
Russia-Turkey: A Relationship Shaped by Energy



Rémi Bourgeot

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Summary

Deepening ties in between Turkey and Russia in the energy sector prompt questions as to where the balance of power between the two countries lies, with the former relying heavily on the latter for its energy needs. In light of Europe's efforts to diversify its energy sources and of tensions in its relationship with Ukraine, Russia is building the South Stream pipeline under the Black Sea (through Turkish territorial waters). At the same time, Turkey is strengthening its position in South Stream's rival pipeline projects, which aim to supply the European Union with gas from the Caspian Sea region. This means there is a difficult balance between the two countries as they try to negotiate a compromise on the basis of several lines of economic interest. While Russia attempts to protect its European revenues, Turkey is trying to enhance its status as an energy hub between Europe, the Caucasus and the Middle East.

As well as the major pipeline projects, the Turkish government and, increasingly, private Turkish operators are developing an energy partnership with Russia in a growing number of fields, including nuclear power. At first glance, this would appear to make Turkey more dependent on Russia. However, the strategic maneuvers surrounding competing regional pipeline projects could give Turkey more room for negotiation and allow it to mitigate its energy dependency.

Lastly, the economic significance and the timescales of all these common energy projects explain the desire of the two countries to play down their contrasting political interests in the Middle East.

Introduction

During the first stage of the global economic crisis, the BRIC group was heralded as a hub for growth, even going so far as to assume the United States' mantle as the true driver of the global economy. These large emerging countries, including Russia, have since gradually been joined by Turkey.¹ They have continued to forge closer bilateral economic ties in order to deal with stagnant advanced economies but also to try and correct some of their own trade and financial imbalances. Against this background, Russia and Turkey have accelerated their economic cooperation in sectors ranging from telecommunications and construction to tourism and, above all, energy. The trade volume between the two countries has increased sevenfold in the last decade, reaching \$32 billion in 2011. Russia overtook Germany as Turkey's leading trade partner in 2008.²

Since the 1980s, Turkey has become increasingly dependent on Russian gas, to the point where Russia accounted for 58% of its gas imports in 2011.³ For its part, Russia has identified Turkey as a key player in its attempts to bypass Ukraine and rival some of the European energy diversification projects in the south of the continent, known collectively as the "Southern Corridor" (see map in annex). In addition to these energy transit issues, Russia has also become more involved in the energy sector in Turkey itself, as shown by the proposed construction and financing by Rosatom of a nuclear power station on the Turkish Mediterranean Sea coast.⁴

Finding sources of growth is all the more crucial for Turkey and Russia in light of their respective histories of especially severe economic and monetary crises before achieving some degree of stability in the last decade. Born out of incomplete industrialization,

Translated from French by Andrew Fanko.

¹ The debate over whether Turkey should be considered part of the BRICS group has been going on for two years. See A. Alabayrak, "International Politics Stand Between Turkey and the BRICS," *Today's Zaman*, 8 April 2012.

² Turkstat, Foreign trade statistics, December 2012: <www.turkstat.gov.tr/VeriBilgi.do?alt_id=12>. Although the trade volume between Turkey and Russia remained high in 2012, Germany could overtake Russia to once again become Turkey's leading trade partner. Turkey is Russia's fourth-biggest trading partner.

³ Costing \$10.8bn. Source: Turkish Ministry of Economy, website on trade between Turkey and Russia, December 2012;

"Never Mind Supply, Russia Tells Turkey," *Hürriyet Daily News*, 29 December 2012, <www.economy.gov.tr/index.cfm?sayfa=countriesandregions&country=ru®ion=2>.

⁴ Construction of the first unit is scheduled for completion in 2019. See: "Construction of First Power Unit of Akkuyu Nuclear Power Plant to End in 2019," *Anadolu Ajansı*, 20 October 2012.

their imbalanced economies encourage them to secure long-term sources of revenue in order to support their respective power strategies. Turkey and Russia have therefore established a complicated and asymmetrical relationship, albeit one that involves certain common interests, particularly with regard to the European Union. The two countries are committed to a strategy of geographical diversification in order to reduce the impact of the European crisis on their foreign trade, but they are minded to retain a long-term European focus and therefore to come to an agreement on the revenues from exporting energy to the West.

The economic dynamic (and more specifically the energy dynamic) that is developing between Russia and Turkey sheds considerable light on the political relationship between the two countries. The impact of the Russo-Turkish energy alliance is highlighted particularly by the Arab Spring. The two countries have responded differently to the unrest in the Middle East and are diametrically opposed in their respective stances toward Bashar al-Assad's regime in Syria. Nevertheless, they have tried to avoid public disagreements where possible, preferring instead to stress the importance of their common economic projects.⁵

⁵ Tensions have been present since the start of the Syrian civil war, none more so than when the Turkish authorities intercepted a Syrian aircraft on route from Moscow to inspect its cargo, and when NATO deployed Patriot missiles to the Turkey-Syria border. Despite this, Russia and Turkey have tried to keep a lid on expressing their diverging views. When Vladimir Putin visited Istanbul on 3 December 2012, the focus (publicly, at least) was on the economy, while differences over Syria were played down.

Economic Imbalances and Energy Dependency

There are certain similarities between the Russian and Turkish economies, particularly with regard to their stage of development.⁶ There are, however, numerous differences, and these help to explain some of the basic characteristics of Russo-Turkish relations. Firstly, the Turkish economic demand is structurally dynamic⁷ and outpaces domestic production, despite its vibrant business scene (including the so-called Anatolian Tigers). This means the country's current-account deficit regularly exceeds 5% of GDP, approaching 10% in 2011. Given that Turkey imports 93% of its oil consumption and 97% of its gas consumption,⁸ half its trade deficit comes from energy imports, where Russia is a major supplier (58% of gas imports and 12% of oil imports in 2011). The tendency toward external deficit of the Turkish economy has brought about regular monetary crises which have put a stop to periods of rapid growth. Net importers of energy generally aim to reduce costs and make budgetary savings; even more crucially, Turkey's objective is to stabilize its growth model.

Russia, on the other hand, is a net exporter whose massive energy exports allowed it to present a significant current-account surplus throughout the last decade. Although the country also attracts a significant amount of FDI, Russia's large trade surplus and heavy capital outflows make its situation the opposite of Turkey's. Unlike Turkey, Russia has weak population dynamic that is weighing on domestic demand and on long-term growth prospects. While Turkey enjoys fast-growing overall domestic demand, the growth of the Russian economy depends greatly on foreign demand, especially for energy.

In spite of their seemingly diametrically opposed economic models, the two countries do share some significant common features. Both have stabilized their economies, particularly in terms of inflation and growth, following severe economic and monetary crises. In addition, they have both experienced difficulties in their industrial

⁶ At purchasing power parity, GDP per capita in Russia is \$17,600, which is 15% higher than in Turkey (just under \$15,000).

Unless otherwise stated, all macroeconomic statistics in this section are taken from the *IMF World Economic Outlook*, October 2012.

⁷ Although domestic demand was supported in 2010 and 2011 by a policy of low interest rates, its demographically driven dynamism is a structural trait.

⁸ M. Bilgin, "Energy and Turkey's Foreign Policy: State Strategy, Regional Cooperation and Private Sector Involvement," *Turkish Policy Quarterly*, vol. 9, No. 2, p. 83, <www.turkishpolicy.com/dosyalar/files/81-92.pdf>.

development over the last two decades, facing competition from Asian companies on European markets owing to lower production costs in sectors that are technologically accessible for emerging industries. Russia in particular has found itself in a perilous economic situation, weakened by the concentration of investments in the energy sector at the expense of infrastructure and industry, in spite of the country's scientific and technological potential. This concentration is such that oil and gas, together with the metal industry, currently represent 80% of Russian exports.

There is a lack of investment in industry in Russia and Turkey, and both countries are finding it hard to position themselves in the face of global competition.⁹ Against such a background, both economies have reached a ceiling in their development whereby per capita income is reasonable but is not progressing toward the levels seen in advanced economies.¹⁰

A Relationship Founded on Energy

A quick look at the bilateral economic relationship between Russia and Turkey reveals that, although there is more trade in a growing number of industries (including agriculture, automotive, textile, chemicals and finance), the major deals can be found in the energy sector. Turkey imports more than half its gas consumption from Russia¹¹ and is second only to Germany in a worldwide list of importers of Russian gas.¹² In 2011, Turkish exports to Russia totaled just under \$6bn, while Russian exports to Turkey were nearly \$23bn,¹³ of which \$17.9bn related to fossil fuels. There have also been more bilateral meetings between political and business leaders on various economic projects, particularly relating to energy:¹⁴ Vladimir Putin and Recep Tayyip Erdoğan have met no fewer than 30 times in 10 years. Around 3,000 Turkish companies are present in Russia, with a direct investment stock of \$7.3bn. Construction companies alone are involved in nearly 1,400 projects in Russia, worth a total of \$38.5bn.¹⁵ Lastly, more than 3 million Russian tourists visited Turkey in 2011,¹⁶ and their numbers

⁹ There have even been recent hints of deindustrialization in Turkey. See: U. Sahbaz, "De-industrialization: A Dangerous Trend in Turkish Economy," *TEPAV Articles*, 30 March 2011.

¹⁰ This situation is commonly referred to as the middle-income trap.

¹¹ M. Bilgin, *op. cit.* [8].

¹² "Russia-Turkey: \$100-bln Friendship Sealed with Oil, Gas and Nuclear Power," *Russia Today*, 13 January 2010.

¹³ Russia accounts for more than 11% of Turkish imports and 4% of its exports. Turkey accounts for 3.2% of Russian exports. Source: WTO Trade Profiles, December 2012.

¹⁴ "Turkey, Russia Accelerate Cooperation," *Hürriyet Daily News*, 19 January 2011.

¹⁵ Turkish Ministry of Economy. Website on trade between Turkey and Russia, December 2012,

www.economy.gov.tr/index.cfm?sayfa=countriesandregions&country=ru®ion=2.

¹⁶ Source: Turkstat, tourism statistics, February 2013, www.turkstat.gov.tr/VeriBilgi.do?alt_id=51.

are set to rise further after the removal of the visa regime during that same year.

Although economic ties between the two countries have become much closer in recent years, their relations in the energy sector are nothing new. In 1984, NATO member Turkey signed a 25-year natural gas purchase agreement with the Soviet Union.¹⁷ Although at the time this agreement was relatively favorable toward Turkey in terms of prices, it also paved the way for an energy dependency that has only grown stronger in the subsequent years. In addition, the initially favorable gas prices encouraged Turkey to strongly embrace natural gas as a source of electricity: around 50% of Turkish electricity is produced from gas, and 55% of Turkish gas imports are used to generate electricity.¹⁸ This is a costly peculiarity that makes Turkey all the more dependent on its imports of Russian gas.

Renegotiation of Gas Contracts

In this context, redefining the terms and conditions of trade is at the heart of the energy relations between the two countries. Like many countries, Turkey is subjected to relatively punishing take-or-pay contracts.¹⁹ Following a 39% rise in Russian gas prices in 2010, Turkey attempted to renegotiate tariffs, blowing hot and cold over renewing a 6 billion cubic meter (bcm) annual import agreement via the Western Pipeline (which runs through the Balkans).²⁰ With the contract between Gazprom and state-owned Turkish operator BOTAŞ not renewed, several private Turkish energy companies showed a keen interest in taking over the contract as part of the liberalization of the network. Accordingly, Gazprom signed contracts ranging between 23 and 30 years with private companies Akfel, Bosphorus, Kibar and Batı Hattı for the import of 6 bcm a year via the Western Pipeline.²¹ Certain Turkish energy groups, such as Aksa and Bosphorus, had already entered into projects with Gazprom to import and distribute gas through the Turkish network.

¹⁷ Commencing in 1987. See: H. S. Ozertem, "Energy Negotiations over Turkish-Russian Line – Analysis," *Eurasia Review*, 17 October 2011, <www.eurasiareview.com/17102011-energy-negotiations-over-turkish-russian-line-analysis>. Gazprom, Foreign partners, February 2013, <www.gazpromexport.com/en/partners/turkey/>.

¹⁸ Energy Information Administration, Country Analysis Briefs: Turkey, February 2011, <www.eia.gov/cabs/Turkey/pdf.pdf>.

¹⁹ Obligation to pay for a minimum contracted amount even if the customer takes delivery of a lower quantity of gas.

²⁰ "Big Players Ready to Race for Russian Natural Gas," *Hürriyet Daily News*, 4 October 2011; "Turkish Gas Company Cancels Russian Contract On Discount Dispute," *Bloomberg Business Week*, 2 October 2011; "Turkey Turns Off Expensive Russian Gas," *Petroleum Economist*, 4 October 2011.

²¹ "Russia's Gazprom Wins 30-Year Export Gas Export Deal in Turkey," Reuters, 26 November 2012.

As we can see, the Turkish private sector is increasingly involved in energy relations with Russia and has actually replaced the public sector in the case of these gas contracts. In theory, this should weaken Turkey's negotiating power compared with negotiations between governments, but it must be remembered that the Turkish government maintains close ties with the country's energy groups. In addition, these private companies are more focused on profits and reducing tariffs—they have secured prices from Gazprom that are up to 40% lower than those paid by BOTAŞ.

At the same time, Russian and Turkish authorities envisage more gas being delivered, perhaps at lower prices, through the Blue Stream pipeline that links the two countries via the Black Sea.²² Turkey could therefore play on its status as a major client (representing around 10% of Russia's gas exports) in a bid to improve its negotiating position.

Nuclear Projects in Turkey

The reality is that Turkey, although trying to reduce its economic dependency, is tending toward broadening the scope of its partnership with Russia, which is increasingly involved in Turkish energy projects. This is highlighted mainly by the addition of nuclear power to the energy relationship between the two countries. Turkey has been regularly declaring its intention to develop a nuclear power program for more than 40 years. In May 2010, it finally made good on its promise by signing a contract with Rosatom worth more than \$20bn for the construction by 2019 of a nuclear power station (with four reactors and a capacity of 4,800 megawatts) at Akkuyu, on the Turkish Mediterranean Sea coast.²³ There has been criticism of the contract in Turkey concerning the cost of the project and becoming even more dependent on Russia.²⁴ The contract does contain some aspects that are politically and economically eye-catching. Rosatom, which is financing the construction, will initially own 100% of the plant and will subsequently sell only a minority share (49%) to another investor, leaving the door open for the Turkish government to buy into the project. The Turkish authorities have also agreed that state-owned electricity distribution company TEDAŞ will buy at a fixed price over 15 years 70% of the power produced by the first two reactors and 30% of the power produced by the third and fourth reactors.²⁵ Technical

²² At the moment, only around 8 bcm of gas a year are delivered from Russia to Turkey via the Blue Stream pipeline, which is just half its capacity. Source: *Ibid.*

²³ *Nuclear Power in Turkey*, World Nuclear Association, August 2011, <www.world-nuclear.org/info/inf128-nuclear_power_in_turkey.html>.

²⁴ "Russia to Build Turkey's Nuclear Plant", *Financial Times*, 13 May 2010.

²⁵ Source: Rosatom. Investor relations website. December 2012, <www.rosatom.ru/en/investmentstrategy/projects/>.

concerns have also been raised following the Fukushima disaster, given the seismic activity in this part of Turkey.²⁶

²⁶ "Turkey Insists on Nuclear Energy", *Hürriyet Daily News*, 10 August 2011.

Is the Balance of Power Shifting?

This energy dependency has significant implications for the stability of the Turkish economy. It is therefore only natural that Turkey is trying to shift the balance in its relationship with Moscow in order to give it more weight during negotiations on importing Russian oil and gas. There are two ways in which Turkey can rebalance the relationship. The first involves reducing its dependency on Russian gas imports by diversifying its sources of supply. The second would be to help Russia in its dealings with a third party in exchange for more favorable terms. In practice, the Turkish authorities are trying to combine both these approaches.

Europe's Gravitational Pull

The central role of Europe in Russo-Turkish relations is key to understanding Turkey's strategy. Although there is no doubt that economic ties between Russia and Turkey have strengthened, the two countries, above all, remain hugely focused on western Europe. The European Union accounts for around half of Russian and Turkish exports and more than a third of their imports.²⁷ Over and above the question of NATO, it is hard to understand the nature of Russo-Turkish relations without factoring in the economic pull the European Union exerts on both nations.²⁸

The European Union responded favorably to the liberal turn taken by Turkey at the start of the 1980s, culminating in the creation of a customs union in 1996. The European economy was more than just an export market for Turkey: it played a central role in the country's industrialization through the creation of subcontracting units and industrial joint ventures, particularly in the automotive sector in the north-west of Turkey (Bursa). In addition, the Turkish economy is

²⁷ During the recent years of economic crisis, the European Union's share of Turkish exports has diminished somewhat, especially in favor of the Middle East, but it remains above 40%. Source: *World Trade Organization Trade Profiles*, September 2012.

²⁸ P. Hanson, "On Europe's Fringes: Russia, Turkey and the European Union," Chatham House, *Briefing Paper*, July 2011, <www.chathamhouse.org/sites/default/files/0711bp_hanson.pdf>. R. Sakwa, "Russia and Turkey: Rethinking Europe to Contest Outsider Status", *Ifri, Russie.NEI.Visions*, No. 48, July 2011, <www.ifri.org/downloads/ifrisakwarussiaturcgretereuropeengmay2010.pdf>.

heavily reliant on European capital to finance its current-account deficit.

As for Russia, the European Union is by some distance its biggest export market for oil and gas. Once again, the outlets it offers put the EU at the heart of the development of Russia's current economic model, which is characterized by extreme concentration on the oil and gas sector and, as a result, a reduced industrial base. The Russian energy sector must now face uncertainties surrounding the volatility of oil and gas prices, the rise in oil extraction costs (which is weighing on margins)²⁹ and the advancement in rival techniques in the rest of the world (notably shale oil and gas). It is therefore vital for Moscow to retain its dominant position in energy flows to the EU, particularly given that existing infrastructure is oriented that way. The Russian authorities are now convinced of the need for other routes into Western Europe, whether by going north (through the already operational Nord Stream) or south (through the South Stream, on which construction started in December 2012).³⁰ Prior to Nord Stream's implementation, around 80% of Russian gas flows to Europe went through Ukraine and 20% went through Belarus, with which Russia has had many gas disputes.

Russia's strategy is thus twofold: avoid the development of rival energy routes to Europe while establishing routes that bypass Ukraine for its own gas exports. The South Stream project meets both these objectives. With the pipeline set to run through Turkish territorial waters in the Black Sea, the approval of the Turkish government is required.

The Southern Corridor and Geopolitical Risk

Russia is pursuing this strategy at a time when the European Union is openly expressing concerns over its dependency on Russian gas and trying to diversify its energy sources. Gas from the Caspian Sea states, as well as liquefied natural gas (LNG) and resources from Algeria and Norway, could add to these sources. The diversification projects seeking new resources from locations south of Russia - the Caspian Sea region and the Middle East - are known collectively as the Southern Corridor. This ambitious group of projects is hindered by the different interests of the countries involved, including Turkey, and by concerns over profitability, especially compared with the rival South Stream project.

²⁹ T. Gustafson, "Putin's Petroleum Problem," *Foreign Affairs*, November/December 2012, <www.foreignaffairs.com/author/thane-gustafson>.

³⁰ Ch.-K. Chyong, "The Economics of The South Stream Pipeline in The Context of Russo-Ukrainian Gas Bargaining," ESRC Electricity Policy Research Group, University of Cambridge, 2010, <www.usaee.org/usaee2011/best/chyong.pdf>.

The fact that almost all of the pipeline proposals require transit via Turkish territory (excepting White Stream) is central to Ankara's ambitions to become an energy hub.³¹ This strategy aims to increase energy flows through Turkish territory and thus generate significant revenues. Turkey has also raised eyebrows by negotiating directly with Azerbaijan over plans for a first section of the Southern Corridor, TANAP,³² which would have an initial capacity of 16 bcm of gas from the second stage of the Shah Deniz field in Azerbaijan and would stretch to the Turkey-Bulgaria border. It should be noted that most questions surrounding pipeline routes and possible extensions also involve Russia. Azerbaijan's involvement in these projects is a delicate issue in terms of Russo-Turkish relations given the country's dispute with Armenia over the Nagorno-Karabakh territory: Azerbaijan is traditionally supported by Turkey, while Armenia enjoys the backing of Russia. Baku has tried to use the energy question as a way of putting pressure on Ankara and preventing any reconciliation between Turkey and Armenia.³³

The main route of the Southern Corridor (linking Azerbaijan to Europe) also travels through Georgia. The war between Russia and Georgia in 2008 briefly interrupted the delivery of Azerbaijani gas to Turkey via the South Caucasus pipeline (Baku-Tbilisi-Erzurum, in service since 2006), which will serve as a basis for TANAP. Over and above territorial and military questions, Georgia is a particularly strategic issue for Russia given that it is involved in major projects for the diversification of energy sources for the EU and Turkey, and that it has significant military backing from the United States. Turkey, which has good relations with Georgia, found itself in a delicate situation in 2008 and opted for caution.³⁴ The perilous nature of the Georgian route would tend to favor a transit route through Iran to reach the Caspian Sea, but that simply is not an option (in the near future, at any rate) given the Iranian nuclear crisis. Pending an improvement on that front, Turkey is doing its best to retain its Iranian gas imports but must still rely on Gazprom to deal with its supply issues.³⁵

There are plans for several branch points for further development of the Southern Corridor. The first would come from the north of Iraq and would therefore need two sections of the Southern

³¹ Yu. Yigitgüden, "Turning the European Periphery Into an Energy Hub," in *Prospects of a Triangular Relationship? Energy Relations between the EU, Russia and Turkey*, Friedrich Ebert Foundation, April 2010, p. 12-18, <<http://library.fes.de/pdf-files/id/07150.pdf>>.

³² "Turkey and Azerbaijan Ink Deal for \$7bn Gas Project", *Hürriyet Daily News*, 26 July 2012.

³³ B. Whitmore, "Azerbaijan Could Scuttle Nabucco Over Turkey Armenia Deal," *European Dialogue*, 19 October 2009, <<http://eurodialogue.org/energy-security/Azerbaijan-Could-Scuttle-Nabucco-Over-Turkey-Armenia-Deal>>;

N. Mikhelidze, "The Azerbaijan-Russia-Turkey Energy Triangle and its Impact on the Future of Nagorno-Karabakh," *Istituto Affari Internazionali*, September 2010.

³⁴ G. Winrow, "Turkey, Russia and the Caucasus: Common and Diverging Interests," Chatham House, *Briefing paper*, November 2009, <www.chathamhouse.org/publications/papers/view/109168>.

³⁵ "Turkey Eyes Russia Fuel to Make Up for Iran Loss," *Hürriyet Daily News*, 3 December 2012.

Corridor to converge in Turkey, which would give Turkey a more important role. The second option is to use more sources via the Caspian Sea, particularly Turkmenistan and Kazakhstan.

Tensions between central government and the Kurdistan Regional Government would complicate matters concerning the Iraqi branch point.³⁶ Such a section would also pass through the south-east of Turkey, where persistent tensions with the Kurds pose a security threat. The situation is aggravated by the civil war in Syria, which is fueling the hopes of a part of the 1.9 million Syrian Kurds for independence. The Ba'athist regime has spoken of granting them an autonomous region,³⁷ yet many of them are fighting alongside insurgents and now control entire territories along the Turkish border. The Kurdish question could therefore be problematic for the major economic and energy projects in the Middle East.

The second proposed extension would involve building an underwater gas pipeline linking Azerbaijan and the east coast of the Caspian Sea (the Trans-Caspian Gas Pipeline), complementing the trans-Caspian tanker transportation system.³⁸ At this stage, it would seem risky to plan such a project without Russia's approval. Russia and Iran are stressing the need for an agreement between all of the countries that border the Caspian Sea.³⁹ Moreover, most oil and gas exports from Central Asia to Europe travel through Russia, which still holds great influence in Central Asia and obviously does not want this situation to change.⁴⁰ The viability of the Trans-Caspian Gas Pipeline depends on an agreement with Russia, even if it is merely a tacit one, but Russia has no interest in the project being completed in its current form.

Against this complex and uncertain backdrop of the Southern Corridor, Turkey is continuing negotiations with Moscow over the South Stream project.⁴¹ This is the project in which the two countries are engaged in strategic bargaining.⁴²

³⁶ Turkey wants to increase its imports of gas and oil from Iraqi Kurdistan and is negotiating directly with the regional authorities, much to the displeasure of Baghdad. See: "Turkey and Iraq Kurds Close to Energy Deal," *Financial Times*, 12 December 2012.

³⁷ "Assad to Play Kurdish Card Against Turkey," *Hürriyet Daily News*, 9 November 2011.

³⁸ A. Dellecker, T. Gomart (dir.), *Russian Energy Security and Foreign Policy*, London, Routledge, 2011.

³⁹ "Trans-Caspian Pipeline Vital to Meeting Turkey's Gas Demands," *Today's Zaman*, 9 September 2012.

⁴⁰ "Securing Energy and Building Regional Security: EU-Turkey Cooperation in the Black Sea and Caspian Sea Basin," The European Geopolitical Forum, *Policy Briefing*, 2 June 2010, <<http://gpf-europe.com/upload/iblock/bc9/energy,%20security%20and%20the%20turkey%20eu%20relationship.pdf>>.

⁴¹ "Turkey in No Place to Decide on Azeris' Gas," *Hürriyet Daily News*, 16 November 2012.

⁴² C. Sidar and G. Winrow, "Turkey And South Stream: Turco-Russian Rapprochement and The Future Of The Southern Corridor," *Turkish Policy Quarterly*, 2011, <www.turkishpolicy.com/dosyalar/files/cenk_garteh.pdf>.

South Stream Negotiations

Russia proposed the South Stream pipeline project⁴³ after Turkey blocked plans to build Blue Stream II, an extension of the Blue Stream⁴⁴ pipeline to southern Europe. South Stream will transport Russian gas via the Black Sea (through Turkish territorial waters) to Bulgaria, and then mainly to Austria. Its initial capacity will be around 16 bcm a year, rising to 63 bcm by 2019. It is hugely questionable whether the demand for gas will be high enough to absorb the output from South Stream and the Southern Corridor.

It may seem something of a paradox that Turkey is involved in both projects at the same time. However, the nature of its involvement in each differs,⁴⁵ and its main objective appears to be to reinforce its status as an essential player in order to secure certain concessions. Turkey dragged its heels over granting approval for geological studies to be conducted in its exclusive economic zone in the Black Sea, which has delayed the South Stream project compared with the Southern Corridor.⁴⁶ However, despite some difficulties, including with regard to financing, Gazprom seems to be making progress and has made a final decision to invest following an agreement with Bulgaria in exchange for discounted gas tariffs.⁴⁷

Having said that, the agreement between Turkey and Azerbaijan over TANAP, the central section of the Southern Corridor, weakens the South Stream project further. The Turkish authorities seem to want to influence the strategic balance of power in the region by playing on the need for their approval to develop South Stream. As well as future concessions on gas prices, Moscow has given Turkey support for another pipeline project taking oil across Turkey, from Samsun on the Black Sea coast to Ceyhan on the Mediterranean coast. In addition to existing flows, this pipeline would enable the port of Ceyhan to receive Russian and Kazakh oil which could then be re-exported via the Mediterranean Sea. As well as reinforcing Turkey's status as an oil hub in the Mediterranean, the Samsun-Ceyhan pipeline would free up congestion in the Bosphorus and Dardanelles straits.⁴⁸ Russia has offered to supply the pipeline with 25 million tons

⁴³ The South Stream operating company, which was created to support the project, has been owned by Gazprom and Italy's Eni since 2009, with EDF and Wintershall investing in 2011.

⁴⁴ Blue Stream, which has been active since 2003, is 1,213 km long and links Russia to Turkey. It cost a total of \$3.2bn.

⁴⁵ Turkey is happy for the South Stream pipeline to pass through its territorial waters, whereas it is actively involved in the Southern Corridor by way of building the TANAP with Azerbaijan.

⁴⁶ "Putins Prekäre Pipeline," *Die Zeit*, 7 December 2012.

⁴⁷ "Borisov Defends Pipeline Deal with Russia," *Financial Times*, 20 November 2012; "Energy Battle," *Financial Times*, 17 December 2012.

⁴⁸ In 2009, Çalık, Eni, Transneft and Rosneft signed a letter of intent for the Samsun-Ceyhan project, which is expected to cost \$3 bn. In order to bypass the Bosphorus, Turkey also plans to build a 50 km canal from the Black Sea to the Sea of Marmara.

of oil, but a final agreement is yet to be reached on either the volumes guaranteed by Russia or the transit costs paid to Turkey.

These negotiations show that Turkey is not concerned only with being a key transit for major oil and gas flows; the conditions in which these flows are carried out are of particular importance. The facilities installed at Ceyhan are a good example of Turkey's desire to transform itself from a mere transit state into an integrated hub for refining, storage and re-export.⁴⁹ It is the very essence of an oil and gas hub: far more than just collecting a transit fee, Turkey wants to extract some of the added value from the flows crossing its territory by having a storage capacity that allows it to have some sort of control over distribution.

The Ceyhan projects have attracted the attention of Russia's leaders, who have expressed an interest in building a gas liquefaction plant and a refinery. In this way, similarly to its actions in the nuclear power sector, Russia is making an economic commitment to Turkey by investing in its energy industry. Turkey's dependency is likely to rise as the Russians become more involved. And yet the Turks seem to have factored this in as they play the energy hub card and establish their country as an essential intermediary between producers and customers. It is a strategic choice that was confirmed by the TANAP agreement with the Azerbaijanis, which took observers by surprise.

Turkey can thus use its central status to place projects that need to pass through its territory in competition with each other and negotiate contract terms. For example, Turkey had demanded of the European Union (whose member states do not often agree on how to deal with energy partners) that 15% of Nabucco's⁵⁰ gas passing through its territory be allocated to its domestic consumption.⁵¹ Previous Russian hesitation over South Stream has also encouraged Turkey to plan its own section of the Southern Corridor, which, if completed, would afford it an unprecedented position of strength in European gas supply.⁵²

Although the Russo-Turkish relationship seems a little unbalanced, for now the closer ties between the two countries in the energy sector (nuclear projects, Russia's involvement in the Turkish energy grid, etc.) do not weaken Turkey's position further. In fact, Turkey is efficiently, if somewhat riskily, consolidating its central role in

See: "Turkey Plans Istanbul Canal for Russian Oil Shipments to Bypass Bosphorus;" Bloomberg, 27 April 2011.

⁴⁹ M. Bilgin, "Turkey's Energy Strategy: What Difference Does it Make to Become an Energy Transit Corridor, Hub or Center?" *UNISCI Discussion Papers*, No: 23, May 2010, p. 113-128, <<http://redalyc.uaemex.mx/pdf/767/76715004007.pdf>>.

⁵⁰ "Nabucco" here refers to the earlier version of the project that was ambitiously supposed to run from Eastern Turkey to Austria. Nabucco West is a revised version which would more modestly link the western end of TANAP (at the Turkish-Bulgarian border) to Austria. See map in annex.

⁵¹ The White Stream project would bypass Turkey by linking Georgia to Romania, but it has encountered several hurdles, not least a lack of political support; See: Yu. Yigitgüden, *op. cit.* [31].

⁵² "Azeri Pipeline to Help Turkey in Talks with EU," *Hürriyet Daily News*, 24 August 2012.

the South Stream and Southern Corridor projects in order to confirm its importance. Economically, the focus is more on the negotiated integration of Russia and Turkey.

Given the scale and scope of the issues connecting the two countries, in terms of costs and investment, it is no wonder the Russian and Turkish governments are keen to play down their political disagreements, particularly over Syria. Although the two countries have built their relationship on coordinating their energy strategies with regard to Europe, their projects are complicated by situations in the Middle East. Having said that, although the political transition in the Middle East frustrates efforts by Russia and Turkey to find common ground, their cooperation remains supported by significant economic factors.

Conclusion

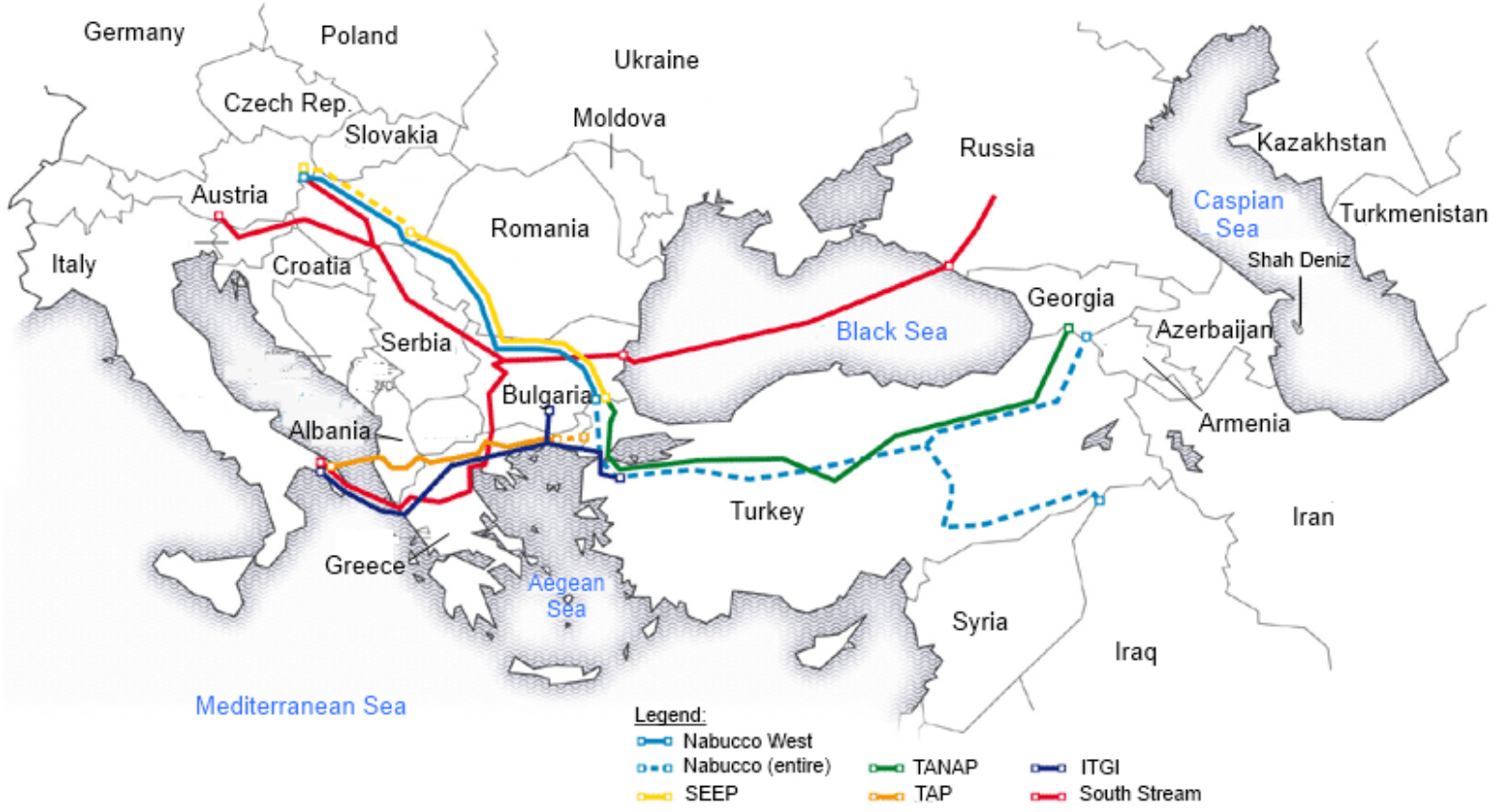
Despite the relative economic successes of Russia and Turkey, both countries must deal with economic imbalances that are directly linked to energy and to certain aspects of their European focus. Each in their own way, Russia and Turkey have factored the idea of diversifying foreign economic relations into their strategic plans. Russia is attempting to increase oil and gas exports to Asia, while Turkey is trying to boost trade with its Middle Eastern partners.

In both cases, however, diversification may prove difficult to achieve. Asia itself is currently affected by a weakening of the global economic outlook, while Middle Eastern markets cannot match Europe's prospects in terms of volume and, above all, industrial sophistication. In this context, it is vital for Russia to secure its position in European oil and gas imports and for Turkey to establish itself as a hub for regional energy flows in order to reduce its trade deficit and generate new types of revenue.

Although the European Union retains a central role in the economic structure of Europe at large, the energy partnership between Russia and Turkey now goes beyond the negotiations over major projects for gas pipelines to Western Europe. Energy relations between the two countries are closer than ever and involve a growing number of major projects (such as the Turkish nuclear program) that also happen to support their respective economic ambitions.

As their economic exchanges increase and their links become more sophisticated, it gradually becomes easier to specify the nature of the relationship between Russia and Turkey. By getting involved in several major regional energy projects, Turkey is improving its negotiating position with Russia while successfully playing out its energy hub strategy, albeit at the risk of increasing its dependency. For its part, by negotiating with Turkey and other market participants, Russia is responding swiftly to European diversification projects, although in doing so it is being forced to make concessions, especially financial ones. Their political differences, especially in the Middle East, mean that Russia and Turkey can enjoy only a partial alliance based on energy issues, but their substantial economic dialog should help them, albeit in a complicated fashion, to adhere to their respective power strategies.

Annex: Gas pipeline projects: South Stream and the Southern Corridor



Source : KircherBurkhardt Infografik, website of Wingaz, <www.wingaz.com/2268.html?&L=1>.