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Russian-Turkish agreement on the South Stream pipeline – an instrument of pressure on Ukraine

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On 28 December in Moscow, the energy minister of Turkey, Taner Yildiz, sent Prime Minister Vladimir Putin a note giving Russia permission to build the South Stream gas pipeline through Turkey's exclusive economic zone. The note's content and the conditions of the permission have not been revealed. On the same day, Gazprom signed an annex to its gas contracts with the Turkish corporation BOTAS which allow it to increase the supply of Russian gas, and is likely to lead to a significant reduction in its price.

The Turkish note does not determine the construction of the South Stream pipeline, which would be an alternative route (to transit via Ukraine) for Russian gas to Europe via the Black Sea (see *map*). In the current situation, Moscow needed Ankara's consent for the project so it could be used as an instrument for putting pressure on Kyiv. The Russian-Ukrainian gas negotiations have recently reached deadlock, as there is no consensus in Ukraine on agreeing to the concessions Russia expects in exchange for lower gas prices. Thus, an agreement with Turkey serves to strengthen Russia's bargaining position with Ukraine. The Turkish agreement to the creation of South Stream does not hinder Ankara's desire to develop its transit potential, as evidenced by the Turkish-Azerbaijani memorandum signed on 26 December concerning the construction of the Trans-Anatolian gas pipeline.

The South Stream pipeline in Russia's strategy

The goals of the South Stream gas pipeline project (which was begun in 2007, and has a planned capacity of 63 billion m^3) were to significantly reduce the dependence of Russian gas exports on transit through Ukraine, and to sabotage the creation of alternative routes (bypassing Russia) for transporting natural gas from the Caspian region to Europe. The necessity to realise the latter of these objectives is decreasing, in the face of growing Chinese involvement in Central Asia – as evidenced by the creation of a gas pipeline from Turkmenistan to China – as well as the unclear prospects for the building of infrastructure links to the EU countries (including the Nabucco gas pipeline). In this situation, resolving the problem of its dependence on Ukrainian transit remains Russia's priority.

Contrary to the claims made by Gazprom, the document obtained from Ankara does not mean that South Stream is now bound to go ahead. Many of the details of this project are

still undefined; there has still not been any feasibility study, and the exact route of the pipeline, and its technical specifications and financing plan, remain unconfirmed. In addition, in October 2011, the European Commission rejected the possibility of granting South Stream TEN status (EU Priority Energy Project), which would have facilitated its financing. At the same time, Moscow's efforts to exclude the gas pipeline from the remit of the Third Energy Package have ended in failure. In this situation, the construction of South Stream remains unlikely. Last December, the head of Gazprom Aleksei Miller declared that if Russia took control over Ukraine's gas pipelines, it could even give up the idea of building South Stream.

Russian pressure on Ukraine

The Russian-Ukrainian negotiations to revise the January 2009 gas contracts, which are unfavourable to Ukraine, have been going on for several months. At the end of September last year, the parties reached tentative agreement to establish a joint consortium between Gazprom and Ukraine's Naftogaz which would take control of the Ukrainian transit pipelines. Since then, intensive discussions about the details of the contract have been ongoing. Media reports indicate that in exchange for a reduction in gas prices, Russia requires the consortium to include the underground gas storage holders, as well as the creation of a second joint venture which would sell gas on the Ukrainian domestic market. Moscow also wants guarantees that the two companies would not be covered by the provisions of the Third Energy Package, which Ukraine has pledged to implement by 2015.

Russia's far-reaching demands brought about an impasse in negotiations at the end of last year. There is no consensus on accepting the Russian conditions within the Ukrainian government. Some of its members, including Energy Minister Yuri Boyko and representatives of the pro-Russian lobby in the ruling elite, favour accepting Moscow's conditions. For his part, Prime Minister Mykola Azarov does not want to agree to such far-reaching concessions. It seems that Kyiv is resigned to the prospect of establishing a consortium for the transit of gas, and would even be willing to resign from the Energy Community (a structure which aims to create a common energy market in Europe, based on EU standards). However, the Ukrainian government does not want to concede control over its internal gas market to Russia, since this would allow Gazprom to manipulate gas prices for businesses, and in the longer term, to favour Russian acquisition of industrial plants in Ukraine.

Turkey's interests

Despite Russia's efforts, from 2009 Turkey withheld consent to the construction of South Stream, as the project was at odds with its aspirations to become a hub for the transit of energy resources from the Caspian region. One element of Ankara's policy, which was

aimed at developing its transit potential, is the Turkish-Azerbaijani memorandum signed on 26 December 2011 to construct a trans-Anatolian pipeline. According to this document, from 2017 Azerbaijan will transfer 16 billion m³ of gas to Turkey, of which 10 billion m³ will then be sent on to the EU market (via which route is still unclear). The change in Ankara's position on South Stream probably stems from the lower prices for Russian gas (the content of the contract's annexes was not revealed), and perhaps a mitigation of the 'take or pay' clause. It also seems – contrary to claims by Gazprom – that the possible construction of South Stream will require yet more negotiations with Turkey on the specific conditions for the pipeline's arrangement and operation. Ankara may want to link this with Russian participation in the emerging Samsun-Ceyhan oil pipeline, which would enhance the status of Turkey as a transit country. Nor can we rule out the interpretation that Turkey's current position on South Stream stems from the belief that there is no chance that the pipeline will ever be constructed.

Prospects

Turkey's consent to South Stream's construction may be crucial for the Ukrainian government, as it increases the likelihood of Ukraine concluding an agreement with Russia (the one that would be unfavourable for Kyiv). It may even be concluded within the next few weeks (another round of Russian-Ukrainian negotiations is scheduled for 15 January). Representatives of the pro-Russian lobby will argue that Ukrainian gas pipelines will be useless after South Stream is constructed, in order to persuade President Viktor Yanukovych to make concessions to Russia. Kyiv could be convinced by Russian guarantees that Ukraine would remain the main transit state for Russian gas, which would ensure a significant income from transit fees (approximately US$1.5 billion annually).

After concluding the gas agreement with Ukraine, South Stream will lose importance for Russia, but we may expect Moscow to continue using it as an instrument to play off both the Central Asian countries and the EU. Gazprom is likely to reduce the route's planned capacity, but will keep the project itself alive with a view to the possible transit of Central Asian gas.

Turkey's consent to the construction of South Stream will not adversely affect its plans to develop its transit potential, and we may expect Ankara to further seek to realise the transit projects which will bring it benefits. However, Turkey is only interested in projects where it would itself be able to control matters, participate in selling the gas, and reap the financial benefits. This explains Turkey's cool attitude towards the Nabucco gas pipeline project.

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Appendix

Gas pipelines