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# Turkmenistan's Export Crisis: Is TAPI the Answer?

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Is Turkmenistan slowly entering an unprecedented export crisis? Recently, the regime's key diversification failure—namely that affecting the country's production structure, which remained unchanged throughout the post-Soviet years—has been compounded by an unexpected yet not unpredictable reduction of Turkmenistan's export options. Exporting gas—Turkmenistan's main source of revenue—might soon become a more challenging undertaking. This short piece intends to contextualise Turkmenistan's export conundrum by questioning whether the TAPI pipeline can ultimately be seen as an adequate answer to the medium-term export crisis faced by the regime headed by Gurbanguly Berdymuhamedov.

## Turkmenistan's export crisis

In early October 2014, Gazprom announced its decision to suspend purchases of natural gas from Central Asian providers, opting not to engage in any future negotiation to renew existing contracts with key regional exporters, including Uzbekistan and, most notably, Turkmenistan. While capturing on the one hand the impact that decreasing oil prices and Western sanctions are exerting on the economy of the Russian Federation, this announcement raised on the other a number of critical questions on the long-term energy strategy of post-Soviet Turkmenistan—Central Asia's largest exporter of natural gas. While Gazprom publicized its eventual withdrawal from the Central Asian gas market, the Turkmen-Iranian energy relationship had already entered a phase of (perhaps) inexorable decline. Trade with China, as a consequence, does now have to be seen as the only long-term option for the export of Turkmenistan's natural gas. This scenario, given the rentier nature of the Turkmen economy and the extremely authoritarian undertone of local governance, is likely to raise a few eyebrows in Ashgabat, where successive regimes have pursued—with different emphases at different junctures—a fairly consistent strategy of diversification for the country's gas linkages.

The events of 2014, nevertheless, merely accelerated a trend that had come to characterize Turkmenistan's export patterns in the most recent years. This trend is ultimately paradoxical, insofar as the progressive emergence of an essentially mono-directional export policy occurred at a moment when Turkmenistan's pipeline network had come to achieve a genuinely multi-vectoral outlook. With the launching of the Central Asia-China natural gas pipeline in December 2009, Turkmenistan had finally accomplished a critically important goal, namely the establishment of a diversified network of routes to export its gas. To this end, it endeavoured to successfully commercialize three major energy partnerships, namely those with Russia, the Islamic Republic of Iran, and China. After 2009, however, the Turkmen regime began to progressively articulate its gas trade in increasingly China-centric terms. This policy decision, in quantitative terms, left a virtually indelible imprint on Turkmenistan's post-2009 gas trade.

Between 2009 and 2013, Turkmenistan's gas trade with China grew by approximately 800 percent, reaching 24.3 billion cubic meters (bcm) per annum in 2013. Data for 2014—when total gas exchanged between Ashgabat and Beijing rose to 25.9 bcm—suggested that such positive trend is persisting, although volumes traded are yet to reach the amount of 30 bcm per annum agreed upon by Turkmengaz and CNPC. A revised deal regulating the commercialization of Sino-Turkmen gas ties has been finalized in 2014, stipulating that, from 2015 onwards, China's imports of Turkmen gas would rise to 40 bcm per year. Preliminary data for 2015 seem to indicate that the parties are on track to reach this quota.

Gas trade with Russia, on the other hand, remained steady throughout 2009-2013. At the end of the period in question, Gazprom's purchases had reached 10.97 bcm—a very marginal increase from the 10.7 bcm it bought in 2009. Pre-2009 gas trade, however, was much more substantive: in 2008, for instance, Gazprom's purchases from Turkmenistan amounted to 42.3 bcm. Two distinct sets of circumstances contributed to the four-fold contraction. To begin with, the parties engaged in a major gas dispute in 2009, when trade along the Central Asia-Centre gas pipeline was interrupted for a protracted timeframe, leading Turkmenistan to experience a 25 percent GDP loss. By the time the pipeline had re-entered into line (early 2010), Turkmenistan's export outlook had been revolutionised by the opening of the Central Asia-China gas pipeline, which contributed to relegate Russia at the very margins of Turkmenistan's gas strategy. In late 2014, Russia's gas giant announced a cap of 4 bcm for 2014 purchases, claiming that recent progress in field exploration elsewhere had made the purchase of gas from Turkmenistan—and Central Asia more in general—an unprofitable enterprise. The Gazprom leadership did also announce a clear intention not to renegotiate beyond 2025 the set of deals that are currently regulating its gas partnership with Ashgabat.

The gas relationship between Turkmenistan and Iran is currently displaying a similarly bleak outlook. Quantitatively, the gas volumes traded across the Turkmen-Iranian border were never as significant as those that Turkmenistan exchanged with Russia or China: in 2006-2013, Iran's total purchases of Turkmen gas did not exceed 56.47 bcm, in spite of the construction of a new pipeline in 2010 and, in December 2013, a new compressor station in the Balkan *velayat*. In 2013, Tehran began to request with some insistence that the purchase of Turkmen gas was to be paid via barter—a practice that the Turkmen government learned to mistrust in the late 1990s, and has only reluctantly accepted ever since. Ashgabat's systematic refusal to proceed to gas-goods swaps questioned the very foundations of its energy linkages with Tehran: in August 2014, Iranian officials announced the eventual suspension of any gas trade with Turkmenistan, stating that a planned increase of domestic production would make imports unnecessary from 2017 onwards. The drastic tones of this declaration were nevertheless diluted by a deal signed in November 2014, in which Iran committed to keep buying Turkmen gas. The real impact of this last-minute deal over the future development of Iran-Turkmenistan gas ties will be appreciated in full only when data for 2015 is ultimately released: recent developments have, however, confirmed that Turkmenistan's traditionally stable gas relationship with Iran has now entered a very tumultuous phase.

The overall decline in gas volumes exported is not the only factor behind the decrease in total revenue derived from the commercialization of the three gas relations in which Turkmenistan is currently involved. Falling gas prices, more specifically, contributed to the recent contraction experienced by the country's gas revenues. At the same time, trade with China has been—and will remain in the short term—unprofitable: traded gas volumes are used by the government in Ashgabat to repay the debt it contracted with CNPC for the construction of the China-Central Asian gas pipeline and the development of the Galkynysh gas field. The politico-economic imperative to repay this debt in the shortest timeframe possible does perhaps represent the ultimate rationale for Ashgabat's manifest willingness to revise upwards the amount of gas volumes to be sold to CNPC.

In its latest iteration, Turkmenistan's energy policy—a critical component in the survival strategies devised by the Berdymuhamedov regime—appears to be fundamentally dependent on China. The multi-layered nature of this specific dependency is an unprecedented feature of the Turkmen energy continuum, insofar as it strands beyond the export and infrastructure sector, and comes to permeate the strategically important areas of field exploration and development—two sectors in which Gazprom never enjoyed the monopolistic position currently occupied by CNPC. Is this scenario tolerable for the Turkmen regime, which has traditionally perceived its own stability as a function of the country's hydrocarbon clout? A closer look at the Turkmen economy seems to suggest that energy dependency is to become, in the medium-term, a significant source of instability for Berdymuhamedov and his associates.

Notwithstanding the unrealistic GDP data issued by the government since the mid-2000s, the Turkmen economy may have now entered a period of crisis. The snap-devaluation of January 1, 2015, when the *manat* lost approximately 20 percent of its value, led to rampant inflation, which hit food prices across the country particularly hard. The economic hardship experienced by the wider population was exacerbated by the government's associated decision to end the system of subsidies that traditionally regulated domestic energy use in both the residential and the transport sectors. Falling gas revenues certainly played a medium-term role in the progressive deterioration of Turkmenistan's economic performance, whereas exogenous factors, and Russia's monetary crisis more in particular, acted as the short-term catalyst for the very negative juncture entered by the Turkmen economy in 2015.

In this context, long-term prospects of total gas dependency on China's purchases have come to haunt decision-makers in Ashgabat: any future decrease in either the prices at which gas trade with China is conducted or, most crucially, in the volumes bought by CNPC will further aggravate the ailing status of Turkmenistan's economy. The commercialisation of new gas relationships and the diversification of gas route exports—two objectives that the regime had apparently settled in 2009—did therefore return to the epicentre of Turkmenistan's foreign energy policy.

In this context, the operationalisation of the Turkmenistan-Afghanistan-Pakistan-India (TAPI) natural gas pipeline project re-emerged as an apparently crucial end to be sought by the regime in Ashgabat. Providing an informed assessment of TAPI's operationalisation prospects is ultimately germane to discuss how future patterns of gas (in)dependency will affect dynamics of regime stability in Turkmenistan: it is precisely to this issue that the next segment will focus its central attention.

**The TAPI saga: A never-ending story**

Since the mid-1990s, a very protracted series of brusquely interrupted negotiations, inconsequential quadripartite agreements, and opaque commercial deals characterised the development of the TAPI pipeline project. At the time of writing, construction works have yet to begin and, while total costs are soaring, the parties involved are yet to identify a commercial champion to execute the operationalization of the 1,814 km-long pipeline.

Speculations about Turkmenistan's interest in TAPI dated back from 1994-1995, when the late Saparmurat Niyazov established a negotiating table with Pakistan and Argentinian energy company Bridas to carry out a feasibility study for a Trans-Afghan natural gas pipeline, the route of which was to be eventually extended to the Indo-Pakistani border. This is not the place to re-analyze the intricate circumstances that saw Unocal and Bridas presenting competing visions for TAPI: nevertheless, a closer look at the factors that led to the project's progressive loss of relevance in the mid- and late-1990s does ultimately facilitate a more focused understanding of the pipeline's current operationalisation prospects.

Beyond the security concerns that crystallised while the Taliban were extending their control over increasingly larger portions of the Afghan territory, two critical questions, which were related respectively to supply and demand, did ultimately compromise the feasibility of TAPI in the 1990s. On the one hand, the size of Turkmenistan's total reserves was at the time believed not to be sufficiently big enough to support the 20 bcm to be pumped each year. On the other, international observers repeatedly questioned whether TAPI's main buyers—namely India and, to a lesser extent, Pakistan—held any potentiality as significant gas markets. Twenty years on, these specific concerns had all but vanished.

After a series of independent audits of specific gas fields, Turkmenistan's total gas reserves are now believed to constitute the fourth largest in the world: a 2013 assessment estimated that total proven reserves were amounting to 17.5 tcm. Official data on the natural gas sector, which the Turkmen government released for the first time in 2014, set a 2015 total production target of 83.8 bcm. Turkmenistan's export potential is therefore rapidly expanding, and will be further boosted by the entry into line of a domestic pipeline connecting the Dauletabadgas field with other major fields located in the country's Balkan *velayat*.

On the other hand, the recent economic development experienced by India and, to a lesser extent, Pakistan, strengthened the structural demand component of the TAPI project: the most recent estimates established that over 95 percent of the 33 bcm of natural gas currently projected to flow through TAPI will be purchased by India and Pakistan. Afghanistan, in this sense, is expected to represent a marginal buyer within the TAPI consortium: its involvement in the project is mostly connected to the transit stage, for which the government in Kabul is expected to reap some significant fees.

And it is precisely the issue of transit that has obfuscated the current implementation prospects for the TAPI pipeline project. Consortium members have reportedly settled on a rather definitive route for the TAPI pipeline, which is now planned to run through four Afghan provinces (Farah, Herat, Kandahar, and Helmand) before reaching Pakistan: in 2015, the security of the pipeline's Afghan segment, which stretches for over 800 km, represents a major concern, just as it did in the late 1990s. To ensure the security of this segment, the government in Kabul has announced the deployment of up to 12,000 security personnel.

Some recent developments, at the same time, opened new scenarios for the wider Turkmenistan-Afghanistan security relationship, and TAPI implementation more in particular. Since late 2014, Taliban militia gained partial control over two Afghan provinces that border Turkmenistan, namely Faryab and Jowzjan. Potentially, proximity with the Taliban could present Turkmenistan with the opportunity to re-open those lines of communication that, in the late 1990s, allowed the Niyazov regime to establish a good relationship with the Islamic Emirate of Afghanistan. It is, however, virtually impossible to predict the impact that the re-establishment of Turkmenistan-Taliban relations could exert *vis-à-vis* the security of TAPI's Afghan segment, and whether such relations could ultimately facilitate the finalization of localized pacts with warlords and tribal leaders along the pipeline's projected route.

Failure to identify a commercial champion for the project has to be seen as the other major obstacle to full operationalization of TAPI. The legislative framework designed to regulate the consortium is rather comprehensive, while the Asian Development Bank has been acting, since late 2013, as the project's transaction advisor. To date, however, very little progress has been made in the identification and the appointment of a commercial leader for the TAPI consortium. In this context, Turkmenistan's sustained reluctance to allow a more flexible ownership structure for exploration rights has to date prevented the involvement of specific energy actors—Chevron and ExxonMobil in particular—which had initially expressed interest in leading the project currently estimated at US$ 8-10 billion. Total, Dragon Oil, and Petronas are repeatedly tipped to be at the forefront of the commercial race for TAPI consortium leadership: this race, in mid-2015, appears to be very far from being concluded.

**Final remarks**

Turkmenistan has entered an energy cul-de-sac. The crystallisation of medium-term dependency on CNPC purchases has put the Berdymuhamedov regime in a very uncomfortable position. Banking on China's protracted gas 'thirst' and on long-term stabilization of gas prices might lead to a further contraction in Turkmenistan's total gas revenues. In an economic system where the hydrocarbon sector continues to account for 35 percent of GDP, 90 percent of exports, and 80 percent of fiscal revenues, long-term decline in revenues is a very risky option.

As diversification of the country's economic structures is simply not an option for a regime that thrives on monopolistic control of gas revenues, the only remedy to total gas dependency on China is represented by a further diversification of Turkmenistan's export routes. The expansion of gas linkages with South Asia, to be accomplished through the operationalization of the TAPI natural gas pipeline, does however represent a very challenging undertaking. Huge financial costs are not the only hurdle to the project's full implementation, as major security concerns and failure to identify a commercial champion appear to prevent TAPI development. A hypothetical relaxation of Turkmenistan's very rigid procedure in regulation of exploration and development of on-shore gas fields might somehow facilitate the appointment of a consortium leader. TAPI's (in)security problems, on the other hand, appear largely intractable. Turkmenistan's security of gas export, in this sense, is not to be achieved by looking at TAPI.