

Putin Uses North Korean Summit to Make Energy Moves

Written by Ariel Cohen

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With the ink barely dry on the historic Trump-Kim summit agreement, Moscow is already maneuvering itself to take advantage of rapprochement on the Korean peninsula. The first order of business: reviving a decades - old energy megaproject that would connect Russian gas and the Trans-Siberian railroad to Seoul via North Korea. As concerning as it may seem for Washington, reinvigorated ties between Moscow and Seoul may prove a strong bargaining chip for Donald Trump in his forthcoming talks with Vladimir Putin -- rumored to take place in Vienna this July.

Over the weekend South Korean President Moon Jae-in met with Vladimir Putin to discuss potential trilateral economic cooperation involving Russia, South Korea, and the DPRK. The possibility of linking the three nations through critical infrastructure was discussed in-depth, as was the notion of a free-trade agreement (FTA). Though no documents have been signed, Moon expressed his intent to set an FTA process in motion that could boost Korea-Russia trade to USD \$30 billion by 2030.

Moon seemed to be living up to his “New Northern Policy,” which envisions greater collaboration with Moscow over of natural gas, railroads, shipping ports, electric power, agriculture and fisheries.

The trans-Korea gas pipeline is near the top of this infrastructure to-do list. Russia’s state-owned supplier Gazprom and Korea’s gas monopoly Kogas have been attempting to construct a pipeline carrying Russian gas to Korea via the DPRK since Putin visited Pyongyang in 2001 (plans for a joint power grid and railroad were also discussed) . Not surprisingly, attempts to finalize the project have been frustrated time and again by security concerns – much like the bedeviled Turkmenistan-Afghanistan-India Pipeline (TAPI). Infrastructure challenges further complicated matters, including different-sized rail gauges between Russia and the Koreas, as well as lack of power generation in Russia's remote Far East.

In 2011 Gazprom chairman Alexey Miller and Kogas president Choo Kangsoo felt that these obstacles could be overcome, and established a roadmap to pipe 7.5 million metric tons of gas per year (mt/y) from Vladivostok, Russia to Seoul under a 30-year contract. Some 700 kilometers of pipe would pass through North Korea – which would receive handsome transit

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fees. But due to the financial crises and the leadership transition in the DPRK shortly thereafter, the pipeline was delayed until 2015. Increased hostility on the Peninsula led to further delays until 2017.

Moscow and Seoul are hoping that recent pledges of denuclearization and sanctions relief could provide the window to make this arrangement possible. But what does each side stand to gain?

Russia is a classic Petro-state, relying disproportionately on oil and gas sales to meet its fiscal responsibilities. In 2017, hydrocarbon (oil, gas, coal) income accounted for nearly half of government revenues. With Europe experiencing falling gas prices, policy preferences for fuel mix diversification, and the specter of transit reliability issues, Russia is eager to pivot its business toward greener pastures in Northeast Asia. Indeed, as part of its 2030 Energy Strategy, Moscow wishes to diversify as much as 25% of its natural gas sales to Asia. As an added incentive, Russia's penetration of Asian energy markets could also yield geopolitical influence at the cost of her Western competition (Canada, Australia, U.S.) which is trying to establish its own foothold in the booming market.

For its part, Korea is one of the world's heaviest energy importers. The ROK purchases over 80% of the energy it uses from abroad, with that number closer to 99% for natural gas. Until it was surpassed by China in December of 2017, Korea was the number two liquid natural gas (LNG) importer behind Japan. Despite its drop in the global rankings, though, Korea will remain a dependable market for gas for years to come. South Korea has revised up its LNG demand projections for the next several years on the back of its efforts to reduce reliance on coal and nuclear for power generation, and is now forecast to grow to 40.49 million mt in 2031, up 11.1% from this year's estimated 36.46 million mt. Today the ROK imports in the neighborhood of 38 mt of LNG.

Korea is also cognizant of its over-reliance on Middle East gas suppliers, who together account for 90% of imports. From an energy security standpoint, Russia would add diversification to the ROK fuel mix.

Let's look at some numbers.

Kogas has term contracts for the following: Kogas has term contracts for the following: Qatar

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9.0 million mt/year; Malaysia 4.0 million mt/year; Oman 4.0 million per year; Australia 3.5 million mt/year; Yemen 2.0 million mt/year; Indonesia 1.7 million mt/year; Russia; 1.5 million mt/year; Brunei 1.0 million mt/year.

The company also started to import 2.8 million mt/year of LNG from the Sabine Pass terminal in Louisiana in June 2017 under a 20-year contract. Could Russia's 7.5 mt/y threaten to displace future U.S. LNG contracts as our export terminals come online? Possibly – but chances are that Korea would limit imports from less dependable Middle East providers before turning its back on U.S. supplies. In my estimation, market set price points will be the ultimate determining factor for Korea's Kogas.

While the United States should be wary of Seoul's growing closeness with Moscow, it can (and should) seize this to opportunity to bring Russia on board with North Korean denuclearization. Any lasting peace on the Peninsula will require buy-in from Russia, and now seems as good a chance as any.

Whether the trans-Korean pipeline finally comes to fruition is anyone's guess. The vested interests are certainly there, but Pyongyang and to an extent Moscow – which has used energy as a weapon in the past – are not famous for their reliability as trade partners. Mutual trust is something that will need to be established alongside a more conducive market environment for this deal to succeed. If it does, it has the potential to be a win-win-win situation for all those involved.

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