this stabilization has come at the expense of democracy and uneven economic development in favor of the raw materials' sector. The massive new wealth from oil and gas sales has also helped spur an increase in corruption and authoritarian tendencies. Russia's stability is very much linked to the ability of the ruling elite to redistribute rents in a way so as to accommodate the various conflicting interests in Russian society. At least indirectly, Russia's stability is thus tied to a well-functioning domestic and international energy market and stable prices. It also depends on Russia's ability to continue playing a significant role as a supplier of energy to international markets. Major disruptions would ultimately test Russia's precarious political stability.

The challenge for Russia's new president will be to manage Russia's energy wealth in the way that is best for the country's long-term political, economic, and social development. Such efforts can best succeed if Russia manages to develop a thriving liberal market that is at least to some extent dependent on an open society.

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Analysis

Russia's New Political Leadership and its Implication for East Siberian Development and Energy Cooperation with North East Asian States

By Yoshinori Takeda, Moscow

Abstract
The transition from Putin to Medvedev marks an important new beginning for the future of East Siberian energy resources and their impact on Russia's Asian neighbors. East Siberian resources have not been developed, but could have great impact on Russia's relations with Asia. China currently has the best relations with Russia, while Japan has made little progress, and Korea has secured one major deal. The Korean arrangements with Russia could serve as a model for future ties because they strongly favor the Russian side, which maintains a 60 percent share of the project while taking on little risk. In the future, Russia's energy decisions will continue to have strong political motivations, but they will be based on better defined rules of the game. Essentially, Russia will use its energy resources to develop the Russian state and only allow foreign companies to participate in projects that meet Russia's national interest.

From Putin to Medvedev
The process of political and economic modernization in Russia entered a new phase on December 10, 2007, when President Vladimir Putin chose First Deputy Prime-Minister Dmitri Medvedev as Russia's next president. Medvedev's nomination clearly demonstrates that over the next four years Russia will seek further economic growth and the social welfare benefits that derive from such growth. Medvedev has been a close ally of Putin's for the last decade, but he is not a former secret service officer. In addition, Medvedev is less hawkish than others surrounding Putin.

Meanwhile, the Russian government is moving extremely slowly in diversifying the economy, a move seen as necessary to ensure continuing economic prosperity regardless of the cost of raw materials. Since almost 70 percent of Russia's budget revenues and export value derive from primary commodities, Medvedev will have to take serious measures towards economic diversification while Russia remains dependent upon oil and gas. Against a backdrop of historically high oil prices, this economic course would help Russia pursue its geopolitical strategy in the foreseeable future and lead the nation to a position of global influence and power with its oil and gas reserves.

Among Russia's oil deposits, East Siberia is the most underdeveloped region. In 2006, its total crude oil production amounted to only 0.7 million tons, or 0.1 percent of the national total. Although East Siberia's oil reserve is estimated to be approximately 75 billion barrels (10.2 billion tons), proven crude amounts are only 7 billion barrels. In addition, exploration has barely begun beyond two fields – the Verkhnechon field in the Irkutsk region and the Talakan field in the Sakha republic. Even Putin, who has shown intense interest in the economic and social development of East Siberia and the Far East by funding a federal program for the region's growth with $24 billion from the state budget in 2007, has done little to spur a search for crude oil in East Siberia. For Medvedev, encouraging exploitation of new fields may be key to averting an expected future drop in Russia's oil output. It may also provide important leverage vis-à-vis Asian countries, especially China, Japan and South Korea.

Russian-Asian Energy Relations: Current Circumstances

Throughout the second term of Putin's presidency, China has been undoubtedly the front-runner in energy cooperation with Russia. A major milestone of Sino-Russia energy relations was the $6 billion loan from the China National Petroleum Corporation (CNPC) to Russia's highest-producing state-owned oil company, Rosneft, in early 2005. This financial resource made it possible for Rosneft to purchase Yuganskneftegaz, the main subsidiary of the former Yukos, at a state-run auction. 2005–2006 saw a series of important deals between Moscow and Beijing: Rosneft and CNPC formed a joint venture for upstream projects in East Siberia; CNPC and Transneft, Russia's state-owned oil pipeline monopoly, agreed to build a Chinese branch of the East Siberia – Pacific Ocean oil pipeline project (ESPO) funded with Chinese money; and CNPC and Gazprom, the world's No. 1 gas company, proposed an ambitious plan to build two huge gas pipelines to China by 2011. These projects are, however, being very slowly developed. While Vostok Energy, the joint company established by Rosneft and CNPC, won two small oil and gas wells in East Siberia at an auction for $45 million, the spur of the ESPO has not yet reached the Sino-Russian border, and the gas pipeline projects are on the verge of collapse.

Japanese-Russian energy talks have been held around the ESPO project (a pipeline originating in East Siberia in Taishet, Irkutsk region, and extending to a Pacific port at Kozmino bay, in the Primorsk region). Regarding this colossal venture, Japan took the position that pipeline economics was not an issue since governments (Russia, Japan and other countries concerned) could provide long-term credits, tax exemptions and subsidies to lower the pipeline's cost. This perspective led Tokyo to raise two points at the negotiating table: exploring reserves in East Siberia and funding for feasibility studies and the construction itself. However, no real progress in Japanese-Russian cooperation in ESPO construction, including upstream projects in East Siberia, has been reported so far. In the meantime, Japanese companies have begun to show interest in other spheres of energy relations, like participating in Gazprom's projects and Rosneft's downstream business (such as oil refineries).

The South Korean economy is not as large as that of China or Japan and, consequently, its energy cooperation with Russia is not substantial, so far. Still, the South Korean national oil company (Korean National Oil Corporation, KNOC) and Rosneft have made one impressive agreement to develop the West Kamchatka shelf that is estimated to hold about 900 million tons of oil equivalents at 26 sites. This deal will become a good model for Asian countries aiming at pragmatic energy cooperation with Russian state-owned oil companies for two reasons. First, KNOC could successfully avoid the strategic fields issue. While the Kremlin's definition of the phrase "strategic field" is not clear and is mostly subjective, one thing is beyond doubt: the participation of foreign companies in projects at strategic deposits is highly politicized and strictly limited. West Kamchatka, however, is apparently not a strategic field for Moscow due to its geographical location (11,000 kilometers, or 6,900 miles from Moscow) and the volume of its deposit. Second, the Koreans have agreed to two key conditions and thus could satisfy Rosneft. The first condition is a 60–40 share division, i.e. Rosneft holds a 60 percent share of this project. This number is important for Rosneft, which wants to promote projects with foreigners from a superior position. The other condition is that the Korean company will invest in prospecting operations, taking on 100 percent of the risk in exploration, and Rosneft will be able to claim a share of the revenues once commercial production begins.

After 2008: a New Hope for Foreigners, including Russia's Asian Neighbors

The slow development of Russian energy cooperation mentioned above has been a problem, not only for Asian countries, but for the U.S. and European partners, as well. Political uncertainties in 2007, due mainly to the lack of clarity about Putin's successor, and the lack of clear rules of the game in Russia's energy policy delayed many projects, while Russia's federal budget enjoyed extra revenues thanks to record-high oil prices.

Perhaps 2008 will see a change in such circumstances. Medvedev's presidency will bring some new elements into Russia's energy policy, including its relations with East Siberia. In attempting to read the future of East Siberia and its implications for Asian countries, it is worth paying attention to two points: political motivation and the formation of the rules of the game.

Political Motivation

Undoubtedly, Moscow can now effectively use its energy resources as tools of geopolitical strategy; i.e. most of the Kremlin's decisions on energy issues are politically motivated. Since 2000, Russian President Vladimir Putin has strongly driven foreign and domestic policy under the slogan of a "strong and self-confident Russia." During the eight years of his presidency, the world's macroeconomic climate, including exceedingly high-priced fossil fuels, allowed Russia to consolidate its role in global politics and markets, especially in the energy field. In spite of criticism from the West towards Moscow's energy leverage, we see no setback to Russia's geopolitical strategy using its rich energy resources. On the contrary, Russia is coming to a position of global influence and power with its oil and gas reserves.

Political incentive plays all the more vital a role in the development of East Siberia because, without special arrangements by the government, it is almost impossible, even for inefficient Russian state-owned companies, to tap new resources that sit under one of the world's most forbidding terrains. Tax holidays of up to ten years for companies developing oil deposits in East Siberia introduced by the Russian government in 2006 are a case in point. Then Minister of Economic Development and Trade German Gref explained the reason for this move, saying that the tax holiday decision and the ESPO project would help increase oil production in East Siberia. Moreover, the Kremlin has a strong political motive to utilize Rosneft and Surgutneftegaz, fourth in oil output among Russia's oil companies and totally loyal to Putin, as tools of East Siberian development. In May 2007, Surgutneftegaz's CEO Vladimir Bogndanov, announced that the company's future production in West Siberia would be flat, with all its output growth likely to come from East Siberia.

This political motivation will certainly lead the Siberian pipeline to the Pacific Ocean, despite uncertainty over the oil reserves and the profitability of this pipeline. 2007 saw some negative elements in the construction of the ESPO: a serious delay in the ESPO's first stage construction (up to Skovorodino, a town in the Irkutsk region near the Sino-Russian border) and the postponement of the start of the ESPO's second stage construction (to Kozmino bay). However, one should take into account the fact that the ESPO is Putin's project. His involvement practically assures the completion of this gigantic project, despite the many negative observations uttered by officials and specialists. A scenario in which the pipeline is not built can be excluded.

The Rules of the Game

The formation of the rules of the game in Russia's energy policy is another decisive factor that could encourage fundamental progress in energy-related business. Actually, throughout the eight years of Putin's presidency, especially after the Yukos affair in 2003, unwritten rules have been formulated. The essential one is simple: Russia has enormous natural resources and should utilize them effectively to attain the social and economic development of the state. Two more fundamental unwritten rules can be added: first, the state must control the export of its resources; second, foreign investors are welcome only when they are ready to participate in projects that answer principally to Russia's national interests.

Now, Moscow is moving to the formation of clear rules, particularly with the adoption of a new version of the subsoil law. For most of Putin's presidency there has been a heated discussion on the bill amending the existing subsoil law. The crucial issue over the proposed amendment is the extent of foreign companies' access to Russian deposits. Until quite recently, the draft completely prevented foreigners from working strategic deposits, which undoubtedly means all large promising oil and gas fields and whose ultimate definition will depend on the Kremlin's subjective decisions. After the nomination of Medvedev, a new move appeared: Minister of Natural Resources Yuri Trutnev stated that his ministry would make a change in the bill and that all issues, including foreigners' participation in strategic deposits and foreigners' access will be discussed by a government committee.

Who Wins?

The idea of establishing a government committee will not increase the transparency of the decision-making process, which is an essential element of corporate governance in the West, but will only add to the existing impression of decision-making behind closed doors. The important point is, however, that the Russian government has expressed its intention to form rules of the game in energy policy. After the long-term twists and turns in the amendments to the subsoil law, the bill will be approved by the newly formed State Duma in the near future, perhaps under Medvedev's presidency. Now, it is clear that political motivation and rules of the game matter for everyone who wants to profit from Russia's natural resources.

As discussed above, these two factors are decisive for East Siberian development since it requires strong political will and enormous funding. Among potential foreign partners, China is already two-three steps ahead since Beijing understands well the importance of the political incentive and has successfully formed a strategic partnership relationship with Moscow in recent years. Moreover, China and India, which buy Russia's military weapons and satisfy Moscow with the formation of a trilateral grouping against U.S. unilateral hegemony, enjoy the advantages of barter trade with Russia and are ready to join upstream projects in East Siberia. However, Japan, South Korea, and even the United States and European countries are not too late for this race. The winner will be the one that understands Moscow's rules of the game and can utilize Russia's political motivation and its own capital.

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Analysis

Shtokman and Russia's Arctic Petroleum Frontier

By Indra Øverland, Oslo

Abstract

The need to develop new sources of natural gas to supply domestic and foreign customers is pushing Gazprom into the Arctic. Two key Arctic projects could, at least in theory, become the company's and the country's new mainstays: Shtokman and Yamal. The realistic time-scales, cost frames and sources of financing for these two projects remain highly unclear. It is also unclear whether the projects will be developed in parallel or sequentially. So far, however, there has been far more organizational stir surrounding the Shtokman field, which is therefore the main topic of this article. The Shtokman field is located close to the Norwegian border in the Barents Sea, and the Norwegian oil major StatoilHydro has been selected as one of the two main foreign partners for the project. The development of the project therefore has implications for Russian–Norwegian relations in the north, which are also discussed in this paper.

Russian Gas Production and the Eurasian Energy Balance

Events in Ukraine in January 2006 and Belarus in January 2007 fuelled worries in some circles about Russia's reliability as a supplier to European markets. More recently, concerns have shifted to whether Russia will be able to supply its customers, even if it wants to. The supply crunch is envisaged as occurring sometime between 2010 and 2012. These fears revolve around Western Siberia's Nadym Pur Taz Region and its three super-giant fields: Medvezhe, Urengoy and Yamburg. Over 90 percent of Russia's natural gas is extracted in Nadym Pur Taz, but production in the region is falling fast. The fields have all been producing for over 20 years (37 in the case of Medvezhe), and injection techniques applied during the Soviet period to boost output have shortened their life span and steepened the production decline. At the same time, Russia's economy is expanding and natural gas remains heavily under-priced. As a consequence, domestic consumption is increasing. Foreign customers and Russian pundits are left wondering where the gas is going to come from in the future, and the simplest answer is Shtokman and or Yamal.

The Russian Arctic and World Energy Supplies

In a widely cited survey, the US Geological Survey estimated that up to 25 percent of the world's undiscovered oil and gas may be located in the Arctic. What is less often noted is that a large part of these resources are located in the Russian part of the Arctic. This is not just because almost half of the Arctic littoral is Russian, but also because the seabed along Russia's Arctic coast includes some of the biggest finds ever in the Arctic, some of the most promising areas, and some of the least explored areas. Thus, Shtokman and Yamal are the gateways to an Arctic Russian adventure that could satisfy a substantial part of the world's future oil and gas demand.

Shtokman versus Yamal

Shtokman is located in North-Western Russia, close to the Nordic countries. Yamal is located further east in the Asian part of Russia. Choosing between the two projects therefore has implications not only for Russia's internal economic geography, but also for the proximity and linkages to the Nordic countries, the EU and overseas markets (for LNG).