

Azerbaijan – The key to EU energy security

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The last few weeks have seen a flurry of activity in the Southern Caspian: the bidding for Shah Deniz II gas; the discovery of significant new gas reserves in the Absheron field; and the European Commission receiving the green light from the European Council to negotiate with Turkmenistan and Azerbaijan to establish a legal framework for constructing the Trans-Caspian Pipeline (TCP). All of these developments represent a step forward in realising the EU's Southern Corridor, a priority energy project aimed at diversifying energy supply routes and sources and boosting EU energy security.

Azerbaijan is at the heart of all these developments. The country is presently the only westward route for Caspian hydrocarbons, breaking Russia's former monopoly on access to world export markets. The Baku-Tbilisi-Ceyhan (BTC) and Baku-Tbilisi-Erzurum (BTE) oil and gas pipelines transport one million barrels of oil per day and 6.6 bcm of gas per year respectively. Azerbaijan is the lynchpin of the EU's Southern Corridor and its geostrategic importance continues to increase.

On 1 October the battle for Caspian gas began to heat up with the start of bidding for gas from Azerbaijan's Shah Deniz II field. Of the 16 bcm of gas available, six have already been promised to Turkey, leaving 10 bcm per year available for EU markets. The EU has three horses in this race: Nabucco, the Trans-Adriatic Pipeline (TAP) and the Turkey-Greece-Italy Interconnector (ITGI). There obviously isn't enough gas for more than one. So which will be selected?

While ITGI and TAP would use existing gas infrastructure and the gas available is sufficient for either of them, they mainly target the already-saturated Italian market, which has many players and well-known commercial challenges. Extra gas for Italy is therefore not of great use to Europe. It would be more welcome in the countries of Central and Eastern Europe, which are in desperate need of both volume and diversity of supply in order to reduce their dependence on Russia. However, Nabucco, which has been the EU's flagship project, is a mammoth pipeline with a capacity of 31 bcm, and requires a second – and large – source to make it commercially viable. While the EU has prioritised Nabucco as a strategic pipeline, describing the other two as "merely incremental", ultimately the main priority should be to get Caspian gas to European markets as quickly as possible. The Shah Deniz consortium and Azerbaijan are not interested in waiting another 20 (or even 10) years before they can sell gas in what (even with the threat of recession) is the best market.

While the final decision will 'officially' be made by the Shah Deniz II Consortium, Baku's opinion is crucial. Azerbaijan's official position is that all three pipelines will be judged pragmatically on a commercial basis (ruling out political considerations). To clarify its position Baku has indicated that the final decision may be based on additional criteria: being a shareholder in the winning consortium and fully utilising the pipeline with commercially guaranteed sources of supply (under-utilisation would result in excessively high transportation tariffs); plus Baku doesn't want to pay to build speculative pipeline capacity.

However, to get Azerbaijani gas to Europe (irrespective of the pipeline), a transit agreement must be concluded between Ankara and Baku. Unfortunately, ongoing negotiations are yet to find a solution. A delay beyond the end of the year could further prevent Shah Deniz II from coming online, which would be very expensive for consortium members. Ankara's main concern seems to be not to repeat the mistake it made in the transit agreement with BTC, when it failed to take into account price fluctuations linked to purchasing Azerbaijani oil. Furthermore, since the transit agreement will cover all pipelines, Turkey would like to agree conditions for all pipeline networks from the Middle East and North Africa that will be connected to the main Southern Corridor

pipeline. Therefore, the conditions that Turkey is proposing to the Shah Deniz II consortium and Baku – and the conditions of gas-producing countries that it is currently considering – must be applicable to all future transit contracts with neighbouring countries.

Azerbaijan also has the potential to be a key transit state for Turkmen gas (around 8 bcm). Ashgabat has sought to diversify its gas exports in all directions, including to European markets. Contrary to popular belief, Russian imports of Turkmen gas are only 10 bcm per year. China now imports more than Russia. Depending on what China takes in the next 10 years (which remains unclear), Turkmen reserves could be enough for Nabucco's second stage. While Ashgabat is seeking commercial and political guarantees, President Gurbanguly Berdimuhamedov has frequently stated his support for a TCP.

Tripartite talks between the European Commission, Azerbaijan and Turkmenistan began last week in Brussels and will cover all issues pertaining to the project's implementation – including construction and commissioning of the TCP – and recognition of commercial agreements. While the talks are not expected to conclude quickly, if successful, then Moscow's imperialistic near-monopoly over pipelines to the EU gas market would end (although Gazprom would still by far and away be the leading supplier). Despite this, it seems the Russians are far from happy with the idea of any trans-Caspian supplies. The Foreign Ministry claims in a statement that the EU should not meddle in Russia's backyard and that the EU is ignoring the legal, environmental and geopolitical situation in the Caspian. In short, Russia (and Iran) is still insisting that the construction of such a pipeline is impossible without a final agreement among all Caspian littoral states on the concerns which it has raised.

However, pipelines have already been laid across existing borders that remain to be agreed upon, including in the North Sea. Therefore ongoing status talks among littoral states should not impede the construction and operation of a TCP.

Nevertheless, Azerbaijan has taken a cautious and well-considered approach. Its leadership states that "according to the European Energy Charter, we are an open transit state, and the infrastructure independent states want to build across their shared border is their own bilateral business [...]. We have already stated our readiness to discuss this issue".

Since independence, Baku has sought to maintain a multivector foreign policy, seeking to maintain a balance between Russia, Iran and the West. The last thing Baku wants is a confrontation with Moscow. While the bulk of Azerbaijan's income is earned directly on international markets and does not pass through Russia, there are still many family and commercial links (e.g. Azerbaijanis working in Moscow and St. Petersburg). Moreover, Baku must consider the significant role played by Russia in resolving the Nagorno-Karabakh conflict with Armenia, Moscow's closet ally in the region. Iran is also concerned and the possibility that Russia and Iran (as they have done in the past) could engage in gunboat diplomacy (literally) must not be ruled out. It is unfortunate that Russia is adopting such a zero-sum game approach. The days of Russian imperial domination of Caspian states are over. Moscow should accept this and stop bullying others into continuing to support a range of post-imperial Russian monopolies.

For the EU, Azerbaijan is a key partner on Caspian regional energy projects. EU Energy Commissioner Günther Oettinger recently stated: "We consider Azerbaijan as the key contributor to the Southern Corridor project." Former Azerbaijani President Heydar Aliyev famously said "happiness is multiple pipelines". As Azerbaijan celebrates twenty years of independence, the country is at least halfway to achieving this. Baku can access international oil markets freely - it now wants to do the same for gas. Azerbaijan possesses at least 2.55 trillion cubic metres of gas reserves and continues to discover more. For Baku it is imperative to access global markets sooner rather than later. A pragmatic solution now would be better than a perfect solution in 20 years' time: like in other areas, the EU should not let "the best be an enemy of the merely good". And imperfect but nevertheless good solutions will be cheaper and deliver benefits to European taxpayers sooner: surely important in this age of austerity.

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