Energy in Southeast Europe

The Sixth Report of the

Monitoring Russia Serbia Relations Project
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Sixth Report
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Introduction to the ISAC Fund Energy Report

The issue of energy, its production, transport, distribution and consumption as well as energy security is in keeping with the overall political discourse of South-East Europe. The region has been significant for centuries as an important trade route and is important today, not only as an east-west transit link, but also as a future energy market and destination of future investments in the energy sector. Challenges on the energy front in this region differ considerably from the rest of Europe. Political insecurity, lack of investments and a fall in energy production from domestic sources have created a shortage of energy in the region. This shortage will need to be compensated in the future. One solution is cooperation with Russia—a country with enormous gas reserves, and an abundance of oil and other energy sources. However, issues of energy production and transport, apart from technical and economic matters, also have a political dimension. With this report, the International and Security Affairs Centre – ISAC Fund contributes to an open and informed debate on the potential for cooperation between countries from the region and Russia in ensuring long-term and sustainable energy security.

Few people dispute the need for cooperation with Russia in ensuring long term energy security. No one question the wide range of possibilities for the development of this cooperation. However, the region of South-East Europe, to which Serbia belongs, has little opportunity for cooperation with Russia outside the general framework of cooperation between the European Union and Russia. There are no planned pipelines, which end in the Balkans. South-East Europe is, therefore, the transit region of energy sources and can enjoy many benefits from its favorable geographical position. Therefore, all discussions and analyses on secure and sustainable energy for the region are determined by EU-Russia cooperation, their trade and investments. This is particularly emphasized in Atanas Georgiev’s article, which points out that the Bulgarian experience of cooperation with Russia shows how political will is necessary for the countries of the region to take advantage of their favorable geographical position and European perspective.

The Report presents Russian and European views on the prospects of cooperation between the region and Russia, thus, seeing to achieve overall balance and objectivity. Both authors from Russia, Igor Tomberg and Konstantin Simonov, underline the need to depoliticize the issue of energy supply, both in the region and Europe, which sometimes, to paraphrase Tomberg, has a “hysterical flavor”. It is important for Russia to guarantee demand and eliminate transportation risks, such as events that occurred during the two “gas wars”. Secondary issues, like mediators in gas supply, underlines Simonov, can be resolved in the future. Tomberg points out that the situation in the Russian energy sector is far from what the opponents of cooperation with Russia wish to portray and that Russia has many alternatives available if cooperation with Europe becomes unfavorable. Simonov, on the other hand, gives a long list of examples of positive results of cooperation between countries in the region of South-East Europe and Russia.

In connection with the South Stream gas pipeline a certain skepticism can be read in András Deák’s and Pavel Baev’s texts. Over-optimistic deadlines, politicization of relations between Russia and the EU, and a number of other examples speak against the current schedule, and have lead Deak to express doubts about the timeline for the completion of South Stream. At the same time, Baev raises questions about the justification of both South Stream and Nabucco, taking into account their actual costs and prospects.

For Serbia, European and regional trends in sustainable energy security are certainly important. Zorana Mihajlović-Milanović, on this occasion as she has done in the past, presents
a number of examples to support her claim that it is necessary to aim at reducing the growing energy deficit in the region, primarily by passing the necessary legislation and developing investment in the region’s energy infrastructure. Political issues, of course, prevail and Mihajlović-Milanović, whose analysis is primarily economic, points that out. Milan Simurdići in his text elaborates these political issues in detail and with plenty of examples, emphasizing the synergy between energy and geopolitical issues, and political tendencies that determine actions both in the EU and Russia.
Zero Option in the Virtual Pipeline Race: Russia and the EU Need to downsize their Energy Ambitions

Dr. Pavel K. Baev*

Introduction

The spring and summer of 2009 witnessed spectacular – at times even grotesque – competition between Russia and the EU regarding the development of new gas flows into Southeast Europe (SEE). The EU-sponsored conferences in Sofia and Prague sharply disagreed with the gathering in Sochi called by Prime Minister Vladimir Putin and bi-lateral talks in Moscow and in Baku between the presidents Dmitri Medvedev, Ilham Aliyev and Gurbanguly Berdymukhammedov.1 Gazprom’s CEO Aleksei Miller confidently asserted at an annual meeting in late June that the South Stream pipeline would carry up to 35 percent of Russia’s gas export to Europe by 2015, and a couple of weeks later, the intergovernmental agreement on the Nabucco pipeline was signed with much fanfare in Ankara — followed by the Russian-Turkish energy deal in August.2

Formally, the EU has no objections to including the South Stream pipeline in its vision for the ‘Southern corridor’ while Russia is openly indifferent to the Nabucco project, so that Putin merely offered some advice: ‘Before investing billions of dollars in a pipe to be buried in the ground, one should first see where to obtain the gas to pump through it’3. As things stand in mid-2009, both projects appear to be on track, opening two parallel streams of gas into the SEE markets by the middle of the next decade.

Indeed, neither the EU nor Russia have taken into account the growing and potentially devastating impact of the current recession, which has made the most meticulous energy forecasts from 2006-2008 strikingly irrelevant. This denial can be interpreted as the psychological response of over-grown, though reasonably successful bureaucracies that have suddenly lost confidence and direction. It is clear that, sooner rather than later, the EU and Russia will have to come to terms with reality and downsize their respective energy ambitions accordingly.4 It is possible that Nabucco and/or South Stream might not survive this ‘correction’. This paper will examine the possible execution and consequences of such a ‘zero option’.

Fragile fundamentals and pointless planning

Gas business is believed from the immanently volatile oil market in its greater stability secured by long-term contracts and materialized in systems of pipelines that lock producers and consumers in a permanent relationship. Yet, in the second half of the current decade, this field has become increasingly turbulent and now all key fundamentals look decidedly uncertain. In

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2 Ed Crooks, ‘No friends, only partners in pipeline realpolitik’, Financial times, 6 August 2009.
4 This analysis draws on Pavel Baev, ‘Competing designs for Caspian energy highways: Russia and the EU face reality checks’, PONARS Eurasia Memo 55, Washington: Georgetown University, May 2009.
January 2006, the ‘gas dispute’ between Russia and Ukraine became an eye-opener for many European customers, who were forced to realize that transit issues were only part of a complex problem hidden under a shocking lack of low transparency in key arrangements.5

In the aftermath of that high-resonance mini-crisis, concerns in the EU were centered on Gazprom’s ability to deliver adequate volumes over the next decade as the powerful company was clearly not investing enough in its core assets, while demand in Russia was growing fast.6 Alongside worries about Gazprom’s politicized behavior, were demands for reducing emissions and going ‘green’, despite the fact that natural gas is one of the cleanest energy sources. Thus, a powerful lobby advocating ‘diversification’, had developed multiple networks in Brussels. It has focused its activity on a set of guidelines known as ‘20-20-20’, elaborated in a number of documents, including the Energy Security and Solidarity Action Plan (November 2008). This specifically prescribes that should oil prices come close to SUS 100 per barrel, the EU gas import will decrease by 3-5 percent in 2020 compared to 20057.

Gazprom was quite upset about this deliberate violation of its favorite principle of ‘security of demand’. Nevertheless, it was inclined to interpret it as a triumph of wishful ‘green’ thinking. It did increase investments in developing the extensive Bovanenkovskoe field in Yamal (peninsula in north Russia, editor’s note), but its main response to the EU’s ‘political phobias’ was to cultivate partnerships with such European majors as E.ON or ENI that had their own reasons for sabotaging the Commission’s plans for liberalization – and could mobilize effective support from their ‘mother-states’. That could have been a sure-win strategy, but the ‘gas war’ in January 2009 inflicted further damage on Gazprom’s business reputation and caused an astounding 40 percent drop in the volume of its export to the EU in the first quarter.8 Miller and other Gazprom top executives tried to put on a brave face and assured that the flow would return to normal in the second half of the year. However, they need to consider the possibility that a declining demand in the EU is beginning to look like a serious prospect.

Undoubtedly, there are many variations behind the EU and its general directives; for example, diversification for Spain means gaining access to Russian piped gas. In SEE, energy consumption is significantly lower than the EU average (not to mention that several countries in this region are not members of the Union). Bringing standards of development up to EU levels can only be achieved by creating new industrial consumers in addition to expanding services and tourism. However, prices are highly elastic in this market, creating a ‘gas bazaar’ dilemma for producers and consumers: the former launch expensive projects, such as South Stream, aiming at covering the costs by delivering big volumes at high prices, while the latter can avail of such deliveries, only if prices are reasonably low. Gazprom’s unquestionable assumption that ‘the era of cheap hydrocarbons is over’ finds few buyers in the Balkans.

Could Ukraine become an acceptable alternative?

A point, often overlooked in debates on the Southern corridor, is that its opening would inevitably marginalize Ukraine’s role on the European energy-political scene. Indeed, the latest Russian plan for South Stream aims at a capacity of 63 bcm, leaving only about 40-45 percent

5 One recent example is the decision of the European Commission to impose heavy fines on German and French ‘majors’ for forming a cartel; see ‘Antitrust: Commission fines E.ON and GDF Suez €553 million each for market-sharing in French and German gas markets’, Brussels, IP/09/1099, 8 July 2009 (http://ec.europa.eu/competition/index_en.html).
8 For a brief assessment of the damage, see Elena Mazneva, ‘Market is lost’, Vedomosti, 16 June 2009.
of its EU export transiting Ukrainian territory. The current deal between Moscow and Ankara envisons a pipeline route across the Turkish exclusive economic zone (EEZ) in the Black Sea, directly depending on a second trunk of the Blue Stream pipeline (increasing its capacity to 24 bcm), which would cut Ukrainian transit by another 5 percent, while the Nord Stream pipeline across the Baltic Sea would diminish it by at least another 10 percent.9

Gazprom’s (and Putin’s) intention to reduce Ukraine’s ability to control its export has never been in doubt, but what is less obvious is the anti-Ukrainian profile of the Nabucco project. Its first trunk (planned capacity 10-15 bcm) could have mostly political and psychological impact, but the full capacity of 30-35 bcm would constitute a significant flow of gas from yet unclear (but definitely non-Russian) sources. Combined with an increased import of liquefied natural gas (LNG), this plan would reduce the share of EU gas import that crosses Ukraine to 30 percent or lower.10 It can not be excluded that both the Nabucco and South Stream projects could become a reality, and that would, to all intents and purposes, eliminate Ukraine from the European gas-political map. A major feature on this map, instead, would be Turkey, which aims at becoming a ‘gas hub’ by concentrating major gas flows and developing a capacity for trading – and not mere transit.

There is no certainty within the EU, and particularly among the SEE states, that such a ‘gas hub’ would be a better arrangement that the current ‘recurrent conflict’. Turkey is as prone as Ukraine to extracting the maximum commercial and political advantage from control over crucial gas pipes. Its economic situation is no less precarious and the recession is affecting the government’s behavior. Moreover, there is an additional complication: Turkey’s EU accession bid has been put on hold – perhaps indefinitely – and frustration over this failed effort could prompt its political elite to pressure European interests as a reminder of broken promises.11

While pushing forward the Nabucco project, the European Commission is not blind to, and is not at all enthusiastic about, the possible strengthening of Turkey’s energy profile. Hence the blitz-talks with the Ukrainian leadership on modernizing the gas infrastructure in spring 2009 resulted in a joint declaration that caused considerable upset in Moscow.12 Gazprom understands better than anyone the urgent need to upgrade the pipelines and pumping stations in Ukraine, which have been heavily used since Soviet time without adequate maintenance. However, Putin and Miller are categorically against giving any funds to Kiev for that purpose, despite any promises given to create an independent and transparent operator. Their master-plan has been to reduce Ukrainian state control over the gas infrastructure to a purely symbolic share of ownership, while making Gazprom the effective manager, perhaps in partnership with E.ON and a few other European ‘champions’.

These ‘evil’ intentions, which amount to stealing the ‘jewel in the crown’, are totally unacceptable to the Ukrainian leadership; furthermore, they are greatly concerned about losing transit privileges. While it is difficult to agree entirely with the Prime Minister Yulia Timoshenko, who told reporters at the Munich security conference that ‘to raise questions

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today about bypassing Ukraine with alternative pipelines is a senseless idea’\textsuperscript{13}, there is, nevertheless, a point in her parochial argument, since the Ukrainian option is certainly the most sensible as far as cost-efficiency is concerned. The European Commission has promised 2.5 billion euro to modernize the Ukrainian gas infrastructure. While this may be less than a half of the total cost, the capacity of this pipeline system could then be expanded to 150 bcm. On the other hand, the preliminary cost estimate for the first trunk of \textit{Nabucco} is about 8 billion euro and the bill for the \textit{South Stream} could reach 20 billion euro.\textsuperscript{14} The major obstacle in contemplating the Ukrainian option seriously in the EU is petty bickering among elite groups. However, there is a chance that the presidential elections, scheduled for 17 January 2010, might make Ukraine more governable, while the very probable departure of Viktor Yushchenko from the political arena would remove a major irritant for Russia.

\textit{Russia reconsiders its relations with Gazprom – more than a ‘what if’ story}

The central role of natural gas in Russian foreign policy is not based only on the specific quality of this energy source, which happens to be so abundant (even if hard to get) in Russia, and makes it so valuable for Europe. It is primarily a consequence of the unique involvement of the Russian leadership in the highly monopolized gas business, which started early in the Putin era and has evolved into such a deep fusion of interests that now it is impossible to establish whether \textit{Gazprom} is an instrument or a goal-setter for the Kremlin.\textsuperscript{15} The reconfiguration of the Russian leadership with Dmitri Medvedev\’s promotion to the presidency has changed little in this respect; the ruling duumvirate continues to identify closely with \textit{Gazprom\textquoteright}s agenda and to lobby enthusiastically for every deal.

This unprecedented symbiosis has been an important source of strength for \textit{Gazprom}, increasing its penetrating power into the European markets; however, it has also alarmed many states and the EU agencies, which have come to view this penetration as a hostile takeover. These tactical advantages have thus translated into a strategic handicap; now every political problem for Moscow in European relations, for instance delays in negotiating a new Partnership and Cooperation Agreement (PCA), resonates negatively in the gas business. This effect may be less prominent in dealings with Turkey; however, the mobilization of political and bureaucratic effort in the EU around the \textit{Nabucco} project, which could seriously weaken \textit{Gazprom\textquoteright}s positions in the SEE markets mid-term, would have hardly happened without the reassessment of Russia\’s trajectory after the war with Georgia.\textsuperscript{16}

There is, however, nothing permanent about this amalgamation between the Kremlin and \textit{Gazprom}, and the deepening recession is already testing this bond by establishing for fact that the interests of the Russian state are not exactly congruent with those of \textit{Gazprom}. The plan to increase domestic gas prices to the level of export prices has been abandoned, and the increasing deficit in the state budget has forced the Finance Ministry to demand a serious increase of taxation for \textit{Gazprom}.\textsuperscript{17} Sharply falling revenues and profits have caused a 15 percent cut (and perhaps as deep as 25 percent) in \textit{Gazprom\textquoteright}s 2009 investment program and in

\textsuperscript{13} See the entry in her blog \textquoteleft{}Yulia Tymoshenko at the Munich security conference\textquoteright{}, 7 February 2009 http://www.tymoshenko.com.ua/ukr/news/first/7020

\textsuperscript{14} See \textquoteleft{}He who pays for the pipeline calls the tune\textquoteright{}, \textit{The Economist}, 16 July 2009.

\textsuperscript{15} One relevant analysis is Svante E. Cornell & Niklas Nilsson (eds), \textit{Europe\’s Energy Security: Gazprom\textquoteright{}s Dominance and Caspian Supply Alternatives}. Washington DC: Johns Hopkins University, 2008.

\textsuperscript{16} See Matvei Ganapolsky, \textquoteleft{}The price of words\textquoteright{}, \textit{Ezhednevny zhurnal}, 16 July 2009, http://ej.ru/?a=note&id=9285

\textsuperscript{17} On the tax increase for \textit{Gazprom}, see Dmitri Butrin, \textquoteleft{}The reserve monopoly\textquoteright{}, \textit{Kommersant}, 2 July 2009.
2010 the available resources are set to decline yet further. Common economic sense dictates shelving (if not abandoning altogether) the plan for the extremely expensive *South Stream* project and it is only obstinate political will that keeps it on track in this impossible situation.

Putin may remain committed to this pipeline no matter what, but his own political future cannot be taken for granted in an economic and social environment that has changed so drastically, compared to the ‘golden years’ of prosperity that had been confidently promised to continue until 2020. The over-centralized political regime, based on distribution of steadily expanding petro-revenues, has obviously outlived its purpose, and Russia’s recovery from the devastating recession would depend upon adopting more flexible and efficient political mechanisms.\(^\text{20}\) The character of such a transfiguration cannot be perceived at this moment in time (and it is useless to speculate about Putin’s personal choices and options), and parallels with the previous crisis on 1989-1992 are hardly informative – but they could give some idea about the correlation between the depth of economic crisis and the scope of political revolution.

It is entirely possible that Russia would avoid any major political breakdown and benefit from a ‘soft’ evolution of the political system; there are few reasons to believe, however, that in the course of such an evolution *Gazprom* would manage to preserve its unique access to and connection with the political leadership. Without this patronage, the *Gazprom* business empire would first crumble on the margins (for instance, cutting off *Gazprom-Media*), then let go several self-sufficient units (like *Gazprom-Bank* and *Gazprom-Neft*), and then would have to separate the transportation into a separate company.\(^\text{21}\) Such a de-monopolization could follow the draft plan for reforming *Gazprom* from early 2003 and would take a few years, but if a convincing start were made, the EU could perform a re-evaluation of the risks for its energy security, and that might result in curtailing its plans for the Southern corridor, including the hapless *Nabucco* pipeline.

**Conclusions**

The cumulative impact of an interrupted trend in energy security in SEE (the sharp drop, followed by uncertain oil prices, and two major events: the Russian-Georgian war and the Russian-Ukrainian ‘gas war’) can not be fully measured as yet. It appears possible that the immediate ‘lessons learned’ by the EU and Russia – centered respectively on constructing the *Nabucco* and the *South Stream* pipelines – are seriously misconstrued. The main shortcomings of these lessons regard resources and risks. The EU has assumed that 10-12 billion euros is an acceptable price for a project that has no guaranteed sources of supply and that the risk of alienating Russia, which would still remain its main source of gas, is manageable. Russia has convinced itself (or rather Putin – himself) that 25 billion euros should be wasted (rather than invested) on a project that could never cover the expenses and that the risk of undermining Ukraine’s balance of payments would be rather an opportunity.

Sticking to positive thinking regarding the in-crisis (rather than post-crisis) near-term future, one would hope that these lessons could be disproved through a reassessment of

\(^{18}\) On *Gazprom*’s investment prospects, see Petr Netreba, ‘Cuts are performed business-like’, *Kommersant*, 14 July 2009.

\(^{19}\) See Pavel Baev, ‘Ten years at the helm: Putin holds a photo shoot and visits Turkey’, *Eurasia Daily Monitor*, 10 August 2009.


resources rather than through coming face-to-face with the risks. Indeed, Russia can hardly remain in denial very much longer after the end of 2009 as the true scale of its budget deficit is acknowledged and demands for spending begin to exceed the actual size of the accumulated financial reserves. The issue for the EU is not so much how to raise funds to launch the Nabucco project, but rather how to collect and deliver a ‘rescue package’ to Ukraine, which struggles to pay its monthly gas bills to Russia and could be forced to declare sovereign default before the forthcoming presidential elections. Important as it is for political leaders to provide reassurance, they should be aware that an ‘it-will-pass’ message can lead to the folly of denial; the EU and Russia will eventually come out of the crisis – but not to the status quo ante.
2009 – the crisis year – brought about crucial changes in the established and seemingly successful picture of the oil market. The New Year “gas war” between Russia and Ukraine consolidated bad tradition, demonstrating the vulnerability of the present structure of the oil and gas market once again. There were no winners, everyone suffered: the supplier, the transporter and the consumers. Conclusions and assessments of the conflict, and its consequences, are, generally, diametrically opposed. This was reflected in the subsequent actions and statements of the players in the market. It seems generally considered that on the ‘gas front’ Russia is leading a war “against all”. This confrontation is not new; but if earlier it could be considered as “debatable”, now resentment towards the actions and positions of Moscow are reaching a kind of hysteria. Such a political context, alongside some recent events, certainly has an influence on the future of the energy security in Europe, especially considering dramatic changes in the oil and gas markets.

New Energy Order

One of the symptoms of the global energy crisis in the acknowledgement that the true test for world energy is expected after the crisis ends. Nowadays, to foresee the realities of the post-crisis era and to prepare for the new paradigms of the world energy market, the revision of established views and strategies takes place in Russia. From the 1970s the overall strategy of the energy market was based on the idea of continuous consumption growth. However, the present crisis demonstrated a reverse tendency, and not only over the next few years, but long-term and for many markets. The markets have faced a fast and wide-scale decrease in the demand for fuel and energy. As this analysis shows, the U-turn in previously existing global tendencies had been threatening long before the crisis. This crisis became a potent catalyst revealing deeper causes behind a new order in the energy market.

It should be admitted that the policy of developed countries in the field of energy supply and the development of alternative energy resources is gradually beginning to bring results. The reduced participation on power-consuming industries in the economy, the steady improvements of standards of power efficiency, amid continuous economic stagnation, have already led to a decrease in absolute volumes of demand. It is important to note that in member countries of the Organization for Economic Cooperation and Development (OECD) a new energy efficiency standards have been introduced on a normative level. Normative controls are in force even at the lowest energy sources, where the competitively of alternative energy sources is not an issue. As a result, the energy capacity of the economy decreases, and in the foreseeable future, the growth of demand will also decrease for energy resources in OECD countries. Therefore, Barack Obama’s Energy Plan and the European Program “20-20-20”, even if only partially fulfilled, will lead to stagnation of demands for oil and gas in the US and Europe in the mid-term. Added to this, the dominant concept in developed countries of energy security and aspiration towards diversification of import sources, and moreover, growth of domestic production, it is almost inevitable that volumes of import of oil and gas imported into

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developed countries after the crisis will be noticeably lower then it was predicted during the last years.

**Crisis and Gazprom**

At the beginning of this year, Russian gas monopolist Gazprom fully felt the decrease in demand on the main markets: minus 20.8 percent within four months and substantial decrease in export. The main reason for this fall is a decrease in demand, both inside the country, by 3.7 percent in February, and, more seriously abroad. Although Gazprom’s forecast foresaw a decrease in supply to Europe by only 5 percent per year, the data for first months of the year do not give grounds for much optimism. And neither does the gas consumption growth data from Europe.

Moreover, if we consider the predicted fall of gas prices from the average US $400 for a thousand cubic meters last year to $210-230 in the middle of this year, then the financial perspectives of the Russian monopoly are not bright. At present, Gazprom officially expects a reduction of income from Europe of about $29bln.

However, it is in such a framework of decreasing demand that a paradoxical strengthening of interdependency in gas supplies between Europe and Russia is taking place. In mid-August this year, the International Energy Agency (IEA) published recent data on the consumption of gas in the EU for May: in the 1st quarter there was a 5 percent decrease, compared to 2008, then, according to the results for January-May, the decrease was already 8.5 percent (while in May it was 14 percent decrease in demand - 31.1bln cubic meters). At the same time, this decrease in consumption has helped Gazprom to re-establish its share of the European market: according to the IEA data, in the 1st quarter it was only 16 percent (compared to 23 percent the year before), and in May it was already 32 percent.

In Gazprom, confidence is high that nothing really dramatic is happening. The company will increase its export in the next six months: the Europeans will refill gas storages, and will remember the main principle of Gazprom’s contracts – “take or pay”. In short, according to the official Gazprom forecast, based on this year’s results, export will decrease by 10.5 percent to 142,3bln m³ for Europe and Turkey, compared to 2008.

**Gazprom is being pushed out from Europe**

Lately, adverse changes in the geographical structure of European gas imports have taken place for Russian gas producers. In January, the insufficient delivery of Russian fuel was compensated with increased import from Norway, Algeria and Libya. The level of additional supplies from competitors was not too substantial: the suspension of Ukrainian transit was met by the European importers who filled up underground gas storages stations “to the top”. More to the point, this very fact was accepted in Brussels with delight as a result of the diversification policy, while for Gazprom, even such a temporary decrease of share on the market, can hardly be desirable under the present conditions.

According to one of the leading experts of the Russian gas industry, the Vice President of the State Duma and the President of Russian Gas Society, Valery Yazev, at present “consistent efforts are being made to push Russia and Gazprom out of Europe”. The statement was given at a press-conference on 21 April this year.
Fears of excessive dependence from the politicized Russian monopolist are, indeed, voiced in the European Union. However, objective processes of the crisis period are obvious in the Brussels’ interpretation, supporting the drive of Europeans to diversify their sources of supply in the name of energy security.

In general, the frequency of reference and the intensity of discussion on the topic of energy security in Europe can, probably, only be compared with the topic of the global financial crisis and its consequences. Considering the general situation in the economy – decrease in demand and plummeting prices of fuel – such great attention is puzzling. It is quite obvious that Brussels tackles two tasks: drawing attention away from the real problems of the crisis and not always successful attempts to overcome them, while laying the foundation for a future, when demand and prices for energy resources will rise and the positions of suppliers (including Russia) will objectively strengthen.

**Southern Europe Political Gas Pipeline Projects**

Growing controversies between Russia and the countries consuming its fuel can be noticed not only in the political or legal spheres, but also in the design of particular gas supply projects. Issues, such as pipe laying and fuel transit conditions, have practically overshadowed earlier problems to which we had become accustomed, such as disarmament or deployment of rockets. New geopolitical games and pipelines involve more and more participants, propose more and more projects and, paradoxically enough, often overshadow and devaluate the only objective purpose – securing energy for the development of the economy.

Such a conclusion is obvious when one analyzes the behavior of the participants. The Europeans, in their almost maniacal commitment to diversification of sources, try to impose their own rules on Gazprom, which is blatantly not interested and considers discriminating. Attempts to push out the Russian supplier, which provides a quarter of EU imports, are obvious, and where is energy security here?

The Nabucco pipeline project is usually presented as a serious threat to the Russian export. Supposedly, it will transit Iranian and Turkmen gas to Europe through Asia Minor. This way the European Union intends to decrease energy dependence on Russia. According to independent experts, Southern Stream and Nabucco do not just compete with each other, but are mutually exclusive because, in the future, EU gas needs, as mentioned above, will be significantly lower than expected levels of supply.

The official point of view of the Russian authorities is that two pipeline projects in the South of Europe are not competitors. At the beginning of July, Vice-Premier Igor Sechin, who supervises the Russian fuel-energy complex, said: “The more opportunities for gas supply provided for consumers, the better”. This opinion concurs with the position of European countries, which are ready to support both projects. At the same time, the accelerating race to see which of the projects will be launched sooner, not only does not correspond with such a restrained position, but damages the normal procedures of preparation, regarding precise calculations of effectiveness and competitiveness.

Seeing these projects as competitors and consequent suggestions to abandon Southern Stream are absolutely inappropriate; there will be no negative fallout for Gazprom if Nabucco is launched. Furthermore, it is tactically important for Gazprom to continue to pressure key countries in relation to South Stream. In this case, it can obtain several advantages: on the one hand, it can speed up construction, and, on the other, paradoxically enough, be included as a beneficiary of the Nabucco project. By gaining access to Nabucco, Gazprom can only
strengthen its presence in Caspian-Central Asian region and on the European market (see below).

Presumably, the *South Stream* pipeline will be laid on the floor of the Black Sea from Novorossiysk to the Bulgarian port Varna. Its two branches will then cross the Balkan Peninsula to Italy and Austria, though their exact routes are not yet confirmed. According to the plans, the pipeline should be in service by 2013. The capacity of the pipeline should be 63 billion cubic meters per year. The total amount of investments is assessed at €25 billion.

A Memorandum of understanding on the implementation of the project between the Italian company ENI and Gazprom was signed on 23 June 2007 in Rome. On 8 January 2008 Bulgaria joined the project; on 21 January the Government of Serbia and Gazprom signed a set of agreements, which includes Serbia’s participation in the project. On 28 February Russia and Hungary signed an Agreement on cooperation on implementation of the Project. Finally, on 29 April Greece joined the project. At present, an agreement with Slovenia is in the negotiation process, while an intergovernmental agreement with Austria is expected to be signed.

Other countries may join the project, but their participation would include only an over-ground network of pipelines. The portion that will transit the Black Sea will belong to Gazprom and Italian ENI in equal shares.

The *Nabucco* project envisions a transfer of gas to Europe bypassing Russia – through Azerbaijan, Georgia, Turkey, Bulgaria, Hungary, Romania and Austria. Therefore, it should become a continuation of the existing Baku-Tbilisi-Erzurum pipeline. Construction of the new pipeline is set for 2010, and should be operational by 2014. The capacity will be 31bln cubic meters and the cost of construction €8bln.

Two events in July-August 2009 put further strain on the political controversy surrounding the two projects. On 13 July in Ankara an intergovernmental agreement on the *Nabucco* project was signed by the leaders of the Governments of Turkey, Austria and Hungary and by the Ministers of Energy of Bulgaria and Romania. Significantly, the ceremony was attended only by potential transit countries, but not by suppliers. Uzbekistan, Kazakhstan, Turkmenistan and, most importantly, Iran have not accepted any formal commitments regarding *Nabucco*. Moreover, at the end of June Gazprom signed an agreement with the State Oil Company of Azerbaijan on the purchase of Azerbaijani gas, after which Baku cannot objectively be considered as a serious participant in the *Nabucco* project. Gas from Azerbaijan and its Shakh-Deniz deposit was to become a source for the first stage of *Nabucco* (10bln cubic meters).

Lately, Turkmenistan has been named as the main potential supplier. Turkmenistan, taking advantage of a suspiciously well-timed explosion on the pipeline, has been talking about reconsidering its gas policy. President Gurbanguly Berdymuhamedov supported the *Nabucco* pipeline, which will create new routes of gas supply. “The question of the sovereign right to choose the energy resource supply route is directly related to defining prices”, said Berdymuhamedov. This should be read as: Ashgabat is ready to sell its gas to the highest bidder. If Gazprom does not buy gas at the price that suits Turkmenistan, then Ashgabat is willing to reconsider schemes and conditions of supply to the West. Alternative directions of supply will be Europe, though the pipeline *Nabucco*, China and Iran.

It is unlikely that Moscow will agree with Ashgabat’s participation in launching *Nabucco*. For the time being, Turkmenistan has nowhere to go with its gas. The limited opening of supply to Iran can not solve the problem and is limited by issues of price. Nevertheless, in August this year, the sides agreed on the construction of supplemental reserve services and increase of Iranian purchase of Turkmen fuel from 8bln to 20bln cubic meters per year. The launch of a pipeline to China in the foreseeable future is unlikely due to lack of
finances and resources, as well as the absence of a price formula. This state of affairs will last for at least two to three years. Formally, this pipeline was planned to be initiated next year, but a substantial gas flow can not be expected earlier than 2012-2013.

In reality, Turkmenistan’s threats to reconsider gas policy or its attempts to play the European card are, unlikely, to bother the Kremlin significantly. First of all, supplying Nabucco with the Turkmen gas in the forthcoming decade seems to be impossible. To start building a pipeline, the legal status of the Caspian Sea and its floor needs to be defined, a process involving the Caspian states (Russia, Iran, Azerbaijan, Kazakhstan and Turkmenistan), which has already failed for many years. Any attempt at laying pipes across the Caspian Sea, which ignores the interests of other countries, may provoke a harsh reaction – especially from Iran, which would not exclude a forceful response to such attempts. Moreover, Moscow too does not exclude the possibility of using force to strengthen its influence on the Caspian Sea. As indicated in the “Strategy of the National Security of the Russian Federation until 2020”, the struggle for the Caspian resources may bring an “imbalance of forces located on the borders of the RF”. In such a situation, according to the Strategy, Russia must strengthen its military presence in the region. For this purpose Russia and Iran can simply block the process of defining the legal status of the Caspian Sea. Recently, a consensus of interests of Moscow and Tehran has also gained a practical dimension: at the beginning of August, for the first time, they conducted joint maneuvers with around 30 vessels on the Caspian Sea.

Furthermore, Turkmenistan does not have infrastructure to transport its energy sources from the Western deposits to the shores of the Caspian Sea. Attempts to build this infrastructure, financed by Russia, did not succeed and European business is not ready for make large investments in Turkmenistan as it is not convinced by this country’s resources.

Another important event that influenced the balance of power in the gas pipeline confrontation was a visit paid by the Russian Prime Minister Vladimir Putin to Turkey and new agreements signed. According to these, Gazprom obtained permission to conduct seismic and ecological explorations in the exclusive economic zone of Turkey, as well as preliminary consent for construction of the South Stream pipeline. Turkey’s support significantly strengthened the South Stream position. At the same time, construction of the pipeline through Turkish waters offers a choice of routes between Romania and Bulgaria, which had not been favorable towards the Russian projects.

However, the destiny of the South Stream project is still not apparent, despite the commitment underlined whenever possible by Russian representatives.

According to preliminary estimates, the cost of Nabucco will be €8bln, and that of South Stream, with the capacity of 63bln cubic meters, will be €25bln. However, since the visit of Vladimir Putin to Ankara, Turkey has started bargaining for a number of concessions, which, should they be accepted by Russia, would lead indirectly to increasing the cost of South Stream.

According to the forecasts of the Ministry of Finance, Ministry for Economic Development and Trade and Gazprom itself, with falling prices and demands, revenue from exports in 2009 may plummet even by $29bln, compared to 2008. According to some estimates, pure debt exceeds $47bln at the moment. Moreover, the gas pipeline program does not correspond to the decreasing demand in gas and its diminishing production in Russia. In 2008, the total volume of Russian gas exported was 158.4bln cubic meters with the spare volumes in the pipes exceeding 37bln cubic meters or 19 percent of nominal capacity. Let us remember that in the first quarter of 2009 supplies to Europe went down by 50 percent, and officially planned volume of Gazprom’s European sales proceeds reduction was about $29bln. Therefore, prospects for the new infrastructure project are not brilliant.
The weakening of political support for South Stream in the EU, alongside the Gazprom’s financial difficulties, can seriously slow down the implementation of the project. Therefore, it is no accident that in his speech at the Gas Summit in Sofia, the Minister of Energy of the Russian Federation, Sergei Shmatko, spoke of postponing the launching date until 2015.

In the meantime, Gazprom has revived discussion of the project Blue Stream 2 - an expansion of existing pipelines targeting the markets of Israel, Lebanon and the entire region. It should not be ruled out that other options are available to secure a stable gas market other than through Southern Europe. The world economic crisis may bring changes into seemingly rigid and consolidated political structures.

The idea of including the Russian Federation into Nabucco is not an exception. Moreover, Gazprom has been invited to participate in that project as a supplier more than once. On signing the agreement, the Prime-Minister of Turkey, Recep Tayyip Erdogan, expressed his hope for the participation of Russia, as well as Iran, in the implementation of Nabucco: “We support Iran’s participation in the project, should circumstances so allow, and we also hope for Russia’s inclusion”. Furthermore, Richard Morningstar made an eloquent confession: “We want Russia to participate in the project as a partner, and we can submit a proposal to supply gas within the Nabucco project”.

One of the possible scenarios is the merger of all hypothetical southern pipelines into one project under the conditional title Southern Corridor and although, all sides obviously intend to defend their own proposals, this option should not be entirely ruled out.

The prospect of filling Nabucco with Russian gas has always provided opportunities for delicate political games, interesting moves and exchanges and, possibly, commercial benefits. Analyzing the expansion of the Blue Stream 2 pipeline, one must pay attention to its intersection with Nabucco near Ankara. Opportunities become apparent for the continuation of the Blue Stream southwards, to Syria and Israel, for instance. Intersection with the European pipeline could become a weighty argument in Gazprom’s favor when competing for export volumes of Azerbaijani gas. It could also be possible to rely on European support in delicate negotiations with Turkey on conditions of transit (not resale) of Russian gas.

In this option there is also an opportunity to cut Iran out of European market by substituting Iranian gas with Russian gas (or Central Asian). To direct the fuel of potential competitor to the East has always been an important geopolitical goal of Gazprom. It is no chance that Moscow has always supported not only the project Peace – the pipeline Iran-Pakistan-Iran, but was also ready to participate in such an exotic initiative, such as the Trans-afghan pipeline which would also direct Turkmen gas towards the east.

Vladimir Putin’s visit to Ankara demonstrated a certain flexibility in Moscow’s policy. As an additional bonus for permission to construct South Stream, Turkey obtained preliminary consent from Russia to consider the possibility of participating in the oil pipeline project Samsun – Ceyhan. More than once Turkey has invited Russia to participate in this project, which would connect the Black Sea port Samsun and the Mediterranean port Ceyhan and allow oil transport avoiding the Bosphorus and Dardanelle straits on the Black Sea. The operators of the project are the Turkish holding Calic Energy and the Italian ENI. Russia’s decision on possible participation in this project will in no way reduce the interests of the Russian companies in the implementation of the Burges – Alexandropoulos project supplying Russian oil to Europe. Therefore, Russia, as well as Turkey, may become participants of two, practically competing, projects – potential benefit winning over political preferences.
**The issue of “reliability of supply”**

The European Union presents its idea of diversification of supplies almost exclusively as a means to increase energy security, since Russia, allegedly, is not a reliable supplier, and Europe’s overdependence on Moscow threatens this security. In more “down-to-earth” versions, this idea goes along with European skepticism about Russia’s ability to provide enough fuel for the growing needs of the EU economy.

Over the last year, however, this topic has been somewhat muted. Firstly, because of the crisis, energy consumption in Europe has decreased, significantly effecting Gazprom’s exports. This cost the company not only a 20 percent decline in production, but also reduced purchase from Central Asia and from Russia’s “independent” gas producers.

However, there are also long-term prospects whereby Russia should not expect an increase of gas demand from Europe. Forecasts of gas consumption in Europe are constantly decreasing. Within the last decade demand estimates for 2020 have been reduced by 180bln cubic meters, and forecasts for import volumes have decreased by 135bln cubic meters. The main reason is a new energy policy in EU countries, aiming at increased energy efficiency in economy and the development of alternative sources of energy. Although many in Europe view these plans as not being very realistic, unclear perspectives becomes real and not a mythical threat to energy security. Since the investment cycle in the field of energy is long and there is a need for appropriate transport infrastructure, decision should be made in the present, alongside limited budgets and extremely uncertain external conditions.

Not surprisingly, this uncertainty of demand assessment and unwillingness to consider guarantying the “security of the supplier” irritates Moscow. “The New Energy Strategy of the EU”, published in November 2008, which targets a decrease of specific demand in energy resources by 20 percent and a respective decrease of gas import, provoked a very clear reaction in Moscow: “Europe must decide whether or not Europeans need a gas pipeline from Russia in the proposed volumes. If not, then we will not construct the pipeline, and will build plants for gas liquefaction and sell it on the world markets”, said Vladimir Putin after negotiations with the Prime-Minister of Finland Matti Vanhanen, and thereby introducing a new discussion on gas export development models.

Therefore, in the contemporary debate, a legitimate question is not whether or not Russia can fill all existing and planned pipelines, but whether Europe is an adequate market in volume and reliability for Russian gas and to what extent the high expenses, which Russia should incur for ensuring a gas supply to the EU, are justified.

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The stability of Russian gas transit through the territory of Ukraine continues to cause concern for European consumers and also for the supplier – Gazprom. As during the last winter, the countries of the South-Eastern Europe, which do not have alternative sources of gas supply to the transit stream that goes through the Ukrainian territory, are in a high risk zone. Indeed, all Moscow’s efforts to organize alternative routs of fuel supply to Southern Europe are aimed at avoiding transit risks and guarantying supply of energy to the consumers. Extreme, often hysterical, politicization of these, mainly technical and financial problems, causes irritability and misunderstanding in Russia, and negatively influences the stability of the markets and prices.

Today, because of the crisis we have a “seller’s market” that causes attempts to pressure Russia – the seller of the fossil fuels. But this situation is temporary: the inevitable recovery from the crisis and the inevitable increase in demand and prices, will reverse the situation.
Europe is not the only market, and the crisis, quite possibly, has given an opportunity and even dictated the necessity to break the monopsony in oil and gas export, by means of market development and the development of the LNG sector. In a number of cases, behind the loud-mouthed statements of the perspective suppliers – Turkmenistan, Iran, Azerbaijan and others, as well as advocates from the camp of European consumers, there are neither any real resources nor short-term solutions for development and transportation.
Assessing Russian Commitments to the 2015 South Stream Deadline

Dr András Deak*

In comparison to its Western counterparts, Nabucco and ITGI (Interconnector Turkey-Greece-Italy), the case of South Stream appears to be simple. Nabucco, for example, faces a number of significant difficulties, most of which are almost non-existent in the Russian project: it includes half a dozen relatively small energy companies without substantial market portfolios or supply assets, and it is constrained by an unresolved leadership issue, despite all the US political and EU moral and financial support. Turkish transit - with all its economic and political considerations - will be a “hard nut” to crack in the future, and the coordination of a large number of different, and often divergent interests, makes any prognosis for a final deadline rather difficult.

In this light, South Stream appears to be a clear-cut project. Its implementation depends almost exclusively on Gazprom. With a strong supply status and a huge European market portfolio the company really does not have to care much about finding incremental supply volumes or demand for its pipeline, and avoiding the major markets on its route, Moscow has a strong bargaining position vis-à-vis the small transit countries. Hence, in contrast to Nabucco, the completion South Stream is a “single actor issue”, where Russian determination and capabilities play an almost decisive role.

Challenges and doubts

South Stream has a short, but spectacular history. In June 2007, ENI and Gazprom signed a memorandum on the project, while Putin had floated the idea among Balkan leaders in Zagreb some days earlier. Intergovernmental agreements were signed with Bulgaria, Serbia and Hungary in January-February 2008. In 2009 the project moved to the next phase: most of the feasibility studies are due by the end of the year, opening the way for business contracts with binding elements to be signed. After several modifications to the original plan, South Stream is designed to have a capacity of 63 bcm, and according to semi-official Gazprom estimates, its construction would cost up to €25billion 1. Russian political leaders, Putin and Gazprom officials stated several times that the network is going to be operational by the end of 2015.

The speed and impetus of the project is indeed striking. The nickname “blitzpipe” - used in non-official European slang - is absolutely fitting, especially in comparison to the slow progress of other pipeline projects in the region. Moscow really seems to be determined and ambitious, keen to have a new, huge transit corridor in the foreseeable future. Despite these appearances, there is still some room for skepticism. Critics generally raise two significant sets of issues, which might pose a threat to the project.

A) The first set of concerns deals with the question of feasibility, going back to the more general problem of the credibility of Gazprom’s deadlines. We have witnessed, for example, a serious underestimation of the complexity and risks of the Nord Stream project, causing – at least – a significant delay in construction. The Shtokman-field, which used to be a priority project some years ago, was promised to be on-line as early as 2013 - an unrealistic deadline,

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1 „Truba na trillion”, Vedomosti, 06.02.09.
The development of the Bovanenkovskoye field, a flagship project on the Yamal Peninsula, is still difficult to assess because of insufficient information on its progress. Technological delays and postponements are usual phenomena in the industry, but the Russian monopoly might have an excessively optimistic view on its building potential and coordination skills. These risks vis-à-vis Russian promises are external. This means, that they do not concern Russian ambitions to build up new infrastructure, but rather its implementation. Gazprom might manage these projects badly, however that does not question their willingness to develop these new networks.

Fitting into the above comparison South Stream is not less complex than its counterparts. Stretching almost 900 km from Russia to Bulgaria, the pipeline has to be laid at the extreme depth of 2000 meters, which is at the very edge of our technological possibilities. Gazprom simply does not have the engineering skills and know-how, to work in such conditions alone. What is more, the off-shore zone has an unsettled legal status. Being undivided between the coastal states, the settlement of the Black Sea off-shore section assumes political and legal coordination with - among others - Ukraine, one of the major opponents of the project. Hardly anything has been done with regards to getting approval for the operational procedures at the EU Commission, either. Some conditions set, i.e. in the Hungarian intergovernmental agreement, do not correspond with the EU acquis, presupposing a longer approval process in Brussels. Even if refusal by European regulatory bodies is not very likely, serious concessions will need to be made by Gazprom in order to fit the pipeline’s legal resolutions into the common acquis. All these risks could only be really evaluated after further feasibility studies and the start of negotiations on these particular issues. Setting deadlines in such a fluid environment appears to be a political or a tactical step. Not by chance, Moscow has already shifted the final deadline from 2013 to 2015, which, fittingly, erodes its credibility only further.

B) The real concerns regarding the South Stream deadlines are, however, the “internal” Russian considerations behind the project. It is not absolutely clear, to what extent Russian political circles, and - what is more important - Gazprom itself, are committed to the completion of the pipeline within the given timeframe. Critics often challenge the Russian statements on different grounds: They point to the exorbitant costs of the construction, the already existing transit capacities in Ukraine and the shaky political and strategic considerations. Pointing out any of these arguments to question the credibility of Russian plans is, however, misleading. The original initiative was based on a number of different stimuli, targets, and sometimes, even attitudes. To make a valid assessment, we have to pick out the most important considerations and analyze them in their own context.

Before this, however, one must make two important observations: First, it is certainly in the long-term Russian interest to build a new network on the given “southern” route. Russian frustration over transit issues is incredibly high. As we have witnessed in the case of the BTS oil pipeline network and the Primorsk oil terminal, all new systems would be built at minimized transit risks. Accordingly, doubts should be interpreted as skepticisms towards the communicated deadline, and not the whole project as such. At the same time, the Nord and South Stream pipelines would create an overall 118bcm additional transit capacity by 2015, almost doubling the current Russian capacity in the given direction (141.6bcm transited in 2007 through Ukraine and Belarus). Hence, even if we accept the Russian wish not to construct new pipelines through problematic transit countries, one may voice some valid concerns regarding the scale of an undertaking that could redraft the whole energy transit landscape of

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2 The representative of Statoil Hydro, owner of 24 percent of the project, publicly expressed his doubts about this deadline. In: “Credit Crisis May Delay Shtokman Project” http://www.rigzone.com/news/article.asp?a_id=70459
Credibility is an issue of particular importance to the participating small Balkan and Central European countries, which are usually fully dependent on Ukrainian transit. Route diversification is a high priority issue for them. If *South Stream* is not ready in the given time and suffers significant delays, these countries should make different investment decisions to manage their dependence. It is the deadline that matters.

Second, it is a cheap and profitable policy for Russia to propagate its future pipeline plans in the region. In the case of Serbia, during the purchase of NIS by Gazpromneft, *South Stream* was a key argument in favor of the relatively low price. In this case, the promise of fast implementation of *South Stream* was a crucial instrument in persuading Belgrade. Actually, Moscow did not have other options, facing similar behavior from the Americans. The US also propagated *Nabucco* as an accessible mid-term option in the region without any real business commitment. Using *South Stream* as a bargaining chip, Moscow has already collected real dividends, while only making limited construction commitments. There is an obvious asymmetry between Russian profits and costs so far, and in reality, the political assurances to future transit countries only slightly increase the chances that *South Stream* may be finished by 2015.

Generally speaking, there are three main “internal” Russian considerations with regards to the *South Stream* project that are worth taking account of: (1) The construction of major new infrastructure is the easiest, if not the only way for Gazprom to get European assets; (2) Russians would like to get rid of the unreliable Ukrainian transit route; (3) Gazprom would like to preserve its control on the European markets against the rival *Nabucco* and ITGI projects.

It is important to understand that an assessment of the *South Stream* project depends very much on which of these three objectives is the strongest in influencing Gazprom’s future steps. If, for example, Gazprom were to focus primarily on acquiring new infrastructure in these countries, it could choose to almost exclusively follow its own pace of implementation. In this case, without the threat of loosing an opportunity, Gazprom would not need to rush to spend a lot of money on markets, which it has, in any case, secured. At the same time, Ukrainian transit is indeed a serious headache for Gazprom. Major milestones in the development of the *South Stream* project have, so far, usually occurred in connection with the escalation of relations between Kiev and Moscow. If we were to accept this issue as the major stimulus behind Russian actions, we would create a strong logical interrelationship between *South Stream* and Ukrainian transit. In this case, an - unlikely – positive development of the latter could significantly decrease Russian willingness to move ahead with the former. Last, *South Stream*’s geographic structure is almost identical to that of the *Nabucco*-ITGI networks, both of which would rely - at least partly - on Central Asian incremental capacity, suggesting that they may be interpreted as competitive projects. It is difficult to imagine that *Nabucco*, for example, even with its estimated initial capacity of only 10bcm (and prospects for another 20bcm) would leave enough room for another pipeline. The construction of one of these networks could mean, at the very least, the postponement of the other.

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Possible Gazprom strategies

“New assets” strategy. Vertical integration and the acquiring of European assets has been a major Gazprom goal since its establishment in the early ’90s. However, internal weaknesses and an unfavorable balance on the gas markets have made the achievement of these aims difficult for many years. Having consolidated its domestic situation, the Miller management could only really turn to this task around 2004-2005.

There are basically only two ways to get closer to European consumers. One way is the renegotiation of Gazprom’s long-term supply contracts. Having a 20-25 year long timeframe, these contracts define almost every important aspect of the relationship between Gazprom and European companies, including price, volumes and trading points. For Gazprom, the only opportunity to change conditions in its favor easily, are the rare renegotiations of these legal frameworks. Since 2006 most European companies have extended their contracts for another 20-30 years. These include among others supplies to Germany, Austria, the Czech Republic, Italy and most of the Balkan countries. A new element of these contracts was that they allowed Gazprom into local markets. Gatekeeper companies and national champions, like ENI or OMV, guaranteed a small portion of their national markets to be supplied directly by Gazprom or by joint stock companies. Altogether, however, this was a relatively modest concession from the side of the Europeans - definitely insufficient for the Russian company - while the signing of the long-term supply documents closed the window of opportunity for Gazprom to gain further concessions for another 20-25 years.

Gazprom has a bad record in taking part the privatization of existing Eastern Europe gas networks, suffering from all the impediments of its Russian monopoly status. New infrastructure, however, especially in the case of expensive storage and pipeline facilities, could be effectively built with Russian involvement. Gazprom’s presence provides significant guarantees for investors with regards to questions about supply and maximal turnover. Typical existing examples for Gazprom’s participation are the evolution of the company’s role on the German market since 1993, Nord Stream asset swaps and the Austrian storage construction at Haidach. Western companies participating in joint projects can be assured of a Russian preference to use the common facility, providing maximum returns for all partners. Besides the prospect of financial gains, South Stream partners have another rational in letting Gazprom into their domestic markets: better security of supply. Most of these countries lack sizeable transit capacities, industrial fundaments and funds to construct cheap storage facilities. Except for Hungary, none of the partners has decided to build storage with budgetary funds. It is always cheaper and more secure to make such decisions together with Gazprom. South Stream would not be feasible without clear Gazprom guarantees that it would use the new network. However, having Gazprom assets on their territory, these countries would have a better position to bargain with the Russian monopoly and secure their domestic supplies.

From the Russian point of view, constructing South Stream’s European on-shore section is a relatively small and favorable undertaking. The network’s two branches would not cost more than €5billion (or even much less) and Gazprom has a good chance to secure most of the construction contracts. In exchange for financing its own €2-2.5billion share, Gazprom could gain direct access to, and become a dominant player in local markets. It could never buy an existing infrastructure at such a low cost. The central questions for Gazprom are the off-shore and Russian sections, which would make up the bulk of the full project costs. Formally, there is no legal connection between these elements. South Stream consists of six national sections without any relation to each other except a promise from Putin. In this, it is very different from Nabucco, where the whole pipeline is built under the umbrella of a single company and
regulatory framework. Moscow builds its network following the old logic of lines of independent national pipelines, which maximizes its room for bargaining. Logically, Gazprom might separate the implementation of each section. On-shore capacities could be easily built and supplied at the contracted 10 plus 10bcm level from the old, existing Progress system through the Ukraine. Expensive off-shore construction could be started, but delays would be, at least legally, affordable. This setup would bring about some losses due to the longer transit routes from the Ukraine to Bulgaria and then back up North, but, in exchange, Gazprom would gain significant flexibility in South Stream’s contractual system. If Gazprom follows this logic, the 2015 deadline is more credible with regards to the on-shore section, where the company has real commitments, than the off-shore part, where some delays are much more likely.

The implementation of the project through this scenario would improve supply security for most of the participating states. However, in order to clarify and map out the possible outcomes during the construction phase, it would be highly advisable for the small partner countries to harmonize their policies towards the project. Negotiating only with and through Moscow, and the lack of a multilateral framework, is a non-affordable luxury in such expensive and complex projects. A binding deadline in a multilateral framework is far more secure than any bilateral commitments and political promises.

Map 1 – Gas export infrastructure to Turkey

![Map 1 – Gas export infrastructure to Turkey](image)


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4 Gazprom’s activity has shown some signs, hinting that it left open this scenario. Having contracted for another 20–25 years the Romanian and Bulgarian transit capacities, it seriously examines freeing up this potential by constructing a new branch of the Blue Stream pipeline to Turkey. The Russian monopoly still insists on the renovation and possibly expansion especially of the southern branch of the Ukrainian system.
‘Ukrainian transit’ strategy. Ukrainian transit (and to a lesser extent Belarus) has been the biggest challenge for Gazprom for some years. Despite all efforts of the last two decades, 70 percent of all gas exports to Western Europe still flow through this country, posing an uncomfortable dependence for the Russian leadership and causing huge financial losses for Gazprom. Decreasing both the dependence and the losses can only be achieved by consolidating the Ukrainian gas industry under Russian terms or simply excluding the country from the vertical chain. The former option has high political and prestige costs, as illustrated by the two ‘gas wars’ of 2006 and 2009, although even these costs may turn out to appear extremely relative if one considers the exorbitant price of constructing an alternative system. What is more, the Ukrainian pipeline network offers not only the cheapest transit route in technical terms, but it also disposes of a unique 34bcm storage capacity, which can hardly be substituted even in the long-term.

In previous years, Moscow tended to support the full exclusion of Ukraine from its export chain. Communicating similarly this time, it is realistic to think that the Kremlin’s true aim is to erode the Ukrainian bargaining position and by lessening its dependence through the planned construction of alternative export channels to the West. Some of this task, however, may already be achieved through the building of Nord Stream, where a substantial part of the capacity (maybe 20-30bcm) could be used for transit diversification purposes. The significant question in regards to Gazprom’s diversification efforts is how much alternative capacity would soften Kiev’s stance sufficiently for a deal to be reached, and when this could be achieved. In this regard, the changeable Ukrainian political situation puts Gazprom in a really difficult situation. In the 2009 contracts, Gazprom agreed to legal and financial commitments to use at least 110bcm of the Ukrainian transit capacity for another 11 years. This shows that Moscow did not really calculate considering other new transit routes becoming available in this period – although this may be just pessimistic anticipation and some sort of ‘insurance policy’ for Gazprom. What appears to be the more realistic assumption is that Moscow has not given up gaining assets in the Ukrainian system, which - if true – would create a very negative outlook for South Stream. The better the situation with Ukrainian transit, the smaller the pressure for Gazprom to move ahead with South Stream. In this light it is important to notice that despite all the brutality of Russian-Ukrainian relations, Gazprom has been progressing steadily in achieving a deal concerning transit issues. It forced Kiev to sign a Western-like supply and transit contract and succeeded in isolating Ukraine with regards to this question in the West. Moscow triumphed in its dealings with Belarus, ruling out a similar outcome in their relations with Ukraine, even in the short–term, could be a serious mistake. The 2015 South Stream deadline might have been a tactical move of the emerging full-fledged conflict between the two sides.

‘Rivalry’ strategy. The suspicion that South Stream is to be set up as a rival to Nabucco and ITGI is widely held among Western analysts, although it is regularly refuted by Gazprom. According to these accusations, incremental supplies of gas into the rival projects would come mainly from the same Central Asian sources and transited through the same countries. The only basic difference could be that it would be sold by one of the transit companies itself (Gazprom), further increasing its leverage on these markets. According to such analysts, Moscow’s only aim is to hinder the construction of Western pipelines and preserve its
monopoly, both on the supply and the demand side. Moreover, controlling the trunk pipeline system on the Balkans, Gazprom could even influence Iraqi or Iranian supplies to Europe.

Gazprom’s basic philosophy, concerning the gas industry, appears to strengthen the above fears. The “they, who have the pipe, have the gas” logic is present in all Gazprom investments. However, South Stream is planned to be built in countries that follow obligatory EU competition regulations. In those, pipeline capacities are supposed to be opened up to all suppliers. Gazprom may apply for exemptions in Brussels, but a significant part of the pipeline will still need to be offered to third parties. Even if regulations are not perfect, this means that having assets in a facility might only increase one’s control over its capacities, but does not assure one’s full authority. Provided that DG Competition exerts its legal power over South Stream, and forces the participants to respect and fully implement the Gas Directive, Gazprom will not be the only one who uses the pipeline. A working, on-line capacity and a connection to the Turkish network by 2015 would facilitate Middle Eastern and Caspian exports to Europe avoiding Gazprom’s balance sheet. Gazprom might hope for imperfections in the regulatory framework, but much would depend on national and European regulatory bodies in deciding how South Stream would work in reality.

In this context, the “rivalry interpretation” might have some logical fundamentals, but it would not create a black-and-white situation. Actually, a relatively early completion of South Stream would help Europe to establish contacts with alternative suppliers. If Gazprom really wants to stop Nabucco, the best place to interfere is Turkey. Turkish consumption relies on Russian supplies and the country has not joined the European Energy Community yet. Having a booming gas demand, Moscow has a much bigger leverage over Ankara than over the other Nabucco countries. Some sort of joint management of supplies coming from the Middle East and the Caspian is a much more realistic scenario than preserving Gazprom’s full capacity control over South Stream. Offering South Stream as transit channel and guaranteeing reliable supplies to Ankara, Gazprom could ask for a share of the gas transit through Turkey. Following this train of thought, the construction of South Stream might be thought of as a rival to competing Western projects, but it would be a mistake to characterize this as a determinative correlation. However, the “competition logic” makes the reliability of the 2015 deadline weaker, since it also assumes that the dependability of the Nabucco project will grow in the years to come.

Summary

Having already put some question marks behind the reliability of the 2015 deadline, we must ask ourselves now, why Moscow would have put forward such an early completion date. The most likely answer could be understood as a sort of “drifting-along-effect.” Equipped with numerous good arguments to build new transit corridors for the future and experiencing a strong pipeline competition in the Balkans, the Russians had to make a move. Their engagement, however, could not gather real credibility without a construction deadline. Moscow’s commitment to South Stream was not the result of responsible pre-planning but rather a step-by-step process in which political push played a significant role. It was not a Gazprom manager, but the highest political leader of the country who made the statements about early completion. Although this may be thought of as a more credible promise, it is less reliable in reality. Politicians tend to be a bit more impatient in energy matters than the industry itself. While Gazprom managed to cancel the original 2013 deadline, it is likely that it had to fight bitterly against another completion date set before 2015. Facing a problem with the

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project in Austria, disagreements about capacity allocation with ENI and significant financial constraints, the early deadline actually worsens Gazprom’s bargaining position in these issues, and might turn into a headache for the company in the future. It is not going to be Putin who is responsible for any failures to implement the original plans, but Gazprom.
Russian Energy Interests in South-Eastern Europe

Dr Konstantin Simonov

Main energy challenges in the region

The energy dialogue between Russia and countries in South-Eastern Europe (SEE) is developing in a rather inconsistent and complicated way. On one side, there are some obvious positive aspects promoting our cooperation. Certain economic ties have remained between Russia and former socialist countries; in a number of cases there are cultural and ethnic ties that facilitate the implementation of cooperative models. On the other side, the elite of these states is burdened with different historical complexes, most actively promoting theses about the “Russian threat” in Europe. Even in Serbia, which is religiously, culturally, historically and linguistically quite close to Russia, there are quite influential forces that advocate a tough position towards Moscow. Russia and the so-called “European option”, selected by the region’s countries, are opposed to each other. In our opinion the “Europe or Russia” dilemma is false. Yet, it is obvious that the memory of the “big brother”, rather strongly, hinders cooperation between Russia and these countries that often perceive Russian investments and new projects as steps towards the reestablishment of the Soviet empire.

As a result, countries in SEE are ready for the ideas often voiced in Brussels, i.e. diversification of suppliers and reduction of energy dependence on the Russian Federation. Moreover, such dependence is especially strong in SEE. Previously this was viewed as an advantage (besides, this region is closer to Russia than France and Germany, which means cheaper gas due to the shorter distance). Now this is considered a serious political threat, since Russia remains a monopolistic supplier of energy resources. However, here comes a trite question – how quickly will Brussels be able to ensure supplies of alternative sources of hydrocarbons to the region? Moreover, some parts of Albania, southern Serbia and Kosovo need an expansion of their gas pipeline systems, while Macedonia has no gas supply infrastructure at all.

So, how should Russia’s energy policy in the region be evaluated? According to the Balkan mass media, the dominating position of Russian companies in SEE is not a coincidence, but a long-term political strategy. There is also an opinion that over the past decade Russian businesses have systematically implemented their plans, supported by Russia’s new leadership, to gain political levers through the energy sector. It is believed that Russian companies spread their influence in the region by buying existing firms and, when this approach did not work, they founded their own enterprises. This was quite an expensive process, but it was aimed at gradually broadening their influence. Meanwhile, some states in the region have already joined the EU, while others are in the process. The conclusion drown is that Russia will use SEE as a bridgehead for a political offensive against the EU.

Besides, these countries were the most heavily affected during the January gas war between Russia and Ukraine. Old Europe has a well-developed system of gas underground storages that were used to pump substantial amounts of Russian gas in the first quarter of 2008. As a result, Germany, France, Italy and Austria were well prepared for the shutdown of gas supplies, while Eastern Europe was most affected. Consequently, countries in this region found themselves in a rather unique situation. For European bureaucracy, their plight represents Russia’s energy faithlessness. But Brussels prefers to provide only verbal assistance to them. A system of underground gas storage facilities is not being developed, and the region will not get really valid alternative sources of gas very soon, if at all. One should not forget that amid

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declining gas production in Europe the share of imported gas will be growing sharply. According to the estimates of the International Energy Agency, in 2030 the share of imported gas may rise to 85 percent of the EU gas balance. This means that Nabucco and other projects will mainly serve to offset the declining gas production in old Europe. Eastern Europe is necessary just as a witness of the threat of energy dependence on Russia. But this region will not get Brussels’ full-fledged assistance in ensuring its energy security. This is why countries in Eastern Europe are facing a difficult dilemma: either to try to normalize cooperation with Russia or to keep demonizing it at Brussels’ request, while not getting any valid alternative solutions in return.

Russian companies in South-Eastern Europe’s oil and oil-refining sector:

Are things so terrible?

Active expansion of Russian businesses into Eastern Europe started with the oil industry. Russians wanted to purchase downstream assets in Europe and this was possible only in its eastern part – opportunities to buy such assets in old Europe had been minimized for political reasons much earlier. A window of opportunity was open; moreover, these countries needed money badly. Let’s us consider whether the experience of cooperation in the oil industry has been positive or negative and whether Russian companies have turned out to be so frightful.

The share of Russian oil on the region’s market is quite substantial. In Hungary it is 98 percent of the market, 90 percent in Bulgaria, 80 percent in Serbia and 40 percent in Greece. Besides, Russian companies own a number of oil refineries and filling stations. But this has not concerned either the population or the political elite for a long time. Expansion continued, but this was perceived quite calmly. Meanwhile, Russian corporations gained control over quite interesting assets.

The most active company in the region is LUKOIL, an absolute leader among Russian oil firms in terms of exploration of retail markets abroad.

In December 2006, ConocoPhillips sold 376 filling stations to LUKOIL. They operated under the Jet brand and were located in six countries, including 30 in Hungary and 14 in Slovakia. In late April 2008, LUKOIL bought 75 filling stations in Bulgaria and a petroleum storage depot near Sofia from Petrol Holding. The deal totaled €237m: €156.1m for the filling stations (about €2.1m per station) and €80.9m for the depot. In Bulgaria, the company has an about 74 percent share on the wholesale market of oil products. Thus, LUKOIL is in possession of 562 filling stations in Bulgaria.

LUKOIL owns an oil refinery in Burgas (Neftochim Bourgas); the Russian firm purchased its controlling stake in October 1999 for $101m. In early 2005, the oil company increased its stake in the Burgas refinery to 93.16 percent having bought 22.05 percent of the facility, based on an offer. The refinery produces unleaded petrol, diesel fuel and petrochemical products that correspond to European quality standards. The refinery processes about 6m to 7m tons of oil per year.

Neftochim Burgas is the only oil refinery in Bulgaria. It produces about 80 percent of the automobile fuel consumed in Bulgaria; at the same time, about one third of oil products produced by Neftochim Burgas is exported.

It is important to note that the deal with LUKOIL led to growth in investments in the enterprise. The oil firm continues upgrading the refinery whose capacity is expected to rise. In 2007 an isomerization unit was put into operation at the refinery; a hydrofining unit of a 1.7m ton capacity per year currently is at the final stage of construction. Moreover, the capacity of a
catalytic cracker is being expanded to 2m tons per year. In 2011 the Burgas refinery will be able to process 10m tons, compared to the current 8.8m tons per year.

LUKOIL’s share on the Romanian market is approximately 22 percent. The Russian oil company owns a chain of over 300 filling stations in this country as well as the Petrotel-LUKOIL refinery in Ploiesti with a 2.4m tons of oil capacity per year. The Russian owner has ensured investments in the enterprise. In 2007, a turbo-generator with a 25megawatt capacity was launched at the refinery; as a result, the combined capacity of the facility’s heat station reached 61megawatts. The first stage of the heat station’s renovation has been completed. On the whole, a renovation project envisages the construction of a boiler unit with a 245megawatt heat capacity in the second quarter of 2009 that will use oil coke as fuel.

In Montenegro’s capital Podgorica, LUKOIL bought six filling stations belonging to Roksped Petrol that had actively cooperated with LUKOIL’s Serbian subsidiary LUKOIL Beopetrol since 2005. The Russian oil firm paid €26.5m for the purchase, which was €4.5m per filling station. According to European standards, this was a high price because in Europe a filling station costs about €1m to €2m on average.

In Croatia, LUKOIL purchased EUROPA-MIL, nine filling stations in Zagreb and Split and five plots of land for the construction of filling stations. The average daily volume of sales at a EUROPA-MIL filling station was 11m tons of oil products, compared to 7.9m tons at a LUKOIL station on average in 2007.

In addition to filling stations, EUROPA-MIL owns an oil product railway terminal with an 8,000 cubic meter storage capacity, located near the town of Vukovar on the Danube River. (In November 2006 the company began construction of a small bio fuel producing plant on the basis of this terminal). As a result, LUKOIL has an opportunity to sell oil products practically all over the country.

Initially the Vukovar terminal had no river transfer reloading license. To have this permit was the condition LUKOIL had put forward to EUROPA-MIL owners before the purchase. Thus, the Russian firm may use river tankers and deliver oil products along the Danube. LUKOIL owns 180 filling stations in Serbia and six in Macedonia.

It is worth mentioning that there was no serious scandal related to LUKOIL’s activities. The company was not perceived as the Kremlin’s instrument of influence. Although LUKOIL launched its strategy of domination on the market in 1998, few observers considered the Russian oil firm’s policy to be a threat. This was probably because LUKOIL is a private company. Besides, the American concern ConocoPhilips has a 20 percent stake in it.

Meanwhile, the attitude towards companies directly controlled by the Russian government has turned out to be completely different. However, they also started actively operating in Serbia and Bosnia and Herzegovina. This concerns Zarubezhneft as well as Gazprom’s subsidiary Gazprom Neft.

Zarubezhneft has marketing assets in the Republic of Srpska (part of Bosnia and Herzegovina). It owns the Bosanski Brod oil refinery with a yearly 4.2m ton capacity, the Modrica engine oil producing plant, a yearly capacity of up to 70,000 tons of engine oil, and 78 filling stations. In 2009, the Russian firm is planning to increase the number of its filling stations in the Balkans to about 150. In the future, according to the Zarubezhneft executive, Nikolay Brunich, the company will raise the number of its filling stations in the Balkans to 300 after the second phase of the Bosanski Brod oil refinery has been put into operation, it will enable the refinery to boost its refining volume from 1.2m to 4.2m tons of oil per year in 2010 / 2011.
In February 2009, Gazprom Neft finally completed the purchase of a 51 percent stake in Serbia’s NIS, while in turn, Gazprom promised to lay a branch pipeline from the South Stream main gas pipeline through this country and to build an underground gas storage facility near Novi Sad. NIS - TNG – a division for LNG production of Naftna Industrija Srbije, an oil company engaged in oil refining and the sales of oil products as well as the production of hydrocarbon resources in Serbia and Angola. The production volume of NIS is about 1m tons of oil per year.

The company owns oil refineries in the towns of Pancevo and Novi Sad with a combined capacity of 7.3m tons per year. NIS has its own marketing network (about 500 filling stations) and it is a leading supplier of oil products on the Serbian market, producing about 85 percent of oil products consumed in the country.

The negotiations started at the end of 2007 and continued for over a year. Russia paid €400m and agreed to invest another €550m by 2012.

These deals were carried out in a much more dramatic way than LUKOIL’s acquisitions. There were accusations of attempts to create a zone of Russian interests and “Moscow’s energy grip” was suspected to be behind them. But there are three points that should be underlined.

The first is that such accusations provide an opportunity to bargain for more benefits from Russian companies by introducing fiscal measures. Thus, Eastern European countries start charging more from Russian firms. These countries use the ‘Russian threat idea’ for commercial purposes, rather than being afraid of it. For example, Gazprom Neft paid quite a high price for Serbian assets, following political bargaining.

The second point is that local companies have to compete against Russian firms entering the market and are not always able to survive. In this case they resort to political accusations. In particular, the purchase of Bosanski Brod by Zarubezhneft seriously shook the position of Croatia’s INA oil firm. INA supplied most of its products to this market, but following the deal the Russian company could sell fuel at a much lower price than the Croatian firm did. As a result, INA even had to transport its fuel to Italy to destroy it at special facilities, which resulted in substantial financial losses.

The third point is the rather difficult adaptation of Russian companies to new assets; however, this is not because of political disagreements. Let’s us consider the situation around Gazprom Neft and its Serbian asset.

In this case there is a collision of two management systems, which is far from politics. Frankly speaking, in the south of Europe there are quite specific labor ethics – people are used to working less intensely, while receiving quite good remuneration. Any attempt to make them work harder and more efficiently causes indignation. On the other hand, Russian top managers are used to big salaries and bonuses and, if they need to cut expenses of their enterprise, they won’t do that at their own expense. It is clear that the arrival of new young managers from Gazprom Neft to Naftna Industrija Srbije, who have established quite favorable financial conditions for their work and in every possible way, demonstrate that they are the elite, consciously keeping Serbian workers at arm’s length, often causes understandable indignation among the enterprise’s workers. However, this conflict is not related to the use of the notorious energy weapon against Serbia.

Thus, there are often economic interests behind political explanations. Nevertheless, a negative background has already been created. As a result, any Russian acquisition causes a sharply negative reaction in the region, even if the buyer is a private company. Any deal is viewed as growth in Russia’s political influence. A clear example is a purchase of a stake in Hungary’s MOL by Surgutneftegaz. Hungary’s reaction to the deal vividly shows how our relations with South-Eastern Europe have deteriorated.
At the end of March 2009, Surgutneftegas, Russia’s fourth largest oil and gas producer, signed a contract buying a 21.2 percent block of shares in Hungary’s Magyar Olaj-es Gazipari Nyilvansosan Mukodo Reszvenytarsasag (MOL) from Austria’s OMV Group. The deal totaled €1.4bn. Surgutneftegas is a private company, although it has a rather non-transparent shareholder structure that is much rumored about. At the same time, the company and its head Vladimir Bogdanov enjoys a certain authority in the Russian oil industry.

The contract was drawn up on March 29 and 30, 2009 at the height of a political crisis that resulted in the resignation of Hungarian PM Ferenc Gyurcsany. Gordon Bajnai, who replaced Gyurcsany, condemned this deal later. The statement Hungarian foreign minister Peter Balazs made in an interview with EurActiv Hungary is quite demonstrative in this regard: “The problem in the MOL case is that we do not know who is behind it. The Russian methods are based on Byzantine tradition, not on Protestant ethics. It is hard to negotiate with representatives of this culture”.

The European parliamentarian representing Hungary, Andras Gyurk, in a written form, inquired of the European Commission whether it considered the sale of the MOL shares to Surgutneftegas to be in line with European principles of transparency.

The following commentary by an undisclosed Croatian expert was published in the Javno newspaper: “The accession of Russia’s Surgutneftegas to the ownership structure of the Hungarian oil company MOL is the culmination of a decade-long attempt by Russian companies to conquer the markets of South-Eastern Europe. They already play a dominant role in many markets, but they failed to do so in Hungary and Croatia. Now having acquired a stake in MOL and thus entering the ownership structure of Croatia’s INA, the Russian firm is preparing the ground to gain control over the energy markets of South-Eastern Europe, from Slovenia to Bulgaria. The domination on these markets is one of Russia’s long-term strategic goals; so, growth in political pressure by Moscow on the Hungarian and Croatian governments can be expected in the near future”.

As a result, Surgutneftegas became a major shareholder in MOL, but it has not managed the company yet. Surgutneftegas was even accused of insidious plans to spoil the construction of Nabucco, which is a rather disputable statement – MOL assets are not enough to ruin this project. Surgutneftegas was refused registration in the shareholder register; as a result, the company was not allowed to participate in the shareholders’ meeting on April 23.

Gas projects: diversification of supplies won’t settle all energy problems in the region

The gas topic is even more politicized, and following the January gas war between Russia and Ukraine that mostly hit countries in the southeast of Europe, it is rather dramatic and is actively discussed. Many politicians in the region rushed to draw a conclusion: it is necessary to decrease dependence on Russia at all costs. Meanwhile, it will be rather difficult to do this. It is enough to study the following statistics:

<table>
<thead>
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<th>2007</th>
<th>2008</th>
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<tbody>
<tr>
<td>Hungary</td>
<td>7.5 (share is 70%)</td>
<td>8.9</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Romania</td>
<td>4.5 (share is 20-25%)</td>
<td>4.2</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2.8 (94%)</td>
<td>2.9</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Greece</td>
<td>3.1 (80%)</td>
<td>2.8</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Macedonia</td>
<td>0.1</td>
<td>0.1</td>
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Gas supplies from Russia (bn cu m):
The volume is not so large, compared to Western Europe. But the dependence on Russia is quite substantial. This is why countries in this region eagerly support calls for diversification of supplies, counting especially on the Nabucco project. But the countries of South-Eastern Europe often forget that they are mostly part of Europe and this is why the problem of the gas balance should be applied to whole of Europe, not separately to its southern, eastern, northern or western parts, and this is the main problem: First and foremost, the declining gas production in Europe.

This means Nabucco will neither save Europe from Russian gas nor will it cover the reduction in the EU’s own gas output. So far, the EU gas balance is not in danger. The share of imported gas in the forthcoming 20 years in the EU has already been mentioned above. This means the task has not been correctly defined. Europe urgently needs to seek additional, but not alternative sources of supply. The objective should be new gas, not diversification. Whereas these seem to be one and the same thing, in reality, from a political point of view, these are absolutely different approaches. The first approach means that Europe’s main task is to get rid of dependence on Russia. The second approach means that the enemy is not Russia, but a growing deficit of gas. This is why the task is not to reduce consumption of Russian gas, but to find opportunities to get gas from other countries, since Russian gas alone will not satisfy the EU demand for this fuel. Besides, dependence on Russian gas is highly exaggerated: Russia’s share of the European gas market has rarely exceeded 25 percent; in the first quarter of 2009, Russia was even outpaced by Norway. However, nobody in the EU has complained about the Norwegian threat.

Energy efficiency and the development of renewable sources of energy have been especially popular ideas in Europe over the past year; these ideas are reflected in the 20-20-20 concept. On the whole, the direction is correct. However, these grandiose prospects of new kinds of energy strongly resemble plans for building communism in the USSR by a particular year. The 20-20-20 strategy is unrealistic, given the envisaged period. This implies that the demand for gas will be quite high in Europe.

Indeed, this is the main problem in Nabucco. Even if this gas pipeline is built, it will not solve the problems of providing Europe with gas. Its capacity is too small – just 31bn cubic meters. All the other issues the Russian side highlights are, in fact, secondary, though they are sound. These are issues related to a resource base, security of transit and the inevitably growing role of Turkey, which is unlikely to satisfy all countries in the south of Europe.

According to plan, the first line of Nabucco will deliver gas from Azerbaijan (about 7bn to 8bn cu m per year), Iraq (7bn to 8bn) and Egypt (about 1bn to 2bn). However, even if the second phase of the Shakh Deniz deposit in Azerbaijan is launched at its full capacity and Baku finally refuses to sell large amounts of gas to Gazprom, Azerbaijan is unlikely to fill Nabucco’s first line independently. Therefore, Nabucco shareholders will depend too much on Iraq, and this is too risky because, as nobody has a long-term understanding of developments in Iraq and whether the level of political stability in this country will be sufficient to secure the gas pipeline’s operation. In the long-term perspective it will be necessary to negotiate with Iran, but it is hard to foresee developments in this state.
Russia suggests another project – South Stream - viewed as Nabucco’s competitor given the EU’s position in this regard. This situation is most dangerous: Europe is at the verge of gas deficit and in such a situation any gas pipeline would be useful. Instead, however, South Stream and Nabucco are opposed to each other, yet competition between them can hardly be called sound. As a result, each project is aimed against a competitor, rather than promoting its own advantages. Unfortunately, this concerns Russia’s policy too; however, such developments only increase the energy risks for Europe.

Moreover, in Eastern Europe there is a paradoxical situation. South Stream and Nabucco have been competing for transit routes; and some countries have realized that they have a good opportunity to obtain concessions from both projects. As a result, the interests of separate countries are prevailing over common European interests.
To date, Eastern European nations have been trying to put pressure on Russia through Nabucco. However, this situation may be reversed later. In particular, Bulgaria’s new PM Boiko Borisov, leader of the GERB party that won the latest elections, spoke about a need to suspend negotiations with Russia on the South Stream project. He made the statement, despite the fact that the Bulgarian president Georgi Purvanov had signed an agreement on participation in South Stream in June 2007, which was ratified by the parliament in July 2008. Moreover, Russia has opted for the Bulgarian option, over Turkey and Romania, which would provide Bulgaria with the possibility of earning over €300m on transit fees annually.

It is quite possible that this is merely ‘blackmail’, which will, however, require additional efforts on the Russian side to ensure the loyalty of Bulgaria’s new leadership. The situation with Serbia is similar. Srbijagas’ general director, Dušan Bajatović, declared his country would participate in Nabucco if a corresponding proposal is forthcoming, despite the fact that Belgrade is still perceived in Moscow as Russia’s ally in the Balkans and Serbia is expected to be the major beneficiary (proportionally to its size and population) from the implementation of the South Stream project.

The logic of Bulgaria and Serbia is quite simple – they realize that Russian premier Vladimir Putin is already involved in the south European gas pipelines struggle and wants to win at any cost. Under such conditions, a transit country can really gain funds or benefits by bargaining with the Russian PM. However, for Russia and Gazprom, the policy of fulfilling the task at any cost may turn out to be dangerously expensive. What is very important for Putin is to show he has achieved the goal and has done things his way. This situation is fraught with mistakes, and Europe, for the same reasons, will loose, not benefit. Considering the predicted gas shortage it is important to implement the maximum number of realistic projects. Moreover, laying a pipeline is a long and expensive procedure.

Besides, Putin could respond to blackmail by changing the route of South Stream. On August 6, Putin signed a protocol on cooperation in the gas sector with Turkey, according to which Turkey allows Russia to conduct surveying within the framework of the South Stream project in its territorial waters. This could imply that in the future Russia may return to the idea of Blue Stream-2. South Stream, in fact, replaced Blue Stream-2 some time ago and now the opposite may happen. However, this is unlikely to be beneficial for either Russia or the countries in South-Eastern Europe.

Main conclusions

Russia is interested in strengthening its presence in the energy sector of South-Eastern Europe. However, this should not be considered as a threat to Europe or a politically motivated step. The largest supplier and the largest consumer should drop mutual political accusations and start more active economic cooperation as soon as possible. Russia and the countries in South-Eastern Europe have positive experience of direct investments in oil refining projects, but over the past few months any move, even by private Russian companies, is given a political interpretation. Such an approach could block growth in capital investments in the region’s energy sector, which will badly affect countries in the southeast of Europe.

In turn Russia should focus on improving the transparency of its business. This mainly concerns the gas industry and there have been several scandals in the region related to the system of gas sales. In particular, in late October 2008, the issue was raised about the operations of an intermediary in gas deals between Russia and Yugoslavia. Yugorosgaz, controlled by Gazprom, received an annual fee totaling €35m (a 5 percent of the total volume of supplies) and resulted in resignation of Srbijagas head Sasha Ilie.
Later, Gazprom and Serbia agreed on a number of additional documents within the framework of an intergovernmental agreement on cooperation in the energy sector. The sides agreed that Srbijagas would increase its stake in the Yugorosgaz Joint Venture from 25 percent to 49 percent and Gazprom would retain 51 percent.

Bulgaria is concerned about another intermediary - Overgas Holding Inc. This is a joint venture of Gazprom and Overgas Holding AD, established in 1995 on a parity basis. Gazprom’s stake is 50 percent; Overgas Holding AD - 50 percent. The company is engaged in the construction and maintenance of transit and main gas pipelines in Bulgaria and participates in the sales of gas to that country. Bulgaria has raised the question of removing the agent, but Gazprom has insisted on retaining it to date.

It appears that the institution of intermediaries will gradually disappear in the future, which should increase trust between parties. An optimal strategy would be for Russia to improve the transparency of its business in Europe, while the Europeans decrease the level of political exploitation of this topic. I believe the most reasonable way to bring common sense back into cooperation between Russia and South-Eastern Europe is the economization of our energy dialogue. This is why the mistakes made at present could be extremely expensive for all concerned.
A Bulgarian Perspective on South-East Europe Energy Issues

Dr Atanas Georgiev*

Whether or not the economic crisis is over soon, most of the energy experts are sure of one thing: the European Union’s energy consumption will grow. At the same time, the local fossil energy resources are diminishing and will play an ever smaller role in the EU’s consumption. This puts energy issues as a key priority for the Union, alongside climate change.

South-East Europe’s energy sector is following the European trend – regional consumption is expected to grow as well, mainly because of economic growth. There are still many aspects of the SEE energy sector that are not clear. The countries in the region have to comply with European requirements and, at the same time, ensure their energy balances. This can only happen if new investments in energy infrastructure are made.

Bulgaria’s position in the region’s energy sector is significant for several reasons. As a new member of the EU, the country has to deal with energy issues in a new way, following an ever larger number of requirements. At the same time, as a long-term partner of Russia, the Black Sea countries, the Caucasian region, and some Middle East states, Bulgaria may play a very important role in connecting supplies of oil and natural gas with European demand.

**European energy policy**

The EU’s 20/20/20¹ target is a focal point of Europe’s energy policy. De-carbonizing the energy sector, energy efficiency and renewable sources express the Union’s will to diminish its role in climate change. This factor will grow in importance alongside the will of some EU-members to reach even greater individual targets. The United Kingdom, France, Germany and others have expressed their will to support their own energy and technology industry to provide solutions at home and abroad.

During the transition to low-carbon and renewable energy, however, the EU has to deal with short-term and mid-term challenges. Currently, the Union is dependent on energy imports for about 50 percent of its consumption. According to IEA analyses, by 2030 this dependency could reach 70 percent, if no alternative measures are taken. Oil consumption in EU-27, which is currently about 10 billion tons per year, may reach up to 18 billions tons by 2030. Until new technologies are available, the EU countries will require secure fossil energy supplies, mostly oil and natural gas.

According to European Commission data from 2007, about 37 percent of the EU-27 energy consumption depends on oil, 24 percent on natural gas, and 18 percent on coal and other fossil fuels. Only nuclear (13 percent) and renewables (8 percent) are provided entirely from local energy production (Figure 1).

At the same time the EU depends on imports for about 60 percent of its natural gas consumption. In 2007, most of the imported gas came from Russia (24.3 percent), followed by Norway (15.9 percent) and Algeria (10.1 percent). All other sources (Nigeria, Libya, Qatar, Egypt, etc.) provided less than 10 percent of the EU’s gas imports in 2007 (Figure 2).

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¹ By 2020 EU has to diminish carbon emissions by 20 percent, to improve energy efficiency by 20 percent, and to ensure that 20 percent of the energy consumption is provided by renewable sources.
This dependence on foreign energy has sharpened the need to diversify not only suppliers, but also routes and sources of natural gas. Part of this policy is using more routes for supplying Russian gas, i.e. the Nord Stream and South Stream pipelines, as well as looking for new resources in the Caucasian region and the Middle East, via the Nabucco pipeline (Map 1 and Table 1). In both cases, these projects depend on and, at the same time, affect South-East Europe. If the entire planned energy infrastructure is built, it will bring not only energy, but also more stability to this part of Europe.
Map 1: European gas pipelines

Source: www.energy.eu

### Table 1: The most important future natural gas pipelines in the EU

<table>
<thead>
<tr>
<th>Pipeline</th>
<th>Connection</th>
<th>Transport capacity</th>
<th>Partners</th>
<th>Scheduled for operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>North Stream</td>
<td>Russia-EU (via Baltic Sea)</td>
<td>55 billion</td>
<td>Gazprom 51%, BASF/Wintershall 20%, E.ON 20%, Gasunie 9%</td>
<td>2 Lines. First scheduled for 2011, second for 2012</td>
</tr>
<tr>
<td>South Stream</td>
<td>Russia-EU (via Black sea)</td>
<td>63 billion</td>
<td>Gazprom 50%, ENI 50%</td>
<td>End of 2015</td>
</tr>
<tr>
<td>Nabucco</td>
<td>Caspian region, Middle East, Egypt to EU</td>
<td>31 billion</td>
<td>BOTAS, BEH, MOL, OMV, RWE, Transgaz. Each 16.67%</td>
<td>End of 2015</td>
</tr>
</tbody>
</table>

Source: www.energy.eu
Southeast Europe’s energy situation

The region of South-East Europe has been an important trade route ever since the Silk Road. The geographical location provides the opportunity to link several important energy-rich regions with Europe: Russia and Asia, the Caucasian countries and the Middle East, as well as even Africa and the Mediterranean basin. Moreover, SEE may play a significant role not only as an energy transporter, but also as an energy supplier, especially on the electricity market. Currently, South-East Europe has an electricity deficit, but large new projects, like the nuclear plants Belene (Bulgaria) and Cernava (Romania) and the coal potential of Kosovo could provide new power sources in the mid-term.

According to the EFT Group, August 2009, the average electricity deficit of SEE in the period 2005-2008 is 10.4 TWh and only three of the countries in the region (Bosnia & Herzegovina, Bulgaria, and Romania), have been net exporters of electricity during this period (See: Map 2). Currently, according to the same source, the consumption per capita of natural gas and electricity in the region is only 46 percent and 53 percent respectively of the EU average. Further economic development, expected in the region, despite the current economic crisis, most probably will lead to an increase in end-use of all types of energy.

Map 2: SEE average energy balance (2005-2008)

The region’s European perspective is a good basis for developing energy relations with regard to EU policy. As a natural step, seven countries from South-East Europe have signed a common energy document with the EU. The Treaty establishing the Energy Community, also known as Energy Community South-East Europe Treaty or ECSEE², was signed on October 25, 2005 in Athens, Greece. It entered into force on July 1, 2006. The contract aims at establishing a single regulatory framework for trading energy across South-East Europe and the EU on the same terms. It was signed by energy and trade ministers, representing the EU,

² Official website: www.energy-community.org
Albania, Bosnia and Herzegovina, Croatia, Republic of Macedonia, Montenegro and Serbia, as well as UNMIK (as Kosovo representative under Security Council Resolution 1244). The treaty affects electricity, natural gas, and oil products. Bulgaria has participated in this initiative since its accession to the EU – January 1, 2007. Other 13 EU states participate in the Energy Treaty as well. Currently, Georgia, Moldova, Norway, Turkey, and Ukraine are taking part as observers.

Unfortunately, many of the regulatory reforms that are required by this document are still not present, which creates obstacles for free energy trade in the region. Moreover, the current energy infrastructure in SEE is not capable of providing capacity needed for full-scale energy trade between the countries in the region and the EU. According to data from the South-East Europe Development Watch\(^3\), issued on December 8, 2008, the Western Balkan countries are highly dependent on energy imports, ranging in 2005, from 32 percent for Serbia and Bosnia & Herzegovina to 51 percent and 58 percent for Albania and Croatia, respectively. The same document also points out some of the main energy projects planned in the region:

**Oil projects**
- The Burgas-Alexandroupolis oil pipeline (Bulgaria-Greece): 30-50 million tons per year;
- The AMBO oil pipeline (Albania-Macedonia-Bulgaria): 30-40 million tons per year;
- The Pan-European Oil Pipeline – PEOP (Romania-Serbia-Croatia-possibly Slovenia-Italy): 60-90 million tons per year;
- The integration of the existing Druzhba and Adria pipelines (Croatin-Hungary-Ukraine-Russia).

**Gas projects**
- Nabucco (Turkey-Bulgaria-Romania-Hungary-Austria): up to 31 billion cubic meters per year;
- South Stream (Russia – Bulgaria, dividing into Greece-Italy and Serbia/Romania-Hungary-Austria/Slovenia-Italy): around 30 billion cubic meters per year (increasing to about 63 billion cubic meters per year subsequently);
- Trans-Adriatic Pipeline (Greece-Albania-Italy): 10-20 billion cubic meters per year.

According to different sources, the structure of electricity demand in South-East Europe will not be impacted very much by the economic crisis. The reason is that the region has relatively low electricity consumption in the industrial and services sectors. There is, however, a possibility of delays or failures in planned investments in new capacities and infrastructure, because of a lack of financing – both from state budgets and from international bank institutions.

However, the high-priority projects for the region of SEE seem the new gas pipelines that are planned to cross the Balkan Peninsula. *Nabucco* and *South Stream* have been defined by some experts as competing projects, but others claim that there is enough room for both. Initially, they were planned with the same maximum capacity (about 30 billion cubic meters per year), but later Gazprom announced that *South Stream* will carry twice as much – about 63 billion cubic meters per year. Currently, the chances that both pipes will be built appear to be equal. Gazprom and ENI have secured the route of the *South Stream* pipe everywhere, even

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\(^3\) South-East Europe Development Watch (SEEDW) - formerly known as Stability Pact Watch - is a coalition of South-east European environmental non-governmental organizations (NGOs) monitoring and campaigning on the investments made by international financial institutions (IFIs) and the European Union (EU). SEEDW is a project within CEE Bankwatch Network
under the Black Sea after signing an agreement with Turkey. Nabucco has many supporters as well. One recent supporting opinion voiced by Dušan Bajatović, CEO of Srbijagas. In a report by SEEbiz/B92, he said that “Serbia would agree to negotiate on the Nabucco pipeline project should an invitation arrive.” According to the same source, he pointed out at the daily Politika that “It would not be bad to link up with the Nabucco pipeline as well, even if it isn’t passing through Serbia’s territory, since gas would be arriving from the Caspian Sea and Central Asia via this pipeline”.

Another interesting gas project, proposed by the Hungarian gas company MOL, is the so-called “New Energy Transport System – NETS”. The idea of NETS is to provide a common ground for interconnecting the gas transmission networks of South-East European and Central European countries. This provides another opportunity to secure gas supplies during short-term crises. NETS (See: Map 3 below) might also compete in trading some quantities of natural gas, although the capacity will be considerably smaller than that of the proposed pipelines Nabucco and South Stream.

Map 3: The proposed interconnections of the NETS project

The energy sector in Bulgaria

About half of the aforementioned energy infrastructure projects should pass through Bulgaria – Nabucco, South Stream, Burgas-Alexandroupolis, and AMBO. The country has the chance to build an energy bridge between its traditional Western and Eastern partners. Currently, a member of the EU, Bulgaria has long-term trade relations with Russia, the Caucasian region, and some Middle Eastern countries. Some of the trade relations have been lost during the transition to a market economy in the period after 1989, but others have been strengthened over the last several years.

Currently, Bulgaria is dependent on foreign oil for almost 100 percent of its consumption and on foreign natural gas for over 90 percent of its consumption. However, because of its nuclear power plant Kozloduy, Bulgaria’s overall energy dependency in 2008 was only 46.2 percent, which is a little lower than the EU-average for the same year – 53.8 percent\(^5\). The country is still a net exporter of electricity with an average export of 6.3 TWh per year in the period 2005-2008, according to data from the EFT Group.

The Bulgarian oil market does not have a clear “market leader” as several international companies are in competition: Eko Bulgaria (owned by Hellenic Petroleum), Lukoil, OMV, Petrol, Rompetrol and Shell. However, the largest refinery in Bulgaria is owned by Lukoil, which is also investing in a local distribution chain. Thus, the petroleum situation in Bulgaria suffers mostly from volatile prices, but no supply shortages are expected.

The natural gas market in Bulgaria is not in a similar situation. Currently, all natural gas imports are of Russian origin, using a single route via Ukraine. One of the companies supplying gas to Bulgaria is Overgas (50 percent owned by Gazprom), which also operates most of the gas distribution network in the country. The network was built in the period after 1991, as Bulgaria did not have any household consumption of gas prior to that.

The lack of alternative natural gas supplies was felt very negatively during the Russia-Ukraine gas dispute in January 2009. Left without gas supplies, Bulgaria could only avail of the gas from its storage facility “Chiren”. However, as its current capacity could cover less than half of the daily consumption in winters, gas supplies for industrial consumers as well as for district heating companies was diminished or stopped during the crisis. Large consumers with a possibility to use reserve fuel (such as gas oil or coal) did not suffer great discomfort, but some industrial consumers had significant losses, since they had to stop work.

The gas crisis in January gave additional impetus to the government in seeking new energy infrastructure opportunities. The Bulgarian Energy Holding (100 percent state owned), which owns the gas transmission and gas transit network operator Bulgartransgaz, and the single wholesale buyer Bulgargaz, started several initiatives over the next months. Some of the main events during and after the crisis were:

- **January 19, 2009**, Bulgaria successfully negotiated gas imports from Greece by reversing the flow and using the same pipeline, which supplied Russian gas to the Greek network. This happened a little before the gas flow through Ukraine was restarted. The imports were negotiated for a quantity of 2.5 million cubic meters daily, about 20 percent of the daily winter consumption in Bulgaria.

- **End of January 2009** in Vienna, Austria, Bulgaria agreed with Azerbaijan to import 1 billion cubic meters of natural gas from the Caucasian country, when the needed infrastructure is present (*Nabucco* or LNG terminals), or, when there is a transit contract with Russia or Turkey, to use their transit lines.

- **April 24-25**, the Bulgarian president organized a summit, called “Natural Gas for Europe. Security and Partnership”\(^6\), which was attended by political figures from the EU and energy-exporting countries. During the summit, the Bulgarian Energy Holding organized a conference, called “Sofia Energy Business Forum”\(^7\), which gathered representatives of international energy companies.

- **May 15, 2009**, in Sofia, the executive director of Bulgarian Energy Holding signed the agreement with Gazprom on *South Stream*. The Russian part signed the

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\(^5\) Source: www.energy.eu


\(^7\) Official website: http://www.bgenh.com/sebf/index.html
agreement in Moscow on April 28, 2009. The document provides that the two companies will create a new entity and will initiate a feasibility study of the project.

- **July 13, 2009,** the inter-governmental contract for *Nabucco* was signed in Turkey. According to the former Bulgarian Prime Minister Sergei Stanishev, who signed the contract, this is a very important step ahead for the project implementation.

- **July 14, 2009,** the Bulgarian Energy Holding signed two gas agreements. The first memorandum is with two companies: DEPA S.A., Greece, and Edison International Holding BV, Italy. BEH will participate with 50 percent in a common venture, which will build, own and operate a gas connection between Greece and Bulgaria. The second contract is between BEH and the Greek company Hellenic Gas Transmission System Operator (DESFA S.A.) and involves partial use of the capacity of the Revithoussa LNG terminal in Greece.

- **July 16, 2009,** the Bulgarian Energy Holding announced that it will seek for funds to increase the capacity of the gas storage “Chiren”. The Holding could guarantee a loan of up to €250 million for its subsidiary company Bulgartransgaz, which operates the storage facility.

### Current political situation in Bulgaria

In July 2009, Bulgaria elected a new parliament for a four-year term. The former ruling coalition, formed by three parties (BSP, NDSV and DPS) completed a full four-year mandate, during which its energy positions were qualified as pro-Russian. These opinion was based on support that the government had given to several pro-Russian projects: the construction of the new nuclear plant Belene (with main contractors Atomstroyexport, Areva, and Siemens), the signed contract for the *South Stream* pipeline (with 50/50 Bulgarian and Russian ownership), as well as agreements for the Burgas-Alexandroupolis oil pipeline (51 percent Russian, 24.5 percent Bulgarian, and 24.5 percent Greek). The former government was formed on the principle of political quotas with a ratio 8-5-3. Thus, different ministries were managed by different parties from the coalition and sometimes the political wills of the partners were not unanimous on important energy and economic issues.

The new government and the new minister of energy Traicho Traikov⁸, former manager in EVN Bulgaria and energy expert, have pleaded for a revision of all energy deals in economic terms. The reason for this, according to the new government, is the expected budget deficit in Bulgaria in 2009. The economic crisis, which could have its strongest effects on Bulgaria in both 2009 and 2010, is the new government’s main concern, as the budget may not cover the expenses of some of the larger energy projects, especially if the agreements made by the former government turn out to be disadvantages. The new government has 116 seats in the 240-seat Parliament. All the right-wing parties support the government, but without making a coalition with the ruling party GERB. The Prime Minister Boiko Borisov, former Mayor of Sofia, decided to take the risk and form the government alone to provide a clear political vision about its activities.

The construction of the Belene nuclear plant has cost about €400 million to date, mainly in engineering, consulting and preparation works. The project is lead by NEK, the national electric company, which is 100 percent owned by the Bulgarian Energy Holding. An international tender for 49 percent of the project was won by RWE (Germany), but still no financing for the project has been secured – either through finance or bank loans. However,

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⁸ Biography of Traikov is available at: [http://www.mee.government.bg/eng/about/about.html](http://www.mee.government.bg/eng/about/about.html)
Russian officials have proposed that Atomstroyexport could finance almost €4 billion of the expenses through leasing contracts. Both the prime minister and the energy minister have expressed their concern about the project’s financing several times and promised a full-scale audit of all contracts.

Bulgaria owns 24.5 percent of the Trans Balkan Pipeline’s Burgas-Alexandroupolis project through the state-owned companies Bulgarian Energy Holding (under the control of the Bulgarian economy and energy ministry) and Technoexportstroy, each of them having 12.25 percent of the shares. On May 15, 2009, BEH decided to cease its participation in the project and transfer the shares to Technoexportstroy. The company is under the control of the Bulgarian regional development and public works ministry. According to the new minister, Rosen Plevneliev, former manager of Lindner in Bulgaria and construction entrepreneur, the project has no economic sense. However, a final decision has still not been made about how Bulgaria will participate in it. Moreover, many of the municipalities on the pipeline route have expressed their concerns about the project’s environmental risks. The new government is expected to make an in-depth review of all such risks.

According to an article of the Russian news agency Prime-TASS, cited by Euractiv9, the new government’s actions have caused concerns in Russia regarding Bulgaria’s pro-Russian orientation and its energy projects, especially South Stream. Still no contract has been changed or terminated, but the new government’s tone sounds different from its predecessors. Even before the elections, the leader of the current ruling party GERB, while still a member of the opposition, urged the previous government not to sign any energy deals in July 2009, as all contracts would have to be implemented by the new government, which did not want to be excluded from any negotiations. The only exception that GERB made was for the signing of the Nabucco inter-governmental contract (Turkey, July 13, 2009). The new government will have to negotiate with Gazprom for new gas supplies in the coming months as the current contract is valid until the end of 2012.

If Bulgaria’s new government follows the European position on new gas pipelines through SEE, then we could expect that both Nabucco and South Stream will be built. The official EU position is that both projects will improve the Union’s energy security. However, according to the EU energy policy, Nabucco should have priority. While South Stream is diversifying routes for supplying Russian gas, Nabucco is expected to support diversification of routes, suppliers and sources of natural gas – by providing access to the gas-rich Caucasian region and Middle Eastern countries. At the same time, the new government is expected to strengthen relations with the USA as well. This could be a chance for more American energy companies to enter the Bulgarian market and provide additional funding for local energy projects.

**Conclusion**

The European perspective of the SEE countries is a key factor for the development of their energy sectors. The region lies in the middle of the routes that connect energy suppliers (Russia, the Caucasian countries, and the Middle East) with the large energy consumers in Central and Western Europe. At the same time, the region itself is increasing its energy consumption. The energy “crossroad” can provide many benefits for SEE countries in terms of new investments in energy capacities and energy infrastructures, if the political will for this is present.

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Energy Security in South-East Europe in Light of Russian Energy Policy

Dr Zorana Z. Mihajlović Milanović*

„As things stand now, if we don’t change our energy system in a radical way over the next ten years, the wheels will come off”, IEA, Fath Birol Chief Economist, 2008

Energy security, economic development and efficient environmental protection have long been fundamental interlinked goals. Consequently, no one national economy can claim to be energy – secure. This situation can be defined as bipolar – some countries have energy pathways at increasingly difficult political price, while others have huge supplies of energy resources with which they attempt to dictate future global growth.

In an attempt to secure energy, new opportunities are being opened for oil and gas companies, infrastructure owners, producers, distributors and others in the energy business, however, this, in term, creates new risks. Thirty years after the first energy crisis, the most important equation of global energy has not been solved – securing sufficient energy in an economic, efficient and ecological manner.

Apart from the urban myth, whereby nine months after the biggest blackout in New York (1977) the number of births increased by 35 percent, everything else is far from romantic. More important than looted stores, mugged citizens and estimated damage of around $300million, the first signs of fear of shortage or lack of access to energy were clearly recognizable. That fear still exists today. Both in 1977 and 2009, after the second gas crisis, it is clear that energy is a condition of subsistence to modern society.

We have not left energy crises and wars behind us. They persist and directly influence energy and national security, through the reduction of energy efficiency, decreased supply, increasing prices and deep geopolitical tensions. There are no winners in energy wars – only losers

Reduced production in consumer countries (which increases their import dependency), lack of investment in energy infrastructure¹, political volatility and conflicts directly influence the level of energy security of the region and the world², reducing energy intensity and slowing down the implementation of region’s energy policies. For instance, the well-known EU gas security issue concerns diversification, on one hand, (which is more theory than reality), but also cooperation within the EU to define and implement a united energy policy. It is clear that without a unified policy, there can be / will be no security of supply, consequently we live today in a constant energy crisis. Because the first and the second gas crisis occurred during the first few days of 2006 and 2009, does not mean that they lasted only a few days. The crisis started before those dates and continues to persist.

Unless energy supplies are reconciled with demand, development can not progress. It is realistic to observe, therefore, that countries with energy resources are in a more advantageous position than those without. Will Russia, for instance, benefit or loose from shutting down gas supply intended for Europe?³ Can Gazprom dispense with thousands of kilometers of gas and

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¹ The International Energy Agency estimates that around $20trillion of investment in energy infrastructure is needed until 2025.

² The Iraq war (due to which decades will be needed to restore production to the pre-war level), conflicts in Equatorial Africa, deeply disturbed relations between suppliers and producers / consumers, political interests, guided reduction or increases in the flow of raw materials, such as oil and gas.

³ During the second gas crisis Gazprom was loosing $200million per day.
oil pipelines worth billions? What would happen to the Russian economy, if this country’s budget were to be reduced for 50 percent, if the EU stopped using and paying for its gas?4

It is a well-known fact that 94 percent of Russia’s total gas exports is to European countries. Russian gas makes up 38 percent of the European import. Future projections serve as a warning to both sides and should be taken into account. By 2030, Europe’s gas import will increase five to six times, compared to home production. Some European countries, such as Germany and Italy, have a significant share in gas import from Russia; consequently, it is not surprising if they are focused on bilateral deals with Russia at the expense of European solidarity. In recent years, Gazprom has signed agreements with ENI (Italy), Gaz de France (France), Gasunie (the Netherlands), BASF (Germany), E.On Ruhrgas (Germany). In a bid to access energy and, of course, profit, European companies play against one another, to achieve more favorable conditions and advantages. If one company refuses to play by Moscow’s rules, others soon agree, leaving the first company with nothing. Moreover, this interdependence influences EU foreign policy, reducing the potential to influence and support key alliances, starting from the Balkan and Central European countries, as well as Asia; especially Ukraine, Azerbaijan, Georgia, Kazakhstan, Turkmenistan, which are the main producing and transit countries. Russian gas also accounts for 98-100 percent of consumption in Belarus, Estonia, Finland, Georgia, Latvia and Moldova.

Graph 1: EU 27 energy dependence, % of Net import in gross internal consumption, coal in red, oil in blue, gas in purple

Approximately one fourth of the EU supply comes from one company – Russian Gazprom. 80 percent of that quantity is being delivered through one route – Ukraine. This is a point of concern, especially for Russia.5 After the collapse of the USSR, Europe was faced with a dual monopoly: a Russian monopoly in quantity, i.e. volume of oil and gas and Ukrainian

4 In January and February 2009, the Ukraine gas transit was reduced by 50 percent. 11 billion m3 of gas transited the Ukraine, which is 53.2 percent less than in the same months in 2008. The main reason for this reduction in consumption in Europe was the economic crisis, but this surely affected the budget and economy of Russia. In the first half of 2009, Gazprom earned 36-42 percent less from gas exports to countries outside the CIS, than in the same period in 2008 ($12billion).

5 Russia – Ukraine relations started to chill after the 2004 elections in Ukraine, when the pro-Western, pro-NATO politician, Victor Yushchenko, won, and the question of security of supply became an issue. The IEA analysts (Tom Gold) remarked: „It is difficult to remove politics from anything to do with Ukraine and Russia“. While Ukraine was being led by a pro-Russian politician, there were no such problems, and the price of gas for this country was, as it is today, non-competitive. Indeed, it was considered friendly at that time.

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monopoly on transit routes. This diminished the room for maneuver of the EU, which, anyhow, lacks energy resources.

The EU will be able to solve its electricity shortages through a revival of nuclear energy, and partly through renewable energy sources, but existing problems with oil and gas can not move at such a pace. Liquid oil gas, bio diesel and bio fuel are options which require a lot of investments and can only partially satisfy the energy demand. Results of this front can only be expected in decades to come.

Since it takes two to tango any deterioration or improvement of EU – Russia relations will affect supply for European consumers. If the supplier refuses to provide gas or offers it at an unreasonably high price, the consumer is unable to react or avail of another source in a short period of time (the consumer can only accept the supplier’s conditions or go without gas, which is not an option). On the other side, if agreements on great infrastructure projects fall short because of a change of government, that is equally as bad as the use of a gas supply as political weapon.

One solution for the EU would be to have a clear relationship and agreement with the Russian side on all matters pertaining to this issue, including those connected to the construction of new gas and oil pipelines. Parallel and not less important are relations with the transit countries, such as the countries of South-East Europe, an indispensable link in establishing good quality cooperation between Russia and the EU. By signing the South-East Europe Energy Charter, these countries have taken a step closer to the EU. Bearing in mind their long-term political and economic links to the former USSR and the heritage of that period, the creation of the Energy Community has been a huge step forward for these countries and a great political success for the EU.

The SEE region has a population of 55 million inhabitants, approximately equal to that of Italy and France, spread across nine countries. Their GDP in 2008 was $417 billion. Without the SEE countries, the EU energy balance would fall short, while Russia would experience a drop in efficiency. This is the comparative advantage of the region, especially for countries, such as Serbia, Bosnia and Kosovo.

Unless these countries are politically stable, with sufficient investments, the comparative advantage of a good geostrategic position would become a disadvantage. They would become a lagging point of development not only for themselves, but also of the entire region. By 2012 this region will require 440MW of new energy capacities and further investments, estimated at €30 billion, will be required by the year 2020.

Table 1. Planned production and infrastructure energy capacities until 2012 in the SEE Region (in MW)

<table>
<thead>
<tr>
<th>Country</th>
<th>Thermo</th>
<th>Hydro</th>
<th>Nuclear</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>578</td>
<td>243</td>
<td></td>
<td>821</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>677</td>
<td>913</td>
<td></td>
<td>1590</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2100</td>
<td>-129</td>
<td>-109</td>
<td>1862</td>
</tr>
<tr>
<td>Croatia</td>
<td>807</td>
<td>146</td>
<td></td>
<td>953</td>
</tr>
<tr>
<td>Macedonia</td>
<td>10</td>
<td>694</td>
<td></td>
<td>704</td>
</tr>
<tr>
<td>Montenegro</td>
<td>210</td>
<td>150</td>
<td></td>
<td>360</td>
</tr>
<tr>
<td>Romania</td>
<td>-3594</td>
<td>194</td>
<td>800</td>
<td>-2600</td>
</tr>
<tr>
<td>Serbia</td>
<td>602</td>
<td>152</td>
<td></td>
<td>754</td>
</tr>
<tr>
<td>Region</td>
<td>1390</td>
<td>2363</td>
<td>691</td>
<td>4444</td>
</tr>
<tr>
<td></td>
<td>31,3%</td>
<td>53,2%</td>
<td>15,5%</td>
<td></td>
</tr>
</tbody>
</table>
Graph 2 and 3:

**Graph 2**: New production capacities 2012/2001, in percentages, thermo, hydro, nuclear, total

**Graph 3**: New production capacities, breakdown by country, 2012/2001, in percentages

There are many points of concern regarding the region’s future energy status. The most important are listed below:

1. Insufficient energy capacity (49.5GW), which is the main cause of power interruption. The deterioration of infrastructure has created a need for additional 4500 MW, i.e. for an investment of around €5 billion by 2012;
2. The average annual increase in energy demand is estimated at 2.3 percent (from 1714 to 2194 TWh) by 2012 (double to the previous decade);
3. The investment environment is still unsuitable for investors in many countries, especially from the point of view of protection (political issues, legislation, regulations, tariff reforms);
4. Analysed by sectors, the biggest energy consumers are households. This highlights an insufficient development of the industrial sector, but also guarantees growing demand in years to come;
5. Oil and gas production is limited, due to the scarce deposits. The Western Balkans are heavily dependent on the import of fossil fuels from outside the region;
6. Energy intensity\(^6\) is high, more than 2.5 times higher than in the EU.

Graph 4 and 5:

**Graph 4**: Energy production, 2007/05, in percentages

**Graph 5**: Export import balance

\(^6\) Energy Intensity is an average quantity of energy necessary for the production of one unit of the GDP.
Although SEE governments at the beginning of 2000 expressed their readiness to restructure the energy sector and establish an energy market, and, although they have signed the Energy Treaty\(^7\), many activities are not being conducted at the desired pace, which directly affects the investment flow negatively, i.e. a slowdown in the building of new capacities.

While there are many investment potentials in the region, they will remain hypothetical unless these countries strictly apply the provisions of the Energy Treaty and EU directives.

Strategic energy goals in the SEE region cannot diverge from those of the EU, particularly those regarding security of supply, acceptable and foreseeable prices of energy sources (which boost competition and not monopolies), ecology, and energy sustainability. The current state of affairs in the region is far from these premises: energy security is decreasing, prices of electricity, gas and oil derivates are neither predictable nor competitive, and the levels of carbon in energy sources and energy production continue to grow. The long-term solutions available to these countries are clear: increasing the share of renewable resources in the energy mix, the production of bio fuel, boosting global partnerships with the EU, investing in new energy technologies\(^8\) - especially in fossil fuels with low percentage of carbon dioxide and increasing energy efficiency.

**Table 2. Electricity production 2007/2005, in percentages**

<table>
<thead>
<tr>
<th>Country</th>
<th>Total electricity production</th>
<th>From Thermo-electric Plants</th>
<th>From Hydro-electric Plants</th>
<th>From Nuclear Power Plants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bosnia and Herzegovina</td>
<td>-6,5</td>
<td>17,8</td>
<td>-33,3</td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>-13,8</td>
<td>5,4</td>
<td>-47,5</td>
<td>-27,0</td>
</tr>
<tr>
<td>Croatia</td>
<td>-1,8</td>
<td>28,7</td>
<td>-31,8</td>
<td>37,4</td>
</tr>
<tr>
<td>Greece</td>
<td>+4,0</td>
<td>9,8</td>
<td>-40,5</td>
<td></td>
</tr>
<tr>
<td>Macedonia</td>
<td>-6,3</td>
<td>0,3</td>
<td>-28,8</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>+2,8</td>
<td>-3,4</td>
<td>-21,5</td>
<td></td>
</tr>
<tr>
<td>Serbia and Montenegro</td>
<td>-1,5</td>
<td>8,0</td>
<td>-19,3</td>
<td></td>
</tr>
</tbody>
</table>

**Table 3. Index of Economic Freedoms and the Perception of Corruption in SEE countries and Russia**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>56</td>
<td>72</td>
<td>Albania</td>
<td>62</td>
<td>85</td>
</tr>
<tr>
<td>Romania</td>
<td>65</td>
<td>70</td>
<td>Turkey</td>
<td>75</td>
<td>58</td>
</tr>
<tr>
<td>Macedonia</td>
<td>78</td>
<td>72</td>
<td>Montenegro</td>
<td>94</td>
<td>85</td>
</tr>
<tr>
<td>Serbia</td>
<td>109</td>
<td>85</td>
<td>Croatia</td>
<td>116</td>
<td>62</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>134</td>
<td>92</td>
<td>Russia</td>
<td>146</td>
<td>147</td>
</tr>
</tbody>
</table>

The geographic location between the energy-rich regions (Russia, Caspian region, Middle East) and the main energy consumers in Western and Central Europe, makes the SEE geopolitically and economically attractive and significant from the energy point of view. The opportunity for the SEE region to become the largest energy hub for gas transit from the

\(^7\) A Treaty Establishing the Energy Community of the South-East Europe countries, signed in Athens on 25 October 2005, ratified by the EU and entered into force on 1 June 2006. This is the first energy-related document which has a binding status, signed between the SEE countries and the EU. Ratification in the parliaments of the signatory states has created an obligation (EU plus nine partner countries) to establish a unique integrated energy market. The goals are: to create conditions to attract new investments into the energy sector, to open the energy markets of these countries in accordance to the EU directives, to strengthen conditions for unhindered environmental protection in the region energy market.

\(^8\) The EU annual investments in energy technologies will be around €1 billion between 2007 and 2012.
Middle East, Central Asia and Caspian region to the EU can only be possible if infrastructure is well developed.

Much remains to be done for this region to satisfy the constantly growing energy demand, especially the demand for gas. Although possibilities for electricity production exist, its current production potential and oil and gas reserves underline how this region has been and is dependent on imports. Russian gas makes up a large share of the gas import in Latvia, Lithuania, Hungary and Slovakia. Countries such as Lithuania, Estonia, Bulgaria and Poland use gas in large quantities in the petrochemical industry. If there is no gas, these factories would simply have to close and petrochemical products would be imported.

Some basic features of the SEE region’s gas industry include: a significant lack of gas storage facilities, non-existent or underdeveloped gas network, low gas consumption and high dependence on one supplier (Russia). Although SEE countries have decided to reform their gas industry, changes are happening a lot slower than expected.

The two gas crises, and especially the second (Jan 2009), demonstrate how sensitive the countries in the region are to gas-related issues and how much gas is a point of concern for EU supplies. The supply in Romania, Bulgaria, Serbia, Greece, Macedonia and Croatia was seriously jeopardized.

Table 4. Gas share in the energy mix of each country in the region and relation between gas imported from Russia compared to the total consumption, in percentages

<table>
<thead>
<tr>
<th></th>
<th>Bulgaria</th>
<th>Greece</th>
<th>Romania</th>
<th>Croatia</th>
<th>Serbia</th>
<th>Bosnia and Herzegovina</th>
<th>Macedonia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas share in Energy Mix</td>
<td>14</td>
<td>9</td>
<td>35</td>
<td>27</td>
<td>12</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Gas import from Russia compared to the total consumption</td>
<td>87</td>
<td>80</td>
<td>35</td>
<td>39</td>
<td>88</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

In the case of most countries, gas primarily enters through Ukraine from Russia. Two countries (Romania and Croatia) have a significant domestic gas production, while another two (Bulgaria and Serbia) have gas, but in smaller quantities. Because the region is a bridge of gas supply between Russia and the EU, the SEE countries’ strategic goals, including future investments policies, are:

1. Increased gas consumption (either in the production of electricity, or in household consumption for heating and cooling);
2. Strengthened regional integration to reduce potential interruptions in supply to the minimum (investments in gas infrastructure and market development);
3. Investment in gas storages and interconnection networks.

The average annual gas demand in the SEE region will increase by 2.6 percent, but with large variations from country to country. Demands for gas are forecast to increase by 72 percent until 2025 (from 26.2 billion m$^3$ in 2005 to 45 billion m$^3$ in 2025). The supply gap, created in this period, will increase for as much as 96 percent.

The countries in the region, which are currently small consumers of gas with insufficiently developed gas infrastructures, will have the highest increase in average gas consumption – Albania, and Bosnia and Herzegovina. On the other hand, the shortage of sufficient gas supply will hit Bulgaria, Croatia and Serbia, including Kosovo.
Table 5. Gas demand and supply gap of SEE countries

<table>
<thead>
<tr>
<th></th>
<th>Romania</th>
<th>Bulgaria</th>
<th>Serbia</th>
<th>Croatia</th>
<th>Bosnia and Herzegovina</th>
<th>Macedonia</th>
<th>Albania</th>
<th>Kosovo</th>
<th>Montenegro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annual gas demand increase rate</td>
<td>1.7</td>
<td>3.2</td>
<td>1.9</td>
<td>1.0</td>
<td>6.1</td>
<td>3.8</td>
<td>10.2</td>
<td>15.5</td>
<td>1.0</td>
</tr>
<tr>
<td>2025/2015., supply gap percent</td>
<td>+92</td>
<td>+106.6</td>
<td>+140</td>
<td>+233</td>
<td>+83</td>
<td>+57</td>
<td>+42.8</td>
<td>+200</td>
<td>+16.6</td>
</tr>
</tbody>
</table>

The SEE market is relatively small under conditions of current and future gas consumption. For this reason, investments into the development of energy infrastructures are even more challenging. If gas is acquired at reasonable prices, one can expect economic and profit margins of investments to be better.

Many countries in the region have one importer and one gas distribution company with the exception of Serbia, which has JugoRosGaz, distributing in the south and Srbijagas in the north and central parts of Serbia. Despite being a small country with low gas consumption, Bosnia and Herzegovina has three distribution companies. On the other hand, the situation and trend in the region call for greater number of distribution companies.

Table 6. Regional gas sector

<table>
<thead>
<tr>
<th>Market</th>
<th>Importers</th>
<th>Distribution Companies</th>
<th>Distribution Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania</td>
<td>Romgaz</td>
<td>Transgaz</td>
<td>Distrigaz Nort</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Distrigaz Sud</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Other small distribution companies</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Bulgargaz</td>
<td>Bulgargaz</td>
<td>Many</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Srbijagas</td>
</tr>
<tr>
<td>Serbia</td>
<td>JugoRosGaz</td>
<td>Srbijagas</td>
<td>JugorosGaz</td>
</tr>
<tr>
<td></td>
<td></td>
<td>JugorosGaz</td>
<td>Many other local</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>distribution companies</td>
</tr>
<tr>
<td>Croatia</td>
<td>INA</td>
<td>Plinacro</td>
<td>Many</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>Energoinvest</td>
<td>Gaspromet Pale</td>
<td>Zvornik Stan</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sarajevo Gas Lukovica</td>
<td>SarajvoGas Sarajevo</td>
</tr>
<tr>
<td></td>
<td></td>
<td>BHGas Sarajevo</td>
<td>SarajevoGAs Lukavica</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Visokogas</td>
<td></td>
</tr>
<tr>
<td>Macedonia</td>
<td>Makpetrol</td>
<td>GAMA</td>
<td></td>
</tr>
</tbody>
</table>

Since gas is supplied by one supplier, it is clear that potential sources of gas and supply routes for this region include, besides Russian gas (through existing and/or new routes), Caspian gas (Nabucco and/or other), and also gas from other southern sources (Iran, Iraq, Egypt). Additionally, a way to bridge the gas gap is by using liquid oil gas (which could be delivered via the Mediterranean from North Africa, Egypt, Libya and Algeria).

Potential large-scale regional projects, which would supply the EU and cover future demand of the SEE region, necessarily involve those who would drill Russian gas and those who would pump Caspian gas. It could hardly be possible to build all these pipelines, nor build competing pipelines (Nabucco and South Stream), primarily because of the pay off rate.
### Table 7. Potential Main Regional Projects

<table>
<thead>
<tr>
<th>Main Pipeline</th>
<th>Gas</th>
<th>Transit Countries</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>TGI Turkey – Greece – Italy</td>
<td>Caspian</td>
<td>Turkey, Greece, Italy</td>
<td>Edison (Italy), DEPA (Greece), i Botas (Turkey)</td>
</tr>
<tr>
<td>TAP Trans Adriatic Gas</td>
<td>Caspian and/or Russian</td>
<td>Turkey, Greece, Albania and Italy</td>
<td>EGL, Swiss</td>
</tr>
<tr>
<td>IAP Ionina Adriatic Pipeline</td>
<td>Caspian</td>
<td>Turkey, Greece, Macedonia, Kosovo, Montenegro, Bosnia and Herzegovina, Croatia, Slovenia, Italy</td>
<td>EGL, Swiss, Plinacro, Croatia</td>
</tr>
<tr>
<td>Nabucco</td>
<td>Caspian</td>
<td>Turkey, Bulgaria, Romania, Hungary, Austria</td>
<td>Botas (Turkey), Bulgargaz (Bulgaria), Transgaz (Romania), Mol (Hungary), i OMV (Austria)</td>
</tr>
<tr>
<td>GUEU White Stream</td>
<td>Caspian, Azerbaijan</td>
<td>Georgia, Romania or Georgia Ukraine, Romania or Georgia, Croatia Poland</td>
<td>GUEU Inc, Private consortium, registered in the US</td>
</tr>
<tr>
<td>Blue Line, Blue stream II</td>
<td>Russian, Turkmen, via Russia</td>
<td>Bulgaria, Serbia, Bosnia and Herzegovina, Croatia</td>
<td>Gazprom</td>
</tr>
<tr>
<td>South Stream, Nord Stream</td>
<td>Russian, Turkmen, via Russia</td>
<td>Bulgaria, Romania, Hungary</td>
<td>Gazprom</td>
</tr>
</tbody>
</table>

To resolve the situation and ensure the security of supply for European consumers in forthcoming years, something more is needed other than measures and changes in strategic plans, such as the new EU directive on increasing the security of gas supply to the EU⁹. It is necessary to reach an agreement between the main stakeholders, in the first instance, the EU and Russia, and subsequently, the transit countries, such as those in the SEE region and countries which are potential additional suppliers from the Caspian region. The common objective for all is to secure sufficient and economically sound gas supplies from viable energy sources. The dynamics behind the construction of gas and oil pipelines will depend on the maturity of the ‘shadow ruler’: politics and its sphere of interests.

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⁹ The New EU Directive on the Security of Gas Supply (July 2009) obliges member states to undertake a series of activities to prevent potential interruptions in gas supply. By March 2014, they should have either secured sufficient capacities of gas storage or diversified their energy offer to withstand a minimum of 60 days interruption of gas supply. By 31 March 2010, an Emergency Plan should be defined and on 31 March 2014 member states should confirm that they have the gas infrastructure specified in the Directive.
Russian Energy Policy and the Balkans

Milan Simurdić*

Basic postulates of Russian Foreign Energy Policy

If one considers foreign policy as an extension of internal policy of a kind, then that postulate can significantly facilitate the analysis of Russian foreign energy policy, including its implementation in the Balkan region.¹ The overview shall limit itself to natural gas, with occasional references to oil, as an inevitable other side of the coin in Russian energy policy. First, a few notes on gas. Unlike oil, which is traded on the world spot market, gas is transported to its final consumers mainly through gas pipelines. Gas pipelines often extend across several states, representing different political and economic systems. This makes it a sensitive product, susceptible to different influences (political, economic, geographical, etc.), along the whole chain – from the producer through the transit states, until it reaches the consumer. In another words, gas is an overtly geopolitical commodity.² It is estimated that the “geopolitics of energy relations has replaced or absorbed the traditional geopolitics of military balances”.³

Natural gas is considered as the fuel of the future, both because of the vast reserves available and because of its ecological acceptability. Gas combustion emits around 40 percent less harmful gases than coal and 30 percent less than oil. As the issue of climate change slowly progresses to the top of the world agenda, this becomes an additional argument to label gas as the fuel of the future. Estimates testify that gas will be the fastest growing source of primary energy in the world: over the next few years it will overtake coal in importance and consumption, and, by 2050, it will also overtake oil. Its use and cost-efficiency in the chemical and metal industries and, especially in the production of electricity, makes gas more than simply a source of energy.⁴


¹ To understand the significance of oil and gas for Russia, it is sufficient to note that almost one half of the GDP, almost two thirds of export profits and one half of the state revenues come from that sector. See: „Cevovodi, politika i moć“ [Pipelines, Politics and Power], Center for European Reform, London, translation into Serbian, European Movement in Serbia, Belgrade, 2009, page 3

² The use of the term geopolitics here is based on the definition given by J. Barnes, M.H.Hayes, A.M.Jaffe and D.G.Victor in the Foreword to the book Natural Gas and Geopolitics-from 1970 to 2040, Cambridge University Press, Cambridge, 2006. According to them, geopolitics is the influence of geographical, cultural, demographic, economic and technological factors on the political discourse between actors in the international sphere. „In this definition, relative gains matter, but so do joint gains from possible cooperation“, say the authors and point out that states which decide to import large quantities of gas put the security of their energy systems partly into the hands of others. This, in return, gives suppliers and users of gas a share in the internal political stability of the other side. Therefore, what we mean by gas geopolitics – is not only an endless race for global position, but also large political actions of governments, investors and other key proponents who decide which gas projects will be built, how the profit will be shared and risks managed, depending on the international gas trade.


⁴ The world’s gas reserves are focused in a relatively small number of states: only five states control 67 percent of worlds gas reserves – Russia, Iran, Qatar, Saudi Arabia and the United Arab Emirates. Russia possesses 27 percent of gas reserves, and together with Iran it controls almost one half of the world’s confirmed reserves. Moscow will surely remain the main world gas producer in the next few decades. By comparison, the US possesses 3 percent. Russia’s reserves are in locations distant from the areas of major future demand – the US, the EU, China, India and Brazil. For this reason it is estimated that the growing role of gas will increasingly influence relations between producers and consumers and thereby the worlds political scene. Around 80 percent of world’s gas reserves, but also oil reserves, are property of or under control of exporting countries or their energy companies.
To address such an ambitious topic, we shall take a look at several elements: the basis of Russian energy policy, connections with its Foreign Policy Concept and with the National Security Strategy. We shall see how it has influenced the Balkan region during the last two years, since Russia initiated the South Stream gas pipeline project. This leads us also to the EU energy policy, which overlaps with Russian energy policy, and not only in gas, but also in transit countries and in the Balkans. Since gas pipelines are long term and complex projects, it is inevitable to return to the issue of gas sources. Finally, we shall try to offer basic conclusions and prognoses.

The starting points of contemporary Russian energy policy are defined in the document: “The Energy Strategy of Russia for the Period up to 2020”, adopted in 2003. The initial statement is that “Russia possesses great energy resources – its territory contains 1/3 of the world’s natural gas reserves, 1/10 of oil reserves, 1/5 of coal reserves and 14 percent of uranium reserves”. The energy policy should be directed towards a change from raw material supplier to active participant on the global market, which is a task of strategic importance. This ensures Russia’s energy security and its position as a stable and reliable partner of the European countries and the world community. The strategy identifies Europe and Asia as the primary markets for Russian foreign energy policy stating that a common energy policy and transport and energy infrastructure in the regions of Europe and Asia fit within Russian strategic interests, indiscriminately providing transit of energy. The document underlines that the state will foster the participation of Russian enterprises in development and construction of great international transport projects for gas, oil and energy in both western and eastern directions. The following section is also wordy of attention: For Russia, which has a unique geographical and geopolitical position, issues of transit has a special meaning...The markets of Central and Western Europe remain among the greatest markets in the forthcoming 20 years. The Russian 2008 Foreign Policy Concept only briefly touches upon energy. However, it puts forward significant tasks for Russian diplomacy:

Strengthen strategic partnership with the leading producers of energy resources, develop active dialogue with consuming countries and transit countries...assuming that measures, being taken to guarantee reliability of energy supplies, should be consistently supported by forthcoming activities aimed at ensuring stability of demand and secure transit.

It is also worthwhile to consider the special attention given to energy producers in the Middle East, which is defined as being of strategic significance to Russia’s national interests. Considering the previous National Security Strategy, energy has received a more prominent place in the new text, with regards to two aspects: as a resource and as a security matter. Energy is represented as an instrument of power which strengthens Moscow’s position in international affairs and secures resources for strategic deterrence. Therefore, when the former Russian president Putin stated in 2005 that “Russia does not have other areas in which to be a leader”, he was underlining an evident truth, since Russia has natural and technological potentials, which offer it a leading role in the global energy sector. At a meeting of the

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6 Unlike consumers for whom energy security means stable, reliable and per acceptable prices supply of energy sources (oil and gas) for producers it means stable and predictable demand and prices which, as a rule, justifies large investments in research, production and transport of energy.
7 The Foreign Policy of the Russian Federation, 12.07.2008, see: www.kremlin.ru
Gazprom represents the embodiment of the Russian foreign energy policy.\textsuperscript{10} It is a company whose majority shareholder is the state.\textsuperscript{11} It came into being from the Soviet Ministry for Gas and, basically, it was conceived to unite systems for the exploitation and transportation of gas in Russia, Ukraine and Belarus. It controls around 80 percent of Russian gas reserves and the entire gas infrastructure, i.e. transport and transit gas networks.\textsuperscript{12} Gazprom has not been privatized as the oil industry has. Although there are no disputes over the assessment that Gazprom’s intention is to control the entire gas pipeline from the source, through transit to the buyers in foreign markets, opinions differ about the background of such a policy. According to some, Gazprom has not given up its intention to control the gas distribution system, especially in Central and Eastern Europe.\textsuperscript{13} He, who controls the pipeline, controls the buyer.\textsuperscript{14} This opinion is contrasted by assessments that Gazprom, like Russia, wants to make money, be strong, rich and respected. Gazprom’s moves are wrongly interpreted as a means of some political strategy: energy is a political business, but it is business first and foremost.\textsuperscript{15}

The dominant word from the abovementioned documents is exactly transit. It is of key importance for Russian foreign energy policy. For Russia it is equally important to maintain both transit monopoly as well as a decisive influence on energy affairs in the post – Soviet area, i.e. in its strategic “nearby neighbourhood”. Russia would like to prevent what happened in the case of oil: the BTC pipeline, which took Caspian oil to the Mediterranean, circumventing Russian territory.\textsuperscript{16}

\textbf{Russian Energy Policy and the Balkans}

Russian energy policy in the Balkans could be viewed as part of the competition for access, control and influence over the oil and gas business, especially in the Caspian basin and in Central Asia.\textsuperscript{17} The Balkans represent the final stage of oil and gas delivery from that region towards, in the case of gas and gas pipelines – the European markets and, in the case of oil, to sea ports transporting oil further to the world market. More and more, the Balkan region is being connected to the “New Great Game”, i.e. the modern re-run of the struggle between

\begin{itemize}
\item\textsuperscript{9} Russia: Is the Georgian Gas Crisis Evidence of Moscow’s New Energy Strategy, \textit{RFE/RL}, 23.01.2006, \url{http://www.rferl.org/content/article/1064978.html}
\item\textsuperscript{10} This year’s Forbes list puts Gazprom at 22\textsuperscript{nd} place of 500 most successful companies of the world; another energy company, Royal Dutch Shell holds the first place.
\item\textsuperscript{11} \textit{Moscow Times} reported on 27 May 2009 that Gazprom used to be at a third place of the list of the biggest energy companies in the world a year ago, with market capital of $350 billion. This year it fell to 40\textsuperscript{th} place with capital of $120 billion.
\item\textsuperscript{12} Gazprom controls almost 160,000 km of gas pipelines, with 218 pumping stations and 25 underground storages. The system transported 714 billion m\textsuperscript{3} of gas in 2008, \url{http://eng.gazpromquestions.ru/index.php?id=6}
\item\textsuperscript{13} See: Gazprom’s Expansion in the EU: Co-operation or Domination, Agota Loskot-Strachota, Center for Eastern Studies, Warsaw, 2008, \url{http://www.isn.ethz.ch/isn/Digital-Library}
\item\textsuperscript{14} Roman Kupchinsky, Russia: Does Gazprom Have a Master Pipeline Plan, \textit{RFE/RL}, 30. January 2006. \url{http://www.rferl.org/content/article/1065233.html}
\item\textsuperscript{15} Dimitri Trenin, Geopolitika energije u odnosima Rusija-EU, “Cevovodi, politika i moć” “[Pipelines, Politics and Power]”, Center for European Reform, London, translation into Serbian language, European Movement in Serbia Belgrade, 2009, page 23
\item\textsuperscript{16} It is important to note that it is extremely important for Russia to keep Iran, which has the second largest gas reserves in the world, under its influence for the longest possible time, and outside of the reach of the European buyers. The strategic partnership with Teheran enables Moscow to only flirt for now, with the idea of forming Gas OPEC, i.e. the cartelization of the gas trade.
\item\textsuperscript{17} Milan Simurdić, „Geopolitika prirodnog gasa” [The Geopolitics of Natural Gas], feuilleton, \textit{Economist journal}, Belgrade, March – May 2008, issues 409-415
\end{itemize}
Imperial Britain and Imperial Russia of the XIX century for influence in Central Asia. Historical parallels aside, the position of today’s stakeholders, and their numbers, have grown into several conflicting lines of divisions. The dissolution of the Soviet Union has opened the possibility for foreign companies to enter the oil and gas rich Caspian region and Central Asia. The US has formulated the “East – West Corridor Strategy”, which would lead to the opening of this region for exploitation and transit of energy, through the Black Sea, the Caucasus and the Caspian Sea. Essentially, the EU supports this concept and strives to arrive on the scene of energy sources in those regions independently, offering the concept of the New Silk Road. China counts on the same region with increased engagement. It has succeeded in entering into long term oil and gas purchase contracts with Kazakhstan and Turkmenistan. Russia views this with some suspicion, reacting to this with intents to preserve its Soviet era primacy, both in access to sources and oil and gas transit, which it wishes to direct through its own territory.

One study of Russian presence in the region estimates that

\[
\text{Russian energy strategy is based on the principle of keeping control over Central Asian resources, both energy production and transit, as long as possible, as well as gaining stakes in infrastructure and energy companies downstream in Europe.}
\]

Russian interest in energy in the region began during the Soviet era in seventies, when fast and comprehensive gasification started in the former USSR and the countries gathered around the Council for Mutual Economic Assistance (COMECON). The first oil embargo after the Arab – Israeli conflict in 1973 influenced this, turning European consumers towards the USSR’s oil supply. This also led European countries to an insufficiently used energy source – gas. At the time, gas arrived to Yugoslavia, through Hungary. The dissolution of the USSR and changes in COMECON halted the spread of gas deals. The dismemberment of Yugoslavia and subsequent wars put an end to the gas deals in the Balkans. However, already in 1996 a joint Russian – Serbian Enterprise, Jugorosgaz, was formed, and in 2006 Serbia was offered participation in the Blue Stream II project, which was the predecessor of the current South Stream.

The South Stream gas pipeline project depicts the contemporary phase of Russian energy policy in the region. It was launched as a Russian – Italian project of Gazprom and ENI, immediately before the energy summit in Zagreb in 2007. Russian President Putin elaborated Russian energy policy in the Balkans in the following manner:

\[
\text{Our strategic objective is to ensure access to reliable energy supplies for all countries in the region. Our policies take into account the Balkan countries’ increasing involvement in the European integration process, and we are ready to develop our relations in cooperation with the European Union.}
\]

21 It reached western parts of Yugoslavia – Slovenia and Croatia – through Austria, and not through the pipeline along Yugoslav territory;
22 It could be interesting to point out that Gazprom was formed on the model of the Italian energy concern ENI, see text in Russian daily Kommersant, 30 August 2008, at: http://www.kommersant.com/p845604/Gazprom_Business_Gas/
He emphasized that “Russian relations with its partners in the Balkans have traditionally been based on mutual sympathy, common spiritual traditions, the closeness of our languages and cultures and a common history.” Putin’s comment that “the project to develop the gas network in Macedonia and expand the gas pipeline network to Albania, Southern Serbia and Kosovo” confirm that this was entirely conceived through a regional approach. Numerous contacts followed and basic agreements on the construction of the South Stream gas pipeline were signed with countries on the potential route on its northern branch - Serbia and Hungary, on southern branch - Bulgaria and Greece, while negotiations with Austria and Slovenia are still underway. For now, it is a preliminary non-binding document, as the final feasibility study will be completed by the end of 2010. It is worth noting that Russian diplomacy advocates the inclusion of as many states as possible into the gas pipeline project.

The project of the South Stream gas pipeline met with many comments. Most analysts emphasize transit as the primary feature of the region, but more and more point to the significance of the Balkan market. Essentially, there are both economic and geopolitical reasons in play. There are assessments that Moscow is aware of European strivings to diversify its gas supply, therefore Russia strives to consolidate its own position in the Balkan states, above all, on their energy markets, because, they will be future EU member states. In this context it is emphasized that the Balkans have long had the image of being a special sphere of Russian interests, and they will hardly get rid of this image in the near future. This can be read as a Russian wish to create a counterbalance to the Balkan states’ tendency towards NATO and the EU. Russian energy interests are fundamental in strengthening Russian influence in the Balkans and South-East Europe. They are a part of the Russian energy strategy towards the EU, with the South Stream and the Burgas – Alexandropulos oil pipelines, as the key projects. Russian energy policy in the Balkans meets two aspects of the EU energy policy. First, a significant number of Balkan stakeholders are already EU member states (Greece, Romania, Bulgaria), and apply the common EU energy policy, which is still predominantly within the competence of EU member states. Brussels also increases engagement on two fronts: strengthening the internal market regulations and better connectedness of gas pipeline infrastructure and intensive foreign energy policy focused on finding new sources of supply. Second, those Balkan states which are not the EU members are, however, stakeholders of the Stabilization and Association Agreements with an open prospective for membership. Simultaneously, through membership in the Energy Community, they are, de facto, integrated in the internal EU energy market. These countries took upon themselves an obligation to implement EU regulations pertaining to gas and electricity. This means that in the Balkan region Russian energy policy converges with the EU policy, which has ambitions to expand its regulations to Russian ‘nearby neighbourhood’ as well. This is done through the export of its regulative norms and through expanding the validity of the rules of its internal market, thereby strengthening its energy security.

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23 Putin’s speech at the Zagreb Energy Summit, 24 June 2007, at: www.kremlin.ru
24 More about South Stream at: www.gazprom.ru
For both stakeholders, the transit significance of the region takes priority. In the case of Russia, it is about an alternative to over-dependence on the Ukrainian transit routes (around 80 percent), while for the EU it is about striving to reduce dependence on Russian gas (an average 25 percent of consumption and around 40 percent of gas imports) and form supply routes independent of Russia. The competition is depicted in the two projects: South Stream and Nabucco. Notwithstanding balanced official statements on both sides, according to which these two projects are not at odds with each other, observers’ and analysts’ rhetoric sounds like the pipeline war. Roughly speaking, South Stream can probably count on enough gas, but has uncertain delivery. Also, the entire route on the southern and northern branch from the Bulgarian diverging point has not yet been completed. Nabucco, on the other hand, has buyers, but, at this stage, insufficient gas. Nabucco counts on strong United States support. The EU possesses significant leverage of influence through regulations of the gas market, which South Stream has yet to establish. Both projects have to face the economic and financial crisis and, also, the fall in demands for gas.\(^{30}\) Essentially, these are two approaches to energy policy. Russia, whose pipelines almost exclusively lead to the West, stands for vertically integrated – monopoly companies such as Gazprom, while the EU stands for liberalized market, antitrust regulations and competition.\(^{31}\)

The accelerated gas diplomacy, along the entire energy chain is visible, especially with regards to South Stream and Nabucco. The construction of the gas pipeline entails four phases: conceptual, political, commercial and the phase of construction. Both projects are in the middle, between the political and commercial phases. Now is the time to draw a line – the final feasibility study for South Stream arrives next year, when the financial framework for Nabucco is also due. When one looks at the broadest picture conceivable, it is quite possible that the reset of relations between Washington and Moscow will grasp this topic and answer the questions whether the energy security is a matter of cooperation or competition. This has been confirmed by the White House with the announcement of talks on cooperation in the energy sphere, especially talks about diversification of supplies around Russia and the region in a manner which is not defined as a “zero sum game”.\(^{32}\) Part of the answer could come relatively quickly, yet this does not mean that the global energy equation and its regional, Balkan counterpart will be resolved soon.

**Conclusions, Prognosis**

The Russian energy strategy in the Balkans is an integral part of the entire foreign policy posture of Russia in the region – the first echelon of advance. Russian energy interests and plans coincide with the region’s approach to the EU. The Balkan states are already EU members, or are, indirectly, through the Energy Community, integrated into the EU. Energy lies within Russia – the EU core relations, which means that the Balkans are a part of the institutionalized Russia – EU energy dialogue, on the side of Brussels. That process has only started and one could expect that Russia will strive to, before the full integration of the region into the EU, strengthen its presence to the fullest extent. This dialogue does not take place in a


\(^{31}\) In the European Council for Foreign Relation’s study „How to Deal with Russian Gas“, author Pierre Noel states that since 1980 the import of Russian (Soviet) gas has been reduced by one half, from 80 percent to 40 percent. Russian gas now represents only 6.5 percent of the primary energy supply of the EU, which has been almost unvaried for 20 years. This will, as the author states, remain so in the near future. The problem, Noel claims, is not dependence, but divisions in the EU, so the real response is the strengthening of the internal gas market in the EU. The study is available at www.ecfr.org

vacuum and is significantly influenced by trends in international affairs. This dialogue contains both elements of cooperation and of competition. The process has two dimensions: political and economical, which are intertwined, mutually complementing and dynamically rotating. On one side, politics or even geopolitics has the upper hand, while, the other, is economy dominated. What is politics for one side, could be economics for the other, and vice-versa. Energy security has become part of the national security strategy, both for Russia and the EU, which, additionally, increases the significance of this topic. The predominant opinion is that the EU and Russia are mutually interdependent and that this is one of the key long-term factors in their mutual relations. The issue, whether Russia invests enough in new gas sources and transport networks, is beside the point. Buyers in the EU fear that under the conditions of permanent growth of gas demand in Russia and low investments in new fields, one could see a significant reduction in Russian gas export quantities in the future. A new formula for mutual dependence is necessary. Russia needs finances and technology, while the EU needs Russian gas.

The economic and financial crisis, followed by a drop in gas demand may, in the short, or even mid-term, influence Russian foreign energy policy. Successive gas crises in Moscow – Kiev relations had damaged trust in the reliability of Russian gas exports. The conflict in Georgia in 2008 adversely affected the geopolitics of gas. Projects, which depend more on geopolitics then economics, might wait for a more suitable time for resolution. However, once drawn, gas pipeline and oil pipeline routes live their own life, independent of implementation and could significantly influence the policies of all stakeholders.

The continuation of gas and oil pipeline competitions in the Balkans in the “zero sum game” manner, does not lead to a sustainable solution. Mutually beneficial win – win combinations are necessary, instead of mutually exclusive projects. For Serbia, alongside the desirability of South Stream, different sources and directions of gas supply are a priority. One should not doubt that a wide and branched gas pipeline infrastructure in the region is, indeed, important for the stabilization of the region. Once built, gas pipelines, especially in a regulated environment, with predictable and transparent rules, add to stability.