

Energy Geo-politics of Russia and the Global Energy Security

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1. Introduction

The world energy market is undergoing a period of great turbulence, and major challenges to global energy security are emerging. Under the current global economic crisis, the world energy demand is likely to stagnate for a couple of years ahead. But in the long run, world energy demand is expected to rise again (China as a centerpiece), when the global economy recovers from the recession. Taking into account of various problems and constraints with regard to supply side, including difficulties to access to resources, unfavorable environment for investment, geopolitical uncertainties, etc, one of the most important challenges is whether the global supply of energy will keep expanding smoothly in line with energy demand. In this regard, development in Russia, which holds great resource potential, is crucial.

For Japan, Russia has an important presence in the field of energy issues. The primary reason is that Japan is dependent on imported energy from the global energy market, and that Russia can significantly influence the stability of that market. The second reason is that there is huge oil and gas potential in areas such as Sakhalin and East Siberia which are geographically close to Japan, and their development will greatly affect the energy market in Asia including Japan.

In addition, it is important to note that we have witnessed various significant developments in Russia which affect global energy market stability. In particular, we are very much interested in such emerging issues as resource nationalism and reinforcement of state involvement in energy sectors, the Russia-Ukraine gas dispute and disruption of gas supply, and geopolitical issues with Europe, Central Asia and China regarding energy.

With this recognition, this paper will address emerging challenges for global energy security with a special focus on the energy situation and strategy in Russia.

2. Energy Challenges for Russia

For the Russian economy, the oil and gas sectors are of the greatest strategic importance. In 2008, Russia's oil and gas exports were approximately 310 billion dollars, accounting for 66% of Russia's

total exports. The oil and gas sectors have made Russia a resurgent power, driving the high growth rate from 2000 to 2007 after the country emerged from the lost decade of the 1990s. On the other hand, as global energy prices soared and supply/demand tightened, the strategic importance of energy resources grew and thus the position of Russia, the world's greatest exporter of oil and gas, was enhanced. Russia recognized the importance of making the best strategic use of its own oil and gas resources. Even though Russia wishes to diversify and improve its economic structure in the long run, it will require a considerable time to do so. Therefore, the oil and gas sectors will remain important for Russia in the foreseeable future.

However, the growth of oil and gas production in Russia has slowed. Russia's oil production in 2008 was 10 million B/D, a decline of 1% over the previous year, and in 2009 is expected to decline again. Although the total production of natural gas in Russia has kept slightly increasing, the production of Gazprom, Russia's largest gas monopoly, has fallen. However, the stagnation and decline is not due to resource constraints. Production has stagnated due to the maturation and aging of existing major oil and gas fields in West Siberia, while new exploration/development has not progressed well. The tax and fiscal systems in Russia did not necessarily function as an incentive to expand production and to promote investment, neither for Russian companies nor foreign firms. In addition, the financial crisis in Russia has made the situation more uncertain.

The current global financial crisis has had a considerable impact on the Russian oil and gas sectors such as: (A) decline of profit from oil and gas due to the decline of global energy prices and decline of oil and gas demand in Europe, and; (B) weakening of the energy industry due to the decline of profit from oil and gas and also due to financial difficulties. In view of the strategic importance of the oil and gas industry, the Russian government is taking various measures, including cutting the tax on crude oil exports and providing emergency financing. However, financial problems of the major Russian companies such as Gazprom and Rosneft have become serious, and securing financial stability is becoming an urgent issue. Under these circumstances, it is important to note any possible changes in Russian energy policies, which include fund raising from foreign firms such as the recent 25 billion dollar financing from China, introduction of foreign capital in oil and gas development projects, prevention of falling oil and gas prices and promoting higher prices. On the other hand, although the current financial crisis is adversely affecting the Russian oil and gas sectors, it is important to remember that their strategic importance remains unchanged and that Russia remains committed to implementing important development projects (Shtokman project, Yamal Peninsula project, East Siberia project, ESPO, etc.) even though some delays may occur.

Apart from oil and gas sectors, Russia's approach towards nuclear power generation is very important. Expectations for and interests in nuclear power generation have been growing

worldwide as a means of addressing energy security and global warming. With this “nuclear renaissance”, the nuclear power generation market is expected to expand in various parts of the world. In response, Russia has established the state-owned company “Rosatom”, which integrates Russia’s entire nuclear industry and is strengthening its business both in Russia and abroad. Recently, Rosatom has been trying to get into the expanding nuclear power generation market in Asia. Russia has also been involved in constructing the Bushehr nuclear power plant in Iran, and is now approaching other Middle Eastern countries which are interested in introducing nuclear power generation. Russia also aims to take the initiative for successfully combining the expansion of nuclear power generation and nuclear nonproliferation, and proposed the International Uranium Enrichment Center Concept. Russia’s recent focus on the foreign nuclear power generation business has an important implication to Japan’s nuclear industry in various respects, and Japan may work together with Russia in the field of nuclear power generation.

3. Russian Energy from a Viewpoint of the Geopolitics of Energy

Russia and Europe are highly interdependent in terms of energy trading. As energy security becomes an increasingly important issue, the strategic significance of the energy relationship between Russia and Europe is growing. However, two recent events have severely affected the relationship. The first is the financial crisis. As energy prices and oil and gas demand in Europe declined because of the economic recession, profits from oil and gas export plunged in Russia. Second, a dispute between Russia and the Ukraine over gas early this year finally resulted in disruption of the gas supply to Europe, and in some Central and East European countries for which Russia is the only supplier, gas supply was cut-off.

The Russia-Ukraine gas dispute and energy security issue in Europe can be analyzed in the following different two categories: the issue between Russia and Ukraine, and the issue between Russia/Ukraine and Europe.

Regarding the former, it is necessary to remember that behind the recent gas dispute there are political aspects, which include political conflicts, tense relations and mutual distrust between Russia and Ukraine, in addition to the economic aspect which includes Russia’s demand for higher gas prices for Ukraine and the issue of “unpaid gas” by Ukraine. The disruption of gas supply to Ukraine (and ultimately to Europe) itself can be considered as Russia’s expression of “political decision”, because the supply cut-off was decided while they seemed to recognize the decision will result in their economic losses and serious damage to their reputation as a reliable supplier.

With respect to the latter, from the European point of view, the reliability of Russia as a gas supplier, and the reliability of Ukraine as a transit country, was seriously damaged. As a result, Europe is stepping up efforts to promote policy options which include 1) constructing a PL which bypasses Ukraine, 2) securing gas supply sources other than Russia, and 3) promoting alternative energies such as nuclear energy and renewable energy. In addition, as a gas supply system, interest in LNG may increase in Europe. This is because procurement with increased flexibility is expected in the LNG market, where spot trading are expanding. Therefore, demand for LNG to help enhance supply security will be increased. By the way, the profound interdependence between Europe and Russia itself cannot be changed easily, and both sides understand the reality. However, various strategies and policies will be drawn up both in Europe for reinforcing energy security, and in Russia for reinforcing energy demand security, triggered by the recent gas crisis.

The strategic importance of abundant oil and gas resources in Kazakhstan and Turkmenistan (and Azerbaijan), has increased. The method, routes and transit country used to export these land-locked resources will have critical importance in terms of politics, economic security and energy geopolitics for all the stakeholders. For Russia, where oil and gas production is stagnant, it needs to meet supply commitment as well as to control the competition both in Europe in China and Asia. To grasp control, Russia is striving to enclose the resources in Central Asia by making sure that oil and gas from Central Asia are exported through Russian infrastructure where possible. For Europe, expanding imports from Central Asia and Azerbaijan is one of the most important options for import diversification. Thus, strategic options accompanied by large-scale investment, including Nabucco PL project, are now being examined and discussed. Meanwhile China is focusing on expanding imports from Central Asia and is taking actions such as constructing PLs in order to diversify imports source and to gain a better position to negotiate with Russia. Central Asian countries, fully recognizing the situations, are developing strategies to maximize their national interests. In fact, the expansion of production and export of oil and gas in Central Asia, and to which regions and by which routes oil and gas are exported, will critically influence the supply/demand balance and stability of the global energy market.

Along with vigorous economic growth, energy demand in China has risen substantially. Net oil imports have continued to increase and China started to import gas in the form of LNG. For China, the expansion of oil and gas imports from Russia, which is geographically adjacent and has abundant resources, is an important supply option for diversification. On the other hand, Russia wishes to expand sales to China, where demand is expected to grow, to reduce its dependency on European markets and to gain a better position to negotiate with Europe. Therefore, various activities and

negotiations have been conducted to strengthen the energy relation between China and Russia in the past decade.

However, the progress remains limited due to differences in the positions of China and Russia about cross-border delivery prices, lack of eagerness forcing both parties to make a decisive compromise, and strategic sense of caution which remains both in China and Russia each other. Meanwhile, China and Russia are maneuvering to secure energy resources from countries in Central Asia and in some case are competing. Concerning the Shanghai Cooperation Organization (SCO), there is a difference in expectations for the respective roles of SCO between China and Russia: Russia (and China as well) emphasizes cooperation on security and politics, such as stabilization of the regions, by taking measures against terrorism, ethnic separatism, and religious fundamentalism. On the other hand, Russia seems to take a cautious stance in closer cooperation on energy in SCO, in which China has great interest.

But how will the financial crisis affect China-Russia energy relations? The Russian energy industry is suffering due to the crisis and is struggling to overcome financial problems. On the other hand, in China where the influence of the economic crisis is relatively limited, foreign investment by the state-owned oil company has become active. China may intensify its approach to Russia, an example of which can be found in the recent 25 billion dollar financing from China to Rosneft and Transneft. It is necessary to monitor the China-Russia energy relation as it will significantly influence the development of potential resources in East Siberia, and ultimately the energy supply/demand balance in Eurasia including Europe.

4. The Implications for Japan

Russian energy strategies and the prospect of oil and gas production and exports are one of the most important determinants in the future global energy market and global energy security, although the power shift to oil-producing countries due to higher crude oil prices eased for the time being. In principle, Russia will remain focused on energy as a tool to implement national strategy. But based on the newly emerging economic situation and global energy outlook, it is important to pay attention to Russia's energy policy with regard to its relationships with foreign companies in terms of financial problems, introduction of technologies, securing and diversifying export outlet. The financial crisis has raised new uncertainties regarding Russia and also Central Asia. Thus, based on more precise, timely and fact-based analysis, a positive and appropriate policy implementation in a timely manner will be required.

Under the turbulent circumstances of global energy market, a flexible response which suits the

respective time, cases and situations is important. At the same time, however, solid strategies are also required to tackle the long-term problems. Although the world is now suffering from the current financial crisis, the world economy will recover and energy demand will increase in the long run. Energy prices may rise again. Considering the long-term global energy market, it is inevitable that resource countries, including Russia and Central Asian countries, will gain importance. In addition, the prospect of energy development in East Siberia and Sakhalin has major implications for the supply/demand balance of the energy market in North East Asia. Therefore, Japan needs to establish and implement long-term energy strategies for Russia and Central Asia. It is also important for Japan to understand correctly the needs and long-term strategic objectives of resource countries, and to make best use of Japan's advantages in terms of technologies, experience and know-how (for example, energy conservation, environmental protection and renewable energy technologies).

To stabilize the global energy market, it is important to promote cooperation and investment in resource-rich countries like Russia and Central Asian countries. In addition to that, energy consumer countries need to enhance cooperation and investment to promote energy conservation/efficiency improvement and diversification of energy supply sources, in order to contribute to the stability of global energy market. It is also important to avoid exacerbating competition for securing supply sources in a "zero-sum game" manner, by promoting energy cooperation among consumer countries. Especially for Japan, to stabilize the Asian energy market, it is important to promote energy dialogue and cooperation with China, and to maintain and enhance the bargaining power as consuming countries. In conclusion, Japan is required to set up and implement long-term energy strategies, based on the reality of the financial crisis, recent international politics and energy geopolitics, while promoting dialog with the world's major consumer and producer countries.

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