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The Means and Ends of Russian Influence Abroad Series

Russia's Energy Diplomacy

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Summary points

- Russia's vast energy resources are a mainstay of its foreign policy and an essential source of its current political power projection and international prestige. These resources can act as a source of economic attraction for neighbours and partners. They are a significant factor in bilateral relations with neighbours that can be traded for political and economic benefit.
- Russia also uses its energy relations as a means of achieving economic and political influence through non-traditional and non-transparent mechanisms. At times, Russia employs energy in coercive ways and to build patterns of dependence.
- While Russsia's energy exports give it international clout, the current development and export model has created a dynamic that has undermined trust and at times created counterproductive outcomes with both CIS and EU countries.
- The changing external environment and pressures to develop new Russian sources of oil and gas production may force changes. Russia may be pushed to run its energy sector more efficiently with greater foreign investment, closer relations with foreign partners and increased mutual market access. If this happens, Russia might develop a qualitatively different energy-based influence across a much wider area.

Introduction

Energy is a mainstay of Russia's foreign policy and an essential source of its current political power projection and international prestige.[1] Without its ability to produce and supply energy, Russia would not have the status it has today. It would not have the same influence as a G8 member, it would not command the attention of the United States as it does, and it would not have the same privileged relations with several leading European Union countries, notably Germany. It would also be of less interest to China.

Russia has the world's largest natural gas reserves, the second largest coal reserves and seventh largest oil reserves. It is the largest exporter of natural gas, and since 2009 has periodically overtaken Saudi Arabia as the world's largest oil producer. It currently supplies around 30% of the oil and 25% of the gas that the EU consumes, and is also a significant global force in the nuclear power industry.

> 'From 2004 Russia benefited from a steady increase in the global oil price that transformed its international position and fuelled a level of economic growth that was unimaginable in the late 1990s'

Russia's use of energy resources as a source of power projection reflects a change over the past 20 years that has seen a significant decline in emphasis on the role of nuclear weapons. From the late 1960s, when the USSR became an increasingly important oil and gas supplier to western Europe, and up to the end of the Soviet period, energy relations had a different place in Moscow's foreign policy. A symbol of reduced political tensions, they provided a source of hard currency for the USSR and an important tool of commercial engagement, particularly with West Germany. For the USSR to have used them for political purposes in a system of mutual restraint imposed by nuclear weapons would have destabilized security relations with the West and damaged the Soviet economy. Now that Russia's power derives far less from military power than in the days of the USSR, energy relations are a different and much more flexible tool of influence. In broad terms, they serve as:

- a source of economic attraction for neighbours and partners,
- a significant factor in bilateral relations with neighbours that can be traded for economic and political benefit and sometimes takes the form of coercion, and
- a means of achieving economic and political influence through non-traditional and sometimes non-transparent mechanisms.

Russia's energy relations can be used in different ways to exert influence at different levels of intensity. Their influence is strongest in the Commonwealth of Independent States (CIS) but it extends far into Europe too. There is pronounced influence in some EU countries, particularly Germany and some new member states whose dependence on Russian energy supplies developed during Soviet times on the basis of Soviet-built infrastructure and favourable pricing arrangements.

Background

Since coming to power Vladimir Putin has shown considerable skill at integrating foreign policy and energy policy to leverage Russia's advantage both as a holder of hydrocarbon resources and as a very important and capable producer in its own right. His understanding of both areas of policy and their overlap has made him a difficult negotiating partner for European leaders. No Western leader has a level of knowledge of the international energy business comparable to Putin's, based on his strong interest in Gazprom. The Russian understanding of the overlap between its energy and foreign policies was reflected in the 2003 Energy Strategy, which noted that Russia's 'significant energy resources and powerful fuel-energy complex' was 'an instrument for conducting

1 This paper is a companion piece to Andrew Wood, *Russia's Business Diplomacy*, Chatham House Briefing Paper, May 2011. For other papers in this series, see p. 16.

domestic and foreign policy' and that 'the role of the country on global energy markets to a great degree determines its geopolitical influence'.[2]

From 2004 Russia benefited from a steady increase in the global oil price that transformed its international position and fuelled a level of economic growth that was unimaginable in the late 1990s. This profoundly changed the attitude of Russia's leaders towards neighbours and partners. When Putin became prime minister in 1999 the price of Brent crude was just under $18 a barrel. In July 2008 it hit $147. There was over-enthusiastic talk of Gazprom becoming a trillion-dollar company and the biggest corporation in the world. This coincided with a peak in Russian foreign policy influence, demonstrated by Putin's outspoken performance at the NATO Summit in Bucharest in 2008, followed by Russia's incursion into Georgia a few months later.

In a matter of months this wildly optimistic prognosis about Gazprom came back to haunt Russia's leaders. With the global economic crisis, the price of oil had dropped to below $45 by December 2008. This exposed as hollow the belief of many of Russia's economic policy-makers that the country was a 'safe haven'. This abrupt change in economic fortunes, albeit without a prolonged crisis at home, tempered Russia's approach to its use of energy in its foreign relations. Nowhere is this more visible than in the area of gas exports, by far the most powerful element of Russia's energy influence. Gazprom's cash-flow situation in 2010 was very far from what it was in 2008. Ambitions for downstream acquisitions and growth have been scaled back in line with investments in capital expenditure.[3]

At the same time, there have been profound changes in the structure of the European gas market, which is the source of roughly two-thirds of Gazprom's revenues from the sales of one-third of its production. Gazprom is disproportionately dependent on the European gas market. With Turkey included, it accounts for over 95% of Gazprom's non-CIS exports. Oil and liquefied natural gas (LNG) can be globally traded in a way that pipeline gas cannot. In short, there have been signs for several years that the relationship of gas interdependence between Europe and Russia has been evolving in a way that is not conducive to Russian interests. This is despite strong pressure from Russia and some of Gazprom's allies in Europe to counter this trend. European concerns about overdependence on Russian gas in the face of decreasing indigenous gas production have started to recede for a number of reasons. These include the current glut of LNG as a result of the use of revolutionary gas production technologies in the United States to develop previously inaccessible unconventional gas, as well as EU renewable energy policies and improved interconnections in response to the 2006 and 2009 gas crises between Russia and Ukraine.

These are not the only factors in play, however. The protected terms of trade for the European gas business that developed in the 1970s have started to unravel. 'Unbundling' of production and transportation assets, provision of third-party access to pipeline infrastructure, as well as moves to limit capacity reservations in pipelines, all mark significant change in market rules and practices. Combined with the start of a move away from oil-indexed pricing as demonstrated by the embryonic spot market for gas, this is making life less comfortable for major investors in the gas business. Gazprom's partners such as E.oN, RWE and Gasunie have seen their business models come under new pressures and have been forced to adapt to the changing realities. In short, Gazprom faces a much more uncertain situation in Europe as competition from other sources puts pressure on prices. Several major European buyers of Russian gas have negotiated discounts on their long-term contracts in response to lower spot prices. Gazprom is understandably concerned at the erosion of the traditional model in which guaranteed demand from European customers underpinned upstream investments. The limited diversity of sources to the European market effectively gave Gazprom and its established partners the opportunity to restrict the supply of gas to the European market and keep prices high. Up to 2007/08 Gazprom's European customers were queuing up to extend their long-term contracts amid concerns about long-term gas supply to

2 *Energeticheskaya Strategiya Rossii na period do 2020 goda* (2003), http://www.rg.ru/2003/09/30/energeticheskajastrategija.html.

3 This pattern may be reversed if high oil and gas prices continue. Gazprom CEO Alexey Miller predicted in April 2010 that the price for gas sold on long-term contracts could reach $500 by the end of 2011 and that Gazprom's exports to Europe in 2011 would rise from 139 billion cubic metres in 2010 to 151bcm , www.*upstreamonline.com*, 25 April 2011.

the European market. This period may prove to have been a high-water mark of Russian influence on European energy policy. According to the *Russian Energy Strategy to 2030*, Russia will devote more effort to increasing market share for its hydrocarbons (including pipeline gas and LNG) in Asia than in Europe, because Europe is regarded as a mature market for gas.[4] To maintain its market position in Europe, Gazprom will have to compete with a range of other sources. At the same time, it will pursue asset swaps with European companies to strengthen its downstream position to secure demand and extract additional rent.[5]

Rising confidence encourages Russia's use of the energy card

Rising prices in the early part of the last decade, coinciding with concerns about future energy balances, gave Russia a springboard to re-establish its position as a major power. Export revenues aside, foreign countries began to view Russia differently by virtue of its abundance of oil and gas reserves and its record of supply to global markets. It is fair to say that if Russia had not boosted its oil production from 2003, the global economy would not have been able to cope with the increased demand from the Asian economies. In this respect, Russia made a very significant contribution to global energy security, which was emphasized by its G8 chairmanship in 2006. This reflected recognition by the Russian leadership that it held an important card which no other country could match.

Russia's leaders also saw that the country was able to use its energy influence to strengthen its positions in the CIS and forge a new type of relationship with the EU and the United States. The energy dialogues established with the EU (2000) and United States (2003) bore little fruit, but Russia had discovered that energy cooperation was highly attractive to a number of European governments and could be used to influence their relations with Russia. The EU's difficulty in finding a 'single voice' to deal with Russia on energy issues is testimony to Moscow's diplomatic achievements. It offered Western governments a deal: invest in the Russian energy sector according to our rules and in return allow Russian energy companies to invest in your countries. The energy consultancy CERA has described this as Russia's 'barbell strategy': European investment in Russia's upstream with Russian participation in the European downstream connected by pipeline.[6]

It is fair to say that Russia is still learning to balance energy among its foreign policy instruments. Recent history shows that as a source of influence, energy resources can be easily overused. As a result, they can repel as well as attract. Their capacity to create counterproductive outcomes for Russia has been particularly visible among EU countries following the gas crises of 2006 and 2009 between Russia and Ukraine. In terms of foreign investment, Russia is still trying to balance its needs with its desire for control, as demonstrated by the 2008 Law on Foreign Investment in Strategic Sectors, which hardly offers a red carpet to foreign energy companies.

In the case of China, energy resources have presented a dilemma for Russia: to supply or not? Despite a firm intention expressed in 2006 by President Putin to supply 70 billion cubic metres a year of pipeline gas to the Chinese market beginning in 2011, and an abundance of gas reserves in East Siberia, Russia still appears hesitant about establishing gas cooperation with China. There are some grounds to believe that Gazprom has been reluctant to commit gas volumes from East Siberia to China for fear that they might be needed to backfill the gas supply system elsewhere in Russia. Nevertheless, over recent years Gazprom senior executives have occasionally raised the prospect of diverting the focus of Russian gas exports from Europe to China because of changing EU regulations. At present, the prospects for oil exports are much better: a spur from Russia's Eastern Siberia–Pacific Ocean pipeline (ESPO) to China has been completed and regular deliveries are due to start in 2011.

However, it is clear that Russia continues for the moment to have doubts about Chinese investment in its energy sector and has favoured Western companies over their Chinese counterparts. China has just one significant upstream investment in Russia – a 49% stake in Udmurtneftegaz

4 *Energeticheskaya Strategiya Rossii na period do 2030 goda*, (2009), pp. 10 ,139, http://minenergo.gov.ru/activity/energostrategy/Strategiya/Energostrategiya-2030.doc.

5 Tatiana Mitrova, 'The Russian Energy Strategy and Europe: A Russian View', paper at conference on 'Russia, Europe and Energy: Rule of Power or Power of Rules?', 14–15 October 2010, Oslo, http://english.nupi.no/Events/Upcoming-Events/Russia-Europe-and-Energy.

6 *Securing The Future*, CERA Special Report (2007).

that has not proved a success. China has, however, been instrumental in providing loans to Rosneft, including a $25bn package provided to Rosneft and Transneft in return for a 300,000 barrel per day oil supply agreement to run for 20 years from 2011. At the same time, there are signs of increased cooperation around projects related to coal, nuclear energy and electricity. For the moment, energy cooperation with China and the rest of Asia is at an early stage. While concerns about the implications of further Chinese economic growth for Russia may constrain the Russian desire to develop a full-blooded energy relationship, there is no reason why Russia cannot develop an energy business in Asia to balance its position in Europe.

Similarly, energy cooperation with India is now a focus of interest. This is reflected in the signing of a number of agreements in the oil, gas and nuclear fields in December 2010. Expansion into the Indian market is logical for Russia given the vast opportunities, and balances its efforts to build a long-term position as an energy supplier to the main Asia-Pacific markets. It already supplies LNG to Japan and South Korea.

Russia has also shown interest in developing energy cooperation (including nuclear) with a number of countries in Africa, including Angola, Egypt, Namibia, Nigeria and South Africa. This is a logical effort to expand Russia's trade relationships using its prime export commodities, in some cases building on experience from Soviet days.

Energy resources as a source of attraction

Given Russia's abundance of energy resources, including its strong nuclear energy capabilities, the country attracts interest from a wide range of foreign governments and companies. This is reciprocated by Russia's interest in exploiting energy resources to access a range of foreign markets.

The picture is diverse since Russia's energy sector remains tightly integrated with the CIS and Baltic countries through shared infrastructure from Soviet days. While this gives it a significant lever in relations with some of these countries, Russia also relies on Belarus, Ukraine and Estonia for access to its foreign markets.

Interest in commercial opportunities with Russian companies both inside and outside the country has encouraged a range of leading international energy companies to invest in the Russian energy sector. Russia has an interest in attracting world-class companies to work in partnership with it to develop its resource base and to benefit from investment and transfers of technology and skills. This has already brought some significant benefits at home. The offshore Sakhalin developments would not have been possible without ExxonMobil and Shell.

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Western companies' interests inevitably become part of their governments' considerations in approaching Russia. There is no better example than Germany, where there has been little change in substance between Chancellor Gerhard Schröder's handling of Russia and that of his successor, Angela Merkel, despite their very different political positions. Both have supported the contentious Nord Stream pipeline project that will bypass Belarus, Poland and Ukraine to bring Russian gas directly to Germany. Both have backed the expansion of cooperation between German and Russian energy companies. Both have tried to limit restrictions on asset acquisitions by Russian energy companies in EU countries and, to different degrees, have soft-pedalled concerns about Russia's political direction and behaviour in its periphery. At the same time, Germany's E.oN Ruhrgas and BASF/Wintershall have deepened what are the closest relationships with Gazprom among European companies, built up over decades with considerable skill and persistence.[7]

7 It should be noted, however, that E.oN sold its 3.5% stake in Gazprom in December 2010; company press release, 1 December 2010.

In the same vein, Italy's ENI has also developed its own brand of energy relations in Russia, in particular with Gazprom. ENI/ENEL's controversial purchase of expropriated Yukos assets in 2007 and their subsequent transfer to Gazprom and its oil arm Gazprom Neft are examples of the lengths to which companies will go to secure their positions in the Russian energy sector. ENI has been keen to develop the 'barbell strategy' with access to the Russian upstream in return for Gazprom's participation in Italy's downstream markets as well as participation in the South Stream pipeline project. These expanded links have taken place in the context of close political links between Italy and Russia, symbolized by the warm personal relationship between Putin and Prime Minister Silvio Berlusconi.

Similarly, Rosneft's initial public offering (IPO) in 2007 was supported by BP and others in a clear commitment to a Russian state company. These are normal business practices that reflect the attraction of the Russian energy market for foreign investors, even if they may sometimes have political overtones. However, there was no political dividend from BP's purchase of Rosneft shares: it did not bring about any perceptible improvement in the United Kingdom's relationship with Russia, nor did it help BP during a very acrimonious dispute with its Russian partners in 2008 that led to TNK-BP's chief executive fleeing the country. While BP held on to its 50% stake in TNK-BP (still a remarkable anomaly in the Russian oil industry), the experience was bruising and suggested that parts of the Russian government were supportive of an agenda to reduce BP's operational control of TNK-BP. The lesson is probably that, despite a Western company's efforts to honour all its commitments and build constructive relations with the Russian government (and BP did everything possible, including the Rosneft IPO), these relations are subordinate to broader political considerations.[8]

Between 2000 and 2008 the Russian leadership successfully exploited concerns in many European governments and energy companies about an impending energy squeeze and Russia's importance as an energy exporter. As Moscow hoped, European utility companies, fearing sharp price rises, rushed to extend their long-term contracts with Gazprom by 20–30 years. Events conspired against them for many of the reasons cited above as the structure of the European market changed and the EU set about addressing its long-term energy challenges. The Third Energy Package (tabled in 2007) and the *Second Strategic Energy Review* (published in 2008) formed a watershed. They provided responses to concerns about the level of Russian influence on EU energy security that was destabilizing relations with Russia. The result has the potential to be a sensible compromise: an important place for Russian supply, notably of gas, in Europe's energy mix but a strong commitment by the EU to diversifying sources and the better functioning of EU energy markets. Despite fierce Russian lobbying in key EU member states, notably France, Germany and Italy, the EU has begun to take energy security more seriously and its full range of policies, including renewables, energy conservation and unbundling, looks set to address more effectively the problem of dependence on Russia.

Aside from the effects of the gas crises between Russia and Ukraine, the EU has noted that Russian rhetoric is not always matched by reality. The idea of a 'Gas OPEC' occasionally trumpeted by Russia's leaders was largely regarded as bluff. Similarly, Russian threats to divert gas from Europe to China if Europe would not clarify its demand requirements sounded empty for the obvious reason that Russia seemed to have doubts about the desirability of exporting large gas volumes to China and showed no signs of building the infrastructure to do so.

For all the concerns in parts of Europe about the expansion strategy of Russian energy companies, there have been no major acquisitions on the scale that some feared as the result of liberalization of EU markets. This does not mean, however, that Gazprom does not have significant shareholdings in some Baltic and

8 Despite its international shareholder base, BP is still perceived in Russia as a British company.

Central European countries. These may be small by EU standards but they are large when measured in terms of domestic markets. Gazprom's 37% stake in the Lithuanian utility Lietuvos Dujos is significant, particularly since the largest shareholder (38.9%) is Germany's E.oN, a company with a long history of close partnership with Gazprom.

Gazprom is invested in a range of transmission and distribution, trading and storage companies in several EU states, especially Austria, the Czech Republic, Hungary, Germany, Italy, Lithuania, Romania, Slovakia, the Netherlands and the United Kingdom. Lukoil has expanded successfully in a number of East European countries and is a strong player in the Balkans. Russia clearly still has ambitions for its energy companies to expand abroad, particularly in 'consumer countries'. In late 2010 TNK-BP bought assets from BP in Venezuela and Vietnam, and Gazprom Neft acquired offshore oil blocks in Cuban waters. The *Energy Strategy to 2030* contains objectives for the 'Strengthening of the positions of leading Russian energy companies abroad'. These include efforts to 'strengthen Russia's positions in regional energy cooperation' with reference to EU countries, the Asia-Pacific region, the Middle East, Africa, Central and Southeast Asia, Latin America and China. A further objective is the 'stable presence of one Russian energy company in the top three leading global energy companies and in the top five of global companies overall and two Russian companies in the top ten of both categories'.[9] With Gazprom's capitalization just over $165bn at the time of writing, Russia's biggest company is not among the top ten global companies.

Energy influence does not derive exclusively from oil and gas. Rosatom, the state-owned nuclear company, is actively expanding its international business, agreeing in 2010 to build two reactors for China and four for Turkey. It is in discussions with India to build 12. It was also bidding in 2010 for its first ever project in the EU, at Temelin, Czech Republic. However, the project is now on hold because of reduced estimates for power demand. Russia's coal reserves are far larger than those of its competitors on international markets and its mines in the Russian Far East are strategically well located to export production to Asian markets. Russia is already a significant coal supplier to North European markets. In 2008 over 50% of UK imports were from Russia, a fact that barely registers in debates about the United Kingdom's energy security.

Russia's energy relations with its neighbours

Russia's relations with CIS and Baltic states are without exception significantly influenced by energy. Whether it is crude oil supply to Lithuania's refinery, investment in Armenia's energy infrastructure or development of Tajikistan's hydroelectric power generation, Russia is the dominant player. For transit countries such as Belarus and Ukraine, on which Russia depends to access export pipelines, energy relations have been particularly complicated and prone to strong politicization. The fact that they are also important consumers in their own right only adds to the complexity and allows Russia to use the energy card in its relations with them to influence other outcomes.

The Caspian and Central Asian oil and gas producers (Azerbaijan, Turkmenistan, Kazakhstan and Uzbekistan) were previously entirely exposed to a Russian monopoly because of their lack of independent export infrastructure. Around 50% of oil exports from the Caspian and a larger proportion of gas exports (around 70% in 2009) still transit Russia. However, the development of new pipelines, including from Turkmenistan to China, and increased exports through existing non-Russian-controlled infrastructure mean that this dependency will be reduced. Gas is much more of a problem than oil for Caspian producers since their landlocked position means that they cannot develop liquefied natural gas for shipping as a way of overcoming their dependency on pipelines.

As a result of its pre-eminent position as 'gatekeeper' to export markets, Russia controls around 80% of Turkmenistan's gas exports and a similar proportion of

9 *Energeticheskaya Strategiya Rossii na period do 2030 goda*, pp. 142–3.

Kazakhstan's oil exports.[10] Russia has exploited the situation with gas over much of the past 20 years by using Central Asian gas as backfill for its domestic needs. It has bought this gas at a very substantial discount on its own export prices for Europe. Finally, Russia extends its influence further through its ability to compete with proposed new pipeline systems from the Caspian region in its attempt to prevent Caspian producers from exporting independently of Russia. The case of South Stream versus Nabucco[11] provides a clear example. Azerbaijan is a source of concern for Moscow by virtue of its oil and gas pipeline infrastructure that gives it direct access to international markets. Moscow is working hard to ensure that some of the production from the Shah Deniz 2 field is sold to Russia and not Europe. This is a deliberate ploy to try to undermine Nabucco although Russian officials contend that South Stream and Nabucco can coexist.

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There are many examples of Russia's coercion in relations with its neighbours through the interruption of energy deliveries. Russia's 'pipeline diplomacy' goes back to 1990 when Moscow tried to curb the independence movements in the Baltic countries. Between 1991 and 2008 there were over 40 politically motivated energy disruptions or threatened disruptions by Moscow.[12] The examples below show how the practice has expanded.

Lithuania

Between 1998 and 2000 there were nine interruptions of crude oil supplies to Lithuania's Mazeikiu refinery as Russia tried to prevent its sale to an American operator. In 2006, shortly after the refinery had been sold again, this time to Poland's PKN Orlen, Transneft cut off supply after a pipeline explosion and never restored it. Many commentators found it hard to avoid the conclusion that the Lithuanian government was being punished for not selling the stake in the refinery to a Russian company. During the tender process for the refinery sale, Kazakhstan's KazMunaiGaz positioned itself aggressively for a bid. In November 2005 Transneft refused to agree terms for transportation of Kazakh crude to Lithuania via Russia and effectively derailed the bid. There was little doubt in Russian industry circles that this was intended to help a Russian company buy a stake in the refinery.

Latvia

In 2003 Russia increased its efforts to gain control of Latvia's Ventspils port, a major crude oil and oil products export terminal. This followed a gradual reduction of Russian export volumes to the port that was widely seen as an attempt to bankrupt the business. Russian crude exports through Ventspils finally stopped despite protests from some Russian independent producers who wanted access to the port because of a general lack of export infrastructure. Transneft did not seem guided by the commercial considerations of other Russian companies. Ultimately, Russia opted to bypass Ventspils for pipeline deliveries of crude oil for export via the Baltic Sea through the new Baltic Pipeline System (BPS-1) completed in late 2001, which relied on the Russian port of Primorsk. This

10 Under an agreement signed in November 2009, Russia has 'locked in' up to 30 billion cubic metres of capacity from Turkmenistan and prevented it being exported to another destination while continuing to import substantially less. This means that to increase supplies beyond current volumes through the new pipeline to China, Turkmenistan will have to develop dedicated new resources.

11 South Stream is the Gazprom-led project to bring 'fourth corridor' gas to Europe from Russia. Nabucco is a Western project without Russian participation to bring gas to Europe from Caspian and Middle Eastern sources.

12 Keith C. Smith, *Russian Energy Policy and its Challenge to Western Policy Makers*, report published by the Center for Strategic and International Studies, Washington, DC, March 2008.

was the first example of bypass infrastructure built to reduce reliance on transit routes through neighbouring countries, where the latter insisted on retaining ownership and control of the pipeline on their territory.

Estonia

In 2007 Russian oil products and coal exports through the port of Tallinn were suddenly stopped in the aftermath of the relocation of a Soviet war memorial by the Estonian authorities, which had provoked a furious reaction from the Russian government. Given that around 25% of Russian oil product exports pass through Estonia by rail, this was a significant reduction of its export capacity that, according to trading sources, had a greater financial effect on Russia because of lost export revenues for its companies and consequent reduced tax payments to the state. It was impossible to see Russia's move as anything other than politically motivated. Interestingly, however, one trading company, Gunvor, was exempted from the restriction. Gunvor handles around one-third of Russia's seaborne exports, and is co-owned by Gennady Timchenko, reportedly a close friend of Prime Minister Putin.

Ukraine

As noted above, in 2006 and in 2009 Russia cut off gas supplies to Ukraine as a result of disputes over pricing and commercial mechanisms. These crises had far-reaching consequences for EU thinking about energy security. The first interruption coincided with Russia's chairmanship of the G8, which focused on energy security. It served as a wake-up call to EU policy-makers that Russia was prepared to risk jeopardizing its reputation as a reliable supplier in order to settle its issues with a neighbour. While Europe had been used to annual eleventh-hour gas supply negotiations between Russia and Ukraine, the 2009 crisis came as a surprise. Although it was legitimate for Russia to seek a price rise to commercial levels, there was no justification for imposing a deal that would bankrupt Ukraine. Putin personally authorized Gazprom to turn off supplies. As a result, some of Russia's largest customers, including Germany, France and Italy, faced serious potential supply problems while others, such as Bulgaria, Slovakia and Serbia, experienced interruptions. In the event, Europe coped with the crisis, but Russia's leaders had over-reacted, possibly as the result of a desire to punish the government of Victor Yushchenko, which they openly despised. Gazprom's reputation was severely dented and the interruption reportedly cost it over $1bn. In reaction to the 2009 crisis, Russia stepped up its efforts, begun in the aftermath of the 2006 crisis, to build infrastructure to avoid Ukraine in the form of the South Stream pipeline. The EU's reaction was to start to implement the conclusions of its 2008 Second Strategic Energy Review and to allocate funds to improve gas storage facilities, interconnections and its overall ability to cope with a supply crisis. Ukraine was forced to accept a sharply increased (but still discounted) gas price. The issue of the privatization of its pipeline system remained off the agenda. In 2010 Russia and Ukraine signed a new ten-year agreement that offered Ukraine a 30% discount on the gas price in return for a minimum 25-year extension of the lease for the Russian Black Sea Fleet at Sevastopol. This agreement underlined Russia's ability to use its energy influence in pursuit of foreign policy goals.

Belarus

Russia and Belarus have had a number of disputes in recent years over commercial arrangements for oil and gas deliveries. The opening of the Yamal–Europe pipeline across its territory in 1999 increased the importance of Belarus as a transit state for Gazprom, raising its capacity to 15% of European exports. Since 1993 Russia has used Minsk's dependency on gas through the regular threat of price increases, restrictions of supply and various debt-management solutions. The approach was similar to that used with Ukraine, except that Gazprom was able to secure a 50% stake in the Belarusian gas pipeline company Beltransgaz. In early 2007 Russia cut crude oil supplies to Belarus. In response, Belarus began siphoning oil destined for export along the northern spur of the Druzhba pipeline. The crisis caused considerable nervousness in countries reliant on the northern Druzhba route, including Poland and Germany. Twice in 2010 Russia cut off or reduced oil supplies to Belarus in disputes over prices and a debt of $187m to Russia. For its part, Belarus contended that Moscow owed it $260m in transit fees. Regular disputes with Belarus over oil transit arrangements also appear to have contributed to the decision to build a second Baltic Pipeline System.

Turkmenistan

An explosion in the pipeline supplying gas from Turkmenistan to Russia in 2009 significantly damaged relations between the two countries. Ashgabat blamed Gazprom for causing the explosion by reducing pressure in the pipeline, while Russian sources suggested that it was a result of decrepitude of the pipeline or Turkmenistani negligence. President Gurbanguly Berdymukhammedov resorted to blunt language towards Moscow and accused Gazprom of disseminating false information.[13] The explosion occurred against a backdrop of Russia being forced to pay much higher prices for Central Asian gas that it needed as 'top up' to meet its domestic and export commitments, which eliminated the hefty notional margin it earned on the export price for the same gas. By early 2009, with significant drops in demand in Ukraine and other markets, Gazprom no longer needed the same amount of gas from Turkmenistan. It seems more than a coincidence that a major pipeline explosion occurred at this time, resulting as it did in a sharp fall in gas exports from Turkmenistan to Russia – down to a third of anticipated volumes.

Russian gains?

The intractable nature of the regular disputes between Russia and Belarus shows that neither side is able to prevail because Russia depends on Belarus for gas transit and Belarus on Russia for supply. Belarus acquiesced in the sale of 50% of Beltransgaz to Gazprom, allowing the latter to reduce its financial and operational risks related to transit through Belarus. By contrast, Ukraine's parliament passed a law in 1995 preventing the sale of all oil and gas assets in response to an effort by Russia to form a joint venture company with Ukraine to manage the pipeline network. Yet this law did not prevent many of Ukraine's oil-refining assets from coming under Russian control. In 2004, Russia was also able to persuade Ukraine to reverse the flow of the Brody–Odessa pipeline, which became an additional outlet for Russian exports to reach the Mediterranean via the Black Sea. In 2010 Ukraine reversed the flow again, this time to carry Venezuelan oil to Belarus, part of Minsk's efforts to reduce its dependence on crude oil imports from Russia. Although Russia seems to be less interested in acquiring a stake in Ukraine's pipeline system, probably because of its apparent commitment to the South Stream project, the idea of a merger between Ukraine's state gas company Naftohaz and Gazprom was mooted in 2010. Ukraine's government has so far been lukewarm to this idea but has noted that Russia still wants access to the management of Ukraine's pipelines. This appears to be part of an effort by Russia to reduce further transit-associated risks but it represents an important red line for Ukraine since Russian control of its gas pipelines would have profound political and strategic consequences.

However, the April 2010 gas accords and the overall state of Russian–Ukrainian relations mean that Moscow has, for the moment, much less reason to be concerned about erratic behaviour on the part of Kyiv. If transit dependency on Ukraine is removed, Russia will potentially have much greater influence over Ukraine as a result of its at least short-term reliance on Russian gas.

An important distinction should be made between Ukraine and Belarus. Ukraine is potentially less dependent on Russia by virtue of its own resources that it has so far failed to develop on a significant scale. Russia has an interest in preserving the status quo. The situation is not always easy to read since resistance to reform of the energy sector by Ukrainian players may be motivated more by their desire to preserve their position than to further Russian interests.

While Russia may be well placed to sustain and probably increase its influence on Ukraine by using energy relations, the reverse is true of Turkmenistan. With reputedly the world's fourth largest gas reserves, it is becoming an increasingly important player as a result of its ability to break out of a Russian stranglehold over its main export route and build a pipeline to supply China directly. Opened in December 2009 and set to supply 40 billion cubic metres a year to the Chinese market, the new

13 Cited in 'Pipeline Explosion Raises Tensions Between Turkmenistan, Russia', Radio Free Europe/Radio Liberty, 19 April 2009.

pipeline will have double the capacity of Turkmenistan's export route to Iran once the latter is expanded. Pipeline capacity to Russia has been up to 70 billion cubic metres. In geopolitical terms, there are grounds to believe that Russia's position in Turkmenistan is being reduced. While it is unclear whether Turkmenistan will be able to deliver gas through a 'fourth corridor' to Europe via the Caspian, perhaps Nabucco, a significant shift has taken place as a result of China's energy needs and its vigorous diplomacy to satisfy them. Russian influence has not been sufficient to counter this. In the case of the Central Asia–China pipeline, China has also demonstrated its ability to devote large-scale financial and human resources to major priority projects.

Energy relations as means of achieving economic and political influence

Over the past ten years, while Russia's leaders have been less successful at influencing EU energy policy than they would have liked, their efforts with individual countries such as Germany and Italy have been amply rewarded. The ongoing construction of the Nord Stream pipeline, despite several obstacles, and the current efforts to mobilize support for the South Stream pipeline are cases in point. Putin was able to recruit former German Chancellor Schröder to become Chairman of Nord Stream's shareholders' committee. Just weeks before Schröder left office in 2005, the German government had agreed $1bn worth of loan guarantees for the project. Both in Germany and abroad, Schröder's decision caused controversy because of a perceived conflict of interest. He had developed a close relationship with Putin, and in late 2004 famously said that he was convinced that Putin was a 'flawless democrat' and would make Russia into an 'orderly' democracy.[14]

This endorsement of Putin's leadership occurred weeks before the expropriation of Yukos' main producing asset, Yuganskneftegaz, which was sold by auction to a company fronting for the state company, Rosneft. This symbolized Russia's move towards sharply increased state control of the energy sector at the cost of damage to its investment environment through selective disregard for property rights. The lesson for Putin, the chief architect and hands-on manager of Russia's energy diplomacy, was that Russia was now in a position to buy the services of former Western politicians whose support could be valuable.

Schröder's political lobbying efforts within the EU, helped by former Finnish prime minister Paavo Lipponen, allowed Nord Stream to clear important hurdles set by environmental authorities in Denmark, Finland and Sweden and paved the way for construction of the pipeline to begin in 2010. In parallel, Putin personally conducted intense politically lobbying in support of South Stream that led to the conclusion of intergovernmental agreements with Austria, Bulgaria, Croatia, Greece, Hungary, Serbia and Slovenia between 2008 and 2010. Gazprom signed bilateral agreements in support of the project with national gas companies in a number of these countries, and while such agreements are not binding, they have made South Stream start to look less like a 'virtual project', as one commentator suggested.[15] However, its commercial underpinning remained highly questionable beyond a desire on the part of Gazprom to create a mechanism for guaranteeing demand for its gas by involving major European companies ENI and EDF as project participants.

Russia's ability to keep Bulgarian support for the project is noteworthy. Bulgaria originally signed up to South Stream in 2008 under a socialist government that was sympathetic to Moscow, but a new centre-right government came to power in 2009 and pledged to review energy projects with Russia. Meanwhile, Russia wooed Romania as an alternative to Bulgaria and apparently later dangled the carrot of a 5–7% reduction in gas prices for Bulgaria ahead of the renewal of its long-term contract with Gazprom in 2012 if it pledged renewed commitment to the project. Ultimately, Moscow was successful and in November 2010 the Bulgarian government put aside its reservations and signed a number of project agreements.

Private sources say that Russia played a very effective diplomatic game with Romania; it succeeded in persuading the Romanian gas company Transgaz to sign a preliminary agreement of intent to study the feasibility of Romania

14 *Hamburger Abendblatt*, 23 November 2004.

15 Vladimir Socor, 'Croatia Joins Gazprom's South Stream Project', *Eurasia Daily Monitor*, vol. 7, issue 44, The Jamestown Foundation, 5 March 2010.

joining the South Stream project. Romania is not renowned for sympathy to Russia and President Traian Basescu has been a staunch advocate of US interests in the region and a strong supporter of the Nabucco project. Nevertheless, Russia has access to powerful networks in Romania and apparently has the ability to lobby effectively and exploit differences within a government. Private Romanian sources indicate that Russian-controlled companies in Romania's metals industry benefit from artificially low prices for electricity. Romania provides an excellent example of what Russia's energy diplomacy can achieve despite the lack of a clearly pro-Russian lobby in the country.

Russia's strong political relationships in Hungary appear to have played a role in the Gyurcsány government (2004–09) becoming one of the first to support the South Stream project in 2007 against the wishes of the Hungarian energy company MOL. The government was widely believed to have close links with Russian energy companies. There has been further controversy in Hungary around the efforts by Surgutneftegaz, one of Russia's most secretive oil companies, to acquire a 21% shareholding in MOL. Surgut acquired the stake from OMV after a hostile takeover bid by the Austrian company failed. Neither MOL nor the Hungarian government was forewarned of the purchase of the stake by Surgut, leaving the CEO of MOL publicly stating that the move could not be friendly.

The fear in the company was that Surgut would try to increase its stake and become a strategic investor in MOL. Surgut has so far been unable to register its shareholding in MOL pending a case in a Budapest court examining the legality of MOL's refusal to enter the stake in the company's register and give Surgut voting power in shareholders' meetings as well as board representation. Although MOL can technically re-purchase the stake, its straitened financial circumstances may not allow it to do so in the short term. The case poses an intriguing test in that Hungary's energy regulator requires companies to disclose ownership details. Surgut's ownership structure is non-transparent and rumoured to be closely connected with senior political leaders. It is Russia's fourth largest oil company, and seemingly a quasi-state company despite its 'private' ownership. MOL may be a tempting target for a Russian company given its participation in the Nabucco project opposed by Russia and its stakes in businesses in several countries across Central and Eastern Europe.

With the second Baltic Pipeline System line (BPS-2) now complete and expected to come on-stream in 2011, Russia has an enlarged bypass capacity to take crude export volumes out of the Druzhba pipeline system and export them to international markets via the Baltic Sea. In the process it has created leverage to acquire refinery assets in countries dependent on the Druzhba for Urals blend crude. Rosneft recently acquired a 50% stake in the German company Ruhr Oel from the Venezuelan company PDVSA, with which Rosneft enjoys a close relationship.

There is also renewed interest in Lotos Group assets in Poland, notably the Gdansk refinery. Lukoil tried on previous occasions to acquire a stake in the Gdansk refinery but its efforts caused an allergic reaction in Polish political circles, not least because its chief lobbyist in Poland was apparently a former KGB officer. Some industry insiders say that Lukoil behaved 'like a bull in a china shop' as it tried to win political support for its bid. It failed for several reasons, not least because of concern in Polish government circles about letting a Russian company with allegedly close links to the Kremlin take over a strategic asset. Nevertheless, in the context of a 'reset' in Polish–Russian relations, Russia's capabilities in Poland should not be discounted on this occasion.

The European Commission issued a stern warning to Warsaw in October 2010 over the signing of a long-term gas contract between the Polish gas company PGNIG and Gazprom since the terms of the contract preventing re-export of gas delivered to Poland were not consistent with EU legislation. Prime Minister Pawlak reportedly did not question Gazprom's terms until the country's foreign minister referred the draft text to the European Commission for review.[16] The Commission has included other conditions on the operation of the Yamal pipeline jointly owned by Gazprom that runs through Poland, to ensure non-discriminatory access arrangements. It is also expected that the pipeline operator will install additional compressors that will allow the pipeline to be used in reverse in case supplies need to be transported from west to east.

16 Judy Dempsey, 'Europe seeks to block polish gas contract', *New York Times*, 10 October 2010.

As in Poland, Lukoil tried hard to curry political favour in Lithuania with a view to buying a significant stake in the Mazeikiu refinery. A Lukoil-related entity made financial contributions to Lithuania's Social Democratic Party, which had close connections with Russia. The party stayed in power until 2008 although it was another Russian company, Yukos, that took over the stake of a US company, Williams, at Mazeikiu in 2001. Former president and next prime minister Algirdas Brazauskas, who was rumoured to have close links with Lukoil, tried to delay the takeover as Lukoil made frantic last-minute efforts to offer better terms. In the event, Williams refused to negotiate further with Lukoil. The crude supply problems to the refinery that had bedevilled it during the years of Williams' ownership (1999–2001) were immediately resolved once Yukos took over management of the refinery. Interestingly, Lithuanian sources familiar with the sector say that Yukos did not behave like a Russian company in Lithuania since it used a transparent PR approach. As one Lithuanian observer put it, 'Yukos behaved like a Western company. They succeeded in washing out the Russian smell.' In 2006, when the refinery was again on the market, there was clear concern on the part of Lithuania's conservative opposition that the sale of the stake to another Russian company could bring back non-transparent business practices to a very important part of the Lithuanian economy and that this would not be a welcome development since it would potentially poison politics and encourage corruption.

The Czech counterintelligence service warned in June 2010 that Russian industrial espionage was growing aggressively in the country's energy sector.[17] It drew attention to a phenomenon that had also been spotted in Germany and Austria a few years earlier: the use of shell companies to disguise Russian control of business interests. In the Czech Republic, Vemex, a gas trading company selling Russian gas, controlled 12% of the Czech domestic market. On the surface a Czech company, it is apparently controlled by Gazprom operating through layers of companies based in Austria, Germany and Switzerland. One of the intermediaries includes Centrex Europe Energy and Gas, headquartered in Vienna, which, according to a 2007 report by the German magazine *Stern*,[18] leads Gazprom's efforts to penetrate the West European downstream market. The report noted that the structures used by Gazprom, in this case through subsidiaries in Austria and Cyprus, allow it to conceal financial flows from Western shareholders in Gazprom.

'The Czech counterintelligence service warned in June 2010 that Russian industrial espionage was growing aggressively in the country's energy sector'

In a further example of Russian influence in the Czech Republic, a prominent left-wing political leader is reported by other sources to have received funding for a new political party from 'Russian-connected lobbyists',[19] including Lukoil's chief lobbyist in the Czech Republic. There is also evidence that a shell company, probably of Russian provenance, was the sole bidder in 2009 for a $80 million project to build a new spent fuel storage facility at the Temelin nuclear power plant in the Czech Republic. Some observers noted that a similar facility had been built in Germany for half the price, raising questions about whether the inflated bid was required to deliver pay-offs to related parties.

A notable success of Russia's energy diplomacy was Gazprom Neft's acquisition in December 2008 of a 51% stake in the Serbian oil conglomerate NIS. The stake was sold for $400 million after a Deloitte & Touche analysis in 2008 valued the company at $2.2bn. It is believed that the heavily discounted price reflected Serbia's gratitude for

17 'Czechs say Russian spies targeting energy sector', Reuters, 23 June 2010.

18 Hans-Martin Tillack, 'Die Gazoviki, das Geld und die Gier', *Stern*, 22 September 2007.

19 Gregory Feifer and Brian Whitmore, 'Czech Power Games: How Russia is Rebuilding Influence In the Former Soviet Bloc', Radio Free Europe/Radio Liberty, 25 September 2010.

Russia's opposition to the independence of Kosovo[20] as well as an expectation that a section of the South Stream pipeline would pass through Serbia. Serbia is an important country for Russian diplomacy. If it joins the EU, its pro-Russian orientation could give Moscow an important additional bilateral relationship for influencing Brussels.

In the most detailed piece of research published so far on the subject of gas-related Russian shell companies in Europe, the late Roman Kupchinsky concludes that 'the existence of dozens of non-transparent "gas trading" companies established throughout Europe by ... Gazprom, constitutes a serious threat to the energy security of the European Union'.[21] He presents evidence to show that some of these companies have been linked to organized crime and are suspected of laundering vast sums of money for the benefit of Russian and Ukrainian officials, among others. There is a clear implication in Kupchinsky's report that some of the proceeds may have been used to buy influence in western Europe, although no supporting evidence is provided. Kupchinsky nevertheless points to the fact that through an elaborate network of shell companies 'hundreds of millions, if not billions, of dollars seem to have been quietly funnelled back to Russia via Cyprus and other off-shore jurisdictions'. He rightly observes that it is unclear who benefits from the 'use of multiple shell companies whose only role appears to be money laundering'.

RosUkrEnergo, the intermediary used to sell 'Turkmen' gas from Russia to Ukraine between 2004 and 2009, is a classic example of the remarkable degree of non-transparency in commercial relations between two state companies, Gazprom and Naftohaz. Gazprom owned 50% of the 'trading company' through Gazprombank initially via an Austrian company called ArosGas Holding AG, while the Ukrainian shareholding was owned by a second Austrian company, CentraGas Holding AG, a subsidiary of the Austrian group Raiffeisen Investment. The Ukrainian owners turned out to be businessmen who had no obvious connection to Naftohaz. The Ukrainian and Russian sides both said that the other wanted to use the RosUkrEnergo vehicle and neither admitted being responsible for creating the company. It has been reported in Russia that the Russian interest in the company was managed by individuals close to Dmitry Medvedev, including Konstantin Chuychenko, allegedly a former KGB officer who headed Gazprom's legal department before moving to a position in the presidential administration after Medvedev's election in 2008.

When the company was established in 2004, President Putin and his Ukrainian counterpart, Leonid Kuchma, hailed the company as 'totally transparent'. It was not and appears never intended to have been. It is far more likely that it was a mechanism for ensuring Ukraine's continued interest in maintaining disproportionate dependency on Russia for supplying its gas needs, although the Ukrainian owners could claim that they were protecting Ukrainian interests – albeit of an opaque and undefined nature. Oleksandr Turchynov, head of the Ukrainian Security Service, launched an investigation in June 2005 into RosUkrEnergo and its predecessor Eural Trans Gas, believing that the middleman structure posed a serious threat to Ukraine's energy security. He was reportedly told by President Yushchenko that by undertaking the investigation the Security Service was 'working against his team'. The investigation was later halted. The issue was a battleground in the wider political struggle between Yushchenko and Prime Minister Tymoshenko who campaigned for the removal of the controversial intermediary.[22]

There was speculation that the dispute between Russia and Ukraine had not been just about gas prices, as suggested, but also about who would earn more from the re-export of gas to Europe. While that cannot be proved at this stage, it is nevertheless clear that the existence of this mechanism at the very least did not encourage Ukrainian decision-makers to reform the country's gas sector and take urgently needed measures to reduce dependency on Russia through a combination of developing indigenous production and reducing the energy intensiveness of Ukraine's industry. These failures cost the country dearly and allowed it to play into Russia's hands. Through RosUkrEnergo Russia found an effective instrument for influencing parts of Ukraine's leadership and helping to split the 'Orange' coalition.

20 Russia undermined its commitment to the non-recognition of the independence of Kosovo by recognizing the independence of Abkhazia and South Ossetia in 2010, a move that caused surprise and disappointment in Serbian political circles.

21 *Gazprom's European Web*, report published by The Jamestown Foundation, February 2009.

22 RosUkrEnergo was eventually removed from the Russian–Ukrainian gas trade after the 2009 gas crisis.

Conclusion

Russia exerts considerable influence by virtue of its different policies designed to exploit the value of its energy resources and its energy industry. This influence takes different forms on a sliding scale from 'soft' to 'hard'. Russia has consolidated a position for itself at the top international tables and developed strong links with influential European countries such as France, Germany and Italy by using its role as a major supplier to foreign energy markets. Several Western companies are prepared to play the long game with Russia, believing that it will be forced at a later stage to open up its energy sector to them. Russia's rejection of the Energy Charter Treaty in 2009 suggests the contrary, however; it implies that it does not wish to be bound by international rules and principles designed to protect the investments of resource holders and importers as well as the transit of energy flows. So far the model promoted by Moscow of upstream/downstream swaps and joint venture companies has not developed on a significant scale, although the recent abortive deal between Rosneft and BP based on a share swap and joint venture may herald a model for future cooperation between Russian oil and gas companies and international partners.

Russia uses energy relations to influence the countries in its neighbourhood. The shared oil and gas pipeline system inherited from the USSR gives it important advantages, for example over some of the Caspian countries. Russia also has the ability to 'spoil' a deal on the delimitation and other issues related to the Caspian Sea that could be the basis for a new large-scale pipeline route to Western markets from Turkmenistan.

In relations with Europe, the situation in 2011 looks very different from that of 2008. Russian influence appears to have peaked and changing market conditions are the principal reason why energy exports to the EU are unlikely to remain such a major source of leverage. This situation is also partly of Moscow's making. Its insensitive treatment of European customers during the gas crises with Ukraine, together with its poorly chosen rhetoric and its rough treatment of investors such as Shell and BP, has reinforced the impression that Russia's energy sector is a perilous place to operate in and that energy partnerships with Russia are much less attractive in reality than in theory. Competitive pressures on Gazprom in Europe, combined with the expected raising of netbacks from domestic sales to European levels over the coming years, mean that domestic sales will reduce commercial imperatives to extract value from foreign markets and may create a new set of dilemmas for Gazprom's managers around how to reconcile commercial and political objectives set for the company by the state.

Russia is now looking at developing an integrated energy transportation corridor to China and the Asia-Pacific markets. This is logical, given the anticipated demand for Russian hydrocarbons in Asia. However, it is not clear that pipeline gas deliveries to China will be started in the near future because of Moscow's apparent caution about making itself dependent on the Chinese market. It is by no means certain that by using energy Russia can achieve in Asia the same levels of influence that it generated in Europe. This is not least because there is no certainty around the volumes of hydrocarbons that it can bring to market and no guarantee that Moscow can replicate the same level of political relationships with key importers that have helped cement its position in the European market. To supply the Asia-Pacific region on a significant scale also presupposes extensive development of the East Siberian resource base and construction of costly major infrastructure. Although this has started, major investments still need to be made. These will place considerable financial and technological burdens on Russian companies.

The export of non-transparent business practices and the exploitation of networks in CIS and central European countries are likely to continue. However, in Central Europe these are declining assets, offset by generational change and the demands of EU regulators. In CIS countries, Russian influence will last longer, although it has started to decline in Turkmenistan. If Ukraine and other western CIS countries eventually reform their domestic gas markets in line with the EU *acquis*, some of Gazprom's influence will be blunted.[23] However, Russian inducements

23 Ukraine joined the Energy Community on 1 February 2011.

such as the low gas price for Ukraine may help to ensure that the reforms required in these markets are delayed or do not take place.

Russia's energy diplomacy is frequently effective because of its persistence and the fact that the prime minister and president are personally involved. This investment of time and effort at the highest level is rarely replicated by other foreign leaders. They also fail to appreciate the integrated thinking of their Russian counterparts, which weaves together elements of energy policy with other policies and interests. This is one case where the so-called 'vertical' of power in Russia can operate effectively.

While Russia has developed much stronger energy influence in the CIS than it has elsewhere, it could have had far greater impact beyond the CIS too had it acted differently. If, instead of breaking up Yukos, it had embarked on a path of international asset swaps based on a liberalized Russian energy sector, the picture would have been very different. The state capitalism model founded on unreformed national champions, monopoly control of infrastructure and arbitrary treatment of smaller players has created instead a dynamic that has undermined trust and occasionally accentuated unattractive elements in Russia's approach to dealing with the West. This may change over time since there are increasingly compelling reasons why Russia needs to run its energy sector along more efficient lines with greater foreign involvement and in keeping with international rules. If it can do so, it might develop a qualitatively different energy-based influence across a much wider area than the CIS.

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The Means and Ends of Russian Influence Abroad

This paper is part of a research project run by the Chatham House Russia and Eurasia Programme which examines the mechanisms that Russia has devised to influence and attract countries in the 'Common Neighbourhood', Western Europe and the US. Papers in this series include:

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