The southern European corridor

by Ilektra Tsakalidou

On Friday 28 June, the Shah Deniz consortium and its leading stakeholders, the State Oil Company of Azerbaijan (SOCAR) and BP, concluded negotiations that have lasted over a decade. With the Trans-Adriatic pipeline (TAP) now chosen to transport Azeri gas from the offshore Shah Deniz field in the Caspian Sea to European markets, a new phase in the supply of gas to Europe may have just begun.

The disputes between Ukraine and Russia that disrupted the flow of gas to eastern Europe in the winters of 2006 and 2009 placed the energy security debate at the forefront of the agenda of both EU member states and the European Commission. Such disruptions are all the more problematic when EU commitments to reduce greenhouse gas emissions - by 20 per cent by 2020 - and increasing doubts over the future of nuclear energy after the 2011 Fukushima Daiichi accident in Japan are taken into consideration.

The EU, therefore, looked for a new and reliable partner in order to diversify its imports (eastern Europe is dependent on Russia for more than 80 per cent of its gas) and introduce additional gas to its energy mix. On 13 January 2010, the president of the European Commission (EC) signed a deal with Azerbaijan for the provision of 10 billion cubic meters (bcm) of natural gas from the newly-developed offshore Caspian fields. Europe has increasingly viewed Azerbaijan as an energy partner of choice because of the maturity of the country's hydrocarbon sector, the involvement of private Western energy companies in Azeri consortia, and the success of the Baku-Tbilisi-Ceyhan pipeline, which transports Azeri oil to the Mediterranean Sea.

The 'last men standing'

For Azeri gas to reach Europe, two pipelines will have to be built. The first will connect Azerbaijan, via Georgia, to the EU-Turkish border, while the second will transport the gas to its final destination. Together they will create the southern energy corridor.

In December 2011, Turkish Prime Minister Recep Tayyip Erdogan and Azeri President Ilham Aliyev signed a memorandum of understanding and tasked BOTAS (Turkish Petroleum Pipeline Corporation), TPAO (Turkish National Oil and Gas Company), and SOCAR with constructing a new pipeline to bring Azeri gas across Turkey. The Trans-Anatolian pipeline (TANAP) - expected to be operational in 2018 - is the first step in bringing 10 bcm of Azeri gas to Europe and 6 bcm to the rapidly expanding Turkish market. The decision to invest in TANAP highlights that both states perceive investment in energy infrastructure as a way of enhancing their geostrategic and commercial goals. This is all the more significant in light of SOCAR's commercial assets in Turkey, the willingness of the Turkish government to remain a strategic partner of the EU, and Turkey's own growing energy demands.

Following Friday's announcement, the 'biggest loser' was Nabucco, a consortium of energy companies from central and eastern Europe. In May 2012, after its original plan for a 31 bcm pipeline running 3900 km from Azerbaijan to Europe was challenged by the creation of TANAP, Nabucco proposed the construction of a 23 bcm pipeline, Nabucco West, connecting to TANAP at the Turkish border, crossing Bulgaria, Romania, and Hungary, and terminating in Austria. Its supporters underlined the project's commercial viability and emphasised the logistical advantages of having the Baumgarten hub at the centre of the European continent.

However, the similar routes of Nabucco West and Gazprom-backed Southstream posed the risk of causing a gas glut in the markets. Uncertainty of financial returns and the risk of potentially raising tensions with Russia - negatively affecting projects in Russian territory where consortium stakeholders are involved - motivated the Shah Deniz consortium to seek an alternative path.

The winning bid came from an 'outsider' in the race to bring Azeri gas to Europe: the 10bcm Trans-Adriatic pipeline designed to link the Greek-Turkish border to southern Italy. Greek Prime Minister Antonis Samaras underlined TAP's comparative advantage during his recent visit to Baku; the construction costs are lower than those of Nabucco West and its length is far shorter (791 km compared to 1391 km).

The arguments in favour of TAP are therefore mainly commercial. Projected profits for the TAP consortium will derive from high gas prices in Italy and SOCAR's projected acquisition of a 66 per cent share of the Greek natural gas distribution network. The EU, on the other hand, is focusing on the potential of developing the gas markets in the Western Balkans. However, supply diversification will bring down regional gas prices, while economic recession and lack of financial resources have kept demand stagnant and delayed potential projects. Furthermore, the lack of a small distribution network in eastern and south-eastern Europe means that countries like Bulgaria will remain heavily dependent on Gazprom, thereby preventing the EU from reducing its reliance on Russian gas.

The pending issues

The main challenges of bringing Azeri gas to Europe, by any route, are the potential insecurity of supply, the uncertainty of demand, and the effects of price deregulation. First, prospective US exports of liquefied natural gas to Europe could alter the market and, together with a shift from oil indexed to spot prices for gas, jeopardise the project's financial returns.

Second, the 'shale gas revolution' could push certain EU member states to overcome their scepticism towards shale gas, begin domestic production and reduce their energy dependence. It should be noted that the development of unconventional resources and the recent gas discoveries in the eastern Mediterranean are encouraging a form of 'energy regionalism' and thereby reducing the attractiveness of large-scale infrastructure projects.

Third, the integration of the US and EU coal markets - driven by the low price of US coal, the collapse of carbon prices in the European Emissions Trading System, and the lack of funds required to finance the building of new infrastructure - have delayed the development of renewable energy projects. The demand for gas, often seen as a flexible complement to intermittent renewable energy, is projected to therefore remain stagnant.

Fourth, concerns exist regarding the security of supply. In order to be financially viable, both the southern energy corridor projects (TANAP and TAP) will eventually have to be supplied with additional gas. Whilst Shah Deniz field can supply a maximum of 25 bcm by 2017, TANAP will start with a capacity of 16 bcm and eventually expand to 30 bcm. Efforts to access new gas sources will also face considerable hurdles: the political isolation of Iran, the disputed legal status of the Caspian Sea, the lack of political will in Turkmenistan to support the construction of a Trans-Caspian pipeline (instead favouring trade with Asia), and the differences in quality between Turkmen and Azeri gas could all threaten the long-term sustainability of the project.

Not just about energy

Beyond being a means to strengthen European energy security and encourage debate over the creation of an integrated pipeline network within Europe, the southern energy corridor also highlights the importance of Central Asia and the Caucasus for the EU. It also creates a window of opportunity for the EU - a diplomatic corridor in its own right - to expand from its traditional development projects and further engage in the process of conflict resolution in the Caucasus.

The announcement of the success of the TAP pipeline bid was met with waves of joy that swept across Athens, Tirana, and Rome. In times of economic hardship, the pipeline can create jobs and boost development while connecting Central Asia with southern Europe. However, it should be remembered that, even if the project proceeds as announced, only the Shah Deniz final investment decision in October 2013 will determine whether the real winner is European (energy) security.

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