

Geopolitical Implications of Turkish Stream - Part I

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Abstract: In its approach to foreign policy and diplomacy, Turkey separates trade from regional conflicts. This is most evident in the signing of the Turkish Stream natural gas pipeline at a time when Russia is using military force to oppose Turkey's objectives in Syria. Part I of this article argues that despite the economic benefits of the project to Turkey, Turkish Stream will facilitate the expansion of Russian influence into Europe and constrain Ankara's foreign policy options. This conclusion is reached by analysing the impact of Turkish Stream within the wider context of Russia's energy trade with Europe in general and Germany in particular. Germany's ability to continue protecting Western interests are found to depend on the ability of leaders such as Angela Merkel to keep voices from Eurosceptic political parties, business lobbies and her own grand coalition focused on the domain of public discussion and not foreign policy. Berlin's support for increasing Europe's energy dependency on Russian imports is also identified as a reason behind growing tensions with the U.S. and EU. Part II will propose changes to Turkey's energy policy and strategic investments that would mitigate these risks.

THE GLOBAL ENERGY INDUSTRY FALLS OUTSIDE OF the international institutional architecture that governs global trade and investment. This is due to the structure of the United Nations Charter, which grants governments full sovereign control over their mineral resources. Hence, the rules and regulations that govern global trade and investment through the World Trade Organisation do not apply to the energy trade. Institutions such as the IMF and World Bank use financial assistance and development loans in attempts to entrench free market principles within the global energy order. These attempts are not always successful, especially when large producers and consumers are independent of these institutions. Hence, energy trade and investment is often governed by bilateral contractual arrangements between producers and consumers. The lack of international enforcement mechanisms for these arrangements can lead to parties dishonoring contractual commitments. To improve governance, producers tend to collaborate through cartels while consumers tend to seek to improve their negotiating positions by working through collaborative institutions such as the OECD and the EU. This article analyses the impact of the recent Turkish Stream deal in the context of weak global energy governance.

Integrating Russia into a Free-Market Global Economy

A key feature of the emerging international system is the continuing rapid decline of North Sea energy production and Western European attempts to replace these sources.¹ The Russian state-controlled natural gas company, Gazprom, has invested heavily in opening new transnational routes into Europe while simultaneously maintaining the older Soviet Era infrastructure. As North Sea production declines, Gazprom is well placed to increase its market share within Europe. However, Russia has been accused of using Gazprom as a decisive foreign

policy tool, having cut off gas supplies to Georgia, Ukraine, Belarus and Moldova during political rows.² For this reason, European reliance on Russian energy is shifting relationships between Russia, Germany, the EU and the United States, as well as creating tension between EU members on how to adequately address these concerns.

A paper published by the Council on Foreign Relations in 2001 provides insight into the role that energy relations have played in integrating Russia and the former Soviet States into a market-orientated global economy.³ The Russian plan to revive its economy was centered on the development of state-owned energy companies that would serve as national champions. During the Soviet era, the state-planned economy made significant investments into pipeline infrastructure for the domestic distribution of energy as well as to supply the lucrative markets in Western Europe. However, after the collapse of the Soviet Union, Russia found that these pipeline export routes went through new sovereign states that were being absorbed into the EU and NATO. Russia believed that these former Soviet states were taking advantage of their transition towards the West. With struggling economies, they were often unable to pay Gazprom for their energy requirements. Russia would respond with energy cuts and other general bullying, blackmailing and interference with the sovereignty of these countries. The former Soviet states would look to the U.S. and EU for support against threats to their independence. The U.S. had at one stage agreed to pay the Ukrainian debt owed to Russia over a two year period, only to find that the debt continued to escalate faster than it was being paid off.

Western Europe had two primary concerns in increasing its energy imports from Russia. Firstly, they worried that tensions between Russia and the former Soviet states might have a devastating impact on their economies and

households as gas cuts to transit countries also reduced their energy supply. The Ukrainian gas cuts of 2009, the most recent example, led to energy shortages across Europe. Secondly, and more importantly, Russia's energy fields were in decline, needing significant technology and capital investment if they were to increase their production volumes. Western multinational energy companies and European multilateral development banks would be key to overcoming these obstacles. Russia would need to restructure its energy policies along free market principles to attract Western private investment into the development of its energy fields. Furthermore, new pipelines would need to be built to bypass the unruly former Soviet states, ensuring that Western European governments would have security of supply and that the multinational energy companies' investments would not be impacted by political rows.

These plans carried significant geopolitical risks. The U.S. and the EU both understood that developing Russia's energy industry would be the best solution for growing its economy and increasing its levels of prosperity. In turn, a prosperous Russia would be less of a geopolitical threat. Furthermore, energy integration with Western Europe would bring Russia closer to the EU. The energy relationship would be critical to developing trust because, while Western Europe needed Russian energy, Russia needed Western capital and technology. More specifically for Russia, close ties to the EU would provide potential insulation from U.S. pressure. For the EU, it was thought that such relations would bring a certain level of foreign policy alignment between the EU and Moscow. However, while this plan to integrate Russia into the global economy found strong support throughout the early 2000s, critics speculated that the opposite was also possible. Developing Russia into an energy exporter would provide it with the



capital and critical energy trade relationships that would give it insulation while it challenged Western interests. Moreover, by developing new export routes that bypassed former Soviet states, Russia would be able to cut off their gas supplies and extract political advantages more effectively. For Russia, this would be a key mechanism through which it could challenge the orientation of these states towards the West. Recent events relating to energy infrastructure projects and Russian expansionism give credence to the views of these critics.

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Developing Russia's Energy Trade with Europe

Gazprom has three key pipeline projects that would give effect to its strategy of having alternative routes to Western Europe. The first is the northern route: a direct underwater Baltic pipeline connecting to Germany, completed in 2011 (Nord Stream). Gazprom further plans to increase the capacity of this line through the Nord Stream 2 project. The second is Blue Stream, an underwater pipeline that runs through the Black Sea and is able to supply Turkey with a significant portion of its demand. The third was a proposed southern route which would have been an underwater Black Sea pipeline connecting to Bulgaria (South Stream). For reasons explained below, this project has now been cancelled in favor of Turkish Stream – a connection to Turkey rather than Bulgaria.

The Northern Route

The Nord Stream pipeline was approved by Germany prior to the Ukraine Gas Crisis of 2009. It has however been a geopolitically sensitive project since the time it was first proposed. Gazprom owns a controlling share of 51%, with German and other European companies holding 31% and 18% respectively. The project was initially championed by the German Chancellor of the time, Gerhard Schroeder. Having gained parliament's approval for the project shortly before the end of his term in 2005, Schroeder controversially accepted the nomination by Gazprom to head Nord Stream's shareholder committee. Angela Merkel inherited the project from her predecessor and continued supporting the pipeline despite reservations from the EU and U.S. over a key NATO member becoming so dependent on Russian energy.⁴

Russia's recent interventions in Crimea and Eastern Ukraine provide an opportunity to understand how the close energy and trade relationships between Russia and Germany have impacted Germany's ability to counter Russia's attempts to undermine Western interests in the former Soviet states. Merkel has led European efforts to apply sanctions on Russia. However, some argue that these sanctions have been weak, as they target the assets of Russian individuals rather than entire industrial sectors. Some EU officials have indicated that reductions in supply to Poland, which have also had a small impact on Germany, are a warning signal against any attempts by Europe to escalate the sanctions.⁵ Even these limited sanctions, however, have had negative consequences for the Russian economy. While trade disruptions have not been very seriously impacted, investor concerns have led to capital flight from Russia. Russia has supported its weakening currency with its foreign exchange reserves as well as considering selling large stakes in energy projects to China.⁶



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Some have argued that Merkel's leadership in securing support by German businesses and other EU members for sanctions on Russia have indicated Germany's firm commitment towards securing Western interests.⁷ Others have argued that Merkel's good leadership is not indicative of an overwhelming German consensus. These critics argue that there are significant voices within Germany's elite that would have preferred diplomacy and accommodation over sanctions. These critics argue that after German reunification, Germany had no choice but to pivot to the West. However, with the close ties that have since developed with Russia, Germany's Western orientation is now a matter of choice.⁸ Since 2013, Germany has witnessed the rapid rise of the Alternative for Germany party, which is represented in 10 of Germany's 16 regional parliaments and has secured 15 percent of the national vote. Founded initially on opposition towards the European common currency, the party now opposes the refugee influx into Germany and advocates for the lifting of sanctions with Russia.⁹ The electoral losses by Merkel's grand coalition have also led to calls for rightward shifts¹⁰ in policy to win back voters.¹¹ With an increasing shift towards the right of the political spectrum,¹² the fact that Germany has a choice is of significant importance given Germany's leadership role within the EU.

Within the context of Germany's ability and willingness to continue protecting Western interests, Berlin's support of the Nord Stream 2 project has created tensions with the EU and

U.S. The project aims to increase the capacity of the pipeline and allow Gazprom to access the UK natural gas market. U.S. Secretary of State John Kerry has indicated that the project is a "specific issue of deep concern" which he is "convinced would absolutely have an adverse impact on Ukraine, on Slovakia, and Eastern Europe."¹³ Besides the support of Berlin, the project also receives support in the form of the lobbying efforts of multinational energy firms domiciled in Germany, France the Netherlands and Austria. While these firms assert the economic benefits of the project, members of the European Parliament have defiantly accused Gazprom of bullying its commercial partners by requiring them to cease using Ukraine as a transit country.¹⁴ Further, the pipeline is threatening European unity¹⁵ with European Parliament members calling the project the "EU's biggest failure on energy policy."¹⁶ Poland, a key critic of Germany's support for the project, has recently managed to deal a significant blow to the financing of the pipeline. While the pipeline does not pass through its territory, multinational companies key to financing the project have withdrawn from the Joint Venture after Polish regulators raised concerns over anti-competitiveness.¹⁷ If found guilty of anti-competitive behavior, they risk penalties for their operations located in Poland.

Nord Stream 2 highlights the challenges faced as a result of the lack of international governance structures within the global energy industry. The EU's multilateral approach is failing to provide a united response to the matter and the bilateral interests between Germany and Russia are being countered with unilateral attempts by Poland to punish multinational energy firms that support the project.



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The Southern Route

Nord Stream ensures that Germany can still receive gas in the event of a cut to Ukraine, Belarus or Poland. However, Turkey, Romania and Bulgaria would still be affected in the case of a gas cut to Ukraine. The alternative route to ensure security of supply to these countries was South Stream.

The initial route planned for South Stream would have had an undersea section through the Black Sea connecting to land in Bulgaria, and then traveling further on into Serbia, Hungary, Slovenia and Austria. The Bulgarian parliament had ratified an agreement with Russia for its portion of the route in 2008.¹⁸ However, the following year, the EU passed energy regulation rules in response to the Ukraine gas crisis of 2006. This "Third Energy Package", required the separation of ownership for gas producers and pipeline operators. Further legislation would prevent Gazprom from including anti-competitive conditions of sale that would prevented customers from selling gas to a third country.¹⁹ For Russia, the legislation would prevent it from blocking third parties building interconnectors that would allow other countries to redirect gas from alternative routes back into Ukraine and other former Soviet states. Unlike Germany, Bulgaria certainly did not have the political strength to challenge the EU. The EU enforced this legislation in the wake of Russia's 2014 intervention in Crimea. Gazprom was forced to abruptly stop construction of the Bulgarian leg when Putin announced that it would

seek an alternative route via Turkey, which was not subject to EU legislation.²⁰ The final agreement between Turkey and Russia was signed in October 2016 after delays relating to a temporary period of tension between the countries following the downing of a Russian military jet.

Turkish Stream has significant benefits for Turkey. As EU legislation has blocked all other routes, Ankara is in a strong price negotiating position. Lower gas prices would improve Turkey's longstanding trade deficit, as the country relies heavily on imported energy. Furthermore, Turkey would be able to charge transit fees for gas exported to Europe.

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Geopolitical Considerations of Turkish Stream for Turkey

As previously mentioned, the U.S. and EU have serious concerns that Gazprom's strategy of bypassing former Soviet states will allow Russia to effectively counter EU and NATO enlargement initiatives. Nord Stream was the first phase of this strategy. EU attempts to block the second phase by blocking Gazprom's ownership of South Stream have been countered by Russia's success in securing a deal with Ankara. When Turkish Stream, and its related connections into Europe, are brought online, Gazprom will have the ability to cut off gas supplies



to Ukraine and maintain deliveries to its key western markets. With previous precedents of using gas as a foreign policy tool in former Soviet states, and recent interventions into Crimea and Ukraine signaling Russia's expansionist policy in this region, it is likely that Turkish Stream will facilitate the reorientation of Eastern Europe away from the West.

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Conclusion

During the early 2000s, some were concerned that U.S. and EU plans to use the energy trade to support the Russian economy and develop interdependencies with the EU would give Russia the insulation it required to counter Western attempts in integrating Eastern Europe into the free-market global economy.²¹ The recent interventions by Russia in Crimea and Eastern Ukraine indicate that these concerns were certainly valid.

It is interesting to note that Russia's expansionist actions had already begun prior to the completion of its strategy to completely bypass Ukraine, Belarus and Poland. Had Russia waited until the construction of South Stream or Turkish Stream, it could have used gas disruptions rather than military actions to force political changes within these former Soviet states. The earlier timing could have been a deliberate strategy rather than a miscalculation, however. Nord Stream, and the close relationship it fosters between Russia and Germany, could be viewed as the enabler of Russia's bold expansionist policy. This can be seen in Germany's limited sanctions targeting individuals rather than economic sectors. EU officials have also speculated that increased sanctions could lead to Russia retaliating by holding back gas supplies. Furthermore, Schroeder, the former

German Chancellor and current head of the Nord Stream shareholder committee, caused a political storm for Germany by supporting Russia's military actions in Ukraine and Crimea.²²

Claims that Germany's Western orientation is now a choice only made possible by Merkel's ability to survive growing support for parties wanting greater accommodation with Russia are certainly plausible. While Russia has not been able to achieve its objectives in Eastern Ukraine, EU sanctions against Russia would create further support for Euroscepticism, particularly in Germany. Energy and other trade relationships between Germany and Russia have brought the two countries closer together. While Merkel continues to support sanctions against Russia, she simultaneously supports increased energy integration with Russia. This has been the cause of tensions between Germany and the EU and U.S. Deepening economic ties over time will likely lead to increased Euroscepticism should sanctions against Russia be required in the future.

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Adding to the risk of Germany's potential accommodation of Russia's foreign policy, the U.S. president elect, Donald Trump, indicated in his campaign that the U.S. could consider recognising the annexation of Crimea by Russia.²³ The leader of the Eurosceptic National Front in France has also indicated that an accommodation with Russia would be on the table should her party win elections in 2017.²⁴

The geopolitical risks of Turkish Stream must be viewed within this broader context of Russia's growing influence over Europe. Despite the economic benefits of the project,



Turkish Stream will also facilitate Russia's influence over former Soviet states. This is especially a concern in the case of Ukraine, which borders the Black Sea. As an ascending regional power, Turkey will need to ensure that its foreign policy is not constrained by its energy relationship with Russia. Part II of this article will propose policy recommendations and strategic investments that will mitigate these risks.



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The Sharq Forum is an independent international network whose mission is to undertake impartial research and develop long-term strategies to ensure the political development, social justice and economic prosperity of the people of Al-Sharq. The Forum does this through promoting the ideals of democratic participation, an informed citizenry, multi-stakeholder dialogue, social justice, and public-spirited research.

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