Istituto Affari Internazionali

IAI WORKING PAPERS 12 | 02 – January 2012

The South East Europe Pipeline: Greater Benefit for a Greater Number of Actors

Elnur Soltanov

Abstract

The South East Europe Pipeline (SEEP), proposed by BP in late September 2011, could eventually be the pipeline carrying Azeri gas to European markets. Compared to its competitors in the Southern Corridor concept - Nabucco, TAP and ITGI - it goes furthest in terms of optimality for all the parties involved. The combined advantages of its size, scalability, usage of existing gas infrastructure in Europe and direction, promises a more reasonable economic and political value for the Shah Deniz Consortium, Azerbaijan, Turkey and Europe, while posing a bearable challenge to Russia. The SEEP seems to offer a greater value to a greater number of actors.

Keywords: *European Union / Energy Supply / Pipelines / Southern Gas Corridor / Nabucco / ITGI / TAP / SEEP / Caspian Basin / Russia / Azerbaijan / Turkey*

ISBN 978-88-98042-39-5

The South East Europe Pipeline: Greater Benefit for a Greater Number of Actors

by Elnur Soltanov[*]

Introduction

The new kid on the block, the South East Europe Pipeline (SEEP), first proposed by BP in late September 2011, could become the solution to the challenge of carrying Azeri gas to European markets. This equation has so many unknowns that it has become an elusive puzzle in the last few years. Although there have been talks about a Russian and two Black Sea routes (White Stream and Azerbaijan Georgia Romania Interconnector - AGRI), the ones that were seriously considered from the start are Nabucco, Interconnector Greece Turkey Italy (ITGI) and Trans Adriatic Pipeline (TAP). Yet all of these variants of the so-called Southern Corridor, referring to non-Russian paths connecting the Caspian Sea to Europe, have not passed the threshold of optimality, justifying a $20 billion investment to develop Shah Deniz II, the giant Azerbaijani gas field. The South East Europe Pipeline could do just that insofar as it combines the best of all projects. To use a modified motto of Utilitarianism, it provides 'the greater benefit for the greater number of actors.'

This paper will compare and contrast Nabucco, ITGI and TAP, pointing out their strengths and weaknesses in terms of the likelihood of realization. Then it will show how the SEEP pipeline does not share these weaknesses, while combing instead these alternative pipelines' strengths. This model is not perfect. Yet, to date, it seems to be the optimal option amongst all serious alternatives. Its strengths could justify its realization.

1. Excluding alternatives: Nabucco, TAP and ITGI

Legally and politically, the Nabucco project is in good shape, as the intergovernmental agreements are already in place and the pipeline is officially backed by the EU. Nabucco, however, is the costliest of all pipeline alternatives ($10-20 billion),[1] which

---

Paper prepared for the Istituto Affari Internazionali (IAI), January 2012. Revised version of a paper presented at the seminar on "Azerbaijan's Energy Diplomacy and Western Competition over Caspian Gas", Rome, 2 November 2011.

[*] Elnur Soltanov is the Director of the Caspian Center for Energy and Environment (CCEE) at Azerbaijan Diplomatic Academy, Baku.

[1] According to the official website of the Nabucco consortium, the "current investment figure" is $10.6 billion, yet it notes that this number is under review "to better reflect a number of recent developments in the market", implying that the estimated cost would probably increase (http://www.nabucco-pipeline.com/portal/page/portal/en/Home/home_faq). Other sources have not been so subtle, speculating the cost range to be between $18-22 billion. See Orhan Coskun, "Nabucco investment seen at 12-15 bln euros-sources", in *Reuters*, 5 May 2011, http://www.reuters.com/article/2011/05/05/nabucco-turkey-idUSIST00770920110505. See also Vladimir Socor, "South-East Europe Pipeline: A Downsized Nabucco

means that the Shah Deniz II consortium, including Azerbaijan, would receive at most modest profits in the medium term. It would also require 31 billion cubic meters (bcm) in order to operate, whereas Azerbaijan currently could hardly go beyond 10 bcm, or at most 15 bcm.

The EU-backed Nabucco project has been revitalized recently by a new EU initiative pushing for the Transcaspian, a pipeline across the Caspian Sea, which would bring Turkmen gas to fill the rest of the Nabucco pipeline.[2] But the EU has significantly less leverage in the Caspian than two regional powers, Russia and Iran, which adamantly oppose such a pipeline. Even if everything moves according to plan, many are the issues that Azerbaijan and Turkmenistan would have to agree upon in order to realize this complex project.[3] The Transcaspian pipeline is certainly not round the corner.

But perhaps, the main problem with Nabucco is Russia.[4] The pipeline is planned to go through Central and Eastern Europe, which is Gazprom's turf. Russia has enjoyed a monopoly especially in this part of Europe, which has given it significant economic and political leverage.[5] A Nabucco pipeline with a capacity of 31 bcm could represent a significant dent on Russia's privileged status. Therefore, Russia could be expected to put a lot of pressure on at least Azerbaijan and Turkmenistan to turn away from the project. And apparently it does. The latter take this pressure seriously. As highlighted by the August 2008 events, Russia is likely to unabashedly pursue its interests and the West is likely watch idly as events unfold.[6]

Among the two pipelines passing through Greece - ITGI and TAP - the former is a better alternative than the latter. Unlike TAP, in the case of ITGI the legal ground has been laid. In fact, according to a high-level diplomat familiar with the issue, political problems between Greece and Albania may kill TAP before it is born. At this point, TAP looks, at most, as an element inserted into the game to increase competitiveness. It is a venture between the Swiss EGL and Norway's StatoilHydro.[7]

Both TAP and ITGI are much less expensive than Nabucco, in fact about 10 times cheaper.[8] Their capacity perfectly fits what Shah Deniz II would be able to sell to Europe after Turkey siphons off its share of 6 bcm out of 16 bcm. Such modest amount and their destination - Greece and Italy - do not concern Russia. 10 bcm does not represent a game changing capacity in Europe, and Greece and Italy are not principal

Proposed By BP", in *Eurasia Daily Monitor*, Vol. 8, No. 202 (2 November 2011), http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=38609.

[2] "EU wants Kazakhstan in Trans-Caspian Pipeline Project", in *Euronews*, 5 October, 2011, http://www.euronews.net/2011/10/05/eu-wants-kazakhstan-in-trans-caspian-pipeline-project/.

[3] Although Kazakhstan's inclusion would also help, in the short run the crucial question concerns Turkmenistan's and Azerbaijan's participation in Nabucco.

[4] Morten Anker *et al*., *The Caspian Sea Region Towards 2025. Caspia Inc., National Giants or Trade and Transit?*, Delft, Eburon, 2010, p. 74.

[5] Dilip Hiro, *After Empire. The Birth of a Multipolar World*, New York, Nation Books, 2010, p. 114.

[6] Catherine A. Fitzpatrick, "Turkmenistan: Berdymukhamedov Pledges Support for Trans-Caspian Pipeline", in *Eurasianet*, 7 November 2011, http://www.eurasianet.org/node/64465.

[7] The latter also happens to be one of the two biggest shareholders, besides BP, and the commercial operator of Shah Deniz.

[8] Jacob Gronholt-Pedersen and Aida Sultanova, "ITGI Pipeline To Cost EUR1.5-2 Billion -Energy Minister", in *Dow Jones Newswires*, 24 October, 2011, http://english.capital.gr/News.asp?id=1311312.

markets for Gazprom. But precisely these considerations also mean that the EU and the Shah Deniz consortium are not particularly interested in this alternative.[9] The markets in the destination counties are small, risky, saturated and liberalized. Greece is not a big consumer (currently consuming a mere 3 bcm) and is stifled by its economic woes. Italy, with its own share of economic problems, has a significantly liberalized gas market as well as a pipeline and LNG terminal for African gas.[10] Although Azerbaijan can also ship some gas to other countries such as Bulgaria, these two countries are supposed to be the main buyers.

2. The added value of the South East Europe Pipeline

Here comes the significance of the South East Europe Pipeline. If ITGI/TAP is a more realistic option than Nabucco, SEEP is an attractive improvement over ITGI/TAP. SEEP is preferable to Nabucco insofar as it would not only be much smaller (and thus cheaper), but also it would mainly use existing pipelines on its route, thus lowering the cost and increasing the potential profit margin.[11] This, of course, is what ITGI/TAP would also do. But unlike ITGI/TAP, the SEEP would reach more reliable markets than Greece and Italy. SEEP would pass through Bulgaria, Romania, Hungary and Croatia, i.e., twice as many markets as ITGI/TAP. Although these are smaller countries in terms of GDP, their combined demand for gas is comparable to that of Greece and Italy, while offering more diversified markets in view of the higher number of countries. A source at BP head office was quoted as saying that the countries on route of the SEEP “have markets on gas sale” after “several engineering project works on this variant” have been conducted.[12]

Furthermore, like ITGI/TAP, SEEP is scalable, that is, it could be expanded in future, if and when more gas will come to be available. But SEEP is scaleable in the direction of Nabucco. One could in fact view SEEP as a “Nabucco junior”, or, as one of the best-informed analysts of the region put it a “modified Nabucco”.[13] When the European Union calls for diversification, it means diversification of the energy sources that lie northwest of Turkey. Therefore, the SEEP would garner more support from the EU than ITGI/TAP, given its future potential.

The SEEP would still anger Russia because of its direction and the future threat it could pose to the Gazprom-dominated markets. Yet it would not create as much resentment and resistance as Nabucco due to its smaller volume and the uncertainty of its future development. Hence, compared to Nabucco, although the SEEP is less attractive to the EU, it would also be viewed as a lesser threat to Russia. Given the EU’s apparent reluctance to push for the Transcaspian pipeline and press forward on Nabucco more broadly, the SEEP could represent a face-saving move for Europe. The

[9] Shah Deniz Consortium is composed of BP (25.5%), Statoil (25.5%), Total (10%), LukAgip (10%), NICO (10%), SOCAR (10%), TPAO (9%).
[10] See British Petroleum (BP), *Statistical Review of World Energy 2011*, June 2011, http://www.bp.com/sectionbodycopy.do?categoryId=7500&contentId=7068481.
[11] Vladimir Socor, “South-East Europe Pipeline ...”, *cit*.
[12] APA, “New export option offered for Azerbaijani gas supplies to Europe”, in *News.az*, 26 September, 2011, http://www.news.az/articles/economy/45293.
[13] Vladimir Socor, “South-East Europe Pipeline ...”, *cit*.

SEEP could be perceived and presented by the EU as a short-term Nabucco or as a promise of Nabucco. Russia may not be very happy with the SEEP, but given its own political and economic challenges in every phase of the gas supply chain, it may not be willing to open another dispute with the EU. The SEEP could turn out to be a face-saving move for Russians too. In the imperfect word of gas pipelines, the SEEP represents the best of possible options for all parties involved.

3. Current challenges of the SEEP

A major concern for the ITGI/TAP and lately for the SEEP has been the Turkish part of their routes. One of the reasons why these pipelines are cheaper than Nabucco, besides their smaller size, is that they would rely on existing pipeline infrastructures in Turkey.[14] However, this also represents a weakness and challenge to these projects. Turkish gas pipelines are already saturated, and there is much disagreement over how to share the costs and assets of Turkey's gas infrastructure as well as over which court to turn to in case of dispute between BOTAS or other Turkish private companies using these infrastructures and the Shah Deniz consortium. The announcement during the Atlantic Council meeting on 17th November 2011 in Turkey by SOCAR President Rovnag Abdullayev could solve this remaining hurdle in the realization of SEEP. He publicly revealed that SOCAR and a Turkish company would build an east-west Trans-Anatolian pipeline with a capacity of 16-17 bcm and a cost of $5-6 billion.

SOCAR's President also noted that SEEP would not entail the end of Nabucco and the Shah Deniz consortium is yet to decide whether it will supply gas to Nabucco, ITGI or TAP.[15] However, since the Nabucco project runs from Turkey to Austria, and Azerbaijan is not part of the company, this is clearly a blow to Nabucco. The volume of the Trans-Anatolian pipeline also runs counter to the logic of Nabucco. Considering that TAP may not go beyond the Greek-Albanian border, the two real competitors for Shah Deniz gas flowing through the Trans-Anatolian pipeline turn out to be ITGI and SEEP. And when time comes to choose between the two, ITGI's chances could be slim against the multifaceted optimality of the SEEP.

The main players in the Shah Deniz II phase are the Shah Deniz consortium, Azerbaijan,[16] the EU, Russia and Turkey. The SEEP is the best option in terms of profit margin for the Shah Deniz consortium and for Azerbaijan. Regarding its strategic value for Azerbaijan, Nabucco could have represented a more solid link to the West. But unlike Nabucco, opting for the SEEP would mean that Azerbaijan would retain much more control over its gas supplies, contain Russia's discontent, and it would not oversupply European markets decreasing its profit margins. From the EU's perspective, the SEEP is second best to Nabucco in terms of diversifying gas supplies. But considering the political and economic capital required to proceed with Nabucco, the SEEP represents a more realistic option in the short run. Furthermore, in view of its

[14] SEEP will continue to rely on existing gas infrastructure beyond Turkey.
[15] Evrim Ergin, "Update 1 - Azerbaijan, Turkey start work on trans-Anatolian pipeline", in *Reuters*, 17 November, 2001, http://www.reuters.com/article/2011/11/17/turkey-azerbaijan-gas-idUSL5E7MH1W520111117.
[16] Although Azerbaijan is part of the Shah Deniz consortium through SOCAR, it can also be regarded as a separate actor in this context as the ultimate sovereign over the Shah Deniz field.

scalability, the SEEP could in time develop into Nabucco. For similar albeit opposite reasons, the SEEP could be perceived as an optimal option for Russia as well: after all, it is not Nabucco. Last but not least, considering that Turkey, another major actor in the game, takes Russia and the EU seriously, their overall consensus would be valued by Ankara. In conclusion, the SEEP is the pipeline that would provide the greater benefit for the greater number of actors.

Updated: 17 January 2012

Istituto Affari Internazionali

Latest IAI Working Papers

The Institute

The Istituto Affari Internazionali (IAI), founded by Altiero Spinelli in 1965, does research in the fields of foreign policy, political economy and international security. A non-profit organisation, the IAI aims to further and disseminate knowledge through research studies, conferences and publications. To that end, it cooperates with other research institutes, universities and foundations in Italy and abroad and is a member of various international networks. More specifically, the main research sectors are: European institutions and policies; Italian foreign policy; trends in the global economy and internationalisation processes in Italy; the Mediterranean and the Middle East; defence economy and policy; and transatlantic relations.
The IAI publishes an English-language quarterly (The International Spectator), an online webzine (AffarInternazionali), two series of research papers (IAI Quaderni and IAI Research Papers) and an Italian foreign policy yearbook (La politica estera dell'Italia).

Istituto Affari Internazionali
Via Angelo Brunetti, 9 00186 Roma
Tel.: +39/06/3224360 Fax: + 39/06/3224363
E-mail: **iai@iai.it** - website: **http://www.iai.it**
Send orders to: **iai_library@iai.it**