Russia: Oil and Politics

Under Vladimir Putin Russia has followed an aggressive energy policy enhancing the contribution of the oil and gas industry in the domestic economy. But as private companies gain dominance through mergers and foreign collaborations, a conflict of interest may emerge between the state and oil barons. Russia has become a major player in the world energy sector and has used oil as a weapon to achieve its foreign policy objectives through energy pipelines.

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Russia's oil industry has been in the news during the past few months. In the third week of April, two major Russian oil companies, Yukos and Sibneft, announced their merger to create the fourth largest oil company in the world, worth $35 billion. The new company, to be called YukosSibneft, commands the largest reserves of about 20 billion barrels, which can produce 2.3 million barrels of oil per day. Economic analysts have considered the merger as one of the most significant events since Russia's transition to a market economy. For instance, on April 23, 2003, *The Washington Post* newspaper commented that the merger had created a "new giant which will be fourth largest producer but number one in the proven reserves of oil". In fact, this was the second major oil deal in the previous 10 weeks; in February 2003, British Petroleum bought 50 per cent of Russia's third largest oil company Tyumen Oil, at $6.7 billion the biggest foreign direct investment in Russia in the past five years. Since 2002, Russia has emerged as a major player in the international energy market. Russia now rivals Saudi Arabia as the biggest oil producer in the world. During the past few years, Russia's oil barons have made huge profits as oil prices rose in the international market. The Russian treasury is getting filled with petro-dollars. However, some analysts in the west and political groups in Russia, from their own perspective, are critical of some of the developments and claims with regard to the country's oil industry. But the fact remains that Russia and oil are intertwined, something aptly commented on by an economic historian. This is clearly evident considering that Russia's president, Vladimir Putin, has been pursuing aggressive policies and measures using its energy resources of oil and natural gas as an economic weapon to serve national interest in world politics.

Before its break-up, the Soviet Union was one of the major producers and exporters of oil and natural gas. For post-Soviet Russia, energy resources continue to be of great importance. This is evident from the fact that in 2002, the energy sector accounted for 25 per cent of the total industrial output of Russia, about 33 per cent of the federal budget and 50 per cent of the country's hard currency earnings. Russia produced about 350 million tonnes of oil and over 600 billion cubic metres of natural gas. Russia has depended upon the export of raw materials for earning much-needed hard currency for the economy in transition. Energy resources were the most acceptable raw material in the international market. Hence there has been a significant increase in the importance of oil and gas in the Russian economy. Russia's gas company Gazprom alone accounted for about 8 per cent of the states revenue. Apart from economic gain from energy resources, the Russian state has used oil and gas as a political weapon to increase its influence within the CIS and in particular with the central Asian states, Byelorussia and Ukraine.

State and Private Sector

Some oil and gas companies of the Soviet era, such as Gazprom and Rosneft continue to operate. But in addition to these, several new ones emerged during the presidency of Boris Yeltsin. For instance, Yukos is the largest vertically integrated company, engaged in activities ranging from geological exploration to marketing of refined oil products. The chief of Yukos, Mikhail Khodorkovsky, is one of the oligarchs (baron) of Russia and a multimillionaire. Similarly, Lukoil is a leader of the Russian fuel energy complex, the first integrated company engaged 'from oil well to filling stations'. The president of Lukoil, Vagit Alekperov, is another oil baron. Before the merger, Sibneft was considered to be one of the world's top 20 private oil companies in terms of the reserves it possessed, concentrated mainly in west Siberia. Boris Berezovsky was one of the chief promoters of this firm and Roman Abramovich is its unofficial head, holding majority share. Tatneft is a joint stock oil company in Tatarstan autonomous state. There are also many medium and small private firms operating in Russia. In the case of state-owned firms, as a result of privatisation, the share of the state has come down significantly. In Gazprom, it has been reduced from 100 per cent to 38 per cent. At the same time, the Russian state holds stakes in some private companies. In Lukoil, it holds 14 per cent share, in Slavneft 50 per cent and so on.

Notwithstanding the privatisation process, there are close relations and interactions between the state and private companies. Lukoil president Alekperov was a former government official and a deputy in the Soviet oil industry. Sibneft chief Abramovich is the governor of Chukota, which is an energy-rich region on the Barents Sea. Yukos chief Khodorkovsky was a leader in Komsomol (the youth wing of the Communist Party) and in 1993 he briefly served as deputy minister of power. The former prime minister of Russia, Viktor Chenomyrdin, was the chief of Gazprom. Anatoly Chubais was a deputy prime minister and was closely associated with Boris Yeltsin and his 'family', a group which was closely linked to the Kremlin. For the past five years, he has been the chief of the 'unified energy system' of Russia and his position has been extended up to 2008. Some analysts have, therefore, argued that the Russian state and private companies complement each other in Russia's energy sector. The Russian state wants to increase its political power both at home and abroad while private companies want to increase their profits. Those who have not adjusted to this situation have been eased out, such as Boris Berezovsky, who was at one time an influential figure and closely associated with Yeltsin. He was not only caught in a few alleged frauds, but was also reported to be opposing president Putin and the policies of the Russian government. He has been squeezed out and is in exile after Putin came to power. It needs to be mentioned, however, that the heads of Russia's oil gas companies are technically qualified professionals. To make the firms competitive internationally, private companies such as Yukos and Tyumen oil have appointed western managers at senior levels, which has reformed the management of the companies. All these efforts have caused the share prices to shoot up in 2003.

The Russian state has been actively supporting the private sector in the development of the oil-gas industry. V I Kalyuzny, the former minister of fuel and energy, appreciated the role of Russian private oil companies in implementing Russia's energy strategy in the 21st century. He said that in a short period Russian oil companies, which although young have taken, a worthy place in the new economic order and are successfully competing with western energy giants. In fact, the Russian government seems to have supported the oil-gas companies to consolidate their positions, which has also helped in attracting foreign capital. For instance, according to Mikhail Fridman, the multibillion-dollar joint venture deal between British Petroleum and Tyumen Oil would not have been possible without the support of the Russian government. According to some analysts, when this joint venture company starts production, it will be a locomotive for the Russian economy. Similarly, the CEO of YukosSibneft, Mikhail Khodorkovsky, has asserted that the company is expected to play a big role in the world oil market. It is important to note that according to some analysts like Daniel Kimmage the merger has taken place with the blessings of the Russian government. In support of this contention, the Russian newspaper *Izvestiya* also reported on April 23, 2003 that Roman Abramovich of Sibneft had "discussed this deal with Putin to save the deal from being acquired by foreigners" as there were rumours that a foreign company might take over Sibneft. *Moscow Times* reported on April 23, that the merger would strengthen ties between the CEO of YukosSibneft and a number of influential figures including politicians and businessmen in the country. Presumably for this reason, France's *Le Monde* wrote on April 23, 2003 that the merger deal was "the most important since the birth of market economy in Russia". The *Economist* has taken a different view, and has commented that the merger by itself may not be a sufficient condition for YukosSibneft to compete with other global oil giants such as Exxon or Mobil. Be that as it may, considering these two recent cases, it appears that the Russian government has been trying to balance the dominant role of foreign companies with that of Russian companies in the country's energy sector. YukosSibneft will play an important role in Russia's oil-gas industry. Moreover, it proposes to boost export capacity significantly by constructing new pipelines. Considering the new developments, the Russian government might reconsider its earlier policy of maintaining total control over pipelines, thus opening the door to private-sector funding and operations in the new pipelines.

Strategic Partnerships

During the past five-six years privately-owned Russian oil companies have also been working in other countries producing oil and gas and participating in strategic partnerships. Russian companies in the energy sector are working in tandem to meet the country's increasing energy needs and increasing oil and gas exports earning hard currency. In fact, according to some analysts, these companies are addressing some of Russia's basic foreign policy tasks. For instance, in 2002 Putin initiated a proposal of greater cooperation between Russia and Turkmenistan in the gas sector. In February 2003, Gazprom chief Alexei Miller met Turkmen president Niyazov to discuss further cooperation in the exploitation of Turkmen gas and its export through Russian pipelines. Gazprom with 38 per cent ownership by the Russian government, has initiated proposals for the modernisation of production activities and construction of new pipelines, which will help increase the gas exports of Russia and Turkmenistan. Proposals have been made by Gazprom and Turkmeneftgaz to jointly build pipelines to export gas to China. Russia and Turkmenistan have concluded and agreement under which, from 2005, Russia will buy 10 billion cubic metres of Turkmen gas annually which will go up to 20 billion cubic metres from 2008. This will further enhance Russia's export capacity.

Russia's private companies have played an important role in increasing the production of oil and gas during the past few years. For instance, from 3.5 million bpd (barrels per day) in 1997, the production of oil shot up to over 7 mn bpd in 2002. This has enabled the country to meet domestic demand and also growing demand in world markets. Many Russian oil companies have invested and participated in joint ventures in the energy sector in many countries. They receive strong support from the Russian government. Lukoil has five big projects to develop oil-gas fields in Kazakhstan. Lukoil and Kazak state-owned firm KazMunGaz Liazzat Kiina have decided to create by November 2003 a joint venture to explore and develop oil-gas in one block of the Caspian Sea, which has reserves of over 100 mn tonnes.

The support of the Russian state for private companies is also strong. Lukoil, along with two other Russian firms, had invested in a project valued at $3.7 billion for the exploitation of the West Qurna oilfield in Iraq. In December 2002, the Iraqi government under Saddam Hussein terminated the contract on the ground that the Russian firms had failed to develop oilfields as agreed upon in the contract. But Lukoil contended that the firms had not violated the contract but were barred from proceeding with their work on the project under the UN sanctions. The issue caused considerable debate in Russia. Political analysts contended that Lukoil was under the "strong protection of the Russian state". A Lukoil spokesman even threatened that the firm would take up the matter legally at the international court. On the December 15, 2002 the Russian foreign ministry issued a statement expressing its displeasure on the issue. Russian political commentators, however, pointed out that Saddam Hussein was still in power thanks to Russia and a few other countries. Thus, feeling the pressure from Moscow, the Iraqi government withdrew the order terminating the contract. Russia has a strong economic stake in Iraq, where it has invested heavily over the past two decades. Therefore, even after the war on Iraq, Russia has not agreed to the US suggestion to write off Iraqi debt. Lukoil has insisted that it proposes to operate in Iraq's oil industry.

The Russian government while extending support to the private sector, is also trying to bring it under its own influence. Under Putin's presidentship, the Russian government seems to be interested in increasing the influence of the state over oil-gas companies. The policy statement of prime minister Kasyanov made a few months back, to bring oil-gas pipelines under construction under the state control, was a clear indication of this development. But this policy, may be reviewed as private companies such as YukosSibneft propose to build pipelines jointly with the government to push exports to new markets. According to some reports, Putin has put his own trusted men from St Petersburg in important positions in Gazprom. In February 2003, Aleksandr Bespalov, who was a colleague of Putin at the St Petersburg regional office of the KGB and is now chairman of the pro-Kremlin Unified Russia's General Council, was named as the head of Gazprom's information policy department. The Russian government has also appointed a former intelligence officer from St Petersburg Sergei Ushakov, as Gazprom's deputy chairman for administration. Valeri Golubev, a former KGB officer and the Leningrad Oblast legislature's representative to the federal council has been appointed to a leadership position in Gazprom's subsidiary company Itera. All these developments indicate the interest of the Kremlin and the Russian state to actively increase their hold on the energy sector. State and private energy companies have been important tools of the state in promoting Russia's economic and political interests.

Politics of Pipelines

Russia under Putin has pursued a very aggressive policy on pipelines for the transportation of oil-gas both for the domestic market as well as for export. At present, Russia has pipeline capacity to export 130-140 mn tonnes of oil. During the past couple of years, many projects have been completed and new projects taken up. For instance, in August 2002 the Caspian Pipeline Consortium (CPC) was inaugurated. In this Tengiz-Novorussisk pipeline of 1,700 km Russia, Kazakhstan and some western firms including Chevron are the partners. This pipeline links Kazakhstan on the Caspian Sea with the Black Sea port in Russia. It has the initial capacity to export 28 mn tonnes of oil, which will increase to 67 mn tonnes over the next 10-15 years. According to some analysts, the Russian government has made efforts to complete this much-awaited pipeline. Russia wants to assert that the pipeline is more economical not only to Russia, but also to Kazakhstan and Azerbaijan compared with the proposed Baku-Tbilisi-Ceyhan (BTC) pipeline route. During the past few years, some western countries including the US have been strongly supporting the BTC pipeline as an alternative route as they are interested in getting oil from Baku on the Caspian Sea through this pipeline, which connects the Turkish port city of Ceyhan on the Mediterranean Sea. Hence Russia has been trying to convey the advantages of CPC over BTC, which, however, may take some more years to materialise.

The Russian state and Russia's oil and gas companies including Gazprom and and Yukos have envisaged several projects to promote its energy exports, including a gas pipeline project to Europe via the Baltic Sea bed, and an oil pipeline from eastern Siberia to China and Japan. According to the Energy Information Administration report of November 2002, international consortiums with the participation of Russian companies are developing projects in Sakhalin Island with proposals to build pipelines to China and Japan where energy demand is increasing rapidly. Thus, Russia wants to strengthen its economic ties to cultivate the market for oil and gas both in the east and in the west. In this regard, an important policy has been taken by the Russian government, when prime minister Kasyanov signed a document on December 11, 2002 calling for the integration of Russia's dominant Druzba pipeline (known in the Soviet era as 'Friendship' pipeline), which passes through Belarus, Poland and Slovakia, with the Adria pipeline, which transits through Hungary and Croatia. This integrated Druzba-Adria pipeline has come under a single economic entity to supply 15 mn tonnes (90 mn barrels) of Russian oil to world markets through the Croatian port of Omisalj. Russia's state-owned Transneft, which initiated the scheme, would operate the project from the Russian side. An equally significant factor in this project will be that Russia will get the advantage of the deepwater port facility of Omislaj, which will overcome the disadvantage Russia has been experiencing so far.

Russia's aggressive policy to expand its pipeline network is also evident from the fact that Putin inaugurated an export terminal at Primosrk on the Gulf of Finland in December 2002, which will allow Russia to control the distribution of Caspian and west Siberian oil to Europe. According to a Russian spokesman this will help both Russia and the central Asian countries to increase exports of oil. Primorsk is the final link in the Baltic Pipeline System (BTS) and the $500 mn that Russia has invested will link Siberia with the port in the Arctic Ocean in the north circumventing the Baltic states. Considering the fact that Russia-Baltic state relations have become sensitive on the already existing LatRostrans pipeline issue, Putin made it a point to state while inaugurating the port that BTS was not intended to sever economic ties with the Baltic states. But he asserted that Russia has to care more about its own security and independence with regard to the export of oil and gas to world markets. The fact that Russia has been using pipelines as a foreign policy weapon is clear from the fact that in February 2003 it decided to bypass Latvia in exporting oil. This is possibly because some of the policies of the Baltic states, including their decision to be part of the NATO and a discriminatory attitude towards ethnic Russians seem to affect Russia's interests. In the first quarter of 2003, Russia has not used the LatRostrans pipeline, which is jointly owned by Russia and Latvia as per the agreement, entered into in 1993. During the past decade this pipeline was used by Russia for exporting oil to Europe from the Latvian port of Ventspils and thus has been a source of income for the Baltic state. But now Latvia has been unhappy, as Russia's action has economically affected its interests. Latvia has also contended that Russia has violated the 1993 agreement. The Latvian government has gone to the extent of approaching the European Union and seeking the help of US president George Bush to intervene for ending the blockade of the pipeline by Russia. The Latvian government has also stated that most of the workers at the Ventspils port are ethnic Russians and that they are being affected by this blockade. But the Russian government has insisted that there was no violation of the agreement. It has also argued that the Latvia-Russia agreement on the joint use of oil pipeline did not regulate supplies.

Similarly, in July 2000, Gazprom decided to bypass Ukraine in exporting natural gas to western Europe and take the route through Belarus and Poland, and the same was done with the export of oil. This was partly due to the fact that in recent years, oil has been stolen by mafia elements from the pipelines in Ukraine. But Russia had to bear the revenue loss. Moreover, there have been disputes between Russia and Ukraine on the amount of debt that the latter has to pay Russia as also delays in the repayment of debt. These could be some of the reasons why Russia tried to use strong-arm tactic by not using the pipeline passing through Ukraine. However, in 2002 there some understanding has been reached at the highest level between Russia and Ukraine. Subsequently, in January 2003, Gazprom and Neftohaz of Ukraine formed a consortium with a capital of $ 1 million, which is expected to upgrade Ukraine's pipeline gas system. In April 2003, Germany's Ruhrgas decided to join the consortium. For Ukraine this is a positive development and a sign that Russia would not abandon it in exporting energy resources to western Europe. Ukraine has 35,200 km of pipelines and in the past about 90 per cent of Soviet export passed through Ukraine. It appears that even as Russia has decided to export part of its oil through pipelines in Ukraine, it does not want to depend upon that country, and additional pipelines are being worked out skirting Ukraine.

An important policy decision has been taken recently, under which the Russian government proposes to increase state control over the pipelines. In January 2003, Russian prime minister Kasyanov said that pipelines under construction in Russia would remain state property. He was speaking with reference to the west Siberian-Murmansk oil pipeline, which will be jointly constructed by four Russian oil companies, Yukos, Tyumen oil, Lukoil and Sibneft. It appears that the government is trying to restrict the role of Russian firms, which are partly or wholly owning the pipelines. By increasing control over pipelines, the Russian state wants to automatically influence the oil-gas sector in general since pipelines become an effective political and economic weapon in the hands of the state. But Russia's privatised and new oil companies are resisting this policy proposal. Several privatised oil and gas companies have flourished by expanding their activities, such as exploiting oil resources and transporting to domestic and foreign markets. They are also able to attract foreign capital in their activities. Increase in state control may affect their development.

Russia and the West

In recent years, there has been growing interest among some western countries in Russia's oil-gas sector as an additional source of supply to that of the Middle East. This is because 18-20 per cent of the total oil consumption of the European Union is met by imports from Russia. For Russia, the European Union is a major oil destination, accounting for 50-60 per cent of its total exports. Political stability and economic growth in Russia under Putin and the reform measures undertaken to build a market economy, including privatisation, seem to have encouraged several western countries to look for investment opportunities in Russia's oil-gas industry. For instance, at the Energy Summit held in October 2000, the European Union agreed to develop Russia's oil-gas resources in return for long-term energy supply commitment and export to the European Union. Thus the Central European Equity Fund (CEE) has invested in several Russian oil firms. By March 2003, its assets exceeded 13 per cent in four companies, with Lukoil 4.1 per cent; Yukos 4.9 per cent, Surgutneftgas 3.5 per cent and Gazprom 0.2 per cent. The growing interest of the CEE in Russian oil is evident from the views of H Ackermann, who is portfolio manager of the CEE. He has opined that Russia has enormous catch-up potential with regard to oil and gas in the years to come. Equally important is his contention that Russia's energy sector is massively undervalued relative to energy companies in the west. These views seem to be the basis for increasing investment by western companies in Russia's energy sector. That Russia has thus become important for western countries is also evident from the fact that for the first time the International Energy Agency (IEA) invited Russia in April 2003 to attend its meeting. The main agenda of the IEA meeting was to discuss policies for stable energy supplies from the viewpoint of oil-producing nations and also to discuss measures to avoid disruptions in oil supplies after the Iraq war.

Russia and west European countries have wide-ranging relations such as trade and investment in the energy sector. Some European countries have entered into joint ventures in Russia's oil industry during the past decade. The latest joint venture, in which British Petroleum has made a huge investment in the Tyumen Oil Company, is a case in point. According to oil baron Mikhail Fridman of the Alfa Group, this joint venture deal is a major vote of confidence in Putin's economic reforms and that it would attract more FDI in Russia's oil industry. But on this issue Moscow newspaper *Pravda* made critical observations on April 24, 2003 stating that "the Russian government believed in selling oil companies to foreigners as a simple way to fill up the treasury" and that both the government and the oligarchs were interested in selling the motherland.

Russia has also come closer to the US in the energy sector. The 'energy dialogue' initiated by Putin and the US president Bush in 2002 has been intended to open up Russia's oil industry for US companies. In July 2002, Russia supplied 2 mn tonnes of oil to the US which was organised by Mikhail Khodorkovsky, the CEO of Yukos, Russia's second largest oil company. In February 2003 he said that Russia hoped to become a leading exporter of oil to the US by supplying 1-2 mn bpd 15 per cent of US imports. There were reports that Yukos and US firm Exxon might enter into a multi-million dollar deal. Similarly, Russia has been making efforts to enter the oil and energy markets of China, Japan and South Korea. These countries account for about 20 per cent of global energy consumption and their demand is expected to increase considerably in the next couple of decades. In 2003, China imported 70 mn tonnes of oil from Russia. Hence Russia also hopes to increase its role in the north-east Asian energy markets.

Russian companies' keenness to export oil and gas to western markets is mainly dictated by the motivation to maximise profits. Under prevailing conditions in Russia, export prices of oil are reported to be double those of domestic prices and hence overall earnings of oil companies will be improved by increasing exports. Notwithstanding several measures taken with regard to liberaslising the economy, there is a strong lobby in the country to protect domestic consumers. Hence domestic prices of oil and gas are deliberately kept low. Apart from price differences, Russian companies supplying oil and gas to the domestic market often do not receive payment on time as most of the regional and local governmental organisations face budgetary constraints. There were reports that in the past Gazprom had not received payment even from the federal governmental agencies. In contrast, Russian firms receive immediate payment in hard currency for exports to foreign markets. Hence the keenness of Russian firms to increase exports is quite understandable. This is particularly evident from the fact that Russian oil producers occasionally try to bypass the restriction of 30 per cent of domestic production for exports fixed under a long-standing quota arrangement and increase their exports.

Russia and OPEC

Russia has somewhat uncertain relations with OPEC and is not a member of the organisation. There are varying views on Russia-OPEC relations in the country. The advisor to the Russian president, Andrei Illarionov, has contended that OPEC members are not benefited since the GDP of the member-countries has fallen over the past two decades. At the World Economic Conference held in Davos in January 2003, he said that Russia would not join the OPEC. The Russian government, however, has often agreed to abide by the OPEC decision to cut oil exports to prevent decline in prices. For instance, in the first quarter of 2002, the Russian government agreed to cut oil exports to 1,50,000 bpd. Notwithstanding this decision, according to some Russian oil companies, Russia was not interested in assuming the obligations to observe the cartel discipline and limit the export of oil. Thus the government decision was not implemented in reality. In fact, as international prices of oil were going up, Russian oil companies increased their exports. Thus in March 2002, exports reached a peak of 5.5 mn bpd against 4mn bpd in January 2002. There are two reasons for this. Firstly, private Russian companies are able to get more profits on their exports since world market prices are almost double those of domestic prices. It is estimated that every \$1 per barrel increase in the price of Russia's Urals Blend benchmark brings in almost \$1 bn in extra earnings. Hence profit motivation is strong among Russian oil companies. Therefore, indirectly the Russian state is also benefited by oil exports. Secondly, the payment on exports is guaranteed for Russian companies unlike when they sell oil in the domestic market. Hence under pressure, the Russian government abandoned its export cuts by July 2002. Russia's push for new oil markets in recent years has been a cause of concern for OPEC.

Russia does not want to be a part of the 12-member OPEC cartel, possibly because it may not be an influential member and will still have to abide by cartel discipline. However, Russia has taken the initiative to form a gas cartel jointly with three central Asian republics, namely, Kazakhstan, Turkmenistan and Uzbekistan. The proposal for the formation of this gas cartel was made in January 2003, when Putin met the Turkemen president Niyazov. The justification for the formation of this cartel seems to be to secure a balance between supply of and demand for gas in world markets, to protect the interests of Russia and the central Asian states and to evolve a single export channel policy. In March 2002, the four countries signed an agreement to cooperate in this regard. The Russian president has considered this as a serious step to come closer on the energy sector. However, Putin emphasised that this agreement was in no way internationally or legally binding. Hence it is to be seen how this cartel proposal will take shape in the near future.

In proposing this gas cartel, Russia has a decided advantage. In 2002, Russia and the central Asian countries produced 620 bn cubic metres of gas, of which Russia's share was 570 bn cubic metres followed by Turkmenistan. Russia's domestic consumption was 280 bn cubic metres hence it was exporting about 300 bn cubic metres of gas. As noted earlier, Russia also has the largest share of reserves of natural gas, accounting for about one-fourth of total world reserves, and together with the three central Asian states they will account for nearly one-third of world reserves. Hence in the next 1-2 decades they will emerge as crucial sources of supply. Russia with this dominant position can play a crucial role. Moreover, at present most of the gas pipelines pass through Russia, which is interested in retaining its control and influence in ensuring gas from the central Asian states flows through its pipelines. This will help Russia to hold the central Asian states together in exporting to world markets. Russia will also benefit economically by charging the central Asian states for the use of its pipelines.

Challenges Ahead

Experts differ on the extent to which Russia can play in world energy market. According to energy experts Fiona Hill and Florence Fee (2002), Russia's resources are much smaller than that of the key players, namely Saudi Arabia, Iraq, Kuwait, UAE and Iran. It is pointed out that Russia has only 5 per cent of proven oil resources and it occupies seventh place in the world. It is argued that Russia has another disadvantage which is that about 50 per cent of its oil resources are located in regions not easily accessible. These factors, it is pointed out, increase the cost of oil production in Russia. Moreover, the relatively low level of technology and low labour productivity further affect Russia's capability to make an impact on the world energy market. These are some of the challenges that Russia faces in being a competitive player in the international energy market.

On some of these issues, Russian economists have different views. For instance, while it is a fact that in proven resources Russia lags behind the key players, according to Russian economists Kuzovkin (2000) and Terekhov (2002), Russia's potential estimated reserves of oil are about 13 per cent, which puts it in second position after Saudi Arabia. Moreover, Russia has taken several measures to overcome some of the disadvantages. Firstly, recent explorations undertaken in various parts of Russia such as Sakhalin Island and eastern Siberian regions closer to China and Japan have given encouraging results. These findings will enable Russian companies to increase production to meet growing demand from the domestic and export market. Secondly, Russian companies have invested in oil-gas projects in several countries such as Kazakhstan, Turkmenistan, Azerbaijan, Iran, Saudi Arabia, and Iraq. As noted earlier, Russia has been able to get commitments from Turkmenistan, Azerbaijan and Kazakhstan to export part of their oil and gas through Russian pipelines. Thirdly, Russia has been playing an active role in bilateral and multilateral negotiations in finding solutions to the problems of sharing of energy resources in the Caspian region. These measures may enhance Russia's role and influence in the world energy market. Fourthly, Russian oil companies propose to use the location of energy resources in Siberia and the Far East to cater to markets in China and Japan. These countries have already shown interest in investing in the Russian oil-gas sector and in projects to build pipelines to meet new and growing demands. Thus Russia is trying to overcome the locational disadvantage contended by some analysts.

Moreover, in the case of natural gas Russia has the largest reserves accounting for 25 per cent of estimated world resources. In comparison, Iran has 15 per cent, Qatar 7 per cent, and Saudi Arabia 4 per cent. Hence, in respect of gas, Russia has a great advantage. The role of natural gas as a source of energy has been increasing in recent years. In the case of the European Union, gas accounts for nearly a quarter of energy consumption. Russia is a major supplier of gas to the EU market, which accounted for 62 per cent of its total exports. Considering environmental concerns, consumption of gas in the developed countries as a clean source of energy is expected to increase. Hence, as opined by some experts such as Adams (2002) with the growing importance of gas Russia has the possibility to shift the thrust from oil to natural gas in the near future. In that case, Russia's role may increase in the world energy market in the next decade.

While energy resources have been a great asset for the country and petro-dollars have immensely helped Putin's Russia in attaining reasonably high economic growth rates during the last few years, over-dependence on oil and gas may not be desirable for the country in the long run. At present, many branches of the Russian economy including engineering, consumer durables, chemical and food processing industries are not doing well. Hence, there is an imbalance in the development of the economy. Moreover, if oil and gas prices drop in the near future with Iraqi oil entering the market in large quantities, Russia's oil industry will be hit badly.

Thus it may be stated that Russia under Putin has followed an aggressive policy to enhance the role of the oil and gas industry, which has enormously enriched the domestic economy. Russia has re-emerged as a major player in the world energy sector, the position USSR had occupied in the past. Russia's entry into new oil markets has caused concern for OPEC members. Even as the Russian state and private oil-gas companies are often working in tandem to promote the country's national interest, the government has tried to exert greater control over private companies. At the same time, as private companies gain dominance in size and capability through merger and foreign collaborations, the conflict of interest between the state and oil barons for economic gains in future may not be ruled out. The Russian state has used oil as a weapon to achieve its foreign policy objectives through energy pipelines. But Russia's ability to sustain its impact on the world oil market in future may be relatively restricted due to the limitations of its oil reserves compared with other key oil producers such as Saudi Arabia and Iraq. But with the largest natural gas reserves in the world, Russia can shift its focus from oil to gas and thus may still have a chance to be able to play a crucial role in the global energy market in the coming decades. EPW

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