

THE ROLE OF ENERGY IN RUSSIA'S RELATIONS WITH TURKEY AND IRAN

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This paper was commissioned as part of a CSIS research project called “The Turkey, Russia, Iran Nexus: Regional Perspectives.” This project, which CSIS is pursuing in cooperation with the Economic Policy Research Institute of Turkey (TEPAV) and Institute of Oriental Studies (IVRAN) Moscow, is exploring evolving relations between these three pivotal countries and their implications for regional developments in the Caucasus, Central Asia, and the Eastern Mediterranean, and for their relations with the United States and other countries. It seeks to promote dialogue and a deeper understanding of these relations among experts and officials in all four countries. CSIS will develop a comprehensive assessment of the forces driving these relations and their long-term implications, and offer various policy recommendations. For more information on the project, please visit our website at <http://csis.org/program/turkey-russia-iran-nexus>.

I. Regional and Global Economic and Energy Strategies

The objective of the energy policy of Russia is to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population, and promote strengthening of Russia's global economic position.

Despite the impact of the global economic crisis, achievement of the long-term guidelines for socio-economic development of Russia, and adequate development of the energy sector are based on the following priorities:

- Development and implementation of the Russian economy's comparative advantages in the energy sector, science and education, high technologies, and other fields;
- Dynamic development of institutions that support entrepreneurial and investment activities, as well as companies' competitiveness;
- Intensive, innovative modernization of manufacturing industry and enhancement of labor productivity;
- Dynamic development of transport and energy infrastructure;
- Intensive improvement in the quality of human capital and formation of a middle class;
- Integration of the Euro-Asian economic area.

The strategic objective of Russian foreign energy policy is to enhance efficiency for full-scale integration into the world energy market, the enhancement of its position therein, and to maximize the profitability of the industry.

The 2009 Energy Strategy of Russia through 2030 (ES-2030) envisions that Russia will become the focal point of the joint Eurasian energy infrastructure linking European and Asian energy markets by the end of that period. Turkey and Iran are important elements in this development. Turkey is one of the largest consumers of Russian energy resources and a major transit country. Iran is seen by Russian companies as a highly desirable potential partner in the development and production of hydrocarbons (mainly natural gas).

It is assumed that Russian gas exports, carried out mainly on the basis of long-term contracts, will continue to provide the required volume of supplies to the European market, along with a sufficient increase in energy exports necessary for meeting the growing demand of the East (to China, Japan, and the Republic of Korea). At the same time, Russian gas companies will actively participate in the development of gas fields in other countries, including in Iran and Central Asia, and in the construction of new inter-regional gas pipelines, particularly in South Asia, as well as in coordinating export policies with these countries.

From 2016 to 2023, the Russian energy strategy will involve a reinvigorated effort to expand its transmission infrastructure, connecting the major gas producing countries, such as Iran and the Central Asian states, and integrating the Eurasian transport system, in order to expedite export and transit flows between Europe and Asia. In particular, Russia will focus on completing construction on the "South Stream" gas pipeline.

An important component of Russia's export policy until 2030 will be market diversification, including both the regions to which Russia sends its exports and the types of energy resources exported. Western and Central European markets will remain fundamental to the Russian energy strategy, and oil will continue to be the dominant energy source. The most dynamic segment of the European market will continue to be natural gas, of which Russia has been the largest supplier, a role it will seek to maintain in the future. However, the main focus of export diversification will be the development of new markets, primarily in the Asia-Pacific region, which, according to ES-2030, should account for up to 26-27 percent of total Russian energy exports by the end of 2023. This region represents the

most promising growth market for Russian energy resources and, given the rich potential of the Eastern regions of Russia, makes the task of export diversification a key component of ES-2030.

The two keys to consistent Russian energy supply to Central and Western Europe include: 1) ensuring the unimpeded transit of Russian energy supplies through Ukraine and Belarus; and, 2) the protection of Russia's position in the European gas market from competition posed by other Caspian region producers.

The transit problem over the last decade has undermined Russia's image and position in the European market. Thus, in 2006, the decision was made to construct the North Stream and South Stream marine pipelines, which allowed Russia to bypass transit states. Though it was a very costly decision, it was in fact the only viable option, given the political situations in Belarus and the Ukraine. As a result of the increased number of export gas facilities, Russia will potentially be able to export some 75 percent more gas than it had prior to the construction of the facilities, creating a tremendous reserve capacity and increased room for maneuvering.

The Caspian countries—including Turkmenistan, Kazakhstan, Azerbaijan and Uzbekistan—have the potential to become serious competitors for Russian gas exports to Europe. Russia's dual desires over the last decade to prevent direct European access to Central Asian gas and to retain maximum control over the supply of gas have caused Gazprom to implement a system of gas purchase from Caspian producers and subsequent resale in foreign markets. In 2009, owing to the collapse in demand for gas, this system was partially destroyed, and although at present Russia is still the largest buyer of gas in the region, the desire of Caspian countries to diversify has led to a change in this whole system of international trade in energy.

Because of its central position within Eurasia, the Caspian region could become a key segment of the transcontinental transport systems, primarily for energy transportation through the North-South and East-West axes. Therefore, all of the major powers have been actively involved in the redistribution of the oil and gas market of the former Soviet republics. The U.S., for instance, has both economic (diversification of energy supply, control over energy resources perspective) and political interests (integrating the Caucasus and Central Asian former Soviet republics into its sphere of influence) in the region.

Russia, China, and Iran seek to reduce U.S. and EU influence in the region, as they consider the flow of Caspian gas to the West a threat to their interests. Turkey, situated between Europe, the Caspian region, Middle East, and Russia, aspires to control the energy and transport infrastructure and an exclusive position in the transit of Caspian hydrocarbons. Turkey is actively supported by the United States.

For their part, the biggest new consumer countries—China and India—are interested in steady flows of Caspian resources to their markets, in order to reduce their dependence on Persian Gulf producers and avoid the "Malacca dilemma," as energy transportation from Central Asia is relatively safe, short, and carried by onshore pipelines. China has counted on the region as a key element in its energy security policy, which aims to diversify imports and prevent the risk of excessive dependence on one supplier. A limited U.S. military presence and the lack of forces to resist China's military power make the region an attractive source of energy in the eyes of Chinese strategists.

It has lately become possible to clarify the size and timing of implementation of the objectives set out by the Russian Energy Strategy. This is due to:

- the crisis in the global economy and Russia's ability to overcome it;
- the changes in the political environment and, in particular, the situation with regard to Iran;

- the changes in the geopolitics and energy policies of neighboring countries and major centers of power in the world, including the events in North Africa and the Middle East, the nuclear disaster in Japan, and breakthroughs in major energy programs; and
- the difficulties encountered by Russia during the first phase of the Energy Strategy (2009-2011).

One example of real steps to correct Russian energy policy is the decision to prepare a new version of the Eastern Gas Program of Russia.

For Russia, a traditional “game changer” on the world energy market, the configuration of international agreements in the energy sector is of fundamental importance. The main international instrument in this area is the Energy Charter Treaty (ECT) and agreements to it, which Russia has not ratified because of disagreements with the EU on transit investments. After the Russian-Ukrainian gas conflict in 2009, which showed the inefficiency of the ECT as a tool for resolving transit disputes, the Russian government terminated its provisional application.

In 2009 Russia launched an initiative to develop a new intergovernmental agreement entitled "Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)." However, no meaningful response to Russian initiatives to revise the legal framework in the energy sector followed from the international community .

One of the central issues of Russia's external energy policy is the struggle against the rules of European Union's Third Energy Package for creating a competitive internal energy market. In particular, Russia did not agree with provisions to divide gas companies according to function (production and transport). Discussion of these issues remains part of the Russia-EU Energy Dialogue.

It should be noted that Russia has now established and continues to maintain a positive trend in its political and economic relations with Turkey and Iran. Earlier concerns about their potential negative impact on Russia's position in the countries of the former Soviet Union are no longer considered relevant by Russian officials.

II. Russian Energy Relations with Turkey

Turkey is one of Russia’s key economic partners as the trade volumes between them steadily grow. Turkey was Russia’s sixth largest export market in 2009 and moved up to fifth in 2010. Likewise, Turkey ranked sixteenth among Russian importers in 2009 and rose to eleventh in 2010. In 2011, bilateral trade volume increased to a new high of \$31 billion.

Russia and Turkey share a number of positions regarding the work of the Black Sea Economic Community, of which they are both members. An important factor is their shared approach to the assessment of the situation around Iran.

Russia and Turkey are now able to discuss the development and execution of a strategic partnership in the fields of politics, security, economics, and energy. The mechanism for the implementation of this partnership is The Joint Strategic Partnership Group, which is chaired by the foreign ministers of the two countries.

Russian energy supplies to Turkey include coal, oil, petroleum products and natural gas (Turkey is third among the major importers of Russian gas). For Russia, Turkey is not only one of the largest consumers of Russian energy resources, but also a partner in the implementation of plans for energy infrastructure development to ensure effective export of Russian hydrocarbons to foreign markets, primarily in Europe.

At the end of December 2011, Russia and Turkey reached agreements in the gas sector. On December 28, 2011 during the meeting of Vladimir Putin and T. Yildiz, the Minister of Energy and Natural Resources of Turkey in Moscow, there was an official transfer of a note from the Turkish Foreign Ministry on the "South Stream" international project in which, Ankara gave Moscow the necessary and unconditional permissions to lay an underwater pipeline across the Black Sea Exclusive Economic Zone of Turkey and to subsequently export Russian gas to Europe.

The construction of "South Stream" is set to begin in December 2012 and completed by the end of 2015 with a pipeline capacity of 63 billion cubic meters per year. Participants in the project are Gazprom (50 percent), Eni (20 percent), Wintershall (15 percent), and EDF (15 percent). In addition, an agreement allowing for Russian gas transit through the Trans-Balkan pipeline was prolonged. In its original form, the contract provided for the delivery of 6 billion cubic meters of gas to Turkey and was to be terminated on December 31, 2011. In September 2011, the Turkish company BOTAS announced that it would not renew the contract, but Russia and Turkey reached a compromise on the treaty, agreeing that in 2012 Russian gas deliveries will be increased by 2 billion cubic meters, up to 28 billion in total, at a discounted price.

The European Union, critically dependent on external supplies of hydrocarbons, has pursued a strategy of supply source diversification through the active development of a "fourth corridor", through which oil and gas can be transported from the Caspian region. The Nabucco project is a key element of supplying hydrocarbons from Central Asia and Azerbaijan to the European market, bypassing Russia in the process. Nabucco has been in direct competition with the Russian South Stream project in recent years and has become a major leitmotif in energy diplomacy in the region, giving rise to the term "gas race" and causing a number of problems in Russian-European relations. It should be noted that in taking a very negative attitude towards direct gas supplies from Central Asia to Europe through Turkey (Nabucco), Russia does not have effective mechanisms to counter similar projects for the supply of Azerbaijani gas (e.g., construction of the Transanatolian pipeline, to which Turkey agreed with Azerbaijan).

The Samsun-Ceyhan oil pipeline, the Russian oil industry's largest joint project, will be laid across Turkey from the Black Sea city of Samsun to the Mediterranean port of Ceyhan to bypass the busy Bosphorus and Dardanelles straits. The projected capacity of the pipeline is 60-70 million tons, at an estimated cost of \$3 billion.

In September 2011 the Russian company Transneft announced the suspension of negotiations on the project. Despite some discussion that this decision was taken to encourage Turkey to issue a permit for construction of "South Stream," it is more likely attributable to other factors. For instance, the Russian company position was based on the high cost of transporting oil through the pipeline. According to Turkish estimates, the delivery of a ton of oil through Samsun-Ceyhan would cost \$22-25 (Russian estimates were in the \$19-21 range). Compared to the cost of delivery by sea (\$2 per ton) and for transporting oil through the Burgas-Alexandroupolis pipeline (\$7-8 per ton), the "Samsun-Ceyhan pipeline" would only make economic sense in the event of a shipping accident in the Straits. According to Russian experts, on this matter, the Transneft company is guided solely by narrow corporate interests, and is considering alternative solutions to the problem of the Straits, in particular the construction of the Transfrakia pipeline.

Cooperation between Russia and Turkey in the field of nuclear energy has been more successful. Russia and Turkey agreed to build Turkey's first nuclear power plant "Akkuyu" in the Mediterranean province of Mersin. The project involves construction of four power units with a capacity of 1.2 gigawatts of Russian project "NPP-2006" with a water-water power reactor. The total cost of Turkey's first nuclear power plant will be \$20 billion.

Under the agreement, Turkey established a joint-stock company for the project, which is supported by the two countries and will provide input into the commercial exploitation of nuclear power units. All of the shares of the JSC will initially be owned by companies authorized by the Russian side.

At the same time the Turkish side does not exclude the possibility of building a second nuclear power plant by Russia, which coincides with the interests of the government of Russia, as well as the interests of Russian companies, despite the unimpressive results of Russian cooperation in the field of nuclear energy with other countries.

III. Russian-Iran Energy Relations

Russian economic ties with Iran are of strategic importance based on the fact that it is Russia's largest trading partner in the Middle East, a vast market for Russian machinery, equipment, vehicles, steel and lumber, and a neighboring country where a number of important transit routes are located.

Russia and Iran have common interests in the Caspian region, especially in the sphere of production and transportation of hydrocarbon resources, the development of international transport corridors for transportation and transit of domestic and foreign goods in the north-south direction, and the protection and sustainable use of its biological resources. Interaction with Iran in the oil and gas industry, including the formation of corridors for transportation of hydrocarbons, would improve Russian foreign policy by strengthening Moscow's position in Central and South Asia and the Middle East, while contributing to the energy security of these regions.

Due to its evolving international situation, Iran attaches great importance to bilateral relations with Russia, as well as to the development of the intergovernmental dialogue on economic issues. However, current bilateral trade volume does not meet the potential of Russian-Iranian cooperation, indicating the need for active efforts to promote economic relations.

In September 2011, Russia and Iran agreed to set up a joint Iranian-Russian energy committee where the "Road Map for Energy Cooperation" was developed and signed. The Road Map provides opportunities for exchange of technical know-how, technology, and expertise in the oil, gas and petrochemical industries, with a focus on areas such as oil and gas production, hydrocarbon processing, marine exploration and research on oil and gas wells, in an effort to capitalize on the knowledge accumulated by each country in these areas.

However, in recent years, Russian companies have worked with Iran with some caution due to sanctions imposed by the U.S. and other countries. In particular, the supply of Russian oil products to Iran has practically stopped. According to customs statistics, only a small amount of liquid fuels for household use were shipped to Iran from Russia in 2011. Instead, Iran attained oil and petroleum products from other countries of the former Soviet Union (Kazakhstan, Turkmenistan, and Azerbaijan), often utilizing swap schemes.

The largest Russian private oil company "Lukoil" left the Anaran project in Iran, and stopped the delivery of diesel fuel in April 2010 in order to save their investments in the U.S. However, public Russian companies that had no business relations with the United States did not break off relations with Iran. Last year, "Gazpromneft", which is an oil branch of "Gazprom", signed an agreement with National Iranian Oil Company (NIOC) to jointly develop two oil fields in Iran. "Gazprom" also has an agreement with NIOC to develop South Pars gas field and build up an oil refinery in Iran. "Gazprom" and the National Iranian Gas Export Company have also agreed to a joint venture to engage in the production and transportation of natural gas, as well as the implementation of mutually beneficial trade in third country markets. At the same time, Gazprom has refused, at least for now, to participate in the construction of a gas pipeline from Iran to Pakistan and India, as it considers entry into South Asia's LNG market more potentially beneficial. Gazprom has expressed interest in the Turkmenistan, Afghanistan, Pakistan, and India (TAPI) pipeline.

Like Russia, Iran opposes the construction of the Trans-Caspian gas pipeline agreed to by Azerbaijan and Turkmenistan. In October 2011, the Turkmen leader announced the start of negotiations on the legal basis of supplying Turkmen gas to Europe and founded a special working group. Russia reacted both quickly and negatively. During a Russian Security Council meeting three days later, President Medvedev reaffirmed opposition to gas pipeline construction under the Caspian Sea.

Russia's arguments against the construction of the Trans-Caspian gas pipeline are:

- The legal status of the Caspian Sea is not defined and the decision to build it must be approved by all five Caspian littoral states;
- The construction of the pipeline has been associated with environmental risks.

Despite the fact that Russia possesses the region's most powerful military, including superiority in naval capabilities, it is unlikely that it will use force.

Nonetheless, Russia's main goal is to prevent Turkmenistan from exporting gas to Europe, where it will be serious competition for Russian gas. In this respect, Russian leaders do not consider the extension of gas supplies from Central Asia to China and to the South as a serious threat to either Russian national interests or to Gazprom, which is probably a mistake.

Russian experts do not see Turkey and Iran as direct partners or competitors in the development of energy resources in Central Asia. Neither has Russia demonstrated the desire to counter Chinese expansion in the energy sector of the Central Asian economies.

Cooperation between Russia and Iran in the Gas Exporting Countries Forum has largely been declaratory, in part because Russia was not keen on forcing its formation. As demonstrated by the decision to not join OPEC and its slow reaction to the recent invitation to join the International Energy Agency, Moscow is clearly in no hurry to commit to unions and associations whose value systems were formed without Russian participation.

In the electricity sector, cooperation between Russia and Iran is expected to intensify as they carry out agreements on the synchronization of their electricity systems via Azerbaijan, as well as on mutual supplies of electricity to third countries ("Inter RAO UES" and the Iranian company "Tavanir").

In the field of nuclear energy, Russia supply fuel for existing reactors, including a joint venture for the maintenance and operation of NPP "Bushehr" upon its completion. The construction of a second unit at the Bushehr nuclear power plant and the participation of Russian organizations in the construction of new nuclear power plants in the Khuzestan province are also considered possibilities.

In general it is possible to underline a great potential for bilateral energy cooperation between Russia, Turkey and Iran. However, there appears to be very little chance of forming a multilateral mechanism of a system of regional energy cooperation between them, at least for now.

Literature:

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