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Southern Gas Corridor managed by Azerbaijan and Turkey

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The Southern Gas Corridor is a European Commission initiative with the aim of facilitating the diversification of the routes and sources of gas imported into Europe in the hope of reducing the EU's dependence on Russia. Although the Southern Gas Corridor – alongside the EU's flagship Nabucco project, which constitutes a part of the Corridor – was originally conceived as a means of furthering the interests of the West (officially the EU but in practice also the US), the implementation of the project has become possible almost exclusively thanks to measures taken by Azerbaijan and Turkey. Consequently, a project which the EU had hoped would protect its political interests has indirectly given Azerbaijan and Turkey considerable influence over the EU, since it is those two countries that have effectively begun to define the shape of the Southern Corridor. This became particularly clear when the Trans-Anatolian gas pipeline (TANAP) agreement was signed on 26 June 2012. If the EU wishes to ensure that the implementation of the Southern Gas Corridor project retains at least some of its original design, Brussels has little choice but to take into account the preferences of Azerbaijan and Turkey at the expense of its own original plans.

The Southern Gas Corridor – what is at stake?

Under the most ambitious scenario, the Southern Gas Corridor is to become the fourth major gas supply route into the EU, after the routes from Russia, Algeria and Norway – it would be an especially important route into Southern and Central Europe. The Southern Corridor is also seen as a way to gain access to additional gas supplies, which is particularly important bearing in mind the projected drop in gas production in Norway and the EU's reluctance to increase its reliance on Russian gas, not to mention the EU's objective of meeting its carbon emissions targets.

The Corridor was also an important element of EU policy on Turkey and potential gas suppliers. Under the original plans, Turkey was to become an 'energy bridge', which would forge a long-term link between Ankara and the EU. The EU had initially hoped to secure an agreement on unrestricted gas transit across Turkey (under the so-called Corridor Agreement), which would reduce Turkey's role to that of a 'transmission belt'; this idea, however, was subsequently rejected by Ankara.

In addition, the infrastructure built as part of the Southern Gas Corridor, or directly linked to the project, was meant to enable the import of gas from the Caspian Sea region (Azerbaijan, Turkmenistan, and in the future also from Kazakhstan and Iran) as well as from the Middle

East (from Egypt via the Arab Gas Pipeline, and from Iraq through new pipelines). Stronger energy links with these countries were aimed at strengthening the EU's position in the region and were to become one of the instruments used in the EU's foreign policy. It therefore follows that the Southern Gas Corridor is important geopolitically not only for the EU but also for the US, due to Washington's interests in the region. This was also the key reason why the US actively supported EU efforts to implement the project.

Since the project's inception, the route and scope of the Corridor has been seen as posing a challenge to the interests of the Russian gas monopoly Gazprom in the EU energy market

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as well as to Russia's political interests in the Caspian Sea region. Moscow has therefore been trying to block the implementation of the project by questioning its economic and technical feasibility. One way it attempted to achieve this aim was through support for the construction of an alternative pipeline – Blue Stream 2; currently

it is backing the South Stream project, which aims to supply gas to the same markets as the Southern Gas Corridor. In 2009, Russia agreed to pay more for gas from Central Asia in order to lower the interest of these gas producers in seeking alternative routes into Europe. It has also been offering to purchase all of the gas produced by the Shah Deniz field, which for the time being is the only secure source of gas for the Southern Corridor. So far, however, Moscow's efforts have not produced the desired results. The Southern Gas Corridor project will remain a key energy and geopolitical initiative for the European Union, and Azerbaijan continues to show interest in exporting its gas to the EU. What has changed, however, is the shape of the Corridor and the role of the individual actors involved in the implementation of the project.

The Evolution of positions on the Southern Gas Corridor

Under the Southern Gas Corridor initiative, the EU has been most active in supporting the Nabucco project; this is seen as the most ambitious of the proposals (involving the construction of the largest gas pipeline, with a maximum annual capacity of 60 bcm) and the one which most fully delivers on the strategic aims defined by the European Union. The European Commission could perhaps be accused of having tried to put pressure on Turkey and Azerbaijan to opt for this project¹ even though it was not in their national interests. Meanwhile, individual energy companies began proposing their own gas transit projects, especially the TAP and ITGI pipelines (for more information about alternative proposals see Appendix 2), which in turn weakened the bargaining power of the EU and gave Azerbaijan more choice. More recently, seeing that it could not impose its own terms on Baku and Ankara, the EU offered to support any project capable of achieving the same objectives as the Nabucco pipeline, while the Nabucco consortium proposed a watered-down version of its original project, known as Nabucco West. Following the difficulties in implementing the Nabucco project in its original form, the most active member of the consortium, Germany's RWE, announced in January of this year that it was considering withdrawing from the project altogether.

It should also be noted that over the last five years Baku's position in negotiations with individual consortia interested in promoting their own projects, as well as the position of the EU itself, has significantly strengthened. Azerbaijan's bargaining power increased following the failure of the EU to secure additional gas supplies for the Corridor (from Iraq and Turkmenistan), which left Azerbaijan as the only secure supplier for the whole project. In addition, Baku's revenue from oil exports has increased significantly, resulting in a greater

¹ This is best exemplified by the efforts of the European Commission to persuade Turkey to sign an intergovernmental Nabucco agreement in 2009. The agreement failed however to meet Turkey's national interests, which significantly contributed to the lack of support for the Nabucco project by Ankara.

confidence and assertiveness from the country. The projects supported by the EU under the Southern Gas Corridor initiative are effectively competing against each other – attempting to secure gas supplies for the Corridor from the same source, which allows Azerbaijan to play games with the individual consortia who attempt to put forward their own proposals. Moreover, Baku has begun to stress that it has other options than to transport its gas across Turkey and has started to propose its own solutions, such as transporting LNG to Romania (under the AGRI project), and has taken steps to diversify its gas export routes (under agreements to supply more gas to Iran and Russia). Baku's position was also strengthened by the financial crisis which continues to affect the EU, while Azerbaijan is benefiting from increased oil export revenue, allowing it to reduce its dependence on foreign investment. A clear shift in the approach to the project could also be seen in Turkey; the government here were interested in increasing gas imports from Azerbaijan at a competitive price but refused to assume only the role of a gas 'transmission belt' between Central Asia and Europe. It is also clear that Turkey wishes to play an important role in its relations with the EU and is not willing to give up its control over strategic projects carried out on Turkish territory. These ambitions, together with the failed 2008-2010 talks on the normalisation of Turkish-Armenian relations, caused tensions in Ankara's dialogue with Baku and delayed agreements on the purchase and transit of gas. In addition, following a drop in Turkey's interest in EU membership, Ankara has also become less interested in the EU's flagship Nabucco project. And although Turkey has never officially withdrawn from the Southern Corridor project, in practice it has abandoned its support for the pipeline.

TANAP – how Azerbaijan and Turkey are building the Southern Gas Corridor

A series of measures implemented by the European Commission, by energy companies, and above all by Baku and Ankara, have resulted over the last several months in the adoption of a new approach to the Southern Gas Corridor. This became possible after Azerbaijan and Turkey successfully overcame a political impasse and reached agreements on the transit and the supply of Azerbaijani gas to Turkey (October 2011). This new level of cooperation was subsequently sealed on 26 June 2012 when the countries signed an agreement on the construction of the Trans-Anatolian gas pipeline (TANAP).

According to media reports, the agreement gives Turkish companies a 20% stake in the TANAP project (Botas 10% and TPAO 10%), while Azerbaijan's SOCAR holds the remaining 80 per cent. Later, however, Turkish officials suggested that Ankara would like to increase

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its stake in the project, and SOCAR reported that it was interested in retaining 50% of the shares and selling the rest to foreign investors (BP was among the companies which expressed interest in investing in TANAP). The final division of the shares and the terms and conditions for the pipeline's operations are to be decided over the coming months. In the meantime,

the companies are to carry out a feasibility study, which is to be completed by the end of the year, and are expected to make a decision about which of the European pipelines TANAP should be linked with.

The TANAP pipeline, with an annual capacity of between 16 and 60 bcm (depending on the version of the project) will run only across Turkish territory, thus ensuring the safe transit of Azerbaijani gas to the Bulgarian border². In effect, by using the same strategic design

² The TANAP project was first unveiled in October 2011 at a meeting scheduled to sign gas transit agreements between Azerbaijan and Turkey.

³ In the first stage of the project, TANAP's annual capacity has been estimated at 16 bcm; in stage two, the capacity will increase to about 31 bcm.

as that proposed for the Southern Gas Corridor (the same source of gas, the same route and the same markets as suggested by the EU) Azerbaijan and Turkey have proposed a solution which gives them full control over the key section of the Southern Corridor. Baku and Ankara will consequently have the power to decide how much gas reaches EU markets and when it is delivered; it should also be stressed that in the future the pipeline could carry not only Azerbaijani gas but also gas from the Caspian Sea area and Iraq³.

As a consequence, both states have found themselves in a significantly stronger position in their relations with the EU. Both Turkey – seen initially as little more than a building site and a weaker partner in relations with the EU – and Azerbaijan – treated simply as a supplier – are now becoming key players who will define the shape and the future of the Southern Corridor. The decision to go ahead with the TANAP project means that the pipeline will no longer be used by Europe as a bargaining tool in its policies towards Azerbaijan and Turkey, but will instead give more powers to Azerbaijan and Turkey in their relations with the EU. Nonetheless, the construction of the TANAP pipeline and the arrival of Azerbaijani gas in Europe will address the EU's basic strategic interests, namely, the diversification of gas supply routes and suppliers.

Which market?

The appearance of the TANAP project on the agenda has also restricted the number of alternative routes considered by local gas producers who are interested in exporting gas to the EU. The Shah Deniz consortium has decided it is no longer interested in pursuing the ITGI and the SEEP alternative routes (abandoned in February and June of this year, respectively). The only thing which still remains uncertain is whether the Azerbaijani gas carried across Turkey via the TANAP pipeline will reach Central Europe (Baumgarten) through Nabucco West or whether it will be transported to Southern Europe (the Western Balkans and Italy) along the Trans-Adriatic route (TAP). The final decision will be made by Azerbaijan and will be based not only on the price offered for the gas but also on Baku's ability to purchase assets in the destination countries.

The Shah Deniz consortium (whose decisions are most strongly shaped by Baku) claims that by mid 2013 it will have decided whether its gas will be transported to Greece and Italy or to Central Europe. This means that over the coming months the competition between TAP and

Over the coming months the competition between TAP and Nabucco West will become much fiercer. It is also possible that the recently rejected proposal for the ITGI pipeline may re-enter the picture if Azerbaijan succeeds in purchasing assets in the Greek firm DEPA.

Nabucco West will become much fiercer⁴. It is also possible that the recently rejected proposal for the ITGI pipeline may re-enter the picture if Azerbaijan succeeds in purchasing assets in the Greek firm DEPA (this company is currently being privatised and it is one of the stakeholders in ITGI). Another important factor affecting the final shape the Southern Corridor will be the measures taken by Russia, both in the EU and across the Caucasus. Azerbaijan, particularly

due to the unresolved Nagorno-Karabakh conflict (in which Russia plays a central role), is not willing to take any steps that could be seen as detrimental to Moscow's strategic interests. This means that SOCAR may choose to avoid openly competing with Gazprom in the European energy market, possibly leading to a secret agreement between the companies on how the market could be divided. This, of course, would depend on whether Russia is interested in such an arrangement.

⁴ This can be seen in the two consortia's attempts to attract additional investors already involved in gas production in Azerbaijan, including BP, Statoil and Total.

Conclusions

The creation of the Southern Gas Corridor on a smaller scale, but consequently also on a smaller budget (using the TANAP pipeline instead of Nabucco) is currently the most realistic and probable solution. It therefore follows that the central role in shaping the Southern Corridor (including, the power to increase its capacity and use it to carry gas from other sources) will be played by Azerbaijan and Turkey, who have effectively 'hijacked' the EU idea. Consequently, the newly-built infrastructure will first and foremost serve Azerbaijani and Turkish interests in their future relations with the EU, rather than the other way round, as had been initially hoped for in Brussels.

Nonetheless, the construction of the TANAP pipeline will help the EU to secure its key strategic objective, namely the diversification of gas sources and supply routes. In this respect the EU has been successful, even though it will not have the final say in the future shape and the use of the Southern Corridor. The EU does however still have a chance to use Ankara's and Baku's conflicting interests to its own advantage, and to exert some influence on how TANAP is operated.

The signing of the TANAP agreement, which effectively meant the launch of the key stage in the implementation of the Southern Gas Corridor project, is detrimental to Russia's economic and political interests⁵ in the Caucasus, Turkey and across the European Union. It is therefore expected that Moscow will do its best to stop, or at least impede, the implementation of the Southern Corridor by, for example, speeding up its work on the South Stream project, in order to complete it before the launch of the Southern Corridor and to enter the lucrative EU markets first. Russia is also likely to use political pressure and 'gas blackmail' against the states and companies involved in the construction of the Southern Corridor. The most effective, although also the most risky, tool wielded by Moscow is the unresolved Nagorno-Karabakh conflict. The risk of further violence is increasing in line with the growing likelihood of a Western military intervention in Syria.

⁵ A Gazprom spokesperson has stated that Russia regrets Turkey's decision to join the project, and suggested that in the future, when Iran suspends its gas supplies to Ankara (which occurs relatively frequently as a result of terrorist attacks), Turkey should turn to Azerbaijan for help, and not to Russia as previously. Due to Turkey's limited gas storage capacity, the possibility of purchasing more gas from Russia (which meets around 60% of Turkey's gas demand) is key for the country's energy security.

APPENDIX 1

Source of gas for the Southern Gas Corridor

Currently, the only secured source of gas already for the Southern Corridor is in Azerbaijan, where the government has made a commitment to use its gas from the Shah Deniz II field to feed the new pipeline. The amount of gas available from the field has been estimated at 16 bcm a year, with a launch planned for 2017. In addition, Azerbaijan is planning to start production at the Umid and Babek fields, which are currently being explored by SOCAR. Experts have suggested that production could begin within the next 5 years, although no concrete development plans have yet been proposed (and no information has been released about the estimated gas production volumes). Azerbaijan also has gas fields in the Absheron Peninsula, where development work is being carried out by Total. According to initial estimates, this area could produce up to 300 bcm of gas annually. Sourcing gas for the Southern Corridor from other potential sources continues to be impossible: Iraq, Egypt and Iran remain out of the picture due to instability across the Middle East. Turkmenistan and Kazakhstan lacks the appropriate conditions to build the infrastructure required to export the gas across the Caspian Sea, particularly due to Russia's objections, a lack of funding, and Ashgabat's policies which keep investors away, as well as the Azerbaijani-Turkmen conflict over the Serdar/Kyapaz field, and Azerbaijan's lack of interest in competing for the European market.

APPENDIX 2

2. Most important projects for the extension of the TANAP pipeline into Europe

Nabucco West – faced with the lack of possibilities to implement the project in its original shape, the Nabucco consortium decided to scale down the project and put forward an alternative proposal called Nabucco West. The proposed pipeline has been envisaged as an extension for the planned TANAP pipeline running across Turkey, and is to carry the gas from the Turkish-Bulgarian border to Baumgarten. Its estimated capacity is not, though, expected to exceed 10 bcm a year. The proposal also shows that the Nabucco West pipeline would be built using the legal basis worked out for the original Nabucco project; consequently, the implementation of Nabucco West would not require any further agreements. The consortium has reported that among the companies interested in investing in the project are: BP, Statoil and Total. The cost of the project has not yet been officially estimated.

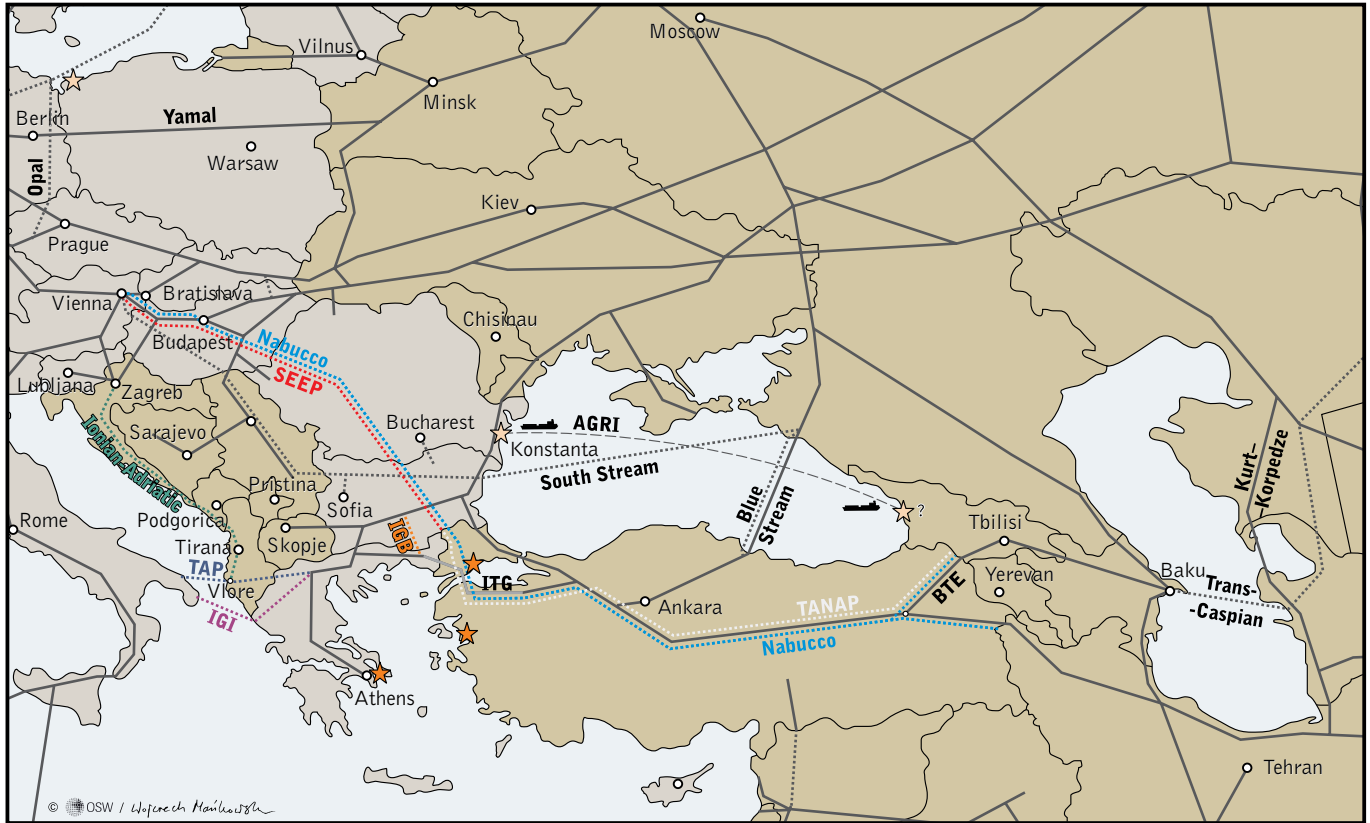
TAP – under the Trans Adriatic Pipeline project (estimated capacity of 10-20 bcm; stakeholders: Statoil – 42.5%, EGL – 42.5%, E.ON – 15%) the pipeline would be built from Greece, across Albania and the Adriatic Sea to Italy. The project also envisages the construction of storage facilities with a capacity of 8.5 bcm in Albania. The cost of the project has been estimated at 1.5-2 billion euros; TAP is the cheapest project proposed for the Southern Corridor. The TAP consortium has already signed memoranda of cooperation with companies involved in the construction of the Ionian-Adriatic Pipeline (designed to run from Albania along the coast to Croatia; with a capacity of 5 bcm). The IAP would allow the TAP pipeline to send its gas to a planned LNG terminal in Croatia. Following the decision of the Shah-Deniz consortium (in February 2012) to abandon the IGI project as a potential route for the export of gas to Italy, TAP is the only project which could enable the export of gas from the planned TANAP pipeline to the Italian market. This is also the only project which could facilitate the export of gas to the energy markets in the West Balkans; although these are poorly developed, they are believed to have great potential for future growth. The gas supplied to the TAP pipeline would come from the TANAP pipeline through the Interconnect Turkey-Greece (ITG).

SEEP – the South East European Pipeline was proposed in September 2011 by BP. Under this proposal, the newly constructed pipeline would start in Turkey and run across Bulgaria and Romania into Hungary (and possibly even to Baumgarten in Austria) – a route analogous to the route proposed for Nabucco West. BP claims that the project could be implemented by the members of the Shah Deniz consortium; in June 2012, however, the consortium rejected this proposal. The annual capacity of the pipeline has been estimated at 10 bcm. The cost of the project has not been disclosed.

ITGI – consists of several projects: the existing Interconnector Greece-Turkey ITG (stakeholders: Botas and DEPA) with an annual capacity of 11.7 bcm; the Interconnector Greece-Bulgaria IGB currently being constructed (shareholders: DEPA, EAD and Edison) with a maximum capacity of 5 bcm a year (the interconnector has received a European Commission grant worth 45 million euros) which is expected to be completed in early 2013; and a planned Interconnector Greece-Italy (known as IGI or Poseidon) with an annual capacity of 10 bcm – the shareholders in this project are Edison and DEPA.

MAP

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