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Completing the Southern Gas Corridor

SGC in a Post-pandemic World

Akhmed Gumbatov

The global spread of the latest zoonotic virus, commonly known as COVID-19, has become an unprecedented calamity for all humankind. By the time this publication goes to press, it is likely that worldwide around 25 million people will have been infected and the number of lives lost will approach the one million mark.

This tragedy has been compounded by another one: the coronavirus pandemic has dramatically demobilized the global economy. In an attempt to curb the further transmission of the virus, many affected countries around the world imposed complete lockdowns of their respective populations, which resulted in severe and extraordinary economic disruption. According to the IMF's most recently updated World Economic Outlook forecast (June

2020), the global economy will shrink by 4.9 percent this year, which represents the worst downturn since the Great Depression of the 1930s.

The energy sector has been hit particularly hard. Limitations on transport, trade, and economic activities have led to a staggering drop in energy demand worldwide. In its latest Global Energy Review, the International Energy Agency (IEA) forecasted a 6 percent drop in global energy consumption.

The organization anticipates a decline in demand for all types of energy sources (except for renewables). For instance, the oil industry expects a drop in consumption of 9.3 million barrels a day this year. The collapse in demand for crude has already sparked turmoil in the global oil market, with prices for Brent crude in April dropping to their lowest level in 18 years and

WTI crude going negative for the first time in history. Moreover, consumption of coal and natural gas for 2020 is projected to fall by 8 percent and 4 percent, respectively, according to the IEA.

In addition to falling demand, many anticipated energy projects are being canceled or postponed. Global investment in the oil and gas sector is projected to drop by almost one third in 2020. Such gloomy developments in the energy sector have provoked discussions about the potential challenges to the on-time completion of one of the world's largest and most expensive energy infrastructure projects: the Southern Gas Corridor (SGC), a \$40 billion 3,500 km-long chain of pipelines aimed at bringing natural gas to Europe from Azerbaijan and the wider Caspian region for the first time ever.

This essay will investigate the impact of COVID-19 on the on-time completion of the Southern Gas Corridor, which appears to remain on track for the end of 2020. It will also consider potential developments regarding the Southern Gas Corridor in a post-COVID-19 world.

The Southern Gas Corridor

The Southern Gas Corridor is the term used to describe a planned chain of infrastructure projects designed to bring natural gas from the wider Caspian region to European markets. The initiative was proposed by the European Commission in 2008 to diversify the EU's natural gas supply routes and decrease its dependency on supplies from Russia, a country that accounted for more than 40 percent of the EU's total imports of natural gas in 2019.

The strategic importance of finding a steady and reliable alternative source of natural gas is strengthened by the fact that the

The Southern Gas Corridor is the term used to describe a planned chain of infrastructure projects designed to bring natural gas from the wider Caspian region to European markets.

EU's indigenous production of natural gas is in steady decline. According to the IEA, the EU's domestic production of natural gas will decrease from a total of 128 billion cubic meters (bcm) in 2018 to 65 bcm in 2025.

In addition, around 100 bcm of long-term contracts are expected to expire by 2025, thus creating favorable conditions for additional imports from new sources.

At the initial stage, natural gas for the SGC project will be supplied from Azerbaijan's Shah Deniz Stage 2 field. Discovered in 1999, Shah Deniz is one of the largest gas-condensates fields in the world. It is located on the deep-water shelf of the Caspian Sea, approximately 70 km south-east of Baku. Shah Deniz Stage 1 started operations in 2006 and has the capacity to produce around 10 bcm of natural gas per year. Since then, the field has become an important source of natural gas supplies not only for domestic consumption in Azerbaijan, but also for exports to Georgia and Turkey via the newly-built South Caucasus Pipeline (SCP), also known as the Baku-Tbilisi-Erzurum Pipeline.

Shah Deniz Stage 2, which began to come online in 2018, will provide an additional 16 bcm of natural gas production per year, with 10 bcm allocated to Europe and 6 bcm to Turkey. The cost of developing the second stage of the Shah Deniz field is \$28 billion, making it the most expensive component of the Southern Gas Corridor. BP is the technical operator of the field and its largest shareholder, with 28.8 percent ownership of the joint venture. Other participants include a division of Azerbaijan's state oil company (SOCAR/SGC), with 16.7 percent; Turkey's national oil

company (TPAO), with 19 percent; Petronas, with 15.5 percent; Lukoil, with 10 percent; and Naftiran Intertrade Company (NICO), with 10 percent.

Besides the development of the second stage of the Shah Deniz field, other major elements of SGC are the South Caucasus Pipeline Expansion (SCPX) in Azerbaijan and Georgia, the Trans-Anatolian Pipeline (TANAP) in Turkey, and the Trans Adriatic Pipeline (TAP) in Greece, Albania, and Italy. The South Caucasus Pipeline (SCP) was commissioned in 2006 to supply around 7 bcm of natural gas per year from Shah Deniz Stage 1 to Azerbaijan, Georgia, and Turkey. The pipeline was expanded in 2019 to accommodate an additional 16 bcm of natural gas for the Southern Gas Corridor from Shah Deniz Stage 2, thus increasing the pipeline's capacity to 23 bcm. It could be further expanded to 31 bcm should more gas supplies become available in the future. The shareholder structure of the pipeline project is identical to that of Shah Deniz.

The next major element of SGC is Turkey's TANAP pipeline, which was officially inaugurated in November 2019 and cost \$6.5 billion to build. The central and also longest part of the corridor (1850 km), TANAP connects Azerbaijan's Shah Deniz Stage

2 natural gas field to Europe via the SCPX pipeline on the Georgia-Turkey border and the TAP pipeline on the Turkey-Greece border. TANAP can transport 16 bcm of natural gas annually, and similar to SCPX, its capacity can be expanded up to 31 bcm. TANAP's shareholders are the Southern Gas Corridor CJSC, with 51 percent ownership; Turkey's BOTAS, with 30 percent; BP with 12 percent; and SOCAR Turkey, with 7 percent.

The final leg of SGC is the TAP pipeline. Connecting with TANAP on the Turkey-Greece border, TAP crosses Greece, Albania, and the Adriatic Sea before coming ashore in southern Italy to connect to the Italian natural gas network. The TAP project, worth €4.5 billion, faced delays in the past, and current plans are for it to be completed in late 2020.

In other words, TAP is the only component of the strategic energy corridor that is still under construction. Once finished, it will begin carrying 10 bcm of natural gas, with 8 bcm for Italy, 1 bcm for Greece, and 1 bcm for Bulgaria via the Interconnector Greece-

Bulgaria (IGB). The IGB project, which also experienced delays in the past, is also set to be completed by the end of 2020.

Once additional energy supplies are available in the future, TAP's transporting capacity can be doubled to more than 20 bcm. The realization of the TAP project will not only improve Italy's energy security, but will also promote the country's aspirations of becoming Southern Europe's gas hub. TAP's ownership is held by six companies: BP, SOCAR, and Italy's Snam, each with 20 percent; Belgium's Fluxys, with 19 percent; Spain's Enagás, with 16 percent; and Swiss-headquartered Axpo, with 5 percent.

When complete, the SGC project will comprise 3,500 km of pipelines, with the total value of works for the whole project worth around \$40 billion. As noted

SGC is considered as one of the most strategic projects for the European Union, helping to diversify the bloc's natural gas supplies routes and improve its energy security.

above, the strategic gas corridor is expected to come online by the end of 2020, when TAP's construction works are completed.

The SGC project represents the first-ever attempt to directly connect natural gas fields located in the Caspian basin with European markets. In this regard, SGC is

considered as one of the most strategic projects for the European Union, helping to diversify the bloc's natural gas supplies routes and improve its energy security. The European Commission has officially recognized both TANAP and TAP as "projects of common interest" (PCI) under the EU's Trans-European energy infrastructure guidelines.

The realization of SGC is great news not only for the EU but also for Azerbaijan's economy, which stands to benefit from increased exports of natural gas, given that the oil and gas sector generates about 40 percent of the country's GDP and 75 percent of government revenue. In addition, the successful execution of a project of such scale, which already involves seven countries and more than a dozen major energy companies, increases Azerbaijan's geopolitical standing. Other participating countries also benefit from transit fees, investments, and new jobs created by the construction and operational activities of the corridor. Should more supplies become available from Azerbaijan and other natural gas producing countries in the region, the corridor's capacity can be doubled, thus further increasing the economic and geopolitical weight of the project. Potential buyers from Albania,

Austria, Bosnia and Herzegovina, Croatia, Hungary, Montenegro, and other countries have already expressed their interest in participating in an expanded version of the Southern Gas Corridor in the future.

The COVID-19 Factor

The coronavirus outbreak has had a negative impact on demand for natural gas. In fact, the pandemic has further exacerbated already shrinking gas consumption caused by historically mild temperatures over the first months of 2020. According to the IEA, the natural gas sector will experience a 4 percent decline in 2020—"the largest recorded demand shock" in history. Global natural gas output is also set to drop by 2.6 percent in 2020.

Prior to the pandemic, global natural gas production in 2020 was expected to be 4,233 bcm. Now the indicator has been revised down to 3,962 bcm for this year, rising to 4,015 bcm in 2021 and to 4,094 in 2022. Weak demand accompanied with abundant supplies has led to a collapse in natural gas prices around the world, with European natural gas prices falling by almost 40 percent since the start of 2020. This is not welcoming news for natural gas suppliers participating in the development of the costly Southern Gas Corridor, as their revenues are also expected to decrease.

Moreover, while revenue is shrinking, costs associated with the development of SGC are increasing. One reason is that investors have been forced to adopt costly safety measures to prevent the spread of the virus in the communities engaged in the construction and operational activities of the corridor. Another is that these activities had to continue amid various lockdowns and quarantines, as well as closed borders.

Despite such challenges, COVID-19 has not caused delays in commercial operations at any of the three completed components of the corridor, namely Shah Deniz Stage 2, SCPX, and TANAP. According to both SOCAR and BP reports, all facilities and operations have performed in line with established goals and timeframes. In the first half of 2020, TANAP transported 1.9 bcm of natural gas to Turkey, which accounts for around 37 percent of Azerbaijan's total exports to Turkey for the reporting period (i.e. 5.2 bcm). Remarkably, thanks to the additional export capacity provided by TANAP as well as a dramatic reduction in imports of natural gas from Russia, Azerbaijan has become the largest supplier of natural gas to the Turkish market in the past few months, well ahead of Russia and Iran.

Of particular concern is the fact that the pandemic has imposed particularly significant hurdles on the on-time realization of TAP—the corridor's final leg and the only component which is still under construction. The past few months have seen significant increases in spending caused by the introduction of strict epidemiological safety measures, including limitations on commercial flights. Together with related factors, this has negatively affected the delivery of staff and materials, which has dramatically complicated the construction process.

Nevertheless, the construction of TAP has not stopped, and the project is steadily progressing towards delivering its first gas by the end of 2020. In previous months, significant advances on TAP's right of way (ROW) were made: land was actively cleared and pipeline parts strung, welded, lowered into the trenches, and backfilled. In short, TAP moved further into the project construction phase.

In late May, TAP started to introduce natural gas into a 4 km section of the pipeline in Albania as a test (the first natural gas to be introduced into the Greek section of TAP had taken place in November 2019). Meanwhile, in June, TAP reached another important milestone: the completion

of the 105 km offshore section of the pipeline under the Adriatic Sea. Finally, TAP's last weld was completed in mid-July, meaning that all components of the 878 km-long pipeline has been joined together. As of mid-August 2020, the TAP project was more than 97 percent complete—a 7 percent increase since January 2020 and quite an impressive logistical feat, given the difficulties caused by COVID-19.

Similar to TAP, IGB is also facing significant challenges imposed by lockdown and quarantine measures. Nevertheless, the project is also steadily progressing, and its completion remains scheduled for the end of 2020, in parallel to TAP. Once realized, the 182 km-long pipeline, worth €240 million, will transport Azerbaijan's Shah Deniz Stage 2 natural gas from TAP in Greece to the national gas transmission system in Bulgaria. IGB is a key part of the EU's strategy for greater integration of its internal gas market, which also includes interconnection projects between Bulgaria and Greece, Bulgaria and Romania, and Romania and Hungary.

As of mid-August, SGC remains on schedule. Nevertheless, as COVID-19 still has a potential to negatively impact on the development of the corridor—particularly

the TAP portion—the consortium requested a second prolongation of what's called a Third-Party Access (TPA) exemption, providing the possibility of postponing the first delivery of gas until December 2021.

TPA, one of the key pillars of EU internal market regulation, entails a system whereby third parties other than owners and operators of the pipeline can have non-discriminatory access to pipeline transportation services. However, an exemption to this rule may be granted by national regulators (subject to approval by the European Commission) for a limited period of time to facilitate a major infrastructure project and make it commercially more attractive by allowing suppliers to fully book a pipeline's capacity without open competition.

Following the approval from the relevant regulatory authorities in Italy, Greece, and Albania, in 2013 the European Commission formally approved TAP's application for a TPA exemption for the initial capacity of 10 bcm for a period of 25 years, which required the pipeline to come online within six years, by June 2019, for the exemption decision to be valid. In 2014, amid anticipated delays in the project's completion, TAP obtained its first TPA extension for the project completion by December 2020.

Despite the expected end of the pandemic and the expectation that this will be followed by some sort of gradual recovery in 2021, the COVID-19 crisis will almost certainly have a long-term impact on natural gas markets. According to the IEA, the “repercussions of the 2020 crisis on growth are set to result in 75 bcm of lost annual demand by 2025, which is the same size as the global annual increase in demand in 2019.”

Most of the post-COVID-19 growth will happen in Asia, led by China and India. Europe's demand is expected to go through a moderate recovery, thus keeping natural gas prices low on the Old Continent. All this also means low revenues for the natural gas suppliers participating in the Southern Gas Corridor.

Undoubtedly, one of the key trends that will increasingly characterize the development of energy infrastructure projects in the near perspective is the transition to clean energy. The trend will be particularly acute in Europe. In December 2019, the European Commission presented the European Green Deal, a set of policies aimed at making the EU climate neutral by 2050. As part of this Deal, the Commission proposed to increase its 40 percent greenhouse gas emission reduction target to 50

percent or more (against baseline 1990 levels) in the decade ahead. While the bloc seems to be divided over the target, most EU member states acknowledge the need for a further reduction in greenhouse gas emissions, particularly in the energy sector, which accounts for 75 percent of the EU's greenhouse gas emissions.

In light of the aforementioned, there are concerns that the Southern Gas Corridor might lose its priority status for the and support from Brussels, which would thus call into question the future expansion of the corridor. The concerns, however, are misplaced, as current projects—including SGC—will not be affected by the European Green Deal.

At the most recent ministerial meeting of the SGC's Advisory Council held in Baku in February 2020, Klaus-Dieter Borchardt, the European Commission's deputy director general in charge of coordinating energy policy, the Energy Union, and external energy policy, underscored that the European Green Pact does not contradict the development or even expansion of the Southern Gas Corridor. Furthermore, by virtue of the fact that natural gas is the cleanest fossil fuel, it is widely accepted as a transition fuel towards a low and zero-carbon economy. In this respect,

the senior representative of the European Commission noted that the transition to clean energy will be realized with the inclusion of natural gas.

High demand in the EU for natural gas, coupled with the bloc's aspirations towards energy supply diversification, indicates the likelihood that the expansion format of the Southern Gas Corridor will remain a key issue on the project's agenda in the post-COVID-19 period. While the construction of SGC has not yet been completed, discussions on the expansion of the corridor have long been taking place.

To determine the need for additional capacity, TAP is required to hold a market test in two stages. The first stage of the market test was non-binding and took place in July 2019. Its purpose was to allow natural gas shippers to express their initial interest in the future expansion of the pipeline's capacity. According to the results, which were announced in October 2019, expressions of interest for using TAP exceeded 11 bcm, thus confirming the need for conducting technical studies for the expansion of the pipeline from 10 bcm up to 20 bcm. Furthermore, as the total

desired capacity exceeds the 20 bcm maximum planned capacity of the pipeline, TAP might consider an expansion that would further increase its maximum capacity to around 24 bcm.

The second stage of the market test is binding and was expected to start in the second quarter of 2020 but was postponed to January 2021. However, due to poor energy market conditions and uncertainties caused by COVID-19, TAP's transmission system operators further postponed the binding bidding phase to July 2021.

Based on the results of the binding market test, a decision by TAP to

expand the pipeline will be made. As actual construction time for any of the expansion works takes up to three years, which suggests that the expansion process is unlikely to happen before 2025.

Expansion Sources

While there are many potential sources of natural gas that can be supplied for an expanded version of the Southern Gas Corridor, Azerbaijan currently seems to be one of the most feasible options. However, depending on domestic production and consumption scenarios, Azerbaijan's natural gas supplies

alone might not be enough to fully book the maximum capacity of an expanded SGC.

The country's peak production years of natural gas—namely, 50 bcm per year—were expected to be 2023-2028, although the effects of COVID-19 are likely to shift this to the 2025-2030 period. This will include around 10 bcm of non-commercial associated gas from Azerbaijan's largest oil field, known as Azeri-Chirag-Gunashli (ACG), thus leaving 40 bcm of natural gas for commercial use. In case of moderate domestic demand, around 30-35 bcm of natural gas would be available for export. Azerbaijan's commitment for exporting 24 bcm of natural gas per year will leave only 5-10 bcm for an expanded SGC.

Turkmenistan is another potential supplier of natural gas to the EU. The world's fourth largest holder of proved natural gas reserves has long been welcomed by the EU and other partners to join the SGC project via the Trans-Caspian Pipeline (TCP)—a proposed natural gas pipeline that would run under the Caspian Sea from Turkmenistan to Azerbaijan.

Discussions on the realization of the TCP project have been particularly active after the Convention on the Legal Status of the Caspian Sea was signed in August 2018,

in the wake of more than two decades of diplomatic efforts. While the convention addresses the legal obstacles on the way to building the TCP, the project's prospects remain unclear due to a number of commercial and also political considerations.

Having said that, modest exports of Turkmen gas to Azerbaijan, either via a small Trans-Caspian link or as swaps via Iran or even Russia, are quite plausible in the near perspective.

The Russia Question

For some time growing concerns have been expressed in parts of the West that Russia's Gazprom could book capacity in an expanded version of TAP—the corridor's final leg located in the EU. As mentioned earlier, due to the Third-Party Access exemption granted by EU regulators, TAP's initial capacity of 10 bcm per year is exclusively reserved to suppliers from Azerbaijan for 25 years. Once expanded, however, the pipeline's additional capacity would be opened for third-party access, meaning that other potential suppliers, including Russia's Gazprom, could book TAP's capacity for delivering natural gas to the Italian market, as well as other ones in the European Union. Although Russia's potential participation in the project contradicts the EU's aspirations to diversify

The SGC expansion process is unlikely to happen before 2025.

energy supplies and reduce its dependency on Moscow, the involvement of Gazprom in the TAP expansion under the current EU regulations is legal and quite plausible.

Technically, Moscow could also use the TurkStream pipeline, which stretches from Russia to Turkey across the Black Sea, to supply natural gas to TAP. The TurkStream project, launched by Turkish president Recep Tayyip Erdogan and his Russian counterpart Vladimir Putin in January 2020, has a total capacity of 31.5 bcm. The first line, which has a capacity of 15.75 bcm, envisages natural gas supplies to Turkey; the second line, which has a similar capacity, is designed to transport Russian gas into the EU through member state Bulgaria.

If warranted, Russia could easily build an additional line to supply natural gas to TAP. In fact, its original design—which was known as South Stream—envisaged the construction of four lines with a total capacity of 63 bcm directly to Bulgaria. However, the European Parliament adopted a resolution in 2014 opposing the project on the grounds that it violated the EU’s energy rules. As a result, Russia was

forced to re-route the project to Turkey and halve its capacity.

In announcing the results of the first market test, TAP did not reveal any information about the companies that had expressed interest in booking the pipeline’s additional capacity, as such information is confidential. Therefore, there is no way of knowing whether Russia’s Gazprom expressed an interest in the TAP expansion. However,

Russia might use the SGC expansion as a medium for delivering its own gas from TurkStream to Italy and beyond.

amid the current uncertainties over the future of Nord Stream 2—an additional 1,200 km-long offshore pipeline being constructed to supply natural gas from

Russia to Europe across the Baltic Sea—it is quite possible that Russia may have expressed its interest in booking TAP’s addition capacity in order to hedge its bets.

Looking Ahead

The new coronavirus outbreak has substantially complicated the realization of the Southern Gas Corridor. Its investors have been forced to adopt numerous safety measures to prevent the spread of COVID-19 in the communities engaged in the construction and operation activities of the corridor. Limitations on flights and the

delivery of staff and materials have put additional hurdles on the project’s completion whilst increasing its costs. However, the construction of SGC has not stopped, and the project seems to be steadily progressing towards delivering its first gas by the end of 2020, as planned.

Despite the anticipated end of the pandemic and the expectation that this will be followed by some sort of gradual recovery in 2021, low demand and low prices for natural gas will remain the likely predominant reality in the immediate post-COVID-19 period, thus further depressing the revenues of SGC shareholders. Another important trend that will be increasingly characterizing the development of energy infrastructure projects in the near perspective is the EU’s transition towards clean energy. However, the shift will not impact the development or even the possible expansion of the Southern Gas Corridor.

While there are many potential sources of natural gas supplies for this expanded version of SGC, Azerbaijan currently seems to be one of the most feasible options. However, depending on domestic production and consumption scenarios, Azerbaijan’s natural gas supplies alone might not be enough to fully book the maximum capacity of an expanded SGC. Amid the current uncertainties over the future of Nord Stream 2, proponents of European energy security are concerned that Russia might use the SGC expansion as a medium for delivering its own gas from TurkStream to Italy and beyond. Lastly, the prospects of building the Trans-Caspian Pipeline to connect gas from Turkmenistan with an expanded SGC remain unclear due to a number of commercial and political considerations. **BD**

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