Russian Oil and Gas Challenges

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Summary

Russia is a major player in world energy markets. It has more proven natural gas reserves than any other country, is among the top ten in proven oil reserves, is the largest exporter of natural gas, the second largest oil exporter, and the third largest energy consumer. Energy exports have been a major driver of Russia’s economic growth over the last five years, as Russian oil production has risen strongly and world oil prices have been very high. This type of growth has made the Russian economy dependent on oil and natural gas exports and vulnerable to fluctuations in oil prices.

The Russian government has moved to take control of the country’s energy supplies. It broke up the previously large energy company Yukos and acquired its main oil production subsidiary. In Central Europe, Russian firms with close links to the Russian government have used leverage to buy energy companies to gain control over energy supply. In East Asia, Russia is contemplating a pipeline destination that would allow it to decide to whom its oil gets sold. Also, Russia briefly cut off gas supply to Ukraine because the latter did not agree to greatly increase what it pays for the gas. Russia restored supply after other European countries, which were affected, complained. Much of Russia’s gas exports to Europe pass through Ukraine. The dispute was resolved temporarily through a compromise.

Russia’s ability to maintain and expand its capacity to produce and to export energy faces difficulties. Russia’s oil and gas fields are aging. Modern western energy technology has not been fully implemented. There is insufficient export capacity in the crude oil pipeline system controlled by Russia’s state-owned pipeline monopoly, Transneft. And, there is insufficient investment capital for improving and expanding Russian oil and gas production and pipeline systems. Moreover, Russia’s cutting off gas supply to Ukraine and subsequent actions and events damaged its reputation as a reliable energy supplier.

A number of proposals would build new or expand existing Russian oil and natural gas export pipelines. Some are contentious, and although the Russian government is faced with a perceived need to expand its oil and gas export capacity, it also has limited resources. This report discusses several different major proposals.

Given that the United States, as well as Russia, is a major energy producer and user, Russian energy trends and policies affect U.S. energy markets and economic welfare in general. An increase in Russia’s energy production and its ability to export that energy westward and eastward may tend to ease the supply situation in energy markets in the Atlantic and Pacific Basins. On the other hand, the Russian government’s moves to take control of the country’s energy supplies noted earlier may have the effect of making less oil available. Possibly as important as Russian oil and gas industry developments is the associated potential for U.S. suppliers of oil and gas field equipment and services to increase their sales and investment in Russia. However, while they consider the climate to be improving, potential investors complain that the investment climate in Russia is inhospitable with respect to factors such as poor intellectual property rights protection, burdensome tax laws, and inefficient government bureaucracy. This report will be updated as events warrant.
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Russian Oil and Gas Challenges

The Russian Federation is a major player in world energy markets. It has more proven natural gas reserves than any other country and is among the top ten countries in proven oil reserves. It is the world’s largest exporter of natural gas, the second largest oil producer and exporter, and the third largest energy consumer. Given that the United States also is a major energy producer and user, Russian energy trends and policies affect U.S. energy markets and U.S. welfare in general.

Oil and Gas Reserves and Production

Most of Russia’s 60-72 billion barrels of proven oil reserves (Table 1) are located in Western Siberia, between the Ural Mountains and the Central Siberian Plateau. This ample endowment of this region made the Soviet Union a major world oil producer in the 1980s, reaching production of 12.5 million barrels per day (bbl/d) in 1988. Roughly 25% of Russia’s oil reserves and 6% of its gas reserves are on Sakhalin Island in the far eastern region of the country, just north of Japan.

Russian oil production, which had begun to decline before the Soviet Union dissolved in 1991, fell more steeply afterward — to less than six million bbl/d in 1997 and 1998. State-mandated production surges had accelerated depletion of the large Western Siberian fields and the Soviet central planning system collapsed. Russian oil output started to recover in 1999. Many analysts attribute this to privatization of the industry, which clarified incentives and shifted activity to less expensive production. Increases in world oil prices, application of technology that was standard practice in the West, and rejuvenation of old oil fields helped boost output. After-effects of the 1998 financial crisis and subsequent devaluation of the ruble may well have contributed. After reaching about nine million bbl/d in 2004 depending upon the estimating source, Russian oil production continued to rise in 2005, but only slightly.

Several consortia have begun producing and exporting oil (mainly to East Asia at present) from Sakhalin island (Figure 4). They also plan to export gas to the United States via pipelines to the Siberian mainland and then from liquefied natural gas (LNG) terminals.

1 Oil and Gas Journal, December 19, 2005. Estimates of proven oil and/or gas reserves by country can differ widely, depending partly on what types of resources are included. Thus, Russia’s ranking of reserve holdings may differ among organizations that compile such data.
With about 1,700 trillion cubic feet (tcf), Russia has the world’s largest natural gas reserves. In 2004, it was the world’s largest natural gas producer and the world’s largest exporter. However, its natural gas industry has not done as well as its oil industry in recent years, as production has increased only a little and exports only have re-attained their level of the late 1990s.

### Table 1. Oil and Natural Gas Reserves and Production

<table>
<thead>
<tr>
<th>Country or Region</th>
<th>Proven Reserves (billions of bbl of oil/trillions of cu. ft. of gas)</th>
<th>Production* (mil. bbl/day of oil/trillions of cu. ft. of gas)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>O &amp; G Journal (1/1/06) 60/1,680</td>
<td>BP (2004) 7.2/19.2</td>
</tr>
<tr>
<td>North Sea^b</td>
<td>O &amp; G Journal (1/1/06) 60/1,680</td>
<td>BP (2004) 7.2/19.2</td>
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<tr>
<td>Saudi Arabia</td>
<td>O &amp; G Journal (1/1/06) 60/1,680</td>
<td>BP (2004) 7.2/19.2</td>
</tr>
<tr>
<td>WORLD</td>
<td>O &amp; G Journal (1/1/06) 60/1,680</td>
<td>BP (2004) 7.2/19.2</td>
</tr>
</tbody>
</table>


n.a. - Not available.

a. Includes natural gas liquids.
b. Includes Denmark, Germany, Netherlands, Norway, and United Kingdom.
c. Energy Information Administration estimate.
Growth of Russia’s natural gas sector has been impaired by ageing fields, near monopolistic domination over the industry by Gazprom (with substantial government holdings), state regulation, and insufficient export pipelines. Gazprom, Russia’s 51%-owned state-run natural gas monopoly, holds more than one-fourth of the world’s natural gas reserves, produces nearly 90% of Russia’s natural gas, and operates the country’s natural gas pipeline network. The company’s tax payments account for around 25% of Russian federal tax revenues. Gazprom is heavily regulated, however. By law, it must supply the natural gas used to heat and power Russia’s domestic market at government-regulated below-market prices.

Potential growth of both oil and natural gas production in Russia is limited by the lack of full introduction of the most modern western oil and gas exploration, development, and production technology.

Exports

Energy exports have been a major driver of Russia’s economic growth over the last five years, as Russian oil production has risen strongly and world oil and gas prices have been relatively high. This type of growth has made the Russian economy very dependent on oil and natural gas exports, and vulnerable to fluctuations in world oil prices. On average, a $1 per barrel change in oil prices results in a $1.4 billion change in Russian government revenues in the same direction.

Petroleum

Almost three fourths of Russian crude oil production is exported; the rest is refined in the country, with some refined products being exported. About two-thirds of Russia’s 6.7 million bbl/d of crude oil exports in 2004 went to Belarus, Ukraine, Germany, Poland, and other destinations in Central and Eastern Europe. The remaining one-third went to maritime ports and was sold in world markets. Recent high oil prices have enabled as much as 40% of Russia’s oil exports to be shipped via more costly railroad and river barge routes. Most of Russia’s exports of refined petroleum products to Europe are fuel oil and diesel fuel used for heating.

Russia’s capacity to export oil faces difficulties, however. One stems from the fact that crude oil exports via pipeline are under the exclusive jurisdiction of Russia’s state-owned pipeline monopoly, Transneft. Bottlenecks in the Transneft system prevent its export capacity from meeting oil producers’ export ambitions. Only about four million bbl/d can be transported in major trunk pipelines; the rest is shipped by more costly rail and river routes. Most of what is transported via alternative transport modes is refined petroleum. The rail and river routes could become less economically viable if oil prices fall sufficiently. The Russian government and Transneft are striving to improve the export infrastructure.

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Unless significant investment flows into improving the Russian oil pipeline system, non-pipeline transported exports probably will grow. For example, without a dedicated pipeline, rail routes presently are the only way to transport Russian crude oil to East Asia. Russia is exporting about 200,000 bbl/d via rail to the northeast China cities of Harbin and Daqing and to central China via Mongolia. Since Yukos was the leading Russian exporter of oil to China, there was concern that the breakup of Yukos by the Russian government (see below under “Energy Policy”) might affect rail exports to China. However, Lukoil has taken over the role of rail supplier.

Oil transportation in the Black Sea region may be in flux. A large portion of Russia’s oil presently is shipped by tankers from the Black Sea to the Mediterranean and to Asia, mostly from the port of Novorossiysk. However, shipments through the shallow and congested Bosporus Straits are limited by Turkey for environmental and safety reasons, limiting the effective capacity of lines to Novorossiysk. Deliveries from the Baku-Tbilisi-Ceyhan (BTC) pipeline (expected to start in the summer of 2006) will be mostly oil produced by Azerbaijan and Kazakhstan, posing competition to Russian oil. If Azerbaijan ships all of its oil via BTC, exports from Novorossiysk will decrease. If BTC is less advantageous than hoped, shipments via Novorossiysk, other Russian Black Sea ports, and Supsa (in Georgia) may not decline.

Eastward, Russia faces competition for China’s oil market from Kazakhstan, which, with China, completed in late 2005 the construction of a pipeline from Atasu in central Kazakhstan to Alaskankou on China’s western border. Eventual capacity will be 190,000 bbl/d.

Natural Gas

Historically, most of Russia’s natural gas exports went to Eastern Europe and to customers in countries that were part of the Soviet Union. But, in the mid-1980s, Russia began trying to diversify its export options. Gazprom has shifted some of its exports to meet the rising demand of Turkey, Japan, and other Asian countries. For Gazprom to attain its long-term goal of increasing its European sales, it will have to boost production as well as secure more reliable export routes to the region.

Issues have arisen with the growth of Russia’s sales to Europe. European Union trade representatives have criticized Gazprom’s dominant market position and two-tiered pricing system. Russia agreed to grant independent natural gas producers access to Gazprom’s pipelines. Also, in response to calls for fair pricing, the Russian government doubled prices to Russian industrial consumers. But the new price level still is less than half of the prices charged at the German and Ukrainian borders.

5 See, for example, Yigal Schleifer, “Russian oil ships stuck in Bosporus strait traffic jam,” Christian Science Monitor, January 25, 2005. Also, Ceyhan, a Turkish Mediterranean port, can handle very large carriers, whereas the Supsa and Novorossiysk ports are restricted to smaller tankers that can transit the Bosporus straits. Ceyhan can remain open all year, whereas Novorossiysk is closed up to two months per year.

Also, as a major supplier of natural gas to European countries, Russia has some ability to set prices. For example, it could withhold supply and thereby affect customer country policies. In 2003, Russian gas accounted for 100% of Slovakia’s gas consumption, 97% of Bulgaria’s consumption, 79% of the Czech Republic’s consumption, and 68% of Hungary’s consumption. Some observers consider Gazprom, Russia’s largest earner of hard currency, to be one of Moscow’s main foreign policy tools.

However, Russia’s natural gas exports to Europe declined markedly in January 2006 as a result of severely cold weather in Russia that greatly increased Russian gas consumption, and also reduced oil exports somewhat. The cold conditions were forecasted to last through the month.

As with oil, Russia faces potential competition for Asian gas markets from Kazakhstan, which, with China, is working on a feasibility study for building a pipeline from the former to the latter to ship Kazakh gas to China. Given the proximity of natural gas producers Turkmenistan and Uzbekistan to Kazakhstan, it is possible that their gas also would go to China via that route.

Energy Policy

The Russian government has moved to take control of the country’s energy supplies. It is arguable that this was partly the motivation behind the government’s prosecution of Mikhail Khodorkovski, CEO of Yukos, who acquired state-owned assets during privatization and adopted open and “transparent” business practices while transforming Yukos into a major global energy company. Yukos is being broken up, with its principal assets being sold off to meet alleged tax debts. Yuganskneftegaz, Yukos’ main oil production subsidiary, was sold at a state-run auction to the Baikal Finans Group (previously unheard of), the sole bidder, for $9.4 billion, about half its market value according to western industry specialists. That group soon after sold the unit to Rosneft, the state oil company.

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7 Energy Information Administration (EIA). Russia Country Analysis Brief, February 2005, Table 1, several sources cited: EIA, BP, CIS and East European Energy Databook, 2004.
9 “Kazakhstan, China Consider Gas Pipeline Construction,” FSU Oil & Gas Monitor, December 7, 2005.
10 Nearly all the material in this section is from: CRS Issue Brief IB92089, Russia, by Stuart D. Goldman; CRS Report RL32087, Russian Oil and Gas Companies and Central and Eastern Europe, by Steven Woehrel; and CRS Report RL32466, Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy, by Emma Chanlett-Avery.
11 It subsequently was revealed that Baikal Finans was a group of Kremlin insiders headed by Igor Sechin, Deputy Head of the Presidential Administration and close associate of President Putin. Sechin has been Chairman of Rosneft’s board of directors since July 2004. The de-facto nationalization of Yuganskneftegaz was declared “the fraud of the year” by...
government takeover followed when Gazprom bought 75% of Sibneft — Russia’s fifth largest oil company. In a possible policy change, President Putin announced on January 31, 2006, that Russia will not seek control of more oil companies.

In Central Europe, Russian firms with close links to the Russian government have used leverage to buy energy companies to gain control over energy supply. For example, Yukos obtained majority control of a Lithuanian refinery (the only one in the Baltic states) by slowing oil supply to it, and buying it at a reduced price. The Transneft pipeline monopoly diverted the flow of oil shipments to Primorsk, a Russian port, stopping flow to the Latvian port of Ventspils. Some see Transneft’s action as a move to obtain control of the firm that operates the Ventspils terminal. Also, Transneft refused to finalize an agreement to transport Kazakhstani oil to Lithuania, undermining Kazakhstan’s KazMunaiGaz’s attempt to buy the cited. The Lithuanian government had intended to buy the stake in the refinery owned by Yukos and sell it to another investor. Final binding offers were made January 27, 2006.

Another example of Russian steps to increase control over energy supplies is the routing of new and planned export pipelines. For example, Russia has agreed with Germany, with the support of the United Kingdom (UK), to supply Germany and, eventually, the UK directly by building a natural gas pipeline under the Baltic Sea, thus bypassing Ukraine and Poland. In late January 2006, Gazprom was negotiating with Uzbekistan to obtain control of three of that country’s gas fields.Russia also is hoping to participate in the venture that is constructing a gas pipeline between Turkey and Greece.

Some have said that Gazprom may have overreached in its aggressiveness. A large share of Russia’s natural gas exports to Western Europe pass through Ukraine, which withdraws a certain amount of gas for its own use at a fraction of the world market price as payment for its transmission of the gas. Gazprom wants to raise Ukraine’s price to the market level. Negotiations on the issue failed, and Gazprom reduced gas pressure and flow through the Ukrainian network on January 1, 2006.

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11 (...continued)

12 “New takeover to make Russia’s giant Gazprom one of the world’s largest oil and gas companies,” Pravda, October 1, 2005 [http://english.pravda.ru/print/Russia/economics/ 8997-gazprom-0] viewed February 6, 2006.


Ukraine compensated by using some gas intended for West Europe; Gazprom accused it of “stealing.” Gazprom restored supply shortly after, when those countries complained and pointed out that Russia was risking its reputation as a reliable energy supplier. In a complicated agreement, the dispute was resolved temporarily on January 4, 2006. Gazprom will sell gas at its asking price to a trading company (half-owned by Gazprom and half-owned by an Austrian bank believed to act on behalf of Ukrainian interests). The trading company will mix Russian gas with less expensive gas from Central Asia and sell the mixture to Ukraine at the higher price that Ukraine had indicated it was willing to pay, but substantially lower than Gazprom’s price. Gazprom will pay cash instead of gas in kind to Ukraine’s pipeline business for increased transit fees. One report stated that Gazprom wanted to gain at least some ownership of Ukraine’s pipeline system. Later in January 2006, through no fault of Russia, the apparent reliability of Russian natural gas supplies suffered further when severely cold weather in Russia boosted Russian demand for gas and cut exports below contracted volumes. As of late February 2006, the full details (including duration) of the Russia-Ukraine agreement had not been agreed upon and signed.

Russia also cut off gas to Moldova in early January in connection with a price dispute. The countries reached an interim agreement after Moldova had been without Russian gas for two weeks. Gas supplies to large parts of Armenia and Georgia were disrupted in late January 2006 when explosions hit two Russian pipelines. The cutoffs to Ukraine and Moldova in price-dispute contexts have led several former Soviet Union as well as West European countries to investigate non-Russian sources of natural gas.

Russia initially opposed western investment in Caspian Sea energy projects, insisted that oil from the region be transported through Russian territory to Black Sea

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21 For fuller discussion, analysis, and updating of the Russia-Ukraine gas dispute, see CRS Report RS22378, *Russia’s Cutoff of Natural Gas to Ukraine: Context and Implications*, by Jim Nichol, Steven Woehrel, and Bernard Gelb.


ports, and argued for equal sharing of Caspian Sea oil and gas. This attitude partly reflected the extensive energy ties between Russia and Central Asian countries stemming from the numerous transportation routes from that area through Russia. But Russia has become more agreeable, and even cooperative with, western projects; and it has signed an agreement with Azerbaijan and Kazakhstan on Caspian seabed borders essentially based upon shore mileage.

In East Asia, China, Japan, and South Korea, are trying to gain access to the largely undeveloped energy resources of eastern Siberia, as those countries strive to meet their increasing energy needs while reducing dependence on the Middle East. China and Japan appear to be engaged in a bidding war over Russian projects and are contesting access to Russian rival oil pipeline routes.

**Major Proposed New or Expanded Pipelines**

Because Russia’s export facilities have limitations of location and size, there are a number of proposals to build new or to expand existing Russian oil and natural gas export pipelines and related facilities. Some proposals are contentious and, while the Russian government perceives a need to expand its oil and gas export capacity, it has limited resources. Several selected proposals are discussed below.

With a 1.2-1.4 million bbl/d capacity, the 2,500-mile Druzhba line is the largest of Russia’s oil pipelines to Europe. It begins in southern Russia, near Kazakhstan, where it collects oil from the Urals and the Caspian Sea. In Belarus, it forks at Mozyr, from which one branch runs through Belarus, Poland, and Germany; and the other through Belarus, Ukraine, Slovakia, the Czech Republic, and Hungary (Figure 2). Work has begun to increase capacity between Belarus and Poland. An extension to Wilhelmshaven (Germany) would reduce Baltic Sea tanker traffic and allow Russia to export oil to the United States via Germany.

**Figure 2. Druzhba and Adria Oil Pipelines**

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24 Much of the discussion of Russian oil and gas pipelines is taken from the *Russia Country Analysis Brief* of February 2005, prepared by the Energy Information Administration.
The Baltic Pipeline System (BPS) carries crude oil from Russia’s West Siberian and Tyumen-Pechora oil provinces westward to the newly completed port of Primorsk on the Russian Gulf of Finland (Figure 3). Throughput capacity at Primorsk has been raised to around one million bbl/d, and, pending government approval, will be expanded to 1.2 million bbl/d. The BPS gives Russia a direct outlet to northern European markets, reducing dependence on routes through the Baltic countries. The re-routing of Russian crude through the BPS has incurred considerable cost to those countries. Russian authorities have stated that precedence will be given to sea ports in which Russia has a stake over foreign ones. But the waterways through which tankers leaving from Primorsk and most other Russian export ports must transit limit tanker size, and therefore the price competitiveness of their cargoes.

Proposed lines would carry oil from Russia’s West Siberian and Tyumen-Pechora basins west and north to a deepwater terminal at Murmansk or Indiga on the Barents Sea (Figure 3). This would enable 1.6-2.4 million bbl/d of Russian oil to reach the United States via tankers in only nine days, much quicker than from the Middle East or Africa. Liquefied natural gas facilities at Murmansk and Arkhangelsk also have been suggested, possibly allowing for gas exports to American markets. The Indiga route would be closer to the Tyumen-Pechora oil fields and shorter; also Transneft’s CEO has said that the Murmansk project is not economically feasible. However, in contrast with Murmansk, the port of Indiga ices over during the winter, a disadvantage that may be reduced or eliminated if Arctic ice melting continues.

The Adria oil pipeline runs between Croatia’s Adriatic Sea port of Omisalj and Hungary (Figure 2). Originally designed to load Middle Eastern oil at Omisalj and pipe it northward to Yugoslavia and then to Hungary, the pipeline’s operators and transit states have been considering reversing the flow — a relatively simple step — giving Russia a new export outlet on the Adriatic Sea. Connecting the pipeline to
Russia’s Southern Druzhba system requires the agreement of Russia, Belarus, Ukraine, Slovakia, Hungary, and Croatia. These countries signed a preliminary agreement on the project in December 2002; however, negotiations over the details (including tariffs and environmental issues) have been slow. Some analysts expect that the Adria pipeline could transport about 100,000 bbl/d of Russian crude oil in the first year of reversal, with an ultimate capacity of about 300,000 bbl/d.

The prospective large Chinese market for oil has led to serious consideration of building a pipeline from the Russian city of Taishet (northwest of Angarsk) to Nakhodka (near the Sea of Japan) or to Daqing, China (Figure 4). Both routes pass close to Lake Baikal — a site with environment-related obstacles. The Nakhodka route, which is longer, would provide a new Pacific port from which Russian oil could be shipped by tanker to Japan and other Asian markets and possibly to North America. Japan has offered $5 billion to finance construction and $2 billion for oil field development. The Daqing option is favored by China, although China could obtain exports via the Nakhodka route. China has pledged to invest US$12 billion in Russia’s infrastructure and energy sector by 2020. From Russia’s point of view, the Nakhoda route would offer access to multiple markets, whereas a terminus at Daqing would give China control. However, Russia’s environmental safety supervisory body rejected the shorter route because it would pass too close to Lake Baikal, a United Nations world heritage site.

Figure 4. Proposed Far East Oil Pipelines

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The 750-mile Blue Stream natural gas pipeline, 246 miles of which is underneath the Black Sea, connects the Russian system to Turkey. In February 2003, natural gas began flowing through the pipeline, which has a design capacity of 565 billion cubic feet annually. In March 2003, Turkey halted deliveries, invoking a contract clause allowing either party to stop deliveries for six months. Turkish leaders reportedly were unhappy with the price structure. Other factors may have come into play, including Turkey’s commitment to receive more supplies than its near term domestic consumption and agreements to transship gas to other countries. An agreement was reached in November 2003 and the flow resumed in December 2003.

The Yamal-Europe I pipeline (Figure 5, unidentified northern route in Russia), which carries 1 tcf of gas from Russia to Poland and Germany via Belarus, would be expanded under one proposal by another tcf per year. However, Poland and Gazprom disagree on the route of the branch that goes through Poland. Poland wants a route entirely through its own country and then to Germany (Yamal-Europe on the map), while Gazprom is seeking a route via southeastern Poland and Slovakia (Yamal II).

Figure 5. Natural Gas Pipelines to Europe

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A North Trans-Gas pipeline, or North European Gas Pipeline (NEGP), extending over 2,000 miles from Russia through the Gulf of Finland to Denmark and, ultimately, to the United Kingdom, via the Baltic and North Seas was proposed in June 2003 by Russia and the United Kingdom. Gazprom and Germany’s BASF and E.ON agreed on September 8, 2005, to set up a joint venture to build the pipeline. Originating in the St. Petersburg region, about 700 miles of the pipeline is to pass under the Baltic Sea. The first leg of the pipeline, which is under construction, is scheduled to come on stream in 2010. Russia sees a gain by no longer having to negotiate transit fees with intermediary countries or pay them in natural gas. The pipeline agreement is criticized by some Europeans who object to the fact that it was reached without consultation with them, and see the pipeline as an unfair bypass with political motivation and environmental risk. Perhaps to supplement or substitute for the NEGP, Gazprom is planning to build an LNG plant in the St. Petersburg area.

Rusia Petroleum — a consortium of TNK-BP, South Korea’s state-owned Korea Gas Corporation, and the Chinese National Petroleum Company — has announced plans to construct a pipeline connecting Russia’s Kovykta natural gas field (2 trillion cubic meters of gas reserves) to China’s northeastern provinces and across the Yellow Sea to South Korea. The plan calls for a pipeline that ultimately would have a capacity of 40 billion cubic meters per year, delivering roughly half of its natural gas to China and the rest to South Korea and the domestic market en route.

**Implications for the United States**

Given that the United States as well as Russia is a major energy producer and user, Russian energy trends and policies affect U.S. energy markets and U.S. economic welfare in general in a broad sense.

Other things being equal, should Russia considerably increase its energy production and its ability to export that energy both westward and eastward, it may

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tend to ease the supply situation in energy markets in both the Atlantic and Pacific Basins. In the Atlantic arena, more Russian oil could be available to the United States. In the Pacific area, there would tend to be more supply available to countries trying to assure themselves energy supplies, such as China and Japan. This may ease the global competition for Persian Gulf oil.

On the other hand, the Russian government’s moves to take control of the country’s energy supplies noted earlier may have the effect of making less oil available on the world market.

Possibly as important as Russian oil and gas industry developments is the associated potential for U.S. suppliers of oil and gas field equipment and services to increase their sales in Russia. Although U.S.-Russian economic relations have expanded since the collapse of the Soviet Union, as successive Russian leaders have been dismantling the central economic planning system, including the liberalization of foreign trade and investment, the flow of trade and investment remains very low. U.S. suppliers of oil and gas field equipment have established a modest beachhead in Russia, however. U.S. exports of oil field machinery and equipment accounted for 9% of U.S. all goods exports to Russia in the first 10 months of 2005, one of the largest export categories. As noted earlier, potential growth of both oil and natural gas production in Russia is limited by the lack of full introduction of the most modern western oil and gas exploration, development, and production technology.

Similar to U.S. trade with Russia, U.S. investments there, especially direct investments, have increased since the dissolution of the Soviet Union, but the levels are far below their expected potential. Even so, as of the end of 2003, the United States was Russia’s second largest source of foreign direct investment, largely concentrated in energy, communications, engineering, and transportation.34

In this context, however, Russian economic policies and regulations have been a source of concerns. The United States and the U.S. business community have asserted that structural problems and inefficient government regulations and policies have been a major cause of the low levels of trade and investment with the United States. While they consider the climate to be improving, potential investors complain that the climate for investment in Russia remains inhospitable. They point to lack of effective intellectual property rights protection, burdensome tax laws, jurisdictional conflicts among Russian federal, regional and local governments, inefficient and corrupt government bureaucracy, and the lack of a market-friendly commercial code as impediments to trade and foreign investments. And, more specifically, the forced breakup of Yukos has clouded prospects for private investment.

In addition, Russian energy trends and policies have possible implications for U.S. energy security. In its oversight role, Congress may have an interest in Russia’s large role as a supplier to world energy markets in general, in Russia’s role as a possible major exporter of energy to the United States, and in the changed patterns of world energy flows that could result from the completion of new Russian oil and

natural gas export pipelines and related facilities or the expansion of existing export pipelines and related facilities