

COULD TURKEY BECOME A NEW ENERGY TRADE HUB IN SOUTH EAST EUROPE?

Is Turkey an important energy transit country, or rather is it an energy trade hub? In order to answer this question, it is prudent to differentiate between Turkey's role in the oil versus natural gas sectors. Regarding oil, Turkey serves as an important transit country due to the Straits and the two major oil pipelines crossing the country, namely Baku-Tbilisi-Ceyhan and Kirkuk-Ceyhan. In natural gas, however, Turkey has a more significant role to play between the East and the West with its 1,850-kilometer contribution in the form of TANAP, which forms the backbone of the Southern Gas Corridor (SGC). In this article, the author argues that the normalization of bilateral relations with Israel and Russia opens up new prospects for Turkey in the Eastern Mediterranean basin, as well as in the form of Turkish Stream. With these two additional natural gas potentials, Turkey may aspire to become a South East European Gas Hub.

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The summer of 2016 will probably be remembered as a crucial turning point in Turkey's long stumbling foreign policy implementation. First of all, the six-year stalemate with Israel has finally been overcome, and the two countries have made an important breakthrough with a view to launching an official process of normalization.

Not surprisingly, there were voices of dissent in both countries who criticized the announcement of an agreement for normalization, but those who welcome the development outnumber those who oppose it. Turkey and Israel have now entered a new phase in their bilateral relations which will require determination and meticulous diplomacy if they are to return to the level of cooperation which existed before the notorious "Mavi Marmara tragedy." It will not be easy, and it will not happen rapidly. Nevertheless, both sides understand all too well the importance of mutually beneficial cooperation and will spare no effort to achieve it.

Another equally important development took place in Turkey's relationship with Russia. The downing of a Russian fighter jet on 24 November 2015 by the Turkish Air Force essentially froze Turkish-Russian bilateral relations for almost nine months.

Both countries felt the adverse effects of such a break. Turkey's tourism industry has been seriously affected and will not recover any time soon, probably falling further in 2017, too. Russia boycotted Turkish goods and looked for new supply sources whereas Turkey's agricultural exports experienced significant losses in the Russian market.

President Recep Tayyip Erdoğan's letter to President Vladimir Putin sent in June 2016 was interpreted as a gesture to meet the condition of apology demanded by the Kremlin. This overture provided Putin with the opportunity to welcome his counterpart in St. Petersburg to launch the process of normalizing bilateral relations. Putin has made it clear that normalization will happen in a "step by step" approach, signaling a prudent foreign policy approach with a view to warming up relations gradually. Turkish-Russian relations will, like Turkish-Israeli relations, also develop through careful diplomatic effort.

Incidentally, both normalization processes have one important factor in common, namely, energy. Turkey has the potential to enhance its role in the global energy game through the Eastern Mediterranean and through the Black Sea.

In the south, Egypt, Cyprus, and Israel offer significant potential to become a new natural gas basin whose exports could become a new factor enhancing Europe's energy

security by diversifying supply. Domestic political difficulties prevented Lebanon from participating in this equation for a while, but it seems that new momentum is already in the making to transform this cooperation into a quadrilateral one.

In the north, Russia is keen to develop new routes of supply to Europe, and Turkish Stream became Putin's new pet project when he declared the cancellation of the South Stream Project in December 2014.

Berat Albayrak, Turkey's new Minister of Energy and Natural Resources, who also happens to be Erdoğan's son-in-law, said in December 2015, that "diplomatic relations between Turkey and Israel had to be normalized in order to transport natural gas from the Leviathan field to Europe through Turkey."¹ Now that such normalization has started, there may be a new chapter of cooperation

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between the two countries in the Eastern Mediterranean. In fact, Prime Minister Benjamin Netanyahu is believed to view Turkey as a very convenient route for the export of gas from Israel's Tamar and Leviathan offshore fields.²

Meanwhile, Turkish-Russian normalization also allows Putin to revisit the "Turkish Stream" project, which has been frozen since November 2015. Immediately after the long-awaited meeting between Putin and Erdoğan in St. Petersburg on 9 August 2016, Russian Energy Minister Alexander Novak said that the first line of the Turkish Stream gas pipeline project would be completed by December 2019. Erdoğan also confirmed that "the Turkish Stream project with Russia will be realized swiftly following a thorough review."

Russia supplies around 55 percent of Turkey's domestic gas consumption. Approximately 16 percent is supplied by Iran and around 13 percent comes from Azerbaijan. These three countries are the major suppliers of Turkey's natural gas imports, with the rest supplied through LNG imports from Algeria, Nigeria, and Qatar.

¹ "No energy deals with Israel without normalization of relations: Turkish energy minister," *Daily Sabah*, 17 December 2015, <http://www.dailysabah.com/energy/2015/12/18/no-energy-deals-with-israel-without-normalization-of-relations-turkish-energy-minister>

² David Barchard, "Turkey's rapprochement with Israel," *Al Ahram Weekly*, 14 July 2016, <http://weekly.ahram.org.eg/News/16814/32/Turkey%E2%80%99s-rapprochement-with-Israel.aspx>

Turkey imports 99 percent of its domestic gas consumption. Although Turkey's relations with Russia have been strained for the last nine months, Turkey did not suffer from any shortages due to gas imports from Russia. Nevertheless, those who argue Turkey needs to diversify its supply line now feel even stronger because they believe that "relying heavily on one supplier may entail risks" and cannot be neglected. Turkey, therefore, should try to explore options for expanding its energy cooperation with Israel.

Ironically, normalization with Israel and Russia simultaneously raises the question of whether a deal with Russia through Turkish Stream could undermine a potential Turkish deal with Israel. Such a question requires a closer look at Turkey's opportunities both in the Eastern Mediterranean and in the Black Sea, as well as the benefits that other partners will see due to cooperation with Turkey.

What is the Significance of Turkey in the Global Energy Game?

The Turkish economy is dependent on fossil fuel imports. Coal, oil, and natural gas are the main denominators of Turkish energy production. Among these, only coal is available in significant amounts domestically. Turkey acquired 93.4 percent of its oil and oil products, as well as 98.2 percent of its gas supply in 2011 through imports.³

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Turkey's share in global oil, gas, and coal production as well as its consumption of those fossil fuels is marginal.⁴ Moreover, Turkey's energy imports do not account for a large share of the global energy trade; it is the eighth largest natural gas importer in the world.⁵

Therefore, it is fair to say that Turkey is not a major global energy actor given its share of both production and consumption, but it is a significant client for natural gas.

Is Turkey an Energy Transit Country?

Turkey is located close to more than 75 percent of the world's proven hydrocarbon reserves, which presents Turkey with a unique opportunity to become a major energy transit country between the East-West and the South-North axes.

³ "Turkish Energy Strategy in the 21st Century: Weathering Uncertainties and Discontinuities," *Global Relations Forum Task Force Report*, (2013), p. 27 <http://energypolicy.columbia.edu/sites/default/files/energy/GRF%20Energy%20Report.pdf>

⁴ *Global Relations Forum Task Force Report* (2013), p. 27.

⁵ *Global Relations Forum Task Force Report* (2013), p. 27.

The Turkish Ministry of Energy and Natural Resources outlines the vision for Turkey becoming an energy trade hub. It might be wiser, however, to separate the differences in Turkey's role in the oil and natural gas sectors.

With regard to oil, two major pipelines cross Turkey, namely the Baku-Tbilisi-Ceyhan crude oil pipeline carrying Caspian oil from Azerbaijan, and the Kirkuk-Ceyhan pipeline transporting Iraqi oil. The full capacity of these two pipelines is 2.8 thousand barrels of oil per day (mb/d).

There is an additional transit route through Turkey for oil transport and this is the Turkish Straits. In 2010, 2.9 mb/d of crude oil and oil products flowed through the Bosphorus and the Dardanelles. The same year, 1.1 mb/d was carried through the two oil pipelines. This total of 4 mb/d of crude oil and oil products represented around six percent of the daily global oil trade. If the existing two pipelines could be used

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to full capacity, it would allow the transport of some 6 mb/d, which would represent a significant total of around eight to 10 percent of the daily global oil trade. In oil, therefore, Turkey serves as an important transit country due to the Straits and these two major oil pipelines.

In natural gas, however, Turkey cannot be considered a significant transit country yet. The finalization of the Southern Gas Corridor (SGC), which consists of the South Caucasus Pipeline (SCP), the Baku-Tbilisi-Erzurum natural gas pipeline (BTE), the Trans-Anatolian Natural Gas Pipeline (TANAP), the Turkey-Greece Interconnector (ITG), and the Trans-Adriatic Pipeline (TAP) is critical for the EU. The SGC is essentially the sum of several East-West gas pipeline projects which are designed to transport gas from the Caspian basin and the Middle East to Europe. Turkey, with its 1,850-kilometer contribution in the form of TANAP, forms the backbone of the SGC.

TANAP will become operational and will transport Caspian gas to Turkey in mid-2018, and going to Europe in 2020. The natural gas with that flows through TANAP will be produced by the Shah Deniz Phase II project, initially six billion cubic meters (bcm) Turkey and a further 10 bcm to Europe. In order for the SGC to become fully operational, all its component parts — namely Shah Deniz Phase II, TANAP,

and TAP — have to be finalized simultaneously. The groundbreaking ceremony for the TAP project, which will connect with TANAP at the Greek-Turkish border, was held in Thessaloniki, Greece on 17 May 2016.

Turkey's geographical location, in addition to its role in the SGC, is important to the realization of two other projects, namely Eastern Mediterranean gas and the Turkish Stream. The question is whether these two projects will be perceived as competitors to TANAP or not.

In the Eastern Mediterranean, although Egypt appears to have the largest offshore capacity in the region in Zohr field, Israel and Cyprus have better prospects for cooperation and coordination with Turkey. Egypt's Zohr gas, which is believed to be around 900 bcm, will probably be exploited and commercialized in the form of LNG. Its primary target is supposed to be the domestic Egyptian market with some export potential.

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The offshore resources in Israel and Cyprus might be more feasible for a pipeline project which could perhaps bolster Europe's supply diversification and enhance its energy security. In Cyprus, Aphrodite has a relatively small offshore capacity of between 110 to 200 bcm. In Israel, Tamar holds around 303 bcm and Leviathan has reserves of 620 bcm. These three offshore resources offer a sum of over 1,000 bcm, which

makes the idea of a pipeline project more attractive than commercialization through LNG. Although some experts underestimate Aphrodite's physical potential, a joint project between Israel and Turkey would only be possible with the participation of Cyprus.

In case of cooperation with Turkey, Israel would be able to bring its offshore gas to Cyprus; then with the additional capacity of Aphrodite, a pipeline connection between Cyprus and Turkey would join the TANAP system, and be transported to Europe via TAP.⁶ Nobody disagrees with the viability, cost-benefit advantages, and feasibility of such a project.

⁶ Ariel Cohen, “Developing a Western Energy Strategy for the Black Sea Region and Beyond,” *Atlantic Council Report*, (November 2015) p. 15.

Unresolved political disputes in the Eastern Mediterranean, however, appear to be the main obstacles facing such a project. Turkey's relations with Israel have now entered a new process of normalization. In Cyprus, the leaders of the Turkish and Greek communities have declared several times that they are close to a resolution of their dispute before the end of 2016. If it happens, Israeli and Cypriot gas in the Eastern Mediterranean would not only enhance the SGC, but also diversify the EU's supply and ensure its energy security. Lebanon's potential will further strengthen the viability of the Eastern Mediterranean natural gas basin.

Russia's Turkish Stream project is a modified version of a previous project called South Stream, which was initiated in 2007 by Gazprom and intended to carry a capacity of 63 bcm/year under the Black Sea crossing through Turkey's territorial waters and linking Russia directly to Bulgaria. This project was meant to bypass Ukraine and did not entail any supply diversification for Europe. However, from Bulgaria onwards, this gas would have to connect to a new pipeline to be constructed through Bulgaria and Serbia, which would also require compliance with the EU's Third Party Access regulations. Moreover, this new infrastructure construction would augment the costs of the South Stream project enormously.

Although there was skepticism that the South Stream project would increase Europe's dependence on Russian gas, some argued that European importers, particularly in Central Europe, would benefit from the diversification of transit routes. Such views also claimed that South Stream and the SGC were not rival projects at all and that South Stream would increase Turkey's power by bypassing Ukraine and enhance its transit role in the East-West gas trade.⁷

When Putin replaced the South Stream project with Turkish Stream, it was obvious that Russia had problems with the EU regulations and that it had to revise its plans. The EU's adoption of the Third Energy Package was the main discouraging reason for Russia because it stopped monopolistic companies, such as Gazprom, from disrupting the markets.⁸ Nevertheless, Turkish Stream also envisaged the transport of 63 bcm of Russian gas, this time, however, not to Bulgaria, but to Turkish Thrace.

The same arguments suggesting that it would become a major rival and hinder the development of SGC were expressed this time against Turkish Stream. It is important to underline, however, that Turkish Stream could meet the requirements of the EU's Third Energy Package although it did not entirely change the basic problem of

⁷ (Onur Çobanlı, "Turkey in the Eurasian Energy Game," *Global Relations Forum Young Academics Program Policy Paper Series No.1*, (November 2014).

⁸ Ariel Cohen, "Developing a Western Energy Strategy for the Black Sea Region and Beyond," *Atlantic Council Report*, (November 2015) p. 4.

diversifying the supply to Europe.⁹ Moreover, the Turkish energy bureaucracy did not view the Turkish Stream project as a plan to make Turkey an energy hub, but rather enhanced its role further as a transit country.

Russian authorities are apparently going back to their Turkish Stream project again since the beginning of normalization of relations with Turkey and have started to mention that it now envisages only two lines, instead of four, with a potential of 31.5 bcm instead of 63 bcm.

Could Turkey Become a Natural Gas Trading Hub?

Given the potential that Turkey may play in natural gas transport between the East and West, Turkey's energy strategy should primarily focus on the role that the country could play in the global energy trade. If the choice is to transform this role from a transit country into a trade hub, then Turkey should develop its infrastructure strategy, planning, and investment policies accordingly.

Turkey can design a strategy of transforming Eastern Thrace into a South East European Gas Hub. Turkey's advantage over all of its regional neighbors is the fact that it has created its natural gas distribution infrastructure through the private sector. Therefore, it has a strong sense of interoperability with the EU and so could be in a better position to comply with EU rules and regulations.

Most of the forecasts by major energy companies as well as the projections of the International Energy Agency (IEA) suggest that fossil fuels will continue to remain the essential source of energy generation in the 21st century. In 2015, Turkey imported 51 bcm of natural gas. With its consumption of 48 bcm, Turkey has become the fourth largest natural gas consumer in Europe in 2015.

As a major component of the SGC, TANAP will initially have a capacity of 16 bcm in 2020 and will easily increase this to 31 bcm in the mid-term. TANAP could also transport Turkmen natural gas if the bilateral differences of opinion between Azerbaijan and Turkmenistan are resolved.

Moreover, natural gas from the Kurdistan Regional Government (KRG) in Iraq as well as the gas from Eastern Mediterranean, will also be potential contributors to TANAP in the not-so-distant future. Such additions could easily boost Turkey's annual capacity to 80-100 bcm, which would easily transform Turkey into a regional natural gas trade hub. The potential envisaged by Turkish Stream could enhance

⁹ Cohen (2015), p. 4.

such a role more substantially. However, there are a few issues that will have to be pursued carefully.

First, Turkey needs to adapt its natural gas market laws in compliance with the new rules of the game based on free market competition and liberal pricing policies. Although the existing law has helped liberalize the market since 2001, BOTAŞ still maintains its dominant role as the sole actor in the market. A new law would create the necessary and sufficient conditions for natural gas infrastructure investments as well as competitive free market pricing policies.

Second, Turkey needs to upgrade its storage and LNG terminal capacity. Turkey has already developed a high pressure infrastructure network of 13,000 kilometers. Yet, Turkey has only two LNG import terminals. These two terminals have an annual capacity of 12.2 bcm which is quite low for a country planning to become a natural gas trade hub. Turkey's limited storage capacity of 2.8 bcm at Silivri also needs to be upgraded to at least 20 percent of Turkey's annual consumption.

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Third, Turkey has to increase the number of its gas import and export terminals. Currently, Turkey has four natural gas import terminals in the form of Bulgaria, Blue Stream, Iran, and BTE, and its sole export terminal is the ITG. As Turkey plans to diversify its natural gas supplies in the future, presumably through the KRG in northern Iraq and the Eastern Mediterranean, it has to formulate a strategy that increases both import and export terminals, with reverse flow capability in the latter as well.

Turkish Stream would become a new input in Turkey's natural gas transport infrastructure. It is important to emphasize, however, that a logical way forward would be to build the Interconnector facility between Turkey and Bulgaria with a view to connecting it to Turkish Stream. This is particularly important because Turkish Stream can become a viable partnership between Turkey and Russia only if it does not present a challenge to the SGC, hence to Europe's strategy of supply diversification and its energy supply strategy. The Turkish-Bulgarian Interconnector could, in that respect, further enhance new infrastructure opportunities in the Balkans.

Concluding Remarks

Foreign policy in the 21st century has become a multi-disciplinary endeavor. Many argue that foreign policy makers should approach conflict resolution through a holistic and visionary perspective. Turkey has failed to do so in the first 15 years of this new century. Normalization of bilateral relations with Israel and Russia may become important game changers in Turkey's new foreign policy strategy.

Both Israel and Russia open up new horizons for upgrading Turkey's role in this region. Notwithstanding the many multifaceted aspects of Turkey's foreign policy implementation in its immediate neighborhood, energy, may also become a new tool in this new environment. Turkey can assume a more responsible role in East-West energy trade as well as in assuring Europe's energy security.

Turkey, by itself, is not a significant actor that affects global energy strategies. Yet, its geographical location and its need for energy imports, particularly in the field of natural gas, make Turkey a key partner. This partnership should be transformed into an active strategy by transforming Turkey into a trade hub rather than a passive strategy that limit its potential to a transit country.

Turkish Stream on the north and Eastern Mediterranean natural gas basin in the south have the potential to make Turkey a trade hub. This role can only be realized if Turkey's new energy strategy prioritizes such an essential objective and prepares the country for this strategic transformation through determined and intelligent infrastructure investment policies. This approach will also enhance Turkey's flexibility vis-à-vis global energy strategies.