Pipeline politics

The formal launch of the Iran-Pakistan gas pipeline project has been billed as part of the solution to Pakistan's deepening energy crisis. Its success, however, is not just a question of diplomacy, as Damon Evans discovers

IP pipeline: Can Pakistan afford the proposed project?

UNDER president Asif Ali Zardari little has been done to solve Pakistan's energy crisis. Energy shortages not only bring daily difficulty to Pakistani households, they are blunting the country's economy as well.

Yet in a bid to woo voters before this May's presidential elections, Zardari initiated the Pakistani section of the IP pipeline on 11 March, much to the annoyance of the country's awkward but longstanding ally the US.

Many see the long-delayed launch as no more than a gimmick to shore up the government's declining popularity at the end of its five-year term rather than a genuine effort to make the pipeline a reality.

But, says Sajjad Ashraf, a former member of the Pakistan Foreign Service and now a professor at the National University of Singapore, in Pakistan there is rare unanimity on the need to complete the pipeline from Iran.

Pakistan's gas shortage is a major challenge for the country's economy. Its economy grew at an average rate of 3% over 2008 to 2013, compared with a 7% growth rate between 2003 and 2008. And the energy crunch has led to a production loss worth over $5 billion per year, according to finance ministry estimates.

It looks set to deteriorate further. With domestic production predicted to fall from around 4 billion cubic feet a day (cf/d) to 2 billion cf/d by 2020, and demand projected to reach 8 billion cf/d by the end of the decade, the gap would only be partially plugged by Iranian gas.

If all goes to plan, the Iran-Pakistan (IP) pipeline will eventually pump 21 million cubic metres per day (cm/d) (about 750 million cf/d) of Iranian gas to Pakistan, Siddik Bakir, a Middle East and South Asian energy specialist at IHS World Markets Energy told *Petroleum Economist*.

This is much less than the Turkmenistan, Afghanistan, Pakistan and India (Tapi) pipeline – a competing project on paper and yet to come into existence – which would have a capacity reaching 90 million cm/d of gas, if it ever materialises, adds Bakir.

Iran will sell its gas to Pakistan for 25 years at a price of $11 per million British thermal units (Btu), based on 65% of crude price plus transportation costs, according to IHS.

This would be more than double Pakistan's domestic gas price, now $5/million Btu. Still, it is 25% cheaper than the cost of fuel oil, and could shave $1 billion per year off the country's fuel bill, says Bakir.

Low reserves

Pakistan is blessed with ample energy resources, especially gas and coal, but high consumption is rapidly depleting them. National oil company Oil and Gas Development Company Limited, predicts domestic oil reserves will be finished by 2025, followed by gas in 2030.

In order to meet Pakistan's energy needs, the pipeline from Iran offers the shortest and quickest possible solution, Qamar Zaman Kaira, Pakistan's minister of information, told state-run Pakistan Television recently.

The US is less enthusiastic about the plan, pushing for the alternative Tapi pipeline, but Kaira said that could not progress until there is peace in Afghanistan.

The US State Department warns that if the IP project actually goes ahead – and that is subject to debate, especially as the the proposal has been put forward at least 10 times in the past 19 years – that sanctions could be triggered.

But while many question the Pakistani government's intentions in signing the IP deal at the end of its term, it could well be a smart tactical move.

Ashraf says it may well be that the threat of sanctions is worth the risk because the Pakistan-dependent US withdrawal from Afghanistan has only just begun and will continue beyond December 2014, when the IP pipeline is due to be finished.

He believes the US may be compelled to ignore the project – like it did with Pakistan's nuclear activities until 1989, when the last Soviet soldier left Afghanistan.

Aside from the international politics, the IP pipeline success will also hinge on the 11 May election.

Other plans

Nawaz Sharif, the frontrunner in the battle to become Pakistan's next prime minister, is much more aligned with the Gulf states, particularly Iran's foe Saudi Arabia, than the current government. Sharif, a former prime minister, was ousted from power in a military coup, and jailed for kidnapping, hijacking and corruption in October 1999. He went into exile in Saudi Arabia in December 2000, and spent much of the next seven years in the Gulf states. He returned to Pakistan at the end of 2007.

Under Sharif, the IP project is much less likely to happen, IHS Asia analyst, James Brazier, said.

Saudi Arabia has reportedly offered to deliver an alternative package, which would include a cash loan and oil import deal if Pakistan abandoned its cooperation with Iran.

It is also thought that Sharif could secure a more favourable liquefied natural gas (LNG) import deal with Qatar than the current government.

However, after the IP pipeline groundbreaking ceremony, local media reports claimed Qatar has offered to sell Pakistan 2 million tonnes per year of LNG at reduced rates. Earlier, Qatar, the world's biggest LNG producer, had offered a deal at around $18/million Btu, but an official at the petroleum ministry said the new rate was expected to be $4 to $5/million Btu lower.

For now, though, Pakistan has no facilities to import LNG.

Nevertheless, putting the political challenges aside, there is also the question of funding the IP pipeline.

According to Iran's deputy oil minister, Javad Owji, the pipeline from the South Pars gas field is all built, except for the final 320km to its border with Pakistan.

But it is not clear how Pakistan, which is strapped for cash, will fund its part of the pipeline, estimated to cost $1.5 billion.

Pakistan says that Iran has offered some $500 million in financing to help pay for the remaining 750km to be built on Pakistan's soil. But even if Iran comes through, Islamabad still needs to find another $1 billion.

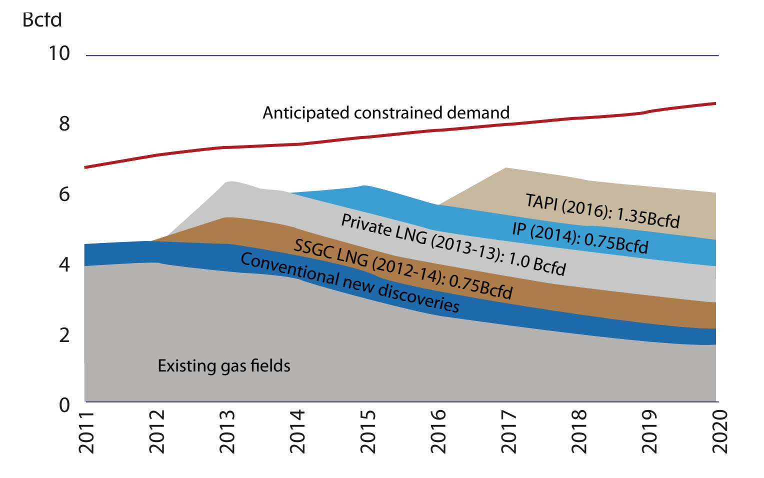
Enter China, which Brazier, says is quietly triangulating the relationship.

Pakistan has refused to speculate in public on China's involvement, although one senior official told IHS that Chinese financing is very likely, which corroborates reports from Western diplomats in Islamabad.

Mindful of the strong US opposition, it's unlikely China would lend directly to the Iranian or Pakistan governments, instead channelling funds quietly through banks to private firms involved in the project, say diplomats.

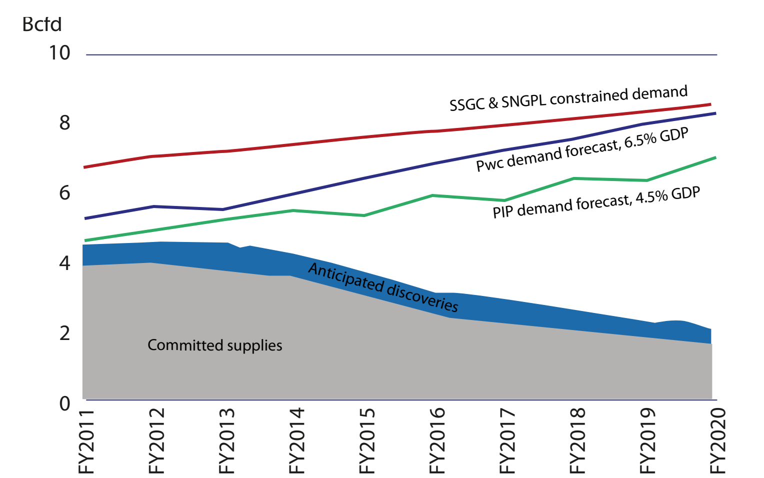
Without Chinese backing, Brazier sees little hope for the pipeline. But Pakistan is offering China a trade and energy corridor via the strategic deep-water port of Gwadar to Xinjiang province. Brazier says that an often ignored

Figure 1: Natural gas supply shortfall mitigation plan



Source: Inter State Gas Systems

Figure 2: Natural gas demand projections



Source: Inter State Gas Systems

Figure 1: Proposed Iran-Pakistan pipeline route

Source: Petroleum Economist

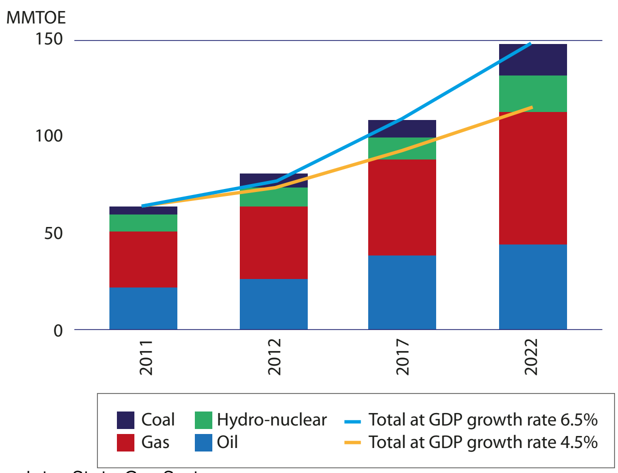
insight into the IP project involves Pakistan's decision to hand over Gwadar port in the southwestern province of Balochistan, where the pipeline will enter Pakistan, to a Chinese operator earlier this year.

A development that concerns the US, not to mention India, for fear that China will extend its naval reach into the Gulf.

Crucially for Beijing, Gwadar, the delivery point for the IP pipeline, lies at the gateway to the Strait of Hormuz, a key world oil supply route. It sits at the juncture of south Asia, central Asia and the Middle East.

Under the plan, oil would be imported from the Middle East, stored in refineries at the port and shipped to China by road, rail or pipeline, thereby cutting out the extra expense and journey time of using the Malacca Straits. Pakistan has also begun talks with Iran about a $4 billion oil refinery at the Gulf port, to be built by Iran, highlighting the convergence of China's interests with those of the Iran in the region.

Figure 3: Projected energy demand



Source: Inter State Gas Systems

Reluctance

Still more investment in transportation infrastructure is needed before Gwadar can be turned into an economic hub, but some analysts suggest China is reluctant to invest in the somewhat volatile Balochistan province, home to a minor insurgency. But Chinese investment is no stranger to hostile environments.

Nevertheless, Brazier points out that the southern coast is relatively safe and if China did land oil at Gwadar it could initially drive tankers east, then northeast up the safer Karakoram Highway.

On the other hand, Brazier would be surprised if the IP pipeline were connected to China, as it would be a major logistical and technical challenge to traverse some difficult terrain, including the Himalayas.

Ultimately, China is bent on diversifying its energy supply routes and Pakistan has opened its doors. It would come as no surprise if Chinese backing helped make the IP project a reality.

Whether Iranian gas will ever flow to Pakistan remains to be seen. But from the end of 2014, Pakistan would be obliged to pay Iran for gas under a take-or-pay contract linked to the pipeline project, regardless of whether it actually received any gas or not.

As Gareth Price, a South Asia specialist at Chatham House, says: "Pakistan needs energy and if the world's largest gas field sits next door, then the pipeline makes sense". ●