Russian Energy Policy and the Balkans

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Basic postulates of Russian Foreign Energy Policy

If one considers foreign policy as an extension of internal policy of a kind, then that postulate can significantly facilitate the analysis of Russian foreign energy policy, including its implementation in the Balkan region.[1] The overview shall limit itself to natural gas, with occasional references to oil, as an inevitable *other side of the coin* in Russian energy policy. First, a few notes on gas. Unlike oil, which is traded on the world spot market, gas is transported to its final consumers mainly through gas pipelines. Gas pipelines often extend across several states, representing different political and economic systems. This makes it a *sensitive* product, susceptible to different influences (political, economic, geographical, etc.), along the whole chain – from the producer through the transit states, until it reaches the consumer. In another words, gas is an overtly *geopolitical* commodity.[2] It is estimated that the "geopolitics of energy relations has replaced or absorbed the traditional geopolitics of military balances".[3]

Natural gas is considered as the fuel of the future, both because of the vast reserves available and because of its ecological acceptability. Gas combustion emits around 40 percent less harmful gases than coal and 30 percent less than oil. As the issue of climate change slowly progresses to the top of the world agenda, this becomes an additional argument to label gas as *the fuel of the future.* Estimates testify that gas will be the fastest growing source of primary energy in the world: over the next few years it will overtake coal in importance and consumption, and, by 2050, it will also overtake oil. Its use and cost-efficiency in the chemical and metal industries and, especially in the production of electricity, makes gas more than simply a source of energy.[4]

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[1] To understand the significance of oil and gas for Russia, it is sufficient to note that almost one half of the GDP, almost two thirds of export profits and one half of the state revenues come from that sector. See: „Cevovodi, politika i moć" [Pipelines, Politics and Power], Center for European Reform, London, translation into Serbian, European Movement in Serbia, Belgrade, 2009, page 3

[2] The use of the term *geopolitics* here is based on the definition given by J. Barnes, M.H.Hayes, A.M.Jaffe and D.G.Victor in the Foreword to the book *Natural Gas and Geopolitics-from 1970 to 2040*, Cambridge University Press, Cambridge, 2006. According to them, geopolitics is the influence of geographical, cultural, demographic, economic and technological factors on the political discourse between actors in the international sphere. „In this definition, relative gains matter, but so do joint gains from possible cooperation", say the authors and point out that states which decide to import large quantities of gas put the security of their energy systems partly into the hands of others. This, in return, gives suppliers and users of gas a share in the internal political stability of the other side. Therefore, what we mean by *gas geopolitics* – is not only an endless race for global position, but also large political actions of governments, investors and other key proponents who decide which gas projects will be built, how the profit will be shared and risks managed, depending on the international gas trade.

[3] Dimitri Trenin, Geopolitika energije u odnosima Rusija-EU,: „Cevovodi, politika i moć" [Pipelines, Politics and Power], Center for European Reform, London, translation into Serbian, European Movement in Serbia, Belgrade, 2009, page 15.

[4] The world's gas reserves are focused in a relatively small number of states: only five states control 67 percent of worlds gas reserves – Russia, Iran, Qatar, Saudi Arabia and the United Arab Emirates. Russia possesses 27 percent of gas reserves, and together with Iran it controls almost one half of the world's confirmed reserves. Moscow will surely remain the main world gas producer in the next few decades. By comparison, the US possesses 3 percent. Russia's reserves are in locations distant from the areas of major future demand – the US, the EU, China, India and Brazil. For this reason it is estimated that the growing role of gas will increasingly influence relations between producers and consumers and thereby the worlds political scene. Around 80 percent of world's gas reserves, but also oil reserves, are property of or under control of exporting countries or their energy companies.

To address such an ambitious topic, we shall take a look at several elements: the basis of Russian energy policy, connections with its Foreign Policy Concept and with the National Security Strategy. We shall see how it has influenced the Balkan region during the last two years, since Russia initiated the *South Stream* gas pipeline project. This leads us also to the EU energy policy, which overlaps with Russian energy policy, and not only in gas, but also in transit countries and in the Balkans. Since gas pipelines are long term and complex projects, it is inevitable to return to the issue of gas sources. Finally, we shall try to offer basic conclusions and prognoses.

The starting points of contemporary Russian energy policy are defined in the document: "The Energy Strategy of Russia for the Period up to 2020", adopted in 2003.[5] The initial statement is that "Russia possesses great energy resources – its territory contains 1/3 of the world's natural gas reserves, 1/10 of oil reserves, 1/5 of coal reserves and 14 percent of uranium reserves". The energy policy should be directed towards a change from raw material supplier to active participant on the global market, which is a task of *strategic importance.* This ensures Russia's energy security and its position as a *stable and reliable partner of the European countries and the world community*.[6] The strategy identifies Europe and Asia as the primary markets for Russian foreign energy policy stating that *a common energy policy and transport and energy infrastructure in the regions of Europe and Asia fit within Russian strategic interests, indiscriminately providing transit of energy*. The document underlines that *the state will foster the participation of Russian enterprises in development and construction of great international transport projects for gas, oil and energy in both western and eastern directions.* The following section is also wordy of attention: *For Russia, which has a unique geographical and geopolitical position, issues of transit has a special meaning...The markets of Central and Western Europe remain among the greatest markets in the forthcoming 20 years.* The Russian 2008 Foreign Policy Concept only briefly touches upon energy. However, it puts forward significant tasks for Russian diplomacy:

> *Strengthen strategic partnership with the leading producers of energy resources, develop active dialogue with consuming countries and transit countries…assuming that measures, being taken to guarantee reliability of energy supplies, should be consistently supported by forthcoming activities aimed at ensuring stability of demand and secure transit.*

It is also worthwhile to consider the special attention given to energy producers in the Middle East, which is defined as being of *strategic significance to Russia's national interests*.[7] Considering the previous National Security Strategy, energy has received a more prominent place in the new text, with regards to two aspects: as a resource and as a security matter. Energy is represented as an instrument of power which strengthens Moscow's position in international affairs and secures resources for strategic deterrence.[8] Therefore, when the former Russian president Putin stated in 2005 that "Russia does not have other areas in which to be a leader", he was underlining an evident truth, since Russia has natural and technological potentials, which offer it a leading role in the global energy sector. At a meeting of the

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[5] *Summary of Energy Strategy of Russia for the Period up to 2020*, see: http://ec.europa.eu/energy/russia/events/doc/2003_strategy_2020_en.pdf

[6] Unlike consumers for whom energy security means stabile, reliable and per acceptable prices supply of energy sources (oil and gas) for producers it means stabile and predictable demand and prices which, as a rule, justifies large investments in research, production and transport of energy.

[7]The Foreign Policy of the Russian Federation, 12.07.2008, see: www.kremlin.ru

[8] Russian Analytical Digest, No.62, 18.06.2009, http://www.res.ethz.ch/analysis/rad/index.cfm

National Security Council, he stated that "energy is the most important force of world economic progress. It always was and will be for a long time".[9]

Gazprom represents the embodiment of the Russian foreign energy policy.[10] It is a company whose majority shareholder is the state.[11] It came into being from the Soviet Ministry for Gas and, basically, it was conceived to unite systems for the exploitation and transportation of gas in Russia, Ukraine and Belarus. It controls around 80 percent of Russian gas reserves and the entire gas infrastructure, i.e. transport and transit gas networks.[12] Gazprom has not been privatized as the oil industry has. Although there are no disputes over the assessment that Gazprom's intention is to control the entire gas pipeline from the source, through transit to the buyers in foreign markets, opinions differ about the background of such a policy. According to some, Gazprom has not given up its intention to control the gas distribution system, especially in Central and Eastern Europe.[13] He, who controls the pipeline, controls the buyer.[14] This opinion is contrasted by assessments that *Gazprom, like Russia, wants to make money, be strong, rich and respected*. Gazprom's moves are wrongly interpreted as a means of some political strategy: *energy is a political business, but it is business first and foremost*.[15]

The dominant word from the abovementioned documents is exactly *transit*. It is of key importance for Russian foreign energy policy. For Russia it is equally important to maintain both transit monopoly as well as a decisive influence on energy affairs in the post – Soviet area, i.e. in its strategic "nearby neighbourhood*"*. Russia would like to prevent what happened in the case of oil: the BTC pipeline, which took Caspian oil to the Mediterranean, circumventing Russian territory.[16]

Russian Energy Policy and the Balkans

Russian energy policy in the Balkans could be viewed as part of the competition for access, control and influence over the oil and gas business, especially in the Caspian basin and in Central Asia.[17] The Balkans represent the final stage of oil and gas delivery from that region towards, in the case of gas and gas pipelines – the European markets and, in the case of oil, to sea ports transporting oil further to the world market. More and more, the Balkan region is being connected to the "New Great Game", i.e. the modern re-run of the struggle between

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[9] Russia: Is the Georgian Gas Crisis Evidence of Moscow's New Energy Strategy, *RFE/RL*, 23.01.2006, http://www.rferl.org/content/article/1064978.html

[10] This year's Forbes list puts Gazprom at 22nd place of 500 most successful companies of the world; another energy company, Royal Dutch Shell holds the first place.

[11] *Moscow Times* reported on 27 May 2009 that Gazprom used to be at a third place of the list of the biggest energy companies in the world a year ago, with market capital of $350billion. This year it fell to 40th place with capital of $120 billion.

[12] Gazprom controls almost 160.000 km of gas pipelines, with 218 pumping stations and 25 underground storages. The system transported 714 billion m^3 of gas in 2008, http://eng.gazpromquestions.ru/index.php?id=6

[13] See: Gazprom's Expansion in the EU: Co-operation or Domination, Agota Loskot-Strachota, Center for Eastern Studies, Warsaw, 2008, http://www.isn.ethz.ch/isn/Digital-Library

[14] Roman Kupchinsky, Russia: Does Gazprom Have a Master Pipeline Plan, *RFE/RL*, 30. January 2006. http://www.rferl.org/content/article/1065233.html

[15] Dimitri Trenin, Geopolitika energije u odnosima Rusija-EU„Cevovodi, politika i moć" " [Pipelines, Politics and Power]„ Center for European Reform, London, translation into Serbian language, European Movement in Serbia Belgrade, 2009, page 23

[16] It is important to note that it is extremely important for Russia to keep Iran, which has the second largest gas reserves in the world, under its influence for the longest possible time, and outside of the reach of the European buyers. The strategic partnership with Teheran enables Moscow to only flirt for now, with the idea of forming Gas OPEC, i.e. the cartelization of the gas trade.

[17] Milan Simurdić, „Geopolitika prirodnog gasa" [The Geopolitics of Natural Gas], feuilleton, *Economist journal*, Belgrade, March – May 2008, issues 409-415

Imperial Britain and Imperial Russia of the XIX century for influence in Central Asia.[18] Historical parallels aside, the position of today's stakeholders, and their numbers, have grown into several conflicting lines of divisions. The dissolution of the Soviet Union has opened the possibility for foreign companies to enter the oil and gas rich Caspian region and Central Asia. The US has formulated the "East – West Corridor Strategy", which would lead to the opening of this region for exploitation and transit of energy, through the Black Sea, the Caucasus and the Caspian Sea. Essentially, the EU supports this concept and strives to arrive on the scene of energy sources in those regions independently, offering the concept of the *New Silk Road.*[19] China counts on the same region with increased engagement. It has succeeded in entering into long term oil and gas purchase contracts with Kazakhstan and Turkmenistan. Russia views this with some suspicion, reacting to this with intents to preserve its Soviet era primacy, both in access to sources and oil and gas transit, which it wishes to direct through its own territory. One study of Russian presence in the region estimates that

> *Russian energy strategy is based on the principle of keeping control over Central Asian resources, both energy production and transit, as long as possible, as well as gaining stakes in infrastructure and energy companies downstream in Europe.*[20]

Russian interest in energy in the region began during the Soviet era in seventies, when fast and comprehensive gasification started in the former USSR and the countries gathered around the Council for Mutual Economic Assistance (COMECON). The first oil embargo after the Arab – Israeli conflict in 1973 influenced this, turning European consumers towards the USSR's oil supply. This also led European countries to an insufficiently used energy source – gas. At the time, gas arrived to Yugoslavia, through Hungary.[21] The dissolution of the USSR and changes in COMECON halted the spread of gas deals. The dismemberment of Yugoslavia and subsequent wars put an end to the gas deals in the Balkans. However, already in 1996 a joint Russian – Serbian Enterprise, Jugorosgaz, was formed, and in 2006 Serbia was offered participation in the *Blue Stream II* project, which was the predecessor of the current *South Stream*.

The *South Stream* gas pipeline project depicts the contemporary phase of Russian energy policy in the region. It was launched as a Russian – Italian project of Gazprom and ENI, immediately before the energy summit in Zagreb in 2007.[22] Russian President Putin elaborated Russian energy policy in the Balkans in the following manner:

> *Our strategic objective is to ensure access to reliable energy supplies for all countries in the region. Our policies take into account the Balkan countries' increasing involvement in the European integration process, and we are ready to develop our relations in cooperation with the European Union.*

[18] More details in the book by Lutz Kleveman, The New Great Game - Blood and Oil in Central Asia, Atlantic Books, London, 2003

[19] Prague EU Summit declaration, May 2009, available at: www.eu2009.cz

[20] "Europe's Energy Security, Gazprom's Dominance and Caspian Supply Alternatives", Central Asia-Caucasus Institute&Silk Road Studies Program, Washington D.C. Stokholm, 2008, http://www.isdp.eu/files/publications/books/Job5_EnergySecurity.pdf

[21] It reached western parts of Yugoslavia – Slovenia and Croatia – through Austria, and not through the pipeline along Yugoslav territory;

[22] It could be interesting to point out that Gazprom was formed on the model of the Italian energy concern ENI, see text in Russian daily Kommersant, 30 August 2008,
at: http://www.kommersant.com/p845604/Gazprom_Business_Gas/

He emphasized that "Russian relations with its partners in the Balkans have traditionally been based on mutual sympathy, common spiritual traditions, the closeness of our languages and cultures and a common history." Putin's comment that "the project to develop the gas network in Macedonia and expand the gas pipeline network to Albania, Southern Serbia and Kosovo" confirm that this was entirely conceived through a regional approach.[23] Numerous contacts followed and basic agreements on the construction of the *South Stream* gas pipeline were signed with countries on the potential route:[24] on its northern branch - Serbia and Hungary, on southern branch - Bulgaria and Greece, while negotiations with Austria and Slovenia are still underway. For now, it is a preliminary non-binding document, as the final feasibility study will be completed by the end of 2010. It is worth noting that Russian diplomacy advocates the inclusion of as many states as possible into the gas pipeline project.

The project of the *South Stream* gas pipeline met with many comments. Most analysts emphasize transit as the primary feature of the region, but more and more point to the significance of the Balkan market. Essentially, there are both economic and geopolitical reasons in play. There are assessments that Moscow is aware of European strivings to diversify its gas supply, therefore Russia strives to consolidate its own position in the Balkan states, above all, on their energy markets, because, they will be future EU member states.[25] In this context it is emphasized that the *Balkans have long had the image of being a special sphere of Russian interests, and they will hardly get rid of this image in the near future*.[26] This can be read as a *Russian wish to create a counterbalance to the Balkan states' tendency towards NATO and the EU*. Russian energy interests are fundamental in strengthening Russian influence in the Balkans and South-East Europe. They are a part of the Russian energy strategy towards the EU, with the *South Stream* and the *Burgas – Alexandropulos* oil pipelines, as the key projects.[27] Russian energy policy in the Balkans meets two aspects of the EU energy policy. First, a significant number of Balkan stakeholders are already EU member states (Greece, Romania, Bulgaria), and apply the common EU energy policy, which is still predominantly within the competence of EU member states. Brussels also increases engagement on two fronts: strengthening the internal market regulations and better connectedness of gas pipeline infrastructure and intensive foreign energy policy focused on finding new sources of supply. Second, those Balkan states which are not the EU members are, however, stakeholders of the Stabilization and Association Agreements with an open prospective for membership. Simultaneously, through membership in the Energy Community, they are, de facto, integrated in the internal EU energy market.[28] These countries took upon themselves an obligation to implement EU regulations pertaining to gas and electricity. This means that in the Balkan region Russian energy policy converges with the EU policy, which has ambitions to expand its regulations to Russian 'nearby neighbourhood' as well.[29] This is done through the *export* of its regulative norms and through expanding the validity of the rules of its internal market, thereby strengthening its energy security.

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[23] Putin's speech at the Zagreb Energy Summit, 24 June 2007, at: www.kremlin.ru

[24] More about *South Stream* at: www.gazprom.ru

[25] Nicolo Sartori, "Russia's Energy Strategies in the Balkans", Interns Yearbook, Analytica, Skopje, 2009, page 48, http://www.analyticamk.org/files/Yearbook_2008.pdf

[26] Peter Bonin, "The last reserve of the imagined Great Power - On the significance of the Balkans for Russian political and economic actors", New Balkan Politics, Issue.3, 2002

[27] See: Dr Mark A Smith, "Russian Energy Interest in the Balkans", Defence Academy of the United Kingdom, 2008, http://www.da.mod.uk/colleges/arag/document-listings/balkan/08(07)MAS.pdf/view

[28] Milan Simurdić, "Energetska politika EU, Zapadni Balkan i Srbija, Izazovi evrorpskih integracija" [EU Energy Policy, West Balkans and Serbia, Challenges of European Integrations], Belgrade, Issue.2009-4, page.63-75

[29] Milan Simurdić, Partnerstvo umesto proširenja [Partnership Instead of Enlargement], *Danas*, Belgrade, 31. May 2009

For both stakeholders, the transit significance of the region takes priority. In the case of Russia, it is about an alternative to over-dependence on the Ukrainian transit routes (around 80 percent), while for the EU it is about striving to reduce dependence on Russian gas (an average 25 percent of consumption and around 40 percent of gas imports) and form supply routes independent of Russia. The competition is depicted in the two projects: *South Stream* and *Nabucco*. Notwithstanding balanced official statements on both sides, according to which these two projects are not at odds with each other, observers' and analysts' rhetoric sounds like *the pipeline war*. Roughly speaking, *South Stream* can probably count on enough gas, but has uncertain delivery. Also, the entire route on the southern and northern branch from the Bulgarian diverging point has not yet been completed. *Nabucco,* on the other hand, has buyers, but, at this stage, insufficient gas. *Nabucco* counts on strong United States support. The EU possesses significant leverage of influence through regulations of the gas market, which *South Stream* has yet to establish. Both projects have to face the economic and financial crisis and, also, the fall in demands for gas.[30] Essentially, these are two approaches to energy policy. Russia, whose pipelines almost exclusively lead to the West, stands for vertically integrated – monopoly companies such as Gazprom, while the EU stands for liberalized market, antitrust regulations and competition.[31]

The accelerated gas diplomacy, along the entire energy chain is visible, especially with regards to *South Stream* and *Nabucco*. The construction of the gas pipeline entails four phases: conceptual, political, commercial and the phase of construction. Both projects are in the middle, between the political and commercial phases. Now is the time to *draw a line* – the final feasibility study for *South Stream* arrives next year, when the financial framework for *Nabucco* is also due. When one looks at the broadest picture conceivable, it is quite possible that the *reset* of relations between Washington and Moscow will grasp this topic and answer the questions whether the energy security is a matter of cooperation or competition. This has been confirmed by the White House with the announcement of talks on cooperation in the energy sphere, especially talks about diversification of supplies around Russia and the region in a manner which is not defined as a "zero sum game".[32] Part of the answer could come relatively quickly, yet this does not mean that the global energy equation and its regional, Balkan counterpart will be resolved soon.

Conclusions, Prognosis

The Russian energy strategy in the Balkans is an integral part of the entire foreign policy posture of Russia in the region – *the first echelon* of advance. Russian energy interests and plans coincide with the region's approach to the EU. The Balkan states are already EU members, or are, indirectly, through the Energy Community, integrated into the EU. Energy lies within Russia – the EU core relations, which means that the Balkans are a part of the institutionalized Russia – EU energy dialogue, on the side of Brussels. That process has only started and one could expect that Russia will strive to, before the full integration of the region into the EU, strengthen its presence to the fullest extent. This dialogue does not take place in a

[30] Milan Simurdić, "Takmaci ili saradnici", [Competitors of Collaborators] *Danas*, Belgrade, 06 July.2009

[31] In the European Council for Foreign Relation's study „How to Deal with Russian Gas", author Pierre Noel states that since 1980 the import of Russian (Soviet) gas has been reduced by one half, from 80 percent to 40 percent. Russian gas now represents only 6.5 percent of the primary energy supply of the EU, which has been almost unvaried for 20 years. This will, as the author states, remain so in the near future. The problem, Noel claims, is not dependence, but divisions in the EU, so the real response is the strengthening of the internal gas market in the EU. The study is available at www.ecfr.org

[32] Obama to Press Kremlin on Energy, *The Moscow Times*, 03 July.2009, http://www.themoscowtimes.com/article/600/42/379258.htm

vacuum and is significantly influenced by trends in international affairs. This dialogue contains both elements of cooperation and of competition. The process has two dimensions: political and economical, which are intertwined, mutually complementing and dynamically rotating. On one side, politics or even geopolitics has the upper hand, while, the other, is economy dominated. What is politics for one side, could be economics for the other, and vice-versa. Energy security has become part of the national security strategy, both for Russia and the EU, which, additionally, increases the significance of this topic. The predominant opinion is that the EU and Russia are mutually interdependent and that this is one of the key long-term factors in their mutual relations. The issue, whether Russia invests enough in new gas sources and transport networks, is beside the point. Buyers in the EU fear that under the conditions of permanent growth of gas demand in Russia and low investments in new fields, one could see a significant reduction in Russian gas export quantities in the future. A new formula for mutual dependence is necessary. Russia needs finances and technology, while the EU needs Russian gas.

The economic and financial crisis, followed by a drop in gas demand may, in the short, or even mid-term, influence Russian foreign energy policy. Successive gas crises in Moscow – Kiev relations had damaged trust in the reliability of Russian gas exports. The conflict in Georgia in 2008 adversely affected the geopolitics of gas. Projects, which depend more on geopolitics then economics, might wait for a more suitable time for resolution. However, once drawn, gas pipeline and oil pipeline routes live their own life, independent of implementation and could significantly influence the policies of all stakeholders.

The continuation of gas and oil pipeline competitions in the Balkans in the “zero sum game” manner, does not lead to a sustainable solution. Mutually beneficial win – win combinations are necessary, instead of mutually exclusive projects. For Serbia, alongside the desirability of *South Stream*, different sources and directions of gas supply are a priority. One should not doubt that a wide and branched gas pipeline infrastructure in the region is, indeed, important for the stabilization of the region. Once built, gas pipelines, especially in a regulated environment, with predictable and transparent rules, add to stability.