



BULLETIN

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Implications of Opening of New Pipelines in Central Asia

by Tomasz Sikorski

The resumption of gas deliveries from Turkmenistan to Russia, the commissioning of a new gas pipeline to Iran, and the opening in December 2009 of a gas pipeline to China—all these developments signal the strengthening of Turkmenistan's position as the largest gas producer in the region. Now that China has provided Turkmenistan with opportunities to diversify its gas exports markets, for several years to come securing Central Asian gas to feed the EU's priority Nabucco pipeline, is going to be difficult. On the other hand, in the medium term such deliveries are by no means impossible, because Turkmenistan will be less vulnerable to pressures from Russia designed to constrain Turkmenistan's capacity to expand its west-bound exports.

The 1,833-kilometer gas pipeline from Turkmenistan to China via Uzbekistan and Kazakhstan was brought on stream on 14 December 2009 in the presence of the presidents of Kazakhstan, PRC, Turkmenistan and Uzbekistan. The three Central Asian states are planning to send, via the gas pipeline, 13 bcm of gas this year, and after the new route reaches its target capacity in 2013—as much as 40 bcm (of which Turkmenistan alone 30 bcm). China does not rule out the enlargement of the pipeline after 2013.

On 6 January 2010 a 30-kilometer pipeline linking the Dovletabad gas field with the Iranian gas pipeline network, with a target throughput of 12 bcm per year (it is scheduled to carry 6 bcm of gas in 2010), was opened during a visit of the president of Iran to Turkmenistan, and on 9 January 2010 deliveries of Turkmen gas to Russia were resumed after a nine months' break. Under the new contract Turkmenistan will sell Russia 30 bcm of gas a year, at a price described in a Gazprom-issued communique as “in line with the terms of the European gas market.”

Background. Until 2008 Turkmenistan sold to Russia, via the post-Soviet Central Asia-Centre (CAC) pipeline network, about 50 bcm of gas annually. This meant heavy dependence on the Russian user. In time Turkmenistan began shifting to an increasingly autonomous policy. Initially the role of Turkmen gas had been to cushion the impact of low prices at which Gazprom was selling gas to Ukraine and Belarus, but, as Russia entered into new long-term contracts with EU countries and as its domestic demand for gas soared while production remained stagnant, Turkmen gas became indispensable for trouble-free discharge by Gazprom of its commitments. The Turkmen side took advantage of this customer's difficult position to obtain higher and higher prices. At the same time, it launched diversification efforts by entering in April 2006 into an agreement with China to lay a gas pipeline across Uzbekistan and Kazakhstan.

When demand for gas in the EU countries and in Ukraine plummeted on the back of the economic downturn, Gazprom was faced with the choice between stopping or reducing, at a high cost, production from its own gas fields, or cutting down imports. The Russian monopolist opted for the latter, prompted additionally by the fact that as the fixed prices of the Turkmen gas were then above those received by Gazprom in Europe, this trade was loss-making.

In April 2009 there was a failure—probably due to Gazprom's willful action—of the Turkmenistan–Russia transmission system and gas flows were stopped. Spurred by losses sustained as a result of this operation (about \$15bn), Turkmenistan decided in July 2009 to build a new gas pipeline to Iran. Thus Russia's pressures for a revision of the terms of contracts with Turkmenistan proved counter-productive: instead of strengthening Gazprom's position, they permanently undermined its influence,

because the opening of the pipelines to China and Iran rings down the curtain on Gazprom's domination as the chief customer for Turkmen gas.

Implications. With the new pipelines going on stream, the energy map of Central Asia will change significantly, particularly from the perspective of Turkmenistan, which has the largest gas reserves in the region and whose room for maneuver in gas negotiations has expanded considerably. Connecting the Dovletabad field, that pre-April 2009 source of deliveries to Russia, to the Iranian network has symbolic significance. On the other hand, the resumption of gas supply to Russia and the opening of the new connector pipeline to Iran strengthen Turkmenistan's position *vis-à-vis* China. This warrants a thesis that the commissioning of the pipeline to Iran (work on this project was reported completed already last November) and the end of the months-long dispute with Russia (the pipeline had been technically operational already in September and, theoretically, the flow of gas could have been resumed then) were deliberately scheduled for after the signing of the agreement with China, to demonstrate Turkmenistan's independence.

From China's perspective, the gas pipeline ensures access to a rich reservoir of energy resources. The implementation of this \$20bn project was an example of the PRC's successful economic and political expansion conducted with instruments not available to the Western countries. For example, China Development Bank provided \$6.7bn preferential-terms loan for the construction of the Kazakh section of the pipeline. This investment will ensure additional benefits for China: diversified sources of supply, a sphere of interests being built in Central Asia, and better expansion opportunities for Chinese businesses (trade between China and Turkmenistan rose 2.5-fold in the first ten months of 2009 from the same period in 2008). The opening of the pipeline in December 2009 was accompanied by the signing of a number of economic agreements with Turkmenistan, Uzbekistan and Kazakhstan: on low-interest loans to be made by China to the Central Asian states, on the avoidance of double taxation, and on upgrading infrastructure. As an additional bonus, China built up its prestige in the region by showing itself capable of coordinating, for purposes of the project, the efforts of far-from-cooperatively-minded states.

The recent developments have demonstrated that Russia's capability to impact the energy situation in the region has waned. Russia failed to block projects prejudicial to its interests. Faced with the prospects of a likely discontinuation of or decline in production from Russian deposits, rising demand for gas with which to fulfill long-term contracts with European customers, and with projections of rising global requirement for gas as the global economy rebounds, in a longer run Russia will probably set out to purchase even more gas from Turkmenistan. Neither can it be ruled out that the expansion of the gas pipeline network between Russia and Central Asia, a project contemplated even before the crisis, will materialize. Russia's actions are going to be determined to a greater extent than to date by differences between the prices of gas imported from Turkmenistan and produced domestically, just as they will necessarily take supplier's interests more visibly into account.

Significance for the EU. In view of the recent developments, exporting massive quantities of gas westward has lost some significance for Turkmenistan. Chances that the European Commission-supported Nabucco project to build a southern transit corridor will come through are now reduced, because Turkmen gas was to be one of that pipeline's sources of supply. Additionally—apart from Turkmenistan's ambiguous position—obstructing the implementation of the project is Turkmenistan's dispute with Azerbaijan over the division of the Caspian Sea shelf and the environmentally and legally motivated protests of Russia and Iran against the laying of a trans-Caspian pipeline.

On the other hand, Turkmenistan has ambitious plans for steady growth of gas exports, to 140 bcm by 2020 and to 200 bcm by 2030. Moreover, owing to the recently achieved diversification of users, the political costs (resulting from Russia's negative reactions) of cooperation with Western states will be less painful for Turkmenistan than before—which will encourage the Turkmen authorities to look for new customers. The authorities of Turkmenistan and of other Central Asian states will be concerned that sales of even more to China, Russia or Iran lead to unduly high reliance on these buyers. The success of projects designed to carry gas to Afghanistan, Pakistan and India being doubtful given the instability in the region, the appeal of the European alternative will be increasing along with Turkmenistan's growing gas output. This makes the establishment of closer cooperation on the Nabucco project a viable medium-term prospect.