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# The evolution of energy relations between Europe and Russia from the 1960s to the present

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## Abstract

Il ruolo delle risorse naturali, petrolio e gas in particolare, occupa un posto centrale nel contesto delle relazioni internazionali.

Le forniture energetiche russe verso i paesi europei hanno assunto un'importanza sempre maggiore per entrambi i lati, in quanto ad oggi la Russia rappresenta il principale esportatore di gas verso l'Unione Europea, la quale a sua volta è il maggiore partner energetico della Russia. La reciproca dipendenza dal commercio degli idrocarburi è diventata fonte di grande preoccupazione per i leader europei e per il governo russo.

Per meglio comprendere le dinamiche dello sviluppo degli export energetici e il loro attuale ruolo nella politica internazionale, è necessario esaminare l'evoluzione della cooperazione energetica tra Europa e Russia.

L'evoluzione delle relazioni energetiche tra Europa e Russia può essere suddivisa in tre fasi. Essendo nato in un periodo di acute tensioni tra il campo sovietico e quello occidentale, il commercio energetico Euro-Sovietico è stato condizionato e complicato dagli antagonismi della Guerra Fredda. La cooperazione nella sfera dell'energia tra i paesi Europei e l'Unione Sovietica iniziò tra la fine degli anni '50 e i primi anni '60, quando importanti giacimenti di petrolio e gas furono scoperti in Siberia. La scarsità di risorse naturali in una situazione di crescente richiesta obbligò i paesi europei ad accrescere le importazioni energetiche. L'Unione Sovietica considerò la possibilità di esportare le proprie risorse energetiche verso i paesi dell'Europa Occidentale come particolarmente vantaggiosa.

La cooperazione energetica tra Europa Occidentale e Unione Sovietica fu accolta con diffidenza dagli Stati Uniti, i quali affermarono che gli export energetici avrebbero potuto essere usati

come un'arma per esercitare pressioni politiche e di conseguenza tentarono di impedire la stipulazione dei contratti anche durante i periodi di distensione. Tuttavia, i rifornimenti sovietici non vennero mai usati come un'arma di ricatto politico.

Questo periodo ebbe fine all'inizio degli anni '90 con il collasso dell'Unione Sovietica e la trasformazione dell'equilibrio politico internazionale. Di fronte ad una Russia indebolita, gli ostacoli politici alla cooperazione energetica diminuirono. Il vuoto politico nello spazio ex-Sovietico negli anni '90 attirò gli Stati Uniti e alcuni paesi dell'Europa Occidentale, desiderosi di espandere la propria influenza nella regione. Considerando la riluttanza russa a lasciare che tali territori passassero sotto la sfera d'influenza americana, diversi studiosi hanno dato un'interpretazione politica ai blocchi all'esportazione verificatisi in questo periodo.

Un terzo periodo ebbe inizio nei primi anni 2000, quando i cambiamenti nella politica interna Russa e nella politica internazionale diedero vita a nuove relazioni energetiche a livello geopolitico e all'interno del paese. La guerra in Iraq obbligò gli Stati Uniti a focalizzare la propria attenzione sul Medio Oriente. Questo evento e il significativo incremento del prezzo del petrolio, in parte provocato dal conflitto, diede modo alla Russia di rafforzarsi politicamente ed economicamente, consolidando la propria influenza in zone strategiche dello spazio ex-Sovietico.

I dibattiti sul tema dell'energia tra la Russia e i paesi di transito divennero più accesi, diventando anche tema di un controverso confronto mediatico.

Alcune fonti giornalistiche hanno accusato la Russia per le cosiddette "guerre del gas e del petrolio" con i paesi di transito, affermando che le interruzioni nell'erogazione di petrolio e gas sono state usate come una misura di pressione politica. Diversi ricercatori russi hanno invece accusato gli Stati Uniti di aver orchestrato i conflitti energetici in quei paesi al fine di

guadagnare il supporto Europeo per la creazione di oleodotti e gasdotti alternativi, che consentirebbero di aggirare il territorio russo. L'analisi di questi materiali ci ha permesso di identificare le ragioni economiche e politiche dei conflitti energetici. Ciononostante, riteniamo che le ragioni principali siano di natura economica.

Sia la Bielorussia che l'Ucraina soffrivano per la stagnazione economica e faticavano pagare gli import energetici a prezzo di mercato, in particolar modo dopo la crescita del prezzo del petrolio nei primi anni 2000. Il governo Russo forniva idrocarburi a prezzi ridotti per i paesi della CSI fino al 2006, senza badare a ritardi nei pagamenti, in cambio di una politica filo-russa e alcune concessioni.

I pagamenti monetari erano parzialmente sostituiti da una politica di integrazione con la Russia. Altre forme di pagamento indiretto per le forniture energetiche erano rappresentate dalla partecipazione russa nelle compagnie per il trasporto di gas e petrolio, così come dal prolungamento del contratto d'affitto della base navale di Sebastopoli. Quando tali condizioni furono più soddisfatte, pur continuando a non pagare le risorse a prezzo di mercato, le forniture furono interrotti.

Per quanto riguarda le conseguenze di tali conflitti energetici, è possibile affermare con certezza solamente che i dibattiti influenzarono negativamente l'immagine della Russia come esportatore energetico affidabile e spinsero i paesi europei a diversificare le proprie fonti.

In risposta a tali conflitti con i paesi di transito, tre progetti furono sviluppati da parte russa per aggirare Ucraina e Bielorussia. Nord Stream, un gasdotto offshore per raggiungere la Germania attraverso il Mar Baltico, è stato inaugurato nel Maggio 2011. Il progetto ha sollevato alcune resistenze nei paesi dell'Unione Europea in quanto potrebbe incrementare la dipendenza dell'Europa dalle forniture di gas russo. Gli altri due progetti, Blue Stream e South Stream, sono

stati progettati per competere con il gasdotto Nabucco, proposto da alcuni paesi europei con l'appoggio degli Stati Uniti per trasportare le risorse del Mar Caspio in Europa.

La costruzione dei gasdotti Nord Stream e South Stream renderebbero più affidabili le forniture russe verso l'Europa. Inoltre, l'acquisizione di Beltransgaz, la compagnia nazionale bielorusa per il trasporto del gas, da parte di Gazprom nel 2010 ha reso possibile per garantire la sicurezza del transito del gas russo attraverso il paese. Per quanto riguarda l'esportazione di petrolio, il Baltic Pipeline System è stato completato nel 2011 e le prime forniture di petrolio hanno iniziato ad arrivare nel Marzo 2012.

Di conseguenza, nonostante alcuni recenti confronti con l'Ucraina riguardo il prezzo del gas, il problema dei paesi di transito è stato risolto.

Gli Stati Uniti hanno giocato un ruolo importante nell'evoluzione dei rapporti energetici tra Russia ed Europa. Avendo interessi strategici nella regione del Caspio e in Asia Centrale, il governo americano ha supportato i progetti alternativi alle condutture russe verso l'Europa. Uno dei progetti più controversi è il gasdotto Trans-Caspico. Una volta completato, il gasdotto collegherebbe Turkmenistan e Azerbaijan, portando il gas turkmeno in Europa attraverso Georgia e Turchia. Sollevando dubbi sullo status legale delle risorse del Caspio, il governo russo si è opposto al gasdotto per minare la fiducia europea nel progetto Nabucco e offrire South Stream come alternativa.

Le "rivoluzioni colorate" nello spazio ex-sovietico sono state fortemente supportate e, secondo alcuni ricercatori, orchestrate dagli Stati Uniti. La rivoluzione delle rose in Georgia del 2003 ha portato ad un allineamento filo-americano del paese e ha aperto la strada a diversi progetti di trasporto energetico.

Nonostante negli anni 2000 la dipendenza europea dalle forniture russe di idrocarburi sia divenuta in Europa fonte di preoccupazione a causa delle crisi riguardanti i paesi di transito, i dati raccolti provano il perdurare di una forte interdipendenza tra Europa e Russia in materia di commercio energetico. In particolare, le entrate statali russe sono strettamente dipendenti dall'esportazione di idrocarburi, di conseguenza ogni blocco del flusso di idrocarburi verso l'Europa è da considerarsi come un'arma a doppio taglio.

Consapevole di questa dipendenza, il governo russo ha tentato di diversificare i propri export energetici nella seconda metà degli anni 2000. La East Siberia Pacific Ocean (ESPO) Pipeline è in grado di trasportare il petrolio russo in Cina, Giappone, Corea del Sud e Stati Uniti. Nonostante questo, il volume delle esportazioni russe verso i mercati asiatici è incomparabile con quello del commercio Euro-Russo. Per quanto riguarda l'Europa, i progetti di gasdotti alternativi supportati dagli Stati Uniti e quelli per l'utilizzo del gas derivante da scisti bituminosi non sembrano poter competere con le forniture russe al punto da poter rivoluzionare il mercato energetico nel breve termine. In una prospettiva a lungo termine, siamo portati a credere che i paesi europei continueranno di diversificare le proprie fonti mentre la Russia tenterà di consolidare la propria posizione nel mercato energetico dell'Asia Centrale. Le relazioni energetiche tra Russia ed Europa continueranno ad essere caratterizzate, seppur in misura minore, dall'interdipendenza.

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## Introduction

At present, the debate over the role of natural resources, in particular oil and gas, occupies a central place in the context of international relations.

As the world's top hydrocarbon reserves are concentrated in a limited number of areas in the Arabian Peninsula, Venezuela, North America and Russia, oil and gas exports have a considerable impact on shaping the international conjuncture and balance of power. Thus, the construction and control of pivotal energy routes have become primary geopolitical objectives as much as the consolidation of political influence in the areas of production.

Russia is the world's second oil and gas producer, the world's second oil exporter and the largest gas exporter<sup>1</sup>. The Russian energy supplies to the European countries assumed a paramount importance for both sides, as at present Russia became the biggest oil and gas importer to the European Union<sup>2</sup>, which is the largest energy trade partner of Russia<sup>3</sup>. The mutual dependence on energy exports became a source of great concern for European leaders and the Russian government. Recently these countries sought to diversify their suppliers or customers, creating new energy routes to alternative energy markets. The recent debates over the reasonability of new pipelines and the competition between Russian and European projects for an access to the Caspian resources make unclear the perspectives of Europe-Russia energy cooperation. A detailed analysis of evolution of energy relations between Europe and Russia would allow examining not only the current state of energy trade in the context of international relations but evaluate the possible long-term effects of the cooperation as well.

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<sup>1</sup> CIA, The World Factbook. Web. Retrieved from:<https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>

<sup>2</sup> Energy from abroad. EU-Russia energy relations. Web. European Commission. Retrieved from:[http://ec.europa.eu/energy/international/bilateral\\_cooperation/russia/russia\\_en.htm](http://ec.europa.eu/energy/international/bilateral_cooperation/russia/russia_en.htm)

<sup>3</sup> Energy from abroad. EU-Russia energy relations. Web, European Commission. Retrieved from:[http://ec.europa.eu/energy/international/russia/russia\\_en.htm](http://ec.europa.eu/energy/international/russia/russia_en.htm)

To understand better the dynamics of energy exports development and their current role in international politics, it is important to examine the beginning of the Europe-Russia energy relations, which root in early 1960s. Then it is necessary to analyze the evolution of the relations between the sides in order to estimate the current impact of the relations and overview the perspectives. The historical-political context of the trade evolution should be assessed as well.

The aim of this work is to examine the evolution of Europe-Russia energy relations. In view of this, the following objectives were set:

- Analyze the historical context of the energy cooperation and define how international relations and foreign policy influenced its evolution;
- Examine the energy cooperation between the Soviet Union and Europe and identify the characteristics common to USSR-Europe and Russia-Europe energy relations;
- Estimate the benefits and obstacles for the energy cooperation at present and assess possible solutions;
- Analyze the influence of the transit countries debates on the Russian energy exports to Europe;
- Evaluate the role of third countries in Europe-Russia energy relations and summarize the impact of the United States' foreign policy initiatives in the region;
- Appraise the level of EU's dependence on Russia's energy exports;
- Examine the impact of new energy routes creation on Europe-Russia energy cooperation;
- Overview the future possibilities of energy relations between Europe and Russia.

The subject of this dissertation is the energy cooperation between Russia and Europe while the object are different studies, statistical reports, databases, researches and articles connected to the topic.

The chronological frames chosen allow taking a holistic approach and analyzing thoroughly the evolution of Europe-Russia energy relations from their beginning to the present.

The thesis sources could be divided in six large groups:

- 1) Researches, reports and articles covering different aspects and periods of the history of Europe-Russia energy relations. The researches of Professor J. Stern, Director of Gas Research at the Oxford Institute for Energy Studies, deserved special attention. Professor Stern examined different periods of Russian- European energy relations. Some of his works have been published before the USSR breakup, others more recently. In his papers a very detailed analysis of contracts including prices and volumes interpretation was performed. For example, in his work “Soviet oil and gas exports to the West”<sup>4</sup>, Stern examined the volumes of Soviet energy exports to Europe, the Soviet energy exports earnings and the dynamics of changing prices. Reviewing the energy contracts concluded, he gave his interpretation of the obstacles and benefits of the cooperation. This group includes works of other scholars, such as M. Slavkina<sup>5</sup>, who dedicated her papers to the development of Russian oil and gas sector in 1960s – 1980s and examined the evolution of USSR’s hydrocarbons exports to Western Europe. Researchers M.Chadwick, D.Long and M. Nissake<sup>6</sup> studied the Soviet oil exports, focusing more on

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<sup>4</sup> J.P.Stern, *Soviet oil and gas exports to the West*, Aldershot:Gower Publishing Company, 1987,p. 123.

<sup>5</sup> ; M.Slavkina, *Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1991гг* [*Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991*], Moscow, 2007

<sup>6</sup> M.Chadwick, *Soviet oil exports: trade adjustments, refining constraints and market behavior*, Oxford Institute for Energy Studies, 1987; David Long, ‘Soviet oil exports and marketing strategies’, *Soviet oil exports:trade*

economic analysis. These studies allow us to compare the volume of natural oil, produced in different regions of the USSR, and delivered to Western Europe in view of different economic indexes.

Several researches cover the period after the USSR collapse. The work “Russian energy power and foreign relations”, composed of articles of different authors, examines Russia’s role in the international energy market. The research of S. Casertano “Sfida all’ultimo barile” and S. Furfari’s paper “Le Monde et L’Energie. Enjeux geopolitiques”<sup>7</sup> analyze energy relations and new gas and oil routes in the context of geopolitics. N. and D. Victor, N. Dobronravin , O. Margania and V. Punushkin, M.Zigar<sup>8</sup>, assess the role of Russian gas in the European market and the connection between Europe’s energy relations and Russian and European foreign policy.

Furthermore, there are particular researches and articles dedicated to very specific aspects of Europe-Russia energy relations. A good example is the paper of K.Demidova “The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency”.<sup>9</sup>

Different articles from Foreign Affairs magazine, Petroleum Economist, Middle East Economic Digest and other journals were examined as well in this paper.

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*adjustments, refining constraints and market behaviour*,1987, Oxford Institute for Energy Studies; Machiko Nissake, ‘Soviet Oil Exports in 1985-6’, *Soviet oil exports:trade adjustments, refining constraints and market behaviour*,1987, Oxford Institute for Energy Studies.

<sup>7</sup> S.Casertano, *Sfida all’ultimo barile. Russia e Stati Uniti per il dominio dell’energia*,Milano:Francesco Briosci Editore, 2009; S.Furfari, *Le Monde et L’Energie Enjeux geopolitiques*,Paris:Editions TECHNIP,2007.

<sup>8</sup> N. Victor, D.Victor, ‘Bypassing Ukraine: exporting Russian gas to Poland and Germany’, *Natural gas and geopolitics. From 1970 to 2040*,Cambridge: Cambridge University Press, 2006; N.Dobronravin, ‘ Нефть, газ и транспортное проклятие: Казахстан, Туркменистан, Азербайджан [Oil, gas and transportation curse: Kazakhstan, Turkmenistan, Azerbaijan]”, *Oil, gas, social modernization*, Moscow: HSE(The National Research University Higher School of Economics) Omega-L, 2010; V.Panushkin, V.Zigar, *Газпром: Новое русское оружие[Gazprom: The new Russian weapon]*, Moscow: Zaharov, 2008.

<sup>9</sup> K.Demidova, *The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency*, Florence: European University Institute.

- 2) Researches, reports and articles covering different periods and aspects of international relations' history. Undoubtedly, the work of E. Di Nolfo "Storia delle relazioni internazionali"<sup>10</sup>, covering the international political events from 1918 to present, is a particularly detailed and comprehensive research. The works of G. Breslauer, A.Graziosi, S. Kotkin, D.Reynolds , V. Shestakov<sup>11</sup> and other scholars provided deep analysis of different periods of the Soviet Union and Russian history. V. Halliday, M.Leffler, G.Lundestad<sup>12</sup> dedicated their works to the Cold War history. Other authors, such as A.Ferrari (history of Caucasus) or A.Rashid (Taliban's rule and oil supplies)<sup>13</sup>, examined thoroughly specific aspects and periods of the international history.
- 3) Databases, statistical reports, laws and official documents. The legal base and official documents of the European Union, Russia Federation, Ukraine, Belarus and other countries were used in this thesis. The author analyzed as well World Bank and United Nations data on GDP per capita and on the world oil prices. Furthermore, the official statistics of the USSR import and export allowed examining the energy cooperation in the Cold War period.
- 4) First-source mass media material, providing the factual basis for recent events, connected to some developments of Europe-Russia energy cooperation. This group contains mostly articles from International and Russian printed media, which had not still become an object of specific scientific research. Among them, there are reports

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<sup>10</sup> E. Di Nolfo, *Storia delle relazioni internazionali*, Roma: Laterza, 2008.

<sup>11</sup> G.W.Breslauer, *Gorbachev and Yeltsin as leaders*, Cambridge:Cambridge University Press, 2002; A.Graziosi, *L'Urss dal trionfo al degrado. Storia dell'Unione Sovietica 1945-1991*, Bologna: Societa' editrice il Mulino, 2008; S.Kotkin, *Armageddon averted: the Soviet collapse, 1970-2000*, Oxford : Oxford University Press, 2008; D.B.Reynolds, 'Soviet economic decline: did an oil crises cause the transition in the Soviet Union', *Journal of Energy and Development*, vol.24 #1 Autumn 1998.

<sup>12</sup> F.Halliday, *Making of the Second Cold War*, London: Inst for Policy Studies, 1993; M.P.Leffler, *For the soul of mankind. The United States, the Soviet Union and the Cold War*, New York: Hill and Wang, 2007; G.Lundestad, *The United States and Western Europe since 1945*, New York: Oxford University Press, 2009.

<sup>13</sup> A.Ferrari, *Il Caucaso*, Edizioni Lavoro Roma, 2005; Ahmed Rashid, *Taliban: Islam, oil and the new great game in central Asia*, London: I.B. Tauris, 2000.

from BBC, The New York Times, Washington Post, Deutsche Welle, Expert, Kommersant, Vedomosti, Nezavisimaya gazeta, Novaya gazeta, Rossijskaya gazeta, Vzglyad etc.

- 5) Literature covering the economic theory, banking and economic aspects of oil and gas market. The works of V. Mitrahjan, A. Archipov, N. Antill, R. Arnott, S.Tabata, G.Hubbard<sup>14</sup> and other authors furnish detailed and reliable information for this issue.
- 6) Brief information on energy cooperation provided by official websites of ministries of energy, ministries of foreign affairs, embassies and oil and gas companies participating in projects of cooperation between Europe and Russia

The methodological basis of the dissertation is composed of historical, logical and philological methods: analogy, analysis, induction, deduction and synthesis.

The thesis consists of introduction, three chapters, conclusion and bibliography.

The first chapter, "Cooperation between rivals: Western Europe and the USSR", examines the evolution of the energy relations between West European countries and the Soviet Union in the context of the Cold War antagonism. The second chapter, "Energy exports in the post-Soviet space: new forms of Europe-Russia cooperation", analyses the specifics of Russian hydrocarbons exports to Europe after the collapse of the USSR. In the third chapter, "A stronger Russia and the competition among new energy routes", different projects of new pipelines are overviewed.

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<sup>14</sup> V.S.Mitrahjan, *Эконометрика [Econometrics]*, Moscow: EAOIB center,2008; A.Arhipov, *Экономика[Economics]*, Moscow: Prospect, 2009; Nick Antill,Robert Arnott, *Valuing oil and gas companies: A Guide to the Assessment and Evaluation of Assets*, Cambridge: Woodhead Publishing, 2000; Shinichiro Tabata, *Dependent on oil and gas : Russia's integration into the world economy*, Sapporo : Slavic research center, 2006; Glenn Hubbard, *Outlines and highlights for money, banking and the financial system*, Cram101,2011.

## **Chapter I .Cooperation between rivals: Europe and the USSR**

### **Energy cooperation in the context of the Cold War.**

The economic relations between the European Union and Russia regarding cooperation in the energy sector contain elements belonging to the Cold War Era. As ideological rivals, Western Europe and the Soviet Union did not have strong economic links, but the energy exports issue was important enough for both sides to overcome the political confrontation. The shortage of hydrocarbon resources in Western Europe forced the governments of these countries to turn to the USSR for its supplies. The Soviet government, in turn, recognizing the necessity to increase investments in the industrial, agricultural and social sector, as well as spending for the armament drive, sought for new sources of income for the state budget. The energy cooperation between the West European countries and the USSR rooted in the 1960, in an atmosphere of extreme tension between the camps, resisted and developed in 1970s and 1980s, surviving under the pressure of the United States even during the beginning of the Reagan presidency. The reason why such cooperation became possible in a context of strong confrontation lies in the fact that the economic importance of energy exports for Western Europe and the USSR exceeded the security risks and the possibility that the hydrocarbon exports could be used as a weapon of political pressure.

During the period analyzed in this chapter, the first gas and oil pipelines connecting the Soviet Union with Western Europe were constructed, forcing the economies of European countries and the USSR to adapt to new interdependent relations. Both sides of the energy exports dialogue became equally subject to energy cooperation, which developed from being only a

series of short-term, advantageous contracts to one of the most significant and discussed issues of the Russia-Europe relations.

This chapter focuses on the hydrocarbons exports as the most influential sector of energy cooperation during the pre-Perestroika period. When analyzing the period between the 1960s and the 1970s, it is important to concentrate on crude oil exports, while in the 1980s on natural gas. Coal was not an important export item in this period and was primarily employed for domestic use.

Many contemporary researches include a brief excursus on the Soviet-European energy relations, but only few of them examine thoroughly the subject<sup>15</sup>. For what concerns the texts published before the Perestroika, some of them contain a rather subjective evaluation of the events. In particular, it is important to note that a relevant part of US journals, as well as official documents, includes a large number of ideological comments. One of the most striking examples is a research of the US Library of Congress<sup>16</sup>, which, allegedly economic, reflects the US government's position on European-Soviet energy cooperation.

The above-mentioned study was prepared during the year of the Berlin Crisis (1961), which is regarded as one of the most critical moments of the pre-detente' period. Only a year later, the tension spilt over into the biggest crisis of the post WWII period - the Cuban Missile Crisis. In that period the Soviet hydrocarbon exports in Western Europe had not still reached a large scale: in fact, the volume of crude oil exports sent there accounted for almost a quarter of the

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<sup>15</sup> For example: Y.Gaidar, *Гибель Империи. Уроки для современной России*[*Collapse of an Empire: Lessons for Modern Russia*], Moscow: Rosspen, 2006; M.Slavkina, *Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1999гг* [*Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991*], Moscow, 2007; M.Rubchenko, 'Заложники индустриализации[Industrialization hostages]', *Expert*, 16 August 2010.

<sup>16</sup> USA. The Library of Congress, *The Soviet oil in the Cold War*, Washington: U.S. government printing office, 1961.



1986 crude oil exports of the USSR.<sup>17</sup> However, the 1961 study already describes the Europe-USSR energy cooperation as something which undoubtedly undermines the security of the region and thus should be discontinued. “The Nation [...] must be constantly alert to the operation of Soviet weaponry [...] Economic weapons constitute an effective part of this Soviet arsenal [...]”, claims the research. According to the authors, the only aim of the Soviet economic expansion in Europe is “destroying the United States” and “there’s no better instrumentality than petroleum...’<sup>18</sup>

Though several researchers argue that one of the aims of the Soviet oil and gas exports was to undermine the capitalist economies, however a significant number do agree that the economic interests played the most important part in this cooperation. Having insufficient resources inside their borders, European countries had to resort to energy imports. The USSR provided its partners with lower prices, and it turned out to be economically profitable to choose this oil producer, especially after the 1973 oil crisis that made OPEC exporters unreliable. On the other hand, the USSR suffered a long stagnation period, which resulted in the growing necessity of importing some categories of goods which were no longer being produced indigenously. In 1960 the Soviet Union imported around 200 thousand tons of grain, while in 1985 the grain imports increased to 44.2 millions of tons.<sup>19</sup> Perhaps, without the financial resources derived from the crude oil and gas exports, the USSR would have collapsed a decade earlier. At the same time, the growing energy exports accelerated the tendency to decline in industrial and agricultural sectors and made the economy vulnerable to external shocks. Yegor Gaidar, a Prime Minister of Russia in 1992, stated in his research titled “*Collapse of an Empire*” that the

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<sup>17</sup> USSR. Goskomstat SSSR, *Внешняя торговля СССР* [Foreign Trade of the USSR], Statistical digest, Moscow: Finance and statistics, 1966.

<sup>18</sup> USA. The Library of Congress, *The Soviet oil in the Cold War*, pp.1-3.

<sup>19</sup> USSR. Goskomstat, *Народное хозяйство СССР за 70 лет* [National economy of the USSR of 70 years], Statistical digest, Moscow: Finance and statistics, 1987.

USSR, as a country rich in natural resources, suffered some effects of the so called “Dutch disease”<sup>20</sup>, which according of some scholars, characterizes also the economy of modern Russia<sup>21</sup>. In the 1980s the Soviet hard currency earnings from the energy exports accounted for almost 80% of total hard currency earnings.<sup>22</sup> Therefore, the economic relations between the West European countries and the Soviet Union corresponded rather to interdependence than unilateral dependence of Western Europe.

Another important issue which will be developed in this chapter concerns the relations between allies. Over a whole period of the Europe-USSR energy relations, the USA as leader of the Western bloc sought to prevent almost any economic cooperation between the USSR and Western Europe in order to maintain the security in the region as it was officially declared. However, in many cases these attempts did not bear fruit but created the opposite effect. On the contrary, the cooperation was not discontinued and the relations between the USA and Western Europe were becoming even more strained. Furthermore, while exerting pressure on the European countries not to transact energy business with the Soviets, the USA themselves developed trade in hydrocarbons with the USSR.

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20 The term was invented and applied by the journalists of *The Economist* magazine in 1970 describing how the gas field discovery influenced economy of the Netherlands (O.Barber, *A policymakers' guide to Dutch Disease*, Center for Global Development, working paper, July 2006, Web. Retrieved from: <http://www.eldis.org/vfile/upload/1/document/0708/doc14813.pdf> ) The mechanism of this process is clearly explained in numerous researches. ( Shinshiro Tabata, Sachs J. D., Warner A. M., Montes M.F, Popov V.V., Nikolaev I., Gaidar Y.etc)The country which produces natural resources obtains high earnings from their exports. As a result, the national currency becomes stronger, wages and level of life increases. As a consequence, it becomes non profitable to develop the manufacturing sector which doesn't stand the competition with goods from abroad. Thus, the exporter country becomes increasingly dependent on earnings from resources exports and on the world prices for them. In case the prices fall, the country suffers from strong economic depression

21 Y.Gaidar, *Гибель империи. Уроки для современной России*[*Collapse of an Empire: Lessons for Modern Russia*, pp.51-57.

22 J.P.Stern, *Soviet oil and gas exports to the West*, Aldershot:Gower Publishing Company, 1987,p. 123.

In this chapter will be made an attempt to analyze the character of the USSR-West Europe energy commerce and the role of the United States in these relations. Different scholars<sup>23</sup> including modern Russian authors, claim that the dependence of the USSR on hydrocarbons exports was the number one reason which led to serious economical problems and later to the collapse of the USSR. In this section, the influence of the energy cooperation on the domestic political events will be analyzed in order to understand whether the Soviet system collapse was conditioned by the energy exports.

### **The first accords on hydrocarbons supplies and the US reaction**

The possession or acquisition of energy resources is a necessary condition for the survival and independence of any country. Economic confrontation between the Soviet and Western blocs during the Cold War led to numerous attempts of both sides to obstruct the adversary's energy supplies. In 1950s some of such attempts were successful as it was shown by the example of the 1953 CIA-backed coup d'état in Iran. The overthrow of Mohammad Mosaddegh government led to the discontinuation of oil supplies to the USSR which caused a number of difficulties to the Soviet manufacturing economy.<sup>24</sup> However, when in 1960s five dozen new oil fields were identified in the USSR, and the Soviet Union became an oil exporter itself, it turned out to be no more possible to undermine the Soviet economy blocking the USSR access to other countries' resources. From that moment Washington concentrated on blocking the USSR hydrocarbons' exports.

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<sup>23</sup> For example: Y.Gaidar, *Гибель империи. Уроки для современной России [Collapse of an Empire: Lessons for Modern Russia]*; M.Rubchenko, 'Заложники индустриализации [Industrialization hostages]'; S.Kotkin, *Armageddon averted: the Soviet collapse, 1970-2000*, Oxford : Oxford University Press, 2008.

<sup>24</sup> Ibid.

After WWII the international oil market was dominated by a monopoly called the “Seven sisters”<sup>25</sup>, which formed a cartel and controlled over 90 per cent of the world oil trade.<sup>26</sup> The emergence of OPEC as well as the new oil fields discovered in the USSR changed the situation. The appearance of two independent oil exporters controlling more than seven per cent of the world oil flows caused an unrecoverable damage to the cartel and transformed the international oil trade system.<sup>27</sup>

It is important to notice that the first economic agreements in the energy field between the USSR and Western Europe had already been concluded at the beginning of the 1960s, that is in a period of extreme ideological confrontation. The official reaction of the USA was definitely negative. In 1958, the CIA director Allen Dulles had already made clear how the volumes of the Soviet oil reserves had to be considered dangerous and had encouraged the USA to engage in a strong propaganda against Soviet energy exports<sup>28</sup>. Along with governmental officers and politicians, the Foreign Affairs magazine authors condemned the tentative European-USSR cooperation from the very beginning. The energy agreements are described as “Russian invasion of European and other markets”<sup>29</sup> and the trade with the Soviet bloc is “inevitably harmful”<sup>30</sup> because “Russians clearly are not averse to using oil as a political weapon”<sup>31</sup>.

West European countries did not possess the necessary resources to satisfy all the sectors of their economies and because of the rising demand of growing industries, they had to import hydrocarbons. In that period, natural resources were imported to Europe mostly from the

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<sup>25</sup> Nick Antill, Robert Arnott, *Valuing oil and gas companies: A Guide to the Assessment and Evaluation of Assets*, Cambridge: Woodhead Publishing, 2000, p.10.

<sup>26</sup> M.Slavkina, Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1999гг [Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991], pp. 150-155.

<sup>27</sup> Ibid., pp.150-155.

<sup>28</sup> Ibid., p.155.

<sup>29</sup> J.T.Duce, 'The changing oil industry,' *Foreign Affairs*, July 1962, p.633.

<sup>30</sup> R. Vernon, 'A trade policy for the 1960s', *Foreign Affairs*, April 1961, p.468.

<sup>31</sup> J. T. Duce, 'The changing oil industry', p. 633.

North African or Middle Eastern countries, but these sources were becoming unreliable as the numerous military conflicts breaking out in 1950s and 1960s impeded secure energy exports.<sup>32</sup> This situation did not result in a substitution of all North African gas and oil with the Soviet one. In 1985 Algeria still provided 24,8% of gas consumed in Italy and 25,4 in France.<sup>33</sup> But it resulted in the conclusion of several accords with the USSR (which after the death of Stalin in 1953 was considered less dangerous) which gave rise to a long period of energetic interdependency between Europe and the Soviet Union and later Russia.

In 1950 the oil production in the USSR raised significantly, it almost duplicated from 1950 to 1955<sup>34</sup> and the country started to seek for new markets. Although in 1958 it had already reached 1 billion barrels (almost 4 times more than in 1950), there were still no important contracts in the international market<sup>35</sup>. The Cold War as well as market competition led to a boycott imposed by the Western bloc countries towards the Soviet oil exporters. This boycott was organized and supported by the USA, which had no economic need of the Soviet oil, while already in 1960s the European countries felt the necessity to enhance their cooperation with the USSR.<sup>36</sup>

The significant breakthrough for Soviet oil came in 1960. The head of Italian state oil company ENI Enrico Mattei, supported by the Italian government, signed a contract with the USSR according to which Italy would receive 100,000 barrels of oil a day for 5 years in exchange of 40inch oil pipelines and other materials for constructing Soviet oil pipeline to Eastern Europe.<sup>37</sup>

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<sup>32</sup> The acquisition of independence by Tunisia (1956), Algeria (1962) and Libya (1951), the following revolution in Libya (1969) as well as strain in political relations connected to the Suez Crisis affected the stability of the oil and gas supplies

<sup>33</sup> J.P.Stern, *Soviet oil and gas exports to the West*, p.122.

<sup>34</sup> USA. The Library of Congress, *The Soviet oil in the Cold War*, p.3.

<sup>35</sup> J.P.Stern, *Soviet oil and gas exports to the West*, p.27.

<sup>36</sup> G.Lundestad, *The United States and Western Europe since 1945*, New York: Oxford University Press, 2009, p.163.

<sup>37</sup> J.P.Stern, *Soviet oil and gas exports to the West*, p.27.; V.Panjushkin, V.Zigar, *Газпром: Новое русское оружие*[*Gazprom: The new Russian weapon*], Moscow: Zaharov, 2008, p.5.

While oil was transported to Europe with liquid cargo carriers, natural gas produced in Soviet countries could be delivered to consumers mainly through a pipeline system. Since there was no technology for large diameter pipes production in the USSR, it was decided to import them from abroad.

### **The Adenauer pipeline contract**

One of the most significant agreements involving pipes imports was signed with West Germany in 1960. As it has already been mentioned, such cooperation with an ideological rival was extremely unpleasant to the United States and the American president John F. Kennedy persuaded German chancellor Konrad Adenauer to cancel the agreement<sup>38</sup>. On April 11<sup>th</sup>, 1963, Adenauer announced in his speech that the contract was undermining the allies' security. Moreover, the German government also refused to finance cooperation between West German business companies and the USSR, which resulted in huge losses for big German companies such as Phoenix-Rheinruhr and Mannesmann. A group of journalists of Russian newspaper "Vremya Novostey" researched this agreement and noticed that West German business elite, already bearing financial losses, refused to support the CDU government and its chairman Konrad Adenauer any longer. Other important West German companies such as Salzgitter AG, Siemens, Haniel, IG Farben, Thyssen, Hoechst and AEG decided to distance from the CDU/CSU, joining companies victims of Adenauer's foreign policy in their protest. The results of the next federal elections in Germany held in 1965 proved that the CDU/CSU positions were weakening, as for the first time after Second World War it had to share places with the Social Democrats (SPD) in the ruling coalition.<sup>39</sup> Moreover, after the elections of 1969 SPD had

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<sup>38</sup> V. Panjushkin, V. Zigar, *Газпром: Новое русское оружие* [Gazprom: The new Russian weapon], p.5.

<sup>39</sup> The federal returning officer of Germany. Web. Retrieved from:  
[http://www.bundeswahlleiter.de/de/bundestagswahlen/fruehere\\_bundestagswahlen/btw1965.html](http://www.bundeswahlleiter.de/de/bundestagswahlen/fruehere_bundestagswahlen/btw1965.html)

already taken 237 seats in Bundestag and CDU did not even participate in the government.<sup>40</sup>

The foreign policy of new German chancellor Willy Brandt, who came to power with SPD's victory in 1969, opened a new chapter in USSR- German relations. The United States attempts to prevent the cooperation only delayed it, moreover, under the social democratic coalition government this cooperation turned out to be considerably stronger.

The difficulties connected to the pipeline production did not last long. Soon the Soviet industry started to produce gas pipelines itself. The first pipes produced were marked with the inscription "Труба тебе, Аденауэр!", a pun literally meaning "Here's a pipe for you, Adenauer" but in a figurative sense signifying "Your business will go bad, Adenauer".<sup>41</sup>

### **Soviet crude oil and natural gas exports in 1960s**

In the 1960s the crude oil export from the USSR to European countries was going forward at a steady rate. The prices for the Soviet oil exported to the OECD countries were lower than what was agreed for the oil imported from North Africa and the Middle East.<sup>42</sup> Moreover, while the annual average crude oil price in 1960s was 2,91 dollar per barrel, Italy paid just 1 dollar per barrel for Soviet oil. From 1961 the USSR had been providing significant oil requirements to Finland, Norway, Sweden, and Denmark and after 1966, when new oil fields were found in Russia (Urengoy) the oil and gas exports almost tripled (from 15,867 to 41,365 thousands of tons).<sup>43</sup> Generally, in this period the economic links between the Soviet Union and the

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<sup>40</sup> E.Labezskaya, F.Lukyanov, A.Slobodin, Y.Shrakov, 'Труба в бесконечность [The pipe to infinity]', *Vremya novostey*, 23 November 2000.

<sup>41</sup> Труба тебе, Аденауэр! [Here is a pipe for you, Adenauer], *Vesti Ural*. Web. Retrieved from: <http://chelyabinsk.rfn.ru/rnews.html?id=102231>

<sup>42</sup> *Oil price history and analysis*, WTRG economics, Web. Retrieved from: <http://www.wtrg.com/prices.htm>

<sup>43</sup> USA. The Library of Congress, *The Soviet oil in the Cold War*, pp.3-4.

European countries became stronger as it could be seen from such examples as the construction of a FIAT automobile plant in Tolyatti in 1966.

The gas exports started later than oil deliveries. The necessity of natural gas purchases for the Europeans was not only a commercial but also a juridical issue. Environmental laws passed in UK, France and West Germany in the middle of the 1950s obliged these European countries to switch gradually to natural gas<sup>44</sup>. However, gas exports developed slowly and, although the first contract for natural gas was signed as early as 1968, the volume of gas exports were incomparable with those of crude oil.

After a while an unavoidable exhaustion of Soviet oil fields made gas the number one export from the USSR and Russia to Europe. It is important to mention, however, that until 1974 the USSR was also an importer of natural gas from Iran and Afghanistan which was consumed in the South West of the country. The first export contracts were signed by the USSR and Austria (1968), the Federal Republic of Germany (1970, 1973), Italy and Finland (1974). These contracts immediately gave rise to discussions on security both in the USA and Europe but, as the relations between the two camps improved, the Soviet gas exports finally were considered secure and reliable.<sup>45</sup>

### **The Soviet energy exports during détente**

The successful development of energy relations between Western Europe and the USSR is strongly connected with the international relations context. During late 1960s West European

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<sup>44</sup> М. Slavkina, Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1999гг [*Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991*], p.171.

<sup>45</sup> J. P. Stern, *Soviet oil and gas exports to the West*.



countries were focused on the European integration and sought to establish détente with the Soviet Union<sup>46</sup>. The United States administration was interested in better relations with the USSR as well. By the end of the 1960s the rivals achieved relative parity in nuclear weapons. The resources-draining Vietnam war and the economic decline of the USA (a fact that the Nixon administration did not hide) against the background of economic rise in Western Europe and Japan, made important contribution in the US decision to bear less expenses on the Cold War race establishing détente with the USSR. Nixon-Kissinger administration favored the European détente with the Soviet Union but wanted it to be run within the NATO framework. The Western European countries, in turn, were concerned about USA-USSR détente as it was believed that the superpowers could have decided Europe's future without asking the opinion of its leaders, creating a "superpower condominium".<sup>47</sup> This fear, the evident economic benefits and the possible integration with East European countries, a burning issue first of all for divided Berlin, forced Western Europe to establish détente with the Soviet Union in the frames of regional cooperation but not on the allies' level as it was demanded by the Nixon-Kissinger team<sup>48</sup>. First De Gaulle's and then Willy Brandt's foreign policy became a source of great concerns for Johnson and Nixon administrations. The ambiguous reaction of the USA to the European détente and especially to Ostpolitik as its culmination, reflected on hydrocarbons commerce development.

The settling transactions played an important part in the development of Soviet-European energy trade. According to agreements concluded with Ruhrgas (FRG), Österreichische Mineralölverwaltung (Austria), Eni (Italy) and Gaz de France (France), the European countries supplied the USSR with all the gas pipelines and necessary equipment to develop gas fields in

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<sup>46</sup> G.Lundestad, *The United States and Western Europe since 1945*, p.163.

<sup>47</sup> *Ibid.*, p.169.

<sup>48</sup> *Ibid.*, pp.165-173; R.J.McMahon, *The Cold War. A very short introduction*, New York: Oxford University Press, 2003, pp.122-126.

exchange of future gas supplies<sup>49</sup>. One of the most important gas commerce achievements of the 1970s was a settling transaction signed by Leonid Breznev and Willy Brandt on the tide of Ostpolitik. According to it, the USSR had to provide West Germany, through the company Ruhrgas, with 3 billion cubic meters of natural gas annually in exchange of 1,2 millions tons of large-diameter pipes delivered by the company Mannesmann<sup>50</sup>, the same company which beard losses after the 1963 break of a deal.

It was one of the best periods in the relations between the two camps. From 1969 to 1974, when Willy Brandt was the Chancellor of Germany and the Nixon-Kissinger team was responsible for US foreign policy, such important agreements as S.A.L.T. were concluded and the traditional restrictions on trade were widely criticized by Nixon administration. Nevertheless, close relations between some European countries and the USSR, such as the Ostpolitik of Willy Brandt, proved to be a source of a great concern for the White House. Even in this period the US government tried to prevent the cooperation between Germany and USSR considering it dangerous. In order to maintain the US privilege for cooperation with the USSR, Henry Kissinger, the US Secretary of State, developed a linkage strategy. According to his view, the commercial concessions should have been used as a political instrument and therefore the contracts shouldn't be negotiated without a political contextualization.<sup>51</sup>

It is important to highlight that in spite of a generally negative attitude from the United States towards European commerce with the Soviet camp, Europe was not the only region which

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<sup>49</sup> M.Slavkina, Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-19991гг [*Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991*]p. 215.

<sup>50</sup> E.Labetskaya, F.Lukyanov, A.Slobodin, Y.Shpakov, 'Труба в бесконечность [The pipe to infinity]'

<sup>51</sup> G. Agnelli, 'East-West trade: a European view,' *Foreign affairs*, 1980, Summer, pp.1019-1020

deepened its energy trade relations with the Soviet camp during the détente period. The United States and Japan as well signed a contract with North Star and Yakutia LNG exports.<sup>52</sup>

The United States leaders criticized Western Europe governments for their energy contracts with the Soviet Union, claiming that they would make the region dependent on the rival country not only economically but politically as well. But one can argue if the United States trying to prevent energy accords was acting for European security interests. The US political influence in Western Europe in late 1960s weakened and it might be argued that these measures against Europe-USSR energy cooperation were rather directed towards maintaining Europe's dependency from the USA than towards avoiding its dependence on the Soviet Union. G. Lundestad, E. Di Nolfo, R.J. McMahon and other researchers<sup>53</sup>, dedicated their books to the history of the USA – European relations, and noticed that the independence of Europe was always considered desirable from an economic point of view but never from a political one. This is actually proved by the energy relations history. The USSR energy exports could not make European countries dangerously dependent, as at the peak of its exports, the Soviet crude oil did not reach 18% of the total consumption of European countries. The only exception was Finland, where it accounted for almost 69%.<sup>54</sup> Moreover, according to the USSR leaders, Soviet oil accounted for just up to 5% of total western oil purchases<sup>55</sup>.

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<sup>52</sup> J. P. Stern, *Soviet oil and gas exports to the West*, p.31.

<sup>53</sup> E. Di Nolfo, *Storia delle relazioni internazionali*, Roma: Laterza, 2008; G. Lundestad, *The United States and Western Europe since 1945*, Oxford: Oxford university press, 2009; R.J. McMahon, *The Cold War: very short introduction*.

<sup>54</sup> J. P. Stern, *Soviet oil and gas exports to the West*, p.113.

<sup>55</sup> I. Jenkins, 'Soviet oil sales put OPEC on the spot', *Middle East economic digest*, London, no.20, 17-23 of May, 1985, pp.12-13.

### **The October War and its consequences: the Dutch Disease.**

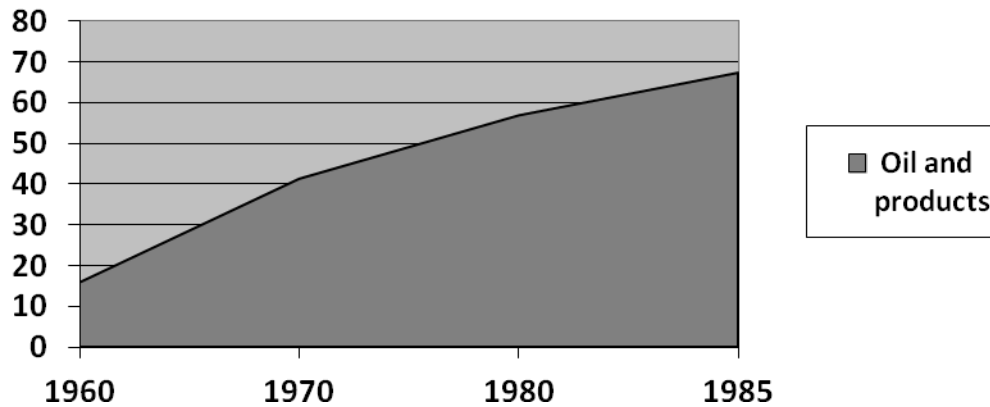
The Yom Kippur War of 1973 influenced significantly the European - Soviet energy relations. The OPEC countries led by Saudi Arabia imposed embargo on oil exports against the countries which supported Israel during the war, that were the countries of the Western Bloc, the USA and Holland. At the same time OPEC limited the production of crude oil. The consequences were fuel shortage and a sudden rise of the oil prices which quadrupled in one year<sup>56</sup>. While the United States possessed the necessary energy resources to overcome the crisis without serious difficulties, the West European countries, which were obliged to import energy resources, started to seek more reliable oil and gas producers. At the sixth general assembly of the UN (April 1974) which was dedicated to raw materials problems, the USSR Minister of Foreign Affairs highlighted that the USSR was ready to extend its economical cooperation with OECD countries even if it politically supported the Arab countries. The Soviet oil and products exports to the OECD countries increased by 28%.<sup>57</sup>

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<sup>56</sup> G. Lundestad, *The United States and Western Europe since 1945*, p. 185; E. Di Nolfo, *Storia delle relazioni internazionali*, pp.1224-1231.

<sup>57</sup> J. P. Stern, *Soviet oil and gas exports to the West*.

## Soviet Crude Oil Exports to OECD countries (million tons)



(Based on data provided in J. P.Stern, *Soviet oil and gas exports to the West*, Aldershot:Gower Publishing Company, 1987)

Different researchers<sup>58</sup> agree that the rise of the oil prices in a long-term perspective influenced the Soviet economy rather negatively than positively. At the end of the 1970s and during the 1980s the Soviet Union had already displayed many characteristics of the Dutch Disease. The USSR dependence on their own oil and gas supplies is shown by the following numbers: in 1970 crude oil exports accounted for 20% of hard-currency earnings (and total energy exports for 27%), in the middle of the 70s the energy export earnings (gas, coal, oil) already accounted for 40% and in 1979-1981 the Soviet energy exports reached 80% of all the earnings<sup>59</sup>. These figures illustrate the Soviet economic dependency on the energy exports sector in the late 1980s.

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<sup>58</sup>Y.Gaidar, *Гибель империи. Уроки для современной России* [*Collapse of an Empire: Lessons for Modern Russia*]; M.Rubchenko, 'Заложники индустриализации [Industrialization hostages]'; J. P.Stern, *Soviet oil and gas exports to the West*, etc.

<sup>59</sup> J. P.Stern, *Soviet oil and gas exports to the West*; USSR. Goskomstat SSSR, *Внешняя торговля СССР* [*Foreign Trade of the USSR*], Statistical digest, Moscow: Finance and statistics, several years.

## **The role of Middle East exports in the Europe-USSR energy relations**

The Middle East oil and gas played an important role in Soviet hydrocarbons exports. The USSR and Iran signed two significant agreements on gas pipelines IGAT 1 and IGAT2 in 1970s. The first pipeline had to provide the south of the USSR with Iranian gas, while the second pipeline was designed to deliver Iranian gas to European countries through the USSR. In exchange, the Soviet countries could receive additional gas from Iran in the same quantities as it was exported to European countries. After the fall of Shah in 1979, the IGAT2 project was suspended and the IGAT1 pipeline was discontinued. Although during the following years the USSR and Iranian governments were keen to re-establish economic relations, the gas supplies were not revived.<sup>60</sup>

When talking about oil, it is important to focus on the OPEC-USSR relations as well. In the 1980s the Soviet crude oil became a threat to Middle East oil exporters, as it was noticed by *The Middle East Economic Digest*<sup>61</sup>. As volumes of the oil exported by the Soviet Union to Europe increased and the exports were undercutting the official OPEC prices, the Middle East oil began to lose the European market.

However, the Middle East oil reached Europe through the USSR. Oil-for-weapon contracts allowed the USSR to re-export to Europe the OPEC oil. Many researchers claim that for this reason it is difficult to estimate the exact Soviet oil supplies to OECD countries. The Middle East countries oil was usually delivered in payment for Soviet military equipment. The petroleum

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<sup>60</sup> J. P. Stern, *Soviet oil and gas exports to the West*, p. 32.

<sup>61</sup> I. Jenkins, 'Soviet oil sales put OPEC on the spot', pp.12-13.

was exported mainly from Libya, Iraq, Iran, Algeria and Saudi Arabia, which was assisting in this way Iraq in his payments for Soviet weapons during the Iraq-Iran war.<sup>62</sup>

### **The crude oil exports in late 1970s – early 1980s.**

The progress of Soviet crude oil exports to Western Europe in the 1970s and in the beginning of the 1980s was considerable. As in the 1980s the oil consumption by the OECD countries reduced owing to high prices and at the same time the Soviet crude oil exports increased, the percentage of Soviet oil among these countries' imports doubled. In 1984 the USSR became the largest supplier of crude oil and oil products to Western Europe<sup>63</sup>.

Generally, the volumes of crude oil exports were rising, with the exception of 1980 and 1985. The crude oil exports decline was connected with the oil production decline in the fields of Western Siberia, which accounted for 63 per cent of total Soviet oil production.<sup>64</sup> The Soviet oil production fell from 1988 to 1992 by 30% and after 1992 by other 20%.<sup>65</sup> Analyst D. Reynolds believes that such sharp decline in oil production in the USSR was one of the main factors that led to the Soviet system collapse. The oil production fell before the decline of the oil consumption, triggering a severe economic crisis. The unmentioned scholar argues that the political reforms in Perestroika period such as market liberalization were attempts to save the economy and thus, the transition was provoked by the oil and economic crisis, not on opposite.

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<sup>62</sup> J. P. Stern, *Soviet oil and gas exports to the West*, p.28.; M. Chadwick, *Soviet oil exports: trade adjustments, refining constraints and market behavior*, Oxford Institute for Energy Studies, 1987, p.31.

<sup>63</sup> Y. Gaidar, *Гибель империи. Уроки для современной России [Collapse of an Empire: Lessons for Modern Russia]*; M. Slavkina, *Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1991гг [Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991]*, p.112.; J. P. Stern, *Soviet oil and gas exports to the West*, p.29.

<sup>64</sup> Machiko Nissake, 'Soviet Oil Exports in 1985-6', *Soviet oil exports: trade adjustments, refining constraints and market behaviour*, 1987, Oxford Institute for Energy Studies, pp.144-146.

<sup>65</sup> D. B. Reynolds, 'Soviet economic decline: did an oil crises cause the transition in the Soviet Union', *Journal of Energy and Development*, vol.24 #1 Autumn 1998.

Discussing about the roots of the oil production decline, many scholars consider the lack of new technology and investments, as well as poor management, the main factors. For example, M.Nissake claimed that shortages of equipment and low reliability of electricity resulted in chronic stoppages of production that had a dramatic impact on Soviet oil production and as a result on its exports.<sup>66</sup> According to P. Lyons and J.Stern, the first crude oil exports' decline was caused by the depletion of its largest deposits in Western Siberia, while the second was connected to the necessity to deploy new oil wells as well as to the recession of the international market.<sup>67</sup> At the same time, according to Reynolds, the main reason was natural; an inevitable depletion of Siberian oil fields did not leave chances to the Soviet government to save the economy by acting differently. The shortage of resources did not allow to provide the East European satellite countries with oil free of charge and in 1989 Gorbachev announced total glasnost in that region, liberating it from Soviet influence and economic support. The decision of the Soviet government to export as much crude oil as possible in order to boost the earnings resulted in domestic fuel shortages. As Reynolds noticed, the 1989 huge agricultural losses were due to the fact that there was no gasoline to gather the harvest and transport it to the market. The crop rotted at the fields.<sup>68</sup>

### **The oil prices landslide**

The oil price shocks of 1973 and 1979-1981 maintained high oil prices rates till the mid 1980s.

While many analysts agree that the first oil crisis rooted mostly in the Yom Kippur war

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<sup>66</sup> Machiko Nissake, 'Soviet Oil Exports in 1985-6'.

<sup>67</sup> A Financial Times Management Report, P.K.Lyons, *The new energy markets of the Soviet Union and East Europe*, London: Financial Times business information, 1990, p.105; J. P.Stern, *Soviet oil and gas exports to the West*, pp. 97-99.

<sup>68</sup> D.B.Reynolds, 'Soviet economic decline: did an oil crises cause the transition in the Soviet Union', *Journal of Energy and Development*, vol.24 #1 Autumn 1998.



consequences, the reasons of the second are controversial. From the political point of view, the US pressure for price-moderation, the Iraq-Iran war and the Arab-Israel conflict undoubtedly influenced the oil market but the scholar F.Parra<sup>69</sup> states that a greater impact had the OPEC price policy of cutting exports affected by the two factors: the desire to control prices and the fear of premature depletion. After several years of extremely high rates, the oil prices fell. The reasons of the mid 1980s oil prices landslide are still being debated. F. Parra<sup>70</sup> noticed that, though OPEC countries agreed to maintain high prices, only Saudi Arabia, Kuwait and UAE did that; other oil producers were exporting their oil on prices below the official level. Furthermore, due to different factors, such as the aspiration of different oil producers to benefit from high oil prices, the supply outreached the demand, which eventually dropped. Such oil producers as Egypt, Iran and the USSR were increasing their exports oversaturating the market<sup>71</sup>. Thus, the competition between the oil-producers contributed oil prices decline as well. Moreover, many researchers stated that the absence of the upmentioned factors forced the crude oil price to return to its “normal” level.

However, some scholars accuse politicians of the oil prices landslide. Peter Schweizer in his book *“Victory: The Reagan Administration's Secret Strategy That Hastened the Collapse of the Soviet Union”*<sup>72</sup>, as well as Maksim Rubchenko in his article *“The industrialization hostages”*, claim that the CIA director William J. Casey was purposely bargaining with Saudi Arabia to drive oil prices down in order to weaken the Soviet economy, which was strongly dependent on oil prices. In particular, they point out that Washington was supplying Saudi Arabia with new weapons, such as planes with airborne early warning and control (AEW&C) system, F-16

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<sup>69</sup> F.Parra, *Oil and politics. A modern history of petroleum*, New York: I.B. Tauris,2004, pp.215-249.

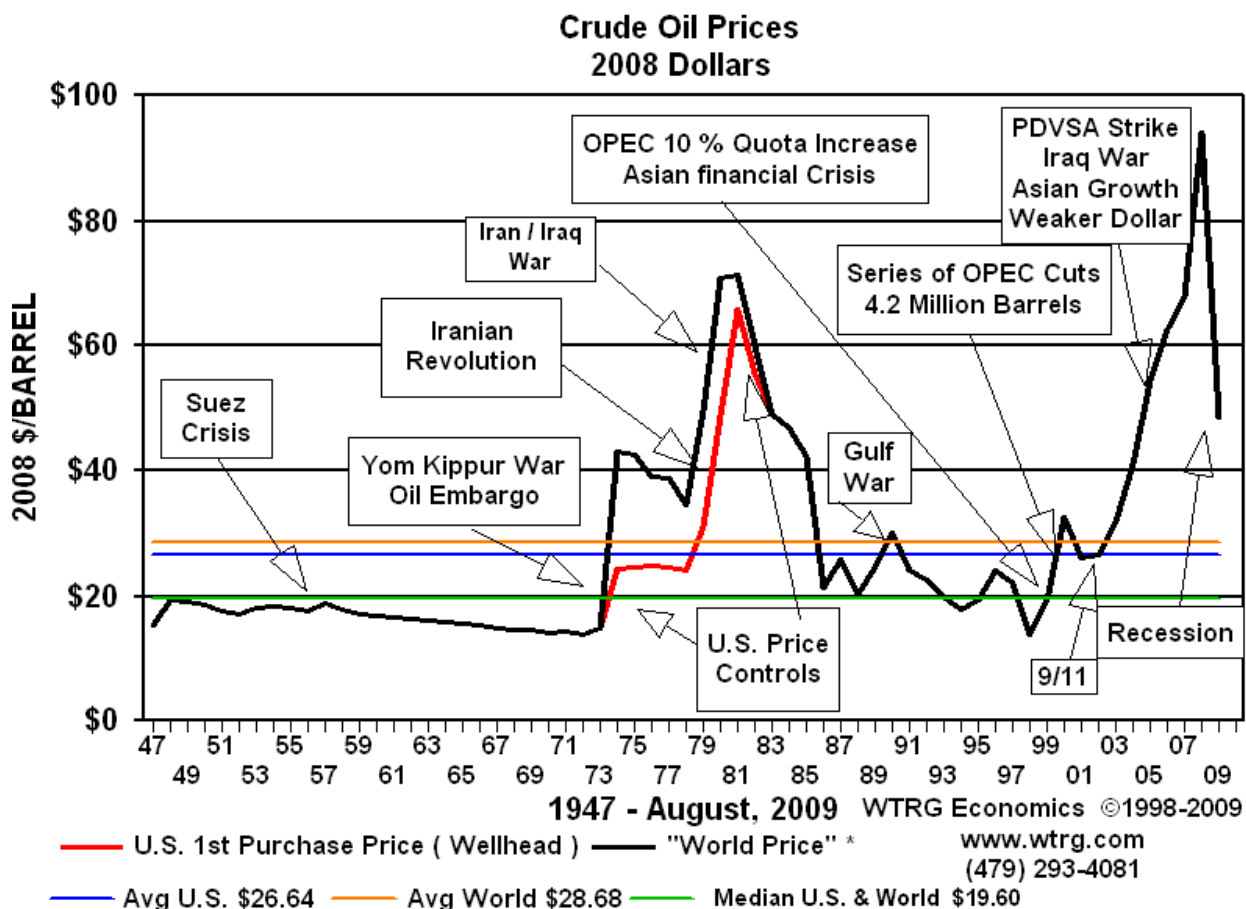
<sup>70</sup> Ibid.

<sup>71</sup> I.Jenkins, ‘Soviet oil sales put OPEC on the spot’, pp.12-13.

<sup>72</sup> P. Schweizer, *Victory: The Reagan Administration's Secret Strategy That Hastened the Collapse of the Soviet Union*,New York: Atlantic Monthly Press, April 1, 1996.

fighters and later FIM-92 Stinger, a portable infrared homing surface-to-air missile, and as well informed Saudi Arabia about the intention of the USA to devalue the dollar, giving that country the opportunity to use that information for its economical benefit. In exchange, Saudi Arabia had to decline oil prices through increasing crude oil production.

However, it is difficult to estimate the validity of this statement and the impact of possible accords on the oil prices rates. According to some international oil market experts such as Venezuela’s Energy and Mines Minister Hernandez Grisanti, the Soviet Union in 1985 was still pushing prices down itself, offering some customers a discount as well as releasing additional oil to the market.<sup>73</sup>



<sup>73</sup> I.Jenkins, 'Soviet oil sales put OPEC on the spot', pp.12-13.

(Retrieved from: <http://www.wtrg.com/prices.htm>)

The facts show that the crude oil prices had been declining permanently since 1982. In 1983 Saudi Arabia reduced the crude oil price from 34 to 29 dollars for barrel and between 1985 and 1986 it increased oil production more than three times<sup>74</sup>. Furthermore, the USSR oil exports to non-communist countries doubled between 1980 and 1984<sup>75</sup>. Thus, the petroleum prices began to decline faster. The oil-producing countries in effort to remain on the market began to reduce oil prices gradually. After 1986 oil prices collapsed and a barrel of oil cost only about 10 dollars<sup>76</sup>.

In 1983 the *"Petroleum Economist"* magazine stated that the USSR would soon face an unavoidable exhaustion of resources and would have to raise exports of natural gas to remain an important energy-exporter.<sup>77</sup>

It was exactly what the Soviet Union tried to do in the beginning of the 1980s. In this period the production of oil was declining and the Soviet Union experienced a shortage in energy exports income. In 1985 hydrocarbons exports were accounting for about four-fifths of Soviet hard-currency earnings.<sup>78</sup> The natural gas had emerged as the number one source of income for the Soviet budget.

### **The West-Siberian natural gas pipeline**

At the beginning of 1980, European energy companies began to negotiate with Soyuzgazexport for a tranche of supplies, which would be delivered through a gas pipeline, which should be

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<sup>74</sup> Y.Gaidar, *Гибель империи. Уроки для современной России [Collapse of an Empire: Lessons for Modern Russia]*.

<sup>75</sup> David Long, 'Soviet oil exports and marketing strategies', *Soviet oil exports:trade adjustments, refining constraints and market behaviour*,1987, Oxford Institute for Energy Studies, p.177.

<sup>76</sup> *Oil price history and analysis*, WTRG economics, Web. Retrieved from: <http://www.wtrg.com/prices.htm>

<sup>77</sup> B.A.Rahmer, 'Muddled planning in energy sector', *Petroleum Economist*, April 1983.

<sup>78</sup> P.Hanson, 'Soviet foreign trade and Europe in the late 1980s', *The World Today*, London, Vol. 42. No. 8-9. August-September 1986. p. 144-146

constructed during the following years. This agreement was concluded between the USSR, West Germany, France and later Italy in 1981. The European interest consisted in the secure energy supplies, while the Soviet in a new source of hard currency earnings. Since the URSS did not possess the necessary technology to construct the pipeline, the above –mentioned countries and the UK signed an additional agreement to provide the Soviet Union with necessary equipment. In exchange, the European continental countries would receive gas supplies, while the UK hard currency.<sup>79</sup> The new gas pipeline, which capacity would be up to 40 billion cubic meters per year should have connected the Siberian gas fields with Western Europe<sup>80</sup>.

The relations between the Soviet Union and the Western Bloc deteriorated in the late 1970s-early 1980s. In order to protest against the Soviet invasion of Afghanistan in 1979 and the subsequent war, president Carter recalled the American Ambassador from Moscow, suspended the ratification of SALT II agreement, imposed embargo on grain exports and cut the commerce with the USSR. Moreover, the United States boycotted the 1980 Olympic Games held in Moscow and boosted the military sector expenses. The presidential elections of 1980 in the USA were won by conservative Republican Ronald Reagan, famous for its anti-Russian rhetoric: in his speech in March 1983 he called the Soviet Union an “evil empire”.<sup>81</sup> He considered détente relations as a mistake and adopted an anti-Kremlin policy. From this moment another period of great tensions between the camps started.<sup>82</sup> A new armaments race, restrictions on commercial relations, proxy wars against the Soviet Union in the third world and attempts to

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<sup>79</sup> K.Demidova, *The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency*, Florence: European University Institute,p.2

<sup>80</sup> J. P.Stern, *Soviet oil and gas exports to the West*,p.33

<sup>81</sup> M.P.Leffler, *For the soul of mankind. The United States, the Soviet Union and the Cold War*, New York: Hill and Wang, 2007, 353.

<sup>82</sup> *Ibid*, pp.334-339.

prevent energy commerce agreements between the USSR and Western Europe characterized American foreign policy of that period.<sup>83</sup>

Washington was aware of the hydrocarbons exports importance for the Soviet economy, as researcher Ksenia Demidova claimed, “this awareness of the USSR’s dependency on gas trade with the West emerges broadly from CIA and National Security documents”<sup>84</sup>. In the situation of a “second Cold War”<sup>85</sup>, cutting the energy exports was considered a good opportunity to undermine the rival’s economy.

The 97<sup>th</sup> Congress of the USA held on November 12th, 1981 was dedicated to a new pipeline. Analyzing the potential dangers of this project, the Congress came to the following conclusion.

“Firstly, it would generate substantial hard currency earnings for the Soviet Union which would help the Soviet Union to further some of its policies contradicting American interest. Secondly, the economic ties and rapprochement between the Soviet Union and Western Europe would inevitably lead to political ties between two regions, and increase the Kremlin’s political influence in Western Europe. Thirdly, relying on soviet gas supply was expected to make Western European allies very vulnerable to cessations of supply. This rationale was a lesson learnt from the energy crises and dependency on Middle Eastern oil, and the possibility of such consequences from dependency on the USSR were considered as quite likely.”<sup>86</sup>

The Congress conclusions meant that the White House administration would seek any occasion to impose sanctions against this project. On December 13th, 1981 the Polish military declared the martial law as a measure to fight anti-communist opposition. As a response, the US

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<sup>83</sup> N.T. Sarantakes, *Dropping the torch. Jimmy Carter, the Olympic boycott and the cold war*, New York: Cambridge University press, 2011; K.Demidova, *The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency*.

<sup>84</sup> Ibid, p.2

<sup>85</sup> F.Halliday, *Making of the Second Cold War*, London: Inst for Policy Studies, 1993.

<sup>86</sup> K.Demidova, *The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency*, p.6.

President Ronald Reagan imposed economical sanctions on Poland.<sup>87</sup> On December 30th the USA imposed an embargo on exports of gas and oil equipment technology manufactured in the USA to the Soviet countries and suspended the licenses of the American companies which were exporting the equipment for the new gas pipeline to the USSR.<sup>88</sup>

Moreover, the European countries involved in the project, started to experience a strong pressure from the USA, which demanded the suspension of construction of the Siberia - Western Europe pipeline. US representatives stated that this pipeline would have made Western Europe dangerously dependent on USSR supplies. European countries' leaders, on the contrary, interpreted this anxiety as something exaggerated and considered the US actions as "an infringement of European sovereignty"<sup>89</sup>. European countries refused to yield to the United States because the natural gas was essential for European economy. Moreover, in 1982 the unemployment level in Europe was higher than ever since 1954 (14 % in the UK, 9% in France, 8% in Germany)<sup>90</sup>, therefore the construction of a new gas pipeline was of a special interest to Europeans not only from the point of view of energy economy, but also because it would have created new working places.

However, compressors and turbines necessary for the Siberian pipeline were designed under license from the USA, even though were produced in Germany, France, Italy or the UK. Therefore, it was impossible to deliver the equipment from these countries as it was agreed in 1981.

The sanctions affected not only the Soviet economy. Numerous European and American companies bore great losses as well. Moreover, the Russian – Japanese joint project on the

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<sup>87</sup> Ibid, p.7.

<sup>88</sup> G.Lundestad, *The United States and Western Europe since 1945*.

<sup>89</sup> Ibid., p.216.

<sup>90</sup> M.Rubchenko, 'Заложники индустриализации[Industrialization hostages]'

construction of the pipeline and oil and gas-fields developments on Sakhalin was suspended, as new American technologies were involved in the project's realization. The reaction of Europeans was different. Ksenia Demidova analyzed the Eurobarometer study, conducted in 1982, 1983, 1984 and 1985 , and came to the conclusion, that the public opinion in West Germany, France and Italy considered the US foreign policy towards the economic cooperation between Europe and the USSR negatively, while in the UK the sanctions imposed were considered acceptable .<sup>91</sup>

Several researchers<sup>92</sup> agree that the sanctions did influence positively neither the US economy nor its political image. Although some US officials foresaw the pipeline construction delay of seven and half years, the USSR brought the completion date forward to January 1st, 1984<sup>93</sup>. David Wilson in his report "*Soviet energy to 2000*" emphasizes the "futility of economic sanctions" and stresses that the result was a "huge Soviet propaganda victory".<sup>94</sup>

However, within the framework of the International Energy Agency, the European governments agreed to "avoid undue dependence upon anyone source of gas"<sup>95</sup>, which estimated the maximum volume of Soviet gas 30-35% of total gas supplies not to be overcome.

Nevertheless, the recession of European markets resulted in decline of actual gas imports, and the Soviet exports to major European countries were far below the indicated level.<sup>96</sup>

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<sup>91</sup> K.Demidova, *The deal of the century: the impact of construction of SNGP on the US-West European relations during the first term of the Reagan presidency*, p.18.

<sup>92</sup> Ibid., p.6.;G.Lundestad, *The United States and Western Europe since 1945*,; N.Graebner, R.D.Burns, J.M.Siracusa, *Reagan, Bush, Gorbachev. Revisiting the end of the Cold War*, Westport: Greenwood Publishing Group, 2008.

<sup>93</sup> D. Wilson, 'Soviet oil and gas in 1983 and 1984', *Quarterly energy review. The world*, No. 1. 1984. p. 37-42

<sup>94</sup> Special report no.231,D.Wilson, *Soviet energy to 2000*, London:The Economist Publications Ltd, 1986,pp.216-217

<sup>95</sup> J. P.Stern, *Soviet oil and gas exports to the West*, p.33.

<sup>96</sup> Ibid.

## **The Europe-USSR energy cooperation during the Perestroika period**

In 1986 the General Secretary of the Communist Party of the Soviet Union Mikhail Gorbachev started the Perestroika, which implied restructuring of the Soviet political and economic system. The reforms affected the energy sector as well. In 1989, the Soviet government made a decision to transform the Ministry of Gas Industry into a state owned company led by the Minister of Gas industry of the Soviet Union Viktor Chernomyrdin, who made a significant contribution into transition from a planned to a market economy in Russia. Thus, he became the first chairman of the Russian biggest gas company Gazprom. This reform was an important step towards the revolution of USSR economy. The Russian energy sector privatization occurred in 1990s did not affect the gas sector, due to the fact that it had been already transformed into a state company, complying with the rules of free market capitalism, and controlled by the government. Therefore, the 1989 reform had a considerable impact on the policy of Russian gas exports in 1990s and 2000s. On December 8, 1991, the Belavezha accords were signed and on December 10 (the same day the Maastricht treaty was drafted in Europe) the agreement was ratified by Ukraine and Belarus, the Soviet Union ceased to exist and the Commonwealth of Independent States was announced.<sup>97</sup> M.Gorbachev considered this formation fictitious, created only to avoid conflicts and control nuclear weapons.<sup>98</sup> However, rapprochement within CIS was one of the most important political objectives of the Russian government during 1990s and 2000s, although the political, economic and cultural ties between the organization members have never become as close as they were in the USSR. The new political system demanded reorganization of numerous institutions and required new reforms. In 1992 the Fuel and Energy Minister Vladimir Lopuhin implemented a reform, according to which the oil sector

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<sup>97</sup> S.Kotkin, *Armageddon averted*, p.110.

<sup>98</sup> A.Graziosi, *L'Urss dal trionfo al degrado. Storia dell'Unione Sovietica 1945-1991*, Bologna: Societa' editrice il Mulino, 2008, p.660.



in Russia was privatized. Meanwhile, the transformation of gas industry into an independent organization enabled the gas sector to avoid the privatization<sup>99</sup>.

The end of the 1980s is characterized by the raise of nationalist movements in the union republics, which claimed local control of the underground resources. In some areas it was already possible to disrupt the flow of oil, gas and coal. Therefore, the growing chaos made the central control of hydrocarbons exports increasingly difficult. In a few years the USSR, one of the biggest oil exporter, suffered gasoline, diesel and aviation fuel shortages, partly caused by the block of Azerbaijani oil products supplies to the Soviet Union.<sup>100</sup>

As far as the nuclear energy sector is concerned, after the 1986 Chernobyl disaster 11 nuclear power stations have been cancelled or closed down<sup>101</sup> which, along with hydrocarbons' transportation difficulties led to the energy shortages in the USSR. Therefore, the energy sector crises, caused by a number of reasons, such as energy shortages compatible with the energy exports dependence and the oil prices landslide, made a significant contribution in the USSR collapse.

Several writers<sup>102</sup>, who dedicated their researches to the history of the USSR in general and its last years in particular, argue whether the Soviet collapse was conditioned by the landslide of crude oil prices in late 1980s or not. By increasing volumes of hydrocarbons exports, the Soviet Union became dependent on hard currency earnings from energy exports. Such a dependence, which lasted for almost thirty years, was an obstacle for the development of other sectors of economy. On the other hand, the USSR official statistics of different years show the increasing dependence of the country on products' imports. From 30 to 50 per cent of earnings derived

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<sup>99</sup> V.Panjushkin, V.Zigar, Газпром: новое русское оружие [*Gazprom: The new Russian weapon*], p.55.

<sup>100</sup> Paul K.Lyons, *The new energy markets of the Soviet Union and East Europe*, pp.101-106.

<sup>101</sup> Ibid, pp.113-114.

<sup>102</sup> Bohanov A.N., Gaidar Y., Gorinov M.M., Graziosi A, Kotkin S., Rubchenko M.

from energy exports were spent only for alimentary products acquisition. In 1975 this number accounted for 90 per cent<sup>103</sup>. The grain, corn, vegetables, fruit and meat production was declining and the necessity of their import was increasing gradually. For example, meat imports between 1960 and 1985 increased from 33.45 to 428, 75 thousands of tons. The researcher Slavkina M. noticed that while the large quantity of oil and gas earnings were spent for alimentary products and ready-made clothes imports, almost nothing was left for technology imports that could help to develop the industry and agriculture.<sup>104</sup> The absurdity of the situation is clearly represented by the following example. In May 1984 the premier N.Tichonov at the politburo meeting claimed that the major part of the energy exports earnings were intended for alimentary products imports and, thus, the budget of the next five-year plan should have included an extra of 5-6 millions of tons of oil exports to be used for alimentary imports.<sup>105</sup> Thus, the Soviet economy of the late 1980s was characterized by some features of Dutch Disease and became very vulnerable to oil and gas prices changes.

With the landslide of oil prices the hard currency earnings declined significantly. At the same time the armaments drive did not allow redistributing the financial resources for the benefit of the economy. The social issue was important as well. There was no more possibility to turn down the reforms. The Perestroika promised a better life and the glasnost allowed Soviet citizens to see examples of Western wellness<sup>106</sup>.

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<sup>103</sup> USSR. Goskomstat SSSR, *Внешняя торговля СССР [Foreign Trade of the USSR]*. Different years.

<sup>104</sup> M.Slavkina, *Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1991гг [Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991]* , p.284.

<sup>105</sup> Ibid. , p.271.

<sup>106</sup> А. Ахиязер, I.Klyamkin, I.Yakovenko, *История России: Конец или новое начало? [The Russian history: the end or a new beginning?]*, Moscow: Novoye Izdatelstvo, 2005.

## The Soviet collapse: economy modernization failure or US victory?

One of the crucial issues of the Soviet economy modernization was the fact that oil and gas earnings were aimed at covering the lack of other incomes instead of introducing innovations. Serious economic problems in the Soviet Union began in 1960s. The necessity to carry out reforms, such as the introduction of some market regulators (for example, profitability), was officially announced at the plenum of the CC CPSU in 1965. As a result, enterprises became more independent and the funding system of factories was modernized. Though, at first, these measures brought fruits and the soviet macroeconomic indicator increased, at the beginning of 1970s similar problems emerged. The possible solution could have been to follow market liberalization reforms, but this was dangerous from an ideological point of view. However, the 1973 oil crisis resulted in a sharp increase of oil prices, which led to huge unexpected earnings for the Soviet government. Production shortness was decided to eliminate resorting to products' imports paid with energy exports earnings, which was considered a safer solution from an ideological point of view. Though the Soviet government doubted that the existence of a communist party as ruling element was possible after the reforms aimed at market liberalization, the economic reforms provided by Deng Xiaoping in China proved this possibility. According to some historians the decision to refute modernization in the 1970s was one of the most significant elements contributing to the economic collapse of the USSR twenty years later.<sup>107</sup>

Some researchers<sup>108</sup> consider the economic stagnation of the Soviet Union the main factor of its break up. Others<sup>109</sup> emphasize the impact of growing expenses for the military sector which

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<sup>107</sup> M.Slavkina, Великие победы и упущенные возможности. Влияние нефтегазового сектора на социально-экономическое развитие СССР в 1945-1999гг [Great victories and opportunities missed. Influence of the oil and gas sector on the social-economic development of the USSR in 1945-1991], pp.322-330.

<sup>108</sup> D.M.Kotz,F.Wier, *Revolution from above. The demise of the Soviet system*, London:Routledge, 1997.

<sup>109</sup> T.G.Brown, 'The Soviet Union as a great power. The need for reform', *The American Economist*, Vol.36, #1.

increased after the Reagan's second cold war policy. D.F.Reynolds<sup>110</sup> believes that the oil production decline caused by oil fields depletion made the greatest contribution in Soviet collapse. However, it might be argued that all these factors had an equally dramatic impact on the USSR's break up. Reynolds noticed that as the first two factors existed also before, the oil production decline was the only new factor and it had crucial role. Nevertheless, it is important to pay attention to the oil price landslide factor. Before the 1970s the USSR state budget was not so deeply dependent on the hydrocarbons exports earnings. The oil fields depletion before the 1970s could not result in the major economic losses of the 1980s as the government would not have tried to maintain oil exports to the detriment of domestic oil supplies. Furthermore, the high oil prices of the 1970s and of the first half of 1980s would have assured the same level of budget earnings though with smaller oil exports. Thus, only the combination of two factors, namely low oil prices and production shortages in a context of growing spending for the armament's race and economy's dependence on exports earnings, resulted in the USSR's collapse. The period of low oil prices lasted till the beginning of 2000s and coincided with the Soviet breakup, which, as S.Kotkin argued, was a complex process composed of different developments running up to the end of 1990s.<sup>111</sup>

Another question that one might ask is if the landslide of oil prices was an independent tendency or was partly conditioned by the USSR's rivals' attempts to undermine the Soviet economy. On the one hand, the United States made their contribution, but it has only strengthened the existing tendency. Several attempts from the part of the USA to prevent the hydrocarbons exports did not bear many fruits but only worsened the USA-Western Europe relations. Furthermore, the Soviet hydrocarbons exports were advantageous for the United States as it made the Soviet economy dependent on market price changes and thereby

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<sup>110</sup> D.B.Reynolds, 'Soviet economic decline: did an oil crises cause the transition in the Soviet Union'.

<sup>111</sup> S.Kotkin, *Armageddon averted*, p.124.

vulnerable. There is another argument in favor of the idea that the United States did not influence directly the USSR collapse. The Soviet breakup turned out to be an unanticipated event for the United States. The US senator William Proxmire analyzed the CIA reports describing the Soviet economy in the late 1980s and stated that the USSR collapse was unexpected even in a distant future.<sup>112</sup>

Different scholars<sup>113</sup> claimed that the Russian economy of the 1990s and the following decade suffered from the Dutch Disease. The economic growth in Russia, which began in the 2000s, coincided with a significant increase of the oil and gas prices.<sup>114</sup> It is important to analyze the actual dependence of Russian economy on oil prices in order to correctly assess the evolution of EU-Russia energy relations in consideration of the Soviet-European energy economic history.

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<sup>112</sup> Y.Gaidar, *Гибель Империи: Уроки для современной России [Collapse of an Empire: Lessons for Modern Russia]*, p.113.

<sup>113</sup> Shinichiro Tabata, *Dependent on oil and gas : Russia's integration into the world economy*, Sapporo : Slavic research center, 2006.; R Ahrend,. D. De Rosa, W.Tompson, *Russian manufacturing and the threat of 'Dutch disease': a comparison of competitiveness developments in Russian and Ukrainian industry*. Working Paper. Organization for Economic Co-operation and Development, Paris, 2007.; Nienke Oomes,K.Kalcheva, *Diagnosing Dutch disease: Does Russia have the symptoms?*, International Monetary Fund, Middle East and Central Asia Dept working paper, 2007.; Younkyoo Kim, *A resources curse in post-communist regime: Russia in a comparative perspective*, Ashgate Publishing, Ltd., 2003 p. 41; OECD economic survey: Russian Federation 2006, OECD,Organisation for Economic Co-operation and Development, p. 82; Manuel F. Montes,V. Popov, *The Asian crisis turns global*, Institute of Southeast Asian Studies, 1999 ,p. 46

<sup>114</sup> B.Nikolayev, 'Монополия душит конкурентов [Monopoly smothers rivals]', *Nezavisimaya gazeta*, 13 October 2009; Crude oil prices 1861-2009.Forbes oil prices statistics. Web. Retrieved from: [http://www.forbes.com/2005/11/01/oil-prices-1861-today-real-vs-nominal\\_flash.html](http://www.forbes.com/2005/11/01/oil-prices-1861-today-real-vs-nominal_flash.html)

## **Chapter II. Energy exports in the post-soviet space: new forms of Europe-Russia cooperation**

The collapse of the USSR brought significant changes in Russia –Europe relations and especially in the energy dialogue. Having started with the Gorbachev Perestroika reforms, the Soviet breakup ended much later than 1991 as it was accompanied by a reorganization of the whole structure of the state and local conflicts lasted till the late 1990s.<sup>115</sup> Initially, the process of USSR dissolution was gradual. In late 1980s the Soviet countries became sovereign. The economic and political system started being reformed. But after the putsch in August 1991 the breakup processes escalated. To the end of the 1991 all USSR republics became independent and the Soviet Union ceased to exist. However, the dissolution process did not come to an end. The military conflicts within regions lasted throughout 1990s. The Soviet Union collapse was accompanied by civil wars and military conflicts in Abkhazia, Chechnya, Ingushetia, Karabakh, Ossetia and Tajikistan. The reorganization of the states' structure, the domestic reforms and geopolitical changes following the USSR breakup made a significant contribution to the reshaping of the Russian energy exports to Europe.

A successful transition from command to market economy required the introduction of the private property concept. Privatization in Russia during 1990s is still one of the most controversial historical issues. The political instability and severe economic decline prevented a well-controlled distribution of the state assets. In this period the major part of the oil sector was privatized while the gas production and distribution was still under the state control.

At geopolitical level, the balance of power within the former Soviet space changed considerably. The Russian Federation faced the loss of control over the neighboring countries,

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<sup>115</sup> S.Kotkin, *Armageddon averted*, 2008.

which sought to become independent from the USSR's successor. The decision to export hydrocarbons to Eastern European countries at market price, dictated by the economic stagnation in Russia, only escalated the trend and provoked several cut offs during 1990s. The political vacuum in the former USSR space attracted the USA as it was viewed a zone of perspective political investment. The Russian reluctance to let off the areas of strategic economic and political interests provoked tensions and political disputes over the resources-rich Caspian region and the gas and oil transit countries: Belarus and Ukraine.

### **The Europe- Russia energy relations after the collapse of the USSR**

As it was shown in the previous chapter, the energy exports assumed a paramount importance for both the USSR and Western Europe and, thus, the potential political risks of such cooperation were ignored. The ideological rival of the Soviet Union, the United States, opposed the development of energy relations between Western Europe and the USSR stressing the potential danger of the cooperation, as the hydrocarbons supplies could have been used as a political weapon. Yet, the Soviet Union leaders never used them as an instrument of pressure, due to the strong ties engendered by interdependent relations between the sides.

The trend changed in the beginning of 1990s when the connection between the energy exports strategy and the Russian foreign policy became evident. The market opportunities and especially a possibility of oil and gas companies to provide new contracts, establish prices for exports and cut down the supplies was used to achieve political goals and vice versa. Though energy exports potential was never used to influence directly the West European countries but was directed to solve problems within the post-Soviet space, especially in the transit countries,

the international image of secure and stable hydrocarbon supplies from Russia was damaged and the alternative to Russian projects became more attractive for European countries.

This chapter focuses on the post-Soviet period of Europe-Russia energy relations. It involves analysis of following issues: influence of Russian political and economic reforms on energy exports, role of transit countries in energy exports, the so-called battle for Central Asian resources, the liberalization and integration of the European energy market. The period analyzed is limited to the beginning of 2000s. The chronological frames chosen provide the necessary division between the two periods in Russian political history as well as in the political history of other countries involved in the process of Russia's energy exports to Europe. It marks as well the turn in the alignment of political power and international cooperation in the region. Thus, above-mentioned factors made a contribution to the emergence of new conditions which shaped the character of the Europe-Russia energy relations.

In the period from the collapse of the USSR until the early 2000s, a unipolar international political system allowed the only superpower remained to exert influence on the former rivals. The rise and consolidation of US presence in the region, promoting the creation of new energy routes during 1990s, gave a significant contribution to the development of Europe-Russia energy relations. The situation changed in 2000s, when the international political and economic balance started to shift towards multipolarism<sup>116</sup>.

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<sup>116</sup> G. Arrighi, B.J. Silver, *Caos e governo del mondo*, Milano: Bruno Mondadori, 2010.



## The neoliberal reforms in Russia and the energy sector

On December 8th, 1991, the USSR ceased to exist and the Commonwealth of the Independent States (CIS) was formed<sup>117</sup>. In order to shift from the socialist model of economic and political governance to capitalism, many former Soviet republics started implementing reforms according to neoliberal approach.

Between two possible ways to carry out the reforms, gradual or fast and radical, the Russian government chose the latter and on January 2, 1992, president Yeltsin launched a process of price liberalization which was the initial step of the shock therapy<sup>118</sup>. Inspired by the example of Bolivia, the government decided to entrust state economy with ideas of Chicago school neoliberals such as Milton Friedman and under the direct control of the International Monetary Fund and American economist Jeffrey Sachs to fight hyperinflation.

Creation of open market, price liberalization and privatization of industries went along with hyperinflation and sharp decline in industrial and agricultural sector. Inflation level in 1992 was estimated at 2,250 percent<sup>119</sup>. As standard of living decreased, in mid 1990s more than one third of population was living under the line of poverty.<sup>120</sup> There is still a growing debate on the reasons of neoliberal reforms' failure in transforming Russia in a welfare state, differently from what happened in Poland. Neoliberal analysts tend to support Jeffrey Sachs position, claiming that shock therapy was not applied in Russia correctly. Some prices such as those for milk and bread remained regulated and the liberalization of energy prices was delayed. Furthermore,

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<sup>117</sup> *Commonwealth of Independent States*. Ministry of foreign affairs of the Russian Federation. November 2009. Web. Retrieved from: <http://www.mid.ru/bdomp/ns-rsng.nsf/a1b765075871a558c325767a0043cb8e/a0569c260927729ec325767b00373f9a!OpenDocument>

<sup>118</sup> "Shock therapy refers to the sudden release of price and currency controls, withdrawal of state subsidies, and immediate trade liberalization within a country, usually also including large scale privatization of previously public owned assets". (Glenn Hubbard, *Outlines and highlights for money, banking and the financial system*, Cram101, 2011.)

<sup>119</sup> S. Kotkin, *Armageddon averted*, p.124.

<sup>120</sup> *Soziologicheskije issledovaniya*, №11, November, 2007.

according to them, the stabilization was weakened by political missteps and absence of international support.<sup>121</sup> At the same time many blame the shock therapy approach itself as an inappropriate way to implement reform. Usually the shock therapy approach is opposed to gradualist transition approach which was successfully realized in China with Deng Xiaoping reforms started from 1978.<sup>122</sup> Some analysts claimed that the Y.Gaidar government should have used a gradualist approach instead of the shock therapy, directing credits to priority industries. However, it was exactly what tried and failed to do the next Prime Minister of Russia V. Chernomirdin<sup>123</sup>.

The Perestrojka process and the reforms carried out during 1990s came under threat several times. The Russian contemporary history would have been definitely different without the appearance of one striking personality: the first Russian president B.Yeltsin. Initially, he supported Gorbachev policy being considered a “democrats” leader. Enjoying wide popularity among Russian citizens, he gained a reputation of “man of the people”<sup>124</sup>. In March 1990 he entered the Russian Republic Congress of People’s deputies and in May became chairman of the Supreme Soviet. In June 1990 B. Yeltsin became the President of Russia, a position just established. The two Russian putsches occurred in 1991 and 1993 became a severe trial for Russian democracy. The first one took place in August 1991 after the decision to sign a treaty on the dissolution of the USSR Supreme Court. A group of officials announced the formation of a State Emergency Committee, the main goal of which was to uphold the integrity of the Union

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<sup>121</sup> L.D. Nelson, I.Y. Kuzes, *Radical reforms in Yeltsin’s Russia: political, economic and social dimensions*, N.Y.: M.E. Sharpe, 1995.

<sup>122</sup> See for example: Linda Yi-Chuang Yueh, *The economy of China*, Cheltenham: Edward Elgar Publishing, 2010, p.28; Mohamed Osman Suliman, *China’s transition to a socialist market economy*, Westport: Conn. : Quorum Books , 1998 p.33; Ilan Alon, *Chinese economic transition and International marketing strategy*, Westport, Connecticut: Praeger Publishers, 2003,pp.280-281; David Harvey, *A brief history of neoliberalism*, Milano: Saggiatore, 2007, p.141.

<sup>123</sup> S.Kotkin, *Armageddon averted*, p.123.

<sup>124</sup> G.W.Breslauer, *Gorbachev and Yeltsin as leaders*, Cambridge:Cambridge University Press, 2002, p.110; S.Kotkin, *Armageddon averted*, p.96.

and to turn back Perestroika moving troops to Leningrad and Moscow. M.Gorbachev was blocked in his Crimea dacha while B.Yeltsin was able to reach the White House where he issued decrees which undermined the authority of golpists and their decisions. His popularity, increased after his famous speech held on a tank, as well as the lack of organization among the members of the Emergency Committee, led to the failure of the coup d'état. The second putsch, occurred in October 1993, was caused by the conflict between B. Yeltsin and the Supreme Court of Russia, which had both legislative and executive functions. The Russian President issued a decree disbanding the Supreme Court which led to an armed uprising. Having support of militaries, B.Yeltsin ordered to shoot the White House and take it by force. As the reforms of the first half of 1990s led to severe economic decline and the GDP fall, the popularity of B.Yeltsin and his administration was sinking. Though, the president was able to win the 1996 elections claiming that the only possible alternative could be the return to the USSR. Later, the 1998 economic crisis and the failure of the Chechen War forced him to leave.<sup>125</sup>

### **The energy sector decline**

It's important to underline that the reforms which took place in Russia during 1990s changed completely the Russian energy sector and critically influenced the character of Europe-Russia energy relations. The shock therapy and privatization of industry brought to significant decline in industry and agriculture. The new-born independent companies were not ready to develop stably without government subsidies; hyperinflation didn't encourage the growth of private sector.

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<sup>125</sup> A.Graziosi, *L'Urss dal trionfo al degrado. Storia dell'Unione Sovietica.1945-1991*; S.Kotkin, *Armageddon averted*; V.A.Shestakov, *Новейшая История России [Contemporary history of Russia]*, Moscow:AST, 2008.

This trend reflected in energy sector which experienced sharp decline as well. Some experts saw the key problem in low domestic energy prices.<sup>126</sup> In the summer of 1993 the domestic prices for natural gas accounted for 10 percent of the world price<sup>127</sup>. As researcher J.D. Grace pointed out, the prices were so low that in fact the domestic market till 1997 “served at an economic loss”<sup>128</sup>. However, other researches<sup>129</sup> consider the low energy prices as an additional element in overall negative trend.

Social services sector, being financed from state budget, suffered delays in payments and, as a result, institutions couldn’t afford paying for water, gas and electricity. “By 1994 non-payments to the electricity system had built up to 85% of turnover, and 56% of gas delivered to Russian consumers had not been paid for”.<sup>130</sup>

Moreover, a decline in industry resulted in reduction of domestic energy demand. According to a research dedicated to analysis of socio-economic situation in Russia during 1990s, “The White book”, Russia’s domestic oil consumption in 2000 was twice lower than in 1990, declining from 250 million tons to 124 million tons<sup>131</sup>. This encouraged increase of corruption and more severe economic decline of state budget which was mostly dependent on energy sector incomes. As a result, a combination of following factors: low energy prices, both domestic and foreign underpayments and non-payments, reduction of demand, undermined energy earnings and state budget. At the same time energy sector itself suffered severe crisis. As scholar Stefano Casertano noticed in his book, oil field exploration declined by 22% from 1990 to 1991, 70% of

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<sup>126</sup> International Energy Agency. (2002). *Russia energy survey 2002*. (In cooperation with the Energy Charter), p. 35, Shinichiro Tabata, *Dependent on oil and gas: Russia’s integration into the World Economy*.

<sup>127</sup> S.Kotkin, *Armageddon averted*, p.125.

<sup>128</sup> John D. Grace, *Russian oil supply page. Performance and prospects*, N.Y.:Oxford University Press.2005, p.95.

<sup>129</sup> Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism*, N. Y.: Metropolitan Books, 2008.

<sup>130</sup> International Energy Agency. *Russia energy survey 2002*, p. 39.

<sup>131</sup>A. Vatansever, *Russia’s oil exports. Economic Rationale Versus Strategic Gains*, Carnegie Endowment for International Peace. December 2010. p. 4. Web. Retrieved from: from:

[http://carnegieendowment.org/files/russia\\_oil\\_exports.pdf](http://carnegieendowment.org/files/russia_oil_exports.pdf)

equipment was out of order<sup>132</sup>. Though, generally, oil exports did not increase during 1990s and provided a stable trend, the hydrocarbons production dropped.(from 571 million tons in 1990 to 337 million tons in 2001). As domestic industry , once the biggest energy consumer, was found in a severe crisis, the percentage of oil intended for exports increased significantly(from 27,8% in 1990 to 67,8% in 2001), while the volumes of exports remained the same.<sup>133</sup>

### **The privatization reforms and the Russian energy sector**

In order to understand the peculiarity of the new conditions of energy cooperation it is necessary to examine the privatization reforms concerning the energy sector in Russia.

A large part of the reforms carried out in 1990s was directed at reconstruction of the economic sector. The privatization program was taken in order to fulfill the transition to capitalism and develop a free market, as well as satisfy one of the conditions of IMF's loans. In 1992 the Russian government formulated different tasks connected to energy sector reforms.

1. To avoid the sharp change of the oil price as it could provoke increase of the inflation.
2. To change taxation and pricing to provide the stable financial incomes for state budget on different levels.
3. To ensure the cover of expenditure of new oil and gas projects and cost efficient production
4. To reform the relations of ownership in this sector.

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<sup>132</sup> S.Casertano, *Sfida all'ultimo barile. Russia e Stati Uniti per il dominio dell'energia*, Milano:Francesco Briosci Editore, 2009, p.160.

<sup>133</sup> S.G.Kara-Murza,S.A.Batchikov,S.Y.Glazyev, *Белая книга. Экономические реформы в России 1991-2001*[ *The White book. The economic reforms in Russia 1991-2001*], Moscow: Algoritm, 2002.

Historically these tasks were performed in three stages of energy sector reforms: 1992-1993; 1994-1995; 1995-1998<sup>134</sup>.

In the first period the energy industry was reorganized into large vertically integrated companies (VICs) and Russian government implemented several reforms aimed at price liberalization. According to the law issued on January 1992, Russian enterprises received right to sell up to 20% of the oil produced at uncontrolled price. Already in February the amount of oil and gas which could be sold at uncontrolled price accounted for 40 to 100%. Finally, the oil prices became totally uncontrolled while the gas prices remained regulated by the state.

A Presidential Decree from November 17<sup>th</sup> of 1992 gave rise to privatization of oil production.

Public companies were transformed into joint-stock corporations. However, the government retained a part of new-formed companies shares (for example, 38% of joint-stock companies created after the reorganization of the state-owned company Rosneft which remained under the control of the government<sup>135</sup>, 45% of Lukoil, Surgutneftgas and Yukos shares). In addition, state-owned oil-transportation companies Transneft and Transnefteproduct were created afterwards. 40% of oil companies' shares were put up for investment auction<sup>136</sup>

A number of legislative acts produced in this period regulated activity of regional oil-and-gas enterprises. In particular, local authorities were enabled to influence energy sectors' privatization. (in Tatarstan, Bashkiria etc)

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<sup>134</sup> Т.А. Вагиров, *Международное значение реформ в нефтегазовом секторе России в 1990-х годах в контексте российско-американских отношений [International significance of the reforms in Russian oil and gas sector in 1990s in the context of Russian-American relations]*, Moscow:2000, pp.32-50.

<sup>135</sup> Presidential Decree #1403 from November 17<sup>th</sup> of 1992. Web. Retrieved from:

<http://www.jurbase.ru/texts/sector170/tez70308.htm>

<sup>136</sup> Т.А. Вагиров, *Международное значение реформ в нефтегазовом секторе России в 1990-х годах в контексте российско-американских отношений [International significance of the reforms in Russian oil and gas sector in 1990s in the context of Russian-American relations]*, pp. 50.

In brief, the period from 1992 to 1993 corresponds to a number of events which enabled creation of a new the new oil-gas system. Enterprises turned into joint-stock companies, new oil and gas companies, among which were LUKoil, NK Surgutneftgas, Rosneft, Transneft and Yukos appeared.

On executive order of November 5<sup>th</sup> of 1992 Gazprom became a stock-company as well. Though the company was largely privatized, the state, being the largest shareholder, possessed 36% of shares and thus could influence the company policy.<sup>137</sup> Just a year later important contracts for twenty years gas supplies were signed with Finland and France.<sup>138</sup>

In the second period the system of new vertically integrated oil companies was finally developed. In 1994-1995 SIDANKO, ONAKO, TNK, JUNKO were created.

The third period, which lasted from 1995 to 1998, has crucial importance for the understanding of the dynamics and character of new Russian oil and gas sectors' development and reviewing it allows estimating the influence of Russian politics on the structure of the energy sector.

One of the most striking examples of such influence was mortgage auction appeared in 1995. The executive order from 1995, dedicated to mortgage auctions, permitted to put in pledge a state's share of oil companies in order to provide state budget with new earnings. Historians doubt the integrity of the auctions claiming that the principle of a free competition was not complied with and stressing different violations which brought to equivocal results.

Many researchers<sup>139</sup> specialized in recent periods of Russian and European history highlighted that the organization of such auctions was hardly accidental and included several breaches.

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<sup>137</sup> A. Belyi, *Trends of Russia's Gas Sector Regulation*, Fourth annual conference on competition and regulation in network industries, 25 November 2011. Web. Retrieved from: <http://www.crnet.com/2011/a4a.pdf>

<sup>138</sup> Gazprom. Web. Retrieved from: [www.gazprom.ru](http://www.gazprom.ru)

<sup>139</sup> T. Bagirov, *Международное значение реформ в нефтегазовом секторе России в 1990-х годах в контексте российско-американских отношений [International significance of the reforms in Russian oil and*

According to them the mortgage auctions were pointed at acquisition of oil production companies by stakeholders for a low price. Some experts<sup>140</sup> claim as well that these auctions were created to get round the three-year ban to sell the government part of oil company's auctions.

The state's economy was still suffering from a severe crisis and the budget couldn't bear the expenses. In consequence the government wasn't able to redeem the money given and had to refuse after three years its part of shares.

Moreover, researcher T. Bagirov underlines the political character of the auctions asserting that "the enterprises which had strategic importance for Russian economy were actually ceded to Russian oligarchs<sup>141</sup> in exchange of their loyalty and financial support of a dominant party".<sup>142</sup>

However, in 1999 the government still possessed 100% of shares of only two oil and gas companies Transneftproduct and Rosneft<sup>143</sup> and controlled Transneft.

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*gas sector in 1990s in the context of Russian-American relations]; V. M.Sergeev, The wild East: crime and lawlessness in post-communist Russia, Armonk, N.Y.: M.E. Sharpe, 1998. p. 150; Ian Jeffries, Economic Developments in Contemporary Russia, London: Routledge, 2011, p. 250; Herman Willem Hoen, Good governance in Central and Eastern Europe: the puzzle of capitalism, Cheltenham: Edward Elgar Publishing, 2001, p. 20; V.S.Mitrahjan, Эконометрика [Econometrics], Moscow: EAOIB center, 2008, p.592; P. Ivanov, N.Smoylova, ' Это сладкое слово- заводы [This sweet word – factories]', Kommersant Vlast, 1 December 1998.*

*140 V.S.Mitrahjan, Эконометрика [Econometrics], Moscow: EAOIB center, 2008, p.592; P. Ivanov, N.Smoylova, ' Это сладкое слово- заводы [This sweet word – factories]'; T.A. Bagirov, Международное значение реформ в нефтегазовом секторе России в 1990-х годах в контексте российско-американских отношений [International significance of the reforms in Russian oil and gas sector in 1990s in the context of Russian-American relations].*

<sup>141</sup> During the privatization of 1990s, vital national assets were acquired by a relatively small group of businessmen, the so-called "oligarchs".

<sup>142</sup> T. Bagirov, Международное значение реформ в нефтегазовом секторе России в 1990-х годах в контексте российско-американских отношений [International significance of the reforms in Russian oil and gas sector in 1990s in the context of Russian-American relations], p.64.

<sup>143</sup> Ibid, p. 82.



As concerns gas, Gazprom remained a monopolist on the gas market producing 94% of natural gas in Russia.<sup>144</sup> The company was controlled by the government possessing the largest part of the company.<sup>145</sup>

Thus, during 1990s the energy sector of Russia contained less monopolistic characteristics and was shared between different big VICs such as Sidanko. Nevertheless, a strong connection between the government and the biggest oil and gas companies was observed. The particular trend in Russian energy business in 1990s was the interference of politics in the creation of energy sector which was evident from the example of pledge auctions. However, in early 2000s, after concluding several agreements aimed at the acquisition of oil and gas companies by Gazprom and Rosneft, the situation changed and the resources were concentrated under the government's control.

### **The European energy market development in 1990s**

At the same time, the European energy market underwent important changes during 1990s as well. The energy policy development in European countries was associated with European integration process.

One of the first steps towards integration was Single European Act adopted in 1987. A green paper produced in 1988 proposed to include the energy sector as well<sup>146</sup>. In the same year, as the European Commission was working on a report over domestic energy market, the first steps to elaborate gas directives were taken. Having passed through different debates stages, it was

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<sup>144</sup> Ibid. , pp.77-78.

<sup>145</sup> A. Belyi, *Trends of Russia's Gas Sector Regulation*, Fourth annual conference on competition and regulation in network industries.

<sup>146</sup> *EU Energy Infrastructure Policy – Unintended Redistribution of Economic Opportunities?*, Fridtjof Nansen Institute. 2007. Web.Retrieved from: <http://www.fni.no/canes/POE-energy-infrastructure.PDF>

published in 1998 in the official journal of the European Community. The report was aimed at the creation of a single energy market instead of 15 through the process of European energy markets liberalization and had significant importance for increase of European industries competitiveness which would have marked down the prices level and stimulate working efficiency.<sup>147</sup>

The European Union creation required the development of new legal regulations. Such important agreements regarding the European Union creation as Single European Act of 1987, Maastricht agreement of 1992 and Amsterdam protocol of 1997 contained laws which regulated energy policy of the countries participated<sup>148</sup>

Furthermore, some documents created during 1990s were dedicated directly to energy policy and thus had particular importance for European energy market regulation. The two directives, Directive 96/92 EC of the European Parliament and of the Council concerning common rules for the internal market in electricity (1996)<sup>149</sup> and Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas (1998)<sup>150</sup> had pivotal importance for European energy market development. The priorities

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<sup>147</sup> D.A.Leonov, *Разработка экономической политики ОАО "Газпром" на европейском газовом рынке в период его либерализации [Development of Gazprom economic policy on the European gas market in a period of its liberalization]*, Moscow, 2003. pp.45-48.

<sup>148</sup> М.Е.Вогучарский, *Энергетическая дипломатия Европейского Союза [Energy diplomacy of the European Union]*, Moscow, 2005, pp.18-21.

<sup>149</sup> Directive 96/92 EC of the European Parliament and of the Council concerning common rules for the internal market in electricity. Web. Retrieved from: <http://www.ems.rs/eng/stranice/regulativa/direktive/dir96-92.pdf>

<sup>150</sup> Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas. Web. Retrieved from: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998L0030:EN:HTML>

of the European energy policy were overviewed in White Paper (1995)<sup>151</sup>, while the milestones of energy strategy of the EU till 2020-2030 were expressed in the Green paper (2000)<sup>152</sup>

Furthermore, transit directives (for example gas transit directive 91/296/EEC /from 1991 and Electricity transit directive 90/547/EEC of 1990, aimed at elimination of obstacles for gas and electricity exchange)<sup>153</sup> played an important role as well<sup>154</sup>.

To sum up it is necessary to underline that generally the legal acts mentioned focused on gradual integration of the European countries and establishment of a common energy policy.

In spite of the common frameworks, some researchers<sup>155</sup> underlined the huge gap between “the principles of free trade” of EU Commission on the one hand and growing influence of energy monopolies such as Gazprom on the other. Different attempts to establish common energy security rules between European countries and Russia were made during 1990s. One of the basic agreements regulating EU-Russia relations was a Partnership and Cooperation Agreement (PCA) which was signed in June 1994 and entered into force in 1997. The article 65 of this agreement was dedicated to energy cooperation and provided for improvement in quality and security of energy supply. In order to achieve this gain the governments acted introducing a number of institutional, legal and fiscal conditions encouraging trade and investment in the energy sector.

Another important initiative of Europe-Russia energy cooperation was the Energy Charter.

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<sup>151</sup>An *energy policy for the European union*. The White Paper. Brussels. 1995. Web. Retrieved from:[http://europa.eu/documentation/official-docs/white-papers/pdf/energy\\_white\\_paper\\_com\\_95\\_682.pdf](http://europa.eu/documentation/official-docs/white-papers/pdf/energy_white_paper_com_95_682.pdf)

<sup>152</sup> *Towards a European strategy for the security of energy supply*. Green paper. Web. Retrieved from:<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52000DC0769:EN:HTML>

<sup>153</sup> T.W. Waelde, *The Energy Charter Treaty: an east-west gateway for investment and trade*, Boston : Kluwer Law International, 1996.

<sup>154</sup> M.E.Vogucharsky, *Энергетическая дипломатия Европейского Союза [Energy diplomacy of the European Union]*, p.33.

<sup>155</sup> For example: G. Nicchia, *The energy issue in EU-Russia relations*, Napoli:Editoriale scientifica, 2008, p. 85.

After the collapse of the Soviet Union, the necessity to create a new legal system which would regulate energy traffic in a new common space over the territory of the new-born states pushed the countries to closer cooperation. In 1991 the Dutch Prime Minister Ruud Lubbers put forward a proposal to establish a Charter which would control gas, oil and energy traffic between Western Europe and the Soviet Union. The Charter political declaration was signed on December the same year, while the Energy Charter Treaty and the Protocol on Energy Efficiency and Related Environmental Aspects were signed by European countries and the former Soviet Union in 1994<sup>156</sup>. Russia was the only country which didn't ratify the treaty afterwards as two significant difficulties emerged.

The first one regarded Transit Protocol which provided for freedom of transit and non discriminatory pricing provision. If Russia had ratified it, Gazprom would have lost control over the pipeline system. In particular, it would have resulted in loss of earnings from cheap Central Asian gas, which was being resold to Europe at a higher price. Currently as researcher Giulia Nicchia claimed "one third of the gas sold to EU comes from Turkmenistan"<sup>157</sup>.

The second difficulty was connected to transparency of the agreements according to GATT-WTO system<sup>158</sup> which could influence negatively Russian energy exports policy as well.

Generally, though some accords between Russia and European Union over common rules of energy exports were concluded, the desired level of the cooperation was not achieved.

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<sup>156</sup> The Energy Charter. Web. Retrieved from: <http://www.encharter.org/index.php?id=7>

<sup>157</sup> G. Nicchia, *The energy issue in EU-Russia relations*, p.90.

<sup>158</sup> S.Furfari, *Le Monde et L'Energie Enjeux geopolotiques*, Paris:Editions TECHNIP,2007,p.131.

## The economic context of the energy exports

The Asian currency crisis of 1997 and its consequences had significant impact on the energy sector of Russian economy. Starting with the financial collapse of the Thai Baht, it soon affected other Asian countries leading to a regional economic crisis and in 1998 to Russian currency crisis<sup>159</sup>, which resulted in floating rate and depreciation of ruble, precipitated collapse of banking system and cut down savings.<sup>160</sup>

The short-term consequences of the crisis were disastrous: the galloping inflation of 80 per cent in 1998 damaged the forming middle class and destructed the financial system<sup>161</sup>. But the scholar Tabata pointed out that in long-term perspective, instead of damaging the economy it triggered the economic growth as the low currency rate didn't obstacle more the development of the economy.<sup>162</sup>

The financial crisis in Russia coincided with a decrease of market prices for hydrocarbons which reached a record low level. As Besborodov, Trofimov and other scholars argued, the dependence of Russian economy on hydrocarbons exports earnings created the necessary conditions to make the economy vulnerable to oil and gas prices and to the emergence of 1998 financial crisis<sup>163</sup>.

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<sup>159</sup>V.N.Kolotov, A.N.Lankov, ' Особенности развития и проблемы стабильности стран АСЕАН: энергетические ресурсы, экономика и политика региона на современном этапе [The particularities of the development and problems of the ASEAN countries stability: energy resources, economy and politics of the region at present]', *Oil, gas, social modernization*, Moscow: HSE(The National Research University Higher School of Economics) Omega-L, 2010, pp. 416-418.; Mine Aysen Doyran, *Financial crisis management and the pursuit of power*, Farnham, Surrey :Ashgate Publishing, 2001, p.79.

<sup>160</sup>S. Closson, 'Russia's key customer:Europe', *Russian energy power and foreign relations*, Centre for Security Studies, Охон:Routledge, 2011, p.92.

<sup>161</sup> А.Арhipов, Экономика [Economics], Moscow: Prospect, 2009, p.574.

<sup>162</sup> Shinichiro Tabata, *Dependent on oil and gas: Russia's integration into the World Economy*, p.52.

<sup>163</sup> К.Т. Трофимов, *Банковское право [Banking law]*, Moscow: Walters Kluver, 2010, p.35; А.В. Безбородов, *История России: новейшее время, 1985-2009 [Modern history of Russia, 1985-2009]*, Moscow: Prospect, 2010, p.140.

Though energy exports provided the state's budget with stable earnings, in long-term perspective they appeared to be rather as a stumbling block of Russian economic development than its accelerator. Analyzing the dependency of economy on raw materials exports many scholars were trying to understand if Russia suffered from the Dutch Disease. Such factors as the manufacturing sector decline and service sector growth combined with the appreciation with a real exchange rate advocate in favor of the opinion that Dutch Disease existed in Russia<sup>164</sup>. The dependence of the state's economy and budget on external factors such as world economic conjuncture and in particular price of hydrocarbons made the country's financial stability rather vulnerable during Asian crises and certainly made a decisive contribution in 1998 crisis. However, it is impossible to assert definitely if during 1990s Russia suffered from Dutch Disease or not but it is true that Russia was dependent strongly on energy exports earnings. This opinion is shared also by those scholars who claim that Dutch Disease was absent in Russia.

### **The impact of foreign policy on energy exports**

At geopolitical level, the USSR breakup brought significant changes in the East European balance of power. Russia, as the Soviet Union's successor, was considered by numerous nationalist movements in these countries as a source of political pressure which was a vestige of past. These movements were strong not only in Baltic countries or the western part of the region but in Russia's historical partner-countries: Belarus and Ukraine. The political void in the region attracted Western European countries and especially the United States to establish their influence there. The Russian government, realizing the country's political and economic

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<sup>164</sup> For example see: N.Oomes,K.Kalcheva, *Diagnosing Dutch Disease: does Russia have the symptoms?*

weakness at that moment but not ready to abandon the Soviet ambitions, tried to use all the leverages it had (and one of the strongest were energy supplies) to hinder Eastern Europe to become totally independent from Russia's influence or to pass under the former rival's control. However, history proved the futility of many of these attempts: most part of East European countries joined NATO and the European Union, while Ukraine and Belarus still remain a battlefield for political influence.

The usage of oil and gas supplies as an instrument of pressure in the former Soviet territory is a trend born in 1990s. Tensions over energy exports in Baltic countries in early 1990s proved that the hydrocarbons supplies were already used as a political tool. Russian – owned state monopoly Transneft stopped oil supplies to Lithuania nine times during 1990s which probably was connected to negotiations between Mazeiku Nafta (known nowadays as ORLEN Lietuva), an oil-proceeding plant of Lithuania, and energy company Williams, based in the USA, over the sale of 33 percent of the Lithuanian refinery. Another indirect reason of the debates was new port facilities and pipelines planned to be constructed in order to diversify oil supplies<sup>165</sup> However, the most striking example of the interconnection between hydrocarbons commerce and political issues, which doubted the security of energy exports, were the debates over transit countries.

Having gained political and economic independence, many ex-Soviet Union member states experienced economic difficulties. Not possessing domestic energy resources, they had to resort to imports delivered through old pipeline system remained from the Soviet Union. Belarus and Ukraine were of particular interest of the Russian government as these nations had a crucial significance for the Russia-Europe energy relations because of their geographical

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<sup>165</sup> S.Closson, 'Russia's key customer:Europe', *Russian energy power and foreign relations*, p.93.

position as transit countries<sup>166</sup>. On territory of only Ukraine were laying gas and oil pipelines providing the European countries with the decisive part of Russian energy resources' supplies; only gas supplies passing there accounted for eighty per cent of Russian gas exports to Europe.<sup>167</sup>

Thus, the Russian government was seeking to provide integration within the region and re-establish economic and political ties lost after the collapse of the USSR.

Over the 1990s many agreements were concluded in order to provide further integration among the states. The CIS created as an alternative union after the collapse of the Soviet Union was based firstly on three countries (Belarus, Ukraine, and Russia), other countries ratified the agreement later. Within CIS, which stimulated integration among all the members, relations between Belarus, Ukraine and Russia were always described as special<sup>168</sup>. During 1990s many bilateral agreements which provided integration, (for example, between Russia and Belarus, the Free Trade Agreement of 1992, the Custom Union Agreement of 1995, the Treaty of friendship, good-neighborliness and cooperation of 1995<sup>169</sup>; Between Russia and Ukraine, the Agreement for visa-free travel of 1997 and the Treaty of friendship, cooperation and partnership of 1997<sup>170</sup>), were concluded. One of the latest developments was the Eurasian Economic Commission Treaty signed on 18 November 2011 and declaration on Eurasian

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<sup>166</sup> During the Cold War period the transit countries were an integral part of the Soviet Union as a single economic unit and the security of energy supplies could not be prejudiced. The political changes connected to the collapse of the Soviet union resulted in the desintegration of CMEA block and created transit countries.

<sup>167</sup> *Ukraine energy policy review* 2006, International Energy Agency, 2006.

<sup>168</sup> According to *The concise Oxford dictionary of politics*, the term usually is used to describe post- WWII relations between the USA and UK, "which are characterized by diplomatic, military, economic and cultural ties". (The concise Oxford dictionary of politics, Oxford: Oxford University Press, 2009, p. 501.) The relations between Belarus, Ukraine and Russia formed after the USSR collapse possessed the same characteristics which in author's opinion allows to title them "special"

<sup>169</sup> The embassy of Belarus in Moscow. Web. Retrieved from: <http://www.embassybel.ru/belarus-russia-relations/legal-acts/dogovor-o-druzhbe-1995.html>; The Embassy of Russia in Belarus. Web. Retrieved from: <http://www.belarus.mid.ru/04.html>; A. Gudkov, D. Baturin, 'Минск принял необложные меры [Minsk has taken measures]', *Kommersant*, 11 October 2010.

<sup>170</sup> The embassy of Ukraine in Moscow. Web. Retrieved from: <http://www.mfa.gov.ua/russia/ru/29165.htm>



Economic Integration, adopted 21 November by the leaders of Belarus, Russia and Kazakhstan which proclaimed the creation by January 1, 2015 of Eurasian Economic Union and thus extend the economic cooperation in Central Asia<sup>171</sup>.

An inability to develop quickly strong and stable market economy, which would provide the budget with necessary financial supplies, as well as good political relations with Russia, resulted for Ukraine and Belarus in arrears with energy payments, accumulation of debts, and more favorable gas prices demands during 1990s.

Legally, Russia-Ukraine as well as Russia-Belarus energy cooperation root in two level agreements: intergovernmental agreements and contracts between the companies.

While the first is dedicated to the policy framework, the contracts provide details of the gas commerce. It is difficult to analyze the latter as the commercial contracts are not publicly available and as long as debates last, the interpretations performed by both countries differ. However, the analysis of the first-level agreements, political scientists' researches, gas companies managers' statements and facts provided by quality printing media of different political shades enabled to recreate the most significant issues of the energy cooperation timeline.

The basic agreement on *Export of Russian Natural Gas to Ukraine and its Transit through the territory of Ukraine to European Countries* signed by Ukraine and Russian Federation on 18

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<sup>171</sup> The Ministry of Foreign Affairs of Russia.Web. Retrieved from: [http://www.mid.ru/brp\\_4.nsf/0/ODOC8D53B935139F44257976001EB0DA](http://www.mid.ru/brp_4.nsf/0/ODOC8D53B935139F44257976001EB0DA); 'Russia sees union with Belarus and Kazakhstan by 2015', *BBC News*, 18 November 2011.Web. Retrieved from: <http://www.bbc.co.uk/news/world-europe-15790452>

February 1994 initiated mutually beneficial arrangements in supply, storage and transit services.<sup>172</sup>

The agreement stipulated that from 1994 to 1995 Gazprom would provide Ukraine with 50 – 70 bcm of gas annually for domestic consumption and 112-144 bcm per year for transit to Europe. The agreement provided as well that Russia would transit 25-35 bcm of Central Asian gas to Ukraine. The precise prices and technical details had to be decided through annual contracts.

Generally, the character of relations between Russia and the two transit countries are alike. Certain trends were set immediately after the Soviet Union collapse. Firstly, the economic crisis resulted in energy underpayments and non payments which brought to accumulated debts. As a response for unpaid debts Russian oil and gas companies provided cut offs in both countries. Secondly, the political concessions often became a sort of unofficial non-monetary payment for oil and gas deliveries and vice versa, energy exports were used several times as a tool of political pressure. Thirdly, European countries were concerned about possible cut offs which would have made supplies unsecure.

Almost immediately after the Soviet Union collapse Russia-Ukraine energy relations experienced two difficult clashes.

The first one was connected to the shortfall in Turkmen supplies which caused 45% shortfall in gas deliveries to the West.

However, other shortfalls occurred by mixture of economic and political reasons. The most part of shortfalls took place during the energy disputes on non-payments as a response for debt

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<sup>172</sup> Agreement between the government of Russian Federation and the government of Ukraine on export of natural gas from Russia to Ukraine and its transpiration through the territory of Ukraine to European countries. Ukraine laws. Web. Retrieved from:[http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=643\\_067](http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=643_067); Ukraine energy policy review. 2006. International Energy Agency.

accumulation. Though there were several unsuccessful attempts to resolve these disputes politically, not all of them bore fruits. During the 1993 summit conference in Crimea B. Yeltsin stated that the debt would be cancelled in exchange of the Black Sea fleet control and Ukraine's nuclear warheads return.<sup>173</sup> However, this idea was abandoned as president Kravchuk refuted the initiative.

The debt was not paid and the supplies were suspended. As a response, Ukraine started siphoning gas in September 1993 and in November 1994<sup>174</sup>.

At the same period several attempts were made in order to resolve politically economic disputes in Belarus as well. After a number of debates over Belarus gas non-payments, the debt reached \$100 million and in 1993 Gazprom suspended gas supplies.<sup>175</sup> That initiated a number of disputes between the two countries during 1990s and 2000s as well and created tensions which haven't been resolved yet. Russian government offered Belarus to eliminate the debt in exchange of control over Belarus Energy Company Beltransgaz. The agreement was signed but the parliament did not ratify it<sup>176</sup>. However, the event had crucial significance for energy exports policy analysis as it initiated the adoption of a new exports strategy – political concessions or control over the energy routes for economical benefits.

At geopolitical level, some researchers<sup>177</sup> consider energy exports conflicts connected to transit countries as a struggle for spheres of political influence.

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<sup>173</sup> J.Lloyd, J.Barshay, 'Ukraine rejects Black Sea Fleet', *Financial Times*, 7 March 1994.

<sup>174</sup> S.Pirani, *Ukraine's gas sector*, Oxford Institute for Energy Studies. June 2007.P.19.

<sup>175</sup> C.Bruce, *Fraternal friction or fraternal fiction?The gas factor in Russian-Belarusian relations*, Oxford institute for energy studies, 2005.p.8.

<sup>176</sup> Ibid. , p.8.

<sup>177</sup> For example, J.M.Torres, A.Alvarez, A.Lauge,J.M.Sarreiegi, *Russian-Ukrainian gas conflict study*, University of Navarra, 2009. Web. Retrieved from:

<http://www.systemdynamics.org/conferences/2009/proceed/papers/P1240.pdf>

## The US influence in the region

Soon after independence, new-born states were appealing to Western countries for economic and technical support, a common tendency in 1990s for all the new-formed states to avoid further influence from Russia. At the same time the countries were seeking to establish new economic relations within and outside CIS union.<sup>178</sup> Different international organizations created and supported by other countries appeared in the region during 1990s as well. In 1997 Georgia, Ukraine, Azerbaijan, and Moldova established GUAM (Organization for Democracy and Economic Development), known from 1999 to 2005 as GUUAM as for this period Uzbekistan participated the organization as well<sup>179</sup>. The organization was supported and consolidated by the United States and, is considered to be founded to oppose Russian influence counterbalancing CIS<sup>180</sup>.

After the collapse of the USSR, the USA appeared to be the only hegemon seeking to spread its influence on the new-born independent zones. The resources-rich countries and the countries which occupied key positions in energy routes were considered vital in American foreign strategy. The former opponent of the USA, suffering from severe economic crisis, was not able to maintain control over the region and the United States used new opportunities to establish their influence.

In 1994 the negotiations over expansion of NATO in Eastern Europe started, although keeping NATO in borders existed was a promise made by the government of Margaret Thatcher and

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<sup>178</sup> N.Dobronravin, 'Нефть, газ и транспортное проклятие: Казахстан, Туркменистан, Азербайджан [Oil, gas and transportation curse: Kazakhstan, Turkmenistan, Azerbaijan]', *Oil, gas, social modernization*, Moscow: HSE(The National Research University Higher School of Economics) Omega-L, 2010, p. 442.

<sup>179</sup> GUAM. Web. Retrieved from:<http://guam-organization.org/node/242>

<sup>180</sup>'Axis of evil shaping against Moscow', *Kommersant*, 03 March 2005; 'ГУАМ:Тоскливо без Узбекистана? [GUAM: does it feel sad without Uzbekistan?]', *Expert Kazakhstan*, 25 June 2007.

Gorge Bush in exchange of Germany unification possibility four years before.<sup>181</sup> These developments and especially those which occurred in 2000s (for example, the Orange Revolution in Ukraine, supported by the United States)<sup>182</sup>, suggest that the conflict over transit countries could be part of a new post-cold war struggle for influence in the region.

### **L.Kuchma and A.Lukashenko: new developments in energy policy.**

A new period of Russia-Ukraine relations started after 1994 as a new-elected pro-Russian candidate L. Kuchma changed the political discourse<sup>183</sup>. While until 1994 Belarusian president Stanislau Shushkevich provided Russian-friendly politics and established close ties between the countries, the 1994 presidential elections in Belarus, on opposite, deteriorated relations between Russia and Belarus as a new elected president Alexander Lukashenko accentuated independence of the country and strained the ties between the country and its partner.<sup>184</sup>

However, the governments of both countries had to accept political concessions and establish ties with Russian Federation in order to provide cheap energy imports and have a possibility to delay payments. Although in 1995 the Belarus gas debt increased, no cut-offs followed that year. Furthermore, a year later, in 1996 the two countries signed a 'zero option' agreement, which meant that Belarus didn't have to redeem energy debts. Researcher Cloe Bruce advocated that there could be different political reasons for such a decision.

Firstly, the agreement on Custom Union, which was encouraging integration between the two countries, one of the milestones of Kremlin foreign policy, was signed in January 1995. This

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<sup>181</sup> S. Casertano, *Sfida all'ultimo barile*, , pp. 171-172.

<sup>182</sup> For example: Régis Genté, 'Dal Caucaso all'Asia centrale, gas e petrolio nel "Grande gioco"', *Manifesto: Le Monde diplomatique*, giugno 2007

<sup>183</sup> J.M.Torres, A.Alvarez, A.Lauge, J.M.Sarreiegi, *Russian-Ukrainian gas conflict study*.

<sup>184</sup> C.Bruce, *Fraternal friction or fraternal fiction? The gas factor in Russian-Belarusian relations*, p.5.

agreement would enable Belarus to pay domestic prices for gas. Another reason concerned the Yamal pipeline debates which were taking place at that period. The project was of pivotal importance for Russian government and it preferred not to upset negotiations. At the same time the cancellation of energy debt would provide Russian government with some advantages. It provided an opportunity to station troops in the country free of charge and to avoid paying compensation for plutonium contained in the nuclear missiles removed from the territory of Belarus and the cost of cleaning up damage from the Chernobyl accident<sup>185</sup>. Moreover, Russian presidential election campaign of 1996 influenced the decision as a possible re-unification within CIS, especially with Belarus, was one of Yeltzin's program issues. Thus, a scandal over energy supplies to this country would have damaged his image.

Though some scholars<sup>186</sup> tend to divide history of Russia-Belarus and Russia-Ukraine energy relations during 1990s in two periods, before and after 1994, in order to highlight the change of political trends, as a matter of fact the difference in bilateral relations is insignificant, both periods are characterized by attempts to maintain political independence providing at the same time large-scale cooperation in the economic sector. The economic benefits, in particular a possibility to delay payments for energy supplies and provide hydrocarbons imports for a reduced price, were possible to achieve in exchange of political and other economic concessions. The win-win collaboration was guaranteed by the importance of the transit countries for Russia-Europe energy relations.

The first conflicts and shortfalls in energy supplies made possible doubting the security of the routes existed. Russia and its European partners were ready to invest in construction of alternative routes for hydrocarbons supplies, first of all gas. In 1997-1999 Gazprom completed

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<sup>185</sup> Ibid. ,p.9.

<sup>186</sup> For example: J.M.Torres, A.Alvarez, A.Lauge,J.M.Sarreiegi, *Russian-Ukrainian gas conflict study*, University of Navarra.

offshore prospecting in the Baltic Sea in order to make possible to develop project Nord Stream, a pipeline which would provide such north European countries as Germany, the UK, the Netherlands, France, Denmark and others with gas supplies. The Nord Stream's first string was put into operation on November, 8 of 2011. November 2006, Gazprom and Italian energy company Eni entered into the Strategic Partnership Agreement which was the first milestone of the South Stream pipeline construction.<sup>187</sup> At the same time the European countries in order to differentiate energy imports took into account such projects as Nabucco, which were connected to other oil and gas producers, as it would allow reducing dependence on Russian hydrocarbons' supplies.

### **The new routes for Caspian and Central Asian resources**

The United States were interested in Russia-Europe energy relations as well. Establishing control over the routes passing through new-born states would enable to consolidate their influence over both the European region and Russia. Furthermore, the Silk Road region was important not only from the point of view of the resources but also as a strategic area connecting rising Asian economical giants, in particular China, with western countries. Thus, Central Asia became one of the key battlefields over the resource routes' control during 1990s.

In 1991 Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan e Uzbekistan became independent states. As Stefano Casertano notices, it was impossible to maintain control over the region and Gorbachev preferred to give autonomy to the countries in order not to make radioactive material fall into bad hands. A significant pressure over the separation of the region

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<sup>187</sup> Gazprom. Web. Retrieved from: [www.gazprom.com](http://www.gazprom.com)

from Russia was exerted by Pakistani president general Mohammad Zia ulHaq till his death in 1988.<sup>188</sup>

After the collapse of the Soviet Union, the region became independent and, though rich of resources and located in an area of strategic importance, was able to avoid external influences for some years. In that period nationalist movements raised were opposing any possibility of closer collaboration with the USSR's direct successor as such collaboration could bring restoration of Russian influence. At the same time the emerged independent Central Asian countries were ready to establish closer relations with western and eastern partners.<sup>189</sup> The region had crucial importance as it occupied a key strategic position between Middle East, Western countries and growing economies of Far East.<sup>190</sup> Furthermore, the region possessed critical mineral resources. Only oil was estimated in early 1990s at 200 milliard barrels and was considered by many political scientists as a dangerously large quantity which had to be controlled. However according to recent researches Central Asian resources made up 33 milliard barrels which was, however, almost eight times less than 260 milliards of Saudi Arabia<sup>191</sup>

Russia-Europe energy relations were influenced by events which occurred mostly in or related to three countries of the region, Azerbaijan, Kazakhstan and Turkmenistan.

The Caspian region and Central Asian resources-rich countries were seeking to find alternatives to the old Soviet pipeline system to deliver and sell hydrocarbons directly to European countries. Intended to remain the main oil and gas supplier for Europe and to maintain earnings

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<sup>188</sup> S. Casertano, *Sfida all'ultimo barile*, p.173.

<sup>189</sup> N.Dobronravín, 'Нефть, газ и транспортное проклятие: Казахстан, Туркменистан, Азербайджан [Oil, gas and transportation curse: Kazakhstan, Turkmenistan, Azerbaijan]', *Oil, gas, social modernization*, Moscow: HSE(The National Research University Higher School of Economics) Omega-L, 2010, p.442.

<sup>190</sup> S. Casertano, *Sfida all'ultimo barile*, p. 174.

<sup>191</sup> Ibid. , p. 174.



from Caspian resources' resale, Russia was trying to oppose the projects being developed and prove the convenience of usage of the pipelines passing its territory.

### **Energy policy in Azerbaijan**

Azerbaijan occupied a key position in Caspian hydrocarbon flows. Military conflict over Nagorno-Karabakh<sup>192</sup> resulted in deterioration of diplomatic relations between Russia and Azerbaijan as Russia provided military support to Armenia during the conflict.<sup>193</sup> As Stefano Casertano claims, there were evidences, however, that the Red Army was supporting both sides in order to prolong the conflict till the moment Azerbaijan and Armenia asked Moscow to interfere. Being a peace-maker and resolving the conflict Russia could re-establish political influence over the region. However, Russia was not the only power intended to use the conflict in its interests. The USA was supporting Armenia as well. The new Azerbaijan president Heydar Aliyev decided to use the will of the countries to gain control over Azerbaijan hydrocarbon resources in behalf of the country. His solution was to invite as many countries as possible for oil exploration. The world's biggest companies were involved into exploration, among them Amoco, Pennzoil, Unocal, McDermott, BP, Ramco, Lukoil, Statoil, Turkish and Saudi Arabia companies. Though the Russian company Lukoil participated in the project, Russian Minister of Foreign Affairs Andrej Kozyrev declared Caspian Sea a lake, according to its geographical characteristics, thus enabling the application of alternative international laws concerning

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<sup>192</sup> The Nagorno-Karabach is a region situated in southwestern Azerbaijan which historically was a disputed territory. In late 1980s Armenian community of this region demanded an independence of Nagorno-Karabach region after a plebiscite held. Numerous conflicts between azerbaijans and armenians over this question developed in a war between the Republic of Azerbaijan and the Armenian population of Nagorno-Karabach backed by the Republic of Armenia which lasted from 1992 till 1994. The conflict stopped with cease fire but the situation wasn't resolved (Ferrari A., *Il Caucaso. Popoli e conflitti di una frontiera europea*, Roma: Edizioni Lavoro Roma, 2005.)

<sup>193</sup> Heiko Kruger, *The Nagorno-Karabakh conflict: A legal Analysis*, Berlin: Springer, 2009. 1st Edition., 2010, p.22.

resources distribution<sup>194</sup>, videlicet the resources had to be developed in common. The contradiction in Russian foreign policy over the same issue was explained as “lack of coordination” but influenced negatively the image of the country.<sup>195</sup>

This event along with other circumstances made a contribution into difficulties the Russian government faced trying to influence energy policy of Azerbaijan and oppose the construction of pipeline, which would connect Azerbaijan to Georgia and Turkey. The pipeline delivered to Turkey oil collected from all over the Caspian region, and became a rival project to ex-USSR pipelines which were intended to create the only convenient route for Caspian hydrocarbons exports passing through Russian territory. Another big challenge to Russian exports to European countries was made by Nabucco pipeline project, developed later.<sup>196</sup>

### **The influence of the Chechen war on Kazakh and Azerbaijani energy routes**

Kazakhstan possesses 85% of the Caspian oil resources. Its geographical position is more advantageous than the one of other Central Asian countries as it borders with Russian Federation, China, Uzbekistan and Turkmenistan which could give in future different opportunities for exports. However, Soviet pipeline system made Russia and Kazakhstan strongly connected. Even now, the most part of energy exports is possible to deliver to a customer just through Russian territory<sup>197</sup>. Only a small part of oil of the west Kazakhstan could be exported through port Aktau. After the collapse of the Soviet Union Nursultan Nazarbaev became a president-for –life of Kazakhstan. As other Central Asian leaders, he was seeking to

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<sup>194</sup> S. Casertano, *Sfida all'ultimo barile*, pp.183-184.

<sup>195</sup> B. Gökyay, *The politics of Caspian oil*, New York: Palgrave Macmillan , 2001, p. 171.

<sup>196</sup> J.Perovic, R.W.Orttung,A.Wenger, *Russian energy power and foreign relations*, CSS Studies in security and international relations, New York: Routledge, 2010.

<sup>197</sup> N.Dobronravin, ‘Нефть, газ и транспортное проклятие: Казахстан, Туркменистан, Азербайджан [Oil, gas and transportation curse: Kazakhstan, Turkmenistan, Azerbaijan]’, p. 451.

gain the US political support and adopted US-friendly policy, one of significant developments of which was Kazakh participation in Start agreement and renunciation of nuclear weapons. The energy resources were divided among the national company Kazmunaigaz (20%), American ChevronTexaco(50%) and ExxonMobil(25%). Though now oil exports are delivered to China through a new pipeline constructed in 2006<sup>198</sup>, during 1990s the only route to transport them was the old Soviet pipeline<sup>199</sup>.

The collapse of the Soviet Union brought to rise of nationalist movements ready to struggle for independence, not only in the Caspian region. On September 6, 1991, General Dzhokhar Dudayev, stormed a session of the Chechen-Ingush ASSR Supreme Soviet and declared independence of Chechnya and Ingushetia. Although in 1993 he gained Chechnya citizens' support at the elections took place afterwards and Chechnya declared full independence, Ingushetia preferred to join Russian Federation. In October 1994 Moscow decided to respond with a military operation which continued till August 1996. The war finished with Chechen victory and the region remained independent till the second Chechen war started in 1999<sup>200</sup>. The region had a crucial significance for Russian government as important pipelines connecting Caspian region and Europe were located on its territory. The separation of the region and two wars followed made the situation instable and realization of some projects connected to energy exports impossible.

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<sup>198</sup> J.Nanay, 'Russia's role in the Eurasian energy market: seeking control in face of growing challenges, *Russian energy power and foreign relations*, CSS Studies in security and international relations, Oxon: Routledge, , 2010, p. 120.

<sup>199</sup> N.Dobronravin, 'Нефть, газ и транспортное проклятие: Казахстан, Туркменистан, Азербайджан [Oil, gas and transportation curse: Kazakhstan, Turkmenistan, Azerbaijan]', p. 451; S. Casertano, *Sfida all'ultimo barile*, pp. 176-178.

<sup>200</sup> A.Ferrari, *Il Caucaso*, Edizioni Lavoro Roma, 2005, pp.77-79.

In 1992 Kazakhstan, the Russian Federation and Oman created Cpc ( Caspian pipeline consortium) in order to provide energy supplies to Europe connecting Kazakh port Tengiz and Russian port on the Black Sea Novorossiysk with a pipeline<sup>201</sup>.



(Retrieved from: <http://www.cpc.ru/desktopdefault.aspx?alias=press&lang=En-US&tabid=3357>)

The beginning of the first Chechen war made the project realization impossible as the pipeline had to pass through Chechen territory. The project was damaged by other developments as well. As Stefano Casertano asserts, the countries financing the pipeline construction recalled investments under pressure from the United States. Nevertheless, the pipeline was completed later as the last 1500 km were constructed in cooperation with Eni, Chevron, Mobil and BP.<sup>202</sup>

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<sup>201</sup>S. Casertano, *Sfida all'ultimo barile*, pp.190.

<sup>202</sup>*Ibid.* , pp.192.



(Retrieved from: <http://eurodialogue.org/Caspian-Pipelines-Map>)

During the same period Azerbaijan became a political battlefield between Russia and the USA for Caspian petroleum. President Aliyev received two proposals over the construction of a pipeline which would deliver Caspian oil to Europe. One runs North and the other South. Though pipeline Baku-Novorossiysk already existed and that made choice of Russian strategy attractive, instability in Chechnya didn't permit to deliver oil without risks or construction of a supplementary part, skirting the region. Washington was supporting the Baku - Ceyhan pipeline project. One of the strategic aims of Clinton administration in 1997 was to avoid cooperation in energy sphere with Russia and Iran, thus, to choose north direction meant for Azerbaijan to make worlds' most powerful enemy. The president decided that the only way to avoid diplomatic clashes was to accept both projects.

The deliveries through Russian pipeline system to Novorossiysk started already in 1997. Firstly Russian companies decided to transit oil through Georgian territory, but later a detour pipeline

was constructed and deliveries flew through Dagestan<sup>203</sup>. The pipeline to Turkey started near Baku and firstly ran to Georgian port Supsa but later traveled through Tbilisi to Ceyhan marine terminal. The project was signed in 1999 but only in 2006 first oil reached the Ceyhan.<sup>204</sup>

### **Turkmen pipeline projects**

One of the most important clashes over Caspian region resources and the routes of their exports to Europe was connected to Turkmenistan, the country which possessed fourth-largest reserves of natural gas in the world<sup>205</sup>. During the Cold War period a large part of Turkmen gas was exported to Western Europe. After the collapse of the Soviet Union, these exports became unprofitable for Gazprom possessed the Soviet pipeline system. The Siberian resources were vast enough to satisfy both Russian domestic demand and exports requests in European countries. Furthermore, Gazprom intended to have the least possible rivals at European market.

The two countries arrived to an agreement according to which Gazprom would buy some of Turkmen gas for reduced price and enable Turkmenistan to use Russian pipeline system to deliver Turkmen gas supplies to Ukraine.<sup>206</sup>

The Russian-Turkmenistan energy relations were damaged by a number of disputes over the prices and payments delays. Scholars explain these delays differently. While Ahmed Rashid

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<sup>203</sup>S. Casertano, *Sfida all'ultimo barile*, pp. 194-196.

<sup>204</sup>Spanning three countries from the Caspian Sea to the Mediterranean coast. BP.Web.Retrieved from: <http://www.bp.com/sectiongenericarticle.do?categoryId=9006669&contentId=7015093>

<sup>205</sup> After Russia, Iran and Qatar. (CIA world factbook. Web. Retrieved from: <https://www.cia.gov/library/publications/the-world-factbook/index.html>)

<sup>206</sup> Country Analysis Briefs: 1994: Profiles of Major World Energy Producers, consumers and transport centers: energy chronology for 1994, Washington, DC : Energy Information Administration, Office of Energy Markets and End Use, U.S. Dept. of Energy ,1995,p. 74; V.Panjushkin, V.Zigar, *Газпром: новое русское оружие* [*Gazprom: The new Russian weapon*].

asserts that three economic partners of Turkmenistan (Russia, Ukraine and Armenia) refused to pay the bills, David G. Victor, Amy Jaffe, Mark H. Hayes as well as Valerij Panjushkin and M. Zigar claim that delays in payments from Russia were conditioned by the delays of Ukraine.<sup>207</sup>

However, Turkmenistan didn't receive as many advantages from gas exports as it could have been if the supplies were delivered avoiding Russian territory and President Saparmurat Niyazov started to search other routes of gas exports. Turkmenistan bordered Russia and Uzbekistan on north, Afghanistan on south and Iran on west, thus the way round Russian pipeline system was rather difficult to create. Nevertheless, Turkmen government took into consideration three possible alternative routes. The easiest choice could be to deliver gas to Turkey through Iranian pipeline system. Another possibility was to deliver gas to Azerbaijan through Caspian Sea and from there to Turkey. The third one was connected to construction of a pipeline through Afghanistan directed to Pakistan. The Turkmen government made an attempt to build all the three routes one by one.



(Retrieved from: <http://www.oxan.com/display.aspx?ItemID=DB141950>)

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<sup>207</sup> Ahmed Rashid, *Taliban: Islam, oil and the new great game in central Asia*, London: I.B. Tauris, 2000, p.151; M.Brill Olcott, 'International gas trade in Central Asia: Turkmenistan, Iran, Russia and Afghanistan', *Natural gas and geopolitics: from 1970 to 2040*, New York: Cambridge university press, 2006, p.223; Country Analysis Briefs: 1994: Profiles of Major World Energy Producers, consumers and transport centres: energy chronology for 1994, Washington, DC : Energy Information Administration, Office of Energy Markets and End Use, U.S. Dept. of Energy ,1995, p.74; V.Panjushkin, V.Zigar, , *Газпром: новое русское оружие [Gazprom: The new Russian weapon]*.

In August 1994 Saparmurat Niyazov signed an agreement with Iranian president Hashemi Bahramani on construction of a gas pipeline which would go to Turkey and Western Europe through Iran. In that period the idea of Blue Stream pipeline<sup>208</sup> project was being developed<sup>209</sup> and Gazprom intended to eliminate a business rival in the Turkish market. After Islamic revolution of 1979 Iran was considered dangerous and consequently tended to be isolated: after a conversation between Prime Minister of Russia Viktor Chernomyrdin and American Vice President Albert Gore, the US government started to exert pressure on countries which could finance the project in order to eliminate the agreements with Iran. Turkmenistan and Iran could not afford the pipeline construction on their own. International financial institutions, foreign private lenders and foreign companies refused to support the project as it was connected to Iran.<sup>210</sup> That made the pipeline construction impossible and the project was abandoned.

Another possibility to deliver gas to Turkey was to lay at bottom of the Caspian Sea a gas pipeline directed to Azerbaijan, which would travel through Baku to Turkey. Taking into consideration possible risks president Nyazov was waiting till 1998 to sign a contract with Azerbaijan's president Heydar Aliyev. However at the last minute president Aliyev changed conditions of the agreement and the contract was not signed<sup>211</sup>.

The third project was strongly supported by the United States. The US oil and gas companies had strong interests in the Caspian hydrocarbons exports. During the 1990s US politicians were deliberately overrating the quantities of Caspian natural resources in order to justify their

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<sup>208</sup> Blue Stream is a Russian gas pipeline which connects Russia and Turkey.

<sup>209</sup> Although the agreement between Turkey and Russia on new gas pipeline construction was signed in December 1997, Gazprom was developing project some years before that (V.Panjushkin, V.Zigar, *Газпром: новое русское оружие* [*Gazprom: The new Russian weapon*], p.170.)

<sup>210</sup> Hooshang Amirahmadi, *The Caspian region at a crossroad: challenges of a new frontier of energy and development*, New York: Palgrave Macmillan, 2000. pp.71-72.

<sup>211</sup> V.Panjushkin, V.Zigar, *Газпром: новое русское оружие* [*Gazprom: The new Russian weapon*], p.171.



interference in that geographical area<sup>212</sup>. The natural oil resources of Caspian Sea were estimated by American analysts at 243 billion of barrels, while international experts confirmed now that it accounted for about 50 billion of barrels, what is almost 1/5th of what was declared in 1990s.<sup>213</sup>

On March 16, 1995 Turkmenistan and Pakistan signed a memorandum on a gas pipeline which would pass through Afghan territory. The financial support was provided by American company Unocal.<sup>214</sup>

On October 21, 1995 Niyazov signed an agreement with Unocal and Saudi-Arabia owned Delta Oil Company on the pipeline construction.<sup>215</sup>

Successful realization of the project depended on security in the region. In 1996 Pakistan and USA- backed Talibans took Kabul<sup>216</sup>. Though many countries later condemned Taliban regime, and in 1999 UN Security council decided to impose sanctions on the country, the group was established under the guidance of Pakistan intelligence and initially was supported by Saudi Arabia and US. A political change happened was profitable to companies involved in the project as Taliban was expected to provide stability and make gas pipelines construction and functioning secure. The pipeline project was considered as a challenge to Russian influence in the region. In order to oppose the pipeline construction as well as to avoid the danger of fundamentalism which could spread over Tajikistan under Taliban's influence, just before the works started, Russia, Iran and four of five Central Asian Republics provided the Northern

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<sup>212</sup> Régis Genté, 'Dal Caucaso all'Asia centrale, gas e petrolio nel "Grande gioco"', *Manifesto: Le Monde diplomatique*, giugno 2007, pp. 12-13.

<sup>213</sup> Régis Genté, 'Dal Caucaso all'Asia centrale, gas e petrolio nel "Grande gioco"', pp. 12-13.

<sup>214</sup> Hooshang Amirahmadi, *The Caspian region at a crossroad: challenges of a new frontier of energy*, p.179.

<sup>215</sup> Ahmed Rashid, *Taliban: Islam, oil and the new great game in central Asia*, London: I.B. Tauris, 2000, p. 160.

<sup>216</sup> Norman K. Denzin, Yvonna S. Lincoln, *9-11 in American culture*, Oxford: Altamira Press, 2003, p.16; Ahmed Rashid, *Taliban: Islam, oil and the new great game in central Asia*, pp.170-180.

Alliance group with weapons to fight against Taliban.<sup>217</sup> The civil war broke out later made the energy supplies through Afghanistan impossible.

### **The United States and the Silk Road Strategy**

The further strategy of the United States in the region was predetermined by a document appeared in 1999. The Silk Road Strategy Act of 1999<sup>218</sup> authorized “specified assistance, including humanitarian, economic, migration and refugee, development, border control, and democracy building assistance, to the South Caucasus and Central Asia countries”<sup>219</sup>. The act involved such countries as Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan and gave following reasons for necessity of US influence consolidation in the region. Firstly, according to the document, economic, political and security ties between the West and Central Asian countries would make them less vulnerable and independent from neighbors’ influence. Secondly, this region “produces oil and gas in sufficient quantities to reduce the dependence of the United States on energy from the volatile Persian Gulf region”<sup>220</sup>.

Moreover, the establishment of GUAM organization (now without Armenia) along with the Silk Road strategy in Central Asia would enable to connect Mediterranean region and Far East; this connection would provide distribution of Caspian hydrocarbons according to US interests and allow them to oppose interests of Shanghai Cooperation Organization.

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<sup>217</sup> Ahmed Rashid, *Taliban: Islam, oil and the new great game in central Asia*, p.5; Hooshang Amirahmadi, *The Caspian region at a crossroad: challenges of a new frontier of energy*, p.179.

<sup>218</sup> Silk Road strategy Act of 1999. Web. Retrieved from: <http://www.govtrack.us/congress/billtext.xpd?bill=h106-1152>

<sup>219</sup> Silk Road strategy Act of 1999. Summary. Retrieved from: <http://www.govtrack.us/congress/bill.xpd?bill=h106-1152&tab=summary>

<sup>220</sup> Silk Road strategy Act of 1999. Web. Retrieved from: <http://www.govtrack.us/congress/billtext.xpd?bill=h106-1152>

Giancarlo Elia Valori underlines the importance to maintain control over Afghanistan in order to influence the Central Asia and separate Russia from India. Furthermore, the implementation of the Silk Road project would enable to minimize possible commercial agreements between Russia and China, to isolate Israel from Persian Gulf tensions and make India concentrate on development of fleet forces acting in Indian and Pacific oceans<sup>221</sup>.

According to the scholar, the control over India and Silk Road could be also important for the containment of emerging economical giants of Far East.

Furthermore, the establishment of GUAM in June 2001 by USA, Georgia, Ukraine Moldova and Azerbaijan aimed to create an alternative to Druzba and BPS(Baltic pipeline system) route for hydrocarbons.

Though officially neither B.Clinton, nor B.Yeltsin and V.Putin announced the political war in Caspian region, many analysts, such as E. Valori claim that the clashes existed could prove the battle over Caspian resources to become a new regional Cold War<sup>222</sup>.

### **The Europe-Russia energy cooperation in the beginning of 2000s**

In the beginning of 2000s, further developments in Russian energy sector as well as in international energy policy resulted in a new shape of energy relations both within the country and on geopolitical level.

The foreign and domestic policy of 2000s in Russia is associated to the personality of V. Putin, who has recently become the Russian president for the third time.

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<sup>221</sup> Gianfranco Elia Valori, *Petrolio.La nuova geopolitica del potere*, Milano: Excelsior 1881,2001,pp.122-123

<sup>222</sup> Ibid.

The new Russian president, soon after the election campaign of 2000, started to reorganize the structure of the state, delegating the president post with more authority. One of the key points of his political program was the transfer of the control of hydrocarbon resources from the local authorities to Moscow and the concentration under state's control of the oil and gas companies. One of the most significant and celebrated event connected to this trend was the trial over one of the biggest Russian oil and gas companies Yukos and its CEO Michail Khodorkovsky. After the trial, the company was sold out and its leader was imprisoned. He was later declared prisoner of conscience by Amnesty International as the reasons of his arrest and sentence were believed to have political roots<sup>223</sup>. Some authors stress as well the importance of commercial issues which influenced Yukos case. Khodorkovsky's supported project of a pipeline leading to Murmansk and his intention to develop a route which would enable to establish close links with China in order to provide energy exports were strongly opposed by the government, which was planning to deliver energy supplies to Japan.<sup>224</sup> Furthermore, some contribution was made by criticism leveled at national company Rosneft and undertakings which were considered by the government dangerous and destabilizing.

The official reason of arrest, occurred in October 2003, was the tax charges. As the company was declared bankrupt, Affiliate Company Yuganskneftgas as well as the most part of Yukos assets was bought by national company Rosneft soon<sup>225</sup>. In consequence, the most part of hydrocarbon resources of the country was found under state's control. The Yukos case had pivotal importance as it anticipated a new trend in Russian politics on centralization and

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<sup>223</sup> *Russian businessman declared prisoners of conscience after convictions are upheld*, Amnesty International, 24 May 2011. Web. Retrieved from:<http://www.amnesty.org/en/news-and-updates/russian-businessmen-declared-prisoners-conscience-after-convictions-are-upheld-2011>

<sup>224</sup> S.Casertano, *Sfida all'ultimo barile*, p.211.

<sup>225</sup> I.Reznik, 'Прокурорский дисконт [Prosecutor's discount]', *Vedomosti*, 25 September 2007.

strengthening of the chain of command and influenced energy exports policy as well, consolidating the existing tendency of energy exports politicization.

Russian mass media often claim that the GDP level of the country increased significantly since V.Putin has become the President. The leaders of different countries and international journalists notice that Russia partially reestablished its political influence lost after the Soviet Union collapse, though having significantly less impact on the international politics than the USSR, it was considered politically stronger and more influential than during 1990s.

However, it is important to highlight that there were two important developments which predetermined such changes in international political conjuncture. The first one was connected to the considerable increase of oil prices in early 2000s. On the one hand, it caused higher earnings to Russia state budget, on the other, it became easier to use the energy supplies as a political instrument. Another development was connected to the US invasion of Iraq, which influenced the oil prices. The American foreign policy objectives were transferred from Russia and the former USSR region to the Middle East. This gave the Russian government and OPEC a possibility of a less restricted foreign policy: such freedom of actions was inconceivable before.

To conclude, USA foreign policy played a crucial role in Russia-Europe energy cooperation. Though the Cold War was over, Russia was still perceived as a potential rival able to restore influence over the region lost with the USSR collapse. Thus, a confrontation between the USA and Russia over the new-born countries was a constant trend of 1990s. The appearance of new routes for hydrocarbons exports to Europe could not only decrease Russian influence on the ex-USSR region but to weaken the ties between Europe and Russia as well.

Several attempts aimed at the establishment of common rules for energy exports between Russia and European countries did not bear many fruits, while the creation of an integrated energy market within the European Union was completed successfully.

In the first half of 1990s, the privatization of energy sector in Russia brought to a possibility for European countries to conclude agreements with different companies independently from the state. However, this trend changed soon and in the beginning of 2000s the most part of energy resources and its distribution system appeared to be under government control.

Differently from the Soviet Period, in 1990s Russian energy supplies were provided in exchange of political concessions and sometimes were used as a tool of political influence, especially in developments related to the transit countries. The European countries and Russia, in order to avoid the transit countries problem, started to develop new energy routes such as South Stream and Nord Stream. Other resources-rich countries as well were developing new routes to provide energy supplies to the European countries directly.

International political conjecture emerged in the beginning of 2000s enables us to consider the following decade as a new period of international political history. The US invasion of Afghanistan and Iraq as well as attempts to influence directly European, Central Asian and Middle East policies, the strengthening of the chain of command in Russia and an increase of the country's role in the region, the colored revolutions in post-soviet space and other developments influenced significantly the conditions of energy exports and Russia-Europe energy relations.

In order to understand the particularities of Russia-Europe energy relations from 2000s onward, an analysis of the connection between energy exports and the changing international relations in the region is necessary.

## Chapter III. A stronger Russia and the competition among new energy routes

### New developments in EU-Russia cooperation

The new century brought changes in the conjuncture of international relations and as a result in international energy policy. As the volumes of energy exports increased since 2000, relations between Russia and the European Union developed. While in 2000 Russia exported in EU countries 119 milliard gas cubic meters, this quantity increased to 134 billion gas cubic meters in 2008. At the same time, the oil exports to EU countries rose from 112 million tons in 2000 to 185 million tons in 2007. The coal exports in the same period quadrupled. However, these higher numbers were connected not only to an increase of volumes of hydrocarbons delivered to EU countries but as well to the extension of the European Union in 2004 and 2007. Many of the new EU members were largely dependent on Russian energy exports<sup>226</sup>.

However, the Russian Federation was depended as well on its energy exports to Europe. In 2002 energy exports earnings accounted for 33,1% of the state budget.<sup>227</sup> The numbers tend to increase with the lapse of time, in 2007 hard currency earnings from raw materials sold to EU contributed already over 40% of the Russian federal budget.<sup>228</sup> In 2008 Europe was importing already 34% of oil from the former Soviet Union, mostly from Russia and around 44% of

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<sup>226</sup> European Commissioner for Energy Günther H. Oettinger, Minister of Energy Sergey I. Shmatko, *Joint Report EU-Russia Energy Dialogue 2000-2010: Opportunities for our future Energy Partnership* Brussels / Moscow November 2010. Web. Retrieved from:

<http://ec.europa.eu/energy/international/russia/doc/reports/2010-11-report-10thtanniversaryfinal.pdf>;  
<http://minenergo.gov.ru/upload/iblock/537/5379590b46eccb229803488dcbc3940c.pdf>

<sup>227</sup> E. Gurevich, E. Vakulenko, P. Krivenko, 'Циклические свойства бюджетной политики в нефтедобывающих странах [Cyclic characteristics of the budgetary policy in oil-producing countries]', *Voprosi Ekonomiki*, #2 2009, pp.51-70.

<sup>228</sup> *EU-Russia energy dialogue*. EurActiv. 23 October 2006. Web. Retrieved from:  
<http://www.euractiv.com/energy/eu-russia-energy-dialogue/article-150061>

gas.<sup>229</sup> According to European commission, in 2009 80% of Russian oil and 70 of gas exports went to EU<sup>230</sup>. From the numbers adduced, it is apparent that between the European countries and Russia existed mutual dependence. Seeking for energy exports diversification the European countries, however, were dependent in a large scale on Russian energy supplies. Having no other large customer, Russia as an oil and gas producer was dependent on European customers in turn.

The awareness of the mutual dependence and insecurity of hydrocarbons exports pushed European countries to differentiate its suppliers and Russia to search for new routes for energy exports.

### **Russian domestic policy and energy exports to Europe**

The economic reforms and political changes in Russia influenced significantly the energy policy of the country during 2000s. One of the most important developments in Russian domestic policy of the beginning of 2000s was the centralization of power. During the period of 1990s the Republics of Russia supervised the local resources distribution. As the local laws underlay the national laws, the national laws could be frozen by the local government, which meant almost complete autonomy of the regions. To establish the central control over the regions and their resources, a number of laws adopted in 2000-2001 provided the redistribution of local and federal subject's functions<sup>231</sup>. According to a decree promulgated in August 2000, seventy nine Russian regions were reorganized in seven federal districts (8 from 2010) which were

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<sup>229</sup>G. Nicchia, *The energy issue in EU-Russia relations*, p.69.

<sup>230</sup> European Commission, EU-Russia energy relations. Web. Retrieved from: [http://ec.europa.eu/energy/international/russia/russia\\_en.htm](http://ec.europa.eu/energy/international/russia/russia_en.htm)

<sup>231</sup> А.В. Везбородов, *История России в новейшее время, 1985-2009* [*The contemporary history of Russia, 1985-2009*], , Moscow: Prospect, 2010, pp.237-239.



controlled directly from Moscow as the Plenipotentiary Representatives watched over the observance of Federal laws in the districts.<sup>232</sup> Through this reform the Russian government gained control over the domestic resources. Supervising the hydrocarbons distribution through state-owned companies Gazprom, Transneft and Rosneft, which became the biggest Russian oil and gas companies after buying Yukos assets, the Russian government could correct the energy policy in conformity with the political discourse and vice versa<sup>233</sup>.

Meanwhile, the foreign investments in energy sector became more restricted. The biggest foreign investors in Russian oil and gas industry were BP(UK), BASF (Germany), Conoco Philips (USA) and E.ON Ruhrgas(Germany). As researcher H. Pleines noticed, “the population strongly opposes any foreign involvement in strategic sector of the economy and in the energy sector in particular” and half of high-rank bureaucrats opened to foreign investment spoke out against it<sup>234</sup>. The Russian government as well was taking measures in order to restrict foreign investments in energy sector during 2000s. For example, it forced Shell and Japanese companies to include Gazprom in Sakhalin-2 project, the only major investment without a Russian partner. In 2008 the government prepared a law over foreign investments, according to which “any purchase of a controlling stake in a state-owned company in strategic sectors or a purchase of more than 10 percent in larger oil and gas deposits were subject to approval by a government commission, made up of representatives of economy-related ministries and security structures including the Federal Security Service (FSB)”<sup>235</sup>

Thus, though the European countries and Russia sought closer cooperation, the foreign investments in oil and gas sector of Russia remained very restricted.

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<sup>232</sup>S. Casertano, *Sfida all'ultimo baril*, p.210.

<sup>233</sup> Ibid. , p.212.

<sup>234</sup> H.Pleines, 'Developing Russia's oil and gas industry', *Russian energy power and foreign relations*, CSS Studies in Security and International Relations, Oxon: Routledge, 2009,p.73.

<sup>235</sup> Ibid. , p.74.

However, other initiatives allowed the sides simplify energy cooperation and make the accords more transparent.

During October 2000 Summit Russia and the European Union concluded an agreement to initiate a regular Energy Dialogue<sup>236</sup>. Thus energy issue became one of the key topics of EU-Russia summits in 2003, 2005 and 2008. On 31 May 2003 the countries established a format of Permanent Partnership Council, which meetings repeated several times afterwards. Moreover, many other initiatives concerning common energy policy and multilateral cooperation in energy field were introduced during following years. The Road Map for the EU-Russia Common Economic Space was adopted during the EU-Russia Summit of 2005. The Partnership and Cooperation Agreement (PCA) was decided to be replaced during the negotiations for a New EU-Russia Agreement in 2008. The Kyoto protocol according to which the countries-members had to reduce greenhouse gas emissions by 5.2% on average<sup>237</sup> entered into force in 2005.<sup>238</sup> In November 2010, the European Commission adopted a strategy “for competitive, sustainable and secure energy” titled “Energy 2020”, which set the challenges in energy field the European Union would take up during next ten years. Another initiative titled “Energy infrastructure priorities for 2020 and beyond - a blueprint for an integrated European energy network” defining “priority corridors for the transport of electricity, gas and oil” was adopted the same month. The initiatives for the gas and oil pipelines construction included the Nord Stream, the South Stream and Nabucco routes.<sup>239</sup>

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<sup>236</sup> EU-Russia energy dialogue, the European Commission. Web. Retrieved

from: [http://ec.europa.eu/energy/international/russia/dialogue/dialogue\\_en.htm](http://ec.europa.eu/energy/international/russia/dialogue/dialogue_en.htm)

<sup>237</sup> Jos G.J. Olivier, Greet Janssens-Maenhout, Jeroen A.H.W. Peters, Julian Wilson, *Long term trend in global CO2 emissions*, 2011 report of Netherlands Environmental Assessment Agency and European Commission, p.26.

<sup>238</sup> *EU-Russia Energy Dialogue. The first ten years: 2000-2010*. European commission, Brussels, 2011. Web. Retrieved from: [http://ec.europa.eu/energy/publications/doc/2011\\_eu-russia\\_energy\\_relations.pdf](http://ec.europa.eu/energy/publications/doc/2011_eu-russia_energy_relations.pdf)

<sup>239</sup> European Commission, Eurostat, Energy production and imports. Web. Retrieved from:

[http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/Energy\\_production\\_and\\_imports](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Energy_production_and_imports)

While the Nord Stream and the South Stream projects were aimed at creation of new energy routes for Russian gas supplies which would allow bypassing the problematic transit countries, the Nabucco, White Stream and European South corridor projects were designed for delivering gas from the Caspian region and the Middle East to the European markets bypassing Russia.

The necessity to build new routes was connected to several problems the Europe-Russian energy cooperation faced during 2000s. Firstly, the numerous conflicts between the Belarus, Ukraine and Russia resulted in energy shortages made the hydrocarbons supplies of the Western European partners through old gas pipelines Brotherhood, Soyuz (passing Ukraine ) and Yamal-Europe (running through Belarus) insecure. The oil supplies through Druzhba pipeline faced similar problem.

Secondly, in near future the European countries were planning to increase the hydrocarbons imports but the capacity of old pipelines not always permitted to raise volumes. The transportation of petroleum on tankers could not solve the problem as the Turkish Straits were 'overloaded'.

Finally, the European countries in order to decrease the dependency on Russian energy supplies invested in construction of alternative routes, while Russia in 2000s concluded some accords with China for construction of an oil pipeline with an access to Pacific oil market in order to diversify its supplies.



(Retrieved from: <http://www.economist.com/node/14041672>)



(Retrieved from: [http://energy-eng.blogspot.com/2009\\_01\\_01\\_archive.html](http://energy-eng.blogspot.com/2009_01_01_archive.html))

To understand the nature of the conflicts over transit countries and estimate the necessity of new routes construction it is pivotal to examine the Russia-Belarus and Russia –Ukraine energy relations during 2000s. As these conflicts became an object of different researches and international mass media reports, with different interpretations of the economic and political facets of the debates, it is important to recreate the timeline of the events using the factual base available and then make an attempt to analyze the international importance of the conflicts.

### **Belarus-Russia energy conflicts**

In spite of the difficulties that Russia and Belarus faced while attempting to cooperate during 1990s, in the beginning of 2000s the relations between the countries improved. The Yamal-Europe gas pipeline construction was completed and this event guaranteed that the countries were ready to develop secure energy relations. As the economic and political ties became stronger, in Foreign Policy Concept of the Russian Federation 2000 Belarus was the only state mentioned separately in the CIS chapter.<sup>240</sup>

In April 2002, Russia and Belarus signed an agreement according to which Russia would guarantee cheap gas supplies at domestic prices. Belarus, in exchange, would enable Gazprom to receive up to 50% shares in gas infrastructure and transportation company Beltransgaz and create a gas transport joint venture based on Beltransgaz.<sup>241</sup> The Russian government

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<sup>240</sup> Heinz Timmermann, 'Кризис разговорного жанра. Москва-Минск: сближение и расхождение интересов [Stage monologue genre crisis. Moscow-Minsk: convergence and divergence of interests]', *Rossiyskaya Gazeta*. 18.11.2003.

<sup>241</sup> Cloë Bruce, *Fraternal friction or fraternal fiction? The gas factor in Russian-Belarusian relations*, p.15.

considered the gas discount an acceptable price for transit security. However, this was not the only condition of favorable gas prices, Moscow expected Minsk to strengthen the political ties. On August the same year, Putin and Lukashenko held talks on possible unification of the two countries after a referendum. President Putin's proposal included two possible scenarios. The first one provided full incorporation of Belarus which would become a Russian district subject to Russian law and provided with economical support from Moscow. Another possibility of integration proposed was a certain variation of European Union relations which stipulated creation of some shared political structures but didn't guarantee energy subsidies. However, president Lukashenko insisted on remaining in the frames of existing agreements<sup>242</sup>.

As a response, the Russian government developed new forms of integration within the countries and next month put forward a proposal for the creation of a Currency Union by 2004 which was refused as well. As the Belarusian government did not accept the initiatives suggested and did not implement the second part of the contract concerning the ownership of Beltransgaz, the relations between the two countries started to deteriorate.

The gas supplies to Belarus were provided by companies Gazprom and Itera. As the Itera gas prices increased to \$36, Belarus refused to purchase gas on the price proposed and consumed Gazprom supplies 15- 20% more rapidly than planned. Gazprom sent a notice to Belarus demanding paying the debt and privatization of Beltransgaz. Having no response, the company reduced supplies by half on November 1st.<sup>243</sup>

The same month Belarusian parliament cancelled the restrictions on the privatization of Beltransgaz. Belarus also agreed to Itera's prices for gas which accounted for 40 dollars per thousand gas cubic meters. However, the process of Beltransgaz privatization reached a

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<sup>242</sup> E.Daneyko, 'Система защиты от Лукашенко [ System defending from Lukashenko]', *Izvestia*, 15 August 2002.

<sup>243</sup> Cloë Bruce, Fraternal friction or fraternal fiction?The gas factor in Russian-Belarusian relations, pp.14-16.

deadlock as the sides were not able to agree on the company's cost. The control over gas transit was an essential tool enabling to use the gas supplies in interests of the owner and to pass the gas transport system to Gazprom meant to lose the only instrument for favorable gas prices, considering this, Lukashenko preferred to maintain the government control over the company.

Gazprom alleging for default of obligations demanded the gas supplies contract to be reviewed in 2004 in order to raise prices from 28 dollars per thousand cubic meters to 50 per thousand cubic meters. The Belarusian government considered the new price as unacceptably high. On January 1st , 2004 Gazprom shut down gas deliveries. The further gas supplies were provided on conditions of short-term contracts by Transnafta and Itera. The compromise over the short-term contracts was not reached as well and at the end of January,<sup>244</sup> Gazprom delivered only the gas for transit. As a response, Belarus started siphoning gas destined for Europe which led to total cut off supplies for one day.

Till July other companies (Itera, Transnafta, which teamed up with Gazprom, and Sibur, a Gazprom's unit), were delivering gas to Belarus on short-term contracts asking for higher prices. The new agreement between Gazprom and Beltransgaz was signed only in July 2004<sup>245</sup>.

### **The 2004 gas conflict and the deterioration of Belarus-Russia relations**

The gas conflict of the January 2004 had both economic and political importance. From one hand, the conflict was the consequence of obligations defaults connected to Beltransgaz privatization and lack of agreement over gas prices and thus, had economic roots. From

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<sup>244</sup> 'Газовая блокада Белоруссии [Gas blockade of Belarus]', *Expert*, 24 January 2004.

<sup>245</sup> Cloë Bruce, Fraternal friction or fraternal fiction?The gas factor in Russian-Belarusian relations, pp. 17.

another hand, the strong connection between economic and political ties in Russia-Belarus relations allows interpreting the conflict as the result of Belarusian reluctance to develop the integration initiatives between the two states such as an establishment of the Currency Union. The political impact of this conflict was underlined by both Russian<sup>246</sup> and European media.<sup>247</sup>

Being an integral part of a wider energy conflict, gas debates occupied an important but not the only place in Russia-Belarus energy relations. Belarus was a big importer of Russian electricity. As from January 1<sup>st</sup> the same year the domestic and export prices for electricity increased, Belarus had to purchase electricity for the higher prices. Repeating the scenario of gas debates, the increase of prices provoked another conflict which was solved in April.<sup>248</sup>

The deteriorating relations between Belarus and Russia influenced negatively both countries' international image as Russian gas supplies to the West were no more considered secure. Economic difficulties did not allow Belarus to purchase gas on European level prices but its government was not intended to provide close integration with Russia in order to have better price and the problem was considered unresolved. Both consequences had significant impact on international politics in general and Europe-Russia relations in particular. It was the first time Russia totally cut off gas supplies to Europe. Even if European countries had enough recourses and the pipe shut down lasted only one day<sup>249</sup>, many politicians started to show concern over the possible future shut downs as the European countries depended on Russian gas supplies.

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<sup>246</sup> 'Белорусы наказаны за болтовню своего президента [Byelorussians are punished for their president's chatter]', *Novaya Gazeta*, 5 January 2004 .

<sup>247</sup> 'Moscow resumed gas supplies to Minsk', *BBC News*, 24 January 2004:  
[http://news.bbc.co.uk/hi/russian/russia/newsid\\_3424000/3424497.stm](http://news.bbc.co.uk/hi/russian/russia/newsid_3424000/3424497.stm)

<sup>248</sup> V.Fedorov, 'Братская дружба попала под напряжение [Fraternal friendship is under a strain]', *Rossijskaya Gazeta*, 04 March 2003; N.Grib, 'Белэнерго торговался недолго [Belenergo bargained not for long]', *Kommersant*, 13 April 2004; Y.Svirko, 'Белоруссия отказывается от русского электричества [Belarus refuses Russian electricity]', *Kommersant*, 02 February 2004.

<sup>249</sup> Cloë Bruce, *Fraternal friction or fraternal fiction? The gas factor in Russian-Belarusian relations*, pp. 17.



Belarus experienced serious economic crisis and foreign subsidies and investments were required to overcome it. To appeal to Russia meant to provide the integration and loose the Beltransgaz. The European countries in turn did not see in Belarus a reliable partner after the energy cuts. Moreover, the policy of Lukashenko in general was not appraised in Europe; the European media were calling him “last European dictator”<sup>250</sup> owing to political repressions in Belarus and authoritarian role he played on a position of a president.

At the end of 2005, Belarus and Russia signed a contract over gas supplies at the price of 46, 68 dollars per thousand gas cubic meters for 2006, while for 2007 it was necessary to conclude another agreement in order to maintain uninterrupted gas flow. In April 2006 Gazprom offered its partner the price of 200 dollars per thousand cubic meters for 2007 supplies, arguing that the price would be lower if Belarus paid with Beltransgaz shares<sup>251</sup>.

In 2007 the average price for a thousand gas cubic meters accounted for 241, 5 dollars in Western European countries and 180 in the ‘near abroad’. On December 31<sup>st</sup>, 2006, Gazprom and Beltransgaz finally reached an agreement to provide gas supplies in 2007 at the price of 100 dollars per thousand cubic meters, which was the lowest fee in the region.<sup>252</sup>

Although the situation was resolved, in view of the long negotiations over the price<sup>253</sup> and intention of Gazprom to cut off the gas if the agreement was not achieved before 1<sup>st</sup> of January 2007, the tensions resulted in many concerns of the European countries upon the possible lack of gas during the winter.

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<sup>250</sup> S. Wagstyl, ‘Alexander Lukashenko: Europe’s last dictator’, *Financial Times*, 15 October 2004.

<sup>251</sup> ‘Повышение цен на российский газ для Белоруссии [The prices for Russian gas for Belarus increase]’, Rambler media group, Lenta.ru, 14 March 2007: <http://lenta.ru/story/belgaz/>

<sup>252</sup> ‘Белорусско-газовый кризис [Belarusian-gas crisis]’, *Russkij reporter*, 10 August 2007; Dimo Bohme, *EU-Russia energy relations: what chances for solution?*, Potsdam: Universitätsverlag Potsdam.2010,p.106.

<sup>253</sup> The contract was concluded at 23:58 on 31December.

In 2007 Gazprom achieved its long-awaited objective, which the company was negotiating for from 1994: the possibility to control the gas transport system in Belarus. On May 18<sup>th</sup>, Belarus and Russia signed an agreement according to which from 2007 to 2010 Gazprom would buy 12,5% shares of Beltransgaz annually to hold 50% in 2010.<sup>254</sup>

Although Gazprom had its political objectives to achieve, the nature of the conflict was economic. If Belarusian oil and gas companies were able to purchase resources at the European price and in time, there would be no leverage for concessions. The difficult economic situation forced Belarus to purchase resources in exchange of political and economic concessions, but in the cases in which the agreement on these concessions was not achieved, the resources flow was interrupted. Thus, as Anastasia Sosnova<sup>255</sup>, analyst of “Investcafe”<sup>256</sup> argued, the energy crisis was probably caused by the reluctance of Belarus to participate in the Customs Union<sup>257</sup>.

However, on juridical level, there were different interpretations of the accords concluded.

Along with the common view that contracts defined the prices for one year, journalist Ali Aliev argued that Belarusian ministry of energy had the right to demand lower prices in order to fulfill the spirit of the Belarus-Russia agreement of 2002 on gas cooperation.<sup>258</sup>

### **The 2008 oil cut –off**

In January 2008, the conflict over energy supplies flared up again: this time the dispute concerned the oil exports.

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<sup>254</sup> Beltransgaz. Web. Retrieved from: <http://www.btg.by/history.html>

<sup>255</sup> Ali Aliev, ‘Газовые сани [Gas sleigh]’, *Expert*, 29 September 2010.

<sup>256</sup> A Russian independent agency of business-analytics

<sup>257</sup> On October 6<sup>th</sup>, 2007 Russia, Kazakhstan and Belarus signed an agreement over the creation of the Customs Union, which would appear in 2010 after several international accords providing common legal foundation were concluded.

<sup>258</sup> ‘Белтранстормоз [Beltranstormoz]’, *Expert*, 26 December 2006.

According to the decision of the Russian government, from January 1<sup>st</sup> the export duty for every ton of oil accounted for 180 dollars. Thus, the price for oil exports for Belarus doubled. As a response, the next day Prime Minister of the Republic of Belarus Sergey Sidorenko declared that the country imposed a 45 dollars tax for every oil ton transited. The Russian state-owned oil company Transneft argued that it didn't receive the necessary documents connected to the tax.

On January 8<sup>th</sup>, Transneft cut off oil deliveries to Belarus and in consequence to Poland, Germany and Ukraine, as these countries were supplied through the pipeline Druzba<sup>259</sup>. The company explained the decision telling that Belarus was illegally siphoning oil off. This raised serious disputes in Europe and resulted in worsening of EU-Russia energy relations. The BBC economics correspondent Andrew Walker commented the oil row saying that "the suspension is an uncomfortable reminder to Europe of the large and growing role that Russia has in meeting its energy needs"<sup>260</sup>.

After a telephone conversation between V.Putin and A.Lukashenko on January 10th Belarus cancelled the tariff taxes and from 11 January the oil supplies through the pipeline Druzba were resumed. Russia, in turn, reduced the export duty for oil from 180 to 53 dollars for a tone.<sup>261</sup>

### **The international reactions on the Belarus-Russia energy debates**

The oil conflict was resolved, meanwhile as far as the gas issue was concerned, Transneft gave the Belorussian partners half a year of adaptation period to pay 55% of a new gas price. At the

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<sup>259</sup> 'Russian oil row hit Europe supply', *BBC News*, 8 January 2007

[:http://news.bbc.co.uk/2/hi/business/6240473.stm](http://news.bbc.co.uk/2/hi/business/6240473.stm)

<sup>260</sup> Ibid.

<sup>261</sup> A.Savkina, 'Хроника нефтегазового конфликта [Chronicle of the oil and gas conflict]', *Kommersant*, 15 January 2007.

same time Belarus could partly pay with shares of “Beltransgaz”. The half a year adaptation period finished on July 23 and 1st of August Gazprom declared that it would start reduce gas supplies to Belorussia until Minsk didn’t provide Gazprom with payments after a six month delay. On August third, Beltransgaz paid the sum and another conflict was resolved.<sup>262</sup>

Vladimir Milov, the president of the Energy policy institute and Ex Deputy Minister of Energy considered the negative consequences of the conflict serious, arguing that “Russia definitely gotten a reputation of an unreliable partner able to act outside the legal framework and with no consideration of consequences”. According to him, Russian energy resources were important but not irreplaceable and Europe had always an opportunity appeal to more expensive but secure Middle East hydrocarbon reserves as an alternative.<sup>263</sup>

The international reaction on the conflict reflected in new international regulations established afterwards. In order to provide secure uninterrupted energy supplies, EU refiners had to hold 66 days-worth of crude reserves while IEA member governments were required to hold oil stocks equivalent to 90 days use<sup>264</sup>.

Meanwhile, the Chancellor of Germany Angela Merkel stressed the necessity to diversify the energy reserves. This crisis pushed Germany to apply to nuclear energy programme development.<sup>265</sup> It was abandoned only after 2011 Japan’s disastrous earthquake when German government decided to close nuclear power plants to 2022 in order to use safer

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<sup>262</sup> ‘Белоруссия заплатит Газпрому за поставленный газ [Belarus will pay Gazprom for gas delivered]’, *Kommersant*, 02 August 2007; ‘Белорусско-газовый кризис [Belarusian-gas crisis]’, *Russkij reporter*, 10 August 2007.

<sup>263</sup> I.Kruger, ‘Поцелуй в насос [A kiss in a pump]’, *Novaja gazeta*, 15 January 2007.

<sup>264</sup> ‘European leaders fire up over Russian oil cut’, IHS analyses, 01 November 2007 Retrieved from: <http://www.ihs.com/products/global-insight/industry-economic-report.aspx?ID=106598524&pu=1&rd=globalinsight.com>

<sup>265</sup> ‘Merkel puts Germany’s nuclear phase-out in question’, *Deutsche Welle*, 09 January 2007.

energy<sup>266</sup>. This decision sent the country back to the 2007 debates over insecurity of energy supplies and the dependency on hydrocarbons exports.

The latest energy conflict occurred in summer 2010. According to a contract signed by Belarus, the price for 2010 gas supplies rose from 150 to 187 dollars per thousand cubic meters. As Belarus continued paying the old price, Gazprom cut the gas flow to Belarus on June providing only 60% of the gas needed in order to force Belarus to pay \$200 million in debt for energy deliveries. Belarus started siphoning the lacking 40% from gas supplies destined for other European countries. The conflict escalated when Belarusian government decided to halt gas transit to Europe. At the same time Belarus raised the traffic prices from 1,45 to 1, 188 dollars per thousand cubic meters from the beginning of 2010 arguing that Gazprom, in turn, had to pay its debt for outstanding transit fees accounted for \$260 million. After a few days of debates, the sides achieved an agreement, paying debt one to another<sup>267</sup>.

The European reaction on the gas conflict was to blame Belarus for attacking the European Union by halting the transit, but in long perspective it damaged the image of Russia pictured as an unreliable business partner.

As it was with other energy conflicts, on the one hand, this conflict had economic roots. On another, the debates over the participation of Belarus in creation of a common customs territory within the Customs Union took place before the conflict, certainly accelerated the conflict. On July 5<sup>th</sup>, 2010 Belarus, Kazakhstan and Russia formed the Customs Union.<sup>268</sup>

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<sup>266</sup> 'Germany: nuclear power plants to close by the 2022', *BBC News*, 30 May 2011: <http://www.bbc.co.uk/news/world-europe-13592208>

<sup>267</sup> 'У друзей как аукнется, так и откликнется [Between friends as the call, so the echo]', *Expert*, 28 June 2010.; A. Aliyev, 'Перепродажная подготовка [Preparation for a resale]', *Expert*, 30 June 2010; M. Schwartz, 'Belarus escalates disputes with Russians over gas', *The New York Times*, 22 June, 2010; M. Schwartz, 'Europe blames Belarus for cut in gas flows', *The New York Times*, 24 June 2010; M. Schwartz, 'Russia restores flow of gas to Belarus', *The New York Times*, 25 June, 2010; 'Belarus 'to suspend Russian gas transit to Europe'', *BBC News*, 22 June 2010 :<http://www.bbc.co.uk/news/10375853>.

<sup>268</sup> A. Kramer, 'Russia and 2 neighbors from Economic Union', *The New York Times*, 5 July 2010; A. Aliyev, 'Preparation for a resale', *Expert*, 30 June 2010.

A year later, on November 25<sup>th</sup>, 2011, Gazprom bought 50% of Beltransgaz shares. Owing already other 50% of the shares purchased during 2007-2010, Gazprom held 100% shares of Beltransgaz controlling the gas transport system in Belarus.<sup>269</sup>

### **Ukraine-Russia energy debates**

The Russia-Belarus energy debates scheme was repeated in another country. During 2000s Russia was embroiled in similar disputes with Ukraine. As in the case of Belarus, they had both economic and political roots.

The Orange Revolution<sup>270</sup> which took place in November 2004- January 2005 changed the political vector of the country and resulted in deterioration of the relations between Ukraine and Russia. The political changes in Ukraine brought to several attempts to reorganize Ukrainian energy market. The new Prime Minister Yulia Timoshenko waged a campaign against a reseller- company Rosukrenergo<sup>271</sup>, the shareholder of which was Gazprom.<sup>272</sup> The energy relations between the two countries gradually deteriorated. In May 2005 it was revealed that the Gazprom's deposits of gas designated to Europe in Ukraine's storages had disappeared.

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<sup>269</sup> Beltransgas. Web. Retrieved from: <http://www.btg.by/history.html>; 'Beltransgas fully owned by Gazprom since November 25', *Novosti Energetiki*. Web. Retrieved from: <http://novostienergetiki.ru/?p=12314>

<sup>270</sup> The Orange Revolution was a series of protests after the 2004 election campaign in Ukraine. The results of the elections and the consequent victory of pro-Russian candidate V.Yanukovych were contested by the opposition. The December revote saw the victory of the pro-Western block led by V.Yushenko. A great number of researchers consider the events a "step for freedom" (Tetyana Tiryshkina) leading to democratic changes. (Anders Åslund, Michael McFaul, *Revolution in orange: the origins of Ukraine's democratic breakthrough*, Carnegie Endowment, 2006; Askold Krushelnysky, *An orange revolution: a personal journey through Ukrainian history*, Harvill Secker, 2006; Tetyana Tiryshkina, *An Orange Revolution in Ukraine – A Step to Freedom*, Lulu Press, Inc. 2007.) On the opposite, other researchers and journalists such as Mat Kelly from Associated press ('US money has helped opposition in Ukraine', *The San Diego Union Tribune*, 11 December 2004.) and Jean-Marie Chauver from Le Monde diplomatique point out that the Orange revolution was largely supported by the USA in order to consolidate its influence on important energy transit country. (Jean-Marie Chauvier, 'Les multiples pieces de elle'echiquier ukrainien', *Le Monde diplomatique*, January 2005, p.4-5.)

<sup>271</sup> S. Pirani, 'Ukraine's gas sector', p.23.

<sup>272</sup> Rosukrenergo. Web. Retrieved from: <http://www.rosukrenergo.ch/>

Gazprom suggested that the price for the vanished gas would be subtracted from the Gazprom's payments to Ukraine for transit. The Ukraine government claimed that it would take the gas from the European supplies. The sides managed to resolve the debate but it resulted in worse relations between the countries. In July 2005 the Russian Duma voted for an increase of the gas prices for CIS countries which achieved the market level. An exception was made only to Belarus, as the Russian government planned to establish an economic union with this country. The gas prices for Ukraine rose as well, nearer to European gas market prices.<sup>273</sup>

As the two countries were required to sign every year a protocol which specified the prices and quantities of gas delivered or transited, in June 2005 Gazprom declared that it wanted to set a new price for Ukrainian gas supplies.<sup>274</sup>

The prices for Germany in 2005 accounted for USD 200 per thousand cubic meters of gas, while Ukraine paid for gas deliveries about USD 50 per thousand cubic meters the same year<sup>275</sup>. Russian government and Gazprom asked for tripling the gas price for the next year so it would total 160 USD for thousand cubic meters<sup>276</sup>.

The Ukrainian and Russian governments continued their difficult negotiations till the beginning of 2006. After the Ukrainian side refused the Russian government's proposal of 230 dollars per thousand gas cubic meters, for a brief period (from 1 to 3 January) Gazprom cut Russian and Turkmen gas deliveries because the contract for 2006 had yet to be signed.<sup>277</sup> The European countries declared that no gas was received by them in that period. At first it was difficult to

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<sup>273</sup> J.Stern, *The Russian-Ukrainian gas crisis of January 2006*, Oxford Institute for Energy Studies, 2006.

<sup>274</sup> Ukraine energy policy review 2006, International Energy Agency, pp.218-222.

<sup>275</sup> 'Gas market and non market prices', *BBC News*, 02 January 2006. Web. Retrieved from:[http://news.bbc.co.uk/1/hi/russian/russia/newsid\\_4574000/4574984.stm](http://news.bbc.co.uk/1/hi/russian/russia/newsid_4574000/4574984.stm)

<sup>276</sup> B.Nygren, *The rebuilding of greater Russia: Putin's foreign policy towards the CIS*, Oxon:Routledge, 2007,p.240.

<sup>277</sup> L.Gukova,L.Kazva, *The Russian history in dates*, Moscow: Prospect, 2011, p.296.

find out whether Russia totally cut the supplies or the Ukrainian side was siphoning gas, but later it became clear that the gas was taken by Ukrainian customers.<sup>278</sup>

A few days later, Gazprom and the Ukrainian national gas company Naftogaz agreed at the price of 230 dollars per thousand cubic meters for the first period of 2006. However, the price was negotiated later and in September the parties agreed on the Turkmen gas supplies flowing through Russian pipelines at the price of 95 dollars per thousand cubic meters<sup>279</sup>.

After 2006 gas debates the Turkmen gas deliveries to Ukraine were implemented by Russian – Ukrainian company Rosukrenergo created by Gazprom. Being a Prime Minister Julia Timoshenko launched a campaign against Rosukrenergo declaring that Ukraine had to buy gas directly from Turkmenistan. Soon Rosukrenergo affiliate company's Ukgaz-energo rights for the domestic market were limited.<sup>280</sup> Defending the interests of the company, on January 7th Gazprom declared a new “gas war”. The company claimed that Ukraine had to pay a debt of 1,5 billion USD till January 12th, otherwise the gas supplies would be suspended. This time the conflict was resolved in time to avoid energy cut-offs. January 12<sup>th</sup>, 2008, the President of Ukraine Viktor Yushchenko went to Moscow where the sides achieved an agreement over gas supplies. The debt was to be paid soon while Rosukrenergo was decided to be eliminated with the lapse of time<sup>281</sup>.

Analizing the upmentioned facts, it is important to highlight that, as in Belarus, the gas debates in Ukraine had both economic and political roots. Energy underpayments were at the base of the conflict and the request to pay the full price for hydrocarbons exports without a discount

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<sup>278</sup> J.Stern, *The Russian-Ukrainian gas crisis of January 2006*.

<sup>279</sup> Gazprom. Web. Retrieved from: [www.gazprom.ru](http://www.gazprom.ru); East European Gas Analyses. Web. Retrieved from: <http://www.eegas.com/ukrtran-ru.htm>; ‘Gas price for Ukraine will triple’, *Dni online newspaper*, 07 June 2005: <http://www.dni.ru/news/economy/2005/6/7/64319.html>

<sup>280</sup> N.Grib, M.Zigar, ‘Базар для троих [Market for three]’, *Kommersant*, 18 February 2008.

<sup>281</sup> Ibid.



seemed fair. At the same time the European and American mass media supported President Yushenko's position claiming that the conflict was politically motivated. The US Secretary of State claimed as well that those debates "appeared to be politically motivated efforts to constrain energy supply to Ukraine"<sup>282</sup> However, the facts prove that in this case the only political motivation was the fact that if the relations between the countries were not deteriorated after the Orange Revolution, Gazprom probably would have suggested better conditions for Naftogas. The researcher S.Stern claims as well that "if Ukraine wishes to turn politically away from Russia towards EU and NATO and is opposed to any relationship with Gazprom in terms of ownership of gas assets – then it can expect the same commercial terms as those countries".<sup>283</sup>

During the parliament election campaign of 2007 the Yulia Tymoshenko's bloc, famous for its strong pro-Western position and attempts to eliminate Gazprom's influence from Ukrainian gas market, achieved a particular success in terms of votes: an undesirable outcome for the Russian government<sup>284</sup>. When Y. Timoshenko became the Prime Minister of Ukraine, she started to challenge the authority of the President V. Yushchenko, who decided to defend Rosukrenergo in order to unite Gazprom against the Prime Minister.

In November 2008, Gazprom declared that it would raise the gas prices which accounted for 179,5 dollars per thousand cubic meters in 2008<sup>285</sup> if the debt of 2,4 milliards USD was not paid soon.<sup>286</sup> Till the beginning of 2009 world natural gas prices, which are connected to oil prices, were increasing and the difference between the old and the new price could influence significantly the national budget of Ukraine. As in January 2009 the debt was not still paid,

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<sup>282</sup> Cited from: J.Stern, *The Russian-Ukrainian gas crisis of January 2006*, pp.12-13.

<sup>283</sup> J.Stern, *The Russian-Ukrainian gas crisis of January 2006*, p.13.

<sup>284</sup> V.Panjushkin, V.Zigar, *Газпром: новое русское оружие [Gazprom: The new Russian weapon]*, p.163.

<sup>285</sup> M.Elder, 'Behind the Russia-Ukraine gas conflict', *Bloomberg Businessweek*, 3 January 2009.

<sup>286</sup> N.Grib, 'Россия выдавливает газ [Russia presses gas out]', *Kommersant*, 21 November 2008.

Gazprom suggested new gas prices accounted for USD 250 per thousand cubic meters of gas. The Ukrainian government refused to sign an agreement considering the new prices unacceptable and Gazprom declared that it would provide gas for Ukraine only at the price of USD 418 for thousand cubic meters of gas.<sup>287</sup> The average price for European countries accounted for 450 USD per thousand cubic meters of gas in that period, Germany paid even more - 500 USD for thousand cubic meters<sup>288</sup>. Thus, the new price was correlated with market rates. At the same time the price increase from 179,5 to 418 was considered by Ukraine, which had still to repay debt for 2008 gas deliveries, as an overwhelming hike. The sides didn't achieve an agreement on transit costs as well.

Having no agreement on gas prices rates, on January 1<sup>st</sup>, 2009 Gazprom cut the gas supplies for Ukraine but was still delivering gas for transit to Europe. The Ukrainian government declared next that it had to siphon 21 billion<sup>289</sup> gas cubic meters out in order to provide successful transit conditions. Gazprom took the matter to international arbitration court of Stockholm declaring that Ukraine was siphoning 50 million gas cubic meters out and on January 7<sup>th</sup> cut off completely the gas supplies both to Ukraine and European countries. Later the European independent commission did not confirm the fact of the gas siphoning.<sup>290</sup> However, in June 2010 the Arbitration Institute of the Stockholm Chamber of Commerce obliged Naftogaz

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<sup>287</sup> 'Q&A Russia-Ukraine gas row', *BBC News*, 20 January 2009. Web. Retrieved from:

<http://news.bbc.co.uk/2/hi/europe/7240462.stm>

<sup>288</sup> 'Agreed for the transit but not for the gas price', *Deutsche Welle*, 11. September 2009. Web. Retrieved from: <http://www.dw-world.de/dw/article/0,,3935917,00.html>

<sup>289</sup> 'Украина продолжает отбор российского газа [Ukraine will continue siphoning Russian gas]', *Dni online newspaper*, 13 January 2009. Web. Retrieved from: <http://www.dni.ru/polit/2009/1/13/156969.html>

<sup>290</sup> 'Комиссар ЕС: Нет фактов несанкционированного отбора газа Украиной [European Commissioner: there are no proofs for unauthorized gas siphoning by Ukraine]', *RBK Ukraine*, 20 January 2009. Web. Retrieved from: [www.rbc.ua](http://www.rbc.ua); 'Европейские специалисты имеют подтверждение того, что Киев не осуществлял несанкционированный отбор российского газа [European specialists have evidences that Kiev did not siphon Russian gas]', *Echo Moscv*, 15 January 2009. Web. Retrieved from: <http://www.echo.msk.ru/news/566107-echo.html>

Ukraine to return 11 billion cubic meters of gas to Rosukrenergo and to provide compensation accounted for 1.1 billion cubic meter of gas.<sup>291</sup>

On January 20<sup>th</sup>, Russian gas deliveries were restored as the sides reached an agreement on the prices according to which Ukraine would pay in 2009 USD 360 per thousand cubic meters of gas having 20% discount from market price and in 2010 would shift to the market rate, while Russia would have a discount for transit through the country in 2009 and would shift to the market rate for transit in 2010.

The effects of the 2009 gas crisis were more severe than those of the 2006 debates. The gas flow was totally interrupted for two weeks. The shortage of gas in winter caused humanitarian consequences in east-European countries. In this case, the gas debate damaged the image of both sides of the conflict.<sup>292</sup>

In August 2009 First Deputy Chairman of the Government of the Russian Federation Igor Sechin declared that Russia would not be intended to give credit to Ukraine for Russian gas<sup>293</sup>. Quite the reverse, the European banks representatives claimed that the Western banks were ready to allow credit for Ukraine<sup>294</sup>.

An important development which influenced significantly Russia-Ukraine energy relations were the Presidential election of 2010 in Ukraine and the victory of pro-Russian candidate V.Yanukovich. An agreement on gas and transit prices was signed on April 21st, 2010 by Viktor Yanukovich and Dmitriy Medvedev. Gazprom would give 30% discount to Ukraine for gas as a

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<sup>291</sup> 'Стокгольмский суд обязал Нафтогаз Украины вернуть РУЭ 12,1 млрд куб. М. Газа – акционер РУЭ [Stockholm court obliges Naftogaz to return 12.1 billion cubic meters of gas to RosUkrEnregog]', *Interfax Ukraine*, 8 June 2010. Web. Retrieved from: [www.interfax.com.ua](http://www.interfax.com.ua)

<sup>292</sup> S.Pirani, J.Stern, K.Yafimava, *The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment*, Oxford Institute for Energy Studies. February 2009.

<sup>293</sup> 'Россия отказалась кредитовать Украину [Russia refused to give credit to Ukraine]', *Rambler Media Group, Lenta.ru*. 10 August 2009. Web. Retrieved from: <http://lenta.ru/news/2009/08/10/nocredit/>

<sup>294</sup> 'Забытый кредит [Forgotten credit]', *Vedomosti*, 10 August 2009.

sort of payment for prolongation of the Sevastopol military base rent by the Russian Black Sea navy for other 25 years (till 2042)<sup>295</sup>

### **The roots of Ukraine-Russia energy debates**

The energy debates between Belarus, Ukraine and Russia draw a wide response in European countries as the cut offs provided during the conflict influenced hydrocarbons deliveries to European countries. The disputes raised a question over the security of existing energy routes and doubted the reliability of Russia as a business partner. The origins of the conflict were widely discussed among politicians and in mass media of different countries. One group shared Gazprom's official position<sup>296</sup> arguing that the roots of the conflicts were purely economic. According to another group, the debates could be interpreted from a political point of view. Many politicians and journalists tend to accuse the Russian government in the debates and the cut offs which were used as an instrument of pressure<sup>297</sup>. Some scholars claim that the Russian government provoked the conflict in order to accentuate Europe's vulnerability and dependence from Russian energy exports and through this make the European foreign policy more flexible. Other considers the energy cut offs and prices rise in Ukraine as a sort of punishment for changing a political vector<sup>298</sup>. The neighboring governments were depicted as victims of Russian pressures.

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<sup>295</sup>Газовый конфликт с Украиной. Спор о долгах, ценах и поставках природного газа из России на Украину и транзите в Европу [Gas conflict with Ukraine. Disputes over debts, prices and Russian natural gas deliveries to Ukraine and transit in Europe]' *Expert*, 7 October 2011.

<sup>296</sup> M.Elder, 'Behind the Russia-Ukraine gas conflict'; S.Pirani, J.Stern, K.Yafimava, *The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment*.

<sup>297</sup> B. Maddox, 'Obnoxious, but gas war is not Putin's worst crime', *The Times*, 4 January 2006; Dimo Bohme, *EU-Russia energy relations: What chance for solutions? A Focus on the Natural Gas Sector*; H. Carrere d'Encausse, *La Russia tra due mondi*, Roma:Salerno editrice,2010.

<sup>298</sup> 'Q&A Russia-Ukraine gas row', *BBC News*.

An opposite position was expressed by Gazprom's Deputy CEO A. Medvedev. He suggested that the dispute was directed by Washington, which orchestrated the Ukraine's actions in order to oppose Russia<sup>299</sup>. In this case the aim of the debates could be to make European countries switch to alternative to Russian energy routes projects<sup>300</sup> and thus weaken Gazprom's influence not only in Europe but in Central Asian region as well.

Political scientist Bogdan Zirnya, director of social democratic institute of Moldavia, shared this opinion and suggested that the organization of gas debates as well as the backing the Colour Revolutions in the post-soviet space and the creation of US - influenced organizations such as GUAM was an attempt to slow the economic development of Russia.<sup>301</sup> However, other scholars consider these ideas highly improbable.<sup>302</sup>

Generally, although the US government was definitely interested in establishing its political influence in the post-soviet space, this move seems to be connected rather to economic than to pure political interests. The resources-rich Caspian region faced difficulties connected to the lack of advantageous transit routes and appealed to Western European and American companies for the construction of new energy routes. Western governments were interested in the region to establish their control over the resources flow to Europe. Thus, Western initiatives in Central Asia seem to be subordinated more to economic than political reasons.

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<sup>299</sup> J. Rodgers, 'Strategy behind Europe's gas game', *BBC News*, 14 January 2009. Web. Retrieved from: <http://news.bbc.co.uk/2/hi/europe/7828471.stm>

<sup>300</sup> For example, Nabucco

<sup>301</sup> B. Zirnya, 'Русско-украинская (американская) газовая война [Russia-Ukraine (USA) gas war]', *REGNUM*, 15.01.2009. Web. Retrieved from: <http://www.regnum.ru/news/1110965.html>

<sup>302</sup> N. Zlobin, 'США-Россия: шесть барьеров [USA-Russia: six obstacles]', *Vedomosti*, 28 January 2009.

## The competing pipelines

In whole, the energy conflicts between Belarus and Ukraine on one side and Russia on another resulted negatively on Russia-Europe energy relations. Russia created an image of unreliable oil and gas producer and pushed the European countries to develop new routes of hydrocarbons exports. Among them there were Europe-Russia projects: the Blue Stream, South Stream and Nord Stream were alternative pipelines which would enable Russia to bypass problematic transit countries in order to provide secure deliveries. Other routes such as Nabucco or the White Stream were designed to provide deliveries from Caspian and Central Asian regions bypassing Russia. At present the Nord Stream project is being criticized, as after huge investments<sup>303</sup>, it did not have the crucial role in energy routes diversification which European countries need to reduce their dependence from Russian supplies. Furthermore, as in 2010 Gazprom gained 100% shares of Beltransgaz and through them the control over Belarusian gas transport system, the Nord Stream route creation was considered less reasonable.

While Russia and EU were trying to diversify energy routes in order to bypass problematic transit countries, Ukraine was searching for a possibility to diversify its energy supplier in order to be less dependent on Russia.

The idea to build an oil pipeline running from Odessa northwards and delivering Caspian oil to Ukraine and Belarus was born during 1990s. The Odessa –Brody oil pipeline construction was started in 1996 and was finished in 2002.

Odessa was a big Black Sea port and the construction of such a pipeline would allow to transfer Caspian oil not only to north Ukraine but in perspective to Poland and other European countries

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<sup>303</sup>B.Nemzov,V.Milov, *Putin. What 10 years of Putin have brought*. Web. Retrieved from: <http://www.nemtsov.ru/?id=706211#11>

bypassing Turkish Straits or Druzba pipeline. The Polish government planned to extend Odessa-Brody pipeline to Plock, a city in central Poland which was already connected to Gdansk.<sup>304</sup>

However, as the pipeline was constructed, for two years it stood idle, as no contract on oil transferring was signed till 2004.<sup>305</sup> On August 18<sup>th</sup>, 2004 Russian Transneft and Ukrainian Ukrtransnafta signed an agreement to provide the reverse flow, using a pipeline to deliver Uralian oil to Odessa. During the following years the Ukrainian and Polish politicians several times discussed a possibility to return averse flow to the pipeline. In 2010 Ukrtransnafta increased the price for transiting the oil for 30 per cent<sup>306</sup>. The flow was stopped in May 2010. As an agreement between Ukrainian and Azerbaijani governments was concluded later, the pipeline shifted the first time to averse flow, delivering oil northwards from February to May 2011. The flow was stopped due to the currency crisis in Belarus and from June the Azerbaijani oil was delivered only to north Ukraine. According to S.Kuyun, the general manager of the Ukrainian consulting company A-95, the latest energy agreements between Russia and Belarus would not allow Odessa-Brody pipeline to reckon upon supplies to Belarus in the near future<sup>307</sup>. The supplies to the Baltic countries will hardly be implemented as well due to start of Baltic Pipeline System-2 in the first half of 2012<sup>308</sup>.

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<sup>304</sup> P.Aalto, 'European perspectives for managing dependence', *Russian energy power and foreign relations*, CSS Studies in Security and International Relations, Oxon: Routledge, 2009, p.172.

<sup>305</sup> V.Vodo, D.Rebrov, 'Казахскую нефть развернут на Польшу [Kazakh oil will be directed to Poland]', *Kommersant*, 01 October 2007

<sup>306</sup> T.Ivzhenko, 'Алиев запустил трубопровод Одесса-Броды [Aliiev started Odessa-Brody flow]', *Nezavisimaya Gazeta*, 29 October 2010.

<sup>307</sup> O.Gavrish, B.Kisil, 'Украина работает со скидкой [Ukraine provides a discount for its work]', *Kommersant Ukraine*, 22 November 2011.

<sup>308</sup> 'Путин запустил Балтийскую трубопроводную систему [Putin opened BTS]', *Rambler Media Group, Lenta.ru*, 22 March 2012. Web. Retrieved from: <http://lenta.ru/news/2012/03/23/start/>

## The Trans-Balkans pipelines

Another problem connected to new routes construction consisted in the limited capacity of the pipelines existed and the overload of shipping lanes in a situation of a growing demand.

This issue concerns in particular the oil exports. While in Northern Europe the Baltic Pipeline Systems (BPS and BPS-2) allow delivering high volumes of oil to North European countries, the South European countries faced oil distribution problems. The overload of the Turkish Straits which could hardly accommodate larger oil-tanker traffic did not permit increasing the volumes of the oil imported from Russia and Kazakhstan and delivered on liquid carriers. The four projects were designed to bypass the Bosphorus and Dardanelles: Burgas – Alexandropolis pipeline, Constanta-Trieste pipeline, the AMBO pipeline and the Odessa-Brody pipeline<sup>309</sup>. The first three projects were passing through the Balkans.

The first project of a pipeline running from a Bulgarian port Burgas to northeastern Greek port Alexandropolis was an important development in Europe-Russia energy relations as it would have become the first Russian-controlled pipeline on the territory of the European Union and NATO countries. While the political memorandum between Bulgarian, Greek and Russian governments was signed already on April 12<sup>th</sup>, 2005<sup>310</sup>, an intergovernmental agreement was concluded on March 15<sup>th</sup>, 2007<sup>311</sup>. According to the agreement Russia would hold a 51% stake in the project. The realization of project, on one hand, would undermine the Odessa-Brody and Constanta-Trieste projects, on another, it would guarantee the demand for Odessa-Brody

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<sup>309</sup> V. Tsachevsky, *Bulgaria, the Balkans and the Pan-European infrastructure project*. Electronic publications of Pan-European Institute, January 2011. Web. Retrieved

from: [http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Tsachevsky\\_netki\\_final\\_2011.pdf](http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Tsachevsky_netki_final_2011.pdf)

<sup>310</sup> Energy sector in Greece, Greek embassy in Washington. Web. Retrieved from:

<http://www.greekembassy.org/Embassy/content/en/Root.aspx?office=1>

<sup>311</sup> Trans-Balkan pipeline website. Web. Retrieved from: <http://www.tbpipeline.com/company/history>



reverse flow as the oil was intended to be delivered to Burgas from Odessa and other three ports: Novorossiysk, Pyvdenny and Tuapse.

The creation of Burgas-Alexandropolis pipeline would allow increasing the volumes of oil supplies not only from Russia but from Central Asia as well, first of all from Kazakhstan. That means that the project could undermine the Trans-Caspian oil export route supported by US government<sup>312</sup>.

However, the project was cancelled later on Bulgarian government's initiative. The official reason was the ecological damage from the pipeline's construction but the journalists of "Kommersant" argued that the real reasons were rather political and the decision made in Bulgaria was connected to change of government.<sup>313</sup>

Alternative projects to deliver Russian and Central Asian oil to Western Europe bypassing the Turkish Straits were the Samsun–Ceyhan pipeline<sup>314</sup> and another pipeline running from the Turkish territory to the Greek port of Alexandropolis bypassing Bulgarian territory<sup>315</sup>.

Another project was the Constanta-Trieste pipeline<sup>316</sup>, which would run from Romanian port of Constantza to Trieste in Italy, crossing Serbia, Croatia and Slovenia. The agreement on the project, designed to transfer Caspian and Central Asian oil from Russian port Novorossiysk and Turkish port Supsa to European countries, bypassing Turkish Straits, was signed on April 3, 2007

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<sup>312</sup> V. Socor, *First Russian-controlled pipeline on European Union territory roars its head*, Center for Transatlantic relations, 2 March 2002. Web. Retrieved from: [http://transatlantic.sais-jhu.edu/transatlantic-topics/Articles/energy-security/energy/first\\_russian-controlled\\_pipeline.pdf](http://transatlantic.sais-jhu.edu/transatlantic-topics/Articles/energy-security/energy/first_russian-controlled_pipeline.pdf)

<sup>313</sup> F. Tzehmistrenko, K. Melnikov, M. Shtreinman, N. Marchenko, 'This will be not surprising for Russia', *Kommersant fm*, 08 December 2011.

<sup>314</sup> K. Melnikov, M. Shteinman, N. Marchenko, 'Болгария обрубила трубу [Bulgaria cut the pipeline]', *Kommersant*, 08 December 2011.

<sup>315</sup> 'Транснефть может построить трубопровод в Грецию в обход Болгарии [Transneft can build an oil pipeline to Greece bypassing Bulgaria]', *Kommersant*, 15 February 2012.

<sup>316</sup> Also known as Pan-European oil pipeline

by all the five European states and the European Energy Commissioner<sup>317</sup>. In 2009 the Kazakh government claimed that it would like to join the project. However, as a result of controversy among the participants concerning financial questions, the implementation of the project is blocked now.<sup>318</sup>



(Retrieved from: <http://www.energy-community.org/pls/portal/docs/772192.PDF>)

Finally, the third project connected to transportation of Caspian and Russian oil bypassing Turkish Straits was the AMBO pipeline. In January 2007 the Bulgarian, Macedonian and Albanese governments concluded an agreement over creation of a route running from the Bulgarian port of Burgas through Macedonian territory to the Albanian port Vlore, the possibility to connect the route with Italy was considered as well. However as ex-counselor at the European Integration Directorate in the Ministry of Foreign Affairs and professor of political

<sup>317</sup> Transnafta.Web. Retrieved from: [http://www.transnafta.rs/en/home/dev\\_projects/peop/](http://www.transnafta.rs/en/home/dev_projects/peop/)

<sup>318</sup> V. Tsachevsky, *Bulgaria, the Balkans and the Pan-European infrastructure project*. Electronic publications of Pan-European Institute, January 2011. Web. Retrieved from: [http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Tsachevsky\\_netti\\_final\\_2011.pdf](http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Tsachevsky_netti_final_2011.pdf)

studies Venelin Tsachevsk noticed in his article “Bulgaria, the Balkans and the Pan-European infrastructure projects”, “Following the lack of financial resources and the difficulty to provide enough oil for the proper functioning of the pipeline, the implementation of the project has not commenced.”<sup>319</sup>

These difficulties along with competition with other trans-Balkan pipelines froze the pipeline construction in 2010.

### **Avoiding dependency: new routes projects**

The last problem that the European countries and Russia faced during 2000s concerned interdependency. Growing demand in Europe required increasing hydrocarbon exports from Russia though this meant becoming more dependent on Russian supplies. The gas disputes between Russia and the transit countries raised a question of reliability of such supplies. Thus European countries appealed to construction of new routes which would allow bypassing Russia delivering Caspian and Central Asian resources or differentiate the suppliers.

At the same time Russia tried to restore its image of secure supplier by creating new routes such as Nord Stream, South Stream and Blue Stream which would bypass transit countries and successfully maintain hydrocarbons deliveries to Europe. Furthermore the first agreements over the construction of pipelines running eastwards were concluded. The East Siberia Pacific Ocean pipeline (ESPO) would allow Russian companies to provide deliveries to Japan, China and other Asian countries.

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<sup>319</sup> Ibid.

In order to avoid the transit countries problem and boost gas exports, three alternative projects for gas deliveries were developed. The first project called “bypass Ukraine”<sup>320</sup>, provided the construction of a new pipeline which would deliver additional volumes of gas through Poland and Belarus running along the Yamal-Europe line. However, from the political point of view this project was difficult to realize. As the researchers N.Victor and D.Victor noticed, “there was enormous concern among Polish politicians that potential allies against Russian meddling - Ukraine, first and foremost – not be split over commercial deals. Polish politicians at the highest level undertook direct negotiations with Ukraine to avoid Russia playing the two countries.”<sup>321</sup> Moreover, several disputes over the gas non-payments during 1990s in Belarus were another obstacle to the project as the country was not considered a reliable partner.

The second alternative was to transform Ukraine into a reliable partner and lift Ukraine’s transit capacity, but the system required first the investments which would allow avoiding its deterioration.<sup>322</sup> Gazprom created an international consortium with the participation of different European governments and companies, in order to maintain and upgrade Ukrainian transmission and storage systems. However, the international political conjuncture in the beginning of 2000s as well as the deterioration of Russia-Ukraine relations after the Orange Revolution and the gas conflict of 2006 did not allow considering the country as a reliable partner.

### **The Nord Stream pipeline**

The third alternative project was a Trans-Baltic pipeline known nowadays as the Nord Stream.

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<sup>320</sup> N. Victor, D.Victor, ‘Bypassing Ukraine: exporting Russian gas to Poland and Germany’, *Natural gas and geopolitics*. From 1970 to 2040, Cambridge: Cambridge University Press, 2006.

<sup>321</sup> Ibid. , pp.156-157.

<sup>322</sup> Ibid. , p.159

The pipeline was one of the most controversial energy projects of 2000s

In late 1990s, offshore prospecting in the Baltic Sea confirmed the technical feasibility and economic effectiveness of the construction of a pipeline running under the Baltic Sea<sup>323</sup>.

The original pipeline project started in 1997 when Gazprom and the Finnish company Neste (in 1998 merged with Imatran Voima to form Fortum, and 2004 separated again) formed the joint company North Transgas Oy for construction and operation of a gas pipeline from Russia to Northern Germany across the Baltic Sea. The pipeline is considered to be one of the biggest projects based on cooperation between Russia and Germany. The fact that the German government was promoting the pipeline's construction did not have a positive impact on president Schroder image. As a researcher Kirsten Westphal noticed, "Schroder Government ...used its strong personal ties with President Putin's administration in Russia in order to promote German-Russian energy relations"<sup>324</sup>

The German energy company E.ON Ruhrgas and Gazprom signed memorandums of understanding in 2004 and 2005 according to which E.ON.Ruhrgas would receive a 24.5 % stake in the Yuzhno Russkoye gas field (Western Siberia), which was one of the main resource base for the gas in the pipeline, in exchange of assets in three Hungarian companies controlled by the German company given to Gazprom. The third partner on the Nord Stream, BASF, possessed another 24.5 per cent of Yuzno Russkoye shares. On September 8<sup>th</sup>, Gazprom, BASF AG and E. ON AG signed an agreement on North European Gas Pipeline construction according to which the partners set up a German-Russian joint venture North European Gas Pipeline Company, where Garzprom would hold 51 per cent, BASF 24.5 per cent, E.ON 24.5 per cent of

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<sup>323</sup> Gazprom. Web. Retrieved from:<http://www.gazprom.com/production/projects/pipelines/nord-stream/spg-history/>

<sup>324</sup> K. Westphal, 'Germany and the EU-Russia energy dialogue', *The EU-Russia energy dialogue*, Aldershot: Ashgate, 2008, p.93.

shares. The project provided the construction of two strings 27.5 milliard cubic meters a year each.<sup>325</sup> On November 8<sup>th</sup>, 2011, the Nord Stream first string was put into operation.

The deal provoked a negative reaction in many European countries. The friendship between German chancellor G. Schroder and Russian president V. Putin<sup>326</sup> made the Europeans doubt the reasonability of the pipeline construction for Germany and especially for other European countries. After the end of the president's term G.Schroder accepted a post of the head of the shareholder's committee of Nord Stream AG proposed by Gazprom<sup>327</sup>. The ex - chancellor was sharply criticized for this decision afterwards and the project caused concern in European countries as damaging the security of the gas supplies which would depend even more on Russia<sup>328</sup>. The Polish president Lech Kaczynski during the energy conference of ten eastern European countries in October 2007 condemned the Nord Stream pipeline construction and argued that Russia could use energy as a political weapon, while Czech Deputy Prime Minister Alexandr Vondra stated: " Unjust manipulation or interruption of energy supplies is as much a security threat as is a military action(...) Post-Soviet countries have been experiencing that on a daily basis, as Russia's appetite for using energy as a political weapon is growing" <sup>329</sup> However, the next German chancellor Angela Merkel though being critical of G. Schroder and V. Putin's friendship supported strongly the Nord Stream project considering it as a necessary step to

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<sup>325</sup> Gazprom.Web.Retrieved from: <http://www.gazprom.com/production/projects/pipelines/nord-stream/spg-history/>; 'Газпром, BASF и Ruhrgas построят газопровод под Балтикой [Gazprom, BASF and Ruhrgas will build a gas pipeline under the Baltic Sea]', *Russian energy and industry newspaper*, 09 September 2005.Web.Retrieved from: <http://www.eprussia.ru/news/base/2005/9111.htm>

<sup>326</sup> According to the "Russian energy and industry newspaper", only in 2005 the two leaders met each other 8 times. ('Газпром, BASF и Ruhrgas построят газопровод под Балтикой [Gazprom, BASF and Ruhrgas will build a gas pipeline under the Baltic Sea]'Web.Retrieved from: <http://www.eprussia.ru/news/base/2005/9111.htm>)

<sup>327</sup> 'Schroeder attacked over gas post', *BBC News*, 10 December 2005.Web.Retrieved from: <http://news.bbc.co.uk/2/hi/europe/4515914.stm>

<sup>328</sup> Ibid. ; 'Gerhard Schroeder's sellout', *The Washington Post*, 13 December 2005; M. Landler, 'German ex-chancellor defends Russian pipeline deal and Putin', *The New York Times*, 12 December 2006.

<sup>329</sup> Cited from: P.Aalto, 'European perspectives for managing dependence', *Russian energy power and foreign relations*, p.166.

avoid the transit countries problem<sup>330</sup>. The researchers N.Victor and D.Victor highlighted as well the commercial utility of the project which was the most direct route to German market.<sup>331</sup>

### **The Blue Stream project**

Another initiative which had particular importance during 2000s was the Blue Stream Project. Originally designed to deliver gas from Russia to Turkey through a deep water pipeline beneath the Black Sea, it was intended to be extended in order to provide gas supplies to Europe transforming Turkey in a transit point country<sup>332</sup>.

The agreement over the Blue Stream project was concluded between the Russian and Turkish governments already on December 15th, 1997. A memorandum describing the financial side of the project was signed by Gazprom and Italian company Eni in February 1999. The first pipeline was completed in March 2002<sup>333</sup>, while the first gas flows started in February 2003.<sup>334</sup> However, after the debates over gas prices occurred in April 2003, the project was inaugurated only in November 2005.<sup>335</sup>

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<sup>330</sup> 'Schroeder attacked over gas post', *BBC News*.

<sup>331</sup> N. Victor, D.Victor, 'Bypassing Ukraine: exporting Russian gas to Poland and Germany', *Natural gas and geopolitics. From 1970 to 2040*, p.164.

<sup>332</sup> Ibid., pp.143-144.

<sup>333</sup> F. Stephen Larrabee, Ian O. Lesser, *Turkish foreign policy in an age of uncertainty*, Santa Monica: Center for Middle East Public Policy (Rand Corporation), 2003, p.111.

<sup>334</sup> 'Правила игры. Голубой поток «пришёл» в Турцию [Rules of the game. The Blue Stream arrived in Turkey]', *Kommersant*, 21 February 2003; 'Blue Stream gas starts flowing', *Upstream: international oil and gas news source*, 20 February 2003. Web. Retrieved from: <http://www.upstreamonline.com/live/article33319.ece>

<sup>335</sup> Gazprom.Web. Retrieved from: <http://gazprom.ru/about/production/projects/pipelines/blue-stream/>

The Blue Stream pipeline was the second route for delivering Russian gas to Turkey. However, the existed pipelines passing Ukraine, Moldova, Romania and Bulgaria were considered as insecure and more expensive<sup>336</sup>.

### **Nabucco versus South Stream**

The extension of Blue Stream, running through Bulgaria, Serbia and Croatia to Hungary, discussed by the Russian President and the Turkish Prime Minister in August 2005 would have competed with the Nabucco pipeline project. The agreement on the latter had been signed two months earlier.<sup>337</sup>

Both projects were destined for building an alternative route to deliver gas to European countries passing through Turkey and Bulgaria.

While the construction of Nabucco was intended to be started at least in 2013<sup>338</sup>, the Blue Stream-2 pipeline would be able to provide gas supplies to South European countries such as Italy, Spain and Greece earlier.<sup>339</sup> However, later it was decided to extend the pipeline southwards providing the supplies to Israel. Though this extension project was considered very important, it was frozen in 2010 due to an incident connected to Gaza flotilla raid on May 31st and the discovery of a new gas field near Israel<sup>340</sup>. The importance of a Russian-controlled

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<sup>336</sup> 'Blue Stream Pipeline', *Hydrocarbons-technology*. Web. Retrieved from: : <http://www.hydrocarbons-technology.com/projects/bluestream/>

<sup>337</sup> G.Yardim, *Nabucco vs South Stream; Chess or race. Turkey's role in region*, Institute of Energy for South East Europe. Web. Retrieved from: [http://www.iene.gr/3rdSEED/articlefiles/Session\\_III/Yardim.pdf](http://www.iene.gr/3rdSEED/articlefiles/Session_III/Yardim.pdf)

<sup>338</sup> 'Blue Stream Pipeline', *Hydrocarbons-technology*. Web. Retrieved from: <http://www.hydrocarbons-technology.com/projects/bluestream/>

<sup>339</sup> N. Pankrashkin, 'Blue Stream of energy', *Oil of Russia*, Lukoil international magazine, #1 2006.

<sup>340</sup> N. Zhuravleva, 'Труба не дотянет до Израиля [The pipeline will not achieve Israel]', *Vzglyad*, 8 June 2010; J. Malisheva, 'Израиль обвиняется [Israel is accused]', *Vzglyad*. 1 June 2010.



route which would compete with Nabucco project pushed Gazprom to conclude an agreement for the construction of another pipeline named South Stream.

At present there are three competing projects, including the South Stream, designated to deliver gas from Caspian region to Europe. Two of them, Nabucco and White Stream, were developed as an alternative to Russian gas supplies. Due to increasing energy demand in Europe, the volumes of exports are intended to be boosted in the near future, which would mean to increase the European dependence on Russian supplies if the routes are not diversified.

The White Stream was a project, initially titled GUEU (Georgia-Ukraine-European Union) which would provide the construction of a pipeline on the seabed transporting gas from the Caspian Region countries through Georgia directly to Ukraine and Romania.<sup>341</sup> The initiative was proposed in order to reduce the dependency of EU countries and Ukraine on Russian gas supplies.

The project competed to another alternative to Russian pipeline designed to deliver Caspian gas to Europe through Turkey, Bulgaria, Romania and Hungary bypassing Russia<sup>342</sup>. The Nabucco Gas Pipeline International Ltd. was established already in 2004. At first, the construction was scheduled to start in 2009 but at present it was shifted to 2013.<sup>343</sup> The EU Commissioner argued that the project was of strategic importance to Europe.

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<sup>341</sup> S. Closson, 'Russia's key customer: Europe', p.106; White Stream. Web.Retrieved from: <http://www.gueu-whitestream.com/main.php?id=1>

<sup>342</sup> A.Orban, *Power, energy and the new Russian imperialism*, Westport: Greenwood publishing group, 2008,pp.148-150..

<sup>343</sup> Nabucco.Web.Retrieved from: [http://www.nabucco-pipeline.com/portal/page/portal/en/pipeline/timeline\\_steps](http://www.nabucco-pipeline.com/portal/page/portal/en/pipeline/timeline_steps)

Being supported not only by the European countries but by the United States as well, the Nabucco pipeline was considered in Moscow an anti-Russian project aimed at reducing the Russian influence in Caspian region and Europe.<sup>344</sup>

As soon as the agreement on the project was signed in June 2005, the Russian government proposed extending the Blue Stream along the similar route. As Hungary had an essential part in the Nabucco consortium, the possibility of its participation in Russia's new pipeline project raised concerns in the European partners and in the United States, which started to exert pressure on the Hungarian government. Having obligation to choose between two projects, the country decided to participate only in the Nabucco project. Although the Blue Stream pipeline extension towards Europe was suspended, the Russian government did not refuse to oppose the project it considered dangerous for Europe-Russia energy relations. In June 2007, Gazprom and Italian company Eni signed a memorandum on the construction of the South Stream pipeline, which would run from Russia to Bulgaria through the Black Sea and would compete with the Nabucco pipeline project<sup>345</sup>. Both companies held 50% of shares of the project.

The competition between the South Stream pipeline and the Nabucco pipeline projects caused different political clashes from 2007 and 2012. For example, Bulgaria, participating in the both projects decided to refuse the South Stream in order to remain inside the Nabucco pipeline project in July 2009.<sup>346</sup> However in September of the same year the country entered the South Stream project again.<sup>347</sup>

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<sup>344</sup> A.Orban, *Power, energy and the new Russian imperialism*, pp.148-149.

<sup>345</sup> Ibid., pp.149-153.

<sup>346</sup> 'Бойко начал [Bojko started]', *Vedomosti* 13 July 2009.

<sup>347</sup> 'Болгария повторно согласилась на участие в Южном Потоке [Bulgaria accepted to participate in the South Stream the second time]', Rambler Media Group Lenta.ru, 21 September 2009. Web.Retrieved from: <http://lenta.ru/news/2009/09/21/stream/>

While the Russian government promoted South Stream as a project which would provide lower prices for gas and the secure supplies<sup>348</sup> bypassing problematic transit countries, the Nabucco pipeline was promoted as a large-diameter pipeline which would enable EU reduce its dependence on Russian supplies and receive gas from different sources, from Azerbaijan and Turkmenistan, as the principal suppliers, to the pipelines running from the Middle East.<sup>349</sup>

While recent accords over the South Stream project suggested that the pipeline would be constructed in the near future, there were no guarantees that the Nabucco project would be implemented. In five years Gazprom and Eni concluded numerous agreements with the governments of the European countries, which territories the pipeline was intended to pass through, in order to provide the secure corridor. Meanwhile, two other countries decided to participate directly in the project. By 2012 the French company Électricité de France and German Wintershall joined the South Stream taking 15%(2010)<sup>350</sup> and 15%(2011)<sup>351</sup> respectively. (At present, Gazprom holds 50% of shares and Italian Eni 20%<sup>352</sup>.) For what concerns the Nabucco pipeline, the Shah Deniz gas field race reduces its chances to be constructed.

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<sup>348</sup> The South Stream's official home page is titled "South Stream. Europe's energy security". Web. Retrieved from:<http://south-stream.info/?L=1>

<sup>349</sup> *The economic impact of export restrictions on raw materials*, OECD trade policy studies, OECD Publishing, 2010, p.138. Web. Retrieved from: [http://www.oecd-ilibrary.org/trade/the-economic-impact-of-export-restrictions-on-raw-materials\\_9789264096448-en](http://www.oecd-ilibrary.org/trade/the-economic-impact-of-export-restrictions-on-raw-materials_9789264096448-en)

<sup>350</sup> 'Электрисите де Франс получит 20% в проекте «Южный поток» [Électricité de France will receive 20% in the South Stream project]', *Interfax*, 26 April 2010. Web. Retrieved from: [www.interfax.ru](http://www.interfax.ru); 'Участники Петербургского форума-2010 увидели свет в середине начала конца [The participants of Saint Petersburg 2010 forum saw a light in the middle of the beginning of the end]', RBC, 21 June 2010. Web. Retrieved from:<http://www.rbc.ru/rbcfreenews.shtml?/20100621080019.shtml>

<sup>351</sup> О.Мордусhenко, П.Нетреба, Е.Кузнецов, 'Немцы взяли российский газопровод. Новым участником South Stream стала Wintershall [Germans have taken the Russian gas pipeline. Wintershall participated in the South Stream]', *Kommersant*, 22 march 2011.

<sup>352</sup> Gazprom. Web. Retrieved from: <http://www.gazprom.ru/about/production/projects/pipelines/south-stream/>

## The Shah Deniz gas field race

Four projects took part in a competition for Shah Deniz gas field second phase in Azerbaijan. Being designated for delivering gas to Western Europe, two of them were intended to run through Bulgaria to Austria (Nabucco and Seep<sup>353</sup>) and other two deliver Azer gas to Italy (ITGI<sup>354</sup> and TAP<sup>355</sup>). The project ITGI was excluded in March 2012 as its rival TAP provided more profitable conditions being shorter and demanding no extra financial support from the countries involved. However, according to an article appeared in "Limes" magazine<sup>356</sup>, the decision could be influenced by Statoil, one of the companies operated the Shach Deniz field, which promoted the project TAP in order to support its interests. At the next stage only one project from two running to Austria will be selected. The winner will compete with TAP.<sup>357</sup>

However, as many journalists noticed<sup>358</sup>, Nabucco is considered a project of difficult implementation and probably will not be able to compete with other similar projects. Being a large-diameter pipeline it would provide 31 bcm of gas to Europe, while Azerbaijan could deliver only 10-15 bcm. Having already a big cost for the European Union in a moment of economic crisis, the pipeline projected would not cover the expenses if it does not receive additional supplies from Turkmenistan. That would be possible only if the Trans-Caspian Pipeline passing from Turkmenistan to Azerbaijan is constructed. Considering Nabucco a pipeline dangerous for Russian energy exports to Europe and at the same time trying to maintain exports of Turkmen gas through Russian territory, the Russian government opposed

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<sup>353</sup> Seep is a South East Europe Pipeline which potentially could run from eastern Turkey to Austria.

<sup>354</sup> ITGI is Interconnector Turkey-Greece-Italy pipeline

<sup>355</sup> TAP is Trans Adriatic Pipeline which would run from Greece through Albania and the Adriatic Sea to Italy.

<sup>356</sup> G. Sanna, 'L'idolo infranto: il Nabucco all'ultimo atto', *Limes*, 8 Marzo 2012 .Web.Retrieved from: <http://temi.repubblica.it/limes/lidolo-infranto-il-nabucco-allultimo-atto/33018>;

<sup>357</sup> Ibid.

<sup>358</sup> Ibid.

the TCP pipeline arguing that the project could be ecologically dangerous and that the construction of a pipeline through the Caspian Sea required the consent of five littoral states<sup>359</sup>.

Moreover, the rival Seep project being more economically attractive is operated by BP which holds the major part of Shah Deniz 2 shares<sup>360</sup>.

Thus, in spite of having the crucial importance for Europe to diversify gas import routes shifting from Russia to other gas producers, the Nabucco project resulted eventually economically and politically difficult to implement.

At present the Nabucco pipeline construction is strongly dependent on Trans-Caspian gas pipeline, which construction in turn is dependent on the debates with Russia over the status of the Caspian Sea. Understanding this, the Russian government stands its ground criticizing the agreement between Azerbaijan, European Union and Turkmenistan over the pipeline and doubting its legal status.<sup>361</sup> Until the pipeline will not be operative, Gazprom is able to control a large part of the gas flowing to Europe and Turkmenistan has to export gas through Russian pipelines or sell it to Russia at low price. Thus Russia can control also the Turkmen gas flows to Europe. Moreover, some researchers argue that the gas resources of Turkmenistan are not enough for both South Stream and Nabucco, hereupon, an accord with one would mean automatically elimination of another. Journalist Joshua Kucera, analyzing Russian mass media articles over the Trans-Caspian pipeline, argued that the Russian government would be ready to respond with every means if the construction starts without the Moscow consensus. Though, these threats seem, at the moment, only an attempt to frighten the participants, according to

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<sup>359</sup>S.Blagov, 'Russia tries to scuttle proposed Trans-Caspian pipeline', Eurasianet.org, 27 March 2006. Web.Retrieved from: <http://www.eurasianet.org/departments/insight/articles/eav032806.shtml>; G. Sanna, L'idolo infranto: il Nabucco all'ultimo atto.

<sup>360</sup> Giuseppe Sanna, L'idolo infranto: il Nabucco all'ultimo atto.

<sup>361</sup> P.Leonard, 'Russia slams EU plans to broker talks between Azerbaijan, Turkmenistan on Caspian gas pipeline', Washington Post, 13 September 2011; A. Vershinin, 'Turkmens slam Russian bid to hinder gas pipeline', THE ASSOCIATED PRESS, 19 October 2011.

the journalist nothing can be excluded in the Central Asian arena.<sup>362</sup> However, other journalists argued that the construction of the Trans-Caspian pipeline and implementation of the Nabucco project will not be realized soon.<sup>363</sup>

### **The US role in Russia-Europe energy relations**

The debate over Central Asian and Caspian resources involved several players, among which one of the most influential were the USA. The state promoted the Nabucco and Trans-Caspian gas pipeline construction in order to defend its interest in the region which had the key importance for the US politicians from 1990s.<sup>364</sup>

The American political discourse in general became tougher in the beginning of 2000s as the republican candidate won the presidential elections in the USA in 2001. In May the same year a National energy policy report which provided the interests of the United States in different areas of the world was prepared. The Caspian region was represented as an area of special interest as “exports from the Western Hemisphere, the Caspian, and Africa are important factors that can lessen the impact of a supply disruption on the U.S. and world economies.”<sup>365</sup>

Among the recommendations made by the NEPD Group were to provide commercial conditions which would allow Kazakhstan exporting oil through BTC (Baku-Tbilisi-Ceyhan) pipeline and to

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<sup>362</sup> J. Kucera, ‘Would Russia go to war over the Trans-Caspian pipeline?’, eurasianet.org , 22 November, 2011.Web.Retrieved from: <http://www.eurasianet.org/node/64568>

<sup>363</sup> D. Melķis, ‘Krievija-skel-eiropas-ekonomisko-politiku’ *Dienas bizness*, 16 February 2012.Web.Retrieved from :<http://www.db.lv/pasaule/krievija-skel-eiropas-ekonomisko-politiku-252236>; V.Volovoj, ‘Who benefits from a war with Iran?’, Public Agency (PA) the Centre for Geopolitical Studies, 27 February 2012.Web.Retrieved from: <http://www.geopolitika.lt/index.php?artc=5237>

<sup>364</sup> D.Helm, *The new energy paradigm*, Oxford: Oxford University Press, 2007,p.234; *Eastern Europe and the Commonwealth of the Independent States*, London:Europa publications limited, 1999,p.834.

<sup>365</sup> National energy policy, report of the National Energy Policy Development Group, May 2001 U.S Government Printing OfficeWashington, p.7-8.Web.Retrieved from:<http://www.ne.doe.gov/pdfFiles/nationalEnergyPolicy.pdf>

help Turkey and Georgia diversify their natural gas supplies through developing Shah Deniz pipeline.<sup>366</sup>

Russia, in turn, was interested in Central Asian resources as cheap hydrocarbons deliveries from that region (first of all Turkmenistan and Kazakhstan) enable Russian companies to boost their energy exports to Europe.

Thus, the region during 2000s was under permanent pressure from Russia and the United States, seeking to maintain control over its resources. The confrontation over the Trans-Caspian pipeline and Shah Deniz gasfield proved the importance of the routes for transporting Caspian resources. One of the most important nodes of the hydrocarbons routes in 2000s was Georgia. In contrast to Azerbaijan, the country was not rich of resources but was located in a point of strategic interest as such important routes as Baku-Tbilisi-Ceyhan pipeline, Baku-Supsa pipeline, South Caucasus pipeline, proposed White Stream and Nabucco pipelines were crossing its territory as well as old Soviet pipelines system allowed to provide hydrocarbons flows to Russia.

### **Georgia as a strategic point for Caspian energy flows**

Though after the Soviet Union collapse the relations between Russia and Georgia deteriorated which was connected first of all to Russian support to Abkhazia during the war of 1992-1993<sup>367</sup>, there were no particular conflicts of interests till 2002. In 1994 Georgia entered CIS, for 1999 the situation over Abkhazian and South Ossetia stabilized as Russia did not interfere in the Georgian domestic policy.<sup>368</sup> However, the change of Russian and American political discourse in the beginning of 2000s influenced role of Georgia on the international scene making it one of

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<sup>366</sup> Ibid.

<sup>367</sup> A. Ferrari, *Il Caucaso. Popoli e conflitti di una frontiera europea*, p.80.

<sup>368</sup> A. Illarionov, 'Как готовилась война [How the war was prepared]', *Novaya gazeta*, 24 June 2009.

the strategic points for both countries. Washington sent to Georgia 64 million dollars of military equipment<sup>369</sup>, Moscow established contact with Zhinvali and Suhumi, the capital of the South Ossetia and Abkhazia. In 2003 56% of North Ossetians obtained Russian passports<sup>370</sup>. Having received the information that Chechen rebels hid in Pankisi Gorge, in north Georgia, in August 2002 Russian militaries bombarded it. The tensions were growing and in September president V. Putin declared that Russia would have right of military intervention according to article 51 of Charter of the United Nations<sup>371</sup> if Georgia represented a threat. As a response, Georgian president E. Shevardnadze declared on the NATO summit in Prague on November 22 that Georgia intended to enter the North Atlantic Alliance.<sup>372</sup>

Later the relations between the countries improved. Georgia made several steps towards Russia in 2003. Shevardnadze declared that he would support Russian companies intended to return to Georgia. On May, 28th he agreed with Gazprom CEO Aleksej Miller, to authorize Gazprom to administer and maintain Georgian gas pipelines system<sup>373</sup>. Meanwhile according to Washington which supported the construction of a pipeline from Shah Deniz passing Georgia<sup>374</sup>, the Gazprom's control of gas transportation system in the country could undermine the project as it would not only complicate the resources routes diversification but impede establishing of the US control over Caspian oil and gas transportation system.<sup>375</sup> Furthermore, the US administration was concerned about the American energy companies in Georgia. The Georgian electric corporation United Distribution Company was administrated by US controlled

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<sup>369</sup> S. Casertano, *Sfida all'ultimo barile*, Mi, p. 217.

<sup>370</sup> A. Illarionov, 'Как готовилась война [How the war was prepared]'.

<sup>371</sup> The article provides the right of self-defence, claiming that "Nothing in the present Charter shall impair the inherent right of individual or collective self-defence if an armed attack occurs against a Member of the United Nations". Web. Retrieved from: <http://www.un.org/en/documents/charter/chapter7.shtml>

<sup>372</sup> A. Illarionov, 'Как готовилась война [How the war was prepared]'.

<sup>373</sup> S. Casertano, *Sfida all'ultimo barile*, p. 219.

<sup>374</sup> 'US supports Caspian gas pipeline project', *Pipelines International magazine*, 1 October 2002.

<sup>375</sup> S. Casertano, *Sfida all'ultimo barile*, pp.219-220.

<sup>375</sup> G. Dvali, 'Американцев выгоняют из Грузии [Americans are driven out from Georgia]', *Kommersant*, 10 September 2002.



PA Consulting from 2003, while the biggest part of the network was administrated by national company Telasi, 75% of which was controlled by another American company, AES, after the privatization.<sup>376</sup> The both companies experienced economic difficulties. Furthermore, in 2002 the financial manager of Aes Telasi Nika Lominadze was killed. A few days later a bomb exploded near one of AES offices in Tbilisi<sup>377</sup>. In August 2003 AES sold its Telasi shares to a Russian company RAO and left the country<sup>378</sup>.

The new developments in Georgian energy sector were considered in the European countries and the USA as a sign that Georgian energy routes were passing under the Russian control.<sup>379</sup>

The Rose Revolution of 2003 changed completely the balance of power in the region.

Parliament election was held in Georgia on November 2, 2003. Though observers announced different violations took place during the election campaign, the government declared the election fair. According to the official results, the pro-government block "For new Georgia" won the elections, while M.Saakashvili, the US-backed<sup>380</sup> opponent of Shevarnadze, won according to the exit polls.

The International Election Observation Mission concluded that the elections "fell short of a number of OSCE commitments and other international standards for democratic elections"<sup>381</sup>.

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<sup>376</sup> S. Casertano, *Sfida all'ultimo barile*, p.220.

<sup>377</sup> G. Dvali, 'Американцев выгоняют из Грузии [Americans are driven out from Georgia]'.

<sup>378</sup> Georgia's State Policy in the Electricity Sector, February 2008. This report was prepared by Transparency International Georgia with funding from BP Georgia.Web.Retrieved from: [http://www.investmentguide.ge/files/160\\_158\\_615717\\_TIGeorgia-GovernmentEnergyPolicyandStrategy-3rdreport.pdf](http://www.investmentguide.ge/files/160_158_615717_TIGeorgia-GovernmentEnergyPolicyandStrategy-3rdreport.pdf)

<sup>379</sup> S. Casertano, *Sfida all'ultimo barile*, pp.218-222.

<sup>380</sup> L.Mitchell, *Uncertain democracy: US foreign policy and Georgia's Rose revolution*, Philadelphia: University of Pennsylvania Press, 2009, p.112-114; M. Bowke, *Russia, America and the Islamic World*, Aldershot: Ashgate Publishing Ltd, 2007, p.150.

<sup>381</sup> OSCE Parliamentary Assembly president visits Georgia, 21 November 2003, Civil.ge (a Georgian daily news online).Web.Retrieved from: <http://civil.ge/eng/article.php?id=5576&search=>

Numerous manifestations aimed at cancellation of elections results followed the announcement of the official results. On November 23 president Shevardnadze resigned.<sup>382</sup> Saakashvili won the presidential elections of January 2004, held afterwards,<sup>383</sup> taking 96% of votes. Though such a result seemed hardly realistic, international observers did not doubt the new elections. The United States decided to support Georgia furnishing financial assistance for new ministers through Open Society Institute and offering economic aid for transportation of Russian troops which had to leave Georgia in order to satisfy the decision of the president Saakashvili.<sup>384</sup> Nevertheless, RAO maintained control over Telasi.<sup>385</sup>

The establishment of American influence in Georgia enabled the European and Caspian region countries to conclude several accords for the construction of new energy routes bypassing Russia, such as the Baku-Tbilisi-Ceyhan oil pipeline inaugurated in July 2006 and the South Caucasus gas pipeline(also known as BTE pipeline) completed in July 2007<sup>386</sup>.

Though the construction of these pipelines was a source of concern for Russia and Iran, the Blue Stream pipeline allowed Russia to achieve Turkish market and the South Stream project compete with proposed Nabucco pipeline as well as with other pipelines running from Azerbaijan southwards to deliver energy supplies to Europe.

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<sup>382</sup> L. Mitchell, *Uncertain democracy: US foreign policy and Georgia's Rose revolution*, p.63.

<sup>383</sup> Ibid. , p.71.

<sup>384</sup> S. Casertano, *Sfida all'ultimo barile*, p.225.

<sup>385</sup> Ibid. , p.226.

<sup>386</sup> H. Peimani, *Conflict and security in Central Asia and the Caucasus*, Santa -Barbara:ABC-CLIO, 2009, p.256.

## The US-Russia confrontation on the international chessboard

As many researchers noticed<sup>387</sup>, the international political conjuncture changed as the development of the European Union, the economic growth of China and India, as well as the strengthening of the economic and political influence of Russia pushed the world towards a new multipolar economic balance.

In these circumstances, the USA and Russia preferred to achieve their interests through the hard power. In 2001, a few months after the September 11<sup>th</sup> attacks, a US-led coalition invaded Afghanistan to overthrow the Taliban regime. From this moment the “war on terror” became a shared objective of US and Russian administrations. Also the second Chechen war started to be represented by the Russian Media as part of the global war against terrorism. However, the relations between Russia and the USA deteriorated after the invasion of Iraq. As Di Nolfo argued, Iraq occupied a strategic position in the Middle East, and to control its territory meant to support Israel and to oppose Russian and Chinese interests. Moreover, rich of natural resources, the country was of interest in terms of energy supplies.<sup>388</sup>

As Russian and Iraqi companies concluded until 2003 about 50 contracts over petroleum resources and one third of crude oil exports were administrated by companies linked to Moscow<sup>389</sup>, the Russian government strongly opposed Operation Iraqi Freedom. In order to obtain Russian support, the United States argued that the payment of Iraq’s 8 billion dollars debt to Russia and the oil contracts were at risk if Russia posed its veto.<sup>390</sup> However, the Russian President decided not to give its support to the war declaring it an extreme measure

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<sup>387</sup> For example: E.Di Nolfo, *Storia delle relazioni internazionali dal 1918 ai giorni nostril*, p.1391.

<sup>388</sup> E.Di Nolfo, *Storia delle relazioni internazionali dal 1918 ai giorni nostril*, p.1375.

<sup>389</sup> S. Casertano, *Sfida all’ultimo barile*, p.242.

<sup>390</sup> M.Wines, ‘Threats and responses: Moscow, Putin again rejects U.S. calls for support of a War, fearing effect on the Mideast’, *The New York Times*, 1 March 2003.

that could throw the Middle East in turmoil<sup>391</sup>. Iraq was attacked in March 2003 thought Russian, Chinese, French and German governments condemned the invasion<sup>392</sup>.

As the relations between Russia and the USA deteriorated after Russian refusal to support the war, American foreign policy towards former soviet nations became more aggressive. The US support of the Coloured revolutions in Georgia (2003), Ukraine (2005) and Kirghizstan(2005) impeded the Russian government to control vital energy routes for Russian gas and oil deliveries to Europe. The further expansion of NATO to East, videlicet over Poland, Hungary and Czech Republic in 1999, then over Slovenia, Slovakia, Bulgaria, Romania, Estonia , Latvia and Lithuania in 2004 and the support of alternatives to Russian pipelines were aimed at undermining Russia's influence in the region and defend American interests in the Central Asian and Caspian regions<sup>393</sup>.

Nevertheless, the Russian government intended to maintain its reputation of large oil and gas producer and biggest partner of the European Union on the energy market as well as reestablish its influence over the former Soviet territory. The developments which occurred in the late 2000s seem to show that the Russian government was able to pursue its objectives

The first group of events was connected with Russian military revival. As Stefano Casertano noticed, the manouvres of Russian military planes patrolling territory from Pacific Ocean and Syberia to the Atlantic Ocean in 2007 was the first demonstration of long-range air power after the Soviet Union collapse.<sup>394</sup>

Secondly, as the oil and gas prices increased during 2000s, the economic situation in Russia improved. The centralization of power and the nationalization of energy assets allowed

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<sup>391</sup> Ibid.

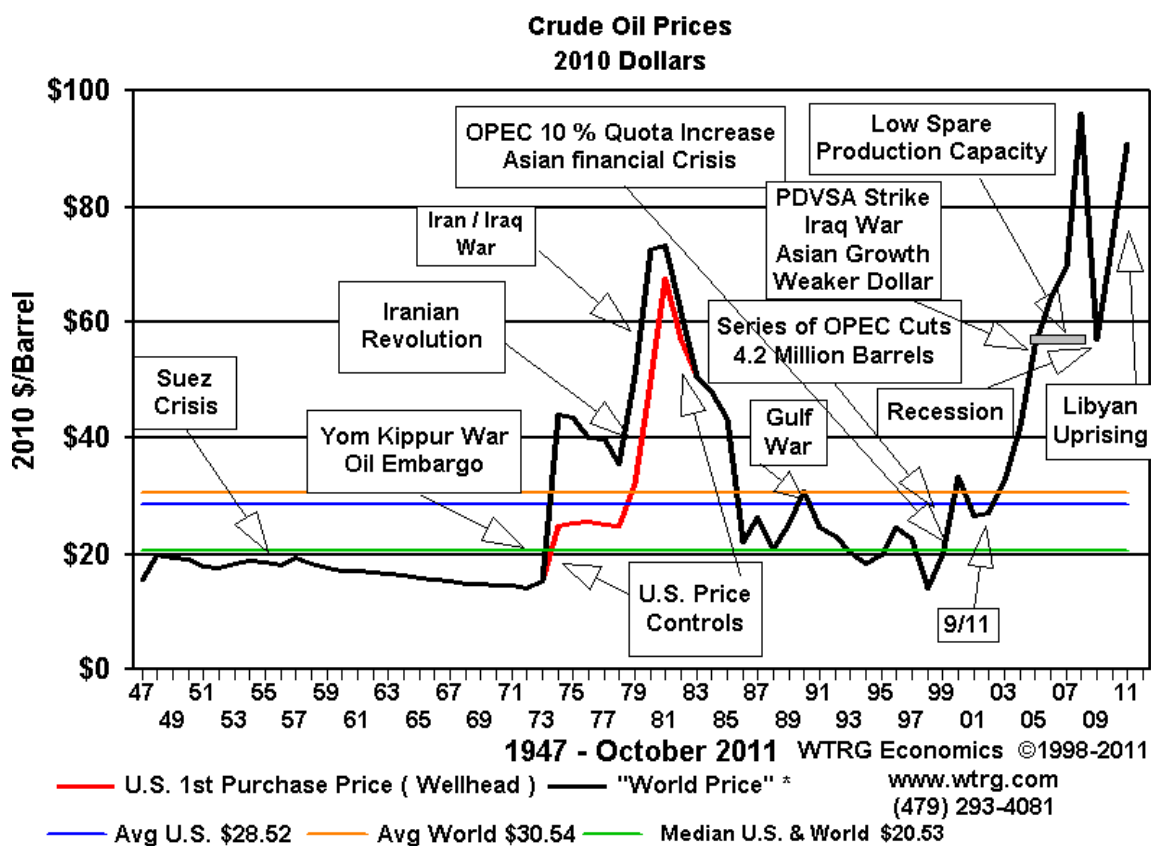
<sup>392</sup> For example: E.Di Nolfo, *Storia delle relazioni internazionali dal 1918 ai giorni nostril*, p.1374.

<sup>393</sup>S. Casertano, *Sfida all'ultimo barile*, p.244.

<sup>394</sup> S. Casertano, *Sfida all'ultimo barile*, pp.244-245.

distributing the energy exports income to support the development of other sectors of the economy.

Finally, the Shanghai Cooperation Organization(SCO) created by China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan in 2001 on the base of the Shanghai Five organization, challenged the American influence in the region. The clashes over military bases provided good illustration for this issue. The same day Russian troops had to leave Georgia, the Uzbek government, under the pressure of SCO, ordered the US air troops to leave the Karshi-Khanabad military base in Uzbekistan.<sup>395</sup>



(Retrieved from:<http://www.wtrg.com/prices.htm>)

<sup>395</sup> Ibid. , pp. 247-248.

## **The alternatives to Europe-Russia energy projects: ESPO pipeline and shale gas exploitation**

During 2000s, important changes in Russia politics, such as power centralization, resulted in a nationalization of the energy assets and led to a transformation of Europe-Russia energy cooperation. As the Russian government controlled the most part of hydrocarbon exports, the hydrocarbon supplies sometimes were used to achieve political goals. Political concessions were accepted as an alternative to monetary payment for energy supplies. The confrontation over gas and oil supplies in Ukraine and Belarus was considered a sign of unreliability of Russian energy exports as deliveries to the European countries were interrupted several times. As a reaction, new routes for hydrocarbons exports were developed. The Russian project Nord Stream allowed delivering gas to North European countries bypassing Ukraine and Belarus. On the South, the Russian pipelines Blue Stream and South Stream were competing European Nabucco, Ukrainian White Stream and different other projects connected to the South corridor from Azerbaijan.

Russia made several attempts to enter Asian energy market in order to diversify oil and gas customers. The interdependence question which the European countries were concerned about became an important issue for Russia as well. In view of the development of alternative routes for Caspian and Central Asian resources, Russia could lose its privileges as biggest energy partner of the European Union.

On May 29<sup>th</sup>, 2003, Russia and China signed an agreement over the construction of a crude oil pipeline connecting Siberian oil fields with Pacific Ocean ports.<sup>396</sup> The first stage of the pipeline was constructed in 2009 while in January 2011 the first oil supplies were delivered to China.

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<sup>396</sup> 'China, Russia sign oil pipeline agreement', *China daily*, 29 May 2003.

As the East Siberia Pacific Ocean pipeline (ESPO) could provide crude oil deliveries to China, Japan, South Korea and the United States, a race for the access to the pipeline started soon.<sup>397</sup>

In February 2012 Beijing claimed that it would be interested to purchase all the Russian oil supplies passing through the ESPO pipeline in order to secure its energy imports and avoid risks connected to tensions over Iran. However, this could be economically unprofitable for the pipeline operator, Transneft, as other consumers of ESPO, especially the United States, purchased oil at higher prices<sup>398</sup>.

For what concerns the diversification of energy routes in Europe, some experts believe that the shale gas exploitation in Europe could be an alternative to Russian gas supplies.<sup>399</sup> The US Department of Energy study of 2011 suggested that Poland had 5.3 trillion cubic meters of shale gas reserves.<sup>400</sup> This quantity could be enough to compete with Russian gas supplies to Europe. However, some months later Poland's Geological Institute published a report according to which the real reserves were lower, probably about 346 -768 billion cubic meters.<sup>401</sup>

Russian specialists argued that the Polish shale gas reserves did not represent a danger for Europe-Russia energy cooperation as the lack of infrastructures and high expenses for treatment and processing it would make the gas prices high and not allow Polish shale gas to compete with the Russian supplies.<sup>402</sup> Moreover, as environmentalists were concerned about the potential negative effects of "fracking fluid" used in shale gas exploration<sup>403</sup>, the Polish companies could face also political obstacles to shale gas development.

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<sup>397</sup> J. Helmer, China beats Japan in Russian pipeline race, *Asia Times*, 29 April , 2005.

<sup>398</sup> 'China wants all oil from Russia's ESPO pipeline', *Rianovosti*, 15 February 2012.

<sup>399</sup> J.Kanter, 'Oil executive promotes shale gas to Europeans', *The New York Times*, 12 October 2011.

<sup>400</sup> 'Shale gas in Poland. Down to Earth', *The Economist*, 15 January 2012

<sup>401</sup> 'Lower Poland shale gas reserves estimated', *United Press International (UPI)*, 23 March 2012.

<sup>402</sup> T. Balmforth, 'Europe's shale gas 'Revolution'. Why Russia is shrugging its shoulders', *Oil and Gas Eurasia*, March 2012. Web. Retrieved from: <http://www.oilandgaseurasia.com/articles/p/156/article/1754/>

<sup>403</sup> 'Shale gas in Poland. Down to Earth', *The Economist*.

If the shale gas development in Europe does not have big impact and the Nabucco project is not realized, the potential growth of demand could increase the volumes of the energy exports and probably little would change in Europe-Russia energy cooperation in the near future.



(Retrieved from: <http://www.erna.or.jp/en/Asia/map/index5.htm>)



## Conclusion

The present study was set out to determine the particularities of Europe-Russia energy relations.

The evolution of the energy trade between Europe and Russia passed through three historical stages. Being born in a period of acute tensions between the Soviet and Western Camps, the energy trade was conditioned and complicated by the Cold War antagonism. In spite of the fact that along the period of USSR-Western Europe cooperation both sides faced the inexorable pressure exerted by the United States, close ties between the countries were established soon. This period came to an end in early 1990s with the USSR collapse and the transformation of the international political equilibrium. As a weakened Russia was not considered anymore a formidable enemy, the number of political obstacles for energy cooperation decreased. Yet, the United States remained an outstanding powerful piece on the European-Russian energy chessboard. The American support of different energy projects in the post-Soviet space to consolidate its influence gave rise to new energy routes. An important characteristic of Europe-Russia cooperation of this period were the first attempts to use energy supplies as a tool for acquisition of political concessions. A third period started in early 2000s, when the changes in Russian domestic policy and in the international political environment gave birth to new conditions and new forms of energy relations at geopolitical level and within the country. The war in Iraq forced the United States to concentrate their attention on the Middle East. This event and the considerable increase of crude oil prices, partially provoked by the conflict, allowed Russia to become politically and economically stronger, consolidating its influence in strategic zones of former Soviet space. The Russia–US relations deteriorated significantly and this process intensified the tensions over the new energy routes. The European countries and Russia drew up different projects of new pipelines construction which would enable Europe to

decrease its dependence on Russian supplies and Russia to bypass problematic transit countries.

In order to reach the objectives set in the introduction, it has been necessary to examine the specific issues of the energy cooperation:

- The use of energy supplies as a political instrument;
- The connection between the increase of Russian energy exports and the country's economic development;
- The role of the United States in the Europe-Russia energy cooperation;
- The debates over the transit countries' supplies stoppages;
- The mutual dependence of Europe and Russia on the energy trade;
- The European alternative routes;
- The Russian alternative routes.

The cooperation in the energy sphere between the European countries and Russia started in late 1950s – early 1960s when the important oil and gas fields were found in Siberia. The shortage of natural resources in a situation of growing demand forced the European countries to boost their energy imports. The Soviet Union, searching for a new source of earnings, considered the possibility to export its hydrocarbon resources to Western European countries as advantageous.

The energy cooperation between Western Europe and the USSR became a source of great concern for the United States, which claimed that the energy exports could be used as a weapon of political pressure and sought to prevent the contracts' conclusion even on the tide of détente. However, the Soviet supplies were never used as a political weapon and were

maintained even in the beginning of 1980s, despite of the tensions between the Soviet government and Reagan administration.

Although the oil shocks of the 1973 and early 1980s allowed the Soviet Union to invest more in the economic sector, many researchers claim that the dependence of the state budget on hydrocarbons exports, combined with the depletion of oil fields and the petroleum prices landslide in the second half of 1980s, as well as the increasing expenses for the armament race, were the most influential factors which led to the USSR collapse.

The political vacuum in the former Soviet space in 1990s attracted the United States and some Western European countries, seeking to establish their influence in the region. In view of Russian reluctance to let those countries pass under the ex-rival's influence, the energy supplies shortfalls were interpreted by some scholars rather as political than as economic actions. For example, S.Closson argued that the oil supply cuts in Lithuania were probably connected to the decision to sell a part of the of Lithuanian oil-proceeding plant Mazeiku Nafta to US-based company Williams and to diversify energy routes providing this country with petroleum in order to decrease its dependence on Russia.<sup>404</sup>

The policy of stoppages in the Eastern Europe became a recurrent issue and in 2007 the Russian Railways discontinued the deliveries of oil to Estonian ports after a Red Army monument situated in the center of Tallinn was decided to be removed.

The oil and gas interruptions as a measure of political pressure in post-Soviet environment became one of the most controversial elements of Russia-Belarus and Russia-Ukraine energy debates. Both Belarus and Ukraine suffered from economic stagnation and could hardly afford paying the market prices for the energy imports, especially after the jump in oil prices of the

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<sup>404</sup> S.Closson, 'Russia's key customer:Europe', *Russian energy power and foreign relations*, CSS Studies in Security and International relations, Oxon:Routledge,2010,p.93.

early 2000s. The Russian government provided lower prices for CIS countries till 2006 (from that year the prices increased to achieve market level, with the exception of Belarus, which continued to pay a special low price) and did not pay attention to delays in payments, in exchange of Russia-friendly policy and some concessions. Thus, the monetary payments were partly substituted for the integration-with-Russia policy. The shares of the national gas and oil transport companies, as well as the prolongation of the contract on the rent of Sevastopol naval base were other examples of non direct payments for energy deliveries. While neither political condition was satisfied, nor market price was paid, the supplies were interrupted.

As major part of oil and gas flows to European countries was passing through Belarus and Ukraine, the energy cut offs in the transit countries resulted in hydrocarbons shortages in other European countries.

Some journalists tend to blame Russia for the so-called “gas and oil conflicts” with the transit countries, resulted in energy supplies shortages, while many Russian researchers accused the United States of orchestrating the energy conflicts in these countries in order to gain the European support for alternative oil and gas routes creation, which would enable bypassing Russia. As the most recent energy debates with these countries have become the subject of only a few researches, the author of this dissertation analyzed the websites and articles in order to correctly evaluate the roots and consequences of the debates. The analysis of this material allowed us to prove both the economic and political roots of the conflicts. The energy conflicts represent a complex of different, often contradictory, actions and decisions in changing circumstances. Although some political coincidences exist, it is probable that the main reason of the conflicts was economic. The idea that the oil and gas exports discounts could be received for political concessions displays the only certain political roots of the debates. For what concerns the consequences, it could be only claimed with certainty that the debates

influenced negatively the image of Russia as a secure energy exporter and pushed the European countries to search new energy routes.

As a Russian response for the transit countries debates, three projects were developed in order to bypass Ukraine and Belarus. The Nord Stream, an offshore Baltic Sea gas pipeline leading to Germany was inaugurated in May 2011. The project was considered in Europe controversial due to the fact that it would raise the dependency of European countries on Russian gas deliveries. The other two projects were intended to compete with the Nabucco pipeline, proposed by some European countries and supported by the United States. Designed to deliver Caspian gas resources bypassing Russia, every year it has fewer chances to be implemented. Being a large-diameter pipeline, it had to receive an access to both Azerbaijani and Turkmen resources. But as the trans-Caspian pipeline remains a difficult project to carry out, in view of Russia's firm position, and, thus, the Turkmen gas becomes difficult to achieve, it is hardly probable that Nabucco would win the Shah Deniz competition and does gain access to Azeri natural gas either. The other two Russian gas pipelines were named Blue Stream and South Stream. The first one was inaugurated in November 2005 and delivers Russian gas to Turkey. In the mid 2000s Gazprom had intentions to extend the Blue Stream to Southern Europe, creating a route similar to Nabucco's one, but the countries involved in the projects have chosen the latter. The South Stream project, the main rival of Nabucco, is not implemented yet (the construction should start in the end of 2012)<sup>405</sup>, although at present the French company Électricité de France, German Wintershall and Italian Eni participate in the project along with Gazprom; the agreements with the countries where the pipeline should pass are already signed.

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<sup>405</sup> Встреча с председателем правления компании «Газпром» Алексеем Миллером [Meeting with the Gazprom's CEO Alexej Miller]. Kremlin. Web. Retrieved from: <http://xn--90aoglh7c4a.xn--d1abbgf6aiiy.xn--p1ai/%D0%BD%D0%BE%D0%B2%D0%BE%D1%81%D1%82%D0%B8/14259>

The Nord Stream pipeline and the construction of the South Stream would make the Russian supplies to European countries more reliable. Furthermore, the acquisition of Beltransgaz, the national gas transportation company of Belarus, by Gazprom in 2010 allowed Russia to provide secure transit supplies through this country.

For what concerns natural oil exports, the Baltic Pipeline System was completed in 2011 and the first oil supplies were provided in March 2012.<sup>406</sup>

Thus, in spite of some recent discussions with Ukraine over gas prices, the problem of “transit countries” was resolved.

The United States played an important role in the evolution of Russia-Europe energy relations. Having strategic interests in the Caspian and Central Asian regions, the American government supported the projects of alternative to Russian pipelines leading to Europe. Such resources-rich countries as Turkmenistan and Kazakhstan had no access to European oil and gas market but for the oil Soviet pipeline system passing through Russian territory. Russian oil and gas companies purchased the resources at low price on the border, to resell them later to European countries. The new pipelines would bring higher earnings to the state budget of these countries. One of the most controversial projects is a Trans-Caspian gas pipeline. Once constructed, the offshore pipeline would connect Turkmenistan to Azerbaijan and allow delivering Turkmen gas to Europe passing through Georgia and Turkey. Doubting the legal status of the Caspian resources, the Russian government opposes the pipeline in order to undermine the Nabucco pipeline construction and force the European countries to choose the South Stream project instead.

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<sup>406</sup> ‘Путин запустил Балтийскую трубопроводную систему [Putin launched BPS]’, *Rossiyskaya gazeta*, 23 March 2012.

Azerbaijan does not border Turkey and a pipeline running from one country to another has to pass the territory of Georgia, Armenia or Iran. Armenia has good diplomatic relations with Russia, while Iran remains a closed zone. The color revolutions in the post-soviet space were strongly supported and, according to some researchers, even orchestrated from the United States. The revolution of Roses in Georgia of 2003 resulted in the alignment of the country with the United States and opened the country for different pipelines projects. (Nabucco, the White Stream, the pipelines of the South Corridor)

In 2000s the European dependence on Russian hydrocarbon supplies became a source of serious concern for European leaders, especially after the gas debates between Russia and the transit countries. The opinion that Russia was not only an insecure gas and oil exporter but it could use its supplies as political weapon became widespread. Many politicians opposed the Nord Stream pipeline as a project which would increase the dependence of Europe on Russia and preferred the creation of alternative to Russian routes for Caspian resources, such as Nabucco.

However, figures prove the Russia-Europe energy relation to be interdependent. According to a joint report of the European Commissioner for Energy and the Russian Minister of energy, in 2010 Russian supplies accounted for only 27 % of total EU's crude oil imports and 31% of gas imports. At the same time, Russia delivered in the EU market 88% of its total oil exports and 70% of its gas exports<sup>407</sup>. If to consider that in 2010 40% of state budget came from oil and gas

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<sup>407</sup> European Commissioner for Energy Günther H. Oettinger, Minister of Energy Sergey I. Shmatko, *Joint Report EU-Russia Energy Dialogue 2000-2010: Opportunities for our future Energy Partnership* Brussels / Moscow November 2010. Web. Retrieved from:  
<http://ec.europa.eu/energy/international/russia/doc/reports/2010-11-report-10thtanniversaryfinal.pdf>;  
<http://minenergo.gov.ru/upload/iblock/537/5379590b46eccb229803488dcbc3940c.pdf>

exports earnings<sup>408</sup>, it is apparent that Russia is more dependent on Europe-Russia energy cooperation than Europe.

Understanding this dependence, the Russian government sought to diversify its energy exports in the second half of 2000s. The East Siberia Pacific Ocean pipeline (ESPO) delivers Russian crude oil to China, Japan, South Korea and the United States. However, the volumes of exports to Asian market are incomparable with those going westwards.

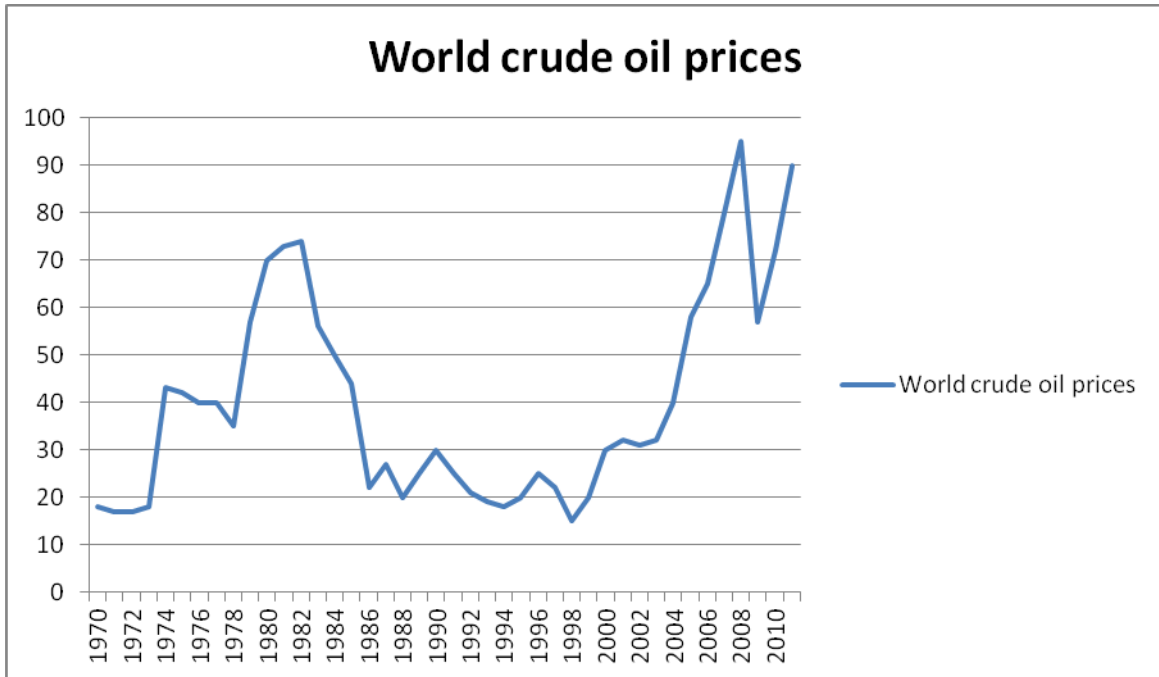
Many scholars highlight that the dependence of state budget on energy exports earnings is a symptom of Dutch disease. This signifies that the exporter country does not develop the manufacturing sector and becomes increasingly dependent on earnings from resources exports and, in consequence, on the world prices for them. From 1970 to 2011 the average world oil prices increased from 18 dollars per barrel to 91 dollars per barrel. The oil prices landslide of late 1980s coincided with the collapse of the Soviet Union, while the flat low prices period in 1990s with economic stagnation in Russia. On contrary, after the Iran revolution and the Iraq-Iran war the oil prices increased as did the economic indexes of the Soviet Union. The economic development of Russia in the beginning of 2000s is marked by the rise of oil prices. The analysis of the per capita Gross Domestic Product UN database allows reconstructing a relative economic growth timeline. Being composed by different countries, the USSR economic indexes are generally lower the Russian ones. Considering that the Russian economy had the highest rates in the post-Soviet space, Russian GDP indexes in 1990s are higher than the USSR's ones in 1980s. Thus, if to consider the collective average GDP of the USSR member countries, the economic depression after the USSR collapse would be more evident from the graph. However, it seems reasonable to connect the USSR GDP with Russian GDP timelines in order to provide a

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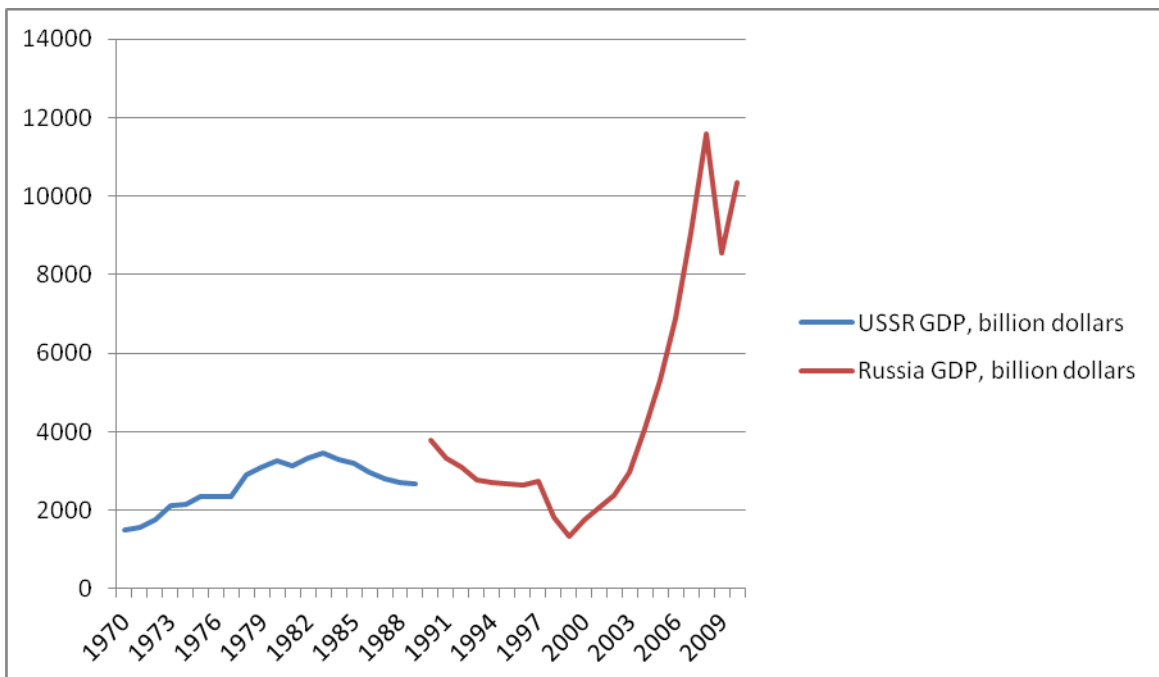
<sup>408</sup> Pami Aalto, *Russia's energy policies: national, interregional and global levels*, Cheltenham: Edward Elgar Publishing, 2012, p.10.



clearer base to compare the GDP rate changes with the oil prices variations. Such a comparison makes evident that the maximum and minimum rates of the graphics coincide and gives the possibility to confirm the fact that Russia depends significantly on its hydrocarbons exports and Europe-Russia energy relations could be described at least as interdependent.



(Based on data provided by WTRG Economics)



Although both Europe and Russia are investing in the construction of new energy routes to diversify their markets, the volume of oil and gas delivered would be incomparable to those which Russia exports to Europe. In a long-term perspective, European countries would seek to find more energy suppliers, while Russia would consolidate its position in the Asian energy market, but probably the Europe-Russia interdependent energy relations would be maintained even if in less dimension.

Finally, a number of important limitations need to be considered. First, the size and the time of the study does not allow introducing the Europe-Russia energy relations in the world energy market and making comparisons with the relations of other oil and gas producers with their importers. Secondly, in-depth economic analyses of the oil and gas rates, the expected and actual prices for new energy routes construction and the analyses of expenses and earnings from energy commerce would provide more detail basis for the findings and could give explanation for different unclear issues. Third, the study did not evaluate the alternative energy sources development which could allow making prognosis for the future energy cooperation.

Future studies could assess the contribution of the foreign policy in the Europe-Middle East and Russia-Asia energy relations, evaluate the Europe-Russia energy relations from the point of view of the alternative energy sources and undertake deeper analyses of economic data.

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