

Securing Energy Supply to Turkey: Should Ankara Continue to Invest into Azerbaijan's Energy Sector?

Vugar Bakhshalizada¹

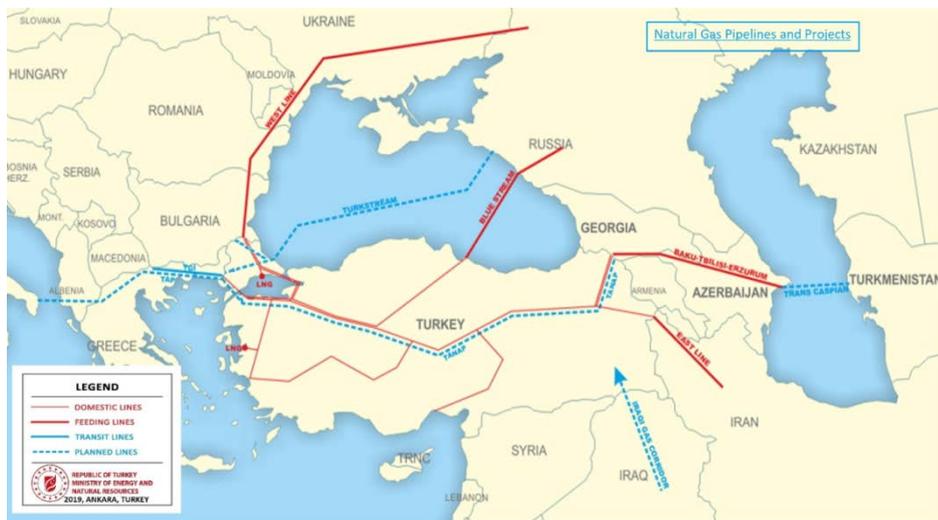
EXECUTIVE SUMMARY

After the dissolution of the Soviet Union, Turkey developed strong relations with newly independent states in the South Caucasus. Azerbaijan became the main destination for Turkish investments in the region due to Azerbaijan's significant amount of proven hydrocarbon resources. To this end, Turkey has invested around \$11.8 billion in Azerbaijan, including \$9.1 billion to oil and gas development (Ministry of Economy of the Republic of Azerbaijan, 2018). ²Ankara's long-term strategy is to turn Turkey into major energy (gas) hub: connecting all transportation routes from Middle East (Iran, Iraq, and maybe Qatar in future); Caspian Sea region (Kazakhstan, Turkmenistan, Azerbaijan), and Russia (South Stream). Moreover, Turkey also becomes not only transportation hub, but gas supplier too. Buying the gas for lower prices from suppliers and reselling it to European Union, would make Turkey invaluable partner and would increase Ankara's political and economic position in the region. Pursuing this idea, Turkish government tried to make Azerbaijan as successful example, investing into its gas and oil projects, and benefiting from it. Such policy helps official Baku too. Azerbaijan from its side gets necessary financial resources to develop its resources and expand export potential. Furthermore, the financial resources it derives from the sale of its hydrocarbon resources help it to greatly modernize its military as well as get necessary funds for further economic development. The following memo will attempt to see whether Turkish policy toward Azerbaijan was justified and successful. Moreover, it will try to estimate the implications of recent oil prices drop and COVID19 consequences for this policy. Finally, the memo will suggest a set of recommendations for the Turkish and Azerbaijani policy-makers on how to cope with recent challenges to strengthening Turkey's energy security and Azerbaijan's economic development.

Key words: Turkey; Azerbaijan; Energy; Hydrocarbon; Resources; Investment.

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² Ministry of Economy of the Republic of Azerbaijan, 2018.



Existing and Planned Pipelines to Turkey from Iran, Iraq, Russia, and Azerbaijan (Republic of Turkey Ministry of Energy and Natural Resources).

Introduction

Turkey's energy market has long been dominated by the Russian, Iraqi and Iranian energy sources. However, due to the geopolitical rivalry with Russia and a risk of a potential instability in both Iran and Iraq, Turkey has been trying to minimize the shares of those countries in its energy portfolio because of the several reasons. First, the overdependence on Russian gas and oil is politically problematic. Russia can always use "gas weapon" tool to pressure the Turkish government in a political crisis as it did before in case with Ukraine (Brown, 2019).³ For example, after the downing of Russian Su-24 aircraft by the Turkish Air Forces, it was a hotly debated topic in Russia to punish the Turks by cutting the energy supply to Turkey, threatening Turkey's gas-fueled economy. That time Russia provided more than 56% of Turkey's gas demand. Any interruption in the supply line would cost Turkey billions of dollars as its economy and industry are highly dependent on gas imports from Russia. For this very reason, Turkey is interested to diversify away from Russian gas and oil as much as possible.

The case with Iran is pretty similar since the country is both a regional rival to Turkey and vulnerable to instability within its own borders fueled by US sanctions. The re-imposition of US sanctions on Iran since May, 2018 significantly curtailed Turkey's import of Iranian gas and oil. In 2018, Reuters reported that the Iranian crude exports to Turkey have fallen to 500,000 barrel per day (bpd) while prior to May 2018, when the U.S. pulled out of the Iran nuclear accord, Turkey imported an average of 912,000 tonnes of oil a month from Iran, or 47% of its total imports. Furthermore, the recent massive protests and calls by the Iranian people to overthrow

³ Brown, Sierra (2019) "Russia's Use of the Energy Weapon: How Russia Manipulates Ukraine, Georgia, and the Baltic States," Scholarly Horizons: University of Minnesota, Morris Undergraduate Journal:Vol.6:Iss.1, Article 1.

the government in Tehran alarm the policy-makers in Ankara that any future instability would potentially cause the interruption of oil and gas supply and harm the Turkish economy.

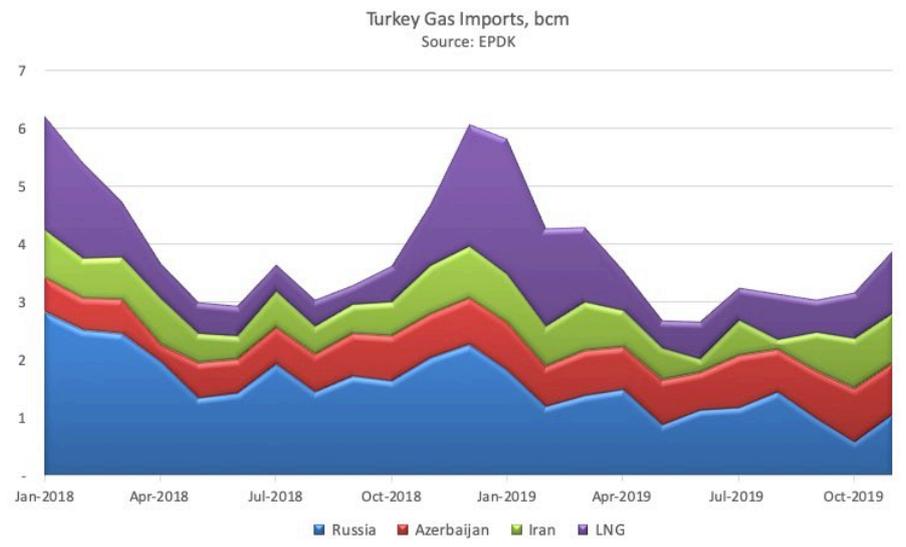
For aforementioned reasons, the energy supply to Turkey by Russia and Iran is quite problematic and troublesome. To this end, Azerbaijan is much more reliable partner for Turkey since it is politically quite stable. Currently, according to OPEC statistics, Azerbaijan's proven natural resources make around 1.27 trln cubic meters. The country is a net exporter of hydrocarbon resources to the world, particularly Turkey and the European Union (Svante E. Cornell, 2019).⁴ In 2018, more than 80% of the exports were merely belonging to the energy sector (The State Statistical Committee of the Republic of Azerbaijan, 2019).

Azerbaijan provides better and secure alternative to the Russian and Iranian gas in the Turkish market, Turkey has been increasing its import of Azerbaijani gas. For example, in 2019, Turkey's gas imports from Azerbaijan rose to 24,3% from 11% in 2016 while imports from Russia and Iran significantly declined (Energy Market Regulatory Authority of the Republic of Turkey-EPDK, 2019).⁵ According to EPDK, Russia's share in Turkey's gas market in 2019 fell to 38% from 56% in 2016. The official statistics indicates that in 2019 Russian Gazprom delivered 14,4 bcm of gas to Turkey, 43% down in 2018 (G. Abay, 2019).⁶ Moreover, the pipeline projects constitute an important gain for Turkey, as it provides Ankara with greater geopolitical importance as an energy corridor between the East and West. For this matter, Turkey puts greater importance on Azerbaijan and its energy sector. Furthermore, the energy projects between Turkey and Azerbaijan benefit the latter as it effectively excludes Armenia and isolates it from the regional energy projects. Additionally, with the participation of Turkey and, to a certain extent, European Union, Azerbaijan gains greater independence from Russian influence as the new pipelines cross Georgian and Turkish territories rather than Russian soil. To this end, this interdependence between Azerbaijan and Turkey leads both sides to deeply cooperate. However, Azerbaijan's capacity to fully provide the amount of energy Turkey needs annually is limited. For example, Azerbaijan produces about 29 bcm of gas annually while Turkey needs more than 50 bcm of gas per year. For this matter, Turkey needs to develop further initiatives for the future to better secure its energy supply. In this sense, this policy brief will provide a set of recommendations for the Turkish authorities to consider.

⁴ Cornell, Svante. "Are Georgia-Azerbaijan Relations at Risk?". The Central Asia-Caucasus Analyst. 2019,

⁵ Energy Market Regulatory Authority of the Republic of Turkey-EPDK, 2019

⁶ Abay, Gurkan. "Turkey's gas imports from Russia down 43% in 2019", Anadolu Agency, 2019,



1. List of Countries from which Turkey imported most of its gas demands in between 2018-2019.
Source: EPDK or Energy Market Regulatory Authority of the Republic of Turkey.

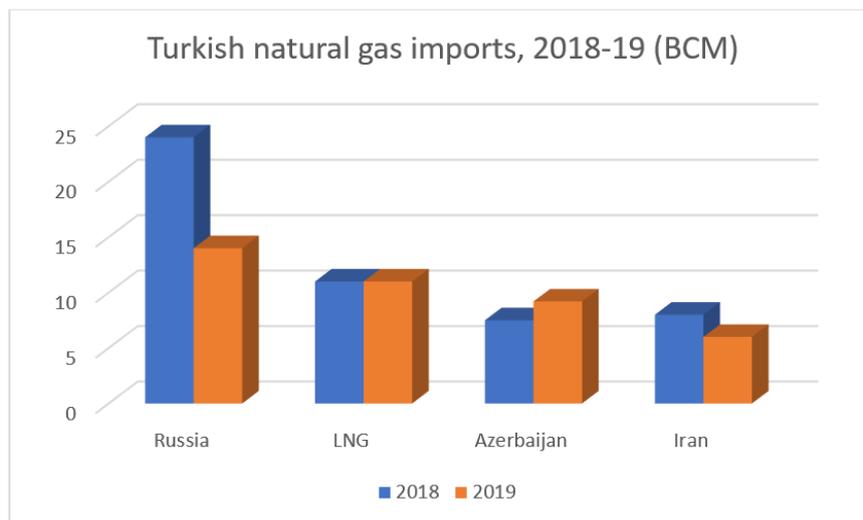
Turkey's Push to End Russo-Iranian Dominance in Turkish Energy Market

Turkey gradually increased the import of Azerbaijani gas that allowed Ankara to decrease some Russian gas import (appx.1). For example, according to Middle East Institute's 2020 Statistics⁷, Turkey has increased its imports of Azerbaijani gas in 2019 while substantially reducing the imports of Russian and Iranian gas. Turkey's Energy Market Regulatory Authority (EPDK) in 2019 reported that natural gas imports from Iran have nearly dropped to one-third compared with the same period in the previous year. According to the statistics of EPDK⁸, in 2019, Russia and Iran constituted 38% and 10,5% of the total gas supply to Turkey, respectively. This in itself indicates that there is a strong incentive among Turkish policy-makers to downsize Turkey's main regional rivals, Russia and Iran's role in the country's energy market while strengthening smaller players like Azerbaijan. Despite recently being repaired after the downing of Russian Su-24 in 2015, the relations between Russia and Turkey are again tense due to the Idlib Crisis in Syria and Russian military build-up in the Black Sea. Therefore, Turkey perceives Russian domination of its gas market as a grave threat to its energy security and unacceptable vulnerability. This derives the Turkish policy-makers to seek other players in the market to diversify its sources of energy away from Russia as much as possible. The same logic applies to Iran as well. Iran and Turkey have clashing regional and sub-regional interests in both the Middle East, the Caucasus and beyond. Furthermore, after the re-imposition of the US sanctions

⁷ Middle East Institute Statistics, 2020

⁸ Energy Market Regulatory Authority of the Republic of Turkey-EPDK, 2019

on the Iranian government, it became even harder to import Iranian hydrocarbons. For example, before May 2018, when the U.S. withdrew from Joint Comprehensive Plan of Action, Turkey imported an average of 912,000 tons of oil per month from Iran, or 47% of its total imports. In the four months since November 2018, when the U.S. imposed sanctions and granted the limited waivers, Turkey imported an average of 209,000 tons of Iranian oil, or 12% of its total imports (Reuters Statistics, 2019). Considering all these reasons, Azerbaijan offers a better and more secure alternative to Turkey. This is the main reason behind a serious surge in Turkey's importation of Azeri gas and oil. In this regard, the figures are expected to rise substantially in the coming years as Turkey is interested to diversify its sources of energy supply.



2. Azerbaijan's share in Turkey's energy portfolio increases in 2019, in contrast to Iran and Russia. Middle East Institute, 2020.

Furthermore, there is another rationale behind Turkey's aggressive attempts to convince energy exporters to build pipelines through Turkey to Europe. Considering that Turkey's importance has significantly diminished in the eyes of the West after the collapse of the Union of the Soviet Socialist Republics (USSR), Turkey aggressively attempts to turn its territory into a major energy hub between Europe and Asia as the country is located at the crossroad of both continents. For this matter, since the 1990s, the Turkish authorities have been engaged in a long campaign to have both energy-importers and exporters met on the Turkish soil. This in itself would grant the Turkish authorities greater geopolitical importance not only in the eyes of the European Union, but also in the eyes of the energy-exporting Asian countries, like Russia, Iran, Iraq, and post-Soviet republics of Central Asia. Therefore, Turkey's investments in Azerbaijan's energy sector should be interpreted in this context as well.

Finally, the recent events of 2020 including COVID19 pandemic and shocking energy prices volatility will definitely affect the situation in the market. Due to drop of oil and gas prices Azerbaijan would need massive investments to intensify its oil and gas reserves. Turkey could be crucial partner in helping Azerbaijan. Next, the looming economic crisis that would hit the world in few months could become beneficial for Turkey, since most of the energy resource

countries would rush to sell oil and gas to Europe via Turkey. Ankara would use such benevolent situation for its own benefits. Azerbaijan from this perspective would need to free all gas resources from domestic consumption and concentrate of export potential. Moreover, Azerbaijan invested around 5 bn USD to the chemical complex in Izmir, Turkey that is considered the largest investment of the country. Baku's strategy was to establish such kind of facility closer to the World Ocean and for easy access to the markets. Currently, the complex works on Russian and Azerbaijani oil, but in future it is planned to substitute everything for Azeri Light oil only.

Conclusions

As one of the major players in the South Caucasus, Turkey prioritizes its relations with Azerbaijan since the latter has a huge amount of hydrocarbon resources. For this matter, since the 1990s, Turkey invested a lot in Azerbaijan's energy sector as to better position itself in the competition with Russia and, to a lesser extent, Iran. Furthermore, another important rationale behind Turkey's massive investment in Azerbaijan's energy sector is its effort to both diversify its source of energy supply and turn Anatolia into an energy hub between energy-exporters of the East and energy-importers in the West. In conclusion, the policy brief finds out that Azerbaijan is a better alternative and has a potential to play a significant role in Turkey's energy strategy to diversify its sources of energy supply. Furthermore, investing in Azerbaijan's energy sector would contribute Turkish attempts to turn Anatolia into a major energy hub. And, all these would better serve Turkey's energy security in the medium and long term.

Recommendations for Turkish and Azerbaijani Policy-Makers

Taken into consideration all problems and challenges, the following recommendations are proposed to policy makers in Azerbaijan and Turkey.

Investing in Trans-Caspian Gas Pipeline and development of Turkmenistan's Gas Field. This is a proposed subsea pipeline between Turkmenistan and Azerbaijan, which aims to bring Turkmen gas to Turkey and European Union through Azerbaijan, circumventing Russia and Iran. Considering that Turkey's annual gas demand is about more than 50 bcm, and Azerbaijan alone cannot meet this demand, it is strategically important for Turkey that this project succeeds. The project is expected to deliver about 30 bcm of gas per year. In this sense, this project can further help Turkey diversify its source of energy away from Russia and Iran. Therefore, the Turkish authorities are encouraged to seriously evaluate investing a huge amount of financial and non-financial resources into this project between Azerbaijan and Turkmenistan. Beyond of that, Azerbaijan itself can export its own gas consumed in the country to Turkey, and substitute it with Turkmen gas.

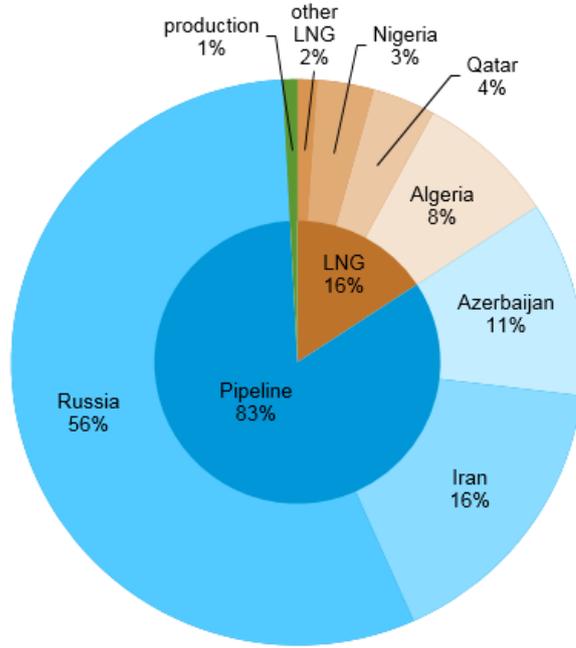
Investing into renewable energy: Currently, the share of renewable energy in Azerbaijan is quite small. According to State Agency on Alternative and Renewable Energy Sources of the Republic of Azerbaijan, 9% of the electricity generated in Azerbaijan in 2011 came from renewable sources, mainly from hydro-electric power. Most of the electrical stations in the country work on gas. Thus, Azerbaijan can significantly reduce the gas consumption and substitute it with renewable energy. Turkey would need to invest money to renewable energy in the country like previously Saudi Company did in Azerbaijan. The freed gas reserves would be exported to Turkey. For this Azerbaijan would need to liberalize its energy market, liquidating the monopoly of Azerenergy and allow other companies to come to the market. From this perspective the EU can play significant role with helping Azerbaijan in its liberalization and investments. For this matter, it is imperative for Turkey to get European companies and governments more deeply involved in these projects with both financial and political support. This would increase the survivability of the projects and help both Turkey and EU diversify their source of energy supply while providing financial benefits to Azerbaijan. For this matter, Turkey had better lobby the European governments to be more involved in energy projects in the South Caucasus.

Institutionalization of Azerbaijan-Turkey Energy Cooperation: Turkey and Azerbaijan should seek to institutionalize the energy-dominated relations in order to be better prepared to address the potential challenges and emerging differences in the future. Otherwise, it would be much harder to resolve any possible conflict of interests without a strongly institutionalized mechanism. Therefore, Turkey is strongly encouraged to invest in public relations and seriously consider the institutionalization of the relationship between the two countries. By this way, Ankara would preserve its relations with Baku in the longer term and better secure uninterrupted energy supply from Azerbaijan.

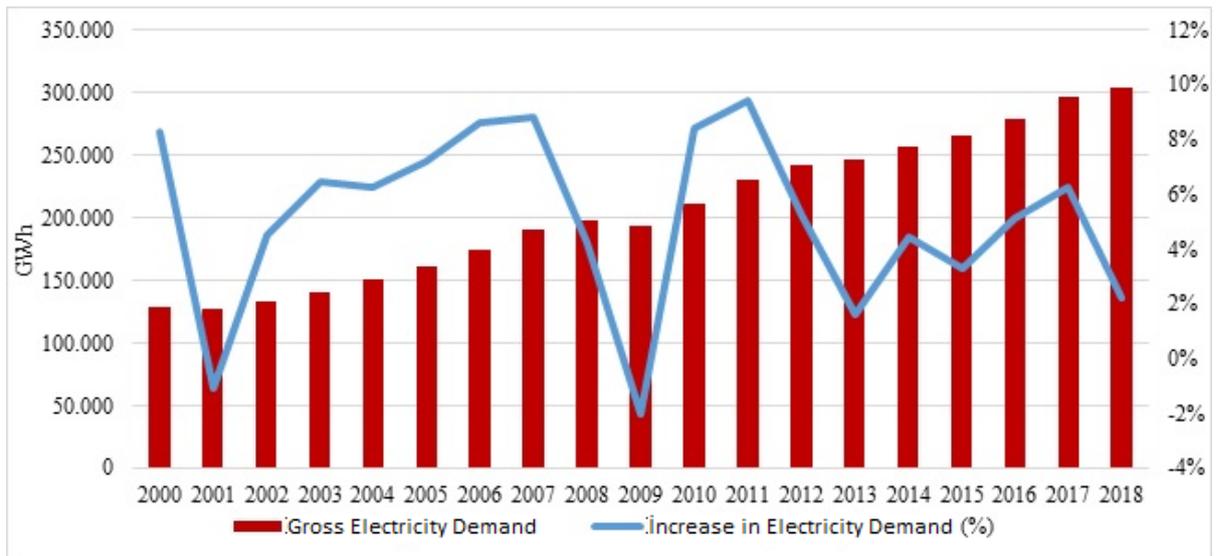
Appendixes:

1. Azerbaijan provides 11 % of Turkey's annual gas imports. US Energy Information Administration, BP Statistical Review, 2016.

Turkey's natural gas supply by source, 2015



2. Gross Energy Demand in Turkey since 2000. Ministry of Foreign Affairs of the Republic of Turkey.





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