Analysis

Europe’s uncomfortable position

Alleviating Europe’s energy dependence in the face of crisis

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The EU is heavily dependent on external producers to meet its demand for natural gas. Currently 53% is imported from external producers of which Russia, Norway and Algeria provide the bulk. If the flow of gas from any of these three states gets interrupted, it will have dire consequences for the economy and societies at large. Therefore, the EU with the support of the US has politically invested in the realization of the so-called Southern Gas Corridor to connect with the energy-rich countries in the Caspian and Middle East region. This article argues that under the current political, social and economic circumstances the realization of this project is nothing more than a distant dream.

The gas market

The features of the gas market are somewhat unique in the natural resources trade due to the gaseous state under normal circumstances. Projects require massive investment to extract and transport the fossil fuel from the production area to the consumer market. Currently there are two methods of transportation: pipelines and liquefied natural gas, LNG, by ship.

The use of either method is primarily dependent on distance, but other reasons also play a part such as politics, geographical location and preferences of producers and consumers. With longer pipelines the costs rise, and therefore generally speaking infrastructure no longer than 4,500 km is economically viable because otherwise costs would outnumber profit in most cases.1

Furthermore, the fixed nature of pipelines means that consumers and producers are bound to each other for a longer period of time. This can be inconvenient when the political reality changes as it has done since the crisis in Ukraine, which has exacerbated the dependence on Russian gas. LNG is a viable alternative because the super cooled gas of -162 °C is transportable by ship providing flexibility to the gas market unimaginable by pipeline.

The relative clean nature, growth of the global economy and abundance of natural gas in the world has led to a stable increase, with some analysts predicting gas to become the primary source of energy somewhere during the next decade. The source of gas consumed in Europe is primarily external due to the absence of major deposits in the European Union (EU). The primary producing countries are Russia, Norway and Algeria, which provide 36%, 25% and 20% of the overall available gas in Europe.

European dependence

The growth of gas consumption in Europe, contrary to other regions, has been hampered by lower economic growth and investment in renewable energy sources. The import and thus dependence on foreign producers will rise though due to slowing domestic production in
the North Sea area and the Netherlands. Imports will rise from the current level of 53% to 70% in 2030.2

Dependence of EU member states on external producers differs significantly from east to west. Due to historical and geographical reasons eastern member states rely heavily on Russia with states such as Hungary, Bulgaria and the Baltics importing almost 100% of their gas from Siberia. This has led to heavy lobbying by the new EU member states for further integration and energy diversification to decrease dependence on external producers, notably Russia.

The energy crisis of 2006 and 2009 between Russia and Ukraine significantly impacted Europe’s perceived reliability of the latter as a transit country and the former as a producing country. Approximately 80 billion cubic meter of gas, bcm, is transported annually through Ukraine to Europe, which is more than 15% of the total gas consumption of the EU. Heavy dependence on a few producers and the crisis in Ukraine have exacerbated the sense of urgency in the EU to diversify.

**The European solution**

The European Commission on 28 May 2014 adopted the EU Energy Security Strategy in order to mitigate and manage the risks to which European states are exposed due to their high dependency on external producers. These measures can be divided into two groups, namely that of short-term and medium to long-term. The first group consists mostly of technical solutions such as increasing reserve capacity, reverse flow infrastructure, and switching to alternative fuels. Medium to long-term measures, however, are more political of nature such as ‘speaking with one voice’ to external producers and diversifying supply countries and routes.3

This process has recently been accelerated due to rising tensions over the crisis in Ukraine, which is illustrated on the official website of the EC that states “in response to the political crisis in Ukraine and the overall importance of a stable and abundant supply of energy the European Commission has released an EU energy security strategy”.4

As previously mentioned the long-term solution for improving European energy security is diversification so that supply risks can be mitigated. Although LNG is a logical solution due to its flexibility, the relative high prices make it less attractive. Furthermore the Fukushima disaster in Japan showed that under certain circumstances LNG also has its disadvantages. As a result of the disaster at Fukushima and the shutting down of all nuclear power stations in Japan massive amounts of natural gas had to be imported in order to meet the demand for power. Increasing demand led to a shift in attention of LNG producing and transporting firms to Asia where higher profits were to be made, and thus increasing the price of LNG in Europe.5

The envisaged SGC, which is meant to alleviate the high dependency of East and Southeast Europe on Russia, has been the single most important project. First proposed in 2008 under the ‘EU energy security and solidarity plan’, it has changed significantly through the years. While some projects have been cancelled and capacity has been reduced, other
propositions have gained traction and attention from capital cities around the region. At the moment the EU has high hopes for improving its energy security through the SGC and LNG.

**Risks of and challenges to the Southern Gas Corridor**

The SGC first saw the light of day as the Nabucco project, which later was cancelled (see figure 1). The current proposed pipelines consist of the Trans-Anatolian Pipeline, TANAP, running from the Azerbaijani capital of Baku to Turkey and the Trans-Adriatic Pipeline, TAP, to Europe. Turkey will receive 6 bcm annually starting from 2018 and the EU 10 bcm starting in 2019 from the Shah Deniz gas field. This is a small drop compared with the total amount of gas consumed in the EU: 460 bcm. However, it is able to upgrade the infrastructure when other producers come online. Although the first phase from Azerbaijan to Europe is being constructed, the overall success of the project in order of becoming a credible alternative source of energy requires the participation of other major producers. However, support from the EU and US is misguided and risks are underestimated as the political situation and third party interests do not coincide with those of Western countries.

At the moment Azerbaijan is the only energy-rich country willing and able to contribute to European energy security. It will be possible to upgrade the infrastructure in the future when other resources than the Azerbaijani Shah Deniz become operational. The political, economic and social environment, however, does not support this, which will be explicated hereafter.

**Azerbaijan**

Without doubt Azerbaijan is the energy-rich country which is most interested in exporting its resources to Europe. However, the proven reserves of natural gas are 28th in the world, which is not enough to provide sufficient amounts in order of being a significant source other than Russia, for example. The decreasing levels of oil output force Baku to look for other means to secure a stable flow of income as the South Caucasus country is heavily dependent on the export of fossil fuels. Furthermore, by maintaining its position as a supplier of energy to Europe, Azerbaijan and its authoritarian leader, Ilham Aliyev, muzzle political backlash for criticism regarding human rights violations.6

This explains Azerbaijan’s eagerness to benefit from the nuclear deal between the P5+1 and Iran, and the lifting of sanctions. The government mouthpiece news agency trend.az regards Azerbaijan as the only viable source of export of Iranian gas to Europe, but Iranian interests and statements from officials do not coincide with Baku as will be discussed later on. Although Azeri and Iranian relations have improved since the presidency of Hassan Rouhani, Iran’s disapproval of Baku’s close relationship with Israel remains a stumbling block, as is Iran’s with Armenia, the arch foe of Azerbaijan. Furthermore, the resumption of fighting between Armenia and Azerbaijan over the breakaway region Nagorno-Karabakh and the potential consequences for the energy industry has Teheran thinking twice before investing heavily in its neighbour.7

**Iran**

Iran’s intentions remain uncertain although strategic considerations and statements of government officials and politicians can give a glimpse of what is to come. Seen from a
strategic point of view, it remains highly improbable for Tehran to invest in a costly project with a lengthy profitability time with a party that has been in a political deadlock for years up until the recent nuclear agreement. However, Europe’s interest in Iranian energy resources and the sheer size of the EU’s economy and its necessity for energy make it a potential lucrative market. Therefore tapping into the European market while maintaining flexibility is a major aim for Teheran, which is not possible with pipelines.

According to Alireza Kemali, head of the National Iranian Gas Export Company, Iran is planning to reactivate its LNG plans when sanctions are lifted. With it Tehran would be able to supply the European market, which is searching for alternative sources due to the conflict with Russia. Furthermore, he declared that pipelines are only suitable to export natural gas to neighbouring Gulf countries, such as Iraq and Oman, because of the relatively short distance, and that littoral states have priority (hinting on requests of European states).

**Turkmenistan**

Turkmenistan’s gas reserves on the other hand are more than sufficient to meet the EU’s needs in providing a credible alternative source of natural gas as it possesses the world’s fourth largest reserves. The geographical location, however, of the Central Asian country poses a challenge for anyone willing to sign a deal with Ashgabat. Turkmenistan possesses no direct link to the open seas or a land border with potential customers. There have been talks of a Trans Caspian Pipeline to connect Turkmenistan with Azerbaijan and consumers in Turkey and Europe. The project, however, has encountered two obstacles: first, the undefined legal status of the Caspian Sea, whether it is a sea or a lake, and thus the right to construct any pipeline without consent of the other littoral states is unclear. Russia and Iran insist that as long as the status is not decided upon, the consent of all littoral states should be taken into consideration. Second, the question of who is going to pay for it is raised.

Another option that has been discussed is a land route from Turkmenistan through Iran to Turkey and the EU. This option appears less realistic due to the status of both Iran and Turkmenistan as energy-rich countries. It seems highly unlikely for Tehran to allow a pipeline on its soil that would be competing with Iranian gas in the future.

**Turkey**

The geographical location of Turkey between East and West makes it the most important link in any future pipeline project to the EU. Any deal would be a step in the right direction of making Ankara’s wish come true in becoming an energy hub. The current unstable political climate in Turkey, however, and the fallout effect of the war in Syria seriously undermine the ability of Turkey to act as a reliable and safe transit country. First, the deteriorating political climate, which has been heavily polarised by the authoritarian style of rule of the incumbent president Erdogan, does not improve the business climate. Furthermore, the questionable role of Turkey in Syria, its alleged support of ISIS, and the violation of the ceasefire agreement with the PKK for domestic political reasons, have dramatically deteriorated the security situation in Eastern Turkey.

Besides the death of dozens of Turkish security officers, PKK fighters, and innocent civilians, all major pipelines in Eastern Turkey have been targeted in the past couple of weeks. On the
28th of July the pipeline from Iran, on the 29th of July the pipeline from Iraqi Kurdistan, and finally the Baku-Tbilisi-Cehyan pipeline from Azerbaijan to Turkey on the 26th of August was blown up on Turkish soil, presumably by the Kurdish PKK. Judging from the current Turkish political climate and polarisation, a permanent ceasefire in Turkey is not on the agenda anytime soon. Therefore Turkey's status as a reliable transit country cannot be taken into consideration in the short term.9

Conclusion

Although currently technical capabilities are being constructed between member states to increase flexibility and stimulate the integration of the European energy market, dependence on external producers remains a dominant feature. The Southern Gas Corridor has been ushered in as a new source of natural gas with which predominantly the heavily dependent southeast and east of the EU can be alleviated from a single producer, i.e. Russia. Unfortunately, the political landscape of the Middle East and the Caspian region does not correspond with that of EU member states. The recent fall of the price of commodities has created further uncertainty in the realization of the Southern Gas Corridor as a credible alternative to the already existing massive infrastructure from other producers.

While the Caspian region and the Middle East basin contain most of the world’s easily recoverable fossil fuels and thus the cheapest energy in theory, the unstable political and social environment are a major constraint. Although the perseverance of the Azerbaijani dictatorial regime and its necessity for future income for its energy riches will result in the export of Azeri gas in 2019, the limited capacity does not mean a game changer in the European energy landscape. The mountain of challenges that is standing in the way of a breakthrough compels us to be more realistic of the envisaged resources and consequences of the Southern Gas Corridor. Though the EU is in desperate need of more exporters to improve its energy security, the path chosen with the SGC has been highly ambitious and full of risks. Therefore, the EU would do a better job in investing in other options to meet its demand.

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