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**Old players, new identities and bargaining instruments:
A cost-benefit discussion of Southern Corridor oil and gas pipelines**

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**Warsaw Gas Forum
September 13, 2010**



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Ladies and Gentlemen:

In my talk today I would like to offer an overview of the oil & gas pipeline network that mushroomed across the territories of the so called Southern (or Black Sea/Turkey/Caucasus) corridor over the last two decades.

The region has become a key transit territory linking Caspian and Central Asian energy supplies to European energy demand, as is well known. Countries in the region are jockeying for position to become the key transit state, a bridge from supplier to consumer, or the pivotal energy hub in the region.

Intense competition, and international cooperation, has replaced the political standoff which governed the geopolitics of the area a mere two decades ago.

An economic boom, based on a burgeoning energy trade, should be characterizing the region and helping it to extricate itself out of localized frozen conflicts, whilst reducing scope for lingering bilateral conflict between states such as Armenia and Azerbaijan.

Decisions based on market principles furthering regional economic growth should be the norm and investment into fixed cross border oil and gas pipeline infrastructure is a pivotal way of promoting cooperation and reducing scope for conflict

However, from serving as a primary economic tool, conceived to transfer energy resources from supplier to customer, such pipelines have now firmly entered the sphere of geopolitics as policy makers have realized the potential implications and consequences that each pipeline carried through transit countries, in both economic and strategic terms.

We are now constantly on the lookout for “Gazprom’s next movements”, for the next “gas crisis”, disruption of supply (from east to west) or other threat to European energy security

We have now reached the point where it is almost impossible to discuss major pipeline projects without entering into bilateral political discussions between states, or entering into discussions about geopolitics.



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We therefore arrive at a number of questions:

- What have been the key factors that have contributed to this situation ? What are now the factors motivating the decisions to invest into the construction of oil and gas pipelines ?
- How will the “final investment decision” on such projects be affected by the current low gas demand environment and overabundance of supply/the improved energy security of the consumer countries ?
- Which projects will come on stream and which ones are likely to fall by the wayside ?

These are some of the questions I want to explore today, talking against the backdrop of the main oil and gas pipeline projects (either currently already operational or themselves in the pipeline, so to speak) in the Southern Corridor, linking Europe via the Balkans, Turkey/the Black Sea and the Caucasus, to the energy resources of the Caspian and Central Asia

Why do countries in the region clamor to become key regional transit states (or regional energy hubs) and what are the implications of such decisions for the governments of such countries ?

Lets look at two examples: Georgia and Turkey.

In the first instance, governments are fast realizing that becoming an “energy hub” may have the consequences of that particular country moving from a peripheral to a more central (strategic) position in regional inter-state systems.

In the case of Georgia, such status has allowed the country to have greater influence over larger and more powerful stakeholders in the region, including foreign governments and foreign investors. Georgia impressed upon the US the need to have a pipeline connecting Azerbaijan to Turkey and employed the concept to further leverage for its own ambitions of Western integration.

The Baku – Tbilisi – Ceyhan (BTC) pipeline became not only the major Western (particularly EU) tool of energy diversification to the chagrin of Russia, but also Georgia’s own channel to attract Western financing and as being a means of elevating its own national agenda to the core of international attention.

In the case of Turkey, a country blessed by the virtue of its political geography, such status has allowed it to find new ways of preserving strategic levels of importance which it has held



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almost eternally. Turkey may have been deprived of its pivotal importance to the West at the end of the Cold War, but the country instead continued to maintain its significance as a key Western ally due to its renewed role as an energy corridor connecting Caspian resources to the Western market.

The NABUCCO, BTC, Baku-Tbilisi-Erzurum, ITGI pipelines are core instruments of the Western energy security concept. Such projects would (and will) be impossible to realize, however, without Turkey's active support and engagement. Energy politics have therefore helped maintain Turkey at the center of the Western strategy despite the changes in history, by giving it new bargaining tools to manipulate its relations with the West, as well as its new energy partner, Russia.

When discussing Turkey, It is important to note that energy cooperation has the scope to completely reshape the map of the international alliances and create new friendships between former national adversaries. The recent and in some ways dynamic case of rapprochement between Russia and Turkey has taken many external observers by surprise.

After centuries of open enmity caused by clashing religious identities and territorial ambitions, Moscow and Ankara found a common ground of understanding in the field of energy. Energy cooperation has provided both countries with new identities, as both develop the role of champions of European energy security (in one way or another).

Both are the "gate keepers of the European energy supply" as well known British energy commentator, John Roberts, once described them. The Russo-Turkish energy partnership has the potential to re-shape European energy ties with both Russia and Turkey, and this partnership has already caused some level of divergence of interest between Turkey and its Western partners, which appeared to be so strong during the 1990s.

Message: geopolitics associated with energy, and the often self proclaimed status of a "energy hub" has firmly entrenched itself as a new feature of contemporary international relations, which assigns new identities to old players and provides them with new negotiating instruments, that are essential for their continued relevance (and perhaps very survival) just as other forms of such instruments have been throughout shifts of time and history.

Let us now turn to some of the oil and gas pipeline projects in the region more closely.



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PIPELINES WITH RUSSIAN PARTICIPATION

SOUTH STREAM (gas)



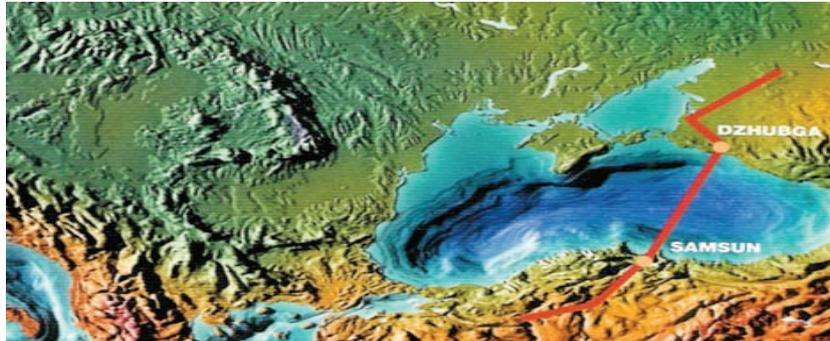
Source: Strategic Forecasting Inc.ⁱ

- **Route:** from the Russian coast to the Bulgarian coast.
- **Capacity:** 63 billion cubic meters (bcm)/year.
- **Benefits for the EU:** increases the energy supply security of the entire European continent and covers the future increase of demand (by 2025 the EU should need an additional demand of 200 bcm). It bypasses Ukraine and therefore prevents any possible dispute between Russia and Ukraine from threatening EU energy security.
- **Benefits for Russia:** allows Gazprom to increase the diversification of supply routes and ensures that Russia will continue playing a significant role in EU energy consumption.
- **Challenges:** South Stream has been criticized for being in competition with the EU endorsed NABUCCO project, which was conceived to reduce European energy dependence on Russia. South Stream appears to be reasserting Russian control over the European energy market. The pipeline does not decrease the EU reliance on Russian energy but simply channels it through a new route.



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BLUE STREAM (gas)



Source: Offshore-technologyⁱⁱ

- **Route:** from the Russian station of Beregovaya to the Turkish terminal of Durusu.
- **Capacity:** 16 bcm/year
- **Benefits for the EU:** Negative (see below)
- **Benefits for Turkey:** ensures reliable supplies of gas for the requirements of Turkish domestic consumption. It cements bilateral relations between Ankara and Moscow. At the time of its conception, many analysts believed that there was insufficient gas demand in Turkey to justify both the Blue Stream and the Trans-Caspian pipelines, so that when the Blue Stream agreement was signed, its pending ratification was widely discussed in both the Turkish Parliament and the National Security Council.
- **Challenges:** consistently increases Turkish dependence on Russian gas. Allows Russia to counter-balance both Western and Turkish efforts to diminish Russian dominance over the Central Asian energy market. Significantly undermines Turkey's efforts to become the pivotal Eurasian energy power through alternative projects such as NABUCCO. Some consider the pipeline to be a Russian "Trojan Horse" in the heart of the EU, since the participation in the project of the Italian national energy company ENI significantly undermines the efforts of the EU to build a common energy policy capable of greater energy independence from Russia.



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PIPELINES THAT BYPASS RUSSIA

NABUCCO (gas)



Source: Strategic Forecasting Inc.ⁱⁱⁱ

- **Route:** Turkey – Bulgaria – Romania – Hungary – Austria.
- **Capacity:** initial capacity of 13 bcm/year, to increase to 31 bcm by 2020
- **Benefits for the EU:** The project is the key component to EU efforts for diversification of energy supplies. Aims to purchase gas directly from Azerbaijan, thereby decreasing EU dependence on the Russian transportation network/supply source.
- **Benefits for Turkey:** Favours Turkey's leading role in Eurasia. Provides Turkey with a pivotal role in the connection & management of the energy network between Europe and Central Asia. Provides Ankara with significant negotiational advantages vis a vis Brussels with respect to Turkey's EU accession bid.
- **Challenges:** Russian Prime Minister Putin claimed that even if the EU manages to open this alternative route, it will still need to be supplied with Russian gas. Russia appears intent on buying up slack Azeri gas reserves and therefore undermine the resource base for the project.

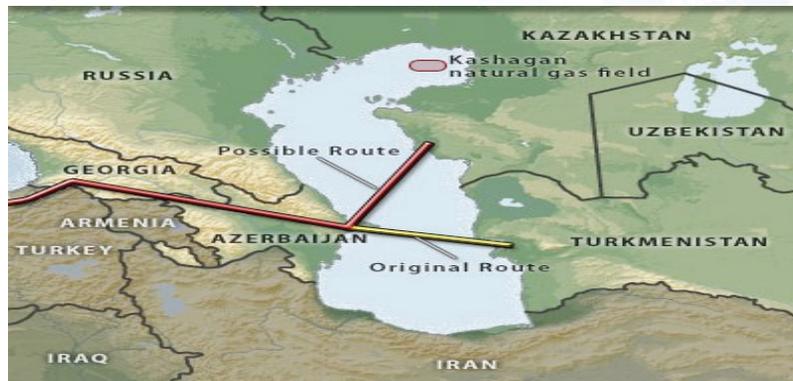
While the project cost is estimated at 3.97 billion Euros, the European Commission has only allocated 272 million Euros so far. Germany appears to favour the alternative Nord Stream pipelines, sponsored by Gazprom and European energy companies. Turkey's problematic negotiations for EU membership have negative bearing on the development of the project, as do bilateral relations between Turkey and Cyprus. There is also uncertainty about Turkey's ability to adopt the regulations of the EU internal energy market, which is currently evolving and being exported to neighbouring states.

As is the case with any pipeline that crosses Turkey, NABUCCO might also become a target for terrorist groups, such as the PKK, which could result in major financial losses and disruption of the energy supply. The gas suppliers for NABUCCO are envisaged to be Azerbaijan, Turkmenistan and Iraqi Kurdistan. The unstable political situation in Iraq, along with Turkey's own problems with the Kurdish guerrillas, presents by no means an insignificant concern for the security of the pipeline. NABUCCO appears, therefore, as a project with great potential, although one undermined by a wide range of threats and potential shortcomings that cast doubts over its prospects.



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TRANS – CASPIAN (gas)



Source: Politics, Peaks and Valleys^{iv}

- **Route:** from Turkmenistan to Azerbaijan under the Caspian Sea.
- **Capacity:** 30 bcm/year
- **Benefits for the EU:** if connected to the NABUCCO, as scheduled, it would represent a major step towards the EU goal of energy supply diversification. Nonetheless, the uncertain status of the NABUCCO itself is undermining the development of the whole project.
- **Benefits for Turkey:** as with the Baku-Ceyhan oil pipeline, the Trans-Caspian pipeline was supported by Washington in order to foster the development of an alternative East-West corridor that would gradually deprive Russia of its centrality in the Eurasian energy transportation network, instead giving such role to Turkey. The pipeline was conceived to transport gas from Turkmenistan and Kazakhstan to Turkey, which would allow the latter to access the expanding European gas market.
- **Challenges:** plans stalled in 2001 due mainly to Russian opposition, given that the pipeline would deprive Gazprom of its monopolistic position over the Eurasian gas market. Russia instead proposed to Turkey the alternative Blue Stream project, in partnership with Italy's ENI. Additional uncertainties over Turkmen commitment to supply gas were highly detrimental to the further development of the project.

The project was resumed in 2006, however. The main current challenges concern both Russian and Iranian initiatives to boycott the project, given their status of transit countries for Turkmen gas. Additional complications come from the uncertainties over NABUCCO. Lack of progress on the development of NABUCCO would deprive the Trans-Caspian pipeline of its value for the EU and would diminish significantly its importance for Turkey.



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BAKU – TBILISI – CEYHAN (oil)



Source: Strategic Forecasting Inc.^v

- **Route:** Azerbaijan – Georgia – Turkey
- **Capacity:** one million barrels/day
- **Benefits for the EU:** allows the EU to purchase oil without Russian mediation and decreases therefore the dependence of the EU on the Russian market & transportation network.
- **Benefits for Turkey:** Favours Turkey's pivotal energy role in Eurasia. Accords Turkey with a pivotal role in the connection & management of the energy network between Europe and Central Asia. The pipeline was sponsored by the Clinton administration in order to foster the development of an alternative East-West corridor that would gradually deprive Russia of its centrality in the regional energy transportation network (and emphasizes such role on Turkey). Minimizes seaborne transportation of oil in the Black Sea and facilitates a bypass of the navigation problems/environmental concerns in the Turkish Straits.
- **Challenges:** the PKK has already attacked the pipeline. Plans for the BTC, which is the main channel of oil supply to the West, were first suspended in the 90s due to the escalation of the conflict between the PKK and the Turkish Armed Forces. They could only be resumed after the capture of Abdullah Ocalan, the PKK leader. The pipeline was attacked on the eve of the 2008 war in Georgia, leading to substantial financial loss and disruption of the oil flow. The pipeline appears therefore as source of instability, and its security remains uncertain, especially in the wake of recent Turkish military offensives against the PKK.



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BAKU – TBILISI – ERZURUM (gas), also known as Southern Caucasus Pipeline (SCP)



Source: East European Gas Analysis^{vi}

- **Route:** Azerbaijan – Georgia – Turkey
- **Capacity:** expected to reach 30 bcm/year.
- **Benefits for the EU:** An important link to NABUCCO which allows the EU to purchase gas directly from Caspian/Central Asian gas suppliers, thereby reducing EU dependence on the Russian market & transportation network, as the Baku-Tbilisi-Ceyhan oil pipeline.

Benefits for Turkey: Favours Turkey's leading role in Eurasia. Accords Turkey with a pivotal role in the connection & management of the energy network between Europe and Central Asia.

- **Challenges:** The main threat concerns the general instability of the Caucasian states. The gas flow through the pipeline was disrupted for two days during the 2008 Georgia-Russia war. As with the Baku-Tbilisi-Ceyhan oil pipeline which runs parallel to the Baku-Tbilisi-Erzurum gas pipeline, the PKK constitutes an additional challenge that questions the security of the project.



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INTERCONNECTOR TURKEY – GREECE – ITALY (gas)



Source: Strategic Forecasting Inc.^{vii}

- **Route:** Turkey – Greece – Italy
- **Capacity:** by 2012, it should reach 11 bcm/year.
- **Benefits for the EU and Turkey:** the pipeline allows the direct linkage between the European and Turkish networks, and is therefore of major importance to both the EU efforts of diversification, as well as Turkish efforts to establish the country as the pivotal transit territory for European energy. Once connected with the Poseidon pipeline between Greece and Italy, the project will allow for direct flow of Central Asian gas into a key European supply region.
- **Challenges:** the project was conceived during a new era of Greek-Turkish rapprochement. As long as cooperation between Athens and Ankara continues along this path, the project looks pretty safe



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PIPELINES THAT BYPASS TURKEY

WHITE STREAM (gas)



Source: GUEU^{viii}

- **Route:** from Georgia to Romania OR to Crimea/Ukraine.
- **Capacity:** it is expected to grow from 8 bcm/year to 32 bcm/year.
- **Benefits for the EU:** allows the establishment of a direct route from the Caucasus to the European continent across the Black Sea. It involves a complete bypass of both Russia and Turkey and increases EU's ability to diversify its sources of the gas supply. The project was conceived partially as a response to the burdens that the NABUCCO consortium has encountered during the challenging negotiations with Ankara and in order to allay the fears of a rising Turkish monopoly over the European energy security which has arisen in some quarters. The project would allow the EU to basically remove any major transportation risk that may arise westward of the Caucasus.
- **Benefits for Turkey:** Negative
- **Challenges:** The main risk comes from the vulnerability of Georgia. The country has been recently involved in a short war with Russia and continues to find itself in a neighbourhood full of geopolitical risks. Moscow continues to view Georgia's energy policy as a threat to Russian monopoly, and is likely to take further steps to reassert its control of the Central Asian distribution network.



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BURGAS – ALEXANDROUPOLIS (oil)



Source: Sofia News Agency^{ix}

- **Route:** from the Bulgarian port of Burgas to the Greek port of Alexandroupolis.
- **Capacity:** 35 million metric tons/year
- **Benefits for the EU:** allows the establishment of a direct route from the Caucasus to the EU Balkan member states across the Black Sea. It involves a complete bypass of Turkey.
- **Benefits for Turkey:** Minimizes seaborne transportation of oil in the Black Sea and allows facilitates bypass of the navigation problems/environmental concerns in the Bosphorus.
- **Challenges:** The pipeline has been considered a Russian “Trojan Horse” in the heart of the EU, because it reasserts a direct role of Moscow in supplying oil to the EU. Moreover, the pipeline allows the Kremlin to strengthen its geopolitical influence in the Balkans in order to counter-balance EU enlargement as well as NATO presence in the area. Moscow has tried to take advantage of Greece’s recent financial crisis, and has hoped to reinforce its traditional ties with Greece for geopolitical gain.



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AMBO (oil)



Source: CEE Bankwatch Network^x

- **Route:** Bulgaria – FYROM – Albania
- **Capacity:** 750,000 barrels/day
- **Benefits for the EU:** Allows the establishment of a direct route from the Caucasus to the EU Balkan member states across the Black Sea. It involves a complete bypass of both Russia and Turkey. Offers development opportunities to the states of the Southern Balkans (Bulgaria, FYROM, Albania) and their integration into the EU energy network.
- **Benefits for Turkey:** Minimizes seaborne transportation of oil in the Black Sea and allows facilitates bypass of the navigation problems/environmental concerns in the Bosphorus.
- **Challenges:** The relative instability of both the FYROM and Albania is the main risk confronting the project. The FYROM was involved in a civil war in 2000/2001, which required a conflict prevention operation by the NATO and the EU. However, the current developments in the Southern Balkans do not seem to pose a serious threat to the pipeline.



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Concluding Thoughts

What conclusions can we draw from the above:

Decisions to invest into oil and gas pipelines in the Southern Corridor countries are rarely based purely on market principles and this situation is unlikely to change in the foreseeable future.

This is not just due to geopolitics, however, but also due to the fact that “etatism”, the practice where the state takes a commanding role in the development of the national economy, is a dominant form of economic culture in the region. There is no precedent of pure market mechanisms, without heavy state involvement, in the ex-USSR, in Turkey or the Arab world.

The economic well being of many of the regional states, if not very survival, depends on the ability of getting resources to markets – and therefore compels them to compete for the prize of being (or becoming) the next regional energy hub.

Despite the recent global economic downturn, we are extremely well placed today in terms of technologies and capital to exploit limited and difficult to access (new upstream) energy resources and get them to markets.

Message: Technology and capital is, in principle, available for complex oil and gas pipeline (transport infrastructure) projects However: new technologies and market opportunities are also accompanied by new vulnerabilities:

Despite the seeming availability of both technologies and capital, cross border energy transportation projects are becoming more a factor fostering (political) tension than fostering international cooperation and goodwill.

In Europe (and in wider Eurasia), energy security has become the overarching (political) priority for all stakeholders in the value chain of the energy trade, and all stakeholders are taking increasingly divergent definition to this concept. Even NATO is getting in on the energy security debate.

When the main factor in making a decision about where and how to invest into a new oil or gas pipeline project should be primarily about the most optimal means of getting resources to markets, we now have to take a much wider range of factors into account

While the current gas glut (oversupply and low demand environment) appears to make some of the above mentioned gas pipeline projects (as well as demand for new gas storage facilities) less urgent, a longer term need for the projects will continue to exist (particularly in the European energy security reckoning)



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While the last Russia-Ukraine gas crisis now seems somewhat distant, many of the negative outcomes of that crisis remain unresolved:

- The crisis demonstrated the lack of congruence in the positions of energy producing, consuming and transiting states, and lack of their ability to prevent a supply crisis
- Politicisation and evaporation of trust
- The crisis demonstrated the vulnerability of all sides (especially EU, lack of EU solidarity, need to diversify sources of supply and push on with the development of a single EU internal energy market
- Weakness of institutions of global governance in the energy sector and their inability not only to prevent, but to contribute to the resolution of the crisis.

Energy transit, with all of its great potential to foster cross border energy cooperation and regional economic growth, instead remains a key policy headache for both consumers and producers.

In a regulatory context underscored by the lack of effective risk mitigation instruments and evaporation of trust, **what are the drivers behind the decisions to build (invest into) major (gas) pipeline projects ?**

- Transit avoidance and diversification – political more than corporate strategies
- Transit is by definition a multilateral arrangement, but national and bilateral interests are winning out over multilateral ones in the energy sphere

Concluding Message: while we have the technology and capital to make sound market decisions about new energy transportation investments (ie, construction of oil and gas pipelines), such investments are now being driven by factors of regulatory weaknesses, national interests and geopolitics (rather than getting resources to markets via the most optimal routes)



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