
Global Energy Facing Military Risks

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The active US and EU diplomacy in the Caspian region, which is mainly aimed to lessen Russia's influence by constructing a maximal number of pipelines bypassing its territory, has long ignored the security dimension of the corresponding projects. Recently the risks surfaced when Georgia's invasion of South Ossetia threatened to disrupt oil and gas supplies via the Transcaucasia. The military conflict affected the energy landscape in the entire Caspian region and - indirectly - the global oil price dynamics. On August 12, all oil and gas pipelines traversing Georgia shut down operations due to security concerns. The view upheld by Russian media is that the situation reflects the tremendous risks entailed by the efforts of Washington and Brussels to construct alternative fuel transit routes circumventing Russia.

Georgia has gained greater importance in the oil and gas transit, especially to Europe, over the past 5-10 years. Besides, it is regarded as a potential avenue in the framework of several projects of oil and gas transit from Central Asia to the global markets, including those of the Black Sea countries. However, Georgia's aggression rendered oil and gas transit via the Transcaucasia highly problematic. Currently, analysts estimate the potential disruptions at approximately 1.6 bn barrels of oil equivalent daily.

Already in the morning of August 11, the price of September futures for WTI oil at the New York Electronic Mercantile Exchange rose to \$116.9 per barrel, \$1.7 beyond the August 8 closing mark. Driven by concerns stemming from the hostilities in South Ossetia, the prices of September Brent futures in London and WTI futures in New York New reached \$112.18 and \$114.8 respectively.

Oil importers say the supply process has been seriously affected. In particular, gas supplies from Russia to Armenia via Georgia have been 30% below target. Exporters are complaining that it became impossible to fulfill contracts and starting to eye alternative markets and routes. Kazakh companies are looking towards the domestic market and Azerbaijan is reorienting its export to the Baku-Novorossiysk pipeline. Momentarily, Georgia became a risky transiter and left other countries contemplating alternatives.

Somehow, the war in South Ossetia has overshadowed another event of great significance in the context. Two days prior to the outbreak of the conflict, fire halted the oil flow on the Turkish section of the Baku-Tbilisi-Ceyhan pipeline. Responsibility was claimed by the Kurdish rebels. The fire took a whole week to extinguish and the oil transit still has not been restored. BP declared a force majeure, thus freeing itself of contractual obligations to deliver crude. On August 12, BP closed the pipeline across Georgia used to transit oil from Azerbaijan to Turkey. At the same time, BP stopped supplying oil via the Baku-Supsa pipeline which comprises a segment located in Georgia and links Azerbaijan to the Georgian coast of the Black Sea.

Even though Russian warplanes never attacked pipelines and the conflict could only tell on marine routes, the reaction of oil exporters was immediate and far-reaching. The State Oil Company of Azerbaijan Republic (SOCAR) suspended export via Georgian seaports and declared that its personnel from the Kulevi terminal would be evacuated. Subsequently the same course of action was taken by Kazakhstan.

Somewhat later than Baku, Astana said it would not export crude via the Batumi seaport. Now Kazakhstan is looking into the possibility of increasing export to China and Russia, and Azerbaijan intends to channel greater volumes via the Baku-Novorossiysk pipeline. SOCAR has already submitted a request to Russia's Transneft to provide greater capacities at the pipeline.

SOCAR Vice President M. Barkov said the company asked to additionally pipe 83,000 tons of oil a month (a total of 166,000 tons).

The impression is that the extraordinary circumstances at the transit routes were not an unexpected development for the oil companies. In any case, the experience of the past several days will make the countries of the region assess with greater care the risks inherent in new transit infrastructure projects and will instill a stronger sense of loyalty to the already existing routes passing across Russia.

The Azerbaijani export dip is not projected to exceed 0.5-1% of the global demand and consequently the disruptions are not going to influence global oil prices to a considerable extent. Nevertheless, as it is stated in a report circulated by the Troika Dialog investment company, the conflict is likely to make companies involved in international oil and gas pipeline projects focus on the risks of transit across Georgia.

The fact that now Azerbaijan is open to new oil export options and transit routes worries Poland, which seeks to alleviate its dependency on fuel supplies from Russia. Warsaw planned to import oil via the Odessa-Brody-Gdansk-Plock pipeline. Most of the workload for it was to be provided by Azerbaijan, but the country is already forced to shift routes as a result of the war.

The conflict can also have an adverse impact on the gas sector. Gas from Azerbaijan is supplied to Turkey across Georgia via the Baku-Tbilisi-Erzurum pipeline which has the potential to transit 30 bn cu km of natural gas annually but currently operates below the planned capacity. Now that the pipeline is not functioning, Baku is likely to appreciate Gazprom's offer to buy all of Azerbaijan's export gas at the global price.

Considering the cost of gas transit to Europe via Turkey in the framework of the pipeline projects which have not been completed but have continuously swelling budgets, competing with Gazprom is clearly going to be an uphill task. In any case, the risks of gas transit bypassing Russia are growing, and the situation around the transit via Georgia is the prime manifestation of the tendency.

At the same time, exotic undertakings like the White Stream project invented by the team of Ukrainian Prime Minister Yu. Tymoshenko finally seem dead.

The idea was to construct a pipeline across the seabed and via Azerbaijan to link Turkmenistan and the Supsa seaport in Georgia, plus a pipeline across the Black seabed and via the Crimea to the EU. The Kyiv dreamers even planned White Stream-2 and White Stream-3, but now the only risk-free route is the one across Russia, and locations like Supsa or even the Crimea need not even be discussed.

It must be understood that it is not the Russian army who is responsible for the shutdown of the Baku-Tbilisi-Ceyhan pipeline. Experts warned about the risks stemming from potential Kurdish attacks against the transit infrastructure already on the eve of the Turkish offensive against Kurds in Northern Iraq (October, 2007).

The US plan to partition Iraq and to establish an independent Kurdistan can easily turn the vast Kurdish-populated region into a zone of a serious

conflict. The offensive against the Kurdish organizations based in Northern Iraq drew a minimal amount of attention in Western media at the time it was launched, though the expression "trans-border operation" disguised an invasion of a neighbor country. Knowing how much experience the Kurdistan Workers' Party had in guerilla warfare, it did not take a prophet to predict that the conflict would be protracted and would contribute to the risks associated not only with hypothetical projects like the Trans-Caspian Gas Pipeline and Nabucco, but also with the existing pipelines such as Baku-Tbilisi-Ceyhan and the ones linking Iraq and Iran to Turkey. The recent sabotage at the Baku-Tbilisi-Ceyhan may be the first in a series of bad news.

Central Asian countries will have to base their decisions concerning the oil and gas transit routes on their understanding of the general political context. Currently the high risk zones are by no means limited to the Transcaucasia. For example, obstacles of military-political character impede the implementation of the Turkmenistan-Afghanistan-Pakistan-India pipeline project. Since its 830-km segment is supposed to lie in the unpacified Afghanistan where the NATO forces seem unable to curb rampant violence, a huge question mark hangs over the entire plan. The tense relations between India and Pakistan are an additional source of political risks to the project.

Thus, the main conclusion to be drawn from the recent events in the Caucasus is that the military risks to oil and gas pipelines are escalating.

Regardless of where the gas comes from - Russia or not E2 in the post-Soviet space the risks affect any supply routes. As the efforts of producers to diversify export avenues are confronted by political and military limitations, it makes sense to return to the time-tested and stable oil and gas transit routes.
