Energy Security in the South Caucasus: The Southern Gas Corridor in its geopolitical environment

Veröffentlichungsversion / Published Version
Arbeitspapier / working paper

DGAPkompakt

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Januar 2014 N° 2
ISSN 2198-5936

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The Southern Gas Corridor in its geopolitical environment

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Summary / Zusammenfassung

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The Southern Gas Corridor was initiated by the European Commission to develop the necessary infrastructure between the wider Caspian region and Europe, in large part in order to diversify the EU's supply of gas away from Russia. Given this goal, discussion of the corridor and its key pipeline, the Nabucco project, have been politicized from the very beginning. The selection of the much smaller TAP and TANAP pipelines over Nabucco is above all an economic decision by the participating companies, which illustrates the limits of political influence on such expensive and complex investments. At the moment Azerbaijan is the only contributor to the Southern Gas Corridor, a country whose main interests are in further diversifying its export paths away from Russian pipelines and earning money in the EU. Nevertheless, the entire region—with Iranian, Iraqi, and Caspian gas—has huge energy potential for the EU.

Energiesicherheit im Südkaukasus

Der Südliche Gaskorridor in seinem geopolitischen Umfeld

von Stefan Meister

Der Südliche Gaskorridor wurde von der Europäischen Kommission initiiert, um die Gasversorgung der EU unabhängiger von Russland zu entwickeln und die kaspische Region mit Europa zu verbinden. Diese Politik war von Anfang an politisiert, da das Kernprojekt des Südlichen Gaskorridors, nämlich Nabucco, vor allem als Alternative zu russischem Gas diskutiert worden ist. Die Entscheidung der beteiligten Firmen gegen Nabucco und für TAP ist in erster Linie eine ökonomische Entscheidung, die die Grenzen von politischem Einfluss auf diese komplexen Investitionen zeigt. Im Moment ist Aserbaidschan der einzige Lieferant für den Südlichen Gaskorridor. Bakus Hauptinteresse ist, seine Energieexporte stärker von Russland zu diversifizieren und Geld in der EU zu verdienen. Jedoch hat die gesamte Region mit iranischem, irakischem und kaspischem Gas ein enormes Potenzial für Energielieferungen.

Energy Security in the South Caucasus

The Southern Gas Corridor in its geopolitical environment

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The Southern Gas Corridor

The Southern Gas Corridor was initiated by the European Commission (EC) to diversify the EU's supply of gas and develop the necessary infrastructure to transport gas from the Caspian region and Middle East—primarily Azerbaijan, Turkmenistan, Iran, and Iraq—to Europe. One main reason for the corridor is to create a supply route alternative to Russian pipelines and reserves. Due to political and economic concerns as well as a lack of developed gas resources and infrastructure, Azerbaijan remains the sole partner for this policy. The Azeri gas field Shah Deniz 2 was slated to be the main contributor to many highly contested pipeline projects: Nabucco (or a shorter version called Nabucco West); the Interconnector Turkey-Greece-Italy (ITGI); the Trans Adriatic Pipeline (TAP) and SEEP (South East European Pipeline). Following the Shaz Deniz consortium's decision in its favor in June 2013, TAP and TANAP will become the main link between Azerbaijan and the EU for the foreseeable future. A considerable number of investors are involved in this mega-project along the entire chain (SOCAR – State Oil Company of Azerbaijan Republic, BP, Total, Statoil, Botas, E.ON and others), which is reported to need above 40 billion dollars of investment this decade: a projected 28 billion dollars for producing the gas in Azerbaijan and transport it to the Turkish-Georgian border alone.

But TAP is only one important link in the chain between Azerbaijan and Europe. Gas will run through existing infrastructure, traveling first through the South Caucasus Pipeline crossing Azerbaijani and Georgian territory to eastern Turkey. From there it will be transported by the Trans-Anatolian Pipeline (TANAP), a joint venture of SOCAR, Turkish Botas and BP. SOCAR holds an 68%share in that project, 12% BP, 20% Botas. TANAP will run across Turkish territory with a capacity of 16 bcm (billion cubic meters) per year—6 bcm delivered to Turkey and 10 bcm to Europe. Thereafter the pipeline will connect to TAP (developed by Norway's Statoil, Switzerland's EGL, and Germany's E.ON) at the Greek border, shipping 10 bcm of gas per year with the option to increase capacity to 20 bcm in the future (compare to the original Nabucco project of 31 bcm annually). It will run from Greece to Albania and under the Adriatic Sea to southern Italy.

The European Commission's strategic objective of the Southern Gas Corridor was to meet 10 to 20 percent of the EU's expected gas demand by 2020—in other words, 45 to 90 bcm per year. Pushed by the EC as a highly strategic geopolitical project, the geographical, commercial, and political realities have largely been ignored. Russia and Iran have no interest in a Trans-Caspian Pipeline which bypasses their territories. Furthermore there are unsolved legal disputes about the legal status of the Caspian Sea. Azerbaijani capacities are limited, holding just 0,7 percent of the world's gas resources. Azeri production capacities are substantial, further significant increases over the current projections, however, seem rather very long-term options. Northern Iraqi gas must be transported through Syria—for the unforeseeable future a huge security risk—or through Turkey which would link the Kurdish controlled Northern Iraq and Turkey. Although the situation in Iran may change, many question marks remain. In the end, economic feasibility to shoulder such investments plus the commercial interests of the energy companies operating in the upstream sector are the main drivers of corridor development, not the EC's political agenda. Nevertheless, the Commission has ignored the differing and divergent priorities of the member states, some of which supported or were otherwise involved in alternative projects.

The Role of Azerbaijan

Azerbaijan has become the key player in the Southern Gas Corridor, both because of the surplus gas available for export and its desire to diversify its energy exports away from Russian streams by developing alternative pipelines directly to Europe. It is at the moment the only country able to supply the EU with a significant amount of gas through the corridor, but there is huge potential in the region considering its connections to Turkmenistan, northern Iraq, and possibly Iran—and, to an uncertain extent, East Mediterranean Gas.

For Azerbaijan, the export of oil and especially of gas is the most important economic sector. Energy contributes 55 percent to its GDP and is the biggest source of export revenues. Even if diversification plays an important role in the strategic planning of the country, energy exports will long remain the key driver of its economy. Georgia is an important ally in the region because it is the main transit country for resources from Azerbaijan to Europe. As a second transit country, Turkey plays a key role, but at the same time participates in Russian pipeline projects like South Stream. The goal of the Turkish government is to become an energy hub to Europe.

Azerbaijan finds itself in a difficult geopolitical environment, with critical relations with Iran, a balancing policy towards Russia, and conflict zones in the South Caucasus, Nagorno-Karabakh, and Georgia. The Russian-Georgian war of 2008 demonstrated the vulnerability of the transit system to Europe. Although Russia has never attacked the pipelines, its occupation of South Ossetia and Abkhazia shows the potential for conflict and the challenge to long-term security of the pipeline system. For the foreign policy of Azerbaijan the export of oil and gas to Europe while bypassing Russia plays a central role in the balance of power between Russia and the West.

A Trans-Caspian Pipeline would be very expensive, yet remains a competitive option as China is interested in increasing gas supply from Turkmenistan. At the same time Azerbaijan has no interest in competing with Turkmen gas on the European market. Iran is still under Western sanctions, but under new President Hassan Rohani it is conceivable that the US and EU might lift these measures, increasing the likelihood of access to Iran's substantial holdings: the world's fourth-largest proven oil reserves and second-largest natural gas reserves.

With the implementation of TANAP, Azerbaijan has demonstrated that it is able and willing to complete projects despite Russian political and energy interests. Azerbaijan plans to export 20 bcm by 2020 and 40 to 60 bcm by 2025 through the exploration of new gas fields. Frustration over the slow progress of Nabucco has led to SOCAR's stronger engagement in construction of the necessary pipeline infrastructure between Azerbaijan and Southern Europe. In June 2013 SOCAR acquired 66 percent of the Greek gas transit company DESFA. With this investment, Azerbaijan is assuming a role on the European market and can influence other strategic projects in the Southern Gas Corridor, such as the Greek-Bulgarian Interconnector and interconnector between Turkey and Greece, where DESFA has a share.

The Role of Russia

Russia has an economic and political interest in controlling all pipeline projects in the post-Soviet region; therefore Azerbaijan's diversification policy is a challenge to Moscow. The key foreign policy project of Vladimir Putin's third term is the integration of post-Soviet states into a Eurasian Economic Union. Azerbaijan is using export diversification of its energy resources to resist Russian integration pressure. At the same time, Russia is developing its alternative pipeline project South Stream in cooperation with Gazprom, Italy's ENI, France's EDF, and Germany's Wintershall. South Stream, in its final stage, will carry 63 bcm per year of Russian gas to Europe via the Black Sea, Bulgaria, the Balkans, Hungary, Austria, and Greece, thus competing with TAP but not directly in its geographical location like with Nabucco. Although the volume of TAP is so small, EU demand nonetheless exists, so the project is economically viable. South Stream will bypass Ukraine, undermining the country's position as the most important transit country for Russian gas to Europe.

Energy Security in the South Caucasus—the View from Azerbaijan

- It is important for Azerbaijan to diversify its energy exports away from Russia and also to enter the European market with direct customer access. For this reason, the country needs economic and political partners in the EU.
- Economic and energy cooperation are the core of Azerbaijan's relations with the EU. The country has no interest in political change or democratic reforms, but does have a huge interest in becoming an important energy supplier to the EU.
- In its geopolitical situation, it is important for the country to balance Russia, Iran, and Turkey. The EU has become a key economic partner, but expectations that it would become an important security partner, too, have not been fulfilled. Only the US and Turkey partly play this role.
- Because of the Georgian conflict zones and the northern Caucasus conflict with Armenia over Nagorno-Karabakh, security plays a key role in the foreign policy of Azerbaijan. This has a fundamental influence on energy policy, given that the country seeks partners to balance Russia and protect its security needs.

The Southern Gas Corridor and Azerbaijan—the View from the EU

- For the EU, Azerbaijan has become the key partner in the Southern Gas Corridor. The volumes Azerbaijan can supply will initially be rather small by comparison, but the entire region has huge potential. For the time being, it is important to develop sufficient and expandable infrastructure to the Caspian Sea which can later be linked with Iran, Iraq, or even Turkmenistan.
- The selection of TAP—the smallest of the pipelines—is primarily a pragmatic economic decision rather than a geopolitical one. It reflects the currently limited economic viability of the whole Southern Gas Corridor. Azerbaijan has limited gas for export. Only if a Trans-Caspian Pipeline is constructed or Iran gets involved can the Southern Gas Corridor become a serious element of the EU's energy diversification strategy.
- The decision in favor of TAP over the much larger Nabucco shows that political initiatives ignoring commercial and economic realities will bring either no or suboptimal results. Azerbaijan's decision to supply the EU rather than Russia with gas is linked more to Azerbaijan's interest in diversifying its exports than to any effect of EU policy or diplomacy.
- Azerbaijan is part of the Eastern Partnership, but the EU is not willing to become a true security partner. Azerbaijan must become more realistic about what the EU is willing and able to do in terms of security policy. At the same time, if the EU wants political change in the region and a reliable partner in Azerbaijan, it needs to link its economic policy with more engagement in conflict management.

This DGAPkompakt was written as a background paper for the participants of the international conference "Energy Security in the South Caucasus—The Southern Gas Corridor in its geopolitical environment", hosted by the DGAP in Berlin on January 30, 2014 with friendly support of BP Europe. Author: Dr. Stefan Meister, Associate Fellow of the DGAP and Senior Policy Fellow at the European Council on Foreign Relations (ECFR).

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