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A NEW ROUTE FOR RUSSIAN GAS, BYPASSING UKRAINE - THROUGH TURKEY POLICIES AND PROSPECTS

LIANA JERVALIDZE

EXPERT OPINION

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During his visit to Turkey on 1 December 2014, President Putin announced Russia's decision to discontinue the South Stream project since the initiative failed to gain the support of the European Union. Moreover, Mr Putin declared Russia and Turkey's joint willingness to construct a new interconnecting 63 bln m³ capacity pipeline which would replace the South Stream as a project by-passing the Ukrainian gas transportation infrastructure and realise Turkey's long-standing dream of becoming an energy hub.

President Putin's statement came as a complete surprise and gave rise to numerous queries regarding the feasibility of redirecting the South Stream to Turkey and what this would mean for Russia and Turkey as well as other stakeholders.

The position of Russian gas exports to the EU markets: In 2013, Gazprom supplied the EU with 161 bln m^3 of gas which amounted to approximately 30% of EU consumption. Of the total, 86 bln m^3 was imported via Ukrainian infrastructure. Russia has three more pipelines supplying Europe: the Nord Stream – 55 bln m^3 (passing along the Baltic Sea bed), Yamal – 32 bln m^3 (passing by Belarus and Poland) and the Blue Stream – 16 bln m^3[1] (entering Turkey via the Black Sea). The Russian and Turkish sides agreed to increase Turkey's annual capacity to 19 bln m^3 by 2020. In the case of a maximum load on these pipelines, Gazprom will be able to transport approximately 100 bln m^3 of gas to Europe, by-passing Ukraine. If Russia maintains the gas market in Europe (161 bln m^3 in 2013), prior to the construction of the new Turkish pipeline (Turkish Stream, 63 bln m^3 of gas will still have to be transported using Ukrainian infrastructure. According to official information, the "Turkish Stream's" capacity should amount to 63 bln m^3 which means that Gazprom intends to fully by-pass Ukraine.

Thus, over 50% (87 bln m^3) of Russian gas exports to the EU will be transported via Turkey.

A significant number of experts agree that the European Union will be unable to substitute 50%, not to mention 100%, of Russian gas with that from other suppliers by 2020 (and even 2025) and at a lower price than Russian gas.

Conflict of interest over the South Stream EU versus Russia: The South Stream was a project of geostrategic magnitude which would not only by-pass Ukraine, "a difficult transit partner" for Russia, but also ensure Russia's energy and economic expansion in Southeast and Central Europe. Along the projected South Stream route, Gazprom set up several joint ventures with local gas transportation companies securing the support of governments and a monopoly position for its gas in transit countries.

1 www.gazprom.com

The design and agenda of the South Stream came across the provisions of a Third Energy package which was enacted in the EU by late 2009. The Third Energy package prohibits access to markets and the possession of shares in pipelines by all gas suppliers, including Gazprom. The European Commission urged the South Stream to comply with the Third Energy package requirements and denied Gazprom any derogation from the existing rules.

In response, President Putin declared the South Stream cancelled and announced that Russian gas would be transported by the so-called "Turkish Stream" via a new route through Turkey. According to official sources, the Turkish Stream's route looks like it has been agreed upon by the Russian and the Turkish sides but some modalities still remain at an early stage of approval. The Turkish Stream is likely to enter the western part of Turkey and end up close to the Turkish-Greek border. The Turkish Stream creates completely new realities for the EU, Russia and Turkey as well as for the Caspian region.

Russia's perceived strategic outline: Turkey is not an EU member state and so the Third Energy package requirements do not apply to it. Through redirecting the South Stream to Turkey, Russia may be pursuing the following objectives:

- Avoiding the impact of the Third Energy package and maintaining the access of its gas to the EU market.
- Strengthening geostrategic and geo-energy relations with Turkey.
- Further exacerbating the disagreement between Turkey and the West within the NATO format as well as on the subject of Turkey's full membership to the EU and Turkey's full-fledged participation in the ongoing negotiations on trans-Atlantic free trade.
- Further exacerbating the conflict of interest among the old EU member states and the new Southeast European members of the EU which suffered economic losses as a result of the cancellation of the South Stream.
- Using the above to the benefit of its own interests (economic and strategic expansion in the Southeast and Central EU).

Turkey's perceived strategic outline: Turkey's long-term proclaimed objectives are to become a full-fledged member of the European Union, become an equal party to the ongoing negotiations on trans-Atlantic free trade and become a hub for the European gas supply; that is, not only to transport gas but also purchase and resell Iranian, Azerbaijani, Turkmen, Northern Iraqi and, now, Russian gas. Furthermore, Turkey may view Russia as a strong partner in maintaining its current status and regulation in the Black Sea.[2]

If and when established as a “gas hub” for the EU, Turkey’s strategic posture will strengthen vis-à-vis its partners in the West (the EU as a consumer of energy) and in the south and the east (as producers of energy resources in the Caspian, Eastern Mediterranean and the Middle East). Of the listed potential suppliers, Turkey may consider Russia as the most reliable gas supplier in terms of a resource base.[3] For Russia, however, maintaining the South Stream in its existing format was crucial since the agreements concluded under the South Stream were designed for serving Russia’s economic and strategic expansion in Southeast and Central Europe.

The new format of Russia-Turkey relations calls for a revision of the established partnership relationships in the region whose outcome is extremely difficult to foresee.

If the above perception of Turkey’s strategic interests is correct, then Turkey’s rapprochement with Russia may be viewed as an attempt by Turkey to attract the attention of its partners in the West to its genuine long-term strategic interests in the region.

According to official media sources, Turkish society is frustrated by the fact that after several decades of the Association Agreement having been signed, the country has not become a full member of the European Union. Further, the West does not fully take Turkey’s interests into consideration as the main regional NATO partner and military power while attempting to arrange a settlement in the Middle East. On the contrary, the current developments in the Middle East have sometimes been viewed as potentially dangerous and bringing about serious implications for Turkey. In addition, Turkey has not been invited as a party to ongoing talks between the US and the EU on free trade[4] which can potentially result in heavy losses for Turkey’s economy.[5]

The **Turkish Stream** envisions the construction of four parallel pipelines[6] on the bottom of the Black Sea stretching from the Russian coastline to

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2 Mehmet Ogutcu, Center for Global Resources, www.globalresourcescorp.com

3 First, Russia is number-one in terms of gas reserves and second, the Turkish Stream is not about new resources but about redirecting the same resources from the Ukrainian route.

4 The open letter published by Carl Bildt and Javier Solana in mid-January 2015 points to the necessity of involving Turkey in the US-EU free trade talks.

5 Kemal Kirișci, “Turkey and the Transatlantic Trade and Investment Partnership Boosting the Model Partnership with the United States,” *Turkey Project Policy Paper Number 2,* Center on the US and Europe, Brookings, September 2013

6 Gazprom plans to utilise the pipelines intended for the South Stream.

the European part of Turkey. It will not connect to the planned Trans-Anatolian Natural Gas Pipeline (TANAP) which is a part of the Southern Gas Corridor and will supply Europe with Azerbaijani gas. The capacity of the Turkish Stream should amount to 63 bln m^3. The installation of the first pipeline with the capacity of 15 bln m^3 is scheduled for completion in December 2016. Gazprom will be able to sell this gas in Turkey, Bulgaria and Romania with no difficulty. However, marketing the remaining 45 bln m^3 in Europe will be more problematic since no relevant infrastructure exists and Gazprom has no intention of building any.[7] Thus, as stated by the Russian side, if the EU wishes to receive Russian gas, it should build a gas transportation network from Greece onward to the EU.

The transformation of the South Stream into the Turkish Stream creates an entirely new dimension for Russia and Turkey as well as for Ukraine and the European Union:

Ukraine: Gazprom's contract with Naftogaz on gas supply and transit to Europe is set to expire in 2019. The parties are not currently conducting negotiations on the supply and transit of gas. Thus, if a new contract is not concluded, by-passing Ukraine will take place as a natural course of action. Ukraine will lose Russian gas transit and, with that, leverage on Russia.

Eastern European transit countries – loss of Russian gas transit and loss of transit revenue: Gazprom's contracts include the provision on use-or-pay which establishes the minimum level of the use of the transit capacity by Gazprom. If Gazprom uses the capacity of the network below the minimum level as provided for by the contract, it will have to pay fines.[8] The majority of these contracts are valid until 2025[9] which allows Ukraine to presume that Russian gas transit will continue via its territory until 2025.[10] Given the fact that Gazprom started working on the South Stream in 2006 and projected to commission it in 2016 (before 2019 when the gas transit contract with Ukraine would expire), it can be assumed that Gazprom would have taken the above provisions and other commitments into consideration under the existing transit contracts. Obviously, Gazprom was aware that it would have to pay fines to transit countries for the non-use or the use below agreed levels of the transit network under the use-or-pay

7 www.caspianbarrel.org, Mikhail Korchemkhin, East European Gas Analysis

8 Tatiana Mitrova, *What Are the Big European Suppliers Going to Do to Model their Supply to the European Market?,* RAS Energy Research Institute, 29 January 2014

9 Tatiana Mitrova, *What Are the Big European Suppliers Going to Do to Model their Supply to the European Market?,* RAS Energy Research Institute, 29 January 2014

10 Mikhail Korchemkhin, "Can Russia, Ukraine and the EU Reach a Gas Agreement?," *East European Gas Analysis*, Carnegie Endowment for International Peace, October 2013

provision of the existing gas transit contracts.[11] Therefore, it is likely that Gazprom would increase the load on the South Stream in parallel to the exhaustion of transit contracts with Ukraine and Slovakia.

Seasonal adjustment of gas transit: Ukraine's transit network is ideal for Russian gas exports to the EU not only due to the old Soviet heritage of the pipeline infrastructure but also the gas storage[12] located at the Slovakia-Ukraine border. With the building of the South or Turkish Stream, Gazprom will have not only built a new pipeline network but also secured new gas storage to meet the high seasonality of gas demand in the EU.

In order to regulate the seasonal demand in the EU, Gazprom has built gas storage of over a 5 bln m^3 capacity in the Krasnodar and Stavropol Kray regions of southwest Russia. In addition, Gazprom has leased gas storage capacities (0.2 bln m^3 and 4.5 bln m^3) in the Netherlands, Germany, Italy, the Czech Republic and Serbia.[13] It is likely that Gazprom had leased the aforementioned storage in the format of the South Stream since the company would no longer be able to rely on gas storage in Ukraine and Slovakia.[14] Thus, having secured gas storage capacities in the EU, Gazprom would have to deal with such issues as the status, direction and point of sale of the onshore pipelines rather than the gas storage.

Turkey as the EU's supply hub – technical aspect: In order for Turkey to become a gas hub for the EU, it has to meet several conditions. It has to possess a high-capacity pipeline infrastructure and gas storage, and buyers and sellers will have to agree on Turkey as the purchase/sale point which implies the existence of adequate trade and financial platforms in Turkey.

According to official sources, Turkey intends to increase the capacity of its pipelines to 110 bln m^3 which envisions the construction of one or two additional pipelines besides the TANAP.[15]

Currently, Turkey does not yet possess the transit gas pipelines and gas storage necessary for serving as a physical gas hub for the EU. In addition, no gas purchase sales platform exists and producers and consumers have

11 The term use-or-pay implies paying a penalty for the non-use of pipelines; in addition, a minimum capacity is determined and the lessee is obliged to pay a fine if employing less than the designated minimum capacity.

12 At its border with Slovakia, Ukraine has 30 bln m^3-capacity gas reservoirs. High-capacity reservoirs are also located in Slovakia.

13 www.gazprom.com

14 Since the South Stream would by-pass both which, naturally, would cause their discontent.

15 *Turkey's Role as a Mega Energy Hub*, Natural Gas Europe, 22 December 2014

not yet agreed on Turkey as a gas sales point. Proceeding from the above, a significant amount of time, energy and financial resources are needed for Turkey before it establishes itself as a gas purchase/sale platform for the EU.

Turkey as the EU's supply hub, geopolitical aspect: Turkey is part of the group of the 20 largest economies in the world and it is the number-two military power in the region after Russia. As such, Turkey tries to secure and consolidate its national interests in the regional and international arenas. Turkey has been striving to become a full member of the EU for a long time already. The EU is in recession while Turkey is manifesting economic growth and stability. Turkey's full membership to the EU would mean that Turkey would have a direct impact on decision-making which is opposed by leading economies within the EU.

Setting a gas hub in Turkey would further strengthen its position vis-à-vis its neighbours and partners in the West, the Middle East, the Caspian region and Russia. Becoming a gas hub will empower Turkey with exceptional conciliatory and mediatory strength in the region. Therefore, the establishment of a gas hub in Turkey may possibly have positive implications on the regional gas trade only if it becomes a full member of the EU and fully complies with the requirements under the Third Energy package.[16]

Thus, Russia-Turkey relations and the establishment of a strategic partnership will depend on whether or not Turkey will be accepted by the West as an equal partner on both sides of the Atlantic. Therefore, it is likely that Turkey may exploit the opportunity of rapprochement with Russia as a tool to influence the West in the same vein that Russia may use the Turkish Stream project to implement the South Stream in the current format.

Possible impact of the South Stream diversion to Turkey on the Southern Gas Corridor: The South Stream was not projected as a new resource base; it was designed for the transportation of the same gas resources to the EU market, by-passing Ukraine. Hence, the Azerbaijani side did not consider this project as competitive to the TANAP. If the South Stream remains in the same format via Turkey (that is, only the resources passing via Ukraine will be redirected), it will not be able to compete with the Southern Gas Corridor which is targeted at the new resource base and theoretically should fill in the supply gap emerging as a result of the decrease of European domestic gas production. Thus, in order to fill in this gap, the demand for Azerbaijani, Iranian and/or Turkmen gas will still exist

16 If the EU extends full membership to Turkey, its internal regulations will apply to the Turkish energy sector as well and if the Turkish Stream is constructed, Russian gas will once again be limited to the Black Sea.

on the EU market (given the demand on the EU gas market remains at the current level as a minimum).

In addition, it is noteworthy that the new version of the South Stream, the so-called Turkish Stream, is set to enter the European Union via the same Turkish-Greek route used by Azerbaijani gas through the Trans Adriatic Pipeline (TAP). The last elections in Greece were won by a Euro-sceptic leftist party which gives rise to numerous questions on whether or not Greece will remain an EU member and a reliable transit partner.

Besides the Greek route, gas can be transported via Bulgaria through the old Nabucco-West pipeline to the Baumgartner hub in Austria. Thus, from the Turkey-Greece border, gas flow can be redirected both via the Trans Adriatic Pipeline (TAP) as well as the old Nabucco-West pipeline. The so-called Western Pipeline, connecting Bulgaria and Turkey through which Russian gas is supplied to the Istanbul agglomerations, can also be used for this purpose if this pipeline is reversed since the term for usage of this channel in the current format (north to south) expires in 2022.

According to Turkish officials, the TANAP and a strategic partnership with Azerbaijan remain a priority for Turkey. In addition to the emerging Turkey-Russia energy partnership, Azerbaijan's rapprochement with Russia, which commenced in 2012, is taking place at an obvious and accelerated rate. SOCAR, the Azerbaijani oil and gas company, signed agreements with the Russian public companies, Rosneft and Gazprom, on the joint use of the transport infrastructure under their control in their respective countries. These agreements, if implemented, would considerably change the status of the East-West energy corridor which has been the only alternative outlet for non-Russian Caspian oil and gas resources to the West.

Furthermore, rapid progress on the Turkish Stream would if not hinder then at least slow down the negotiations on the development of the trans-Caspian gas transportation network meant for linking up Turkmen or Iranian gas to the TANAP pipeline. Some Azerbaijani and British experts point out that if the Turkish Stream were built earlier than the TANAP, then the Trans Adriatic Pipeline could be expanded to accommodate Russian gas rather than Azerbaijani gas from Absheron, Umid, Babek and other fields which would come on stream later with the development of the TANAP.[17]

Bulgaria, as a stakeholder in the implementation of the South Stream, continues its efforts to retain this project in some form. On 15 December 2014, Bulgarian Prime Minister, Boiko Borisov, visited Germany where he appealed for German support for the implementation of the South Stream

17 Gulmira Rzayeva, Southern Caucasus Gas Corridor presentation, GIOGIE, 25 March 2015, Tbilisi

project in such a way that would transform Bulgaria into a Russian gas hub for the European Union.[18] This proposition has yet to receive official endorsement and no follow up comments have yet been issued by Russia. In general, the establishment of a Russian gas hub/sell point in Bulgaria or Turkey restricts Russia's strategic expansion in Southeast Europe which was served by the South Stream as well as providing a gas supply.

Given the abovementioned, the South Stream in the existing format was the most significant project for Russia in the condition of no energy hubs in either Bulgaria or Turkey. Thus, the proposed Turkish Stream project is likely to be a mandatory move for Russia to counter EU opposition. ***For Turkey, this may validate the prospect for its development into a European Union gas supply hub.***

In conclusion:

Technical

- The construction of the Turkish Stream's first and possibly second pipeline is feasible since Gazprom will utilize the pipelines acquired for the South Stream without incurring additional costs. Gazprom can easily find a market for this gas in Turkey, Greece and Bulgaria where the transport infrastructure is planned to be built (Greece-Bulgaria Interconnector) or the existing pipeline can be reversed (the West Pipeline connecting Bulgaria and Turkey) for this purpose.
- Ample time, funds and efforts will be required for the establishment of a gas hub in Turkey. The most difficult for the parties in this task (gas suppliers and consumers) will be to come to an agreement on establishing a gas purchase/sale platform in Turkey.
- There is no gas transport infrastructure in place after the Turkey-Greece border onward to EU countries. The Greece-Bulgaria Interconnector is planned to be built but there are no pipelines connecting Bulgaria with other EU member countries; thus, the European Union will have to build a new infrastructure and carry out all associated expenses.

Geopolitical

The geostrategic rapprochement of **Russia and Turkey:**

Will contribute to the exacerbation of the disagreement between Turkey and the West in the NATO format, as well as the European Union and trade formats alike, and it will intensify the conflict of interests among

18 Natural Gas Europe, www.naturalgaseurope.com

old EU member states and new Southeast European members which have been economically affected due to the cancellation of the South Stream project.

The alignment of Azerbaijan and potentially other Caspian states with the Turkey-Russia agenda (if it takes place) would potentially:

- Either change the status of the East-West energy corridor as an alternative to the Russian transportation network.
- Or slow down if not hinder the development of the trans-Caspian gas transportation network (aimed at linking Turkmen and maybe Iranian (?) gas with the TANAP-TAP pipeline network) and thus narrow the transit position of Georgia in the region.

Proceeding from the above, the Russia-Turkey strategic energy partnership may have serious implications for energy producers in the south and east of Turkey, for consumers in the EU and for the transit of energy resources in the region. Georgia may see its transit position consolidated or reduced in the region, depending on how current developments evolve in the future.

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