RUSSIA AND ENHANCED COOPERATION ON NORTHEAST ASIA ENERGY SECURITY

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Key Findings:

- Due to high growth in energy demand China will stay a key factor defining Northeast Asia (NEA) energy security, and Russia, as the only one important regional supplier of energy, is capable to make a critical input in achieving it. Taking into account composition and quantity of natural resources' proved reserves in Russia, in future NEA countries would be able to import substantial amounts of Russia’s oil and especially gas in both pipeline and liquefied natural gas (LNG) forms.

- To speed up realization of international projects in NEA, and to contribute to the development of the Russian Far East (RFE), during the last several years the Russian Government has made large scale financial investments into natural resources extraction and transportation in the RFE, and announced immediate plans to construct several new oil and gas processing plants in this part of the country. Thus major Russian state companies (Gazprom, Rosneft, Transneft) consider NEA energy market as an important destination that would help them to achieve ambitious aims of the Russian Governments’ energy strategy for next 20 years.

- Russia is interested in international cooperation in the energy sector to diversify regional exports, to increase energy resources development, processing, energy end-use use efficiency and energy infrastructure safety, etc. Thus foreign countries’ (Japan, China, ROK, USA) contribution in the form of financial investment, new processing technologies, etc. is very desirable. In this context APEC 2012 annual program events Energy Ministers’ Meeting in St. Petersburg in June and summit meeting in Vladivostok in September) became a unique chance for Russia to clarify its priorities in this area: to enhance the share of natural gas in NEA regional energy mix; to focus on renewable energy sources, especially hydropower power option; to ensure the safe and efficient use of nuclear energy; to rely more on means of subregional cooperation and multilateral approach in achieving NEA energy security goals, etc.
Introduction

Sizable amounts of natural resources are located in East Siberia and the RFE. Thus Moscow is able to make a critical input into NEA energy security. Natural gas is particularly attractive, because, in comparison to coal and oil, its use is causing much less environmental damage. Gas usage is expected to grow three times as fast as that of oil. While oil will remain the dominant fuel even in 2030, gas will become the world second largest source of energy (32% and 26% of the global needs, respectively). ¹

During his second presidential term (2004-2008), Vladimir Putin introduced the New Energy Policy (NEP), which is based on the following principles: diversification of the energy supply market, sustaining sovereign control over strategic decisions on oil and gas exploration and transit routes, signing long-term contracts with foreigners to develop Russian natural resources, and regulating foreign access to them. According to the NEP, Russia would only agree to invest in energy infrastructure projects if consumer states sign 20- to 30-year contracts. ²

Russia plans to diversify energy supply market by increasing exports of natural resources to Asia. In July 2006 Putin made a commitment to increase the Asian share of Russian energy exports in 15 years from the current 3% to 30%. This means that Russia would sell to Asia at least 60 million tons of oil and 65 billion cubic meter of gas per year.³

Russia’s Activities and Vision of Energy Policy in Northeast Asia

Due to a very short time allocated for our presentations, I will mostly cover Russian activities and plans in gas and oil extraction and export spheres. In 2007 Putin approved a proposal granting two state-owned companies (Gazprom and Rosneft) the exclusive right to develop oil and gas extraction projects on the Russian continental shelf.

The RFE is a critical area for Gazprom’s expanded investment activities. The first gas exports from the RFE occurred in 2009 when Gazprom started to sell LNG to Japan and Korea from the Sakhalin-2 project. Overall gas extraction at Sakhalin in 2011 reached 25,5 bln. cubic meters: Sakhalin-1 contributed 9,1 bln. cubic meters, and Sakhalin-2 – 15,4 bln. cubic meters.

¹ Exxon Predicts Gas Use Will Surpass Coal's - The Wall Street Journal, 27.01.2011


In September 2011 Gazprom finished construction of the first part of the gas pipeline “Sakhalin - Khabarovsk - Vladivostok” with an annual capacity to deliver 6 bln. cubic meters of gas (at the final construction stage this pipeline capacity will reach 30 bln. cubic meters). This will make it possible to achieve Gazprom’s goal of making gas available to NEA countries. Gazprom chose to rely on gas from the Sakhalin-3 project as a main source to supply domestic and foreign customers in the near future. This project consists of four gas and oil fields producing more than 700 million tons of oil and 1.3 billion cubic meters of gas.

Current prospects for large-scale foreign investments in eastern Siberia and the RFE differ country by country. The only example of substantial American investments is the Sakhalin-1 venture. In February 2012 Exxon made an offer to Gazprom to transfer it a gas component of the Sakhalin-1 project on “certain conditions” that are so far undisclosed.4

Japan’s Osaka Gas signed a contract with Sakalin-2 operator Sakhalin Energy to buy annually 20,000 tons of liquefied natural gas produced at a plant in southern Sakhalin and then shipped to Osaka. The Japanese contract account for 98% of the LNG plant’s productive capacity and, according to the contract terms, Sakhalin Energy will provide Japan with this amount of LNG for 23 years.

Due to the lack of non-contracted LNG resources, Russia could not immediately help Japan to compensate deficit of energy which occurred after the Fukushima incident. Nevertheless, Japanese companies reached a preliminary agreement with Gazprom to construct a new LNG producing plant in Vladivostok aimed at selling LNG mostly to Japan, and in early 2012 presented this plant construction proposal to Gazprom for further consideration.5

In June 2009 number one LNG importer in the world KOGAS established a 100% subsidiary KOGAS Vostok to take part in gas businesses and seeking potential projects in the RFE. This company is interested to increase its Russian LNG annual imports from current 1,5 mln. tons to 7,5 mln. tons in 2017. These projected numbers include gas that should be produced at the new LNG plant to be constructed in Vladivostok in the next several years.

In August 2011 then North Korean leader Kim Jong-il and then Russian President Dmitry

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4 Exxon Neftegas predlagaet peredat Gazpromu gas s Sakhalin-1” - "Vesti economica", 08 February, 2012
URL: http://lenta.ru/news/2012/02/08/exxon/

Medvedev agreed to develop a plan of Russia-DPRK cooperation in arranging initial annual transit of about 10 bln. cubic meters of the Russian gas to ROK through the DPRK territory. It should become a trilateral project with participation of the RF, ROK, and DPRK aimed at construction of a gas pipeline from Russia to ROK. So far it is not clear whether this project would be implemented, due to political, technical and other obstacles.

Active exploitation of the Chinese energy market is a key condition for Moscow to achieve its energy strategy aims. In 2004 Russia proposed to build a new complex gas transportation system called to deliver gas to China through two (western and eastern) pipelines. The western pipeline would go from the Altai territory in western Siberia to the Xinjiang Uigur Autonomous Region in China supplying up to 30 billion cubic meters of gas annually. The eastern pipeline (projected annual capacity up to 38 billion cubic meters) would go from eastern Siberia and from Sakhalin island to northeast China and also to Vladivostok, and then possibly to the Korean Peninsula. Moscow and Beijing came to mutual consent on main aspects of the long term contract to deliver Russian pipeline gas to China. However, it is still not signed due to remaining disagreements on gas delivery price.

RUSSIA’S FUTURE INPUT INTO NEA ENERGY SECURITY

To evaluate Russia’s future input into NEA energy security we should analyze the RF Government’s latest financial commitments and plans in oil and gas extraction and export. In October 2010 then Prime Minister Putin stated that during the next 10 years Russia would maintain annual oil output at its current level of 500 mln. tons. It means that Moscow has no plans to increase extraction of oil, because oil reserves in Russia are already worked out by 50%, and there are no new deposits around with easy access to them.

At the same time Putin declared that in the foreseeable future natural gas has no alternative as a main source of energy. Thus during over the next 20 years Russia would increase annual extraction output from 650 billion cubic meters of gas (extracted in 2010) to one trillion cubic meters (about half of this huge amount should be exported). To achieve this strategic aim new gas extraction areas would be formed on the Yamal Peninsula, in eastern Siberia and on the continental shelf, and more than 25 thousand kilometers of pipelines would be constructed. Besides, the share of private gas producers in Russia should increase from current 20% to 30%. And, finally, considering Russian natural gas, it is practically an inexhaustible source of energy (total gas reserve forecast in Russia is about 165 trillion cubic meters).


**Recommendations and Conclusions**

Russia-China energy partnership has developed a firm intergovernmental and business foundation. Interestingly enough, Beijing accepted one of the principal features of the Russian NEP: during the last several years China either signed or achieved principal agreements on contracts with Russia in oil, coal and gas using the same model – allocating very substantial financial loans as a guarantee of long term supply of Russian energy resources.

However, to avoid placing Beijing in the position of a buyer’s monopoly in price negotiations, Moscow should find ways to deliver a substantial part of energy resources to Japan, the ROK, USA and other countries. In this context multilateral approach to energy cooperation in NEA has considerable advantages for Moscow. That was why Russia became one of the founding members of the Intergovernmental Collaborative Mechanism on Energy Cooperation in NEA. As far as the wider Asia-Pacific is concerned, Russia is an active participant of the APEC Energy Working Group (its 10th Energy Ministerial annual meeting took place in St. Petersburg in June 2012).

For the last decade Russian oil companies, primarily Rosneft, had been successful in increasing oil export to the Asia-Pacific countries from 6 mln. tons (2003) to 45 mln. tons (2012), it is a fifth part of the Russian oil export to the world market. While ESPO oil due to its high quality has a good chance to become an Asian crude oil benchmark. Besides, Japanese JOGMEG company participation in oil exploration helps to get more oil to fill the ESPO pipeline. Another important plan for Rosneft (may be in cooperation with Lukoil) is to start construction of a new oil processing plant in Vladivostok area. It is a real challenge for Rosneft: to become economically viable this plant should be based on very competitive technologies, because it will face serious competition from such plants in neighboring Japan and ROK. Lastly Rosneft has been very active in establishing partnerships with world leading oil companies, and it may become a good opportunity to implement same model to realize its Asian projects.

In 2011 Gazprom extracted 520 bln. cubic meters of gas (overall Russian gas output reached 671 bln. cubic meters). For 2014 the extraction plan for Gazprom is 570 bln. cubic meters of gas, and for the whole Russian gas industry - 741 bln. cubic meters. It means that Russian gas export quantities to NEA are growing.

In this context I could only partly agree with an argument in the Subregional study (page 24) that “There have been a number of proposals on the pipeline routes and financing mechanisms for tapping and delivering Russian gas, but concrete plans have not been yet agreed upon among the stakeholders”. Just two weeks ago Gazprom Chairperson Alexei Miller finally coordinated with most critical Russian stake-holder (President Vladimir Putin), and officially announced a grand plan to develop
eastern part of the Altai project and to construct a new LNG production plant in Vladivostok area. To make the eastern gas pipeline a sustainable project, Gazprom decided to construct a new gas pipeline system from oil and gas deposits in Chayanda (Yakutsk area) all the way to Khabarovsk, and to connect it there with Sakalin-Khabarosk-Vladivostok pipeline. To develop Chayanda deposit to the oil and gas production level, and to construct this 3200 kilometers-long gas pipeline by 2017 Gazprom would need 430 bln. and 770 bln. Russian rubles respectively. For constructing a new LNG production plant the gas giant would need to allocate 220 bln. rubles, so overall expenditures for three interrelated projects would reach around $50 bln.

To implement these formidable projects cash-stripped Gazprom would have to borrow money from the Russian Government or on international financial markets. However, to speed up realization of these formidable projects Gazprom has a better alternative. At modern times, when international competition in gas extraction, delivery technologies, etc. (not forgetting a technology revolution brought by shoal gas) is becoming increasingly high, it is a critical moment when Gazprom may try to implement more market based approach, and to invite foreign companies not only as gas consumers but as direct investors to share production capabilities, financial burden and new technologies. Such an approach, especially in multilateral format, would be helpful in developing trust between regional countries and facilitating energy security.

In May 2013 Vladivostok will host the Asia Pacific Energy Forum (APEF) arranged at the level of Ministers of Energy. At this forum Russia would clarify again its priorities in energy cooperation in the Asia-Pacific. It would help to show that Russia is ready to become one of the leaders in formulating the APEF agenda, and to increase its practical input into achieving NEA energy security goals. I think that an idea of enhancing NEA energy cooperation architecture, proposed in the NEA subregional study by professors Jae-Seung Lee and Jungmin Yu is a very productive one. During this meeting in Vladivostok in May 2013 Russia may wish to propose this theme (to form NEA INGO for cooperation in energy security on ministerial or may be summit level) for a more detailed discussion with other regional participants.