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The Politics of Oil: How Russia Pursues Its Energy Dream in the Middle East

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Abstract: Against the backdrop of instability in the global energy industry, Moscow is seeking to consolidate its share of the oil and gas markets as well as ensure that its revenue stream from the oil trade does not thin out. With that in mind, Russia pursues a policy of engaging its natural rivals in the industry from the Middle East with the aim of dividing up the markets fairly and on mutually beneficial principles. Moscow negotiated an almost-impossible deal with Saudi Arabia to cut oil output and made peace with Turkey against all odds in order to protect its interests in the European gas market. These steps show that despite remaining 'frenemies' Russia and its regional counterparts find ways to maintain a balance in the global energy market.

IN MAY 2009, RUSSIAN AUTHORITIES RELEASED A new edition of their National Security Strategy,[1] which mentioned the issue of energy for the first time, elaborating on the opportunities and challenges it presented. The Strategy seems outdated only eight years later given the set of new threats that have emerged for Moscow in the meantime, but it does name the challenge of the increased delivery of energy from the Middle East to Europe as a major threat to Russia. This statement does not appear in any other Russian official document, including the 2030 Energy Strategy of the Russian Federation.[2] It draws the contours of the strategy that Moscow has chosen for engaging its regional partners. The saying "Keep your friends close, and your enemies closer" is probably the best way to describe the Kremlin's energy strategy in the Middle East.

Increasing domestic production of oil in the U.S. and the resulting reduction in imports of crude from the Gulf is changing the landscape of the energy industry in the Middle East. With instability in the oil markets, producers have become more pro-active in search of new customers, which presents a threat to Russia by challenging its oil and gas monopoly in Europe. But Saudi Arabia, Qatar and Iran are all also looking for stability in this troubled industry and are more willing to negotiate to divide up the energy market, something on which they are beginning to agree with Moscow. Massive oil and gas revenues allowed Russia to create a financial cushion of reserve funds in the 2000s that are proving to be extremely handy during crises such as the one it is experiencing at the moment. These reserves are depleting fast, however, with some estimates saying that one of the funds may run out by the end of 2017.[3] Moscow is therefore seeking to restore oil prices as well as create a predictable global energy market that would allow it to make long-term financial plans.

Energy as a Foreign Policy Tool

The 2015 oil glut exposed the perceived threat of Middle Eastern energy giants for Russia and intensified the competition for clients in Europe and Asia. Over the last two years, competitors from the Middle East have demonstrated their ambitions to increase deliveries of oil to Europe. There are several factors that have allowed these countries to start taking a larger share of Russia's traditional market there. First of all, the low price of crude has made it economically unviable to store the resources, and incentivizing companies to sell it all sometimes means undercutting competitors. Second, the transportation of oil by sea is now extremely cheap, meaning that producers in the Middle East are more willing to fight for a share of the European market.

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The European Union, whose 28 members make up the world's largest natural gas imports market, has historically been among Russia's most stable clients, importing up to 40 percent[4] of its gas and 36 percent[5] of crude from the country. The Baltic countries, as well as some states in Central Europe, until very recently imported all of their gas from Russia, making them fully dependent on its supplies and the political expectations attached. Following the crisis in Ukraine, the EU imposed several rounds of sanctions against Moscow and embarked on a plan to break its dependence on Russian energy resources by diversifying its portfolio of suppliers.

In 2015, Saudi Aramco was welcomed at Poland's port at Gdansk to deliver its first-ever shipment of oil to the country in an attempt to contest Russia's energy monopoly in Europe. This was followed by the signing of a permanent contract in May 2016.[6] After the partial lifting of sanctions against Iran, the country also moved on to exploring new opportunities in Europe by delivering 2 million barrels of crude to the newly-opened terminal in Gdansk. Elsewhere in Europe, Hungary, Russia's fourth largest oil export market, increased its oil imports from Iraqi Kurdistan.

These newly emerged supply routes demonstrate how the oil glut is reshaping the oil market and how European customers are ready to go to great lengths to cut their energy dependence on Russia. While logistical complications will hardly allow Iran and Saudi Arabia to squeeze Russia out of the European market, their attempts to offer clients lower prices have sent an unsettling signal to Moscow. With oil and gas exports making up 50% of Russian budget revenue and the country's GDP dropping from $2.1 trillion in 2014 to $1.2 trillion in 2016, maintaining its client portfolio is becoming an imperative for the country. Despite political disagreements and continuing heated arguments with the EU, what Moscow is pursuing is a freeze on the status quo in which Russian suppliers are able to dictate their own terms to European customers, and they continue to fight relentlessly to maintain this situation. This is the reason why Russia seeks to impose boundaries for "external" energy supplier. However, instead of negotiating this with the EU due to worsening relations, Moscow has decided to make a deal with emerging competitors from the Middle East.

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In this context, Russia's so-called energy pivot to Asia is a two-fold strategy whose objective is to make the country's long-term energy planning more sustainable and predictable. China is the key pillar of this concept in East Asia, but Turkey arguably plays a crucial role in allowing Russia to expand its energy ambitions not only in Europe but also in the Middle East.

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The Turkish Stream project signed by President Putin and President Erdogan on December 1, 2014, is a demonstration of this policy. The project, a 1,100-kilometer pipeline linking Russia with Turkey, will carry up to 63 billion cubic meters of natural gas per annum, most of which could be later transported through Turkey to Greece. It was proposed in order to replace the South Stream pipeline with Bulgaria, which Vladimir Putin scrapped due to the EU's alleged lobbying against the project as part of Western sanctions against Russia.[7] Turkey's rising natural gas demands underpin Russia's ambition to become the sole provider of energy for the country[8]. Iran, as the second largest supplier, also sees Turkey as a prospective transport hub for gas deliveries to Europe, potentially pitting Moscow and Tehran against each other in competition for the EU market. The centrality of Turkey in Russia's energy equation for Europe to a large extent explains why despite a temporary breakdown in relations Putin and Erdogan managed to bring about a thaw and put the Turkish Stream project back on the rails.

In pursuing a gas pipeline project with Turkey, the Kremlin also raises the ante in relations with the EU. As of yet, European capitals have not voiced a unanimous position on the prospect of receiving Russian gas through Turkish Stream. Once the pipeline is fully operational, however, Russia intends to cut gas transfers to Europe through Ukraine, one of the key points of contention between the two sides. Equally important is the fact that engaging Ankara in Russia's energy equation essentially renders a number of other alternative pipeline projects for carrying natural gas to Europe through Turkey, such as Nabucco and the Qatar-Turkey pipeline, infeasible. By killing rival projects and ridding the EU of options to break its dependence on Russian gas, Moscow hopes to impose its own rules of the game on the European energy market, and Turkey will play a pivotal role in this strategy.

Energy Diplomacy

Russia's idea of energy diplomacy is based on a motivation to strengthen communication and promote cooperation as well as competition and jointly maintain world energy market stability with major exporting countries. The Russian leadership sees clearly that a turbulent energy market is a boat that it shares with OPEC, and hence its fair regulation is based on the mutually accepted rules of the game would allow all energy producers to get a share of this increasingly shrinking pie.

Russia has considerable weight in exercising control over the oil market, but it remains a non-member of OPEC, a dominant player in the global market. The two have historically had a love-hate relationship: Russia is regularly invited to attend the cartel's meetings and has pledged many times to cooperate with it on production cuts, but more often than not Moscow has reneged on its promises. This relationship should be seen through the lens of the Russia-Saudi dynamic, which might explain why Moscow has for a long time sent mixed signals to OPEC.

Russia and Saudi Arabia are natural rivals, constantly competing to be the world's leading producer of oil. For a long time Riyadh has been a champion, producing more oil than any other country, but in May 2016 Russia surpassed Saudi Arabia by output. By November Russia was producing 11.2 million barrels a day (levels unseen since the fall of the Soviet Union) as opposed to 10.6 million for KSA.[9] This development came about at a time when both countries were in crucial talks to slash oil output in order to stimulate the world crude price. Both countries were clearly ramping up production ahead of the anticipated oil deal. As a result, it is from these production levels that Russia and Saudi Arabia reduced their outputs by 300,000 and 486,000 barrels respectively as part of the deal.[10] Russia essentially outsmarted its regional partners by delaying the deal and agreeing to it at the precise moment when its commitment would allow Russian companies to produce oil at the rates at which they did when prices were lower than they are today and still make a profit.

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Following the deal to cut oil output, many have suggested that Russia may join OPEC now that it is expected to deliver on this agreement, but becoming a member of the cartel is not something Moscow envisions for itself. Russia recognizes that OPEC is an organization dominated by Saudi Arabia and it accepts that there cannot be two headliners in it. In fact, negotiating a deal on a par with Saudi Arabia only became possible because Russia is an outsider in this hierarchy. Moscow, however, has no intention of undermining the role of OPEC because in a playing field without the cartel's restrictive rules Russia would likely be constantly catching up to Saudi Arabia in terms of output and access to markets.

Over the past five years, the Russian government has been exploring opportunities to secure oil and gas investments from the Gulf, a policy stimulated not only by falling levels of Western investment, but also by the desire to integrate the Russian energy industry into the global market.

Russia is more interested in maintaining its dominant position in the gas market given the fact that it holds the largest proven reserves of natural gas.[11] To that end, since the mid-2000s Moscow has been promoting the idea of a gas cartel with Russia as a leading country. The creation of the Gas Exporting Countries Forum (GECF) in 2001 fell in line with Russia's ambition to set quotas and prices in the gas industry alongside Iran. For a while, GECF was marketed around the world as a "gas OPEC" led by Russia, Iran and Qatar. But the project failed to kick off and now seems dead. Unlike Qatar, which sells LNG gas at spot prices, Russia prefers to sign long-term contracts with its clients. The absence of an integrated global gas market and the lack of coordination over output and trade policies in that regard are key reasons why the GECF remains a discussion platform without binding commitments.[12]

As per the Russian Energy Strategy, the country pursues the goal of mutually beneficial cooperation in the energy industry with partners around the world, foremost in the Middle East. Cooperation, however, is something that Russia is still rediscovering in the wider region. Historically the Soviet Union played a role of a mentor for regional allies, helping them develop their own extraction industries, not for profit but in order to buy the loyalty of non-aligned states. Over 350 energy projects were implemented by the USSR in Egypt, Iraq, Algeria, Syria, Libya and Yemen.[13] The Soviet Union financed a bulk of these projects as well as introducing its indigenous exploration and extraction technologies to these countries. Today the balance of power has shifted and so have Russian energy priorities in the region. Inadvertently, it has to look to the Gulf for new business opportunities.

Nuclear power has also come to prominence in the Russian energy strategy. This industry, concentrated in the hands of just one state company, Rosatom, is a pivotal element of Russia's policy to gradually loosen its dependence on oil and gas.

Despite the ongoing fight with Saudi Arabia and Qatar for leadership in the energy market Russia has managed to compartmentalize its relationship with them and pursue joint energy projects. This strategy is not only profit-driven but also helps make respective markets interdependent to minimize risks and deter unhealthy competition. Over the past five years, the Russian government has been exploring opportunities to secure oil and gas investments from the Gulf, a policy stimulated not only by falling levels of Western investment, but also by the desire to integrate the Russian energy industry into the global market. In December 2016, Russian oil giant Rosneft secured a $5 billion investment from Qatar,[14] the largest energy deal the country has entered into with a GCC state. UAE's Mubadala Petroleum and Rosneft are also nearing a deal to jointly explore two oilfields in Eastern Siberia.[15] The Russian Direct Investment Fund in the meantime has set up a number of partnerships with GCC sovereign wealth funds, securing multi-billion investment pledge agreements with them, including in the energy sector. These include Mubadala, Kuwait Investment Authority, Saudi Public Investment Fund, Qatar Holding and others.

Russian energy companies have also developed an extensive portfolio of projects elsewhere in the region. Its three leading energy companies, Rosneft, Gazprom and privately-owned Lukoil, significantly increased their stakes in oil and gas projects across the region before the oil glut. Often building upon the heritage of Soviet energy cooperation, Russia is engaging in promising projects in Egypt,[16] Iraq (including in Kurdistan),[17] Libya,[18] and Iran.[19]

Nuclear power has also come to prominence in the Russian energy strategy. This industry, concentrated in the hands of just one state company, Rosatom, is a pivotal element of Russia's policy to gradually loosen its dependence on oil and gas. Moscow also increasingly relies of its nuclear industry to engage partners around the world, since Rosatom is just one of the few global companies able to handle the full cycle of constructing nuclear power plants and servicing them. There has been tremendous interest in the Russian nuclear industry from the Middle East: Almost all regional powers, whether oil-producing and not, have reached out to Rosatom to explore the prospects of cooperation. Moscow has taken note of the growing interest and perceives its nuclear industry as an effective foreign policy tool. Rosatom made a huge leap in marketing its nuclear energy in the Middle East in spring 2016, opening its first regional office in Dubai. This office will oversee ongoing projects in Egypt, Iran, Jordan, and Turkey, as well as the UAE. Saudi Arabia, which has ambitious plans to build 16 reactors by 2032, has also reached out to Russia and forged a deal to promote nuclear cooperation in 2016[20] which may see Moscow build Saudi nuclear infrastructure from scratch.

Endnotes

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