

THE BLACK SEA AS AN ENERGY TRANSIT CORRIDOR

Due to the market condition of energy resources, we are experiencing heightened competition globally. The reserves of the Caspian region and Russia render the Black Sea an important pasageway. However shipment of oil through the straits with tankers has proven dangerous and projects to bypass them are ongoing. On the other hand additional potential projects are still evolving. At this particular juncture in time, Russia is a critical player in the picture and competition between Russia and the U.S. regarding how future transportation routes will take shape continues.

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Markets for oil and natural gas have been subject to a degree of strain over the past year not experienced for a generation. Increased demand and the decreasing of net additional production capacity of oil have resulted in the absorbing of a significant amount of the slack in energy markets. There is mounting evidence that by 2008 the world oil market may suffer a structural supply deficit.

Geographical concentration of world oil and gas proven reserves in geopolitically uncertain regions – the Middle East, West Africa, South America - combined with increasing efforts by the Russian Government to manipulate its energy companies for its foreign policy ambitions (exemplified by the Russian-Ukrainian gas row and the threat to gas supplies for Europe) makes the Black Sea region of high importance to Europe and the world.

The Black Sea, due to its geographical location is a natural route between two major oil and gas supply regions- Russia and the Caspian, and large markets like Turkey, Europe and the Mediterranean.

The Caspian region is one of the great potential reserves of oil and gas, not as much so as the Middle East, but comparable to North Sea reserves. With Russia's proven oil reserves of 60 billion barrels and the worlds largest natural gas reserves that amount to 1,680 trillion cubic feet,¹ it is not difficult to grasp the country's key importance to the world energy markets. For instance, Russia is the largest oil supplier in the world, with a production of 9.63 million b/d as opposed to Saudi Arabia at 9.52 million b/d, and is the largest gas supplier with a daily output of 1.84 billion cubic meters.

Current Russian and Caspian oil exports via Black Sea ports total nearly 2.0 million b/d. Most of this cargo is shipped via the Turkish Straits. Only a small fraction of these volumes are offloaded in Black Sea ports. The historic Bosphorus – the connection between two continents – is gradually becoming a jammed traffic route. Due to safety and pollution concerns, Turkey has been struggling to reduce traffic through sensitive passages. In response to rising volumes and growing accidents rates, in 2002 the Turkish Government passed legislation to restrict shipments through the straits. Turkey limited the size of tankers passing the Bosphorus and Dardanelles to 200 meters and 250 meters respectively, and also prohibited loaded oil tankers from passing through straits at night and in other instances when visibility is obscured. Although according to the Montreux Convention, in peacetime merchant ships have the right of free passage through the straits, Turkey restricted traffic arguing that it threatens the environment and the health of the several million people living in the area. The consequences of the new legislation were considerable delays to tankers. Therefore Russia's Prime Minister Mikhail Kasyanov accused Turkey of taking harmful unilateral steps

¹ Russia Energy Survey 2002, p.111, <http://www.eia.doe.gov/>

and not talking with other states that are affected by such legislation. Also international oil companies investing in the oil industry in Russia and the Caspian region argued such restrictions harmed their development.

To bypass the overcrowded Bosphorus various large scale projects were developed by the countries involved and the international oil companies investing in the region.

The efforts to bypass the Bosphorus are apparently taking shape with the so called "Main Export Pipeline" for AIOC's (Azerbaijan International Operating Company) Azeri Oil - in other words the BTC pipeline (Baku-Tbilisi-Ceyhan). AIOC's partners in the project are BP, Chevron, the State Oil Company of Azerbaijan (SOCAR), Inpex, Statoil, ExxonMobil, TPAO, Devon, ITOCHU and Amerada Hess. This pipeline will facilitate exporting crude from the Caspian region without using the Bosphorus. The U.S. is setting hopes high for the BTC pipeline, although even at total capacity BTC would only represent around 10 percent of the U.S.'s crude imports. Reportedly, Kazakhstan is also interested in joining the BTC. The 1,762 km pipeline spanning three countries, including Azerbaijan, Georgia and Turkey will be capable of transporting 1 million b/d of crude when fully operational. However, in the initial phase, the pipeline will flow at a rate of 300,000 b/d by the end of 2006. The start-up of the pipeline was delayed several times, apparently because of environmental protection concerns and the implementation of social programs for the people living along the route. The cost of the construction has totaled more than 4 billion dollars. The official inauguration ceremony is planned for July 13th, 2006.

With the green light given in May 2006 to another project across Turkey (Samsun-Ceyhan), has taken a further step towards boosting its status as an energy hub. Turkey's Çalık Energy and the Italian state company ENI will conduct further studies over the next six months on the proposed construction of a pipeline between Samsun on Turkey's Black Sea coast and Ceyhan on the country's Mediterranean shores. The decree nominating Çalık Energy to build the pipeline was agreed on April 26 by the Turkish Cabinet, and was later that day ratified by Turkish President Ahmet Necdet Sezer. The pipeline is intended to transport both Russian and Caspian oil to European, Mediterranean and Asian markets, while further reducing traffic on the straits of the Bosphorus and Dardanelles. The Samsun-Ceyhan pipeline is thus seen as a favorable alternative that will offer some respite to the bottleneck occurring on the waterway. With a projected capacity of around 1.2 million b/d the Samsun-Ceyhan project has many advantages. Samsun is the nearest Turkish port to Russia's major Black Sea port of Novorossiisk while Ceyhan has all the necessary infrastructure and is deep enough to accommodate the largest tankers. Turkey's ambitions of Ceyhan becoming a key global oil facility are also looking closer to realization with the latest approval of the ENI-Çalık co-operation. Yet questions remain over Russia's willingness

to play along with the new route. At an energy conference held in Samsun in November 2005, Russian President Vladimir Putin was not exactly warm to the idea of the pipeline.²

Alternatively, Russia is looking into other projects that might transport its oil to European markets. The two other options most often referred to are the TransBalkan and Burgas-Alexandroupolis pipelines. The first project would cross to the Adriatic Sea through Bulgaria, Macedonia and Albania. The other would cross to the Aegean via Bulgaria and Greece. An earlier idea to construct a pipeline across Turkish Thrace to the Aegean Gulf of Saros has largely been abandoned. The Samsun-Ceyhan pipeline project will, if realized, increase Turkey's standing as an important oil transit route, yet there is still some way to go, with the cost likely to be a key factor in deciding which of the various routes which will eventually be chosen - although geopolitical influences should not be forgotten.

The Samsun-Ceyhan pipeline has an advantage over the trans-Balkan plan, in that it limits the number of countries involved in transit arrangements to just one and takes advantage of existing port and pipeline infrastructures. Yet the route is longer and the eventual destination further from European markets - although closer to the growing markets of the east.

Although the Russian government welcomes and fully supports the trans-Balkan idea it is doubtful that the pipeline would be filled with enough oil for the project to be operationally feasible. Some question marks still prevail over the possible expansion of the CPC (Caspian Pipeline Consortium) pipeline by the end of decade. Despite the fact that Kazakhstan's president Nursultan Nazarbayev announced in mid-April that the Russian government had finally agreed to the expansion of the link from the Tengiz field in Kazakhstan to the Black Sea port of Novorossiisk, some doubts about a potential boost from the current 643,000 to 1.35 million b/d remain, due to Russian President Vladimir Putin reluctance to comment on the issue. After the president of the Russian pipeline state monopoly Semyon Vainshtok linked the expansion of the CPC pipeline to the construction of the Burgas-Alexandroupolis pipeline, Rosneft also stressed that it would only support expansion of the project if the construction of a new route connecting Bulgaria and Greece was to take place. For the latter, the Russian government has named TNK-BP, Rosneft and Sibneft as possible participants. In late April, Chevron and KazMunaiGaz allegedly also expressed their interest in the project. The pipeline's initial capacity is estimated at 700,000 -800,000 b/d, which would then increase to 1.2 million b/d, even though until now no timeframe has been given for the project's completion.

In addition, a pipeline from the Black Sea port of Odessa to the city of Brody, near the Polish border was planned to transport crude to the European markets

² Kadir Dikbafi "Samsun-Ceyhan Pipeline" *Zaman*, 6 June 2006

without using the Bosphorus and Dardanelles straits. However, after standing idle for three years the route was reversed in 2004 and since then was used by Russian oil companies to transport Russian crude to the Black Sea. Some progress has been made on Romania's Constanta-Trieste Pipeline (CTPL). The CTPL would run from Constanta through Romania, Hungary and Slovenia to Trieste. There it would be linked to the Trans-Alpine line (TAL). A U.S.-financed study found that the line could be commercially feasible. Similar in concept is ENI's South East European Line (SEEL). The SEEL would follow a similar route, but also pass through Croatia. An alternative variant of SEEL would reverse the existing Adria pipeline, which is connecting Omisalj terminal to Sisak refinery (Croatia) and the Serbian refineries at Novi Sad and Panchevo.

Unlike oil, remote natural gas-such as that in Russia and the Caspian region- is traded under long-term (20 years or more) contracts using fixed, purpose-built infrastructure (pipelines, LNG export terminals, and degasification plants). Hence, trade configurations depend on existing and future infrastructure which in turn, will only be built if commercially feasible.

Currently all Black Sea countries import Russian gas through the following existing infrastructure:

- Along the western Black Sea shore across Ukraine, Moldova, Romania and Bulgaria to both Greece and Turkey. The system has capacity of 10.5 bcm/year.
- Across the Caucasus mountains into Georgia, Azerbaijan and Armenia.
- The blue stream pipeline. The pipeline consists of three sections. Russia's land section is 373 km long. Russia's marine sector is 396 km long and Turkey's land section is 444 km long. The pipeline has a designed capacity of 16 bcm/year.

In the longer term, Turkey could play an important role in the transit of gas from massive reserves in the Middle East and Caspian region to the energy consuming nations of Europe. Studies have been undertaken, with EU support, to look at the feasibility of extending the Turkish natural gas system to Greece, thus forming part of a Southern European ring.

There are several large scale projects for which financing, technical and other issues are yet to be resolved.

- The Nabucco pipeline project is a proposed pipeline planned to transport natural gas from Turkey to Austria, via Bulgaria, Romania and Hungary. Construction of the 3,300-kilometer pipeline is expected to begin in 2008 and is planned to be finished by 2011. The construction work, estimated to cost 5 billion dollars, is to be shared between the five gas companies in each of the countries. The company leading the project is OMV from Austria. Once completed, it would allow transportation of natural gas from producers in the Middle East and Caspian

region such as Iran, Azerbaijan and Turkmenistan to Western Europe and to the countries along its path. The western end of the pipeline will be Baumgarten an der March, a major natural gas hub in Austria. The transport capacity of the pipeline will reach up to 30 billion cubic meters per year in the long term.

The Trans-Caspian pipeline project, to carry Turkmen gas under the Caspian Sea and via Azerbaijan and Georgia into eastern Turkey was introduced in 1991 by Turkey and Turkmenistan. The project was given full support by the governments of Turkey, Azerbaijan, Georgia and Turkmenistan at the December 1999 OSCE summit in Istanbul. The U.S. has also backed the project as a part of an energy corridor, bypassing Iran and Russia. A mandate to lead the project was given to a Pipeline Solution Group (PSG) formed by Bechtel and General Electric by Turkmenistan. This was heavily opposed by Iran and Russia, who again raised the issue of the Caspian Sea³, and although an Agreement between Turkey and Turkmenistan was ratified by their respective governments, the U.S. backed plan collapsed. The mandate given to PSG was not renewed.

- The South Caucasus Pipeline (SCP) was designed to transport gas from the Shah Deniz field in the Azerbaijani sector of the Caspian Sea, through Georgia to the Georgia-Turkey border. The 692 km pipeline is due to finish in September 2006. At full capacity the pipeline would carry up to 16 bcm/year. At the border the pipeline links up to the Turkish built extension joining SCT to the domestic supply grid at Erzurum. SCP is constructed in the same corridor as the BTC pipeline.

With the BTC pipeline now on stream and crude oil flowing into the Mediterranean, interest by Central Asian countries to participate in pipeline projects following this route has grown. With existing infrastructure locking their export route only to Russia, the Central Asian countries will have to overcome Russian and Iranian opposition to the Trans-Caspian Pipeline project. With Russia's and Iran's interest taken into account, it could be possible to solve the legal status of the Caspian Sea and pursue the project.

The challenge of transporting resources from the landlocked Central Asian countries to international markets will remain high on the agenda for the foreseeable future. The completion of BTC can be regarded as a partial success for the U.S., as the countries Azeri Crude flows through are those that are considered to be under U.S. political influence. However the question remains as to whether the U.S. will be successful in linking Kazakh and Turkmen oil and gas to the BTC

³ The debate over the Caspian's legal status remains complicated. The main problem is whether it should be treated as a lake or a sea. Depending on this, the shares of the sea's substantial reserves, including oil, natural gas and fish, will be divided among the littoral states differently. If the status of lake is decided on, the five littoral countries (Russia, Iran, Azerbaijan, Turkmenistan and Kazakhstan) would jointly exploit the resources i.e. each country would receive one-fifth of the reserves. This is an option which Iran and Turkmenistan have been pushing for. Throughout the 1990s Russia also took this position, however it now calls for the Caspian to be defined as a sea, which means it would have to be divided into exclusive national sectors using the median-line principle, resulting in smaller shares for Iran and Turkmenistan.

pipeline. In this sense the U.S. is competing with Russia. Russia currently controls the exports of these two countries resources as they are dependant on the ex-Soviet export infrastructures.

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