UNITED NATIONS UNIVERSITY
UNU-CRIS
Institute on Comparative Regional Integration Studies

Policy Brief

NUMBER 04, 2018

Keywords

Gas, energy, Turkmenistan, Trans-Caspian Pipeline, Caspian Sea

Bringing Turkmen Gas to the European Market

Executive Summary

A growing mistrust in Russia's strategic intentions in Eastern Europe, together with a growing European dependency on Russian gas, made the diversification of gas supplies a priority for the European Union (EU) and prompted the idea of creating gas export routes from Turkmenistan to Europe bypassing Russia. This led to a renewed interest in the Trans-Caspian Pipeline (TCP) as an integral part of the new Southern Gas Corridor. However, so far, only little progress has been achieved in creating this new gas supply route and many obstacles still need to be overcome before the Trans-Caspian Pipeline can materialize.

Due to price differences with Russia and Iran, Turkmenistan became nearly solely dependent on China for its export of natural gas in 2017. Together with the low oil and gas prices of 2017, this has resulted in a deteriorating domestic economic situation for Turkmenistan, which in turn is forcing President Gurbanguly Berdimuhamedov to ameliorate relations with neighboring countries in the hope of multiplying the export possibilities. The current context has already resulted in a Strategic Partnership with Azerbaijan and renewed talks with Iran after the gas dispute. Yet, these kinds of events could be described more as a mere normalization of ties between Turkmenistan and the neighboring countries instead of deep comprehensive deals on key issues like energy.

A new Convention on the Legal status of the Caspian Sea was signed between the five littoral states, Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan on 12 August 2018. The Convention reaffirms the status of the Caspian Sea as an inner sea only to be used by ships sailing under the flag of one of these littoral states and only allowing armed forces of these states. Yet, the delimitation of the seabed and subsoil is left to bilateral agreements of the boundary states. The construction of pipelines like TCP can still be blocked by the other Caspian states on the basis of environmental standards laid out in the Teheran convention, as is mentioned in article 14 of the new Convention on the Legal Status of the Caspian Sea.

The EU should use the momentum created by the new Convention on the Legal Status of the Caspian Sea and the ongoing discussions on the Special Purpose Vehicle (SPV) to develop working groups for the establishment of a network of gas transactions between Iran, Azerbaijan and Turkmenistan as an addition to the Southern Gas Corridor.

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Introduction

Following the deadlock of the Nabucco project in 2013, interest in the Trans-Caspian Pipeline (TCP) seemed to have faded. Yet, the TCP is still considered as a project of common interest by the European Union. The pipeline would open up a new gas supply line for the EU, which bypasses Russia and could thus help to decrease the dependency on Russian gas, especially for Greece, Italy and possibly the South Eastern EU member states.

The possibility of increased diversification of the gas market is not only of geopolitical significance for the EU, but it would also improve the economic and geopolitical position of Turkmenistan. Due to price disputes, Turkmen gas exports to Russia came to a halt in 2016. Long term contract-based gas exports to Iran also stopped because of a price dispute in 2017. Gas exports resumed in the form of small gas swap deals between Iran, Azerbaijan and Turkmenistan. The only big consumer of Turkmen gas is now China. China invested heavily in Turkmen gas extraction and transportation and managed to negotiate a low contract price. As China's current monopoly on Turkmen gas has a devastating effect on Turkmenistan's economy, it is pushing Turkmenistan closer to the other Caspian states in its efforts to diversify its gas exports.

The delimitation of the Caspian Sea is still the biggest hurdle in the completion of TCP. There is still no agreement on the border between Azerbaijan and Turkmenistan. The gas and oil fields of Omar/Azeri, Osman/Chirag and Serdar/Kyapaz remain disputed territories. In August 2017, Turkmenistan and Azerbaijan signed a strategic partnership. Signs of rapprochement of the two countries could lead to a solution in the near future. At the Caspian Summit for the five littoral states in Astana in the summer of 2018, the new Convention on the Legal Status of the Caspian Sea was signed. This new agreement outlined the sea surface in internal and territorial waters in which the sovereignty of the littoral state is extended. It also saw the creation of fishery zones, which give exclusive economic access to the littoral state and a common maritime space, which is open for all users. Yet, the seabed and the subsoil are left to be delimited on the basis of bilateral agreements. Therefore, the convention entitles the littoral states to build new pipelines in their sector. However, they must comply to environmental standards as agreed in previous international agreements to which they are a party, including the Tehran Convention. On the basis of this, Russia and Iran called for a moratorium on the TCP because of environmental issues. This policy brief outlines how the situation of the TCP has evolved since the Nabucco project was laid to rest in 2013 and looks at what would need to be done in order for the TCP to become operational and how Turkmen gas can effectively reach the European market.

A Changing Dependency Between 2015-2017

Turkmenistan has experienced a significant economic downturn in the past few years. With Gazprom no longer buying Turkmen gas and due to the worldwide low gas prices, the country's GDP growth more than halved from 13.12% in 2015 to 5.36% in 2016 according to Countrywatch. Exports to Russia dropped from 40 bcma (billion cubic meters per annum) in 2008 to 4 bcma in 2015 and to eventually 0 bcma by the start of 2016. The exports to China did rise but not to the desirable contract amount of 35 bcma. In 2014, gas exports to China amounted to 25.9 bcma while in 2016 it grew to 30 bcma. According to the Russian news agency TASS the contract price was rather low with a price of 185$/1000m^3 and the meager profit would be used to pay off Chinese debt made by the huge Chinese investments in Turkmen gas infrastructure and the development of gas fields in the east of the country. The total amount of domestic natural gas consumption in 2015 is believed to be 37.45 bcma on a total production of 79.4 bcma by Countrywatch. Although gas exports to Iran doubled to 9 bcm (billion cubic meters) it remained under the 12 bcma. By 2017, exports on a long-term contract were halted due to a price dispute originating from the winter of 2007-2008 that resulted in a debt of 1.5 billion $ from Iran to Turkmenistan. This led to China becoming the only big importer of Turkmen gas.

Gas Swaps with Iran and Azerbaijan

Due to the price dispute and the halting of the long-term contract between Iran and Turkmenistan gas deliveries between the two countries took the form of gas swap deals. These deals swapped Turkmen gas between Turkmenistan and Iran and between Iran and Azerbaijan for an amount of 2.16 bcm in 2017. Azerbaijan used its storage capacity to buy its share of the gas in the summer when the prices are the lowest. The gas swap deals are also used by Iran for its geopolitical agenda. Iran has tried multiple times to convince Turkmenistan of swapping gas with Iran in order to reach Pakistan instead of awaiting the completion of the TAPI-pipeline. Yet, both countries, and especially Pakistan, await how the new sanctions of the US could affect this deal. The gas swap deals between Azerbaijan, Turkmenistan and Iran were used by Iran to push for a solution around the development of two disputed oil fields in January 2018. The swap was resumed when an agreement was reached. Iran is also refusing to swap Turkmen gas directly to Turkey because both countries compete to fill up the remaining 6 bcma reserve capacity of TANAP.

Delimitation of the Caspian Sea

From the start of the proposal for the TCP, the legal status of the Caspian proved problematic. Not only are the borders between Azerbaijan disputed, the interim agreement or Teheran Convention allows Iran and Russia to pose a moratorium on the project because of environmental issues. The Teheran convention was agreed between the five littoral Caspian states in 2006 on the basis of UNCLOS environmental principles. For years, there was no definite conclusion on the definition of the Caspian as an international lake or as an international sea. If the system of Russian channels is seen as a passage to the Sea of Azov, then the Caspian could be seen as an international sea. In this case, the delimitation is based upon the UNCLOS principles with the installation of EEZ's, international waters and guaranteed free access of third countries through the Russian channel system. Previous agreements between the USSR and Iran in 1931, 1935 and 1940 did specify a 10 NM EEZ, but also excluded third countries from navigation and exploitation in the Caspian Sea.

Another possible framework could be that of an international lake. In this case, the Caspian Sea would then be partitioned with a multilateral treaty in equilibrium of five parts according to common law. But Iran wants an equal surface distribution since Iran has the second smallest coastline and because most oil and gas fields are relatively far from its coastline. The other littoral states wanted a distribution on the basis of equidistance to the shorelines. In the run-up to the next multilateral negotiations of the summer of 2018 between the five littoral states in Astana Russia claimed a draft has been agreed upon by all five states. This draft would comprise a hybrid solution where freedom of navigation would be guaranteed for all five littoral states and by which the sea-floor would be delimited on the principles of equidistance. Iranian officials, however, deny every agreeing to such proposal. Eventually, the hybrid solution was signed, thereby leaving the issue of delimitation of the seabed up to bilateral agreements. This leaves the offshore fields of Omar/Azeri, Osman/Chirag and Serdar/Kyapaz still disputed between Azerbaijan and Turkmenistan. This, together with a continuing moratorium of Iran and Russia, makes the completion of the TCP very uncertain.

Russian Involvement

With the draft proposal on the delimitation of the Caspian and with the promise of free navigation in Caspian waters, Russia seems to have pulled the card of multilateral cooperation. But the proposal could also be seen as an attempt to isolate Iran from the other four Caspian states. Bilateral agreements with Kazakhstan and Azerbaijan already delimited the Russian part of the Caspian. Both Russia and Iran have the same interest in the blocking of the TCP. Furthermore, cooperation with Turkmenistan went both ways. Although Gazprom halted the imports of Turkmen gas in 2016, in the same year Russia intensified the cooperation on building the fleet of Turkmenistan. Both countries also engaged in negotiations with the Afghan Taliban because security around the Afghan parts of TAPI proved to be a key issue for Turkmenistan. Interesting to note is that Turkmenistan was since 2002 a major supply hub for the NATO forces, which resulted in the American mission of training the Turkmen border guards. Simultaneously, its military received also training and weapons from Russian trainers. In essence, all five littoral states enjoy Russian military cooperation and the Russian strategy in the region could be described as Divide et Impera. Although Azerbaijan tries to decrease its military dependency on Russia by looking towards other arms exporters, the Azeri government did choose TAP instead of Nabucco as to not offend the Kremlin too much. Since 2017, Azerbaijan has also resumed imports of Russian gas for 1.6 bcma in order to be able to complete its supply promises to Europe.

Natural Gas from the Caspian Sea

In total, there are # possible routes to get Turkmen gas to the European transmission systems. The first possibility would be the TCP. This gas pipeline would connect the Turkmen East-West pipeline with the Azeri Sangachal Terminal, which would in turn connect it to the SCP and then on to TANAP and entering the European markets through TAP. Although the TCP would have a capacity of 30 bcma, the initial reserve capacity on SCP and TANAP would only be 6 bcma. And the TCP option is presently blocked by Iran and Russia based on the Teheran Convention.

Another possible route would be via a split section of the SCP into Georgia, where Turkmen gas would be brought via White Stream to the Ukrainian transmission system from where it can be connected to Hungary, Romania, Slovakia of Poland. The route was on the PCI-list of the European Commission between 2013 and 2016. It was removed as the demand could not be guaranteed due to Ukraine's declining gas consumption and possible Russian interruptions. These could negatively affect the pressure in the Ukrainian pipelines systems, which could cause technical difficulties that hinder the connection with White Stream.

With some adaptions of the Iranian transmission system, Turkmen gas could reach Azerbaijan via Iran. But Iran also competes with Turkmenistan to fill the 6 bcma capacity on SCP and TANAP and as a transit country Iran would get the better price. Continuing the gas swaps could be a temporary solution but the renewal of American sanctions on Iran could deter SOCAR from further involvement with its Iranian counterpart NGIC, as SOCAR has oil and LNG assets in Texas.

LNG is a final possibility in order for Turkmen gas to reach European markets. Since 2009, Kiyanli has been the first Turkmen maritime LNG terminal with an annual production of 0.27 bcma. Turkmenistan already vowed to upgrade the LNG production to 4.14 bcma by 2030. These amounts are too small and LNG is costlier. Yet, there is an agreement for the transportation of LNG from Azerbaijan through Georgia over the Black sea to Romania. Turkmenistan could connect to this AGRI accord and since 2010 the project has been on the PCI list of the European Commission. Romania is ready to build its terminal in Constanza, yet construction is halted by SOCAR in Georgia because of the high cost and, additionally, because of Azeri pressure on Georgia to abandon an Iranian proposition to connect to the Iran-Armenia pipeline.

Policy Recommendations

It is clear that for Turkmen gas to reach European markets, Azerbaijan and Iran play a crucial role. With the TCP, gas swaps with Iran and the AGRI-accord as the most likely options for Turkmen gas to enter Europe, both countries play a role in each of these three routes. The delimitation of the Caspian Sea and especially the Turkmen claims on the three disputed oil and gas fields is the main hurdle for Azerbaijan. Even if TCP would become operational, then the capacity of the TANAP and TAP connections needs to be doubled if Turkmenistan wants to sell 30 bcma instead of the meager 6 bcma. For Turkmenistan, the strategic choice would be to invest in LNG capacities in the short term, negotiate more gas swaps with Iran and finish the TAPI connection as soon as possible. But with security as a main concern it is impossible to say when this will happen.

Therefore, the European Commission should further invest in its role as a go-between through existing platforms, such as the Baku initiative, through which the European Commission can improve the relationship between Azerbaijan and Turkmenistan. This could be done through concrete projects like fulfilling the AGRI accord, further supporting the TCP and the establishment of common LNG standards and exchange of best practices.

At the same time, the EU should make sure that the Special Purpose Vehicle (SPV) that it is currently working on for Iran accommodates gas transactions between the Azerbaijani, Turkmen and Iranian state gas companies and the Central and South Eastern Europe Energy Connectivity (CESEC) region. Within this SPV framework, temporary workgroups between actors from those partners could evolve in a Memorandum of Understanding on the need for more regional interconnectivity. These work groups could thrive on the momentum created by the last summit on the delimitation of the Caspian Sea, the rising gas prices and the uncertain geopolitical stage. Whilst understanding the deep vaults between those countries, the outlook for all three countries should be to expand their share on the southern European gas markets. Geopolitical wrangling of the US, Russia and Saudi Arabia should be foreseen but mitigated, as the European Commission is merely trying to work on a more competitive European market. Furthermore, the transactions within this framework in the first five to ten years would be marginal in comparison with the volumes imported from those larger geopolitical players.

Steps taken to improve relations with these autocratic regimes should be taken purely out of the strategic objective of energy security and diversifying the natural gas supply of the CESEC states. Negotiations should not touch on sensitive political discussions, but neither should they be solely used to strengthen or to give increasing legitimacy to the leadership of those countries. This dire balance should be kept in check through European parliamentary oversight, similar to that in trade discussions.

Whilst facilitating transactions with the state gas companies of Iran, Turkmenistan and Azerbaijan, the principles of the Gas directive should still apply. Exception clauses could be used to grant enough securities for those firms to invest in this hopefully lasting European connection with the region.

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Robbert Bossuyt obtained an MA degree in EU Studies from Ghent University. This policy brief is based on his Master's dissertation. An earlier version of this policy brief was presented at the BACES workshop "The EU, China and Central Asia: Global and Regional Cooperation in a New Era", which took place at UNU-CRIS in Bruges on 7-8 June 2018.

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