

RESEARCH NOTE

Northeast Asia's Kovykta Conundrum: A Decade of Promise and Peril

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EXECUTIVE SUMMARY

This article seeks to explain why—despite the potential for gas from Siberia and the Russian Far East to provide greater energy security for Northeast Asia—a decade of negotiations has still not resulted in an agreement to construct the Kovykta pipeline.

MAIN ARGUMENT

Gas from Russia's Kovykta field has the potential not only to drastically reduce Northeast Asia's energy shortage but also to help diversify Northeast Asia's traditional sources of energy away from the Middle East.

The potential for Kovykta gas to reach any Northeast Asian country, however, has been delayed for over ten years due to the following factors:

- *The politics of route determination* ≈ Though routing the pipeline via North Korea and Mongolia would be cheaper, government and private sector sensitivities have resulted in proposed routes that circumvent the two countries and thus drive up the costs of any such pipeline.
- *Inherent complexities of gas investments* ≈ Natural gas is intrinsically more difficult to trade than oil, and gas deals require much more confidence, guarantees, and money from investors and governments.
- *Demand security* ≈ China's market is important to Kovykta's success. Despite plans for further gas market development, however, China's reliance on cheap coal has created a soft market for higher-priced gas.
- *Russia's resource nationalism* ≈ Rising oil prices have given Moscow impetus to renationalize Russia's energy sector, thereby both complicating negotiations and causing investors to be wary of a Russia that could use energy as a political weapon.

POLICY IMPLICATIONS

Though a more centralized role for Russia in the Kovykta project could speed the decisionmaking process, striking a price that suits both China and Russia will be the key determinant in the fate of the pipeline. Gazprom is currently focused on other projects, however, and Kovykta will possibly remain idle for several years to come. Not allowing Russia's giant gas field to have significant market outlets in Asia will keep gas prices higher than they would be otherwise, potentially diminish available supplies to the U.S. West Coast, and keep incentives in place for Asia to increase ties to "rogue" gas-supplier states such as Iran and Myanmar.

Energy security is gradually replacing the previous ideological confrontation that was characteristic of the Cold War to form a new security paradigm in the Asia-Pacific. Maintaining strong relations with Russia is extremely advantageous to regional states given that the import of oil and gas from Russia's Far East has the potential to enhance Northeast Asia's energy security interests by reducing domestic energy shortages and diversifying energy imports. Since the end of the Cold War, Russia has often been portrayed in Asia as a waning political and economic force. Since the dissolution of the Soviet Union, however, Russia has sought to become a pivotal regional player in Asia. Russian president Vladimir Putin clearly hopes to upgrade Russia's prestige and influence in the region by promoting his country's role both as an objective mediator and as a reliable energy supplier. In the last several years in particular Russia has demonstrated power and influence in the new geopolitical environment of high energy prices. With enormous oil and gas reserves in Siberia and the Far East, Russia has an economic interest in expanding the country's energy markets into the Asia-Pacific region.

Despite this great potential, the reality is that Russian energy projects have not emerged as a substantial functioning unit of economic activity thus far. The many efforts in the last ten years by Northeast Asian states—notably China, South Korea, and Japan—to exploit opportunities in Russia's Far East have had only marginal success. Gazprom is now in the midst of taking over controlling stakes in Russia's remaining foreign-owned energy projects. In mid-June of 2007 Gazprom took a majority share of the Kovykta gas field project by forcing TNK-BP out of the consortium. For ten years this gas field, located in Russia's Irkutsk region, has promised to be a keystone for physically connecting the nations of Northeast Asia in a way that no other energy project could. Though governments of China, Mongolia, South Korea, North Korea, and Japan have actively discussed Kovykta's development over the last decade, the development of gas pipelines from Russia has been extremely slow. Several factors have impeded progress, including China's underdeveloped and unpredictable gas market, issues related to regional distrust, political and commercial risks regarding pipeline routing options, the Asian financial crisis in the late 1990s, and Russia's renationalization of the energy sector. Gazprom's focus on westward exports and lack of technological expertise could seriously impair Russia's prospects for a greater share of Asian gas exports. As such, many consumer countries in Northeast Asia have held off on dealing with Russia and are beginning to turn elsewhere to fulfill future

gas needs. With little development having ensued since Gazprom's takeover of the Kovykta project, the fate of this venture is uncertain.

This article uses the case study of the Kovykta gas pipelines proposed in the region to illustrate both the potential for and the major obstacles to Russia becoming a major provider of energy security for Northeast Asia.

This article is divided into five sections:

- ≈ pp. 108–14 examine both the current state of natural gas development in South Korea and China and the overall benefits of potential Kovykta gas exports to the two countries
- ≈ pp. 114–21 outline Kovykta's changing development and export plans over the last ten years
- ≈ pp. 121–29 analyze the major economic obstacles to the development and export of Kovykta gas to Northeast Asia
- ≈ pp. 129–37 examine Russia's resource renationalization and other domestic factors that have impinged on the export of Kovykta gas to Northeast Asia
- ≈ pp. 137–40 consider the future outlook for Kovykta gas introduction into Northeast Asia and the geopolitical and economic implications for Asia and the United States

THE POTENTIAL BENEFITS OF KOVYKTA GAS DEVELOPMENT

Russia's Untapped Potential

Russia has been described as the world's "treasure trove" of gas. Around twenty new giant gas fields have been discovered in the last couple of decades, each containing over 500 billion cubic meters (bcm). These twenty fields comprise close to three-quarters of Russia's total gas reserves. Capable of producing as much as 130 bcm of natural gas by 2020—equivalent to the current level of Russia's gas exports to Europe—the Russian Far East can play a very important role in shaping cooperative energy schemes in Northeast Asia.¹ In the last ten years Northeast Asian governments and companies have made several attempts to capitalize on a number of major energy projects in the Russian Far East.

¹ See Stephen White, "Is Russia a Country in the Globalization Era?" (presentation prepared for conference on the Regional Cooperation of Northeast Asia and Russia's Globalization for the 21st Century, Seoul, South Korea, June 22–24, 2003); and Eugene M. Khartukov, "Russia," in *Rethinking Energy Security in East Asia*, ed. Paul B. Stares (Tokyo: Japan Center for International Exchange, 2000), 141.

One of Russia's largest gas fields is the Kovyktinskoye (Kovykta) gas condensate field. Discovered in 1987, this field contains an estimated two trillion cubic meters of natural gas and condensate.² Put into perspective, Kovykta contains more gas than the entire nation of Canada, the major supplier of gas to the United States. Due to the sheer size and location of the field, Kovykta's development represents a timely and important opportunity for China and South Korea. Development of this field as last proposed by the consortium—with 20 bcm per year going to China and 10 bcm per year going to South Korea—could hold many benefits for Russia. Development at this level could facilitate diversification of Russia's Europe-centric export market, increase government revenues, spur economic development in the desolate regions of the Russian Far East and Siberia, and promote regional energy integration.

With Gazprom's recent takeover of the project (discussed in detail below), pipeline development into Northeast Asia could—if planned carefully—represent a significant opportunity for Russia. The projected \$1.2–1.4 billion per year in annual tax revenues from the export of Kovykta gas by 2020 would benefit both the federal and local governments.³ In 2006 gas rents accounted for approximately half of Russia's total energy rents. Furthermore, Gazprom currently exports all of Russia's gas to Europe and Eurasia; a major pipeline to Northeast Asia could therefore diversify the company's export portfolio. In 2006 Gazprom produced 556 bcm of gas and exported around 260 bcm—approximately half the total—to Europe, the Baltic States, and Central Asia.⁴ Thus, potential Kovykta gas exports of around 30 bcm per year would represent over 10% of Gazprom's current exports.

As of early 2007, however, domestic consumption of gas supplied from the Kovykta field amounted to only 2 bcm. The main consumers of this initial production have been the sparse populations of Angarsk, Sayansk, Irkutsk, and Usolye-Sibirsk.⁵ These populations will never consume as much gas as this field could potentially produce. For the benefit of both the project consortium and the Russian state, Kovykta gas must reach Asian markets.

² "Kovykta Project," TNK-BP \approx <http://www.tnk-bp.com/operations/exploration-production/projects/kovykta/>.

³ Ibid.

⁴ "Gazprom Annual Report 2006," OAO Gazprom, 2006 \approx http://www.gazprom.com/documents/Report_Eng.pdf.

⁵ Ibid.