

Turkish Stream back on the agenda?

Marco Giuli

The meeting between Russian President Vladimir Putin and his Turkish counterpart, Recep Tayyip Erdoğan in St Petersburg on 9 August 2016 has raised the possibility of putting the Turkish Stream pipeline – a subsea gas corridor connecting the Russian Anapa terminal to the Kıyıköy coastal village in North-West Turkey – back on the agenda. However, despite the political rapprochement between Moscow and Ankara, an increasingly complicated regional geopolitical environment should be taken into consideration in assessing the prospects for this project. This commentary argues that Turkish Stream might go against Turkish ambitions of becoming a regional gas hub, and that the EU should capitalise on this ambition in order to limit an undesirable growth of Turkey's energy dependence on Russia.

Turkish Stream: a troubled story

Turkey has not always been at the core of Russia's long-standing ambition to circumvent the Ukrainian gas route to Europe. However, it began to gather speed following the demise of Gazprom's South Stream pipeline project – which aimed to connect Russia with the EU market via Bulgaria – in 2014 due to its incompatibility with EU competition rules. Russia cultivated the idea of Turkish Stream in order to supply South-East Europe and Turkey, selling gas to the EU at the EU-Turkey border in order not to incur problems with EU legislation. However, a deterioration of diplomatic relations between Moscow and Ankara, following the shooting down of a Russian jet over the Syrian-Turkish border in November 2015, froze the project.

Attempts to reset relations had been ongoing and received further impetus after the failed coup attempt on 15 July against Erdoğan; the Western response, which infuriated the Turkish President, gave added impulsion. Russia hopes to profit from Erdoğan's need to signal to the West – especially to European governments – that the country is not isolated, and from Ankara's wish to avoid the possible creation of a Kurdish state in Northern Syria.

According to statements from Turkish officials, this might bring Turkish Stream – or at least two strings of it amounting to 31.5 bcm – back on the agenda, as Russian energy priorities remain unchanged. Apart from the political objective of bypassing Ukraine, Russia would expand its capacity to confront the competition of an oversupplied global liquefied natural gas (LNG) market.

The north-south conundrum

The normalisation of Turkish-Russian relations also coincides with mounting scepticism about the parallel 55 bcm expansion of the Nord Stream pipeline – the other pipeline which allowed Russia to significantly reduce its reliance on the Ukrainian transit corridor to Europe.

The expansion of Nord Stream met a negative ruling by the Polish antitrust authority UOKiK in late July 2016. As a result, the European partners of the consortium decided to withdraw, ceding entire ownership of the project to Gazprom. This is a serious obstacle to the project, considering Gazprom's shrinking attractiveness as a borrower. Furthermore, full Gazprom ownership of Nord Stream 2 risks being incompatible with the Third Energy Package, especially if the legal orientation according to which EU legislation applies in the Exclusive Economic Zone will prevail.

However, it would be a mistake to believe that the Russian leadership sees Turkish Stream and Nord Stream 2 as alternative options. When it comes to the political rationale of the pipelines, only a combination of the two would allow Russia to halt its transit through Ukraine. Nord Stream expansion alone would allow Moscow to deliver to Central Europe and Italy, but not to South East Europe and Turkey. To maintain its role in the Turkish mix, bypassing Ukraine would require at least one string of Turkish Stream – amounting to 15.75 bcm per year. A second one will be needed if Russia intends to arbitrage between a future increase in Turkish and EU gas demand. As such, the Turkish side has a lot to reflect on before embarking in a revival of Turkish Stream.

A two-string Turkish Stream would go against Turkey's interests, as Gazprom's ability to flood the Turkish market would increase the risk premium associated with investments in alternative supplies (ranging from the Eastern Mediterranean, to Iran, Northern Iraq, and the Caspian). This would happen at a time when Azerbaijan's Socar is negotiating with international financial institutions to raise finance for the Southern Gas Corridor – a flagship diversification initiative for the EU.

Regional hub or transit country?

Turkey needs to clarify whether its long-term ambition is to become a regional gas hub or a simple transit country. A hub is a competitive market place where gas from multiple sources is stored and traded at spot prices. Any version of Turkish Stream larger than one string would put such an ambition in danger by dis-incentivising investments in Turkish storage, LNG, alternative pipelines and demand reduction. Two strings of Turkish Stream would make it more likely that Turkey would become a transit country. It would benefit from transit fees, but not necessarily increase its geopolitical relevance to Europe, which would only see Turkey as another corridor for the same old Russian gas.

Erdoğan probably realises that the current reconciliation is purely tactical, and that it is not in Turkey's interest to further expand the Russian grip on Turkey's gas market (56.3% of Turkish gas imports) driving attention away from much needed investments in Turkey's gas market resilience. Moscow needs Turkish Stream much more than Ankara because Russia has no alternative to Turkey if it wants to recover the \$12 bn cost borne so far in adapting its domestic transit capacity to South or Turkish Stream. This puts Turkey in a strong negotiating position.

Within this framework, it is crucial that Europe does not compromise its gas cooperation with Turkey. Arbitraging between gas from Russia, Turkey, and LNG is in the long-term interest of the EU, as it will enhance energy security in South East Europe and help prevent axes between Moscow and Ankara against the EU's interests. Turkish Stream goes against these interests.

EU-Turkey relations have become strained after the coup, but gas cooperation is still possible given that by increasing its reliance on Russia, Turkey will lose geostrategic significance to the EU – one of Ankara's best assets. The EU should therefore provide clear signals such as speeding up the Southern Gas Corridor, and proposing to jointly further the engagement with other regional suppliers, notably Turkmenistan – which recently approached German Chancellor Merkel stating its will to diversify to European gas exports in order to reduce its overreliance on the Chinese demand – Iran, and Eastern Mediterranean countries. In exchange for this, and financial and technical assistance to improve the resilience of Turkish energy sector, the EU should also emphasise that a hub requires competition – meaning that no more than one string of Turkish Stream is necessary – and transparency – meaning legislation aligned as much as possible to the EU.

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