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The European Commission's Policy Towards the Southern Gas Corridor: Between National Interests and Economic Fundamentals

Nicolò Sartori

Abstract

The European Union launched the ambitious Southern Gas Corridor initiative with the goal of enhancing the security of its energy supply. The corridor - a virtual transit route running from the gas-rich Caspian basin to the EU while bypassing Russian soil - is meant to increase diversification of the EU's supplier and transit countries. While various projects have been proposed to give life to the corridor, the European Commission has given particular support to the realisation of Nabucco, a 3,893km pipeline running from Turkey to the European gas hub of Baumgarten in Austria, via Bulgaria, Romania, and Hungary. The Commission's choice is, however, flawed in several respects, as it fails to take account of key factors, such as the diverging, and sometimes conflicting, interests of individual EU member states, the geopolitical challenges of the Caspian basin, and the commercial constraints on Nabucco. This short-sighted approach has hindered the efficient development of the Southern Gas Corridor and weakened the EU's energy policy.

Keywords: *European Union / European Commission / Energy Security / Energy Diversification / Security of Supply / Pipelines / Southern Gas Corridor / Nabucco / ITGI / TAP / Caspian Basin / Russia / Azerbaijan*

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The European Commission's Policy Towards the Southern Gas Corridor: Between National Interests and Economic Fundamentals

by Nicolò Sartori[*]

Introduction

During the first decade of the 21st Century, energy security has emerged as a key issue on the European policy agenda.[1] The security of energy supplies is increasingly perceived by both national governments and European Union (EU) institutions as an area of priority concern, as the depletion of intra-EU resources and growing international demand have led to growing and more expensive energy imports.[2] The natural gas sector is particularly subject to such concerns, due to the features of gas as a regional commodity (the transportation of which depends mainly on fixed pipeline infrastructure) and the patterns of decreasing production, rising consumption and the highly concentrated supply which currently characterises the European context.[3]

According to the International Energy Agency (IEA), from now until 2030, natural gas is the fossil fuel whose consumption is expected to grow at the fastest pace globally; the EU will contribute significantly to consolidating this trend.[4] The choice of energy-voracious countries such as Germany and Italy either to dispose of or to abandon nuclear programmes - a move heavily influenced by the March 2011 Fukushima nuclear disaster in Japan - is just one reason for the expected rise in the EU's demand for gas. The EU's indigenous production still represents the main source of supply for the EU gas market; however, this is projected to decline substantially in the next two decades because of the rapid depletion of both Dutch and British North Sea reserves. Consequently, EU member states will increase their shares of gas imports from outside the Union. Today about 82% of total EU imports come from only three suppliers: Russia, Norway and Algeria. A disruption of supplies from one of these countries would have a dramatic impact on European citizens' daily life.

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[1] Council of the European Union, *Report on the Implementation of the European Security Strategy - Providing Security in a Changing World*, Brussels, 11 December 2008, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/EN/reports/104630.pdf. See also Javier Solana, *Address at the EU Energy Conference Towards an EU External Policy*, Brussels, 20 November 2006, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/EN/discours/91788.pdf.

[2] Paul Belkin, *The European Union's Energy Security Challenges*, Washington, Congressional Research Service, January 2008 (CRS Report ; RL33636), http://www.fas.org/sgp/crs/row/RL33636.pdf.

[3] Nicolò Sartori, *The Southern Gas Corridor: Needs, Opportunities and Constraints*, Roma, Istituto affari internazionali, June 2011 (Documenti Iai ; 1108), http://www.iai.it/pdf/DocIAI/iai1108.pdf.

[4] International Energy Agency (IEA), *Are We Entering a Golden Age of Gas?*, World Energy Outlook 2011 Special Report, June 2011, http://www.worldenergyoutlook.org/golden_age_gas.asp.

In this complex scenario, energy diversification, either in terms of transit routes or suppliers, has become the cornerstone of the EU's energy policy.[5] Since 2003 the development of the Southern Gas Corridor - a virtual transit route running from the gas-rich Caspian basin to the EU and bypassing Russian soil - represents the EU's most promising solution for achieving these energy diversification objectives.

Currently, there are three major projects competing to become the South Gas Corridor: the Interconnector Turkey-Greece-Italy (ITGI), the Trans-Adriatic Pipeline (TAP), and Nabucco. All projects aim at accessing the Caspian countries' gas markets. On October 1 2011, for instance, the consortia running the three projects submitted competing bids to access Azerbaijan's Shah Deniz II gas field, which is expected to commercialise 17 billion cubic metres (bcm) of natural gas by 2017. The consortium that operates Shah Deniz II is scheduled to award the transportation contract at the beginning of 2012. Should any of the three pipeline projects mentioned above be selected, European countries will have taken an important step towards greater diversification. Nonetheless, the diverging and sometimes conflicting interests of individual EU member states, geopolitical challenges and commercial constraints still hamper the complete development of the corridor as envisaged by the European Commission (EC).

The aim of this paper is to describe the drivers and to evaluate the effectiveness of the EU's external energy policy with specific reference to the Southern Gas Corridor. It aims at identifying the limits of EU action, while trying to indicate potential solutions to existing problems. This paper is not meant to assess whether or not it is a good idea for the EU to speak with one voice on energy matters through the creation of a single external energy policy. Rather, it aims at assessing whether the EU's energy diplomacy has had positive effects on the member states' energy security.

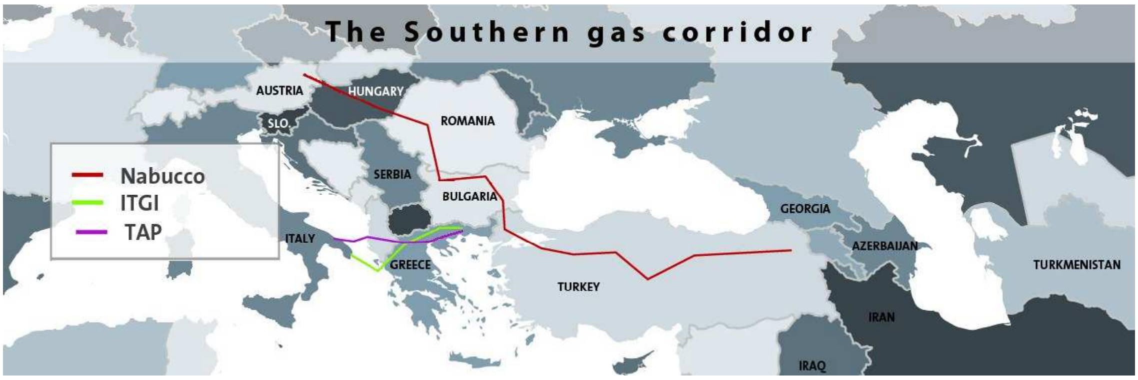
1. The competing bids for the Southern Gas Corridor

As mentioned above, there are three projects that realistically have a chance to get the transportation contract from the Shah Deniz II consortium: ITGI, TAP, and Nabucco.

ITGI is a project led by the Franco-Italian enrgy firm Edison and the Greek state-owned gas company DEPA. The project comprises the already operational Interconnector Turkey-Greece pipeline (ITG), which has a transport capacity of about 11.5 bcm per year, and the proposed 800km long Interconnector Greece-Italy pipeline (IGI). The latter, expected to have a transport capacity of about 10 bcm a year, will be composed of two sections: a 600km onshore pipeline crossing Greek territory, and the 200km Poseidon pipeline running across the Ionian seabed. According to the consortium, the project's capacity could be upgraded to 20 bcm in case of further supplies from the Caspian region. Estimated realization costs vary between 1.5 and 2 billion dollars.

[5] Former Energy Commissioner Andres Piebalgs, and current Commissioner Günther Oettinger repeatedly stressed in their speeches the need of an enhanced European policy of diversification in the gas sector. See, for instance, Commissioner Oettinger speech at the South Stream event held in Brussels on May 25th 2011 (Speech/11/382), http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/382.

Figure 1. The Southern Gas Corridor: ITGI, Nabucco and TAP's routes



TAP, proposed by the Swiss firm EGL in collaboration with the German E.ON and the Norwegian national energy company Statoil, will link Greece to Italy's southern coasts, near the port city of Brindisi. The pipeline's 680km onshore section will pass through Greece and then Albania, while the 105km offshore part will cross the Adriatic Sea in its shallowest and shortest stretch. The initial capacity of the pipeline is expected to be about 10 bcm a year - expandable to 20 bcm - with a reverse flow capacity of up to 8.5 bcm to supply Albania and Greece in case of need. TAP realization costs are officially estimated to be around 1.5 billion dollars.

ITGI and TAP are very similar projects, as they expect to bring the 10 bcm of gas available from Shah Deniz II to the Greek, Albanian and Italian markets. Both projects are flexible, relatively inexpensive, and completable in a short time frame, allowing Azeri gas to be marketable as soon as it comes onstream in 2017. However, while ITGI is backed by the respective governments of Greece and Italy, which see it as a national interest, TAP's rationale is purely commercial and its shareholders are purely profit-seeking.

The third pipeline project, Nabucco, differs substantially from both ITGI and TAP in terms of capacity, transit route and costs. It is developed by a consortium of national energy companies (meaning companies that are fully or majority owned by the state): Austria's OMV, Hungary's MOL, Romania's Transgaz, Bulgaria's Bulgargaz and Turkey's BOTAŞ. Germany's RWE is the only private partner.[6] The 3,893km pipeline will run from Turkey to the European gas hub of Baumgarten in Austria, via Bulgaria, Romania, and Hungary. Nabucco's completion may not be achieved until 2018. Its full transport capacity is expected progressively to reach 31 bcm a year by 2020. Estimated realization costs - officially placed at 10.9 billion dollars - are to rise to 13-18 billion dollars according to EU Energy Commissioner Günther Oettinger.[7]

[6] The German Treasury owns 5% of RWE shares. State participation in the other Nabucco's companies varies from 25% to 100%.
[7] Tom Kaeckenhoff, "Nabucco could cost up to 14 bln euros - Oettinger", in *Reuters*, 13 October 2011, http://www.reuters.com/article/2011/10/13/nabucco-idUKL5E7LD2X520111013.

Nabucco is a considerably more ambitious project than its competitors, as it expects to transport much larger volumes of gas to Europe. However, the Shah Deniz II's capacity is insufficient to provide that level of supply, thereby jeopardising the economic feasibility of the project. Thus the consortium is in desperate need of additional resources - roughly 20 bcm - from other regional gas producers in order to keep Nabucco alive.

Table 1. ITGI, Nabucco and TAP main features

	Partners	Countries of Transit	Length	Capacity	Costs	Operational From
ITGI	DEPA Edison	Greece Italy	800 Km (600 onshore, 200 offshore)	10 bcm a year - expandable up to 20 bcm	$1.5-2 bln	2017
Nabucco	BOTAŞ Bulgargaz OMV MOL RWE Transgaz	Turkey Bulgaria Romania Hungary Austria	3,893 Km (onshore)	31 bcm	$ 13-18 bln	2018 (First Phase) 2020 Fully operational
TAP	EGL E.ON Statoil	Greece Albania Italy	785 Km (680 onshore, 105 offshore)	10 bcm a year - expandable up to 20 bcm	$1.5 bln	2017

2. The EC's energy diplomacy on the Southern Gas Corridor

Since the early 2000s, the EU has been struggling to set up a common external energy policy. In March 2006 the European Commission released a Green Paper, *A European Strategy for Sustainable, Competitive and Secure Energy*, which formally encouraged the establishment of a coherent EU external energy policy.[8] Moreover, the Treaty of Lisbon provides a solid legal basis for the EU's policy aimed at securing energy supplies (Art. 194, 1 (b) TFEU[9]). Over the years, the development of the Southern Gas Corridor has become the testbed for the EC's increasingly proactive external energy action. Top officials in Brussels, including Commission President José Manuel Durão Barroso, have invested personal political capital in the promotion of the initiative.

The history of the Southern Gas Corridor dates back to the late 1990s, when the EC identified the Caspian and Central Asian regions as the key targets for its energy diversification initiatives. With the Interstate Oil and Gas Transport to Europe (INOGATE) programme[10], launched in 1997, as well as the 2004 Baku Initiative[11], the

[8] European Commission, *A European Strategy for Sustainable, Competitive and Secure Energy*. Green Paper (COM(2006) 105 final), Brussels, 8 March 2006, http://europa.eu/documents/comm/green_papers/pdf/com2006_105_en.pdf.
[9] *Consolidated version of the Treaty on the Functioning of the European Union*, Title XXI - Energy, Art 194, March 2010, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[10] The INOGATE Programme's mandate is to support the development of energy co-operation between the European Union, the littoral states of the Black & Caspian Seas and their neighbouring countries. The co-operation framework covers the areas of oil and gas, electricity, renewable energy and energy efficiency. INOGATE is also concerned with the broad energy security strategies of both the Partner Countries and the EU.

EU attempted to develop stable energy relations with the region's governments. The declared objectives of these initiatives were to promote the security of the EU's energy supply by increasing the number of source countries; integrating the EU's and supplier countries' energy markets; and building new transport infrastructures.[12]

This latter point started to feature high on the EU's energy agenda in 2003, when the European Parliament and the Council supported the construction of a corridor in southeastern Europe across Greece, Macedonia, Serbia and Montenegro, Bosnia Herzegovina, Croatia, Slovenia and Austria; and between Austria and Turkey through Hungary, Romania and Bulgaria, with the goal of meeting the needs of the internal market and strengthening the security of supply.[13] In December 2003, the EC awarded the Nabucco consortium a grant to cover 50% of the estimated total cost of the technical, commercial and financial feasibility studies. Thanks to the EU's political, diplomatic and financial[14] sponsorship, the pipeline rapidly became the EU's energy flagship project. High-level European officials started promoting the Nabucco cause around Europe and in key third countries such as Turkey, Azerbaijan and Turkmenistan. Strong support from the EU's eastern members, eager to ease their reliance on Russian supplies, was also a crucial factor.[15]

In 2006 the Decision No 1364/2006/EC[16] officially established the Natural Gas route 3 (NG.3.) - the natural gas pipeline network that should connect the EU to the Caspian Sea and Middle East countries. At the same time, former Commissioner for Competition Neelie Kroes stated that "the Commission is favourably predisposed towards projects such as the planned Nabucco pipeline, due to link Iran and the

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[11] The "Baku Initiative" was launched on the occasion of the Energy Ministerial Conference held in Baku on 13 November 2004 with the participation of the EC and the Black Sea and the Caspian Littoral States and their neighbours, namely Azerbaijan, Armenia, Bulgaria, Georgia, Iran (observer), Kazakhstan, Kyrgyzstan, Moldova, Russia (observer), Romania, Tajikistan, Turkey, Ukraine and Uzbekistan. The Baku Initiative aims to facilitate the progressive integration of the energy markets of this region into the EU market as well as the transportation of the extensive Caspian oil and gas resources towards Europe, be it transiting through Russia or via other routes such as Iran and Turkey.

[12] Such activities were integrated by two Ministerial Conferences on Enhanced energy co-operation between the EU, the Littoral States of the Black and Caspian Seas and their neighbouring countries, held in 2004 and 2006.

[13] *Decision No. 1229/2003/EC of the European Parliament and of the Council laying down a series of guidelines for trans-European energy networks and repealing Decision No 1254/96/EC*, June 2003, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:176:0011:0028:EN:PDF.

[14] In March 2010 the EC granted the Nabucco consortium 200 million euros from the European Economic Recovery Plan (EERP). In September 2010 the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC) confirmed their intention to assure preferential loans to the project through a financing package of up to 4 billion euros. Anthony Williams, "EBRD, EIB and IFC Start Appraisal of Nabucco Pipeline", in *EBRD News Stories*, 6 September 2010, http://www.ebrd.com/pages/news/press/2010/100906.shtml.

[15] In 2010 Russia provided 100% of Bulgaria, Estonia, Latvia, Lithuania and Slovakia imports of natural gas. 89% in the case of Poland, 85.5% for Hungary and 73% for Czech Republic. Source: British Petroleum (BP), *Statistical Review of World Energy 2011*, June 2011, http://www.bp.com/sectionbodycopy.do?categoryId=7500&contentId=7068481.

[16] *Decision No 1364/2006/EC of the European Parliament and of the Council of 6 September 2006 laying down guidelines for trans-European energy networks and repealing Decision 96/391/EC and Decision No 1229/2003/EC*, September 2003, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:262:0001:0001:EN:PDF.

Caspian region with Austria."[17] No mention of any other regional projects already on the table, such as ITGI or TAP, was made on the occasion, an apparently unquestionable hint at the EC's preference for Nabucco. That the EC had put its bet on Nabucco became evident in the following years. The 2009 EC Communication on *An Energy Policy for Europe* established the post of a special coordinator[18] whose tasks were to promote a transparent legal framework for the project and facilitate new investments in it.[19]

At the same time, the EC redoubled its efforts to ensure additional natural gas supplies for Nabucco, a matter which might well be described as 'existential' for the project. In November 2006, the Commission signed the first of a series of Memorandums of Understanding (MoU) with Kazakhstan, aimed at increasing the flows of Kazakh gas into the EU. In 2008, Andris Piebalgs and Benita Ferrero-Waldner, respectively Commissioners for Energy and for External Relations, paid visits to the government of gas-rich Turkmenistan. The conclusion of an energy MoU, accompanied by Turkmenistan President Gurbanguly Berdimuhammedov's pledge to supply 10 bcm of natural gas to the EU, was a tangible achievement for the EC's energy diplomacy.[20] In 2010, Commissioner Piebalgs and the EU's High Representative for Foreign Affairs and Security Policy, Catherine Ashton, broadened the EU energy diplomacy horizon, signing an MoU on Strategic Partnership in Energy with Iraq.[21] Finally, in January 2011, the Commission signed an MoU on energy cooperation with the government of Uzbekistan.

In 2011, with the deadline for the Shah Deniz II transportation bid drawing closer, the EC intensified its efforts to promote Nabucco. In January, President Barroso signed a Joint Declaration on the Southern Gas Corridor with Azerbaijani President Ilham Aliyev,[22] which he presented as a major breakthrough for European energy security.[23] According to the deal, Azerbaijan will deliver 10 bcm of gas per year to EU markets. In September 2011, just a few weeks before the Shah Deniz II 1 October deadline, the EU Foreign Affairs Council authorised the EC to facilitate a bilateral agreement

[17] Neelie Kroes, *What's Wrong with Europe's Energy Markets*, Energy Sector Inquiry Conference, Vienna, March 2006 (Speech/06/137), http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/137.
[18] Jozias Van Aartsen is European coordinator for the project of European interest n° NG 3. His mandate provides for a role of "facilitator" and support to the Nabucco International onsortium and the Member States authorities concerned in the promotion of this project. Jozias van Aartsen, *Activity Report September 2007-February 2009: Project of European interest n° NG3* , Brussels, 4 February 2009, http://ec.europa.eu/energy/infrastructure/tent_e/doc/axis/2009_axis_linking_activity_report_2007_2009.pdf.
[19] European Commission, An Energy Policy for Europe (COM(2007) 1 final), Brussels, 10 January 2007, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0001:FIN:EN:PDF.
[20] *Memorandum of Understanding and Co-operation in the field of Energy between the European Union and Turkmenistan*, Ashgabat, 26 May 2008, http://ec.europa.eu/energy/international/international_cooperation/doc/mou_turkmenistan.pdf.
[21] *Memorandum of Understanding Between the Government of Iraq and the European Union on Strategic Partnership in Energy*, Baghdad, 18 January 2010, http://ec.europa.eu/energy/international/bilateral_cooperation/doc/iraq/2010_01_18_iraq_mou_en.pdf.
[22] *Joint Declaration on the Southern Gas Corridor*, Baku, 13 January 2011, http://ec.europa.eu/energy/infrastructure/strategy/doc/2011_01_13_joint_declaration_southern_corridor.pdf.
[23] Joshua Chaffin, "Pledge boosts Europe's pipeline plans", in *Financial Times*, 16 January 2011, http://www.ft.com/intl/cms/s/0/7c1b74f8-21a2-11e0-9e3b-00144feab49a.html.

between Azerbaijan and Turkmenistan for the construction of a Trans-Caspian gas pipeline (TCP).[24] The construction of a pipeline across the Caspian Sea between Turkmenistan and Azerbaijan would significantly increase the chances of Nabucco being awarded the Shah Deniz II contract. As a matter of fact, Nabucco is the only proposed pipeline that could transport gas supplies greater than the 10 bcm currently promised by Azerbaijan.

However, the effective realization of the TCP is still far from becoming reality.[25] In particular, Russia and Iran - which expect to be involved in any decision concerning the Caspian basin - will presumably try to halt any initiative in this sense. Nevertheless, the fact that the Council has agreed to empower the Commission with negotiating authority over the TCP seems to indicate that, in the three-way competition for the Southern Gas Corridor between IGTI, TAP and Nabucco, the pendulum has swung towards the latter.

3. National interests

Despite the EU institutions' attempts to increase convergence, energy security remains mainly a national issue, as member states are wary to yield sovereignty in this strategic policy area. The Treaty of Lisbon itself (Art. 192) states that "EU measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply."[26] Yet, the persisting pre-eminence of national interests casts a shadow of uncertainty on the future of the Southern Gas Corridor. Not all member states fully support the Commission's initiatives. As a result, individual national governments have slowed down, to say the least, the development of the corridor as proposed by the EC.

EU member states are extremely heterogeneous in terms of resources, energy mix, level of demand, and structure of supply.[27] Some countries have developed complex policies of energy diversification (both in terms of resources, suppliers and transit routes), while others continue to rely on a limited set of alternatives.[28] Since natural gas, as a regional commodity, is heavily reliant on fixed infrastructures such as pipelines, geographical location and political ties condition the gas trade. Countries that have developed a widely diversified import strategy, like Italy, Spain and France, have

[24] Vladimir Socor, "European Union Officially Endorses Trans-Caspian Pipeline to Link Up With Nabucco", in *Eurasia Daily Monitor*, Vol. 8, No. 172 (20 September 2011), http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=38425.

[25] First negotiations over the construction of the pipeline date back to late 1990s, under the initiative of the United States government. Unresolved legal disputes between littoral states over Caspian Sea boundaries constrain the realization of the project. See Nicolò Sartori, Can NATO Enhance Energy Cooperation in the Caspian Region?, Rome, NATO Defence College, December 2008 (NDC Forum Paper ; 5), p. 24-25, http://www.ndc.nato.int/download/downloads.php?icode=23.

[26] Consolidated version of the Treaty on the Functioning of the European Union, *cit.*

[27] Among the EU member states there are hydrocarbons producers, such as the Netherlands and the UK; countries heavily reliant on nuclear energy such as France and Sweden (which is extremely competitive also in the renewables sector); big natural gas consumers, such as Germany and Italy.

[28] Oliver Geden, Clémence Marcelis and Andreas Maurer, *Perspectives for the European Union's External Energy Policy. Discourse, Ideas and Interests in Germany, the UK, Poland and France*, Berlin, Stiftung Wissenschaft und Politik, December 2006 (SWP Working Paper FG 1 ; 2006/17), http://www.swp-berlin.org/fileadmin/contents/products/arbeitspapiere/External_KS_Energy_Policy__Dez_OG_.pdf.

different perceptions, needs and interests from the EU's eastern members, such as Slovakia or Hungary, which depend almost entirely on Russian supplies.

The governments of France and Italy are uncomfortable with the EC's support for Nabucco.[29] The two countries, along with Greece, are the big sponsors of ITGI, which would bring Azeri gas directly to their own national gas grids.[30] In their opinion, the European Commission's open support for Nabucco infringes on the principle of fair competition for the Southern Gas Corridor. In January 2011, shortly after the signature of the EU-Azerbaijan Joint Declaration, Italy's minister for economic development (in charge of energy issues), Paolo Romani, and his French counterpart, Éric Besson, questioned the compatibility between Nabucco, ITGI and South Stream. In an apparent attempt to sideline the Commission, the two ministers called for more intergovernmental coordination among the large nations (namely France, Germany and Italy) to find a final agreement on the development of the Southern Gas Corridor.[31] Indeed, French support for Nabucco came to an abrupt end in 2008, when Gaz de France-Suez (GdF), France's state-controlled gas company, withdrew its candidacy to become a partner in the consortium. No official reason was given to explain the decision. However frictions between France and Turkey, due to Paris' request that Ankara accept historical responsibility for the 1915-17 Armenian genocide, seem to have played an important role.[32] In the following months, GdF decided to join Nord Stream, the gas pipeline under the Baltic Sea developed by German and Dutch companies in cooperation with Russia's state-owned gas monopoly, Gazprom. GdF's participation in Nord Stream sanctioned the re-orientation of France's energy policy towards Russia.[33]

Of the various controversies surrounding the Southern Gas Corridor, the one that has received by far the most attention is the supposed competition between Nabucco and South Stream, the offshore pipeline under the Black Sea originally launched by Gazprom in joint venture with Italy's gas giant ENI, but later enlarged to companies from Germany and France. In part, the magnitude of the controversy has depended on the Commission's depiction of South Stream as running counter to the rationale behind the Southern Gas Corridor, that is, reducing the EU's reliance on imports from Russia.

Notwithstanding the Commission's displeasure, Italy remains strongly interested in the realization of South Stream - a 900-km offshore pipeline potentially capable of bringing 63 bcm a year of Russian gas directly to the EU. Italy has quite a stake in South Stream. Gas trade between Italy and Russia has been ongoing since the end of the 1960s, and Rome is strongly committed to preserving its preferential relationship with the world's largest holder of natural gas. Moreover, Italy has an important industrial

[29] Ansa, "Gas: Romani, su gasdotti Europa dovrà fare una scelta", 21 January 2011, http://wwww.ansa.it/web/notizie/canali/energiaeambiente/energietradizionali/2011/01/21/visualizza_new.html_1618077588.html.
[30] In reality, this would not be the case of France, as it will not be directly reached by the ITGI. The gas would have to pass through the Italian infrastructure.
[31] Ansa, "Gas: Romani, su gasdotti Europa dovrà fare una scelta", *cit.*
[32] Muriel Boselli, "GDF eyes new projects after Nabucco bid failure", in *Reuters*, 7 February 2008, http://in.reuters.com/article/2008/02/07/gdf-nabucco-idINL0764152520080207.
[33] UPI, "GDF Suez joins Nord Stream project", 1 March 2010, http://www.upi.com/Business_News/Energy-Resources/2010/03/01/GDF-Suez-joins-Nord-Stream-project/UPI-84111267477649.

interest in the project, as ENI expects its subsidiary, Saipem, to build the offshore section from Russia's Black Sea coast to Varna in Bulgaria.

The mismatch between the EC's approach to energy security and the member states' interests has been further emphasised by the recent enlargement of the South Stream consortium. In mid-September 2011, the French energy giant Electricité de France (EdF) and the German company Wintershall (a subsidiary of the energy giant BASF, already partner of Gazprom in Nord Stream) officially joined the consortium with a 15% share each. Hence, energy firms of Italy, Germany and France, which along with the UK are the EU's largest consumers, are involved in the realization of South Stream, lending the project a more pan-European facade. The involvement of French and German firms in this project has marked a significant setback for the EU's energy policy, showing that the EC's priorities in the energy domain do not fully correspond to (or, rather, probably diverge from) those of some key member states.

Another factor complicating the Commission's plans for the Southern Gas Corridor is the ambiguous behaviour of Nabucco-supporting countries concerning the onshore section of South Stream. Between 2009 and 2010, despite their strong commitment to the Nabucco project, the governments of Austria, Bulgaria and Hungary agreed to bilateral transit agreements with Russia, smoothing the way for the realization of South Stream.[34] While signing, Hungary's then Prime Minister Ferenc Gyurcsány stated that his country was interested in having as many pipelines as possible. This further attests to how national governments often prefer to defend their perceived energy interests by keeping multiple options open, irrespective of the fact that those options may well be in conflict with one another.

4. Commercial and economic factors

Some of the difficulties experienced by the EC derive from miscalculations of the availability of energy resources.

In 2010, the EC officially set as a strategic objective the corridor's capacity to supply 10-20% of the EU's gas demand by 2020, equivalent roughly to 45-90 bcm a year. Such an ambitious target is based on estimates made by the EC, which gathered data on proved reserves of what it has defined as "the largest deposit of gas in the world, the Caspian - Middle East basin".[35] In recent documents the EC has stressed that the corridor can provide a direct link between these (estimated) 90.6 trillion cubic meter (tcm) reserves and the EU gas market. Starting from these assumptions, it is easy to understand why Brussels has invested heavily in Nabucco: with a capacity of 31 bcm of gas per year, the EU energy flagship project has a strategic advantage compared to

[34] Also Turkey, which has a key transit role in the Nabucco framework, signed an agreement with Russia in August 2009, allowing the South Stream offshore pipeline to cross its territorial waters. Lyubov Pronina and Ali Berat Meric "Turkey Offers Route for Gazprom's South Stream Gas Pipeline", in *Bloomberg*, 6 August 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a.TM4QijmIMk.
[35] European Commission, *Energy Infrastructure: Priorities for 2020 and Beyond - A Blueprint for an Integrated European Energy Network*, (COM(2010) 677 final), Brussels, 17 November 2010, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2010:0677%2801%29:FIN:EN:PDF.

other options such as ITGI and TAP (both with a capacity of 10 bcm, upgradable to 20 bcm).[36]

However, despite the region's great energy potential, the EC has evidently downplayed a number of geographical, commercial and political obstacles that have been hampering its plans to access the huge Caspian natural gas resources:[37]

- Central Asia's landlocked location would force Kazakhstan, Turkmenistan and Uzbekistan to export their gas via Iran and Russia. The construction of the TCP across the Caspian would ease this situation. However, because of the unsettled legal status of the Caspian Sea, its realization is conditioned on consent from Iran and Russia, which strongly oppose this option.
- Political tensions between the EU and Iran over development of the country's nuclear programme prevent Tehran from becoming a gas supplier for the EU, or even a transit option for Central Asian gas heading westward.
- The volatile security situation in Iraq limits the country's ability to increase its gas production. Iraq's export capacity is further constrained by the critical security situation in Syria, the only transit option - excluding Iran - for Iraqi gas supplies heading for Europe.
- Azerbaijan's production capacity is limited. Despite its fundamental contribution to the development of the corridor, Azerbaijan cannot be considered a major player on the world's gas scene. Its proved reserves amount to 1.31 tcm (0.7% of the world's total), and it is unlikely that it will be able to increase its production to meet the EC's expectations.

It is therefore highly unrealistic for the EU to obtain the expected gas supplies - 45 to 90 bcm a year by 2020 - from the region. In the short to mid-term, the only resources actually available to flow westward are the 10 bcm from Shah Deniz II. Such scarce availability of natural gas could compromise the commercial and economic feasibility of Nabucco, which needs an annual flow of at least 20 bcm to be economically viable.

Moreover, the industrial and commercial interest of energy companies operating in the upstream (extraction and production) sector of the region is a fundamental driver of the development of the corridor. This is particularly true for the Shah Deniz II field, which is led by profit-oriented companies such as UK's BP and Norway's Statoil (with a share of 25.5% each).[38] As the selection of the preferred pipeline is one of the most important decisions in ensuring continuity in upstream activities, in recent months the Shah Deniz II partners have held more than forty meetings with rival pipeline consortia and talked with dozens of potential gas buyers around Europe. The Shah Deniz II consortium has set specific criteria to ensure a fair and transparent selection process: commerciality, project deliverability, financial deliverability, engineering design, operability, alignment and transparency, and scalability.[39] Although Shah Deniz II partners do not exclude

[36] Because of its higher throughput capacity Nabucco is often defined as a strategic project, while ITGI and TAP are considered tactical options.
[37] For a detailed analysis see Nicolò Sartori, *The Southern Gas Corridor …*,*cit*
[38] BP is also the operator of the Shah Deniz II field. Other partners include SOCAR (10%), Total (10%), LukAgip (10%), NIOC (10%), and TPAO (9%).
[39] Shah Deniz Consortium, *Principles for the selection of an export route to Europe for Shah Deniz gas*, February 2011,

that public policy considerations - both in terms of Azeri strategic considerations and European objectives - will be taken into account, they have repeatedly stressed that the final decision will depend on which commercial export and sales solution is deemed most valuable and most efficient in terms of both transit and transportation feasibility, and on the tariff and price conditions assured by the bidding consortia.[40]

While the consortium has clearly expressed its willingness to deliver Shah Deniz II gas to the EU market through one of the three competing pipelines, uncertainty about the competitiveness of their proposals has driven the partners to look for other, potentially more viable, solutions.[41] At the end of September 2011, BP, the Shah Deniz II operator, announced its intention to launch a 1,300 km project known as South-East Europe pipeline (SEEP).[42] BP's idea is to combine Nabucco's geopolitical approach - delivering gas to southeastern European countries - with the commercial rationale behind more flexible options such as ITGI and TAP by making use of the Turkish energy infrastructure and building a 10 bcm upgradable pipeline from Bulgaria to Austria. According to BP, this fourth option, whose transit route across southeastern Europe has not yet been defined, would address the EC's key goal of introducing new energy supplies while reducing pipeline costs.

Moreover, on December 26 the governments of Azerbaijan and Turkey signed an MoU for the construction of the so-called Trans-Anatolia Gas Pipeline.[43] According to the agreement, a 16 bcm pipeline would run from Georgia to Bulgaria across the Turkish territory. If implemented, the Trans-Anatolia pipeline would determine the death of Nabucco - whose Turkish section would be replaced by the new pipeline (the potential route through the European territory would then be defined in separate agreements with EU companies). As Turkey and Azerbaijan have yet to start the project's feasibility studies, which usually take months, the Azeri government is likely to postpone any decision on Shah Deniz gas sales to late 2012 or even later than that. The delay risks preventing the EU from getting the expected amount of Azeri gas by 2017, as currently planned.

Financial feasibility is another important issue. Nabucco's pricetag is almost becoming unsustainable compared to ITGI, TAP (and probably SEEP). Moreover, the pipeline's costs are likely to be covered by public funds, mainly drawn from the EU's €9.1 billion structural funding earmarked for loan guarantees and grants.[44] Considering the EU's

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http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/pq/Principles_for_selection_of_an_export_route_to_Europe_for_Shah_Deniz_gas.pdf.

[40] See, for instance, Richard Tawse, *Shah Deniz and the Opening of the Southern Corridor*, 21 September 2011, http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/s/Shah_Deniz_and_the_Opening_of_the_Southern_Corridor.pdf.

[41] Tim Webb, "European gas pipeline costs double", in *The Guardian*, 20 February 2011, http://www.guardian.co.uk/business/2011/feb/20/european-gas-pipeline-nabucco-costs-double.

[42] David Blair, "BP plans gas pipeline to Europe from Azerbaijan", in *Financial Times*, 26 September 2011, http://www.ft.com/intl/cms/s/0/ed9151b8-e84c-11e0-ab03-00144feab49a.html.

[43] Ali Berat Meric, "Turkey, Azerbaijan Agree on 7 Billion Euro Gas Pipeline Plan", in *Bloomberg*, 26 December 2011, http://www.bloomberg.com/news/2011-12-26/turkey-azerbaijan-agree-on-7-billion-euro-gas-pipeline-plan-1-.html.

[44] EurActiv, "EU Launches 9 Billion Energy Infrastructure Plan", 21 October 2011, http://www.euractiv.com/energy/eu-launches-9-energy-infrastructure-plan-news-508430.

current financial troubles, this factor adds to concerns about the overall viability of Nabucco.

In conclusion, much greater attention has to be paid to the financial, commercial and industrial aspects of the various projects. Such an approach is essential for curbing the distortions in competition introduced by both the European Commission and national governments, which risk undermining the viability of the whole Southern Gas Corridor initiative.

Conclusions

In the last years, the European Commission has invested heavily in the realization of the Southern Gas Corridor. The EC's strong commitment to this initiative was initially the result of the "call for energy supply diversification", expressed in particular by those EU member states that depend most on Russian supplies. Over time the European initiative has taken on broader connotations: development of the corridor, and in particular the realization of Nabucco, have become the key testbed for the EC's increasingly proactive external energy policy. In Brussels, Nabucco has become a byword for European energy security, to the extent that the whole process of creating a truly common EU energy policy has been linked to its success.[45]

However, the EC's action has failed to take a series of key factors into due account:

- The different (and often diverging) priorities concerning development of the corridor of Europe's national governments.
- Geopolitical challenges in the Caspian region, and the opposition of key energy players to the EU initiative.
- Financial and commercial constraints limiting the overall viability of the project, and the diverging commercial interests of private companies involved in the region's energy sector.

By downplaying the impact of these factors, focusing on Nabucco as the only strategic solution for the EU's energy diversification problems, and altering the conditions for fair competition between competing projects, the EC has probably concurred in hindering the efficient development of the corridor. Recurrent speculation regarding potential mergers of pipelines[46] shows the current lack of clarity surrounding the Commission's action which contributes to putting the EC's credibility as an energy actor at risk. Nabucco's failure to win the Shah Deniz II transportation contract would amount to an additional setback for the EU's external energy policy.

The experience of the Southern Gas Corridor demonstrates that, in the energy domain, political initiatives that do not take commercial, industrial and economic dynamics into consideration produce suboptimal and ineffective results. It is still more likely that Azerbaijan's gas will flow westward to European markets than northwards to Russia or

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[45] Günther Oettinger, *Europeanisation of energy policy*, European Energy Forum, Strasbourg, 19 October 2010 (Speech/10/573), http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/573.
[46] EurActiv, "EU pushes pipeline merger in Southern gas corridor", updated 24 February 2011, http://www.euractiv.com/energy/eu-pushes-pipeline-merger-southern-gas-corridor-news-502272.

southwards to Iran. However, the decision to supply the EU rather than Russia or Iran with Shah Deniz II gas will hinge more on the Azeris' interest in diversifying their export markets than the good effects of EU diplomacy. If anything, the uncertainty and confusion on the European side have risked pushing Azeri resources into the hands of Moscow or Teheran.

In conclusion, the lesson learned from the Southern Gas Corridor initiative is that the EU still lacks the capacity to act as a key external energy player. It is indeed this limited ability that should prompt the European Commission to adopt a pragmatic approach to external energy matters, and focus on its traditional task of keeper of the EU single market. By ensuring a level playing field and the effective functioning of market forces, the EC would contribute more effectively to the necessary energy diversification efforts, guaranteeing that more efficient and viable solutions are implemented.

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