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The Energy Dimension in Russian Global Strategy

**A joint energy study sponsored by the Energy Forum of the
James A. Baker III Institute for Public Policy at Rice
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Key Findings

- Russia is entering a potentially historic moment of opportunity as a world energy superpower
- The potential for strong growth in oil production is real
 - ◆ Oil exports could rise by over 2 million b/d by 2008 based on known resources and existing cash flow
 - ◆ Increase could be obtained mainly from production areas controlled by Lukoil, Yukos, TNK and Surgutneftegas
- Kremlin's plans to reorganization could dampen level of increase by disrupting speedy implementation of plans to remove infrastructure constraints or if it causes a slow down in capital expenditures and project development



Pipeline Issues

- Sustainable export growth depends on removing major bottlenecks in
 - ◆ Eastern Siberia
 - ◆ Northern route to Barent's Sea for ocean bound movements by ultra large tankers
 - ◆ Bypass to Bosphorus Strait

State control in pipeline sector unlikely to change
Problem of financing –state funds and higher tariffs
unlikely to be enough

Outside investors?

State Stabilization Fund?



Geopolitical Trends

1. **Russia actively being courted by U.S., China, Japan, Europe**
 - Kremlin as a moderator of global prices?
2. **Russia worried about fate of eastern regions**
 - Emigration a demographic threat to Russia's sovereignty
 - Fears of splintering of oil-rich distant regions
3. **Energy as key plank to Russia's diplomacy in Asia**
 - Russia wants to speed up integration process with Asia Pacific but pipeline routing remains an economic and diplomatic problem



Putin reasserting government control over Russia's natural resources

- Philosophy dates back to late 1990s
- Believes in a mixed system of state and private ownership in assets but state protecting the interests of the nation
 - ◆ Since early 2004, new appointments of like minded officials to cabinet, presidential administration and state oil and gas firms
 - ❖ Many have background that includes service in state security organs
- Sea change likely to affect business model for Russian industry
 - ◆ New round of redistribution of petroleum assets
 - ◆ Corporate responsibility a la Russe; need to follow “unwritten rules” to succeed in Russia
 - ◆ These rules involve limits to Western involvement and Western style management



Market Impact of Russian Oil and Gas

■ Asian oil premium

- ❖ Not enough Russian oil to eliminate premium
- ❖ Higher Russian and non-Saudi Middle East purchases need to be combined with oil demand management

■ LNG prices

- ❖ Eastern pipelines will hold Asian LNG prices at lower levels over time
- ❖ Pipeline supplies will reduce LNG prices by 20 to 30 cents per million btu



Consumer Country Strategies

- More measured and concerted effort by oil consuming nations to establish energy policies that do not depend on influencing outcomes inside oil producing countries
- Higher priority to alliances with other major oil consuming nations
- Need to enhance institutional mechanisms that favor markets over political intervention by governments; bring rules of global oil trade and investment into harmony with rules governing trade in manufactures and services
- Liberalization and open access for investment –European Energy charter
- International cooperation on alternative energy technologies, improved automotive efficiency and renewable energy such as solar-derived energy and clean coal