CHANGING MARKET DYNAMICS IN CENTRAL ASIA: DECLINING RUSSIAN INTERESTS AND AN EMERGING CHINESE PRESENCE *

Background

Control over the transportation of energy resources from Central Asia to Europe is a crucial determinant in Russia's energy and pipeline policies. Russia's pipeline policies have long been designed to ensure energy power via control of regional transportation infrastructure. This strategy blocks strategic pipeline projects seeking to bypass Russia's territory in the east-west direction from the Caspian Basin, and focuses on re-exporting natural gas from Central Asian producers and maintaining strategic grip over the natural gas deliveries to the European markets.

From the early 1990s, Russia, as a key importer of Central Asian gas, took control over the Central Asia-Center gas pipeline system. It bought and resold huge volumes of natural gas from Turkmenistan and Uzbekistan to the Europe, enjoying a monopoly in the European energy market and monopsony in Central Asian. However, starting from 2009 Gazprom drastically reduced natural gas supplies from Turkmenistan and Uzbekistan. In 2008 the company bought approximately 40 bcm of natural gas from Turkmenistan, and almost 15 bcm from Uzbekistan; by 2014 the total volumes of exported gas from these countries had decreased to 10 bcm and 4.5 bcm respectively.

Despite the significance of the region for Russia's energy security, Gazprom has continued cutting back on purchases. During the Investor Day held by Gazprom in Hong Kong in February 2015, the company Deputy Chairman Alexander Medvedev announced that Gazprom plans to reduce the volume of gas purchases from Uzbekistan and Turkmenistan down to 10 billion cubic meters in 2015. The company plans to reduce Turkmen gas purchases from 10 bcm to 4 bcm, and Uzbek gas purchases from 4.5 bcm to 1 bcm. This decision did not come as a surprise, as in October 2014, Gazprom's Marketing and Trading Director Pavel Oderov announced company's plan to continue reducing volumes of imported gas, as part of the company's revenue maximization policy through optimization of domestic production.

So the key questions at this point are: why is Gazprom continuing to cut back on purchases from Central Asia? Which factors have affected this decision? What are the implications of the decision for regional producers?

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The key argument presented by Gazprom officials is based on increasing domestic production. But this reasoning is somewhat problematic, since it fails to address the evident impact of other, more important factors, including the escalation of the Ukrainian crisis and shifting market dynamics.

**Analysis**

Energy decisions are frequently determined by political and economic dynamics. In the case of Russia and Central Asia, the historical trajectory of the decision reveals multiple influences. Based on different factors and conditional variables, the decision to reduce purchases is best analyzed in two phases: from 2009 till 2014 and from 2014 until the present. However, this categorization does not entail that the second phase emerged as a continuation of the first phase.

**First phase**

The first decision on reducing natural gas purchases from Turkmenistan dates back to the pipeline explosion in 2009, which resulted in the decline of imports and damaged energy relations between Turkmenistan and Russia. Moreover, the beginning of Russia's energy relationship with China and the construction of the Central Asia – China Gas pipeline system have opened up a new market; with its huge demand for Turkmen gas, this market has been accorded higher priority by Ashgabat.

In the case of Uzbekistan, the situation is a bit different. Uzbekistan is the third largest natural gas producer in Eurasia. However, the growing national consumption and aging energy infrastructure have slowed production and hindered the export of natural gas to Russia. The decline of production has weakened Uzbekistan’s position as reliable and stable supplier for Russia.

On the other hand, because of the rise of natural gas prices in Central Asia, reselling Turkmen and Uzbek gas became less profitable for Russia. Gazprom could optimize revenues by exploiting its own fields, instead of being a porter of gas for Central Asian suppliers. In sum, it is possible to argue that during the first phase, the decline in supply was driven by the internal interests of Russia, Uzbekistan and Turkmenistan.

**Second phase**

The more recent decision to reduce purchases should be reviewed from a different perspective, whereby external factors, especially the current Russian-Ukrainian crisis, play a more decisive role. For Russia, cutting off the natural gas supply to Ukraine and the EU sanctions affecting energy sector have negatively impacted the demand side. Gazprom’s statistics show that demand for Russian gas in the European markets has declined almost to 9%. A comparison of the data from 2013 and 2014 demonstrates that the volumes of exported natural gas from Russia to European markets have been decreased by 15 bcm. In 2013 Gazprom exported 162 bcm of natural gas to Europe, compared to 147.2 bcm in 2014.
Of course, the fall in European demand for Russian gas is not exclusively the result of the crisis in Ukraine. The warm winter of 2014 and the availability of alternative gas supplies in the form of LNG also have influenced the situation. Without a doubt, the ongoing Ukrainian-Russian conflict, political decisions aimed at weakening Russia’s political and economic power, and the intensification of the EU’s energy diversification policy have challenged Russia’s market position by increasing uncertainty around European demand for Russian gas in the near future.

It can be concluded that the latest decision to reduce purchases from Turkmenistan and Uzbekistan has been caused by the decline of the actual demand for Russian gas. By cutting back on purchases Russia can balance the difference between high production and low demand. This analysis demonstrates that these two phases do not follow on from one another in terms of causality, since the determinant factors are of different origins.

Implications for the region

Consequently, the next question is: “where will the 10 bcm Central Asian gas surplus go?”

Gazprom’s decision opens new market opportunities for Turkmenistan and Uzbekistan in the light of growing energy production in the region, and signals changes in the energy policy priorities of Central Asian producers. Russia is not the only player in the region engaged in energy projects with the regional producers. As part of their energy security strategies, regional producers are developing multi-vector gas export policies and are showing interest in cooperation with China, EU, Iran and Turkey.

Following the Gazprom decision, the State News Agency of Turkmenistan reported that Ashgabat would increase exports of natural gas to China through the Central Asia – China Gas Pipeline transmission system. Moreover, according to Ria Novosti, Uzbekistan plans to export an additional 10 bcm of natural gas to China in 2015. The decision to raise exported volumes to China was reached during the fall of 2014.

China’s increasing role in both the global energy market and the Central Asian region has caused a shift in market dynamics. Starting from the middle of the last decade, China has actively pursued a targeted pipeline strategy, transforming itself into the main consumer of the region’s natural gas resources.
By comparing volumes of natural gas exported to Russia and China, we can see that the drop in natural gas exports to Russia has coincided with increased natural gas imports by China via the Central Asia-China Gas Pipeline system. The pipeline system has three operational lines in parallel, each running for 1,830 kilometers through Turkmenistan, Uzbekistan and Kazakhstan, with an overall delivery capacity of 55 bcm. Moreover, in 2013, Uzbekistan and China began construction of the fourth line, with an annual transmission capacity of 30 bcm.

Further, EU member states have several times stressed their interest in energy cooperation with Central Asian suppliers, especially Turkmenistan. The EU is trying to get Turkmenistan involved in the Southern Gas Corridor, in order to diversify its supply sources. However, political, commercial and legal barriers have impeded involvement of Central Asian suppliers in SGC. Now, in the light of increasing Turkmen natural gas production, Gazprom’s decision can be considered as a window of opportunity for the EU. Indeed, the success in this regard depends on how effectiveness and intensity of the political actions undertaken by the EU and partner states involved in SGC.

At the moment, Central Asian suppliers are more interested in gaining access to the Asian market. Energy cooperation with China is more attractive for Central Asian producers, because political issues are not interlinked with commercial interests.

Conclusion

Political and economic factors affected the decision to reduce purchases of natural gas from Turkmenistan and Uzbekistan during the different time frames. However, it is difficult to link the causality of these decisions. The February 2015 decision flows from the decline of European demand for Russian gas as a result of the Russian-Ukrainian crisis, followed by Russia’s decision to cut off gas supplies to Ukraine. Russia needed Central Asian gas to meet the growing energy demand in the EU. Now, in the light of the demand decline and uncertainty of future demand, it makes more sense to reduce the surplus, in this case, natural gas imports from Turkmenistan and Uzbekistan.

In contrast, Central Asian suppliers needed Russia, because the Central Asia-Center gas pipeline system was only the means for natural gas transportation. The construction of the Central Asia–China Gas pipeline system has minimized Russia’s strategic importance for Turkmenistan and Uzbekistan in terms of energy politics, and continues to open new market opportunities for these countries.

The weakening of Russia’s economic presence in Central Asia opens up space for interactions between other regional actors. Indeed, the Asian market holds more appeal than the European market for Uzbekistan and Turkmenistan.
Moreover, growing energy demand in China and the increase in market shares of Central Asian suppliers within the Asian market provides certain level of sustainability, due to the absence of political concerns.

The entrance of Central Asian producers into the European energy market introduces some complications. As long as political factors continue to impede cooperation between the EU and Central Asian countries, Turkmenistan’s participation in the Southern Gas corridor is unlikely. The success of the EU in this regard depends on the political strategies of member states. Additionally, the Russian factor should not be forgotten. As long as Gazprom’s revenues are mostly dependent on the European market, Russia will continue to block the construction of the new pipeline system in the western direction.

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