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Pipeline success for Russia: TurkStream's offshore section completed

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On 19 November, Gazprom completed the construction of the offshore section of the TurkStream gas pipeline running from Russia via the Black Sea to Turkey (from the Russian port of Anapa to Kıyıköy on the European coast of the Black Sea in Turkey). The pipeline consists of two branches, 930 km in length and each with a capacity of 15.75 bcm. The first branch of this pipeline is designed to supply the Turkish market; the second is to be used for Russian gas exports to the markets of southern European countries. The onshore part of the pipeline's infrastructure on the Turkish coast is still under construction.

The first, draft memorandum on the TurkStream project between Gazprom and the Turkish state energy company Botas was signed during President Vladimir Putin's visit to Istanbul on 1 December 2014. Russia and Turkey signed an intergovernmental agreement on the construction of the pipeline on 10 October 2016, and the construction of the offshore section began on 7 May 2017.

Gazprom is the operator and owner of the offshore section. The onshore branch, intended for the Turkish internal market, will be owned by Botas. The second, transit branch of TurkStream running through Turkish onshore territory (180 km) will belong to the gas company TurkAkim Tasima AS, in which Gazprom and Botas each have a 50% stake. Issues concerning the route and the conditions for its construction outside of Turkey have not been resolved.

Turkey is one of the major importers of Russian gas. The level of supply has increased from 18 bcm in 2010 to 26 bcm in 2011, and since then has remained at the level of 25-27 bcm per year; in 2017 the volume of supplies reached 29 bcm.

Commentary

- The TurkStream (Turkish Stream) project, announced on 1 December 2014, was another part of the Russian plan to build an export pipeline across the Black Sea to Europe. Originally Russia had been planning to build the South Stream pipeline, which was to include four branches with a total capacity of 63 bcm of gas per year, and run from Russia through the Black Sea to Bulgaria, and then through Serbia, Hungary and Slovenia to Italy (branches to Montenegro, Macedonia, Bosnia & Herzegovina and Croatia were also considered). The project was cancelled, primarily because of the European Commission's formal objections; Brussels claimed that the intergovernmental agreements between Russia and the countries participating in the project concluded in 2008-2010 failed to take into account the fact that Gazprom, as manufacturer and supplier, could not also be the owner and operator of the pipeline while failing to ensure access for third parties to the pipeline. Also, the EC accused Moscow of arbitrarily regulating the transit fees without any reference to the regulatory bodies. Although in its initial variant TurkStream was to have had the same capacity as South Stream, in October 2015 Gazprom announced that only two branches of the pipeline would be constructed. This decision was related primarily to uncertainty regarding the demand for Russian gas in southern Europe, and to the announcement of plans to build the Nord Stream 2 pipeline (June and September 2015).

- The completion of construction work on the offshore section of the pipeline does not mean the entire project has been finalised. Work is continuing on the construction of the land section on the Turkish coast; TurkStream will need to build adequate land infrastructure on Turkish territory for the second branch to be used. Detailed conditions for the construction of this infrastructure, including the pipeline's transit branch, were to be set out in the additional protocol to the intergovernmental agreement of 2016, which Gazprom and Botas signed on 26 May 2018 (the details of this have not been disclosed, nor has any information about the start of the construction work been made public).
- It is most likely that the failure to start the effective construction of TurkStream's transit branch is linked with the presently unclear prospects for using the second branch of the pipeline, as well as the still unresolved question of its final route and the principles for its operation in Europe. The binding agreements to resolve the route via which Russian gas would be transported from Turkey to European customers have still not been concluded. It would also be necessary to build additional infrastructure connections in south-eastern Europe. From the consultations held so far between the Russian government & Gazprom with their European partners, it appears that two options are being considered: 1) transporting Russian gas from Turkey via Greece to Italy, and possibly from Greece towards Bulgaria; 2) from Turkey to Bulgaria, and then to the Balkans, Central and Eastern Europe. The latest intergovernmental consultations and the interventions by the south-eastern European countries (including Bulgaria), together with the responses from Russia (including from President Putin in May, and Foreign Minister Lavrov in November), suggest that at present the second variant is arousing greater interest.
- Although the construction of TurkStream's offshore section ended two years later than originally planned, it should nevertheless be considered a success for Russia. Its importance is even greater as this new infrastructure has been created under conditions of severe political tensions between Russia and the West in relation to the Russian aggression against Ukraine, in the face of the current sanctions, as well as the controversy regarding Nord Stream 2. The new pipeline will first of all reduce the transit of Russian gas through Ukrainian territory, which is a strategic objective of the Russian Federation's external energy policy (redirecting supplies to TurkStream's first branch will reduce the export of Russian gas via the Ukrainian route by around 14%, assuming that the 2017 transit figure of 93.5 bcm remains constant). If both branches are used, Ukraine's transit significance will fall by around 30%. Secondly, thanks to plans to build a new export gas pipeline via the Black Sea, the domestic gas infrastructure in southern

Russia has been expanded, which has contributed to an increase in the level of the country's gasification, and also allowed for a significant reduction in gas purchases from Central Asian countries (which had previously been used in part for the purpose of supplying gas to southern Russia). Thirdly, the expansion of the export infrastructure could benefit Gazprom itself, as the Russian company will be able to expand its options for responding more flexibly to changing demand on the European market. In addition, Gazprom hopes that thanks to the new infrastructure it will be able to compete more effectively with the alternative sources to Russian gas in southern Europe, particularly the gas supplies from Azerbaijan which are intended to bolster the Southern Gas Corridor.

- However, the implementation of the project has been associated with the need to incur major financial outlays. Although officially Russia has estimated the investment budget at around €7 billion, according to expert assessments (including analysts from Sberbank) the actual total cost of the project will be almost three times higher (after adding the costs associated with the development of the internal infrastructure). According to the agreements concluded, in particular the intergovernmental agreement of 10 October 2016, the Russian side should completely cover the cost of constructing the offshore infrastructure. In addition, Turkey's agreement to the investment is linked to its need for Gazprom to grant discounts for supplying gas to Turkish customers – both Botas and private importers. In addition to the economic costs, the political issues are also an important element. The possible launch of a second branch of TurkStream will mean Russia becomes transit-dependent on Turkey, and the two countries have a rather complicated bilateral relations. The tensions which occurred in the period from November 2015 to June 2016, after Turkey shot down a Russian aircraft, exemplify the political risks which may accompany the two countries' growing interdependence in the gas sector.