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Keeping energy options open

AZERBAIJAN HAS A KEY ROLE TO PLAY IN ENERGY SUPPLY TO EUROPE

In the past year four major events have impacted on Azerbaijan’s energy policy: the ongoing global economic slowdown, the drop in energy prices, uncertainty in the transportation solution for its vast gas resources and the fact that the country has reached a significant level of oil and gas production and turned into a serious oil and gas exporter. As a result, the country’s already complex energy policy has been further complicated as it seeks to remain on good terms with both Western consumers and, its giant neighbour, Russia.

At the annual oil and gas conference held in the Azerbaijani capital of Baku in April, Industry and Energy Minister Natik Aliyev confirmed that Azerbaijan is pressing for access to European markets as the main export destination for Azerbaijani gas. Mr. Aliyev also said that the country has the resources to keep both Russia and Europe supplied, but that doing so depends on setting up an effective energy corridor from the Caspian region. Which is why Mr. Aliyev has been busy talking with representatives from many countries including Turkey, Iran, Russia, Greece and Italy, looking for the best conditions to get his country’s gas out into the international market.

In its bid to keep two competing power blocs happy, Azerbaijan sees that the solution is multiple oil and gas pipelines. The president of the country’s state-run oil company SOCAR, Mr. R. Abdullayev, says that Azerbaijan needs an effective transport corridor to deliver gas to Europe, which is key to the investment decision required to extract more of its proven gas reserves. “The two issues – increasing production and delivering gas to markets – are inter-independent, because if we have no way to transport the gas we can’t increase production,” he said in June. At present Azerbaijan possesses four export gas pipelines, running through its neighbours Georgia, Iran, and Russia.

A major gas player

Though Azerbaijan has significant oil deposits, analysts say that in the future this country will also become a major supplier of natural gas. Azerbaijan and the international consortium signed the contract on the Shah Deniz project back in 1996 in the expectation of a large oil find, instead of which a giant deposit of natural gas and condensate was discovered. The field’s recoverable gas reserves are estimated to be at least at 1.2 trillion cubic metres. The consortium includes BP (as project operator) and Norway’s StatoilHydro with stakes of 25.5 per cent each; Azerbaijan’s State Oil Company, the Russian Lukoil, the National Iranian Oil Company, and Total of France, with 10 per cent each; and Turkish Petroleum with 9 per cent. A separate consortium with an identical structure owns and operates the dedicated export pipeline from the field via Azerbaijan and Georgia to Turkey (South Caucasus Pipeline), with BP as technical operator and StatoilHydro as commercial operator. Phase one of commercial production at Shah Deniz started in 2007 and jumped to 8.5 billion cubic metres (bcm) in 2008, but is expected to grow only slightly to 9 bcm in 2009. Of this amount, 6.6 bcm are due for export annually through the Baku-Tbilisi-Erzurum pipeline to Turkey, 0.8 bcm will be supplied to Georgia. Phase two of production at Shah Deniz is expected to reach 20 bcm in the plateau years, now deferred until 2016. Azerbaijan is already producing 27 bcm annually and expects that figure to reach 30 bcm this year. It currently exports gas to four countries, with Russia about to become the fifth. As the West switches powering its electricity generating plants from coal to natural gas, SOCAR can offer Europe an alternative to traditional suppliers, among which Russia is currently the most important.

Despite Russia’s assurances that its motives are business driven, many nations in Europe and the region want to secure alternative supplies and energy sources. A role that Azerbaijan, now no longer landlocked, is perfectly placed to carry out.

Pipeline decisions

A deal has been imminent on getting Nabucco started for the last two years, but so far work has not begun on the proposed 2,050-miles Nabucco pipeline route from the Turkish border with Georgia through Romania, Bulgaria and Hungary to Austria. The estimated cost is now put at US$12 billion. Work was due to begin last year. When, and if, it is up and running, Nabucco would have a maximum capacity of 31 bcm a year. The consortium behind the project now comprises six national energy companies: Botas (Turkey), Bulgargaz (Bulgaria), Transgaz (Romania), MOL (Hungary), OMV (Austria), and RWE (Germany). Current plans call for an initial 8 bcm of gas annually from Azerbaijan for Nabucco, an amount that should increase to 31 bcm as other regional suppliers join up.

Will Nabucco ever happen?

The Nabucco project has gained fresh impetus in the wake of the Russia-Ukraine gas standoff, which cut supplies to much of Europe for nearly two weeks earlier this year. The EU currently imports about a quarter of the gas that it needs from Russia via Ukrainian pipelines. “We need to learn the lessons of the recent gas crisis and invest heavily in energy,” European Commission President Jose Manuel Barroso said in Brussels in February.

EU Energy Commissioner Andris Piebalgs said at the time that all the preconditions were now in place so that in 2015 gas will reach Europe via Turkey from the Middle East and from the Caspian. Mr. Piebalgs added that pursuing the project does not rule out the realisation of Russian gas monopoly Gazprom’s South Stream gas pipeline project. In addition to new pipelines, Europe must boost gas-storage capacity and improve its own pipeline connections to increase energy security, he added. But a gas supply agreement reached at the end of June between Azerbaijan and Russia has underlined again the requirement for the timely construction of Nabucco.

The deal to start the flow of Azerbaijani gas to Russia in January 2010 represents a breakthrough at a time when Moscow and the European Union are courting Baku in hope of tapping its vast gas deposits to fuel their respective pipeline projects to Europe. SOCAR and Gazprom signed on the 29th June general terms and conditions for the contract to buy gas from Azerbaijan. The agreement came during a state visit by Russian President Dmitry Medvedev to Baku. The five-year deal would allow Azerbaijan to export at least 500 million cubic metres of gas annually beginning in 2010. Although the volumes under the deal are modest, the deal in itself is important in that it demonstrates Russia’s intent to buy further volumes of Azerbaijani gas, which could then be used to pump via the proposed South Stream pipeline, while the supply agreement also indicates that Azerbaijan has other gas export options in the context of the ongoing discussions with Turkey over gas prices, transit terms, and future supplies.

The contract can be seen as another effort by Russia to expand its grip on European energy resources. EU countries currently receive a large portion of their energy resources from Russia with approximately 20 per cent of exports running via pipelines in the Ukraine. While no details were disclosed about the price during the signing ceremony, Azerbaijan’s President Ilham Aliyev told reporters in Baku that “Cooperation will be successful and mutually beneficial, which will fully ensure the interests of Azerbaijan and Russia,” At the same time SOCAR officials point out that there is no “preferred buyer” for its gas. The talks are being continued with potential buyers and all proposals are being considered. But the EU hopes that the Nabucco pipeline will still be in time to tap into the second phase of Shah Deniz. At the earliest, Nabucco would not be finished until 2015.

Azerbaijan is still being positive about Nabucco. “This pipeline would be of strategic importance not only to Azerbaijan, but to the other newly independent states as well”, says SOCAR’s Vice-president Elshad Nassirov. “This is a reliable way to the world’s markets.” Analysts say that Baku has enough gas to sell to Russia and the EU, but that Brussels needs to start pushing forward with talks on Nabucco and feeding it through the gas of the Shah Deniz field. Azerbaijan has also been talking to Iran about gas sales. In January Tehran proposed buying all of the gas produced from the phase two development of Shah Deniz.

The Iranian proposal would provide for Iran’s own natural gas security from Shah Deniz’s second phase while undercutting Gazprom’s efforts to buy up all future Caspian and Azeri natural gas production. If Iran, who is also considered as a potential supplier to Nabucco will join it, it will potentially get access to advanced Western technology to begin bringing its own massively underdeveloped gas fields online. This might also sidestep Washington’s sanctions, as it represents Iranian foreign investment into a trusted Western energy partner rather than Western companies entering the Islamic Republic’s market.

Natural gas originating from Iraq is also considered as one of the resources for Nabucco.

Other options

That said, Nabucco is not the only gas pipeline option for Europe. The launch in November 2007 of a new pipeline between Turkey and Greece was a historic event, but one that went largely unreported in the European media. The 300 kilometre-long natural gas pipeline carrying Azerbaijani gas through Greece to Italy via the Adriatic Sea is the first time Caspian gas has reached the continent without going through Russia.

The achievement sent a message to the Caspian states that they need not depend solely on Russia to export their hydrocarbon resources to Europe or to meet their energy needs. The Turkish-Greek pipeline, dubbed the “South European Gas Ring Project,” is part of a complex network of pipelines and proposed pipelines to carry gas and oil from the Caspian and Central Asia to the markets of Europe and the world via the Caucasus’s and Turkey.

Landlocked Turkmenistan also has huge resources of natural gas and no access to world markets. As a result, it sells its gas for a price lower than the international market price through Russian pipelines. At the same time Turkmenistan has the opportunity to send part of its vast gas reserves through the Baku-Tbilisi- Erzerum (BTE) delivering gas from the Shah-Deniz field. Meanwhile, BTE has significantly reduced Georgia’s energy dependence on Russia. Georgia has also proposed the construction of a 700 km gas pipeline under the Black Sea to connect Georgia to the Ukraine, and therefore Europe, bypassing Russia. Kazakhstan might also be interested in joining the BTE via an underwater gas pipeline that would link Kazakhstan to Azerbaijan under the Caspian Sea.

In late 2006, the Baku-Tbilisi-Erzerum pipeline, also known as the South Caucasus Pipeline, began transporting gas from the Shah-Deniz field to the eastern Turkish city of Erzerum. The first aim of the pipeline is to supply gas to Turkey and Georgia. As a transit country, Georgia has rights to take 5 per cent of the annual gas flow through the pipeline in lieu of tariff sand can purchase a further 0.5 bcm of gas a year at a discounted price. The South Caucasus Pipeline could also supply Europe with Caspian natural gas through the planned Nabucco, Turkey-Greece, and Greece- Italy pipelines.

Oil exports

Azerbaijan decided almost a decade ago to construct a US$4 billion pipeline from Baku via Tbilisi to Turkey’s Mediterranean deep-water port of Ceyhan, dubbed the BTC pipeline. The BTC consortium, which is responsible for the construction and management of the pipeline, is led by BP.

In 2005, oil began to flow into the 1,768 km pipeline, and by early 2006 the BTC-pipeline, designed for 1 million barrels a day - equivalent to 1.3 per cent of world demand, became fully operational. Kazakhstan, the region’s other oil giant, has signed a deal to pump five million tons of oil a year through the BTC, a figure that would eventually rise to 60 million tonnes. “Our goal is to maximise the capacity of BTC by attracting regional oil output for export through the pipeline,” says Natik Aliyev, Minister of Industry and Energy. He brushes off accusations that Baku was playing at regional power politics by deciding to go west rather than through Russia.

“The route through Turkey was an entirely commercial decision,” says SOCAR vice president Elshad Nassirov about the BTC. “Contrary to what many commentators say, there were no political considerations. Mr Nassirov says that the BTC is not competing with the Russian pipelines but enhances the existing network. But he also points out: “BTC is the only non-OPEC, non-Russian, and non-Middle Eastern pipeline in the region.” Eventually, the BTC pipeline could meet 25 per cent of world demand growth.

Mr Natik Aliyev says that Azerbaijan will continue to use existing routes as well as the BTC for the time being: “It would be untimely to discard Baku- Novorossiysk pipeline as one of the variants of our export diversification process. This pipeline is often referred to as the northern route, which exports roughly 40,000 bbl/d of SOCAR oil via Russia to the Black Sea. Mr Aliyev adds that the other pipeline to the Georgian port of Supsa is still one of the most effective routes for oil transportation. “This is our cheap access to the Black Sea basin”, he says. The Azerbaijan International Oil Consortium only exports oil produced from ACG field via the pipeline from Baku to the Georgian port of Supsa (Western Route), through rails to the Georgian port of Batumi and through the BTC to the Turkish port of Ceyhan. SOCAR is also using its own Terminal at Kulevi on the Georgian Black Sea coast.

In November 2007, the leaders of Azerbaijan, Georgia and Turkey inaugurated the construction of a US$600 million regional railway line that will run alongside the BTC oil pipeline and the Baku-Tbilisi- Erzurum gas pipeline. The Kars-Akhalkalaki-Tbilisi- Baku railway is the third major regional project resulting from the three countries’ cooperation. It is the region’s first major project not directly related to energy, and, like its predecessors, it bypasses Armenia.

Azerbaijani Industry and Energy Minister Natik Aliyev says the project will bring stability and cooperation to the region along with billions of dollars in revenue. “The railway will ensure the uninterrupted transport of passengers and freight. It is expected to lead to further development of the Europe-Caucasus- Asia transport corridor within the reconstruction of the ancient Great Silk Road," he says.

With Baku at the junction of the major North- South and West-East transport corridors, the launch of the railway could also benefit Iran, Kazakhstan and Turkmenistan, as well as China and India, which have expressed interest in future involvement in the project.

At the same time, plans are being considered to extend the railway from Azerbaijan to the Iraqi city of Basra and then on to the countries of the Persian Gulf. There are also hopes that in the future the railway will extend from China in the east to Europe in the west via Kazakhstan, Azerbaijan, Georgia, and Turkey. Thus, Azerbaijan is set to continue playing the role of an energy transit corridor between Europe and China via Turkey, the South Caucasus, and Central Asia

SOCAR: an energy industry is born

The rebirth of Azerbaijan's energy industry came with the collapse of the Soviet Union, and under the guidance of former president Heydar Aliyev. SOCAR, established in 1992 from the merger of the two state offshore and onshore oil production units, is the driving force behind the comeback of the Azerbaijani oil and gas industry. The company is the largest taxpayer in Azerbaijan and it the largest employer, with more than 60,000 employees.

OCAR and its many subsidiaries are responsible for the production of oil and natural gas in Azerbaijan, for the operation of the country's two refineries and gas processing plant, for running the country's pipeline system (except the Baku-Tibilisi-Ceyhan pipeline), and for managing the country's oil and natural gas imports and exports. As the country's largest company, it also plays a key role in driving economic growth. Although government ministries handle exploration and production agreements with foreign companies, SOCAR is party to all of the international consortia developing new oil and gas projects in Azerbaijan.

In 1994, Heydar Aliyev blessed the deal known as "The Contract of the Century": the Azeri-Chirag-Gunashli (ACG) Production Sharing Agreement (PSA). Valued at US$10 billion of CAPEX, oil production under this PSA operated by the Azerbaijan International Operating Company (AIOC), began in November 1997. "Former president Aliyev understood the need to establish solid investment guarantees, and as such, the PSAs are law: they cannot be changed by any future government," points out SOCAR vice president Elshad Nassirov.

President Aliyev also created a system of fair and transparent redistribution of oil revenues that has fuelled the country's development. Azerbaijan had all the preconditions for turning its oil revenues into the foundation of a corrupt and monopolised system where groups in power would struggle for financial flows and would distribute them amongst each other. The then president avoided this by setting up the State Oil Fund (SOFAZ) in 2000. Following the death of Heydar Aliyev, his son, President Ilham Aliyev continued this strategy of using the oil and gas money for the rapid transformation of Azerbaijan into well developed and prosperous country.

The main recipients of oil revenues in the country are the State Oil Fund (SOFAZ), the State Budget, and SOCAR. Revenue also goes into the State Social Protection Fund and a number of state enterprises, banks, and other organisations. Azerbaijan is also a member of the Extractive Industries Transparency Initiative (EITI