

# CONTROVERSIES OF PUTIN'S ENERGY POLICY: THE PROBLEM OF FOREIGN INVESTMENT AND LONG-TERM DEVELOPMENT OF RUSSIA'S ENERGY SECTOR

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*ABSTRACT: This work evaluates the long-term effects of Putin's energy policy on the development of the Russian energy sector from the perspective of Critical Security Studies. One of the concerns related to recent developments of the Russian energy sector is the increasing level of governmental control over energy production and the limitations imposed on both private domestic producers and foreign investors. This policy has resulted in a lack of investment in the development of new oil and gas fields and in the upgrading of infrastructure. To avoid further decline in natural gas production and the deterioration of natural gas transportation networks, Russia needs to encourage foreign investors. However, while many foreign companies want to invest in the Russian energy sector, they often feel insecure due to the current legislation.*

**KEYWORDS:** Russian energy policy, Foreign Direct Investment, securitisation

## INTRODUCTION

Ever since Vladimir Putin came to power in the early 2000s the energy sector has played an important role both in Russia and in EU-Russian energy relations. It is argued that the nature of the energy trade between Russia and Western Europe changed dramatically in the 2000s and there is a view that the Kremlin has attempted to regain the status of a superpower using energy supplies. Rutland notes that 'it has become commonplace to refer to Russia as an "energy superpower."<sup>1</sup> Both Russian and Western publications discuss the ability of Russia to use energy supplies as a "political weapon." For instance, Rahr writes that due to the uneven distribution of energy reserves and their crucial importance for economic growth,

the energy resources have a potential to become ‘the nuclear weapon of the twenty first century.’<sup>2</sup> This article argues that the motives behind Putin’s changes to Russian energy policy are primarily driven by domestic factors: an enhanced position in the international arena could only be achieved by becoming strong domestically. According to the view of the current Russian government, this internal strength could be achieved by the exploitation of the Russian energy sector.

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According to Oleinov, the hydrocarbons sector contributes to around 25% of Russia’s overall GDP, 30% of its industrial production, 50% of the federal budget income and 65% of income from exports.<sup>3</sup> Russia is one of the world’s leaders in hydrocarbons production and export. 169 billion cubic meters of gas and 247 million tons have been produced in Russia in 2011. The Russian Federation is also the world’s largest exporter of gas and the second biggest exporter of oil.<sup>4</sup> The energy sector plays the key role in Russian economy ever since Putin came into power. This article looks at the development of Putin’s energy policy from the perspective of the securitisation theory proposed by the Copenhagen School of Critical Security Studies. This article argues that the securitisation of the Russian energy sector created vulnerabilities in the future development of the energy industry. The article also discusses the importance of introducing changes to the position of foreign investors in Russia’s strategic industries in order to ensure the long-term energy security of the country.

#### THEORETICAL FRAMEWORK

This article applies securitisation theory to the analysis of Russian energy policy. According to the Copenhagen School the issue could be securitised through the speech act. The securitisation process includes three main elements: the speech act, the securitising actor and the audience.<sup>5</sup> Sheehan explains this process as ‘something is designated as a security issue because a convincing argument can be made that this issue is more important than other issues on the political agenda, and that it should therefore take absolute priority.’<sup>6</sup> The important question is who can act as a securitising actor for the speech act to be accepted by the audience? For the speech act to be successful, the authority of the securitising actor should

be accepted by the audience. Spitzel argues that ‘an actor cannot be significant as a social actor and a speech act cannot have an impact on social relations without a situation that constitutes them as significant.’<sup>7</sup>

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The Copenhagen School considers language to be a central aspect of the securitisation process. The securitising actors articulate specific issues as the referent objects of security in order to justify the use of exceptional measures.<sup>8</sup> However, McDonald argues that the Copenhagen School underestimates the importance of the context for the success of the securitisation, in particular, ‘the dominant narratives of identity,’<sup>9</sup> which contribute to the construction of security in general. He writes that ‘those interested in the construction of security must pay attention to the social, political and historical contexts in which particular discourses of security... become possible.’<sup>10</sup> The context influences the construction of security throughout time and space. Depending on the identity of the specific audience, certain issues may or may not be accepted as threats. Spitzel writes about two main types of context: socio-political and socio-linguistic.<sup>11</sup> He explains the importance of these contexts as follows:

Actors can exploit linguistic contexts as a reservoir of analogies, similes and contrasts. We can therefore often observe that securitizing actors speak to and from broader linguistic context by framing their arguments in terms of the distinct linguistic reservoir that is available at a particular point in time. In contrast, the socio-political context concerns the often more sediment social and political structures that put actors in positions of power to influence the process of constructing meaning.<sup>12</sup>

To summarise, the securitisation process includes the securitising actor, whose authority is recognised and accepted by the audience, and the context, which influences both the perspective of the securitising actor and the possibility for justification of the issue to be significant enough to become the referent object of security. This article argues that the main figure behind the securitisation of energy trade in Russia is Putin: current Prime Minister and former President of Russia. Putin’s personal vision of the way to reconstruct the Russian economy and position in domestic and international politics is centred around the use of natural

resources. He is an influential figure in Russia, strong enough to 'influence the evolution of an individually proposed meaning into a collectively held representation.'<sup>13</sup> In other words, the audience accepts his perspective on the importance of the energy reserves for Russian national security. However, the securitisation of the energy sector is not only caused by the personal views of the former Russian president. An equally important concept in understanding the roots of the securitisation process in Russia is the concept of identity. Both Putin's ideas and the willingness of the population to accept this position have been influenced by historical, political and economic factors. The narratives of identity are used by Vladimir Putin both to defend his speech act and to influence his own understanding of security construction. In the case of Russian energy security, the identity is both the reason for and the mechanism of securitisation.

An important element of identity construction is the distinction between "us" and "them." According to Buzan (et al), Russian identity might be vulnerable to the strengthening image of other identities as compared to the Russian one.<sup>14</sup> Buzan writes that: 'Russia is worried about ...a "world order" of concentric circles, with Russia somewhere in the second circle.'<sup>15</sup> At the same time, the desired self-image could be used as an argument for securitisation of particular issues in order to achieve political goals. For instance, Sheehan deploys the following example: 'US foreign and defense policy are seen as playing a crucial role in creating the very identity they defend.'<sup>16</sup> In the case of Russia, in the last ten years the authorities have used the image of a resurgent Russia in international relations to support the securitisation of energy production in Russia. For example, the Energy Charter Treaty is presented in Russia as an attempt by the West to take advantage of Russia by imposing values and rules which contradict Russian interests. Ultimately, the decision on whether or not to ratify the ECT has been presented as a zero-sum game: either Russian national interests would prevail over the ones of the European Union or vice versa.

This identity was used in the construction of security not only in relations with external actors, but also internally. Using the concept of securitisation as a speech act, it is possible to argue that Vladimir Putin labelled the issues and actors in the Russian energy sector as threatening the security of the state. Buzan (et al.) note

that ‘if securitising actor “a” on behalf of community “A” claims “A” is threatened by “B”, he or she will present “B” as an actor, as responsible for the threat as an agent who had choice.’<sup>17</sup> The oligarchs who became rich in the early 1990s because of the imperfections of the privatisation reforms became “actorised” in the way described by Buzan. One of the first steps of Putin’s energy policy was the prevention of oligarchs from influencing politics and the consolidation of the energy sector under governmental controls. One of the most well-known examples of this policy is the Yukos case. Putin used the negative image of the oligarchs by the majority of the Russian population to justify the Kremlin’s actions (questionable from the Western perspective). Below is a quick overview of Putin’s vision of Russian energy policy, along with its implications and the outcomes of this policy.

#### PUTIN’S ENERGY POLICY

The level of governmental control over energy sector increased significantly after Putin came into power. Hanson describes Putin’s policy change as: ‘the move for control of parts of the economy – both by direct state ownership and by ensuring that politically compliant businessmen are running things – would on this view be a move to ensure that no significant base of independent social and political power exists.’<sup>18</sup> Putin believes that the collapse of the Soviet Union itself is one of the biggest geopolitical catastrophes of the twentieth century, along with some of the decisions over domestic governance. In particular, he argues that the liberalisation of the energy sector in the 1990s wasn’t thought through and that the mineral resources should be used by the Russian government to restore Russian economic and societal stability. It is widely known that in 1997 Putin completed a thesis on the importance of natural resources for the reconstruction of the Russian economy. Two years later he published an article in the Journal of the Sankt Petersburg Mining Institute expanding on his ideas with regards to Russian energy reserves. These academic publications present the reader with Putin’s views of the key role of energy resources for the development of the economic and geostrategic position of Russia.<sup>19</sup> Hober provides us with a summary of Putin’s views:

Russian government should play a decisive role in major decisions about energy and natural resources. Total control is not necessarily required, but rather a “managed” market with the possibility of multiple forms of ownership. While the importance of market forces and private property is recognised, it is clear that the primacy of the state in Russia’s energy sector is non-negotiable.<sup>20</sup>

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This means that Putin believes that even though private property could still exist, the rights of property owners are not absolute, and the state’s interests are superior to those of private firms and market regulations.<sup>21</sup> In the opinion of Putin, governmental control over the mineral resources would protect the interests of society as a whole by ensuring economic security.<sup>22</sup> In his article, Putin argued that in order to catch up with the world’s leading economies Russia needs an annual economic growth rate of between 4% and 6%.<sup>23</sup> Indeed, Putin emphasised the development of the energy sector. Balzer summarises his views as follows:

If used effectively mineral resources can provide the basis for Russia’s entry into the world economy. This means the raw materials sector is crucial to all aspects of the state supporting industry and providing 50% of GDP and 70% of export revenues. It represents the basis for modernizing Russia’s military-industrial complex. It promotes social stability and can raise well-being of the population.<sup>24</sup>

When Putin came to power, he began the slow re-organisation of the energy sector according to the ideas described above. At the end of Yeltsin’s term, the Russian oil sector consisted of thirteen major vertically-integrated companies, eight of which were held in private ownership with three under governmental control, but by the end of Putin’s second term the amount of oil companies had been reduced to five. Pleines divides this process into two stages, which are interlinked with Putin’s two presidential terms:

1. **1999 to 2004:** During these years the number of major oil companies was reduced from thirteen to eight. The Federal state retained control over just one oil company, Rosneft, which reduced governmental ownership of the oil sector to less than 15%.<sup>25</sup>
2. **2004 to 2008:** The energy sector in Russia was dominated by five major companies: Gazprom (with Gazprom Neft),

Rosneft, Lukoil, Surgutneftegaz and TNK-BP, with two former companies being under state control and three later being in private hands. As a result of the consolidation process state shares in oil production had risen to nearly 40%.<sup>26</sup>

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At the centre of Putin's beliefs is the idea that the State as the guarantor of social well-being and stability has exclusive rights over the industry and local authorities. He believes that 'the Russian state had fallen victim to the very reforms, which it had sponsored'<sup>27</sup> and needed to fight back. Starting from his time as Russian Prime Minister he began to take actions to reduce the presence of oligarchs in politics and to consolidate the energy sector with a higher level of governmental control. Consolidation of the energy sector under the control of vertically integrated companies and higher levels of governmental interference in the sector is criticised in the European Union. It is assumed in the Western Europe that Putin's energy policy undermines the results of privatisation and liberalisation reforms of the 1990s. In particular, Western commentators were disappointed with the YUKOS affair and with the increase of the governmental share in Gazprom to 51%, and the sale of Sibneft to Gazprom, which became Gazprom Neft.<sup>28</sup> However, neither Putin nor the majority of the Russian population considers privatisation to be beneficial for the development of the Russian Federation. According to opinion polls conducted in 54 cities in the Russian Federation the majority of the Russian population does not believe that privatisation reached its aims. 60% of participants think that the privatisation was conducted without respect to Russian legislation; 77% think that the owners of large corporations do not have legal rights for ownership; 80% of respondents mentioned the negative consequences of corruption which resulted in an unfair distribution of strategic industries.<sup>29</sup>

Putin himself believes that by 'the assertion of state authority in the energy sector'<sup>30</sup> the government protects the interests of the Russian population. He believes that energy resources are important for Russian economic recovery. At the same time, he is sceptical about the mechanisms of the world market. He is concerned that the global market forces would not be able 'to provide the economic opportunities and social support necessary for the Russian people to make a successful transition to a modern European-style economy and political system.'<sup>31</sup> In summary, Putin thinks that by

acting as the “supreme regulator” of the energy sector, the state protects the interests of society.<sup>32</sup> As a matter of fact, the Russian population seems to share Putin’s views. For instance, the YUKOS affair is presented in the EU as an unlawful attempt to regain control over the energy sector from private hands. At the same time, the majority of the Russian population saw it as the reconstruction of order and the rightful punishment of the billionaires who gained their wealth at the expense of the Russian population.<sup>33</sup>

The introduced changes to the structure and ownership of the energy sector were supposed to ensure domestic energy security and boost Russia’s economy. For example, the Gazprom representative emphasised in his interview the specific role of Gazprom in the domestic system of gas supply. He said that: ‘the natural gas supplies to Russian population by the low price are the priority for Gazprom.’<sup>34</sup> The section below describes the implementation of this policy and its consequences for the natural gas sector.

#### DUAL PRICING POLICY ON THE DOMESTIC MARKET OF NATURAL GAS

As mentioned above, Putin’s energy strategy aims to use the energy sector to reconstruct the Russian economy and to improve the standard of living of the Russian population. In this case, Gazprom’s dual pricing policy is one of the ways to achieve this goal. The price of gas for domestic consumers is set by the Federal Tariff Service. Gazprom is obliged to supply domestic consumers with gas at set prices according to the Russian Federation Act on Natural Gas Supply.<sup>35</sup> Non-Gazprom producers supply only around 28% of domestic consumption requirements.<sup>36</sup> Gazprom, together with Russian authorities, establishes the annual gas consumption balance.<sup>37</sup> There are different tariffs for households and industrial consumers. The household price is 25% lower than the one for industrial consumers.<sup>38</sup> Since January 2005 there are 13 pricing zones, depending on the distance from the wellhead.<sup>39</sup> Beforehand there were 7 pricing zones.<sup>40</sup> Moreover, up to 80% of households are not paying according to their consumption volumes. Their prices are calculated according to the size of the living space and number of people living there.<sup>41</sup> Industrial consumers have a specific volume of gas which they can buy at a regulated price; if they consume more than this

limit, they have to pay a higher price. According to Ahrend and Tompson some large industrial consumers are able to buy all their gas from Gazprom at regulated tariffs, while many others buy 30–50% of their needs at much higher prices.<sup>42</sup>

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According to Dudek (et al.), Russian domestic pricing policy for natural gas could be considered a cross-section subsidy. According to the 2006 data ‘the long-term marginal cost of natural gas production is equal to \$44–50/toe, well above household or industrial prices.’<sup>43</sup> Of course, the natural gas industry (including Gazprom) would benefit from the deregulation of the domestic prices from a commercial point of view. The deregulation of prices on the Russian gas market is a part of the requirements for Russian WTO accession and an important issue in EU-Russian cooperation in the energy sphere.<sup>44</sup> The main argument in favour of the price liberalisation is the potential financial benefits. Grigoryev writes that if domestic prices were to reach the European level this would bring an additional 60 billion US Dollars in profit to Gazprom. And this, in turn, would allow Gazprom to invest in the infrastructure and new gas field developments.<sup>45</sup>

However, at this moment such an increase is impossible for a number of reasons. Prior to a significant increase in the gas price for domestic consumers, the Russian government would need to ensure that domestic consumers are capable of paying this price. Non-subsidised natural gas would ‘be unaffordable for the majority of Russian population.’<sup>46</sup> As a result, it may lead to a decrease in gas demand at the domestic level in favour of coal consumption, which, in turn, would have a negative impact on the environment.<sup>47</sup> Independent gas producers do not have to regulate their prices and are allowed to sell their gas at a higher price than Gazprom. However, since Gazprom controls access to pipeline networks, their access to consumers becomes difficult. That is why independent producers such as Novatek<sup>48</sup> have had to sell gas at a significant discount (up to 20%).<sup>49</sup> The situation around the independent gas producers causes concerns in the EU. It is important to understand the roots of these decisions. Independent producers are not going to be interested in selling gas to domestic consumers, because in order to be competitive domestically they will need to set prices at the same level as Gazprom or possibly even lower. That is why if they were to have free access to the transportation networks they would prefer

to export the natural gas abroad, which would undermine the interests of Gazprom, which is already affected by the dual pricing policy.

Due to the specific pricing policy, Gazprom's revenues from domestic sales and sales to the Commonwealth of the Independent States are significantly lower than from the European market. Domestic pricing policy requires Gazprom to sell gas internally at prices below the full recovery costs. According to Ahrend (et al.) exports to Europe, which take up around one third of Gazprom's output, account for two thirds of its income. For these reasons, Gazprom used to lose money in the domestic market up to 2004.<sup>50</sup> In recent years, Gazprom has started to raise prices for natural gas on the domestic market. In the time period between 2000 and 2006 average domestic prices rose almost threefold.<sup>51</sup> And, according to Russian obligations to the World Trade Organisation (WTO) and as a part of the EU-Russia energy cooperation, Moscow agreed to gradually lift prices up to 2015.<sup>52</sup>

Nevertheless, Gazprom is currently in desperate need of investment. The Russian gas monopoly needs to invest in the upgrade of the existing infrastructure, the development of new gas fields, and into the gasification of the Russian territory as well. The development of the new fields is the key priority. Currently, the biggest share of Gazprom's output comes from the three major fields: Urengoy, Yamburg and Medvezhie. All three fields have been in decline since the beginning of the 2000s. Stern estimates the decline to be 18-25 billion cubic meters per year.<sup>53</sup> At the same time, domestic demand has continued to grow. In such a situation the investment into the development of new fields is crucial for Russia to maintain its current contract obligations.<sup>54</sup>

The economic recession affected the implementation of Gazprom's investment strategy. As pointed out by Stern, due to the economic recession Gazprom had to reduce funds for investment in the development of the natural gas fields situated on the Yamal Peninsula, and the construction of the essential infrastructure (railway and pipelines).<sup>55</sup> Stern provides us with the following data: 'By July 2009, the reduction of Gazprom's investment programme included a reduction of Yamal-related investment by RR62 to RR147 bn.'<sup>56</sup> The other important consequence of the investment reduction is the delay in the development of the supergiant Shtokman

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gas field in the Barents Sea. According to Russian estimations the Shtokman field accounts for 3.8 trillion cubic meters of gas and 37 million tons of gas condensate.<sup>57</sup> The potential output of Shtokman field is going to be aimed at export: through the second string of the Nord Stream pipeline, and through the LNG terminal to be constructed near Murmansk.<sup>58</sup> The Shtokman development costs are estimated at 30 billion US Dollars.<sup>59</sup> However, due to the economic problems, the development of the field has been postponed and the final decisions with regards to the investment plans are to be made by April 2012.<sup>60</sup> The question of investment becomes even more pressing because the out of date infrastructure contributes to energy losses. As Boehme writes: 'transmission and storage amount for 65% of total losses, production and processing for 12% and distribution and end use for 23%. Gazprom estimates leakage from its high-pressure pipeline network at 8 bcm or 1.4% of total throughput for 1998.'<sup>61</sup>

The delays in Russian investment plans are expected to have a negative impact on Russian production capacities. Sheffield points out that, in order to meet domestic demand and export contract obligations, Russia needs to invest around 11 billion US Dollars annually in the natural gas sector.<sup>62</sup> However, Stern does not support this argument. He wrote that the concerns over Russian inability to meet the contract obligations are overrated. Stern points out that the economic recession influenced not only Gazprom's investment strategy, but also the demand for energy on the world market.<sup>63</sup> Stern notes that

if Gazprom had made the investments to start the Bovanenko field in 2011 or even earlier as many of its critics were urging – it would during 2009-2012 be facing an even larger problem of shutting in production, having invested as much as \$20 billion on a gas delivery system that turned out not to be needed for several years<sup>64</sup>

Considering, that the rise in domestic prices to European levels is not possible at the moment, the only solution for Russia is to attract foreign investors into the development of the Russian energy sector. The situation around foreign investment is another stumbling block for Russian energy policy. From one point of view, the Russian government is interested in attracting foreign investors, but at

the same time the Kremlin cannot allow the rights demanded by foreign investors due to the internal aims of the energy policy.

#### FOREIGN DIRECT INVESTMENT INTO THE HYDROCARBONS SECTOR

*Putin's  
Controversial  
Energy Policy*

According to interview evidence provided by Cameron, Director of the EU-Russia Energy Centre, foreign investors have concerns about the ability of the Russian government to protect the rights of foreign investors.<sup>65</sup> Cameron says that the position of foreign investors in Russia has changed a number of times throughout history depending on the priorities and needs of the government.<sup>66</sup> The representative of EU Commission also said that Russian legislation imposes a lot of bureaucratic barriers on foreign investors.<sup>67</sup> The most common type of foreign investment in the Russian energy sector is through the Production Sharing Agreement (PSA). The PSA Law was developed and signed under Yeltsin's administration in 1995. Such an agreement is signed between the Investor, the State and the local authorities in the region in which the Investor wishes to invest.<sup>68</sup> This agreement gives an investor the rights to exploration, development and production of energy resources for a certain period of time. Both Russian and foreign companies can sign the PSA agreement, but for foreign investors there is an established limit of 30% of Russian energy resources.<sup>69</sup> There are other requirements which an investor should consider. They include: Russian companies have a priority to sign such an agreement, 80% of the personnel should be Russian, and an investor pays the State either in share of resources extracted or share of product sales. An Investor has the right for reimbursement 'for the costs of its investment out of an agreed portion of the oil that the Investor produces, before any profit oil is taken by the parties to the agreement.'<sup>70</sup> At the beginning of his first term, Putin promised to improve the situation for foreign investors. However, by the time of his re-election it became obvious that improvement of the FDI laws would clash with the new developments of Russian energy policy.

When Putin came to power he claimed that Russia needed to become more attractive for FDI to support the Russian economy. Indeed, the inflow of FDI increased during his first presidential term. According to Liuhto, in 1990-1995 the annual inflow of foreign

investment into the Russian economy was around \$1 billion (USD). Ten years later (in 2005) the number had risen nearly fifteen fold.<sup>71</sup> Nevertheless, the situation changed again after his re-election for a second term. In 2004-2005 the additional limitations of the investment into Russian strategic industries were explained by the security implications. Liuhto quotes Putin's address to the Federal Assembly in April 2005:

Investors sometimes face all kinds of limitations, including some that are explained by national security reasons, though these limitations are not legally formalised. This uncertainty creates problems for the state and investors. It is time we clearly determined the economic sectors where the interests of bolstering Russia's independence and security call for predominant control by national, including state, capital. I mean some infrastructure facilities, enterprises that fulfil state defence orders, mineral deposits<sup>72</sup>

The sectors mentioned in this address are referred to as the strategic industries. Consequently, foreign owned companies could not be permitted to participate in the development of large hydrocarbons reserves.<sup>73</sup> In April 2007 Putin signed a new law on foreign investment in the strategic industries of the Russian economy. The law states that any foreign company wishing to obtain a controlling stake in a company operating in a strategic sector, or to buy more than 10% in larger hydrocarbons deposits, needs to get the approval of a governmental commission. Putin himself became head of this commission after his second presidential term.<sup>74</sup>

In other words, foreign investors have different experiences in Russia depending on the industry they invest in. For example, companies working in the retail sector feel more secure compared to investors interested in the natural resource sector. According to interview evidence with the representative of DG Energy in the European Commission, European investors are apprehensive with limits imposed on foreign investors wishing to participate in strategic sectors. Moreover, there is no legal international framework that can guarantee the interests of investors: 'there is no agreement on FDI since 2008, when Russia withdrew from the Energy Charter Treaty.'<sup>75</sup> The European concerns with regards to protection of foreign investment have also been expressed by Cameron, director of the EU-Russia Centre. In his opinion, it is worrying that

without a clear international framework the Russian government has the opportunity to change legislation at any moment (as it used to do in the past). That is why small and medium sized businesses avoid investing in the Russian energy sector.<sup>76</sup> However, even the larger investors (such as BP) are not protected from the controversies of Russian legislation on foreign investment. This article uses the examples of the Kovytko gas deposit license, and the Sakhalin-2 projects to demonstrate how the interests of the Russian government override the interests of foreign investors.

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### *The Case of the Kovytko Gas Deposit License*

Kovytko is situated in Irkutsk Oblast. This gas field boasts 2.13 trillion cubic meters of gas and 108 million tons of condensate.<sup>77</sup> It is one of the richest gas deposits with potential annual production of 40–45 billion cubic meters. According to Perovic and Orttung, 'Kovytko could produce enough gas to satisfy 15–20% of the non-contracted gas demand of China and South Korea by 2020.'<sup>78</sup> The original licence holder for the development of this field used to be RUSSEA Petroleum, the company jointly owned by TNK-BP and Interros. TNK-BP owned a 62.4% stake in RUSSEA Petroleum.<sup>79</sup> Gazprom has been interested in participation in the development of Kovytko's gas since the beginning of the 2000s. For TNK-BP it had been extremely difficult to avoid inclusion of Gazprom in the project because 'Gazprom is the official coordinator for the development of gas production in the Russian East, and... has the right to own and operate gas export pipelines.'<sup>80</sup> In June 2010 TNK-BP announced the bankruptcy of RUSSEA Petroleum. In March 2011 Gazprom bought the assets of RUSSEA Petroleum at auction.<sup>81</sup>

### *The Case of Sakhalin-2 Project*

Some other foreign investors also experienced pressure to sell parts of their shares of major energy operating companies to major Russian companies. Sakhalin-2 was established in 1994. The license for the development of hydrocarbons belongs to a company, Sakhalin Energy, which used to be owned by three foreign companies: Royal Dutch/Shell (55%), Mitsui (25%) and Mitsubishi (20%).<sup>82</sup> For a long time, Sakhalin-2 was the only project that lacked Russian

participation in it.<sup>83</sup> However, in December 2006 Gazprom also acquired stakes in the Sakhalin-2 project. Perovic and Orttung argue that the Russian government used the accusation of violations of Russian environmental legislation to press foreign partners to sell shares of Sakhalin Energy to Gazprom.<sup>84</sup> At the moment Gazprom owns 50 plus one share of Sakhalin Energy, Royal Dutch/Shell owns 27.5% of shares, Mitsui 12.5% and Mitsubishi 10%.<sup>85</sup>

Returning to securitisation theory it includes three main elements: the securitising actor Putin (as it is established above), the speech act and the audience. The audience should accept the securitisation of the particular issue for the speech act to be successful. According to Balzacq, aspects influencing the construction of security are: '(i) the power position and the personal identity of who "does" security; ...(ii) the social identity, which operates to both constrain and enable the behaviour of the securitising actor; (iii) the nature and the capacity of the target audience.'<sup>86</sup> In the case of Russian energy policy, the social identity was an important mechanism, which Putin skilfully used to justify his actions. Putin's policy might be criticised abroad, but the Russian population demonstrated a lot of support towards Putin's decisions. For instance, the controversial issue of Foreign Direct Investment is criticised in the EU, but comforts traditional Russian lack of trust towards foreign investors.

For a long period in Russian history, the hydrocarbons sector has been closed to foreign investment. Only before the revolution private foreign firms were actively involved in the development of the industry. Between 1898 and 1917 foreign investors had almost absolute freedom in trade and industrial production in the Russian empire, and the only exemption was in military production. At that period of time foreign investors were responsible for 54% of oil extraction and 75% of trade in oil. After the Bolshevik revolution the legislation on foreign investment has changed dramatically: since the nationalisation process in 1918 all foreign companies have been included into Soviet planned economy. Soviet leaders had mainly negative attitudes towards foreign investors<sup>87</sup> with the exception of the short period of time known as the New Political Economy, which among other ideas, included the decision to invite foreign investment into Russian oil production. The collapse of the USSR did not dramatically improve the investment climate.

That is why, in the early 1990s the question of foreign direct investment into strategic industries, including the hydrocarbons sector, caused a hot debate among Russian politicians. More conservative parts of the Russian government called any concessions to foreign investors 'selling country's mineral endowment to foreigners at fire sale prices.'<sup>88</sup> This negative perspective towards the foreign direct investment from some Russian politicians and the Russian people almost undermined the development of the PSA Law in the middle of the 1990s.<sup>89</sup> The negative perspective on foreign investment in the Russian energy sector is shared by the general public as well as the politicians.<sup>90</sup> The Russian Public Opinion Research Centre conducted two opinion polls in 2006 and 2007 about the necessity of Foreign Investment into strategic industries, including the hydrocarbons sector. In 2007 none of the respondents thought that all the restrictions on foreign investment should be lifted in either the oil or gas industry. At the same time 51% considered that any foreign investment is unacceptable in the oil sector, and 17% were against any foreign participation in the gas production industry. The majority of the respondents (39% for the oil industry, and 63% for gas) thought that foreign investment into the energy sector should be limited to 25%.<sup>91</sup> In 2005 Putin also introduced the term "strategic industries:" such industries as military complexes and the telecommunications and energy sectors. These sectors are considered to be of major importance for Russian national security, which is why access of foreign companies has been limited in these sectors.

#### THE OUTCOMES OF PUTIN'S ENERGY POLICY

The outcomes of the securitisation of the energy sector are controversial. Putin's policy brought some positive results: his regime enjoyed the support and trust of the population, the Russian economy had overcome the crisis of 1998–1999 and Russia paid off the biggest share of its foreign debt. And, most importantly, the Russian domestic political situation stabilised. But the achievements of Putin's policy came with a price. The consolidation of the energy sector under the governmental control, gaps in the legislation on foreign investment and the reliance on energy exports for economic reconstruction created a risky situation for the energy sector and the

Russian economy in general. Many experts argue that Russia could not be considered a rising economic power, as, for example, China or India was. For instance, Youngs writes the following: 'Russia... is on a long term path of decline enjoying new influence thanks to a moment of rising energy prices.'<sup>92</sup> The potential fluctuation of oil prices is the main risk to the Russian economy.

The successes of Russian economic growth have been achieved by the exploitation of the Russian natural reserves. Moreover, the growing revenues from the hydrocarbons sector have been achieved not by the increase in production, but due to the increase in oil prices since the beginning of the 2000s. For instance, oil prices fell in 1998 which resulted in a fall in Russian revenue from oil sales, which in turn contributed to the collapse of the country's economy. Conversely, oil prices rose in 2000, which resulted in an extra 70% of revenue for Russian oil companies and accordingly an additional \$8.1 billion (USD) in tax for the Russian state.<sup>93</sup> Keeping in mind that oil price levels change over time and that a period of price growth would most likely be followed by a period of price fall, the Russian economy may be vulnerable to this fluctuation. Moreover, the income received from the energy sales was minimally invested in the development of the industry. On the contrary, outputs of natural gas are stagnant: three supergiant fields that have been in operation since the Soviet times and are in decline. Oil production also slowed down after a short period of growth in the early 2000s.<sup>94</sup>

Considering that energy sales constitute 50% of Russian exports, the only realistic way to increase the export to match the import growth is to increase the export volumes of hydrocarbons.<sup>95</sup> Nevertheless, at the moment there is a question of whether Russia can increase the exports at all, including the energy sales. Already in 2003 it was known that some of the major gas fields were in decline. For instance, Stern provides us with the following numbers: 75.8% of reserves of Medvezhe gas field have been used, 65.4% in the case of Urengoy, and 54.1% of the Yamburg gas field has been exhausted.<sup>96</sup> To keep up with the current supply volumes Gazprom needs to invest a lot into the development of the new oil-and-gas fields. A lot of these fields are situated in the 'inhospitable areas, especially the Yamal Peninsula, as well as eastern Siberia and the Barents Sea.'<sup>97</sup> Moreover, big pipeline construction projects (Nord Stream, South Stream, etc.) also require large investment and put additional

limits on Gazprom's investment budget. According to rough estimations, Russian productions declined at the approximate rate of 18–25 bcm/year in the 2000s.<sup>98</sup> The current policy doesn't offer a solution to investment problems. It is almost impossible to support such a demanding sector without private investors. If Russia would let foreign investors participate in some of the projects it would be able to get essential money to increase the productivity of the energy sector and improve its image in the EU. If European customers could be involved in the development of new energy fields in Russia or pipeline projects it would help to rebuild trust between Russia and the EU. Recently, Russian experts have begun to realise this. For instance, Simonov said that Russia would invite more foreign investors in future.<sup>99</sup>

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## CONCLUSION

This article provides an evaluation of Putin's energy policy and the potential improvements to the energy policy. The article adopts the provisions of the securitisation theory proposed by the Copenhagen School. The Copenhagen School defines the securitisation as a speech act: the specific issue is presented as a threat to security through the negotiation process between the securitising actor and the audience. In the case of the Russian energy sector, the securitising actor is Putin and the audience is the Russian population. This article argues that Russian national identity plays an important role in the securitisation process. First, it affected the personal views of Putin with regards to the development of Russian energy policy, and second, it has been used by Putin to influence the perspective of the audience on the securitisation process.

When Putin came to power he emphasised the energy sector as a key method of recovery of the socio-economic situation in Russia. Using the terminology of the Copenhagen School, Putin is the main securitising actor, the driving force behind the securitisation of energy trade. In the EU, his actions are interpreted as an attempt to use the energy sales as a political weapon. A closer look at the motives behind Putin's actions demonstrate that energy security has been placed at the top of the Russian security agenda mainly because of domestic factors, rather than Russian international ambitions. Indeed, the Russian government strives to be the key actor

in international affairs. However, Putin believes that this should be achieved by becoming stronger domestically. In other words, the energy sector is the basis for reconstruction of the Russian economy, but not the lever of international influence. Putin came into power at the time of a growing demand for energy sources and growing oil prices. In his opinion, Russian energy potential was and is the main way to strengthen Russia: first to reconstruct the Russian economy by exploiting the energy sector, thus a strong economy would guarantee a stable socio-political situation and consequently Russia would become much stronger actor internationally.<sup>100</sup>

From one point of view, Putin's policy decisions paid off: the Russian economy has demonstrated signs of stable growth over the last ten years, the political situation within the country is more stable, and finally Russia has started to be perceived as a stronger player in the international arena. The Russian economy overcame the crisis of 1998 and 1999. The growth and progress of the Russian economy was acknowledged by the International Monetary Fund in 2004. A large proportion of revenues from energy sales have been used to establish the stabilisation fund. Some of this money was used to pay off Russian foreign debt, which went down to just 4% of GDP in the middle of 2007.<sup>101</sup> The inflation rate has been brought down as well.<sup>102</sup> These achievements required significant changes in the Russian energy sector. First of all, the Kremlin had to exercise higher levels of control over the energy production. The energy sector became the referent object of security, and all the forces (domestic and foreign) which could undermine the Kremlin's position in the energy sector were presented as a threat.

Even though in the short term Putin's energy policy brought some positive results, it came at a price: the securitisation of energy production and trade put Russia into a vulnerable position to any changes on the European energy market (especially drops in price). Gazprom needs to invest \$4–5 billion (USD) per year in the development of the new fields in order to keep the current supply rates.<sup>103</sup> At the moment Russia is spending only around \$1 billion (USD) per year.<sup>104</sup> In the last couple of years, not only did Gazprom not increase its investment budget, but on the contrary it reduced it. In 2009, Gazprom announced that the development of the new Bovanenkov field on the Yamal Peninsula would be postponed and that production would begin in the third quarter of 2012 instead of

2011 as had been planned before.<sup>105</sup> Kjaestad and Johnsson write that large investments are needed in more or less all parts of the Russian energy sector in order to guarantee future supplies.<sup>106</sup> Without investing in the development of the new fields and upgrades to the existing infrastructure, Russia may lose its share of the European market<sup>107</sup> and, this, in turn, will negatively affect the Russian economy. To ensure energy security in the long term, Russia should work on the improvement of the investment climate and encourage the participation of European investors in the development of new hydrocarbons fields. This can both help the development of the Russian energy sector and improve EU-Russian energy relations.

Putin's  
Controversial  
Energy Policy

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