Energy Intelligence

VOL. 33, NO. 35
SEPTEMBER 1, 2022
WWW.ENERGYINTEL.COM

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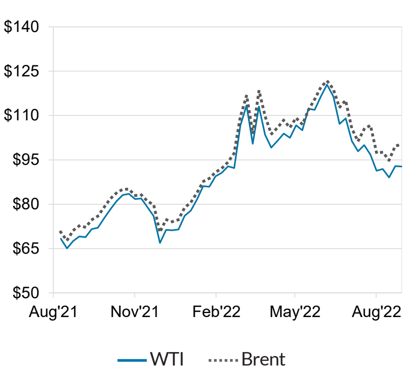

Source: CME, ICE

THE BIG PICTURE

What's the Real Potential of Iran-Russia Ties?

- *The interests of Iran and Russia are increasingly overlapping, pushing the two sides to intensify collaboration.*
- *The potential of closer ties lies in the opportunity to shape geopolitics and economic alliances by closely aligning with China and other eastern powers.*
- *Less clear is how this translates into tangible results for both sides, particularly when it comes to energy.*

Diplomacy and collaboration are alive and well between Iran and Russia. This week, Iranian Foreign Minister Hossein Amir-Abdollahian met his Russian counterpart Sergei Lavrov in Moscow to discuss the revival of the 2015 nuclear deal along with broader cooperation between the two countries, both of which presently face varying degrees of Western sanctions. Common interests are wide ranging. In Syria, both Moscow and Tehran have been backing embattled President Bashar al-Assad. Plans for a 20-year cooperation agreement covering economic and security aspects are in the making. Intensifying energy cooperation is also on the table.

"Clearly, Russia and Iran have a close relationship and it's only gotten closer … It is not to be underestimated," said one close observer of regional geopolitics. Russian President Vladimir Putin's July visit to Tehran yielded a memorandum of understanding between the National Iranian Oil Co. (NIOC) and Gazprom potentially worth $40 billion for raising reservoir pressure at the giant South Pars gas field — among other oil and gas projects such as LNG plants, export pipelines and gas swaps, according to Gazprom. This week, Lavrov reiterated that Russian oil and gas companies would start implementing projects in Iran.

Liftoff for such projects, and potential oil and gas swaps between the two, may be another matter, however — whatever the deepening political alignment between Tehran and Moscow.

Swap Constraints

The potential for oil swap deals, for example, looks limited — even if some Iran sanctions are lifted under a nuclear deal. For more than a decade up until around 2010, Iran was receiving up to 150,000 barrels per day of crude from Russia, Kazakhstan and Turkmenistan, shipped across the Caspian Sea to the Neka terminal and then delivered by pipeline to its two northern refineries at Tabriz and Tehran. In return, the shippers were allocated an equivalent volume of Iranian Light crude at Kharg Island after paying a "swap" fee that took into account the difference in quality between the Caspian grades and the Iranian blend.

Among the big shippers at the time was Russian giant Lukoil, which shipped crude from Asktrakhan, and Swiss trading giant Vitol, which delivered a combination of

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Kazakh and Turkmen barrels. All contracts were signed with Naftiran Intertrade Co., a Swiss subsidiary of NIOC later on a US and EU sanctions blacklist.

Trading sources say the small tonnage of the ships operating in the Caspian mean volumes going to Iran will be limited, and a small fraction of what Iran can handle from Kharg and other export terminals in the Gulf. There is also a finite amount of Russian crude that Iran's northern refineries can handle, they say. The Neka terminal itself is also relatively small. But it is understood that Iran is interested in receiving Russian oil products, which could also be delivered via the Caspian Sea.

Iranian Oil Minister Javad Owji meanwhile said last week that a contract with Russia for gas swaps would be signed in the near future, without elaborating further. But an Iranian official told Energy Intelligence that infrastructure constraints meant Russia probably couldn't send more than 30 million cubic meters per day to Iran. Supplies would likely come via Kazakhstan and Turkmenistan. If such a scheme materializes, it would follow a 5 MMcm/d gas swap deal signed in November that involves Turkmenistan delivering gas to northeastern Iran and Iran sending equivalent volumes to Azerbaijan.

Gas supplies are not subject to sanctions. But Iran is a relatively small-scale gas exporter, and exports to neighbors Iraq and Turkey have at times been a rocky affair — amid sanctions-related payment problems, technical issues, disagreements over price, and, at times, domestic demand taking priority.

Energy Investment — Potential vs. Reality

Moscow remains committed to supporting Iran's ambitions to expand capacity at the Russian-built Bushehr atomic power plant, and Russia is building Bushehr-2 and Bushehr-3 with an estimated price tag of more than $10 billion. Sanctions mean Iran has had problems paying Russia's state Rosatom, however, an issue that Lavrov this week said requires "special attention."

Russia is also mulling plans to establish the so-called International North-South Transport Corridor, in which Iran would play a key role as a transit country for various products from Russia delivered via the Caspian Sea. The 7,200 kilometer network of ship, rail and road routes would allow freight to be moved from St. Petersburg to India.

In light of these aims, Russian analysts argue that the restoration of the Iran nuclear deal could bring more positives than negatives for Moscow, easing payment problems at Bushehr and making investment in Iran easier. Neither is a deal expected to prompt Iran to abandon its pivot east, with Western companies and banks likely to exercise caution over Iran investment for fear of a future US repeat exit from the nuclear deal. Even if talks fall apart and sanctions remain, Moscow and Tehran will stay focused on "creating reliable and constructive mechanisms" to cooperate "regardless of any diktat," Lavrov said this week.

Lavrov added that Russian oil and gas companies, which have played little to no role in Iran's sector so far, will start implementing projects. But what Russia brings to the table here is less apparent.

Take Iran's gas, for example. High-quality steel pipelines are needed at South Pars due to its highly corrosive sour gas, Rystad Energy notes. Sanctions currently block Iran's access to such materials, which Russia cannot provide. Neither is Russia a helpful partner on LNG, with Russia's technological capabilities limited to small-scale plants. Further, aiding Iran's LNG sector doesn't seem to align with Russia's own new emphasis on LNG export capacity as Europe turns away from its pipeline exports.

That points to the potential wider strategic clash that could serve to limit cooperation between two major energy producers — especially if a revived nuclear deal enables Iran to boost oil sales into the European market as EU bans on Russian oil imports take hold. Some experts, however, argue that the Opec-plus framework can help the two avoid intensifying competition in global energy markets. Iran is not expected to be subject to a quota within Opec-plus after years of sanctions. But strong Saudi-Russia ties, alongside Saudi Arabia's cautious approach to market management, likely mean Moscow can expect any market fallout from Iranian barrels to be limited.

Oliver Klaus, Dubai, and Paul Sampson, London

GEOPOLITICS

Breakthrough for Israel-Lebanon Maritime Dispute?

The planned September start-up of Israel's offshore Karish gas field has injected fresh momentum into efforts to resolve a decades-old maritime dispute between Lebanon and Israel. Escalating rhetoric between Israel and Lebanese Shiite militant group Hezbollah in June gave way to a concerted shuttle diplomacy carried out by US Energy Envoy Amos Hochstein between the Israeli and Lebanese governments. Negotiators are now "closer than ever" to a deal, as a US official puts it, but talks have fallen apart before.

• The current Lebanese border proposal stops short of territory that encompasses the Karish field that Israel is developing, marking a retreat from a more expansive claim Beirut made in 2020.

Hezbollah leader Hassan Nasrallah has repeatedly threatened Israeli development of Karish — and other Israeli platforms — since London-listed Energean's floating production, storage and offloading vessel arrived at the field in early June. Parts of Karish sit north of Lebanon's Line 29 claim, put forward in late 2020. The field, where output is targeted at 630 million cubic feet per day, was not in disputed territory under Lebanon's previous Line 23 claim (see map).

Lebanon's proposal has reportedly shifted in recent months to somewhere in between, with Beirut wanting all of Blocks 8 and 9 — which abut the Line 23 claim — plus additional territory that covers the portion of the Block 9 Qana prospect that extends beyond Line 23, according to a source close to Hezbollah.

• A deal will facilitate production in Israel, but it won't necessarily mean a rapid boon for Lebanon, currently suffering an energy and economic crisis.

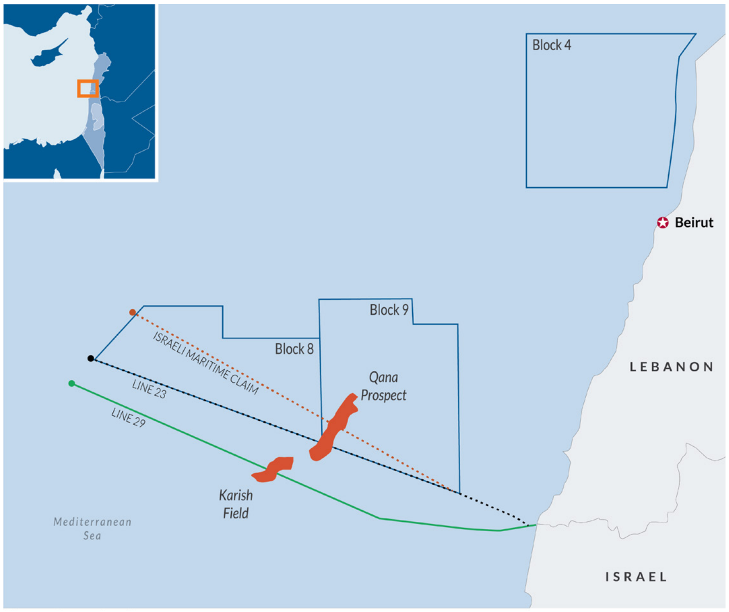
For Israel, the Karish development comes at an opportune time — if it can be done without triggering conflict. Europe's desire to wean itself off Russian gas after Moscow's decision to invade Ukraine has reopened a possible market for Mediterranean gas.

The prospects for Lebanon are less clear. The TotalEnergies-led consortium that holds Block 9 won't drill in disputed territory, Energy Intelligence understands, leaving Qana's prospectivity unknown. Private Russian firm Novatek is also planning to leave the consortium, which also includes Italy's Eni. And major oil and gas firms are having trouble commercializing even massive proven reserves — witness Total's troubled Mozambique LNG development.

Still, "there's enough of an argument that if things go well and the natural gas reserves are there, they can be used for the Lebanese people in the medium and long term," the International Crisis Group's David Wood said.

Egyptian gas supplied via the Arab Gas Pipeline could yet offer nearer-term relief. Lebanon, Syria and Egypt have agreed for state Egyptian Natural Gas Holding Co. (Egas) to transport 650 million cubic meters of gas per year to Lebanon via Syria to alleviate chronic blackouts — a deal that only works if Washington comes up with a workaround to its existing sanctions on Syria to facilitate World Bank funding. The US' Hochstein has said the two issues aren't linked, but Lebanese officials believe they are — and that reaching an agreement on the maritime border could help pave the way for the piped gas in the near term.

HOT ZONE: THE ISRAEL-LEBANON MARITIME BORDER DISPUTE



Source: Energy Intelligence

• Domestic political issues on both sides may yet serve as obstacles to finalizing a deal.

The two sides have been close to agreement before, only for a deal to fall apart as domestic politics took over. In 2012, the government of then and current Lebanese Prime Minister Najab Mikati collapsed, putting an end to the prospects of a different compromise than what is on the table today, according to an account by then-negotiator Frederic Hof. This time around, Lebanese President Michele Aoun's term expires Oct. 31, and a deal could mark a much-needed win for his term.

Israel meanwhile faces a political transition of its own. Ahead of Nov. 1 parliamentary elections, there is some speculation that Israeli Prime Minister Yair Lapid may prefer to push a possibly controversial deal back until after the poll. "I think the incentives do exist for Israel to do a deal and bring it across the line, but there obviously are some domestic obstacles," Wood said. There is also US pressure to get the deal done. In an Aug. 31 phone call with Lapid, US President Joe Biden "emphasized the importance of concluding the maritime boundary negotiations between Israel and Lebanon in the coming weeks," a White House readout said.

Waiting until after the election to finalize a deal also presents other problems for Israel. First there's the risk that Nasrallah carries through on the threat to attack Karish if production begins there before an agreement. But any Israeli decision to delay Karish risks looking like acquiescence to those threats. The US official is optimistic a deal can be done before the Karish start-up, and does not need to wait until Israeli elections.

Emily Meredith, Washington, and Yousra Samaha, Dubai

OPEC-PLUS

Dangers Proliferate for Producers

- *Challenges, on both the supply and demand sides, are ramping up ahead of Opec-plus' ministerial meeting next week.*
- *When faced with uncertainty, producers' traditional response is to do as little as possible.*
- *A desire to maintain group unity will likely trump other priorities, such as revamping Opec-plus' discredited quota system.*

Interest in Opec-plus' Sep. 5 meeting is ratcheting up, and with good reason. With the group's post-Covid-19 supply agreement having expired, all options are open. Demand concerns driven by fears of an economic downturn have kept prices under pressure in recent weeks, despite recent Saudi talk of a potential supply cut should the market warrant it. Whatever happens, ongoing Opec-plus coordination seems a sure thing, with Russian Deputy Prime Minister Alexander Novak saying Thursday that his view "is that we need to continue such cooperation" given its effectiveness to date.

A preliminary report to the Opec-plus' advisory Joint Technical Committee (JTC) of experts meeting on Wednesday highlighted inflation as a major concern. "Rising energy prices pose another risk going forward," the report added. "The latter may lead to a more significant reduction in consumption than currently anticipated, especially towards the end of the year," it warned. Opec's latest *Monthly Oil Market Report* already slashed its forecast for demand growth, with second-half growth cut by over 700,000 barrels per day compared to its previous report (see table).

'Yo-Yo' Alert

The JTC also reiterated recent comments by Saudi Energy Minister Prince Abdulaziz bin Salman over market volatility. "The paper and physical markets have become increasingly more disconnected," the report said. "In a way the market is in a state of schizophrenia, and this is creating a type of a yo-yo market and sending erroneous signals," it argued. Opec-plus would do whatever it took to deal with current challenges, including cutting supply if needed, the report said.

Despite the demand growth downgrade, the JTC halved its projection for 2022 oversupply to 400,000 b/d. This revision was driven by significantly lower projections for Opec-plus supply, compared to last month's JTC report, as a result of the inability of many countries to hit their targets.

For those market watchers looking for hints of a potential cut, the reference to members' capacity woes could be laying the groundwork for a quota redistribution, likely necessary in any cut scenario. And while the JTC projects oversupply for 2022, this peaks in the current quarter. In the fourth quarter, demand actually outruns supply by 300,000 b/d, according to the base-case scenario — a somewhat inimical environment for slashing supply.

Prince Abdulaziz's comments elicited widespread public support from other Opec-plus members, sparking fears both of a cut and that producers were inflating their price ambitions. Both of these concerns could well be overblown.

True, transition concerns could well be prompting Opec-plus members to think more in terms of maximizing revenues in the short term. But if history has taught anything, it is that producers will respond to market signals. The truth of the matter is that such is the range of market threats currently facing Opec-plus that preparation for all eventualities is only prudent.

Certainly, producers should be ready to act in the event of serious further demand weakness, especially should it be joined by news of a breakthrough in nuclear talks between the US and Iran. This could add around 1 million b/d to supply over 10 months, according to Energy Intelligence's Research and Advisory service.

Supply Shortfalls

But an Iran deal is by no means assured, and the balance of probability points to supply shortfalls. For the moment, Iraqi flows remain uninterrupted, but continued political unrest could yet disrupt oil operations at Opec's No. 2 producer (p5). Libyan output in August appeared to be recovering from June-July lows, according to loading data from analytics firm Kpler, until a recent flare-up of fighting in Tripoli between the country's warring factions. Add to these concerns the looming expiry of the 1 million b/d OECD stocks release and it is easy to argue that, barring significant demand destruction, the market could well need more, not less, oil.

Most significant is the inability of many Opec-plus members to hit their own quotas. A gaggle of capacity laggards comprised of Nigeria, Angola, Malaysia, Azerbaijan, Brunei, Equatorial Guinea and Congo (Brazzaville) appear structurally unable to get anywhere close to their targets

July output from the 19 Opec-plus members participating in cuts was almost 2.9 million b/d below quota, representing an overcompliance rate of 546%, according to Opec's average of six secondary sources. Russian production is down nearly 5% compared to the start of the war in Ukraine.

The buoyant price environment of the past two years has allowed Opec-plus to escape any consequences for the capacity slippage among its members. But going forward this is

OPEC-PLUS' BASE-CASE VIEW OF THE YEAR AHEAD

(million b/d)	Q3'22	Q4'22	2022	Q1'23	Q2'23	Q3'23	Q4'23	2023
Demand	99.9	102.2	100.0	101.8	101.3	102.9	104.8	102.7
Supply	102.0	101.9	100.4	102.1	102.2	102.5	103.0	102.5
Of Which: Non-Opec-Plus Supply	49.3	49.0	48.2	49.2	49.2	49.6	50.1	49.5
Opec-Plus Supply	47.3	47.5	46.8	47.5	47.5	47.5	47.5	47.5
Balance	2.1	-0.3	0.4	0.4	0.8	-0.4	-1.8	-0.3
Implied Stockbuild (million bbl)	194	-25	136	32	76	-36	-169	-115
Difference to 2015-19 Avg. (million bbl)	-211	-181	-181	-154	-154	-190	-225	-225

Note: Opec NGLs not shown for purposes of brevity. Source: Opec-plus JTC

likely to become an increasingly serious issue. The producer group could lower output targets quite substantially and still fail to meet quotas, undermining the credibility of any cut.

The JTC lowered its projection for Opec-plus 23 output from the fourth quarter to end-2023 by 500,000 b/d to 47.5 million b/d, but the jury is out if even this is attainable.

Creative Inaction

Similarly, any push to increase supply without first restructuring the distribution of quotas to give a larger share to those, like Saudi Arabia and the United Arab Emirates, that actually have the ability to increase output will likewise fail to gain significant market traction.

The problem for Opec-plus is that any restructuring of quotas is likely to be politically challenging and disruptive to group cohesion. Of course, there is a "Goldilocks" scenario whereby a combination of demand weakness and tepid supply keep prices near or around current high levels. Such a scenario, entirely plausible, would enable Opec-plus to continue on its current lucrative autopilot trajectory.

Rafiq Latta, Nicosia

COUNTRY RISK

Iraq's Political Crisis Pushes Baghdad to the Brink

The clashes in Baghdad's International Zone on Monday briefly raised the specter of civil war and renewed alarm at the direction Iraq is heading in. The fighting ended swiftly when powerful Shiite cleric Moqtada al-Sadr called his supporters back. But the worst fighting in the Iraqi capital for years — at least 30 people were reportedly killed in the clashes between al-Sadr's backers and Iran-aligned militias in the security forces — resulted from al-Sadr's frustration at being prevented from forming a government by his Iran-backed rivals 11 months after elections. There is no resolution to the crisis in sight, even if calls for fresh elections are growing. Energy Intelligence considers some possible scenarios.

• Violence escalates amid al-Sadr's determination to get his way, his rivals' refusal to give up their share of the spoils, and Tehran's inability to broker a compromise.

This week's unrest showed how quickly Iraq's miscellaneous security forces could turn against each other, and very well might if al-Sadr's Shiite rivals somehow found a way to form a government that excluded him, perhaps with the judiciary's help. Intra-Shiite fighting is not new in post-Saddam Iraq. Al-Sadr's militia — formerly the Mahdi Army that was disbanded and revived as the Peace Brigades — clashed with different pro-Iran factions in the years after the US invasion. "But the situation today feels different because it came out of pure anger and frustration as an act of retribution," says Sajad Jiyad, with the Century Foundation think tank, writing in *New Lines* magazine.

An unusual statement by an Iran-based elderly Shiite religious scholar at the weekend appears to have fueled that anger, prompting al-Sadr to announce his "final retirement" from Iraqi politics, which triggered the storming of the Republican palace by his supporters. Ayatollah Kadhim al-Haeri, the spiritual leader of many Sadrists, on announcing his own retirement a day earlier had urged his followers to rally behind Iran's Supreme Leader Ali Khamenei. That was a blow to al-Sadr, who lacks his father's religious credentials and has become an outspoken critic of Iran's interference in Iraq's political affairs.

A descent into civil conflict would surely accelerate the decline in foreign investment in Iraq's energy sector, fatally impeding the country's efforts to raise oil and gas production and phase out gas flaring — while also potentially disrupting production and exports in the near term. A Kurdish industry source says numerous foreign firms outside the energy sector are already inquiring about moving their Iraqi headquarters from Baghdad to Erbil.

But the Kurdistan region isn't immune from the same set of tensions. There, a string of recent rocket attacks has prompted US contractor Exterran to suspend work to expand the 450 million cubic foot per day Khor Mor gas field after insurance costs spiked, according to the Kurdish source. The Iran-backed militias reputedly behind the attacks appear to be aiming to prevent Kurdish gas from displacing Iranian gas in Turkey and sending a message to Kurds over their support for al-Sadr. Then there's the escalating row between Baghdad and Erbil over control of the Kurdish oil sector.

• The status quo persists, with the parties under growing domestic and international pressure but unable to break the deadlock.

The Sadrists may not be able to form a government, but they don't have the military capability to take control of the country either, despite al-Sadr's ability to mobilize the masses. Escalation remains a real possibility, but all-out civil war is neither in his nor Iran's interest.

The parliamentary arithmetic means, however, that the coalition of mainly Iran-backed Shiite parties led by al-Sadr's nemesis, former Prime Minister Nouri al-Maliki, will also struggle to get the two-third's quorum they need to appoint a president and vote in a new prime minister. This is partly because al-Sadr has the support of key Kurdish and Sunni factions concerned by the proliferation of, and perceived threat from, Iran-backed militias.

The status quo scenario is facilitated by record-high oil revenues. Indeed, those revenues magnify the importance of protecting Iraq's crude production and exports that are so vital to the ruling elite's patronage networks.

But the caretaker administration of Mustafa al-Kadhimi — who warned this week that he would "vacate his post" if the chaos continued — lacks the authority to enact crucial policies or make any big decisions on new oil and gas projects, like the one agreed with TotalEnergies a year ago. More social unrest driven by unemployment and poor public services seems inevitable, including in the southern oil heartlands, with demonstrators targeting oil fields, refineries and state-run companies. "Protests against the ruling system will never be far away while no serious reforms are undertaken," notes Jiyad.

• The flare-up focuses minds and leads to fresh elections.

Iraqi President Barham Salih on Tuesday added his voice to the Sadrists' call for early elections as the only way out of the political crisis. Al-Maliki has refused to endorse the idea, even if some members of his coalition who fared badly in the previous poll have cautiously welcomed it. The plan is further complicated by the process of dissolving parliament and agreeing on an electoral system. As the International Crisis Group's Lahib Higel notes, the vote could take a year to organize and create problems for al-Kadhimi's caretaker government, with many in al-Maliki's camp against him staying in charge.

The Supreme Court was on Thursday due to consider a petition refiled by al-Sadr's camp on whether the judiciary has the authority to dissolve parliament, paving the way for fresh elections. Some argue that another vote might do little to resolve the situation. It is not certain, for example, that al-Sadr would secure a larger number of seats if his opponents learn from some of their organizational mistakes in 2021. Given the low turnout in the October 2021 election, another poll risks eroding what is left of the country's democracy — especially if it was held simply to placate al-Sadr, says Hamzeh Hadad with the European Council on Foreign Relations. But a new government would at least mean a budget, the authority to sign off on new projects like Total's, and a new chapter in Baghdad's relations with Erbil.

Simon Martelli, London

GEOPOLITICS

Caspian Neighbors Build New Bridges

- *Kazakhstan and Azerbaijan are discussing plans to open up new trade routes heading west across the Caspian Sea to Turkey and Europe, and away from Russia.*
- *An envisaged scheme would bring large volumes of Kazakh oil by ship to Baku, to be fed into existing cross-border pipelines running to the Mediterranean and Black Sea.*
- *Both countries will need to tread carefully with Russia, which could shut down transit routes across its territory if it feels either is moving too close to the West.*

Kazakhstan and Azerbaijan, which are not connected by land but share a maritime border in the Caspian Sea, are moving closer together as they look to build new bridges (or expand existing ones) with Europe and reduce their dependence on Russia. It is a tricky balancing act for both countries. Kazakhstan exports most of its oil via Russia, has sizable Russian populations in its northern areas, and had to call on Russian military assistance in January to quell a wave of insurrection. Azerbaijan, while not relying so heavily on Russia as a transit route for its energy exports, needed the Kremlin's help to recapture territory from Armenia in a four-month war last year. Its ruling family, the Aliyevs, also has private business interests in Russia that could be at risk. Baku in July pledged to double gas exports to the EU by 2027, when the EU hopes to have ended its reliance on Russian gas.

The Corridor of Uncertainty

When Kazakh President Kassym-Zhomart Tokayev met with Azeri leader Ilham Aliyev in Baku on Aug. 24, he stressed the need to develop new transportation infrastructure that would allow Kazakhstan to direct more of its trade across the Caspian

Sea to Baku, and then overland to Turkey and Europe. This so-called western "corridor" has been in operation for well over 20 years, and has allowed Kazakhstan to move oil and dry goods, including grain, to the West. Until now, volumes have been limited, as most of Kazakhstan's trade, especially its oil exports, went north via Russia — by far the quickest and cheapest route to market.

The war in Ukraine has changed the calculus, however. Since the invasion started on Feb. 24, Kazakh oil flows via Russia have dropped due to a series of disruptions at the Caspian Pipeline Consortium (CPC) terminal on the Black Sea that, with a capacity of 1.4 million barrels per day, is the country's main export outlet. There has also been a fall in throughput along the 300,000 b/d pipeline that runs from Kazakhstan's western oil hub of Atyrau to Russia's Samara region. Some analysts see the Kremlin's hand behind the interruptions, as a way of warning the Kazakhs not to move too close to the West. Tokayev is meanwhile seeking to strengthen his grip on power by calling for snap presidential elections this autumn that he is certain to win.

Whatever the truth, Kazakhstan appears determined to start shipping more of its oil via the trans-Caspian route. This month, the finance chief of state oil company Kazmunaigas, Dauren Karabayev, said negotiations were being held with various parties on using two pipelines that pump Azeri oil from the Sangachal terminal near Baku: the BP-operated, Baku-Tbilisi-Ceyhan (BTC) pipeline that is running at around half of its 1.2 million b/d capacity, and the much smaller line that runs to the Georgian Black Sea port of Supsa.

It is not clear when shipments will kick off, and it could take several more months to hammer out agreements. Kazakh officials say volumes will be minimal, due to the lack of existing port capacity.

Navigating the Caspian

In the medium term, Kazakhstan will need to work out how much oil it can realistically transport across the Caspian, and how much it would cost to build an entire new transportation system — including building a new port and having a fleet of new ships to travel back and forth to Baku. There is a model to work from: Some 15 years ago, the Kazakhs and various Western majors such as Chevron and TotalEnergies devised a concept called the Kazakhstan Caspian Transportation Scheme (KCTS) that was designed to handle future oil production from the giant offshore Kashagan project, as well as the Chevron-operated Tengiz field. The idea was to build KCTS in phases, with Phase 1 having a capacity of around 250,000 b/d that would be doubled in Phase 2.

In the end, the scheme fell by the wayside, because the company decided it would not be needed. "The consensus was that CPC could handle all these extra volumes," a Western oil executive who was involved in negotiations over KCTS says. "Nobody thought too much about its vulnerability."

Chevron Over a Barrel

As operator of Tengiz, Kazakhstan's largest oil field, Chevron may emerge as the largest foreign investor in KCTS. (Under an ongoing expansion, Tengiz will increase oil production by some 30% to 900,000 b/d in the next two to three years.) It would be a tough call for Chevron, as its 40-year joint venture contract with the government expires in 2033. "Before committing, Chevron would need a cast-iron assurance from the government that they would extend the contract," a source who worked on Tengiz for years says. "Otherwise, it's money down the drain."

Azerbaijan Bides Its Time

While the Kazakhs are desperate to get the trans-Caspian route off the ground, the Azeris are in less of a hurry — and may drive a hard bargain on tariffs, industry sources say. "Kazakhstan will have to give up quite a lot of ground, as they're in a much weaker position," a veteran Caspian observer says. In the past, he says, the Kazakhs had to sell oil at a hefty premium to Socar to gain access to the BTC pipeline. "They were not happy about it at all." Azerbaijan has every reason to take the Kazakh barrels as its own production has been in steady decline for years. Output from the giant offshore Azeri-Chirag-Guneshli fields operated by BP averaged just 424,000 b/d in the first half of the year, just over half its plateau some 12 years ago.

Meanwhile, European Commission President Ursula von der Leyen said in July that increased Azeri gas imports would help Europe diversify away from Russia as it turned to "more reliable, trustworthy suppliers." The Southern Corridor pipeline system via Turkey to southeast Europe flowed around 8 billion cubic meters of gas last year.

Paul Sampson, London

CLOSING ARGUMENTS

Kosovo-Serbia Compromise, Turkey Digs In on Nato

Kosovo: Compromise With Serbia Forestalls Conflict

For the past month, Europe has been living with an almost unnoticed ticking time bomb in its backyard. While most eyes were on the ongoing Russian-Ukraine conflict, Serbia and Kosovo were squaring off in a dispute over travel documents and vehicle registration that hit a sovereignty nerve for both parties. Facing a Sep. 1 deadline for entry rules coming into effect in Kosovo, EU foreign affairs chief Josep Borrell was able to get Serbia and Kosovo to agree to guarantees that each would recognize the validity of the other's passports and national ID cards for travel between the two nations. Still festering is the issue of vehicle registration plates, with Kosovo this week setting a deadline of Oct. 31 for those with Serbian plates to switch. Kosovo Prime Minister Albin Kurti described the decision as "nothing more or less than an expression of the exercise of sovereignty."

Serbian authorities, meanwhile, were quick to note that their acceptance of Kosovar documents for travel purposes did not constitute recognition of Kosovo's independence — and therein lies the rub: The compromise over travel documentation simply kicks the proverbial can that is the issue of Kosovar independence down the road. While many in the EU recognized Kosovo as a sovereign state when it declared independence from Serbia in 2008, Serbia and several EU member states did not. The result is a permanent state of tension between Kosovo and Serbia that has been kept from exploding into outright conflict by the presence of several thousand Nato peacekeeping troops. Russia's war in Ukraine has added another dimension to the Serbia-Kosovo dispute — namely, the possibility of direct confrontation between Nato and Russian troops over tensions there, should the dispute erupt into fighting that draws in both Nato peacekeeping forces and Russian military assistance to Serbia. A traditional Russian ally, Serbia has not joined the EU in sanctioning of Russia over its invasion of Ukraine. Its military has undergone a widespread modernization program with the help of Russian-made military equipment, while Russia's ambassador to Serbia recently alluded to the possibility of Russia establishing a military base on Serbian soil.

Borrell's diplomatic intervention appears, for the moment at least, to have forestalled the possibility of a war between Kosovo and Serbia, and by extension Nato and Russia. But the compromise deal over travel documents does not resolve the issue of Kosovar independence and sovereignty, meaning tensions between Serbia and Kosovo will remain high. This further complicates Europe's already-strained relations with Russia by keeping open the possibility of direct Nato-Russian military confrontation elsewhere in Europe.

Turkey: Holding Swedish-Finnish Nato Membership Hostage

A memorandum of understanding (MOU) negotiated at the Nato summit in Madrid in late June appeared to bring closure to the issues surrounding Sweden and Finland joining the trans-Atlantic military alliance. Turkish President Recep Tayyip Erdogan had voiced strong objections to both countries' potential membership, arguing they had become "safe houses" for terrorists — citing their effective support for Kurdish separatist forces and members of the Gulenist movement, seen as linked to the July 2016 attempted coup against Erdogan.

But the MOU — struck between Turkey, Sweden and Finland — paved the way for a unanimous vote on the part of Nato to admit the two Nordic countries, pending ratification by the legislative bodies of all thirty alliance members.

Since then, several Nato members (including the US) have ratified Swedish and Finnish membership, setting a pace that could, under normal circumstances, lead to the two nations formally joining the alliance by the year's end. But these are not normal times. Erdogan, despite Ankara's commitments at the Madrid summit, has made Turkish ratification contingent upon both Sweden and Finland turning over dozens of Turkish nationals resident there for prosecution.

Erdogan's decision to Sweden and Finland's Nato membership hostage in such a public manner has made any quiet, behind-the-scenes diplomatic agreement between Turkey, Sweden and Finland over the issue all but impossible. Both Sweden and Finland have refused to comply with the Turkish demands. That seemingly leaves Erdogan to either retreat from his position, or create a huge crisis in Turkish-Nato relations by engineering the Turkish parliament's rejection of the Nordic bid for membership.

Domestic Turkish politics — namely a general election in June 2023 — offer a way for Erdogan to avoid dealing with this problem. Amid rising anti-West sentiment that Erdogan has helped stir within Turkey, including to distract attention from a worsening economy under his watch, Erdogan is unlikely to act decisively on Sweden and Finland's Nato membership ahead of the June poll. Instead, expect Erdogan to use the issue of European support for Kurdish "terrorists" to generate popular angst — and support — among the Turkish electorate. Invoking the Kurdish threat is a tactic Erdogan has long used to rally the Turkish nationalist vote behind him. One way or another, the issue of Nato expansion may have to await the holding of elections in Turkey next year.