

Azerbaijan will decide the shape of the Southern Gas Corridor

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In the coming months, Baku is expected to make a decision defining the scheme for the long-term export of Azeri gas. This decision will be of fundamental importance for the EU's policy of energy security based on the Southern Gas Corridor concept. This consists of four mutually alternative plans for gas transport, including the Nabucco pipeline. The visits to Baku (and Ashgabat) on 13-15 January by the European Commission's President Jose Manuel Barroso and the Energy Commissioner Günther Oettinger were the most important – and probably last before the final decision – attempt to specify the shape of the Southern Corridor together with Azerbaijan, which is the only reliable gas supplier for this route. Although the launch of the corridor on the basis of Azeri gas is presently a near-certainty, it has not yet been established via which route nor under what conditions the gas will be transmitted into Europe. In practice, Azerbaijan will decide the shape and route of the corridor, on the basis of their own calculations and what they estimate will be the most convenient variant for themselves. This could call into question the EU's flagship project – Nabucco.

The object of the game

The European Union has for years been looking to diversify its sources and routes for natural gas to Europe (counting on gas producers from the Caspian region and the Middle East), and thereby to reduce its dependence on other suppliers, especially Russia. The effect of the EU's work has been the emergence of the Southern Corridor concept (2009), in which Brussels has supported various consortia as they have competed with each other, pushing through their different (and mutually exclusive) projects: Nabucco, ITGI, TAP, and White Stream. Although this was never formally expressed, it seemed the Nabucco pipeline project was most favoured by the European Commission, and for some time this project was identified with the Southern Corridor by the media. Nabucco is the most ambitious of the ventures; it assumes the construction of a new infrastructure of huge capacity (31 bcm of gas per year, with the possibility of doubling that amount), which would allow the real diversification of supplies to the EU, and would at the same time also tie the Caspian region and the Middle East closer to Europe in a geopolitical sense. The other projects are more conservative and are largely based on existing infrastructures, but provide for less capacity, although for all these reasons, they are cheaper.

At present the only secure supplier of gas to the Southern Corridor is Azerbaijan, which in the upcoming months will take a decision on the development of its gas sector. In 2011 Baku plans to approve the second phase of the development of Shah-Deniz, the largest gas

deposits on its territory; to sign contracts for the sale of additional gas from these deposits (around 14 bcm from the period from 2017 to 2019, of which around 6 bcm is destined for Turkey and around 8 bcm for Europe); and at the same time determine the direction and route for transporting the gas. For strategic reasons, Baku is determined to sell the bulk of the gas to the European market (as it is the largest, most financially attractive and most secure from the geopolitical point of view), and not to Iran or Russia. However, the key question remains as to which of the routes promoted by the EU Azerbaijan will choose to supply its gas to Europe: the Southern Corridor (Nabucco, ITGI, TAP or White Stream), or the AGRI project promoted by Romania.

The situation of Turkmenistan is more complex. In 2011 it has the opportunity to extract around 5 bcm of gas from the Caspian shelf, and potentially to increase production to 10 bcm in the short term; the European market is one of the potential export options for this gas. Currently, however, it does not appear that Turkmenistan would be able to export its gas through the Caucasus, because of problems both political (resistance from Russia) and technical (connected with the infrastructure), and above all because doing so without the question of Azerbaijan's gas exports being settled first would be a hasty move.

The visits and their effect

Barroso and Oettinger's visits to Baku and Ashgabat confirmed the EU's determination to gain access to Caspian oil; for the first time, leading EU officials came to request it personally. Azerbaijan's interest in exporting gas to Europe was also confirmed, by the signature of a joint declaration on the Southern Corridor and an agreement to establish a working group to monitor the progress of its implementation. Once again, the prospect of gas supplies from Turkmenistan was outlined, as long as the EU finds a way to import Turkmenistan's gas from the Turkmen border and onto the European market. However, the visit did not produce any decisions on the final shape of the Southern Corridor. Furthermore, it seems that the EU has exhausted the array of measures with which it had hoped to influence the concept's final form. The visit by Barroso and Oettinger was EU diplomacy's last attempt to affect the implementation of the Nabucco concept.

Prospects

At this stage, it seems that the most important and decisive player in the matter of the Southern Corridor is Azerbaijan, which is in talks with the consortia involved in developing the Nabucco pipeline, ITGI and TAP (White Stream is not treated as a serious option for gas transport), and is analysing the alternative variants for gas export via the Black Sea. Baku is trying to make the most of the competition between those projects and consortia, and has threatened to use alternative gas export options; an example of this was the signing of a contract for export to Iran (1-2 bcm of gas for the period 2011-2015) on the eve of the EU officials' visit. In this situation, the future and shape of the Southern Corridor will depend on how Baku assesses the risks and calculates the benefits connected with the implementation of the various routes, as well as the offers from the various consortia. It should be noted that Baku is aware that the Nabucco pipeline project has little chance of

coming to fruition if there is no other gas provider in addition to Azerbaijan.



Appendix

Characteristics of the individual projects for exporting gas from Azerbaijan

Nabucco This project involves the construction of a new pipeline (about 4300 km in length) from the Turkish-Georgian and Turkish-Iraqi borders, through the territories of Turkey, Bulgaria, Hungary and Romania, to the gas hub in Baumgarten, Austria. The capacity of this pipeline is planned to be 31 bcm of gas per year, with the possibility of increasing it to approximately 60 bcm. The Nabucco pipeline consortium includes RWE, OMV, MOL, Transgaz, Bulgargaz and Botas. The cost of the project is approximately US\$10 billion.

From Azerbaijan's standpoint, the main problem with Nabucco is the unsolved question of who the second supplier of gas to the pipeline will be (the 'second supplier problem'). Baku fears that it will be forced to bear the full costs of maintaining the pipeline until it is filled completely (up to 31 bcm), which may not happen. In addition, Baku has called for access to the markets which the Nabucco gas will reach. This is also the only project which has raised strong opposition and criticism from Russia, which is one of Azerbaijan's strategic partners, and also supports the competitive South Stream pipeline project (which is largely focused on the same markets as the Nabucco project).

ITGI (Interconnector Turkey-Greece-Italy) A section of this pipeline between Turkey and Greece already exists, with a capacity of approximately 12 bcm of gas per year (ITG); the cost of building connections between Greece and Italy with a planned capacity of 8 bcm of gas will be around US\$1.5bn. The consortium includes Edison, DEPA, and Botas, although the connection between Turkey and Greece belongs to Botas and DEPA alone.

In 2011 Azerbaijan will have the right to sell gas on the Greek market, thanks to the concession by the Turkish company Botas of a contract to supply gas to the Greek DEPA. From Azerbaijan's standpoint, ITGI would allow them to sell gas not only on the Greek and Italian markets, but also to Bulgaria and the Western Balkans (including the Macedonian, Albanian and Serbian markets). The advantage is that the project has already been partially implemented (the Greek-Serbian-Bulgarian IGB connection is also under construction, supported financially by the EU). However, a disadvantage is the need for Botas to modernise the transportation infrastructure on Turkey's territory (the costs of this are estimated in the billions of US dollars), as well as the need to harmonise the conditions for the transit of gas with Turkey.

The **TAP (Trans-Adriatic Pipeline)** assumes the construction of a pipeline from Greece to Albania and Italy. The capacity of the route is planned to be 10 bcm, with the possibility of doubling this figure later. The cost of the project is approximately US\$2 billion. The consortium includes Statoil, E.ON and EGL. The TAP's gas is to be provided by using an

existing connector between Turkey and Greece (the ITG).

From Azerbaijan's point of view, the project has similar advantages (allowing access to similar markets) and disadvantages (the need for Turkey to address transit issues) to the ITGI. The presence of Statoil, which has a 25.5% stake in the Shah-Deniz fields, is not unambiguously positive for the TAP either, because it is SOCAR which is holding talks with potential gas customers.

The **White Stream** project is based on the construction of a pipeline from the Georgian coast via the Black Sea to Romania, with a potential branch-off in Ukraine. It is not known who the investors behind the project are. It is not being seriously considered by Baku as an option for the transport of gas.

AGRI (Interconnector Azerbaijan–Georgia–Romania) assumes the construction of a terminal for the liquefaction of natural gas on the Georgian coast of the Black Sea (most likely in Kulevi, which is controlled by SOCAR), and a terminal for LNG (liquefied natural gas) in Constanta in Romania. According to the latest estimates, the project should cost between US\$2,5-5 billion. The project's capacity is estimated in three variants: 2, 5 or 8 bcm of gas. Currently a feasibility study is being developed. The project has met with interest, apart from Romania, by Hungary and Ukraine.

From Azerbaijan's point of view, AGRI would reduce the dependence on transit through Turkey. Moreover, according to a memorandum from April 2010, the parties are to agree on transmission tariffs for gas transit via Romanian territory, as well as conditions of access to Romanian gas storage, suggesting that Azerbaijan will obtain the right to sell gas independently on the EU market.

The project for gas export in the form of **CNG to Bulgaria** assumes that Bulgaria will import up to 3 bcm of gas per year in the form of CNG (compressed natural gas). The project does not require the construction of infrastructure on the coast, but only investments in vessels capable of transporting CNG. For these reasons, its implementation would probably be cheaper than AGRI (although its indicative costs have never been made public), although it is more expensive to use; CNG technology causes a lower reduction in the gas's volume compared to LNG, which means that less CNG can be carried in a ship of the same displacement than LNG. The CNG plan involves Bulgaria, Azerbaijan and Georgia; it is being discussed on the basis of a memorandum from November 2009. From Azerbaijan's point of view, starting gas exports via Turkey's territory along any of the Southern Corridor routes would seriously diminish the attraction of this project.