The Outlook for Peace in Cyprus after the Financial Crisis and Gas Discoveries

Finansal Kriz ve Doğalgaz Keşifleri Sonrası Kıbrıs'ta Barış için Görünüm

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Abstract

The end of Cold War eased political tensions in many corners of the World however the conflicts arising from regional dynamics were carried on to the new century. The Greek-Turkish power struggle on Cyprus is among those hot spots where a political settlement has not been reached yet even though the root of disagreement lies in Cold War years. The rejection of Annan Plan by the South in 2004 created a frustration in the Northern Cyprus and Turkey breaking hopes for reconciliation. This status quo was fundamentally altered when the economic model of Cyprus collapsed as a consequence of contagion from European financial crisis. Almost simultaneously significant reserves of natural gas deposits were discovered in Eastern Mediterranean some of which were located to the south of the island. Aphrodite natural gas reserve promised the recovery of economic glimmer of the island provided that legal and technical issues on the extraction and transfer of this resource to European markets are resolved. Turkey has the means to increase transaction costs for Cyprus and energy companies if left out of this deal but can alternatively provide a transit route to European markets for Cyprus' natural gas. The demise of Cyprus as an off-shore financial center and the prospects for becoming and energy supplier to European markets changed the payoffs of this deadlocked game considerably. In this new setting Turkey, Greece and Cypriots have a strong incentive to cooperate in order to realize the potential in the energy game.

Keywords: *Cyprus, European financial crisis, energy cooperation, natural gas, Eastern Mediterranean*

Özet

Soğuk Savaş'ın sonu dünyanın birçok köşesindeki politik gerilimlerin azalmasına sahne olsa da bölgesel dinamiklerden kaynaklanan çatışmalar yeni yüzyıla taşınmıştır. Kıbrıs üzerindeki Türk-Yunan güç mücadelesi de henüz bir siyasi çözüme ulaşılamayan bu sıcak noktalardan biridir. 2004 yılında Annan Planı'nın Güney'de reddi Kuzey Kıbrıs'ta ve Türkiye'de hayal kırıklığı yaratmış, çözüm umutlarının kaybolmasına yol açmıştır. Bu durum, Kıbrıs'ın ekonomik kalkınma modelinin Avrupa ekonomik krizinin bir uzantısı olarak çökmesiyle temelden değişecektir. Neredeyse eş zamanlı olarak da bir kısmı adanın güneyinde olan doğalgaz rezervleri Doğu Akdeniz'de keşfedilmiştir. Afrodit doğalgaz sahası, gazın çıkarma ve transferine ilişkin hukuki ve teknik sorunların çözülmesi kaydıyla adanın kaybolmakta olan ışıltısını geri kazandırma umudunu taşımaktadır. Kıbrıs'ın bir off-shore finansal merkez olarak çöküşü ile beraber Avrupa pazarlarına enerji ihracatçısı haline gelme ihtimali bu kilitlenmiş siyasi oyundaki muhtemel getirileri değiştirmiştir. Bu yeni durumda, Türkiye, Yunanistan ve Kıbrıslılar'ın enerji oyunundaki potansiyeli gerçekleştirebilmek için işbirliği yapmalarına güçlü bir gerekçe çıkmıştır.

Anahtar Kelimeler: *Kıbrıs, Avrupa mali krizi , enerji işbirliği, doğal gaz, Doğu Akdeniz*

Introduction

The ongoing political stalemate in Cyprus is a relic from Cold War years and it continues to occupy a significant space in Turkey's relations with Greece and the West. Two British military bases are still active due to strategic location of the island at the crossroads of Eastern Mediterranean maritime routes. Cyprus is located right to the north of Suez Channel and is in direct control of all maritime traffic in the region making those bases strategically important for dominance of Eastern Mediterranean. As a result of its geographical value, Turkey and Greece as well as Turkish and Greek communities of the island are unwilling to make compromises from their political position.

The decision to admit Republic of Cyprus into EU a decade ago and Turkey's acceptance as a candidate country for membership seemed to be able to break the ongoing deadlock in negotiations (Michael 2011, 164-169). Turkey, in return for a prospective membership in EU, would be more willing to soften its stance on the question. AKP government that started its first term in 2003 was the most enthusiastic party to reach an agreement on Cyprus stalemate. When UN General Secretary Annan and his staff prepared a plan for unification of the island, despite opposition from die-hard groups within the Military and Foreign Office, Turkish government supported the solution. The plan was separately voted in a referendum in the North and the South of the island and the Turkish Cypriots overwhelmingly supported the deal. For Turkish Cypriots, the plan was going to end decades of isolation from the World and at the same time guarantee the identity and rights of Turkish community (Kızılyürek 2005, 384-390). Nevertheless the fate on the island was not solely going to be decided on the North.

In the South, neither Greece nor Republic of Cyprus had enough incentives to make any compromises for a solution (Michael 2011, 181-184). Greece was not only a member of European Union but managed to bring her economy into the Euro-zone which brought a temporary but illusive feeling of prosperity. Republic of Cyprus had already guaranteed accession to EU by 2004 and was in no mood to fall behind the 1974 status. The result of the referendum was understandably a solid "no" for unification from the Greek side in which Turkish side achieved important concessions[1]. The failure of referendum on Greek side buried the plan for some time but important external shocks would shift the payoffs considerably within a decade.

Collapse of Cyprus as an Offshore Financial Center

Southern European economies benefited considerably from the launch of Euro as capital flux created an atmosphere of optimism while the interest rates converged to North European levels in the first decade of 2000s. Euro-zone was a project designed to bring member states together under a single monetary policy; a step of enormous importance on the road to create a single European market. Nevertheless, from the beginning there were warnings that the current state of Europe did not allow for the creation of a single currency zone. A single currency zone should allow for labor mobility, price and wage flexibility that is necessary for adjustment of macroeconomic imbalances, a fiscal authority that will proactively engage in counter-cyclical policies in diverging zones and convergence of economic cycles over the entire zone (Mundell 1961). Apparently by the launch of Europe, neither of those conditions was perfectly met in member countries. As a result of the disappearance of national currencies Northern European economies started to gain competitiveness while the Southern Europe enjoyed a false spring that would last until the tide turned.

The situation of Cyprus was further complicated thanks to its singular positioning as an off-shore tax haven within Europe. Authorities encouraged the inflow of capital by a low 10% tax rate for international companies in order to compete with other EU tax havens like Liechtenstein, Luxemburg, Gibraltar and British Isles. After the collapse of Beirut in the 1980s as a financial center, Cyprus was well poised to benefit from its proximity to Middle Eastern and East European capital and bilateral double taxation agreements well served this purpose. Primarily the Russian investors chose to park their funds in the island's financial system (Pelto, Vahtra, & Liuhto 2004) encouraged by the tacit guarantee of European Union on their deposits. The size of bank assets ballooned to reach eight times that of GDP when the crisis hit and the deposits of Russian citizens were well over 30 billion dollars (Hanke 2013). An off-shore financial center under EU's protective umbrella seemed to be a perfect shelter for oligarchs' treasures. However there has never been an implicit underwriting of member states financial liabilities neither in the form of bank deposits nor sovereign bonds. It was only an assumption by the investors that EU would never allow member states to default, fearing the loss of credibility of European Union and the risk of a contagion to other countries. A similar reasoning was applied to Eurobond markets where spreads on Southern European bonds stayed unsurprisingly low for nearly a decade despite an obvious loss of competitiveness in their economies and the unsustainable path of current account deficits.

The investors' confidence in a tacit European guarantee seemed to be justified in the case of Italy, Spain and Portugal when ECB committed to buy their bonds in order to avoid a sovereign default contagion. However for Greek bond holders a restructuring took place and the bondholders suffered from haircuts on their principal payments and interests. Cypriot banks were also among the major losers of Greek restructuring (Oehker-Sincai 2013) and they had to book losses on their exposure to Greek risk. Already the breakneck speed expansion in Cypriot banking balance sheets was drawing attention. The assets of banks were eight times larger than South Cyprus' GDP and this was a clear indication that the financial sector was completely cut off from real sector and the government could in no way support banking industry if needed.

The Cypriot government had ran out of tools to rescue its banks by itself, primarily because a Euro-zone country had already given up its function as a lender of last resort in the absence of a national central bank. Providing liquidity to distressed financial institutions could no longer be achieved singlehandedly. It was the European Union and ECB who could pull Cypriot banks from an inevitable meltdown but they would also not throw money in an off-shore tax haven where Russian oligarchs laundered their money. Help would be conditional and the Cyprus economy would have to be under custody of major European powers henceforth. European taxpayers' money could not be wasted to save the deposits of the ultra-rich, especially the Russian oligarchs, who ventured into the off-shore financial markets to evade taxation at home. Desperately, the Cypriot government even waited for a bail-out from Russian government but that would also come on conditions of gas extraction rights for offshore resources in the Mediterranean. The least bad choice for Cyprus was to let the bank depositors and especially the big ones into the fray. Deposits under 100.000 Euro was guaranteed by the government but bigger bank customers had to endure the consequences of bank defaults and debt consolidations. Furthermore a limit of 300 Euros per day was imposed upon withdrawals from bank deposits in order to forestall a bank run. Although those measures were required to prevent a full scale collapse of the financial system, they also melted the confidence towards banking system. Once considered a safe haven for big money, the economy of Cyprus collapsed bringing down the sandcastle that the Greek Cypriots depended for their prosperity. The authorities played with the idea of leaving Euro-zone for some time but fears of contagion to other European markets (Eichengreen 2010) convinced policy makers to drop this plan.

In 2013, the economy shrank by 5% while the unemployment rates climbed up to 17%. The figures in Table 1 illustrate clearly how the Cypriot economy overheated in the first decade of the millennium and show why this model could not be sustained.

Table 1: Key Economic Indicators of Republic of Cyprus:

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Growth											
Rate	4,2	3,9	4,1	5,1	3,6	-1,9	1,3	0,4	-2,4	-5,4	-2,3
CAB*/											
GDP**	-5,0	-5,9	-7,0	-11,8	-15,6	-10,7	-9,8	-3,4	-6,9	-3,0	-5,1
Inflation											
Rate	2,3	2,6	2,5	2,4	4,7	0,3	2,4	3,3	2,4	-0,4	-1,4

Capital flows well in excess of the economy's capacity to absorb, resulted in extremely high levels of current account deficits. Growth and inflation rates picked up but when the global crisis hit and Cyprus lost its status as an off-shore tax haven, the economy went into an ice age in terms of business activity. While the economy is contracting heavily, the Cypriot economy is still giving current account deficits, although at a much moderate pace. Adoption of Euro removed the possibility that the exchange rate be used as an adjustment mechanism. Worst of all, still the real estate markets are in decline and there seems to be no end to the economic hardship. In that case, as in many other parts of southern Europe, Cypriot economy has to endure long and hard periods of wage and price deflation. This means significant amount of production losses ahead in the coming years. One should not wonder why the Cypriot government is so anxious to utilize any resource that can provide a boost to its economy.

Although the economic collapse brought significant hardship for ordinary Cypriots, it can also provide an opportunity to establish a sustainable economic model right from its foundations. That would take years and even decades to come out but can also create incentives for the reunification in the island. Cyprus as an off-shore tax haven submerged under the waters of Mediterranean but energy companies are starting to drill out natural gas from underneath the basin of the same sea.

Turkey's Role as a Transit Route between Energy Suppliers and Markets in Europe

Turkey has become the main transit route for Europe that wanted to establish a Silk Road of natural gas in order to diversify its suppliers (Tagliapietra 2014). The policy was in effect since the 1990s with the Baku-Tiblisi-Ceyhan project but its urgency and necessity became more obvious after the energy crisis of 2006 when Ukraine intercepted Russian natural gas deliveries to Europe as a result of disagreement on gas prices between these two countries. The crisis was repeated in 2009 and supplies to Europe was once again cut off albeit for a longer period this time, convincing European policy makers of the urgency to find alternative routes for energy. The blockage scrapped the assumptions that oil and gas are exclusively economic goods rather than strategic ones (Umbach 2010, 1230). According to this logic, Russia was also mutually dependent on European markets and could not risk antagonizing its best customer, namely EU. Moreover disruptions could be dealt with as alternatives existed, so energy security should not be a factor of high importance. Those double energy crises terminated those unjustified claims.

Considering the fact that Turkey is surrounded by countries that supply 73% of World's proven oil reserves and 72% of proven gas reserves[2] and links those resources to the gigantic European market one could easily understand the significance of a transit strategy (Bilgin 2015). Turkey's position may stay as being a mere energy corridor or may progress towards becoming an energy hub or at best an energy center, depending on the success of policies implemented. In the case of an energy corridor Turkey would host a variety of oil and gas pipelines from the supplying countries to Europe and accrue transfer fees. An energy hub, on the other hand, will bring in the possibility of affecting terms and conditions of energy trade. There are at the same time various obstacles in front of Turkey's desire to become a hub as well as major rewards if succeeded. Turkish desire to become a main energy lifeline needs the commitment of European policy makers to its role as a energy hub for the region, otherwise it may well antagonize Russia by pursuing the strategy. In economic terms, aggressive policies may cause Turkish market to be oversupplied if markets necessary for those resources are not developed as planned (Shaffer 2006, 103). Besides further investments are needed to cope with political and natural contingencies such as war, earthquake etc.

The most ambitious of those plans, the prospect of becoming an energy center, will require massive investment on infrastructure and complete dedication to this goal. This would also allow Turkey to project political influence thanks to its dominant position. Nevertheless, the fact that Turkey's current contracts with supplying countries does not allow significant influence on terms or conditions of sales, nor is the infrastructure sufficient for a sophisticated policy (Bilgin 2010, 127-128). Hence Turkey currently seems rather concerned with diversifying energy supplies in order to divest its dependence to Russian energy and improve its terms of purchase. In the long run with the completion of nuclear power plants and gas storage facilities, in parallel with more favorable and sustainable agreements with energy producers may help Turkey become an energy hub as well.

Turkey's unique geographical position linking producers with Europe provided it with an advantage in establishing a key position in this commerce (Tekin & Williams 2011, 145-146; Özdemir, Yavuz, Tokgöz 2015: 100). Except for White Stream and AGRI all the projects envisioned carrying the natural gas over Turkish territory[3]. Despite failure of Nabucco project that aimed to supply gas from Shah Deniz II in Azerbaijan to Central Europe passing through Turkey, Trans Anatolian Pipeline (TANAP) and Trans Adriatic Pipeline (TAP) projects will target consumers in southern Europe. Until 2020-2025 Turkey will only transit the 10bcm/year Shah Deniz II gas through its territory (Fackrell 2013, 70-71) as other projects are still in premature stages. This figure will only constitute 3% of EU's natural gas demand. However this initial step may open the gates for further investments and extensions on gas through Turkish territory.

Southern Gas corridor may also eventually bring gas from fields in Turkmenistan as well (Özkan 2015) when issues related to transit through Caspian is resolved. A possible solution proposed by ENI is the compressed natural gas (CNG) project that will liquidify Turkmen gas and transport to regasification. However economically and strategically this project does not seem justified. Nabucco project that targeted consumers in Central Europe via Southern Corridor had the potential to undermine Russian strategy to control all energy supplies directed to this region. So its failure was a relief to Gazprom and Russia but Southern corridor still exists through TAP and TANAP only to serve customers in southern Europe instead (Güney 2015). Having in mind the fact that Southern European markets are already saturating after the economic crisis resulted in the freezing of demand, one could argue that abandoning Nabucco was a strategic blindness. Nevertheless, the financial and strategic difficulties in bringing about Nabucco convinced supplier countries to look for alternatives. The shale revolution in US cut down the demand for LNG imports putting a pressure on its prices but still as the costs of liquidification and regasification make LNG an expensive alternative for pipeline projects. That is why countries like Azerbaijan and Turkmenistan are content to reach southern European markets as the second best option. Turkey, on the other hand, is happy to connect supplying countries to its pipeline network irrespective of final destinations in Europe (Fig. 1).

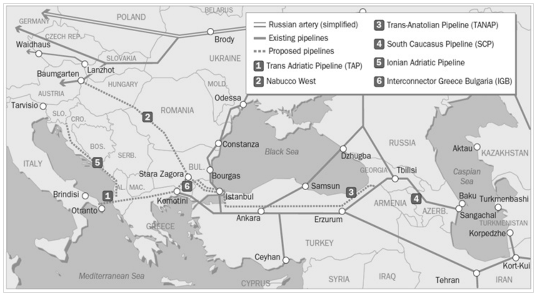

Figure 1. Pipeline Map into Europe (Source: Review of Environment, Energy and Economics)

Southern corridor offers an array of benefits to the regions countries not only in economic terms but also political aspects. First of all, Caspian region countries will have the opportunity to diversify their export routes and will not be bound neither by northern route and nor sales to Asia any more. Second, the route is not controlled by Gazprom and this is good news taking into account the fact that European Commission is promoting competition in energy markets. Gazprom is the vehicle for Russian policy makers' strategy to become an energy super-state and the most importance premise of this scheme is to control energy resources supplying European market (Kazantsev 2010; Belyi & Goldthau 2015). Apparently European Union's priorities are directly in conflict with Russia's and Gazprom's motives. Third, despite a temporary slump because of European crisis, the market is expected to grow and due to huge price drops in US market as a consequence of shale revolution, Europeans are also anxious to improve their buying terms as their natural gas costs are already triple the cost in US. This seriously compromises competitiveness in energy intensive sectors in Europe. Bringing in more suppliers in order to enhance competition is the key to achieve this target. Finally, it will allow further strengthening of political ties between Europe, Turkey and especially supplier countries like Azerbaijan and Turkmenistan, a much needed contribution to maintain political stability (Koranyi 2014, 3-4).

Increasing the number of supplier countries, combined with a buyer's market in Europe can bring down energy costs of Turkey in the coming years. This is increasingly becoming important considering the fact that Turkey's energy bill is the main reason underlying its burgeoning current account deficit and Turkish gas imports are illustrating a continuous upward trend in the last 10 years. In fact, it can also be claimed that Turkey's primary concern in conducting its energy policy is securing its supplies whereas a transit route to Europe is a secondary perspective (Winrow 2013, 146), (Table 2).

Southern corridor also has significant benefits for energy producers such as Azerbaijan and Turkmenistan basically for the fact that there seems to be no other route to reach Western markets and heavy investments on downstream can only be justified if and only if the gas can be brought to the market. Iraq also has the potential to export through Turkish pipeline system as much as 10bcm/year by 2020 (Tunçalp 2015: 73). Turkey's relations especially with Kurdistan Regional Government involve substantial cooperation in the field of energy. Genel Energy of Turkey in partnership with Norwegian partner DNO is exploring and producing oil in energy sector (Bilgin 2010, 89). The only reliable route to market for Kurdish gas is through Turkey and Turkish policy makers are intending to exploit it in order to strengthen their hand against other suppliers as well. The more pragmatic approach of AKP government to the Kurdish entity in the north of Iraq enabled a room for maneuver in the energy game (Mills 2013, 62).

However the biggest potential is coming from Iran that has not been exploited mainly as a result of political reasons (Tagliapietra 2014, 9-18). The recent nuclear deal reached between Iranian administration and P5+1 opens the possibility of bringing in immense underground resources of the country to global markets. Years of neglect as a result of wars and embargos left Iran's energy industry in a poor condition and it will require massive capital expenditures and time to uplift production. Yet in the long run, Anatolian peninsula seems to be the only conduit to Europe to lay pipelines. Iran may divert a major part of its natural gas resources to Eastern markets and may also use liquidification option for its reserves in the Gulf (Omidvar 2015) however Turkish corridor still needs to be a part of Iranian export strategy for diversification.

Table 2. Turkey's Natural Gas Consumption in Billion Cubic Meters

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
17.4	20.9	22.1	26.9	30.5	36.1	37.5	35.7	39.0	44.7	45.3	45.6	48.6

Source: BP Statistical Review of World Energy 2015.

Mediterranean and the Cypriot Gas

The consumption of natural gas is expected to rise in the Mediterranean region from 114 Mtoe in 2009 to 239 Mtoe in 2030. Significant growth is expected in the regions' demand for energy which is mostly coming from the southern and eastern Mediterranean countries. Nevertheless, gas production in the region is also expected to show an increase in parallel, protecting current surplus levels (Table 3).

We should also note that northern Mediterranean countries are net importers of natural gas while Algeria, Egypt and Libya are countries supplying the market. In the Levantine basin the potential was left untapped for a long time but recent research is indicating a world class hydrocarbon province[4]. Whereas the offshore field Leviathan with estimated reserves of 453 bcm by 2010 is discovered in Israeli Exclusive Economic Zone, Cyprus is also blessed with energy resources. The Cypriot government investigated plans to establish a LNG plant near Vassilikos on the southern coast along with Noble Energy and Israel's Delek group (Hafner, Tagliapietra, & El Elandaloussi 2012, 10). Those reserves can be utilized to meet the burgeoning energy demand in the region but at the same time be transferred to European markets.

The possibility of bringing in gas from Eastern Mediterranean offshore fields has come out after the recent explorations in the region. In 2009, Noble energy discovered gas reserves in Tamar offshore field and this finding was followed by further discoveries in Leviathan Field in offshore Israel and Aphrodite field south of Cyprus in 2011. While the fields in off-shore Israel are estimated to hold 800 bcm of natural gas and when they become operational they are expected to produce 10bcm gas per year, Aphrodite field in off-shore Cyprus may contain 140-220 bcm gas reserves[5] according to estimates. At a very conservative price estimate of 200 $ / bcm, current value of reserves can top 40 billion dollars in total. For an island of approximately 1 million inhabitants, it is not hard to see the significance of recent explorations. Republic of Cyprus has a GDP of 24 billion US dollars and the public debt of the country is slightly above 18 billion dollars. Noble Energy and Republic of Cyprus have made a 65/35 split agreement on profits from natural gas fields in Aphrodite area. So with the assumption that the revenues will be spread through a period of 20 years and the government will receive 50% of the revenues after deduction of costs, net revenue of close to 1 billion dollars can be expected (Emerson 2013, 167). That could be a considerable sum assuming that total government revenues in Cyprus is slightly over 10 billion dollars (Fig. 2).

Figure 2. Cyprus Natural Gas Reserves Map (Source: Cyprus Gas News)

Table 3. Rise of the Consumption of Natural Gas in the Mediterranean Region

Mtoe	2009	2015	2020	2025	2030	Annual
Avg Growth						
Gas Production	150	184	227	261	294	3,2%
Gas Consumption	114	154	177	207	239	3,6%
Net Imports / Exports	-36	-30	-50	-54	-55	1,8%

The discovery of gas in offshore Cyprus fields once again increased tensions on the issue a settlement on the island's future. Under current conditions Turkish population in the north of the island has no word in those agreements and will not benefit from the riches of the region (Öğütçü 2012). Republic of Cyprus signed delimitation agreements with Egypt, Israel and Lebanon to define its Exclusive Economic Zone (EEZ) in the Mediterranean but Turkey does not recognize these arrangements. When Cyprus started exploration agreement to the south of island Turkey authorized Turkish Petroleum Company (TPAO) for oil exploration in the zone between Cyprus and Turkey.

The delimitation agreements were based on UN Convention on the Law of the Sea (UNCLOS) but this convention has not been signed by Turkey. The current dispute between Turkey and Greece on the Aegean Sea is the major reason behind Turkish rejection of the Convention but the fact that this is a widely accepted agreement by the international community weakens Turkish position (Emerson 2013, 168-170). Furthermore, powerful economic incentives behind the exploitation of these resources reduce the power of Turkey's objection. While Turkish government claimed that a final agreement was necessary before those resources could be exploited, Republic of Cyprus already considers Russia's Novatek, Italy's ENI, France's Total, Malaysia's Petronas, Korea's Kogas, Israel's Delek, US Marathon Oil and Australia's Woodside Energy Holdings as potential candidates for further exploration (Tagliapietra 2014, 22). Under these circumstances it is unlikely that Turkey will be able to block exploration activities singlehandedly.

Although Turkish objections on exploration and drilling of natural gas resources went unheeded, transportation of those resources dominated the agenda. Turkey could well offer an access to Eastern Mediterranean gas to European markets (Winrow 2013, 157). Turkey has already covered a considerable distance in linking East West corridor but for these recent natural gas reserves political problems still prevail. In order to overcome the necessity of using Turkish infrastructure, Cypriot government started to investigate LNG option. A proposed LNG plant could be located in Vassilikos port that could be operational as early as 2019 (IAE, 2013). The liquification plant is proposed to be constructed will have an initial export capacity of 5 million tones and will be expandable to 15 million tones when necessary. Noble Energy, Delek Drilling and Total have already signed a memorandum of understanding with the government for the LNG plant but still the commercial viability of the project is dubious. The liquification plant will have a cost of 6 billion $ plus 3 billion $ for a train[6]. The next two trains will also have additional cost of 3 billion $ each, making the total investment cost to 15 billion $. As the estimated gas reserves are being downsized already, it will be harder to go for LNG strategy as a potential export route to Europe. There is the possibility of bringing in Israeli gas from Leviathan and Tamar fields to increase the supply of resources. The ongoing Israeli-Turkish tensions could have induced Israel to opt for an LNG option to bypass Southern corridor but recent signs show that behind the doors, rational calculations can dominate sentiments and both countries can come to an agreement to transfer gas via the pipeline system going through Turkish territory. Taking into consideration the upstream, liquification and transportation costs, selling Eastern Mediterranean gas to European market does not look profitable but thanks to high prices in Asian markets that option looks feasible (Henderson

2013, 5). Considering the fact that European policy makers are already concerned with energy dependence to foreign sources, the discoveries in Eastern Mediterranean is extremely good news. Rather than bringing in the gas to European markets, liquefying it to sell in Asian markets sounds running counter to basic needs of Europe.

On the other side of the table, Russia also has stakes in this new scheme and makes sure its influence is felt by a combination of carrot and stick policies. Russia does not wish to see Eastern Mediterranean gas to give boost to Southern Corridor hence their plan is to transport and sell it in LNG form in European markets using Gazprom' capabilities. Turkey threatened to blacklisting companies working with Cyprus on a number of occasions. However this warning is unlikely to work in Gazprom's case because of the important leverage that Russians have in Turkish market (Öğütçü 2012, 5).

Another major rival to trans-Turkey pipeline projects is the Eastern Mediterranean gas corridor that links off-shore gas resources between Israel, Cyprus and Egypt to southern Europe via submarine pipelines. This option has been reevaluated in a recent tripartite meeting between Israel, Greek and Cyprus leaders in January 2016 in order to bring unexploited gas reserves to markets. However the feasibility of this project is also questionable especially after Noble Energy downgraded the potential gas reserves in Aphrodite fields off Cyprus shores. The depth of sea does not allow for large diameter pipes because of high pressure. Consequently there should be five to six pipes to be laid in order to carry desired amounts of gas to the mainland but that also makes to project uneconomic (Henderson 2013, 12) The search for a route to by-pass Turkish territories has much to do with the political problems that Greece, Cyprus and Israel are having with Turkey for the moment. Despite the fact that Southern Corridor is the most economically sensible route to reach markets, those political issues trigger outpouring of alternatives for the producing nations. The relations between Turkey and Israel deteriorated sharply after Operation Cast Lead in Gaza in 2009 and reached a nadir after Mavi Marmara incident where Israeli commandos ambushed a Turkish ship and killed 9 civilians. Turkish government reacted with rancor to the attack asking for a formal apology, compensation for the families of the victims and lifting of the embargo and Gaza. Although Israeli government issued an apology and offered payments to families, still a full normalization has not been achieved as of today.

For Cyprus, the presence of Turkish troops on the island is a major problem and Greece has ongoing issues to be solved with Turkey. That is why Israel-Cyprus and Greece were in search of forming a net to overcome their problems with Turkey (Stavris, 2012) and they are also supported by Gazprom who seems willing to undertake the task of transferring the gas in Levant Basin to European markets. On the other hand, the détente between Turkey and Greece in the last decade should also be mentioned in order not to overemphasize the solidity of this net around Turkey. Greece also has few stakes to push forward a costly and risky submarine pipeline project under the Mediterranean Sea. In fact, the relations between Turkey and Greece has improved significantly for a while (Öniş & Yılmaz 2008) and Turkey offers Greece the possibility of becoming a partner in its network via TAP and TANAP pipelines (Tagliapietra & Zachmann 2015, 6).

Israel is also showing signs of finding a common ground with Turkey once again in order to fully exploit their natural gas potential. They are considering options for the sale of its gas and a scenario including a floating LNG terminal and a submarine pipeline to be connected to Southern Corridor. Moreover Israel is also probing the possibility of selling its gas to Palestinian Authority, Jordan and to Asian markets from Eliat Port. Turkey also is a major natural gas market in which the consumption is expected to reach 70 bcm in 2020 (IEA 2014). This demand is almost completely supplied by imports so Turkish policy makers' fundamental concern is to diversify sources in order to reduce risks. On the other hand Turkey is also trying to develop nuclear energy to reduce its reliance in natural gas.

It is also necessary to briefly mention Russia's position as an energy super-state on the recent energy findings in the region. Although Russia was heavily engaged in the region during Cold War supporting Arab countries against Israel, she decided to withdraw in the 1990s. Only after Putin came into power did Russia once again made her bid to become a key player in the region (Delanoe 2013). In 2013 Russia conducted large scale naval drills in the region both as a response to increasing Western attention to Syrian crisis and also because of Turkey's intervention to oil and gas research in the area. The relations between Russia and Cyprus had already improved considerably since 2000s as oligarchs parked their wealth in off-shore accounts. The corporate tax rates were as low as 10% while the Russian citizens enjoyed a bilateral tax treaty as well as %5 tax on dividends (Delanoe 2013, 86). Furthermore, those Russian citizens who have invested a minimum 300.000 € on property were granted a permanent residence thus made the island a backdoor to Europe. As explained previously, cooperation on financial issues between Russian capital and Cyprus was shattered by the financial crisis.

Starting with 1996 Cyprus and Russia have also invested in military cooperation and especially when Republic of Cyprus tried to purchase Russian S-300 surface to air missile system Ankara objected vigorously. Those systems with eventually deployed in Crete rather than Cyprus as a result of US pressure (Delanoe 2013, 89). Those two countries would also cooperate during the Syrian War. When the closure of Tartus base in Syria was discussed, which is the unique naval Russian base in Mediterranean, Cyprus was indicated as an alternative to Tartus.

Conclusion

There still remain important pockets of resistance for an eventual settlement in Cyprus problem and those groups on both sides of the table can bring the negotiations to a deadlock by insisting on maximalist positions. Nevertheless, the financial crisis and the prospects of natural gas findings have transformed the payoffs that all parties have in this context.

First of all, Republic of Cyprus is the party that is most affected by the stream of events. Obviously, energy income is the most likely candidate to replace the lost wealth from financial flows. This will ensure that the population of the island will carry their prosperity to next generations. The most economically sensible route to market for Cypriot gas is to connect with Turkish pipeline system by an underwater pipeline. The distance between the island and mainland is short but the gas will also have to compete with energy from Caspian and Iraq (Henderson 2013, 13). Furthermore, a settlement may also provide a boost to income from tourism sector by ending the division of the island. Concerns about a military conflict seem to be diminished already after membership to EU has been achieved. Nevertheless, a final settlement will nullify the risks associated with an armed confrontation reducing the need for defense spending. In Presidential elections of 2013, candidate of DISY, the party who favored a yes vote to Annan Plan in 2004, Nicos Anastasiades was elected. In Northern Cyprus electoral victory of Akıncı, brought a new enthusiasm to negotiations bringing hope to international community about a final agreement. Nevertheless, Anastasiades also has to deal with the ongoing economic crisis and takes unpleasant measures under pressure from European Union. The costs and compromises needed to close a deal remain at their place so the President has less room to ask for patience and understanding form his constituency. Material benefits associated with a political settlement have significantly increased but political and psychological factors may still block the road to peace

For Greece, economic troubles constitute the single most concern in the last years and there is no sign that these problems will dissipate. Greek government will welcome any development that will reduce the economic pressure as a peace dividend or increased cooperation between the states in the region. Enmity with Turkey has few benefits to offer, while a continuation of easing tensions will allow Greece to save on defense costs. Turkey has also started to offer a potential source of income as more Turkish citizens prefer Greece for touristic purposes. Resolution of Cyprus issue will open the gates for a final settlement an all Turco-Greek disagreements such as Aegean Sea dispute.

Turkish Cypriots are for the last decade been the most pro-unification group in this scheme while the dreams of EU integration became a reality for the southern part of the island. Becoming part of Europe induced Turkish Cypriots to vote overwhelmingly for unification in 2004. The rejection of Annan Plan in the South created disappointment and consternation in the north and today we witness a declining support for unification among Turkish Cypriots[7]. This may also be triggered by the ongoing economic crisis in Europe and in Southern Cyprus, yet there are still positive benefits entailed with a political settlement and public opinion may again shift towards unification in the north. Furthermore, leaving aside the fluctuations in public mood, we aim to analyze the changes in the payoff structure that policy makers are facing within the context of this paper.

Turkey also has also considerable gains to make from an eventual solution to the stalemate in Cyprus. After Turkish intervention in the island, Turkey endured serious economic sanctions and political pressures by the international community. The failure to reach an agreement on the issue constrained foreign policy options as well as creating a burden on finances of the government who found herself in the obligation to support the economy of Northern Cyprus. The Turkish part of the island could not stand by itself because of its isolation form the world and the inhabitants looked over to the southern part of their home to see in envy the increasing prosperity of the Greek side. Hence Turkey made important sacrifices to support living standards in the North and maintained a considerable military force in the island. More importantly, the presence of Turkish troops on the island strained the relations with the West and has been used as a pretext to block negotiations of adhesion with Turkey.

Turkey's desire to become an energy corridor or better an energy hub can only be achieved if the resources of neighboring countries can be directed to the Turkish pipeline network. Turkey has to diversify its resources not only in order to improve its buying conditions but also to show Europe that it can serve as a reliable route to market. If Turkey can prove its importance as an energy lifeline to EU's decision makers, it can increase its leverage and enhance its chances of becoming a EU member in the future.

European Union's aim to diversify its energy resources will also be well served if the resources in the Eastern Mediterranean can be brought to the continent (Umbach 2010, 1237-1238). Currently, Europe is heavily dependent on energy supplies from Russia (Tekin & Williams 2011, 73-82) and this fragility may increase as the production in North Sea and Norway will fall in the next decade. A host of pipeline projects are hoped to give European Union alternatives if push comes to the shove. The task of reducing energy dependency seems more urgent as Russians are also finding alternatives to their gas in Asia. Finalization of a gas deal with China underlines the fact that now the Russians have more room of maneuver against the Europeans. While Russia is diversifying its export markets, Europe feels the pressure to find alternative suppliers more than ever.

There are positive signs that inspire optimism for the future of negotiations on Cyprus issue. Turkish and Greek Cypriots are negotiating directly first time since 1963 without the interference of intermediaries. Both parties in the island, seem to be closer to the idea of a loose federation more than ever, where the decisions affecting everyday life will be taken at the level of constituent states. On the other hand, there will be a single international personality and single foreign policy for the united Republic of Cyprus. This kind of a resolution will entail scrapping of trade restrictions imposed on North Cyprus and bring an end to difficulties faced by Turkey on EU accession process because of the situation on the island. The support given by US and EU point out to the fact that finally a large coalition of powers are in favor of a solution to the stalemate in Cyprus. This brings further hope for a final settlement on the fate of the island where all parties may finally see their concerns are met.

Notes

1. Annan Plan met the expectations of Turkish side by limiting the right to return of Greek Cypriots to the federal state in the North. A bicameral legislature in which the Senate was equally shared by Greek and Turkish communities was also hoped to overcome the anxiety of the Turkish side that feared being overwhelmed by the Greek majority.
2. Those figures may change as shale revolution is making more resources accessible especially in the United States. Nevertheless Turkey's southern neighbor Iraq also has the potential of increasing its supply and Turkey's position in the midst of resources and markets will continue in the future.
3. White Stream is a submarine pipeline Project in Black Sea linking Georgia to Romania and Ukraine while AGRI is the name of the Project to cover the same distance by LNG facilities and sea transport.
4. Israel's Ministery of Energy and Water resources estimate that reserves could increase up to 1,3 tcm within a few years. See http://energy.gov.il/English
5. LNG intelligence
6. LNG plants consists of typically one kilometer long series of industrial processes. In the trains the gas is cooled down to minus 160 centigates allowing for the reduction of size up to 600 times.
7. Social Cohesion and Reconciliation Index (SCORE) report launched in November 2015 finds out that only 28% of Turkish Cypriots are willg to vote "yes" in a referandum for unification whereas 32% declare that they are undecided. Web: http://www.seedsofpeace.eu/research/score/reports/item/105-reflections-paper-on-the-2015-score-index-for-cyprus-turkish.html (Accessed: March 2, 2016).

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Biographic Sketch

Akif Bahadır Kaynak received his BA degree from Boğaziçi University Economics Department. Kaynak completed his PhD in Istanbul University International Relations Department in 2012. The same year he started as a Faculty Member in Istanbul Kemerburgaz University International Relations Department. Kaynak is currently working as an Assistant Professor in the same department and is also the Director of Social Sciences Institute. His work is mainly focused on energy issues and their implications on political relations.

Otobiyografik Öz

Akif Bahadır Kaynak lisans derecesini Boğaziçi Üniversitesi Ekonomi Bölümü'nden aldı. Kaynak, doktorasını İstanbul Üniversitesi Uluslararası İlişkiler Bölümü'nde 2012 yılında tamamladı. Aynı yıl İstanbul Kemerburgaz Üniversitesi'nde Uluslararası İlişkiler Bölümü'nde Öğretim Üyesi olarak göreve başladı. Kaynak, aynı bölümde Yardımcı Doçent olarak çalışmaya devam etmekte olup aynı zamanda Sosyal Bilimler Enstitüsü Müdürü olarak görev yapmaktadır. Çalışmaları ağırlıklını olarak enerji konuları ve siyaset bağlantısı üzerinde sürdürmektedir.