

The Geopolitics of Natural Gas

Turkey's Energy Policy and the Future of Natural Gas

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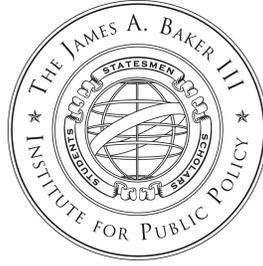
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JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY
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TURKEY'S ENERGY POLICY AND THE FUTURE OF NATURAL GAS

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ABOUT THE STUDY

Some of the most dramatic energy developments of recent years have been in the realm of natural gas. Huge quantities of unconventional U.S. shale gas are now commercially viable, changing the strategic picture for the United States by making it self-sufficient in natural gas for the foreseeable future. This development alone has reverberated throughout the globe, causing shifts in patterns of trade and leading other countries in Europe and Asia to explore their own shale gas potential. Such developments are putting pressure on longstanding arrangements, such as oil-linked gas contracts and the separate nature of North American, European, and Asian gas markets, and may lead to strategic shifts, such as the weakening of Russia's dominance in the European gas market.

Against this backdrop, the Center for Energy Studies of Rice University's Baker Institute and the Belfer Center for Science and International Affairs of Harvard University's Kennedy School launched a two-year study on the geopolitical implications of natural gas. The project brought together experts from academia and industry to explore the potential for new quantities of conventional and unconventional natural gas reaching global markets in the years ahead. The effort drew on more than 15 country experts of producer and consumer countries who assessed the prospects for gas consumption and production in the country in question, based on anticipated political, economic, and policy trends. Building on these case studies, the project formulated different scenarios and used the Rice World Gas Trade Model to assess the cumulative impact of country-specific changes on the global gas market and geopolitics more broadly.

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Introduction¹

Buoyed by a decade of economic growth, Turkey is more prosperous than ever before. At the forefront of this transformation, Turkey's Justice and Development Party (AKP) has reaped the rewards of economic success and political prestige. But as the party strives to institutionalize its gains, it faces growing challenges at home and abroad. Domestic polarization erupted into massive unrest during the Gezi protests of June 2013, potentially threatening Turkey's hard-won reputation for political stability. Alongside this domestic trend, Turkey's region is perpetually dangerous with spillover from Syria's civil war and worsening fractionalization in Iraq at the forefront of Ankara's regional concerns.

These trends have important implications for Turkey's natural gas trajectory. The AKP has demonstrated its preference for natural gas and led in the expansion of Turkey's capacity to import and transmit supplies across the country. The party has also presided over an ambitious project to expand the role of the private sector in this arena. But for the AKP, national power and political prerogatives are what truly matter. As Turkey's domestic appetite for gas has grown, so has its aspiration to turn its geographic location into an advantage in the Eurasian natural gas game. In recent years, Turkey has begun to entertain the ambition of becoming a "Eurasian entrepôt" of natural gas exchange. Not only is this policy aimed at producing economic benefits for Turkey, but it is also a part of Turkey's ambition to play a greater role within its region.²

Turkey's minister of energy, Taner Yildiz, proclaims that "Turkey is indispensable when it comes to addressing some of the key global energy problems. Turkey is also at the center of energy geopolitics."³ Prime Minister Recep Tayyip Erdogan is of the same mind, describing Turkey's strategy as "making use of its geography and geostrategic location by creating a corridor between countries with rich energy resources and energy consuming countries."⁴ Yet, as it stands, Turkey's natural gas demands are a strategic liability for the Turks, who often have to

¹ The authors would like to thank Altay Sedat Otun for his assistance with this article.

² For a discussion of the various terms used to describe Ankara's aspirations, see Gareth Winrow, "The Southern Gas Corridor and Turkey's Role as an Energy Transit State and Energy Hub," *Insight Turkey* 15, no. 1 (Winter 2013): 145-163.

³ Taner Yıldız, "Turkey's Energy Economy and Future Energy Vision," *Turkish Policy Quarterly* 9, no. 2 (October 2010): 13-18.

⁴ Brenda Shaffer, "Turkey's Energy Policies in a Tight Global Energy Market," *Insight Turkey* 8, no. 2 (April-June 2006): 97-104. http://belfercenter.ksg.harvard.edu/files/insight_turkey_shaffer_energy.pdf.

bend to Russia, Iran, and Azerbaijan on regional affairs so as to avoid putting Turkey's gas needs at risk.

Economic Factors: Feeding a Growing Appetite for Natural Gas

Meeting Demand

Turkey cannot become a regional energy player without first tending to its gas needs at home. The Turkish economy has tripled in size over the past decade, driven by a competitive manufacturing sector. This burst of production and the accompanying welfare gains have fueled the rapidly growing demand for energy in Turkey—and natural gas is a growing part of the portfolio that will meet this demand. Turkey first began importing natural gas in 1987, with the USSR as the sole supplier. During its early years, Turkey's total natural gas imports were less than 1 bcm.⁵ Since then, Turkey's natural gas consumption has increased to 39 bcm per year. By 2010, a full 16.4 percent of Turkey's energy consumption came from natural gas,⁶ and the share could rise even further as transmission networks expand.

In the near term, the industrial sector and the electricity sector will drive demand. Currently, industrial use composes 25 percent of natural gas consumption in Turkey,⁷ and a continued period of economic growth would feed this appetite.

Electricity will also drive demand significantly. Although government policy aims to reduce electricity generation's share of natural gas consumption,⁸ Turkey has developed a lasting reliance on natural gas as a primary source for electricity generation. In Turkey, natural gas is the third largest source for electricity generation, behind coal and hydroelectric energy.⁹ In 2002, Turkey consumed 129 billion kilowatt hours of electricity. By 2010, this number had increased

⁵ TÜSİAD, *Liberalization of the Energy Sector: The Case of Turkey and the EU*, TÜSİAD Energy Strategy Series – 4, November 2009, http://www.tusiad.org/_rsc/shared/file/Liberalizationguncel.pdf.

⁶ E. Toklu, M.S. Güney, M. Işık, O. Comaklı, K. Kaygusuz, "Energy production, consumption, policies and recent developments in Turkey," *Renewable and Sustainable Energy Reviews* 14, no. 4 (May 2010): 1,172–1,186.

⁷ Ibid, 1.

⁸ Yusuf Yazar, *Türkiye'nin Enerjideki Durumu ve Geleceği* (Ankara, Turkey: SETA, 2010), <http://arsiv.setav.org/ups/dosya/58085.pdf>.

⁹ F.E. Boran and K. Boran, "Evaluation of Natural Gas Systems: A Comparison Study for Turkey," *Energy Sources* 7, no. 3 (2012): 222–229.

to 211 billion kilowatt hours, and the Turkish Ministry of Energy predicts that by 2023 Turkey will consume 450 billion kilowatt hours per year.¹⁰ This increase is reflected in the massive growth of power generating facilities being constructed across Turkey. Between 2002 and 2011, Turkey built 300 new power plants, an amount nearly equivalent to the total number of power plants it constructed in the prior 80 years.¹¹ In order to meet these demands, Turkey will need to increase its natural gas consumption considerably. Turkey's state-owned gas supplier, BOTAS, recently predicted that Turkey's gas demand will rise to 70 bcm by 2020.¹²

Amidst uncertainty about imports and domestic supply, some have warned of possible supply shortages in the near term.¹³ Despite these short-term gaps, Turkish Energy Minister Taner Yildiz envisions natural gas maintaining its prominent position in Turkey's energy portfolio through 2035.¹⁴

Due to its poor energy endowments, Turkey will have to import almost all of its gas. Currently, Turkey only produces around 2 percent of its natural gas supplies, although Ankara is working to develop local sources.¹⁵ The yearly investment budget for Turkey's state-owned hydrocarbon enterprise, TPAO, has increased 16-fold over the past decade.¹⁶ In 2013, Turkey is positioned to commission more wells than any other country in Europe.¹⁷ The Turkish Petroleum Corporation (TPAO)—the country's government-owned oil company—has announced plans to construct offshore exploratory wells in the Black Sea in partnership with a number of international energy firms.¹⁸ TPAO general director Mehmet Uysal claimed that Turkey could find reserves in the

¹⁰ Taner Yildiz, *Türkiye Enerji Politikalarımız* (Ministry of Energy, November 11, 2011).

¹¹ Ibid.

¹² "BOTAS: 2020 yılında gas ihtiyacı 70 milyar metrekup olacak," *Enerji Enstitüsü*, November 16, 2012.

¹³ TÜSİAD, *Liberalization of the Energy Sector*; Deloitte, *Turkey's Natural Gas Market: Expectations and Developments 2012* (Deloitte Turkey, April 2012).

¹⁴ "10 yılda enerjiye ne kadar yatırım yapıldı?" *Haber 7*, November 2, 2012.

¹⁵ TÜSİAD, *Liberalization of the Energy Sector*.

¹⁶ Yazar, *Türkiye'nin Enerjideki Durumu ve Geleceği*.

¹⁷ Selcan Hacaoglu and Brian Swint, "Turkey Beating Norway as Biggest Regional Oil Driller: Energy," *Bloomberg*, January 10, 2013.

¹⁸ "Turkey's TPAO plans 4-5 deep exploration wells in Black Sea," *Reuters*, July 20, 2011, <http://uk.reuters.com/article/2011/07/20/turkey-tpao-blacksea-idUKL3E7IK0IJ20110720>.

Black Sea as large as 3 Tcm.¹⁹ Turkey has also teamed with Shell to explore areas off its coast in the Eastern Mediterranean, although no major finds have been made.²⁰ Stores of unconventional energy could also add to Turkey's natural gas endowments.²¹ Southeastern Turkey contains deposits of shale reserves clustered in the Hamitabat and Mezdere regions.²² Shell has a license to explore for shale gas near Diyarbakir, and in September 2012, Exxon reportedly entered an agreement to explore with TPAO for shale gas in adjoining areas.²³

Turkey is also becoming a destination for spot LNG to fill the gaps in supply.²⁴ As of summer 2013, 21 private companies were licensed to import LNG,²⁵ although only one firm, EGEGAZ, had started importing. BOTAS currently operates an LNG import terminal on the Sea of Marmara near Istanbul, and EGEGAZ has completed an additional LNG terminal in Izmir.

Even as Turkish reliance on imported natural gas grows, Ankara remains determined to transform Turkey into a net exporter of natural gas, or at the very least a transit country that collects fees and burnishes political leverage. This would entail developing Turkey's pipeline infrastructure as well as its storage capacity. Currently, Turkey's only storage facility is in Silivri with a capacity of 1.6 bcm—about 5 percent of Turkey's current consumption.²⁶ Turkey has plans to develop an additional 5 Bcm of storage capacity in Tuz Golu.²⁷

¹⁹ "TPAO's investments in Black Sea reach \$4 billion," *Hurriyet Daily News*, April 22, 2010, <http://www.hurriyetdailynews.com/default.aspx?pageid=438&n=tpao8217s-investments-in-black-sea-reach-4-billion-2010-04-22>.

²⁰ Mehmet Ogutcu, *Rivalry in the Eastern Mediterranean: The Turkish Dimension* (Washington, D.C.: German Marshall Fund, 2012).

²¹ International Energy Agency, *Golden Rules for a Golden Age of Gas: World Energy Outlook Special Report on Unconventional Gas* (Paris, France: IEA Publications, 2012).

²² Deloitte, *Turkey's Natural Gas Market*.

²³ Ercan Ersoy, "Exxon Seeks Turkish Shale-Gas Exploration License, Hurriyet Says," *Bloomberg*, September 6, 2012, <http://www.bloomberg.com/news/2012-09-06/exxon-seeks-turkish-shale-gas-exploration-license-hurriyet-says.html>.

²⁴ Ibid.

²⁵ Energy Market Regulatory Authority (EMRA).

²⁶ Turkish Ministry of Energy, "Doğal gaz," accessed November 25, 2013, <http://www.enerji.gov.tr/index.php?dil=tr&sf=webpages&b=dogalgaz&bn=221&hn=&nm=384&id=40694>; Naki Bakir, "BOTAS, 569 milyona gazı Tuz Gölü'ne depolayacak," *Ekonomi Ayrinti*, May 11, 2012.

²⁷ Mert Bilgin, "Energy Policy in Turkey: Security, Markets, Supplies and Pipelines," *Turkish Studies* 12, no. 3 (2011): 399-417.

So far, apart from modest volumes of gas transiting from the Caspian to Greece, Turkey has not completed a major project to serve European markets. This could change in the coming decade as Turkey and Azerbaijan initiate the Trans-Anatolian Pipeline (TANAP), a project that envisions building Anatolian capacity to transport gas to European pipelines (see the geopolitics section below).

As Turkey builds its material infrastructure, it also aims to develop an institutional environment more suitable to commercial gain and political influence. Turkey has made a leap toward liberalization of its energy markets, but the pace and ultimate commitment to full liberalization remain topics of debate.

Making a Market

Until the mid-1980s, the state controlled nearly all energy production and distribution. This began to change under a liberalization initiative set in motion by President Turgut Ozal. Initially, poor legal groundwork and a resistant judiciary made it impossible to accomplish widespread privatization in the energy sector.²⁸ As an alternative, the government began to utilize quasi-privatization methods such as “build, operate, and transfer contracts” (BOTs), in which private companies were allowed to build and run infrastructure, which they would then return to the state after recovering a profitable return on their investment.²⁹

The real impetus for privatization arrived with the economic crisis of 2001. This shock afforded the opportunity to pass two landmark laws pertaining to the natural gas market: the Natural Gas Market Law No. 4646 (2001) and the Electricity Market Law No. 4628 (2001). These two laws became the basis for a continuing restructuring of the energy sector based on an ambitious liberalization agenda.³⁰ Major components of the reform included mandating the separation of production, wholesale, and distribution, as well as setting 20 percent as the maximum market share for BOTAS, the state-owned gas enterprise. It also established a legally independent regulatory body, the Energy Market Regulatory Authority (EMRA). The first several years after

²⁸ For a detailed discussion of the legal aspects of Turkey's privatization, see Izak Atiyas, “Recent Privatization Experience of Turkey: A Reappraisal,” draft paper, Sabancı University, 2009.

²⁹ Toklu et al., “Recent developments in Turkey.”

³⁰ Seyit Ali Dastan, “Analysing success of regulatory policy transfers: Evidence from Turkish energy markets,” *Energy Policy* 39, no. 12 (2011): 8,116–8,124.

the passage of this legislation witnessed rapid reforms, and the liberalization of downstream activities has proceeded apace. In fact, private firms have been involved in distribution since the 1990s. Progress has also been made on wholesaling. Currently, 37 companies are licensed to engage in wholesale activities, and 12 companies have been able to access the BOTAS transmission network.³¹

However, in upstream activities, the liberalization process has slowed. Policymakers seem to have lost enthusiasm for the ambitious goal of reducing BOTAS' share to 20 percent, and the requirement to unbundle the company's upstream activities has not been achieved.³² BOTAS is contractually bound to purchase a certain volume of gas from neighboring countries that leaves little room for private competitors.³³ To remedy this, the Natural Gas Market Law requires that BOTAS transfer its contracts to private firms. A number of auctions have been attempted to comply with this law. So far, one arrangement allows for the transfer of 4 bcm from Russia's western line to Enerco, Bosphorus Gas, Avrasya Gas, and Shell.³⁴ Under the terms of this deal, by 2007, the first private firms began to access the transmission network. In 2011, BOTAS seemed to be moving closer to an additional deal when it allowed a 6 bcm purchase agreement from the Russian western pipeline to expire so that private firms could take over the supply. However, private actors were unable to conclude a deal with Russia, and BOTAS has taken the supplies for the interim.³⁵

Political Factors: Credible Commitment in the Era of AKP Predominance

Turkey Under Single-Party Rule

In June 2011, the AKP won its third consecutive election under the charismatic leadership of Prime Minister Recep Tayyip Erdogan. With this victory, the AKP became the most electorally successful party in Turkish history, actually increasing its share of the vote in its third electoral victory. The AKP has moved deftly to transform these victories into sustainable predominance for the decades ahead. The party recently incorporated major personalities from Turkey's

³¹ Deloitte, *Turkey's Natural Gas Market*.

³² Ibid.

³³ TÜSIAD, *Liberalization of the Energy Sector*.

³⁴ Deloitte, *Turkey's Natural Gas Market*.

³⁵ Ibid.

Islamist tradition as well as names from Turkey's center-right establishment. From a demographic perspective, this could be a masterstroke. The various currents of conservatism in Turkey make up a sizable majority of the Turkish electorate, and by incorporating the traditional Islamists and the old-style center-right, the AKP stands to grow its share of this segment.

This strategy also positions the AKP to attract voters from the far-right Nationalist Action Party (MHP), which won about 11 percent of the vote in recent elections. Local, presidential, and general elections in 2014–2015 offer the AKP a chance to expand its share of the popular vote beyond the 49.5 percent it won in 2011. Turkey's electoral system allocates seats disproportionately to the majority party, so even minor gains in the popular vote could bestow the AKP with a three-fourths supermajority in the parliament. This would enable the party to amend the constitution without requiring opposition support and usher in a redoubled era of AKP predominance. But this institutional ascendance has met fierce backlash from elements of society that feel marginalized by the AKP's grand coalition. Grassroots protests flared during the Gezi protests in June 2013. The AKP's heavy-handed response bruised Turkey's international reputation for democracy and stability, but the domestic costs of the protests should not be overstated. Erdogan's ability to consolidate his conservative coalition will prove the ultimate determinant of AKP predominance, and this task is possible even in the face of vociferous opposition from Turkey's secularists, liberals, and the various other groups that feel threatened by conservative hegemony.

Prime Minister Erdogan will likely run in the presidential election slated for 2014, cementing a position from which to steer the course of the country over the long term. Turkey's current president, Abdullah Gul, could then assume the post of prime minister, in a move that in some respects would resemble the Putin-Medvedev duo, but with one crucial exception: Abdullah Gul is not likely to confine himself to a subordinate role to Erdogan. Power will have to be shared between the two figures or party unity will suffer. A lagging economy or a spiraling crisis in Syria could also deflate the AKP's prospects.

The AKP's political primacy is magnified by the centralized structure of the Turkish state. Turkey's governing institutions are historically rooted in the French model of administration,

with a strong emphasis on the dominance of the central authority over the peripheries. Ankara appoints governors, and local elected leaders will increasingly come from AKP cadres thanks to the party's successful push to redraw administrative districts in anticipation of the 2014 local elections. With these changes, urban areas have been subsumed within larger districts that include vast rural areas. This redrawing could mean the urban strongholds of Turkey's Kemalists and secularists will be diluted by rural AKP voters, resulting in AKP dominance in most of Turkey's 29 major municipalities—which will drive growth and energy demand in the coming decades.

In the past, the Turkish judiciary acted as a major veto-player to government economic policies, particularly to privatizations. But as Turkey's legal infrastructure becomes clearer, and as the judicial culture evolves to become more aligned with AKP preferences, this veto point will likely weaken.

The main actors in energy policy are the political leadership, including the ministries charged with economic planning. Input also comes from commercial actors such as BOTAS and TPAO, and private interests are capable of mustering limited lobbying efforts, especially given that private sector interests and government policies often intersect.

In short, decision-making in Turkey is drastically different from the pluralist policymaking structure of the United States or the corporatist structure in Europe. This applies to the energy arena as well, where Turkey's powerful executive is poised to become the salient factor in determining the policy process.

Benefits from Stability

Turkey's consolidation of a majority government is no doubt a welcome change for those who remember the chaotic minority governments that plunged the country into crisis during the 1990s. Indeed, the comparative stability that has reigned during the AKP decade has been both a cause and a consequence of the party's success.

During its decade-long tenure, the AKP government has had the opportunity to shape the regulatory regime according to its own vision. The AKP also has the advantage of a longer planning horizon for strategic projects, and AKP leaders often boast that their longevity has given them the ability to make credible commitments to private actors and foreign governments. Recent years have witnessed an increase in private money invested in energy projects in Turkey.³⁶

From an international perspective, the AKP is eager to display its neo-liberal credentials and reputation for responsible governance. The party readily advertises its desire to attract foreign investment and looks to present itself as a responsible player in the international economy. Turkey is a party to the Energy Charter Treaty (ECT), the only legally binding document devoted to energy in international law. The ECT requires that states create a fair environment for international investors and establishes mechanisms for arbitration and enforcement. This disposition seems to be paying off. In 2011, Turkey's energy sector attracted about \$4 billion of foreign investment.³⁷ Turkey, however, has not moved beyond observer status in the European Energy Community.³⁸

The AKP has demonstrated its ability to quickly enact sweeping regulatory reform. The party harmonized Turkey's commercial code with international accounting standards and transparency principles³⁹ and has also enacted a regional investment incentive package designed to draw capital to economically depressed areas. Under this initiative, the AKP has established the Incentives Implementation Authority for Foreign Investment (*Teşvik ve Uygulama ve Yabancı Sermaye Genel Müdürlüğü*). This bureau has been tasked with designing and implementing policies that lower taxes and tariffs for large investments and provide practical guidance for large international investors.⁴⁰ The government also passed a new petroleum law in December 2012

³⁶ Dastan, "Analysing success."

³⁷ "Enerjiye gelen yabancı yatırım 4 milyar \$," *Dunya*, December 4, 2011, <http://www.dunya.com/enerjiye-gelen-yabanci-yatirim-4-milyar--140605h.htm>.

³⁸ "Members," Energy Community, http://www.energy-community.org/portal/page/portal/ENC_HOME/MEMBERS

³⁹ For a summary of the criticisms, see "Yeni Ticaret Kanunu KOBİ'leri bitirir! Şirketi olan hapisane veya tımarhaneye gider!," *Euractiv*, December 1, 2012.

⁴⁰ Teşvik ve Uygulama ve Yabancı Sermaye Genel Müdürlüğü, "Enerji Yatırımları ve Teşvik Tedbirleri," (presentation, Ekonomi Bakanlığı, Ankara, Turkey, April 2012), http://enerjipostasi.com/haber_resim/files/dosyalar/icci/O8_Harun_Gazali.pdf.

with the stated intent of attracting foreign energy firms in the exploration and extraction of resources in Turkey.⁴¹

These policies reflect the leadership's adherence to liberal economic doctrine, although the AKP has put a priority on taming capitalism's social impacts with extensive formal and informal distributive policies. The party has put this model to the test over the past decade, and it has demonstrated remarkable political and economic success.

Too Much of a Good Thing?

On the other hand, the preponderance of AKP authority could also create certain risks to stable policymaking. Executive power is approaching its zenith in Turkey, ushering in a more overbearing style in Ankara as the party draws strength from the ballot box and dismantles institutional checks. The June 2013 Gezi protests testified to the potential for this trend to trigger backlash.

A master of charismatic politics, Prime Minister Erdogan is not averse to making sudden forays into detailed policy issues. This imperiousness went on display during a chaotic bout of education reform last year. In an unusually extreme instance of Turkey's legislative process gone wrong, the ruling party steamrolled an attempt to filibuster an education overhaul. To wit, the AKP's disciplined parliamentarians physically blocked opposition deputies from entering the floor while the bill was hastily read and approved by the ruling deputies. In characteristic fashion, this legislation was brought to the floor with little warning, and critics complained of inadequate time for studying the technical feasibility of many of the proposals.⁴² As this example suggests, the dark side of Ankara's ability to legislate decisively is a penchant for strong-arm tactics that have created bitter polarization between the ruling party and elements of the opposition in parliament and in society more broadly.

⁴¹ "Yeni Petrol Kanunu'yla 'gerçek' yatırımcının önü açılıyor," *Enerji Dergisi*, January 18, 2013.

⁴² For an example of this line of criticism, see Mehmet Kayadelen, "Planlar ne işe yarar?," *Enerji*, October 2, 2012.

This brand of criticism has been on the rise of late as the leadership unveils an array of new megaprojects—from a massive canal to carve the Black Sea into the Sea of Marmara to a major expansion of the underground highway network in Istanbul.

Commenting on a proposed plan to build a mega-mosque in Istanbul's Camlica district, the head of the Istanbul Independent Architects' Association remarked, "The government thinks that they have all the authority, which they surely have on political issues, but then they expand this into technical issues. This is the key problem today."⁴³ It is telling that the Gezi protests were triggered when the police cracked down on peaceful protestors demonstrating against a commercial development project in Turkey's historic Taksim Square.

But these pressures have yet to moderate the AKP's majoritarian tendencies. In some sense, the party's political culture may make it difficult to forge compromise. The AKP, after all, was born in the throes of a crisis that emanated from the "old-guard's" inability to govern effectively. By taking the reins, the AKP catapulted Turkey into an era of impressive economic growth. Given these origins, it should hardly come as a surprise that the AKP regards itself as the only political party that truly has the public interest at heart. This conviction has led to disdain for minority parties, which are often painted as a contrarian obstacle to decisive governance. The courts and the former state elites receive a similar treatment due to their previous alignment with the status quo Kemalist factions that fought hard to keep the AKP out of power—by hook or by crook.

Against these trends, decision-making in the AKP may crystalize around an insulated prime minister who is unreceptive to outside input or criticism and not averse to intervening in detailed and technical policy spaces. The prime minister has also gained a reputation for conflating policy with personal relations. In his dealings with political peers, Erdogan is committed to his friends, but he can become irate when he feels betrayed—even steering the ship of state into squalls to get even. On this point, an outburst by Prime Minister Erdogan in January 2013 is suggestive. During an interview on Turkish broadcast television, Erdogan declared that Turkey is considering joining the Shanghai Cooperation Organization as an alternative to the European Union. The facetiousness of the remark notwithstanding, Erdogan regularly bristles at the

⁴³ Justin Vela, "Turkey: Istanbul Mosque Debate about Democracy or Islam?," *Eurasia.net*, November 7, 2012.

European Union, a stance that became especially vehement during the Gezi protests that rocked Turkish cities in June 2013.

Geopolitical Factors

As it stands, Turkey's natural gas demands constitute an overall strategic liability. Turkey has to expend more political effort to ensure secure gas supplies than it gains in leverage from its position as a transit country. In other words, Turkey often has to compromise on its preferences in the international arena so as not to alienate suppliers. Currently, the overwhelming majority of Turkish gas comes from Russia, Iran, and Azerbaijan—three suppliers over which Turkey is not in a position to exert substantial influence.

In light of these circumstances, Turkey's aspiration is no doubt to improve its natural gas positioning so that energy becomes a net strategic asset. In principle, Turkey would accomplish this by increasing its diversity of suppliers and developing its capacity to transport and store gas. Success in such a venture would not only yield commercial gains, but it would also strengthen Turkey's hand in regional politics. The contours of Ankara's current position and future prospects can be illuminated by taking a closer look at Turkey's relations with its current suppliers, as well as Ankara's ambitions for diversifying supply.

Turkey's Suppliers: A Tough Crowd

Russia

Energy has been at the center of Ankara's recent efforts to strengthen bilateral ties with Russia. In 2004, Prime Minister Erdogan became the first Turkish head of state to visit Moscow in decades.⁴⁴ During this historic meeting, Erdogan signed a series of military and economic agreements with Russia aimed at laying the foundation for deeper bilateral cooperation, including energy. This convergence entered a new phase in May 2010, when Russian Prime Minister Dmitri Medvedev visited Ankara to initiate a new mechanism for top-level policy coordination, the Joint Strategic Planning Group, made up of top cabinet officials from both

⁴⁴ Bahri Yilmaz, *The Role of Turkey in the European Energy Market* (Malta: Mediterranean Academy of Diplomatic Studies, 2012), <http://research.sabanciuniv.edu/18977/1/Energy.BY.MEDAC.Malta.pdf>.

countries and chaired by their respective foreign ministers.⁴⁵ This approach matches Ankara's general template for strengthening bilateral ties with important neighbors, suggesting that Ankara views Russia as a vital element of its "zero problems" agenda.⁴⁶ As Turkish Foreign Minister Ahmet Davutoglu puts it, Ankara's relationship with Moscow "constitute[s] an integral component of Turkey's multidimensional foreign policy. We maintain a sincere and open dialogue with Russia in order to preserve and strengthen the atmosphere of mutual trust and to further our cooperation to the mutual benefit of both sides."⁴⁷

These interactions have led to growing strategic interdependence between the two states. Russia relies on Turkey as a path for diversifying its transit options, and Turkey relies on Russia for energy supplies. These developments are taking place against a backdrop of growing trade ties. In 2011, bilateral trade volume increased to a new high of \$31 billion,⁴⁸ and Turkish construction contracts in Russia are worth an estimated \$40 billion.⁴⁹ Against these dynamics, Turkey gave its blessing to the South Stream gas pipeline. Not only does this project disrupt Azerbaijan's attempt to break into European markets, but this mega-pipeline also complements Russia's North Stream pipeline by delivering gas without transiting Ukraine.⁵⁰ If fully completed, this project will allow Russia to transport an additional 63 bcm of gas to Europe.

Russia and Turkey benefit from energy cooperation, but this is not a partnership of equals. Russia's vast supplies and well-developed infrastructure allow it to negotiate from a position of advantage, with implications that reach beyond the energy arena. The Syrian crisis is an important indicator of this imbalance. As the crisis in Syria deepens, Turkey's borderlands have become a zone of acute crisis, threatening Turkish internal security. Viewing Syrian President

⁴⁵ Vladimir Likhachev, *The Role of Energy in Russia's Relations with Turkey and Iran*, part of "The Turkey, Russia, Iran Nexus: Regional Perspectives" (Washington, D.C.: Center for Strategic and International Studies, March 29, 2012), http://csis.org/files/attachments/120529_Likhachev_Russia_Energy.pdf; Faruk Akkan, "Turkey and Russia develop strategic alliance," *Today's Zaman*, January 29, 2012.

⁴⁶ Bulent Aras and Pinar Akpinar, "The Relations Between Turkey and the Caucasus," *Perceptions* 16, no. 3 (Fall 2011): 53–68.

⁴⁷ "Interview by Ahmet Davutoglu," *The Cairo Review of Global Affairs*, The American University in Cairo School of Global Affairs and Public Policy, March 12, 2012.

⁴⁸ Likhachev, *The Role of Energy*.

⁴⁹ Hasan Kanbolat, "Türk-Rus İlişkilerinde ÜDİK Boyutu," ORSAM, December 3, 2012; "Trade Forecast Update: Turkey," HSBC, February 2012, <http://tradeconnections.corporate.hsbc.com/~media/TradeConnections/Files/trade-forecast/february-2012/Turkey%20-%20February%202012.ashx>.

⁵⁰ Yilmaz, *The Role of Turkey*.

Bashar al-Assad as responsible for the crisis, Ankara has pushed for his ouster, by force if necessary. This position runs directly against Moscow's preferences, and Russia has worked consistently to foreclose a sudden collapse of the Assad regime. This incongruity surfaced publicly in October 2012, when Turkey intercepted a Russian passenger plane headed to Syria, suspecting it was transporting weaponry to the Assad regime. However, Turkey did not use the interdiction to attempt to embarrass Moscow, and it has been careful to prevent these fissures from damaging overall ties. Putin made a high-profile visit to Istanbul in December 2012, when a series of supplemental energy cooperation agreements were signed.⁵¹ Various factors are behind Ankara's efforts to manage its disagreements with Moscow; prominent among them is Moscow's vital role in supplying Turkey with gas in the winter months. Moscow is not only the largest, but also the most reliable supplier of Turkish gas, often stepping in when Iranian supplies falter and LNG deliveries are insufficient to fill the gaps. Losing Russia as a supplier of last resort would deal a serious blow to Turkey's energy security.

Not only is Russia the main supplier of Turkish gas, but also, because of long-term "take or pay" agreements, Turkey is contractually obligated to pay Russia for large volumes of gas it does not always use. As the spread between Turkey's contracted prices and the spot price of gas has widened, Turkey and its European neighbors have groaned under their contractual obligations. Turkey may have paid out as much as \$2.5 billion to Russia in 2011 for gas it didn't use under these ToPs.⁵² Another inducement for cooperation is Moscow's major role in Turkey's efforts to develop nuclear energy. Russia is responsible for the construction and provision of Turkey's first nuclear power plant in Akkuyu on Turkey's southern coastline. Critics have argued that this only enlarges the scope of Turkish energy dependence on Russia.⁵³

Azerbaijan

Turkish-Azerbaijani energy relations are more balanced than Turkish ties with Moscow. Turkey and Azerbaijan are currently linked by the South Caucasus gas pipeline, operated by BP. Energy cooperation serves the interests of both parties: Baku wants energy routes that can provide

⁵¹ "Rusya ve Turkiye Arasinda Enerjide 3 Anlasma Imzalandi," *Energy Enstitusu*, December 4, 2012.

⁵² Ercan Ersoy, "Botas of Turkey Had Loss of \$309 Million in 2011, Star Says," *Bloomberg*, April 2, 2012, <http://www.businessweek.com/news/2012-04-02/botas-of-turkey-had-loss-of-309-million-in-2011-star-says>.

⁵³ Cumhuriyet Halk Partisi, *AKP'nin Nükleer Macerasına Hayır!*, Enerji Komisyonu, November 2012, http://www.chp.org.tr/wp-content/uploads/2012/11/nukleer_enerji_raporu_kasim_2012_myk.pdf.

alternatives to Russia, and Ankara needs Baku for its own Caspian imports, as well as to further its aspiration to transport supplies to Europe. It also helps that Turkey pays less for Azerbaijani gas than for Russian or Iranian supplies.

However, in developing this relationship, Ankara would be remiss if it expects Baku to play a subordinate role. Indeed, Baku has shown its ability to use its energy leverage to serve its own interests when disagreements arise with Ankara—a tendency that reared sharply during Turkey's short-lived rapprochement with Armenia. In 2009, Turkey's AKP government seemed poised to break the ice with Armenia after a bout of “soccer diplomacy” that culminated in a set of protocols to move toward normalizing bilateral relations. For Baku, this stoked fears that Turkey might take pressure off Yerevan over the bitter dispute for control of the Nagorno-Karabagh region. As progress slowed, Azerbaijan made it clear that it opposed Turkish-Armenian rapprochement so long as this dispute remained unresolved. In the end, Ankara allowed the momentum to stall under the tacit threat of Azerbaijan renegeing on its cooperation with Ankara on energy issues.

More recently, Turkish business interests began to lobby for improved highway and rail linkages in the Caucasus to stimulate economic activity. Reportedly, these gestures raised the same concerns regarding Armenia, leading Baku to dispatch SOCAR (Azerbaijan's state-owned oil and gas company) representatives to quietly apply pressure against the plans.⁵⁴ Over the long term, Baku's impasse with Armenia represents a major obstacle to Turkey expanding its influence in the former Soviet space. Nevertheless, these fissures do not diminish the fact that Ankara and Baku cooperate closely. In October 2011, after long negotiations, Azerbaijan and Turkey agreed on transit terms for TANAP, a more modest version of the European-backed Nabucco project. This deal resurrected the prospect of a feasible initiative to bring Caspian gas to Europe and challenge Russian energy hegemony. But even this project testifies to Ankara's disadvantage in energy politics. Initially, Ankara had been asking for permission to reexport the full volume of its gas imports for a profit, but the final deal was more modest, permitting Turkey

⁵⁴ Paul Goble, “Turkey Wants to Open a Transportation Corridor through Georgia to North Ossetia,” *Eurasia Daily Monitor*, Jamestown Institute, November 16, 2012, http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=40128&tx_ttnews%5BbackPid%5D=27&cHash=42da4a091042364a297a11b0d0af56bd.

to consume or reexport a limited volume of its imports.⁵⁵ Furthermore, Azerbaijan's state-owned SOCAR took an 80 percent stake in the TANAP line, a portion of which it is looking to sell to international investors.⁵⁶ Also, SOCAR retains ultimate control over the supply. These terms suggest that Turkey is hardly Baku's "big brother" when it comes to energy cooperation. Even if SOCAR's stake is reduced as more partners join the venture, Baku is set to garner much of the economic and strategic benefit of TANAP.

Iran

With possibly the second largest proven reserves of natural gas on the planet, Iran would seem to represent a promising source for diversifying Turkish supply. However, Turkey's experience with Iran as a supplier has been plagued by commercial disagreement and unreliable supply. Worse, the international political climate casts additional uncertainty on the future of natural gas cooperation. Currently, Turkey's natural gas trade is not officially proscribed by US or EU legislation. However, Iran's exclusion from the international finance system has made an impact. For a time, the state-run bank Halkbank stepped in to facilitate payments for Turkish natural gas. Because sanctions prevent payment in dollars or euros, Turkey makes its payment in Turkish lira (TL). Iran has apparently been using these TL inflows to purchase massive quantities of gold from Turkish markets, effectively amounting to a massive gold-for-gas barter. This trade has caught Washington's attention, leading to measures that have made the exchanges more uncertain and costly.

Turkey and Iran have long had an uneasy energy relationship. In 1996, the Turkish government signed a long-term supply contract with Iran for 10 bcm of gas per year. Turkey's former prime minister Necmettin Erbakan, a politician known for his rhetoric in support of Islamic solidarity, spearheaded the agreement. The agreement was upheld by the secularist government that replaced Erbakan after his ouster by Turkish generals. After several delays, a pipeline running from Tabriz to Ankara was completed in 2002. With this pipeline in place, Iran makes a significant contribution to Turkey's gas needs. However, stunted by international isolation, Iran's gas industry is highly underdeveloped and unlikely to provide greater supply in the near term. In

⁵⁵ Vladimir Socor, "Aliyev, Erdogan Sign Inter-Governmental Agreement on Trans-Anatolia Gas Pipeline to Europe," *Jamestown Foundation*, June 27, 2012.

⁵⁶ "BP, Statoil, ve Total TANAP'a Ortak oldu," *Enerji Enstitüsü*, November 8, 2012.

previous years, the AKP government has sought to take advantage of this capital scarcity by promising to invest in Iranian fields that Western companies cannot enter due to sanctions. In 2007 and 2008, Turkey and Iran signed memorandums of understanding concerning the development of the Iranian South Pars field. According to these agreements, Turkey's TPAO would develop the field to reach an annual export capacity of 35 bcm, boosting Iran's ability to transit gas from Turkmenistan in addition to its own supplies. This agreement irked Washington, which warned Turkey not to initiate any deals that might conflict with sanctions on the Iranian regime.

Turkey has not yet acted on these plans, though in February 2010 Prime Minister Erdogan announced that Turkey still plans to increase energy cooperation and move forward on existing projects with Iran. In turn, Ankara granted a Turkish firm, Turang Transit, permission to build a pipeline from Iran to transport gas across Turkey to Europe. However, as Iran faces tightening European sanctions, finding a European destination for the gas will be difficult. Indeed, the future of Turkish-Iranian energy cooperation is gloomy against the backdrop of rapidly changing geopolitical dynamics. Set in motion by the Arab Spring and the US withdrawal from Iraq, Iran and Turkey are finding themselves in competition on a number of fronts. The two regional heavyweights are at odds in Syria, while Iraq becomes an arena of increasingly overt competition. These tensions have periodically manifested themselves in menacing rhetoric from Iranian parliamentarians, especially after Turkey agreed in 2011 to host a NATO radar facility capable of identifying missiles fired from Iran. Divisions between Iran and Azerbaijan add another dimension to this geopolitical cauldron. Not only is Baku aligned with the West on many issues, but it has also played a part in shutting Iran out of the Southern Corridor.

Chronic commercial friction has also plagued the relationship. Construction on the current Iran-Turkey pipeline was delayed for over three years due to snags on both sides, a harbinger of things to come. When the pipeline did eventually begin operation, supplies from Iran proved less reliable than expected. In 2006, Iran cut off supplies in order to meet domestic demand. Supplies were cut again in 2007 and 2008 due to supply disruptions from Turkmenistan. Sabotage by the PKK (Kurdistan Workers' Party) also results in periodic shutdowns. Turkey typically makes up for Iranian shortfalls with imports from Russia, an ironic outcome given that a major justification

for the Iranian line was its potential to reduce dependence on Moscow. Disagreements over pricing and terms have also been a problem. Turkey's long-term supply contracts have forced it to pay above market prices for Iranian gas for years. After ongoing disagreement, the two sides renegotiated contract terms in Turkey's favor. Still, Turkish complaints about the quality of Iranian gas continue, and Turkey pays comparatively high prices for Iranian gas. Again in 2011, Turkey requested renegotiation and arbitration to address these disagreements.

As Turkish and Iranian ambitions collide in the Levant and economic pressures mount on Tehran, the prospects for greater gas development grow ever distant. In fact, Ankara has more reason than ever to doubt the dependability of Iranian supplies. Amidst these uncertainties, Turkish energy minister Taner Yildiz continues to insist that Ankara will maintain its current level of gas imports from Iran.⁵⁷ Prime Minister Erdogan has remarked that Iranian gas imports are of strategic importance, and if asked to do so, Turkey would not include them in its efforts to economically pressure Iran.⁵⁸ But beneath this rhetoric, Turkey has been scrambling to secure greater LNG supplies from Qatar and Algeria, order higher volumes of gas from Russia, and expand its coal-fired generation capacity.

Overall, Turkey's major gas suppliers are unlikely to soften their stance any time soon. Changing the geopolitical balance to favor Ankara will necessitate attracting a wider variety of supplies, preferably from sources more compliant with Ankara's political interests. For over a decade, Ankara has been involved in plans to develop the Southern Gas Corridor with supplies from the Caspian basin, but as discussed above, this entails dependence on Azerbaijan. Recently, Ankara has shifted its gaze toward northern Iraq as an additional source of supply, as well as newfound sources in the Eastern Mediterranean. These new prospects are beset by political uncertainty, but they bear the potential upside of granting Turkey favorable terms from energy-rich client states.

⁵⁷ "10 yılda enerjiye ne kadar yatırım yapıldı?," *Haber 7*, November 2, 2012.

⁵⁸ "Erdogan: ABD'nin Enerji Konusunda Yaptirimlarına Uymagacagiz," *Enerji Enstitusu*, December 4, 2012.

Prospects for Diversification

The Southern Corridor

The ambition to deliver Caspian gas to European markets has excited Europe's imagination for over a decade, but as obstacles mount and commitments falter, some in Europe have concluded that the focus should shift closer to home, toward supplies in northern Africa and the Eastern Mediterranean.⁵⁹ Yet Turkey and Azerbaijan continue to envision a Southern Corridor, if perhaps a more downgraded version. For its part, Europe—to the extent it can speak with one voice—remains devoted to the general objective, as EU energy commissioner Günther Oettinger confirmed in November 2012.⁶⁰

The first grand plan for the Southern Corridor was the Nabucco line, favored by Europe because it bypasses Russia. In its original proposal, the Nabucco pipeline was to deliver gas from the Caucasus through Turkey and finally through southern Europe toward Austria. Russia answered with its own project, South Stream, routed across the Turkish section of the Black Sea toward Europe. This route bypasses Ukraine, giving Russia a southern route to add to the North Stream pipeline.

In addition to the challenge from South Stream, Nabucco was hamstrung by a number of difficulties, namely reluctance on the part of its financiers and the lack of a confirmed source of supply for its capacity. Meanwhile, Turkey authorized the South Stream pipeline in December 2011, and construction is scheduled to begin shortly. In South Stream's shadow, and against Nabucco's anemic prospects, Turkey and Azerbaijan made a separate deal on a pipeline to cross Anatolia toward Europe, the Trans-Anatolia Line (TANAP). This project would build on the capacity of the already operational South Caucasus gas line. TANAP would start small, with a capacity far below Nabucco's original design, but it would develop in stages, perhaps eventually reaching a capacity of up to 60 bcm.⁶¹

⁵⁹ Gulmira Rzayeva and Theodoros Tsakiris, *Strategic Imperative: Azerbaijani Gas Strategy and the EU's Southern Corridor* (Center for Strategic Studies under the President of the Republic of Azerbaijan, 2012).

⁶⁰ "Oettinger talks up Tanap pipeline," *Euractiv.com*, November 15, 2012.

⁶¹ Vladimir Socor, "Turkey Sees Opportunity in Trans-Caspian Gas Pipeline Project," *Eurasia Daily Monitor* 9, no. 164 (September 2012), [http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=39826](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=39826).

Gas from the Azerbaijani fields only promises 16 bcm for European markets, leaving a major supply gap that Turkmenistan could potentially fill. For the past decade, Turkmen supplies seemed destined to orient eastward in light of disputes over Caspian ownership and hungry markets in India and China. But in 2011, the EU Commission endorsed negotiations for purchasing Turkmen gas, and a year later the Turkish Ministry of Energy announced its intent to sign on to a deal for Turkmen supplies. This opening resurrected plans for a Trans-Caspian pipeline, this time slated to link with the proposed TANAP line.⁶²

As TANAP gained favor as an alternative to Nabucco, European firms entered the running to construct the western link bringing gas from Turkey to Europe. With price tags estimated in the \$3–7 billion range, as opposed to Nabucco's possible \$19 billion,⁶³ these projects were marketed as more conservative ways to achieve greater diversification in suppliers to Europe. The Trans Adriatic Pipeline (TAP), which will deliver gas to Italy, has become the first project to strike a deal with the Shah Deniz consortium. Other connectors from Turkey into Europe may gain acceptance as well. As a result, TANAP—combined with some of these smaller projects—would amount to a less ambitious “Nabucco in slices,” which would be capable of delivering Caspian gas to Europe for a smaller up-front price tag.⁶⁴

If nothing else, Ankara regards developing the Southern Corridor as a means for increasing its leverage in Europe, perhaps even prying open the door to the European Union. Turkish Prime Minister Erdogan attested as much in 2009 when he suggested that Ankara might use the Southern Corridor as a bargaining chip for Turkey's EU membership.⁶⁵ Under the right conditions, a high-capacity line crossing Turkey would make Ankara vital to European energy security, but plans in their current conception suggest that developing the Southern Corridor will not necessarily lead to overall greater independence for Ankara. If SOCAR holds onto its major

⁶² Ibid.

⁶³ Zoe Schneeweiss, “Nabucco Pipeline May Cost \$19 Billion, BP Says, Guardian Reports,” *Bloomberg*, February 22, 2012, <http://www.bloomberg.com/news/2011-02-22/nabucco-pipeline-may-cost-19-billion-bp-says-guardian-reports.html>.

⁶⁴ The authors are indebted to Tuncay Babali for this comment. See “Ankara assumes Nabucco West will win,” *United Press International*, May 16, 2012, http://www.upi.com/Business_News/Energy-Resources/2012/05/16/Ankara-assumes-Nabucco-West-will-win/UPI-57451337172735/.

⁶⁵ “Turkey may rethink Nabucco if EU talks stall,” *EU Observer*, January 19, 2009, <http://euobserver.com/15/27431>.

stake in TANAP and expands into downstream components of the supply chain,⁶⁶ Ankara will have to accept the reality that its gains depend on getting along with Baku. And even in the best scenario, volumes transiting the Southern Corridor will pale in comparison to Russian pipeline capacity.

Iraqi Kurdistan

Explorations in northern Iraq have revealed gas resources that could make a crucial contribution to the Southern Corridor. These supplies are also conveniently located near Turkey's burgeoning hub at the southwestern port of Ceyhan. For this reason, Turkey has long sought to exploit Iraqi energy supplies. Turkey has operated an oil pipeline with Iraq since 1973, and Turkish companies have been working directly with the Iraqi Kurds in gas and oil explorations for over a decade. However, the tilt toward deeper energy ties with Iraq's Kurdish region at the expense of Baghdad is a recent phenomenon.

Today, Turkey's relations with the Iraqi Kurds are at an all-time high. The Kurdistan Regional Government (KRG) has sought to portray itself as a constructive player in resolving Turkey's conflict with the Kurdish Workers' Party (PKK) and in steering the orientation of the Kurdish political awakenings in Syria, although its leverage in these areas may have proven weaker than Turkish officials hoped. Meanwhile, ties with Baghdad are suffering their darkest period in recent memory. Ankara suspects Baghdad is working in concert with Iran against Turkish interests across the region, and a personal feud between Erdogan and Prime Minister Nouri al-Maliki of Iraq has enflamed the rivalry. Political consideration aside, Baghdad appears to have less to offer in terms of natural gas. Baghdad has signaled a preference for developing its gas reserves for domestic consumption, not export to Europe. When export plans are discussed, selling gas to Arab neighbors seems to be the priority.

This configuration could make for a major change in Ankara's gas policy. Ankara has traditionally insisted on making all its purchases of Iraqi energy through the central government. Discussion of Iraqi natural gas exports first began in 1996 under Saddam Hussein. After Hussein's fall, Turkey continued its preference for Baghdad. In 2009, Erdogan met with al-

⁶⁶ For an analysis of Baku's strategic outlook, see Rzayeva and Tsakiris, *Strategic Imperative*.

Maliki in Baghdad to sign a number of strategic collaboration agreements, including support for the construction of an 8 bcm natural gas line from Iraq to Turkey.

Yet, in light of the fissures between Baghdad and Ankara, Turkish officials have shown more tolerance toward energy cooperation with the Iraqi Kurds, an attitude Baghdad abhors. And Turkish energy firms have moved quickly. On May 22, 2012, the KRG hosted an international energy conference to showcase its potential as a supplier. On this occasion, BOTAS international general manager Ibrahim Palaz remarked that Turkey was eager to purchase northern Iraqi gas for export to Europe. So far, Ankara has eschewed gas deals that directly defy Baghdad, and Turkey's bilateral agreements with Baghdad, as well as international legal complications, would likely preclude any direct violation. Moreover, many of these finds have been in disputed territories, further complicating any attempt of the Iraqi Kurds to export independently of Baghdad.

All the same, Baghdad has been brandishing its ability to push Turkey out of Iraq's rich energy opportunities. In November 2012, Baghdad suddenly revoked TPAO's permission to operate on a field in southern Iraq,⁶⁷ and shortly thereafter, Baghdad refused to grant its blessing for a natural gas project in Iraqi's north.⁶⁸ Baghdad has resorted to any number of creative tactics to rankle Ankara, threatening to close its airspace to Turkish planes⁶⁹ and denying Turkey's energy minister permission to land in Erbil in an attempt to block Turkish discussions on energy cooperation with the KRG.⁷⁰

The Eastern Mediterranean

The combined energy wealth of the natural gas fields in the Eastern Mediterranean could rank among the largest gas reserves in the world.⁷¹ With the proximity of these supplies to Turkey's emerging hub at Ceyhan, cooperation between Israel, Cyprus, and Turkey has great commercial

⁶⁷ Ahmed Rasheed, "Iraq says Exxon to quit oilfield, ends Turkey TPAO deal," *Reuters*, November 7, 2012, <http://www.reuters.com/article/2012/11/07/us-iraq-exxon-idUSBRE8A60Y420121107>.

⁶⁸ "Petrolde sonra doğalgazda da Irak'tan kötü haber geldi," *Enerji Enstitüsü*, November 10, 2012.

⁶⁹ "Turkish Planes Stranded in Arbil as Iraq Closes Airspace," *Today's Zaman*, July 17, 2012.

⁷⁰ Orhan Coskun, "Turkish minister's plane denied permission to land in N. Iraq," *Reuters*, December 4, 2012, <http://www.reuters.com/article/2012/12/04/turkey-iraq-minister-idUSL5E8N48HX20121204>.

⁷¹ United States Geological Survey, *Assessment of Undiscovered Oil and Gas Resources of the Levant Basin Province, Eastern Mediterranean*, World Petroleum Resources Project, 2010.

potential. However, the promise of this supply is overshadowed by the various overlapping political disagreements dividing the region. First, Cyprus' unresolved division has made it impossible for Turkey to welcome Cypriot energy finds. Meanwhile, Turkey and Israel are experiencing the worst relations in recent memory, turning recent discoveries into a cause for brinkmanship, rather than cooperation.

Cypriot national sovereignty has been a topic of bitter conflict for decades, and the island remains divided between its Turkish and Cypriot population. Turkey is the only nation that recognizes Turkish Northern Cyprus as a legally independent state—and the Republic of Cyprus continues to hold that it “represents the people of Cyprus as a whole, including Turkish Cypriots.”⁷²

This conflict has led to disagreement over who has the right to explore and benefit from potential gas windfalls near Cyprus. Turkey claims that Cypriot control over gas will only worsen conditions for Cyprus' Turkish population, and Ankara stands firmly opposed to exploration under current political conditions. Nicosia has rebuffed Ankara and moved quickly to exploit its potential undersea wealth. Cyprus first issued licenses for hydrocarbon exploration in 2007. Then, in December 2011, the US firm Noble Energy announced it had discovered 5–8 Tcm of gas in Cyprus's Exclusive Economic Zone. Cyprus has subsequently settled its maritime border with Egypt and Israel, laying the groundwork for extraction,⁷³ while Lebanon has signed—but not ratified—a maritime border agreement.⁷⁴

Turkey has responded forcefully. Ankara sent its own armed exploratory expeditions to the area in 2011⁷⁵ and made counter-claims to undersea blocs based on the assertion that sections of the

⁷² The Exclusive Economic Zone of the Republic of Cyprus Hydrocarbon Exploration,” Embassy of the Republic of Cyprus, October 2011.

⁷³ Ibid.

⁷⁴ “Israel, Cyprus gas finds spur Mediterranean race,” *Jerusalem Post*, April 19, 2012, <http://www.jpost.com/DiplomacyAndPolitics/Article.aspx?id=266767>.

⁷⁵ *Emre Peker and Stelios Orphanides*, “Erdogan's Fighter Jets Challenge Cypriot Gas Exploration in Mediterranean,” *Bloomberg*, October 9, 2011, <http://www.bloomberg.com/news/2011-10-09/erdogan-s-gunboats-challenge-cyprus-gas-search-in-mediterranean.html>.

waters west of Cyprus are part of its own continental shelf.⁷⁶ In April 2012, as the Republic of Cyprus prepared to issue another round of bids for exploratory licenses, Turkey's TPAO began its own exploratory drilling off the waters of northern Cyprus, a move that Nicosia denounced as illegal.⁷⁷ Shortly thereafter, Cyprus issued an international tender, provoking a retort from Turkey threatening that companies taking part would be barred from cooperation with Ankara.⁷⁸

Israel is another newcomer to the Eastern Mediterranean gas game. In December 2010, Nobel Energy announced major discoveries in the offshore Leviathan and Tamar gas fields.⁷⁹ These are timely discoveries for Israel, as its long-term gas agreements with Egypt are suddenly in jeopardy after the revolution in Cairo.⁸⁰ In fact, until newfound supplies are operational, Israel faces a natural gas shortage and may be forced to replace gas with costly fuel oil in its factories.⁸¹ But if energy resources near Israel can be developed, the country will suddenly be in a position not only to meet domestic demand, but to export gas as well. However, any future export scheme is complicated by the deteriorated state of Turkish-Israeli ties, especially after the Mavi Marmara incident in which Turkish citizens were killed in an Israeli operation aimed at preventing activists from reaching Gaza.

Israel has looked for alternatives to Turkey by cooperating with Cyprus. In 2010, Cyprus and Israel signed a maritime border agreement, although the border with Lebanon remains in dispute.⁸² Still, without Turkey, the prospects of this venture are uncertain. Israel has yet to commit to a concrete plan for cooperation with Cyprus, and without Turkey, export options are

⁷⁶ "Turkey warns of faceoff over east Medgas," *United Press International*, May 25, 2012, http://www.upi.com/Business_News/Energy-Resources/2012/05/25/Turkey-warns-of-faceoff-over-east-Medgas/UPI-52041337977383/.

⁷⁷ Menelaos Hadjicostis, "Turkey seeks oil, gas in north Cyprus," *Associated Press*, April 26, 2012, <http://www.washingtontimes.com/news/2012/apr/26/turkey-seeks-oil-gas-in-north-cyprus/>.

⁷⁸ "Turkey Warns Firms for Greek Cyprus Gas," *Journal of Turkish Weekly*, May 19, 2012, <http://www.turkishweekly.net/news/136408/turkey-warns-firms-for-greek-cyprus-gas.html>; "Turkey warns oil majors against Cyprus gas bid," *Today's Zaman*, May 18, 2012, <http://www.todayszaman.com/news-280732-turkey-warns-oil-majors-against-cyprus-gas-bid.html>.

⁷⁹ "Noble lands gas deal with Israel," *United Press International*, March 16, 2012, http://www.upi.com/Business_News/Energy-Resources/2012/03/16/Noble-lands-gas-deal-with-Israel/UPI-26601331897943/.

⁸⁰ Edmund Sanders, "Egypt-Israel natural gas deal revoked for economic reasons," *LA Times*, April 23, 2012, <http://articles.latimes.com/2012/apr/23/world/la-fg-egypt-israel-oil-20120424>.

⁸¹ Simon Henderson, *Energy Resources in the Eastern Mediterranean: Source for Cooperation or Fuel for Tension?*, (Washington, D.C.: German Marshall Fund, April 2012).

⁸² *Ibid.*

economically costly. Linking with the Turkish hub at Ceyhan appears to be the most commercially sound option, the political obstacles notwithstanding.⁸³

Meanwhile, Ankara has continued to flex its muscles to deter further exploration. On May 16, 2012, Turkish jets intercepted an Israeli fighter flying off the coast of northern Cyprus, signaling Ankara's willingness to up the ante in a dangerous game.⁸⁴

Overall, the fate of Turkish-Israeli relations will likely decide Turkey's potential role in exploiting Eastern Mediterranean gas fields. If strains between Turkey and Israel persist, Israel may cement its overtures toward the Greek Cypriots. In response, Ankara could use its hard power to press its claims for resources within its continental shelf, if for no other reason than to complicate Nicosia's efforts at scoring a financial windfall for Cyprus, a development the Turks fear would strengthen Nicosia's bargaining position.

Scenarios Analysis

This section will analyze Turkey's natural gas prospects under four distinct counter-factual scenarios introduced in the Baker Institute's July 2012 scenarios workshop. In the Turkish context, the two major variables examined will be: 1) Turkish economic growth and internal politics; and 2) Turkey's dependence on Russia and the future of the Southern Corridor. These scenarios will also include a constant related to Turkey's relations with Iraqi Kurdistan. This assessment will assume that Turkey will grow more willing to place its bets with the KRG for gas deals. However, political turbulence between the KRG and Baghdad will impede the rapid start-up of major projects.

⁸³ Ibid.

⁸⁴ "Turkish warplanes intercept Israeli jet violating Turkish Cyprus airspace," *Today's Zaman*, May 16, 2012, <http://www.todayszaman.com/news-280604-turkish-warplanes-intercept-israeli-jet-violating-turkish-cyprus-airspace.html>.

1. Shale Success, Liberalization Increases

Turkish Economic Growth and Internal Politics

Lower natural gas prices benefit Turkish consumers and industry, promoting economic growth. The AKP reaps the political benefits and continues to consolidate its power in a stable environment, able to maintain party unity and electoral success in 2014–2015. Turkey also begins to benefit from the gradual exploitation of its own shale reserves. However, the sensitive location of the resources gives rise to new political cleavages and adds a new layer of complexity to Turkey's Kurdish issue.

Turkey's Dependence on Russia and Prospects for the Southern Corridor

Greater and more diverse gas supplies embolden European decision-makers to directly challenge Russia's energy position. This creates the political will for the Southern Corridor to transit Turkey. However, Russia responds by abandoning the oil-indexed price regime, and Moscow begins to test its competitive edge by lowering its own prices, enabled by its domestic liberalization. With these quantity and price shifts, the sizable investment required for the Southern Corridor no longer boasts much economic appeal, and actual action on these projects is unlikely. However, rhetoric favoring these projects continues, if only as a jab to Moscow and an instrument to assert political unity. Small-scale deals with the KRG continue, but government-to-government agreements are unlikely.

2. Shale Failure, Liberalization Failure

Turkish Economic Growth and Internal Politics

Unable to quickly scale up its share of renewable energy production, Turkey remains locked into its high reliance on natural gas. This hurts the competitiveness of Turkish products abroad and has inflationary impacts at home. These economic troubles give rise to a more vocal opposition within the AKP. Erdogan reacts by pulling to the far right of the political spectrum to produce a rally-around-the-flag effect and sideline his rivals. As part of this tactic, he takes an uncompromising line on the Kurdish issue, using national security and national unity discourse to win political advantage. The resulting polarization leads to new outbreaks of violence and unrest. The PKK stokes this discord and improves its logistical ties with regional backers in Syria and Iran.

Meanwhile, a protectionist global environment encourages ambivalence on the future of BOTAS reform and temptations grow to weaken EMRA, the independent regulator. Desperate political leaders look for levers to stimulate support among their constituents, and fragmented leadership creates more opportunities to exploit public assets for private gain.

Volatility at the highest levels of government becomes a growing problem. Moderates in the party become privately, and even publicly, critical of the top leadership, creating difficulties in policy implementation and lapses in parliamentary discipline. Intraparty fractures and rivalry become a distinct possibility.

Turkey's Dependence on Russia and Prospects for Southern Corridor

Lack of liberalization and a clear, compatible regulatory framework forestalls the development of a diversified gas hub in central Europe. This makes it impossible for the European Union to conduct an effective gas policy, and collective action problems dissuade European actors from pursuing an aggressive diversification agenda. Only a catastrophic scenario, such as the collapse of the Russian state, seems sufficient to create conditions that would induce European willingness for the Southern Corridor.

Sensing the change in political winds, Turkey places its bets with Russia's South Stream pipeline, even though it stands to collect only paltry economic or geopolitical benefit. Ankara hopes currying favor with Moscow will at least result in more flexibility on take-or-pay contracts, as well as continued assistance in developing nuclear energy. Iraqi gas begins to flow to Turkey, but it is restricted to Turkish markets, and the low prices are absorbed as rents for the well-connected or to subsidize politically important consumers.

3. Shale Failure, Liberalization Success

Turkish Economic Growth and Internal Politics

For Ankara, this could be the most economically and geopolitically beneficial scenario. Turkey eventually frees itself from high-priced, long-term commitments by increasing LNG imports and diversifying its pipeline infrastructure. Eager markets in Europe boost Turkey's bargaining position with both suppliers and demanders, and Turkey uses this advantage to extract rents and negotiate lower prices for its own consumers.

Turkey's Dependence on Russia and Prospects for Southern Corridor

Turkey follows Europe's lead and develops its own integrated and financially deep gas market. This enables gas from the Caspian, Iraq, and potentially the Eastern Mediterranean to flow through Turkey into Europe. With operations and ownership in private hands or governed by internationally binding agreements that Turkey is loath to violate, Ankara will have limited ability to use gas coercively. However, Turkey's importance to Europe will grow, weakening the obstacles to Turkish EU accession. Turkey also benefits from flexible LNG cargoes arriving from North Africa and the Gulf. With these options at hand, Turkey gently weans itself from long-term contracts with its major suppliers, replacing them with agreements that carry less volume risk.

4. Shale Success, Liberalization Failure

Turkish Economic Growth and Internal Politics

The rise of shale has some supply-side benefits for Turkey. Falling demand for LNG in the United States frees cargoes for delivery to Turkish markets. Meanwhile, witnessing the success of shale in the United States and Europe, Turkey exploits its own shale deposits in the southeast. However, with limited mobility of supplies across borders, Ankara remains mostly reliant on its long-term supply contracts with its major suppliers. These volumes are not retransmitted to markets in Europe. The result is doubly painful: Turkey faces high prices for gas, and is unable to capture rents from transit. These conditions become a chronic drag on the Turkish economy.

Limited success in shale exploration allows for some increase in domestic production. Feeling threatened by these developments, Turkey's Kurdish nationalists strike back. Using environmentalist and leftist rhetoric, Kurdish nationalists politicize the issue and mobilize a vocal grassroots opposition force. Kurdish politicians take to the streets, chanting slogans and giving speeches that label shale exploration a new iteration of the state's longtime practice of exploiting the Kurdish community.

Turkey's Dependence on Russia and Prospects for Southern Corridor

The fragmented market in Europe is not hospitable to Southern Corridor supplies, and shale development dampens the sense of urgency in key European states, even as some European

buyers face gas shortages as Russia reroutes supplies to Asia. This fragmented infrastructure and political incoherence dooms the Southern Corridor to interminable limbo.