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Russian Energy Policy in the Middle East

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ABSTRACT *Following the fallout between Russia and the West, Moscow embarked on a strategy to make its energy industry a foreign policy tool. In this context, it engaged Turkey in an effort to assert itself in the European market and solidify control over it. Looking to implement its pivot to the East, Russia has also sought to become a major energy producer in Asia by squeezing competitors out of the region. The Middle East came into the spotlight for Moscow when it decided to hedge its bets in the energy sector and gain more control over global markets. To that end, Russia pursued mutually beneficial cooperation with the GCC states to make the market more predictable. Russia has also come forward as a major energy supplier for former Soviet clients in the Middle East.*

Soviet Energy Overtures to the Middle East

Despite the USSR's abundance of energy resources, historically this factor has not been the dominant one in the country's foreign policy. Traditionally driven by ideology and often lacking in pragmatism, Soviet foreign policy has typically attempted to counter Western "imperialistic" expansion, with the Middle East being the primary battleground for ideological face-offs. With regional states leaning toward one or the other of the political camps during the Cold War, the USSR's strategy in the Middle East focused on winning the allegiance of local elites, and although various instruments were employed, energy was rarely one of them.

The "pre-oil era" in the Middle East was marked by paradoxical political developments that seem nearly impossible today. For instance, the communist Soviet Union enjoyed a warm relationship with the Kingdom of Hejaz and Nejd, and became the first state to recognize it, while Moscow's envoy to the Kingdom, Karim Khakimov, was a personal friend of its founder Ibn Saud. Sovi-

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et-Saudi relations turned sour after Khakimov was executed in Moscow, which happened two months before the discovery of the largest deposit of oil in the world in March 1938 in Saudi Arabia. Arguably, had the Soviets not killed their sole link to the Saudi King and by extension to his gigantic oil wealth, the Middle East might well look very different today.

Competition with Western firms for oil concessions first in Saudi Arabia and later elsewhere in the Gulf was impossible due to both the nature of the Soviet state-owned planned economy and the lack of proper technology. Moreover, it was not until after the Second World War that the Soviet Union started realizing the export potential of its own oil industry. During the Cold War, the irony of the Soviet policy in the Middle East was that the monarchies that welcomed Western energy giants had no interest in dealing with the Soviet Union, while the autocratic states, some of which were essentially Soviet clients, nationalized their own energy industries.

However, it would be incorrect to argue that there is no linkage between Soviet energy policy and the Middle East. The oil embargo imposed by the Organization of Arab Petroleum Exporting Countries in 1973 is evidence of that. A response to the U.S. support for Israel during the Yom Kippur War, the oil exports embargo led to an oil glut and saw crude prices jump from \$3/barrel to \$12/barrel. This rapid political decision by the Arab states led Moscow to fundamentally reassess its own energy policy.

After the end of the Second World War, despite its modest oil production rates, the Soviet Union took the responsibility of supplying the countries of the Warsaw Pact with energy. For the purpose of pumping oil to Hungary, Czechoslovakia, Poland and East Germany, the Soviet Union constructed an oil pipeline called *Druzhba* (Friendship). The oil crisis of 1973 marks the moment when this policy changed. Following the imposition of the oil embargo, the Soviet Union with its vast energy resources came into the spotlight as a potential source of energy for Western Europe. Moscow and OPEC launched a round of talks aimed at getting Soviet energy policy aligned with that of the Arab oil-exporting states. However alluring the opportunity to blackmail the West may have been, the Soviet Union chose a more pragmatic path and came to replace Arab oil exports in Europe; after all, unlike the Warsaw Pact states, Western Europe was ready to pay U.S. dollars for oil imports.[1] The 1973 oil crisis marked an expansion of Soviet energy exports to Western Europe but also signified increased competition with the Gulf

President Putin, met with the Saudi King Salman bin Abdulaziz al-Saud, at the Kremlin on October 5, 2017.

AFP PHOTO / SPUTNIK / ALEXEY NIKOLSKY

States for a share of the global energy markets. Because the Soviet Union was producing oil en masse and the Soviet system kept labor costs low, Russia was able to sell its crude at prices almost 50 percent lower than oil from the Middle East.[2]

Although the embargo was over by March 1974, it solidified a new status quo in the energy market that resulted in the Soviet Union becoming the world's largest oil producer by 1980.[3] The oil crisis only amplified the political tensions that existed between Moscow and oil-producing states in the Middle East. The 1979 revolution in Iran did not create a friendly dynamic between Moscow and Tehran, while the Saudi-Soviet relations had remained poisoned ever since Karim Khakimov's execution in Moscow.

Emboldened by its extraordinary surge in energy wealth, the Soviet Union embarked on an ambitious foreign policy by the end of the 1970s, which was a contributing factor to the invasion of Afghanistan in December 1979.[4] Western academia saw this development to a large extent through the lens of the growing importance of the Gulf region in the West's energy equation. Based in southwest Afghanistan, Soviet military aircraft could reach the chokepoint in the Strait of Hormuz (that back in the early 80s transported 40 percent of the Western oil supply) within hours and disrupt the flow of cargo vessels.[5] Seen from the Gulf, the Soviet invasion of Afghanistan was the first step in a wider plan of taking over the Gulf's energy resources and gaining full control over the global oil supply market.

In the late 70s, the oil factor began to manifest itself in international relations giving birth to a new term: energy diplomacy. While the USSR was not the economic partner the Middle East was looking for, it used its abundant energy resources as a factor of economic pressure. Cheap Soviet oil and later natural gas became the backbone of the formation of the socialist bloc. Through the export of energy resources and the construction of dozens of the world's largest energy infrastructure projects, the USSR exerted a tremendous influence on the policies not only of the socialist bloc in Eastern Europe but also on Algeria, Angola, Egypt, Iraq, Syria, Yemen and Libya. The most well-known example of how the Soviet Union invested in large infrastructure projects is the construction of the Aswan High Dam that became a landmark in Egypt and allowed Moscow to buy the loyalty of Gamal Abdel Nasser. Historically, the Soviet Union played the role of a mentor for regional allies helping them develop their own extraction industries, albeit not for profit making but for buying the loyalty of non-aligned states. Over 350 energy projects were implemented by the USSR in Egypt, Iraq, Algeria, Syria, Libya and Yemen.[6] The Soviet Union financed the bulk of these projects and introduced exploration and extraction technologies to these countries.

Politics and Russia's Energy Strategy

As noted in the previous section, the nature of the Soviet economy pre-determined its inability to form strong partnerships based on economic interests. This meant that while Western oil companies were buying into concessions in the oil-rich Middle East, Moscow sought other ways of cementing alliances, primarily through arms trade. As a result of these processes, Russia had almost no inroads into the Middle East once the Soviet Union broke up in 1991. Energy-wise Russian exports were almost entirely oriented towards Western Europe in the 90s, while against the backdrop of the massive liberalization of the country's markets, Germany, France, Italy, Spain and the UK accounted for 87 percent of Russian oil exports.

Until very recently, Russia had no partnerships in the energy sector in the Middle East. There are several reasons for this. First, competition for partnerships is high in the region and Western competitors have more to offer to prospective partners than Russia does. Second, the country's energy strategy is deeply intertwined with politics, and while it has become an effective instrument of foreign policy, its entrenchment draws strict rules for what Moscow can and cannot do in the Middle East.

In May 2009, the Russian government published a new edition of its National Security Strategy,[7] one that dwells on the issue of energy for the first time, elaborating on opportunities and challenges linked to it. Although eight years later that Strategy seems largely outdated, given the set of new threats that have emerged for Moscow in the meantime, it does, however, identify the challenge of increased delivery of energy from the Middle East to Europe as a major threat to Russia. The dangers posed to Russian interests in the energy domain by suppliers from the MENA region has been a central theme in the leadership's assessments of the country's energy security, despite not being mentioned in any other official documents, including the 2030 Energy Strategy of the Russian Federation.[8]

As per the Russian Energy Strategy, the country pursues the goal of mutually beneficial cooperation in the energy industry with partners around the world, first of all in the Middle East

A careful study of other Russian official documents reveals an interesting tendency: while the security bloc of the government views expanding energy supplies from the Middle East as a clear threat to Russian interests, other documents point out prospects for cooperation in the energy sector. As per the Russian Energy Strategy, the country pursues the goal of mutually beneficial cooperation in the energy industry with partners around the world, first of all in the Middle East. It is this duality of views on energy producers in the Middle East that makes the combination of pull and push factors in Russia's policy towards the region notable.

It was with Vladimir Putin's ascent to power in 2000 that energy came to the fore in Russian politics. In order to rebuild the country's economy, which was in shambles after the damaging economic policies of Boris Yeltsin's government in the 90s, President Putin embarked on making the energy sector the backbone of the economic revival. That required taking several steps back on how the governance of the country's resources was arranged. Loyal political figures were appointed to lead key energy companies while foreign ownership of these key assets was discouraged. As a result of these processes a vertical governance structure appeared in oil and gas companies that were fully aligned with government policies and more often than not were connected to the top leadership in the Kremlin through personal ties.

In his 1999 article discussing the future of Russia's energy sector, "Mineral Natural Resources in the Strategy for Development of the Russian Economy," Vladimir Putin makes it clear that "Regardless of whose property the natural resources and in particular the mineral resources might be, the state has the right to regulate the process of their development and use." This vision of the Russian energy industry pre-determined what it looks like today and why it was put into the service of the government's political agenda.

The Pioneering Spirit vessel, which will carry out construction of the offshore section of the Turkish Stream natural gas pipeline, sails through the Bosphorus on May 31, 2017.

AFP PHOTO / GÜRCAN ÖZTURK

Russia has clearly identified the regions where it intends to remain a monopoly energy supplier. As noted above, Russia has historically kept its energy priorities entirely in the West, that is, first in Europe's socialist bloc, later focusing on capitalist Europe and finally identifying the EU as its primary customer. Moscow was too late to identify growing energy needs of expanding Asian markets as an opportunity worth tapping into; when it did do so, it was largely motivated by political need rather than long-term policy planning.

The oil glut that occurred in 2015 dramatically changed the status quo in the global energy market. Coupled with a severe diplomatic crisis in relations, and Western economic measures against Moscow, that among other things targeted the energy sector, the Russian economy was dealt a serious blow. Making things even worse for Moscow, the EU started actively engaging alternative energy suppliers to break its dependence on Russia's oil and gas, ridding Russia of another perceived tool to manipulate European partners.

As a result of this turbulence, the Russian government embarked on a mission to hedge its energy options by engaging potential partners in Asia and the Middle East. This strategy has had two major objectives: it was designed to apply pressure on European clients of Russian energy companies, forcing them to accept Russia as a monopolist supplier, and it also allowed Moscow to do what had been needed for many years, which is to expand its energy ambitions in the lucrative Middle Eastern energy market.

By killing rival projects and ridding the EU of options to break dependence on Russian gas, Moscow hopes to impose its own rules of the game on the European energy market and Turkey plays a pivotal role in this strategy

In the context of this policy, Moscow placed a strong focus on building a constructive relationship with Turkey. The Turkish Stream project that was signed by President Putin and President Erdoğan on December 1, 2014, aims at solidifying Russia's control of the European gas market as well as providing it an entry point into one of the largest Middle Eastern energy consumers. The project of a 1,100 kilometer pipeline proposes to link Russia with Turkey and carry up to 63 billion cubic meters of natural gas per annum, most of which could be later transported through Turkey to Greece. It came to replace the South Stream pipeline with Bulgaria, which Vladimir Putin scrapped due to the EU's alleged lobbying against the project as part of Western sanctions against Russia.[9] Turkey's rising natural gas demands underpin Russia's ambition to become the sole provider of energy for the country.

By partnering with Ankara, Russia has also managed to undercut Iran's standing with regard to prospects of expanding its gas exports to the European markets. Iran, which is the second largest supplier to Turkey, sees it as a potential transport hub for gas deliveries to Europe, which could pit Moscow and Tehran against each other in competition for clients in the EU. The centrality of Turkey in Russia's energy equation for Europe to a large extent explains why, despite a temporary breakdown in relations in late 2015, Putin and Erdoğan managed to bring about a thaw and put the Turkish Stream project back on the rails.

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

Besides trying to solidify its control over the European gas market, Russia also looks East trying to diversify export markets. Following the imposition of a round of financial sanctions by the EU, Vladimir Putin engaged in an intense battle with Saudi Arabia over who would be the top supplier to China. While Beijing has traditionally been one of Moscow's main energy clients, the relative underdevelopment of Russia's energy transportation routes to the country inhibited wider cooperation. To change this dynamic, Moscow signed a 30-year deal in 2014 to supply natural gas to the world's largest emerging market. The contract is worth an estimated $400 billion. Russia is also constructing the second East Siberia Pacific Ocean oil pipeline to China to expand its deliveries of crude. With this massive expansion towards China, Moscow is clearly trying to squeeze Saudi Arabia out of China, which for a long time has monopolized the supply of energy there.

Since January 2015, Saudi Arabia and Russia have traded positions as China's top source of crude oil imports. However, the opening of an oil pipeline between Siberia and China helped Russia overtake Saudi Arabia to become China's biggest crude oil supplier for the first year ever in 2016, largely aided by increased demand for Russian oil from China's independent oil refineries that found its northern supplier more flexible than Saudi Arabia. Analysts expect that the oil production cuts deal that Moscow and Riyadh negotiated in November 2016 will benefit Russian companies in the Chinese market far more than it will benefit Saudi Aramco, since Saudi Arabia will have to shoulder the lion's share of supply cuts while Russia may even increase its deliveries.

Russia has considerable weight in exercising control over the oil market, but it remains a non-member of OPEC, a dominant player in the global market. The relationship between Moscow and the cartel has historically been on the rocks: Russia is regularly invited to attend the cartel's meetings and has pledged many times to cooperate with it on production cuts, but more often than not Moscow has backtracked on its promises. The Russia-Saudi dynamic might explain why Moscow has for a long time sent mixed signals to OPEC.

Russia and Saudi Arabia are natural rivals constantly competing to be the world's leading producer of oil. For a long time Riyadh has been a champion producing more oil than any other country but in May 2016 Russia surpassed Saudi Arabia in output. By November Russia was producing 11.2 million barrels a day (levels unseen since the fall of the Soviet Union) as opposed to 10.6 million for Kingdom of Saudi Arabia. This development came about at a time when both countries were in crucial talks to slash oil output in order to stimulate world crude price. Russia delayed the deal for a long time, agreeing to it at the precise moment when its commitments under the agreement would allow Russian companies to produce oil at the rates they had when prices were lower than they are today and still make a profit.

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

Russian oil and gas companies are seen as instruments for the implementation of the government's political agenda, rather than independent, profit-driven actors

Seeking New Opportunities for Cooperation

Seen through the realism theory of international relations, Russia's energy policy may seem inherently competitive where geopolitical calculations supersede the lust for profit. In this context, Russian oil and gas companies are seen as instruments for the implementation of the government's political agenda, rather than independent, profit-driven actors. While it is true that the concepts of politics and energy strategy are intertwined, it would be inaccurate to see Russia's energy industry exclusively through a geopolitical lens. The balance of power has significantly shifted in the region, and so has the Kremlin's understanding of how to engage local governments. Russian energy companies, such as Rosneft, Gazprom and Lukoil have international standings strong enough to try and compete with Western rivals in trying to secure lucrative deals. Inadvertently, Russia will have to look at the Gulf to explore new business opportunities.

Despite the ongoing fight with Saudi Arabia and Qatar for leadership in the energy market, Russia has managed to compartmentalize its relationship with them and pursue joint energy projects. This strategy is not only profit-driven but also helps make these countries' respective markets interdependent to minimize risks and to deter unhealthy competition. Over the past five years, the Russian government has been exploring opportunities to secure oil and gas investments from the Gulf, its policy stimulated not only by dropping Western investments but also by the desire to integrate the Russian energy industry into the global market. In December 2016, Russia's oil giant Rosneft secured a $5 billion investment deal with Qatar,[10] the largest energy deal the country has ever struck with a GCC state. UAE's Mubadala Petroleum and Rosneft are also nearing a deal to jointly explore two oil fields in Eastern Siberia.[11] The Russian Direct Investment Fund in the meantime has set up a number of partnerships with

President Putin (2nd R), accompanied by Sechin (3rd R), the CEO of oil giant Rosneft, meets with participants of the Rosneft privatisation deal on January 25, 2017.

AFP PHOTO / POOL / ALEXANDER NEMENOV

GCC sovereign wealth funds securing multi-billion investment pledge agreements with them, including in the energy sector. These include Mubadala, Kuwait Investment Authority, Saudi Public Investment Fund and Qatar Holding.

Russian energy companies have also developed an extensive portfolio of projects elsewhere in the region. The three leading energy companies, Rosneft, Gazprom, and privately-owned Lukoil, have significantly increased their stakes in oil and gas projects across the region before the oil glut. Often building upon the heritage of Soviet energy cooperation Russia is engaging in promising projects in Egypt,[12] Iraq (including in Kurdistan),[13] Libya[14] and Iran.[15]

Russia's Rosneft is increasingly diversifying its energy portfolio focusing on the Middle East following its investment deal with Qatar. In December 2016, Rosneft bought a 35 percent share in the largest natural gas project in the Mediterranean off the Egyptian coast for $1.13 billion and looks to increase its investment in the project to $4 billion.[16] Rosneft has made it a priority to strengthen its partnership with Egypt given the importance of the Mediterranean as a key energy transport route. In the context of the company's ambition to increase its share in the LNG market, Rosneft signed a contract with EGAS for the delivery of 10 shipments of LNG in 2017. This came after the company delivered three shipments in 2016 and assessed that the demand in Egypt would continue to grow.[17]

Nuclear power has also risen to prominence in the Russian energy strategy. Russia's nuclear industry is concentrated in the hands of just one state company, Rosatom, and nuclear energy is a pivotal element of Russia's policy to gradually loosen its dependence on oil and gas. Moscow also increasingly relies on its nuclear industry to engage partners around the world, since Rosatom is just one of the few global companies able to handle the full cycle of constructing nuclear power plants and servicing them. Middle Eastern interest

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in the Russian nuclear industry has been tremendous; almost all of the regional powers, both oil-producing and not, have reached out to Rosatom to explore the prospects of cooperation. Moscow has taken note of the growing interest and perceives its nuclear industry as an effective foreign policy tool. Rosatom recently made a huge leap in marketing its nuclear energy in the Middle East and opened its first regional office in Dubai in spring 2016. The office will oversee ongoing projects in Egypt, Iran, Jordan, Turkey, and the UAE.

Saudi Arabia has ambitious plans to build 16 reactors by 2032; in 2016 it reached out to Russia and forged a deal to promote nuclear cooperation[18] which may see Moscow build the Saudi nuclear infrastructure from scratch. Russia and Egypt are also in the final stages of negotiating a deal on the construction of the latter's first nuclear power plant in the Dabaa region. The two governments signed an agreement on the construction of the Dabaa plant in November 2015. It will consist of four nuclear power units of 1,200 megawatt each. Rosatom is projected to build the plant within 12 years. Once completed, the power plant will also be serviced by the Russian company.

Conclusion

Russia has made a great leap in positioning its energy industry internationally as an effective foreign policy tool, not just a profit-generating sector of the economy. A heritage of the Soviet engagement of authoritarian regimes in the Middle East and North Africa, the energy industry is to this day used to manipulate foreign governments into accepting Russia's rules of the game, as evidenced by Russia's policy towards the EU and post-Soviet Union states. However, Moscow has organically embraced the idea that it needs to be part of the global energy market and needs to seek new partnerships in order to survive.

Against the backdrop of instability in the global energy industry, Moscow is looking to consolidate its share of the market and to make sure that the revenue stream from its oil trade does not end. With that in mind, it pursues a policy of engaging its natural rivals in the industry from the Middle East to try and make a concerted effort to divide the markets fairly and on mutually beneficial principles. Moscow negotiated an almost-impossible deal with Saudi Arabia to cut oil output and made peace with Turkey against all expectations to have its interests in the European gas market protected.

Endnotes

1. Soviet oil exports to Western Europe grew from 44 million tons to 63.6 million tons during the 1970s. By 1985 they reached 80 million tons annually. The spike occurred against the backdrop of record crude prices.

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11. "Rosneft Signed More than 50 Agreements at St. Petersburg International Economic Forum," *Rosneft*, (May 24, 2014), retrieved from https://www.rosneft.com/press/today/item/175533/.

12. In December 2016, Rosneft bought a 35 percent share in the largest natural gas project in the Mediterranean off the Egyptian coast for $1.13 billion.

13. Since 2009, Lukoil and Gazprom have won a number of large contracts in Iraq, including at West Qurna. In 2012, Gazprom Neft signed two deals with the Iraqi Kurdistan, making it the fourth major oil company to enter the region. A major breakthrough in cooperation between Russia and Erbil came in June 2017 when Kurdish Prime Minister Nechirvan Barzani signed a 20-year oil deal with Russia's Rosneft. According to the June 2 agreement, Russia will buy Kurdish oil and refine it in Germany. As a first step, Moscow agreed to invest $3 billion in KRG territory.

14. Gazprom and Tatneft both invested up to $200 million in oil exploration in Libya before the Arab Spring. In February 2017, Libya's NOC signed a cooperation agreement with Rosneft, the Russian oil giant, to help boost Libya's oil output.

15. In August 2014, the Russian Ministry of Energy announced an oil-for-goods deal with Iran worth $1.5 billion per month. Under the proposed terms, approximately 500,000 barrels of Iranian oil per day would be provided at a discount in exchange for Russian goods and services.

16. Stephen Jewkes and Valentina Za, "Eni Spreads Egypt Gas Field Risk with Rosneft Stake Sale," *Reuters*, (December 12, 2016), retrieved from https://www.reuters.com/article/us-eni-zohr-rosneft-oil-idUSKBN14112U.

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