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Azerbaijan's gas on its way to Europe

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On 6 October, the Turkish government ratified part of the provisions of a June memorandum which allows the sale via Azerbaijan of small amounts of gas on Turkey's internal market (1.2bn m³), and the export of gas via Azerbaijan to Greece, Syria or Bulgaria (2bn m³). This puts Azerbaijan in a comfortable situation, allowing it to directly deliver gas to Europe, as well as to further diversify its gas exports in the medium term. However, the problem remains unresolved of how to transmit the gas from the second stage of development of the biggest deposit on Azerbaijan territory, Shah Deniz (SD-2), which is supposed to be the source of gas for the Southern Corridor. The question also remains open of which of the projects for the corridor (the Turkey-Greece-Italy pipeline [ITGI], the Trans-Adriatic TAP or the Nabucco) will actually be undertaken. At the same time, the compromise between Turkey and Azerbaijan increases the likelihood that the ITGI pipeline will be used to transmit large amounts of gas to Europe.

Turkey agrees to the sale and delivery of Azerbaijan's gas to Europe

The Turkish government's decision on 6 October to ratify part of the provisions included in a memorandum of 7 June this year allows Azerbaijan's state oil & gas concern SOCAR to sell 1.2bn m³ of gas on Turkey's internal market, the Petkim petrochemical enterprise, which SOCAR controls (owning 51% of the shares), will be first in line. The gas is to be distributed by the Turkish state firm BOTAS, from reserves of gas which Azerbaijan will deliver to Turkey as part of a contract to export it from the first stage of development of the Shah Deniz deposits. According to this contract, Turkey can receive up to 6.6bn m³ of gas. SOCAR has already stated that it plans to sign a similar contract with BOTAS by the end of the year.

Moreover, Turkey's BOTAS is supposed to deliver 2bn m³ of gas to SOCAR, for it to sell onward to Syria, Bulgaria or Greece. It is also supposed to cede SOCAR the right to a sales contract between BOTAS and the Greek company DEPA. As part of this contract, BOTAS has so far re-exported around 750m m³ of Azerbaijan gas annually to Greece, which Azerbaijan has objected to. The Turkish firm began exporting gas in 2007, using the existing section of the ITGI pipeline, one of the Southern Corridor projects. The details of how these provisions will be implemented will be the subject of negotiations between the governments of Azerbaijan and Turkey.

The authorisation of some of the memorandum's provisions will allow relations between Ankara and Baku to improve; these chilled significantly when Turkey tried to force a process of normalisation with Armenia in 2009-10. Turkey is also trying to lend credence to its role as a transit state for gas sent from Azerbaijan to Europe.

Consequences

One of the most important problems in relations between Turkey and Azerbaijan has now been solved. Implementing the memorandum's provisions will be a success for Azerbaijan, which for a long time has demanded an agreement to sell its gas to the Petkim enterprise, as well as a transit agreement via Turkish territory. For the first time in its history, Azerbaijan has *de facto* obtained a chance to sell its gas on European markets (Greece, Bulgaria) and to the Near East (Syria). In the medium term (until production from the second phase of the Shah Deniz deposit, planned for 2016, begins), this will allow Baku to diversify its routes and directions of gas export. In turn, the opportunity to sell gas on the Turkish market, including to the Petkim petrochemical enterprise, will increase the profitability of this business for SOCAR. The Azeri company will also be the only one able to sell its gas on the internal Turkish market.

In turn, Bulgaria and Greece will gain a real chance to import gas from Azerbaijan; this gives Bulgaria the chance to diversify and reduce its dependence on Russia (Greece already now buys gas from Azerbaijan, but from Turkey). What is more, starting exports via Azerbaijan to these countries shows that it is easier for Baku to reach an understanding with individual EU countries than with companies or with Brussels, all of which are trying to force through a plan for the Southern Corridor.

Forecast

In the medium term, until gas from Shah Deniz-2 arrives, the directions and customers for Azerbaijan gas export have now been defined. For the next five years, Azerbaijan will most probably sell gas to Russia, Iran, Georgia, Turkey, Syria, Bulgaria and Greece.

Meanwhile, it remains unclear which route (ITGI, TAP or Nabucco) will in the long term be used for the Southern Corridor to export large amounts of natural gas from Azerbaijan. According to Baku's plans, the production of gas from the second phase of the Shah Deniz deposit, which is supposed to be the source of deliveries for these projects, is to begin in 2016, and reach 16bn m^3 of gas at its peak. It must be expected that Azerbaijan's opportunity to sell gas onto the European market before the SD-2 project is implemented will strengthen its position in its negotiations with the representatives of the consortia engaged in above-mentioned projects. These are supposed to end within the next twelve months. In turn, the chance that Azerbaijan may start to sell gas to Greece via the existing section of the ITGI pipeline may increase the likelihood of that project being undertaken.

Appendix

Structure of Azerbaijan gas exports in 2010

Azerbaijan's gas is exported onto foreign markets by the state company SOCAR and by the Shah Deniz consortium, in which SOCAR has 10% of shares.

Structure of SOCAR's exports in the period from January to October 2010 (in billions m³ of gas)

Country	Amount
Russia	0.618
Iran*	0.264
Georgia	0.247
total	1.128

Structure of gas exports from the Shah Deniz consortium from the first phase of the deposit's development (in billions m³ of gas)

Country	2010**
Turkey	5
Georgia***	1.4
total	6,4

** Exports to Iran are carried out as swap operations; in exchange, Iran delivers gas to the Nakhchivan Autonomous Republic, an exclave of Azerbaijan. Although a contract to export gas to Iran was signed (aside from the deliveries made within the swap agreement), in January this year the deliveries were not made, for political reasons.*

*** Estimates by the CES on the basis of data from SOCAR.*

**** Georgia receives some gas as part-payment for transit via its territory.*

Existing and planned pipelines from Azerbaijan

pipelines from Azerbaijan