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Russian energy and grand strategy

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RECOMMENDATIONS

- Energy resources play an important role in Russian strategic designs.
- Policymakers and experts responsible for shaping national and international security policies should monitor developments on the global energy market, to be able to make well-founded predictions on the impact of oil prices and access to export markets on Russia's strategic behaviour.
- Careful monitoring of regional and global energy markets is required to assess how the changes in the pattern of energy interactions are factored into Russian strategic thinking.
- This can help to indicate the implications for Russia's ability to improve its military capabilities and to project economic and energy power in relations with the West – which is set to remain Russia's main energy partner for at least the coming decade.

What makes Russian energy strategically important?

Russia ranks as the top global exporter of energy, the third-biggest global producer and the fourth-biggest consumer of energy and emitter of greenhouse gases. In 2018 Russia's total energy production reached 1484.1 mtoe: third place in the global ranking of energy producers, behind China and the USA. In 2019 Russia was the second-largest global producer of oil, behind the USA, producing 560 mtoe, or 12.7% of global production, and the second-biggest exporter of oil behind the Saudi Arabia, exporting 260 mtoe of oil. Moreover, in the same year, Russia was the second-biggest global producer of natural gas, with production reaching 750 bcm, exceeded only by the USA, and was the number one global exporter of gas, exporting 265 bcm. In coal production Russia occupied sixth position behind China, India, the USA, Indonesia and Australia, producing 418 mt of this commodity, and was ranked third on the list of coal exporters, exporting 189 mt. Altogether, Russia's net export of energy reached 701.3 mtoe, making it the number one global exporter of energy resources. To meet its domestic energy needs, Russia consumed 759.3 mtoe of energy.

As of the end of 2019, Russia had 14.7 thousand million tonnes of crude oil in reserves. This represented 6.2% of global reserves and could secure production at current levels for the next 25.5 years. Further, Russia had 38.0 trillion cubic meters or 19.1% of known global gas reserves and could maintain production at current levels for 55.9 years. Russia is also a global coal power: its coal reserves – 162 166 million tonnes – represent 15.2% of global coal reserves and can secure production at the current level for the next 369 years.

Russia's endowment with energy resources, and the existing and planned energy infrastructure, provide several strategic advantages – but they also pose some strategic challenges.

Energy and strategic advantages

Abundant energy resources help Russia to cover its own needs and export huge volumes of energy to other markets. The endowment with energy resources helps also secure political stability and support for the current regime. Especially during Putin's two first periods as president, the regime opted to channel some of the energy profits to improve the economic situation of various groups in Russian society, tired and impoverished after the difficult years of economic, social and political transition in the turbulent 1990s.

Russia's geography offers another strategic advantage. Geographical proximity to the major European energy markets, which are experiencing shrinking own energy production, and relatively stable demand for energy offer great opportunities for Russian energy producers and exporters. Geography makes it also possible to swing to another major consumer – China, with its almost insatiable appetite for energy – helping to make Russia less dependent on one sole regional energy market.

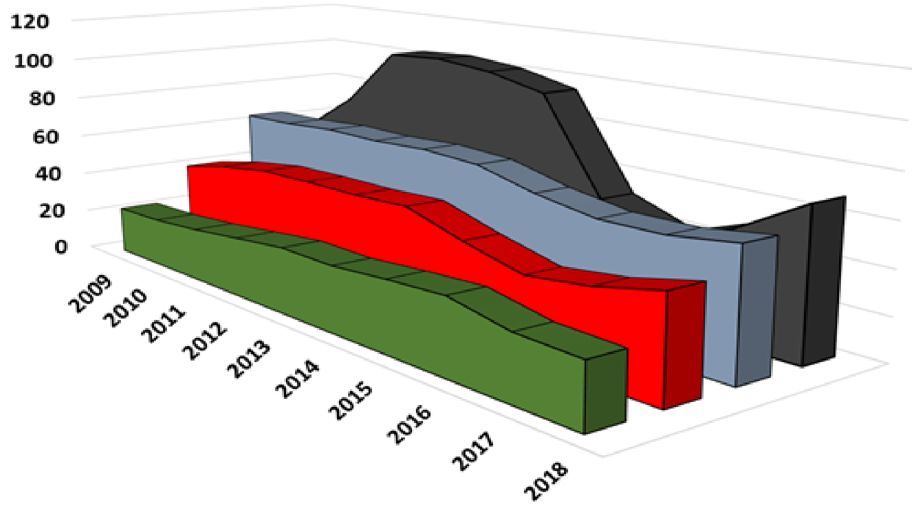
The production and sales of energy commodities generate huge revenues not only for the owners of the energy companies, but also for the Russian state. As shown in Figure 1, in 2012, 2013 and 2014 these revenues represented between 50 and 51% of budgetary revenues. In the ensuing years the share has been falling – not because special measures were introduced but due mostly to the lower price of oil on the global market, yielding lower levels of taxation of export of Russian petroleum products. The Russian state still depends on these revenues to be able to implement a range of budget-funded programmes – including in national defence and security, which saw reductions in 2016 due to the lower oil price. This makes this sector important in economic as well as strategic terms – which also is one of the reasons why the Russian leadership decided to retain control over its most important energy assets by placing trusted representatives of the regime in key positions. Two close personal friends of Vladimir Putin, Alexei Miller and Igor Sechin, now have responsibility for running Russia's two main energy companies – Gazprom, which still has a monopoly on the export of piped gas; and Rosneft, the major Russian producer and exporter of oil.

Energy resources remain the main export commodity. Depending on production levels and not least the oil price, they have generated up to almost 70% of the value of Russian exports. Between 2000 and 2019, the export of oil, petroleum products and natural gas brought in USD 4.038 trillion, and represented 61.7% of total Russian exports in this period. In 2019 Russia's share in global exports of fossil energy commodities was as follows: oil 12.7%, oil products 13.2%, natural gas 26.1%, and coal 16.6%. Trade in energy has also helped Russia to establish strong economic and political ties with various key actors; these relations can be used both to influence policies and to project economic and political power beyond Russia's borders. However, these ties also entail certain strategic disadvantages, as they create a situation of heavy energy interdependence.

Revenues generated by the energy sector have allowed Russia to accumulate huge gold and currency reserves, some of which can be set aside as a financial cushion. The Stabilization Fund of the Russian Federation, established in 2004, was split in 2008 into two funds – the Russian Reserve Fund, which ceased to exist on 1 January 2018 after all its reserves had been spent, and the Russian National Wealth Fund, which, as of the end of August 2020, was worth more than USD 176 billion.

Energy and strategic challenges

Russia's endowment with energy resources also poses some strategic challenges. In particular, de facto dependence on the global oil price has become a key factor shaping the Kremlin's strategic room for manoeuvre. The question of volatility of oil price and its unpredictability



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Def and security	22.7	23.34	25.41	28.35	31.22	30.78	32.95	34.56	29.05	28.17
Budget rev	40.67	46.12	49.63	50.20	50.18	51.28	42.92	35.99	39.58	46.35
Export rev	64.18	64.69	66.32	65.75	66.89	65.30	58.25	53.63	53.89	57.90
Oil price	55.61	74.11	101.74	103.14	100.41	94.21	50.12	39.56	50.53	67.83

Figure 1. Average annual oil price, share of petroleum resources in value of export, in state budget revenues and the share of budgetary spending on defence and security

must be factored into strategic calculations. Since the level of taxation of production and export of petroleum commodities is strongly correlated with global oil price, budget and export revenues depend on developments on the global energy markets. For instance, with the reduced demand for energy commodities on the global market caused by COVID-related lockdowns, the share of petroleum revenues in Russian federal budget revenues almost collapsed, falling from 43.2% in the first half of 2019 to 29.3% in the first six months of 2020. Russian policymakers are fully aware of the country's strategic exposure to global oil prices, but energy commodities remain the backbone of the national economy; this strategic dependence seems set to continue also in the coming decades.

The second strategic challenge the country's energy sector – and the Russian state – must deal with is the question of heavy energy interdependence. Whereas actors dependent on supplies from Russia to cover their energy needs face the challenge of security of supply, Russia, as the number one global exporter of energy, faces the challenge of *security of demand*. What makes the situation even more challenging is the fact that Russia must export almost 50% of the energy it produces, as domestic demand remains limited. In 2019, Russia exported 46% of its oil production, 35% of its gas production and 45% of its coal production. The planned introduction of various energy-saving measures in Russia will make producers even more dependent on access to external markets. According to the recently issued national energy strategy until 2035, Russia plans to increase its overall export of energy commodities in the coming years to levels between 15.2% and 46.2% higher than in 2018. In some categories the planned increases are even higher – for instance export of Russian LNG is to increase by 2035 by between 400% and 700%+ compared with 2018.

The need to address the problem of massive interdependence is well understood in Russian decisionmaking circles. The country has embarked on an ambitious strategy of market diversification but still depends heavily on access to the European energy market – a serious strategic challenge in a situation when political relations with the EU are strained after Russia's annexation of Crimea, intervention in Ukraine and a more aggressive policy in other regions, including the Middle East. The announced energy turn to Asia is seen as part of the solution to the problem of market diversification. However, the results have been mixed. In 2019 the share of Europe in Russian oil exports was 53.5%, as against 27% to China. Further, Europe received 64.5% of the export of Russian petroleum products, whereas 14.9% went to Asia and the Pacific (China a mere 1.9%). Also in 2019, 86.5% of the export of Russian piped gas went to Europe; even with the LNG that was developed to redirect supplies of Russian gas to Asia, Europe had a 52% share and Asia 45.4%. Only in Russian exports of coal did Asia have a higher share than Europe – 50% and 41% respectively.

The need to diversify Russian energy markets has become even more pressing now that the EU has embarked on policy of transition to a more sustainable energy system that in the mid-and long-term perspective can make Russian fossil fuels less relevant in this market – if not completely redundant. In the coming years and decades, climate-change mitigation can pose policy challenges to the strategic interests of the Russian energy sector – and indirectly to interests of the Russian state. However, this has been severely under-communicated in the Russian public debate, and is even sometimes referred to as Russia's 'ostrich approach'. The inability to factor this challenge into strategic calculations can undermine the economic foundations of the current regime and its popular support, as well as depriving Russia of economic and political instruments that allow it to play an active role on the international stage.

Finally, Russia's endowment with energy resources seems to disincentivise the country's policymakers from embarking on much-needed policies to promote the political, economic, social and technological modernisation. The ambitious policy of multifaceted modernisation launched by Medvedev in 2009 has now been almost completely abandoned; Russia has entered a path of economic stagnation or a very slow growth which will not help it to catch up with others, even in the post-COVID period of recovery. In the mid- and long-term perspective, this will cripple Russia's ability to play a major part in global affairs, in effect demoting it to the position of an underdeveloped nuclear power.

Energy and Russian grand strategy

In today's world, energy occupies a central place in every country's strategic evaluations and calculations. In the case of Russia this is beyond dispute: with its reserves of fossil fuels and its regional and global role as a key energy player whose 'strategic wellbeing' hinges on revenues generated by production and export of energy resources, the strategic importance of energy is even more obvious. However, the big question is not whether Russia's policy- and decisionmakers have adopted a strategic approach to energy – but whether they understand what role energy could play in the Russian variant of a grand strategy. Policymakers will need to explore how to combine various instruments of national power in order to achieve strategic objectives while also shaping the international environment.

The strategic importance of natural resources appears well understood by Russian policymakers, who treat energy resources as crucial in both economic and national security contexts. Figure 1 sums up the strategic importance of energy resources by showing the actual role they play in Russian strategic designs. From a grand strategic perspective, energy resources can be viewed as 1) a resource/means facilitating achievement of other strategic goals – for instance, the re-establishment of Russia's position as a great power to be reckoned with, by providing the funding necessary for modernisation of the armed forces as exemplified by the increasing share of spending on defence and security in the period of oil-price boom; 2) an instrument/tool helping Russia to project its economic and political power to areas that depend on energy supplies from Russia, as evident in the role that energy resources play in Russia's exports; 3) an objective/goal of Russian state policy, keen to extend the lifespan of this sector – 'the goose that lays the golden egg' – a resource that generates a substantial share of state revenues crucial for securing the stability and survival of the current regime as well as its ability to project power beyond Russia's borders and to shape the international environment to its liking – the two major strategic objectives pursued by the Kremlin.

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