CENTRE FOR EUROPEAN REFORM
NEW IDEAS FOR A NEW EUROPE

Turkey and European energy security

minutes by Katinka Barysch

This meeting, organised by CER and hosted by RUSI, brought together a number of energy experts, think tankers and diplomats on March 17th.

Among the experts were Mehmet Ogutcu (BG Group), John Roberts (Platts), Gottfried Steiner (OMV), David Buchan and Shamil Yenikeyeff (both Oxford Institute for Energy Studies), Fadi Hakura (Chatham House), Bobo Lo, Tomas Valasek and Simon Tilford (CER) and Shirin Akiner (SOAS). We also had diplomats from Austria, Turkey, Romania and Hungary.

The discussions took place under Chatham House rules.

The CER paper on "Turkey role in European energy security" analyses the issues involved in Nabucco. http://www.cer.org.uk/pdf/essay_turkey_energy_12dec07.pdf

I can only offer an incomplete attempt to summarise what was an extremely rich and wide-ranging discussion.

Why do we need Nabucco?

Nabucco will not solve the EU's energy supply problems. By 2030 we will probably need another 300 bcm of gas annually. Nabucco's final capacity will be 31 bcm annually.

But Nabucco would show that the EU is serious about diversification of supplies and prove that it has an external energy policy that goes beyond declarations of intent.

Nabucco is not an anti-Russian pipeline though. Under EU law, we would not be permitted to deny Gazprom access to the pipeline if it wanted to use it.

Nabucco is the best way of getting to Caspian / Central Asian gas without relying on the Russian pipeline system. It's the only gas that is likely to be available and accessible in the foreseeable future. EU's own resources are depleting. Russia is likely to have a supply gap. The Middle East has 40 per cent of the world's gas but they exports little (it gets used for industrialisation and for keeping up pressure in oil fields). Qatar's moratorium on new developments is likely to be extended.

Why are there doubts about Nabucco's future?

Nabucco is running behind schedule. Even in an optimistic scenario, full capacity would not be reached until 2018. But there are doubts that it will be built at all.

*** South Stream:** There is a widespread perception that the reason why Nabucco is in trouble is Gazprom's skilful game of pipeline poker. Romania is the only one of the EU Nabucco consortium members that has not expressed support for South Stream. Hungary says it remains committed to Nabucco but admits that South Stream looks more likely to be built. Is it? South Stream is not beyond the MoU stage. Cost estimates of $10 billion (for 30 bcm) may be too low. Ukraine and Romania may use environmental and maritime safety concerns to delay the construction of the underwater Black Sea part, just like Estonians and Swedes have done with Nord Stream.

South Stream could be a rival to Nabucco if Russia hoped to feed it at least partly with gas from Azerbaijan or Turkmenistan. If not, South Stream would be mainly used for gas that currently comes through the Ukrainian pipeline system. Given that Russia's gas output is stagnating, only Nord Stream would transport additional gas. South Stream would be an alternative route for existing volumes supplied to the growing EU gas market. From the demand side at least, it would not necessarily make Nabucco superfluous.

*** Financing:** Nabucco's estimated costs are already going up. Currently estimated at $6bn, of which 30 per cent will be equity and 70 per cent debt financing. The money will only be available if sufficient supplies are guaranteed. Could the EU help to get it off the ground? It could provide direct financing (it pays €1 billion for Gallileo) or give a guarantee for an EIB loan. There may be competition issues though.

*** Regulatory issues:** Van Aartsen's visit to Ankara last month does not seem to have brought much progress. Turkey insists that it does not just want to be a transit country. It wants to benefit from its strategic location through additional business (terminals etc); keep control over the Turkish part of the Nabucco pipeline (buying gas at the border and re-selling at the other); and take as much as 20 per cent of Nabucco's throughput off at advantageous prices. The Nabucco consortium members say that unless Turkey moves to the same regulatory regime as the EU members (ie non-discriminatory access for third parties), the pipeline simply will not happen. Van Aartsen so far seems to have paid more attention to the supply question (talking to Turkmens and Azeris) than the regulatory issues (he only visited Turkey six months after he was appointed).

Given that power shortages loom in 2009, the Turkish government seems determined to speed up long-delayed energy sector reform to attract more investment. Investors are watching whether Turkey moves to a transparent, non-discriminatory pipeline regime, as another sign of improvements in the business environment.

*** Supplies:** Most importantly, the supply side still remains uncertain. Gas will initially come from Azerbaijan. The second phase of the Shah Deniz development has been delayed but may be bigger than initially thought: 16 bcm in addition to the 9 bcm of the first phase, which means 25 bcm available for export (of course big share goes to Turkey, Georgia). Nabucco construction can start once 10bcm annual supplies have been committed. But in the long term, Nabucco will need 31bcm to be commercially viable. Additional gas will have to come from: Turkmenistan, Iran, Iraq, Egypt or Russia. All are tricky, of which more below. Since the gradual increase in throughput implies very uneven revenue flows, the consortium may consider a revenue equalisation scheme.

How does Nabucco link to EU accession?

The EU describes Nabucco as the number one priority in its diversification policy. But not clear how that translates into action. Fact is: the main players are individual companies from the transit countries. RWE has just joined and is probably determined to make Nabucco happen because it's the company's only big foreign project. Gaz de France completed the paperwork for joining but Ankara blocked it because of the Armenian resolution and Sarkozy's stance on accession.

EU unbundling negotiations could complicate Nabucco. The current draft directive has a 'Gazprom clause' that says that non-EU energy companies may not buy stakes in EU pipelines unless there is special agreement and they are themselves unbundled. Botas is not an EU company and it is not (yet?) unbundled. So its participation would need a special deal if the current directive is adopted (which looks unlikely at the moment). The same would apply to Azerbaijan's potential participation in Nabucco, which is currently being talked about.

Turkish participants described Nabucco as a "political project" and a "bargaining chip" in EU negotiations. Turkey is also mindful of its relationship with Russia: Turkey gets over 60 per cent of its gas from Russia (it is Gazprom's 2nd most important market after the EU); Russia has just replaced Germany as Turkey's most important export market; and there is growing military co-operation. Turkey realises that Nabucco is in its own long-term interest. But in the short-term it may be more convenient (and cheaper) not to annoy Russia – unless the Europeans can offer something attractive to make it worthwhile.

Where will Nabucco supplies come from?

*** Turkmenistan:** Gas reserves are currently estimated at 3.5 trillion cm but audits could show as much as 7-10 trillion. Currently, Turkmenistan produces 80 bcm annually of which 50 bcm are committed to Russia on a long-term basis and 30 bcm to China. Turkmenistan has been making some encouraging noises towards the EU that it would be interested in getting access to the high-value European market (meaning a revival in the Trans-Caspian pipeline plan).

Russia has just promised that it would pay "European prices" to the Central Asian producers from 2009. Perhaps to foil Nabucco, perhaps because it is worried about China's growing role in Central Asian energy. It's not yet clear what European prices will mean: presumably EU border prices (will probably be $400 per 1,000 cm in 2009) minus transport costs, so around $270/tcm? Russia would pass these costs on to Ukraine, which takes much of the gas that Russia buys from Turkmenistan. If Russia pays the same as potential exports to Europe, the latter look a lot less attractive. "$270 would kill Nabucco", said one participant.

An equalisation of gas prices would also make it easier for Russia to push for long-standing plans of a Central Asian-Russian gas association, as a nucleus for a planned gas OPEC.

China is planning to raise the share of gas in its energy mix from 3 per cent today to 12 per cent in 2030. That may be optimistic (coal is available and cheap, nuclear does not need to be imported). But it has struck deals with Turkmenistan and Kazakhstan so there is intensified competition for Central Asian resources before the Europeans have even properly arrived. On participant recounted a Kazakhs saying: "The Europeans come here and talk. The Chinese come, sign a deal, and construction starts a week later."

*** Iran:** Some hope that Iran could one day sell as much as 80 bcm to Europe. But the obstacle to Iranian gas exports is not only US sanctions but domestic political and economic uncertainty, which have prevented development of gas fields for exports. Insofar as more investment is forthcoming, Iran will want to keep much of the gas for its own industrialisation, to pressurize its oil fields and to replace oil in domestic power generation (oil exports have priority).

US sanctions will delay the development of Iran's energy sector but not stop it. The Iran sanctions act only applies to US companies although US exerts political pressure on others. Total and Shell already invest in Iran. OMV is planning to. Botas too but its 2007 deal probably more symbolic, given that it can offer neither a lot of cash nor expertise. Gazprom already invests in South Pars and has just said it has signed another deal for "two or three blocs". The signature of the Iran-China mega deal (initially $20bn, now more like $16bn) keeps on getting postponed. Since CNOOC is actually listed in the US it may be subject to US sanctions deal.

There will also be intense competition for Iranian exports, not only from EU. Ukraine wants 20bcm to replace gas coming from Russia; 40 bcm have been committed to prospective LNG developments; around 30 bcm for the planned pipeline to Pakistan and India (India is wavering under US pressure but the Chinese have just said that they would step in and buy the gas if India drops out).

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