Russia as an energy superpower

Peter Rutland

New Political Economy, 13: 2, June 2008, 203-10.

It has become commonplace to refer to Russia as an 'energy superpower'.[1] Russia is the world's leading natural gas producer, and ties with Saudi Arabia for first place in oil production. Russia accounted for 48 per cent of the increase in world oil supply 1998-2004.[2] Russia accounts for 22 per cent of global output of natural gas and holds 27 per cent of proven reserves.[3] It supplies 25 per cent of the gas used by the European Union and accounts for 40 per cent of the gas that the EU imports. In 2007 Russia has been pumping 9.8 million barrels of oil a day, about 12 per cent of the global supply. Russia accounts for about 20 per cent of European oil consumption. For the time being, Russia also controls the export of oil and gas from Kazakhstan and Turkmenistan, since the export pipelines from those countries cross Russian territory.

Clearly, oil and gas are key to Russia's return to prominence on the international stage. It is widely assumed, both in the Kremlin and abroad, that this energy wealth will enable Russia to regain some of the 'superpower' status that it enjoyed in its Soviet incarnation prior to 1991. At the same time, on the domestic front the influx of petrodollars has facilitated the consolidation of a new authoritarian regime under President Vladimir Putin.[4]

European leaders are sensitive to supply disruptions emanating from Russia. Price disputes with Ukraine and Belarus caused temporary shutdowns of gas and oil supplies in January 2006 and 2007. Although these interruptions were brief and actual deliveries to end users were not affected, these incidents drove home to European consumers their vulnerability to a single supplier. European anxiety is exacerbated by the knowledge that Russia's vast reserves mean the situation is unlikely to change in the foreseeable future. Although Russia currently only reports 5 per cent of the world's proven oil reserves, unexplored fields in Russia's vast territory may well double that proportion. Central Asia holds another 3-4 per cent of proven oil reserves, with the Kashagan field, discovered in Kazakhstan's section of the Caspian Sea in 2000, being the largest find since North Sea oil in the 1960s. Russia is building new pipelines to increase the flow of oil and gas deliveries to Europe, and new gas pipelines across the Baltic and Black Seas to avoid being held hostage to transit disruptions by Belarus and Ukraine.[5]

European leaders face a dilemma – should they embrace their dependence and deepen their economic and political partnership with Moscow; or should they look for alternative sources of supply? Some fear that Russia is too politically unstable to be a reliable partner. Others fear that Russia is too strong – that it will use its petrodollars to rebuild its military and win political concessions from neighboring countries.[6] Europeans are also wary of expansion by Russia's energy and metals conglomerates, many of them state-owned. They have been aggressively pursuing acquisitions of production facilities and distribution networks across Europe.[7]

Russia's energy diplomacy is also making its presence felt in Asia. China is now the world's second largest oil importer, and growing pollution problems make Russia's natural gas an attractive substitute for domestic coal. Russia currently exports only 3 per cent of its oil to Asia (by rail), but newly-opened fields in Sakhalin and East Siberia mean that it could increase the proportion of Russian oil sent to Asia to 30 per cent of total output by 2020. However, that will require large investments in developing those fields and building long, expensive pipelines to Asian markets. After several years of intense bargaining, ground was broken in 2006 on an East Siberia-Pacific oil export pipeline. The plan is to build branches both to Daqing, China and to the port of Nakhodka for export to Japan and South Korea. In this way Russia will avoid dependency on a single customer (i.e. China) – a response, perhaps, to its problems with pipelines across Ukraine and Belarus.

It is, however, worth keeping a sense of historical perspective. European dependence on Russian oil and gas is nothing new. The oil and gas fields that still account for the bulk of Russian production were discovered back in the 1960s. The Friendship oil pipeline line was built in 1964, and following West Germany's agreement to buy Soviet gas in 1970 the Soyuz, Urengoi and Yamal pipelines were built. The United States objected to German purchases of Soviet gas and tried to block the construction of the export pipelines, generating considerable controversy within NATO in the early 1980s.

What, then, has changed in recent years? Concern over climate change and worries that global oil production may be peaking are certainly contributing to the heightened anxiety. But the main change seems to be political rather than economic. In the 1990s, Western leaders embraced the idea that Russia was on the path to 'market democracy,' so the concerns about political linkage that had dogged the Soviet gas projects of the 1980s had receded. President Boris Yeltsin seemed committed to recognizing the independence of the post-Soviet states.

The crucial turning point in Russia's relationship with the West was Moscow's angry reaction to NATO's war in Kosovo in 1999. That, together with the replacement of Yeltsin by 17-year KGB veteran Vladimir Putin later that year, raised concerns that the Kremlin might start trying to rebuild a sphere of influence in what the Russians called the 'near abroad.' These fears were fanned by a growing sense that Russian democracy was in retreat, epitomised by the 2003 arrest of Mikhail Khodorkovsky; the sweeping victory of the pro-Kremlin United Russia in the 2003

Duma elections; and the abolition of elections for regional governors a year later. Putin's reluctance to withdraw troops from Georgia and Moldova; his crude interventions in the Ukrainian presidential election of 2004; and increases in Russian defense spending[8] were fodder for those who argued that Russian imperialism was on the march. These developments all served to exacerbate European anxieties about European dependency on Russian energy.

Converting oil to influence

There are however some question marks hanging over this picture of Russia's inexorable rise as an energy superpower.

First, there are serious questions about the economics behind Russia's energy-led strategy for national revival. Although Russia's reserves are indeed vast, so are the geological challenges that must be overcome. Most of the newly-discovered fields lie far deeper than earlier finds; they are located in permafrost zones; and many of them are offshore (notable the Sakhalin deposits and the Shtokman gas field in the Barents Sea). These factors substantially increase the extraction costs, and increase the uncertainty over total outlays, which make concluding contracts with foreign partners more difficult. This, together with the cost of ever-longer export pipelines, means that the long-term price of oil will have to stay above $30-35 a barrel for these projects to be commercially viable. (In contrast the cost of Gulf oil is less than $5 a barrel.) Although oil currently (as of the end of 2007) is sitting above $100 a barrel; the average oil price over 1997-2007 was $35 a barrel, and during the first half of 2007 the spot price of oil on global markets briefly dipped to the $35 range a couple of times. A global recession, or serious action to curtail oil demand in the US, could play havoc with Russia's short and long-term energy finances.

Second, there are the problems with corporate governance in Russian energy. The effective re-nationalisation of the oil sector over the past five years means that the future of Russian development is now in the hands of state-owned oil and gas corporations, controlled by the Kremlin officials who sit on their boards of directors. The political masters of these state corporations may focus their efforts on rewarding insider cronies and maintaining populist price subsidies. They are less likely to make a priority of efficiency and rational investment planning. Gazprom is a case in point. It has been a state-owned corporation since its creation in 1992, and its export revenues have been used to subsidise domestic customers, leaving little incentive or opportunity for the company to invest in developing new fields.[9] As a result gas output has been flat for the past decade. Gazprom provides half of the energy for the electricity monopoly RAO EES, so reform of these two sectors is closely intertwined. Privatisation and restructuring of RAO EES is urgently needed to promote new and more efficient investment in power generation. Despite the fact that Putin made reform of RAO EES a priority when he took office in 2000, the restructuring is still nowhere near complete. It remains to be seen whether the enormity of Russia's resource wealth will be matched by the huge capacity of its state bureaucracy for waste, corruption and mismanagement.

Third, there are profound political risks associated with an energy-led development strategy. The dangers of the 'resource curse' are well documented.[10] Global experience indicates that countries with a heavy reliance on energy exports (that is, when energy accounts for more than one third of export earnings[11]), are more likely to experience slower economic growth, and less likely to undergo a transition to democracy. Elites are seduced into corruption by the easy money flowing from oil and gas exports, and have no incentive to create clean electoral democracies.[12]

Authoritarian regimes are more prone to political crises than democratic regimes. Factional struggles fighting for a share of the resource rents can disrupt development projects and scare away foreign investors. Western investors were alarmed by the battle to expropriate Yukos and hand it over to Rosneft, and by the forced sale of oil company Sibneft to Gazprom. The exclusions of TNK/BP from the Kovykta gas field and of Shell from the Sakhalin II energy project in 2007 were clear signals of the change in policy. A new subsoil resources law will bar foreign companies from more than 50 per cent ownership of 'strategic' fields. Russian energy companies believe they have the managerial skills to be the lead investors on new projects, contracting with Western firms for technical services as necessary. In ten years' time we will have some idea whether their confidence is justified.

There are some grounds for believing that Russia might be able to beat the resource curse. Unlike the typical Third World petrostate Russia has a diversified economy with a substantial manufacturing sector[13]; a modern, literate society; and a strong state tradition. During the chaotic transition years of the 1990s, these structural advantages of Russia were hard to see. But under Putin the Russian state has regained its capacity to levy taxes on the oil and gas sector, and has followed an impressively conservative fiscal and monetary policy.[14] Foreign debts were paid down from $150 billion to $50 billion; foreign currency reserves by September 2007 had reached $350 billion; and a Stabilisation Fund was created in 2004 which is not accessible for current spending. Inflation has been kept below 10 per cent a year, as has the real appreciation of the ruble (which nevertheless has appreciated by 80 per cent since 1999). The non-tradable sector of the Russian economy (construction and services) has been booming and the OECD and World Bank estimates that oil and gas accounts for half of the growth since 1999 (which means that non-energy sectors account for the other half).[15] Again, only time will tell if this optimistic interpretation of the sustainability of the Russian economic boom is correct.

A fourth problem is that the concept of an ‘energy superpower’ is somewhat contradictory, lumping together two quite distinct logics: that of the energy market and that of military superpowers. Despite its vast wealth (and its spiritual role as the birthplace of Islam) we don’t think of Saudi Arabia as a world power. It is unusual to see a resource-rich country taking on the attributes of a world power: historically, it was the colonised countries and not their imperial masters who were the resource exporters. Typically, resource-rich countries have not used military power to create empires. Rather, it is usually resource-poor countries that create empires in order to acquire more resources. The United States itself has a rich resource base, but it was its manufacturing industry and not resource exports that were the backbone of the US rise to superpower status. The US itself began to import oil in the late 1940s, and it was precisely the *search for* oil that was (and remains) a contributory factor to the US willingness to shoulder the superpower role.

Russia of course is the grand exception: Tsarist Russia was rich in land and resources, and exported commodities such as grain and timber, but it created the world’s largest empire. The Tsars were driven by a concern for security and prestige rather than a search for resources. Likewise, the Soviet Union’s quest for empire was not primarily driven by a need for more resources, but by a combination of security fears and ideological fervor.[16]

Presumably a similar logic is at work in Putin’s Russia. The Kremlin wants to preserve the territorial integrity of the Russian Federation (hence the war in Chechnya) and to maintain its sovereignty in the face of foreign subversion (hence the fear of foreign NGOs plotting a Russian ‘orange revolution’). It also wants to insure itself against military intimidation: hence the anger at NATO’s eastward expansion; the desire to hold onto the naval base in Sevastopol, Ukraine; the chafing at Conventional Forces in Europe arms limitations; and hostility to the US plans to build missile defenses in Eastern Europe. Moscow wants to protect itself against such threats by building up its military muscle and by trying to use its energy exports as a political weapon. Hostile countries will be punished by denial of energy deliveries, while friendly powers will be rewarded, perhaps by allowing their companies a minority stake in developing Russian oil and gas fields.

However, can oil really be used effectively as a ‘weapon’? The global energy market is complex, fragmented and competitive. No single country or company is capable of exerting decisive influence over the market. Russia supplies less than 10 per cent of global oil or gas; it is hard to imagine this market share could be leveraged into ‘superpower’ status. Only in collusion with other producers could there be some serious risk of the market being cornered. Such was the case with the control exercised by the leading oil corporations (the ‘seven sisters’) from the 1920s to the 1970s – a position that was based in turn on the military and political power of their sponsoring countries (Britain, France and the US). That situation changed radically in the 1970s, when the Organisation of Petroleum Exporting Countries (OPEC) showed that it was capable of radically increasing oil prices by restricting output. But nobody talked about a Saudi or Kuwaiti ‘energy superpower.’ Those regimes remained heavily dependent on other states (i.e. the USA) for their military security, and their impact on the global oil market came through their joint actions as an alliance of producers. The Arab states were unable to use their oil wealth to achieve any of their political goals, such as the defeat of Israel. The conventional wisdom on the role of energy in state development is quite contrary to the ‘energy superpower’ idea:

resource dependency usually means slower long-term economic growth and greater political instability. So it seems contradictory to argue both that Russia is dying from the 'resource curse' and that is a dangerous energy superpower.

So why is Russia supposedly different? Russia of course was a military superpower prior to 1991, and retains some of the USSR's military capacity: a stockpile of nuclear weapons and delivery systems; some advanced technological capacity; and substantial international arms sales. It is Russia's potential to fuse oil wealth with Soviet military hardware that makes the idea of an 'energy superpower' credible. But it has proved quite tricky for Russia to wield the 'energy weapon' to good effect. Trade is a relationship of mutual benefit and dependence between buyer and seller. Use of trade as a 'weapon' can hurt the supplier just as much as the customer. The literature on economic sanctions argues that they are only effective about half the time and only when they are multilateral sanctions applied by a group of states.[17] Russia's efforts to wield energy as a political lever are starkly unilateral. Russia has not even been willing to try to coordinate its actions with OPEC, and moves to create a natural gas OPEC have made little progress.

Using oil as tool of influence is seen as a clumsy and anachronistic, a 'hard power' approach to international relations in this era of 'soft power' and global integration. If anything, Russia's efforts to use energy in this way have had negative linkage. Rather than boost Russia's prestige and authority, it has stoked anxiety and driven countries to seek alliances and take other steps to protect themselves from Russian pressure.

Both the European Union and rising powers such as China are stressing the benefits of trade and cooperation through regional institutions. It is striking that despite its role as a major energy supplier and despite Putin's skillful and energetic diplomacy, Russia is still rather isolated on the international stage. It is hard to come up with a single country who could be described as a close ally – one that would come to Russia's aid in the event of armed conflict for example. The United States is the only other nation as wedded to 'hard power' as is Russia, but unlike the latter, and despite the disaster of the Iraq war, the US has managed to maintain a dense web of close international allies.

Any hopes for a global condominium of the two 'hard powers', Russia and the US, have long since disappeared. Washington was only prepared to take on Moscow as a junior partner, one that embraced Western values of market democracy and that would accept American leadership of the global system. As an oil importer, the US will benefit from an increase in Russia's role as an energy exporter. But as the 'sole superpower,' the US does not want to see a reinvigorated Moscow returning to challenge its global hegemony. So the US will do what it can to blunt Russia's drive for 'energy superpower' status.

If one looks at Russia's track record as a putative 'energy superpower' over the past seven years, what does one find? There is scant evidence that energy is a viable tool of international diplomacy. Vladimir Milov (head of the Institute of Energy Policy and a former Russian Deputy Energy Minister) concludes that 'energy is not politics. Attempts to mix them will not lead to anything good.'[18] Moscow's intervention in the Ukrainian presidential election campaign of 2004, offering strong support to Viktor Yanukovich (including the promise of cheap energy) totally backfired. It helped trigger support for Viktor Yushchenko and the 'orange revolution' that overturned the rigged first round election results. Likewise, when Russia decided to 'get tough' with Ukraine in January 2006, hiking energy prices and shutting down the pipeline for two days when Ukraine refused to accept new terms, the result was universal alarm and condemnation by Western powers. Very few Western commentators were prepared to accept Russian protestations that their actions were motivated by a simple commercial desire to get the best price for their products. Similarly, Russia's aggressive stance towards Estonia and Latvia drove those countries more quickly into the arms of NATO and the EU, and made those organisations more willing to accept them as members. Trade embargoes and inflexibility over the status of Abkhazia and Ossetia have done little to dent the pro-Western policies of President Mikheil Saakashvili in Georgia.

Using energy as a carrot rather than a stick has not proved any more effective. Ten years of subsidised energy prices for Belarus did not produce a loyal and subservient ally. Belarusian President Alyaksandr Lukashenka grew increasingly hostile towards Putin, whose arrival as leader of Russia shattered Lukashenka's dream of becoming president of a Union of Russia and Belarus. In 2004 Gazprom asked Belarus to double the price it was paying for gas to $47 per 1,000 cubic meters – still less than half the price European customers were paying. When Minsk refused to pay, Gazprom briefly cut shut down the pipeline, which Lukashenka described as 'an act of terrorism.'[19]

Moscow has had more success in Central Asia. In May 2007 Putin struck an agreement with the presidents of Kazakhstan and Turkmenistan to build new a gas export pipeline across Russian territory and not across the Caspian Sea. That was a major blow to Western efforts to develop an east-west export route for Central Asia's hydrocarbons. At the same time, Moscow has to deal with a growing Chinese presence in the region. Beijing raced to build a 1,000 km oil pipeline from Atasu in Kazakhstan to the Chinese, which was completed in July 2005.

Conclusion

Prior to Putin's accession to power, outside observers saw the Russian economy as weak and stagnant, and the Russian state was regarded as corrupt and incompetent. Russia was a 'failed state,' incapable of providing domestic order, still less projecting power abroad. In the 1990s, no-one was thinking of Russia returning to 'superpower' status.[20] Russia's economic recovery since 2000, and the consolidation of a new authoritarian regime, caused commentators to gradually revise their approach to Russia's great power status. However, the idea of Russia as an 'energy superpower' has more polemical than analytical content. It exaggerates Russia's ability to use oil and gas as 'weapons' to augment Russian influence over its neighbors and on the world stage. For the reasons explained above, the idea of an 'energy superpower' is something of a contradiction in terms. If such a category exists, Russia is the only candidate to fit the description. Skeptics argue that the term is based on flawed logic, and is held together simply by suspicion and fear of Russia, when the term is used by Western critics – or by irrational hubris, when it is used by Russians. At best, energy can be used as a hard power resource only when it is combined with the other tools at Russia's disposal, including military capacity and diplomatic bargaining.

Notes

---

[1] The term was used a handful of times in the 1990s, but only really came into more widespread usage in the wake of the Russia's interruption of natural gas supplies to Ukraine in January 2006.

[2] William Tompson and Rudiger Ahrend, 'Realizing the oil supply potential of the CIS,' (OECD, 18 May 2006).

[3] Various estimates are available at the US Energy Information Administration website: http://www.eia.doe.gov/

[4] Younkyoo Kim, *The Resource Curse in a Post-Communist Regime: Russia in Comparative Perspective* (Ashgate, 2003); Michael Ellman (ed.), *Russia's Oil and Natural Gas. Bonanza or Curse?* (Anthem Press, 2006).

[5] Construction on Nord Stream started in 2005, it will cross the Baltic Sea from Vyborg to Germany. Blue Stream was finished in 2005 and brings gas across the

Black Sea to Turkey. South Stream is planned to carry gas to Bulgaria, Greece and Italy, with a branch to Romania and Hungary.

[6] Adam Stulberg, *Well-Oiled Diplomacy: Strategic Manipulation and Russia's Energy Statecraft in Eurasia* (State University of New York Press, 2007).

[7] Putin scored a coup in 2005 in hiring former Social Democratic Chancellor Gerhard Schroeder to head the new Gazprom joint venture building the Nord Stream pipeline across the Baltic. Similarly, in 2007 Putin persuaded the Social Democratic government in Hungary to use Budapest as a hub for the planned South Stream pipeline across the Black Sea. South Stream is a rival to the EU sponsored Nabucco project, which would bring gas from Azerbaijan (and hopefully Turkmenistan) through Turkey and Greece.

[8] In 2007 Putin announced a 10-year, $250 billion military spending program.

[9] Jonathan Stern, *The Future of Russian Gas and Gazprom* (Oxford University Press, 2005).

[10] Michael L. Ross, 'Does oil hinder democracy?,' *World Politics*, Vol. 53, No. 3, 2001, pp. 325-361 and 'The political economy of the resource curse,' *World Politics*, Vol. 51, No.1, January 1999, pp. 297-322.

[11] 60 per cent of Russia's export earnings come from oil and gas, and another 30 per cent from resource-intensive metals exports.

[12] On the corrosive influence of oil on Russian democracy, see Stephen Fish, *Democracy Derailed in Russia* (Cambridge University Press, 2005), ch. 5. Former presidential economics advisor Andrei Illarionov is also a skeptic, see his article 'A long-term project for Russia,' *Russia in Global Affairs*, No. 13 ,(2005), pp.49-56

[13] For example, only 56 per cent of its crude oil, 34 per cent of its natural gas, and 42 per cent of refined oil products are exported. The rest is used among other things for manufacturing metals and chemicals. Shinichiro Tabata, 'Oil and gas revenues and their influence on economic growth in Russia,' paper presented to the ICCEES conference, Berlin, July 2005.

[14] Sadek Bousseni and Catherine Locatelli,'Towards a more coherent oil policy in Russia?' *OPEC Review*, Vol. 29, No. 2, (2005) pp. 85-100.

[15] World Bank, *Russian Economic Report*, No. 12, April 2006.

[16] As George Kennan noted half a century ago, Russia's defensive paranoia could be self-defeating. 'X' (George Kennan), 'The sources of Soviet conduct,' *Foreign Affairs*, July 1947.

[17] Daniel W. Drezner, *The Sanctions Paradox. Economic Statecraft and International Relations* (Cambridge University Press, 1999).

[18] Vladimir Milov, 'Would Russia cut off gas supplies to Europe?,' *Argumenty i Fakty*, 17 May 2006.

[19] Askold Krushelnycky, 'Rift threatens Belarus ties with Russia,' *The Independent*, 20 February 2004.

[20] In 2000, Putin himself pointed out that at 8 per cent annual growth it would take 18 years for Russia to catch up with Portugal in terms of GDP per capita.