
ENERGY

The Nabucco Project: Implications for the EU Strategic Energy Review

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Global context and new specific challenges

Energy is a key issue of this year's European political agenda. Article 194 (1) of the Lisbon Treaty states that the Union energy policy will aim – amongst others things – to “ensure the functioning of the energy market,” “ensure security of energy supply in the Union” and “promote the interconnection of energy networks”. Article 194 (2) declares that the European Parliament and the Council will “establish the measures necessary to achieve the objectives in paragraph 1”. The development of a Southern Gas Corridor has also been declared in the 2nd EU Strategic Energy Review to be essential to EU energy needs. Energy projects in South-Eastern Europe, the Caspian and the Middle East, which used to be hampered by regional conflicts, are now facing the additional challenge of the global economic crisis. The signature of the Intergovernmental Accord for the Nabucco project was a positive step and a success of the last European Trio Presidency, yet much remains to be done. A strong European energy strategy would not only limit the scope for individual member state energy strategies and provide a clear example of European solidarity towards smaller member states and the rest of the world; it would also increase the probability that crucial projects such as the Nabucco are realised. Such a success would increase EU legitimacy in foreign policy-making, which is all the more useful as the provisions of the Lisbon Treaty come into force.

Current status

The signature on 13 July 2009 of the Intergovernmental Accord for the Nabucco project made headlines across Europe. A project ridden with doubt and uncertainty since its inception came closer than ever to realisation when representatives of Turkey, Bulgaria, Romania, Hungary and Austria signed an agreement which paved the legal ground for the realisation of the project. With an approximate budget of eight billion euros, a length of 3,300 km and a transport capacity of 31 billion cubic meters per annum, the Nabucco pipeline aspired to be one of Europe's main tools in its effort to improve its access to energy resources, as well as to reduce

its energy dependence on Russia by diversifying its natural gas supply. Non-Russian natural gas from the Caspian and the Middle East would gain access to the European energy market. An additional interesting feature of the project is that it would not directly involve any states or companies which export natural gas and normally control the corresponding pipelines. It would be a purely commercial project, open to any exporter and importer of natural gas.

Yet problems cast doubt on the feasibility of the project from the very beginning. First, the fact that Nabucco partners were not simultaneously natural gas producers meant that all of the pipeline's capacity had to be contracted in the Caspian or the Middle East. Yet political instability and Russia's preferential links with natural gas exporting states in the Caspian meant that Nabucco partners had to face fierce competition to secure natural gas supplies. The inability of the Nabucco partners to secure the supply of natural gas quantities sufficient for the operability of the pipeline remained a sword of Damocles hanging over the viability of the project. On the demand side, gaining a share of Europe's natural gas market was already a formidable task. This became even more difficult due to the raging economic crisis, which took a toll on European economic growth and energy consumption. Moreover, partners failed to come to agreement on the economic terms of natural gas transit. Turkey, where the largest part of the pipeline would be located, insisted on extracting a 15% discount on the gas price.

These fears were somewhat allayed when Azerbaijan committed large quantities from the Shah Deniz II natural gas field whose exploitation was expected to begin in 2013. Additional support for the project came from the Middle East. The Prime Minister of Iraq, Nuri Al-Maliki, stated that Iraq would provide 50% of the pipeline's natural gas capacity, about 15 billion cubic metres. Iraq's reconstruction and infrastructure development meant that the country would be able to export natural gas via pipeline for the first time and also commit quantities to the Nabucco project, which would be crucial for the viability of the project. Finally, the completion of the Trans-Arab pipeline linking the networks of Egypt, Jordan, Syria and Turkey would mean that Egypt could also become a Nabucco supplier, albeit a minor one. Turkmenistan and Kazakhstan were also earmarked as potential sources.

Nevertheless, the credibility of these statements was questionable on political and technical grounds. The ability of Azerbaijan to provide the promised quantities would depend on the successful completion of the offshore Shah Deniz II investment, as well as its determination to resist Russian bids to purchase its own gas. As regards the Iraqi statement, it depended on major investment in the upstream natural gas infrastructure, an agreement about revenue sharing between the central government and Northern Iraqi authorities and the viability of the Iraqi government and Iraq itself, following the planned departure of US troops from the country. In addition, Egypt's contribution – while welcome – could not be critical for the viability of the project. The contribution of significant quantities from Turkmenistan and Kazakhstan would only be possible through the construction of a trans-Caspian pipeline, a project which has been frozen for years due to the dispute among littoral states regarding the legal status of the Caspian.

The feasibility of the Nabucco project is also linked to regional politics. The course of Turkish-Armenian relations may prove critical, as they directly concern one of the Nabucco's chief prospective suppliers, Azerbaijan. Armenian-Azeri relations have been marred due to the war in Nagorno Karabagh. Turkey has since then maintained an adamant pro-Azeri position, demanding the withdrawal of Armenian forces. The recent rapprochement process between Turkey and Armenia which culminated with the signature of protocols of reconciliation on 10 October 2007 has the potential to lead to a serious deterioration of Turkish-Azeri relations. A major issue will be the reopening of the Turkish-Armenian border, one of the key items on the Turkish-Armenian negotiation agenda. The Turkish-Armenian border was closed in 1993 in retaliation against Armenian aggression in the Nagorno Karabagh war. Since then the closed Turkish-Armenian border, which has severely hurt the economy of Armenia, and also that of Turkey's Eastern provinces, has turned into a symbol of Turkish solidarity towards Azerbaijan. If Turkey agrees to the reopening of the border without a resolution of the Nagorno Karabagh conflict, this would create disillusionment and anger in Azerbaijan. Baku might then use its most powerful tool, energy, as leverage against Turkey and the West. Withdrawing from supply commitments in the Nabucco project or interrupting the flow of oil and natural gas towards Turkey would not be inconceivable then. This could derail the realisation of the Nabucco project.

Developments in Iraq will also have a critical bearing on the project. The attempts of the Obama administration to create the conditions for the departure of US troops from the country have not born fruit yet. While the Kurdish-controlled north of the country enjoys relative stability, it would not remain unaffected by a deterioration in Iraqi politics. The status of the city of Kirkuk and the dispute between Iraqi Kurdish regional authorities and the central government regarding control over revenues from Kirkuk's oil and natural gas fields are two key issues which have yet to be addressed and could have disastrous destabilisation consequences. Without a permanent settlement in Iraq it is difficult to imagine the completion of energy projects in the north of the country which might allow the fulfilment of Iraqi Prime Minister's pledge, namely that Iraq would supply half of the Nabucco's supply capacity in natural gas.

The state of EU-Turkey relations provides an additional point of concern. Turkey's EU accession negotiations are proceeding at a very slow pace. Only one negotiating chapter has been finished, while several others have been vetoed by France and Cyprus. In particular, the opening of the accession chapter related to energy has been blocked by Cyprus due to Turkey's refusal to extend its customs union with the European Union to the new EU member states. In addition, Turkey has refused to sign the Energy Community Treaty (ECT) of South-Eastern Europe, which would allow for the regional integration of energy markets in the Balkans. Its somewhat uncompromising stance on a range of issues of interest for the European Union – including the Nabucco negotiations – could be linked with disenchantment from Europe, as accession looks today more distant than in 2004.

Russia's regional strategy is another factor. Nabucco has been long seen as a project aiming to reduce Russia's energy leverage on the European Union. To counter this project, Russia came up with its own pipeline project in South-Eastern Europe, the South Stream, and increased efforts to purchase natural gas from Caspian exporting states, which could have been otherwise exported through Nabucco. Meanwhile, the stalemate regarding the legal status of the Caspian Sea and the resulting lack of trans-Caspian pipeline networks allowed for Russia's preferential access to the natural gas resources of Kazakhstan and Turkmenistan. Russia's recent agreement with Azerbaijan for the purchase of 0.5 billion cubic metres per annum concerned a negligible quantity but showed that Russia maintained considerable influence in the Caspian and that Azerbaijan should not be considered an exclusive energy partner of the West.

Recent overtures towards Turkey underlined the strength of Russia's regional energy policy. The bilateral agreement signed in August 2009 granted Russia the right to construct part of the South Stream in Turkish territorial waters in the Black Sea, thus avoiding crossing Ukrainian territory. This agreement underlined Russia's improving ties with Turkey, as well as the intention of the Turkish government to consolidate Turkey's transformation into an energy hub by promoting competing energy projects.

Proposals

The rotating Trio Presidency (Spain, Belgium and Hungary) should deliver the promised introduction of a new 'EU Energy Security and Infrastructure' instrument, as well as the implementation of the six priority infrastructure actions, outlined in the 2nd Strategic Energy Review, which include the Southern Gas Corridor. The European Commission needs to intensify efforts for the finalisation of the Security of Gas Supply Regulation and the promotion of natural gas diversification.

The High Representative of the Union for Foreign Affairs and Security Policy needs to come up with a coherent and comprehensive energy strategy and external energy policy which would greatly facilitate the realisation of the Nabucco project. The recent ratification of the Lisbon Treaty could be useful in that respect. The following policy initiatives would be of critical importance. In particular, the EU needs to play an active role in conflict resolution in the Caucasus. This includes active involvement in the Nagorno Karabagh negotiations, as well as the Turkish-Armenian rapprochement process. Resolving the Nagorno Karabagh conflict is essential for the feasibility of the Nabucco project. Given that a large part of the natural gas to be transported is expected to be of Azeri origin, Azerbaijan may be tempted to use energy as leverage in its relations with Turkey and the European Union. If there is no considerable progress in the Nagorno Karabagh question, Turkish-Armenian rapprochement could be interpreted as a sell-off of Azeri interests by Turkey and trigger commercial and diplomatic measures on behalf of Azerbaijan. This would not only have

negative effect on regional stability, it would also raise questions about the viability of the Nabucco project.

More attention should also be devoted to the political situation in Iraq. Supporting moderate forces and assisting the US disengagement should be coupled with mediation in Iraq's domestic disputes, such as the future of Kirkuk and control over hydrocarbon resources in northern Iraq. Making sure that Iraq does not recede into violence and instability is imperative for the fulfilment of the Iraqi commitment to supply half of Nabucco's transport capacity, which is in turn critical for the realisation of the project.

The revitalisation of EU-Turkey accession negotiations would also boost the chances of realising the Nabucco project. While the opposition of the current French President and the ambivalence of the German Chancellor could limit the leverage of EU officials, much can be done regarding the Cyprus issue. Intensifying efforts towards the resolution of this issue could help remove one of the biggest obstacles to the smooth conduct of Turkey's EU accession negotiations. It would also increase the bargaining power of European authorities on issues such as the ratification of the Energy Community Treaty by Turkey.

Last but not least, European authorities need to devise a new common energy strategy towards Russia based on mutual interest and interdependence. This would give European consumers a stronger voice in their negotiations with Europe's biggest natural gas supplier. By clarifying that the construction of the Nabucco and the South Stream are not necessarily mutually exclusive, European authorities could even – under certain conditions – allow Russia's participation in the Nabucco project. Promoting an international agreement on the legal status of the Caspian Sea would also not only advance regional peace and stability it would also facilitate access to natural gas resources east of the Caspian, thus promoting European energy security.