

Restoring Brotherly Bonds TURKISH-AZERBAIJANI ENERGY RELATIONS

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In Eurasian energy politics, the relations between regional powers are as central as their relations with global powers. Few are of more consequence than the relations between Turkey and Azerbaijan. Given past price disputes, inconclusive negotiations on the Nabucco gas pipeline project, and, most recently, the June 2012 Trans-Anatolian pipeline (TANAP) agreement, Turkish-Azerbaijani energy relations have proceeded with ups and downs. However, since late 2011, they have begun to gain momentum anew.

Turkey's energy relations with Azerbaijan have become increasingly important, as Turkey has been trying to diversify its energy resources in terms of both energy type and country of origin. It has also been struggling to be an energy bridge between major oil and gas resources of Eurasia and energy-thirsty Europe.

Turkey is an energy dependent country, importing \$54 billion worth of energy in 2011 (corresponding to approximately 69 percent of Turkey's balance of accounts deficit). It imports 58 percent of its natural gas and 12 percent of its crude oil (2011) from Russia. It also imports 19 percent of its gas and 51 percent of its oil from Iran. In comparison, Azerbaijan's share of Turkish natural gas imports is relatively low (about 10 percent of Turkey's total natural gas imports), and its share of Turkish oil imports is marginal (less than .5 percent). Yet future uncertainties about potential pipeline projects, as well as the impact of the Arab Spring, can create changes in supplies resulting in a higher share for Azerbaijani gas.

Political issues are also important in shaping Turkish-Azerbaijani energy relations. The signing of an April 2009 agreement between Turkey and Armenia, which defined a provisional roadmap for normalizing relations, created discomfort in Azerbaijan. Just three days after the signing of the agreement, the president of SOCAR, Azerbaijan's state-owned oil and natural gas company, demanded a new deal on energy

prices, as the agreement that had defined natural gas prices had expired in 2008. Since then, Turkey had been importing natural gas at the old prices. The fact that Azerbaijan played the gas price card right after the Turkish-Armenian rapprochement had begun suggested that developments in foreign relations still strongly affected energy policy.

The result was a new compromise. The Turkish minister of energy at the time, Hilmi Güler, declared that there was no disagreement but negotiations continued apace. At the start of May, Turkish Prime Minister Recep Erdoğan reshuffled his cabinet (in response to the AKP's relative setback in local elections earlier that year) and Güler was ousted in the process. It has been argued that the ongoing price dispute had an impact on this decision. Whatever the cause, the first task of the new minister, Taner Yıldız, was to deal with the price dispute. Following technical bilateral negotiations, a visit to Azerbaijan by Erdoğan in mid-May was instrumental in easing tensions. During the visit, the Turkish side assured Baku that they would not violate Azerbaijani interests in their negotiations with Armenia, while Erdoğan acknowledged that a new deal would be made on fair pricing.

After this promise to resolve the price dispute, Turkish-Azerbaijani energy relations entered a new phase with a July 2009 intergovernmental agreement on the Nabucco pipeline. The main goal of the Nabucco pipeline, which aimed to take Azerbaijani natural gas to eastern and central Europe through Turkey, was a diversification of European energy suppliers and routes. However, serious concerns have plagued the project from the outset. One main challenge was the lack of throughput commitment, especially from Turkmenistan. Moreover, questions about the amount of resources available to finance and sustain the project caused repeated hesitation among investors. Also, the EU partners failed to evince a strong determination and a consensus to realize the project. Russia has also been a persistent obstacle. Since the Nabucco pipeline threatened its East-West energy transit monopoly, Moscow tried to prevent Nabucco from going forward by pressuring Turkmenistan and Kazakhstan, which were to be important suppliers.

In 2010, the price dispute between Azerbaijan and Turkey was finally settled through agreement on the Shah Deniz-II (or Stage 2) project, a major expansion of Azerbaijani gas production and westward export. During the negotiations, the parties also discussed prices on Shah Deniz-I gas. According to the agreement signed in June 2010, Turkey agreed to pay compensation to Azerbaijan for importing gas at pre-2008 prices. In the end, the parties agreed on a new pricing deal. As is customary with Turkish-Azerbaijani gas deals, the new net price remained confidential, but parties confirmed that prices would now fluctuate according to market conditions. Turkey would reportedly retain a discount in its import price for Azerbaijani gas, relative to the price it pays for Russian imports.

Uncertainty about the future of Nabucco and Russia's policy aiming to maintain its monopoly on energy transit led Turkey and Azerbaijan to seek new initiatives. The two sides signed a memorandum of understanding on a new Trans-Anatolian pipeline project (TANAP) in the last week of 2011. At the time when the agreement was signed, the prospects for Nabucco looked bleak. According to the agreement, about 16 billion

cubic meters (bcm) of natural gas are to be transported annually, with Turkey using 6 bcm and Europe receiving the remaining 10 bcm. TANAP's capacity is expected to reach 31 billion bcm—Nabucco's planned full capacity—in fifteen years. In June 2012, Erdoğan and Azerbaijani President Ilham Aliyev inked the deal to launch TANAP with the first gas to flow in 2018.

Many have said that TANAP is the end of Nabucco, or at least a serious competitor to it. In response, Yıldız said that TANAP and Nabucco could easily be merged, with Azerbaijani gas added to Nabucco in Bulgaria, rather than in Georgia as was originally planned. Yıldız's expectations turned out to be correct. Two days after the agreement, the Shah Deniz gas producers' consortium announced that a shortened "Nabucco West" would take Caspian gas to Europe. Still, the final configuration of pipelines remains uncertain. TANAP may still be the "kiss of death" for the Nabucco project while breathing life into a more limited, yet far more feasible pipeline. Most likely, Nabucco West will operate only between the Bulgarian border and Baumgarten in Austria, with TANAP replacing almost two-thirds of the Nabucco pipeline project.

TANAP's only major contender is the Trans-Adriatic Pipeline (TAP), which can potentially be used to transit Stage-2 Azerbaijani gas via Greece to Italy. Only when capacity is increased after 2023 will there be a need for other suppliers. The Shah Deniz consortium will continue to negotiate with the owners of these two selected pipeline options and is expected to make its final investment decision by mid-2013. Reviving Nabucco, even in a more limited version, will be significant to Azerbaijan, Turkey, and European states. A combination of TANAP and Nabucco-West or TAP will allow for the transfer of large quantities of Azerbaijani gas to Europe.

It may also give Baku leverage in its relations with Moscow. Russia is one of Azerbaijan's biggest economic partners, and Russian purchases of Azerbaijani gas will increase in the near future. Likewise, Russia plays an important role in regional political issues that directly concern Azerbaijan (such as the Karabakh conflict and relations with Iran). The transfer of Azerbaijani gas to Europe could create an opportunity to mitigate Russian influence over Azerbaijan. The collaboration will also serve SOCAR's goal of becoming an important energy player through extensive penetration into the rapidly growing Turkish market

The deal is also important for Turkey. A gas supply of 6 bcm a year from Azerbaijan will do much to diversify Turkish energy sources. In addition, Azerbaijani SOCAR and Turkish Turcas have agreed to build a refinery in Izmir, which can refine almost 10 million tons of oil. This will help realize the Turkish goal of becoming an energy hub.

At the same time, the prospect of moving forward with TANAP requires Ankara to play an even more delicate balancing game with Moscow. Russia remains the leading natural gas supplier of Turkey, and these projects are considered threats for Russian domination of Turkish and European energy markets. Especially since the United States is not as engaged in the Eurasian energy game in natural gas (as it was with the BTC oil pipeline), regional actors such as Turkey and Azerbaijan have to be more accommodating toward Kremlin pressures.

This is why Ankara signed an agreement with Moscow enabling Russia to transport natural gas to Europe via the planned South Stream pipeline that is to cross the Black Sea from Russia to Bulgaria via Turkey's Exclusive Economic Zone. The South Stream pipeline will enable Russia to diversify its transfer routes and bypass Ukraine. Vladimir Putin called this agreement a "New Year's gift" from Turkey. The agreement was signed just two days after the December 2011 signing of the TANAP memorandum of understanding. As another part of this balancing game, Turkey signed an agreement with Russia to construct its first nuclear power plant in Akkuyu, Mersin.

The latest developments in Turkish-Azerbaijani energy relations have important implications for the region. TANAP is an important opportunity for Turkey and Azerbaijan to enhance their bilateral relations and decrease their respective dependencies on Russia. At the same time, as indicated by Turkey's recent show of support to Russia for the South Stream project (along with their new nuclear energy partnership), Ankara continues a balancing act in the region that may very well be producing dividends.

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