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ESSAY

NEW PLAYERS IN THE RUSSIAN GAS GAME: THE RISE OF NON-GAZPROM GAS PRODUCERS IN RUSSIA

András MOLNÁR

ABSTRACT

The share of non-Gazprom gas producers in the Russian domestic gas market has been rising for the last decade. This paper examines this trend in the Russian domestic natural gas sector giving special attention to the field development and business strategy of the challengers of Gazprom such as Novatek, Rosneft and LUKOIL. Their market share is rising due to the high cost of Gazprom's greenfield developments on the one hand, and their effective company strategy on the other. However this would not be enough for their success without the growing political backing of the Kremlin. All this could lead in the medium term to the transformation of the Russian domestic gas market, and in longer run maybe also to that of the natural gas export policies and structure of Russia.

Keywords: Russia, Gazprom, Novatek, natural gas, non-Gazprom gas producer

INTRODUCTION

Russia holds 16.8% of the world's proven conventional natural gas reserves and provides 17.9% of world production,¹ outperformed only by the U.S.² The Nadym-Pur-Taz region in West Siberia has long been the most productive gas producing area of Russia, giving around 85% total of its output in the 1990's and early 2000's.³ Nevertheless, since at least 2006 various Western and Russian experts and analysts have warned that the three major gas fields of the state-owned energy giant Gazprom in the area – Urengoykoye, Yamburgskoe and Medvezhe – are in steady decline, while it has not made the necessary investments in order to ensure future production for domestic and foreign markets and especially to fulfil its long-term contract obligations to European costumers.⁴ Rather, huge investments have been made in overseas projects in Latin America, the Middle East and African countries¹ and the oil and electricity sectors of Russia.² All this could have long-term effects on the Russian gas market and gas export.

Gazprom dominated the Russian gas market throughout the whole Post-Soviet period, with various state bodies regulating the establishment of its prices, the latest being the Federal Tariff Service. Prices have been kept very low for long, sometimes even below production costs, but in the last few years significant effort has been made by the Putin administration to push domestic gas prices up to the level of European export prices that is netted back to Russia. The price increase and the improvement in the

¹ In 2010 Gazprom Neft - a subsidiary of Gazprom - started to expand in the global oil and gas market. It signed a contract to develop the Badra field in Iraq, and became the leader of a consortium of Russian oil companies in a project to develop the Junin-6 oil block in Venezuela. It also joined, on the basis of production sharing, an offshore project in Equatorial Guinea at a geological exploration stage, and also acquired stakes in an offshore geological exploration project in Cuba. OAO Gazprom Neft. "2012 Annual Report - Effective Strategy for Growth," Accessed June 9, 2014. [http://www.gazprom-neft.com/annual-reports/2012/Gazprom-Neft Annual Report 2012 eng.pdf](http://www.gazprom-neft.com/annual-reports/2012/Gazprom-Neft%20Annual%20Report%202012_eng.pdf).

² In the electricity sector between 2007 and 2008, as a result of the reform of RAO UES - the Unified Energy System of Russia - and buying of shares of power generating companies Gazprom became Russia's largest power generating asset owner with 36,6 GW of capacity. According the company's planes it is going to boost its power production capacity by 7 GW to 43.6 GW in total until 2016. The oil producing branch of Gazprom, Gazprom Neft was established on May 13, 2006, after Gazprom acquired controlling interest (75.68%) in OJSC Sibneft. In the same year it entered the retail market in Central Asia by creating a subsidiary – Gazprom Neft Asia – to sell petroleum products in Kyrgyzstan, Tajikistan and Kazakhstan. In December 2007, Gazprom Neft acquired a 50% stake in Tomskneft, a company producing oil and gas in the Tomsk Region and Khanty-Mansiysk Autonomous District. OAO Gazprom Neft. "About Gazprom - Power Industry." Accessed December 28, 2013. <http://www.gazprom.com/about/production/energetics>.

economics of gas sales in Russia it withdrew have attracted several new entrants to the market, such as non-Gazprom gas producers (NGPs) like Novatek, oil companies such as Rosneft, and LUKOIL who have significant marketable gas reserves. The so far reserved attitude of these potential rivals of Gazprom seem to be changing recently, which may foster a radical shift in the Russian gas sector.

This paper examines the background and the consequences of the rise of non-Gazprom gas producer in Russia in a time frame – between 2008 and 2013 – when Gazprom had the chance to countervail their ascension but missed the chance to do so.

CHALLENGES FOR GAZPROM

Gazprom, holding approximately two thirds of total Russian gas production, has to make a series of important decisions in the near future. Its most productive fields face output decrease while the company is responsible for meeting the needs of domestic consumers, in an economic situation where domestic prices, despite increasing, still stay below netback parity. Historically, the gap between European export gas prices and domestic ones has been wide, making it possible for Gazprom to cross-subsidize the domestic market with European export revenues.⁵ In fact, it has been calculated that dual pricing allowed Russia to keep its GDP some 2% higher than otherwise.⁶ Nowadays, especially with its mounting greenfield development projects becoming more expensive, this business model keeps on getting less and less sustainable. Meanwhile, the downward pressure on prices by decrease in overall European gas consumption, growing North American shale gas supply in Western Europe, pressure from the side of European customers on contract renegotiations mainly in terms of price formulas and new LNG projects in other parts of the world mean further increasing challenge.

It is also worth mentioning that Gazprom owns all pipeline networks in Russia, which, on the one hand, is a serious competitive advantage, but on the other hand it puts a significant financial constraint on the company. At present, as more than 25% of the pipeline network is 30 years or older, there has been an increasing need for investments aiming replacement and modernization. Consequently, pipeline reconstruction expenditures constituted 25% of all expenses in the sector between 2007 and 2010.⁷ Beside this, if we take into consideration the

decline in the production of the three major fields of the Nadym-Pur-Paz area, in the forthcoming one or two decades, Gazprom's production will increasingly have to rely on new fields. Recent developments in the Nadym-Pur-Paz region that have been operating since 2005 like the South-Russkoe and Yakhinskoe gas fields can be regarded cost-efficient given that they are located near the existing pipeline network.⁸ However, they fail to compensate for the decrease in the three main assets of Gazprom. Thus Gazprom has no other choice but ensure new production capacity with the development of the Shtokman and Yamal gas deposits that, according to the company's estimates, could provide 70 and 200 billion cubic meters (bcm) per year, respectively.

However, in order for this to come into being, transport capacity needs to be expanded by vast investments in infrastructure, in a region – the Arctic – where the financial and time frames of exploitation significantly exceed those of an average gas field. To sum up, in case Gazprom should not meet these challenges, NGPs could have the opportunity to increase their output as long as there is sufficient market demand.

NON-GAZPROM GAS PRODUCERS

The NGPs in Russia do not constitute a homogeneous group but various sub-groups. There are independent gas producing companies like Novatek and Itera, oil companies such as Rosneft, LUKOIL or Surguneftegaz, and also foreign companies usually in cooperation with Gazprom, for example ENI or Enel and smaller regional enterprises like SeverEnergia and Tatneft. Altogether around 70 individual gas producers can be identified within the Russian gas industry with approximately 9800 bcm of reserves.⁹ Significant part of these resources is associated gas, which requires relatively low investment to be developed if it is located near the existing pipeline network. Thus, their exploitation is a financially more advantageous option than the greenfield developments of Gazprom. Out of these companies only a few are significant enough to merit attention, in particular, Novatek and Rosneft are likely to have major impact in the next decade.

NOVATEK

Novatek, being the second largest gas company of Russia in terms of proved natural gas reserves and output, is also ranked among the top five companies worldwide. During 2012 its new supply contracts with Russian consumers constituted half of all new NGP contracts in the country. At the end of 2013 Novatek had 3.11 tcm proved gas reserves under the PRMS definition³ and 2.47 tcm according to the more strict SEC system;⁴ furthermore, it also owned around 700 million barrels of oil and condensate reserves.¹⁰ This means that, at the current production rate, the company's reserves are ensured for the next 31 years according to the SEC classification system, and for 48 years counting with the proved plus probable definition (PRMS). The company achieved a significant production increase in the last few years: it produced approximately 30 bcm natural gas in 2006, 37.2 in 2010 and 53.5 in 2011 – this means an imposing 39% average growth annually.¹¹ This increase is not only based upon Novatek's existing reserves and the organic growth induced by it but also upon a significant amount of shares it acquired over the last years in a number of companies, such as SeverEnergiya, Sibneftgas and Northgaz. These newly acquired assets include fields on the Yamal and Gydan peninsulas, from where 2.5tcm of potential gas reserves could be exploited, and thus they also deserve special attention.⁵

Although it is obvious that Novatek has to face risks deriving from the expansion through the development of these assets, nearly doubling production records and successfully achieved output targets between 2006 and 2012 support the assumption that the planned 112 bcm output by 2020 is a realistic goal.

Moreover, beside natural gas the company's liquid reserves also contribute to ensuring economic stability. While the production of liquids constitutes less than 10% of the total output, it accounts for

³ The PRMS - Petroleum Resources Management System – is a reserve classification methodology approved by the Society of Petroleum Engineers. According to the PRMS standards, reserves can be classified as proved, probable, and possible. Considered is not only the fact of hydrocarbon discovery in the subsurface, but also the economic efficiency of production and transportation, current prices for hydrocarbon feedstock and other factors.

⁴ The SEC standards are the strictest, as they set forth most serious requirements for the category of “proved” reserves and consider the period of validity of the license: reserves may not be recognized as proved if their extraction is planned after the expiry of the license.

⁵ These are the South-Tambeyskoye and the Malo-Yamalskoye fields on the Yamal peninsula and the Geofizicheskoye and Salmanovskoye fields on the Gydan Peninsula.

nearly 40% of Novatek's revenues, which proves the company's ability to achieve high margins despite having to sell its gas at a relatively low price at the domestic market. The production of liquids is going to have a more emphatic role in Novatek's production portfolio in the future: a tripled production of 270,000 barrel per day is planned to be achieved in 7 years.¹² Consequently, there is high chance for Novatek to carry on with competitive gas pricing on the domestic and probably on foreign markets supposing that it will be able to ensure the necessary political support. Furthermore, as Novatek's assets are located in a relatively narrow geographical domain in the Nadym-Pur-Taz and Yamal Nenetsk regions of West Siberia, it can also be assumed that the company would be able to benefit from existing infrastructure and also developing it effectively, setting a reasonable growth trajectory for the company.

Another fact indicating the competitiveness of the company is that Novatek's activity is limited to the domestic market, where prices are regulated at a relatively low level. Nevertheless, the company demonstrated that it is able to surpass Gazprom even without access to foreign markets. The net profit margin of Novatek in 2011 was 32%, while Gazprom only secured 28% including domestic and foreign revenues.¹³ Novatek's capability to establish higher domestic prices is clearly not the only reason of this, as in 2010 its prices exceeded those of Gazprom by only 1%. Moreover, in 2012 Novatek's prices actually went below the regulated level, still providing profit for the company.¹⁴

To sum up, by using its reserve capacity, developing its exploration portfolio and by an active portfolio management, Novatek can be assumed to be able to expand its existing assets. It is a central question then, what will happen in case of a conflict of commercial interests of Gazprom and Novatek and also other NGPs, Rosneft above all.

ROSNEFT

Since 2006, when it made its initial public offer, one of the largest ones in financial history, Rosneft has aimed to build a large-scale gas business in Russia. The company's ambitions were supported by the fact that as of December 31, 2012 according to the SEC classification, it had 753 bcm of proved natural gas reserves and under the PRMS standard calculation 992 bcm¹⁵ but only

produces 16.39 bcm,¹⁶ meaning that it has a reserve stock for 46 and 61 years, respectively. Obviously, this amount of reserves provide opportunity for further development in output and revenue acquisition. Because of this, in 2013 Rosneft announced its plans to develop its gas marketing and thus achieve 77 bcm production within 5 years¹⁷ by supplying gas to Fortum, E.ON and Enel. The company has made a significant step toward achieving this goal when it entered into cooperation with the ITERA Group in 2012, which refers to joint venture and sales through the extensive marketing network ITERA has built in Russia. Rosneft contributed its non-producing assets in its Kynsko-Chaselskoya Neftegaz subsidiary and \$173mm in cash to the joint venture for which it acquired 51% of the stakes while ITERA offered all of its gas assets, with current output of 13bcm.¹⁸ However, the greatest benefit that cooperation with ITERA may have does not reside primarily in its existing output but rather in its marketing experience. Thus Rosneft aims at taking advantage of these capacities given that its goal is developing its own gas portfolio beside the joint venture.

Another move that contributed to the strengthening of Rosneft's position on the Russian gas market was purchasing TNK-BP from BP and AAR.⁶ By doing this, not only did Rosneft become the third largest oil producer in Russia, but the largest publicly traded oil and gas company worldwide. Also, the Rospan field in West Siberia, upon which the former TNK-BP based its gas production plans, now as part of Rosneft provides opportunity for the company to realize its ambitions of further growth in gas output. TKN-BP's production of 14 bcm of gas in 2011 - out of which 11 bcm was associated gas - was planned to increase over 30 bcm by 2020, due largely to the planned output growth of the Rospan field, whose current production of 3 bcm is expected to reach 16 bcm over the next five years.¹⁹

Taking all this into account, it seems that Rosneft, with its vast resource base and potential to enhance its marketing strategies, is likely to achieve a dynamical growth of sales and market share on the Russian domestic market. The final goal of 100 bcm of production that the company itself has set seems achievable within a decade with Rosneft's organic asset base and the realization of its

⁶ Rosneft became holder of BP's 50 per cent interest in TNK-BP in exchange for \$16.65 billion in cash and 12.84 per cent of Rosneft shares. With a separate agreements Rosneft acquired AAR's 50% share for 27.73 billion in cash. In addition OFSC ROSNEFTEGAZ sold 5.66 per cent in Rosneft to BP in return for \$4.87 billion in cash.

merger and acquisition projects. In fact, the company has the necessary potential even to outperform Novatek and become the second largest gas producer of Russia by 2025.

OTHER NON-GAZPROM PRODUCERS

LUKOIL, Russia's second largest oil company also has ambitions of further development in the gas sector. However, its strategy differs from that of Novatek and Rosneft for two reasons, firstly because domestically it has built closer ties with Gazprom, secondly because it opted for investments in overseas gas assets.⁷ Still, the company is to be regarded as a competitor in the increasing market competition for selling gas at the domestic market. As of January 1, 2013 LUKOIL had 665 bcm proved gas reserves in Russia of which the bulk is located in the West Siberian Naksodinskaja field.²⁰ It has contributed with 8.041 cubic meters of natural gas to the company's production in 2012, which accounts for more than 90% of overall output. The rest of LUKOIL's gas reserves is mainly located in the West Siberian region as associated gas and in the Yuri Korchagin and Filanovsky fields in the North Caspian region, which provide the company's power assets in Southern Russia. Nevertheless, LUKOIL's agreement with Gazprom to sell up to 12 bcm of natural gas annually to the company from the Nakhodkinskoye field at the wellhead until 2016²¹ hinders the company's acquisition of larger market shares in Russia. After the agreement expires, LUKOIL expects having increased the output of the West Siberian region by 5-10 bcm by 2020 as new fields in the area are brought onstream.

The most important risk factor that could hinder LUKOIL's ambitions is its exposure to Gazprom as a third party gas buyer, otherwise the company's plans to increase Russian gas output to 40 bcm by 2020²² seem realistic.

It is also worth mentioning that LUKOIL's Caspian and other international assets may also affect the overall gas strategy of Russia. Especially LUKOIL's investments in Uzbekistan's gas assets²³ - a move motivated by concerns regarding the Russian domestic gas market – makes it a potential competitor of Gazprom

⁷ The Company had 115 gas production wells in international projects at the end of 2012, of which 94 were actually in use. These wells are located in Kazakhstan, Uzbekistan, and Azerbaijan. OAO LUKOIL. "LUKOIL Fact Book 2012" Accessed: January 23, 2014. http://www.lukoil.com/materials/doc/FactBook/2013/Lukoil_FB_eng.pdf.

in providing supplies for the Chinese gas market. Accordingly, LUKOIL concluded a deal to export gas to Western China via the new Central Asian pipeline grid, while Gazprom faces difficulties persuading the China National Petroleum Corporation to buy gas transported though the Altai pipeline.

The next most significant gas producer in Russia is the Surguneftegaz oil company that had an output of 12.2 bcm of associated gas in 2012²⁴ trading mostly local power and industrial companies. Nevertheless, Surguneftegaz has not elaborated any clear strategic vision to expand its gas business yet, thus its gas output can only increase in parallel with the company's oil production.

In contrast, GazpromNeft – the fourth largest oil producer in Russia, and the subsidiary of Gazprom - achieved significant increase in the past two years regarding gas output and sales by making its associated gas production more effective and setting various new natural gas projects into operation. The most important production growth took place in the Muravlenskoye and Novogodneye fields in Western Siberia, where gas output has risen from 4 bcm in 2010 to 9.1 bcm in 2011. The SeverEnergiya joint venture project realized in cooperation with Novatek, ENI and Enel is also going to contribute to a gradual output increase in the close future.

The rest of NGP gas output is associated with oil production, however, there are a small number of gas companies, mainly joint ventures and projects that are worth mentioning. SeverEnergiya, for instance, is a joint venture of Yamal Development LLC (51%) – of which Gazprom Neft and Novatek hold 50-50% - and Arctic Russia B.V. (49%) – 60% of the shares belonging to ENI and 40% to Enel – seems to be able to achieve 36 bcma of gas output and associated condensate by 2017.²⁵ All this is going to make Enineftegas, the joint venture of ENI and Enel one of the most significant foreign gas producers of Russia with a total output of 18 bcm per year. The French energy company Total, partner of Novatek in the Yamal LNG joint venture, is also gaining a more important role in Russian gas supply given that the South-Termokarstovoye field, which is involved in the project, is expected to reach a combined total output of 29 bcma by 2019.²⁶ Gazprom's German joint partners, Winthershall and E.ON have also acquired notable Russian gas

assets: both have interests in the Sount Russkoye field⁸ producing 25 bcma and Wintershall also holds 49% of shares of the deep gas condensate Achimgas project also in cooperation with Gazprom.²⁷

Finally, there are four more domestic companies to be paid attention to. Northgas, in which Novatek holds 49% and Gazprom 51% of the shares, produces around 3-4 bcma at the North Urengoy field, with a potential to reach 15 bcma if the parties could agree on a development plan. Norilskgazprom and Taimygaz sell 3.5-4 bcma in the Norilsk region, mostly to the Norilsk Nickel mining complex, while Yakutgazprom provides 1.5 bcma to the Sakha region. However, as these companies have no access to the main pipeline network, their production is likely to keep at the current level in the foreseeable future.

Overall, there are two main sources influencing the future development of NGP gas output in Russia, namely Novatek and Rosneft, the other NGPs only have a smaller potential to achieve production growth in the next decade. Nevertheless, the existence of this potential does not entail that it will be taken advantage of, especially now that Gazprom has set the Bovanenskoye field on Yamal peninsula on-stream, which would provide an estimated 115 bcm output by 2017.²⁸ Thus, in case NGP producers would like to make use of their potential, they will be forced to implement aggressive sales strategies on the Russian gas market in order to maintain and increase their market share.

POLITICAL SUPPORT OF NGPS

However, the support of the government keeps on having vital importance in any kind of balance shift on the Russian gas market, though in the short- to-medium term the increasing prices on the domestic market and the cost-competitive approach that characterizes NGP gas sales promotes the development of a more competitive market landscape. The primary reason for this is that the interior and exterior market changes involve significant consequences for Gazprom, the most important and most productive company in Russia. It may not be a surprise, then, that the NGPs increasing acquisition of market shares happened in

⁸ As of 31 December 2012, the field was estimated to contain 481.4 bcm of proved natural gas reserves and 13.4 mmt of proved liquid hydrocarbon reserves, under SEC reserves methodology. OAO Novatek, "South-Tambeyskoye Field, Yamal LNG Project." Accessed 19 February, 2014. <http://www.novatek.ru/en/business/yamal/southtambey/>.

parallel with the strengthening political support of NGP gas production from 2009 January on, with Prime Minister Vladimir Putin's statement that NGPs should be provided more access to the pipeline system of Gazprom.²⁹ Moreover, Putin has taken a further step toward this aim when in February 2010 he claimed that Gazprom should take up a more active role in the development of supplies to industrial customers, also adding that "Gazprom must treat the development of the infrastructure that helps provide the energy sector with gas as responsibly as possible. If the company itself proves unable to cope with all of these tasks it means we will have to involve other companies."³⁰

Beside the sharpening rhetoric on the government's side, various other signs support that shifts of opinions are in progress in the gas sector of Russia. As a first step, in June 2012 the Presidential Commission for the Strategic Development of the Fuel and Energy Complex was formed⁹ in order for Putin to gain a direct oversight of the energy, and especially the gas sector. Consequently, this way a parallel type of control has been created, given that a supervisory body – the Ministry of Energy - had already existed. Interestingly, Igor Sechin, the former Deputy Prime Minister responsible for Energy - a close confederate of Putin - and currently holding the position of CEO of Rosneft, is among the members of the Presidential Commission as well. Being secretary of the Presidential Commission, he has the ability to facilitate the changes of the market in a way Rosneft and other NGPs could take advantage of the new opportunities for bringing significant reserves of gas into the Russian gas market.

Closely related to this, President Putin has begun to use the commission as a catalyst for the revision of the Russian gas sector's competitive position and its relationship with the Russian economy. In October 2012 he even urged Gazprom to elaborate a new approach to global gas market trends, with special attention to the shale gas revolution in the US. Moreover, Putin has acknowledged the existence of efficiency and corruption issues

⁹ Its members are: Deputy Prime Minister Arkady Dvorkovich, Minister of Economic Development Andrei Belousov and his deputy Stanislav Voskresensky, Finance Minister Anton Siluanov, Minister of Industry and Trade Denis Manturov, Minister of Energy Alexander Novak, Presidential Aide Elvira Nabiullina, Head of the Federal Anti-Monopoly Service /FAS/ Igor Artemyev, Head of the Federal Customs Service Andrei Belyaninov, Minister of Natural Resources and Ecology Sergei Donskoy, Head of Rostekhnadzor Nikolai Kutyin, Head of the Federal Tariffs Service Sergei Novikov. ITAR-TASS. "Igor Sechin resumes supervision of Russia's fuel and energy complex." Accessed 21 January, 2014. <http://itar-tass.com/en/russianpress/677422>.

surrounding Gazprom. As he claimed in October 2012 at an investor conference, “Our infrastructure companies are not without faults, which are inherent in the whole economy - that goes without saying. We are more and more often hearing complaints about how Gazprom does business, that there are corrupt elements. (...)There probably are, but the police should catch them and throw them in prison. I am already aware of this and have standing orders given repeatedly to law enforcement bodies.”³¹

All the above support the idea that Putin is monitoring the gas sector closely and the current status quo is being reviewed. It is also a significant factor in the short term for the evolution and transformation of the Russian gas market that Putin has agreed to re-introduce an exchange for trading gas, most likely in St Petersburg. In case of establishing it, a gas trading system would evolve that would be independent from Gazprom. This can be traced back to physical reasons, namely that with the fallback in the output of Gazprom’s major fields in the Nadym-Pur-Taz region more and more extra pipeline capacity has become available in the past 3-5 years coming out of West Siberia, which is highly probable to remain so in the future.

Lastly, even Gazprom’s once incontestable export dominance seems to be open to review, which two or three years ago would have been unimaginable. According to Loe (2012) “third party access problems are a myth, not a reality, as long as gas producers meet the specific requirements for transport.”³²

SHARPENING COMPETITION FOR CONTRACTS

Of course, the only true evidence are signed and honoured long-term contracts. From this perspective, the development of the gas market in Russia over the last few years can be measured the most visibly by the number of new deals between NGPs and new end-user customers. Novatek’s contract in 2009 with Inter RAO, a power trader in Russia, to supply the generating subsidiary OGC1 with 65 bcm of gas between 2010 and 2015 was the first sign suggesting increasing competition among domestic producers. By this move, Novatek managed to squeeze out Gazprom, Itera and TNK-BP from providing gas supplies to Inter RAO, although its contract with Gazprom lasted until 2012. Novatek achieved this by setting more advantageous conditions for gas supplies, most probably lower prices - meaning the regulated gas price or even less

– more favourable terms than those offered by Gazprom and other competitors. What could be the reason for this level of success of Novatek?

The company itself considers its long-term contracts soon to be signed to be of key importance in the business competition on the gas market. The more advantageous conditions include willingness to compromise instead of take-or-pay type of contracts, and the introduction of the monthly settlement of accounts, without fixing a compulsory minimum consumption per year. The acquisition of Gazprom Mezhhregiongaz Chelyabinsk in December 2011 also contributed to the significant gas marketing upsurge of Novatek.³³ This takeover led to signing of contracts with Magnitogorsk Iron & Steel Works (MMK) the third largest steel company in Russia for ten years and with Mechel, one of the most important mining and metallurgical companies in Russia for eleven and a half years. Hereby Novatek took Gazprom's position of the leading supplier.

In accordance with its strategy to gain long-term customers, Novatek signed contracts with Uralchem, Severstal, Fortum and E.ON. Russia thus expanding the market for its own increasing gas production, and squeezing out Gazprom.

However, the most important move of Novatek was the contract for three years of supply with Mosenegro, a Gazprom power subsidiary. According to the agreement, Mosenegro will be provided with 27 bcm of gas between 2013 and 2015 by Novatek, which covers one third of its gas consumption.³⁴ It can be observed, thus, that the gas consumers of Russia, even if partly owned by Gazprom, are now open to more advantageous arrangements for gas supply outside Gazprom, the once predominant Russian gas producer. Similar moves aiming at the acquisition of a higher market shares can be observed in the case of Rosneft as well.

Rosneft only took up an active role in gas marketing from 2011 on, especially after February 2012, when a joint venture with Itera was formed and 51% of its shares were acquired by Rosneft.³⁵ The company expects to sell 75 bcma of gas by 2011 and 100 bcma soon after this. These plans of Rosneft were first confirmed/supported by purchasing TNK-BP, then on 1st November 2012 it even signed the currently largest NGP gas contract with Inter RAO, a diversified energy holding company. Rosneft then announced its goal to increase gas sales to 75bcma by 2017 and to 100bcma shortly thereafter, and confirmed this plan not only through the purchase of TNK-BP but more importantly through the signing of

the largest NGP gas deal to date, with Inter RAO, a diversified energy holding company on 1st November 2012. Thanks to this contract, the sales of around 35 bcma are ensured for the next 25 years for Rosneft. Beside this, as Rosneft takes one of Novatek's most important costumers this move is the best proof of increasing competition among NGPs. Given that Novatek traded gas at the regulated price to Inter RAO, Rosneft supposedly offered even lower pricing. This means that it is possible to maintain profitable sales even with prices set below Gazprom's level.

CONCLUSION

All in all, NGPs seem to possess the ambition, resources, marketing skills and political support necessary to become real rivals for Gazprom, currently within Russia but later possibly on overseas markets as well. The NGPs fast increasing market share in the Russian gas market from 2009 on indicates that they have the potential to compete with the regulated gas prices of Gazprom. Concerning future development, the 300 bcm NGP production by 2020 according to Novatek's estimations seems to be a realistic goal, which can only be hindered by limited market demand in Russia and Europe but possibly not by political reasons.

Besides, it is also probable that in case of a lack of demand, the output of Gazprom would decrease to the levels of the 2008-2009 crisis, i.e. below 500 bcma. According to data of 2012, Gazprom purchased 42 bcm of gas from NGPs to be re-sold besides selling its own 515 bcm of output.³⁶ This year, Gazprom expected to achieve a production of 529 bcm, however, in September the company was 19 bcm behind its 2012 output, thus almost 40 bcm were missing in order to achieve the 2013 target. This pattern continued this year as well, falling far behind the expected 500 bcm production. The most important reasons for this are the decrease in Western European exports, dropping from 150 to 140 bcm in 2012 a decline observable in CIS exports, especially to Ukraine where sales were 15 bcm less in 2012 than in 2011, and the increasing competitiveness that characterizes the domestic market.

Consequently, it would be a logical step of Gazprom to stop buying gas from companies that challenge its position on the Russian domestic gas market. The increasing domestic gas marketing competition withdraws a number of conclusions for the Russian government: apparently, support provided for NGPs

promotes the development of a more cost-efficient gas sector that is able to offer significant amounts of gas below the regulated price for domestic costumers. It is evidently advantageous for both the Russian economy and the well-connected entrepreneurs and finally for the population as well, manifesting in form of lower gas prices.

Thus, to sum up, the entrance of new competitors into the gas market of Russia enhances the development of such conditions that address the challenge of commercial realities in today's Russian gas sector. Novatek and Rosneft, two major NGPs are the pioneers of the process beside a number of smaller NGPs from Russia and abroad, who would like to ensure a market for their increasing gas production by applying more and more aggressive marketing strategies. Taking into account the possible extra gas output on the Russian market, it would be a logical step and a very significant innovation in a sector monopolised by a single company for decades. Given that the government-controlled energy giant Gazprom has shown hardly any response or the threats deriving from growing competition so far, NGPs could hold more than one third of domestic sales of gas and a notable share of export sales in the coming decade.

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ESSAY

THE END OF AN ERA? THE PROBLEMS OF THE CONTROVERSIAL EU-RUSSIA ENERGY RELATIONS

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ABSTRACT

Energy has become one of the most debated topics in the current relations between the European Union and the Russian Federation. One of the most important effect of the Ukraine crisis is that it has revealed that the former political cooperation between the two actors has failed to solve the underlying problems in which political and energy-conflicts are inexorably intertwined. The aim of this paper is to understand, why the cooperation failed to solve this mainly technological problem in a neutral way, what were the signs of the failure and what were the answers given by the two parties to the new challenges of the changing political and energy relations, and the probable consequences of their efforts.

Keywords: European Union, Russia, energy, gas and oil supplies, cooperation

INTRODUCTION

One of the most common stock phrases about the EU-Russia relations is that energy is probably the most important aspect of it - but the most controversial as well. Energy cooperation was one of the key factors in the establishment of the conversation between the European Union and the former Soviet Union, long before its collapse. However, the asymmetrical interdependence, which comes from the growing energy needs of the EU that forces the Union to rely unilaterally on Russia's supplies makes it difficult to continue a balanced dialogue. Different disputes and conflicts have come up during the last decades between the European Union and Russia, but none of them escalated as fast as the Ukraine crisis, which started in 2013. This confrontation can be seen as a final proof for that energy cooperation comes along with political overtones. Every question related to energy is also a political issue in the relationship between the EU and Moscow. Therefore it is extremely difficult to reach a compromise on disagreements that could appear during the negotiations.

Russia is the third largest trading partner of the European Union, while the EU is Russia's most important market. In this exchange, raw materials, especially oil and gas constitute an enormous part. According to the European Commission, the size of their mutual trade reached record levels in 2012 and the highest energy dependency rates were also recorded in that year, for crude oil (88.2 percent) and for natural gas (65.8 percent)."¹ "In 2012, some 33.7 percent of the EU-28's imports of crude oil came from Russia, slightly below the shares recorded for 2010 (34.7 percent) and 2011 (34.8 percent). Russia became the principal supplier of solid fuels in 2006, overtaking South Africa, having overtaken Australia in 2004 and Colombia in 2002."² Other essential partners are Algeria (for natural gas import), Saudi Arabia (for crude oil) and Norway (both) but the most important partner in energy trade has been Moscow since the 1970s.

THE DEVELOPMENT OF ENERGY COOPERATION BETWEEN THE EU AND RUSSIA

Although the European Union did not have a common energy policy until 2007, when the Treaty of Lisbon came into force, this

issue has always been important for the member states. The European Coal and Steel Community and the European Atomic Energy Community were both established in accordance with different kind of energy sources (coal and nuclear power). In the meantime, the members of the former European Community had their own bilateral energy trade relations with the Soviet Union.

After the fall of the Soviet Union these ties did not dissolve as Russia inherited almost all of its legal claims and commitments, which it could use to renew its relationship with the member states of the European Communities.

The European Community did not seem to care about the distortions of the Russian economy and besides of the bilateral partnerships, the organisation started to move towards a common relationship with Russia. The first step was the Partnership and Cooperation Agreement (PCA) in 1994, in which energy issues were mentioned, but they had only a secondary role. In the PCA the priorities were to build a stable framework for political dialogue and encourage the mutual trade and investment.³

In the building of the energy cooperation the first major measure was the establishment of the Energy Charter in 1991, which has showed the intentions for mutual support at political level.⁴ It was the first place, where the European Union acted as one actor in the field of energy policies, and the first, where its energy cooperation with Russia was raised into an official agenda

Then the Energy Charter Treaty was established in 1997. It was originally designed to establish a cooperation in the energy sector with the eastern European and former Soviet Union countries. The aim was to stimulate economic growth and improve the EU's security of supply. The purpose of the Treaty was to promote East-West industrial cooperation through legal guarantees concerning investments, transit and trade. It was signed together with the Energy Charter Protocol, which was related to energy efficiency and its environmental aspects. The key provisions were the protection of investment, trade in energy materials and products, transit and dispute settlement.⁵

In 2000, the European Union made a further step to prepare for the future demand of energy and the European Commission published the *Green Paper on the Security of Energy Supply*⁶ in which the Commission analysed the main issues related to Europe's ever increasing energy dependence.⁷ This was the first strategic paper on energy policy in the history of the European

Union.⁸ In this document, the so-called external energy policy took an accentuated part, and, regarding this, the cooperation with Russia was the main segment⁹. One of the EU's main aim was to ensure flexible and reliable external supply conditions, for which it was willing to use all of its influence, both economic and political. It was clear to the EU that to complete this goal first it had to achieve mutual benefits with its trading partners, for which it has to mobilize technical assistance. Therefore the Green Paper stated that the European Union must establish an ongoing dialogue with producer countries, which can lead to transparency and stable prices on the energy market.¹⁰ According to the paper, the EU has three areas, where it has to take long-term actions: rebalancing supply policy (described above), assessing the contribution of nuclear energy, and providing “a stronger mechanism to build up strategic stocks and to secure new import routes for increasing amounts of oil and gas.”¹¹

In 2003, Russia also published an energy strategy until 2020. (Энергетическая стратегия России на период 2020 – Russia's energy strategy until 2020)¹² Although the paper was slightly optimistic, and predicted that the gross domestic product will triple (or according to the moderate foresees, it will double) in the period of 2000-2020,¹³ the need for technological modernisation and enhanced energy efficiency were essential parts of this analysis. This is why Moscow needed Europe - besides the huge consumer market for its hydrocarbon production – and was willing to adapt to the EU's conditions – at least for a time.

In 2000, Jacques Chirac, Javier Solana and Romano Prodi (as the leaders of the European Union) and Vladimir Putin published a *Joint Declaration* in which they assured each other of their mutual support and made clear that their main goal was Russia's acceptance to the World Trade Organization and to organize the Energy Dialogue on a regular basis.¹⁴ The Dialogue's main aim was to promote trust and transparency in the EU–Russia energy relations and to avert the obstacles from reciprocal energy investments and market developments.¹⁵ Four Thematic Groups were established in its framework in 2004, comprising Russian and European experts from the private and public sectors for working together on infrastructure, investments, energy efficiency and trade. Then, in 2006 the EU-Russia Energy Efficiency Initiative was launched. The implementation of the Initiative was a task of the Thematic Groups. The priorities were to increase energy

efficiency, expand the standard of living of the population, expand the range and level of services on offer, to harmonize the legal and regulatory base, and to reduce the impact on the environment by introducing new energy efficient and environmentally clean technologies and renewable sources of energy.¹⁶

The first decade of the twenty-first century was rather optimistic, where the EU and Russia accelerated the establishment of a secure and calm cooperation. However, only a little attention was paid to the differences between the structures of the two actors and their goals, which has led to misunderstanding and mutual mistrust.

ANOMALIES IN THE GOOD RELATIONS

Although both Russia and the European Union emphasised many times, that their relations are excellent and the cooperation is prosperous, from time to time, disputes and disagreements appeared since the beginning of the renewal of their relationship.

For Russia it is more convenient to deal with the EU member states one by one, in the framework of bilateral negotiations instead of, within the remit of the European Commission. Therefore Moscow is trying to push the member states towards bilateral relations, which can cause frictions within the European Union.¹⁷

Meanwhile, the EU implemented the Eastern Neighbourhood policy, which have clearly provoked Moscow, as its destinations are the post-Soviet countries, which have traditionally belonged to Russia's sphere of influence.¹⁸ Putin's efforts to maintain this influence is recently gaining form in the idea of the Eurasian Economic Union, which was established in 2015.

The EEU's member states are Armenia, Belarus, Kazakhstan, and Russia, with the implicit dominance of Moscow. Kyrgyzstan has signed documents on its accession to the Union in May 2015, but there is still a sharp debate whether it should join to the organisation.¹⁹ The combined population of the EEU is 182.1 million people, its gas production is around 18.4 percent of the global share (with 682.6 million cubic meters).²⁰ It could develop to be a serious factor in world politics, although right now it has a lot of weak points. Several experts claim, that that the recently established organisation is already dead, like Nate Schenkkan, who argued in *Foreign Affairs* that "the Eurasian Economic Union

is dead in all but name. It will survive as another hollow post-Soviet multilateral institution celebrated with presidential summits but producing no progress toward its stated goals. Russia has been able to assure control over small fragile states such as Armenia and Kyrgyzstan, but its ability to project power past its traditional area of influence has shrunk.”²¹

Many scholars who study the post-Soviet region also believe that the EEU will not last long. Ukraine stepped out from the project before it has even started, as a consequence of the current crisis. Both Kazakhstan and Belarus are trying to loosen the Russian ties, meanwhile the former has serious debates with Yerevan about custom checkpoints between Armenia and Nagorno-Karabakh.²² But in spite of all the difficulties, right now it seems that Putin’s political will is enough to keep the Union alive, although no one can be sure, for how long.

As we can see, both the EU and Russia are trying to expand their influence at the same time (and in most of the cases in the same region). This fact meant a serious cause of frictions between them, and the underlying conflict finally became manifest in the Ukraine crisis, which turned the state into a buffer state according to several experts.^{23,24}

The first problems came right after the so-called Orange Revolution, which was labelled in Russia as “anti-Russian” and “pro-American” and was portrayed as if it was „masterminded by the United States government and its various puppets in Ukraine’s civil society, mass media, political parties and state apparatus.”²⁵ After the first removal of Viktor Yanukovich, the West celebrated Yushchenko’s accession to power as its victory over Russia in a geopolitical gameplay.

In the summer of 2004, the Russian government, Gazprom and the Ukrainian government agreed on the terms of paying Ukraine’s past debts, and it seemed that the required elements for regularising gas trade were in place for the next five-ten years.²⁶ But disagreements emerged when Gazprom suggested that if Ukraine could not afford to pay higher prices, the company would extend loans to Ukraine for this purpose. Moreover President Putin stated that if the Ukrainian side was prepared to agree to this gas price, the increase could be suspended for three months before the switch to market prices.²⁷ The Ukrainian side rejected the suggestions and on 1 January, 2006, Gazprom cut off gas supplies to Ukraine. The impact on European countries was immediate, as

falling pipeline pressures and non-deliveries of gas were reported in many countries. "With Gazprom insisting that it was supplying the correct contractual volumes to its European customers, and Ukraine insisting that it was not taking gas from the transit pipelines to Europe to which it was not entitled, it was initially difficult to understand what was happening."²⁸ But these anomalies could only have resulted from Ukrainian companies diverting gas from the pipelines or because Gazprom failed to pump enough gas into those pipelines. Given Gazprom's desire to earn money from gas exports to Europe, the only possible explanation is that gas was taken by Ukrainian customers.²⁹ The volumes of gas delivered to the EU fell down, but Gazprom reacted quickly: it promised that it would pump an additional 95 million cubic metres per day into the network to compensate for Ukrainian withdrawals. After that Gazprom and Naftogaz announced to sign a five year contract to settle the dispute. The West viewed this conflict as a politically motivated dispute in which Moscow tried to blackmail Ukraine by placing it under extreme economic pressure.³⁰ This suspicion was supported by the fact that Yulia Tymoshenko came to power, who was against Moscow's will. This conflict was the first proof that if Ukraine would turn away from Russia toward the EU and the NATO, then it can expect the same commercial terms as those countries, which was a clear economic threat for Kyiv.

The tension increased again in 2009, when the two sides (Ukraine and Russia) failed to agree on a price for Russian gas supply to Ukraine and a tariff for the transit of Russian gas to Europe. The previous agreement expired on 31 December and Moscow cut off the gas exports to Ukraine on 1 January. The most seriously affected countries in the Balkans experienced a humanitarian emergency, as parts of their populations became unable to heat their homes.³¹ This second gas crisis had even more serious consequences than the first one. Russia's reputation as a reliable supplier was seriously damaged and the EU started to consider the possibility of diversification of its energy supplies. Projects, like the South Stream or North Stream got a real potential. After numerous talks, the deliveries to both Ukraine and other European countries restarted on 20 January following the signing of two new ten year contracts.³²

All of these disputes pointed in one direction: they can be seen as presages of a bigger, much more serious conflict in which the cleavages show themselves in their real depth. The rivalry for

influence zones between Russia and the EU enhanced in 2013, when the Euromaidan movement began, because President Viktor Yanukovich, struck a deal with Putin, in which Russia bought \$15 billion in Ukrainian bonds and slashed the price on natural gas by a third. This deal showed the Ukrainian citizens that the president had no intention of looking west toward Europe instead of becoming a Russian ally once more. A wave of demonstrations and civil unrest spread all over the country demanding the resignation of Yanukovich and the signing an Association Agreement with the European Union.³³ The differences between the Eastern and Western parts of Ukraine became stronger as the former half has been supporting the Russian approximation. Finally, Yanukovich fled the country and the conflict has deepened.

If we accept that the 2009 gas dispute had serious consequences, we can guess that the Ukraine crisis which started in 2013 and has continued ever since will cause fundamental changes in the energy relationship of the EU and Russia. In the next part of my essay I will outline the different possible strategies used by the parties, who are trying to adapt to the new situation which has developed in the recent few years – especially in no small measure as a consequence of the Ukraine crisis.

RUSSIA'S NEW PIVOT TO ASIA

The actors answer differently to these insecurities. This is a result of their very different characters and of course of the diverse situations of the consumer and the supplier. As I mentioned in the first chapter, the Russian Federation is the principal producer of hydrocarbons for the European Union and their mutual energy dependence reached record levels in 2012.

At first glance it could appear that the EU members are more dependent on since oil and gas are essential for every state and Europe at present cannot replace Russia's supplies.

However, Russia is much more reliant on Europe than it would seem because its economy is heavily dependent on oil and gas exports and right now this means tight bonds with the EU. Moreover, the EU's dependence on Russia's energy is decreasing because of the efforts taken for more widespread diversification, which was an obvious manifesto of the rising mistrust after the natural gas shortages which were experienced during the Russia-Ukraine gas dispute in 2006 and 2009. These crises reminded

European nations how vulnerable they are and the European countries started to develop strategies that could allow them to mitigate not only Europe's vulnerability to disputes between Moscow and intermediary transit states, but also to loosen its general dependence on energy from Russia.³⁴ Vladimir Putin is aware of this fact and he is trying hard to search for alternative consumers. This is even more important for Moscow now that the European Union introduced multiple and strict sanctions against Russia because of the Ukraine crisis.

The Russian president's main aim is to be East Asia's leading partner in oil and gas markets and there are monumental plans to build a network of pipelines connecting the oil and gas fields to Asian consumers.

Of course vast differences exist in the scale and patterns of energy use among the different states in Asia. But if we look just at the members of the Association of Southeast Asian Nations (ASEAN) we can see that their energy demand has risen two-and-a-half times since 1990. In 2013 the oil demand was around 4.4 millions of barrels per day and the natural gas demand was 141 billion cubic meters, according to the International Energy Agency's special report on the energy outlook of Southeast Asia.³⁵ And although the region is relatively well-endowed with fossil fuels and renewable energy resources, they are unevenly distributed. Moreover, the IEA estimated that "134 million people in Southeast Asia, or 22% of the region's population, currently do not have access to electricity and around 280 million people rely on the traditional use of biomass for cooking, almost half of the region's population. Access to affordable and reliable energy services is crucial to reducing poverty and improving health, increasing productivity, enhancing competitiveness and promoting economic growth."³⁶ Among the ASEAN countries, China stands out, because its energy demand is increasing sharply, especially for liquid fuels. China's oil consumption growth accounted for one-third of the world's oil consumption growth in 2013 according to the U.S. Energy Information Administration (EIA), who predicted that China would surpass the USA as the largest net oil importer by 2014.³⁷ In 2011 coal supplied 69 percent of China's total energy consumption and oil was the second-largest source, accounting for 18 percent. And although Beijing made serious efforts to vary its energy supplies, these two has remained the main sources (hydroelectric sources are around 6 percent, natural gas is around 4, nuclear power nearly 1

percent, and other renewables are also around 1 percent)³⁸. The EIA forecasted a steady growth for China's oil and liquids production - 4.6 million bbl/d in 2020 and 5.6 million bbl/d by 2040 – but the country's demand still made up almost the third of the global share. Therefore it is not surprising that the country's government is trying hard to diversify its oil import sources by establishing international oil pipeline connections with neighboring countries such as Kazakhstan, Myanmar, and Russia.³⁹

As a part of these efforts, in May 2014 a 400 billion USD worth, 30-year natural gas deal was announced between China and Russia which is counted as the biggest single trade agreement in history, and as Kenneth Curtis wrote “it has a significance far beyond the immediate time horizon.”⁴⁰ The agreement stated that Russia will cover 70 billion dollars in upfront spending on infrastructure, while China will pay 22 billion dollars in advance and, as a consequence the gas will start flowing to China by 2018.⁴¹ In November 2014, the two states have also signed a memorandum for establishing another pipeline, called Altai. According to the agreement Altai will connect West Siberian fields to the Xinjiang Uyghur Autonomous Region of China. Also, in North Siberia, Russia's largest field to be put into production in the last 25 years. This field is called Vankorskoye and it feeds into the Eastern Siberia–Pacific Ocean pipeline.¹⁰ Moreover, the Russia-Asia Energy Summit in Singapore will be held in May 2015, the main theme of which is going to be “developing mutually beneficial energy collaboration between Russia and Asia.”⁴² The conference's partners are China, Japan, South Korea, India, and the countries of Southeast Asia, which are treated as the future key partners.

As we can see, Putin is heading East and the national gas monopoly, the Gazprom is following his direction and quickly started building up its eastern empire. In 2007 it had gained control over Kovytko, one of the largest gas fields in the world. After the takeover the enterprise soon started drawing up a new plan for using the acquired gas fields, primarily for domestic purposes, except for a certain proportion which will likely go to

¹⁰ The CNPC (China National Petroleum Corporation) is a Chinese state-owned oil and gas corporation and the largest integrated energy company in China. See: Pipelines International. “Russia looks to Asia to ease Oil and Gas Pressures, signs MoU for new Pipeline: GlobalData Analyst.” Last modified January 15, 2015. Accessed February 13, 2015. <http://pipelinesinternational.com/news/russia-looks-to-asia-to-ease-oil-and-gas-pressures-signs-mou-for-new-pipeline/090749/>.

China by 2017. In the light of the current events these plans are even more important for Gazprom and for Putin as well.

The other state-owned gas giant, Rosneft is also rapidly expanding its eastern territories. Initially, it owned the Komsomolsk refinery, “then it acquired all YUKOS refineries in 2007, including Angarsk and Achinsk in East Siberia, and its eastern fuel stations.”⁴³ Now Rosneft plays an essential role in Russia’s cooperation with China, South Korea and India.

All things considered, we can say that although the two monopolies, Gazprom and Rosneft have a long history of rivalry which is intensifying in the East, both of them successfully managed to strengthen their positions in the eastern regions and the “Russification” and “etatisation” of the domestic oil and gas sector will probably continue.”⁴⁴

With the combination of developing new partnerships with Far Eastern countries, obtaining the strategic gas fields from rivals and by the continued nationalisation of the oil and gas sector, Russia has developed a long-term strategy, which in short the short run can complement the Western markets. Russia clearly hopes that in the long-term, it could replace its old costumers, even if only partially.

RUSSIA: OLD CONSUMERS, OLD STRATEGIES

The strategies described in the former chapter do not mean that Moscow would abandon its old consumers. Right now Europe is an unavoidable partner for Russia and probably will remain so for a long time. Even if the Asian partnerships work well, the Western markets are too important to leave.

Before the Ukraine crisis, Gazprom tried to re-establish its expansion strategy in Europe and is still continuing these efforts, especially in Central Europe. Gazprom’s aim has been to increase its own participation in delivering its products to end-users. Therefore the company “has made overtures to gain direct access to large industrial and gas-fired power generation markets in Western and Central Europe.”⁴⁵ This is important for another reason as well. This way the company seeks to obtain new technologies which are inevitable for the development in mining at greater depths or in coastal sites.⁴⁶ This is necessary because the Russian gas monopolies have one big disadvantage: the lack of innovation and the bad quality of the developments.

Besides these endeavours, Gazprom has also tried to diversify the structure of its consumer base. Building the North Stream and South Stream pipelines would have served this goal but right now both of them are off the table. The first part of the North Stream was opened in 2011, but for the time being further expansion is not to be expected soon. As for the South Stream, at the end of 2014 Putin announced the cancellation of this project. Instead of South Stream, a new hub could be built on the Turkish-Greek border.⁴⁷ In February 2015, Aleksei Miller, head of Gazprom declared that “Turk Stream is now the only pipeline,” and their “European partners have been notified of this, and their task now is to establish the necessary gas-transporting infrastructure from the borders of Turkey and Greece.”⁴⁸

Russia is also trying to continue its old strategy of contracting long-term agreements with the consumer states, usually for 25 years. As Gazprom argues, “only long-term contracts with oil pegged prices based on the take-or-pay commitment may guarantee that producers and exporters will get returns on multibillion investments in major gas export projects and importers will enjoy secure and uninterrupted gas supply in the long run.”⁴⁹ These years are of strategic importance because several contracts expired and Gazprom wants to renew them with the same conditions as before. Until now it has succeeded in Bulgaria,⁵⁰ in Austria with OMV,⁵¹ and in Germany, with Shell Energy Europe and with E.ON Gastransport GmbH.⁵²

THE EUROPEAN UNION: INTERNAL AND EXTERNAL DIMENSIONS

These renewed contracts have significance not just for the contracting EU members but beyond their state interest as they reveal the Union’s biggest weakness: to act together. This was a serious problem during the Ukraine crisis as well, as those who are more dependent on Russia’s gas imports were against the sharpest sanctions and it was very difficult to arrange the current punishments. In January 2015, for example, news spread that seven EU member states would support the lifting of the sanctions against Russia. These countries were Austria, Hungary, Italy, Cyprus, Slovakia, France and the Czech Republic.⁵³ And although this rumour was denied later by more European Union foreign ministers,⁵⁴ this example shows the disruptions in the EU’s unity.

Putin is well aware of this and he has kept intensifying the pressure on vulnerable countries. According to the European Commission's Occasional Paper (*Member States' Energy Dependence: An Indicator-Based Assessment*), in 2013 these were Malta and Cyprus "regarding the security of energy supply, the combination of import dependency, geographical diversification of energy imports (risk of dependence on one country), and diversification of energy sources" and Bulgaria "regarding the energy and carbon intensity of Member States' economies" followed by Estonia, Romania, Slovakia, the Czech Republic and Poland. The Commission's report also stated that "energy products can be significant contributors to current account imbalances" and that may negatively affect competitiveness and "measured by the net energy trade balance in terms of GDP, this negative contribution is the highest in Bulgaria, Cyprus, Lithuania, Slovakia, Slovenia and Latvia."⁵⁵

As the crises from the past ten years showed it is sorely needed for the EU to find a solution to soften the dependence on Russia's energy import, otherwise Moscow can always use its beneficial position for blackmailing and influencing the member states and tying up the Union's hands in the current conflicts.

Right now the EU has two important tasks: to integrate its internal energy markets and to diversify its natural gas supply in its external energy policy. The first challenge has an essential role in the next five years for the Juncker Commission. The five key priorities are "ensuring the supply for Europe, deeper integration of EU national energy markets, reducing EU energy demand, reducing carbon emissions from the energy sector, and promoting research and development in energy."⁵⁶ Although the EU has made progress in liberalising energy markets, according to the International Energy Agency much more improvements are needed,⁵⁷ In its latest report, the Agency stated that until important interconnections are built across the entire bloc – not just at the northern and western parts – a real, integrated Energy Union cannot be reached. Moreover, for the time being the markets are very distorted because of the "persistence of regulated prices and rising green surcharges and levies"⁵⁸ (International Energy Agency). An effective energy union comes together with strong climate cooperation and efficient climate policy. This is essential because „EU electricity systems and markets need to accommodate growing shares of variable renewable energy. At the same time, the

EU faces the retirement of half its nuclear generating capacity in the next ten years.”⁵⁹ The use of the renewable sources can help relieve the weight of the whole energy sector and Europe can play a leader role in the future’s climate cooperation, begin with the United Nations Climate Change Conference at the end of 2015.

As for the second task, the EU had made several plans to reduce its energy dependence on Russia’s gas and oil export. The first plan was the Nabucco pipeline which would have run from Turkey to Austria sidestepping Russia. The project started in 2002 and the main supplier was expected to be Azerbaijan, but Turkmenistan, Iraq and Egypt would have played an essential role. However, now it seems that the Nabucco project will not come into existence due to political and commercial reasons.⁶⁰

Instead of Nabucco, a number of other plans were initiated to replace Russia in the energy field, such as the Southern Corridor which would contain the Trans-Adriatic pipeline (from Azerbaijan through Turkey), the Trans-Caspian gas pipeline (from Turkmenistan under the Caspian Sea) and the Trans-Anatolian pipeline (from western Turkey to Greece, Albania and across the Adriatic, to Italy). The other possible alternative for avoiding Russia would be the Interconnector Turkey-Greece-Italy (ITGI), but not all of them will be carried out. These are enormous investments and even now, strong lobby activities are going on in the background and the competition is sharp. Several projects have lost their relevance (for example the South East Europe Pipeline) and some other actors such as Iran fight hard to take part in the gas transportation business.⁶¹

As we can see, there are numerous applicants for taking over Russia’s role in the European Union’s energy market but the political and financial clashes set back the construction of the new pipeline systems.

Meanwhile, other possible alternative solutions are considered, from which the LNG gas transport can be the most promising. Liquefied natural gas industries went through a significant development in the past decade and they could have a huge impact on the energy markets. First of all, the USA can be “a significant LNG exporter taking the bronze medal after Qatar and Australia” according to Laszlo Varro, head of Gas, Coal and Electricity Markets Division at the International Energy Agency.⁶² This means that the competition between the two former Cold War superpowers may sharpen in the future. The Agency also stated

that LNG trade will rise by 40% by 2019 and the USA will have a huge share not only in the world trade but in Europe's import as well. It is already developing its export capacity to increase its presence in the old continent. Apart from the USA, Algeria, Norway and Qatar are important providers of energy for the European Union as well.

But for Russia, the growing LNG market is not the only chagrin. In 2013 the EU project "Liquefied Natural Gas Blue Corridors" has started with the co-foundation of the European Commission and Natural & bio Gas Vehicle Association Europe (NGVA). Its goal is to "establish LNG as a real alternative for medium and long distance transport."⁶³ LNG Blue Corridors brings together the (industrial) partners and research institutes in LNG transport and infrastructure technology. The project also prepares the first phase of producing LNG refuelling stations, as well as it represents a broad market development for heavy duty vehicles running with liquefied natural gas.⁶⁴

These projects progressed very fast and in September 2014 the GLE group¹¹ declared that large, unused LNG capacities could have been used in case Russia would have turned off the gas imports due to the conflict with Ukraine, because Europe now has potentially enough LNG import capacity to meet over a third of its annual demand.⁶⁵ From those member states which are the most vulnerable and dependent on Russia, Lithuania and Poland are planning to build their own terminals with the straight-out plan of breaking away from Russia's influence.

Both the internal and external dimensional tasks mean difficult tasks for the EU. As for the first dimension, the member states are opposed fiercely to the further liberalisation because they fear that this would lead to losing more of their state sovereignties. The countries are concentrated in two blocks: the opponents and supporters, which cause another cleavage in an already divided organisation.

The external tasks could be little more promising: the LNG market shows great progression and new cooperation were born to avoid Russia in gas transport, but the actual building of such

¹¹ European LNG Terminal Operators Group.

pipelines are questionable and even if they would be set up, it would take a long time.

WHY HAS THE COOPERATION FAILED? THE ANSWERS OF THE INTERNATIONAL RELATIONS THEORIES

In light of the changes the EU-Russia relations described above, the question of the failure of the peaceful cooperation process emerges. After an outwardly promising beginning why were the two sides unable to resolve their disputes with dialogue and compromise? And why has every conflict been handled as a political question? These disagreements were more or less implicit until 2006. Then, with the Ukraine-Russia gas disputes in 2006 and 2009 the weak points of the energy cooperation became visible and the high-level meetings were rarefied, while the mutual mistrust increased. But even before the gas disputes, there were academic experts who tried to solve these questions and long before the open confrontations they warned that the outwardly good relations can easily turn out to be rather difficult to handle.

The seemingly insolvable misunderstandings have been an object of interest for scholars from the fields of International Relations Theories, who have not only intended to understand why these problems occur and why it is such a hard task to find a solution, but for fulfilling this aim, they have also found it necessary to conceptualise these questions in a broader framework.

The successively increasing tension between Europe and Russia was not a new development. The image of the wild and hardly manageable “Russian bear” is widely known in Europe since the 19th century. In 2001, the European Union also got an apt metaphor from Michael Emerson: an elephant which is “even bigger than the bear, but is readily domesticated and has a placid character. It moves slowly but with great weight. It sometimes unintentionally tramples on smaller objects.”⁶⁶ The two animal’s habits are different and that is a very important aspect not just in conflicts but in their cooperation as well.

In the case of Russian politics realism seems to offer the most plausible answers as Putin is clearly following a kind of power politics in which he tries to compensate the risks, threats and his country’s vulnerability by trying to gain more power and by

aggressive foreign policy. In the realist point of view Moscow has almost all the capabilities to be a great power. As Kenneth Waltz pointed out, a state's power depends on the combination of the following items: "size of population and territory, resource endowment, economic capability, military strength, political stability and competence."⁶⁷ Out of these seven Russia clearly demonstrates high levels of capacity in five. The last object, namely the "competence" of a state was vaguely explained by Waltz, so it can be interpreted in many ways. In his essay, *The Spread of Nuclear Weapons: More May Better* Waltz himself mentioned political and administrative competences (as a factor that can influence a nuclear state, how to use its nuclear weapons).⁶⁸ But the real trouble for Moscow is unstable economic capability, which cause lots of problems and for the present no one can predict whether the other facilities will be enough to keep the country from national bankruptcy and losing its influence in foreign affairs. However, as long as Europe depends on raw materials - especially on gas and oil - we can assume that Moscow will have a key asset to preserve its influence.

John Mearsheimer, one of the prominent authors of neorealism has warned already in 1990 that the post-bipolar era will not be as peaceful as some liberal theorists had hoped.⁶⁹

In his paper (*Back to the future*) he stated that the optimism of economic liberalism is flawed, because the liberal international relations theorists make a mistake, when they ignore the effects of anarchy on state behaviour, in spite the fact that the international political system is anarchic. And when this omission is corrected, according to him, the liberal arguments collapse, because of two main reasons. Firstly, the competition for security makes harder to accomplish peaceful cooperation because when security is scarce, state are more concerned about *relative* gains, than *absolute* gains – and anarchy guarantees that security is often be scarce. And secondly because "interdependence is as likely to lead to conflict as cooperation, because states will struggle to escape the vulnerability that interdependence creates."⁷⁰ He argues that in a highly dynamic and interdependent economic system, there will always be the opportunity for blackmail and brinkmanship, considering that the actual level of dependence will not be equal. He noted that states that depend on others for critical economic supplies will be afraid of cut-offs in times of crisis or war.⁷¹ The Ukraine-Russian gas disputes in 2006 and 2009, as well as the Ukraine crisis proved

that this concept was right. Just as Mearsheimer predicted, economic powers – or in this case energy superpowers - would use their potential to enforce their will. Moreover he showed that economic interactions between states often cause serious frictions – even if the overall consequences are positive. As an example he brought up World War I, which broke out in spite of that “the years between 1890 and 1914 were probably the time of greatest economic interdependence in Europe’s history.”⁷²

In 2014 Mearsheimer published an article in which he argued that the Ukraine crisis is just as much the West’s fault as it is Russia’s. In this paper he continued his former work by writing about how Russia’s aggressive politics was a result of the EU’s and NATO’s (and with NATO comes along the USA) expansive foreign policy. In his point of view it was a clear case of *realpolitik* when an actor feels threatened and answers with trying to gain more power and ultimately, with aggression. He stated that the Soviet leaders agreed that U.S. forces remain in Europe and NATO stays intact to keep the reunified Germany pacified, but they have made clear that they do not want the NATO to grow any larger. However, the first enlargement took place in 1999 in Middle Europe, and in 2008 the organisation started to look even further as the alliance considered admitting Georgia and Ukraine. These development were interpreted by Russia as threats to its security.⁷³ During the Euromaidan, several American politician expressed their support for the events. Moreover, a leaked telephone recording has been revealed, in which Ambassador Victoria Nuland, Assistant Secretary of the Bureau of European and Eurasian Affairs, had advocated a regime change and said, she wants Arseniy Yatsenyuk to become prime minister in the new government, which he did⁷⁴. Mearsheimer once again accused the liberals on believing that the end of the Cold War “had fundamentally transformed international politics and that a new, post-national order had replaced the realist logic that used to govern Europe.”⁷⁵ As he wrote probably one of his most important observations, the current conflict is a result of that “Putin and his compatriots have been thinking and acting according to realist dictates, whereas their Western counterparts have been adhering to liberal ideas about international politics.”⁷⁶ With this statement he revealed one of the biggest problems in the negotiations between the West and Russia.

On the other hand, one must look into the internal structure of the Russian society to understand the differences from the Western

values. Besides realism, social constructivism is also widely used among those who are studying the EU's and Russia's complex and often contradictory relationship. The reason for this is that after the collapse of the USSR, Russia went through a serious identity crisis which is still causing insecurity and conflicts in the society. As Ted Hopf wrote, "a world without identities is a world of chaos" because "in telling you who you are, identities strongly imply a particular set of interests or preferences" by defining who you are and distinguishing you from the others.⁷⁷ A strong self-image is inevitable for a state taking into account that without it, the possibility increases that an inner conflict will the country's ability to act outside its borders. The lack of a coherent identity can also cause troublesome relationships, since other actors prefer a stable and reliable partner. And from their perspective, without coherent identity, the level of commitment remains lower and this increases the perceived unpredictability of the actor.

In the time of the big optimism in the 1990s, the differences between the characteristics of the Russian Federation and those of Europe were largely ignored in the process of rebuilding the political and economic partnership. Most of the decision-makers and political thinkers expected Russia to become a western-type liberal democracy. But instead of that the renewed rivalry of the three main groups, the Westerners, the Slavophiles and the Eurasianists have continued about the country's role in the international stage. This dispute has a long, two centuries-old history. Even "the two-headed eagle, which symbolises the Russian state, gazes simultaneously east and west, one head is seemingly oblivious to the other."⁷⁸ Nowadays it seems that Putin is trying to oppress the adherents of the Westerners and instead prefers the Slavophiles, but even more the Eurasianists. The followers of the two latter groups underline the most poignantly Russia's unique character. They say that in the Russian region a specific combination of the Slavonic and the Turanian cultures was established and, as a consequence, Russia is the synthesis of Europe and Asia. This leads to the belief in Russia's „messianistic third way" and imperial destiny. Moreover, some of their adherents believe that Europe is not even a substantive continent, just the periphery of Eurasia and so Russia plays a central role in the continent.⁷⁹

This assumption is very popular among Russians in present days as well. Levada Centre, a Russian non-governmental research

organization released its surveys at the end of 2014 which are clear proofs for this tendency and it also shows the solidarity for Putin's politics in the Russian Federation. A poll in November 2014 showed that 68 percent of the people considered Russia as a superpower and 77 percent thought that "Russia will become a prosperous country only by differentiating itself from the West and taking a different path from the West"⁸⁰. On the other hand, 57 percent said that Moscow should strengthen its relationship with the West, economically, politically and culturally. These are answers for some other questions about western-type liberal democracies from September:

Do you think that Russia needs democracy?

	Oct. 11.	Aug. 13.	Sep. 14.
Yes, Russia needs democracy	61	56	62
No, the democratic form of government is not for not for Russia	25	22	24
It is difficult to say	14	22	14

Which kind of democracy does Russia need?⁸¹

	Oct. 11.	Aug. 13.	Sep. 14.
The same as in the developed countries of Europe and in America	19	26	13
The same as it was in the Soviet Union	14	17	16
A completely special kind that corresponds with the national traditions and specific character of Russia	49	34	55
Russia does not need democracy	7	8	5
It is difficult to say	11	16	11

By utilising these beliefs and enhancing the nationalist-patriotist trends Putin has reached a serious political success as his popularity soared and is higher than at any point during the last few years with up to more than 80 percent.

This leads us back to his power politics which is the biggest difference between the politics of Russia and the EU, and probably the most important reason why the two actors cannot cooperate well in spite of all the efforts. While the European Union follows a

liberal-institutionalist and even constructivist policy where values play a primary role, Russia has traditionally pursued a strongly interest-oriented policy, often with authoritarian tendencies. These divisions often lead to misperceptions and conflicts because the misunderstanding causes insecurity and mistrust. Meanwhile the West ignores the fact that Russia feels threatened, because it views the world in its own – liberal or constructivist – point of view, while Russia is not able to break away from its habits from the Cold War.

And since energy is one of the most important key elements in their relationship not only to rebuild trust, but also to enforce dialogue, it is also one of the most delicate parts in every alliance. This is where the partners are the wariest not only because of the above-mentioned reasons, but since it is a natural effect of their mutual dependence reaching its highest level. And meanwhile Mearsheimer is right when he writes about the differences in the parties' interpretations of the world politics, the constructivist approach gives us a valid information about Russia's internal processes, without which one cannot understand the ongoing confrontations in their full depth, which would be inevitable to solve the current problems.

CONCLUSION

The relationship between the European Union and Russia is very complex, in which energy cooperation plays a primary role. After the collapse of the Soviet Union the renewal of the cooperation between the two sides has begun but neither of the parties took account of their different nature during these negotiations. Their historical development, culture and societal structure are very different and this leads to mistrust and misperceptions. The warning signs had appeared in 2006 and 2009, in the Ukraine-Russia gas disputes and it soon became evident for the EU that the overdependence on Russia's supply has serious disadvantages both economically and politically. But the true catalyst of the search for alternatives was the outbreak of the Ukraine crisis and the annexation of Crimea. The EU's reaction was the establishment of serious economic and financial sanctions against the Russian Federation. However, most of the economic relations remained intact as both of them are essential partners for each other – which does not mean that they are not looking for

other possible solutions in order to reduce the dependence on each other.

Russia is heading East, where the energy hunger is growing intensely and Europe is searching for other energy sources, primarily in the LNG market, but by looking for another possible hydrocarbon transport routes as well. Besides of that, it also tries to integrate its internal energy markets. It seems that maybe in the short-term Russia is in a better position. However in the long-term Europe could also find the proper surrogate, which would not only mean that the overdependence on a single supplier is over, but also that the EU could take the lead in innovations in the energy market which is inevitable for adaptation to the new challenges.

Temporarily, significant changes cannot be expected but in the long-term these efforts can lead to a change in the whole energy market. And although it is very likely that Russia remains a dominant state for a long time in this area, Europe will not necessarily be its biggest consumer, which may give a chance for other actors to become significant suppliers. This could also mean that other sources can be used world-wide as an auxiliary resource or even as substitutes for the oil and gas supplies. There are several possibilities, such as LNG, renewable resources and shale gas. And although right now none of them are able to fully replace oil and gas supplies, in time they could change the market, not just in terms of energy, but in political respects as well.

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REVIEW

ENERGY CHALLENGES AROUND THE CASPIAN SEA

The Caspian Sea Chessboard: Geopolitical, geo-strategic and geo-economic analysis (eds.: Carlo Frappi and Azad Garibov. Egea, 2014, 242 p.)

Kinga SZÁLKAI

ABSTRACT

This review intends to introduce the book ‘The Caspian Sea Chessboard: Geopolitical, geo-strategic and geo-economic analysis’, edited by Carlo Frappi and Azad Garibov. The volume aims “to address the relevance of the Caspian Sea in the contemporary international and regional systems, analysing both soft and hard security issues and threats emerging from the basin, as well as the policies of littoral and extra-regional actors” (p. 18). From the aspect of energy policy, the book deals with two especially important issues among others: Firstly, with the question of the legal status of the Caspian Sea, which influences the division of offshore natural resources, and secondly, with energy security, which does not only include the protection of the extended pipeline systems and processing plants, but the matter is also linked to the diversification of energy sources from the aspect of Europe and to the role of littoral states in this question.

Keywords: book review, Caspian Sea, energy, Azerbaijan, geopolitics

The Caspian region is one of the most important areas in contemporary global and regional energy politics. Significant oil and gas reserves are located there, both in onshore and offshore fields, accompanied with an extensive network of pipelines and processing plants. According to the U.S. Energy Information Administration, there are 48 billion barrels of oil and 292 trillion cubic feet of natural gas in proved and probable reserves in the Caspian basin,¹² which make the region one of the most promising areas in terms of energy production.

During the Cold War, these resources and the Caspian Sea itself were legally divided between the Soviet Union and Iran, practically allocating the most important benefits to the former, and excluding non-littoral actors from the use of the resources. After the collapse of the Soviet Union, four new states emerged on the shores of the Caspian: Azerbaijan, Kazakhstan, the Russian Federation and Turkmenistan, while Iran remained an important littoral state. On the other hand, new, influential international actors entered the region in the forms of great powers, international organisations, transnational companies and NGOs. Many of these states and international actors have considerable interests concerning the plentiful energy resources and the energy infrastructure in the Caspian area. As a consequence, several challenges appeared, many of which are directly related to energy and energy policies.

The book *The Caspian Sea Chessboard: Geopolitical, geo-strategic and geo-economic analysis* deals with these challenges from the aspects of geopolitics, geo-strategy and geo-economy, and in this sense, it fills a gap in the literature on the Caspian region. The 242 pages long volume was edited in Italian-Azerbaijani cooperation by *Carlo Frappi* (ISPI, Istituto Per Gli Studi Di Politica Internazionale, Italian Institute for International Political Studies) and *Azad Garibov* (SAM, Strateji Araşdırmalar Mərkəzi, Center for Strategic Studies), and it was published by the EGEA company in Milan.

The aim of the book is “to address the relevance of the Caspian Sea in the contemporary international and regional systems, analysing both soft and hard security issues and threats emerging from the basin, as well as the policies of littoral and extra-regional

¹²U.S. Energy Information Administration. “Overview of oil and natural gas in the Caspian Sea region.” Accessed May 4, 2015. <http://www.eia.gov/countries/regions-topics.cfm?fips=CSR&src>.

actors.” (p. 18) For the detailed analysis of these issues, the book is divided into three parts. The first part, *What is at Stake: Transnational Issues*, discusses the most important challenges concerning the whole Caspian Basin, such as the determination of the legal status of the Caspian Sea and the division of its offshore resources, the militarisation of the Caspian Sea, the protection of critical energy infrastructure in the region, and environmental protection. The second part, *Littoral State's Perceptions and Policies*, delves deeper in the domestic and foreign policies of the five littoral states concerning the role of the Caspian Sea and the challenges that these countries have to face due to their geopolitical location. The third part, *Interests and Policies of Global and Regional Actors*, broadens the focus of the analysis, investigating into the policies of the European Union, the United States, China and Turkey in the region.

From the aspect of energy policy, the majority of the studies included in the book contains relevant information. However, there are two especially important discussed issues in this sense: on one hand, the question of the legal status of the Caspian Sea, which influences the division of offshore natural resources, on the other hand, energy security, which does not only include the protection of the extended pipeline systems and processing plants, but the matter is also linked to the diversification of energy sources from the aspect of Europe and to the role of littoral states in this question. These issues also imply the involvement of the already mentioned extra-regional actors, the EU, the USA, China and Turkey, the significant interests of which are closely linked to energy and natural resources in the Caspian region.

The study of *Kamal Makili-Aliyev* is a detailed overview of the debate on the legal status of the Caspian Sea. He deals with the historical development of agreements concerning the delimitation of the water body and the contemporary dispute on whether it can be considered as a sea or a lake – which determines the applicable regulations of international law about the borders of riparian states and the possible division of offshore resources. He describes the standpoints of littoral states, introducing the development of consensus among Azerbaijan, Russia and Kazakhstan, the related bilateral agreements, and the argumentation of Iran to consider the Caspian as a condominium. Although Makili-Aliyev does not directly deal with energy questions, his conclusion makes it obvious that a clearly defined international status and the consequent

peaceful coexistence and cooperation are inevitable for the sustainable development of the region.

The analysis of *Azad Garibov* mainly deals with the naval militarisation of the Caspian Sea, but he also highlights the relevance of energy questions in this issue. Garibov mentions that disagreements on the delimitation of oil and gas fields sometimes lead to “power show-offs”, to discourage the neighbours from exploration works in disputed areas. In this sense, he reflects on the fact that the division of energy sources can function as a catalyst of conflict, while the utilisation of oil and gas fields contributes significantly to the development of military forces. The increasing militarisation of the Caspian Sea may enhance the possibilities for escalation, as riparian states appear to become more and more engaged for protecting their interests, or at least for deterring their rivals from taking actions in disputed fields.

Matteo Verda highlights the importance of critical infrastructure protection in the Caspian region. He claims that energy infrastructures are primary strategic assets for the riparian states, and their damage may lead to huge economic losses. The regional context of tensions and international terrorism are the most important challenges in this respect. These can only be tackled by a multi-level strategy based on multilateral and bilateral cooperation and efficient national coordination. Verda gives a detailed description about the origin of threats to the energy infrastructure in general and in the Caspian context in particular. He also emphasises the need for clarifying the legal status of the Caspian Sea, to avoid the risks stemming from the existing tensions and for building cooperation concerning the energy infrastructure.

Matteo Villa comes to the same conclusions in terms of environmental issues in the region. He analyses the risk of overexploitation of the Caspian Sea, and he claims that a typical example of the “tragedy of commons” is under way due to the lack of coordination among self-interested rational actors. In his study, he assesses the impacts of overexploitation on the Caspian region, giving evidence of the depletion and the degradation of its environment. One of the most important sources of pollution is related to energy production. Hydrocarbon extraction, “construction of sea platforms and jetties, construction and operation of underwater pipelines, shipping and transporting of hydrocarbons” (p. 80) may all lead to water contamination. This is

in close connection with the decline of fisheries and the marine population. Villa also introduces the legal framework to protect the Caspian environment, highlighting its strengths and weaknesses.

In the second part of the book, the authors deal with the standpoints, interests and foreign policy directions of littoral states. The question of energy emerges inevitably in all these studies. From *Rovshan Ibrahimov's* study it becomes very clear that the Caspian Sea and the related energy infrastructure plays an essential role for Azerbaijan. He introduces the development of the Azerbaijani standpoint about the delimitation of the Caspian Sea, then he evaluates the geostrategic importance of the water body and its offshore reserves. Azerbaijan is one of the oldest oil extracting states in the world and lies in a juncture between East and West, therefore it offers a perfect location for pipeline systems. Ibrahimov explains how the construction of the existing pipeline systems interacted with the Azerbaijani foreign policy and how the country contributed to the diversification of energy sources towards the West, reducing the influence of Russia.

In the next analysis, *Tomislava Penkova* focuses exactly on this latter issue, describing the role of Russia on the shores of the Caspian. She examines the place of the Caspian region in the Foreign Policy Doctrines of Russia since 2000, the standpoint of Moscow on the delimitation and international legal status of the sea, and the role of Vladimir Putin in rearticulating Russian interests concerning Caspian hydrocarbons. Surprisingly, she treats Russia as “an important but not dominant player in the international oil market”, while she highlights its exceptional position in terms of the gas industry. She also evaluates the possibility of constructing new pipelines with the significant contribution of Russia. In the conclusion part, she reminds the reader that the times when the USSR and Iran ruled the Caspian as their exclusive condominium are long past, and Russia has to face the growing influence of not only the West, but also the newly independent littoral states.

Reshad Karimov deals with the other main former actor in the Caspian region, Iran. Although the study concentrates mainly on the security environment of the country in a broader sense, energy questions are also mentioned within the framework of “complex interconnection of economic and political motivations driving regional politics.” (p. 129.) Iran is a member of the OPEC, but its hydrocarbon interests are predominantly linked to the southern

part of the country, and due to the unsolved debate on the delineation of offshore fields, its ambitions in the Caspian are significantly hampered, therefore it cannot play a decisive role in the extraction of these resources.

It is not the case with Turkmenistan and Kazakhstan, which are increasingly involved in the development of hydrocarbons in the Caspian region. *Mukhit B. Assanbayev's* analysis is an extensive summary of the geopolitics and foreign policy of the two states, including the detailed and very informative description of existing and planned pipeline systems in the area. Of course, this article also describes the standpoints of the examined states about the legal status of the Caspian and the division of its resources.

In the third part of the book, the reader can get a closer look into the energy-related interests of influential great and regional powers in the Caspian area. *Michela Ceccorulli* writes about the lack of stronger links between the European Union and the Caspian basin, in spite of the fact that its energy security needs bind the EU tightly to the hydrocarbon reserves of the region. The EU has a specific interest both in clarifying the borders (so that hydrocarbon extraction can get a boost) and in developing pipeline systems and related processing plants, because of its extended energy needs and its aim to diversify its energy sources. Ceccorulli introduces the main EU frameworks and initiatives related to the Caspian region, evaluating their success and outcomes. She argues that the EU inevitably needs a comprehensive strategy aimed directly to the region, because the lack of an overall framework endangers fundamental EU interests and undermines its global objectives as well.

In the case of the United States, the Caspian basin has played a special role for a long time, claims *Carlo Frappi* in his analysis, although he also argues that the US has no vital interests here, and it has never coined a direct Caspian policy. The relevance of the region for Washington lies in its geopolitical location, its significant hydrocarbon reserves and its regional power transition after the collapse of the Soviet Union, which makes it an important example of the post-Cold War policies of the United States. Frappi examines the role and aims of the US in the Caspian region in three different eras: under the presidency of Clinton, Bush and Obama. He claims that the Clinton administration reached the most important successes in the region by constructing the oil and gas pipeline

systems which avoid Russia and enable Europe to diversify its energy sources.

The greatest success of China in the Caspian basin is still being held by the future, but the article of *Lorena di Placido* shows that Beijing has significant interests and aims related to the area and its energy resources. China focuses mainly on the Central Asian part of the Caspian region, importing gas from Turkmenistan and oil from Kazakhstan, which also necessitates being involved in the construction of pipeline systems. In its current position, di Placido claims, China is a more direct rival of Russia in the region than the EU or the US. It is partly because of Beijing's policy, which expects neither commitments to the principles of democracy and market economy like the EU or the US, nor adaptation to the exclusive and direct political and economic influence of a state like Russia in exchange for providing investments, loans and development aid, facilitating economic growth. The current trends show that China is becoming one of the most significant actors in the region, including the sphere of energy.

Turkey acts as a less successful player in the Caspian basin, according to *Oktay F. Tanrisever's* study. She deals with the analysis of Turkey's foreign policy in the region, which is primarily focused on the aims to gain regional leadership. In terms of energy policy, Ankara's main role lies in providing export routes for hydrocarbons extracted in the Caspian basin bypassing Russia. Although the Blue Stream project questioned the loyalty of Turkey to the Western pipeline initiatives against Russia, the planned 'southern energy corridor' to Europe is only imaginable with the cooperation of Turkey. In other fields, such as political and economic influence or soft power, Ankara's capabilities cannot match those of the US, Russia or even the EU in the region, although after the initial failures in the 1990s, the 2000s brought improvements in the political and economic cooperation among Turkey and the states of the Caspian basin.

All in all, the book reached its initial aim to provide an outlook of "the relevance of the Caspian Sea in the contemporary international and regional systems," its studies managed to examine the overall geopolitical, geostrategic and geo-economic situation of the Caspian region, including the domestic and foreign policies of the littoral and extra-regional players, investigating into the most current security issues and threats. From the viewpoint of energy security, the articles present a comprehensive picture of

the related issues, including both the overview of the questions concerning the significant hydrocarbon reserves located in the region and the description of the related extensive energy infrastructure and its security-related matters.

A distinctive feature of the volume is that it represents the Caspian region mainly from the viewpoint of Azerbaijan, the fundamental interests of which are tightly linked to the water body, and which is involved deeply in the described processes. It is also visible that the authors intended to avoid the generalisations of 'Western' approaches and to give an authentic, 'insider' picture of the region. These characteristics give a unique nature to the book and make it an even more interesting read.

Overall, the book is a useful source for those who want to know more about the geopolitical, geo-strategic and geo-economic features of a region, which is central to global energy production. It also benefits those who intend to discover current processes, trends and developments in the domestic and foreign policies of the littoral players, or those who aim to examine the influence of extra-regional actors. Furthermore, it helps to form a comprehensive picture of the energy infrastructure which can be of key importance in providing energy security to Europe.

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