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The EU's Quest for Energy Diversification: Limitations of the Southern Gas Corridor

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Executive Summary

In light of this year's Russian aggression and its invasion of Ukraine, the European Commission is now focusing on major alternative energy suppliers, one of them being Azerbaijan, whose reserves are estimated to be capable of replacing 4-5% of Europe's overall gas imports (Muradov 2022). Given Europe's acute need to diversify supplies in order to de-escalate its growing dependence on Russian gas, the Southern Gas Corridor (SGC) initiative[2] is now back in focus and is being widely and publicly discussed.

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[2] SGC (the Southern Gas Corridor) is a large-scale infrastructure project that incorporates one of the world's longest international natural gas pipelines - it brings gas from the Caspian Sea to markets in Europe and is one of the most significant demonstrations of international cooperation in terms of energy supply and diversification. The SGC comprises the Shah Deniz natural gas-condensate field and a 3,500 km pipeline of three sections connecting Azerbaijan with Italy: 1) The South Caucasus Pipeline (SCP), which feeds from Shah Deniz gas field in the Caspian Sea, crossing Azerbaijan and Georgia; 2) The Trans-Anatolian Natural Gas Pipeline (TANAP), the longest section of SGC, with a length of 1811 kilometers, running across Turkey and transiting 20 Turkish Provinces; and finally 3) the Trans-Adriatic Pipeline (TAP) that passes through Europe, arriving at its final destination in Italy (Southern Gas Corridor n.d., TANAP n.d.)

However, the SGC hardly has the potential to fully secure the European Union's (EU)'s energy supply considering the limited Shah Deniz gas field capacity,[3] coupled with international observers' concerns regarding Azerbaijan's political regime. As a recent speech by the European Commission's president, Ursula von der Leyen, has revealed, the EU reached 90% of its gas storage capacity as of October 2022 and has been replacing the drastically reduced supply of Russian gas by relying more on other partners, such as Norway and the United States (European Commission 2022). Importantly, no particular emphasis was put on Azerbaijan in this context, indicating that the EU is indeed aware of the limitations of the SGC. What is more, the current energy standoff has been further exacerbated by Europe imposing sanctions on Russia, unprecedented in their number and range, for its war in Ukraine. As a result, at the beginning of September the state-owned Russian energy corporation, Gazprom, announced the shut-down of the Nord Stream 1 pipeline, and the Kremlin made this official by saying the closure will be for an indefinite period (BBC News 2022; Pavlova and Cooban 2022), leaving Europe on the brink of an energy crisis. In detail, since mid-August natural gas prices have risen more than seven times, reaching the record high of $3100 per 1000 cubic meters, while electricity price levels have risen four times (The Economist 2022). Meanwhile, European families are bearing the brunt of the energy price shocks, facing one of their coldest and most expensive winters.

This policy brief attempts to answer the following research questions – *what are the limitations of the Southern Gas Corridor, and to what extent does Azerbaijan contribute to fulfilling the European Union's goal of energy diversification?* – and looks into the European Energy Strategy, Azerbaijan's political environment and its implications for the regional dynamics of the South Caucasus, encompassing its relationship with Armenia and the benefits Georgia reaps as a transit country. Finally, after identifying the challenges and limitations of the SGC initiative and its future potential, the policy brief gives recommendations to the main stakeholders: the EU, Azerbaijan and Georgia.

Keywords: *Azerbaijan, Georgia, European Union, Energy, Southern Gas Corridor*

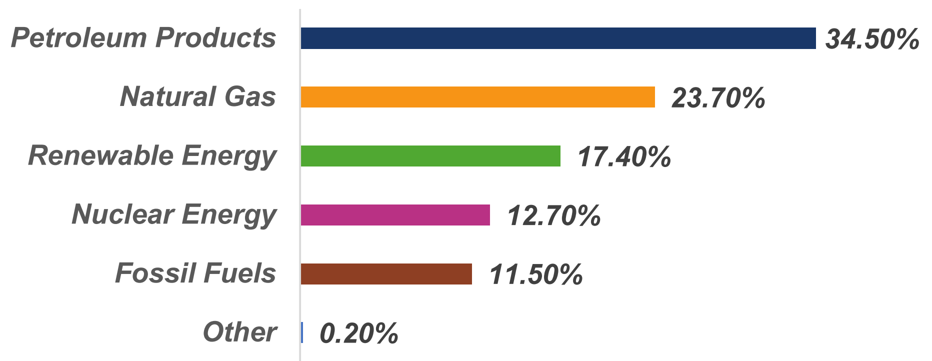
[3] Azerbaijan's natural gas production amounted to only 31.8 billion cubic meters in 2021 and much less than Europe's other bigger gas suppliers - such as the United States (934.2 billion cubic meters), Russia (701.7 billion cubic meters) and Norway (114.3 billion cubic meters). However, as of 2021, Azerbaijan's annual growth rate for gas production (23.3%) is much higher than that of the United States (2.3%), Russia (10.4%) and Norway (2.8%) (bp 2022).

Introduction: The Evolution to This Day of European Energy Strategy

Europe has always stressed the need for a consistent and ample supply of energy for its economy and security, as emphasised in the European Energy Security Strategy document (European Commission 2014). Competitive, sustainable and secure energy supply is also one of the five pillars of the European Commission's Energy Union Strategy, proposed in February 2015 and aiming at fundamentally transforming the continent's energy supply (the European Council and the Council of the EU 2020). Not surprisingly, due to Europe's systematic and long-term policy throughout the last few decades, most EU Member States have had no severe disruption in their energy supplies since the 1970s oil crisis.

Moreover, in line with the European Green Deal – the EU's green transition agenda and an ambitious multi-sectoral policy document – the EU has been putting a lot of effort into seeking to diversify its energy mix and reaching ambitious net-zero future goals. In fact, European businesses and industries have achieved significant successes in this regard and have already reduced emissions by over 35% over the last 15 years (Business Europe 2021). However, despite Europe's vigorous attempts to decarbonise its economy, it is still greatly dependent on fossil fuels - such as petroleum-based energy from local sources - and most importantly, on imported natural gas. The latter carries enormous political weight, given that the current energy crisis is not only a European phenomenon, but global, shaping countries' foreign policies. (see *Figure 1*)

***Figure 1**. EU 's Energy mix*



***Source:** Eurostat*

Until recently, Russia enjoyed the position as Europe's primary supplier of natural gas and oil. In 2020 on average 29% of Europe's crude oil imports came from Russia (Eurostat n.d.), while in the first quarter of 2022 the EU imported almost 60% of its natural gas supply through the Nord Stream 1 pipeline (Statista 2022). These figures, however, have since plummetted dramatically, and in the span of the last three months imports of Russian gas have dropped from 1.2 billion a week to reach 62 million cubic meters at the beginning of September 2022 (ibid.). However, these drastic changes are negatively correlated with Azerbaijani gas exports to Europe, which are expected to double as per the new deal between the two parties and to bring additional benefits to Georgia as a transit country in the SGC initiative.

Is the Southern Gas Corridor Enough? Identifying Challenges and Looking into the Future

The SGC initiative, first introduced in 2008, allows Europe to diversify its Russian energy supply with gas obtained via supply routes from the Caspian region to some extent, rendering Europe less dependent on Russia. The 8th Ministerial Meeting of the Southern Gas Corridor Advisory Council in Baku on 4 February 2022, demonstrated the willingness of the EU and Azerbaijan to form a bilateral strategic energy partnership and ensure a secure energy supply to Europe. This led to the signing in Baku on 18 July 2022 of a new Memorandum of Understanding for a Strategic Partnership in the Field of Energy (European Commission 2022). According to the new agreement, the Commission commits to doubling its gas imports through the SGC by 2027. Azerbaijan has already increased its transfers over the last year from the Shah Deniz gas field to Europe by 48% and is expected to export at least 20 billion cubic meters of natural gas in the next five years, which amounts to a 147% increase compared to 2021 (ibid.). However, even though these figures look impressive, in absolute numbers they are still not comparable to Europe's imports from other larger energy suppliers, such as the US or Norway; Moreover, the EU's total natural gas consumption amounted in 2021 to 397 billion cubic meters (Statista 2022) – an amount than cannot possibly be met by Azerbaijani gas alone.

In the wider context, the SGC, whose construction took seven years and which became fully operational at the end of 2020 (BP 2021), has substantial political and economic implications and directly impacts Georgia as a transit country. It is estimated to be transporting 7.41 billion cubic metres of natural gas every year which it carries from the Shah Deniz field to the Turkish-

Georgian border through 249 km of its territory (Southern Gas Corridor n.d.). Furthermore, Georgia has received approximately $2 billion worth of capital investment since 2013 during the pipeline's construction, 20% of which was spent on procuring goods and services from local suppliers, and more than 2000 jobs were created for the local population (BP Georgia 2022). In addition, according to the Host Government Agreement, Georgia receives 5% of the volume of transit gas carried through the SCPX (Caucasus Pipeline Expansion) pipeline, which contributes to its energy security (ibid.).

The new EU-Azerbaijan deal affects South Caucasus political dynamics in other ways as well, and while it contributes to deepening the Georgian-Azerbaijani partnership, it potentially puts an additional burden on the already strained relationship between Armenia and Azerbaijan. Namely, the July 18 agreement has been highly criticised in Armenia, and certain experts have accused EU officials of exhibiting double standards. The EU did not adopt the same approach of denouncing gas imports (that were used allegedly to fund the Karabakh war in 2020) as they did in the case of Russia, whose income from gas exports has been invested in military action against Ukraine (CIVILNET 2022).

Furthermore, while Commission President von der Leyen describes Azerbaijan as "a very reliable and prominent renewable energy partner to the European Union" (European Commission 2022), other observers have raised the issues of human rights concerns and consider Azerbaijan barely different fundamentally from Russia in this area. Freedom House categorises Azerbaijan as a consolidated authoritarian regime ruled by its president, Ilham Aliyev, and his family for almost 19 years. According to various freedom reports, the country is rated worldwide as unfree on multiple components, such as political rights and civil liberties, and has been given a Democracy Percentage rating of only one out of 100 in Freedom House's report "Freedom in the World", rendering Azerbaijan the least democratic among nations in transition (Freedom House 2022, 22). It may be assumed that in different circumstances from those of today, when pursuing energy diversification and relying on the SGC, the EU might, before deepening its partnership with Azerbaijan, have subjected the country to conditionality. It might have also demanded the release of the high number of political prisoners or improvements in democracy and human rights more generally. Apparent lack of concern on these issues may suggest how limited Europe is in its choice of energy suppliers. There is a precedent in that, despite Russia's long history of human rights violations, it continued to export gas to the EU without any disruptions before breaching the principles of international law and waging an illegal war in Ukraine.

Finally, as emphasised previously, Europe is striving to diversify its energy mix and end its dependency on Russian gas, increasing its resources by storing gas from alternative suppliers. However, it remains questionable if the SGC could be the sole alternative as Azerbaijan's current export capacity is too low. This needs to be combined with other sources of natural gas, or significant mid-term investments must be made to increase its capacity, to ensure for Europe a sufficient and stable supply of gas. For comparison, the now-suspended Nord Stream 2 pipeline was envisioned to be able to provide 110 billion cubic meters of gas for Europe, double what the original Nord Stream 1 pipeline from Russia was able to supply (Congressional Research Service 2022). At the same time, TANAP's actual annual natural gas transmission capacity is 16 billion cubic meters, six billion of which Turkey consumes, while the remaining ten billion cubic meters are transported to Europe through TAP (NS Energy n.d.). However, Azerbaijan is currently actively involved in triparty swap deals with Iran and Turkmenistan and, as per the 1 January 2022 agreement, is entitled to receive two billion cubic meters of natural gas annually to meet its growing export demand and its own gas consumption needs (Business Turkmenistan 2022). Therefore, it is doubtful that Azerbaijan is relying solely on the supply from the Shah Deniz gas field. Thus, it could be argued that the SGC cannot be relied on as a replacement for Nord Stream gas for Europe without considering alternative gas suppliers, such as Norway or the United States.

Conclusion and Recommendations

The Southern Gas Corridor has been the subject of academic research since its proposal in 2008 which focuses on its potential, the challenges on the roadmap to it becoming a reliable source of gas for European countries, and on its future outlook, especially in view of the current energy crisis. Thus, the recent geopolitical developments in Europe and the South Caucasus region put the SGC under a new spotlight. So, this policy brief attempts to discuss its renewed significance given Russia's military aggression against Ukraine, and the signing of the new Memorandum of Understating between the EU and Azerbaijan. The main findings suggest that, despite its limitations in terms of capacity, the SGC project still has significant implications for South Caucasus' political and economic dynamics. Namely, on the one hand the SGC contributes to deepening Azerbaijan's future relations with the EU and benefits Georgia as a transit country. On the other hand, it raises suspicions that the EU has double standards in its foreign policy regarding its energy diversification strategy and this exacerbates the Armenia-Azerbaijan conflict.

Finally, based on the analysis given above on the potential of the SGC and the associated challenges, this policy brief proposes the following recommendations to the relevant stakeholders:

***To the government of Azerbaijan*:**

- Seize the opportunity brought by the new EU-Azerbaijan gas deal and work towards enhancing bilateral relations with Europe, potentially signing the Association Agreement (AA) and Free Trade Agreement (FTA) in the nearest future in order to gain from the numerous benefits of close economic and political cooperation from European integration;

- As a Member of the Council of Europe, strive towards achieving an approximation in national legislation to EU law, with a special emphasis on protecting fundamental human rights and preserving and promoting democracy and the rule of law, with the incentive of influencing EU initiation of AA negotiations.

To the Government of Georgia:

- Reinforce its position as a transit partner country in the SGC project and work with other partners, such as Azerbaijan and Turkey, to invest in research and infrastructure with the aim of enhancing the capacity of the pipeline to its full extent - the more gas transited through Georgian territory, the more energy security and income for the country;

- Reaffirm partnership and cooperation with Azerbaijan and Turkey as a strong actor in the SGC project and other political and economic matters that drive regional dynamics, with the ambition of becoming an EU candidate country in the nearest future.

To the European Commission:

- Maintain a consistent foreign policy and adopt the same conditionality, in line with EU values, towards partner countries, even while making rigorous efforts to move away from Russian gas;

- Appraise Azerbaijan's low democracy score, lack of freedom and the high number of political detainees, and make future steps on the Memorandum of Understanding conditional on the Azerbaijani authorities' adequate response to human rights activists' concerns. Otherwise, reconsider any deepening of future economic and political relations with Azerbaijan.

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List of Abbreviations

AA	Association Agreement
EU	European Union
EC	European Commission
FTA	Free Trade Agreement
SCP	South Caucasus Pipeline
SCPX	Caucasus Pipeline Expansion
SGC	Southern Gas Corridor
TANAP	Trans-Anatolian Natural Gas Pipeline Project
TAP	Trans-Adriatic Pipeline

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