



საგარეო საკითხებისა და საერთაშორისო ურთიერთობების ქართული ფონდი
GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

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**EXPECTED RESULTS OF THE LIFTING OF
SANCTIONS ON IRAN AND THE OPENING OF
THE NORTH/SOUTH ENERGY AXIS**

LIANA JERVALIDZE

EXPERT OPINION



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In accordance with an agreement reached in 2015, sanctions imposed on Iran are scheduled to be lifted in January 2016. Iranian troops, together with the Syrian army¹, are actively engaged in ground operations in Syria with the support of the Russian Air Force. This Russia/Iran/Syria cooperation implies not only the strengthening of the strategic and military North/South Axis, but also the opening of the Caspian Sea/Persian Gulf transport corridor. Lifting the embargo on Iran will open the way for Iranian energy resources to access the international market, and also will bolster Iran's position as a transit country. Thus, Iran's opening will pave the way for Caspian oil and gas to move into the Persian Gulf and oceanic transportation routes. However, this is unlikely to have a significant impact on either the quantity of gas transported through the Southern Gas Corridor or Georgia's foreign policy orientation.

Brief historical review: Following the collapse of the Soviet Union, the route across Iran was considered one of the most cost-effective means for Caspian oil exports to enter international markets. Iran's strategic location between the Caspian Sea and the Persian Gulf and its role as a link connecting the landlocked Caspian Sea to international oceanic channels were the preconditions for the country's development into a major transit artery. The first project to transport Kazakh oil exports to the international market, developed and lobbied by French oil company "Total," implied using the territory of Iran for transit.² However, stakeholders in the Tengizchevroil Consortium decided to use the Caspian Pipeline Consortium to transport their oil from the Tengiz Field to the Novorossiysk Marine Terminal in the Black Sea in Russia. Thus, the Kazakh/Turkmen/Iranian pipeline project was shelved.

Later, in 2009, Kazakh oil gained access to China, when the three-stage construction of the Kazakhstan/China Pipeline was completed. Prior to the tightening of sanctions against Iran, Kazakhstan and Russia conducted oil swaps with Iran. Following the lifting of the embargo, these operations are likely to resume.³ Upon lifting the sanctions, the Iranian government

1 Russia actively engaged in the Syrian conflict in October 2015.

2 Active lobbying on the project was carried out in 1991-93.

3 Which will not contribute to the load of the Baku/Tbilisi/Ceyhan pipeline.

has declared its readiness to begin oil, natural gas and petrochemicals swaps with its Caspian Sea neighbors.⁴ According to reports by international news agencies, Iran has already resumed negotiations with Azerbaijan, Turkmenistan and Russia regarding gas swaps.⁵

According to international media sources from 2012, prior to the tightening of sanctions against Iran, talks were already underway between Russia, Iran and Syria regarding the opening of the North/South Axis for gas transit to the eastern Mediterranean coast of Syria. In March 2011, Syria and Iran signed an agreement on the construction of the Iran/Iraq/Syria gas pipeline. According to some international sources, Russia offered Iran transit of Russian, Turkmen, and possibly Azerbaijani gas (prior to the approval of the TANAP project) via the North/South corridor. The issue concerned the transportation of gas not only via Syria to its Mediterranean coast, but also further transit through pipelines and in liquid form in various directions. These talks were interrupted by the tightening of sanctions on Iran in 2012 and the subsequent civil war in Syria.

Current talks on gas swaps: according to media sources, upon lifting sanctions, Iran is offering⁶ Azerbaijan, Turkmenistan and Russia supply of gas to northern Iran in return for equivalent volumes of gas in the south of the country via pipeline or liquefied gas.⁷ Iran has no oil or gas deposits in the north of the country.⁸ Therefore, Iran's industrial zone in the northwest is supplied with oil and gas from deposits located in the south, in the Persian Gulf. Upon lifting sanctions and parallel to expected economic growth, it is likely that gas consumption will increase in Iran and especially in the country's industrial northwest region. For this purpose, Iran has been planning to construct the new IGAT-9 gas pipeline.

For the parties involved in the talks - Iran, Russia Turkmenistan and Azerbaijan- gas swaps appear to be profitable.

4 Private Sector Ready for Swap, www.shana.ir 22 April 2015

5 www.reuters.com, 23 November 2015

6 Iranian Oil Minister Zanganeh, Press conference, Isna Agency, Tehran, 17 November 2015

7 The differences in quality between Iranian and Russian/Turkmen gas are likely to be offset by regulating quantities.

8 Iran claims that there are deposits in its section of the Caspian shelf, although exploration has not yet been carried out and the presence of the resources has not been confirmed (L. J.)

Iran: If Iran receives natural gas from Azerbaijan, Russia and Turkmenistan⁹ in its northwest region via the above-detailed swap operations, there will be no immediate need for Iran to build an estimated \$6 bln north/south gas pipeline in the west of the country. As some volumes of gas initially designed to feed the northwest industrial zone will be released for exports,¹⁰ it will not be urgent to amend internal energy sector regulations, which prohibit the access to major upstream. Furthermore, Iran would be able to reinforce its positions in strategically significant areas, such as Central Asia and the Caucasus.

Azerbaijan, Turkmenistan and Russia: If these swaps were to take place, these countries would diversify their gas export and enter the pipeline and liquefied natural gas (LNG) market in the Persian Gulf. Moreover, these countries would further enhance their strategic positions among the Persian Gulf countries to the south.

Iran has already finalized the construction of the segment of the gas pipeline connecting Iran, Pakistan, and India. Once Pakistan completes its section, Iran will gain direct access to both Pakistani and Indian markets. At the same time, Iran and India have been in talks on the construction of an interconnecting seabed pipeline¹¹. According to official sources, upon lifting sanctions, Iran will return to construction of a gas interconnector with Oman and seek to utilize the latter's unloaded LNG terminal. By 2019, Iran plans to construct a gas liquefaction plant with an annual capacity of 10 million tons. The country is currently negotiating terms for the lease or purchase of a floating liquefied natural gas (FLNG) plant.

Prior to the tightening of sanctions, Iran had signed natural gas supply agreements with almost all Persian Gulf countries, with the exception of Saudi Arabia and Qatar. In addition, agreements for LNG production were signed with several international oil companies. These agreements provide for the annual export of 152.8-158.4 bcm (billion cubic meters) of natural

9 There are two gas pipelines from Turkmenistan to Iran with the total capacity of 20 bcm. The funding of the Russia/Georgia/Armenia/Iran and the Russia/Azerbaijan/Iran pipelines will be a task for Russia, rather than for Iran.

10 Iranian gas has a much higher calorific value than gas from the Caspian countries. The sides would counterbalance the higher calorific value of the Iranian gas with increased quantities of Caspian natural gas.

11 Iran, India FMs Discuss Enhanced Ties, Gas Line Project, www.shana.ir 09 December 2015

gas via pipeline or LNG, which the country will not be able to achieve without foreign direct investment (direct engagement of transnational companies) in upstream.

Gas swaps, particularly with Russia and Turkmenistan¹², would allow Iran to carry out a certain amount of gas export operations without needing to introduce radical and immediate changes in energy sector regulations, as Iranian legislation prohibits the access of Majors upstream.

Gas Export Projects Launched but Not Implemented by Iran Prior to the Imposition of Sanctions¹³

Agreement with Bahrain: In 2007, the two parties reached an agreement on the delivery of natural gas to Bahrain (via a planned pipeline). The parties frequently engaged in political scandals, which hampered the implementation of the agreement.

Kuwait: The country experiences a gas shortage in the summer. Saudi Arabia, Iran and Kuwait maintain a joint oil and gas field on the continental shelf, known as Arash. Since 2005, Iran and Kuwait were discussing the possibility of supplying 3 bcm of natural gas from the Iranian section of the field to Kuwait. However, the agreement was impeded by the fact that the two countries do not have demarcated maritime boundaries and failed to reach an agreement on price. In 2010, Iran once again announced its intentions to supply 8.5 bcm of natural gas to Kuwait via a planned seabed pipeline.

Oman: in 2005, the parties signed a Memorandum on the delivery of 8 bcm of natural gas to Oman via a seabed pipeline from the Iranian Kish and the jointly owned Hengam Gas Fields, which would be jointly developed.

United Arab Emirates: in 2001, Iran signed a 25-year deal with the UAE company Crescent Petroleum to supply 5.2 bcm of natural gas via pipeline from the Salman Gas Field. The construction of the pipeline concluded in 2008. However, the two sides were unable to reach an agreement on the

12 Azerbaijan has already contracted Phase 2 natural gas from Shah Deniz, and it is unlikely that there will be any additional gas intended for export prior to the opening of new fields in 2025 (L. J.)

13 David Ramin Jalilvand, Iran's Gas Exports: Can Past Failure Become Future Success, The Oxford Institute for Energy Studies, June 2013

price. The volume of planned but not implemented export of pipeline natural gas is 20.4-22.4 bcm.

Launched and Suspended LNG Projects

Since the 70s, Iran has sought to enter the liquefied natural gas market. Its attempts were hampered by the revolution in 1979 and the war with Iraq in 1980-1988. According to the National Iranian Gas Export Company (NIGEC), starting from 2000, the Iranian government has made its entire focus the implementation of **LNG projects** on the Pars Gas Field. Iran has already invested \$1.3 billion in the development of the required infrastructure (storage tanks, etc.). It was planned to build two gas liquefaction plants with the capacity of 5.4 million tons (15 bcm) each, in partnership with Chinese and South Korean companies. Iran obtained the permit for the use of gas liquefaction technology from the German industrial gases and engineering company, Linde; however, Iran couldn't use it due to the imposed sanctions.

In 2010, Iran planned and took some steps towards the implementation of the following LNG projects on the South Pars Gas Field: Pars LNG (Total and Petronas) – 14 bcm, Iran LNG (OMV) –15 bcm and Persian LNG (NIOC, Shell and Repsol)– 22 bcm. All three projects were suspended due to the embargo. In addition, the following LNG projects were planned in other gas fields but failed to see any progress: Golshan LNG– 14 bcm, Lavan LNG – 3-4 bcm, North Pars LNG– 28 bcm, Qeshm LNG – 4.5 bcm.

In total, the export of 100-102 bcm of liquefied gas was planned but not implemented. The export of 152.8-158.4 bcm of gas (via pipeline or in liquefied state) in total was planned but not carried out.

Azerbaijani, Russian and Turkmen natural gas swaps with Iran afford these three countries the opportunity to engage in the above-detailed projects (those scheduled for implementation).

Russian Gas Transit to Northern Iran; It is likely that Turkmenistan will be interested in gas swap operations with Iran and will use the existing two gas interconnectors with Iran for its own export purposes. Thus, Turkmenistan will probably not allow Russian gas transit through its two gas pipelines to Iran.

Under these circumstances, Russian gas may be transported to northern Iran via either the Russia/Azerbaijan/Iran or the Russia/Georgia/Armenia/Iran gas pipelines, or both. Currently Azerbaijan does not yet produce enough natural gas to engage in gas swaps- the Shah Deniz Phase 2 gas has been fully contracted, and Azerbaijan will be able to produce additional volumes of gas for exports by 2020-2022 when Absheron, deep water Azeri/Chiragi/Giuneshli, Umid/Babek and other gas fields will be brought on-stream¹⁴. Therefore it can be assumed that transit of Russian gas southward to Iran does not create competition with Azerbaijani gas in the near or medium term.

The opening of the North/South Axis implies the involvement of Georgian gas pipelines in the delivery of Russian gas to northern Iran via Armenia. The upgrade of the Russia-Georgia-Armenia gas trunk pipelines¹⁵ will allow for the transit of a significant amount of Russian natural gas to northern Iran.

If Russia successfully conducts negotiations with Iran, Azerbaijan, and Armenia, it will be able to deliver significant volumes of natural gas (12-15 bcm) to northern Iran via the South Caucasian (Georgian/Armenian and Azerbaijani) infrastructure.

The opening of North South gas transit axis does not pose a threat to Georgia if the North/South trunk gas pipeline remains under the country's possession. On the contrary, as a result Georgian infrastructure will be loaded, and the country will gain more leverage over Russia. Armenia, in turn, being isolated from international transit projects as yet, will strengthen its geopolitical status.

Two questions become crucial in terms of the opening of the North-South gas transportation axis:

- 1. Will the opening of the North/South Gas Transportation Axis interfere with the load of the South Caucasus Gas Corridor?***
- 2. Will the opening of the North-South Axis signal a change in the Georgian foreign policy orientation in favor of Russia?***

¹⁴ Giulmira Rzaeva, The Outlook of Azerbaijani Gas supplies to Europe, Challenges and Perspectives, The Oxford Institute for Energy Studies, June 2015, p. 49-60

¹⁵ Expansion of Georgian and Armenian infrastructure, reversal and expansion of the pipeline linking Iran and Armenia.

I - Will the opening of the North South Gas Transportation Axis interfere with the development and the load of the South Caucasus Gas Corridor?– It will not, for the following reasons:

Azerbaijan’s gas from Shah Deniz Phase 2 has been contracted for transportation in the Southern Gas Corridor. Gas production in Azerbaijan is not expected to increase until 2020-2022 when new gas fields will be brought on-stream; thus, Russian gas being transported to northern Iran via Azerbaijan will not compete with Azerbaijani gas in the short and medium term. Furthermore, the market for Azerbaijani natural gas is in the EU, whereas that of the Russian gas transported via South Caucasus (Russia-Georgia-Armenia and Russia-Azerbaijan) is centered in the Persian Gulf and South East Asia.

The opening of North-South Axis will not pose a threat to the Trans-Caspian Gas Pipeline–Turkmenistan has a very high potential for gas production; it is the only country, besides Russia, able to simultaneously export gas in several different directions. Thus, it will be able to produce enough volumes of gas in order to ship 30 bcm via the Trans-Caspian Pipeline and dedicate another 20 bcm for swap operations with Iran.¹⁶

Competition with the EU market: The gas potentially transported through the North –South Axis (South Caucasus) is not intended for the EU market, but rather for the Persian Gulf countries, India/Pakistan, and South East Asia. Thus, it will obviously not compete with the gas transported through the South Caucasus gas corridor.

The talks on opening of the North/South Gas Transport Axis may encourage and accelerate decision-making with regards to the Trans-Caucasian Gas Pipeline, rather than interfere with it.

II - Will the opening of the North-South Axis signal a change in Georgia’s foreign policy course? – It will not.

- **Georgia, as a transit country for Russian gas to South East Asia (via the Persian Gulf), will gain more leverage over Russia¹⁷.**

¹⁶ Interview with the Minister of Oil and Mineral Resources of Turkmenistan, Muhament-nur Halylov, whom the author met during the Annual Energy Charter Conference, where he confirmed that despite swaps with Iran, Turkmenistan will supply the Trans-Caspian Gas Pipeline with an annual 30 bcm of natural gas.

¹⁷ Russian gas transit to Armenia currently is a dead lock with no expansion beyond Armenia

- **Armenia, which has thus far been isolated from international transit projects**, would strengthen its geopolitical status in the region and would also gain more leverage over Russia.
- Georgia would secure the opportunity to diversify its natural gas import sources as well as be able to lay the grounds for the establishment of a transparent and competitive gas market, as provided for by the EU Association Agreement and ongoing talks on Georgia's full membership in the European Energy Community.

Concerning those who consider the opening of the North/South Axis a foreign policy threat: what, then, can be said of Ukraine, which is currently at war with Russia and nevertheless seeks to maintain the transit of Russian gas¹⁸? Of Turkey, which has until recently sought to become Ukraine's alternative for the delivery of Russian gas to Europe? Of Poland and Ukraine and Slovakia, which have protested against the expansion of Nord Stream due to the expected decrease in the Russian gas load of the Yamal-Europe pipeline, and Ukraine-Slovakia network that traverse these countries? Of Germany, which strives to become the distributor of Russian gas in the EU via Nord Stream-2?

None of the above-named countries interested in retaining or expanding Russian gas transit have been known for pro-Russian policies; on the contrary, they are distinguished by their strong anti-Russian approach. Hence, the assertion that the potential use of the Georgian North/South trunk pipeline for the transit of Russian gas to northern Iran is necessarily indicative of a change in Georgia's political course and orientation for the benefit of Russia is groundless.

¹⁸ Yatsenuk Urges EU to Block Nord Stream 2 Gas Pipeline, www.lentaru.ru 07 December 2015