basis**



Source: Petroneft <http://petroneft.com/projects/west-siberian-oil-basin/> (Accessed on 08 February 2011)

### 10.1.3. Major Oil Companies

In 2008, according to the Petroleum Intelligence weekly, five Russian companies were within the top 50 list of world's largest oil companies, which are Gazprom (13), Rosneft (16), Lukoil (18), Surgutneftegaz (29), and TNK-BP (43). Remarkable point was Russia's Rosneft makes biggest jump, from 24<sup>th</sup> to 16<sup>th</sup>.<sup>564</sup> On the other hand, rank by oil equivalent reserves in 2009 listed as follows; Gazprom (11-29,261 m/bbl), Rosneft (12-22,984 m/bbl), and Lukoil (15-13,700 m/bbl).<sup>565</sup> In 2003, 80% of the oil production came from five major private companies (Lukoil, Yukos, TNK-BP, Surgutneftegaz and Sibneft) and two regional companies (Bashneft and Tatneft).<sup>566</sup> However, the oil industry structure of Russian Federation began to change in 2005 with the re-nationalization strategy. As a result of it, state companies are the ones who produce the major amount of the oil in the country.

**Table 23: Production of Russian Oil Companies in 2009**

	<b>Oil Companies</b>	<b>Production in million bbl/d</b>
<b>Private Companies</b>	Lukoil	1.80
	TNK-BP	1.41
	Surgutneftegaz	1.18
	Slavneft	0.31
	Russneft	0.24
<b>State-controlled companies</b>	Rosneft	2.41
	Gazprom	1.05
	Inc. GazpromNeft	0.9
<b>Regional Companies</b>	Tatneft	0.52

<sup>564</sup> Petroleum Intelligence Weekly, December 2008.

Available on site [http://www.energyintel.com/documentdetail.asp?document\\_id=245527](http://www.energyintel.com/documentdetail.asp?document_id=245527) (Accessed on 30 January 2011).

<sup>565</sup> Petro Strategies (2009) Ranks by Oil Equivalent Reserves

[http://www.petrostrategies.org/Links/worlds\\_largest\\_oil\\_and\\_gas\\_companies.htm](http://www.petrostrategies.org/Links/worlds_largest_oil_and_gas_companies.htm) (Accessed on 08 February 2011)

<sup>566</sup> Sarah DIXON: (2008) *Organizational Transformation in the Russian Oil Industry*, Edward Elgar Pub., p.22.

	Bashneft	0.25
<b>Other (including PSA)</b>		0.79
<b>Total</b>		9.96

Source: Catherine LOCATELLI and Sylvain ROSSIAUD: (2011) “A Neoinstitutionalist Interpretation of the Changes in the Russian Oil Model”, *Energy Policy* 39, p.5593.

### 10.1.3.1. Gazprom Neft (Sibneft)

Gazprom occupies a unique position in Russian politics and economy. Some experts called the company “Russia's Ministry of Foreign Affairs for the 21<sup>st</sup> Century”. Victor Chernomyrdin, the first Prime Minister of Russia approved by a parliamentary majority in autumn 1992, founded the company.<sup>567</sup> Sibneft was created by a decree by Yeltsin in 1995. It took Noyabrskneftegas (production), together with Noyabrskneftegasgeophysica (exploration) and Omsknefte product (marketing) to create a new company in 1996.<sup>568</sup> It was first privatized by Berezovsky and then sold to Abramovich. Taking lesson from Yukos and Khodorkovsky trials, Abramovich easily convinced to sell the company for \$13 billion.

Gazprom seemed to be the chosen tool for Kremlin to re-acquire a sufficient share of ownership, and therefore control, over the oil industry. As part of this development, Gazprom on 2 November 2004 formally established Gazpromneft, registered in St. Petersburg with 30 million rubles (1 Million US\$) in capitalization, as a wholly owned Gazprom oil subsidiary.<sup>569</sup> After lobbying by Igor Sechin<sup>570</sup> on behalf of Rosneft, Alexei Miller, the head of Gazprom and Medvedev, then the President and the head of Gazprom board, appointed Rosneft President Sergei Bogdanshikov as the general director of the new company.<sup>571</sup> A few days later, on 11 November 2004, Kremlin gave its formal approval for Gazprom to take over the state owned oil company Rosneft. This deal would also increase

<sup>567</sup> Stanislav L. TKACHENKO: (2008) “Political Economy of Energy Policy of Russian Federation Towards USA and European Union”, *Paper presented at the ISA Panel, California, March*, p.10.

<sup>568</sup> LARSSON: (2006) p.29.

<sup>569</sup> Micheal FREDHOLM: (2005) “The Russian Energy Strategy and Energy Policy: Pipeline or Mutual Dependence?”, *Conflict Studies Research Centre, Russian Series 05/41*, p.34.

<sup>570</sup> Deputy Prime Minister in Vladimir Putin’s cabinet, he was between 31 December 1999 to May 2008 Deputy Chief of President.

<sup>571</sup> SAKWA: (2009) p.326.

the state's share in Gazprom ownership from 38.7% to 50% plus one share, which of course meant that the Russian state henceforth would become the majority owner of Gazprom.<sup>572</sup> As a result, Gazprom bought a controlling stakes of Sibneft (76,68%) and on May 2006, the company's name changed to Joint Stock Company Gazprom Neft.<sup>573</sup> In 2005, Gazprom became its major shareholder. With the emergence of the new name Gazprom Neft; the company's strategies and its goals have undergone great changes. The company's plans include increasing annual oil production volume to 80 million tonnes by 2020.<sup>574</sup>

Gazprom Neft supplied 15,6 m/t of oil to the global market in 2009, a 3.7 m/t decreased compared to 2008. This includes 14,8 m/t from the company resources (including its stakes in Slavneft and Tomsneft), of which 11 m/t were exported by sea, 3 m/t via the Druzhba pipeline and 0,7 m/t via the Atasu-Alashankou pipeline to China (transit through Kazakhstan).<sup>575</sup> By 2020 Gazprom Neft aims to increase its production to 100 m/toe per year, and also aims to increase refining to 70 m/t per year by 2020 as the Company increases its own oil refining capacities to 40 m/t in Russia and 25-30 m/t abroad.<sup>576</sup>

### **10.1.3.2. Rosneft**

Rosneft was established in 1993 as a state enterprise on the basis of assets previously held by Rosneftegaz, the successor to the USSR Ministry of Oil and Gas. In 1995, Russian government decree transformed Rosneft into an open joint stock company. By the rising of the Putin into power, Rosneft increased its oil output sharply from 98.56 million barrels (13.47 million tonnes) in 2000 to 148.26 million barrels (20.27 m/t) in 2004.<sup>577</sup> However, Rosneft owes its power to operation of buying Yukos. On December 19, Russia auctioned a 76,79 % share in Yukanskneftegaz in order to recover its \$28 billion unpaid tax. Only two companies took a part in the auction, a Gazprom subsidiary and a previously unknown

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<sup>572</sup> FREDHOLM, p.34.

<sup>573</sup> Gazprom Neft – Company Timeline Available on site <http://www.gazprom-neft.com/company/history/> (Accessed on 08 February 2011).

<sup>574</sup> Gazprom Neft Company Available on site <http://www.gazprom-neft.com> (Accessed on 10 January 2011).

<sup>575</sup> Gazprom Neft Business Available on site <http://www.gazprom-neft.com/business/export/> (Accessed on 10 January 2011).

<sup>576</sup> Gazprom Neft Company Strategy Available on site <http://www.gazprom-neft.com/business/export/> (Accessed on 10 January 2011).

<sup>577</sup> Rosneft Company Available on site <http://www.rosneft.com> (Accessed on 15 May 2010).

company, Baikalfinansgroup, which had been registered only two weeks previously with a share capital of 10.000 rubles (\$358.00) in a small town. Only four days later it was required by Rosneft.<sup>578</sup> Goldman says that if Rosneft itself had entered such a bid at the auction, it might also have been threatened with a lawsuit in a European court.<sup>579</sup>

The Yukos case, in which assets were transferred from private company to Rosneft, whose chairman was Igor Sechin, was the crucial element in developing the system like Putin has envisioned.<sup>580</sup> Rising of Rosneft and the state's increased stake in Gazprom and Rosneft have all made it easier for the Kremlin to take advantage of the country's energy power as a way of promoting its foreign policy goals, as Putin has advocated since the beginning of his presidency.<sup>581</sup> In 2004, Chinese banks finance Rosneft's acquisition of Yukanskneftegaz with a \$6 billion loan in exchange for long-term contracts for oil. The humiliating part of the deal for China was that Yukos had agreed to build a pipeline to China from Russian Far East. However, instead of getting pipeline, it was forced to finance for the Yukos' transfer to Rosneft.<sup>582</sup> Two years later, this time Rosneft bought Yukos's transport subsidiaries, which owned leasing contracts on railway oil tankers, pumping stations and pipelines.<sup>583</sup> As a result, Rosneft produced 739,97 m/bbl in 2007, 776,30 m/bbl in 2008, and 794,40 m/bbl in 2009.<sup>584</sup>

### **10.1.3.3. Lukoil**

Lukoil is the oldest, biggest and best known of the giant corporations that grew out of the ruins of the Soviet Oil Ministry and has long been a flagship of the Russian oil industry both at home and abroad. From the beginning, Lukoil was Russia's first bold experiment

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<sup>578</sup> Edward LUCAS: (2009) *The New Cold War*, Palgrave, New York, p.50

<sup>579</sup> Marshall I. GOLDMAN: (2008) *Petrostate, Putin, Power and the New Russia*, Oxford Uni. Press, p.120.

<sup>580</sup> Robert W. ORTTUNG: (2009) "Energy and State-Society Relations, Socio-political Aspects of Russia's Energy Wealth", in Jeronim Perovic, Robert W. Orttung, and Andreas Wenger (ed.) *Russian Energy Power and Foreign Relations*, Routledge, p.65.

<sup>581</sup> Jeffrey MANKOFF: (2009a) *Russian Foreign Policy, The Return of Great Power Politics*, Rowman & Littlefield Pub., p.175.

<sup>582</sup> Niklas NORLING: (2006) "Russia's Energy Leverage Over China and the Sinopec-Rosneft Deal", Central Asia-Caucasus and Silk Road Studies Program, *China and Eurasia Forum Quarterly*, Vol.4, No.4, p.33.

<sup>583</sup> LUCAS, p.50.

<sup>584</sup> Rosneft Production and Development Available on site  
<http://www.rosneft.com/Upstream/ProductionAndDevelopment/> (Accessed on 08 February 2011)

with private oil ownership and with decentralized oil industry decision-making and took the Western oil and gas majors as its model.<sup>585</sup> Its shareholders include the Russian government, management of the company, Russian banks and even multinational company ConocoPhillips. Lukoil has very strong positions in European countries and in the Caspian area.<sup>586</sup>

In 2002, Lukoil was the first Russian oil company to list its shares on a Western exchange (London). Company not only interests of petrol stations in US but also gas stations too. They bought 750 Mobile gas stations in the east coast of US since 2004 and recently, bought 11 more gas stations from Philadelphia Getty.<sup>587</sup> In 2003, Lukoil bought from Getty and Mobil more than 2000 petrol stations on the eastern coast of the US, whilst there are only 1711 Lukoil petrol stations in Russia. The Russian company is supplying, its own oil products for retail via a chain of petrol stations abroad, and today Lukoil's sales in the US market alone are bigger than in the domestic Russian market.<sup>588</sup>

According to Gorst, Lukoil has some characteristic features;

- Lukoil appears to be totally loyal to the state and has for long acted as a bridge between the government, industry and foreign companies.
- Lukoil has acted as a pioneer in the Russian oil industry during a period of massive change, moving a head of the pack into new upstream and downstream areas.
- Lukoil is the only Russian oil company to have built up a diversified business empire that now spans the globe. The company has interests in the Caspian, Middle East, Central Europe, North Africa, North and South America. This unique international portfolio allows Lukoil to serve as an oil ambassador for the Russian government overseas.
- Lukoil has established itself as an important independent gas producer forging a rare modern Vivendi with the Gazprom monopoly.
- Lukoil has expanded into the petrochemicals sector which will in the future provide a commercial outlet for its growing gas production.<sup>589</sup>

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<sup>585</sup> Isabel GORST: (2007) "Lukoil: Russia's Largest Oil Company", *The James A. Baker III Institute for Public Policy*, Rice University, March, p.1, Grace, p.111.

<sup>586</sup> Stanislav L. TKACHENKO: (2007) "Actors in Russia's Energy Policy Towards the EU", *Paper presented at ISA Panel*, US, March, p.20.

<sup>587</sup> Natalie KOSTELNI: (2011) "Lukoil Buys 11 Phila. Getty Stations", *Philadelphia Business Journal*, 11 January  
[http://www.bizjournals.com/philadelphia/blogs/real\\_estate/2010/01/lukoil\\_buys\\_11\\_phila\\_getty\\_stations.htm](http://www.bizjournals.com/philadelphia/blogs/real_estate/2010/01/lukoil_buys_11_phila_getty_stations.htm)  
1 (Accessed on 08 February 2011)

<sup>588</sup> TKASHENKO: (2007) p.20.

<sup>589</sup> GORST, p.5.

**Table 24: Lukoil Interim Consolidated Financial Statements (Million of US Dollars)<sup>590</sup>**

	<b>For the three months ended September 30, 2010</b>	<b>For the three months ended September 30, 2009</b>	<b>For the nine months ended September 30, 2010</b>	<b>For the nine months ended September 30, 2009</b>
Sales of crude oil within Russia	225	429	706	472
Export of crude oil and sales of oil of foreign subsidiaries	6,663	5,332	19,351	14,388
Sales of refined products within Russia	2,971	2,279	7,944	5,679
Export of refined products and sales of refined products of foreign subsidiaries	14,985	12,503	43,399	32,401
Sales of chemicals within Russia	170	162	520	338
Export of chemicals and sales of chemicals of foreign subsidiaries	128	158	398	432
Other sales within Russia	661	525	2,112	1,535
Other export sales and other sales of foreign subsidiaries	714	553	1,842	1,557
<b>Total sales</b>	<b>26,517</b>	<b>21,941</b>	<b>76,272</b>	<b>56,802</b>

<sup>590</sup> Lukoil Interim Consolidated Financial Statements (2010) 30 September Available on site [http://www.lukoil.com/fa\\_6\\_.html](http://www.lukoil.com/fa_6_.html) (Accessed on 10 December 2010)

**Table 25: Proved Oil Reserves of Lukoil (end of year) m/bbl)<sup>591</sup>**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Total</b>	<b>15,972</b>	<b>16,114</b>	<b>15,927</b>	<b>15,715</b>	<b>14,458</b>	<b>13,696</b>
Russia	15,485	15,500	15,319	15,220	13,866	13,080
Western Siberia	8,536	8,572	8,574	8,616	7,798	7,305
Urals	2,130	2,170	2,112	2,151	2,082	2,040
Volga	478	468	697	657	623	669
including Caspian	184	183	448	407	376	450
Timan-Pechora	3,892	3,833	3,496	3,346	2,912	2,649
Bolshekhetskaya Depression	195	203	197	203	219	187
Other	254	254	243	247	232	230
International	487	614	608	495	592	616
Oil reserves replacement ratio,%	99	121	73	70	(79)	-
Oil reserves to production ratio, years	25.2	24.3	22.7	22.0	20.6	19.0

When we look at the financial report of the Lukoil, we see that the company affected from the 2008 crisis and sensed its impacts in 2009 in its financial situation. However, Lukoil increased its net profit in the first nine months of the year 2010 by 29% and \$6,8 billion. Moreover, revenues in the same period also grew 34,3% compared with the same period in 2009 to \$76,272 billion.<sup>592</sup> On the other hand, probably due to negative impact of the 2008 crisis, Lukoil faced a lack of reserves in 2010 but tries to solve the problem by boosting exploration and efficiency as well as through cooperating with state energy companies. Lukoil President Vagit Alekperov said that *“the company forced a lack of resources for further development and a decline of active drilled reserves. As a result, we have to increase resources by means of geological exploration and foster conversion of resources into proven reserves”*. He also added that, the company output may fall as Lukoil reroutes

<sup>591</sup> Lukoil Analyst Databook (2010) Available on site

<http://www.lukoil.com/materials/doc/DataBook/DBP/2010/db2010eng.pdf> (Accessed on 10 January 2011)

<sup>592</sup> RIA Novosti (2010) *“Lukoil Boosts Nine Months Net Profit 29% to \$6.82 billion, Above Forecast”*, 10 November <http://en.rian.ru/business/20101130/161557178.html> (Accessed on 05 February 2011).

its investment to projects in the Caspian Sea, Iraq and Western African and consequently in 2011-13 hydrocarbons output will increase 4%.<sup>593</sup>

Today, Lukoil has 1% of world reserves, 1.4% of world oil production, 0.4% of world gas reserves, 0.1% of world gas production, 1.6% of world oil refining capacities and 1.7% of world refinery throughputs. It is the largest privately owned oil and gas company in the world by proved reserves of oil, 3<sup>rd</sup> largest owned oil and gas company in the world by proved hydrocarbon reserves, 3<sup>rd</sup> largest privately owned oil and gas company in the world by production and 5<sup>th</sup> largest privately owned oil and gas company in the world by hydrocarbon production.<sup>594</sup>

#### **10.1.3.4. TNK-BP**

Larsson thinks that it can be stated that of the ones that today operate independently, the most prominent one is the Tyumen Neft Komponiyo (Tyumen Oil Company) (TNK) that was founded in 1995 as state-owned company.<sup>595</sup> The joint venture between TNK and BP was succeeded in February 2003. TNK was owned by four Russian billionaires, and BP paid them about \$7.7 billion. Their interests in TNK-BP are represented in three companies; Alfa with 25%, Access Industries with 12.5%, and Renova with 12.5% known by the acronym AAR.<sup>596</sup> The year 2008 was a tough year for TNK-BP because on March 20, an employee of the company and an official of the British Alumni Club (who is also the brother of the TNK-BP employee) were arrested on charges of industrial espionage). In fact, TNK-BP is a vital company for BP because the BP stake in TNK-BP provides 22% of BP's oil production and 19% of its oil and has provided for nearly all of BP's reserve growth in recent years.<sup>597</sup>

TNK-BP is a vertically integrated oil company with a diversified upstream and downstream portfolio in Russia and Ukraine. The company's upstream operations are located primarily in West Siberia, East Siberia, and Volga-Urals. The independent audit

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<sup>593</sup> RIA Novosti (2011) "*Lukoil Faced Reserve Shortage in 2010*" 14 January <http://en.rian.ru/business/20110114/162143453.html> (Accessed on 05 February 2011).

<sup>594</sup> Lukoil Fact Book 2010, p.2 Available on site [http://www.lukoil.com/fa\\_6\\_.html](http://www.lukoil.com/fa_6_.html) (Accessed on 09 February 2011)

<sup>595</sup> LARSSON: (2006) p.28.

<sup>596</sup> Robert E. EBEL: (2009) "The Geopolitics of Russian Energy, Looking Back, Looking Forward", CSIS, July, p.57 Available on site [http://csis.org/files/publication/090708\\_Ebel\\_RussianEnergy\\_Web.pdf](http://csis.org/files/publication/090708_Ebel_RussianEnergy_Web.pdf) (Accessed on August 2009)

<sup>597</sup> Ibid, p.58.

conducted by DeGolyer and MacNaughton confirmed that as of 31 December 2009 TNK-BP's Total Proved Reserves 11.667 billion barrels of oil equivalent.<sup>598</sup> In 2009, company sold approximately 47,7 m/t of crude oil.<sup>599</sup> After the agreement signed between Rosneft and BP on exploring the Arctic Shelf, news erupted that Rosneft could buy the full 50% stake in the TNK-BP from the AAR consortium of Russian shareholders, and a buy of 1% from BP, to gain 51% controlling stake of the company. The agreement was not accepted by the AAR consortium and after Rosneft had a swap deal of \$16 billion share with BP on January 14, they opposed the deal and secured an injunction in London's High Court on February 1 in order to suspend the deal. As a result, the deal was suspended until February 25. Finally, on 4 February, Rosneft made an announcement that the company is not in talks with Russian shareholders in the TNK-BP on buying their stakes.<sup>600</sup>

TNK-BP's strategic goals are;<sup>601</sup>

- Became a world-class Russian company.
- Aggressive production growth while replacing 75% or more of production.
- Achieve growth internally through high technology applications to existing fields and monetization of natural gas reserves.
- Acquire assets when the combination yields synergies such as in shared infrastructure.
- Maximize export options in the midstream and downstream segments including potential gas exports to Asia.
- High-grade the asset portfolio through divestitures of under-performing or non-core assets.

#### **10.1.3.5. Surgutneft**

Surgutneftegaz is one of the largest companies in the Russian oil sector. It accounts for almost 13 % of the country's crude output. Crude oil production in 2008 is 61.7 million tons.<sup>602</sup> Most analysts agree that Surgutneftegaz is one of the Kremlin's most loyal firms.<sup>603</sup> It is the only vertically-integrated oil company which left its headquarters in

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<sup>598</sup> TNK-BP Company Available on site <http://www.tnk-bp.com> (Accessed on 20 January 2011).

<sup>599</sup> Ibid.

<sup>600</sup> RIA Novosti (2011) "*Rosneft Denies Interest in AAR Stake in TNK-BP*", 4 February <http://en.rian.ru/russia/20110204/162453401.html> (Accessed on 08 February 2011)

<sup>601</sup> GORDON, p.53.

<sup>602</sup> Surgutneftegaz Available on site <http://www.surgutneftegas.ru/en/> (Accessed on 20 January 2011).

<sup>603</sup> LARSSON, p.155.

Surgut instead of moving them to Moscow.<sup>604</sup> The company's Director General Vladimir Bogdanov (who was the West Siberian campaign manager in President Putin's first election campaign.<sup>605</sup>

Surgut's strategic goals

- Production growth combined with improved operating efficiency.
- Continued use of both drilling and acquisitions to achieve growth.
- Increase the role of natural gas and improve profitability including gas processing and gas-fired power generation at key fields.<sup>606</sup>
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**Table 26: Surgutneftegaz Key Operating Results<sup>607</sup>**

Item	Unit	2003	2004	2005	2006	2007	2008	2009
Crude oil production	m/t	54	59,6	63,9	65,6	64,5	61,7	59,63
Gas production	bcm	13,9	14,3	14,4	14,6	14,1	14,1	13,6
Primary hydrocarbon processing	m/t	15,2	16,0	18,5	20,2	19,9	20,6	20,4
Total capital investments	RUR mn.	41 329	44 700	55 399	67 145	95 026	104 286	124 495
- crude oil production								
- refining								
- marketing								
Average number of producing wells	wells	15 387	15 325	15 340	15 813	16 308	16 727	17 262
Average number	persons	95 885	93 084	92 867	96 558	101 835	104 043	106 197

<sup>604</sup> Nina POUSSENKOVA: (2004) "From Rigs to Riches: Oilmen vs Financiers in the Russian Oil Sector", (The Energy Dimension in Russian Global Strategy), *The James A. Baker III Institute for Public Policy*, October, p.20.

<sup>605</sup> GRACE, p.136.

<sup>606</sup> GORDON, p.45.

<sup>607</sup> Surgutneftegaz Key Operating Results Available on site <http://www.surgutneftegas.ru/en/about/main/> (Accessed on 09 February 2011)

of personnel								
Revenue from sales of goods, works, and services	RUR mn.	213 335	288 064	428 741	500 510	595 882	546 695	551 779

Close friend of Prime Minister Putin, Bogdanov and his staff is controlling more than 50% of the company's stock. Past few years, the company had two serious problems; firstly, after being praised in 1998 and 2004 for the way its workers were treated, workers of Surgutneftegaz went to the streets in May Day protest in 2006 to demand higher wages and an end of the arbitrary awarding of bonuses to management favorites. Secondly, the Harvard Management Company, which manages Harvard University's billions of endowment, filed a claim against Surgutneftegaz with the American Arbitration Association in New York.<sup>608</sup> Harvard University claimed that they were underpaid at least \$3,7 billion worth of dividends. The applicants think the methods used by Surgutneftegaz in calculating the net profit to pay the shareholders was such that in 2003 only 35% of the due amount was directed to pay off the dividends and 21% in 2002.<sup>609</sup>

“Harvard University today will commence international class action arbitration against publicly held Russian oil and gas company JSC Surgutneftegaz [Surgut] for internationally denying holders of its preferred shares as much as 80% of the administrations to which they are entitled.<sup>610</sup>

One of the important actions of Surgutneftegaz is the initiative to buy the MOL. In March 2009 Surgutneftegaz announced that will pay €1,4 billion to buy 21,2% stake in Hungary's oil and gas group MOL from the Austrian OMV Group.<sup>611</sup> On March 2009, Surgutneftegaz bought 21,2% of MOL from OMV but the deal displaced Budapest, with Hungarian President Laszlo Solyom saying the purchase threatened the country's energy security. MOL considered the deal between Surgutneftegaz and OMV as a hostile and accused OMV of collusion with the Russian company. Afterwards, in April, MOL's Board of

<sup>608</sup> GOLDMAN, p.125.

<sup>609</sup> Kommersant (2004) “Harvard University Demands \$3,7 Billion From Surgutneftegaz”, 29 June [http://www.kommersant.com/p-1105/r\\_500/Harvard\\_University\\_Demands\\_\\$37\\_Million\\_from\\_Surgutneftegaz/](http://www.kommersant.com/p-1105/r_500/Harvard_University_Demands_$37_Million_from_Surgutneftegaz/) (Accessed on 09 February 2011)

<sup>610</sup> Ibid.

<sup>611</sup> RIA Novosti (2009) “Russia's Surgutneftegaz to Pay \$1,8 billion for 21% of Hungary's MOL”, 30 March <http://en.rian.ru/business/20090330/120812422.html> (Accessed on 08 January 2011).

Directors refused to include Surgutneftegaz in a shareholder list. But this time, Surgutneftegaz has filed a court suit against MOL for the refusal and include it in the shareholder list.<sup>612</sup> When Russian Deputy Prime Minister Igor Sechin met with Europe Energy Commissioner Gunter Ottinger, he did not hesitate to request EU's help for Surgutneftegaz problem with MOL.<sup>613</sup>

## 10.2. NATURAL GAS

Natural gas is the most common form of gas as an energy resource. Without gas, the military industrial complex would not be able to operate. It is mainly used for power generation and within industrial production, but also for private heating and cooking.<sup>614</sup> Natural gas is called “the prince of hydrocarbons” and the fastest growing energy source in the world;<sup>615</sup>

“Unlike the oil and coal, natural gas cannot simply be loaded on a ship or train transportation from its source to the consumer. Gas requires expensive pipelines, which are uneconomic over large distances, or complicated conversion systems that cool the gas into liquid form, compress the gas to higher pressures, or modify its chemical composition to allow conversion to other products.

Liquefied natural gas (LNG) is natural gas that has been converted temporarily to liquid form of ease of storage or transport. The LNG business developed in the wake of the oil crisis of 1973/74 and began to deliver market across the globe.<sup>616</sup> The main problem of natural gas is the transportation. First of all it costs too high to storage so it should be arrived to the market as soon as possible. There are two transportation type of natural gas, LNG, by sea with using complex and expensive technology and pipelines from long distances even by passing state borders.<sup>617</sup>

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<sup>612</sup> RIA Novosti (2010) “Russia Asks EU to Help Surgutneftegaz Acquire MOL Shares”, 3 November <http://en.rian.ru/business/20101103/161193873.html> (Accessed on 08 January 2011)

<sup>613</sup> Reuters (2010) “Russia Asks EU to Ensure Surgut Rights in MOL”, 3 November <http://af.reuters.com/article/commoditiesNews/idAFLDE6A20LR20101103> (Accessed on 08 January 2011).

<sup>614</sup> LEIJONHJELM and LARSSON, p.55.

<sup>615</sup> Chandra VIVEK: (2006) *Fundamentals of Natural Gas, An International Perspective*, Penn Well Corporation, p.1.

<sup>616</sup> The Gas Supply Outlook for Europe, The Roles of Pipeline Gas and LNG (2008), Clingendael International Energy Programme Available on site <http://www.Clingendael.nl/ciep> (Accessed on 27 June 2009).

<sup>617</sup> Richard E. ERICSON: (2009) “Eurasian Natural Gas Pipelines: The Political Economy of Network Independence”, *Eurasian Geography and Economics*, Vol.50, No.1, p.29.

According to the Oil and Gas Journal's 2008 survey, Russia holds the world's largest natural gas reserves, with 1.680 trillion cubic feet (Tcf) (47,04 bcm), which is nearly twice the reserve in the next largest country.<sup>618</sup> John Grace estimates that Russia has 47 tcm of natural gas, making about one quarter of the world's natural gas reserves.<sup>619</sup> And BP statistics in 2010 estimates that Russian proven reserves are 1567,1 Tcm-44,38 bcm.<sup>620</sup> The International Energy Agency (IEA) 2004 predicts that world natural gas demand will be about 30% higher by 2030, with gas potentially overtaking coal as the world's second largest energy source. Moreover, the IEA predicts that the power sector will account for 60% of the increase in gas demand.<sup>621</sup>

### **10.2.1. The Geology of Gas Basins**

#### **10.2.1.1. Cenomanian Gas**

The Cenomanian age were deposited about 30-40 million years later and are at 1.000 to about 1.400 m. The gas is tripped in very large structures and the reservoir section is directly overlain by a thick (hundreds of meters) shale.<sup>622</sup> Gas in the shallow reservoirs is dry. It contains no associated oil or natural gas liquids. The gas is dry because it is biogenic methods generated in the same way as "swamp gas". As a result of the shallow depth, good reservoir quality and absence of liquids, Soviet and then Russian engineers have produced nearly all West Siberian gas from the Cenomonian reservoirs at a small number of fields.<sup>623</sup> The reservoirs are sandstone, which have very good production characteristics, with single well gas flows in excess of 1 million cubic meters per day.<sup>624</sup>

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<sup>618</sup> Russia: Country Analysis Briefs, p.8.

<sup>619</sup> TKACHENKO: (2008) p.2, STERN: (2005) p.1.

<sup>620</sup> BP Statistical Review of World Energy (2010).

<sup>621</sup> Peter R. HARTLEY and Kenneth B. MEDLOCK III: (2004) "Russian Natural Gas Supply Some Implications for Japan", (The Energy Dimension in Russian Global Strategy), The James A. Baker III Institute for Public Policy of Rice University, October, p.2

<sup>622</sup> D.D. Rice, (1992) "Controls, Habitat, and Resource of Ancient Bacterial Gas" in Roland Vially (ed.) "*Bacterial Gas, Conference, September 25-26, 1989, Milan*", Editions Technip, p.109.

<sup>623</sup> Jonathan P. Stern, (2005) "*The Future of Russian Gas and Gazprom*", Oxford University Press, p.63-64

<sup>624</sup> B. SÖDERBERGH, K. JAKOBSON, and K. ALEKLETT: (2010) "European Energy Security: An Analysis of Future Russian Natural Gas Production and Exports", p.8 Available on site [http://www.tsl.uu.se/uhdsg/publications/Russian\\_Gas\\_Article.pdf](http://www.tsl.uu.se/uhdsg/publications/Russian_Gas_Article.pdf) (Accessed on 09 February 2011)

#### 10.2.1.2. Neocomian Gas

The Neocomian epoch extended between (roughly) 125 to 145 million years ago. Approximately 1.300 meters deeper, at the same gigantic fields, is a second set of reservoirs, containing about one-third of West-Siberia's gas. The deeper gas and liquid resources in West Siberia have been little exploited due to greater depth.<sup>625</sup> The gas in the Neocomian reservoirs are thermogenic, that is, they were formed from the thermal cracking of marine organic matter in the same late Jurassic and Neocomian shales that have sourced the large oil fields in the Middle Ob region.<sup>626</sup>

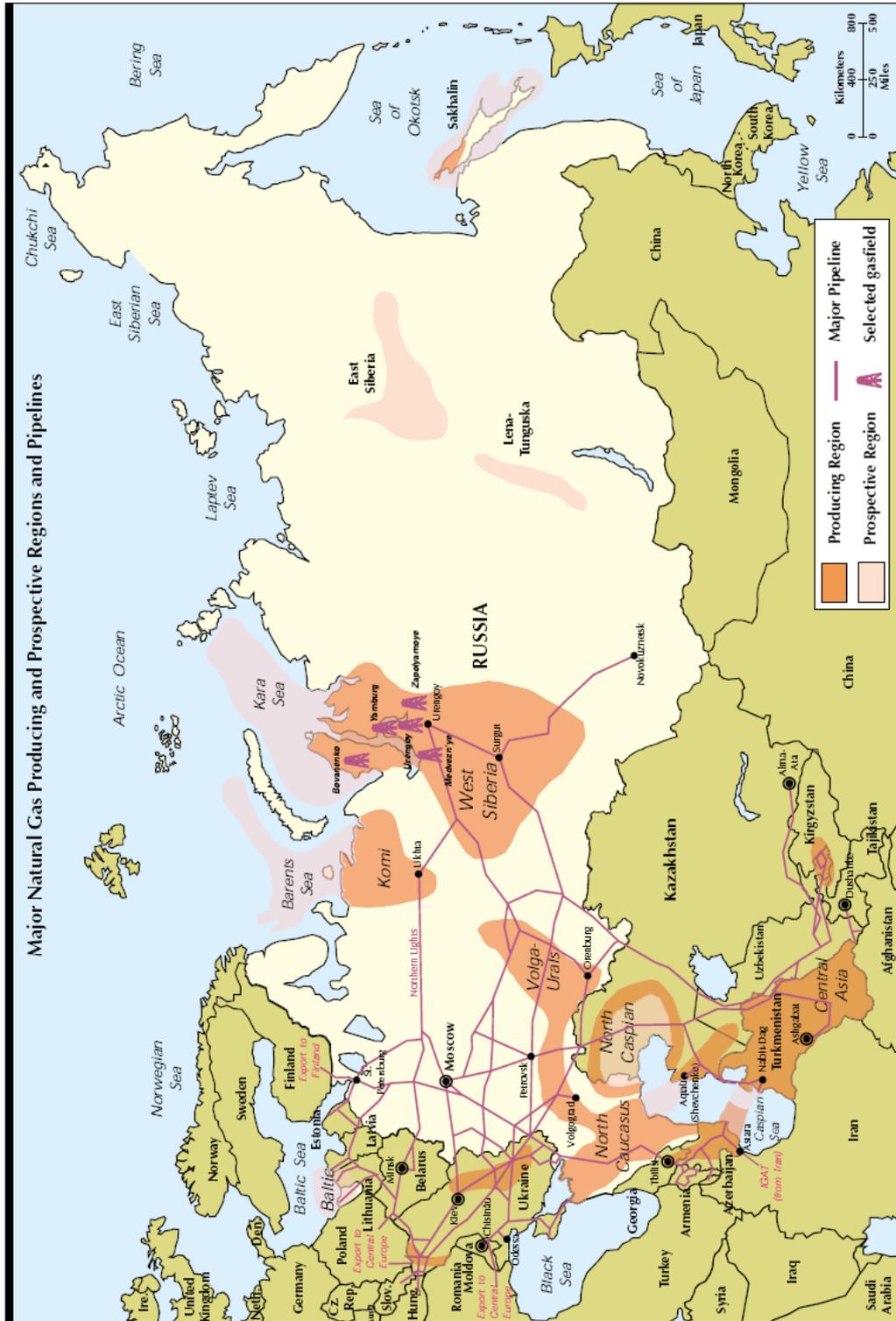
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<sup>625</sup> STERN: (2005) p.63-64.

<sup>626</sup> SÖDERBERGH, JAKOBSON, and ALEKLETT, p.9.

## 10.2.2. Natural Gas Reserves and Production

Map 2: Russian Natural Gas Reserves

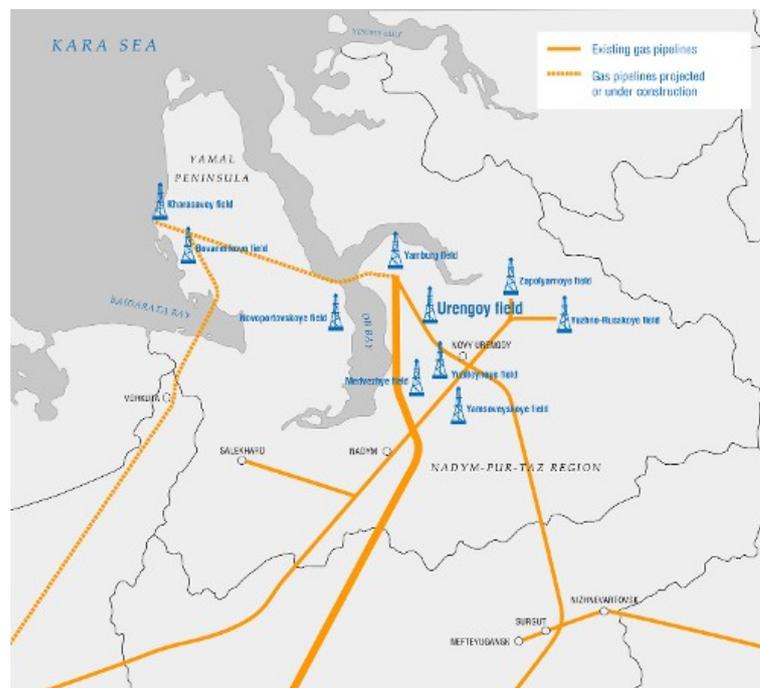


Source: Energy Strategy of Russia, (1996) International Energy Agency, p.166  
 Available on site <http://www.iea.org/textbase/nppdf/free/1990/rusinrus96.pdf> (Accessed on 10 August 2008)

Although the Soviet gas production began to develop as early as in the 1940s in the Ukrainian SSSR republic, large discoveries of gas within what today constitutes the European parts of Russia, were made in the 1950s at several sites along the Volga river and in the Urals area.<sup>627</sup> Afterwards, number of supergiant fields – Medvezhe, Urengoy, Yamburg, and Zapolyornoye – were discovered in Western Siberia and at Orenburg (in Southern Russia) in the mid to late 1960s. These were followed in the 1970s by the Yamal Peninsula fields (in particular Bovanenko and Kharasevey) which firmly established Western Siberia at the centre of Russian gas production for decades to come.<sup>628</sup> In the future there are three important areas that promising huge amount of natural gas which are Nadyum Pur Taz, Yaman Peninsula and Shtokman. (Grace, 2005:10)

### 10.2.2.1. Nadym Pur Taz (NPT)

**Map 3: Nadym Pur Taz**



Source: Gazprom, Fields, Archimov Deposits Available on site  
<http://www.gazprom.com/production/projects/deposits/achimovskie-deposit/> (Accessed on 05 January 2011)

<sup>627</sup> SÖDERBERGH, JAKOBSON, and ALEKLETT, p.2.

<sup>628</sup> Ibid, p.1

-Decline has been evident for some years at Urengoy, Yamburg, Medvezhe and Orenburg;  
 -Komsomoskoye, Yubilyeinoye, Vynga-Yakhinskoye have already peaked although they are likely to produce at 2004 levels for some years;  
 -Zapolyernoye (17.2 Bcm), Yen-Yakhinskoye (1.6 Bcm), Kharvutinskoye (11.9 Bcm), West Tarkosalinskoye (10.5 Bcm), Petsovoye (25.8 Bcm) and Yeti-Purovskoye (12.5 Bcm) are expected to increase production up to 2010.<sup>629</sup>

Its three supergiant field (Yamburgskoye, Urengoiszkoye, and Medvezhye) supplied over 90% of natural gas in NPT, but the production in the region is falling fast. The fields have all been producing for 20 years to 40 years.<sup>630</sup> Gazprom is the active company in the region and every year Gazprom recovers over 60 bcm of natural gas in NPT. As Stern and Overland mentioned above, Russian government is also aware of declining resources in NPZ. Thus, the government has written its strategy for the NPT in its latest energy strategy document;

- Within the period upon 2010, the compensation of reduction in gas production will be provided predominantly at the expense of development of new deposits as well as of prepared for exploitation horizons and sites of developing deposits in the NPT district.<sup>631</sup>
- At the first phase of the Strategy implementation the Russian gas industry will satisfy domestic and export needs of Russian economy for natural gas mainly at the expense of existing deposits exploitation and putting new deposits into operation in the Nadym-Pur-Taz district.<sup>632</sup>

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<sup>629</sup> STERN: (2005) p.10

<sup>630</sup> Ingra OVERLAND: (2008) "Natural Gas Projects in the Russian North: Implications for Northern European Cooperation", in Pami Alto, Helge Blakkisrad, and Hanna Smith (ed.) "*The New Northern Dimension of the European Neighborhood*", Centre European Policy Studies, p.132.

<sup>631</sup> Energy Strategy of Russia For The Period Up To 2030 (2010), p.77

<sup>632</sup> Ibid, p.81.

**Table 27: The Forecast of Phase by Phase Gas Production Development for the Period up to 2030 (bcm)<sup>633</sup>**

	<b>2005 (actual)</b>	<b>2008 (actual)</b>	<b>Phase 1</b>	<b>Phase 2</b>	<b>Phase 3</b>
<b>Gas production – total</b>	641	664	685–745	803–837	885–940
<b>including:</b>					
<b>Tyumen Region</b>	585	600	580–592	584–586	608–637
<b>including the following regions:</b>					
<b>Nadym – Purtazovsky</b>	582	592	531–559	462–468	317–323
<b>Ob-Taz bay</b>	-	-	0–7	20–21	67–68
<b>Bolshekhetskaya valley</b>	3	8	9–10	24–25	30–32
<b>Yamal</b>	-	-	12–44	72–76	185–220
<b>Tomsk Region</b>	3	4	6–7	5–6	4–5
<b>European regions</b>	46	46	54–91	116–119	131–137
<b>including:</b>					
<b>Caspian Sea Region</b>	-	-	8–20	20–22	21–22
<b>Stockman deposit</b>	-	-	0–23	50–51	69–71
<b>Eastern Siberia</b>	4	4	9–13	26–55	45–65
<b>Far East</b>	3	9	34–40	65–67	85–87
<b>including:</b>					
<b>Sakhalin Island</b>	2	7	31–36	36–37	50–51

<sup>633</sup> Energy Strategy of Russia For The Period Up To 2030 (2010), p.146-47.

### 10.2.2.2. Yamal Peninsula

Gazprom's VNIIGaz Institute's study divides the Yamal Peninsula fields into three different groups.

1. The Central Group: Bovanenko, Kharasevey and Kruzenshtern which contain 8.2 Tcm or 62% of the gas resources on the Peninsula. Plateau gas production is anticipated to be 211 Bcm/year and 4 mt of unstable condensate, comprising;
  - Bovanenko 140 Bcm (Cenomanian 115, Neocomian 25)
  - Kharasevey 38 Bcm (Cenomanian 32, Neocomian 6)
  - Kruzenshtern 33 Bcm
2. The Northern (or Tombey) Group: South Tombey, North Tombey, West Tombey, Tassikoye, Maliginskoye, Syadorskoye comprising 3.6 Tcm of gas reserves or 27% of Yamal reserves. Plateau production will be 65 Bcm/year and 2.5 mt of unstable condensate.
3. The Southern Group: Novoportovskoye, Nuiminkoye, Mala-Yamalskoye, Rostatsavskoe, Arkticheskoye, Sredne-Yamalskoye, Khambateyskoye, Neitinskoye, Kamennomyskoye with 1.4 Tcm of gas resources or 11% of the total. Plateau production will be 30 Bcm/year.<sup>634</sup>

Gazprom says that 11 gas and 15 oil, gas and condensate fields with approximately 16 Tcm of explored and preliminary estimated gas reserves (ABC1+C2) and nearly 22 Tcm of in-place and forecast gas reserves (C3+D3) have been discovered on the Yamal Peninsula and in its adjacent offshore areas. Reserves of condensate (ABC1) are estimated at 230.7 m/t and those of oil – 291.8 m/t.<sup>635</sup> The Energy Strategy up to 2030 document says that

- Creation of industrial centers of natural gas production on the Yamal Peninsula and continental shelf of the Barents, Pechora and Kara seas will satisfy the prospective demand of the economy for natural gas, provide energy security of the country and sustainable development of the fuel and energy complex on a long-term basis under conditions of growing demand of economy for energy resources.<sup>636</sup>
- 26 deposits with proven gas reserves of 10.4 trillion m<sup>3</sup> were discovered within the Yamal Peninsula. Within the nearest 25 years, cumulative capital investments in

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<sup>634</sup> SERN: (2005) p.13

<sup>635</sup> Gazprom Yamal Mega Project Available on site <http://www.gazprom.com/production/projects/mega-yamal/> (Accessed on 03 January 2011)

<sup>636</sup> Energy Strategy of Russia For The Period Up To 2030 (2010), p.60.

the amount of US \$166 to 198 billion will be required for the development of deposits on the Yamal Peninsula (Bovanenkovskoye, Kharasaveiskoye, etc.). The commencement of gas production is planned for the end of the first phase of the Strategy implementation; by 2030, the production will achieve 185–220 billion m.<sup>637</sup>

### 10.2.2.3. Shtokmanovskoya (Shtokman) field

**Map 4: Shtokman Field**



Source: Gazprom Projects Shtokman

Available on site <http://www.gazprom.com/production/projects/deposits/shp/> (Accessed on 02 January 2011)

The Shtokman field, discovered in 1984, is estimated to have total reserves of 3.2 Tcm but lies 550 km offshore to the north of Murmansk at water depths of around 300-330

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<sup>637</sup> Ibid, p.77.

meters,<sup>638</sup> more than the entire proved reserves of the EU and more than the half of the proved reserves of the US. Rough sea-bed conditions are compounded by drifting ice and very harsh physical, as well as fragile environmental, conditions.<sup>639</sup> Gazprom planned to export all of the gas from the field via LNG, but Gazprom is now tentatively planning to pipe some of the gas via the Nord Stream pipeline. In May 2008, Deputy Gazprom Chairman Alexander Medvedev announced that 50% of the field's LNG export would go towards the Russian LNG facility in Canada.<sup>640</sup>

In 2006 Gazprom surprised the world and began to negotiate with five Western company for the development of the Shtokman field. Only nine months later, Gazprom signed a framework agreement with Total for 25% of the first phase of the Shtokman project. Few months later, Gazprom and Norway's StatoilHydro signed for 24% of the project. Although Total and StatoilHydro will present the reserves in their portfolio, Gazprom has entire ownership and control.<sup>641</sup> The development of Phase 1 of the Shtokman Project is being carried out by Shtokman Development AG, which was established in February 2008. Gazprom says that the plan for Phase 1 is to produce 23.7 billion cubic meters of natural gas per year. The Shtokman Field production is scheduled to begin in 2016. The LNG Plant is scheduled to be commissioned in 2017.<sup>642</sup>

### **10.2.3. Major Natural Gas Companies**

#### **10.2.3.1. Gazprom**

Gazprom State Gas Concern was established in 1989 on the basis of the USSR Gas Industry Ministry. In 1993 the Concern laid the foundation for setting up Gazprom Russian Joint Stock Company, which was renamed in 1998 as Gazprom Open Joint Stock

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<sup>638</sup> Vladimir FEYGN: (2007) "Are The Energy Major in decline?", *Russia in Global Affairs*, January-March

p.1

<sup>639</sup> STERN: (2005) p.17

<sup>640</sup> Russia: Country Analysis Briefs (2010), p.10, Robert E. EBEL: (2009) "The Geopolitics of Russian Energy, Looking Back, Looking Forward", CSIS, July, p.35 Available on site [http://csis.org/files/publication/090708\\_Ebel\\_RussianEnergy\\_Web.pdf](http://csis.org/files/publication/090708_Ebel_RussianEnergy_Web.pdf) (Accessed on August 2009)

<sup>641</sup> Charles EMMERSON: (2010) *The Future History of the Arctic*, United States by Public Affairs Published, p.212.

<sup>642</sup> Shtokman Company Available on site <http://www.shtokman.ru/en/about/> (Accessed on 09 February 2011)

Company.<sup>643</sup> During the first decade of its existence, it was state-owned to 38.7% but the state, as a part of a major restructuring scheme, increased its ownership share to 51% during 2005.<sup>644</sup> Gazprom mostly called as “state monopoly”, “gas giant”, “global gas company”, “Kremlin, Inc.” or “gas empire”. Controlling more than 60% of Russian gas reserves and 84.7% of national gas production, Gazprom alone accounted for 10.6% of Russian GNP in 2006.<sup>645</sup> On 27 May 2008 Russian President Dmitry Medvedev, who used to head the energy giant's board of directors, said Gazprom contributes around 20% of the federal budget's revenues. President Medvedev said that “around 20% of federal budget revenue comes from Gazprom, whose capitalization has increased 46 times since 2000,” and described the company's role as “exemplary.” Gazprom's market capitalization then stood at \$362 billion.<sup>646</sup>

Gazprom is the largest gas producing company in the world; employing nearly 300.000 people either directly or through its numerous subsidiaries.<sup>647</sup> Although organized as a joint stock company and despite having some limited foreign ownership (in particular the German firm E. ON Ruhrgas AG, a part of E. ON Energie AG which owns 5.7% of Gazprom), Gazprom in many ways operates as a government agency.<sup>648</sup> When Putin first came to power, he changed the leadership of Gazprom in spring 2001 and consolidated into the hands of its leadership at least half of its assets, which had been trusted to friendly companies” by the previous generation of Gazprom’s managers.<sup>649</sup> As a result, in 2001, Aleksey Miller, official of the St. Petersburg administration and friend of Putin, was appointed as the new CEO. Despite the tremendous pressure from the US and the EU, Putin has rejected the proposals to divide Gazprom into several smaller companies.<sup>650</sup> On 17 February 2003, Putin gave a speech at a reception commemorating the 10<sup>th</sup> anniversary of the founding of Gazprom: “Gazprom as a strategically important company, should be

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<sup>643</sup> Gazprom Company Official Website Available on site <http://www.gazprom.com/about/> (Accessed on May 2010)

<sup>644</sup> LARSSON, p.138.

<sup>645</sup> BUCCELLOTO and MICKIEICZ, p.393.

<sup>646</sup> Global Security, Russian State Budget Available on site <http://www.globalsecurity.org/military/world/russia/budget.htm> (Accessed on 22 September 2010).

<sup>647</sup> Mesut Hakkı CAŞIN: (2006) *Rus İmparatorluk Stratejisi*, Okumus Adam, p.501.

<sup>648</sup> FREDHOLM, p.18.

<sup>649</sup> TKACHENKO: (2008) p.4

<sup>650</sup> Stanislav L. TKACHENKO: (2007) “Actors in Russia’s Energy Policy Towards the EU”, *Paper presented at ISA Panel*, US, March , p.19.

kept, and has been kept, as a single organism... Gazprom is a powerful political and economic level of influence over the rest of the world.”<sup>651</sup>

Ivanenko states that;

The Russian government recognized that providing natural gas at households and power plant – regardless of customers’ ability to pay – was a key to social stability. Gazprom enjoys a special status within the Kremlin’s hierarchy of domestic monopolies. First, the latter continues to see Gazprom’s money as not being fully separated from the federal budget. For example, the Ministry of Finance believes that Gazprom should contribute to the Stabilization Fund like oil companies do. Second, because Gazprom enjoys strong economic clout in many ex-Soviet states, the Kremlin is occasionally tempted to use the company as a tool to advance Russian political objectives abroad. Third, as a globally important company Gazprom is a potential engine of national growth. Fourth, being an unreformed Soviet organization, Gazprom serves as the benchmark against which the excesses of privatization in energy sector are highlighted.<sup>652</sup>

The preservation of Gazprom’s monopoly and vertically integrated structure combined with direct and detailed price regulation both served the Government’s long-term interests and protected consumers from arbitrary monopoly prices.<sup>653</sup> Putin himself described Gazprom as “powerful political and economic lever of influence over the rest of the world”, and Russian attempts to gain control of downstream assets in Europe and the former Soviet state assets to the reach of this and similar levers”.<sup>654</sup> It is a fact that Gazprom much more than a company for Russian administration. As long as Russian foreign policy will be integrated with energy strategy, then the Gazprom will be at the center of Kremlin politics as well. The main question whether it is benign or malign or both of them?

**Table 28: Gazprom’s Foreign Subsidiaries and Affiliates**

Country	Company name	Types of operations	Share of Gazprom (%)

<sup>651</sup> FREDHOLM, p.19.

<sup>652</sup> Vlad IVANENKO: (2006) “Russian Energy Strategy in Natural Gas Sector”, *Working Paper Series*, December, p.3-4

<sup>653</sup> Theocharis GRIGORIADIS and Benno TORGLER: (2006) “Energy Regulation and Legislative Development in the State Duma of Russia: A Special Analysis of Roll Call Votes with the Optimal Classification Model, Russia 14-2003”, CREMA, *Working Paper*, No.2006-07, Basel, p.6

<sup>654</sup> MANKOFF: (2009a), p.35.

Armenia	Armrosgazprom	Gas distribution	40
Austria	Gas und Warenhandelsge- sellschaft	Sale of gas	50
Belarus	Beltransgaz	Gas distribution	50
Bulgaria	Overgaz	Gas distribution	23
	Overgaz Incorporated	Investing	50
	Topenergo	Gas distribution	100
Cyprus	Leadville Investments Ltd.	Investing	100
Czech Republic	Gas Invest	Investing	n.d.
Estonia	Eesti Gaas	Gas distribution	37
Finland	Gasum	Gas distribution	25
	North Transgas OY	Gas transportation	50
France	Fragaz	Gas trading	50
Germany	Wingas	Gas distribution	35
	WIEH	Gas distribution	50
	ZMB	Gas distribution	100
	GWH	Gas distribution	100
	ZGG	Gas distribution	100

Source: Mert BİLGİN: (2011) “Energy Security and Russia's Gas Strategy: The Symbiotic Relationship Between the State and Firms”, *Communist and Post-Communist Studies* 44, p.125.

#### 10.2.4. Private Gas Companies

Stern says that in a Russian context, the term “independent gas company” is used as shorthand for any organization that produces or supplies gas not 100% owned by Gazprom. But instead of calling them “independent” or “non-Gazprom”, I prefer to call them private companies. At least, concerning to their financial structural, they might be accepted as private companies. However, calling them “independent” is not a case in Russia since

2000. Moreover, there are such companies both dealing with oil and gas. As mentioned before as the main oil companies Lukoil, Surgutneftegaz and TNK-BP will not be mentioned under this title. According to Stern's "Non-Gazprom" categorization;

1. Companies whose main business is oil, but have significant reserves and interests in gas: Lukoil, Surgutneftegas, TNK/BP
2. Companies whose business activities are gas-related. Itera and Novatek
3. Companies in which Gazprom has a substantial shareholding, such as Sibur and Purgaz.<sup>655</sup>

#### **10.2.4.1. Itera**

Itera had been founded in 1992 by Igor Makarov, a Russian born in Turkmenistan and a former cycling champion who began trading food for Turkmen oil in the early 1990s before he founded Itera. In 1994, Itera opened an office in Jacksonville, Florida, in a failed attempt to secure guarantees from US officials.<sup>656</sup> Initially, Itera and Gazprom operated in harmony within the former Soviet Union. Itera sold Turkmen gas to other CIS states with the permission of Gazprom.<sup>657</sup> In 2000, Itera produced nearly 18 bcm of gas, purchased around 30 Bcm of gas on commission from the Yamal-Nenets regional authorities in Siberia, and 35 bcm from Central Asian countries, mainly Turkmenistan but also Kazakhstan and Uzbekistan.<sup>658</sup> Itera remains the second most important independent gas company in terms of sales. Yamal-Nenets Autonomous District is a major region for production activity of Itera. And Itera obtained new licenses for undertaking exploration work in Kamykia (Tatarstan).<sup>659</sup>

In 2010, Itera sold 21 bcm of natural gas, more than in 2009 (18,3 bcm) but less than in the pre-crisis year 2008 (23,8 bcm). In 2010 company produced 9,35 bcm compared to 9,08 bcm in 2009. It is estimated that in the next two years production will grow to nearly 1,28

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<sup>655</sup> STERN: (2005) p.19.

<sup>656</sup> FREDHOLM, p.20.

<sup>657</sup> LARSSON: (2006) p.148.

<sup>658</sup> STERN: (2005) p.22.

<sup>659</sup> Itera Company Available on site <http://www.itera.ru> (Accessed on May 2010).

bcm in 2011 to 1.71 bcm in 2012. Almost 8 bcm of gas, Itera produced in a joint venture with Gazprom JSC Purgaz.<sup>660</sup>

#### **10.2.4.2. Novatek**

Novatek, originally FIK Novafininvest, was established as an open joint stock company in August 1994 to provide a central legal entity for the management of construction activities, exploration and production in the Russian oil and gas industry. Novatek has been actively selling natural gas directly to the end users since December 2002. In 2008, Novatek produced 30,88 bcm of natural gas. The company accounted for approximately 8% of total natural gas deliveries to consumers in Russia, and 5% of total Russian natural gas production.<sup>661</sup> All fields and license areas which Novatek functions are located in Yamal-Nenets Autonomous District of the Russian Federation. In 2010, Novated produced 37,78 bcm of natural gas, compared with the year 2009 gas production has increased 5 bcm (15,3%). In November 2010, a 50/50 joint venture between Novatek and Gazprom Neft, acquired a 51% participation interest in SeverEnergiya holding licenses for the development of oil and gas condensate fields in Yamal-Nenets Autonomous District.<sup>662</sup> Novatek has maintained a good relationship with Gazprom by seeking to deliver gas to the Russian domestic market rather than to export.<sup>663</sup>

#### **10.2.4.3. Northgas**

It was formed out of a 1993 joint venture between Gazprom (51%), Bechtel (BERC 44%), and Farco (5%) with a license to develop gas and condensate in the Neocomian horizons of the North Urengoy field.<sup>664</sup> Through a deal signed in June 2006, Gazprom regained control of Northgas, the gas monopoly's last major asset lost under the previous management,

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<sup>660</sup> Itera Press Releases (2011) "2010 Itera Implement 21 Billion Cubic Meters of Gas", 28 November Available on site <http://www.itera.ru/isp/go/index/smi/985/13/> (Accessed on 05 February 2011).

<sup>661</sup> Novatek Company History Available on site <http://www.novatek.ru/eng/about/history/> (Accessed on 05 February 2011).

<sup>662</sup> Ibid.

<sup>663</sup> STERN: (2005) p.26.

<sup>664</sup> Ibid, p.27.

following a long legal battle.<sup>665</sup> In 2007 Northgas produced 367.3 mil m<sup>3</sup> of natural gas and 579.1 thousand tons of unstable gas condensate.<sup>666</sup> Recently, it was announced that Russia's state-controlled power giant Inter RAO had agreed to buy 100% of the British holding company of REDI for \$1.5 billion, which owns a 49% in Northgas. In 2010 the company produced 3 bcm of natural gas and plans to increase the amount to 4 bcm in 2011.<sup>667</sup>

### 10.3. PIPELINES

The Russian Federation inherited from the Soviet Union 46,000 kilometers of oil pipelines, 15,000 kilometers of pipelines intended for oil products as well as the world's largest grid of gas pipelines comprising altogether 152,000 kilometers. All of these pipelines are in state ownership or at least under total functional control of public institutions.<sup>668</sup> After the dissolution of the Soviet Union, each new state gained ownership over the pipelines crossing their territory such as Ukraine, Neland and Moldova, and also provide them with a means of counteracting Russia's oil and gas exporting from time to time.<sup>669</sup>

Concerning to these pipelines, Transneft is the state owned company that has a monopoly over Russian oil pipeline transport. Private companies are allowed to build and own pipelines but only if used solely for their internal needs.<sup>670</sup>

The main oil production areas are linked by an integrated oil pipeline system that is controlled by Transneft, which oversees the transfer of 95% of oil to Russia's oil refineries, as well as to export terminals via the Druzhba oil pipeline network and deep-sea oil loading terminals on the Black and the Baltic Sea.<sup>671</sup> Transneft is the only single entity that

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<sup>665</sup> RIA Novosti (2006) "Russia's Northgas Boosts Gas by 15,2% in 1H06", 7 July <http://en.rian.ru/russia/20060707/51032828.html> (Accessed on 05 January 2011).

<sup>666</sup> Northgas Company Available on site <http://www.northgas.ru> (Accessed on 15 May 2010).

<sup>667</sup> Andrey OSTROUKH and Toni VOROBYOVA: (2011) "Refile-Russia's Inter RAO Says Buy 49 pct in Northgas", 17 January, Reuters, <http://in.reuters.com/article/2011/01/17/russia-interrao-northgas-idINLDE70G0LZ20110117> (Accessed on 08 February 2011).

<sup>668</sup> TKACHENKO: (2008) p.2.

<sup>669</sup> Margarita M. BALMACEDA: (2008) *Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's Power, Oligarchs' Profits and Ukraine's Missing Energy Policy, 1995-2006*, Routledge, p.4.

<sup>670</sup> FREDHOLM, p.7, EBEL, p.7.

<sup>671</sup> Alexander ARBATOV, Maria BELOVA, and Vladimir FEYGIN: (2006) "Russian Hydrocarbons and World Markets", *Russia In Global Affairs*, Vol.4, No.1, p.122.

has to be pointed out as Russia's main lever in the politics of oil.<sup>672</sup> This system has left oil producers with three major options: to export via rail and river barge to external markets; to export petroleum products, instead of route; or to sell their oil on the domestic market.<sup>673</sup> The logic of Transneft's current position and its role in future pipeline projects as a non-integrated quasi monopoly is a uniquely.<sup>674</sup> Regarding to gas pipeline system Gazprom owned the Russian Unified Gas Supply System (UGSS) which is the world's largest gas transformation system is about 160.000 km of gas pipelines. The average transportation distance in 2008 was 2900 km for gas supplies to Russian consumers and 3222 km for gas export utilities.<sup>675</sup>

**Table 29: Russian Federation Gas Pipelines' Status**

<b>GAS</b>			
<b>EXISTING</b>	<b>UNDER CONSTRUCTION</b>	<b>IN PROGRESS</b>	<b>UNDER DISCUSSION</b>
The Yamal European Gas Pipeline	The North-European Gas Pipeline	Eastern gas program	Murmansk – Volkhov
Blue Stream	Sakhalin – Khaborovsk – Vladivostok	South Stream	The Yamal-Europe II
Central Asia-Center	Pre-Caspian		Blue Stream II
Kasimovskoye UGS – Voskresensk CS	Gryazovets – Vyborg		
Minsk – Vilnius – Kaunas – Kaliningrad	SRTO - Torzhok		
	Pochinki – Gryazovets		
	Bovanenko – Ukhta and Ukhta – Torzhok		
	Dzuarikau – Tskhinval		
	Dzhubga – Lazarevskoye – Sochi		

<sup>672</sup> LEIJONHIELM and LARSSON, p.37.

<sup>673</sup> Gawdat BAHGAT: (2004) "Russia's Oil Potential: Prospects and Implications", *OPEC Review*, 28:2, p.142.

<sup>674</sup> GORDON, p.16.

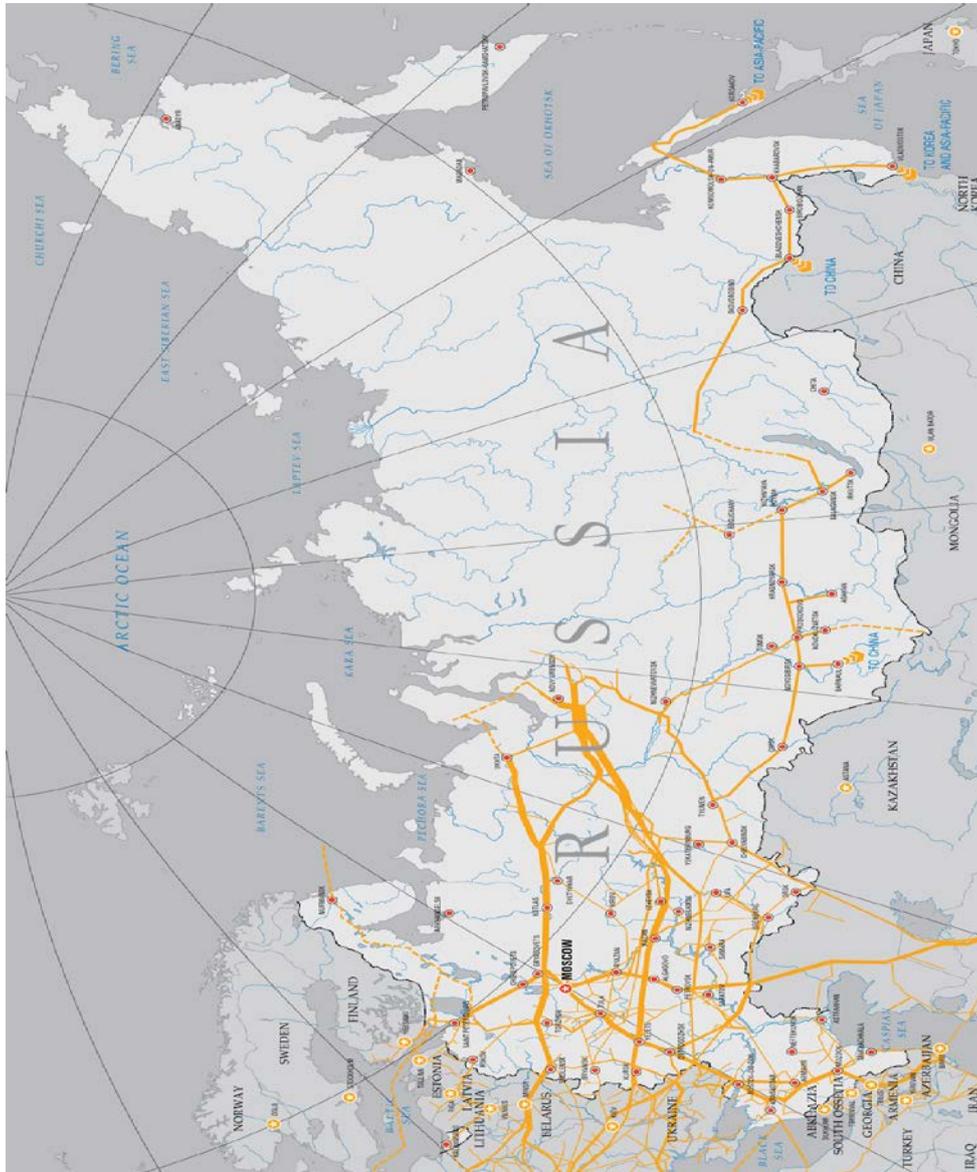
<sup>675</sup> Bengt SÖDERBERGH, Kristofer JAKOBSSON, and Kjell ALEKLETT: (2010) "European Energy Security: An Analysis of Future Russian Natural Gas Production and Exports", *Energy Policy*, 38, p.7830.

**Table 30: Russian Federation Oil Pipelines' Status**

<b>OIL</b>			
<b>EXISTING</b>	<b>UNDER CONSTRUCTION</b>	<b>IN PROGRESS</b>	<b>UNDER DISCUSSION</b>
Druzhba Pipeline	1. BPS II	1. Burgas – Alexandroupolis Oil Pipeline	1. Druzhba –Adria integration
Baltic Pipeline System (BPS)		2. Samsun-Ceyhan Oil Pipeline	2. Kharyaga – Indiga and Murmansk
Baku – Tikharetsk – Novorossiysk Pipeline			3. Purpe-Samotlar Project
Atyrov – Samara Pipeline			
Caspian Pipeline Consortium (CPC)			
Sakhalin I			
Sakhalin II			
ESPO			

### **10.3.1. Gas Pipelines**

#### **Map 5: Russian Gas Pipeline System**



Source: Gazprom Pipelines

Available on site [http://www.gazprom.com/f/posts/15/301731/map\\_tv\\_ocean\\_eng.jpg](http://www.gazprom.com/f/posts/15/301731/map_tv_ocean_eng.jpg) (Accessed on 05 January 2011)

### 10.3.1.1. Existing Pipelines

#### 10.3.1.1.1. The Yamal-Europe Gas Pipeline

The project is designed to provide natural gas supplies to Europe. The Yamal Peninsula is one of the most promising oil and gas bearing provinces of West Siberia and the most important of Gazprom's new strategic regions.<sup>676</sup> The project included two 1420-mm pipeline strings 4100 km long to carry gas from the Yamal fields to German across, Russia, Belarus and Poland. About 17bcm of gas are currently exported each year through the Yamal-Europe gas pipeline.<sup>677</sup> The post-Soviet problems of transit through Ukraine during the 1990s became sufficiently serious.<sup>678</sup>

**Map 6: Yamal-Europe Pipeline**



Source: Gazprom, Yamal Europe Pipeline

Available on site <http://www.gazprom.com/production/projects/pipelines/yamal-evropa/> (Accessed on 05 January 2011)

<sup>676</sup> ARBATOV, BELOVA, and FEYGIN, p.129.

<sup>677</sup> Gazprom Export Company Available on site <http://www.gazpromexport.ru> (Accessed on 10 January 2011)

<sup>678</sup> STERN, p.118.

### 10.3.1.1.2. Blue Stream

The Blue Stream gas pipeline is designed to transit Russian natural gas to Turkey across the Black Sea bypassing third countries. The pipeline will supplement the existing gas transmission corridor from Russia to Turkey crossing the territory Ukraine, Moldova, Romania and Bulgaria. The total length of the Blue Stream gas pipeline accounts for 1213km.<sup>679</sup> It is very important for Gazprom, given the competition from other suppliers, to secure a large share of this market for Russian gas.<sup>680</sup> The gas pipeline design capacity is 16 bcm of gas per annum. Gazprom totally supplies 7,5 bcm (2006), 9,5 bcm (2007), 10,1 bcm (2008) and 9,8 bcm (2009) via Blue Stream.<sup>681</sup>

**Map 7: Blue Stream Pipeline**



Source: Gazprom Blue Stream Available on site

<http://www.gazprom.com/production/projects/pipelines/blue-stream/> (Accessed on 9 September 2010).

<sup>679</sup> Gazprom Blue Stream Available on site <http://www.gazprom.com/production/projects/pipelines/blue-stream/> (Accessed on 9 September 2010).

<sup>680</sup> STERN: (2005) p.123.

<sup>681</sup> Gazprom Blue Stream.

### 10.3.1.1.3. Central Asia – Center Gas Pipeline System (CAC)

This is a Gazprom controlled system of natural gas from Turkmenistan through Uzbekistan and Kazakhstan to Russia. The pipeline system was laid in two major corridors: a main branch consisting of four pipelines (CAC-1, -2, -4, and -5) that passes through Uzbekistan, and which accounts for the bulk of the systems' capacity, and a smaller branch consisting of only one pipeline (CAC-3) that runs only through Kazakhstan.<sup>682</sup> The principal route for the export of Turkmen gas is the CAC pipeline system, which was built in stages from 1960 to 1974. The combined capacity of the system estimated of 90 bcm per year. By the mid 1970s the 13,750 km CAC transmission system had been completed.<sup>683</sup>

**Map 8: Central Asia – Center Gas Transmission System**



Source: Gazprom Pipelines

Available on site <http://www.gazprom.com/production/projects/pipelines/central-asia/> (Accessed on 05 January 2011)

<sup>682</sup> FREDHOLM, p.31-32

<sup>683</sup> Martha Brill OLCOTT: (2004a) "International Gas Trade in Central Asia: Turkmenistan, Iran, Russia and Afghanistan", *Geopolitics of Gas Working Paper Series*, James A. Baker III Institute for Public Policy, Rice Uni., No.28, May, p.24.

#### **10.3.1.1.4. Kasimovskoye UGS – Voskresensk CS Pipeline**

Moscow and its suburban areas consume around 45 bcm of natural gas annually. Pipeline was commissioned on October 23, 2009 in the aim of securing maximum reliability of natural gas supplies to Moscow and the Moscow Oblast. Owing to the maximum daily gas withdrawal from the Kasimovskoye and Uvyazovskoye UGS facilities (aggregate active gas capacity equals 10 billion cubic meters, i.e. nearly as much as Moscow consumes in the cold weather time), the new gas pipeline will additionally supply consumers with up to 130 million cubic meters of natural gas per day during the autumn-winter period.<sup>684</sup>

#### **10.3.1.1.5. Minsk – Vilnius – Kaunas – Kaliningrad**

Kaliningrad is an isolated territory of Russian Federation, inherited from former Soviet Union near Baltic Sea and surrounded by EU countries. Gas pipeline construction has begun in October 2008 and completed in December 2009. Pipeline capacity is expanded from 1.4 bcm to 2.5 bcm annually. It is very important to increase the pipeline throughput capacity as it will stimulate production growth in the related industries, primarily manufacturing of cars (the region produces BMW, KIA, Chevrolet), gas industry and railroad equipment as well as instruments.<sup>685</sup>

### **10.3.1.2. Under Construction**

#### **10.3.1.2.1. North European Gas Pipeline (NEGP) – Nord Stream**

North Stream is a gas pipeline that will link Russia and the EU via the Baltic Sea. It is a joint project of five companies which are Gazprom, BASF, Ruhrgas, Nederlandse Gasunie and SUEZ. Nord Stream will be 1,224 km long and will consist of two parallel lines which will be laid across the Baltic Sea, from Vyborg, Russia to Greifswald, Germany. Nord

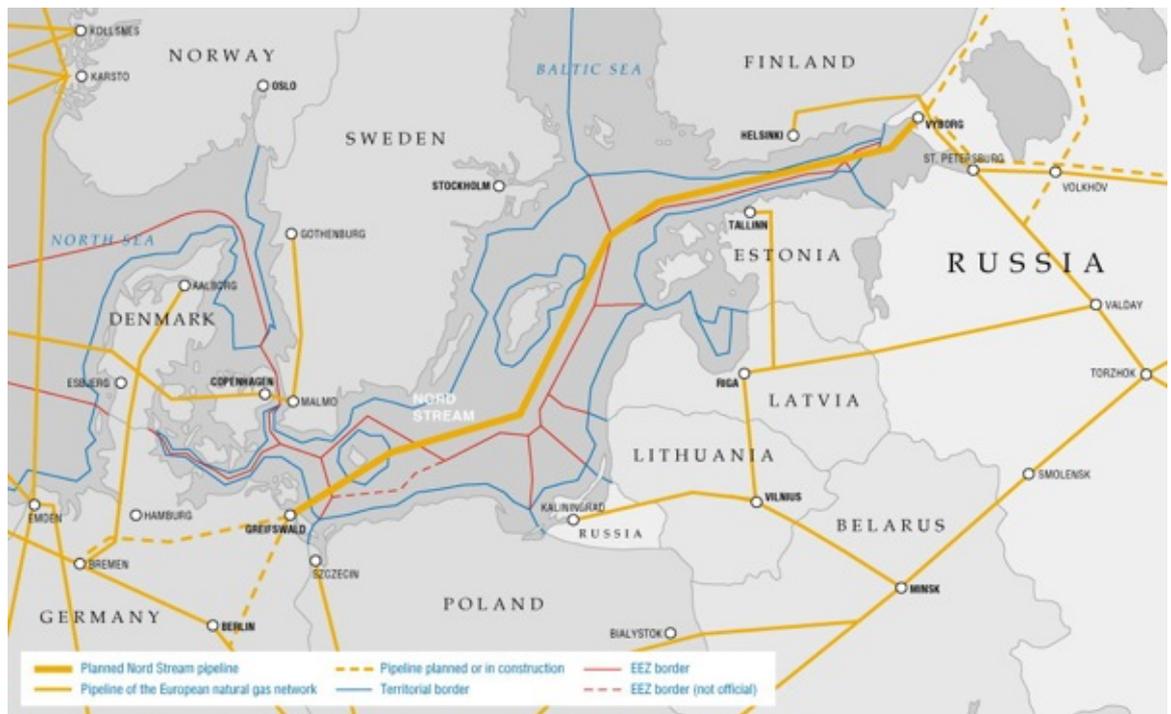
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<sup>684</sup> Gazprom Pipelines Kasimovskoye UGS – Voskresensk CS Pipeline Available on site <http://www.gazprom.com/production/projects/pipelines/kasvoseng/> (Accessed on 05 January 2011)

<sup>685</sup> Gazprom Pipelines Minsk – Vilnius – Kaunas – Kaliningrad Available on site <http://www.gazprom.com/production/projects/pipelines/mvkk/> (Accessed on 05 January 2011)

Stream will transport gas to Germany, where it can be transported onwards to Denmark, the Netherlands, and Belgium, the UK, France and other countries.<sup>686</sup> The project is expected to cost more than \$11 billion (or 7.4billion Euros, two times as much as originally planned).<sup>687</sup> Former President Putin who, in May 2004 made a speech to the Duma, confirmed the priority attached to the project: “In export, the construction of the NEGP is most important. It will make it possible to diversify export flows, directly linking the networks of Russia and countries of the Baltic region with the total European gas network.<sup>688</sup> The first phase of pipeline with the capacity of 27.5 bcm has launched in November 2011. It is expected that the pipeline will be completed and function in 2012 with the capacity of 55 bcm.

**Map 9: North European Gas Pipeline**



Source: Gazprom North Stream Available on site

<http://www.gazprom.com/production/projects/pipelines/nord-stream/> (Accessed on 05 January 2011).

<sup>686</sup> Nord Stream Pipeline Route Available on site <http://www.nord-stream.com/en/the-pipeline/pipeline-route.html> (Accessed on 05 January 2011).

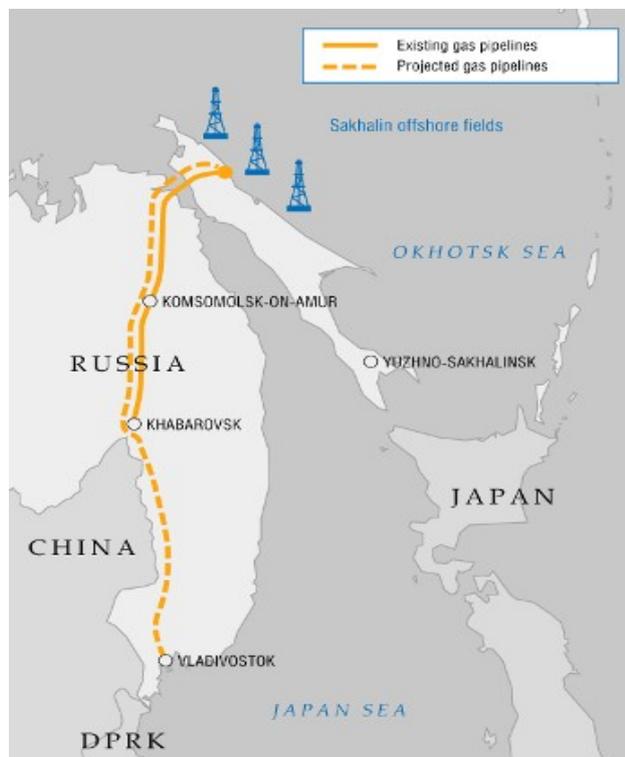
<sup>687</sup> Russia: Country Analysis Briefs (2010), p.13

<sup>688</sup> STERN: (2005), p.122

### 10.3.1.2.2. Sakhalin – Khabarovsk – Vladivostok Pipeline

In 2008 Gazprom started designing the Sakhalin – Khabarovsk – Vladivostok gas transmission system. On July 31, 2009, Russia started the construction of a major gas pipeline supplying its Pacific Ocean port city of Vladivostok, which would eventually be used exports of gas to Japan. During the inauguration ceremony Prime Minister Putin said that “the priority for gas in East Siberia is above all to serve the domestic market”. When the pipeline completed, it will be 1,800 km long and will be able to transport 30 bcm of gas a year. The pipeline is expected to be ready in the second half of the 2011.<sup>689</sup>

**Map 10: Sakhalin – Khabarovsk – Vladivostok Pipeline**



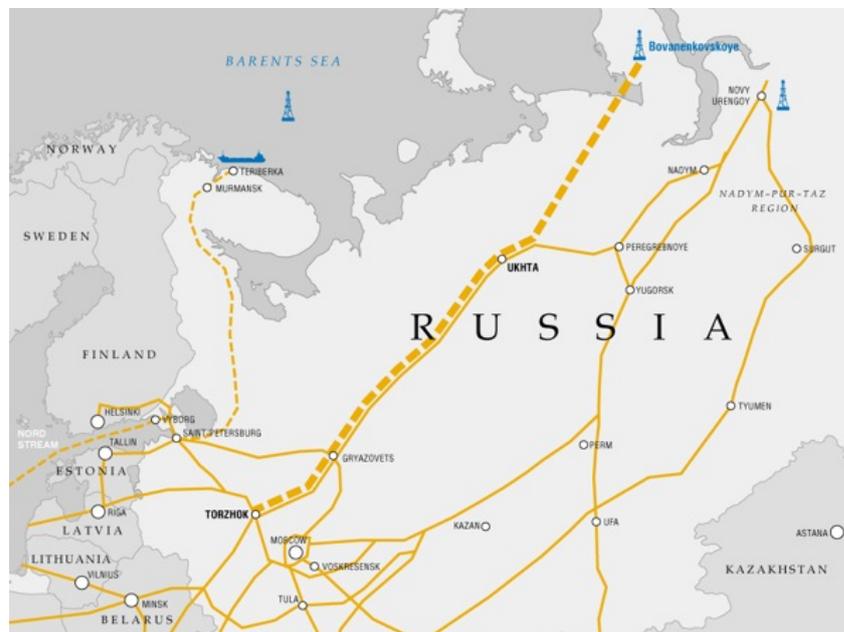
Source: Gazprom Sakhalin – Khabarovsk – Vladivostok Pipeline Available on site <http://www.gazprom.com/production/projects/pipelines/shvg/> (Accessed on 05 December 2010)

<sup>689</sup> Yuri ZARAKHOVICH: (2009) “Sakhalin-Khabarovsk-Vladivostok Pipeline Launched”, *Eurasia Daily Monitor*, Vol.6, Issue 154, 11 August [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=35395](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=35395) (Accessed on 05 December 2010).

### 10.3.1.2.3. Bovanenko – Ukhta and Ukhta – Torzhok Gas Pipelines

In order to deliver gas from Bovanenko field with projected production of 115 bcm per year, it is planned to construct a multi-line gas transmission system that would correct the Yamal Peninsula and central Russia. The pipeline route will exceed 2400 bcm. Over 745 km of the linear part have been welded up so far. It is planned that the pipeline's first string more than 1,200 km long is to be constructed in 2011.<sup>690</sup>

#### Map 11: Bovanenko – Ukhta and Ukhta – Torzhok Gas Pipelines



Source: Gazprom Bovanenko – Ukhta and Ukhta – Torzhok Gas Pipeline Available on site <http://www.gazprom.com/production/projects/pipelines/by-ytg/> (Accessed on 05 February 2011)

### 10.3.1.2.4. Gryazovets – Vyborg Gas Pipeline

The Gryazovets – Vyborg gas pipeline is planned for securing gas deliveries to the Nord Stream gas pipeline and supplying consumers of Russia's Northwestern region the pipeline length will be 917 km and will have capacity 55 bcm.

<sup>690</sup> Gazprom Press Release (2011) “Over 745 km of Bovanenko-Ukhta Gas Pipeline Linear Part Welded Up”, 3 February Available on site <http://www.gazprom.com/press/news/2011/february/article108535/> (Accessed on 05 February 2011)

## Map 12: Gryazovets – Vyborg Gas Pipeline



Source: Gazprom Gryazovets – Vyborg Gas Pipeline Available on site

<http://www.gazprom.com/production/projects/pipelines/gvg/> (Accessed on 05 January 2011)

### 10.3.1.2.5. SRTO – Torzhok Gas Pipeline

Starting from 1995, Gazprom has been constructing a gas pipeline from the Urengoy field located in the Western Siberia to the town of Torzhok, one of the Key points of the Unified Gas Supply System. Gazprom says that the Northern Tyumen Regions (SRTO) – Torzhok gas trunkline is being built today in order to withdraw additional gas volumes from the NPT region. The gas pipeline length is at 2.200 km, its design capacity varies from 20.5 to 28.5 bcm per annum at different sections. The competition of the pipeline facilities is slated to 2011.<sup>691</sup>

<sup>691</sup> Gazprom SRTO – Torzhok Gas Pipeline Available on site  
<http://www.gazprom.com/production/projects/pipelines/srto-torzhok/> ( Accessed on 05 January 2011)

### Map 13: SRTO – Torzhok Gas Pipeline



Source: Gazprom SRTO – Torzhok Gas Pipeline Available on site

<http://www.gazprom.com/production/projects/pipelines/srto-torzhok/> (Accessed on 05 January 2011)

#### 10.3.1.2.6. Pre-Caspian Gas Pipeline

On May 12, 2007, the Presidents of Russian Federation, Kazakhstan and Turkmenistan signed the Joint Declaration to build the Pre-Caspian gas pipeline. Afterwards, on December 20, 2007 a trilateral agreement on cooperation for the construction of Pre-Caspian gas pipeline was signed. Caspian project is designed to provide huge reserves of gas from Kazakhstan and Turkmenistan with a route through Russia to European markets. During the signature ceremony Prime Minister Putin (President at that time) said that “this pipeline will provide long term supplies of gas to our partners. It will also become a considerable contribution to energy stability in Europe.”<sup>692</sup> Pipeline will be length 1700 km (1200 km Kazakhstan and 500 km Turkmenistan) and will have the capacity of 40 bcm (30 bcm Turkmenistan and 10 bcm Kazakhstan).<sup>693</sup>

<sup>692</sup> RT (2007) “*Pre-Caspian Pipeline a Blow to EU and US*”, 20 December <http://rt.com/business/news/russias-pre-caspian-pipeline-a-blow-to-eu-and-us/> (Accessed on 05 January 2011)

<sup>693</sup> Gazprom Pre-Caspian Gas Pipeline Available on site <http://www.gazprom.com/production/projects/pipelines/pg/> (Accessed on 05 January 2011)

**Map 14: Pre-Caspian Gas Pipeline**



Source: Gazprom Pre-Caspian Gas Pipeline Available on site

<http://www.gazprom.com/production/projects/pipelines/pg/> (Accessed on 05 January 2011)

#### **10.3.1.2.7. Dzhubga-Lazarevskoye-Sochi**

The gas pipeline will stretch for 117 km, including the 158,5 km offshore section. The pipeline route will run on the Black Sea bottom along the coastal line to the Kudepsta gas distribution station near Sochi. Pipeline will have the capacity of 3,8 bcm.<sup>694</sup>

#### **10.3.1.2.8. Dzuarikou – Tskhinval**

Pipeline runs from Dzuarikou (Russia) across the Caucasus mountain ridge and the town of Kvaisa to Tskhinval (South Ossetia). The length of the pipeline is 162,3 km and has capacity of 252,5 mcm of gas per year. Dzuarikou-Tskhinval gas pipeline is the highest in the world which goes though the Kudari Pass at a height of 3148 m. The pipeline is

<sup>694</sup> Gazprom Dzhubga-Lazarevskoye-Sochi Available on site  
<http://www.gazprom.com/production/projects/pipelines/dls/> (Accessed on 05 January 2011)

significant in terms of de-facto independence of South Ossetia, due to this reason Georgia was strongly opposed the launch of the new pipeline.<sup>695</sup>

#### **10.3.1.2.9. Pochinki – Gryazovets**

Pipeline will run across the Nizhny Novgorod, Vladimir, Ivanovo, Yaroslavl and Vologda Oblasts. Pipeline length will be 650 km and convey 36 bcm gas per annum. When natural gas deliveries from Yamal are started, the pipeline will be switched to reverse flow and gas will be rerouted to the central region.<sup>696</sup>

#### **10.3.1.3. In Progress**

##### **10.3.1.3.1. Eastern Gas Program**

According to the September 2007 Order by the Russian Federation Industry and Energy Ministry approved the state-run Development Program, for an integrated gas production, transportation and supply system in Eastern Siberia and the Far East, taking into account potential gas exports to China and other Asia-Pacific countries (Eastern Gas Program).<sup>697</sup> In December 2009 Gazprom Export and CNPC's daughter company of Petro China signed an agreement on the principal conditions for delivery of gas from Russia to China, particularly form three ways –Western Siberia (Altai Project, Eastern Siberia, and Sakhalin. If whole projected pipelines will be completed, Gazprom could deliver to China around a third of the amount of gas that it sells to Europe.<sup>698</sup>

The problem of price is still the biggest problem for China. During the preparations of this study, negotiations were still going between two states. According to Russian authorities,

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<sup>695</sup> Artem GORBUNOV: (2009) “*Tbilisi Loses its Levers Over Tskhivali*”, Georgia Times, 04 September <http://www.georgiatimes.info/en/articles/10287-1.html> (Accessed on 05 January 2011)

<sup>696</sup> Gazprom Pochinki – Gryazovets Available on site <http://www.gazprom.com/production/projects/pipelines/pochgr/> (Accessed on 06 January 2011)

<sup>697</sup> Gazprom Eastern Gas Program Available on site <http://www.gazprom.com/production/projects/east-program/> (Accessed on 01 February 2011)

<sup>698</sup> RIA Novosti (2010) “*Gazprom Agrees Long Term Gas Deal With China*”, 7 June <http://en.rian.ru/business/20100607/159332231.html> (Accessed on 01 February 2011)

the price for Russian gas deliveries to China will be fixed in the first half of the 2011.<sup>699</sup> On the last days of the January 2011, Gazprom Deputy Chairman Alexander Medvedev stated that Russia and China are likely to reach an agreement in mid-2011 regarding the supply of Russian natural gas to China via two pipelines. He added that “under this agreement, Russia would commence gas deliveries to China via the West Siberia pipeline in 2015. According to the 2010 agreement signed between China and Russia, Russia will export 70 bcm of gas to China annually. The West Siberia pipeline will transport 30 bcm, while the Eastern pipeline capacity will be 38 bcm.<sup>700</sup> First supplies expected to be exported in 2015.

### Map 15: Eastern Gas Program



Source: Gazprom Eastern Gas Program Available on site

<http://www.gazprom.com/production/projects/east-program/> (Accessed on 01 February 2011)

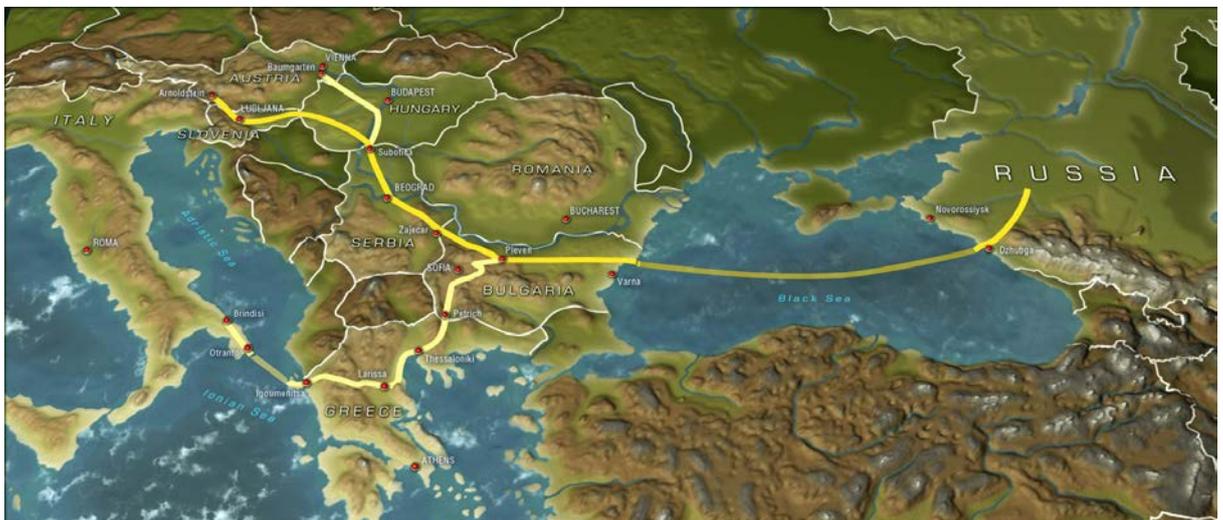
<sup>699</sup> RIA Novosti (2010) “Price for Russian Natural Gas Deliveries to China to be set by July 2001-Sechin”, 21 September <http://en.rian.ru/world/20100921/160662039.html> (Accessed on 01 February 2011)

<sup>700</sup> Pipelines International (2011) “China and Russia Talk Siberian Pipelines”, 25 January [http://pipelinesinternational.com/news/china\\_and\\_russia\\_talk\\_siberian\\_pipelines/012101/](http://pipelinesinternational.com/news/china_and_russia_talk_siberian_pipelines/012101/) (Accessed on 01 February 2011)

### 10.3.1.3.2. South Stream

A Memorandum of understanding to develop a pipeline route from Russia to Italy was signed in June 2007 in Moscow by Gazprom and Italian Company ENI in the presence of Energy Minister Victor Khristenko and Italian Minister for Economic Development, Pierluigi Bersani.<sup>701</sup> The first component of the South Stream project plans to send natural gas from Bregovaya for 560 miles under the Black Sea, achieving a maximum water depth of 2300 km. The second, onshore component will cross Bulgaria with two alternatives: one directed towards the northwest, crossing Serbia and Hungary and linking with existing gas pipelines from Russia; and the other directed to the Southwest through Greece and Albania, linking directly to the Italian network.<sup>702</sup> Gazprom has signed bilateral agreements on cooperation in the field of project implementation with the authorized national companies: Serbian state-owned company Srbijagas, Hungarian Development Bank (MFB), Bulgarian Energy Holding EAD, Greek gas transmission system operator DESFA, Austrian OMV. The capacity of the pipeline will be 63 bcm annually.

**Map 16: South Stream Project**



Source: South Stream Available on site <http://south-stream.info/index.php?id=3&L=1> (Accessed on 14 March 2010)

<sup>701</sup> Mark A. SMITH: (2008) “Russian Energy Interests in the Balkans”, Defense Academy of the United Kingdom, Advanced Research Group and Assessment Group, *Balkan Series* 08/07, March, p.3

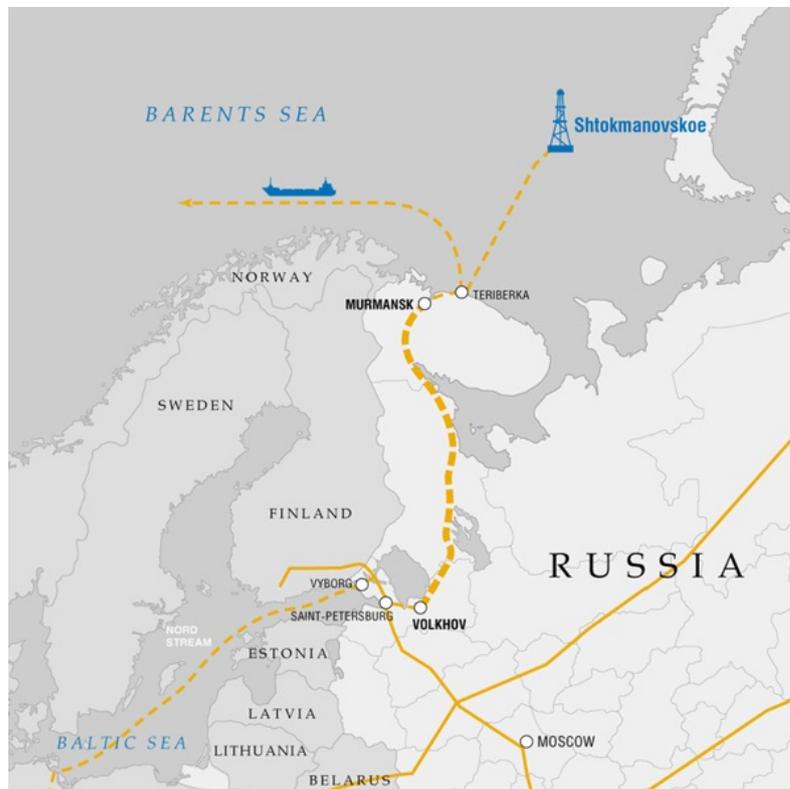
<sup>702</sup> Russia: Country Analysis Briefs (2010), p.12

#### 10.3.1.4. Under Discussion

##### 10.3.1.4.1. Murmansk – Volkhov Gas Pipeline

The Murmansk – Volkhov gas pipeline will ensure gas supplies from the Shtokman field to consumers in Northwestern Russia and gas exports via Nord Stream. The proposed capacity of the 1.365km-long gas pipeline will account for 28-50 bcm depending on production volumes. The gas pipeline commissioning is due in 2013.

##### Map 17: Murmansk – Volkhov Gas Pipeline



Source: Gazprom Murmansk – Volkhov Available on site

<http://www.gazprom.com/production/projects/pipelines/mvg/> (Accessed on 10 September 2010)

##### 10.3.1.4.2. Blue Stream II

Putin offered Turkey the Blue Stream II, during his visit to Ankara in 2002. The proposed line, parallel to Blue Stream I under the Black Sea, would continue overland in Turkey, north-south across Anatolia all the way to the Mediterranean coast. At first Putin and

Erdogan said in news conference that Blue Stream II would carry Russian gas potentially destined for any of the following countries: Syria, Lebanon, Israel and Cyprus.<sup>703</sup> During his visit to Turkey in June 2010, Prime Minister Putin said that Russia is committed to the second stage of the Blue Stream II gas pipeline, but it will not extend to Israel. Putin said that Israel recently discovered huge reserves, so they do not need any more blue fuel. However, behind this, the reason could be the low-profile relationship between Turkey and Russia. He also added that Blue Stream II would provide additional supply to Turkish market and transit to third countries.<sup>704</sup>

#### **10.3.1.4.3. Yamal-Europe Gas Pipeline II**

The Yamal-Europe I Pipeline which carries natural gas from Russia to Poland and Germany via Belarus would be expanded under this proposal. Gazprom and Poland were disagreed on the exact route of the second branch as it travels through Poland. Poland wants the branch to travel through its own country and then as to Germany.<sup>705</sup> However, because of the project of North Stream, this project is currently not on the agenda.

### **10.3.2. Oil Pipelines**

#### **10.3.2.1. Existing**

##### **10.3.2.1.1. Druzhba Pipeline**

The Druzhba Pipeline remains the main export channel for Russian crude, capable of handling up to 1.3 m b/d. Its northern branch, with a capacity of about 900.000 b/d, feeds Poland and Germany, while the southern branch, with a capacity of 400.000 b/d, facilitates exports to Hungary, Slovakia, the Czech Republic and the former Yugoslavia.<sup>706</sup> Druzhba, which began to deliver oil in 1962, is the longest oil pipeline in the world, 2.500 miles

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<sup>703</sup> Vladimir SOCOR: (2009) "Gazprom, Turkey Revive and Reconfigure Blue Stream Two", *Eurasia Daily Monitor*, Vol.16, Issue:154, August 11.

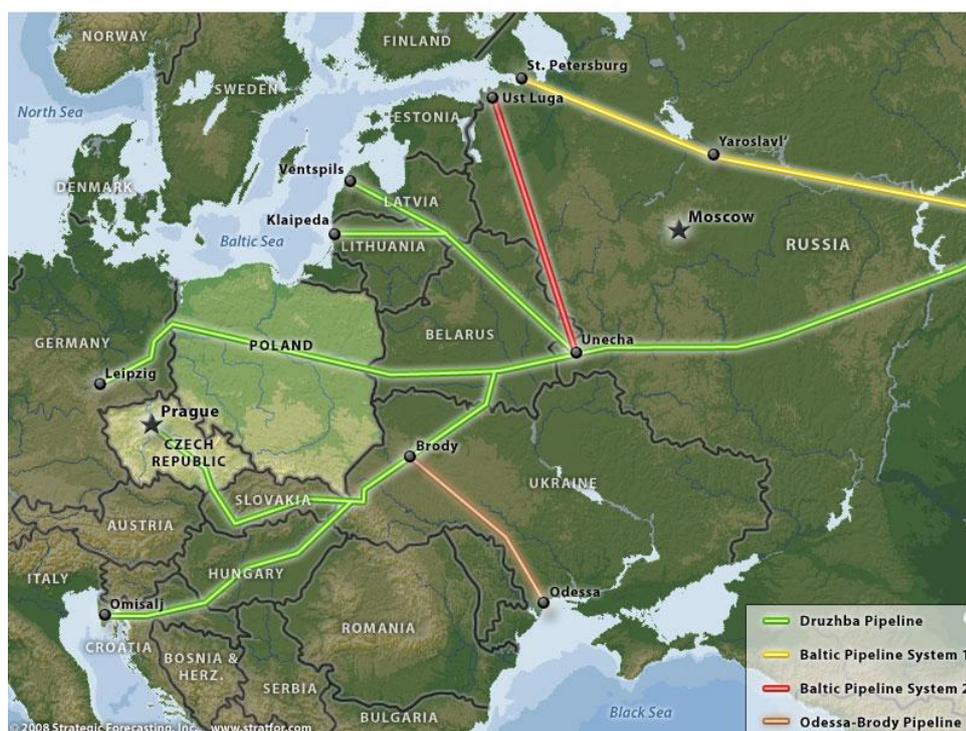
<sup>704</sup> RT (2010) "Blue Stream 2 Still In Plans", 08 June <http://rt.com/business/news/blue-stream-pipeline-turkey/> (Accessed on 03 February 2011).

<sup>705</sup> Russia: Country Analysis Briefs (2010), p.12.

<sup>706</sup> Eugene KHARTUKOV and Ellen STAROSTINA: (2005) "Ex-Soviet Oil Exports: Constraints, Outlook, and Global Impact", *Energy Politics*, Issue VII, Fall, p.35

(4.000km). The centrality of the Druzhba pipeline to world oil markets was illustrated in July 2006, when the pipeline's spur to Lithuania broke, causing an oil spill and suspension of supplies to Baltic Sea ports.<sup>707</sup>

**Map 18: Druzhba Pipeline**



Source: Choussudovsky, Micheal (2008) “The Eurasian Corridor: Pipeline Geopolitics and the New Cold War”, Global Search, 22 August Available on site <http://www.globalresearch.ca/index.php?context=va&aid=9907> (Accessed on 15 May 2009)

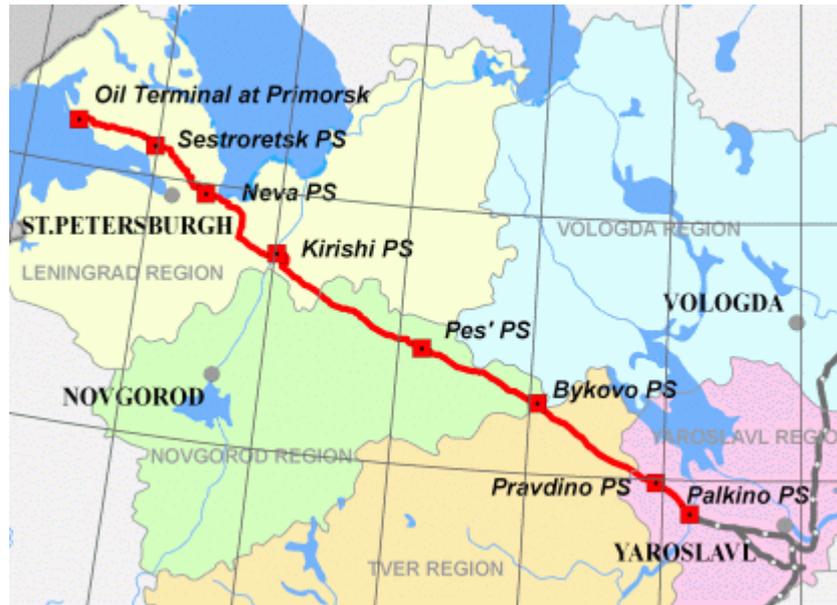
### 10.3.2.1.2. Baltic Pipeline System

The project started in 1997 and construction was completed in December 2001. The Baltic Pipeline System (BTS) is one of the most promising projects in the whole of the Russian Federation. It was designed for a new direction of oil exports from the Timan-Pechora region, West Siberia, and the Urals-Volga region, as well as oil exports from the CIS

<sup>707</sup> Brenda SHAFFER: (2009) “*Energy Politic*”, University of Pennsylvania Press, p.49, Ksenia BORISICHEVA: (2007) “Analysis of the Oil and Gas Pipeline Links Between EU and Russia”, *CERE*, Centre for Russia and Eurasia, Athens, Greece, November, p.5

states, mainly Kazakhstan.<sup>708</sup> The construction of the BPS which carries oil to the port of Primorsk is designed specifically to bypass the Baltic States by directing most West Siberian crude oil to Russian controlled ports.<sup>709</sup> Pipeline has a capacity of 76,5 m/t to export in a year.

### Map 19: Baltic Pipeline System



Source: Environmental Centre IFPA, Baltic Pipeline System (BPS) Available on site <http://www.ecifpa.ru/projects.asp?pn=318&lang=en> (Accessed on 05 March 2009)

#### 10.3.2.1.3. Baku – Tikhoretsk – Novorossiysk Pipeline

It is pipeline which was inherited from the Soviet era and runs from the oil terminals outside the Azerbaijani part of Baku to Novorossiysk through southern Russia.<sup>710</sup> This pipeline also known as Northern Route Export Pipeline, is an 830 km long oil pipeline, which runs from the Songachal Terminal near Baku to the Novorossiysk terminal at the Black Sea coast in Russia.

<sup>708</sup> Leningrad Region, The Baltic Pipeline System Available on site <http://eng.lenobl.ru/economics/investment/principlefederalprojects/balticoilpipeline> (11 November 2010).

<sup>709</sup> Pami AALTO: (2008) *“The EU-Russian Energy Dialogue: Europe’s Future Energy Security”*, International Political Economy of New Regionalisms Series, Ashgate Publishing, p.150

<sup>710</sup> John ROBERTS: (2003) *“Caspian oil and Gas – How Far Have We Come and Where Are We Going?”*, in Sally Cummings (ed.) *“Oil, Transition and Security in Central Asia”*, Routledge, p.151

## Map 20: Baku – Tikhoretsk – Novorossiysk Pipeline



Source: Stratfor Available on site <http://www.stratfor.com/> (Accessed on April 2010)

### 10.3.2.1.4. Atyrou – Samara Pipeline

Atyrou – Samara Pipeline is 432 miles with the capacity 280.000 b/d. It runs from the Kazakh terminal at Atyrou to the Russian Urals refinery at Samara and then connects with Russia's east-west Druzhba system. Prior to 1997, exporters of Caspian oil has only one major pipeline option available to them, the Atyrou – Samara pipeline from Kazakhstan to Russia.<sup>711</sup> The Atyrou-Samara pipeline links Kazakhstan with the Russian Transneft system which, in turn, provides a connection to the world markets via ports at the Black Sea. Among the oil companies that currently use the pipeline are KazMunaiGas, Mangistaumunaigas, and other smaller companies.<sup>712</sup>

<sup>711</sup> Joan Edelman SPERO and Jeffrey A. HART: (2009) *The Politics of International Economic Relations*, Cengage Learning, p.363, Roberts, John, p.151

<sup>712</sup> Silk Road Intelligencer (2008) "Atyrou-Samara to be Expanded to 17 m/t a year by 2009", 20 October <http://silkroadintelligencer.com/2008/10/20/atyrou-samara-to-be-expanded-to-17-million-tons-a-year-by-2009/> (Accessed on 08 February 2011)

**Map 21: Atyrou – Samara and CPC Pipelines**



Source: ENI, Karachaganak Available on site [http://www.eni.com/en\\_IT/innovation-technology/eni-projects/karachaganak/karachaganak-project.shtml](http://www.eni.com/en_IT/innovation-technology/eni-projects/karachaganak/karachaganak-project.shtml) (Accessed on 02 January 2011).

#### **10.3.2.1.5. Caspian Pipeline Consortium (CPC)**

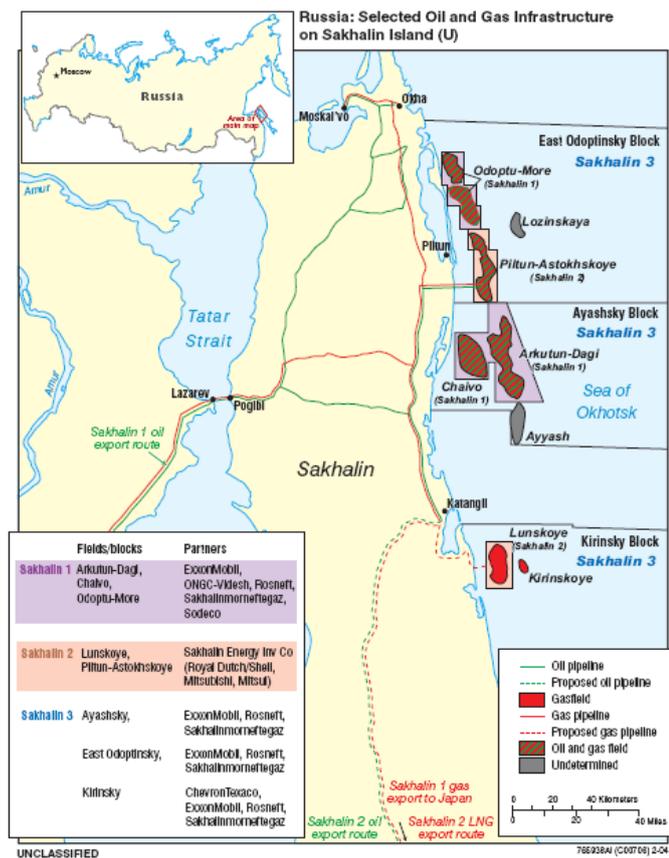
The CPC crude pipeline system is the largest operating investment project with foreign participation on the territory of the former USSR. The length of the main pipeline that connects the oil fields in Western Kazakhstan with the new Marine Terminal is 1.510 km. On October 3, 2001, CPC for the first time loaded oil onto a tanker at its Marine Terminal near Novorossiysk. This is the first new large volume pipeline to be built in the post-Soviet era.<sup>713</sup>

<sup>713</sup> Caspian Pipeline Consortium Available on site <http://www.cpc.ru/portal/alias!press/lang!en-us/tabID!3357/DesktopDefault.aspx> (Accessed on 08 June 2009)

### 10.3.2.1.6. Sakhalin I

Sakhalin I project is led by Exxon Neftegaz, in conjunction with consortium members SODECO, ONGC Videsh, and two Rosneft subsidiaries (Sakhalinneftegaz and R.D. Astra). Via its subsidiaries, Rosneft holds a 20% share in the project. Consortium members began drilling in May 2003, and commercial production from the Cheyvo field began in October 2005.<sup>714</sup> The oil transportation system was commissioned in August 2006. Construction was completed on a 226 kilometer (140 mile) pipeline to transport crude from the onshore processing facility across Sakhalin Island and the Tatar Strait to the De-Kastri terminal in Russia's Khabarovsk Krai.<sup>715</sup>

**Map 22: Sakhalin Island Pipelines**



Source: EIA Sakhalin Island (2008)

<sup>714</sup> EIA Sakhalin Island (2008), May Available on site

<http://www.eia.doe.gov/emeu/cabs/Sakhalin/Background.html> (Accessed on 07 April 2009)

<sup>715</sup> Sakhalin I, Oil Transportation System Available on site [http://www.sakhalin1.com/Sakhalin/Russia-English/Upstream/about\\_phases\\_chayvo1\\_oiltransport.aspx](http://www.sakhalin1.com/Sakhalin/Russia-English/Upstream/about_phases_chayvo1_oiltransport.aspx) (Accessed on 05 January 2011).

### **10.3.2.1.7. Sakhalin II**

Sakhalin Energy Investment Corporation SEIC divided the Sakhalin II project into two phases. Phase 1 focused on oil production which began in 1999. Phase 2 is gas development and in July 2001, the Corporation's observatory board approved a plan to move ahead with "an integrated oil and gas development that will be world's largest LNG Project."<sup>716</sup> Phase I of the Sakhalin Island project focused on oil development and went into seasonal production during mid-1999. And the Sakhalin II project phase II was completed in February 2009. The oil and gas are transported via 800 km onshore pipelines to Prigorodnoye, at the south of Sakhalin Island, the site of the new LNG plant and oil and LNG export terminals.<sup>717</sup>

### **10.3.2.1.8. East Siberia – Pacific Ocean (ESPO)**

On 29 May 2003 Russia and China signed an agreement on construction of the pipeline. Former President Putin announced that Russia would commit to building a pipeline from the Russian city of Tayshet to Kozmino Bay, southeast of Nakhodka in two stages. Construction of the pipeline started in April 2006.<sup>718</sup> The first stage of ESPO pipeline construction was completed and commissioned in December 2009. The first stage consists of 2,694 km length from Tayshet to Skovorodino with the capacity of 80 m/t of crude oil a year. The branch to China is expected to have a capacity of 30 m/t a year. The second stage of the pipeline will involve the construction of 1,963 km from Skovorodino to the Pacific Ocean terminal at Kozmino.<sup>719</sup>

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<sup>716</sup> STERN, p.148.

<sup>717</sup> Hydrocarbons-Technology, Sakhalin II, Crude Oil and LNG, Sakhalin Island, Russia Available on site <http://www.hydrocarbons-technology.com/projects/sakhalin2/> (Accessed on 05 January 2011).

<sup>718</sup> Russia: Country Analysis (2010) p.21

<sup>719</sup> Transneft, East Siberia-Pacific Ocean Available at site <http://www.transneft.ru/projects/project/?zpID=4248> (Accessed on 05 January 2011), Hydrocarbons-Technology, ESPO Pipeline, Siberia, Russia Available on site <http://www.hydrocarbons-technology.com/projects/espopipeline/> (Accessed on 05 January 2011).

## Map 23: East Siberia – Pacific Ocean Pipeline



Source: Stratfor Available on site <http://www.stratfor.com>

### 10.3.2.2. Under Construction

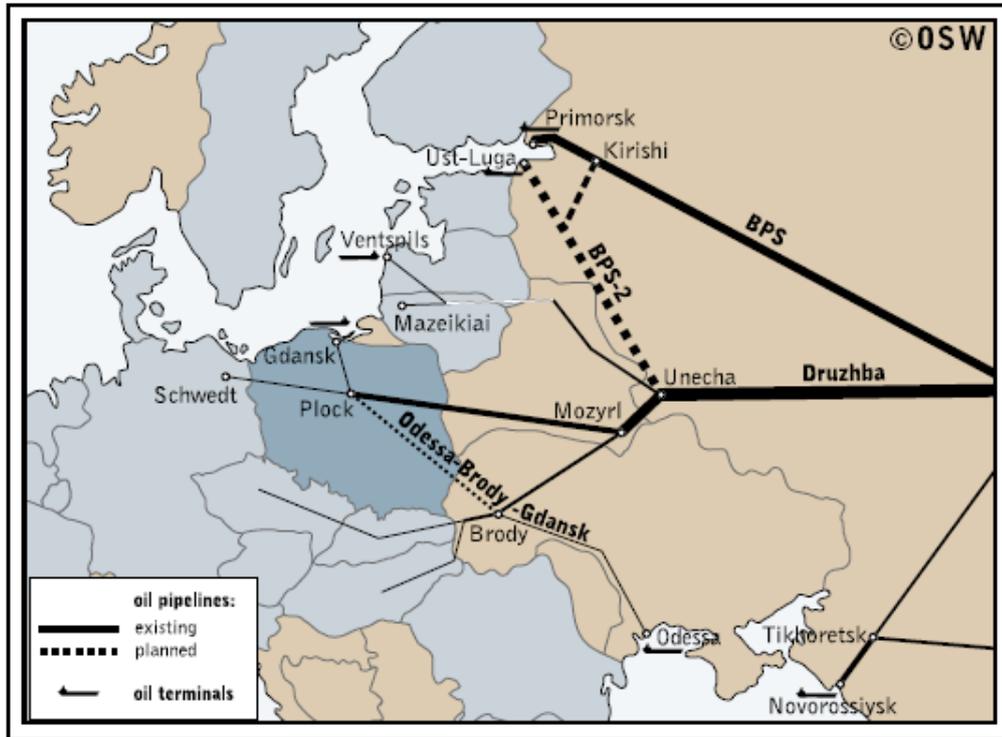
#### 10.3.2.2.1. Baltic Pipeline System II - BPSII

On 26 November 2008, the Prime Minister Vladimir Putin signed a decree design and construction of the BPSII, along the route, the Urecha (Bryansk region) – Ust Luga (Leningrad region) and a capacity of 50 m/t per year. The project was proposed after an oil dispute between Russia and Belarus at the beginning of January 2007. The 1.170 km (730m) long BPSII will run from the Urecha near the Russia – Belarus border to the Ust Luga terminal on the Gulf of Finland with 172 km long branch line to Krishi oil refinery.<sup>720</sup> The BPSII oil pipeline will be built in two stages. The first pipe, with the

<sup>720</sup> Baltic Pipeline System II Available on site <http://www.transneft.ru/projects/project/?zpID=8115> (Accessed on 01 January 2011).

annual capacity of 30 m/t will be completed by September 2012. The pipeline's capacity will be increased to 50 m/t by the end of 2013.<sup>721</sup>

**Map 24: Baltic Pipeline System II**



Source: Kononczuk, Wojciech (2009) “The Construction of the BPS-2 Oil Pipeline Starts”, *East Week*, Analytical Newsletter, Issue 22 (172), Center for Eastern Studies, 17 June, p.5.

#### 10.3.2.2.2. Purpe – Samotlar Project

This project is intended to create a bridge between western and eastern part of Russia's pipeline system. Pipeline from Purpe to Samotlar includes the construction with total length of 429 km with a capacity of 25 m/t of oil annually. The route passes through the territory of the Yamal-Nenets and Khanty-Mansiysk autonomous district. The construction has started in March 11, 2010 and is expected to be completed in the second half of the year 2012.<sup>722</sup>

<sup>721</sup> Wojciech KONONCZUK: (2009) “The Construction of the BPS-2 Oil Pipeline Starts”, *East Week*, Analytical Newsletter, Issue 22 (172), Center for Eastern Studies, 17 June, p.4.

<sup>722</sup> Transneft, Purpe-Samotlar Pipeline Project Available on site <http://www.transneft.ru/projects/project/?zpid=8516> (Accessed on 02 January 2011).

### 10.3.2.3. In Progress

#### 10.3.2.3.1. Burgas – Alexandroupolis Oil Pipeline

In March 2007, when Putin visited Greece, Russia, Bulgaria and Greece signed an agreement to build an oil pipeline from Burgas to Alexandroupolis. The 176 mile (300 km) pipeline, worth about \$1.2 billion, will have the carrying capacity of 700,000 barrels a day with the potential to eventually reach over a million barrels a day. Russia owns 51% of the International Project Company which will be operating the pipeline. Greece and Bulgaria each own 24.5% of the company.<sup>723</sup> The proposed scheme serves to strengthen the energy security of Europe, and will reduce the volume of oil transportation by tankers through the congested Bosphorus and Dardanelles.<sup>724</sup> However, it is believed that Russia's real motive is to bypass Turkey completely in order to gain more control over the oil transport.<sup>725</sup>

Map 25: Burgas – Alexandroupolis Oil Pipeline



Source: Dimas, Christos, (2005) “Why the Burgas-Alexandroupolis Pipeline?”, *BAPLINE*, Oil and Gas Transportation in the CIS and the Caspian Region Emerging Europe Summit, Vienna, November, p.18

<sup>723</sup> SMITH, p.5

<sup>724</sup> Transneft Company Available on site <http://www.transneft.ru> (17 August 2008)

<sup>725</sup> MAKIVIERRIKKO, p.41

### 10.3.2.3.2. Samsun- - Ceyhan Oil Pipeline

On October 19, Turkey, Italy and Russia signed a memorandum of understanding on the Samsun-Ceyhan oil pipeline (SCPa). The SCPa was developed by Turkey as a bypass route for the transportation of Russian and Kazakh crude to ease pressure on the heavy tanker traffic in the Turkish Straits, which has emerged as one of the world's major bottlenecks.<sup>726</sup> The length of the pipeline will be 550 km on the territory of turkey passing through North to South (Mediterranean – Ceyhan port). It will have a maximum capacity of 1,5 m/bbl a day. It is expected that the construction will start in the second half of the 2011.

**Map 26: Samsun-Ceyhan Oil Pipeline**



**Source:** Karadaş, Şaban “Russia Joins the Samsun-Ceyhan Pipeline”, *European Dialogue* Available on site <http://www.eurodialogue.org/Russia-Joins-The-Samsun-Ceyhan-Pipeline> (Accessed on 05 February 2010)

<sup>726</sup> Şaban KARADAŞ: “Russia Joins the Samsun-Ceyhan Pipeline”, *European Dialogue* Available on site <http://www.eurodialogue.org/Russia-Joins-The-Samsun-Ceyhan-Pipeline> (Accessed on 05 February 2010)

#### 10.3.2.4. Under Discussion

##### 10.3.2.4.1. Druzhba Pipeline and Adria Reversal Project

Of the 1.5 bbl/d of oil transported via the Druzhba Pipeline, only around 350.000 bbl/d flows to the south to Hungary, the Czech Republic and Slovakia. Reversal of the Adria pipeline which spans between Croatia's port of Omisalj on the Adriatic Sea and Hungary, has been under consideration since the 1990s.<sup>727</sup> This integrated line will take Urals' blend crude nearly 2.000 km through Ukraine to the Adriatic port with its direct access to the Mediterranean Sea, thus bypassing the increasingly crowded and otherwise problematic Bosphorus exit from the Black Sea.<sup>728</sup> Connecting the Adria pipeline to Russia's Southern Druzhba system would require the cooperation of six countries (Russia, Belarus, Ukraine, Slovakia, Hungary, and Croatia.) In December 2002, these countries signed a preliminary agreement on the project. Since then, however, progress has been slow moving, while the transit states wrangle over the projects details (including tariffs and environmental issues.)<sup>729</sup>

**Map 27: Adria Pipeline Reversal**



<sup>727</sup> Russia: Country Analysis, (2010) p.6

<sup>728</sup> William E. RATLIFF: (2003) "Russia's Oil in America's Future: Policy, Pipelines, and Prospects", Hoover Press, p.12

<sup>729</sup> Oil and Gas Articles (2006) "Russia's Proposed Oil Pipeline Routes and Pipeline Expansion Projects", 1 September Available on site <http://www.oilgasarticles.com/articles/396/1/Russias-Proposed-Oil-Pipeline-Routes-and-Pipeline-Expansion-Projects/Page1.html> (Accessed on 08 November 2009)

Source: EIA: Russia: Country Analysis Briefs (2010)

#### **10.3.2.4.2. Kharyaga – Indiga and Murmansk Oil Pipelines**

Transneft was proposed Kharyaga-Indiga pipeline would serve as an export line for crude oil produced in the Timan-Pechora region and oilfields in northern Russia. In January 2005, Transneft was considering a shorten western route with a terminus at Indiga instead of Murmansk, and Transneft's CEO clearly said the Murmansk proposal had no future. The new Indiga proposal is closer to the Timon-Penchora oil fields than the Murmansk pipeline.<sup>730</sup>

#### **10.4. Conclusion**

Russian pipeline strategy mainly focused on three directions; West, East, and South. Western route means European countries for Russian energy exports since 1960s with the beginning of Druzhba oil pipeline in the Cold War. Recently, Europe became dependent not only to Russian oil but also to Russian natural gas supplies through heritage of Soviet pipelines and new pipelines such as Nord Stream. According to the western route strategy, Russian other aim is to prevent European market to reach Caspian resources bypassing Russian pipelines which would lessen Russian leverage over both formulating Russian gas prices and Central Asian gas prices that being sold to Russia. For that reason, South Stream will serve Russian energy strategy towards western route to increase European dependency, to prevent other optional pipelines and decrease transporter countries' leverage such as Ukraine.

On the other hand, China has a huge energy market potential for both Russian and Central Asian resources. Before China's involvement into Central Asia, the energy relationship between Central Asian countries and Russia has provided more or less advantage for Russia. However, when China has managed to construct direct pipelines from Central Asia to its territory, it helped Central Asian countries to raise its prices to Russia and Chinese demand of reduce prices from Russia. Until recently, Russia has completed the first phase of ESPO oil pipeline from Russia to China but still could not reach a price solution for the prospecting gas pipeline from Russia to China. Russia desires to supply natural gas from

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<sup>730</sup> Ibid.

its eastern Siberian reserve areas to China in order to open another market for its gas in east and improve its eastern regions. Otherwise, first Central Asian states could fulfill Chinese natural gas need and Russia could lose its negotiations' advantage over Central Asian gas prices including losing the market.

Finally, through the southern route, Russia first aims to transfer its oil (and Kazakh oil) more quickly to Mediterranean and reach European market before Middle East countries' supply by for instance Samsun-Ceyhan oil pipeline. Second aim is to realize South Stream gas pipeline project which will pass through subsea of Black Sea and reach Bulgaria and Southern Europe market without any transferring country. If Russian South Stream project will be completed, it would entail the end or suspend of European projects such as Nabucco. As a result, new pipelines will entail Russia Turkey increase its incomes from energy imports in the near future. Without these pipelines, it would be very hard for Moscow to establish its own foreign policy objectives. And unless, Russia could not implement these projects, other western options could replace Russian projects and reduce Russian monopoly all over the region.

## **CHAPTER FOUR**

### **RUSSIAN FOREIGN ENERGY RELATIONS WITH WEST**

#### **11. RUSSIAN FEDERATION-EU PROXIMITY**

The collapse of the Berlin Wall in 1989 and the breakup of the Soviet Union in 1991 indicated deep changes in the institutional make-up of economic and political relations on the European/Asian continent and rooted an inevitable major shift in the balance of power of the world system. These changes also influenced the energy trade and the diplomacy all over the region. The EU and NATO were enlarged through the East European countries that had belonged to the space of Soviet Union.<sup>731</sup> Following the dissolution of the Soviet Union, the EU had invited membership applications from the Central and East European states at the European Council Summit in Copenhagen in June 1993.<sup>732</sup> However, throughout the 1990s, Russia tended to underestimate the impact of the EU's forthcoming eastward enlargement, due to reasons of its own transition period problems. Present day, all the continent of Europe –exception of Switzerland and Norway- stands as a united entity across Russian Federation.<sup>733</sup>

#### **11.1. Important Documents Between Russia and EU**

##### **11.1.1. The Partnership and Cooperation Agreement (PCA) Between Russia and EU**

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<sup>731</sup> The Gas Supply Outlook For Europe – The Roles of Pipeline Gas and LNG (2008) Clingendael International Energy Programme, August, CIEP 2008/04, p.20 Available on site [http://www.clingendael.nl/publications/2008/20080800\\_ciep\\_energy.pdf](http://www.clingendael.nl/publications/2008/20080800_ciep_energy.pdf) (Accessed on 07 June 2010).

<sup>732</sup> Graham TIMMINS: (2004) “Coping With the New Neighbors: The Evolution of European Union Policy Towards Russia”, *Perspectives on European Politics and Society*, 5:2, p.359, The Geopolitics of EU Gas Supply – The Role of LNG in the EU Gas Market, p.24; “...After 1990, not only the Soviet Union broke up in 15 independent states, but also the COMECON ceased to exist as a unifying system. The Baltic States and 5 former COMECON countries have become 9 new EU member states, adopting the “energy acquis”, and one was absorbed into the unified German state.”

<sup>733</sup> Dmitri TRENIN: (2005) “Russia, the EU and the Common Neighborhood”, *Centre for European Reform Essays*, September, p.1.

The legal basis of the EU-Russia relationship remains under the PCA, signed by President Boris Yeltsin and European leaders at Corfu in 1994, in force since December 1997, and due to expire in 2007 or automatically, be renewed annually under the treaty's provisions.<sup>734</sup> By signing this agreement, it was aimed to use those economic instruments which would replace Russia's state-planned economy with the market economy and support the post-communist transformation process in Russia.<sup>735</sup> The PCA provides a legal basis for ongoing political dialogue between Russia and the EU across a wide variety of areas, including energy.<sup>736</sup> The objectives of the agreement was to establish the integration of Russia and to create the necessary conditions for the future establishment of a free trade area between the European Community and Russia creating the conditions for bringing about freedom in the establishment of companies, foreign policy cross-broader trade in services and of capital movements.<sup>737</sup>

During the EU-Russia Summit in Sochi in May 2006, the renegotiation of the EU-Russia PCA, which was the greatest for re-examining institutional rules on energy sector investment and trade, ended twice in Russian refusal to discuss Gazprom's export monopoly and third party access to networks. Russia displayed that sees itself as a sovereign power and has no plans to become part of a European common political and economic space and has no immediate interest in bringing its regulations in the line with European legislation.<sup>738</sup> Putin affirmed that West European companies would only get better access to Russian oil and gas fields if Russian companies were allowed to buy gas distribution companies and other downstream assets in the big EU countries.<sup>739</sup>

### 11.1.2. The Common Strategy Paper of EU

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<sup>734</sup> Cynthia A. ROBERTS: (2007) "Russia and the European Union: the Sources and the Limits of Special Relationships", *Strategic Studies Institute (STI)* February 2007, p.22, Available on site <http://www.StrategicStudiesInstitute.army.mil/> (Accessed 21 June 2008).

<sup>735</sup> TIMMINS, p.360-361, Danam S. HAGHIGHI: (2007) *Energy Security, The External Legal Relations of the European Union with Major Oil and Gas Supplying Countries*, Hart Pub., p.343.

<sup>736</sup> Amelia HADFIELD: (2008) "European-Russia Energy Relations: Aggregation and Aggravation", *Journal of Contemporary European Studies*, 16:2, p.233.

<sup>737</sup> Sergey SELIVERSTOV: (2009) "Energy Security of Russia and the EU: Current Legal Problems", *IFRI*, April, p.4.

<sup>738</sup> Dominique FINON and Catherine LOCATELLI: (2007) "Russian and European Gas Interdependence, Can Market Forces Balance Out Geopolitics?", *LEPII-EPE*, No.41, Universite de Grenoble, January, p.24.

<sup>739</sup> Katinka BARYSCH: (2006) "The EU and Russia: From Principle to Pragmatism?", Centre for European Reform, *Policy Brief*, 10 November, p.4 Available on site [http://www.cer.org.uk/pdf/EU\\_russia\\_barysch\\_final\\_10nov06.pdf](http://www.cer.org.uk/pdf/EU_russia_barysch_final_10nov06.pdf) (Accessed on 22 September 2009).

It was in response to the Russian unilateral involvement in Kosovo and the Russian domestic economic crisis that the German government pushed through an initiative for a common strategy on Russia which was agreed at the Vienna Council summit in December 1998. Followed by the Cologne European Summit in June 1999, the Common Strategy on Russia was launched and represented the first manifestation of the EU's desire to strengthen its foreign policy profile and was set within the EU's evolving concept of "strategic partnership" with Russia.<sup>740</sup> The document identifies the goals of EU, principally the consolidation of democracy, the rule of law and public institutions, the integration of Russia into a common European economic and social space, including WTO membership, and enhanced cooperation to strengthen stability and security in Europe.<sup>741</sup> And also it was issued by the EU as a unilateral foreign policy instrument designed to make clear the vision and implement the objectives of the European Council regarding Russia.<sup>742</sup>

### 11.1.3. The EU-Russia Energy Dialogue

When it became clear that Energy Charter Treaty would not work as expected in relation to Russia, the EU made a further attempt to secure its energy supplies by proposing the EU-Russia Energy dialogue in 2000.<sup>743</sup> Moreover, it was launched on the initiative of Presidents Chirac and former President Putin and Commissioner Prodi, in order to provide a forum for the discussion of all questions of common interest in the energy sector and bind Russia and the EU into a closer relationship.<sup>744</sup> The EU-Russian Energy Dialogue emerged from the Common Strategy.<sup>745</sup> The two sides announced a regular dialogue on energy to enable the "definition and arrangements for an EU-Russia Energy Partnership",

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<sup>740</sup> TIMMINS, p.363.

<sup>741</sup> Christopher PRESTON: (2003) "Russia in the EU or the EU in Russia? Approaches to Kaliningrad", in Julie Smith and Charles Jenkins (ed.) *"Through the Paper Curtain"*, Chatham House Papers, Blackwell Pub., p.150.

<sup>742</sup> HADFIELD, p.234

<sup>743</sup> Pami AALTO and Kirsten WESTPAL: (2008) "Introduction", in Pami Aalto (ed.) *The Europe-Russian Energy Dialogue, Europe's Future Energy Security*, Ashgate, p.12.

<sup>744</sup> Andrew MONAGHAN: (2006b) "Russia-European Relations: An Emerging Energy Security Dilemma", *Pro et Contra*, 10:2-3, Summer, p.2

<sup>745</sup> Susan HANDKE and Jacques J. DE JONG: (2007) "Energy As a Bond: Relations With Russia in the European and Dutch Context", *Clingendael International Energy Programme*, The Hague, CIEP, 02/2007, p.59

and to get around the deadlock of ongoing Russian rejection of the ECT.<sup>746</sup> Although the sectoral Energy Dialogue seems to find support on both sides, Moscow authorities have criticized the PCA on several occasions, saying it is too “bureaucratic” and slow to deliver results.<sup>747</sup>

Alto and Westpal identifies the objectives of EU-Russia Energy Dialogue as;

1. The main aim of the energy dialogue is the typical diplomatic one of facilitating the flows of energy trade and investment by providing a political and institutional framework for increasing EU-Russia energy trade. Both parties are motivated for this as a result of the strong interdependence created by the EU’s need to secure its supplies from Russia, and Russia's need to secure its energy demand from the EU, where it sells around 60% of its exports.<sup>748</sup>
2. On the EU’s side, the energy dialogue represents a means of adjusting the divergent positions of EU member states in the energy trade in Russia. However, absence of the Constitution implies inability to establish instruments for coordinating energy policies along the lines the EU has developed in other areas.<sup>749</sup>
3. For the Russian party, the EU-Russian energy dialogue represents at least an opportunity of sorts for attracting investments in order to maintain and eventually expand its energy exports, modernize its decaying energy infrastructure, and create better conditions for the country’s economy.<sup>750</sup>

#### 11.1.4. Energy Charter Treaty

In mid 1991, Dutch Prime Minister Ruud Lubbers launched the proposal for a European Energy Community. The ECT has its root in a political declaration on East-West cooperation in the energy sector. In December 1991, the political declaration on the Energy Charter was signed.<sup>751</sup> ECT was a key instrument for EU which would place Russia's pipeline network under multilateral regulations and challenge Gazprom’s monopoly. Russia signed this treaty in 1994,<sup>752</sup> but then refused to ratify the ECT due to its protocol

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<sup>746</sup> HADFIELD, p.237, SELIVERTSTOV, p.10, “...The reason for that was basically the refusal of the Russian Federation to ratify the ECT.”

<sup>747</sup> Jackie GOWER and Graham TIMMINS: (2009) *Russia and Europe: In the Twenty-First Century, Uneasy Partnership*, Anthem Press, p.261

<sup>748</sup> AALTO and WESTPAL, p.13.

<sup>749</sup> Ibid, p.13.

<sup>750</sup> Ibid, p.14, STERN, 2005, p.134.

<sup>751</sup> HANDKE and DE JONG, p.51.

<sup>752</sup> Richard YOUNGS: (2009) *Energy Security, Europe’s New Foreign Policy Challenge*, Routledge, p.80.

on Transit, which is one of the centre pieces of treaty.<sup>753</sup> Russian critics of the ECT that it is an instrument used by the EU to force too many unfavorable onto the Russian side, while Russian energy corporation will gain few advantages after the ratification of the Treaty. In addition to that US, Algeria and Norway have either not participated in the whole process or has also not yet ratified the Treaty.<sup>754</sup> On the other hand, EU complained that Russian was unwilling to abide by market principles and relinquish its monopoly over Caspian pipelines.<sup>755</sup>

ECT was not kindly welcomed in Russia by the major energy companies. Companies such as Transneft and Gazprom opposed ratification, arguing that “it would oblige them to open their network to lower cost gas from Central Asian countries that became members of the ECT.”<sup>756</sup> The politicized gas relationship may be one of the reasons why Russia has not ratified the ECT yet.<sup>757</sup> Gazprom firstly claimed that the ECT would introduce mandatory third party access to the Russian pipeline network. Secondly, ratification would threaten the system of long-term contracts for gas supplies to Europe. And thirdly certain provisions of the Treaty’s Article 7 were ambiguous and required clarification. This includes a requirement for national treatment of energy flows in transit no less favorable than domestic transportation.<sup>758</sup> Finally, so far, Moscow succeeded for over a decade in convincing the EU that it has free to go its own way as long as the Duma did not ratify the agreement.<sup>759</sup>

### 11.1.5. Russian Federation Middle Term Strategy Towards EU(2000-10)

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<sup>753</sup> AALTO and WESTPAL p.12.

<sup>754</sup> HANDKE and DE JONG, p.52.

<sup>755</sup> YOUNGS, p.80, HAGHIGHI, p.323; “Article 7 of the ECT on transit of energy products, materials and equipments is one of the most controversial articles in the treaty. Article 7 of the treaty ECT obliges contracting parties to take “necessary measures” to “facilitate transit”. In doing so, they shall apply the principle of freedom of transit and they should not distinguish between materials, products and equipments as to origin, destination, ownership, and pricing, and they should allow transit without imposing any unreasonable delays, restrictions or changes.”

<sup>756</sup> Ibid, p.348-349.

<sup>757</sup> Miklos LOSONCZ: (2009) “Some Institutional Factors of the EU’s Logistics in the EU-Russia Natural Gas Relations”, in Kari Liuhto (ed.) “*The EU-Russia Gas Connection: Pipes, Politics and Problems*”, Pan-European Institute, 8/2009, p.154.

<sup>758</sup> HANDKE and DE JONG, p.57, Andrey KONOPLYANIK: (2008) “Regulating Energy Relations: Acquis or Energy Charter?”, in Katrina Barysch (ed.) *Pipeline, Politics and Power – The Future of EU-Russia Energy Relations*, Centre for European Reform, October, p.107.

<sup>759</sup> Keith C. SMITH: (2010a) “Managing the Challenge of Russian Energy Policies, Recommendations for US and EU Leadership”, *CSIS*, November, p.17.

The document was published in 1999, regarding relations between the EU and Russia should be based on the “objective need to establish a multipolar world”, which means Russia being one of the poles;

“During the period under review, partnership between Russia and the EU will be based on the treaty relations, i.e. without an officially stated objective of Russia's accession to or “association” with the EU. As a world power situated on two continents Russia should retain its freedom to determine and implement its own domestic and foreign policies, using the status and advantages of a Euro-Asian state and as the largest country of the CIS, independent of its position and activities at international organizations.<sup>760</sup>

According to the document, primary objectives are; maintenance of national interests and enhancing the role and image foreign policy Russia and Europe and in the world through establishing a reliable pan-European collective security system, and at mobilizing potential and managerial experience of the EU to promote the development of a socially oriented market economy in Russia.<sup>761</sup> Helm thinks that during Putin’s first term of office there was much optimism about the willingness of Russia to engage positively with the West. However, this optimism has gone by the election of 2004 and beginning of the Putin’s second term. The two reasons behind this progress are; first, Russia has increasingly wanted to be treated as an equal with the EU, and hence the PCA no longer matches Russia's expectations as to its status and secondly, the Dialogue and the PCA has the Energy Charter and the Transit Protocol as their preferred basis.<sup>762</sup>

## 11.2. Russian Foreign Energy Affairs with EU-27

**Table 31: EU-27 Import and Dependency Number of Oil and Natural Gas from Russia in 2009**

Country	Oil			Natural Gas		
	2009	2009 All	Ratio of	2009	2009	Ratio of

<sup>760</sup> Christer PURSIAINEN: (2007) “Theories of Integration and the Limits of European-Russian Relations”, Paper presented at the International Studies Association Convention, USA, March 1, p.8.

<sup>761</sup> Andrei MELVILLE and Tatiana SHAKLEINA: (2005) *Russian Foreign Policy in Transition Concepts and Realities*, Central European Uni. Press, p.165 .

<sup>762</sup> Dieter HELM: (2007) “The Russian Dimension and Europe’s External Energy Policy”, Oxford Uni. September 3, p.47-8 Available on <http://www.dieterhelm.co.uk/node/655> (Accessed 10 January 2011).

	<b>Russia Eurostat m/t</b>	<b>countries Eurostat m/t</b>	<b>total import %</b>	<b>Russia Eurostat bcm</b>	<b>total Eurostat bcm</b>	<b>total import %</b>
Belgium	11.248	31.224	36	0.526	18.6812	2,8
Bulgaria	4.489	6.158	73	2.6620	2.6620	100
Czech Republic	5.097	7.187	70	6.8368	9.9058	69
Denmark	-	3.511	-	-	-	-
Germany	34.649	98.028	35	36.0786	95.3639	38
Estonia	-	-	48*	0.6560	0.6560	100
Ireland	-	2.678	-	-	4.9522	-
Greece	5.710	17.780	32	1.8577	3.7013	50
Spain	8.201	52.297	15	-	39.6923	-
France	10.251	71.404	14,5	7.4768	50.8677	14,6
Italy	15.128	76.297	20	20.4613	70.8509	29
Cyprus	-	-	-	-	-	-
Latvia	-	-	-	1.7456	1.7486	100
Lithuania	8.359	8384	100	2.7349	2.7349	100
Luxembourg	-	-	-	0.335	1.3897	24
Hungary	5.425	5.425	100	8.1633	9.8778	83
Malta	-	-	-	-	-	-
Netherlands	16.202	48.203	33	3.2475	22.9704	27
Austria	0,295	7.424	0	7.4469	11.8760	63
Poland	18.930	20.098	94	8.3561	10.1880	82
Portugal	-	-	-	-	5.3296	-
Romania	2.467	6894	35	1.9697	1.9963	100
Slovenia	-	-	-	0.5023	1.0355	48,5
Slovakia	5.704	5.704	100	5.9721	6.0171	100
Finland	9.581	10.784	88	4.3524	4.3524	100
Sweden	7.167	19.005	37	-	1.5198	-
United	5.831	47.104	8	-	44.0622	-

Kingdom						
EU-27 total	154.475	624.465	31 (35)**	121.3811	422.4434	28,7 (45,6)**

\*Estonian numbers does not exist in Eurostat. Johann Fabian-Marks, “Energy Security Position Paper – Estonia.

\*\*Individual ratio of each country.

Source: Eurostat Available on site

<http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/> (Accessed on 07 November 2011).

Leonard and Popescu categorize of all EU members’ policy approach towards Russia are;

*“Trojan Horses”* (Greece and Cyprus) who often defend Russian interest in the EU system, and are willing to veto common EU positions, *“Strategic Partners”* (France, Germany, Italy and Spain) who enjoy a special relationship with Russia which occasionally undermines common EU policies, *“Friendly Pragmatists”* (Austria, Belgium, Bulgaria, Finland, Hungary, Luxembourg, Malta, Portugal, Slovakia and Slovenia) who maintain a close relationship with Russia and tend to put their business interests above political goals; *“Frosty Pragmatists”* (Czech Republic, Denmark, Estonia, Ireland, Latvia, the Netherlands, Romania, Sweden and The United Kingdom) who also focus on business interests but are less afraid than others to speak out against Russian behaviors on human rights or other issues and *“New Cold Warriors”* (Lithuania and Poland) who have an overtly hostile relationship with Moscow and are willing to use the veto to block EU negotiations with Russia.<sup>763</sup>

On the other hand Monaghan says that two main camps exist in the EU regarding policy towards Russia: “Friends of Russia” and “Russia Realists”. The first group, including France, Germany, Spain, Italy, Portugal and Greece, seeks to pursue good relations with Russia. Second group pursues a more critical approach to Moscow. But only the UK can be considered in between.<sup>764</sup> Moreover, in terms of the energy dependency, Youngs describes three groups; first group is the low dependents which are Spain, Sweden, the UK, the Netherlands, Portugal, Belgium, Ireland; (emphasis added: Cyprus, Malta, and Luxembourg) in total ten member, second group is the medium dependence, including France, Italy and Germany, and the final group is the high dependence which includes

<sup>763</sup> Mark LEONARD and Nicu POPESCU: (2007) “A Power Audit of EU-Russia Relations”, ECFR, *Policy Paper*, November, p.2.

<sup>764</sup> Andrew MONAGHAN: (2005) “From Plans to Substance: EU-Russia Relations During the British Presidency”, *Russie.Nei.Visions*, IFRI; August, p.2.

Austria, the Czech Republic, Greece, Hungary, Poland, Romania, Slovenia, Finland, Latvia, Lithuania and Slovakia.<sup>765</sup>

In this study, after calculating the EU-27 import and dependence of oil and natural gas and oil from Russia in 2009,<sup>766</sup> the average number of them was chosen as the basic categorization process. As a matter of fact, most of the countries have a chance to import oil from other suppliers; this is not the case in natural gas. Moreover, after deciding that the average number is the road map, it was preferred to categorize the member countries as *Low Dependent* who is importing their natural gas between the ratio of 0-25%, *Moderate Dependent* with 25-50%, *Dependent* with 50-75% and finally *High Dependent* with 75-100%.

**Table 32: Dependency Model for EU-27**

<b>Low Dependent</b>	<b>Moderate Dependent</b>	<b>Dependent</b>	<b>High Dependent</b>
<b>0-25%</b>	<b>25-50%</b>	<b>50-75%</b>	<b>75-100%</b>
Belgium	Germany	Czech Republic	Bulgaria
Spain	Greece	Estonia	Lithuania
France	Latvia	Romania	Hungary
Italy	Netherlands		Poland
Luxembourg	Austria		Slovakia
Slovenia			Finland
Sweden			
United Kingdom			
Ireland			
Cyprus			
Malta			
Portugal			

\* Denmark is out of dependency (-36.8%)

<sup>765</sup> YOUNGS, p.80-1.

<sup>766</sup> During this study progress, the data of 2010 was still not present at the Eurostat web site. (Accessed 07 November 2011)

## 11.2.1. Low Dependent

### 11.2.1.1. France

When President of France Nicolas Sarkozy elected, he suggested that he will shift French priorities towards a warmer relationship with the US, which was unimaginable during the Chirac era; Sarkozy blamed Russia for “making somewhat brutal use of its assets, especially oil and gas”.<sup>767</sup> Paris pays a great amount of attention to the development foreign policy Russian energy groups from two different angles. The first is to set up genuine industrial partnership, not merely trade agreements. At the same time, the French authorities closely monitor Russian companies’ investments in Europe – particularly those of Gazprom, which has been maneuvering to aim direct access to European consumers.<sup>768</sup>

Since Nikolaz Sarkozy’s election in May 2007, Franco-Russian relations have witnessed several changes, triggered in part by bilateral initiatives. Total and Gazprom signed a highly ambitious agreement over the Shtokman gas field in the Barents Sea (July 2007).<sup>769</sup> It seems that Russian and French energy relations are not the same as the first years of Sarkozy. Russia and France reached agreements on natural gas pipelines in November 2009 while importing its 14,5% of oil and 14,6% of natural gas need from Russia in 2009. French electricity giant EDF will take a 10% stake in the Gazprom natural gas pipeline South Stream, to run under the Black Sea, said the chief executive of Gazprom, Alexei Miller.<sup>770</sup> On June 19, 2010 Gazprom, ENI and EDF signed the trilateral Memorandum providing for specific steps towards the French company’s entry in the shareholding structure of South Stream AG. The Memorandum contemplates that the entry will be accomplished before the end of 2010 through ENI’s stake reduction in the JPC. EDF’s

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<sup>767</sup> LEONARD and POPESCU, p.31.

<sup>768</sup> GOMART, p.10-11.

<sup>769</sup> Ibid, p.6.

<sup>770</sup> Andrew E. KRAMER and Matthew SALTMARSH: (2009) “*Russia and France Reach Agreements on Autos and Natural Gas Pipelines*”, NY Times, November 27, <http://query.nytimes.com/gst/fullpage.html?res=9C00E6DB1E3EF93BA15752C1A96F9C8B63> (Accessed on 02 December 2009).

participation in the project will be not less than 10%.<sup>771</sup> Thomas Gomart<sup>772</sup> said that “the Kremlin uses bilateralization; it’s a very traditional tool for Russian diplomacy. The Russians are using commercial and personal links created by Gazprom with national companies over many years. Yet, Sarkozy has concluded that Russia is better engaged than isolated”.<sup>773</sup>

President Dmitri Medvedev has visited Paris with a delegation of richest businessman at the beginning of March 2010. During his visit, French GDF Suez and Gazprom announced that they had agreed in terms for deals for France to take more Russian gas and invest in Nord Stream. CEO of Suez Gerard Mestralliet said that “the agreement with Gazprom, out long term Russian partner and largest gas producer in the world, illustrates the high-quality relationship developed over the years”. After signing the second important agreement which includes that Suez will take 9% of stake in Nord Stream, he also added that “by entering the Nord Stream and increasing its gas purchase from Russia, GDF Suez aims at contributing the security of supply of Europe.”<sup>774</sup>

It is observed that President Sarkozy has shifted its foreign policy about Russia particularly in energy sector. French not only efforts to increase its energy cooperation with Russia, in the near future planning to increase its natural gas dependence with the South Stream too. Presently, while France is following a pragmatist foreign policy towards Russia, Russia, on the other hand, plans to strengthen its economic ties with France. Apparently, Russia is using the advantages of secret competition between France and Germany in pipeline politics.

#### **11.2.1.2. Italy**

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<sup>771</sup> South Stream Info Available on site [http://south-stream.info/index.php?id=38&L=1&tx\\_ttnews\[tt\\_news\]=149&cHash=c10d53cf5b](http://south-stream.info/index.php?id=38&L=1&tx_ttnews[tt_news]=149&cHash=c10d53cf5b) (Accessed on 05 January 2011).

<sup>772</sup> Director of the Russian Center at the French Institute of International Relations in Paris.

<sup>773</sup> Lucion KIM: (2009) “*Putin Seeks Energy Partners, Russian Car Rescue in France Visit*”, Bloomberg, November 26, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ahMQn7eaF0D8> (Accessed on 16 May 2010).

<sup>774</sup> Focus Information Agency (2010) “*Medvedev in Paris: Energy and Mistral*”, 02 March <http://www.focus-fen.net/?id=a1097> (Accessed on 02 February 2011).

Italy has imported 20,80 bcm of natural gas and more than 20 m/t oil in 2009. These numbers figured out that Italy is buying its %32 of gas needs and 21% of oil needs from Russia. As well as Russia is a significant supplier for Italy, Italy is one of the main markets for Russia too. Italy is the fourth biggest trade partner after Netherlands, Germany and China in 2009. Under Silvia Berlusconi, the strong economic links were advanced by an extremely warm personal relationship with Putin, which even extended to a public defense by Berlusconi of the conduct of the war in Chechnya.<sup>775</sup> While the US and some EU countries were supporting Nabucco, Berlusconi government decided to support Russian rival project and in June 2007 ENI agreed with Gazprom to build a €10 billion gas pipeline under the Black Sea which is called South Stream.

When President Medvedev visited Italy in 2009, 18 agreements was signed between Italy energy group ENI and Russian partner Gazprom authorizing French firm EDF to join the South Stream gas pipeline project.<sup>776</sup> Moreover, on 19 October 2009, Italy, Russia and Turkey signed joint agreement concerning the construction of the Samsun-Ceyhan oil pipeline between Turkey's Black Sea coast and its Mediterranean coast. The Samsun-Ceyhan pipeline will facilitate safer transport across the Bosphorus and Dardanelles Straits.<sup>777</sup> Therefore, Italy is a significant partner in Russia's South Stream and Samsun-Ceyhan pipeline projects which shows Italy's unilateral policy rather than thinking its European partner's interest first. It is for the reason that; Italy has natural gas exploration licenses in Russia and hoping more licenses and less price with the South Stream. On the other hand, Samsun-Ceyhan oil pipeline project is crucial for ENI's oil investments in Kazakhstan's Caspian oil fields.

Though, Italy and Russia having serious problem about price of natural gas. Italy's energy company Edison has filed a lawsuit against Gazprom demanding lower prices on long-term contracts, which is the first time a European consumer has applied a court on such an issue. Edison blaming Promgas, a joint venture between Gazprom and ENI, saying it lost money

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<sup>775</sup> LEONARD and POPESCU, p.32

<sup>776</sup> "The Sydney Morning Herald (2009) *"Italy, Russia Agree on Security, Energy"*, AFP, December 4 Available on site <http://news.smh.com.au/breaking-news-world/italy-russia-agree-on-security-energy-20091204-k989.html> (Accessed on 18 January 2010)

<sup>777</sup> ENI, (2009) *"Italy, Russia, and Turkey Sign Joint Agreement on Samsun-Ceyhan Oil Pipeline"*, October 19 Available on site [http://www.eni.com/en\\_IT/attachments/media/press-release/2009/10/2009-10-19-Italy-Russia-Turkey-sign-joint-agreement-on-Samsun-Ceyhan-oil-pipeline.pdf](http://www.eni.com/en_IT/attachments/media/press-release/2009/10/2009-10-19-Italy-Russia-Turkey-sign-joint-agreement-on-Samsun-Ceyhan-oil-pipeline.pdf) (Accessed on 20 October 2009)

buying gas from Gazprom as market prices are lower.<sup>778</sup> Gazprom officials said that they expect the rejection of this file in Stockholm Arbitration court. On the other hand, in terms of the corporation between Russia and Italian energy companies are also advancing. Gazprom agreed to buy %51 stake of SeverEnergia from Italian co-owners ENI and Enel from \$1,6 billion. SeverEnergia is an Italian company which hold the licenses to develop hydrocarbon reserves in Western Siberia. According to Gazprom statement; “SeverEnergia shareholding structure will be as Gazprom 51%, the Italian partners 49% -via a joint venture between ENI and Enel holding 60% and 40% respectively.”<sup>779</sup>

### 11.2.1.3. Spain

Russia supplies approximately 18% of Spain’s oil needs but no gas. According to Leonard and Popescu, Spain’s approach to Russia is driven by economic priorities and a desire to avoid irritating the Kremlin. In October 2006 Spain sought to weaken the EU Council Conclusions on the Russian blockade against Georgia.<sup>780</sup> Spain and Russia have signed a broad agreement on energy cooperation involving production from fossil fuels and renewable sources. The deal was announced during a state visit by Russian President Medvedev to Spain in 2009. The Spanish Prime Minister said that “I’d like to say Russia is favorable to establishing partnerships between our big energy companies and their European counterparts. Cooperation between businesses is the best way to establish energy security in Europe.”<sup>781</sup>

Bilateral relations between Spain and Russia were revived when Zapatero’s socialist government came to power in 2004. Routing away from the Atlanticist foreign policy of Aznar, Spain became more sympathetic to Russia's interests in Europe. For instance; at the Bucharest NATO Summit in 2008 Spain joined France and Germany in blocking the accession of Ukraine and Georgia to NATO Membership Action Plans. Madrid argued that

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<sup>778</sup> RIA Novosti (2010) “*Italy’s Edison Sues Russia’s Gazprom Over Long-Term prices*”, 3 November <http://en.rian.ru/business/20101103/161194837.html> (Accessed on 09 January 2011).

<sup>779</sup> RIA Novosti (2009) “*Gazprom Buys Controlling Stake in SeverEnergia for \$1,6 billion*” 23 September <http://en.rian.ru/business/20090923/156228505.html> (Accessed on 09 January 2011).

<sup>780</sup> LEONARD and POPESCU, p.33.

<sup>781</sup> Euronews.net (2009) “*Spain and Russia Sign Broad Energy Deal*”, March 3, <http://www.euronews.net/2009/03/03/spain-and-russia-sign-broad-energy-deal/> (Accessed on 05 January 2010).

their accession could have led to an undesirable increase of tension with Russia.<sup>782</sup> It is interesting because Spain is not dependent on Russia, yet follows a policy to construct good relations with this long-distance friend. In return for this policy, Spain signed an agreement with Russia which gives Spanish companies greater access to Russian fields and could smooth the path for Russian firms to buy stakes in Spanish energy companies. During the press conference, Spanish Prime Minister Zapatero said that “this agreement opens the door collaboration between our country and one of the biggest energy players in the world.”<sup>783</sup>

#### 11.2.1.4. United Kingdom

United Kingdom considers Russia to be important as the EU’s largest neighbor, major energy supplier, as a nuclear power, as a key player on proliferation issues, but “hindered by social problems and underdeveloped legal and market infrastructures.”<sup>784</sup> At the beginning of the 2000s, Moscow was seen as a “strategic partner” in London. Nevertheless, Former Prime Minister Tony Blair was the first EU leader to build a strong partnership with Vladimir Putin. However, when UK courts refused to transfer the oligarch Boris Berezovsky<sup>785</sup> and one of the Chechen leaders Akhmed Zakaev in 2003, the relationship has worsen.<sup>786</sup> The rejection by the UK courts of Russia's extradition attempts has led to Moscow regularly accusing London of double standards.<sup>787</sup>

The British tradition of political relations with Russia is weak. Moreover, UK is currently not dependent on Russian energy as long as its own supplies from the North Sea (which are rapidly declining) and Norwegian supplies continue to flow into the country.<sup>788</sup> In early 2008, Gazprom continued earlier efforts to buy Centrica, the largest actor in the UK

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<sup>782</sup> Natalia SHAPOVALOVA: (2010) “Does Spain Have an Ostpolitik?”, FRIDE, *Policy Brief*, No.27, January, Lilia SHEVTSOVA: (2007) “Post-Communist Russia: A Historic Opportunity Missed”, *International Affairs*, Vol.83, No.5, p.1.

<sup>783</sup> O. SHCHEDROV and B. HARDING: (2009) “Russia, Spain Sign Energy Deal, Smoothing Investments”, Reuters, 3 March <http://www.reuters.com/article/2009/03/03/gazprom-repsol-idUSL357888920090303?pageNumber=1> (Accessed on 05 January 2010).

<sup>784</sup> MONAGHAN: (2005) p.3.

<sup>785</sup> Former owner of the Sibneft.

<sup>786</sup> LEONARD and POPESCU, p.42, Thomas GOMART: (2007) “Paris and the EU-Russia Dialogue: A New Impulse with Nicolas Sarkozy?”, *Russie.Nei.Visions*.No.23, IFRI, October, p.14.

<sup>787</sup> MONAGHAN: (2005) p.6.

<sup>788</sup> Pami AALTO: (2009) “European Perspectives for Managing Dependence”, in Jeronim Perovic, Robert W. Ortung, and Andreas Wenger (ed.) *Russian Energy Power and Foreign Relations, Implications for Conflict and Cooperation*, Routledge, p.173.

market. Company considered buying Britain's largest gas distribution company Centrica in 2006 but U.K. authorities blocked the takeover fearing excessive dependency on Russian supplies.<sup>789</sup> On the other hand while Russia seeks to work in the UK, BP has experienced many problems with its operations in Russia.<sup>790</sup>

In 2011, Russian major oil company Rosneft and BP agreed a \$16 billion swap deal on January 14 under which Rosneft will give BP 9,5% of its stock in exchange for 5% of BP. Companies also agreed to jointly undertake exploration and production on the Arctic Shelf which is a very important development. Because in the short term, Russia is planning to produce oil and gas in this region as regards to its new Energy Strategy document. This agreement also accepted as a signal that Russia is open to foreign investment the International Energy Agency (IEA) announced. The IEA authorities said that “the deal may mark a more realistic attitude towards foreign investment in its hydrocarbons by the Russian government.”<sup>791</sup>

Why Russia chose BP instead of other big companies? It was a question which Russian authorities announced the agreement. However, Russian displayed its understanding and culture is how different that the West one more time. Deputy Prime Minister Igor Sechin said in an interview that BP's in cleaning up the catastrophic Gulf of Mexico oil spill was one of the reasons Russia chose the British oil firm to develop its fragile shelf oil fields.<sup>792</sup> That means Russia chose the best cleaner not the best clean keeper. Nevertheless, the story may be different than Sechin's answer. After the event of Gulf of Mexico, BP has to manage lots of problems both financially and socially. BP could be the best choice with its situation which cannot put on the table any precondition. That probably makes the greatest candidate for Russian foreign investment policy.

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<sup>789</sup> RIA Novosti (2007) “*Russia to Seek WTO Backing If EU Restricts Its Energy Companies*”, 12 December <http://en.rian.ru/russia/20071012/83659386.html> (Accessed on 06 February 2011).

<sup>790</sup> Aalto, (2009) p.174.

<sup>791</sup> RIA Novosti (2011) “*Rosneft –BP Share Swap Shows Russia is Open to Investment – Report*”, 10 February <http://en.rian.ru/business/20110210/162536385.html> (Accessed 10 February 2011).

<sup>792</sup> Conor HUMPHRIES: (2011) “*BP's US Spill Experience Plus: Russian Minister*”, Reuters, 15 January, <http://www.reuters.com/article/2011/01/15/us-bp-rosneft-gulf-idUSTRE70E1DJ20110115> (Accessed on 15 January 2011).

## 11.2.2. Moderate Dependent

### 11.2.2.1. Germany

According to Germany, Russia is a crucial economic partner because of its energy dependence and the huge and diverse investment of Gazprom and German companies in Russia.<sup>793</sup> During Schroder's term, Germany became Russia's most important trading partner. The interdependence was seen in German dependence on Russian energy and Russian dependence on German goods and investments. When Merkel came to power, raised the concerns of becoming too dependent on Russian energy and called for diversification and promoted energy efficiency.<sup>794</sup> While EU had a problem of maintaining stable energy policy towards Russia, Schroder used its strong personal ties with President Putin's administration in Russia in order to promote German-Russian energy relations, particularly between 1998 and 2005. Schroder's along with close ties with Putin likewise benefitted some German companies. However, they were also blamed about undermining European approach on developing common external policy and legitimizing Putin's renationalization policies in the oil and gas industry. Westphal says that the Schröder government, during 1998-2005, followed a unilateral foreign policy and pursuit German national interests rather than multilateral approach.<sup>795</sup>

E.ON Ruhrgas is Gazprom's largest foreign shareholder with direct interests in accumulation of 6.5% of shares. Since 2000, the Chairman of the Board of Ruhrgas, Burchard Bergmann, is the first foreign representative to be elected into the Board of Directors of Gazprom. Gazprom and Ruhrgas not only cooperating in Germany and Russia, but also in Baltic countries, two companies are the major stake holders in Lietuvos

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<sup>793</sup> HANDKE and DE JONG, p.41

<sup>794</sup> Robert L. LARSSON: (2007) "Nord Stream, Sweden and Baltic Sea Security", Sweden Research Agency, FOI-Russia-2251-SE, March, p.29-32 Available on site <http://www2.foi.se/rapp/foir2251.pdf> (Accessed on 19 June 2008)

<sup>795</sup> Kirsten WESTPHAL: (2008) "Germany and the EU-Russia Energy Dialogue", in Pami Aalto (ed.) *The EU-Russian Energy Dialogue*, Ashgate, p.93-101

Dujos (Lithuania), Latvijas Gaze (Latvia), Eesti Gas (Estonia) and Gasum (Finland).<sup>796</sup> Moreover, Ruhrgas has contracts through 2030 to import 20 bcm of gas from Gazprom annually, which presently makes up about 30% of the total imports of Ruhrgas.<sup>797</sup> The North Stream gas pipeline is the crown of the personal relationship between Schroder and Putin, and as such, it works to cement German-Russian energy relations. The Nord Stream deal was signed deliberately on the eve of the early elections in Germany on 18 September 2005, and was interpreted as Putin's support for Schroder's campaign.<sup>798</sup>

When Merkel elected for office in November 2005, firstly criticized Schroder for promoting the interests of German industry at the expense of human rights issues, particularly regarding Chechnya and attacked him for "double standards" due to Schroder's criticism of the Bush administration and silence on Putin's policies.<sup>799</sup> Conversely, starting from 2006 the energy relations between Ruhrgas and Gazprom continued to advance by the confirmation of Merkel herself. First in August 2006 crucial contracts had signed between two companies to purchase a total of around 400 bcm of gas by 2036 to Germany. The annual supply of volume is planned as 24 bcm which accounts for one third of all the gas that Ruhrgas purchases. Subsequently, in 2008 Ruhrgas and Gazprom signed an agreement on participation in gas production on Siberian gas field of Yuzhno Russkoye. Ruhrgas acquired 25% stake minus 1% share, in return Gazprom received a package of its own 3% shares through an asset swap.<sup>800</sup> As a result, Ruhrgas had only 3,5% stake in Gazprom.

Year 2011 was critic for Germany, first it announced to abandon nuclear energy over the next 11 years, as a result of Japan's Fukushima disaster to replace atomic power with renewable energy sources.<sup>801</sup> Afterwards, 13 years of planning and two years of construction, the Nord Stream pipeline has began to deliver its first supplies of Russian gas

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<sup>796</sup> K. KILBITS, A. PURJU, and S. PADOM: (2005) "Russia's Foreign Direct Investments in New EU Member States: The Case of the Baltic States", in Kari Liuhto (ed.) *"Expansion of Exodus, Why Do Russian Corporations Invest Abroad?"*, The International Business Press, p.67-8.

<sup>797</sup> WESTPHAL, p.102

<sup>798</sup> Ibid, p.107

<sup>799</sup> Ibid, p.113-114

<sup>800</sup> E.On Ruhrgas, "E.ON Ruhrgas and the Russian Gas Industry" Available on site <http://www.eon-ruhrgas.com/cps/rde/xchg/er-corporate/hs.xsl/1004.htm?rdeLocaleAttr=en> (Accessed on 07 February 2011)

<sup>801</sup> Juergen BAETZ: (2011) "Germany Nuclear Power Plants To Be Entirely Shut Down By 2022", *Huffingtonpost*, 30 May, Available on site [http://www.huffingtonpost.com/2011/05/30/germany-nuclear-power-plant-shut-down\\_n\\_868786.html](http://www.huffingtonpost.com/2011/05/30/germany-nuclear-power-plant-shut-down_n_868786.html) (Accessed on 30 May 2011)

of 27.5 bcm in November 2011. It is planned that the second phase of Nord Stream will be completed at the end of year 2012 with the total capacity of 55 bcm.<sup>802</sup> Hence, by closing its nuclear power plants, the dependence on Russian gas of Germany will automatically rise in the future. And Nord Stream will enable Germany to receive Russian gas directly from Baltic Sea which is out of transportation problems of the old east corridor. Following that Germany left the historical transporter states such as Ukraine and Poland to their destinies by considering its energy needs first.

In the case of energy, the fear in other European countries is that Germany's national interests in energy are rather different those of Europe as a whole, and the bilateral relationships which Germany has been pursuing with Russia are at the expense of the European wider interests.<sup>803</sup> Germany has been criticized for the last decade about its unilateral energy relationship with Russia especially by the former Soviet Union countries, such as Poland. Recently, Germany changed its strategy about Russia. Ruhrgas complained about Gazprom's gas prices and demanded cut off in prices of natural gas from the Russian side. Gazprom has refused extra demands by saying that they had already cut the prices and lost a lot of money. After this development, Ruhrgas announced that it is agreed to sell its %2,7 stake in Gazprom state-owned Russian investment bank Vnesheconombank (VEB) for €3,4 billion, while the 0,8% has been to sold on the market.<sup>804</sup> As a part of the €15 billion selloff program, Ruhrgas Chief Executive Johannes Tyssen stated that the stake in Gazprom as "non-strategic". The company has announced a major strategy shift, deciding to turn its focus away from Europe, in favor of emerging markets in Asia and South America.<sup>805</sup>

#### **11.2.2.2. Netherlands**

Netherlands has a huge importance for Russian exports' destination. However, Netherlands does not put Russian concerns above a common EU Eastern neighborhood policy, and it

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<sup>802</sup> RT: (2011) "Nord Stream Launched: Russian Gas flows to Europe", 13 November, Available on site <http://rt.com/business/news/nord-stream-strat-november8-769/>(Accessed on 13 November 2011)

<sup>803</sup> HELM, p.35

<sup>804</sup> RIA Novosti (2010) "*E.On Sells 2,7% of Gazprom to VEB, Remaining 0,8% Sold to Market*", 1 December <http://en.rian.ru/business/20101201/161578716.html> (Accessed on 07 February 2011).

<sup>805</sup> Pedersen, J.G. (2010) "*E.ON Ruhrgas In Talks to Sell Gazprom Stake*", The Wall Street Journal, 24 November <http://online.wsj.com/article/BT-CO-20101124-708514.html> (Accessed on 07 February 2011).

tends to raise human rights issues in relation to Russia.<sup>806</sup> However, in recent years the talks about human rights replaced with Yamal or Sakhalin II. On June 19-20, 2009 President Medvedev visited Amsterdam to discuss the new structure of European energy security, particularly an alternative of the European Energy Charter. On 2008 the leading Dutch company N.V. Nederlandse Gasunie purchased 9% of shares in Nord Stream. Netherlands is one of the partners of Russia in Sakhalin II project.<sup>807</sup> During the visit of Medvedev, the President urged the Dutch authorities to push ahead with talks on participation in projects in northwest Siberia's Yamal run by Gazprom. Consequently, Dutch Prime Minister Balkenende said that he hopes that potential cooperation in Yamal would boost Russian-Dutch energy contracts.<sup>808</sup>

The Netherlands was Russia's second-largest trading partner in 2008, with a total volume of about \$62 billion, while Dutch investment in Russia reached \$45.2 billion, or 18 percent of total foreign investment in the same year.<sup>809</sup> Netherlands imported more than 16 m/t of oil which equals to 15,8% of what is needed and 4.26 bcm natural gas which also equals to 19% of all gas imports.

### 11.2.2.3. Austria

In 2009 Austria purchased 5,44 bcm natural gas from Russia which equals to 46% of its needs and makes Austria as moderate dependent. Austria has signed long-term deals with Russia on gas supplies and the construction of gas storage facilities in Baundgarten. It's Reiffeisen Bank together with Gazprom controls RusUkrEnergo, the cloudy monopolist importer of gas into Ukraine.<sup>810</sup> When the United States administration announces plans of deploying defense shield in Eastern Europe, Austria was one of the Central European states that loudly stood against this plan. Austrian Defense Minister Norbert Dorabos has called that

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<sup>806</sup> LEONARD and POPESCU, p.47.

<sup>807</sup> Andrei FEDYASHIN: (2009) "After Peter the Great and Vladimir Putin, Dmitri Medvedev is off to the Netherlands", RIA Novosti, 18 June, <http://en.rian.ru/analysis/20090618/155283797.html> (Accessed on 05 January 2011).

<sup>808</sup> RIA Novosti (2009) "Russia's Medvedev Pushes Dutch cos. Ahead with Gazprom Projects", June 20 <http://en.rian.ru/russia/20090620/155303927.html> (Accessed on 05 January 2011).

<sup>809</sup> L. PRANINA and C. TORREY: (2009) "Russia, Netherlands Discuss 'Serious' Energy Plans" Bloomberg, 20 June <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aNaDDiaNfACs> (Accessed on 05 January 2011).

<sup>810</sup> LEONARD and POPESCU, p.37

US plan for a missile defense shield in Eastern Europe is a “provocation” reviving Cold War debates.<sup>811</sup>

Russian President Medvedev and Chancellor of Austria Werner Faymann met in Moscow in November 2009 and negotiated the possibility of joining South Stream proposed pipeline being constructed by the joint venture of Russia's Gazprom and Italian ENI.<sup>812</sup> During the Faymann's visit in Moscow, Putin stated that “...Russia and Austria are convinced that this new (South Stream) route is very important for ensuring energy supplies for European consumers, and for making them even more reliable”.<sup>813</sup> The efforts of Austrian initiative to take part in South Stream project is accepted as betrayal to Nabucco or at least expire it too many years later.<sup>814</sup> Later on, Russia and Austria signed the deal which brings Austria into the South Stream project in April 24, 2010 in Vienna. According to the deal, pipelines will carry 31 bcm of Russian natural gas across the Black Sea to Bulgarian and further on to Italy and Austria.<sup>815</sup> Under this circumstances Austrian gas purchase will increase by 2 bcm annually, which will formulate the total number about 7,5 bcm and the dependency more than 60%.

Austria has an importance for keeping Russian underground gas storage. Concerning this storage, on February 2010, Gazprom officials said that “Gazprom's board has decided it is reasonable to increase capacities of underground gas storage facilitate abroad to no less than 51% of annual exports before 2030 with the creation of won capacities as priority”. Therefore, Gazprom is planning to launch the second stage of the Haidach storage facilities in Austria to increase its capacities from 1,3 bcm to 2,8 bcm. Haidach storage facility is

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<sup>811</sup> Reuters (2007) “*US Missile Shield is Provocation: Austrian Minister*”, 23 August <http://www.reuters.com/article/2007/08/23/us-usa-shield-austria-idUSL2352932420070823> (Accessed on 09 January 2011).

<sup>812</sup> Vladimir CHERNUKHA: (2009) “*Russia Ready to Promote Energy Security in Austria*”, The Voice of Russia, November 10, <http://english.ruvr.ru/2009/11/10/2212024.html> (Accessed on 10 December 2010)

<sup>813</sup> Vladimir PUTIN: (2009) 11 November Available on site <http://premier.gov.ru/eng/events/news/8221/> (Accessed on 10 December 2010).

<sup>814</sup> Kostis GEROPOLUOS: (2010) “*Nabucco, South Stream Face off in Austria*”, New Europe, 24 January. <http://www.neurope.eu/articles/98645.php> (Accessed on 10 February 2010)

<sup>815</sup> RIA Novosti (2010) “*Putin Hails Russia's Gas Reserves As Austria Joins South Stream Project*”, 24 April <http://en.rian.ru/world/20100424/158729140.html> (Accessed on 10 February 2010).

supporting Russian gas supplies to the Baumgarten gas hub, and for consumers in Slovenia, Croatia, Hungary, Austria, Germany, Slovakia and Italy.<sup>816</sup>

#### **11.2.2.4. Greece**

Gazprom is not only dependent country for Russian resources but also requiring for the transportation country status in the future. Russia has signed agreements with both Bulgaria and Greece for the 280 km oil pipeline of Burgas-Alexandroupolis which is also rivalry to the Turkey's project of Samsun-Ceyhan oil pipeline. Moreover, Greece is an important partner in the South Stream gas pipeline project, which would bring gas under the Black Sea bed, via Bulgaria and Greece in to Italy. When the European Commission put forward proposals for “unbundling” big energy companies into energy providers and transit companies, Greece was one of nine countries to oppose it. Greece also blocked the appointment of EU border liaison officers to Abkhazia and South Ossetia in Georgia.<sup>817</sup>

#### **11.2.2.5. Latvia**

Latvia has increasingly sought a more moderate tone in its relations with Russia. In 2005, it was the only Baltic state to attend the Russian celebrations marking the 60<sup>th</sup> anniversary of World War II Victory Day. In fact, Russia tends to cultivate good relations with at least one of the three Baltic States at any given moment. The result is that Russia has ratified its border agreement with Latvia (but not with Estonia).<sup>818</sup> In January 2003, Russia ceased supplying oil via pipeline to Latvia's Ventspils Nafta export facility.<sup>819</sup> When the owners of the port Ventspils rejected an acquisition offer from Transneft and Lukoil, almost immediately, Transneft announced that no Russian crude oil would be carried by the pipeline to Ventspils until a sale was negotiated that would give a majority of shares to a

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<sup>816</sup> RIA Novosti (2011) “*Russia's Gazprom Says to Double European Storage Capacities by 2015*”, 10 February <http://en.rian.ru/business/20110210/162539773.html> (Accessed on 11 February 2010).

<sup>817</sup> LEONARD and POPESCU, p.28.

<sup>818</sup> Ibid, p.46.

<sup>819</sup> BARAN: (2007b) p.133

Russian company.<sup>820</sup> Handling of oil products has been gradually decreasing in Ventspils due to the decisions being made in Russia.<sup>821</sup>

### 11.2.3. Dependent

#### 11.2.3.1. Czech Republic

According to the numbers of Eurostat and BP, Russia supplied more than 5 m/t oil and 6, 40 bcm natural gas to Czech Republic. Like the other former satellite states of East Europe, Czech Republic is dependent on Russian resources in terms of hydrocarbons. Czech Republic witnesses an event which showed that Russia would not hesitate to use its energy card in terms of security and foreign policy. In July 2008, without warning, the Russian oil pipeline monopoly Transneft cut oil deliveries to the Czech Republic by 70%. The cuts occurred one day after the Czech government signed an accord with the US allowing Washington to base part of its missile system in the Czech Republic.<sup>822</sup> During the crisis, Transneft officials stated that when full operations will resume though the Druzhba pipeline.<sup>823</sup>

Presently Vaclav Klaus is at the top of the Czech administration, whom known as euroskeptic and pro-Russian. Klaus is being criticized about resisting on signing the Lisbon Treaty of EU instead getting closer to Kremlin. So, he is being accused on working for the Kremlin's foreign policy of dividing European community. After the oil punishment of 2008, Klaus is acting much more pragmatist and looking for the balance if it is necessary. When NATO has officially invited to participate in the creation of a missile defense shield in Europe, Czech Republic's situation regained a high importance on the security agenda of both sides, meaning West and Russia.

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<sup>820</sup> Eiki BERG: (2008) "The Baltic Gateway: A Corridor Leading Towards Three Different Directions?", in Pami Aalto (ed.) *The EU-Russian Energy Dialogue*, Ashgate, p.153

<sup>821</sup> Alla PETROVA: (2010) "*Ventspils Freeport: Reducing Cargo Values are due to Russia's Political Decision*", The Baltic Course, 26 August <http://www.baltic-course.com/eng/transport/?doc=30858> (Accessed on 10 February 2011).

<sup>822</sup> F. Stephen LARABEE: (2010) "Russia, Ukraine, and Central Europe – The Return of Geopolitics", *Journal of International Affairs*, Spring/Summer, Vol.63, No.2, p.44

<sup>823</sup> Judy DEMPSEY: (2008) "*Russia Further Cuts Oil Deliveries to Czech Republic*", New York Times, <http://www.nytimes.com/2008/07/30/world/europe/30iht-czech.4.14893867.html> (Accessed on 11 February 2010).

### **11.2.3.2. Estonia**

In 2007, Estonia found itself at the forefront of a dispute with Russia after it decided to change the location of a war memorial the Soviet leaders. The result was a major diplomatic row, with Russian economic pressure on Estonia and riots in Tallinn in May 2007. In response, Estonia has introduced a travel ban against a number of pro-Kremlin activists from the “Nashi” group who were in provoking riots.<sup>824</sup> In Estonia, a Russian gas cut off occurred in 1993 after the implementation of a new law on citizenship, which was aimed at clearing up the legal status of non-Estonian residents. Moscow condemned the responsible of this law and called it as “a form of ethnic apartheid”. Cutting of the gas supplies after this statement could be just a coincidence.<sup>825</sup>

Following the events in Tallinn, Russia significantly reduced its use of Estonian railways and ports for its export goods, which had a noticeable economic effect. In June 2007 the port of Tallinn handled 17.5% less freight than the year before, and by September the volume of Russian goods being transported with Estonian railways had dropped 30%.<sup>826</sup>

### **11.2.4. High Dependent**

#### **11.2.4.1. Bulgaria**

Bulgaria has an increasingly economic relationship with Russia, which is Bulgaria’s second most trade after Germany. Lukoil is one of the biggest companies operating in Bulgaria. Besides hosting the future Burgas-Alexandroupolis pipeline, Bulgaria is a key state for Russia's plan to build the South Stream gas pipeline under the Black Sea.<sup>827</sup> Sofia is highly dependent on Russian gas and oil. As it seen in Table 32 Bulgaria has received all of its oil and natural gas from Russia. Bulgaria’s Neftochim Burgas, the biggest refinery in

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<sup>824</sup> LEONARD and POPESCU, p.46.

<sup>825</sup> Bendik Solum WHIST: (2008) “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”, Fridtjof Nansen Institute, *FNI report 15/2008*, p.23.

<sup>826</sup> Ibid, p.24.

<sup>827</sup> LEONARD and POPESCU, p.37

the Balkans, is controlled by Lukoil, and the country's Kozloduy nuclear power plant uses Russian fuel.<sup>828</sup>

Year 2010 was beneficial for both Russia and Bulgaria. In November, after months of talks and negotiations, Bulgaria and Russia signed an intergovernmental agreement for the construction of the Bulgarian section of the South Stream gas transit pipeline. In addition to that, there was a proposal of Burgas-Alexandroupolis oil pipeline which will transport Russian and Kazakh oil from Burgas (Black Sea) to Alexandroupolis (Greece – Aegean Sea) and bypass Turkish straits. Bulgarian side complained about the environmental risks of the project in order to gain cutting off prices of natural gas from Russia. And finally, in November 2010, shortly after a visit to Sofia by Russian PM Putin, Bulgaria's National Electric Company NEK and Russian state company Rosatom signed a memorandum providing for a final fixed price for the two reactors of €6.298 billion.<sup>829</sup> However, in November 2011, Bulgarian side decided to withdraw from the Burgas-Alexandroupolis project by claiming that project cannot be implemented on its terms and using the financial indicators stipulated in the 2007 agreement.<sup>830</sup>

#### **11.2.4.2. Hungary**

Orban says that the Medgyessy (2002-4) and Gyurcsany governments never develop a strategy for Hungary to diversify its energy supplies, and they were open towards Russian investments in the energy sector. After 2004, Hungary followed a pragmatic relation with Russia. Russian authorities were so pleased about Hungary; “it was the only EU member, not terminate its bilateral agreements with Russia, but to merely modify them.”<sup>831</sup> However, with the emerging of the Nabucco project, Hungary found itself in the core of the dilemma. After Gyurcsany met with Putin in March 2007, made a speech that Hungary shares the EU's aspiration for diversification of energy sources which means the supporting of the

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<sup>828</sup> Boryana DZHAMBASVA: (2009) “*Bulgaria Re-thinks pro-Russian Energy Policy*”, Businessweek.com, November 26, [http://www.businessweek.com/globalbiz/content/nov2009/gb20091126\\_882942.htm](http://www.businessweek.com/globalbiz/content/nov2009/gb20091126_882942.htm) (Accessed on 10 February 2010)

<sup>829</sup> Ivan DIKOV: (2011) “*The Bulgarian 2010 Review: Energy*”, Novinite, Sofia News Agency, [http://www.novinite.com/view\\_news.php?id=123897](http://www.novinite.com/view_news.php?id=123897) (Accessed on 09 February 2011).

<sup>830</sup> RIA NOVOSTI: (2011) “Bulgaria decides to drop Trans-Balkan oil pipeline project”, 7 December, <http://en.rian.ru/business/20111207/169455198.html> (Accessed on 7 December 2011).

<sup>831</sup> Anita OORBAN: (2008) *Power, Energy, and the Russian Imperialism*, Praeger Security International, p.113.

Nabucco pipeline regarding to the “EU energy policy”.<sup>832</sup> Dempsey wrote in her article that “As the European Union struggles to achieve a common energy security policy; the Socialist-led government of Hungary has broken with the bloc by *joining forces* with Gazprom, the Russian energy giant, to extend a pipeline from Turkey to Hungary.” While Russia was expecting Hungary to support his projects, Europe using the cold war terminology against any competing projects.<sup>833</sup>

By siding with Russia, however Hungary not Austria, would be a new energy hub of central Europe. Hungary receives 67% of its gas imports 97% of its oil imports from Russia. Because Hungary’s support is critical for Nabucco, a lack of cohesion in the EU could potentially sink another much-needed pipeline.<sup>834</sup> In March 2009, Siberia-based Surgutneftegaz purchased a 21.2 percent stake in MOL from Austria’s OMV AG for €1.4 billion which MOL termed a hostile takeover attempt. When Hungarian National Development Minister Tamas Fellegi visited Moscow, said that Hungary is seeking to abolish its one-sided energy dependence and supports both the EU’s Nabucco and Russia’s South Stream natural gas pipelines.<sup>835</sup> Consequently, it is vital for Hungary to maintain a fine balance when making efforts to resolve disputes that have been complicating bilateral economic relations with Russia, while keeping up a definite western orientation.<sup>836</sup>

#### **11.2.4.3. Poland**

Poland resents and fears the special relationship between Russia and Germany. For Poland, the Russian/Ukrainian crisis in January 2006 seemed to confirm that Russia is using energy as a political tool. Despite a contract running with Gazprom until 2022 that should prevent any renegotiation of price, Poland is worried about receiving sufficient quantities. The

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<sup>832</sup> Ibid, p.115.

<sup>833</sup> Judy DEMPSEY: (2007) “*Hungary Chooses Gazprom Over EU*”, New York Times, 12 March <http://www.nytimes.com/2007/03/12/world/europe/12iht-hungary.4885468.html> (Accessed on 11 February 2011).

<sup>834</sup> Michael MIHALKA: (2008) “Should and Unholy Cabal of German Greens and Industrialists Finance a Resurgent Russia? Natural Gas, Central Asia and Europe After the Georgian War”, *China and Eurasia Forum Quarterly*, Central Asia-Caucasus Institute and Silk Road Studies Program, Volume 6, No.3, p.138

<sup>835</sup> Balazs PENZ: (2010) “*Russia, Hungary Discussed Energy Issues, Malev, Development Ministry Says*”, Bloomberg, 9 October <http://www.bloomberg.com/news/2010-10-09/russia-hungary-discussed-energy-issues-malev-development-ministry-says.html> (Accessed on 11 February 2011).

<sup>836</sup> Takacs GABOR: (2010) “Russian Relations”, *Hungarian Political Summary*, 29 November Available on site <http://nezopontintezet.hu/en/hungarian-political-summary/russian-relations/> (Accessed on 11 February 2011).

building of the new pipeline will end Poland's transit status and with it, its transit fees and political leverage with larger quantities.<sup>837</sup> The victory of the Poland PiS political party (Law and Justice) in the legislative elections of September 2005 and the subsequent election of the Lech Kaczynski as President have accentuated tension between Russia and Poland.<sup>838</sup>

Poland vetoed the beginning of negotiations for a new agreement between the EU and Russia, which was to replace the PCA. The idea behind that move was to force EU to convince Moscow to lift the ban on Polish meat and vegetables, as well as ratify the EES and transit protocol. Though, Russia did not accept the Polish terms and also after Bulgaria and Romania entered into the EU, threaten them to ban all EU meat imports. The ban on Polish meats was lifted in December 2007.<sup>839</sup> Afterward, another crisis emerged when Poland agreed to deploy missile base for an American antimissile shield on its territory. The answer to this position was harsh from Putin himself; "if the United States built missile bases in the Czech Republic and Poland, Russia would point its nuclear weapons at both countries".<sup>840</sup>

In the energy sector Poland is importing its 88% of oil and 70% of natural gas from Russia. When the project of Nord Stream signed by Russian and German authorities, Poland did not welcome the agreement. Polish Defence Minister Radoslaw Sikorski likened to the notorious 1939 Molotov-Ribbentrop Pact in its consequences for Poland.<sup>841</sup> However, it was Germany who had undermined Poland by agreeing to a direct pipeline without passing through Poland or any other EU countries. Poland tried to gain support inside the EU community, but indeed could not gain support from many of its EU partners.<sup>842</sup> In fact,

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<sup>837</sup> Oliver GEDEN, Celmence MARCELIS, and Andreas MAURER: (2006) "Perspectives For the EU's External Energy Policy: Discourse, Ideas and Interests in Germany, the UK, Poland and France", *Working Paper*, FG1, SWP Berlin, 17 December, p.19.

<sup>838</sup> GOMART, p.14.

<sup>839</sup> ORBAN, p.108.

<sup>840</sup> *Ibid*, 112.

<sup>841</sup> MANKOFF: (2009a) p.157-58.

<sup>842</sup> YOUNGS, p.84.

being highly dependent on gas and oil supplies from Russia, Poland wanted to maintain their energy security by keeping Russia dependent on transportation through its territory.<sup>843</sup>

#### 11.2.4.4. Lithuania

Lithuania has kept a lower political profile in relations with Russia. Compared to Latvia and Estonia, it has a much smaller, better integrated Russian minority, reducing the possible irritants in relations with Russia.<sup>844</sup> First problem was occurred when Transneft temporarily cut oil supply to Lithuania's Mazeikiu oil refinery in 1999. Between 1998 and 2000, Transneft cut off oil supplies to less than nine times in order to stop the Lithuanians from selling their port, pipeline and refinery to the American company Williams International.<sup>845</sup> Afterwards, Williams who invested first into the Mazeikiu refinery in 1998, sold its shares to Yukos in 1998. The shares owned by Yukos and the Lithuanian government were bought by Polish Company PKN Orlen in December 2006.<sup>846</sup> Before the announcement of the deal, July 2006, Moscow shut down a pipeline supplying Lithuania's Mazeikiu Nafta refinery, which is the largest company in Lithuania and one of the biggest oil refineries in central and Eastern Europe.<sup>847</sup> Russia claimed that this cut off was the result of technical difficulties yet refused all offers from third parties to examine the damaged pipe or assist repairs in any way.<sup>848</sup>

As the latest development, Lithuania is having problems with Gazprom on the issue of gas prices. Lithuania will apply to EU for the formal complaint and accuse Gazprom of abusing its dominant position as the country's main gas supplier and hindering the liberalization of Lithuania's energy industry. As a result, Lithuania is expecting from Brussels to prevent Gazprom increasing economic pressure and impose on Gazprom a

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<sup>843</sup> Tatiana ROMANOVA: (2008) "Energy Dialogue From Strategic Partnership to the Regional Level of the Northern Dimension", in Pami Aalto (ed.) *The Europe-Russian Energy Dialogue, Europe's Future Energy Security*, Ashgate, p.87.

<sup>844</sup> LEONARD and POPESCU, p.50.

<sup>845</sup> WHITST: (2008) p.23.

<sup>846</sup> BERG, p.153.

<sup>847</sup> Zeyno BARAN: (2007b) "EU Energy Security: Time to End Russian Leverage", *The Washington Quarterly*, 30:4, p.133

<sup>848</sup> *Ibid*, p.135

requirement to supply natural gas on the basis of transparent and reasonable terms.<sup>849</sup> It seems so hard for Lithuania to get what they expected from Brussels.

#### **11.2.4.5. Slovakia**

Russia has supplied 100% of its gas and 99% of its oil needs in 2009. Slovakia has been known to support at times the Russian point of view within the EU. It was also the only new EU member state (apart from S. Cyprus) which opposed a discussion on an EU peacekeeping role in Moldova in February 2006.<sup>850</sup> Russia is Slovakia's third largest trade and economic partner after Germany and the Czech Republic. Slovakia's oil, gas and nuclear fuel demands are fully covered by Russian deliveries on the basis of long-term contracts. Slovakia is also an important transit country for Russian energy carriers. It transports over 50 bcm of Russian gas designed for Europe annually.<sup>851</sup> Slovak Prime Minister said that "There are no obstacles to Russian energy giant Gazprom forming a joint partnership with Slovak companies for gas deliveries."<sup>852</sup>

### **11.3. INTERDEPENDENCE BETWEEN RUSSIA AND EUROPEAN UNION**

The relationship between (EU-Russia) has become increasingly characterized by asymmetric interdependency over time due to high degree of EU dependency on Russian energy exports and the EU's need for security and stability in this policy area.<sup>853</sup> Leonard and Popescu claimed that there is asymmetric interdependence which is the way Russian energy companies have sought to swap assets with their EU counterparts. In these deals, Gazprom gets access to "downstream" markets in EU member states, while EU companies

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<sup>849</sup> N. TAIT and L. CHAFFIN: (2011) "Vilnius to Hit at Gazprom in EU Complaint", Financial Times, 26 January <http://uk.finance.yahoo.com/news/Vilnius-hit-Gazprom-EU-ftimes-1274324623.html?x=0> (Accessed on 10 February 2011).

<sup>850</sup> LEONARD and POPESCU, p.38

<sup>851</sup> RIA Novosti (2009) "Putin, Slovak PM Fico to Talk Cooperation in Slovakia", November 15, <http://en.rian.ru/business/20091115/156848125.html?id=> (Accessed on 10 December 2009)

<sup>852</sup> UPI (2009) "Slovakia Warms to Gazprom", November 17, [http://www.upi.com/Science\\_News/Resource-Wars/2009/11/17/Slovakia-warms-to-Gazprom/UPI-50171258483054/](http://www.upi.com/Science_News/Resource-Wars/2009/11/17/Slovakia-warms-to-Gazprom/UPI-50171258483054/) (Accessed 17 November 2009)

<sup>853</sup> Hughes, James (2006) "EU Relation With Russia: Partnership or Asymmetric Interdependency?", *London LSE*, Research Online, p.1 Available on site <http://eprints.lse.ac.uk/651/1/Hughes.EU-Russia.2006.pdf> (Accessed on 22 December 2009)

E.ON, BASF, BP or ENI get “upstream” access to fields in Russia.<sup>854</sup> Baran says that due to the extremely close relationship between the energy industry and the Kremlin, Russia's oil and gas companies can pursue strategies that make little economic sense but that serve the long-term interests of the Russian state, ensuring European dependence on Russian energy supplies.<sup>855</sup> As a result of this process, Gazprom’s dominance over the Europe on natural gas market is increasingly becoming a concern among Europe’s policy-makers.<sup>856</sup>

Dimitriova and Dragnet see interdependence as the driving force for institutionalization. For example; the EU started formulating an energy strategy and institutionalizing a policy internally because it needs to deal with energy dependence on Russia and transit dependence on Ukraine. Therefore, interdependence with Russia is a key variable defining the effectiveness of the EU’s external governance.<sup>857</sup> But, is this a practicable matter concerning the foreign energy relations of Europe and Russia. According to Stern, “For most countries, the objective is less that of achieving independence, and more about restructuring commercial relationships in order to achieve a more politically acceptable framework of economic and energy interdependence”.<sup>858</sup> According to Losoncz, as far as relations between Russia and the EU are concerned, the parties may apply the principle of reciprocity in their bilateral relations in general and in energy relations in particular, at least in theory. Russian companies are allowed to invest in the downstream sectors of the EU countries. On the other hand, western companies may not do the same in Russia. Therefore, it is not a surprise that the EU may feel it appropriate to restrict the downstream penetration of Russian companies.<sup>859</sup>

As a part of its foreign energy strategy, Russia targets of buying natural gas distribution companies and petrol station chains in Western Europe. Regarding this strategy, in early 2006 Gazprom declared intention to consider the opportunity to acquire UK’s largest gas

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<sup>854</sup> LEONARD and POPESCU, p.23

<sup>855</sup> BARAN: (2007b) p.134-36

<sup>856</sup> Nicklas NORLING: (2007) “Gazprom’s Monopoly and Nabucco’s Potentials: Strategic Decisions For Europe”, Central Asia – Caucasus Institute-Silk Road Studies Program, *Silk Road Paper*, November, p.2

<sup>857</sup> Antoaneta DIMITRIOVA and Rilka DRAGNETA: (2009) “Constraining External Governance: Interdependence with Russia and the CIS as Limits to the European’s Rule Transfer in the Ukraine”, *Journal of European Public Policy*, 16:6, p.854

<sup>858</sup> David DUSSEAULT: (2009) “Europe’s Triple By-Pass – The Prognosis for Nord Stream, South Stream and Nabucco”, in Kari Liuhto (ed.) “*The EU-Russia Gas Connection: Pipes, Politics and Problems*”, Electronic Publications of Pan-European Institute, 8/2009, p.26.

<sup>859</sup> LOSONCZ, p.149.

distribution company Centrica which was welcomed by the Stock market, but not so much the politicians. British politicians thought that the entrance of a Russian company to the British market, direct access to consumers and ensure 20% of supply until 2015 can provide the opportunity to shape one's own rules of the game.<sup>860</sup> This was not an answer what Kremlin what expected. The reaction of the Former Russian President Putin was: "Which [European] companies came to us it is called investment and globalization, but when we go there it is called expansion by Russian companies". In the spring of 2006, the UK government decided to review the merger control regime in order to block the possible passage of Centrica to Gazprom's in order to preserve the British energy security.<sup>861</sup>

Moscow responded to UK with kind of threat and at the same time a message to the whole European continent. Gazprom's CEO, Alexei Miller, warned EU ambassadors in Moscow that Russia could divert natural gas now going to Europe to China and the United States if the company were not allowed more freedom to buy European downstream energy facilities.<sup>862</sup> Gazprom's official web site says, that "the strategic goal is to make a Gazprom Company a leader among the global energy companies through development of new markets, diversification of activities, and assurance of supply reliability". There is no doubt that this strategy includes acquisition of foreign assets for instituting control over the energy supplies along the whole network of upstream-midstream-downstream.<sup>863</sup>

Russian initiative on buying Centrica in UK alarmed all Europe about entrance of the Gazprom into local markets which would undermine local control of vital assets, and further intensifies the overall dependence on one supply source. In order to stop this expansion, the European Parliament has amended the "Gas Directive" to include provisions for "Unbundling" and "Third country aspects", (required as Gazprom Clause) which requires effective unbundling of transmission system operators, supply and

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<sup>860</sup> Kestutis BUDRYS: (2006) "EU-Russia Energy Dialogue and Lithuania's Energy Security", *Lithuanian Russian Foreign Policy Review* 2006-18, Available on site <http://www.lfpr.lt/uploads/File/2006-18/Budrys.pdf> (11 May 2008).

<sup>861</sup> Ibid.

<sup>862</sup> Keith C. SMITH: (2007) "Russian Energy Pressure Fails to Unite Europe", *CSIS, EURO-FOCUS*, Vol.15, No.1, January 24, p.3 Available on site [http://csis.org/files/media/csis/pubs/eurofocus\\_v13n01.pdf](http://csis.org/files/media/csis/pubs/eurofocus_v13n01.pdf) (Accessed on 23 September 2009).

<sup>863</sup> Michael GONCHAR, Vitalii MARTYNUK, and Andriy CHUBYK: (2009) "The Impact of Nord Stream, South Stream on the Gas Transit Via Ukraine and Security of Gas Supplies to Ukraine and the EU", in Kari Liuhto (ed.) "*The EU-Russia Gas Connection: Pipes, Politics and Problems*", Electronic Publications of Pan-European Institute, 8/2009, p.50

production activities not only at national level but throughout the EU.<sup>864</sup> Alexei Miller reacted to this amendment; “attempts to limit Gazprom’s activities in the European market and questions of gas supplies, which are in fact entirely within the economic sphere, will not produce good results (...) It should not be forgotten that we are actively seeking new markets such as North America and China.”<sup>865</sup>

Gazprom has consolidated the strategy of downstream diversification, which it has been developing since the 1990s. In the middle of the 1990s Gazprom started Wingas in Germany, a joint venture with BAF-Wintershall, to transport gas and sell it directly. This ended to take a 13% share of the wholesale market.<sup>866</sup> Major natural gas companies of Europe have pointed to the need to counter-balance Gazprom’s bargaining power to restrict liberalization measures and justify their mergers, as the managers of E.ON opportunely did when the company took over Ruhrgas in Germany in 2003 and as the management of GDF and Suez did in France in 2006.<sup>867</sup> As the heart of the European gas market in Germany, and in particular Ruhrgas. The commercial common interests between Ruhrgas and Gazprom are obvious: Gazprom needs a counterpart to long-term gas supply contracts, and Ruhrgas needs long-term supplies.<sup>868</sup> Handke and De Jong think that Gazprom’s European energy strategy is based on obtaining the market power. In order to establish this strategy Gazprom wants to control the whole chain of supply – from production to transportation and distribution. Moreover, Gazprom seeks to establish dependencies via the construction of export pipelines and long-term contracts.<sup>869</sup>

On August 4, 2006, Algerian Gas Company Sonatrach and Gazprom signed a memorandum on cooperation in natural gas prospecting and production.<sup>870</sup> Russia rewarded Algeria because of this progress and Putin cancelled nearly \$5 bil by Algerian debt saying that “trade” with Algeria is more beneficial than debt repayment.” Considering that Algeria is the third gas supplier to Europe after Russia, if Gazprom would achieve to

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<sup>864</sup> BORISOCHEVA, p.12

<sup>865</sup> NORLING: (2007) p.13

<sup>866</sup> FINON and LOCATELLI, p.11

<sup>867</sup> Ibid, p.23.

<sup>868</sup> HELM, p.34.

<sup>869</sup> HANDKE and DE JONG, p.33.

<sup>870</sup> RIA Novosti (2006) “Russia’s Gazprom, Algeria’s Sonatrach Sign Memo to Top Gas”, 4 August <http://en.rian.ru/business/20060804/52283099.html> (Accessed on 09 May 2010).

control the Algerian gas sector, Russia would surround Europe from East, North and South. Then, what will happen to Europe's policy of diversification of resources?<sup>871</sup> Algeria is one of the important place what Russia looking for to increase its investments. While BP was having trouble with the catastrophe of Gulf of Mexico, it was rumored that BP would sell its assets in Algeria. Alexei Miller did not wait one minute to make a statement that "If the Algerian side offers these [BP's] assets to us, we will consider this possibility".<sup>872</sup>

The 2004 enlargement of the EU incorporated eight states from Central and Eastern Europe that have traditionally been even more dependent on Russian energy supplies than longer-standing EU members, increased the total dependency of EU as a regional organization.<sup>873</sup> The European Commission forecasts that the EU's energy import dependency will reach 70% by 2030 as a result of declining indigenous production and ongoing demand growth.<sup>874</sup>

The demand and supply balance and reliability are significant matters for European energy security. In this context, it is observed that European energy consumption and import dependency is rising. It is expected that in 2030, the EU will consume 15% more energy than it consumed in 2000. On the other hand, European energy production is declining sharply, particularly in hydrocarbons, solid fuels, and nuclear energy. Between 2000 and 2030, the production of European oil, gas and solid fuels is expected to decline by 73%, 59% and 41%. Moreover, dependence on imported oil will remain extremely high, reaching 94% in 2030.<sup>875</sup> Thus, the West is in a vulnerable position when it comes to energy supply, since an oil or gas shortage which lasts for more than a couple foreign policy weeks could pose major problems for Western economies and military forces, and

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<sup>871</sup> NORLING, p.8, BUDRYS.

<sup>872</sup> RIA Novosti (2010) "*Gazprom Expresses Interest in BP's Assets in Algeria*", 6 October <http://en.rian.ru/business/20101006/160858260.html> (Accessed 11 November 2010).

<sup>873</sup> Debra JOHNSON: (2005) "European-Russian Energy Links: A Marriage of Convenience?", *Government and Opposition*,40:2, p.256.

<sup>874</sup> *Ibid*, p.263-264.

<sup>875</sup> Ariel COHEN: (2007b) "Europe's Strategic Dependence on Russian Energy", *Backgrounder*, The Heritage Foundation, No.2083, November 5, p.1 Available on site <http://www.policyarchive.org/handle/10207/bitstreams/13043.pdf> (Accessed on August 2008)

raise serious domestic political questions.<sup>876</sup> Consequently, growing EU dependence on imported energy resources is considered as a threat.<sup>877</sup>

While Europe is feeling a threat due to its dependence on Russian resources, Gazprom wants to expand its networks of pipelines in order to ship gas directly to its customers in Western Europe, avoiding the transit fees and political risks linked to the transit through 3<sup>rd</sup> countries. According to company's strategy, liberalization of European gas markets as a good opportunity to expand. The main focus areas of the company are; Germany, Italy, the UK and the several Balkan countries.<sup>878</sup>

**Figure 9: EU-27 Development of Import Dependence up to 2030 (Baseline Scenario)<sup>879</sup>**

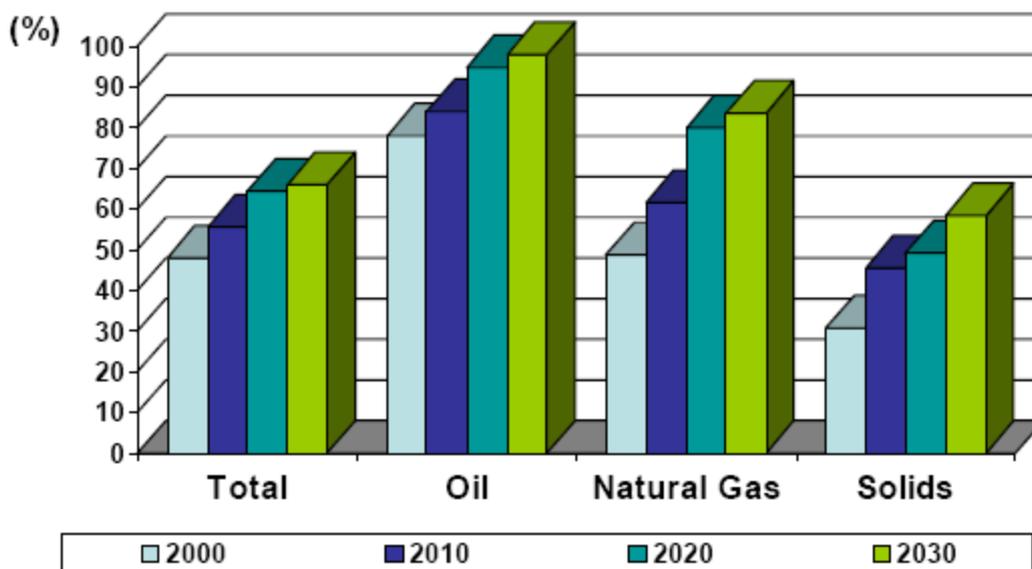
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<sup>876</sup> Andrew MONAGHAN and Lucia JANKOWSKI-MONTANARO: (2006) "EU-Russia Energy Relations: The Need for Active Engagement", *EPC Issue Paper*, No.45, March, p.11

<sup>877</sup> Christian EGENHOFER, Leonid GROGORIEV, Vladimir SOCOR, and Alan RILEY: (2006) "European Energy Security – What Should It Mean? What To Do?" *ESF Working Paper*, No.23, October, p.19

<sup>878</sup> HANDKE and DE JONG, p.22

<sup>879</sup> European Commission Staff Working Document – EU Energy Policy Data (2007) October 10, Brussels, p.13 Available on site [http://ec.europa.eu/energy/energy\\_policy/doc/02\\_eu\\_energy\\_policy\\_data\\_en.pdf](http://ec.europa.eu/energy/energy_policy/doc/02_eu_energy_policy_data_en.pdf) (Accessed on 08 June 2010)



As it is seen in the European Commission's document, EU dependence on energy import or estimated to grow to about 70% by 2030, and Russia's share is expected to remain high.<sup>880</sup> Götz thinks unlikely by saying "the major problem in the future will not be excessive dependence on Russia, but rather receiving sufficient amounts of gas from there in a timely manner."<sup>881</sup> Additionally, as Yegorov and Wirl mention "the main problem is the balance between growing demand for gas in Europe and the growth of exports of gas from Russia." Because, there is a possibility that Russia may not fulfill all European demand of gas in the future because of several reasons: (i) too slow growth of domestic gas extraction because of the growing cost of gas extraction development; and (ii) reorientation of export to other markets (Asia).<sup>882</sup>

There are some analysis that the demand for gas imports will grow fast in the US and the Asia Pacific (mostly China). Under these conditions, even a modest growth of European gas demand (at annual rate of 2-3%) would put Europe into brutal competition for gas supplies with other major consumers.<sup>883</sup> Conversely, there is another argument that as

<sup>880</sup> EU – Country Strategy Paper, 2007-2013, Russian Federation, p.35 Available on site [http://ec.europa.eu/external\\_relations/russia/docs/2007-2013\\_en.pdf](http://ec.europa.eu/external_relations/russia/docs/2007-2013_en.pdf) (Accessed on 08 June 2010)

<sup>881</sup> Roland GÖTZ: (2006) "Russian Gas and Alternatives for Europe", Research Unit Russia/CIS Stiftung Wissenschaft und Politik German Institute for International and Security Affairs, *Working Paper* FGS 2006, June, p.1

<sup>882</sup> Yuri YEGOROV and Franz WIRL: (2008) "Energy Relations Between Russia and European With Emphasis on Natural Gas", *OPEC Energy Review*, December, p.310

<sup>883</sup> *Ibid*, p.319

dependent as the EU may be on gas imports, Russia is even more dependent on gas exports. About 90% of Russia's total natural gas exports are delivered to European countries. When adding oil exports and other raw materials, Russia's energy exports to the EU account for roughly 75% of Russia's export earnings and 40% of Russia's budget receipts.<sup>884</sup>

### 11.3.1. Divide and Rule

Although EU has a great economy and a trading partner in the world, it lacks of its own energy policy. In this context there can be no sufficient EU foreign policy, as the EU will remain vulnerable. EU energy policy mainly focuses on Russia.<sup>885</sup> Bilateral energy agreements between some member states, remarkably Germany, Italy, France, and Bulgaria and Russian firms, generate continued disagreement within the EU on how best to deal with Moscow.<sup>886</sup> Long-term bilateral energy agreements such as the Baltic pipelines agreement between Russia and Germany, the South Stream pipeline contracts between Italy and Bulgaria and Gazprom, and LNG contracts signed between Spain and France and Algeria demonstrate that member states continue to view energy security primarily as a national policy issue.<sup>887</sup>

Since the break-up of the Soviet Union, Russia's gradual politicization of energy relations has prompted the principal member states to develop their external energy policies automatically.<sup>888</sup> Each EU member state places a different emphasis on the role of energy within its own national foreign and security policy. European Council and Commission is trying to form a device for common external energy policy by which the EU as an energy actor could “speak one voice” have made control the rhetoric rather than the reality of securing European energy.<sup>889</sup> Many EU member states have longstanding, trustful, and mutually friendly relations with Russia. But in negotiations at the EU level, countries show

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<sup>884</sup> Quentin PERRET: (2007) “The EU, Russia and Gas: Intimations of Mortality and Supremacy of Politics”, Foreign Policy Research Center, *Lithuanian Policy Review*, Issue No.19/2007, p.171

<sup>885</sup> Sascha M. KRAENNE: (2008) *Energy Security*, Verlag Antje Kunstman, p.77.

<sup>886</sup> Paul BELKIN: (2008) “The European Union’s Energy Security Challenges”, *CRS Report for Congress*, Order Code R133636, January 30, p.8

<sup>887</sup> *Ibid*, p.20

<sup>888</sup> FINON and LOCATELLI, p.26

<sup>889</sup> HADFIELD, p.233

an image that diverging according to their national interests or experiences. After the 2004 EU enlargement, policy makers have found it increasingly difficult to keep the political aspects of EU-Russian relations on track with the growing economic interdependence.<sup>890</sup> Due to reasons that the new members from Eastern Europe's transition of post-communist and restructuration of both economy and the identity, EU was in a difficult position regarding the energy relations with Russia. Mainly, the EU has two major problems. First, it cannot offer membership to Russia, which is usually its most powerful tool of influence. Second, the EU does not have a common policy approach to Russia.<sup>891</sup>

The EU is not a homogenous entity geographically, institutionally, demographically, economically or in terms of member state energy needs or policies. Due to legislative incongruities in the EU of the energy sector, core issues such as access to upstream supplies have become increasingly politicized.<sup>892</sup> Christie thinks that by using this opportunity, Russia has pursued a careful strategy of divide and rule over the EU and is likely to continue to do so in the future.<sup>893</sup> Most of the EU member states that have close ties with Russia do rely on their bilateral relations. Without these bilateral instruments, relations between the EU and Russia would develop even slower than they do at the moment.<sup>894</sup> Moscow prefers to deal with the EU member states separately rather than as a group so that and the most importantly Russia can price-discriminate among its customers, charging each country as close to its full paying potential as possible.<sup>895</sup>

For Russia, to keep its relations with EU at bilateral level is significant in order act like a super energy power. Konstantin Kosachev, the Chair of the Duma's International Committee, summed up the new perspective in an interview with Leonard and Popescu: "We are sick and tired of dealing with Brussels bureaucrats. In Germany, Italy, France, we can achieve much more. The EU is not an institution that contributes to our relationship,

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<sup>890</sup> HANDKE and DE JONG, p.1

<sup>891</sup> Ibid, p.38

<sup>892</sup> DUSSEAUULT, p.40-41

<sup>893</sup> Edward CHRISTIE: (2009) "European Security of Gas Supply – A New Way Forward", in Kari Liuhto (ed.) *The EU-Russian Gas Connection: Pipes, Politics and Problems*, Electronic Publications of Pan-European Institute, 8/2009, p.5

<sup>894</sup> HANDKE and DE JONG, p.39-40

<sup>895</sup> COHEN: (2007b), p.3

but an institution that slows down progress.<sup>896</sup> Since the European Community came into being, member states have been unwilling to give up their sovereignty in energy matters, considering the stakes to be too high with respect to their national interests in the area of energy dependence and control of their resources.<sup>897</sup>

The EU has been enormously divided on the issue of energy security, with member states resorting to their own national policies and interests. It is therefore questionable whether the EU would indeed rally to an individual member states' aid in the case of an ambivalent and arbitrary shutdown of energy supplies, particularly when large gas consumers such as Germany and Italy would not want to jeopardize their own business relations with Russia.<sup>898</sup> By dividing Europe through energy questions, Russia is able to increase its leverage towards the big EU countries by making them more dependent on its energy supplies and using a non-supply threat towards the smaller members, if it manages to build direct pipes to Central Europe.<sup>899</sup>

Indeed, Russia continued its divide and rule tactics toward European governments. Since January 2006, Moscow began negotiating separate deals with energy companies from Germany, France, Italy, Hungary, Serbia, Slovakia and Denmark that could undercut Europe's efforts to build additional pipelines to bypass Russia's near monopoly of supplies from Central Asia.<sup>900</sup> Russia has long tried to "divide and rule" the EU countries, often successfully. In the past, European leaders such as Gerhard Schröder, Silvio Berlusconi and Jacques Chirac happily discarded EU position of the EU, and allowed the Kremlin to assert that the EU cannot be taken seriously.<sup>901</sup>

### 11.3.2. Nord Stream, South Stream and Nabucco

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<sup>896</sup> LENOARD and POPESCU, p.13-14

<sup>897</sup> FINON and LOCATELLI, p.22

<sup>898</sup> Roderick KEFFERPÜTZ: (2009) "EU-Russian Natural Gas Relations – Pipeline Politics, Mutual Dependency, and the Question of Diversification", in Kari Liuhto (ed.) *"The EU-Russian Gas Connection: Pipes, Politics and Problems"*, Electronic Publications of Pan-European Institute, 8/2009, p.105

<sup>899</sup> Kari LIUHTO: (2009) "The European Needs a Common Energy Policy – Not Separate Solutions by its Members", in Kari Liuhto (ed.) *"The EU-Russian Gas Connection: Pipes, Politics and Problems"*, Electronic Publications of Pan-European Institute, 8/2009, p.120

<sup>900</sup> Keith SMITH: (2007), p.2

<sup>901</sup> Katinka BARYSCH: (2009) "Russia, Realism and EU Unity", Centre for European Reform, *Policy Brief*, July, p.2 Available on site [http://www.touteurope.eu/fileadmin/CIE/06-observatoire/etudes/policybrief\\_russia.pdf](http://www.touteurope.eu/fileadmin/CIE/06-observatoire/etudes/policybrief_russia.pdf) (Accessed on 12 August 2008).

**Map 28: Nord Stream, Nabucco and South Stream Pipelines**



Source: <http://www.energy.eu/routes>

### 11.3.2.1. Nord Stream

In 2003, German Chancellor Gerhard Schröder and President Putin agreed to build the Nord Stream to supply Germany with Russian natural gas by the direct subsea pipeline. Lucas says that Nord Stream is the child of the most notorious diplomatic alliance in Europe's modern history, between the previous German government, headed by former

Chancellor G. Schröder and Putin's Kremlin.<sup>902</sup> The pipeline will cross the Baltic Sea from the Russian port Vyborg to German Grefswald, bypassing Ukraine, Belarus and Poland.<sup>903</sup> During the 2000s, the Belarus-Poland route became problematic for Gazprom not just because of financial difficulties in completing the line and the February 2004 incident in Belarus, but also because of the political difficulties in the gas relationship with Poland.<sup>904</sup> The Nord Stream project became the symbol of Russian energy strategy. President Putin who, in a May 2004 speech to the Duma, confirmed the priority attached to the project: "In export, the construction of the NEGP [Nord Stream] is most important. It will make it possible to diversify export flows, directly linking of Russia and countries of the Baltic region with the total European gas network."<sup>905</sup>

Although there was another inexpensive route, instead of building a second Yamal pipeline from Russia to Germany transiting Belarus and costing around \$2.25 bil, Russia and some European states have chosen the option of a Baltic undersea pipeline costing around 12 billion (or \$8-10 bil by Russian estimate).<sup>906</sup> The option would be considerably cheaper than the offshore pipeline in the Baltic Sea, not only because laying onshore pipeline is cheaper in itself, but also because the first Yamal pipeline is constructed in such a way that it would be possible to add a second pipeline at a later stage.<sup>907</sup> In the year 2006 due to the active resistance of the Baltic countries and Poland, Nord Stream has raised particularly numerous discussions.<sup>908</sup> According to Gonchar, Vitali and Chubyk, the main consumer of gas that is to be transported via the Nord Stream pipeline are Germany, the Great Britain, the Netherlands, France and Denmark. They have the minimum dependency on Russian gas supply among the other EU member states.<sup>909</sup> These countries first chose to increase their dependency to Russia in terms of gas and also underestimated the interests of the Baltic members of the EU. So, Russia has achieved two goals at the same time, increased

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<sup>902</sup> Edward LUCAS: (2009) *The New Cold War*, Palgrave, New York p.166

<sup>903</sup> Ariel COHEN: (2009b) "Russia: The Flawed Energy Superpower", in "*Energy Security Challenges for the 21<sup>st</sup> Century*" (ed.) Hal Luft and Anne Kurin, Greenwood Pub., p.94.

<sup>904</sup> STERN: (2005) p.117

<sup>905</sup> Ibid, 120.

<sup>906</sup> NORLING, p.9

<sup>907</sup> Bendik Solum WHIST: (2009) "Nord Stream – A Solution or Challenge for the EU?", in Kari Liuhto (ed.) "*The EU-Russia Gas Connection: Pipes, Politics and Problems*", Electronic Publications of Pan-European Institute, 8/2009, p.183.

<sup>908</sup> BUDRYS.

<sup>909</sup> GONCHAR, MARTYNUK, and CHUBYK, p.57

its gas import and eliminated the suspension possibility of the gas from the states which Russia has experiencing some problems.

According to its advocates, Nord Stream project is a European that represents an important step in the way towards more security of supply for the EU.<sup>910</sup> While the Germans favored the Nord Stream project, the East European – particularly Ukraine, Belarus, and Poland – opposed it. They were not only worried that Nord Stream would eliminate their shipments, but they were also concerned that they would lose substantial transit fees.<sup>911</sup> When Polish Minister of Defense Radoslaw Sikorski compared the project with the Molotov-Ribbentrop Pact of 1939, advocates of Nord Stream, mostly Germany, Russia and the Nord Stream consortium, have largely dismissed the concerns as unnecessary and argue that the pipeline is a common European project that all EU-members should embrace, as it will provide much-needed gas to an increasingly energy-thirsty union.<sup>912</sup> The Nord Stream decision is understandable from the German-Russian perspective, however, regarding to the Common Energy Policy of the EU, it caused many tensions between Germany and Poland, Denmark, Sweden and the Baltic States subsequently. Establishment of such a project is against the interests of smaller and more dependent member states, such as Slovakia, Hungary, and the Czech Republic. These countries are predominantly dependent on Russian supplies and have almost no diversification possibilities.<sup>913</sup>

On the other hand, in Sweden, the private sector has pushed for increased gas usage in Sweden, and the Nord Stream would clearly be beneficial to the companies involved if Sweden was connected. However, there was a strong parliamentary majority against a Swedish connection.<sup>914</sup> Sweden insists that Nord Stream must have the approval of all the countries whose territory will be traversed by the pipeline. Later on, Estonia has claimed that it had sovereignty over the territorial waters from three to twelve nautical miles, which means that the Russians will now also need Estonia's permission. However, Estonia has

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<sup>910</sup> WHIST: (2009) p.167

<sup>911</sup> Marshall I. GOLDMAN: (2008) *Petrostate, Putin, Power and the New Russia*, Oxford Uni. Press, p.159

<sup>912</sup> Whist, (2009) p.168.

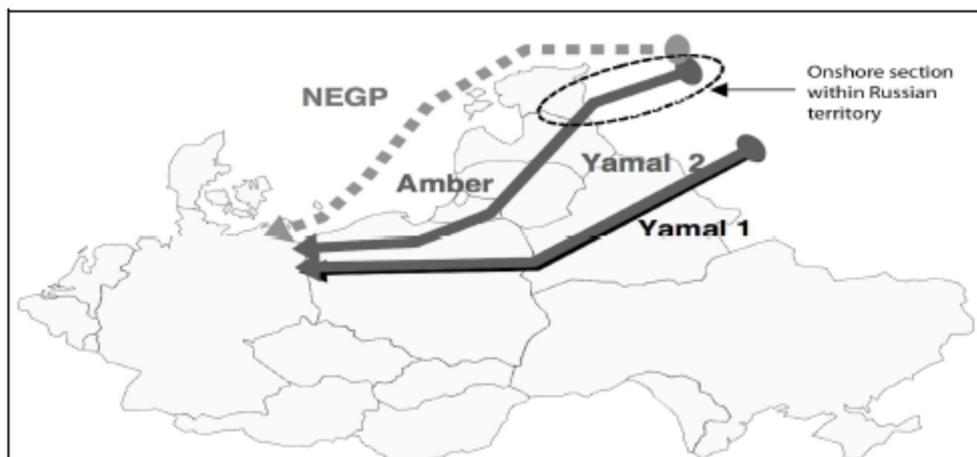
<sup>913</sup> Lenka KOVACOVSKA: (2007) "European Union's Energy (In) Security: Dependence on Russia", *Obrana a Strategie/Defense and Strategy*, 2/2007, p.13

<sup>914</sup> Robert L. LARSSON: (2007) "Nord Stream, Sweden and Baltic Sea Security", Sweden Research Agency, FOI-Russia-2251-SE, March, p.55 Available on site <http://www2.foi.se/rapp/foir2251.pdf> (Accessed on 19 June 2008)

rejected Nord Stream’s request to conduct a survey of the Baltic seabed in Estonia’s offshore economic zone. Due to objections of the some Baltic countries who are also members of EU, Nord Stream conduction has postponed about one year.<sup>915</sup>

In early 2004, Poland and the Baltic States came with the idea of a third alternative, “Amber”, which would bring Russian gas through Latvia and Lithuania to Poland, where it would join the Yamal route to Germany. The Amber pipeline would thus contribute to route diversification and bring Russian gas to Germany and the EU without passing through non-EU transit states.<sup>916</sup> Nevertheless, by cutting out current transit countries Poland, Belarus, and Ukraine, Nord Stream will turn Germany into a hub for Russian gas sales to Europe and a recipient of transit fees.<sup>917</sup>

**Map 29: Alternative Onshore Routes – Yamal II and Amber<sup>918</sup>**



For Russia, Nord Stream totally serves its foreign energy strategy. At the end of year 2011, the first phase of Nord Stream has completed and the first flow of gas has begun (27.5 bcm/y). When Nord Stream begin to function fully in 2012 (55 bcm/y), in case of suspension of the gas transit to Ukraine, Poland or Belarus, Germany will not be affected. Most probably, we will not see Cancellor of Germany in the first plane directed to

<sup>915</sup> GOLDMAN.

<sup>916</sup> WHIST: (2009) p.183.

<sup>917</sup> Jeffrey MANKOFF: (2009a) *Russian Foreign Policy, The Return of Great Power Politics*, Rownan & Littlefield Pub, p.157.

<sup>918</sup> WHIST: (2009) p.182.

Moscow, to ensure the gas supply. As a result being the first recipients of gas from Nord Stream, the Germans would not have to worry about transit states taking their shares or not.<sup>919</sup> Not only, Nord Stream has a capacity to become a foreign policy tool for Russian ambitions to realize its objects, but also will serve as a gate to enter the European energy sector, especially Nord Stream's mother company Gazprom, will be the main force for the penetration into the European downstream market.<sup>920</sup> As we seen in the case Nord Stream that it is an evidence of the fact that bilateralism still prevails over common EU energy policy.<sup>921</sup>

### 11.3.2.2. Nabucco Versus South Stream

Being the gas connection between Turkey and Azerbaijan, the Baku-Erzurum pipeline forms a main route from the Caspian Sea to Europe, but there is a missing link between Erzurum and European pipeline grids. Nabucco is designed to fill the link via Turkey, in order to maintain a diversification of reliable gas supply for the EU.<sup>922</sup> The Nabucco Project designed to connect the Caspian region, Middle East and Egypt via Turkey and with Bulgaria, Romania, Hungary, and Austria and further on with the Central and Western European gas markets.<sup>923</sup> Russia suggested that the construction of South Stream will cost \$5.5 billion and will transport 30 bcm (later the capacity was updated to 63 bcm) annually of Russian gas to Europe through the Balkans.<sup>924</sup> In addition to that Russia and Croatia signed an intergovernmental agreement on building and operating and operating the Croatian segment of the South Stream gas pipeline on 2 March 2010. The gas pipeline is expected to start operating on late 2015 and account for about 35% of Russian natural gas supplies to Europe.<sup>925</sup>

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<sup>919</sup> WHIST: (2008) p.51.

<sup>920</sup> LARSSON: (2007) p.6.

<sup>921</sup> Ibid, p.7.

<sup>922</sup> NORLING, p.2-3.

<sup>923</sup> Burcu GÜLTEKİN-PUNSMANN: (2008) "Black Sea Regional policy Approach: A Potential Contributor to European Energy Security", ICBSS, *Policy Brief*, No.6 May, p.5.

<sup>924</sup> LUCAS, p.177-78.

<sup>925</sup> RIA Novosti (2010) "*Croatia Joins Russia-Backed South Stream Gas Pipeline Project*", March 2, <http://en.rian.ru/business/20100302/158066885.html> (Accessed on 02 March 2010)

Although the construction of the Nabucco Pipeline has planned for 2009 with an envisaged start up of transportation of gas in 2012, the construction could not started yet so far.<sup>926</sup> Moreover, on 27 March 2009, in Moscow, the leader of Azeri Energy Company SOCAR Rovnag Abdullayev signed the Memorandum for Azerbaijan gas supply to Russia which diminishes the chances of the European Nabucco project to transport gas from Azerbaijan.<sup>927</sup>

According to Liuhto Nabucco's main problems are linked four issues:

1. Where to find enough gas to fill the pipeline,
2. How to convince all the necessary parties need,
3. How to secure the pipeline from terrorist attacks,
4. How to ensure that Turkey does not to use its strengthening role as a strategic transit hub to press the Union to accept its membership before both the parties are ready for deeper integration.<sup>928</sup>

Concerning that the EU is planning the transportation of at least 30 bcm of natural gas from the Nabucco pipeline, Azerbaijan does not have sufficient amount of supply and began to export its surplus value of gas to Russia starting from 2009. In addition to that Iran is an unwanted actor in region so under these circumstances, Iran option does not have potential either. The only option remain is the Northern Iraq, but 30 bcm of export production is not a case in the concerning region too. EU trying to push the Turkmenistan option but this option has also finalized with the deal of Pre-Caspian pipeline project between Russia, Kazakhstan and Turkmenistan in 2007. Yet, these obstacles still does not mean that Nabucco is out of agenda both for EU and Russia.

In the beginning of the 2007, Hungary became one of the most important targets of Russia's energy policy in order to maintain the cooperation concerning the project of the South Stream gas pipeline. Gazprom and Hungarian government reached an agreement that the pipeline will pass through the territories of Bulgaria, Romania, Serbia, and will reach Hungary. In return for the Hungarian participation into the project, Hungarian biggest oil and gascompany was rewarded with construction of a new complex of gas storage facilities in Hungary. It was not surprise that the Russian project matches the route of the Nabucco

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<sup>926</sup> Ibid, p.6.

<sup>927</sup> GONCHAR, MARTYNUK, and CHUBYK, p.58.

<sup>928</sup> LIUHTO, p.117

gas pipeline project.<sup>929</sup> Gazprom offered to provide Hungary with an attractive long-term supply contract, and to make the offer even harder to resist, Gazprom promised that under its proposal, Hungary rather than Austria would become the European hub.<sup>930</sup> Afterwards, Gyurcsany announced his support for the South Stream extension at the expense of Nabucco, he stated that the EU-backed project was nothing but a “dream” and that “South Stream” is backed by a very strong will and a very strong organizational power.<sup>931</sup>

The South Stream project was announced to the world on June 23, 2007, when Italian ENI CEO Paolo Scaroni and Russian Gazprom Vice-President Alexander Medvedev signed a memorandum of understanding.<sup>932</sup> However, in September 2007, Gyurcsany changed his mind and insisted that Hungary was still a strong supporter of Nabucco. Most probably, Budapest did not welcomed the Kremlin’s increasing influence in neighboring Austria, where the main oil and natural gas company, OMV, is meant to be coordinating the Nabucco project. When Putin visited Vienna on May 23 and 24, 2007, he promised to make Austria a “hub” for Russian exports of natural gas – including, ironically, much of the Central Asian gas that was supposed to flow through Nabucco.<sup>933</sup> OMV, a partially state owned Austrian energy company, signed a long-term gas import deal with Gazprom.<sup>934</sup> It seems that Gazprom tried to create competition between the Hungarian and Austrian energy industries over which it will have the closest ties with Russia.<sup>935</sup>

Thanks to the Nord Stream project which is already on process, Russia has considerably reinforced its ties with Germany and presently, South Stream is serving a parallel strategy in the South, towards Italy.<sup>936</sup> According to Mankoff, Nord and South Stream thus fit together with Russia's strategy of seeking privileged relationship with the established

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<sup>929</sup> Laurynas KASCIUNAS and Zygimantas VAICIUNAS: (2007) “Russia's Policy Towards the EU: the Search for the Best Model”, *Lithuanian Foreign Policy Review*, Issue No.19, p.65

<sup>930</sup> GOLDMAN, p.155

<sup>931</sup> BARAN: (2007b) p.141.

<sup>932</sup> Zeyno BARAN: (2008) “Security Aspects of the South Stream Project”, *Hudson Institute*, European Parliament, October, p.1 Available on site <http://www.hudson.org/files/publications/Baran-South%20Stream%20for%20EP.pdf> (Accessed on 11 March 2010).

<sup>933</sup> LUCAS, p.179

<sup>934</sup> COHEN: (2007b), p.3

<sup>935</sup> LUCAS, p.179-80

<sup>936</sup> Laurent VINATER: (2009) “With or Without South Stream? Russia's Energy Strategy Between the European Union and Turkey”, *Institute Thomas Moore*, July 9, p.5

Western European powers, especially its two largest customers, Germany and Italy.<sup>937</sup> In November 2006, Gazprom and ENI reached a strategic cooperation agreement. This had three key components; first Gazprom would have direct access to Italian consumers, second the two companies would swap assets; and third, they would construct a pipeline between their two countries which was to be Blue Stream II, but it was replaced by South Stream.<sup>938</sup>

After these developments, Putin dismissed the notion of a competition between Nabucco and South Stream: “There can be no competition, when one project has the gas and the other does not.”<sup>939</sup> For Russia, the main purpose of the South Stream gas pipeline project is to prevent Nabucco from transporting Caspian gas directly to European markets without its involvement. In other words, South Stream directly competes with Nabucco.<sup>940</sup> However, South Stream will not end altogether Gazprom’s need to use Ukraine line -63 bcm annually. Although it was announced at the beginning of the project that the capacity will be 30 bcm, later it was updated by Putin himself to 63 bcm annually.<sup>941</sup> Therefore total-Nord Stream 55 bcm, Ukraine line 95 bcm (2011), South Stream 63 bcm- amount of the Russian natural gas supply to Europe will reach to more than 220 bcm only by pipeline in 2015. Indeed it will give the Russians options and increase their bargaining power enormously.<sup>942</sup>

### **11.3.3. Ukraine Gas Crisis and Their Impacts on Relations Between Russia and the EU**

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<sup>937</sup> MANKOFF: (2009a) p.179

<sup>938</sup> BARAN: (2008) p.25.

<sup>939</sup> Vladimir SOCOR: (2008b) “South Stream Gas Project Defeating Nabucco by Default”, *Eurasia Daily Monitor*, Vol.5, Issue.42, March 4 Available on site [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=33432](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=33432) (Accessed on 12 September 2009)

<sup>940</sup> BARAN: (2008), p.9

<sup>941</sup> RIA Novosti (2010) “Gazprom Gets 50% of Bulgarian South Stream Gas Pipeline JV”, 16 December <http://en.rian.ru/business/20101216/161800258.html> (Accessed on 07 February 2011).

<sup>942</sup> Ed CHOOK: (2010) “Gazprom’s Nord Stream and South Stream Gas Pipelines are no, but are they needed?”, *Financial Times*, February 9, <http://blogs.ft.com/energy-source/2010/02/09/gazproms-nord-stream-and-south-stream-gas-pipelines-are-go-but-are-they-needed/> (Accessed on 9 February 2010)

#### 11.3.4. Ukraine Gas Crisis in 2006

All Russian gas exports to Europe (except deliveries to Finland and the portion of Turkish exports delivered via the Blue Stream pipeline) transit through three countries: Ukraine, Belarus, and Moldova. For that reason, Ukraine holds the pivotal geographic position with more than 80% of Russian gas exports to Europe delivered via that country.<sup>943</sup> While Ukraine was paying \$50 tcm to Russia, the market price in the West at the time was \$150 tcm. So paying the higher price would cost Ukraine \$3-5 billion a year. In other words, as Putin said, “Ukraine should think twice about any such embrace of the West.” By contrast, at that time Belarus was charged less than \$50 tcm for its deliveries, not much different from what users within Russia itself had to pay in 2006.<sup>944</sup> It was essentially a conflict over gas prices in a county that has a monopoly of transit, yet a dominating supplier.<sup>945</sup>

On January 1, 2006, Gazprom demanded from Ukraine to pay \$150 tcm, a threefold increase from the earlier charge. Ukraine insisted on paying the lower fee, arguing that this lower price had been agreed to during previous contracts. Any reduction or termination of gas deliveries through the pipeline by Gazprom would be a contract violation. The pipeline was not only pumping gas to Ukraine which was also carrying the gas exports to Europe. However, Gazprom insisted that the contract had expired and proceeded to reduce the flow of gas, sending through just enough to meet its contract obligations to its customers in Western Europe. Ukraine, on the other hand, continued to withdraw the same amount of gas from the pipeline that it had prior to December 31, 2005.<sup>946</sup> Ukraine claimed that it has a right to take 15% of the remaining supplies in the pipelines as payment for transporting gas to Western Europe.<sup>947</sup>

Moscow did not hesitate to shut down the gas supplies to some of its post-Soviet neighbors in order to secure its higher energy prices. When Russia shut down gas deliveries to Ukraine in January 2006, there were immediate supply shortages for a number of European

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<sup>943</sup> Jonathan STERN: (2006) “Natural Gas Security Problems in Europe: the Russian – Ukrainian Crisis of 2006”, *Asia-Pacific Review*, 13:1, p.33

<sup>944</sup> Goldman, p.144.

<sup>945</sup> Christian EGENHOFER, Leonid GROGORIEV, Vladimir SOCOR, and Alan RILEY: (2006) “European Energy Security – What Should It Mean? What To Do?” *ESF Working Paper*, No.23, October, p.21.

<sup>946</sup> GOLDMAN, p.145.

<sup>947</sup> BBC News (2006) “Ukraine Gas Row Hits EU Supplies”, 1 January  
<http://news.bbc.co.uk/2/hi/europe/4573572.stm> (Accessed on 10 May 2009).

countries, reminding them how dependent they are on Russian energy. The shortage of gas in 2006 caused the discussions among EU that how reliable partner Russia is?<sup>948</sup> The fall in volumes delivered to EU countries caused on country all over Europe. By January 2, Hungary was reported lost up to 40% of its Russian supplies; Austrian, Slovakian and Romanian supplies were said to be cut down by one third, France 25-30% and Poland by 14%, Italy reported having lost 32 mcm around 25% of deliveries, during January 1-3.<sup>949</sup> As a result, on 4 January 2006 Energy Commissioner Piehalgs argued that: Europe needs a clearer and more collective and cohesive policy on security of energy supply... security of energy supply is only really considered at national member state level; but in reality we need a much greater European-wide approach as this issue.<sup>950</sup> Although the conflict was commercial and must be seen as part of the painful transition of energy trade relations among the states of the former Soviet Union to a more market-based energy trade, many judged the refusal to deliver gas on January 1, 2006, as an act of Russian regional energy power politics.<sup>951</sup>

When Gazprom decided to cut off supplies to Ukraine, many EU policy makers and politicians in the member states thought that the combination of increasing power of Russia and EU's dependence on energy supplies is becoming a matter of concern.<sup>952</sup> Helm also adds that whatever the long-term consequences of the exercising of the power to physically interrupt supplies, the immediate effect was to extend Gazprom's downstream control over the Ukrainian pipelines.<sup>953</sup> There is another argument that lies behind the crisis that it was undoubtedly linked to the recent political changes in Ukraine which have seen a more pro-West foreign policy under President Yuschenko, including a strong push to join NATO and the EU.<sup>954</sup> However, Marshall says that when the flow of gas was reduced, Gazprom spokesman repeatedly insisted that none of this pressure on Ukraine was political. The flow of gas would be resumed once the Ukrainians agreed to pay the

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<sup>948</sup> Jeronim PEROVIC: (2009) "Introduction: Russian Energy Power, Domestic and International Dimensions", in Jeronim Perovic, Robert W. Ortung and Andreas Wenger (ed.) *Russian Energy Power and Foreign Relations, Implications for Conflict and Corporation*, Routledge, p.9.

<sup>949</sup> STERN: (2006), p.44

<sup>950</sup> HADFIELD, p.240

<sup>951</sup> The Gas Supply Outlook For Europe – The Roles of Pipeline Gas and LNG (2008) Clingendael International Energy Programme, August, CIEP 2008/04, p.19 Available on site [http://www.clingendael.nl/publications/2008/20080800\\_ciep\\_energy.pdf](http://www.clingendael.nl/publications/2008/20080800_ciep_energy.pdf) (Accessed on 07 June 2010)

<sup>952</sup> HANDKE and DE JONG, p.2

<sup>953</sup> HELM, p.24

<sup>954</sup> HUGHES, p.10

market price, with the emphasis on market price. To the contrary, it was not Russia that was at fault but Ukraine. By diverting the gas intended for Western Europe to itself, the Ukrainians were simply stealing Europe's gas.<sup>955</sup> The crisis of 2006 was resolved by the political intervention of Putin, who imposed a complex agreement that essentially doubled the price.

### 11.3.5. Ukraine Gas Crisis 2009

**Table 33: Gas Transit Volumes through Ukraine to Europe + Turkey (2000-2009)<sup>956</sup>**

Year	Total Transit	Transit to EU+	Ratio %
2000	120.6	109.3	90
2001	124.4	105.3	84
2002	121.4	106.1	87
2003	129.2	112.4	86
2004	137.1	120.4	87
2005	136.4	121.5	89
2006	128.5	113.8	88
2007	115.2	112.1	97
2008	119.6	116.9	98
2009	120.0	116.9	97

On 18<sup>th</sup> December 2008, Gazprom announced that it would interrupt supplies to Ukraine as of 1<sup>st</sup> January 2009 unless agreement was reached over Ukraine's outstanding payments and a new contract signed. Immediately, Russia officially activated the EU – Russia Early Warning Memorandum on 18<sup>th</sup> December 2008. The Russian Deputy Zubkov wrote to President Barosso and 27 member states to warn them that a gas interruption could be inevitable as a result of coming gas supply dispute.<sup>957</sup>

<sup>955</sup> GOLDMAN, p.145

<sup>956</sup> GONCHAR, MARTYNUK, and CHUBYK, p.63

<sup>957</sup> The January 2009 Gas Supply Disruption to the EU: An Assessment (2009) Commission Staff Working Document, SEC (2009) 977 Final, Brussels, July 16, p.5 Available on site [http://ec.europa.eu/danmark/documents/alle\\_emner/energi/2009\\_ser2\\_autre\\_document\\_travail\\_service\\_part1\\_ver2.pdf](http://ec.europa.eu/danmark/documents/alle_emner/energi/2009_ser2_autre_document_travail_service_part1_ver2.pdf) (Accessed on 07 June 2010)

The gas crisis between Russia and Ukraine in January 2009 is significant due to its consequences for EU-Russia energy relations and the energy security of the EU. During the crisis, Russia exports to Ukraine were cut off to Ukraine on 1 January and furthermore on 2<sup>nd</sup> January gas deliveries to several European members states were affected, notably, Poland, Slovakia, Hungary and above all Bulgaria and Romania. On the night of 6<sup>th</sup> to 7<sup>th</sup> January, all supplies from Russia to Ukraine to the EU were cut.<sup>958</sup> Only two weeks later gas supplied has recovered in Europe. According to Vahtra, as a result of the crisis, from the European perspective, both Russia's reputation as an energy supplier to Europe as well as Ukraine's reputation as an energy transit country was seriously damaged.<sup>959</sup>

On 5 January Gazprom claimed that Ukraine illegally tapped 50 mcm of Russian natural gas bound for European consumers. Gazprom authorities said that, "Over the past 24 hours, we fed 295 mcm of gas into the Ukrainian gas transportation system, that is a bit more than requested by European consumers, but we had only 270 mcm on the output. They stole 25 million. Minus 25 mcm RosUkrEnergo does not get from Naftogas for its export operations".<sup>960</sup> Ukraine further claimed that they used certain amount of the gas as the "technical" fuel which was needed to operate the network.<sup>961</sup> On 6 January Gazprom CEO Aleksandr Medvedev stated at press conferences in both London and Berlin that Ukraine had blocked 3 of the 4 transit lines "in an unprecedented and unilateral move" at 2.30. The next day, Gazprom CEO Alexei miller stated that Gazprom had stopped all deliveries into the system because Ukraine had closed it down; Naftogaz said it had closed down the system because Gazprom had stopped delivering gas at 07.44.<sup>962</sup>

### **Map 30: Situation in Ukraine After the Gas Cut to EU on 7 January 2009<sup>963</sup>**

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<sup>958</sup> The January 2009 Gas Supply Disruption to the EU: An Assessment (2009), p.4

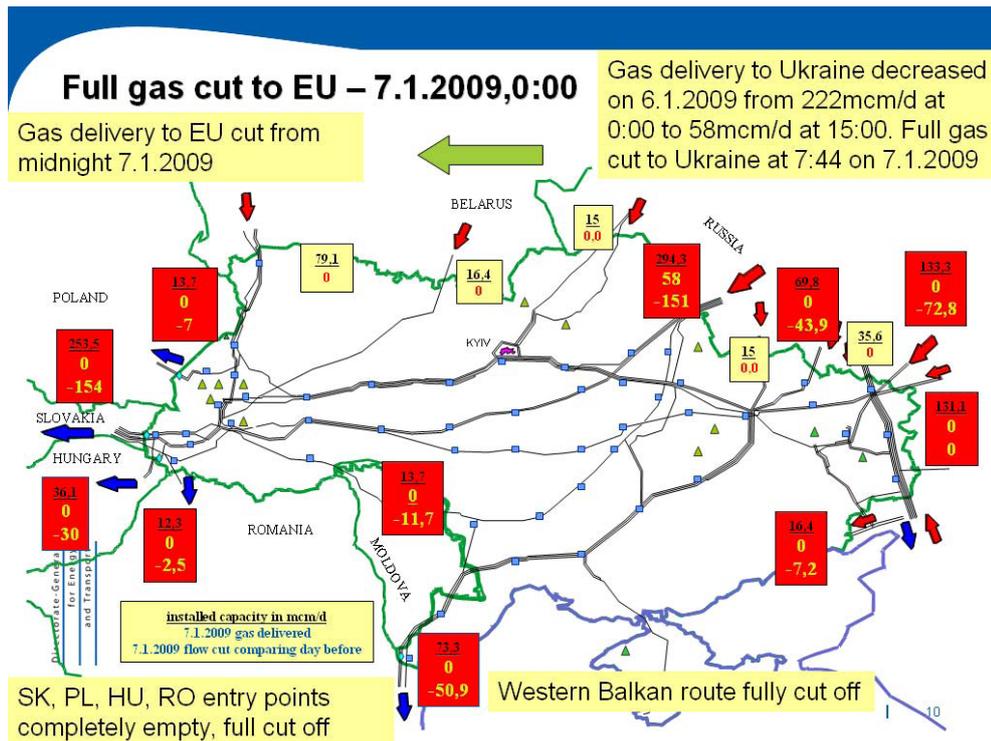
<sup>959</sup> Peeter VAHTRA: (2009) "Energy Security in Europe in the Aftermath of 2009 Russia-Ukraine Gas Crisis", in Kari Liuhto (ed.) *"The EU-Russia Gas Connection: Pipes, Politics and Problems"*, Electronic Publications of Pan-European Institute, 8/2009, p.159.

<sup>960</sup> RIA Novosti (2009) *"Ukraine Tapped 50 mcm of Europe-Bound Gas Over 24 hours"*, 04 January <http://en.rian.ru/world/20090104/119366284.html> (Accessed on 04 January 2009).

<sup>961</sup> Simon PIRANI, Jonathan STERN, and Katja YAFIMOVA: (2009) "The Russo-Ukrainian Gas Dispute of January 2009: A Comprehensive Assessment", *Oxford Institute for Energy Studies*, Natural Gas 27, February, p.19-20.

<sup>962</sup> Ibid, p.21-22.

<sup>963</sup> The January 2009 Gas Supply Disruption to the EU: An Assessment (2009), p.22.



Two sides finally negotiated two new contracts covering supply and transit which were signed on 19 January. On 19 January 2009, Prime Ministers Putin and Timoshenko signed an agreement to end the dispute, and the heads of Gazprom and Naftogaz signed supply and a transit contract, both covering the 10 year period 2009-2019.<sup>964</sup> According to the agreement, it was accepted that the price for natural gas for Ukraine in the first quarter of 2010 to be \$305 and \$330 in the second quarter. On 22 January the pipelines began to operate again and two days later levels of gas returned to normal.

According to Pirani, Stern and Yafimova, the agreement that ended the dispute made little progress towards European netback prices, other than it strengthened Russia's position in four other respects:<sup>965</sup>

1. It ended the practice of border deals, paved the way for greater transparency
2. Gazprom's version of events is that supply and transit were separated, and along-term transit contract, which was intended to make supplies to Europe independent of Russo-Ukrainian gas trade, was signed.
3. Ukraine would no longer negotiate directly with Turkmenistan. All Turkmen export volumes were now bought by Gazprom Export at the Turkmen border, and, apart from

<sup>964</sup> PIRANI, STERN, and YAFIMOVA, p25-26

<sup>965</sup> Ibid, p.8

small amounts used in Russia, resold to Rusunkergo, which would ship and supply Ukraine's imports and sell 7-10 bcm/year in Central Europe Prices were based not on a European netback calculation, but on a "net forward" from Turkmenistan export prices, which reached an average of \$140/mcm in 2008.

4. A wholesale trader, Ukgaz-Energo, a joint venture between RUE and the Ukrainian state-owned oil and gas company Naftogaz Ukrainy, was given a dominant position in the Ukrainian domestic gas market.

As a result of the 2009 crisis, Vahtra argues that Gazprom's reputation as a reliable energy supplier has been irreparably damaged. As a major part of European citizens were directly and seriously affected by the disruption. In addition to that the main lesson learned from the crisis should be that prevailing geopolitical realities, Russia and Ukraine are not reliable suppliers of gas. After the crisis, EU began to re-discuss the strategy of diversification of resources forcing Europe to advance its search for alternative supply options.<sup>966</sup>

#### **11.4. Conclusion of the Russian Foreign Policy and Energy Strategy Towards EU**

There are four important points which Russia focused towards the EU – bilateralising relations with most of the EU member states, strengthening Russian influence in the post-Soviet space, revisiting the natural gas at the political, legal and economic basis of relations with the EU, and promoting asymmetric interdependence with a divided EU.<sup>967</sup> Norling summarizes, the Russian energy strategy under Putin consist of three components:

- Reasserting state-control over the energy sector by dismantling private companies;
- Controlling CIS gas production for domestic consumption and/or re-exports to Europe;
- Dominating the European market by crowding out other producers, controlling downstream delivery, while maximizing all export outlets.<sup>968</sup>

As it seen in the case of Russia-EU relations, the aim of Russia is to become an "energy superpower" and play a key geopolitical role, by positioning itself as an essential supplier

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<sup>966</sup> VAHTRA, p.161

<sup>967</sup> LEONARD and POPESCU, p.13

<sup>968</sup> NORLING, p.11

for major regional energy markets, and by organizing competition between countries and regions to possess its importance.<sup>969</sup> Monaghan thinks that “*Diversification*”, one of the key principles of energy security, may begin to undermine the EU – Russia relationship, as both seek to diversify away from each other in an effort to enhance their energy security. As a result of this, EU could find itself increasingly at the mercy of an ever more authoritarian Russia.<sup>970</sup>

It is commonly accepted that Russia and the EU stand at the opposites polar of the foreign energy policy spectrum. Russian foreign energy policy is connected to an abundance of concentration in both its raw materials and the positioning of its energy policies.<sup>971</sup> According to Trenin, in 2005, as the Kremlin began to prepare for the first ever Russia hosted G-8 Summit in St.Petersburg, it identified energy security as the dominant theme. However, Trenin thinks that priority of Russian energy policy much more about seeking profits rather than establishing political domination.<sup>972</sup> On the other hand Kasciunas and Vaiciunas are underlining the importance balance policy regarding to Russian foreign energy policy;

The principle of supremacy of sovereignty also has a direct impact on Russia's policy towards the EU. The tools of influencing the internal EU processes used by Russia are conceptualized by the traditional concept of balance policy. The purpose of the balance policy is the encouragement of “renationalization” of foreign policy of the EU member states through bilateral agreements, as a consequence limiting of the autonomy of the EU as a united geopolitical subject.<sup>973</sup>

As a part of its diversification policy, the EU is interested in energy supplies from the Caspian region. Russia is responding these activities by defending its economic interests in the region more conservatively. Due to economic considerations, Russian policies towards it's “near abroad” so focused on the resource-rich Central Asian region and important transit countries to the West.<sup>974</sup> It is clear that both EU and Russia are pursuing active energy diversification strategies. EU is occupied with diversifying its suppliers, and

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<sup>969</sup> FINON and LOCATELLI, p.4

<sup>970</sup> MONAGHAN: (2006b), p.4-8

<sup>971</sup> HADFIELD, p.231-32

<sup>972</sup> Dmitri TRENIN: (2008a) “Energy Geopolitics in Russia – EU Relations”, in Katinka Barysch (ed.) “*Pipeline, Politics and Power – The Future of EU –Russia Energy Relations*”, Centre for European Reform (CER), Octoberp.15

<sup>973</sup> KASCIUNAS and VAICIUNAS, p.43

<sup>974</sup> HANDKE and DE JONG, p.39

therefore transportation routes. On the other hand, Russia is attempting to increase the energy export levels to its established markets, diminish dependency on post Soviet transit states, and is looking to expand into new markets.<sup>975</sup> And Cohen points that Russia's energy strategy concentrated to make Europe increasingly dependent on Russian oil and gas. It creates dependency by lacking in demand with energy importers, consolidating the supply of oil and gas by signing long-term contracts with Central Asian energy producers, and securing control of strategic energy infrastructure in Europe and Eurasia.<sup>976</sup>

At the beginning of 2000s, Russia was eager to conclude new and renew old long-term supply agreements in order to solidify their position into the EU market. However, in couple of years, their strategy has changed and they are seeking new types of agreements in which they can not only reach the EU markets through diversified routes, but can also gain direct entry into the EU market as a distributor.<sup>977</sup> In this context Locatelli commends that Vladimir Putin's desire to place hydrocarbons at the service of his economic and foreign policies, notably by making use of large, internationalized companies owned primarily by the state, remains in the background.<sup>978</sup>

Sergey Yostizhemy said that "...we keep stressing to our European partners that we need to deal with each other on equal terms. Russia should get adequate access not only to energy distribution assets in the EU, but also to other sectors are as important for the EU economy as energy is for Russia."<sup>979</sup> The main problem in relations between Russia and the West not only in the energy area, but much more broadly is Russia's lack of motivation to engage with the West.<sup>980</sup> According to Cleutinx and Piper, increasing interdependence between the EU and Russia on the European continent is natural and should be evaluated

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<sup>975</sup> BORISOICHEVA, p.17

<sup>976</sup> COHEN: (2007b), p.3

<sup>977</sup> The Gas Supply Outlook For Europe – The Roles of Pipeline Gas and LNG, (2008) p.25

<sup>978</sup> Catherine LOCATELLI: (2008) "EU Gas Liberalization as a Driver of Gazprom's Strategies?", IFRI, *Russie.Nei.Visions*, No.26, February, p.4

<sup>979</sup> Sergey YOSTIZHEMSKY: (2008) "Trust, not Double Standards: What Russia Expects from the EU", in Katinka Barysch (ed.) "*Pipeline, Politics and Power – The Future of EU –Russia Energy Relations*", Centre for European Reform (CER), October, p.37; Sergey Yostizhemy was the Russian President's special envoy for relations with the EU until May 2008.

<sup>980</sup> Vladimir MILOV: (2008) "Russia and the West: the Energy Factor", CSIS/IFRI Project, "*Europe, Russia and the United States: Finding a New Balance*", July, p.14 Available on site [http://csis.org/files/media/csis/pubs/080731\\_milov\\_russia&west\\_web.pdf](http://csis.org/files/media/csis/pubs/080731_milov_russia&west_web.pdf) (Accessed on May 2009).

positively in the light of security of supply and security of demand, but it has to be balanced in terms of market access.<sup>981</sup>

## **12. RUSSIA – US COMPETITION ON ENERGY**

### **12.1. Russian Foreign Policy Towards US After the Dissolution of USSR**

Russia's first Foreign Policy Concept, published in 1993, acknowledged that the USA was a major priority – “in the rankings of priorities of Russian foreign policy”. The concept also noted that relations with the USA should be enhanced and expanded – but not at the expense of Russia's independent role: it must not damage Russian interests and should be developed based on consideration of Russia's interests”.<sup>982</sup> By the mid-1990s, following the appointment of Yevgeniy Primakov to the post of Foreign Minister in January 1996, Russian foreign policy concentrate on advocating more independence from US, based on the concept of multipolarity.<sup>983</sup>

After September 11, Russia decided to side with US in the struggle against Al Qaeda and saw the attacks as the culmination of trends that had been under way for many years. Moscow thought that bandwagoning with US could be beneficial for Russia, at different levels, from an alliance with the US: it would acquire leverage and international prestige in what appeared to Europe the beginning of a new phase in American foreign policy and international relations; and it could use its contribution to the campaign against terrorism to demand less interference in its internal affairs, starting with human rights issues and the Chechnya question.<sup>984</sup> President Putin made a strategic choice that international cooperation –along with the restoring the domestic bases of Russian strength- was the most effective means of recapturing Russia's global influence.<sup>985</sup>

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<sup>981</sup> Christian CLEUTINX and Jeffery PIPER: (2008) “The EU-Russia Energy Dialogue”, in Katinka Barysch (ed.) “*Pipeline, Politics and Power – The Future of EU – Russia Energy Relations*”, Centre for European Reform, October, p.29

<sup>982</sup> Andrew MONAGHAN: (2006c) “Calmly Critical: Evolving Russian Views of US Hegemony”, *The Journal of Strategic Studies*, Vol.29, No.6, p.990

<sup>983</sup> Ibid, p.991

<sup>984</sup> Riccardo ALCARO and Emilliano ALESSANDRI: (2009) “Re-Setting US-EU-Russia Relations, Moving Beyond Rhetoric”, *Paper presented at the conference on “Transatlantic Security Symposium 2009”*, Rome, June 22, p.3

<sup>985</sup> MANKOFF: (2009a) p.24

The G.W. Bush administration had pushed the democratic reform agenda in Russia to the periphery of US-Russian relations soon after entering office in January 2001. Both President G.W. Bush and V. Putin spearheaded a *realpolitik* approach as the political philosophy that would guide relations between the US and Russia.<sup>986</sup> The high point of the Bush-Putin relationship came after 9/11 at the Moscow Summit in May 2002. The US needed bases in Central Asia for its war in Afghanistan, and Putin accommodated this request. However, in early 2003, France, Germany, and Russia jointly protested US plans for a war in Iraq against Saddam Hussein.<sup>987</sup> In return, as a result of the renationalization of

With the confiscation of the oil company Yukos, initiated in 2003, Russia began its oil and gas assets, American companies' loss amounted to as much as \$12 billion, but the US government did not publicly protest.<sup>988</sup>

By the end of President Putin's second term in May 2008; the question was how much of the content of US-Russia relations reflected a Cold War agenda. The focus was on the balance of forces in Europe: NATO expansion, US bases in Bulgaria and Romania, planned US missile defense systems in Eastern Europe, the Conventional Forces in Europe (CFE) Treaty, the Balkans (Kosovo), and European energy dependence on Russia.<sup>989</sup> Barrack Obama's rise to power released the atmosphere surrounding US-Russian relations which by the fall of 2008 had reached their lowest point in the last 25 years. The beginning of negotiations on a new agreement to limit strategic offensive weapons, on understanding on Afghanistan, and Washington's decision not to locate missile sites in Central Europe, as well as the convergence on Iran, provide a basis for optimism.<sup>990</sup> Russia is important for US foreign policy in many ways. The US needs a more constructive relationship with

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<sup>986</sup> Brent GARRET: (2008) "Russia and the United States: Lukewarm Friends or Hostile Rivals?", *Paper presented at the 6<sup>th</sup> Midwest Political Science Association Annual Meeting*, Chicago, April 3-6, p.15

<sup>987</sup> Anders ASLUND and Andrew KUCHINS: (2009) "Pressing the 'Reset Button' on US-Russian Relations", CSIS, *Russia Balance Sheet*, No.PB09-6, March, p.2

<sup>988</sup> *Ibid.*

<sup>989</sup> Thomas GRAHAM: (2008) "US-Russian Relations – Facing Reality Pragmatically", CSIS/IFRI, p.5 Available on site [http://csis.org/files/media/csis/pubs/080717\\_graham\\_u.s.russia.pdf](http://csis.org/files/media/csis/pubs/080717_graham_u.s.russia.pdf) (Accessed on May 2009)

<sup>990</sup> Feodor LUKYANOV:(2009b) "What Next After Warheads and Ideologies?", *Russian Analytical Digest*, "US-Russian Relations", No.66, 20 October p.2

Russia to address many core global security issues including nuclear security and non-proliferation, terrorism, energy, and climate change.<sup>991</sup>

The US goods trade deficit with Russia was \$12,8 billion in 2009, down \$14,4 billion from 2008. US good exports in 2009 were \$5,4 billion, down 42,3% from the previous year. Corresponding US imports from Russia were \$18,2 billion, down 32%. Russia is currently the 28<sup>th</sup> largest export market for US goods.<sup>992</sup> The United States exports automobiles, machines and tools including tractors as well as agricultural goods, and imports raw materials, such as petroleum products and minerals. There is no energy relationship to speak of the United States interests in Russia are almost entirely strategic, starting with nuclear weapons and Russia's role in areas of key importance to the United States, especially Central Asia and the Caucasus.<sup>993</sup>

While America does not depend on Russian imports, the role of Russia as a major supplier of gas to Europe, as well as major producer of oil, make it a crucial actor in global energy markets and a factor in US energy security and economic development. It is a kind of a twilight zone for US policy makers that oil and gas incomes are making it possible for Russia to improve itself a super power and a challenger against American interests. As long as Russia supplies the oil and gas to the big markets, US economy will be vulnerable to these market movements. Yet, without Russian oil and gas, US economic interests would suffer as the price of oil would likely rise even higher.<sup>994</sup>

## **12.2. Energy Relationship Between Russia and the United States**

In recent years, trade between Russia and the US has grown fast but it is still on a low level. Since 2000, US exports to Russia have increased 22% per year an average while US

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<sup>991</sup> ASLUND and KUCHINS, p.1

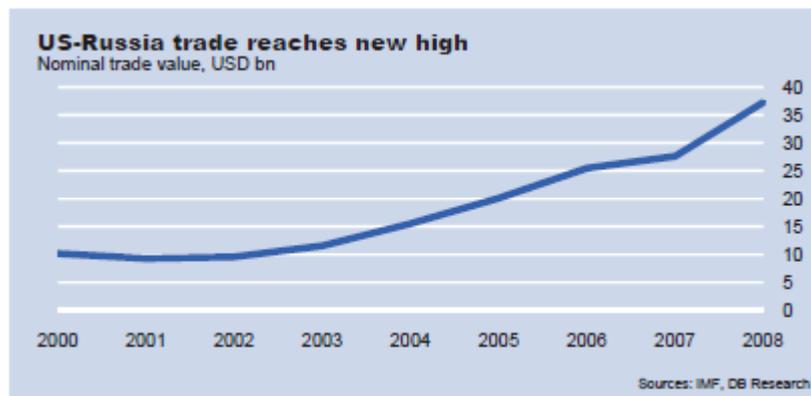
<sup>992</sup> 2009 National Trade Estimate Report on Foreign Trade Barrier: Russia, Available on site [http://www.ustr.gov/sites/default/files/uploads/reports/2010/NTE/2010\\_NTE\\_Russia\\_final.pdf](http://www.ustr.gov/sites/default/files/uploads/reports/2010/NTE/2010_NTE_Russia_final.pdf) (Accessed on 14 May 2010)

<sup>993</sup> Stephen F. SZABO: (2009) "Can Berlin and Washington Agree on Russia?", *The Washington Quarterly*, 32:4, October, 23-41p.30

<sup>994</sup> Eugene B. RUMER and Angela E. STENT: (2009) "Repairing US-Russian Relations: A Long Road Ahead", INSS and CERES, April Available on site <http://www.amacad.org/russia/report.pdf> (Accessed On May 2009) p.21-22

imports from Russia have risen 19% annually. Still, Russia accounted for only 0.7% of US exports and 1.3% US imports in 2008. Vice versa, the shares were slightly higher with the US accounting for 3.3% of Russia's exports and 4.4% of Russia's imports.<sup>995</sup> Energy security ranks as a top agenda issue in US politics. Since the oil-shocks in 1974 and 1978, energy security has been a prioritized issue among American politicians. The US economy is dependent on easy and plentiful access to cheap oil, coal and natural gas.<sup>996</sup> Hitherto, one of the most underdeveloped areas of the US-Russia relationship is commerce. One reason direct US investment in the Russian economy is so small is that the US does not have a ratified bilateral investment treaty (BIT) with Russia, unlike 38 other nations. Americans usually invest in Russia through a European subsidiary that enjoys better legal protection.<sup>997</sup>

**Figure 10: US-Russia Trade Reaches New High**<sup>998</sup>



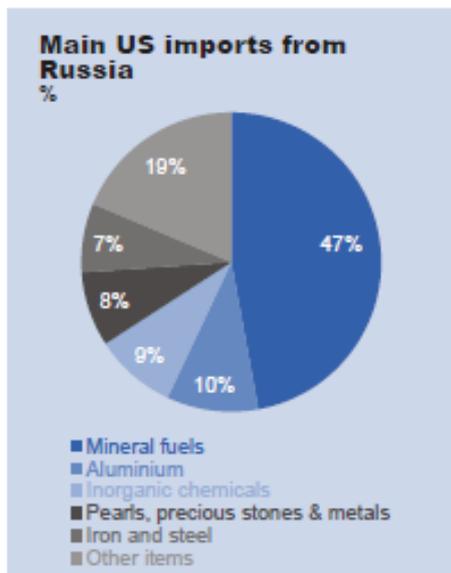
<sup>995</sup> Thoster NESTMANN: (2009) "US-Russia Economic Relations", Deutsche Bank Research, *Current Issues*, July 6, p.2 Available on site [http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000243816.pdf](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000243816.pdf) (Accessed on 15 May 2010)

<sup>996</sup> Guri BONG: (2010) "Energy Security and Climate Change: Triggers For Energy Policy Change in the United States?", *Energy Policy*, 38, p1645-1646

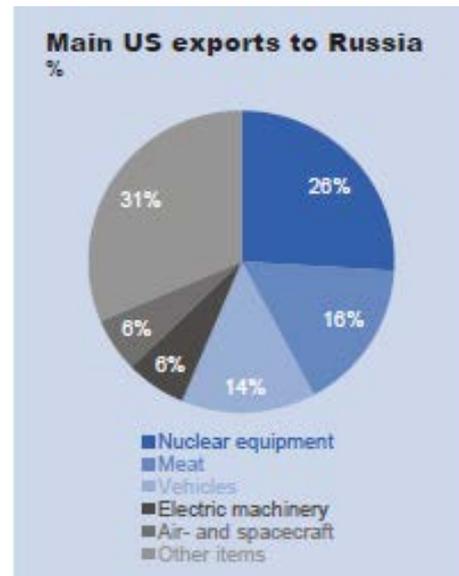
<sup>997</sup> ASLUND and KUSHINS, p.10

<sup>998</sup> NESTMANN, p.1

**Figure 11: US Imports From Russia**<sup>999</sup>



**Figure 12: US Exports to Russia**<sup>1000</sup>



The US exported more than US\$229 million worth of oil and gas field equipment and ports to Russia in January-September 2009. In 2008, these exports showed annual growth of 4% total more than \$422 million, after growing 33% in 2007 in and 50% over 2004-2006. In January-September 2009, the US imported more than 165 million barrels of crude oil and petroleum from Russia, an increase of 25% on the year. In 2008, imports grew 13% annually to 170 million barrels from 135 million barrels in 2007.<sup>1001</sup>

**Figure 13: Monthly US Imports from Russia of Crude Oil and Petroleum Products**<sup>1002</sup>

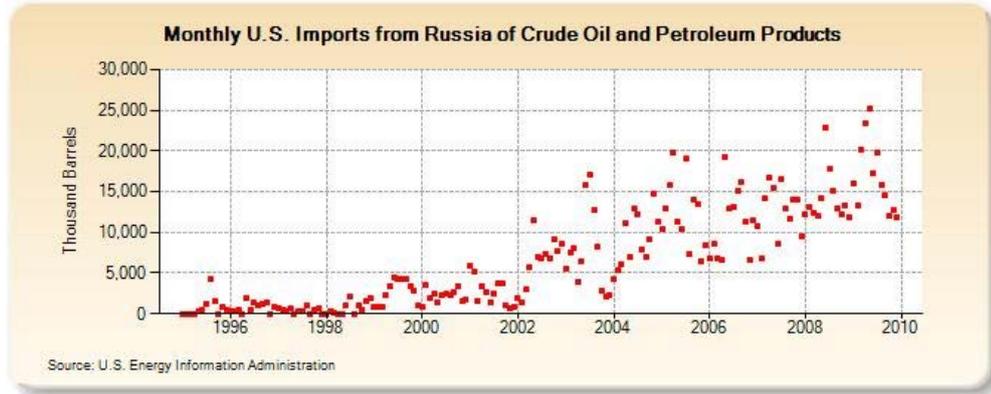
<sup>999</sup> Ibid, p.2

<sup>1000</sup> Ibid, p.3

<sup>1001</sup> The Russian Market: opportunities For The US Energy Sector (2010), Coalition for US-Russia Trade, September Available on site <http://www.usrussiatrade.org/documents/Energy.pdf> (Accessed on December 2010)

<sup>1002</sup> U.S. Energy Information Administration Available on site

[http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MTTIM\\_NUS-NRS\\_1&f=M](http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MTTIM_NUS-NRS_1&f=M) (Accessed on 30 January 2011)



**Table 34: US Imports From Russia of Crude Oil and Petroleum Products (Thousand Barrels)<sup>1003</sup>**

Year	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec
<b>2000</b>	898	3,485	1,952	2,481	1,359	2,242	2,412	2,276	2,655	3,427	1,485	1,710
<b>2001</b>	5,904	5,126	1,641	3,438	2,716	1,423	2,520	3,652	3,725	1,044	663	931
<b>2002</b>	1,877	1,420	2,956	5,750	11,487	6,944	6,814	7,305	6,763	9,153	7,663	8,558
<b>2003</b>	5,609	7,581	7,981	3,961	6,455	15,809	17,063	12,751	8,244	2,894	2,124	2,239
<b>2004</b>	4,227	5,347	6,027	11,155	7,016	12,963	12,293	7,938	7,029	9,143	14,711	11,302
<b>2005</b>	10,451	12,979	15,799	19,797	11,324	10,487	19,032	7,344	13,973	13,486	6,497	8,512
<b>2006</b>	6,776	8,524	6,805	6,589	19,248	12,904	13,164	15,049	16,103	11,332	6,702	11,450
<b>2007</b>	10,768	6,767	14,109	16,682	15,462	8,558	16,542	12,909	11,671	14,022	14,103	9,481
<b>2008</b>	12,155	13,083	12,466	12,053	14,268	22,914	17,740	15,185	12,999	12,214	13,343	11,844
<b>2009</b>	15,983	13,377	20,138	23,361	25,200	17,345	19,735	15,882	14,579	11,945	12,748	11,923
<b>2010</b>	14,353	11,850	15,115	17,604	22,293	22,791	22,295	24,371	19,427	20,298	16,579	

<sup>1003</sup> Ibid.

Energy consumption in the US has been steadily growing in the past several years due to a growing and economic development. For the time being, oil and natural gas production in the US is unstable and does not meet the growing demand. The US's dependence on oil import has grown from zero in 1950 to 50% by the 1980s and is expected to reach 70% by 2025.<sup>1004</sup> In 2002-03, there were business energy summits between Russian and US trade and energy ministers, which examined prospects for stimulating bilateral cooperation. After that, a new energy dialogue was initiated between Russia and the US; however, that dialogue went nowhere.<sup>1005</sup>

First in November 2002, four Russian companies (Yukos, Lukoil, TNK and Sibneft) formed a consortium to build \$3,5 billion oil pipeline from Western Siberia to Murmansk, with a planned capacity of around 100 m/t, to open in 2007. The line would have bypassed the Transneft system and opened up world markets, meaning America.<sup>1006</sup> Later in September 2003, more than 250 American officials and petroleum industry shared up on 22-23 September in St. Petersburg for the second Commercial Energy Summit.<sup>1007</sup> Shortly after that event, companies signed a Memorandum of Understanding on a project for the construction of a pipeline system to ship crude oil through a sea terminal near Murmansk which was estimated to cost roughly \$300 million.<sup>1008</sup> Unlike the ports of further east, the Kola fiord is ice-free year round and deep enough to receive super tankers with a dead weight of up to 300.000 tons. The distance from Murmansk to the US East Coast is only 9.300 kms, less than half the distance from the Persian Gulf to the East Coast (approximately 2.500kms).<sup>1009</sup>

After Yukos was renationalized towards strengthening state control over strategic sectors of industry became a kind of a Rubicon in Russia. Major American energy companies began to leave the country. McDermott pulled out of the Sakhalin II project and sold its

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<sup>1004</sup> A. BAGIROV: (2008) "Russia-US Cooperation and Global Energy Security", *International Affairs*, No.1, Vol.54, p.107

<sup>1005</sup> Ibid, p.102.

<sup>1006</sup> SAKWA: (2009), p.134.

<sup>1007</sup> Edward C. CHOW: (2003) "US-Russia Energy Dialogue: Policy, Projects, or Photo Op?", *Foreign Service Journal*, December, p.31-32.

<sup>1008</sup> Kristian AATLAND: (2007) "Russia's Northern Fleet and the Oil Industry – Rivals or Partners? A Study of Civil-Military Relations in the Post-Cold War Arctic", *Paper prepared for the 48<sup>th</sup> Annual Convention of the International Studies Association*, Chicago, February 28-March 3, p.11.

<sup>1009</sup> Ibid, p.10.

stake to Shell. ExxonMobil lost its license to Sakhalin III, while Chevron encountered problems with the Caspian Pipeline Consortium and the Sakhalin V project. Moreover, US companies were not permitted to participate in developing the Shtokman natural gas field on the Barents Sea shelf.<sup>1010</sup> As a result, Kremlin displayed its power that without its permission, nobody can think about to plan its own pipeline. However, Russian business had intensely interested in going access to the US market. For that reason, Gazprom, Rosatom, Russian Aluminium, Lukoil, and Rosneft, all want to enter or to expand their US presence, yet it is not so easy. Gazprom's 2006 decision to use Shtokman to supply piped gas to Europe rather than LNG to North America is in part a result of Russia's disappointment over the desired acquisition of gas networks along the US East Coast.<sup>1011</sup>

The July 2006 G-8 Summit in St. Petersburg, was a platform for Vladimir Putin and Russia's reemergence on the international stage. It was only six months after the Ukraine gas crisis, however, President Bush acted as though nothing had happened and attended the St. Petersburg G-Summit, which was hold as a celebration of Putin's role in Russia; the US concluded bilateral WTO negotiations with Russia in November 2006.<sup>1012</sup> The G-8 issued on "Energy Statement". From the statement of the summit:<sup>1013</sup>

"Energy is essential to improving the quality of life and opportunities in developed and developing nations. Therefore, ensuring sufficient, reliable and environmentally responsible supplies of energy at prices reflecting market fundamentals is a challenge for our countries and for mankind as a whole".

In August 2006, the Russian government announced that it wants to review the three major PSAs that it signed with Western and Japanese energy firms in the early 1990s. These three PSAs were negotiated when the price of oil was hovering around \$15 a barrel in the mid 1990s. The \$10 billion being invested in oil and gas extraction on Sakhalin represents the largest single foreign investment in Russia ever.<sup>1014</sup> Meanwhile the costs of the Exxon-led

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<sup>1010</sup> BAGIROV, p.107.

<sup>1011</sup> Dmitri Trenin, (2007a) "Russia Redefines itself and Its Relations with the West", *The Washington Quarterly*, 30:2, Spring, p.104.

<sup>1012</sup> ASLUND and KUCHINS, p.2.

<sup>1013</sup> Joseph FERGUSON: (2006) "US-Russia: Energy and Strategy", *Comparative Connections*, A Quarterly Europe-Journal on East Asian Bilateral Relations, Vol.8, No.3, p.55-56.

<sup>1014</sup> Peter RUTLAND: (2006) "Russia's Economic Role in Asia: Toward Deeper Integration", in Ashley J. Jellis and Micheal Wills (ed.) "*Strategic Asia 2006-07, Trade, Interdependence and Security*", The National Bureau of Asian Research, p.185.

consortium Sakhalin I development project would rise from an initial estimate of \$12 to \$17 billion. Exxon holds about 300 m/t of oil reserves in Sakhalin 1 and 150 m/t in Sakhalin 2. The Russian government has strongly warned Exxon-Mobil that it would forbid and further spending on the Sakhalin I project.<sup>1015</sup> On June 2004, the Russian government cancelled the license for the development of the Sakhalin 3 fields that had been won by Exxon-Mobil back in 1993. Presently, Rosneft holds 74,9% and Sinopec holds 25,1% stake in Sakhalin 3.<sup>1016</sup> The operator of Sakhalin II, Sakhalin Energy, was criticized by the government for alleged environmental violations that occurred during pipeline construction and came under pressure from the government for cost over-runs. In the wake of this pressure, members of the Sakhalin Energy Consortium (led by Shell) agreed to reduce their stakes by selling a controlling share to Gazprom. The two remaining PSAs are Exxon-Mobil-led Sakhalin I and Total led Kharyaga, both of which have come under pressure from various state bodies.<sup>1017</sup>

Chevron cooperation is one of the largest investors in Russia's oil and gas infrastructure, with US\$ 800 million invested in the Caspian Pipeline Consortium, a \$US 2.7 billion project with the majority of its investment focused in Russia. Chevron also sells lubricants in Russia through two wholly-owned subsidiaries.<sup>1018</sup> Chevron and Gazprom have also worked on joint ventures in the past, one of which was between Chevron's subsidiary Neftegaz and Gazpromneft since 2006. Chevron works jointly with Gazprom in exploring and developing Western Siberian oil fields.<sup>1019</sup>

### **12.3. Grand Game for Central Asia**

As a consequence of September 11, the US expanded its military presence in Central Asia, Caucasus and the Caspian Sea basin, areas traditionally viewed by Russia as its special sphere of influence.<sup>1020</sup> According to the geopolitical theory of Sir Halford Mackinder, control of its Eurasian Heartland, with its "incalculably great" resource base and central

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<sup>1015</sup> FERGUSON, p.57.

<sup>1016</sup> Rutland, (2006) p.185.

<sup>1017</sup> 2009 National Trade Estimate Report on Foreign Trade Barrier: Russia, p.426,.

<sup>1018</sup> The Russian Market: opportunities For The US Energy Sector (2010)

<sup>1019</sup> Live Oil Prices (2009) "*Oil Companies in Russia and the Foreign Investment Climate*", 26 November [http://www.liveoilprices.co.uk/oil/oil\\_companies/11/2009/oil-companies-in-russia-and-the-foreign-investment-climate.html](http://www.liveoilprices.co.uk/oil/oil_companies/11/2009/oil-companies-in-russia-and-the-foreign-investment-climate.html) (Accessed on 04 April 2010).

<sup>1020</sup> Özden Zeynep OKTAV: (2005) "American Policies Towards the Caspian Sea and The Baku-Tbilisi-Ceyhan Pipeline", *Perceptions*, Spring, p.30.

strategic location, was the key to global leadership.<sup>1021</sup> Russia and the US were the two main ‘architects’ of this post-Cold War transition in Central Eurasia in general, and Central Asia in particular, during the first half of the 1990s.<sup>1022</sup> According to Culler, the years 1989-1994 represent the “preservation” of US-Russian bipolarity in the region. The years 1995-2000 represent the destruction of that bipolarity as those new currents were “settling down” into pattern of international relations. And the years 2001-2006 represent the transcendence of that former superpower bipolarity.<sup>1023</sup>

Washington has consistently opposed Moscow’s interference in the affairs of the new independent states on its borders and sought to resist any kind of imperial revival. The US State Department/US Agency for International Development Joint Strategic Plan for the years 2007-2012, for example, describes aggressive Russian policies toward its neighbors as “a major challenge”.<sup>1024</sup> Moscow’s efforts of carving of a “sphere of privileged interests” in Eurasia and rewrite the rules of European security have negative implications for US-Russia relations, international security, the autonomy of the independent former Soviet states, and Europe’s independence.<sup>1025</sup>

The US is the world’s largest energy consumer, and securing access to global supplies of energy resources is a vital national interest. It does not heavily depend upon Eurasian sources of hydrocarbons, but the role of Eurasia in world energy markets is increasingly important.<sup>1026</sup> After the dissolution of the USSR, assuring access to Caspian resource has become an important strategic goal of Washington. US policy in the post-Soviet era has been directed toward facilitating the construction of multiple pipelines, allowing more equitable access that is not uniformly subject to Russian control. Therefore, US strategy

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<sup>1021</sup> Craig R. NATION: (2007b) “US Interests In The New Eurasia”, Russian Security Strategy Under Putin: US and Russian Perspectives, Strategic Studies Institution, November, p.1.

<sup>1022</sup> Robert M. CULLER: (2006) “US-Russian Strategic Relations and the Structuration of Central Asia”, *Perspectives on Global Development and Technology*, 21 August, p.10.

<sup>1023</sup> *Ibid*, p.11.

<sup>1024</sup> NATION: (2007b), p.4-5.

<sup>1025</sup> Ariel COHEN: (2009a) “How The Obama Administration Should Engage Russia”, *Testimony Before Senate Foreign Relations Committee Hearing on “Prospects For Engagement With Russia*, March 19, p.3 Available on site <http://www.heritage.org/research/testimony/how-the-obama-administration-should-engage-russia> (Accessed on May 2009).

<sup>1026</sup> NATION: (2007b), p.8-9.

was based on lessen Central Asian countries' degree of dependence upon Russia and encouraged leaning on the US as an alternative of foreign policy orientation.<sup>1027</sup>

The second half of the 1990s was a time of sharp confrontation in troubles between the US and Russia with American and Western penetration to Central Asia. When Moscow was dealing with the negative aspects of the transition economy, on 20 September 1994, former Soviet Republic, Azerbaijan signed a historic oil contract with leading Western energy companies (BP, Exxon, Amaco, Pezoil, Statoil, Unocal, Ramco and several others). It is called as "the Contract of the Century". This agreement has tied Azerbaijan oil supplies directly to Western markets just after few years of independence.<sup>1028</sup> Afterwards, Chevron began development in the Tengiz oil field in Kazakhstan as the principal investor.<sup>1029</sup>

The conflict between Russia and the Western powers regarding Caspian oil arose in full scale through the construction of the pipeline. The countries participating in the developments of the Caspian oil fields formed a consortium called the Caspian Pipeline Consortium (CPC) and began construction of the pipeline. In addition to that, Russia proposed a line to transport Caspian oil to its Black Sea port of Novorossiysk in order to secure its controlling position of the pipelines.<sup>1030</sup> The Baku-Tbilisi-Ceyhan (BTC) oil pipeline was first proposed by Turkey in 1992 and gained the strong support of the United States in the late 1990s. Completed in 2005, the pipeline was designed to bypass Russia and the Bosphorus strait in delivering crude oil from the Caspian region to Europe.<sup>1031</sup> While the agreement on the construction of the BTC oil pipeline was a large enough events to American interests that President Clinton valued it as the largest achievement of American foreign policy in 1999, to Russia it was a tremendous diplomatic loss, and an event that reduced Russia's influence in the region of the Caspian Sea.<sup>1032</sup>

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<sup>1027</sup> Ibid, p.10.

<sup>1028</sup> Fariz ISMAILZADE and Kevin ROSNER: (2006) *Russia's Energy Interest in Azerbaijan*, GMB Pub., p.9.

<sup>1029</sup> Younkyoo KIM and Gu-Ho EOM: (2008) "The Geopolitics of Caspian Oil: Rivalries of the US, Russia, and Turkey in the South Caucasus", *Global Economic Review*, 37:1, p.90.

<sup>1030</sup> Ibid.

<sup>1031</sup> Keith C. SMITH: (2010b) "Russia –Europe Energy Relations Implications for US Policy", *CSIS*, February, p.10 Available on site [http://csis.org/files/publication/100218\\_Smith\\_RussiaEuropeEnergy\\_Web.pdf](http://csis.org/files/publication/100218_Smith_RussiaEuropeEnergy_Web.pdf) (Accessed on 17 September 2009).

<sup>1032</sup> KIM and EOM, p.100.

Another major supported by the US is the long-discussed Nabucco gas pipeline, designed to transport Caspian gas to European markets via Turkey and the Balkans.<sup>1033</sup> Although US will not get any gas from concerning Nabucco pipeline, but it remains as the big supporter of the project. There are three reasons behind that strategy: Firstly, EU dependence on Russian gas should be reduced otherwise they are vulnerable to Russian political maneuvers. Secondly, if Central Asian gas could be transport via non-Russian pipelines that mean this would be their second day of independence. And finally, it is a psychological motive that to promote “You are not alone” in Central Asia. It is clear that Russia is aware of all of these US efforts, and as a reason they came up with the project of the South Stream, which designed with the intention of killing the Nabucco project; thus leaving Europe with no access to Caspian or Central Asian gas except via Russia. Smith says that;

US officials have made numerous trips to the region attempting to drum up support for Nabucco. The Azeris have reportedly questioned visitors as to why the US has appeared to be more supportive of diversifying Europe’s gas supplies than have the Europeans. At the “Nabucco Summit” in Budapest in January 2009, the Commission and the German delegation conspicuously fails to offer their backing for this alleged major priority project. At the conference, the Azeris and the Kazakhs appeared to be disappointed with the lack of European support for a project that they were prepared to support.<sup>1034</sup>

As a result, after the success of BTC pipeline, Russia took lessons and by the rise of Putin, updated its energy strategy to confront US particularly in its near abroad. So far, Russia has developed its relations with Central Asian states as well exception of Georgia. Although, US developed new pipeline projects for the region; so far Russia is signing contracts with resource-rich countries. Yet, this does not mean that US leave the region to the hands of Kremlin. It is clear that in the long-period, the two big powers will continue to compete for the domination of the region.

#### **12.4. Foreign Policy Crossroads**

After 9/11, relations between Moscow and Washington appeared to improve considerably. President Putin was the first world leader to telephone President Bush with words of

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<sup>1033</sup> SMITH: (2010b), p.10.

<sup>1034</sup> Ibid, p.11.

support after the 9/11 terrorist attacks in New York and Washington. Putin's strategic cooperation with the US after September 2001 even confronted opposition among the Red Army General Staff.<sup>1035</sup> Russia's eagerness to allow American access to airspace in Central Asia was a major reversal of Russian foreign policy and was viewed as such; it was said to be a symbol of just how significantly the Russian position on America had changed.<sup>1036</sup> Nevertheless, since the Iraq War, Kremlin championed the notion of 'multipolarity', in which US influence would be checked by Russia, China, India, and a swath of authoritarian states.<sup>1037</sup> Trenin describes the situation as "the US and Russian foreign policy agendas are very different. Washington's agenda is currently dominated by Iraq, terrorism and the proliferation of weapons of mass destruction. Washington and Moscow conflict more directly on the issue of US influence in the post-Soviet area."<sup>1038</sup>

Russia's relations with NATO, an organization which many in Russia consider to be an extension of US power and influence, have also improved since the establishment of the NATO-Russia Council (NRC) in 2002.<sup>1039</sup> The NATO-Russia Council (NRC), established by the 2002 Rome Declaration, built on the Russia NATO Founding Act of 1997, and provides a forum in which Russia and NATO meet as equals at 27, rather than in the NATO+1 format. Meetings are held at least monthly at the level of ambassadors and military representatives, twice yearly at foreign and defense minister and Chief of Staff level, and occasionally at summit level.<sup>1040</sup>

Addressing a security conference in Munich in February 2007, then President Vladimir Putin warned Western policymakers and analysts that further plans to expand NATO without regard for Russian interests would lead to a new Cold War.<sup>1041</sup> Russia is officially declared that it is opposed to possible NATO membership of Ukraine, Georgia and Azerbaijan. Saakashvili, according to many Russian leaders, is what Venezuelan President

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<sup>1035</sup> Robert M. CULLER: (2006) "US-Russian Strategic Relations and the Structuration of Central Asia", *Perspectives on Global Development and Technology*, 21 August, p.10

<sup>1036</sup> Kari ROBERTS: (2004) "Empire Envy: Russia-US Relations Post-9/11", *Journal of Military and Strategic Studies*, Vol.6, Issue 4, Summer , p.1-2

<sup>1037</sup> COHEN: (2009a) p.6

<sup>1038</sup> TRENIN: (2007a) p.102

<sup>1039</sup> MONAGHAN: (2006c) p.1000

<sup>1040</sup> Andrew MONAGHAN: (2006a) "Russia, NATO and the EU: A European Security Triangle or Shades of a New Entente?", *Russie.Nei.Visions*, IFRI, May, p.7

<sup>1041</sup> RUMER and STENT, p.3

Hugo Chavez is to the US.<sup>1042</sup> It is estimated that neither Georgia nor Ukraine will join NATO any time soon, but Obama's and Biden's comments made clear that the US remains supportive of their eventual membership and of keeping an open-door policy for NATO.<sup>1043</sup>

The most visible area of confrontation between US and Russian interests is in the Transcaucasian. The pivot of the area is Georgia a historically ally of Russia, where relations with Moscow began to deteriorate toward the end of Gorbachev's rule. After the last election of the President Saakashvili, the country took a decisively pro-American stand.<sup>1044</sup> In 2008 both Georgia and Ukraine applied for membership action plans (MAPs) to NATO. Putin responded that "if Ukraine ... was allowed to join NATO, this may bring into question Ukraine's existence as a sovereign state". After the NATO Summit, Russia quickly strengthened its support for the two parts of Georgian territories which are Abkhazia and South Ossetia. On August 7, Russian troops invaded parts of Georgia when international news channels were broadcasting live. Moreover, Russia formally recognized Abkhazia and South Ossetia as independent states.<sup>1045</sup>

By the invasion of Georgia, Russia shocked both US and Europe, because the expectation was optimistic about Medvedev in the West. Georgian crisis showed that the NATO expansion to these areas seems not possible in the near future. Instead of being part of the West, Georgia lost its control over the country as a result of the encouragement of the Western actors. Another reason what Smith says that, further NATO enlargement has been stopped, in part, due to Moscow's energy ties with the wealthier Western European states. The US government's ability to influence European energy policy has significantly diminished over time.<sup>1046</sup>

Few months later, the US decision to secure sites in Poland and the Czech Republic, in order to place a radar station and an antimissile battery capable of intercepting missiles

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<sup>1042</sup> TRENIN: (2007a) p.102

<sup>1043</sup> David J. KRAMER: (2010) "Resetting US-Russian Relations: It Takes Two", *The Washington Quarterly*, 33:1, January, p.63

<sup>1044</sup> Micheal RYWKIN: (2008) "Russia: In Quest of Superpower Status", *American Foreign Policy Interests*, 30:1, p.17.

<sup>1045</sup> ASLUND and KUCHINS, p.3

<sup>1046</sup> Keith C. SMITH: (2010) p.1

coming from a south-eastern direction, created an immediate hostile reaction from Moscow.<sup>1047</sup> On November 2008, a few hours after the election of Barack Obama as US President, President Dmitri Medvedev held his first annual address to the Russian parliament. Ignoring the newly elected US President Medvedev announced that Russia may deploy Iskander tactical ballistic missiles in the Kaliningrad exclave, targeting Poland and Czech Republic since they had accepted American missile defense installations.<sup>1048</sup> Lavrov says that “Washington’s unilateral plans to deploy elements of the US missile defense system in Europe are also in the ‘Russia containment’ mentality.”<sup>1049</sup> Kramer thinks that, Medvedev’s threat against the Czech Republic and Poland days after meeting with Obama, and his visit to South Ossetia a week after Obama’s visit to Moscow, should be read as a warning that the current Russian President will be no pushover when it comes to standing up to the United States.<sup>1050</sup>

Obama has changed course on US policies that have most irritated Russia. First, in a letter to Dmitri Medvedev in February 2009, Obama hinted that the US might not build missile defense sites in Europe after all. Second, the US President has poured cold water on NATO enlargement to Georgia and Ukraine, neglecting to mention the two countries in his first speech to the alliance in April.<sup>1051</sup> Shortly after, Vice President Joseph Biden set the line of the Obama administration on US-Russia relations in his speech in Munich on February 7, 2009, when he stated: “It is time to press the reset button and to revisit the many areas where we can and should work together. He also stated that “the US and Russia can disagree and still work together where our interests coincide”.<sup>1052</sup>

After meeting with Medvedev in April 2009 in London, Obama went to Moscow in July where he and Medvedev issued a number of joint statements and understandings. The most notable areas were on the transit of US equipment across Russian territory for forces needed in Afghanistan and a framework for an arms control treaty. He demonstrated a

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<sup>1047</sup> RYWKIN, p.18

<sup>1048</sup> ASLUND and KUCHINS, p.3

<sup>1049</sup> Sergei LAVROV: (2007) “Containing Russia: Back to the Future?”, *Russia in Global Affairs*, No.4, October-December, p17

<sup>1050</sup> KRAMER, p.74

<sup>1051</sup> Tomas VALOSEK: (2009) “Obama, Russia and Europe”, Centre for European Reform, *Policy Brief*, June, p.1

<sup>1052</sup> ASLUND and KUCHINS, p.6

desire to develop a new tone in the bilateral dialogue and ‘reset’ relations with Russia.<sup>1053</sup>  
Joint statement by President Barack Obama and President Dmitri Medvedev of Russia:<sup>1054</sup>

“While acknowledging that differences remain over the purposes of development of missile defense assets in Europe, we discussed new possibilities for mutual international cooperation in the field of missile defense, taking into account joint assessments of missile challenges and threats, aimed at enhancing the security of our countries, and that of our allies and partners. The relationship between offensive and defensive arms will be discussed by the two governments.”

On 18 and 19 June 2009, the US Senate and House of Representatives passed resolution describing the imprisonment of the two men as politically motivated and called for the charges against them to be dropped. Nevertheless, the Khodorkovsky case provides the US Congress with an excuse to keep Russia under the Jackson-Vanik amendment.<sup>1055</sup> Khodorkovsky has faced a new trial scheduled to begin around April 1 around the same time Presidents Obama and Medvedev meet in London for the first time. The trial was widely believed to be a political revenge and to have no legal merit.<sup>1056</sup>

Russia's strengthening position on the Iranian question, which took place in 2009 definitely resulted from Obama's decision to reject placing missile defense sites in Poland and Czech Republic at that time.<sup>1057</sup> Russia's interests in Iran are well known and span from billions in arms sales and sales of nuclear technology to lucrative oil and gas contracts for Russian companies on- and offshore. This serves the dual purpose of keeping the US and its allies pre-occupied and preventing Western Companies from helping Iran to send its gas West through the proposed Nabucco gas pipeline.<sup>1058</sup> Moreover, with Russian President Dmitri Medvedev at his side, Bakiyev announced in Moscow in 2009 that he wants the US to

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<sup>1053</sup> KRAMER, p.61

<sup>1054</sup> Joint Statement by President Barack Obama and President Dmitry A. Medvedev of Russia, (1 April 2009) The White House Available on site [http://www.whitehouse.gov/the\\_press\\_office/Joint-Statement-by-Dmitriy-A-Medvedev-and-Barack-Obama/](http://www.whitehouse.gov/the_press_office/Joint-Statement-by-Dmitriy-A-Medvedev-and-Barack-Obama/) (Accessed on 01 May 2009)

<sup>1055</sup> Henry Plater ZYBERK: (2009) “US-Russia Strategic Relations: Obama and Biden Visit Moscow, Tbilisi and Kiev – Planned Contradictions?”, *Defense Academy of the UK*, 09/10, August, p.2-9; “Jackson-Vanik amendment of the Trade Act of 1974 was aimed at allowing religious minorities, mainly Jews, to emigrate from the USSR. After a unanimous vote of support by both houses of the US Congress, President Ford signed the amendment into Law in January 1975. The Russians regard the amendment as a Cold War weapon used inappropriately in the post Cold War in order for Washington to advance its trade and political interests in Russia.”

<sup>1056</sup> COHEN: (2009a) p.11.

<sup>1057</sup> LUKYANOV: (2009a) p.3.

<sup>1058</sup> COHEN: (2009a) p.7.

leave Manas Air Base, key military cargo hubs at the airport of the Kyrgyz capital Bishkek that has been used by NATO and US troops in Afghanistan since 2001.<sup>1059</sup> This picture was a message to US that honey moon in Central Asia was over. With this move, the Kremlin signaled the West that to gain access to Central Asia's Western countries must first request permission from Moscow and pay the Kremlin for transit.<sup>1060</sup> According to Trenin, US global hegemony is directly challenged by Russia's regional great power ambitions.<sup>1061</sup>

As a result, it is inevitable that Russia will be a key element of a wide array of policies to the Obama administration, including dealing with Iran and the construction of a broader nonproliferation regime, energy security, nuclear arms reductions, and Afghanistan. Russia policy will also be central to US designs for NATO, including how to deal with Georgia and Ukraine.<sup>1062</sup> According to Baran, diversification away from Russian energy is not only important for the European and the Euro-Atlantic community's safety and security, but also because of the essential role that it plays in the democracy efforts in Central and Eastern Europe –as well as in other parts of the former Soviet space such as the Caucasus and Central Asia.<sup>1063</sup>

### **13. RUSSIA AND TURKEY - ENERGY COOPERATION OR RIVALRY**

Turkey controls the Bosphorus and the Dardanelle Straits, the only maritime “entrance” to the Black Sea region. They are strategically important for the entire region because the countries located to the Black Sea carry out either most or a very big part of their trade via this maritime route. Turkey is also considered as a “natural” bridge between Central Asia,

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<sup>1059</sup> Ibid, p.5

<sup>1060</sup> Samuel CHARAP, Laura CONLEY, Peter JUUL, Andrew LIGHT, and Julian WONG: (2009) “After the ‘Reset’: A Strategy and New Agenda for US Russia Policy”, *Center for American Progress*, July, p.18 Available on site [http://www.americanprogress.org/issues/2009/07/after\\_reset.html](http://www.americanprogress.org/issues/2009/07/after_reset.html) (accessed August 2009)

<sup>1061</sup> Dmitri TRENIN: (2008c) “Thinking Strategically About Russia”, *Carnegie Endowment for International Peace*, December, p.2 Available on site [http://www.carnegieendowment.org/files/thinking\\_strategically\\_russia.pdf](http://www.carnegieendowment.org/files/thinking_strategically_russia.pdf) (Accessed on 23 May 2010).

<sup>1062</sup> SZABO, p.23

<sup>1063</sup> Zeyno BARAN: (2007a) “Central and Eastern Europe: Assessing the Democratic Transition”, *Testimony for US House of Representatives Committee on Foreign Affairs*, Serial No.110-102, July 25, p.9 Available on site <http://foreignaffairs.house.gov/110/36990.pdf> (Accessed on 14 May 2009).

the Caucasus and Europe.<sup>1064</sup> In terms of being a transporter country, compared to Russia, Turkey stands in an entirely different relationship to the Caspian. Unlike the Caspian, Russian borders the EU, has access to international ports and is an established and significant exporter to the West. Turkey is therefore, more likely to compete with Russia for the transit of Caspian exports than to become its energy transit route.<sup>1065</sup>

Concerning the oil transportation, according to the Turkish Ministry of Foreign Affairs, 3,7% of the world's daily oil consumption is shipped through the Turkish straits.<sup>1066</sup> On the other hand Turkey is an immense consumer of gas and dependent on imports. Currently, natural gas is carried from Russia to Turkey via two routes: The eastern branch of the Trans-Balkan pipeline, which reaches Turkey via Ukraine, Romania and Bulgaria (completed in 1987 during the Soviet Union) and Blue Stream, which runs from Isobilnoye, Russia to the Black Sea port of Dzhughba, then beneath the sea, to Samsun on the Turkish Black Sea Coast.<sup>1067</sup> Turkey's demand for natural gas has grown more than three-fold in the last decade. At the moment, Turkey is not short of gas. On the contrary, the long-term contracts that it has signed with Russia, Iran and other suppliers commit it to buying more than it actually needs. Therefore, Turkey needs to build infrastructure for storing gas in order to re-export the gas to the third countries.<sup>1068</sup>

**Table 35: Turkey's Natural Gas Supply and Demand Forecast (bcm)<sup>1069</sup>**

Year	2003	2004	2005	2006	2007	2008	2009	2010	2020
Total demand	24	30,8	32,2	46	47,9	49,5	52,2	55,1	82,8
Contracted volumes									
Russia	6	6	6	6	6	6	6	6	-
Russia	8	8	8	8	8	8	8	8	8

<sup>1064</sup> Adam BALCER: (2009) "The Future of Turkish-Russian Relations: A Strategic Perspective", *Turkish Policy Quarterly*, Vol.8, No.1, Spring, p.82

<sup>1065</sup> Ali TEKIN and Iva WALTEROVA: (2007) "Turkey's Geopolitical Role: The Energy Angle", *Middle East Policy*, XIV, No.1, Spring, p.89

<sup>1066</sup> Arda BAYKAL: (2009) "Turkey's Energy Politics", *House of Commons Library*, SN/IA/5301, International Affairs and Defense Section, 27 January, p.5.

<sup>1067</sup> Gülden S. AYMAN: (2009) "Turkey Courts Russia on Energy", *Institute Thomas Moore*, September 8, p.1 Available on site [http://www.institut-thomas-more.org/pdf/370\\_en\\_GAyman-Sept2009.pdf](http://www.institut-thomas-more.org/pdf/370_en_GAyman-Sept2009.pdf) (Accessed on 24 April 2010).

<sup>1068</sup> Katinka BARYSCH: (2007) "Turkey's Role In European Energy Security", *Centre For European Reform*, Essays, December, p.2 Available on site [http://www.cer.org.uk/pdf/essay\\_turkey\\_energy\\_12dec07.pdf](http://www.cer.org.uk/pdf/essay_turkey_energy_12dec07.pdf) (30 September 2009).

<sup>1069</sup> Gareth M. WINROW: (2004) "Turkey and the East-West Gas Transportation Corridor", *Turkish Studies*, 5:2, p.29

(Turusgaz)									
Russia (Blue Stream)	2	4	6	8	10	12	14	16	16
Iran	5	6	7	9	10	10	10	10	10
Azerbaijan	-	-	-	2	3	5	6,6	6,6	6,6
Turkmenistan	-	-	-	5	7,2	7,2	8,2	9,2	16
Algeria (LNG)	4	4	4	4	4	4	4	4	-
Nigeria (LNG)	1,2	1,2	1,2	1,2	1,2	1,2	1,2	1,2	1,2
Total supplies	25,9	28,8	31,8	42,4	48,4	52,3	56,8	59,7	56,1

Turkey and Russian federation signed protocols under three subjects to improve cooperation in the energy field; gas, oil and nuclear energy. The protocol on extension of gas agreement has signed which was originally scheduled to expire in 2011. While Turkey gets more gas from Russia, in return Turkey officially allows to Russia to carry out feasibility studies to route South Stream gas pipeline through Turkey's exclusive economic zone which is the rival project to Nabucco. And finally, Turkey's Atomic Energy Agency and Russia's RUSATOM also signed two separate agreements for use of nuclear energy for peaceful purposes, and for early notification of nuclear accidents.<sup>1070</sup> According to Russian scholar Sotnikov, the winning of the contract to construct the Akkuyu nuclear power plant by the Rosatom-led Russian-Turkish consortium in a competition against 14 companies highlighted the current positive trend in the relations between Russia and Turkey, in general and in the nuclear energy sector in particular. He also adds that the Russian nuclear energy sector must be credited with major success for winning the contract to construct the Akkuyu nuclear power plant, especially in the light of the fact that Turkey is a NATO country with special ties with the US.<sup>1071</sup>

### Map 31: Gas Pipelines of Turkey<sup>1072</sup>

<sup>1070</sup> AYMAN, p.1

<sup>1071</sup> Vladimir SOTNIKOV: (2010) "Russia to Build Nuclear Power Plant in Turkey", RIA Novosti, 08 June [http://en.rian.ru/international\\_affairs/20100608/159347024.html](http://en.rian.ru/international_affairs/20100608/159347024.html) (Accessed on 08 June 2010).

<sup>1072</sup> Turkey's Energy Strategy", Republic of Turkey, Ministry of Foreign Affairs (January 2009) Deputy Directorate General for Energy, Water and Environment Available on site [http://www.mfa.gov.tr/data/DISPOLITIKA/EnerjiPolitikasi/Turkey's%20Energy%20Strategy%20\(Ocak%202009\).pdf](http://www.mfa.gov.tr/data/DISPOLITIKA/EnerjiPolitikasi/Turkey's%20Energy%20Strategy%20(Ocak%202009).pdf) (Accessed on 10 May 2010)



### 13.1. Blue Stream Pipeline

In 1996, Russia made an offer to Turkey to supply additional natural gas via an offshore pipeline under the Black Sea. In December 1997, the Blue Stream agreement was signed between the two countries. It was executed through the creation of a joint venture between Gazprom and Italy's ENI.<sup>1073</sup> Gas flows from Russia to Turkey via Blue Stream started in 2003. The total length of the pipeline is 1,213 km and the subsea section is 396 km long. The total cost of the Blue Stream pipeline was 3.2\$ bil.<sup>1074</sup> During the official opening ceremony for the Blue Stream gas pipeline in Turkey in November 2005, the Russian energy and industry minister, Victor Khristenko, spoke of the future construction of

<sup>1073</sup> Kevin ROSNER: (2006) "Gazprom and the Russian State", GMB Pub., p.51.

<sup>1074</sup> Yurdakul YİĞİTGÜDEN: (2010) Turkey – Turning the European Periphery Into An Energy Hub?", in Kristen Linke and Marcel Victor (ed.) "Prospect of a Triangular relationship? Energy Relations Between the EU, Russia and Turkey", Friedrich Ebert Stiftung, April, p.14

another undersea pipeline, this time under the Mediterranean that would carry Russian gas exports from Turkey to Israel.<sup>1075</sup>

### **13.2. Blue Stream Pipeline II**

A second gas pipeline, parallel to Blue Stream, was first mentioned by the Russian side in 2002. In August 2005, then President Putin officially proposed the building of the Blue Stream II gas pipeline to the Turkish Prime Minister. The Blue Stream II pipeline was intended to supply gas to Turkey and the Middle Eastern countries, including Israel.<sup>1076</sup> In 2007, Putin shelved the Blue Stream II and instead came up with the South Stream project. In 2009, the Russian Prime Minister Vladimir Putin proposed a revised “Blue Stream II” parallel to existing Blue Stream pipelines, but to connect to trans-Turkey Ceyhan pipeline in order to supply Syria, Lebanon, Israel and Cyprus.<sup>1077</sup>

### **13.3. Nabucco Gas Pipeline**

It was estimated that gas reserves at Azerbaijan’s Shah Deniz field would sufficiently supply for the Nabucco pipeline’s first commercial phase, from 2013 onward, via Georgia. However, investors would expect second-phase supplies to be identified by the time construction work starts on the pipeline’s first phase. Second-phase supplies can come from Central Asia via Azerbaijan and Georgia, if Brussels and Washington can coordinate a commercial and transport package offer to Central Asian producer countries.<sup>1078</sup> Western countries support Turkey as an alternative route from the Caspian to create competition to Gazprom and Russia. Furthermore, some Caspian producers also perceive Turkey as a better transit country for their exports. This fuels the rivalry between Russia and Turkey in

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<sup>1075</sup> Fiona HILL and Ömer TAŞPINAR: (2006) “Russia and Turkey in the Caucasus: Moving Together to Preserve the Status Quo?”, IFRI, *Russie.Nei.Visions*. No.28, January, p.8

<sup>1076</sup> YİĞİTGÜDEN, p.14

<sup>1077</sup> BAYKAL, p.13

<sup>1078</sup> Vladimir SOCOR: (2008a) “Sourcing the Nabucco Pipeline to Prevail Against South Stream”, *Eurasia Daily Monitor*, Vol., Issue 25, February 2, p.1 Available on site [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=33365](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=33365) (Accessed on 10 January 2010).

the energy field and forces Russia to take into consideration the importance of Turkey in the geopolitics of the region.<sup>1079</sup>

In June 2009 Russia has signed the agreement for early gas purchases from Azerbaijan starting from 2010. This had diminished the European hopes of securing gas from Azerbaijan via Nabucco. In addition to the Azerbaijan deal with Russia, Turkmenistan's signing a 30 year agreement for supplying gas to China also narrowed the capacity of Nabucco project.<sup>1080</sup> It is a reality that Nabucco could make a higher difference to Turkey's role as an energy hub. However, there is real uncertainty on the subject of the supplier. Nabucco's gas would come from Azerbaijan and possibly Turkmenistan, and maybe one day Iran and Iraq too. Because of this uncertainty, it is not the ultimate suppliers and buyers that are planning the pipeline but a consortium of companies from the transit states.<sup>1081</sup> Analysts say that the Nabucco Gas Pipeline will be a white elephant initially because there is not enough gas ready to flow into the pipeline that is supposed to carry about 30 bcm of gas a year to Central Europe.<sup>1082</sup> And finally Martimer quotes to Stern by saying;

J. Stern has researched the qualities coming on stream from the gas fields of Azerbaijan, Turkmenistan, Iraq and Iran. These countries have vast amounts of gas below ground; but haven't developed their fields to the point where there are sufficiently large quantities ready to top. "There will not be 30 bcm of Caspian and Middle Eastern gas available for any pipeline –Nabucco or any other- until about 2020", Stern says.<sup>1083</sup>

#### **13.4. Samsun-Ceyhan Oil Pipeline (SCPa)**

Samsun-Ceyhan Pipeline project which is also known as Trans-Anatolian Pipeline is planned to carry crude oil between Black Sea oil terminal in Samsun and Mediterranean oil terminal in Ceyhan in Turkey. The 550 km pipeline has a nominal capacity of 1.5mil b/d. ENI of Italy and Çalık Holding of Turkey are developing the project jointly. The ground-

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<sup>1079</sup> TEKIN and WALTEROVA, p.90

<sup>1080</sup> AYMAN, p.3

<sup>1081</sup> BARYSCH: (2007) p.4.

<sup>1082</sup> Jasper MARTIMER: (2009) "Reducing Natural Gas Dependence on Russia", *Pipeline and Gas Journal*, February, p.44.

<sup>1083</sup> Ibid.

breaking ceremony was held on 24 April 2007 in Ceyhan.<sup>1084</sup> The aim of this project is to provide an alternative route for Russian and Kazakhstan's oil and also ease the traffic burden of the Bosphorus and the Dardanelles.<sup>1085</sup> SCPa is a significantly strategic for both Russia and Turkey. Although Turkish NATO partners desire to reach the Central Asian oil by non-Russian pipelines, Turkey insisted on this project in accordance to its national interests. After Russian and Kazak oil arrive to Ceyhan port in the Mediterranean, there is a possibility to construct a pipeline to Israel, and then pump it to the Gulf of Aqaba, where the supertankers will wait for the carry them to India.<sup>1086</sup> As a result, Turkey and Russia will progress one more step in the interdependence of each other.

**Map 32: Samsun-Ceyhan Pipeline**<sup>1087</sup>



### 13.5. Impacts of Georgia Conflict to Russia and Turkey Relations

Concerning the Black Sea, Turkey and Russia two times opposed American proposal in 2006 about American entrance into region by the way of international organizations. The first one was the inclusion of the US in the Black Sea Economic Cooperation (BSEC), an organization which was established in 1992. The second was the extension of NATO led

<sup>1084</sup> YİĞİTĞÜDEN, p.15, Vlad POPOVICI: (2009) "Black Sea Region Stands At Energy Crossroads", *Oil and Gas Journal*, 107, 45, December 7, p.59

<sup>1085</sup> AYMAN, p.3

<sup>1086</sup> Ibid.

<sup>1087</sup> Vladimir SOCOR: (2009b) "Russia Shows Interest in Samsun-Ceyhan Oil Pipeline Proposal", *Eurasia Daily Monitor*, Vol.6, Issue.157, August 14, Available on site [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=35415](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=35415) (Accessed on 10 September 2009)

Operation Active Endeavour into the Black Sea. Turkey was more concerned that NATO or the presence of ships belonging to non-riparian states would require modification of the Montreux Convention and provoke Russia.<sup>1088</sup> Ankara has resisted expanded NATO operations in the Black Sea, arguing that they are unnecessary and will only feed Russian fears of encirclement, including stability in the Caucasus.<sup>1089</sup>

NATO sent a small flotilla of warships through the Turkish straits in late August in the wake of the Russian-Georgian hostilities. The flotilla comprised of three American warships and support vessels from Spain, Germany and Poland. Moscow has subsequently accused Turkey of breaching the 1936 Montreux convention, an allegation that may have consequences for Turkey's energy security.<sup>1090</sup> Moreover, immediately after the invasion, Anatoly Nogotitsyn, Deputy Chief of Russia's General Staff, warned Ankara that Moscow would hold Turkey responsible for allowing US navy ships through the Turkish Straits to provide humanitarian assistance to Georgia and US ships should not remain in the Black Sea for more than three weeks, as stipulated by the Montreux Convention.<sup>1091</sup> On the other hand, in order to pressure the Turkish government to invoke the Montreux Convention, Russia did not want US military ships to transit the Black Sea to provide aid to war-devastated Georgia and Russian customs officials began targeting Turkish truck shipments for increased scrutiny. As a result, hundreds of Turkish trucks stopped at the Russian border, Ankara threatened Moscow with retaliation, but then quickly backed off. Ankara reneged that, as Turkish PM Erdoğan put it, “otherwise we would be left in the dark”.<sup>1092</sup>

Despite Turkey's strategic energy and transport relationship with Georgia as a conduit for the BTC and Baku-Tbilisi-Erzurum (BTE) pipelines and the Baku-Tbilisi-Kars railway, Ankara tried to play the role of a mediator between Moscow and Tbilisi after Russia's August 2008 invasion of Georgia. It was also striking that, while much of the West still

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<sup>1088</sup> Lema K. YANIK: (2007) “Allies or Partners? An Appraisal of Turkey’s Ties to Russia 1991-2007”, *East European Quarterly*, XLI, No.3, September, p.357, Hill, and Taspinar, p.10.

<sup>1089</sup> KUCHINS and PETERSEN, p.67.

<sup>1090</sup> Alexander MURINSON: (2008) “Russia Accuses Turkey of Violating Montreux Convention”, *Central Asia-Caucasus Institute*, October 15, Available on site <http://www.cacianalyst.org/?q=node/4960> (Accessed on 13 March 2010).

<sup>1091</sup> Tuncay BABALI: (2009) “Turkey At The Energy Crossroads”, *Middle East Quarterly*, Vol.19, Issue 2, Spring, Available on site <http://www.meforum.org/2108/turkey-at-the-energy-crossroads> (Accessed on 02 May 2010).

<sup>1092</sup> KUCHINS and PETERSEN, p.67

invoking new Cold War imagery after the Georgia war, in September Turkey signed a contract for \$70 mil to receive Russian antitank guided missiles;<sup>1093</sup> that is Moscow's first arms sale to the NATO member in 11 years.<sup>1094</sup> Turkey's increasing dependence on Russian energy imports also restricted its freedoms of maneuver: there was little criticism of the Russian military operation by the Turkish government. The situation is even more complex because Turkey has provided considerable support to the armed forces of Georgia, helping them to adapt to NATO standards.<sup>1095</sup> As a result in the immediate aftermath of the Russian invasion of Georgia on 8 August 2008 doubts were raised about the security of the gas pipeline network in the Southern Caucasus Stability and Cooperation Platform. Aware of Turkey's energy dependence on Russia, Turkey could not afford to jeopardize relations with Moscow.<sup>1096</sup>

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<sup>1093</sup> Ibid.

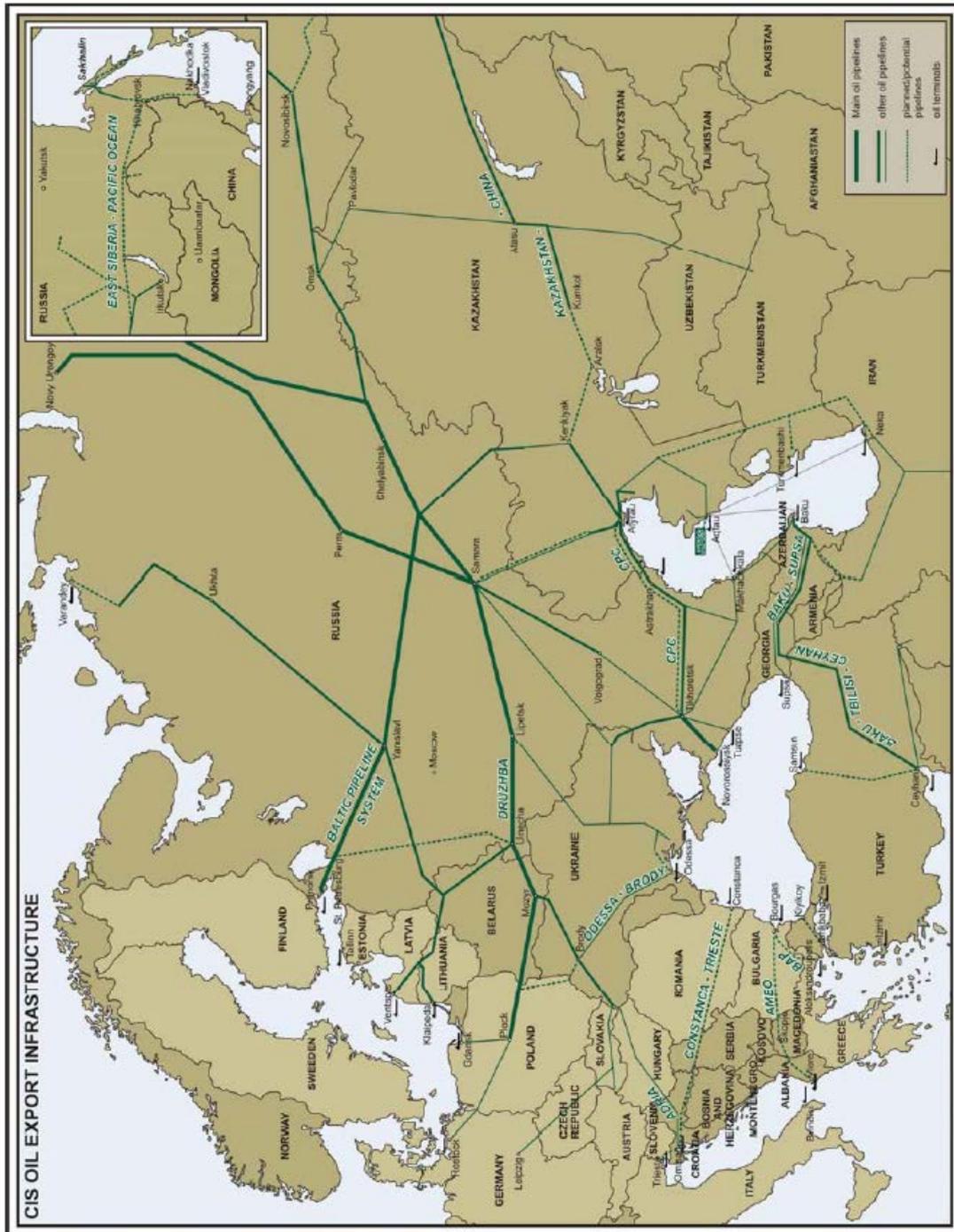
<sup>1094</sup> Nabi ABDULLAEV: (2008) “*Turkey Buys 80 Russian Anti-Tank Missile Systems*”, Defense News, 23 September <http://www.defensenews.com/story.php?i=3737946> (Accessed on 20 May 2010).

<sup>1095</sup> Stefan MEISTER: (2010) “The EU, Russia and Turkey – Prospects of an Energy Triangle?”, in Kristen Linke and Marcel Victor (ed.) “*Prospect of a Triangular relationship? Energy Relations Between the EU, Russia and Turkey*”, Freidrich Ebert Stiftung, April, 22-27, p.25.

<sup>1096</sup> WINROW: (2009) p.4.

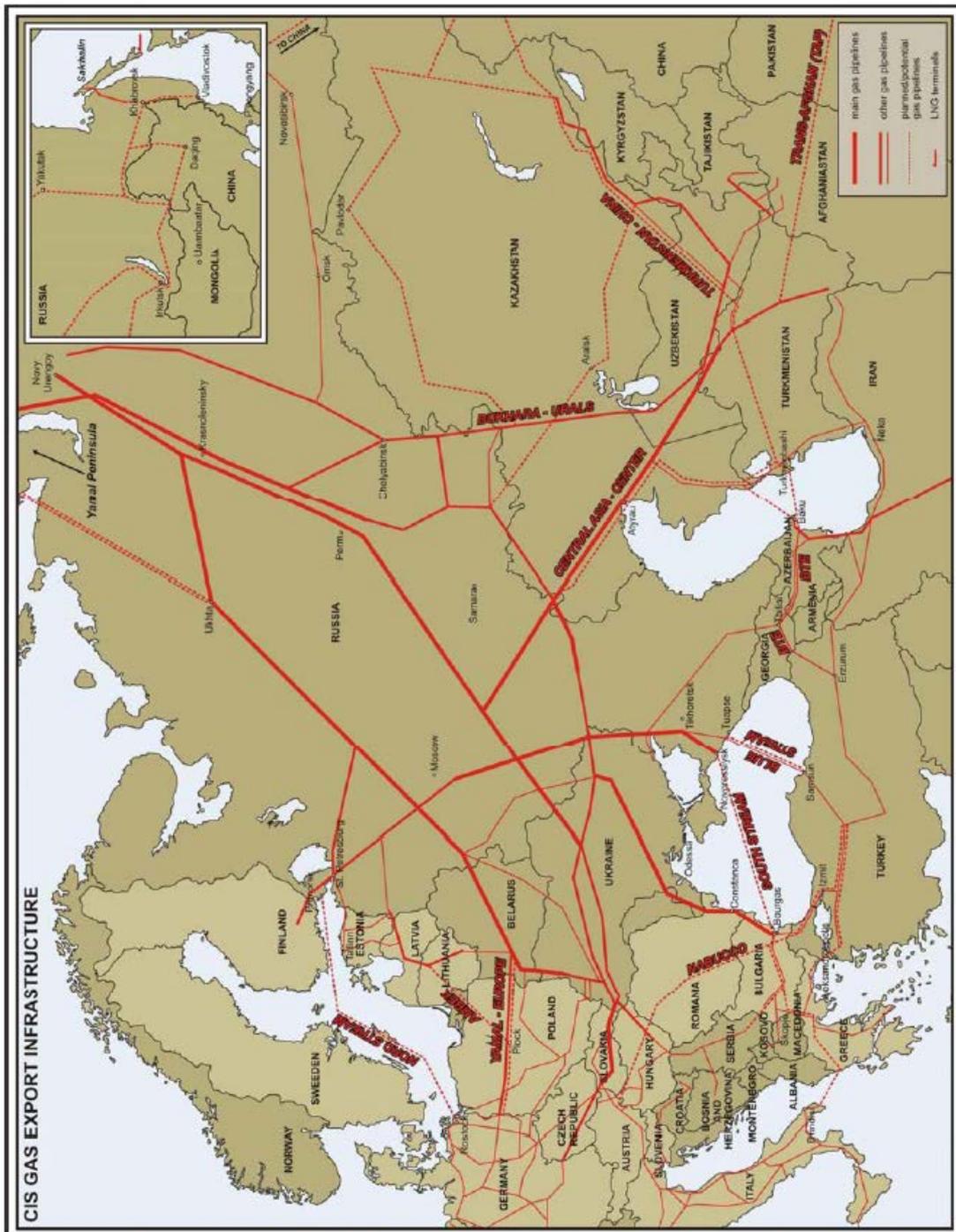
**CHAPTER FIVE**  
**RUSSIAN FOREIGN ENERGY RELATIONS WITH NEAR ABROAD AND**  
**CHINA**

**Map 33: CIS Oil Export Infrastructure**



Source: European Commission (2008) “The Economic Aspects of the Energy Sector in CIS Countries”, Case (Centre for Social and Economic Research, Economic Papers 327, June, p.189 Available on site [http://ec.europa.eu/economy\\_finance/publications/publication12678\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication12678_en.pdf) (Accessed February 2009).

**Map 34: CIS Gas Export Infrastructure**



Source: European Commission (2008) “The Economic Aspects of the Energy Sector in CIS Countries”, Case (Centre for Social and Economic Research, Economic Papers 327, June, p.190 Available on site [http://ec.europa.eu/economy\\_finance/publications/publication12678\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication12678_en.pdf) (Accessed February 2009).

#### 14. RUSSIAN ENERGY RELATIONS WITH UKRAINE, BELARUS AND MOLDOVA

## 17.1. Russia-Ukraine Energy Relations

Ukraine is the second largest gas importer from Russia after Germany with 24,5 bcm, while producing 19,3 bcm in 2009 and fourth biggest gas consumer in Europe with 47 bcm of gas.<sup>1097</sup> Moreover, Ukraine oil consumption in 2009 was 14,1 m/t with a high dependence on Russian oil. Ukraine is also a oil transporter country as well as gas, which it transported 17,3 m/t of Russian oil in 2009.<sup>1098</sup> Ukraine is importing gas currently from both Russia and Turkmenistan. At the same time, it is a major transit corridor for Russian gas sales to Europe (100 bcm), although the pipeline system is aged and have technical problems in its operations.<sup>1099</sup> Russia and Ukraine has been dealing with problems almost since the beginning of the dissolution of the USSR mainly on: gas delivery prices to Ukraine, accumulation of Ukrainian debts to Russia, linked to domestic non-payment; theft of gas from the transit system; and Russian pressure on Ukraine to exchange equity in the transit network and storage facilities for gas debts.<sup>1100</sup>

The terms of gas imports and gas transit has been subject to continuing bargaining between Gazprom and Ukraine involving political dialogue at the highest levels and disagreements, leading to threats of supply disruptions.<sup>1101</sup> Natural gas accounts for half of Ukraine's energy usage. Ukraine's steel and other heavy industries, which play a key role in Ukraine's exports, are highly inefficient users of energy. Russian firms supplied energy to Ukraine at prices far below market rates. In the early 1990s, these firms cut off supplies to Ukraine at times due to unpaid energy debts.<sup>1102</sup>

### 14.1.1. New Neighbor, Ukraine

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<sup>1097</sup> BP Statistical Review of World Energy (2010).

<sup>1098</sup> Dennis DYOMKIN: (2010) "Russia Oil Export Via Ukraine to Rise to 18,5 m/t", Reuters, 26 November <http://www.reuters.com/article/2010/11/26/russia-ukraine-oil-idUSLDE6AP1I620101126> (Accessed on 05 January 2011).

<sup>1099</sup> European Commission (2008) "The Economic Aspects of the Energy Sector in CIS Countries", Case (Centre for Social and Economic Research, Economic Papers 327, June, p.21 Available on site [http://ec.europa.eu/economy\\_finance/publications/publication12678\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication12678_en.pdf) (Accessed February 2009).

<sup>1100</sup> Simon PIRANI: (2009) "The Russian-Ukrainian Gas Dispute 2009", in "The Russian-Ukrainian Gas Conflict", *Russian Analytical Digest*, No.53, 20 January, p.5.

<sup>1101</sup> European Commission (2008) p.21-22.

<sup>1102</sup> Steven WOEHREL: (2008) "Russian Energy Policy Toward Neighboring Countries", *CRS Report for Congress*, Order Code RL34261, 17 January, p.7.

Under Ukraine's first President, Leonid Kravchuk, the country attempted to sever ties with Moscow in favor of working with the West. The futility of this approach was evident in the energy crisis of 1993-1994, in which Ukraine's reliance on cheap energy imports and failure to engage in economic reform brought the economy to a dangerous precipice.<sup>1103</sup> During the 1990s, the Ukrainian-Russian gas relationship was characterized by Stern as:<sup>1104</sup>

- Ukrainian ability to pay for up to 50 bcm/year which it imported from Russia, leading to very high levels of debt and unpaid bills which led to.
- Reduction of Russian gas supplies to Ukraine for short periods of time, aimed at restoring payment discipline which in turn led to.
- Unauthorized diversion of the volumes in transit to European countries.

In 1993 and 1994, Russia reduced gas supplies to Ukraine, in part, to force Kiev to pay for previous gas supplies, but also to pressure Ukraine into ceding more control to Russia over the Black Sea Fleet and over Ukraine's energy infrastructure.<sup>1105</sup> The hard security of nuclear weapons, the Sevastopol naval base, the status of the Azov Sea, the transit of energy and the construction of a Russian dike at the Krench Strait are a few examples of issues that have filled the relations with tension over the years.<sup>1106</sup> The events of 1990s demonstrate that how Russia used the energy tool in order to achieve its security aspect.

In 1993, Russia gave Ukraine an ultimatum demanding that it was to give up its remaining nuclear weapons to Russia, in addition to transfer the Black Sea fleet to Russia. Black Sea fleet and Sevastopol almost affected the strategic partnership between Kiev and Moscow during the 1990s. It was an enormous problem even reflected to the terminology of the two

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<sup>1103</sup> Eric A. Miller, (2003) "The Changing Face of Eurasia: Russian and Ukrainian Foreign policy In Transition", *Comparative Strategy*, 22, p.373.

<sup>1104</sup> Jonathan Stern, (2006b) "The Russian-Ukrainian Gas Crisis of January 2006", *Oxford Energy Studies*, 16 January, p.3.

<sup>1105</sup> Keith C. Smith, (2006) "Security Implications of Russian Energy Policies", CEPS Policy Brief, No.90, January, p.1.

<sup>1106</sup> Jan LEIJONHJELM and Robert L. LARSSON: (2004) "Russia's Strategic Commodities: Energy and Metals as Security Levers", Swedish Defense Research Agency FOI-R-1346-SE, November, p.121 Available on site <http://www.foi.se/upload/english/reports/foi-russias-strategic-commodities.pdf> (Accessed on 10 August 2008).

countries. While Ukrainians were saying “the Russian naval base in Sevastopol”, Russians were saying “the Russian naval base is Sevastopol”.<sup>1107</sup> One week before negotiations was to be held between Presidents Yeltsin and Kravchuk, Ukraine’s gas supplies were cut off, officially due to non-payments. And secondly, at one time in 1995, Russia raised its export price on gas for Ukraine above world market price at the same time as it proposed that Ukraine would join the CIS Custom Union.<sup>1108</sup>

The period between the 1998 and 2000 must count as one of the most hostile in Russian Ukrainian gas relations. Due to reason of the economic crisis of 1998, Russian and Ukrainian gas relations also fell in trouble because of price disputes, diverted gas from transit pipelines and the debt of gas which was reached \$1,6 billion.<sup>1109</sup> Russia did temporarily halt exports of oil and electricity to Ukraine in response to the theft of nearly 4 bcm of gas in November 1999. Gazprom declared that any gas taken illicitly from the transit pipelines could be charged at \$83 mcm and added to the existing debt mountain which, according to Gazprom, had already reached \$2.8 bn.<sup>1110</sup> President Kuchma’s position vis-à-vis Russia was seen as “complicated maneuvering, as he tried to defer payments on Ukraine a numerous debts, drive out the Russian Black Sea Fleet, and also get Moscow to grant favorable trade terms and support him in the upcoming presidential election.”<sup>1111</sup>

In mid 2000, which claims that 9 (and perhaps as much as 15) bcm had already been taken from the pipelines during the current year, Gazprom proposed the construction of a bypass pipeline to allow 30 to 60 bcm of gas to more directly from Belarus and Poland and south to Slovakia.<sup>1112</sup>

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<sup>1107</sup> Sergiy GEBOV: (2007) “The Russian Black Sea Fleet and Ukraine’s Security Strategy: Agenda 2017”, in Luis Rodrigues and Sergiy Glebov (ed.) “*Military Bases: Historical Perspectives, Contemporary Challenges*”, IOS Press, p.181.

<sup>1108</sup> LEIJONHIELM and LARSSON, p.121.

<sup>1109</sup> STERN: (2005) p.88.

<sup>1110</sup> Ibid, p.89-91

<sup>1111</sup> Mikhail A. MOLCHANOV: (2002) “*Political Culture and National Identity in Russian-Ukrainian Relations*”, TAMU Press, p.238.

<sup>1112</sup> STERN: (2005) p.89-91

Afterwards, in August 2004, Gazprom and Naftogaz<sup>1113</sup> signed long-term contract, according to which the price of \$50 tcm of gas was agreed and settled the past debts.<sup>1114</sup> Furthermore, Kremlin was surprised and displeased by the December 2004 election of pro-Western Yushchenko and criticized his policies of moving Ukraine closer to the EU and NATO. This provoked Moscow into demanding revisions of the 2004 gas agreement.<sup>1115</sup> A four-fold increase from \$50 to \$230 tcm was demanded by Russia in 2003, however, was of justified, particularly in light of the 2004 agreement between Kuchma government and Gazprom.<sup>1116</sup> Ukraine's new President turned to Turkmenistan and signed an agreement about strategic cooperation until 2026. According to the signed contracts between Ukraine and Turkmenistan, Turkmenneftegaz was obliged to supply gas to the amount of 50-60 bcm annually to Ukraine from 2006 to 2026.<sup>1117</sup> This was followed by a joint Ukrainian/Iranian announcement of a new pipeline exporting Iranian gas to Europe, bringing 20-30 bcm of Iranian gas to Ukraine via Armenia, Georgia and Russia.<sup>1118</sup>

On January 4, 2006, Gazprom and Naftogaz announced an end to the dispute with the signing of a 5 year contact with the following terms:<sup>1119</sup>

1. Gazprom will pay Naftogaz a tariff of \$1.60/mcm/100 km for transit of gas to Europe.
2. RosUkrEnergo will be the company which delivers gas to Ukraine. Gazprom will not deliver Russian gas to Ukraine, and Naftogaz will not export any gas which it has received from Russia.
3. RosUkrEnergo and Naftogaz will form a joint venture by February 1, 2006 in order to market gas in Ukraine which has been received via the territory to the Russian Federation.
4. RosUkrEnergo's annual gas balance will consist of:
  - 41 Bcm of Turkmen gas
  - Up to 7 Bcm of Uzbek gas purchased from Gazexport
  - Up to 8 Bcm of Kazakh gas purchased from Gazexport
  - Up to 17 Bcm of Russian gas purchased from Gazprom with a base price of \$230/mcm

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<sup>1113</sup> Naftogaz of Ukraine was formed in May 1998. Available on site <http://www.naftogaz.com/www/2/nakweb.nsf?Open> (Accessed on 06 January 2011).

<sup>1114</sup> OECD/IEA (2006) *Ukraine Energy Policy Review*, p.221.

<sup>1115</sup> Keith C. SMITH: (2006a) "*Russian Energy Policy and Its Challenge to Western Policy Makers*", Joint Hearing, Serial No.109-204, US Government Printing, May, p.84.

<sup>1116</sup> *Ibid*, p.85.

<sup>1117</sup> P. ROSTYSLOV: (2006) "Ukraine, Turkmenistan and Russia: Post revolution Energy Policy and Relations with Russia", in Kevin Rosner (ed.) "*Ukraine: Post Revolution Energy Policy and Relations with Russia*", GMP Pub., p.28.

<sup>1118</sup> STERN: (2006b) p.4.

<sup>1119</sup> *Ibid*, p.9

According to Tymoshenko,<sup>1120</sup> Ukrainian energy strategy should be;

1. Pursue a new strategy of increased domestic production of onshore and offshore oil and gas via incentive programmes for direct foreign investment.
2. Adopt the international standard of cost-sharing agreements that lost 10-20 years.
3. Work with Ukraine's foreign suppliers, consumers and industrial end-users to develop a structured transition to market prices.
4. Seek diversification of energy supplies through continued development of coal and nuclear resources, and by encouraging the construction of new pipelines to deliver Central Asian gas to Ukraine and Europe.<sup>1121</sup>

The main subject of year 2008 in Ukraine was the competition among the President and the Prime Minister to see who would change Russian-Ukrainian gas relations. First, Yushchenko signed an agreement with Russia during his visit to Moscow in 12 February 2008, which includes the replacement of RusUkrEnergy by two companies belonging to Gazprom and Naftogaz. It was harshly criticized by Tymoshenko and prevented the implementation of the agreement. As a response, Gazprom temporarily reduced the gas deliveries to Ukraine in March. Finally, in October 2008, Tymoshenko and Putin signed an agreement and announced the elimination of middlemen from Russian-Ukrainian gas trade.<sup>1122</sup> However, it went wrong. Firstly, because Ukraine failed to clear the debts promptly as it had agreed. Secondly, because the two sides failed to agree on how exactly European netback prices should be arrived at.<sup>1123</sup>

At the end of the year 2008, Gazprom wanted to increase the price of gas from \$250 to \$418 tcm, which at that time European countries paid around \$500 tcm.<sup>1124</sup> Due to the price dispute, Russian exports to Ukraine were cut off on 1 January. Exports to 17 EU member states and Moldova were drastically reduced on 6 January and cut completely

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<sup>1120</sup> Former Prime Minister of Ukraine.

<sup>1121</sup> Yulia TYMOSHENKO: (2008) "Securing Europe's Energy Future: The Ukrainian Perspective", *Centre for European Studies*, 7, p.109-110.

<sup>1122</sup> Andrzej SZEPTYCKI: (2009) "The Putin-Tymoshenko Gas Agreement and Political Developments in Ukraine", the Polish Institute of International Affairs, *Bulletin*, No.6(6), 23 January, p.2.

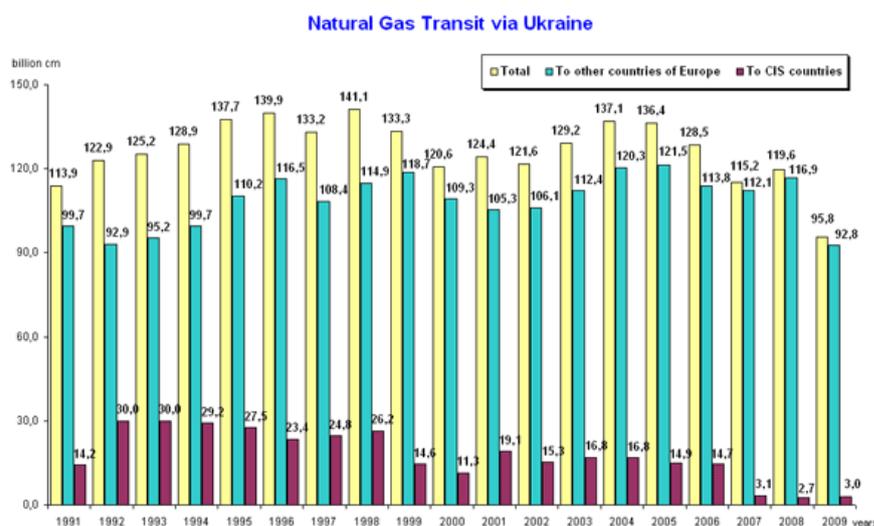
<sup>1123</sup> PIRANI, p.2-3.

<sup>1124</sup> Andrew E. KRAMER: (2008) "Russia Cuts Off Gas Deliveries to Ukraine", *New York Times*, 1 January <http://www.nytimes.com/2009/01/02/world/europe/02gazprom.html> (Accessed on 01 January 2009).

from 7 January. Deliveries to both Ukraine and European countries restarted on 20 January following the signing of two new ten year contracts.<sup>1125</sup>

On 1 January, Gazprom press secretary Kyprianov said: “The main problem was not that we disagreed on the price of gas but that the Naftogaz did not have a mandate to sign a new contract. According to the Russian side, Ukraine was blocking the pipelines and according to the Ukrainian side, Russia failed to deliver gas.”<sup>1126</sup> Ukraine’s debt to Gazprom and other suppliers has been a recurring problem in the relationship since Ukraine’s independence in 1991, a problem complicated by issues of state responsibility for private debts, non-repayment of previously restructured debt, and accusations of illegal re-exports and the unsanctioned siphoning of gas.<sup>1127</sup> As a result, on January 10, the Ukrainian government was dismissed by a non-confidence vote in parliament following accusations by the opposition that the gas agreement signed by the government was bad for the country.<sup>1128</sup>

**Figure 14: Natural Gas Transit Via Ukraine**<sup>1129</sup>



<sup>1125</sup> Simon PIRANI, Jonathan STERN and Katja YAFIMOVA: (2009) The Russo-Ukrainian Gas Dispute of January 2009: A Comprehensive Assessment”, *Oxford Institute For Energy Studies*, NG27, February, p.4.

<sup>1126</sup> Ibid, p.32-63.

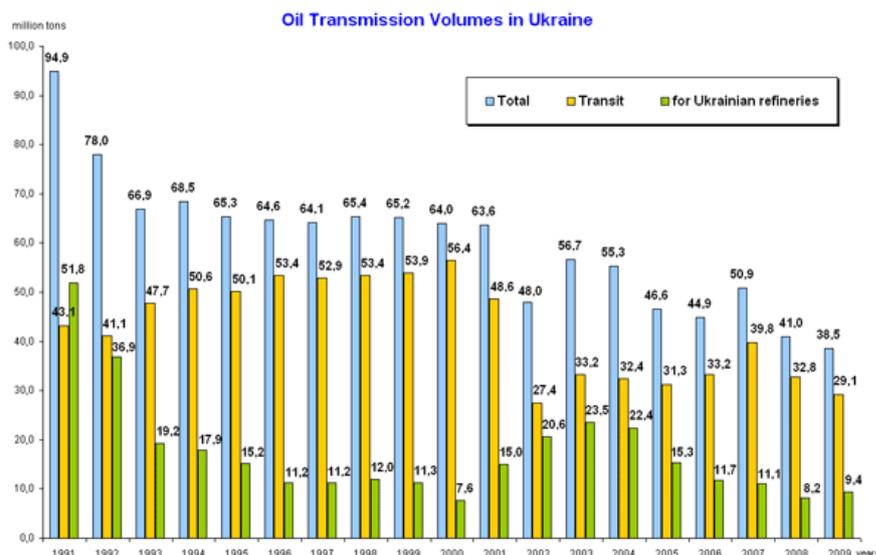
<sup>1127</sup> Margarita BALMACEDA: (2009a) “Background to the Russian-Ukrainian Gas Crisis: Clarifying Central Issues and Concepts”, in “The Russian-Ukrainian Gas Conflict”, *Russian Analytical Digest*, No.53, 20 January, p.22.

<sup>1128</sup> STERN: (2006b) p.12.

<sup>1129</sup> Naftogaz Company – Transport Available on site

<http://www.naftogaz.com/www/2/nakweben.nsf/0/B9D8558AE5F6C551C22574090044D7A8?OpenDocument&Expand=2.2.3&#> (Accessed on (Accessed 25 April 2009).

Figure 15: Oil Transmission Volumes in Ukraine<sup>1130</sup>



#### 14.1.2. Russia, Ukraine and West Triangle

When Soviet Union disintegrated, Russia realized that it will not be as easy as it was before to export gas and oil to the West, due to the fact that pipelines were on territory belonging to Belarus and Ukraine which consequently imposed tariffs on the Russian transit. This new geopolitical situation causes transit interruptions and leads to disputes related to the future of energy relations with both with Ukraine and Europe.<sup>1131</sup> Russia has always been Ukraine’s largest single trading partner and the source of most energy imports. Cultural and historical links are also important for a large part of the population, especially in the more Russophone Southern and Eastern regions. Victor Chernomyrdin, named ambassador to Kyiv in May 2001, made attractive promises with regard to Russian-Ukrainian economic and especially energy integration.<sup>1132</sup>

By 2004, according to the results of presidential election pro-Western Yushchenko received 39.9% of the votes and pro-Russian Yanukovych 39.3%. In the run-off election,

<sup>1130</sup> Naftogaz Available on site  
[http://www.naftogaz.com/www/2/nakweben.nsf/0/B9D8558AE5F6C551C22574090044D7A8/\\$file/OilTransmissionE.gif](http://www.naftogaz.com/www/2/nakweben.nsf/0/B9D8558AE5F6C551C22574090044D7A8/$file/OilTransmissionE.gif) (Accessed on (Accessed 04 March 2010).

<sup>1131</sup> LEIJONHIELM and LARSSON, p.121.

<sup>1132</sup> Theodor TUDOROIU: (2007) “Rose, Orange and tulip: The Failed Post-Soviet Revolutions”, *Communist and Post-Communist Studies*, 40, p.327.

hold on November 21, exit polls predicted a Yushchenko victory; but the electoral commission declared Yanukovich the victor with 49.5% of the vote, compared with Yushchenko's 46.6%.<sup>1133</sup> On December 26, 52% of the Ukrainian electorate re-voted for Yushchenko and 44.2% for Yanukovich. *The Orange Revolution's* victory was followed by the creation of a reformist, pro-western government, Yulia Tymoshenko, a deputy Prime Minister during Yushchenko's term as Prime Minister in 1999-2001, became Prime Minister. Then pro-EU and pro-NATO Barys Tarasyuk was appointed Prime Minister.<sup>1134</sup> Yergin says that "they [Russia] saw the Orange Revolution or the change of government in Ukraine as threat to Russian security. After the Orange Revolution, there was a feeling in Russia that Russia was next that the Western Powers, in fact, were going to try to topple the Russian government."<sup>1135</sup>

As soon as they took office, in the end of January – beginning of February 2005, President Viktor Yushchenko and his Prime Minister Yulia Tymoshenko, let it be known that they wished to fundamentally reform Ukraine's energy system and begin a new bilateral cooperation with Russia.<sup>1136</sup> Yushchenko administration suggested that gas transit tariffs should be moved to "European" levels and paid in dollars. At the same time, the new administration raised objections to the participation of Raiffeisenbank in RosUkrEnergo, asking for a 50:50 partnership and a split of the profits from this venture- with Gazprom.<sup>1137</sup>

Ukrainian foreign policy tried to strike a balance between improving ties with the West, including nominal support for Euro-Atlantic Western leader, said Ukraine would conduct serious reforms so that it could join NATO and the EU as soon as it was ready.<sup>1138</sup> The Russian leadership, in fact, declares that it is not opposed to NATO as an organization: it objects solely to NATO's close approach to Russia's borders. Russia regards Ukrainian

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<sup>1133</sup> Ibid, p.327-28.

<sup>1134</sup> Ibid, p.328-29.

<sup>1135</sup> Daniel YERGIN: (2006) *Statement*, Joint Hearing, Serial No.109-204, US Government Printing, May, p.73.

<sup>1136</sup> Arnaud DUBIEN: (2007) "The Opacity of Russian-Ukrainian Energy Relations", *Russie.Nei.Visions*. No.19, IFRI, May, p.8

<sup>1137</sup> STERN: (2005) p.96; "RosUkrEnergo was registered in Switzerland by Gazprombank and Austrian Raiffeisenbank and will be jointly managed by a consortium of Gazprom, Naftokhaz Ukraine, Gazprombank and Raiffeisenbank."

<sup>1138</sup> Steven WOEHREL: (2008) "Russian Energy Policy Toward Neighboring Countries", *CRS Report for Congress*, Order Code RL34261, 17 January, p.7-8

NATO membership as problematic in terms of both security and identity. Because if Ukraine enters into NATO, Russia may no longer be able to base its Black Sea Fleet at Sevastopol after 2017 and Russians see Sevastopol as a city of Russian glory.<sup>1139</sup>

Throughout Putin's presidency, the question of Ukraine's payments for Russian gas was the major obstacle to improve Russo-Ukrainian relations. For instance, when the dispute became a crisis, Gazprom cut off deliveries on January 1, 2006. When the government of Prime Minister Yury Yekhanurov refused to sign an agreement on Gazprom's terms, the Russian gas monopoly stopped deliveries on January 1.<sup>1140</sup> For many observers in the West, the whole dispute appeared an obvious attempt by the Kremlin operating through Gazprom, to punish Ukraine for the Orange Revolution and for its leaders' interest in seeking integration with Western institutions.<sup>1141</sup> Nevertheless, everything has turned back to where it first started because pro-Russian Yanukovich won the final run off on February 7, 2010 election by only 3.48% of the vote. This time, Kremlin was much experienced, and preferred not to support actively their candidate in Ukraine rather than which Putin openly expressed his support for Yanukovich and promote his candidacy during the elections of 2004. Yanukovich made an improvement of ties with Russia an important plan in his campaign and strongly opposed to Ukrainian membership of NATO. He also supported the Russian invasion of Georgia as well as Moscow's recognition of South Ossetia and Abkhazia.<sup>1142</sup>

In March 2010, Yanukovich quietly shut down a government commission that had been preparing the country for eventual membership in NATO, removing that controversial option from Ukraine's to do list. Yanukovich met with Russian President Medvedev and signed a deal to extend Moscow's lease of the Ukrainian port of Sevastopol, where the Russian Navy's Black Sea Fleet (BSF) is headquarter, for 25 years. In exchange Ukraine

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<sup>1139</sup> Andrey MAKARYCHEV: (2009) "Russia and NATO, and the Color Revolutions", *Russian Politics and Law*, Vol.47, No.5, p.43-5

<sup>1140</sup> Jeffrey MANKOFF: (2009a) *Russian Foreign Policy, The Return of Great Power Politics*, Rowman & Littlefield Pub, 252.

<sup>1141</sup> Ibid, p.253.

<sup>1142</sup> F. Stephen LARABEE: (2010) "Russia, Ukraine, and Central Europe – The Return of Geopolitics", *Journal of International Affairs*, Spring/Summer, Vol.63, No.2, p.39

will get a 30% discount on imported Russian gas.<sup>1143</sup> In addition to that Ukraine proposed that Russia and the EU build a new gas pipeline across its territory to increase Russian gas transit to Europe, President Yanukovich said. He also said that “As far as the gas transportation system is concerned, we have our own concept, which we proposed to our partners in the EU and Russia. This concept envisions the establishment of joint EU-Russian-Ukrainian Company to build a gas pipeline across Ukrainian territory, which would ensure extra gas transit to Europe.”<sup>1144</sup>

Much of Russian gas sold to Europe is transported via pipelines that traverse Ukraine. This gives Ukraine a degree of counter-leverage. Ukraine can siphon off some of the gas, disrupting the flow of gas to consumers in Europe as it did in January 2006, thereby preventing Russia from fulfilling its commitments and damaging Russia's reputation as a reliable supplier.<sup>1145</sup> However, in terms of Ukraine's reputation, at the time of January 2009, Gazprom underlined that Ukraine is not only as politically reliable, but also technically unable to carry out its transit role.<sup>1146</sup> Although EU is promoting Ukraine's approach to west but energy security is a matter of survival for Europe. Due to this reason in the near future, first Nord Stream which 75% has completed and then the South Stream project which is under research; are on the agenda of both EU and Russia. After the complete of these pipelines, Russian gas will be able to go directly to European customers bypassing Ukraine. Therefore, Ukraine will lose its leverage against Russian demands.

## **14.2. Russia-Belarus Energy Relations**

Soviet disintegration presented a huge negative shock for all newly independent states including Belarus. At the end of the 1980s, nearly all exports and imports were traveled within the Soviet Union, the bulk of it with Russia. The chaos resulting from the collapse

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<sup>1143</sup> Fred WEIR: (2010) “*Ukraine-Russia Relations: Why Kiev Made a Dramatic United States-Turn Back Toward Moscow*”, *Christian Science Monitor*, 5 July  
<http://www.csmonitor.com/World/Europe/2010/0507/Ukraine-Russia-relations-Why-Kiev-made-a-dramatic-U-turn-back-toward-Moscow> (Accessed on 10 August 2010)

<sup>1144</sup> RIA Novosti (2010) “*Kiev Asks Russia, EU to Build New Gas Pipeline Across Ukraine Territory*”, 2 July  
<http://en.rian.ru/world/20100702/159668682.html> (Accessed on 10 August 2010)

<sup>1145</sup> LARABEE, p.40

<sup>1146</sup> Margarite M. BALMACEDA: (2009b) “*Energy Leverage in Conditions of External Shock: the Case of Russian Energy Relations with Ukraine and Belarus, 2006-2009*”, *American Political Science Association Annual Convention*, Toronto, September 3-6, p.8-9

of the coordinating centre in Moscow, price liberalizations and the subsequent monetary squeeze initiated by Russia in January 1992 took other Soviet republics largely by surprise and had serious economic consequences.<sup>1147</sup>

Belarus has close historical and cultural ties to Russia as well as being its second largest trading partner.<sup>1148</sup> “Belarus is, on paper, the Kremlin’s closest ally”, says Lucas. After coming to power in 1994, the Belarusian President Lukashenka suggested merging his country with Russia to form a Russian-Belarusian Union, sometimes known as the Union State. However, Putin’s suggest was that Belarus should simply join Russia, with Lukashenka’s presidency either being abolished or downgraded to openly ceremonial position.<sup>1149</sup> According to Ambrossio, Lukashenka has also used the idea of Union to increase his popularity in Belarus.<sup>1150</sup>

Since 1992, Russia has supplied the CIS subsidized gas, and prices for Belarus have typically been lower than anywhere in the region. Energy subsidies have helped boost the standard of living in Belarus and with it the popularity of Lukashenka, who is dependent upon Russian gas both for the country’s economic health and for his own political staying power.<sup>1151</sup> However, Belorussia faced rising energy prices for Russian hydrocarbons, which they could not pay, compounding their debt to Russia annually.<sup>1152</sup> Belarus is able to meet just 13-5% of its energy needs from its own reserves. And its basic fuel is natural gas imported from Russia. Its share in the structure of energy consumption is between 75 and 80%.<sup>1153</sup> At the same time, it is an important transit country for Russian gas and oil sales to Europe (with around 20% and 30% shares, respectively). Gas is the primary input for

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<sup>1147</sup> Peter HAVLIK: (2009) “Belarus Between Russia and the European Union: Some Reflections on the Belarusian ‘Economic Miracle’ and Future Prospects”, in Hans-Georg Heinrich and Lumilla Lobova (ed.) “*Belarus: External Pressure, Internal Change*”, Oxford, p.56

<sup>1148</sup> Chloe BRUCE: (2005) “Friction or Fiction? The Gas Factor in Russian-Belarusian Relations”, *Chatham House, Russian and Eurasia Programme*, REP BP 05/01 May 2005, p.2

<sup>1149</sup> Edward LUCAS: (2009) *The New Cold War*, Palgrave, New York, p.134

<sup>1150</sup> Thomas AMBROSIO: (2006) “The Political Success of Russia-Belarus Relations: Insulating Minsk from a ‘Color’ Revolution”, *Paper presented at the annual meeting of the International Studies Association*, San Diego, USA, March 22, p.12

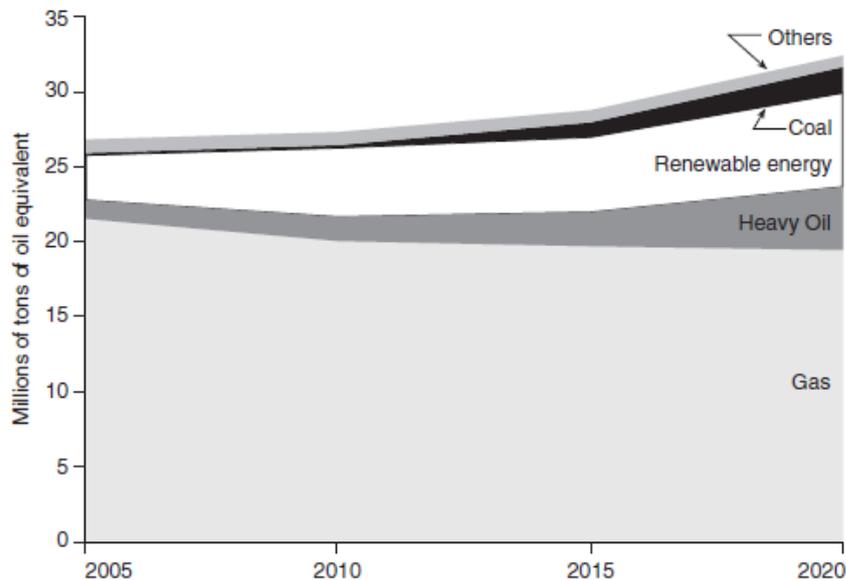
<sup>1151</sup> BRUCE, p.2

<sup>1152</sup> Stacy CLOSSON: (2009) “Russia's Key Customer: Europe”, in Jeronim Perovic, Robert W. Ortung and Andreas Wenger (ed.) “*Russian Energy Power and Foreign Relations*”, Routledge, p.93

<sup>1153</sup> Tatiana MANENOK: (2010) “Belarus-Russia: Dependency or Addiction?”, Heinrich Böll Stiftung, Warsaw, June 2, p.1 Available on site [http://www.boell.pl/downloads/Belarus\\_Russia\\_energy.pdf](http://www.boell.pl/downloads/Belarus_Russia_energy.pdf) (Accessed on September 2010)

electricity production and Belarus is a very large consumer of this commodity.<sup>1154</sup> In 2009, Belarus imported almost 16 bcm of natural gas and 6 m/t oil from Russia.<sup>1155</sup>

**Figure 16: Energy Consumption in Belarus 2005-2020<sup>1156</sup>**



Following the collapse of the Soviet Union and Belarus signed a “so-called zero option”, whereby Belarus swapped its share of former Soviet assets abroad for cancellation of its debts, the bulk of which were owed to Gazprom. However, by August 1993 Belarus’ gas arrears had mounted to \$100 million, and Gazprom cut supplies. According to Bruce, although Belarus was able to pay with the help of an IMF loan, this proved to be the first of the periodic debt disputes that have determined the two sides to the present day.<sup>1157</sup> In September 1993, Russia made its first move to gain control of Belarus’ gas transmission network with the signing of an agreement on the transfer of Beltransgaz to Gazprom. Under these agreements the assets of Beltransgaz, the gas transmission company, were to be transferred to Gazprom under a 99 year lease. In return, Russia was said to have agreed

<sup>1154</sup> European Commission, (2008) p.15, Katja YAFIMAVA and Jonathan STERN: (2007) “The 2007 Russia-Belarus Gas Agreement”, *Oxford Energy Institute for Energy Studies*, January p.2

<sup>1155</sup> BP Statistical Review of World Energy (2010)

<sup>1156</sup> Roland GÖTZ: (2007) “Ukraine and Belarus: their Energy Dependence on Russia and Their Roles as Transit Countries”, in (ed) Daniel Hamilton and Gerhard Mangott, “*The New Eastern Europe: Ukraine, Belarus, Moldova*”, Center for Transatlantic Relations, Washington DC, p.165

<sup>1157</sup> BRUCE, p.3, STERN: (2005) p.97; “By late 1998, Belarusian gas debts were \$0.25-\$0.5 bn and failure to agree on prices caused gas to be delivered without a contract in the first few months of 1999.”

to double its deliveries to Belorussia by 2010:<sup>1158</sup> 21 bcm by 1995, 26 bcm by 2000 and 33 bcm by 2010.<sup>1159</sup> But the Belarus parliament did not ratify the agreement.

In the following years debts accumulated further, but Gazprom gave up from pressure against Belarus because in 1994 Russia and Belarus agreed on a currency union and the free deployment of Russian troops at the same time. Bruce says that it is the first clear instance of gas to political issues came in April 1994, when Moscow and Minsk signed an agreement on a proposed monetary union, wherein Belarus agreed not to charge Russia for the stationing of troops on Belarusian territory in exchange for subsidized energy prices.<sup>1160</sup> Only in 1997 Gazprom increased pressure on Belarus to pay its overdue taxes. In 1997 (50%) and 1998 (30%) Gazprom reduced gas supply to Belarus and demanded cash payment instead of barter. In 1998 the private companies Itera and Transnafta started gas supply to Belarus since 1999 Belarus has had to pay only the low Russian domestic gas price, which means a reduction from \$40 to \$30 per 1000 m<sup>3</sup>.<sup>1161</sup>

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<sup>1158</sup> STERN: (2005) p.97.

<sup>1159</sup> BRUCE, p.8.

<sup>1160</sup> Ibid, p.3

<sup>1161</sup> GÖTZ: (2007) p.166, BRUCE, p.12, Jakob HEDENSKOG and Robert L. LARSSON: (2007) "Russian Leverage on the CIS and the Baltic States", *Swedish Defense Academy*, FOI-R-2280-SE, p.73 June Available on site <http://www2.foi.se/rapp/foir2280.pdf> (Accessed May 2008)

Map 35: Energy Resources, Production and Transportation Lines on Belarus<sup>1162</sup>



- |   |   |   |  |
|---|---|---|--|
|  | Major gas pipelines<br>(line thickness indicates pipeline capacity) |   | Nuclear power plants<br>(operating / projected / closed) |
|  | Major oil pipelines   |  | Major fossil fuel power plants                           |
|  | Oil fields  |   | Major hydropower plants<br>(operating / projected)       |
|  | Oil refineries<br>(operating / under construction)                  |    | Coal deposits  |
|  | Oil terminals<br>(in use / considered)                              |    | Uranium deposits   |
|  | Main oil and gas areas  |    | Peat deposits  |
|  | Gas fields  |    | Underground gas storages                                 |
|  | Gas processing plants   |   |  |

<sup>1162</sup> UNEP/GRID-Arendal Maps and Graphics Library. 2007. Available on site <http://maps.grida.no/go/graphic/energy-resources-production-and-transportation>. (Accessed 02 February 2011).

### 14.2.1. Friends or Partners

In September 1999, Prime Minister Putin made his first visit to Belarus and announced that Belarus was a foreign policy priority and agreed to cancel \$70 million of the country's debt. In November, Gazprom agreed to continue supply Belarus with cheap gas in 2001 at a price of \$30 mcm. In exchange, it would receive heavily subsidized transit fees.<sup>1163</sup> In September 2002 Gazprom discovered that Beltransgaz was still on the national list of strategic companies that could not be privatized. Belarus President Lukashenka refused to privatize Beltransgaz. Then Russia threatened Belarus with the suspension of its gas deliveries and price increases.<sup>1164</sup> Russia insisted that the matter of Belarus gas privatization "was a purely economic affair" and not a political one. Zaitseva deservedly asks and answers the question that why should a state (Belarus) who seemingly did not mind the energy dependence on Russia and expressed a desire for economic re-integration behave in such a way? It is a fact that President Lukashenka heavily relied on profits from the gas sector for his political livelihood. In case of privatization, these political and economic dividends would be last for the Belarus leader.<sup>1165</sup> Finally, by November 2003, Belarus gave in to Russia's demand and agreed to let Gazprom lease Beltransgaz for 99 years in return for increased gas deliveries. However, the Belarusian Parliament refused to ratify the agreement. After that, Lukashenka stated that "now our relations with Russia will be poisoned by gas for a long time".<sup>1166</sup>

In December 2003, Gazprom offered Belarus to continue receiving subsidized as if Belarus accepted Gazprom's offer of \$600 million for Beltransgaz. On the other hand, Belarus demanded \$5 billion, and Gazprom countered by cutting Belarus' gas supplies. The independent Russian gas producers Itera and Transnafta were allowed to temporarily

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<sup>1163</sup> BRUCE, p.13-14

<sup>1164</sup> YAFIMAVA and STERN, p.2, STERN: (2005) p.97; "The Intergovernmental agreement of April 2002 set out the terms for future Russian sales to Belarus and the development of the Beltransgaz joint venture for the management of the gas network in the country."

<sup>1165</sup> Maria N. ZAITSEVA: (2005) "The Perils of Dependency: An Examination of Russia's Use of Energy Leverage With Selected Former Soviet States", *International Studies Association Annual Meeting*, Hawaii, March 2005, p.24-25

<sup>1166</sup> HEDENSKOG and LARSSON, p.73

supply Belarus with gas as they did in 1998-99.<sup>1167</sup> First on February 12, Gazprom cut all supplies to Belarus –aside from exports in transit through the Yamal pipeline- but these were restored when Beltransgaz signed a contract with the company of Transnafta covering 5-6 days of supply.<sup>1168</sup> Belarus responded to the cut-off by siphoning gas destined for Europe via the Yamal pipeline. However, it raised the serious supply concerns in Europe, and highlighted the fact that Gazprom had not solved the transit issue. Indeed, it was the first time in Gazprom’s 30 year history of gas exports that total cut-off had occurred on a key transit country.<sup>1169</sup> According to Stern cutting of gas supplies in the middle of winter to a range of third countries including Poland, Latvia and Lithuania and Russian exclave Kaliningrad caused a serious protest. The European Commission expressed concern, and significant political problems arose in Poland as a result of the incident.<sup>1170</sup> In the late August 2004 at a meeting of the two presidents in Sochi, a new contract was finally signed to ensure Gazprom’s gas supplies to Belarus for the remainder of 2004 with 10,2 bcm at a higher price of and at a higher transit route of \$0,75/mcm/00 km, instead of \$0,53/mcm/00 km via the Northern Lights and \$0,46 per mcm/100 km via Yamal-Europe pipeline.<sup>1171</sup> The main difference was that Gazprom intends to deliver all of the gas rather than relying on independents.<sup>1172</sup>

At the end of March 2006, right after the presidential elections that confirmed Lukashenka in office for another five years, Gazprom made it clear that it was set to raise gas prices starting in 2007.<sup>1173</sup> Few months later in May 2006, Russia announced its New Energy Doctrine –a new strategy toward the post-Soviet space.<sup>1174</sup> According to this new strategy, Gazprom decided that 2007 deliveries to Belarus would be made at market prices. Kremlin

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<sup>1167</sup> Rune RIVEDAL: (2009) “Russian Energy Aggression 2000-2008: A Multiple Case Study of Russian Energy Aggression During Vladimir Putin’s Presidency”, The University of Bergen, Norway, *Master Thesis*, September, p.55.

<sup>1168</sup> STERN: (2005) p.98, ZZAITSEVA, p.33.

<sup>1169</sup> BRUCE, p.17.

<sup>1170</sup> STERN: (2005) p.99.

<sup>1171</sup> YAFIMAVA and STERN, p.2.

<sup>1172</sup> STERN: (2005) p.100.

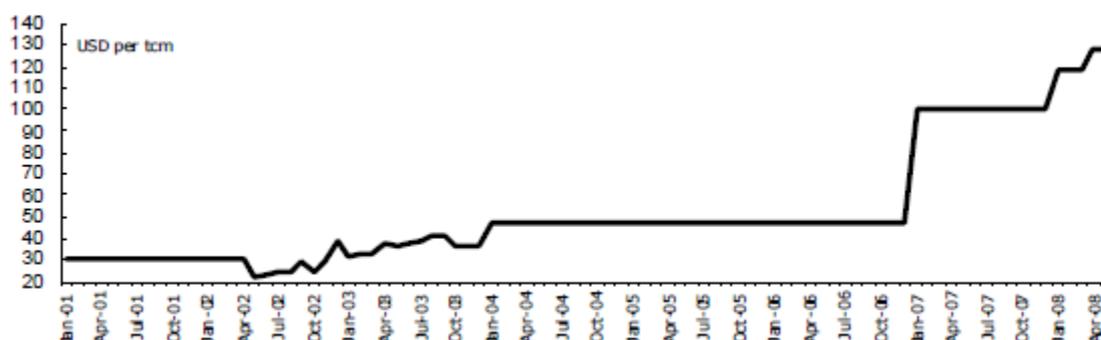
<sup>1173</sup> Belarus and Russia: Friends Forever...?”, *PONTIS Foundation*, Center for Political Education, March, p.1 Available on site

[http://www.nadaciapontis.sk/tmp/asset\\_cache/link/0000016004/Belarus%20and%20Russia%20Friends%20Forever.pdf](http://www.nadaciapontis.sk/tmp/asset_cache/link/0000016004/Belarus%20and%20Russia%20Friends%20Forever.pdf) (Accessed on 28 May 2009).

<sup>1174</sup> Rainer LINDNER: (2007) “Neighborhood in Flux: EU-Belarus-Russia, Prospects for the European Union’s Belarus Policy”, in (ed) Daniel Hamilton and Gerhard Mangott, “*The New Eastern Europe: Ukraine, Belarus, Moldova*”, Center for Transatlantic Relations, Washington DC, p.63.

decided that Gazprom long supplied Belarus with energy at Russian domestic prices and provided a large indirect subsidy to the Lukashenka regime.<sup>1175</sup> Gazprom suggested that Belarus should pay \$200. During the negotiations, Gazprom lowered its price from \$200 to \$170, to \$110 and then to \$105. Belarus insisted that this would be a violation of the Customs Union Agreement according to which Belarus should receive gas at Russian domestic prices. Belarus refused to sign the 2007 supply contract on such terms and threatened that an increase in transit fees from \$0,75 to at least 1,6 mcm/100 km would be necessary. As a result, Gazprom threatened that it would stop supplies to Belarus on 1 January 2007.<sup>1176</sup>

**Figure 17: Dynamics of prices for gas imported by Belarus, 2001 – early 2008<sup>1177</sup>**



**Table 36: Gas prices paid by Ukraine, Moldova and Belarus in 2006–2007 (in \$/tcm).**<sup>1178</sup>

	2005	2006	2007
Ukraine	50	95	130
Moldova	80	110-160	170
Belarus	47	47	100

Finally, on December 31, 2006 Gazprom and Belarus signed a new gas contract for the years 2007-2011. Belarus will pay \$100 per tcm in 2007, a 114% increase from the previous level. According to the agreement Gazprom will pay 50% of Beltransgaz for \$2,5

<sup>1175</sup> WOEHREL, p.13.

<sup>1176</sup> YAFIMAVA and STERN, p.3.

<sup>1177</sup> European Commission (2008) p.277.

<sup>1178</sup> Grzegorz GROMADZKI and Wojciech KONONCZUK: (2007) "Energy Game: Ukraine, Moldova and Belarus Between the EU and Russia", *Stefan Batory Foundation*, Warsaw, p.25.

billion. Under this agreement Belarus will receive relatively cheap Russian gas compared to the other prices for other CIS states will have to pay (Ukraine \$130, Moldova \$170 and Georgia \$235 – European market \$250).<sup>1179</sup> The drop in support from Moscow has caused Lukashenka to cut some government spending and to look to Western banks for loans. In addition, Belarus received 1,5 billion stabilization loans from Russia to offset increased energy costs.<sup>1180</sup> As a result, the Russian gas price increased the deficit in the Belarusian state budget. Business sector had to cope with the huge increase in the energy price, which could push especially large and energy intensive enterprises into unprofitability.<sup>1181</sup>

The Belarusian-Russian gas crisis has continued by the oil crisis of 2007. At the end of the 2006, Russia estimated that it was losing almost \$4 billion annually due to Belarus' non-payment of the oil export duty.<sup>1182</sup> So, Russia first asked Belarus to repay the amount. It was a fact that Belarus was actively stealing oil from Russia, and reaching contractual agreements has been ignored in the West. As 1995 agreement between Russia and Belarus stated that Belarus could re-export oil products refined from Russian oil but had to split the profits with Russia (85% to Russia); since 2001, Belarus no longer has transferred any payment.<sup>1183</sup> On December 8, 2006 Russia decided to introduce a duty of \$180/t on crude oil export. According to Goldman, for Belarus, this was much more than an unfriendly gesture from what he had expected from a partner. Because Belarus was depended on these subsidized and cheap petroleum imports from Russia and their re-export to Europe at higher prices.<sup>1184</sup> Belarus reacted by increasing the charge of transit duty to \$45/t on Russian oil transported through Druzhba pipeline and then began stealing oil.<sup>1185</sup>

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<sup>1179</sup> GÖTZ: (2007), p.166-67, Jeffrey MANKOFF: (2009b) "Eurasian Energy Security", CFR, *Council Special Report*, No.43, February, p.16, Robert PIROG: (2007) "Russian Oil and Gas Challenges", CRS Report For Congress, Order Code RL33212, June 20, p.9, Vladimir SOCOR: (2007) "Gazprom Taking Over Pipelines in Belarus", *Eurasia Daily Monitor*, May 21.

<sup>1180</sup> George DURA: (2008) "The EU's Limited Response to Belarus' Pseudo New Foreign Policy", *CEPS Policy Briefs*, No.151, February, p.3.

<sup>1181</sup> LINDNER, p.59.

<sup>1182</sup> Rune RIVEDAL: (2009) "Russian Energy Aggression 2000-2008: A Multiple Case Study of Russian Energy Aggression During Vladimir Putin's Presidency", The University of Bergen, Norway, *Master Thesis*, September, p.58.

<sup>1183</sup> Jerome GUILLET: (2007) "Gazprom as a Predictable Partner – Another Reading of the Russian-Ukrainian and Russian-Belarusian Energy Crises", *IFRI*, Paris, March, p.17.

<sup>1184</sup> GOLDMAN, p.151.

<sup>1185</sup> GROMADZKI and KONONCZUK, p.24-25.

Subsequently, in 10 January 2007, Transneft shut down the Druzhba oil pipeline through which Germany receives 20% of its oil imports. According to Belkin, many European observers have characterized the Russia-Ukraine and Russia-Belarus gas and oil crisis as “wake up” calls exposing Europe’s energy security vulnerability exam to understand supply disruptions. Additionally, Russia’s reliability began to question as well as the Moscow’s willingness to use its energy power as a political weapon.<sup>1186</sup> As a result, the Belarus’ demand of \$45/t transit charge was accepted and also Russia lowered the export duty cost to \$53/t.

Gazprom which supplies annually 20 b/cm of natural gas to Belarus was threatened once again by Russia in August 2007 to cut gas supplies to Belarus as a result of the unpaid gas bill of \$456 million of gas deliveries in the first half of the 2007.<sup>1187</sup> The threat was not executed because Belarus has agreed to pay the concerning debt and made the first payment of \$190 million in 3 August. Lately, we witnessed the crisis between Russia and Belorussia in June 2010 once more on the subject of the payment debts. According to the protocol of the 2007 Beltransgaz sale of 50% was finalized in February 2010 which means that any decision can only be taken if both owners agree. Belarus already saw the coming payment crisis and asked Gazprom to maintain annual price at \$150/mcm. Automatically, it was refused by Gazprom. Although Belarus had to pay \$169.22/mcm in the first quarter, and \$184.79/mcm in the second quarter of 2010, Belarus unilaterally decided to pay Gazprom only \$150/mcm, and as a result its debt reached to \$192 million by June 2010.<sup>1188</sup>

On June 18, Belarusian Deputy Energy Minister Edward Tavgirets said that “Gazprom owes Belarus an equal amount of nearly \$200 million for gas transit, therefore leaving Minsk with no debts before Moscow”. He said that the energy ministry of Belarus received a telegram from Gazprom stating that in the case of non-payment for arrears of some \$200 million by Beltransgaz, Gazprom would reduce the delivery of gas to Belarus by 85% for

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<sup>1186</sup> Paul BELKIN: (2008) “The European Union’s Energy Security Challenges”, *CRS Report for Congress*, Order Code R133636, January 30p.5

<sup>1187</sup> DURA, p.3

<sup>1188</sup> Katja YAFIMAVA: (2010) “The June 2010 Russian- Belarusian Gas Transit Dispute: A Surprise That Was to be Expected”, *The Oxford Institute for Energy Studies*, NG43, July, p.5-8

June.”<sup>1189</sup> And another important speech made by the Belarusian Energy Ministry Spokesman said that a drastic cut in gas supplies could entail problems with gas transit to Europe. Therefore, Russia immediately warned European consumers of possible problems.<sup>1190</sup> Meanwhile, Alexei Miller said on 19 June that the company is looking into the perspectives of bypassing Belarus in gas deliveries to Europe, adding that it is technically possible.<sup>1191</sup> Afterwards, President Medvedev agreed Miller’s proposal to gradually reduce supplies to Belarus by amount proportional to accumulated debt.<sup>1192</sup>

It was officially stated by the First Deputy Prime Minister of Belarus that Belarus will pay for natural gas in two weeks. He also added that “we are not hiding that we have difficulty with currency”.<sup>1193</sup> Surprisingly on June 23, Belarus paid its debt of \$187 million to Gazprom and then demanded from Gazprom to pay \$260 million for transit and threatened cutting the pipeline. The main question how did Lukashenka find the money in two days, still not clear but there was an argument that Kurmanbek Bakiyev, who has taken refuge in Belarus, could have give the money to Lukashenka. Although Bakiyev denied the claims but Lukashenka told to Russian Foreign Minister Sergei Lavrov that he borrowed the money from my friends today and will pay as soon as possible, without giving any clue where the money came from.<sup>1194</sup> On the other hand, Belarus has refused for the second time a request to extradite the ousted Kyrgyz President Kurmanbek Bakiyev.<sup>1195</sup> As a result, on July 2, Beltransgaz announced that the addendum, stipulating a transit fee of 1.88/mcm/00 km in 2010, was finally signed. And Gazprom confirmed this signature.<sup>1196</sup>

### 14.3. Russia-Moldova Energy Relations

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<sup>1189</sup> RIA Novosti (2010) “*Belarus Says Russia's Gazprom Owes Equal Amount of \$200 million in Debt*”, 18 June <http://en.rian.ru/exsoviet/20100618/159483620.html> (Accessed on 10 September 2010)

<sup>1190</sup> RIA Novosti (2010) “*Gazprom Says Will Not Wait 2 Weeks For Minsk To Pay Off Gas Debt*”, 21 June <http://en.rian.ru/business/20100621/159517793.html> (Accessed 17 August 2010)

<sup>1191</sup> RIA Novosti (2010) “*Urgent: Russia's Gazprom Possibly to Bypass Belarus in Gas Deliveries to Europe*”, 19 June <http://en.rian.ru/russia/20100619/159493978.html> (Accessed on 10 August 2010)

<sup>1192</sup> Yafimava, p.8

<sup>1193</sup> RIA Novosti (2010) “*Belarus Says Will Pay for Russian Gas in 2 weeks*”, RIA NOVOSTI, 21 June <http://en.rian.ru/business/20100621/159518702.html> (Accessed on 10 August 2010)

<sup>1194</sup> RIA Novosti (2010) “*Bakiyev Denies Lending Belarus Money to Gas Debt*”, 23 June <http://en.rian.ru/world/20100623/159546950.html> (Accessed on 10 September 2010)

<sup>1195</sup> RIA Novosti (2010) “*Belarus Rejects Second Bakiyev Extradition Request*”, 27 August <http://en.rian.ru/exsoviet/20100827/160364259.html?id=> (Accessed on 10 September 2010)

<sup>1196</sup> YAFIMAVA, p.10

According to the World Bank, Moldova is the poorest landlocked country in Europe. It is totally dependent upon Russia not only for its energy resources, and also as a market for the wine and agricultural products which are Moldova's main exports.<sup>1197</sup> In the late of 1980's, as the Moldovan-speaking population was reasserting its separateness, the mainly Russian-speaking population of Transnistria and the Turkic-speaking Gagavuz minority declared separate republics within Moldova. Between 1990 and 1992, there was a major fighting between the secessionist Tiraspol and the central government forces from Chisinau.<sup>1198</sup> A ceasefire agreement was signed by Moldova and Russia in July 1992 which ended the conflict. However, no political solution has been achieved until today.<sup>1199</sup> After signing the agreement for ceasing fire in the summer of 1992 and outlining the further controlled territory, a big part of the patrimony of Russia of Moldova including the gas transport lines remains in under control of the Transnistrian administration.<sup>1200</sup> Transnistria makes up 8% of Moldova but accounts for up to 40% of the state's industrial production.<sup>1201</sup> Mankoff says that Russian support of the Transnistria's separatist regime and the presences of Russian peacekeepers have served throughout the post-Soviet period to check Moldova's foreign policy.<sup>1202</sup> Moldova is also an important transit route along which all gas to south-eastern Europe and western Turkey.<sup>1203</sup>

During the 1990s, Gazprom gained control over Moldova's gas pipelines while some of Chisinau's gas debts were transformed into Russian assets.<sup>1204</sup> Therefore, the most important issue for Moldovan energy sector was the debt to Russia-Gazprom. An agreement was signed in September 1994 stipulates that "Gazprom" will possess slightly less than 51% of shares in the statutory capital of the newly create enterprise. In one sense Moldova sold its property at the price of its debt. When the agreement was signed,

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<sup>1197</sup> WOEHREL, p.10

<sup>1198</sup> Angela E. STENT: (2007) "The Lands In Between: The New Eastern Europe in the Twenty-First Century", in (Ed) Daniel Hamilton and Gerhard Mangott, "*The New Eastern Europe Ukraine, Belarus, Moldova*", Center for Transatlantic Relations/Austrian Institute for international Affairs, p.8; "...the difference between the Romanian and Moldovan languages and culture is a matter of some debate."

<sup>1199</sup> W. Alejandro SANCHEZ: (2009) "The Frozen Southeast: How the Moldova-Transnistria Question has Become a European Geo-Security Issue", *The Journal of Slavic Military Studies*, Vol.22:2, 157

<sup>1200</sup> Victor PARLICOV and Tudor ȘOITU: (2007) "The Gaze Industry in RM: The Burden of Importance and the Cost of Errors", Institute for Development and Social Initiatives (IDIS), *Politici Publice*, p.6

<sup>1201</sup> Sanchez, p.158

<sup>1202</sup> Jeffrey MANKOFF: (2009a) *Russian Foreign Policy, The Return of Great Power Politics*, Rowman & Littlefield Pub, p.246

<sup>1203</sup> STERN: (2005) p.101

<sup>1204</sup> Janusz BUGAJSKI: (2004) *Cold Peace: Russia's New Imperialism*, Greenwood Pub, p.101.

Moldova's debt to Gazprom was only \$22.2 million, including \$14.3 million debt to Transnistria. The debt of Moldova to Gazprom at the end of 1997 constituted \$510.8 million. This is including the penalties in the amount of \$149 millions.<sup>1205</sup> In 2001, Moldova owed more than \$600 million (\$500 of this debt is for Transnistria) only to Gazprom, and over \$861 million in total. In mid-2003, the debt amounted to \$1.137 billion.<sup>1206</sup>

In 1998, Moldova's government saw its debt as impossible to pay off and even planned to hand over its whole gas supply system to Gazprom. In 1998, Gazprom threatened to cut-off Moldova's gas supply due to non-payments and a contractual dispute. As a response, Moldova threatened to cut-off the transit gas to Bulgaria, Turkey and Greece and as this would result in economic losses for Russia, the cut-off never came about.<sup>1207</sup> After gas deliveries were halted because of outstanding debts, Putin changed this situation in April 2000, by agreeing to reschedule the debt for 20 years. Putin promised that Moldova would have to pay less for Russian gas supplies and in return, Russia would get more shares in a joint gas company. In 2002, Russia once again promises to supply cheap gas, but this time in exchange for contracts to reconstruct the Moldovan Hydropower Station.<sup>1208</sup> However, it is strange that during the cut-offs (1999-2000) Transnistria has received gas all the time. The official explanation given was that the confrontation of the pipeline system makes cut-offs of Transnistria impossible without also affecting supply to states like Romania and Bulgaria.<sup>1209</sup>

In 2004, the obligations of Moldova and Transnistria had been separated out by Gazprom with both entities having difficulty in collecting payments from consumers. According to Stern, by April 2004, debts had mounted to \$308 million for Moldova and \$960 million for Transnistria.<sup>1210</sup> Although there was a threat to cut-off the supply, it did not occur due to reason of the Moldova's transit role. But when the subject is the Ukraine's debt, Russia

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<sup>1205</sup> PARLICOV and ŞOITU, p.6-17.

<sup>1206</sup> LEIJONHIELM and LARSSON, p.126.

<sup>1207</sup> Ibid, p.127.

<sup>1208</sup> Bertil NYGREN: (2008) *The Rebuilding of Greater Russia, Putin's Foreign Policy Towards the CIS Countries*, Routledge, p.96.

<sup>1209</sup> LEIJONHIELM and LARSSON, p.128.

<sup>1210</sup> STERN: (2005), p.102

does not hesitate for cutting-off the transition to Europe. Most probably, Moldova's debt was still not at the limits of such an action or Russia did not want to lose Transnistria.

During the Putin's second term, Russia cut off gas to Moldova in January 2006 due to price dispute.<sup>1211</sup> Gazprom cut off natural gas supplies to Moldova, after Moldova rejected Gazprom's demand for a doubling of the price Moldova pays for natural gas. Gazprom restored supplies on January 17, in exchange for a price increase from \$60/tcm to \$110/tcm.<sup>1212</sup> This time, Gazprom asked for a controlling share of MoldovaGaz. Instead, Moldova offered its own shares in MoldovoGaz in Transnistria to Gazprom to alleviate the negotiations on gas prices.<sup>1213</sup> Later, Moldova also agreed to give Gazprom, already the majority shareholder, Transnistria's 13% stake in MoldovaGaz, which controls Moldova's natural gas pipelines and other infrastructure (Moldova had earlier ceded majority control to Gazprom in exchange for settling Moldova's gas debts). As a result of the agreement, Gazprom now holds 63.4% of MoldovaGaz's shares and has control of Moldova's domestic gas infrastructure. One year later, Gazprom increased the price of its gas to Moldova to \$170 per tcm.<sup>1214</sup>

On September 17, 2006, the residents of Transnistria voted in favor of joining Russia by a margin of 97% for to 2% against. While not unexpected, the vote encouraged President Voronin to seek some relations of Moldova's differences with Moscow. In the summer of 2007, as Russian-Georgian relations reached on impasse, Putin decided to open negotiations with Voronin for diplomatic settlement. Some issues were resolved-ending the boycott of Moldovan wines and reaching agreement on the price of Russian natural gas.<sup>1215</sup> Head of Gazprom, Alexei Miller met with the Moldovan authorities in Moscow in September 2009 to discuss the matters of cooperation between Gazprom and Moldova's gas company MoldovaGaz, in which Gazprom has a 50% share based on a 1999 agreement. According to the official statement, they met to discuss the gas price for Moldova will reach a Central European level in 2011. However, according to some sources

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<sup>1211</sup> PIROG, p.9

<sup>1212</sup> WOEHREL, p.10, Vladimir SOCOR: (2006) "Russia-Moldova Gas Armistice: A Precedent For Others?", *Eurasia Daily Monitor*, Vol.13, Issue:12, January 18.

<sup>1213</sup> NYGREN, p.97.

<sup>1214</sup> WOEHREL, p.10, SOCOR: (2006).

<sup>1215</sup> Robert H. DONALDSON and Joseph L. NAGEE: (2009) *The Foreign Policy of Russia: Changing Systems, Enduring Interests*, M.E. Sharpe, p.206

actual reason behind the meeting was Gazprom's fear that its 50% share in MoldovaGaz might be under the threat. In fact, Gazprom was worried due to statements of Chisinau's mayor Kirtoake<sup>1216</sup> about nationalizing important enterprises such as MoldovaGaz.<sup>1217</sup>

In conclusion, Moldova is looking for another energy projects in order to decrease its dependency to Russia. The recent project is the LNG transportation between Romania, Georgia and Azerbaijan. The project is designated as the Azerbaijan-Georgia-Romania Interconnector (AGRI) and the cost has been estimated at between 4 and 6 bil € The AGRI had drawn the attention to the Moldovan authorities as a real prospect of improvement of the energy potential and reducing of dependence on Russian natural gas. It might be an advantage for be a priority for the energy security of Moldova, especially entirely the dependence of country on Russian gas supplies.<sup>1218</sup>

## **15. RUSSIAN ENERGY RELATIONS WITH CAUCASIA**

### **15.1. Russia-Georgia Energy Relations**

The conflict between Moscow and Tbilisi goes back a long way. Georgia was the first former Soviet republic to leave the Soviet Union. In 1993, Russian troops intervened in a civil war for supporting Eduard Shevardnadze, the former Georgian president. Since then, tensions have risen steadily over a number of issues, from the presence of Russian military bases in Georgia to Russian allegations that Chechen rebels used Georgia as a safe haven.<sup>1219</sup> The geographic proximity of Georgia to the Black Sea region, the Caspian and Central Asia makes this transit country an important player in relation to the current and future energy exports from Azerbaijan, Kazakhstan, Turkmenistan and possibly Uzbekistan.<sup>1220</sup>

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<sup>1216</sup> Dorin Kirtoake, Kishinev's mayor and leader of the Moldovan Liberal Party.

<sup>1217</sup> Eurasia Energy Observer (2009) "Gazprom's Share in Moldovagaz No Longer Self Evident", 22 September 22 <http://www.eurasia-energy-observer.com/news/2009/moldova-to-pay-central-european-gas-price-for-russian-gas-in-2011> (Accessed on 22 September 2009)

<sup>1218</sup> Viorica ANTONOV: (2010) "Opportunities to Enhance Energy Security of the Republic of Moldova", *Moldova's Foreign Policy Statewatch*, Issue 6, July, p.1

<sup>1219</sup> Ivars INDANS: (2007) "Relations of Russia and Georgia: Developments of Future Prospects", *Baltic Security and Defense Review*, p.132

<sup>1220</sup> Shamil Midkhatovich YENIKEYEFF: (2008b) "The Georgia-Russia Standoff and the Future of Caspian and Central Asian Energy Supplies", *Oxford Institute for Energy Studies*, August, p.1.

**Map 36: Caucasian Pipelines**



Source: <http://hikm.wordpress.com/2006/01/27/gas-oil-pipelines-in-the-caucasus-region/>

The Russian company Itera was the main supplier of gas to Georgia from 1996 to 2003. In 1998 the Georgian partners of Itera acquired ten distribution networks in the industrially active regions of Kvemo Kartli and Shida Kartli. Itera demanded that the Georgian government sell it Tbilisi distribution, the main pipelines, and Rustavi Azoti in exchange for writing off the existing debts (according to Itera by 2002 the debts amounted to 91 million USD). The Georgian government refused to sell the Tbilisi distribution and main pipelines to Itera, but it agreed to transfer the Rustavi Chemical Company.<sup>1221</sup>

Gazprom made its first big move into Georgia in 2003, taking over the gas transportation business from Russian-American gas trader Itera, itself affiliated with former Gazprom officials.<sup>1222</sup> Georgia signed a 25 year agreement on strategic partnership with Gazprom on 1 July 2003 despite strong objections from partners within east-west corridors. The

<sup>1221</sup> Georgia's State Energy Policy in the Natural Gas Sector, (29 February 2008) p.1-2 Available on site [http://www.investmentguide.ge/files/160\\_158\\_967660\\_GeorgiasEnergyPolicy-NaturalGasSectorENG.pdf](http://www.investmentguide.ge/files/160_158_967660_GeorgiasEnergyPolicy-NaturalGasSectorENG.pdf) (Accessed on September 2010).

<sup>1222</sup> INDANS, p.137.

agreement provided almost everything including operation of the Georgian pipeline network.<sup>1223</sup>

In January 2005, Gazprom announced its interest in privatizing Georgia's gas pipeline system. The Georgian gas pipeline system includes pipes which distribute gas in Georgia's regions and pipelines which are used for transporting gas from Russia to Georgia and Armenia.<sup>1224</sup> On the other hand, in April 2005, Georgia Prime Minister Zurab Nagaideli announced that trade turnover between Russia and Georgia had increased by 90% since 2003. While Saakashvili and his alliance are criticized former President Shevardnadze's economic deals with Russia, upon coming to power they have pushed for increased Russian investment and Russian participation in Georgian privatization efforts.<sup>1225</sup> Jervalidze and Rosner claim that "Russia's energy policy consisted in undermining or in gaining control of local gas markets and in creating barriers to a competitive transit route for Turkmen and Azeri gas through Georgia and Turkey."<sup>1226</sup> According to European specialists, Gazprom main agenda is to create a unified gas infrastructure by interconnecting Iranian, Armenian, Georgian, and Russian pipelines. This would enable the Russian company to control the potential gas flow from Iran to the European Union. Such developments would certainly strengthen the geopolitical role of Gazprom and Russia in the Caucasus and the Persian Gulf.<sup>1227</sup>

At the end of 2005 and the beginning of 2006, the Georgian government resumed negotiations with Gazprom regarding the conclusion of a long-term agreement on gas supply. At the end of January 2006, however, after the explosion that took place on the pipelines incoming from Russia (on the Russian territory) and left the Georgian population without heating for almost ten days in winter, the negotiations were suspended.<sup>1228</sup> Explosions occur on the Russian side of the Georgian-Russian border, damaging a gas pipeline and an electricity transmission line and cutting gas and electricity supplies to

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<sup>1223</sup> Liana JERVALIDZE and Kevin ROSNER: (2006) *Georgia: Russian Foreign Energy Policy and Implications for Georgia's Energy Security*, GMB Pub, p.34.

<sup>1224</sup> INDANS, p.137.

<sup>1225</sup> Eric R. SCOTT: (2006) "Uncharted Territory: Russian Business Activity in Abkhazia and South Ossetia", in ", in Andreas Wenger, Jeronim Perovic, and Robert W. Orttung (ed.) *Russian Business Power – The Role of Russian Business in Foreign and Security Relations*", Routledge, p.220.

<sup>1226</sup> JERVALIDZE and ROSNER, p.17.

<sup>1227</sup> Georgia's State Energy Policy in the Natural Gas Sector, (29 February 2008) p.4.

<sup>1228</sup> Ibid, p.5.

Georgia. These explosions occur days after Russia cut energy supplies to Ukraine, and are blamed on unidentified terrorists.<sup>1229</sup> Georgian President Saakashvili said after the explosion that “we have received numerous threats by Russian politicians and officials at different levels to punish us for basically for not giving them pipelines”.<sup>1230</sup>

Nevertheless, by the end of January 2006 Georgian gas units, except for the main pipelines and cement works, were sold to Russian-Georgian and Russian-Kazakh business groups related to Gazprom. The relations between Russia and Georgia further deteriorated in 2006 and the Russian side imposed a full economic embargo on Georgia.<sup>1231</sup> Simultaneously Gazprom doubled prices for Georgia to \$110 tcm and proposed a further rise to \$230 at the start of 2007 - the highest for the former Soviet Union Republics.<sup>1232</sup> Gazprom said that the reason was commercial, and Russian officials also said that the wine and mineral water restrictions are health-related. Georgians saw all these acts as political, and had retaliated by withholding approval for Russia's bid to join the World Trade Organization.<sup>1233</sup>

Gazprom's move in December 2006 to double natural gas prices for Georgia increased the pressure on Georgian government and also increased the incentive for the Georgian authorities to diversify their energy supply, which they have sought to do in recent discussions with Azerbaijan, Turkey and Iran.<sup>1234</sup> As a result, the Georgian government addressed Turkey with a request to allow Georgia to retain part of the Shah-Deniz gas to be transported by the South Caucasus Pipeline (SCPb). The price was \$120 USD tcm and Georgia was requesting Turkey to assign part of this gas. Turkey ultimately did not assist Georgia because it was already dependent on Russian gas (65% of Turkish gas came from

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<sup>1229</sup> Svante E. CORNELL, Johanna POPJANEVSKI, and Niklas NILSSON: (2008b) “Russia's War in Georgia: Causes and Implications for Georgia and the World”, Central Asia-Caucasus Institute & Silk Road Studies Program, *Policy Paper*, August, p.6.

<sup>1230</sup> BBC News (2006) “*Russia Blamed For ‘Gas Sabotage’*”, 22 January <http://news.bbc.co.uk/2/hi/europe/4637034.stm> (Accessed on 11 November 2009).

<sup>1231</sup> CORNELL, POPJANEVSKI, and NILSSON, p.6

<sup>1232</sup> Heidi KJAERNET: (2009) “The Energy Dimension of Azerbaijani-Russian Relations: Maneuvering for Nagorno-Karabakh”, in *Russian Analytical Digest*, “Russia's Energy Relations with Its Caspian Neighbors”, Center for Security Studies, ETH, Zurich, No.56, 3 March, p.3

<sup>1233</sup> INDANS, p.133

<sup>1234</sup> Eric R. SCOTT: (2007) “Russia and Georgia After Empire”, in *Russian Analytical Digest*, “Russian-Georgian Relations”, No.13, 16 January, p.4

Russia) at that time and a further increase of the level of dependence was neither economically nor strategically desirable for Ankara.<sup>1235</sup>

The relations between Russia and Georgia has weakened as a result of the Georgia's "Rose Revolution" which place in 2003 and brought President Saakashvili to power. Saakashvili stated that his country should be closer to the EU and NATO. He criticized Russian military bases in Georgia and wanted to upgrade Georgia's position on the route of new pipelines taking gas and oil from the Caspian Sea region to the west which would give western companies a route avoiding Russia.<sup>1236</sup> Yet, as the orange and rose revolution changed the situation in the region, Moscow started to using Gazprom as an instrument to extract a substantial financial crisis.<sup>1237</sup> Moreover, in July 2008, Russia adopted a new Foreign Policy concept that reaffirmed the "fundamental importance" of the CIS and characterized "the development of bilateral and multilateral cooperation with CIS member states". According to the new foreign policy concept, President Medvedev said that "Russia, like other in the world, is entitled to privileged in certain key region, notably the CIS."<sup>1238</sup>

In 8 August 2008, when Russian-Georgian war broke out, world had caught unprepared. The surprising part was the scope of Russia's willingness to employ military force against a neighboring state. According to many experts, the main objective of Russia was not related to South Ossetia or Abkhazia, but to punish Georgia and to restore its primacy over the former Soviet Union's territory.<sup>1239</sup> Some in the west saw Russia's invasion as an attempt by Moscow to influence discussions within NATO on the Membership Action plan for Georgia and Ukraine by demonstrating that the full integration of these countries into the alliance could undermine stability. Additionally, some see Russia's intervention as a response to the unilateral moves taken by the US and its allies, which led to sharp

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<sup>1235</sup> Georgia's State Energy Policy in the Natural Gas Sector, (29 February 2008) p.6-7.

<sup>1236</sup> INDANS, p.133

<sup>1237</sup> DONALDSON and NAGEE, p.176.

<sup>1238</sup> Mark KRAMER: (2008) "Russian Policy Toward the Commonwealth of Independent States-Recent Trends and Future Prospects", *Problems of Post-Communism*, Vol.56, No.6, p.3; "...in February 2006 the Georgian government withdrew from the CIS Council of Defense Ministers, declaring that Georgia was "setting out to join NATO and could not be part of two military blocks simultaneously".

<sup>1239</sup> CORNELL, POPJANEVSKI, and NILSSON, p.3-4, Krzysztof STRACHOTA and Wojciech GORECKI: (2008) "The Southern Caucasus and Central Asia After the Russian-Georgian War – the Geopolitical Consequences", Center for Eastern Studies, *CES – Commentary*, Issue 10, September 9, p.2

differences with Russia over issues such as Kosovo, NATO enlargement and the missile defense system to be deployed in Eastern Europe.<sup>1240</sup>

The conflict temporarily disrupted railway transport of Azerbaijani oil to Black Sea ports and some oil and gas pipeline shipments; although no major pipelines were damaged.<sup>1241</sup> During the Georgian-Russian crisis, when the BTC pipeline was frozen, Azerbaijan diverted its oil supplies to Russia via the Novorossiysk pipeline and to Iran via the Neka port. After the war, Baku continued its supplies through these routes.<sup>1242</sup> Shortly after the US administration strongly supported the Georgia and signed the US-Georgia Charter on Strategic Partnership in January 2009, which states that “our two countries share a vital interest in a strong, independent, sovereign, unified, and democratic Georgia”. It was also expressed that energy security goals includes “increasing Georgia’s energy production, enhancing energy efficiency, and increasing the physical security of energy transit through Georgia to European markets.”<sup>1243</sup>

As a result, Russia's success in Georgia, sent the message that Russia is willing to cut off energy supplies to achieve its objectives. This conflict has helped Moscow consolidate its domination over Caspian oil and natural gas transit routes. It has also encouraged Europe to focus more attention to alternative supplies.<sup>1244</sup> According to Jaffe, another conclusion is also, as Russia's military invasion of Georgia demonstrated, including the BTC pipeline from Azerbaijan to Turkey, the BTE pipeline from Azerbaijan via Georgia to Erzurum, and the CPC pipeline from Kazakhstan, operated only under the permission of Russia.<sup>1245</sup>

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<sup>1240</sup> Archil GEGESHIDZE: (2009) “Post-War Georgia: Resetting Euro Atlantic Aspirations?”, *Caucasus Analytical Digest*, “NATO and the South Caucasus”, No.6, 16 April, p.5, Chicky, Jon E. (2009) “The Russian-Georgian War: Political and Military Implications for US Policy”, Central Asia-Caucasus Institute & Silk Road Studies Program, *Policy Paper*, February, p.3.

<sup>1241</sup> Jim NICHOL: (2009a) “Armenia, Azerbaijan, and Georgia: political Developments and Implications for US Interests”, *CRS Report For Congress*, Order Code RL33453, April 9, p.1.

<sup>1242</sup> Nona MIKHELIDZE: (2009) “After the 2008 Russia-Georgia War: Implications for the Wider Caucasus and Prospects for Western Involvement in Conflict Resolution”, Paper of the conference “The Caucasus and Black Sea Region: European Neighborhood Policy and Beyond”, Istituto Affari Internazionali, Rome, 6-7 February, p.9

<sup>1243</sup> Jim NICHOL: (2009b) “Russia-Georgia Conflict in August 2008: Context and Implications for US Interests”, *CRS Report For Congress*, Order Code CRS RL 34618, March 3, p.7

<sup>1244</sup> Amy Myers JAFFE: (2009) “Russia and the Caspian States in the Global Energy Balance”, *Rice University, James A. Baker III Institute for Public Policy*, May 6, p.18

<sup>1245</sup> JAFFE, p.31

## 15.2. Russia-Azerbaijan Energy Relations

Modern commercial oil production in Azerbaijan began in about 1806, when oil was produced from shallow pits. An early problem for the oil producers was to transport their oil to the world's major oceans. The earliest exports went by river, road and railway to the main cities of Russia. In 1877, a railway from Azerbaijan to Batumi and Black Sea allowed the first exports directly by sea, though there were limited by the fact that the oil could only be shipped in individual barrels.<sup>1246</sup> Hundred years later, in 1901 Baku was producing majority of the world's oil supply. Zeynelabidin Tagiyev, Ludvig Nobel, and the Rotchilds<sup>1247</sup> laid a pipeline 500 miles from Baku to the Black Sea coast, where oceangoing ships were waiting their cargos to transport directly to European refineries. After this development, pipelines became the key to exploiting the Caspian resources.<sup>1248</sup> In the early 1990s, the Caspian Basin became the focus for the world oil industry for several reasons:

- The Caspian producing potential was judged to be world-class;
- This potential could not be realized within an acceptable time-frame without outside foreign participation;
- The oil and gas to be produced would be for the export market.<sup>1249</sup>

Between 1988 and 1994 the war between Azerbaijan and Armenia was cornerstone for Azerbaijan's foreign policy in the future. Azerbaijan chose to follow a closer relationship with US and Europe rather than with Russia. When Elchibey refused to join the CIS, the Azeri oil industry was effectively cut off from its access to the oil Soviet pipeline system.

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<sup>1246</sup> "Oil and Energy Trends (2008) "Exports From Azerbaijan: is Europe Being Too Optimistic?"; Vol.6, Issue 157, 18 April.

<sup>1247</sup> These are the families operating in oil sector at that time.

<sup>1248</sup> Steve LEVINE: (2007) *The Oil and the Glory, the Pursuit of Empire and Fortune on the Caspian Sea*, Random House Pub., p.217.

<sup>1249</sup> G. RABALLAND and G. REGIS: (2008) "Oil in the Caspian Basin, Facts and Figures", in Boris Najman, Richard Pomfret and Gael Raballand (ed.) *The Economics and Politics of Oil in the Caspian Basin*, Routledge, p.9.

This led Azerbaijan in 1992 to enter into discussion with Turkey for the construction of BTC.<sup>1250</sup> In 1993 President Abulfaz Elchibey was ousted in a coup and former KGB high officer Heydar Aliyev took the Presidency. During the time of Russian military assistance to Armenia, Aliyev was able to attract Western companies, which were essential in helping Azerbaijan to develop its oil and gas resources and to build pipelines that bypassed Russia.<sup>1251</sup> From its geographic location, Azerbaijan naturally has come to play an intermediary role with Russia, Turkey, the US, the EU, and Central Asia. This role of Azerbaijan is the often named “*Silk Road*” in the South Caucasus linking Europe and Central Asia due to the characteristics of its geographic location.<sup>1252</sup> In other words, Azerbaijan is a natural crossroads for the growing continental land – based trade and its geostrategic location is a key to connecting the transportation networks and markets of Europe, Asia, the Middle East and the Mediterranean region.<sup>1253</sup>

As Bahgat pointed, Azerbaijan is one of the Caspian states that view the development of their hydrocarbon resources as a cornerstone to their economic prosperity. However, Azerbaijan is a landlocked country and cannot ship its resources without transferring neighboring states. Instead, they have to be transported to their target markets by pipelines, which cross multiple international boundaries.<sup>1254</sup> As a result, Azerbaijan is emerging as an important of oil and natural gas and as a transport corridor between Europe and Central Asia. Its strategic location bordering the Caspian Sea has attracted significant interest in developing its oil and natural gas reserves.<sup>1255</sup>

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<sup>1250</sup> Martha Brill OLCOTT: (2009) “Russia, Central Asia and the Caspian: How Important is the Energy and Security Trade-off?”, *Energy Forum*, James A. Baker III Institute for Public Policy, Rice University, May 6p.12

<sup>1251</sup> Julia NANAY: (2009a) “Russia’s Role in the Eurasian Energy Market”, in Jeronim Perovic, Robert W. Orttung, and Andreas Wenger (ed.) *Russian Energy Power and Foreign Relations*, Routledge, p.112

<sup>1252</sup> Younkyoo KIM and Gu-Ho EOM: (2008) “The Geopolitics of Caspian Oil: Rivalries of the US, Russia, and Turkey in the South Caucasus”, *Global Economic Review*, 37:1, p.94

<sup>1253</sup> Taleh ZIYADOVI: (2007) “Azerbaijan”, in (Ed) S. Frederick Starr, “*The New Silk Roads: Transport and Trade in Greater Central Asia*”, Central Asia-Caucasus Institute & Silk Road Studies Program, p.304

<sup>1254</sup> Gawdat BAHGAT: (2002) “Pipeline Diplomacy: The Geopolitics of the Caspian Sea Region”, *International Studies Perspectives*, 3, p.322

<sup>1255</sup> Azerbaijan Energy Data, Country Analysis Briefs (2009) Energy Information Administration October Available on site <http://www.eia.doe.gov/cabs/Azerbaijan/Background.html> (Accessed on 6 September 2010).

Russia-Azerbaijan relations are primarily economic; trade represented 1.7 bil\$ in 2007, increasing by 57% from January to September 2008.<sup>1256</sup> Trade between Azerbaijan and Russia was worth \$848.555 million in the first half of the 2010. Exports to Russia were \$360.352 million in the reporting period, which is 3,52% of all Azerbaijan's exports, according to figures from the State Statistical Committee. Imports were \$48.204 million, 16,82% of all Azerbaijan's imports. The trade deficit with Russia was \$127.853 million. In 2009, trade between Azerbaijan and Russia was \$1.815 billion. In year 2009 exports to Russia were worth \$745 million, 5,07% of Azerbaijan's exports. In the same period imports were worth \$1.07 billion, which was 17,5% of all Azerbaijan's import.<sup>1257</sup>

### 15.2.1. Pipeline Diplomacy

Three principal objectives were guiding Azerbaijan's pipeline diplomacy as well as its foreign policy in the early aftermath of its independence: retaining independence, restoring territorial integrity, and securing economic recovery and self-sufficiency.<sup>1258</sup> Estimates of Azerbaijan's proven crude oil reserves range between 7 and 13 billion barrels. The State Oil Company of the Azerbaijan Republic (SOCAR) estimates proven reserves at 17.5 billion barrels, which may include reserves that are either not viable or not fully proven. Azerbaijan has proven natural gas reserves of roughly 30 Tcf (850 bcm), and there are potentially larger reserves.<sup>1259</sup> Most of the Azeri energy deposits are developed by the State Oil Company of the Azerbaijan Republic (SOCAR). The company was established in September 1992. Almost half of SOCAR's oil production comes from the offshore field Gunashli. Azerbaijan International Operation Company (AIOC) is the leading international consortium in charge of expanding the country's oil production and exert. (BP, Unocal, SOCAR, Inpex, Statoil, ExxonMobil, TPAO, Devon Energy, Itochu, and Delta/Hess are the main partners.)<sup>1260</sup>

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<sup>1256</sup> Jean-Philippe TORDIEU: (2009) "Russia and the Eastern Partnership After the War in Georgia", *IFRI*, August, p.15-16

<sup>1257</sup> Rufat ABBASOV: (2010) "Trade Between Azerbaijan and Russia Tops \$848 m", *New.Az*, 20 July <http://www.news.az/articles/19486> (Accessed on 8 August 2010)

<sup>1258</sup> Murad ISMAYILOV: (2010) "Continuity and Change in Azerbaijan's Energy Diplomacy", *Caucasian Analytical Digest*, No.16, 26 April, p.2

<sup>1259</sup> Ross YOUNG and Ruth WINSTONE: (2005) "The Caspian Basin, Energy Reserves and Potential Conflicts", *House of Commons Library*, Research Paper 05/24, 16 March, p.37-8

<sup>1260</sup> Gawdat BAHGAT: (2007) "Prospects for Energy Cooperation in the Caspian Sea", *Communist and Post-Communist Studies*, 40, p.159-60

**Table 37: Azerbaijani Oil - Proved Reserves at the end of 2009**<sup>1261</sup>

Thousand mil. ton.	Thousand mil. barrels	Share of total
1.0	7.0	0.5%

**Table 38: Oil and Gas Sector of Azerbaijan**<sup>1262</sup>

	1999	2005	2006	2007	2008	2009
<b>Oil – (mil ton)</b>						
Production	13.9	22.4	32.5	42.8	44.7	50.6
Consumption	5.7	5.3	4.8	4.3	3.5	2.8
Surplus	8.2	17.1	27.7	38.5	41.2	47.8
<b>Natural Gas – (bcm)</b>						
Production	5.4	5.2	6.1	9.8	14.8	14.8
Consumption	5.4	8.6	9.1	8.0	9.2	7.7
Surplus	-	-3.4	-3	1.8	5.6	7.1

In November 1994, an international consortium of oil companies (the Azerbaijan International Operation Company, AIOC) signed a PSA known as “Contract of the Century” with the SOCAR to develop the Azeri, Chirag, and Guneshli oil fields (ACG) located offshore in the Caspian Sea. The agreement called for a total \$7.4 bil investment over 30 years in the 3 offshore oil fields.<sup>1263</sup> Azerbaijan’s 1994 decision to open its energy sector in the Caspian Sea to international investors coupled with the Baku-Supsa and BTC oil pipelines and the BTE gas pipeline, aimed to strengthen Azerbaijan’s place in Europe, in close cooperation with Turkey and the United States.<sup>1264</sup>

Through most of the first post-Soviet decade, Moscow actively opposed the building of an east-west pipeline, championing continued export through Russian pipelines in order to maintain Caspian States’ dependency on Russia. The attitude changed in the late 1999 and

<sup>1261</sup> BP Statistical Review of World Energy (2010)

<sup>1262</sup> Ibid.

<sup>1263</sup> William PARTLETT: (2010) “Enforcing Oil and GAs Contracts Without Courts – Reputational Constraints on Resource Nationalism in Russia and Azerbaijan”, *Demokratizatsiya*, Winter, p.87

<sup>1264</sup> Mert BILGIN: (2009) “Geopolitics of European Natural Gas Demand: Supplies From Russia, Caspian and the Middle East”, *Energy Policy*, 37, p.44-87.

early 2000 when Moscow accepted the BTC project.<sup>1265</sup> Due to US Caspian policy supports break and new directions from the Russian transport monopoly, the question was raised whether the policy is directed against Russia itself.<sup>1266</sup>

**Table 39: Main oil and gas export pipelines in the South Caucasus<sup>1267</sup>**

Route	Start of Operation	Oil/Gas	Capacity	Notes/Expansion Plans
BTC	2006	Oil	1 million b/d	Expansion to 1.2 mb/d by end 2008, possible up to 1.8 mb/d
Baku-Supsa	1999	Oil	100 kb/d	Re-opened summer 2008 following 18 months repair
Baku-Novorossiysk	1983	Oil	100 kb/d	Originally north-south line, since 1997 sporadic use south-north
Baku-Tbilisi-Erzurum	2007	Gas	8 bcm/y	Expansion to 16-20 bcm/y in line with increased Azeri gas output.

#### 15.2.1.1. Baku-Tbilisi-Ceyhan Oil Pipeline, BTC

The majority of oil exports pass through the BTC pipeline system, which runs 1100 miles from the ACG fields in the Caspian Sea, via Georgia, to Ceyhan, Turkey. From Ceyhan port, the oil is shipped by tanker mainly to European markets, with Italy reportedly being the largest importer of Azeri crude in 2008 at about 40% of it exported. The BTC pipeline is also used to export Kazakhstan oil, which travels by tanker across the Caspian to the pipeline head at Sangachal Terminal, near Baku.<sup>1268</sup> To weaken Russian and Iranian

<sup>1265</sup> Brenda SHAFFER: (2005) "From Pipedream to Pipeline: A Caspian Success Story", *Current History*, October, p.345

<sup>1266</sup> Steven R. MANN: (2003) "Caspian Futures", in Jan M. Kalicki and Eugene K. Lawson (ed.) "*Russian-Eurasian Renaissance ? : US Trade and Investment in Russia and Eurasia*", Woodrow Wilson International Center for Scholars, p.152.

<sup>1267</sup> Perspectives on Caspian oil and Gas Development (2008), IEA Directorate of Global Energy Dialogue, December, p.47 Available on site [http://www.iea.org/papers/2008/caspian\\_perspectives.pdf](http://www.iea.org/papers/2008/caspian_perspectives.pdf) (Accessed on 02 January 2011)

<sup>1268</sup> Azerbaijan Energy Data, Country Analysis Briefs (2009).

control of Caspian oil and gas, the United States has heavily promoted the BTC. The BTC pipeline was originally proclaimed by BP, where Zbigniew Brzezinski, acting as a consultant to BP during the Clinton era, urged Washington to support the project.<sup>1269</sup>

According to Tsereteli, the construction of the BTC pipeline solidified the region's dramatic break from the shadows of an overbearing Russia, and it came into the visor of the rest of the world.<sup>1270</sup> Russia lobbied aggressively for the BTC consortium to be modeled on the Caspian Pipeline Consortium operating in Kazakhstan, in which the Russian government and Russian oil companies have a 45% stake, and was suspected of instigating civil society groups to protest against the construction of the BTC pipeline.<sup>1271</sup> According to the Russian experts, the construction of the BTC oil pipeline contradicts Russia's interests. Having obtained this alternative access to Azerbaijani oil, and avoiding passing through Russian territory thanks to the West, Russia consequently lost the ability to control the process of extraction and transportation of Azerbaijani oil.<sup>1272</sup>

The BTC pipeline Kazakhstan and Azerbaijan and as a result in June 2006, Presidents Nazarbayev and Aliyev agreed to create a Kazakhstan-Azerbaijan oil transportation system comprising a network of small crude oil tankers to ferry, at least initially, 7 m/t of Kazakh oil per year across the Caspian sea and into the BTC, an amount that accounts for just under 10% of BTC's maximum annual throughput.<sup>1273</sup> Russia, on the other hand, is strongly opposed to any transportation system that can reliably and cost-effectively carry sizeable amounts of oil or gas from the eastern shore of the Caspian to the western shore and thereafter link up to the existing BTC and BTE pipelines in Azerbaijan.<sup>1274</sup> Most importantly, Azerbaijan hoped that the BTC project would enhance international efforts to resolve the Nagorno-Karabakh conflict with Armenia. Georgia hoped its participation in

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<sup>1269</sup> Guo XUETANG: (2006) "The Energy Security in Central Eurasia: The Geopolitical Implications to China's Energy Strategy", *China and Eurasia Forum Quarterly*, Vol.4, No.4, p.127.

<sup>1270</sup> Mamuka TSERETELI: (2008) "Economic and Energy Security: Connecting Europe and the Black Sea-Caspian Region", Central Asia-Caucasus Institute & Silk Road Studies Program, *Silk Road Paper*, March, p.60.

<sup>1271</sup> Li-Chen SIM: (2009) "Russian-Azerbaijani Relations: All Change After the August 2008 War?", *Paper Prepared for the Annual Meeting Political Science Association*, Toronto, 3-6 September, p.13.

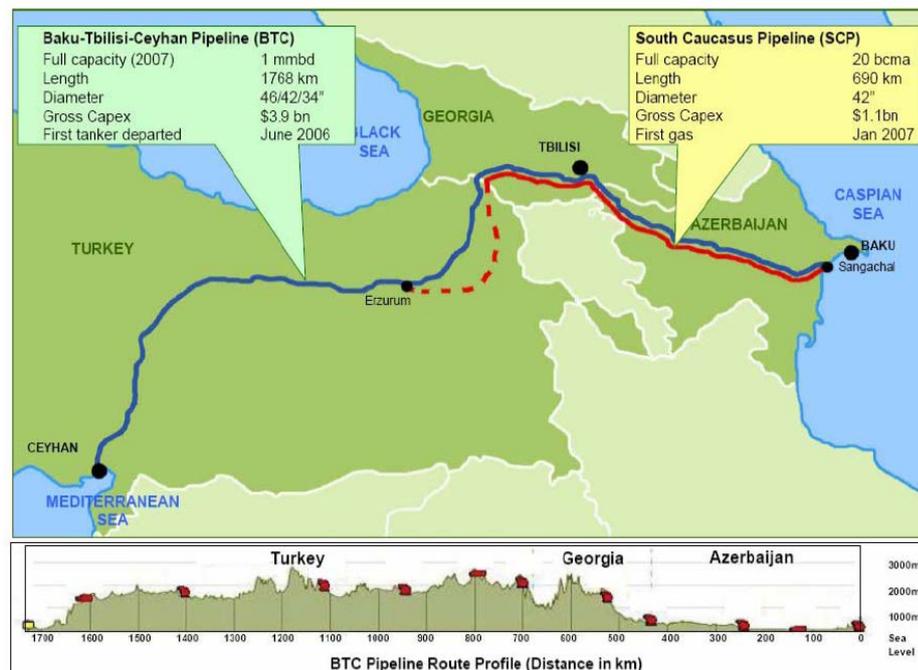
<sup>1272</sup> Eldar ISMAILOV: (2008) "A New Concept for Caucasus", *Southeast Europe and Black Sea Studies*, 8:3, p.191.

<sup>1273</sup> SIM, p.28.

<sup>1274</sup> *Ibid*, p.29

the project would encourage the international community to bring pressure on Moscow and its client separatists in Georgia to concede disputed territories back to Tbilisi. Neither of these scenarios has transpired, despite the opening of the pipeline.<sup>1275</sup>

### Map 37: BTC Pipeline



Source: Baloghanov, Elshan (2009) "Azerbaijan and New Energy Resource", *The Fourth Annual New Silk Road Conference*, Chicago, June 9 Available on site [http://www.azconsulatela.org/az\\_in\\_world/chicago.pdf](http://www.azconsulatela.org/az_in_world/chicago.pdf) (Accessed on 27 May 2010).

#### 15.2.1.2. Baku-Supsa Oil Pipeline

The construction of the 985 km-long Baku-Supsa oil pipeline in 1998 marked a significant shift in Azerbaijan's energy policy and was a milestone in developing the East-West energy corridor. The Baku-Supsa pipeline was the first pipeline that bypassed Russia. Although the pipeline has a limited capacity (115,000 bbl/d or 5 m/t of oil annually) and its

<sup>1275</sup> SHAFFER: (2005) p.346, Jean-Philippe TARDIEU: (2009) "Russia and the Eastern Partnership After the War in Georgia", *IFRI*, August, p.17; "...Situating within Azerbaijan's borders, Nagorno-Karabakh seceded during the Armenian-Azerbaijani war of 1994. The Armenian majority proclaimed the N-K Republic, supported by Yerevan, cutting off around 15% of Azerbaijan's territory. Since then, the issue has formed the basis of Azerbaijan's foreign policy, with Baku accusing Russia of supporting Armenia. Yet, the crisis in Georgia has shown that a "frozen conflict" could degenerate into armed confrontation."

initial purpose was to transport “early Azeri oil”.<sup>1276</sup> The Baku-Supsa pipeline is an alternative to BTC and its existence does decrease the region’s dependence on Russia.<sup>1277</sup> BP and most of its AIOC partners invested over \$500 mil in constructing an “early oil” pipeline from Azerbaijan to a new maritime terminal at Supsa in Georgia.<sup>1278</sup>

### **15.2.1.3. Baku-Novorossiysk Oil Pipeline**

The 830 mile long, 100.000 bbl/d capacity Baku-Novorossiysk pipeline runs from the Sangachal Terminal to Novorossiysk, Russia on the Black Sea. SOCAR operates the Azeri section and Transneft operates the Russian section.<sup>1279</sup> Since 2005 when the BTC became operational, an increasing proportion of Azeri oil has been diverted from the Baku-Novorossiysk pipeline to the BTC. Some Azeri officials have hinted that SOCAR might completely stop using the Novorossiysk route. They claim that they are losing millions of dollars due to mixing their high quality crude with Russia's Urals.<sup>1280</sup> In January-September 2010 the SOCAR exported 1.56 m tons of oil by this pipeline which is a decrease by 295.000 tons over the same period in 2009.<sup>1281</sup>

### **15.2.1.4. Baku-Tbilisi-Erzurum Gas Pipeline**

Baku-Tbilisi-Erzurum pipeline which runs from the BTC oil pipeline for 429 miles. The pipeline began exporting in 2007 with an initial capacity of 233 bcf (6,5 bcm) annually, which is to be increased in the future to 700 bcf (19,5 bcm) with the addition of the compression stations.<sup>1282</sup>

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<sup>1276</sup> Ziyadovi TALRH: (2007) “Azerbaijan”, in (Ed) S. Frederick Starr, “*The New Silk Roads: Transport and Trade in Greater Central Asia*”, Central Asia-Caucasus Institute & Silk Road Studies Program, p.317

<sup>1277</sup> Martha B. OLCOTT: (2000) “Regional cooperation in Central Asia and the South Caucasus?” in Robert Ebel and Rajan Menon (ed.) “*Energy and Conflict in Central Asia and the Caucasus*”, Rowman and Littlefield Pub., p.127.

<sup>1278</sup> Edward C. CHIW and Leigh E. HENDRIX: (2010) “Central Asia’s Pipelines: Field of Dreams and Reality”, The National Bureau of Asian Research, *NBR Special Report*, No.23, September, p.32

<sup>1279</sup> Azerbaijan Energy Data, Country Analysis Briefs (2009)

<sup>1280</sup> BAHGAT: (2007) p.167

<sup>1281</sup> News.Az (2010) “*SOCAR Reduces Oil Export by Baku-Novorossiysk Pipeline*”, 04 October <http://www.news.az/articles/economy/25840> (Accessed on 10 October 2010)

<sup>1282</sup> Azerbaijan Energy Data, Country Analysis Briefs (2009)

### 15.2.2. Growing Potential of Azerbaijan's Gas Sector

Azerbaijan's major natural gas production increases in the future are expected to come from the continuing development of the Shah Deniz field. The Shah Deniz offshore condensate and gas field PSA was signed in June 1996. Participants in the project include BP (25,5 %), Statoil (25%), SOCAR (10%), Total (10%), and TPAO (9%). It is estimated reserves are 1,2 Tcm of gas and 1,75 b/bbl of condensates.<sup>1283</sup> Phase I of the Shah Deniz field's development was completed in 2007. The field produced 110 bcf (3,1 bcm) in 2008 and is expected to increase production to 270 bcf (7,6 bcm) in 2009. Phase II of the Shah Deniz development is expected to have peak capacity of 700 bcf (19,8 bcm) but its completion is being delayed from 2013-2014 to 2016 due to lack of a transit agreement between Turkey and Azerbaijan.<sup>1284</sup> Since late 2005, Iran is also engaged in a gas swap deal with Azerbaijan, for the Azeri Republic of Nakhchivan. As stipulated in the 25 year contract, 80 mcm/y to Iran, who then delivers 85% to Nakhchivan. The delivery is due to rise to 402,5 mcm/y in the period 2009/2024 of which Iran will transfer 350 mcm/y to Nakhchivan.<sup>1285</sup>

Until 2006 when Shah Deniz first began production, Azerbaijan routinely relied on Russia for around 4,5 bcm of gas imports a year. Firstly, when Azerbaijan was preparing for the export of its own gas to Turkey, Gazprom insisted on increasing gas prices. After the rejection of the demand by Azerbaijan, Gazprom cut supplies immediately at the end of 2006, forcing Azerbaijan, Turkey and Georgia (which had also found itself facing much higher than expected prices for renewed Gazprom supplies) to restructure their own agreements.<sup>1286</sup> The price that Gazprom asked from Azerbaijan meant a rise in price from 60\$ to 100\$/tcm. Baku quickly agreed to Russia's demands as it did not want to upset Russia at a time when progress on, for example, Nagorno-Karabakh was being made.<sup>1287</sup> However, all the roles of actors have redistributed in the region, after Azerbaijan became

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<sup>1283</sup> NANAY: (2009a), p.116.

<sup>1284</sup> Azerbaijan Energy Data, Country Analysis Briefs (2009)

<sup>1285</sup> Perspectives on Caspian oil and Gas Development (2008), IEA Directorate of Global Energy Dialogue, December, p.29 Available on site [http://www.iea.org/papers/2008/caspian\\_perspectives.pdf](http://www.iea.org/papers/2008/caspian_perspectives.pdf) (Accessed on 02 January 2011) p.29, Oil and Energy Trends (2008) "Exports From Azerbaijan: is Europe Being Too Optimistic?", Vol.6, Issue 157, 18 April, p.5

<sup>1286</sup> John ROBERTS: (2009) "The Role of Azerbaijan in European Gas Supply and the Greek Interest", ICBSS, *Policy Brief*, No.15, May p.3

<sup>1287</sup> LARSSON: (2006) p.236.

gas exporter country. Secondly, in 2006, Gazprom proposed to more than double the price of gas from \$110 to \$235 for 2007. It is believed that, it was a reaction to Azerbaijan's increasing energy independence. Aliyev refused the offer and labeled it "commercial blackmail". As a breaking point of the Azerbaijan history, Aliyev decided not to accept to Gazprom price hike, and stopped importing Russian gas.<sup>1288</sup> Contrary to the other respondent states, Azerbaijan resisted on Russian pressure and actively reacted.

In June 2008 Russia offered to buy Shah Deniz II gas at "European-level" prices, and Iran has also expressed an interest. From a Russian perspective, getting Azerbaijan to supply the northern Caucasus areas of Russia makes strategic sense; it would supplement the Russian gas balance for the South Stream project, and enable Azerbaijan to supply alternative routes, particularly Nabucco.<sup>1289</sup> From the beginning, Azerbaijan saw its hydrocarbon resources as a key political tool. Heydar Aliyev, the Azeri President, reportedly said during the 1990s: "My weapon is oil, and with that we will manage to win the war in Nagorno-Karabakh."<sup>1290</sup> Although Azerbaijan hoped that its pipeline diplomacy would produce a solution for the Nagorno-Karabakh, Baku has failed in its strategy to be supported either by Washington or by Brussels, of the fact that Armenia occupies part of its territory. The reality of this situation is demonstrated in the voting record on UN General Assembly Resolution 10693 (passed on 14 March 2008), reaffirming the territorial integrity of Azerbaijan and demanding "the immediate withdrawal of all Armenian forces from all occupied territories there." The United States and France voted against.<sup>1291</sup> Even Stephen Blank believes that Washington is losing to Russia in the Caucasus policy. Blank thinks that, Russia sees itself as a responsible for security in the region and has moved to assume primacy in resolving the Nagorno-Karabakh issues.<sup>1292</sup>

As a result of the latest developments shows that Azerbaijan turned back to Russia. For instance, President Ilham Aliyev was not invited to the Nuclear Summit in Washington in April 2010, attended by all other regional leaders, including those of Armenia and Georgia.

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<sup>1288</sup> Georgeta POURCHOT: (2008) *Eurasia Rising, Democracy and Independence in the Post Soviet Space*, Greenwood Pub., p.82.

<sup>1289</sup> Perspectives on Caspian oil and Gas Development (2008), p.41-2.

<sup>1290</sup> PARTLETT: (2010) p.80

<sup>1291</sup> ISMAYILOV: (2010) p.3.

<sup>1292</sup> News.Az (2010) "Washington Losing to Russia in Caucasus Policy", 13 October .<http://www.news.az/articles/politics/24514> (Accessed on 15 October 2010)

In response Aliyev cancelled the military exercises with the US planned in May.<sup>1293</sup> Azerbaijan sent a message to the West that it can consider other options for its gas exports, including Russia. In October 2009 Gazprom signed an agreement with Azerbaijan's State Oil Company (SOCAR) on the export of 500 million cubic meters of Azerbaijani gas to Russia through the Baku-Novo Filya pipeline (it also proposed to buy the whole volume of Azeri gas).<sup>1294</sup>

Since the beginning of 2010 Russia has been allowed a greater role in Baku's energy export, a change reflected in a short-term contract with Russia's Gazprom on export (for market prices) of no less than 500 mcm of Azerbaijani gas annually.<sup>1295</sup> The gas relations have developed in September 2010 and two sides agreed on doubling the amount of the gas. So according to the latest contract between Azerbaijan and Russia, Azerbaijan will double gas exports to in 2011 and increase them further from 2012, that could undercut Europe's drive to secure supplies for the Nabucco project. Gazprom CEO Alexei Miller said about the latest contact that "this means Azerbaijan is giving priority to Russia, when it comes to ramping up exports of its natural gas suppliers". He also added that Russia would like to secure even larger supplies for its planned pipeline known as South Stream, a rival to Nabucco project.<sup>1296</sup> According to Rzayeva, in doing so, Azerbaijan not only weakens Turkey's position as a major transit state for delivering Azerbaijani and Central Asian gas to Europe but also undermines EU and US interests in reducing Europe's dependence on Russian gas. As a result, Azerbaijani reserves could be easily delivered to Europe by South Stream pipeline, rather than through Nabucco in the near future.<sup>1297</sup>

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<sup>1293</sup> Nona MIKHRELIDZE: (2010) "The Azerbaijan-Russia-Turkey Energy Triangle and Its Impact on the Future of Nagorno-Karabakh", *Instituto Affai Internazionali, Documenti* IAI 10-18, September, p.5.

<sup>1294</sup> Ibid, p.6-7.

<sup>1295</sup> ISMAYILOV, p.4, News. Azerbaijan (2010) "Azerbaijan Supplies 618 m cubic meters of Gas to Russia", 08 October <http://www.news.az/articles/economy/24252> (Accessed on 08 October 2010); "...since the beginning of 2010 SOCAR has exported 618 mcm of natural gas to Russia".

<sup>1296</sup> The Peninsula Qatar (2010) "Azerbaijan, Russia Seal Major Gas Deal" 4 September <http://www.thepeninsulaqatar.com/business-news/125348-azerbaijan-russia-seal-major-gas-deal.html> (Accessed on 8 September 2010)

<sup>1297</sup> Gulmira RZAYEVA: (2009) "Azerbaijan 's Diversified Energy Security Strategy", *Central Asia-Caucasia Institute-CACI*, November 26 Available on site <http://www.cacianalyst.org/?q=node/5222> (Accessed on April 2010)

### 15.2.3. Russia and the Importance of the Caspian Sea

The Caspian Sea is a 700-mile long lake with all four sides surrounded by land. Azerbaijan, Iran, Kazakhstan, Russia, and Turkmenistan are the five littoral states adjacent to the lake. Out of the volume produced in the Caspian Sea, Kazakhstan holds the largest ratio at 55%, and Azerbaijan holds approximately 20%. The amount of the oil reserves in the Caspian Sea is estimated at 18-34 m/bbl for oil. Moreover, the region produces more than 100 bcm and approximately 5% of the world gas production.<sup>1298</sup> Energy reserves are primarily located in Azerbaijan, and in three Central Asian states: Kazakhstan, Turkmenistan and Uzbekistan. Kazakhstan and Azerbaijan have the most significant oil reserves, while all four countries have substantial natural gas resources that have yet to be fully developed, with Turkmenistan accounting for the largest reserves.<sup>1299</sup>

According to Bahgat, there are three main challenges about Caspian Sea; assessment of the Caspian Sea's hydrocarbon potential, disagreements over the legal status of the Caspian Sea and rivalry over the most cost effective pipeline routes.<sup>1300</sup> The Caspian Sea is a unique body of water. It is the world's largest inland sea and possesses extensive oil and natural gas resources. Legal regimes in place for management of other inland seas and large lakes relate primarily to issues that are connected to the surface of the body of water.<sup>1301</sup> According to the UN Conventions on the Law of the Sea, nations bordering a sea may claim 12 miles from shore as their territorial waters and beyond that a 200-mile Exclusive Economic Zone. If the basin is considered a lake, the Caspian and its resources would be developed jointly.<sup>1302</sup>

The predominant Russian view during the 1990s was that the Caspian as a body of water has unique characteristics; therefore its status has to be regulated on an exceptional basis. Moscow insists that the Soviet-Iranian treaties of 1922-1940 still should be regarded as

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<sup>1298</sup> KIM and EOM, p.96.

<sup>1299</sup> HILL and FEEL, p.474.

<sup>1300</sup> BAHGAT: (2007) p.158.

<sup>1301</sup> Brenda SHAFFER: (2010) "Caspian Energy Phase I: Beyond 2005", *Energy Policy*, 38, p.7210

<sup>1302</sup> BAHGAT: (2007) p.161.

valid and providing the main legal base for this status.<sup>1303</sup> In July 2002, Russia and Azerbaijan laid down the principles for drawing the long disputed boundary of the Caspian seabed. Afterwards, Russia, Azerbaijan and Kazakhstan signed a trilateral agreement which divides the northern 64% of the Caspian Sea into three unequal parts according to a median line principle, giving Kazakhstan 27%, Russia 19%, and Azerbaijan 18%. Iran and Turkmenistan have refused to sign up.<sup>1304</sup> Iran does not recognize the trilateral agreement between Baku, Moscow and Astana and proposes that each state should be allocated an equal 20 percent share.<sup>1305</sup> The status of the surface of the Caspian is subject to different principles, on which there is not yet formal unanimous agreement. Russia's position had been that the surface should be held in common, which in practice would have given that country, with the superior military power on the Caspian, effective control.<sup>1306</sup>

### 15.3. Russia-Armenia Energy Relations

Armenia, the smallest of the three Transcaucasia republics, is a landlocked mountains country bounded on the north by Georgia, on the east and southwest by Azerbaijan, on the south by Iran and on the west by Turkey.<sup>1307</sup> Since 1989, Azerbaijan has closed railways and pipelines traversing its territory to Armenia and also Turkey closed its borders with Armenia in 1993. These obstructions have had a negative impact on the Armenian economy, since it is heavily dependent on energy and raw materials.<sup>1308</sup> The only two access options for general commodities, containers or raw materials that Armenia has are through Iran, or through Georgian ports.<sup>1309</sup> Of all the countries of the South Caucasus, Armenia is the only one to maintain a pro-Russian foreign policy, and is the closest with Russia, as well in terms of capital and trade relationships.<sup>1310</sup> In addition to the historical ties between Moscow and Yerevan, Russia signed agreements with Armenia, under which

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<sup>1303</sup> Andrei SHOUMIKHIN: (1997) "Developing Caspian Oil: Between Conflict and Cooperation", *Comparative Strategy*, 16, p.338-39.

<sup>1304</sup> Jeronim PEROVIC: (2005) From Disengagement to Active Economic Competition: Russia's Return to the South Caucasus and Central Asia", *Demokratizatsiya*, Vol.13, No.1, Winter, p.68-9.

<sup>1305</sup> Ziyadovi TALEH: (2007) "Azerbaijan", in (Ed) S. Frederick Starr, "*The New Silk Roads: Transport and Trade in Greater Central Asia*", Central Asia-Caucasus Institute & Silk Road Studies Program, p.326.

<sup>1306</sup> YOUNG and WINSTONE, p.11

<sup>1307</sup> European bank of Reconstruction and Development (2010) Armenia, May Available on site <http://www.ebrd.com/downloads/research/factsheets/armenia.pdf> (Accessed on 4 August 2010).

<sup>1308</sup> NICHOL: (2009a) p.20

<sup>1309</sup> TSERETELI, p.64

<sup>1310</sup> KIM and EOM, p.91

Russia became the main supplier of arms and fuel supplies to the latter.<sup>1311</sup> Armenia hosts one of the Russia's largest bases abroad rent free and Yerevan also delegates the guarding of its Turkish and Iranian borders to Russia.<sup>1312</sup>

Natural gas is the most important energy source, and it is imported from Russia. The designed capacity of the high-pressure gas transportation network of Armenia is 17 bcm a year. In 1980, the maximum demand for natural gas in Armenia was above 5-6 bcm. There have been five main gas pipelines built, which ensured the gas delivery from three sides: Georgia, North and West Azerbaijan. Today, only the Georgian route is operating. In 2009, the natural gas demand was 1,662 bcm, but the expected demand by the year 2017 will be 5.5-6.2 bcm/year. The gas pipeline Iran-Armenia is fully constructed and ready to put into operation since spring 2009.<sup>1313</sup> Russia remains Armenia's foremost commercial partner with a trade volume of 700 m\$ in 2007, up 60% since 2005. Russian investors control, in particular, Armenia's railways and 90% of the mobile telephone operator Armentel. Russia provides Armenia with nuclear fuel for its "Metsamor power station" as well as gas. Considered to be Russia's primary ally, Armenia is highly dependent on Georgia, through which 80% of its foreign trade transits.<sup>1314</sup>

When Baku was signed the "Contract of Century" with western consortiums in 1992 and when NATO was finalized its Partnership for Peace with countries of the CIS, including Armenia, Russia has considered Armenia as Russia's outpost in the region.<sup>1315</sup> The strategic alliance with Armenia especially after the revolution in Georgia, has deepened in economic and military terms. During the Georgian political crisis in November 2003, the Russian and Armenian defense ministers signed agreements deepening military cooperation.<sup>1316</sup> Finally Russia extended the lease on its base in Armenia from 2020 to

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<sup>1311</sup> BAHGAT: (2002) p.321

<sup>1312</sup> Jean-Philippe TORDIEU: (2009) "Russia and the Eastern Partnership After the War in Georgia", *IFRI*, August, p.14

<sup>1313</sup> European Bank of Reconstruction and Development (2010) Armenia

<sup>1314</sup> TORDIEU, p.14

<sup>1315</sup> Goidz MINASSIA: (2008) "Armenia, a Russian Outpost in the Caucasus", *IFRI*, February, p.7

<sup>1316</sup> Stanislav SECRIEU: (2006) "Russia's Foreign Policy Under Putin: CIS Project Renewed", *UNISCI Papers*, No.10, January, p.299

2044.<sup>1317</sup> However, as soon as Medvedev signed a military agreement with Armenia, Russian President flew to Baku and discussed the urgent issues with President Aliyev. In fact, Russia wants to develop its relations simultaneously with Armenia and Azerbaijan without losing any of them.

### 15.3.1. Isolation Problem of Armenia

The BTC pipeline brought about the effect of isolating Armenia, which Azerbaijan sees as being able to be used as a lever in negotiations over the Nagorno-Karabakh region.<sup>1318</sup> For Armenia, the resolution of the conflict is a necessary condition for its full-scale integration in the potentials of regional cooperation. However, it is observed that energy production and transportation, is in the interest of all parties.<sup>1319</sup> Russia's decision to raise the tariff for gas supplied to Armenia in the winter of 2005–2006 and the closure of the Verkhny Lars crossing point at the Russia- Georgia border had some negative effects on the Armenian economy and caused serious concern in Yerevan. Even the pro-Russian Armenian politicians have understood that Russia has changed its policies, including its policies towards its most loyal partners.<sup>1320</sup> Through a combination of debt-for-equity swaps and buying out the American company AES, RAO UES controls now some four-fifths of Armenia's electricity generating capacity. Among other things, the company acquired a 100 percent stake in Armenia's only nuclear power plant.<sup>1321</sup>

On March 19, 2007, Armenian President Robert Kocharyan and Iranian President Mahmoud Ahmadinejad inaugurated an 88-mile gas pipeline from Tabriz in Iran to Kadjaran in Armenia. Initial deliveries reportedly will be 4 bcm of Iranian (and possibly Turkmen) gas. The Russian-controlled ArmRosGazprom joint venture operates the Iran-Armenia pipeline. Work has started on the second part of the pipeline, a 123 mile section

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<sup>1317</sup> Vladimir RODIONOV: (2010) "Russia Seeks to Maintain Balances Relations With Armenia, Azerbaijan", RIA Novosti, 8 September <http://en.rian.ru/analysis/20100908/160519251.html> (Accessed on 8 September 2010)

<sup>1318</sup> KIM and EOM, p.102

<sup>1319</sup> TSERETELI, p.62

<sup>1320</sup> Stepan GRIGORYAN: (2008) "The Future of Southern Caucasus In the Light of New Geopolitical Reconfigurations", *Lithuanian Foreign Policy Review*, No.20, p.107

<sup>1321</sup> PETROVIC: (2005) p.67

from Kadjaran to Ararat.<sup>1322</sup> According to Tsereteli, this event has some geo-strategic significance. It indicates a possibility for Iranian gas to be shipped to Russia for later export to Europe (assuming that Georgia agrees to transit Iranian gas). It also diversifies Armenia's energy supplies from a single Russian supply line, although Russia has indirect control over the Armenian portion of the Iran-Armenia pipeline through Gazprom's Armenian subsidiary ArmRosGas.<sup>1323</sup>

Minassia expresses the energy dependency of Armenia to Russia;<sup>1324</sup>

In April 2006 Gazprom and Yerevan signed a 25 year agreement on energy cooperation. In exchange for the opening of an oil refinery in Meghri on the Armenia-Iran border, and of a moderately increased gas price 56\$ tcm to 110\$ tcm, Russia has committed itself not to increase its rates until 2009 and has taken control of 75% of the Iran-Armenian gas pipeline, originally intended to diversify Armenia's energy supplies. Alexander Ryazanov, Vice President of Gazprom, warned in February 2005 that "if we do not participate in the Iranian-Armenian gas pipeline, nobody knows where this gas will end up". Russia thus made sure that the pipeline diameter was 34 inches (70 cm) instead of 48 inches (120 cm), preventing Armenia from becoming a transit country for natural gas. Thus, by securing control over the Iranian-Armenian gas pipeline, Russia is protecting its own projects to Europe to Turkey in the event of a normalization of the relations between the Iran and the EU.

In addition to gas pipelines, Armenia and Iran also planning to launch a construction of a fuel-pipeline to ship Iranian petrol and diesel to Armenia by the end of the 2010. The 375 km long fuel pipeline will run from Iranian Tebriz to Armenian Aragats -110km on Iranian territory and 265 on Armenian. The cost of building the fuel pipeline with a capacity to transport 1,5 m/t of fuel a year is \$160-180 million. It will be split equally between Armenia and Iran.<sup>1325</sup> On the one hand, Armenia is trying to reduce its dependence on Russia and diversify its resources, dealing with another problem at the same time. Head of the Moscow-based National Energy Security Fund Konstantin Simonov said that "Armenia's problem is that its neighbors are implementing large energy projects that have

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<sup>1322</sup> NICHOL: (2009a) p.34

<sup>1323</sup> TSERETELI, p.85

<sup>1324</sup> MINASSIA, p.8

<sup>1325</sup> ARKA News Agency (2010) "Armenia and Iran to Launch of Fuel Pipeline By the End of the Year", 25 October <http://www.arka.am/eng/energy/2010/10/25/22077.html> (Accessed on 25 October 2010)

their impact on Armenia's energy sector" and "Armenia has what many other countries dream to have 40%-50% energy surplus but the question is what to do with it."<sup>1326</sup>

## 16. RUSSIAN ENERGY RELATIONS WITH CENTRAL ASIA

### 16.1. Russia-Kazakhstan Energy Relations

In December 1991, Alma-Ata (former capital city of Kazakhstan) hosted a meeting of eleven leaders of the Soviet republics who signed the declaration of the end of the existence of the USSR. After gaining the independence, President Nursultan Nazarbaev came to power in 1989 and still governs the country even today.<sup>1327</sup> According to Abazov, "Kazakhstan shares the longest part of its borders with Russia,<sup>1328</sup> but also both countries' controversial relations were in the centre of the intellectual discourse in the post-Soviet Kazakhstan.<sup>1329</sup> Due to this reason, Russia was seriously considered as a way out of the systematic crisis and maintaining social stability in the country. Besides, Nazarbaev was the originator and the champion of the idea of "Eurasian integration" in the FSU and called Kazakhstan, "the Eurasian bridge", implying a country with geographic, cultural and historic affiliation to both Europe and Asia.<sup>1330</sup> But the plan failed to gain support among the other newly independent states that had only just rid themselves of a different (Soviet) type of union and were not eager to try another.<sup>1331</sup>

Kazakhstan is a landlocked state and share borders with Russia, China, Uzbekistan, Kyrgyzstan and Turkmenistan. The country has declared a "multivectoral" foreign policy which means a willingness to develop and improve strategic, diplomatic and economic

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<sup>1326</sup> ARKA News Agency (2010) "Armenia Has No Energy Security Problems: Russian Expert", 1 October <http://www.arka.am/eng/energy/2010/10/01/21698.html> (Accessed on 26 October 2010)

<sup>1327</sup> Rafis ABAZOV: (1998) "Practice of Foreign Policy Making: Formation of Post-Soviet Politics of Kazakhstan, Kyrgyzstan, and Uzbekistan" (final report), p.1-12 Available on site <http://www.nato.int/acad/fellow/96-98/abasov.pdf> (Accessed on April 2010).

<sup>1328</sup> Ibid.

<sup>1329</sup> Richard WEITZ: (2008) "Kazakhstan and the New International Politics of Eurasia", *Silk Road Paper*, Central Asia-Caucasus Institute & Silk Road Studies Program, July, p.115; "...the Russian – Kazakhs frontier represents the world's longest continuous land borders at over 7.000 km."

<sup>1330</sup> Evgeny VINOKUROV: (2010) "The Evolution of Kazakhstan's Position on Relations with Russia in 1991-2010", *MPRA Paper* No.22187, March, p.1-2 Available on site <http://mpra.ub.uni-muenchen.de/22187> (Accessed on 7 April 2010).

<sup>1331</sup> WEITZ: (2008) p.11.

relations with the major geopolitical powers in the international arena, namely China, Russia, the United States and Europe.<sup>1332</sup> From Wood words, “basically, the multivector idea appears of consist of the notion that the independent state should seek a abundance of alignments and bilateral relationships with as many outside powers as possible and avoid dependence on any one.”<sup>1333</sup>

From Kremlin’s point of view, Kazakhstan’s foreign and domestic policies have proven much less problematic for Russia than that of many other former Soviet republics. Since independence, Russia has remained Kazakhstan’s most important economic partner, especially for Kazakh energy exports, which are still heavily dependent on Russian controlled pipelines first constructed during the Soviet period.<sup>1334</sup> As an example for the Kazakhstan’s foreign policy perspective, Nazarbaev’s 18 February 2005 statement is especially important. He said that,<sup>1335</sup>

“today, we are witnessing superpower rivalry for economic dominance in our region. We have to address correctly this global and geo-economics challenge. We have a choice between remaining the supplier of raw materials to the global markets and waiting patiently for the emergence of the next imperial master or to pursue genuine economic integration of the Central Asian region. I choose the latter”.

In addition to that, in March 2009, during the 2<sup>nd</sup> Astana Forum, Nazarbaev said that integration processes should continue under the aegis organizations which set the course for a Customs Union, a common currency, common energy, and transport markets, and collective security. He certainly underlines that Kazakhstan will make full use of the advantages its energy resources, while maintaining a balance between the interests of major powers.<sup>1336</sup> The Customs Union has been established between Russia, Kazakhstan, and Belarus in 2011 and will begin to be implemented on January 1<sup>st</sup> of 2012.<sup>1337</sup>

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<sup>1332</sup> Zhanibek SAURBEK: (2008) “Kazakh-Chinese Energy Relations: Economic Pragmatism or Political Cooperation?”, *China and Eurasia Forum Quarterly*, Vol6., No.1, p.79.

<sup>1333</sup> Tom WOOD: (2008) “Failed Multilateralism or Emerging Bilateralism in Central Asia?”, *ISA Annual Conference*, San Francisco, p.3.

<sup>1334</sup> WEITZ: (2008) p.114.

<sup>1335</sup> Stephen BLANK: (2005) “China, Kazakh Energy, and Russia: An Unlikely Menage a Trois”, in “Energy Security”, Central Asia – Caucasus Institute & Silk Road Studies Program, *The China and Eurasia Forum Quarterly*, Vol.3, No.3, November, p.101.

<sup>1336</sup> VINOKUROV, p.8.

<sup>1337</sup> Forbes: (2011) “Putin's Dream Of Eurasian Union Could Control World's Energy, 11 November, <http://www.forbes.com/sites/greatspeculations/2011/11/11/putins-dream-of-eurasian-union-could-control-worlds-energy/> (Accessed on 11 November 2011).

### 16.1.1. Energy Sector of Kazakhstan

**Table 40: Kazakhstan's Oil and Gas Proven Reserves**<sup>1338</sup>

Oil	At end 1999 Thousand million tonnes	At end 2008 Thousand million tonnes	At end 2009	
			T m/ton	T m/bbl
	25.0	39.8	5.3	39.8
Natural Gas	At end 1999 Tcm	At end 2008 Tcm	At end 2009	
			Tcf	Tcm
	1.78	1.82	64.4	1.83

**Table 41: Kazakhstan's Oil and Gas Production**<sup>1339</sup>

	1999	2005	2006	2007	2008	2009
Oil million tonnes	30.1	62.6	66.1	68.4	72.0	78.0
Natural gas Bcm	9.0	22.6	23.9	26.8	29.8	32.2

On the eve of independence, when the Soviet Union as a whole produced 600 m/t of crude oil, output in Kazakhstan reached about 22 m/t per annum.<sup>1340</sup> Kazakhstan's oil production reached 72 m/t in 2008, more than double the level of a decade earlier. Kazakhstan has the Caspian Sea region's largest recoverable crude oil reserves and its production accounts for over half of the roughly 2.8 m/bbl per day. Kazakhstan's growing petroleum industry accounts for roughly 30% of the country's GDP and over half of its export revenues.<sup>1341</sup> According to the Ministry of Energy and Mineral Resource of Kazakhstan, by 2020 Kazakhstan should be producing around 200 m/t per annum.<sup>1342</sup> In addition to BP estimates of 64 Tcf (1,7 Tcm) of proven natural gas reserves, in January 2009, the Oil and Gas Journal estimated Kazakhstan's proven natural gas reserves at 85 Tcf (12,4 Tcm). Natural gas production has also increased from 9 bcm in 1999 to 32,2 bcm in 2009. Although, Kazakhstan consumed slightly more than it produced, domestic consumption

<sup>1338</sup> BP Statistical Review of World Energy (2010)

<sup>1339</sup> Ibid.

<sup>1340</sup> Rafael Kandiyoti, (2008) "What Price Access to the Open Seas? The Geopolitics of Oil and Gas Transmission From the Trans-Caspian Republics", *Central Asian Survey*, 27:1, p.77

<sup>1341</sup> Michael P. Barry, (2009) "Foreign Direct Investment in Central Asian Energy: A CGE Model", *Eurasian Journal of Business and Economics*, 2:3, p.44

<sup>1342</sup> Nadia CAMPANER and Shamil YENIKEYEFF: (2008) "The Kashagan Field: A Test Case for Kazakhstan's Governance of Its Oil and Gas Sector, *IFRI*, October, p.6

has been increasing at 9,5% per year in the past decade compared with production growth of 22% per year. According to EIA, it is apparent that Kazakhstan is shifting from a being a net natural gas importer to becoming a net exporter within the next few years.<sup>1343</sup>

#### **16.1.1.1. Oil Sector of Kazakhstan**

Today, Kazakhstan's major four large oil fields are; Tengiz, Uzen, Karachaganak and Kashagan. With somewhere between 6 and 9 b/bbl of recoverable oil, Tengiz is one of the richest fields in the world<sup>1344</sup> which was originally discovered in 1974. Kashagan is also Kazakhstan's largest offshore hydrocarbon field, known as the largest oil field outside the Middle East and the 3<sup>rd</sup> largest in the world<sup>1345</sup> with potential of 38 b/bbl of oil. Kashagan's recoverable hydrocarbon resources are estimated 7-9 b/bbl of oil and 489,5 bcm of gas.<sup>1346</sup>

In 1993, American company Chevron signed a deal with the government of Kazakhstan on establishment of TengizChevroil joint venture (TCO), which put Tengiz, containing 9 b/bbl of recoverable oil, on the global map. Shareholders of the TCO are ChevronTexaco 50%, ExxonMobil 25%, Kazmunaigaz 20% and LukArco 5%.<sup>1347</sup> In fact, Russian entrance was not on the plan, but Prime Minister Chernomyrdin assigned Lukoil boss Vagit Alekperov to Kazakhstan to demand a share in the joint venture. Alekperov said to the Kazakhstan administration that "we want to be a partner and want some part of Tengiz. Followed by, the Arco-Lukoil partnership paid \$200 million to Chevron in exchange for 5% of its Tengiz holdings.<sup>1348</sup>

In 1995 the American company Chevron began development in the Tengiz oil field in Kazakhstan as the principal investor. During the oil development in Kazakhstan large Russian influence was displayed Kazakhstan was not able to export its oil without going

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<sup>1343</sup> Kazakhstan: Country Analysis Briefs (2009) Energy Information Administration November Available on site <http://www.eia.doe.gov/cabs/Kazakhstan/pdf.pdf> (Accessed on 6 September 2010).

<sup>1344</sup> KANDIYOTI, p.78

<sup>1345</sup> BAHGAT: (2007) p.159

<sup>1346</sup> CAMPANER and YENIKEYEFF, p.5

<sup>1347</sup> Saulesh YESSENOVA: (2008) "Tengiz Crude, A View From Below", in Boris Najman, Richard Pomfret and Gael Raballand (ed.) *"The Economics and Politics of Oil in the Caspian Basin"*, Routledge, p.178.

<sup>1348</sup> LEVINE, p.280-2.

through the Russian oil pipeline. As the carrying capacity in transporting only Russian oil through the pipeline was insufficient, though the production volume of oil in Kazakhstan, was 90.000 bbl a day the transport volume capped by the Russian government at 65.000 and there were situations where the transported volume was reduced even further.<sup>1349</sup>

Central Asia was not only land-locked; it was completely isolated even from its immediate neighbors outside former Soviet space. Refineries in eastern Kazakhstan ran West Siberian crude oil production from Western Kazakhstan and shipped to Samara in the Russian Federation.<sup>1350</sup> According to a swap agreement, part of Kazakh oil goes to the refinery in Samara in Russia, in exchange, the rest of Kazakh oil extracted in the west was initially pumped through the Atyrau (former Guriev)–Samara oil pipeline into the Russian system. In the mid-to-late 1990s, Transneft only gave limited and unreliable access to Kazakh oil shipments from Tengiz through the Atyrau–Samara line.<sup>1351</sup>

Chevron restructured the previously ill-conceived attempt to build the CPC project into oil company-controlled dedicated primarily to moving crude oil from Kazakhstan to its own separate terminal on the Russian Black Sea coast.<sup>1352</sup> The construction of a pipeline bypassing Russian territory is not likely to meet with enthusiastic support but rather with critical and cold comments from the Kremlin. The reason is simple; transportation of oil directly to the consumer substantially reduces the dependency of Kazakhstan on Moscow and weakens the Kremlin’s influence in the region.<sup>1353</sup>

**Table 42: International Oil Pipelines of Kazakhstan**<sup>1354</sup>

Project	Project Partners	Route and Distance	Project Partners
CPC	Russia 24%, KazMunaiGaz% 19, Chevron 15%, LukArco 12.5%, Mobile Caspian Co. 7.5%, Rosnef-Shell 7.5%, CPC Co.	Tengiz to Novorossiysk (Russia) 1.510 km)	CPC Started crude oil export in 2001 to the terminal near Novorossiysk on the Black Sea on the test base. In

<sup>1349</sup> KIM and EOM, p.98

<sup>1350</sup> CHOW and HENDRIX, p.31

<sup>1351</sup> KANDIYOTI, p.79

<sup>1352</sup> CHOW and HENDRIX, p.32

<sup>1353</sup> SAURBEK, p.90

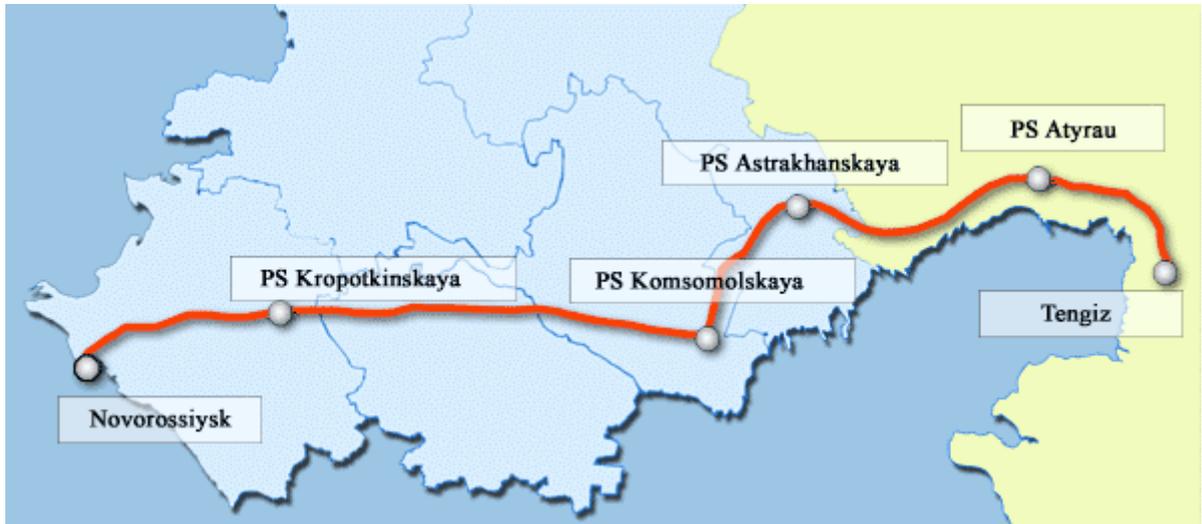
<sup>1354</sup> Naoko DOI: (2010) “Kazakhstan’s Energy Outlook”, IEEJ, September 2010, p.11 Available on site <http://eneken.ieej.or.jp/data/3324.pdf> (Accessed on 20 October 2010)

	7%, Eni Int. 2%, BG 2%, Kazakhstan Pipeline Ventures LLC 1.75%, Oryx 1.75%		2003, the first phase of the CPC system started regular operation. After all phases of the pipeline have been completed, the maximum throughput of the CPC pipeline system will reach 67 m/t of oil per year.*
ATYRAU-SAMARA	Russian Transneft and Kazakh KazTransoil	683 km	Prior to the commissioning of the CPC pipeline, the Atyrau-Samara pipeline was the main export pipeline. Current pipeline capacity stands at 321.000 bbl/d. Project operators plan to expand capacity to 522.000 b/d by 2015.
Kazakhstan-China	CNPC (China) and Kazmunaigaz	Atyrau (Kazakhstan) to Alashankou-Dashazi (China) 3.000 km	The construction of Kazakhstan-China crude oil pipeline was made in 3 phases with the first phase (Atyrau-Kenkyak) completed in 2003, the second phase (Atasu-Alashankau in China) completed in 2005, and the third phase linking the two pipelines (Kenkyak-Kumkol) completed in 2009. The initial capacity at 200.00 bbl/d is expected to double to 400.00 bbl/d once supply sources in the Caspian region are secured.

\* <http://www.cpc.ru/portal/alias!press/lang!en-US/tabID!3444/DesktopDefault.aspx>

### 16.1.1.1.1. CPC – Caspian Pipeline Consortium

**Map 38: CPC – Caspian Pipeline Consortium**<sup>1355</sup>



In 1992, the international Caspian Pipeline Consortium was formed by Kazakhstan, Russia and Oman to build a pipeline from Tengiz to Astrakhan and on the Russian Black Sea port to Novorossiysk. At that time, Chevron found the pipeline project unattractive and as a result the work was delayed. After the restructuring has begun in 1996, Chevron's share was cut.<sup>1356</sup> Later, the 1510 km pipeline was completed in 2001 at a cost of US\$ 2.6 bil and had an initial annual capacity of 28 m/t. The system was designed with an eventual maximum capacity of 67 m/t per annum.<sup>1357</sup> It is the only oil export pipeline on Russian territory not controlled by Transneft.<sup>1358</sup>

In December 1999, only a few months after being appointed Prime Minister and two weeks after the CPC groundbreaking ceremony, Putin organized a meeting in Moscow between Russian representatives and the principal directors of the private CPC shareholders. It was

<sup>1355</sup> Central Asia Executive Summary Series, Kazakhstan Country Profile (2009), *Program for Culture and Conflict Studies (CCS)*, Department of National Security Affairs, Naval Postgraduate School, No.4, July, p.25 Available on site [http://www.nps.edu/Programs/CCS/Docs/Central\\_Asia/Kazakhstan\\_July09.pdf](http://www.nps.edu/Programs/CCS/Docs/Central_Asia/Kazakhstan_July09.pdf) (Accessed on June 2010)

<sup>1356</sup> Peter RUTLAND: (2000) "Paradigms For Russian Policy in the Caspian Region", in Robert Ebel and Rajan Menon (ed.) *Energy and Conflict in Central Asia and Caucasus*, Rowman and Littlefield, p.175.

<sup>1357</sup> KANDIYOTI, p.79

<sup>1358</sup> Adrian DELLECKER: (2008) "Caspian-Pipeline Consortium, Bellwaver of Russia's Investment Climate", *Russie.Nei.Visions*, No.31, IFRI, June, p.6

accepted as a signal that Russia would show a keen interest in the pipeline.<sup>1359</sup> The CPC pipeline carries oil from Kazakhstan to the port of Novorossiysk on the Black sea. This gives Russia a near monopoly on the transport of Kazakh oil destined for western markets. In addition, Moscow has presented the Western oil companies with repeated financial demands, and threatening them with legal proceedings for allegedly unpaid taxes to Russia if they do not comply.<sup>1360</sup> In early March 2005, transit fees for the CPC line were raised from an already \$27 to \$ 29,5 per tonnes. Russia's obstruction of CPC expansion is likely to cause oil companies to hesitate to invest in a new pipeline through Russia for Kashagan.<sup>1361</sup> Moreover, the quantities of oil coming out of the Kashagan project forecast at 450.000 bbl/d in 2010 and eventually up to 1,2 million bbl/d will require at least one major new export pipeline. Thus, Kazakhstan has three options: a parallel CPC line; feeding Kashagan into the BTC; and exporting to China.<sup>1362</sup>

#### **16.1.1.1.2. Atyrau-Samara Pipeline**

Kazakhstan's other major oil export pipeline, from Atyrau to Samara, is a northbound link to Russia's Transneft distribution system, which provides Kazakhstan with a connection to world markets via the Black Sea. The line was upgraded in 2009 by the addition of pumping and heating stations and currently has a capacity of approximately 600 thousand bbl/d.<sup>1363</sup> Before the completion of the CPC, Kazakhstan exported almost all of its oil through this system. Since the early 2000s the Atyrau-Samara system lost some of its significance due to the completion of the CPC. But, in June 2002, Kazakhstan and Russia signed a 15 year oil transit agreement under which Astana will continue exporting part of its oil via the Atyrau-Samara pipeline.<sup>1364</sup> Under this agreement, Kazakhstan will export at least 17,4 m/t per year (350,000 bbl/d) of crude oil using the Russian pipeline system.<sup>1365</sup>

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<sup>1359</sup> Ibid, p.8

<sup>1360</sup> WOEHREL, p.4

<sup>1361</sup> CHOW and HENDRIX, p.35

<sup>1362</sup> Svante E. CORNELL: (2008) Trans-Caspian Pipelines and Europe's Energy Security", in (Ed) Cornell, Svante E., and Nilsson, Niklas, (Ed), "Europe's Energy Security, Gazprom's Dominance and Caspian Supply Alternatives", Central Asia-Caucasus Institute & Silk Road Studies Program, p.147

<sup>1363</sup> Kazakhstan: Country Analysis Briefs (2009)

<sup>1364</sup> BAHGAT: (2007) p.167

<sup>1365</sup> CAMPANER and YENIKEYEFF, p.29

Map 39: Oil Transportation Routes of Kazakhstan<sup>1366</sup>



### 16.1.1.1.3. Kazakhstan – China Oil Pipeline

The construction of the Kazakhstan – China pipeline is one of the most discussed projects in Central Asia. Because it contributed to the diversification of Kazakhstan’s hydrocarbon resources through alternative routes; and it resulted in the extension of Kazakh’s supplies directly to the consumer without transit through a third country.<sup>1367</sup> The pipeline has 998 km length and a capacity of 250 thousand bbl per day. It also connects to Trans-China Pipeline, which is the longest on the earth of 4,300 km.<sup>1368</sup> Consequently, in the east Russia faced competition with China considering the pipeline strategy and the energy market. In December 2005, China and Kazakhstan put into operation the Atasu Alashankau pipeline and Kazakhstan began delivering oil to China in May 2006. The initial capacity is 10 m/t per year and could be increased to 20 m/t. The Atasu Alashankau 3.000 km long oil pipeline is scheduled to be completed in three stages by 2011 and is expected to bring

<sup>1366</sup> SAURBEK, p.83

<sup>1367</sup> Ibid, p.86.

<sup>1368</sup> Ariel COHEN: (2006) *Kazakhstan: Energy Cooperation with Russia, Oil, Gas and Beyond*, GMP Pub., p.9.

around 200 thousand bbl/d to China.<sup>1369</sup> By 2015 it is planned to pump not less than 20 m/t annually, however, it is not clear that Kazakhstan will be able to extract the planned quantity of oil in 2015.<sup>1370</sup>

#### **16.1.1.2. Natural Gas Sector of Kazakhstan**

Kazakhstan's natural gas reserves represent about 1% of the world's reserves. Most of Kazakhstan's gas reserves are located in the west of the county near the Caspian Sea, with nearly 25% of proved reserves located in the Karachaganak field.<sup>1371</sup> Apart from being a gas producer, Kazakhstan is one of the former Soviet Union's main transit countries. The total projected annual capacity of Kazakhstan's pipelines is 235 bcm, with a combined length of 10.138 km of gas trunk pipelines.<sup>1372</sup> All the transportation and other logistical infrastructure of Central Asia were directed toward European Russia as part of the Soviet legacy. As well as oil and gas infrastructure pipelines crucially ran to Russia, likewise, communications, railroads, river and air transport were linked with Russia and nowhere else.<sup>1373</sup> Central Asian gas plays an important role in Russia's gas export strategy in relation to Ukraine, and Europe. In 2007, nearly the entire volume of Kazakhstan's total exports of around 8 bcm ended up in Ukraine.<sup>1374</sup>

In 2006, Kazakhstan transported 7.8 bcm of its own gas via the Russian route, in addition to 42 bcm of gas from Turkmenistan and around 9 bcm of Uzbek gas. According to preliminary KazMunaiGaz estimates, from 2010 to 2020 Kazakhstan could supply 5.83 bcm of Tengiz gas and 3.3 bcm of Kashagan gas annually via the Russian route if a large portion of gas is re-injected.<sup>1375</sup> Because of Kazakhstan's divided distribution network, Karachaganak's natural gas is exported northward to Russia's Orenburg processing plant.

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<sup>1369</sup> CAMPANER and YENIKEYEFF, p.32, Central Asia Executive Summary Series, Kazakhstan Country Profile (2009), p.27.

<sup>1370</sup> Vladimir PARAMONOV and Aleksey STROKOV: (2007) "Structural Independence of Russia & Central Asia in the Oil and Gas Sectors", Conflict Studies Research Centre, *Central Asian Series* 07/16E, June, p.9

<sup>1371</sup> Central Asia Executive Summary Series, Kazakhstan Country Profile (2009) p.26.

<sup>1372</sup> Shamil Midkhatovich YENIKEYEFF: (2008a) "Kazakhstan's Gas Export Market and Export Routes", *Oxford Institute for Energy Studies*, NG 25, November, p.33

<sup>1373</sup> CHOW and HENDRIX, p.31

<sup>1374</sup> YENIKEYEFF: (2008a) p.57

<sup>1375</sup> CAMPANER and YENIKEYEFF, p.34, Richard E. ERICSON: (2009) "Eurasian Natural Gas Pipelines: The Political Economy of Network Independence", *Eurasian Geography and Economics*, Vol.50, No.1, p.42

Russia and Kazakhstan signed an agreement and formed a joint venture between KazMunaiGaz and Gazprom which will upgrade the Russia's Orenburg plant to upgrade the amount to 15 bcm until 2012, which 7 bcm of will return to Kazakhstan. The remaining gas will be supplied to consumers in Russia or exported.<sup>1376</sup> According to Doi, Kazakhstan will be able to export about 15 bcm in 2030. Export to China may account for 5 bcm, and export to Russia through CAC may account for 10 bcm in 2030. However, Kazakhstan's natural gas production is also subject to the development of additional natural gas pipelines for both export and domestic supply, and government regulation over foreign investments.<sup>1377</sup>

**Table 43: International Natural Gas Pipelines of Kazakhstan**<sup>1378</sup>

Project	Type	Route and Distance	Project Status
CAC	Transit	Turkmenistan, Uzbekistan, Kazakhstan and Russia (5.000 km)	Main natural gas export pipeline in Central Asia (constructed in 1967), transporting gas from Turkmenistan, Uzbekistan, Kazakhstan and Russia. Two branches have a combined total capacity of 100 bcm. The Kazakhstan part serves as a transit. Connecting Turkmenistan and Kazakhstan with 10-30 bcm of capacity is planned to be built.
Turkmenistan – Kazakhstan – China Pipeline	Transit/Export	Turkmenistan, Uzbekistan, Kazakhstan and China (1818 km)	The construction of the first part of two parallel lines was completed in November 2009, and the second line is scheduled to be completed in 2014. Out of the total capacity at 30-40 bcm, Kazakhstan will export about 5-10 bcm to China.
Pre-Caspian Pipeline	Transit/Export	Turkmenistan, Kazakhstan, and Russia (1.700 km)	Signed in December 2007. The annual gas volume to be conveyed is projected to reach 30 bcm.

<sup>1376</sup> Mehmet ÖĞÜTÇÜ: (2006) "Kazakhstan's Expanding Cross-Border Gas Links, Implications for Europe, Russia, China and other CIS Countries", *CEPMLP Internet Journal*, Vol.17, Article 18, 21 November, p.8-9 Available on site [http://www.dundee.ac.uk/cepmlp/journal/html/Vol17/article17\\_8.php](http://www.dundee.ac.uk/cepmlp/journal/html/Vol17/article17_8.php) (Accessed on September 2008).

<sup>1377</sup> DOI, p.11.

<sup>1378</sup> Ibid.

Kazakhstan – China Pipeline	Export	Kazakhstan and China (1.300 km)	Signed in 18 August 2007 and projected to reach full capacity of 40 bcm by 2013.
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#### 16.1.1.2.1. Central Asia – Centre Pipeline

The CAC system supplied natural gas from the fields in Turkmenistan and Uzbekistan to the Soviet republics of the northern Caucasus, Russia, Kyrgyzstan and southern Kazakhstan. In terms of the growing competition over the energy resources of Central Asia, Moscow views this pipeline system as strategic economic and geopolitical priority and has tried to revitalize the gas transport link in order to keep the supply of gas to Europe under Kremlin control.<sup>1379</sup> In 2008, the annual volume of its gas transit is projected to reach 118.83 bcm. Since 2005, gas transit has slightly declined mainly due to the introduction of gas swap deals between Russia, Kazakhstan and Uzbekistan and the reduction of Russian and Turkmen gas volumes transported through Kazakhstan’s trunk pipelines in winter months.<sup>1380</sup>

#### 16.1.1.2.2. Pre-Caspian Gas Pipeline

On December 2007, a trilateral Agreement on Cooperation for the construction of the Pre-Caspian gas pipeline was signed. The aim of this cooperation was to carry the natural gas from the Caspian Sea and Turkmenistan and Kazakhstan to Russia. The annual natural gas volume to be conveyed via this pipeline is projected to reach 30 bcm from Turkmenistan and 10 bcm from Kazakhstan. The Pre-Caspian pipeline length will be estimated as 1.700 km, of over which 5.000 km will run via Turkmenistan, and about 1.200 km via Kazakhstan.<sup>1381</sup> It is accepted as a major success for Russia because this project would provide a much lower cost for both Turkmen and Kazakh natural gas exports than building a new-trans-Caspian pipeline, capturing future Central Asian gas for the Russian system and undercutting European bypass route hopes.<sup>1382</sup> Besides that, the excess gas could be the source of South Stream in short term. The initial cost of building this pipeline was

<sup>1379</sup> Central Asia Executive Summary Series, Kazakhstan Country Profile (2009), p.30.

<sup>1380</sup> YENIKEYEFF: (2008a) p.38.

<sup>1381</sup> Gazprom Company – Pre Caspian Pipeline Available on site <http://www.gazprom.com/production/projects/pipelines/pg/> (Accessed 25 April 2009).

<sup>1382</sup> ERICSON, p.51.

estimated at \$1 billion. Pre-Caspian pipeline will be built in two stages: at the initial stage (2009-2010), the pipeline will have an annual capacity of 20 bcm, of which Kazakhstan and Turkmenistan will contribute up to 10 bcm each.<sup>1383</sup>

### 16.1.1.2.3. Kazakhstan-China Gas Pipeline

**Map 40: Kazakhstan-China Pipeline Project.**<sup>1384</sup>



On August 2007, Kazakhstan and China reached an agreement on the construction and operation of the Kazakhstan-China gas pipeline network. 1.300 km Kazakhstan-China natural gas pipeline construction has started on July 8, 2008. The pipeline will be constructed in three stages. Initially, it will pump 4.5 bcm of gas and will reach full capacity of 40 bcm by 2013 when the final stage is completed. This new pipeline will cost approximately more than \$8.5 billion. The new transit route is part of a larger project to build two parallel pipelines connecting China with Central Asia's vast natural gas reserves. The pipeline will be more than 7.000 km from Turkmenistan, Uzbekistan and Kazakhstan, and enter China's northwestern Xinjiang region. The pipeline is the first significant independent gas link connecting the former Soviet region with eastern markets while

<sup>1383</sup> YENIKEYEFF: (2008a) p.62.

<sup>1384</sup> SAURBEK, p.87

bypassing Russia.<sup>1385</sup> In June 2010, Kazakhstan and China also have signed a new deal to build and finance a natural gas pipeline. Under this new agreement, the two countries will build a 1.400 km gas pipeline. It will link with an existing gas pipeline running between China and Central Asia.<sup>1386</sup>

## 16.2. Russia-Turkmenistan Energy Relations

When Turkmenistan became an independent country in December 1991, its president, Saparmurad Niyazov, had little preparation for the tasks that he faced. The Turkmen leader likens himself to Ataturk taking the name Turkmenbashi in 1993.<sup>1387</sup> President Saparmurad Niyazov governs a highly centralized authoritarian system with a strong personality cult. Preferring a title over the ordinary “president,” he has named himself Turkmenbashi, “Leader of all Ethnic Turkmen.”<sup>1388</sup> Niyazov abandoned multilateral approaches with bilateral relations articulated through the concept of “Positive Neutrality”. In December 1995, the UN officially recognized Turkmenistan’s position.<sup>1389</sup> Turkmenistan stayed outside the various abortive efforts by the other four Central Asian countries to create a Central Asian economic community and the Russian-led integration initiatives culminating in the Eurasian Economic Community (EurAsEc).<sup>1390</sup> Turkmenistan has cooperated with Russia in some areas while seemingly resisting other Russian influence. In 1992, the two states signed a Friendship and Cooperation Treaty containing security provisions. Although Turkmenistan joined the post-Soviet Commonwealth of Independent States, it did not sign the Collective Security Treaty and refused to sign other CIS agreements

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<sup>1385</sup> Silk Road Intelligence (2008) “Construction of Kazakhstan-China Gas Pipeline Started”, 9 July <http://silkroadintelligencer.com/2008/07/09/construction-of-kazakhstan-china-gas-pipeline-started/> (Accessed on 10 November 2009)

<sup>1386</sup> Wan ZHIHANG: (2010) “China, Kazakhstan Sign New Gas Pipeline Deal”, China Daily, 14 June [http://www2.chinadaily.com.cn/china/2010-06/14/content\\_9976764.htm](http://www2.chinadaily.com.cn/china/2010-06/14/content_9976764.htm) (Accessed on 15 August 2010)

<sup>1387</sup> Martha Brill OLCOTT: (2004a) “International Gas Trade in Central Asia: Turkmenistan, Iran, Russia and Afghanistan”, *Geopolitics of Gas Working Paper Series*, James A. Baker III Institute for Public Policy, Rice Uni., No.28, May, p.1

<sup>1388</sup> Kathleen J. HANCOCK: (2006) “Escaping Russia, Looking to China: Turkmenistan’s Pins Hopes On China’s Thirst For Natural Gas”, *China and Eurasia Forum Quarterly*, Vol.4, No.3, p.68

<sup>1389</sup> Steven SABOL: (2010) “Turkmenistan: Permanent Transition or Elusive Stability”, *The China and Eurasia Forum Quarterly*, Central Asia and Caucasus & Silk Road Studies Program, Vol.8, No.3, Autumn, p.18

<sup>1390</sup> Richard POMFRET: (2008) “Turkmenistan’s Foreign Policy”, *China and Eurasia Forum Quarterly*, Vol.6, No.4, p.21

viewed as violating its sovereignty and neutrality.<sup>1391</sup> Shortly after the Niyazov's death in December 2006, observers waited to see if the political process would collapse by virtue of "Color Revolution" or withstand the uncertainty of political succession. Nevertheless, Berdymuhammedov was rapidly selected as acting President.<sup>1392</sup>

### 16.2.1. Russia in Turkmenistan Again

About 70% of the country's territory has the potential to produce gas and this increase to 85% if including its offshore deposits in the Caspian Sea. Proven recoverable gas reserves total about 3Tcm. On the other hand, Russian specialists estimate Turkmenistan's gas potential at 4-15,5 Tcm. While Turkmenistan claims it has at least 23 Tcm of gas, and maybe up to 44 Tcm, Western experts estimate the numbers to be of a much lower range.<sup>1393</sup> In fact the natural gas reserves increasing every year. It was 2,1 Tcm and 13<sup>th</sup> in 2006<sup>1394</sup>, 2,67 Tcm and 11<sup>th</sup> in 2007<sup>1395</sup> and currently 8,1 Tcm and 4<sup>th</sup> largest after Russia, Iran and Qatar. The country's gas reserves increased significantly after the recent discovery of the super giant gas field, South Yolatan, in 2006.<sup>1396</sup>

The biggest Turkmen gas field is Dauletabad, located in the Amu'Darya basin. Brought into operation in the early 1980s, it currently accounts for 24,47% of the country's proven reserves. The most recently discovered fields are South Yolotan<sup>1397</sup> and Osman, in the Murgan basin.<sup>1398</sup> 90% of the Central Asian gas exports use the Russian gas network, and its main supplier is Turkmenistan. The Russian government is interested in maintaining this significant flow of Turkmen gas and in trying to involve Gazprom significantly in the operation and transportation of the new Turkmen reserves discovered in the South Yolotan

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<sup>1391</sup> Jim NICHOL: (2009d) "Turkmenistan: Recent Developments and US Interests", *CRS Report For Congress*, Order Code 97-1055, September 10, p.3-4.

<sup>1392</sup> SABOL, p.21.

<sup>1393</sup> TSERETELI, p.40-41.

<sup>1394</sup> HANCOCK, p.70

<sup>1395</sup> Marco GIULI: (2008) "Nabucco Pipeline and the Turkmenistan Conundrum", *Caucasian Review of International Affairs*, Vol.2 (3), Summer, p.125

<sup>1396</sup> Siamak ADIBI: (2010) "How Much Turkmen Gas in Middle East and Asian Gas Markets", *Hydrocarbon Asia*, January-March, p.26.

<sup>1397</sup> Stephen BLANK: (2007) "Turkmenistan and Central Asia After Niyazov", *Strategic Studies Institute*, September, p.27-31; "...it was claimed that the newly discovered field at Yolatan had reserves of 7 Tcm of gas more than twice Russia's holdings at Shtokman field."

<sup>1398</sup> GIULI, p.126

area.<sup>1399</sup> Following a dramatic decline in the late 1990s the volume of gas production and exports has been on the rise in recent years, but has not reached the level of the late 1980s. Large gas reserves are the key assets of the country’s energy sector. Problems arise due to limited access to gas export markets, neglected physical energy infrastructure and an unreformed economic system.<sup>1400</sup>

**Table 44: Natural Gas Sector of Turkmenistan (bcm)<sup>1401</sup>**

	1999	2005	2006	2007	2008	2009
Production	20.6	57	60.4	65.4	66.1	36.4
Consumption	11	16.1	18.4	21.3	19	19.8

According to Hancock, Russia has opportunistically used Turkmenistan’s pipeline vulnerability to gain concessions from Niyazov. Because, in 1993, Turkmenistan was the only CIS state that refused to sign the Agreement on the Formation of Economic Union. That year, Russia exported 11 bcm of Turkmen gas to Europe. Despite Europe’s ability to pay, Russia failed to reimburse Turkmenistan for two months of exported gas, worth about \$185 million, and then informed Turkmenistan it would transport Turkmen gas only to the former Soviet republics and not to Europe. This was a major blow to Turkmenistan, which was already owed about \$1.5 billion for natural gas exported to Azerbaijan, Armenia, Georgia, Kazakhstan, Ukraine, and Uzbekistan.<sup>1402</sup> Since all the pipelines connecting the region to world markets were owned by Gazprom and routed through Russia, Turkmen natural gas became relatively uncompetitive in market terms and, consequently, Turkmenistan had little incentive for increasing its production of natural gas.<sup>1403</sup>

Hill and Fee express that, Gazprom has developed a strategy to export Russian gas at high-cost to markets in Western Europe and leave Turkmenistan to supply gas at low-cost to former Soviet states such as Ukraine, which have fallen behind in their energy payments to Russia. Ukraine wanted to buy Turkmen gas through a combination of cash and in-kind

<sup>1399</sup> Miguel A. Perez MARTIN: (2010) “Geo-Economics in Central Asia and the Great Game of Natural Resources: Water, Oil, Gas, Uranium and Transportation Corridors”, Central Asia Observatory, *Working Paper* 59/2009, 19 April, p.5

<sup>1400</sup> European Commission (2008), p.22.

<sup>1401</sup> BP Statistical Review of World Energy (2010).

<sup>1402</sup> HANCOCK, p.71, NICHOL: (2009d) p.7.

<sup>1403</sup> YOUNG and WINSTONE, p.26.

payments on a long-term contract basis. In 1997, Gazprom denied Turkmenistan access to the Russian pipeline network in retaliation for a payments disagreement, completely breaking its gas exports.<sup>1404</sup> The price which Russia pays for Turkmen gas is less than half of what Russia gets for the same gas once it resells it to other countries in Europe. For this reason, Turkmenistan cut its supplies to Russia for almost two years beginning in 1997, and again in early 2005.<sup>1405</sup>

Turkmenistan initially had the smoothest relationship with Russia, given the carry-over of leadership. Beginning in 1995, through the joint venture TurkmenRosGaz, the production of natural gas was effortlessly produced and marketed throughout the CIS through the trading firm Itera. However, this agreement broke down in 1997, when Niyazov dissolved TurkmenRosGaz and Gazprom responded by refusing purchase Turkmenistan's natural gas.<sup>1406</sup> In addition to that in March 1997, Turkmenistan cut off gas supplies to its main debtor, Ukraine. After negotiations with Russia and the gas importers over debt rescheduling and future payment agreements, large-scale gas exports were resumed in January 1999.<sup>1407</sup>

Starting in 1999 GDP of Turkmenistan began to grow rapidly, driven entirely by energy exports. But it was an important factor that Turkmenistan's bargaining position was weak, and the long-term contracts were interpreted in ways that were disadvantageous to the seller.<sup>1408</sup> Thus, it is inevitable that Turkmenistan's dependence on gas exports and the place of pipelines as the dominant mode of delivery mean that pipeline politics play a large role in Turkmenistan's foreign policy. The government is aware of the benefits of a range of pipeline options, but the profitability of pipelines with their high construction costs depends critically on world energy prices.<sup>1409</sup>

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<sup>1404</sup> HILL and FEE, p.14-15.

<sup>1405</sup> TSERETELI, p.48.

<sup>1406</sup> Martha Brill OLCOTT: (2009) "Russia, Central Asia and the Caspian: How Important is the Energy and Security Trade-off?", *Energy Forum*, James A. Baker III Institute for Public Policy, Rice University, May 6, p.12.

<sup>1407</sup> Richard W.T. POMFRET: (2006) *The Central Asian Economies Since Independence*, Princeton University Press, p.115-6.

<sup>1408</sup> POMFRET: (2008) p.19-25.

<sup>1409</sup> Ibid, p.29-30.

Ukraine's President Leonid Kuchma visited Niyazov to discuss the gas exports. Afterwards, Ukraine, Turkmenistan and Russia signed a 25 year contract which indicated that when the current gas sales contract between Turkmenistan and Ukraine expires in 2006, it might be impossible to renew it unless pipeline capacity can be greatly increased. It was also reported that Ukraine and Turkmenistan President's discussed about construction of a new pipeline on the basis of existing line.<sup>1410</sup> As part of the contract, Niyazov agreed to the low and locked- in price of only \$44 per thousand cubic meters.<sup>1411</sup> Due to reason that the change in the Turkmen export price to 44\$ on a cash only basis at the Turkmen border caused Turkmen gas to become uncompetitive in the Russian market.<sup>1412</sup> According to the contract Turkmenistan would supply 6 bcm of gas in 2004 (about 12% of production), and rise to 80 bcm in 2009-28. After signing the accord, Turkmenistan has requested several price hikes for its exported gas.<sup>1413</sup>

This deal allowed Gazprom to continue exporting its gas to high paying European markets while purchasing cheaper gas from Turkmenistan. Again in December 2004, Turkmenistan proposed a new price for its natural gas to Russia and Ukraine, stating that the price of gas would be increase to \$60 tcm from \$44 (international market prices which were around \$220 to \$250 at that time). After Gazprom announced that it refused the proposal, Chief of Naftogaz Ukraine visited Turkmenistan and signed the contract of prices for the supply of Turkmen gas to Ukraine for \$58 tcm.<sup>1414</sup> However, in the second half of the year, Turkmenistan agreed to lower the rate back to \$44 provided Ukraine paid in cash.<sup>1415</sup>

In September 2006, Gazprom accepted to sell pay 100\$ per tcm to Turkmenistan when average sale price to Europe was \$162. Due to reason that Russia offered Turkmenistan up to \$130 per tcm in the first half of 2008 and 150 in the second half of 2008, shortly after, Gazprom's average sale price was tcm to Europe increased to \$169 in 2007 and \$179 in 2008.<sup>1416</sup> During March 2008, it has been reported that Gazprom has agreed with the heads

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<sup>1410</sup> Ukraine Weekly (2003) "*Ukrainian, Turkmen Leaders Discuss Gas*", News Briefs, 20 April, <http://www.ukrweekly.com/old/archive/2003/160306.shtml> (Accessed on 10 February 2011).

<sup>1411</sup> HANCOCK, p.72.

<sup>1412</sup> STERN: (2005) p.78.

<sup>1413</sup> NICHOL: (2009d) p.7.

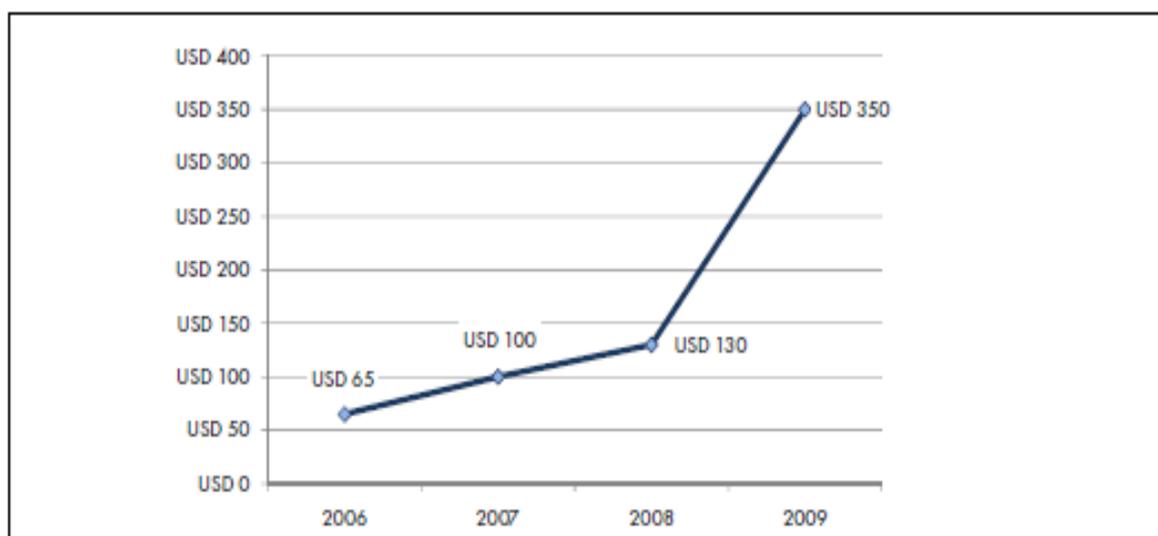
<sup>1414</sup> ROSTYSLOV, p.27.

<sup>1415</sup> HANCOCK, p.73.

<sup>1416</sup> BILGIN, p.4487.

of state-controlled gas companies from Kazakhstan, Uzbekistan and Turkmenistan that those countries will receive European prices for their deliveries in 2009, estimated between US\$350 and US\$400 per 1000 cubic meters of gas.<sup>1417</sup>

**Figure 18: USD per 1000 m3 of Natural Gas Paid Russia to Turkmenistan**<sup>1418</sup>



### 16.2.2. Pipeline Diplomacy

After Vladimir Putin took over the presidency, Gazprom's interest in Turkmenistan increased. Partly this was a result of increased analysis of Gazprom by the Kremlin, which sought to end the long-rumored corrupt practices of the Russian gas giant.<sup>1419</sup> With Niyazov's death in December 2006, Turkmenistan again became a critical factor in Caspian energy diplomacy, as the new regime in Ashgabat has sought to follow the Kazakhs in balancing between Russia and outside powers.<sup>1420</sup> On the other hand, Moscow was also eager to use the occasion of Niyazov's death to draw Turkmenistan closer to Russia. Russian displayed a desire to restore its influence in the "Near Abroad", but also attempted to thwart any moves by the United States or the other Western powers to

<sup>1417</sup> KANDIYOTI, p.89.

<sup>1418</sup> Indra OVERLAND: (2009) "Natural Gas and Russia-Turkmenistan Relations", in "Russia's Energy Relations with Its Caspian Neighbors", *Russian Analytical Digest*, No.56, 3 March, p.12.

<sup>1419</sup> OLCOTT: (2004a) p.25.

<sup>1420</sup> GIULI: (2008) p.127.

increase their presence in the region.<sup>1421</sup> While Giuli thinks that new president Gurbanguly Berdymuhammedov appears undecided about Russia’s dominant position in Turkmenistan. Though financing remains problematic, he is exploring new pipelines to Iran, South Asia, and China.<sup>1422</sup> Anceshi argues that Berdymuhammedov regime did not revolutionize the domestic political landscape, preferring instead to guarantee continuity of the politics of the prior regime and positive neutrality remained the cornerstone of Turkmen foreign policy. And as a result of the new abroad policy implemented by Putin, Turkmenistan was convinced to re-entry into Moscow’s orbit.<sup>1423</sup>

**Table 45: Pipeline Plans of Turkmenistan**<sup>1424</sup>

<b>Pipelines</b>	<b>Export Capacity</b>	<b>Completion Date</b>
Prikaspiisky: Turkmenistan-Kazakhstan-Russia	30 bcm/year	2015
Trans-Caspian: Turkey-Caspian Sea-Azerbaijan	30 bcm/year	2015
TAPI: Turkmenistan-Afghanistan-Pakistan-India	30 bcm/year	
Expansion of Central Asia Center: Turkmenistan-Uzbekistan-Kazakhstan	80-100 bcm/year	2015
Turkmenistan-Uzbekistan-Kazakhstan-China Pipeline	40 bcm/year	2013

In 1997, Turkmenistan and Iran completed a short connecting export pipeline between two countries. The \$190 million Korpeje-Kord Kuy pipeline includes a 25-year contract under which Iran will purchase between 5 and 6 bcm annually. In fact, with this deal, Turkmenistan became the first Central Asian state to bypass Russia in exporting natural gas via a pipeline.<sup>1425</sup> Afterward in July 2009, Turkmenistan announced that a new gas pipeline—from a field that until April had supplied gas to Russia—would be completed by the end of 2009 to more than double Turkmenistan’s export capacity to Iran.<sup>1426</sup> Followed

<sup>1421</sup> Christopher BOUCEK: (2009) “Maintaining Gazpromistan: the Politics of Turkmen Gas Exports”, in Daniel Morgan and James A. Russel (ed.) “*Energy Security and Global Politics, the Militarization of Resource Management*”, Routledge, p.161.

<sup>1422</sup> GIULI, p.127

<sup>1423</sup> Luca ANCESHI: (2009) *Turkmenistan’s Foreign Policy, Positive Neutrality and the Consolidation of the Turkmen Regime*, Routledge, p.152.

<sup>1424</sup> OLCOTT: (2004a) p.30.

<sup>1425</sup> HANCOCK, p.74.

<sup>1426</sup> NICHOL: (2009d) p.8.

by the agreement in December 2009, Iran completed the construction of 35 km pipeline connecting Turkmenistan's Dauletabad and Iran's Hasheminejad gas processing plant, which is located in the north-east of Iran near Sarakhs.<sup>1427</sup>

In May 2007 Russia, Turkmenistan and Kazakhstan signed an agreement to build a new pipeline along the eastern coast of the Caspian, the Prikaspiisky route or Pre-Caspian, feeding into the Russian pipeline network. The agreement was widely seen as a preemptive move to forestall Caspian gas going to China, although it did not stop the July 2007 Turkmenistan-China agreement.<sup>1428</sup> Blank says that the consequence of Pre-Caspian pipeline is enormous;<sup>1429</sup>

First, in the Russian, though not the Turkmenistan view, this agreement thwarts the projected US-backed plan for a \$10 billion Trans-Caspian pipeline that would connect Turkmenistan's gas to a Baku-Europe gas pipeline, bypassing Russia and allowing it to market its gas directly to Europe. Secondly, this deal suggests that Turkmenistan is moving away from neutrality and will, especially international relations Russian analysts are correct, have no choice but to depend upon Russia for its economic survival.

There is significant strategic pipeline project in the agenda of Turkmenistan which is also vital for the balance of power in the region, Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline. The pipeline first envisioned in the mid-1990s but could not realize due to instability in the region. The length of the pipeline is 1680 km and will source the 33 bcm gas from Dalutabad gas field in Turkmenistan to Fazilka town in India.<sup>1430</sup> From Russian perspective, creating such alternatives both reduces Russian leverage and increases the bargaining power of these states in the negotiation over supply to/through Russia.<sup>1431</sup> Lately, the framework intergovernmental agreement was signed in Ashgabat by three Presidents – Hamid Karzai of Afghanistan, Gurbanguly Berdymuhammedov of

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<sup>1427</sup> ADIBI, p.26.

<sup>1428</sup> POMFRET: (2008) p.29

<sup>1429</sup> BLANK: (2007) p.36-37

<sup>1430</sup> Sameer JAFRI: (2011) "*TAPI Pipeline: A Win-Win For All*", Eurasia Review, 2 January

<http://www.eurasiareview.com/analysis/tapi-pipeline-a-win-win-for-all-02022011/> (Accessed on 03 January 2011).

<sup>1431</sup> ERICSON, p.43.

Turkmenistan and Asif Ali Zardari of Pakistan –and India’s Energy Minister, Murli Deora.<sup>1432</sup>

It is known that Russia has expectations to join the TAPI project. Deputy Prime Minister Igor Sechin said on 22 October 2010 that “we are discussing new projects, including Gazprom’s possible participation in the TAPI pipeline project.”<sup>1433</sup> However, it was a disappointment that Berdymuhammedov did not attend the latest meeting of CIS heads of states in Moscow on 10 December 2010 due to a meeting of partners involved in the TAPI. On the other hand, Berdymuhammedov said on the same day that Turkmenistan is looking to increase ties with the Russian government “both in bilateral and CIS formats”, which means briefly not in TAPI.<sup>1434</sup>

During a summit meeting in Beijing in April 2006, Chinese President Hu Jintao and Turkmen President Saparmurad Niyazov signed a major agreement on the construction of a gas pipeline directly linking their countries and facilitating the flow of Turkmen gas to China.<sup>1435</sup> Under the terms of the deal, Beijing would purchase 30 bcm of gas from Turkmenistan annually, over three decades. In addition, the China National Petroleum Corporation (CNPC) would participate in the development of a gas field near Turkmenistan’s Amu Darya River.<sup>1436</sup> In Turkmenistan CNPC is the only foreign company to have signed a PSA to develop gas fields in Turkmenistan. Therefore, with the construction of the 2.000 km gas pipeline to China, will create a major competition to Russia for Turkmen gas supplies and will provide Turkmenistan will leverage to negotiate attractive gas sales prices with all its customers.<sup>1437</sup> Chow and Hendrix think that the

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<sup>1432</sup> BBC News (2010) “*Turkmen Natural Gas Pipeline TAPI to Cross Afghanistan*”, 11 December <http://www.bbc.co.uk/news/world-south-asia-11977744> (Accessed on 11 December 2010)

<sup>1433</sup> RIA Novosti (2010) “*Gazprom May Join TAPI Pipeline Project – Russia’s Deputy PM*”, 22 October, <http://en.rian.ru/business/20101022/161051544.html> (Accessed on 22 October 2010)

<sup>1434</sup> Central Asia News Wire (2010) “*Turkmenistan Pledges Increased Ties With Russia*”, 13 December <http://centralasianewswire.com/Turkmenistan/Turkmenistan-pledges-increased-ties-with-Russia/viewstory.aspx?id=2630> (Accessed on 13 December 2010)

<sup>1435</sup> Zhiqun ZHU: (2010) *China’s New Diplomacy, Rationale, Strategies and Significance*, Ashgate, p.130, Cornell, p.150.

<sup>1436</sup> Marc LANTEIGNE: (2007) “China’s Energy Security and Eurasian Diplomacy: The Case of Turkmenistan”, *Politics*, Vol.27:3, p.151.

<sup>1437</sup> Julia NANAY: (2009b) “Testimony Before the US-China Economic and Security Review Commission”, May 20, p.4 Available on site [http://www.uscc.gov/hearings/2009hearings/written\\_testimonies/09\\_05\\_20\\_wrts/09\\_05\\_20\\_nanay\\_statement.pdf](http://www.uscc.gov/hearings/2009hearings/written_testimonies/09_05_20_wrts/09_05_20_nanay_statement.pdf) (Accessed on January 2010).

Russian attitude seems to be, if Central Asian gas is to be exported by a route other than Russia, it is better for the gas to go east than west, where it would compete against Russian gas in its primary European market.<sup>1438</sup> So, Russian aim is no longer seems to be maximize Russian profit on Turkmenistan's exports. Now the grand objective is rather to undermine western efforts to make the Trans-Caspian Gas Pipeline viable. In this sense, Turkmenistani exports to China are far from the worst thing that could happen to Russia.<sup>1439</sup>

On the night of April 8-9, 2009, a section of a gas pipeline from Turkmenistan to Russia exploded, halting Turkmen gas shipments. Turkmen side blamed Russia for the pipeline disruption, saying Russia's gas export monopoly Gazprom had "irresponsibly" cut imports of gas and caused the incident. Moreover, Turkmenistan foreign ministry said that "such an approach [low gas imports] is a unilateral, rude violation of the terms of the take-or-pay gas supply contract".<sup>1440</sup> The Turkmenistan was right about to be suspicious because just two weeks ago, Berdymuhammedov had failed to reach agreement with Medvedev on Moscow's financing for an east-west gas pipeline across Turkmenistan, to be linked to a proposed pipeline to Russia. However, Berdymuhammedov announced an international tender for the east-west pipeline to ensure "reliable and safe supplies of energy resources to world markets," including a possible link to Azerbaijan.<sup>1441</sup>

A few days later, gas traffic between Turkmenistan and Russia was reduced by 90%. Due to reason of the nine months disruption of the gas exports, Turkmenistan experienced a record GDP loss of 25%. Russian and Turkmenistan finally signed agreement on December 22, 2009, in which Russia will buy 30 bcm of gas from Turkmenistan at the price of about \$250 tcm. Normal gas traffic between Turkmenistan and Russia resumed on January 10 2010.<sup>1442</sup> After the conclusion of the 2009-2010 gas disputes, Russo-Turkmenistani relations underwent a rapid process of normalization. In the aftermath of a

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<sup>1438</sup> CHOW and HENDRIZ, p.38.

<sup>1439</sup> OVERLAND, p.10.

<sup>1440</sup> Marat GURT and Olzlas AUYEZOV: (2009) "Pipeline Blasts Turkmen Gas Exports to Russia", Reuters, 9 April <http://www.reuters.com/article/2009/04/09/turkmenistan-russia-gas-idUSL959981620090409> (Accessed on 22 June 2009).

<sup>1441</sup> NICHOL: (2009d) p.8.

<sup>1442</sup> Luca ANCESCHI: (2010) "External Conditionality Insulation and Energy Security: the International Politics of Post-Niyazov Turkmenistan", *The China and Eurasia Forum Quarterly*, Central Asia –Caucasus Institute & Silk Road Studies Program, Vol.8, No.3, p.100.

summit Russian Foreign Minister Sergei Lavrov, Berdymuhammedov stated that “Turkmenistan will always have enough gas for Russia” in March 2010.<sup>1443</sup> Finally, President Medvedev visited Turkmenistan in 22 October 2010. It is understood from the words of the Presidents’ that Russia is welcomed in Ashgabat. While Berdymuhammedov said that they are ready to sell gas to Russia, Medvedev responded that “energy is the key element of our cooperation and we are ready to develop it in further areas, including electric energy”.<sup>1444</sup>

### 16.3. Russia-Uzbekistan Energy Relations

Since 1991 the super-presidential regime of Islam Karimov in Uzbekistan has successfully defended the country’s new independence and his authoritarian rule by cleverly enlisting the aid of outside powers such as Russia, China and the USA.<sup>1445</sup> In addition to that, Uzbekistan has achieved independence and stability by exploiting its natural resources through a strategy of “staple globalism”, and by balancing the great powers against each other.<sup>1446</sup> Energy policy began to play an important role in Uzbekistan after the independence. It was correlated with the capital-intensive industrialization policy and overall macroeconomic policy on domestic stabilization.<sup>1447</sup> According to Salikhov;

the first stage of energy policy of Uzbekistan between 1991-97 mainly focused on geopolitical component and achievement of independence. The second stage between 1998-2002, aim was to reform the oil and gas branch. Since 2002, the aim of this period is to increase efficiency on use of energy and to create necessary conditions for realization of energy saving measures providing preservation of energy independence and export potential of the country.<sup>1448</sup>

According to BP 2009 report, Uzbekistan’s proved oil reserves are 0,1 thousand m/t with the production of 4,5 m/t and the consumption of 4,9 m/t. Moreover, proved natural gas

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<sup>1443</sup> Ibid.

<sup>1444</sup> RIA Novosti (2010) “Russia Ready to Increase Energy Cooperation with Turkmenistan”, 22 October <http://en.rian.ru/business/20101022/161050913.html> (Accessed on 19 November 2010).

<sup>1445</sup> Dina Rome SPECHLER and Martin C. SPECHLER: (2009) “Uzbekistan Among the Great Powers”, *Communist and Post-Communist Studies*, 42, p.159.

<sup>1446</sup> Ibid, p.353.

<sup>1447</sup> Sagduallaev DJAKHANGIR: (2005) “Energy Policy, Economic Cooperation, and Sustainable Development in Central Asia: The Case of Uzbekistan”, *Dissertation in Justus-Liebig University*, 15 April, p.81.

<sup>1448</sup> T. P. SALIKHOV: (2006) “Uzbekistan Energy Strategy”, p. 47 Available on site <http://www.sei.irk.ru/aec/proc2006/7.pdf> (Accessed on May 2010)

reserves are 1,68 Tcm with the production of 64,4 bcm and the consumption of 48,7 bcm.<sup>1449</sup> Concerning the domestic pipelines a 350 km gas pipeline between Gazli and Nukus went into operation in 1997 and 300 km Pakhtakar-Yeniyer-Tashkent gas pipeline joined service in 1998 to make for secure gas supplies to household in the Tashkent region and the Fergana Valley.<sup>1450</sup> In the subject of the oil, after the disintegration of the Soviet Union, Uzbekistan began to increase its own oil extraction. By 1996 the extradition of oil in Uzbekistan had reached 8 m/t a year, and between 1997 and 2003 Uzbekistan did not import any oil. In 2004, however, oil extraction in Uzbekistan began to decline, and now Uzbekistan is buying oil from Russia again.<sup>1451</sup>

Since the beginning of the Putin's presidency, Uzbekistan gradually saw some progress in cooperation with Russia. In 2002, 10 year contract was signed between Russia and Uzbekistan to supply gas to Russia including Russian investments into the hydrocarbon deposits. Afterwards, Russia and Uzbekistan signed a 15 year PSA with Gazprom on gas extraction at the Shokhpakhty gas fields, and Russia's Lukoil signed an agreement for 35 years to develop the Kandym gas field. Following the improvement in relations with Russia after the crackdown in Uzbekistan's Andijan<sup>1452</sup> region in 2005, Gazprom announced future investments in Uzbek gas projects.<sup>1453</sup> On May 2005, Uzbekistan quit the GUUAM grouping which was generally viewed as pro-Western.<sup>1454</sup> The Uzbek authorities blamed Americans because of Andijan events and engineered a declaration on the SCO Summit in July 2005 which effectively called for US withdrawal from the region and

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<sup>1449</sup> BP Statistical Review of World Energy (2010)

<sup>1450</sup> SALIKHOV: (2006) p.49.

<sup>1451</sup> Vladimir PARAMONOV and Aleksey STROKOV: (2007) "Structural Independence of Russia & Central Asia in the Oil and Gas Sectors", Conflict Studies Research Centre, *Central Asian Series* 07/16E, June, p.9.

<sup>1452</sup> Alexander COOLEY: (2008) "Principles in the Pipeline: Managing Transatlantic Values and Interests in Central Asia", *International Affairs*, 84:6, p.1176, "...Andijan events: On Friday, 13 May 2005, thousands of demonstrators gathered around Babur Square in the centre of the city. Uzbek security forces dealt with the protesters ruthlessly, surrounding the demonstrators in armored vehicles and proceeding to fire into the crowd. The Uzbek government received unequivocal backing for its actions from Russia and China, but crack down in Andijan sent shock waves through the West."

<sup>1453</sup> Bertil NYGREN: (2008) "Putin's Use of Natural Gas to Reintegrate the CIS Region", *Problem of Post-Communism*, Bol.55, No.4, July/August, p.10, Martha Brill OLCOTT: (2006) "Friendship of Nations in the World of Energy", *Pro et Contra*, Vol.10, Issue 2-3, Summer, p.3

<sup>1454</sup> SPECHLER and SPECHLER: (2009) p.368

Uzbekistan demanded the removal of United States airmen from Karshi-Khanabad base.<sup>1455</sup>

On January 25, 2006, at the St. Petersburg summit of the Eurasian Economic Community (EEC), Uzbekistan officially joined the organization. During the summit, Gazprom signed two agreements with Uzbekistan, pledging \$1,5 billion of Russian investments in the Uzbek energy sector and agreed that Gazprom and Uzbekistan's energy company, Uzbekneftegaz<sup>1456</sup>, would sign, by June 2006, a 25 year PSA on the development of the Ustyurt gas fields.<sup>1457</sup> Furthermore, on August 2006, Uzbekistan rejoined the CSTO, from which it had withdrawn in 1999. This was also a signal for further moment of rapprochement between Tashkent and Moscow.<sup>1458</sup>

Beginning from 1 January 2006, Uzbekistan increased the price of gas exported to Kazakhstan, Kyrgyzstan, and Tajikistan from \$42 to \$55 per tcm. In 2006, Gazprom bought Uzbek gas for \$60 and paid \$1,1 for the transit of 1000 cm over 100 km. On 1 January 2007, Uzbekistan increased the export price of gas to USD \$100 for 1000 cm for all importer countries.<sup>1459</sup> While Uzbekistan was dealing with the rise of price for the natural gas export, Uzbek authorities continued negotiations with China. As a result of that on June 30<sup>th</sup> 2008, a ceremony was held in Bukhara for celebrating the start of the construction on the Uzbek section of the Central Asia Gas Pipeline.<sup>1460</sup> In addition to natural gas, China and Uzbekistan also cooperated in oil sector. CNPC has signed

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<sup>1455</sup> Michael MIHALKA: (2007) "Not Much of a Game: Security Dynamics in Central Asia", *China and Eurasia Forum Quarterly*, Central Asia –Caucasus Institute, Silk Road Studies Program, Vol.5, No.2, p.26

<sup>1456</sup> Uzbekneftegaz Available on site <http://www.ung.uz/ru/> (Accessed on 4 June 2010); "National Corporation of the Oil and Gas industry Uzbekneftegaz was set up as a fully government owned company in 1992."

<sup>1457</sup> Igor TORBAKOV: (2009) "Russia Welcomes Uzbekistan Into Its Eurasian Energy Empire", *Eurasia Daily Monitor*, Vol.3, Issue:19, January 27 Available on site [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=31332](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=31332) (Accessed on 3 March 2009)

<sup>1458</sup> Matteo FUMAGALLI: (2006) "Uzbekistan Rejoins the CSTO – Are Russian-Uzbek Relations Heading Toward Mutual Entrapment?", *Central Asia-Caucasus Analyst*, 18 October, p.9; "...CSTO was originally envisaged as an institutional framework to ensure collective security in a moment when the former Soviet states were still in the process of establishing Soviet States were still in the process of establishing their own separate armies and defense structures."

<sup>1459</sup> European Commission (2008) p.356

<sup>1460</sup> China Chemical Reporter (2008) "CNPC Commences Construction of Central Asia Gas Pipeline", 16 July, p.11 [http://goliath.ecnext.com/coms2/gi\\_0199-8164815/CNPC-commences-construction-of-Central.html](http://goliath.ecnext.com/coms2/gi_0199-8164815/CNPC-commences-construction-of-Central.html) (Accessed on 20 September 2010)

agreements with Uzbekneftegaz concerning joint actions to increase oil and gas production in Mingbulak Field.<sup>1461</sup>

Russia watches carefully Uzbek-China relations as well as the other Central Asian states. As a response to 2008-2009 China-Uzbek cooperation, on 22 January 2009, Russian President Dmitri Medvedev visited Uzbekistan. One day before Medvedev's visit, Vagit Alekperov<sup>1462</sup> met with Kerimov, and it was announced that Lukoil plans to invest \$5 billion in Uzbekistan's energy sector. During the visit Russian and Uzbekistan also signed an agreement for the construction of a new trunk gas pipeline that would expand the capacities of the presently operating CAC pipeline. Most important point of the agreement was on issue of the gas price. Therefore, Russia agreed to buy Uzbek gas at world market prices and the volume of imports will be increased to 31 bcm which also means that reducing gas exports to Kyrgyzstan and Tajikistan due to increased prices.<sup>1463</sup> While Uzbekistan is important for the Kremlin, as the region's largest and most strategically located state, bordering of all four of the Central Asian states as well as Afghanistan<sup>1464</sup>, Gazprom and Russia is also important for the Uzbekistan.

#### **16.4. Russia-Kyrgyzstan Energy Relations**

The Kyrgyz Republic gained its independence at the end of 1991 with the dissolution of the former Soviet Union. Scientist and mid-level communist party official Askar Akayev had been elected president just before Kyrgyzstan gained independence.<sup>1465</sup> In the March of 2005 a group of opposition who were dissatisfied with the result of the Parliamentary Election taken place on February 27th and March 13th of 2005 upraised against incumbent regime of Askar Akayev.<sup>1466</sup> Former opposition politician Kurmanbek Bakiyev was

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<sup>1461</sup> UZ.Daily.com (2009) "CNPC and Uzbekneftegaz to Jointly Develop Mingbulak Field", 17 July <http://www.uzdaily.com/articles-id-6417.htm> (Accessed on 20 August 2010)

<sup>1462</sup> Vagit Alekperov, Azeri originated Russian businessman and Head of Lukoil.

<sup>1463</sup> Erik AKHMADOV: (2009) "Medvedev Visits Tashkent – A Thaw in Russian-Uzbek Relations?", *CACI Analyst*, January 28.

<sup>1464</sup> Vladimir PARAMONOV and Aleksey STROKOV: (2007) "Structural Independence of Russia & Central Asia in the Oil and Gas Sectors", Conflict Studies Research Centre, *Central Asian Series* 07/16E, June, p.22.

<sup>1465</sup> Jim NICHOL: (2010) "Kyrgyzstan: Recent Developments and US Interests", *CRS Report For Congress*, Order Code CRS 97-690, September 9, p.1

<sup>1466</sup> Yılmaz BINGOL: (2006) "The Colorful Revolution of Kyrgyzstan: Democratic Transition or Global Competition?", *Alternatives: Turkish Journal of International Relations*, Vol.5, No.1&2, p.73.

elected the new president in July 2005. In 2007, under the control of Bakiyev, the new referendum and a new constitution had organized.<sup>1467</sup>

On July 23, 2009, Bakiyev was re-elected with 85% of the vote and immediately suppressed the opposition protests challenging the election result.<sup>1468</sup> The winter of 2009-10 created terrible conditions for Kyrgyzstan population with growing electric power outages and increase in electricity and gas prices. Under these conditions people began protesting the Bakiyev administration and forced the state for new elections. On 8 April 2010, Bakiyev announced that the new elections will be held in six months.<sup>1469</sup> Afterwards, Roza Otunbayeva, a former foreign minister and ambassador to the United States, was declared the acting prime minister. Bakiyev initially fled to his native region in southern Kyrgyzstan but was given refuge in Belarus on April 19.<sup>1470</sup>

According to Cutler, Kyrgyzstan historically close to Kazakhstan, did not have significant strategic relations with Russia in the first half of the 1990s, although this had engaged by the next decade. Its official foreign policy priorities at the time were China, Turkey, Iran and Pakistan.<sup>1471</sup> During the first stage of the independence, Kyrgyzstan experienced a serious economic crisis and rise of social unrest. One of the most crucial issues was a need to halt the economic decline of this mountainous republic that lacked significant reserves of natural resources.<sup>1472</sup> Primarily Kyrgyzstan formally declared neutrality, but very soon it reconfirmed its alliance with Russia, for the Kyrgyz government clearly recognized its inability to defend itself from incursions by gangs of war lords from abroad.<sup>1473</sup> During the Soviet era there was an effective organization for sharing energy resources between Russia and the countries of Central Asia. The essence of this arrangement was the rational and

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<sup>1467</sup> NICHOL: (2010) p.1.

<sup>1468</sup> Erica MANAT: (2009) “*Bakiyev Wins Presidential Election, Opposition Declares [War]*”, Eurasia Daily Monitor, Vol.6, Issue 142, 24 July.

<sup>1469</sup> BBC News (2010) “*Kyrgyz President Bakiyev [Will Resign If Safe]*”, 13 April  
<http://news.bbc.co.uk/2/hi/8617729.stm> (Accessed on 24 April 2010)

<sup>1470</sup> NICHOL: (2010) p.1.

<sup>1471</sup> Robert M. CUTLER: (2006b) “US-Russian Strategic Relations and the Structuration of Central Asia”, Perspectives on Global Development and Technology, 21 August, p.4 Available on site  
<http://www.robertcutler.org/download/pdf/ar06pgdt.pdf> (Accessed on 7 May 2008).

<sup>1472</sup> ABAZOV, p.14 .

<sup>1473</sup> Alexei BOGATUROV: (2004) “International Relations in Central Eastern Asia: Geopolitical Challenges and Prospects for Political Cooperation”, *The Brookings Institution*, 1 June, p.3 Available on site  
[http://www.brookings.edu/papers/2004/06russia\\_bogaturov.aspx](http://www.brookings.edu/papers/2004/06russia_bogaturov.aspx) (Accessed 1 May 2008).

mutually-advantageous exchange of the hydroelectric resources of Kyrgyzstan and Tajikistan for the non-renewable fuel resources of the other republics.<sup>1474</sup>

#### 16.4.1. Energy and Security Challenges in Kyrgyzstan

The Kyrgyz Republic owns 2% of Central Asia's energy resources, including huge coal reserves and 30% of its hydro energy resources.<sup>1475</sup> Kyrgyzstan relies on imports of gas mainly from Uzbekistan and oil and oil products from Russia and Kazakhstan. Kyrgyzstan is an important element of the water-energy inter-relations in Central Asia, where it, would prefer to release water for electricity production in winter and accumulate it in summer, while neighboring downstream countries (Kazakhstan and Uzbekistan) need water for irrigation in spring and summer.<sup>1476</sup> However, in terms of the economic structure, by the early 2000's, the government of Kyrgyzstan's external debt been equal to the country's GDP.<sup>1477</sup>

While Kyrgyzstan was challenging with economic instability and crisis, the significance of Kyrgyzstan to the United States increased after the September 11, 2001, terrorist attacks on the United States. Kyrgyzstan offered to host U.S. forces at an airbase at the Manas international airport outside of the capital, Bishkek, and it opened in December 2001.<sup>1478</sup> The US use of an air base at the expanded Manas airport has come to act as lever in both Kyrgyz international and domestic politics.<sup>1479</sup> Only two years later; Russian Kant Air Base was officially reopened in September 2003 which was the first overseas air base opened by the Russian military since 1991. By the end of 2003, therefore, Bishkek was

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<sup>1474</sup> PARAMONOV and STROKOV, p.5.

<sup>1475</sup> Mazhitova OLGA: (2010) "Fostering Investment in Electricity Generation in Central and Eastern Europe and Central Asia", *UNECE-e8-EBRD-WEC*, Geneva, November 22-24.

<sup>1476</sup> European Commission (2008) p.17.

<sup>1477</sup> Azamat K. JUNISBAI: (2010) "Understanding Economic Justice Attitudes in Two Countries: Kazakhstan and Kyrgyzstan", *Social Forces*, Vol.88, No.4, June, p.1678.

<sup>1478</sup> NICHOL: (2010).

<sup>1479</sup> Peter SINNOTT: (2007) "Kyrgyzstan: A Political Overview", *American Foreign Policy Interests*, 29/2007, p.433; "Ganci-named after NY Fire Chief Peter Ganci who died in the September 11 attacks".

surrounded: the American air base by 16 miles to the northeast, the Russian airbase was 12 miles to the east.<sup>1480</sup> In addition to the Kant Air Base, Kyrgyzstan and Gazprom signed a cooperation agreement on May 15, 2003 to promote joint efforts to explore and develop oil and gas deposits. Under this agreement Gazprom will buy gas from Uzbekistan and Turkmenistan and then selling to Kyrgyzstan.<sup>1481</sup>

In February 2005, the Russian Foreign Ministry pressured the Kyrgyz government to reject a U.S. request to station AWACS aircraft at Ganci.<sup>1482</sup> Then in October 2005, Kyrgyz President Kurmanbek Bakiyev demanded either that the United States greatly increase fees paid for use of the Manas airbase or close it. After prolonged negotiations, agreement was reached in July 2006 on an increase from \$2 million per year for leasing the base to \$17,4 million for a five-year period.<sup>1483</sup> Meanwhile, Kyrgyzstan was hit by acute electricity in the winter of 2007-8. And the country's main water source, dropped critically by early spring 2008. The Kyrgyzstan government introduced severe restrictions on energy consumption both for industry and the population, and announced an increase in electricity tariffs.<sup>1484</sup>

At the beginning of the 2008, Kyrgyzstan awarded Gazprom exploration for two oil and natural gas fields and invited Gazprom to buy stakes in the state-owned companies.<sup>1485</sup> Later in October 2008, Gazprom has signed a MoU with the government of the Kyrgyz Republic for cooperation in the privatization of a part of the state-owned gas company, Kyrgyzgaz.<sup>1486</sup> Then, in June 2009 two committees of parliament approved cooperation

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<sup>1480</sup> Sophie IBBOTSON and Max LOVELL-HOARE: (2010) "Bishkek and the Great Game", *Russian Life*, September/October, p.29.

<sup>1481</sup> OLCOTT: (2004a) p.26.

<sup>1482</sup> Celeste A. WALLENDER: (2007) "Russian Transimperialism and Its Implications", *The Washington Quarterly*, 30:12, p.158.

<sup>1483</sup> Jim NICHOL: (2009b) "Kyrgyzstan and the Status of the US Manas Airbase: Context and Implications", *CRS Report For Congress*, R40564, July 1, p.4.

<sup>1484</sup> Juraev SHAIRBEK: (2009) "Energy Emergency in Kyrgyzstan: Causes and Consequences", *EUCAM-EU-Central Asia Monitoring*, No.5, February p.1.

<sup>1485</sup> Olga DZYUBENKO: (2008) "Russia's Gazprom Gets Kyrgyz Gas Field Licenses", Reuters, 20 February <http://in.reuters.com/article/2008/02/20/gazprom-kyrgyzstan-idINL2046013920080220> (Accessed on 20 September 2010).

<sup>1486</sup> Redorbit (2008) "Gazprom Signs Agreement to Participate in Kyrgyzgas Privatization", 10 December [http://www.redorbit.com/news/business/1584644/gazprom\\_signs\\_agreement\\_to\\_participate\\_in\\_kyrgyzgaz\\_privatization/index.html](http://www.redorbit.com/news/business/1584644/gazprom_signs_agreement_to_participate_in_kyrgyzgaz_privatization/index.html) (Accessed on 03 January 2011).

agreement between Kyrgyz and Russian governments by which 75% of securities plus one share will be bought by Gazprom. According to Kyrgyz authorities;

“the only delivery pipe, connecting Uzbekistan, Kyrgyzstan, Kazakhstan, and through which gas is delivered to Kyrgyzstan and Almaty, was laid on in 1969. The working lifetime expires and it needs reconstruction. We lack money for the purpose; moreover, gas pipes of middle pressure, supplying the capital have served their term.”<sup>1487</sup>

In February 2009, during a visit to Moscow to meet with Russian President Dmitri Medvedev, President Bakiyev voiced his frustrations openly and once again his determination to expel US forces from Manas. At the same meeting, however, President Medvedev pledged \$1,7 billion in aid to Kyrgyzstan for infrastructure and energy investments, and \$450 million for budget stabilization, prompting assessments that the aid had been conditioned on the closure of Manas.<sup>1488</sup> Russia also agreed to cancel a \$180 million debt owed by Kyrgyzstan in exchange for some properties. The next day, Medvedev suggested that the member-countries of the Russia-led CSTO could compensate for the airbase closure by offering land transit for non-lethal supplies for NATO forces in Afghanistan.<sup>1489</sup> However, four months later after accepting Russia's deal, Bakiyev forgot his promise to expel the US from Manas Air Base. And in June 2009, it was announced that Kyrgyzstan and US had an agreement and changed the name of their air base to “Manas Transit Center”.<sup>1490</sup> So, Wilson says that,

Russia experienced an embarrassing setback in June 2009, when the Kyrgyz government announced that it had reversed its decision on February 2009 to close the US airbase at the Manas airport. Russia, which has resorted to its own form of dollar diplomacy as a means of obtaining the expulsion of the US from the site, received

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<sup>1487</sup> Aizada TOIGONBAEVA: (2009) “*Gazprom-Kyrgyzgaz: Gas Independence?*”, 24.kg News Agency, 22 June <http://eng.24.kg/business/2009/06/22/8300.html> (Accessed on 20 September 2010).

<sup>1488</sup> Report of the Majority Staff, Rep. John F. Tierney (2010) “Mystery At Manas – Strategic Blind Spots in the Department of Defense’s Fuel Contracts in Kyrgyzstan”, Chair, Subcommittee on National Security and Foreign Affairs, US House of Representatives, December, p.11 Available on site [http://merln.ndu.edu/archivepdf/centasia/Mystery\\_at\\_Manas.pdf](http://merln.ndu.edu/archivepdf/centasia/Mystery_at_Manas.pdf) (Accessed on 20 December 2010); “...in exchange for a rent increase from \$17.4 million to \$60 million per year, and \$36 million for infrastructure improvements, \$20 million for air traffic control system upgrades, \$20 million for economic development, \$21 million for counternarcotics, and \$10 million for counterterrorism efforts. Total \$177 million”, Micheal EMERSON and Jos BONSTRA: (2010) “Into EurAsia, Monitoring EU’s Central Asia Strategy”, EUCAM, *EU Central Asia Monitoring*, p.38.

<sup>1489</sup> NICHOL: (2009b) p.6.

<sup>1490</sup> IBBOTSON and LOVELL-HOARE, p.29.

partial compensation with the announcement in August 2009 that a new Russian military base would open later in the year in Osh in southern Kyrgyzstan.<sup>1491</sup>

According to the Report of the Tierny;<sup>1492</sup>

On April 1, 2010, Russia imposed a substantial tariff on all fuel exports to Kyrgyzstan, reportedly in response to their discovery of Kyrgyzstan's re-direction of commercial fuel exports for use by the US military. Russia imposed a tariff of \$193.5 per ton on fuel exports to Kyrgyzstan. The tariff went into effect on April 1, 2010, had an immediate inflationary impact on the Kyrgyz economy. On April 5, 2010 – two days before Bakiyev was overthrown- it was reported that the tariff increased fuel prices by up to %30 and had a tangible and immediate political impact: “the expected rise in prices of basic commodities will heighten the anti-Bakiyev mood”.

Bakiyev announced a state of emergency in April 7, but it was too late because the public opinion had turned against him, and he was on the run.<sup>1493</sup> Finally in the last week of the 2010 the new Prime Minister of Kyrgyzstan Almaz Atambayev visited Moscow and met his counterpart Vladimir Putin. Russia has reportedly promised the new government a loan of \$200 million. It recalls the latest loan offer which follows the demand of closing the Manas. During the meeting, Atambayev said that “Russia is our main strategic partner, and there is no alternative”.<sup>1494</sup>

## 16.5. Russia-Tajikistan Energy Relations

Tajikistan was among the Central Asian republics least prepared and inclined toward independence when the Soviet Union broke up.<sup>1495</sup> Tajikistan found itself in the terrible situation. After the former communist leaders were overthrown by a coalition of moderate liberals and Islamic radicals in 1991, conflict between regional clans was appeared.<sup>1496</sup>

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<sup>1491</sup> Jeanne L. WILSON: (2010) “The Legacy of the Color Revolution's for Russian Politics and Foreign Policy”, *Problems of Post-Communism*, Vol.57, No.2, March/April 2010, p.32.

<sup>1492</sup> Report of the Majority Staff, Rep. John F. Tierny, p.46.

<sup>1493</sup> IBBOTSON and LOVELL-HOARE, p.32.

<sup>1494</sup> Bektour ISKENDER: (2011) “*Press Review: Putin Welcomes the New Pro-Russian Government of Kyrgyzstan*”, Kloop, 5 January <http://kloop.info/2011/01/05/press-review-putin-welcomes-the-new-pro-russian-government-of-kyrgyzstan/> (Accessed on 5 January 2011).

<sup>1495</sup> Jim NICHOL: (2009d) “Tajikistan: Recent Developments and US Interests”, *CRS Report for Congress*, Order Code 98-594, July 29, p.4.

<sup>1496</sup> Alexei BOGATUROV, p.3.

Russia supported the regime of President Immomali Rakhmanov during the Tajik civil war of 1992-1997.<sup>1497</sup> In September 1992, former President Yeltsin took 201 Motor Rifle Division (MRD). According to some scholars, 201<sup>st</sup> MRD is the most effective military force in Tajikistan and in Central Asian republics overall.<sup>1498</sup> A year later, it was announced that Russia would obtain a new air base near Dushanbe, with housing available for 6.000 military personnel.<sup>1499</sup> Therefore, since the dissolution of the Soviet Union, Russia has maintained a substantial military and diplomatic presence in Tajikistan, although Tajikistan shares no common border with Russia and no virtually oil or gas production.<sup>1500</sup> The civil war came to an end in 1997 by a comprehensive peace agreement with Rakhmanov and opposition leader Nuri.<sup>1501</sup>

### 16.5.1. Neither Gas Nor Oil But Water and Location

In 1999 Russia awarded a 10-year stationing right to base its 201<sup>st</sup> army division in Tajikistan, whose principal function was the protection of Tajikistan's border with Afghanistan.<sup>1502</sup> After the military base agreement (the Status of Forces Treaty), President Rakhmanov announced that Russia was and will continue to be Tajikistan's most important strategic partner.<sup>1503</sup> Shortly after the September 11, US looked forwards to possibility to cooperate with Tajikistan but Tajikistan hesitated to follow such a policy due to the existence of the Russian military in Tajikistan lands. In order to negotiate the new Status of Forces Treaty, Putin visited Dushanbe in April 2003 and in May 2003 Gazprom signed a twenty-five year cooperation deal and agreed to explore and develop new gas fields in Tajikistan.<sup>1504</sup>

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<sup>1497</sup> Leszek BUSZYNISKI: (2005) "Russia's New Role In Central Asia", *Asian Survey*, Vol.45, No.4, p.558.

<sup>1498</sup> M.J. ORR: (2001) "The Russian Garrison in Tajikistan – 201<sup>st</sup> Gatchina Twice Red Banner Motor Rifle Division", Conflict Studies Research Centre, *Occasional Brief*, No.85, p.2-5.

<sup>1499</sup> Richard WEITZ: (2006) "Averting a New Great Game in Central Asia", *The Washington Quarterly*, 29:3, Summer, p.157.

<sup>1500</sup> Gregory GLEASON: (2001) "Why Russia is in Tajikistan?", *Comparative Strategy*, 20, p.77

<sup>1501</sup> NICHOL: (2009d) p. 4; Niklas L.P. SWANSTÖRM and Svante E. CORNELL: (2005) "A Strategic Conflict Analysis of Central Asia – With a Focus on Kyrgyzstan and Tajikistan", *Central Asia and Caucasus – Silk Road Studies Program*, p.5; "... Tajikistan is the only country in Central Asia that was affected by a civil war after independence, a tragic war which cost Tajikistan 50.000 lives and close to 700.000 refugees and internally displaced persons who fled the war."

<sup>1502</sup> Marlene LARUELLE: (2008) "Russia's Central Asia Policy and the Role of Russian Nationalism", Central Asia-Caucasus Institute - Silk Road Studies Program, *Silk Road Paper*, p.14.

<sup>1503</sup> GLEASON, p.77.

<sup>1504</sup> NYGREN, p.11.

On June 4, 2004, Putin and Rakhmanov met in Sochi and declared that the Russia was granted the full use of Tajik bases without payment or time limit. Rakhmanov only got from the negation is the cancelation of the Tajikistan's debt (\$250 million) and \$50 million energy invest into the country. As a result, Russia's approximately 5,500 contract troops in Tajikistan constitute its second-largest military presence abroad (2.200 meter near to Chinese border), after the Black Sea Fleet in Ukraine.<sup>1505</sup> In the following mounts when Putin and Rakhmanov met again, it was announced that Russian participation in several hydroelectric projects, including \$1.3 billion project at Ragun and \$370 million project at Sangtuda. Afterwards, the agreement was collapsed due to the disagreement over the controlling stake in the project.

The water distributions in the Amu Darya Basin reflect the legacy of the Soviet Union regulations; the downstream riparian states, Turkmenistan and Uzbekistan, were utilized to produce cotton while upstream Tajikistan used water for energy production and planning to increase its reservoir capacity to provide water storage.<sup>1506</sup> Tajikistan is planning that the construction of a series of hydropower plants, will rescue the country from energy dependency on its neighbors, meaning importing gas from Uzbekistan.<sup>1507</sup> Although Uzbekistan relies on Tajikistan's water for irrigation, it imposes high prices on Tajikistan. In addition to that in the 2007 winter (until 2008 February) Tajikistan hit by a harsh winter and it caused a great damage to its water and electricity system, including the cut-off gas supply. This caused a enormous damage in rural population who has relied on production for domestic consumption and self-sufficiency.<sup>1508</sup> Under these circumstances UN involved into the issue and began providing emergency aid for Tajikistan.

In terms of the energy sector of the Tajikistan; it produced very limited oil amounts (240 bbl/d in 2008 and have no oil refinery. Thus, all petroleum products have to be imported. On the other hand, natural gas production is 0.28 bcm a year and consumption is 0.84 bcm.

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<sup>1505</sup> NICHOL: (2009d) p.4

<sup>1506</sup> Kai WEGEREISCH: (2008) "Hydro-hegemony in the Amu Darya Basin", *Water Policy*, 10:2, p.71.

<sup>1507</sup> Murodbek LALDJEBAV: (2010) "The Water-Energy Puzzle in Central Asia: The Tajikistan Perspective", *International Journal of Water Resources Development*, 26:1, p.28

<sup>1508</sup> Matteo FUMAGALLI: (2008) "The Food-Energy Water Nexus in Central Asia: Regional Implications of and the International Response to the Crises in Tajikistan", *EUCAM – EU-Central Asia Monitoring*, No.2, p.2.

Tajikistan only imports gas from Uzbekistan. On January 11, 2010 Uzbektransgaz reduced its natural gas supplies to Tajikistan almost %60 because of a dispute over non-payment. After meetings of representatives of Tajikgas and Uzbektransgas, the price was renegotiated and decreased from US\$300 to US\$240 per 1000m<sup>3</sup>. This change was an increase of US\$90 from the previous year.<sup>1509</sup>

The reduction may also have seen as retaliation for the Tajikistan's decision for the construction of Rogun dam hydro power plant project. If Tajikistan succeeded to complete this project in the future, Rogun hydropower (3.600MW) would be the highest dam in the world.<sup>1510</sup> In mid-June 2009, Tajik presidential advisor Suhrob Sharipov asserted that the salvation of the people of Tajikistan depended on the construction of the dam, so that opposing the construction was traitorous.<sup>1511</sup> It is expected that Russia's military presence will be the main factor regarding the bilateral diplomatic and military agenda in the near future. Russia's military facility demands which was suspended for a while, started by Tajikistan itself just recently. It might be due to Russia's decision to raise export duties on petrochemicals which has increased the prices in Tajikistan. In the near future, or when it is necessary, Russia could decrease duties and demand new privileges on terms and status of Russian military deployments.<sup>1512</sup>

## **16.6. Russia-China Energy Relations**

### **16.6.1. Energy Strategy Of China**

Between 1985 to 1995 Chinese oil demand raised from 1,7 million bbl/d to 3,4 million bbl/d. next decade the amount of oil demand doubled again and reached to 6,8 million bbl/d in 2005.<sup>1513</sup> During the 1980s until 1993 China was a net exporter of about 20

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<sup>1509</sup> LALDJEBAV, p.29.

<sup>1510</sup> Tajikistan: Country Brief (2010) Estandarts Forum, Available on site <http://www.estandartsforum.org/system/briefs/321/original/brief-Tajikistan.pdf?1270241749> (Accessed on 23 January 2011).

<sup>1511</sup> NICHOL: (2009d) p.3.

<sup>1512</sup> Sanobar SHERMATOVA: (2010) "*Central Asia: A Forecast for 2011*", RIA Novosti, 26 December <http://en.rian.ru/analysis/20101228/161972004.html> (Accessed on 25 January 2011).

<sup>1513</sup> Xuecheng LIU: (2006) "China's Energy Security and Grand Strategy", The Stanley Foundation, *Policy Analysis Brief*, September, p.3

million tons of oil per year, mainly to East Asian markets.<sup>1514</sup> China's net oil imports reached about 4,3 million bbl/d in 2009 and became the second largest oil importer after United States. According to Oil and Gas Journal (quoted in EIA), China has 20,4 billion barrels of proven oil reserves<sup>1515</sup> and BP gives the number of 2,0 Thousand m/t. The International Energy Agency (IEA) projects that by 2030 China's oil demand will climb to 16,5 million bbl/d and its production will decline to 3.4 million bbl/d. Furthermore, net oil imports will rise to 13,1 million bbl/d, and China's dependence on imported oil will increase to 80%.<sup>1516</sup> In terms of the gas sector, according to Oil and Gas Journal, China has 107 Tcf (3 Tcm) of proven natural gas reserves. (2,46 Tcm in BP records). At the end of 2008, CNPC announced that China's total proven reserves amounted to 5,94 Tcm. There are three major basins which are Tarim, Ordos and the Sinchua –detain more than half of China's total proven reserves.<sup>1517</sup> In 2007, for the first time in almost 20 years, China became a net natural gas importer.<sup>1518</sup> On the other hand the production of natural gas increased from 14,3 bcm in 1980 to 58,6 bcm in 2006. It is estimated that China will import 130 bcm of gas by 2020.<sup>1519</sup> The major Chinese domestic reserves, of oil in particular, are located in the north and the west. Meanwhile, energy demand is surging in the south and the east, where the China's middle class is concentrated.<sup>1520</sup>

**Table 46: China's Production, Consumption and Import of Crude Oil, 1980-2004**  
(m/t)<sup>1521</sup>

Year	Production	Consumption	Import
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<sup>1514</sup> Sonja DAVIDOVIC: (2008) "China's energy Policy in the Geopolitical Context", in Celeste Wallender, *Geopolitics of Energy in Eurasia – MSFS 536*, p.13-14 Available on site <http://www.atlantic-community.org/app/webroot/files/articlepdf/China%5C's%20Energy%20Policy.pdf> (Accessed on 10 June 2009).

<sup>1515</sup> China: Country Analysis Brief (2010) Energy Information Administration, November, p.3 Available on site <http://www.eia.doe.gov/cabs/China/pdf.pdf> (Accessed on 10 December 2010).

<sup>1516</sup> Erica S. DOWNS: (2010) "Sino-Russian Energy Relations An Uncertain Courtship", in James Bellacqua (ed.) *"The Future of China-Russia Relations"*, The University Press of Kentucky, p.148-50, 146-56.

<sup>1517</sup> Nabuyuki HIGASHI: (2009) "Natural Gas in China, Market Evolution and Strategy", IEA, *Working Paper Series*, June, p.6.

<sup>1518</sup> China: Country Analysis Brief (2010) p.11.

<sup>1519</sup> DAVIDOVIC, p.15-6.

<sup>1520</sup> Kent E. CALDER: (2006) "Coping With Energy Insecurity: China's Response in Global Perspective", *East Asia*, Vol.23, No.3, p.50, 49-66.

<sup>1521</sup> H. H. LAI: (2007) "China's Oil Diplomacy: Is It a Global Security Threat?", *Third World Quarterly*, Vol.28, No.3, 520, 519-537.

1980	106	87,6	0,4
1985	124,9	91,7	0,7
1990	138,3	114,9	2,8
1995	149,0	160,7	17,1
2000	162,6	230,1	70,3
2001	164,8	232,2	60,3
2002	168,9	245,7	69,4
2003	169,3	252	91
2004	175,5	292,7	122,7

**Table 47: China's Oil and Gas Sector in 2009 in BP Report<sup>1522</sup>**

	Proved Reserves	Production	Consumption
Oil m/t	2,0 (Thousand m/t)	189	404,6
Natural Gas (bcm)	2,46 (Tcm)	85,2	88,7

In 1997, Chinese President Li Peng declared the first national energy policy of China which states that the development in the petroleum sector should rely on two markets (domestic and overseas) and two resources (oil and gas). The new policy pointed three strategic regions: Central Asia and Russia, the Middle East and North-South Africa.<sup>1523</sup>

Another important document of the Chinese energy strategy is the 10<sup>th</sup> Five Year Plan of Economic Development of Social Development;

- Diversify sources of supply; (increase imports from Russia and Central Asia)
- Enhance overseas energy investments by State oil companies;
- Increase investment in oil and gas infrastructure;
- Establish government-controlled strategic petroleum reserves;
- Adjust energy consumption structures and reduce dependence on oil through coal gasification, liquefaction, and development of nuclear power;
- Work to establish a regional energy security system.

Moreover, the latest document of Chinese energy strategy distinguished in 2010 as the 12<sup>th</sup> Five Year Plan (2011-2015). Main points of the document are;<sup>1524</sup>

<sup>1522</sup> BP Statistical Review of World Energy (2010).

<sup>1523</sup> Jaewoo CHOO: (2006) "Energy Cooperation Problems in Northeast Asia: Unfolding the Reality", *East Asia*, Vol.23, No.3, 96, 91-106.

<sup>1524</sup> Irina I. POP: (2010) "China's Energy Strategy in Central Asia: Interactions with Russia, India and Japan", *UNISCI Discussion Papers*, No.24, October, p.201, 197-220.

- It will continue to implement resource strategies to accelerate the pace of oil and gas exploration and development, to expand international oil and gas cooperation;
- It will seize favorable opportunities for the development of the low-carbon economy;
- It will accelerate the optimal adjustment of the downstream business structure, and speed up business integration and production base construction;
- It will speed up the construction of strategic oil and gas channels, marketing networks and storage facilities;
- It will quicken the pace of technological progress and break the bottleneck of resource development and that of clean development;
- It will vigorously carry out mutually beneficial international cooperation.

China's oil strategy for the 21st century focused on diversifying oil imports, cooperation on developing oil and gas wells in other countries which is also called "the going abroad" plan".<sup>1525</sup> In addition to that Calder summarizes the Chinese strategy to reduce energy vulnerability are; promoting energy efficiency, diversifying away reliance on coal and oil, toward nuclear and natural gas, improving domestic energy infrastructure, promoting national energy companies, deepening reliance on friendly states and reducing alliance on sea lines where US Navy navigates.<sup>1526</sup>

#### **16.6.1.1. Oil Sector of China**

In the 1990s, when world oil prices were low and the Russian oil industry was looking for capital, Russia was more interested in selling oil and natural gas to China. However, China was not interested as much as Russia, due to reason of the low oil prices, China considered to invest in Russia is too risky.<sup>1527</sup> In 1994, Russia had first proposed the idea of an oil pipeline linking western Siberia with China<sup>1528</sup> and both countries cooperated on feasibility studies to examine the viability of an oil pipeline from Angarsk to Daqing in China. In addition to that Russian private oil company Yukos and CNPC started negotiations over the possibility of constructing pipeline in 1998. While these negotiations were being held, Prime Minister Primakov signed a framework agreement to investigate the export of oil

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<sup>1525</sup> Charles E. ZIEGLER: (2006) "The Energy Factor in China's Foreign Policy", *Journal of Chinese Political Science*, Vol.11, No.1, Spring, p.5, 1-23.

<sup>1526</sup> CALDER, p.49.

<sup>1527</sup> DOWNS, p.154.

<sup>1528</sup> Peter FERDINANAD: (2007) "Sunset, Sunrise: China and Russia Construct a New relationship", *International Affairs*, 83:5, p.848, 841-867.

and gas from Russia's Far East.<sup>1529</sup> Afterwards, when Putin and Zemin signed the Treaty of Good Neighborliness and Friendly Cooperation in July 2001, also two countries agreed to construct the pipeline with the aim of Russia exporting 20 m/t of crude oil to China from 2005 and 30 m/t from 2010.<sup>1530</sup>

Shortly after, Transneft proposed the three stage construction plan including the pipeline segments beginning of Taishet to Nakhodka on the Pacific coast of Russia. With the announcement of support for the Pacific route during Japanese Prime Minister Koizumi's visit to Moscow in January 2003, Russia initiated a competition among China and Japan. While the oil prices were climbing in 2003 (because of Iraq and China's growing consumption), Japan's interest in the pipeline project grew simultaneously.<sup>1531</sup> On the other hand, Yukos and CNPC signed the development of the Angarsk-Daqing pipeline which President Putin did not attend the signing ceremony.<sup>1532</sup> Finally, in September 2005, President Putin announced that the pipeline (ESPO) would first go to China's Daqing and then continue to the Pacific Coast.<sup>1533</sup> In terms of the geo-strategic significance of ESPO for Russia are;

Firstly, it is the country's access to one of the largest markets of the Asian-Pacific region. Secondly, the commissioning of the oil pipeline will give an opportunity to Russian oil companies to diversify oil exports, shipping oil both to Europe and Asia. Thirdly, the pipeline is running through Eastern Siberia and the Far East will give a powerful impulse to the socio-economic development of these regions and the development of new hydrocarbon fields.<sup>1534</sup>

In 2009 China and Russia signed a formal agreement exchanging loans for oil. According to the agreement China will provide long-term loans of \$25 billion to Russia, with \$15 billion going to the Russian oil company "Rosneft" and \$10 billion to the Russian oil

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<sup>1529</sup> DOWNS, p.154, Shaichi ITAH: (2010) "Sino-Russian Energy Relations: True Friendship or Phony Partnership?", *Russian Analytical Digest*, No.73, 23 February, p.10.

<sup>1530</sup> ITAH, p.10.

<sup>1531</sup> Joseph FERGUSON: (2008) *Japanese-Russian Relations 1997-2007*, Routledge, p.111-4, Marcin KACZMARSKI: (2008) "An Asian Alternative? Russia's Challenges of Making Asia an Alternative to Relations with the West", *Centre for Eastern Studies*, Warsaw, June, p.49.

<sup>1532</sup> Metallinou SPYRIDOULA-AMALIA: (2006) "Energy Security: The Russian Trans-Siberian Pipeline and the Sino-Japanese Courtship", September, p.3 Available on site [http://www.idis.gr/GR/Ekpaideutika/hydra\\_papers/metallinou\\_amalia-spyridoula.pdf](http://www.idis.gr/GR/Ekpaideutika/hydra_papers/metallinou_amalia-spyridoula.pdf) (Accessed on 10 June 2009).

<sup>1533</sup> Cindy HURST: (2007) "China's Global Quest for Energy LCDR", IAGS, *Energy Security*, January, p.5 Available on site <http://www.iags.org/chinasquest0107.pdf> (Accessed on 09 June 2009).

<sup>1534</sup> DAVIDOVIC, p.29 .

transportation company “Transneft”.<sup>1535</sup> In return 300 m/t of oil will be delivered for 20 years, beginning in 2011. Russia will deliver 15 m/t a year via a pipeline spur to Daqing, a refining center in northeastern China.<sup>1536</sup> Construction on china-Russia Oil Pipeline’s Russia section was started on April 27<sup>th</sup>. The pipeline with a length over 4.000 km will be used to transmit Russian oil, with a design capacity of 30 m/t.<sup>1537</sup> In December 2009, the first phase of the ESPO pipeline opened which carries oil from Siberian oil fields to the town of Skovorodino. From there it is shipped by rail to Kozmino Bay. This was a major achievement for Russia, giving the country a significant opening to the Far East.<sup>1538</sup> Finally, in August 2010, the first section of the pipeline (1.000 km) was opened. The pipe connects Russian oil fields with Daqing. A second stage of construction on the pipeline is planned to be finished by 2014.<sup>1539</sup> Russian companies, mainly the TKN-BP also deliver oil from Western Siberia to Chin by Kazakhstan pipeline of Atasu-Alashankou about 1 m/t per year. Another small volume of Russian and Kazakh oil are delivered to Asia-Pacific region through Iran and also Black Sea ports by supertankers.<sup>1540</sup>

**Table 48: Deliveries of Russian Crude Oil to China (1999-2008), in million tones<sup>1541</sup>**

Route	1999	2003	2004	2005	2006	2007	2008
<b>The East Siberian Railway</b>	0.5	4.0	4.0	6.4	10.3	8.9	8.9
<b>Other</b>	-	1.0	2.0	5.6	5.7	4.1	4.1
<b>Total</b>	0.5	5.0	6.0	12.0	16.0	13.0	13.0

### 16.6.1.2. Natural Gas Sector of China

<sup>1535</sup> Zhao HUASHENG: (2010) “Sino-Russian relations 2009 to 2010: A Perspective From China”, *Russian Analytical Digest*, No.73, 23 February, p.6.

<sup>1536</sup> Andrew BARNES: (2010) “Russian-Chinese Oil Relations: Dominance or Negotiation?”, PONARS, *Eurasia Policy*, Memo No.12, p.3 Available on site [http://www.gwu.edu/~ieresgwu/assets/docs/pepm\\_124.pdf](http://www.gwu.edu/~ieresgwu/assets/docs/pepm_124.pdf) (Accessed on 03 January 2011).

<sup>1537</sup> China Chemical Reporter (2009) “China and Russia Sign Energy Agreements”, 6 May Available on site <http://www.entrepreneur.com/tradejournals/article/200116653.html> (Accessed on 18 June 2010).

<sup>1538</sup> BARNES: (2010) p.3.

<sup>1539</sup> BBC News (2011) “Russia-China Oil Pipeline Opens”, 2 January <http://www.bbc.co.uk/news/world-asia-pacific-12103865> (Accessed on 20 February 2011).

<sup>1540</sup> Leonty EDER, Philip ANDREWS-SPEED, and Andrey KORZHUBAEV: (2009) “Russia's Evolving Energy Policy For Its Eastern Regions, and Implications For Oil and Gas Cooperation Between Russia and China”, *Journal of World Energy Law and Business*, Vol.2, No.3, p.231.

<sup>1541</sup> Ibid, p.230.

China became natural gas importer in 2007 by producing 69,2 bcm and consuming 69,5 bcm of natural gas.<sup>1542</sup> China is planning to expand its natural gas sector in its economy in the near future. As a hunger state for gas, Russian Far East resources are waiting their new routes. The IEA also projects that China will become increasingly dependent on imported natural gas of 106 in 2030.<sup>1543</sup> China's first import natural gas pipeline is the Central Asian Gas Pipeline (CAGP-1,130 miles), which brings natural gas imports to China from Turkmenistan, Uzbekistan, and Kazakhstan.<sup>1544</sup> Moreover, in March 2006 Russian President Vladimir Putin and Chinese President Hu Jintao signed a joint declaration in Beijing clarifying that energy cooperation was one of the critical components of their bilateral strategic partnership.<sup>1545</sup> As a result, in 2008 Moscow and Beijing reached a framework agreement on plans to construct two routes (East and West) to China from existing Russian gas pipelines, through which Russia will provide China with 68 bcm of natural gas annually.<sup>1546</sup> The western pipeline would go from the Altai territory in western Siberia to the Xinjiang Uygur Autonomous Region in China, while the eastern pipeline would go from eastern Siberia to northeast China, and then to the Korean Peninsula.<sup>1547</sup>

At the end of December 2009 Gazprom Export and CNPC Petro China signed an agreement on the basic terms of gas supplies. In September 2010, Russia and China finalized the document on general terms of Russian gas supplies to China. However, the export contract could not sign due to disagreement on the price of natural gas. According to Russian top officials, the price for Russian gas deliveries to China will be fixed in the first half of 2011.<sup>1548</sup> The opening of gas export route to China will create two advantages for Russian energy strategy. First of all, the Chinese dependence on Russian exports will increase and the far east regions of the Russia will be benefitted from this trade. And secondly, Russian diversification of export routes would be realized in terms of East and West.

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<sup>1542</sup> BP Statistical Review of World Energy (2010).

<sup>1543</sup> Mark A. SMITH: (2010) "The Russo-Chinese Energy Relationship", *The Defense Academy of the United Kingdom*, 10/14, October, p.10.

<sup>1544</sup> China: Country Analysis Brief (2010), p.14

<sup>1545</sup> Sergey SEVASTYANOV: (2008) "The More Assertive and Pragmatic New Energy Policy in Putin's Russia: Security Implications for Northeast Asia", *East Asia*, 25, 28 March, p.46, 35-55.

<sup>1546</sup> HUASHENG, p.6.

<sup>1547</sup> SEVASTYANOV, p.46, Mark A. SMITH: (2010) p.6.

<sup>1548</sup> RIA Novosti (2010) "Price for Russian Gas Deliveries to China to be Set by July 2011-Sechin", 21 September <http://en.rian.ru/world/20100921/160662039.html> (Accessed on 25 February 2011).

### 16.6.2. Russia-China and the Grand Strategy

When the Soviet Union disintegrated, the “new Great Game” theories began to be discussed in the international arena. Although 19<sup>th</sup> century “Great Game” main actors were mainly Russia and Great Britain, the situation is much more complex in 21<sup>st</sup> century. Concerning the new version, not only governments were involved, but foreign and multinational corporations as well.<sup>1549</sup> Torbakov is also agreed that the 19<sup>th</sup> century Great Game model is an inadequate epistemological tool for understanding the 21<sup>st</sup> tangled interaction in the region.<sup>1550</sup> (Appendix 3 and 4) In this context, Central Asian states are the producers of the oil and gas, Russia and China are the great customers that looking forward to reach these resources. On the one hand, Russia and China are competing with one another for the Central Asian resources, on the other Western powers or companies are eager to participate into this competition. Therefore, so far, Russia and China managed to cooperate on certain terms regarding the strategic control of resources in the region. However, there are arguments that between the two powers in Central Asia in the future is inevitable.<sup>1551</sup>

China’s economic security concentrates on three areas; economic growth, energy security and environmental protection. Therefore, China is trying to develop strong ties with major energy exporting countries, secure overseas energy supplies and establish a reliable pipeline network from its neighbors.<sup>1552</sup> Throughout the history, China did not interest on Central Asian region due to its own internal problems. However, since the dissolution of the Soviet Union, China has followed close relations with newly independent Central Asian states.<sup>1553</sup> The instability of the Middle East, the passage of about 80% of China’s oil imports through Malacca Strait, with its security problems, the need to diversify its energy suppliers, and the necessity to develop the north-west China, all these factors

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<sup>1549</sup> Mustafa AYDIN: (2004) “Eurasian Security and Geopolitics: Conflicts and Cooperation Since the End of the Cold War”, in Gabriele Rasuly-polueczek and Julia Katschnig (ed.) “*Central Asia on Display*”, Vienna Central Asian Studies, LIT Verlag, p.453, 447-66.

<sup>1550</sup> Ivan TORBAKOV: (2008) “The West, Russia and China in Central Asia: What Kind of Game is Being Played in the Region?”, *USAK Yearbook*, Vol.I, p.306-7, 297-307.

<sup>1551</sup> Ibid.

<sup>1552</sup> Liu, p.2.

<sup>1553</sup> Kevin SHEIVES: (2006) “China Turns West: Beijing’s Contemporary Strategy Towards Central Asia”, *Pacific Affairs*, Vol.79, No.2, Summer, p.205, 205-26.

determined the reorientation of China's foreign energy policy towards Central Asia and Russia.<sup>1554</sup> At this point, the challenge of China's rise both as a superpower and presence in Central Asian countries makes the issue top point in Russian foreign and security policy.<sup>1555</sup>

**Table 49: Chinese Actions in Central Asia**

June 2005	CNPC signed a joint venture agreement with Uzbekneftegaz to invest \$600 million.
August 2005	CNPC and KazMunayGas signed an agreement for the exploitation of Darkhan oil field.
October 2005	CNPC paid \$4,18 billion for the takeover of PetroKazakhstan.
December 2005	Atasu-Alshankou oil pipeline from Kazakhstan to China opened.
April 2006	China and Turkmenistan signed the delivery of 30 bcm of gas.
May 2006	The first transnational oil pipeline was opened from Kazakhstan to China.
June-August 2006	CNPC signed contract with Uzbekistan to invest \$210 million and to explore oil and gas deposits in Aral Sea.
July 2007	CNPS signed PSA to develop and extract gas in Turkmenistan's Bagtiyarlik field.
November 2007	CNPC and KamunayGas signed an export agreement for 5 bcm.
October 2008	CNPC and Uzbekneftegas signed an agreement to develop the Mingbulak oil field.
July 2009	The Kenkiyok-Kumkol phase of the China-Kazakhstan oil pipeline was completed.
December 2009	CNPC was awarded to develop South Yolatan gas field in Turkmenistan.
December 2009	Central Asia Gas Pipeline (CAGP) began operations.
June 2010	CNPC signed a MOU with Uzbekistan to deliver 10 bcm through the transmission line which would connect CAGP.
June 2010	China and Kazakhstan signed an agreement to construct the second phase of the China-Kazakh oil pipeline.

China is using economic and trade policies towards Central Asian states; to provide security to the region thereby giving them significant economic support for not flaming separatist movements in Xingjian, to gain access to natural resources in order to diversify its energy imports, and consolidate political influence to become a regional hegemon.<sup>1556</sup> For instance, China-Kazakhstan Oil Pipeline played an important role in the strategic

<sup>1554</sup> POP, p.205-6.

<sup>1555</sup> Eugene B. RUMER: (2006) "China, Russia and the Balance of Power in Central Asia", National Defense University, *Strategic Forum*, No.223, November, p.4.

<sup>1556</sup> Christina Y. LIN: (2010) "The Caspian Sea: China's Silk Road Strategy Converges with Damascus", *China Brief*, The Jamestown Foundation, Vol.X, Issue 17, 19 August, p.10, 9-12.

balance of the region. First, it lessens China's dependence on oil from the Persian Gulf. Second, the location in the inland of Eurasia makes China's oil supply route safer. And third, it provides China with a long-term and stable land-based oil supply alternative.<sup>1557</sup> The last decade developments display that despite Russia's efforts to exploit the proximity between China and Central Asian states is not totally successful. The leaders of these states seemed determined to widen their options and expand their freedom of action by continuing signing agreements with China.<sup>1558</sup>

It is a fact that Moscow's primary goal is to control the pipelines of the region as long as possible. Yet, when China joined the energy game, Central Asian states gained another card against Russian unilateral energy rules in the region. For instance Kazakhstan managed to balance between the competing demand of Russia and China by signing multiple deals. In addition to that Turkmenistan forced Moscow to pay European prices for its gas in 2008 by using the possibility of a deal with outside powers. As a result, many leaders of the region have used China option as a potential way against Russian influence.<sup>1559</sup> Although, China emerged as a big power in the Central Asian energy game, Russia is still the dominant actor in the region. First of all, the geography and the pipeline infrastructure is still an advantage for Russia. Secondly, Chinese dependence on Russian oil is increasing annually and natural gas is on the way. And finally, Central Asian states believe that without Russian authorization, it is impracticable to act unanimously including cooperation with China.

### **16.6.3. Nuclear Aspect Between Russia and China**

For many centuries the advancement in military technology shapes the decisions of states about how resources can best be employed to pursue national interests.<sup>1560</sup> According to Kremlin, to have a nuclear weapon is kind of a status and provides a permanent seat on the UN Security-Council and remains indications of Moscow's great power ambition.

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<sup>1557</sup> Guo XUETANG: (2006) "The Energy Security in Central Eurasia: the Geopolitical Implications to China's Energy Strategy", Central Asia-Caucasus Institute & Silk Road Studies Program, *China and Eurasia Forum Quarterly*, Volume 4, No. 4, p.130, 117-137.

<sup>1558</sup> DONALDSON and NOGEE, p.202.

<sup>1559</sup> MANKOFF: (2009a), p.277-9.

<sup>1560</sup> Avery GOLDSTEIN: (2000) *Deterrence and Security in the 21<sup>st</sup> Century – China, Britain, France, and Enduring Legacy of the Nuclear Revolution*, Stanford University Press, p.41.

Moreover, Moscow's nuclear power status is in accordance with Russian approach on international system as Multipolar in which Russia sees itself as one of the center of power.<sup>1561</sup> Russia and China share close opinions on the policy of multipolar international system and an opposition to US missile defense system.<sup>1562</sup> Nuclear weapons are part of Russian military strategy regarding to new developments in the international system. Menon claims that the National Concept of the Russian Federation 2000 and the Military Doctrine introduced a concept which can be summarized as a "realistic containment strategy".<sup>1563</sup> Document was concentrated on Kremlin's concern about overwhelming US conventional power and capacity to limit Russian foreign policy actions. Afterwards in 2007, it was leaked that Russia was in a process of renewing its Military Doctrine and in 2010 President Medvedev approved new doctrine which allows preventive nuclear strikes against potential aggressors.

According to Sokov, Yuan, Potter, and Hansell; the main drivers of the policies of both Russia and China are connected with concerns over US action:<sup>1564</sup>

1. The overwhelming US superiority in conventional weapons undermines traditional nuclear deterrence.
2. The US is seen as having used force in a variety of circumstances over the past decade, often without UN Security-Council authorization; this has created some unease in Russia and China over a possible US role in existing or potential regional conflicts.
3. Russia and China perceive US missile defense plans as potentially harming their ability to deter a US strike. The US justification for missile defenses –the need to

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<sup>1561</sup> Nikolai N. SOKOV: (2009) "The Evolving Role of Nuclear Weapons in Russia's Defense Policy", in (ed) Cristina Hansell and William C. Potter, "*Engaging China and Russia on Nuclear Disarmament*", Monterey Institute for International Studies, *Occasional Paper* No.15, April, p.73.

<sup>1562</sup> Cristina HANSELL and Nikita PERFILYEV: (2009) "Strategic Relations Between the United States, Russia, and China, and the Possibility of Cooperation on Disarmament", in (ed) Cristina Hansell and William C. Potter, "*Engaging China and Russia on Nuclear Disarmament*", Monterey Institute for International Studies, *Occasional Paper* No.15, April, p.133.

<sup>1563</sup> Wang ZHONGCHUN: (2007) "Nuclear Challenges and China's Choices", *China Security*, Winter, pp.52-65, p.56.

<sup>1564</sup> Nikolai N. SOKOV, Jing-dong YUAN, William C. POTTER, and Cristina HANSELL: (2009) "Chinese and Russian Perspectives on Achieving Nuclear Zero", in (ed) Cristina Hansell and William C. Potter, "*Engaging China and Russia on Nuclear Disarmament*", Monterey Institute for International Studies, *Occasional Paper* No.15, April, p.2.

intercept missiles launched by “rogue” states such as Iran and North Korea- is not regarded as credible in Beijing or Moscow.

4. The 2001 Nuclear Posture Review issued by the G.W: Bush administration created the impression that the US plans to integrate nuclear weapons into an array of other military assets and lower the nuclear threshold.

During the Cold War, China’s aim to develop nuclear weapons was rooted that its alliance with the Soviets did not provide adequate security and a self-reliance strategy of dissuasion by nuclear deterrence would better serve China’s national interest.<sup>1565</sup> Nevertheless, China’s nuclear doctrine is based on no-first-use of nuclear weapons instead seeks to deter other countries from using nuclear weapons against China, oppose the nuclear threats of enemies and counterattack against any major nuclear attacks, developing a lean and effective nuclear force and support comprehensive nuclear disarmament.<sup>1566</sup> Furthermore, there is a division between Russian analysts that Chinese nuclear power and improving military force is either harmless or a threat. On the one hand, member of Academy of Sciences Sergei Brozkun and Former Minister of Atomic Energy Victor Mikhailov claims that rise of China’s military and improved nuclear capabilities are benign, or even helpful for Russia's security and Russia has nothing to fear from growing Chinese arsenal.<sup>1567</sup> And on the other hand, member of Russian Academy of Sciences Vitaly Tsygichko argues that China’s hegemonic intension in Asia threatens Russian interests.<sup>1568</sup> Gill assumes that China has avoided engaging in a nuclear arms race with Russia or the USA owing to past technological and financial constraints, and most importantly, owing to consistent doctrinal constraints. Gill also adds that China’s international partners should not expect major steps forward in the near-term, but rather should seek incremental progress at best on the NPT (Non-Proliferation Treaty), an FMCT (fissile material cut-off treaty) and other mechanisms.<sup>1569</sup>

#### **16.6.4. The Role of Shanghai Cooperation Organization**

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<sup>1565</sup> GOLDSTEIN, p.62.

<sup>1566</sup> WANG, p.60.

<sup>1567</sup> HANSELL and PERFILYEV, p.134.

<sup>1568</sup> Ibid, p.135.

<sup>1569</sup> Bates GILL: (2010) “China and Nuclear Arms Control: Current Positions and Future Politics”, *SPIRI Insights on Peace and Security*, No.2010/4, April, p.3-14.

SCO was formally created in 2001 by Russia, China, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. The SCO is the only structure that provides an opportunity to both Russia and China to promote their interests in the region regarding to energy strategies.<sup>1570</sup> According to the organization's founding charter, the SCO was established, among other reasons, in order to build a democratic, just, and rational international political and economic new order and maintain a global strategic balance and stability.<sup>1571</sup> One year later the official charter was signed in St. Petersburg which;

confirmed the SCO's mandate to build "mutual trust, friendship and good neighborliness", and to encourage "comprehensive cooperation". Other key elements of the document included the confirmation that a Regional Anti-Terrorism Structure (RTS) would be created to act as an information nexus for regional security and that decisions would be based on mutual consensus.<sup>1572</sup>

Since its July 2005 summit, which called upon the US to commit to withdraw its military personnel from Central Asia, has declared to be against US expansion in the region. As a result, it emerged as an organization for Russian and Chinese diplomacy that aimed to counter US influence in the region.<sup>1573</sup> According to Russian and Chinese decision makers, the potential spread of instability close to their borders (such as Andijan, Tajikistan and Kyrgyzstan events) could seriously weaken their internal political stability, damage regional trade and the energy infrastructure and also delay the realization of new pipelines. Therefore, Russia and China improved their cooperation in terms of the security in the region after the interethnic clashes in Kyrgyzstan in April 2010.<sup>1574</sup> For Russia, the SCO mainly serves to its interests in three ways; it counterbalances American influence in Central Asia, adds the weight of Russia and China in the global balance of power and it provides a vehicle for cooperation with those nations fighting terrorism.<sup>1575</sup> On the other hand, SCO provides a forum for China to exercise leadership in a multilateral organization

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<sup>1570</sup> Olga GARANINA: (2007) "Russian-Chinese Relations: Towards an Energy Partnership", 1<sup>st</sup> IAEE Asian Conference, "*Asian Energy Security and Economic Development in an Era of High Oil Prices*", Taipei, 5-6 November 2007, p.3-4.

<sup>1571</sup> Thomas AMBROSIO: (2004) "The Foundation of an Anti-Hegemonic Coalition? The Geopolitics of Russo-Chinese Relations", *Paper Presented at the Southern Political Science Association*, p.13.

<sup>1572</sup> Mark LANTEIGNE: (2009) *Chinese Foreign Policy, An Introduction*, Routledge, p.69.

<sup>1573</sup> RUMER: (2006) p.1

<sup>1574</sup> Fabio INDEO: (2010) "Russia and China in Central Asia: growing Geopolitical Competition", ISPI Policy Brief, No.199, October, p.4-5

<sup>1575</sup> DONALDSON and NOGEE, p.354.

and expand its influence in a region of growing geo-political and geo-economic significance.<sup>1576</sup>

It seems that for Kremlin, the SCO not only serves for security matters but also could be the mechanism for the new energy device whether it is an “energy forum” or “energy club”. The idea was firstly expressed by President Putin in 2006, at the summit of the SCO in Astana. The proposed mechanism would be equivalent of an OPEC for natural gas and would allow Russia both to set the global market price for gas.<sup>1577</sup> In 2009, at the summit of the SCO in Beijing, Prime Minister Putin once more brought the issue on the table and said “energy traditionally holds a key position on the global agenda, which prompts me to remind you of Russia's proposal to set up a permanent mechanism for dialogue on the issue, a SCO Energy club or forum”.<sup>1578</sup> Besides the “energy club” proposal, Russia has repeatedly blocked China from achieving its own top priority in the SCO to form a SCO free trade zone. Russia is aware that Central Asian economic infrastructure is not ready for the Chinese invasion and vulnerable to economic crisis.<sup>1579</sup> Therefore, both Russia and China are pursuing their own agendas under the SCO structure. As a result, the organization successfully serves for maintaining the balance of power in the region.

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<sup>1576</sup> Jing-Dong YUAN: (2010) “China’s Role in Establishing and Building the SCO”, *Journal of Contemporary China*, 19:67, p.856, 855-69.

<sup>1577</sup> Stephen BLANK: (2006) “The Shanghai Cooperation Organization As An ‘Energy Club’, Portents For the Future”, *CACI Analyst*, 4 October Available on site <http://www.cacianalyst.org/?q=node/4224> (Accessed on 26 February 2011).

<sup>1578</sup> Geopolitical Monitor (2009) “*Putin Pushes SCO Countries to Form Energy Forum*”, 14 October <http://www.geopoliticalmonitor.com/putin-pushes-sco-countries-to-form-energy-forum-2812/> (Accessed on 26 February 2011).

<sup>1579</sup> Thrassy N. MARKETOS: (2009) *China’s Energy Geopolitics, The Shanghai Cooperation Organization and Central Asia*, Routledge, p.46.

# **PROJECTIONS AND CONCLUSION**

## **PROJECTIONS FOR RUSSIAN FOREIGN ENERGY POLICIES FOR THE FUTURE**

Since the proclamation of Russian Federation in 1991, until today, Russia has pursued a foreign energy policy regarding to its urgent needs as a result of the dependency on hydrocarbon exports ration in its economy structure. After the dissolution of the USSR and end of the Cold War, world has introduced with the new concept which is “Unipolarity” and the “lonely” superpower, the United States. However, since the mid-1990s, Russia foreign policy focused on supporting multipolarity, essentially based on counting China as a superpower and tried to stand faraway from Cold War terminology. The main arguments of mid-1990s were briefly; whether Russian Federation will survive or not? It should be noted that the year 2000 was a turning point for Russia, when Vladimir Putin became Russian President and began to design Russian foreign policy and energy strategy. President Putin has realized that if Russia does not improve itself both economically and socially and not become a superpower again, and then it is condemned to be disappeared from world history. Hence President Putin has integrated Russian foreign policy and energy policy and used energy card wherever it is possible for Russian national interest. In

that sense, in this study there are three projections –short term, midterm and long term- for Russian foreign energy policy.

### **Short Term for 1-5 Years**

During the Presidency of Vladimir Putin, Russian budget achieved a surplus between 2000-08, and the Russian government managed to pay its foreign debts.<sup>1580</sup> Many experts observe that one of the reasons behind this rapid economic recovery is the rise of oil and gas prices as well as income from growing oil and gas export incomes.<sup>1581</sup> According to 2010 statistics, today, Russia is leading oil producer (10.2 bbl/d), second oil exporter (more than 133 m/t) and 8<sup>th</sup> largest reserve (10.6 billion tones, share of %5.6) in the world. In the field of natural gas, Russia is the number one exporter (177 bcm) with its largest reserves (45 Tcm) and largest producer (more than 600 bcm) in the world. As an energy export dependent economy Russia has to diversify its export commodities as well as constituting new pipelines for its short term supplies. In the oil sector there are four pipeline projects on the table; ESPO, Baltic Pipeline System II, Burgas-Alexandroupolis and Samsun Ceyhan oil pipelines.

### **Map 41: Russian Existing, Under Construction, In Progress and Unders Discussion Oil Pipelines<sup>1582</sup>**

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<sup>1580</sup> RUMER and WALLENDER:(2003) p.59,

<sup>1581</sup> GRIGORIEV: (2006) p.15.

<sup>1582</sup> Adnan VATANSEVER: (2010) “Russia's Oil Exports – Economic Rationale Versus Strategic Gains”, *Carnegie Papers*, No.116, December, p.11



The first phase of ESPO pipeline has completed and already began pumping oil to China and the second phase will be completed in 2014. Another important route Baltic Pipeline System II will be completed in 2012. Thus, Russia has designed its new oil routes to East and West, however, the southern route has not started yet. There are two pipeline projects to bypass Turkish Straits, Burgas-Alexandroupolis and Samsun Ceyhan pipelines. Although two pipeline projects seems rival to each other, Samsun-Ceyhan leads the race so far. Russia seeks new reliable roots for its excess supply of oil including growing volume of Kazak oil. For that reason, in the short term, Russia will decide to initiate one of southern route options. In this route, Russia does not want to initiate any oil pipeline unless the South Stream natural gas pipeline has began. It should be expected that after the forth

coming presidential elections in the early 2012, we will see a rapid actions in these pipeline negotiations.

Another important sector in Russian foreign energy policy is the expansion of pipelines both internal and external. Internal pipelines are crucial to develop far resources and link them to the central pipeline systems. Furthermore, external pipelines are the export tools of Russian gas as well as Central Asian gas imported by Russia. The pipeline of Murmansk-Volkhov (50 bcm) will carry gas supplies of Shtokman field to consumers of northwestern Russia and gas exports via recently opened Nord Stream.<sup>1583</sup> Russia needs this pipeline in the near future to fulfill the required gas of North Stream that will fully function at the end of 2012 with the capacity of 55 bcm (at the moment 27.5 bcm). Although the construction of this pipeline does not started yet, the first phase of Nord Stream has completed very recently which provides Germany to import Russian gas directly bypassing the transferring states. President Medvedev also stated during the launch ceremony that:

“We are launching the first pipeline of Nord Stream, which opens a new page in our country's cooperation with the European Union, and all previous speakers took note of that. For the first time, Russian gas will reach countries of the European Union directly.”<sup>1584</sup>

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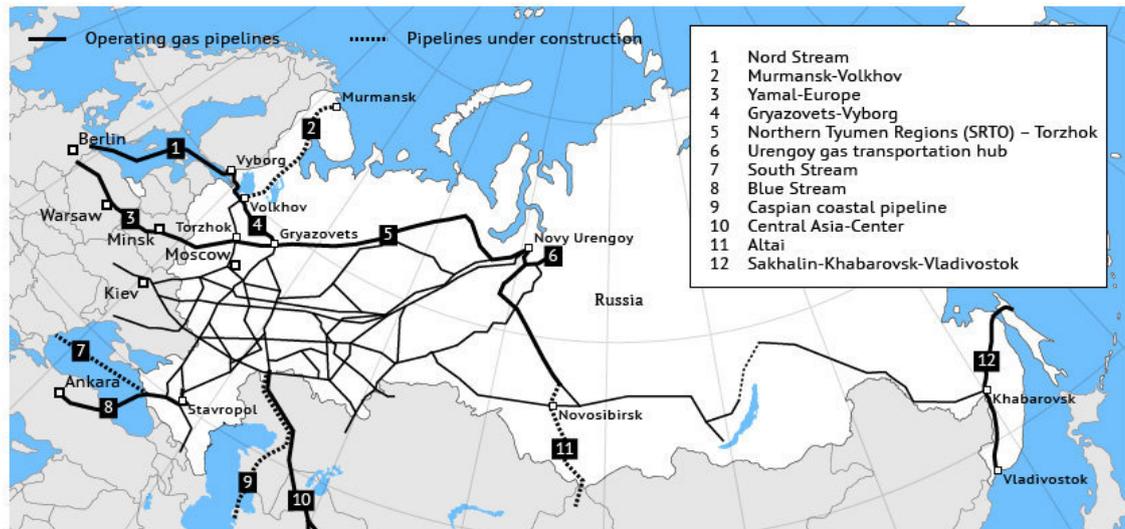
<sup>1583</sup> Gazprom – Projects, <http://www.gazprom.com/production/projects/pipelines/mvg/>

<sup>1584</sup> RFERL (2011) “Merkel, Medvedev Launch Nord Stream Pipeline Beneath Baltic Sea”, 25 November, [http://www.rferl.org/content/russia\\_germany\\_nord\\_stream\\_pipeline/24384263.html](http://www.rferl.org/content/russia_germany_nord_stream_pipeline/24384263.html) (Accessed on 25 November 2011)

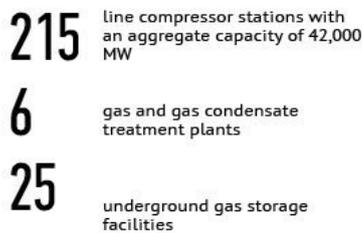
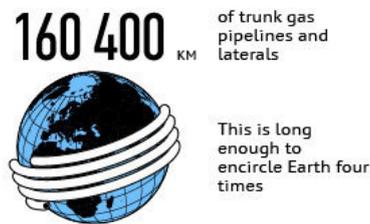
Map 42: Russian Gas Pipelines

## Russian gas pipelines

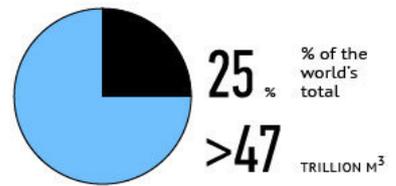
The Unified Gas Supply System (UGSS) of Russia is the world's largest gas pipeline network



The UGSS comprises:



Russia is the world's leader in terms of prospected gas reserves



RIANOVOSTI © 2011 WWW.RIA.RU

Source: Gazprom's website

Source: RIA Novosti, <http://en.rian.ru/infographics/20111029/168167122.html> (30 September 2011)

South Stream natural gas pipeline is the Russian one of the significant short term objectives needs to be completed as soon as possible in order to avoid the rival pipelines such as Nabucco, and now Trans-Anadolu gas pipeline. Trans-Anadolu natural gas pipeline has been proposed by Azerbaijan's SOCAR last month in Istanbul. The pipeline is projected to have capacity of 16 bcm and will cross Turkey from East to West and then will connect with Greece pipeline system. The pipeline will carry the gas of Shah Deniz II

field and financially cost about 6 billion dollar.<sup>1585</sup> Therefore Turkish and Azerbaijan officials claim that Trans-Anadolu gas pipeline will enable the Southern Corridor of Europe and not diminish the projects of Nabucco and ITGI. However, Russia's South Stream has the capacity of 67 bcm and already finds the half of its gas requirements in Caspian resources by signing Pre-Caspian Pipeline agreement in 2007. And now Russia is planning to develop the Shtokman fields in the short term in order to increase its gas production to fulfill its gas export strategy. Otherwise, although the rival projects have not considerable capacity as South Stream, but once the rival has completed, it could be upgrade and maintain a bypass status from Russian monopoly strategy.

Another important project of Russian energy policy, the construction of Caspian Coastal Pipeline or Pre-Caspian Pipeline (30+10 bcm) has finally started in 2010 and scheduled to be completed in 2015. The 40 bcm of natural gas will be imported by Russia and then will export them to the Southern European countries by the way of South Stream. Therefore, South Stream should be simultaneously completed by Pre-Caspian gas pipeline.<sup>1586</sup> The Altai gas pipeline is projected to enter into Chinese border between Kazakhstan and Mongolia and will carry the gas of Western Siberia of Russia. Although first supplies were planned to reach China in 2015 with the capacity of 30 bcm annually, Russia and China could not reach an agreement on price of gas. In addition to that China signed an agreement with Turkmenistan to increase natural gas supplies from Ashgabat. Turkmenistan agreed to sell gas to China for \$250 per 1000 bcm which is \$150 lower than Russian gas price.<sup>1587</sup> In the short term, Russia aims to sign a gas contract with China due to reason to avoid growing energy relations between China and Central Asian states and increase its income by exporting natural gas as well as binding Chinese gas sector to be dependent on Russian gas.

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<sup>1585</sup> Dow Jones Deutschland, Turkey, Tran Anadolu Pipeline Must Be Done By 2017-18", 2011, 18 November, Available on site <http://www.dowjones.de/site/2011/11/turkey-trans-anadolu-pipeline-must-be-done-by-2017-18.html> (Accessed on 18 November 2011).

<sup>1586</sup> RIA Novosti: (2010) "Turkmenistan Starts Construction of East-West Gas Pipeline", 31 May, <http://en.rian.ru/exsoviet/20100531/159233492.html> (Accessed on 20 November 2011).

<sup>1587</sup> Anna SULIMINA: (2011) "China Gas Deal Sidelines Russia", The Moscow News, 24 November, <http://themoscownews.com/energy/20111124/189231999.html> (Accessed on 24 November 2011).

## Medium Term for 5-10 Years

According to Russian foreign energy policy, the main external challenges are; the instability of world energy markets and volatility of world energy prices. For instance, during the 2008-09 global economic crisis, the price of crude oil fell to 41.48\$ in December 2008, which was 113, 85\$ only four months ago. Afterwards, the price of oil recovered to higher than 100\$ in February 2001 and recently it is around 109\$ due to crisis in the Middle East.<sup>1588</sup> Libyan production of has suspended as a result of the “Arab Spring” events and therefore the price of oil has increased. However, it is uncertain that how long the prices will continue to stay over 100\$? Therefore Russia set of objectives in order to maintain an economic development for the medium term process in its Energy Strategy 2030 document are; improve Russian living standards regarding to developed countries, achieve scientific and technological developments, change Russian economic structure in favor of less-intensive sectors, switch Russian export ratio from raw materials to manufactures including decreasing the share of the fuel and energy sector, increase of investments in the energy sector for the modernization of the sector, and improve its energy efficiency and reduce energy. The anti-crisis action programme for 2009 could be accepted as part of this strategy because for the first time in Russian history, Russian federal budget became a reality. The Russian government approved the anti-crisis action programme that exceeds 4 trillion Rubles (\$120 billion) including social measures, supporting industry and stability of the banking system.<sup>1589</sup>

It is an undeniable fact that energy sector including oil and gas will continue to determine both Russian socio-economical status and foreign policy. Due to this reason, not only Russia must secure its status as a largest energy supplier in the world, but also must diversify its commodity structure and destinations of energy exports. Otherwise, Russian dependence on energy exports and European route will increase vulnerability of Russia and hinder Kremlin’s multipolar foreign policy approach. Therefore, Russia determined new

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<sup>1588</sup> Index Mundi, Crude Oil (petroleum); Dated Brent Monthly Price - US Dollars per Barrel <http://www.indexmundi.com/commodities/?commodity=crude-oil-brent&months=300> (Accessed on 24 November 2011).

<sup>1589</sup> Leonid GRIGORIEV and Maria BELOVA: (2009) “EU-Russia Gas Relations”, in (ed.) Kari Liuhto, “*EU-Russia Gas Connection: Pipes, Politics and Problem*”, Turku School of Economics, Electronic Publications of Pan-European Institute, 8/2009, p.73

production areas to increase its oil and gas production, particularly in the east part of Russia for the Eastern route to China, Japan, Korea and etc. Another reason behind Russian attention on Far East is the vulnerability of the demographic structure of the region. Moscow realized that the Eastern regions should be modernized and industrialized otherwise Chinese population near Russian border is about 300 million. Primary energy developing areas for the Russian energy strategies are; Eastern Siberia, Far East, Yamal Peninsula, and Arctic region. Locatelli and Sylvain argue that a decline in Russian oil production is likely to be observed unless significant investment is made in the development of new production areas.<sup>1590</sup> Despite of the fact that pipelines are significant for Russian foreign energy policy, LNG production and transportation has also growing attention in Kremlin's strategy, LNG will enable Russian natural gas to reach far foreign markets such as Japan and USA. It is also shown by the Figure that the decrease of Russian own resources will be substituted by Independent and Central Asian producers, and new fields of Gazprom. Furthermore, all these new areas required huge amount of investment by Gazprom in the medium term.

Eder, Andrews-Speed, and Korzhubaev summarize the objectives for the oil and gas industries of the Eastern region of Russia are;<sup>1591</sup>

- The formation and development of new large centers of oil production in Eastern Siberia and the Sakha Republic.
- The development of transport infrastructure in Eastern Siberia and in the Far East Russia to increase the efficiency and capacity for exporting crude oil and oil products, and to ensure diversification with respect to modes of transport, direction and routes of deliveries to domestic and foreign markets.
- The strengthening of state regulation of the oil industry, the improvement of the tax laws and the enhancement of the legislation covering the exploitation of oil in order to accelerate exploration, particularly in Eastern Siberia and in the Far East.
- The development of unified system of gas supply and its expansion into the east of Russia, thereby strengthening the regional integration of the country.

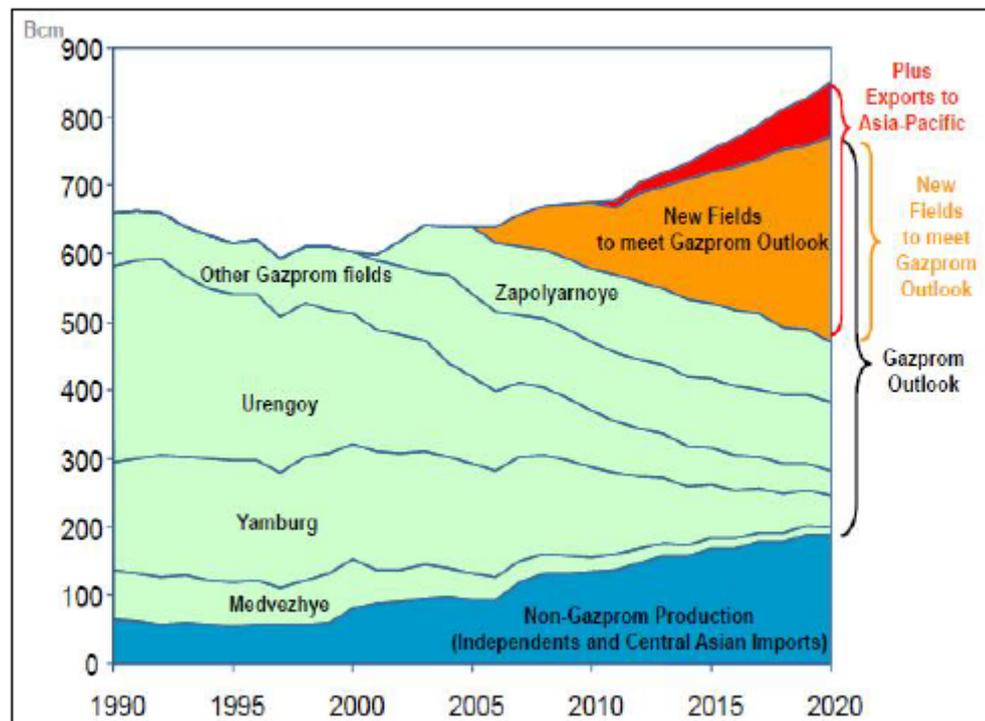
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<sup>1590</sup> LOCATELLI and ROSSIAUD, p.5596

<sup>1591</sup> EDER, ANDREWS-SPEED, and KORZHUBAEV, p.227-28.

- The maintenance of political interests and the strengthening of economic position of Russia in Europe and also in Asia-Pacific region.
- Rational use of the proven resources of gas.
- Increased exploration to maintain the level of gas reserves.
- The formation and development of new, large gas-producing areas in Eastern Siberia and in the Far East.
- The establishment of Liquefied Natural Gas (LNG) plants for export, especially in the Far East, in Sakhalin.
- The organization of export deliveries of natural gas by pipeline from the fields of Eastern Siberia and the Far East to China and to other countries of the Asia-Pacific region, and also as LNG from fields of Sakhalin.

**Figure 19: Russian Gas Supply Outlook to 2020**



Source: Edward CHRISTIE: (2009) “European Security of Gas Supply – A New Way Forward”, in (ed.) Kari Liuhto, “EU-Russia Gas Connection: Pipes, Politics and Problem”, Turku School of Economics, Electronic Publications of Pan-European Institute, 8/2009, p.9.

Although Fernandez is optimistic about the growing capacity of Russian natural gas until 2020, Russia has huge gas reserves, but the old basins are to decline. Kremlin is also

recognized the situation and stated in Energy Strategy up to 2030 document that State will provide \$96.2 billion in 2011-15 and \$115.3 billion in 2016-20 for investment in the gas industry. On the other hand, Fernandez estimates the export of Russian gas in 2020 in three different scenarios that are Low 195 bcm, Moderate 260 bcm, and High 330 bcm, which are lower compare to Energy Strategy up to 2030 document.<sup>1592</sup> (Appendix 5 and 6) as a result of this strategy, it is expected that Russia will focus on Central Asian countries more strictly by aiming to sign long-term contracts for their energy resources. Another important goal of Russia is to invest other resource-rich countries such as Algeria and Iran to secure its superiority of being monopoly to European energy needs. Therefore, Russia would not allow regime changing in these countries otherwise Russia would lose its geopolitical advantage in favor of Western states which will completely destroy Russian foreign energy strategy. Moreover, Russia has a strategy of intervening distribution system of consumer states in order to raise its profit ratio and maintain the superiority of determining price of natural gas. Hence, Russian energy companies actions derives from Russian energy strategy while making investments in Europe, Middle East and etc. Russian energy companies take advantage of the State's political capabilities to dominate domestic markets, control supplies such as in Caspian and Caucasus.<sup>1593</sup> In addition to that main goal of Kremlin is to establish Eurasian integrated gas transportation system between Europe and Asia. As a result, Russia will become the regional leader in terms of energy security and will have an impact to determine the price of energy commodities. And finally, the Central Asian countries will be dependent to Kremlin not only by energy means, but also by foreign policy and security aspects.

### **Long Term for 10-20**

It is expected that energy sector will be key element of Russian economy. Therefore, Russian economy needs investment especially for the infrastructure and modernization compare to western economies. (Appendix 7) In other words, according to Russian foreign energy policy, Russian energy production capacity is in need of expansion and

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<sup>1592</sup> Rafael FERNANDEZ: (2009) "Russian Gas Exports Have Potential to Grow Through 2020", *Energy Policy* 37, pp.4029-4037.

<sup>1593</sup> BİLGİN: (2011) p.119.

modernization, which entails investment.<sup>1594</sup> In that sense Guriev and Tsyvinski argues that economic policy during the global crisis of 2008-09 was adequate but still Russia faces with challenges. They support the idea of a renewal of structural economic reforms to improve economic efficiency and governance that aims to prevent the stagnation.<sup>1595</sup> If Russia cannot sustain a functioning economy in the long term, there is a danger that Russia falls into the tarp of becoming a petro-state that an economically and technologically backward country used as a source of raw materials for the EU and China, as mentioned in the European Commission Country Strategy Paper of 2007-13.<sup>1596</sup> Another important aspect of the economy that Russia should focus in the long term projection is the advanced technology. Despite of the fact that Russia is aware of its acute potential danger of resource-led development, Russia is still highly dependent on energy sector. Vladimir Putin has already noticed the situation when he was President in December 2001 by stating that “in developed countries, advanced technologies, not the energy sector, account for more than 50% of GDP, and I am convinced that this is where Russia's future lies.”<sup>1597</sup> However, 10 years has past until this speech but Russia still remains its dependency on energy sector.

Russian energy sector also urgently needs to improve its technologies in some certain aspects; firstly, energy saving technologies in production, transformation, and consumption, secondly, exploration and production of oil and gas in difficult geological and climate conditions, thirdly, LNG production and transformation, and finally in oil and gas processing.<sup>1598</sup> Most important of these demands is the need of advanced technology in difficult geographies such Arctic region and Far East Russia. The research shows that some of Russian giant fields are in decline and Russia will have to develop new reserves in the future in order to fulfill its own needs and export strategy. Meanwhile, Russia should consider sign long term partnership contracts with foreign companies for the need of investment and technology.

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<sup>1594</sup> Ander ASLUND, Sergei GURIEV, and Andrew KUSCHINS: (2010) “*Russia After the Global Economic Crisis*”, Peter G. Peterson Institute for International Economics, p.xiii.

<sup>1595</sup> GURIEV and TSYVINSKI: (2010) p.9-38.

<sup>1596</sup> European Commission, Russian Federation – Country Strategy Paper 2007-2013, p.10, [http://eeas.europa.eu/russia/docs/2007-2013\\_en.pdf](http://eeas.europa.eu/russia/docs/2007-2013_en.pdf)

<sup>1597</sup> Younkyoo, KIM: (2003) “*The Resource Curse in a Post-Communist Regime: Russia in Comparative Perspective*”, Ashgate Pub. Ltd., p.7.

<sup>1598</sup> Tatiana MITROVA: (2011) “Strategy of the Russian Energy Sector Development with its Implications for the Technologies”, February, Japan, [http://www.eriras.ru/papers/mitrova\\_japan.pdf](http://www.eriras.ru/papers/mitrova_japan.pdf)

In terms of geopolitics on the one hand Russian foreign energy policy is concentrated on Europe, Central Asia and China, on the other hand BRIC (Brazil, Russia, India, and China)<sup>1599</sup>, East Asia, South America, North Africa, Cyprus, and Eurasian Union. As a major emerging economy, India is Russian potential energy customer in the long term. Although it seems difficult to construct pipeline which is under control of Russia, Kremlin tries to involve Central Asian pipeline projects such as TAPI aims to prevent Central Asian countries act alone. Concerning the East Asia, South America and North Africa, for instance Gazprom has already began to implement projects in these regions such as Algeria, Bolivia, Venezuela, Vietnam, Iraq and Libya.<sup>1600</sup> Recently, Cyprus is a new perspective for Russian foreign energy policy. Since this year, the resources of Cyprus were a dispute between the Cyprus government and the Turkish government. In spite of Turkish government's opposition, Cyprus has signed a contract with an American based firm to produce natural gas in its waters. Russia supported the Cyprus claims for the exploration of fields in the south Mediterranean because Russia and Cyprus has close relations and Cyprus should sign energy contracts with Russian firms as a reward of supporting Cyprus against Turkey that is highly dependent on Russian energy resources.<sup>1601</sup>

The newest project of Kremlin is the Eurasian Union as a long term project. Eurasian Union is a regional organization formed by Russia, Kazakhstan, and Belarus. On October 3, Prime Minister Putin wrote an article in *Izvestia*; "the new integration project for Eurasia – a future that is born today". In this article, Putin states that "the project, without exaggeration, a historic landmark not only for our three countries but also for all post-Soviet states thus call countries of Kyrgyzstan and Tajikistan to the Union. As a result of the agreements signed between Russia, Kazakhstan, and Belarus, the Common Economic

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<sup>1599</sup> The idea of BRIC was formulated by former Brazilian President Lula da Sile in 2007 between Brazil, Russia, India, and China who are dissatisfied with the global economic system and political order dominated by the United States and Western countries.

<sup>1600</sup> Gazprom in Figures 2006-2010 Factbook, <http://www.gazprom.com/f/posts/55/477129/gazprom-reference-figures-2006-2010-en.pdf>

<sup>1601</sup> Sarah Fenwick: (2011) "Russia Sends Nuclear Subs To Patrol Cyprus Waters", *Cyprus News Report*, 25 August, <http://www.cyprusnewsreport.com/?q=node/4540>

Space will be launched in January 1, 2011.<sup>1602</sup> However, how long this project will continue and find support is a question. All three of the countries are ruled by long term Presidents, adding that Putin declared his candidacy for the Presidential Election of 2012 for the six years term period.<sup>1603</sup> The main challenge of this project is the exchange of leaderships in these countries. In case of replace of regimes with liberal leaders, this project could be overrated in the region. Other than that, the function of such a regional organization under the leadership of Russia, could add additional privileges in the region by also alienating Western powers totally.

After the dissolution of the USSR, the Caspian Sea legal status was left to an ambiguous situation regarding to exploitation of Caspian Sea natural resources and littoral state's territorial and economic rights.<sup>1604</sup> From the beginning Russia always kept its eyes on Caspian Sea issues especially after the BTC in order to prevent other bypassing pipeline projects. In 2011, Caspian littoral states seemed to achieve a great progress to solve the legal status of Caspian and initiated to sign a multilateral agreement (Caspian Convention) in 2012. During the summit of Baku in November 18, the leaders of Azerbaijan, Iran, Kazakhstan, Russia, and Turkmenistan signed an agreement on security cooperation saying that only the littoral states are responsible for Caspian Security. More importantly, Kremlin insisted that all major energy projects could pose an environmental risk for the Caspian Sea. Therefore, all the agreements should be approved by consensus among all the littoral states including a right to veto any subsea pipeline projects.<sup>1605</sup> In the long term the Caspian Convention might be part of Russian project of Eurasian Union in terms of its foreign energy policy and security. As a result of the "Arab Spring" events, the long time leaders of Caspian States and Iran could develop a closer relationship in order to prevent the regime changing and "colorful revolutions". And, Russia could benefit this situation by attracting these countries into Eurasian Union under the leadership of Moscow. In other

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<sup>1602</sup> Vladimir PUTIN: (2011) "The New Integration Project for Eurasia – A Future That is Born Today", *Izvestia*, 3 October, <http://izvestia.ru/news/502761>

<sup>1603</sup> RIA NOVOSTI: (2011) "Vladimir Putin Nominated For President", <http://en.rian.ru/video/20111128/169108911.html>

<sup>1604</sup> Gennady CHUFRIN: (2004) "Russia's Caspian Energy Policy and Its Impact on the US-Russian Relationship", (*The Energy Dimension in Russian Global Strategy*), The James A. Baker III Institute for Public Policy of Rice University, p.4.

<sup>1605</sup> Sergei BLAGOV: (2011) "Moscow Aims For Caspian Settlement in 2011", Jamestown Foundation, *Eurasia Daily Monitor*, Vol.7, Issue 216, 3 December, <http://www.cdi.org/russia/johnson/russia-caspian-settlement-dec-452.cfm>

words, another episode of “Great Game” will be displayed in the region between Russia and the Western powers.

Under these circumstances it is expected that the energy sector will continue influencing Russian foreign policy and socio-economic policy including determine quality of life of Russian population. The Energy Strategy Document up to 2030 states that:<sup>1606</sup>

1. Reduction in the share of gas in the primary energy consumption from 52% in 2005 to 46-47% in 2030.
2. Increase in the share of non-fuel energy consumption from 11% up Turkey 13-14% by 2030.
3. Large scale reduction in the specific energy intensity of the economy and the energy sector (by 2.1-2.3 times) along with significant growth of domestic consumption (by 1.4-1.6 times), export (by 1.1-1.2 times) and production (1.3-1.4 times) of energy.

The decreasing oil and gas fields are another vital conflict that Kremlin has to deal with. In that sense, the continental shelf of Arctic Seas and northern regions of Russia will be the key determinant of oil and gas production and substitute the decreasing fields of Western Siberia for the period of 2015-30. For this purpose, the Russian government adopted a Arctic Strategy in September 2008 which aims the developing the transport and communication infrastructure in the region. The Arctic Strategy also maintains to establish special Arctic military formations in order to protect Russian national interests in the region.<sup>1607</sup> According to Energy Strategy Document up to 2030 the forecast of phase-by-phase oil production development for the period up to 2030; total oil production will be 530-535 m/t per year, North-North West region 42-43 m/t per year, Volga region 34-36 m/t per year (decrease), Urals 25-29 m/t per year (decrease), Caucasus and Caspian Sea region 21-22 m/t per year, Tyumen region 291-292 m/t per year (decrease), Tomsk region 10-11 m/t per year (decrease), Eastern Siberia 75-69 m/t per year, and Far East 32-33 m/t per year.

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<sup>1606</sup> Energy Strategy of Russia for the Period Up To 2030 (2010), p.59.

<sup>1607</sup> Katarcyna ZYSK, “Russia's Arctic Strategy: Ambitions and Constraints”, Geo Politics in the High North, [http://www.geopoliticsnorth.org/index.php?option=com\\_content&view=article&id=84&limitstart=2](http://www.geopoliticsnorth.org/index.php?option=com_content&view=article&id=84&limitstart=2)

Furthermore, formation of new industrial centers of natural gas production on the Yamal Peninsula, continental shelf of Barents, Pechora, and Kara seas will fulfill the demand of natural gas and provide energy security in the long term. A field by field study of 83 giant gas fields shows that the major producing Russian gas fields are in decline, and starting from 2013 new gas fields will be needed in order to avoid a decline in production and fulfill the export pipelines. As an example, in 2006 EU demand for natural gas was 532 bcm/y, will reach to 680 bcm/y in 2030. Moreover, the gap between production and consumption of natural gas will require an 87% increase of import volumes between in 2006-30 in EU. Hence, Russian gas supplies will play the decisive role in satisfying the EU natural gas demand in the long term.<sup>1608</sup>

The prospective regional structure of gas production by 2030, according to the Energy Strategy Document up to 2030;<sup>1609</sup>

- gas production in the European part of Russia is planned to be • increased up to 131–137 billion m<sup>3</sup> (against 46 billion m<sup>3</sup> in 2005) at the expense of development of the Timano-Pechorskaya oil and gas producing area and shelf deposits (first of all, Stockman deposit);
- gas production in the Western Siberia is expected at the level • of 608–637 billion m<sup>3</sup> at the expense of development of the deposits on the Yamal Peninsula and waters of the Gulfs of Ob and Taz intended to compensate decreasing output of “old” deposits (Urengoiszkoye, Medvezhye, Vyngapurovskoye and Yamburgskoye deposits);
- gas production in the Eastern Siberia and Far East will increase • up to 132–152 billion m<sup>3</sup>.

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<sup>1608</sup> SÖDERBERGH, JAKOBSSON, and Kjell ALEKLETT: (2010) p.7827-28.

<sup>1609</sup> Energy Strategy of Russia for the Period Up To 2030 (2010), p.78.

## CONCLUSION

In this study it was aimed to analyze the foreign energy policy of Russian Federation first alluding on Russian foreign policy roots from international relations theories, and Russian foreign policy orientations including significant documents and decision makers, secondly, economy of Russia, thirdly, energy sector of Russia basically oil and gas fields, reserves, pipelines, and determinant energy, fourthly, Russian foreign energy policy towards West, and fifthly, Russian foreign energy policy towards its “Near Abroad” and China. Consequently, at the end of the study, the projections of Russian foreign energy policy towards short, mid, and long term were shaped.

When Soviet Union was dissolved, the concepts of international system was changed in the post-Cold War era and raised new questions about the coming “new world order”. At this point international theorists began to analyze the concept of Russian foreign policy in terms of classical approaches and also new approaches. Therefore, some realist arguments accept that President Putin followed *realpolitik* with recognition of interdependence and international economic integration. Liberalists, on the other hand, raised a question of identity and claimed that Russia is European, not a Eurasian and supported the policy of close relationship with West, particularly the US. The constructivist theory sees Yeltsin first term as an example in terms of priority of cooperation and engagement with the world, rather than preserving or reviving Russia's material power. The basic argument about Russian foreign policy is whether it has imperial or neo-imperial ambitions or not. Some sees the actions of Putin terms as the resettlement of Russia in Central Asia with neo-imperial ambitions. It is understood from this study that Russia once more focused on

imperialist approach particularly for the Near Abroad. Yet, Russian first choice is not militaristic this time, instead political and mainly economical.

While there is an ongoing research on Russian foreign policy perspective from outside of Russia, there is also discussion among two main groups inside Russia, Westernists and Eurasianists. Two groups essentially differs in definition of the national identity. Nevertheless, in this study, it is observed that Russian decision makers followed the third way in terms of aiming to construct a control in Near Abroad, while maintaining good relationship with West, if possible. The aim of being member to WTO is an example for this approach. Furthermore, Russia needs stable relations with its customer states in order to develop its energy export oriented economy. In spite of the fact that Russia is in favor of coherent relations with west, Russian foreign policy document of 2008 rejects further expansion of NATO, concerning on possible memberships of Ukraine and Georgia, and US missile shield in Europe.

Russian foreign energy policy is basically designed by former President, current Prime Minister and coming President of Russia Vladimir Putin since 2000. When he first came to power, his main goal was Russia's survival by increasing Russian status to a modern great power that would be economically strong, technologically advanced, socially developed and politically influential. Putin rightly saw that the future of Russia dependent only restoring its economic strength. For this purpose, young President first reduced Russia's foreign debt by using oil revenues. In addition to that, Putin favored the idea of nationalization energy sector as he wrote in his Theses; subsequently Putin has shifted the centre of energy coordination and decision-making back towards the state, away from the private business sector. Through the beginning of the Putin's second term in Kremlin in 2004, Russian foreign policy began to challenge with the United States in terms of US expansion efforts in the Central Asia as a strategy of "Unipolarity" and hegemony. In other words, Russia began to support the idea of "Multipolarity" against American "Unipolar" strategy by counting China as a great power too. When Dmitri Medvedev came to power in 2008, there were many questions about his character and loyalty to Vladimir Putin. Above all, Georgian war in August 2008 showed that if it is needed, Medvedev would continue the foreign policy approach of Putin. The result of Putin's economic structure was

displayed during the global economic crisis of 2008-09. Although Russian economy is dependent to energy exports, Russia achieved to control the side effects of the crisis and completed the year 2010 as the 12<sup>th</sup> rank in Leading Exporter Countries. In spite of the fact, Russian financial system and economic system need to be improved, it is not the Russia where it used to be in 1990s.

In this study, the dependency of EU countries' categorized as low, moderate, dependent, and high according to their imports of oil and gas from Russia. Russia prefers to develop relations with EU countries bilateral based on national interests instead of taking into consideration the common policies of Brussels. Long-term bilateral energy agreements such as the Baltic pipelines agreement between Russia and Germany, the South Stream pipeline contracts between Italy and Bulgaria and Gazprom, and LNG contracts signed between Spain and France and Algeria demonstrate that member states continue to view energy security primarily as a national policy issue. Therefore Russian foreign energy policy towards EU is sometimes called "Divide and Rule", which Moscow is successful so far. In this strategy Russia mainly cooperates with big states of EU, such as Germany, Italy and France. In addition to that Russia takes the advantage of the big countries competition to each other in energy politics. For instance, while Germany is constructing Nord Stream in the Baltic's, France or Italy announces that they support the project of South Stream in Black Sea. Moreover, Russia faced with resistance when Gazprom attempted to buy Centrica, the largest actor in the UK market. UK blocked the takeover in order to prevent the dependency of Russian supplies. It is not a surprise that due to result of this resistance, BP has experienced many problems with its operations in Russia.

Today, Germany is the crucial partner of Kremlin because of its energy dependence and the huge and diverse investment of Gazprom and German companies in Russia. Russian Gazprom and German Ruhrgas is cooperation on many countries, particularly in the Baltics. In 2011, German Chancellor Merkel announced that Germany will shut down its nuclear power plants in 20 years which means an increase to Russian natural gas in the future. The gas pipeline of Nord Stream will enable Germany to receive gas directly from Russia instead of passing through Poland or Baltic states. The Nord Stream project is a great example for Russian "divide and rule" tactics because during the implementation of

project, Poland, Sweden and three Baltic states criticized the project and accused Germany to establish an alliance with Russia despite the common policies of EU.

According to Russia, the former Warsaw Pact countries are rather at different situation than the other European countries. First of all, in case of Russian national interests, Russia does not hesitate to punish these countries with its energy weapon which means cutting supplies, such as Ukraine, Lithuania, and Belarus. Secondly, if Russia requires a new pipeline project for the purpose of bypassing these countries, Russia again cuts supplies to prove the unreliability of these transporter states and the necessity of the new project, such as Nord Stream and South Stream. And finally, the Georgian example showed that in case of need, Russia might use of force for its national interests. All of these options give Kremlin, the advantages of sometimes being the direct supplier, sometimes the transporter and sometimes the price determinant.

Furthermore, there is an increasing interdependency between EU and Russia due to high degree of EU dependency on Russian energy exports and Russian dependency to income of European route. Though, Russia seems increasing its dominance over Europe thanks to Gazprom's entrance into European energy market whereas Russia does not allow foreign companies to operate in Russian gas market except investments in exploration and production under certain conditions. According to Gazprom's strategy, liberalization of European gas markets as a good opportunity to expand. The main focus areas of the company are; Germany, Italy, the UK and the several Balkan countries. The figures show that EU's energy import dependency will reach 70% by 2030 subsequently to the Russian gas as a result of declining indigenous production and ongoing demand growth. Both EU and Russia are pursuing active energy diversification strategies. Russia is attempting to increase the energy export levels to its established markets, diminish dependency on post Soviet transit states, and is looking to expand into new markets, as well as increasing European dependency to Russian energy exports.

Russian politics towards the United States is based on keeping Washington out of Near Abroad particularly Central Asia, Caucasus and Ukraine. Major American companies withdrew from Russia after the Yukos event as a result of beginning of the nationalization

of energy sector. McDermott pulled out of the Sakhalin II project and sold its stake to Shell. ExxonMobil lost its license to Sakhalin III, while Chevron encountered problems with the Caspian Pipeline Consortium and the Sakhalin V project. On the one hand, Russia opposes the unilateral acts of the United States around the world, on the other, Washington is opposed Russian imperial approach through former Soviet states. For that reason, history of international relations is once again dealing with “Great Game”. The US is the world’s largest energy consumer, and securing access to global supplies of energy resources is a vital national interest. Washington entered into new century with success of BTC pipeline, hoping to continue with the others. Yet, Russia did not allow any other Western based project either in the Caucasus or Central Asia. In order to re-excess this region Washington has to establish a colorful revolution as happened in the Middle East and North Africa in the middle of 2011 namely the “Arab Spring”. It is announced that Prime Minister Putin will be the candidate for the presidency election of March 2012 for the period of six years. Therefore, Washington’s only choice is to influence Russian society to elect another liberal and non-imperialist candidate. Still, it is expected that Vladimir Putin will be the only Russian leader to be elected third time next year. And project of Eurasia Union will be a direct challenge against US initiatives and will increase Russian energy leverage on the region.

Turkey is another significant country for Russian foreign energy policy because Turkey is a both consumer and a transporter country. Until now, Turkey has not got any Russian pipeline for the transportation but Turkish straits are crucial particularly for Russian oil export. On the other hand, Turkey is part of the BTC pipeline project which bypasses Russian pipeline monopoly and encouraged Caspian states to develop projects. Over the last years, Russia and Turkey signed many protocols and improve cooperation on energy fields; gas, oil and nuclear energy. Currently, Turkey needs Samsun-Ceyhan oil pipeline and Russia needs South Stream gas pipeline. Above all, Turkey is highly dependent on Russian energy resources and bilateral trade. It is estimated that Russia and Turkey will simultaneously agree on realization of two projects which will at least suspend Nabucco gas pipeline and Burgas-Alexandroupolis oil pipeline.

As in the examples of Ukraine, Belarus, and Georgia, Russia uses energy weapon according to its national interest. Russian supplies that flow from Ukraine route cut twice in 2006 and 2009 in the middle of winter. The pipeline was not only pumping gas to Ukraine which was also main gas route to Europe. When Russia shut down gas deliveries to Ukraine in 2006 and 2009, there were immediate supply shortages for a number of European countries and remind them how dependent they are on Russian energy. Currently, Russia calls Ukraine to be member of Customs Union on the way of Eurasia Union in order to get natural gas lower. Now, Ukraine is at the parting of ways; to be a member of European Union or Eurasia Union. First of all, in the near future EU looks not ready to absorb Ukraine as a result of its own economic problems. Secondly, if pro-Russian government is elected in Ukraine, the new government would get closer to Moscow and consider being part of Eurasia Union. And Finally, Russia foreign energy policy cannot accept Ukraine's membership of either or NATO, therefore it is expected that Russia will play the energy card in order to obtain Ukraine into Eurasia Union. Belarus has also experienced cutting of supplies from Russia several times both on oil and gas transportation. Belarus leader found himself a pressure between Western critics for not being liberal and Russia for not obeying contracts. Belarus highly dependent on Russia and finally this year signed the contract of Customs Union for aiming to get oil and gas from the prices of Russian domestic levels.

Georgia was the only instance that Russia has intervened military out of its border since the dissolution of USSR. Russia showed to world that it is ready to use of force when there is a threat to its national interest. Although the excuse of Russian intervenes was South Ossetia, the main reason was preventing Georgia to be member of NATO. In that case, Ukraine would have been lost to NATO wing and Black Sea could be surrounded by NATO countries. Thus, it would be impossible for Russian to control Black Sea and implement the project of South Stream and lose all of its control in Caspian. Caspian resources are crucial for Russia foreign energy policy due to reason that Russia fulfills its export capacity with the imports from Central Asia. Another conclusion of the Georgia even was; the BTC pipeline from Azerbaijan to Turkey, the BTE pipeline from Azerbaijan via Georgia to Erzurum, and the CPC pipeline from Kazakhstan, operated only under the permission of Russia.

Over the last years as a result of Turko-Armenian protocol, Russian-Azerbaijan relations developed in terms of gas relations. Russia began to purchase Russian gas and stated that ready to buy all Azeri excess gas supply which would mean the end of Nabucco. Although Azerbaijan announced the project of Trans-Anadolu in November 2011 which will carry the Azeri gas through Turkey to European consumer. Therefore, Azerbaijan and Turkey replaced the Nabucco with the new one which could be rival to Russian South Stream. Azerbaijan is the only Caspian state relatively low dependent to Russian pipeline monopoly, yet Georgian war showed that Russia could stop the delivery of BTC, BTE and Baku-Supsa. For that reason, it would be difficult to realize a pipeline targeting South Europe while Russia is getting ready for the South Stream. Armenia on the other hand is almost totally dependent to Russia and Russian energy resources. Russia even can modify the pipeline diameter in case of Iran-Armenia gas pipeline in order to control the gas volumes in the region.

Among all Central Asian states Kazakhstan and Turkmenistan are the crucial states due to their rich resources and geographic location. Both countries' economy is based on energy export oriented and selling their oil and gas to Russia and China. When China proposed to purchase Central Asian oil and gas, Russia felt threatened because it means a negotiation opportunity for Central Asia states. Yet, formation of the Eurasia Union including Kazakhstan ended the Chinese interference in Kazakhstan energy resources without Russian permission. Turkmenistan on the other hand attempts to follow much more independent policy than the other Central Asian states. Turkmenistan sells most of its gas to Russia and Russia sells Turkmen gas to the third countries. Still, according to Russian foreign energy policy, Turkmenistan should be kept under Russian pipeline control and could not develop any other pipeline projects. If it is impossible to prevent another project, Russia strategy is to take a part in concerning projects, for instance it is well known that Russia want to join the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline.

China is now one of the main targets of Russian foreign energy market in terms of its demand for oil and gas. Russia aims; first to increase Chinese dependency on Russian energy resources, second to develop Eastern part of Russia thanks to new incomes from

China and third, to prevent Central Asia states to fulfill all energy needs of China and keep them highly dependent to Russian pipeline monopoly. There is no doubt that China joined the energy game in Central Asia and formed a balance in the region. For instance Kazakhstan managed to balance between the competing demand of Russia and China by signing multiple deals. In addition to that Turkmenistan forced Moscow to pay European prices for its gas in 2008 by using the possibility of a deal with outside powers. Above all, Chinese energy demand is increasing every year, and has a great potential for the development of Far East regions of Russia and an alternative to Europe.

In conclusion, Russia foreign energy policy is mainly based on its national interests. From West to East, Russia follow an energy oriented foreign policy and diplomacy. The concept of diplomacy and actions diverges according to the power of countries. Hitherto, Russia did not hesitate to cut off supplies to many post-communist states and even used force in the Georgian case. Furthermore, Russia did not have direct pipelines to great European countries until the launch of Nord Stream gas pipeline except the Blue Stream gas pipeline to Turkey. Russia and Germany had developed a close relationship over the last decade. However, all the evidences shows that Russia can use energy weapon against the European powers, if feels itself threaded such as NATO missile shield. Finally, as long as Russian economy is based on incomes of energy resources export, we will observe an active Russian foreign energy policy all over the world.

## APPENDIX

### Appendix 1: Macroeconomic Indicators

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP, %-change	5.1	4.7	7.3	7.2	6.4	8.2	8.5	5.2	-7.9	4.0
GDP, RUR billion	8944	10819	13208	17027	21610	26917	33248	41429	39101	44491
Industrial production, %-change	2.9	3.1	8.9	8.0	5.1	6.3	6.8	0.6	-9.3	8.2
Fixed investments, %-change	10.0	2.8	12.5	13.7	10.9	16.7	21.1	9.1	-17.0	5.1
Exports, \$ billion	101.9	107.3	135.9	183.2	243.6	304.5	355.2	471.8	304.0	357.7
Imports, \$ billion	53.8	61.0	76.1	97.4	125.3	163.9	223.1	292.0	191.9	221.5
Current account, \$ billion	33.9	29.1	35.4	59.5	84.6	94.7	77.8	103.7	49.0	72.6 <sup>e</sup>
Unemployment, % (end of period)	8.6	9.0	8.6	8.3	7.6	6.9	6.1	7.8	8.2	6.7

Population, mln persons, Jan.1st	146. 3	145. 6	145. 0	144. 2	143. 5	142. 8	142. 1	142. 0	141. 9	141.
GDP, %- change	5.1	4.7	7.3	7.2	6.4	8.2	8.5	5.2	-7.9	4.0
GDP, RUR billion	894 4	1081 9	1320 8	1702 7	2161 0	2691 7	3324 8	4142 9	3910 1	4449 1

Source: BOFIT Russia Statistics Available on site

[http://www.suomenpankki.fi/bofit\\_en/seuranta/venajatilastot/Pages/default.aspx](http://www.suomenpankki.fi/bofit_en/seuranta/venajatilastot/Pages/default.aspx) (Accessed on 06 February 2011)

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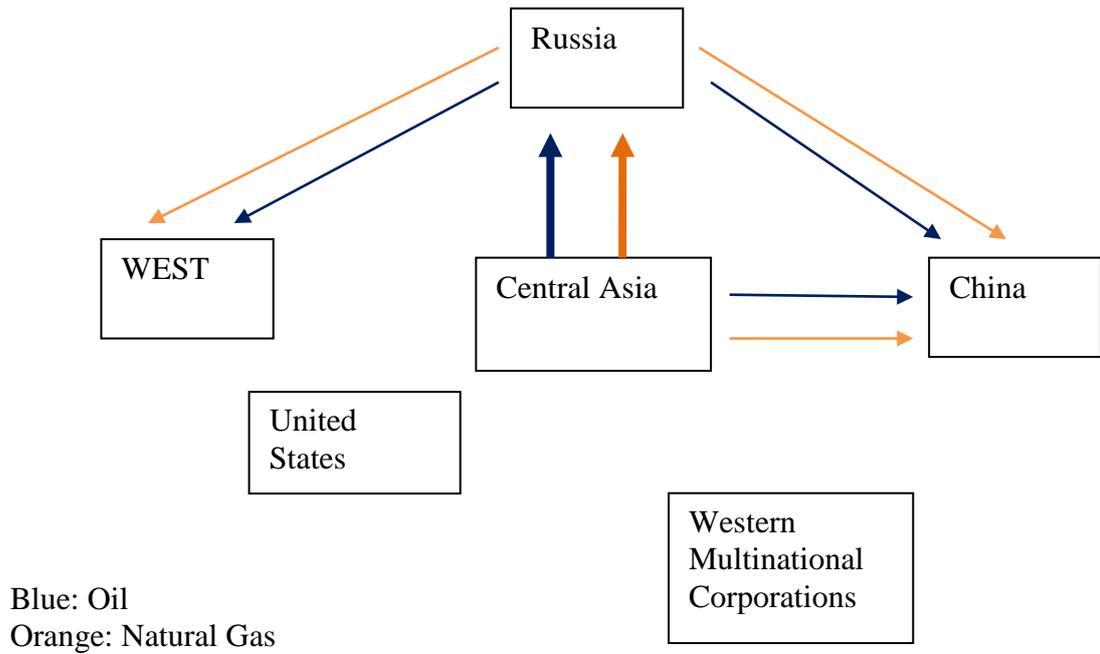
## Appendix 2: Production and Export of Oil and Gas in Russia

	Units	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>Oil, including gas condensate</b>											
Production	million tons	306.8	301.2	305.6	303.3	305.2	323.5	348.1	379.6	421.3	459.1
Export	million tons	127.4	126.0	127.3	137.2	134.5	144.4	162.1	188.4	223.4	257.4
Ratio of export to production	per cent	41.5	41.8	41.6	45.2	44.1	44.6	46.6	49.6	53.0	56.1
Export	bill. dollars	13.3	15.9	14.8	10.3	25.3	25.3	24.6	28.9	38.8	59.3
Share in total export	per cent	16.1	17.7	17.0	13.8	24.1	24.1	24.1	26.9	28.6	32.4
<b>Natural gas</b>											
Production	bcm	570	575	544	564	564	555	551	563	581	591
Export	bcm	194.3	198.5	200.9	203.4	205.4	193.9	180.9	185.6	189.4	200.4
Ratio of export to production	per cent	34.1	34.5	36.9	36.1	36.4	34.9	32.8	33.0	32.6	33.9
Export	bil. dollars	12.1	14.7	16.4	13.5	11.3	16.6	17.8	15.9	20.0	21.9
Share in total export	per cent	14.7	16.4	18.9	18.1	14.9	15.8	17.5	14.8	14.7	12.0
<b>Petroleum products</b>											
Production	million tons	182	176	177	164	169	173	179	185	190	195
Export	million tons	47.1	57.0	61.3	53.9	50.8	62.6	63.5	75.4	77.7	82.1
Ratio of export to production	per cent	25.9	32.4	34.6	32.9	30.1	36.2	35.5	40.8	40.9	42.1
Export	bil.dollars	5.0	7.5	7.3	4.3	4.7	10.9	9.4	11.2	14.0	19.3
Share in total export	per cent	6.0	8.4	8.3	5.7	6.2	10.4	9.2	10.4	10.3	10.5
<b>Oil, natural gas, petroleum products</b>											

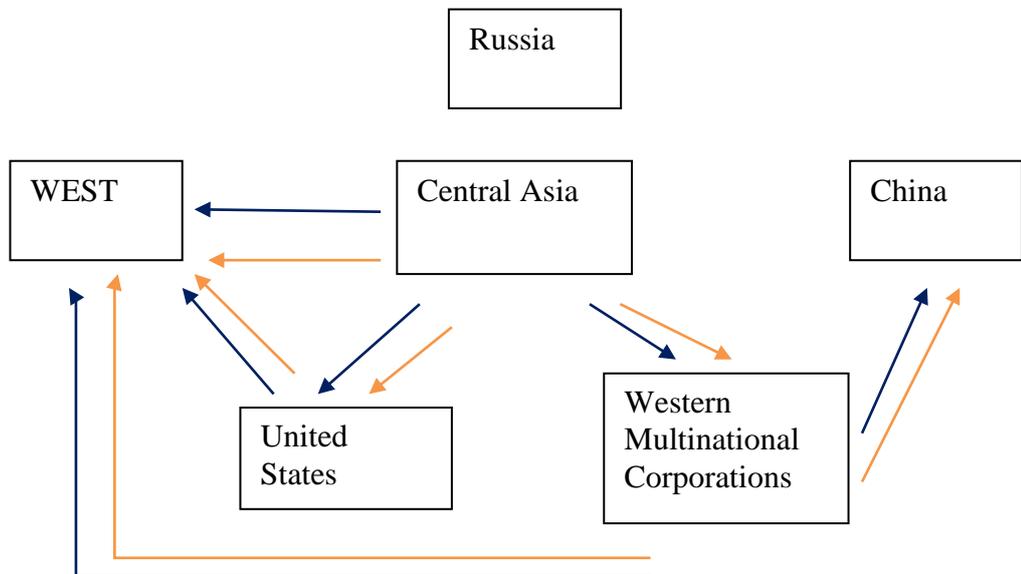
Export	bil. dollars	30.4	38.1	38.5	28.1	30.1	52.8	51.8	56.0	72.8	100.5
Share in total export	per cent	36.9	42.5	44.3	37.7	39.8	50.2	50.8	52.2	53.6	54.9
<b>Total foreign trade of Russia</b>											
Exports of goods	bil. dollars	82.4	89.7	86.9	74.4	75.6	105.0	101.9	107.3	135.9	183.2
Imports of goods	bil. dollars	62.6	68.1	72.0	58.0	39.5	44.9	53.8	61.0	76.1	97.4
Balance of trade in goods	bil. dollars	19.8	21.6	14.9	16.4	36.0	60.2	48.1	46.3	59.9	85.8

Source: Tabata, Schinichiro (2006b) "Price Differences, Taxes and Stabilization Fund", in Michael Elman (ed.) "*Russia's Oil and Natural Gas – Bonanza or Curse?*", Anthem, p.36

### Appendix 3: Current Grand Game Situation



### Appendix 4: Strategy of the West and US for the New Grand Game



### Appendix 5: Oil Production Development up to 2030

	<b>2005</b>	<b>2008</b>	<b>Phase 1</b>	<b>Phase 2</b>	<b>Phase 3</b>
<b>Total oil production (m/t)</b>	470.2	487.6	486-495	505-525	530-535
<b>Same (in % as compared to 2005)</b>	100	103.7	103-105	107-112	113-114
<b>Including (m/t)</b>					
<b>North, North-West</b>	24.5	29.1	32-35	35-36	42-43
<b>Volga Region</b>	52.7	54.1	49-50	44-45	34-36
<b>Urals</b>	49.2	52.6	45-47	36-41	25-29
<b>Caucasus, Caspian Sea Region</b>	4.9	4.8	7-11	19-20	21-22
<b>Tyumen Region</b>	320.2	319	282-297	275-300	291-292
<b>Tomsk Region</b>	14.1	13.7	12-13	11-12	10-11
<b>Eastern Siberia</b>	0.2	0.5	41-52	41-52	75-69
<b>Far East</b>	4.4	13.8	30-31	30-31	32-33

### Appendix 6: Natural Gas Production Development up to 2030

	<b>2005</b>	<b>2008</b>	<b>Phase 1</b>	<b>Phase 2</b>	<b>Phase 3</b>
<b>Gas production – total bcm</b>	641	664	685-745	803-837	885-940
<b>Including:</b>					
<b>Tyumen Region</b>	585	600	580-592	584-586	608-637
<b>Including the following regions:</b>					
<b>Naduyam - Purtaovsky</b>	582	592	531-559	462-468	317-323
<b>Ob-Taz bay</b>	-	-	0-7	20-21	67-68

## Appendix 7: Investment Need of Russia up to 2030

	<b>Phase 1</b>	<b>Phase 2</b>	<b>Phase 3</b>	<b>2009-2030 total</b>
<b>Fuel and energy complex - total</b>	449-456	391-523	979-1.196	1.819-2.177
<b>Including:</b>				
<b>Oil industry</b>	162-165	134-139	313-321	609-625
<b>Gas industry</b>	150-155	131-136	284-299	565-590
<b>Coal industry</b>	12-13	14-16	42-47	68-76
<b>Electric energy industry</b>	122-126	110-233	340-529	572-888
<b>Energy supply spheres - total</b>	85-98	125-142	329-356	547-588

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After the dissolution of the USSR and the Cold War at the beginning of 1990s, the international system has evolved to another system in the Post-Cold War era, namely “Unipolar hegemony of the United States ”. New state Russian Federation had revealed from the long-time socialist state as a liberal and democratic state in 1991. Afterwards, new question arose in international arena in order to analyze the future of Russian Federation and power capacity. Since the independence of Russian Federation , twenty years past and during this process Moscow has challenged with many conflicts as well as successes many priorities. When the transformation period of Russian Federation from closed economy to liberal economy commenced, it was understood that the main indicator of Russian economy will be the energy resources and their production. For that reason, inevitably “the concept of energy” revealed as a both weapon and a vulnerability of Russia . In this context, Russia formed a new kind of diplomacy that is called “Foreign Energy policy”; “The Strategic objective of the foreign energy policy is the maximum efficient use of the Russian energy potential for full-scale integration into the world energy market, enhancement of positions thereon and gaining the highest possible profit for the national economy.” After picturing the Russian oil and gas reserves, pipelines, main companies and strategy documents, in order to research the Russian foreign energy policy actions, the two directions East and West of Russian energy connections have been analyzed concerning the period of last decade. Furthermore, it was observed that Russia may use energy weapon anytime it feels a threat against its national interest or regional strategy. Yet, Russia did not directly cut any supplies to Germany and Turkey is a way to establish it demand. Moreover, there are many instances that Russia uses energy card as a weapon against former Warsaw Pact and USSR states. Finally, according to the Russian analytical documents, Russian economy will maintain to depend on energy export commodities in the long term. Consequently, it is expected that Russia will continue to employ its energy privilege in case of requirement regarding to its foreign energy policy.

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