

PROSPECTS FOR ENERGY INTERACTION WITHIN THE SCO

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Reliable energy provision is an important factor of sustainable development and political stability in the world. Not only growth of the global economy, but also the population's quality of life depend on the uninterrupted and efficient functioning of the energy industry, since it is the latter that ensures each and everyone access to the primary benefits of civilization.

During the past 2-3 years, the growth rates in demand on the energy market have exceeded all expectations, with China and other developing Asian countries taking the lead in this respect. In particular, the demand for oil increased in the PRC by 15.4% (whereby there has been a double-digit increase in this index for the second year in a row).¹

Questions of energy provision and, more broadly speaking, energy security are currently occupying the minds of politicians and scientists alike, as well as of the ordinary people. Everyone has come to understand that the world must be viewed as a single whole in this area, and this topic has become a regular feature in discussions of our planet's present and future.

These concerns and searches for solutions can be seen at the global, regional, and even subregional levels. At the last G-8 summit, the Russian president raised the issue of energy supply, which became one of the central topics on the forum's agenda.

Kazakhstan President Nursultan Nazarbaev came forward with the idea of drawing up an Asian energy strategy. The Kazakhstan side has still not presented a developed vision of this conception, but the very call for a common Asian solution to the energy problem is of course not accidental and deserves attention. The fact that energy security has also been placed on the agenda of a multi-profile association like the Asia-Pacific Economic Cooperation Forum also speaks in favor of this attitude.

Specific efforts are being exerted at the subregional level to create a regulation mechanism. For example, in particular, the Declaration on East Asian Energy Security adopted at the January 2007 East Asia summit held on the Philippine island of Cebu and bringing together 16 countries of East and South Asia, as well as of the southern part of the Pacific Ocean, aroused great interest.

It stands to reason that, in this case, we are talking more about a declaration of intent, while practical implementation of the ideas envisaged in the document is something for the future. Nevertheless, the APR is taking the first steps to create a mechanism of consultations regarding the energy problem in Northeast Asia. As early as August 2005, the U.S., followed by the Republic of Korea, spoke in favor of creating a five-sided Energy Forum of the NEA states, with the intention that Japan, the PRC, and Russia would also join it.

These considerations were specified through the foreign ministries and ministries of energy with subsequent involvement of the business community. The structure is already in operation (admittedly without Russia's participation), but there is still not enough information on its specific activity to carry out analysis and forecasts. We can only rely on the preliminary arguments expressed by the founders when the issue was first considered.

The new structure appears to be seen as a dialog on the problems of energy, development, and the transfer of pure energy technology as a regional specification of the global initiative called Asia-Pacific Partnership on Clean Development and Climate. Four blocks of issues were to be discussed—multilateral cooperation in energy, supply and demand on the world energy resource market, the functioning of global markets of hydrocarbons, and raising the energy efficiency of the world economy. Special attention was given to the creation of strategic reserves of energy resources, the progress of pipeline infrastructure and the investment climate, the prospects for world oil and gas markets, and the development of new technologies in all the energy spheres. The American side, as stands to reason, wanted the NEA Energy Forum to discuss broad aspects of security, including unresolved territorial disputes in the region.

Judging from the above, the impression is created that Washington and the subregional capitals allied with it have primarily aimed, by means of the new structure, to ensure diversification of their sources of energy resource supply and uninterrupted deliveries in the region (in order to counterbalance the import of oil and gas from the politically unstable countries of the Middle East).

¹ See: *China Statistical Yearbook*, China Statistics Press, Beijing, 2006.

The feeling unwittingly arises that one of the tasks of the NEA Energy Forum is to maintain control over deliverers and rival consumers. No mention has been made so far about measures for assisting them, for example, technological help to improve the production of energy resources or economize on their expenditure. This could be perceived as a form of unilateral pressure and not a format of equal interaction. We will stipulate again that there are not enough data so far for drawing final conclusions. However, there is quite a widespread tendency recently to engage in one-sided criticism of manufacturers or of “those consuming far too much.” We believe that setting some partners off against others is unproductive in the post-confrontational world built on principles of multipolarity, mutual respect, and mutual benefit. After all, the recognized interdependence among the countries on our planet has long been manifested in the fact that manufacturers, transit countries, and importers are partners and not adversaries.

The same moods, worries, and intention to seek a solution to common problems that is acceptable to everyone are also characteristic of the Shanghai Cooperation Organization region. The influence of geopolitical factors, the development of partnership between Russia and China in the energy sphere, the PRC’s interest in developing Central Asia’s hydrocarbon fields, as well as the striving of the Central Asian republics to ensure the reliable sale of energy resources are giving rise to the need to structuralize relations in the energy sector of this region. The SCO with its perfect system of consensus structures is, in our opinion, the necessary foundation for mutually advantageous ties between energy resource deliverers and consumers, keeping in mind the position of the transit countries as well.

Questions of energy supply are extremely pertinent for the SCO members. In particular, it can be said that poor diversification of oil import sources is arousing serious concern among Chinese experts. Today, approximately half of the import of this raw material is ensured by deliveries from the Middle East. By 2010, this region’s share in imports could increase to 80%. The worries are aggravated by the region’s susceptibility to armed conflicts. So the PRC is trying not to become dependent on this region.²

Many Chinese experts regard Russia as the most promising partner, the priority ranking of which is defined in particular by two circumstances. First, the complementariness of the two countries’ interests: the Russian Federation has to develop the oil and gas resources of Siberia and the Far East, and China has to diversify its energy sources. Second, territorial proximity, which makes it possible to carry out deliveries of high-quality resources at optimal prices.

In fact, Russian-Chinese interaction in the energy industry has already accumulated vast practical experience; there are also corresponding mechanisms. For example, the Russian-Chinese Sub-Commission on Cooperation is regularly and actively functioning in the energy industry.

The Sub-Commission’s work has been placed on a firm basis. As of the present, a Program for Creating a Unified Gas Production, Transportation and Supply System in East Siberia and the Far East has been fully drawn up in Russia taking into account the possible export of blue fuel to the markets of China and other Asia-Pacific Region countries. The fundamental principles of this program were approved by the Russian Federation government as early as March 2003.

An important aspect of the development of the Russian-Chinese energy dialog was Russian President Vladimir Putin’s visit to the PRC on 21-22 March, 2006. This visit resulted in signing memorandums on creating an energy alliance between the two states. These documents presume the drawing up of long-term contracts on deliveries of gas, oil, and electric power to China.

Specifically, energy cooperation between the two countries is going on in several areas.

² See: A.A. Volovich, “Kitai na energeticheskom rynke Blizhnego Vostoka,” available at [www.iimes.ru/rus/stat/2004/22-09-04.html], 12 June, 2007.

■ Gas Deliveries.

During the Russian president's above-mentioned visit, the Gazprom Company and the Chinese National Petroleum Corporation (CNPC) signed a Protocol on the Delivery of Natural Gas from Russia to the PRC, which stipulated the main terms with respect to deadlines, volumes, and routes (Western and Eastern) for blue fuel deliveries, as well as the principles for forming price formulas.

According to the above-mentioned document, China's need for natural gas from the Russian Federation will amount to 68 bcm by 2020, including via the Western route—30 bcm and via the Eastern—38 bcm.³

The sides' intention to participate both in the joint development of deposits and in building pipeline branches draws attention to itself. In particular, Russia is helping CNPC's subsidiary—the Huabei Oil Company—to carry out research work and build an underground gas storage facility in the province of Hebei at the Ren-11 oil field. On the other hand, in correspondence with the current Russian-Chinese intergovernmental agreements, TNC-BP has been working (since 1999) with CNPC on a project to develop the Kovykta Gas Condensate Field (KGCF) and build an export gas pipeline. In this way, the Russian Federation is providing its Chinese partners with access to truly unique supplies of raw gas. The Kovykta GCF is the most ready of the East Siberian fields for beginning industrial development. Production at this unique structure (up to 40 bcm a year for 30 years) will make it possible to fully satisfy the needs of the domestic regional market (4-5 bcm a year) and provide a new export channel for deliveries of Russian pipeline gas to the countries of Northeast Asia.⁴

■ Oil Deliveries.

This area is very extensive; much information has been published about it. We will not go into details, but present just two examples.

During Vladimir Putin's visit to the PRC, Rosneft and CNPC entered an Agreement on the Main Principles for Creating Joint Ventures in the Russian Federation and People's Republic of China to intensify cooperation in the oil industry. The purpose of the agreement was to create joint ventures for surveying and developing oil and gas fields in Russia, as well as for oil refining and the sale of petroleum products in China.

We can also refer to the Protocol signed by the Transneft Company and CNPC on the planning and building of an oil pipeline to the Skovorodino section-PRC border. Working groups have been created in compliance with this document, which are engaged in processing organizational and technical issues regarding the project.

Transneft is the general contractor and ordering party for drawing up a declaration of intent and investment feasibility evaluation for building the above-mentioned oil pipeline. The Russian company has finished drawing up the declaration of intent; the necessary information about the contents of the document has been passed on to the Chinese side. The investment feasibility study will be completed in 2007.

■ Electric Power Industry.

It goes without saying that the active company on the Russian side in this sphere is RAO UES of Russia's subsidiary INTER RAO UES Closed Joint-Stock Company. The company is delivering electric power to the border regions of the PRC's northeast provinces via two

³ See: M. Gafarly, "Moskva obespechit kitaitsev gazom, neftiu i elektroenergiey," *Novye izvestia*, 23 March, 2006; "Fitch: rezul'taty energodialoga RF i KNR neodnoznachny," available at [www.aksnews.ru/m/100357/fitch:_rezultaty_energodialoga_rf_i_knr_neodnoznachny.html], 12 June, 2007.

⁴ See: *Ibidem*.

interstate power transmission lines: Blagoveshchensk-Heihe and Sivaki-Shipazhan (with a branch to the Baina electric power substation).

Within the framework of the intended increase in the export of electric power to the border regions of China's northeast provinces, an investment project for building the Zavitaia-Xiongke line is being implemented in specific high-load areas (mainly the industrial zones being created), and the possibility of building an Obluchie-Luobei line is being considered.

In keeping with the *Definition of Conditions and Maximum Possible Volumes of Electric Power Export from Vostok Unified Energy System until 2020*, implemented by Dalenergo setproekt Open Joint-Stock Company, the areas for distributing the capacities of the Primoriye energy system, Primorskaia State District Power Plant-Raohe and Ussuriysk-Dongning, are also considered promising.

As a result of the activity carried out, on 21 March, 2006, the sides signed an agreement in Beijing on the comprehensive drawing up of a feasibility study for a project to deliver electric power from the Russian Federation to the PRC in keeping with the following stages:

- the first stage—from 2008, transmission capacity—600-720 MW, annual volume—3.6-4.3 billion kWh;
- the second stage—from 2010, transmission capacity—300 MW, annual volume—18 billion kWh;
- third stage—from 2015, transmission capacity—640 MW, annual volume—38.4 billion kWh.⁵

At present, the final system for distributing capacities and the export price for the first stage are being agreed upon.

As we know, Russia and China are also cooperating in this sphere to develop China's peaceful atomic power. In particular, Russian companies are participating in building the second line of the Tianwan Atomic Power Plant.

■ Development of Coal Deposits.

Coal energy, which was once subjected to ostracism and semi-neglect, is currently enjoying demand in the world economy once more due to the increase in the price of oil and the looming leap in gas prices. Russian-Chinese partnership is also focusing attention on it. For example, an agreement has been in effect since the end of 2005 between the Russian Tekhnopromexport Company and China's Shanxi International Electric Power Corporation on cooperation in building two coal thermal power plants: Ruiguang (2x300 MW) and Zhaoguang (2x600 MW).

■ Deliveries of Contemporary Equipment and Technology.

Both Russian companies and their solicitous rivals are pointing to the fact that Russia's innovative technology and state-of-the-art equipment (which is not the most expensive) are in great demand on the markets of the APR countries.

As for the Russian Federation and PRC, the SCO principle of reciprocity is frequently observed in this respect: Russian and Chinese corporations act on the basis of reciprocal deliveries. Here we can present the example of the above-mentioned Tekhnopromexport Company and the Shangdong Luneng Corporation which signed a memorandum on mutual understanding in 2006 envisaging joint participation in innovative projects and reciprocal deliveries of equipment during building projects, both in China and in Russia.

■ Financial Support of Energy Cooperation.

⁵ According to the information of RAO UES of Russia, available at [www.raoes.ru], 12 June, 2007.

The long-term nature and scope of Russian-Chinese interaction in the energy sphere require proper financing and bank services. The sides have accumulated extensive practical experience in this area; without aiming to shed light on all its details, I would like, as above, to present specific examples.

Russian banks are actively supporting Russian-Chinese trade and economic partnership. In January 2005, Vneshekonombank (VEB) drew a loan for 6 billion dollars from the China Development Bank and Eximbank for pre-export subsidizing of oil deliveries to the PRC. Vneshekonombank is servicing the contract between Transneft and CNPC for delivering crude oil from Russia to China.

VEB is also servicing the contract for the planning and building of the Tianwan Atomic Power Plant and is participating in building the Bureia Hydropower Plant. VEB is actively cooperating with the PRC State Committee on Development and Reforms within the framework of the project for creating the East Siberia-Pacific Ocean pipeline system, and has stable partnership relations with the China Development Bank and CNPC.

Cooperation with PRC counter agents in the energy sphere along VEB lines mainly features in the projects of the Silovye mashiny Open Joint-Stock Company and Ziomar Engineering Company, which are carrying out currency control transactions and guaranteed procedures through the aforementioned bank.

In this way, the large amount of work on the joint projects, interaction in all areas of the power industry (from processing to delivering energy to the end consumers), exchange of technology, and bank servicing of the transactions carried out could all form a solid foundation for active bilateral partnership between Russia and China, in so doing becoming the necessary basis on which a SCO Energy Club could be built in the future.

Another aspect of Russian-Chinese cooperation should be noted, which is probably not very interesting to the outside world, but is extremely important for Russian society. After all, big partnership can only be built on big social support. In the above-mentioned Program for Creating a Unified Gas Production, Transportation and Supply System in East Siberia and the Far East, the priority was placed in particular on satisfying the demand of Russian consumer's for blue fuel and providing Russia with stable supplies of gas by expanding the unified gas supply system to the East. As a result, the population of the Russian regions of Siberia and the Far East will gain access to reliable gas supply, including by carrying out a single export policy taking into account the current agreements on production sharing.

But nor should we forget the cooperation between the PRC and the Central Asian states, which is gaining momentum. The participation of Chinese companies in different joint projects, joint construction of oil and gas pipelines, and simply China's purchase of oil companies of the region's countries not only indicate China's immense cooperation experience with the Central Asian republics, but they are also being prompted to join forces in order to protect their interests in the energy sphere.

The idea of joining forces on the energy market within the SCO is a logical consequence of the new interest being shown in energy security on the agenda of international meetings. The heads of state and government are actively discussing the idea of uniting the energy potential of the region's countries.

For example, Russian Prime Minister Mikhail Fradkov suggested at a meeting of the SCO heads of government (23 September, 2004) that a conception of a single oil and gas transportation system be developed and a club of energy resource consumers and manufacturers be created within the SCO.

This problem was discussed at an international conference called "The Energy Market of Central Asia: Trends and Prospects," which was organized in Tashkent by the Center of Political Research of Uzbekistan on 6-7 December, 2005. During the event, several proposals were put forward on forming a

specialized structure that would ensure the interests both of the regional manufacturers and of the consumers of raw hydrocarbons. According to director of the Center of Political Research G. Karimova, a single energy space within the SCO—the SCO Energy Club—could become the formation capable of harmonizing interests.

This idea was repeatedly put forward by the Russian Federation at summits and large meetings, since creating a SCO energy market is in harmony with the task posed by President Putin to form a strategy aimed at achieving global energy security (the G8 summit, 15-17 July, 2006, St. Petersburg).

On 15 June, 2006, when talking in Shanghai at the anniversary meeting of the Council of Heads of State of SCO Member States in the extended format, Vladimir Putin officially put forward the idea of founding the Club: “I believe the proposal to create a SCO Energy Club to be pertinent. In so doing, Russia is looking at the possibility of financially supporting certain projects in the economic sphere.”⁶

The meeting of the Council of Heads of Government of SCO Member States held on 15 September, 2006 in Dushanbe raised more specific tasks for forming a single energy space. When talking at this event, Kazakhstan Prime Minister D. Akhmetov noted the need to begin discussing the idea of creating a single energy market within the SCO. A joint communiqué on the results of the Dushanbe meeting of premiers of the SCO member states noted the importance of forming and launching mechanisms for special working groups on fuel and energy industry issues.

The heads of government entrusted a special working group for fuel and energy industry issues to study, in the shortest time possible (in cooperation with the SCO Secretariat), the possibility of creating a SCO Energy Club. According to the present agreement, the Kazakhstani and Russian sides are to present their ideas to those concerned about holding in 2007 a meeting of the SCO member states’ heads of ministries and departments responsible for the fuel and energy industry.

We believe that forming a SCO Energy Club will make it possible to draw other large manufacturers, as well as energy consumers—Iran, India, and Pakistan—into a constructive dialog in the future. What is more, it will also be possible for other interested sides to join up. The idea of a club, and not a strictly structured formation, will make it possible to hold a broad dialog in terms of the number of participants and problems raised with the possibility of entering into specific agreements without rigid bureaucratic frameworks.

In order to successfully implement the project, it would be expedient to base the SCO Energy Club on long-term, reliable, environmentally acceptable energy supply at substantiated prices, which suit both the exporter countries and the consumers. Of course, transit countries should not be forgotten either.

We believe that a program of action on energy cooperation should be drawn up, which would include such elements as forming a unified electric power system, a trans-Asian gas pipeline, raising energy efficiency and energy conservation, developing renewable sources of energy, coordinating regional energy policy, and planning.

In addition to harmonizing the interests of the participants of a single SCO energy market, practical measures should be defined for ensuring stable supply of the traditional types of energy resources.

The first step toward implementing the idea should be to compile country reports on energy that include an analysis of the energy balance and policy in this sphere, a statistics section, and a review of the supply and predicted demand for energy resources. The main goal of this activity is to define specific areas of mutually advantageous energy cooperation among the region’s states.

The structure created will make it possible to find a conflict-free solution to the problem of surveying and developing raw hydrocarbon fields, define its transportation routes, become acquainted

⁶ Vladimir Putin’s speech at the SCO summit in Shanghai, 15 June, 2006, available at [www.kremlin.ru].

with precise data on the growth rates of demand for oil and gas of regional consignors, implement joint investment projects, and so on.

At the same time, the formation of a SCO Energy Club is not pursuing and should not pursue the goal of creating an alliance aimed against third parties. Incidentally, the member states are invariably emphasizing not the confrontational, but the cooperative nature of their organization. We believe that as an informal association of business circles, this Club can serve as a base for developing new ways of interaction on the global energy market. At present, it is precisely the SCO, by using its experience of consolidating efforts in the fight against terrorism, that can apply this experience to forming a general platform, principles, and practical characteristics of cooperation within the framework of the oil and gas markets.

In conclusion, when reviewing questions of SCO energy partnership, we will permit ourselves to discuss a topic not directly related to this, but which has been giving rise to heated arguments and even gloomy predictions in the expert community recently. We are talking about the idea roaming around in people's minds of creating something akin to OPEC in the gas industry.

In actual fact, the idea as such is suggesting itself in some sense. As most specialists have predicted, the role of gas in the global energy industry is growing; its prices will keep on rising. What is more, we should keep in mind that the global supplies of blue fuel are rapidly depleting (in particular in the U.S., its largest consumer). This will inevitably lead in the next 5-10 years to a rapid increase in demand for gas and, as a result, to tough competition on the corresponding market.

These trends could bring the situation to a point where both consumers and manufacturers feel a real need to coordinate their actions on the world commercial arena. This does not mean forming a gas cartel (although the idea might seem tempting to some manufacturers), but, primarily, ensuring a certain amount of stability on the global blue fuel market.

What is more, according to analysts' forecasts, regional differences in gas prices will gradually be eroded, and in this case the mentioned cartel could become a reality, even without its official institution.

The gas producers already have a contact mechanism, even if it is largely in the form of a dialog. As early as 2001, the Gas Exporting Countries Forum (GECF) made up of 15 states (including Algeria, Iran, and Russia) held its first meeting in Tehran. According to the Oxford Institute for Energy Studies, the GECF members account for more than 40% of the world's blue fuel production and its delivery via pipelines, and as far as supplies are concerned, they account for 80%. Nevertheless, the Forum has still not grown into a cartel, since its participants are of the most diverse opinions.⁷

Essentially all the gas produced at present—in contrast to oil—does not enter into free price bidding on the stock market: it is exported according to contracts which state the delivery volume and method of price calculation. This is preventing gas producing countries from coming to terms among themselves on a general price policy and dictating conditions to consumers. One of the differences between the gas and oil sectors is largely related to the fact that the largest amounts of gas (including liquefied) are transported by pipeline, they cannot be shipped like tankers of oil to different consumers at different ports, and this requires long-term contracts.

Incidentally, at the beginning of August 2006, Gazprom and its Algerian analog, Sonatrach, the two main gas deliverers in Europe, signed a Memorandum of Mutual Understanding which called for coordinating the price of blue fuel. In this way, the situation in GECF could change if a Russian-Algerian agreement is signed.

Domestic Russian problems could prevent GECF's rapid transformation into a "gas OPEC." Russian consumers are Gazprom's biggest customers, but they receive gas at the lowest prices. As a result, the company is not making any profit on its largest market. A cartel could, first, demand that

⁷ See: "Rossia peresmotrela otnoshenie k gazovomu karteliu," *Nezavisimaya gazeta*, 14 February, 2007.

everyone in Russia buy gas at world prices, and, second, insist on greater transparency of the Russian gas industry.

In this way, the idea of creating a SCO Energy Club is becoming increasingly pertinent. It will be based on the long-term and complicated relations of the East Asian energy security ring (Russia, India, China, and the Central Asian and Middle East countries) relating to production, transit, deliveries, and consumption of energy resources. This will make it possible to ensure a balanced approach to energy security issues throughout the Eurasian space, and in the future in the Asia-Pacific Region as well.

After developing on the basis of common interests in the gas sphere, the new structure will accumulate and acquire the experience needed for interacting and searching for solutions, will form a unified position and observe common interests in order to further transform into a full-fledged SCO Energy Club capable of resolving energy security questions relating to all types of energy resources.

The SCO states are well aware of the importance of cooperation in the gas sphere. As early as 2002, a joint statement was made at an unofficial CIS summit in Almaty by the heads of Kazakhstan, Turkmenistan, Uzbekistan, and Russia, with the active support of the meeting's organizer, Nursultan Nazarbaev, on cooperation in energy policy and protection of the interests of the gas producing countries.

The SCO participants are not undertaking any accelerated "cartelization" of the gas industry. For example, when answering a corresponding question at a joint press conference with Emir of Qatar, Sheikh Hamad bin Khalifa Al-Thani, held in February 2007, President Vladimir Putin subtly called the idea of creating a cartel "interesting."

In so doing, the platform of the SCO Energy Club could become an association of gas-exporting states, which would make it possible to take into account the interests of both the deliverers and the consumers. For it is precisely the Club's informality, as an open arena of opinion exchange, that makes it possible, in our opinion, to involve Russia, Kazakhstan, and Uzbekistan in its activity as members of the SCO, and Iran as observer. This same feature of the Energy Club could later open its doors to other producing countries too: Qatar, Algeria, Libya, and Turkmenistan. All together they will represent more than 60% of the world gas supplies.

It would be beneficial to use the potential of the SCO, to which Russia, Kazakhstan, Uzbekistan, and Iran (as the largest deliverers) belong with different statuses, as well as India and China (as the largest consumers), for achieving greater coordination of action between this club of importers and the consignors.

There may be no need to institute the Energy Club as an organization with a Charter, structure, and management bodies.

First of all, it would be expedient, with the help of the unofficial basis and discussion nature of the Club, to come to a general understanding on a multitude of issues, which include access to the transportation system and its progress, price formation, coordination of revenue, profitability of production and transportation, strategic planning, and forecasting of the development of the gas industry in the region.

The next step, which already technically designates the borders and composition of the Club, might be to draw up and sign a SCO Energy Club Memorandum, a document defining the purposes, tasks, and rules of conduct in the energy industry for those states wishing to join this Club.