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Veröffentlichungsversion / Published Version
Arbeitspapier / working paper

Zur Verfügung gestellt in Kooperation mit / provided in cooperation with:
SSG Sozialwissenschaften, USB Köln

Empfohlene Zitierung / Suggested Citation:

Rahr, A., & Meister, S. (2008). *Russian ambitions in the energy sphere and the global financial crisis*. (DGAPaktuell, 7). Berlin: Forschungsinstitut der Deutschen Gesellschaft für Auswärtige Politik e.V.. <https://nbn-resolving.org/urn:nbn:de:0168-ssoar-128988>

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Russian ambitions in the energy sphere and the global financial crisis

For the time being, the current financial crisis has halted the Russian economic boom. The government is compelled to invest \$ 100 billion for the bail-out of the banking system, money that comes from the Kremlin's foreign-currency reserves totalling \$ 600 billion. Currently, capital outflow exceeds the inflow. Having financed their acquisitions with Western money, Russian oligarchs feel the pain too, as credits, due to the liquidity crisis, are not granted anymore. The reform and modernization programme, proposed by Russian president Medvedev earlier this year seems to have been postponed. The state appears to be gaining ground again. If the global price of oil continues to fall, Moscow will not be able to implement the ambitious budget set for 2009. As yet, however, it is too early to issue an obituary to Russia's economy. Speaking at the "Russia Breakfast" on the implications of the financial crisis for Russian energy policy, Tatiana Mitrova, head of the Centre for International Energy Market Studies at the Energy Research Institute of the Russian Academy of Sciences emphasized that the current condition represents a serious test case for the Russian economic system.

According to Ms Mitrova, the closing down of international credit markets for Russian enterprises represents the greatest problem of the country's private economy. Indeed, next to the rents from the energy sector, it were foreign credits that pushed Russia's "economic miracle". Due to the financial crisis, many investment projects were decelerated or even halted – also in Russia's most sensible sphere, the energy sector. Because of a global decline in economic activity and the ensuing contraction of demand for raw materials, moreover, the price of oil dropped below \$ 70 per barrel.

The leading Russian energy companies lack the financial resources necessary for future investments and modernization projects which are profitable only with prices above \$ 100 per barrel. In this regard, Ms Mitrova reported of Gazprom's halt in building the strategic Altai pipeline to China. This decision, however, was taken because China was not willing to pay the minimum price that was necessary to render the

pipeline economically viable. The progress of other projects in the energy sphere, notably the development of the Shtokman fields in the Barents Sea and Eastern Siberia will possibly be delayed too, with respective implications for Nord-Stream. If the oil price remains low, moreover, there will be implications for the 2009 budget.

Change of Strategy at Gazprom

The financial crisis will continue to halt Gazprom's growth. In the last years, the strategy of the gas monopoly has developed in the right direction: the focus was laid on the maximization of profits, not the quantity of production. Ms Mitrova reminded the audience of the company's investment strategy, announced in April 2008: to spend less money for prestigious projects such as the acquisition of media or investments abroad, and more for the development of natural mineral deposits and the modernization of existing in-

frastructure. This decision to partially re-orient investments was prompted, among other things, by demands on the part of EU Energy Commissioner Andris Piebalgs. The credit crunch, however, will negatively impact the newly targeted investments as Gazprom and the other energy giants have a lack of own capital and only limited access to new credits. In the foreseeable future, therefore, the Russian energy companies will have to pay particular attention to their expenses. Therefore, rather than investing into the development of new fields, emphasis will be laid on the modernization of existing infrastructure. Such a step may be a first warning signal to the West, heralding the potential for shortness of supplies in the future.

Liberalization of the Russian Energy Market

Gazprom has been trying to push through higher gas prices on the Russian market for years. Tellingly, it was only in 2007 that the company realized a profit in its domestic market where it sells two thirds of its products. The Russian government feared social protests on the part of the population, thus far therefore, only the domestic industry was affected by the price hike. However, a gradual price increase for the population is inevitable. The liberalization of the Russian energy market is completed in the realms of hydrocarbon, coal, and energy supply. The nuclear energy sector will stay free of privatization, due to the evident danger potential. The monopoly of Gazprom represents a considerable challenge to gas market liberalization. For now, the state continues to determine the gas prices. With 0,1 per cent market share, renewable energy plays a negligible role in Russia. In this sector, there is a lack of incentives and investors: the prices for conventional energy sources are too low; therefore, the enormous investments are not economically viable. In the realm of energy efficiency there is also considerable development potential which, however, cannot be realized due to the lack in expertise and governmental subsidies policy. The existing ownership structures and financing possibilities hinder investments in this sphere.

European Energy Policy

In the past years, Russia's relationship with the European Union, Moscow's most important export market for energy products, did not develop well. According to Mitrova, the liberalization policy of the European Commission has played an impeding role in regard of investment projects. Russian energy companies receive credits that go into investments on the basis of concluded long-term contracts. Thus European countries, with Germany amongst them, have supply agreements for up to 35 years with Gazprom. According to the European Commission, such long-term contracts distort free markets; therefore, flexibility is demanded. However, it is precisely the long-term contracts that give Russia the security of demand which is indispensable for planning, and, consequently, indispensable to secure supply. Ms Mitrova is convinced: the Commission questions the Russian business model and will continue to encounter considerable resistance in the realm of juridification of structures in Russia.

Gazprom is just as critical in respect of the Commission's de-coupling policy which, so Mitrova, does complicate the cooperation for the Nord and South Stream pipelines. Here, Russia criticizes the European Energy Charter and, in particular, the transit protocol. As for the latter, Russian energy companies fear that, if agreed upon, it would enable the Central Asian states, among others, to send their hydrocarbons through the Russian pipeline system without having to make special arrangements with Moscow. In other words, the Russian pipeline monopoly would be dampened. The last factor that frustrates investments into the Russian energy sector is, according to Mitrova, the country's new foreign investment law which only allows for minority foreign participation in those economic sectors dubbed 'strategic'. This appears particularly problematic considering that the Russian government has made attempts to appropriate strategic natural mineral deposits through the use of political pressure. Consequently, foreign investments flow out the country.

Nabucco

Since the war in Georgia, the political will of EU countries to build a gas pipeline that bypasses the Russian pipeline system has increased. One particularly positive piece of information for the Europeans is the assessment given by an independent British company regarding the reserves of the Turkmen Yolotan and Yashlar fields. According to the experts, these fields are among the largest in the world and could easily fill the Sino-Turkmen pipeline that is currently in construction as well as a (potential) European one. Not surprisingly, the upcoming visit by Turkmen president Gurbanguly Berdymuhammedov to Germany, Brussels, and the US is expected with excitement.

Oil and Gas OPEC

The visit by Russian deputy Prime Minister Igor Sechin to an OPEC summit in this year's early September aroused pronounced attention. According to Ms Mitrova, thus far, Russia fared well without the OPEC, taking advantage of the latter's pricing policy without having to succumb to its quota. However, as quotas appear to be losing their impact on the price of crude and the fundamentals for price creation cease to be clear, Russia, in preparation for energy crises, seeks rapprochement with OPEC. Should the oil prices drop to an alarming level, Russia is likely to act in accord with the other core oil exporting countries. The idea of a gas-OPEC is similar and could potentially be agreed upon by Russia, Iran, and Qatar in mid-November 2008. Thus, Russia would have strengthened

its position as an energy supplier vis-à-vis the energy-importing countries.

Chance for Cooperation

Against the background of the financial crisis and the mutual dependence in the realm of energy, one would expect a more pragmatic approach to cooperation on the part of Russia and the EU. De-politicization of energy relations as well as a more realistic assessment of the potential strategic partnership are needed if the upcoming negotiations on the Partnership and Cooperation Agreement (PCA) between both entities are to be successful. As for other CIS countries, the financial crisis has hurt the resource poor ones such as Belarus, Ukraine, and Georgia, in particular. The World Bank and the IMF have promised some credit injections, Belarus will borrow money from these institutions as well as Moscow. The financial crisis has uncovered the extent of global inter-linkage and weakness of most states, among them Russia, and requires collective solutions. The US and EU have agreed upon a series of collective summits and consultations to be held in the next weeks. They would be well advised to include Russia, a member of the G8, into these processes, too.

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Russia's Energy Strategy and the European
Energy Security
Russia Breakfast
14 October 2008, 8.30–10.00