

AZERBAIJAN KEEPS SOLIDARITY WITH GEORGIA FACING RUSSIAN ENERGY SUPPLY CUTS

by Vladimir Socor

On December 6, Gazprom spokesman Sergei Kupryanov confirmed recent press reports that Gazprom will abruptly cut gas supplies to Azerbaijan to 1.5 billion cubic meters in 2007, down from 4.5 billion cubic meters in 2006; and that it would raise the price as of January 1, 2007, to between \$200 and \$230 (“European price”) per 1,000 cubic meters, up from \$110 in 2006 (Interfax, December 6). These Gazprom decisions are correlated with its declared intention to stop gas supplies to Georgia as of January 1, unless Georgia agrees to pay the extortionate \$230 price.

Gazprom hardly bothers to adduce economic rationales for that price, which is in fact political and punitive: It practically equalizes Azerbaijan with Georgia at \$230 while their neighbor, Moscow-allied Armenia, continues paying \$110 per 1,000 cubic meters. However, Gazprom explains the volume reduction of its deliveries by citing Azerbaijan’s potential to increase its internal output of gas.

Moscow has two unstated reasons for cutting the supply to Azerbaijan: First, to prevent it from supplying gas to Georgia, if Gazprom cuts off Georgia completely as planned; and, second, to shift some Russian export volumes to European Union markets, where Gazprom can no longer be certain of meeting its growing supply commitments from the stagnant extraction levels in Russia.

Further complicating Azerbaijan’s situation, Russia’s Unified Energy Systems (UES) announced in late November that it would deeply cut electricity supplies to Azerbaijan, from the equivalent of 300 megawatts per day in 2006 to a daily equivalent of 60 megawatts after January 1, 2007, as well as raising the price of that electricity by 13%. As in Gazprom’s case (and partly due to Gazprom’s deficiencies), UES faces difficulties in supplying domestic and foreign customers at the same time, given stagnant gas supplies to UES electricity-generating plants. However, UES has hit Azerbaijan selectively, even as the company seeks to increase its electricity exports in other directions.

As a cumulative result of these moves, Azerbaijan will have to use a large portion of its internally produced gas, as well as more expensive fuel oil, instead of Russian gas, to generate electricity. Until now, Azerbaijan was using most of its internally produced gas to supply heat to households. Azerbaijan expects an internal output of 5.5 billion cubic meters of gas in 2006, slightly up from 2005. In addition, the international oil consortium seems set to produce 2.5 billion cubic meters of gas in 2006. Moscow apparently calculates that Azerbaijan would be hard pressed to meet electricity requirements and heating requirements at the same time from a still-limited internal output of gas.

Moscow’s measures follow in the wake of Azerbaijani President Ilham Aliyev’s visits to Brussels and Moscow last month. In Brussels, Aliyev made clear his country’s intention to work closely with the European Union on energy supplies from the Caspian basin to

the EU. Indeed, official Baku seems more consistent and visionary than most EU countries themselves in promoting that goal. In Moscow, Aliyev turned down reported Russian entreaties to Azerbaijan to cooperate at least passively with a Russian energy blockade of Georgia. Thus, Russian measures to cut energy deliveries to Azerbaijan seem designed to disable the latter from assisting Georgia as well as to complicate Azerbaijan's own situation.

Addressing a December 1 cabinet of ministers meeting, President Aliyev characterized the \$230 price per 1,000 cubic meters of Russian gas as exorbitant and unjustifiable commercially -- a position in tune with Georgia's. Azerbaijan is prepared to respond by slashing or even stopping its deliveries of crude oil through the Baku-Novorossiysk pipeline. Azerbaijan exported 4.1 million tons of oil through that pipeline in 2005 and seemed set to pump 5 million to 06 (almost double the pre-2005 annual figures). Part of the volume that was going to Novorossiysk would now be used in Azerbaijan to produce fuel oil to generate electricity, and another part can usefully be shifted to the Baku-Ceyhan pipeline.

Gas from Azerbaijan's giant Shah Deniz offshore field might, apparently, not be available to Azerbaijan and Georgia this winter in the time-frame and amounts required to make a decisive difference. The first volumes of gas were scheduled to be pumped into the Baku-Tbilisi-Erzurum (Turkey) pipeline in September 2006. However, gas extraction at the field and pipeline construction on Turkish territory are several months behind schedule.

Under existing agreements, Georgia is entitled to receive 800 million cubic meters of gas annually from that pipeline, including 300 million as compensation for transit services and 500 million cubic meters at the discounted price of \$55 per 1,000 cubic meters. That volume would cover almost one half of Georgia's annual requirement at present. Georgia seeks to increase the volume of its entitlement from that pipeline to 1.5 billion cubic meters annually, effective from January 2007 or as soon as that volume becomes available. Azerbaijan apparently agrees, but Turkey has yet to clarify its position.

In January-February of this year, Azerbaijan helped Georgia survive a temporary total cutoff in Russian energy supplies. Azerbaijan delivered small volumes of its own gas and electricity to Georgia and also transited small volumes of Iranian gas to its beleaguered neighbor. At that time, Iranian gas reached Georgia through Azerbaijan's recently rehabilitated, small-capacity Astara-Gazi Mahomed-Gazakh pipeline. This route might provide a partial solution this year as well on an emergency basis for Georgia, with Azerbaijan's cooperation.

(Roundup based on Azerbaijani media reports, December 1-7)

--Vladimir Socor