



# Energy security and Russia's gas strategy: The symbiotic relationship between the state and firms

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## ABSTRACT

The way how Russia ignores the EU's quest for liberalization and sustains a control over markets and supplies is directly related to her use of gas as leverage. Russia's strategy affects many European and non-European countries during all stages: demand, supply and transit. It is not, however, possible to generalize a common statement that the EU's position is based on a policy of market liberalization while Russia pursues an opposing strategy of increased state control. Russian energy strategy leads markets in Europe; sets tone for energy supplies at homeland and abroad, benefiting from a variety of means. This article shows how a symbiotic relationship between the Russian state and Russian energy companies emerge from a structure in which trade, markets and international politics have been embedded within the state interests and firm behavior. It identifies the economic and geopolitical trends with regard to recent developments of Russia's strategy.

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## Introduction

Russian Federation (Russia) is the most significant energy supplier to the European Union (EU), whereas the latter is the biggest purchaser of Russian energy products. The shared interests are being jeopardized by the difficulty of comprising the European standards of liberalization with Russia's energy policies (Barysch, 2005, 115–132; Noel, 2009; Pirani et al., 2009). Energy security concerns arise not only because of sporadic events such as Russian–Ukrainian gas crises but also because of a mismatch between the EU's quest for a liberal framework of energy relations and Russia's state centric strategy (Aalto and Westphal, 2008, 1–22; Finon and Locatelli, 2008, 423–442). Russian energy strategy is complex. On the one hand, Russia adopts a realist perspective of international relations, on the other hand, her strategy is based on the priorities of the state (Shakleyina and Bogaturov, 2004, 37–51). It is not, however, possible to identify this mismatch by a common statement that the EU's position is based on a policy of market liberalization, while Russia pursues an opposing strategy of increased state control. Russia leads markets in Europe (and therefore eases the EU pressure concerning liberalization) and the supplies in homeland and abroad. The way Russia uses energy in general, and gas in particular, is important for demand and supply sides in a broader geographic context beyond the European markets.

Russian energy strategy is originated by the state, yet it pragmatically benefits from liberal trade, free markets and companies' behavior in due course. It is therefore possible to talk about a symbiotic relationship between the state and Russian energy companies because they continuously collaborate with each other, offering mutual benefits, and yet sustain their own institutional characteristics. Firm's behavior derives from Russian energy strategy while making investments in Europe. Energy companies, however, take advantage of the state's political capabilities to dominate domestic markets, control supplies in Caspian, and penetrate Middle East and Africa (Bilgin, 2007, 6383–6394, 2009, 4482–4491; Kalotay, 2008, 85–107; Nichol et al., 2006, 52). In turn, energy firms do not only allow the state to sustain an influx of energy revenues extracted in European markets, but also to build a geopolitical zone based on the control of supplies and transit routes. This is why the EU–Russian energy relations go beyond a mere interaction between the two counterparts, and make a special sense for the third parties as well.

This paper moves on from these attributes and addresses the complexity of Russian energy strategy in order to highlight the symbiotic relationship between the state's interests and firm's behavior. It puts a particular focus on gas trade with the assumption that the "gas card" intertwines trade, markets and politics by leading to a synergy between the state and Russian energy companies. In the second chapter following this introduction, the paper defines the "European markets, energy framework and Russian gas strategy". The aim of this analysis is to indicate the legal framework in which the Russian gas strategy emerges. In the third chapter it focuses on "Gazprom's exceptional features and supply side implications". This part addresses the supply side reasons that force Gazprom secure gas from Caspian, Middle East and Africa. The fourth chapter addresses "re-centralization in Russia and Gazprom's corporate expansions abroad." Accordingly, the way Russian firms benefit from liberal markets in Europe does not coincide with the investment difficulties faced by European and other multinational firms in Russia. This section, therefore, points to another aspect of the symbiotic relationship between the Russian state and the Russian energy companies, showing how the Russian state incorporates firm's behavior, especially in European markets. Russian energy companies, in the meantime, benefit from state's vast political capabilities to control domestic markets and expand their upstream and downstream activities abroad. The conclusion, within this context, indicates the premises and limits of Russia's gas strategy and discusses to what extent firms' behavior can support Russia's geopolitical interests, and vice versa.

### European markets, energy framework and Russian gas strategy

The Partnership and Cooperation Agreement (PCA) can be considered as the legal basis that defines bilateral political, economic and cultural relations between the EU and Russia. Similar PCAs, which the EU had already signed with Ukraine and Moldova, are still effective. "The PCAs do not grant trade preferences, nor do they provide a time table or framework for facilitating trade through approximation of partner countries legislation to that of the EU's single market (Harris, 2004, 108)." The PCA between the EU and Russia, which was signed on 24 June 1994, became effective on 1 December 1997 for ten years. It defines the principles to foster trade and investment. One of its main objectives is to create necessary conditions for a future establishment of a free trade area between the EU and Russia (Mau and Novikov, 2005, 103–112). The PCA, therefore, aims at creating spill-over effects by enhancing trade relations on liberal terms. "Two years later, in 1999, the EU Common Strategy towards Russia set as a goal, the integration of Russia into a common European economic and social space and spoke of the establishment of a free trade area between the EU and Russia and then of a single economic space resulting from the gradual adoption of compatible laws and standards" (Mau and Novikov, 2005, 104). Within this context, is it yet possible to talk about spill-over effects?

This process made a positive contribution to Russia's liberalization and affected its positions in many organizations and institutions such as The World Trade Organization (WTO), The Organization for Economic Co-operation and Development (OECD), The European Investment Bank (EIB), The European Bank for Reconstruction and Development (EBRD) and the World Bank (WB). Russia signed, in 2004, an agreement with the EU regarding its WTO accession (de Souza, 2008, 89–90). Russia's signature of the Kyoto Protocols, as precondition of the WTO process set by the EU, indicated how economic expectations could channel paths to international cooperation in matters such as environmental governance.

Nevertheless, still reluctant about WTO accession, Russia did not accept the new framework agreement with the EU, which was expected to be the legal basis of the relations. The PCA was automatically extended for one year in 2007 to be replaced by the EU–Russia framework agreement. The negotiations on this framework were resumed in 2008. This was related to the Kremlin's use of energy as a source of wealth and power in general and to the role of Gazprom in particular. The first Strategic Energy Review had already called for a comprehensive framework agreement, including a fully-fledged energy partnership benefiting both sides; the conditions for market principles necessary for new investments; and the Energy Charter Treaty and draft Transit Protocol (EU Commission, 2007, 23, 2008). An important aim of the EU indeed was to make Russia adopt market principles in the energy sector and to secure supply and demand reliability in a broader region. Russia signed the Energy Charter Treaty (ECT) in 1994 when liberalization and transition to market economy appeared as goals with high priority to overcome the negative effects of the disintegration. However, Russia did not ratify the agreement. For the EU part, this refusal was a sign of Russia's resistance against market liberalization in the energy sector. Russia, in the meantime rationalized her refusal of ECT on economic basis. "Russia [emphasizing that Norway and Algeria have not signed the agreement] pointed to double standards in both European governments blocking Gazprom from buying EU energy companies and the fact that the ECT's crucial transit protocol would not apply between European countries themselves, the EU defining itself as a single economic space (Yongs, 2009, 80–81)."

The delay in defining a legal framework for energy relations was caused largely by Russia's geopolitical concerns which were highly related to resurgence of the state power. The gas crisis between Russia and Ukraine in January 2009 indicated how Russian state was involved in energy trade relations. Gazprom had exported natural gas to Europe first in 1967 and then continuously increased the volume from 20 bcm/y in 1977 to 40 bcm/y in 1990; 100 bcm/y in 1995; 140 bcm/y in 2003 and 180 bcm/y in 2008 (Kupriyanov, 2009, 30). This uninterrupted growth of export volumes to European markets gained the company a high reputation of "forty years of impeccable operating track record (Kupriyanov, 2009, 30)." In April 2009, Russia proposed a new framework agreement to improve the energy relations with the EU. The proposal first aimed at increasing roles of gas producers and consumers in energy transit routes passing through third countries to secure flow of gas. It then recommended regular publication of an online energy balance report on the needs of consumers so that Russia can plan long term investments while meeting obligations of the contracts (Kupchinsky, 2009). This plan did not propose a legal framework of energy relations between Russia and the EU from a neofunctional perspective. It, however, reflected Russia's concern to

impede European involvement in Ukrainian transport system as envisaged in the Ukrainian–EU agreement which was signed in Brussels on March 23, 2009. The Ukrainian–EU agreement envisioned that the EU renovate and expand the capacity of the Ukrainian gas trunk pipeline from the present through-put capacity of 145 bcm/y annually by 58.6 billion – without Russian participation (Kupchinsky, 2009). Russia therefore does not completely count on neofunctional approach and tries to build bilateral relations with her counterparts with the least possible involvement of the EU.

In fact, Russia's energy strategy until 2020 identifies several priority axes which include efficient use of primary resources; upgrading energy technologies for exploration; mining and transit, promotion of market principles (in particular reforming natural monopolies and making them more transparent in their operations) competition; development of new resources; increase of coal use for electricity generation; and diversification of export markets and a more persistent strategy for integration into the global markets (Romanova, 2008, 67–68). This energy strategy attributes a special significance to Gazprom which had already entered other sectors including media. Gazprom, within this context, appears as an exception to Russia's initial efforts of reforming natural monopolies. "The EU wants Russia to reform its energy markets as a precondition for accession to the WTO. The EU also fears an increasing mismatch between its own efforts to liberalize its energy markets and the supply of Russian gas through Gazprom" (Barysch, 2005, 125). Gazprom's economic (for some analysts political and strategic as much as economic) significance for the Russian state makes it abstain from any commitments of liberalization in the gas sector. "Any efforts of breaking Gazprom's domestic monopoly would have important implications on the Russian government's foreign trade policy, and in fact, would deprive it of a powerful foreign policy weapon" (Aalto and Westphal, 2008, 13). From this perspective, Russia's political and economic concerns are linked to natural gas sector which makes it defy any anchor of liberalization in due course. This implies that there is a contradiction between the effect of natural gas on Russia's liberalization and the need for committing liberal anchors set by the EU.

### Gazprom's exceptional features and implications on the supply side

Gazprom's special role in European markets is a natural outcome of mutual reliability and successful corporate expansions since the very first export from The Union of Soviet Socialist Republics (USSR) in 1967. Energy trade between the EU and Russia increased after the disintegration of the USSR in 1991. Doubts, however, on spill-over effects of energy trade with Russia, and realization that natural gas was the Kremlin's political weapon, emerged since then. Gazprom, therefore, necessitates a further analysis in order to define its particular role that affects the resurgence of state control in Russia.

As of April 2009, Gazprom's proven gas reserves were estimated to be around 29 tcm by the company resources. This accounts for 17% of the world's proven gas reserves and for over 60% of the reserves in Russia (Gazprom, 2008). The Ministry of Natural Resources of Russia reports a total reserve of 236 tcm divided into 160.3 tcm onshore and 75.8 tcm offshore including (Stern, 2005, 1–2):

12.8 tcm of cumulative production

46.8 tcm of A + B + C<sub>1</sub> (roughly equivalent to proven – A, probable – B, and some possible – C, reserves)

142 tcm of C<sub>2</sub> (possible) reserves

162.3 tcm of C<sub>3</sub> + D<sub>1</sub> + D<sub>2</sub> (inferred and yet to be discovered) reserves.

Yet for some experts, Gazprom's and Russia's natural gas reserves are highly contentious. The controversy arises from insufficient data on the prospective fields which are not in production. "Possibly the most significant observation about Gazprom's reserve position is that if the fields on the Yamal Peninsula and the Shtokman field – neither of which are yet in production – are excluded the total reserve figures reduce to 20.5 tcm A + B + C<sub>1</sub> and 13.3 tcm of proven and probable reserves" (Stern, 2005, 4). This controversial picture explains Gazprom's corporate expansions in Central Asia, Middle East and North Africa to sustain a control over alternative resources which also promise a special geopolitical power to the Russian state.

A critique on Gazprom runs that, although Gazprom may have huge reserves, it has not paid enough attention to developing them and, at the behest of the Russian government, it has invested hugely in the Russian oil and electricity sectors, as well as overseas projects in African, Middle Eastern and Latin American countries (Stern, 2009a, 2,b). This explains how

**Table 1**  
From Oligarchs to Silovarchs in Russia.

Oligarchs	Key oligarch-controlled companies, c. 1996	Key oligarch-controlled companies, c. 2006	Key silovarch-controlled companies, c. 2006	Silovarchs
Boris Berezovsky, Roman Abramovich	<i>Avtovaz, Aeroflot, ORT, Sibneft</i>		<i>Aeroflot, Almaz-Antei</i>	Viktor Ivanov
			<i>Rosoboron-export, Avtovaz</i>	Sergei Chemezov
Vladimir Gusinsky	<i>NTV</i>			
Rem Vyakhirev	<i>Gazprom</i>		<i>Gazprom, Sibneft, NTV, OMZ</i>	Alexei Miller
Mikhail Khodorkovsky	<i>Yukos (including Yuganskneftegaz)</i>		<i>Rosneft, Yuganskneftegaz</i>	Igor Sechin
Vladimir Potanin	<i>Norilsk Nickel, Silovye Mashiny</i>	<i>Norilsk Nickel</i>	<i>Russian Railroads</i>	Vladimir Yakunin
Mikhail Fridman	<i>Alfabank, TNK</i>	<i>Alfabank, TNK-BP</i>		

Source: Treisman, 2007, 146.

**Table 2**  
The Russian gas matrix in 2008.<sup>a</sup>

Supply Sources	Bcm	Markets	Bcm
Gazprom Production	550	Russian Gas Demand	353 <sup>b</sup>
Non-Gazprom Production	114	Exports to CIS countries	92
Central Asian Imports	61	Exports to Europe	159 <sup>c</sup>
Total	725		604

Source: Stern, 2009b, 4.

<sup>a</sup> Major building blocks only, total supply is very different to total markets principally because of gas used for transportation, net changes in storage, gas used outside the UGSS in Siberia and in the Far East.

<sup>b</sup> Gazprom figure of sales delivered to customers in Russia via the UGSS.

<sup>c</sup> Long term contract sales only, total European sales were 189 Bcm.

business and economics have been subject to geopolitical maneuvers of the state that aims to sustain control over alternative gas resources. Regarding production phase, giant fields such as Urengoi, Yamburg, Medvezhe and Zapolyarny are in decay and there is a need of further investments concerning the field developments in Kovykta, Shtokman, Sakhalin II and Yamal. More than 60% of Sakhalin II's LNG (liquefied natural gas) is going to Japan. Regarding the fields which concern supplies to Europe there is a need for massive investments. Gazprom points out that \$20 billion of investments are necessary every year on gas upstream development until 2030 to respond to developments in domestic markets while realizing the export commitments. The annual investments in gas development are well beneath the level they should have been according to Gazprom's plans. "Gazprom's \$20.1 billion investment program for 2007 included \$6.4 billion for acquisitions against \$3.9 billion for development of major fields" (Hanson, 2009, 41). Reluctance on making massive investments in new fields, the problems which jeopardize foreign companies, and the illiberal investment regulations in Russia put a challenge on Gazprom's intention to increase exports to Europe and Asia while satisfying the rising domestic demand.

How did the illiberal investment conditions re-emerged in Russia which had once been keen to liberalize its energy markets following the disintegration of the USSR? It should, first of all, be mentioned that post-communist de-centralization in Russia took place with the rise of a new oligarchy. Boris Yeltsin's (1991–1999) oligarchs dominated the government in 1990s by benefiting from de-centralization of the Soviet economic system. Under President Putin's administration (2000–2008) Yeltsin's *oligarchs* were replaced by *silovarchs* who meant to be 'little-known cohort of executives' from the network of security service and law enforcement veterans (Treisman, 2007, 146). These cadres supported Putin's authoritarianism against liberal parties in Russia (Shlapentokh, 2007, 493–499). This shift, which can be followed from Table 1, accelerated re-centralization in Russia and encouraged the Kremlin implement state centric policies in and around Russia.

Gazprom fit this transformation. It adopted state's geopolitical approach and involved in corporate expansionism to control gas resources in Central Asia, the Middle East and Africa instead of making huge investments to increase domestic production from an economic perspective. Why? Following the break-up of the USSR in 1991, Gazprom was converted from a state owned monopoly into a joint stock company in 1993. The state first had a 40% share, which was increased to 51% in 2003 (Siegel, 2008, 182–183). As of 29 December 2007, Russia (50.002%), ADR Holders (21.020%) and other registered entities were reported by Gazprom to be the stake holders of the company. The shares of the Russian state belong to The Federal Agency for Federal Property Management (38.373%), Rosneftegaz (10.740%) and Rosgazifikatsiya (0.889%) (Siegel, 2008, 182–183). Gazprom, within this structure, dominated reserves, production and exports to Europe as summarized by Table 2.

On 2 March 2008 presidential elections, Gazprom's former chairperson Dmitry Medvedev succeeded Vladimir Putin, who was the president for two subsequent terms of four years since 2000, as the new president. Putin sustained his political legacy by holding the prime minister position after the appointment made on 8 May 2008. Re-centralization under *silovarchs* and embedded interests between Kremlin and Gazprom proved to be effective in relations with neighboring countries.

Regarding the transport phase, Gazprom inherited a well developed system of gas pipelines as it can be seen from the Table 3. Gazprom still relies on the transit corridor through Ukraine which carries about 80% of the gas exported to Europe while the rest of the exports go through Belarus.

Gazprom's dependence on Ukraine proved to be vulnerable to the problems between these two countries. Gas flow to Europe was halted in January 2006 and in January 2009 because some economic and contractual problems arose between Ukraine and Russia. The 2006 crisis was considered by some to be an example showing how the Kremlin was ready to use gas

**Table 3**  
Gazprom's operational and prospective pipelines for European markets.

Pipeline	Capacity (bcma)	Length (km)	Start-up	Status
Ukraine	143	1538	1967	needs upgrading
Yamal-Europe	33	1258	1999	functional
Beltransgas	10	601	1980	functional
Blue Stream	16	1213	2003	functional
Nord Stream Project	55	1223	2011	being constructed
South Stream Project	31–47	902	2015	negotiations continue
Caspian Coastal Pipeline Project	30 or more	1600 or more	2011	negotiations continue

Source: Medvedev, 2009, 23.



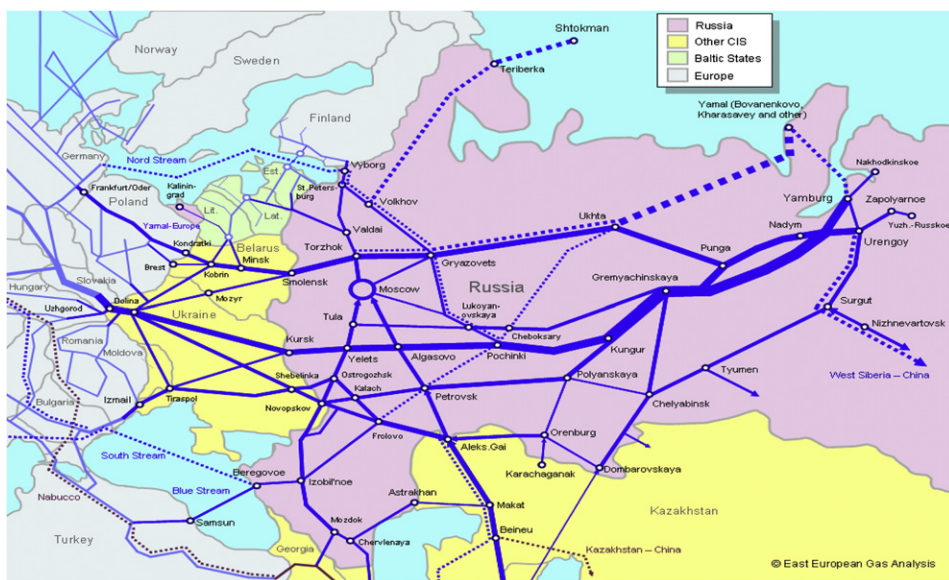
as a political tool as it did against Ukraine's Orange Revolution. The EU experts considered 2009 crisis as an economic dispute between the parties. The 2009 crisis caused a cut off of the gas flows to Europe for two weeks. "The EU called the supply cut *completely unacceptable*, demanded immediate restoration and entered into shuttle diplomacy between Kiev and Moscow, whereas some independent critics labeled the crisis as another sign which showed that Russia was using its energy resources as a political weapon to pressure European and former Soviet countries to adopt favorable stances towards Moscow" (BBC, 2009). The crisis made some European countries, mainly Slovakia and Bulgaria, suffer from gas shortages from 7 January (when gas flow was completely halted) to 12 January when a deal was reached following the shuttle diplomacy of the EU representatives (Pirani et al., 2009, 57–62). Gazprom, in turn, accelerated efforts to build direct pipelines between Russia and Europe. New pipelines, however, do not mean that more gas will necessarily be exported to Europe. Nord Stream and South Stream pipeline projects make a lot of sense to secure gas flow (Medvedev, 2009, 23) in addition to existing Ukraine, Yamal-Europe, Beltransgas and Blue Stream pipelines (see Map 1 and Table 3). New projects, such as Trans-Sahara and Nabucco, in the meantime are expected to support European energy security, challenging Gazprom's demands. Consequently Russian state turns out to be more concerned with re-centralization in the domestic market, while Gazprom becomes more active to acquire shares from a myriad of projects in and around Europe through corporate expansions.

### Re-centralization in Russia and Gazprom's corporate expansions abroad

Despite a significant breakthrough in reporting outward investment and acquiring foreign shareholders, Russia's market capitalization ranks below its European counterparts. Gazprom indicates a higher ranking in market value by the help of high oil prices since 1997. The comparative analysis in Table 4 of 15 largest Russian firms indicates Gazprom's exceptional features in terms of its market rank and the share of state ownership (Kalotay, 2008, 90).

Gazprom valued \$91 billion at the end of 2007, surpassed the market value of General Electric and China Mobile, ranked as the world's third-largest company, employed 432,000 people, paid taxes equal to 20% of the Russian budget, expanded subsidiaries in various industries, including farming and aviation, and built contacts to boost exports to Asian markets, like China and South Korea (Kramer, 2008). Gazprom's corporate expansions were highly related to its, and therefore Russia's, dependence on gas sales to Europe. Global financial crisis verified this concern by depressing the domestic demand in Russia and in Europe in 2009. It made a major impact on Gazprom's profits (down about 40%) and its market capitalization (RT, 2009). Relatively low oil prices (when compared to 2008) and decreasing demand resulted in Russian budget deficit amounted to 2.326 trillion rubles (approximately \$78.58 billion) in 2009 (FM, 2010).

Gazprom's economic significance to Russian state is self-evident. Yet the political meaning is contentious. "Although there are signs that the state did not completely control firms like Gazprom with the shares it retained, it clearly retained veto power over company's policy and had a great deal of influence when it became necessary" (Hale, 2006, 160). Gazprom stayed out of liberalization process as much as possible. "This was especially true of Gazprom, whose long-time "patron" was the prime minister of Russia during 1993–1998" (Hale, 2006, 160). The Law on the Gas Supplies in Russian Federation, which was passed by Duma on 20 January 1999, strengthened the relations of Gazprom with the state. "In particular the law fixed the blocking share of the holding (25% plus one share) in the state's ownership, provided that the share of nonresidents is 25% minus one



Map 1. Russian Grid of Natural Gas Pipelines. Lines describe existing pipelines. Dots describe pipeline projects Source: EEGA, 2010.

**Table 4**

The 15 largest Russian firms, ranked by market capitalization, 2005.

Company	Industry	Fortune 500 rank	National rank in sales	State ownership (%)	Major foreign shareholder	Report on outward investment
Gazprom	Oil & gas	10	1	50.01	E.ON (6.5%)	Yes
Lukoil	Oil & gas	76	2	–	ConocoPhillips (20%)	Yes
Surgutneftegas	Oil & gas	94	7	–	–	Not
Sberbank	Banks	232	9	60	–	Not
UES	Electricity	234	3	52.70	–	Yes
Norilsk Nickel	Metals	376	10	–	–	Yes
Sibnefta	Oil & gas	–	8	–	–	Yes
TNK–BP	Oil & gas	–	6	–	BP (50%)	Yes
AFK Sistema	Telecom	–	15	–	–	Yes
VimpelCom	Telecom	–	30	–	Telenor (26.6%)	Yes
Novolipetsk Iron & Steel	Metals	–	21	–	–	Not
Novatek	Oil & gas	–	63	–	–	Not
Tatneft	Oil & gas	–	18	–	–	Yes
Severstal	Metals	–	12	–	–	Yes
Mechel	Metals	–	24	–	–	Yes

Source: Kalotay, 2008, 90.

share (versus the 9% stipulated by presidential decree No. 529 of 28 May 1997)” (Radygin and Shmeleva, 2003, 495). Gazprom, since then, appeared as a natural monopoly, the reformation of which was legally prohibited by the statute 15 of the law on The Gas Supplies in Russian Federation (Radygin and Shmeleva, 2003, 495). This legal arrangement favored managerial control over Gazprom. “Through an extended period of high oil prices and economic recovery from 1997 to 2009, Russia has scrambled to rebuild the state’s power apparatus through the resurrection of control over the energy sector” (Rosner, 2005, 2). The Russian state consequently launched domestic and foreign policies with minor attention on the level and quality of liberalization and democratization. “The shifts in Russia’s energy sector in 2005, in the internal ownership and control over Gazprom, and in the broadening and deepening of its involvement in the Russian oil industry, raised certain fundamental questions about the... company that accounted for approximately 20% of global gas production” (Rosner, 2005, 2).

From the Russian point of view, there was no state control over Gazprom. In a press conference held on 4 June 2007 Putin emphasized that unlike the common understanding, Russia had extensively liberalized the energy sector with partial exception of Gazprom (and Rosneft) which even had 49% of its shares on the market and the shares of foreigners counted more than 20% according to their calculations (Goldman, 2008, 173).

Yet the company’s chief executive officer was officially delegated a proxy to exercise the government shares; and successive attempts at asserting the government’s control over Gazprom’s internal operations, increasing tax revenues collected from the gas monopoly, and imposing open access to the domestic pipeline system were significantly attenuated by the management’s own initiatives (Stulberg, 2007, 69).

Despite this legal framework, neither Gazprom nor the Russian state would accept one’s control over the other. “Alexander Medvedev (president since 2008 and former chairman of Gazprom’s board of directors) insisted in a presentation in St. Petersburg on June 21, 2007, that to the contrary, Gazprom operated free of interference from the Kremlin” (Goldman, 2008, p. 143). According to this perspective; Russia does not officially consider Gazprom’s exceptionalities as a major impediment to liberalization but rather defines it as a company independent from the state with extensive contributions to the state. “What mattered however was not who actually owned the shares but whether the managers of these companies acted as the agents of the state and adhered strictly to the goals set out by senior state officials as if they were wholly owned by the state” (Goldman, 2008, p. 173).

Within this perspective, the government’s decision to re-control strategic resources, by changing or omitting the terms of the PSAs made with Western investors in 1990s are noteworthy. Gazprom’s new strategy to control 50% plus one stake in production projects as well as the illiberal investment environment in Russia limited activities of foreign companies. On the Sakhalin-2 project Gazprom obliged Shell, Mitsui and Mitsubishi to sell additional shares and acquired a 50% plus one share stake in Sakhalin Energy for \$7.45 billion in cash (Mitsui, 2007). Gazprom then claimed that BP-TNK failed at meeting its contractual obligation to increase production as much as it was planned. “In June 2007, Moscow forced BP-TNK, which controlled development of the Kovytko oil field, to sell its 62.9% stake to Gazprom for just \$900,000, a paltry sum for a stake in a project worth about \$20 billion when it is completed” (Shevtsova, 2007, 140–141). Gazprom and BP-TNK have not yet completely agreed on Kovytko. The foreign partners accepted lower prices and made payments to compensate for the cost overruns whereas the original PSA remained in place and Gazprom continued to be the major beneficiary (Stern and Bradshaw, 2008). ExxonMobil, in the meantime, faced up to operational problems with Gazprom concerning the Sakhalin-3 project (Shevtsova, 2007, 140–141). Furthermore, the company found itself at odds with Gazprom on the Sakhalin-1. ExxonMobil (with its partners Russia’s Rosneft and India’s ONGC in Sakhalin-1), wanted to export gas at World prices (Bergin, 2009). Gazprom, in turn, claimed to be the only buyer of the Sakhalin-1 gas at local prices, which were far below the level of global markets.

**Table 5**

Gazprom's foreign subsidiaries and affiliates.

Country	Company name	Types of operations	Gazprom's share (%)
Armenia	Armrosgazprom	Gas distribution	45
Austria	Gas und Warenhandelsgesellschaft	Sale of gas	50
Belarus	BelTransGaz	Gas distribution	50
Bulgaria	Overgaz	Gas distribution	23
	Overgaz Incorporated	Investing	50
	Topenergo	Gas distribution	100
Cyprus	Leadville Investments Ltd	Investing	100
Czech Republic	Gas Invest	Investing	n.d.
Estonia	Eesti Gaas	Gas distribution	37
Finland	Gasum	Gas distribution	25
	North Transgas OY	Gas transportation	50
France	Fragaz	Gas trading	50
Germany	Wingas	Gas distribution	35
	WIEH	Gas distribution	50
	ZMB	Gas distribution	100
	GWH	Gas distribution	100
	ZGG	Gas distribution	100

Source: de Souza, 2008, 79.

Gazprom, while concentrating on gas trade, purchased another producer Northgas, obtained a 20% share in Novatek oil reserves, and purchased Sibneft; nevertheless the company entered other sectors such as: electricity, media, equipment and construction as well (Finon and Locatelli, 2008, 426). Many economists in Russia consider this era of re-nationalization a serious weakness which hampers Gazprom's and Russia's long terms interests in exchange of short term political gains (HLEUC, 2008, 49). Many political figures and most of the public opinion hold the opposite view believing that the state control on strategic resources is indispensable for the sake of whole nation (HLEUC, 2008, 49). Some experts even indicate that Gazprom is "close to pursuing the right rational strategy: to monopolize the domestic sources, owning the reserves and pipes, controlling as much of the downstream market as it can (buying pipes and other assets in Europe); pursuing a policy of divide and rule to get bilateral contracts with particular countries and entering into politics with all the other sources of supplies" (HLEUC, 2008, 49).

Gazprom's investments in Europe indicate the opposite by showing that the company has been benefiting from the liberalizing investment environment in Europe. Gazprom, in fact, attained a very strong market position of the biggest market share supported by increasing subsidiaries and affiliates in European countries as shown in Table 5 (de Souza, 2008, 79).

In addition to investments in Europe Gazprom has been accelerating corporate expansion in Caspian-Central Asia, Africa, Asia and Latin America.

Concerning Caspian-Central Asia, Gazprom, with the aim of re-exporting to Europe, plans to purchase 70–80 bcm/y of Turkmen gas between 2009 and 2028; 30 bcm of Uzbek gas starting from 2010, and increasing terms of Kazakh gas (from Karachaganak) starting at 7 bcm/y by 2009. Purchases from Caspian-Central Asia and other regions might increase if Gazprom cannot succeed at increasing its production to 600 bcm/y by 2015. Central Asian gas is, therefore, indispensable for Gazprom to increase exports to Europe and Asia while meeting the demand in Russia (Stern and Bradshaw, 2008).

Concerning investments in other regions; Gazprom is looking for new production sharing agreements and/or trade agreements with alternative producers in the Middle East (mainly with Iran), Africa (mainly with Libya, Algeria and Nigeria) Latin America and Asia. In addition to a PSA with GAIL of India and a JV with Petrovietnam; Gazprom has made exploration agreements with national counterparts in Venezuela and Bolivia. In the Middle East and Africa, Gazprom has been negotiating with Iran (on South Pars field), with Libya (to buy all volumes of produced gas at market prices as pointed out by Alexei Miller who met Muammer Gaddafi in July 2008) with Algeria (Gazprom opened its first office in Algeria in 2008), and with Nigeria (concerning the gas to be produced and transported to Europe via planned trans-Saharan pipeline).

Gazprom's expansions in and around Europe can be considered as a corporate strategy based on economic purposes which can be identified by firm behavior. However developments in Russia's energy sector, problems throughout gas transit phases to Europe, and finally the conformity between the Kremlin's priorities and Gazprom's corporate expansions strengthen doubts on whether Gazprom is not only a source of revenues for the Russian state but also a political tool intended to serve Russia's priorities. "Oil and gas are major instruments of Russian foreign policy..., says Fyodor Lukyanov, chief editor of the journal, *Russia in Global Politics*" (Nichol et al., 2006, 52). Accordingly, Russia's use of energy includes Gazprom's corporate expansion which cannot be simply defined by firm behavior. Gazprom's investments are interrelated with state centric international policies, and can be best defined in terms of Russia's use of the energy card which embeds state's concerns within corporate expansions.

## Conclusion

This paper addressed the complexity of Russian energy strategy and pointed out how restraints and opportunities in the energy sector made the state to embed geopolitical goals within Gazprom's corporate behavior. Russia benefits from liberal

markets abroad, facilitates corporate expansion of Gazprom and other energy companies in Europe and around; yet strictly adheres to state centric policies at domestic and foreign arenas. This three faceted energy strategy is also linked to the discrepancies between demand, supply and transit.

Concerning the demand, Russia needs good relations with the EU because oil and gas sales to European countries provide 25–30% of state revenues depending on prices and volume. Russian state, which is supposed to implement energy policy for gaining power, is therefore vulnerable against demand side failures (such as the market shrink of 2009 caused by the global financial crisis). Russia would definitely prefer well-functioning markets and well-established relations in Europe instead of failures resulting in losses in state revenues. Russian state's dependence on gas sales to Europe, however, leads to a geopolitical approach to control the production and transit from alternative suppliers.

Russia's supply security is based on Gazprom's production capacity, re-exports from Central Asia and therefore is vulnerable, given the rise of alternative suppliers such as those in Caspian (Azerbaijan, Kazakhstan, Turkmenistan), the Middle East (Iran, Iraq, Qatar) and Africa (Nigeria along with Egypt, Libya and Algeria). The state embeds geopolitical concerns within Gazprom's behavior to sustain a control over alternative supplies. Russia, in the meantime, promotes cooperation and partnership with multinational companies and other states to increase production in emerging fields such as Shtokman. Foreign investments in Russia, however, confront illiberal implications, some of which have been emphasized in the last chapter.

Regarding the transit phase, Russia is still dependent on Ukraine which transports 80% of gas to Europe. The crisis between Russia and Ukraine caused disruption of gas flow to Europe in January 2009. The conflicts and contradiction between Russia and Ukraine were settled by negotiations backed by the EU. This was important to show how the EU was interested in promoting trade instead of geopolitical maneuvers. Russia launched Nord Stream and South Stream pipeline projects to curb dependence on Ukraine. This strategy generated further cooperation with European countries and companies. Russia, by cooperating with European partners, is likely to complete Nord Stream shortly and decrease transit dependence on Ukraine.

Gazprom's behavior and corporate expansions prove to be effective in Russia's relations with other actors along with the Kremlin's priorities. In its turn, Gazprom's corporate expansion supports state's interests as well.

Could market and trade oriented goals channel constructive spill-over effects rather than purely political concerns? Not in the nearest future, as it seems difficult to reconcile differences in the EU and Russian energy agendas because of political priorities. Russian firms have been increasing their shares in European energy grid. They follow a rigorous corporate expansion policy and hold a sort of monopoly in Russia. Having secured a leading share in European markets, Gazprom is in search of controlling gas supplies from Caspian to Europe while acquiring as much share as possible from production and transit projects in the Middle East and Africa. On the one hand, this picture can be defined from the perspective of the firm's behavior. Energy companies are in search of profit maximization by increasing market share and expanding corporate activities. On the other hand, the symbiotic relationship between the state and energy companies lead to a geopolitical pattern in which Russia secures the European markets and controls alternative supplies in Eurasia, Caspian area, Middle East and Africa. This may even appear as a gas containment policy in Europe. In turn, doubts and risks in Europe remain, and will affect Russia's position, so far as the latter keeps on refusing a liberal framework of energy relations with the EU, and follows a geopolitical approach over alternative supplies where Gazprom has already launched a corporate expansion strategy.

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