Frontier Europe Initiative

Turkey's energy relations with Russia: How should the West respond?

Dimitar Bechev

March 2021

Middle East Institute

@MEIFrontier • @MiddleEastInst • 1763 N St. NW, Washington D.C. 20036

About the author

Dr. Dimitar Bechev is a fellow with MEI's Frontier Europe Initiative. He is also a senior fellow with the Atlantic Council's Eurasia Center, a research fellow at the Center of Slavic, Eurasian, and East European Studies at the University of North Carolina, and the director of the European Policy Institute, a think-tank based in Sofia, Bulgaria.

Dr. Bechev has published extensively, in both academic and policy format, on EU foreign relations, the politics of Turkey and the Balkans, Russian foreign policy, and energy security. His book *Rival Power,* published by Yale University Press in 2017, explores Russia's role in Southeast Europe (Balkans, Greece, Cyprus, and Turkey). He has held research and teaching positions at Oxford and Hitotsubashi University in Tokyo as well as visiting fellowships at Harvard and the London School of Economics. From 2010 to 2014, he was the head of the European Council on Foreign Relations (ECFR) office in Sofia.

Dr. Bechev is a frequent contributor to *Foreign Policy*, Al Jazeera Online, *Oxford Analytica*, *POLITICO*, and EUObserver. His quotes have appeared in leading newspapers such as the *Financial Times,* the *Economist,* the *Wall Street Journal*, and the *New York Times*. He holds a DPhil in international relations from the University of Oxford.

Turkey's energy relations with Russia: How should the West respond?

On Jan. 8, 2020, Presidents Vladimir Putin and Recep Tayyip Erdogan launched the TurkStream natural gas pipeline at a ceremony in Istanbul. While the security relationship between Russia and Turkey has seen ups and downs throughout the years, energy ties have remained stable. Indeed, multibillion-dollar projects such as TurkStream and the Akkuyu Nuclear Power Plant (NPP) symbolize the rapprochement between Moscow and Ankara since 2016. This is driven by overlapping interests. Russia sees Turkey as a key market for its hydrocarbons and nuclear technology as well as a conduit for energy exports to the EU. The Turkish government in turn regards the four-unit Akkuyu NPP – a facility to be built, owned, and operated by Rosatom – as essential to meeting future demand and to technological development. For its part, TurkStream has turned Turkey from a gas consumer to a transit country with all economic and strategic benefits flowing from it. The Istanbul ceremony was attended by the leaders of Bulgaria and Serbia which are currently building the pipeline's extension into the EU.

But that is not the whole story. Rather than fully siding with Russia, Turkey has made strides toward reducing its dependence. The opening of the so-called Southern Gas Corridor (SGC) and the surge of liquefied natural gas (LNG) purchases have resulted in a dramatic decline of gas imports from Russia – imports fell by nearly 50 percent between 2017 and 2019. Changes in global energy markets have tipped the power away from producers toward consumers like Turkey, which have greater room for maneuver. Turkish interests remain largely aligned with those of the West, even if Ankara sees itself as an independent player which has links to both Russia and the EU and the US.

This paper outlines ideas on how to improve cooperation between Turkey and the West in relation to Russia.

The backstory

Russia's and Turkey's energy systems became increasingly intertwined in the 1990s and especially the 2000s. Ankara began importing natural gas from the then Soviet Union in 1988 through the newly completed Trans-Balkan Pipeline crossing Romania and Bulgaria. In December 1997, Gazprom and the Turkish government agreed to build a second pipeline, Blue Stream, establishing a direct connection between the two countries via the Black Sea. A three-way partnership between Gazprom, Turkey's gas utility BOTAŞ, and ENI of Italy, the pipeline was completed in November 2005. It has an annual capacity of 16 billion cubic meters (bcm) and supplies gas to Ankara and Central Anatolia. Thanks to Blue Stream, Turkey became a top market for Russian gas exports, second only to Germany. In 2018, for instance, the country imported 24.54 bcm from Russia which corresponded to 53 percent of its overall gas consumption.

Turkey and Russia teamed up because their economic interests proved complementary. Between 1990 and 2012, Turkey's power consumption rose fivefold, with natural gas growing by a factor of ten.[1] Gazprom was a pillar of Russian diplomacy in the 2000s, aimed at securing new markets through partnerships with large European firms and governments as oil and gas prices soared. At the same time, the relationship was not problem-free. Turkish policymakers saw the overreliance on gas – accounting for 30 percent of power generation in the early 2010s – as a vulnerability. Dependence on strategic competitors Russia and Iran, which accounted for a quarter of Turkish imports, presented a challenge as well. Large purchases of gas exacerbated the negative trade balance between Russia and Turkey, only partly offset by Turkish exports to the Russian Federation (agricultural products, construction services, tourism services etc.).

[1] Gulmira Rzayeva, "Natural Gas in the Turkish Domestic Market: Policies and Challenges", *Oxford Institute for Energy Studies*, (February 2014), https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/02/NG-82.pdf

Turkey has been looking at nuclear energy as a partial alternative to natural gas. In May 2010, during a visit of then President Dmitry Medvedev, the Turkish government signed an agreement with Rosatom to build an NPP at Akkuyu, near the Mediterranean city of Mersin. Importantly, the project was part of a larger package including two further power plants projected to be built at Sinop on the Black Sea coast, as well as near the border with Bulgaria, again on the Black Sea. Ankara entered into negotiations with Korean, Japanese, and French companies, suggesting it was keen to diversify its nuclear portfolio. Talks with Rosatom on the particulars of the Akkuyu contract – including mandatory quotas to be bought by the national electricity company TETAS, the price of electricity, and tax breaks – took years. A final agreement was only reached in 2016 as part of the reconciliation between Erdogan and Putin. This was unsurprising as Russia managed to obtain the concessions it had been lobbying for. Construction began in 2017 and Akkuyu's first unit is scheduled to come online in 2023, the centennial of the Turkish Republic. With 1114 MW, Akkuyu's first unit (out of four in total) corresponds to roughly 1.6 percent of the country's current generation capacity.

TurkStream is the last piece of the puzzle. It was first proposed to Putin during a visit to Ankara in December 2014 as an alternative to the defunct South Stream pipeline. The European Commission had come to blows with Gazprom over non-compliance with the EU's competition rules, a dispute made worse by the annexation of Crimea. Turkey offered a new route to European markets which Putin blamed for South Stream's failure. Still, the commercial negotiations with regard to TurkStream dragged on for years, with Ankara demanding a renegotiation of existing long-term supply contracts signed by Gazprom with BOTAS and several Turkish private companies. As with Akkuyu, the TurkStream deal was finalized only in October 2016 when Putin attended the World Energy Congress in Istanbul, a sign of reconciliation with Erdogan. TurkStream has a capacity of 31 bcm, half of South Stream's. It runs over two parallel lines, one of which supplies the Turkish market (replacing the Trans-Balkan Pipeline) and one bound for the EU. The first line is currently operational, unlike the second which has been delayed in completing the interconnection of Bulgaria and Serbia's gas grids.

SOURCE: Gazprom, (2018), https://www.gazprom.com/press/news/2018/february/article408339/

Turkey's diversification agenda

Turkey has been working to diversify energy supplies away from Russia since the 2000s. In recent years, this effort has finally paid off – thanks to the SGC coming online as well as a drop in LNG prices.

Southern Gas Corridor

The SGC aims to connect the energy producers in the Caspian region with consumers in Europe. Turkey, lying in between those two groups of countries, has always supported the project because of the geopolitical and economic gains it offers. The SGC's first milestone was the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the parallel-running Baku-Tbilisi-Erzurum (BTE) gas pipeline completed in 2005. In December 2011, Turkey and Azerbaijan reached agreement on the Trans-Anatolian Pipeline (TANAP) which extended BTE to the Turkish-EU border in the West. Lastly, in June 2013, the Shah Deniz consortium led by BP endorsed the Trans-Adriatic Pipeline (TAP) which links TANAP to a terminal in southern Italy. With TANAP coming online in 2018 and TAP in November 2020, the much-debated 3,500 km gas corridor running from the Caspian to the EU is now a reality. Currently, the SGC transports 16 bcm from the Shah Deniz offshore field – of which 6 bcm is for Turkey's BOTAŞ, 8 bcm is delivered to Italy (EDF, E.ON, Shell and several other companies), and 1 bcm is allocated each for Greece's DEPA and Bulgargaz.

The new gas corridor will grow in importance over time. Toward the mid-2020s, the Shah Deniz consortium is planning to double its production, with some of the gas exported to Turkey and the rest to the EU and possibly the Western Balkans. Ankara has encouraged Central Asian producers to divert their exports to Azerbaijan and the SGC. It has a contract with Turkmenistan for 15.6 bcm a year from 2016, on top of two contracts with the Shah Deniz consortium for 6.6 bcm (BTE) and 6 bcm (TANAP).

The SGC has the blessing of the U.S. and the EU. The Clinton and the Bush Administrations backed BTC/BTE in the 1990s and the 2000s, encouraging Central Asian nations to channel their oil and gas exports through the westward route. The European Commission made financial grants to both TANAP and TAP which has also won a 25-year exemption from EU competition rules due to its contribution to energy security. Despite the general drift between Turkey and the West, they have largely remained on the same page when it comes to oil and gas transit from the Caspian region to Europe.

LNG

Turkey has invested heavily in LNG capacity. It has recently commissioned two new floating storage and regasification units (FSRUs). One, located off the coast of the Hatay province bordering Syria, began operation in February 2018. Another, at Aliaga near Izmir, entered into service in December 2016. That brings the total number of LNG import facilities to five. Another FSRU is planned to start operation in the Gulf of Saros, Turkish Thrace, in 2021. Moreover, Turkey is expanding its gas storage capacity with the aim of reaching 20 percent of its annual consumption. BOTAŞ could buy gas when prices are low to match demand from households, electricity producers, and industries during peak periods, for example the winter months.

Upgraded infrastructure allows BOTAŞ as well as private companies to import larger volumes of gas from exporters such as Algeria, Qatar, and Nigeria, as well as the U.S. which has entered the global LNG market thanks to the shale boom. BOTAŞ has long-term supply contracts with Algeria's Sonatrach, with Qatargas, and with Nigeria's NLNG but has also been buying on the spot market, including from U.S. companies. Turkish firms can buy cargoes at their discretion and at prices dictated by supply and demand rather than pricing formulas embedded in long-term contracts.

Black Sea gas

Turkey has been interested in exploring indigenous resources. It has put forward claims in the Eastern Mediterranean antagonizing Greece, Cyprus, Israel, Egypt, among others. But the Black Sea offers better prospects for developing gas production. On Aug. 22, 2020, Erdogan announced the discovery Tuna-1 field containing an estimated 320 bcm of natural gas in

its Exclusive Economic Zone (EEZ). That volume covers demand for about seven years and therefore does not make a critical difference by itself. Yet the Turkish Petroleum Corporation (TPAO) may be able to find additional deposits, attract energy majors which have the technical know-how regarding deep-water drilling and production, and ensure that the venture is economically profitable.

The Tuna-1 find opens prospects for cooperation amongst Black Sea nations. Romania and Bulgaria have been prospecting for gas and oil in their EEZs for decades. Romania's Neptun Deep field, next door to Tuna-1, holds 42-84 bcm of gas. About 4 percent of Ukraine's proven 880 bcm are located in the Black Sea too, even if the conflict with Russia in the aftermath of the Crimean annexation puts a brake on potential production. Unlike the Eastern Mediterranean, where disputes over EEZ limits and sovereignty are the norm, Turkey has no such issues with neighbors which also favor joint efforts.

What next for Russia-Turkey energy relations?

The last couple of years have seen a dramatic decline of Russian gas sales to Turkey. Deliveries slumped from 29 bcm in 2017 to 24 bcm in 2018 to just 15. 4 bcm in 2019.[2] Currently Turkey is behind the UK, Italy, and Germany as a market for Russia.

The combined effect of TANAP and cheap LNG has had a significant effect. In 2019, Turkish purchases from Azerbaijan rose by a third from 7.5 bcm to 9.2 bcm. LNG went up to 12.7 bcm which is 28.3 percent of all its natural gas imports. To put it in a longer-term perspective, LNG deliveries to Turkey expanded from 6.1 bcm to 12.7 bcm between 2013 and 2019.

The trend gathered momentum in 2020. In the first half of the year, LNG imports reached 43 percent of the total.[3] In January to March 2020, Turkey imported some 3.57 bcm from Azerbaijan compared to 2.6 bcm in the first quarter of 2019. Deliveries from Russia seem to have bounced back in August to September but that may not dramatically change the annual figure.

The economic crisis makes it unlikely gas demand in Turkey will grow significantly in the coming years. Consumption contracted from 50 bcm in 2018 to 45.2 bcm in 2019. The COVID-19 pandemic is taking a toll on growth and energy demand, which is likely to affect pipeline deliveries from Russia to a larger degree than LNG due to price differentials. Ironically, nuclear energy may turf out gas too. The Akkuyu NPP facilitates the switch to renewable sources because it provides baseload compensating for intermittent supply from solar, wind, hydropower or geothermal sources, which currently account for 45 to 50 percent of production in Turkey.[4]

The critical question is whether BOTAŞ will be able to use the new market conditions to renegotiate in its favor the long-term contracts with Gazprom. The deals covering the so-called Western route, currently served by TurkStream, expire at the end of 2021. The Blue Stream contract is ending in 2025. The bone of contention is the so-called take-or-pay (ToP) clause which obliges the consumer to a minimal offtake – believed to be 80 percent of the contracted volume. Because of failing to meet its ToP commitment, BOTAŞ owes Gazprom a reported $2 billion in compensation.[5] This will inevitably be discussed at the state-to-state level, not just by the two respective public companies. Indexation to oil, rather than prices at trading hubs, is another agenda item.

Turkey's ability to bargain for better terms will be closely watched by other customers of Gazprom. In Greece, DEPA succeeded in renegotiating its contract in early 2020, taking advantage of the LNG surge and access to Caspian gas. Bulgaria's Bulgargaz

---

[2] *PJSC Gazprom Annual Report*, (2019), https://www.gazprom.com/f/posts/72/802627/gazprom-annual-report-2019-en.pdf
[3] "Turkey's LNG import share reaches 43% in 1H20", Anadolu Agency, (December 3, 2020), https://www.aa.com.tr/en/energy/lng-lpg/turkey-s-lng-import-share-reaches-43-in-1h20/31208
[4] "2020 a Turning Point for Renewable Energy in Turkey – Minister Says", Daily Sabah, (November 23, 2020), https://www.dailysabah.com/business/energy/2020-turning-point-for-renewable-energy-in-turkey-minister-says
[5] David Gauthier-Villars, "As Turkey Shunned Russian Gas, Its Companies Amassed Debt", Wall Street Journal, (June 15, 2020), https://www.wsj.com/articles/as-turkey-shunned-russian-gas-its-companies-amassed-debt-11592216429

secured a 40 percent price cut in March 2020. This sets a precedent as the current long-term supply contract is ending in 2022. Moldova, which unlike Georgia and Ukraine is reliant on Russian supplies, is similarly pushing for a discount under the current three-year deal it signed in 2019.[6]

Policy Recommendations

Turkey's interests converge with those of the EU and the Black Sea countries: diversify gas supplies and renegotiate contractual relations with Gazprom to lower prices and increase flexibility. To that end, Turkey and its partners in the West and in the region should focus on the following priorities:

1. Scale up the Southern Gas Corridor to bolster competition in markets where Russia is traditionally the dominant or only supplier. Gazprom should play by the new rules set by supply and demand rather than Moscow's relationship with individual downstream countries. The SGC should be leveraged to relaunch energy cooperation between Turkey and the EU which is now hampered by the disputes in the Eastern Mediterranean.
2. Improve cross-border connectivity in the Black Sea littoral. Following the commissioning of TurkStream, the Trans-Balkan Pipeline is now underused. Its flow can be reversed northwards allowing LNG and Caspian gas to be piped to Moldova and Ukraine. Turkey as well as other partners in the SCG such as Azerbaijan and Georgia will benefit.
3. Strengthen regional cooperation on energy in the Black Sea. Turkey should establish a mechanism to share data and expertise on offshore prospecting for oil and gas with other littoral countries. Governments should also put on their agenda the joint exploitation of adjacent fields. This could be done in partnership with international majors for whom shared production results in improved profitability thanks to the economies of scale.

[6] Madalin Nescutu, "Moldova Pushes Gazprom to Lower Price for Gas", Balkan Insight, (September 2, 2020), https://balkaninsight.com/2020/09/02/moldova-pushes-gazprom-to-lower-price-for-gas/

@MEIFrontier • @MiddleEeastInst • 1763 N St. NW, Washington D.C. 20036