

The NABUCCO PROJECT AND TURKEY

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General

Affordable and uninterrupted supply of energy sources is of fundamental importance for a country's sustainable economic development. It is directly related to the competitiveness of industries and citizens' economic welfare. Moreover, energy supply security is also closely associated with the national security of a country and no country is capable of dealing with its energy issues on its own.

Already the sixth largest economy of Europe and 17th of the world Turkey's energy demand increases at a yearly rate of 6-8%. Turkey imports around 70% of its energy needs. The share of natural gas in our energy supply is expected to be around 37% by the year 2010.

Located geostrategically at the intersection of different continents, Turkey is a natural bridge between the energy rich Caucasus, Central Asia, Middle East and the European markets. Therefore Turkey links the east and south energy corridors to Europe and is committed to be a reliable transit country that would ensure energy safety for Europe.

To this end, the East-West Energy Corridor concept has been developed in cooperation with our partners and neighbors to help diversify the energy supply routes for the transportation of Caucasus and Central Asian hydrocarbon resources to the world markets through safe and alternative routes.

Natural Gas Dependency and Turkey's demand forecast

Diversification is a key phenomenon for the Turkish energy policy. More than oil, nowadays natural gas has become more strategic commodity for all producer, consumer and transit countries. Between 1987-1994 Turkey was dependent on Russian gas (western route) %100. In 1994 Algeria LNG contract started. Nigeria LNG imports followed in 1999. Iran line was opened in 2001. Blue Stream became operational in 2003. In July 2007, Azeri gas arrived to Turkey through BTE line. Dependence shares as of 2008: To Russia % 61.80 (34.41 Western Route, 26.39 Blue Stream); Azerbaijan %12,33; Iran %11.07; Algeria %11.16 and Nigeria %2,74. In 2008, Turkey obtained %1 of its supply from spot market.

In 2007 Turkey imported 38 bcm gas. Gas demand according to BOTAS will be 41,6 bcm in 2009; 44,5 bcm in 2010; 56,9 bcm in 2015; 66,6 bcm in 2020; 76,4 in 2030. Consumption in 2008 was 36.8 bcm.

The EU depends on Russian gas %40 on average. EU gas demand will increase %80 in 25 years.

With a view to securing her energy supplies and in a bid to contribute to Europe's energy supply security, Turkey strongly supports the Southern Gas Corridor. The involvement of the US will be crucial for the realization of the Southern Corridor in the context of the East-West Energy Corridor. Moreover, the implementation of the Southern Corridor will assist Turkey in becoming Europe's fourth artery of natural gas after Russia, Norway and Algeria.

Turkey's energy strategy is in line with the objective of the EU to diversify both its energy sources and supply routes. It is our expectation to see EU being more involved and engaged in the region as well as in different energy projects that we are working on.

The Nabucco Project, Turkey and the EU

A consortium of European energy companies including Turkey's Botas AS, Bulgarian Energy Holding EAD, MOL PLC of Hungary, Austria's OMV Gas & Power GmbH, RWE AG of Germany and Transgaz SA of Romania has been planning for Nabucco's construction since 2002. The 3,300-kilometer (2,050-mile, almost 2000 km is in Turkey) long Nabucco pipeline, with a planned maximum capacity of 31 bcm (intended to start as an 8 bcm project in 2013-14, the aim is to expand it to the maximum capacity five years later), is slated for construction in 2010 and is aimed at diversifying the EU's supply sources and improving competition for the benefit of the consumers. The project is estimated to cost 7.9 billion euro (\$10.24 billion) and planned to be operational between 2013-2015. Although Nabucco will meet 5 percent of Europe's gas needs (on current levels), this will be an important step in terms of diversification of source and competition for the market.

The completion of the Nabucco natural gas pipeline project which will contribute to Europe's energy supply security is Turkey's important energy policy priority. Other than Turkey, other partner countries in the Project are EU members.

E.U. Efforts: Wake up calls heard!

The EU has been criticized for having wasted time in the past because nobody apparently was in charge of the project, or really took it seriously in terms of coordination efforts. However, there is a pick up in motivation since the Russian-Ukrainian gas dispute last month. First Intergovernmental Conference and Nabucco Summit in Budapest are cases in point.

Previously, the EU Energy Commissioner discussed the Nabucco project during his successful visit to Turkey in November 2008. Turkey and the European Commission jointly developed an initiative to set up a joint venture to be known as the "Caspian Development Corporation" (CDC). This corporation will enable the partner companies and countries, together with the financial institutions, to negotiate with the source countries in order to purchase large amounts of gas. We believe that this approach will be attractive for the source countries and encourage them to produce and extract their natural gas resources. Work is underway on the legal and technical infrastructures of the project. The first Intergovernmental Conference to discuss IGA was held in Brussels on January 22-23, 2009 and the second meeting took place in Vienna on 5-6 February, 2009. The Intergovernmental Conference process will establish the planning, tax, and regulatory issues that will ensure that the Nabucco project is bankable and legally sound. The agreements will give long-term financial assurance on income and tax to all investors in the pipeline. The IGA and the Project Support Agreements are scheduled to be signed in the first half 2009 in Turkey.

The Nabucco Summit held in Budapest on the 27th of January 2009 gave an important opportunity for all parties to reiterate their political support to the Nabucco project and to

assess the consequences of the Russia-Ukraine gas crisis. A Declaration was announced at the end of the Summit.

In a significant move on February 4, European Commission allocated 250 million euros to help launch the construction of the pipeline's first stage, and 100 million euros for Turkey-Greece-Italy (TGI) pipeline. European Investment Bank (EIB) committed to finance up to 25% of the Project during the Budapest Summit. European Bank of Reconstruction and Development (EBRD), depending on the outcome of the IGA will lend strong support to the pipeline project. These are first concrete and significant steps in finance efforts. The project seems more bankable now.

Satisfying Turkey's energy needs

Turkey's primary energy demand increases at a yearly rate of approximately 6%. Turkey imports around 70% of its energy needs. The share of natural gas in our energy supply is expected to approach 40% by the year 2010. Consequently, Turkey must consider its own supply security. In this framework, Turkey is willing to buy at a cost reflective price 15% of the gas that ships through the pipelines via the territory of Turkey.

E.U accession process and Turkey's role

Energy security is too important to be linked to specific points in the EU-Turkey accession negotiations. The opening of the energy chapter in accession negotiations between Turkey and the EU is not a precondition for our support to the Nabucco project. Prime Minister Erdoğan has stated in his visit to Brussels in January that "Turkey supports the Nabucco project fully and consistently."

We will press ahead with Nabucco even if the accession talks don't make progress. There is no formal link between (Turkey's) EU accession and Nabucco, because Nabucco is advantageous for Turkey anyway. However, progress on Nabucco would be accelerated if the energy chapter of Turkey's EU accession talks was opened. This would speed up the adoption of EU law on energy policy on the part of Turkey and therefore also speed up Nabucco.

The supply problem is the most urgent challenge lying before the project. The main gas suppliers for the pipeline according to Turkey will be Azerbaijan and Turkmenistan. Other potential suppliers are Egypt and Iraq. As discussed during Budapest Summit, for Turkey too, strategic importance of Nabucco comes first and commercial criterias are secondary. Nabucco line is important initiative to prevent as some call "the Energy Iron Curtain" in Central and Southern Europe.

Previously successfully completed major projects such as the Baku-Tbilisi-Ceyhan Crude Oil Pipeline, the Baku-Tbilisi-Erzurum Natural Gas Pipeline and the Turkey-Greece Gas Interconnector attest to the role Turkey will play in the decades to come for the transportation of oil and gas from Caucasus, Central Asia and Middle East with a view to enhancing global energy supply security.

Key players: Azerbaijan and Turkmenistan and the U.S.

Azerbaijan

Azerbaijan is seen as one of the primary source of supply for Nabucco. However, it is also seen as the prime gas supply source for other planned EU pipelines, including the Turkey-Greece-Italy Interconnector -- which is already backed by an intergovernmental treaty -- and the less advanced Trans-Adriatic pipeline led by EGL of Switzerland.

Azerbaijan produced 22 to 23 billion cubic meters of gas in 2008, expects to produce some 27 billion cubic meters in 2009, and forecasts an output of 50 to 60 billion cubic meters annually after 2015 (APA, January 7; Bloomberg, January 27).

At present, Azerbaijan exports small volumes of its gas at preferential prices to Georgia and Turkey. It has begun exports to Greece and is set to export to Italy through the TGI Interconnector for Azerbaijani gas (due to expand from 4 to 8 billion cubic meters per year by 2012). It has also recently agreed to export one billion cubic meters to Bulgaria (pending a solution on transport or swapping).

Ilham Aliyev, President of Azerbaijan reaffirmed his country's commitment to Nabucco during the high-level Nabucco conference in Budapest on January 26 and 27, but he also gave notice there that Azerbaijan's decisions would ultimately depend on a number of factors, four of which will be crucial. These are: the timetable for pipeline construction, its financing, the purchase price for Azerbaijan's gas, and the transit regime through Turkey and other countries (Bloomberg, January 27; see EDM, January 29, 30).

Mr. Aliyev expressed also a concern during in an interview at the World Economic Forum, "We have not a very big margin, not a very big amount of time to figure out what to do." Citing Gazprom's offer in July to buy all of Azerbaijan's available export volumes of gas at European netback prices, Aliyev described it as attractive and worth considering. The offer is being evaluated. Mr. Aliyev complained that Azerbaijan already has been forced to delay the second phase of developing its Shah Deniz gas field by at least a year (from 2014 to 2015), owing to uncertainty over whether the Nabucco gas pipeline will be built.

Transit talks between Turkey and Azerbaijan:

Negotiations are underway between two countries. The main difference is on volume of gas to be purchased by Turkey. Price is a secondary issue.

We will of course continue our talks with the Azeri side in order to come to a solution which would be mutually acceptable.

Turkmenistan

Turkey is pleased that Turkmenistan is looking for more international cooperation. President Berdimuhamedov has attended the NATO summit in Bucharest. He is the first Turkmen leader to seek contact with NATO.

Berdimuhamedov has adopted a strategy of diversifying export routes to the global markets. During the EU Troika-Central Asia meeting in Ashkabat (9-10 April 2008), President Berdimuhamedov agreed to provide 10 billion m3 gas for NABUCCO project.

Large gas reserves which were recently proven in the fields of “Güney Yolöten and Yaşlık” have alleviated concerns that Turkmenistan may be “over-contracted.”

Realization of NABUCCO seems to depend on the resolution of long standing dispute between Azerbaijan and Turkmenistan over the delimitation of the Caspian Sea.

The Trilateral Summit held between the Presidents of Turkey, Turkmenistan and Azerbaijan on 29 November 2008 has been an important step forward.

Mr. Yagshygeldy Kakayev, Executive Director of Turkmen State Agency for Management and Use of Hydrocarbon Resources attended the Nabucco Summit in Budapest. This is important sign that Turkmenistan takes this option seriously.

Future important steps to follow on the Nabucco project:

- Conclusion of Project Support Agreements and Intergovernmental Agreement
- To make Caspian Development Corporation (CDC) operational
- Co-operation with EIB, EBRD and IFC concerning Environmental and Social Impact Assessment (EISIA) - procedure
- Performance of Front End Engineering Design process incl. EISIA
- Turkmenistan's intention to hold a high-level conference in 2009 (on transit issues to be held on 23-24 April, 2009) based on the Resolution of the 63rd Session the United Nations General Assembly on the Reliable and Stable Transit of Energy and Its Role in Ensuring the Sustainable Development and International Cooperation initiated by Turkmenistan;
- The Sofia Energy Summit “Natural Gas for Europe: Security and Partnership” to take place on 24-25 April 2009;
- The “Southern Corridor Summit” to be organized by the Czech Presidency of the Council of the European Union on 7 May 2009;
- The closing event of the Nabucco Intergovernmental Conference and signing of the agreement in the first half of 2009 in Turkey.

Role of the U.S. and Prospects for Turkish-US Cooperation

The East-West Energy Corridor was successfully implemented as a result of close Turkey-US partnership. As of January, 2008, around 550 million barrels of oil have been shipped through the Baku- Tbilisi-Ceyhan (BTC) crude oil pipeline to world markets. The Aktau-Baku section was brought to life in the beginning of November 2008 and the Kazakh oil began to flow through the BTC pipeline. Thanks to the second leg of the said corridor, namely the Baku-Tbilisi-Erzurum natural gas pipeline, Azeri natural gas is being transported to Turkey and beyond via an alternative route.

"Energy" constitutes an important dimension of Turkey-US strategic relations. Continuity and efficiency of bilateral cooperation in the field of energy and close and regular consultations are of utmost importance. Turkey would like to continue regular consultations

through the Turkey-US Energy Working Group meetings, second of which took place in Ankara on January 16, 2008 (first one was on September 15, 2009).

Turkey welcomes the acknowledgment of her energy security concerns by the US Administration and is looking forward to cooperating on issues highlighted during Deputy Energy Secretary Kupfer's visit to Turkey on October 30-31, 2008, together with the Presidents of OPIC, US Eximbank and TDA. According to an understanding reached with Deputy Secretary of Energy Mr. Kupfer, technical team visited Turkey in January 2009, worked on the details of financing mechanisms and on projects aiming to improve energy efficiency, as well as to increase the share of renewable energy sources and nuclear within our energy basket.