Natural Gas supply to Europe: a new dimension of Azerbaijan’s energy policy

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ABSTRACT

Since the independence Azerbaijan has been one of the key countries of the Caspian region exporting crude oil to the global energy market. However, discovery of the huge natural gas reserves on Azerbaijan’s offshore territory, the start of negotiations between Turkmenistan and Azerbaijan to establish a legal framework for constructing the Trans-Caspian Pipeline and the recent transit gas agreements signed between Azerbaijan and Turkey have turned Azerbaijan to the major natural gas exporting country. Nowadays, natural gas supply to the European markets through the southern gas corridor is the main focus of Azerbaijan’s energy policy. The southern corridor being part of the energy diversification policy is the only westward route for the exporting hydrocarbons recourses from the Caspian Sea, which is aimed to break Russia’s monopoly in the European gas markets. Indeed, the natural gas supply by creating long-term linkage and increasing interdependency between suppliers and consumers make the situation politically mostly vulnerable. The export of hydrocarbon resources from Caspian Sea to Europe is challenged by certain factors such as geopolitical interests of Russia and Iran, competing pipeline projects, changes within the supply routes and technical challenges. By perusing multi-dimensional energy policy Azerbaijan has taken a cautious and balanced approach aimed to avoid any direct confrontation with Moscow in the realization of the southern gas corridor. In this case political interests along with economic interests play very important role in defining the priorities within the long-term energy projects. This paper elaborates Azerbaijan’s natural gas supply policy and focuses on certain factors shifting security dynamics within the southern gas corridor.
**Introduction**

Since the hydrocarbon reserves close to traditional markets are being depleted, the import of oil and natural gas from the remote sources has been considered as a way to meet the growing energy demand in European markets. Supply of hydrocarbon resources from the new areas will bring new active players with different interests to the energy markets and will shift the power relation between consumers and suppliers by increasing latter's advantages. Nowadays, oil and gas markets differ from each other. In contrast to oil, natural gas markets are regionally fragmented, which more likely can increase the dependency of consumers from one or few suppliers.

In the next twenty years the natural gas consumption in Europe will grow 0.5 percent per annum on average and natural gas import will increase 1.6 percent per annum on average (Honore, 2006). In order to meet the growing demand and diversify supply options by reducing natural gas monopoly mainly in Southern and Eastern European markets, the European Union has launched in 2009 the southern gas corridor initiative to enable the flow of natural gas to European markets from the Caspian region, namely from Azerbaijan and Turkmenistan. However, at the current stage the realization of the westward supply chain is decelerated by certain impediments and at the same time, followed by some positive developments.

The major impediments can be characterized as followings. First, landlocked nature of the Caspian region by constraining supply options increases the dependency of the energy producing states on transportation system in the neighbouring states. Since neither Azerbaijan nor Turkmenistan have direct access to the high seas, they need transit pipelines to gain access to European energy markets. In fact, transit pipelines are more vulnerable to political and economical pressure along the supply chain. The lack of common regulations and gaps within the legal framework can be seen as another main challenge. As there is no open market structure for the natural gas, most of decisions are determined not by market mechanisms but by long-term contracts. Finally, geopolitical interests of Russia and Iran cause difficulties for materialization of the Trans Caspian Pipeline, which is one of the key elements of the southern gas corridor. Not to lose its apparent energy monopoly in European gas markets, Russia uses all its efforts to block the construction of this pipeline. Without Turkmen gas there will be not enough natural gas to realize a pipeline project with large capacity in the long term.

Despite all the challenges, there are also positive developments for successful realization of the southern corridor. The discovery of huge natural gas reserves on Azerbaijan’s offshore territory and possibility to extend existing South Caucasus Pipeline (SCP) infrastructure towards westward direction make the supply of natural gas from Azerbaijan to Europe more valuable for the development of diversified supply chain from the Caspian region at the first stage. With development of natural gas production in Azerbaijan, all attention moved from Ashgabat to Baku. With the development of gas production Azerbaijan has entered into the new stage of its energy export policy, which, indeed, differs from the previous stage, mainly determined by oil export.
Nowadays, natural gas supply to Southern and Eastern European markets through the southern gas corridor is the main focus of Azerbaijan’s current energy strategy. Moreover, the initial supply of natural gas via the southern gas corridor is expected to flow from its Shah Deniz field, one of the world’s giant gas fields. At the moment there are four pipeline projects, namely NABUCCO, Trans-Adriatic-Pipeline (TAP), Interconnector – Turkey – Greece – Italy (ITGI) and South-East Europe Pipeline (SEEP), competing over the right to bring Shah Deniz gas to Europe.

The boost of the investments in natural gas production and development of new pipeline projects based mostly on Azerbaijani gas have significantly increased Azerbaijan role as energy country. The recent transit gas agreements signed between Azerbaijan and Turkey and follow-up agreement on construction of Trans-Anatolian-Pipeline (TANAP) have brought the southern corridor close to its realization and at the same time, shifted the dynamics within the pipeline politics turning Azerbaijan to the major natural gas producing and exporting country.

However, natural gas supply from Azerbaijan is also challenged by certain factors such as geopolitics, landlocked nature of the region, competing interests of key players, limits of transportation options and need for transit pipeline to deliver natural gas to the European markets. Consequently, Azerbaijani government set the following mechanisms to address these challenges and achieve export objectives: a) avoid or minimize transit risks by owning major share in export infrastructure in transit states; b) diversify pipeline routes through developing multiple export options and; c) pursue market-oriented policy.

This paper generally focuses on natural gas supply from Azerbaijan to Europe and examines challenges associated with current pipeline politics within the southern gas corridor. The paper begins by elaborating new dimension of Azerbaijan’s energy strategy and explains how natural gas production has got priority within the energy policy. Then it attempts to identify the impact of landlocked geography, political and economical interests on export options and at the same time, to analyze the outcome of the current changes that shifted pipeline policy dynamics within the southern gas corridor.

**Switching from oil to natural gas supply**

Following the break up of the Soviet Union, supply of hydrocarbon resources from Azerbaijan, Kazakhstan and Turkmennis to the world markets has become at the centre of energy policy debates. Within this constellation Azerbaijan and Kazakhstan were considered as main oil exporting and Turkmenistan as a key natural gas supplying country of the region. Since the existing pipeline system from those countries was a part of old soviet transportation network, there was a strong support of Turkey and Western countries to develop new oil and gas pipelines in east-west direction. Theoretically, this would help energy-producing countries of the Caspian region to export their hydrocarbon resources independently to world markets without using Russian pipeline system or traversing its territory.
Construction of new pipeline system from Caspian Sea to world markets, mainly in westward direction became the first priority underlined in the energy policy agenda of the Western and Caspian states. Since Moscow had other plans and vision how to export hydrocarbon resources from the region, the outcome was mixed and they could not reach all initial objectives. From the beginning Moscow was blocking all pipeline projects crossing through the seabed by referring to environmental concerns and unresolved status of the Caspian Sea. Hence, the initial attempts to construct Trans-Caspian Pipeline system for exporting Kazak oil and Turkmen gas failed at the end of 1990s. There was a new pipeline build from the territory of Kazakhstan. Caspian-Pipeline-Consortium (CPC) starts at the Kazakhstan’s Tengiz oil filed and runs to Russia’s Black Sea coast. The dependence of Caspian energy producers on the Russian pipeline system limited transportation options moderately in Kazakhstan and overwhelmingly in Turkmenistan (Bilgin, 2007). Nevertheless, it was possible to build Baku-Supsa and Baku-Tbilisi-Ceyhan oil pipelines, which did not transit the Russian territory. Even though, Russia was able to maintain monopoly over natural gas supply from the region to European markets during the first phase of Caspian energy development.

As soon as oil pipelines become operational, Azerbaijan has started to export its hydrocarbon resources to world markets. During the first phase of Caspian energy development the crude oil production and export was constituted the main course of Azerbaijan’s energy strategy and was the major base of its economy. Moreover, most of foreign investments were directed towards exploitation and development of oil fields. In contrast to oil, the natural gas production has been developed as sideline and reserves were not estimated to be huge enough and were left out of attention.

The situation around Caspian energy changed in 1999, when the expectation to find oil in Azerbaijan’s Shah Deniz field failed. Instead of that a giant deposit of natural gas and condensate was discovered (Nasirov, 2010). Shah Deniz field is one of the world’s largest gas-condensate fields, with over 1 trillion cubic meters (tcm) of gas in place (BP Caspian). This became a turning point not only in Azerbaijan’s energy policy, but also has affected energy supply policy of the region, by significantly increasing Azerbaijan’s natural gas export possibilities along with crude oil export. Azerbaijan has entered into new phase of its energy policy determined by the start of natural gas supply to European markets.

The discovery of huge gas field on Azerbaijan’s offshore territory led to the realization of another pipeline project, namely the South Caucasus Pipeline (SCP), which aimed to be used for natural gas supply from Shah Deniz field. The exploitation of the field has been conducted in two phases. Due to complexity of exploitation works, it took approximately seven years, when the first phase of natural gas production in Shah Deniz became operational. In 2006 Azerbaijan has started to export around 8.6 billion cubic meters (bcm) of natural gas annually to Georgia and Turkey via SCP. After the full development of second phase, it is expected to export additional 16 bcm of natural gas per year from the field. In fact, it increases Azerbaijan’s chance to export natural gas further to European markets through the southern gas corridor by providing the initial flow to come directly from the Shah Deniz field.
With the discovery of the Shah Deniz field, the core driver behind the southern gas corridor shifted from Turkmenistan to Azerbaijan (Pflüger, 2012). It turned Azerbaijan to one of the main natural gas producing countries in the region. Moreover, following the Russian-Ukrainian gas crisis in 2006, the European Union began to push more intensively for implementation of the southern gas corridor and the concept to link Caspian gas to European markets has come close to its realization. So, the second phase of Caspian energy has started with the reopening of negotiations over the southern gas corridor.¹

Currently, there are several pipeline projects competing over the right to bring natural gas from Shah Deniz field to European markets at the initial stage of the southern gas corridor. Four main projects are involved in this pipeline race: Nabucco, TAP, ITGI and SEEP. Also there are two other pipeline projects, namely Trans-Anatolian-Pipeline and Trans-Caspian Pipeline, which compose the key components of the southern gas corridor. All these projects being transit pipelines are differently motivated and constitute elements of various gaming strategies among different players. Consequently, it has affected Azerbaijan’s policy decisions regarding supply direction and relation with neighbouring states.

Azerbaijan’s role as natural gas producing and exporting country has significantly increased after the find of new large gas fields on its offshore territory. Each of these newly opened gas fields, Shafag, Asiman, Nakhchevan, Dan Ulduzu, Ashrafi, and Babek, has estimated volume of 200-400 bcm (Rzayeva, 2010) and according to preliminary estimates, gas reserves in Umida and Absheron fields are around 600-700 billion cubic meters. Hence Azerbaijan’s proven natural gas reserves grow up to 2.6 tcm (Aliyev, 2012). The recent discovery of huge hydrocarbon fields has tremendously shifted country’s energy policy. It has turned Azerbaijan from oil to natural gas producing country, which in the near future can produce and export more natural gas than oil to energy markets.²

Politics around Caspian energy become more intense with the start of tripartite negotiations between Azerbaijan, Turkmenistan and moderated by the European Commission on establishment a legal framework for constructing the Trans-Caspian Pipeline (TCP). Being a strategic pipeline project TCP, in case of construction, will strengthen Azerbaijan’s role as energy transit country. The growing volumes of natural gas production require reliable transit corridor that could efficiently serve the requirements of suppliers and consumers. Since Azerbaijan is landlocked country, there will be certain supply challenges related to transportation and transit issues.

¹ The first round of negotiations to supply natural gas to European markets from the Caspian region started in 1998. US government proposed and supported construction of the Trans Caspian Pipeline. That time Turkmenistan was seen as only potential country able to supply natural gas to Europe.
² Azerbaijan’s proven oil reserves are estimated at 2 billion tons.
Supply challenges faced by Azerbaijan

Landlocked nature of the Caspian region constrains supply options of hydrocarbon resources from the region to world markets by leaving much less space for maneuverability. In this case, energy-exporting countries of the region need to get access to transportation facilities in their neighboring countries, in order to transit their products and participate in international trade. This increases the dependency of landlocked energy exporters on transit states, due to a relative lack of flexibility in finding alternative transportation routes. Furthermore, under certain conditions transit pipelines might cause challenges for the natural gas supply from landlocked areas.

Production and export of crude oil from landlocked areas is a quite different process than production and export of natural gas. First, oil can be transported to world markets from Azerbaijan by pipelines, railway and then by sea tankers. In contrast to oil, transporting natural gas is far more expensive and there are only two options for its delivery: pipelines and Liquefied Natural Gas (LNG). In fact, LNG is cost-competitive with pipelines only over distances in excess of 4000 km. That is why pipelines are highly required to deliver natural gas to markets from Azerbaijan and the given region, while LNG is not cost-effective in a short distance. Second, natural gas delivered to markets via pipelines creates long-term linkage between supplier and consumer. Any interruption to the flow would risk devaluing the entire investment both upstream and downstream of the pipeline (ESMAP, 2003). Compare to the natural gas, the case of oil is a bit different. Since there exists a global oil market, the producer can sell its product to any buyer and the consumer can easily shift from one seller to another. So natural gas supply strategy necessitates accurately measured and market oriented policy.

Natural gas supply from Caspian region to European markets will significantly reduce Russia’s energy monopoly in the region. However, due to landlocked nature of the Caspian region, the export of natural gas via pipelines from Azerbaijan and Turkmenistan very complicated. In case of the Caspian energy supply through the southern gas corridor, the pipeline will transit territory of Georgia and Turkey, as well as Caspian Sea and territory of Azerbaijan in case of transportation of Turkmen gas to European markets. Transportation of natural gas by pipeline from Azerbaijan and also from Turkmenistan to European markets is only relevant export option at the moment. However, there are some factors challenging the supply of natural gas via trans-Caspian pipeline system from Turkmenistan to Azerbaijan. Since the TCP has to be constructed through the seabed, it is less likely that Russia and Iran will not object the construction of the pipeline based on their geopolitical interests hidden behind environmental issues and unresolved legal status of the Caspian Sea. On one hand, Russia will prefer to keep control merely over the hydrocarbon transportation from the Caspian region, and on another hand, Iran will favor supply of Turkmen gas through its own territory, which also can lead to the lifting of the sanctions. According to officials of the both states, the construction of TCP can be possible after final agreement among all littoral states. In this case, considering geopolitical situation in the region, Baku will avoid open confrontation with Moscow and will prioritize the development of production in its own reserves.
rather than actively support export projects from Turkmenistan. Moreover, apart political support there are not any commercial players who are ready to finance TCP (Pflüger, 2012).

There is another compelling fact concerning natural gas supply by pipelines. The delivery must involve transit states. In fact, transit lines are extremely vulnerable to political manipulation and economic pressure, which will syphon off any profitability in what is a zero-sum game between the pipeline owner and the transit country (Stevens, 1996). Moreover, due to the high costs, the lengthy time factor in mobilizing finance and building the pipelines, and the geographic limitations on venues, energy-importing and energy-exporting states are limited in their supply venue options, and it takes years to establish alternative routes if a transit state disrupts the supply flow (Idan & Shaffer, 2011).

**Gas negotiations and TANAP**

As the history shows there are specific challenges and success stories related to transit pipelines. If transit state is dependent on foreign development investment and also is off-taker from the line, like in the case of Georgia, it will be less interested in supply disruption. On the other hand, the dynamics of transit pipelines made the concept of obsolescing bargain an important issue to be considered as a threat to security of supply. Since transit pipelines once built and start to operate, become vulnerable to the obsolescing bargain by putting transit state in more favorable position by shifting bargaining powers. As Vernon describes, “almost from the moment that signature dried on the document, powerful forces go to work that renders the agreement obsolete in the eyes of the host government” (Vernon, 1971). In this case obsolescing may take the form of renegotiation of transit terms and change in payment procedure. Negotiation over transit terms of Shah Denis phase one between Turkey and Azerbaijan can be very interesting example for that.

Shortly after the discovery of Shah Deniz field, Baku and Ankara signed a purchase and sale agreement for the delivery of 6.6. bcm of natural gas per year to Turkey via SCP starting form 2007. According to the gas agreement signed in 2001 Turkey had to pay low price with respect to high transit fee for the natural gas from the first phase of Shah Deniz production. In order to make this low price more acceptable for Baku, it was agreed that it would be renegotiated one year after the start of gas deliveries to Turkey (Lussac, 2010). For Baku the prize would be won from renegotiating a transit agreement had three dimensions: acceptable transit fee, relatively fair price for sold natural gas in the territory of Turkey and access to other European markets through Turkey.

But, Ankara had its own interests in this energy game, which cast a shadow on the gas agreement between Baku and Ankara (Pritchin, 2010). Renegotiations started in 2008 reached a deadlock, since both sides had different positions concerning transit terms. In fact, Turkey was willing neither to pay more for the Azerbaijani gas nor get agreed on decreasing transit fee. Moreover, Ankara expressed its intention to buy and resell gas from Shah Deniz field in European markets. On the background of the growing importance of the southern gas corridor, Turkey wanted to become an energy hub for the EU and aspired to be
the owner of transit gas or easily obtain 15 percent of fuel volume for transportation (Pritchin, 2010). It was an unacceptable deal either for Baku or for the EU. In fact, Turkey is aware of its importance as a key transit state within the supply chain and can easily manipulate with its geographical position by using it as political leverage.

If all parties feel they are benefiting from the project, they will have an incentive to stay with it and to work out any conflicts or disputes that may arise (ESMAP, 2003). After two years of negotiations both parties were able to get agreed over the new transit terms. Since Turkish energy market is a major consumer of Azerbaijani gas and Azerbaijan is a key energy supplying country within the southern corridor initiative, both parties need each other to implement their commercial interests and achieve certain policy objectives. By agreeing on new transit terms, Azerbaijan and Turkey solved the problems related to transit fee, gas price and volume of natural gas that supplied from Shah Deniz phase I.

However, the main steps toward realization of natural gas supply from Azerbaijan to European markets would be signing of another gas agreement between Turkey and Azerbaijan on Shah Deniz phase II. It was believed that after signing this agreement the dilemma around Caspian energy could be easily solved. One might mention that the second phase of negotiations were even more tough and difficult. Hence, prolonged negotiations over new gas agreement between these states led to growing uncertainty in implementation of the east-west supply chain.

More than year both sides were negotiating over the terms of new gas contracts, since the parties had different positions concerning the supply volume and transit terms. In fact, the setting of transit terms for a long period has always been a difficult and controversial issue. Since there is no ‘objective’ or ‘fair’ way to set transit fees, the outcome, in the form of the transit agreement, depends upon relative bargaining power and the skill with which that power is used in the negotiations between the transit government and the transit pipeline company (Stevens, 2009).

At the end of 2011, in Izmir, Azerbaijan and Turkey signed new gas agreements over the price, volume and transit fee by establishing legal and commercial terms for gas transit from Azerbaijan to Turkey and to Europe through the territory of Turkey. Izmir agreements also reshuffle the cards in the competitive tender, by which the Shah Deniz producers’ consortium in Azerbaijan are choosing a pipeline route to Europe from among four options (Socor, 2011). The turning point or even unexpected outcome of the negotiations was the initiative to construct a new pipeline, Trans-Anatolian-Pipeline from eastern border of Turkey to its western border, where Azerbaijan’s State Oil Company (SOCAR) will have 80% of share and two Turkish national companies, Botas and Turkish Petroleum 10% for each. Azerbaijan as the main owner in the pipeline project will control the allocation of transportation capacities and other key decisions.
However, Shah Deniz consortium members\(^3\) can also join to the project as third parties getting relatively small shares. Since Turkey becomes an active partner within the new project, which will invest and bear risks, then it is less interested to cause disruption in supply flow. Every successful pipeline project features a well-balanced and usually sophisticated alignment of the interests of all stakeholders (ESMAP, 2003).

TANAP is Azerbaijan’s direct road to Europe, which will run from the Georgia-Turkey border to the Turkey-Bulgaria border and there will connect with European supply network. The pipeline being as only export route from Caspian region is aimed to deliver natural gas from Shah Deniz II, starting from 2017. The key advantage of the TANAP project is its scalability. The capacity of the pipeline is planned at 16 bcm per year in the first stage and it can be increased to 24 bcm per year in the second stage, when production of natural gas grow and Turkmen gas become available to be exported to Europe. Obviously, it is more rational to build the pipeline with sufficient capacity, which will meet the initial throughput needs and later can be upgraded.

For the Azerbaijani side, the logic of TANAP has been driven from the concept that the best guarantee for a full pipeline operation lies in owning both the production and the line. TANAP has become not only crucial step toward realization of the southern corridor, but also determined priorities of Azerbaijan's energy policy. First, by owning transportation infrastructure in the transit country Azerbaijan minimized transit risks, since for energy supplier it is important to have a good reputation and enable supply security. Second, it demonstrated that to maximize the profit from the supply chain Azerbaijan would act more than just as energy producer country by getting ‘in’ on different parts of the southern gas corridor. Since Azerbaijan can sell its gas directly to European costumers on Turkish-Bulgarian border, it turns to an active player in the energy markets abroad. Finally, it has created an opportunity to use its own transportation infrastructure for the transit of natural gas from other producers. In other words, the spare capacities of the pipeline can be hired by other gas producers to supply natural gas to Europe.

The projection of TANAP has influenced the pipeline dynamics within the whole supply chain. In wider perspective, TANAP is a game-changer, with multiple ramifications across the space from Ashgabat and Baku to Vienna and Brussels (Socor, a, 2012). With the emergence of the new pipeline project in the southern gas corridor, the level of uncertainty around the Caspian gas politics has increased and at the same time it has shifted the power relation between different players. TANAP has different implications on the initial projects of southern gas corridor and Trans-Caspian Pipeline.

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\(^3\)Shareholders in the Shah Deniz consortium are: BP (25.5%), Statoil Hydro(25.5%), Total(10%), LukAgip(10%), SOCAR(10%), NICO (10%) and TPAO (9%).
Projects of the southern corridor and economics of pipeline

For a long time, Nabucco was the only strategic pipeline project aimed to transport natural gas from the Caspian region to Europe. It got strong political and financial support from the European Commission, due to its design capacity and market destinations, which also provided rational solution for transporting Azerbijani and Turkmen gas to Southern Eastern Europe. After several adverse developments for Nabucco, the pipeline project lost its momentum and credibility. Moreover, Nabucco at 31 bcm looks premature, as long as Turkmen gas has not yet crossed the Caspian Sea to the South Caucasus (Socor, 2012). It is more obvious than that a critical mass of throughput is required to be in place before the project can seriously be considered. Otherwise, an empty pipeline will be very expensive.

Consequently, two factors are essential for the realization of a pipeline project: actual capacity and the reliable source of financing. In contrast to Nabucco, other three projects within the southern gas corridor have lower capacity, which is equal to available 10 bcm of natural gas planned to be exported to Europe from Shah Deniz II at the first stage. According to economics of scale, pipelines are extremely capital-intensive activity and full capacity operation is important for profitability. As capacity throughput falls, the average cost of throughput rises exponentially and consequently does severe damages to any profitability inherent in the line (Stevens, 1996). Hence security of supply with respect to throughput is essential for profitable operations.

With the development of TANAP project Nabucco partially lost its value. Moreover, TANAP has got more strategic importance for Azerbaijan rather than the EU-backed pipeline project. Consequently, the Shah Deniz consortium will be not in the favor of choosing Nabucco as a supply route for Azerbijani gas. As gas pipelines tend to be natural monopolies, it implies that between two points only one line is desirable (Stevens, 1996). At the same time, deepening of the financial crisis in Europe and involvement of relatively low-cost pipeline projects – TAP, ITGI and SEEP – into pipeline race decreased chances of costs overrunning Nabucco to be realized in its initial design⁴.

Since TANAP has become a fundamental part of the southern gas corridor and has entirely replaced Turkish section of the Nabucco project, it required modification of the pipeline project. It has led to the development of Nabucco-West at a fraction of the “old” Nabucco’s length and cost, and with scalable capacity to accommodate growing gas volumes over time (Socor, b, 2012). This made possible Nabucco’s re-invention as a continuation pipeline from TANAP into Central Europe. The new Nabucco-West project by getting cheaper and shorter starting at Turkish-Bulgarian border and crossing through the territory

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⁴ According to Nabucco’s initial design, the pipeline at 31 bcm annual capacity and 3300 km length would run from the Turkish-Georgian border to Baumgarten in Austria, transiting the territory of Turkey, Bulgaria, Romania, Hungary and Austria. Moreover, the pipeline project overruns its initial costs estimated at 8 bn. euros.
of Bulgaria, Rumania, Hungry and Austria has gained an advantage to be chosen as a supply route in the north direction.

As it was implied, high costs or absence of financing increase the risks and threaten the viability of a pipeline project. This is the main problem faced by ITGI pipeline project, which in reality unites two projects in one: the Greek onshore section and IGI-Poseidon, linking Greece and southern Italy by crossing Ionian Sea. Due to current financial crisis, this project lacks a credible solution to explain how the pipeline infrastructure will be financed and become ready on time to deliver Shah Deniz gas to Southern European markets. This fact has put ITGI at the last place within the pipeline race.

ITGI and TAP are almost similar projects. Compare to ITGI, TAP does not have problems with financing, since its shareholders StatOil, EGL and E.on RuhrGas are not local energy companies and have credibly financial support. By connecting the Turkish-Greek interconnector with the Italian pipeline system across Albania, TAP can be considered as a “missing link” within the South European supply chain. Besides that, the project targets geographically vulnerable regions, namely Western Balkans and Southern Europe, with a certain level of energy poverty and it emphasizes its importance respectively. But, as a transit pipeline has to cross the territory of non-EU and EU member states, the fragmentation of jurisdiction can be underlined as a main obstacle. Hence, the lack of common regulations can create certain gaps within the legal framework. To avoid this and enable supply security it is necessary to get agreed with all transit states before the construction of pipeline. Moreover, involving the transit states into the project on a joint venture basis may reduce potential conflicts in the future.

To minimize the transit risks TAP shareholders have invited Greek DESFA to enter into a joint venture. In addition, Albania reacts positively to the planning and construction of the pipeline through its territory. It recognizes the enormous chance of the integration into a transnational energy project of this dimension and sees the advantages of becoming an energy-hub for the Balkans, as there are concrete ideas of building an interconnector from Albania to transport gas to its Balkan neighbor countries, the Ionian-Adriatic Pipeline, thereby opening the perspective for an entirely new market (Pflüger, 2012). In view of the fact that Azerbaijan pursues multidimensional energy supply policy and targets different energy markets it makes TAP first in the priority list to be considered as one of the potential routes, mainly in the southern direction.

While speaking about the projects of the southern corridor, one must mention the South-East Europe Pipeline as one of the competing pipeline projects in the northern direction. In general, basic concept of the project repeats restructured and substituted version of the Nabucco-West pipeline project and plans to use already existing nationally owned pipelines and interconnectors in the South-Eastern Europe. Similar to what the TAP project offers regarding the possibility to transfer gas to other Balkan states, SEEP could also deliver gas to additional countries along the route including Bulgaria, Romania, Hungary and potentially Croatia (Pflüger, 2012). It does not look like a scalable project and does not leave
any space for transporting Turkmen gas to Southern-Eastern European markets. In fact, SEEP is more a concept, rather than a well-developed project.

**Conclusion**

The analysis of current developments around the Caspian energy helps to understand the new dimension of Azerbaijan’s energy policy. Mainly focusing on political and economical considerations, this paper sheds light on number of issues determined by energy export policy. Natural gas supply from the Caspian Sea to European markets is relatively expensive and complicated, since it should involve transit states due to landlocked nature of the region. At the same time, it is highly influenced by geopolitical and commercial interests of the several actors.

The rise of natural gas production on Azerbaijan’s offshore territory has totally changed the core drivers behind the southern gas corridor by increasing country’s strategic significance within the east-west supply chain. Azerbaijan has turned from oil exporting to natural gas producing country. In fact, the existing transportation constrains and challenges have affected Baku’s energy policy decisions. Three main lines are detected in this regard: a) avoid or minimize transit risks by owning major share in export infrastructure in transit states; b) diversify pipeline routes through developing multiple export options and; c) pursue market-oriented policy. It is possible to observe all three points at the different stages of the pipeline politics in the framework of the southern gas corridor.

The main step taken towards reducing transit vulnerability is the signature of the agreement between Azerbaijan and Turkey on construction of the Trans-Anatolian pipeline. However, the initiative also had several impacts on pipeline dynamics in the region and determined further directions of Azerbaijan’s energy policy. Being a long-term project and holding the decisive advantages over other pipeline projects suggested within the southern gas corridor, TANAP guarantees natural gas supply from Azerbaijan and also considers natural gas supply from the other sources in the future. Despite the fact that the TANAP replaces Turkish section of the Nabucco project, it does not invalidate project’s fundamental idea. Since TANAP ends at the Turkish-Bulgarian border, it necessitates continuation of the pipeline into Southern and Eastern European markets. In this case, Nabucco-West becomes a potential supply route in the northern direction. On the other hand, considering the fact that Azerbaijan pursues market-oriented policy and favors multiple export options, another supply route will be in the southern direction, which targets South European markets. In this case, TAP gets advantages over ITGI, because of its commercial viability and credibility.

The supply of Turkmen gas to European markets is still challenged by geopolitical interests of Russia and Iran. Both regional actors will try to bloc the TCP project referring to legal and environmental grounds. As long as Turkmen gas will not cross the Caspian Sea, Azerbaijan will be only natural gas supplying country to European markets through the southern corridor.
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