

RUSSIAN ENERGY POLICY AND STRATEGY

Russia's Strategic Vision and the Role of Energy

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- Elaborate a bit further on market side of the coin and ask what they tell us on some core questions Robert has raised.
- In particular, I would like to:
 - Shed some more light on assumed link between Kremlin's foreign policy agenda and Gazprom's actions towards Russia's near Abroad
 - Look at chances of Russia redirecting gas supplies to China instead to Europe
 - Briefly discuss what we should instead worry about.

1.) Is there a link? And more importantly: Consider Gazprom's situation for a moment:

- Highly regulated domestic market (dual pricing system/ keeps prices low/ faction of prices charged WE clients/ home market does not generate a single RR of profits)
- To generate profits: foreign markets
- Either these markets are profitable (25% of production in WE = 100% corporate profits) / or rendered profitable
- push for end of subsidizing CIS countries/ higher prices
- gas disputes with Ukraine, Georgia and even Belarus, last remaining ally
- PR disaster for the Kremlin

At the same time:

- Gazprom tries to strengthen position on lucrative Western European markets
 - By enhancing grip on infrastructure delivering gas to Europe, including new Nordstream and Southstream pipeline projects
 - By locking up CA gas through long-term contracts
 - By buying into the lucrative downstream sector in Southeastern and CE
- Rational behaviour of a company!
- Obviously *supported* by the Moscow and its foreign policy.
- But: who is in driver's seat? Not necessarily the Kremlin.

- in line with Robert's conclusion: Russian foreign policy is rather subordinated to the interests of especially Russian gas, not vice versa.

Answer is: not very likely.

- True, China's growth is legend
- Has turned net importer of oil 15 years ago / imports 60% of its demand
- Needs more of everything (raw materials, feedstocks, food); fast
- One likely exception: gas
- IEA, Chinese import market for gas will remain comparably small
 - in 2030 130-160 bcm
 - compared to > 200 bcm NA
 - and over 750 bcm in Western Europe (substitute nuclear, try to turn green, abandon coal fired power plants)
 - at same time: higher priced
- reason: coal in domestic electricity consumption
- cheaper than especially high-priced LNG.
- so in addition to lacking infrastructure (as stressed by Robert):
 - market size may simply not be big enough to justify redirecting supplies to a well paying customer, with infrastructure investment written off decades ago
- we may see Sakhalin LNG rather being directed towards Freeport (Texas) or Zeebrugge in Belgium than to Qingdao or Shenzhen

2.) What should we really worry about?

- Two intertwined trends: Maturing giant fields & fast rise in domestic Russian consumption
- IEA estimates: Massive investment needs:
 - ~ USD 400 bln in oil sector until 2030
 - ~ USD 410 bln in gas sector until 2030
- Oil sector may be responsive to growing demand and market signal

- Despite recent takeovers of Sibneft or Yugansneftegaz: only 25% of oil production / 16% of refining capacity under state control
- Companies serve global markets and are profit driven
- Gas sector, however, may respond less:
 - Monopolist, Gazprom
 - Acts like a textbook monopolist!
 - curb third party access to its domestic grid -> deprives independent producers of incentive to invest / increase production
 - Attempts to take over competitors/ control them/ drive them out of business (as recently observed with the takeover of a 50% stake in TNK-BP)
- At same time: No reforms in sight, that change the domestic pricing structure and liberalize market

Energy use will remain terribly inefficient (400 bcm out of 600 bcm production consumed on domestic market -> grow independent producers will rather flare gas than feed it into grid result: Russia will have hard times meeting its export commitments and growing domestic demand if nationalization continues also in oil sector, also less efficiency there

 - Gas is already the slowest growing sector in Russia
 - Same investments problems!
- Conclude by referring to Robert's questions again:
 - Is the Kremlin ready to use energy in its foreign policy? Probably
 - Does it sit in the driver's seat? Hardly
 - Does that relief us from thinking about Russian energy? No, but rather in terms of investment than in terms of geopolitics