

Energy and Russia

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Russia is 'a great power'

For Russia and its citizens, a great power status is absolutely critical.

The essentials of a great power:

- Significant military and economic potential.
- Ability and willingness to resort to unilateral (typically military) action.
- Operates over large (global) area.
- Has the will to act like a great power.

(Russia background comments based on M. Romancov's work)

How does Russia view itself?

- Russia is large (It always was).
- Russia is victorious.
- Russia is exceptional.
- Russia needs to be respected and shown gratitude (WWII).

What troubles Russia?

- Perceived loss of respect.
 - Confusion over soft power vs. interference in internal affairs.
 - The impossibility of negotiating with West based on geopolitical principles without involving references to human rights and other „Western-liberal“ values.
- = Russia, as a classic realist actor, resists liberal principles like non-zero-sum cooperation, conflict-limiting collaboration, and prioritizing economic gains over political dominance.

What to expect?

- Russia wants to be big, important, to have a role in deciding what happens (and what does not happen) in the world – (vs. its real capacities).
- Catherine the Great's foreign policy minister Alexander A. Bezborodko (1747 – 1799): „...not a single gun in Europe dared to fire without our permission“.
- In 1990s and zero years Russia hesitantly accepted the „West order“ and discourse. From 2014 an effort to confront West (= USA) using all available options – economically, militarily, legally.
- Struggles to apply soft power, threatens with nuclear weapons instead.

Role of energy

- Russia is a world energy supplier. This role of "hydrocarbon superpower" gives it a prominent position in the international environment.
- Energy resources are a key revenue stream for the state.
- Energy resources make it possible to exert influence.

Energy in the Soviet Union

- The Soviet oil industry, damaged during WWII, had fully recovered by the 1960s.
- The Druzhba Pipeline, following an agreement signed in 1959, reached Bratislava (Slovakia) by 1962 and Litvínov (Czechia) by 1965, becoming the longest oil pipeline in the world at over 5,000 km.
- It has two branches: the northern branch (Poland, Germany) and the southern branch (Ukraine, Slovakia, Czech Republic, Hungary).
- Notable supply disruptions occurred in 1990 and 1992 (Baltic countries), 2007 (Ukraine/Russia over fees), 2008 (Czech Republic after US radar installations), and eight times between 1998-1999 to Lithuania's Mažeikiai refinery.

Energy in the Soviet Union

- Exploration in the 1950s began as a by-product of oil production.
- By the 1960s, growing output turned gas into a standalone industry, with deliveries to Soviet Republics like Georgia and Armenia.
- The USSR, needing technology for higher-pressure pipelines, imported equipment from Germany and Italy.
- During the 1960s, Europe faced energy shortages, but NATO imposed an embargo on large-diameter pipes for oil and gas, which lacked unity and had limited impact.
- Gas deliveries expanded to Belarus, Latvia, and Lithuania in the 1960s, and in 1967, the Brotherhood Pipeline was constructed.

Energy in the Soviet Union

- In the 1970s, the first gas deliveries reached Western Europe, building on the success of the Druzhba oil pipeline.
- By 1975, all Soviet satellites were connected to the network, except Romania.

Primary Russian Oil and Gas Pipelines to Europe (U)

- Oil pipeline
- Proposed oil pipeline
- Gas pipeline
- Proposed gas pipeline
- Russian-dominated pipeline^a
- Tanker terminal

0 500 Kilometers
0 500 Miles

^aAll or most of the oil or gas moving through a given pipeline is from Russia.



Politics of hydrocarbons during Cold War

In the West:

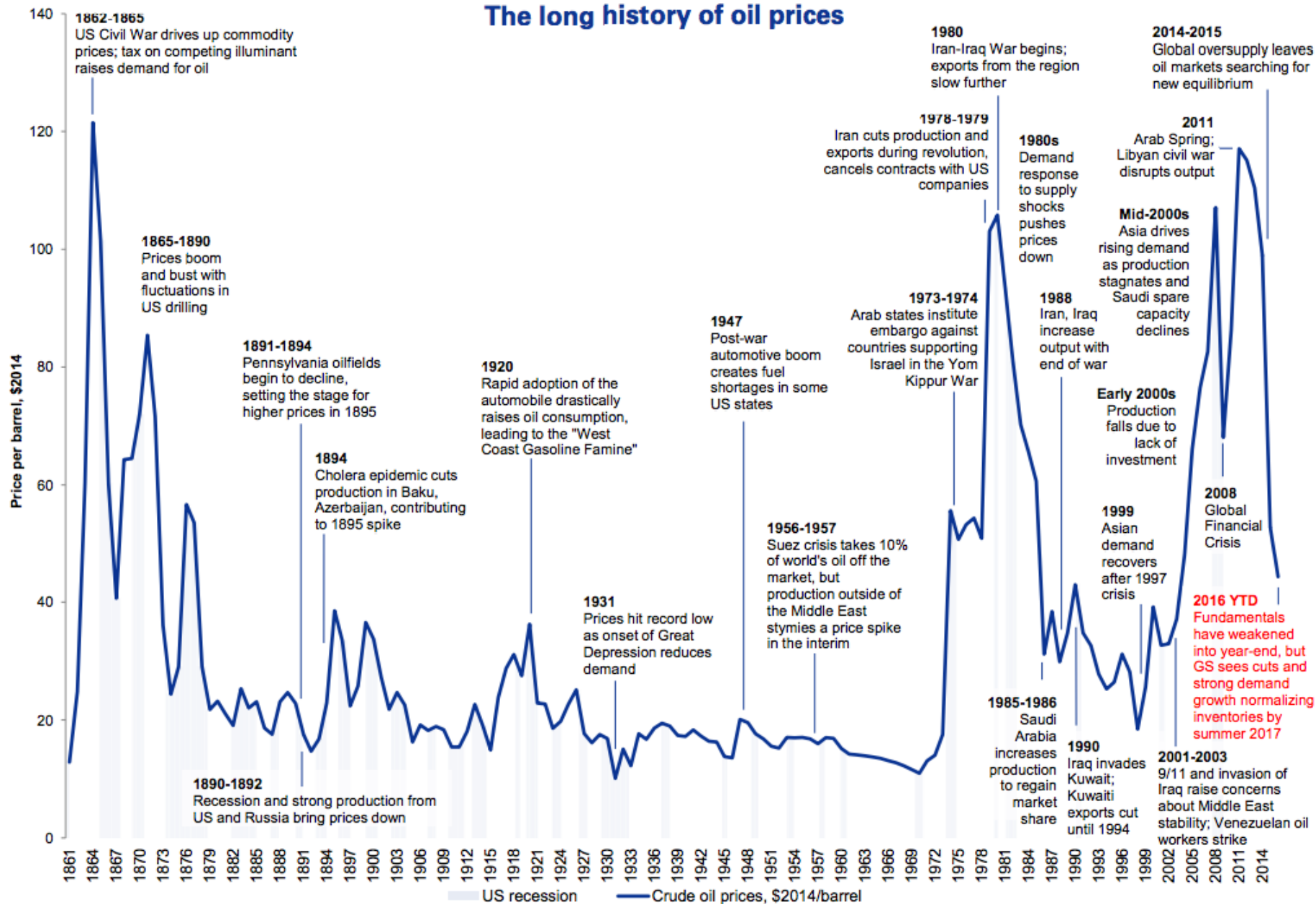
- The oil shock, Détente, and Ostpolitik under Willy Brandt shaped policies.
- Cooperation with Italy in industrial production, including Italian pipes for Soviet oil, later replaced by Austria as the closest partner.
- Economic considerations dominated over geopolitical concerns.
- The U.S. maintained a markedly different stance.

Politics of hydrocarbons during Cold War

In the East:

- Under Khrushchev's "Socialist division of labour," the USSR supplied subsidized oil and gas to the Soviet bloc to ensure dependency and political compliance.
 - Industries in Eastern bloc countries were built around cheap energy, leading to highly inefficient consumption.
 - Hydrocarbons were exported to the capitalist West to earn hard currency, showcase communist achievements, and limit U.S. influence in Europe.
 - The USSR adhered to contractual obligations.
- = Path dependencies created.

The long history of oil prices



An earlier version of this chart appeared on pg. 16 of *Top of Mind Issue #52: OPEC and Oil Opportunities*.

Note: 2016 price shown is YTD average as of Dec. 19, 2016.

Source for data: BP, NBER/Federal Reserve Bank of St. Louis, Haver Analytics.

Source for annotations: ©James Hamilton, "Historical Oil Shocks," University of California, San Diego, February 2011; various news sources; Goldman Sachs Global Investment Research.

Yeltsin's era (1991 – 1999)

- Oil prices stayed low (below \$20) from 1986 to 2000, pushing the government to export hydrocarbons desperately for hard currency.
- Economic turmoil, with a 40% decline, halved oil and gas production, slashing revenues.
- Privatizations, like Sibneft sold for \$100 million in 1995 (later \$13 billion in 2005, Roman Abramovich), led to wealth extraction by oligarchs.
- By then, the state controlled only 10% of oil production, with Gazprom's full privatization being considered (state held 38%).

Putin's era

- Oil prices rose dramatically.
- The state regained control (though not full ownership) over fossil fuel production (e.g., Khodorkovsky's Yukos, Sibneft to Gazprom Neft in 2005, Russneft to Oleg Deripaska in 2007).
- An active pipeline policy emerged, with increased efforts to control pipelines in transit countries (Baltics, Poland, Belarus, Ukraine, Balkans) and diversify consumers.
- The economic situation stabilized, foreign debt was repaid, and reserves grew, enhancing Russia's foreign policy leverage.
- Foreign companies were pushed out of hydrocarbon production control (e.g., Shell's exit from Sakhalin II in 2006).

Natural gas disputes 2006 - 2009

- Tensions rose after the 2004 Orange Revolution.
- Ukraine, paying \$50/tcm, faced Gazprom's demand of \$230/tcm.
- Gas was cut off on January 1, 2006, impacting European customers, but flow resumed the next day.
- Gazprom accused Ukraine of siphoning gas from transit pipelines, which Ukraine denied, resulting in a price of \$95/tcm.
- In 2007, Russia proposed a joint venture to manage Ukraine's transit system, but Ukraine blocked it by passing a law banning the privatization, sale, or lease of the system.

Natural gas disputes 2006 - 2009

- In February 2008, Gazprom claimed over \$1.5 billion in debts and briefly halved supplies.
- Naftogaz agreed to repay the debt.
- In October 2008, a memorandum was signed for Ukraine to gradually transition to market prices over three years.
- After weeks of negotiations on debt and 2009 prices, Gazprom cut off all gas supplies to Ukraine on January 1, 2009.
- Gazprom initially proposed raising the price to \$250 from \$179.5, while Ukraine offered \$201 and sought to increase transit fees.
- Gazprom then raised the price to \$458.

Natural gas disputes 2006 - 2009

- Russia accused Ukraine of stealing gas intended for Europe, and on January 7, PM Putin halted all supplies to and through Ukraine.
- For two weeks (January 7-20, 2009), 16 EU member states and Moldova faced gas shortages, with parts of the Balkans experiencing a humanitarian emergency and economic damage.
- The EU lacked infrastructure to redistribute gas (reverse pipelines), marking a wake-up call for the bloc.

Putin's era

Despite the conflicts cooperation continues.

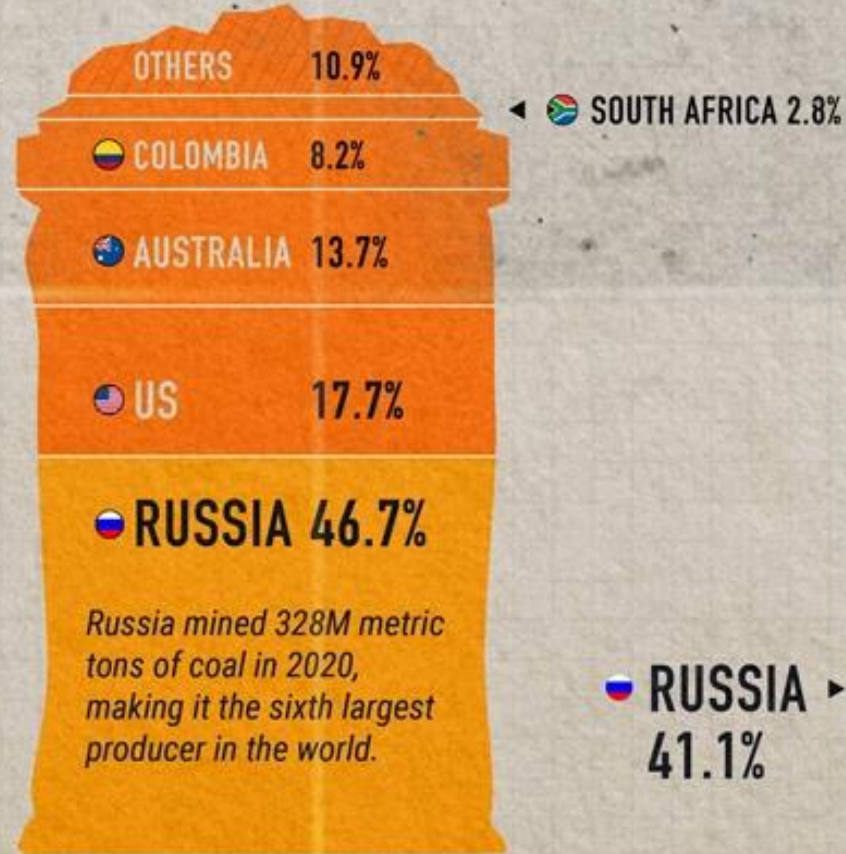
- 1997 – Yamal pipeline.
- 2001 – Blue Stream.
- 2005 – Start of Nord Stream
- Long term contracts extended.
- Gas trades stable or increasing.

EU IMPORTS

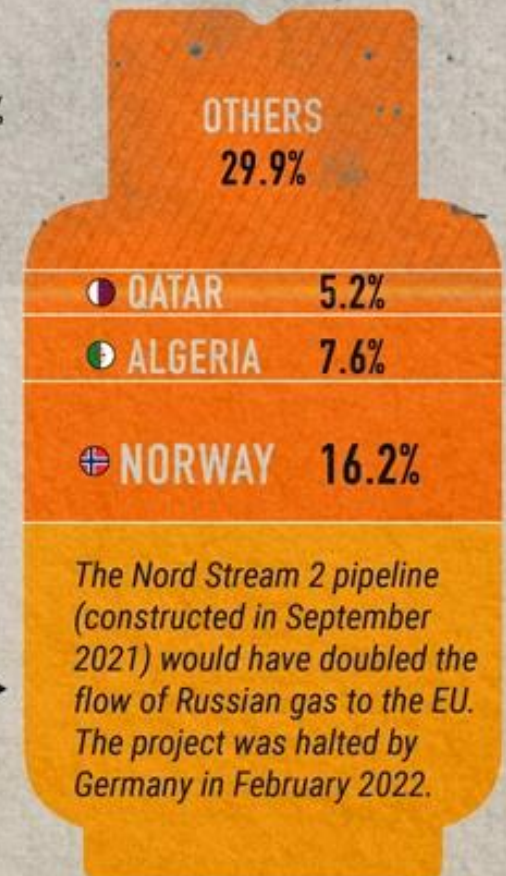
CRUDE OIL



SOLID FUEL (COAL)



NATURAL GAS



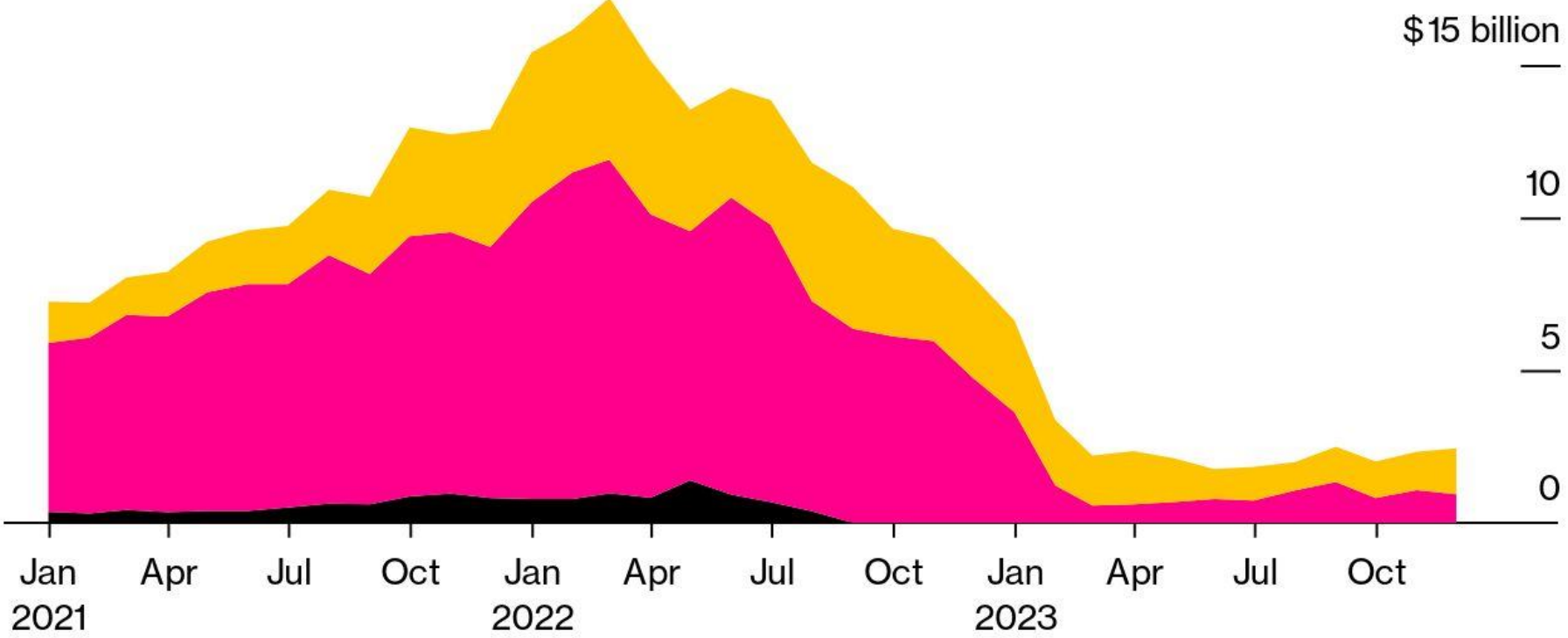
A gloomy future?

- Russia is losing its energy position, which will inevitably affect its power position in international relations.
 - Loss of European markets.
 - Global energy transition (decarbonization).

EU market is lost

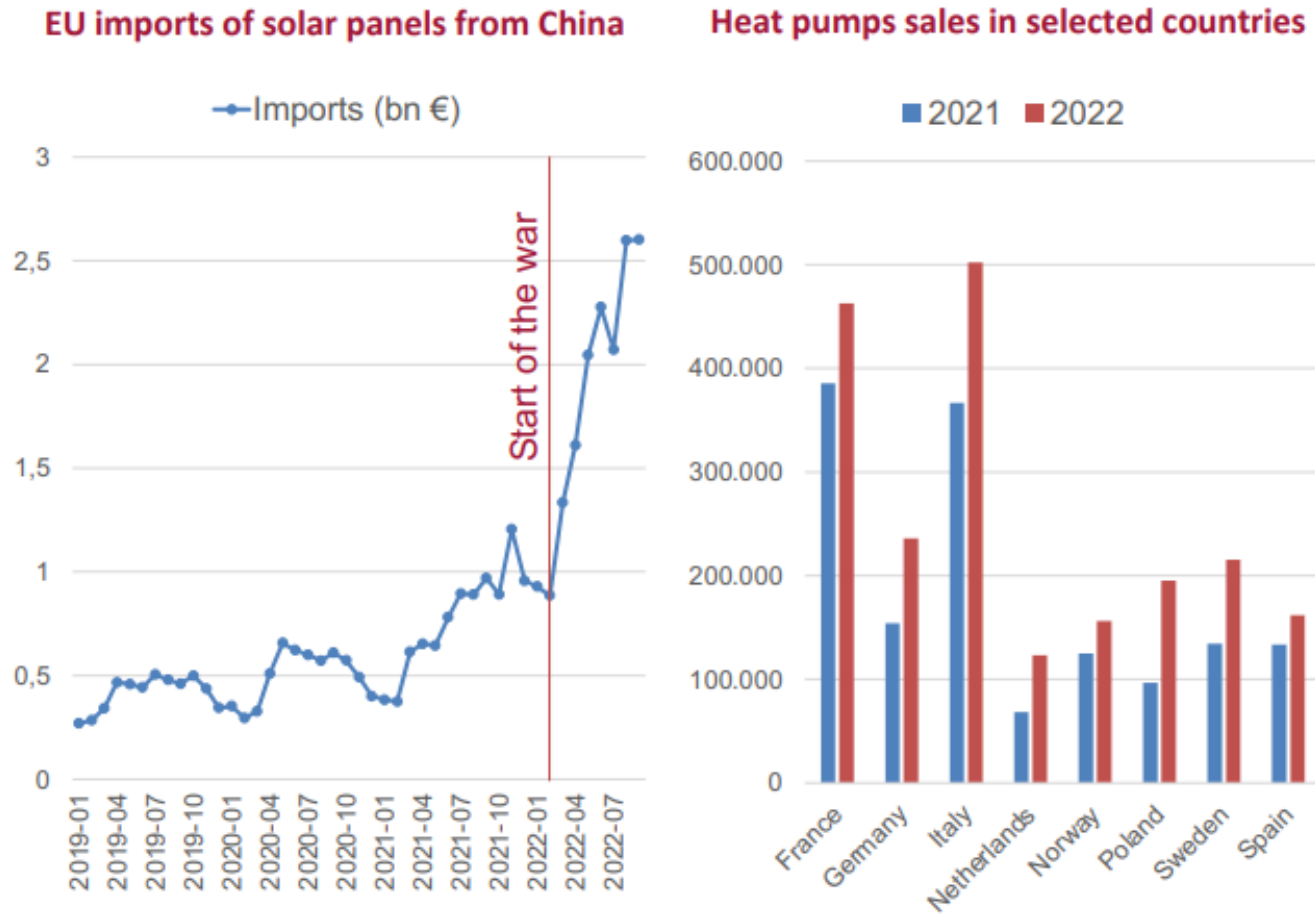
Monthly exports of Russian fossil fuels to European Union

■ Coal ■ Petroleum ■ Gas



Source: Bruegel

Energy crisis accelerated transition



Source: Bruegel

China's market and LNG

- Unlike in the EU, Russia's pipeline gas is not the cheapest option in China.
- LNG from Yamal faces supply challenges due to the Arctic Ocean route.
- Competes with Central Asian suppliers (Turkmenistan, Kazakhstan) and existing supplies from Australia, Qatar, Malaysia, Indonesia, plus competition with coal.
- New pipelines are being discussed, but progress is slow.
- Increasing role of LNG (Novatek, Leonid Mikhelson) – sent to the West during winter, to Asia in summer via the Northern Sea Route (In 2017, the first LNG tanker reached Asia).

Climate change debate and politics

- 93% of Russians acknowledge climate change. 52% describe it as a significant issue, 40% consider it overblown.
- Up to 75% of Russians are unwilling to pay more for alternative energy sources. 94% of the population supports tree planting as a solution.
- Putin presents differing positions on climate issues to domestic and international audiences.
- Russian elites and leadership strongly endorse the traditional model of fossil fuel development and export.

Crude oil

- In 2019 (pre-pandemic), Russia earned USD 188 billion from exports, accounting for 44% of all exports.
- Igor Sechin, CEO of Rosneft (responsible for 38% of Russia's oil production), holds a highly conservative outlook on global oil demand. He expects absolute demand to continue growing, especially in Asia.
- This contrasts with Western expectations that oil consumption will peak in the 2030s or 2040s.

Crude oil

- Mature fields: Mainly in West Siberia (75% of production), as well as in the Volga-Urals and Timan Pechora regions.
- New fields: Located on the periphery of established fields, including East Siberia and offshore.
- Low investment and inadequate technology due to sanctions (70% of horizontal drilling relies on foreign technologies; over 85% in fracking).
- Russian oil is competitive at around USD 25 per barrel. New fields require USD 70+ per barrel, and Arctic oil needs USD 100+.
- According to the IMF, the fiscal breakeven price for Russia in 2020 was USD 69 per barrel.
- Energy Strategy to 2035 (Ministry of Energy, 2020) predicts a peak in global oil consumption by 2030.

Natural gas

- In the 1990s, Russia's gas sector was highly developed, relatively new, and the largest in the world, supported by the world's largest gas reserves.
- Today, infrastructure is aging, with the majority of production coming from declining fields in West Siberia and Sakhalin Island.
- Since 2006, development has focused on the Yamal Peninsula.
- New fields in East Siberia are being developed to supply China.
- There is enormous, inefficient domestic consumption, with 70% of gas heavily subsidized.
- Russian pipeline gas remains the cheapest for Europe.
- Gas demand is expected to almost double by 2050.

Takeaways

- Hydrocarbons are central to Russia's political economy and national security.
- Russia views restrictions on its oil and gas markets (sanctions, climate change agenda) and nuclear industry as a major security threat. And attacks on Russian values.
- Before Ukraine's invasion, Russia's energy role was seen as a moderating force, despite using energy for political leverage. Not anymore.
- War has pushed Russia to seek alliances with China, Iran, Saudi Arabia, and African states.
- Either way, from a medium-term (war consequences) and long-term (decarbonisation) perspective, Russia's future as an (energy) superpower does not look good.

Sources

- Reuters (2009): Timeline: Gas crises between Russia and Ukraine.
- Romancov, M. (2018): Rusko v mezinárodních vztazích (Pátečníci).
- Newnham, R.(2011): Oil, carrots, and sticks: Russia's energy resources as a foreign policy tool.