

## The declared end of South Stream and why nobody seems to care

Arno Behrens\*

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**M**ore than seven years after the South Stream pipeline project was first announced in June 2007, it finally seems to have been dropped by Russian President Vladimir Putin on his visit to Turkey this week. This CEPS Commentary looks at the ostensible reasons for President Putin's decision as well as what's potentially behind them. It concludes that the EU may actually benefit from this decision in being able to secure more gas with less political interference from Russia.

The primary reason for abandoning the project stated in President Putin's speech was that the European Commission had been "unconstructive". "It's not that the European Commission has helped to implement this project - it's that we see obstacles being created in its implementation".<sup>1</sup>

He is referring to the insistence by the European Commission for participating member states to respect internal market legislation and thus to carry out their obligations associated with the EU *acquis communautaire*. In particular, the Commission called on member states to comply with the Third Energy Package and the associated Gas Directive, which has two central elements: the effective separation of networks from supply ('unbundling') and non-discriminatory access by third parties to the infrastructure.

Against this background, the Commission in December 2013 found that the Intergovernmental Agreements (IGAs) for the construction of South Stream between Russia on the one hand and Austria, Bulgaria, Croatia, Greece, Hungary, Serbia and Slovenia on the other were all in breach of EU law *inter alia* regarding 'unbundling' and 'third party access'. Serbia, as a member of the Energy Community, is obliged to implement EU energy regulation as well. As the result, the Commission concluded that all IGAs needed to be renegotiated. However, such a reopening of the agreements evidently proved unacceptable to Russia, which argued that EU rules did not apply to trans-boundary projects with non-EU countries. It was thus international law that governed EU-Russia relations, rendering the IGAs valid.

In addition, the Commission opened an infringement procedure against Bulgaria for failing to implement rules on public procurement, which subsequently stopped construction activities

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<sup>1</sup> <http://eng.kremlin.ru/transcripts/23322>

\*With research assistance from Anna Dimitrova. Arno Behrens is Research Fellow and Head of the Energy research unit at CEPS.

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in June 2014. This meant that Bulgaria has made a decision to respect the rules of the internal market.

With his announcement of last week and the ‘threat’ to work on the construction of the pipeline by another route through Turkey, President Putin may have tried to divide the EU on the South Stream project ahead of the energy minister’s meeting in Brussels on December 9<sup>th</sup>. However, fears that such a potential ‘bluff’ might divide EU member states over this issue were dispelled by Commission President Juncker after a meeting with Bulgarian Prime Minister Borisov on Thursday, December 4<sup>th</sup>, when he declared that “we will not accept any blackmailing on energy matters”.

Although the legal arguments may have played a role in President Putin’s decision, it may actually have been the economic arguments that gave the final blow to the project. Although it has been argued that with the Russian economy on the brink of recession, oil prices at their lowest levels in the past five years and the Russian ruble continuing to lose ground it becomes increasingly difficult for Russia to finance projects as expensive as South Stream, such relative short- to medium-term considerations tend not to be grounds for terminating a project, certainly not in such an abrupt fashion. The real economic blow to the project originates from the fact that EU gas demand may never recover to the pre-crisis levels of 2008. In fact, from 2007 (the year that South Stream was announced) until 2014, the International Energy Agency has revised downwards its EU gas demand forecasts for the year 2030 by 18%.<sup>2</sup>

For the EU, all of this might actually be good news. While the Nabucco pipeline failed for a lack of sufficient gas supplies, South Stream may have failed largely because EU energy legislation was consequently applied against anti-competitive practices. These examples also show that commercially viable projects tend to be more successful than political ones. This is part of the reason why the Trans-Adriatic-Pipeline (TAP) bringing Azeri gas through Turkey to Greece and Italy is the only pipeline project currently left of the ‘southern gas corridor’. Incidentally, on December 1<sup>st</sup>, TAP completed the market test showing that it can accommodate demand for capacity in full compliance with applicable regulation.

Finally, the EU must now rethink its strategy for the ‘southern gas corridor’, which presents the opportunity to find new alternatives in view of a real diversification – both in sources and in routes. Such a strategy could constitute a compromise between the Nabucco approach and the South Stream projects in the sense that it could combine both non-Russian and Russian gas sources. There are plenty of options for non-Russian supplies, including from the Caspian region, the Middle East and the eastern Mediterranean. At the same time, Russian Gazprom and Turkish Botas have just agreed to convey 50 billion cubic metres of natural gas to the Turkish-Greek border.<sup>3</sup> In such a ‘South Stream light’ scenario, the EU may benefit from the possibility to build its own much-needed gas interconnectors in southeastern Europe without political interference from Russia, while ensuring that enough gas is available to fill them.

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<sup>2</sup> Comparing projections for 2030 in the Alternative Policy Scenario of the IEA World Energy Outlook 2007 with projections in the New Policies Scenario of the IEA World Energy Outlook 2014.

<sup>3</sup> <http://www.gazprom.com/press/news/2014/december/article208505/>