
Russia's New Energy Alliances: Mythology versus Reality



Vladimir Milov

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Abstract

This brief paper analyzes the energy relations between Russia and its “new” energy partnerships – with China and Turkey – that the Kremlin tends to publicly promote as an alternative to energy relations with the West. The past 12 to 15 months have been marked by intensive negotiations, summits, and memorandums of understanding between Russia and these “new” partners. However, the progress is insufficient to merit talk about relationships of a truly global scale, and the many problematic issues indicate that these partnerships are working to only a limited extent. An examination of the Sino-Russian and Turkish-Russian partnerships shows that neither of these new strategic partners is ready to engage in Russia’s globally oriented energy games – instead they want to pursue their own pragmatic energy interests. The Russian attempts to instigate tectonic shifts in the energy markets through partnerships has failed, and both the “Power of Siberia” and “Turkish Stream” projects are rapidly turning into very localized bilateral stories, which are not truly significant in the context of a broader market picture.

Introduction

The past year has been marked not only by the Ukrainian crisis and unprecedented tensions in political relations between Russia and the West, but also by a rather radical change in Moscow's approach to international energy affairs. Widely promoted new energy partnerships with countries such as China and Turkey were supposed to demonstrate that Russia has a choice in mass-scale international energy cooperation, as compared to the previous domination of the European dimension, and that, if West wishes to cut ties with the Kremlin, Russia has somewhere else to go.

However, does Russia really have the option of developing new international energy partnerships comparable in scale and significance to those with Europe as the consumer of energy, and with Western international oil companies (IOCs) as key agents helping to secure further exploration and development of Russian oil and gas resources? The practical results of the past 12–15 months have very much put that idea into question: new energy partnerships with China and Turkey, promoted through very strong public relations efforts, are not truly moving forward toward a significant scale.

Sino-Russian Energy Relations: Beyond the Mythology

China, Russia's best energy partner?

The deep strain in relations between Russia and the West due to the Ukrainian crisis has given rise to the idea that Putin's Russia will instead develop closer relations with China, particularly in the energy area. Both official Russian propaganda and most commentators have predicted that things would evolve in this direction, given Russia's vast oil and gas potential, and China's growing demand for energy imports. This seems, after all, to be a natural match.

However, in reality, over the past 12–15 months, Sino-Russian energy relations have delivered far less than the optimists had hoped for, raising the question of whether the emergence of a mass-scale Sino-Russian energy partnership is plausible. First and foremost, the “deal of a century” gas supply contract signed between Russia and China in May 2014 has not turned out to be such a huge-scale deal as Moscow wants the international and domestic community to see it, and the project itself is already experiencing certain problems (see below for more details).

Secondly, none of the further major gas deals that were announced have gone through since May 2014. CNPC declined the 49 % equity stake in the Vladivostok LNG project, as offered by Gazprom. No extension for the May 2014 contract for gas deliveries via the Eastern Route has been signed, contrary to constant claims by Gazprom. Also, nothing specific was signed about Gazprom's much-hoped-for contract for gas deliveries via the Western Route (see more on that below).

Thirdly, none of the large-scale equity deals between Russia and China, related to the acquisition of Russian energy assets, have gone through. The main hope the sale to CNPC of 10 % of the Vankor oil field (the largest Eastern Siberian oil-producing field, with output of around 440 kbd, or thousand of barrels per day), announced by Vladimir Putin on 1st September 2014, and collapsed, despite the memorandum on the matter signed in November 2014. As in other cases, there appears to be a huge gap between the Russians, who want to sell the asset at the highest possible price, and the Chinese, who do not want to overpay. The oil price collapse has widened this

asset price gap. Also, the Chinese do not appear to be satisfied with the fact that, rather than large equity stakes in major projects, they are being offered relatively limited minority stakes, similar to those offered to other partners, such as Indian companies. Thus, Chinese companies are not being offered the kind of exclusive and preferential treatment they probably hoped for.

Fourthly, for apparently the same reasons, the potential sale to CNPC of shares in the Arctic blocks in the Barents and Pechora seas (the West-Prinovozemelsky, Yuzhno-Russky and Medynsko-Varandeytsky blocks), announced as early as in 2013, has not progressed since; thus, the Chinese have not shown any interest in participating in Russian Arctic oil and gas development. In contrast, most Western partners (ExxonMobil, Eni, Statoil) have agreed to Rosneft's partnership conditions for the Arctic projects (including the standard scheme of 66 %/33 % ownership, with dominant control by Rosneft). CNPC has apparently declined participation because of excessive Russian asset price demands, the capital costs of these projects, the controversial economics of Arctic exploration, and the unwillingness of the Russians to grant larger-scale control over joint ventures (JVs) beyond just the standard 33 % offered to international partners.

Fifthly, Chinese banks have not become a source of large-scale debt financing for Russian energy projects, contrary to Moscow's hopes after the de-facto international credit blockade of Russia had emerged following the Western financial sanctions of mid-2014. In fact, over the past year or so, China has barely lent any money to the Russian private sector.

The "deal of a century" signed between Gazprom and CNPC in May 2014, which envisaged the construction of the "Power of Siberia" gas pipeline from Russia to China and gas deliveries of 38 bcm per year, appears now, one year on, to have been oversold to the public. Its scale is not nearly as significant as the currently developing partnership between China and Turkmenistan. Earlier this year, it was reported that China had already reached a level of imports of natural gas from Turkmenistan equal to 35 bcm in annual terms.¹ Since 2009, CNPC and Turkmengaz have reached a series of consecutive agreements that set the target of Turkmen gas exports to China at 40 bcm per year in 2015 and 65 bcm per year in 2020.

In that context, the Russian deal signed in May 2014 looks unimpressive: it envisages peak supplies of gas from Russia to China only as 38 bcm per year, and, as was recently revealed by Gazprom's Deputy CEO Vitaly Markelov, about 10 bcm is to be supplied in 2020, 15 bcm in 2021, and 22 bcm in 2024, while the maximum level of

¹ "Chinese CNPC's Current Turkmenistan Gas Imports Reach 35 Bcm/year", Platts, January 2015, <www.platts.com/latest-news/natural-gas/singapore/chinese-cnpcs-current-turkmenistan-gas-imports-26993230>.

38 bcm may not be reached until 2031.² These figures clearly illustrate how much China prefers imports of Turkmen over Russian gas.

The “Power of Siberia” project itself is not moving ahead without difficulties. When the contract on gas supplies from Russia to China was signed in May 2014, the key announcement about the project was the supposed Chinese advance payment for gas supplies via “Power of Siberia”, in the amount of \$25 billion. However, the idea of advance payment was dropped later; by fall 2014 (at the time of the Sino-Russian summit in November 2014), Gazprom admitted that the \$25 billion advance payment “is not on the agenda anymore”. Gazprom rushed to reassure the public that it would “easily” manage to finance the construction of the pipeline, but that appears to be too optimistic an assessment. Due to Western sanctions against Russia, international financial markets are virtually closed to Russian borrowers; although Gazprom is not on the sanctions lists, private-sector lenders prefer not to rush into providing debt financing even to “clean” state-linked Russian borrowers, due to high political uncertainty around the Ukrainian crisis and the somewhat surprising resolve of Western countries in introducing tough sanctions against top players in the Russian corporate and banking sector. Furthermore, Gazprom’s financial situation doesn’t look too bright: in 2014, it lost around \$14 billion in export revenues in European and CIS markets combined as compared to 2013, and exports have continued to decline this year (exports to Europe fell by some 14 % year-on-year in the first four months of 2015).

The financing situation for “Power of Siberia” may not be particularly critical in 2015, when only a little over \$1 billion (under current exchange rates) is allocated to finance the beginning of construction. However, in 2016, over \$5 billion is planned to be spent, and Gazprom currently has no clear source of financing for pipeline construction.

The main mystery surrounding the contract is price. It has been widely suggested that the gas supply price under the “Power of Siberia” contract is around \$10/MMBtu; if true, this still makes this project a “frontier” one in terms of profitability. Although independent estimates are scarce, the author of this paper believes that just the ex-field cost of gas produced in Yakutia may be as high as \$4/MMBtu (estimates circulating around 2010 indicated \$2.3/MMBtu as the projected cost on paper³), and, if the transportation costs to the Chinese border are above \$5/MMBtu,⁴ the whole economics of the

² “Gazoprovod ‘Sila Sibiri’ zakonchat k 2031 godu” [The pipeline “Power of Siberia” will be finished in 2031], <gazeta.ru>, 5 May 2015, <www.gazeta.ru/business/news/2015/05/05/n_7167333.shtml>.

³ 1 April 2010, <www.trubagaz.ru/issue-of-the-day/chajandinskoe-gnkm-jakutii/>.

⁴ This is totally unclear due to lack of transparency on costs, but the costs of oil shipping via the Eastern Siberia–Far East oil pipeline, along with analysis of the

project may be put in question. No wonder Gazprom applied for extensive tax exemptions in connection with this project, asking for zero tax rates for all major taxes applied to the “Power of Siberia”.

However, even the economics outlined above may seem relatively acceptable compared to the situation as regards fallen oil prices. Russian officials in fall 2014 admitted that the price in the “Power of Siberia” contract was oil-indexed, and that Gazprom might have lost about a quarter of the contract’s value since the signing of the contract in May 2014.⁵ Details of price formulas are not known, but it is reasonable to expect that lower oil prices will put the project’s economic viability further into question.

Also, contrary to attempts by Russia and Gazprom to present “Power of Siberia” as a “groundbreaking” project of global importance, it still remains very much a localized, regional story. For Russia, it’s about the development of two remote Eastern Siberian gas fields (Chayanda field in Yakutia and Kovykta field in Irkutsk region), from which gas can’t be shipped to Europe in a commercially viable way. For China, this project is aimed at replacing coal with natural gas mainly in three remote north-eastern provinces bordering Russia (Heilongjiang, Jilin, Inner Mongolia), which currently mainly lack connection to the Chinese gas pipeline network, and are much more easily accessed from Russia. At the same time, the environmental situation in these provinces is troublesome, leading to social and political problems,⁶ and deliveries from Russia obviously seem a preferable option, given that Russians will build most of the infrastructure by themselves. The limited scale of the “Power of Siberia” project, as compared, for instance, to the above-mentioned larger-scale gas import contracts with Turkmenistan, supports the theory that this project has a local mission only, to supply the three north-eastern Chinese provinces currently lacking gas as an energy source. The peak volume of gas supplies under the “Power of Siberia” contract – 38 bcm per year (as noted above, not to be reached until 2031) – will be less than the peak recorded annual supplies to Germany in 2013 (40 bcm) and about 24 % of the peak recorded supplies to Europe in the same year.

After signing the “Power of Siberia” with CNPC contract in May 2014, Gazprom publicly suggested that “this was just the beginning” of truly large-scale gas supply cooperation with China, and the first step in opening a major new market for Russian gas. It was suggested that this contract would be followed by three other major

publicly available Gazprom data about the “Power of Siberia” project, suggest that this estimate may be reasonable.

⁵ A. Sotnikova, “Kontraktnaja cena ‘Sily Sibiri’ snizilas’ na \$80 mlrd iz-za cen na neft’ [The cost of the “Power of Siberia” pipeline reduced to \$80 bln due to oil prices], *RBK*, 20 November 2014,

<<http://top.rbc.ru/business/20/11/2014/546db818cbb20f68014dba1c>>.

⁶ “China smog emergency shuts city of 11 million people”, Reuters, 21 October 2013, <www.reuters.com/article/2013/10/21/us-china-smog-idUSBRE99K02Z20131021>.

projects, bringing supplies of gas from Russia to China to a truly significant level:

- 1) Vladivostok LNG, where CNPC was offered a 49 % equity stake
- 2) Extension of supplies via “Eastern Corridor” – basically, a new contract for more volumes to be delivered via the “Power of Siberia” gas pipeline (planned to be extended to over 60 bcm annual capacity)
- 3) New contract to be signed regarding supplies of gas via the “Western Corridor” (often also called the Altai gas pipeline project), southward from the western Siberian gas fields through the narrow piece of the Sino-Russian border between Mongolia and Kazakhstan in the Altai Mountains

One year after these public announcements, Vladivostok LNG (option 1) seems to be completely off the agenda; CNPC has not shown any interest in participating in this project, and Gazprom has even publicly admitted that the whole Vladivostok LNG project might as well be canceled.

No new contracts have been signed regarding the extension of gas supplies via the “Eastern Corridor” (option 2), and there is no news on the practical perspectives of signing such an extension.

The Altai gas pipeline project, or “Western Corridor” (option 3) seems to be the most desirable for Gazprom, as it creates the real possibility of diverting supplies of gas produced in the main Western Siberian fields (still delivering the bulk of Russian gas production) away from Europe towards the Asian market. That is not the case with “Power of Siberia”, as it relies on the resource base of the remote Eastern Siberian gas fields that, as noted above, can not realistically be considered as a potential source of gas for Europe.

Therefore, regarding the Altai project, Gazprom was keen to “make something happen” as quickly as possible, to demonstrate to its European partners that there is a solid alternative to the European gas market, and that Russian gas may move there if Europeans push too hard with various pressures on Gazprom. However, so far, any attempts to sign a contract on gas supplies via the Altai route have failed. Remarkably, they have failed in connection with at least two Sino-Russian presidential summits (in November 2014 and May 2015), ahead of both of which Gazprom heavily bombarded the media with predictions that “the Western Corridor contract will be indeed signed” at these summits. None of this has happened. At the November 2014 summit, the parties signed merely a memorandum of understanding on that project, little different from many others on the matter signed over almost a decade, including the first memorandum on the same subject signed in March 2006 in Beijing. At the May 2015 summit, a document with a more ambitious title, “Basic conditions of a contract”, was signed, but it amounted to just another memorandum (the parties just confirmed that supply volumes might constitute 30 bcm per year, the same as in the March 2006

memorandum). After the summit, Russian Energy Minister Alexandr Novak publicly admitted that “there is no agreement on price of gas supplies via the Western route”.⁷

If one looks at the general picture, therefore, it's easy to see that large-scale Sino-Russian energy cooperation remains very much wishful thinking (mainly on the part of the Russian side), and the medium and longer-term cooperation so far is limited to wholesale exports of oil and gas from the Eastern Siberian fields, which remains very much a localized regional story. The idea of exporting massive volumes of oil and gas to China from Western Siberia, the key Russian-producing region for decades to come, and thus “diversifying export destinations” away from Europe, is not any closer to realization, contrary to earlier claims by Moscow.

So far, Moscow has failed to engage China as (a) a key oil and gas upstream development partner, (b) a partner in the development of LNG and Arctic exploration, (c) a partner providing major financing for energy projects, and, probably most importantly, (d) a partner presenting a significant alternative as an export destination for Western Siberian oil and gas.

Is Russia's global energy shift from the West to the East realistic?

Why is the idea of a major turn away from Europe as the main consumer of Russian oil and gas, in favor of China, not working? There are several main reasons:

First, oil, compared to gas, is a more global, less politicized and more commercialized commodity. The current oil-supply logistics from Western Siberia and other key regions of Russian oil production (Volga, Urals, Timano-Pechora, North Caspian) to Europe are simply far more convenient as compared to exporting oil to China. Therefore, it's quite natural that China remains a target market only for oil produced mainly in the Eastern Siberian fields.

Second, despite some short-term fluctuations, Chinese import prices largely remain far less favorable to Russian exporters than European prices. According to the Rosneft IFRS financial reports for 2014, the company lost around \$5/bbl for each barrel of oil exported to China as compared to European exports.⁸ Gazprom's European

⁷ “Novak: Dogovorennosti mezhdru RF i KNR po cenam postavok gaza poka net” [Novak: There are no gas agreements between Russia and China yet], *RIA Novosti*, 9 May 2015, <<http://ria.ru/economy/20150509/1063534881.html>>.

⁸ The sales price to Asia (mainly China) is about \$3.35 lower than that to Europe, and transportation costs are about \$1.4-1.6 higher as compared to European export

gas export prices over a significant period have been substantially higher than Chinese import gas prices,⁹ which have predetermined the substantial price gap at Sino-Russian gas-supply negotiations in past years – a problem that still very much overshadows these negotiations now, as Chinese LNG import prices fell to \$7,5/MMBtu in June 2015,¹⁰ as compared to Gazprom's average gas price export to Europe in Q1 2015 of over \$9/MMBtu. The large price gap in negotiations obviously complicates reaching an agreement on new potential contracts.

Third, China does not greatly need extra gas supplies from Russia. Total current net imports of natural gas by China are just over 40 bcm a year. If one assumes that Chinese net gas imports will reach up to 150 bcm per year by 2020¹¹ – given that supplies via “Power of Siberia” and Turkmenistan would together constitute up to 100 bcm per year, and Chinese LNG import capacity would reach about 70 bcm per year (source – IEA) – it's easy to calculate that China does not need large extra volumes from Russia in the medium term. Maybe this will change beyond 2020, but that does not suggest that the Chinese are motivated to sign new gas import deals with Russia any time soon, beyond what has already been signed.

Fourth, an important issue is the clear preference of the Chinese to secure control over upstream projects instead of just buying wholesale volumes on “border basis”. For instance, gas supplies from Turkmenistan have developed much more rapidly than from Russia,¹² among other reasons, this is due to the fact that over 90 % of these supplies came from the CNPC-controlled upstream project on the right bank of the Amu Darya river in Turkmenistan. Equity ownership appears to be an important factor for the Chinese, but the Russians, contrary to their public rhetoric about “readiness to give away control to Chinese investors over strategic projects”,¹³ are not too inclined to cede control in reality (as mentioned above, the specific offers

destinations. See <www.rosneft.com/attach/0/12/99/MDA_ENG_4Q_2014.pdf>, p. 28 and 14 respectively.

⁹ M. Chen, “The Development of Chinese Gas Pricing: Drivers, Challenges and Implications for Demand”, Oxford Institute for Energy Studies, July 2014 <www.oxfordenergy.org/wpcms/wp-content/uploads/2014/07/NG-89.pdf>

¹⁰ World LNG Estimated June 2015 Landed Prices, May 2015, <www.ferc.gov/market-oversight/mkt-gas/overview/ngas-ovr-lng-wld-pr-est.pdf>.

¹¹ Energy Supply Security 2014, <www.iea.org/media/freepublications/security/EnergySupplySecurity2014_China.pdf>.

¹² The first memorandum on building a gas pipeline from Turkmenistan was signed by China in April 2006, just after the first memorandum with the Russians was signed (in March 2006), but the actual supplies from Turkmenistan began as early as 2009 and have reached more than 35 bcm per year (as of now), whereas Russian gas supplies are only expected to begin 3–4 years from now.

¹³ Remarks by Deputy PM Arkadiy Dvorkovich at the Krasnoyarsk economic forum in February 2015, “Dvorkovich dopustil uchastie Kitaja v osvoenii strategicheskikh mestorozhdenij” [Dvorkovich Admitted China's Participation in the Development of Strategic Fields], RBK, 27 February 2015, <<http://top.rbc.ru/economics/27/02/2015/54f002189a7947255e32ef80>>.

included 10 % in the Vankor oil field and 33 % in three Arctic exploration blocks, which suggests that the Russian view of a tolerable extent of control over upstream projects for their Chinese partners is not too generous, to put it mildly).

Several other factors have been preventing successful negotiations on the Altai project for almost a decade now:

China has no deficit of gas in the western part of the country (unlike the north-eastern part, where future gas demand is to be satisfied by supplies of gas via “Power of Siberia”), and the needed supplies will mostly come from Turkmenistan (see above). In March 2015, Reuters quoted a CNPC representative (in connection with Gazprom’s PR-buildup regarding “potential signing of contract on gas supplies via Altai pipeline in May”) who basically said that China does not need Russian gas in the west of the country.¹⁴

China apparently has doubts about Gazprom’s ability to fulfill any commitment to build the Altai pipeline quickly, both from a technical and a financial perspective. Construction of the Altai gas pipeline faces the challenge of extremely difficult high-altitude mountainous terrain near the Sino-Russian border, with altitudes reaching 3,000–4,000 m. Given the painful experience of constructing a gas pipeline to South Ossetia at similar record-breaking attitudes (around 3,000 m),¹⁵ construction of the mountainous Altai pipeline section will be extremely difficult, requiring tunneling and other costly options. This is further complicated by the fact that mountainous Altai completely lacks the basic infrastructure required (roads, electricity, communications, etc) to deliver cargo, workers, supplies, and so on. The Altai project cost was estimated at \$14 billion a couple of years ago, but a substantial cost increase may be expected. Given Gazprom’s above-mentioned financial difficulties, it’s almost certain that Gazprom would approach the Chinese for aid in financing the pipeline’s construction, but China apparently does not want to be a source of financing for that.

The Altai project would force China to invest in costly infrastructure solutions to link its existing pipeline with the remote mountainous corner at the western part of its border with Russia. The high-altitude terrain lacking basic infrastructure does not end at the 50 km Sino-Russian border in Altai, but continues well into Chinese territory. The Chinese would have to build a similar complicated, high-

¹⁴ “Gazprom ubezhdает Kitaj stroit’ zapadnyj eksportnyj marshrut v piku Evrope” [Gazprom Urges China to Build the Western Export Route to Challenge Europe], Reuters, 17 March 2015,

<<http://ru.reuters.com/article/businessNews/idRUKBN0MD1GL20150317>>

¹⁵ Construction of the 160 km pipeline to South Ossetia, passing through mountains as high as more than 3,000 m, began in 2006 and was supposed to be finished in 2007, but lasted until the second half of 2009 (three years) and cost over \$500 million.

mountain pipeline at their own end, a prospect they do not seem to be happy about – particularly for just 30 bcm a year of supplies.

All this, together with an increased price gap in the negotiations due to the collapse of the international gas price, makes swift realization of the Altai pipeline idea unlikely at the moment, contrary to Gazprom's assurances that the contract on gas deliveries via the "Western Corridor" will be signed "soon". The author of this paper believes that this issue is being pressed in public by Gazprom with only one purpose – to "blackmail" Europe with the potential threat of Gazprom's withdrawal from the European market and redirecting gas flows to China. However, this does not look to be a realistic possibility, given everything said above.

Another problem for the Russians is the unsuccessful attempts to obtain large-scale debt financing for oil and gas projects from Chinese banks. This was a great hope when Russia started to experience Western financial sanctions and an international credit blockade in mid-2014, but since then, the Russians have managed to obtain just a few billion dollars in loans from Chinese banks (compared to dozens of billions of dollars needed), and these were almost completely tied to procurement of Chinese goods and services. Russian hopes that China would replace the West as main creditor were dashed for several reasons. First, the Chinese financial system is much smaller than those of the Western economies (the total assets of the Chinese financial system are about four times less than those of the US and about three times less than those of the European Union), and is not designed to lend money to outsiders, but rather to provide credit to domestic businesses and Chinese exporters. Second, accordingly, Chinese financial institutions lack the necessary instruments to assess and hedge risks while lending large amounts of money to outside borrowers. Third, the Russian record in this regard was much damaged by falling oil prices, the domestic economic downturn, Western sanctions, the downgrade of sovereign credit ratings to junk levels, etc. Novatek and its Yamal LNG project are suffering particularly badly from lack of access to Chinese capital despite a long period of negotiations: in May 2014, Novatek's co-owner Gennadiy Timchenko promised to secure \$20 billion in Chinese debt financing for the Yamal LNG project, but so far none of these funds have been secured.

To sum up, the practical status of and prospects for the Sino-Russian partnership a year after the May 2014 gas agreements do not look as bright as Russian propaganda would like.

“Turkish Stream”: a Road to Nowhere?

Vladimir Putin first openly mentioned the possibility of finding a “non-EU surface entry state” for the troubled “South Stream” gas pipeline project in May 2014, during the St Petersburg economic summit.¹⁶ Not much attention was paid to his remarks at the time; all eyes were focused on negotiations with Bulgaria, which was then considered a surface entry country for the “South Stream” pipeline. However, Putin’s idea materialized later, after a new government opposed to “South Stream” took over in Bulgaria after parliamentary elections in October 2014. Less than a month after the new Bulgarian government led by Boyko Borissov was sworn in on 7th November 2014, Putin announced, during his meeting with Turkish President Recep Tayyip Erdoğan in Ankara on 1st December 2014, the cancelation of “South Stream” and its replacement with “Turkish Stream”.

Although “Turkish Stream” was announced as a “completely new” project, its planned capacity is similar (63 bcm of gas per year) and its route almost completely duplicates the former “South Stream” corridor, except for the last 250 km, which turn southwards from the Bulgarian shore toward Turkey. However, after that point the difference between the two projects becomes quite distinctive: whereas there was full clarity about the route of the European surface extension of “South Stream”, and even specific relevant agreements were reached with gas transit and consumer countries (Serbia, Hungary, Austria), in the “Turkish Stream” case such clarity is totally lacking. Gazprom’s public statements continually suggest that gas will be delivered to the Greek-Turkish border, and that it would be Europe’s problem to figure out how to transport it further to the markets.

At the same time, Gazprom has made public statements suggesting that it will completely stop gas transit through Ukraine by 2019,¹⁷ thus leaving the consumer countries currently relying on

¹⁶ “Putin prigozil Brjusselju izmenit' marshrut 'Juzhnogo potoka” [Putin Threatened Brussels with Changing the Route of “South Stream”], RBK, 24 May 2014, <<http://top.rbc.ru/economics/24/05/2014/926006.shtml>>

¹⁷ “Russia to Stop Gas Delivery via Ukraine by 2019, Push Ahead with Turkish Stream – Miller”, RT, 13 April 2015, <<http://rt.com/business/249273-gazprom-ukraine-gas-transit/>>.

transit deliveries via Ukraine with only one option: to switch to gas supplies via “Turkish Stream”, which is supposed to be commissioned by 2019.

There are two major obstacles to the approach suggested by Gazprom.

First, the “South to North” pipeline infrastructure which may help deliver Russian gas from the Greek-Turkish border to the current main markets of Central and South-Eastern Europe (Italy, Balkans, etc) simply does not exist, and so far there are no specific plans to build it. Russia tried to work with Greece to force it to begin the construction of a pipeline extension of “Turkish Stream” through Greek territory – Russian loans were even discussed as a source of financing for such construction – but Russian officials are now admitting that Greece will not be able to borrow money from Russia for launching this project, as it has limits on sovereign borrowings currently imposed by international creditors.

Second, Gazprom’s current contractual obligations with customers currently receiving gas through the Ukrainian pipeline system contain specific geographic points of delivery, which simply can’t be accessed through the proposed “Turkish Stream” route, not to mention that existing contractual obligations simply do not allow Gazprom just to drop the gas at the Greek-Turkish border, and instead demand delivery to specific geographic locations in consumer countries.

The above two issues are too serious and too important to be discounted, while relying only on Russian official press releases about “moving ahead” with “Turkish Stream”. They raise fundamental questions about the whole credibility of the project:

- If no supporting infrastructure is built by 2019 to connect Greece with key gas consumers in Italy, West Balkans, and Central Europe, does it mean that “Turkish Stream” will be able to supply only a fraction of gas as compared to the whole planned capacity (63 bcm)?
- Would Gazprom still want to stop transit of gas through Ukraine by 2019, given that some countries (Austria, Czech Republic, Italy, Slovakia, Western Balkan countries) may not have other physical options for receiving Russian gas by that time?
- Is Gazprom actually threatening these consumer countries with a cessation of supplies from 2019? Or is it trying to force them to undertake independent actions to build the relevant infrastructure connecting them to “Turkish Stream”? If so, does Gazprom consider that there may be easier options to get access to alternative gas supplies?

Given these questions, it does not look as if “Turkish Stream” offers a well-developed and understandable scheme of supplies, in contrast to the one that “South Stream” had. Instead, there are so

many strategic uncertainties surrounding “Turkish Stream” that target European gas-importing countries have visibly intensified their efforts to increase potential alternatives to imports of Russian gas:

- Romania virtually abandoned Russian gas imports in April 2015,¹⁸ when these were already at historically low levels,¹⁹ due to self-balancing gas production and consumption and plans to develop Black Sea gas offshore.
- Bulgaria also plans to develop its Black Sea offshore deposits and announced new licensing rounds for offshore gas in the Black Sea, while actively pursuing a plan to turn Bulgaria into a gas hub.²⁰
- At the end of April 2015, Bulgaria and Romania signed a joint declaration supporting the Southern gas corridor, including the Trans Adriatic Pipeline (TAP) and Trans-Anatolian Natural Gas Pipeline (TANAP) projects, pledging to improve the Romania-Bulgaria reverse gas interconnections, and connecting Romania, Bulgaria and Greece through the Vertical Gas Corridor initiative.²¹ Bulgaria, Hungary, Romania and Slovakia have signed a joint declaration of support for the construction of the new 1,274 km Easting pipeline running across all four countries, designed to have a capacity of 20 bcm a year in the first stage and 40 bcm in the final stage, supplying gas from Central Europe to the Slovak-Ukrainian border to the Bulgarian-Turkish border. It may also connect up to a potential gas hub in Turkey, enabling reverse-flow supplies from the Caspian basin.²²
- Russia’s key strategic ally in the region, Serbia, uncertain about the future of “Turkish Stream”,²³ started to pursue official talks with Romania about the prospect of imports of Black Sea gas as an alternative to Russian gas.

¹⁸ “Economica: Romania Plans to Abandon Russian Gas Imports in April 2015”, Focus New Agency, 20 March 2015, <www.focus-fen.net/news/2015/03/20/366889/economica-romania-plans-to-abandon-russian-gas-imports-in-april-2015.html>.

¹⁹ “Romania Cuts Dependence on Gas and Russia”, Interfax, 2 March 2015, <<http://interfaxenergy.com/gasdaily/article/15402/romania-cuts-dependence-on-gas-and-russia>>.

²⁰ “Bulgaria Seeks to Redraw EU Oil and Gas Routes Away From Russia”, *Moscow Times*, 15 April 2015, <www.themoscowtimes.com/opinion/business/article/bulgaria-seeks-to-redraw-eu-oil-and-gas-routes-away-from-russia/519127.html>.

²¹ “Romania and Bulgaria Sign Joint Declaration on Strengthening Regional Energy Cooperation”, *Business Review*, 27 April 2015, <<http://business-review.eu/featured/romania-and-bulgaria-sign-joint-declaration-on-strengthening-regional-energy-cooperation-79646>>.

²² “Romania, Bulgaria Back New Gas Pipeline”, *Turkish Weekly*, 25 May 2015, <www.turkishweekly.net/news/186161/romania-bulgaria-back-new-gas-pipeline.html>.

²³ “Serbia in talks with Romania over Black Sea gas – PM Vucic”, *Reuters*, 22 January 2015, <<http://af.reuters.com/article/energyOilNews/idAFD0N0NT00S20150122>>.

- East Mediterranean gas may arrive in the Central and South-Eastern European market in the longer term, adding even more competition to a market already rapidly diversifying its sources of gas supply.

All this shows that, at the same time as Russia decisively insists that countries of Central and South-Eastern Europe should line up to get gas from “Turkish Stream”, key consumer countries are either already minimizing gas purchases from Russia, or taking active steps to diversify their import sources. This may significantly change the landscape of this geographic segment of the European market just 5–7 years down the road. And the question arises: If “Turkish Stream” is built, will there be any demand for the gas that it can deliver?

Of key importance in all this is the position of Italy – the biggest recipient of Russian gas currently transported via Ukraine, and potentially to be transported via “Turkish Stream” (25–30 bcm per year out of roughly 60 bcm). Italy was surprisingly calm during the whole story concerning the cancelation of “South Stream”, and, as a matter of fact, significantly contributed to the abrupt end of “South Stream” the way it happened. In early November 2014, the new CEO of Italy’s Eni, Claudio Descalzi, spoke publicly (nearly for the first time) about “South Stream”, expressing his discontent with the huge construction cost overruns announced by Gazprom, and threatening to withdraw from the project if Gazprom insisted on the cost overruns (Eni was a major international shareholder of “South Stream”, with a 20 % share). The author of this paper believes that the cancelation of “South Stream” was directly connected with Eni’s position, as the subsequent meeting between Descalzi and Gazprom’s CEO Alexey Miller, in Sochi on 24th November 2014 (just a week before Putin’s visit to Ankara where the cancelation of “South Stream” was announced), was not able to bridge the gap between the two key “South Stream” shareholders, Eni and Gazprom. It will be interesting to observe the further actions of Italy, which, given Gazprom’s threats to cease gas transit through Ukraine and uncertainties around “Turkish Stream”, is obviously exposed to most risk. Until recently, Italian companies were visibly exploring various gas supply alternatives (including Egypt and other Eastern Mediterranean countries) and showing no anxiety regarding the uncertain situation with “Turkish Stream”. This Italian equanimity does not seem to be a good sign for Gazprom.

In this situation of clear lack of interest from Central and South-Eastern European consumers in connecting to the proposed “Turkish Stream”, an increasing number of experts have been suggesting that the pipeline’s capacity may be reduced to just two lines (around 30 bcm capacity) instead of four (60 bcm), with the construction of the remaining two lines being postponed to an undetermined period. Most of the gas supplied via the two first lines of “Turkish Stream” will go to Turkey, which has already reached a record level of imports of Russian gas (over 27 bcm in 2014), and is

interested in more. Turkey already enjoys strong leverage on Russia due to its potentially growing dependence on gas transit through Turkish territory, which allows it to aggressively demand gas price discounts from Gazprom. At the same time, Turkey faces little risk, as the developing network of pipeline alternatives (TANAP, etc) and a growing share in Gazprom's exports (already nearly a quarter of Gazprom's Western European sales in 2014!) put it in a rather advantageous position with regard to the Russian monopoly.

Similar to the situation regarding the "Power of Siberia" pipeline to China (as explained above), this all suggests that "Turkish Stream", far from being a "strategic" project aimed at changing the whole logistics of European gas imports, will amount merely to a local, bilateral Russian-Turkish story. In the current circumstances, it looks as if the many uncertainties and risks related to Russia have forced its most loyal consumer base in Central and South-Eastern Europe to seek real supply alternatives – thus greatly reducing the strategic importance of "Turkish Stream".

Conclusions

The main conclusion to the above analysis is that the “new Russian partnerships” in the international energy arena, which are often promoted as an “alternative” to partnership with the West, are clearly “oversold” in the public sphere. An examination of the Sino-Russian and Turkish-Russian partnerships indicates that neither of these new strategic partners is willing to engage in Russia’s globally oriented energy games. They want instead to pursue their own pragmatic energy interests. The Russian efforts to instigate tectonic shifts in the energy markets by developing new partnerships have failed. Both the “Power of Siberia” and “Turkish Stream” projects are rapidly turning into localized, bilateral stories, and, in the context of the broader market, lack any real significance.

These developments in fact, along with geopolitical factors and the political rift with the West and, specifically, the European Union, put into question the whole concept of “diversifying the demand away from Europe”, as promoted in recent years by Gazprom. Recent difficulties and shortcomings in Russia’s energy relations with China and Turkey once again highlight what a generous energy partner Europe was and is for Russia, in offering the best prices and steadily increasing sales volumes, compared to those who became Moscow’s main international energy hopefuls – the rather tough and extremely pragmatic negotiators in the East.