Russie.Nei.Visions n°18

Gazprom as a Predictable Partner. Another Reading of the Russian-Ukrainian and Russian-Belarusian Energy Crises

Jérôme Guillet

March 2007

Russia/NIS Center

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Contents

Summary

The recent crises over oil & gas deliveries from Russia to Ukraine and Belarus have triggered alarm and virulent criticism in the West. This article describes how these conflicts are in fact not very different from those that took place in the early 1990s and reflect behind-the-scene conflicts between powerful factions inside the Kremlin and in Ukraine rather than the exercise of an “energy weapon.” In the context of a European energy policy driven by Britain’s panic at becoming a gas importer and by the ideological zeal to liberalize, the West should worry less about the exercise of a purported aggressive geopolitical strategy and more about Putin’s lack thereof, and his inability to control his warring lieutenants. Above all, the West should stop considering that Russia owes Europe any gas beyond its contractual obligations, which it fulfills with alacrity.

Introduction

Energy has figured prominently in the news in the past few years, on the back of regularly increasing oil prices, Middle Eastern tension and worries about global warming. But nothing has quite captured the attention of European politicians and media like the successive crises between Russia and its neighbors Ukraine and Belarus about the price of the oil and gas these countries receive from Russia, over the last two winters. The temporary delivery interruptions that caused shortages in exports to Western Europe apparently shook our capitals to the core.[1]

Mostly analyzed as a blunt exercise by Russia of its "energy weapon" to exert influence on these countries, these twin events have generated new worries about Europe's growing dependency on energy imports in general and on Russian gas in particular. There has also been a lot of commentary about Russia's increasingly authoritarian trend, and its growing hostility to Western investment in the strategic oil & gas sector.

This paper seeks to analyze these two crises taking into account the Russian point of view, and the very specific nature of the pipeline infrastructure which was the core of the conflict. It aims at identifying similarities and differences to find possible rationales for the behavior of Russia and Gazprom. It will also provide a different perspective on the European gas market.

[1] Separate crises with Moldova, Azerbaijan and Georgia also took place over that period; as the stakes were to a large extent different for both Russia and Europe, they are not discussed here.

Europe Held Hostage?

It is first worth nothing that there were actually three separate disputes (excluding those with Georgia and Azerbaijan, which will not be discussed here): a confrontation about gas with Ukraine in December 2005, resolved in early 2006, a confrontation on gas with Belarus in late 2006, and a new confrontation with Belarus a few days later in early 2007, about oil this time. In each case, the dispute took place in the context of the re-negotiation of yearly contracts for delivery of Russian gas or oil to the other country, and was generated by Russia's desire to increase the price for its deliveries. In each case, the then-applicable prices were significantly lower than the prices for deliveries to Europe, and Russia's goal was to bring the prices for future deliveries in line with those of the market, as determined by sales to Europe. The importing republic refused such increases, which led to ultimatums by Russia and, ultimately (except in the Belarus gas dispute, where an agreement was reached prior to that), to delivery cuts by Russia. The importing republic then decided to siphon off gas or oil from the pipelines on its territory used by Russia for its exports to Europe. In the case of the Belarus oil crisis, this led Russia to cut off deliveries altogether in the relevant pipelines, whereas in the Ukrainian dispute, Russia restored deliveries almost immediately. In ether case, exports to Europe were disturbed, which created a storm of protests from the importing countries, and the blame was put almost unanimously on Russia for using inappropriate and heavy-handed tactics.

Russia was accused of blackmailing its neighbors into compliance, of flexing its "energy muscles" against Europe, and of taking a confrontational stance, while still refusing to ratify the Energy Charter, and while foreign investors in Russian oil & gas projects are seen to be pressured into abandoning stakes to the newly rebuilt national oil & gas behemoths. The case of Shell on the Sakhalin-2 project, whereby Gazprom was brought into the transaction after months of tough negotiations, was emblematic. The Russian State was seen as acting partially as it brought up environmental suits against the project to threaten to take away its licenses—suits that immediately disappeared once Gazprom's position was secured. Following on the steps of the Yukos nationalization, the purchase by Gazprom of Sibneft and other explicit policies by the Kremlin to take back control of "strategic industries", as well as parallel disputes over oil or gas with other former republics like Georgia or Azerbaijan, there is no doubt that these crises took place in a context of growing assertiveness by the Russian authorities.

History Stutters: The Russian-Ukrainian Pipeline Wars of the 1990s

In the early 90s, Gazprom delivered 80-90 bcm/y[2] of gas to Ukraine. That gas was distributed under the mechanisms set up under Soviet times, to big industrial users and for household consumption. When Ukraine became independent and took over the part of the network on its territory, local customers started paying their gas to Kyiv (Ukrgazprom) rather to Moscow (Gazprom), with the newly created national gas company in principle centralizing purchases from Gazprom. The problem was, of course, that the Ukrainians never paid for their gas. Tensions between the two countries (on this topic like on others) rose and, eventually, Gazprom tried to force the Ukrainians to pay for gas by withholding supplies. The Ukrainians responded then, as in 2005, by withholding gas intended for Europe. Deliveries were cut by Russia in October 1992, in February 1993 and again in November 1993 and each time, gas pressure to Europe dropped. A defiant vice-Chairman of the Ukrainian State Committee for oil & gas bluntly stated that "no gas for Ukraine, no gas for Europe."[3] European buyers (Gaz de France, Snam, Ruhrgas), deeply worried, all hurried to open offices in Kyiv in order to convince the Ukrainians not to block their supplies, and were quickly satisfied when Gazprom chose to restore deliveries to Ukraine—despite not being paid—in order not to curtail exports to Europe.

[2] bcm/y – billion cubic meters per year.
[3] AFP, 1 March 1993.

Figure 1: Russian Gas Pipelines

Source: US Energy Information Agency.[4]

After many such episodes, the situation more or less stabilized in 1994 after Leonid Kuchma came to power in Ukraine (the only election in the CIS where an incumbent lost an election and abided by that vote) on the basis of a cashless trade—Russian delivering gas to Ukraine, and Ukraine allowing transit of Russian exports to Europe—with side agreements on industrial sectors. In 1994 Ukraine had the only factories in the former USSR for large pipelines (1420 mm and 1220 mm) and small pipelines (219 mm, 325 mm, 426 mm), but depended on Russian factories for midsize pipelines (530 mm and 720 mm).[5] In 1994, 70% of all gas industry workers in Siberia were Ukrainians (as were a majority of Gazprom's board members), reflecting the fact that the Soviet gas industry was born in Ukraine in the 1920s and that the Ukrainian gas pipeline network was—and still is—a vital part of the Russian network.[6]

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[4] "Major Russian Oil and Natural Gas Pipeline Projects", US Energy Information Agency, <www.eia.doe.gov/emeu/cabs/russia_pipelines.html>.

[5] Makar & Kliukatch, "Transportation of Oil and Gas by Pipelines in Ukraine", presentation to the "Oil & Gas in Ukraine" Conference, 17-19 May 1994, organized by the Ukrainian Academy of Science and the Ukrainian Academy of Oil & Gas.

[6] See the map posted online J. Guillet, "Russia vs Ukraine—Tales of Pipelines and Dependence", *European Tribune*, 30 December 2005,

The main lesson Russian authorities learnt at that time[7] was that there were immediate international repercussions to their disputes with Ukraine, and that they could not use the blunt instrument of cutting gas supplies to Ukraine because that led to supply disruption to their vital export markets. That lesson held true for the next 10 years, but seems to have been forgotten by the new masters in the Kremlin. However, what caused it to be breached was not some grand geopolitical strategy but the pursuit of the private interests of a well-placed people.

This is linked to the slow transformation of the gas trading business between Russia and Ukraine following the crises of 1992-94, and the increased importance of private interests over those of countries or companies like Gazprom.

<www.eurotrib.com/story/2005/12/30/173336/17>. Map initially prepared by author during internship with Gaz de France in Kiev in 1994.

[7] Including, first and foremost, the leadership of Gazprom under Rem Viakhirev.

The Great Fiction of "Turkmen" Gas

What happened first was a slow chipping away by the Russians of this agreement with the central Ukrainian authorities. In September 1994, Gazprom cut gas deliveries to just one city, that of Mariupol, on the Black Sea coast. That city presented two unusual characteristics—its gas came from a small pipeline connected directly to the Russian network and not to the Ukrainian network,[8] and it hosted Azovstal, one of the largest metallurgical companies in Ukraine and one of its biggest exports—a company that used a lot of gas, and that was able to pay for it. Azovstal's gas was cut off despite the fact that it was still paying for it—to Ukrgazprom. Following lobbying by Azovstal, Gazprom obtained the right to be paid directly by Azovstal for its gas deliveries to that company, cutting out Ukrgazprom. With Azovstal making up almost 10% of the whole Ukrainian gas consumption, that made a significant portion of Russian deliveries to Ukraine that suddenly were being paid for.

Not coincidentally, this is the time when various mysterious traders started becoming involved in the trade of gas to Ukraine. Names like Nordex, Slavutich or Respublika may have been forgotten, but they were the ancestors of Itera, EuralTransGas and RusUkrEnergo, their better known, and more recent, successors. Their fundamental business model is to get the money actually paid by Ukrainian gas users and capture it while not giving a pretext to the central Ukrainian authorities to cut off gas transit.

A good way to understand what happened is to consider the situation of a big metallurgical company in Eastern Ukraine, paying its gas deliveries to Ukrgazprom in Kyiv at 80 $/tcm[9]—money which is never handed to Gazprom in Russia. It would certainly be profitable for that company—and for Gazprom—to be able to pay only 50 $/tcm, but to pay it directly to a trader which has access to Gazprom's gas or its pipelines.Yet the central government in Kyiv did not allow this, thanks to its hold over Gazprom via its export pipes. But that leverage by Kyiv could be avoided if the gas were bought from someone other than Gazprom, such as Turkmenistan, which was not exporting anything to Europe. Thus the big Ukrainian industrial users teamed up with Gazprom managers and a few well placed people in the Central Asian republics to create the illusion that they were buying gas not from Gazprom, but from other suppliers—despite the fact that the gas

[8] For more background on the intricacies of the Russian-Ukrainian gas negotiations, see "Russia vs Ukraine—Tales of Pipelines and Dependence", *op. cit*.
[9] $/tcm: US dollars per thousand cubic meters.

was going through the exact same pipelines—“through Russia” instead of “from Russia.”

Other such large Ukrainian end-users then tried to grab more of the domestic gas market beyond their own needs, using their specific supply schemes. By offering gas at 60 $/tcm to other industrial users in their region, the trader got paid for more gas, and the first buyer could make a 10 $/tcm profit along the way. Of course, this undermined Ukrgazprom (which would lose revenue from paying customers), and led to vicious infighting inside Ukraine, which dominated the politics of the country for the next 10 years, as the biggest gas consumers tried to become the entity that could buy directly from the trader and sell more (at a profit) to others in Ukraine.

That money, captured by a few intermediaries, did not profit Gazprom itself, but certainly allowed a few of its well-placed managers (high enough in the hierarchy to make it possible to get several tens of billions of cubic meters of gas transported through Gazprom’s pipelines) and a few Central Asian oligarchs to make huge fortunes. The scheme is inherently unstable, as those that have to buy the gas from the local trader will always try to get rid of that middleman by going to the source. Thus metal-bashing plant no.2, which buys gas from metal-bashing plant no.1 at 60 $/tcm (who itself buys its from “Turkmen” trader at 50 $/tcm for its own needs as well as for resale within Ukraine) will try to offer 55 $/tcm to the trader to switch places with metal-bashing plant no.1. Thus Russian intermediaries played off Ukrainians one against the other to extract cash from Ukraine—something that Gazprom was structurally unable to do itself.

2005: Forgotten Lessons

Which brings us to 2005. The underlying dispute was, as usual, about the control of gas trading mechanisms, but things got out of control because there was infighting both on the Ukrainian side (a three-way fight between the Yanukovich, Timoshenko and Yuschenko factions—to simplify, the Donetsk, Dniepropetrovsk and Kyiv groups) and on the Russian side (between Putin underlings Medvedev and Sechin over the control of Gazprom, or at least of its less visible side activities) over the spoils. These disputes, which the parties had learnt to keep mostly out of the public eye suddenly burst into the international press as the crisis boiled over and led to what had not happened in over 10 years, i.e. public ultimatums to cut gas deliveries to Ukraine. In the context of Putin's ill-advised intervention in the Ukrainian elections, which gave the Orange Revolution its strong symbolism, this was interpreted as an attempt to mix energy-dominated bilateral relations and domestic politics, and quite simply, as crude blackmail.

While it can be considered deeply worrisome that Russian authorities (both in their personal and institutional roles) were unable to resolve their dispute with the Ukrainians without creating a major international crisis, the most overlooked fact of the Ukrainian crisis is that Gazprom decided to restore gas deliveries *before* a solution was found with the Ukrainians, i.e. the current Russian leaders learnt the same lesson their predecessors had learnt in 1992-1994. This simply reflects the fact that Gazprom's management belatedly realized the damage that the highly public dispute was doing to Gazprom's export reputation, its most valuable asset, and put a stop to the public brinkmanship.[10] From all media commentary in the West, it seems to have come too late,[11] but the fact remains that Gazprom, as an institution, chose to give up yet again its attempt at extracting increased revenues from Ukraine as soon as this threatened its reputation as a

[10] Gas deliveries were restored on January 3 ("Gazprom Vows to End Gas Shortage", BBC, <http://news.bbc.co.uk/2/hi/europe/4575726.stm>); an agreement was announced the next day ("Ukraine and Russia Reach Gas Deal", BBC <http://news.bbc.co.uk/2/hi/europe/4579648.stm>), but it was hard to make sense of the numbers. A more substantial agreement was signed on 11 January between Yushchenko and Putin, which was contested by the Ukrainian Parliament ("Gas pressure", *Kommersant*, 11 January 2006, <http://commersant.com/t640085/r_3/n_33/Gas_Pressure/>).

[11] "Press Shivers from Gas Woes", BBC, <http://news.bbc.co.uk/2/hi/europe/4578000.stm>.

supplier to Europe—while negotiations moved to the backroom.[12] While this reflects a lot of worrying trends in the Russian power structure (its amateurism, the extent to which internal power struggles and personal motivations can trump State policy), it does show that the crisis was not a show of force by Russia toward Europe, nor a calculated geopolitical message, but rather an accident that took the Kremlin insiders by surprise.

In any case, to put the crisis in perspective, gas deliveries from Russia to a number of European countries were indeed down by a significant amount (20 to 40%) for a couple of days, but that was not enough to put Gazprom in breach of its contractual obligations. Most of Gazprom's contracts with European buyers include a nominal volume and a minimum volume for the year, which is usually 20% lower than the nominal volume. Importantly, that minimum volume applies to both parties (i.e. Gazprom has to deliver such a volume, but the buyer has to buy, or pay in any case, even if it does not take delivery of the gas, such a volume as well—thus the name "take-or-pay" for these contracts) in order to guarantee volumes for both parties—supply is guaranteed to the buyer, and income is guaranteed to the supplier. That obligation will usually apply on a seasonal basis or on a monthly basis. Gas consumption is highly seasonal, with winter demand up to 3 times higher than in summer, and deliveries are also larger in winter (those that have storage capacity will fill them up in the summer and empty them in the winter). The two-day disruption in early January 2006 was not enough to put Gazprom in breach of its contracts, but it was highly visible because it came at a time of very high demand when pipelines are usually filled to capacity. In fact, gas deliveries were disrupted a lot later in January,[13] when the cold wave in Russia pushed demand within Russia to record levels and put a lot of strain on Gazprom's pipeline system, which was required to function at maximum capacity for a long time.

[12] For an attempt at understanding the terms of the agreement announced, see J. Stern, "The Russian-Ukrainian Gas Crisis of January 2006", Oxford Institute for Energy Studies, <www.oxfordenergy.org/pdfs/comment_0106.pdf>.

[13] "Extreme Cold Forces Russia to Reduce Gas Deliveries to Europe", *Moscow News*, 18 January 2006, <www.mosnews.com/money/2006/01/18/gazpromcuts.shtml>; "Russian Gas Deliveries Fall Short", *USA Today*, 24 January 2006, <www.usatoday.com/money/industries/energy/2006-01-24-gas-usat_x.htm>.

A Convenient Diversion from Europe's Own Contradictions

But the January episode generated a tremendous amount of political commentary focused exclusively on the theme of Russia's imperialistic ambitions, and its apparent willingness to use the "energy weapon" against other countries, including from senior US officials.[14] A lot of hand-wringing took place in Europe, led by Tony Blair in London and José Manuel Barroso in Brussels, with scathing criticism of Gazprom and Russia, calls for a common European policy and simultaneous suggestions to create a European monopsony to face Gazprom, further liberalization of European energy markets, and forcing Russia to open up its pipelines and reserves to foreign investors.

What was never mentioned was that these tensions did not take place in a vacuum. Several basic pieces of highly relevant information are rarely discussed in the same breath as Russia's "imperialism", but matter nonetheless:

1. This crisis occurred precisely when the UK became a gas importer for the first time in over 20 years. When Europeans worry about Europe suddenly becoming globally more dependent on imported gas, one must realize that, in practice, that means essentially the UK rapidly turning from a self-sufficient market to a large importer. France, Germany, Spain and Italy already import all or most of the gas they consume, and have behaved as importing countries for a long time. Security of supply is not a new issue for them, and it has been dealt with in the time-honored way this problem can be tackled, namely, by diversifying supplies and creating stable, binding, long term relationships with suppliers. Western Europe has imported gas from the Soviet Union under such contracts for close to 40 years now and there has never been a glitch. There is no reason why the UK should be unable to do the same via a mixture of piped and liquefied gas (LNG). But as it does not have a large company which could be a credible counterpart in such long term contracts, it has found it

[14] "US Seeks to Limit Gazprom Hold on Europe", *Financial Times*, 29 April 2006, <http://news.ft.com/cms/s/ce4c7ef0-d6ea-11da-b64c-0000779e2340.html>; C. Mandil, "Russia Must Act to Avert Gas Supply Crisis", *Financial Times*, 22 March 2006, <www.ft.com/cms/s/ad8c8604-b90a-11da-b57d-0000779e2340.html>.
For a wider sample, see also J. Guillet, "The New Gas War", *European Tribune*, <www.eurotrib.com/story/2006/4/30/85022/0161>.

harder to do so, and the country's political leadership is suddenly panicking, and lashing out at supposedly ungrateful European neighbors that will not share their gas or at the Russians that supposedly would not sell it.

2. UK companies (BP and Shell) have large investments in the Russian oil & gas sector, and access to the export markets is the easiest way to make these investments worthwhile. Thus the permanent pressure on Russia to open up its pipelines and let Western companies take a share of the hydrocarbons rent. While this would clearly benefit those companies, it is not clear how it would benefit Russia. Claims that Russia, the largest producer in the world of both oil & gas, would be unable to produce more than Western investors would, are quite presumptuous and silly. The experience of Shell in Sakhalin, or that of the Kashagan consortium in Kazakhstan, both plagued by massive cost overruns and delays suggests that Western oil companies have no lessons to give to their Russian counterparts with respect to keeping budgets and timetables in harsh Siberian conditions. Western consumers whose prices are determined by world markets, not by production costs will not notice any difference in any case. Russia has always supplied all the gas it could to Europe (and it has every incentive to do so, as it is its most profitable market). So the arguments about Russia's control of the oil & gas should be seen in view of that attempt by the Western majors to capture part of the economic rent available in Russia's rich subsoil, and enroll their governments in that quest.

3. Europe is in the middle of a very ideological drive to liberalize energy markets—unbundling networks from production, creating competition across the continent, and entrusting the private sector with the decisions on how to invest in future capacity. The very direct consequence of that policy has been a boom in the construction of gas-fired plants, which are cheaper to finance and thus preferred by the private sector.[15] Complaining about dependency on Russian gas at the same time as one promotes policy choices that structurally encourage increased gas consumption is completely incoherent, hypocritical, or both.

4. While Europe imports roughly 25% of its gas from Russia, Russia sends 100% of its exports[16] to Europe, so it is utterly dependent on the European market for its sales—and it has no possible alternative. The much-touted contracts with China are still many years away and will require the construction of very lengthy and very costly

[15] J. Guillet, "Liberal Markets Create an Addiction to Gas", *Financial Times*, 2 February 2007, <www.ft.com/cms/s/014ff2a8-b167-11db-b901-0000779e2340.html>.

[16] Gazprom still distinguishes between "exports" and "deliveries to the CIS". There is a very real difference between the two categories, in that exports go to countries that pay prices which are more or less market prices, while the CIS countries, up to now, have paid (or have been billed) much lower prices. "Exports", which represent only 20% of Gazprom's production, bring in around 60% of its income, because of the price differentials with CIS deliveries and domestic sales.

pipelines—and they will use in any case gas from other gas fields, further east in Siberia, than those currently used for deliveries to Europe, so they will come (by 2015 at the very earliest) only in addition to European contracts and not as substitutes. Potential exports to China cannot and will not divert a single drop of gas going to Europe. Meanwhile, these existing exports to Europe represent a high fraction of overall Russian exports (up to 25% some years) while taxes paid by Gazprom (thanks to these export revenues) provide a significant part (more than 10%) of federal budget receipts. Export revenues have also made it possible for Gazprom to provide cheap electricity and cheap heating to Russia's population for the past 15 years, ensuring basic services are provided to all—a very matter of life and death in such a cold country. Finally, in that context, it must be noted that the long term contracts that buyers are keen to enter into are also vital for Gazprom as seller, as they provide it with stable future demand that allows it to plan investments. This is true of all gas producers; gas is essentially an infrastructure business, where most of the costs are incurred in the transport of the gas rather than in its production, and where very heavy investments are needed upfront before a single dollar of income can be generated (a gas field will be worthless until the pipeline that connects it to the end user, or at least to the existing network, is not completed in full). That requires long term financing, to amortize over many years the early investment, and it makes the financing of projects the single most important driver of the cost of gas. Banks appreciate long term contracts and are willing and able to provide better terms when they are in place—indeed, they usually require them. Thus Gazprom, which until recently had no other way to raise large scale loans, is keen to sign such stable supply contracts and, naturally, to fulfill them in order to maintain its reputation as a reliable industrial partner. As long as official Russian policy is to keep control of investment in this sector, it is not unreasonable to ensure that the appropriate framework is in place, and Europe can do something about its security of supply worries by allowing for long term sale and purchase contracts.

European leaders' anguish or anger at Russia's behavior on the gas front are therefore either counterproductive or a cynical diversion from other issues.

The Belarus Confirmation

The more recent crisis will Belarus exposed these contradictions starkly. While there are many similarities, which were used to paint Russia in the same nasty light as during the Ukrainian episode (a dispute over price for Russian oil or gas, a cut in deliveries leading to interrupted supplies to Europe, Russia blamed for "using the energy weapon"), the differences are so flagrant that they merely highlight the fact that the real stakes are elsewhere.

- Belarus is an authoritarian regime, generally considered to be part of Russia's sphere. The argument that Russia is using the energy weapon to prevent that country from moving away from Russia (toward democracy and the West) obviously does not apply here—and makes Russia's arguments that its behavior had more to do with commercial matters rather than domestic politics a lot stronger;
- The fact that Belarus was very actively stealing oil from Russia, and breaching contractual agreements has been completely ignored in the West. A 1995 agreement between the two countries stated that Belarus could re-export oil products refined from Russian oil but had to split the profits with Russia (85% to Russia); since 2001, it no longer was transferring the portion it owed Russia, effectively capturing several billion dollars of profits each year.[17] The export duty that Russia slapped back on 18 December 2006 was meant to correct for that contractual breach. Westerners that pontificated the rule of law and the sanctity of contract when Shell was driven to re-negotiate the Sakhalin-2 project and give a 50% stake to Gazprom were quite silent about Belarus' behavior;
- The very suspicious timing, once again, of announcements shows that other negotiations were proceeding in parallel to the public ones. Belarus announced on 10 January 2007 that it capitulated[18] and renounced the 45$/ton transit fee it had imposed in retaliation to Russia's export duty, in order to get oil deliveries flowing again. Thus, Russia appeared to have prevailed fully in their dispute. And

[17] After the crisis, Vladimir Putin claimed that Russian subsidies to Belarus would still amount to $ 2.5 billion for oil and $ 3.3 billion for gas, "Energy Subsidies for Belarus to hit $5.8 billion in 2007", *RIA-Novosti*, 15 January 2007, <http://en.rian.ru/world/20070115/59085196.html>.

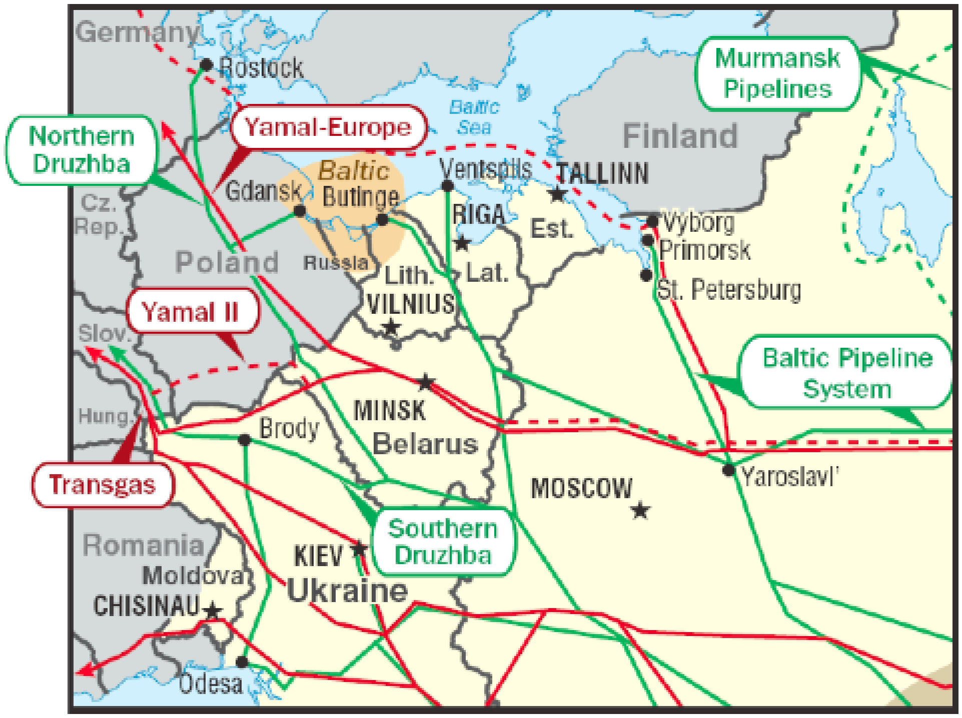
[18] "Russia-Belarus Oil Blockade Ends", *BBC News*, 10 January 2007, <http://news.bbc.co.uk/2/hi/business/6248251.stm>; "Belarus Cancels Oil Transit Tax; Druzhba Oil Deliveries Resumed", *Global Insight*, 11 January 2007, <www.globalinsight.com/SDA/SDADetail8016.htm>.

then, unexpectedly, two days later, it unilaterally decided to reduce the export duty it had succeeded to impose on Belarus back from 180 $/ton to 53 $/ton.[19] Why would Russia essentially give up the gains it had made in that dispute, considering that the price included yet another degradation of its image as a supplier in the West? It is much harder to know what is going on in Belarus than in Ukraine, but the most obvious conjecture is that a portion of the profits made by Belarus via the export of refined products manufactured from subsidized Russian oil are shared between a few well placed people in both countries;

- What made Belarus's initial collapse in bilateral negotiations quite unexpected is the fact that, like Ukraine, they have a strong hold over Russia's export. It is not quite as tight as Ukraine's hold (whereby 90% of Russian gas exports go through the Ukrainian system), but it is more than enough to disturb Russian exports (about 30% of gas exports go through its territory, including about 20% which also go through Ukraine, and close to 40% of Russia's oil exports cross its territory at some point, as shown on the map below), and thus Belarus should have been in a position to impose its will on Russia—or at least to extract relatively favorable conditions. That it did not do so strongly suggests that there was more to the dispute than was made public.

[19] "Russia Slashes Belarus Oil export Duty from $180.7 to $53 per mt", *RIA Novosti*, 12 January 2007, <http://en.rian.ru/russia/20070112/58992033.html>.

Figure 2: Oil & Gas Pipelines



Source: extract of a US Energy Information Agency map, via Wikipedia.[20]

- Another fact too often overlooked is that, in the case of oil, Russia has no obligation whatsoever to sell its oil to the West. With respect to gas, Gazprom has committed contractually to long term deliveries and it is indeed its responsibility to take care of transit issues (the point of sale of gas is where the Iron Curtain used to be, i.e. the Czech-German border or the Slovak-Austrian border, depending on the ultimate destination)—and Western buyers have actual legal grounds to protest if deliveries are interrupted beyond the allowed tolerances. In the case of oil, there is no such long term commitment. Russia sells its oil because it finds it profitable to do so, but it is absolutely free not to do so—and the West has absolutely no right to that oil. The fact that we protested so loudly speaks volumes of our *need* for that oil, and of our implicit claim that oil located in other countries should still find its way to our markets, ideally under our control. As President Bush said in his 2006 State of the Union address, we are "addicted to oil", and we get angry at our dealers if they stop delivering our "fix". That does not make the West right.

[20] Original map: "Selected Oil and Gas Pipeline Infrastructure in the Former Soviet Union", EIA, <www.eia.doe.gov/emeu/cabs/Russia/images/fsu_energymap.pdf>; Extract: "Pipelines in Eastern Europe", *Wikimedia Commons*, <http://en.wikipedia.org/wiki/Image:Pipelines_in_Eastern_Europe.png>.

The real lesson here is that these crises show a lack of strategic thinking in the Kremlin, and the increasingly visible interference on public policy caused by infighting and the capture of the “jewels of the crown” by a few well placed insiders. It tells us more about Putin’s weakness and his inability to control the clans inside the Kremlin than about any master plan for Russia to impose its will on Europe.

A Different Take on These Crises

The Ukraine and Belarus energy "crises" represented the convergence of several trends that are only likely to continue in the future: it is therefore essential to learn the correct lessons. Treating them as an expression of Russia's newfound imperialism, and an unacceptable use of the "energy weapon" misses the point completely.

The first trend is the evolution of energy markets. Strong demand growth in the face of a constrained resource base have pushed prices up and changed the balance of power between buyer and suppliers in favor of the latter. All oil & gas producing countries that do accept foreign investment are renegotiating more favorable terms, and Russia is doing the same. This, in turn, drives the assertive diplomacy of countries like the US and the UK, which are currently unusually close to oil corporations. The hostile media blitz against Russia simply reflects the frustration over a situation more favorable to Russia and that the sharing of the oil and gas rent is not favorable to the oil and gas majors. It is unlikely to succeed. Europe, in its parallel drive to liberalize its energy markets, is making things worse by accelerating demand for gas; finding an external scapegoat, one that many member countries view with a high degree of suspicion, is an easy way to avoid discussion of internal policy contradictions.

The second trend is internal to Russia. After several years in power, the *siloviki* around Putin are finally converting their political power into economic and financial assets. The takeover by the Kremlin of a number of Russian companies, in particular in the resource sector is first and foremost a takeover of these companies from their previous owners by a small number of new oligarchs coming from the "force ministries". These new bosses are fighting among themselves (with the prospect of the 2008 presidential election in Russia) as much as with their competitors, and their actions are driven—it is often the case in Russia—as much by the private interests of a few people as by the interests of the company or even of Russia itself. The fact that the new "owners" are to be found within the Kremlin makes it particularly hard to distinguish between these separate goals, especially when the "loot" is to be found in the dealings with neighboring countries. This is indeed a worrying trend for the West, but it should not be mistaken for a Russian grand strategy on the world stage.

The real long term worry is the inability of Russia to produce enough oil and gas for its own internal demand as well as for Europe's growing needs. Such shortages will not be linked to Russia using the "energy weapon", or to its inability to invest, but to the fact that its resource base is being depleted, and is likely to go into decline in the near future (a few years for oil, a couple of decades for gas). Facing that hard fact would require massive changes in our energy policies, focused on reducing demand rather than finding, as in the past, new supplies. The political revolution this requires has not taken place so far, and it is a lot easier to find outsiders to blame rather than to confront the problem head on.