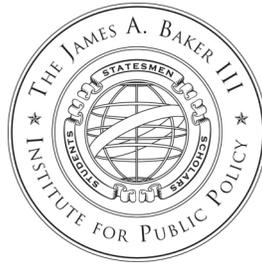


# Russia and the Caspian States in the Global Energy Balance



## The History and Politics of Russia's Relations With OPEC

Jareer Elass and Amy Myers Jaffe



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THE HISTORY AND POLITICS OF  
RUSSIA'S RELATIONS WITH OPEC

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### **ABOUT THE STUDY: RUSSIA AND THE CASPIAN STATES IN THE GLOBAL ENERGY BALANCE**

Russia's position as a major energy supplier has great significance not only for its foreign policy but for its relationships with major energy-consuming countries. The nature of Russia's future geopolitical role in world energy markets has become a major concern of international energy security with important implications for Europe, Japan, and the United States. Given a range of economic and geopolitical uncertainties, the fate of Russian and Caspian natural gas exports remains a major risk factor in global energy supply. For this study, researchers examined several scenarios for Russian and Caspian oil and natural gas production, possible export routes, and the geopolitics involved.

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### **Abstract**

As the second-largest producer and exporter of petroleum in the world, Russia has considerable weight in exercising its control over the international oil market. However, it remains a nonmember of the Organization of Petroleum Exporting Countries (OPEC), which is the dominant player in the global market. Although it frequently attends OPEC meetings and has made many pledges to cooperate with OPEC production cuts, Russia has a history of renegeing on its promises to the cartel and has repeatedly acted to undermine the authority of OPEC in determining prices on the world market. Russia's self-image as an industrial superpower motivates it to behave in a contrarian manner, despite the fact that the global economic crisis has hit Russia particularly hard, such that this environment membership in OPEC might be particularly beneficial. As a result of Russia's assertions of power and sense of entitlement, Saudi Arabia, currently the world's leading petroleum producer and exporter, is not inclined to trust the Russians. On the same note, countries that have attempted to overtake Saudi Arabia's position of supremacy in the past have met with dire fates. Additionally, Russia's conflict with Saudi Arabia has proved detrimental to many of its political goals in the past, in regard Saudi Arabia's historical role as a major counter-Soviet influence. Due to these various points of contention, Russia is not likely to become a full-fledged member of OPEC at any time in the foreseeable future.

### **I. Introduction**

As the world's second largest oil producer and exporter, Russia is a major power in the global energy market and has been taking an increasingly visible and assertive role. Its oil production averaged 9.98 million barrels a day (bbl/d) in 2007, or 12.2 percent of world output. Russia's number two position is extremely close to leading global oil superpower Saudi Arabia, with an average production of 10.4 million bbl/d in 2007, or 12.7 percent of world output. In addition to holding the eighth-largest proven oil reserves in the world, Russia is home to the largest natural gas reserves in the world, accounting for some 1,680 trillion cubic feet (tcf) of reserves, or more than one quarter of the world's natural gas total reserves. This is nearly double the amount of

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natural gas reserves of Iran, the country second behind Russia. When both oil and natural gas exports are considered, Russia exports more hydrocarbons than Saudi Arabia.

Beyond the scale of its resources, Russia holds pivotal market positions. It is the major natural gas supplier to Europe and a possible future resource provider to neighboring China. Russia also controls through geography, or geopolitics, the major pathways for the export of oil and natural gas from the hydrocarbon-rich Caspian countries. Thus, Russia's position as a major energy market player has many elements, all of which enhance its geopolitical presence on the world stage.

Russia's international energy position is being tapped by the Kremlin to provide a means to reassert its place as a global superpower. Russia's leverage on energy corridors has helped it sustain its influence in its so-called "Near Abroad" in a manner that does not overly tax its faded military. The country's vast resources brought senior Chinese leaders courting Moscow with favorable loans and other offers of cooperation. Possibilities of energy cooperation have created ample photo opportunities for Russia's leaders Vladimir Putin or Dmitry Medvedev and heads of state that might have previously avoided the Kremlin, including the oil producers of the Persian Gulf, North Africa, and even South America. Russian arms sales to oil-producing states are also on the rise, as is Russian investment in foreign oil exploration sectors in the developing world and in downstream and market assets in Eastern Europe.

But Russia's superpower re-aspirations raise questions about its relations with the Organization of Petroleum Exporting Countries (OPEC), which currently (and historically) sits as the dominant world oil player. Igor Sechin, Russian deputy prime minister in charge of energy and Rosneft chairman, speaking at the opening of the OPEC September 2008 conference, made a point of reminding those present that Russia was approximately tied with Saudi Arabia as the world's leading oil producer.<sup>1</sup> A few weeks later, Russian Energy Minister Sergei Shmatko said that Russia had "such a significant position in the high society of world oil, a Russian factor

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<sup>1</sup> Stanley Reed, "Russia Weighs In At OPEC Meeting," *Business Week*, September 9, 2008, [http://www.businessweek.com/globalbiz/blog/europeinsight/archives/2008/09/the\\_most\\_intrig.html](http://www.businessweek.com/globalbiz/blog/europeinsight/archives/2008/09/the_most_intrig.html).

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should appear.”<sup>2</sup> But Russia's assertion of its desire to be a central influence in global energy decision making was not necessarily well-received by important members of OPEC—and recent public discussion of Russia joining OPEC has made little progress.

This paper looks at the history and current geopolitics of Russia's relations with OPEC and its key producers. In analyzing Russia's current policies towards OPEC, the authors hope to shed light on the geopolitical implications of emerging rivalries and alliances among major oil and natural gas producers and their implications for global energy security. The paper will investigate Russia's recent interactions with OPEC as an organization, as well as Moscow's bilateral relations with a few key OPEC members, notably Saudi Arabia, Iran, and Qatar, and the geopolitical potential for a Gas-OPEC.

### II. The History of the Soviet Union and Middle East Oil

The USSR's early policies towards the Arabian Peninsula were generally reactive and opportunistic, rather than ideologically linked to utopian concepts of the worldwide socialist revolution. Still, to the extent that oil-rich colonial regions engaged in a struggle for independence from British rule, this created opportunities for the Soviet Union to align with anti-imperialist governments and enhance its power relative to the capitalist West on the global stage. As described by Stephen Page in 1971, “The belief that the loss of their colonies would fatally weaken the imperialist countries left Soviet policy makers predisposed to see the colonial and dependent world as a natural ally in their struggle against capitalism.”<sup>3</sup> The Soviet Union tapped the chances to provide economic, military, and technical assistance where possible in the Middle East, notably in Egypt, Yemen and Iraq, and created goodwill among Arab nations for its military and diplomatic assistance to the Arab confrontation states during the successive Arab-Israeli wars. As the Arabian Peninsula transitioned to independence, Moscow's interest in the Gulf came to be attributed to “its desire to control this oil and to use it to pressure the West.”<sup>4</sup> Moscow attempted to wedge its way further into the Persian Gulf but its support for socialist

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<sup>2</sup> “Russia Wants to Influence Global Oil Price-Minister,” *Reuters*, September 25, 2008, <http://www.reuters.com/article/rbssEnergyNews/idUSLP47710620080925>.

<sup>3</sup> Stephen Page, *The USSR and Arabia: The Development of Soviet Policies and Attitudes Towards the Countries of the Arabian Peninsula 1955-1970* (London: The Central Asian Research Center, 1971), 133.

<sup>4</sup> Atef A. Gawad, “Moscow's Arms-for-Oil Diplomacy,” *Foreign Policy*, Summer 1986, no. 63: 147-168.

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regimes in Cairo and Baghdad, as well as its backing for a Marxist presence in Yemen and Ethiopia, put it in the crosshairs of Saudi Arabia and the other conservative oil states, despite occasional offers to supply arms to help the region counterbalance Western influence.

The 1979 Egyptian–Israeli peace accord, brokered by the United States, initially seemed like a substantial blow to Moscow's leverage to manipulate the Arab–Israeli conflict to feed its influence in the region, but new opportunities emerged with the fall of the Shah of Iran in the same year.

The breakout of the Iraq–Iran war gave the Soviet Union a new opportunity to expand its presence in the region. Moscow created barter deals wherein it swapped arms for Iranian and Iraqi oil, which it then re-exported to the West to gain hard currency. But the war did more than widen the opportunity for the USSR to attain hard currency and expand its regional arms sales. The war played into Soviet national interests in other ways; some analysts commented that Moscow believed that prolonging the Iraq–Iran war “shield(ed) Soviet Moslems from Islamic fundamentalist influences...prolonging the war help(ed) the Kremlin hold back the Islamic threat by keeping Iranian leader Ayatollah Ruhollah Khomeini preoccupied with Iraq and staving off the spread of the Islamic revival into Soviet territories.”<sup>5</sup> The Soviets also invaded Afghanistan to further protect its southeast flank, prompting Saudi Arabia to take counter moves, both through active support for the Taliban and Mujahedeen fighters in Afghanistan and also through policies to moderate oil prices.

As the Iraq–Iran war, and then the Cold War came to an end, Moscow had reversed many of its previous policies that had been perceived for decades as threatening to the countries of the Arabian Peninsula. It ended its military occupation of Afghanistan and pulled back its support from South Yemen and Ethiopia. But most significantly, the Kremlin backed United Nations Security Council resolutions demanding the withdrawal of Iraqi forces from Kuwait and authorizing the use of force, should sanctions fail to work. It is in this context that the USSR (and Russia after its collapse, began to seek new relationships with the oil producers of the Arabian Gulf, including Saudi Arabia.

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<sup>5</sup> Ibid., 156, 159.

### III. Russia's Complex Relationship with Saudi Arabia

During the Soviet period, Saudi–Russian relations were relatively poor. Saudi foreign policy aimed for many years to counter Soviet support for Marxist regimes in Yemen and Ethiopia, and the Saudi–U.S. relationship focused squarely on the shared interest to combat the “Godless Communism” of the Soviet Union.<sup>6</sup> By the last years of the Soviet Union, Saudi Arabia was actively trying to weaken the USSR by lowering oil prices and providing military aid to its enemies.

But as the Soviet empire was collapsing, Moscow took a different tack towards the Arabian Gulf and backed U.N. resolutions authorizing the use of force to drive Iraq from Kuwait. The gesture paid off and, in 1990, Riyadh agreed to restore diplomatic ties with Moscow.<sup>7</sup> By 1991, relations had thawed further and Saudi Arabia provided \$2.5 billion in economic aid to Moscow. The breakup of the former Soviet Union (FSU) meant that Muslims in the FSU were able to freely practice their religion, thereby eliminating another traditional point of tension between Moscow and the Arab Gulf. Russia hoped that the warming of relations would mean “large-scale Saudi investment in Russia as well as Russian arms sales to the kingdom.”<sup>8</sup> But throughout the 1990s, a growing friendship never developed as Russia blamed Saudi Arabia for alleged interference in the conflict in Chechnya, for the growth of Islamic fundamentalism in the FSU, and for choosing to invest its petrodollars in the Caspian states but not in mother Russia.<sup>9</sup> Moscow had hoped Saudi Arabia would help replace the benefits Moscow reaped from its lucrative relationship with Saddam Hussein's Iraq, but, by 1991, it was clear that this was unlikely to emerge.

With little to show from its ten year diplomatic dance with Saudi Arabia over the 1990s and in light of the jolting events of the September 11, 2001, terrorist attacks on the United States, Russia changed its focus and abandoned efforts to woo the Saudis. Instead, Moscow sought to tap common interests with the United States in countering Islamic extremism and, in a gesture of

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<sup>6</sup> Rachel Bronson, *Thicker than Oil: America's Uneasy Partnership with Saudi Arabia* (London: Oxford University Press, 2006), 3.

<sup>7</sup> Mark N. Katz, “Saudi-Russian Relations in the Putin Era,” *Middle East Journal* 55, no. 4, (Autumn 2001): 603-622.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

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warming Russo–U.S. relations, offered itself to Washington to compete head-on with Saudi Arabia as the most reliable oil supplier to the United States.<sup>10</sup> With cooperation from the West, Russia began rapidly increasing its oil production capability and stepped up efforts to displace Saudi Arabia and OPEC as a key supplier to the West. As respected oil commentator Edward Morse and analyst James Richard noted at the time, “In economic terms, energy production lets Russia integrate itself into the industrialized West. In political terms, energy resources can be used to buttress Moscow’s goal of becoming a key partner of the United States.”<sup>11</sup>

But the U.S.–Russian courtship proved short-lived, and Russo–American relations soured over a number of issues, including NATO expansion, European missile defense, and Russia’s policies towards the Ukraine and the Caucasus. In the end, after a couple of heady years of discussions of new ports, pipelines, and mega-projects to bring Russian oil to American shores, Russian enthusiasm for Western energy cooperation fizzled against the more compelling domestic imperative of resource nationalism. The United States continued to rely on Saudi Arabia to provide extra oil to calm the international market, for example, ahead of the U.S. invasion of Iraq in 2003.

In recent years, Russia has tried squaring the U.S.–Russian–Saudi triangle by wooing Saudi Arabia in different ways. In May 2004, Russian firm Lukoil bid to take an 80 percent stake in the 29,900 sq km Block A of the Saudi Arabian natural gas development initiative. In April 2007, Saudi Aramco awarded Gazprom’s construction subsidiary, Stroytransgaz, a \$100 million contract to build an oil pipeline that was to extend more than 200 km from Shaybah in the *Rub al-Khali* desert in southeastern Saudi Arabia to Abqaiq, with completion scheduled for the end of 2008. The project was the first given to a Russian contractor to carry out construction of oil and gas facilities in the kingdom.<sup>12</sup>

In February 2007, Russian President Vladimir Putin visited Saudi Arabia, offering the kingdom a range of nuclear aid. Saudi Foreign Minister Prince Saud al-Faisal later acknowledged that the

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<sup>10</sup> Edward L. Morse and James Richard, “The Battle for Energy Dominance,” *Foreign Affairs*, March/April 2002.

<sup>11</sup> *Ibid.*

<sup>12</sup> “Saudi Aramco Awards Stroytransgaz \$100Mn Pipeline Contract,” *Middle East Economic Survey L*, no. 15, April 9, 2007.

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desert kingdom was in talks with Russia over the possible purchase of Russian weapons.<sup>13</sup> A subsequent trip by Saudi Crown Prince Sultan Bin Abdul-Aziz to Moscow the following November was expected to produce the framework for an agreement on military cooperation that could pave the way for Saudi Arabia to buy Russian arms.

According to a report in the Russian daily *Kommersant*, Saud Al-Faisal made it clear during a trip he made to Moscow in February 2008 that the kingdom would offer Russia lucrative arms contracts only in exchange for Moscow curtailing military cooperation with Iran. During a subsequent visit by Saudi Prince Bandar Bin Sultan to Moscow in July 2008 in which a Saudi-Russian military cooperation agreement was inked, Prince Bandar reiterated the Saudi demand to President Medvedev and Prime Minister Putin. A Russian government spokesman denied *Kommersant's* claim that the deal was linked to Iran, saying that any attempt to tie cooperation with Riyadh to other issues was “not right and not proper.”<sup>14</sup>

Saudi displeasure with Moscow's military support for Iran could have broader ramifications for oil markets and global geopolitics if 5-plus-1 diplomacy (the five permanent members of the U.N. Security Council—the United States, the United Kingdom, France, Russia, and China—plus Germany)<sup>15</sup> fails to resolve the nuclear standoff with Iran. If Saudi Arabia feels its interests are truly threatened, it has the same arsenal it has used in the past against the Soviet Union and Iran—including support from regional movements, militias, or counterinsurgents and the ultimate trump card of an oil price war.<sup>16</sup> The slump in global demand, combined with expansions at the kingdom's oil fields have left it with a large arsenal of spare oil production capacity and the ability to flood oil markets at will.<sup>17</sup> Moreover, Riyadh's foreign reserves to

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<sup>13</sup> “Putin Meets Top Saudi Official as Russia Eyes Arms Sale,” *Agence France-Presse*, November 23, 2007, <http://afp.google.com/article/ALeqM5j0VCHj7OC5bDyHgm4AobsoII--lQ>.

<sup>14</sup> Guy Faulconbridge, “Saudi Offers Russia Arms Deal to Curb Iran ties,” *Reuters*, July 15, 2008, <http://www.reuters.com/article/worldNews/idUSL1541793320080715>.

<sup>15</sup> Brian Knowlton, “US Opens Door for Direct Talks with Iran,” *International Herald Tribune*, April 9, 2009.

<sup>16</sup> Adam Robinson, “View of the Day: Saudi Oil Tactics,” *The Financial Times*, March 12, 2009. “Now might be the perfect time for the Saudis to crash the price of oil,” suggests Mr. Robinson, who argues this tactic would force other producers to share the burden of output cutbacks and allow Riyadh to promote its interests with the new administration in Washington. He argues that keeping Iran focused internally would allow Saudi Arabia a headstart in filling the political vacuum that will arise after the US withdrawal from Iraq.”

<sup>17</sup> “Saudi Spare Capacity to Reach 4.5 million bbl/d,” *Reuters*, March 15, 2009.

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withstand a prolonged drop in oil prices are substantial at \$523.6 billion, making it one of the largest creditor nations in the world.<sup>18</sup>

As will be discussed later in the paper, this tension between Riyadh and Moscow over Iran comes on top of oil-related disagreements. Russia has a history of conflict with Saudi Arabia over oil market share and pricing, and some observers have suggested that Riyadh and the Kremlin are in a “contest for energy dominance.”<sup>19</sup> Other commentators focus on Russian politicians’ concerns (and Russian public concerns as well) about “whether other nations regard Russia as a great power.”<sup>20</sup> Sums up one author, “Moscow sees Saudi Arabia as the one country that could, at any time, dramatically reduce Russia’s desperately needed oil revenue. Further, Moscow feels frustrated by the fact that it is Saudi Arabia and not Russia (either singly or in conjunction with other oil producers) which has the upper hand when it comes to setting oil prices.”<sup>21</sup>

However, an assertive Russian effort to overtake Saudi Arabia as a superior oil power could prove risky to Moscow. Other less powerful, but nonetheless geopolitically prominent, regimes who have taken on this ambition—such as the Shah’s Iran, Saddam Hussein’s Iraq and Rafael Caldera’s Venezuela—all failed to outlast the Saudi regime and their countries, Iran, Iraq and Venezuela have seen their oil industries greatly weakened by tumultuous oil markets highly influenced by Saudi pricing and production policies. Saudi Arabia has also been a major force countering Soviet power in the past, as already discussed.

### IV. Russia and Iran: Counterbalance to Saudi Power

Russia has found that it can enhance its geo-strategic power through collaboration with Iran, especially with regards to oil power relations with Saudi Arabia. Friendly relations between Russia and Iran, including military cooperation, are threatening to Saudi Arabia, which, in past

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<sup>18</sup> SAMA Foreign Asset Report.

<sup>19</sup> Edward L. Morse and James Richard, “The Battle for Energy Dominance,” *Foreign Affairs*, March/April 2002.

<sup>20</sup> Katz, “Saudi-Russian Relations.”

<sup>21</sup> Katz, “Saudi-Russian Relations.”

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times, has experienced terrorist attacks and civil unrest fomented with Iranian assistance. Saudi Arabia has warned Tehran against “Shi-ite proselytism.”<sup>22</sup>

Moscow also gets other benefits from supplying Iran with military equipment and nuclear technology and actively blocking U.N. sanctions against Iran over its nuclear activities. This Russian strategy achieves several goals simultaneously. Iran's nuclear activities, supported by Moscow, thwart Iran from gaining opportunities to compete with Russia in the energy sphere. Iranian natural gas exports to Europe are essentially blocked by U.S. economic sanctions policy which, in turn, seeks to penalize Iran for its nuclear program. Iran's nuclear program, in turn, remains in part a function of Russian assistance; hence Russia gives military and technical aid to Iran, which then ensures that Iran's natural gas will not compete with its own. (See Appendix: Russia's Arms and Nuclear Dealings with Iran).

The tensions between the United States and Iran over its nuclear program also gives international oil markets the jitters, buttressing oil prices and thereby enhancing Russian oil revenues.

Finally, Russia's relationship with Iran is also threatening to other important competing Middle East energy suppliers other than Saudi Arabia, notably Qatar, which shares a large border natural gas field with Iran.

The North Field/South Pars gas field, shared by Qatar and Iran, was clearly demarcated in a maritime border deal in the late 1980s. But, in April 2004, Iran accused Qatar of overproducing its share of natural gas from the giant offshore North Field that straddles the Qatari-Iranian border, warning that Iran would resort to “other ways and means of resolving the issue” if Qatar did not enter new negotiations about regulating production from the field.<sup>23</sup> More recently, Tehran has hinted it would like to cooperate with Qatar on joint development of North Field-South Pars structures.<sup>24</sup> Russia's military alliance with Iran and Iran's border dispute with Qatar

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<sup>22</sup> “Saudi King says Iran Putting Region in Danger,” *Reuters*, January 27, 2007.

<sup>23</sup> “Iran Accuses Qatar of Overproducing Gas,” Energy Intelligence Group, *Oil Daily International*, April 24, 2004, <http://www.energyintel.com>.

<sup>24</sup> “Troika Outshines GECF,” *World Gas Intelligence*, December 31, 2008.

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creates a more risky situation for Qatar to refuse to discuss coordinated efforts towards its policies related to the North field.

### V. Russia and OPEC

With the Kremlin moving to take stronger control of Russia's oil industry in recent years, Russia has far more in common with OPEC member countries than it did in the late 1990s and early 2000s when its cooperation with OPEC and compliance with OPEC–non-OPEC agreements was generally poor.

As previously mentioned, in the late 1990s and into the early 2000s, Russia was more focused on improving its relations with the West than on courting OPEC. Russia did agree to cut its own production in March 1999 as part of an agreement between OPEC and non-OPEC producers to bring oil prices off their lows. At an OPEC meeting on March 23, 1999, the organization announced that OPEC and a group of four non-OPEC producers—Norway, Mexico, Russia, and Oman—together had pledged to reduce global oil supplies by some 2.1 million bbl/d, with the independent players contributing 388,000 bbl/d of the cut. For its part, Russia had promised to provide a 100,000 bbl/d decrease in output,<sup>25</sup> yet analysts believed at the time that any resulting drop in Russian output was more attributable to Russia's debt crisis than deeper cooperation with OPEC.

The next time OPEC sought Russian cooperation was in the aftermath of the terrorist attacks of September 11, 2001, and the subsequent global economic downturn. OPEC found even less cooperation from Russia, whose oil industry was becoming increasingly privatized and whose oil field investment was on the rise.<sup>26</sup> Russia's oil revival was a direct threat to OPEC which had to cede market share to Russian companies. Frustrated by weakening oil prices, OPEC in November 2001 said it would only cut its oil output to defend prices if several non-OPEC

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<sup>25</sup> Youssef M. Ibrahim, "Oil Countries Approve World Cutback of 3%," *The New York Times*, March 24, 1999, [http://query.nytimes.com/gst/fullpage.html?res=9401E1DB1F31F937A15750C0A96F958260&sec=&spon=&page\\_wanted=2](http://query.nytimes.com/gst/fullpage.html?res=9401E1DB1F31F937A15750C0A96F958260&sec=&spon=&page_wanted=2).

<sup>26</sup> Sabrina Tavernise, "Russia Raises Oil Output and Exports," *The New York Times*, August 24, 2001, <http://query.nytimes.com/gst/fullpage.html?res=9C0CE0DE1231F937A1575BC0A9679C8B63&scp=4&sq=Russia.%20OPEC.%201998&st=cse>.

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producers agreed to a collective 500,000 bbl/d decrease in their production. Russian companies made a token offer of a 50,000 bbl/d cut, which angered OPEC ministers.<sup>27</sup>

In the aftermath of Russia's offer to the United States to counter OPEC, Kuwaiti Oil Minister Adel al-Sabah raised the prospect of a collapse in oil prices to \$10 a barrel—a price last seen in 1998—if non-OPEC nations refused to help shoulder the burden of oil supply curbs. “Reaching \$10 will be a hard hit for all of us and even harder for those with a higher cost of production,” he said, indicating that Russia would lose more from the showdown with OPEC. Saudi Oil Minister Ali Naimi was also quoted at the time as saying that, “We are in a crisis mode and we need help .... We make the appeal especially to Russia, to heed the lessons of the past ... this course of action is disastrous and will lead us to a loss.”<sup>28</sup>

By December 2001, to hedge its bets, Russia announced that it would make a 150,000 bbl/d cut in output. The announcement came after a meeting of then Russian Prime Minister Mikhail Kasyanov and the heads of the country's biggest oil companies. Although the Russian decision temporarily prompted a price boost, oil analysts were skeptical at how much of the Russian cut would actually be implemented, given that Russia's oil exports typically decline during the winter due to rises in domestic demand.<sup>29</sup>

In March 2002, Russian oil executives, after meeting with the prime minister, agreed to extend their 150,000 bbl/d cut through the second quarter of 2002, seemingly to appease OPEC. However, just how much Russian production had been curtailed, if at all, was never fully established. Russian officials were vague about the benchmark date they used to calculate cuts, with some oil executives suggesting that the Russian government used average exports from the third quarter of 2001, when exports had been unusually high.<sup>30</sup>

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<sup>27</sup> Saeed Shah, “OPEC Refuses to Cut Oil Output Unless Russia Follows,” *The Independent*, November 15, 2001, <http://www.independent.co.uk/news/business/news/opec-refuses-to-cut-oil-output-unless-russia-follows-617051.html>.

<sup>28</sup> Saeed Shah, “OPEC in ‘Crisis Mode’ as Showdown with Russia Threatens Oil Price War,” *The Independent*, November 16, 2001, <http://www.independent.co.uk/news/business/news/opec-in-crisis-mode-as-showdown-with-russia-threatens-oil-price-war-617118.html>.

<sup>29</sup> “Russia cut prompts oil price surge,” *BBC News*, December 5, 2001, <http://news.bbc.co.uk/1/hi/business/1693156.stm>.

<sup>30</sup> Sabrina Tavernise, “Russians To Keep Limits On Oil Exports Through June,” *The New York Times*, March 21, 2002, <http://query.nytimes.com/gst/fullpage.html?res=9B03E6DD1038F932A15750C0A9649C8B63>.

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The issue faded with time as by spring of 2002 international oil prices were recovering given the rebound in the global economy. The Russian government announced in May 2002 that it was jettisoning the limitations on oil production, despite OPEC's resolve to continue its production restraint for the remainder of the year.<sup>31</sup> Post facto analysis showed that Russia had not cut its output in 2002 and that its output had seen a substantial rise over the year.<sup>32</sup>

Oil prices rose significantly between 2003 and 2007, obviating any need for Russia to contribute oil production cuts to help OPEC defend oil prices. But by 2007–2008, the geopolitics of Russian-OPEC relations as well as the Russian oil industry (now more centralized in the hands of state-controlled entities) had greatly changed. Russia's overtures to OPEC and the rumors that the oil producer might consider becoming a member of the organization in the fall of 2008 came on the heels of deteriorating Western Russian relations in the aftermath of Russia's invasion of Georgia in August 2008.<sup>33</sup> In the past year, Russia has increasingly referred to its desire to become more of a force within the international oil and natural gas markets.

Russia's active energy diplomacy in recent years has raised questions about the intent of such efforts. Does Russia intend to build such relationships to grab more economic resource rents through alliances with other energy producers or to wrest geopolitical or political benefits using energy as a vehicle?

There is no question that Russia has concrete reasons right now to cooperate with OPEC. Russia's economy has taken a hard hit from a devalued ruble and depressed oil prices. On January 20, 2009, Russian Prime Minister Vladimir Putin called on the state budget to be revised drastically, by more than half from the original 2009–2011 budget plan based on \$95 a barrel, to \$41 a barrel.<sup>34</sup> Russia also announced that it had the smallest budget surplus in five years in 2008 and Finance Minister Alexei Kudrin reinforced that 2009 and 2010 will likely bring significant

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<sup>31</sup> "Russia Scraps Oil Export Cap," *BBC News*, May 17, 2002, <http://news.bbc.co.uk/2/hi/business/1993889.stm>.

<sup>32</sup> David Knapp, "Russian Pledge to Cut Output Falls Short," Energy Intelligence Group, *International Oil Daily*, December 30, 2008.

<sup>33</sup> "Russia Seeks Oil Control with OPEC Move," *The Daily Telegraph*, September 19, 2008, <http://www.telegraph.co.uk/news/worldnews/europe/russia/2990736/Russia-seeks-oil-control-with-OPEC-move.html>.

<sup>34</sup> Alex Nicholson and Torrey Clark, "Budget Figures Hint At Looming Deficit," *Bloomberg*, January 21, 2009, <http://www.moscowimes.ru/article/600/42/373747.htm>.

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budget deficits. The budget surplus shrank to 1.7 trillion rubles (\$51.67 billion) or 4.0 percent of gross domestic product in 2008, down from 5.5 percent in 2007.<sup>35</sup> Kudrin suggested late in December 2008 that Russia would face a budget deficit equivalent to \$52–\$70 billion in 2009, amid declining world oil prices. “In 2009, the budget will have a deficit of 1.5 to 2 trillion rubles, which we will have to make up from the national Reserve Fund,” Kudrin said.

With oil prices at least \$30 per barrel below even the most pessimistic planning scenarios for Russia's initial 2009 budget, Russia's hard currency reserves are being rapidly depleted through an unsuccessful effort to support the ruble and through government monies spent on selected corporate bailouts ordered by the Kremlin. Furthermore, for a host of reasons including the financial crisis but also relating to perceived political risk in the aftermath of the Georgia war, there has also been a massive capital flight from Russia; some of this is from foreign investors exiting the country, and even more from Russians selling stocks at home to cover borrowing and trying to save assets being held abroad. All this means that Moscow may be far less resilient than it might have thought to a lasting downturn in oil prices.

But while working in cooperation with OPEC might make sense for Russian finances, Moscow has not been able to overcome its history with OPEC, which from the producer group's point of view includes a record of free-riding off OPEC's efforts and renegeing when it comes to agreeing with OPEC on pledges of crude output cuts. Moscow's 2008 production cuts were seen as another empty gesture by the oil cartel. OPEC officials say they continue to see those cuts as merely symbolic. While OPEC and other non-OPEC producers do the work of slashing their oil output to restore world prices, Russia, these producers say, reneges on its promises and maintains high output during price crises to benefit financially and gain coveted market share.

Though Russia has for years attended OPEC ministerial meetings with an observer status, the appearance of Igor Sechin, Russian deputy prime minister in charge of energy and Rosneft chairman, and a delegation of 20 officials at the September 9–10, 2008, OPEC gathering in Vienna suggested that Moscow was more seriously interested in the outcome of the producer

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<sup>35</sup> “Russia Eyes '09 Budget Deficit, '08 Surplus Shrinks,” *Reuters*, January 21, 2009, <http://sg.news.yahoo.com/rtrs/20090119/tbs-russia-budget-7318940.html>.

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group's deliberations than it had been in the past. Speaking at the opening of the OPEC conference, Sechin talked about Russia's desire for enhanced cooperation with the cartel.<sup>36</sup>

Sechin stated that his government was drafting a memorandum of understanding (MOU) on deepened cooperation between Russia and OPEC, which could include providing for a "stable pricing environment" for producers and consumers.<sup>37</sup>

About two weeks after that September OPEC meeting, Russian Energy Minister Sergei Shmatko added that Russia wanted to influence global oil prices through output forecasts and mothballing some Russian oil fields. "We think that since we have such a significant position in the high society of world oil, a Russian factor should appear," the minister was quoted as saying.<sup>38</sup>

In late October 2008, OPEC Secretary General and Libyan Oil Minister Abdalla Salem el-Badri met with Russian President Dmitry Medvedev in Moscow, presumably to test the waters about Russian participation in OPEC's recent output restraint and to warn that the cartel was losing patience with once again having to carry the burden of stabilizing prices on its own. While Medvedev told el-Badri that Russia was interested in closer ties with OPEC, he was careful not to promise any Russian commitment to reducing its own production to make a direct contribution to OPEC production cuts designed to stabilize the market.

During the OPEC official's Moscow visit, Sechin announced the possibility of Russia forming a national petroleum reserve by diverting some oil from exporting that would help international oil prices during a future crisis.<sup>39</sup>

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<sup>36</sup> Stanley Reed, "Russia Weighs In At OPEC Meeting," *Business Week*, September 9, 2008, [http://www.businessweek.com/globalbiz/blog/europeinsight/archives/2008/09/the\\_most\\_intrig.html](http://www.businessweek.com/globalbiz/blog/europeinsight/archives/2008/09/the_most_intrig.html).

<sup>37</sup> Neil King, Spencer Swartz and Anna Raff, "Russia's Bid to Strengthen OPEC Ties May Sow Unease," *Wall Street Journal*, September 10, 2008, <http://online.wsj.com/article/SB122098635628015775.html>.

<sup>38</sup> "Russia Wants to Influence Global Oil Price-Minister," *Reuters*, September 25, 2008, <http://www.reuters.com/article/rbssEnergyNews/idUSLP47710620080925>.

<sup>39</sup> Andrew E. Kramer, "OPEC Chief Meets With Russian President but Gets No Promises," *The New York Times*, October 22, 2008, [http://www.nytimes.com/2008/10/23/business/worldbusiness/23ruble.html?\\_r=1&scp=3&sq=Russia,%20Opec&st=cse](http://www.nytimes.com/2008/10/23/business/worldbusiness/23ruble.html?_r=1&scp=3&sq=Russia,%20Opec&st=cse).

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When OPEC ministers gathered in Oran, Algeria, on December 17, 2008, to approve a 2.2 million bbl/d output cut, Sechin reappeared with a large delegation, but once again, Russia was vague in its actual commitments to OPEC. Although Russian oil companies and officials had previously signaled the intent to provide as much as a 300,000 bbl/d reduction in Russian supplies that would be in tandem with the group's December cuts, Sechin did not make such a commitment official at the Algeria gathering.<sup>40</sup> The deputy premier told OPEC delegates that Russia might have to restrict its supplies by 320,000 bbl/d in 2009, if current low prices remained.<sup>41</sup> But he did not portray the cuts as a move coordinated with OPEC's output reductions—rather he referred to the production loss as a reality of the impact that the plunge in international oil prices would continue to have on the Russian oil industry. Analysts forecast that natural declines in Russian output could reach between 3 to 5 percent in 2009, pulling some 300,000-400,000 bbl/d of Russian crude off the market.<sup>42</sup>

It is unclear how the United States and Western Europe would respond to a Russian announcement that it would formally join OPEC. Such an alliance would mean that the organization would effectively control 50 percent of the world's oil production. Since Russia has historically only looked out for itself in energy matters, this has not put its oil policy in direct confrontation with the West.

In advance of OPEC's December 17, 2008, meeting in Algeria to decide on an additional 2.2 million bbl/d reduction in cartel output, Russian President Medvedev suggested that Russia could not rule out joining the organization. Pointing out that Russia had to protect itself because oil and gas was the country's "income base," the Russian president stated that "such protective measures" might include "not only a reduction of crude production volumes, but also participation in the existing organization of suppliers." Prior to Medvedev's comments, Lukoil Vice President Leonid Fedun had publicly advocated that Russia formally join OPEC, while

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<sup>40</sup> "OPEC Offers Record Cut, But Few Details," *Petroleum Intelligence Weekly*, December 22, 2008.

<sup>41</sup> Anatoly Medetsky, "Sechin Sends OPEC Weak Signal," *The Moscow Times*, December 18, 2008, [http://rbth.ru/articles/2008/12/18/181208\\_sechin.html](http://rbth.ru/articles/2008/12/18/181208_sechin.html).

<sup>42</sup> Nelli Sharushkina and John van Schaik, "Moscow Keeps OPEC in Dark About Cooperation," *The Oil Daily*, Energy Intelligence Group, December 19, 2008.

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other Russian company officials had argued in favor of cooperating with cuts but rejected a membership in the organization.<sup>43</sup>

Yet, within days of Medvedev's statement, Deputy Prime Minister Sechin cast doubt over Moscow's true intentions by suggesting Russia opt instead to obtain "permanent observer status" within the organization, and that, while his country was not ruling out eventual full membership, "We are not rushing."<sup>44</sup>

On the OPEC side, the group's president has publicly called on Russia to become a formal member of the group. On December 15, 2008, Algerian Oil Minister Chekib Khelil was quoted as saying that, "We always wanted [Russia] to join OPEC," adding that such a move would increase the authority and influence of the organization.<sup>45</sup> Yet, it is telling that the memorandum that Russia provided to OPEC at the group's September 2008 ministerial conference calling for closer cooperation in the future between the two parties remains unsigned in early 2009.

OPEC officials complain that Russia perceives itself "above" joining OPEC as a member.<sup>46</sup> Russia sees OPEC in an inferior status, since OPEC's member states—as developing nations—are beneath Russia's industrialized, superpower self-perception. So Russia looks to influence OPEC by other means. Russia, for example, can offer the protection of its Security Council veto to key OPEC members such as Iran. It can also employ bullying tactics, such as holding up its Middle East military alliances (notably with Iran) to seem menacing to neighboring Gulf states. It can also offer diplomatic assistance via its ability to resist the United States and its willingness to use force (notably with Georgia) to establish why other oil capitals should care what the Kremlin is thinking. This approach has left many countries inside OPEC uncomfortable—complaining privately that Russia wants to influence OPEC, perhaps even pulling its strings,

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<sup>43</sup> "Russia Ready to Support OPEC Cut, Doesn't Rule Out Joining," *International Oil Daily*, Energy Intelligence Group, December 16, 2008.

<sup>44</sup> George Jahn, "OPEC Cuts Record 2.2 million Barrels a Day," *Associated Press*, December 17, 2008, [http://www.breitbart.com/article.php?id=D954KDNO0&show\\_article=1](http://www.breitbart.com/article.php?id=D954KDNO0&show_article=1).

<sup>45</sup> Eric Watkins, "OPEC Urges Russia to Join the Group, Cut Production," *Oil & Gas Journal*, December 15, 2008, [http://www.ogj.com/display\\_article/347990/120/ARTCL/none/GenIn/1/OPEC-urges-Russia-to-join-the-group.-cut-production](http://www.ogj.com/display_article/347990/120/ARTCL/none/GenIn/1/OPEC-urges-Russia-to-join-the-group.-cut-production).

<sup>46</sup> Authors' interviews with OPEC officials party to meetings with Russia regarding its membership, late 2008 and early 2009.

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without offering up any responsibilities, contributions or the sacrifices that come with actual membership.

Another key vehicle at Moscow's fingertips to influence individual OPEC members is its willingness to embed itself with individual OPEC member states through investment, aid, arms sales, and sales of nuclear technology. In September 2008, a Russian official announced that Moscow was negotiating deals to sell military hardware to both Iran and Venezuela. Sergei Chemezov, head of state-owned Russian Technologies, stated that he was negotiating to sell anti-aircraft systems despite American objections. There had been speculation that Russia was to sell its S300 surface-to-air missile system to Iran, as previously discussed in this paper. In addition, Chemezov revealed that Venezuela had expressed interest in buying Russian anti-aircraft systems, armored personnel carriers and SU35 fighter jets when they come into production in 2010.<sup>47</sup>

Russia and Venezuela have signed a number of major arms deals since 2005, totaling around \$4.4 billion. These agreements have included Caracas purchasing 54 helicopters, 24 Sukhoi fighter jets, and 5,000 Dragunov sniper rifles.<sup>48</sup>

Russian President Medvedev's visit to Caracas in November 2008 came a week before Russia and Venezuela conducted joint naval exercises led by the Russian nuclear-powered warship, Peter the Great, in Caribbean waters close to U.S. territorial waters. These exercises marked the first time a Russian fleet had been in the area since the end of the Cold War.<sup>49</sup> In addition, during the 2008 visit, Moscow and Caracas signed an agreement for Russia to provide assistance to Venezuela in the construction of a nuclear power plant.<sup>50</sup> Chavez has said that the reactor, which may be based in the eastern state of Zulia, was solely for peaceful purposes.

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<sup>47</sup> "Russia Ratchets up US Tensions with Arms Sales to Iran and Venezuela," *The Times*, September 19, 2008, <http://www.timesonline.co.uk/tol/news/world/europe/article4781027.ece>.

<sup>48</sup> Sara Miller Llana and Fred Weir, "Russia's New Presence in Latin America," *The Christian Science Monitor*, November 24, 2008, <http://www.csmonitor.com/2008/1125/p01s01-woam.html>.

<sup>49</sup> "Russia-Venezuela exercises begin," *BBC News*, December 2, 2008, <http://news.bbc.co.uk/2/hi/americas/7759892.stm>.

<sup>50</sup> "Russia-Venezuela nuclear accord," *BBC News*, November 27, 2008, <http://news.bbc.co.uk/2/hi/americas/7751562.stm>.

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Russia has also made strong diplomatic and economic overtures with military- and energy-related side benefits to two African OPEC members, Libya and Algeria—both of which have had long-standing relations with Moscow.

In an obvious mending of fences, Putin announced during his April 2008 visit to Tripoli that Russia had agreed to cancel the \$4.5 billion of Libyan debt in exchange for major contracts for Russian firms.<sup>51</sup> The deals signed during Putin's Libyan stay included a \$3.5 billion contract for Russian state monopoly Russian Railways (RZD) to build a 500-km rail line in Libya between the cities of Sirte and Benghazi, and possibly a \$2–\$4 billion agreement for Tripoli to purchase Russian modern arms. As a part of that package, Russia would supply the Libyan military with spare parts and maintenance for the Soviet-made equipment still in its inventory.<sup>52</sup>

When then-President Putin visited Algeria in March 2006, he also had a *quid pro quo* deal for the North African producer: Russia would cancel Algeria's \$4.74 billion Soviet-era debt, but only if Algiers agreed to purchase some \$7.5 billion worth of Russian weapons and combat planes. Algeria reportedly committed to buying 40 MiG and 20 Sukhoi fighters and 16 Yak jet trainers, as well as eight S-300 missile systems and 40 T-90 tanks.<sup>53</sup> But by the spring of 2008, Algeria announced that it was returning 15 MIG warplanes it had received under the 2006 Russian arms deal because of substandard parts. Russia strongly denied any problem with the quality of the aircraft. Russian officials speculated that Algeria's decision may have been influenced by heavy lobbying from other arms suppliers—France was aggressively pushing sales of its Rafale fighter jets in the region—and by differences between various groups within the Algerian government.<sup>54</sup>

As a result of these and other overtures, there are certainly member countries within OPEC that might welcome the opportunity to have Russia as a new member, namely fellow price hawks Iran, Venezuela, Libya, and Algeria, since they have recently developed or strengthened economic, energy, and arms ties with Moscow. These members would most certainly also like to

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<sup>51</sup> "Russia Swaps Libyan Debt for Deals," *BBC News*, April 18, 2008, <http://news.bbc.co.uk/2/hi/europe/7353997.stm>.

<sup>52</sup> Ariel Cohen, "The Real World: Putin in Libya," *Middle East Times*, April 18, 2008, [http://www.metimes.com/Politics/2008/04/18/the\\_real\\_world\\_putin\\_in\\_libya/2760/](http://www.metimes.com/Politics/2008/04/18/the_real_world_putin_in_libya/2760/).

<sup>53</sup> "Algeria in Russian Weapons Deal," *BBC News*, March 11, 2006, <http://news.bbc.co.uk/2/hi/africa/4796382.stm>.

<sup>54</sup> Lamine Chikhi, "Algerian Spat Shows Challenge to Russian Arms Sales," *Reuters*, April 1, 2008, <http://www.iiss.org/whats-new/iiss-in-the-press/april-2008/algeria-spat-shows-challenge-to-russian-arms-sales/>.

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see the role of OPEC powerhouse Saudi Arabia diminished within the organization. Russia's similarly-sized production and military might would provide it with particular clout, should it ever join the oil cartel, though it lacks the spare oil production capacity of Saudi Arabia that gives Riyadh a unique weapon to punish other oil market players by pushing prices lower. From Russia's point of view, however, its military and financial aid and oil and natural gas investment may be more intended to build friends inside OPEC and to incentivize these allies within OPEC to push for policies inside the oil cartel to Moscow's liking, rather than to bring Russia directly into the organization.

In fact, it is improbable that Russia would ever be granted membership within the organization without Saudi Arabia's tacit approval. Such a move does not appear to be in Riyadh's interests. For sure, the kingdom would not want to cede its leadership position within the group nor have to try to rein in yet another price hawk as it strives to balance OPEC's short-term revenue needs with its national interests to maintain long-term demand for oil. Russia is unlikely to want to take a backseat to the kingdom in leading the organization, and Russia's membership within the group could affect OPEC's cohesiveness on reaching agreements on output levels and price targets. While it is true that Saudi-Russo relations have improved since the visit of then-Saudi Crown Prince Abdullah to Moscow in September 2003—including the proposed \$4 billion Saudi purchase of Russian weaponry in May 2008—it is safe to say that the Saudis do not entirely trust Moscow, particularly when it comes to energy interests.

And it is unclear what Russia would gain from being a full-fledged member, instead of sitting as an influential observer with superpower status and an agenda to push. Moscow has long reaped the benefits of free-riding off OPEC's production cuts to prop up oil prices while Russia enjoys its continued maximum flow of its oil onto world markets. In a recent statement, Igor Sechin, who currently heads the Russian delegation attending OPEC's meetings, confirmed that Russia should not official join OPEC, claiming such a move would be "irresponsible;" rather, he promotes "coordinating actions" with OPEC to keep oil prices high.<sup>55</sup> It is hard to see what the incentive would be for Russia to allow developing world countries to lock it formally into a

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<sup>55</sup> Gregory L. White, "World News: Moscow Warns on Low Oil Prices," *The Wall Street Journal*, March 31, 2009, <http://proquest.umi.com/>.

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national quota. Such a concession seems out of line with Russia's superpower self image and its aspirations to reassert its individual national geopolitical power and global standing. Moreover, OPEC has shown it will act to stabilize oil prices with or without Russia, so Moscow is receiving the benefits from OPEC without membership, giving it less incentive to join.

Some Russian analysts have suggested that the Kremlin uses its energy diplomacy to ends other than influencing OPEC deliberations.<sup>56</sup> Some cynically believe that President Medvedev and Prime Minister Putin just want to enjoy the photo opportunities of meeting heads of state for their own sake (i.e. to seem personally important) and that expressions of interest in OPEC or Gas-OPEC discussions merely provide this platform for head-of-state travel and personal prestige. Others say heads-of-state meetings using OPEC and/or Gas-OPEC matters as a door opener allow the Kremlin to enhance its revisionist agenda of "appearing to be" a great power with multiple client, vassal, or at least allied states. Others suspect that commercial gains (either personal or national) are behind the many energy diplomacy state-to-state visits where other business dealings are then brought onto the agenda. One possible scenario would be if Moscow used such trade meetings to become the key arms supplier to U.S. and European oil and natural gas suppliers, and, thereby gain, itself the means to threaten the stability or security of Western energy supplies.

### **VI. Russia and Gas-OPEC**

The question of the viability of a global natural gas cartel, that is, a Gas-OPEC, goes to the root of how serious Russia's efforts to get a natural gas cartel off the ground are. With Russia's natural gas industry in disarray and the first mover advantage so evident in global natural gas trade, Gazprom faces many challenges to defending its existing market share. While organizing a Gas-OPEC might seem like a clear solution to stave off competitors from its prized European market, so far Gazprom has had trouble gaining traction for solid coordination among major natural gas exporters.

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<sup>56</sup> Based on the authors' conversations at off-the record seminars in Moscow organized by the Carnegie Moscow Center.

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Economic analysis by Russian economic academic scholars has shown that a global natural gas cartel may have little economic viability.<sup>57</sup> One critical factor is that the elasticity of alternative supply and the elasticity of demand for natural gas (as compared to competing fuels such as oil, coal and nuclear power) are both relatively small, allowing consumers to switch away from Gas-OPEC supplies to other fuels or other fringe suppliers as prices rise. Another factor cited in Russian academic studies is that even if Russia succeeds in raising its export prices for natural gas to Europe, it might not wind up economically as the price of European goods being sold back to Russia may increase by the same amount. Jaffe and Soligo find similar results that any natural gas producer cartel is “unlikely to exercise significant market power in the near term,” given the fact that there are many countries with sufficient undeveloped resources to provide multiple and varied competing sources of supply.<sup>58</sup>

Still, Gazprom has, at the highest levels, approached the leadership of its biggest liquefied natural gas (LNG) or pipeline gas competitors in Iran, Libya, Algeria, and Qatar, discussing a range of options for cooperation from location swaps trading (exchanging natural gas deliveries by relative proximity of customer location to reduce costs and gain better market control) to joint upstream investment. But, so far, Gazprom has failed to create convincing partnerships that could serve as the basis for cartelization. And, ironically, an effective collaboration between a few top natural gas suppliers in today's markets might provide only limited increase in economic rents while, at the same time, running the risk of ceding further future market share to Iraq and other nascent players.<sup>59</sup>

Iran and Russia are natural competitors for access to European gas markets, and, perhaps under different geopolitical circumstances, Iran could serve as a rival transit pathway for Caspian energy export. For its part, beyond tapping any geopolitical leverage over Qatar from serving as

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<sup>57</sup> Sergei Chernavsky and Oleg Eismont, “Is Gas OPEC Profitable for Russia? (For the Case of European Gas market)” (research report, New Economic School Research Center, Moscow, 2008), [http://www.nes.ru/russian/research/pdf/2008/Eismont\\_Chernavski.pdf](http://www.nes.ru/russian/research/pdf/2008/Eismont_Chernavski.pdf).

<sup>58</sup> Amy M. Jaffe and Ronald Soligo, “Market Structure in the New Gas Economy: Is Cartelization Possible?” in *Natural Gas and Geopolitics: From 1970 to 2040*, eds. David G. Victor, Amy M. Jaffe and Mark H. Hayes (Cambridge: Cambridge University Press, 2006) 439-464.

<sup>59</sup> Kenneth Medlock and Peter Hartley, “Scenarios for Russian Natural Gas Exports: The Role of Domestic Investment, The Caspian and LNG” (paper presented at Russia and the Caspian States in the Global Energy Balance conference co-hosted by the James A. Baker III Institute for Public Policy, Moscow, Russia, March 20, 2009), <http://www.rice.edu/energy>.

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a military benefactor to Iran, Russia has also courted Qatar as well with proposals for mutual commercial advantage from natural gas swaps.

In current markets, Russia and Qatar have been visible supply competitors. Spare receiving capacity at some European terminals has meant that 10 to 15 additional cargoes of LNG per month could be mobilized to replace as much as 5 to 10 percent of Europe's Russian pipeline imports through Ukraine with relative ease. Indeed, during Russia's recent cut off to the Ukraine in January, Greece's state Depa purchased spot LNG cargoes to replace its 7.7 million cubic meters per day of Russian supply, while Turkey's Botas did the same. U.S.-bound cargoes from Atlantic and Mediterranean suppliers were diverted during the cut off. But down the road, supplies from Qatar's new extra large mega-trains will pose a solid alternative to Russian deliveries.<sup>60</sup>

Perhaps trying to ease some of this competition, Gazprom deputy chief executive Alexander Medvedev has suggested that a gas troika of Iran, Qatar, and Russia consider joint "projects that could be implemented by the three countries in gas production and transportation."<sup>61</sup> Addressing a December 23, 2008, gathering of the Gas Exporting Countries Forum (GECF), a loose grouping of natural gas producers, Prime Minister Putin hinted that a gas producer group might be rent-seeking. Because the cost of extracting gas was rising sharply, Putin contended that "the era of cheap energy resources, of cheap gas, is of course coming to an end."<sup>62</sup>

While denying that a successful, rent-seeking natural gas cartel is the ultimate goal, the Russian–Iranian–Qatari gas troika has agreed to meet three or four times a year to discuss "the most important gas market developments that are of mutual interest."<sup>63</sup> Gazprom has referred to the gas troika as serving as a "locomotive" for the GECF, which is currently seen as a platform for speeches but lacking real organization.<sup>64</sup> One project the three producers were considering is a

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<sup>60</sup> "Russia Row Invites Fresh Look at LNG," *Petroleum Intelligence Weekly*, January 19, 2009.

<sup>61</sup> Ibid.

<sup>62</sup> "Putin Says 'Cheap Gas Era' Ending," *BBC News*, December 23, 2008, <http://news.bbc.co.uk/2/hi/europe/7796806.stm>.

<sup>63</sup> Andrei Glazov and Carter Tellinghuisen, "World's Top Gas Holders Launch 'Gas OPEC,'" *The Oil Daily*, Energy Intelligence Group, October 21, 2008.

<sup>64</sup> Andrei Glazov, "Gazprom Extends Global Reach," *Nefte Compass*, Energy Intelligence Group, November 20, 2008.

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joint venture to develop Iran's giant South Pars gas field, but discussions on that sensitive topic are at a very initial stage, and Iran has made it clear that it would only accept Qatar and Russia "investing in South Pars and the production of gas to be done on a partnership basis in Iran"—ruling out gas from the field being sent to Qatar to be liquefied there.<sup>65</sup> According to Miller, the troika's dialogue will be based on three-way projects, with the three producers collaborating on joint projects across the entire gas chain.<sup>66</sup>

But such cooperation could prove unwieldy, as Iran has hinted its main interest in collaboration would be to gain access to the Russian network in Europe. "Iran wants to export gas to Europe. We can benefit from the Russian pipeline network," an Iranian official told *World Gas Intelligence*.<sup>67</sup> Iran's desire to tap into the European market is not in Russia's interests and is out of step with more common agenda items—such as protecting oil price levels and trade in nuclear equipment. Iran's keen interests in building up its natural gas industry is, thus, out of step with a key goal to Russia's Iran strategy and may eventually provide an opening for the West to find a diplomatic carrot (increased access to European and Caspian energy markets) with which to tempt Iran into a compromise solution on Tehran's nuclear standoff with the West.

Russian analysts suggest that one target of Russia's highly publicized Gas-OPEC efforts is the European Union, which Gazprom may fear could organize monopsony power against the Russian state energy giant, were it to get its act together and act as a large, single buyer.<sup>68</sup> Russia's Gas-OPEC meetings may be designed to intimidate and provide a "preventative defense" against European buyers pressing for a reworking of contracts in the face of mounting competition from growing LNG supplies, some analysts speculate.<sup>69</sup> Others suggest Moscow's intentions may be political, since failing to organize a strong multinational regional organization

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<sup>65</sup> "Gazprom Still Pushing Troika, China Sales," *World Gas Intelligence*, Energy Intelligence Group, November 19, 2008.

<sup>66</sup> Alexei Miller's interview with Channel One Russia, "Vremya" news program, November 1, 2008, Gazprom Web site, <http://www.gazprom.com/eng/articles/article33043.shtml>.

<sup>67</sup> Ibid.

<sup>68</sup> For a good analysis of things the EU could do to greatly weaken Gazprom's gas grip on Europe, see Jeffrey Mankoff, Eurasian Energy Security, Council on Foreign Relations Special Report No. 43, February 2009, New York.

<sup>69</sup> Off-the-record seminars in Moscow organized by the Carnegie Moscow Center.

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including itself and Central Asian states, the Kremlin is looking to find another “grouping” to lead.

### **VII. Conclusion**

Russia increasingly sees its international energy role as a means to reassert its place as a global superpower. Moscow now regularly attends OPEC meetings, in an attempt to exert its influence within the prominent international club of oil producers. Russia has sought to influence OPEC by means other than becoming a full member. It has attended meetings as an observer and informally tried to influence deliberations. It has also tried to strengthen its influence on OPEC's decision making by promoting bilateral relationships with individual OPEC member states, which might therefore be more inclined to listen to Moscow's wishes because they are dependent on the Kremlin for foreign aid, military assistance, and nuclear technology and training. For Iran, Russia's right to veto on the U.N. Security Council is an important carrot. Towards the Arab Gulf, pointing to the value of its regional military alliances (notably with Iran) serves as a veiled threat that Moscow could use its military friends to pressure Arab producers who fail to support high enough oil prices. Russia can also offer its ability to resist the United States as a plus to countries that might run amok with Washington.

However, Russia's attempts to make itself the center of energy-producer decision making and the dominant energy superpower is putting it in competition with Saudi Arabia, which sees itself as (and arguably is) the primary power in the oil-producing world. Russian Deputy Prime Minister in charge of energy and Rosneft chairman Igor Sechin has asserted that Russia is on even footing with Saudi Arabia as the world's leading oil producer. But Russia is not in a strong position to challenge Saudi Arabia, which has a history of knocking out rivals through an oil price war strategy. Russia's hard currency reserves are being rapidly depleted, putting the Kremlin under both internal political and economic pressures. Moscow may be far less resilient than it might have thought to a lasting downturn in oil prices, with energy security implications for Europe if lower oil and natural gas export earnings mean Russian companies cannot sustain investments in future capacity.

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### Appendix: Russia's Arms and Nuclear Dealings with Iran

In December 2000, then-Russian President Vladimir Putin abandoned a pledge to the United States made by his predecessor Boris Yeltsin in 1995 that Moscow would honor a ban on arms sales to Iran. In October 2001, Russia signed an agreement with Iran to provide Tehran with up to \$300 million a year in conventional weapons. Russia's then-defense minister, Sergei Ivanov, insisted that Moscow would sell only defensive arms to Iran and would not violate international laws or norms, while his Iranian counterpart, Ali Shamkhani, said the pact “is not aimed against any country”—an obvious reference to Israel. The agreement was considered a framework for future sales of weapons.

In January 2007, Russia's arms export company, Rosoboronexport, completed delivery of 29 Tor M1 radar-guided anti-aircraft missile launchers to Iran, in a deal that was signed in late 2005 and valued at \$700 million. That delivery ironically strengthened Iran's air defenses just as the United States was trying to marshal support for tough U.N. sanctions against the country, which was continuing to reject international demands to scale back its nuclear program.

There has been some confusion about whether Russia has gone through with a deal to sell its controversial S-300 surface-to-air missile system to Iran. Following statements made by several Russian officials in September 2008 that an agreement on the missile system was in the works, a Russian Foreign Ministry spokesman denied that Russia would sell the missile system to Iran. Russia was also quick to counter a comment made in December 2008 by Esmail Kosari, deputy head of the Iranian Parliament's Commission for Foreign Affairs and National Security, that “after a few years of talks with Russia, now the S-300 system is being delivered.” Both Russia's agency for monitoring international defense cooperation—the Federal Military and Technical Cooperation Service—and Russia's main weapons exporter, Rosoboronexport, quickly refuted the Iranian's claims.

Interestingly, Russia inked a deal with Israel in April 2009 for Moscow to purchase several surveillance drones from Tel Aviv, with the contract valued at about \$50 million. According to the Israeli *Haaretz* newspaper, the deal followed a pledge by Russia to not go through with its

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sale of the S-300 missile system, although Israeli defense sources were quoted as saying that Russia has given nothing more concrete than vague promises that the arrangement with Tehran wouldn't happen.

When then-Russian President Putin visited Tehran in October 2008, he made news not only for being the first Russian leader to travel to Iran since 1943 but also for warning the United States against taking military aim at the Gulf state and reaffirming Russia's support of Iran's development of its nuclear program. During his visit, Putin reassured Iran that the Bushehr nuclear plant—the \$1 billion project being built by Russia that had seen serious delays—would indeed soon be completed. Iranian state television reported that Putin spoke of wanting “deeper” ties with Tehran and that an arms deal, as well as a commercial aircraft agreement, was part of the discussions being conducted. Moscow's assistance in building Iran's Bushehr nuclear plant in southwestern Iran and subsequent supplying of the facility with nuclear fuel has proven to be a constant thorn in Russian–American relations. The Russians signed on to finishing the construction of the Bushehr nuclear plant in 1995, after German work on the facility was interrupted by the Iranian Revolution and subsequent Iran–Iraq war. Despite growing concerns by the United States and other Western nations that Tehran was using the facility as a cover for obtaining nuclear weaponry, Russia has steadfastly maintained Iran's position—that the Gulf country has peaceful intentions to use the nuclear energy as electricity.

While Moscow has repeatedly stated that it does not believe that Iran is pursuing a nuclear weapons program, it has also called on Tehran to be as transparent as possible. The \$1 billion project to build a light-water reactor experienced its share of delays, and some of that was a result of Russian–Iranian squabbling over claims that Iran was behind on payments. In 2006, Russia agreed to ship low-enriched fuel to the plant in southern Iran by March 2007, and to open the facility in September, with electricity generation to start by November of that year. However, in February 2007, Russia said it was slowing down construction on Bushehr, claiming that Iran was behind in two \$25 million payments that in part had to do with Iran insisting that it be able to make payments in Euros rather than dollars, without contractual changes being made. Russian officials also cited as a cause of the delay a holdup in the delivery of safety equipment for the

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reactor from an unspecified third country. Russian officials suggested that these delays could push the delivery of Russian nuclear fuel back a year.

In December 2007, shortly after Tehran and Moscow had resolved their payment dispute, the Gulf country announced that it had received its first delivery of enriched uranium fuel rods from Russia. Iran said it had no intention of suspending its own controversial uranium enrichment work just because it had received the fuel shipment for Bushehr, and it even confirmed that it intended to enrich uranium for another nuclear power plant reportedly being built in southern Iran. The Bushehr plant is expected to be commissioned sometime in 2009.

Although Russia did sign on to three U.N. Security Council resolutions in 2008 that sought to sanction Iran if it did not stop its uranium enrichment program, it has used its position as a permanent member of the council alongside China to weaken the resolutions and stall any future sanctions, while encouraging more inspections of Iranian facilities by the International Atomic Energy Agency and pushing Tehran to be more transparent in its development of nuclear energy.