PART II

Turkey and the EU: Pipeline Politics
The Scramble for Energy Supplies to South Eastern Europe: The EU’s Southern Gas Corridor, Russia’s Pipelines and Turkey’s Role

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1. Introduction

For over a decade, the European Union and Russia have been making plans to build new routes for the transportation of gas in the Black Sea region and the Balkans. Their motivations are different. The European Union (EU) would like to reduce its reliance on Russian gas by replacing part of it with imports from Azerbaijan and potentially from Iran and Turkmenistan. Russia, on the other hand, would like to maintain its current role as Europe’s main gas supplier. In order to do so, it wants to replace the Soviet-time infrastructure for gas exports to South Eastern Europe, which currently runs through Ukraine, with new pipelines crossing the Black Sea. Following the Euromaidan revolution and the military escalation between Moscow and Kiev, Russian leaders no longer consider Ukraine as a safe transit country.

While the EU- and the Russia-sponsored projects are different in their nature and goals, both imply that Turkey will inherit from Ukraine the role of key transit country for energy supplies to South Eastern Europe. In the plans of Moscow and Brussels, Ankara has been assigned a strategic position in this respect. Moreover, Turkey’s large market and growing gas demand also make the country a lucrative partner as an end consumer of gas, rather than just a transit country. The economic and geopolitical calculations that surround the proposed energy projects in South Eastern Europe are complex and require systematic analysis. This chapter attempts to shed light on the topic by first examining the main agents and their objectives. Subsequently, it explores the proposed infrastructural projects and assesses their chances of being implemented. In the final sections, the chapter investigates some of the broader and most salient geopolitical issues that may influence the energy projects under analysis, particularly those supported by the EU.
2. Agents and Their Goals in South-East European Energy Politics

2.1 The European Union

The EU is one of the world’s largest importers of energy. More than half of the EU’s energy consumption is satisfied through imports.\(^1\) Total EU energy consumption has declined in recent years, but so has its domestic energy production, which explains the persistence of the Union’s import dependence.\(^2\) This has caused concerns for the EU, particularly in the field of natural gas, where imports cover around 67% of consumption and come from a restricted number of countries. Moreover, some sections of the European gas market – particularly in East-Central Europe – are not well connected to the other regional and world markets, relying primarily on one supplier, Russia.

In the 2000s, the European Commission planned to offset this dependence through the creation of a Southern Gas Corridor (SGC), designed to transport large quantities of non-Russian gas to South Eastern and Central Europe. The costs of the project, uncertainties about available supplies of gas earmarked for it and changed European market conditions in recent years (stagnating demand and low prices) led to delays and revisions. However, the current Ukraine crisis and worsening relations between the EU and Russia have given new political impetus to the SGC. The European Commission has become warier about Russian gas imports and, despite unfavourable market conditions, it has revived projects to diversify

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its suppliers. Both the key documents concerning energy security that were elaborated by the EU after the onset of Ukraine crisis, the Energy Union and the Energy Security Strategy, stress the necessity of building the SGC. In order to secure gas supplies for the SGC, the EU has to promote a partnership with Azerbaijan, which is currently the only gas producer committed to the project.

2.2 Azerbaijan

Azerbaijan has developed a partnership with Western countries and companies (primarily British Petroleum) for the export of oil and gas since the 1990s. During the 1990s, infrastructure for oil exports to the West began to be built, notably the Baku-Supsa pipeline. In 2005, the larger Baku-Tbilisi-Ceyhan (BTC) pipeline was inaugurated, transporting oil from the Caspian Sea to the Turkish Mediterranean coast. Shortly afterwards, gas exports to Georgia and Turkey began via the South Caucasus pipeline (SCP). All these pipelines bypassed Russia and granted the West an access route to Caspian energy resources that was not controlled by Moscow. The SGC is driven by the same geopolitical considerations. It would constitute for the EU an expansion and extension of the SCP from the point where it currently ends, the Turkish city of Erzurum.

Azerbaijan has drawn large profits from its role as energy supplier to neighbouring countries and the West. It is planning to strengthen its role through the exploitation of new resources, particularly gas from the Shah Deniz-2 field. However, the income from energy exports has also contributed to consolidating the authoritarian power of President Ilham Aliyev.


and fuelled large-scale corruption. Moreover, a large part of this income has been spent on armaments, in view of a future conflict with Armenia. Azerbaijan and Armenia have been confronting each other militarily since the late 1980s, when a full-scale war led to the Armenian conquest of the contested region of Nagorno-Karabakh and some adjacent Azeri territories. As a result of the conflict, over half a million ethnic Azeris fled from the region to other areas of Azerbaijan. In the 1990s the conflict was frozen, but skirmishes and occasional larger-scale clashes have continued ever since. The conflict area is only a few dozen kilometres away from the pipelines that export oil and gas westwards.

2.3 Russia

Russia is the main supplier of fossil fuels to the European Union. The state-owned company GAZPROM has a monopoly of Russian gas exports via pipelines and its revenues have made a substantial contribution to the federal budget. In 2013, gas exports made up 14% of the country’s total export revenues. Europe is by far the largest importer of Russian gas and, despite Russia’s recent efforts to diversify its customers (especially in Asia), the path dependencies created by geography and the already existing infrastructure mean that Europe will retain this role in the next decade. As GAZPROM cannot easily replace the European market with other customers, it has an interest in defending its European market shares by competing with projects such as the SGC. This is one of the key pur-

6 According to international law and the principle of uti possidetis, Nagorno-Karabakh should have become part of independent Azerbaijan after the collapse of the Soviet Union.
poses of the GAZPROM-sponsored pipelines in the Black Sea region, South Stream and TurkStream.

As with the SGC, economic and political goals are closely interconnected in the Turkish and South Stream projects. If built, the pipelines will considerably reduce and eventually cancel Russia’s dependence on Ukraine’s transit pipelines for gas exports to Europe, and South Eastern Europe in particular. This would diminish Kiev’s bargaining power vis-à-vis Moscow in the broader context of Ukraine crisis. Furthermore, Russia has an interest in using energy projects as a form of soft power to promote economic and political cooperation with Southern and South-East European countries. Italy, Greece, Bulgaria and Turkey (which are directly involved in GAZPROM’s proposed pipelines) are among Moscow’s close political interlocutors in Europe and are keen on continuing their energy partnership with Russia.

2.4 Turkey

Turkey is both a large gas importer and a key transit country for both the SGC and the TurkStream projects. Turkey has an interest in the construction of additional pipelines going through its territory for several reasons. Firstly, they would provide the country with additional supply sources and routes for its growing domestic gas consumption. Currently, Turkey imports 57% of its gas from Russia (through the Trans-Balkan and the Blue Stream pipelines), 20% from Iran and 10% from Azerbaijan. Secondly, by acquiring the status of transit country for Russian and Azeri gas exports to the West, Turkey will earn revenue from transit fees. Thirdly, by hosting energy infrastructure that is critical for European energy security as well as lucrative Russian and Azeri exports, Turkey can increase both its strategic significance and bargaining power vis-à-vis its partners.

In relations with the EU, the role of key transit country for the Union’s gas imports would further increase the considerable bargaining power that

Turkey has acquired in recent months, most notably through the deal on refugees and its influence in Middle Eastern geopolitics. Aware of the country’s growing strategic significance, the Turkish leadership has pursued a proactive and multi-vector foreign policy, trying to combine its long-standing Western military alignment with enhanced cooperation with Russia and regional powers in the Middle East. The position of Ankara in the field of energy politics reflects this approach: it supports both the West-sponsored SGC and Russia’s TurkStream project.

2.5 The Energy Sector

Energy companies often work in close coordination with states and their political leadership. This is particularly true of state-owned companies, such as Russia's GAZPROM, Azerbaijan’s SOCAR and Turkey’s BOTAŞ, which all play important roles in the projects discussed below. However, it also applies to private companies such as British Petroleum (BP), which seek support and guarantees from governments, especially before embarking in large and expensive projects (the SGC is a prime example). At the same time, it is important to recognise that energy companies (private and public) are not mere instruments in the hands of states, and their interests may sometimes differ considerably from those of political leaders. This contributes to explaining why, despite considerable political support, some large energy projects (such as the Nabucco pipeline or the development of the Shtokman field in the Barents Sea, Russia) have not been implemented. Energy policy is usually the result of complex interaction between states and companies, politics and economics, market forces and geopolitical interests.


3. The Competing Projects

3.1 The EU’s Southern Gas Corridor

The debate on the creation of the EU’s Southern Gas Corridor started over a decade ago. For a long time, it centred on construction of the Nabucco pipeline, a megaproject which was meant to transport 31 billion cubic metres of gas a year (bcm/y) from the Caucasus to Central Europe via the Balkans. In recent years, changed market conditions and the economic recession in Europe has led to a decrease in gas demand and prices, which in turn has reduced the rationale of Nabucco and led to a revision of the SGC. In its current form, the SGC consists of four sections, bringing gas from the Caspian Sea to Greece and Italy, covering 3,500 kilometres in total. The first section includes the Shah Deniz-2 gas field and extraction facilities in the Caspian Sea; the second part concerns the expansion of the South Caucasus Pipeline; the third and the fourth involve construction of the Trans Anatolian Pipeline (TANAP) and the Trans Adriatic Pipeline (TAP), respectively. The total cost of the SGC is estimated at 45 billion dollars.

The Shah Deniz gas field is owned by a consortium led by British Petroleum, which is currently developing the second phase of the field. This will allow the extraction of an estimated 16 bcm/y by the mid-2020s, from which 6 bcm/y are already contracted for sale to Turkey and another 10 bcm/y further West (Greece, Albania and Italy). The gas will be channelled first through the SCP, in Azerbaijan, Georgia and Turkey. On Turkish territory, the SCP will connect to the TANAP, which will cross the whole of Turkey in an East-West direction as far as the Greek border. From there, the gas will be transported via the TAP across Greece to Albania and, under the Ionian Sea, to Italy. Both TANAP and TAP are scheduled for completion in 2018.

Advocates of the SGC have argued that the volume of exports could be doubled to 32 bcm/y in the future if further gas becomes available. In fact, such an expansion of the SGC appears an unlikely prospect unless further infrastructure is built to connect it to other potential suppliers, notably Iran and Turkmenistan. This would involve additional costs, which would

question the already dubious economic competitiveness of gas imported to Europe through the SGC. As experts have noted, at current market prices, this gas could be exported to Turkey and South-East European countries, but would not be economically competitive in the bigger Western European markets.\textsuperscript{15}

In its current shape, the Southern Gas Corridor would not diminish significantly Europe’s overall reliance on Russian gas: in 2015, GAZPROM exported 158.6 billion cubic metres of gas to European countries (approximately sixteen times the volume of gas that the SGC is meant to export to Europe).\textsuperscript{16} Conversely, the SGC could help diversify the supply of small South-East European markets where GAZPROM has a dominant position, such as Greece and (if interconnections to their national distribution systems are built) Western Balkan countries. Nonetheless, given current market trends, it remains questionable whether or not building the SGC is the best way to diversify the energy supply of South-East European countries. Most notably, the project involves a large investment in fossil fuel infrastructure at a time when the EU has committed itself to reducing carbon emissions and switching to a low-carbon economy by 2050.\textsuperscript{17}

Furthermore, in order to secure its energy supplies via the SGC, the EU has made uncomfortable agreements with increasingly authoritarian countries. In September 2015, a resolution of the European Parliament highlighted that Azerbaijan, currently the only SGC supplier, “has suffered the greatest decline in democratic governance in all of Eurasia over the past ten years”\textsuperscript{18}. Similarly, Freedom House has repeatedly condemned the rule of law situation in the country and recently argued that the SGC “is likely to shower Baku’s repressive leadership with new income”, thereby blaming EU energy policy for contributing to the consolidation of authoritarianism in Azerbaijan.\textsuperscript{19}

\textsuperscript{15} Pirani, Azerbaijan’s Gas Supply Squeeze. pp. 13-14.
\textsuperscript{19} Foley. Corruption on the Caspian, 2016.
Nevertheless, both EU Commission Vice-President Maros Sefcovic (who is in charge of the Energy Union) and High Representative Federica Mogherini continue to support the project, arguing that it will contribute to EU energy security.\textsuperscript{20} Although the United States is not directly affected by the SGC, political reasons (making European allies less dependent on Russian energy) have led the US Special Envoy for International Energy Affairs to declare Washington’s ‘unshakeable commitment to the project’.\textsuperscript{21} This political support is essential to guarantee access to private and public capital for the project, which would otherwise struggle to gain investors’ confidence due to current market conditions and serious security dilemmas (see below). However, while political support for the SGC appears solid at the moment, following the release of construction permits the project also has to face a vocal protest and legal actions from the residents and local administrations in the region crossed by the Italian section of TAP, which could have repercussions on completing the final part of the pipeline.\textsuperscript{22}

### 3.2 South Stream: Rise, Fall and Rebirth?

From 2007 until 2014, the South Stream pipeline was the Russian competitor of the Nabucco and SGC projects. South Stream was promoted by a consortium led by GAZPROM (50% shareowner) which included a group of European companies, most notably the Italian ENI, Électricité de France and the German Wintershall. According to GAZPROM’s initial plans, the pipeline was to carry 63 bcm/y of gas to South Eastern and Central Europe via the Black Sea. From the Russian perspective, South Stream (together with its ‘sister’ project Nord Stream, which became operational...
in 2011-2) was meant to end GAZPROM’s dependence on Ukrainian transit pipelines for its exports to Europe. Despite the strong support that it received from Moscow, the South Stream project was considerably hindered by its high cost and worsening market conditions. In the summer of 2013, following the decision of the Shah Deniz-2 consortium to abandon the Nabucco project and supply instead the more modest TAP-TANAP pipelines, South Stream also lost its main geopolitical competitor and hence a considerable part of its rationale (preserving GAZPROM’s dominant position as gas supplier in the Balkans and Central Europe).

Moreover, in December 2013 the European Commission stated that the intergovernmental agreements (IGA) signed by Russia with several European countries (Bulgaria, Serbia, Greece, Hungary, Slovenia, Croatia and Austria) for the construction of South Stream breached EU law and had to be renegotiated. According to the Commission, South Stream did not comply with the EU’s Third Energy Package, which requires unbundling energy generation from energy transmission, as well as regulated Third Party Access to pipeline capacity. Shortly after the Commission’s pronouncement, relations between the EU and Russia deteriorated considerably as a result of Ukraine crisis. In this context, Vladimir Putin announced the cancellation of South Stream and, during a press conference with Turkish president Recep Tayyip Erdoğan on 1 December 2014, he stated that the project would be replaced by TurkStream (discussed below).

Following this announcement, it seemed that South Stream would disappear from the policy agenda, both in Russia and the EU. However, a revised (and smaller) form of the project was presented in February 2016. GAZPROM signed a memorandum of understanding with the Greek company DEPA and the Italian Edison for a new route to import Russian gas through the Black Sea and a ‘third country’ – which, despite remaining unnamed in the document, could only be either Turkey or Bulgaria, for ge-

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For the transport of gas to Greece and Italy, the proponents resolved to revive the ITGI/Poseidon pipeline project, connecting the two countries through an offshore pipeline with a capacity of 8 bcm/y. The EU has already classified ITGI as a Project of Common Interest, which eases its planning and financing, and given authorisations for its construction and operation. The project would not face the regulatory constraints that hindered South Stream because GAZPROM would not own the section of the pipeline on EU soil and, significantly, ITGI has already received a 25-year exemption from the rule on third-party access.

Motivations behind the revised South Stream project included the crisis in Russian-Turkish relations between November 2015 and the summer of 2016, which questioned the future of TurkStream, as well as GAZPROM’s desire to maintain its position as dominant supplier in South Eastern Europe. Although the volumes channelled via the revised South Stream would be much lower than originally planned, they would suffice to challenge the SGC and further question its economic viability. The project faces numerous uncertainties, linked ‘inter alia’ to its final route and supply sources. Ultimately, it may be merged with TurkStream, which has gained fresh momentum with the rapproochement between Moscow and Ankara starting in August 2016.

3.3 TurkStream

As introduced earlier, the TurkStream project was presented in December 2014 during an official visit of Russian president Putin to Ankara. On this occasion, GAZPROM and Turkey’s energy company BOTAŞ signed a memorandum of understanding for constructing a series of pipelines from the Russian Black Sea coast to Turkey. The infrastructure will then be extended to the Greek-Turkish border, with a total capacity of 63 bcm/y (in September 2015, however, GAZPROM and BOTAŞ announced that they will only build infrastructure for half of the initially announced capacity.

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namely 31.5 bcm/y). GAZPROM will pay for the offshore part of the project, while costs for the section in European Turkey would be shared.26

The driving logic of TurkStream is the same as South Stream's: bypassing Ukraine to supply South Eastern Europe. However, TurkStream will also supply the Turkish market, one of GAZPROM's few customers with rising gas demand. Specifically, TurkStream will land in European Turkey and allow the replacement of supplies that have reached this area via Ukraine and the Soviet-time Trans-Balkan pipeline (6 bcm/y via Romania and Bulgaria).27 Moreover, as TurkStream is designed to end at the Greek border, it will relieve GAZPROM of further costs related to additional pipeline construction on EU territory and the need to comply with EU energy market regulations. It is expected that, for further transport within the EU, TurkStream gas will rely on either the ITGI interconnector or the spare capacity of TAP that should become available for third party users after 2020.28

However, Turkey and Russia did not immediately sign an intergovernmental agreement for the project, nor did Turkey release the necessary permits for the construction of the offshore section in Turkish waters. The two parties were still negotiating the conditions of the agreement (BOTAŞ wanted an unconditional discount on the price of the gas purchased from GAZPROM while GAZPROM would grant it only once the pipeline was built29) when, in November 2015, a Turkish fighter jet shot down a Russian bomber close to the Syrian-Turkish border. Bilateral relations soured and the TurkStream project was frozen.

Nevertheless, geopolitics again changed the project’s fortunes in the summer of 2016. Following the failed Turkish coup d’état in July and Ankara's worsening relations with the West (which was accused of supporting the coup), Erdoğan swiftly managed to repair relations with Rus-
sia. In late September 2016, GAZPROM received the first permits for the offshore segment of the project in Turkish waters and in October 2016 the IGA between Moscow and Ankara was signed. Future progress on project implementation depends primarily on the continuation of good bilateral relations. While it is probable that one line of TurkStream carrying gas to the Turkish market will be built, construction of the section meant for export to the EU depends on the future evolution of EU-Russia relations, as well as the stance of EU member states that are most affected (Italy and Greece).

4. The Interplay of Economic and Geopolitical Factors in the Southern Energy Corridor

As has emerged from the analysis thus far, geopolitical factors play an important role in the gas infrastructure projects of South Eastern Europe. Some of the actors’ goals are easier to identify: Russia wants to maintain its dominant position as supplier while diminishing reliance on Ukrainian transit; the European Commission wants to differentiate EU imports away from Russia and receives political support from the US, as Washington wants to preserve its influence in Europe and stave off geopolitical competitors. The position of other actors is less defined. With support from their respective governments, Greek, Italian and Turkish companies are involved in both the EU- and Russia-driven projects. By doing so, they seek to maximise profits, pursue national energy security and attempt to strengthen their strategic position in international energy politics.

The geopolitical position of Azerbaijan is more nuanced than its role as key supplier of the SGC suggests. On the one hand, Baku has keenly accepted the energy partnership with the West, which allows Azerbaijan to earn large revenues and assert its emancipation from Moscow’s control. On the other hand, Azerbaijan continues to trade gas and maintain close contacts with Russia, as well as Iran. This is due both to economic/techni-

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30 As in the EU competence for energy policy is shared between member states and supranational institutions (see Article 194 of the Treaty on the Functioning of the European Union), national governments and companies do not necessarily follow the political line pursued by the European Commission.
cal reasons (for example, ensuring that domestic gas demand is satisfied[31]) and to broader security considerations. As a predominantly Shiite but secular state, Azerbaijan is particularly interested in cooperation with Moscow and Teheran in order to counter the spread of jihadism and the Islamic State (ISIS) in the South Caucasus.[32]

Furthermore, Russia has considerable influence in the Nagorno-Karabakh conflict as Armenia’s military ally and arms supplier to both Armenia and Azerbaijan. Being a member of the Collective Security Treaty Organisation (CSTO), Armenia is shielded from potential external aggression by Russia’s security guarantees. In February 2016, Armenia received a 200-million dollars loan from Moscow to buy Russian military hardware, including advanced missile systems.[33] However, Russia has also provided Azerbaijan with 4 billion dollars’ worth of armaments since 2010. Russia’s sales of modern military equipment to both sides contribute to volatility in the region. In early April 2016, intense fighting took place between the Armenian and Azeri armies. Although the clashes stopped after four days, they highlighted both the risk of another full-scale war and the vulnerability of the energy infrastructure in the South Caucasus. Boosted by income from energy exports, the Azeri military budget has risen tenfold in the last decade. Expecting an Azeri attempt to regain control of Nagorno-Karabakh by force, the Armenian military has simulated attacks on Azerbaijan’s energy infrastructure, which would cripple the Azeri economy.[34] Thus, the security situation in the area casts serious doubts on the appropriateness and reliability of projects such as the SGC.

Besides hard security risks, the SGC also has to cope with fierce competition for gas supplies. As previously argued, in order to carry more than 10 bcm/y of gas to Europe, the project will have to tap into Turkmen or Iranian resources. However, Turkmenistan has already sold most of its current (and future) gas production to China, which has also built the necessary import pipelines.\(^{35}\) Exports of Turkmen gas to the EU via the SGC would require the construction of a pipeline under the Caspian Sea, but this will hardly be possible until all riparian states define the legal status of the Sea (including Russia and Iran, which have proven reluctant thus far). As for imports from Iran, their prospects depend on a large range of factors, including the future of the country’s political relations with the West and large investments to develop the necessary infrastructure. Even if the EU starts importing gas from Iran, it is likely that it will come by sea in the form of liquefied natural gas, as imports via pipelines (and the SGC) would entail very high transit costs.\(^{36}\)

5. Conclusion

This chapter has highlighted the political and economic complexities surrounding the main projects for future gas imports to Turkey and South Eastern Europe. The tensions between the EU and Russia after the Ukraine crisis have revived the competition between their respective plans. However, the chapter has shown that other regional actors – including Turkey and Azerbaijan – also play an important role in the contest. At the time of writing (October 2016), both the EU and Russia are advancing their projects, regardless of the economic and political uncertainties associated with them. The EU and its partners appear determined to implement the SGC; the work for its construction has accelerated during 2016. It is possible that the SGC will start delivering gas to Turkey and the EU by 2020.


Simultaneously, Russia’s proposed pipelines have also gained momentum. The intergovernmental agreement signed by Ankara and Moscow in October 2016 has paved the way for the future supply of 15.75 bcm/y of Russian gas to Turkey via TurkStream. The construction of a second line to export gas to the EU, with the same capacity, is also possible. Greek and Italian companies have shown an interest in the project, which could rely on additional pipelines already approved by the EU (ITGI and TAP) for the distribution of gas within the Union. The Turkish government stands to gain from both the EU- and the Russia-sponsored projects, as it will earn transit fees and secure supplies for its national demand. Indeed, if both are implemented, Turkey could replace Ukraine as the main transit country for gas supplies to South Eastern Europe.