

EUROPEAN UNION KEEN ON TRANS-CASPIAN PIPELINE DEVELOPMENT – IMPROVEMENT OF RELATIONS WITH RUSSIA AND TURKEY A KEY HURDLE–

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SUMMARY

- For the EU, which depends on Russia for 40% of its natural gas imports, supply source diversification is a major issue. For many years, the EU has been working on building the Trans-Caspian Pipeline (TCP) as the missing link to complete the Southern Gas Corridor for transporting natural gas from the Caspian Sea region to Europe.
- In 2018, Russia and the other four Caspian littoral countries reached an agreement on the legal status of the Caspian Sea, opening the way to the realization of the TCP. Although the EU has confirmed its basic policy of covering up to 75% of the eligible costs of the TCP's construction, realization of the project remains unpredictable due to questions over its economic viability.
- With various interests of Europe, the US, and Russia intertwined, it is particularly important for the EU to improve relations with Russia and build good relations with Turkey, which is the main transit country for the Southern Gas Corridor.

1. THE SOUTHERN GAS CORRIDOR'S ROLE FOR THE EU AND THE TRANS-CASPIAN PIPELINE BLUEPRINT

The European Commission decided to introduce its first common energy policy¹ in 2006 following the 2005 Russia-Ukraine gas dispute during which the transportation of Russian natural gas to the EU via Ukraine was halted. Included in this policy were plans to accelerate efforts to diversify and expand gas supply routes and sources. To supplement the gas supply via the Northern Gas Corridor, that is, from Russia through Ukraine and Belarus to the EU, the policy stressed the necessity to build a Southern Gas Corridor linking the EU with the gas fields of Azerbaijan and Turkmenistan through Turkey. However, for the Southern Gas Corridor to become fully operational as envisioned by the EU, the Trans-Caspian Pipeline (TCP) should be built. The TCP remains as the missing link and the final hurdle to the realization of the Southern Gas Corridor project.

Under the latest "Reference Scenario²," the EU's natural gas imports are forecast to increase at an annual rate of 0.6% between 2020 and 2030, and reach approximately 330 billion cubic meters by 2025³. Peter Zeniewski, senior analyst at the International Energy Agency (IEA), points out that since more than half of the existing import pipelines exceed 80% of their maximum monthly transmission capacity, it will be essential to expand the

¹ Commission of the European Communities (COM (2006) 105 final), "GREEN PAPER. A European Strategy for Sustainable, Competitive and Secure Energy."

² Capros P. et al., "EU Reference Scenario 2016 - Energy, transport and GHG emissions Trends to 2050."

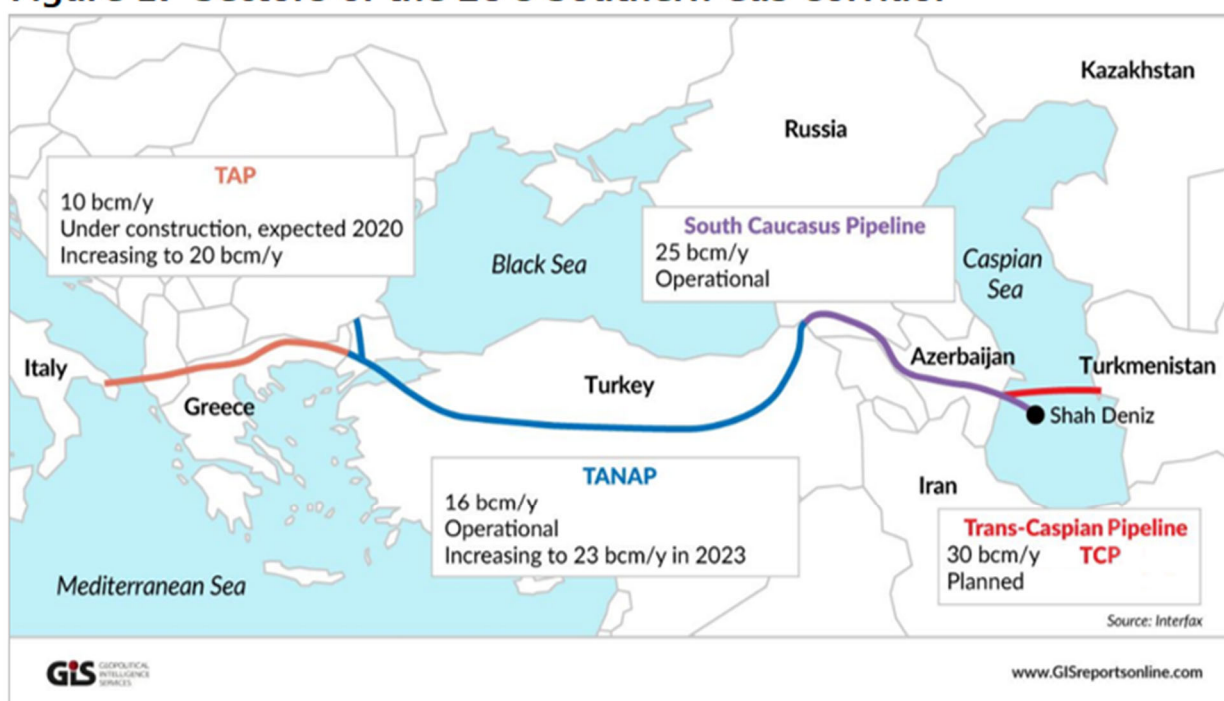
³ This data is based on the natural gas supply and demand equilibrium PRIMES model, which takes the future structure of the EU energy market into account. In addition to pipeline gas from Russia, North Africa, and other locations, as well as the importation of LNG from various parts of the world, the securing of gas from Turkmenistan is highly positioned.

pipeline network. He also cautioned that as long as Asia remains the centre of global LNG demand, the natural gas supply and demand in the EU will be under strain. Consequently, the necessity for the EU to secure new supply sources of about 100 billion cubic meters by 2025 is another factor making the Southern Gas Corridor increasingly important⁴.

Built by a consortium including Azerbaijan's state oil and gas company SOCAR and BP, the TANAP pipeline, which extends the existing South Caucasus Pipeline (SCP) for natural gas to the western part of Turkey, was completed in 2018, and the TAP pipeline, which connects TANAP to Italy, is expected to open by 2020. The EU's blueprint is to further extend TAP, TANAP, and SCP up to Turkmenistan. This is the idea of the TCP construction that would fill the missing link in the Southern Gas Corridor.

The plan is to deliver up to 30 billion cubic meters of natural gas annually from Turkmenistan to Baku in Azerbaijan across the floor of the Caspian Sea, and, from there on, to the EU via Georgia and Turkey. TCP's overall length will be approximately 300 km (Figure 1).

Figure 1: Sectors of the EU's Southern Gas Corridor



Source: Geopolitical Intelligence Services

2. AGREEMENT OF THE CONVENTION ON THE LEGAL STATUS OF THE CASPIAN SEA

The biggest hurdle to realizing the TCP plan was the territorial disputes over the Caspian Sea. Until the collapse of the Soviet Union in 1991, the only two countries bordering the Caspian Sea were the Soviet Union and Iran, and the border between the two countries had been set under a treaty signed in 1921. However, following the disintegration of the Soviet Union, the number of countries bordering the Caspian Sea increased to five, and since the discovery of natural gas and other resources in the 1990s, disputes over territorial rights have continued. Moreover, it has been pointed out that Russia did not seek to resolve the territorial issue because it aimed to obstruct the construction of the TCP, which is a route that would bypass Russia and transport Turkmen gas to Europe without Russian control. This is because Russia monopolized the gas transit route from Turkmenistan that had been laid during the Soviet Union era, through which it re-exported cheaply procured gas to Europe.

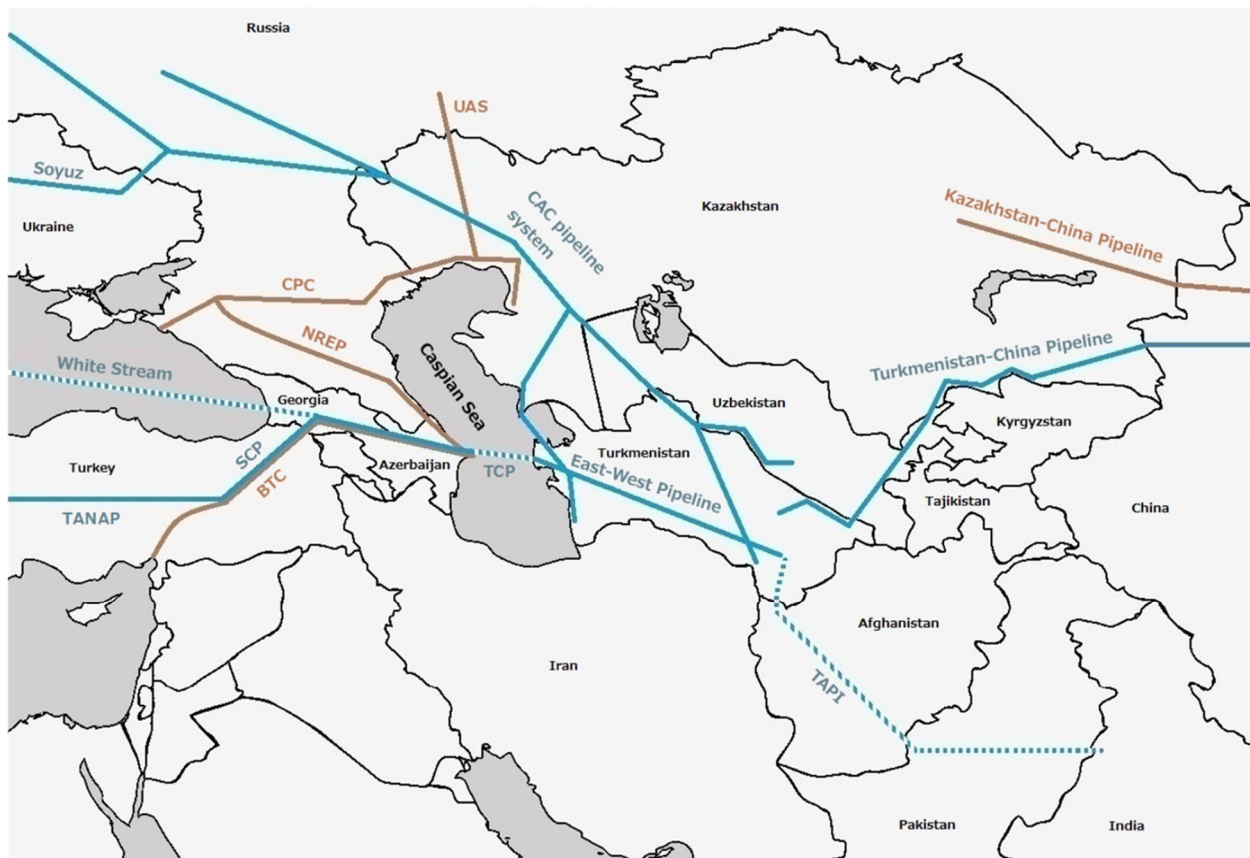
⁴ Peter Zeniewski, "Commentary: A long-term view of natural gas security in the European Union" (www.iea.org/newsroom/news/2019/march/a-long-term-view-of-natural-gas-security-in-the-european-union.html).

Nevertheless, at the Caspian Summit held in Kazakhstan in August 2018, the leaders of the five Caspian littoral countries signed the Convention on the Legal Status of the Caspian Sea⁵, setting forth matters including the legal status of the sea and utilization of seabed resources, as well as an agreement that prohibits the entrance of military forces from other countries into the Caspian Sea. Instead of defining the Caspian Sea as a sea or a lake, the convention gives it a “special legal status.” In terms of territorial waters, each of the five littoral states has territorial rights extending 15 nautical miles off its coast, as well as an exclusive fishing zone up to 25 nautical miles offshore. At the same time, Russia, Kazakhstan, and Azerbaijan have already agreed on their seabed boundaries. For the remaining boundaries, the decision would be made among parties concerned later to clearly delineate respective boundaries.

This agreement is about to completely change the situation with regard to the TCP. Article 14 of the convention has particular significance for the stalled TCP plan. This article clearly states, “The Parties may lay submarine cables and pipelines on the bed of the Caspian Sea,” and adds, “Submarine cables and pipeline routes shall be determined by agreement with the Party the seabed sector of which is to be crossed by the cable or pipeline.”

As a result of this, Turkmenistan and Azerbaijan can effectively proceed with the TCP initiative on their own without Russia’s involvement. The TCP would be linked to the East-West gas pipeline (spanning 800 km with an annual capacity of 30 billion cubic meters), completed in 2015, that connects the gas field belt in eastern Turkmenistan with the Belek gas compressor station on the Caspian Sea coast. This has opened the way for the TCP to become one of Central Asia’s major gas transmission routes, along with those linking Turkmenistan to Russia via the CAC gas pipeline system (capacity: 44 billion cubic meters), to China via the Turkmenistan-China gas pipeline (capacity: 55 billion cubic meters), and to India via the TAPI gas pipeline (planned capacity: 33 billion cubic meters). The Caspian Sea region is increasing its presence as an international energy hub (Figure 2).

Figure 2: Main energy export routes in the Caspian Sea region



Source: Prepared by the author based on the "Overview of oil and natural gas in the Caspian Sea region," U.S. Energy Information Administration (2013)

⁵ "Convention on the Legal Status of the Caspian Sea" (<http://en.kremlin.ru/supplement/5328>).

3. TCP AND THE INTERTWINING INTERESTS OF RUSSIA, THE US, AND OTHER PARTIES

Interest in the Caspian Sea region does not end with the five littoral countries. Following is a brief summary of the interests mainly of Russia, Turkmenistan, and the US as far as their connections with the TCP are concerned.

3-1 Russia

There are three main reasons why Russia abandoned its former stance of blocking the TCP.

(1) The Caspian Sea plays an important role for Russia in terms of its military interventions in the Middle East region, as evidenced, for example, by the fact that a Russian fleet deployed in the Caspian Sea launched cruise missiles into Syria as part of an intervention in the Syrian Civil War. The Convention on the Legal Status of the Caspian Sea contains an agreement prohibiting foreign troops from other countries from entering the Caspian Sea. This means that, in effect, the signatory countries have allowed Russia to maintain its military influence in Central Asia and the Middle East.

(2) The first gas pipeline directly connecting Russia and China (Power of Siberia) has become operational in December 2019, and its biggest competitor is Turkmenistan. If Turkmenistan also exports gas to Europe, it will put upward pressure on the price of gas due to competition for gas between China and Europe, which means that Russia will be able to demand a higher price for its own gas exports to China.

(3) Poland, the three Baltic nations, and the US have all adopted an unequivocal stance in opposition to the Nord Stream 2 pipeline (under construction) that will transport Russian gas to Germany bypassing Ukraine, fearing the pipeline would increase Europe's dependence on Russia. It appears that, in order to soften US criticism, Russia has toned down its policy of obstructing the construction of the TCP originally proposed in 1997 by US companies Bechtel Enterprises, GE Capital, Amoco, and Anglo-Dutch company Royal Dutch Shell.

3-2 Turkmenistan and neighbouring countries

For many years, the gas export routes laid in Turkmenistan during the former Soviet Union era were monopolized by Russia. By opening a pipeline connecting China in 2009, with a view to increasing its export routes, Turkmenistan accelerated its move away from Russia. In 2016, Turkmenistan declined to meet Russia's demand to cut the price of its gas, causing Russia to stop importing gas from the country. As a consequence, Turkmenistan, which relies on gas for about 70% of its national income, was left with China as its only export destination. For this reason, the TCP is essential for Turkmenistan to diversify its gas export destinations. In addition, Azerbaijan, Georgia, and Turkey have high expectations for the transit fees that can be earned from the Southern Gas Corridor, and they are actively working towards the realization of the TCP.

3-3 US

The US played a major role in the Caspian Sea region and Central Asia following the collapse of the Soviet Union. Both the Clinton and the Bush administrations, irrespective of their being Democratic or Republican, contributed significantly to the realization of the BTC oil pipeline connecting the Azerbaijani sector of the Caspian Sea with the Turkish sector of the Mediterranean Sea. In addition, several US military bases were established in the region with the cooperation of Central Asian countries in the wake of the 9/11 terrorist attacks. However, US presence in Central Asia has relatively declined since the closure of its base in Kyrgyzstan in 2014.

Under these circumstances, the Trump administration is now looking to increase its presence in the region again. In March 2019, President Trump sent a letter to Turkmenistan's President Berdimuhamedow, in which he referred to the Convention on the Legal Status of the Caspian Sea, and expressed his hope that Turkmenistan would begin exporting gas to Europe. This may also be taken as a warning shot against Nord Stream 2, which the US opposes.

4. EFFORTS TO REALIZE THE TCP AND THE CHALLENGES INVOLVED

While the EU is actively working to realize the TCP, doubts over the project's economic viability still cannot be dispelled. Moreover, for a stable development and operation of the Southern Gas Corridor, not only the cooperation of Russia, but also of Turkey, whose territory the corridor will cross, and with which relations have deteriorated, are essential. On the other hand, since the EU is both Russia's and Turkey's largest trading partner, it is important for both countries to seek a route to restoring good relations with the EU.

4-1 EU efforts

The EU has been actively working to bring about the TCP since immediately after the agreement on the legal status of the Caspian Sea. In August 2018, German Chancellor Angela Merkel visited Georgia, Armenia, and Azerbaijan, and promised the EU's cooperation in realizing the TCP. A statement published in October by the German Federal Foreign Office emphasized that the TCP is expected to play an important role in diversifying the EU's gas supply sources, whereas US LNG is not competitive enough to be a supply option. Germany says that both Nord Stream 2 and the TCP are essential projects for the diversification of natural gas supply, the former for reducing transportation risk via the Northern Gas Corridor, the latter as the key to realizing the Southern Gas Corridor. In addition, a joint communication entitled "The EU and Central Asia: New Opportunities for a Stronger Partnership," issued in May 2019 by the European Commission and the High Representative of the European Union for Foreign Affairs and Security Policy⁶, underscored the EU's intention to continue to focus on enhancing the role of Central Asia in contributing to the security of energy supply and diversification of supply sources and routes. The communication also confirms the EU's firm intention to realize the TCP, stating that it will accelerate its assessment of the viability of building the pipeline.

4-2 Questions over economic viability

Some energy experts question the economic efficiency of the TCP. In a paper on this subject⁷, Simon Pirani, Senior Visiting Research Fellow at the UK's Oxford Institute for Energy Studies, states, "the economics of bringing gas from Turkmenistan to Europe would remain problematic, even if all the political issues were resolved." For example, it is estimated that the price of supplying gas to the EU (Italy) via the TCP would be US\$10/MMBtu, approximately twice that for gas supplied via Russia and Ukraine (to Austria, 2011). Moreover, a report by leading UK energy research consultancy Wood Mackenzie⁸ flags a number of issues, including the cost of extending the SCP, which runs through mountainous terrain. However, since diversification of natural gas supply routes is viewed as extremely important, both the extension of the SCP and the construction of the TCP have been included in the EU's Projects of Common Interest (PCI) list⁹ since 2017. Under the PCI system, up to 75% of the eligible costs of construction would be covered by the EU budget (Connecting Europe Facility = CEF), and this is a sign of the EU's eagerness to get down to the business of completing the Southern Gas Corridor. The conceptual design phase (preFEED)¹⁰ of the TCP is expected to be completed by 2020, and all eyes will be on whether or not the EU will then enter a specific design phase.

⁶ European Commission, High Representative of the Union For Foreign Affairs and Security Policy (JOIN (2019) 9 final) "JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL. The EU and Central Asia: New Opportunities for a Stronger Partnership."

⁷ Simon PIRANI, "Let's not exaggerate: Southern Gas Corridor prospects to 2030" (OIES PAPER: NG 135) (www.oxfordenergy.org/wpcms/wp-content/uploads/2018/07/Lets-not-exaggerate-Southern-Gas-Corridor-prospects-to-2030-NG-135.pdf?v=24d22e03afb2), July 2018.

⁸ Wood Mackenzie INSIGHT, "The Caspian Sea's legal status: what does this mean for oil and gas?" August 2018.

⁹ Commission delegated Regulation (EU) 2018/540 (<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0540&from=EN>).

¹⁰ For an outline of preFEED, see the 10-year development plan of the European Network of Transmission System Operators for Gas (ENTSOG), p.562 "TYNDP 2018 - Scenario Report" (www.entsog.eu/sites/default/files/2018-12/TYNDP%202018%20-%20Annex%20A%20-%20Projects%20Sheets.PDF).

4-3 Urgent improvement in relations with Russia and Turkey required to realize the TCP

Furthermore, in order to realize the TCP, in addition to improving relations with Russia, it is important for the EU to build good relations with Turkey, which is the main transit country for the Southern Gas Corridor.

Although Russia is unable to block construction of the TCP after agreeing to the Convention on the Legal Status of the Caspian Sea, concerns remain over the possibility of construction delays should Russia point to violations of the Framework Convention for the Protection of the Marine Environment of the Caspian Sea (the “Tehran Convention” signed by the five Caspian littoral states in 2003). However, as pointed out by Robert Cutler, a senior researcher of the Canadian Energy Research Institute¹¹, while the Moscow Protocol¹² of the Tehran Convention stipulates that signatory countries intending to undertake economic activity consult with the other signatory countries on environmental protection, the power to determine whether to proceed with the activity lies with the parties directly concerned. Accordingly, it can be said that Russia has no legal means of delaying construction of the TCP, but in any event, improving EU-Russia relations is a vital element.

The EU’s strict sanctions against Russia over its annexation of Crimea in 2014 have cooled relations between the two sides. However, now that Russia is pursuing a closer alliance with China, there is an active debate underway in the EU over the dilemma of whether its relationship with Russia should be a matter of “principle or realpolitik,” and increasingly loud calls for both sides to improve relations are starting to emerge. At the forefront of this movement is the French government, which believes that, while it would be premature to lift sanctions, efforts should be made to overcome the distrust between the two sides and improve relations. The fact that former Polish prime minister and leading EU Russia hawk Donald Tusk will retire as President of the EU Council in November 2019 may also help boost EU-Russia relations. Speaking in September 2019, Mr. Tusk’s successor, Belgium’s then-Prime Minister Charles Michel, stressed the need for realpolitik, noting that while Russia poses a security threat, the EU must also deal with the reality that “Russia remains a neighbor too.”

In addition, although good relations with Turkey are essential for the establishment of the Southern Gas Corridor, a report on the progress of Turkey’s accession to the EU, published in May 2019, strongly criticized the Erdogan administration as being autocratic, and displayed a deep distrust. With the transition to a presidential system in 2017, the office of the prime minister, which had previously been responsible for administration in Turkey, was abolished, and President Erdogan, who had already been in power for 16 years, took over full administrative control. While Erdogan once followed a moderate path, including his stance on progressing accession negotiations with the EU, the relationship between the EU and Turkey has deteriorated since the negotiations were suspended by the EU in 2016. The fact that the relationship between Turkey and Russia is growing closer is also a cause of major concern for the EU.

On the other hand, the EU has promised EUR 6 billion in financial aid to Turkey in order to stem the flow of migrants and refugees from the Middle East to the EU, and this cooperative relationship is still ongoing. If the EU maintains its relationship with Turkey along realpolitik lines, as in the case of cooperation on the refugee issue, then a further expansion of cooperation can be expected, including the introduction of visa exemption measures that have already been promised, and updating of the EU-Turkey customs union that came into effect in 1996. Going forward, it will be necessary to keep a close eye on improvements in EU-Turkey relations for the effective use of the Southern Gas Corridor.

¹¹ See Robert M. Cutler, “The Caspian Sea Basin and Europe’s Energy Security” (www.behorizon.org/author/robert-m-cutler/).

¹² “The Protocol on Environmental Impact Assessment in a Transboundary Context” (www.tehranconvention.org/IMG/pdf/PROTOCOL_ON_ENVIRONMENTAL_IMPACT_ASSESSMENT_IN_A_TRANSBOUNDARY_CONTEXT_EN-2.pdf) adopted and signed July 2018.

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