



South Stream has yet to be built, construction on Nord Stream has already started. Photo: Wintershall

South Stream: a grand geopolitical gamble

On the 23rd of June 2007, the Russian energy colossus Gazprom and the Italian oil company Eni, signed a momentous accord for the building of a 3,200 km long gas pipeline running from the Black Sea port of Berezovaya to various points in western and eastern Europe. The project, South Stream - the sister pipeline to the Nord Stream pipeline that is being built from Russia to Germany - has far-reaching economic and political ramifications, and will influence energy policies on a Pan-European scale.

| *By Ioannis Michaletos*

The South Stream cooperation memorandum between Gazprom and Eni, in which Greece and Bulgaria participate, sets out the construction of an underwater pipeline that transfers natural gas first over a distance of 900 km from the Russian Black Sea port of Bregovaya to Burgas in Bulgaria. After that, the pipeline will split into two "Streams" - one southwest to mainland Greece and southern Italy (Otrando) via another underwater pipeline. The other route northwest will pass through Bulgaria, Romania, Serbia, Slovenia and Hungary, and terminates in the Central-European markets. The total network has an estimated length of 3,200km, a transport capacity of approximately 30 billion cubic meters (bcm) of natural gas per annum, and will cost \$14-15 billion to build. Construction is scheduled to start at the end of 2008. The two companies each hold a 50% stake in the South Stream venture, whilst the other participating countries must reach individual agreements concerning passage dues in the future.

Both Eni and Gazprom are, of course, quite positive about the agreement. Eni believes that 'following the commercial agreements and Eni's entry in Russian upstream production, this new agreement further strengthens the alliance between Eni and Gazprom and will make a significant contribution to improving the security of the energy supply for the European Union'. According to Saipem, the energy consultancy of Eni which was responsible for the technical feasibility study of the South Stream venture, 'preliminary studies indicate that the costs are comparable with the development of an LNG chain - liquefaction plants, ships and re-gasification plants'.

A spokeswoman from Gazprom notes that Italy is important to the Russian company as the third largest gas market in Europe, after the UK and Germany, and the second largest importer of Russian gas in Europe after Germany. Italy imported 86% of its gas needs, with the bulk coming from Russia and Algeria and is heavily

dependent on gas: 30% of its primary energy consumption derives from natural gas. Gazprom supplies gas to Italy under five long-term contracts. In 2005 it delivered 22 bcm to Italy. In 2006, Italy received 24 bcm from Russia and 20 bcm from Algeria. Italy has been buying gas from Russian giant Gazprom since their ground-breaking deal in 1969, and the two countries have a long history in energy cooperation. This latest development, which occurs in conjunction with the Burgas-Alexandroupoli oil-pipeline deal, signed between Greece, Bulgaria and Russia in March 2007, heralds the dawn of a new era for the wider southeastern European region that will be characterized by an increased role for Russian exports.

For all this, the question is whether South Stream will actually ever be built. The significant issue is the actual cost of the project and the partners' ability to deliver profit to their shareholders. If the pipeline cannot become profitable,

that 'small amounts of Turkmen gas will also be exported through the pipeline'. Recently, Turkmenistan signed a deal with Russia to raise its price of gas by 50% from \$100 per 1,000 cubic meters to \$150. The price rise will facilitate plans for the future construction of a new Caspian pipeline from Turkmenistan to Russia via Kazakhstan. Consequently, this gas might eventually flow to Europe. So the hypothesis that South Stream may be using Turkmen gas might be valid in the long term.

The United States is looking with concern at the South Stream venture. 'It would not be beneficial for European energy stability to commit resources and political capital into forging very strong ties with the Putin administration', says an American diplomat and energy expert in Athens who does not want to be named. 'South Stream seems to be a very expensive and technically complicated project and it would be beneficial if other

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it would constitute a political rather than an economic initiative. Professor Jonathan Stern, Director of Gas Research of the prestigious Oxford Institute for Energy Studies, points out to European Energy Review that 'it is not quite sure yet that the pipeline project will go ahead after all. It seems that the main motive behind it is to bypass existing transit countries. Technology and cost are still the main difficulties in relation to its construction'. In relation to the source of the gas to fill the pipeline, Stern assumes that 'it will originate from Russia; more specifically, it is the same gas currently flowing through the Ukraine'. Stern does not believe that the pipeline, if it is constructed, will have an effect on gas prices in Europe.

Totalitarian |

Theodoros Tsakiris, an energy expert at the Athens-based IENE Institute, assumes

networks would run in parallel with it so as to have a pluralist transportation of energy commodities'.

A Russian diplomat and energy expert in Athens said he was confident that 'South Stream will provide economic benefits to all countries involved and it will assist to secure Europe's energy supply. I am sure that South Stream will go ahead and that the relations between all states and corporations involved are at a very good level'.

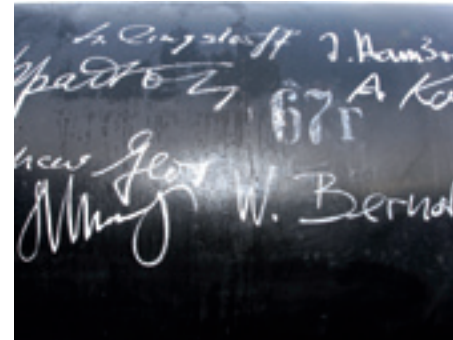
Vitalii Martynyuk, a political analyst for the Ukrainian Independent Political Research Centre, said that 'the geopolitical motive of Russia is to be the only gas producer and supplier amongst the post-Soviet countries by reselling Caspian gas (Kazakh and Turkmen) to Europe. Presently, the Blue Stream, the Ukrainian pipeline, and one other pipeline crossing Belarus are not enough for Russia to transport the gas to Europe'.



Stack of pipes at a construction of a gas pipeline.
Photo: Ashley Cooper, Corbis



Working on Nord Stream. Photo: Wintershall



Signatures of ceo's on the first sections of Nord Stream. Photo: Wintershall

The role of the EU may be important in future negotiations. 'The EU may try to discourage Russian ownership of the pipeline, but they will not succeed', Professor Stern comments.

Having alternative routes for the transportation of natural gas, thus gaining the advantage of not having to rely on certain countries, might explain the political motives behind the Russian point of view. Vladimir Socor, analyst for Eastern European Affairs of the Jamestown Foundation and a columnist of the Wall Street Journal, says 'Russia is putting a multiplicity of options on the table, so as to pressure countries it regards as recalcitrant into transportation deals that are favorable to Moscow. Therefore, instead of investing in extraction in Russia itself, Gazprom is mainly interested in the construction or capture of assets in Europe'.

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According to a spokeswoman from Gazprom, both Nord Stream and South Stream are 'steps towards the execution of Gazprom's strategy on route diversification of Russian natural-gas supplies to European countries'. Stern agrees: 'The two pipelines will certainly be complementary and in no case competitive with each other'.

Perilous situation |

Dr. Konstantinos Philis, an expert on post-Soviet Russia and Director of the Athens-

based Center for Eurasia Studies, is certain that 'Moscow supports South Stream because it excludes Turkey and Ukraine to a great extent. From a Russian point of view it is important to secure alternative routes so as to be able to predict any geopolitical difficulties. Bulgaria, Greece and Italy also like to import gas via various routes in order to have a stable energy flow regardless of what happens in their neighboring states'.

Recent developments in Turkey and the Ukraine, such as the delicate social balance in Ankara between Kemalists and Islamists and the perennial "Kurdish issue", along with the Russian-American rivalry for influence in Kiev, have certainly set off alarm bells in Sofia, Athens, and Rome, all of whom are desperately seeking to secure imports in order to address their rising energy needs. The perilous situation in the Middle East and the record oil price makes natural gas a safer choice, despite

the fact that it ultimately leads to a greater reliance on Russia.

Philis is convinced that 'South Stream is not viable as far as the economics are concerned, and the political motivation is the driving force of this pipeline'.

The effects of South Stream on the Ukraine, increasingly a political hotbed for the US and Russia, should not be underestimated. The analyst Martynyuk tells EER: 'For now the Ukraine is an equal negotiator with

Russia, because the former owns the pipeline with the largest transport capacity (180 bcm per annum). The new pipelines, including South Stream (30 billion cubic meters) and Nord Stream (55 bcm) weaken the Ukraine's position significantly, and ultimately that means that Russia might dictate the rules of the game by playing its natural-gas card'.

So, some conclusions can be drawn at this point. First, the economics of the pipeline are questionable. Geopolitical motives seem at least as important at this point. The Russians are seeking to gain more clout in their energy-export negotiations with Europe and to isolate the Ukraine. At the same time, the pipeline might bind the Central-Asian states closer to Moscow, since these have few other options to get their commodities to the West.

Second, the project will not have any effect on reducing gas prices in Europe, since Gazprom is actually strengthening its role as a producer and distributor.

Third, the political landscape of southeastern Europe might change to some extent, and the Russian influence will be supported by a system of pipelines and associated investments. Russian-American relations could become even more strained.

Fourthly, Italy and Europe are following a policy of gaining access to Russian gas imports regardless of the political motives, most likely because all other alternatives are less interesting at the moment. Russia will clearly gain advantages and more footholds in the market and at the same time it is revealing the grander strategy of regaining lost influence, especially in the Ukraine. ■