



NORMALIZING RUSSIAN-TURKISH ECONOMIC RELATIONS

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Dimitar Bechev

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Abstract: Russia and Turkey have come a long way in restoring their political and economic links after the near-rupture between November 2015 and July 2016. However, the pace of normalization in the area of trade and investment has been uneven. Moscow has succeeded in dictating its terms on issues such as agriculture and energy, with the Turkish government making a series of concessions. Moreover, both the crisis and its aftermath have seen trade interdependence turned into an instrument of soft coercion. As a result, though Turkey sees Russia as a partner on key political issues such as the war in Syria, it continues to search for ways to improve its position in other areas such as energy security. Despite the progress scored by strategic projects such as the TurkStream pipeline and the nuclear power plant at Akkuyu, Ankara has not given up on its long-standing goal to ensure diversification of supplies. To make the normalization of trade and investment links healthier, there should be concessions by Russia as well as by Turkey. To advance further and deliver maximum benefit to producers and consumers on both ends, economic relations need to be depoliticized. of supplies. To make the normalization of trade and investment links healthier, there should be concessions by Russia as well as by Turkey. To advance further and deliver maximum benefit to producers and consumers on both ends, economic relations need to be depoliticized.



“I want to note at the beginning of our meeting that our relations can be considered practically completely restored.” That’s how Russian President Vladimir Putin opened the summit with his Turkish counterpart, Recep Tayyip Erdoğan, on Nov. 13, 2017 in the Black Sea resort town of Sochi. The same assertion is heard more or less any time the two of them meet. Here is Putin, speaking on May 3 2017 after yet another meeting in Sochi: “[t]he period of restoration in Russian-Turkish relations is now over; we are back to a normal partnership.”¹ It is hard to contradict the Russian leader: from Erdoğan’s visit to St. Petersburg (August 2016) onwards, the two states have managed to bury in the past the so-called jet crisis which led to a near-rupture in political and economic ties in late 2015.² Nowadays, the Russian Federation and Turkey are cooperating in Syria, discussing the purchase of advanced anti-aircraft missile systems (S-400), and pursuing major infrastructure projects such as the TurkStream gas pipeline and the nuclear power plant (NPP) at Akkuyu.

Few would have foreseen such a dramatic turnaround two years ago when the Kremlin accused the Turkish government of aiding terrorists in Syria and introduced harsh trade sanctions in response to the downing of its military plane. The effects on were devastating: trade contracted by a third from \$23.9 billion in 2015 to 16.8 billion in 2016 (see Table 1).³ Turkey lost more than \$10 billion – over 1 percent of GDP. Worst affected were Turkish tourism, construction and agriculture,⁴ which were targeted by the Russian authorities for bans and restrictions. By contrast, natural gas, the main item on Russian export list, continued to flow without interruption. In other words, it was mostly the Turkish exports of goods and services to Russia which absorbed the shock.

Table 1: Turkey’s trade with Russia, 2009-17
(billion of USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Turnover	22.7	26.2	29.9	33.3	32	31.2	23.9	16.8	22.2
Imports	19.5	21.6	23.95	26.6	25.3	3	20.3	15.1	19.5
Exports	3.2	4.6	6	6.7	7	5.9	3.6	1.7	2.7

Source: Turkish Statistical Institute (www.tuik.gov.tr)

Even under the best of circumstances, the restoration of trade ties would be riddled with difficulties. It is no wonder therefore that, contrary to official statements, Russia and Turkey have not yet gone back to the situation prior to November 2015. Restrictions are being phased out gradually while Moscow is using the crisis to renegotiate some of the bilateral deals struck with the Turkish government over the years. This paper analyses the stumbling blocks remaining in the way of Russian - Turkish economic cooperation.

Contrary to official statements, Russia and Turkey have not yet gone back to the situation prior to November 2015. Restrictions are being phased out gradually while Moscow is using the crisis to renegotiate some of the bilateral deals struck with the Turkish government over the years

Restoring trading ties: the devil is in the details

All summits between Erdoğan and Putin have been accompanied by steps to ease the Russian sanctions. Thus, in August 2016, Russian authorities lifted the ban on charter flights serving Turkish resorts.⁵ Then, at the World Energy Congress in Istanbul (Oct. 10, 2016), Putin oversaw the signature of the agreement on TurkStream, a gas pipeline he had proposed back in 2014. On Mar. 9, 2017, right before Erdoğan came to town to discuss Syria, Moscow removed the ban on most types of fruits and vegetables from Turkey.⁶ The summit coincided with a session of the



High-Level Cooperation Council, a joint body involving the two governments, which had been inactive since December 2014. On May 31, Putin signed a decree to enable holders of Turkish service passports (over a million individuals), diplomatic and consular officials and families, airline crews and certain categories of business people to enter the Russian Federation visa-free.⁷

Tomatoes spurred a short-lived trade war as Turkey retaliated, on Mar. 15, 2017, by slapping a 130 per cent tariff on imports of wheat and maize and freezing the issuance of licenses for deliveries of rice, peas and sunflower-seed oil from Russia

With a closer reading however, the picture turns several shades bleaker. Despite progress, economic relations have not been restored in full. Russia, taking one step at a time in order to exert leverage over the Turkish government, is yet to remove all restrictions. The most prominent, if somewhat prosaic, example concerns tomatoes, a major item on Turkey's export list along with citrus fruits. Tomatoes were explicitly excluded from the list of Turkish agricultural produce allowed into the Russian Federation. Officials on both sides explain that Russia wishes to develop its domestic production. Putin himself has argued that Russian farmers had already taken banking loans and invested extensively. That, however, is an unlikely proposition; it would take at least five years to scale up internal production to meet demand. A more likely reason pressure from vested interests. The Agriculture Minister Aleksandr Tkachev and his family are examples of high-level officials involved in the farming and food sector.⁸ It is a small wonder, therefore, that Tkachev is one of the loudest voices calling for keeping the restrictions: "We gave our homeland's business a strong signal on the issue of meeting the demand for tomatoes on our Russian market. Of course, state

money has been spent. [...] We, of course, are not prepared to bring back Turkish tomatoes and are not going to do it."⁹

Tomatoes spurred a short-lived trade war as Turkey retaliated, on Mar. 15, 2017, by slapping a 130 per cent tariff on imports of wheat and maize and freezing the issuance of licenses for deliveries of rice, peas and sunflower-seed oil from Russia. The countermeasures were a boon for the protectionist lobby in Russia as it confirmed the status quo. Tkachev commented that they put in question "the sincerity of [Ankara's] intention to build reliable ties."¹⁰ But under direct pressure from Putin, Erdoğan agreed, on April 3, to repeal the decision. At the Black Sea Economic Cooperation (BSEC) meeting in Istanbul (May 22, 2017) Prime Ministers Binali Yıldırım and Dmitry Medvedev formalised the deal in a government-to-government agreement.¹¹

Thereafter, the Turkish authorities tried to talk their Russian counterparts into watering down the tomato ban by making it seasonal.¹² Yet Moscow opted for a different approach. In late October, the Agriculture Ministry allowed a quota of 50,000 tons until the end of 2017. The first shipment of Turkish tomatoes reached Russia in mid-November.¹³ We are yet to see how the issue will play out in 2017 – and whether Turkish exporters will be able to go back to the volumes before the Russian embargo (e.g. 338 tons in 2015).¹⁴

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All in all, it is clear that Russia has applied a "salami tactic", relaxing restrictions step-by-step, in the interest of domestic vested interests but also to preserve diplomatic leverage over Turkey. The timing of most



concessions, around key bilateral summits discussing economic as well as security issues, is suggestive. There is a likelihood Moscow will continue to use trade access as both a carrot and a stick in dealing with Ankara. A seemingly trivial matter such as the tomato ban made it all the way to Putin and Erdoğan, whereas normally it would be a matter for the agricultural ministries (or perhaps the Deputy Prime Ministers Arkady Dvorkovich and Mehmet Şimşek). That makes normalization hostage to the politics of the day.

The visa issue

Another point of friction concerns visas. Moscow has been reluctant to reinstate the visa-free regime for all Turkish nationals suspended in November 2015, citing the threat of terrorism as a reason. However, there are no cases of Turkish nationals being involved in attacks on Russian territory.¹⁵ Visas are a burden to Turkey's construction business, which is struggling to recover its market share in the Russian Federation. Turnover fell to under \$500 million in 2016, from close to \$1 billion in previous boom years (the economic slowdown has hurt Russian contractors as well).¹⁶ There have been some green shoots lately: the Turkish firm Esta Construction won a \$250 million project for a Mercedes Benz assembly plant in the Moscow region and is now bidding for a regional airport in the city of Saratov (another Turkish firm, Limak, is in the race too).¹⁷ But it is too early to tell whether Turkish contractors will make a full comeback so long as hurdles are in place. In September 2016, agents of the Federal Security Service (FSB) were taken into custody for being allegedly bribed by Esta to bypass visa and immigration restrictions.¹⁸ Alongside with agriculture, construction services are key for Turkey to balance its trade with Russia whose exports, mainly gas, are valued at \$25 billion, compared to just \$5 billion in imports.

The energy haggle

A similar dynamic is at play in energy, which accounts for the bulk of trade flows between the two countries – a one-way street, since Turkey is a consumer of Russian natural gas. On the one hand, large-scale projects put on hold at the end of 2015 are now “unfrozen”. That includes TurkStream, a pipeline projected to ship 31 billion cubic meters (bcm) of gas annually to Turkey and the EU via the Black Sea and the Nuclear Power Plant (NPP) at Akkuyu near the Mediterranean port city of Mersin, a venture initiated back in 2010. On the other hand, Ankara's strategic interests diverge from those of Moscow. Turkey has to deal with the challenge of external dependency, reaching close to 100 percent in the case of gas and more than 90 percent for crude oil, as internal demand sees a constant rise. It is keen to drive down the price of Russian gas and mend the chronic trade deficit; diversify supplies away from Russia and establish itself as a trading hub at the nexus between producer and consumer countries; limit the share of gas in the overall energy mix (by boosting its share of renewables, nuclear, and even coal)¹⁹; and have foreign investors (including Russians) bear the commercial risk of implementing ambitious projects.

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Currently, Russia is squeezing out concessions that the Turkish government was reluctant to grant. Up to December 2015, it appeared as if the Turks held most of the bargaining chips relative to Gazprom and Rosatom. The government was demanding a substantial discount on the long-term gas contract attached to TurkStream and was resisting Moscow's request for tax breaks on



Akkuyu NPP. But now, it seems, the tables have turned. The combined effect of the trade sanctions, Syria, and the resultant wish by Erdoğan to restore relations has amplified the leverage Moscow brings to bear in commercial negotiations. The linkage between high politics and business is working in Russia's favor.

TurkStream

Turkey and Russia trade substantial volumes of gas. After the launch of the Blue Stream pipeline in November 2005, Turkey became the second largest customer for Gazprom after Germany, with 24.76 bcm in imports for 2016 (covering roughly 60 per cent of domestic consumption).²⁰ The flow of gas remained stable, largely unaffected by the downturn in diplomatic relations. Speculations that Russia was about to deploy its overhyped "energy weapon" to punish the Turks by cutting off deliveries proved unfounded. Beyond the sheer size of Turkey's market, Moscow values its potential to become an alternative route for gas shipments to the EU, bypassing Ukraine. During a visit in December 2014, Vladimir Putin unveiled TurkStream as an alternative to South Stream, which had been blocked by the European Commission over non-compliance with the EU's competition rules.²¹

The relaunch had been agreed during the first reconciliatory summit between Putin and Erdoğan (St Petersburg, August 2016) so the TurkStream treaty appeared to be a price Ankara was paying for the normalisation of trade links

TurkStream has not had a smooth ride. Bilateral negotiations stalled in 2015 as a result of Ankara's insistence on a substantial discount in the long-term contract for the gas to be shipped through the pipeline. In order to increase the pressure, state utility BOTAŞ even lodged an arbitration suit

against Gazprom. By the time the Russians suspended TurkStream in early December 2015, its prospects were becoming growingly uncertain. The rapprochement in the summer of 2016 gave it a fresh boost. Turkey agreed to sign an intergovernmental agreement in October 2016, before the resolution of the pricing dispute.²² The relaunch had been agreed during the first reconciliatory summit between Putin and Erdoğan (St Petersburg, August 2016) so the TurkStream treaty appeared to be a price Ankara was paying for the normalisation of trade links. Another concession to the Russian side has been the mutual agreement to set the capacity of the pipeline to 31.5 bcm, of which half will be absorbed by Turkey and half be pumped further to the EU and the Western Balkans. Though the original South Stream had twice the volume (63 bcm) and was meant to divert the entire flow passing through Ukraine, TurkStream still gives Russia an advantage, especially if the second string serving the EU gets a go-ahead. In May 2017, the physical construction began for the underwater section in the Black Sea. As of January 2018, more than 700 km out of a total of 940 km of pipeline have been laid down on the seabed.²³ BOTAŞ and Gazprom also reached an agreement concerning the financing of the venture, including the overland section between Kiyıköy and Lüleburgaz in the Turkish province of Thrace.²⁴

TurkStream is a key plank in Turkey's realignment with Russia. Demand for Russian gas is furthermore on the rise, with 2017 setting a record (Table 2). Yet, the strategic consequences of the new pipeline are not as straightforward as usually thought:

First, the prospects for a second string of the pipeline bound to the EU are far from clear. Whether it will make headway and extend TurkStream beyond Turkey and into Greece or Bulgaria hinges upon on whether and how Gazprom settles its regulatory disputes with



Brussels over providing access to competing suppliers.²⁵ Negotiations are likely drag on and might also depend on the general course of EU-Russian relations. Up until March 2014, a working group between Russia and the European Commission was trying to hammer out a compromise on South Stream (TurkStream's predecessor) and "third-party access". Yet the annexation of Crimea put a premature end to discussions.²⁶ Russia's best bet is to obtain a temporary derogation from EU rules on ground of security of supply. To this end, it would need support from member states. But right now most of its attention is directed to Nord Stream 2, a pipeline running to Germany over the Baltic Sea, rather than TurkStream's second leg.

Pursuing other ambitious ventures such as Nord Stream 2 and the Power of Siberia (to China), Gazprom is sure to face difficulties to raise the needed funds to complete TurkStream's extension, especially if access to international financial markets is constrained by the new round of sanctions

Second, Gazprom is affected by the latest round of sanctions imposed by the U.S. Congress in July 2017, which impede collaboration with Western companies in possession of the required technology to build underwater pipelines.²⁷ Pursuing other ambitious ventures such as Nord Stream 2 and the Power of Siberia (to China), Gazprom is sure to face difficulties to raise the needed funds to complete TurkStream's extension, especially if access to international financial markets is constrained by the new round of sanctions.

Third, Turkey has been trying for a long time to diversify gas supplies away from Russia (as well as its second largest seller, Iran). Its goal is to leverage its geographic location and become a conduit – or even a trading hub – of hydrocarbons from the Caspian, Central

Asia and the Middle East to Europe, reaping commercial and geopolitical dividends. That is the underlying logic behind infrastructure projects such as the Trans-Anatolian Pipeline (TANAP) and its extension into the EU, the Trans-Adriatic Pipeline (TAP), linked to the Shah Deniz gas field off Azerbaijan's Caspian coast, which are expected to come onstream in 2019 or shortly thereafter. Over time, TAP, whose initial capacity is just 10 bcm, could be scaled up to pump additional volumes sourced from the Kurdish region in Iraq, Iran or Turkmenistan.

Fourth, Turkey has shielded its domestic market from Russia. In June 2017, Gazprombank announced it was selling stakes in two companies, Enerco and Avrasya, and indicated it might let go of another local spinoff, Bosporus Gaz.²⁸ All these firms had licenses to sell directly to end customers, rather than go through BOTAS, and profit from higher margins. Gazprom Deputy Chairman Aleksandr Medvedev explained the decision through the "unpredictability" of the Turkish market. The counterbalancing move is indicative of the limits putting the spanner the Russo-Turkish energy partnership. Though it does not introduce a new hurdle for TurkStream per se, it demonstrates, yet again, that Turkey's long-term objective is to reduce dependency on Russia.²⁹

Table 2: Imports of Russian natural gas
(billion cubic meters)

Year	2014	2015	2016	2017
Amount	27.3	26.6	24.76	29

Source: Turkish Statistical Institute (www.tuik.gov.tr)

Akkuyu NPP

The nuclear plant at Akkuyu – whose four reactors (capacity 4,800 mW), once complete, would meet up to 7 percent of Turkey's electricity needs – has similarly proceeded in fits and starts over the past decade. It is the largest facility built by Rosatom abroad and



is of high value as a showcase of the Russian Federation's technological advancement to potential customers worldwide. Importantly, Rosatom will retain ownership over the NPP, which means a stable stream of revenue given Turkey's commitment to buy electricity at a set price.³⁰

After a period of uncertainty, Akkuyu rebounded again at Erdoğan's meeting with Putin in August 2016. Suing for peace, the Turkish president accepted in principle Russia's long-standing demand to award the project "strategic investment" status. The decision's significance lies in the favorable customs and tax regime extended to the NPP and adjacent infrastructure. According to estimates, the decision saves Rosatom around \$3 bn, or more than 10 per cent of the overall cost.³¹ No wonder, there had been resistance in Ankara, notably by the influential former minister of energy and natural resources Taner Yıldız during his term in office between 2009–15. Erdoğan similarly dragged his feet before he made good the promise made to Putin. The government's formal decision came only in early May 2017, ahead of the two leaders' summit in Sochi where Russia committed to lift remaining restrictions on imports from Turkey. A consortium made up by Cengiz Holding, Kolin İnşaat and Kalyon İnşaat (CKK), backed by guarantees from the Turkish state, agreed to buy a 49 per cent stake in the NPP. Though the sale may appear as a gain for Turkey, it relieves Rosatom from part of the financial burden it has been carrying.³² The Turkish side has agreed to share the considerable financial risk. In practice, the inclusion of business entities with close connections to the government in Ankara locks in the tax break and other privileges accorded to the project.

Conclusion

Russian-Turkish economic links are on the upswing once again, in parallel to closer cooperation in security affairs. Yet the

interests of the two states are often at odds. Russia has been using the momentum in its favour in order to dictate the terms on a range of issues, including trade in agricultural products, visas, and energy. Turkey has lost bargaining power.

Moscow has been using economic interdependence as a form of soft coercion. That reflects badly on business actors on both sides who wish to capitalize on the closer political relationship, be they Turkish construction firms and agricultural exporters or Russian tour operators

In the short term, that turn of events has no direct bearing on political relations. The imperative to find a settlement in Syria as well as the crisis in Turkey's ties with both the U.S. and principal EU powers such as Germany are bringing Moscow and Ankara closer. The security dimension of the relationship is overshadowing all disagreements in the economic sphere. For instance, Turkey's ongoing operation in Syria against Kurdish militias aligned with the outlawed PKK, codenamed "Olive Branch", would not have been possible without the endorsement of Russia which has control over Syrian airspace. Moscow is critical to the enforcement of the so-called "de-escalation zones" agreed in the Astana talks on Syria and co-sponsored with Turkey and Iran. In short, Russia is vital to Turkish political and diplomatic priorities.

In the medium and long term, however, the discrepancy of economic interests along with Russian pressure on the Turkish government may result into new tensions. At the end of the day, Moscow has been using economic interdependence as a form of soft coercion. That reflects badly on business actors on both sides who wish to capitalize on the closer political relationship, be they Turkish construction firms and agricultural exporters or Russian tour operators. To make the normalization of trade and investment links



healthier, there should be concessions by Russia as well as by Turkey. To advance further and deliver maximum benefit to producers and consumers on both ends, economic relations need to be depoliticized.



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ABOUT ALSHARQ FORUM

The Sharq Forum is an independent international network whose mission is to undertake impartial research and develop long-term strategies to ensure the political development, social justice and economic prosperity of the people of Al-Sharq. The Forum does this through promoting the ideals of democratic participation, an informed citizenry, multi-stakeholder dialogue, social justice, and public-spirited research.

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Normalizing Russian-Turkish Economic Relations

Russia and Turkey have come a long way in restoring their political and economic links after the near-rupture between November 2015 and July 2016. However, the pace of normalization in the area of trade and investment has been uneven. Moscow has succeeded in dictating its terms on issues such as agriculture and energy, with the Turkish government making a series of concessions. Moreover, both the crisis and its aftermath have seen trade interdependence turned into an instrument of soft coercion. As a result, though Turkey sees Russia as a partner on key political issues such as the war in Syria, it continues to search for ways to improve its position in other areas such as energy security. Despite the progress scored by strategic projects such as the TurkStream pipeline and the nuclear power plant at Akkuyu, Ankara has not given up on its long-standing goal to ensure diversification of supplies. To make the normalization of trade and investment links healthier, there should be concessions by Russia as well as by Turkey. To advance further and deliver maximum benefit to producers and consumers on both ends, economic relations need to be depoliticized. of supplies. To make the normalization of trade and investment links healthier, there should be concessions by Russia as well as by Turkey. To advance further and deliver maximum benefit to producers and consumers on both ends, .economic relations need to be depoliticized