

Escalating standoff with Russia threatens oil and gas supplies



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Editor-OGFJ

The Russian bear has awakened and is again threatening the US and its allies. Flush with petrodollars and under the de facto leadership of Prime Minister Vladimir Putin, a former KGB commander, the Kremlin seems determined to extend its authority – if not its sovereignty – over its neighbors in direct conflict with US and European interests.

In August, Russia invaded the small Caucasus state of Georgia, once a Soviet republic, but now an independent nation and a prospective member of NATO. After independence, Georgia embraced Western ideals of democracy and the West reciprocated by building two key petroleum pipelines that transported crude oil and natural gas from the Caspian Sea through Georgia to its major port on the Black Sea and another pipeline that runs through Georgia and Turkey to the Mediterranean.

The \$3.9 billion BP-operated Baku- Tbilisi-Ceyhan (BTC) pipeline connects Baku, the capital of Azerbaijan; Tbilisi, the capital of Georgia; and Ceyhan, a port on the southeastern Mediterranean coast of Turkey, and is the second-longest oil pipeline in the world after the Druzhba pipeline, which runs from southeastern Russia to points in Ukraine, Hungary, Poland, and Germany. The first oil pumped through the BTC pipeline reached Ceyhan in 2006.

These three pipelines are currently the only means of transporting oil and gas from the landlocked Caspian Sea to Europe that do not go through Russia, which apparently does not like the competition.

Striving to take advantage of the sudden turn of events in the Caucasus, Russia is pressing the Caspian region's three top oil and gas producers – Azerbaijan, Turkmenistan, and Kazakhstan – to increase their export volumes through Russia. There are signs this leveraged approach is working.

Georgian President Mikheil Saakashvili said that Russia is seeking to destroy his country's economy because Georgia has sought to integrate into the Euro-Atlantic community. In a column published in the Aug. 15 issue of the Houston Chronicle, Saakashvili said the Russian invasion of his country was premeditated: "The thousands of troops, tanks, and artillery amassed on our border are evidence of how long Russia had been planning this aggression."

At the time this issue of Oil & Gas Financial Journal went to press, Russia had halted its advances into Georgia but continued to occupy strategic parts of the country, including Poti, its major port on the Black Sea. On Aug. 26, the US Coast Guard cutter Dallas, bringing humanitarian aid to Georgia, was forced to dock at Batumi, a smaller port. As it did, Russia dispatched three warships, including a missile cruiser and two missile boats, to Batumi, 180 miles to the north.

The dockings came a day after Russia officially recognized two Georgian territories, Abkhazia and South Ossetia, as independent states within the Russian sphere of influence. This prompted harsh criticism but no other immediate action from Western nations. Anatoly Nogovitsyn, a top Russian general, also warned NATO and Western nations against sending any more ships to the Black Sea.

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In recent years, Russia's Putin has used gas exports to Europe as a tool of foreign policy. In 2005, Russia reduced supplies to Eastern Europe in an effort to force them to curtail pro-Western ambitions. Western Europe, especially Germany, is especially vulnerable to reduced supplies because their options are limited.

The dispute between Russia and Ukraine, also a former Soviet republic and hopeful future NATO member, reached a crisis in early 2006. The two parties were unable to reach an agreement on gas prices, so Russia cut off their supply. Ukraine, a transit point for Russian gas, simply took 15% of the gas passing through their lines. Eventually, the two countries reached a compromise, but subsequent disputes arose in October 2007 and March 2008, as Russia wielded its energy supplies like a club.

In another threat against a neighboring country, Gen. Nogovitsyn recently warned Poland that it would be "100% exposed" to a nuclear attack if it follows through with plans to host a US missile defense system. Poland, formerly a client state of the old Soviet Union, is a member of NATO, an alliance of 26 countries that are pledged to come to the defense of any member that is attacked.

Moscow seems determined to parlay its success in Georgia into a total monopoly over Caspian energy supplies. The Russians are playing hardball, and the US, bogged down in Iraq and Afghanistan, and its allies seem reluctant to take any meaningful steps to curb Russian economic and military aggression.

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