Episode Transcript

Episode Title:
Russia’s Economic Ties to the Middle East

Guests:
Carole Nakhle, Nikolay Khozanov, and Olga Oliker

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In March of 2020, as the much of the world was shutting down in the face of Covid-19, a price war between Russia and OPEC was heating up.

News Clip:
This week: a battle for the hearts of OPEC. Who will capitulate first: Putin or MBS, as a price war decimates the markets.

At a meeting in Vienna, Saudia Arabia pressed Russia to cut production to compensate for declining global demand, and Russia refused. Saudia Arabia said if Russia wouldn’t cut its production, Saudia Arabia would maximize its own production, making up for lower prices with greater market share. Oil prices plummeted.

Over the course of this series, I conducted over a dozen interviews with experts on Russia in the Middle East. I asked them about the recent battle over oil production between Russia and Saudi Arabia. They all had different views on the winners and losers of the price war.

For Russia, it was beneficial that this kind of production cuts or production shutdowns had been in an orderly manner that would allow it perhaps, once, oil prices to recover.

In accordance with the most recent statistics the share of the Middle East in the Russian external profit is just about four percent if we exclude Turkey. But in terms of the importance of these corporations for selected industries, the meaning of the Middle East, should not be underestimated. For instance, Russian agricultural sector is...
exporting 50 percent of its produce to the Middle East. The Middle East is responsible for 20 percent of Russian arms trades, for instance, and definitely Moscow is interested in cooperation in the oil and gas sector.

**Jon Alterman:**
That’s three areas that matter: energy, arms sales, and other commercial ties. Let’s take them one-by-one.

To understand the global oil market, and particularly the relationship between Russian and Middle Eastern oil markets, you have to understand how the United States has changed energy markets in the last decade.

Over the last ten years, a revolution has transformed the global oil and gas marketplace, says Carole Nakhle, founder and CEO of Crystol Energy.

**Carole Nakhle:**
As a result, we saw completely new supplies coming into the market, in the form of shale oil or tight oil from the U.S.A.

**Jon Alterman:**
It used to take around seven years after initial investment for oil to hit the market. But the rise of shale oil, especially in the United States, has reduced that time to months.

Middle Eastern oil and gas producers have to sell in a global market, and so do their Russian counterparts. And when the United States flipped from being a major energy importer to a net energy exporter in only a few years, that rocked their world. The United States was a wildcard, and its production kept climbing. Russia and Middle Eastern states saw an increasing interest in coordinating their production.

**Carole Nakhle:**
There was this opportunity of joining forces with OPEC to introduce some production cards and stop oil prices from declining further. And that's what they did in 2016.

**Jon Alterman:**
Now, OPEC is not a Middle Eastern organization, but more than half its members are from the Middle East, and Middle Eastern producers pump the majority of OPEC’s oil.

Russia is a global megaproducer, rivaling Saudi Arabia for its output. And oil matters a lot to the Russian economy. In 2012, oil and gas contributed 16 percent to Russia’s GDP and constituted over 70 percent of Russia’s exports. That was all at risk now.

As U.S. oil production took off, global energy prices started drifting downward. Russia joined forces with OPEC, or the Organization of Petroleum Exporting Countries, in December 2016 to create OPEC-Plus.

**Carole Nakhle:**
Then it was the biggest kind of alliance or partnership in the history of the oil industry. We had actually not just Russia. There was a group of non-OPEC producers, including, for example, countries in central Asia, such as Kazakhstan and in the Middle East countries that are not OPEC members, such as Oman, joining forces, but Russia led this non-OPEC group because of the production cost that they committed to do as part of the OPEC-Plus alliance.

**Jon Alterman:**
The goal was to coordinate production and increase profits again, for all countries involved, not just Russia.
Nikolay Kozhanov, a consulting fellow at Chatham House and expert on Russia in the Middle East, has this to add:

**Nikolay Kozhanov:**
If we look back at the history of Russian cooperation within OPEC-Plus starting with the end of 2016, we will see that basically these collaborations were a constant attempt by Moscow to be a free rider, to extract profits from these deals, while the most difficult part of it was on the shoulders of Saudi Arabia.

**Jon Alterman:**
Nakhle agrees, but adds that differences in how the oil markets in Russia and Saudi Arabia are structured affects how production cuts are implemented.

**Carole Nakhle:**
Throughout the history of OPEC, Saudi Arabia always carried the heaviest burden in terms of production cuts. Furthermore, an important difference to highlight between Saudi Arabia and Russia is the industry structure.

**Jon Alterman:**
Saudi Arabia has a national oil company, Saudi Aramco. Any decisions made by the government can immediately be implemented by the national oil company.

**Carole Nakhle:**
In Russia, the industry structure is much more fragmented. Yes, we do have state owned companies, but we also have privately owned companies. And some of these companies were not happy about the OPEC-Plus deal.

**Jon Alterman:**
Russian companies are concerned that OPEC-Plus was a completely inadequate response to U.S. energy competition.

**Carole Nakhle:**
And according to Sechin and other companies in Russia—

**Jon Alterman:**
That’s Igor Sechin, CEO of Rosneft and a former deputy prime minister of Russia.

**Carole Nakhle:**
—it was that OPEC-Plus deal that's allowing the US to take market share from both actually, OPEC and Russia, within their conventional markets, particularly in Europe and in Asia, although the US is starting from a very low base. But they blamed OPEC-Plus deal on this kind of loss of market share.

**Jon Alterman:**
Russian oil companies depend on collective action with OPEC and OPEC-Plus countries in order to stay competitive in the global oil markets. Without that cooperation, Russian companies and the entire Russian economy would suffer.

So we’ve seen the Russian government and Middle Eastern governments cooperating on energy. But the energy business is a involves lots of producers from lots of places. They are dealing with a global market, and it requires a lot of give and take between them.

The arms trade is a more direct link between Russia and the Middle East. Russia is one of the largest arms exporters in the world, second only to the United States. The Middle East purchased $21.4 billion worth of arms from Russia in 2016. It’s the second most important arms market for Russia, after Asia. That means the Middle East is a natural region for Russia to both showcase its equipment and to sell to.
Dmitri Trenin, the director of the Carnegie Moscow Center and episode one guest, explains:

**Dmitri Trenin:**
The Middle East stands for the arms. Even if most important Russian clients, in terms of arms and military equipment, are not found in the Middle East rather, but they're watching. They're watching, Russia is. So it's an exhibition, if you like, for the Russian arms industry. An exhibition that is moving, that is fighting, that is firing shots and firing missiles so it’s something that you can exploit.

**Jon Alterman:**
The arms industry is an influential interest group in Russia, and arms sales have long played an important role for the Russian economic and security sectors. Domestically, the defense sector is a major source of employment and important part of the economy.

Olga Oliker, director of the Europe and Eurasia Program at the International Crisis Group, explains:

**Olga Oliker:**
I've never seen anything to suggest that the Russian arms industry suggests specific wars that the Russian government ought to be involved in. But the Russian arms industry is certainly interested in selling as much as possible to as many people as possible. And that there are a couple of things in play here.

**Jon Alterman:**
One element in play is showcasing Russian technologies.

**Olga Oliker:**
So you see some pretty high tech stuff being used, say in Syria, where maybe you wouldn't really need anything that high-tech, and clearly, where elsewhere in the conflict, you're using dumb bombs. And then suddenly you're firing really advanced weaponry from naval vessels. You kind of wonder what's going, and part of what's going on is that it's an advertisement. Right? Look at this stuff. Gee whiz, don't you want to buy it yourself?

**Jon Alterman:**
Russia also aims to leverage the purchase of arms into larger contracts and economic investments, says Oliker.

**Olga Oliker:**
The other piece of it of course, is that when you have relationships with these countries and provide them with support, they may also buy weapons, all sorts of weapons. And with the weapons come trainers and with the weapons come maintenance contracts and all of those things, which are very good for the Russian arms industry. Now, you don't necessarily need to send Russian soldiers abroad for that to work, right?

**Jon Alterman:**
But another element links weapons sales to Russian foreign policy.

**Olga Oliker:**
Ideally, you just sell the weapons. But I think it's certainly a benefit to the Russian weapons industry to have Russian troops advertising for them, and also to have these relationships that develop with a range of countries in the Middle East and elsewhere that can support weapons sales. I'll also say the Russians have historically viewed weapon sales as a tool of influence. They're certainly not alone in that. So that's something they also pursue. It's an easy thing to do. Russian weapons are generally ... have a good reputation and aren't as
expensive. So it's something that Russia has to offer that gets a decent number of takers.

**Jon Alterman:**
Russia’s willingness to sell to almost anyone, no strings attached, has helped it form unlikely partnerships in the region. Algeria, Egypt, and Iraq are all historically significant buyers of Russian weapons.

But what about general economic cooperation?

We should divide economic cooperation between Russia and the Middle East into two categories, says Chatham House’s Nikolay Kozhanov.

**Nikolay Kozhanov:**
The first group is where economic cooperation for a corporation is perceived as an important source of income for the Russian economy and the second group of cases is related to the situation when the economy is just considered to be a leverage to pursue certain goals. Like for instance, in the case of Egypt, the Russian attempt to construct nuclear power plants in Egypt.

**Jon Alterman:**
What Kozhanov is referring to is a 2017 agreement between Russia and Egypt to build a nuclear power plant in Dabaa, Egypt. Moscow uses a wide range of trade and economic tools, like the nuclear power plant deal, to leverage its diplomatic power. Russia will promise investment or sign joint declarations about expanded economic cooperation.

**Nikolay Kozhanov:**
The attempt is largely determined by Moscow’s interest to create a certain background for the sustainable development or for bilateral political dialogue and a way to increase Moscow's presence in Egypt. But for instance, in the case of Russian arms sales in most cases, or in the case of Russian exports of agricultural products, it is definitely a situation where Moscow is extremely interested in getting profit from these trade transactions.

**Jon Alterman:**
Kozhanov is saying that there are agreements that principally have an economic rationale, and they are pretty straightforward. But there are also deals with more of a political or strategic objective. They’re a lot more complicated. Nakhle explains how the Egyptian nuclear power plant deal is beneficial economically and politically for Russia:

**Carole Nakhle:**
So in Egypt, the government got a sweet deal from the Russians, a loan to allow the building of that nuclear power plant. But again, building a nuclear power plant doesn't happen overnight. It's a very long term end over to just start from the investment today to really building the plant. Now, of course, in terms of benefits, there are tremendous benefits for the technology exporters, and here Russia is one of the leaders in terms of exporting nuclear technology, particularly reactors. And here, I like to quote Russia's ROSATOM Deputy Director General—

**Jon Alterman:**
Nakhle is referring to ROSATOM Deputy Director General Kirill Komarov, who has experience in state corporations’ foreign investments and civilian nuclear assets.

**Carole Nakhle:**
—who once said that for every ruble the company invested into supporting the state of nuclear technology abroad, Russia's GDP would gain two rubles. Now whether this is still correct today or not, I'm not quite sure,
and it has to investigate. But you should look at these nuclear projects, they are hardly between two private companies.

**Jon Alterman:**
Even though commercial businesses are involved with the development of the project, Nakhle says the project is actually aimed at developing political and economic cooperation.

**Carole Nakhle:**
And if we look at what comes with it, I like to think of nuclear power plants as a part of a much wider package of establishing cooperation with economic and political ties, spanning decades to last a long lifecycle of the nuclear energy project. So even if no power plant is built, civil nuclear cooperation oftentimes is a starting point for long lasting economic cooperation that goes beyond the building of the nuclear power plant.

**Jon Alterman:**
The strategy of making economic investments to build strategic ties works both ways. Wealthy Gulf countries use economic investment in Russia as their own diplomatic leverage. This strategy has had mixed results, says Kozhanov.

**Nikolay Kozhanov:**
If we are going to speak about the bright side, then definitely about 50 percent of projects implemented by the Russian direct investment funds, the sponsors in one way or another by the sovereign wealth funds from the Gulf—and first of all by the Saudis and by the Emirates—but in terms of the quality of these projects they are quite local and they are oriented to the development of certain infrastructure of local importance in Russia.

**Jon Alterman:**
To Russia, the prospect of Middle Eastern investments in Russia is important. It helps break the international isolation caused by U.S. and EU sanctions and provides needed economic relief.

The implementation of sanctions against Russia partly caused closer economic relations between Russia and the Middle East, says Nakhle.

**Carole Nakhle:**
After the imposition of sanctions on Russia in 2014, because of its annexation of Crimea, Russia had to turn to some sources to raise capital because the sanctions constrained its access to capital, and it found the answer, at least part of it, in the Middle East. And that is one of the reasons perhaps where we saw the kind of rapprochement between Russia and the eastern countries, particularly the oil rich countries of the GCC.

And this is, in my opinion, why we saw Russia discussing various investment opportunities, not only in oil. I mean, of course, energy is central and here you're talking not only about oil and gas, as well as nuclear projects, but that covers the whole of the Middle East and North Africa region.

**Jon Alterman:**
Kozhanov says that like with Russian economic promises to the Middle East, Middle East promises to Russia haven’t always delivered.

**Nikolay Kozhanov:**
But from the attempts of the United Arab Emirates to invest in the service competency in Siberia, we cannot name any large infrastructural projects that would have importance for all of Russia, but rather they have certain regional, local importance.
Jon Alterman: But as Kozhanov reiterates, those regional investments might make a difference economically on the local level, but on the political level they are more complicated.

Nikolay Kozhanov: I would say that the serious problem is, again, created by the fact that sometimes these investments they are considered by the Russian political elite, and to a certain extent by the Middle Eastern political elites, as a certain political move rather than an economic action. So as a result, these projects, they are often dependent on the dynamics or bilateral relations. So for instance, if we again return to the Russian-Saudi economic dialogue, we can see that basically all those ambitious projects that most kept in mind in terms of involving the Saudi side. They were put on hold after the beginning of the recent price war.

Jon Alterman: So while wealthy Gulf countries have promised investment in Russia, the implementation of those investments has lagged. And after 2020’s oil price war, frosty relations between Russia and the Gulf make those promises even more dubious.

So where are we? Moscow’s overall trade relationship with the Middle East may not immediately seem significant. However, as Carole Nakhle explained, the health of Russia’s oil industry depends on strong relationships with OPEC, which means with the major Middle Eastern oil exporters. Without that, Russian private companies, and not just the Russian state, suffer.

Similarly, the Middle East purchases billions of dollars of arms from Russia each year. Russia’s military involvement in the region allows it to not just sell arms to regional states, but also to test and advertise their weapons in the region.

Finally, Russia and the Middle East both use investment as a tool to gain diplomatic leverage. However, when there’s too much politics in economic deals, you often end up with small, local projects, or ones that don’t get off the ground at all.

In absolute terms, Russia’s economic ties to the Middle East don’t make deadlines. But in strategic terms, the two regions are finding their economic interests increasingly intertwined. That means in the years to come, the Middle East will matter more the Russia, and Russia will matter more to the Middle East.

Next time on the podcast, we look at Russia’s security interests in the Middle East and explore Russia’s military presence in the region. To do so, we are joined by Alexei Khlebnikov and Becca Wasser.

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