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Thinking Beyond TAP: Turkey's Role in the Southern Energy Corridor

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Abstract

Energy security is one of the hot topics on the European energy agenda. The EU's Southern Energy Corridor initiative is an attempt to reduce dependence on Russian supplies by tapping into Caspian and Middle-Eastern natural gas resources. Turkey, who aspires to be a regional energy hub, has emerged as the key country in the Southern Corridor. Although the TAP project in its current state satisfies neither Turkey's energy hub ambitions nor the EU's resource diversification efforts, it may serve as the first building block of the Southern Corridor. There are promising developments in the region that can increase volumes and add new routes to the initiative. Private companies have already shown their interest in developing a pipeline infrastructure for possible South-East Mediterranean and Northern Iraq natural gas exports, but complex geopolitical issues pose the greatest threat to the way ahead. Thanks to its unique location, Turkey is destined to be one of the key players in the Southern Corridor. The convergence of Turkey's energy hub ambitions and the EU's energy security objectives present mutual gains, but also demand sustained collaboration between the two in light of several technical, legal and political hurdles.

Keywords: *European Union / Turkey / Energy supply / Natural gas / Pipelines / Cyprus / Israel / Northern Iraq*

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Thinking Beyond TAP: Turkey's Role in the Southern Energy Corridor

by Fatih Özgür Yeni*

Introduction

When the Shah Deniz Consortium announced the selection of the Trans Adriatic Pipeline (TAP) as the transport route for Azerbaijani gas to European markets on 28 June 2013, it also heralded the opening of the long-awaited Southern Energy Corridor (SEC). Together with the Trans Anatolian Pipeline (TANAP), which will carry Shah Deniz Phase II production across Turkey to the Greek border, TAP completes the link between European natural gas markets and the rich Caspian resources. Although there are some who scorn the outcome for its relatively low capacity, the real importance of TAP lies in its strategic impact on the region. Above all, since a non-Russian route is now possible, other resource-rich nations in the region will be encouraged to make their resources available to Western energy markets. In this context, recent developments in the South-East Mediterranean and Northern Iraq have been greeted with excitement in Brussels and Ankara, as these regions can boost volumes in the SEC and strengthen Turkey's position in it.

Energy has become a central concept in Turkish foreign policy as a result of the country's special geostrategic location at the nexus of major supply and demand centers. Turkey has made a great deal of progress in filling the role of transit energy bridge in the region thanks to the over 10,000 tankers that pass through the Bosphorus strait every year, pipelines that transport Iraqi and Azerbaijani oil to its port of Ceyhan, and finally the planned TANAP-TAP natural gas pipelines. Ankara is eager to field additional pipeline projects in the SEC with a view to transforming the country from a transit bridge that has no say in energy deals into a regional energy hub. This will require importing gas from different resources to the Turkish gas pool, where domestic and European energy firms can trade volumes and re-export surplus volumes to European markets. This vision will not only increase the country's geopolitical standing and foster lucrative business in the forms of new storage, export and trading facilities, but will also enhance the flexibility of Turkish and European energy markets and create more competitive pricing schemes.

As a candidate for European Union (EU) membership, Ankara also expects energy to be a catalyst for deeper EU-Turkey relations and to enhance Turkey's membership bid. Despite the fact that Ankara and Brussels share similar interests in the region, debates surrounding Turkey's candidacy has hijacked EU-Turkey collaboration in the SEC to date.

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This paper analyzes the post-TAP situation in the region and discusses how Turkey's energy hub ambitions could converge with the EU's energy security objectives. The analysis in the following section focuses on evaluation of EU gas demand and supply in order to facilitate understanding of the EU's resource diversification efforts. Section 3 provides a brief overview of the structure of the Turkish natural gas market and the decision-making process in Turkish energy policy. Section 4 considers not only the historical background of the TAP project but also its effects on European and Turkish energy policy. Section 5 sets out recent developments in the South-East Mediterranean and Northern Iraq, and discusses possible pipeline options that could enhance the SEC and Turkey's role in it.

1. The European natural gas balance

Over the last two decades, natural gas has overtaken coal and become the second most highly consumed fuel in the EU, accounting for 24% of total gross inland energy consumption. In 2012, Europeans consumed roughly 400 million tons of oil equivalent (Mtoe) of natural gas, making the EU the world's second-largest natural gas consumer after the United States (US).[1] Nonetheless, European natural gas markets have shown signs of stabilization for the last couple of years. Some experts read this trend as maturation of European natural gas markets, while many others explain it in terms of the recent economic downturn on the continent. Although projections for natural gas demand in the EU have been revised and slower growth rates are now expected, with the economic recovery, demand for natural gas in the EU-27 is estimated to rise to 471 Mtoe in 2035, and the share of natural gas in power generation is expected to be 28% in 2035 (it was 25% in 2010).[2] We should also take into consideration Germany's plans to phase-out its nuclear power plants by 2020, as well as the fact that, under the EU's 2001 Large Combustion Plants Directive, many coal-fired plants are expected to be decommissioned after 2015. Furthermore, the EU's efforts to boost renewable resources for power production under its 2020 targets should strengthen the status of natural gas in power generation in order to balance the high amount of intermittent renewables in the system.[3] Given that the EU continues to pursue low carbon energy policies, demand for natural gas in the EU-27 is estimated to be as high as 525 Mtoe in 2035, and its share in power generation may rise to 33% by that date. It is a fact that natural gas demand growth is closely linked to the economic recovery. In the worst case scenario (prolonged and deep economic recession), demand levels are projected to be almost the same as in 2012.[4]

However, even with stable demand levels we can still expect growing dependence on external sources, since domestic production continues to decline due to the depletion

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[1] British Petroleum (BP), *BP Statistical Review of World Energy 2013*, June 2013, http://www.bp.com/en/global/corporate/about-bp/statistical-review-of-world-energy-2013.html.

[2] Eurogas, *Long-term Outlook for Gas to 2035*, Brussels, Eurogas, October 2013, http://www.eurogas.org/uploads/media/Eurogas_Brochure_Long-Term_Outlook_for_gas_to_2035.pdf.

[3] The power system requires real-time supply and demand balance. Renewable resources on the other hand produce electricity as long as the wind blows or the sun shines. Hydroelectric power plants or natural gas fired power plants are used to balance the unstable renewable production in the system as they are able to come online almost instantly.

[4] Eurogas, *Long-term Outlook for Gas to 2035*, *cit.*

of mature production basins (mostly from the United Kingdom). Import dependency for natural gas has risen sharply from 48.9% in 2000 to 67% in 2011.[5] Considering the skepticism about shale gas and other unconventional production methods in European public opinion, we can expect higher import dependency levels in the future.[6]

Import dependency for the EU implies dependence on Russian natural gas exports. Due to its geographic proximity and vast natural gas resources, Russia has been a major supplier for the European continent. Russia supplied over 30% of total natural gas imports and 24% of total supplies in 2011.[7] This high level of dependence on a single country raises concerns about energy security, especially given the events of the mid and late 2000s, when Russia cut off supplies to Europe due to disagreements between Gazprom and the transit countries of Ukraine and Belarus. At that time, 80% of total Russian natural gas exports to Europe passed through those two countries. Even though gas flow was soon resumed, these events demonstrated the vulnerability of European natural gas markets, and raised questions about the trustworthiness of Russia as a supplier. The conflict between Russia and Georgia in 2008 only added insult to injury, when President Putin threatened European governments over energy supply in retaliation for their stance against the Russian intervention.[8]

As a matter of fact, the EU has no difficulty in satisfying its future natural gas demand from the abundant Russian natural gas reserves. However, given the perceived unreliability of Russia, the essence of security of supply for the EU is diversification of routes and resources. Correspondingly, the EU has declared its intention to develop stronger economic and political relations with Central Asian and Middle Eastern countries which have substantial amount of natural gas reserves.

In this context, the European Commission initiated the 4th corridor or SEC project, which aims at tapping into the Caspian and Middle Eastern natural gas reserves, bypassing Russia. Although the SEC cannot fully substitute imports from Russia, and although Russia will probably continue to be the major natural gas supplier for decades to come, this new energy corridor would bring choice to European consumers, increase competition in the market and strengthen security of supply for the continent.

2. Turkey's stance in regional energy diplomacy

Strategically located between East and West, Turkey has emerged as the key country in the SEC. Every pipeline project has to consider the Turkish route in order to be

[5] Eurostat, *Energy statistics*, http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/data/database.
[6] Unlike in the US, unconventional gas recovery methods are not expected to be a game-changer for European natural gas markets, considering the fact that European public opinion is relatively more environmentally sensitive, as well as the continent's dense population.
[7] Eurogas, *Statistical Report 2012*, Brussels, Eurogas, December 2012, http://www.eurogas.org/uploads/media/Statistics_2012_21.11.12.pdf; European Commission, *EU Energy in Figures. Statistical Pocketbook 2013*, Luxembourg, Publications Office of the European Union, 2013, http://ec.europa.eu/energy/publications/doc/2013_pocketbook.pdf.
[8] Damien McElroy and Bruno Waterfield, "Vladimir Putin threatens Europe over energy supply", in *The Telegraph*, 31 August 2008, http://www.telegraph.co.uk/news/worldnews/europe/russia/2656824/Vladimir-Putin-threatens-Europe-over-energy-supply.html.

economically competitive, as the country offers the shortest route to the Caspian and Middle Eastern regions. Despite the country's geographical proximity to the world's richest hydrocarbon reserves, Turkey has negligible domestic production to fuel its fast-growing economy. In contrast to fairly flat European demand, Turkey's natural gas demand increased almost three-fold during the last decade, and reached 41.7 Mtoe in 2012.[9] Natural gas accounts for an increasing share of the energy mix in Turkey; it has overtaken oil and become the most important fuel in terms of volumes consumed. Turkey almost exclusively relies on imports, since only 2% of this fast-growing demand can be met by indigenous production. Russia again supplies the lion's share of total Turkish natural gas imports, with 58%.[10] Russia is also building Turkey's first nuclear power plant, which is expected to become operational in 2020. In view of such close ties, Turkey tries not to offend its northern neighbor in regional energy games. In fact, Ankara could not reject Russia's South Stream Gas Pipeline project, which passes through Turkish territorial waters in the Black Sea, despite the fact that it directly competes with SEC projects on the Turkish route. President Putin himself considered Turkey's approval as a Christmas gift for his country,[11] as Russia tries to lure the EU away from resource diversification by offering an alternative route that bypasses the troubled Ukraine and Belarus routes.

Being well aware of its special geostrategic importance, energy has become the central concept in Turkish foreign policy in the post-Cold War era. Ankara has ardently supported the SEC initiative not only for the possible revenues it could generate for the Turkish economy, but also in order to bring the EU and Turkey closer and to enhance Turkey's EU membership bid. Turkish politicians remind their European counterparts on a regular basis that Turkey's possible membership would add to energy security of the EU. In fact, Turkey and the EU share similar interests in the region, as they both suffer from over-dependence on a single country. They would both like Caspian and Middle Eastern gas to reach European markets in order to reduce their dependence on Russian supplies, and Turkey hopes to take a portion of the natural gas that is due to flow through its territory to meet its own domestic demand.

It is impossible to disaggregate Turkey's energy strategy from its EU membership bid. Although accession negotiations are moving at a snail's pace, Ankara is in the process of harmonizing its energy legislation with the EU *acquis*. In 2001, the Turkish Parliament passed the Natural Gas Market Law, which aims at liberalizing the Turkish natural gas market by opening it up to competition. The main pillar of this new legislation was phasing out the monopoly position of the Turkish Pipeline Company (BOTAS). The legislation required BOTAS gradually to transfer 80% of its import contracts to the private sector by the end of 2009, but in practice, for several reasons, only 10% could be transferred by that time. While the Energy Market Regulatory Authority (EMRA), the autonomous energy market regulator in Turkey, has published several communiques on the establishment of a liberal natural gas market in the

[9] BP, *BP Statistical Review of World Energy 2013*, *cit.*
[10] Interntional Energy Agency (IEA), *Oil and Gas Security Emergency Response of IEA Countries. Turkey 2013 update*, Paris, IEA, 2013, http://www.iea.org/publications/freepublications/publication/name,38110,en.html.
[11] Eric Watkins, "Russia to build South Stream gas pipeline via Turkey", in *Oil & Gas Journal*, 30 December 2011, http://www.ogj.com/articles/2011/12/russia-to-build-south-stream-gas-pipeline-via-turkey.html.

country, BOTAS has been defending the idea that its monopoly position should be maintained so that it can compete with international giants as the national champion of Turkey.

It is hard to foresee the future market configuration in Turkey due to the conflicting signals that emanate from the Turkish government. The Western Line contract with Gazprom, which supplied the Western part of the country with 6 billion cubic meters (bcm) of natural gas annually, expired at the end of 2011, and BOTAS decided not to extend it. Instead, four private Turkish companies reached an agreement with Gazprom to replace BOTAS in the Western Line,[12] increasing the share of the private sector in the Turkish natural gas market to 25%. Meanwhile, despite the fact that the Natural Gas Market Law forbids BOTAS from entering into new purchase contracts via pipeline[13] until its market share falls to 20%, BOTAS inked a new purchase agreement for Azerbaijan's Shah Deniz Phase II production to a plateau volume of 6 bcm per year.

These inconsistent policies are mainly the result of disconnected decision-making in the Turkish energy bureaucracy. Several governmental entities are involved in energy issues, all with different mindsets and interests. While the Ministry of Energy determines the overall energy strategy of the country, EMRA sets the rules for domestic gas market operations. In addition, the Ministry of Foreign Affairs, the Ministry of Development, the Turkish Army, BOTAS and several other governmental agencies are also involved in energy-related issues. As a result, it has been difficult to coordinate all actors and to formulate a coherent energy policy for the country. This said, all actors agree on the principle that Turkey has to benefit from its geostrategic location and become an energy hub in the region.

Ankara follows developments in the SEC closely, as it is no less important for Turkey than it is for the EU. Against this backdrop, the Nabucco pipeline project emerged as the first serious attempt to transport Caspian and Middle Eastern natural gas to European energy markets through Turkey.

3. Post-TAP conditions for the EU and Turkey

Since its independence, Azerbaijan has struggled to mobilize its rich natural resources for its economic growth. Transportation is pivotal for Azerbaijan's energy strategy, since natural gas as a commodity is worth more in European markets than at the well-head. In late June 2012, the Azerbaijani and Turkish governments agreed to build a brand-new natural gas pipeline, named TANAP, to transport Azerbaijani natural gas from the Georgian border across Turkey to the EU's border. Along with the agreement on the legal and commercial terms of gas transport, Turkey secured an additional 6 bcm over its already-contracted 8 bcm from Azerbaijan, leaving only 10 bcm for European markets. The TANAP decision rendered the Turkish section of Nabucco obsolete, since Shah Deniz Phase II was the only available resource at the time, and forced the Nabucco consortium to downsize itself into Nabucco-West (the Bulgaria-

[12] Ece Toksabay, "Russia's Gazprom wins 30-year gas export deal in Turkey", in *Reuters*, 26 November 2012, http://www.reuters.com/article/2012/11/26/turkey-energy-licences-idUSL5E8MQ6X820121126.
[13] This ban excludes LNG purchase agreements.

Austria section of the original Nabucco project). In the end, Nabucco-West and TAP remained the two alternative pipelines to link TANAP to the EU. While the former runs from the Bulgarian border to Austria's Baumgarten Hub, the latter would receive gas at the Greek border and transport it to Italy via an Adriatic subsea section.

On 28 June 2013, the Consortium that controls the Shah Deniz Phase II field located offshore Azerbaijan finally made its decision and chose the TAP project over Nabucco-West, at one time the world's most ambitious pipeline project with the greatest degree of political support. The decision of the Consortium left no gas to Nabucco and raised serious doubts about the future of the project. TAP, together with TANAP, completes the export infrastructure for Azerbaijani natural gas production and connects European natural gas markets to the rich Caspian Sea resources for the first time. However, the announcement of the selection of TAP received conflicting reactions in energy circles. While some experts scorned the decision as an end to the SEC, many others welcomed it as the first building-block of the same corridor.

Since the early discussions over the possible supply routes for the SEC, the Nabucco project enjoyed abundant political support from Brussels, Washington and Ankara owing to the fact that it better served Europe's energy security by reaching Central and Eastern European (CEE) countries which are heavily dependent on Gazprom supplies and were hard hit during the natural gas crises late 2000s. TAP, on the other hand, would reach Italy, which has a relatively more diversified import portfolio. However, this strategic and political advantage of Nabucco was slowly eroded by the commercial upper-hand of TAP, as EU energy security was a significant concern for neither Azerbaijan nor the Shah Deniz Consortium. The TAP Consortium offered lower transport fees and higher prices at the terminus of the pipeline, and also proved itself to be a self-standing project by demonstrating that project finance would rely on shareholders rather than international financial institutions. Finally, the acquisition of DESFA (the Greek pipeline operator) by the State Oil Company of Azerbaijan (SOCAR) in June 2013 sweetened the TAP deal.[14] The selection of TAP once again demonstrated that without economic backing, political will is not enough to realize such sizable international investments.

With the TAP deal on the table and Caspian gas finally projected to flow to Western markets, one may question the hype around the TAP project, as it will supply only 2% of total European demand, far less than the EU's initial Nabucco plans. However, the real importance of the project lies in its strategic impact on the region, which will be greater than imagined.

First, the SEC is now open and Caspian gas will be available to European consumers independent of Russia's Gazprom. Both TANAP and TAP are scalable and able to host future gas supplies as they become available in the future. The very existence of such infrastructure will surely encourage other resource-rich countries in the region to make

[14] For detailed background information on the TAP-Nabucco competition, see Nicolò Sartori, "Energy and Politics: Behind the Scenes of the Nabucco-TAP Competition", in *IAI Working Papers*, No. 13|27 (July 2013), http://www.iai.it/pdf/DocIAI/iaiwp1327.pdf.

their natural gas reserves available to Western markets.[15] Being well aware of this fact, Russia has already hastened its efforts to build its South Stream Pipeline in order to retain its strong grip on CEE countries.

Second, although the current version of TAP does not reach those CEE countries most critically in demand, this objective can be achieved by means of a series of interconnections. Building a Greece-Bulgaria interconnector could enable gas to be supplied from TAP to Bulgaria, and similarly building a Bulgaria-Romania interconnector will enable gas to move onwards to Hungary through an already-existing Hungarian-Romanian interconnector. The European Commission has already been pushing for further interconnections in the region as part of its North-South Gas Ring Initiative. Caspian gas may also be shipped from Italy to Austria's Baumgarten Hub, the original destination of Nabucco West, through the Trans Austria Gas Pipeline.[16] Additionally, through the proposed Ionian-Adriatic Pipeline, the Western Balkans would be able to receive gas from the SEC after a future boost in supplies.

Third, increasing supplies for European energy markets will make it difficult for Gazprom to maintain its monopolistic pricing mechanism, which has already been challenged by the implementation of the third energy package.[17] Increased competition is expected to lead to lower energy prices and support the competitiveness of European economies.

Finally, the preference for TAP over Nabucco West does not necessarily rule out the latter, since European markets can easily accommodate both pipelines and associated gas volumes. The EU, Turkey and Azerbaijan have declared their continuing support for the project. Recent discoveries in the South-East Mediterranean and further supplies from Azerbaijan, along with Northern Iraqi gas reserves, discussed in further detail below, could easily fill even the expanded versions of these two pipelines in the next decade.

So, where does Turkey stand in this picture? What did she lose or gain by the TAP decision? During the emergence of the several alternative pipeline projects in the SEC, Turkey has taken a neutral stance and simply preferred to sit on the fence. By doing so, she has expected to be the winner in each scenario, and in a sense this strategy has worked so far. Although the colossal Nabucco project, which that would have collected gas from Caspian and Middle Eastern countries, is not on the table anymore, the first piece of the SEC puzzle is in place, and Turkey was able to secure its own place in that picture.

[15] Nick Snow, "Pieces moving into place for Azerbaijan-to-Europe gas pipeline", in *Oil & Gas Journal*, 16 September 2013, http://www.ogj.com/articles/2013/09/pieces-moving-into-place-for-azerbaijan-to-europe-gas-pipeline.html.
[16] Matthew Bryza and David Koranyi, "A Tale of Two Pipelines: Why TAP has won the day", in *Natural Gas Europe*, 2 July 2013, http://www.naturalgaseurope.com/southern-corridor-strategic-importance-tap-nabucco.
[17] The EU's third energy package is a legislative package that prohibits gas companies from operating both distribution and long-distance transport networks. It also makes it illegal to charge different prices to different countries.

Before anything else, Turkey will receive larger volumes of natural gas from Azerbaijan than it was offered under the plans for Nabucco. This will have a positive impact on Turkey's energy security, but the country will still depend on Russian supplies for its fast-growing domestic demand. Although Turkey was ready to accept the entire Shah Deniz phase II production, this offer was not supported by the Azerbaijani government since natural gas is seen as a strategic commodity for Azerbaijan and as something that will link the country to the Euro-Atlantic community.

In addition to the substantial foreign direct investment that Turkey will receive for the construction of TANAP, Turkey has also managed to secure Azerbaijani gas at a preferential rate.[18] Energy imports are the primary cause of Turkey's current account deficit, which is considered the soft belly of the Turkish economy. The agreement also strengthened the strategic energy relationship between Azerbaijan and Turkey, which may pave the way for future deals.

Nonetheless, the TANAP and TAP projects in their current state do not fully solve the EU's energy security issue or make Turkey an energy hub. The project depends solely on Shah Deniz Phase II production, and the 10 bcm supply for European natural gas markets is only a small fraction of total European demand, while the 6 bcm supply for Turkey can barely balance the country's fast-growing demand. These projects should only be considered an important first step that may pave the way for future projects. There are in fact promising developments in the region that could increase volumes and add new routes to the SEC initiative. Thanks to its unique location, Turkey is destined to be one of the key players in the SEC, but to what extent it will realize its energy prospects depends not only on the resolution of the complex geopolitical issues in the region but also on the synchronization of efforts with the EU in the SEC.

4. The road ahead

If one looks back at the maps for the first Nabucco plan, one sees dotted lines that connect Azerbaijan, Turkmenistan, Kazakhstan, Iran and even Egypt to the Turkish section of the pipeline. Those dotted lines vanished one by one as the giant Nabucco pipeline project foundered. The Trans-Caspian pipeline was never realized due to disagreements among the littoral states over Caspian maritime borders; international sanctions left the Iranian government sitting idle on top of the world's second largest natural gas reserves; and Egypt has become a net natural gas importer, let alone an exporter, due to the turmoil in the country. In the end, Azerbaijan remained the sole reliable source for the SEC. Whether the problems inherent in these resource-rich countries will ever be solved is unclear, but it is almost certain that they will not be able to make their resources available to Western energy markets anytime soon. While hopes for a substantial SEC were slowly fading away, developments in the South-East Mediterranean and Northern Iraq have once again raised excitement among supporters of the idea.

[18] "TANAP-transported gas for Turkey to be 12% cheaper than Russian", in *News.az*, 4 July 2012, http://news.az/articles/turkey/63637.

Recent studies indicate that offshore discoveries made in the South-East Mediterranean by Cyprus and Israel in the last couple of years have the potential to satisfy their domestic demand and leave surplus natural gas to be exported to world energy markets. Due to its proximity to the region, Europe stands as the most attractive option for possible future exports. However, several technical, legal and political challenges need to be addressed before any investment decision is made as regards export infrastructure.

Cyprus has already begun drafting a natural gas liquefaction facility on the island, and hopes to start exporting Liquefied Natural Gas (LNG) by 2019. Although a pipeline to Turkey is economically more attractive than a liquefaction facility due to the short distance between the two countries, Turkey's aggressive reaction to drilling activities by Greek Southern Cyprus seriously damaged the viability of this option. Turkey threatened to send naval ships to the region and put pressure on foreign oil companies such as the Italian ENI to halt their Cyprus operations. Ankara claimed that this exploration could only be undertaken after a revenue-sharing agreement was reached between Turkish and Greek Cypriots. Cyprus responded by blocking the opening of the energy chapter in the accession negotiations with Turkey, where a screening process had been successfully completed.

In October 2013, the US-based company Noble energy, which carries out drilling activities in both Cypriot and Israeli fields, significantly lowered its estimates for the Cyprus offshore section, once again turning the tables in the region.[19] Although Cypriot officials announced that they would stick to their LNG plans, the participation of Israel in the project is now increasingly needed in order to pool the costs of an expensive liquefaction facility.

While Tel Aviv considers Nicosia's joint export proposal, it is also flirting with Ankara behind closed doors. Relations between Turkey and Israel are showing signs of improvement after the US-brokered apology of Israel in April 2013 for the Mavi Marmara incident. According to some experts, the timing of this apology is not simply coincidental.[20] Israel lacks a suitable coastal site to host its own LNG facility. Even if a pipeline to Turkey offers less flexibility than LNG trade, it would cost far less and allow Israel to reach European markets via the SEC. Turkey has become an even more attractive route in the wake of the Cypriot economic crisis, which is clouding plans for cooperation between Cyprus and Israel.[21] Turkish private firms have already expressed their interest in building a pipeline with a capacity of 16 bcm from Israel's giant Leviathan field to the Turkish coast.[22] Israeli companies also welcomed the idea, and according to recent reports have already advanced talks with Ankara.[23]

[19] Michele Kambas, "Noble's Cyprus gas drill at lower end of estimates", in *Reuters*, 3 October 2013, http://www.reuters.com/article/2013/10/03/cyprus-gas-idUSL6N0HT29F20131003.
[20] Karen Ayat, "Israel and Turkey: Friends Again", in *Natural Gas Europe*, 28 March 2013, http://www.naturalgaseurope.com/israel-and-turkey-friends-again.
[21] Joshua Mitnick, "Israel, Turkey Explore Energy Links", in *The Wall Street Journal*, 27 March 2013, http://online.wsj.com/news/articles/SB20001424127887324105204578382243773388484.
[22] "Turcas Petrol Proposes 470 KM, $2.5 Billion Pipeline to Connect Israel's Leviathan Gas Well to Turkey", in *The Algemeiner*, 13 September 2013, http://www.algemeiner.com/2013/09/13/turcas-petrol-proposes-470-km-2-5-billion-pipeline-to-connect-israels-leviathan-gas-well-to-turkey.
[23] Steven Scheer, "Israeli gas group in talks on pipelines to Turkey, Jordan,Egypt", in *Reuters*, 6 August 2013 http://www.reuters.com/article/2013/08/06/delek-natgas-exports-idUSL6N0G72F920130806; "Israel

A pipeline from the South-East Mediterranean to Turkey makes economic sense, but regional anxieties present the highest risk for the future. Ankara assumes that strengthening ties with Israel would eliminate Nicosia's room to maneuver. However, even if Turkey and Israel agree on a joint pipeline project, this has to go through Cyprus' exclusive economic zone in order to utilize the shortest route to the Turkish coast. Opposition from Nicosia would further complicate matters, and may discourage investors from investing in a multibillion dollar pipeline project. In fact, Turkey's hand against Cyprus in this energy game is weak. Cyprus has already signed several agreements with international energy companies with the backing of the EU and the US. What Turkey needs is a tone shift in its regional diplomacy. Military threats or blacklisting foreign companies is a self-defeating path and will not help Turkey realize its ambition to become an energy hub. A constructive dialogue with Cyprus and Israel would not only enhance its position in the SEC, but may also unblock the opening of the energy chapter. There is no doubt that energy will be a dominant factor in the future of the countries in the South-Eastern Mediterranean. If TAP is to be taken as an example, we may anticipate that economic fundamentals will be the ultimate drivers in the decision-making process. Resources beneath the Mediterranean waters could eventually promote energy security and regional peace and prosperity instead of fueling regional confrontations.

Recently, Northern Iraq has emerged as another source of additional volumes in the SEC. The semi-autonomous Kurdistan Regional Government (KRG) is eager to monetize its hydrocarbon resources as quickly as possible, and Turkey is the natural direction for its exports to world markets. Despite opposition from Baghdad and Washington, Turkey and the KRG have signed independent energy deals for the exploration and transportation of hydrocarbon resources in the Kurdish territories. Genel Enerji, a Turkish-British joint venture, has begun exporting oil from KRG's Taq Taq oil field to Turkey's Ceyhan port on the Mediterranean Sea by truck, bypassing the Baghdad-controlled Kirkuk-Yumurtalik pipeline. Furthermore, a new oil pipeline with a capacity of 300,000 barrels per day is expected to be completed by the end of 2013, which will further strengthen the KRG's efforts for export independence.

In terms of natural gas, the region is even more important for Turkey's energy plans. Its LNG contract with Algeria is about to end, and Turkey is desperately trying to reduce its dependence on expensive Russian supplies. For some experts, the KRG's gas supplies could be three times cheaper than what Turkey pays for Caspian, Russian, and Iranian sources because of its easy production and transportation.[24] In September 2013, the EMRA finally issued an import license for the Istanbul-based Siyahkalem Company, valid for 26 years, to import natural gas from Northern Iraq. According to recent reports, the deal, which could be signed by the end of 2013, would see the KRG export 10 bcm of gas per year to Turkey. So far, there is no infrastructure for delivering the gas, though analysts think an export pipeline could be built within a year and the necessary gas processing facilities within 30 months.[25] Ankara is now strongly

Persisting With Turkey Pipeline Project", in *Natural Gas Europe*, 18 February 2013, http://www.naturalgaseurope.com/israel-turkey-gas-pipeline.

[24] Olgu Okumus, "Turkey's Cross-Border Energy Policy's Tone Shifted", in *Natural Gas Europe*, 24 September 2013, http://www.naturalgaseurope.com/turkey-cross-border-energy-policys-tone-shifted.

[25] Guy Chazan, "Genel increases Kurdistan gas estimate", in *The Financial Times*, 30 July 2013, http://www.ft.com/intl/cms/s/0/5f50e0b6-f872-11e2-92f0-00144feabdc0.html.

supporting energy projects that may help the KRG to gain further autonomy, a strategy that was unthinkable for Turkey a couple of years ago, when KRG-Turkey relations were antagonistic due to PKK-related issues.[26] Turkey used to criticize the KRG's autonomous actions on the grounds that such behavior might jeopardize the territorial integrity of Iraq. Such a change in Turkey's strategy is a clear indication of how Turkey can be pragmatic when it comes to energy issues. However, despite the fact that Turkey is forging ahead in signing independent energy deals with the KRG, it does not want to risk relations with the Iraqi central government. Ankara is trying to restore relations with Baghdad after a very long period of fruitless megaphone diplomacy between the two. Most recently, Turkish Energy Minister Taner Yildiz announced that the two countries are working on a solution to Baghdad's concerns over the monetization of Northern Iraq's natural resources.[27]

An estimated natural gas reserve of 2.8 trillion cubic meters in Northern Iraq is hard to ignore. That is about four times greater than Azerbaijan's reserves and has the potential to be a game-changer in the SEC. Many of the world's largest oil and gas companies, including American majors Chevron and ExxonMobil, are already operating in the region. Whether Turkey will be able to establish common ground between Erbil and Baghdad, or whether it will continue to execute independent energy export projects with the KRG, is a question to be answered in the coming months.

As Northern Iraqi and South-East Mediterranean supplies enter into the equation, the available remaining capacity of TANAP and TAP will be outstripped. Even worse, although SOCAR, the operator of TANAP, announced that it would welcome other supplies from different countries,[28] it may in the end wish to reserve the remaining capacity of the pipeline for future increases in exports from Azerbaijan. In that case, a substantial upgrade in the Turkish natural gas grid or swap operations[29] may be considered. It is also very likely that such a volume boost in the SEC will create scope for new infrastructure, such as the expansion of TAP through the addition of a parallel line, or the revival of Nabucco West, which enjoys ongoing support from Brussels and Ankara. However, the future of the SEC depends not only on the choices of resource countries, but also on how the EU and Turkey collaborate.

So far, energy talks have been held hostage to the wider debate surrounding Turkey's accession process. The EU is trying to persuade Turkey to align its legislation with the energy *acquis* by joining the Energy Community Treaty (ECT),[30] which aims to establish a single regulatory framework for uniform energy trading across South-Eastern Europe and the EU. Turkey, on the other side, has reaffirmed that it will be a member of the ECT on condition that the energy chapter is opened and progress

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[26] The Kurdish seperatist organization PKK used Northern Iraq as a base for attacks on Turkish soil. Turkey has accused the KRG several times of harboring PKK combatants in the region. The KRG on the other side has criticized Turkey's military operations in Northern Iraq as a violation of international law.

[27] Tulay Karadeniz, Humeyra Pamuk, Nick Tattersall "Turkey proposes acting as a broker in Iraqi oil revenue share", *Reuters*, 15 November 2013, http://uk.reuters.com/article/2013/11/15/uk-turkey-iraq-oil-idUKBRE9AE0MH20131115.

[28] TANAP website, http://www.tanap.com/en/what-is-tanap.

[29] Such as consuming Israeli or Northern Iraqi gas in the domestic market while re-exporting the entire Azerbaijani supply to European markets.

[30] Katinka Barysch, "Turkey's role in European energy security", in *CER Essays*, December 2007, http://www.cer.org.uk/publications/archive/essay/2007/turkeys-role-european-energy-security.

therefore made in its accession process.[31] Despite the fact that former ECT members Bulgaria, Romania and Croatia joined the EU later on, officials in Ankara believe that Turkey would accept an inferior status by being a member of the ECT.

The Turkish government, along with Turkish society, has already shown signs of losing interest in EU membership. If the EU is to protect its energy security in the future, it has to include Turkey in its energy plans. Progress in the accession negotiations will surely restore Turkey's membership ambitions, and unblocking the energy chapter will lay the ground for a common energy strategy.

As to Turkey, it has several technical, legal and political tasks to accomplish in order to transform itself from a transit bridge to an energy hub. It has to upgrade its natural gas grid and increase storage capacity to host tradable natural gas volumes. Also, by using its special geostrategic position as leverage, Turkey should be able to secure re-export rights in future purchase contracts. Even if Turkey chooses to keep BOTAS as its national champion, system operations should be administered by an independent entity. Furthermore, Turkey should abandon its *ad hoc* approach and implement a transparent legal framework to facilitate transit gas flows, a point also underlined in the Commission's 2013 Turkey Progress Report.[32] Finally, Turkey has to earn political confidence in the region in its role not only as a strategic country, but also as a reliable partner in energy issues.

Conclusion

Energy security will continue to be among the hottest topics on the European energy agenda. The EU is struggling to reach non-Russian resources and the SEC initiative is the backbone of this policy. The TAP project in its current state does not fully satisfy the EU's resource diversification efforts or Turkey's energy hub ambitions, but is nevertheless a welcome development. It does not rule out other projects, as the SEC can accommodate new resources and accompanying infrastructure projects when they become available. The South-East Mediterranean and Northern Iraq have emerged as two new regions which could raise the SEC to a more significant level in terms of both volumes and routes. Despite the fact that economic fundamentals support the routing of transport infrastructure through Turkey towards European markets, complex geopolitical issues in the region demand a well-coordinated energy strategy between the EU and Turkey. In this regard, Turkey's membership bid should facilitate a common energy strategy rather than complicate issues between the two. As long as myopic polices do not spoil the prospects for mutual benefits for all parties, the SEC will significantly contribute to efforts to bring security, prosperity and cooperation to a troubled region.

Updated: 29 November 2013

[31] See the Turkish Foreign Ministry website, http://www.mfa.gov.tr/turkeys-energy-strategy.en.mfa.
[32] European Commission, *Turkey 2013 Progress Report* (SWD(2013) 417 final), 16 October 2013, p. 36, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=swd:2013:0417:fin:en:pdf.

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