

TURKISH NATURAL GAS HUB AND ENERGY SECURITY: Theory and Practice

By Faig Galib Abbasov

On the eve of World War I (WWI), Winston Churchill, as the first lord of the Admiralty, converted the Royal Navy from coal to oil. As a result, a shift emerged in the imported fuel dependency, from Welsh Coal to Iranian oil. Then Churchill declared, “Safety and certainty in oil lie in variety and variety alone”.¹ In modern parlance this attitude denotes diversification of energy supplies.

Theoretical analysis: Diversification Gospel

Diversification of energy supplies, both in terms of supply sources and transit routes is at the heart of consumers’ energy strategy, as it ensures security of supply, resilience against disruptions and has a downward pressure on the prices by facilitating competitiveness in

energy markets. In this sense, multiplicity of energy supplies is the best recipe for a mid-term and even possibly long-term energy security for the consumer states.

From the producers’ perspective energy security holds to a similar principle, but at the opposite end of the spectrum. As the single biggest source of income for the most of the hydrocarbon producers, energy security entails continuous sales of their energy resources at the highest possible prices. Disruptions of energy exports will deprive the governments from substantial national income and destabilize the economy. In modern gas market diplomacy, on the other hand, the best commercial conditions to retain and increase the market share have become a new criterion for the energy security of the producer countries. This is especially important in Europe, where



the bulk of the imported natural gas is supplied based on long-term pay-or-take commercial contracts. Therefore, the revenues of the energy producers, especially, Europe's non-European gas suppliers are highly dependent upon their ability to acquire as big as possible market share under favorable commercial conditions. In turn, the best market conditions and the continuous flow of energy exports can be assured via, *inter alia*, security of demand. Thus, security of demand constitutes the bedrock of energy security of hydrocarbon producing states.

Accordingly, the security of demand is contingent upon the producers' ability to increase the number of their buyers and access various markets simultaneously. Branching out of energy exports safeguards producers from disruptions in a particular market, whether it is caused

by technical difficulties or as a result of diminished demand.

Secondly, security of demand necessitates diversification of export routes, as over-dependence upon a single route/infrastructure and disruptions thereof will stymie their exports reaching the necessary markets. This, in turn, will have deleterious effect on their revenues, as well as a blow on their reputation as a reliable supplier. In this sense, from suppliers' perspective happiness in energy security lies in multiple pipelines and multiple clients.

The third facet of energy security is the concept of affordability. However, affordability entails different assumptions for producer and consumer states. If from an importer's perspective, affordability equals to continuous supply of energy resources at *lowest* possible prices, from



a producer perspective it means continuous demand at the *highest possible price*.² Therefore, the diverging perceptions of energy security by consumers and producers lead to everyone expanding their energy relations and partners. Efforts by consumers, but also producers to diversify their energy supplies and markets, have given rise to what Luft and Korin call “a *new breed of countries*”, i.e. transit countries of energy relations and trade.³

Although, the notion of transit countries is not new in international trade, their strategies to influence energy flow and governmental policies of end users and suppliers have gained a new momentum in at the turn of the 21st century. In this regard, with its strategic location at the crossroads of Europe, Africa and Asia, the Republic of Turkey is blessed with all the necessary natural endowments to fine-tune its politics with its advantageous geographical position and utilize it as a strategic instrument of foreign policy.

Turkish bargaining chip

Currently, the European Union is increasingly importing a lion's share of its gas consumption from outside, the bulk of which is accounted by Russian Federation. Although being a reliable partner much of the time during the “cold war”, since the break-up of the Soviet Union Russia has repeatedly failed to stick to its end of the bargain in supplying Europe with natural gas. Perennial disruptions in Russian gas supplies, coupled with increasing import dependency on non-EU suppliers in the backdrop of dwindling indigenous reserves, drove the security of energy supply to the top in the political agenda of EU institutions and paved the way for

the slow but strongly incentivized attempts to build a common European energy policy.

The bedrock of the EU's supply security policy is constituted upon diversification of energy sources and transit routes. Such a policy is intended to bring additional supplies to the EU and ensure the liquidity of its gas markets, which will also serve as a “suspension” against disruptions from traditional suppliers. On the other hand, multiplicity of supplies will foster competitiveness in European outlets and help to tackle pricing monopoly of the dominant supplier.

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In this respect, developing a new – Southern corridor is of geostrategic and commercial value for the EU, upon which Brussels has largely hedged its bets. The corridor is envisaged to link vast and largely untapped gas fields of the Middle East and Caspian basin with European energy markets. As things stand, Turkey will be the key transit country for the delivery of these resources to the EU through Southern Energy Corridor, although the country currently suffers from bottlenecks in energy infrastructure.

All the more so, despite having officially applied for the EU membership in 1987 and commenced accession negotiations in 2005 the overall process is heavily protracted with France and the Republic



of Cyprus blocking several chapters of the EU *acquis communautaire*, *inter alia*, the energy chapter. Ironically, while keeping the energy chapter closed, the EU calls Turkey to sign up for the Energy Community, which is intended to serve as a “bridge-head for exporting EU energy market policy and practice further east, to Turkey and beyond”⁴; the call Turkey duly ignores. As Gareth Winrow best put it:

“[...] to the annoyance of EU bureaucrats and representatives of energy companies, officials in Ankara have questioned why they should accept the applicability of EU laws on Turkish territory when Turkey is not a member of the EU and the opening of the energy chapter remains blocked due to a political veto”.⁵

In this respect, it seems only reasonable for Turkey to aspire for becoming a

natural gas hub at the entry point of the EU, with the possibility of buying and re-exporting of Caspian and Middle Eastern originated gas. Although lacking its domestic gas resources, such a position would render Turkey as an important “supplier” of the EU, consequently increasing Ankara’s political weight vis-a-vis Brussels and serve as a bargaining chip in its accession negotiations. Before proceeding with further investigation on the matter, however, it is necessary to clarify the definition of the term “gas hub”, as it became a buzzword in energy policy circles and expresses different attitudes.

Natural gas hub does not simply infer physical juncture of a number of outsourced gas pipelines in a particular geographical area and differs from transit function of a given country. Although, there is not any single comprehensive definition of the “gas hub”, the one offered by Vladimir Socor conveys the essential functions of the one.

“A hub country buys another country’s gas, stores it and re-sells it as its own gas to third countries at a higher price. A transit country, however, provides transit service through pipelines on its territory for an agreed (cost-based) fee, enabling the producer country to enter into direct commercial relations with the customers for its gas”.⁶ Thus, as opposed to transit country, a gas hub plays a role of a middleman and becomes directly involved in the transactions between the sellers and the buyers in the third countries.

In this regard, natural gas hub aspiration of Turkey envisages certain benefits for the country. Such a



position would be commercially rewarding for the Turkish energy industry. Buying gas from the Caspian energy producers in cheap and re-selling it in lucrative European markets at a higher price would be of value added business for the Turkish state-controlled energy companies. Secondly, turning the country into a gas hub will increase the liquidity in the domestic gas market and ensure the availability of extra gas during the peak demand periods.

Furthermore, Egyptian, Iranian, as well as Iraqi gas should be taken on board in scrutinizing Turkish energy hub ambitions. Although being currently stalled by the Syrian political imbroglio, the Pan-Arab pipeline (PAP) originating in Egypt and the possibility of joining Iraqi gas fields to the latter in Syrian territory, increases the importance of Turkish energy corridor. On that account, unfavorable political attitude by the Turkish authorities towards the Assad regime is largely explained by the rationale of this energy geopolitics, which also sheds light on the Russian-Qatari showdown on the issue.

In such a intricate state of affairs, the sanctions on Iranian oil and gas industry play for the Turkish energy strategy. Being the only ally of the West to go on with its energy relations with conflict-ridden Iran, Turkey currently increases its pressure on Tehran for the imported gas prices. With international sanctions tightening around Iran's Central Bank, Turkey affords leverage in further blackmailing the former and securing a cheaper deal.⁷

Thus, by scoring a "seriously discounted price" for Russian gas after giving a green light to South Stream pipeline⁸ and

rumors on new pressures on purchased Azeri gas prices, coupled with intentions of building a nuclear power plant, Turkey seems to not only ease its energy bills, but also free some of its gas purchases for re-export to the European markets, hereby consolidating its energy-hub ambitions.

While serving as stepping stones towards eventual EU membership, such an energy strategy will also confer upon Turkey leverage for playing several suppliers against one another. In the picture unfolding, cheap gas contract bargained with Azerbaijan plays for Turkey's hand in negotiating new gas contracts or re-negotiating the existing

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ones with Iran and Russia. The sequel of discount related pressures upon its main suppliers points out to Turkey's mostly successful "energy juggling diplomacy".

According to the recent media leaks, however, Turkey's gas import pricing list reveals certain asymmetries with regard to the country's natural gas bills and energy relations with its major suppliers. The price for Azeri gas imports (\$282 for 1000 bcm), way below the market prices, can largely be explained with the latter's high dependence on Turkish transit corridor and currently major export market (not least by the friendly relations between the two countries). Insignificant disparities between the Russian (\$418) and Iranian (\$423) gas prices, however, is followed by disproportionate commercial pressure upon each of them.



While the current Russian gas prices are not mentioned among the government's concerns, Iran is being sued to the international arbitration over the "unacceptable level of gas prices".⁹

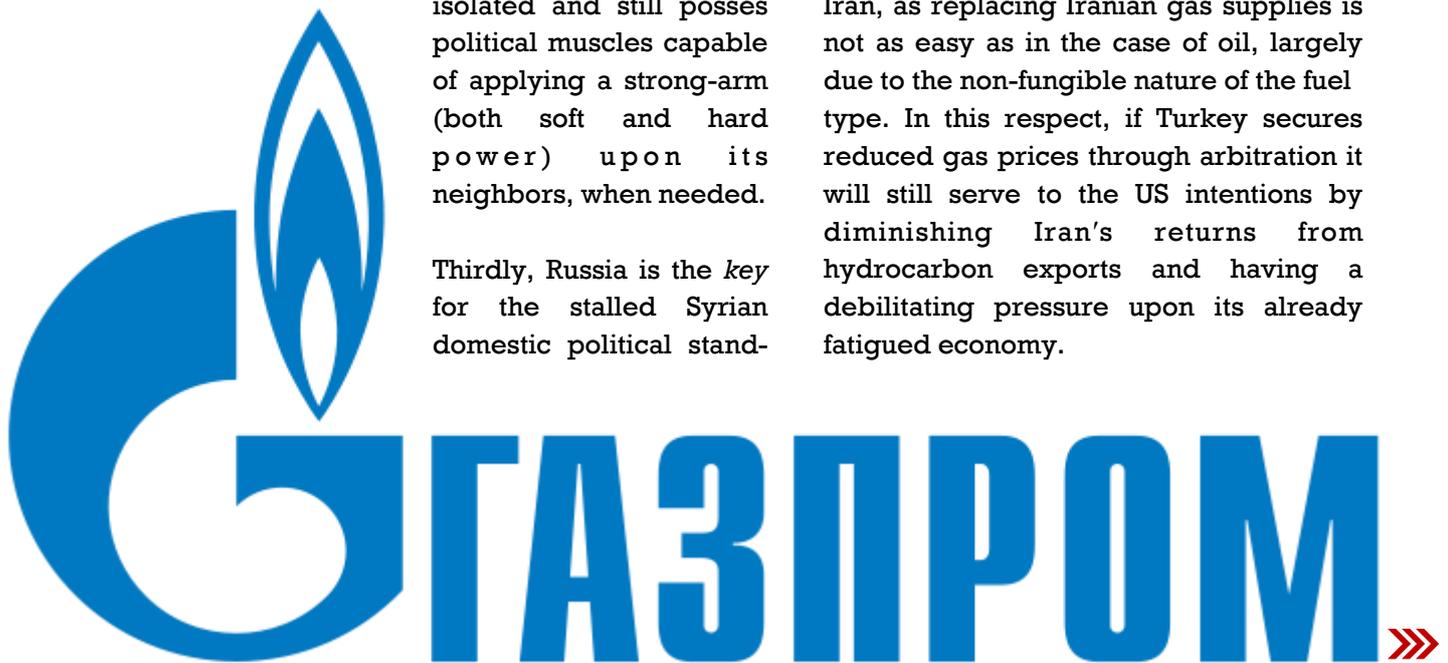
Although, some analysts are mostly right in pointing out to the relative reliability of Russian supplies as a major reason behind this discriminated pressure against Iran,¹⁰ it must also be acknowledged that, the high dependence upon Russian gas supplies (58%) and relative inferiority of Turkey's political weight vis-a-vis Russia have a part to play. On the first hand, in past Russia has served as a back-up supplier when Iran failed to meet its contractual commitments during the times of hiked domestic gas consumption related with the sensitive weather conditions. Hence, Ankara acknowledges the fact that its capacity to put pressure on Russia is limited, as it is Russia whom Turkey is likely to turn to when facing supply shortages from other suppliers, the fact of which official Moscow is aware. Secondly, unlike Iran the ex-superpower

is not internationally isolated and still possesses political muscles capable of applying a strong-arm (both soft and hard power) upon its neighbors, when needed.

Thirdly, Russia is the key for the stalled Syrian domestic political stand-

off, which threatens Turkey's interests in terms of military, energy (PAP) and demographic security. In this regard, the last point deserves special attention in the light of up-surged refugee inflow into the bordering regions with Syria following the Assad regime's harsh crack-down upon military and civil opposition. Therefore, by taking it easy with Russia, Turkey intends to play a "carrot" diplomacy and soften the Kremlin's support to Assad regime.

Last but not the least, increased Turkish pressure upon Iranian gas prices has also certain political rationale in the light of the latter's support to official Damascus and escalating international pressure linked to Tehran's nuclear ambitions. Turkey has already slashed Iranian oil imports by 20% (although not halting it, as opposed to the EU's plans), thus saving its grace before the (mostly) unified international community. In addition to this, Turkey's taking Iran to international arbitration over the gas prices can be interpreted as the former's attempt to secure exemption from the US sanctions against its banks dealing with Iran, as replacing Iranian gas supplies is not as easy as in the case of oil, largely due to the non-fungible nature of the fuel type. In this respect, if Turkey secures reduced gas prices through arbitration it will still serve to the US intentions by diminishing Iran's returns from hydrocarbon exports and having a debilitating pressure upon its already fatigued economy.



Gazprom is the largest extractor of natural gas in the world and the largest Russian company.

In sum, Turkish natural gas hub ambition is of economic importance to the country, not least of political. Tactfully combining the two will double the country's geo-economic preponderance in the region and increase its weight vis-a-vis the EU, of which Turkey long aspires to be a member. On the flipside, however, the prospect of realization of Turkish energy hub is not equally welcoming for the EU and Azerbaijan Republic, which is to serve as the initial feedstock for the Southern gas corridor.

Azerbaijan's energy strategy: why to put all your eggs in one basket?

Currently, Azerbaijan is widely considered to be one of the potential natural gas suppliers to the European Union through the yet to be established Southern Energy Corridor. Official Baku's aspirations to access the lucrative European markets, coupled with additional market appetite of its industrial partners, namely, Norwegian Statoil and British Petroleum (BP), makes the project feasible in terms of supply sourcing. The leadership of the country has, in principle, agreed to supply the EU with 10 bcm of natural gas from the second phase of the massive gas field Shah-Deniz via one of the several competing pipelines, namely TAP, Nabucco, ITGI and SEEP.

Although, reaching out to the European energy outlets is of strategic and commercial importance to Azerbaijani government, it is by far not the only goal. The EU must not expect to be the exclusive purchaser of Azeri gas, not least for commercial reasons. As a producing country Azerbaijan is interested in ensuring the security of demand and best possible pricing for its natural gas sales. Correspondingly, in a

liberal market security of demand and best pricing for the traded commodity can be achieved through accessing variety of customers. Such a market condition will trigger competitiveness for the traded product and enable the seller to negotiate the best conditions for the deal among the several consumers (although not excluding political benefits of such a bargaining position vis-a-vis the EU). Additionally, direct access to the European markets will elevate Azerbaijan's energy strategy to a new level, where the policies aimed at increasing and competing over the market share will dominate the geo-

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economical game strategy. In this regard, diversification of energy partners is of commercial interest for Azerbaijan. On the other hand, access to multiple customers will safeguard the country from the potential shocks caused by disruptions in one of the target markets, thus mitigating the overall burden to the country's energy export oriented economy.

In this vein, Turkey's aspiration to emerge as a major natural gas hub for the Caspian and Middle Eastern gas exports is detriment to Azerbaijan's strategy of diversification of its energy partners. As a landlocked hydrocarbon producer, Azerbaijan is heavily dependent on Turkish transit route. That is why, Turkish "gas hub" ambition stirs up uneasiness in official Baku.



According to the natural gas contract with Azerbaijan Turkey have been privileged to buy Azeri gas way below European market prices for domestic consumption, as well as for export to

Europe, namely to Greece. Although, official Baku was collecting rents from gas sales, selling an exhaustible national asset for pittance is neither strategically, nor commercially agreeable for Azerbaijan. Such an unfavorable commercial condition is the bottom-line of Azerbaijan's incentive to directly engage with the European consumers and negotiate the pricing and volume of the supplied natural gas.

After a prolonged and onerous negotiations official Baku managed to secure a deal with Turkey on the transit of Azerbaijani gas to the European market in 2010. This averted the prospects of Turkey purchasing all of Azeri gas and re-selling it in Europe. Nonetheless, Turkey still retains a right to re-export 6 bcm of natural gas that will be purchased from Azerbaijan on the second phase of the development of Shah -Deniz gas field,¹¹ which still gives a hope to Turkish aspirations of becoming a gas hub.

Despite being strategic partners in broad foreign policy affairs, which largely stems from the close ethno-linguistic ties, energy politics is the base line of disagreements between the two nations. Although having signed natural gas transit agreement with Azerbaijan, Turkey continues to exert political and economic pressure on the former over the export routes and trade partners. This was especially salient during the World Economic Forum in Davos forum in 2012, when Azerbaijan was expected to sign an liquefied natural gas (LNG) supply deal with Ukraine, but backtracked latter on unconvincing grounds of Ukrainian arms sales to Armenia, which currently holds 20% of Azerbaijani territory under occupation despite international condemnation.



Contrary to the initial perception, Turkish energy hub aspirations had twofold direct impact on the fate of the mentioned contract. Firstly, the LNG deal would loosen Azerbaijan's dependence over the Turkish transit route and set a precedence of the possibility of the second alternative route from the Caspian basin towards Europe via "non-territorial" Black Sea waters. As Turkey is set to consolidate the East-West energy corridor along its territory, any projects bypassing it is likely to meet Ankara's frowning. Such a geo-economic strategy on the part of Turkey can also explain the reasons behind its intentions to renegotiate the shares in TANAP, the pipeline intended to bring Azeri gas to the EU's doorstep under official Baku's operatorship.¹² Although, Baku is an independent actor, in current geopolitical circumstances, it is obliged to bring Ankara's position into its energy policy calculations. In this regard, if Turkey manages to keep midstream (transit) under its legal and economical control, it will be able to play hardball with Baku by sourcing gas from alternative suppliers, mainly from the Middle East and Russia. However, if Azerbaijan manages to control TANAP, then it will be up to official Baku to decide whose gas will flow through the pipeline: what volume and at which costs.

Secondly, although 2010 deal between Azerbaijan and Turkey theoretically enabled the former's direct access with the European consumers, Turkey's re-export right of 6 bcm of natural gas it is to acquire from SDII. If to factor in Turkey's intentions to supply Ukraine with natural gas, although itself being an import country¹³, it is not difficult to infer that Azerbaijan's gas sold to Turkey can constitute a competitor to

its own energy deals with the third countries.

Therefore, in case of Turkey's becoming an energy hub for the Caspian gas exports and first-hand buyer of all Azerbaijani natural gas, the latter will lose its ability to negotiate the pricing for its gas sales among the prospective consumers, namely, the EU member and non-member states, as well as Middle Eastern energy importers.

The same might be true from the consumers' perspective. Being a huge energy market, the EU is interested in the diversity of energy supplies and transit routes, which will ensure competitiveness and security of supply in its domestic energy market. Turkey's becoming a non-EU energy hub for the Caspian, Middle Eastern and Egyptian energy exports is against to these objectives, as it will strongly affect the EU's negotiating clout vis-a-vis Ankara's monopoly over the imported natural gas. This will be true for the pricing of the imported energy carriers, as well as in terms of Turkey-EU accession negotiations.

In sum, Turkey's natural gas hub aspiration has different repercussions for the energy strategies of the regional actors. Although it is in Ankara's best interest to bring the strategy into fruition, successful realization of this grand design is detriment to the national interests of suppliers and consumers, which largely explains their unfavorable attitude to such a plan.

Notes:

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