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Russia's energy strategy: Between keeping the grip on the European Union and diversifying into Asia

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President Dmitry Medvedev's visit to Azerbaijan on September 3rd, 2010 showed that Russia is pursuing a strategy that will enable it to remain an energy superpower for the time being. In Baku, Russia's state energy monopoly Gazprom signed an agreement with Azerbaijan's state energy company Socar to buy at least 2 billion cubic meters (bcm) of gas at market prices, starting in 2011 – twice as much as it was imported in 2010 – with the potential to increase in 2012.

Maintaining the grip on the European Union

This move follows a similar long-term deal struck with Turkmenistan in 2003. Until the economic downturn at the end of 2008, Gazprom was buying the bulk of the Turkmen annual production, 50 bcm out of 75 bcm. But a pricing dispute between Moscow and Ashgabat halted deliveries for almost all of 2009. In December of that year, Russia and Turkmenistan clinched another long-term agreement under which Gazprom would buy a much lower volume of 30 bcm a year, at market prices.

The logic of the Turkmen and Azeri deals is to prevent these gas volumes from flowing directly to the European market. In fact, there is no economic benefit for Russia, as Gazprom and the federal budget lose US\$360 million in profit and custom duties per year when re-exporting to Europe.

Moscow is clearly expecting a political gain because this deal will help it to maintain a solid grip on the European market as Brussels struggles to diversify away from the Russian gas.

Since 2004, the European Union has been pushing to build its own gas pipeline – Nabucco – to bring up to 31 bcm from the Caspian region through Turkey, Bulgaria, Romania and Hungary to the Austrian gas hub of Baumgarten.

But until now, Nabucco shareholders have been unable to clinch the necessary supply deals in order to give use to the pipeline. The Kremlin's decision to double Azeri importations could add to the woes of the poorly conceived Nabucco and increase European Union reliance on Russian gas.

Furthermore, Russia is building a competing project – South Stream – which runs under Black sea to Bulgaria and then splits into two legs, one going north to Austria and another going south to Italy.¹

Contrary to Nabucco, South Stream has enough resources to become fully operational, as Prime Minister Vladimir Putin pointed out two years ago.

In the meantime, Russia, the largest oil producer and second-largest exporter (after Saudi Arabia), has been trying to diversify its energy exportations and reduce its dependence on the European Union by opening an Asian route to the Chinese, Korean and Japanese energy hungry markets.

Going East

In February 2009, state controlled firms Rosneft and Transneft secured a US\$25 billion loan from Beijing in exchange for a

¹ Philippe Conde, "South Stream contre Nabucco" (*Regard Sur l'Est*, 1 September 2009).



twenty-year oil supply deal – 15 million tons annually from 2011 to 2030 – to China. Also, during that month Russia launched its first liquefied natural gas (LNG) plant from Sakhalin-2. These projects are part of the Russian effort to take a foothold in the profitable Asian markets. Moscow plans to up its share in this region from a current 4% to around 20% or 30% by 2030. China is supposed to be the main market for Russian oil in the future as exploration starts in Eastern Siberian fields.

On August 29th 2010, a new step brought Russian oil closer to the Chinese industries and consumers. Prime Minister Vladimir Putin opened the Russian section of the Russia-China oil pipeline in the Far East Amur region.² The Russian Premier stressed that this project was vital for Moscow because it would help to diversify away from Europe, as today Russia exports 75% of its oil and 80% of its gas to the European Union. Once into operation, the new pipeline will deliver up to 30 million tons of oil (50 million in case of expansion) to China and the Asia-Pacific region.

This tube is fully integrated in the largest East Siberia-Pacific Ocean pipeline (ESPO), which was launched in December 2009, and stretches from Taishet in the Eastern Siberian region of Irkutsk to Kozmino bay in the Primorye Territory (Pacific Ocean). When fully operational by 2014, the entire pipeline system could carry 80 million tons of oil to the Asia-Pacific markets.

Furthermore, if as agreed on September 22nd 2010 – and an important topic during Medvedev's visit to China – Russia is able to enter the Chinese gas market by 2015, it will get the ultimate weapon that any energy exporter could dream of: great leverage over two big markets.³

Then, almost nothing would prevent Russia from setting energy volumes and prices, depending on its political will, in Europe and in Asia.

So one can argue that diversification will turn into a nightmare for Brussels as soon as Moscow gets the chance to play Europe against Asia. In addition, Moscow will continue to strictly control gas flows from Central Asia and Azerbaijan.

Consequently, Europe will be pushed into a corner and left no room to maneuver.

In the East, the ESPO blend crude could replace, in the medium term, the Platt Dubai blend as the new benchmark for the entire Asia-Pacific region. ESPO blend has two main advantages. Its quality is better than Platt Dubai's and, above all, its delivery time is just off two weeks, compared to the two or three months necessary for oil coming from the Persian Gulf countries. Thus Russia has every chance to become a major provider of energy for Asia and the Pacific Rim through its pipelines or its LNG tankers in the coming years.

Finally, like a spider, Russia is patiently making its web, which already covers the Eurasian continent. And in the next five years, when LNG deliveries to North America start gaining momentum,⁴ it will cover the three leading world markets. This diversification strategy will pave the way to turning Russia into a genuine global energy superpower and increasing its political clout, notably in China, and further on the world stage.

2 "Putin participates in opening ceremony of Russia-China oil pipeline's Russian section" (*RIA Novosti*, 29 August 2010). The Chinese section from Daqing in the northern Heilongjiang province should be completed by year-end so oil could start flowing in January 2011.

3 In 2006, Gazprom and China national petroleum corporation (CNPC) signed a memorandum of understanding in order to develop gas deliveries but failed to agree on a price formula until 2009. Finally, on September 22nd 2010, the Russian gas monopoly consented to deliver 30 billion cubic meters to China per year, starting in 2015. See "Gazprom, China's CNPC agree key terms for gas supply to China" (*RIA Novosti*, 22 September 2010).

4 "Gazprom set to strengthen positions in North America" (*RIA Novosti*, 30 September 2009).

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