

New opening in energy relations between Bulgaria and Russia

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Last week has brought new developments in Bulgarian-Russian energy relations, when the Bulgarian government withdrew from a project to build a nuclear power plant in Belene. This meant the failure of its second flagship energy project developed jointly with Russia; last December, Sofia withdrew from the Burgas-Alexandroupolis (Bulgaria-Greece) oil pipeline project. At this stage, however, Moscow's reaction to Sofia's decisions has been surprisingly calm. Despite earlier announcements, the Russian companies have not brought actions for damages against Bulgaria. Moreover, Russia's Gazprom made a short-term 11-percent reduction in the price of gas to Bulgaria (to last until the end of this year) in exchange for a political declaration from Sofia that it will accelerate its consent for the construction of the South Stream gas pipeline.

Recent events have shown that a compromise solution on the most sensitive issue in relations between the two countries is slowly being drawn up. It seems that Bulgaria will agree to the quick construction of the South Stream gas pipeline, in exchange for preferential treatment for Russian gas supplies, and Russia not imposing any sanctions related to abandoning the construction of the Belene NPP. These arrangements appear to be beneficial for both countries. For Russia, constructing South Stream is a priority for its energy policy; however for Bulgaria, it is essential to maintain correct relations with Moscow and to minimise the potential financial losses associated with its withdrawal from the Belene project.

Bulgaria rationalises its approach to major energy projects

In the past four months, Bulgaria has withdrawn from two of the three strategic energy projects which it was implementing in cooperation with Moscow. Both of the abandoned projects were primarily political rather than economic in nature.

The Burgas-Alexandroupolis oil pipeline project served mainly to further the interests of Russia. Its plan included diversifying oil export routes and reducing dependence on transit through the Turkish straits. Bulgaria supported this initiative, seeing it as an opportunity to increase its own transit role in the region, and to emphasise its 'strategic' relations with Russia. But the project would not have provided many significant financial benefits for Bulgaria; their section of the pipeline would have been short, which would have translated into low transit revenues. The project also brought about serious objections from environmentalists and protests by local businesses, and so was ultimately abandoned.

Meanwhile, thanks to the Belene project, Bulgaria was to have become an electricity supplier to the Balkan states. This project was also a response to the EU's demand to close some of the reactors at the Kozloduy plant. However, the Belene project was not supported by reliable financial analyses or forecasts of electricity demand in the region. Additionally a number of errors were made while signing the contracts for the project. In 2008, Bulgaria signed a binding contract to build power plants with the Russian company Atomstroyeksport, despite the lack of sources for financing the investment, or of any strategic investor. Inaccurate records allowed the Russians to increase the contract's value of €4bn to €6.3bn, as a result of relying on a different method for indexing prices. According to the Bulgarian Prime Minister, Boyko Borisov, this would have led to the final construction cost rising to over €10bn. In the light of the problems with financing the project, and a dispute over the final construction costs which lasted over two years, Sofia decided to stop the investment. The Bulgarian government, however announced that one of the reactors planned for the power plant in Belene will be used in the power plant in Kozloduy, which is already in existence. Bulgaria has to date spent 700 million euros on the Belene project and has announced it will pay the Russian operators 140 million euros for the first reactor. It is unclear whether Russia's Atomstroyeksport will seek damages for the failure of the contract for the second reactor for Belene to be honoured

Russia's conciliatory attitude

Moscow's measured response to the failure of the Belene project and the trans-Balkan pipeline is probably due to the manoeuvring going on around the last of the three major projects: the South Stream gas pipeline. Bulgaria is crucial to this plan because of its geographical location. Moscow wants to obtain Sofia's rapid approval for its implementation, as some new elements of the EU's Third Energy Package are expected to come into force in March 2013; these could make it difficult for Moscow to obtain exemptions for the South Stream pipeline from European law. The pressure to get the pipeline project under way also derives from growing opportunities for the Caspian region, which is in competition with Russia, to supply the EU with gas. Bulgaria will thus seek to obtain additional benefits from rapidly approving South Stream's construction. Sofia is primarily interested in obtaining low gas prices and eliminating intermediaries in its trade with Russia. At the end of this year, the previous contracts for supplying Russian gas to

Bulgaria will expire. Sofia will also aim to guarantee high revenues from the South Stream transit pipeline, and also to make the principles of its operation transparent – something which will be extremely difficult for Russia to accept – in line with European legislation.

Bulgarian energy policy unlikely to be re-shaped

Bulgaria's abandonment of the projects to build a nuclear power plant in Belene and the Burgas-Alexandroupolis oil pipeline, together with its ongoing talks with Russia on cooperation in the gas sector (both in activating work on South Stream and the new gas contracts), have opened the door to a modification of the energy relationship between Russia and Bulgaria. By initiating a process of limiting the 'strategic' dimension of its energy relationship with Russia, Bulgaria has opened the way for implementing new priorities in its energy policy which will not necessarily be in line with Russia's interests. Reducing spending on major infrastructure projects will increase the chances of completing smaller energy projects, such as modernising coal-based power plants, expanding renewable energy sources, and raising the country's very low energy efficiency (Bulgaria has the most energy-intensive economy in the EU). This would reduce Bulgaria's dependence on Russian supplies.

However, the current energy policies are most likely to continue, because of the path dependency tendencies as well as high share of coal and nuclear power in Bulgaria's energy production (see Appendix). The preparations to modernise and expand the nuclear power plant at Kozloduy indicate that Bulgaria will continue to concentrate on developing nuclear energy. This will open the way for the Russian nuclear industry, which is a natural contender to modernise the Russian-based power plant technologies. It is also unlikely that Bulgaria will increase very low proportion of gas in its energy production. Under public pressure, the Bulgarian government introduced a total ban on the exploration and production of shale gas in January this year. The gas interconnectors currently being constructed will enable Bulgaria to reduce its dependence on Russian gas supplies, but is rather unlikely they will be a "game changer" in the process of setting priorities in Bulgarian energy policy.

Appendix.

Bulgaria's overall energy balance sheet in 2010

Figures in thousand tons of oil equivalent	Gross inland consumption	Primary production	Import	Export
Coal	6828	4 931	1700	46
Crude oil	6095	23	6072	-
Nuclear energy	3849	3849	-	-
Gas	2300	59	2 131	-
Renewable energy sources	917	779	7	63
Electricity	495	55	-	826
Total	17829	10234	11743	4507

Source: Bulgarian National Statistical Institute