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Kusznir, Julia

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The Southern Gas Corridor: Initiated by the EU, Completed by Others? TANAP, TAP, and the Redirection of the South Stream Pipeline

By Julia Kusznir, Bremen

Abstract

This article reviews the latest developments in the Southern Gas Corridor, which seeks to reduce European dependence on Russian gas by increasing supplies from the Caspian. Turkey and Azerbaijan are the main beneficiaries of recent events, while Russia is losing its influence over European energy markets, as evidenced by its decision to redirect the South Stream Pipeline to Turkey. The situation remains volatile and depends heavily on Russia's evolving relationship with the West and the ability of Turkey and Azerbaijan to position themselves between the EU and Russia.

Introduction

On 20 September, 2014, the Azerbaijani government inaugurated construction of the second branch of the South Caucasus Pipeline (also known as the Baku–Tbilisi–Erzurum pipeline or Shah Deniz pipeline). The pipeline is a part of the EU-supported Southern Gas Corridor (SGC) project. EU officials initiated this effort in 2007 in order to reduce reliance on Russia for gas supplies by developing the pipeline infrastructure necessary for transporting gas from Caspian producers, including Azerbaijan, Turkmenistan and Iraq, to Europe. The representatives of the countries involved in the SGC project named it a model of global cooperation that significantly strengthens European energy security. In the words of the then President of the European Commission José Manuel Barroso, the Corridor "will be a strategic energy avenue for the 21st century, a true geostrategic project". In light of these considerations, this article analyses the project's recent developments and what the current situation means for the countries involved and for the stability of gas supply from the Caspian Basin to Europe.

Since its establishment, the SGC has been the subject of numerous "pipeline struggles": the status of the planned pipelines have undergone significant changes and/or faced uncertain futures for a long period. Originally, the SGC consisted of three pipelines: (1) the Interconnector Turkey–Greece–Italy (ITGI) with a capacity of 10 billion cubic meters (bcm) per year, (2) the Trans-Adriatic-Pipeline (TAP) with an annual capacity of 10 bcm, and (3) the Nabucco pipeline with a capacity of 31 bcm per year. The ITGI project lost the competition because of technical and financial problems. Then, in 2012 the long-planned Nabucco pipeline project underwent radical changes—the project was scaled back into a Nabucco West project with a shorter route and smaller capacity (16 bcm per year) resulting from high financial costs and the lack of necessary gas suppliers. At the same time, Russia began to build its South Stream gas pipeline (initiated in 2007)—a rival project to the EU-backed pipelines Nabucco and TAP that was supposed to transport 63 bcm of gas per year to European markets via the Black Sea.

The Southern Corridor received a new boost in June 2013 when the Shah Deniz consortium, exploiting the Shah Deniz gas deposit in Azerbaijan, announced the TAP project to be its preferred transportation route to Europe. According to the consortium, Nabucco West lost out to TAP for commercial reasons, such as capital and operating costs, and because of the price that the developers where able to procure for Azerbaijan's gas on the European market. This marked the beginning of the modified Southern Gas Corridor, which consists of three projects: (1) the expansion of the existing South Caucasus Pipeline (SCP) running through Azerbaijan and Georgia to Eastern Turkey; (2) the construction of the Trans-Anatolian Gas Pipeline (TANAP), and (3) the building of the TAP. The new SGC will be some 3,500 km long. The total investment in the pipeline will be US$45 billion (see Table 1).

At the moment, the gas from the Shah Deniz field will be the main source for the Southern Gas Corridor. Thanks to proven gas reserves estimated at 1.2 trillion cubic meters, Shah Deniz is one of the world's largest gas fields. The project aims to reach gas output at a level of 16 bcm per year in 2019 and 31 bcm in 2026. The production at the field is scheduled to begin in late 2018 with deliveries to Georgia and Turkey. Commercial sales to European consumers will follow in 2019. The hope is to cover 20 percent of European gas needs in the long term. Regarding the export route, Shah Deniz gas will run through the SCP to Eastern Turkey and then will be transferred into TANAP with an initial capacity of 16 bcm per year. Of this, 6 bcm is earmarked for the Turkish domestic market, and the remaining 10 bcm will be transported into the TAP at the Turkish–Greek border. The TAP will then ship this gas through Greece and Albania under the Adriatic Sea to southern Italy. It will eventually connect with a number of existing

and proposed pipe interconnectors within Europe and enable delivery to European markets, including Southern Europe and the Western Balkans. TAP's current capacity is planned to increase up to 20 bcm.

Remarkably, new driving forces for the modified Southern Gas Corridor have emerged: TANAP was initiated by Azerbaijan's state energy company SOCAR and Turkey's state pipeline operator BOTAS in 2011 as reaction to the long and ineffective negotiations on the Nabucco project. Initially, SOCAR owned 80 percent of TANAP stakes while Turkish partners BOTAS and TRAO held the remaining 20 percent. In 2013, British BP—the operator of the Shah Deniz consortium—decided to join TANAP by buying a 12 percent share in the project. In June 2014, SOCAR sold 10 percent of its share to BOTAS, reducing SOCAR's share in TANAP to 58 percent. While the TAP project was initially developed by Norwegian Statoil, Swiss EGL Group (now named Axpo) and German E.ON, in June 2013 SOCAR—together with British BP, French Total and Belgian Fluxys—joined the project. After the withdrawal of E.ON and Total in 2014, SOCAR's stake rose—along with BP's and Statoil's—to 20 percent making it one of the three biggest shareholders in TAP. To sum up, SOCAR has succeeded in getting shares in both pipeline projects that allow the company to have an influential position in the projects' decision-making processes. Furthermore, SOCAR has acquired a controlling stake in the Greek transmission company DESFA, strengthening its position on the European gas markets, too.

Under the aegis of the EU, the SGC was plagued by essential obstacles: (1) a lack of additional gas sources and (2) the increasing Russian political and economic activities in the South Caucasus and the Caspian region that could cause serious problems for the stability of gas supplies in the long-term (e.g., the South Stream gas pipeline). The new players face the same obstacles.

Search for Additional Gas Sources

Consequently, Azerbaijan and Turkey have increased their engagement with other regional gas producers, including Turkmenistan, Iraq and Iran offering to ship natural gas from these producers to Europe via the TANAP-TAP pipelines. In November 2014, SOCAR officials said that the company is willing to help Turkmenistan with its existing gas and oil pipeline infrastructure in order to develop Turkmen oil and gas offshore projects. More recently, Turkey and Turkmenistan have signed a framework supply agreement that aims to deliver Turkmen natural gas to Europe via TANAP through Turkish territory. Two options are under discussion: (1) The Turkmen gas could be shipped via the Trans-Caspian Pipeline (TCP). Since 2011, EU officials have been working together with Azerbaijani and Turkmenistani officials on an agreement to construct the TCP. However, an unresolved legal dispute over the status of the Caspian Sea between the littoral states has hindered the realisation of the project. The TCP project also faces high costs and technical difficulties. (2) Another option would be to transport Turkmen gas through Iranian pipelines to Turkey and then transfer it to TANAP. However, the implementation of this option is unlikely in the short-term because of the international sanctions imposed on Iran's regime.

The agreement between Turkey and Turkmenistan was reached at a time when one of the main gas importers from Turkmenistan, Russia's state-owned gas company Gazprom, had announced that it is no longer interested in natural gas imports from Turkmenistan. The company is working to cancel the existing supply contracts, justifying this move with the argument that it expects domestic gas production to grow in the coming years and that there will be no need for additional imports. Western sanctions have pressured Gazprom into shrinking planned investment projects and reducing its demand for Turkmen gas.

Azeri authorities have also held talks with the Iraqi authorities and representatives from the Kurdish Regional Government on developing bilateral energy cooperation. They have discussed, among others options, using the Southern Corridor infrastructure to ship Iraqi gas to European markets. Consequently, Iraqi representatives have stressed that the TANAP pipeline is an ideal option for transporting Iraqi gas to Europe that they are willing to use. These negotiations are very important because they simultaneously involved the highest level Iraqi policy-makers and the Kurdish Regional Government. This means that a compromise between the two sides regarding the gas exports can be achieved and the Iraqi gas could eventually reach European markets. Interestingly, the European companies and the EU representatives were less successful in their negotiations on gas supplies for the Nabucco pipeline with the Iraqi government.

Russia as a New Threat?

Whereas Russian authorities have recently reoriented Russian gas export routes toward Asian markets, they have also been looking for alternative routes and locations for exports in the Caspian region. In May 2014, for example, the Russian oil company Lukoil—a stakeholder in the Shah Deniz consortium and the South Caucasus Pipeline company—decided to ship part of its oil production from the Russian shore of the Caspian Sea to the pipeline terminal of the Baku–Tbilisi–Ceyhan pipeline (BTC) for further transportation to the European markets**.** A month later, the Russian state oil

company Rosneft and SOCAR held talks on expanding energy cooperation. Both sides agreed, among other things, to employ together the existing pipeline infrastructure. This includes the use of the BTC pipeline to transport Rosneft's crude exports. Rosneft is also planning to buy a share in the Azeri Absheron gas project on the Caspian shelf. Its gas reserves are estimated at 350 bcm of gas and 45 million tonnes of gas condensate. SOCAR hopes to use Absheron gas for exports via TANAP-TAP pipelines in the future. Remarkably, the deals with Rosneft and Lukoil were reached at a time when the EU and the US had imposed sanctions against Russian companies. It seems that the deals will ensure profits for both sides. For Russia, the BTC pipeline is an alternative route for its crude exports to Europe that is not affected by the EU sanctions. For Azerbaijan, the deals with Russian companies guarantee the crude needed to fill the half-empty BTC pipeline. They will also secure transit fees from Russian oil and additional investment for the exploration of the new gas fields.

The Russian South Stream gas pipeline project, connecting Russia with Bulgaria beneath the Black Sea, was also facing significant obstacles in the aftermath of the Russian annexation of Crimea: the EU and US sanctions blocked the necessary financing and construction work on EU territory. More importantly, EU officials say that the project violates European competition regulations, including the provisions of the Third Energy Package and that all intergovernmental agreements between South Stream partners and Russia should be renegotiated according to European law. After long unsuccessful consultations, Russian officials decided to freeze the South Stream project and redirect the pipeline toward Turkey. On 1 December 2014, the Russian state gas company Gazprom and Turkey's Botas signed a memorandum to build an underwater pipeline with a capacity of 63 bcm and create an additional gas hub on the Turkish border with Greece for gas deliveries to South European markets. Given the growing gas demand in Turkey and Turkey's ambitions to become an energy hub by 2023, the deals are very valuable because they guarantee more gas (Russia would supply Turkey with additional 14 bcm) for a lower price—Turkey would get a 6 percent discount for Russian gas from 2015 and would profit from selling Russian gas. Moreover, Russian officials announced that in the long-term Russian gas may be supplied to the European markets from Turkey via TANAP-TAP pipelines resolving the problems with gas capacities for the Southern Corridor. For the time being, it is not clear how the route will run and how much it will cost. However, if built, it will significantly change the original design and main goal of the SGC project, namely supplying non-Russian gas to Europe.

These events give the impression that the Azeri and Turkish officials, particularly now, are trying to take advantage of the Russian–EU conflict for the economic and geopolitical benefit. However, the Kremlin could put political and economic pressure on Azerbaijan and Turkey. SOCAR's representatives have stressed in the media that Azeri gas exports to Europe will not pose any threat to Russian gas exports to the European market. It has claimed that its main interests are to become a reliable supplier for Europe, while also developing additional export routes to Azerbaijan's neighbours Georgia, Turkey and Russia. As Azerbaijan's relatively neutral position in the Ukraine crisis shows, it will try to avoid any direct political conflict with Russia. Therefore, the expansion of energy cooperation between both countries could be seen as a means of seeking protection against Russia.

Moreover, alongside annexing Crimea and supporting the separatist uprising in Eastern Ukraine, Russia has been taking radical political steps toward the South Caucasus corridor as well: it has sent the message that it will not abandon its aim to establish a "Eurasian" empire, of which the South Caucasus Corridor is an integral part as it connects the Black Sea with the Caspian Sea and secure access to Central Asia. This strategy finds an echo in the recently signed agreement between Russia and the Republic of Abkhazia that substantially extends Russian political and economic influence in the region. Abkhazia is a disputed region within Georgia that is one of the post-Soviet "frozen conflict" zones. The Russian–Georgian war in 2008 and the current conflict between Russia and Ukraine have clearly demonstrated that Russia is ready to use its hard and soft power mechanisms at any time. This could be a significant threat to the Southern Corridor's gas supplies in the future.

No less important is the fact that Azeri gas will be delivered to the West Balkan countries, including Bosnia and Herzegovina and Montenegro, where Russia has been constantly expanding its political and economic influence. In particular, Gazprom has been a major gas supplier to the region for decades. In addition, it owns a large-scale network of petrol stations and holds shares in the local retail fuel markets there. There should be no doubts that Russia, if the political situation does develop in its favour, will try to exert its influence through its grip on the energy sector there as well.

Conclusion

From the above analysis, we can conclude that Azerbaijan and Turkey have taken advantage of the EU's weak position on the pipeline projects in the Caspian region. Azerbaijan helped to reformulate the initial idea of a Southern Corridor in its favour so that it became

not only the key gas supplier in the project but also the key stakeholder and decision-maker. In addition, it has secured direct access to the European energy markets and strengthened its energy independence from Russia.

The realisation of the TANAP-TAP pipeline projects is of significant importance for Turkey: the projects strengthen its role as an energy hub regionally and globally; they also guarantee extra gas deliveries to cover its domestic growing gas demand and a high volume of direct investment in the country's energy infrastructure. They secure transit fees and therefore will contribute significantly to Turkey's economy. Moreover, through its active negotiations with the Caspian producers such as Turkmenistan and Iran, Turkey has taken on the EU's role in the SGC project and strengthened significantly its geopolitical role in the region. Consequently, in the EU-initiated SGC project, gas suppliers and transit countries have successfully pursued their national interests. Azerbaijan and Turkey have become frontrunners in the development of the EU-supported Southern Corridor.

However, it would be wrong to argue that Azerbaijan—as a main supplier and key stakeholder in the TANAP-TAP projects—can fully control and influence the decisions related to the routes and supplying conditions on its own. The Southern Corridor is an international project, and the interests of other important stakeholders, such BP and the Turkish energy companies, must be taken into account. Additionally, due to the fact that the Shah Deniz 2 is a technically difficult project, the Azeri reliance on foreign investment and technology is one of main prerequisites for successfully implementing the project.

Western sanctions have not only significantly damaged the Russian economy, but also undermined Russian ambitions to increase its role on the European energy markets. As a result, Russia needs to diversify its energy sales. Azerbaijan and Turkey offer a solution to this. As current events have shown, these two countries will use this opportunity and intensify their cooperation with Russia.

Russia does not want the South Caucasus region and the Balkans to become integral parts of the West; this would mean Russia's loss of influence in these territories. Russia will therefore try to maintain its influence in the future through bilateral economic and, in particular, energy cooperation. By tightening its influence, the Kremlin can eventually undermine the political and economic stability and security of these regions. This will destabilise further energy deals with European markets. Therefore, the stability of gas supplies from the Caspian to Europe will also depend on the new geopolitical situation in the Caspian and the ability of Azerbaijan and Turkey to cooperate with Russia on the European energy markets.

About the Author:
Dr. Julia Kusznir is a postdoctoral fellow at Jacobs University. Her research interests include geopolitics, global energy security, energy politics and energy relations in the European Union and Eastern Europe. She also focuses on the development of energy markets in Central Asia and the Caucasus and their impact on national politics.

Further Readings

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Table 1: TANAP, TAP, TCP, East–West gas and Gazprom-Botas Undersea Pipelines: an Overview

Gas pipeline project	Route	Project partners/ Stakeholders	Planned Capacity [bcm/per year]	Estimated costs of construction	Start of construction
Trans-Anatolian Pipeline (TANAP)	From Georgian–Turkish border to Turkish European border with two branch to Greece and to Bulgaria (2.000 km long)	SOCAR 58% BOTAS 30% BP 12%	From 16 bcm to 31 bcm (by 2026)	10–11 billion US dollars	April 2015 Expected to be completed by 2018
Trans Adriatic Pipeline (TAP)	As the third-part pipeline for Azeri gas to Europe it will connect with TANAP at the Turkish–Greece border and run via Greece, Albania and the Adriatic Sea to Italy (870 km long)	SOCAR 20% BP 20% Statoil 20% Enagas 16% Fluxys 19% Axpo 5%	from 10 bcm to 20 bcm	1,5 billion Euros	Planned to start in 2016 Expected to be completed by 2019
Trans-Caspian Pipeline (TCP)	From Turkmenistan through the Caspian Sea to Azerbaijan, (the length is still not clear)	still not clear	30 bcm	5 billion US dollars	still not clear
East–West Pipeline	Designed to connect the eastern and western (shore of the Caspian Sea) parts	Turkmengaz	30 bcm	2 billion US dollars	Announced in 2012 Expected to be completed by June 2015
Gazrpom-Botas undersea pipeline	From Russia through the Black Sea to Turkey (the length is still not clear)	Gazprom and Botas	63 bcm	Still not clear	Still not clear

Source: compiled by the author after bringing together information on gas pipeline projects based on the data of companies' websites and of <www.newsbase.com>.