The Nabucco Gas Pipeline Project and its Impact on EU Energy Policy in the South Caucasus

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Abstract
If constructed, the Nabucco Gas Pipeline would provide Europe with up to 31 billion cubic meters of gas a year from non-Russian sources. While a variety of problems hinder construction of the pipeline, Russia's evolving relationship with Ukraine may promote change in the current stagnant situation. However, a growing role for the European Union in the South Caucasus may provoke new tensions in its relations with Russia.

Introduction
For about 15 years after the collapse of the Soviet Union, there was very little activity in the energy relations between the European Union and the countries of the South Caucasus. At the beginning of the 1990s, the European Commission created the program of Technical Assistance to the Community of Independent States (TACIS) to support the development of the post-Soviet countries. Two components of this program covered cooperation with Armenia, Azerbaijan and Georgia: TRACECA and INOGATE, which focused on, among other areas, improving the energy transportation network, guaranteeing energy supply and coordinating investment in pipeline projects. In this context, EU institutions have supported the development of the South Caucasus hydrocarbon transportation routes, including the Baku–Batumi railroad and three pipelines: the Baku–Tbilisi–Ceyhan (BTC) oil pipeline, the Baku–Supsa oil pipeline and the South Caucasus gas pipeline (SCP). However, the EU only provided technical support and helped in framing the agreements between the countries involved (Azerbaijan, Kazakhstan and Georgia). At the same time, the EU devoted less attention to Armenia. This lack of cooperation was explained by the dearth of energy resources in Armenia and the country's high dependence on Russian gas giant Gazprom. In general, the EU saw the South Caucasus as part of the Russian "Near Abroad". Another reason for the EU's relative lack of interest in active energy cooperation was the considerable divisions between, and competition among, the different actors and institutions at the EU level. There was also no consensus on the external policy toward the South Caucasus due to the anxiety that direct competition with Russia in this region would have a negative impact on EU–Russian energy relations.

In the mid-2000s, the situation began to change as a result of the rise in European gas demand and the increasing imports from Russia to meet it. Currently, Russia provides 40% of the EU's gas imports. The EU Commission forecasts that the Russian portion of gas supply will rise to over 60% by 2030, strengthening its position as the dominant importer to the European energy market. The fact that a number of EU states, above all the new Central and East European members, are completely dependent on Russian natural gas for their domestic energy consumption makes the situation more difficult. At the same time, the frequent conflicts over the last few years between Russia and the transit countries Ukraine and Belarus have raised questions regarding Russia's reliability as a partner and her willingness to use her energy power as a "political weapon" to influence European foreign and economic policy.

This increasing dependence on Russian energy resources led European policy-makers to develop in 2007 the EU Security and Solidarity Action Plan. This document focuses on liberalizing the EU energy market, enhancing energy efficiency and diversifying energy supply. One of its main priorities was the promotion of the Southern Gas Corridor as a means of developing new supply sources and infrastructure to transport gas from the Caspian and Middle Eastern regions, particularly from Azerbaijan, Turkmenistan, Iran and Iraq. Three main gas pipeline projects were included in the Southern Corridor plan: (1) the Interconnection Turkey–Greece–Italy pipeline project (ITGI), (2) the Trans-Adriatic Pipeline project (TAP) and (3) the Nabucco pipeline project (for an overview of the pipelines, see Table 1). Following the adoption of the Security and Solidarity Action Plan, the Nabucco pipeline was named as a flagship project for the European Union. The European Commission viewed the project from two perspectives: (1) as a foundation for the diversification of gas supply and (2) as a real opportunity to realize its geopolitical vision of connecting the Caucasus and the Caspian region into one energy network. The EU has accorded Azerbaijan an important role within this project as a major energy-producing country.

Nabucco as a Flagship Project for the EU
Nabucco has been in planning since 2002. It is envisaged as a 3,900 km pipeline from Turkey to Austria via Bulgaria and Hungary that would carry up to 31 billion

cubic metres (bcm) of gas to Europe per year with estimated construction costs of over 7.9 billion euros. Currently, the Nabucco consortium is made up of Austria's OMV, Bulgaria's Energy Holding Bulgargaz, Germany's RWE, Hungary's MOL, Romania's Transgaz and Turkey's Botas, each of which holds a 16.67% stake. The project plans to receive about 20 bcm of gas per year from the Azerbaijani Shah Deniz gas field 2 (SD2) and, initially, 10 bcm from Turkmenistan. In the long term, gas should also come from Iraq. In addition, there are negotiations with other suppliers, such as Kazakhstan and Egypt. The construction of the pipeline has been postponed many times. According to optimistic forecasts, the project will start in 2013 and the first supplies will be commissioned in 2017.

In spring 2007, the project was accorded highest priority as laid down in the guidelines for trans-European energy networks (TEN-E). Within this system, the European Commission has given significant support for Nabucco in a number of ways. First, the European Commission (based on a mandate from the 27 EU states) was actively involved in the negotiations between the Nabucco consortium and the supplier countries. As result, an intergovernmental agreement lasting 50 years was signed in July 2009 and later ratified by the state governments and the parliaments of the EU members involved in Nabucco, as well as by Azerbaijan and Turkey. The consortium also received financial support: European banks were willing to contribute 4 billion euros (2 billion of which came from the European Investment Bank, 1.2 billion from the European Bank for Reconstruction and Development, and 800 million euros from the International Finance Corporation). The rest is expected to be financed through shareholder borrowing and by private investors. In addition, the European Commission helps coordinate the administrative, environmental and social impact assessments in the countries through which Nabucco will run.

However, the competition among the three planned pipeline projects in the Southern Corridor (ITGI, TAP and Nabucco) became evident when the Shah Deniz consortium led by BP and the Azerbaijani state oil company SOCAR announced in summer 2011 a bid for the Shah Deniz gas. All three consortia submitted their comprehensive transportation proposals. However, BP has also announced a plan for its own South East Europe Pipeline (SEEP), which would be able to transport SD2's post-2017 gas output of 10 bcm per year to Europe. This would be a third of Nabucco's volumes. In addition, SEEP put forward its proposals for the SD2 gas in the case that none of the three proposed pipeline projects meet the Shah Deniz consortium's needs. Consequently, there are currently four proposals in the running, but it is not clear which is a front runner. The partners from the Shah Deniz consortium have stressed that they will select from these four proposals the best route to transport SD2's gas to Europe at the end of this year or early next year. However, the European Commission strongly believes that Nabucco is the only project in the Southern Corridor that will enable a diversification of Europe's gas supply.

Meanwhile, the representatives of the Azerbaijani government pointed out that there are also other pipeline projects in planning that could be attractive for the transportation of gas from the SD2 field to the European market; the Nabucco pipeline could therefore be a good future option when the gas from Azerbaijan's other gas from fields located in other countries of the Caspian basin are available. In addition, Baku has stressed many times that it is much more interested in the diversification of its export routes and that it would prefer to concentrate on smaller pipeline projects, which could be more profitable. As a result, Azerbaijan's SOCAR and Turkey's state operator BOTAS have declared the establishment of their own gas corridor across Turkish territory by building the Trans Anadolu Pipeline (TANAP), which will run parallel to Nabucco's planned route and have a capacity of 16–17 bcm per year.

According to many experts, the BP pipeline proposal seems to be more attractive than its three competitors because it would be based on a combination of existing and new infrastructure. Moreover, there are powerful arguments against the other two small projects (ITGI and TAP): while they plan to deliver gas to several European countries, the main gas volume is intended for the Italian market, which is already oversupplied. The current financial problems of Greece also place doubt on the realization of these two projects. Taking all this into account, the Shah Deniz consortium has also renewed discussions about other possible supply options to Europe, for example by expanding the capacity of the existing transport infrastructure in Azerbaijan and Georgia or using tanker routes across the Black Sea.

Troubles Surrounding the Nabucco Project

All these factors are weakening the momentum of the Nabucco project and reducing significantly its chance of being selected as the optimal delivery route for SD2 gas to Europe. Although the Shah Deniz consortium still has time to decide which pipeline it will use and the Azerbaijani government has the right to veto any decisions on the pipeline routes, it seems that a smaller project—possibly the SEEP project supported by BP—is the frontrunner in the matter of the Southern Corridor. However, the European Commission has refused to give up. As a compromise, it has suggested cooperating with all the gas pipeline consortia involved in order to combine pipelines into one gas delivery system for SD2's gas to Europe.

The Nabucco project has made very slow progress since 2002 for several reasons. First, rising costs and the lack of the necessary financial support have prevented the project from going ahead: a few months ago, the consortium announced that the pipeline's estimated costs were 12–15 billion euros instead of the 7.9 billion euros initially planned, but the final price tag could to be considerably higher. The EU hopes to encourage private investors to invest in the project. At the same time, the lack of a common set of clear laws and regulations at the EU level that could underpin the investment undermines these efforts.

Second, the questions concerning the availability of gas in the Caspian basin and the Caspian Sea's unclear legal status make the realization of Nabucco much more difficult. In addition, there is uncertainty about the availability of gas in Turkmenistan; most of the gas fields there are inaccessible for European companies because of the lack of a pipeline connecting the fields with Azerbaijan's existing export infrastructure. The Azerbaijani government has declared many times that it has the right to build a trans-Caspian pipeline to import gas from Turkmenistan and to fill Nabucco with additional gas. However, the littoral states Russia and Iran, which are not included in any of these projects, have proclaimed that all five littoral states in the basin must consent to any Caspian projects, otherwise they would face legal obstacles. They have also claimed that the construction of the pipeline is very risky and unacceptable from an environmental point of view. Moreover, the uncertainty about the development of the gas fields in Iraq in the short term raises further doubts about the availability of additional gas sources for the project. The protest by the Bagdad authorities against the deal made between the pipeline consortium's shareholders OMV and MOL and the Kurdish Regional Government has stopped the first stage of operation. EU sanctions on business with Iran rule out the country's participation.

Thirdly, since the inception of the Nabucco project in 2002, a lot has changed in the global gas market, including the increased viability of unconventional gas from shale, which makes Nabucco less commercially attractive for private investors.

The situation surrounding Nabucco became more complicated when Russia started pushing ahead with its own South Stream pipeline project (initiated in June 2007), which will be a rival to Nabucco. The gas pipeline will transport Russia's gas to, among others, Bulgaria, Austria, Greece and Italy. It is expected to cost more than 15 billion euros and will carry about 63 bcm of gas per year. Construction is planned to begin in 2013. The Russian authorities are hoping that the EU will support this project, above all by giving South Stream Trans-European Network (TEN-E) status. They are seeking German help to achieve this; Germany is already viewed by Russia as an ally because of their successful cooperation on the Nord Stream pipeline across the Baltic Sea. France, too, was asked to support the project. With their help, Russia is hoping to lobby the European institutions to change the regulation of the EU's Third Energy Package. Kremlin officials have also often declared that none of the planned pipelines in the Southern Corridor should be taken seriously because of the lack of necessary gas volume; they claim that South Stream would be the best solution. In pushing the project ahead, Russia's Gazprom has reached several intergovernmental agreements necessary to the project with transit countries such as Austria, Bulgaria, Greece, Hungary, Serbia and Slovenia. In addition Gazprom has signed bilateral agreements on cooperation in the field of project implementation with companies including OMV, MOL and Bulgargaz, which are also involved in Nabucco project. That has seriously increased doubts about their loyalty to Nabucco.

There are still other problems for Nabucco to clear up. Most of the proposed pipeline is planned to run across Turkey. This would make both the EU and the suppliers more dependent on the policy of that transit country. Turkey's government is already trying to set the rules by directly influencing the prices and transportation volumes.

Conclusion

Europe's expected demand for gas has risen recently. In addition, Germany's decision to shut down its nuclear plants in the wake of the Fukushima disaster has increased European gas demand by 31 bcm per year. We can assume that the share of gas in the EU's primary energy demands will increase: The EU currently consumes more than 500 bcm of gas. Consequently, the 31 bcm delivered through Nabucco will only represent a relatively small addition to this. However, the project is still a political and economic priority for the EU because it will promote non-Russian routes, increase the gas capacity available to Europe and strengthen energy networking inside the Southern Corridor, as well as the political and economic role of the EU in general.

It is also worth noting that the Lisbon Treaty's regulations on EU energy policy have simplified the institutional structures responsible for the policy in the Caspian region and made them more unified and transparent. These have promoted the development of a more consistent policy in the area of European energy security, particularly toward the Southern Corridor. Nevertheless, it seems that other important factors, such as the intensity of bilateral energy relations between the countries involved in the Nabucco project and Russia or the geographical location and access to alternative energy sources of these countries, still play the main role in the further development of the project. Moreover, the emergence of two groups inside the EU—the group of the CEE states and that of Western countries led by Germany and France—following very different strategies hinders the adoption of a common position on Russian gas. It is also evident that the EU's proclaimed goal of "speaking with one voice" has not been achieved. Nabucco has shown that the EU member states involved in this project have generally not acted in the long-term common interest of the energy security of the EU but according to their own calculation of costs and benefits. This could also have a negative impact on the project's development.

However, we can assume that the situation will change in the near future as a consequence of the accession to power of a new and more pro-Russian Ukrainian government in 2010. This has given Russia the opportunity to renegotiate the regulation of Ukraine's gas transit system in its favour. In turn, this could reduce the need for a South Stream project and, thus, lessen the political tension surrounding Nabucco. It is obvious that an increase in EU involvement in the South Caucasus region would help the region's countries, above all Azerbaijan, to secure direct access to the European energy market and to strengthen their economic independence from Russia. The strengthened position of the EU in the South Caucasus would also signify a new phase in the relationship between two powers—the EU and Russia—by perhaps increasing the mistrust of the latter towards the former with unpredictable results for the relations between the two.

About the Author
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