

# RUSSIA AND ITS ENERGY MONOPOLIES

By Laila Mahdiyeva

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**I**n 1990s, due to the lack of economic independence, Russia was not able to play an active role in international affairs. The country was highly dependent on donations from the United States and Europe.<sup>1</sup> Oil production had dropped by 50% after the collapse of communism. As much as Russia was willing to repair the damages of the past, it lacked a strategic vision for future.

With Putin's rise to power, Russia saw a dramatically different approach to its relations with the West. Putin, an ambitious man, strived to give Russia its one-time hegemonic position. Referring to Russia, "A voice to be heard and a presence to be reckoned with" are kind of statements reflecting Putin's foreign policy rhetoric.<sup>2</sup>

In his interview published on February 27, 2012, in *RIA Novosti*, Vladimir Putin stated:

*"Our foreign policy objectives are*

*strategic in nature and are not based on opportunistic considerations. They reflect Russia's unique role on the world political map as well as its role in history and in the development of civilization."*

The new Foreign Policy Concept, approved by Medvedev in 2008, outlines the main points of Russian foreign policy priorities. In regards to the international economic and environmental cooperation, the Russian Federation:

- ◆ *"seeks maximum benefit and minimizes risks in the process of further integration of Russia in the world economy taking into account the need to ensure economic, energy and food security of the country;*
- ◆ *created favorable political conditions for diversifying Russia's presence in the world markets through expanding the export range and geography of foreign economic and investment links of Russia;*



- ◆ *takes trade policy measures to protect interests of the Russian Federation in accordance with international rules and counteracts trade and political measures of foreign States encroaching upon the rights of the Russian Federation and Russian enterprises;*
- ◆ *provides state support to Russian enterprises and companies in getting access to new markets and in developing traditional markets, counteracts discrimination of national investors and exporters, especially in the markets of high-tech products and goods of high level of procession;*
- ◆ *assists in drawing foreign investments in science-intensive and other priority areas of the Russian economy;*
- ◆ *continues to build up and modernize the capacity of the fuel and energy industry to support its reputation of a responsible partner in the energy markets, while ensuring sustainable development of its economy and*
- ◆ *contributing to the maintenance of balanced world energy markets;*
- ◆ *strengthens strategic partnership with the leading producers of energy resources, develops active dialogue with consuming countries and transit countries on the basis of the principles of energy security enshrined in the final documents of the Saint Petersburg G8 Summit in 2006, assuming that measures being taken to guarantee reliability of energy supplies should be consistently supported by forthcoming activities aimed at ensuring stability of demand and secure transit;*
- ◆ *actively employs possibilities of regional economic and financial organizations to protect interests of the Russian Federation in the corresponding regions, paying special attention to the activities of organizations and institutions that contribute to strengthening of integration processes in the CIS space;*

◆ *in accordance with the norms of international law, uses all available economic leverage, resources and competitive advantages to protect its national interests.*<sup>3</sup>

The same concept recognizes the primacy of national interests as the basis for all foreign policy decisions and states that Russia seeks to cooperate on an equal ground, as an equal partner, in accordance with the international law.

Russian foreign policy has been substantially economized. Russian



Russian Finance Minister Alexei Kudrin at the G-8 Summit in 2006



economy became increasingly integrated into the world market. The backbone of this integration has been oil and gas exports that augmented budget revenues and helped country regain status of hegemony.

*“Russian foreign policy has been consistent in pursuing its main realist interests: maximization of power and security as well as maximization of utilities- military and economic capabilities- vis-à-vis the West, but also with the help of the West. Russia is also aiming at maximizing prestige and at receiving Western recognition as a great power.”<sup>4</sup>*

As Russia was going through a period of self-definition after the end of the Cold War, leading political analysts and politicians were struggling to give clearer contours to foreign policy analysis. The debate inspired by ideologies of the elite groups is one among the supporters of nationalism, Eurasianism, centrism and Atlanticism. Western analysts assess Putin’s foreign policy track as one balanced between Eurasianism and Atlanticism, which is centrism, while they view Medvedev as a clear Atlanticist.

According to Jeffrey Mankoff, adjunct fellow with the CSIS Russia and Eurasia Program,

*“Under Medvedev, Moscow has elaborated a new framework governing relations with the West, one that continues to respect Russia’s self-proclaimed position as one pole in a multipolar world order but at the same time pursues a high degree of economic integration with Western states and institutions. The*

*watchword for Medvedev’s approach is modernization, which in the Russian context means overcoming the country’s dependence on energy as the foundation of Russia’s economy and international influence.”<sup>5</sup>*

Although Russian government has in the past held fields of strategic importance, such as energy sector, under tight government control, the event that marked the official linkage of Kremlin’s foreign policy and energy was the 2005 purchase by the government of Gazprom’s control shares.<sup>6</sup> Gazprom is the leading company in Russia and the largest natural gas extractor in the world. It is responsible for exploration, production, transmission, storage,

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processing and marketing of gas for local and international consumers. The Russian government own 50.02% of the company. It is controlled by Kremlin appointees, which is why the line between the company and the Russian state is often blurry. A good example is the one of Dmitri Medvedev himself, who prior to being elected as President served as Gazprom’s chairman of the board. Exerting close control over company’s activities ensures that the latter’s commercial interests will also benefit the state’s foreign policy.

Gazprom is currently chaired by Alexei Miller, who served at the Saint Petersburg Mayor’s Office, Committee for External Relations in early ‘90s, headed by Vladimir Putin during the



same period of time. The company is growing fast, expanding both to the East and to the West simultaneously. About half of Gazprom's revenues come from sales to the EU, which the former sees as an issue. For this reason, the Shtokman field that is currently being developed might supply Asian consumers, namely China and Japan, with Russian gas.<sup>7</sup> Sakhalin-Khabarovsk-Vladivostok natural gas pipeline, presently supplying local consumers, might also become part of an international export route transporting Russian gas to China, South Korea and Japan.<sup>8</sup>

Over the years, Russian government has made sure the state has the ability to control energy companies, who would have to work in the interests of the government. The term currently applied to those companies is that of 'natural monopoly entities'. The 1995 law of the

Russian Federation No. 147-Fz, defines natural monopolies in the following way:

*“natural monopoly shall mean the state of the commodity market in which demand is more effectively satisfied when due to technological peculiarities of production there is no competition (due to substantial reduction of the production cost per unit of commodity as a result of increasing output), and in which commodities manufactured by natural monopoly entities cannot be substituted with other commodities in the market, thus causing the demand in the given commodity market to be less responsive to changes in price compared to the demand for other types of commodities.”*

The state has purchased controlling shares in many of them. Lukoil, Russia's largest oil company and the second largest private company in the world in terms of reserves, would be an exception, since it is privately owned and presided by Vagit Alekperov, an Azerbaijani businessman, who served as deputy minister of Oil and Gas Industry in the early '90s.<sup>9</sup>

The case most reflective of how much influence Russian state exerts in the energy sphere is YUKOS affair. YUKOS was the major Russian oil company, controlled by Mikhail Khodorkovsky, who was convicted of fraud and sent to prison in 2003. It consisted of several enterprises, the largest of which, Yuganskneftegas, was



# YUKOS



transferred to the state-controlled Rosneft, after YUKOS went bankrupt.

In a report published on November 7, 2003, in the Heritage Foundation, Ariel Cohen, Senior Research Fellow for Russian and Eurasian Studies and International Energy Policy at The Kathryn and Shelby Cullom Davis Institute for International Studies, stated:

*“YUKOS has become Russia’s most successful oil company. Just a month ago, it merged with Sibneft to form the world’s fourth largest oil company. It introduced western accounting standards and management, pioneered shipping Russian oil to the US market, and launched a private consortium to build a pipeline from western Siberia to the arctic port of Murmansk. It has also bought hundreds of millions of dollars worth of US oil equipment. Over the years, YUKOS paid billions of dollars in taxes and gave hundreds of millions to charity. It was also the company most independent from the government.”*

Rosneft, Russian largest oil producer, focuses on the exploration, production and marketing of oil and oil products. It belongs to the state by 75.16%<sup>10</sup> and comprises twelve enterprises, which produce oil in Western Siberia, Eastern Siberia, Timan-Pechora, Central Russia, the southern part of European Russia and in the Russian Far East. In 2010, Rosneft produced 847.41 th. Barrels of oil.<sup>11</sup> Rosneft has recently gained access to the North American energy resources by signing a deal with Exxon Mobil creating a joint venture. This important step forward won Rosneft an opportunity to develop seven projects in North

America, of which the former chose three to start with- in West Texas, the U.S. Gulf of Mexico and in Canada’s province of Alberta.<sup>12</sup>

Gazprom Neft is another major oil company in Russia. It is involved both in upstream and downstream activities. The Gazprom Neft Group consists of seventy oil producing, refining and marketing companies in Russia, CIS and non-CIS countries. It was created as a result of the purchase by Gazprom of Sibneft in 2005. In 2006, the company was renamed Joint Stock Company Gazprom Neft. In 2011, the latter’s income accounted for \$5.347 billion, which is a 70.6% increase compared to the previous year. Mounting oil prices, increase in extraction and processing value, reportedly explain this growth in financials.<sup>13</sup>

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Transneft, a company responsible for national oil pipelines, is also owned by the state. The company’s website lists two recently realized, six current and three future projects. Its total network length accounts for 50,000 km, making it the owner of the largest pipeline system in the world. Transneft comprises twenty two enterprises.<sup>14</sup> In 2007, Russian parliament gave Gazprom and Transneft the right to establish armed units to patrol the pipelines. The companies reportedly needed military protection against possible attacks.<sup>15</sup>

Today, Russia’s energy empire is actively expanding into foreign markets, by acquiring assets in the leading energy





# ROSNEFT

firms of Europe. For instance, in 2011 Gazprom took possession of 50% stake in Belarus' national gas pipeline operator, Beltransgaz.<sup>16</sup> Another example is Czech RSP Energy, electricity and natural gas company, in which Gazprom acquired 51% last year.<sup>17</sup> The latter could reportedly become co-owner of a transportation company soon to be set up in Lithuania. According to Turkish media, Gazprom is also interested in entering Turkish electricity market. The company's buyout of German energy provider Envacom comes during the same period.<sup>18</sup> Gazprom Neft has recently announced it might buy a stake in Hellenic Petroleum, which is looking for buyers of its 35.5% stake.<sup>19</sup>

At this rate, Russia is unlikely to easily leave the European market and focus on other regions instead. As much as the state is willing to rid itself of the excessive dependence on Europe, the continent will remain crucial for Russian foreign energy policy in the mid to long-term. Some analysts argue that low gas

prices in the United States might have an impact on Russia's relations with its European partners: Russia's commercial partners might demand a decrease in prices on commodities. However, according to Vitaliy Mihalchuk from "Investcafe" agency, there's no such immediate risk.<sup>20</sup>

#### Notes:

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