

# AZERBAIJAN'S NEW GAS STRATEGY

*The global financial crisis led to a serious narrowing of the EU gas market – the main market for Azerbaijan in the future. Baku is forced to find a solution for their surplus of gas production. The Azerbaijani strategy in the gas sphere is a diversified export policy with a huge list of partners, whereby Baku has more than twenty consumers for its oil in different parts of the world, just as they have already achieved in the oil market. This article evaluates the alternative paths taken by the Azerbaijani government in constructing its export policy.*

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**T**he situation in the world gas market and the drawn-out Azerbaijan-Turkey negotiations in the gas sphere have forced Azerbaijan to change its long-term export priorities. All evidence points to the fact that the State Oil Company of Azerbaijan (SOCAR) is going to follow a more diversified policy and begin to find new consumers for its fuels. Thereby, Baku is ready to open north and south energy routes to decrease dependence on the existing route to the west. This article will offer a brief evaluation of Azerbaijan's new energy alternatives.

### ***The Changing Gas Market***

The global financial crisis led to a serious narrowing of the EU gas market – the main market for Azerbaijan in the future. According to a 2005 forecast, EU's gas consumption in 2009 should have been about 600 bcm.<sup>1</sup> While in the year 2008 all European countries consumed 440.9 bcm of natural gas, in the year 2009 it was around 413.9 bcm, a reduction of almost six percent.<sup>2</sup> Observers do not expect the market to be restored until 2015-2016. The situation is the same with main Azerbaijani customers. Turkey should buy 6.3 bcm of natural gas annually from "Shah Deniz - 1". However, in 2010 Turkey has only been able to purchase five bcm of natural gas. The consumption of Georgia and Greece has also decreased. Moreover, domestic demand for gas in Azerbaijan decreased several times over the last years, from 12 bcm to nine bcm. This has happened due to an increase in the price of gas. Thus Azerbaijan has almost two bcm of unclaimed gas in 2010.

Baku is forced to find a solution for the surplus of their gas production. One of the aims of the new Azerbaijani gas strategy is to increase the capacity of gas storage. SOCAR currently has the ability to store two bcm of gas. But in 2011, storage volume is set to increase to three bcm and by 2015 to five bcm of natural gas.<sup>3</sup>

### ***Gas Negotiations Between Turkey and Azerbaijan***

One of the main uncertainties of developing Azerbaijan's gas industry is linked with the prolonged Azerbaijan-Turkey negotiations about cooperation in this sphere. This sounds strange because Ankara and Baku have been the closest allies in the region. Moreover, collaboration in the energy sector with Turkey for the last twenty years has helped Azerbaijan to enter the world market, bypassing Russia with the operational oil pipeline Baku-Tbilisi-Ceyhan and the gas pipeline Baku-Tbilisi-Erzurum. There is also a planned pipeline which would link Azerbaijan with Greece and

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<sup>1</sup> World Energy Outlook, *International Energy Agency*, 2005, <http://www.iea.org/textbase/nppdf/free/2005/weo2005.pdf>

<sup>2</sup> *BP Statistical Review of World Energy*, June 2010, <http://www.bp.com/sectiongenericarticle.do?categoryId=9023781&contentId=7044478>

<sup>3</sup> "Components Of Success", *Caspian World*, June 2010.

Italy through Turkey (ITGI pipeline). Keeping in mind the unstable Russian-Ukrainian gas background, full of contradictions, Azerbaijan and Turkey can become a prospective alternative to Russian fuels for the EU. But at this important moment Ankara has realized that it has its own interests in this energy game, which cast a shadow on the gas agreement between Baku and Ankara.

The previous agreement between the two allies extended until 15 April 2008. Turkey and Azerbaijan had different positions about three points of the new agreement: the price of gas from the “Shah Deniz - 1” project, the volume of Azerbaijan’s gas supply within the framework of developing “Shah Deniz - 2”, and the price and transit conditions of Shah Deniz - 2 through Turkey. The first two questions relate to the commercial aspect of Turkish-Azerbaijani bilateral relations. The solution of these issues heralds the opportunity to develop the 20 billion dollar project “Shah Deniz - 2”. This is simply because Turkey is the biggest consumer of this gas. The third part of the agreement has been the most important issue for Azerbaijan from a strategic point of view. SOCAR is seeking to become an independent gas supplier for the European Union. Stable and clear conditions for transit are a clear prerequisite for this aim. On the other hand, Turkey wants to be an energy hub for the EU and aspires to be the owner of transit gas or easily obtain 15 percent of fuel volume for transportation. The Turkish position is hence unacceptable for a supplier like Azerbaijan and for the EU, which is the main consumer. After two years of hard negotiations, Baku and Ankara have arrived at a consensus on all the outlined controversial issues. The new agreement is a compromise because it gives Turkey the ability to lower its supplies up to 20 percent depending on Turkish needs. In return Ankara has established a uniform transportation tariff for Azerbaijan’s gas for all projects. However, despite all the resolved key issues between allies, Baku is still interested in further diversification of its natural gas export.

### ***Russia Becomes a Big Consumer of Azerbaijan’s Gas***

In the medium term Russia can become a remarkable consumer for Azerbaijani gas. On 14 October 2009, Russia’s Energy Company, Gazprom, and SOCAR signed a contract to supply Azerbaijan’s gas to the Russian North Caucasus from the beginning of 2010. The agreement is very flexible and specifies only the minimum amount of supplies, which is a mere 0.5 bcm per year. Partners expect that Russia will buy as much gas as Azerbaijan can sell. Transportation is through the gas pipeline Baku-Novofily, which only three years ago was used for supplies of Russian gas to Azerbaijan. Capacity of this transmission infrastructure is about seven bcm per year. Baku and Moscow have determined the volume of gas to be bought by Russia as one bcm in 2010 and two bcm in 2011. According to head of Gazprom Aleksey Miller, since 5 March, gas purchases from Azerbaijan have increased to three million cubic meters per day.

Cooperation in the gas sphere is mutually beneficial. Firstly, Azerbaijan receives the best price for its gas – 230 dollars for thousand cubic meters. Georgia pays Azerbaijan 120-140 dollars for the same amount, and Turkey only since 2010 has begun to pay the market price. Secondly, the north direction of Azerbaijan's gas export can become strategic in the medium term especially in case of problems with traditional Western partners like Turkey, Georgia and Greece. Russia also

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has strategic aims for collaboration with Azerbaijan. Gazprom buys part of Azerbaijan's gas that could enter European markets. Thereby the Russian monopoly tries to save its position. On the other hand Baku does not want to depend strongly on Moscow on this question and is willing to send Russia only a quarter part of the total export. For Azerbaijan, the best option is to that SOCAR be able to use Gazprom's transmission infrastructure for selling

its gas to Europe. In this case Baku may consider the possibility for its participation in Russia's ambitious South Stream project. But now it is uncertain whether Gazprom will open its pipelines for Azerbaijan and the Central Asian countries. In any case Russia and Azerbaijan, due to their common interest in the gas sphere, were able to overcome difficulties in their relations that remained since the 1990s, starting afresh their bilateral dialogue.

### **South Direction**

The third strategic direction for Azerbaijan's gas export after the West (Georgia and Turkey) and the North (Russia) can be the South, where the Islamic Republic of Iran is located. On 13 January 2010, SOCAR and the National Iranian Gas Export Company signed a contract regarding Azerbaijan supplying gas to Iran. The head of the Centre for Oil Studies, Ilham Shaban, said that in 2010, when the old gas pipeline is repaired, its capacity would become 1.5 bcm per year. Furthermore, Iran and Azerbaijan have agreed to construct a new pipeline with five bcm capacity. Collaboration with Iran is very important for Azerbaijan because it initiates a constructive mode of cooperation with this important neighbor. Additionally, Iranian Oil Industries Engineering and Construction has a 10 percent share in "Shah Deniz - 1" project. On the other hand, tensions surrounding the Iranian nuclear program and the new sanctions against Tehran cast doubt on plans of developing collaboration in the gas sphere.

## ***Prospective Energy Routes***

Although Azerbaijan will soon have three main directions for export of natural gas, the country is still exploring the possibility of several new projects. One of them is the Azerbaijan-Georgia-Romania Interconnect (AGRI) project, which involves construction of an Azerbaijani gas-processing terminal on Georgia's Black Sea coast and the transportation of gas by ship to Romania for further shipment to Europe's domestic gas pipeline network. The project is being considered in two directions – LNG and CNG. On 12 May 2010 an agreement was signed by the Minister of Industry and Energy of Azerbaijan, Natiq Aliyev, the Minister of Commerce, Business Environment and Economy of Romania Minister, Adrian Videanu and the Minister of Energy of Georgia, Alexander Khetaguri. According to preliminary data, the project will cost 4.6 billion Euros.<sup>4</sup> If the project is realized, Azerbaijan will gain access to the European market, bypassing Russia and Turkey. On the other hand, observers warn that the AGRI project with the declared capacity of two to seven bcm per year would be too expensive and would not be commercially viable.

Azerbaijan is also interested in the Pan-Arab gas pipeline project. The construction of the pipeline, which will connect the Turkish and Syrian gas systems, could allow Azerbaijani gas to be transported via Turkey to Syria and Jordan. Earlier, Syria made a proposal to buy one to 1.5 billion cubic meters of Azerbaijani gas over 20 years. Gas supplies can launch from the middle of 2011.<sup>5</sup>

SOCAR is also trying to gain a foothold in traditional gas markets. Now it is the owner of 31 regional gas distribution companies in Georgia. SOCAR is the main contender –as well as the one politically most acceptable for Tbilisi– for the anticipated privatization of Georgian gas transmission infrastructure too. If SOCAR obtains this asset, Azerbaijan can become the biggest player in the gas sector in the South Caucasus.

## ***Conclusion***

Although Azerbaijan became a net gas exporter only in 2007, in this short period of time the national company SOCAR, with the support of the government of Azerbaijan, has acquired experience working in new markets and forming a balanced list of consumers. As a conclusion it could briefly be stated that the Azerbaijani strategy in the gas sphere is a diversified export policy with a huge list of partners, just as that they have already achieved in the oil market, where Baku has more than twenty consumers for its oil in different parts of the world.

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<sup>4</sup> "Components Of Success", *Caspian World*, June 2010.

<sup>5</sup> *Ibid.*