



TURKIC ENERGY SUPPLY AND EU DEMAND

Türk Enerji Arzı ve AB Talebi

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The European Union has been and continues to be heavily dependent on Russian gas imports, therefore, it warmly welcomed in the summer the decision by Azerbaijan to select the Trans-Adriatic Pipeline (TAP) to export gas from its Shah Deniz gas field to the EU.

ÖZET

Günümüzde Turki Devletlerin adı geçtiğinde akla ilk gelen enerji ve doğal kaynaklar olmaktadır. Özellikle enerji ithalatçısı durumunda olan ülkeler için Türk Dünyası gittikçe önem arz etmektedir. Dünyadaki en büyük enerji ithalatçılarından birisi olan Avrupa Birliği de Hazar havzası ve Orta Asya'daki enerji potansiyeline artan ilgi ile bakmaktadır. Enerji çeşitliliğini benimsemiş olan AB, Güney Koridor ve benzeri projelerin hayata geçmesini arzulamaktadır. Bu makalede AB'nin enerji ihtiyacı ve Türki Devletlerin Çin ile olan enerji diplomasisi incelenmektedir.

ABSTRACT

In today's world whenever one of the Turkic states is mentioned what first comes to mind is energy and their natural resources. For those countries who are energy importers the Turkic world is becoming ever more important. The European Union which is one of the world's largest importers of energy is increasingly looking with interest towards the energy potential of the Caspian basin and Central Asia. The EU having adopted energy diversification as a principle desires the implementation of projects such as the Southern Corridor. This article investigates the energy demand of the EU and the energy diplomacy between the Turkic States and China.

Keywords: *Energy, Turkic States, EU, China, Gas*

In international relations one tends to focus quite heavily on politics. Within this realm security is the first port of call for all states. After all, without survival no other goals can be attained. Having said this, it is also a truism that in the complex web of global relations, economics too plays a very important role. Within this key category, it is energy that rules as king. All other economic as well as strategic and political matters seem to revolve around it. This was quite clear to with the visit of the EU Special Representative for Central Asia to Turkmenistan in October, discussing with President Berdimuhamedov of prospects for future cooperation in the trade and energy sectors. Whilst the declared topic was energy and cooperation in related fields, the underlying theme concerned diversifying the European Union's energy sources. Quite naturally, related to this was the corollary of Turkmenistan seeking new and/or deepening export markets.

The European Union has been and continues to be heavily dependent on Russian gas imports, therefore, it warmly welcomed in the summer the decision by Azerbaijan to select the Trans-Adriatic Pipeline (TAP) to export gas from its Shah Deniz gas field to the EU.¹ The prospective capacity of this project, termed the "Southern Gas Corridor" is believed to be in the range of 10 bcm.² This might not sound as quite a lot on its own, especially so when compared to the total

EU consumption of 500 bcm, being in truth only a drop in the ocean in terms of percentage of gas for the southern corridor, as it relates to approximately 2% in terms of the EU's gas demand.³ Nevertheless, the southern corridor is important not due to the large quantities of gas transported, but increasing the energy security and adding to the diversification strategy of the EU.

According to the European Commission's office in Turkmenistan⁴ bilateral energy relations have been at the forefront, highlighted by the Memorandum of Understanding on Energy, signed in May 2008, which promotes the whole gamut of energy relations with regard to energy security as well as enhancing industrial development including the development of renewable energy sources.

Furthermore, the European Commission over the years through utilising the Development Cooperation Instrument, has reinforced its bilateral cooperation with Turkmenistan and supported the economic, social and institutional sector reforms announced by the host country. The EU has supported Turkmenistan in terms of national-level programmes to the tune of €22 million, for the 2007-2010 period and €31 million for the period 2011-2013.

Brussels has also become very interested in discussing and encouraging Turkmenistan to become part of the south-

ern corridor sometime in the future. Such a venture would entail greater amounts of gas being imported, consequently less having to be demanded from other suppliers such as Russia.

EU Option: Southern Corridor

So far, the southern corridor consists of Azeri gas being pumped through the Trans-Anatolian Pipeline (TANAP) through Turkey meeting the TAP on the Turkish-Greek border.⁵ Why this alternative gas import route offered by the southern corridor is important for the EU can best be understood due to three essential factors.

At first, it concerns the future gas requirements of the EU. According to British Petroleum, global energy is set to increase by up to 40% in the next two decades or so, of which 90% will take place in non-OECD countries such as China and India.⁶ Needless to say the EU is also part of the global increasing demand for energy. Despite the fact that most of Europe is still slowly recovering from the 2008 financial crisis, the IEA predicts that in the community as a whole gas could be demanded in increasing quantities by both consumers and businesses.⁷

Second, the European Union is concerned about its existing supply routes. At present the EU has three major gas import routes. The first runs from the north, from Norway. Second is the eastern gas route, which is imported from Russia. Third is the southern route which transports North African gas to mainland Europe. It is the latter two routes that raise concern in the corridors of power in Brussels.

The Northern Africa route is plagued with instability and uncertainty. The repercussions of the Arab Spring, the delicate political situation in Libya as well as the ongoing political stalemate in Egypt all lend themselves to making it very difficult to predict the future in terms of accessing gas steadily from North Africa.

As for importing from Russia, the EU continues to be involved in a lawsuit against Russian global energy giant Gazprom. Lithuania is one of a number of member states that is involved in legal disputes with Russia over the supply of energy, consistently accusing Gazprom of charging much higher prices for gas than other EU countries such as Germany. As Bryza and Tuohy have identified “In 2012, Gazprom flexed its monopolistic muscles by charging Lithuania \$497 per thousand cubic meters (tcm) of natural gas—over 15% higher than the \$431.30 it charged Germany, whose considerably greater distance from Russia’s border should result in a higher price to cover transportation costs.”⁸

In August, Lithuania approached Russia offering to end litigation and an investigation into management of a local energy company in which Gazprom has more than a third

of share, as well as dropping a €1.4bn claim in a Stockholm arbitration court concerning compensation for overcharged gas supplies since 2004.⁹ This offer was made conditional on reduced gas prices. The real bargaining chip, however, is Lithuania developing a floating liquefied natural gas platform in the Baltic Sea, which when it becomes operational next year will mean Russia losing its monopoly role as supplier of Lithuania’s gas.¹⁰

Other EU states from central Europe also have outstanding contracts with Gazprom which will need to be renegotiated when they mature¹¹. Not having any alternative sources - as Lithuania will in 2014 - makes them price takers and strengthens the hand of the gas provider.¹² Therefore, it is the addition of another dimension through the Caucasus to import energy to the EU which makes clear sense, as it diversifies its energy sources.

The third important factor that the European Union attaches to the southern corridor is the potential for it to create regional stability. It will certainly enhance Turkey’s role



as an energy hub, drawing it further closer to Europe as well as once more sending a clear message to Georgia and Azerbaijan that they are welcome in joining the western value system identified with open markets and liberal democracy.

A stable region on the borders of the EU is much desired given the difficult circumstances currently being witnessed in North Africa, especially in Libya and Egypt. If this is a by-product of energy policy it will certainly be considered a positive spillover onto the European Neighbourhood Policy in terms of ensuring its south-eastern neighbourhood contains democratically inclined free-market minded states.

Moreover, any increase in the security supply for Brussels means a corresponding less dependence on Russian gas, primarily through Ukraine, which coincidentally is once again on the agenda with regard to EU-Ukrainian relations with rumours circulating that a possible presidential pardon is in the offing concerning ex-prime minister Yulia Tymoshenko, which would certainly assure the signature of the Deep and Comprehensive Free Trade Area agreement.¹³



Kazakhstan and Turkmenistan

Just as it is clear that there is an increase in global demand for energy, it is equally clear from where this desire for energy will be met. Heading the list is Turkmenistan, which has begun gas production in its massive Galkynysh gas field near the border with Afghanistan as well as continuing to speedily construct its domestic East-West pipeline, fully funded by national coffers.¹⁴ When completed it will allow gas produced from most of its gas fields to be transported either East or West.

Furthermore, in the same vein Kazakhstan has recently begun to start oil production in its massive Kashagan field - considered to be the world's largest discovery in the last three decades or so - overcoming recent problems to continue pumping oil.¹⁵ Therefore, the eastern littoral states of the Caspian Sea look set to be the potential providers of energy that the EU currently requires and looks set to need more of in the future.

Gazing into a crystal ball, the EU would welcome Ashgabat participating in the southern corridor and 2015 may well be a very opportune moment for a decision to be taken one way or the other regarding this project, as at that time the domestic east west gas pipeline is expected to come into fruition.¹⁶ Nevertheless, the chances of a Trans-Caspian pipeline being successful face several hurdles, not least of which are the legal issues which continue to persist over the division of, as well as the increasing militarisation of the Caspian Sea.¹⁷

The Turkmen strategy so far has been very much a wait and see approach whereby deeds and actions are considered much more important and worthy than pure words. Once deeds match the promises, then getting a positive decision concerning participation in the southern corridor can be reasonably expected. It must be born in mind that Turkmenistan continues to hold steadfastly to its unique principle of permanent neutrality, therefore, for such an important strategic decision to be made only when plans have actually materialised, needs to be understood and interpreted in this light.

Ultimately decisions concerning pipelines are not simply about economics, but heavily involve politics too. The EU is very much aware of this which is why it is pursuing Turkmen energy with such vigour and perseverance in trying to

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court it to join the southern gas corridor. Given the fact that it faces fierce competition from the sub-continent, such a development would certainly be a feather in the cap of Brussels in terms of enhancing its energy security and diversifying energy suppliers.

Consequently, it seems highly likely that in the near future, Turkic states will export more of their energy resources west to the European Union. This of course does not mean that China and India will not be potential customers either. Especially, with regard to Turkmenistan the TAPI project is still one which is very much cherished by Ashgabat and given the fact that India's growth rate is increasing, a potential improvement in the security situation of Afghanistan next year will make this project much more likely to be implemented, with China also expressing an interest to participate in the project.¹⁸

China-Turkic States Energy Diplomacy

China is an unparalleled giant both in terms of energy and population. It became the world's largest energy consumer in 2009.¹⁹ Similar to the rest of the world it suffered from the 2008 financial crisis but the impact was minimal; only slowing down its growth rate.²⁰ In contrast, most countries in the European Union witnessed a contraction in their economies, with some enduring a double-dip recession.²¹ The Chinese economy buoyed by a huge trade balance, continues to steadily grow.²² This growth is, however, dependent on finding the energy resources to power more than a billion inhabitant's homes and workplaces.

It was twenty years ago when China became a net oil importer.²³ Before that it was able to meet its domestic energy demands through its own natural resources. With the tremendous economic growth spurt its energy demands have grown year-on-year. Due to this requirement, China has looked to have oil and gas producers to satisfy its needs. Quite naturally, neighbouring countries have been the first port of call. Given the fact that China shares a border with



Russia which possesses the world's largest natural gas reserves and is the second largest oil producer, energy relations with Moscow have been at a premium.²⁴

Another western neighbour, namely Kazakhstan has also featured prominently in Beijing's energy milieu. Kazakhstan's Central Asian neighbours have also attracted the attention of China, especially Turkmenistan which holds fourth place in terms of the world's largest natural gas reserves.²⁵ Since the ending of the Cold War, discussions, negotiations and finally agreements, have been made in terms of importing oil and gas from the Russian Far East as well as from the Turkic states of Central Asia. China has been more than willing to fund the infrastructural projects required to



physically transport the natural resources from the origin to Chinese territory.²⁶

Due to rising energy needs China has also either intentionally or due to necessity, looked to many other countries to import energy from. This policy of diversification has dampened down concerns relating to energy security. The past decade and a half has witnessed greater amounts of Middle Eastern oil being transported to China.²⁷ One of the fears in such an energy relationship has been qualms relating to the actual transportation of oil to Chinese ports. Whether China likes it or not it has been dependent, just like all other countries, on the effectiveness of the United States Navy in keeping the sea lanes open for all maritime transport.

China's interest in importing oil and gas from Turkmenistan and Kazakhstan has also made these two countries quite content as they are also able to diversify their export markets.

Kashagan Oil & Galkynysh Gas

The benefit of importing oil and gas from the Turkic states, however, is that there is no requirement to transport them through the sea, as they can all flow through newly constructed land-based pipelines. In order to maintain a steady supply and to look into increasing volumes, Chinese President Xi Jinping ventured into a long official tour of four Central Asian states last month with precisely these questions in mind.²⁸

The visit was intended to promote regional trade and security, but the primary item on the top of the agenda naturally concerned energy. China over the last two decades or so has been transforming its economic relationship with the region, consistently exporting more manufactured goods and importing increasing amounts of oil and gas in return.

President Xi began his tour in gas rich Turkmenistan, where more than a dozen agreements concerning bilateral cooperation was signed which has been termed by some observers as reaching a “new strategic level”.²⁹ The Chinese have been encouraged by and financially supported the Turkmen government in developing Galkynysh – the second largest gas field in the world.³⁰ The Turkmens welcomed the opportunity to export more gas eastwards and agreed to increase their gas delivery to China from the Galkynysh field by 25 bcm annually.³¹ This will be made possible through the construction of an upstream complex whose second stage should be finalised in five years' time.³² Once again financing for this project will come from the China Development Bank which has a record of generosity in offering low interest loans to build pipelines in particular. Primarily due to the energy relationship, Ashgabat has become China's biggest foreign supplier of natural gas, China has also become Turkmenistan's largest trade partner with trade turnover having crossed the \$10 billion threshold last year.³³

The second country to be visited was neighbouring Kazakhstan where almost two dozen agreements estimated to be worth \$30 billion was signed in agriculture transport, construction as well as the energy sectors.³⁴ The development that naturally attracted the most attention concerned the official agreement for the Chinese National Petroleum Corporation (CNPC) acquiring an 8.33% share in the Kasha-

gan offshore oil project for an estimated \$5 billion.³⁵ Incidentally, Kashagan is the largest oil field discovery the world has witnessed in the last half century.³⁶

US energy giant Conoco Phillips had announced last November its desire to release itself from the project and to sell its shares which India's Oil and National Gas Corporation (ONGC) had expressed interest in.³⁷ The Kazakh energy giant KazMunaiGaz preferred to partner itself with CNPC, thus it will be the Chinese who will finance half of the second development phase of Kashagan which is estimated to cost approximately \$3 billion after 2020.³⁸ Just days after the visit the oil facilities at Kashagan began to enter into production and despite some minor problems which were quickly resolved, production has continued according to schedule.³⁹

During the visit to Astana the Chinese President made a pledge towards working towards a "silk road economic belt" which would boost multilateral trade, encourage further investments and improve regional infrastructure, providing more interconnections.⁴⁰ Both countries were satisfied with the agreement to produce oil from the eastern Caspian oilfields and to transport them further east to China, which would naturally boost bilateral trade. In terms of trade, total turnover is closely reaching the level of \$25 billion and is forecast to reach an impressive 40 billion in the next two years.⁴¹

The third visit was to Uzbekistan where \$15 billion worth of contracts in the energy sectors were signed with both countries agreeing to extend the China-Kyrgyzstan-Uzbekistan pipeline all the way to the eastern gas fields of Turkmenistan.⁴² The Uzbek-China bilateral trade is not in the same range as Turkmenistan or Kazakhstan, having barely reached \$3 billion in 2012.⁴³ This year however, it has picked up considerably as it has almost reached last year's figures in the first six months of 2013 expected to reach nearly 4 billion dollars by the year's end.⁴⁴ Related to this, President Xi expressed his desire to increase bilateral trade to \$5 billion in the next four years, which is highly likely given the fact that China is already the largest foreign investor in Uzbekistan.⁴⁵

The fourth country visited was Kyrgyzstan, where the Chinese President attended the SCO summit held in the capital Bishkek. \$3 billion worth of investment agreements were signed between the two countries which focused primarily on healthcare, transportation and energy.⁴⁶ Given Kyrgyzstan's size the total trade turnover with China is less than \$1.5 billion a year, although it has increased to more than 2.2 billion for the first half of this year making Beijing, Bishkek's second largest trading partner.⁴⁷ On the side lines of the SCO summit President Xi met with the Tajik President where they agreed to construct a pipeline crossing Tajik territory for almost 400 km which will transport Turkmen

gas to China. The pipeline is intended to be completed in three years' time and will supply China with 25-30 bcm per year.⁴⁸

Turkic States as Energy Magnets

Through these bilateral agreements one can see that China considers Central Asia to be a much more preferred region from which to import energy. Given the fact that energy is centred on land-based supply, it becomes a preferred choice given the alternative of maritime transportation from the Middle East. Due to this important factor, some analysts predict that within the next 15 years or so Central Asia could provide up to a tenth of China's total energy requirements.⁴⁹

What the trip highlighted was that China prefers to be involved in the extraction dimension of natural resources as well as the purchasing side. Beijing has been interested and increasingly involved in participating in exploration and extraction, as well as funding the development of pipelines so that they can be connected to the wider national Chinese network. Therefore, the participation of CNPC into the Kashagan oilfield is a highly significant step given the fact that it is the largest oil field outside of the Middle East.⁵⁰

When evaluating the recent visit as well as the previous orientation of China toward Central Asia, it is clear to see that Beijing considers the Turkic states to provide an opportunity to increase its energy security through diversifying its energy imports. In this vein, it must also be recalled that Russia which is the biggest energy player in Eurasia ten years ago signed with China an agreement to initiate the East Siberian Pacific pipeline, run by the Russian oil pipeline monopoly Transneft, which declared in late July that it planned to boost the annual capacity by 80% in five years' time.⁵¹

China's interest in importing oil and gas from Turkmenistan and Kazakhstan has also made these two countries quite content as they are also able to diversify their export markets. In the immediate aftermath of their independence, most analysts believed that they had no alternative but to export to the West, primarily to the European Union through the old Soviet pipeline system. In fact that was what highlighted the first decade of their energy policy.

Today, however, given the fact that there is a major energy importer demanding more and more natural resources from the East, as well as the growing interest by the European Union in the West to acquire greater Caspian oil and gas; these are naturally very welcome developments for both Ashgabat and Astana. If energy prices remain high, and there is no evidence to counter this, then the near future promises higher rates of economic growth and greater standards of living for the Turkmens and Kazakhs.

Concluding Remarks

Energy is always at a premium when economic growth is occurring or forecast. Given that the global economy is predicted by the IMF to increase by 2.9% in 2013 and 3.6% in 2014, with positive signs of recovery in the euro area it is not surprising that the EU and other industrialised states are watching the energy markets very closely.⁵² In the Eurasian region it is the Turkic states that warrant greater attention due to their wealth of natural resources.

Table: 1 Turkic Energy

Central Asia is beginning to see a genuine move away from barter deals towards commercial deals in accordance with market forces.
Contrary to much perceived wisdom, in Central Asia it is Gazprom, Russia's natural gas export monopoly, that is leading the way in the movement towards market forces.
Central Asian natural gas and oil will to some extent be able to satisfy European demand, but available reserves and infrastructure will be insufficient to allow Central Asia to replace other gas and oil regions as primary suppliers to European markets.
Russian and Central Asian oil prices have already reached international levels, and the gas prices are moving in the direction of European levels.
However, transportation bottlenecks remain and infrastructure often remains insufficient for Central Asian gas, and to some extent oil, exports even to gain available market share in European markets. For exports elsewhere, such as to China or India, transportation bottlenecks still pose even greater problems.
Kazakhstan is expected to become a net exporter of natural gas in 2008 and is already an established oil exporter. Although crude oil has been very important to the country's economy, Kazakhstan must still import oil products for its own needs due to a lack of refinery capacity. Kazakhstan has since 2001-2002 quietly taken steps to reverse the large-scale privatisation of oil assets undertaken in the mid-1990s, and the Kazakhstani state is reasserting its dominant position versus the commercial actors.
Uzbekistan is self-sufficient in natural gas production but again needs to import oil. Even so, the country has great potential as an oil and natural gas exporter.
Turkmenistan already exports substantial volumes of both natural gas and oil. However, Turkmenistan has concluded so many agreements to export natural gas that the country will not be able to fulfil all export obligations.
Azerbaijan, in comparison, became a net exporter of natural gas in 2007 and is an established oil exporter. Crude oil has indeed been spectacularly important to the country's economy.

Source: Michael Fredholm, "The World of Central Asian Oil and Gas Power Politics, Market Forces, and Stealth Pipelines", Asian Cultures and Modernity Research Report No. 16, Stockholm University, December 2008, p.5

Beijing has been interested and increasingly involved in participating in exploration and extraction, as well as funding the development of pipelines so that they can be connected to the wider national Chinese network. Therefore, the participation of CNPC into the Kashagan oilfield is a highly significant step given the fact that it is the largest oil field outside of the Middle East.

Fredholm⁵³ (see Table: 1) has captured the essence of Turkic energy developments though should the Ayazli gas field located in the Black Sea, offshore Turkey discovered in 2004 be the precursor to other wells, more gas may be available both for Turkey and the EU, though the chances of this happening are negligible at present.

Given its close proximity India has sought to establish Central Asia as an important potential energy supplier. So far however, India has not been successful in bidding for Central Asian energy investments. Another factor which has been detrimental is that regional gas pipelines have made only very little progress due to both a lack of funding closely associated with regional security issues as well as difficulties arriving at a mutual acceptable price of gas.

China's growing demands for energy has focused its attention on both Central Asia and the Caucasus. Having already become an important player in Central Asian energy markets, Beijing has garnered attention with significant investments and rapid construction of new oil and gas pipelines. Of all the Turkic states, in terms of oil imports, it is Kazakhstan which promises to be a significant, though still a relatively small source for China, whereas in terms of gas, Turkmenistan stands to meet a large portion of Chinese demand.

Given the unpredictability of medium-term projections for supply and demand it would seem at first hand that China does not require pipeline gas imports beyond the volumes pledged by Turkmenistan, though there are uncertainties with regard to future supplies and demand which may well lead to Russian gas taking on board a leading role. If China is able to move towards a more coherent and market-

based regulatory system in terms of changing its complex and at times contradictory strata of administrative decrees and pricing formulas, then there will be a change in gas demand which could lead to importing greater amounts from Russia and the Caspian region.

All in all, it is not supply that is in question at the moment, but the levels of EU demand. According to the US Energy Information Administration (EIA), concerning precisely this issue “comparing 2013 to 2012 (through late September), natural gas imports from Russia to Western Europe are up more than 30%, while imports from Norway are down about 7%, according to Bentek Energy”⁵⁴. The EIA listed the following as key factors affecting gas prices and supply:

- Competition for LNG from Japan, China, and South Korea.
- Pricing structure indexed to oil.
- Norwegian gas production.
- Supply disruptions due to regional conflict in Algeria and Libya.
- Non-uniform pricing by Russian gas suppliers.

- Limited storage capacity availability, especially in northwest Europe.
- Coal price in Europe are affected by abundant supply due to favourably priced US exports of coal.
- Electric power sector changes following the Fukushima disaster and the retirement of nuclear power reactors, and environmental initiatives by the carbon price.

Bearing all of these in mind one arrives at several conclusions. The Turkic states have abundant supplies of natural sources. Economically developing states such as China and India are eager for greater imports to keep their growth rates on track. The EU demand for energy, in particular gas is affected by a multitude of factors and whilst it is recovering, albeit slowly, from the after effects of the 2008 financial global crisis, it is definitely looking set to diversify its energy sources and routes. In this respect, Azerbaijan, Kazakhstan and Turkmenistan become important players in providing energy and Turkey can become an important energy hub in terms of transporting these resources to the west.



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