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"Fueling a U.S.-Russian Strategic Alliance?"
A Conversation with Mikhail Khodorkovsky

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Speaking at a recent Nixon Center dinner, Yukos Oil Company Chief Executive Mikhail Khodorkovsky called for increased cooperation between the United States and Russia on energy issues and promoted his country's potential as a major supplier to global energy markets. Center Advisory Council Chairman James Schlesinger, a former Secretary of Energy, moderated the meeting, and former National Security Advisor Robert C. McFarlane introduced Mr. Khodorkovsky.

Russia's Energy Potential

Mr. Khodorkovsky claimed that the generally accepted international estimate of Russia's oil reserves – approximately 50 billion barrels – severely understates the country's actual reserves. [In comparison, Saudi Arabia has an estimated 260 billion barrels]. He pointed out that Yukos' audited proven reserves alone constitute 12 billion barrels, and that the company's estimated reserves approach 27 billion barrels. Noting that Russia's largest oil company, Lukoil, possesses reserves at least as large, and that the Russian government consistently auctions off 2.5 billion barrels of reserves per year, Mr. Khodorkovsky asserted that the country's true reserves greatly surpass the 50 billion barrel estimate.

He expressed similar optimism regarding future Russian oil production. Stating that the country's oil output could increase by 2.5 million barrels per day (bpd), Mr. Khodorkovsky estimated that Russia could supply an additional three or four million bpd on world markets for a minimum of forty years. [Russian production is now approximately seven million bpd, and Russian exports total 4.5 million bpd]. If other factors favoring increased production develop – such as improved technological and labor efficiency and greater exploration of the Arctic region – he claimed that Russia could supply at this level for a period of seventy years.

Mr. Khodorkovsky also emphasized Russia's potential as a natural gas supplier. While estimates generally place 30 percent of the world's gas in Russia, production currently lags because Russian companies lack markets for gas exports. If Russian companies are able to gain greater access to international markets, Mr. Khodorkovsky suggested that gas production could quickly increase.

U.S.-Russian Energy Cooperation

The distance between Russian oil fields and U.S. ports is the primary obstacle to cooperation in the energy sector. Mr. Khodorkovsky set out several options to overcome this challenge, including swaps, which he said provide the easiest method to utilize Russian oil to increase supplies to the U.S. Under this scenario, Russia would supply more oil to Europe, thereby freeing reserves from sources such as the North Sea that could be transported to the U.S. less expensively. Mr. Khodorkovsky claimed that such an approach is held back by political issues rather than technological hurdles. Europe is reluctant to become more dependent on Russia for its energy security, despite the very small chance for Russia to use oil as leverage against such a powerful entity as Europe in the post-Cold War environment.

Mr. Khodorkovsky also described another option – direct transit – by which Russian oil could be shipped to the U.S. Yukos is currently experimenting with this option this summer: earlier in the year, the company loaded oil from smaller tankers onto a supertanker near Greece that has already departed for the U.S. Mr. Khodorkovsky explained that Yukos will be able to evaluate the viability of direct transit after it determines the transport costs and the amount by which the oil is discounted in the U.S. when it arrives in early July.

However, Mr. Khodorkovsky said that several obstacles complicated this transport method. First, the U.S. has only one deep water port – capable of offloading supertankers – to which Yukos was not permitted access. Because of this, the supertanker's oil will have to be transferred onto several smaller ships at sea for shipment to port in the U.S. This process costs both time and money. A second complication involves transporting oil to the Mediterranean to be loaded onto the supertankers and, according to Mr. Khodorkovsky, is primarily a political challenge. Turkey controls the Bosphorus strait, the traditional sea route to the Mediterranean, and claims that it is nearing the limit of oil traffic that it is able to accommodate. Mr. Khodorkovsky asserted that if the U.S. wanted the oil shipments, a solution would be found.

More generally, he stated that when oil prices reach or exceed $25 per barrel, transportation costs become less significant and Yukos could supply the U.S. with oil on a commercially viable basis. However, the weather conditions in which Russia's oil fields are located do not allow regulation of supply by turning the pumps on and off when prices fluctuate.

The Future of Yukos

Mr. Khodorkovsky characterized Yukos' revelation of its stock ownership earlier in the week as "a step forward, but not a turning point" for Russian corporate governance. In his view, the real turning point took place when President Vladimir Putin told Russia's leading businessmen that the results of Russia's privatization process would not be revisited. Had President Putin taken a different course, Mr. Khodorkovsky claimed, oil production in Russia today would be lagging or nonexistent.

Reflecting on Russia's large gas reserves, Mr. Khodorkovsky said that he views Yukos as both an oil and a gas company. He urged, at a minimum, that the Russian gas monopoly Gazprom be forced to allow other firms equal access to its pipelines and other transportation infrastructure. He acknowledged that Gazprom would resist this, but said that it would be a first step toward liberalizing the Russian gas industry. Mr. Khodorkovsky said, however, that big technological hurdles remained before gas supplies might be transported efficiently to the U.S. Yukos is discussing this issue with several large American companies.

The U.S.-Russian Relationship

Regarding the broader U.S.-Russian relationship, Mr. Khodorkovsky stated that in order for Russia to become integrated into the international economy and to continue to experience high rates of economic growth, the country would have to position itself as a junior partner to the United States. He expressed his belief that both the Presidential Administration and Russia's regional elite understand this necessity, which he described as a radical change. But many in the bureaucracy still want full and unobtainable symmetry in relations with America. Mr. Khodorkovsky also affirmed his interest in U.S. oil companies investing in Russia. Such investment would change international markets' view of Russia, he said, and would lower the costs of borrowing for the Russian oil industry and increase the value of Yukos' (and other firms') assets.

According to Mr. Khodorkovsky, Iran provides a good example of the importance Russian companies place on cooperation with the U.S. Foreign investment in the production of a new pipeline is essential to increasing Iranian oil exports, he said, yet while European companies have poured capital into Iran, Russian firms have not. Explaining this situation, Mr. Khodorkovsky stated that while Russian firms were intrigued by investment opportunities in Iran, they were "not yet as interesting" to them as the United States, and that they are unwilling to risk losing the opportunity to work with American firms to compete in Iran.

This **Program Brief** *was prepared by Center Director Paul J. Saunders and Assistant Director Martin Hrivnak.*

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