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The Eurasian Energy Corridor: Turning Into a Cul-de-sac?

At the OSCE Summit in Istanbul in November 1999, the presidents of Turkey, Azerbaijan, and Georgia signed a legal framework agreement witnessed by President Clinton that was intended to commence the implementation of the multi-billion dollar project to transport Caspian oil from Baku, Azerbaijan to world markets through the Turkish Mediterranean port of Ceyhan. Four months later, there has been no concrete progress, despite innumerable meetings between officials from the three countries, the United States, and oil company representatives. Meanwhile, across the Caspian Sea in Turkmenistan, President Saparmurat Niyazov appears on the verge of a decisive turn away from the U.S.-backed Trans-Caspian gas pipeline (TCP) – intended to carry Turkmen gas to Turkey – which was also reaffirmed through an additional agreement witnessed by President Clinton in Istanbul.

The Baku-Ceyhan project and the TCP have been touted by the Clinton administration since 1995 as the two legs of the Eurasian Energy Corridor that would allow the exploitation of Caspian oil and gas, with Turkey playing a key role. At the signing of the protocols, Clinton declared that, “The agreements which were just signed were truly historic,” and that “The United States had worked intensively with all these countries on the Baku-Ceyhan and Trans-Caspian pipeline.” Clinton said that the two projects would not only allow the countries of the region “to stand on their own two feet,” but would also “put Turkey, our trusted ally, front and center in the effort to create a secure energy future.” As the Clinton administration slides into its final months, however, the Eurasian Energy Corridor appears to be in serious trouble.

The TCP Tottering

In 1999, Turkmenistan produced approximately 22.4 billion cubic meters (bcm) of natural gas, an increase of over 70 percent from 13.1 bcm in 1998. President Niyazov has declared his intention to raise annual gas production to 120 bcm by 2010. Scheduled for completion by 2002, the 2,000-km TCP would run beneath the Caspian Sea to Azerbaijan, through Georgia, and on to the energy-hungry Turkish market, initially carrying 16 bcm a year, eventually rising to 30 bcm. From the outset, the TCP was dogged by Russian and Iranian objections, ostensibly related to environmental concerns and the need for prior resolution of Caspian Sea delimitation issues. Their objections, however, most likely originate from the political and economic interests of Turkey’s two neighbors, which have their own lucrative gas agreements to protect. With recent gas finds from its own fields, Azerbaijan is also determined to ensure a share in the Turkish market. Considering the competition, it is not surprising that the efforts of the Pipeline Solutions Group (PSG) – a joint venture made up of General Electric

and Bechtel, that was given the mandate to build TCP parallel to Shell's upstream work in Turkmenistan never really got off the ground.

On February 7, a Turkmen government official announced that Shell and the Turkmen government had indefinitely postponed the signing of a production-sharing agreement, which was scheduled on February 20, on extracting gas from three fields in eastern Turkmenistan. Niyazov then apparently allowed the PSG mandate to expire on February 19, despite a personal appeal by President Clinton. In his letter to the Turkmen president on February 11, Clinton was reported to have expressed confidence that all the financing issues would be resolved this year. In addition, Clinton appealed to Niyazov to extend the consortium's mandate by officially inviting Azerbaijan to join the project as an exporter and granting project sponsors flexibility in concluding economically viable and mutually beneficial agreements.

On February 17, Niyazov cast potentially fatal doubt on the TCP project by rejecting a proposal for his country and Azerbaijan to split almost equally the capacity of the proposed pipeline. "We cannot make some sort of compromise which would be to the detriment of our economic interests and which was proposed for political reasons," Niyazov declared. In exchange for allowing the construction of the pipeline across its territory, Baku had apparently asked to export 14 bcm of natural gas annually through the pipeline, parallel to the 16 bcm that Turkmenistan had already agreed to sell to Turkey. Niyazov said that the Azerbaijani demand "ran counter to Turkmenistan's economic interests" because Turkmenistan, which was ready to use the pipeline's entire capacity immediately, had to "wait six years for Azerbaijan." Niyazov added that, "We won't act to damage our own interests, agreeing to terms advanced exclusively out of political considerations."

The following day, Niyazov received Rem Vyakhirev, the president of Russia's Gazprom. The Russian gas company had handled all of Turkmenistan's gas exports through the existing Soviet-era gas pipeline system until a disagreement on selling price brought cooperation to a halt at the end of 1997. Niyazov stated after the meeting that there was, "a wish to broaden a mutually advantageous partnership," and that the two sides planned "to sign an agreement for supplying 50 bcm of Turkmen gas per year to Russia over the next 30 years." While the price remains to be determined, Niyazov said that the existing gas pipeline system could eventually transport as much as 100 bcm of Turkmen gas annually.

On February 19, Niyazov and acting Russian President Vladimir Putin spoke about the proposed deal, and Niyazov said that he had invited Putin to make an official visit to Turkmenistan after the Russian presidential election and had received a positive reply. Niyazov made it clear that the gas accord would probably be signed in April during Putin's proposed visit. The possibility of raising gas supplies to Russia had been discussed at the summit of the Commonwealth of Independent States (CIS) in Moscow on January 24-25. Moreover, the writing was on the wall as far back as December 17, when Niyazov signed an agreement with Vyakhirev in Ashkabad on the resumption of Turkmen gas supplies to Russia. Twenty bcm of Turkmen gas would be sold for \$772 million dollars, which would be paid in a combination of foreign currency and goods. Delivery began on December 28.

On January 18 there was a meeting in Ashkabad on the TCP between officials from Turkmenistan, Azerbaijan, Georgia, and Turkey, attended by John Wolf, the U.S. special envoy on Caspian energy issues. However, while Wolf said after the meeting that the disagreement between Azerbaijan and Turkmenistan over the amount of gas that Azerbaijan would be permitted to export via the TCP "was

not discussed”, it is clear in retrospect that this was the main issue which effectively scuttled the TCP and opened the way for Niyazov’s new relationship with Gazprom.

On February 15, BP-Amoco, operator of the Shah-Deniz consortium, said that it had drawn up an outline plan for the potential export of Azeri gas to Turkey from the Shah- Deniz field. With a first stage production of 5 bcm a year rising possibly to 16 bcm, the proposed line could deliver the first gas to Turkey in the winter of 2002-2003. Andrew Hopwood, BP-Amoco’s chief executive in Azerbaijan observed that, “The establishment of a competitive gas export route from Azerbaijan will build a bridgehead to the Turkish market and affirm Azerbaijan as an important regional producer of gas as well as oil.” Significantly, consortium officials were reported to have said that they would not wait to see if there would be space on the U.S.-backed TCP.

If the Turkmen-Russian gas deal is eventually signed and the TCP project fizzles out, the next confrontation over access to the Turkish market will surely pit Azeri gas against Russia. The Russian-Turkish “Blue Stream” project involves delivery of an additional 16 bcm of Russian natural gas per year to Turkey by way of a pipeline beneath the Black Sea. Construction of two sections of pipeline began a few weeks ago, and the likelihood of Turkmen gas deliveries to Russia will further strengthen the hand of Moscow and its friends in the Motherland Party, which controls energy policy in the current Turkish government. Turkmen gas will almost certainly be sold to Gazprom at around one-third of the price at which gas will be delivered to Turkish consumers, leaving a handsome margin to be shared by the parties involved in this very expensive and technically difficult project.

Baku-Ceyhan: Tied up in Technicalities

Despite the legal framework agreement signed on the sidelines of the Istanbul Summit, numerous problems remain in establishing tariffs, transit fees, and security guarantees in the lower-level discussions. The latest round of talks designed to finalize the Baku-Ceyhan pipeline project ended on February 23 in Baku. The 10-day long meeting of representatives from Turkey, Georgia, Azerbaijan and the AIOC, as well as the ubiquitous U.S. envoy, John Wolf, was concluded without an agreement on transit fees and the final tariff needed to allow the project to move forward to the financing stage.

Peter Henshaw, representative of AIOC leader BP-Amoco, characterized the proceedings as an exercise in frustration saying, “We cannot go further until the issues with regard to Georgian demands have been solved.” The Georgian officials have apparently raised objections on four issues – land expropriation, environmental standards, security of the pipeline, and transit fees. While the first three issues were reportedly settled, the talks remain stalled over transit fees, as Georgia demands an increased share.

In order to understand fully the Georgian foot-dragging, one has to look at the bigger picture in the Caucasus. Now that Grozny has been reclaimed as a ruin by the Putin-led Russian offensive, Azerbaijan’s President Heidar Aliyev and, to a greater extent, Georgian President Eduard Shevardnadze have inevitably been forced to make subtle policy adjustments to guard themselves against overt Russian pressure or even action in the South Caucasus. Georgia’s aspirations for NATO membership, for example, have been replaced with statements of intent to declare neutrality. Equally significant are parallel talks between the Russian and Georgian Interior Ministries concerning cooperation against “terrorism,” as well as a free trade pact between Moscow and Tbilisi, which had languished since 1994, but was recently ratified by the Georgian Parliament.

What Now?

At the signing of the Istanbul agreements, Clinton remarked, “I’ll bet if you polled the citizens of the United States and Turkey, over 90 percent of them would never have heard of the Baku-Ceyhan oil pipeline, or the

Trans-Caspian gas pipeline. But if we do this right, 20 years from now, 90 percent of them will look back and say, thank you for making a good decision at a critical time.” As it becomes increasingly apparent that Russia is gaining the diplomatic and economic – as well as the military – upper hand in the Caspian region, a belated review of U.S. Caspian Basin diplomacy is in order. The administration’s willingness to allow Russia to wage a merciless campaign against the Chechens and its declarations of a willingness to deal with a “pragmatic” Putin, coupled with its failure to back its words with real security or financial support for the Eurasian Energy Corridor, have inevitably contributed to a loss of credibility in the region. As the experienced and equally pragmatic ex-Soviet leaders deal with the resurgence of Russia and try to make themselves less vulnerable, perhaps the worst casualty will be the U.S.-Turkish relationship, bolstered during recent years by U.S. “support” for Turkey in Caspian energy development. If the Eurasian Energy Corridor does indeed become a cul-de-sac, as every driver knows, extrication is much more challenging than entry.

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