GlobalResearch
Center for Research on Globalization

Ukraine and Turkey: Liquefied Natural Gas (LNG) and the European "Energy Coup"

By Global Research News
Global Research, October 23, 2013
Oilprice.com

Region: Europe, Russia and FSU
Theme: Oil and Energy

Though Norway in June overtook Russia in total exports of natural gas to Europe, the balance of Russian gas to Europe comes through Ukraine, which itself is dependent upon Russia for 60% of its current gas consumption.

While Ukraine controls the transit of 90% of its gas to Europe, Russia is consistently trying to use its gas exports to Ukraine to gain greater control of the Ukraine transit system, which itself deems a strategic asset. The struggle for control of export to Europe and Ukraine's own struggle to increase domestic production and move closer to Europe, with an European Association Agreement set to be signed in November this year, has put extreme stress not only on the energy independence of Ukraine but of Europe as a whole.

From an energy geostrategic standpoint, Europe needs Ukraine to move closer to Europe, "but for all its planning, Europe also knows retribution, in the shape of an energy squeeze, is likely from Russia.

Moscow, which has a long-standing disagreement with Ukraine over gas, has said it will raise Ukraine's gas prices and officials do not rule out it doing the same for the EU, which gets nearly 40% of its gas from Russia. "The EU should not look at Ukraine as a business opportunity alone, particularly in light of currently lagging gas demand, but should examine the long-term future of European energy security and the key role Ukraine will continue to play in it. Partnership with the EU is not a silver bullet for the troubled Ukrainian energy sector, but it is certain to reduce the volatility of future pricing disputes and is perhaps the only solution that does not leave Ukraine's fate entirely in Russian hands," according to an article by Richard B Andres and Michael Kofman.

Ukraine has also done much in the past 18 months to increase its energy independence. Recent shale tenders with Shell and Chevron and with Exxon for the development of the Ukrainian Black Sea have the potential to greatly reduce the dependence Ukraine has on Russian exports and potentially for Europe as well. "While the full picture of unconventional gas is expected to be assessed in the coming years, the key to success, as is the case of Ukraine, is infrastructure. If the future of shale gas exploration is to be bright, a new infrastructure will have to be built to link the sources of unconventional gas with the grid to allow for the commercialization of the gas.

"To ensure that the Energy Community brings results, once operationalized the shale gas opportunity should be extended to the Eastern Neighborhood. It would allow the Eastern Neighborhood, in particular Ukraine, to create stronger bonds between the EU and the region and, as a result, galvanize stronger energy interdependence between the EU and

Russia by stabilizing Ukraine's internal energy supply," according to a policy paper from the Black Sea Trust for Regional Cooperation (BST).

Coup in the Making?

In the past five years, there has been significant growth in Europe's LNG [**Liquefied Natural Gas**] import capacity; however, high LNG prices driven by Japanese demand, and the higher oil-linked price that LNG receives in Asia has diverted much of this supply from the European market.

An agreement between Ukraine and Turkey for the transit of LNG through the Bosporus, as the gateway to the Black Sea, would be a major coup for European energy security. It would put downward pressure on current LNG prices due to the high demand and premium paid in Asia and would eventually provide Europe with cheap shale gas through a viable alternative marketplace.

It's an idea developed by Robert Bensh , energy advisor to Ukrainian Vice Prime Minister Yuriy Boyko, managing director of Pelicourt Limited and senior advisor for Cub Energy Inc., which operates in both Ukraine and Turkey.

The potential for LNG exports to Europe without a deal between Turkey and Ukraine for liquefied natural gas (LNG) through the Bosporus will fall flat, and Russia will continue to provide at least 30% of Europe's natural gas through 2023.

"The European Union can and should play a more active role in shaping the Black Sea security environment. As a full regional player, it should promote cooperation on an equal footing, and refrain from acting as a sponsor as it does, for instance, in the Mediterranean. As a privileged partner of all countries of the region, the EU should use its bilateral relations with each of them, including Russia and Turkey, to contribute towards the emergence of a cooperative security environment in the Black Sea region," according to a European Parliament briefing .

A CRS Report for US Congress agrees, stating:

> "Development of more liquefied natural gas (LNG) transport and reception facilities from distant suppliers, such as Nigeria, into Europe could be another course of action. Coupled with the development of new oil and gas pipelines could be an offer from NATO (and/or EU) members to provide security for energy infrastructure in periods of unrest or conflict in supplier and transit countries.

For both Ukraine and Turkey, such a deal would also be a political and economic coup of vast proportions, Bensh says.

For Ukraine, LNG is the key to energy independence. For Turkey, LNG is the key to becoming one of the most important energy hubs between the Middle East and Europe. In combination with the Trans-Anatolian Pipeline (TANAP), which will bring Azerbaijani gas from Shah Deniz through Turkey on to European markets, controlling the LNG segment through the Black Sea would give Turkey broader leverage than any other player in Europe. For both Ukraine and Turkey, it would mean greater access to the economic benefits of the European Union, control over Europe's LNG market and a level of political leverage over the continent that would render both world-class strategic players.

The benefits to Ukraine and Turkey are significant:

Benefits to Ukraine

- Independence from Russia
- Greater access to the European Union, with Kiev able to be assertive on the terms
- Political leverage in Washington, which is keen to see a Turkey-Ukraine LNG deal put through, especially one focused in part on Qatari gas as opposed to Iranian gas
- Control of the European market for LNG
- Economic prosperity by giving an edge to heavy gas-reliant industries
- Strategic positioning and leverage that goes beyond Europe and into the Middle East/Gulf and especially between competitors Qatar and Iran

Benefits for Turkey

- Control of the European LNG market
- Rise as an energy *hub* between the Middle East and Europe, not just an energy transit country
- Political leverage over Europe and access to the EU on Ankara's terms
- Political leverage with Washington
- Strategic positioning as an energy hub that renders Turkey the decision-maker from Europe to the Middle East/Gulf
- Diversification of supplies, with less reliance on Russian and Iranian deliveries, including from emerging African powerhouses such as Angola and Ghana

Timing is important, and the window of opportunity should be taken advantage of before new pipelines come online and while two of the world's biggest gas players—Qatar and Iran—are in a desperate race to grab the European market. If an LNG agreement is solidified within this timeframe, it will dictate rather than serve as an afterthought to Europe's gas future.

In this respect, Ukraine and Turkey together already have a certain amount of leverage at the negotiating table, particularly with respect to Qatari supplies, which are very eager to get to the wider European market. Timing is critical as Iran, suffering under economic sanctions that has caused widespread unemployment and a recession (the under 35 age group is thought to have unemployment of over 40%; a sobering thought in a period of Arab Springs) is attempting to have access to markets from which it currently is cut off from; and there is no better indication of this than the British government's current reconsideration of the embargo on BP's joint venture with the Iranian National Gas Company in the Rhum field. One additional factor in the conflict in Syria was, Qatari-versus-Iranian plans to run a pipeline through the country to Turkey, eyeing the European market.

In terms of critical timing, Ukraine and Turkey would be better positioned strategically were they to strike an LNG deal before the beginning of Phase Two production at Azerbaijan's Shah Deniz field, and before TANAP begins operations. The price of LNG is more volatile due to the Asian market, and it would be more beneficial for LNG to secure this market, while natural gas futures for Shah Deniz supplies, which have already been contracted out for 25 years to nine European companies.

Another Black Sea LNG project—the Azerbaijan-Georgia-Romania Interconnector (AGRI) project—is also being delayed due to the perception that European demand is not ready for this project. This is a false perception that is driven by the Asian-driven LNG price spikes and the diversion of cargoes away from the European market. AGRI at present is languishing as it waits for the market to develop. This is an opportunity for a Ukraine-Turkey LNG agreement. The first to develop will control the market.

The AGRI project is hoping to transport natural gas from the Caspian region (primarily Turkmenistan) to Europe designed as a part of the Southern Corridor and as the shortest direct route for Caspian gas to European markets. If realized, AGRI would transport Azerbaijani LNG from Georgia, across the Black Sea, to an LNG terminal planned for construction on the Romanian Black Sea coast, then piped through to Hungary through the interconnector with Romania and then further into Europe.

Azerbaijan, Romania and Georgia signed the Memorandum of Understanding for this project in April 2010, but not much has happened since then. The project requires the construction not only of a regasification terminal in Romania, but also a liquefaction plant in Georgia.

Competition for this strategic positioning will come from the development of Mediterranean LNG projects, which could also be a game-changer for Europe. Potential projects here (Cyprus and Israel, first and foremost) remain uncertain, but if realized they would offer gas to high-demand Southeastern European markets with attractive pricing. In the absence of an LNG agreement between Ukraine and Turkey, Cyprus and Israel have the potential to capture the European market from the Mediterranean side. Timing is critical and the advantage will go to the players who recognize the opportunity to fill the long-term LNG supply gap that has been created by the diversion of cargo to Asia. Ukraine, has the potential to fill this gap and control the market.

LNG'S Role in European Energy Security

The European Market for LNG at a Glance:

- Relative to 2011, LNG deliveries to the EU fell 31% in 2012, with imports from Qatar down 35%, Nigeria 31% and Algeria 18%, while imports to Asia have grown by up to 70%
- So far for 2013, LNG deliveries are in line with this downward trend
- For the first quarter of 2013, gas flowing out of LNG terminals into pipelines (LNG send-out to grids) in the UK, Netherlands and Belgium was down by 60% over the same period in 2012, and down 40% in France and 30% in Spain, Italy and Portugal
- The average price of spot pipeline gas in Europe is around $10 per MMBtu, while the average spot LNG price is $11.40/MMBtu (there is a wide range of LNG pricing across Europe)
- In Japan, LNG prices are about 40% higher (as of Q1 2013) than spot prices in the UK, for example

LNG in Europe, Present and Future

At the close of 2012, LNG accounted for 19% of Europe's gas supply, while 81% was natural gas transported via pipeline.

The Fukushima disaster in Japan forced European countries to reconsider their nuclear policies, and this has forced a stronger focus on coal, natural gas and LNG. Before Fukushima, LNG was favored over natural gas because supplies were greater at that time and prices were cheaper than piped-in gas. As a result of the Fukushima disaster and Japan's resultant eschewing of nuclear power reliance, is a run on LNG by Japan and other Asian nations who are willing to pay higher prices. This has driven LNG prices up and diverted supplies to the Asian market. In addition, it has caused fewer LNG development projects to be pursued in Europe. This translates into future gas shortages when LNG supplies can no longer meet growing Asian demand and when there is a lack of long-term LNG commitment in Europe. This is the critical window of opportunity in the market for Ukraine and Turkey. (There is a certain counter-intuitive momentum to be grasped here.)

Because Asia signs on to long-term LNG agreements with high, oil-linked prices, there are predictions that Europe will find itself with extremely restricted access to LNG in the near- to medium-term future, with a recovery in demand and a growing reluctance to rely on dirty coal for power generation.

This past decade has seen global LNG supplies double and regasification and shipping capacity triple. The exception is Europe, where Ukraine and Turkey are singularly positioned to take advantage of this LNG gap before demand picks up and the opportunity for strategic positioning is weakened.

The LNG market is set to expand globally over the next decade, and demand for LNG in Europe is most likely set to rise even without affecting natural gas supplies. Thus, TANAP and a Ukrainian-Turkish LNG agreement would work in tandem, not in competition, to control an even greater market share.

If Russia ends up building natural gas storage facilities in Turkey—an idea for which Gazprom expressed interest earlier this year—Turkey will lose its chance for maximum political leverage. This past winter, Gazprom redirected natural gas from its storage facilities in Europe after a spike in demand in Turkey. This prompted a Russian justification for potentially building storage facilities in Turkey ostensibly to come to the rescue when supplies are insufficient. In theory, though, this would represent an increased Russian energy footprint in Turkey that would negatively impact Turkey's energy hub ambitions and would only help to solidify its dependence on Russian supplies, which amount to about 58% of Turkey's total supplies. An LNG deal with Ukraine would give Turkey greater access to additional alternative supplies, and this, combined with an anticipated increase in Azerbaijani supplies from Shah Deniz will allow Turkey to become a true, diversified energy hub.

Qatar is heavily courting both Ukraine and Turkey for LNG through the Bosporus. From Qatar's perspective, if Qatari LNG is allowed to pass through the Turkish-controlled Bosporus, this will deal a heavy blow to Iran. As such, Qatar recognizes Turkey's role here as a key geopolitical power broker on the energy scene. Along this same line of thought, Qatar's perception is that Russia is not capable at this time of preventing a Turkey-Ukraine energy deal focused on Qatari gas.

For Turkey, though, such a deal would allow it to further diversify its supplies, reducing reliance on both Russian and Iran—the latter which has been unreliable in terms of supplies over recent years.

Such a deal also further underlines the extent of political leverage Ukraine and Turkey would enjoy well beyond Europe, and into the Middle East.

Geopolitically, if Ukraine and Turkey were to bring Qatari gas through the Bosporus and on to European markets, this would help balance the power of a Russian-Iranian axis. It would reshape geopolitical dynamics, with Turkey the driving force through its strategic position as a Middle East-Europe energy hub.

Turkish and Ukrainian interest can either merge, or diverge to be counter-productive both to their gas supply needs and to European energy security. The perceptions of competition between Ukraine and Turkey are there, however, it is only through the combined, complementary force of the two that we will see a new energy powerhouse emerge.

LNG is the future, and globally we are looking at a major upswing in demand, including for Europe in the medium-to-long term.

As becomes clearer every year, pipeline gas delivery is hindered severely by economics and geopolitics. It limits room for consumer maneuvering, especially for those who are reliant on few, or single, sources. LNG can avoid much of these same hurdles, despite the investment cost associated with LNG facilities. There is a great deal of market flexibility to be found in LNG due to the absence of piping contracts.

LNG will become the key fuel of the future, and the forces that grasp the Black Sea market for LNG first will be among the most influential players on the global energy market. There is also the Black Sea marine industry to consider here, and the future is likely to see this converted to LNG—with new and converted transport vehicles and vessels running on LNG.

Source: http://oilprice.com/Geopolitics/Europe/Ukraine-Turkey-The-European-Energy-Coup.html

By. Oil & Energy Insider Analysts

This report is part of Oilprice.com 's premium publication Oil & Energy Insider . Oil & Energy Insider gives subscribers an information advantage when investing, trading or doing business in the energy sectors. http://oilprice.com/premium

---