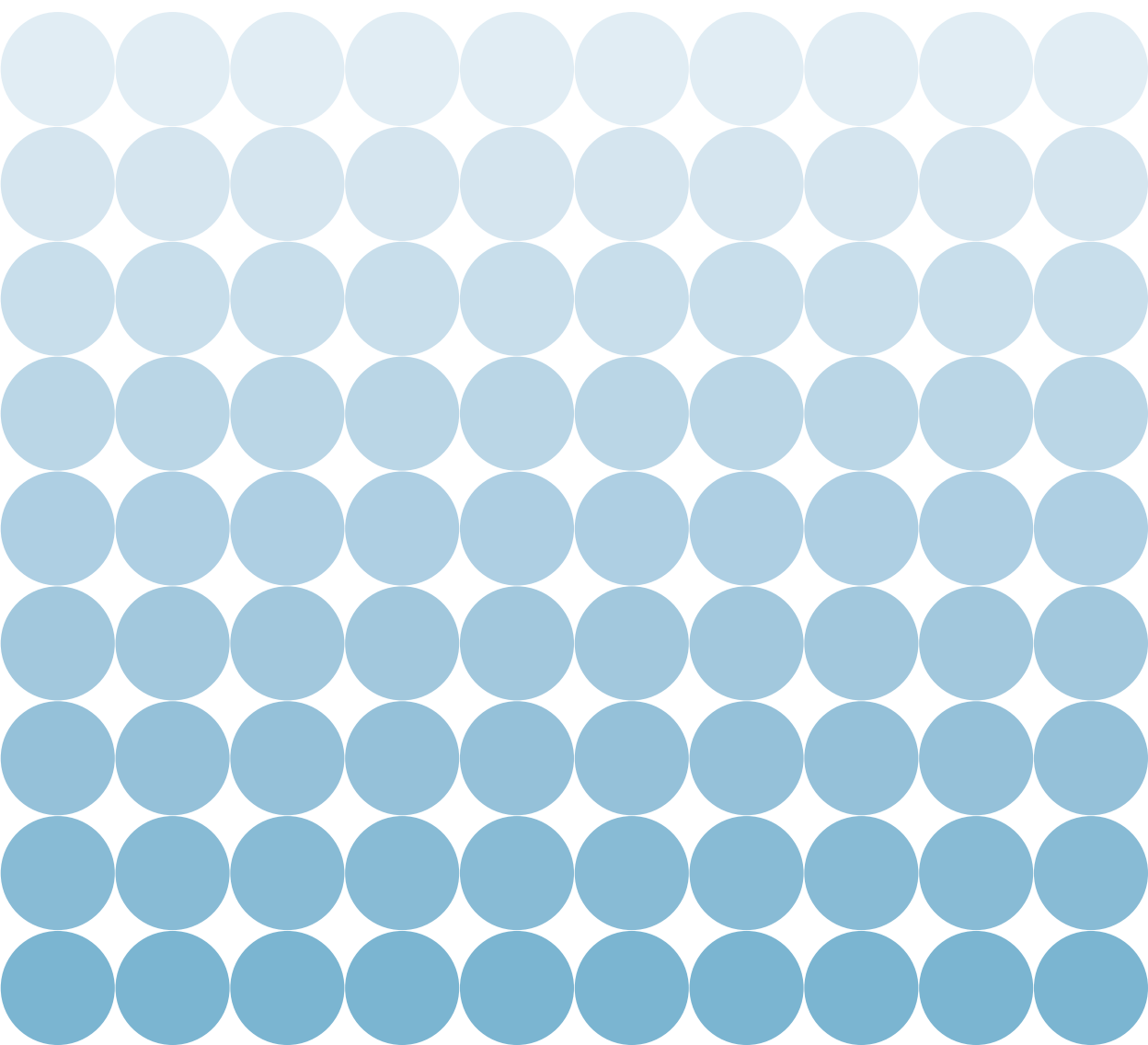


# **RUSSIA'S EVOLVING ARCTIC STRATEGY**

Drivers, Challenges  
and New Opportunities

EKATERINA KLIMENKO



## **STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE**

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### **STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE**

Signalistgatan 9  
SE-169 70 Solna, Sweden  
Telephone: +46 8 655 97 00  
Fax: +46 8 655 97 33  
Email: [sipri@sipri.org](mailto:sipri@sipri.org)  
Internet: [www.sipri.org](http://www.sipri.org)

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SIPRI Policy Paper No. 42

EKATERINA KLIMENKO



**STOCKHOLM INTERNATIONAL  
PEACE RESEARCH INSTITUTE**

September 2014

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Printed in Sweden

ISSN 1652-0432 (print)

ISSN 1653-7548 (online)

ISBN 978-91-85114-86-3

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# Preface

This Policy Paper is being published at a particularly important and sensitive moment. While the Arctic contains considerable undeveloped resources, realizing their potential benefits depends on cooperation.

In the not-too-distant past, it seemed possible that the Arctic would emerge as a region in which states would develop a rule-based, peaceful and prosperous common future through constructive engagement. However, recent events have cast doubt on whether or not there is any basis for cooperation between Russia and partners in Europe, or the wider Euro–Atlantic community, to bring major projects in the Arctic to fruition.

In 2015, the year of the 40th anniversary of the signing of the Helsinki Final Act, which led to the creation of the Organization for Security and Co-operation in Europe (OSCE), states are likely to begin thinking about how to design a post-OSCE security system for Europe. In a climate of declining trust, the credibility of political agreements is being questioned and the scope for reaching legal agreements is reduced. Against a background of economic sanctions and restrictive measures, the investment climate is likely to deter partners from making major commitments to long-term projects. Even when international financing can be found, it is likely to be more expensive than anticipated—raising the cost of projects.

The scope for expanded cooperation between Russia and China in the Arctic region is examined in detail in this Policy Paper. As the author makes clear, the potential for expanded cooperation exists, but the prospect of translating potential into reality is by no means certain.

I am grateful to Ekaterina Klimenko for preparing this Policy Paper, which builds on extensive research carried out over a period of several years as part of SIPRI's Arctic Futures project, which explores the emerging political and security dynamics related to the future development of the Arctic region. On behalf of SIPRI, I would like to thank the Swedish Foundation for Strategic Environmental Research (MISTRA) for its generous funding of the project, without which the work would not have been possible.

Dr Ian Anthony  
Director, SIPRI  
Stockholm, September 2014

# Summary

Russia has identified the Arctic as both a strategic priority and a resource base for the 21st century. Against a backdrop of expectations about the opportunities available in the Arctic, Russia has primarily pursued a policy focused on strengthening national sovereignty in the region. However, despite the considerable attention given to the development of the Arctic by the Russian leadership, progress in achieving Russia's goals in the Arctic has been slow.

While debate has increased in the media and research community with regard to China's potential as a partner for development of the Arctic, significant challenges stand in the way of a major reorientation of Russian Arctic policy towards China. The success of Russia's recent energy cooperation with China will depend on solving previous problems, developing mutually acceptable forms of cooperation and increasing mutual trust.

# Abbreviations

ARC	Arctic Research and Design Center for Offshore Developments
CNPC	Chinese National Petroleum Corporation
COSCO	China Ocean Shipping (Group) Company
EU	European Union
LNG	Liquefied natural gas
NSR	Northern Sea Route
UN	United Nations
UNCLOS	United Nations Convention on the Law of the Sea



# 1. Introduction

The Russian Federation has made the development of the Arctic a strategic priority. Russia's President, Vladimir Putin, has stated that the Arctic is 'a concentration of practically all aspects of national security—military, political, economic, technological, environmental and that of resources'.<sup>1</sup>

The Russian leadership has identified the region as the resource base of the 21st century. The high price of energy and natural resources globally in the past decade and the expected increasing accessibility of the region as a result of climate change underpin Russia's positive assessment of the Arctic. Against a backdrop of strong expectations about the opportunities available in the Arctic, Russia has primarily pursued a policy focused on strengthening national sovereignty in the region.

Russia has sought to secure its territorial claims in the Arctic via the 1982 United Nations Convention on the Law of the Sea (UNCLOS), which Russia ratified on 12 March 1997.<sup>2</sup> UNCLOS defines the rights and responsibilities of states as regards the use and protection of the marine environment. Taking the view that the Arctic is the 'home' of Russia and other Arctic states, Russian officials have supported steps to develop a regionally determined set of rules for the development of the region through the Arctic Council—which consists of Canada, Denmark (including Greenland and the Faroe Islands), Finland, Iceland, Norway, Russia, Sweden and the United States—and the format of the so-called Arctic five (A5)—Canada, Denmark (via Greenland), Norway, Russia and the USA.<sup>3</sup> The Russian authorities have outlined ambitious plans to build up new Arctic capabilities and develop the region's resources and infrastructure. Simultaneously, the Russian Government has sought to place state companies in a position to play a leading role in the exploitation of energy resources and development of the Northern Sea Route (NSR).

Despite the considerable attention given to the development of the Arctic by the Russian leadership, notably by Putin himself, progress in achieving Russia's goals in the Arctic has been slow. Moreover, Russia has gradually come to understand that such progress rests not only on ownership of the region, but also on access to key markets, investment capital, and international expertise and technology. In the future Russia's management of interdependence, rather than its assertion of sovereignty in the Arctic, is likely to determine the prospects for development of the Russian Arctic.

In the context of an emerging wider Russian partnership with China on the basis of the convergence of interests, particularly in the spheres of energy and transport, debate has increased in the media and research community with

<sup>1</sup> Putin, V., 'Meeting of the Security Council on state policy in the Arctic', 22 Apr. 2014, <<http://eng.kremlin.ru/news/7065>>.

<sup>2</sup> United Nations Convention on the Law of the Sea (UNCLOS), opened for signature 10 Dec. 1982, entered into force 16 Nov. 1994, United Nations Treaty Series, vol. 1833 (1994).

<sup>3</sup> Six international organizations representing Arctic indigenous peoples also have permanent participant status in the Arctic Council. Arctic Council, <<http://www.arctic-council.org/>>.

regard to China's potential as a partner for development of the Arctic.<sup>4</sup> However, significant challenges stand in the way of a major reorientation of Russian Arctic policy towards China—challenges that stem from the countries' past energy cooperation.

Russia has traditionally looked to Western countries for its primary energy markets and for investment partners, expertise and technology. However, far-reaching shifts in energy markets and the deterioration of the political relationship between Russia and the countries of the West—especially in the light of Russia's actions in Ukraine, in mid-March 2014, to absorb Crimea into its territory—have forced Russia to look elsewhere. The importance of the Asia-Pacific region is also increasing, and Russian policy documents reflect the priority to 'turn East'.<sup>5</sup>

This Policy Paper analyses the evolving Russian Arctic strategy in the changing international context. Chapter 2 examines Russia's progress in the development of its Arctic resources and the NSR, and the international context of Russia's cooperation with other states in the Arctic in the light of the crisis in Ukraine. The prospects and obstacles for potential Chinese-Russian collaboration in the Arctic are explored in chapter 3 in the context of increasing Russia's oil and gas cooperation with China. Chapter 4 provides conclusions.

<sup>4</sup> See e.g. Byers, M., 'China could be the future of Arctic oil', Al Jazeera, 22 Aug. 2013, <<http://www.aljazeera.com/indepth/opinion/2013/08/2013821135829162420.html>>; Bennett, M., 'Unrest in the West: what does Ukraine mean for Russian Arctic gas development?', Cryopolitics: Arctic News & Analysis Blog, 26 Feb. 2014, <<http://cryopolitics.com/2014/02/26/unrest-in-the-west-what-does-ukraine-mean-for-russian-arctic-gas-development/>>; Pinchuk, D., 'Arctic gas project backs political strategy as Russia turns East', Reuters, 11 Apr. 2014, <<http://in.reuters.com/article/2014/04/11/ukraine-crisis-russia-yamal-idINDEEA3A04D20140411>>; and Blank, S., 'Russia's energy deals with East Asia: who wins?', *The Diplomat*, 3 July 2013, <<http://thediplomat.com/2013/07/russias-energy-deals-with-east-asia-who-wins/>>.

<sup>5</sup> Lo, B., 'Russia's eastern direction—distinguishing the real from the virtual', Institut français des relations internationales (IFRI), Russia/NIS Center, Jan. 2014, <<http://www.ifri.org/?page=contributiondetail&id=7952>>, p. 10.

## 2. Russia's Arctic strategy: ambitions and constraints

In 2008 Russia adopted its first comprehensive strategy on the Arctic region: the 'Foundations of the Russian Federation's state policy in the Arctic until 2020 and beyond'.<sup>6</sup> The main objectives of Russia's Arctic policy were declared to be use of the Arctic zone as a strategic resource base, which would enable the solution of socio-economic development problems, and use of the NSR as a national, integrated transport and communication system.

Major policy documents have also reflected these objectives. The energy strategy that was adopted in 2009 emphasized the Arctic seas, particularly the Barents, Pechora and Kara seas, and the Yamal peninsula as the most important regions for future development by the Russian oil and gas industry.<sup>7</sup> The 'Transport strategy of the Russian Federation for the period until 2030' stressed that development of the NSR was the basis for improving the social-economic development of the North (i.e. northern Russia).<sup>8</sup>

These objectives were further detailed in the 'Russian Strategy of the Development of the Arctic Zone and the Provision of National Security until 2020', which was adopted in 2013.<sup>9</sup> It placed considerable emphasis on improving geological prospecting on the continental shelf, implementation of large-scale resource projects, and development of transport infrastructure and infrastructure related to the resources projects.

This chapter analyses the major policies that aim to achieve these goals and the progress in their implementation.

### Development of Russia's Arctic energy resources

According to the Russian Ministry of Natural Resources and Environment, the resources of the Russian Arctic shelf are estimated as equivalent to 83 billion tonnes of oil, 80 per cent of which are located in the Barents and Kara seas. The Russian Arctic shelf contains between 5 and 9 per cent of Russia's liquid hydrocarbon resources (of which at least 2 per cent is oil) and up to 12.5 per cent of its

<sup>6</sup> An English translation of the text is available at Burgess, P., 'Foundations of the Russian Federation's state policy in the Arctic until 2020 and beyond', Arctic Portal, 1 Dec. 2012, <[http://icr.arcticportal.org/index.php?option=com\\_content&view=article&id=1791%3](http://icr.arcticportal.org/index.php?option=com_content&view=article&id=1791%3)>.

<sup>7</sup> 'Energy strategy of Russia for the period up to 2030 (ES-2030)', approved by Decree no.1715-r of the Government of the Russian Federation, 13 Nov. 2009, <[http://www.energystrategy.ru/projects/docs/ES-2030\\_\(Eng\).pdf](http://www.energystrategy.ru/projects/docs/ES-2030_(Eng).pdf)>.

<sup>8</sup> 'Transport Strategy of the Russian Federation for the period up to 2030', approved by Decree no 1032-r of the Government of the Russian Federation, 11 June 2014, <[http://rosavtodor.ru/storage/b/2014/03/23/trans\\_strat.pdf](http://rosavtodor.ru/storage/b/2014/03/23/trans_strat.pdf)> (in Russian).

<sup>9</sup> Pelyasov, A., 'Russian Strategy of the Development of the Arctic Zone and the Provision of National Security until 2020', adopted by the President of the Russian Federation on 8 Feb. 2013, no. Pr-232, 2013 Arctic Yearbook, <<http://www.arcticyearbook.com/index.php/commentaries-2013/74-russian-strategy-of-the-development-of-the-arctic-zone-and-the-provision-of-national-security-until-2020-adopted-by-the-president-of-the-russian-federation-on-february-8-2013-pr-232>>.

gas resources.<sup>10</sup> The Arctic zone also contains significant onshore resources: the gas resources of the Yamal peninsula alone are 505 569 billion cubic metres, while gas reserves equal 10 847 billion cubic metres; and oil resources amount to 4144 million tonnes, with reserves of 2921 million tonnes.<sup>11</sup>

As Russia has significant onshore resources, offshore projects were not a priority for its energy policy in the 1990s and early 2000s. While attempts were made to develop some offshore resources, including those in the Arctic, no comprehensive policy existed.<sup>12</sup> In the second half of the 2000s, driven by high oil and gas prices, diminishing resources in traditional production areas in West Siberia and geopolitical considerations, the Russian authorities made development of gas and oil resources a main strategic goal of state policy for the Arctic. The private interests of the Russian political elite involved in oil and gas, energy transport, shipbuilding and other sectors active in the Arctic have also played a significant role in determining the developmental agenda of the region.<sup>13</sup>

The development of Arctic resources has been promoted at the highest level of the Russian Government. In 2008 the Russian President, Dmitry Medvedev, stated that the first and main task was to turn the Arctic 'into a resource base of Russia in [the 21st] century'.<sup>14</sup> The steady demand for Russian energy resources in European markets, the potential of the US energy market, political support at high levels and powerful private interests all gave new impetus to the development of not only Arctic shelf projects, such as those at Prirazlomnoe and Shtokman, but also of onshore deposits.

In line with Putin's policy of increasing state control over the oil and gas sector in the 2000s, the Russian Government put state companies in control of shelf projects, including those in the Arctic. In 2008 amendments to the Law on Subsoil Resources limited access to the shelf deposits to companies with over 50 per cent state ownership and not less than five years' experience of work in marine exploration—thereby restricting the number of eligible entities to two major state companies, Gazprom and Rosneft. Thus, foreign companies and private Russian companies were only allowed to work on the shelf in cooperation with Gazprom or Rosneft.

However, the preferential position of Gazprom and Rosneft did not automatically lead to progress in the implementation of the plans set up by the Russian leadership. Both companies were unready for independent development

<sup>10</sup> Bogoyavlensky, V., Bogoyavlensky, I. and Budagova, T., [Environmental safety and environmental management in the Arctic and world oceans], *Burenie i Neft*, no. 12 (2013), p. 15 (in Russian).

<sup>11</sup> Donskoy, S., Minister of Natural Resources and Environment of the Russian Federation, 'The development of resource potential and ensuring ecological safety of the Arctic', Pro-Arctic, 25 Sep. 2013, <<http://pro-arctic.ru/07/10/2013/resources/5082>>.

<sup>12</sup> Moe, A., 'Russian and Norwegian petroleum strategies in the Barents Sea', *Arctic Review on Law and Politics*, vol. 1, no. 2 (2010), p. 231.

<sup>13</sup> Laruelle, M., *Russia's Arctic Strategies and the Future of the Far North* (M. E. Sharpe: Armonk, NY, 2014), p. 8.

<sup>14</sup> [The Security Council approved the government policy of the Russian Federation in the Arctic until 2020: we will be producing oil and gas there, if the USA and Canada do not outstrip us], Newsru, 17 Sep. 2008, <<http://www.newsru.com/russia/17sep2008/sovbez.html>> (in Russian).

of the continental shelf due to lack of experience with offshore exploration.<sup>15</sup> Development of the Arctic shelf will also entail significant financial investment; by 2050 its development will have required a total investment of \$500 billion.<sup>16</sup>

So far, the only success on the Russian Arctic shelf has been the December 2013 start of drilling at the Prirazlomnoe oil deposit in the Pechora Sea. The first oil from the site was shipped in April 2014. However, development of the Prirazlomnoe field started long before the 'Arctic euphoria' and has taken Gazprom over 20 years owing to significant delays and at a cost considerably exceeding that planned for exploration. In total the project has so far cost 90 billion roubles (\$2.5 billion).<sup>17</sup>

Experts argue that it will be difficult to proceed with further exploitation of the Arctic shelf deposits because extensive geological prospecting will be needed, and Russia lacks that capacity. Only one Russian company—Arktik-morneftegazrazvedka, which was established during the Soviet era—is able to carry out exploratory drilling. Its fleet has largely been lost or sold, and it currently owns only two rigs, *Valentin Shashin* and *Murmanskaya*, which work on Viet Nam's continental shelf. Thus, in 2012 and 2013 development of the Arctic shelf was marked by the absence of exploration drilling, a situation that had not occurred in the past 30 years.<sup>18</sup> Geological prospecting is also very expensive; the Ministry of Natural Resources and Environment has reported that 22 billion roubles (\$607 million) will be required by 2030.<sup>19</sup>

Appealing to the fact that the efforts of the state companies on the Arctic shelf had been insufficient, a faction of the Russian Government led by the Deputy Prime Minister, Arkady Dvorkovich, and the Ministry of Natural Resources and Environment tried to force the state companies to place greater focus on development.<sup>20</sup> Dvorkovich and the Minister of Natural Resources and Environment, Sergey Donskoi, have repeatedly stated that excessive concentration of licences in the hands of the state companies stalls development of the Arctic.<sup>21</sup> The Ministry of Natural Resources and Environment has attempted to delay granting new licenses and has promoted a 'programme on the development of the shelf until 2030', which advocates expanding the number of entities eligible to conduct economic activities on the Arctic shelf.<sup>22</sup>

<sup>15</sup> Moe, A. and Wilson Rowe, E., 'Northern offshore oil and gas resources: Russian policy challenges and approaches', RUSSCASP, Russian and Caspian energy developments and their implications for Norway and Norwegian actors, Working Paper, June 2008, <<http://www.fni.no/russcasp/WP-Moe&Wilson.PDF>>, pp. 3–5.

<sup>16</sup> [Development of the Arctic shelf will cost 500 bn dollars], RBC, 10 Oct. 2012, <<http://top.rbc.ru/economics/10/10/2012/673648.shtml>> (in Russian).

<sup>17</sup> 'First oil from Prirazlomnaya', Barents Observer, 8 Apr. 2014, <<http://barentsobserver.com/en/energy/2014/04/first-oil-prirazlomnaya-08-04>>.

<sup>18</sup> Bogoyavlensky, Bogoyavlensky and Budagova (note 10), p. 11.

<sup>19</sup> [Ministry of Natural Resources: budget will spend 22 billion roubles on geological prospecting of the Arctic shelf], Newsru, 10 Sep. 2013, <<http://www.newsru.com/finance/10sep2013/rushelfgeo.html>> (in Russian).

<sup>20</sup> Filimonova, N., 'Scramble for the Arctic offshore oil & gas resources in Russia', *Arctic Yearbook 2013*, <<http://www.arcticyearbook.com/>>, p. 284; and Topalov, A., [Shelf hangs between Sechin and Dvorkovich], *Gazeta.ru*, 2 Aug. 2012, <<http://www.gazeta.ru/business/2012/08/02/4707749.shtml>> (in Russian).

<sup>21</sup> Aliyev, A., [Shelf mirage], *Expert Online*, 19 Oct. 2012, <<http://expert.ru/2012/10/19/shelfoviy-mirazh/>> (in Russian).

<sup>22</sup> Topalov (note 20); and Aliyev (note 21).

Private companies have also challenged the state companies' monopoly on the Arctic shelf. On 12 April 2012 the head of Lukoil, Vagit Alekperov, and the heads of three other major private oil companies—Vladimir Bogdanov, the chief executive of Surgitneftegaz, Aleksandr Korsik, the president of Bashneft, and German Han, the director of TNK-BP—wrote a letter to Putin, stating that the state companies' monopoly was a key factor that negatively affected the state programme of exploration of the continental shelf.<sup>23</sup>

Both initiatives met strong resistance from the state companies. The heads of Gazprom and Rosneft, Alexsei Miller and Igor Sechin, wrote a letter to Putin claiming that granting access to private companies would be dangerous for the strategically important Arctic region.<sup>24</sup> Putin agreed and personally ordered the Ministry of Natural Resources and Environment to grant all licences to the state companies 'without further delays', thus maintaining the status quo. The 'programme on the development of the shelf until 2030' remains under consideration.

In 2012 Rosnedra, the Federal Agency for Subsoil Use, approved Rosneft's application for 12 new licences for various parts of the Arctic whose estimated resources were equivalent to 29 billion tonnes of oil. This brought the total number of Rosneft's offshore Arctic fields to 28, with total resources equivalent to about 190 billion tonnes of oil.<sup>25</sup> Gazprom's application was for 17 licences, most of which it received by the end of 2013.<sup>26</sup> In all, by 2013, the licences granted to state companies encompassed 80 per cent of the Russian Arctic shelf.<sup>27</sup>

Clearly, the major state companies have won the battle against the private companies and more liberally inclined officials. However, despite this 'victory', Gazprom and Rosneft have felt increasing pressure owing to their lack of necessary experience and technology and the need to invest significant resources in order to meet the demands of the new licences. The amount of work that they have pledged to carry out has forced them to expedite engaging international partners in their Arctic projects.<sup>28</sup>

The development of onshore resources in the Russian Arctic zone has progressed on the Yamal peninsula. In 2008 Gazprom started Megaproject Yamal, which includes development of a number of gas deposits on the peninsula, among them the Bovanenkovskoye, Kharasaveyskoye, Novoportovskoye, Kruzenshternskoye, Severo-Tambeyskoye, Zapadno-Tambeyskoye, Tasiyskoye and Malyginskoye fields. In 2012 Gazprom began production at its first oil deposit site, the Bovanenkovskoye field. However, as was the case at Prirazlomnoe, production at Bovanenkovskoye has begun significantly later than planned.

<sup>23</sup> [Russian oil companies have asked for access to the shelf], Vestifinance.ru, 12 Apr. 2012, <<http://www.vestifinance.ru/articles/10202>> (in Russian). TNK-BP was acquired by Rosneft in 2013.

<sup>24</sup> [Miller and Sechin bombarded Putin with complaints], Lenta.ru, 26 Oct. 2012, <<http://lenta.ru/news/2012/10/26/letter/>> (in Russian).

<sup>25</sup> Stroganova, G. S. P., [Rosnedra made Rosneft a gift by granting deposits], RBC, 14 Dec. 2012, <<http://www.rbcdaily.ru/industry/562949985327860>> (in Russian).

<sup>26</sup> [Gazprom has received six deposits in the competition], Rambler.ru, 30 Oct. 2013, <<http://news.rambler.ru/21886779/>> (in Russian).

<sup>27</sup> [Gazprom and Rosneft will develop the shelf together: Ministry of Natural Resources suggests to give both companies access to the same deposit], *Vedomosti*, 20 May 2013 (in Russian).

<sup>28</sup> [Gazprom has disrupted the drilling schedule on the Arctic shelf: Rosneft claims it is ahead of schedule], ZNAK, 14 Jan. 2014, <<http://znak.com/yamal/news/2014-01-14/1016642.html>> (in Russian).

The current energy market situation has also significantly complicated the development of the Arctic shelf deposits. The global financial crisis that began in 2008 and the boom in the development of unconventional hydrocarbon resources have led to a considerable drop in gas prices on the world market. This has affected the plans of all of the international companies that are working to develop the resources of the Arctic continental shelf. For example, in January 2014 Royal Dutch Shell decided to drop its plans to drill for offshore deposits in Alaska.<sup>29</sup>

The shale gas revolution in the USA has also resulted in the loss of potentially profitable markets for Russian Arctic gas. The urgency to develop new shelf deposits has been questioned, especially in the light of decreased demand for Russian gas in Europe due to its reorientation towards other suppliers and other sources of energy, including cheap coal from the USA.

One of the most widely known projects on the Russian shelf, the Shtokman gas condensate deposit, had to be left for 'future generations' as its resources were primarily aimed at the US market.<sup>30</sup> Since the Shtokman deposit has lost its potential consumer, it would have to be 'reoriented' to other markets. Were it to be developed now, it would create competition for other Gazprom projects, including the Bovanenkovskoye field. In November 2013 Gazprom announced that the volume of extraction at Bovanenkovo would be reduced by 30–50 per cent due to the change in demand.<sup>31</sup>

The global financial crisis and the drop in oil prices has also complicated development of the oil deposits on the Arctic shelf. For example, according to Mikhail Krutikhin of the consulting firm RosEnergy, 'The cost of a barrel of oil on the platform [Prirazlomnaya] itself is \$40. But transporting it in small tankers is very expensive and geometrically raised the price of the oil. If the price of oil per barrel falls to \$80 or \$90, the project will not be profitable at all.'<sup>32</sup>

The need to intensify activities on the Arctic shelf and to mitigate the unfavourable situation in regional energy markets as well as the need for foreign technology and capital have led the Russian major state companies to actively seek international engagement and to develop necessary mechanisms for such participation in their Arctic projects. Since 2011 Rosneft has signed agreements with various international partners, including a strategic cooperation agreement with ExxonMobil for exploration of the areas covered by Rosneft's licences in the Kara Sea. In 2012 Rosneft signed a number of agreements to establish joint ventures for the development of the Arctic shelf with Statoil (in the Barents and Okhotsk seas) and Eni (in the Barents Sea). In early 2013 Rosneft and Exxon-Mobil expanded their strategic partnership by including seven additional licence areas in the Arctic: in the Chukchi, Laptev and Kara seas.<sup>33</sup>

<sup>29</sup> Kavanagh, M., 'Royal Dutch Shell suspends Arctic drilling plans', *Financial Times*, 30 Jan. 2014.

<sup>30</sup> Serov, M. and Mordiushenko, O., [Stockman put aside in a fund for future generations, the development of the field can be frozen indefinitely], *Kommersant*, 3 June 2013 (in Russian).

<sup>31</sup> Hodyakova, E., [Gazprom decreases level of extraction at Bovanenkovo], *Vedomosti*, 17 Oct. 2013 (in Russian).

<sup>32</sup> McGwin, K., 'Russia's new blend', *Arctic Journal*, 2 May 2014.

<sup>33</sup> Rosneft, 'Off-shore projects', [n.d.], <<http://www.rosneft.ru/Upstream/offshore/>>.

Under the agreements the foreign partners fund the initial investment and exploration costs and receive a 33.33 per cent share. For example, ExxonMobil will cover all initial exploration costs, which total \$3.2 billion, with its total investment possibly reaching over \$500 billion.<sup>34</sup> The deal also presupposes the transfer of know-how and the creation of the Arctic Research and Design Center for Offshore Developments (ARC). The first fieldwork in the parts of the Kara Sea licensed to Rosneft and ExxonMobil started in 2012 with seismic exploration. In August 2014 geological drilling commenced in Universitetskaya-1, Russia's most northern oil well.<sup>35</sup> Taking into account that the total cost of the drilling is \$600 million, such cooperation enables Rosneft to limit its financial risks.<sup>36</sup> The partnership also allows Rosneft to fulfil its licence obligations and reduce the risks and capital exposure of Arctic exploration.<sup>37</sup>

Gazprom has lagged slightly behind Rosneft in forming partnerships with international actors. Since an agreement with Statoil and the French company Total to develop the Shtokman gas condensate deposit fell apart, it has only managed to secure a deal with Royal Dutch Shell (in April 2013).<sup>38</sup>

Russia's top leadership has placed high emphasis on recent deals: Putin attended the signing ceremonies for the three deals mentioned above.

Russia's goal to make the Arctic a 'strategic resource base' faces significant difficulties, especially as regards development of the Arctic shelf. Although some progress has been achieved, the lack of experience and technology for offshore drilling and the unfavourable situation on the world energy market have created significant financial obstacles to further exploration of the Arctic shelf. After having ensured the primary rights of the state companies to develop the Arctic shelf, focus has been placed on attracting foreign partners. The Russian Government and the major state companies have understood that development of the enormous oil and gas riches in the Arctic would be difficult without foreign engagement.

### **The Northern Sea Route: a transport artery of international importance?**

According to the 'Foundations of the Russian Federation's state policy in the Arctic until 2020 and beyond', one of Russia's main strategic goals in the Arctic is to use 'the Northern Sea Route as a national integrated transport-communication system of the Russian Federation in the Arctic'.<sup>39</sup> As the fastest maritime route to connect the eastern and western parts of Russia, the NSR has played an

<sup>34</sup> Kramer, A. E., 'Exxon reaches Arctic oil deal with Russians', *New York Times*, 30 Aug. 2011.

<sup>35</sup> Rosneft (note 33); and Rosneft, 'Rosneft and ExxonMobil start drilling in the Kara Sea', 9 Aug. 2014, <<http://www.rosneft.com/news/today/09082014.html>>.

<sup>36</sup> Bierman, S., 'Exxon's \$900 billion Arctic prize at risk after Ukraine', Bloomberg, 28 Apr. 2014, <<http://www.bloomberg.com/news/2014-04-28/exxon-s-900-billion-arctic-prize-at-risk-after-ukraine.html>>.

<sup>37</sup> Overland, I. et al., 'Rosneft's offshore partnerships: the re-opening of the Russian petroleum frontier?', *Polar Record*, vol. 49, no. 2 (2013), p. 152.

<sup>38</sup> Gazprom, 'Gazprom and Shell agree to jointly develop Arctic shelf and produce shale oil in Khanty-Mansiysk Autonomous Area', 8 Apr. 2013, <<http://www.gazprom.com/press/news/2013/april/article159865/>>.

<sup>39</sup> Burgess (note 6).



important role in the course of Russian history. It has provided 'severny zavoz' (northern delivery)—the only way for the Russian northern regions that are not connected by land transport infrastructure to survive. Russian state and private companies working in the North have already begun to use the NSR and are considering its future exploitation.<sup>40</sup>

The NSR was long closed to international shipping due to its strategic importance. However, in 1991 it was opened for foreign use. In 2011, during the second International Arctic Forum, Putin mentioned increasing international transit as one of the top priorities for Russia's policy in the Arctic. 'We are planning to turn it into a key commercial route of global importance. I'd like to emphasise that we see its future as an international transport artery capable of competing with traditional sea routes in cost of services, safety and quality.'<sup>41</sup> Opening up the NSR does not mean relinquishing national sovereignty. Russia, however, has stressed its view that, due to historical circumstances, the NSR is under its national jurisdiction and will remain so. According to the most optimistic estimates, the overall cargo turnover along the NSR could reach 64 million tonnes in 2020 and 85 million tonnes by 2030.<sup>42</sup>

In 2012 and 2013 a significant shift occurred in shipping along the NSR. For example, in 2009 the first commercial transit voyage of non-Russian flag vessels, the MV *Beluga Fraternity* and the MV *Beluga Foresight*, via the NSR saved them more than 4800 kilometres and 10 days compared to transit via the Suez Canal. The first non-Russian bulk carrier, the MV *Nordic Barents*, sailed along the NSR in 2012.<sup>43</sup> In 2012 the first liquefied natural gas (LNG) tanker, the *Ob River*, also travelled on the NSR from Hammerfest, Norway, to Tobata, Japan, delivering Gazprom Group-owned LNG cargo.<sup>44</sup>

Nonetheless, it is not possible to assert that shipping on the NSR is rapidly increasing; these were experimental, not normal, voyages. Overall, in 2012 shipping on the NSR had increased by just 2.5 times compared to 1998, the year of minimum shipping. Additionally, shipping via the NSR still accounts for only 60 per cent of the maximum, 6.6 million tonnes, which was reached in 1987. In order for the NSR to be economically profitable and effective the turnover needs to be 20 million tonnes per year.<sup>45</sup>

One of the main obstacles to development of the NSR is the underdeveloped commercial transport infrastructure, including both its maritime (e.g. rescue and refuelling bases, seaports and equipment for response to oil spills) and land

<sup>40</sup> Nikolaeva, A., [The Northern Sea Route: problems and prospects], *Vestnik Kol'skogo Nauchnogo centra*, no. 4 (2011) (in Russian), reprinted in *The Arctic Region: Problems of International Cooperation* (Russian International Affairs Council: Moscow, 2013), p. 37.

<sup>41</sup> Putin, V., Opening speech at the second International Arctic Forum, 'The Arctic: territory of dialogue', Arkhangelsk, 22 Sep. 2011, <<http://archive.premier.gov.ru/eng/events/news/16536/>>.

<sup>42</sup> Novikova, A., [Northern Sea Route will increase turnover 50 times], *Izvestiya*, 7 Aug. 2011 (in Russian).

<sup>43</sup> Nilsen, T., "'MV Nordic Barents' makes historic voyage', *Barents Observer*, 26 Aug. 2010, <<http://barentsobserver.com/en/sections/murmansk-obl/mv-nordic-barents-makes-historic-voyage>>.

<sup>44</sup> Gazprom, 'Gazprom successfully completes world's first LNG supply via Northern Sea Route', 5 Dec. 2012, <<http://www.gazprom.com/press/news/2012/december/article150603/>>.

<sup>45</sup> Selin, V., [Evaluation of the possibilities for the development of sea communications in the Russian Arctic], *Vestnik Kol'skogo Nauchnogo centra*, no. 4 (2011) (in Russian), reprinted in *The Arctic Region: Problems of International Cooperation* (note 40), p. 18.

components (e.g. the realization of several large-scale railway projects in the North). The implementation of projects to address these deficiencies will require state and private investments of up to 1 trillion Russian roubles (\$27 billion).<sup>46</sup> The Russian Government has taken some initial steps to improve the situation, but progress is slow and costly.

For example, in 2008 Russian authorities announced the construction of new search and rescue centres in the Russian Arctic. By 2015 the Ministry of Civil Defence, Emergencies and Disaster Relief plans to establish 10 comprehensive rescue centres; their construction will cost 910 million roubles (\$25 million).<sup>47</sup> The first such centre was opened in August 2013 in Naryan-Mar.<sup>48</sup>

Construction of the Sabetta seaport started in July 2012, and it is planned to become operational by 2016. The federal budget allocated almost 47.3 billion roubles (\$1.3 billion) for its construction.<sup>49</sup> However, modernization of other Arctic ports remains unlikely as the programme for the development of the transport system for the period 2010–15 has not allocated funds for their construction.<sup>50</sup>

Despite the fact that the Arctic ice is melting, it will remain impossible to ensure safe shipping along the NSR without icebreaker support. According to Russian regulations, only Russian icebreakers may provide assistance to ships in the NSR. However, most Russian icebreakers will soon be removed from service due to age. For example, both *Taimyr* and *Vaigach* will be taken out of service even after their work capacity is increased by 175 thousand hours. By 2020 only *Yamal* and *50 Years of Victory* will be in use.<sup>51</sup>

The process of building new icebreakers is a slow one. In September 2011 Putin announced at the second International Arctic Forum that Russia would build new icebreakers in order to avoid an 'icebreaking pause', a period when old icebreakers have been taken out of service and new ones are not yet ready for use. However, it took almost a year for that decision to be implemented. The agreement to build the first new nuclear-powered icebreaker was signed in August 2012, and construction started at Baltiyskiy Shipyard in St Petersburg in 2013.<sup>52</sup>

The current tariff system also presents a significant obstacle to increased shipping on the NSR. Russia charges ships for icebreaker assistance on the basis

<sup>46</sup> Ruksha, V., 'The development of international commercial shipping', *Arctic Herald*, vol. 32, no. 6 (2013), p. 71; and Kortunova, M. V., [Overall evaluation of the communications capacity of the Arctic and Arctic routes: the state of its transport infrastructure, The 'new' Arctic and Russia's interests], *Krasnaya Zvezda*, 2012 (in Russian), reprinted in *The Arctic Region: Problems of International Cooperation* (note 40), p. 37.

<sup>47</sup> [Second Arctic rescue centre will open by the end of the year], RIA Novosti, 25 Sep. 2013, <<http://ria.ru/arctic/20130925/965633619.html>> (in Russian).

<sup>48</sup> [The first rescue centre opens in Naryan-Mar], *Rossiiskaya Gazeta*, 21 Aug. 2013 (in Russian).

<sup>49</sup> President of Russia, [Meeting on the Yamal LNG project and Sabetta port construction], Kremlin.ru, 26 Sep. 2013, <<http://kremlin.ru/transcripts/19285>> (in Russian).

<sup>50</sup> Ponomarev, V., [Via the Northern Sea Route], Expert Online, 16 Aug. 2011, <<https://expert.ru/2011/08/16/severnoyim-putem/>> (in Russian).

<sup>51</sup> Ruksha, V. V. et al., [Economic development of the Arctic region and the icebreaking fleet of the Russian Federation], *Arktika: ekologiya i ekonomika*, vol. 5, no. 1 (2012) (in Russian).

<sup>52</sup> Rosatom Flot, [The keel of the head icebreaker LK-60 was laid at the Baltic shipyard], Rosatomflot.ru, 5 Nov. 2013, <<http://www.rosatomflot.ru/index.php?menuid=49&date=2013-11-0&newsid=592>> (in Russian).

of cargo volume only, which makes it very expensive. For a long time the tariff was between \$20 and 30 per tonne, while the Suez Canal's tariff was around \$5 per tonne. In 2010 the tariff was reduced and the volume of international shipping on the NSR increased.<sup>53</sup> However, experts claim that the reduction is not enough and that the structure of the tariff ought to be reconsidered. They have suggested that its current basis on the amount of cargo should be replaced with a tariff based on several parameters, including icebreaker assistance, distance, vessel speed and technical specifications. The foremost consideration should be to make the tariff understandable to Russia's international partners.<sup>54</sup>

The current situation has significantly hampered the growth of transit shipping. In 2013, 71 voyages were carried out, which was a 65 per cent increase over the number of voyages in 2012 (see table 2.1). Closer analysis reveals that, in terms of cargo, the increase was only 7.5 per cent. In 2013 ships from 11 states used the NSR—a greater range than the ships from 7 states that used it in 2012. In 2013 fewer ships under a foreign flag used the NSR: 25 ships, compared to 28 in 2012. Moreover, 63 per cent of the voyages were between two Russian ports.<sup>55</sup> According to Vladimir Mikhailichenko, an expert on the topic, only 41 voyages can be considered international transits, with a total of some 1 200 000 tonnes of cargo. An additional 30 ships made intra-Arctic voyages.<sup>56</sup> Only 26 of the voyages had non-Russian ports as their point of departure or their destination. Thus, the data supplied by the Northern Sea Route Information Office fails to substantiate the claim of a significant increase in international shipping along the NSR.<sup>57</sup> The number of transits on traditional shipping routes is greater than those via the NSR; for example, transits on the NSR are only 0.2–0.3 per cent of those via the Suez Canal.<sup>58</sup>

The development of Arctic shipping and resources will not occur in a vacuum. General shipping industry trends will significantly influence the future of Arctic shipping. The new generation of ultra-large container ships, which are not suitable for navigation over the NSR, are able to achieve unprecedented levels of effectiveness and economies of scale in shipping.<sup>59</sup> In addition, because the NSR is quite shallow, it will not be able to compete with other shipping routes.<sup>60</sup>

<sup>53</sup> Mikhailichenko, V., [Northern Sea Route was originally locked not by ice, but rather by the high rate], Arctic-info, [n.d.], <[http://www.arctic-info.ru/ExpertOpinion/Page/severnii-morskoi-pyt\\_iznaca\\_l\\_nozapiral-ne-led--a-visokii-tarif-](http://www.arctic-info.ru/ExpertOpinion/Page/severnii-morskoi-pyt_iznaca_l_nozapiral-ne-led--a-visokii-tarif-)> (in Russian).

<sup>54</sup> Ruksha (note 46), p. 71.

<sup>55</sup> Northern Sea Route Information Office, 'Transit statistics', <[http://www.arctic-lio.com/nsr\\_transits](http://www.arctic-lio.com/nsr_transits)>.

<sup>56</sup> Mikhailichenko, V., Executive Director, Non-Profit Partnership for Coordination of the Northern Sea Route Navigation, Presentation at The Arctic: Region of Development and Cooperation forum, Moscow, 2 Dec. 2013, <<http://russiancouncil.ru/en/arctic2013/presentations/>>.

<sup>57</sup> Northern Sea Route Information Office (note 55).

<sup>58</sup> Bogoyavlensky, V., 'Oil and gas transportation systems in the Russian Arctic', *Arctic Herald*, no. 2, vol. 6 (2013), p. 81.

<sup>59</sup> Humpert, M., 'The future of Arctic shipping: a new silk road for China?', Arctic Institute, Center for Circumpolar Security Studies, 13 Nov. 2013, <<http://www.thearcticinstitute.org/2013/11/the-future-of-arctic-shipping-new-silk.html>>, p. 13.

<sup>60</sup> Laruelle (note 13), p. 177.

**Table 2.1.** Transit via the Northern Sea Route, 2011–13

	2011	2012	2013
Total volume of transit cargo (tonnes)	820 789	1 261 545	1 355 897
Total number of transit voyages	34	46	71

*Source:* Northern Sea Route Information Office, 'Transit statistics', <[http://www.arctic-lio.com/nsr\\_transits](http://www.arctic-lio.com/nsr_transits)>.

It is unlikely that international transit along the NSR will rapidly expand in the coming decade. Currently, most of the cargo shipped via the NSR is hydrocarbon resources (see table 2.2), and the prospects of the NSR will probably depend on the success of oil and gas projects in the Arctic. For example, when the Yamal LNG project becomes operational, it alone could lead to an increase in shipping of up to 10 million tonnes.<sup>61</sup>

### **Changes in the international context of the Russian Arctic strategy**

Russia's economic interests and efforts to strengthen its sovereignty in the Arctic have promoted international cooperation in the region. Since a controversial expedition to the North Pole in 2007, which was seen as a demonstration of Russia's aggressive stance in the region, the Russian leadership has taken significant steps to improve relations with other Arctic states. In order to resolve border issues and to ensure Russia's rights in the discussion of an extension of the area designated as the Arctic continental shelf, Russia has fostered bilateral and multilateral cooperation with other states that have an interest in the Arctic.

Russia has repeatedly stressed that it adheres to UNCLOS and views the convention as the means to resolve disputes about borders and the limits of the Arctic continental shelf. On several occasions, Putin has mentioned that Russia will act strictly 'in line with international law'. In March 2014 the UN Commission on the Limits of the Continental Shelf recommended that Russia be given the right to a 52 000-square-kilometre area in the Sea of Okhotsk, the 'bottom of which is the continuation of Russia's continental shelf', according to Putin—a clear win for Russia.<sup>62</sup>

Bilaterally, in 2010, Russia signed a delimitation treaty with Norway, thereby resolving a 40-year dispute related to boundaries in the Barents Sea.

Russian officials have strongly supported the informal A5 format of cooperation among the five littoral Arctic states in order to maintain the Arctic as a zone of 'peace and cooperation' and to develop the 'rules of the game', a set of criteria for engagement of non-Arctic states in the region. According to the Russian Minister

<sup>61</sup> Ruksha (note 46), p. 73.

<sup>62</sup> Putin (note 1).

**Table 2.2.** Northern Sea Route cargo transit, 2013

Cargo type	No. of vessels	Volume (tonnes)	Displacement (tonnes)
Liquid	31	911 867	..
Bulk	4	276 939	..
Liquefied natural gas	1	66 868	..
Ballast	15	..	469 703
General cargo	13	100 223	..
Repositioning	7	..	38 027
<b>Total</b>	<b>71</b>	<b>1 355 987</b>	<b>507 730</b>

Source: Northern Sea Route Information Office, 'Transit statistics', <[http://www.arctic-lio.com/nsr\\_transits](http://www.arctic-lio.com/nsr_transits)>.

of Foreign Affairs, Sergey Lavrov, the A5 states have a 'special responsibility' for the Arctic region.<sup>63</sup>

Russia has also been very active in the Arctic Council. For example, Russian officials have been actively engaged in developing two legally binding documents in the framework of the Arctic Council on search and rescue and marine oil-pollution preparedness and response. On several occasions, Lavrov has expressed Russia's support for strengthening the Arctic Council and turning it into a fully-fledged international organization.<sup>64</sup> Putin has also underlined the importance of the Arctic Council when it comes to 'issues pertaining to cooperation in border areas, maritime transportation, and rectification of consequences of accidents in hydrocarbon production on the marine shelf'.<sup>65</sup>

Russia's efforts seem to have paid off, since international scholars and officials from the Arctic states have positively assessed the changed Russian policy towards cooperation and its efforts to engage with other states in the region.<sup>66</sup> Additionally, the shared interest of all Arctic states to resolve the territorial issues in the Arctic in a peaceful manner has spurred cooperation with Russia.

However, events in Ukraine, a country far from the Arctic Circle, have raised questions about the sustainability of international cooperation in the Arctic. Russia's actions in Ukraine have forced many Arctic countries to re-evaluate their cooperation with Russia, including in the Arctic region. Concern has been expressed that the current situation in Ukraine has revealed Russia's territorial ambitions and its readiness to use military force to achieve them.<sup>67</sup>

Speaking in Montreal, the former US Secretary of State, Hillary Clinton, called for Canada and the USA to unite against Russia in the Arctic. According to

<sup>63</sup> [Cold calculation: foreign ministers of five Arctic states showed restraint], *Rossiiskaya Gazeta*, 31 Mar. 2010 (in Russian).

<sup>64</sup> Lavrov, S., 'Nuuk Declaration: a new stage of cooperation among Arctic states', *Arktika: Ekologiya i Ekonomika*, no. 3 (2011), (in Russian).

<sup>65</sup> Putin (note 1).

<sup>66</sup> See e.g. 'Iceland's saga: a conversation with Ólafur Ragnar Grímsson', *Foreign Affairs*, Jan./Feb. 2014.

<sup>67</sup> Norris, S., 'Despite Crimea, Western-Russian cooperation in the Arctic should continue', *Eurasia Outlook*, 27 Mar. 2014, <<http://m.ceip.org/moscow/eurasiaoutlook/?fa=55121>>.

Clinton, Putin is trying to 'redraw the borders established after World War II', a policy that could affect other countries and territories, including those in the Arctic.<sup>68</sup>

Norway has also condemned Russia's actions in Ukraine and has suspended its bilateral military cooperation with Russia, including the Northern Eagle military exercises in the Barents Sea. The Norwegian Defence Minister has stated that 'We are in a completely new security situation where Russia shows both the ability and the will to use military means to achieve political goals.'<sup>69</sup>

In April 2014 Canada cancelled its participation in an Arctic Council meeting of the Arctic Council Task Force for Action on Black Carbon and Methane that was held in Moscow. According to Leona Aglukkaq, the Canadian minister responsible for the Arctic Council, the action was part of Canada's 'tough stance' against Russia's 'occupation of the Crimean Peninsula'.<sup>70</sup> Given that Canada will chair the Arctic Council until 2015, the question has emerged as to whether normal engagement with Russia will continue.

The changing international situation presents a number of challenges to Russia's Arctic development plans. Following Russia's actions to absorb Crimea into its territory, the European Union (EU) and the USA imposed targeted sanctions against high-ranking Russian officials.<sup>71</sup> Subsequently, in July 2014, the USA imposed a second round of sanctions limiting access to the US debt market to a number of Russian banks and companies, among them Rosneft and Novatek.<sup>72</sup> Later the same month the EU and the USA imposed a third round of sanctions targeting specific companies and industries. The Russian Arctic projects have been particularly affected as sanctions have banned the export to Russia of hi-tech oil equipment needed in Arctic, deep sea and shale extraction projects.<sup>73</sup>

At the moment opinions differ on the possible effect of the sanctions on the future of these cooperation projects. On the one hand, difficulties for cooperation have certainly been created, particularly between Rosneft and Novatek and their international partners. So far, neither of the companies has expressed a definite view on the future of international partnerships with Russian companies. A representative of ExxonMobil stated that the company is 'assessing the impact of

<sup>68</sup> Staalesen, A., 'Hillary warns against Russia in Arctic affairs', Barents Observer, 3 Apr. 2014, <<http://barentsobserver.com/ru/arktika/2014/04/hillari-predosteregaet-protiv-rossii-v-arkticheskikh-delah-04-04>>.

<sup>69</sup> Fouche, G., 'Wary of Russia, Norway urges NATO vigilance in Arctic', Reuters, 20 Mar. 2014, <<http://www.reuters.com/article/2014/05/20/us-norway-defence-russia-idUSBREA4JOHE20140520>>.

<sup>70</sup> 'Canada boycotts Arctic Council Moscow meeting over Ukraine', CBC News, 16 Apr. 2014, <<http://www.cbc.ca/news/canada/north/canada-boycotts-arctic-council-moscow-meeting-over-ukraine-1.2611964>>.

<sup>71</sup> 'Lavrov says hysterical US policy makes Russia consider appropriate response', RIA Novosti, 14 May 2014, <<http://www.en.ria.ru/world/20140514/189825593/Lavrov-Says-Hysterical-US-Policy-Makes-Russia-Consider.html>>.

<sup>72</sup> 'New U.S. sanctions against Russia go further than ever before', Forbes, 17 July 2014, <<http://www.forbes.com/sites/dougschoen/2014/07/17/new-us-sanctions-against-russia-go-further-than-ever-before/>>.

<sup>73</sup> Baker, P., Cowell, A. and Kanter, J., 'Coordinated sanctions aim at Russia's ability to tap its oil reserves', *New York Times*, 29 July 2014.

the sanctions'. While the French company Total's CEO said 'we'll have to wait and see the nature of these new sanctions first'.<sup>74</sup>

On the other hand, since the Western companies have already invested significant resources, a solution will be found, as it would be too difficult for them to pull out without significant loss.<sup>75</sup>

It is important to note that the sanctions do not concern previously signed contracts, which makes it possible to find a way forward for continuing cooperation. For instance, so far ExxonMobil and Rosneft have continued their plans for drilling in the Kara Sea as the contract on the drilling platform with a Norwegian company, the North Atlantic Drilling unit of Seadrill Ltd, was signed one day before sanctions were introduced.<sup>76</sup>

The situation in Ukraine, the new wave of sanctions and the absorption of the new territory into Russia will place additional burdens on Russia's state budget. Funds will have to be redirected to meet Russia's new obligations, which will potentially create financial and investment difficulties for its Arctic plans. For example, it has become known that, in order to develop the ports of the Azov-Black Sea basin in Russia and Crimea, the Russian Government has already discussed plans to reduce its financing of the Murmansk Transport Hub project, an important Arctic port, by 75 per cent.<sup>77</sup>

Although it would be an exaggeration to say that the era of Arctic cooperation is over, recent events show that such cooperation does not occur in a vacuum. Development can be held hostage by events far beyond the region. The crisis in Ukraine is just one example of possible future turmoil.

The changing international situation will force Russia to deal with new challenges in the Arctic, seek political support from other countries and diversify the sources of investment for all its projects, including those in the Arctic. If Russia's previous efforts were mostly focused on strengthening cooperation with the Arctic states and using Western companies to enhance its Arctic projects on the basis of shared interests and capability to work in the Arctic, the new political reality might spur Russia to redirect its focus. In recent years Russia has started to seek partners other than its established Arctic colleagues.<sup>78</sup> Among the non-Arctic states, China is often seen as a potential partner for development of the Russian Arctic.<sup>79</sup>

<sup>74</sup> 'How sanctions will affect the West's \$35bn invested in Russian oil', *Russia Today*, 30 July 2014, <<http://rt.com/business/176760-sanctions-russia-bp-exxon/>>.

<sup>75</sup> 'How sanctions will affect the West's \$35bn invested in Russian oil' (note 74).

<sup>76</sup> Geropoulos, K., 'Rosneft, Exxon, duck US, EU sanctions in Arctic', 1 Aug. 2014, <<http://www.neurope.eu/article/rosneft-exxon-duck-us-eu-sanctions-arctic>>.

<sup>77</sup> 'Murmansk to become the first Crimea donor', *Barentsnova*, 21 Apr. 2014, <<http://barentsnova.com/node/2679>>.

<sup>78</sup> [Indian ONGC will help Russia to develop oil and gas in the Arctic], *RBC*, 21 Oct. 2013, <<http://top.rbc.ru/economics/21/10/2013/884069.shtml>> (in Russian); and [Russia and South Korea have discussed ways of cooperation in the Arctic for the first time], *Kommersant*, 9 Feb. 2014 (in Russian).

<sup>79</sup> [Carte blanche: the Arctic can be made Russian-Chinese], *Nezavisimaya Gazeta*, 20 Mar. 2014 (in Russian).

### 3. Russia's turn to the East: a new driver of Russian Arctic development?

Russian policy documents have repeatedly reflected the need and desire to turn East, to pay more attention to Asian energy markets and to attract investments from Asia.<sup>80</sup> The goal of diversifying Russian energy flow via focus on the East was stated in the 2009 'Energy Strategy of Russia for the period up to 2030'.<sup>81</sup> In 2012, in an article prepared as a part of then Prime Minister Putin's election campaign for the presidency, he stated that China's economic development represented a good opportunity for Russia and a 'chance to catch the Chinese wind in the sails of our economy'.<sup>82</sup>

Until recently, however, this idea has received only partial implementation, often limited to political declarations.<sup>83</sup> Although the two countries might seem 'perfectly matched in the energy sphere', the partnership has been developing rather slowly.<sup>84</sup> However, in 2013 and 2014 Russia's cooperation with China has appeared to be accelerating.

In the light of increasing energy cooperation with China, debate has increased about whether such cooperation could reach as far as the Russian Arctic and whether Russia's 'turn to the East' could be used to speed up its Arctic development. Although in the past there was much speculation that Russia sought to deter the involvement of non-Arctic states, particularly China, in the region, in 2013 and 2014 Russian officials have repeatedly stated that non-Arctic states are welcome to the region, especially if they follow the 'rules of the game' and, in particular, respect the sovereign rights and jurisdiction of the Arctic states.<sup>85</sup>

The following discussion analyses the increasing energy cooperation between China and Russia and the extent to which it affects Russia's development activities in the Arctic.

#### **Increasing Russia's oil and gas cooperation with China**

During his visit to China in May 2014 Putin finally had the opportunity to witness the signing of an historic gas deal contract with China after 10 years of negotiations. Talks on Russia's supplying gas to China started in 2004 and, originally, both an eastern and a western route were discussed, with a total supply of 70 billion cubic metres per year. However, in March 2013 a decision was taken

<sup>80</sup> Lo (note 5), p. 10.

<sup>81</sup> 'Energy strategy of Russia for the period up to 2030 (ES-2030)' (note 7).

<sup>82</sup> Putin, V., [Russia and the changing world], *Moskovskiy Novosti*, 27 Feb. 2014 (in Russian).

<sup>83</sup> Lo (note 5), p. 10.

<sup>84</sup> Jakobson, L. et al., *China's Energy and Security Relations with Russia: Hopes, Frustrations and Uncertainties*, SIPRI Policy Paper no. 29 (SIPRI: Stockholm, Oct. 2012), p. 26.

<sup>85</sup> Vasiliev, A., Keynote address at SIPRI-IMEMO Workshop Russia's strategy for developing the Arctic region until 2020, 30 Sep. 2013, <<http://www.sipri.org/research/security/arctic/arcticevents/russias-strategy-for-developing-the-arctic-region>>.



to confine the deal to the eastern route, with delivery of up to 38 billion cubic metres per year. Construction of the Power of Siberia gas pipeline was planned to connect the Chayandinskoye field in Yakutia to Vladivostok, with a spur to China.<sup>86</sup> However, China and Russia could not agree on one of the most important issues—the price.

As Gazprom had secured long-term contracts with European countries over the past 20 years, the Russian gas giant was not particularly interested in cooperation with China. It was inflexible in its negotiations with the Chinese partners and reluctant to rush into a deal that had the potential to generate lower returns than those on its European market.<sup>87</sup> However, the global financial crisis and Europe's policy to decrease its dependency on Russian gas, which received new impetus in the light of events in Ukraine, changed the situation. The future of supplying Russian gas to the European market beyond contracted volumes has come to be questioned.<sup>88</sup> In these changed circumstances, China is now viewed as one of few potential new and growing markets for Gazprom.<sup>89</sup>

The gas deal agreement that was finally achieved in May 2014 was, to some extent, a political move by the Russian leadership, which was keen to show the West that it has a 'back-up plan' in the event of further EU sanctions. Gazprom's Miller stated that the 38 billion cubic metres of gas contract is 'only the beginning... we will start negotiation on the "western route" as well. When it comes to the "western route" the principal difference is that the resource base is the same as for the gas supplies to Europe'.<sup>90</sup>

The rise of independent gas producers is another important factor in Russia's increasing cooperation with China. In 2013 Gazprom's monopoly over gas exports was challenged, and on 2 December 2013 Putin signed a law to liberalize LNG exports. The law—lobbied for by Rosneft and Novatek—grants the right to export LNG to companies whose licences were filed prior to 1 January 2013 and included construction of the LNG plant, as well as to state-owned companies, working on the shelf. Only Rosneft and Novatek met these criteria.

Another historic deal with China had been concluded in October 2013 when Rosneft and Sinopec signed a memorandum of understanding for an oil export agreement: 10 million tonnes of oil per year for 10 years (i.e. 100 million tonnes for \$85 billion) starting in 2014.<sup>91</sup> The deal was the second largest agreement on pipeline oil delivery in the history of Russia's energy cooperation with China and the second agreement concluded under the 'capital for oil tomorrow' scheme.

The first such agreement had been signed in 2009 with the Chinese National Petroleum Corporation (CNPC), and China had provided long-term loans

<sup>86</sup> Himshiashvili, P. and Hodjakova, E., [Gazprom has not agreed with China on gas supplies], *Vedomosti*, 20 May 2014 (in Russian).

<sup>87</sup> Belogoriev, A., Deputy Head of the Institute of Energy Strategy, Interview with author, Moscow, 9 Dec. 2013.

<sup>88</sup> Perlez, J., 'China and Russia reach 30-year gas deal', *New York Times*, 21 May 2014.

<sup>89</sup> Belogoriev (note 87).

<sup>90</sup> [Gazprom and CNPC have signed a contract on gas supplies to China], ITAR-TASS, 21 May 2014, <<http://itar-tass.com/ekonomika/1202314>> (in Russian).

<sup>91</sup> [Rosneft and CNPC signed agreement on oil deliveries], 21 June 2013, Rosneft.ru, <<http://rosneft.ru/news/pressrelease/210620139.html>> (in Russian).

totalling \$25 billion, of which \$15 billion went to Rosneft and \$10 billion to Transneft, the company responsible for pipeline construction in Russia. Thus, in fact, China paid for construction of the Eastern Siberia–Pacific Ocean (ESPO) oil pipeline, which transports gas from East Siberia to the Russian Far East port Kozmino and to a spur to Daqing, China. Rosneft agreed to repay the Chinese loans with 300 million tonnes of oil—15 million tonnes (110 million barrels) annually over the period 2011–30.<sup>92</sup>

In the past 10 years the major factors leading to Russia's success have been its policy of diversifying its energy partners and the involvement of the head of Rosneft, Igor Sechin, who is also an influential figure in Russian politics. Since Sechin became involved in Rosneft's activities he has aimed to make it a 'major global oil company'. As a result, the company is in need of cash and capital to pay for its increasing acquisitions.<sup>93</sup> Infusions of Chinese capital have saved Rosneft more than once.<sup>94</sup> For example, in 2005, using his influence in the Russian Government and Chinese upfront payments for oil delivery and credit, Sechin enabled Rosneft to obtain Yuganskneftegaz, the most important production subsidiary of the former petroleum company Yukos.<sup>95</sup> In 2013 a significant breakthrough occurred when Rosneft expanded further. When Rosneft needed \$55 billion to acquire TNK-BP, Chinese capital again covered its debt.<sup>96</sup>

The contracts that have been signed in 2013 and 2014 indicate signs of an acceleration of energy cooperation, although a number of old problems that have hindered cooperation for many years remain. Energy relations between China and Russia have always suffered from a low level of trust. Russia has persistently feared that it would become a 'resource appendage' of China, and that China would thereby become too influential in some parts of Russia, especially in the Far East.<sup>97</sup>

Thus, the Russian Government has endeavoured to avoid China's expansion, either by deterring China's entry into key sectors of Russia's economy or by counterbalancing it with European and other Asian consumers.<sup>98</sup> During the discussion of various options for the oil pipeline to China the Russian Government sought not to tie itself to one Asian consumer. A compromise was reached so that the pipeline runs to the Pacific shore of Russia with a spur to China.<sup>99</sup> The new gas pipeline is also not limited to China alone.<sup>100</sup> Russia has also deterred China's

<sup>92</sup> [Pipe has been aimed at Beijing, Russian oilmen signed a contract to supply China with 'black gold' for next 20 years], *Rossiiskaya Gazeta*, 14 Apr. 2009 (in Russian).

<sup>93</sup> Poussenkova, N., Senior Research Fellow at the Institute of World Economy and International Relations (IMEMO) of the Russian Academy of Sciences, Interview with author, 11 Dec. 2013.

<sup>94</sup> Poussenkova (note 93).

<sup>95</sup> Derbilova, E. et al., [How they bought Yugansk: Rosneft explained in its report], *Vedomosti*, 5 July 2005 (in Russian).

<sup>96</sup> Blank (note 4).

<sup>97</sup> Karaganov, S., [Asia strategy], *Rossiiskaya Gazeta*, 17 June 2011 (in Russian).

<sup>98</sup> Lo, B., *Axis of Convenience* (Brookings Institution Press: Washington, DC, 2008), p. 144; and Itoh, S., *Russia Looks East: Energy Markets and Geopolitics in Northeast Asia* (Center for Strategic and International Studies: Washington, DC, 2011), p. 22.

<sup>99</sup> Itoh (note 98), p. 24.

<sup>100</sup> Gazprom, 'The power of Siberia', [n.d.], <<http://www.gazprom.ru/about/production/projects/pipelines/ykv/>>.

entry into the Russian energy sector. When Rosneft listed shares for sale in 2006, China was allowed to buy only 0.6 per cent (\$500 million); however, China was prepared to invest up to \$3 billion.<sup>101</sup>

Another major obstacle to energy cooperation between China and Russia has always been Russia's unwillingness to grant more than limited access to its upstream (exploration and production) projects to Chinese companies.<sup>102</sup> For example, China unsuccessfully attempted to participate in the bidding during privatization of the Slavneft oil company in 2002.<sup>103</sup> The Russian authorities have always retained control over projects and kept them under the control of Russian companies, while Chinese companies have always been interested in acquiring a stake in upstream development.<sup>104</sup> In this regard, the two approaches to cooperation have never coincided. Having to negotiate a balance between them has created a serious obstacle to successful cooperation.<sup>105</sup>

However, Rosneft was forced to partially open up its upstream activities to Chinese companies because of increasing dependency on Chinese capital. In 2005, after obtaining a loan from China, Sinopec became part of Rosneft's Gazprom's Sakhalin-3 project in the Sea of Okhotsk. In 2006 Rosneft and CNPC established a joint venture, Vostok Energy Ltd, to develop hydrocarbons in Russia.<sup>106</sup> As a part of a 2013 deal, Rosneft and China established another joint venture for development of resources in the Srednebotuobinsk field in East Siberia.<sup>107</sup> However, China's involvement is minor compared with that in other parts of the world.<sup>108</sup> On the other hand, Gazprom has not announced plans to open its deposits for joint development.

As well as the long-term desire to develop energy relations with China, two main factors have contributed to the current acceleration of cooperation between China and Russia. First, the key actors in Russia's oil and gas sector have needs that China can meet: Rosneft needs cash and Gazprom needs to diversify its energy markets. Second, international pressure on Russian authorities is increasing due to the crisis in Ukraine. Although there was a political intention to turn East before 2013 and 2014 many projects, including the supply of gas to China, had not been realized. Thus, Western sanctions and political pressure served as catalysts for Russia to curb its 'fear of rising China' and conclude the

<sup>101</sup> Itoh (note 98), p. 37.

<sup>102</sup> Rogisky, S., Docent, High School of Economics, Interview with author, Moscow, 10 Dec. 2013; Belogoriev, A., Deputy Director, Institute of Energy Strategy, Moscow, Interview with author, 9 Dec. 2013; and Jakobson et al. (note 84), p. 36.

<sup>103</sup> Poussenkova, N., 'Russia's Eastern energy policy: a Chinese puzzle for Rosneft', Institut français des relations internationales (IFRI), Apr. 2013, <<http://ifri.org/downloads/ifrirnv70poussenkovarosneftengapril2013.pdf>>, p. 15.

<sup>104</sup> Henderson, J., 'The pricing debate over Russian gas exports to China', Oxford Institute for Energy Studies, Sep. 2011, <<http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/10/NG-561.pdf>>, p. 25.

<sup>105</sup> Itoh (note 98), p. 37; Rogisky (note 102); and Belogoriev (note 102).

<sup>106</sup> [Vostok Energy was officially registered in China and gained access to Russian oil], Newsru, 25 Sep. 2007, <<http://www.newsru.com/finance/25sep2007/china.html>> (in Russian); and Poussenkova (note 99), p. 11.

<sup>107</sup> Rosneft, 'Rosneft and CNPC sign memorandum to expand cooperation in upstream projects in East Siberia', Rosneft.com, 18 Oct. 2013, <<http://www.rosneft.com/news/pressrelease/18102013.html>>.

<sup>108</sup> Belogoriev (note 102); and Jakobson et al. (note 84), p. 32.

gas deal in May 2014. Nonetheless, despite recent progress, the previous problems remain largely unresolved.

### **Emerging cooperation between China and Russia in the Arctic**

Although Arctic issues have never been on the official agenda of meetings between China and Russia and most of their cooperation as regards oil and gas has been focused on the Russian Far East and East Siberia, in 2013 and 2014 the Arctic became part of the two countries' increasing cooperation in the field of energy.

During the round of negotiations on oil delivery that was held in February and March 2013, CNPC and Rosneft also discussed possible cooperation on the shelf projects in the Arctic, Barents and Pechora seas—in particular the Zapadno-Prinovozemelsky, Yuzhno Russky, Medyskoe Sea and Varandeykskoe Sea deposits.<sup>109</sup> It is notable that the Medyskoe Sea and the Varandeykskoe Sea oil deposits are two of the most promising, and their annual production of oil is estimated at up to 3.9 million and 5.5 million tonnes, respectively.<sup>110</sup> In early 2014 Rosneft's Sechin confirmed the company's commitment to work with China in the Arctic shelf.<sup>111</sup>

Private Russian companies have also sought to cooperate with China in the Arctic. In February 2013 the head of Novatek visited China as part of an official Russian delegation to discuss possible cooperation on the Yamal LNG project, Novatek's main Arctic project, which it has been developing together with the French company Total. As a result of this visit and several subsequent rounds of negotiation, on 5 September 2013 CNPC and Novatek signed a contract for the sale to CNPC of a 20 per cent share in the Yamal LNG project, and the Russian Government approved the deal in November 2013.<sup>112</sup> During Putin's visit to China in May 2014 the deal was officially closed.<sup>113</sup>

The project presumes investment of \$29 billion, 30 per cent of which CNPC will cover. China has pledged to assist in attracting external financing from Chinese financial institutions for the project.<sup>114</sup> Under the agreement, Novatek concluded a long-term contract to supply at least three million tonnes of LNG per year to China.<sup>115</sup>

<sup>109</sup> Zagorodnov, A., 'Rosneft to attract Chinese, Korean investment to Arctic shelf', *Russia Behind the Headlines*, 19 Feb. 2013, <[http://rbth.ru/news/2013/02/19/rosneft\\_inks\\_memorandum\\_with\\_sinopec\\_on\\_possible\\_oil\\_delivery\\_increase\\_23037.html](http://rbth.ru/news/2013/02/19/rosneft_inks_memorandum_with_sinopec_on_possible_oil_delivery_increase_23037.html)>; and Topalov, A., [Shelf for China: 'Rosneft' agrees on the participation of Chinese corporations in the development of the Russian Arctic shelf], *Gazeta*, 18 Feb. 2012 (in Russian).

<sup>110</sup> Bogoyavlensky, Bogoyavlensky and Budagova (note 10), p. 16.

<sup>111</sup> [Rosneft is waiting for China on the Arctic shelf], *Arctic-info*, 7 Feb. 2014 <<http://www.arctic-info.ru/News/Page/-rosneft--jdet-kitaicev-na-seL-fe-arktiki>> (in Russian).

<sup>112</sup> Khodyakova, E., [Novatek closed the deal on selling 20% stake of Yamal LNG to Chinese CNPC], *Vedomosti*, 15 Jan. 2014 (in Russian).

<sup>113</sup> Staalesen, A., 'China's biggest Arctic project', *Barents Observer*, 22 May 2014, <<http://barentsobserver.com/en/energy/2014/05/chinas-biggest-arctic-project-22-05>>.

<sup>114</sup> Khodyakova (note 112).

<sup>115</sup> [Novatek and CNPC agreed on terms of the gas supplies from project Yamal LNG], *Vedomosti*, 22 Oct. 2013 (in Russian).

According to Total's chief executive officer, Christophe de Margerie, since the Ukrainian crisis began a number of European banks have become negative about funding the Yamal LNG project. Thus, it is now becoming even more dependent on Chinese investment as 'European financial institutions can be replaced by Chinese'.<sup>116</sup>

The Russian leadership has also recognized other emerging possibilities for cooperation. For example, during the 2013 Asia–Pacific Economic Cooperation (APEC) summit in Indonesia, Putin suggested joint development of the NSR's infrastructure to his Asian counterparts: 'We invite business partners from the Asia–Pacific region to join in these projects and take part for example in the large-scale modernisation of the Trans-Siberian and Baikal-Amur railways, and developing the Northern Sea Route. I know that many Asian countries are very interested in developing this transport corridor'.<sup>117</sup>

Development of the Yamal peninsula's resources together with Chinese companies could encourage further development of the NSR and improvement of existing infrastructure. For example, as part of the deal with Novatek, China's investment will be directed towards construction of the Sabetta seaport and establishment of Novatek's LNG tanker fleet.

It is too early to assess whether a major breakthrough will occur in shipping cooperation, although Chinese ships have made some first experimental voyages via the NSR. In 2012 the polar research icebreaker *Xuelong* was the first Chinese vessel to successfully navigate via the NSR to the Barents Sea, returning to the Bering Strait via the transpolar sea route, near the North Pole. In 2013 the first commercial vessel under a Chinese flag, the 19 000-tonne container ship *Yong Sheng* (operated by the China Ocean Shipping (Group) Company, COSCO) sailed from Dalian, China, to the Dutch port of Rotterdam.<sup>118</sup> The 15 000-kilometre journey took 33 days, which was one-and-a-half times faster than through the Suez Canal. According to Ma Zehua, COSCO's chairman, 'This sea route will offer our clients more convenience and choice, while allowing us to save time, lower costs and reduce emissions'.<sup>119</sup>

The owner of the Russian icebreakers, Atomflot, has reported that in 2014 it plans to increase cooperation with COSCO in order to provide icebreaker assistance for 8–10 ships under a Chinese flag.<sup>120</sup>

However, a dose of realism is needed in the assessment of the potential use of the NSR by China. In line with the common trend in the development of the world shipping industry, China is investing in the new generation of ultra-large container ships that, as noted above, are not suitable for transit through the

<sup>116</sup> Staalesen, A., 'Frenchmen keep up pressure in Yamal', *Barents Observer*, 19 May 2014, <<http://barentsobserver.com/en/energy/2014/05/frenchmen-keep-pressure-yamal-19-05>>.

<sup>117</sup> President of Russia, 'Vladimir Putin took part in the APEC CEO summit', *Kremlin.ru*, 7 Oct. 2013, <<http://eng.kremlin.ru/news/6086>>.

<sup>118</sup> [Cargo ship from China in first voyage on the Northern Sea Route], 12 Aug. 2013, *RBC*, <<http://top.rbc.ru/economics/12/08/2013/869860.shtml>> (in Russian).

<sup>119</sup> Mitchell, T. and Milne, R., 'First Chinese cargo ship nears end of Northeast Passage transit', *Financial Times*, 6 Sep. 2013.

<sup>120</sup> [Atomflot expects this year's record traffic on the Northern Sea Route], *Rosatom*, 29 Oct. 2013, <<http://www.rosatom.ru/journalist/atomicsphere/fe53738041a207a98925dd0bb97c3242>> (in Russian).

NSR.<sup>121</sup> Nevertheless, the NSR could become a good seasonal alternative for bulk freighter and tanker shipping.

While the recent increase in energy cooperation between China and Russia has involved the Arctic, this is a long-term investment whose results will probably not be evident for a decade or two. Since Arctic cooperation is part of a broader agenda, cooperation in the region could face the same challenges and factors that determine its success as cooperation with China in other areas. Significant time may be required in order to agree on how Chinese companies can participate in the Arctic projects and what share they should have in Arctic resource development and possible infrastructure projects.

<sup>121</sup> Humpert (note 59), p. 14.

## 4. Russia and the Arctic: go east to go north?

Initial planning for Russia's Arctic development occurred in a favourable energy market situation that made the Arctic resources Russia's new 'treasure chest' and promised enormous benefits in the future. Currently, turning the Arctic shelf into a 'resource base of the 21st century' remains a 'declaration of intent' rather than reality.<sup>122</sup> Financial crises and developments in the regional oil and gas markets have significantly undermined opportunities to develop Russia's Arctic shelf oil and gas resources and have diminished 'Arctic euphoria'.

The Russian leadership has associated sustaining its 'great power status' in the world with the success of its energy policy and has affirmed both its intent to develop the region and the necessity of doing so. Recently, Putin reiterated that Arctic will be developed: 'I would like to stress that we will continue to invest heavily in the the Arctic, to resolve issues dealing with this area's socioeconomic development, and strengthen security.'<sup>123</sup>

However, in order to develop its Arctic territory, Russia has had to balance between the two approaches of its Arctic policy: the desire to establish and enhance its sovereignty and the need to cooperate. The five years since adoption of the 'Foundations of the Russian Federation's state policy in the Arctic until 2020 and beyond' have clearly demonstrated that development of the Russian Arctic significantly depends on markets, investments and technologies based outside the Arctic and outside Russia. The state companies were unable to implement their Arctic projects due to the lack of technology and, in part, the high costs. Both Gazprom and Rosneft needed to build alliances with international partners in order to gain access to the necessary capital and technology.

Despite the fact that Russia has always been mostly oriented towards cooperation with Western companies, its fragile political relationships with European countries and the USA, which have been weakened by Russia's actions in Ukraine, have revealed the necessity for Russia to develop a 'plan B'. Although EU and US sanctions against Russia have not had a radically negative influence on Russia's relationship with the Western companies yet, they significantly hamper further development of cooperation. Additionally, the current situation is an indication of Europe's further reorientation of its long-term policy in this area. Russia may therefore have to attempt to limit its risks before it adopts new energy plans, including those related to the Arctic. The failure of cooperation with Statoil and Total to develop the Shtokman oil field and the loss of the USA as a potential consumer have also forced Russian state companies and, to a large extent, private companies to diversify as regards partners.

Owing to these circumstances, China, which is one of the most interested non-Arctic players in the region, could become a key potential partner for Russia's Arctic development plans. First, China represents a market for Arctic energy,

<sup>122</sup> Laruelle (note 13), p. 136.

<sup>123</sup> Putin (note 1).

primarily LNG. Second, it is one of the most interested international customers and a potential investor for the NSR. Third, China can provide necessary capital, which is impossible to generate within Russia, and which is becoming more difficult to obtain in the West.

A number of factors favour Chinese–Russian cooperation, the prospects of which appear good. First, Russia has pursued a general policy of diversification of its energy partners in recent years that has been significantly intensified in the light of the global financial crisis, the difficulties related to the development of regional energy markets and the conflict in Ukraine. In addition, both China and Russia claim to be enjoying the best relations in their histories.<sup>124</sup>

Second, Russian energy companies, primarily Rosneft and Novatek, have shown an interest in cooperating with China, and Rosneft's experience of collaboration with Chinese companies demonstrates that its corporate interests and needs coincide with China's interest in Russia's projects.

These factors create a favourable ground for future cooperation in the Arctic. Currently, Rosneft has partners for only half of its licensed deposits and it remains interested in attracting more, in part because its increasing obligations to deliver oil to China create pressure to locate new deposits in order to secure deliveries. Rosneft has already directed part of the funding that it received from China towards the development of strategic projects, including those on the Arctic shelf.<sup>125</sup>

The private players in the Russian energy sector are also interested in cooperation with China. This is especially true of Novatek, whose need for investment in the Yamal LNG project led to its 2014 deal with China. Novatek sold CNPC a significant share in one of the most promising projects on the Yamal peninsula in return for a long-term contract to supply LNG and access to financial resources. Chinese capital not only allowed Novatek to implement the project, but also to avoid competition for customers with other LNG projects both in Russia and abroad.

However, over-optimism should be avoided as regards the China–Russia partnership and, although Western sanctions catalysed Russia's push towards the East, their importance still remains to be determined. While a desire exists to diversify energy markets, existing markets will be difficult to replace. While the Russian gas contract signed with China accounts for more than one-quarter of Russia's current natural gas exports, Russia hopes to increase this amount.<sup>126</sup> Development of the Arctic resources relies on the existence of European markets as current pipeline infrastructure is oriented towards Europe and the construction of new pipelines and LNG facilities will take significant time.

According to Gazprom's Miller, the gas supply contract signed in May 2014 also opens up new opportunities for gas cooperation in the Arctic between Gazprom

<sup>124</sup> 'Russia–China ties at highest level in history—Putin', *Russia Today*, 18 May 2014, <<http://rt.com/news/159804-putin-china-visit-interview/>>.

<sup>125</sup> [Rosneft will direct the prepayment of the CNPC to the strategic projects], *Vedomosti*, 2 May 2014 (in Russian).

<sup>126</sup> Chang, F. K., 'Friends in need: geopolitics of China–Russia energy relations', *Foreign Policy Research Institute (FPRI)*, May 2014, <<http://www.fpri.org/articles/2014/05/friends-need-geopolitics-china-russia-energy-relations>>.



and Chinese companies. In particular, the possibility of supplying gas from the Yamal peninsula via the western pipeline route has been discussed.<sup>127</sup> However, this is a long-term prospect; official discussion has yet to begin and another 10 years may be needed before a deal is reached.

Despite the fact that Russia needs additional sources of capital for its Arctic projects, Russia remains cautious about granting too much access to China. Its past fear of 'China's rise' could become one of the serious obstacles to the development of their cooperation in the Arctic.

Although China wishes to invest in the Russian Arctic, its approach to cooperation and that of Russia still do not correspond. While Chinese and Russian companies have been able to agree on a model of cooperation for the LNG to be produced on the Yamal peninsula, CNPC's partner Novatek is a private company, which may present other challenges. As regards China and state-owned Rosneft, a significant period of time may be needed before a balance can be found between the interests of both and those of the Russian authorities, as the problem of Chinese companies' participation in upstream projects has illustrated.

Finally, Russia cannot, and so far has not tried to, replace its Western partners when it comes to technological cooperation in the Arctic. While Chinese companies are able to provide capital and have experience working offshore, that experience is not in the Arctic. Thus, while Putin has stated in talks with Western journalists that, if sanctions are increased, Russia 'will have to think about who works in the Russian Federation and how they work in key sectors of the Russian economy', Russia appears unlikely to be able to reconsider its partnership with Western companies in the Arctic as few partners have the necessary technology, skills and experience to work on the Arctic shelf.<sup>128</sup> Thus, if sanctions further limit the possibilities for cooperation between them, the development of Russia's Arctic resources will be significantly delayed.

Russia is dedicated to turning the Russian Arctic shelf into a treasure chest, and it will continue to work with Western companies if they are willing and able to do so. Nonetheless, continued attempts will be made to limit risks and develop other partnerships, certainly with China among them. However, although the recent energy cooperation between China and Russia increases opportunities for collaboration in the Arctic, time will be needed to develop a fully-fledged partnership. Its success will depend on solving previous problems, developing mutually acceptable forms of cooperation and increasing mutual trust.

<sup>127</sup> ['Gazprom' pulled China closer to Europe: contract for the supply of natural gas to the country concluded], *Kommersant*, 22 May 2014 (in Russian).

<sup>128</sup> [Putin will not respond to Western sanctions yet], *Lenta*, 30 Apr. 2014, <<http://lenta.ru/news/2014/04/30/putin>> (in Russian).



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## Russia's Evolving Arctic Strategy: Drivers, Challenges and New Opportunities

Russia has identified the Arctic as both a strategic priority and a resource base for the 21st century. Against a backdrop of expectations about the opportunities available in the Arctic, Russia has primarily pursued a policy focused on strengthening national sovereignty in the region. However, despite the considerable attention given to the development of the Arctic by the Russian leadership, progress in achieving Russia's goals in the Arctic has been slow.

This Policy Paper analyses the evolving Russian Arctic strategy in the changing international context. The author argues that, while debate has increased in the media and research community with regard to China's potential as a partner for development of the Arctic, significant challenges stand in the way of a major reorientation of Russian Arctic policy towards China. The success of Russia's recent energy cooperation with China will depend on solving previous problems, developing mutually acceptable forms of cooperation and increasing mutual trust.

**Ekaterina Klimenko** (Kyrgystan) is a SIPRI Researcher currently conducting research as part of the Arctic Futures Project and the Conflict and Peacebuilding in the Caucasus Project. She holds a masters of advanced studies degree in international and European security from the University of Geneva.

ISBN 978-91-85114-86-3



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