

EU-RUSSIAN ENERGY RELATIONS:

How Russia's power affects its willingness to cooperate with the European Union in gas-related matters



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ABSTRACT

The present thesis addresses the political relationship between the EU and Russia in gas-related matters to follow up the question to what extent the level of cooperation declined between 1999 and 2011, on the one hand, at to what extent this development was affected by an increase in Russia's relative power after the turn of the millennium, on the other hand. Respectively, the thesis constitutes a trend study observing the EU-Russian gas interaction over the time period 1991-2011. By making use of the Neorealist propositions explaining international behaviour of states, a causal link between Russia's relative power position and its willingness to cooperate internationally is proposed, which is then tested empirically by observing the level of the Russo-European cooperation in gas-related matters, and measuring the size of Russia's power sources with respect to the gas industry.

It is found that while the size of Russia's power sources starts to increase considerably in the early 2000s, the level of its cooperation with the EU remains moderate throughout the whole observation period, with only a slight tendency towards deterioration in the years after 2006. The thesis hence concludes that the increase in Russia's power had an effect on its cooperation with the EU, albeit only marginally.

Using both 'Western' and Russian sources, this study contributes to a better understanding of the Russian gas sector and its role for the state's foreign affairs strategy. Finally, the work demonstrates that the conventional impression of an intransigent Putin's Russia with energy as a political tool used against the EU member states is misplaced, at least for the observed time period.

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LIST OF ABBREVIATIONS

bcm	Billion cubic metres of natural gas
BP	BP p.l.c. ¹
bn	Billion
CIA	United States Central Intelligence Agency
CIS	Commonwealth of Independent States
ECT	Energy Charter Treaty
EIA	U.S. Energy Information Administration
EU	European Union
FSB	Federal Security Service of the Russian Federation
Gazprom	“OAO Gazprom”, Open Joint Stock Company “Gazprom”
GDP	Gross domestic product
IEA	International Energy Agency
LNG	Liquefied natural gas
NATO	North Atlantic Treaty Organisation
OECD	Organisation for Economic Co-operation and Development
PCA	Partnership and Co-operation Agreement
PSA	Production sharing agreement
Russia	Russian Federation
TACIS	Technical Assistance for the Common Wealth of Independent States Programme
TCA	Trade and Cooperation Agreement
TEN-E	Trans-European Energy Network
UGSS	Unified Gas Supply System of the Russian Federation
US\$	United States dollar

¹ Formerly known as “British Petroleum”, but today is a group of companies that includes Amoco, ARCO and Castrol and uses the backronym “Beyond Petroleum”.

1. INTRODUCTION

As the indigenous primary energy production of fossil fuels continues to decline, the European Union faces a situation where it is increasingly reliant on imports in order to satisfy demand. Here, the Russian Federation has emerged as the Union's leading supplier for hard coal, crude oil and natural gas². However, notably in the aftermath of the supply interruptions of 2006 and 2009, concerns are raised about Europe's future gas supply security and Russia's reputation as a reliable partner³. Against conventional wisdom, these concerns are not raised because of an 'over-dependence' on Russian gas – in fact, Russia's share in the EU-27 imports is constantly decreasing (see fn. 1), while the supply volumes remained relatively unchanged in the last twenty years. What alarms the scholars, though, is a rising tension in the EU-Russian gas relations since the turn of the millennium, which is explained either as a reflection of the more general inertia in relations between Russia and the West (cf. Light, 2008; Cameron, 2009), or as a result of the fundamentally different market regulation approaches the EU and Russia take (cf. Van Der Meulen, 2009). Most commonly, however, scholars refer to a change in Russia's behaviour towards the Union: triggered by the transition of the Russian political system under Putin and the soaring oil and gas prices in the 2000s, Moscow is now regarded as objecting earlier attempts to be 'Europeanised' and demanding an 'equal' partnership with Brussels instead (cf. Lukyanov, 2008). In consequence of the limited cooperation observed, a perception is set that, in the mid- to long-term, Russia's behaviour towards Europe may threaten the latter's security of gas supply: having enhanced its power and confidence, Russia is said to pursue a strategy of 'dividing-and-ruling' the European states over the gas issue and thus weakening their decision-making ability (cf. Barysch, 2007, Leonard & Propescu, 2007, Noël, 2008).

Despite the numerously expressed deterioration in the EU-Russian gas relations, a systematic empirical study on this development has been rather overlooked so far. Moreover, adequate empirical evidence for the effect of Russia's power increase on the EU-Russian gas relations is missing as well. The present work aims to fill those gaps and add to the hitherto knowledge by investigating the extent to which the level of cooperation in the EU-Russian gas interactions has declined in the last twenty years and how Russia's relative power could have

² In 2008, Russia supplied 23.7% of EU-27 hard coal imports (as compared to 7.9% in 2000), 29.0% of its crude oil imports (18.7% in 2000), and 31.5% of the Union's natural gas imports (40.4% in 2000) (European Commission, 2011, p. 544).

³ See for instance a statement by the IEA's chief economist Fatih Birol of January 15th, 2009, where he urges the EU countries to "wake up" and "restructure their energy issues": *Russia no longer reliable gas supplier: IEA*, Retrieved July, 2012, from Reuters: <http://www.reuters.com/article/idUSTRE50E3G020090115>.

possibly affected this development. In this light, the central research question of the study goes:

To what extent can the pattern of EU-Russian interactions on gas-related issues be characterised as having developed from cooperation to inertia over the last twenty years and what are possible causes for this?

For two reasons, the present thesis focuses on the EU-Russian *gas* relations only. First, unlike coal and oil, gas⁴ transportation heavily relies on pipelines⁵, which means that the gas producer-consumer relationship necessitates an especially high commitment from all parts of the supply chain⁶ and hardly allows for partner elasticity, as the gas destination and route are not subject to switching (in contrast to an oil cargo, for instance). Second, concerns for the EU's dependence on Russia are raised particularly with regard to gas, and in light of future supply security. The EU-27 gas import dependence is forecasted to increase to some 83% in 2030⁷ (European Commission, 2010). Here, Russia is very likely to remain the Union's largest single gas supplier – it has the world's largest proven gas reserves (CIA, 2011a), while additional supply potential from alternative producers such as Norway and Algeria is questionable (cf. Noël, 2008).

This work proceeds with determining possible explanations for the alleged deterioration in the EU-Russian cooperation which are provided by theory. It will be argued that the Neorealist theoretical approach presents the most accurate expectation on why the EU-Russian gas relations have developed from cooperation to inertia, reasoning that Russia's willingness to cooperate internationally is affected by the degree of its relative power. The empirical part will assess this expectation by first measuring Russia's relative power sources with regard to gas over the past two decades, and then identifying the respective level of its cooperation with the EU. By conducting a before-after analysis of the dynamics of Russia's power sources and

⁴ Here, gas is understood in terms of conventional natural gas which, in general, denotes gas that is extracted from subsurface deposits conventionally, i.e. by drilling. By contrast, non-conventional gas embraces a set of gas resources that are contiguous in nature and require special drilling and stimulation techniques to release the gas from the formations in which it occurs. Non-conventional gas includes coal-bed methane, tight gas sands and gas shales. Such resources are widespread worldwide, but the development of their extraction techniques has generally been limited so far to North America (International Energy Agency, 2008).

⁵ Despite the possibility of LNG, about 80% of gas imported by the EU is currently transported via pipelines (BP p.l.c., 2010).

⁶ In addition, the pipeline infrastructure requires large (upfront) investments and is linked to high entry costs, which results in long-term exclusive contracts between suppliers and consumers as means of reducing the risks involved in those investments (International Energy Agency, 1995).

⁷ In contrast, net imports in 2010 equalled 64.08% of gross inland natural gas consumption (European Commission, 2010).

the EU-Russian cooperation level, the work discusses whether and how an increase of Russia's power has indeed affected cooperation in its gas relations with the Union.

The thesis concludes that, while a gradual increase in Russia's power sources can be measured since after the turn of the millennium, the observed level of cooperation declines only marginally in the mid-to-late 2000s. These development coincide to a considerable extent; the size of Russia's power sources can therefore be regarded as affecting, at least slightly, the level of cooperation with the EU.

2. THEORETICAL FRAMEWORK

Because of the crucial role energy plays for the security, functioning and competitiveness of states, governments regard energy as part of the state's economic, political and strategic instruments and thus often interfere in energy-related matters (cf. Van Der Linde, 2007). Moreover, particularly gas trade, due its dependence on a physical link between producer and consumer, is largely regulated on the governmental level of producer, transit, and consumer countries, since it demands high commitment from all sides. The problem of cooperation between Russia and the EU with regard to gas, therefore, will be addressed from the perspective of inter-state relations, i.e. International Relation Theory, leaving aside the macro-economic level and international trade theory⁸.

2.1. Explaining international cooperation

According to Milner (1992, pp. 476-468), scholars of international relations agree on defining international cooperation as occurring when states mutually adjust their policies in order to achieve certain aims in form of gains or rewards. In this regard, we can deduce that international cooperation is not a necessity, but a strategic decision of states to work together, in the anticipation of benefits. Yet, scholars disagree on the conditions under which states are likely to decide to cooperate or not. Here, several paradigms compete for which more accurately depicts those conditions; the three most prevailing include the Realist, Liberalist, and Cognitivist thought patterns. In the following, these thought patterns shall be discussed with regard to their core assumptions and applicability of derived expectations on the present case study.

⁸ International trade theory, rather, addresses the question of why states choose to cooperate or not based on economic reasons, such as cost advantages. This theory is not applicable here since barriers to trade like tariffs do not pose a primary problem for the EU-Russian gas cooperation.

2.1.1. Realist explanations

The very starting point of Realist thought patterns is the assumption of an anarchic state of the international system, meaning the absence of a universal sovereign, or a world government, capable to regulate international relations. As a consequence, Realists maintain, states are primarily concerned with securing and strengthening their positions in the international system. The means by which states measure their position is considered power, estimated by a comparison of power capabilities, or sources, across a number of states (cf. Waltz, 1979). In this respect, states seek to maximise their power in relation to others (cf. Grieco, 1993).

The Realist perspective assumes the likelihood for international cooperation to be very low. Despite the anticipated benefits from cooperation, states, if they can afford it, i.e. if their relative power position enables them to, reject cooperation. Firstly, cooperation can lead to disproportionately higher benefits for the other in the long-term and thus threaten one's own international position, therefore endanger one's survival; and secondly, cooperation can lead to dependence on goods or services that may be denied in crises or wars (cf. Waltz, Summer 2000). In this light, Realists expect that a relatively strong Russia will seek independence and reject cooperation with the EU. They expect the EU countries, on the other hand, to do whatever necessary to prevent Russian power dominance, including the creation of necessary collective institutions to push for cooperation.

2.1.2. Liberal explanations

The leading Liberal paradigm focusing on international cooperation, Liberal Intergovernmentalism, was developed by Andrew Moravcsik. It contends that international relations are to be assessed from the perspective of state-society relations, whereby state behaviour is motivated by the realisation of its interests and preferences which are, in turn, shaped and influenced by the dominant domestic coalitions of individuals and private groups (cf. Moravcsik, 1997). Accordingly, the primary interest of national decision-makers externally is not the assertion of their state's position in the international system, but the extension of their own influence domestically (cf. Wolf, 2002).

In this sense, the likelihood of international cooperation is dependent on the compatibility of interests of the respective influential societal groups. If, for instance, the ruling coalitions pursue incompatible preferences and interests, the likelihood of cooperation is reduced. Liberal Intergovernmentalists would then ask whether the domestic coalitions in favour of cooperation are bigger in the EU and Russia. Yet, because Liberal Intergovernmentalism regards threats to security as either fixed or endogenous variables (cf. Moravcsik, 1997) empirically, its application is limited to domains where security or survival considerations do

not constrain chances for cooperation.

However, when placing the EU-Russian gas relations within the wider context of the interactions between Russia and the West, one can see that such considerations are given at least in Russia. The Union's recent enlargement rounds, NATO's eastward expansion as well as its missile policies and plans on accession of Ukraine and Georgia are seen as provocation⁹ in Russia and pose concerns for its international influence and autonomy. Moreover, Moscow regards its geopolitical influence to be strongly determined by the state's role in the global energy market – as stressed in both of its Energy Strategies (cf. Ministry of Energy of the Russian Federation, 2003; 2010); we can therefore reasonably assume 'high politics' to be at stake. As a consequence, Liberal Intergovernmentalism is empirically insufficient to adequately capture the effects of security concerns on the EU-Russian gas relations and hence to explain the declining level of cooperation on gas.

2.1.3. Neoliberal Institutional explanations

Neoliberal Institutionalism incorporates the basic Realist assumptions of the anarchic international system and states' reliance on self-help (cf. Keohane, 1993; 2005). However, it argues that those are conditional and only apply in situations where threats to security are high and a state has the impression that the counterpart intends to use its capabilities adversely (cf. Keohane, 1993). If, however, security is not at stake, Neoliberal Institutionalists focus on the collective action problem and assume cooperation to be impeded by fears of the other's cheating or defection. They generally expect incentives for cooperation to be high and look at how international institutions can foster cooperation by providing information on the rules and norms of behaviour and the consequent compliance of states with those rules and norms. But the EU-Russian gas relations, as we will see, are not characterised by an institutionalisation process – in the years 1991-2011, Russia was neither a member of the World Trade Organisation (WTO), nor has it ratified the Energy Charter Treaty (ECT) –, and, as argued above, the notion of threats to security is high.

On the other hand, one may argue that, since the European Union is an institution itself, any research focusing on the EU should make primary use of Institutionalism. However, whatever the Union's internal issues of domestic policy formation may be, this study is interested in the external dimension, i.e. policy output. Hence, for the purposes of the present thesis, the EU is assumed to be a sovereign unit of the international system, acting as a unitary, rational entity, just as a 'traditional' state.

⁹ Putin made this very clear in his speech at the Munich Security Conference in 2007, massively criticising the US, its planned anti-missile defence shield and expansion of NATO to the East (Rolofs, 2007).

Deterioration in the EU-Russian gas relationship thus cannot be fully explained and solved within the Neoliberal Institutional framework.

2.1.4. Cognitivist explanations

Finally, Cognitivist thought patterns, such as Social Constructivism, regard the whole international system and its units not as constants, but as socially constructed entities and therefore question Rationalist approaches for treating the identities and interests of states as “exogenously given” (Wendt, 1992, p. 391). They deny any objective constraints posed by international anarchy and instead reason that “anarchy is what states make of it” (Wendt, 1992, p. 395). In this light, Constructivists emphasise that states see each other as friends, rivals or enemies and treat them differently. Cooperation, in this respect, is very likely with states that are regarded friends; it never occurs with enemies, and only sometimes with rivals. According to Tsygankov (2006; 2008), for instance, Russia’s willingness to cooperate depends on how the decision-makers identify Russia in relation to Europe and European norms and values, which ultimately shapes Russia’s strategic visions, threat perceptions and foreign policy objectives. Constructivists, thus, expect that Russia’s intransigent behaviour towards the EU was triggered by the former’s foreign policy transformation under Putin towards ‘great-power pragmatism’ – as reflected by increased normative disagreements with the West in general, and on human rights issues particularly.

However, because Cognitivists deny the Positivist line of reasoning (cf. Hasenclever, Mayer, & Rittberger, 1997), deriving testable hypotheses from this theoretical approach is inconsistent. Rather, Constructivism is well suited for the purposes of complementary explanations for variations in international behaviour and outcomes.

2.1.5. Bridging the gap: combined explanations

Having regard to the propositions on the motives for the recent inertia in the EU-Russian gas relations, one may conclude that (1) they are not necessarily mutually exclusive, and (2) that only the Realist proposition is expected to fulfil the ‘sufficiency’ condition for explaining Russia’s uncooperative behaviour.

The Liberal and Cognitivist explanations can be treated as intervening variables reinforcing the role of Russia’s relative power on its willingness to cooperate with the EU. In this light, Cognitivist propositions regarding the role of identity may affect Russia’s willingness to use its power resources for geopolitical goals. Russia’s geopolitical interests may be shaped by the Soviet heritage, particularly in its ‘near abroad’, while they are influenced by concerns for security and international influence. Furthermore, the Liberal tenet as described here can give

useful insights on how internal interests affect preferences over foreign policies. Thus, the Union's preference for free trade is formed by the interest of the coalition of industrial manufacturing and consumers for lower gas prices which are generally expected from liberalisation. On the other hand, lower domestic prices in Russia are guaranteed by the extensive monopolisation of gas supply by "Gazprom", which sells gas for subsidised prices. The coalition of industrial manufacturing and consumers in Russia would thus oppose free trade. However, Brussels and Moscow have introduced a number of policies that cannot be fully explained by Liberal Intergovernmentalism, such as the 'Gazprom clause' in the EU's third energy liberalisation package¹⁰, or the maintenance of Gazprom's monopoly position despite the enacted gradual increase of gas prices in Russia. The Realist proposition of a state's strive for a stronger international position and the concept of power, thus, remain important for explaining such behaviour.

In the following, the Realist propositions on the dynamics of the EU-Russian gas relation will be discussed systematically.

2.2. Realist propositions for Russia's un-cooperative behaviour

The Realist's core assumption is the anarchic state of the international system; sovereign nation-states are regarded as the key units and assumed to behave as "unitary-rational agents" (Grieco, 1993, p. 15). Yet, Realists slightly differ in their assumptions on how exactly the international anarchy affects states' behaviour.

Classical Realism in the style of Morgenthau assumes states to be 'offensive' positionals and suggests that the immediate aim of international politics is power and influence. States in anarchy, therefore, constantly seek to maximise power, which Morgenthau conceptualises as "control over certain actions" (cf. Morgenthau & Thompson, 1985, p. 31). However, as power maximisation of one state threatens the security position and influence of another state, the latter intensifies its power maximisation all the more. Eventually, this leads to a security dilemma, where power maximisation aimed at increasing security in the end leads to lower security and thus provokes international conflict (cf. Morgenthau & Thompson, 1985). Classical Realism, hence, assumes the likelihood of cooperation to be very low.

¹⁰ Within the framework of ownership unbundling - the separation of integrated energy firms' production assets from their transmission assets - the Commission has proposed a 'reciprocity clause' for energy relations with third countries, which implies that any company from a third country will have to comply with the same unbundling requirements as EU companies (EurActiv, 2007a). Since Gazprom does not fulfil these criteria, this clause is often termed as 'Gazprom clause', reflecting the EU's aim to protect the openness of its gas market and prevent a further acquisition of EU energy grids by Gazprom.

By contrast, Neorealism, or Structural Realism, as advanced by Waltz and Grieco assumes the core interest of states to be survival as independent actors of the international system; states therefore are assumed to be rather ‘defensive’ positionalists. Because states can never be sure of the intentions of other states, they seek to secure their position by maximising their power relative to other states (cf. Waltz, 1979). If, however, one state is perceived to maximise its power overwhelmingly, the other states will either try to ‘balance’ against the dominant state by forming strategic alliances, or they will ‘bandwagon’ with the dominant state to enhance prospects for their own security (cf. Waltz, 1979). Neorealists thus expect cooperation to occur only if it leads to the maximum self-sufficiency in a given situation. They expect such alliances to last so long as there is a power asymmetry towards the dominant state; when power becomes more equally distributed, the alliances fall apart.

Finally, Keohane’s Neoliberal Institutionalism, sometimes termed ‘modified Structural Realism’, incorporating the basic Neorealists assumptions, argues that states not only evaluate capabilities but intentions as well (cf. Keohane, 1993). Only in situations where a state perceives that the other intends to use its capabilities adversely, such as in situations related to security matters, do relative power considerations constrain cooperation. In situations other than that, proponents of this paradigm see institutionalised cooperation as the dominant attribute of international politics.

This is the theoretical aspect of international cooperation. Empirically, however, one might expect the willingness of states to cooperate as well as the actual level of cooperation to vary over time and subject. If this is the case in the gas relations between Russia and the EU, the Neorealist version provides a higher predictive value than Classical Realism, which assumes no cooperation to ever occur, or Neoliberal Institutionalism, which expects states to cooperate via institutions. In this regard, we may revise the original research question by adapting it to the Neorealist theoretical framework.

2.2.1. *Revised research question*

The fundamental assumption of the Neorealist perspective expects a causal link between a state’s power position and its willingness to cooperate. The general proposition drawn from this, relevant for the gas relations under study, then, states that *an increase in a state’s power resources leads to lower willingness to cooperate internationally*. Based on this proposition, two expectations are developed. First, *a relatively weak Russia shortly after the collapse of the Soviet Union cooperated with the EU* – either to bandwagon for financial and technical aid, for instance under the Technical Assistance for the Common Wealth of Independent

States Programme (TACIS); or to balance against the US. Second, *the relatively powerful Russia in the mid-2000s declined to cooperate with the EU* – unwilling to subscribe to any binding agreements in relation to strategically-important economic sectors.

In addition, motivated by a maximisation of its influence in the international system, Russia is expected to strengthen its position on the European gas market. As a general extension of the Neorealist proposition, thus, a third expectation is developed: *a relatively powerful Russia seeks to prevent EU countries from allying against itself and will thus encourage the Union's internal fragmentation.*

In this context, taking into account the role that Russia's relative power is expected to play for the level of cooperation with the EU, the central research question of the study is revised and goes:

To what extent was the relatively weak Russia in the 1990s more willing to cooperate with the European Union in gas-related matters than the relatively strong Russia in the 2000s?

3. RESEARCH METHODOLOGY

3.1. Research design

The present case study of cooperation between Russia and the EU in gas-related matters seeks to assess (1) to what extent there has been a change in the pattern of interactions from cooperation to inertia over the past twenty years and (2) to what extent this change was affected by an increase in Russia's power sources. The research, thus, is designed as a correlational trend study observing changes on the independent and dependent variables for the time period of 1991-2011.

The dependent variable is considered the 'nature' of the EU-Russian gas relations, classified in terms of three levels of cooperation. These levels can range from 'absent cooperation' over 'moderate cooperation' to 'high cooperation'. The independent variable is the size of Russia's power sources with regard to gas. It is expected that an increase in Russia's power sources reduces its willingness to cooperate with the EU, which is then reflected in Russia's intransigent behaviour towards the Union, and hence results in 'absent cooperation'.

The covered time period begins in 1991, denoting the dissolution of the Soviet Union and therewith the foundation of the Russian Federation as a sovereign and independent state. Observations end in 2011, which marks the year of most recent data available.

3.2. Operationalisation

3.2.1. *Dependent variable: level of cooperation*

The ‘nature’ of the EU-Russian gas relations is operationalised such as to range from ‘absent cooperation’ over ‘moderate cooperation’ to ‘high cooperation’ (see Table 1).

Referring to Helen Milner’s review article *International Theories of Cooperation among Nations: Strength and Weaknesses* (1992, cf. pp. 467-468), cooperation is conceptualised as occurring when states mutually adjust their policies “to the actual or anticipated preferences of others ... such as to reduce their negative consequences for the other state”, in order to achieve certain aims in form of reciprocal gains or rewards.

The ‘level’ of cooperation analysed here, however, denotes not only the respective policy adjustments (if enacted), but the way in which they are achieved as well. For instance: was cooperation previously negotiated or was it achieved tacitly? This enables to identify the actual (long-term) willingness of a state to cooperate on a regular basis as contrary to a one-time policy adjustment.

Moreover, since the present work is primarily interested in assessing a possible change in Russia’s willingness to cooperate with the EU, focus will be laid on Russia’s cooperative behaviour.

In this respect, ‘absent cooperation’ in the EU-Russian gas relations is denoted either by Russian policy adjustments that do not reduce negative consequences for the EU, or by no policy adjustments at all (inactivity).

In accordance with Axelrod & Keohane (1985), ‘high cooperation’ is denoted by an institutionalisation of the EU-Russian gas relations, i.e. when Russia agrees upon, ratifies and/or implements a mutually binding agreement regulating its gas relationship with the EU. In *Achieving Cooperation under Anarchy: Strategies and Institutions*, Axelrod & Keohane (1985) found that if states institutionalise cooperation, they oblige themselves to adjust policies adequately. Cooperation, thus, becomes binding and the possibility of defection is decreased for defectors which are likely to be prosecuted and penalised.

‘Moderate cooperation’ is located in the middle of the spectrum. It is characterised by an adjustment of Russian policies reducing their negative effects for the EU, without being preceded by any explicit binding agreements with the Union, i.e. the EU is not enabled to ‘prosecute’ Russia for possible non-compliance. Furthermore, moderate cooperation is denoted by intensive communication on the political level – such as formal meetings, summits

and conferences – which are aimed at an exchange of information in the short-term and cooperative policy adjustments in the long-term. Table 1 summarises the three levels of cooperation.

Table 1: Dependent variable: three levels of cooperation

LEVEL OF COOPERATION:	ABSENT COOPERATION	MODERATE COOPERATION	HIGH COOPERATION
Denoted by:	<ul style="list-style-type: none"> - inactivity; - unilateral behaviour that does not reduce negative consequences for the other side; - competitive / conflictual behaviour resulting in a reduction of gains available to the other side or a hindrance of its want-satisfaction 	<ul style="list-style-type: none"> - enacting of policies that result in a reduction of negative consequences to the other side, without previous binding agreement - creation of institutions demanding no policy adjustment (inconclusive consultations) 	<ul style="list-style-type: none"> - conclusion of binding agreements and their ratification / implementation

In order to identify the respective level of cooperation in a given year, five units of observation are chosen which reflect the main aspects of the EU-Russian gas interactions.

The first two observation units indicate to what could be called the institutionalisation process of the EU-Russian gas relations, i.e. the fact whether the relations are characterised by formal regulatory frameworks. If they are, we can deduce that the level of cooperation is high.

Here, observation unit 1 refers to the ratification process of the European Energy Charter Treaty (ECT) and its Protocol on Energy Efficiency, signed on December 17, 1994, and entering into force in April 1998. Although not being a bilateral agreement between Russia and the EU, it is considered the major multilateral treaty to regulate energy cooperation, covering broad provisions on energy trade, transit, investment and dispute settlement. For measuring the level of EU-Russian cooperation on gas, thus, the fact whether Russia applies and ratifies the ECT provisions is an important and meaningful indication.

Observation unit 2 refers to the presence of negotiations on, and respectively, the signing of a new agreement replacing the Partnership and Co-operation Agreement (PCA) between the EU and Russia. The PCA is considered the legal basis for the general relationship between Russia and the EU; it was signed in 1994 and came into force in 1997 for an initial duration of 10 years with automatic extension on an annual basis provided that no side withdraws. Although the PCA addresses energy only slightly (Art. 65 PCA), its replacement agreement should

include “substantive, legally binding commitments in all areas of the partnership, including... economic cooperation... as well as solid provisions on trade, investment and energy” (European Commission, 2008). The fact whether negotiations on the new agreement were launched, maintained and eventually resulted in a signing can therefore contribute to the assessment of the level of cooperation under study.

Observation unit 3 addresses the effectiveness of political dialogue between Russia and the EU under the Energy Dialogue, which was established in 2000 at the sixth EU-Russian bilateral summit in Paris. Although the Energy Dialogue merely is a communication platform where common interests are highlighted (it thus on no account can capture the level of ‘high cooperation’), the mere presence of exchange of information could facilitate the activities of the private sector and thus contribute indirectly to cooperation on the political level. Besides, under the Energy Dialogue framework, concrete joint EU-Russia cooperation projects can be launched, which then denote moderate cooperation.

Finally, observation units 4 and 5 refer to Russia’s possible ‘active non-cooperation’ in the sense that they indicate Moscow’s strive for a stronger position internationally.

Russia is often alleged to follow a strategy of ‘dividing-and-ruling’ the EU, i.e. to conduct bilateral relations with single member states rather than with the EU as such, reinforcing the Union’s internal fragmentation (cf. Leonard & Popescu, 2007). It thus encourages disunity on certain issues, undermining the development of a truly European (external) energy policy, and hence weakening Brussels’ bargaining leverage. Observation unit 4 captures the means applied by Russia for such a ‘divide-and-rule’ strategy.

Observation unit 5 denotes possible conflicts that never occurred before, while having strengthened Russia’s bargaining leverage. Table 2 summarises the five observation units and the classification of their values to the respective levels of cooperation.

Table 2: Dependent variable: units of observation

	Value of observation unit according to the level of cooperation		
	ABSENT COOPERATION	MODERATE COOPERATION	HIGH COOPERATION
OBSERVATION UNIT 1: Application of the ECT (ratification process on track)	no	yes / provisional application	yes / ECT ratified
OBSERVATION UNIT 2: Negotiation process on track for a new agreement replacing the PCA	no	yes	yes / new agreement signed and ratified
OBSERVATION UNIT 3: Outcomes of meetings under the EU-Russia Energy Dialogue necessitating policy adjustment	no	yes / policy adjustment not binding	n. a.
OBSERVATION UNIT 4: Russia's 'divide-and-rule' strategy in gas-related matters	yes / means are applied	no	no
OBSERVATION UNIT 5: Single conflicts leading to Russia's stronger leverage position	yes	no	no

3.2.2. Independent variable: the size of Russia's power sources

The independent variable is the size of Russia's power sources with regard to gas. Here, a brief discussion on the concept of power is indispensable, as it is essentially contested in IR theory and the proper definition of power remains "a matter of controversy" (Baldwin, 1993, p. 15).

As Barnett & Duvall (2005, p. 41) note, power works in too many forms and has "various expressions that cannot be captured by a single formulation" **Es ist eine ungültige Quelle angegeben..** In general, power can be defined as a means, i.e. providing the ability to affect "the behaviour, attitudes, beliefs, or propensity to act" of others (Baldwin, 1993, p. 16). As well, power is contextual in the sense that it is evaluated in the context of its 'scope and

domain'¹¹, its 'zero-sum problem'¹², and its 'fungibility'¹³ (cf. Baldwin, 1993, pp. 15-22). Finally, power can be regarded as the aggregate of certain capacities. Morgenthau, in this respect, refers to national power as including the following elements: geography, natural resources, industrial capacity, military preparedness, population, national character, national morale, and the quality of diplomacy and of government (cf. Morgenthau & Thompson, 1985). Similarly, Waltz describes power as the "combined capabilities on all of the following items: the size of population and territory, resource endowment, economic capability, military strength, political stability and competence" (Barnett & Duvall, 2005, p. 41).

However, the objective of the present study is very specific in nature, i.e. the goal is to analyse how power works to Russia's advantage particularly in gas-related matters. Therefore, only specific elements of national power will be examined with respect to their size and Russia's capability to use them. In particular, this will be (1) Russia's economic performance, with the gas sector being an important aspect of it, and (2) Russia's ability to convert this performance into political capital. Such a conception draws merely on Morgenthau's 'elements of national power', being aware though that it does not capture Russia's aggregated national power as such. Table 3 summarises the effect of the size of its power sources on its respective international position.

Table 3: Independent variable: the size of Russia's power sources

		The size of power sources	
		RELATIVELY WEAK	RELATIVELY STRONG
Russia's power sources (relevant for gas trade)	ECONOMIC POWER SOURCES	Dependent on foreign investments and loans, which are often issued on a conditional basis; the state is therefore not able to make truly sovereign decisions	Relative independence from foreign financial sources; the state is therefore able to make sovereign decisions
	POLITICAL POWER SOURCES	The state is not able to use its economic power for the national well-being	The state is able to adequately manage and use economic power resources

¹¹ Baldwin defines *domain* as referring to "the actor or actors with respect to which power is exercised" and *scope* as referring to "the dimension of their behaviour that is affected" (Baldwin, 1993, p. 25).

¹² Meaning the idea that power is often, but not always, zero-sum in the sense that "more for one actor means less for another" (Baldwin, 1993, p. 18).

¹³ Baldwin describes fungibility as referring to "the ease with which capabilities in one issue-area can be used in other issue-areas" (Baldwin, 1993, p. 20).

Economic power sources

As illustrated in Table 3, an economically powerful state has a higher ability for independent behaviour in the international system. With respect to the gas relations with the EU, the size of Russia's economic power sources is primarily indicated by the world oil prices¹⁴, the size of Russia's Gross Domestic Product (GDP), and the size of its foreign debt (% of GDP), as summarised in Table 4.

Russia has the world's largest proved gas reserves (CIA, 2011a); moreover, it is the world's largest gas exporter (CIA, 2011b). This suggests that its economy is considerably dependent on gas trade. However, as Heinrich & Pleines (2012) note, resource-rich countries often perform poorly in economic terms if the state is characterised by institutional weakness and is unable to mitigate the negative consequences¹⁵ of a 'resource boom' through adequate policy choices. It is therefore essential to capture the possible transformation of Russia's gas resources into political power sources.

Political power sources

Drawing on Heinrich's & Pleines' (2012) concept of resource challenges, four further indicators are introduced to measure the Russian state's ability to deal with the respective resource challenges on the political level. These indicators are cumulative, in the sense that the more the state consolidates control over the gas market, the higher is the size of its political power sources.

Indicators 4, 5, and 6 relate to the Russian state's control over the gas resources, gas production and exports. Indicator 7 refers to Russia's ability to effectively manage its resource revenues, on the one hand, and to provide a 'cushion' for times of falling prices and thus to avoid symptoms of 'Dutch disease' (through the instrument of the Sovereign Wealth Fund (SWF)), on the other hand.

Table 4 summarises the indicators for Russia's economic and political power sources and the classification of their values to the respective size of Russia's power sources.

¹⁴ Not only is the world oil price important for Russia's oil exports, but the pricing formula for Russia's gas exports to Europe is based on prices for key petroleum products (mostly to residual fuel oil (RFO) and light fuel oil (LFO)), with a time-lag of about 6-9 months (see Konoplyanik, 2012, p. 42).

¹⁵ Such as 'Dutch disease' or 'rentier state'.

Table 4: Independent variable: indicators for Russia's power sources

		The size of power sources	
		RELATIVELY WEAK	RELATIVELY STRONG
ECONOMIC POWER SOURCES	INDICATOR 1: World oil price	relatively low	relatively high
	INDICATOR 2: GDP dynamics	declining	growing
	INDICATOR 3: Foreign debt dynamics (% of GDP)	growing	declining
POLITICAL POWER SOURCES	INDICATOR 4: Control over gas resources (ownership of reserves)	no	yes / majority control
	INDICATOR 5: Control over gas production (ownership of production companies)	no	yes / control of majority of production
	INDICATOR 6: Control over gas exports (ownership of export routes)	no	yes
	INDICATOR 7: Effective management of resource revenues / establishment of SWF	no	yes / SWF in operation

3.3. Data collection and analysis

The data collected on the observation units of the dependent variable will consist of primary literature on the respective bilateral and multilateral agreements, as well as domestic legislative acts provided by official electronic sources. Their analysis will consult secondary literature addressing, interpreting and commenting on the respective primary literature.

The data collected on the indicators of the independent variable will consist of both quantitative and qualitative data. Because statistical data may be biased and not complete, I will consult several data sources in order to provide the most neutral and complete analysis possible. The main data sources used include the BP Statistical Review of World Energy 2012, Gazprom's Annual Reports, as well as statistics provided by the World Bank, the U.S. Energy Information Administration, and the Central Bank of Russia. Qualitative data sources

include Russia's domestic legislative acts provided by the official electronic sources (such as the Websites of Duma or Russia's Ministry of Energy), as well as critical secondary literature by Russian and 'Western' academics.

The main language of the collected data and consulted literature will be English. However, particularly the secondary literature reflecting the Russian perspective is often not available in English; here, I will reproduce the main arguments to my best knowledge.

Observations will be conducted for each year (if applicable) with a view to any patterns established on both the dependent and independent variables. The expectation is that the level of cooperation in Tables 1 and 2 declines as the measured size of Russia's power sources in Tables 3 and 4 increases.

3.4. Limitations of research design and measurement

The main limitation of the applied research design concerns internal validity, or 'spuriousness'. Here, the effects of possible third variables have been minimised largely on a theoretical basis (see Chapter 2), however, one should keep in mind that they cannot be fully ruled out. Methodologically, the study therefore focuses on correlation rather than a causal relationship.

Furthermore, as mentioned above, the statistical data consulted may be biased and incomplete. As well, data provided by the different sources may not be comparable. Yet, this study is primarily interested in patterns. Ideally, the mentioned limitations will not significantly constraint the development of evidence.

Finally, the observation period of 20 years may be too short to enable the measurement of several variations on both variables. For historical reasons, though, relations between the Russian Federation and the European Union cannot be observed prior to 1991.

4. ANALYSIS

Chapter 2 has introduced the core assumption for the present thesis, stating that an increase in a state's power sources leads to lower willingness to cooperate internationally. The expectation is then that the relatively weak Russia in the 1990s was more willing to cooperate with the European Union in gas-related matters than the relatively strong Russia in the 2000s.

Based on this, this chapter starts with empirical findings obtained from the measurement of the independent variable – the size of Russia's power sources in the years 1991-2011 as

presented in Table 4. It then analyses the observations conducted on the dependent variable – the level of cooperation between Russia and the EU over the same time period in accordance with Table 2. What will become clear is that after a decade of poor economic performance with a bottom during the Asian crisis in 1998, Russia's economy developed considerably during the 2000s thanks to increased world oil prices. At the same time, the Russian state has gradually consolidated control over the gas sector, particularly by means of the 'energy giant' OAO "Gazprom". On the other hand, the level of the Russo-European cooperation has declined from 'high-to-moderate' in the 1990s to 'moderate-to-absent' in the 2000s. The extent to which these developments coincide will be analysed in the last section of the present chapter.

4.1. Russia's power sources

In accordance with Table 4, the size of Russia's power sources will be measured by using three indicators on the economic dimension and four on the political dimension. The economic power sources are indicated by 1) the world oil price, 2) Russia's GDP dynamics, and 3) its foreign debt dynamics. Indicators for political power sources include the state's control over: 4) gas resources, 5) gas production, 6) gas exports, as well as 7) effective management of resource revenues. Here, a special attention will be directed towards the Russian state's relationship with OAO "Gazprom", since it is by means of monitoring this monopoly that the government acquires control over resources, production and exports.

As hypothesised in Chapter 2, the measured size of Russia's power sources is expected to increase in the 2000s compared to the 1990s.

4.1.1. Economic power sources

Indicator 1: World oil price

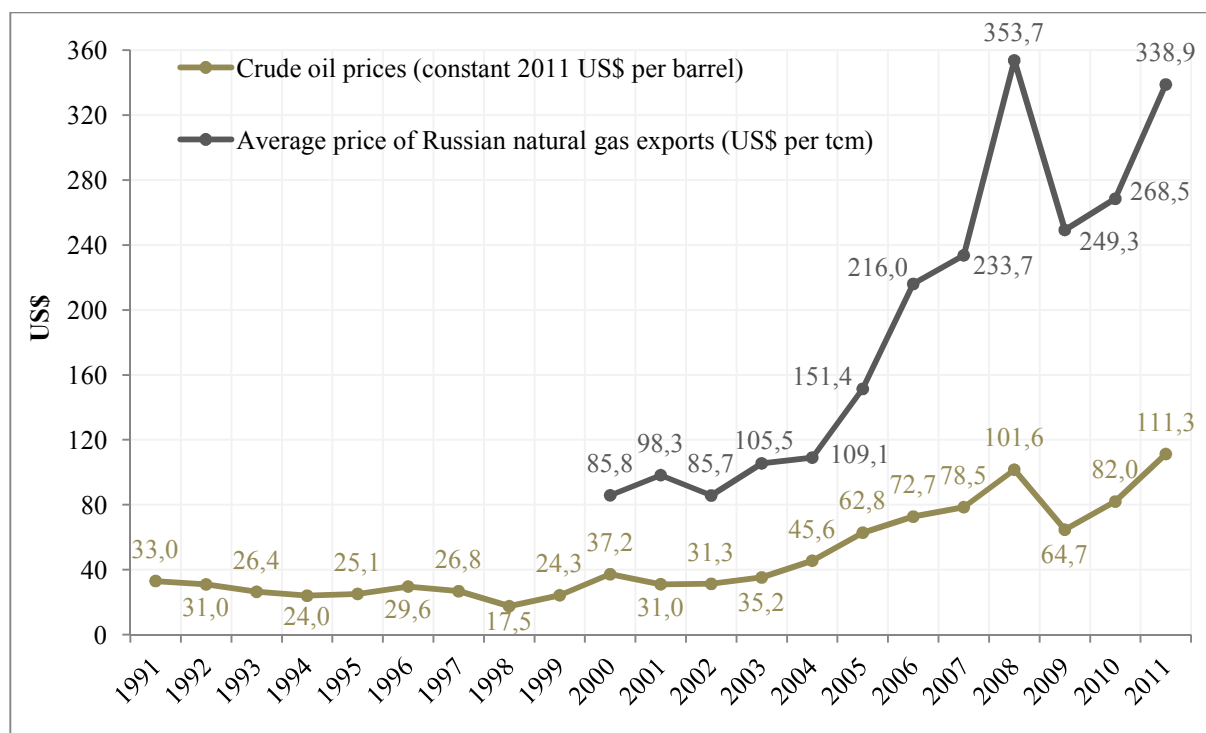
In 2010, Russia has been ranked the world's largest natural gas (CIA, 2011b) and second largest oil (CIA, 2011c) exporter. The country's economic performance, thus, is assumed to be positively correlated to the development of world oil prices.

Figure 1 illustrates the annual prices for the 'Brent' crude oil in constant 2011 US\$ per barrel for the years 1991-2011, as well as the annual average prices for the Russian natural gas exports in current US\$ per trillion cubic metre. The graph shows that oil prices fell constantly between 1991 and 1998; their average equalled 27 US\$ per barrel. From 1999 onwards, prices began to rise until 2009, where they dropped as a result of the global economic crisis. The average price per barrel for the years 1999-2008 equalled 52 US\$. In 2010, crude oil prices rose again and surpassed the 2008 level in 2011. A similar development can be observed in

the price for Russia's natural gas exports.

On average, crude oil prices in 1999-2011 were twice as high as those in 1991-1998, which is expected to be reflected in Russia's GDP development.

Figure 1: BP crude oil prices and average prices of Russian gas exports, 1991-2011



Sources: *for Russian average price of gas exports*: Bank of Russia (2012);

for crude oil prices: BP p.l.c. (2012)

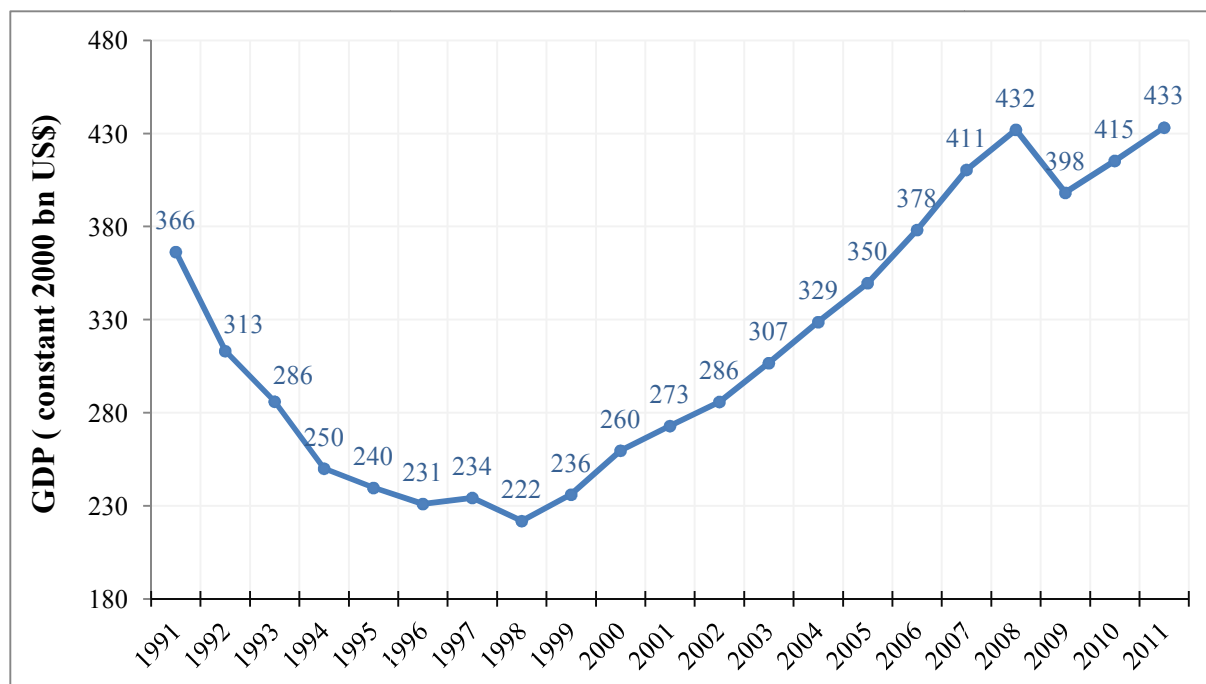
Indicator 2: Russia's GDP dynamics

The GDP is an important indicator for measuring a country's economic performance, as it captures the aggregate market value of goods and services produced by all of the state's economic sectors in a given year. It is equal to the sum of consumption, investment, government spending and 'net' exports (i.e. exports minus imports).

Russia's (real) GDP development between 1991 and 2011 is illustrated in Figure 2. Generally, it can be divided into two periods: a recession period of 1991-1998, and a recovery period of 1999-2011, with a drop of about 8 per cent in 2009 as a result of the global economic crisis. In the recession period, Russia's GDP value fell for about 40 per cent between 1991 and 1998; only in 2006, the GDP reached the 1991 level. In the recovery period, Russia was able to almost double its GDP and the 2008 level was about 95 per cent higher than that of 1998. Russia's relative annual GDP growth is presented in Figure 3. Here, we can see that values for Russia's relative GDP fluctuate more than the average values for the EU, OECD countries, or the world. We can also see more clearly that the Russian state performed weaker in the years

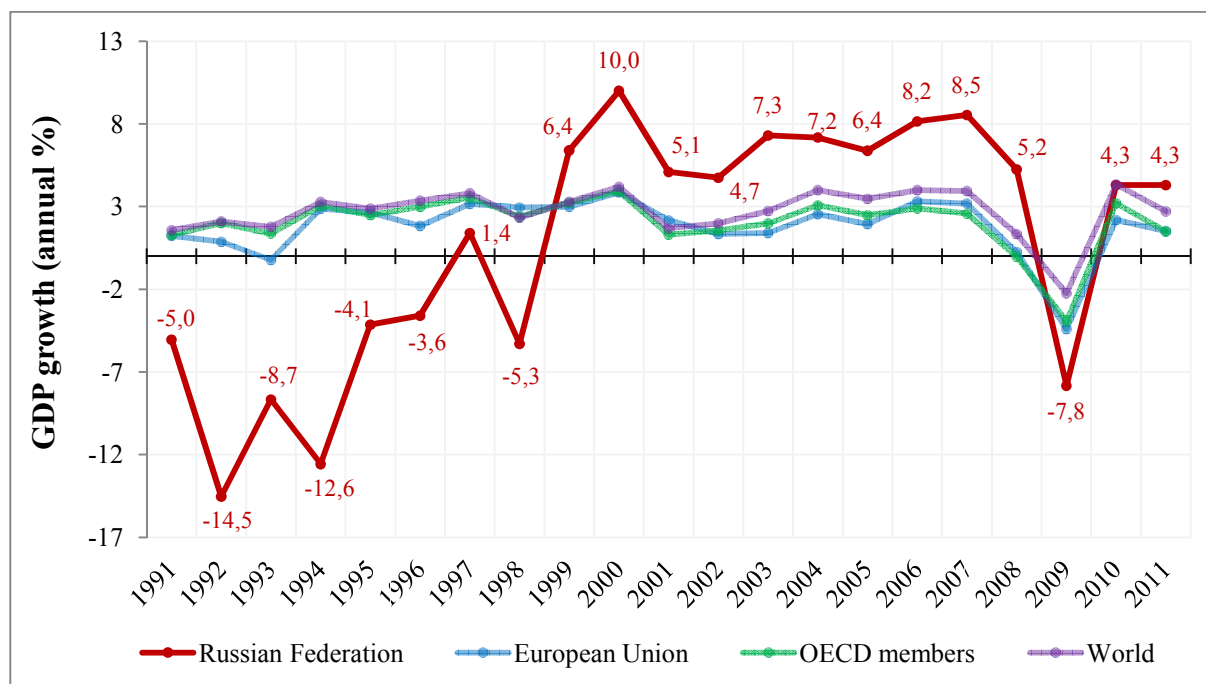
1991-1998, with negative GDP growth values (except in 1997). Starting in 1999, however, the country's annual GDP growth was positive and outperformed that of the EU, OECD countries, or the world. Again, the negative values for 2009 are to be attributed to the world economic crisis.

Figure 2: Russia's GDP (constant 2000 bn. US\$), 1991-2011



Source: The World Bank Group (2012)

Figure 3: Russia's GDP growth (annual %), 1991-2011

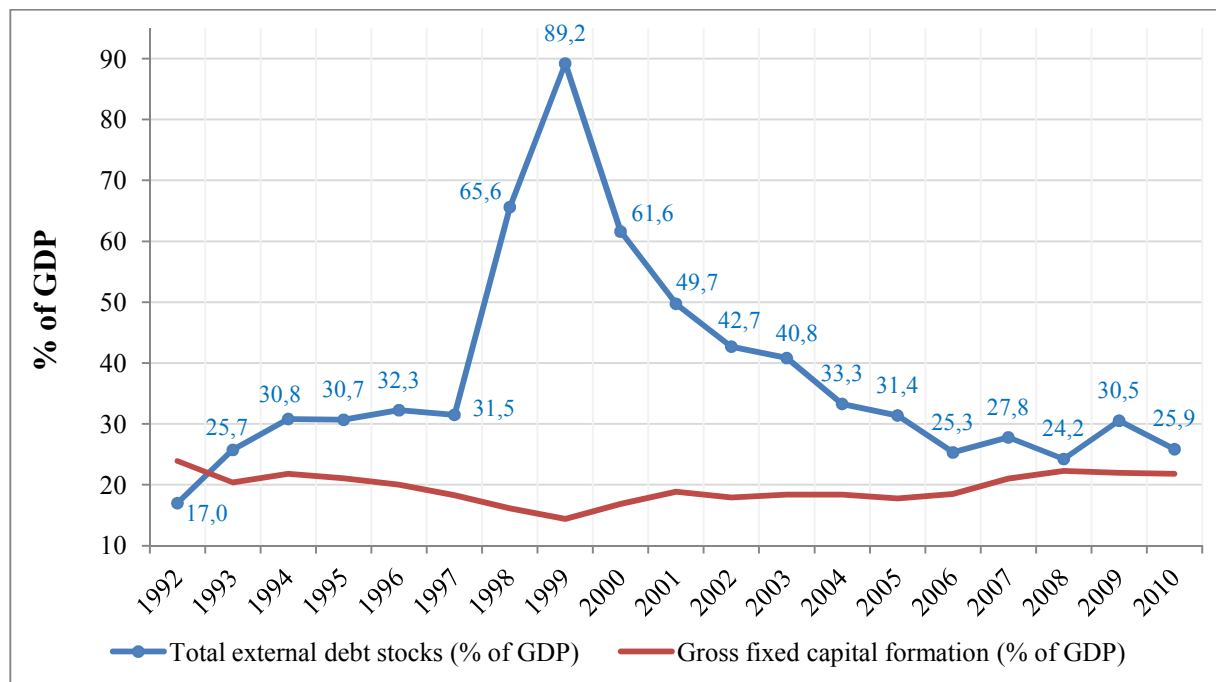


Source: The World Bank Group (2012)

Indicator 3: Russia's foreign debt dynamics

With the advancing globalisation process, the extent to which a country is dependent on external funds strongly determines its room for manoeuvre in the international arena. Russia's total external debt therefore is seen as an important indicator for the country's economic performance. As illustrated in Figure 4, the share of external debt in Russia's GDP has doubled between 1992 and 1997. In the following two years, the share increased steeply and almost tripled its value in 1999 as a result of the Asian economic crisis. We see how it decreased since 2000 and stabilised around 25-30% in 2005, which roughly corresponds to the share of gross fixed capital formation. In this regard, in 2006 at latest, Russia's external debt mainly flew into its own productive capacity and thus was used to boost the economic performance rather than borrowed for consumption.

Figure 4: Russia's total external debt and gross fixed capital formation (% of GDP), 1992-2010



Source: *for gross fixed capital formation:* The World Bank Group (2012);
for the share of total external debt in GDP: own calculation based on “External debt stocks, total (DOD, current” as a share of “GDP (current US\$)” provided by The World Bank Group (2012)

Summary of Russia's economic power sources dynamics

Comparing the three indicators for Russia's economic power sources measured above, three observations are made: First, Russia's GDP dynamics generally reflect the price formation of crude oil prices and prices for its gas exports. This suggests that the Russian state's economy

is largely dependent on both oil and gas exports, as well as their pricing. Second, the share of Russia's external debt in its GDP naturally depends on the real GDP development: the higher the GDP, the lower the share of foreign debt. Third, the dynamics of all three indicators denote a positive development for Russia since 1999/2000. Consequently, the size of Russia's economic power sources has increased in the 2000s as compared to 1990s.

Furthermore, the higher oil and gas prices in the 2000s reinforced Russia's GDP and net profits from oil and gas exports by 'flooding' its economy and state budget with 'petrodollars'. We may therefore expect the state to try to influence its energy sector to its advantage, seeking to control the gas production and reserves, as well as exports to secure higher revenues.

4.1.2. Political power sources

The extent to which the Russian state succeeded in establishing control over its gas sector throughout the years 1991-2011 is measured by an analysis of its relationship with the Open Joint Stock Company (OAO) "Gazprom"¹⁶, on the one hand, and by a study of the latter's role in the Russian gas sector, on the other hand. The reasons for choosing this approach are twofold.

First, Gazprom has traditionally been the largest player in Russia's gas industry. At the time of writing, the company is one of the world's largest energy companies engaged in natural gas¹⁷, gas condensate and oil prospecting, production, transmission, processing and marketing both inside and outside Russia as well as in power generation (OAO Gazprom, 2012a). It holds about 18% of the world's gas reserves and accounts for about 15% of its gas production. On the domestic market, Gazprom holds exclusive rights in the transportation and export of gas; it accounts for about 78% of the Russian gas output and 17% of its power generation (OAO Gazprom, 2012b). It significantly contributes to the state's GDP (7.96% in 2010)¹⁸, and accounted for 7.7%¹⁹ of Russia's 2010 consolidated budget. Moreover, about 60% of its output is sold on the domestic market at highly subsidised prices, which backs the

¹⁶ The term OAO "Gazprom", or "Gazprom", is used here to refer to the "Gazprom Group", i.e. to the head company Open Joint Stock Company "Gazprom and its subsidiaries taken as a whole.

¹⁷ Recently, it has been ranked the leader of the world's most profitable companies in 2011 by Forbes magazine (Autonomous Non-Profit Organisation (ANO) "TV-Novosti", 2012).

¹⁸ Own calculation based on Gazprom's net sales as presented on the company's Website and Russia's GDP value for 2010 as provided by the Russian Federal State Statistics Service, available on: http://www.gks.ru/bgd/regl/b12_06/IssWWW.exe/Stg/d01/04-01.htm.

¹⁹ Own calculation based on Gazprom's total cash taxes paid as presented in *Gazprom Databook 2011*, available on: www.gazprom.com/f/posts/51/402390/gazprom-databook-9m-2011-en.xls, and Russia's consolidated budget as presented by the Russian Federal State Statistics Service, available on: http://www.gks.ru/bgd/regl/b11_12/IssWWW.exe/stg/d02/23-01.htm.

Russian energy-intensive economy (EurActiv, 2012).

Second, after the dissolution of the Soviet Union, Russia's transition to an open market economy has led to liberalisation attempts of the gas market. But with increasing energy prices in the early 2000s, the government re-asserted control over Gazprom and hence, given the figures stated above, over the whole gas sector.

If, thus, one aims to analyse the Russian state's control over its gas industry, both the Kremlin-Gazprom relationship as well as Gazprom's market position provide a good insight.

Gazprom and the Russian government

The relationship between Gazprom and Russia's central government can be regarded as occurring on two levels: first, the state holds a certain share of the company's capital, while, second, it has the right to nominate members of Board of Directors²⁰ who are then elected by all shareholders in the General Shareholders Meeting. Depending on the ownership stake and the ratio of board members nominated by the government, the Kremlin's ability to influence Gazprom's strategies and tactics varies.

The state's ownership stake

Gazprom takes its roots in the Ministry of Gas Industry of the USSR, which, under the leadership of Viktor Chernomyrdin, was reorganised into the State Gas Concern Gazprom in 1989, with Chernomyrdin becoming its first chairman. Following Presidential Decree No. 1333 of November 5, 1992²¹, the State Gas Concern Gazprom was 'privatised' and transformed into the Russian Joint Stock Company (RAO) Gazprom in February, 1993. At that time, 100% of the company's shares of stock were owned by the state (OAO Gazprom, 2012a). Following the General Shareholders Meeting in 1998, RAO Gazprom was reorganised into the Open Joint-Stock Company (OAO) Gazprom (OAO Gazprom, 2012c).

Figure 5 shows the Russian government's ownership stake in Gazprom in relation to the organisation of the company over the observation period of 1991-2011. The state had full control of the company throughout the years 1991-1992, when it was a State Gas Concern. Following the reorganisation in 1993, Gazprom's stocks were gradually distributed to other shareholders, such as the company's employees or other legal entities, while the state enshrined its right on 40% in the Council of Ministers' Resolution No. 138 until 1999.

²⁰ According to Gazprom's Statute, the right to nominate candidates for the Board of Directors is enabled by a 2% ownership stake and above.

²¹ The Presidential Decree No. 1333 "On the Transformation of State Gas Concern "Gazprom" into the Russian Joint Stock Company "Gazprom" (RAO Gazprom)" was accordingly confirmed by a Resolution of the Council of Ministers of the Russian Federation No. 138 on February 17, 1993.

However, according to Poussenkova (2011), the government signed a Trust Deed with the then chairman of Gazprom's Board of Directors, Rem Viakhirev, under which 35% of the state's sharing stakes were transferred in the latter's personal trust.

With the adoption of Federal Law No. 69 in 1999²², the state's share in Gazprom's ordinary stocks was prescribed to amount to at least 35%, while the nominal share of foreign citizens or organisations to not exceed 20% (Art. 15 of FL-No. 69). In reality, the state succeeded in keeping 39.262% of Gazprom's stocks throughout the years 1999-2005 either directly, or via the Federal Agency for Federal Property Management and the state-owned OAO "Rosgazifikatsiya". Finally, following Federal Law No. 182²³ of December 2005, under President Putin, the Kremlin re-gained its control over Gazprom by acquiring a 'controlling stake' of 50% + 1 ordinary stocks (50.002% share). In particular, this law followed after 10.74% of Gazprom's shares were handed over to the state-owned OAO "Rosneftegaz" (OAO Gazprom, 2006, p. 68). By the same law, restrictions to foreigners were abolished for the purpose of 'liberalisation' of the Gazprom stocks.

The state's influence via personal relationships

While the state managed to re-gain legal control over Gazprom throughout the 2000s, political control over the company's management was re-established earlier. As a shareholder with significant stakes in the company's stocks, the government, among other shareholders, nominates candidates for Gazprom's Board of Directors. Starting in 1993, four out of eleven elected members were government representatives. With Putin's election to President of the Russian Federation, however, their number was increased to five in 2000 and since 2002, six out of eleven members represent the state²⁴ (cf. Poussenkova, 2011). Moreover, within Putin's first two years of presidency, both the chairman of the Gazprom Board of Directors and the chairman of the Managing Committee were replaced by Putin's adherents Dmitry Medvedev and Alexey Miller, respectively. Finally, as Nemtsov & Milov (2008) note, in 2008, 11 out of 18 members of the Board holding key positions were people who can be identified as Putin's followers: in the 1990s, they worked either in the St. Petersburg administration, or at

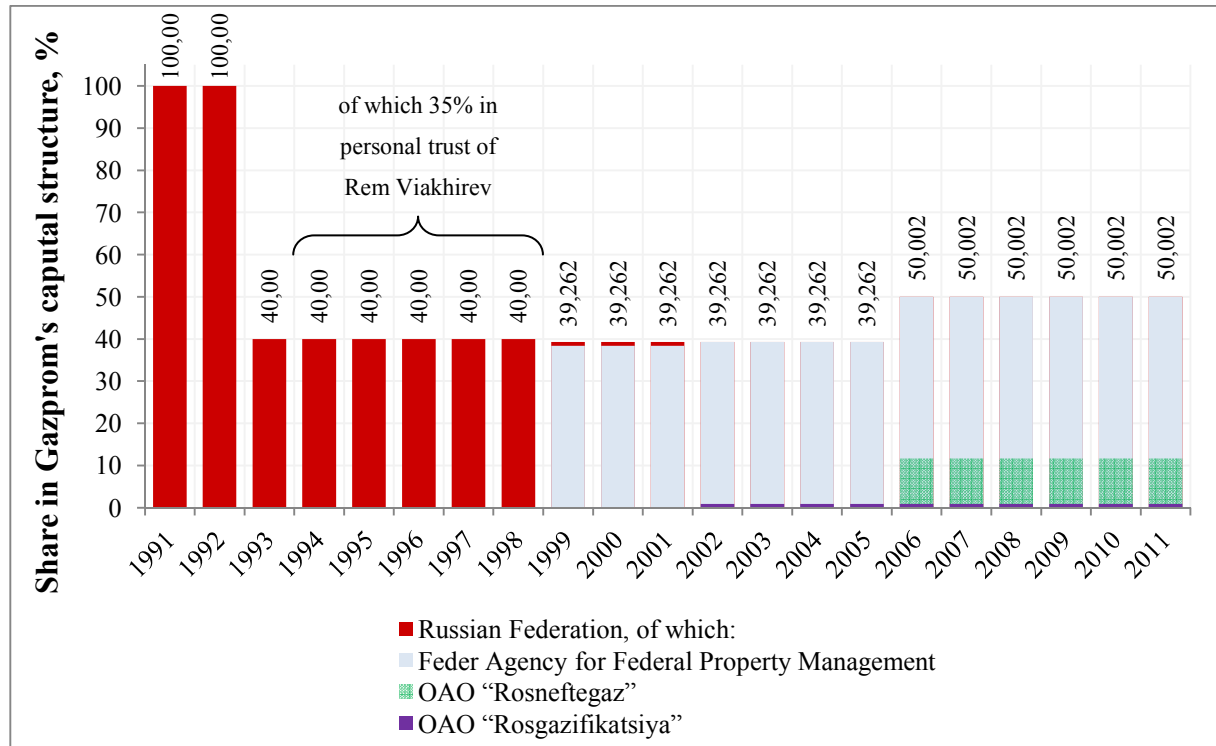
²² Federal Law No. 69 of March 31, 1999 (Federal Law Bill No. 98048258-2): "On gas supplies of the Russian Federation".

²³ Federal Law No. 182 of December 23, 2005 (Federal Law Bill No. 230195-4) changed Art. 15 of FL-No. 69 as described above.

²⁴ This, however, is neither enshrined in the company's Statute, nor prescribed by law, but is rather better explained by personal relationships (i.e. Putin and his influence).

OAo “Sea Port St. Petersburg”, or in some commercial structures of St. Petersburg, or in Russia’s FSB²⁵.

Figure 5: The Russian state’s share in the capital structure of Gazprom, 1991-2011



Sources: for 1991-1992 figures: OAo Gazprom (2012a);
 for 1993-1998 figures: Art. 6(4) of Resolution of the Council of Ministers of the Russian Federation No. 138 of February 17, 1993;
 for figures from 1999 onwards: OAo Gazprom (2001; 2005; 2006; 2007; 2008; 2009; 2010; 2011; 2012f)

In this respect, we can conclude that both levels of government control over Gazprom, i.e. stake ownership and leadership appointment, have been actively (re-)established since 2000. We can hence reasonably assume that Gazprom’s decision-makers are acutely aware of the Kremlin’s policy goals. The following section analyses whether the government’s control over Gazprom in fact enables the state to control the gas sector with respect to resources, production, export and revenues.

Indicator 4: Control over gas resources

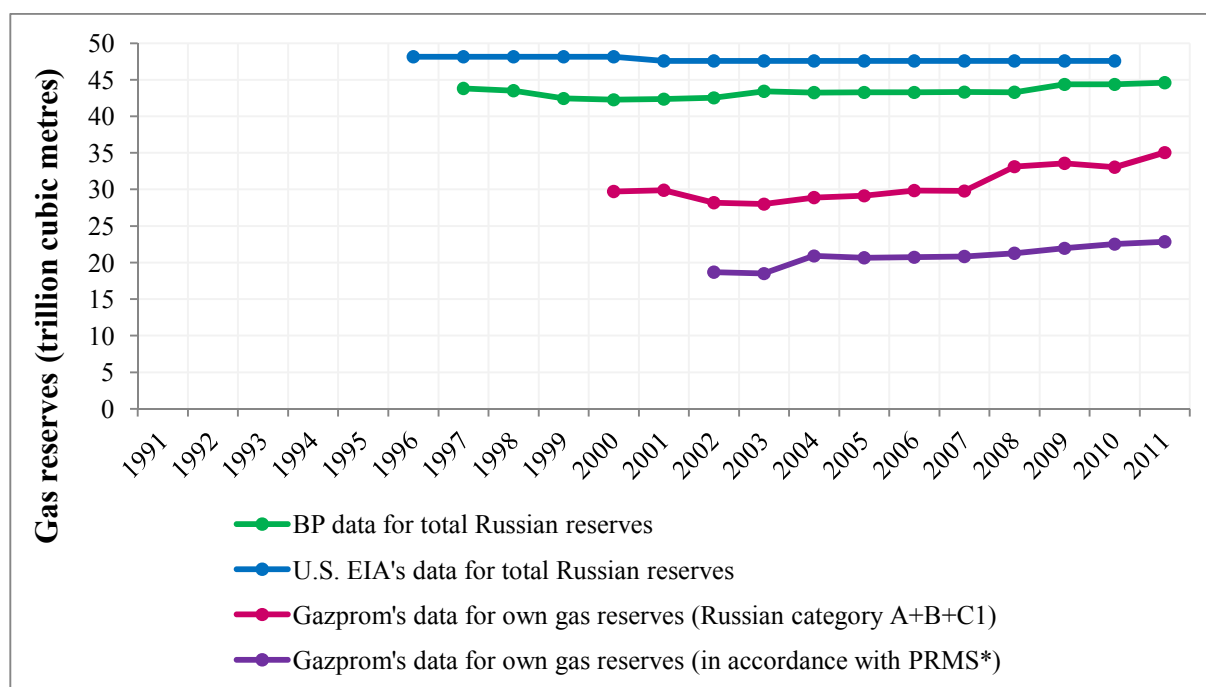
While the state owns the legal right of disposal (*Ius possidendi*) over the subsoil within the territory of the Russian Federation²⁶, it grants licenses for their ‘use’ (*Ius utendi*) and

²⁵ Similarly, Putin’s ‘siloviki’ hold key positions in other ‘strategic’ sectors, such as oil, media, metallurgies, or weapon exports (cf. Bilgin, 2011).

‘possession’ (*ius possessionis*) for the purpose of extraction of natural resources by adopting respective federal laws.

In this light, Figure 6 illustrates the total Russian gas reserves explored under the granted licenses so far as well as their volumes controlled by Gazprom.

Figure 6: Total Russian and Gazprom's gas reserves, 1996-2011



* PRMS stands for Petroleum Resources Management System, which was developed by the Society of Petroleum Engineers in 2007 and which sets standards for the classification of hydrocarbon reserves as proved, probable, and possible with regard to the economic efficiency of their production. In contrast, the Russian system of reserves assessment is divided into the explored reserves (categories A, B, C₁), preliminary estimated reserves (category C₂), in-place resources (category C₃) and forecast resources (category D₁, D₂) (see OAO Gazprom, 2012d).

Sources: *for BP data*: BP p.l.c. (2012);

for EIA's data: U.S. Energy Information Administration (n.d.);

for Gazprom's reserves:

2000-2001: International Energy Agency, 2002, p. 111;

2002-2011: OAO Gazprom (2005; 2006; 2007; 2008; 2009; 2010; 2011; 2012f)

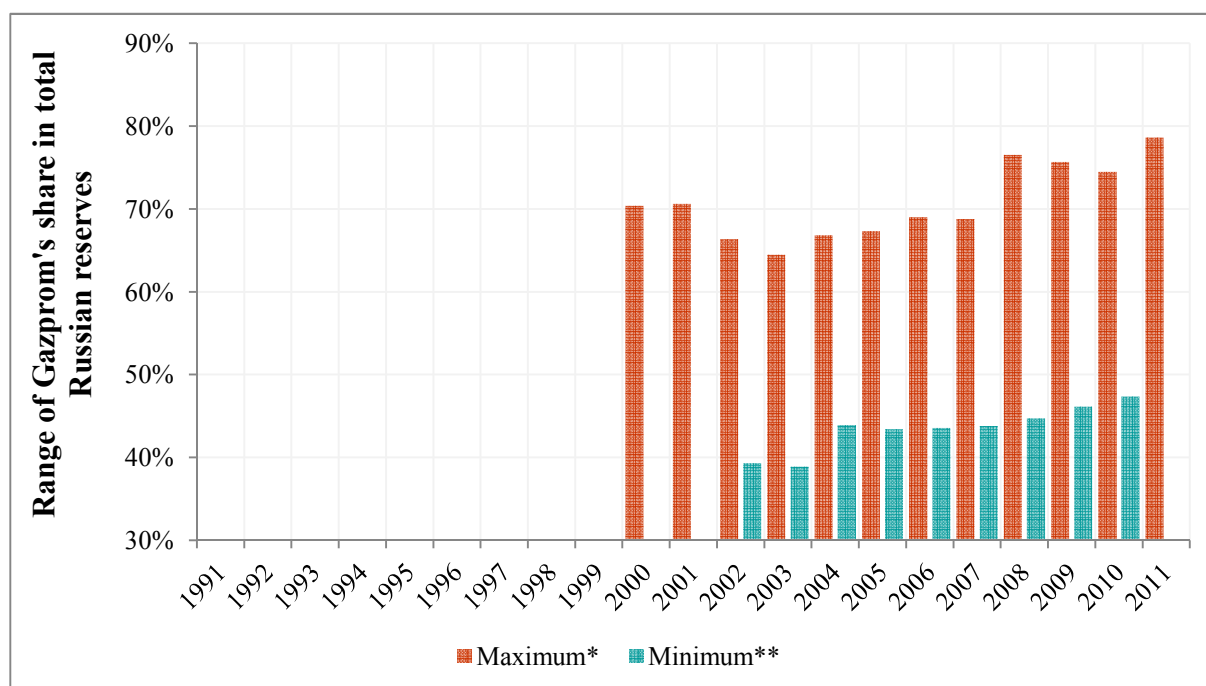
At the time of writing, official data by the Russian Federal State Statistics Service are not available, while data by international official sources varies (as reflected by data provided by BP and U.S. EIA). Moreover, the data is not available for the whole observation period and the categorisation of proven gas reserves varies between the Russian and international

²⁶ Art. 1-2 of Federal Law No. 27 of March 3, 1995 "On Subsoil".

evaluation standards. This results in a potential incomparability of data for calculating Gazprom's share in Russia's total gas reserves. As Figure 7 indicates, the respective Gazprom's share ranges between a minimum of approx. 40% and a maximum of approx. 80%, albeit the minimum values are rather unlikely taking into account Gazprom's 'lion's' share in total Russian gas production presented below.

Nevertheless, we can derive from these figures that, first, Gazprom's control over gas reserves has increased slightly both in absolute and relative terms (at least throughout the 2000s), and second, even with a share of approx. 40%, the company is likely to be Russia's largest single gas reserves holder. Based on this, we can conclude that the state has a major share of its total gas reserves which has grown in the 2000s.

Figure 7: Gazprom's share in total Russian gas reserves, 2000-2011



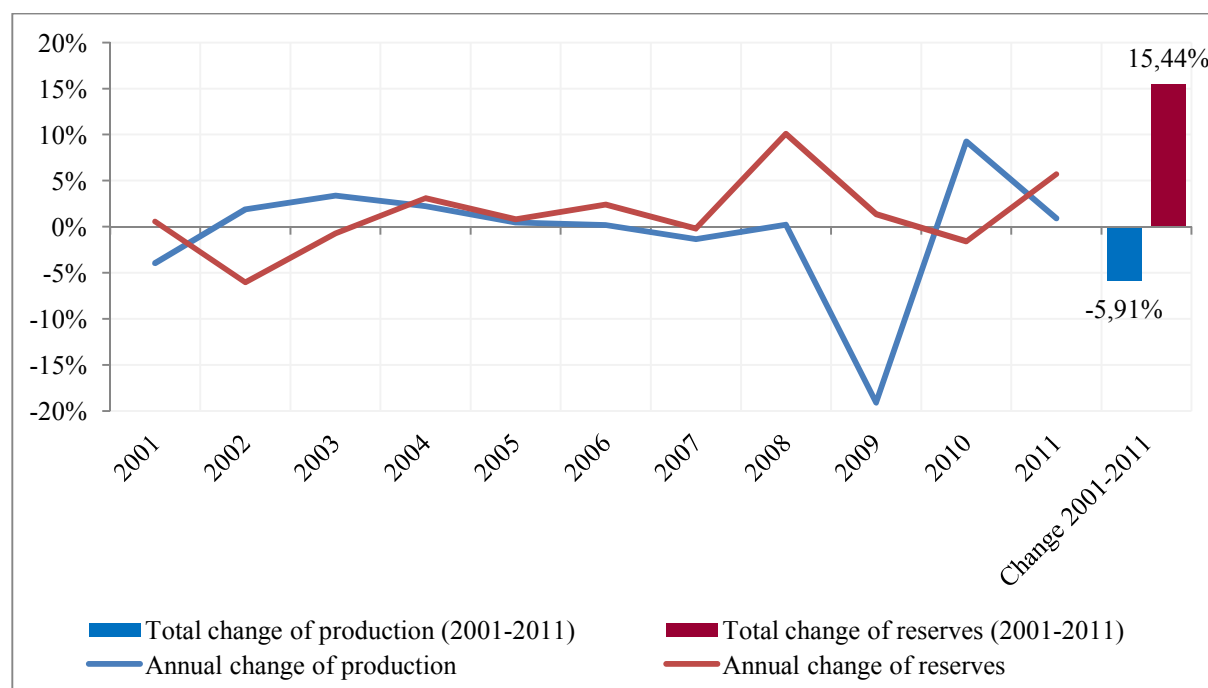
* *Maximum values* are calculated as a share of Gazprom's data for own gas reserves (Russian category A+B+C1) of BP's data for the total Russian reserves.

** *Minimum values* are calculated as a share of Gazprom's data for own gas reserves in accordance with PRMS of U.S. EIA's data for the total Russian reserves.

Despite the missing data for the pre-2000 time period, the literature addressing Gazprom's reserves points out that particularly in the 2000s, the government actively backs the company's position in the market. With respect to foreign legal entities seeking licences, Heinrich & Pleines (2012, p. 4) argue that the state gives an increasingly privileged role to Russian companies. While, as Poussenkova (2009, p. 7) notes, state-owned companies are

granted preferential access to particularly efficient gas fields. More precisely, with the adoption of Federal Law No. 120 of July 18, 2008, Art. 10 and 12 of Federal Law No. 69²⁷ were changed such as to allocate fields of major significance for Russia (strategic federal fields) to state-owned companies without any tender²⁸. In 2007, the Ministry of Energy and Industry made a list of 37 strategic gas fields, containing total gas reserves of about 11 tcm (cf. Poussenkova, 2009, p. 7), which explains Gazprom's growing reserves volumes presented in Figures 6 and 7. Yet, as will be argued below, Gazprom's production volumes are decreasing. Figure 8 illustrates the annual and total changes in the company's production and reserves volumes between 2001 and 2011. While production fell for about 5.9% in total during these 10 years, Gazprom acquired licenses which increased its reserves for about 15.4% in total. Having regard to the licenses duration of 20 years, such a development suggests that Gazprom is actively securing resources in order to guarantee future production levels and maintain its quasi-monopoly in the Russian gas sector, thus limiting competition by the help of the Russian government.

Figure 8: Comparison of Gazprom's production and reserves dynamics, 2001-2011



Sources: *for Gazprom's reserves*: 2001: International Energy Agency, 2002, p. 111, 2002-2011: OAO Gazprom (2005; 2006; 2007; 2008; 2009; 2010; 2011; 2012f); *for Gazprom's production*: OAO Gazprom (2005; 2006; 2007; 2008; 2009; 2010; 2011; 2012f)

²⁷ Federal Law No. 69 of March 31, 1999 (Federal Law Bill No. 98048258-2): "On gas supplies of the Russian Federation".

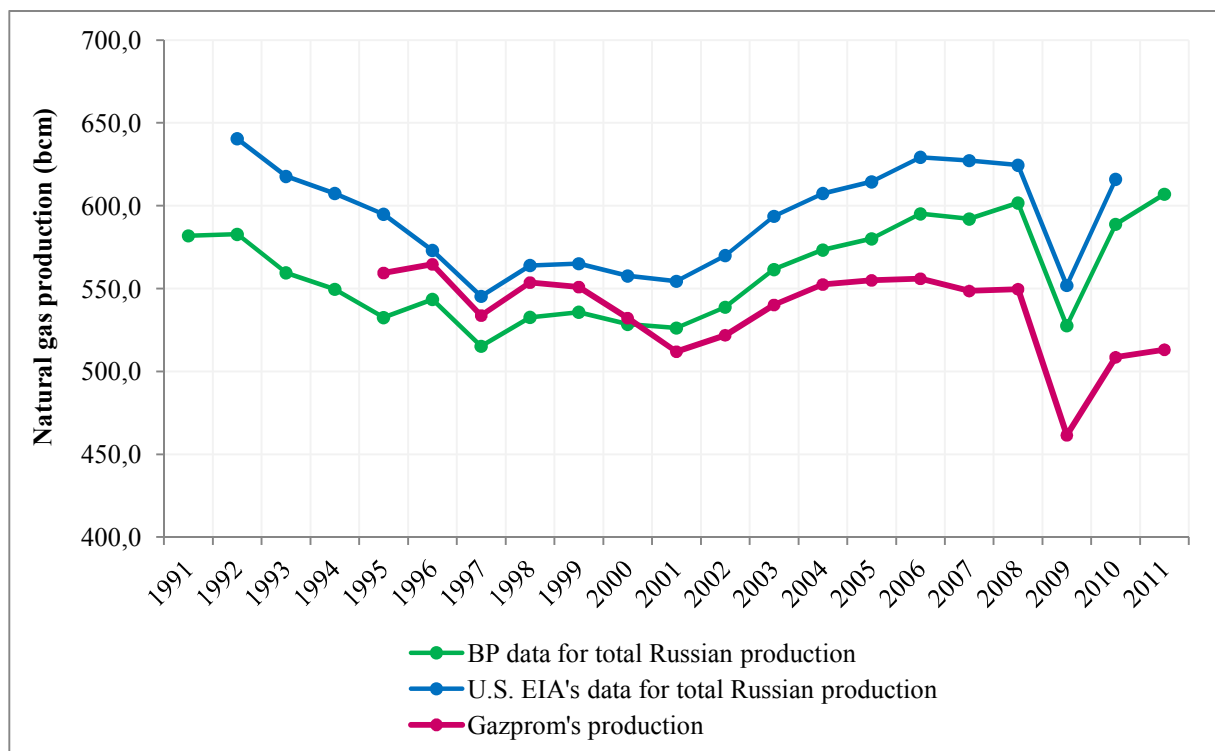
²⁸ Accordingly, fields having reserves of more than 50bcm of gas were identified as 'strategic federal fields'.

Indicator 5: Control over gas production

Russia's total natural gas production, as well as Gazprom's production, are presented in Figure 9. Here, again, official data by the Russian Statistics Service are not available, and data by international official sources varies (BP and U.S. EIA). Nevertheless, we can deduce that Gazprom strongly dominates Russia's total gas production (about 70-80%) throughout the whole observation period.

Both figures for the total Russian, and for Gazprom's gas production show a gradual decline throughout the 1990s and a subsequent gradual increase in production throughout the 2000s until the world financial crisis in 2009, where the volume of produced gas fell significantly, but increased again quickly in 2010-2011.

Figure 9: Russia's natural gas production, 1991-2011



Note: Figures from different sources may not be comparable.

Sources: for BP data: BP p.l.c. (2012);
 for EIA's data: U.S. Energy Information Administration (n.d.);
 for "Gazprom's" production:
 1995-1999: International Energy Agency, 2002, p. 112;
 2000-2011: OAO Gazprom (2005; 2006; 2007; 2008; 2009; 2010; 2011; 2012f)

However, what we can also see is that, starting in 1998, Gazprom's dominance in the Russian production is decreasing, which is explained by the fact that the company's main production

fields are in decay²⁹. Moreover, according to Poussenkova (2009, p. 6), Gazprom was able to maintain its production levels in the 2000s only by establishing control over other formerly independent producers rather than by opening new gas fields³⁰.

While the trend for declining Gazprom's production may indicate a weakening of the state's direct control over production in the years to come, indirect control is kept via the Unified Gas Supply System (UGSS) - the world's largest gas transmission system which incorporates a "unique complex of gas extraction, processing, transmission, storage and distribution facilities" (OAO Gazprom, 2012d). Gazprom was charged with control over the operation of UGSS already in 1993 (Art. 3 of Resolution of the Council of Ministers of the Russian Federation No. 138) and has never been relieved from this duty since. In this manner, 'independent' Russian gas producers are dependent on Gazprom in order to deliver their gas to the end consumer, which gives Gazprom the ability to deny access to the UGSS.

In March 1999, Gazprom was legally 'forced' to open up the UGSS for independent gas producers. Art. 27 of Federal Law No. 69 prescribed that the "organisations-owners of the gas supply systems are required to provide non-discriminatory access to any organisations active in the Russian Federation, to the free capacities of their gas transmission and distribution networks in the manner prescribed by the Government of the Russian Federation". Yet, the law failed to define how to measure the congestion of gas transmission pipelines of the UGSS, which reserves Gazprom the right to refuse pumping 'independent' gas when referring to the limited transmission capacity. Here, Poussenkova (2011), for instance, notes that in 2003, Gazprom denied access to the independent "ITERA Group"³¹ to make use of the UGSS. Moreover, Art. 21 of the same law allows Gazprom as the owner of the UGSS to define the internal transportation tariffs³², in other words to provide discounted tariffs to its affiliated companies (the shippers of gas through the UGSS). As a result, independents assert that they

²⁹ Such as Urengoi, Yamburg, Medvezhe and Zapolyarny (cf. Bilgin, 2011).

³⁰ Such as for instance Zabsibgazprom, Vostokgazprom, Purgas and Severneftegazprom in 2002; Sevmorneftegaz, Purgazdobysha and Stimul in 2004; Irkutskgazprom and Northgas in 2005; and Sibneftegas in 2006 (cf. Poussenkova, 2009, p.6). Also in 2006, Gazprom bought 19.4% of the shares of Russia's second largest independent gas producer Novatek.

³¹ ITERA was established in 1992 in Florida, USA. Originally a commodities trading company, it has been involved in marketing natural gas from Central Asia in the CIS and the Baltic States since 1994, which made it the second largest gas trading company in Russia in the late 1990s. In 1996-1998, ITERA began to develop production of gas by purchasing a number of large gas fields in North Russia; however, in the early 2000s, Gazprom largely denied ITERA access to the UGSS and re-granted it only after ITERA signed a cooperation agreement with Gazprom (cf. Poussenkova, 2011) which, among other things, included a joint development of Beregovoye gas condensate field whose reserves amount to 319.22 bcm of natural gas, 4.94 MM tons of gas condensate and 7.53 MM tons of oil. For further information, please see ITERA's Websites: "Itera USA": <http://www.itera.com/> and "Itera Russia": <http://www.itera.ru/isp/eng/>.

³² However, Gazprom does not have to provide information on these internal tariffs.

not only have been facing difficulties accessing the UGSS, but are also confronted with discriminative treatment compared to Gazprom's affiliated companies (cf. Tsakiris, 2011, p. 42).

Indicator 6: Control over gas exports

Until 2006, the export of gas has been primarily arranged by two major players – OAO Gazprom and the “ITERA Group”. While Gazprom concentrated on customers in Europe, ITERA was active in re-exports of Central Asian gas to other CIS and Baltic countries (cf. International Energy Agency, 2002, pp. 110-111, 135). At least in terms of export volumes to CIS countries, ITERA became almost as large a player as Gazprom.

Yet, with the adoption of Federal Law No. 117³³ in 2006, the Russian government assigned exclusive rights on natural gas exports to the “organisation-owner of the ‘Unified Gas Supply System (UGSS)’ or its affiliated society of which the UGSS owns a 100% share of nominal capital”. In other words, Gazprom acquired a legally backed monopoly on Russian gas exports³⁴, which are executed via Gazprom's 100% subsidiary “Gazprom Export”.

Indicator 7: Effective management of resource revenues

Although the Kremlin has some measure of control over Gazprom, the question remains whether Russia's gas sources can actually be converted into real political power and the state's interests in accordance with Table 3. Answers to this question will be given by analysing the SWF and Russia's taxation policy with regard to the gas sector.

Russia established the Federal Stabilization Fund on January 1, 2004 as part of the federal budget in order to balance at the times when the oil price falls below a previously set cut-off price (Ministry of Finance of the Russian Federation, n.d. (a)). In 2008, the Stabilization Fund was split into two: the National Wealth Fund and the Reserve Fund. The latter substitutes the Stabilization Fund; however, in contrast to Stabilization Fund, the Reserve Fund “accumulates not only federal budget revenues from production and export of oil, but also revenues from production and export of natural gas and oil products” (Ministry of Finance of the Russian Federation, n.d. (b)). The maximum size of the Reserve Fund is limited to 10% of the Russian Federation GDP forecasted for the corresponding fiscal year. The Fund served as a financial cushion in the 2009 world financial crisis (cf. *ibid.*).

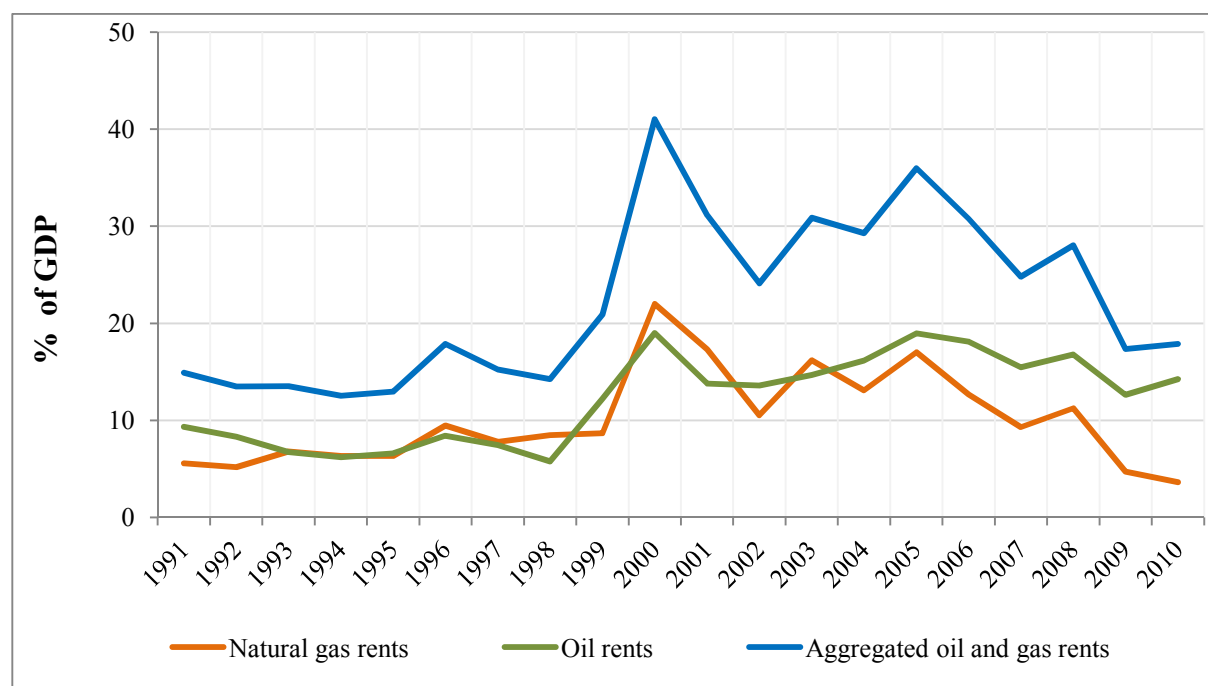
³³ Federal Law No. 117 of July 18, 2006 (Federal Law Bill No. 305993-4): “On gas exports”.

³⁴ Except for gas extracted on the basis of Production Sharing Agreements (PSA).

Figure 10 and Figure 11 illustrate the role of natural resources for Russia's GDP formation³⁵. Particularly, the natural gas and oil rents together aggregated to about 14% of Russia's GDP in its recession period (1991-1998), and to about 28% in the recovery period (1999-2010), with a peak of 41% in 2000 (Figure 10), which corresponds with the 2000 peak in Russia's annual GDP growth (Figure 3). Moreover, revenues from natural gas and crude oil exports accounted for about 6% of GDP in total during the recession period, while equalling about 14% in the recovery period (Figure 11). The value for natural gas and crude oil exports constitutes about a half of the value for Russia's total goods and services exports.

However, with increasing GDP values, and in particular since 2000, the shares of natural gas rents and revenues from exports in Russia's GDP are slightly, but constantly decreasing, while the same shares of crude oil are more or less stable. These figures cannot be attributed to a privileged taxation of the gas sector, though. Rather, the growth in oil production reflects the GDP development more than the gas sector does. Between 2000 and 2011, Russia's oil production increased for about 58%, while its gas production increased 'only' for about 15% (BP p.l.c., 2012), the taxes and duties collected from the oil sector therefore are higher than those collected from the gas sector.

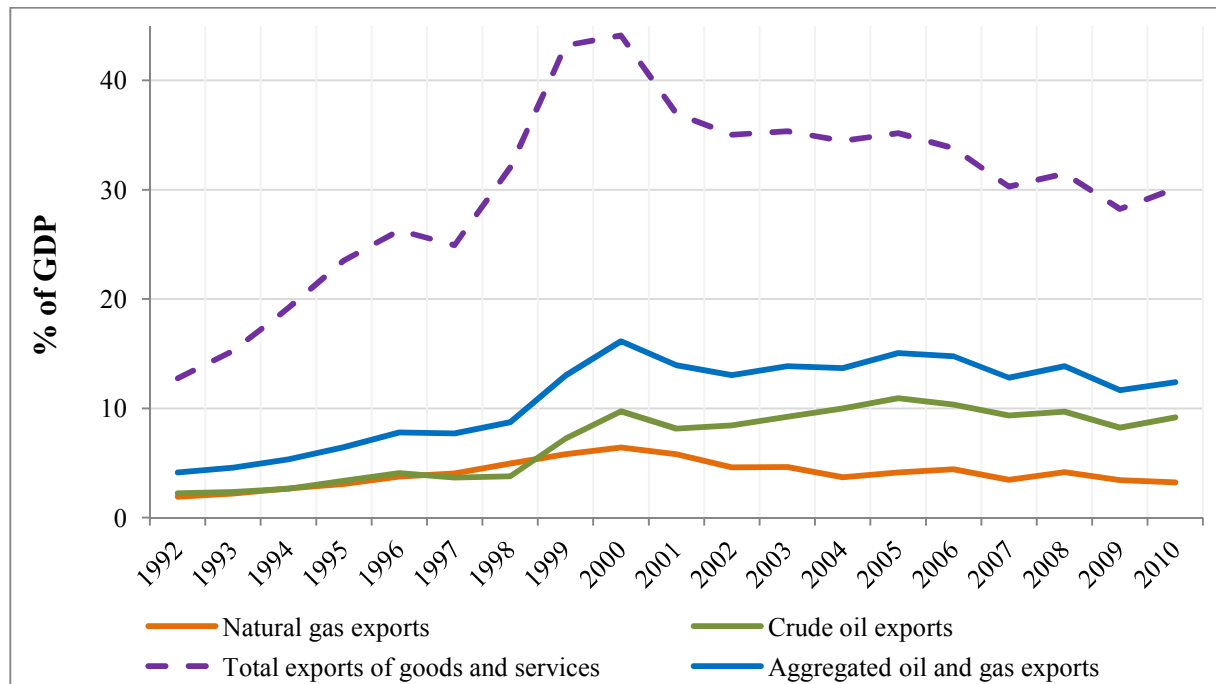
Figure 10: Russia's Natural resources rents (% of GDP), 1991-2010



Source: The World Bank Group (2012)

³⁵ Unfortunately, because publications on Russia's consolidated budget by the Russian Statistics Service as well as by the Federal Treasury combine financial receipts from the oil and gas sector together with other energy sectors as receipts from the 'natural resources sector', a reconstruction of the share of the gas sector in Russia's budget could not be established. It is therefore difficult to fully comprehend the state's management of revenues from gas. For this reason, Russia's GDP is chosen as a substitute for budget.

Figure 11: Russia's gross revenues from crude oil and natural gas exports (% GDP), 1992-2010



Source: Own calculation based on data from the Bank of Russia (2012)

Summary of Russia's political power sources dynamics

The empirical findings gained from the observation of Russia's political power sources can be summarised as follows. First, the government re-asserted control over Russia's gas 'giant' Gazprom throughout the 2000s, by securing the majority of seats in the company's Board of Directors in 2002, as well as by acquiring a 'controlling' share of 50.002% of its stakes in 2006. Second, taking into account the missing data for the 1990s, the data for 2000s denotes that Gazprom holds a large and constantly increasing share of Russia's natural gas reserves. At the same time, the company has been Russia's largest gas producer while controlling the UGSS transportation system throughout the whole observation period. Indirectly, this means that by acquiring control over Gazprom, the Russian government gained control over its gas sector with respect to resources and production. Third, since 2006, Gazprom holds a monopoly in exports of Russian gas, which provides the state with an additional power source for its foreign policy configuration. We can therefore conclude that Gazprom is regarded by the Kremlin's as an instrument for domestic as well as foreign policy goals, in exchange of privileged licences for lucrative production fields, or exclusive transportation and export rights. Finally, the measurement of the 'effectiveness' of Russia's gas sector management denotes that while the established SWF served as a cushion in the recent economic crisis, no

significant changes with regard to the management of gas rents and revenues have been observed.

4.1.3. Preliminary conclusions

The thesis expected the size of Russia's economic and political power sources with respect to its gas sector to increase significantly in the 2000s as compared to the 1990s. This expectation was met. The Russian economy has considerably profited from the increased world prices in the 2000s, as denoted by GDP growth and the reduction of external debt used for consumption. At the same time, central control over the gas sector was re-established by means of increased influence on the state's largest gas company, Gazprom, whose strong market position with respect to resources, production and exports was secured via the Kremlin's executive and legislative powers. By doing so, the state was able to convert its enhanced economic performance into political power.

As the Neorealist school of International Relations proposes, an increase in a state's power resources leads to lower willingness to cooperate internationally. The extent to which the level of cooperation between Russia and the EU in gas-related matters has decreased will be analysed below.

4.2. Level of cooperation in the EU-Russian gas relations

In accordance with Table 2, the level of cooperation is measured by using five units of observation: 1) Russia's ratification process of the ECT, 2) negotiation process for a new agreement replacing the PCA, 3) outcomes of the EU-Russia Energy Dialogue, 4) Russia's 'divide-and-rule' behaviour, and 5) possible single conflicts.

4.2.1. Ratification of the ECT

The Energy Charter Treaty established a multilateral legal framework for cross-border energy cooperation. It was signed on 17 December 1994 by 51 states and the European Communities (EC and Euratom) on 16 December 1997; after ratification by 30 states, it entered into force in April 1998 together with its Protocol on Energy Efficiency and Related Environmental Aspects. The ECT's primary goal is to encourage and facilitate international energy cooperation by achieving several objectives that are spread across various provisions, including: investment protection; trade in energy, energy products and energy related equipment, based on the WTO rules; freedom of energy transit; improvement of energy efficiency; international dispute settlement, including investor-state arbitration and inter-state arbitration; and improved legal transparency (cf. Energy Charter Secretariat, 2008).

The Russian Federation signed the ECT, but never ratified it³⁶. However, in accordance with Art. 45 (1) ECT, Russia applied the Treaty's terms on a provisional basis as they were not inconsistent with its constitution, laws or regulations. Yet, on October 19, 2009, the Russian state terminated the provisional application of the ECT, which means that it currently stays as a signatory, but with a different status.

The reasons for Russia's non-ratification and its eventual termination of the ECT's provisions are often attributed to effective lobbying by Gazprom. According to Ruud Lubbers, the initiator of the Energy Charter, and Andrey Konoplyanik³⁷, the head of the Russian delegation in negotiations on the ECT, Gazprom was the main opponent to the ECT, while representatives of the electric power and oil industries as well as the Russian government were the main supporters (Konoplyanik, 2002). Russia's ECT ratification process started in 1996. However, opponents of the ratification in the Russian State Duma (who, according to Konoplyanik, were influenced by Gazprom) provided several arguments against the ECT; the most frequent objections were threefold and referred primarily to trade with nuclear materials, to gas transit (in particular, non-discriminatory third-party-access to Russia's gas pipelines), and to long-term gas supply contracts (cf. Konoplyanik, 2010a, pp. 131-132). The objections related to gas both referred to Art. 7 ECT, which prescribes the principle of free transit without distinction as to the origin, destination or ownership of energy materials and products. In the opponents' view, this provision would enable and even enforce the transit of cheap Central Asian gas via Russia to Europe and thus diminish Russia's role in the European gas market. During the parliamentary hearings on the ratification of the ECT in January 2001, the Duma adopted a pragmatic and legally feasible solution: Russia's concerns regarding the transit provision of the ECT should be resolved in a special legally binding protocol on transit (cf. Konoplyanik, 2011, pp. 119-120). Now, the ECT ratification was coupled on the ratification of the Transit Protocol. By 2003, all disputes regarding the Transit Protocol have been resolved, except for two. Disagreement remained between Russia and the EU on the 'right of first refusal'³⁸ as proposed by Russia and the 'Regional Integration clause (REIO)'³⁹,

³⁶ Federal Law Bill No. 96043844-2.

³⁷ At that time, Konoplyanik worked in the Ministry of Fuel and Energy of the Russian Federation. He later became Deputy Secretary of the Energy Charter Secretariat.

³⁸ Refers to Art. 8 (4) of the 2003 Draft on Energy Charter Protocol on Transit, Part III on 'Utilisation of Available Capacity', which provides that in case the transit contract expires before the supply contract, the existing user of the expiring transit contract shall be given the first opportunity for the new transit agreement.

³⁹ Refers to Art. 20 of the 2003 Draft on Energy Charter Protocol on Transit, Part V on 'Regional Economic Integration Organisation' and to Art. 7(10)(a) of ECT; here, the EU aimed to be recognised as a regional economic integration organisation, which would enable it to bypass the ECT provisions and be treated as one

as proposed by the EU (cf. Haghighi, 2007, pp. 328-331). In the end, these disputes between the EU and Russia lead to the suspension of negotiations on the Transit Protocol in 2003 which, until now, have not been formally resumed (Energy Charter Secretariat, 2007).

Among the reasons for Russia's termination of the provisional application of the ECT – which, according to Talseth (2012, p. 12) was decided after intense pressure from the then Prime Minister Putin and his Vice Premier for energy Sechin⁴⁰ – two are most frequently articulated: (1) Russia's gas dispute with Ukraine in January 2009 and (2) the 'Yukos affair'. The first refers to Russia's dissatisfaction with the functioning of the ECT: in its view, Ukraine's violation of transit provisions under the ECT was neither assessed adequately by the EU and its Member States nor by the Energy Charter Secretariat (cf. Konoplyanik, 2011, p. 122). In contrast, the 'Yukos affair'⁴¹ refers to the lawsuit between the "Yukos" shareholders and the Russian Federation, which was enabled by Art. 26 ECT, providing the possibility for 'direct action' by foreign investors against the host country via international arbitration courts. It is often (arguably) claimed that Russia terminated the application of ECT provisions in order to avoid further similar lawsuits⁴² (cf. Konoplyanik, 2011, p. 131).

While the real decisive reason for Russia's termination of the provisional application of the ECT is not definite (transit / functioning of the ECT / intention to continue possibly discriminatory treatment of foreign investors), the level of cooperation on this observation unit can be identified nevertheless: (1) no cooperation took place in the years 1991-1994 (no ECT in place); (2) moderate cooperation established in the years 1994-2009 with Russia's signing and provisional application of the ECT; while (3) since 2009, cooperation can be regarded as absent again, as Russia terminated its provisional ECT application.

Moreover, Konoplyanik's works denote Gazprom's strong influence on the Russian politics at least in the late 1990s – the company's effective lobbying constrained the early ECT ratification process in Russia.

contractor party for the transit of gas on its entire territory; in other words, only the Union's provisions on the internal market would apply rather than ECT provisions.

⁴⁰ Igor Sechin is the former chairman of the state-owned oil company "Rosneft", which in late-2003 "swallowed most of YUKOS after Khodorkovsky's arrest and trial"; together with Putin, Sechin is regarded as the most powerful "chieftain" of Russia's energy sector (Talseth, 2012, p. 12).

⁴¹ Subject of the claim is discriminatory measures and expropriation of investments, in reference to Art. 13 ECT.

⁴² Albeit Russia terminated the provisional application, this action is not retroactive, and Russia in accordance with Art. 45 (3-b) ECT will be bound by the implementation of the investment provisions of the Treaty, as well as the procedures for resolving disputes, until 2029 (cf. Konoplyanik, 2011, p. 133).

4.2.2. *Negotiations on the new agreement*

The Partnership and Co-operation Agreement (PCA), signed in 1994 and in force since 1997, gives the EU-Russian general relations a legal basis⁴³. It was concluded for an initial duration of ten years with an automatic extension on annual basis given neither side withdraws (Art. 106 PCA). Its goal was to create an economic and technical assistance framework, to ultimately establish a free trade area with Russia and to further facilitate Russia's accession to the WTO (cf. Haghighi, 2007, p. 343). The PCA addresses the EU-Russian energy relations only slightly in Art. 65, stating that cooperation shall include, amongst others, the "improvement of the quality and security of energy supply", the "improvement in management and regulation of the energy sector in line with a market economy", and a "formulation of energy policy"⁴⁴. Following Russia's objection to ratify the ECT, the new agreement replacing the PCA initially anticipated incorporating the basic Charter's principles⁴⁵ and including "substantive, legally binding commitments in all areas of the partnership, including... economic cooperation... as well as solid provisions on trade, investment and energy" (European Commission, 2008). However, this rhetoric was abandoned in the course of negotiations.

Negotiations on the new agreement are headed by Permanent Representative of the Russian Federation to the EU Ambassador Vladimir Chizhov and Chief Operating Officer of the European External Action Service David O'Sullivan. They are conducted in four working groups, addressing energy in the group 'on sectoral economic issues', and subsequently reviewed at official plenary session meetings (cf. Permanent Mission of the Russian Federation to the European Union, 2012).

The talks are characterised by a relatively slow progress due to a number of controversies, which already marked the preparation of negotiations. The latter were expected to start in 2006, as agreed upon on the EU-Russia Summit in Sochi in May, 2006 (European

⁴³ Prior to the PCA, there existed a Trade and Co-operation Agreement (TCA) between European Communities and the Soviet Union, signed in 1989, and a single technical instrument – the TACIS-programme, initiated in 1991 (cf. Haghighi, 2007, p. 342, fn. 6).

⁴⁴ Agreement on partnership and cooperation establishing a partnership between the European Communities and their Member States, of one part, and the Russian Federation, of the other part, of 28 Nov., 1997, OJ L 327, retrieved June 21, 2012 from: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21997A1128%2801%29:EN:HTML>

⁴⁵ As urged by the European Parliament in its Resolution on the EU-Russia Summit in Khanty-Mansiysk on June 19, 2008 (P6_TA(2008)0309). Retrieved August 2012, from the Website of the European Parliament: <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2008-0309&language=EN&ring=P6-RC-2008-0235>.

Commission, 2006); yet, they were postponed due to the Polish and Lithuanian vetoes⁴⁶ to Commission's mandate on opening negotiations. Only in 2008, following the EU-Russia Summit in Khanty-Mansiysk, negotiations were launched and are currently in process. Despite the limited information on details of ongoing talks, several events and issues are articulated as hampering the advancement of negotiations. These are not exclusively related to energy, but also include the Russo-Georgian war of August 2008; disputes over the human rights issues and visa abolishment; internal restructuring of the EU by the Treaty of Lisbon with respect to institutions and responsibilities, and the new customs regime between Russia, Belarus and Kazakhstan, which is in force since July 2011 (cf. Zagorski, 2011). With regard to gas, the unbundling regulation introduced by the EU's third energy package (see fn. 10) further added to already existent controversies on the ECT. However, what is more important, according to Zagorski (2011), is the divergence between Russia and the EU regarding the approach towards and the anticipated scope of the agreement. Here, Brussels is "aiming at a comprehensive and detailed instrument which would include directly applicable norms governing practical cooperation with Russia in the relevant subject areas" (Zagorski, 2011, p. 18). Naturally, the EU prefers such 'comprehensive' negotiations, as it tends to be most successful when dealing with multiple issues, thereby exchanging concessions in different areas and eventually putting together complex package deals (cf. Leonard & Popescu, 2007; Zagorski, 2011). Moscow, in contrast, prefers "a relatively short framework document outlining general principles of cooperation" in the respective subject areas, with detailed regulations to be addressed "in sectoral agreements complementing the treaty" (Zagorski, 2011, p. 18).

Thus, by the end of 2010, twelve negotiation rounds were completed, while the thirteenth round is yet to be launched (cf. Permanent Mission of the Russian Federation to the European Union, 2012). Here, both sides agreed that negotiations will be resumed after Russia's accession to the WTO, which is currently in ratification by the State Duma (ibid.).

In this light, with reference to Table 2 on the level of EU-Russian gas cooperation, we can conclude that: (1) no value can be assigned for the years 1991-2005 since the new agreement was not necessary; (2) between 2006 and 2008, the value of 'absent cooperation' is justified, as negotiations were postponed; (3) 'moderate cooperation' level denotes the ongoing

⁴⁶ The reasons for the Polish veto were Russia's rejection to ratify the ECT and its ban on Polish meat (EurActiv, 2007b), while Lithuania was frustrated by Russian plans to close the Druzhba-1 pipeline delivering Russian oil to the only refinery in the country, and additionally insisted on Russia's respect for the territorial integrity of Georgia and Moldova and on its effective cooperation in the field of justice and law enforcement (EurActiv, 2008).

negotiation process during the time period 2008-2010; and (4) since 2010, negotiations are in a 'waiting mode' for Russia's WTO accession and thus anew indicate 'absent cooperation'. Here, however, one should not over-estimate Russia's role in slowing down the negotiation process. Rather, both the EU and Russia are somewhat evenly responsible for the relative lack of dynamism.

4.2.3. EU-Russian Energy Dialogue

Based on the initiative of the President of the European Commission Romano Prodi, the EU-Russia Energy Dialogue was established at the sixth EU-Russia Summit in Paris on 30 October, 2000, arising from the notion that a dialogue was needed to accompany the anticipated boost of Russian fuel supplies to the EU in return for investment and technology transfer (cf. Voloshin, 2004). Its primary goal was to provide a forum for raising, and, respectively, resolving "all the questions of common interest relating to the [energy] sector" (European Commission, 2000). In more general terms, the Dialogue aimed to "provide reliability, security and predictability of energy relations on the free market in the long term and to increase confidence and transparency on both sides" (European Commission DG for Energy, 2009).

The structure of the Energy Dialogue consists of three to four thematic groups with representatives from the respective energy, economic, trade and financial ministries and departments from the EU and Russia, which are coordinated by senior officials of the European Commission and the Russian government (cf. European Commission DG for Energy, 2011). The progress of the Dialogue is assessed in progress reports which are published at the end of each calendar year.

In analysing the twelfth progress report, published in December, 2011, Talseth (2012, p. 3) criticises the Energy Dialogue for having "degenerated into a technical talk-shop between semi-empowered, semi-interested technocrats". In fact, the Dialogue never intended to be a regulatory framework; rather, it presents a platform where common interests are highlighted on the political level, while leaving the actual participation in the energy sector – in terms of upgrading the energy infrastructure, obtaining long-term gas contracts and building new energy transportation facilities – to the private sector and the energy companies (Haghighi, 2007). Yet, Talseth (2012) reasonably notes that the Dialogue is more of a rhetoric nature, while the real decisions affecting the EU-Russian energy trade are made outside its framework. Namely, they are made in Kremlin "by way of government representatives in Russian energy companies such as Gazprom" on the Russian side, while the EU energy policy

“is largely defined by national governments” (Talseth, 2012, p. 7). In this respect, the outcomes of meetings under the Energy Dialogue per se have limited value.

Nevertheless, the Dialogue has produced some achievements with regard to the EU-Russian energy cooperation level. Thus, in 2004, it has enabled Moscow and Brussels to find a compromise regarding subsidised energy prices on the Russian domestic market which was heavily criticised by the Union within the ECT and WTO framework (cf. Voloshin, 2004; Haghighi, 2007). Accordingly, Russian domestic prices shall approach the world level in the long term. As well, after years of negotiations, the Energy Dialogue has helped Russia to secure the importance of long-term contracts for the gas trade in 2005, while at the same time, it helped the EU to limit the so-called ‘destination clauses’ which prohibited importing countries to re-export Russian gas (cf. European Commission DG for Energy, 2011; Talseth, 2012).

Keeping in mind that the Energy Dialogue is primarily a platform for the exchange of information, its mere existence can be located somewhere between ‘absent’ and ‘moderate’ cooperation level. The most important outcomes of its meetings have taken place in 2004 and 2005, which denotes a rather ‘moderate cooperation’, since both the EU and Russia have achieved some non-binding concessions for the mutual gas trade.

4.2.4. *Russia’s ‘divide and rule’ strategy*

Importing about 60 per cent of its gas demand (BP p.l.c., 2010), naturally the European Union is aiming to diversify its supply sources and routes⁴⁷ in order to limit dependence on single producers. Russia, in contrast, is interested in securing and strengthening its international influence by means of energy (see Chapter 2). Maintaining its strong position as the Union’s largest single gas supplier thus not only guarantees stable revenues, but also limits the EU’s bargaining leverage. Because the single member states are differently dependent on gas in their national energy mixes, while they differ in their reliance on Russian gas⁴⁸, they often face difficulties to unite on a common position towards Russia or energy in general (cf.

⁴⁷ For the first time, diversification of gas supply routes and sources was called on by the European Commission’s Green Paper entitled “A European Strategy for Sustainable, Competitive and Secure Energy” [COM(2006) 105 final]. Available online on: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0105:FIN:EN:PDF> (Retrieved August, 2012).

⁴⁸ Several of the ‘new’ member states in Central and Eastern Europe rely exclusively on Russia for their gas imports and consumption, while others don’t import Russian gas at all, incl. Denmark, Sweden, Luxembourg or Portugal.

Leonard & Popescu, 2007; Noël, 2008). Hence, Moscow seeks to prevent the Union's diversification approach.

The Union's measures aimed at diversifying gas supply routes and sources include a better promotion of the liquefied natural gas (LNG) capacity, as well as the development of a Southern Corridor. The latter is directed at supplying natural gas from Caspian and Middle East sources bypassing Russia. The Southern Gas Corridor, also referred to as the NG 3 (Natural Gas Route 3) in the Trans-European Energy Network (TEN – E)⁴⁹ context, includes three proposed pipelines of strategic importance: (1) the White Stream, transporting natural gas from Georgia's Caspian region to Central Europe via Romania and Ukraine; (2) the ITGI (Interconnector Turkey-Greece-Italy); and (3) the Nabucco pipeline, a 'flagship' project, which is proposed to be fed with mainly Turkmen or Azeri gas and running from Turkey via Bulgaria, Romania, and Hungary to Austria (see Figure 12), delivering about 5 per cent of the EU total gas consumption by 2020 (Van Aartsen, 2009).

Figure 12: Projected routes of Nabucco, Nord Stream and South Stream



Source: BBC News

⁴⁹ TEN-E refers to Trans-European Energy Networks, i.e. projects designed for transporting electricity and gas that are “essential for the effective operation of the internal energy market in particular and the internal market in general” and that are “eligible for Community assistance” (European Commission, 2012).

Constructing competitive pipelines from Russia to the West, and thus aiming at preventing the Union's diversification efforts from Russia appears to be the most obvious means of Moscow's 'divide-and-rule' strategy. Due to limited consumption 'capacity', as well as restricted financial sources, pipelines cannot be constructed in indefinite numbers. Here, aiming at bypassing Ukraine as a transit state, Moscow has initiated two projects which, while diversifying supply routes, obviously strengthen Russia's position in the Union's gas market and delimit the role of the Southern Corridor. These projects are the Nord Stream and South Stream pipelines.

While the latter is currently in discussion and constitutes the main competitor for the Nabucco project, the Nord Stream pipeline is already in operation. It has been assigned a TEN-E status by the European Commission in 2000, and links Russia's Baltic Sea coast near Vyborg with Germany's Baltic Sea coast in the vicinity of Greifswald, with the main target markets being Germany, the UK, the Netherlands, France, and Denmark (OAO Gazprom, 2012e). The pipeline's annual capacity is planned to be 55bcm (about 12% of the EU consumption in 2011)⁵⁰, delivering gas via two strings with the first operating since November 2011 (Nord Stream AG, 2011). From the beginning, the project was perceived as controversial, particularly by Poland and the Baltic states, mainly due to increasing the dependence on Russian gas, but also due to environmental considerations (EurActiv, 2006), as well as because of its costliness. Non-officially, we can assume that reservations reached further. The Baltic States and Poland, for instance, may have opposed the project for the impression that they have been left out as transit countries. On the other hand, Nord Stream may have 'swallowed' financial sources that otherwise could have been directed to developing intra-European pipeline infrastructure, in Central and Eastern Europe for instance.

According to Grätz (2012, p. 9), the Nord Stream pipeline is overwhelmingly cost-intensive in comparison to other alternative routes, such as Yamal peninsula. This suggests that economic motivations are accompanied by Russia's political interests. As Grätz (2012, p. 10) reasons, a more expensive project creates a binding long-term effect on consumers, while it prevents competition from other projects (due to limited financial resources available). Both factors work in Russia's favour. We can therefore conclude that the realisation of the Nord Stream pipeline was a successful element of Russia's 'divide-and-rule' strategy, reinforcing the member states' divisions (for instance, the objection by Baltic states and Germany's support) and hindering the EU's 'want-satisfaction' in terms of diversification efforts.

⁵⁰ Based on BP Statistical Review of World Energy 2012 data.

Moreover, in January 2009, Russia succeeded to finally impede prospect for the EU-favoured Nabucco project, by introducing the ‘netback-replacement-value’ pricing for gas from Central Asian countries, such as Turkmenistan (cf. Konoplyanik, 2010b, p. 24). Under the ‘netback-replacement-value’ system, the gas producers receive higher values for their gas exports, as in contrast to the ‘cost-plus’ pricing system which was used previously to 2009. By modifying the pricing system, Russia has managed to outplay the competitive advantage European companies have enjoyed prior to 2009 in negotiations with Central Asian countries, and exports through the proposed Nabucco pipeline are no longer more financially advantageous to Turkmenistan than exports through Russia (cf. *ibid.*).

Respectively, the measurement of Russia’s ‘divide-and-rule’ behaviour with regard to cooperation with EU can be summarised as occurring more frequently in the 2000s: both the Nord Stream pipeline and the new pricing system for Central Asian gas exports undermine the Union’s diversification strategies and underpin Russia’s position in the international gas market. However, with a common European energy policy being absent, the effect of Russia’s fragmentation approach cannot be over-estimated.

4.2.5. *Single conflicts*

Single gas-related conflicts occurred in 2006 and 2009 as a result of gas disputes between Russia and Ukraine on the issue of transit tariffs, when Russia cut off exports to Ukraine and gas deliveries to Europe were subsequently stopped. Here, the 2009 gas conflict was more significant. For about two weeks, exports to 16 EU member states and Moldova were cut and the most seriously affected countries in the Balkans experienced a humanitarian emergency, with parts of the populations unable to heat their homes (Pirani, Stern, & Yafimava, 2009)⁵¹. Significant economic problems, but not of a humanitarian kind, were also caused in Hungary and Slovakia. As a consequence, the EU and Russia agreed on the Early Warning Mechanism under the framework of Energy Dialogue. The Mechanism covers oil, natural gas and electricity, and includes three basic steps: Notification on any likely supply interruption, Consultation and Implementation of a joint plan of solution (European Commission, 2009).

While both supply interruptions affected the EU member states, they were primarily directed towards Ukraine and did not necessarily lead to a stronger Russia’s bargaining position vis-à-vis the EU. One may assume that in the aftermath, Gazprom received more support for its

⁵¹ See the EU’s memo of 9 Jan. 2009 for a detailed member state’s general situation according to the significance of impact: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/3&format=HTML&aged=0&language=EN&guiLanguage=en> (Retrieved August, 2012).

pipeline projects aimed at bypassing Ukraine; yet, it may as well be the contrary and reinforcing the Union's efforts towards diversifying away from Russia. In any case, we cannot conclude that the mentioned conflicts significantly affected the level of Russia's cooperation with the Union in gas-related matters.

4.2.6. Preliminary conclusions

The thesis expected the level of cooperation between Russia and the EU in gas-related matters to decline. Based on findings gained from the observation of the units listed in Table 2, we can conclude that this expectation was partially met.

The 'nature' of the EU-Russian gas relations cannot be classified as showing a 'high cooperation' level throughout the whole period of observation, since it has not been institutionalised in the sense of establishing and ratifying legally binding agreements. Attempts to intensify cooperation have taken place in the late-1990s, such as the signing and provisional application of the ECT by Russia, as well as the signing and ratification of the PCA⁵². This time period can therefore be classified as denoting the 'moderate' level of cooperation with a slight tendency towards 'high' cooperation level.

The early 2000s were characterised by Russia's continued application of the ECT provisions; however, ratification was conditioned on the ratification of the Transit Protocol. At about the same time, the Energy Dialogue was established, reinforcing hopes for a more substantial cooperation between Russia and the EU. Here, agreements were recorded on Russia's domestic energy pricing, as well as compromises found on the long-term contract scheme. The level of cooperation in the early 2000s can thus be regarded as fluctuating in the grey zone around 'moderate cooperation'.

The interactions in the late-2000s increasingly faced contentions. Negotiations on the new agreement replacing the PCA were launched with a delay in 2008 and continuously show disagreements on several issues. In 2009, Russia officially terminated its provisional application of the ECT⁵³. Moreover, it began to more progressively advocate its interests on the European gas market, with regard to the Union's diversification efforts as well as with regard to its disputes with Ukraine. Hence, we can reasonably classify the level of cooperation as still 'moderate', albeit with a light tendency towards 'absent' cooperation.

Summing up, the level of the EU-Russian gas cooperation is classified as 'moderate' throughout the whole observation period. Yet, its tendency can be regarded as developing

⁵² Which, however, did not include any binding and concrete provisions for the gas trade.

⁵³ Please note that Russia is nevertheless bound by its partial implementation until 2020 (see fn. 42).

from ‘moderate-to-high’ towards ‘moderate-to-absent’ cooperation. Seen in these terms, the level of cooperation is declining. However, one should not over-estimate this tendency, particularly with regard to Russia’s soon WTO accession.

4.3. Discussion

Having observed a considerable increase in the size of Russia’s power sources in section 4.1 whilst a slightly declining level of its cooperation with the EU in section 4.2, we now turn to the analysis of the extent to which these developments coincide.

The theoretical background applied here suggested that states in international anarchy seek to strengthen their position by means of maximising their relative power. As such, they seek independence from other states and hence avoid cooperative arrangements if they can afford it. A relatively powerful Russia was thus expected to be less willing to cooperate with the EU. Taking the historical context into account, the ‘new’ Russian Federation shortly after the dissolution of the Soviet Union was relatively weak – it was faced with the need of economic and political reforms in order to compete internationally or to even survive as a sovereign state. Following the ‘Western’ example, it aimed economic transition towards market economy, while it sought for democracy on the political level. Within this context of weakening economic performance, as well as social and political struggles, the first international cooperative agreements were concluded. Thus, the relatively weak Russia in the early-to-mid 1990s signed the European Charter Treaty and concluded the Partnership and Co-operation Agreement with the EU in 1994. The PCA was seen as a welcomed measure to gain technical assistance and financial means to boost its economy and support political reform, while providing some guidance of what to expect on the international level politically. The ECT, however, was an energy-specific document and required policy adjustments that would seriously harm Gazprom’s market position. Gazprom, formerly the Ministry of Gas Industry of the Soviet Union, and hence a monopoly, was very powerful in the early 1990s. The company’s decision-makers, former officials of the ministry, naturally opposed any loss of the company’s assets. Despite liberalisation efforts, Gazprom remained Russia’s largest gas producer and retained its gas transportation system (UGSS). Having former colleagues in the government and the State Duma, Gazprom’s directors effectively lobbied against the ratification of the ECT, (arguably) reasoning that it would diminish Russia’s role as Europe’s gas supplier. Being faced with other difficulties, such as the conflict in Chechnya or the society’s increasing criminalisation, Yeltsin didn’t interfere much in ‘Gazprom’s’ matters (cf. Poussenkova, 2011). Moreover, under Yeltsin, the so-called ‘oligarchs’ gradually took over strategic stakes in the financial, economic, media, as well as political sectors (cf. Price, 2007).

The European Union of the early-to-mid 1990s, on the other hand, consisting of half of the number of member states as in the mid-to-late 2000s, found it easier to agree on a strategy towards Russia. Moreover, it attempted to secure its energy supply by means of the ECT.

With Putin's election to President of the Russian Federation and the growth in world oil prices in the early 2000s, the situation has changed. Putin took a different approach towards the state's economic and political organisation than Yeltsin. Rather than economic liberalisation and democratisation in the 'Western' sense, he preferred consolidation of the state power, reflected by gradual development towards 'sovereign democracy' and central control of economic sectors where Russia has comparative international advantage. The Russian 'oligarchs' were replaced by Putin's adherents, the 'siloviki' (cf. Bilgin, 2011). Thus, the Kremlin gradually re-gained control over Gazprom, acquiring a majority of its shares in 2006, while placing pro-Putin officials in the company's Board of Directors already in 2001-2002. Putin saw Russia's position in the international energy market as strongly affecting the state's international influence. The relationship between Kremlin and Gazprom was thus a win-win situation: the government could control the domestic and external strategies of Gazprom, while the latter was privileged with regard to production assets and the access towards the lucrative European market.

In 2000, the EU-Russian Energy Dialogue was established, which served as a communication platform rather than binding the partners to any policy adjustments. Hence, with the oil and gas prices rising in the 2000s, and the state gaining ever more control over Gazprom, the size of Russia's power sources increased. At the same time, the level of cooperation with the EU in gas-related matters remained moderate.

Realising that the chances for Russia's ECT ratification are low, the European Union began to find other means to establish a regulatory framework for energy trade with Russia in the mid-to-late 2000s. The Energy Dialogue served as a first step, a diplomatic way to use 'soft power'. Meanwhile, the Commission issued several policies to liberalise the EU's domestic gas market, aiming at greater supply security by means of diversification, ownership unbundling, investing into network infrastructure, increasing energy efficiency and promoting renewable energy sources. Externally, it intended to include the ECT's provisions in the new agreement replacing the PCA, negotiations for which were due to start in 2006. While this rhetoric was not maintained during the process of negotiations, parts of the ECT provisions are reflected in the agreements under the WTO framework (such as GATT, for instance). The

EU is currently awaiting Russia's WTO accession in order to complete negotiations on the new agreement.

Since around 2006, the EU-Russian cooperation level began to tend towards 'absent' cooperation. In 2006, Gazprom secured its export monopoly, enabling the state to control exports, if necessary. As well, the first significant conflict with Ukraine over gas prices took place. Further, negotiations on the new agreement were postponed until 2008, as Poland and Lithuania vetoed the Commission's mandate to start negotiations due to bilateral disagreements with Russia. In the years 2006-2008, we thus see how Russia begins to actively sustain its international position and fragmenting the European member states.

Since 2009, this strategy is reinforced. The second Russo-Ukrainian gas conflict takes place in winter 2009, with significant implications for Eastern member states. In summer 2009, Russia officially terminates its provisional application of the ECT. Around the same time period, construction of the Nord Stream pipeline is started, bypassing Ukraine, Poland and the Baltic states as transit countries, and with Gazprom being the major shareholder. Until now, this project can be regarded as the peak in Russia's strategy towards strengthening its international position with regard to the EU. On the one hand, it has reinforced the Union's internal fragmentation on the security of gas supply issue. On the other hand, it binds European consumers on Russia as gas supplier in the long-term, limiting competition from other possible suppliers. Furthermore, in 2009, Russia changed its pricing system for gas imported from Central Asian countries such as Turkmenistan. In this regard, it has limited the Union's bargaining leverage in negotiations with these countries as alternative gas suppliers.

In this respect, the increased size in Russia's power sources has led to change in its international behaviour. With energy in general, and gas in particular, being the Kremlin's strongest political tool to strengthen its position internationally, it is less willing to cooperate with the EU on gas-related matters in the 2000s as compared to the 1990s. However, because the level of cooperation was never 'high', i.e. Russia never agreed to subscribe to any binding policy adjustments and thus to give up sovereignty over certain decisions, the effect of the slightly declining level of cooperation should not be over-stated.

5. CONCLUSION

The central research goal of this study was to answer the question to what extent the relatively weak Russia in the 1990s was more willing to cooperate with the European Union in gas-

related matters than the relatively strong Russia in the 2000s. Based on empirical findings gained from the observation of the level of cooperation and from the measurement of the size of Russia's power sources, the thesis concluded that there is some extent of correlation between Russia's increased power and a tendency towards decreasing level of cooperation with the EU. However, this correlation should not be over-stated and it is questionable whether the developments observed here should be interpreted as a threat towards Europe's long-term gas supply security. As well, one should be cautious in assuming that Russia uses energy, or gas in particular, as a political 'weapon' to extract concession from the EU. At this point, such assumptions are exaggerated and misplaced. In the long-term, Russia is interested in securing revenues from gas exports to Europe, while politically 'aggressive' behaviour only reinforces the Union's efforts towards diversification of supply sources, towards the use of alternative energy sources, towards promoting energy efficiency, and, most importantly, towards the regulation of the 'openness' of its internal gas market for third states. From today's point of view, by introducing the third energy packet, the Union has limited Gazprom's position on the European market for gas, since any third-state-company is bound by the EU's internal legal regulations, i.e. has to confirm with its unbundling directive, for instance.

This work has primarily focused on the Russian 'side' of the EU-Russian cooperation in gas-related matters. It sought to identify the major players in Russia's gas policies as well as their interests and strategies domestically and externally. Yet, for a complete analysis of the Russo-European gas interactions, the European perspective is crucial. Here, we have identified patterns of correlation between the size of Russia's power sources and its willingness to cooperate with the EU. For gaining additional knowledge, however, it would be interesting to examine to what extent the level of the EU-Russian cooperation is affected by the Union's international behaviour, taking into account the Union's internal collective action problems or the effect of the liberalisation of its internal market on its bargaining leverage.

Finally, it would be interesting to conduct a similar study in a few years from now, when Russia has finally accessed the WTO; when its domestic gas prices have increased and thus gave more incentives for independent gas production; and when, presumably, its civil society is more developed. Such a study would provide a higher explanatory value for the hypothesised relationship between a state's relative power and its international behaviour.

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