



THE CHANGING GEOPOLITICS OF ENERGY INFRASTRUCTURE IN THE CASPIAN SEA REGION

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The Southern Gas Corridor: Prospects and Challenges for EU Foreign Policy

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Abstract

As the construction of the Southern Gas Corridor (SGC) is nearing completion, the European Commission has recently expressed an interest in the future doubling of its capacity. In addition to Azeri gas, Turkmen gas could be made available through gas swaps involving Iran. However, the SGC poses an ethical, environmental and security conundrum for European energy and foreign policy. Major issues include the partnership with Azerbaijan's regime, transit dependence on Turkey and large public investments in infrastructure that may become stranded as the EU transitions away from fossil fuels and due to competition from Russian gas and liquefied natural gas (LNG). Moreover, current US policy casts doubt on Iran's future involvement and regional stability.

Introduction

The Southern Gas Corridor (SGC) is the outcome of a long-term quest of the European Union (EU) to diversify its gas imports by accessing Caspian Sea fields through a route that bypasses Russia. Russia supplies approximately 40% of EU gas imports and is the main gas provider to most Eastern and South-Eastern European countries (European Commission 2018, 11). In some of these countries, concerns about Moscow's dominant market position and the security of its supplies has grown over time, particularly following the gas transit crises between Russia and Ukraine (in 2006 and 2009) and the deeper conflict between the two countries following Russia's annexation of Crimea in 2014 (see Siddi 2018 for an overview of the energy aspects).

In the 2000s, the EU elaborated ambitious plans to import gas from the Caspian basin and Central Asia. The Nabucco pipeline project, with a planned capacity of 31 billion cubic metres per year (bcm/y), was the embodiment of these plans. Nabucco aimed to import gas from Azerbaijan, Iran and/or Turkmenistan to Europe. However, it was never built due to adverse economic conditions and the lack of sufficient gas to fill the pipeline. In particular, this was due to the international sanctions on Iran's energy exports after 2006 and the legal and economic obstacles to building a Trans-Caspian Pipeline allowing access to the vast Turkmen resources.

In 2013, the Shah Deniz consortium—which extracts the Caspian gas intended for export to Europe—opted for a more modest export route to the EU, the Trans Adriatic Pipeline (TAP), with a capacity of 10 bcm/y (Chazan and Shotter 2013). This represents only a fraction of the EU gas import demand, which reached 363 bcm in 2018 (European Commission 2018, 10). However, SGC gas could partly diversify the portfolio of countries such as Greece and, potentially, Bulgaria. Currently, Azerbaijan is the only gas supplier to the SGC.

In its destination markets, the SGC will face competition from Russian pipeline gas and possibly liquefied natural gas (LNG), particularly if new import terminals are built in the Balkans and the LNG prices are competitive. Nonetheless, the EU has provided relentless support to the SGC, both through financing and diplomacy, because it considers it a strategic (that is to say, geopolitical) project to bypass Russia. The same logic explains the vocal US support for the project. Geopolitical confrontation with Moscow after 2014 has supported this rationale.

The following sections describe the main technical and financial aspects of the SGC, the security and foreign policy challenges related to its route, and the ethical and environmental issues that have been largely disregarded in the EU's official debate.

The SGC: Route and Financing

The SGC consists of four sections, with a total length of approximately 3,500 kilometres (from the Caspian Sea to the Southern Italian region of Apulia). The first section comprises the Shah Deniz gas field and extraction facilities in the Caspian Sea. The second part includes the South Caucasus pipeline, running from Baku to the eastern Turkish city of Erzurum. This pipeline has been operational since 2006, but its capacity will be expanded to allow additional exports from the SGC project. From Erzurum, the gas will be channelled westwards via the Trans-Anatolian Pipeline (TANAP), which crosses Anatolia and European Turkey all the way to the Greek-Turkish border. The building of the TANAP was completed in July 2019. Further west, construction is still ongoing on the TAP, which will carry gas from the Greek-Turkish border to Italy via Greece, Albania and an offshore section in the Adriatic Sea. According to the estimates of the TAP consortium, the work will be completed in 2020, and the gas will start flowing by the year's end.

A total of 10 billion cubic metres per year (bcm/y) of gas will be channelled to the EU via the SGC. The prospect of expanding the volume of exports to 20–25 bcm/y has been discussed (Gotev 2019), but this would require additional infrastructure, investments and gas sources (Pirani 2018). In the foreseeable future, Greece and especially Italy will be the main recipients of Azeri gas. Other countries in the Balkans, such as Bulgaria, could receive SGC gas following the completion of the necessary infrastructure, notably the Gas Interconnector Greece–Bulgaria and the Vertical Gas Corridor (also known as BRUA, connecting Bulgaria, Romania, Hungary and Austria).

Estimates of construction costs of the SGC have oscillated between 40 and 45 billion US dollars (USD). A substantial part of the costs has been covered with bank loans. The largest lender has been the European Investment Bank (EIB), a public bank owned by EU member states, which has provided a total USD 2.8 billion for the construction of TAP and TANAP. The World Bank has loaned USD 1.8 billion to TANAP, whereas the European Bank for Reconstruction and Development (where EU member states and EU institutions hold a majority of shares) has loaned a total USD 1.7 billion to TAP, TANAP and the Shah Deniz consortium. Other prominent funders have been the Asian Development Bank (USD 1.3 billion) and the Asian Infrastructure Investment Bank (USD 0.6 billion).¹ As noted by some NGOs, billions of European public monies have been spent on supporting the construction of the SGC.

Security and Foreign Policy Challenges

There are two sets of security and foreign policy issues regarding the SGC: the first concerns the existing project, whereas the second stems from proposals to involve suppliers such as Iran and Turkmenistan.

The SGC follows a route that is dangerously close to several regional conflicts. It runs only a few kilometres from Nagorno-Karabakh and South Ossetia. The prospect of another war between Azerbaijan and Armenia over Nagorno-Karabakh remains very real, as highlighted by the clashes in April 2016 (Broers 2016). The Armenian air force has simulated attacks on Azeri energy infrastructure, which could take place in the event of a full-out war (Kucera 2012). Such a conflict may also involve Russia, Armenia's ally within the Collective Security Treaty Organization.² Moreover, Russian troops stationed in South Ossetia are within easy reach of the SGC infrastructure in Georgia and have already

crossed the current SGC route during the August 2008 war against Tbilisi (Siddi 2019, Marriot and Minio-Paluello 2013, 147–157).

In the Turkish territory, the SGC runs through areas where frequent clashes occur between the Turkish army and Kurdish militias. This conflict has not spared the energy infrastructure in the past (see, for instance, Reuters 2015). Ankara's changed geopolitical stance and relationship with the EU also has potential implications for the transit of SGC gas through Turkey. EU–Turkey relations deteriorated following the attempted coup d'état in Turkey in July 2016. Ankara has also cooled its relations with NATO and the West and has pursued a policy of rapprochement with Russia, exemplified by the construction of the TurkStream pipeline and the purchase of the S-400 missile defence system (Hürriyet 2019).

While EU–Turkey relations have deteriorated, some key EU policies have become more dependent on Turkey. This is particularly the case of the migration policy following the 2016 migration deal, through which Brussels gave Turkey a central role in managing (or blocking) the arrival of asylum seekers from the Middle East to the EU. This means that Ankara has influence on a highly politically sensitive EU policy area. The SGC creates a new dependency on Turkey for the EU, this time in the form of energy transit. This further strengthens the Turkish leverage over the EU at a time of difficult relations between Ankara and Brussels. Developments in the summer of 2019 illustrated the implications of this situation, including the possibility that Turkey will link migration and energy issues in its relationship with the EU. In July, Turkey suspended the migration deal following the EU's imposition of sanctions on Ankara in response to Turkish gas drilling activities in Cypriot waters.

A second set of issues relates to plans to expand the SGC, which would most likely require additional supplies from Iran or Turkmenistan. The reintroduction of US sanctions against Iran since 2017 have made Iranian involvement in the SGC an extremely unlikely prospect. Even before the Trump administration took this highly controversial decision, market factors suggested that Iran would rather seek to export its gas as LNG, rather than through a long and expensive land route (Tabatska 2015).

Regarding substantial gas imports from Turkmenistan via the SGC, these are also unlikely. The Turkmen gas export policy is already oriented towards China and is unlikely to change significantly. Even if it were to

1 The NGO Bankwatch published a breakdown of approved and proposed public finances for the different components of the SGC, which is available at: <https://docs.google.com/spreadsheets/d/1NktFpFQY8x1Y8pxnGiEnL3i5hIKIq2GRsl5Vm3u4vt8/edit#gid=247408276>.

2 For another hypothesis (albeit rather speculative) on how Russia could intervene militarily in the region, see Baev 2019.

change, a Trans-Caspian pipeline would have to be built to link the Turkmen gas network to the SGC. Despite last summer's agreement on the legal status of the Caspian Sea, which seemingly removed the main legal obstacle to the construction of the pipeline, political hurdles persist, including Russian and Iranian opposition to the project (Brzozowski 2018). Moreover, the economics of Turkmen exports to Europe via the SGC and a Trans-Caspian pipeline remain problematic: with current prices and transit costs, Turkmen gas would not be competitive against Russian gas or LNG in the EU (Pirani 2018, 11–18). On the other hand, Turkmenistan has recently sold gas to Azerbaijan and Armenia through swap deals with Iran. According to press reports, Iranian and Turkmen officials hope to strike more such deals and export up to 5.4 bcm/y to Azerbaijan and Armenia, thereby possibly allowing Baku to channel some additional gas via the SGC (Gotev 2018a).

However, additional SGC exports to South-Eastern Europe may face increased competition from Russia, the dominant gas supplier to the region. Russia's Gazprom plans to complete the construction of the TurkStream pipeline—transporting gas to Turkey and the Greek–Turkish border via the Black Sea—by the end of 2019 (Platts 2019). TurkStream has a capacity of 31.5 bcm/y, half of which is meant for exports to Europe. While construction of the adjoining pipelines in the EU will take longer, substantial volumes of competitive TurkStream gas will probably be available in the Balkans by 2021 or 2022, before the infrastructure for additional SGC exports is built. This prospect casts doubt on the economic rationale of expanding the SGC, especially as gas demand in the destination markets is not expected to grow.

Ethical and Environmental Concerns

No less important than foreign policy and economic issues, EU gas imports from Azerbaijan and the SGC involve serious ethical and environmental concerns. Gas revenues are essential in propping up Azerbaijan's authoritarian government, which has a vast record of human rights violations (see, for instance, Bankwatch 2019, Marriott and Minio-Paluello 2013). If the EU imports of gas from Turkmenistan begin, the EU would *de facto* provide lucrative business opportunities for the leadership of another authoritarian country. The EU's quest for a partnership with Azerbaijan and Turkmenistan, largely due to energy interests, contradicts its claims to pursue a values-based foreign policy.

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Please see overleaf for References

The construction of the SGC has led to several protests and problems all along its route. In Turkey, it is likely to create a high security, militarized corridor across the entire country, causing loss of land and environmental problems for locals (Bankwatch 2019). Land acquisition and poor compensation have caused grievances in both Albania and Greece. In Italy, large protests have occurred in the areas where the TAP is planned to land due to the fear of negative consequences for local tourism, agriculture and the fisheries. Opposition to TAP was also one of the main electoral themes of the now governing Five Star Movement, which initially pledged to stop the project but had to change course once in power due to the prospect of paying huge penalties (Gotev 2018b).

The EU's political and financial support to the SGC also appears in contradiction with its commitment to decarbonize the European economy. Large sums of public money were loaned to support an expensive, long-term gas project that may further lock European economies into fossil fuel consumption. Arguably, the EU's stance towards the SGC reveals how geopolitical logic can still trump ethical and environmental concerns in European decision making.

Conclusion

Following years of construction and various types of controversies, the SGC appears close to completion. While the gas will probably start flowing relatively soon and even contribute to some (limited) diversification in South-Eastern European gas markets, the political and foreign policy issues described above will continue to feed uncertainty in the foreseeable future. If, in the 2000s, the original goal of importing gas from the Caspian region was that of making a substantial contribution to European energy security, the achievements have been modest. The security benefits of the SGC appear particularly dubious due to the numerous crisis zones (potential and real) dispersed along its route.

Even before the gas began to flow, some European officials and business actors began to talk about expanding the capacity of the SGC. However, the economics of this endeavour, as well as the concrete availability of additional gas to fill new pipelines, are highly uncertain. Prospects for further EU gas imports from the Caspian region and Central Asia will also depend on whether geopolitical arguments continue to prevail in the EU over ethical and environmental considerations.

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