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**Relations between Russia and Europe  
from the Perspective of Energy Strategy**

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## Foreword

Energy supply is not a new strategic challenge. Spreading industrial growth has triggered a high rise in energy consumption, which has been particularly disproportionately high in countries with extreme growth rates but low production efficiency per capita. This development has contributed to further destabilize the sensitive balance of demand and supply between highly industrialized but resource-poor recipient countries and the resource-rich supplier countries on which they depend. Russia, being one of the lucky resource riches, is – at first glance – in the comfortable position of being able to direct the market and choose clients ready and able to pay what Russia wants. The global “great energy game” may have helped Russia’s new *nomenklatura* to leave behind the Yeltsin years of economic despair. Putin’s entourage has self-awarely rediscovered geopolitics, based on oil/gas give and take – and the Ukraine, Georgia and even faithful Belarus were the first to learn about this new Russian approach to its neighbourhood. The European Union was indirectly affected because Russia’s blackmail of her neighbours also resulted in minor austerities in the energy supply to Western Europe. For the first time the EU became aware of possible negative consequences of her 30 percent dependence on Russian supplies. Russia has promised not to attempt supply gambles with the West. But will Russia stick to its promises, if it turns to different strategic priorities? Both the EU and Russia have to reconsider the premises of their relations in order to find a reliable basis for long-term cooperation. Interestingly, with Cheng Jian an author takes a look at the issue, who has an outside perspective, but who comes from a country that is as extremely interested in close energy relations with Russia as in stable economic relations with Western Europe. The strategic relation between Russia and the European Union, therefore, is also of strategic interest for China. Dr Cheng Jian was a visiting research fellow to the Institute of Peace Research and Security Policy at the University of Hamburg (IFSH) in 2007. Dr Cheng is Professor at the Center for European Studies at the East China Normal University in Shanghai (ECNU). His fellowship was made possible by a generous grant from the European Union and is a part of the bilateral cooperation between the IFSH and the ECNU. His paper summarizes the results of six months of research in Hamburg.

Hans J. Giessmann



After the Cold War, Russia and the EU made great improvements in their economic ties and political contacts. However, differences in ideology, geopolitics and so forth still exist, making the relationship between Russia and Europe more and more complex and changeable. On the one hand, the Western world maintains a policy of containment toward Russia. Moreover, NATO and the Dual Eastern Expansion of the EU impose direct pressure on Russia's traditional sphere of strategic influence. On the other hand, Russia is recovering from the ruins of the disintegration of the Soviet Union and actively engaging in military and energy diplomacy, trying to return to great power status by way of its own asymmetric advantages in resources. Because of this resource strategy, energy plays an indispensable role for the evolution process of bilateral relations.

## 1. EU's Energy Strategies toward Russia

Since the beginning of the industrial era most European countries have comprised a majority of the world's energy consumers. But their energy self-sufficiency rate has shown a trend of yearly decrease. According to statistics, in 2005 the EU depended on foreign trade for nearly 80% of its oil, and 45% and 47% for natural gas and coal respectively. With the gradually declining production in North Sea oil and gas and the addition of ten Central and Eastern European countries the EU's energy self-sufficiency rate declined further, to around 50%, along with an increasing degree of dependence on foreign trade. If there is no big change in the energy resources structure, the EU's energy self-sufficiency rate is estimated to drop to 30% by 2030.<sup>1</sup>

Due to the lack of indigenous energy EU countries have to resort to global energy markets, trying to protect their energy security through energy cooperation with the Middle East, Norway, Russia and the Central Asian region, as well as the African countries.

### 1.1 The Common Energy Strategy of the EU

The European common energy policy started in 1986. In the same year, the EC approved an energy policy which laid the legal foundation for the modern European energy policy and also identified goals to be reached by the mid-1990s. In December 1995, the European Commission approved the "White Paper: An Energy Policy for the European Union", which described the main goals of the EU's energy policy. These key objectives were limited to "the completion of internal market building, the protection of energy supply and security based on competition, and the improvement of the ecological nature of energy."<sup>2</sup> In 2000, the EU initially approved a new green paper on energy strategy which emphasized the necessity of ensuring the energy supply from external sources. In 2006 the green paper "A European Strategy for Sustainable, Competitive and Secure Energy" established three core objectives for the EU's future common energy policy: to ensure sustainable economic development, energy industries' competitiveness (disputes exist in the open market), and a secure supply of energy to the EU. The above-mentioned policies comprise the foundation for the EU's energy policy and have become a guide for the EU's common energy diplomacy.

The EU's collective energy security is related to its increasing trend of dependence on imported energy. The European Commission declared that

The European Union [has] structural weaknesses regarding energy supply, namely Europe's growing dependence on energy, the role of oil as the governing factor in the price of energy and the disappointing results of policies to control consumption. Without an active energy policy, the European Union will not be able to free itself from its increasing energy dependence.... Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence, but aims to reduce the risks linked to such dependence. Among the objectives to be pursued are those balancing between and diversifying the various sources of supply (by product and by geographical region).<sup>3</sup>

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1 China Petrochemical Newspaper, "EU's Multiple Diplomatic Solution to Energy Worries", 29 September 2006.

2 European Commission, "White Paper : An Energy Policy for the European Union," COM(95) 682, December 1995

3 European Commission, "Green Paper – Towards a European strategy for the security of energy supply," COM(2000) 769, November 2000, p. 2.

In its energy policies the EU has always stressed the development of political and economic cooperation with energy supplier countries and the signing of relevant bilateral and multilateral agreements. In addition, the EU emphasizes developing and implementing long-term cooperation frameworks with the key countries concerning the EU's energy interests, strengthening the EU's common diplomatic and external economic policy in the area of energy, and establishing and perfecting the relevant mechanisms. Still, the countries participating in the development of trans-European energy infrastructure are not only EU countries. These non-EU countries are able to dominate this infrastructure because they control sections of the energy supply lines into the Union. Therefore, the EU also places high weight on consolidating relations with these countries.

Due to the constantly increasing prices of international energy products, in order to ensure the EU's energy security European energy policy makers have attached great importance to the study of the feasibility of changes in energy supply, i.e. whether the EU countries could replace the current external supply sources with internal energy sources by using new energy-saving technologies and increasing the production of alternative energy.

Ensuring the operation of the internal market is directly relevant to the development and perfection of the entire EU internal energy market. The governments of EU member-states have to consider their common interests and development of the EU internal energy market. At the same time, they may make independent decisions regarding national energy priorities policy on different levels. In view of the conflicts between the energy policies of some of the EU members and their possible negative impact on the common interests and goals of the EU, Brussels stresses the important role of the leading institutions in the prevention of these adverse effects. A primary goal is making the policies of each country more consistent with those of the EU and gradually achieving policy integration. All of the EU's institutions are involved in the process of resolution-making in the field of energy, but the party that plays the main role is the European Commission, which is directly responsible for the development of common energy policies. The Commission is directing the drive toward policy coordination and eventual integration.

The EU has developed comprehensive external policies and external economic measures. It has established cooperation frameworks with many countries in the field of energy and keeps in regular contact with these countries to maintain a continuous dialogue. Taking energy security interests into account, the EU attaches great importance to the implementation of institutional agreements it initiated and developed in order to resolve the energy transit issues for the energy supply to the EU market. The "European Energy Charter," launched in 1991 and later renamed the "Energy Charter," is the best embodiment of this idea. The Charter developed a series of principles in the fields of energy trade, transit shipment and investment, aiming at strengthening the energy cooperation between Russia and Eastern Europe. Currently, 51 countries have signed the "Energy Charter." China and the USA have become Charter observers. The EU has been promoting the Energy Charter as a legal framework for regional energy market building, with coverage to the Caspian Sea in the east, Norway in the north, and the large areas of the Mediterranean Sea and Middle East in the south. The Charter has become a bridge that links energy relation between the East and the West.

In addition, the EU signed the "Energy Community Treaty" with Albania, Croatia and other South-east European countries in October 2005 in order to promote the liberalization and opening up of the national energy markets in these countries as well as to expand the unified EU energy market to these neighboring countries. The EU is pleased to see that Norway, as a major energy supplier, and Turkey and Ukraine as energy transit countries, are also preparing to join the treaty.

## **1.2 Energy Exchanges between Europe and Russia**

As seen above, the EU attaches importance to developing bilateral relations with major oil producing countries in different regions. In addition to the traditional energy-producing areas of the Middle East and North Sea regions, the EU is also actively developing relations with Russia and other emerging energy exporting countries in Central Asia, with Iran and Libya, and with a number of North African countries. The EU also engages in dialogues with the Organization of Petroleum Exporting Countries (OPEC) in an attempt to make joint-action agreements in order to lower oil prices and maintain the stability of the oil market.



Of all of these countries, historical, geopolitical and economic complementarities make it an EU priority to develop energy trade relations with Russia. In fact, as early as the 1970s the Soviet Union launched large-scale natural gas contracts with Germany, France, Italy, Austria and other important European countries. These compensation agreements played a significant role in the promotion of the gas trade between the Soviet Union and Western Europe. Western European countries first provided pipeline and compression equipment, which the Soviet natural then compensated with gas. The energy trade between the Soviet Union and the Western European countries had largely made up the shortage of funds and equipment for the Soviet Union in developing and transporting natural gas, promoted the exploration of natural gas resources, and the development of the gas industry. Using funds and equipment from the Western European countries, the Soviet Union built three gas pipelines to Western Europe and an integrated enterprise for gas extraction and processing, which played an important role in the development of the natural gas industry and the expansion of natural gas production and transportation capacities. In addition, the expanding energy trade also increased the Western countries' economic dependence on the Soviet Union, which later generated many contradictions and differences between Europe and the United States on some major issues relating to policy toward the Soviet Union. An obvious example is the push to impose economic sanctions against the Soviet Union in the 1980s, led by the United States. Due to close economic relations with and energy dependence on the Soviet Union, a significant number of Western European countries were not brave enough to seriously support the implementation of the economic sanctions. After this incident some western scholars began to worry that the Soviet Union's energy might "weaken the unity on political, economic and military issues for the United States and its allies, which may lead to 'the splitting of NATO'"<sup>4</sup> After the independence of Russia and the EU enlargement, EU member-states' dependence on Russian energy has been greatly strengthened (For data on the EU's energy dependence on foreign trade please see the table below).

*The Table of EU's Sources of Oil Import in 2004 and Their Respective Proportions<sup>5</sup>*

Oil		Gas	
Origins	Percentages	Origins	Percentages
Russia	26	Russia	29
EU member states	18	EU member states	37
Middle East	16	Norway	17
Norway	13	Algeria	13
America	8	Nigeria	1
Africa	6	Qatar	1
Other CISs	3	Others	2
Others	10		
Total	100	Total	100

According to the data in the "Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy," issued by the EU in March 2006, the 25 EU member countries had an oil consumption of about 650 million tons in 2005. The EU itself produced about 130 million tons, or about one-fifth of its consumption. The oil that the EU imported from Russia accounted for 30% of the total. The natural gas consumption of the EU was about 515 billion cubic meters, of which the EU member-states Britain, the Netherlands, Germany, Italy and Denmark provided 46%, and Russia 25%. The remaining part was from Norway, North Africa and the Middle East.<sup>6</sup>

The British BP oil company entered the Russian oil market as early as 1998, taking over 25% of the shares of the Russian Sidanco Oil Company at the expense of 500 million US dollars. On 11 February 2003, the BP signed agreements with Russia's two industrial holding companies: "Alpha"

4 Alexander Taylor, "A Soviet Pipeline to the West," *Time Magazine*, 16 February 1981.

5 Tian Fan, "EU seeks for energy security by integration," *China Petrochemical News*, 24 February 2005.

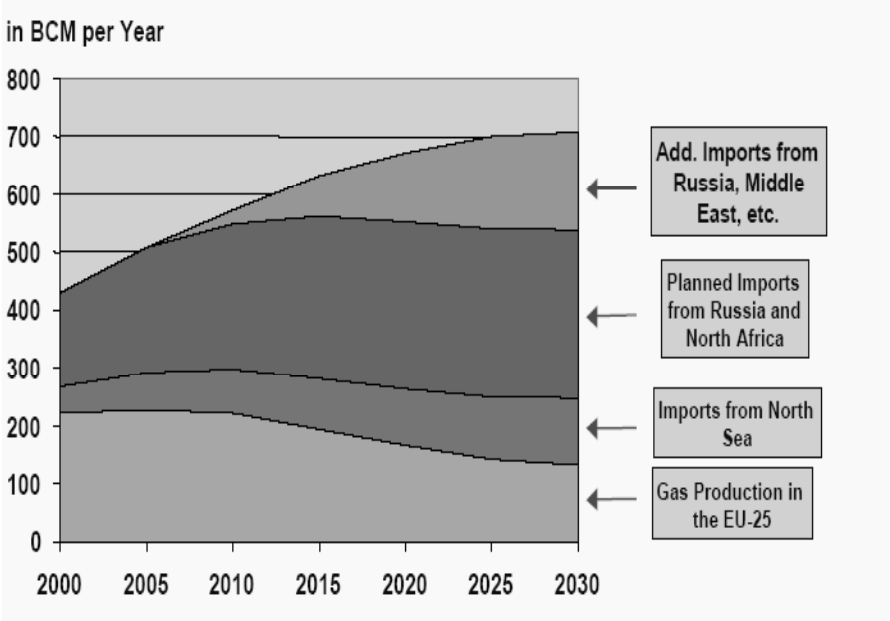
6 European Commission, "Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy," COM(2006) 105, March 2006.

Group and Access / Renova. According to these agreements, BP would pay 6.75 billion US dollars to the two companies, thus forming Russia's third-largest oil company. BP's ownership of 50% of the shares of this new company created the largest overseas equity investment project in Russia history. In addition, many large Russian oil and gas companies have already issued a large number of energy bonds in Europe, aiming at attracting foreign investment and building gas stations in Europe to ensure the stability of the European downstream (demand) market.

Since the 1990s the EU, as the world's largest importer of energy, is in increasing demand for energy. The European Commission estimates that the EU's energy consumption will show steady growth at an average annual rate of 0.4% until 2030. Currently, 50% of the EU's energy supply is imported; oil imports from the Middle East account for 36% of the total. By 2030 the proportion of the EU energy imports is expected to rise to 70%, with 90% reliance on oil imports and 70% on natural gas imports<sup>7</sup>. However, the oil and gas reserves in current supplier areas are increasingly unable to meet the EU's growing demand for energy. In order to guarantee the region's energy security and sustainable economic development, the EU needs to find a long-term, stable and reliable energy supplier. Furthermore, the unstable political situation in the Middle East casts a shadow over the region's oil and gas supply, especially after the United States' control over Iraq. The US shows clear signs of holding control of oil exports in the Middle East, which brings a lot of risks for the EU in terms of importing oil from the Middle East. A diversification of energy imports may be an important measure to prevent the possible emergence of oil hegemony. Russia, which has an abundance of energy and whose energy production accounts for nearly 13% of the world's total output, has naturally become one of the major alternatives for the EU's energy imports. The EU has an urgent need to strengthen EU-Russian energy cooperation in order to ensure its energy supply security before 2030.

As for natural gas supply, most EU countries rely on imports, with the exception of Denmark and the United Kingdom. 100% of Belgium, Finland, Greece, Luxembourg Portugal, Spain and Sweden's natural gas is imported. The European Commission estimates that the EU's demand for natural gas imports will mount to 198 million tons by 2010 and 431 million tons by 2020, or 53% and 68% of the EU's total demand for natural gas respectively. According to signed agreements, by 2020 the EU's gas imports from Russia will reach 38%, Norway 34% and Algeria 23%. It can thus be said that the EU's energy dependence on Russia will be continually strengthened.

*The Table of Natural Gas Import Trend of the EU's 27 Members<sup>8</sup>*



7 "Energy dependence is not a one-way street," *Le Figaro*, 28 May 2002.

8 Jeff Piper, "Towards an EU-Russia Energy Partnership", *The EU-Russia Dialogue*, [www.iea.org/textbase/work/2003/soyuzgaz/proceedings/Piper\\_slides.pdf](http://www.iea.org/textbase/work/2003/soyuzgaz/proceedings/Piper_slides.pdf) [25 January 2008].

Accordingly, in 2000 the leaders of the EU, France, Germany and Britain launched an energy dialogue with Russia. In late September of 2000, the European Commission proposed an initiative to further develop and expand cooperation with Russia in the field of energy. The initiative was named after the President of the European Commission, Romano Prodi and called “the Prodi Plan.” From October to November 2000, through contacts at different levels, the EU and Russia identified five major tasks:

- First, actively promote dialogues between energy production and consumption countries by the use of Russian’s ties with OPEC, and discuss the stability and balanced development of the world oil market at the beginning of the 21st century.
- Second, study the issue of expanding Russia’s oil exports to the EU nations.
- Third, study the possibility of doubling Russia’s natural gas exports to the EU nations.
- Fourth, begin EU participation in the development of infrastructure in the CIS, including importing oil through the pipelines of the newly independent countries in order to facilitate energy imports from Russia.
- Fifth, expand the scale of the EU’s investment and technical support in Russia in order to promote the implementation of specific energy plans in Russia.

At the Russian-EU Summit (Paris, 30 October 2000), the energy dialogue was supported. In a joint statement after the summit, it was announced that “the Russian Federation and the EU have decided to begin regular dialogue in the energy field to promote the establishment of a partnership between Russian Federation and the EU...in the energy field. The dialogue will also study all the concerned issues in this field, including energy conservation, production and the rationalization of transport infrastructure, as well as the possibility of investing in Europe and developing cooperation between the energy-producing and consuming countries.”<sup>9</sup>

In March 2001, Russia and Europe established four thematic working groups based on the energy dialogue. These groups focus on energy policy, the transfer of technology, energy infrastructure, investment and energy conservation, and environmental protection issues. Thus far the “Russia and Europe Energy Dialogue” has published seven comprehensive energy reports, which reached a series of agreements on projects to establish and expand Russian gas and oil pipelines; optimize related laws on energy investment, production and transportation in the Russian Federation; build energy technology centers; improve efficiency in the use of energy and conduct energy saving tests; and establish joint Russian-European energy reserves and a common market. During these dialogues, at the London Summit in October 2005, Russia and the EU confirmed the Nordic gas pipeline project. In the latest energy dialogue progress report, published in November 2007, it was stressed that Russia and Europe would further promote bilateral exchange of information, coordination of energy policy, share potential economic risks possibly caused by new oil and gas field development and construction of pipelines, and further reduce energy trade barriers in order to eventually promote “mutual” energy security for Russia and the EU.

The EU has signed a trade agreement and a Partnership and Cooperation agreement with Russia. Articles 65 and 66 of the Partnership and Cooperation Agreement set out a fairly broad framework of energy cooperation, including the development of a common energy policy. It must be pointed out that both Russia and the EU have appealed for the development of special bilateral agreements at different levels on energy cooperation based on related provisions of the Partnership and Cooperation Agreement. The two sides also proposed to establish a common institution that coordinates bilateral energy cooperation; as both Russia and Europe believe that this proposal is reasonable, we may see such an institution established in the relatively near future.

A further EU priority is to improve bilateral relations with some other CIS countries such as Kazakhstan, Azerbaijan and Turkmenistan, as well as Ukraine, Belarus, Moldova and Georgia, because for the EU, these countries are transit countries for energy transportation.

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9 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 135.

### 1.3 The EU's Predicament toward Russia's Energy Policy

Russia possesses the world's largest natural gas reserves and is both an energy producer and a transit country. It has a model of democracy and national framework similar to Europe's. These factors, combined with the established methods of natural gas trade since the Soviet Union era and the realities of the gas pipeline and distribution systems construction have laid a solid foundation for Europe-Russia energy cooperation. For this reason the EU once considered Russia as a "reliable energy partner" even under turbulent circumstances in the Middle East.

Regarding the energy cooperation between Russia and the CIS countries, the EU's main economic interests concentrate on accessing the raw materials base, participating in energy development and delivering energy to the EU market in a safe and reliable manner. This not only connects with the EU's strategy of expanding external sources of energy supply, but also is related to the reduction of dependence on the energy supply from Persian Gulf countries, as well as the strategies of promoting diversified external energy sources. In the long run, the development of this kind of cooperation between Russia and the CIS countries will strengthen the political stability of the Eurasian space and also conform to the long-term interests of the Europeans.

However, the EU has encountered great difficulties in the formulation and implementation of energy policy, especially toward Russia:

On the one hand, the EU countries are Russia's traditional market for energy exports; they are also the providers of Russia's energy equipment and technology. In addition, the EU has substantial financial resources necessary for the modernization of the Russian energy industry. To some extent, energy has become the most realistic and most direct carrier of interests connecting Europe and Russia.

On the other hand, the EU countries express grievances about the totalitarian practices implemented since Putin took office, constant worries over Russia's great-power chauvinism, and serious doubts about the Russian government's practices in expanding its strategic space by the use of energy diplomacy. EU member-states also worry about Russia's willingness to cut off oil and gas lines to deter neighboring countries. For historical and geopolitical reasons many new EU members, especially Poland and Estonia, maintain a vigilant and even hateful mentality towards Russia. They see Russia's actions as a "Russian threat".

Since the founding of the EU, the Europe-Russia relation has experienced a transition from moderate to cold; its watershed was the outbreak of the Iraq war in 2003. Before that, the EU's policies toward Russia were mainly based on "Cooperation + Vigilance." These policies aimed at cultivating Russia's sense of identity and connection with European polices, in the hope that through economic aid and political dialogues Russia could be integrated into Europe within 10 years. But after the outbreak of the Iraq war in 2003, different attitudes towards the war the EU divided Europe into "old" and "new" camps,<sup>10</sup> and presented the threat of severe internal discord. The new EU members were suspicious of Russia, which affected the overall Russia-Europe relation. In the same year, after the parliamentary election in Russia and the consolidation of the strong state system of presidential control, Russia's political ideas of "controllable democracy"<sup>11</sup> conflicted with the concepts of freedom and democracy promoted by the EU. In addition, Europe and Russia were both engaged in heated confrontation over the "Yukos Event" of 2003, in which the Kremlin attempted to take control of the large and relatively independent Yukos oil company. Because of these events, the EU's policy toward Russia was converted into "Engagement & Containment," and the majority of EU countries think that Russia needs more time to integrate into Europe.

The EU has the following concerns in terms of the risks of depending on Russia's energy:

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10 Secretary Rumsfeld Briefs at the Foreign Press Centre, 22 January 2003, [http://www.defenselink.mil/transcripts/2003/t01232003\\_t0122sdfpc.html](http://www.defenselink.mil/transcripts/2003/t01232003_t0122sdfpc.html) [14 January 2008].

11 The "controllable democracy" refers to ending political chaos and achieving the unity and free-flowing of decrees by the application of a mandatory or quasi-mandatory means; establishing national political system centering on the power of the President at the expense of weakening democratic system and the implementation of power expansion, its essence is to end social chaos caused by radical changes by strengthening state power to achieve national prosperity and development.

First, the EU is worried that Russia might use energy as a “geopolitical weapon” to achieve its foreign policy objectives. European countries always have a fear that one day energy dependence will turn into political dependence, thereby affecting the EU’s geopolitical security. Therefore, in view of the EU’s high dependence on Russia energy and the political uncertainty in Russia, the possibility of Russia’s using energy resources as political tools has recently become a hot topic among European strategists. Some European analysts have argued that “if a change occurs in Russia’s internal political situation Russia may use energy as an effective diplomatic and security policy tool, because Russia’s energy policy is different from that of the EU, which pursues economic interests. It is largely affected by geopolitical and security policy considerations”<sup>12</sup>.

In recent years there have been appeals for the “re-nationalization of natural resources” in Russia. The Putin government has increased its control of GAZPROM and the Russian state-owned oil and gas company ROSNEFT, as well as its control of almost all the pipeline facilities in the former Soviet Union regions. This conflicts with EU policies that appeal for free competition in the energy market to ensure diversified energies and stable energy supply. Therefore, the EU has tried to put pressure on Russia, calling on Russia to join the Energy Charter Treaty. The treaty would allow a third country to use pipeline facilities in Russian territory and speed up the liberalization of Russia’s domestic energy enterprises in order to reduce GAZPROM’s control over gas exports. However, thus far Russia has refused to accede to the treaty.

Secondly, the EU is worried that Russia’s energy cannot meet EU expectations in terms of production, mining and supply capacity. Due to aging equipment and other reasons, Russia has a very low efficiency level. For example, the amount of oil used in creating a certain GDP is 2.5 to 5 times higher than in the developed countries. Russia has great domestic demand for oil. Exported oil accounts for only 50% of its oil production, while export of natural gas accounts for only 30%. According to estimates by the USA, during the period 2000-2020, Russia will need about 140 billion US dollars only to maintain basic operation of its production system. About 14% of the 15,490 km gas pipeline network is overdue for replacement, and 80% were in urgent need of maintenance.<sup>13</sup> According to an estimate from “Russia’s Energy Strategies before 2020,” by 2020 Russia will need about 480-600 billion US dollars in investment to support its entire energy economy.<sup>14</sup>

Third, the EU has concerns about Russia’s current investment environment. Although Europe and Russia have developed a “European Energy Priority Report,” which appeals for strengthened cooperation in the energy field and the assurance of foreign investment in Russia, European investors lack confidence in Russian investments due to Russia’s long delay in approving the European Energy Charter Treaty, which includes a commitment to improve the investment environment and comply with the rules of the market economy. Other Russian actions have exacerbated this lack of trust. For example, Moscow is investigating several major oil companies because of supposed violations of permit and environmental regulations. Analysts believe this is an attempt to rewrite the agreements reached in the 1990s and to increase Russia’s shares in the energy projects. The project led by Shell on Sakhalin Island, worth 22 billion dollars, is now closed because Russia is worried about ecological destruction, and is also facing the risk of losing its operation license. BP’s multi-billion dollar project is facing a similar fate. The British Risk Control Group claimed that the Russian government’s control of oil production has increased from 10% in 2004 to 30% in 2006. The Russian government has introduced a draft paper entitled “Foreign investment is of strategic significance for national security: Control measures on Russian enterprises” and is ready to prevent foreign investors from having access to key sectors including the aerospace industry, railways, nuclear energy, mineral exploitation, war material production, and other important industries and in-

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12 Antje Noetzold, *Die Europaeische Strategie zur Energieversorgungssicherheit*, (Brussels: European Office of the Konrad-Adenauer-Stiftung, Apr 2005).

13 Sun Xiaoqing, “The Energy Factors in current EU Relations with Russia”, *Contemporary International Relations* vol. 16 no. 2, February 2006.

14 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 73.

dustrial sectors. Moscow claims that foreign investors must declare the controlling interests in purchases of strategic enterprises, and the state has the power of veto over the transaction.<sup>15</sup>

Fourth, the EU's energy diplomacy toward Russia has also showed obvious political limitations. It has dual characteristics: economic interest dictates pragmatism, but the EU also hopes to maintain the "European" approach and prompt Russia to accept European values. However, the answers to the question of how the EU should position itself in dealing with its strategic partnership with Russia, energy diplomacy toward Russia and its overall diplomatic goals are very vague. Thus, in handling relations with Russia, the EU seems unable to decide whether to stay in a pragmatic relationship that focuses on interests or have a strategic partnership that involves long-term, mutual economic and political trust and benefit, including the prospect of integration.

The EU's energy diplomacy toward Russia, including energy dialogue and the G8 summit, plays a positive role in ensuring Russia's energy supply to the EU. However, because the EU excluded Russia from the Dual Eastern Expansion of NATO and the EU Russia was rather disappointed at the EU's policies because no real commitment had been made. Russia felt compelled to take a "road of Russian characteristics." The EU is now very worried that this road is the "old approach of traditional power politics and equilibrium policy," and that Russia may become a "volatile partner."<sup>16</sup> Given such contradictions, the EU's energy diplomacy toward Russia wavers between two options: one is to consider Russia as an ally of pragmatic interests, and the other is to see Russia as a geo-economic and political strategic partner despite some disappointed expectations. This uncertainty of positioning will in turn influence Russia's policies, urging Russia to pay more attention to its own "national interests" and economic security and to abandon a long-term conception of Europe-Russia relations.

Finally, it needs to be emphasized that how the EU handles relations with its new neighbors -- the Commonwealth of Independent States and states in Central Asia -- also directly affects the EU's energy supply security. After the Dual Eastern Expansion of NATO and the EU, a power vacuum showed up in Europe-Russia and Europe-Asia geopolitical relations. The EU is trying to occupy this vacuum, while European policies continue to have impact on the process of democratization in Russia. Russia, which is being squeezed in its traditional geopolitical space, is indicating a sense of insecurity, particularly since the outbreak of the "Color Revolution" in the CIS countries. Such sense of insecurity has generated more strongly anti-Western tides in Russia. However, if EU member states have felt that democracy-exporting to Russia is blocked, that Russia's future is unknown, or that it is unclear how to deal with Russia in the future, they have never reflected on how the dual nature of the EU's policy toward Russia has played its part in this issue.<sup>17</sup>

In fact, although Russia paid a heavy price in pursuit of Westernization, regardless of its national situation during the early 1990s, it is still defined as a neither-East-nor -West geopolitical "otherness." From this perspective, the current European energy strategy analysts should reflect on Europe's own policy shortcomings and study what prompted Russia to change rather than simply accusing Russia of using its "energy diplomacy" to construct an empire. In terms of the energy demand, the EU countries' energy dependence on Russia can be roughly divided into three categories: the first category covers the countries that have more than 50% energy dependence on Russia and includes the three Baltic states, the Czech Republic, Slovakia, Hungary and other countries in Central and Eastern Europe. Of these countries, the natural gas imports of Estonia, Finland, Latvia and Lithuania rely 100% on Russia. Russia's natural gas accounts for nearly 80% of Czech and Greek total domestic natural gas demand. More than 2/3 of Turkey, Austria and Hungary's natural supply relies on Russia. The second category covers the countries that have more than 10% energy dependence on Russia, including Germany, France, Italy, Poland, etc. Among them, Russia's natural gas exports to Germany and Poland account for 40% of their total demand. One-fourth of Italy

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15 "Report by Minister of Industry and Energy Viktor Khristenko at a Meeting of the Government of the Russian Federation", 31 January 2007, <http://www.minprom.gov.ru/eng/appearance/38> [25 January 2008].

16 Katrin Bastian and Roland Goetz, *Deutsch-russische Beziehungen im europaischen Kontext*, SWP-Discussion Paper (Berlin: Stiftung Wissenschaft und Politik, March 2005), p. 8-10.

17 Katrin Bastian and Roland Goetz, *Deutsch-russische Beziehungen im europaischen Kontext*, SWP-Discussion Paper (Berlin: Stiftung Wissenschaft und Politik, March 2005).

and France's natural gas imports rely on Russia. The third category covers the countries that have less than 10% energy dependence on Russia, such as Norway, Denmark, Spain, Britain and other countries.

The EU countries have totally different political attitudes towards Russia – which, for historical and political reasons, do not always accord with their respective energy dependence on Russia. Although the Central and Eastern European countries can hardly break away from Russia in terms of sources of energy, due to grudges formed during the Soviet Union era and the constant geopolitical pressure from the East, as well as the pro-US political tendency that was strengthened after independence, they have high domestic anti-Russian sentiment. There is significant tension between Poland, Estonia and Russia that has even affected the implementation of the EU's common diplomacy and security policies. In contrast Germany, France, Italy, and Spain, which always consider energy supply security as vital national interests, have consistently advocated maintaining a dialogue with Russia to avoid over-stimulating Russia's political attitudes. Their current energy dependence on Russia is relatively small, but because they are facing energy depletion in the middle and long term as well as the issue of diversification of imports, they choose to pursue a conciliatory stance. These differing perspectives and policies strongly affect the EU's position as a whole to hold energy negotiations with Russia.

Due to these circumstances, the EU has not yet formed a unified energy policy and energy strategy. The European Commission called on member states to establish a unified energy strategy, and to strengthen this strategy by way of signing contracts with Russia. It also proposed the establishment of a unified institution in Europe, which can be used to coordinate EU energy policy. However, on the issue of energy the European Commission only in theory acts on behalf of the EU countries. Although German Chancellor Merkel rejected Putin's special partnership proposal (with Germany) when she held the rotating presidency of the EU and stressed that the EU would unify its policies toward Russia, no agreements have yet been reached within the EU, neither on the establishment of a common energy market nor a common energy strategy toward Russia. Relatively speaking, Russia's energy strategy toward the EU has proved to be a success.

## **2. Russia's EU Energy Strategy**

As the successor of Tsarist Russia and the Soviet Union, Russia's huge oil and gas complex and rich oil and gas resources not only play an important role in its national economic life, but also provide a strong material foundation for Russia's energy diplomacy. Under the leadership of President Putin, Russia has taken advantage of its huge oil and gas reserves and its capacity of production and export to support its economic recovery and enable Russia to occupy a unique position in the international energy situation. In sum, oil and gas resources have become an important means to achieve Russian national strategic objectives.

### **2.1 Russia's Energy Strategy**

As early as the mid-1970s, the Soviet Union had replaced OPEC as one of the world's largest oil producers. With the rapid development of large oil fields in Second Baku and the West Siberia, by 1988 the oil production of the Soviet Union had reached a new record of 568 million tons, with a daily output of an unprecedented 11.4 million barrels.<sup>18</sup> The managers of the Soviet Union oil industry doubled the Soviet Union's oil production by enhancing the production of West Siberian oil fields to three times the original output.

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18 Clifford G. Gaddy, Barry W. Ickes, "Resource Rents and the Russian Economy", *Eurasian Geography and Economics* Volume 46, Number 8 / December 2005.

After the breakup of the Soviet Union, both in the Yeltsin era and in the new Russia under President Putin, the Russian government places great expectations on the energy industry. The energy industry not only provides support such as fuel & power, taxation, foreign exchange and foreign capital to the Russian economy, but also stimulates the development of relevant industries.

Russia has huge potential in energy resources. According to the ranking of proven oil reserves, Russia and Iraq, Iran, Kuwait and the United Arab Emirates are listed after Saudi Arabia. The estimates indicate that Russia's proven oil reserves will be 70-100 million tons in just a few years, accounting for 8-13% of the world's total proven oil reserves. In addition, its annual output remains at 3.3-3.4 million tons, ranked among the world's top three. Russia's proven natural gas reserves and output respectively account for about 38-45% and 25-27% of the world's total.<sup>19</sup> The energy industry also provides important tax and financial support for the transition of the Russian economy. From 2001 to 2005, the various taxes paid by the Russian oil and gas companies accounted for 78% of the tax on mineral use, 72% of the consumption tax (mainly the gas sector) and 52% of tariffs respectively. The sum total accounts for 1/3 of the Russian federal budget. In the federal budget revenues, the proportion of the oil and gas sectors has increased from 21% in 1999 to 32% in 2004.<sup>20</sup> The Russian government is definitely aware of that these rich natural resources could provide a strong backing for its re-emergence as a world power. The energy industry, as an important pillar for the Russian national economic and social development, still retains 65% of the oil processing capacity of the Soviet Union despite heavy losses at the initial phase of the Soviet Union breakup. Russia has intensive oil and gas networks in Europe, which possess rich resources. Therefore, it has been a key step for presidents from Yeltsin to Putin to formulate an energy strategy as soon as possible to restore the natural energy industry in an attempt to revive the Russian economy and restore Russia's great power status.

After the three major changes in 1995, 2000 and 2003, the Russian government finally approved "The Energy Development Strategy of The Russian Federation before 2020" in August 2003. This strategy identified Russia's energy development objectives and tasks until 2020; clarified the future energy development model; set the development objectives and basic planning of each energy sector and strategic regions; clarified basic regulatory and supervisory mechanisms for the domestic oil and gas industry monopoly and competition; identified a series of supporting policies, including taxation, investment, technology and regional development; and stressed Russia's status and role in the world energy market, as well as the principles for international cooperation.<sup>21</sup>

Before the Energy Development Strategy was announced, the Russian government and the academic world had heated discussions on the concepts and other issues contained in the energy strategy. Russian Foreign Minister Igor Ivanov pointed out that one priority of Russia's energy strategy was to further expand and deepen mutually beneficial cooperation with foreign countries. Under this principle, Russian energy diplomacy should have regional and global priorities.<sup>22</sup> Stanislav Z. Zhiznin, Professor of Moscow State Institute of International Relations of the Russian Foreign Ministry, indicated in his *Fundamentals of Energy Diplomacy* that the external energy strategy should include the objectives, tasks and priorities, as well as the mechanism of implementation of the energy strategy developed in accordance with Russia's political and economic interests in the field of world energy. For the majority of industrialized countries whose energy supply depends on imports, energy security firstly involves ensuring constant and sustainable sources of energy import under acceptable economic and political conditions. But for a large energy export country like Russia, the first thing to ensure energy security is, on the one hand, to ensure the stable operation of energy production and related industries in order to meet the requirements for national economic development and living, and on the other hand, to enhance export potential and competitiveness

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19 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p.11.

20 Qi Wenhai, "Identity and Contradiction: The Relationship between the Energy Industry and Economic Transition in Russia" *Journal of World Economics and Politics* 12 (2005).

21 For details please see the website of the Russian Federation Embassy to China at <http://www.russia.org.cn/eng/> [14 January 2008].

22 Zhang Li, "The Russo-Japanese summit: 'Angarsk-Nakhodka line' written into the summit joint statement," *Beijing Youth Daily*, 19 December 2003.



and actively maintain and expand Russian shares in the international energy market in order to ensure that oil and gas exports play a pillar role in Russia's economic development.<sup>23</sup> The introduction of "The Energy Development Strategy of The Russian Federation before 2020" drew a satisfactory conclusion to this heated discussion. The government officials, experts and scholars have formed a consensus on energy strategy, agreeing that the energy strategy should present the long-term guidelines, policies and measures of the national energy sectors. In addition, the document specifies the country's energy objectives, guidelines and tasks and makes relevant policies in accordance with the political and economic environment at home and abroad, the geo-political and development progress of the energy sectors and the adjustment and revision of the national external energy export strategies and regional energy policies. The overall objectives of Russia's external energy strategies include: protecting the energy security of the country by taking into account the nation's external economic and geopolitical interests; strengthening Russia's status in the international energy market; and supporting equal participation in international energy cooperation through foreign policy means.<sup>24</sup>

In the Energy Development Strategy, the Russian government mapped out its plans for the development of the Russian energy industry over the next 20 years. It expects the demand for energy before 2020 to increase 25-37% over 2000 and GNP to increase 1.2-1.8 times in the same period. Therefore, it plans to enhance the development of backup resources reserves to stabilize exports, increase Russia's energy exports to 35% by 2020; increase the energy industry revenue by 50%, the state budget revenues by 20%, and GDP by 70% by 2010.<sup>25</sup>

Russia will explore energy export channels in the North, East and South to increase the proportions of these areas in the geopolitical structure of its energy exports. Currently, Europe is Russia's main market. It must strengthen constructive energy dialogues with European countries so as to play an active role in promoting industrial growth in the EU countries, which in turn will lead to its own economic development. In the Asia-Pacific region, Russia's main energy cooperation partners are China, South Korea, Japan and India, which are the main markets for Russian oil and gas, electric power, nuclear power and nuclear technology products. Since the end of 2003, and especially the development of the oil and gas industry since 2004, the Russian government has made big adjustments to its energy (oil and gas) regulations and policies, as well as to the development directions of the oil and gas industry. These adjustments are mainly reflected in the shifts in oil and gas production and export objectives, as well as the changes to the pipeline infrastructure constructions and oil and gas development plans in new regions (in particular, the far east region in East Siberia), including:

1. In 2003-2004, Russian oil production and export levels increased significantly. In 2005 oil production reached a new record of 470 million tons, close to the highest target of 2010 in "The Energy Development Strategy of The Russian Federation before 2020."<sup>26</sup> Thus, the Russian government has made adjustments to the development goals before 2008.

2. East Siberia and the Far East region are the major areas for Russia's oil output growth in the future. However, currently the oil output in these regions is limited. The future trend of growth mainly depends on the investment policies and development plans of the Russian government, particularly the actual investment and construction for infrastructure. In the future, if the eastern region cannot increase the output as planned, then the increases in overall Russian oil production will be unsustainable. The East Siberia - Pacific oil pipeline system agreed at the end of 2004 was a significant adjustment on the development plan for the eastern region.

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23 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 71-85.

24 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 81.

25 Распоряжение правительство Российской Федерации от 28 августа 2003 г. № 1234-р: *Энергетическая стратегия России на период до 2020 года*.

26 Sino-Russia Economy and Trade Website, "Russia's Oil Output increased by 2.5% in 2005", 6 January 2006, <http://www.crc.mofcom.gov.cn/> [14 January 2008].

3. Gazprom<sup>27</sup> is Russia's monopoly on natural gas production and transmission. Gazprom was designated by the government as a coordinator of gas planning in the eastern region. Gazprom's gas development planning in East Siberia and the Far East region is consistent with Moscow's intentions.

By studying Russia's oil and gas strategies and their adjustments and changes, we find:

1. The energy (oil and gas) development strategy formulated by Russia is very clear, comprehensive, systematic, and coordinated. This strategy and its changes not only demonstrate the future development direction of the Russian oil and gas industry, but also reflect Russia's energy security concerns and the country's overall interests. The Russian energy expert S. Zhiznin pointed out that Russia had not established a formal energy strategy while he was writing *Fundamentals of Energy Diplomacy*,<sup>28</sup> but in recent years, Russia's oil strategy of "control the upstream, open the downstream" domestically and internationally "strive for the Caspian Sea, stabilize Western Europe, breakthrough North America and develop the East, and challenge the OPEC" has been gradually taking shape.<sup>29</sup> This strategy was fully embodied by the Russian government's handling of the Yukos affair and competition with Ukraine and Belarus for oil and gas pipelines and the right of pricing.

2. Through adjustments in its energy development strategy the Russian government has increased the volume of the oil and gas industry, which highlighted both the current state of development of Russian infrastructure and the momentum of the future development. The volume increase also reflects the focus on the development of key regions. Russia's construction proposals for oil and gas export pipelines indicate a focus on domestic trunks, extensions, transit routes and the pipelines in third countries. These measures will not only greatly enhance Russia's export capacity but also enable the unified oil and gas system to be more flexible. Therefore, Russia lays particular emphasis on the pipeline construction of every part being an extension of the unified oil and gas system.

3. Currently, the interests of Russia's central and local governments, state-owned enterprises and private enterprises still need to be coordinated. Contests between these parties have also caused inconsistencies in Russia's energy policies, but based on the unified development of the Russian energy industry all of these contradictions will be solved. Take the construction of oil pipelines as an example. Enthusiasm for the construction of pipelines comes from both oil companies and oil transportation companies. Although the construction plans and processes of the two parties may differ, coordinated development and complementation can still be expected. Of these two actors, the oil transportation companies represent the government's vision. As specified in the currently drafted Gas Long-distance Transmission Pipeline Act: The state owns the trunk line and encourages private investment. The investors' interest could be considered in terms of the cost of freight; private investment is encouraged to put into the construction of extension line.<sup>30</sup>

4. The East Siberia - Pacific oil pipeline system is a major infrastructure construction project for the next few years, It has the dual nature of main trunk line and export line. This is in full compliance with the Russian government's notion of development strategy. It just takes time to determine the specific direction of the pipeline and the coordination with interest groups. In addition, Gazprom's monopoly on the field of transportation cannot be challenged in the short or medium-term. The gas pipeline project in the Far East regions it proposed has won strong support from the Russian government.

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27 i.e. The Russian Natural Gas Industry, Co., Ltd, or 'Gazprom'.

28 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 80.

29 Cheng Jian: "Tons of work to do in the field of energy", *21st Century Economic Report*, 31 March 2007.

30 Viktor Khristenko, Russian Minister of Industry and Energy, "Prospects of development and use of the systems of transportation of the hydrocarbons and products of the processing", meeting of the Government Commission on the Fuel and Energy Complex, 9 October 2006, <http://www.minprom.gov.ru/eng/appearance/36>.

5. According to Russia's energy resources (oil and gas) development strategy, the total oil and gas investment demands before 2020 will be 500-650 billion US dollars. According to its strategic planning arrangements and advice from Russian energy strategy experts, 80% of the funds needed for the future development could be acquired domestically, but the precondition is that the Russian economy continues with smooth development.<sup>31</sup> In terms of attracting foreign investment, the Russian government mainly targets a series of international energy export-oriented projects, and the executors include Gazprom as well as other Russian energy enterprises.

It can be said, "The Energy Development Strategy of The Russian Federation before 2020" has made clear Russia's energy strategy and energy policy at the beginning of the 21st century. In the development process of this strategy, the Russian government's price confrontation with OPEC has provided a realistic basis and criteria for its introduction. The main concepts of this strategy were reflected in Russia's competitions and cooperation with OPEC, the EU and East Asia thereafter. Under the leadership of President Putin, Russia takes advantage of its huge oil and gas reserves as well as its capacity of production and export, making them the main supports for its economic recovery and boosting itself to a unique position in the international energy situation. Thus, oil and gas resources have become an important means to achieve Russian national strategic objectives. By looking at the constant adjustments of Russia's energy policies, it can be seen that the main concepts of the new energy strategy of the Putin Government are: taking energy as a new strategic weapon and using energy supply as a lever to control Russia's traditional sphere of influence; establishing a new partnership with energy consumption countries through energy cooperation; maximizing geopolitical interests through the pursuit of geo-economic interests; and ultimately realizing Russia's ambitious dream of super-power rejuvenation.

## 2.2 Russia-EU Energy Relations

As a big power across both the Asian and European continents, with the world's largest land area, Russia is more influenced by European civilization. It has always considered itself as a European country. As President Putin said, "In terms of spirit, history and culture, Russia is a natural member of the European family."<sup>32</sup> From a historical perspective, since the Europe-oriented national development vision of Peter the Great in the early 18th century Russia has always taken "disengage from Asia and join Europe" and "integrate into Europe" as basic state policy.

After the breakup of the Soviet Union, in order to achieve recovery of the Russian economy Russia was in urgent need of political support and economic assistance from the West. Thus the EU became a very important partner in Russia's foreign trade and international exchanges. The EU is Russia's most important trading partner. Until recently Russia's foreign trade volume with the EU accounted for 40% of the total, a figure that has risen to around 50% with the further eastern expansion of the EU. In the Russia-EU Summit in Moscow in May 2002, the EU formally recognized Russia as a market economy country and signed the final protocol in 2004 for Russia's accession to the WTO, helping Russia take an important step forward towards the door of the WTO.

In 2000, more than half of Russia's oil exports went to the EU, which accounted for about 16% of the EU's total oil consumption. In November of the same year Russia and Europe signed the "Energy Strategic Partnership Agreement," which determined the overall plan for energy cooperation. In 2001, 17% of the EU's oil imports were from Russia, valued at 15.4 billion Euros. More importantly, Russia is also a major natural gas provider to the EU. In 2000, 62% of Russian gas exports went to the EU, accounting for 20% of the EU's total natural gas consumption, while in 2004 the figure quickly rose to 29%.<sup>33</sup> According to the latest statistics, 30% of the EU's oil imports and

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31 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 83.

32 Vladimir Putin, "Europe has nothing to fear from Russia", *Financial Times*, 21 November 2006.

33 Fiona Hill: "Russia: The Energy Superpower in the 21st Century", *Brookings Review*, Spring 2002.

44% of gas imports were from Russia.<sup>34</sup> The Russian government also plans to double its natural gas exports to the EU in the next 20 years. Therefore, the EU has long considered Russia as its largest and most stable gas supplier, while Russia also sees the EU as an important energy diplomacy partner, after the former Soviet Union regions.

Most countries in Central and Eastern Europe that newly joined the EU have all been connected to the “peace” unified energy system since the early 1990s. The system is closely linked with the unified energy system of the former Soviet Union. Moreover, these countries also have a common energy transportation and technology system. At present, the majority of these countries are still Russia’s huge energy consumers as well as the transit corridors for Russian energy exports to the Western European market. In addition, the connection between these countries and the EU has changed Russia’s conditions in developing bilateral cooperation with these countries. In this sense, relations with the Central and Eastern European countries should become Russia’s diplomatic priorities. Unfortunately, due to various reasons Russia’s relations with the Central and Eastern European countries happen to be the weakest link in the whole relation between Europe and Russia.

Many Western European countries form a Russian energy sales market. Some of these countries are Russia’s main energy equipment suppliers. These countries are also important potential capital exporters for Russia’s energy areas. In this light, it is of special importance for Russia to develop bilateral cooperation in the energy field with Germany, France, Italy, Britain and other Western European countries, as well as to develop cooperation within the Russia-EU framework. A main objective of such cooperation would be to promote Russian companies’ entrance into the Western European countries’ domestic energy wholesale markets and the development of their retail markets. Russia should also commit to the development of a long-term energy security strategy with the EU countries. In 1995, the Russian-European Energy Security Strategy International Conference, held in Moscow, identified the overall outline of this strategy. Of course, there are some potential conflicts of interest. Particular attention should be paid to the fact that the EU’s energy policy calls for the establishment of Eurasian gas transit corridors that bypass Russia, as well as the development of directives that impede Russian gas exports. Therefore, the Russian-EU energy dialogue launched by the Brussels initiative shows a certain prospect in the search for balance of interests between Russia and the EU countries.

In order to expand gas exports to Europe, in 1995 Russia’s Gazprom and Germany, France and Italy invested two billion US dollars in the construction of the “Yamal-Europe” mainland gas pipelines that bypass Belarus, Poland and Slovakia through to Western Europe, with an annual transmission capacity of 60 billion cubic meters. In February 2000 Gazprom began laying the only transmission trunk road “Blue Stream” that bypasses the Black Sea through to Turkey, which was completed and put into operation on 30 December 2002. At the end of 2001 a joint venture pipeline construction project between Russia, Bulgaria and Greece also started; by the completion of this project, the new pipelines will be able to transmit oil from the Russian Caspian Sea to Europe. In November 2002, the construction of a separate gas pipeline—the Nordic gas pipeline—was undertaken.<sup>35</sup> This pipeline is of strategic significance, running from Vyborg through the Baltic Sea to the German coast. This route has multiple roles. It can expand the gas supply to the Scandinavian countries and also reliably transmit gas to Western Europe, northwest Russia and Kaliningrad. On 10 June 2002, Russia signed a natural gas pipeline deal with Ukraine and Germany for the joint use of gas pipelines. According to this agreement, Russian natural gas can be transported to Western Europe through Ukraine. Putin said that energy cooperation between these three countries would help enhance European partners’ trust in Russia. Schroeder claimed that Russia’s energy supply is extremely important for the European economy; it would be able to greatly reinforce European energy security. In addition, since 1997 Russia has been the main gas provider to Turkey. Nearly 70% of Turkey’s natural gas imports are from Russia. The Russian government expects to increase natural gas exports to Turkey in the next 20 years.

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34 European Commission, “Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy,” COM(2006) 105, March 2006.

35 Li Mu: “One Decade of the Gazprom”, *Russia’s Central Asian and Eastern European Market*, 4(2003).

In 2001 at the Brussels Summit, President of the Russian Federation Putin, General Secretary of the European Council and High Representative for the EU Common Foreign and Security Policy Javier Solana and President of the European Commission Romano Prodi again issued a statement on energy, recognizing Russia as the closest, reliable and major energy exporter of the EU, while the development of the EU's internal market will also create a large, integrated energy market for Russia. The two sides reached a consensus on the future direction of development and cooperation. The EU will help Russia improve its legislation on energy production and transportation as well as help with a series of new transportation infrastructure projects, while Russia will guarantee, under legal bindings, a long-term supply of fuel and energy.

In May 2002 the Russia-Europe Summit signed an "Energy Cooperation Statement," stressing that Russia "has special rights of access to the European energy market." In June of the same year, Russia signed an agreement with Ukraine and Germany on the joint use of natural gas pipelines, which ensures that Russia's natural gas will be constantly shipped to Europe bypassing Ukraine. In November of the same year, Russia began construction on a separate natural gas pipeline – the Nordic gas pipeline. Starting from St. Petersburg, Russia, continuing through northern Germany and ending at the British eastern coastal areas, it facilitates the supply of natural gas to the Russian northwest, the European countries and the United Kingdom.

In Russia's energy policy and diplomacy, ecology, investment and technology are of great significance to the international interests of the Russian energy industry. In view of the important role of ecological factors in the Russian and international energy industry, the ecological position of Russia in its energy policy can also play a role as an external economic factor affecting national strategic interests. "Russia's Energy Strategy" established the principle of acceptable ecology. According to this principle, the adverse environmental impacts of energy development should not be increased. The attendant problem is that Russia must fulfill its international obligations in ecological areas, including the "UN Convention On Cross-border Long-distance Air Pollution," its Memorandum, "the United Nations Convention on Global Climate Change" and the "Kyoto Protocol." Yet engaging in foreign trade business in accordance with the "Kyoto Protocol" provisions (cooperative execution and the flexible mechanisms on the sale of greenhouse gas emissions quotas) can only partially meet the financial resources needed for the modernization of Russia's energy industry.

Energy-saving policies are directly related to Russia's interest in the world's energy field and Russia's huge potential for energy benefits. According to the "Energy Strategy," achieving the energy potential requires energy consumption to be reduced by 40-48% before 2020 so that Russian oil and gas exports could be enhanced without the expansion of production.

The Russian energy industry needs large-scale investment, according to the "energy strategy" estimate. As discussed above, domestic investment will be able to account for 80% of the costs of modernization only if the Russian economy continues to develop smoothly. In this regard, Russia's energy strategy interests are complementary to vigorous attraction of foreign investment; otherwise Russia's development in energy sectors and the modernization process will be very difficult. Therefore, a series of large-scale international energy export-oriented projects are of extremely important significance. In addition, Russian companies' participation in commercial activities in the field of international energy would expand its presence in investment business in some countries, which will also require corresponding diplomatic support. By looking at Russian history, we can see that Germany, Britain, France, Italy and other major EU countries are Russia's main investors. These countries are very interested in Russia's heavy industry, especially the energy industry and machinery manufacturing industry. For instance, in the Sakhalin Island and the Kovytko gas field and other projects eligible for foreign capital accession, the Shell Group, Total Oil and Norway companies have invested large sums of money.

"Russia's Energy Strategy" proposed a series of measures regarding technical modernization, including the introduction of advanced foreign technologies based on maximum use of domestically made equipment and technology. In this regard, the "technical" key direction of Russia's energy diplomacy is to guarantee free-flowing access to foreign high-tech; streamline the programs of the new technologies; and support equal and mutually beneficial international cooperation in energy

technologies. In terms of all the energy technologies and management above-mentioned, Russia has to have strong support from the EU.

At present, the biggest problem for Russia-EU energy cooperation is largely due to Russia's excessive barriers to foreign direct investment. Placing too much emphasis on "economic independence" and "avoiding dependence" in foreign economic ties, the Russian government is willing to incur debt in its economic recovery efforts rather than attach more importance to establishing a sound legal system and social environment to attract foreign direct investment. Although Russia's official documents mentioned its welcome of foreign direct investment several times, the Russian government has not actually created favorable legal and conditions or infrastructure facilities. In five years, before the outbreak of the financial crisis in 1998, Russia had attracted foreign direct investment that amounted to less than 100 billion dollars, which was largely due to the government's excessive prevention of foreign capital from directly entering Russian production fields.<sup>36</sup>

Overall, although Russia's political relations with the EU have experienced ups and downs, most of the time the energy cooperation between the two parties moves in a very good trend. In the next decade, despite the constant changes of the EU's energy policies, along with increasingly fierce competition of the oil and gas exports in the Caspian Sea region and Africa, EU-Russia energy interdependence is expected to continue to deepen. Russian Energy Minister Viktor Khristenko even predicted that by 2020 nearly 70% of the total demand for natural gas in Europe would be provided by Russia.<sup>37</sup> With the continued chaotic situation in the Middle East, the increasing reduction in North Sea oil and gas production, and the implementation of the EU's policies for its own diversified gas import channels, Moscow's role as a hub will be even more obvious.

### 2.3 The Implementation of Russia's Energy Strategy toward the EU

Russia tried to accomplish something in the international oil market, but after years of dealing with OPEC, Mobil, Exxon and other transnational oil companies, the Kremlin gradually realized that Russia is facing a mature oil market that maintains balance through competition from each party. Since the domestic oil production capacity is unable to have a decisive impact on the existing oil markets and inter-country political situations, Russia's oil companies must abide by the rules of the game. They should be cautious of other countries' oil diplomacy policies that were developed after careful consideration. However, it is difficult to guarantee Russia's national interests in such an interactive process.

According to proven reserves, Russia's oil supply can be maintained for 22-25 years. According to forecasted reserves, it will last for 50 years.<sup>38</sup> Evidently, unrestricted oil export does not conform to Russia's national interests. Although in 2005 Russian oil production reached a record high of 470 million tons, close to the highest target for 2010 in "the Russian Energy Development Strategy before 2020," this was apparently its limit. Output increased by only 2.5% that year, the minimum increase since 1999.<sup>39</sup> Some evidence also suggested that the majority of the recent highs in Russian oil exploitation simply illustrated that the oil was from the mines that were not exploited during the economic decline and chaos of the late 1990s and the remaining oil left in the 1980s after improper pumping.<sup>40</sup> If there were no new oilfields for extraction, the current oil output in Western Siberia

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36 В. Волков: Российская экономика- итоги 1997г. // Экономисты, 1998. № 03. С.31.

37 Igor Torbakov: "Moscow Skillfully Uses Energy Leverage to Divide Europe", *Eurasia Daily Monitor* vol. 2 issue 187, 7 October 2007.

38 Stanislav Z. Zhiznin, *Fundamentals of Energy Diplomacy*, 2003, translated by Qiang Xiaoyun, Shi Yajun, Cheng Jian et al., *International Energy Politics and Diplomacy* (Shanghai: East China Normal University Press, 2005), p. 82.

39 Sino-Russia Economy and Trade Website, "Russia's Oil Output increased by 2.5% in 2005", 6 January 2006 <http://www.crc.mofcom.gov.cn/> [15 January 2008].

40 Leslie Dienes, "Observations on the Problematic Potential of Russian Oil and the Complexities of Siberia," *Eurasian Geography and Economics* 45 (2004), pp. 237-238.

would reach its peak in 2005-2010. This output would be maintained for some time and then gradually decline.<sup>41</sup>

Although the EU currently consumes approximately equal percentages of Russia's oil and natural gas (27% and 24% respectively),<sup>42</sup> Russia is facing bottleneck problems on oil exports to the EU. European countries recently imposed more stringent requirements on the sulfur content of import fuel; as Russian oil generally has high sulfur content this puts a major constraint on the sale of Russian oil to the European market. Russia consequently has losses each year as high as 20-25 billion dollars. Meanwhile, although the European market is mainly controlled by North Sea oil, the growth capacity of the North Sea oil has reached its limit. Its control will therefore gradually decrease in the future. As Russia's oil output and exports continue to grow it will be forced to transcend traditional regional markets, because the Western European market is a saturated market (in oil demand). The current growth of demand is repressed by high taxes. In terms of exports, Russia is facing competition from quality crude in Central Asia and the Caspian Sea. Sakhalin, East Siberia and other new oil fields will mainly target China, Japan, India, South Korea and other non-European markets.

In the field of natural gas, Russia's status is as pivotal as Saudi Arabia's is in the field of oil. Across Europe and Asia, with vast gas fields starting from Sakhalin Island through East Siberia, Russia has a unique advantage in the field of gas. Russia accounts for 32.6% of the world's proven natural gas reserves, ranking first in the world. According to proven reserves, the supply of Russian natural gas can last for about 90 years, and 100 years according to the estimated reserves. Gazprom, the Russian natural gas industry giant, not only has a monopoly on 95% of Russia's entire natural gas production and almost all the natural gas pipelines, but also controls a quarter of the world's gas reserves, far ahead of Iran (15.7%), Qatar (5.8%), Saudi Arabia and the United Arab Emirates (4% each).

With the increasing proportion of natural gas consumption in the world, especially in the EU countries, President Putin was acutely aware of the development potential of natural gas as a clean energy in the 21st century. He therefore switched his focus from oil to natural gas and started to build a huge energy empire centering on natural gas. As compared with the oil market, a gas-pricing mechanism has not yet been formed. By virtue of having the world's largest natural gas distribution system, built from the Soviet Union era, Russia has gained a right of speech and decision in the still-immature international natural gas market. Moscow can not only influence the world's gas market prices but also penetrate into the gas transmission and distribution networks through the expansion of natural gas exports, thereby affecting the production of electricity, gas processing, etc.

According to "Russia's Energy Development Strategy before 2020" the Russian government plans to enhance natural gas exports and implement the diversification of gas products sales and export channels. In terms of Russia's gas diplomacy priorities it is particularly important to maintain a stable and reasonable natural gas price in international trade, which requires a long-term natural gas supply contract system with the EU countries. In addition, in order to ensure natural gas transit security Russia participated in gas exploration with its close neighbors<sup>43</sup> as well as distant foreign countries.<sup>44</sup> Russia also entered the sales systems of natural gas importing countries.<sup>45</sup>

In the international energy market, the Russian government closely cooperates with Gazprom and Rosneft, the major Russian energy companies. The implementation of a series of measures has

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41 Dienes, op. cit.; Robert Ebel, *Russia-King of the Oil Hill*, Center for Strategic and International Studies presentation, 21 July, 2004, p. 4.

42 European Commission, "Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy", COM(2006) 105, March 2006.

43 'The close foreign countries' refers to the geographical scope of former Soviet Republics that are neighboring to Russia, including the CIS countries and the countries of Central Asia. The Russia Government thinks that it has natural strategic impact and geo-political interests in these regions.

44 'The distant foreign countries' refers to the Central and Eastern European countries and other neighboring countries of the Eurasian continent that are not directly adjacent to Russia, such as China, North Korea, etc. The distant foreign countries represent the geopolitical space that Russia expects to expand and cover.

45 Распоряжение правительства Российской Федерации от 28 августа 2003 г. № 1234-р: *Энергетическая стратегия России на период до 2020 года*.

aroused a high degree of attention from the international community, which frequently mentions a “Putin Energy Empire.”

In dealing with the European countries, the primary methods of Putin’s diplomatic strategy are ‘divide-and-rule’ and ‘delay for change’. Due to cost considerations and Russia’s relative backwardness in Liquefied Natural Gas (LNG) technology (especially LNG transport ship-building), gas transportation pipelines are mainly used for gas transmission. The resulting problems of secure supply have increased the geopolitical considerations of natural gas diplomacy.

First of all, following its diplomatic tradition Russia’s energy diplomacy focuses on the former Soviet (FSU) regions. This is mainly based on geopolitical considerations. In fact, from Presidents Yeltsin to Putin Russia’s leaders have always considered the former Soviet states (the CIS region, at least) as Russia’s own sphere of influence. They have never given up establishing a state group centering on Russia, Belarus and Ukraine, with a buffer zone of surrounding states. This zone would be composed of Kazakhstan, Turkmenistan, Georgia and other former Soviet Islamic republics. Russia tries to control these countries to varying degrees in order to exclude the influence of other countries.<sup>46</sup>

Although Russia’s military strength plummeted after the breakup of the USSR, the gas and oil distribution channels covering the former Soviet republics – which Moscow inherited control over – allowed the Russian government to threaten any disobedient counterparts with cutting off its gas or oil supply. By doing so, Russia succeeded in maintaining the economic unification of the CIS countries and obtained the control and the right to use the majority of the pipelines. Natural gas is widely used in CIS countries for power generation and heating. A cutoff of gas supply in the winter would not only shut down the industrial production of the CIS countries that use Russian natural gas but also greatly harm residential heating. The governments in the former Soviet Union regions are thus subject to great pressure from Moscow.

Russia’s natural gas diplomacy focuses on the EU. Some EU countries, including Germany and Austria, carried out large-scale natural gas trade with the former Soviet Union as early as during the Cold War. After the independence of Russia and the EU enlargement, the EU countries’ gas dependence on Russia was greatly strengthened. In 2000, 62% of Russia’s gas exports went to the EU, accounting for 20% of the EU’s total natural gas consumption; this figure had risen to 41% by 2001.<sup>47</sup> The Russian government also plans to double its natural gas exports to the EU over the next 20 years. The two sides have long considered each other as key energy partners.

In the energy diplomacy process with the EU, the two sides’ different understandings on some issues -- including democratic values, the rule of law and a number of important political issues -- do not seem to hamper mutual rapprochement on issues of common economic interest. In addition, Russia is very skilful in the use of the divide-and-rule strategy. Although Putin has meetings with EU officials acting as one entity, he still favors one-on-one dealings with the European leaders in an attempt to extract good deals from the individual EU member countries. Russia’s huge amount of energy reserves, and natural gas in particular, indeed create a lot of problems for the EU in both economic and political terms. The EU member-states as a group have been unable to implement a common foreign policy and are especially unable to reach agreement on strategies toward Russia.

However, the Ukraine gas dispute in early 2006 resulted in EU countries’ deep worries about future energy security, which forced the EU to introduce a new Energy Green Paper in March 2006. Entitled “A European Strategy for Sustainable, Competitive and Secure Energy,” the paper attempted to accelerate the EU unified market and the development of common energy foreign policy.

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46 Samuel Huntington, *The Clash of Civilizations and the Remaking of the World Order*, translated by Zhou Qi et al., (Beijing: Xinhua Press, 2002), p.177.

47 European Commission, “Communication from the Commission to the Council and the European Parliament on the development of energy policy for the enlarged European Union, its neighbours and partner countries”, 13 May 2003; EC press release, “EU and Russia to further promote convergence of energy strategies”, 21 October 2003, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/1422&format=HTML&aged=0&language=EN&guiLanguage=en> [25 January 2008].



### 3. Energy Game between Russia and Europe: Case Studies

Energy is not only the source of state power, but more importantly, it has been put at the absolute center of the global power distribution and redistribution system.<sup>48</sup> Therefore, the energy issue now comprises one of the core interests of the major powers. As mainstream IR thinking in the post-Cold War era has transformed from a zero-sum game to a conflict-competitive paradigm, so are Russia-Europe energy relations composed of competition as well as cooperation. The difficulties they are facing and the results they have achieved are the results of this non-zero-sum game; the future development of the two parties will also depend on mutual understanding and compromise.

#### 3.1 Russia-Ukraine Natural Gas Dispute

One of the former Soviet republics, Ukraine has a shortage of energy. Its oil and gas extraction can only meet 11% and 25% of domestic demand, respectively. Ukraine has to rely on significant imports to meet its oil and gas consumption demand. After the breakup of the Soviet Union, for geopolitical and historical traditions considerations Russia is Ukraine's main gas supplier. 85% of Ukraine's oil and 95% of its gas are imported from Russia, at a price much lower than the market price. In the past 15 years, the price of the natural gas Russia exported to Ukraine was maintained at 50 US dollars per 1,000 cubic meters. Meanwhile, Ukraine is Russia's major energy pipeline transit country. 90% of the oil and 80% of gas that Russia exports to Europe pass through the oil and gas pipelines laying in the territory of Ukraine. There are currently five major natural gas pipelines from Russia through Ukraine; three of them are for the export of natural gas to Europe, while the other two supply natural gas to Ukraine itself.

Ukraine is both the main transit country for Russia's gas supply to its European customers and itself a main consumer of natural gas. Ukraine's annual natural gas consumption is estimated at 80 billion cubic meters, of which 25 billion cubic meters are from Russia. The remainder passes through Russian gas pipelines even though most of it comes from Turkmenistan and other Central Asian countries. Therefore, Russia takes considerable initiative in its energy diplomacy with Ukraine, implementing a variety of energy diplomacies.

However, due to Ukraine's long-term economic depression, it is unable to repay its large energy debts. Russia and Ukraine have a long history of arguing on this dispute, Russia seeks to reduce or even interrupt oil and gas supply as a means to exert pressure on Ukraine. In turn, Ukraine threatens to cut off the oil and gas pipelines that link Russia to the Europe as a revenge. Ukraine often withholds Russia's transit natural gas without Russian permission and dumps to other countries at a resale price, which infuriates the Russian Government.

In December 2005, Russia and Ukraine had a controversy over the price of natural gas. Gazprom required Ukraine to pay 230 US dollars per 1,000 cubic meters, instead of the "internal price" of 50 US dollars. While Ukraine hoped that the Russian government would increase the price through graded adjustments, so as to avoid too much impact on Ukraine's domestic economy. President Putin pointed out that the Russian government and Gazprom could export natural gas to Ukraine in the first quarter of 2006 at the 2005 price, with the precondition that Ukraine must sign contracts with Russia by 31 December 2005 indicating that the gas would be sold at market prices starting in the second quarter of 2006. This proposal was rejected by Ukraine. Russia then cut off the supply of natural gas at 10:00 A.M. Moscow time on 1 January 2006. This was a fatal blow to Ukraine, which needs large quantities of gas through the cold winter. Ukrainian President Yushchenko immediately responded that Ukraine was willing to purchase natural gas from Russia at a reasonable market price starting 1 January.

On 4 January, the presidents of Gazprom Russia and Gazprom Ukraine announced in Moscow that Russia and Ukraine had reached an agreement on gas prices, and signed a five-year contract. Ac-

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48 Joseph S. Nye, *Understanding International Conflicts: An Introduction to Theory and History*, translated by Zhang Xiaoming. (Shanghai: Shanghai People's Publishing House, 2002), p. 296.

According to the contract, Gazprom Russia would sell natural gas to a newly formed "Russia-Ukraine Energy" company at a price of 230 US dollars per 1,000 cubic meters. The "Russia-Ukraine Energy" company would mix the natural gas from Turkmenistan, Kazakhstan, Uzbekistan and other central Asian countries and resell it to Ukraine for 95 US dollars per 1,000 cubic meters. At the same time, the gas transit fees for natural gas exported to the EU countries via Ukraine would be increased from 1.09 US dollars per 1,000 cubic meters /100 km to 1.6 US dollars. Even this compromise adjusted price is still a blow to the depressed Ukrainian economy.

But the crux of the matter lies in the fact that Russia has already imposed market prices in the CIS countries and adopted new pricing mechanisms in other countries. If Russia provides gas to Ukraine at lower prices than to the European and other world markets – prices even lower than Russia's domestic prices – it does not sound fair. The one exception is Belarus, a strategic partner of Russia, which continues to pay 47 US dollars per 1,000 cubic meters.

The other reason for the controversy, according to many experts, is that Russia cut off the gas supply to express its dissatisfaction with Ukraine after the outbreak of the "Orange Revolution." From November to December 2004, Ukraine shocked the whole world with the Orange Revolution. Opposition party leader Yushchenko claimed that the election of the Ukrainian President had been fraudulent and launched a large-scale "street fight", forcing the authorities to re-vote. Later, Yushchenko was elected President. With a political tendency toward the United States and the West and an alienated attitude toward Russia, Yushchenko even announced that Ukraine would strive to join NATO before the end of 2008. This was undoubtedly a heavy blow to the region's traditional power Russia. After the Orange Revolution occurred in Ukraine, "Color Revolutions" also broke out in Georgia, Kyrgyzstan and other Soviet Union republics one after another. Russia felt that it must use energy as a weapon to warn those countries against trying to break away from Russia's sphere of influence. Coupled with Ukraine's upcoming parliamentary election in March 2006, Russia also hoped to put pressure on Ukraine by taking advantage of this opportunity to allow voters to think about what kind of representatives should be elected to the Parliament in the cold winter.

Several days after the crisis Ukraine reached an agreement with Russia and resumed gas supply to Ukraine, but the dispute remains a beacon of European countries' concern for the security of their energy supply. Members of the EU have already been victims of Russia-Europe energy conflicts: Since 17:00 on 1 January, Austria's gas imports from Russia have decreased by 18%, Hungary's gas imports from Russia via Ukraine reduced by 25%, and Poland's by 14%. Romania's gas imports from Russia have slowed down by 5 million cubic meters per day. EU Energy Commissioner Andris Piebalgs pointed out that the Russian-Ukrainian energy stalemate highlighted the EU countries' fragility in the supply of natural gas. The 2006 G8 Summit was held in St. Petersburg, Russia. President Putin hoped to put energy security as the main topic of the summit. However, this crisis created by Russia's Gazprom prompted the Western critics to be more convinced that Russia is not eligible to hold the G8 presidency. The European countries may now increasingly tend to not believe the guarantees made by the Kremlin. They may also worry that Russia will use other means to demonstrate its strength. Although Russia had months of negotiations with Ukraine and Putin issued a warning, business people and government officials still believe Russia was incorrect to increase the price of natural gas by four times in one jump. This will make Europe very hesitant to further increase its energy dependence on Russia. Of course, Ukraine, as a gas transit country, threatened unauthorized interception of Russia's natural gas supply to European countries as counter strategy to Russia's cutoff of its natural gas supply. This led to the expansion of the conflict between the two countries, which sparked global concern.

The development of the situation showed that Russia and Ukraine, which have a myriad of ties to each other, are both incapable of defeating the other once for all. In order to prevent an escalation of the situation from affecting their international images and long-term interests, the two countries eventually chose to maintain the existing gas supply system.

Since the breakup of the Soviet Union, many people in Russia's political arena are very worried that losing Ukraine would ruin Russia's economy. They are also worried that the Ukraine will eventually join the EU, thereby forming a coalition that has a tendency of opposing Russia or being used by Western countries to fight against Russia. This would pose a serious geopolitical challenge to Russia and a direct threat to Russia's national security. Of course, this fear is largely instigated by the western media, including the former national security adviser of the United States Zbigniew

Brzezinski.<sup>49</sup> He strongly advocated that the United States and its Western allies, if not able to impel Ukraine to become a counter force against Russia, to at least make it a buffer zone between Russia and the other European countries. In fact, this worry was later confirmed by the fact that Ukraine not only established the “GUUAM” Group in 1997 (Uzbekistan also joined the group in 1999) which is drifting outside the CIS and in Georgia, Azerbaijan and Moldova, but also has been trying to maintain a “balanced” foreign policy between Russia and western countries. It has also established a special partnership with NATO, which Russia strongly opposes.

Marching to Europe and seeking integration is Ukraine’s dominant foreign policy approach, which strongly conflicts with Russia’s strategic objectives. Under such circumstances, Ukraine’s diplomatic direction will remain in a state of confusion. On the one hand, it pursues non-alignment, not participating in the CIS Collective Security Treaty Organization; on the other hand it is also concerned about becoming a buffer or bridge between the East and the West. As President Qi Ma said: “Ukraine does not want to become a buffer, because it is suffocating to try to please two sides at the same time. Ukraine does not want to become a bridge either, because if too many people walk on the bridge, the bridge will collapse.”<sup>50</sup>

Although under the influence of the EU Russia and Ukraine chose to compromise, the battle between the two sides will not end. Russia’s cutoff of natural gas supply to Ukraine also affected the EU’s gas supply, and Ukraine may pass its losses caused by the higher natural gas prices to the EU countries, which is unacceptable for the EU. Therefore, diversified sources of energy have become the EU’s largest concern. To avoid an impasse on the issue of energy the EU continues to consolidate its ties with its main energy partners Russia, Norway, Algeria and other countries, while at the same time is making efforts to find a diversified energy supply. Up to now, the EU has signed energy cooperation agreements with Azerbaijan, Ukraine, Kazakhstan and other energy suppliers and transit countries. In terms of the development of renewable energy and energy-saving technologies, the EU has introduced a number of incentive policies, including enhanced financial support for alternative programs. Germany, Finland, Sweden, Denmark, the Netherlands and other Nordic countries have conducted many trials in this regard and have achieved remarkable results.

The Russia-Ukraine gas crisis seems on the surface to be a commercial dispute between the two countries, but it is actually Russia’s efforts to grasp gas pricing power and control over energy pipelines, which is part of Russian energy diplomacy. This diplomacy has also exerted great influence on Europe. The energy crisis objectively sent a warning to Europe: 153,000 km of gas transmission pipelines are under the control of the Russian Government. To mess with Russia would result in serious consequences.

### 3.2 The Issue of the Energy Charter Treaty

If considering Russia’s initiative in energy diplomacy as a game, then the EU’s efforts in persuading Russia to join the Energy Charter Treaty can be seen as a clever counter-game.<sup>51</sup> On 25 June 1990, at the European Commission meeting in Dublin, the then-Dutch Prime Minister Ruud Lubbers proposed the concept of the European Energy Charter, which aims to “help” the economic recovery of the Soviet Union and Eastern European countries. Lubbers pointed that the European Energy Charter could play a role as the political and legal basis for East-West cooperation through the concept of improving the economy of the East to support economic transition and enhance political stability throughout Europe. The best method is “the establishment of an economically active circle in the East, starting from the energy sectors.”<sup>52</sup> Since then, the use of energy as a breakthrough point and establishing energy cooperation institutions has begun to enter the EC’s consideration. Such thinking is an inevitable result of the development of the European political and economic

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49 Lu Qihua, *Russia and European Security*, (Beijing: Central Compilation and Translation Press, 2001), p. 99.

50 Zhang Peifeng, “Analysis of Ukrainian Balance of Diplomacy”, *Russian Studies* [Eluosi Yanjiu], 6(1997), p. 32-35.

51 For relevant concepts please see Hu Jian, “Energy Game and the Structural Paradigm’s Transformation of Russia-European Relation”, *Forum on International Issues*, 1(2007), <http://www.sis.org.cn/web/fourm/2007spring.html> [25 January 2008].

52 Craig S. Bamberger, Jan Linehan, and Thomas Waelde, “Energy Charter Treaty in 2000: in a new phase”, *Journal of Energy & Natural Resources Law* Vol. 18, No.4, 2000.

situation. The objective of this concept is to consolidate security and stability in the energy area. Thus, this concept has gained support from the European Union and all other member states of the European Security and Cooperation Organization.

On 17 December 1991, the majority of the European countries, the EU, Australia, Canada, Turkey, the United States and Japan signed the European Energy Charter in The Hague. The European Energy Charter is a political document whose main objective is to create a favorable environment for mutually beneficial energy cooperation in the Eurasian space, so as to establish an open energy market in the whole of Europe. The subsequent Energy Charter Treaty then transformed the objectives and declarations of the European Energy Charter into legal obligations.

Negotiations on the Energy Charter Treaty began in January 1992. The difficulties and complexities involved in the negotiations of this treaty had many causes. First, the countries involved in the negotiations had (and still have) different levels of development. Second, most of the countries are the members of GATT and the Economic Cooperation and Development Organization, while some of the Eastern European and CIS countries are not. Third, not only in the field of energy trade, transit transmission and investment regulations, but also in many of the basic rules of the market, the industrialized countries and the “transitional” countries present different positions. Fourth, the energy sector is closely linked with other sectors of the economy, which makes it difficult to formulate international treaties on this sector only. Fifth, the EU, the United States, Canada, Japan and other countries have different positions on the issue of entering the former Soviet Union energy market.

On 17 December 1994, the Energy Charter Treaty and some of the related documents were open for signature in Lisbon. The related documents include: The Final Documents of The European Energy Charter Conference, and the Protocol on Energy Efficiency and Related Ecological Issues. Considering that many non-European countries participated in the Charter process, the word “Europe” in the treaty was deliberately deleted. In 1995, a total of 51 countries and the EU signed the Energy Charter Treaty and the related documents. Virtually all European countries, including the CIS countries and the Baltic countries, as well as Australia and Japan signed these documents. In 1996, Macedonia and Bosnia joined the Energy Charter Treaty. In 1997, Mongolia also submitted an application.

The EU has been actively advocating and promoting the construction of the Energy Charter Treaty due to its significance to the EU.<sup>53</sup>

First of all, the Energy Charter is one of the important initiatives of the EU in dealing with energy crisis and ensuring energy security.

Secondly, the Energy Charter will help the EU in maximally safeguarding its own energy interests. The EU takes the European Energy Charter, G8, the International Energy Agency and other international organizations as energy diplomacy tools to constrain Russia, so as to realize as many of its energy interests as possible.

Third, the Energy Charter is a carrier of and channel for the EU’s communication with energy supply countries. In addition to strengthening energy cooperation with Russia and other suppliers the Charter has also actively promoted cooperation with OPEC, which had laid a solid platform for the EU to strengthen communication with energy supply countries.<sup>54</sup>

In the signing of the Energy Charter Treaty and the Final Documents and Protocol, Russia showed concerns on the manner of payment, nuclear materials trade and other issues, which was reflected in the Chairman’s Statement of the European Energy Charter Conference and the summary of the Lisbon meeting.

The Energy Charter Treaty and its related documents are the products of mutual compromises and concessions, reflecting the ways each party has found of balancing its own interests. The main ob-

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53 Cheng Chun-hua, “The European Energy Charter and Russia -Europe Oil and Gas Cooperation,” 6(2006), *Petroleum Economics* [Guoji Shiyou Jingji].

54 Ria Kemper, “Dialogue to develop between OPEC and the Energy Charter,” *Oil, Gas & Energy Law Intelligence* vol. 1 issue 2, March 2003, [http://www.gasandoil.com/ogel/samples/freearticles/article\\_12.htm](http://www.gasandoil.com/ogel/samples/freearticles/article_12.htm) [15 January 2008].

jective of the treaty is to establish a legal framework to promote long-term energy cooperation. The Energy Cooperation Treaty is a multilateral treaty based on five key components: investment in the field of energy; sovereignty over domestic resources; and free access to the energy market, energy transit, and the related capital flow of energy investment. The Energy Charter Treaty requires the approval of the legislative authority of the participating countries and takes effect 90 days after the 30th approval letter submitted to the depositary country (Portugal). By April 2002, 45 countries, including the 10 CIS countries, Latvia, Estonia, Lithuania and the 15 EU countries had completed the ratification process. In addition, the European Parliament has agreed a formal approval of the Energy Charter Treaty and its relevant documents.

Russia was elected as a representative to participate in follow-up activities within the framework of the Energy Charter Treaty. The negotiation over supplementary (investment) terms is of decisive significance. The main objective of this provision is to make amendments to the 10th Article of the Energy Charter Treaty, which strictly regulates the encouragement and protection of investments and investment mechanisms. The essence of these changes is to enable the inviting country to treat national and foreign investors equally, or provide other favorable treatments to foreign investors. The supplementary provisions require each party to keep records of all the fines imposed on foreign investors. From the perspective of encouraging energy investment at the final stage of investment, Article 10 may play a more important role than the Energy Charter Treaty.

The energy transit issue is very complicated. It requires the establishment of a universally applicable international legal framework. In this regard, the development of the draft of the Energy Charter Transit Protocol is of great significance. But the negotiations on the supplementary provisions and the Transit Protocol were not successful. The Russian delegation actively participated in the negotiations. As the process of the Russian Federation Duma's ratification of the "Energy Charter Treaty is complicated, the Russian delegation encountered certain difficulties.

Russia's position on the Energy Charter Treaty is that it affects the Russian economy in key areas. About half of its foreign trade, the export trade, would be given priority. The main significance of Russia's participation in the Energy Charter Treaty is to establish a broad legal framework for domestic and foreign energy investors, including the regulation of transit transport.

Before the Energy Charter Treaty came into effect, the majority of the consultation countries, including Russia, agreed to temporarily adopt this treaty. In 1996, the Russian-Azerbaijani Caspian "early" Oil Transportation Agreement adopted some of the provisions of the Energy Charter Treaty. In addition, based on the Treaty the CIS Economic Union Economic Committee signed a multilateral agreement on the implementation of common policies on the oil products pipelines trunk line transit on 12 April 1996.

After preparation, the Energy Charter Treaty and its related documents was sent to the Russian Federation Council for approval. In 1997, at a hearing held in the Duma, lawmakers made a series of suggestions on this treaty. They endorsed the treaty but thought it needed further discussion before formal approval. In January 2001, another hearing was held. Based on the results of the hearing, the Duma requested the President of the Russian Federation to mandate the Security Council's thorough analysis of the possible geopolitical and economic impact on Russia after the approval of the treaty.

Under the present situation, if the Russian legislative authorities can formally approve the Energy Charter Treaty and introduce a series of laws, it would create the necessary conditions for the attraction of domestic and foreign investment. Once the Energy Charter Treaty is officially approved, it will solidify Russia's international obligations and be adopted into its national legal system. This will be reflected in the competition methods, state procurement system, foreign exchange adjustments and external economic activities, and investment regulations, as well as the national regulations on international arbitration. The approval of the Energy Charter Treaty will largely affect the legal basis of the whole economy.

The provisions of the Energy Charter Treaty will apply to Russia's relations with other CIS countries in the energy field, thereby pushing these relationships onto a more civilized track and in particular helping to solve Russia's transit issues with Ukraine. In addition, the Treaty will facilitate the convergence of Russia's economic system with the EU's, reducing obstacles to the entry of EU capital and technology into Russia. It is also of positive significance to the enhancement of Russia's energy efficiency. From the perspective of the country's overall interests, the balance of rights

and obligations that Russia will obtain in the treaty is positive and useful. After the development of supplementary provisions and implementation, Russia will be ready to provide the same treatment to national and foreign investors in energy exploration, processing and transport. This will improve the investment environment and is expected to attract large-scale foreign investment. Meanwhile, Russian companies will be able to enter energy consumption markets and foreign energy equipment markets without discrimination. They will have access to capital markets, which will ensure convenient and efficient access to investment from energy and related sectors, particularly favorable conditions in Russian energy transit, and so on.

The Energy Charter Treaty is built on a foundation of national energy market liberalization. The signing parties of this Charter must open up their energy markets in various aspects, from production to distribution to foreign investment companies. Therefore, as the government's monopoly is broken, the influence of energy-exporting countries in the formulation of energy prices and exports will be weakened. Although the Russian government has signed the Energy Charter Treaty, it still has the Duma as a hurdle. Of course, the Energy Charter Treaty has not been passed in all EU member states, nor in the United States and Canada, which hold divergent views on this issue. This divergence has led to the European countries' inability to form a harmonious view on the energy policy issue. In view of these differences, the issue of energy security has become harmful to every European country that needs a large amount of foreign energy. Thus, putting pressure on Russia and forcing Russia to open up its energy market to European companies has become a common purpose of the EU member countries.

However, whether Russia can ultimately pass the Energy Charter depends on its ability to gain preferential access concessions from European countries. Moscow has proposed the opening-up of the European energy market to Russia's Gazprom. The Kremlin rulers have a profound understanding on the importance of energy in their political game with Europe and the world, thus they would never give up their oil and gas trump card. Therefore, although the European countries attempt to put pressure on Russia in the hope that Moscow will adopt the Energy Charter Treaty immediately, all signs indicate that the Russian government will not soon succumb to the pressure of the European governments. At the G8 Summit in July 2006, Putin said, "Some specific issues remain unsolved in the Energy Charter itself and within the framework of its Additional Protocol ... We need to know, in return, what we can get."<sup>55</sup> The delay on the adoption of the Energy Charter Treaty has also affected the progress of Europe-Russia energy cooperation. Russia is skeptical about the supplementary and transit provisions, concerned that it might not be able to maintain its gas export monopoly to the European. This is the crux of the current problem.

The Energy Charter Treaty was initiated by the EU member states. The initial objective of the development of a framework of documents that put constraints on energy trade was to regulate the energy trade between Russia and Europe. This can be seen as an EU effort to convince Russia to integrate into the European family. Despite setbacks, the two sides have not cancelled dialogue and negotiation. Russia's Energy Planning by 2020 and the Green Paper passed by the EU in 2006 were both aimed at convincing Russia to join the Energy Charter Treaty. It is anticipated that negotiations will continue and Russia will ultimately accede to this treaty, but only in compliance with bilateral interests.

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55 "Putin: Contradictions exist in the Energy Charter", rusnews.cn, 17 July 2006, [http://rusnews.cn/eguoxinwen/eluosi\\_caijing/20060717/41497763.html](http://rusnews.cn/eguoxinwen/eluosi_caijing/20060717/41497763.html) [15 January 2008].

## 4. Conclusion

The Russia-Europe energy relationship, despite posturing games in the short term and control/counter-control competition by both sides, will continue for some time. In the long run, the relationship will center on cooperation and compromise, because the establishment of a positive energy interaction is a common need for both actors.

In terms of the decision-making mechanisms of the two sides, Russian mechanisms can be vividly described as taking a shape similar to the human body: The head refers to the policy-makers, i.e. President Putin and Russia's top political elites. The body parts comprise Russia's huge bureaucratic institutions, including many departments in the central and local governments, the oligopolistic enterprises' spokesmen and outside groups within the government. Two of the largest energy companies, Gazprom and ROSNEFT<sup>56</sup>, make up the two arms. The lower part of the body has many legs made up of the other financial oligarchies in the energy industry. The problem of the whole mechanism lies in that the head, the decision-making organ, is too small while the trunk and extremities are too big. It is difficult to keep a balance between hands and feet. Taking into account the interests of various parties, the introduction of any energy policy in Russia must go through long internal games between various government departments and enterprises. Even in the process of implementation problems occur due to various reasons. Therefore, in Russia's external games with western energy companies Russia's frequent changes of decisions are often caused by the imbalance of the internal forces rather than a conscious policy alteration by the government or the top policy makers. Nevertheless, the head can play the role of arbiter. In this system of body parts, President Putin and his aides still make the final decision. Though the head cannot ensure a timely response in the right place, it is able to make and implement a final resolution.

As a regional international organization, the EU common energy policy-making mechanism is a very abstract and loose structure. Although common energy diplomacy is nominally coordinated by the European Commission and entrusted to the President of the European Commission Jose Manuel Barroso for coordination, the specific energy policy is decided by the countries themselves. If also using a vivid analogy to describe the case, the EU's energy decision-making mechanism is like a galaxy. The common energy diplomacy center in this galaxy is a very small star with little gravity, while the EU member states are the 27 satellites rotating around the star in different directions. One can imagine the difficulty of enhancing the gravity of the star and regulating the rotation of the satellites in this state.

Because energy concerns their core national interests, most EU countries make their own energy policies. Still, the EU has managed to form a preliminary consensus on the development of energy-saving technologies and new energies, as well as the building of an internal common energy market. It has also demonstrated a common diplomatic posture in its energy diplomacy with Russia. However, the EU's energy dependence on Russia will strengthen, at least in the near future. The common foreign energy policy is still elusive, as diversified energy supply cannot be guaranteed, in particular diversified sources of natural gas, and the development of new energies has failed to make substantive progress.<sup>57</sup>

The world has entered an era of high energy prices: various factors have determined that the energy market will be a seller's market in the medium and long-terms. As an energy supplier Russia possesses and has consolidated its advantages in pricing, transportation, supply and many other areas. Meanwhile, in Russia-EU energy exchanges, as Russia's traditional energy consumer as well as technology and funds provider, the EU is not entirely passive.

As far as Russia is concerned, at present its energy offensives at home and abroad are very aggressive. Its future also seems to be promising in the context of a global energy shortage. However, I hold a cautious attitude toward the prospects of Russia's gas diplomacy: Although there are many favorable factors, Russia should remain extremely cautious in its energy diplomacy including the handling of natural gas, because using oil and gas resources as a strategic weapon is a double-

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56 i.e. The Russian oil company.

57 Giacomo Luciani, "Security of Supply for Natural Gas Markets. What is it and what is it not?", FEEM Working Paper no. 119.04, March 2004.

edged sword – it may be quite effective in the short term, but cannot possibly achieve strategic objectives in the long-term.

History supports the idea that aggressive energy diplomacy will eventually backfire. In November 1973, oil prices rose greatly after OPEC's announcement of an oil embargo on the United States and the Netherlands, which made the Western world panic. The consequence was the Western countries reduced their dependence on oil by adopting energy efficiency measures and new technologies which ensured sustainable and healthy economic growth. In contrast Saudi Arabia and other OPEC countries conducted no adjustments to their economic structures after enjoying several years of huge profits, resulting in plummeting income per capita.

At the time, the Soviet Union was in the Brezhnev era. The leaders of the Soviet Union had determined to reform the country's economic structure, but the accidental rise in oil prices caused them to immediately switch attention to energy diplomacy. The Soviet Union supported the two oil crises and gained a lot of benefit from them: the Soviet Union successfully entered the oil industries of Iraq, Iran, Egypt, Yemen, Algeria and other countries in the mid-1970s in the name of "aid". At the end of 1973, right after the oil crisis took place, Iraq sold 6 million pounds' worth of oil to the Soviet Union at a low price, to pay off the arms debts it owed from the anti-invasion war of October 1973. Before the shipment, the Soviet Union had already sold the oil to West Germany for 18 million pounds.<sup>58</sup> This sudden oil wealth hid serious economic difficulties in the Soviet Union. Oil exports enabled the Soviet Union's extensive economic growth to continue and made political reform seem inappropriate.<sup>59</sup>

The current international energy situation strikingly similar to that of the 1970s. Although the causes of energy crisis may differ, all countries in the world are facing high oil and gas prices, with the only difference that China, India and other emerging economies are experiencing more serious difficulties than the United States, Europe and other developed countries because they lack sufficient energy reserves and diversified sources of imports.

Compared to OPEC, the United States and European countries with large energy resources, Russia has a relative lack of experience in energy diplomacy. However, in the last two years it has tasted the benefits of such diplomacy. In the future, its use of energy as a weapon will become more frequent. A Russian expert believes that the Nordic Gas Pipeline Project is a more effective tool of diplomacy than "the armed forces of the Soviet Union deployed in Germany in the past."<sup>60</sup> The Kremlin's use of energy, especially natural gas resources, to control the CIS, split apart the EU and enter Asia has become obvious. Yet as it enjoys short-term economic and geopolitical benefits from natural gas diplomacy, it also assumes risks for the long term.

As the history of OPEC and the former Soviet Union noted above, bulging coffers from oil dollars will weaken the government's determination to reform its economic structure. The rapid growth of foreign exchange reserves will easily persuade political leaders that they have a powerful national economy. Such a faulty assessment of the economic situation will deprive leaders of the best timing for economic and political reforms, ultimately leading the country to become a "Middle East Assimilated" single energy exporter. Russia's economy has shown a straight upward trend since 2001, but its excessive dependence on the export of raw materials, especially since the structure of oil and gas exports has not been changed, has aroused concerns from many people of insight, including Russian experts.

Indeed, Russia plays a key role in the formation of pricing mechanisms in the global natural gas market. However, the rapid formation of a global natural gas market to a large extent depends on the possibility of creating a climate that can gain the confidence of investors who can provide huge amounts of financial and intellectual capital. In addition, the perfection of this market also relies on the large-scale construction of gas consumption terminals in the importing countries, which also requires substantial financial and human resources. Most of the studies have shown that despite abundant global natural gas resources, many reserves are located in countries with little or no tradi-

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58 Sun Wuche, "Review of the strategies of the United States toward China", (Beijing: International Institute for Strategic Studies, 2004), <http://str.chinaiiss.org/content/2007-04-08/150.shtml> [27 January 2008].

59 Zhang Jianjing, "Sub-profit Share Groups – the root causes of the collapse of the Soviet Union", *Nan Feng Chuang Magazine*, September 2004, p. 46-49.

60 Igor Torbakov: "Moscow Skillfully Uses Energy Leverage to Divide Europe", *Eurasia Daily Monitor* vol. 2 issue 187, 7 October 2007



tion of attracting private investors. The natural gas industry's capital-intensive, long-term returns (15-20 years, some very complex projects need even longer) have made investors extremely cautious in their decisions. Russia's grim domestic political situation and the uncertainty of Russian foreign policies in the Putin era make the main gas-consuming countries in Europe and the United States unwilling to make large-scale investment decisions.<sup>61</sup>

In order to safeguard its sphere of influence in the former Soviet Union region, Russia has threatened to cut off natural gas to its neighbors. In doing so, it has taken the oil and gas facilities of Moldova, Lithuania and other countries into its own energy transmission network. Moscow currently covets the gas pipelines in Ukraine. Although its diplomatic methods have strengthened Russia's bargaining power in energy diplomacy, they have also deepened the Eastern European countries' phobia about Russia, which has made the EU doubt Russia's the reliability as a "guarantor of energy security". Britain, France, Germany, Italy and other major EU member countries have begun a revision of energy policy, setting the diversification imports and energy saving as their main objectives. In the long run, some of Russia's energy diplomacy tactics will prove (and have proven) counterproductive.

To achieve the dream of creating an energy empire, President Putin has implemented a series of iron-fisted policies, such as the suppression of domestic media, the appointment of Miller, P.A.Медведев, Igor Sechin and other cronies as heads of state-owned energy enterprises. P.A.Медведев is also charged with the first deputy prime minister's responsibilities and is commonly recognized as one of the 2008 presidential candidates. At the end of 2005, at Putin's behest the Duma adopted a bill that imposes restrictions on non-governmental organizations. Political measures of this kind have not only aroused concerns from the United States and Europe regarding Russia's "democratization" process and energy diplomacy objectives but also caused the Russian people to have doubts about Russian domestic justice and freedom of speech. These latter consequences in particular have greatly undermined the authority of the political bureaucracy and powerful groups, and even President Putin's prestige. Meanwhile, the Putin government's sustained pressure through administrative means on Boris Berezovsky, Vladimir Gusinsky and Khodorkovsky and other oligarchs has caused panic among Russia's rich and powerful, such that the transfer of assets has become inevitable. According to Russian Central Bank statistics, in 2004 the scale of leaked Russian capital was four times than that of the 2003, or 94 billion dollars. This data can be considered as demonstrating the worry of the Russian business community about the domestic economic and political situation.<sup>62</sup>

Overall, Russia's huge energy reserves have granted it a unique strategic advantage. Fiona Hill, an expert on United States energy and Russian foreign policy and Senior Researcher on Foreign Policies Research Projects at the Brookings Institute, was correct in her assessment that although currently Russia is only a rising energy country, it will become the natural gas superpower within 20 years.<sup>63</sup>

Oil and gas could be both Russia's most lethal weapons in the 21st century and the engine in the rejuvenation of its great power status. However, in view of the various risks in the implementation process of energy diplomacy, they may also be the trap that entombs Russia's dream of rejuvenation. The outcome depends on whether the Kremlin leader will be able to plan ahead and work out a more forward-looking strategy for domestic and foreign energy.

The EU has its own way of coping with an aggressive Russia. Recently, EU foreign policy chief Javier Solana and EU Commissioner for External Relations Benita Ferrero-Waldner announced EU plans to carry out a series of diplomatic efforts to meet its growing energy needs. EU decision-makers will make the assurance of oil and natural gas supply a top priority in EU foreign policy.<sup>64</sup>

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61 *Geopolitics of Natural Gas: An Analysis of Prospective Developments in the Natural Gas Trade and the Geopolitical Implications*, joint study by The James A. Baker III Institute for Public Policy of Rice University and The Stanford Program on Energy and Sustainable Development, May 2004, [http://www.rice.edu/energy/research/LNG%20\(GeoPol%20NG\)/geopoliticsofLNG.html](http://www.rice.edu/energy/research/LNG%20(GeoPol%20NG)/geopoliticsofLNG.html) [15 January 2008].

62 Источники из статистиков Центра Банка России, 2004 г.

63 Fiona Hill: "Russia: The Energy Superpower in the 21st Century", *Brookings Review*, Spring 2002.

64 "Commission proposes an integrated energy and climate change package to cut emissions for the 21st Century", European Commission press release, 10 January 2007, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/29&format=HTML&aged=0&language=EN&guiLanguage=en> [16 January 2008]; Council of the European Union, "Presidency Conclusions," Brussels European Council, 8-9 March 2007, p. 13-14.

EU governments must support the development and implementation of their domestic energy policies and solidify partnerships through joint actions with energy-exporting countries, including Russia.

The EU's measures to Russia's energy diplomacy can generally be divided into the following categories:

*a) Signed extensive agreements on energy cooperation with Russia.*

The EU-Russia "Energy Community" concept developed by the EU was put on the agenda of global energy issues in the 1990s. The afore-mentioned controversial energy incidents that have occurred in the last two years have made a deep impression in this relatively new policy area. In the EU's view, Russia's current energy policies are both destabilizing and de-rationalizing oil and gas prices. The EU hopes that Russia will soon be able to guarantee the price and supply of natural gas, as well as sign the International Energy Charter. In turn, Russia expects the EU's energy demand on Russia to continue for 10 to 20 years, with continued investment in energy exploration as a precondition. Although Europe and Russia failed to sign an energy cooperation agreement at the Samara Summit due to poor political relations, the agreement is of self-evident importance to the both sides. Therefore, continued consultations and eventual agreement can be expected with certainty.

*b) Integration of the EU internal market to jointly deal with Russia*

In terms of the building of a unified internal energy market, the EU is still facing a small problem, which is mainly reflected in the conflict of energy interests among the EU countries and the differences in their respective energy policies.

In the coordination of energy policy, the new energy strategy pointed out that the 27 EU member states should strengthen cross-border integration and regulation in the energy market, so as to form a unified internal energy market. In this regard, the EU Commission proposed "dismemberment" of a number of large energy enterprises for the decoupling of energy production and transmission.

The EU leaders all agreed to analyze and adjust their respective national energy policies; actively support the construction of a Europe-wide energy network with the unified technical standards and specifications to further develop energy resources in the North and Caspian Seas; gradually break the monopoly of state-owned enterprises and select companies over the energy market to form a free market; and the formation of a single supply system for gas and electricity to ensure stable supply and demand as well as reasonable prices in the EU energy market. According to the plan, the electricity and gas markets in the EU countries would be completely open by July 2007. However, currently protectionism still exists in this field. Based on their own considerations, the differences of the EU countries on the liberalization of the energy market are still irreconcilable. Such a situation is obviously inconducive to the formation of a common EU energy policy.

Recently, the EU has been worrying that the Putin government plans to merge the world's largest natural gas company, Gazprom, with the Rosneft oil company. Such a merge reflects the Russian government's consideration of trying to control the energy industry, which is clearly contrary to the EU's expectation of free competition to ensure a stable energy supply.

The EU also pays close attention to the Russian gas companies' expansion attempts. The British Department of Trade and Industry has considered amending the relevant annexation bills to prevent Russian gas companies from taking over the British gas company. The German government also expressed support for the EU's plan to formulate appropriate policies to reduce dependence on Russian energy. The German companies RWE and Eon are cooperative partners of the Russian Natural Gas Company. They have bought a large number of shares in the Russian Natural Gas Company and invested in the exploitation of Russian natural gas. Now the Russian Natural Gas Company in turn wants to buy shares in the German company in order to enter the German energy consumption market, which Germany and the EU do not want. Therefore, consolidating forces within the EU member states and reaching a consensus to jointly deal with Russia has become urgent.

*c) Energy cooperation and dialogues with energy importing countries to prevent Russia from raising prices.*

Brussels calls on EU member states to further strengthen cooperation and dialogue with other energy-consuming countries such as the United States, Japan, China and India. The EU is particularly alert to China's intensive search for links with the global oil production countries to meet its growing energy needs as well as the global energy supply shortage caused by the rising energy consumption of the United States. The EU is mainly worried that the global energy shortage will lead to higher energy prices, which may aggravate the price-pushing of energy exporting countries such as Russia.

*d) Development of alternative energy sources and improvement of energy efficiency to reduce energy dependence on Russia.*

The EU's energy consumption breaks down as follows: roughly 40% oil, 23% natural gas, 16% nuclear energy, and 6% renewable energy. European countries have been trying to eliminate the negative effects of high oil prices on European economic development, but their efforts have had little success. Despite sharp oil output increases in the North Sea by Britain and Norway, the period remaining for exploitation is only five to eight years due to limited reserves. Dependence on OPEC oil and Russian energy is difficult to change. All these factors will lead to the EU's further dependence on Russian energy. Due to the energy supply and demand interdependence between the EU and Russia, unprecedented economic interdependence has occurred between the Atlantic and the Urals. Currently, the European economies have to rely on Russia's energy supply. Germany, for instance, obtains 35% of its oil and 40% of its natural gas from Russia, more than any other country in Europe. Some experts predict that by 2020 these figures will reach 60% to 70%. Therefore, alternative energy sources and improving energy efficiency have become a priority of EU energy policy, and even nuclear energy has become a somewhat attractive choice to avoid a Russian natural gas supply monopoly.

Moreover, the EU can also impact on Russia's energy policies through investment, technology transfers, environmental protection cooperation, and other means.

In the last part of this chapter, let us take a look at the incidents that have happened between Russia and Europe since 2006 in the field of energy:

*Summary of Europe-Russia energy relations since 2006*

Incident	Time	Content	Conclusion
Russia-Ukraine natural gas dispute	01/2006	Price rises, natural gas cutoff (Market factors + ideology)	Russia and Ukraine compromise; EU seeks diversified energy imports
The EU Green Paper	03/2006	Sustainable development, competitiveness and supply security	EU and Russia establish energy relations under a legal framework
The St. Petersburg G8 Summit	7/2006	The Declaration of Global Energy Security	Russia and EU liberalize their energy markets; EU i expands investment in Russia
Russia-Belarus energy dispute	01/2007	Price rises, oil cutoff (Mainly market factors)	Russia and Belarus compromise; EU doubts Russia's reliability, common energy diplomacy is enhanced
Putin's visit to Turkmenistan & The Poland Energy Summit	05/11-13/2007	The Caspian Pipeline Construction & oil pipeline bypassing Russia (organization of anti-Russian energy alliance)	Russia controls Central Asia's main natural gas resources → Russia is still the key energy supplier to the EU
The Samalaou Europe-Russia Summit	05/18/2007	The discussion of new Partnership and Cooperation Agreement (PCA); Energy cooperation, climate change, Russia's entry into the WTO, etc.	Partnership and cooperation agreements prove difficult, no progress in energy cooperation

From the table it can be seen that after the Ukraine gas conflict in January 2006, the EU began to develop a new energy strategy toward Russia, emphasizing sustainable development, competitive-

ness, supply security and the establishment of a legal framework for EU-Russia energy relations. At the St. Petersburg G8 Summit in July 2006, the EU also issued the Declaration on Global Energy Security, which calls for Russia and Europe to both liberalize their energy markets, and the EU to expand investment in Russia. But in January 2007, at the outbreak of the Russia-Belarus energy conflict, the EU began to doubt Russia's reliability. Although the incident ended in a compromise, it also highlighted the need to strengthen the common foreign energy policy. Therefore, in May 2007 the EU and Russia started to discuss the issue of energy pipeline construction, with the conclusion that Russia still has primary control of the Central Asian natural gas resources. This game indicated that the status of Russia as the EU's main energy supplier will be difficult to shake in the near future. At the following Samalau Europe-Russia Summit, Russia and Europe clearly showed mutual distrust and discontent. The extreme difficulties reaching a new partnership and cooperation agreement has disabled the development of energy cooperation. Russia-Europe energy relations have reached a new low.

The above difficulties are mainly due to political and economic changes on both sides, including Poland and Estonia's conflict with Russia and, the rotation of leaders in France, Germany the United Kingdom and other major EU countries. Nevertheless, we can still assert that the Europe-Russia energy relationship is merely experiencing a cyclical downturn, because their structures have not undergone fundamental changes. Russia-Europe energy interdependence remains. The position of the Russia-Europe geological space is more impossible to change. In the Post-Cold War Era or the so-called Post-Post-Cold War Era<sup>65</sup>, each country increasingly emphasizes economic or soft power competition. Many believe most contradictions and conflicts can be solved through negotiation, rather than a deadly game. In this era, "energy has become the currency of political and economic force; it is the decisive factor in the power hierarchy system among countries, even a new chip of success and material progress. Therefore, it has become a priority overriding everything to obtain energy in the 21st century."<sup>66</sup> In other words, energy has become the key issue in the field of contemporary international politics, an important pillar of inter-state relations in the present era. Under this background, even the great differences on energy issues between Russia and Europe are not irreconcilable. We can see that even at the lowest point of mutual relations the energy trade has not been permanently affected.

Europe's reliance on Russian energy is unlikely to change any time soon, while Russia's largest importer of energy is Europe. If Russia loses this market it will mean the loss of a source of huge funds. In such an interdependent relationship the unilateral use of energy weapons or energy sanctions will cause great harm to the EU as well as Russia. Thus, unless some structural changes occur in Europe-Russia energy relations such as the success of Russia's development of its energy distribution system in the Far East region or the EU's success in finding new alternative energies that ensure huge production, the Europe-Russia energy relationship will not be too much affected by political considerations.

From the perspective of the European geopolitical pattern, the EU is an ally of the United States but also maintains a partnership with Russia, with which it shares the European continent. The EU definitely will not simply follow the United States in confronting Russia. By studying the EU's Green Paper on energy and Russia's Energy Strategy before 2020, we can conclude that there are no fundamental conflicts between EU and Russian economic interests. The current problems are now more political than economic. Therefore, the EU's energy diplomacy toward Russia should focus on long-term strategic relationship while paying close attention to energy resources.

Finally, I would like to quote one sentence from EU Energy Commissioner Andris Piebalgs as the conclusion of this chapter. "Russia and Europe need each other in the energy sector..The energy products the EU purchases from Russia are the key to Russian economic recovery while a stable, reasonably priced energy supply is also an important economic development engine for the EU. In this area, in other words, we are mutually reinforcing."<sup>67</sup>

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65 Ralph A. Cossa, "Opening up the Post-post- Cold War Era", *Korea Times*, 12 October 2001.

66 Paul Roberts, *The End of Oil*, Chinese translation, Wu Jinglian, ed., (Beijing: CITIC Publishing House, 2005), p.159-160.

67 Andris Piebalgs, Commissioner on Energy of the European Commission, speech at International Energy Week in Moscow, 30 October 2006.