



UNISCI Discussion Papers

CASPIAN PIPELINE POLITICS AND IRAN-EU RELATIONS

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Introduction

For several reasons, the Caspian region, has been receiving world attention after the collapse of the Soviet Union. In addition to the region's geostrategic location, there is also an important economic reason for regional and external powers to become entangled, which is the existence of substantial hydrocarbon reserves and the routes by which these reserves should reach the energy markets. As the Caspian is a land-locked region, and there is only a small local demand for oil and gas, there is therefore a need to construct long distance pipelines to Western countries that are dependent on energy imports and see the Caspian basin as a potentially new, non-OPEC source of oil and natural gas. In this regard, gaining control over the Caspian energy resources and pipelines in a region where local and external actors are competing for influence, and pursuing different agendas will be significantly important and is linked to series of political and economic factors. It appears that pipeline policy forms the most important subject in the political and economic developments in the Caspian region. On the other hand, the recent energy crisis between Russia and Ukraine which threatened European energy supply, proved this reality that EU should diversify its energy resources. In this regard, as some European politicians announced, the role of Iran is getting more important in energy supply to Europe.

This paper is going to answer two questions; what comprises "Pipeline Politics"? And how energy supply can play a positive role in Iran-EU Relations?

1. What comprises "Pipeline Politics"?

The term "Pipeline Politics" consists of two different, but interconnected subjects. First, there is a struggle for gaining control over the energy resources of the Caspian. Due to some ambiguities, especially the uncertain legal status of the Caspian Sea, the control over its resources has been complicated and is among those conflicting interests of littoral states.

¹ *Las opiniones expresadas en estos artículos son propias de sus autores. Estos artículos no reflejan necesariamente la opinión de UNISCI.* The views expressed in these articles are those of the authors. These articles do not necessarily reflect the views of UNISCI.



There are no internationally recognized borders dividing the sea shelf among the littoral states except those of 1921's and 1940's between the Soviet Union and Iran. It seems that until this problem is solved, any political or even military dispute is possible.

Secondly, pipeline politics comprises problems regarding the exploitation and export of these resources. These two problems are closely connected. The countries that possess hydrocarbon deposits do not have the technology and financial capability which is necessary to start the exploitation. These countries are dependent on some Russian and Western oil companies. These firms and their countries of origin may also use other ways to influence the exploitation of the Caspian hydrocarbon resource. This is where international politics and international economics come together.

The current power struggle for control over the Caspian hydrocarbon resources has been named the "New Great Game" which refers to the old one. This time there are more actors involved and the prize for victory is Caspian energy. Some analysts argue that the New Great Game consists of an old-fashioned zero-sum competition between different states, in which direct control over the resources is the policy goal of the states involved. But for a single country, making decisions concerning hydrocarbon export routes seems very difficult. As economics and politics are entangled, not only at the national level, but also regionally and internationally, obtaining international support, as well from neighboring states is extremely essential. The international economy is political in nature because it concerns the process of "who gets what, when and how", and this is politics. The overlap between economics and politics are clearly visible when looking at the decision to start construction of the Baku-Tbilisi-Ceyhan Pipeline. Instead of taking the shortest and safest export route, which would pass through Iran, an expensive pipeline has been constructed from Azerbaijan, across the Caucasus to Turkey's Mediterranean coast, defying economic arguments. In addition, there are three possible conflict zones in the surrounding area which threatens safe operations of this pipeline. Only strong American support could enable this project. The United States wants this particular export route, because it enhances American position in the region and bypasses both Russia and Iran.

For all the actors in the region, the geopolitical factor seems to be of dominant importance. Russia has deepened its relations with Iran and Armenia, in an attempt to increase its influence over the Caucasus. Turkey fears an emerging geo strategic competition between two blocks in the Caucasus or even the whole of Eurasia. The balance of power in the region remains unsettled. Azerbaijan and Georgia, wary of Russian intentions, aligned themselves with Turkey and the US. The plan to construct the BTC oil pipeline has increased US presence in this area, providing the US government with a direct influence on the shaping of future political, security and economic initiatives. These two blocks may grow into regional geopolitical rivals.

2. How can Caspian energy and pipeline politics play a positive role in Iran-EU Relations?

To answer these questions and to make a proper analysis of the subject, we need to have a look at the Caspian energy reserves, current oil and gas pipelines in the region, Europe's energy supply vulnerability and the Iran's capabilities in the region.



2.1. The Caspian Reserves

During the former Soviet period, there was hardly any mention of the Caspian Region, let alone its possible abundant energy reserves. With the exception of Iran, the border of which represents the whole southern coast of the Caspian boundary, the Caspian was mainly controlled by the USSR and was primarily known as the world's main producer of caviar. In this period, Baku accounted for about 70% of Soviet oil production by 1940².

There are differing views on the potential of Caspian hydrocarbon reserves. Some believe that it is enormous, to the extent that it has been called "the 21st century Persian Gulf"³. It seems that politics, rather than geophysical analysis, is responsible for different conclusions. US officials wanted to talk up the opportunities for Caspian hydrocarbon investment; Russia and Iran were at that time seeking to play down Caspian prospects. In addition, Russia appears to have made a significant discovery off its Caspian coast.

The highest estimations have been provided by the US State Department, according to which the region's resource base might contain as much as 200 bbl of "implicitly" recoverable reserves, the equivalent of almost one-fifth of the world's proven reserves at that time⁴. It means that the Caspian reserves could be enough to supply the world for eight years, and 7,000 billion cubic meters of natural gas, at the current rate of consumption for 16 years, which is likely to be enough to supply the European market⁵.

In contrast, some Russian and Iranian circles are taking an equally pessimistic view. For instance, Russian financial analyst Oleg Timchenko wrote in 1998, following the failure of one Western group to find oil off the Azerbaijan coast, that: "The moral of this story is that the Caspian is not really a 'sea of oil', not every well is going to be successful and there is considerable risk involved in what might appear sometimes to be a low-risk region in which to operate"⁶. However, in a less optimistic report, it has been estimated that Caspian offshore petroleum reserves vary from 15 to 40 billion barrels of proven oil reserves, approximately 70- 150 billion barrels of additional reserves, between 6.7 and 9.2 trillion cubic meters of known natural gas reserves and probably 8 billion cubic meters of additional reserves. This would represent 1.5% and 4% of the world's known oil reserves and 6% of its gas reserves⁷. Some other experts support the above report and claim that the regional reserves range between 50 billion and 200 billion barrels, which ranks the potential impact of the Caspian reserves at the same level as the North Sea⁸.

On the other hand, some other studies indicated that the Caspian oil reserves are nowhere close to the estimations given by the US State Department, nor is it near the known oil-producing centers in the Persian Gulf- even not comparable with Russia by itself. In that context, a survey by the International Institute for Strategic Studies (IISS) concluded that the consensus of oil industry forecasts lie in the range of between 25 billion barrels (bbl) and 35 bbl. It means that instead of the 16% of world reserves the US State Department implies,

² <http://www.iea.org/nme/Caspian/steeegl.htm>.

³ "Black Caviar versus black gold in The Caspian". *Financial Times*, 6 March 1999.

⁴ US Department of State, *Draft memorandum on the Caspian*, distributed in May 1997.

⁵ *Strategic Survey*, International Institute for Strategic Studies, 1997/98.

⁶ Timoshenko, Oleg (1998): *Russia morning comment*, United Financial Group.

⁷ <http://www.iea.org/nme/Caspian/steeegl.htm>.

⁸ Bremmer, Ian: "Oil politics: America and the riches of the Caspian Basin", *World Policy Journal*, Vol. 15, No. 1 (Spring 1998), pp. 27-35.



the true figure for the Caspian is likely to be closer to 3%⁹. This view casts a serious doubt on forecasting the Caspian Sea as a major long-term competitor for the Persian Gulf. Besides, due to the scale of its oil and gas reserves, the high costs of extraction and slowness in developing the new energy fields, Caspian energy may not be as significant as is sometimes believed.

However, in spite of differing views concerning the size of the Caspian reserves and the lack of consensus on the exact size, the strategic importance of their existence in terms of diversification of supply in the context of the global energy market, remains significant.

2.3. Caspian pipelines: the carriage of Caspian oil and gas to European markets

A) Oil pipelines:

The problem with pipeline politics is that it must combine often opposing economic and political interests. Oil companies want the cheapest route to the best market. For example, Iran will be a key actor for proposed outlets of oil and gas for export from the Caspian region. The US, however, is afraid that such a pipeline project will dramatically increase Iranian influence in the region. Other actors seize upon such anxieties to press their favored alternatives. Regional powers such as Azerbaijan and Turkey strive for a western route. For Azerbaijan, being exclusively dependent on a route running through Russia would mean an increase in economic dependence on that country. Turkey's increasing oil and gas demand can no longer solely be satisfied by Russian supplies. Georgia also hopes for a western route and the handsome tariff revenue it would receive as a transit country. Thus the real fight about pipelines is as much about geopolitical influence as about the oil business itself. At the same time, the internal structural crisis, which manifests itself in terms of ethnic conflict, the fragile political stability and the economic crisis have to be accommodated along the way. Some existing and proposed pipelines, for instance, go through such confidence-inspiring places as Chechnya, Abkhazia and Kurdish-dominated eastern Turkey.

Exactly where such pipelines will run, who will finance them and who will control them remain the key issues upon which billions of dollars and the political future of the region will depend. The final decisions will depend on various aspects of local and regional interests as well as technical and infrastructure practicalities.

At the moment, there are several different routes under consideration. The three existing lines are:

- *Atyrau-Samara*. This is a 280 000-b/d capacity Soviet-era line which runs from the Kazakh terminal at Atyrau to the Russian Urals refinery at Samara and then connects with Russia's main East-West Druzhba system. The pipeline has a length of 691.2 km and transportation could be increased to 310,000 bbl/d. To increase the capacity will cost approximately US\$37.5 million. In 2001, the majority of Kazakh oil exports was shipped through the Atyrau-Samara pipeline with additional supplies shipped by rail and by barge across the Caspian Sea. In March 2001

⁹ International Institute for Strategic Studies: "Caspian Oil: Not the Great Game Revisited", *Strategic Survey 1997/98*, in <http://www.treemedia.com/cfrlibrary/library/energy/greatgame.html>.



Kazakhstan took a major step towards increasing its oil exporting potential with the launch of the CPC pipeline¹⁰.

- *Baku-Novorossiysk*. This Soviet-era line runs from the oil terminals outside the port of Baku to Novorossiysk through southern Russia. It has a nominal capacity of 180 000 b/d, but Western oil men in Baku consider that the Russian section, part of which was re-routed in 1999-2000 to avoid Chechnya, still limits throughput from Azerbaijan to approximately 50 000 b/d.
- *Baku-Supsa*. This line, opened in late 1998 with first deliveries in March 1999, runs from Baku to the Georgian Black Sea port of Supsa. Currently the route transports 145,000 bbl/d. After the proposed upgrades transport could increase to between 300,000 bbl/d and 600,000 bbl/d. It has a length of 824 km. The costs before upgrade are US\$600 million. A detailed engineering study started in June 2001. Construction was scheduled to begin in 2002 and completion is targeted for 2004¹¹.
- *Dyubendi-Batumi*. This line runs from the Azerbaijani oil terminal at Dyubendi to the Georgian port of Batumi and should have an initial capacity of 70 000 b/d, perhaps rising later to 140 000 b/d. It is being developed by Chevron to handle Kazakh crude from the Tengiz field which will first be shipped across the Caspian from the Kazakh port of Aktau. In due course it will probably handle output from Texaco's North Buzachi field.
- *Baku-Tbilisi-Ceyhan* from Azerbaijan through the Georgian capital Tbilisi and Turkey to the port of Ceyhan on the Mediterranean. On 18 September 2002, Georgia, Azerbaijan and Turkey inaugurated the pipeline. The pipeline has a length of 1,730 km with a section of 1,070km in Turkey. The projected completion date was 2005. Its costs are estimated at US\$3-4 billion. The Baku-Ceyhan pipeline is by far the most expensive pipeline of the western options. Turkey has promised to cover the costs on its territory at US\$1.4 billion. Based on a transport of 800,000 bbl/d through this pipeline the total estimated transport costs from Baku to Italian ports are US\$2.80 per bbl. This is more than any other western alternative pipeline options¹².

Various other oil pipeline proposals, although they may have been discussed at various times at quite senior levels, remain ideas that are not likely to lead to serious project work for many years, if at all.

B) Gas pipelines:

Presently there are several gas pipelines connecting European markets with the Eurasian deposits. The most important and the largest of them are Russian routes, including the Trans-Balkan gas pipeline and the recently built Blue Stream. A route connecting Iran with Turkey has also been operational. Within the next years, the Baku-Tbilisi-Erzurum (BTE) gas pipeline should also be completed. It will transport Caspian (Azeri) gas to the Turkish market.

¹⁰ EIA: *Kazakhstan-Country Analysis Brief* (July 2002), on-line version.

¹¹ EIA: "Caspian Sea Region: Reserves and Pipelines Tables" (July 2002), on-line version.

¹² Cohen, A: "Caspian Pipeline Construction Efforts Move Forward", *Eurasia Insight* (March 2002), on-line version.



There are several projects, and most of them are supported by the European Commission, as they will potentially increase the EU's energy security and serve as a confidence building measure between Turkey and Greece, the Balkan countries and the post-Soviet area. The most important of those projects include (a) an interconnector gas pipeline between Turkey and Greece. (b). *Nabucco* which is to cross Bulgaria, Romania and Hungary to Austria and possibly the Czech Republic. (c). The Balkan project – the least advanced project for the time being. It aims to build a route via the Western Balkan countries that will ultimately reach Central European markets.

2.3. Europe's energy supply vulnerability

During the 1970s, OPEC countries played an important role in oil supply to Europe. The restriction on production imposed by OPEC during this decade and its decision to raise the price of oil was a painful shock to the European economic and political system. Table 1 presents the EU's top ten crude oil supply origins in 1978. The rather large crude oil import share from countries surrounding the Persian Gulf and particularly Saudi Arabia is striking and illustrates the degree of the EU's vulnerability. The top ten were good for 88 percent of the total supplies in 1978, with the United Kingdom being the only West-European supplier on the list.

Table 2: EU's Top 10 crude oil supply origins in 1978¹³

Rank	Country	1000 tones	%
1	Saudi Arabia	151,709	24
2	Islamic Republic of Iran	84,563	13
3	Iraq	69,286	11
4	United Kingdom	53,475	8
5	Libya	41,581	6
6	Kuwait	38,449	6
7	Nigeria	38,092	6
8	United Arab Emirates	37,666	6
9	Former USSR	31,210	5
10	Algeria	20,843	3
Subtotal		566,874	88
Total Supplies		643,150	100

¹³ IEA Oil Information (2002), OECD/IEA.



Although after the 1970's energy crisis European countries intensified their national approaches to energy security in order to be better prepared for this sort of crisis, as the EU has the largest energy imports of all regions of the world the dependency of European countries on energy imports remains severe. European energy imports currently amounts to approximately 16 percent of the world energy market.¹⁴ The total primary energy demand in the EU is expected to rise by 0.7 percent per year from 1,456 Mtoe in 2000 to 1,811 Mtoe in 2030. The share of coal in total primary energy use will decline from 15 percent in 2000 to 10 percent in 2030. The share of gas is expected to increase from 23 percent in 2000 to 34 percent in 2030, almost closing up on oil, which is expected to decline from 41 percent to 37 percent. The share of renewables other than hydro also rises steadily, contributing nine percent of primary energy supply in 2030, whereas the share of nuclear will decrease¹⁵. Oil will remain Europe's primary source of energy. Demand will increase 0.4 percent per year from 2000 to 2030. The EU's transport sector will continue to depend heavily on oil, since it is expected that no real substitute in this field will become available. Thus, the transport sector contributes the biggest share of the demand increase. Aviation fuel consumption will grow most quickly, followed by diesel and gasoline. As a result of this general rise in demand, net imports of crude oil are expected to reach a level as high as 590 Mtoe in 2020, approximately the same absolute level as in the late 1970s. By way of comparison, the EU imported 475 Mtoe in 2001. However, despite the predicted absolute demand increase for the EU Member States, the IEA expects that the importance of oil for primary energy supply will fall slightly from 41 percent in 2000 to 37 percent in 2030.

A strategy aimed at fostering domestic production and energy saving that started as a reaction to the international oil crises in the 1970s led to a decline of EU oil imports until 1985. Since then however, the import of crude oil again began increasing. The growing import dependence has caught the attention of the European Commission. The concerns of the Commission can be found in the Green Paper¹⁶ *Towards a European strategy for the security of energy supply*, published in November 2000. With respect to energy supply the report concludes that the EU's dependence on external energy sources will rise from around 50 percent to 70 percent by 2030. For oil, the report concludes that unless specific measures are taken, especially in the transport sector, crude oil import dependence could reach 90 percent by 2020. This oil will most likely originate from countries and regions which are politically sensitive (Russia, the Caspian Sea region and the Middle East), where local and regional conflicts could take place in the near future, disrupting energy supplies.

The former Soviet Union countries will play a very important role in satisfying increasing EU demand. In particular, Russian crude oil production could double during the next 20 years from 7.8 million barrels a day in 2000 to 14 million in 2020¹⁷. The Caspian Sea basin is also expected to become very important for securing future European supplies. Production costs are significantly higher in these areas compared to the costs of production in most of OPEC member countries. However, crude oil prices of about US\$ 20 per barrel should make investments economically viable and secure production and transportation from these areas.

¹⁴ *Ibid.*, p. 178.

¹⁵ *Ibid.* p. 184.

¹⁶ Green Papers are communications published by the Commission on a specific policy area. Primarily they are documents addressed to interested parties, organizations and individuals, who are invited to participate in a process of consultation and debate. In some cases they provide an impetus for subsequent legislation.

¹⁷ Willenborg, Robert; Tonjes, Christoph and Perlot, Wilbur (2004): "Europe's Oil Defenses", *Clingendael Energy Paper*, The Hague, The Clingendael Institute, p. 15.



Apart from Russia and the Caspian Sea basin, OPEC member countries will likely capture a great deal of Europe's future need for crude oil. More than 70 percent of the world's oil reserves are located in these countries. Currently OPEC accounts for 42 percent of EU oil imports. The CEC Green Paper estimates that by 2020 OPEC will supply the EU with 55 million barrels a day, as compared with 32 million barrels a day for 2000.

Under the aspect of security of supply, natural gas is a very different energy source in comparison to oil. In Europe, 87 percent of natural gas sold on the European market is transported by pipeline from outside Europe. Eighty percent of world natural gas reserves are located within a radius of 4,500 km from Central Europe. Western Siberia, the South Caspian/Persian Gulf region, North Africa (plus Nigeria) and European domestic reserves represent four-fifths of the world reserves. It is a matter of fact that 67 percent of European imports come from Russia, 32 percent from Africa, but just 1 percent from the Middle East (the latter by LNG), although the Middle East can produce more cheaply and is closer to Europe than Western Siberia. The South Caspian and Persian Gulf region, however, counts for 40 percent of world reserves and is practically invisible in this market. Iran owns the second largest reserves, with 15 percent of world reserves, and is the only country that links the Caspian Sea and the Persian Gulf. A major supply line from the South Caspian/Persian Gulf region would provide the opportunity for a competitive market in Europe including price competition that allows a total decoupling of the natural gas price from the oil price. The import demand growth specifically means the following: Europe imported 186 billion cubic meters of natural gas in the year 2000. In 2030, according to EU figures, this import amount will be 2% times larger and according to International Energy Agency figures more than 3 times larger. In contrast, during the past twelve years, Europe's major supplier Russia faced a ten percent decline in its natural gas production. Russia, however, does not permit contracts to be signed by other countries and Europe. Instead, Russia wants to control the amount of natural gas flow to Europe itself and regulate the price and thus wants to be the exclusive contract partner of the producer states. The Russian notion of a natural gas OPEC (or OGEC) is now substituted by a Eurasian Gas Alliance. This, of course, can neither be in the interest of the Europe as the world's largest natural gas import market, nor in the interest of the suppliers in the Caspian region if there is a transport alternative.

Like all forecasts, the EU's energy supply outlook for 2030 has a variety of uncertainties, from changing political circumstances which might lead to different perceptions of risks connected, to certain supply regions, to new possibilities emerging with regard to oil supplies. For instance, the Green Paper only very briefly mentions unconventional sources of crude oil such as the Canadian tar sands or extra heavy bituminous crude oil found in Venezuela. Recoverable reserves for these two sources are estimated at 580 billion barrels, exceeding the combined conventional reserves in the Middle East¹⁸. Here lies another diversification opportunity for EU oil supplies. The importance of these sources will depend largely on the development of international oil prices. In any case, the sheer volume of reserves, particularly in Canada, should provide a counterweight to the expected increasing dominance of OPEC countries in world oil markets. Some commentators argue that instead of stronger concentration of oil production in the Middle East, there will be a wider geographical distribution of supply origins.

¹⁸ IEA (2002), *op. cit.*, p. 101.



2.4. Iran's energy capabilities in the region

For over ten years Iran produced approximately 3.5 million barrels of oil per day (b/d) (currently 5 percent of world production) with a rather narrow variance of less than 0.3 million b/d. Slightly more than 2 million b/d of production are available for export. Iran is the fourth largest oil producer (behind Saudi Arabia, the U.S. and Russia) and the fourth largest exporter (behind Saudi Arabia, Russia and Norway). Its reserves are larger than those of the U.S. and Russia but smaller not only than those of Saudi Arabia, but also of Iraq.

Iran has the world's second largest gas reserves. Iran's priority at the moment is to increase gas exports. For political reasons, Tehran is most interested in the European market, but in terms of the economy and the profitability of actual projects, the fast-growing South Asian markets located closer to Iranian deposits appears to be more realistic and easier to "conquer". The easiest way for Iranian gas to reach Europe, both geographically and in terms of infrastructure availability, is via the neighbouring Turkey. The first Iranian export gas pipeline (to Turkey) was launched in 2001. In 1996, Iran and Turkey signed an agreement for the delivery of natural gas over a period of 23 years. The pipeline, which runs from the western Iranian city of Tabriz to the Turkish capital Ankara, opened on December 10th 2001. It has a length of 2,577 km, and an expected capacity of 4 bcm in 2002, with export expected to rise to 10 bcm in 2007. The deal between Iran and Turkey has faced objections by the US as it rivals the TCGP. Turkey, however, argues that it needs both pipelines to meet its rising energy demands. However, due to some differences between the two countries¹⁹, and the high price paid for Iranian gas on entry to Turkey²⁰, Turkish transit may face some problems that should be solved.

Iran already has an extensive pipeline system and the Persian Gulf is a good exit point from which to serve the European and Asian market.

In addition, there are some other projects as follows:

- Turkmenistan and Iran signed a 25-year contract when Turkmenistan opened the 124-mile gas pipeline linking the Korpeze gas field in western Turkmenistan to the town of Kord-Kui in northern Iran in December 1997. The US\$190 million pipeline has a length of 198.4 km. In 2001 it exported 154 bcf with an expected peak capacity of 282 bcf/y²¹. According to the 25-year contract between the two countries, Iran will take between 177 bcf and 212 bcf of natural gas from Turkmenistan annually. 35 percent of Turkmen supplies will be allocated as payment for Iran's contribution to building the pipeline. The presidents of Turkmenistan and Armenia reached an agreement in December 2001 according to which Turkmenistan will supply up to 70.6 bcf/y of natural gas to Armenia via the Korpeze-Kord-Kui pipeline and across Iran. The implementation of this deal is contingent on the construction of an already long-delayed Iran-Armenia natural gas pipeline. The deal on this pipeline was signed between Iran and Armenia in December 2001 at a cost of about US\$120 million.

¹⁹ The Iranians claim that Ankara discriminates against their gas. They see signing of the Energy Charter and its Transit Protocol as a way to counter this. The Charter and the Protocol have been signed by Turkey, so they could provide a set of rules for the transmission of energy carriers, and a dispute resolution mechanism, binding on both countries.

²⁰ Iranian gas is extracted from deposits in the south of the country, and, if transmitted to Europe, it has to cover a long and geologically complex route.

²¹ EIA: "Central Asia Country Analysis Brief" (May 2002), on-line version.



- A strategic project of the Iranian government and TotalFinaElf is the construction of a pipeline from Baku in Azerbaijan via Tabriz in Iran to the Iranian Caspian coast at Neka. It will have a length of 560 km and a probable capacity of 200,000 to 400.000 bbl/d. The costs are estimated at US\$500 million²².”
- Iran hopes to extend its domestic pipeline network with the development of a pipeline from Neka to the refinery Rey. This would link the refinery network with the inland pipeline system. The aim is to take Turkmen, Kazakh and Azeri crude to the Iranian northern refineries near major population centers, delivering in return an equal amount of Iranian crude from the Persian Gulf.
- The swap of Azeri, Kazakh and Turkmen oil and gas that is exported to Iran’s northern refining centers at Tabriz, Tehran and Araak for exports of Iranian oil from Iran’s main Persian Gulf terminal at Khark Island. The advantages are that Iran’s already existing pipeline system could be used for this project. It is estimated that the maximum swaps could amount to 400,000 to 500,000 bbl/d. According to information by industry and local officials, Malaysia’s Petronas and China’s CNPC are interested in investment in an Iranian route. This route could transport their own future Caspian production and they could generate transit fees from other producers when the US sanctions are lifted.

Oil companies have discovered that the Iranian route is a quick and cheap solution, but one that is hampered by the US sanctions prohibiting trade with Iran.

3. Is Iran a key factor for Europe’s Security of Energy Supply?

In order to understand what is at stake for the European energy sector a more general approach is required. Europe’s interest in Iran is quite different with regard to oil, on the one hand, and natural gas on the other. The gas sector is politically more complex and important. Oil is more interesting from a global supply perspective. Europe, like any consumer dependent on the import of a product sensitive to its economy needs both a long term security of supply and reasonable prices. Both are served best if the major suppliers are competing on the European market. At present, Iran is not a major supplier of either oil or natural gas to the European Union. Although the country is the fourth largest oil exporter worldwide, and oil is about 80 percent of Iran’s € 6.6 billion worth of exports to the EU, imports from Iran represent no more than 5 percent of European oil consumption. However, Iran’s relatively minor role as Europe’s energy partner will not remain minor forever, and as one of the European analysts argues, “given its geographic location, particularly as the link between the Persian Gulf/Middle East and the Caspian Sea, it will be a major player in the medium term. Considering the less competitive alternative of Russian controlled gas, the development of Iran into a major player is in Europe’s best interest and cooperation in the energy field, such a development would be in the interest of both sides.”²³

Like the US, Europe has to be prepared for major changes in its energy supply structure and Iran, which owns the third largest combined oil/natural gas reserves worldwide (behind

²² EIA: “Caspian Sea Region: Reserves and Pipelines Tables” (July 2002), on-line version.

²³ Muller, Friedemann (2003): “Why Iran Is Key for Europe’s Security of Energy Supply?”, *Iran and Its Neighbors*. Berlin, SWP, p. 68.



Russia and Saudi Arabia) will play an important role in this structure as a supply option, if political developments allow it. The EU Commission initiated a strategic plan in 1999, testing whether Iran will move in a direction that allows a more intense relationship with regard to energy production and trade. The test is still far from producing definite results but is encouraging.

Therefore, infrastructure is required which would make possible an unlimited supply from the South Caspian/Persian Gulf region to Europe. Today this is not completely available. Why isn't there a major pipeline from the South Caspian region to Europe which could be fed from all South Caspian and Persian Gulf states? The main reason is political. Private investors will not take the risk building a pipeline which might be disputed due to U.S. sanctions against Iran (ILSA). Presently, the attitude of the US towards Iran is especially frigid because of Iran's nuclear project and because Iran is allegedly destabilizing the situation in Iraq. The United States prevents the plans of Tehran and individual European investors to transit Iranian energy resources via Turkey to the EU.

Therefore, a careful process of confidence building measures started in 1999 with an ad hoc working group, followed by an expert committee, and a working group on INOGATE, an EU institution that promotes infrastructure mainly in the post-Soviet space, including a natural gas pipeline from Iran to Armenia. This process led to the opening of an Energy Cooperation Center in Tehran in October 2002, the beginning of negotiating a trade and cooperation agreement in December 2002, and also the granting of observer status to Iran in the Energy Charter Treaty process in 2003. All this together, shows that the EU follows a long-term strategy. This negotiation process is accompanied by concrete economic actions, among them the signing of a USS300 million agreement between Iran and Greece on extending an Iranian-Turkish natural gas pipeline into Greece. This, quite obviously, will be a test enterprise for a more extensive and longer-term cooperation. Early 2003, Iran received observer status at the Energy Charter Treaty (ECT), an agreement of common rules for investment and transportation in the energy sector. Presently, membership is restricted to OECD and OSCE member countries.

It remains to be seen how the situation through out the Middle East will develop and whether there will be stability and proper conditions for exports of energy carriers. The success (or failure) of the stabilization of Iraq, and future developments over Iran, will also certainly influence the situation.

Conclusion

In the Caspian region, the development of oil resources and to export it would certainly have a huge impact on the political and security configuration of the region. Political instability remains the biggest threat to future oil and natural gas exports from the region. Unsettled disputes in Georgia, Azerbaijan, Turkey and Russia could develop into violent conflicts, transforming oil or natural gas pipelines into potential targets. In the regional context, the pipeline politics have also a significant impact on the interests and the strategies of the states involved and shape their relations. Escalating or easing some regional conflicts in the territories, through which the multipipeline routes may pass, is among those impacts. Europe will most probably face a declining domestic oil production in the future, necessitating increasing imports. Conventional views predict over the next 30 years a stronger market share. Europe, like any consumer dependent on the import of a product sensitive to its



economy needs both a long term security of supply and reasonable prices. Both are served best if the major suppliers are competing on the European market. Iran, as the fourth largest oil producer and exporter worldwide and the second largest holder of natural gas reserves and due to its geopolitical location between the Persian Gulf/Middle East and the Caspian Sea, can be a major player in Europe energy supply in the medium term. More interesting, however, is the natural gas sector. This is obviously the both side's interest. To reach to this level, two things should be built, a) the necessary transport infrastructure and the necessary confidence measures. The main cause is politics. The process of confidence-building measures between Iran and EU which has been started in the late 1990 should be continued.