

Russia's Gas Export Strategy to Respond to the New Situation

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On March 4, the Institute of Energy Economics, Japan held a seminar featuring a presentation by Prof. Jonathan Stern, chairman of the Natural Gas Program at the Oxford Institute for Energy Studies, who is known as an internationally recognized authority on natural gas problems. Prof. Stern presented a very interesting analysis on Russia's gas export strategy under the new situation since 2014. In the following, I would like to take up four points from his conclusion that I felt were particularly important.

First, Russia has changed its European gas market strategy. Europe is dominantly important as oil/gas export destination and sales channel for Russia whose economy depends heavily on the oil/gas sector. In 2013, the European market absorbed 72% of Russian gas exports (pipeline gas and liquefied natural gas). Europe is a money-making market for Russia. Naturally, Russia has positioned the maintenance of the money-making market as a basically important policy.

But the relationship between Europe and Russia has posted great changes. They include a prolonged decline in demand in the European gas market. Economic stagnation, growth of coal, renewable energy and other rival energy sources, and competition from non-Russian gas have put even potentially competitive Russian gas into a difficult position in the European market. In another development causing a major problem for Russia, the European Union enhanced the unbundling of transportation services under its third energy package to form a unified regional market, promote market competition and secure market transparency, blocking Russian state-run gas company Gazprom's plans to participate in or acquire gas sales companies and enhance control on pipelines in the downstream gas sector. Furthermore, the Ukraine crisis has grown more serious since February 2014, prompting the EU to adopt reduction of its dependence on Russian gas as one of its key policies.

Given that European market conditions for Russia have grown more unfavorable, Russia has begun to set back its plan to expand into the downstream gas sector while viewing the European market as still important. While giving priority to forming direct relations with European users in a manner to get around the problem of gas supply via Ukraine, Russia has growingly seen Europe as a simple business partner rather than a strategically important market as conceived in the past, Prof. Stern noted.

Second, he pointed out that Turkey has been rapidly growing more important for Russia within or in comparison with the European market. This change is based on Russia's realistic decision in a sense. Russia gave up on the South Stream gas pipeline plan to link Russia to Eastern Europe and Western Europe via the Black Sea late last year and began to consider the Turkish Stream gas pipeline plan to bridge itself to Turkey via the Black Sea. This is because the Turkish market is expected to further grow and the gas pipeline is set to become a leading channel to Europe getting around Ukraine.

The third point Prof. Stern made is the Russian gas strategy's accelerated shift to Asia. While Europe, excluding Turkey as mentioned above, is unlikely to expand its gas market, gas demand in the Northeast Asian market including China is well expected to increase for various reasons. For Russia, the strategy of enhancing access to the new expanding market speaks for itself. Given the international political environment for Russia, the enhancement of its China strategy is dominantly important in its Asia strategy. China's gas market is actually expanding and is expected to expand over a medium to long term, despite the possibility of economic deceleration. Russia signed a contract with China for gas sales via an eastern route last May and a memorandum for sales via a western route last November. China is now one of a few countries with which Russia can have large scale business negotiations. As a matter of course, Russia may have expectations on the Japanese market from the viewpoint of its diversification of Asian customers (to avoid its heavy dependence on China). But Prof. Stern noted that Russia giving top priority to China would be important from the viewpoint of a realistic strategy. This means that the problem is how realistic deals with other Asian countries would be for Russia.

Fourth, Prof. Stern pointed out that Russia's gas strategy is now giving priority to pipeline gas exports again. Russia has planned to launch various LNG projects for Europe and Asia to become a global LNG player. But Asian LNG buyers have grown more cautious about signing new long-term LNG purchase contracts with Russia even amid an easier supply-demand balance due to Western countries' economic sanctions on Russia after the Ukraine crisis and various other market uncertainties. Furthermore, crude oil price drops have made it necessary to revise the profitability of LNG projects. These developments have prompted Russia to take a realistic approach, giving priority again to pipeline gas exports for which it has abundant experiences and capabilities. Excluding some such as the Yamal LNG project, Russian gas export projects that have made specific progress or that are under serious consideration are all for pipeline gas exports, represented by the Turkish Stream and China-Russia pipeline projects. Pipeline exports are accompanied by export tax, while LNG exports are free from such tax. For the Russian government plagued with financial difficulties under low oil prices, export tax revenues from pipeline gas exports would be important.

The four Russian gas strategy changes have come as Russia has been required to revise its strategy in response to new difficulties. The Russian gas export strategy could change further, depending on future situational changes. For the immediate future, however, it would be very important for us to sufficiently understand the four points in analyzing the Russian gas problem.

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