

**Gazprom and the Russian Economic Diplomacy
Towards the EU: Blurred Frontiers Between the Company and the
State**

Estela Vieira

estelav@eeg.uminho.pt

MSc. Student in International Relations

Abstract

This study seeks to analyse the Russian energetic sector as the backbone of the Russian economy and its importance in the shaping of the Russian foreign policy. The scope of our analysis is the company Gazprom, a state 'quasi-gas-monopoly', which plays an assertive role in the steering of the Russian strategy to become a leading international actor. It is an undeniable fact that interdependence ties both international players: The EU and Russia. The EU fears Russia might use energy (gas and oil) as a 'weapon'. Nevertheless, considering that there is strong mutual dependence, we do not foresee Russia attempting to use this as a diplomatic lever because it would ruin its eagerness to be perceived as a hydrocarbons reliable supplier in the international scenario.

Key words: Gazprom, gas, weapon, leverage, assertiveness and interdependence.

1. Introduction

In the aftermath of the Yeltsin period, which almost eroded the Russian economic, political and social fabric in late 1990's, Vladimir Putin was elected as the President in March 2000. At the outset of his first mandate, his very first task was to put Russia back on its feet and regain Russian national pride, which he did. He was elected to a second mandate, which just ended in March 2008. From 2004 onwards, Putin engaged himself in the shaping and building of a strong Russia whilst tailoring the Russian strategy to become a leading international actor just as it used to be throughout the Soviet period. Again, Putin was able to meet his strategic goals after the unstable 1990's. The 'bear is back'.

While the EU seeks to go beyond the 'nation-state' paradigm and, at the same time, tailor a supranational model relying upon the 'rule of law' and its institutions, Russia seeks to restore nationalism and 'power politics' (Kagan. 2008). This is in line with Putin's 'vertical sovereignty' thus outshining as an assertive coercive international actor willing to play a major role in the shaping and building of international society.

This study aims to analyse the energetic sector's input for the stabilisation of Russia's economy and determine whether it can be considered a coercive, aggressive and assertive actor of economic diplomacy internationally. Evidence sheds light upon interdependence between Russia/Gazprom and the EU. The truth is that the EU depends on Russia (its fossil natural resources) and on the 'transit countries' and Russia also strongly depends on the EU markets and on the 'transit countries' as well.

Gazprom appears to be a Presidential tool and we fail to pinpoint the frontiers between government and company. The question is can we speak of a "government corporate diplomacy" player or are we face-to-face with a "corporate government diplomacy" actor?

2. The Russian energetic sector

The Russian energetic sector has been his most favourable ally, especially the oil prices which have dramatically increased in the last few years. According to Hill, (2004. i) "It has transformed itself from a defunct military superpower into a new energy power". In this light, the hydrocarbons have played a major role and may be considered as the milestones which supported and steered the Russian economic and political home stabilisation. Indeed, Russia sits upon considerable reserves of oil and upon the world's richest natural gas resources which is why they have also fuelled the Russian foreign policy. Russia has thus become a strong assertive player internationally.

Although Russia's natural energetic resources outshine as undeniable foreign policy levers, we should not ignore it has to accommodate its interests with its neighbours', namely the Commonwealth of Independent States (CIS) and the European Union (EU). Thence, one can pinpoint a relation of strong interdependence amongst all the involved actors. The EU "remains the primary export market" (Miller. 2008)¹; on the other hand, the EU does also have to adjust to Russia's and the CIS's interests as well. Should both actors ignore this most important premise, which would create an outpouring of conflict and negative impact upon good neighbourly relations. Last, yet not the least, the Russian decision-making process is also utterly conditioned by its neighbours (CIS), the European Union and the United States of America.

3. The GAZPROM 'behemoth'

Gazprom was founded in the aftermath of the Soviet Empire in 1993. It is the Russian natural gas 'champion' due to the fact that it owns most of Russia's natural gas resources; it controls the pipeline grid system which distributes "nearly all gas in Russia". It is also responsible for "the

¹ Alexei Miller is Gazprom CEO.

marketing of natural gas on the domestic market" (Heinrich & Kuszniir 2005:5). It therefore dominates the Russian natural gas output growth. Despite its ongoing leap forward in terms of production and the internationalisation process, the natural gas sector had been quite lethargic for decades.

As the world's largest natural gas company, Gazprom's array of production activities include geological exploration, production, transmission, storage, processing and marketing of gas and other hydrocarbons. It sits on the world's richest natural gas supplies and its share in the global gas production is 20% and 85% of domestic production. Taking one look at global figures, it possesses over 60% of "the global and Russian proven gas reserves"². It is a reliable supplier as it owns the world's largest gas transmission grid: it holds control of over 80% of the national gas distribution pipeline system³.

Gazprom is owned by more than 500,000 shareholders; it employs about 430,000 employees and the state's share is 51,002%. Its share capital structure, as of September 2007, is as displayed below:

Table 1: OAO Gazprom⁴ Share Capital Structure

Shareholder	Share %
Russian Federation	50,002
Federal agency for federal property management	38,373
OAO Rosneftegaz	10,74
OAO Rosgazifikatsiya	0,889
ADR* Holders	16,84
Other registered persons & entities	33,158
Total	100

Source: www.gazprom.ru.

² See www.gazprom.ru.

³ See www.gazprom.ru.

⁴ Gazprom was founded on 17 February 1993 and its designation was RAO Gazprom – Russian Joint Company Gazprom. It has undergone a privatisation process in 1998 and its new name is OAO Gazprom which stands for Open Joint Stock Company Gazprom. [www.gazprom.ru.].

Source:

http://eng.gazpromquestions.ru/fileadmin/template/docs/light__engl_28_03_08.pdf

* Gazprom shares are traded in the foreign market in the form of ADRs. Therefore, to be sold in the foreign market shares have to be converted in ADRs.

Gazprom is undeniably "Russia's quasi-gas-monopoly" (Heinrich 2008:8), which feeds the domestic market and supplies its major consumers in the West (the EU) as well as the CIS. It is the cornerstone of the Russian industrial, economic and social policies which, in our view, explains the state's eagerness to fully control the company. The Russian Federation is the major shareholder: it owns about 51% of shares, which allowed the state to reinforce its control over the company. This is of strategic importance for the national economy⁵. Gazprom's taxes account for about 25% of the State budget. It controls about 95% of the natural gas reserves and it produces 86% of Russian gas.

Thence, it acts as an extension of the Russian government. As Putin (2008) states: "The success of the company has been in large part due to intelligent and flexible policies, not only Gazprom's but also those of the government and the State. Such close cooperation is in full accord with the current trends in the global oil and gas industry"⁶. We deem it important to underline that we do not foresee a change in this policy as he continues to say "(...) it provides the company, (...) with additional opportunities for long-term development. Given Gazprom's strategic importance for Russia, the State will continue to keep the situation under its direct control".

Gazprom CEO Miller's statement is consistent with Russian President Putin's approach the international markets: "Boosting the state's share of Gazprom (...). Ongoing global competition to gain and control over

⁵ See www.gazprom.ru.

⁶ Vladimir Putin's Speech at a Gala Evening to celebrate the 15th Anniversary of Gazprom's Incorporation, 11 February 2008, Moscow.

[http://www.kremlin.ru/eng/speeches/2008/02/11/1416_type84779type127286_159879.shtml].

hydrocarbon reserves has shown that state-owned and backed companies have considerable advantages in obtaining positions in international markets. (...)"'. In the Russian elite view Gazprom definitely "combines successfully the advantages of transnational energy giants with the beneficial features of the national state owned companies"⁷.

Regarding Gazprom's strategy to delve into international alliances and businesses, it has been addressing mostly its principal western consumer, the EU. Although some western countries have been attempting to materialise some barriers to its expansion, it has been investing in European downstream markets – via the acquisition of assets in Europe, which is consistent with Gazprom "striving for greater integration in the world market" during the last years (Heinrich 2006: 2). In this light, Gazprom has tailored a foreign investment policy we would consider assertive in order to enter international markets. On the other hand, this internationalisation strategy uncovers the fact that Gazprom has been quite active in its attempts to "consolidate its dominant monopoly position in the opaque markets of the CIS" (Heinrich 2006: 6).

4. *Gazprom and the EU and the CIS's 'Transit Countries'*

As aforementioned, the European Union outshines as Russia's and Gazprom's major market. Heinrich (2008) claims that the EU gas market liberalisation⁸ has most certainly steered Gazprom's internationalisation process in Western Europe.

⁷ Alexey Miller, Gazprom's annual general shareholders' meeting to convene 30 June 2006. "Gazprom- Strategy for the energy sector leadership. [<http://www.gazprom.com/eng/articles/article20334.shtml>].

⁸ Andreas Heinrich (2008: 8) establishes a timeline along which there can be depicted a pattern that fuelled Gazprom expansion: the EU gas directive (98/30/EC), which "laid down the common rules for an EU internal gas market in which eventually all users were to have a choice of supplier (...) came into force in 2000"; the directive (2003/55/EC), which establishes "the EC wanted to reduce the power energy companies by obligating them to split up or 'unbundle' the ownership of generation and distribution networks (...) [it] granted all non-household gas consumers the right to choose their supplier freely as of July 2004 (...) with all costumers to have this right by 1 July 2007"; the third liberalisation package would

On the other hand, we deem it important to emphasise that the EU liberalisation directive intends to free access to pipelines to all gas producers. However, the Commission "acknowledges that the bedrock of Europe's gas supplies are its long-term import contracts with Gazprom, which contain a 'take and pay' provision"⁹, meaning European gas importers are committed to their long-term agreements with Gazprom

Table 2. Long-Term Agreements between Gazprom and European Importers

		Year
France	Gaz de France	2030
Germany	E.ON Ruhrgas	2035
	Winteshall	2035
Finland	Gasum	2025
Czech Republic	RWE Transgas	2035
Italy	ENI	2035
Contract Extension and new arrangements were agreed on with:		
Austria	Econgas	s.d.
	GWH	s.d.
	Centrex	s.d.
Romania	Conef Energy SRL	as of 2010 till 2030

Source: www.gazprom.ru.

This is consistent with the idea that they do not seek to do business with the EU, which lacks a 'common stance' in terms of its common energy policy. Instead, it privileges the fact of doing business with each EU's capital. Grazin (2008: 10) claims "Russia is smart enough to avoid any energy deals with Europe as a whole. It is clever enough to grasp Europe's fundamental humanitarian value and nationalistic enough to itself to seek to divide individual countries from one another by offering the special energy deals on a one-to-one basis". This is in line with the idea that liberalisation of the EU gas market has to go hand in hand with further diversification (for example LNG) and there is no point in protecting national energy

be enforced in September 2007 and it would focus upon "anti-competitiveness within European energy markets".

⁹ <http://eng.gazpromquestions.ru/index.php?id=4>.

champions. Thence, it means the whole energy sector in the EU leaves Gazprom to its own manoeuvring, which sheds light upon a classic company strategy, and it is up to the EU to tailor a 'common stance' seeking to hinder Gazprom from resorting to bilateralism. It would thus allow the EU to shape and build its "bargaining position toward Gazprom/Russia" and it should seek to stimulate both Russia and the CIS's 'transit countries' to adopt a more business-like behaviour (Heinrich. 2008).

It is worth mentioning Verlag's claims regarding this matter. Verlag (2008) produced a review on Alexander Rahr's *Russland gibt gas*. According to Rahr, Russia and Europe mutually depend upon each other "in purely pragmatic, geopolitical way, and this basis can be used to build trust and to nurture common values". As Rahr understands this relation, Russia seeks to deepen this "pragmatic interdependence". Thence, should Europe ignore Russia's expectations, it may seek to further stimulate Russia to establish partnerships with the Asian giants (India and China). However, we deem it important to highlight the fact that Gazprom is already expanding eastwardly (construction of new pipelines, *et cetera*) and also in Northern Africa, in Algeria and Libya, which highlights Russia's eagerness to diversify its markets globally.

5. Gazprom is perceived as the Bear

Resorting to a 'double standard policy' clearly highlights Gazprom/Putin attempts to be part of the EU decision-making process, *de facto*, whilst seeking to smooth, preferably eradicate, the impact of European policies (in this case, the energy policy) on Russia's internal affairs. This coercive and assertive economic diplomacy model also outshines in the 'near abroad'. As aforementioned, natural gas exports are a clear foreign policy lever manoeuvred by the Kremlin in their relation with the 'transit countries' – CIS – whilst attempting to exert a hegemonic influence. Therefore, it favours the 'state-regulated markets model' (*status quo*) in the CIS. In our view, this seems to explain that the "mutual manipulation and instrumentalisation between Gazprom and Government is

commonplace" (Heinrich 2008). It is interesting to highlight, the 'double standard policy' is also commonplace in their attempt to manipulate its EU importers and the international market, the 'far abroad', which is in line with Gazprom being keen to bilateralism. In our opinion, this is consistent with the continuous gas cuts which show the Kremlin's manipulative policy of the 'near abroad' market and it feeds the 'far abroad' scepticism about Gazprom's credibility as partners, albeit they have been reliable for over thirty years now. In addition, the EU is utterly worried about energy security as it fears Russia may use its energy policy as a weapon and leverage tool. For example, should the EU not favour liberalisation, Putin would retaliate: "The EC legislation ... bans any non-EU companies from controlling European gas networks" (Heinrich 2008:9). The EU did not enforce the legislation and Gazprom "could still acquire generation, production and retail assets" (Heinrich 2008:9), which is why Gazprom did not have to "take retaliatory measures if the EU decided to limit its expansion" (Heinrich. 2008:9).

6. Does Russia suffer from an endemic 'natural resource curse'?

The Russia-EU economic dialogue seems to be the most institutionalised one, especially in the energy policy related field¹⁰. This sector's exports have played a key role in the Russian economy because it allowed the equalising of the Balance of Payments. Its contribution to GDP is 25-30% at current (ruble) prices (Hanson 2008). It is important to underline that Gazprom only exports 37% of its production (to Europe, mainly), whereas this 37% corresponds to about 65% of its revenue. In this light, 63% of its production is for home consumption, which only accounts for 35,5% of the net income. Therefore, Russia depends too much on oil

¹⁰ This dialogue is regulated by the Partnership Agreement Cooperation (PAC), the Four Common Spaces and the Road Maps (for the Four Common Spaces). Regarding the 'near abroad', Russia failed to ratify the "Transit Protocol" with the CIS and in the 'far abroad' it refuses to sign and enforce the Energy Charter Treaty (ECT). Finally, Russia is still conducting encompassing negotiations to be a partner within the World Trade Organisation (WTO). Russia has to raise prices at home as agreed in the EU *fora* to enter the WTO.

and gas exports. According to Hanson (2008), Russian economic growth is 'oil-fuelled', which means that when oil and gas prices rise, it somehow boosts the whole production fabric. Its GDP is rather sensitive to the international oil price. A dramatic fall could even reverse its growth, *ceteris paribus*. Hanson believes Russia is not free from complications associated to the natural resource curse. Its policy-making rests highly on the current oil prices and upon a "state-led innovation strategy" and no sort of stimuli to diversity investment cannot be traced. Hanson believes Russia cannot secure the current hydrocarbons output growth throughout the next decade in the sense that it may actually slow down.

On the contrary, Heinrich (2008) claims that Russia has a rather sophisticated industrial and economic tissue. In this sense, it is poorly affected by the so-called 'resource curse' as nations like Azerbaijan or Kazakhstan. Still Russia is not a typical petro-state implying it should avoid over reliance on its natural resources and restrain its desire to over protect industries from 'national importance'. "A reliable and clear FDI regulation would be helpful to attract foreign investors and to improve the competitiveness of Russian companies" (Heinrich. 2008).

Pondering these two different views, it seems that a few questions are to be answered in the future. Can Russia increase and/or maintain the current level of production? Can it rely upon gas and oil as the main drive to a "fast growing economy"? Evidence shows that the frontiers between the State and the company itself are too blurred and one questions if the west¹¹ can rely on Russia as its hydrocarbons main supplier? Is there any energetic security?

7. Asymmetry and interdependence

As we have seen, there is evidence of a strong over reliance upon the gas and oil exports. Indeed, Russia strongly depends on not only the EU but also its neighbours (Ukraine and Belarus). These are involved in the

¹¹ When the author refers to the "West", she refers mainly to the European Union.

transfer/distribution process of natural gas and crude as well. The 'transit countries' have been a milestone while a 'connecting-link' between Russia and the EU.

Likewise, the dependence of the EU on Russia's hydrocarbons is undeniable. The EU imports about 1/3 of its oil consumption from Russia and about half of its natural gas consumption. This dependence differs from country to country: some Member States depend a lot (Germany) and others do not depend at all (Portugal and Spain). This dependence can be measured, though. It is between 34-40%. This is a matter which utterly concerns the EU and it, therefore, attempts to design ever more consistent partnerships with Russia and to nurture energetic dialogue in a most transparent style.

The EU also asserts that it wants to shape the relationship and not to fuel bitterly the dialogue in order to avoid Russia's claims that it does not endure other than a mature relationship. Russia demands to be treated as an 'equal partner' instead of a 'junior partner' whenever both economic diplomacy actors negotiate new partnerships and/or review the established ones.¹²

The EU also depends on the 'transit countries'. The Russian-Ukrainian crises (2005-2006) and the Russian-Belarusian one outshined the dependence of the EU on the 'transit countries'. "(...) the EU depends not solely on the Russian decision making, but on the Ukrainian and Belarusian one as well" (Borisova 2007: 17).

The aforementioned disputes between Russia and its 'near abroad' have taught the EU a lesson: Russia does not seem to be hindered by the EU but rather it is ready to adopt unilaterally any measure to secure its interests. The EU should then seek to diversify its supplying markets, namely Algeria.

¹² The PAC is a paradigm in this case. It was enforced in 1997 and it lasted until late 2007. It is now in force but no revision was made. The *acquis* between both actors is poor, but Russia made clear the EU should not take for granted it accept any sort of treaty. Russia is mature enough to design and propose new treaties to be discussed in-depth by the involved parties.

It is interesting to point out that Russia continues to invest abroad. Gazprom has been attempting to manipulate Algeria and Libya "in an attempt to establish an international cartel to control the majority of the European market's gas supplies (Heinrich. 2008:10). We deem it interesting to mention that most recent developments, when Putin officially visited Libya, corroborate this idea: "The world's major gas-producing nations are undecided about whether to turn to the current informal group, the Gas Exporting Countries' Forum, into a more formal organisation with an OPEC-Style Charter" (Twickel 2008). It is worth mentioning that the EU and the USA have already voiced their concern about this: "warned that a gas cartel would pose serious danger to global energy security and create a room for price manipulation" (Twickel. 2008). We may conclude there is growing tension.

Conclusion

The 'Bear is back'. Russia has succeeded in pulling itself together from the chaotic 1990's. Russia seeks to be a leading global nation and Gazprom is clearly used as a foreign policy lever which is used to manipulate and shape decision-making internationally.

Russia's assertive strategy to go international and global is consistent with its strong investment policy in the European downstream markets; nonetheless, Russia/Gazprom has to stimulate home upstream investment in order to change current production obsolescence. Although some innovation can be depicted, it is not sufficient to respond to medium and long-run impact of a future slowing down of the levels of production, overreliance on hydrocarbons and exhaustion of natural resources reserves in the decades to come. On the other hand, and due to the international agenda on climate change, Russia needs also to deal with international organisations' pressures to reduce greenhouse gas emissions.

Gazprom is an assertive bilateral player eager to follow a 'double standard' model whenever its interests are at stake. Although Gazprom is an economic diplomacy actor resting upon coercive and aggressive tools to

defend the Kremlin's interests, it also has to bear in mind that international markets are interdependent, in general. In particular, the Kremlin should seek to equate the fact that if its major market (the EU) depends a great deal on its energetic natural resources (hydrocarbons), and on the 'transit countries', it also depends on the EU markets and on the 'transit countries'. We, thus, believe the EU should seek to liberalise its markets whilst encouraging and fuelling both Russia and the 'transit countries' to render formal a more business-like behaviour model. In addition, a lack of a 'common stance' favours and strengthens Russia bilateralism.

Finally, considering the fact that Gazprom is a state's tool to stabilise its domestic economy and a foreign policy lever, and also that a clear frontier between the Kremlin and Gazprom/company cannot be depicted, the question is: do we have a "government corporate diplomacy" actor or are we dealing with a "corporate government diplomacy" actor?

We believe Putin seeks to tailor a 'politically correct market economy' (Larsen.2006) to enter international markets. Yet, he fosters bilateralism, applying a 'double standard'. The result is that the Kremlin's policy is ostentatiously functional and builds a disregard of the 'rule of law' and a centralised economy. Under these circumstances, the market is in line with the Kremlin's agenda, which attempts to hide its presence. Putin's 'vertical power' masks domestic instability which worsens overreliance on Russia's fossil resources.

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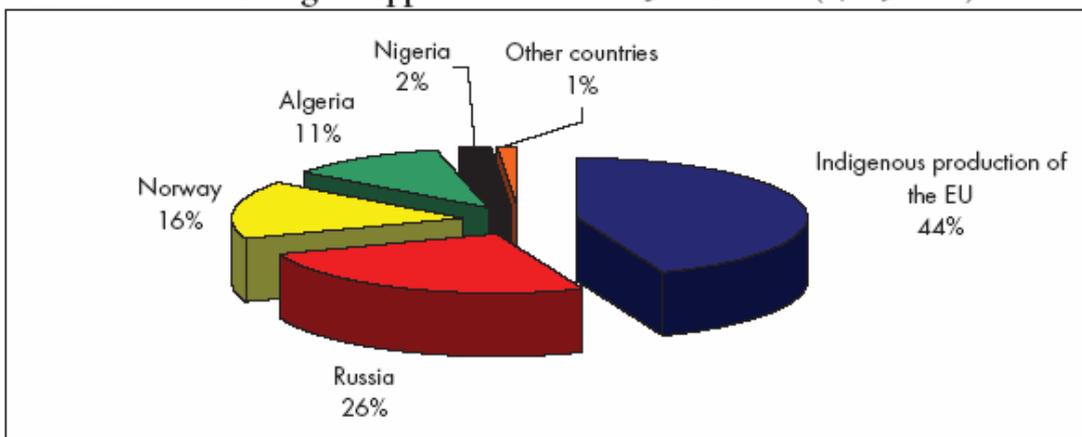
Appendices

Table 1: Gazprom's prices for natural gas produced by the company itself (US\$ per 1000m³)

	2005	2006
CIS		
Ukraine	50	230
Belarus	47	47
Georgia	68	110
Azerbaijan	60	110
Armenia	56	110
Estonia, Latvia, Lithuania	85–95	120–125
Moldova	80	160
Russia		
Average domestic price	38	46
Europe		
Average price for Western Europe	174	250
Germany	200	n. a.
Poland	120	n. a.
Turkey	75	n. a.

Source: Roland Götz, *SWP Aktuell No.3*,
www.swp-berlin.org

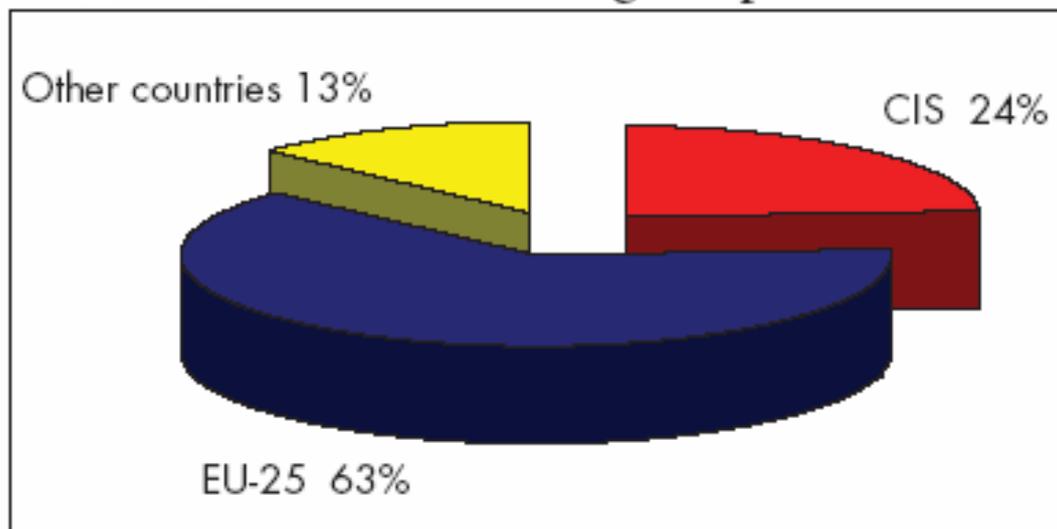
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Natural gas supplies of the EU-25 countries (474.94 m³)

Source: BP Statistical Review of World Energy 2005, p. 27–28; author's calculations.

In Andreas Heinrich. 2006. *Gazprom – A reliable partner for Europe's energy supply?* Russian Analytical Digest, No. 1 [http://www.res.ethz.ch/analysis/rad/].

Russian natural gas exports



Source: BP statistical review of World Energy 2005, p.27-28; author's calculations

In Andreas Heinrich. 2006. *Gazprom – A reliable partner for Europe's energy supply?* Russian Analytical Digest, No. 1 [http://www.res.ethz.ch/analysis/rad/].