

On December 1, 2014 Russian President Vladimir Putin surprised the energy world by announcing, during a state visit to Turkey, the demise of the long-planned South Stream pipeline project and the launch of a new project to evacuate Russian gas to Turkey and South-East Europe bypassing Ukraine: Turkish Stream. Since 2007 South Stream has represented a key element of the discussions concerning the EU security of gas supply and the overall EU-Russia relations. For this reason, the unexpected demise of South Stream and the quick rise of Turkish Stream need to be carefully evaluated both under the economic and geopolitical perspectives. This article will first provide an overview of the Russian gas export strategy to Europe in order to entrench the current discussion on the major long-term trends concerning the issue. On the basis of this analysis the article will then discuss the future prospects of Turkish Stream, arguing that the EU could seize this new reality to launch the formation of a fluid, reliable and interconnected South-Eastern European regional gas hub.

1. Introduction

On December 1, 2014 Russian President Vladimir Putin surprised the energy world by announcing, during a state visit to Turkey, the demise of the long-planned South Stream pipeline project and the launch of a new project to evacuate Russian gas to Turkey and South-East Europe bypassing Ukraine: Turkish Stream.

Considering the enormous regulatory difficulties encountered by the South Stream project, Putin's decision cannot be defined as a bolt from the blue. However, it is certainly true that no one would have expected such a rapid U-turn. Probably not even the stakeholders of the project themselves, since they have taken notice of the demise of the project directly from the press while they were preparing the operations for the laying of the offshore pipe in the Black Sea.

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FEEM Working Paper "Turkish Stream: What Strategy for Europe?" faces this challenging issue, with the specific aim to explore a new strategy of the EU vis-à-vis this complex situation. The key results of the paper are summarized in this article.

Ukraine: from key pillar to key problem of Russian gas export strategy

Until the break-up of the Soviet Union in 1991, all gas export to Western Europe happened across the Ukraine-Slovak border as crossing Poland and in particular the German Democratic Republic (GDR) was by the soviets considered politically not sufficiently reliable. After the break-up of the Soviet Union, Ukraine continued to represent the main route for Russian gas exports to Europe due to the fact that all existing pipeline infrastructure was crossing Ukraine, and as Ukraine's storage capacities on its western border were

particularly valuable to Russia.

For several decades Ukraine represented a reliable transit platform for Russian gas exports to Europe. However, in the aftermath of the independence of the two countries, gas conflicts between Russia and Ukraine started to emerge. These conflicts occurred as transit usually became a part of the price dispute on the Russian gas price for the Ukrainian domestic market.

However, it was not until January 2006, one year after the Orange revolution had taken place in Ukraine that resulted in a strongly pro-Western and anti-Russian Government, that the first major Ukraine-Russia gas crisis erupted. Following disagreement on prices, Russia cut off supplies to Ukraine for three days, Ukraine diverted volumes destined to Europe, and as a consequence supply to some Central European countries fell briefly, but supplies were never cut off completely on that occasion. Due to the pro-European government in Kiev, the EU was fully supporting Ukraine and strongly blaming Russia for the crisis.

The second major gas crises between Russia, Ukraine and Europe of January 2009 became a very high profile event. As a result of this crisis, the transit of Russian gas through Ukraine was completely cut for two weeks, which resulted in humanitarian crises in several Central and Eastern European countries that were strongly dependent on Russian gas supplies across Ukraine. This dispute has resulted in long-term economic consequences and affected the reputation of Russia as a reliable supplier and of Ukraine as a reliable transit country.

The Russian quest to diversify its gas transit routes away from Ukraine

The policy responses to these gas crises were different in Europe, Ukraine and Russia.

The EU's response, particularly to the major crises of 2006 and 2009, was to strengthen the internal market, to foster gas flows and gas sources diversification (including building LNG receiving terminals in Central and South-East Europe, pursuing the Southern Corridor to evacuate new Caspian and Middle Eastern gas supplies to Europe via Turkey, and to pursue climate change policies (energy efficiency, renewables, clean coal with carbon capture and storage technologies, nuclear).

Ukraine's response to the crises was to develop strategies aimed at reducing dependence on imported gas by limiting the share of gas in the fuel mix, by implementing energy saving measures and by increasing own gas production. However, all these policies (implemented since the 1990s) failed due to political and economic weaknesses.

Russia's response to the crises was first to push for ownership of the Ukrainian transit system by a consortium involving Ukrainian, Russian and European gas companies. As it became increasingly clear that this option was not acceptable for Ukraine, Russia launched a strategy of diversification of its gas transit routes to Europe away from Ukraine.

The Yamal-Europe Pipeline, launched in 1994, represented the first phase of the Russian strategy to diversify its gas transit routes away from Ukraine. This was followed by the construction of Blue Stream, a pipeline designed to deliver Russian gas to Turkey through

the Black Sea instead of passing through Ukraine, Romania and Bulgaria. The third step was represented by the conceptualization and realization of Nord Stream, a pipeline designed to evacuate Russian gas directly to Germany bypassing transit countries, notably Ukraine. Finally, the closing of the ring of this diversification strategy should have been represented by South Stream, a pipeline conceptualized to secure Southern and Eastern European markets. After years of evolution, the South Stream project was finally demised in December 2014, due to a number of reasons illustrated in the Working Paper. This demise paved the way for the emergence of an alternative project to evacuate Russian gas to Southern and Eastern Europe bypassing Ukraine: Turkish Stream.

Turkish Stream: what is it all about?

On December 1, 2014 Russia President Vladimir Putin declared the demise of South Stream and the launch of a new alternative project: Turkish Stream. After this declaration, Gazprom CEO specified that Russia's plan was to construct a new pipeline under the Black Sea to Turkey with the same capacity of South Stream (63 bcm per year), to supply 14 bcm per year to Turkey and the rest to be used for a gas hub on the border with Greece. He also declared that primary aim of the pipeline was to completely eliminate Ukraine from Russia's gas transit to Europe.

Turkish Stream

Considering that Turkish Stream represents an element of continuity in the long-lasting Russian strategy of diversifying its gas transit routes to the EU and Turkey away from Ukraine it is possible to expect this project to quickly advance. However, Turkish Stream will represent only the first part of the overall infrastructure to evacuate Russian gas to Europe. In fact, on the contrary of the South Stream project where gas was to be delivered directly to the various European receiving countries (Bulgaria, Serbia, Hungary, Slovenia, Austria and Italy), with the Turkish Stream project gas will be delivered at the Turkish-European border and from that point onwards, it will be up to Europe to decide how to evacuate the gas to final consuming countries.

With his statement of December 1, 2014 President Putin made it clear that with the new pipeline Russia targets the creation of a new gas hub at the Turkish-Greek border, also with the underlying intention to punish Bulgaria over its approach on South Stream. However, this initial decision seems to be not "carved in stone", considering that during a visit to Hungary on February 17, 2015 President Putin suggested that Bulgaria could become part of the project again, for instance being linked to the pipeline via Greece, also in order to serve as transit route to Serbia, Hungary and Austria as in the case of South Stream. This U-turn of President Putin on Bulgaria came after the EC asked Russia to reconsider Bulgaria for implementing the project. This request was stimulated by Bulgarian Prime Minister Borissov himself, who asked in January 2015 the EC Vice President Maroš Šefcovic to lobby Russia for re-launching the South Stream project after having realized that his country was

potentially on the verge of an energy catastrophe without good relations with Russia. Just for the record, the previous Borissov government had to resign in May 2013 precisely because of boisterous protests following hiked electricity prices.

Turkish Stream: what strategy for Europe?

In the new framework of Turkish Stream the role of Europe will be far more important than the one envisaged in the South Stream project. In fact, a strong coordination between European gas companies, transmission system operators (TSOs), energy regulators, EU financial institutions and the EC will be crucial to ensure the realization of the necessary infrastructure to deliver Russian gas from the Turkish-Greek border to the various Southern and Eastern European markets.

With this regard, many are the options that might be taken into consideration (all of them are widely described in the Working Paper): i) Trans-Adriatic Pipeline; ii) Ionian-Adriatic Pipeline; iii) Nabucco West; iv) East-Ring Pipeline; v) Greece-Macedonia-Serbia-Hungary-Austria Pipeline.

The need for a “Regional Grand Strategy”

Considering these various options to deliver Turkish Stream gas to European costumers in Southern and Eastern Europe, a regional approach would be much more effective than a micro approach focalized on single projects.

In other words, Europe could seize the new reality created by the launch of Turkish Stream to launch the formation of a South-Eastern European regional gas hub. In addition to Russian and Azeri gas, also other gas from the Middle East (e.g. Iraq, Iran), the Caspian Basin (e.g. Turkmenistan) and the Eastern Mediterranean (e.g. Israel, Cyprus, Lebanon) might reach Turkey and South-East Europe in the medium term.

This regional gas hub might not only consist in a network of various pipelines, but also in a network of storage facilities to be developed in various countries in the region. For instance, a country that in the region might provide a great contribution in terms of gas storage is Romania, due to its high number of depleted gas fields.

A proper interconnection among South-Eastern European countries and with the rest of Europe is a precondition to a well-functioning European gas market and to addressing European gas security of supply.

The development of this South-Eastern European regional gas hub should be left to market players such as gas companies and TSOs. Up to them is to decide which projects are more commercially viable and financially sound.

However, the EU institutions do have an important role to play in this game, in particular as far as the implementation of a sound regulatory framework and the promotion of dedicated public finance mechanisms are concerned.

For this reason, the EC might play a crucial role as coordinator and facilitator between gas companies, TSOs, energy regulators and European financial institutions, such as the

European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), which might be interested -in line with their mandates- to support the financing of a regional gas infrastructure system crucially important for the energy security and economic competitiveness of the overall South-Eastern European region.

Such a coordinated, regional, approach might well have the potential to transform Turkish Stream into a unique opportunity to create a fluid, reliable and interconnected South-Eastern European regional gas hub based on Russian but also Caspian, Middle Eastern and Eastern Mediterranean supplies.

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