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INDEPENDENT NEWS FROM RUSSIA

Anticipated Chinese Gas Deal Falls Through

By Howard Amos

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Presidents Hu and Medvedev gathering with their wives at Medvedev's Gorki residence near Moscow last week. **Dmitry Astakhov**

ST. PETERSBURG — Moscow and Beijing have failed to conclude one of the biggest energy deals in history, estimated to be worth $700 billion over 30 years, to supply Siberian gas to the Chinese market amid an inability to resolve differences on pricing.

Signing an agreement would have resolved five years of unproductive talks between the two sides and was planned as the highlight of both the St. Petersburg International Economic Forum and a four-day visit by Chinese President Hu Jintao.

A supply deal is important for energy-hungry China, which saw its gas demand increase 22 percent in 2010, and for Russia, which is looking to diversify its exports away from Europe and to exploit Asian markets. But experts said neither side yet had a sufficiently strong reason to make the required compromise on price.

"We are very close to the final arrangement, but very often when you are close it is difficult to make the last step," Gazprom deputy head Alexander Medvedev said in comments carried by Bloomberg.

"I am sure that during this year an arrangement will be reached," he said.

Senior Russian and Chinese officials said previously that a deal would be reached by mid-2011.

"We would like this work to be completed before the start of the forum," Arkady Dvorkovich, economic aide to President Dmitry Medvedev, said in May. Deputy Prime Minister Igor Sechin had also forecast a mid-2011 agreement.

Even the participation of Prime Minister Vladimir Putin and Hu in discussions Thursday at Gazprom's Moscow headquarters failed to resolve the remaining problems.

Disagreements on the price of deliveries determined by any contract proved too entrenched to resolve. In a deal of this size, even a tiny alteration in price means a loss or gain of billions of dollars.

The price difference between Gazprom and China National Petroleum Company is reported to be about $100 per 1,000 cubic meters, with the two sides looking at a compromise of $250 to $350 per 1,000 cubic meters. Gazprom sold pipeline gas to Europe in the first half of 2011 for an average of $346 per 1,000 cubic meters and may raise the price for long-term contracts to $500 per 1,000 cubic meters by December on the back of high oil prices.

China is seeking a discount on the price at which Gazprom sells gas to its European customers.

During a meeting between Medvedev and chief executives from global energy companies at the St. Petersburg forum on Friday, 42 percent of participants predicted in a push-button poll that the gas price would average $300 to $400 in 2013. This group included Gazprom head Alexei Miller, according to the results of the poll posted online.

Despite the price differences, negotiations are unlikely to cease. .

"There should be no rush. We had a good chance to sign a deal during President Hu Jintao's visit to Russia, but both sides must show flexibility," said Energy Minister Sergei Shmatko.

"We expect talks to continue," he added, Reuters reported.

Alexander Medvedev, of Gazprom, stressed that a final decision would not depend on politics but economics. "It's the wrong assumption that companies can establish a price by themselves — market forces decide," he said.

Under the terms of an agreement signed in 2006, Gazprom is due to begin supplies of about 70 billion cubic meters of gas a year to CNPC in 2015. China consumed 107 billion cubic meters of gas in 2010.

But a senior banker in Moscow said this deadline could easily be pushed back.

In addition, the International Energy Agency, citing objective difficulties and the huge levels of necessary investment, did not factor a Russia-China gas deal into 2016 market forecasts it released last week.

China is developing other sources for the supply of gas to its domestic market. Regasification terminals for liquefied natural gas, or LNG, are being installed along its eastern coast, with an annual import capacity target of 64 billion cubic meters by 2015. The country's potential reserves of shale gas are thought to be substantial.

Russia does not need to compromise drastically on price, said the banker, because it believes that China has no choice but to turn sooner or later to Siberian pipeline gas. Coal is a highly polluting energy source, and LNG prices are predicted to rise, he added.

Despite a lack of immediate pressures on the two sides, it is unlikely an agreement that will be delayed forever.

"We're not at a critical juncture yet, but the deal is inevitable," he said.

In other energy news from the forum, BP chief Robert Dudley held closed meetings with Rosneft president Eduard Khudainatov and Gazprom CEO Miller. Asked about ongoing negotiations following the collapse of BP's $16 billion deal with Rosneft in May, Dudley told The Moscow Times on Friday that "there was no new news."

Khudainatov said Rosneft was aiming to pick an international partner to develop its Arctic reserves by late 2011.

Russia's fifth-largest oil company, Gazpromneft, and Anglo-Dutch oil major Shell signed a cooperation agreement Friday under which the two companies will look at joint ventures in both upstream and downstream projects in Western Siberia as well as in other domestic and international locations. The agreement was signed by Shell CEO Peter Voser and the chairman of Gazpromneft's management committee, Alexander Dyukov.

During a session with leading international financiers, Finance Minister Alexei Kudrin said oil and gas output accounts for 17 percent of the country's GDP, while producers contribute 35 percent to 40 percent of the government's revenue. The government needs the price of crude oil to average $115 a barrel to balance its budget, he said.