

Recent International Energy Situation and Russia

Ken Koyama, PhD
Director
Strategy and Industry Research Unit
The Institute of Energy Economics, Japan

From April 18 to 21, I had an opportunity to visit the Russian capital of Moscow for talks with experts on Russian energy. Based on the talks, I would like to make my comments about what energy policy or strategy Russia is planning and implementing under the recent fast-changing international energy situation.

First, an important point is that the international situation surrounding Russia has been changing dramatically. Following the global financial crisis, the Russian economy decelerated rapidly and plunged into a contraction as oil and gas export revenue was reduced while European gas prices declined on rapid drops in crude oil prices amid a global energy demand slowdown. This simply indicated how the Russian economy depended on the oil and gas sector. Later, however, crude oil prices turned up. They have recently shot up on the destabilized Libyan situation, as indicated by the European benchmark Brent crude oil futures price's rise above \$120/barrel. Russian crude oil output turned up in 2009 after a decline in 2008 and has continued a moderate upward trend. Under such situation, the Russian economy has turned up. Several Russian policymakers have begun to make remarks indicating that they are gradually confident of Russia's recovery from the economic crisis. During the recent Moscow visit, I sometimes saw Russian experts making optimistic or upbeat comments about the present Russian economy and the future course of its energy sector including the gas market.

Second, I felt many Russian experts recognize that their urgent challenge is to overcome various problems existing in the Russian economy and its energy sector, even though Russia has passed the worst phase and continued improvements. The first problem is that Russia should shift away from its economic structure which is heavily dependent on the oil and gas sector and promote its structural improvement and advancement. The second is that Russia needs to promote institutional reforms and improvements to resolve tax, resources development access and other problems that have made the future course of the oil and gas sector uncertain and which are restricting the future growth of the sector. The third problem is that Russia should address various energy supply/demand and policy problems with reference to European market, on which the Russian oil and gas sector depends heavily. Russia is now required to overcome a wide range of problems.

These problems will have great impacts on and relations to the future advancement and development of Russia's politics, economy and society. For example, the first problem will become one of the important policy challenges toward the March 2012 Russian presidential election. The second problem strongly reflects great insecurities and uncertainties about the future course of

Russian crude oil and gas production that has continued to expand up to now. Regarding European market that absorbs most of Russia's oil and gas exports, accounting for 60-70% of its total export revenues, there is a mountain of tough problems including Europe's future oil and gas demand, its introduction of LNG competing with Russian pipeline gas, tough negotiations with European buyers on pricing formulas under these problems, and discussions about the application to Russia's Gazprom of the EU's third "Energy Package" that calls on EU energy companies to unbundle energy production and transportation and give third parties access to transportation infrastructure.

I also feel that Russia's attention to and expectations on Asia have grown dramatically under such situation. First, Russia may have to seek for better economic integration with Asia and reap the economic fruits of Asian development to help promote its own economic recovery as Asia including China is becoming the driving force of the world economy. Russia may also have to enhance its partnership and cooperation with Japan and other Asian countries in diversifying and improving its economic structure. In a specific effort, Russia will pursue its partnership and cooperation with Asia-Pacific countries in various areas when it hosts the annual APEC summit in Vladivostok in 2012.

Russia also has natural reasons to increase its attention on Asia in the energy area. First, the enhancement of energy relations with Asian countries, including China with energy demand expanding under rapid economic growth, is a major challenge for Russia. China-Russia energy relations have made dramatic progress over the past decade. For example, Russia's pipeline oil exports to China started this year on the completion of the East Siberia-Pacific Ocean oil pipeline's portion and branch line for China, deepening bilateral energy trade. Still, there are some difficult bilateral problems, including China's rejection of payments for the amount with which they have dispute over pricing for their pipeline oil imports. But Russia's relationship with China is likely to grow more important as the neighbor has a great presence in terms of economic and energy market sizes.

Second, Russia has made progress in expanding energy supply from its regions neighboring Asian countries to meet growing Asian demand. Russian crude oil exports to Asia have grown close to 1 million barrels per day as Russia has realized exports under the Sakhalin 1 and 2 projects, ESPO crude exports from Kozmino and those to China as noted above. LNG exports under the Sakhalin 2 project have also become an important energy source for Asia. Russia also has pending oil and gas production plans including those for Sakhalin and Eastern Siberia. As Western Siberia is losing its position as Russia's mainstay energy producer on a production decline, oil and gas production expansion plans in Sakhalin and Eastern Siberia close to Asia have become significant for Russia.

Third, Russia has recently been paying growing attention to Japan. Just after the March 11 East Japan Earthquake, Russian Prime Minister Vladimir Putin offered support for Japan, giving statement to provide Japan with additional LNG when necessary. On March 22, Russian Deputy Prime Minister Igor Sechin proposed (1) an increase in LNG exports under the Sakhalin 2 project, (2) an expansion in coal exports, (3) the installation of submarine cables for electricity supply, and other measures at his meeting with Japanese Ambassador to Russia Masaharu Kono. In addition, Russia has reportedly proposed cooperation with Japan in energy projects including the development of the Kovykta and Chayanda gas fields. For Japan that has suffered from heavy earthquake-tsunami damage and is destined to see growing demand for LNG and other fossil fuels for electricity

generation this summer, fuel procurement is very important. In this respect, support and cooperation from Russia and other oil-producing/resource-rich countries are significant. During my recent talks with Russian experts, I had an opportunity to come to know Russia's kind willingness to support and cooperate with Japan which is suffering from the heavy disaster damage. I also felt that Russia has great interest in Japan with regard to how to deepen energy relations in response to Japanese energy supply/demand problems over a medium to long term in addition to over a short term. Nowadays, it seems Japan has emerged a key point for Russia that is paying growing attention to Asia.

Contact: report@tky.ieej.or.jp

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