The South Caucasus is a region of strategic importance for Europe’s energy supply. This is why energy security is so high on the agenda of both the EU’s bilateral relations with regional states, and of the Eastern Partnership. However, the current political instability of the South Caucasus represents a threat to future European energy security and to the security of the region itself. The 13th RSSC SG publication offers an insight into the current situation and provides an overview of the energy framework and its potential for the future. Furthermore, the behaviour of important regional actors is disclosed to see how they cope with the current instabilities and if their aim to establish a regional energy community would balance the needs of affordability, availability, and access of the regional countries.
The Geopolitics of Energy in the South Caucasus:

Towards a Regional Energy Community

13th Workshop of the PfP Consortium Study Group
“Regional Stability in the South Caucasus”

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Foreword

Frederic Labarre and George Niculescu

The 13th RSSC SG workshop, held in Chisinau (Republic of Moldova) on 07-09 April 2016, deepened the debate started during the 10th workshop of the Study Group on “Towards Europe?! Straddling Fault Lines and Choosing Sides in the South Caucasus”.

At the time (November 2014), the Study Group looked at the European and Eurasian integration as competing commercial-cum-geopolitical projects. The proposed reconciliation was to establish therein a free economic zone, commercially accessible from the otherwise competing integrative processes. On the other hand, the Eurasian Economic Union (EEU) should have become more attractive, and its policies more transparent not only to the domestic actors, but also to the international stakeholders. It was thought that such a solution might have liberated the regional states from the painful consequences of their strategic dilemma between a European and an Eurasian future. And it could have induced both the West and Russia to engage in the South Caucasus in a way that would have favoured the removal of inter- and intra-regional dividing lines. In such circumstances, post-conflict regional economic integration in the South Caucasus, including in the area of energy, should have become the norm.

However, the current geopolitical realities, in particular the geopolitical fragmentation of the South Caucasus that has continued to splinter regional energy security, have continued to reinforce this process of protracting the conflicts of the region.

The workshop in Chisinau aimed to provide a framework for a regional energy resources regime, and divorce energy from politics. We understand “regime” in the sense of the term coined by Joseph Nye and Robert Keohane in the mid-1970s with their landmark study on “Power and Interdependence”; a regime is a system of norms of behaviour that regulates conflictual relations. Institutionalisation and regulation make relations more predictable, and may eventually lead to spill-over effects that sustain coop-
eration. It is thought that, this way, the countries of the region might exercise greater sovereignty over market integration choices without affecting the energy supply of countries downstream, thereby reversing the breakout of energy security in the South Caucasus. In this context, we asked participants whether this solution would be feasible, and to work out to the best interest of all actors involved how to make it happen.

The keynote speech offered an insight into the evolving role of the Energy Charter Treaty (ECT) in energy cooperation, and reflected on its potential as an example of positive development that could be furthered in the South Caucasus. In that vein, there was no need to reinvent the wheel in regional energy cooperation, though it might be improved upon. The ECT has a special role in bringing together the producer and transit countries from the South Caucasus, and linking them to the main consumer markets for their energy products. In fact, the fundamental aim of the ECT was to strengthen the rule of law on energy issues, by creating a level playing field for all participating governments, thereby reducing risks associated with energy-related investment and trade. However, given the three blocks currently evolving in Eurasia (European Union’s Energy Union, the Eurasian Economic Union, and the Silk Road Economic Belt) there is a danger of developing fault lines. The countries from the South Caucasus straddle those potential fault lines. There is therefore a need for a regional forum for energy dialogue, as well as a system of global energy governance, to include all relevant players, if the fragmentation of energy markets in the Eurasia is to be avoided. Energy dialogue is very important, but it is not enough. The challenge would be to move from dialogue to governance. However, for the moment, the political will to achieve this is scarce.

The first panel was meant to define energy security in a way that might facilitate a separation of energy security and geopolitics. However, all speakers thought that energy and geopolitics were bound to remain “innately correlated” in the South Caucasus. Many factors conspire to make cooperation difficult in the South Caucasus; the aggravation of persistently unresolved conflicts, Russian manigances, clashing Middle Eastern interests, and the undetermined status of the Caspian Sea bed. Why have energy security and geopolitics become fundamentally intertwined? One possible explanation is that energy security as an integral part of geopolitics; the geopolitical picture cannot be understood in a realistic manner, unless the
energy security pieces of the larger jigsaw puzzle were properly put together. From this perspective, only a radical change of regional mind-sets can really separate energy from geopolitics. To build up a new, energy cooperation-prone mind-set, one needs to resolve the regional conflicts, have regional governments perceive their mutual interest in energy cooperation, develop a new vision for the South Caucasus as a profitable energy “aorta”, and promote pragmatism over national security concerns.

If regional energy cooperation and geopolitics could ever be divorced from each other, one speaker suggested the establishment of a South Caucasus Joint Energy Group that might increase and diversify energy imports and exports, enhance, harmonize and inter-connect energy infrastructure, create a unified legal framework that would attract foreign investment, and promote strategic and policy dialogue among the stakeholders. This would turn the region into an energy hub inter-connecting the European, Eurasian and Middle Eastern energy markets. Otherwise, the Joint Energy Group or any other similar regional structure for energy cooperation would remain a mere “pipedream”.

The second panel looked at the energy security strategies of the South Caucasian states against the background of the broader geopolitical interests of regional powers, and the ongoing unresolved conflicts in Abkhazia, South Ossetia, and Nagorno-Karabakh (NK).

For Armenia, energy security has been one of the pillars of its national security. With no oil and gas resources of its own, Armenia imports natural gas for both domestic consumption and production of electricity. At the same time, it has developed a renewable energy sector, which, in the longer term, might lessen Armenia’s dependence on energy imports. Armenia’s energy security strategy provided for the necessity of regional cooperation, and of diversification of energy supply sources and routes. In addition, the construction of a new Nuclear Power Plant (NPP), as well as the development of new generating capacities, mostly using renewable energy sources, have been also put forward. Armenia has been excluded so far by Turkey and Azerbaijan from all East-West regional energy projects in an attempt to compel Yerevan to make concessions in NK conflict negotiations. However, the exclusion of Armenia from regional energy projects didn’t result into a breakthrough in NK conflict resolution, but it offered a momentum
for Russia to cement its energy (and wider economic) grip on Armenia, and it favoured the development of a North–South energy corridor in the South Caucasus to Russia, from Iran via Armenia and Georgia. Expanding the energy relationship with Iran should become a priority for the Armenian government as a means to diversify its energy supply. Moreover, such a shift in Armenia’s energy priorities would be also most advantageous beyond the NK conflict resolution, since the existing Southern Gas Corridor, established by Azerbaijan will need Iranian gas, which could be delivered via Armenia. However, it is likely that Russia would prevent Armenia from developing the full potential of its energy relations with Iran in order to maintain its ability to take advantage of its current energy dependence.

Azerbaijan, as the only major regional energy producer in the South Caucasus outside of Russia, had a quite different perspective on energy and its relationship with regional security. By occupying parts of Azerbaijan, Armenia excludes itself from regional energy projects in the South Caucasus. Azerbaijan would favour developing regional energy cooperation in the South Caucasus, provided that significant steps were made on NK conflict resolution. Baku is concerned with the Georgian shift in importing gas from Russia (instead from Azerbaijan), which creates increased mistrust in Baku towards the prospects of an emerging Georgian-Russian-Armenian gas deal. Baku is also concerned by threats from Armenians from Nagorno-Karabakh against Azerbaijani energy infrastructure, in the context of an outbreak of military confrontation in NK. It is interesting to note the Armenian response to Azerbaijani allegations that Armenians would be mismanaging the water resources from NK and the seven Azerbaijani districts around NK by artificially flooding or creating droughts in downstream Azerbaijani territories: “let’s manage jointly the Sarsang Water Reservoir in the same way Georgians and Abkhazians were jointly managing the Inguri hydropower station”. This proposal seemed to get some traction with the Azerbaijani side provided it was discussed at the level of local communities from NK. However, establishing dialogue among local communities from NK might seem a non-starter from an Armenian perspective, at this stage.

Reconciling the European and Eurasian energy security strategies in a way that would favour the removal of the emerging fault lines in the South Caucasus was the main focus of the third panel.
With the declared aim to become an energy hub for the European energy markets, and with a growing domestic demand of energy, Turkey has become an important factor in European energy security. Turkey’s energy strategy has aimed not only at diversifying its own, but also the European energy supply. To this end, Ankara needs to develop sustainable regional energy cooperation with all the countries from the South Caucasus. However, a gap between its ambitious strategic objectives, and its limited energy resources, as well as the current energy overdependence on Russia, and the failure to integrate Armenia in any regional energy cooperation framework has weakened Turkey’s ability to contribute to sustainable regional energy cooperation in the South Caucasus. Greater coordination between Turkey and the European Union is critical in preventing Russia from exploiting energy vulnerabilities in the South Caucasus.

An energy transit regime, developed and implemented under the Energy Charter Treaty (ECT), may contribute to increasing regional stability and cooperation. To that end, the institutional capacity of the ECT should be enhanced, not only to regulate the energy trade among the South Caucasus countries, but also to potentially sustain broader regional energy cooperation. Nevertheless, large energy transport projects, like the Southern Gas Corridor, may actually raise questions about the security of critical infrastructure and its relationship with the regional conflicts. In the absence of an internationally binding energy transit regime, how could one guarantee the energy security of the region in case a conflict erupts? Or while the international community failed to help the parties in finding a viable, permanent solution to the conflict on Nagorno-Karabakh, to what extent would be the current status-quo in the Azeri-Armenian conflict sustainable? Those questions could be addressed through defining an institutional energy transit regime in the South Caucasus, while this new regional energy community might mitigate the potential for conflict by increasing the energy cooperation between its members.

The Russian perspective on energy security in the South Caucasus is quite different from that of most of the other players. While South Caucasus regional security is not perceived as a threat to Russian energy security, and Moscow didn’t envisage full scale regional energy cooperation, the main challenges facing Russian energy security would stem from volatility of the global oil price, plummeting demand, rising extraction costs and Western
sanctions and other technology exports constraints against Russia. To mitigate the impact of these energy security challenges, Russia has focused on expanding its Asian energy markets (i.e. new energy deals with China), as well as on defending its share from the European energy market against potential competitors, such as Azerbaijan, Iran, Iraq and the emerging energy producers from the Eastern Mediterranean. It also aims at diversifying its energy export routes to Europe away from Ukraine, to allegedly decrease their vulnerability to security and geopolitical risks in the wake of the Crimea and Donbas conflicts. The downing of the Russian jet over Syria by Turkish air forces has further undermined Russian ability to diversify its energy transit routes to Europe. In that respect, the apologies offered to Russia by President Erdogan are indicative of Turkey’s vulnerability. The most likely scenario on reconciling European and Eurasian energy strategies in the South Caucasus, at this stage, would be a “neutral scenario”, whereby mutual respect for each other’s interests, no escalation of regional conflicts, and limited regional energy cooperation prevailed.

Building on the role of energy in bringing about regional cooperation, the RSSC SG sketched an embryonic regional organization to manage and resolve energy issues in the South Caucasus. One of the aims of this organization might be to join-up the region under the banner of joint energy management. Its main mission therefore would be to promote the development of region-wide energy infrastructure to generate market and distribute energy within the region and beyond. Particular ideas were put forward, such as the creation of a regional emergency management function to deal with natural or man-made disasters impacting energy transfers, the establishment of a regional trust fund to cushion the shock of energy price fluctuations (for suppliers as well as for clients), and the draft of a workable institutional structure. During the 14th workshop of the RSSC SG, these ideas will be further explored and developed against the background of best practices in public administration, institution-building, international law, disaster management, finance and budgeting, and in the governance of regional organizations.
Abstract

The South Caucasus is a region of strategic importance for European energy supply. This is why energy security is so high on the agenda of both EU’s bilateral relations with regional states, and of the Eastern Partnership. The EU Energy Security Strategy provides for diversifying external supplies and related infrastructure as a key pillar to promoting the energy interests of the Union. The establishment of the Southern Corridor, crossing the South Caucasus along an East-West axis, prepares the ground for increasing energy supplies to Europe from the Caspian region and beyond. Moreover, the Southern Corridor is vital in providing future opportunities for EU’s energy connection with the Middle East. The recent review of the European Neighborhood Policy has advocated for establishing gas reverse flow capacities to Ukraine, and completing the Southern Gas Corridor as important steps towards achieving pan-European energy security. It also stipulates that the EU will enhance full energy market integration with Georgia, the Republic of Moldova, and Ukraine through the Energy Community, and pursue regulatory approximation with other South Caucasus partners in related areas of mutual interest.

However, the current geopolitical instability of the South Caucasus region imposes a risk to the current energy security. The 13th RSSC SG workshop provided a framework for a regional energy resources regime, and separated the energy agenda from the political agenda. Key questions on the regional concept of energy security, the perception of regional actors and the future of EU, US, Turkish and Russian/EEU energy security strategies will be answered in this Study Group Information.
I am very honoured to participate and to deliver this Keynote speech at this PfP Consortium Study Group Workshop.

As I address the issue the geopolitics of energy in the South Caucasus: towards a regional energy community, I will inevitably place much emphasis on the Energy Charter as an example of an instrument for energy cooperation. That is because of my role as Senior Adviser in the Secretariat of the Energy Charter!

I will first briefly describe the Energy Charter, including the Energy Charter Treaty, to provide context for the rest of the talk.

Secondly, I will focus on the role and relevance of the Energy Charter to the countries of the South Caucasus region; Armenia, Azerbaijan and Georgia. I will try to outline what membership of the Energy Charter has already achieved for these countries. The Energy Charter is an example of a means of energy cooperation that has already existed in the South Caucasus for over 20 years. That is something that should be noted. If I may say so, there is no need to reinvent the wheel. That is a point that I intend to emphasise.

Thirdly, I will discuss the problems that may arise in the region, of what fault lines may develop among different economic spheres. I will have in mind some of the key questions in the programme of this event. In that context I will discuss the new International Energy Charter, and its potential as an example of a positive development in cooperation that could be furthered in the South Caucasus. I believe that it can be seen as a good example of regional and international cooperation.
The Energy Charter

The European Energy Charter was signed in 1991 in The Hague. It was the first real institutional step taken towards the establishment of a framework of rules for East-West energy trade. This had been envisaged by the Dutch Prime Minister, Ruud Lubbers, at the end of the Cold War.

The Energy Charter Treaty (ECT) followed in 1994 and incorporated the principles contained in the 1991 Charter into a legally binding mutual commitment. The Treaty endorses the need to develop open and efficient energy markets. The Treaty deals with the promotion of conditions for the encouragement of Foreign Direct Investment, on a non-discriminatory basis. At the same time the Energy Charter Treaty contains a specific acknowledgement of state sovereignty over natural resources.

The Energy Charter Treaty was signed by all of the countries that were members of the former Soviet Union. However the Russian Federation is one of four countries who have not ratified the Treaty, but who nonetheless play a role in the Energy Charter Process. All the countries who are now members of the European Union ratified the Treaty. So did Turkey, a near neighbour in the region.

What is important in the context of today’s workshop is that the South Caucasus states – Armenia, Azerbaijan and Georgia – are all members of the Energy Charter. Because of the strategic position of Armenia, Azerbaijan and Georgia between Europe and Asia, each of these countries is an important and active member of the Energy Charter constituency. Georgia was the first country to ratify the Treaty in 1995. Azerbaijan did so in December 1997, and Armenia in January 1998. Georgia held the chairmanship of the Energy Charter Conference in 2015. They have all faced the challenge of adjusting their national and regional policies to the requirements of the Treaty.

The Energy Charter is unique among international energy organisations because it can count all of the countries not only of the South Caucasus; but also, the Caspian, and the Black Sea regions as participants in the Energy Charter Process. This means that the Energy Charter Treaty has a special role in bringing together the producer and transit countries of these...
regions, and linking them to the main consumer markets for their energy products.

The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating rules for a level playing field to be observed by all participating governments, thereby reducing risks associated with energy-related investment and trade.

Large-scale foreign investment is required if the full energy potential of any region is to be realised. Foreign investors are simply reluctant to invest where the rule of law is not in place, or fully developed. The investment climate can be much improved by reducing the level of risk. That is what the Energy Charter Treaty does, and what it has already done in the South Caucasus.

I refer you to the investment promotion and protection provisions of the Treaty. There you will find a legally binding commitment by parties to the Treaty to abide by international investor-state arbitration in cases of dispute. These provisions also have the effect of strengthening the rule of law and transparency.

The Energy Charter and the Caucasus region

The countries of the Caucasus connect the Caspian and Black Seas, which, combined, are amongst the most exciting regions in the world of energy. Since Azerbaijan and Georgia’s first involvement with the Energy Charter, they have proved to be reliable transit partners for transporting Caspian energy resources to global markets.

There is an enormous potential in the Caspian region. The need for the successful exploitation of these abundant energy resources has become all the more pressing over the last two decades. This is due not only to local factors, but perhaps even more importantly; it is the result of the changing position of the Caspian region within the fast evolving global energy markets.
Perhaps the most important long-term observable trend in Azerbaijan and Georgia has been steady reforms in the energy sectors. Such reforms have facilitated the transportation of energy resources of the landlocked Caspian region to the outside world. In the 1990s, the main focus of this trend was on the oil sector, with the creation of new pipeline networks that today enable Caspian oil to reach global energy markets.

In the last decade, the major focus has shifted to expanding gas connections from the Caspian region to the leading consumer markets – in both directions: East (China) and West (Europe). Here the challenges have been different – not only in a technical way but also in terms of the politics in the Caspian as well as the Black Sea regions.

Today in the wake of COP21, the South Caucasus states also have an important potential as the world looks to transition to low-carbon solutions. These countries have well known strengths and resources in hydropower. There has already been quite an amount of development of hydro power in Georgia. Armenia has great hydro power potential. Armenia can, moreover, boast of energy efficiency ratings that put the country near the top of the lists of former Soviet Union states. As energy efficiency and renewable energy sources become more important, the potential or the need for regional networks with regard to these resources becomes more urgent.

Georgia, for its part, faces security challenges, yet also has perhaps the strongest position in the region. Georgia is already acting as an energy hub for power and hydrocarbon flows, and this role will only expand. Furthermore, the country has a robust hydro sector with potential for more development. Both of these facts offer a multitude of opportunities for development in the future, especially as hydro and new power transit corridors become more important.

In Azerbaijan, like other powerful hydrocarbon states, the oil price crash of the past few years has created some difficulties. Combined with the drop in revenue, Azerbaijan has faced challenges in diminished oil field output, though natural gas has filled some of the void.

While one can point to the great successes and developments in the energy sectors of the three South Caucasus countries, much more investment will
be needed over the coming decades, particularly when considering the COP21 initiatives. These investments will not be achieved without mobilising private investors and capital. This therefore represents an opportunity for a region as important as the South Caucasus, with its striking potential in areas such as hydropower and gas, as well as its critical location at a crossroads. The region could become an energy hub, developing its own energy sources, while leveraging the supplies of surrounding countries such as Iraq, Iran, Turkmenistan, and feeding them on to hungry markets in Turkey and beyond. That makes the need for regional cooperation all the more important, precisely as this workshop is required to focus on.

There are important provisions in the area of transit within the Treaty. Indeed the relevance of the Energy Charter was clearly demonstrated during negotiations on the Baku-Tbilisi-Ceyhan (BTC) pipeline. The BTC agreements referred to the Energy Charter Treaty and to its rules for a level playing field. The Treaty requires that those rules should be observed by all participating governments. This has had the effect of mitigating risks associated with investments, transit and trade.

Transit is obviously a major issue. It is so for Russia and for the Caspian region as energy producing regions. It is also so for China and the EU as energy consuming regions. The geographical location ensures that Azerbaijan and Georgia have been critical to this issue. The fact that the Caspian countries are land-locked means that the transit arrangements of the region are vital not just to them but also to the consumer nations of Europe and Asia. That is where membership of the Energy Charter can continue to benefit all.

Under the Energy Charter Treaty, the Contracting Parties are obliged to facilitate transit of energy consistent with the principle of freedom of transit. Countries (and that includes those of the South Caucasus) should treat transit of energy no less favourably than energy originating in or destined for their own markets. Obstacles should not be placed to the creation of new capacity in energy transport facilities, and established cross-border flows shall be secured.

However, it is not a secret that the negotiations on a Transit Protocol to the Treaty have had great difficulties. A form of deadlock was reached in
these negotiations. If a reliable common framework for transit were in place at this stage, there would be no need for expensive bypass pipelines. I should also emphasise that the Energy Charter is available as a multilateral framework to address emergency situations with regard to energy supply.

**The International Energy Charter**

My third point concerns the fault lines that are developing, and which are of such critical importance to this region. These indeed are the essential point of today’s discussions, and on which I am keen to hear your views.

The European Union has recently put forward its proposals for an Energy Union. To the East of the European Union a regional energy market is taking shape. I refer to the Eurasian Economic Union. The participating states include Armenia, and also Belarus, Kazakhstan and Kyrgyzstan, and the Russian Federation. I should mention that all of those with the possible exception of the Russian Federation are Contracting Parties to the Energy Charter Treaty. These states may have diverging and different interests but it is clear that some shape of common market will emerge. It is difficult to predict what the impact of this new structure will be. Perhaps it may deepen the fragmentation of energy markets in Europe and Asia, or on the contrary it may be the catalyst for new opportunities for cooperation and market integration. There is also the question of what internal reforms may be required by the process for the member states. In the 1990s the transit of Central Asian gas through Russian pipelines was a sticking point within the Energy Charter process as it attempted to negotiate a protocol on transit. Gazprom wished to protect its monopoly on transport and exports. It is therefore unlikely that the Eurasian Economic Union integration process will lead to any change there.

There is a view in Europe that the Eurasian Economic Union is a project aimed at isolating its members from the European Union and establishing a political coalition under the leadership of the Russian Federation. On the other hand there is a view that the processes can be complementary and ultimately facilitate closer cooperation. To develop a Eurasian Economic Union wide energy grid and to modernise the energy market, enormous foreign investment, know how, and technology transfer will be required.
A difficult situation may arise in the South Caucasus where Georgia is a candidate for the Energy Community, and so being linked to the Energy Union of the European Union, while Armenia is looking towards the Eurasian Economic Union. Azerbaijan is so far striving to maintain a balanced relationship with both the European Union and the new Eurasian Economic Union; if you like a balance between Brussels and Moscow.

Meanwhile China and Russia are discussing the possibility of integrating the Eurasian Economic Union into the Silk Road Economic Belt. The fragmentation of energy markets in the Eurasian continent should be avoided, as it would only create new lines of conflict and serious commercial disputes. Moreover free and liberalised energy trade is in everyone’s interest.

The countries of the South Caucasus are placed on the convergence of those potential fault lines. There is therefore a great need for a forum for dialogue, for a system of global energy governance, to include all these players.

Energy dialogue is a very important exercise. Some forms of energy dialogue are already facilitated in forums such as the International Energy Agency. At regional level there are forums such as the five Economic Commissions within the United Nations. There are also some forums within the G7. The most recent addition to this “family” is the International Energy Forum, the Secretariat of which is based in Riyadh in Saudi Arabia.

But energy dialogue is not enough. The challenge is the move from dialogue to governance. That precisely is the potential of the Energy Charter. And as I said at the beginning all the countries that we are discussing today, those of the South Caucasus, Turkey, Ukraine, and Moldova are members. That is why I say, there is no need to reinvent the wheel!

In 2015 in The Hague, the International Energy Charter was adopted by consensus by the seventy-three countries present. A number of other countries have since signed. Most significantly the International Energy Charter takes the Energy Charter from its original Eurasian context and brings it to a global level. This was best illustrated by the fact that China was one of the
signatories to the new Charter in The Hague. There are also countries from the continent of Africa and from the Americas. Essentially the International Energy Charter is an effort to create a global energy framework.

The adoption of the International Energy Charter is a clear demonstration that the Energy Charter Process is inclusive, that it is non-discriminatory, that it is open to any country willing to share the principles. Meanwhile, it addresses such contemporary challenges as access to energy. The necessity to invest in renewable energy has also been added. The focus for all countries and companies remains on energy investments, which would pay huge dividends for the South Caucasus states and provide an opportunity to leverage their advantageous natural resources and crossroads locations.

The International Energy Charter can be used by the countries of the Caucasus to ensure cooperation at a working level – for example high voltage grids, experiences in unequal power generation, and regional distribution, mechanisms of cross-border trading, network planning and IT security. Such efforts would contribute to ensuring compatibility between all, or at the very least prevent further drifting apart at the technical, commercial and regulation levels.

There are three particular issues where I believe that the multilateral approach – as embodied in the Energy Charter Treaty – can make a vital contribution to more predictable energy policy and legal certainty in the South Caucasus. That is something that would be in the interests of all. Those three issues are; investment protection, secure and reliable transit, and building confidence and promoting cooperation. However to achieve this full potential will of the member states must be exercised.

A recent demonstration of such political will is the meeting on Regional Electricity Cooperation in South Caucasus held on July 1st 2015 under the Chairmanship by Georgia of the Energy Charter. In a statement following that meeting the Ministry of Energy of Georgia called for the creation of a forum within the framework of the Energy Charter to exchange information on best practices and lessons learnt for developing cross-border energy markets and transport corridors. There was a welcome for the establishment of a regional platform to bring together government officials, represent-
tatives of transmission system operators and regulatory authorities, as well as representatives of donor community and regional organisations.

Ladies and Gentlemen, distinguished panellists, I hope my remarks will contribute to your deliberations today here in Chisinau. Later in the Workshop discussions I hope to hear of the strengths and opportunities in the South Caucasus to overcome challenges and be a leader in this new, post-Paris Agreement world. I ask you to reflect on the International Energy Charter of 2015 and its potential value for the promotion of energy investments, cross-border trade and transit, for Armenia, Azerbaijan and Georgia, but also in the greater region and beyond.
PART I:

UNDERSTANDING THE MEANINGS OF ENERGY SECURITY FROM THE BLACK SEA TO THE CASPIAN
Great Expectations or Lost Illusions: Energy Security in the South Caucasus

Elizaveta Egorova

Today, the subject of energy security is vital in foreign policy, as much as global terrorism, weapons of mass destruction smuggling, international conflicts, or drugs trafficking. The raging increase in global demand for energy resources makes energy routes and transports the focal point in the strategic battle for their ownership. Consequently, energy security and geopolitics are tightly intertwined. Not surprisingly, the energy nature of contemporary foreign and domestic policies determines many political processes, including international conflicts – potential and real. Energy security cannot be viewed as only securitization of energy supply and availability, but also as an instrumentation of national power. Of course, energy pipelines, the “markers” of geopolitical influence and leverage, divide the energy community into exporters, importers, and transit states. More importantly, however, the world divides into those who receive and benefit from the pipeline routes, the energy community, and those, outside the energy community, who do not. The “do-nots” are isolated from natural resources and their direct and indirect advantages.

Approaches and perceptions on energy security

There is no global consensus on the determination of energy security, its dimensions, and indicators. It is a multifaceted conceptual understanding that differs from country to country, depending on national interests and priorities, and the role of energy in the countries domestic and foreign policy. Energy security can be viewed as a cluster: energy availability, afforda-

3 Papanikos, Gregori. “Energy Security, the European Energy Union and the Mediterranean Countries”. Paper was presented at the roundtable discussion on “Energy Secu-
bility, efficiency, infrastructure development, environment and social effects, regulation and governance. Another key aspect of energy security is the variety of stakeholders; state, non-state, local, national, and international. Each having a different perception of energy security and, therefore, using a different articulation to address their concerns.

Energy security strategy of the European Union and of the Russian Federation

The European Union (EU) faces a new reality after the Russian Federation violation of Ukrainian territorial integrity when the annexation of Crimea was followed by Russia backing the separatist war in the Donbass Region. Russian aggression in its neighbour Ukraine, the primary energy transit hub to Europe, has shattered EU confidence in Russia as a reliable source of energy supply. The Donbass action removed the remaining doubts.

The EU’s energy security policies and approaches are being challenged. In response to the changed geopolitical reality, and disabused of safe dependence on Russia’s energy imports, the EU crafted new energy security strategies to ensure its member states have a stable and abundant supply of energy resources, and limited vulnerability to supply disruptions. Therefore, in the wake of geopolitical turbulences and a transforming global energy environment, the Black Sea and Caspian regions, rich with hydrocarbons, emerged as a target of EU’s diversification strategy. In this light, the South Caucasus increases in importance as a major alternative energy source and an enhanced transit hub to satisfy the EU’s need for assured energy.

Since Czarist times, Russia has controlled and dominated the majority of oil fields and later pipeline projects in what was to become the Soviet Union, using them as a foreign policy tool to cement Russian economic and geopolitical interests. Traditionally, the key energy import destinations were the European countries. However, given the recent transformations in geopolitical reality, the EU’s members have decided to diversify their imports and establish as much energy independence from Russia as possible. The new European strategy will have a significant impact on Russia’s energy exports in the long term, diminish Russia’s presence in the global energy market, and weaken Russia’s energy leverage—a Russian means of influencing Western foreign policy and securing its national interests.

Economic and political sanctions imposed by the Western countries shortly after Russia’s annexation of Ukrainian peninsula Crimea in 2014, and the EU’s ongoing alternative energy projects, forced the energy behemoth, Russia, to turn from West to East. Asian markets should diversify and secure Russia’s exports capacities, economy, and reduce dependency on the European market and Western political conjuncture. The Kremlin considers energy security to be the most important element of Russia’s national and economic security, which it defines as security of demand and of transit points.6

The recently updated Russian Energy Security Strategy spans two decades, to 2035. It emphasizes the number of challenges and threats to the energy sector, including the dwindling prospects of increasing energy exports in the European market due to the narrowing demand. Similarly, the potential growth in the Asian direction is limited due to the lack of export infrastructure and the need for major Russian public and private investments in Asian market development.7 Therefore, although the diversification to the East is an inevitable scenario to accommodate Russia’s resource-driven economy, preserving Russia’s dominant energy presence in Europe is vital

to support export revenues and maintain political leverage in the foreign policy theatre. The potential South Caucasus energy projects, offering the EU an alternative to Russian hydrocarbons, weaken the Russian energy position in the long run, especially if the Central Asian and the Middle Easter countries join the most anticipated gas project by the European Union, called the Southern Gas Corridor.

**Energy security threats and challenges to the South Caucasus**

The three independent countries of the South Caucasus are united by geography. Armenia, Azerbaijan, and Georgia each play a similar geopolitical and energy security role due to their cartographic location. A strategic chessboard for millennia, the current South Caucasus counts additional players, Russia, Turkey, Iran and non-regional actors, the EU and NATO. The energy-hub South Caucasus, between the energy-thirsty EU and the energy-rich Caspian Sea and Central Asia, has great potential in the EU’s diversification strategy to get the West off the Russia’s energy needle.

The region is highly fragmented: the peoples divide and subdivide along cultural, political, religious, and ethnic lines which cross and crisscross frontiers. The resulting array of security challenges, in addition to unresolved territorial conflicts, such as those in Nagorno-Karabakh, South Ossetia, and Abkhazia, make this a precarious region for national and international investment and development. There is deeply rooted and persistent cognitive dissonance – regional mental stress about conflicting relations among Armenia, Azerbaijan, and Georgia. This lack of political and technical integration within the South Caucasus countries has its routes in history, beyond the scope of this paper. A long memory is one of the predicaments of this region.

The South Caucasus states are also fragmented, internally and externally, by their energy dependency, international frameworks, regional preferences

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and partnerships, and by the different political and legal approaches and views in the South Caucasus. Armenia joined the Russia-led Eurasia Economic Union in January 2015. Azerbaijan is maintaining its neutrality as of 2016. Georgia had earlier signed an EU Association Agreement in June 2014. However, Armenia, Azerbaijan, and Georgia are all members of the European Union’s Eastern Partnership. Such classic South Caucasus fragmentation and cross-allegiances are obstacles to energy cooperation among Armenia, Azerbaijan, and Georgia, between the South Caucasus and EU, or even between the South Caucasus and Russia.

Energy-poor Armenia and less-poor Georgia are both heavily dependent on gas imports. Land-locked Armenia relies on gas imported mostly from Russia – 80 percent and from Iran – 10 percent. Georgia receives its gas from Azerbaijan – 88 percent and Russia – 10 percent. Moreover, in these two energy-dependent South Caucasus countries, the majority of their energy infrastructure, including energy supply and distribution, transmission, and power plants, has been privatized by foreign companies. The companies are headquartered in neighbouring Azerbaijan as well as Russia, Kazakhstan, and the United Kingdom, to give just a few locations. These companies are no strangers or newcomers; British Petroleum (BP) for example, was founded as the Anglo-Persian Oil Company in 1908.

In order to facilitate the energy security of the South Caucasus today, it is vital to assess the current views on the concept of energy security in Armenia, Azerbaijan, and Georgia, to select key aspects, and highlight stark differences and common similarities in approach.

**Armenia**

Around 75 percent of the total energy supply Armenia receives comes from Russia. Russian monopolization and presence in Armenia’s energy sector is immense. Gazprom Armenia dominates and has fully owned, since January

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2014, Armenia’s distribution networks, and delivers gas via Georgia to the Armenian domestic gas market and for power generation. In 2015, Gazprom Armenia took over the ownership of the pipeline section on the Armenian-Iranian border through which a lesser amount of gas comes from Iran, a barter agreement, in exchange for electricity deliveries from Armenia to Iran.\(^\text{10}\)

Armenia has a substantial electricity capacity for domestic production and for export, although it has certain limitations in the cold season, when the Hydro Power Plants (HPP) cannot operate fully and the demand for consumption is at its peak. Currently, their electricity trade with Georgia is hampered due to differences in their networks and thus exports are low. However, in December 2015, Armenia, Georgia, Iran, and Russia signed a memorandum to work on the development of a power transmission system to enhance electricity trade between the aforementioned nations, thereby strengthening regional cooperation through power trade.\(^\text{11}\) New power converter and transmission lines with Georgia are planned for construction. Interconnectors with Azerbaijan and Turkey do not operate due to stalled political disputes. The electricity market is relatively closed to new players and is controlled by the Armenian government.

Armenia is dependent on nuclear energy. The 36-year-old Metsamor nuclear plant, located 120 km from Azerbaijan, and only 16 km from Turkey, is another stumbling block in Armenian-Azerbaijani relations, besides the conflict in Nagorno-Karabakh. Due to the reactor’s aging technology and location in a potentially hazardous seismic zone, its exploitation puts at risk the neighbouring states of Azerbaijan, Turkey, and Georgia.\(^\text{12}\) The Arme-

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\(^{10}\) “Russia Tightens Its Hold on Armenia”. Stratfor, 02.11.2015. https://www.stratfor.com/analysis/russia-tightens-its-hold-armenia, accessed on 4.4.2016. Note from the editors; this outcome is certainly linked to the “electricity riots” which took place in Yerevan in 2015.


nian Nuclear Power Plant (ANPP), or VVER 440 Model 230, at Metsamor, is designed to handle only small ruptures and does not have a safety compartment to protect its nuclear fuel. Therefore, in the event of a strong earthquake, a disaster similar to that of Fukushima, Japan, the system would vent directly to the atmosphere. In a worst case scenario, another Chernobyl lurks.

In June 2012, a severe flood occurred near the ANPP, which could have been disastrous. If the damages to the reactor had been severe, its cooling water would have drained into Lake Sevan and thereby spread into rivers, contaminating the Azerbaijani river system. Living in close proximity to the potentially dangerous nuclear plant raises certain fear among Azerbaijani and Turkish authorities and residents alike.

Despite these concerns, Armenia is unlikely to shut down its reactor and has repeatedly denied EU proposals to phase out the aging nuclear plant. The ANPP supplies 40 percent of Armenia’s energy and the government cannot close it without alternative sources of power. Metsamor’s power plant operation has been extended from 2016 to 2026 with the approval from the International Atomic Energy Agency (IAEA), and it will close only when the new advanced reactor VVER 1000 model is constructed with Russian assistance.

In order to strengthen Armenian energy security, achieving energy independence through supply diversification must become the focal point in the development of Armenia’s national energy strategy. Provision for the domestic energy demand, on the other hand, should be ensured by the government, bearing in mind the level of political tension with Azerbaijan and regional instability due to the ongoing conflict.

Through the creation and the update of the alternative sources of energy, including the installation of additional hydro and thermal power plants, building interconnectors with Iran and Georgia, and the replacement of its Metsamor nuclear plant, Armenia would significantly improve its energy security, increase its exports capacities, and strengthen regional integration. Therefore, attracting foreign investments is a critical factor to implement the government’s aspirations in achieving Armenian energy security.

To attract and flourish in the investment climate, the government must address ongoing concerns regarding the continuing corruption, feeble legislative framework, monopolization, and vague state and local regulations and policies. Opening the market to outside players, with fair participation and competition, would bring investments to the energy market.

Additionally, establishing the dialog between the government and its citizens, and the inclusion of the local NGO’s, environmental groups, and the energy companies would contribute to the development of a clearer mutual understanding and transparency in the approach to the country’s energy security.

**Energy security threats summary – Armenia**

- High dependence on energy imports from single supplier;
- Seasonality of hydroelectric energy supply;
- Lack of technical efficiency and vulnerability of the aged equipment to the technical accidents or natural disasters;
- Energy unaffordability due to the tariffs increases;
- Ongoing conflict with Azerbaijan;
- Weak governance and poor regulation, corruption, lack of transparency.

**Azerbaijan**

Rich in ample oil deposits and natural gas reserves, Azerbaijan is a primary energy producer and transporter in the South Caucasus region. The state on the Caspian Sea shore has been the world’s fastest growing economy in recent years, as a result of successful strategies in oil and gas developments, and attraction of foreign investment. Furthermore it has liberalized its trade
The Southern Gas Corridor is pivotal to the EU vision for transportation of 10 billion cubic meters of Azerbaijani gas from Shakh Deniz II field, the world’s biggest gas project. From there it will pass through Georgia and Turkey via the Trans-Anatolian Pipeline (TANAP), and then the Trans Adriatic Pipeline (TAP) will deliver the gas on, through Greece and Albania, to Italy. The first gas supplies through the corridor are scheduled for late 2018, beginning 2019. The Shakh Deniz consortium, formed by BP 25.5 percent, Statoil 25.5 percent, State Oil Co. of Azerbaijan Republic (SOCAR) 10 percent, Lukoil 10 percent, Total 10 percent, Naftiran Intertrade Co. 10 percent, and Turkish Petroleum AO 9 percent, has an ambitious plan – to increase the pipeline’s capacity up to 16 bcm by 2020.

Azerbaijan’s notable success in attracting foreign investment in the country’s oil and gas fields development stems not only from considerable improvement of the legislative and regulatory framework and streamlined procedures for international companies to enter the market but more from the government’s independence in foreign policy and the Azerbaijani pragmatic view of the world. Trying not to being caught in the crossfire of interests of neighbours Russia and Iran to the North East, and of the EU and the rest of the West, Azerbaijan refuses to join any alliances and focuses instead on the maintaining stable relations with all players in the region, keeping in mind the prevailing importance of its own national interests. Such a strategy proved viable in realization of the Baku-Supsa, Baku-Tbilisi-Ceyhan (BTC) and Baku-Tbilisi-Erzurum (BTE) pipelines, and a prosperous cooperation with Turkey as a major partner and consumer of Azeri fossil fuels.

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17 Gurbanov, Ilgar. “Importance of NATO’s Engagement in Critical Energy Infrastruc-
Therefore, the energy sector is central in Azerbaijan’s economy and its national security formulation, and has contributed to the robust economic growth of the past decade.\textsuperscript{18} Foreign investment resulted in the development, modernization, and rehabilitation of the energy infrastructure across the country to ensure stable supply and reduce electricity shortages. Domestic electricity generation is run by gas, accounting for 90 percent. Only about 8 percent comes from hydropower.\textsuperscript{19}

Although Azerbaijan has experienced an impressive boom in the energy sector, the government has been widely criticized internationally for their lack of democratic norms, presence of corruption and monopolization, poor human rights laws, no freedom of the press, pressure upon civil society, and absence of free and fair elections.\textsuperscript{20} All are important factors that may undermine Azerbaijani and world energy security stability, if not addressed promptly.

Among the Azerbaijani government’s major concerns regarding energy security is the uninterrupted export to international markets and domestic supply, viewed as twin pillars of national economy and security. Protection of energy infrastructure from physical threats is the fundamental factor in ensuring uninterrupted imports and exports. In 2008, the Kurdistan Workers’ Party (Kurdish: Partiya Karkerên Kurdistanê, PKK) carried out its first attack on the BTC pipeline and targeted the energy infrastructure on Turkish territory several times after.\textsuperscript{21} Geopolitical implications of the South Caucasus region, and particularly, the ongoing conflict in Nagorno-Karabakh with a serious instability over the “contact line”, add to the threats to the Azerbaijani energy infrastructure and security.

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Energy security threats summary – Azerbaijan

- Physical threats to the pipelines in Azerbaijan and in transiting countries;
- Regional instability and ongoing conflict in Nagorno-Karabakh;
- Economy’s dependence on energy exports – total oil and gas exports constitute 90 percent;
- Corruption, lack of transparency, in both public and private sectors;
- Unaddressed human rights, and pressure of civil society and the media;
- Governance and unequal distribution of the energy revenues.

Georgia

Georgia reaps its benefits from its strategic geographical location, bridging the East-West and North-South energy routes in the South Caucasus. It is the only country interconnected to all four countries in the neighbourhood: Russia, Armenia, Azerbaijan, and Turkey. Georgia is a major energy hub for the Caspian hydrocarbons transportation to the European market, and, therefore, a magnet for foreign direct investment (FDI) and development projects on its territory. Georgia maintains strategic energy partnerships with Azerbaijan and Turkey through participation as a transit territory for the oil and gas pipelines, notably, Baku-Tbilisi-Supsa, Baku-Tbilisi-Ceyhan with the parallel South Caucasus Gas pipeline.

Georgia’s energy relies on its well-developed system of hydropower. The country is rich in rivers. However, only 12 percent of the water resources are utilized for hydro energy. In warm weather, hydropower meets 100 percent of the electricity demand with an ability to export the surplus of generated electricity to neighboring countries. Cold weather increases the country’s dependence on natural gas imports from neighbouring Azerbaijan – 88 percent, and Russia – 10 percent to satisfy its seasonal energy demands.

Because Georgia is a transit hub for Azeri and Russian gas, the state enjoys Azeri price discounts, and, in the Russian case, Georgia takes an annual gas cut, skimmed off the top of Russian gas shipments to Armenia.
The government demonstrated considerable efforts to make its country a favourable destination for foreign investment, thus increasing its energy sector’s attractiveness. The state implemented several correction actions, notably minimal government interference, liberalization of the economic environment, deregulation and privatization, and ease of licensing and taxation, all contributing to the Georgian stable and reliable energy sector. Central to Georgian energy security strategy is energy source diversification, particularly boosting hydropower generation, to increase export capacity to the neighbouring markets.

Armenia Azerbaijan and Georgia are contracting parties to the Energy Charter Treaty (ECT), which provides a multilateral framework for energy cooperation under international law. The ECT is an important mechanism for addressing national development of the energy sector and provides a stable platform for multilateral cooperation. In this spirit, Georgia’s flagship initiative – proposed in 2015 when chair of the ECT, to foster regional cooperation through cross-border electricity trade – is a viable attempt to start the communication process.

The initiative proposes the establishment of two ministerial-level Task Forces, one comprising the East-West energy corridor countries and the other the North-South. This is a pragmatic idea, given the tensions between Armenia and Azerbaijan. It is aimed to strengthen regional electricity trade, enhance transport corridors, and attract foreign investments into energy infrastructure development schemes. Such a proposal is especially important to Georgia due to the current geopolitical situation in the Middle East, and in particular, the rapidly fraying Russian-Turkish relations. Georgia has no alternative but to balance the external influence and diversify its market in order to secure its own position in the likelihood of increasing regional instability. With the return of Iran to the game after the lifting of international sanctions, Georgia envisages a potential energy import diversification and new trade relations.

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23 Ibid.
Among the existing energy security risks in Georgia, the unresolved territorial conflicts in Abkhazia and South Ossetia threaten not only Georgian resources supply and availability, but also that of neighbouring Azerbaijan. In 2015, South Ossetia expanded its territory by moving administrative borders and seized control of 1.6 km of the Baku-Supsa oil pipeline, operated by British Petroleum. Consequently, BP decided to abandon that section of the pipeline and replace it with a part running on Georgian territory. Moreover, the important Enguri-Vardinili hydropower cascade, producing about 40 percent of Georgia’s electricity, is located partially on the Abkhazian territory and thus can be used as political leverage. Overall, there is still room for Georgia to improve in governance and regulation of its energy sector, specifically in promotion of transparency and energy affordability.

Energy security threats summary – Georgia

- Unresolved conflicts in South Ossetia and Abkhazia;
- Dependence on seasonal hydro energy and surplus trade;
- Gas imports diversification;
- Governance and regulation.

Challenges and threats to energy security in the South Caucasus – Summary

- Unresolved conflicts in Nagorno-Karabakh, Abkhazia, and South Ossetia endanger the stability and security of the energy supply to the local and European markets;
- Global terrorism threatens the physical security of the pipelines and undermines the confidence in an uninterrupted energy supply;
- Cyber attacks have become a new challenge to the security of the pipelines’ infrastructure;
- Absence of a unified understanding, concept, and approach to the energy security in the region makes the energy security questionable;

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- Russian double-game and aggressive policies in the neighborhood region;
- Internationally undetermined status of the Caspian Sea limits the access to the Central Asian energy stockpiles.

Conclusion: Energy security in the South Caucasus has both great expectations and lost illusions

Energy security is an essential part of national security and interests. Armenia, Azerbaijan, and Georgia all recognize the importance of energy security as a key national priority. Nevertheless, none of these countries concur in their perception and articulation of energy security. The hierarchy of energy needs vary from one South Caucasus country to another. Energy security, from resource availability and affordability, energy efficiency and infrastructure development, environment and social effects, to regulation and governance, appear, disappear, and jostle for primacy. Energy security is a complex notion; it is a polyhedron. Each player, both regional and non-regional, sees a special side facing its national security and interests.

Political tension over territorial conflicts in Nagorno-Karabakh, South Ossetia, and Abkhazia destabilize the region, preventing energy cooperation and integration among Armenia, Azerbaijan, and Georgia. The decades-long regional-geopolitical-ethnic conflicts in South Caucasus cannot be resolved in the near future, thus must omitted from energy security discussion. Can economic benefits and self-preservation become compelling enough impetus for these three powers to repress racial memories and ethnic politics? Is the region ready for great expectations?

A change of mindset is crucial to overcome the stalemate. Armenia, Azerbaijan, and Georgia could be successful in energy cooperation and integration if the three states would perceive it not as a regional but as a part of a global process – transformation of the entire South Caucasus into a profitable efficient energy “aorta” pumping the major energy hub, linking East to West, and North to South. Open minds would be the key to unlocking South Caucasus economies to new markets, better trade relations, and more foreign investment for regional development. Regional energy integration would diversify each state’s markets and benefit their economies.
Consequently, a vibrant energy sector would enrich and stabilize the South Caucasus as a region.

Therefore, only politically and emotionally muted discussion and a perception of individual benefit from mutual regional energy cooperation could persuade and incentivize these disintegrated countries to converge. As of today, there are no joint regional groups of policymakers from South Caucasus countries to coordinate their energy security strategies and approaches. The establishment of a joint group is a delicate but essential step for Armenia, Azerbaijan, and Georgia. The group should focus purely on energy cooperation and achieving broad mutual pragmatic goals:

- Increase energy exports;
- Diversify energy imports;
- Enhance, harmonize, and interconnect energy infrastructure;
- Exchange approaches, strategies, and practices in energy infrastructure development;
- Create a unified legal framework and ease market regulations to attract foreign investment;
- Expand energy market to the European and Middle Eastern countries;
- Become a major energy hub between the East and West, North and South.

Different stakeholders, including governmental, public, and private, should be represented in the regional joint group to increase the effectiveness of addressing energy concerns. Shared understanding of the joint initiative and common articulation are fundamental in achieving desired results. Establishing a joint energy group is an ambitious project given the complexities and peculiarities in the relationships of the South Caucasus states. A small-steps approach to regional cooperation, for example, a discussion over potential of renewable energy trade and harmonization of aging energy infrastructure, could be one starting mode.

Other players could hamper a regional energy cooperation initiative, even if Armenia, Azerbaijan, and Georgia were able to overcome their political tensions and disputes and work together. Russia, Turkey, Iran, and even the EU could undermine this, sensing a threat to their vast economic and political presence in the region. Therefore, on top of mutual pragmatic goals for the South Caucasus countries should be a coordinated balanced policy towards their main foreign stakeholders and those interests. Domain interests and leverages coming from Russia, Turkey, Iran, and EU must be factored in the policy.

Current South Caucasus energy projects could be developed and move from potential to real threat to Russia’s energy security, specifically security of supply demand. Once completed, the South Caucasus Pipeline will bring energy from East to West, undermining Russia’s export volume and become a real competitor on the European energy market. The Russian government cannot afford to lose its dominant energy position in the EU, as this would directly affect Russia’s energy-dependent economy. The Kremlin’s recent attempts to entice the EU with a new grand South Stream gas pipeline project bypassing Ukraine were unsuccessful, meeting with strong traction among European countries. Neither did an alternative to it – the Turkish Stream project, further hobbled by Russian-Turkish crippling relations. In order to preserve its leading place in the world’s energy community and to secure its national and geopolitical interests, Russia would scuttle any attempt to lower its rank in or squeeze it out of the global energy market.

While the South Caucasus energy projects could pose a threat to the Kremlin, the Russian eagle closely monitors energy developments in Armenia, Azerbaijan, and Georgia. Always retaining a roost for quick maneuvering and control over the situation, Russia maintains a multi-dimensional presence in the South Caucasus. Its level of political and economic influence ranges from country to country. If a joint South Caucasus energy group is established, a strategy must be readied to permit Russian cooperation. If not coopted, the Kremlin might perceive the initiative as an attempt to exclude Russia from the region. Given Russia’s strong military presence at 102nd Military Base in Gyumri, Armenia, and sturdy economic ties with Armenia, the Russian government could and would use all possible mecha-
nisms (non-coercive and assertive) to prevent such a scenario, thus destabilizing the South Caucasus further.

A subdivision of the South Caucasus joint energy group could be comprised of Russian, Turkish, Iranian, and EU representatives. This could be used as a ground for wider joint energy cooperation to address concerns, define recommendations, and discuss potential projects. Healthy and fruitful negotiations can be far-reaching only if all parties’ interests are mutual and treated equally. Energy and geopolitics are deeply intertwined when it comes to decision-making where to place a pipeline or with which bordering country to install an interconnector to trade electricity. The success of the joint group lies in the formulation of the common goal – to make the South Caucasus an energy hub bridging East to West, and North to South, rather than the creation of a South Caucasus energy hub to annihilate Russia’s energy hegemony in the European Union, or elsewhere.

Are all illusions to be lost? The proverb, “He who rides a tiger is afraid to dismount”, perfectly conveys the dilemma of Armenia. Is it possible Armenia could have the courage to remove itself from Russian protection and face the Kremlin’s wrath? The potential of a South Caucasus joint energy group is further diminished by the events of April 2nd, 2016. The heaviest fighting in a decade has flared up in Nagorno-Karabakh’s contact line, thus significantly escalating tensions between Armenia and Azerbaijan.27 Grave concerns regarding the South Caucasus fragility, stability, and energy security looms over regional and non-regional stakeholders, thus making a joint energy group, comprised of Armenia, Azerbaijan, and Georgia, a pipe dream.

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From “Jet Crisis” to “Energy Crisis”: Convulsions in Security in the Black Sea and the South Caucasus

Jeyhun Novruzov

Abstract

This article tries to look into the consequences of the break-up of the Russia-Turkey relationship as a result of “the jet crisis” that took place on 24 November 2015, and it discusses the “closed circuit” effects sent across the security “gridline” in the South Caucasus. It argues that “the jet crisis” caused “an energy crisis” in the wider region, which can be detrimental to the security of the entire region. The article further suggests that “the jet crisis” should be eliminated before it leads to other “crises”. At time of writing the perspective of de-escalation of the “jet crisis” is not promising.

Introduction

The first sub-heading of this article discusses the immediate consequences of the “the jet crisis” between Russia and Turkey and tries to reframe its initial impact on their bilateral relations. It discusses further the consecutive manoeuvres of Georgia between Russia, Azerbaijan and Iran trying to ensure a better energy deal for itself.

Further in the article, it highlights the rapprochement between Russia and Georgia in the context of Kremlin’s strategic goal to change energy policies in the wider region. It also underlines Armenia’s pursuit of a better energy deal with its key energy partner and close ally, Russia.

The following section portrays Azerbaijan in the context of a battleground of a long-standing energy war between the West and Russia, which therefore makes it a crucial part of the geopolitical games in the region.

Finally, this paper draws on an analysis of the implications of “the jet crisis” and argues that its consequences must be eliminated as soon as possible; the concern expressed here is that the longer “the jet crisis” lasts the
more negative its impact will be on the overall security of the South Caucasian region and beyond.

**Demand vs. Perseverance**

Everything began with the downing of a Russian fighter jet “Su-24” by Turkey on 24 November 2015 near the Syrian border. It was not surprising that this incident upset the Russian political and military establishment and Turkey has since become the object of harsh and occasionally threatening Russian rhetoric. Followed by this, the focus of not only the parties concerned but also of those in the wider region turned to the fate of key energy projects between these countries waiting to see what their destinies will likely be.

Firstly, all minds became pre-occupied with contracts on natural gas export from Russia to Turkey, and the projected “Turkish Stream” as well as the “Akkuyu” nuclear power plant, which had been underway. Under the escalating pressure of Russia calling for immediate “apologies” or “confessions” for this “wrongdoing”, Turkey preferred not to succumb to this pressure and weathered a storm. Amongst its many endeavours to duck the pressure, Turkey sought for alternatives in case of possible energy supply cuts by Russia. As the winter was looming, the fear that Gazprom may choose to immediately cut its gas supply and put Turkey in the cold was not fanciful at all. Contrary to all expectations of Turkey and of other regional players, Russia did not resort to harsh measures as initially expected. However, Turkey realized that it should minimise its energy dependency from Russia; at least decisions were made to ready Turkey for all possible scenarios.

Turkey’s consequent manoeuvres towards seeking an alternative supplier made her turn to another gas giant, Qatar, by securing an initial agreement on LNG purchases from this country. Thus, the first phase of “the jet crisis” ended up with confrontational and threatening political rhetoric.

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1 Turkish President Erdogan has since apologized for the downing of the Russian plane.
from Russia and Turkey. These formerly regional allies now turned out to be incompatible, infusing more uncertainties in the wider region. Nevertheless, the dividends of a possible “energy crisis” between Russia and Turkey, especially a potential gas supply cut, arguably would have not played into the hands of Russia. Otherwise, Russia, aware of the memory of the near past concerning the cut of gas supplies to Europe, back in 2006, preferred this time not to further damage its reputation as a reliable gas supplier. That is probably why a little after the “jet crisis”, Russia quickly moved to confirm that the development of a nuclear power plant in Turkey and the “Turkish Stream” would not be frozen. However, the import ban imposed by Russia on Turkish goods, particularly investment capital and agricultural products, was based on earlier official rhetoric from the Russian side.

As expected, since the early days of 2016, Russia started to retaliate against Turkey with a range of trade sanctions. On the other hand, Russian political debates warned that should “Gazprom” chose to cut its gas supply to Turkey, Turkish gas market might be irreversibly closed for Russian gas once and for all. The supporters of this idea were vigorously arguing that Turkey’s agreement with Qatar was a clear indication of this country’s vigilance for the worst-case scenario. Consequently, the early days of 2016 guided by bad omens, triggered by the “jet crisis”, sent shocking waves across the wider region. Even at this stage of political developments in the region, it became ostensibly clear that the traditional friendship ties between Russia and Turkey had turned into vulnerable partnership bonds, evoking dire memories to those past regional rivals.

**Antagonism vs Collaborationism?**

An additional “shock wave” with regard to the imminent change to the established energy security map in the South Caucasus that swept the region came from Russia. Moscow suddenly issued an ultimatum to Georgia about the necessity to convert to monetary payment, instead of commodity payments, for the Russian natural gas transited to Armenia through Georgia. Until that moment, Georgia retained 10 per cent of natural gas shipments from “Gazprom” to Armenia as a transit fee.3 This time Georgians

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3 “Грузия достигла договоренности с Газпромом”. Gruzija Online (in Russian)
were shocked to learn that their government was determined to hold negotiations with the Russian gas giant Gazprom – a long-standing nemesis of Georgia from 2005-06. The explanation of Georgian authorities to this was that it was an attempt to diversify energy supplies. However, after Gazprom’s supply cut to Georgia in 2006, Azerbaijan acted as a reliable supplier of gas, selling gas for much cheaper price than Gazprom. This Georgian move, in turn, provoked Azerbaijan as a long-standing energy supplier to act as quickly as possible, since the security of the Georgian market and other related issues were at stake. The reason Russia acted this way may suggest that it wished to restore its control over Georgia by employing its key instrument and put more pressure on Tbilisi.

In the past, Tbilisi reduced its reliance on Russian gas in the wake of the major supply breakdown in 2006. At the time, President Mikheil Saakashvili’s administration accused Moscow of trying to blackmail Georgia and pull it away from its Western integration goals. We can only speculate that Russia hoped that this time its attempts would yield the expected fruits. Even the fact of replacing Azerbaijani with Russian gas supply would have seriously affected the energy policy in the region. Theoretically, by alienating Azerbaijan, which supplied 90 per cent of its imports, Georgia would have put itself in a risky position and jeopardised or ceased to be in the chain of the important energy and transit corridor between Asia and Europe. The country certainly enjoyed being a regional energy and transit hub – part of the New Silk Road connecting China with Europe. Moreover, political rhetoric coming from Georgia in an attempt to explain its “Gazprom rapprochement” was rather self-contradictory. Some statements were suggesting that Georgia desired, at least partly, to replace Azerbaijani gas with Russian gas. The other rhetoric from Georgian officials noted that it was Armenia that wanted to buy more gas from Russia and that is why Georgia had no option but to talk to its northern neighbour. In any case, it could not guarantee anything good for Azerbaijan as to the perspective of


5 Ibid p. 2.
both losing its gas market share, and continuing the further isolation of Armenia from any sort of regional developments – a policy which has long been pursued by Azerbaijan due to the Nagorno-Karabakh conflict. Besides, this Georgian plan would have deeply disappointed Europe, which put a lot of effort in diversifying from Russian natural gas supply. Georgia, as a gas transit hub, played an important role in this regard. Admittedly, under the current circumstances, Georgia is overly dependent on a single major source of supply, Azerbaijan. And the fact that Russia remains the country’s only possible gas alternative to Azerbaijan suggests that there will still be a constant rivalry between potential suppliers for securing the dominant position on the Georgian market.

Yet another intriguing issue related to Georgia was that, apart from speculations that it had been only talking about additional supplies from Russia, they were also actively working with Iran – another regional energy giant. News that Georgia and Iran held negotiations for the supply of Iranian gas to Georgia via Armenia, with the initial contract plan of 7 months starting from 21 March 2016, quickly made it to the top of the regional political agenda. Although an outstanding issue was getting permission from Armenia as a transit country, the matter suggested that it might take quite some time before making the Iranian-Georgian project possible. For Georgia, getting transit permission from Armenia in theory would not have been so difficult, since Armenia would benefit from it both economically and politically. Moreover, benefitting from a transit fee and getting involved in a regional project against the wishes of Azerbaijan would bring political dividends to Armenia as well. However, the final decision with respect to the Georgia-Iran energy project would take some time before giving further tangible results. Suddenly, things started to develop not in an unexpected way for Yerevan. In early February 2016, Georgian Energy minister K. Kaladze having hastily visited Baku, met with Azerbaijani top officials. On the background of gas negotiations with Baku, Georgia’s new gas plans

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failed to get approval by the wider public, and they were harshly rebuked particularly by the domestic political opposition. By characterizing the negotiations with Gazprom as “backstabbing,” an activist of the political opposition further noted that the conversion to the monetary transit fee for Russian natural gas to Armenia was controversial, and warned against danger of such a plan for the Georgian government. Probably, Azerbaijan, although silent against Georgia’s new plans, had the same feelings about being “backstabbed” and feared that it would be left aside by its strategically.

Despite this gloomy background, the gas negotiations in Baku went well for Georgia. Azerbaijan agreed to optimise the volume of natural gas supply to Georgia at around 500 million m$^3$ on top of previous gas supply volume. Moreover, Azerbaijan agreed to provide local gas stations with USD 35-40 for 1000 m$^3$ of gas, which was a concession. After intense negotiations, Georgia triumphantly declared that since Azerbaijan agreed to boost volume of natural gas supply, there was no further need to buy extra volume of natural gas from Iran. Subsequently, Georgia held parallel talks with Iran for the possible import of natural gas. In theory, the shipment of natural gas from Iran was doable but it could not be easily implemented in such a short period of time. With the final agreement, Azerbaijan, in turn, managed to hold on to the Georgian market though had to compromise over commercial benefits.

Therefore, for the time being the issue of the rapprochement between Georgia and Gazprom seems to be over, as the sides retained their previous agreements. Nonetheless, political speculation behind Georgia’s Gazprom gamble is still rife. In this regard what is also interesting is that Georgia on the eve of these events voiced the possibility of the unification of the energy grid of the countries from the South Caucasus. According to this idea, Russia, Georgia, Azerbaijan and Armenia could unite their energy grids with Georgia becoming a regional transportation hub for electricity. What emboldened Georgia to come forward with initiatives that would imply fundamental changes to the energy security situation in the region? Otherwise, who tries to change the energy policy more or less established in the region and why? So far, Georgia seems to have tactically benefitted from the recent developments in the regional energy policy by securing a better deal with its long-standing gas supplier, Azerbaijan. Azerbaijan man-
aged to keep its dominant position on the Georgian gas market with minor commercial losses. In the meantime, Russia looks to have tactically failed to regain control over Georgia via its Gazprom venture. However, it appears that Moscow doesn’t intend to stand idle on other security related issues in the region.

**Efforts never die**

The Kremlin tactics appeared to be changing as it had revealed its military plans in the Caspian Sea to launch a military paratrooper ship in the sea. As military experts note, the naval ship that Russia is planning to launch is an assault ship. In parallel, Russia has provided Armenia with a preferential loan worth of 200 million USD for modernisation of the latter’s army. What is Russia trying to achieve with the reinforcement of the military fleet in the Caspian? Why is it so worried?

After the Russia-Turkey break-up, Azerbaijan presumably worried that as an ally and a strategic partner of Turkey, it could become a target. Strategically, Russia’s military build-up in the Caspian can well be associated with the future transportation of energy resources from the Caspian to the West. What is on the table today is that the Trans Adriatic Pipeline (TAP) and the Trans Anatolian Pipeline (TANAP) projects have been finally approved at the second Southern Gas Corridor Advisory Council Meeting held in Baku on 29 February 2016. And the EU has already lit the green light for TAP. Russia may well be concerned about this progress since the Southern Gas Corridor, in line with the EU’s Energy Security Strategy, remains key for the common objective of diversification of sources and suppliers. There may be many reasons for concern.

Admittedly, energy security policy in the South Caucasus, as elsewhere, is dynamic vis-à-vis the economic tendency in the region. And what lies behind Gazprom’s recent advances towards Georgia may be deeply rooted in the overall energy security policy of Europe. As we all know, on the European front, Gazprom has also recently faced problems, which have urged it

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to break the deadlock and seek exit strategies. Therefore, Gazprom is aware of the fact that it no longer holds an upper-hand position in the wider regional energy-related affairs as it used to do some 10-15 years ago. The epoch of its dominancy, when it was dictating its commercial rules in Europe and other gas markets is already past. And the EU-backed Southern Gas Corridor project supports building competition from the Azerbaijani gas.

This may negatively affect Gazprom’s policy or projects. Besides, the failure of the “South Stream” project, which was not supported by the EU, also added to its frustration. Russia’s immediate movement about “Turkish Stream” project aiming to deliver Russian natural gas to both Turkey and the EU borders was an alternative idea to the “South Stream”. In parallel, Gazprom’s declaration of its intention to cut off gas supply to Europe via Ukraine in 2018 due to security concerns was another sign of an imminent challenge to Europe’s energy security. However, this was not all that went erroneously for Russia’s plan. The “Turkish Stream” project as was the case with its predecessor (e.g. “South Stream”) has met a number of obstacles for the settlement of whom Gazprom simply preferred tricking about.

Hence it declared forthcoming plans to construct the pipeline in the Black Sea. According to Gazprom’s arrangement, the construction is due to start in June 2016, although so far no inter-governmental agreement about the pipeline construction or transportation of oil and natural gas via the Turkish territory has been signed. Gazprom had to pay a high price for this trick as it had to terminate its contract with Italy’s Saipem that was supposed to expand “Turkish Stream’s” capacity in the Black Sea. Despite the initiation of the “Turkish Stream” project its main element – gas price between Turkey and Russia has never been agreed. At least, neither side has ever since stated that there was a common denomination of this price. It is only known that Turkey had declined the Russian proposal about the gas price because the latter demanded more concessions.9

This also suggests that this project is still up in the air, and it will remain so, particularly on the background of deteriorated relations between Russia and Turkey caused by “the jet crisis”. Yet, another gloomy perspective for Gazprom are the outstanding issues related to the accusation of tax evasions in Turkmenistan, and the recession of the Chinese economy, which obstruct its Asia-oriented gas projects. And in this case Russia simply cannot stand still. It has to deal with Turkmenistan properly since a disgruntled Turkmenistan may opt for joining, for example, the TAP project in the Southern Gas Corridor via the projected Trans Caspian pipeline, which would be a nightmare for the Kremlin especially given that Gazprom is still in search of breaking the deadlock. In search for an exit strategy it neither declared about its intention to hold negotiations with Ukraine on the prolongation of the transit agreement post-2018, nor came with the idea for expanding the capacity of “North Stream”. So, all issues Gazprom is facing are of a political nature and come from its uncompromised position.\footnote{“Газпром в поисках выхода”. Trend News Agency, 25 июля 2015. \url{http://www.trend.az/business/energy/2419733.html}, accessed on 23/03/2016.}

**Who is behind the scenes?**

Based on the aforementioned analysis, the fight for the expansion of Russian political influence in the South Caucasus is what lies behind the frequent “gas attacks”. And the neighbouring countries in the South Caucasus not only fight for dominance over each other, but also attempt to benefit from the ongoing geopolitical rivalry between the West and Russia. The fight for economic dominance under the current circumstances is more prominent. The deterioration of Russian-Turkish relations affected by the “jet crisis”, as well as the predictable activation of Iran after the sanctions were lifted inevitably signalled the emergence of new tendencies and approaches in the South Caucasus. Gazprom’s sudden advance probably can be partly explained due to the emergence of recent factors. This leads to the assumption that Russia wishes to create Russia-Georgia-Armenia-Iran axis to counter Azerbaijan-Georgia-Turkey partnership and make an attempt to squeeze both the EU and the US out of the region. This is due to the fact that huge energy resources were concentrated along the Azerbai-
jan-Georgia-Turkey axis and these resources would be directed to the West, contradicting Russia’s aspirations.

To this end, the sudden and insufficiently argued Georgian plan of importing natural gas from Iran has indicated that these efforts did not emerge overnight. While Georgia’s energy supply diversification plans may be economically justified, its practical solution seems difficult under the current circumstances. There is simply no technical infrastructure to import natural gas from Iran, particularly via a direct pipeline connecting these two countries. However, the transport of Iranian gas via Armenia to Georgia could have been a viable option. In that case, Iran would have supplied Georgia with natural gas through Gazprom Armenia. Afterwards, Gazprom Armenia could sell it to Georgia as complimentary volume of gas being transmitted via the pipeline connecting Russia-Georgia-Armenia. In other words, based on swapping rules, gas coming directly from Russia will be called Iranian gas due to the increased volume of its transit. Although this scenario may seem to be an utter speculation, yet it may explain the reasons of Gazprom’s overtures in the region.

A friend in need vs. a friend indeed

On the other hand, Armenia, Russia’s traditional ally, wants to take advantage of recent developments and tries to use it for its own good. It is true that discussions about higher gas prices for Russian gas in Armenia have been around for a while now. But since the early days of 2016, these discussions became more obvious as Armenia moved to open discussions with its strategic ally, Russia. Already in September 2015 at the ministerial meeting of the Eurasian Economic Union, Armenia proposed to use Russian Ruble instead of USD in trading energy commodities between the member-states. In fact, Armenia has traditionally been heavily dependent on natural gas, as its economy particularly the agricultural and transport sectors consumed almost half of the country’s overall demand. To this end, the revision of the high price of the gas imported from Russia and the payment for it with a weakened Russian Ruble rather than US Dollar would

be a great boost for the country’s economic growth. However, the proposed gas price discount would come with a serious currency loss for Russia’s Gazprom at about 50 million USD per year.\(^\text{12}\) Besides, Gazprom’s comeback to the South Caucasus met with failure, namely because of Georgia which drifted away from continuing negotiations at the last minute. Gazprom will have to be more cautious.

Moreover, Russia’s political stance in the region may further be complicated if Gazprom doesn’t move to meet Armenian demands. However, there still are confusing news about the final agreement related to gas pricing between Armenia and Russia. Apparently, Armenia’s desire for a further discount of gas prices by Russia is based on the latter’s recent unsuccessful efforts in the region. Armenia knows that unsuccessful opening to Georgia can further make Gazprom to seek alternative ways to enter in the regional market, which means that it will be willing to compromise in gas pricing. Gazprom’s further discount in gas price for Armenia cannot be excluded and it is likely to happen. However, it will still have a certain price, and even Armenia, as a key ally of Russia in the region, will not be secure against the consequences of its dependence on Russian gas supply. For the time being, Armenia’s “gas attack” is likely to achieve its goal, but it will further push this country into the arms of Russia.

At the same time, it seems that across the border, in Georgia, domestic political processes are also playing a part in stopping Gazprom from further advancing into the region. Recently, the political opposition in Georgia staged public protests with such slogans as: “Gazprom – no”, “SOCAR – yes,” thus putting an end to the imaginable “gas attack” from Russia, at least in the foreseeable future.\(^\text{13}\)


Not only a “gas war”

The recent processes also saw the South Caucasian region as a playground in the “gas war” between the EU and Russia, where Azerbaijan found itself in the frontlines.

As the EU is set out to seriously deal with reducing dependency on Russian gas and seek alternative sources of supply, the EU-Russia rivalry is getting more intense. The European Commission has already approved the EU’s Energy Union strategy, which is to control all the agreements of the member states related to external energy commodities particularly natural gas. The Energy Union is also designed to restrict the ability of individual EU member countries to deal with external suppliers, thus ensuring an effective common approach to energy security strategy. This means that individual member-states will have limited scope of contacts should they choose to act on their own with foreign suppliers.

Thus, based on its energy security strategy, the EU has already started comprehensive discussions with Azerbaijan and Turkmenistan and is determined to go beyond political statements and secure long term commercial agreements as part of an effort to stabilize its gas supply. As noted above, although the EU has buried the “South Stream” project, this made Russia come forward with “Turkish Stream” which is likely to meet the same fate. As the EU is decisively moving towards the acquisition of Caspian resources, this will eventually turn Azerbaijan into a transit hub of the region; initially as a supplier and consequently as a transit for possible Turkmen gas. The necessary infrastructure, such as extending the capacity of the South Caucasus Gas Pipeline and the construction of the TAP and TANAP for the transportation of initial volumes of Azerbaijani gas to Europe, is being intensively developed. Consequently, there will remain a rather small 300 km-long pipeline to build across the Caspian in order to fill in the missing parts for the shipment of Turkmen gas via the Southern Gas Corridor to Europe.

Whilst the entire picture is getting clearer, Russia is becoming more anxious to observe Europe creeping towards Caspian resources. Everything here is certainly not about gas at all. A renewed clash of the geopolitical interests of the West and Russia in the region is apparently in the making. That is
why perhaps Russia is so determined to push “Turkish Stream” ahead despite many uncertainties about this project. As the perspective of transportation of Russian gas via Turkey to Europe is gloomy, it plays to the Caspian region’s advantage, particularly putting Azerbaijan in the front row. However, the gas issue may lead to more complications between Russia, Turkey, and Azerbaijan. These complications have become even more probable after the recent meeting of the Advisory Council of Southern Gas Corridor (SGC) held in Baku on 12 February 2016, where Azerbaijan asserted itself as an alternative source of natural gas supply for Europe. As the results of this meeting suggested, Turkey and Azerbaijan are determined to expedite the construction of TANAP, an important part of SGC, which means that the EU may get Azeri gas earlier than it was initially planned, given that, Russia will move to revise its gas policy according to current realities. By virtue of badly deteriorated relations between Russia and Turkey after “the jet crisis” and unsettled commercial disputes related to the price of exported gas to Turkey, the current state of affairs may create new complications between Russia and Turkey.

It is also intolerable for Russia to see Turkey attempting to take advantage of energy projects in order to enhance its influence particularly in the South Caucasus. As further clashes of interests between them become more inevitable, the repercussions may even go beyond reasonable limits and cause other security implications for the entire region. In other words, the Russian-Turkish relations that have already significantly deteriorated are turning into a source of threat not only for the South Caucasus but also for Europe as a whole.

Taking stock – The axe goes downwards

The antagonism between Russia and Turkey in the Black Sea and the South Caucasus has never been a new phenomenon and dates back to past centuries. However, the “jet crisis” has remarkably downgraded their partnership to an all-time lowest level. Until recently, their partnership was exemplary. However Russia started to blame Turkey for all the disasters. Russia seemed not ready to reach out to Turkey until the latter moved to admit its “wrongdoing” and acknowledged its fault. So far, Russia-Turkey contradictions have had a remarkably negative impact on their bilateral trade and Turkey’s tourism has particularly suffered a heavy blow. Moreover, the
more the ongoing crisis in Syria escalated tensions between them the more the West obviously got concerned about it. At the same time, the Russia-Turkey conflict created additional difficulties in their relations with the South Caucasus and Central Asian countries as their close regional partners. The Armenian-Azerbaijan conflict over Nagorno-Karabakh is yet another source of tension between them. Armenia, being a member of the Russia-led Collective Security Treaty Organisation (CSTO) and the Eurasian Economic Union, enjoys its full support and is part of Russia’s security system in the region. Whereas Azerbaijan and Turkey as Turkic countries share much in common and refer themselves as fraternal nations or “one nation, two states”.

Azerbaijan especially pays much attention to its security co-operation with Turkey as the latter played a vital role in the realization of Azerbaijan’s oil and gas projects. Turkey’s strategic role is yet to grow due to the current energy projects, such as TAP and TANAP, in which Azerbaijan is a crucial player. Nevertheless, Azerbaijan also tries to balance its relations with Russia and buys arms and ammunition from this country. After the break-up of Turkey and Russia, Azerbaijan feared that in order to avenge against Turkey, Russia might want to resort to actions that could affect Azerbaijan. This is why Baku is interested to reconcile the two conflicting sides as a means to ensure its own security. For instance, Russia could enhance its security measures in Armenia, which may lead to an escalation of tensions, particularly cross-border armed clashes in Nagorno-Karabakh. From 2-5 April 2016, these clashes in the Nagorno-Karabakh conflict zone nearly escalated into full-scale war between Azerbaijan and Armenia. There is no guarantee that the deadly confrontation in Nagorno-Karabakh will not be repeated.

**Iran on the stage**

Iran, as neighbouring country to Turkey, Azerbaijan and Armenia may take advantage of the Russia-Turkey break-up and start playing a bigger part in regional affairs, particularly on the background of the possible deterioration of regional security due to the Nagorno-Karabakh conflict. As it is known, Iran has long been against Russia and the West in their attempts to deal with the Nagorno-Karabakh conflict, and it has been meddling with regional affairs in general. Iran has amiable relations with Armenia; irritating
Azerbaijan, which does not feel the same sincerity from its southern neighbour across a set of security and energy related issues in the Caspian Sea. Besides, Russia would not be so delighted to see Iran interfering with regional issues, especially with the Nagorno-Karabakh conflict settlement. Otherwise, any outside interference in this process could diminish Russian influence in the region.

Recovery vs. side effects

No doubt that the “jet crisis” is not the only reason for the deterioration of the Russian-Turkish relations in the last years. In fact the “jet crisis” became the culmination of the break up because of Russia’s complex policy in the wider region. Both Russia and Turkey should recognize that they have been important actors in the region and will remain so. The settlement of many regional issues requires Russia’s and Turkey’s cooperation. On top of that, current domestic socio-political tendencies in the South Caucasus countries, particularly the consequences of the social tensions in Armenia and the economic downturn in Georgia and Azerbaijan due to the devaluation of their national currencies may also expose fragilities of political stability in the region. In this situation the ongoing Russia-Turkey tensions may cause additional volatility of the regional security, the deterioration of which may have broader side effects starting from the Caspian across the Black Sea and even beyond. In order to avoid further crises, it is important not only for the conflicting sides, but also for other regional actors to eliminate the consequences of the “jet crisis”. Sadly, the perspective of a deescalation between them is not promising so far.

References


Energy Security: An Armenian Perspective

Benyamin Poghosyan

Introduction

Energy security is one of the significant pillars of national security. Energy plays a key role in the economy, defence and other spheres of state activities. That is why the provision of energy security is of utmost importance for sustainable development of both state and society. The provision of energy security can be divided into two main sectors: the production and unfettered supply of resources (natural gas, electricity, oil, coal, uranium) and the construction of generating infrastructure. States with limited energy resources have to make efforts for ensuring both unfettered supply as well as the establishment of relevant generating capacities for providing necessary levels of energy security. Armenia belongs to this group of states.

Brief description of Armenia’s Energy Generating Infrastructure

<table>
<thead>
<tr>
<th>Name</th>
<th>Capacity (MW)</th>
<th>Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenian Nuclear Power Plant</td>
<td>385</td>
<td>Armenian State</td>
</tr>
<tr>
<td>Yerevan Combined Cycle Gas Power Plant</td>
<td>220</td>
<td>Armenian State</td>
</tr>
<tr>
<td>Hrazdan Gas Power Plant 1-4 Blocks</td>
<td>4x185</td>
<td>Inter Rao (2006-2015), Tashir Group (Russian private company) 2015 - till now</td>
</tr>
<tr>
<td>Hrazdan Gas Power Plant</td>
<td>440</td>
<td>Gazprom</td>
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<td>Sevan Hrazdan Hydro Power Plant</td>
<td>559</td>
<td>Rus Hydro</td>
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<tr>
<td>Vorotan Hydro Power Plant</td>
<td>404</td>
<td>Contour Global (US Private Company)</td>
</tr>
<tr>
<td>Small Hydro Power Plants and Wind Power Plants</td>
<td>222</td>
<td>Armenian Private companies</td>
</tr>
</tbody>
</table>

With no oil and gas resources Armenia is importing natural gas for both domestic consumption and production of electricity, simultaneously trying to develop a renewable energy sector, which in long term perspective may lessen, but not neutralize the dependence on energy imports.

**Energy security: The first 15 years of independence**

Soviet Armenia enjoyed a pretty high level of energy security. Being part of the Soviet Union it had no problems in both energy import and production. Through heavy investments in energy sector gas and hydro power plants were constructed to satisfy the demand of the growing heavy industry and population. One of the key decisions made during the Soviet times was the construction of the Armenian Nuclear Power Plant (NPP) in Metsamor.

The situation has dramatically changed during the last years of the Soviet Union and first years of independence. Immediately after the 1988 Spitak earthquake, the demand was growing within the Armenian society for the closure of the NPP which played a significant role in the energy balance of the Armenian Soviet Socialist Republic (SSR). The decision to close the NPP was adopted in 1989 with no immediate effects on the energy balance, but creating additional strain on the gas and hydro power plant system. Armenia faced nearly a catastrophic situation in the energy sector just after acquiring its independence in 1991. Azerbaijan, as part of the policy to exert economic pressure on Armenia, closed the gas pipeline which brought Russian gas through Azerbaijan to Armenia. Simultaneously, almost daily subversion acts (including blow-ups of gas pipelines) were committed in Azerbaijani populated areas of Georgia to thwart the flow of Russian natural gas to Armenia via Georgia. Consequently, the new independent state was facing acute shortage in energy production having relied mainly on its hydro power plant recourses. In 1992-1995, cyclic power cut-offs in electricity supplies were common in Armenia with the population receiving electricity only for 2-4 hours per day, with no natural gas supply, and a ruined central heating system. In those circumstances, the Armenian leadership made the only possible decision to re-launch the Metsamor plant’s second unit in accordance with all international security standards, and in cooperation with the International Atomic Energy Agency (IAEA). This decision as well as the improvement of the security situation in Georgia
significantly contributed to the stabilization of the energy sector in Armenia. Since the end of 1995, 24-hour electricity supply is provided to the population; in 2001 the overall renovation of the natural gas distribution network was launched. Thus it can be emphasized that Armenia was able to overcome the critical situation in energy security during her first period of independence, and in the mid-2000s she enjoyed a relatively high level of energy security.

New developments in Armenian energy security: the Iran-Armenia gas pipeline

Since the mid-2000s, considerable efforts have been made to diversify energy, particularly natural gas, supply routes. As it was mentioned above, for the energy consumer states, having secure and diversified supply lines is key in providing energy security. This was the case for Armenia too, which was receiving its natural gas only from Russia via Georgia. Russia is Armenia’s strategic ally, and Armenia enjoys friendly cooperative relations with Georgia, but it was obvious that natural gas diversification was needed to avoid putting Armenia’s energy security at risk due to any kind of accidents or developments in Russia or Georgia. Two other states have natural gas export capacity in the region besides Russia; Azerbaijan and Iran. Taking into account the “no war no peace” relations with Azerbaijan due to the Karabakh conflict, the only alternative source for natural gas supply for Armenia was Iran. Energy cooperation with Iran was complicated due to the international sanctions imposed as a result of the Iranian nuclear program, but nevertheless, Armenia started negotiations with Iran to build the Iran-Armenia gas pipeline. In this regard, I would like to emphasize the neutral approach of the United States to the Iran-Armenian cooperation in general, and to the possible import of Iranian gas in particular. American partners had a clear understanding that by having closed its borders with Turkey and Azerbaijan, Armenia had no alternative as to develop economic ties with Iran, without breaching any UN Security Council imposed mandatory sanctions.

The Iran-Armenia gas pipeline was launched in 2007 with a maximum annual capacity of 2.3 billion cubic meters. According to the bilateral agreement, imported Iranian gas is being transformed into electricity which itself is exported back into Iran (3 KWh electricity for 1 cubic meter gas). Ac-
cording to the former Armenian Minister of Energy and Natural resources, in 2015, Armenia exported 1.253 billion kWh to Iran. Although the Iranian gas is not currently used for home consumption purposes, and the Armenian part of pipeline is owned by Gazprom Armenia (Gas Distribution Company with 100 percent of shares belonging to Gazprom) it plays an important role in diversifying Armenian energy supply routes.

### The Project of a new Nuclear Power Plant

Another key issue for the provision of Armenia’s energy security is the construction of a new NPP. The projected expiry date for the current working block life time is September 2016. Armenia cannot afford an energy system without nuclear energy as it plays key role in diversifying energy production capacities and decrease the dependence of Armenia from energy imports. Another important factor is the price of electricity produced by the gas and the nuclear power plants. Nuclear energy produces cheaper electricity which plays a key role in fostering Armenian overall economic competitiveness and in procuring an affordable electricity supply for the population. Taking into account these factors, the Armenian Government was actively involved in activities aimed at finding relevant investments for the construction of a new nuclear power plant. In October 2009, the National Assembly adopted a special law on the construction of new nuclear power plants in Armenia with maximum capacity of 1200 MW, which paved the way for the involvement of international and private investments in this project. The Armenian Government made a decision to create a close joint-stock company with the Russian Federation (with equal distribution of shares) to construct a nuclear power plant equipped by Russian 1060 MW capacity nuclear reactor with 60 years exploitation period. The approximate cost of the project is 5 billion USD.

The 2008-2009 global economic crises created huge obstacles in finding relevant investments for launching the new nuclear power plant construc-

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2 “Armenia exports over 1.4 billion kWh electricity in 2015”.

tion. Taking into account the fact that construction requires minimum 6 years, it became obvious in 2012 that the new nuclear power plant could not become operational before September 2016. Thus, the Armenian Government made a decision in 2013 for upgrading the safety and extending the lifetime of the Armenian Nuclear Power Plant. In this regard, the safety issues became especially important. The State Nuclear Safety Regulatory Committee under the Armenian Government and the International Atomic Energy Agency established the minimum safety level, in compliance with which was mandatory for the issuance of a license for lifetime extension. The LTE program lists the actions necessary to bring the unit’s safety level in line with the licensing requirements, describes their sequence and deadlines.

On 27 March 2014, the Armenian Government adopted a Protocol Decision No. 12 on Approval of the ANPP Unit 2 Design Lifetime Extension Program, which will be conducted in two phases. The list of works, their sequence and timing required for being in compliance with the licensing requirements are described in the program. The first phase of the program comprises an Assessment of Technical Feasibility of the Unit 2 LTE (including complex inspection and safety analysis of the unit). It is intended to implement an analysis of efficiency measures and programs aimed at increasing the safety level. At the end of the first phase it is planned to develop a Program for Preparation of the Unit for the period of extended operation. The second phase is the preparation of the unit for the period of extended operation which includes implementation of all the measures defined within the first phase for obtaining a license for the project when its design lifetime is expired. This phase is about to be completed in November 2016.

In this regard international support for the project should be emphasized. Continuous technical assistance is provided to the Armenian NPP on safety upgrade, Unit 2 lifetime extension, including implementation of procedures, personnel training, and improvement of safety analysis capabilities. Since 1996, the US, the EU, Russian Federation, the Czech Republic, Great Britain and Italy have been providing support to raise the safety level of Armenian NPP. During that period safety measures have been implemented in the framework of the technical cooperation with the approxi-
mately value of 160 million USD. The implementation of the safety measures was coordinated by the IAEA.\textsuperscript{4}

The overall cost for the Nuclear Power Plant life time extension program has been approximately 300 million USD. The Russian Government will provide a 270 million USD loan and an additional 30 million USD grant to cover the expenses. According to the project, the Metsamor nuclear power plant life time will be extended for an additional 10-11 years to 2026-2027. The Armenian Government will continue its efforts to find the necessary investment for the construction of the new nuclear power plant till that deadline. Meanwhile, it should be noted that Armenia is looking for possible other types of nuclear reactors with smaller capacities, which would make the project more commercially viable. In this regard, the Canadian CANDU reactors with 670 MW capacity, and the Chinese ACP 600 reactors with 610 MW capacity are being discussed as possible alternatives for Russian 1060 MW capacity reactors. Another possibility is to equip the new nuclear power plant with smaller SMR reactor with 360 MW capacity. This type of reactor is currently in the final stages of development in the United States, Russia, Japan, and South Korea.\textsuperscript{5}

The construction of new generating capacities, renewable energy and energy efficiency

Another significant development for Armenia during the last decade has been the construction of new generating capacities. In this regard, the construction of the Yerevan combined cycle gas power plant (launched in 2010, entirely completed in 2013 with a maximum of 220 MW capacity) with a loan from the Japanese Government, and the launch of the 440 MW capacity Hrazdan 5 combined cycle gas turbine should be mentioned. The latter project was implemented within the framework of the agreement between the Government of Armenia and the Russian company “Gaz-


prom”. The possibility of constructing two more gas power plants within the next decade is being discussed, which will cover the potential gap in the electricity production after the cease of operations of 4 blocks at the Hrazdan Gas Power Plant.

The Armenian Government paid great attention to the development of renewable energy (RE) resources including hydroelectric power, solar power, wind power, and biomass. As it was already mentioned, hydroelectric power was actively used during the Soviet period. The two biggest projects were the Sevan-Hrazdan cascade (1936-1962) with a 559 MW capacity and the Vorotan Cascade (launched in 1970-1989) with a 404 MW capacity. During the 2005-2013 periods, through active state support, approximately 140 small private hydropower plants have become operational in Armenia with a 210 MW output. Renewable energy annual electricity generation increased from 150 GWh in 2005 (2.5 percent of the total generation) to 740 GWh in 2013 (around 10 percent of the total generation).

It should be mentioned that the donor community plays an important role in promoting the development of RE in Armenia through investment and technical assistance to improve the legal and regulatory framework, as well as through a number of projects including resource assessment and mapping. The research and development of other renewable energy technologies are underway including geothermal and solar power. The research is underway to explore the possibilities of establishing a full industrial cycle of bio-ethanol production in Armenia with the goal to cover 10 percent of the fuel consumption in Armenia by bio-ethanol in the mid-term perspective. In 2012, the Armenian Government approved the Energy Efficiency project under the financing of the World Bank. The project has been targeted to implement energy saving activities in public facilities to reduce the level of energy consumption by social and other public facilities. The cost of the project is estimated to be about 10.7 million USD. Membership in the Eastern Europe Energy Efficiency and Environment Partnership (E5P) will enable implementing very important energy efficiency projects. The investment from Armenia will amount to about 1 million Euros to be paid in portions in addition to some 20 million Euros in grants.⁶

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⁶ “Energy Strategy of Armenia: Accomplishments, Challenges, Next Steps”.
Within the last three years, some important measures have been taken in Armenia to foster energy security. First of all, the elaboration and adoption of the Energy Security Provision Concept in 2013 should be mentioned in this regard.\(^7\) The Energy Security Provision Concept describes the current situation in Armenia, main goals and tasks to ensure the high level of energy security, as well as possible ways to achieve those goals. Another milestone in the institutionalized approach towards energy security was the adoption of the “Ways of Long Term (up to 2036) Development of the Energy System of the Republic of Armenia”.\(^8\) This scenario based document was adopted by the Government in December 2015 and it outlined several scenarios of development with concrete programs for each of them. In both documents the necessity for regional cooperation, diversification of supply routes and sources, the construction of a new NPP, as well as the development of new generating capacities with a focus on renewable energy resources such as hydro, solar, and bio-ethanol were put forward.

The geopolitics of energy: energy security in the context of regional developments

The regional security dynamics could not and should not be ignored while discussing the issues of energy security. It is clear that some if not most decisions affecting energy security, development of energy infrastructure and the establishment of new energy corridors are driven by geopolitical interests and calculations. The South Caucasus is not an exception especially taking into account its geographical location enabling the possible flow of energy resources from the Caspian basin and Central Asia towards Europe.

Since the mid-1990s, several projects have been elaborated enabling the flow of Azerbaijani oil and gas via Georgia to Turkey and further to

Europe. Two major pipelines: Baku-Tbilisi Ceyhan oil and Baku-Tbilisi-
Erzurum gas pipelines have been constructed and put into operation. The
construction of the Trans-Anatolian pipeline (TANAP) has commenced,
which will bring additional an additional 16 billion cubic meters of Azerbai-
jani natural gas via Georgia to Turkey and Europe starting from 2019. Ar-
menia was excluded from all these regional projects due to the active ef-
forts by Turkey and Azerbaijan, which isolated Armenia from any regional
projects using this policy as a trump card to convince or compel Armenia
to make unilateral concessions on the Karabakh issue.

This policy has been in effect for more than two decades, but paradoxically
the main beneficiary was neither Azerbaijan, nor Turkey. The attempts to
isolate Armenia from regional economic projects and to exert pressure
boded well only for Russia, which in a very skilful manner has exploited
this situation to strengthen its economic grip over Armenia. Being block-
aded by Azerbaijan and Turkey and until recently having no possibilities of
large scale economic and in particular energy cooperation with Iran due to
international sanctions, Armenia had virtually no alternative but to deepen
its economic cooperation and to grow its reliance on Russia not only for
military but also for economic and energy security. As a result of the Azer-
baijan-Turkish joint policy we have Russian companies controlling key pil-
lars of Armenian energy infrastructure. As it was mentioned above, Russian
Gazprom is the owner of 100 percent shares of “Gazprom Armenia” gas
distributive company in control of Armenian domestic gas network includ-
ing Armenian part of Iran-Armenia gas pipeline. Gazprom is the owner of
the newly constructed Hrazdan 5 Gas Power Plant. The Russian Company
Rus Hydro is owner of the Sevan-Hrazdan hydro power plant, which is
providing approximately 10 percent of the electricity of Armenia.9

Since 2006, the Russian Company Inter Rao is a 100 percent owner of the
Armenian electricity distribution grids as well as 4 blocks of the Hrazdan
gas power plant. In 2015, after months of street protests due to the electric-
ity price hike, an agreement was signed between Inter Rao and the Russian

9 “RusHydro secures USD 25 mn loan from Asian development bank for modernization
private Tashir Group, according to which the Tashir Group will gradually take control of the distributive networks and the 4 blocks of Hrazdan power plants. Meanwhile, it should be noted that the owner of the Tashir group is a prominent Armenia-born Russian-Armenian billionaire which may lead to the conclusion that Russia may have retained some indirect control over the network.

Russia is the main supplier of natural gas to Armenia, and as it was mentioned above, is financing through loans and grants the life time extension project for the Armenian NPP. Natural gas plays a significant role in the energy balance of Armenia. It is being used both for industry, electricity production, and household heating as well as for fuelling more than 70 percent of the vehicles. Thus the gas price offers leverage to Russia in relations with Armenia.

The nuclear deal between Iran and the P5+1 States may create alternatives for Armenia to diversify its regional economic and energy cooperation. The short term possibility is to increase the capacity of electricity transmission from Armenia to Iran. Immediately after the nuclear deal reached in July 2015 an agreement was signed to start the construction of Armenia-Iran third 400 KV high-voltage electricity transmission line. The third line will be operational by the end of 2017, and it will increase the export capacities of Armenia to 6 billion Kwh. The construction of the Meghri hydropower plant on the Araks river near the Armenian-Iran border is another important joint Iran-Armenian project. The original agreement was signed in October 2010, and envisaged that the funding would be provided by Iranian companies. This hydropower plant would export all produced electricity to Iran for the first 15 years after which the ownership of the plant would be transferred to Armenia. The ground breaking ceremony was

held in November 2012 but no active construction has taken place due to the lack of financial resources. Hopefully, the Iran nuclear deal will create additional opportunities for this project too.

Another important direction for regional cooperation for Armenia is Georgia. In this regard, some important steps have been already undertaken. Armenia-Georgia joint working group has been established to conduct the economic analysis to implement information exchange and modelling of the Armenia and Georgia integrated power system. Additionally, Armenia-Georgia joint-working groups are developing the legal framework for their power systems’ integration. The construction of additional 400 KV high voltage electricity transmission lines is being discussed.

Meanwhile, it should be noted that the bilateral Armenian-Iranian and Armenian-Georgian contacts in the energy sphere created a positive atmosphere for fostering regional energy cooperation and prepared the ground for establishing a quadrilateral Iran-Armenia-Georgia-Russia energy corridor. On December 23-24, 2015 at a joint session of Armenian, Russian, Georgian, and Iranian energy ministers held in Yerevan, a quadrilateral Memorandum of Understanding was signed on fostering regional energy cooperation. Another meeting in this format took place in Yerevan on April 13, 2016. During that meeting, a road map for a “North-South” energy corridor creation was signed.

Thus it can be pointed out that the policy of Turkey and Azerbaijan to exclude Armenia from regional energy projects has not achieved its strategic goal to isolate Armenia and compel her to make unilateral concessions on the Karabakh issue, but it provided Russia with momentum for cementing its economic hold on Armenia, and contributed to the further development of the quadrilateral Iran-Armenia-Georgia-Russia energy cooperation with the mid-term perspective of creating a North-South electricity corridor.

Another key development in the Armenian energy sector has been the agreement with the American “Contour Global” energy giant on purchasing the Vorotan cascade. The 180 million USD investment represents the largest ever U.S. private investment in Armenia, and the first U.S. investment in Armenia’s energy sector. Under the terms of the agreement, Contour Global Hydro Cascade, a direct and wholly owned subsidiary of Contour Global, will supply power to the Armenian grid under a long-term power purchase agreement. It will also invest 70 million USD over the next six years in a refurbishment program to modernize the plants and improve their operational performance, safety, reliability, and efficiency.\(^{15}\)

The Iran nuclear deal may create another opportunity for involving Armenia into regional energy projects. Iran owns one of the biggest natural gas reserves in the world and the elimination of the economic sanctions created new possibilities for Iranian gas export to Europe. It is worth mentioning that initially the “Nabucco” gas pipeline project envisaged the involvement of Iranian gas, but the project was frozen due to the economic sanctions against Iran. Currently, active expert-level discussions are underway to identify optional routes for Iranian gas exports.\(^{16}\)

The Iran-Armenia-Georgia route is one of the options. This option envisages either the construction of an LNG terminal on the Georgian Black Sea coast or connecting Georgia with Europe via a Black Sea pipeline. In addition to that, new Iran-Armenia and Armenia-Georgia gas pipelines with export capacities should be constructed to bring Iranian gas to the Georgian Black Sea coast.

It should be mentioned that any tangible volumes of Iranian gas may reach European markets within 5-7 years taking into account the necessary investments to be made in Iranian gas production capacities, as well as for the development of additional domestic pipeline capacities to connect the

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Southern gas fields with the Northern distribution networks. In any case, the establishment of the North-South energy corridor with the involvement of Iran-Armenia-Georgia-Russia may create auspicious conditions also for choosing the Armenia-Georgia route for possible future Iranian gas exports to Europe.

**Conclusions**

Energy security is one of the key pillars for ensuring Armenian national security. Bearing in mind the harsh consequences of the energy crisis during the first years after the independence of Armenia, the hurdles and obstacles towards achieving the necessary levels of energy security have gradually been overcome. The construction of a new NPP, the diversification of energy supply routes, the development of renewable energy sources and fostering regional cooperation are key elements of Armenian energy policy. Despite Azerbaijani and Turkish efforts to exclude and isolate Armenia from regional energy projects and thus compel her to undertake unilateral concessions in the negotiations on Karabakh, Armenia has gained a relatively high level of energy security, and through developing cooperation with Iran, Georgia and Russia, she may become a regional hub for electricity transmission. Russian energy companies have extensive presence in the Armenian energy sector controlling some significant assets, meanwhile the Vorotan hydro power plant deal with America’s “Contour Global” and the joint energy projects with Iran have enabled Armenia to gradually diversify its energy portfolio.
PART II:

RESPONSES TO CURRENT ENERGY SECURITY CHALLENGES IN THE SOUTH CAUCASUS
The impact of unresolved conflicts on energy policy in the South Caucasus

Vusal Gasimli

Introduction

The fragmented intermarium of the South Caucasus, lying between the basins of the Black and Caspian seas, can be characterized in terms of two types of intertwined knots, where the entangled interests of geopolitical powers may result in either positive or negative consequences: either positioning the region as an ongoing geopolitical and geo-economic battleground, or alternatively creating a breeding ground for development. Energy projects are a unifying factor for the South Caucasus countries, while conflicts prevent Armenia, Azerbaijan and Georgia from achieving the desired level of mutual engagement. Cooperation in the field of energy would serve as a platform to boost regional integration, while foreign actors have been using conflict-based methods such as coercion, inducement, persuasion and exhortation to extend their influence. Conflicts provide the main leverage for major players from outside the region to maintain their influence on the South Caucasus. Nevertheless, Azerbaijan and Turkey are working with Georgia, Iran, and Turkmenistan through targeted multilateral projects to strengthen regional security, economic and energy development, and improve diplomatic relations between Eurasian states. The trilateral format also helps deepen ties between other Caspian Basin and South Caucasus countries, promote Eurasian-European energy collaboration through these states, and balance external pressures from a newly assertive Russia.

Energy cooperation between Azerbaijan and Georgia is a brilliant example of how to reduce the negative impact of outside actors and develop integration. Energy cooperation converts disadvantages into assets that support South Caucasus economic integration. In contrast, the Armenia-Azerbaijan

conflict over Nagorno-Karabakh attracts outside players that misuse this conflict to hinder regional cooperation. Thus, since energy cooperation leads to self-sufficiency and energy security, which discourages foreign intervention, the ongoing unresolved conflicts and the broader geopolitical interests of big players negatively influence energy-related decisions. Azerbaijan as an energy-rich, and as a transit country, Georgia as a transit-country, and Armenia as a country with no involvement in regional energy projects shape the energy landscape of the South Caucasus. The independence of the South Caucasus countries depends considerably on their energy security. In effect, energy self-sufficient Azerbaijan is the most independent country in the South Caucasus, while energy-dependent Armenia is the least independent one. By having relied on neighbouring Azerbaijan’s energy supply, and by providing a strategic transit location, Georgia has also ensured its own energy security.

In attracting foreign players to the South Caucasus, two intertwined issues – energy cooperation and conflict resolution – must be separated from each other. This kind of approach might diminish opportunities for using one issue as leverage to influence the other.

There are two dimensions of energy cooperation in the South Caucasus: Iran-South Caucasus-Russia and Azerbaijan-Georgia-Turkey-the EU.

**Iran-South Caucasus-Russia energy cooperation**

On this dimension, the Armenia-Azerbaijan Nagorno-Karabakh conflict has defined two directions: first, cooperation along the axis Iran-Azerbaijan-Georgia-Russia; while the second direction embodies networking efforts for Iran-Armenia-Georgia-Russia. Azerbaijan is interested in developing the interconnection of its electricity networks with Iran, Georgia and Russia. Recently, Iran’s Energy Minister, Hamid Chitchian, observed that electricity consumption in Azerbaijan, Georgia and Russia usually reaches its peak in the winter, while Iran experiences peak consumption in the summer. The surplus of energy could therefore be traded seasonally, offering potential for the sides to exchange electricity and avoid the cost of construction of new power plants. Azerbaijan, as a transit country, can carry out electricity export-import operations by linking its electricity system with those of Russia and Iran, and obtain dividends for the transmis-
sion of electricity. Azerbaijan may also benefit from net exports and transmission of electricity within the framework of Iran-Azerbaijan-Georgia-Russia cooperation. According to the Armenian Ministry of Energy and Natural Resources, a 400-500 kV power transmission line between Armenia and Georgia, along with a 400 kV power transmission line between Armenia and Iran, will start operating in 2018. Electricity exchange capacity between Armenia and Georgia will reach 350 megawatts (MW), with a further planned increase to 700 MW by 2021; exchange capacity between Armenia and Iran will reach 1200 MW. Since all transmission networks linking Armenia with Georgia and Iran will be operated by the Russian company Gazprom, Georgia has geopolitical concerns because of the increasing influence of Russia over the planned South Caucasus electricity network. Liana Jervalidze, an independent energy analyst in Tbilisi, believes that energy security, economic benefit, and geo-strategy would suggest that “it is in Georgia’s best interest to remain a place for gas transit to Armenia, not the other way round”. On the other hand, Russia has been limiting the extent of energy cooperation between Armenia and Iran, especially following the lifting of Western sanctions. It seems that Russia and Armenia are not going “hand-in-glove” regarding Iranian involvement in the South Caucasus energy market.

Thus, as a strategic player, Georgia tends to be involved in energy cooperation among Iran-Azerbaijan-Georgia-Russia rather than that among Iran-Armenia-Georgia-Russia. Energy cooperation between Georgia and Iran looks likely to be implemented via Azerbaijan through the Kazi Magomed-Astara-Abadan natural gas pipeline. Incidentally, before the Islamic Revolution, the Southern Caucasus republics of the Soviet Union were supplied by the Kazi Magomed-Astara-Abadan pipeline starting from Iran. Thus, Iran-Georgia energy cooperation could be an additional stimulus to involve Iran in the Azerbaijan-run Southern Gas Corridor.

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Within this framework, on the basis of reciprocity and mutual benefit, and
guided by a common will, enhanced cooperation can be fostered along with the
development of the North–South corridor. Beyond energy, this corridor will open the
door for Georgia and Azerbaijan towards the Persian Gulf.

Along with multilateral networks, Azerbaijan has developed bilateral energy cooperation with Russia, Georgia and Iran. For example, starting in 2016, Georgia will be supplied with an additional 500 million cubic meters of Azerbaijani gas at a price reduced from 318 USD to approximately 280 USD per 1,000 cubic meters in accordance with the agreement signed between SOCAR and the Georgian government in early 2016.

A whole host of factors muddy the picture of Georgia’s actual energy requirements: its reliance on a complicated mix of energy suppliers, growing demand for natural gas, its status as both gas importer and transit country, as well as seasonal fluctuations in demand. Apart from the volume of gas received as a transit fee (10 percent of Russian natural gas delivered by Gazprom to Armenia); Georgia imports the lion share of its domestic demand for gas from Azerbaijan. The recent flirtation of the Georgian government with diversification of its gas sources through negotiations with Iran and Russia, at the potential expense of Baku, led to a decrease in the price of gas imported from Azerbaijan of 12 percent. This followed the price drop in Europe and the strengthened position of SOCAR in the Georgian energy market. Therefore, this latest gas agreement between Georgia and Azerbaijan has been a “win-win” for both sides.

Thus, while Azerbaijan has begun its gas imports from Russia, in accordance with the five-year agreement signed in September 2015 with the possibility of extension up to 2 bcm per year, it has increased its gas exports to Georgia and Turkey.

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Azerbaijan-Georgia-Turkey-EU energy cooperation

The Baku-Tbilisi-Ceyhan (BTC) oil pipeline has been a stepping stone for deepening westward cooperation. The EU and the Caspian states, together with the companies that handle much of the export flows from the Caspian to the European, Mediterranean and Atlantic markets, have a shared interest in what is commonly called the Southern Energy Corridor. Broadly speaking, this term is typically used to describe a mélange of routes that serves to connect oil and gas producers in the Caspian, along with a range of Middle Eastern energy suppliers, including Iran, Iraq and even Egypt, to a variety of major international markets. At a time when the European Union is attempting to broaden its horizons regarding energy sources, the South Caucasus seems attractive, with Georgia positioning itself as a transport bridge, and Azerbaijan attempting to renew its historical status as the “Land of Fire” – nowadays as a source of energy. Azerbaijan, Georgia and Turkey formalized their trilateral cooperation following the opening of the BTC oil pipeline in 2006, and solidified it after the shock of the August 2008 Russia-Georgia War, which challenged their mutual economic and security interests. The trailblazer role of Turkey in the westward direction opens new opportunities for Azerbaijan and Georgia to be integrated into the European Energy Community. Energy Community membership would give Turkish companies the opportunity to participate, on equal terms with EU member states, in EU institutions including the European Agency for the Cooperation of Energy Regulators (ACER), the European Network of Transmission System Operators for Electricity (ENTSO-E) and the European Network of Transmission System Operators for Gas (ENTSOG). The free flow of electricity within the Azerbaijan-Georgia-Turkey triangle and the permanent synchronous operations creates an opportunity to export electricity from the South Caucasus through Turkey to Europe. Wire-

8 Kopac, Janez and Ekinci, Mehmet. “Turkey as a Member of the Energy Community”. Daily Sabah, https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3602146/0F472146E9147C0FE053C92FA8C0BAC9.PDF.
less power transfer – electricity transmission without the use of discrete man-made conductors – might be an additional stimulus to increase electricity supply from the energy-rich South Caucasus to Europe in the future. For example, currently, Azerbaijan is generating about 24 billion kWh of electricity per year, with a capacity to export some 2 billion kWh.

The oil and gas pipelines – Baku-Tbilisi-Ceyhan, Baku-Tbilisi-Arzurum and Baku-Supsa – are important not only for the energy security of Georgia, but also for supporting Georgia’s statehood, and its efforts towards European integration. Georgian sensitivity regarding the Armenia–Azerbaijan Nagorno-Karabakh conflict is obvious. One of the largest trade partners and investors in Georgia is Azerbaijan’s closest ally, Turkey, which is aligned with NATO and the EU; while Russia, the master of Armenia, a CSTO and Eurasian Economic Union member, dismembered Georgia. Exacerbating this, 300,000 Azerbaijanis live in the Kvemo-Kartli region of southern Georgia, on the border with Azerbaijan, while 250,000 Armenians are predominantly located in the Samtskhe-Javakheti region in the southwest of Georgia, near Armenia.

Therefore Georgia has concerns regarding the potential escalation of the Armenia-Azerbaijan conflict on its territory. Georgian Prime Minister, Giorgi Kvirikashvili, acknowledged that this conflict may negatively affect the security of the whole South Caucasus.10

The Azerbaijan-Georgia-Turkey energy-backed entente – codified in the 2012 Trabzon Declaration – affirmed their mutual respect for their sovereignty and territorial integrity, and for the peaceful settlement of disputes. Thus, Azerbaijan, Georgia and Turkey consider that “protracted conflicts emanating from existing occupations are the main obstacle to peace and stability in the South Caucasus”.11 Despite their differences in foreign policy orientations, Azerbaijan and Georgia share the same positions on conflict resolution based on the inviolability of borders, and on energy policies

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with a European dimension. Turkey’s participation in this entente gives it real substance. However, there has been little trilateral focus on the latest escalation in Nagorno-Karabakh. Turkey strongly demanded that Armenia released the occupied Azerbaijani territories, while Georgia found itself in a delicate position and tried to maintain a balance between Armenia and Azerbaijan. In addition to other reasons, the wariness of Georgia to take sides on the Nagorno-Karabakh conflict has been attributed to the threat of Armenian separatism in the Samtskhe-Javakheti region, which may get out of control. Many ethnic Armenians do not speak Georgian fluently, and some analysts and politicians also consider the region susceptible to separatism, allegedly encouraged by Russia.12

The Eurasian Economic Union and the South Caucasus

As long as the threat of the escalation of the conflict between Armenia and Azerbaijan hangs in the air, and while Azerbaijan's main economic partners, Turkey and Georgia, continue to prefer European integration, Azerbaijan is reluctant to join any bloc reminiscent of the Soviet Union, including the Eurasian Economic Union (EAEU), at the expense of loss of sovereignty, and of political independence. The supranational regulatory and judiciary bodies of the EAEU – Eurasian Economic Commission and the Court of the EAEU – would restrict Azerbaijan’s sovereignty, including in the field of energy policy, as well as its efforts to repair territorial integrity. Meanwhile, Russia is hoping that through the resolution of the Nagorno-Karabakh conflict, it can compel Azerbaijan to join the CSTO and the Eurasian Economic Union (EAEU).13

Armenia’s reason for joining the EAEU lies in her traditional security problems and complex regional surroundings.14 Turkmenistan – Azerbaijan’s


14 Ter-Matevosyan, Vagram. “Does the Eurasian Economic Union have a future?”
maritime neighbour on the opposite shore of the Caspian Sea – also seems reluctant to join the EAEU. Turkmenistan is firmly determined not to enter the EAEU as Ashgabat fears it will only serve the interest of Russian supremacy in Central Asia.\textsuperscript{15} The Eurasian Economic Union is not an advantage for Azerbaijan’s physically and economically large southern neighbour, Iran, but on the contrary would be devastating, especially because sanctions against Russia may increase in the future.\textsuperscript{16} At the same time, Armenia is lobbying for a free trade agreement between Iran and the Russian-led Eurasian Economic Union.\textsuperscript{17} After the lifting of international sanctions, Iran is attempting to integrate with the global economy, and to attract western investment, secure new niches in the global oil and gas markets and import technology. Those objectives are not in line with the membership of the Russian-led EAEU. In contrast, Iran and Russia are competing to increase their influence in both the South Caucasus and on the global oil and gas markets.

Although officially Baku has kept its distance from becoming a member of the EAEU, a free trade agreement between Azerbaijan and the EAEU member-states – Russia, Kazakhstan, Belarus and Kyrgyzstan – was signed under the CIS umbrella on 15 April 1994. At the same time, Russia is the biggest non-oil export destination for Azerbaijan. By maintaining the European dimension of its energy exports, the Eurasian dimension in its non-energy trade turnover, and by its commitment to the development of both the North-South and the East-West corridors, Azerbaijan has balanced its relations with the EU, and the US against those with the EAEU, as well as with the regional players, and it has avoided excessive dependence on any of them. Azerbaijan’s balanced policy, grounded on economic power and coupled with the trilateral dimensions of its foreign policy –

Azerbaijan-Georgia-Turkey, Azerbaijan-Iran-Turkey, Azerbaijan-Iran-Russia and Azerbaijan-Turkmenistan-Turkey, have increased Baku’s options.

Figure 1. GDP composition of the world (percentage)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>22.34</td>
</tr>
<tr>
<td>China</td>
<td>13.28</td>
</tr>
<tr>
<td>Japan</td>
<td>5.90</td>
</tr>
<tr>
<td>EAEU</td>
<td>2.78</td>
</tr>
<tr>
<td>Euro area</td>
<td>17.20</td>
</tr>
<tr>
<td>Rest of the world</td>
<td>60.84</td>
</tr>
</tbody>
</table>


As long as the Eurasian Economic Union with its scanty GDP amounted to 2.2 trillion USD lags behind the Euro area (13.4 trillion USD), China (10.4 trillion USD) and the U.S. (17.4 trillion USD), the Moscow-led economic union cannot be attractive for the “near-abroad”, unless Kremlin used other leverage to force states in. “Never say never”, Mammadyarov said when asked if his country would consider membership of the Eurasian Economic Union. Mammadyarov explained that Azerbaijan was focused on “building up more bilateral level cooperation” within the EAEU.\(^{18}\)

The impact of the Armenia-Azerbaijan Nagorno-Karabakh conflict on the energy sector

The fighting that erupted in Nagorno-Karabakh between 2 and 5 April, 2016, has been considered not only the most significant outbreak of hostilities in recent years, but also a threat against the infrastructure for the transport of oil and gas from the Caspian basin towards Europe. A representative of the Armenian armed forces threatened to attack the oil transportation facilities of Azerbaijan using different types of rockets. The front line is only 30 miles from the BTC pipeline, operated by BP with a throughput capacity of 1.2 million barrels per day. The BTC pipeline passes through 13 districts in Azerbaijan, six of which – Yevlakh, Goranboy, Samukh, Shemkir, Tovuz and Agstafa – are within the firing range of the Armenian armed forces. The destruction of the BTC would prevent about 35-40 million tons of crude oil from being loaded onto tankers at Turkey’s Mediterranean port of Ceyhan. BTC is crucial in a volatile world energy market, and it is the only oil and gas route that bypasses the Russian stranglehold on energy exports from the region. During the Russia-Georgia war, bombs targeted the BTC but missed their target.

Also under threat of bombing by the Armenian armed forces is the South Caucasus Pipeline (SCP) that follows the route of the BTC with a daily average throughput of 18.6 million cubic metres of gas per day. The expansion of the South Caucasus Pipeline is part of the Shah Deniz Full Field Development project. With a budget of 45 billion USD, this expansion involves laying a new pipeline across Azerbaijan and the construction of two new compressor stations in Georgia. This will triple the gas volumes exported through the pipeline to over 20 billion cubic metres per year.

There is potential for bombing to delay the Southern Gas Corridor, a game changer for the European energy map.

An additional threat is that Russia might also instigate separatist sentiments in Georgia’s region of Samtskhe-Javakheti, populated by ethnic Armenians and crossed by the BTC oil pipeline that carries Azeri oil through Georgia to Turkey.  

PACE on January 26, 2016 published a report entitled “Inhabitants of frontier regions of Azerbaijan are deliberately deprived of water”. The report called on the Armenian authorities to stop the use of water resources “as a tool of political influence”. The point is that the Sarsang reservoir in the occupied Azerbaijani territories is dangerous to the entire border region, as well as for the low-land population of Azerbaijan. Water-deficient Azerbaijan cannot use neither the Sarsang reservoir nor other water resources – especially in Kalbajar that should be released by Armenian forces according to the UN Security Council resolution 822 adopted in 1993. So the Nagorno-Karabakh conflict is hampering the development of the renewable energy sources based on water resources, as well.

Conclusion

The solution of the Nagorno-Karabakh conflict would offer the ground to raise energy efficiency by shortcutting pipelines, using water resources to generate power, and eradicating the dangers associated with the negative impact of conflicts on energy security.

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The Potential of Abkhazia in Ensuring Energy Security in the South Caucasus

Dmitry Mushba

Brief characteristics of the South Caucasus in the context of energy security

The Caucasus is unique in its geopolitical options. It is like a “bridge” linking the North and the South, Asia and Europe, Islam and Christianity. The Caucasus has the potential to become a key factor in ensuring broad international security outside of its geographical boundaries. A number of strategic evaluations show that regional security in Central Eurasia depends on peace and stability in the Caucasus, especially in the southern region bordering Russia, Iran and Turkey.¹

The geopolitical role of South Caucasus is unique because of its potential and its geographical location. It is situated between the territory of the former Soviet Union, which went through major changes in its political, economic, cultural and ideological systems in the last 25 years and the region of greater Middle East, which is currently in a state of great tension.

The South Caucasus is of interest as a supplier of natural resources, particularly oil and gas from the Caspian region. It is also important in the region as a transit state for the supply of hydrocarbons to the world markets. Control over South Caucasus allows to provide leadership in transcontinental transport operations and to exert political influence on regional processes.

When Soviet Socialist Republics became independent, the region became even more interesting for international players, including the United States (US) and the European Union (EU). They increasingly compete with Russia, which has been traditionally playing a key role in the region. It is obvi-

ous that some NATO members have geopolitical interests in the region, since it provides access to the waters of the Black and Caspian seas.

It should be noted that in the case of South Caucasus, we are talking about the relationship of six states. Three of them have wide international recognition: Azerbaijan, Armenia, Georgia. Two countries are partially recognized: Abkhazia, South Ossetia and the sixth is Nagorno-Karabakh. It is obvious that without taking into account the interests of all states, no system of regional security can be effective.

The Republic of Abkhazia in the context of regional security

It has become customary to view the Georgian-Abkhaz conflict in the context of the collapse of the USSR. This event was undoubtedly a powerful catalyst in the escalation of the conflict and its transition to an armed phase. However, one cannot ignore the fact that serious Abkhazian-Georgian contradictions and inter-ethnic tensions existed throughout the Soviet period. Representatives of the Abkhaz nation periodically went on mass protests against Georgian policy. Abkhazians believed that this policy was aimed at the suppression of the Abkhaz national and cultural identity.

Today the conflict is still “frozen”. During the entire post-war period Abkhazia has led unsuccessful negotiations on the establishment of state and legal relations with Georgia. But the Georgian leadership is unwilling to sign a legally binding document on the non-use of force against Abkhazia. This fact can only mean one thing – the Abkhazian-Georgian relations are far from normal and the threat of the renewal of the conflict still exists.

In order to encourage the parties to start negotiating, the mediators have to be neutral at least in appearance. However, in the Abkhazian-Georgian case, we see total support for one side in all of its initiatives and requirements and total disregard for the achievements of the other side to the conflict. It is obvious that such a policy encourages the Georgian government to put further pressure on Abkhazia, particularly by putting pressure on civilians. Consequently, the Abkhaz society is frustrated about the prospects of cooperation with the European institutions and disappointed to see such blatant display of double standards.
Despite the opposition from the Georgian side and its policy of blocking all foreign economic contacts of our country, the Abkhaz economy has developed. Along with agriculture, tourism is the main industry. It is enough to say that in 2015, Abkhazia was visited by about 1.5 million tourists. The Republic has reached the performance of the pre-war period. The recreational potential of Abkhazia is huge and the hydro resources of the country are unprecedented.

Traditionally the main actors in conflict resolution were Russia, the USA and the UN. For a long time, the EU did not have a clear strategy on participation in conflict resolution in the Caucasus. With the EU entry of new states from Eastern Europe, the EU begins to participate more actively in the political processes in the post-Soviet space, in particular in South Caucasus.

Unlike the US and the NATO, the EU did not focus on military and political, but the socio-economic sphere in its “Caucasus policy”. Another priority of the EU is to ensure stability in the region, as well as respect and compliance with the European standards of human rights and democratic freedoms.

The fact that the EU stressed the need to resolve frozen conflicts without violence, gained the trust of the population of Abkhazia, which was tired of the one-sided view of international mediators – especially the US and the so-called “group of friends of the UN Secretary General on Georgia”.

However, enthusiasm soon gave way to disappointment. Today, the attitude of European countries towards Abkhazia can be defined as “frozen inauspiciousness”. For decades, the tone and even the terminology of declarations of international organisations towards Abkhazia has not changed. In Abkhazia, such a policy is tantamount to “stagnation”. The ongoing substitution of concepts and the non-recognition of Abkhazia as a party to the conflict make it unsolvable.

Bruno Coppieters notes that the government of Georgia has more opportunities to influence decision-making than the “de facto” (from the point of view of the EU) governments of Abkhazia and South Ossetia. This gives Georgian leaders an opportunity to establish control over the activities of
the EU in the transformation of the conflict with Abkhazia and South Ossetia. This does not contribute to the positive dynamics. Tbilisi is trying to restrict the activities of the EU only to interaction with the NGOs.\textsuperscript{2} It is afraid that in the process of their interaction with the EU, formal power structures of Abkhazia and South Ossetia can gradually acquire greater legitimacy in the eyes of the EU.

The initiative called “involvement without recognition” voiced by Peter Sommeby, the EU’s special envoy for South Caucasus, has turned into a strategy of non-involvement.

As rightly pointed out by Coppieters, “from the Abkhaz point of view, the idea of Europeanisation has long been present in Abkhazia, but the international community is wrongly configured on the integration of Abkhazia into Georgia and not into Europe”.\textsuperscript{3}

However, the EU is able to place at the forefront of its foreign policy the opening of channels of communication between Abkhazia and the outside world; Europe, the countries of the Black Sea basin and the South Caucasus. This, in turn, could create more favourable conditions for the interaction between Abkhazia and Georgia in those areas, where there is mutual interest. An example of cooperation based on the real needs of today is the interaction at the Ingur hydro power plant.

**Case study: The Ingur hydroelectric power station and the potential of the energy sector of the Republic of Abkhazia**

The Ingur hydro power plant (HPP) is located on the border between Georgia and Abkhazia (the hydroelectric dam is in Georgia and the underground power plant and three HPP stations are in Abkhazia). These three stations, each with the capacity of 40 megawatts (MW), need renovation. The capacity of the Ingur HPP is 1300 MW. Five generators are active on the Ingur HPP. Three other generators are working on the HPP-1. They


\textsuperscript{3} Ibid.
have the capacity of 220 MW. The three HPPs are potentially capable of producing about 4 billion kW. Real output is about 3.2 billion kWh. This is more than two times higher than the required amount of electricity in Abkhazia.

The ownership of the Ingur hydroelectric power station plays a key role. The power plant is under the jurisdiction of two states, Abkhazia and Georgia. Today, the electricity produced at the Ingur hydroelectric power station is distributed between the Abkhaz and the Georgian side on the principle of 40 to 60 respectively. In winter, when the output is very low, Abkhazia consumes about 90 percent of the electricity. In the summer-autumn season, when the river Ingur is filled with water, the consumption on the Abkhaz side does not exceed about 10 percent. The rest of the generated energy goes to Georgia. The Ingur hydroelectric power station is the only major source of generation and it fully provides for the need of electricity in Abkhazia. At the same time, the station produces, according to various estimates, from 20 to 40 percent of Georgia’s electricity.

The Ingur hydroelectric power station is perhaps the only example of the interaction between Abkhazia and Georgia. This interaction has become customary, and, despite all differences, the parties benefit from cooperation.

Interestingly, this coexistence of Abkhazian and Georgian interests is not rejected in the Abkhazian society. Although sometimes this question is raised in domestic political discourse, as it happened in the winter of 2016. As a result of the dry summer, the water level in the reservoir became critically low and the generation was reduced dramatically. In order not to lead the HPP to a full stop, there had to be a restriction of energy supply. Later, thanks to agreements with the Russian energy sector, the electricity supply was fully restored.

While having other sources of generation, Georgia is exporting the electricity generated at the Ingur hydroelectric power station. At the same time, there are allegations that the Abkhaz side does not participate in the maintenance of this dam and its reconstruction. It is true that Georgian companies carried out repair work at the station on the money received from the European Bank for Reconstruction and Development (EBRD) and the
European Investment Bank (EIB). Although it is not yet clear, whether Abkhazia could legitimately export electricity, should the question of the ownership of the Ingur hydroelectric power station be resolved. If Abkhazia could benefit from the electricity export, then it would have the profits to repair the station and restore all the generating capacities on the Abkhazian territory.

There are high risks to the energy security of Abkhazia. The depreciation of the equipment is estimated to constitute 70 percent. According to preliminary estimates, to bring the energy complex of Abkhazia in compliance with current requirements, the required investment is 35 billion rubles (500 million US dollars).  

At the same time, the volume of electricity consumed in Abkhazia is growing every year. For 2015, the load on the electrical system of Abkhazia increased by 10 percent. As the Abkhazian state evolves, there is growing social and commercial infrastructure and improvements in the quality of life. Yet, the power system of the country significantly lags behind the overall pace of development of Abkhazia.

Today in Abkhazia, the price for electricity is low without parallel, only 0.6 US cents for individuals. In comparison, the residents of Georgia pay 4-5 US cents with moderate electricity consumption and about 8 cents for consumption over 300 KW. In Armenia, the price for electricity is 6 to 8 cents, for night and day tariffs respectively. In the subject of the Russian Federation - the Krasnodar territory, which is Abkhazia’s neighbour, the price per kilowatt of electricity for individuals is about 6 US cents. Thus, in Abkhazia, the price of electricity is 10 times lower than the regional average. Yet, even in these favourable conditions, the revenue for electricity is extremely low. In the post-war reality, when people are used to constant power outages, they have developed a habit of non-paying for the electricity. Today a lot is being done to improve the tax discipline of the population. For example, the Cabinet of Ministers decided to deny the issue of

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4 Interview with the Director Chernomorenergo A. Basaria.
5 Ibid.
licenses for commercial activities and other administrative permissions to those individuals who owe money for energy.

Security in the energy sector remains one of the major goals reflected in the strategy of socio-economic development of the Republic of Abkhazia. One of the main objectives is the establishment of the national energy system (NES).

Attracting investments to the development of the NES and the development of public-private partnership in the implementation of energy projects are also the main priorities.

To avoid becoming an isolated energy island, Abkhazia’s electricity system needs to operate more harmoniously with those of Russia and Georgia. Limited regional connectivity and absence of trade opportunities create considerable risks for energy availability. Whereas the Abkhazian government is interested in electricity imports to address the problem of shortages and in exports during the summer season, such opportunities remain bleak in the absence of diplomatic relations with Georgia.

At the same time, there is a view that if the power system of Abkhazia will be in the hands of a private investor, and in the case of Abkhazia it almost certainly will be a foreign company, then this will inevitably have an effect on the electricity tariffs, leading to their increase. The recent events in Armenia have shown what an increase in electricity tariffs can cause. Public pressure brought by ElectricYerevan convinced the Armenian President Serzh Sargsyan to backtrack on the authorisation to increase prices and order an audit of the Electric Networks of Armenia (ENA). In the meantime, Inter RAO UES decided to sell the ENA. This move was widely perceived by the Armenian civil society as an attempt by the Russian state company to distance itself from the energy business which provoked public unrest.

**Energy policy in the context of an unresolved conflict**

In 2016-2017, according to the program of the socio-economic development of the Republic of Abkhazia, financial assistance to the energy sector in the amount of 600 million Rubles (8.9 million USD) has been planned.
However, these funds are insufficient to significantly change the status quo in the industry. So there is a lot of discussion about attracting private investments to this sector of the economy.

Despite all the difficulties, the interest of foreign investors in the energy sector of Abkhazia is great enough. Periodically, there are a number of different projects for the implementation of public-private partnership. However, it is obvious that without taking into account the interests of Abkhazia, no project can be implemented. Not only the economic, but first of all the political dimension is important to Abkhazia. Can Abkhazia be accepted as an equal party to the negotiations, a party that has to be reckoned with?

When in 2008 Georgia has auctioned a number of hydroelectric power plants, including the shares of the Ingur hydroelectric power station, the Vice-President of “Azerenerji” stated that Azerbaijan can take part in the privatisation of power plants. This has logically caused confusion in Abkhazia, as this issue was not discussed with the Abkhaz side. Later in December 2008, the Chairman of the Board of Inter RAO UES Evgeny Dod and the then Minister of Energy of Georgia Alexander Khetaguri signed a Memorandum of understanding on the effective operation of the Inguri hydroelectric power station. According to the agreement, Inter RAO UES received the use of a dam located on the Georgian side and the generating capacity in the Gal district of Abkhazia. Thus, apart from Georgia and Abkhazia, electricity would be supplied to Russia as well. Once again, the Abkhazian side was not invited to the negotiations. However, later at a meeting with President Sergei Bagapsh, a representative from Inter RAO UES described the agreement as non-binding.

The position of the Abkhazian side on this question is simple and straightforward – the agreement on the Ingur hydroelectric power station can be signed only with the participation of the Abkhaz side and by taking into account its interests.

Today the possibility of selling electricity in Russia is not as relevant. Before the Sochi Olympics, a number of generation facilities were built in Southern Russia and now there is no shortage in electricity there. However, Abkhazia still has a huge potential to export electricity.
The electrical system of Abkhazia is connected to the Georgian system since the Soviet period. If these systems are connected to the Russian system, it should be possible to supply electricity from Russia to other countries in the region via Abkhazia and Georgia. The EU, Russia and international organizations can become the guarantors of supply.

At the expert level, the possibility of resuming railway communication via Abkhazia has been discussed for years. There is a long-established interest in a road project linking Russia and Armenia. Taking into account the interests of Abkhazia, this project could play a positive role in stimulating regional economic growth.

Speaking of investments, one needs to understand that large multinational companies operate on the territory of Georgia. By starting projects in Abkhazia, they risk to incur the costs associated with the pressure of the Georgian authorities.

**Conclusion**

Post-war Abkhazia tries both to prevent a new Georgian aggression and to exercise greater independence in the conditions of a growing influence from Russia. By declaring that Abkhazia is occupied by Russia, Georgia hinders the emancipation of Abkhazia, thus exacerbating its dependence on Russia, making it harder still for anyone to convince the Russian Federation to remove its troops from there.

In Abkhazia, there is an understanding that the issues of state-building remain the exclusive prerogative of the leadership of Abkhazia. The independent position of the Abkhaz leadership has been noted by many foreign experts.6

Despite all the problems and challenges of the energy industry of Abkhazia, it is necessary to note that Abkhazia is the only state in South Caucasus whose energy complex has not been sold to private companies. It remained

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6 Thomas de Waal: the new Treaty is not a watershed in Russian-Abkhaz relations http://www.caucasustimes.com/article.asp?id=21391 Перевести вGoogleBing.
in the hands of the state, despite the great post-war difficulties that Abkhazia went through.

While in other countries of the region state controls only some of the most sensitive assets in the energy sector.\textsuperscript{7} All electricity and gas distribution as well as hydro and thermal power plants have been privatised and ownership lies mostly with foreign energy companies. Moreover, a large share of foreign state-owned companies in energy sector is seen to be at risk.\textsuperscript{8}

The claims of Georgia that Abkhazia is under occupation can withstand no criticism, since Abkhazia is on the course of preserving the strategically important sectors of the economy in the hands of the state.

There are projects that could potentially be interesting to all participants, both regional and global. Transit potential of Abkhazia can be of great benefit in strengthening stability in the region of South Caucasus. The example of cooperation between the Abkhaz and Georgian sides in the electric power industry is interesting from the point of view of conflict transformation. If the policy is divided from economy all parties could benefit. In this case energy can become a driver of the process of the conflict resolution.

Unfortunately these days, one can say that there is an ongoing course on the full isolation of Abkhazia and its economic strangulation. This primarily affects the civilian population and it does not allow the Abkhazian economy to develop. The full energy and transit potential of Abkhazia remains unused.


\textsuperscript{8} Energy security in the South Caucasus: views from the region Interviews with representatives from the Georgian National Energy and Water Supply Regulatory Commission and environmental NGOs.
The Domestic Politics of Energy: The Case of Armenia and Corruption

David Shahnazaryan

With no proven reserves of hydrocarbons, energy policy is crucial to Armenia in terms of economic development and choice of foreign policy alternatives. It is also an important element of the domestic policy, which is based on corruption schemes.

For the citizens of Armenia, who survived the crippling energy crisis in 1992-1995 that determined their future in many ways, energy policy has become a factor of utmost importance. Due to the armed conflict with Azerbaijan over Nagorno-Karabakh, the Turkish transport blockade and the ineffective system of electricity distribution and sale inherited from the previous regime, electricity for households was rationed to a few hours per day.

The first corruption schemes with state-owned property in Armenia involved power generating and distributing utilities. Former president Robert Kocharian, who served for two terms, between 1998 and 2008, used sophisticated corruption schemes to resell several times the national power distribution networks, eventually handing them over to Russia. In 2015, the owner of the national power distribution company – the Electrical Networks of Armenia (ENA) – the Russian Inter RAO, accused of inefficient and corrupt management, required another increase in electricity prices to avoid bankruptcy. The government’s permission to allow another hike sparked two-week demonstrations in Yerevan, which forced it to keep the energy rates unchanged for most households and some small businesses through a subsidy.

The protests were driven by a widely held belief that Armenians are being forced to pay for widespread corruption within the ENA management. While defending the rate increase, government officials acknowledged that the national electric utility was mismanaged by the Russians.
Eventually, the government allowed the sale of ENA to the Tashir Group of Russia-based billionaire of Armenian descent, Samvel Karapetyan.

Earlier, in 2002, in another suspicious deal known as “Assets for Debt”, Robert Kocharian handed over to Russia the Sevan-Hrazdan cascade of hydropower plants, the Hrazdan thermal power plant, and several other enterprises of strategic importance in return for writing off an Armenian debt of 100 million USD. In 2003, Armenia’s nuclear power plant in Metsamor was placed under Russia’s concessional management.

Russian Gazprom is the only supplier of natural gas to Armenia, as stipulated by the Armenian-Russian gas agreement of 2014. The agreement has stipulated that the current and future Armenian governments cannot raise taxes or make any other changes in the regulatory environment for the Gazprom-owned network until January 2044 (!). The Armenian side is also obliged to ensure that domestic gas tariffs in the country are high enough for Gazprom to recoup 9 percent of its capital investments in the network annually.

In 2013, the Armenian government sold its 20 percent share in the domestic gas distribution network – Gazprom Armenia (formerly ArmRosGazprom) – to Russia’s Gazprom monopoly. In return for gaining 100 percent ownership of the network, Gazprom wrote off a 300 million USD debt which the government incurred as a result of secretly subsidizing the price of Russian natural gas supplied to Armenia since 2011.

The construction of the Armenia-Iran gas pipeline, supposed to reduce Armenia’s dependence on Russian energy resources, was completed in 2008. But it appeared that the 41-kilometer section running from the Iranian border to the South-Eastern Armenian town of Kajaran had been sold to Gazprom by a “tentative agreement” finalized in 2007 with a 30 million USD “prepayment” made by the company at the time. Moreover, under the Armenian-Russian gas agreement, Armenia has no right to buy gas from Iran – the gas shipped to Armenia through the pipeline is converted to electricity at Yerevan thermal power plant, and is sent back to Iran at the rate of 3 kWh per one cubic meter of gas. Originally, the pipeline’s diameter was projected at 1,500 millimetres. The Armenian government reportedly agreed to cut it to just 710 millimetres under pressure from Russia,
which feared losing its status as the region’s main gas supplier. Currently, the pipeline operates at only 20 percent of its capacity.

The importation of petrol to Armenia might also deserve special attention. In the past two years, it has been brought only from Russia - private Armenian oil traders have to buy petrol from Russian Rosneft. This means that the import of petrol cannot be regulated by the bilateral intergovernmental agreement. However, despite the falling petrol prices on the world markets, its price in Armenia did not drop. In response to persistent requests to explain this phenomenon, the head of the Armenian anti-trust agency declared that the pricing of gasoline in Armenia is a state secret.

Over the past 2 months, the Armenian government adopted a number of decisions with purely political or purely corrupt implications. For example, it borrowed 30 million USD from the World Bank to compensate the Electric Networks of Armenia for its losses. By the way, when ENA was still owned by Russian Inter RAO, it paid first its debt to the Russian–owned Hrazdan thermal power plant.

On March 10, the Armenian government passed an executive order allowing Gazprom Armenia to keep all of its profits, which would essentially mean exempting it from paying taxes. Russia’s overall control of Armenia’s energy sector has provided virtually unlimited opportunities for various corruption schemes in this area. As Russia’s own energy sector lacks transparency concluding predictable transactions is simply impossible. On the other hand, since Russia is considered a guarantor of Armenia’s security and some elements of this security are considered confidential, any corrupt dealing may be proclaimed, if needed, as emanating from the “national security interests”.

Russia’s total control of Armenia’s energy system has translated to an important political leverage. When Armenia was preparing to join the Russia-led Eurasian Economic Union, its advocates would argue that the membership would result in the decreased price of Russian natural gas for Armenia. Indeed, following its formal accession the price of gas supplied by Gazprom dropped from 184 USD to 165 USD (150 USD, as Russian Prime minister Medvedev announced on 7th April in Yerevan) per thousand cubic meters. However, in fact, Gazprom has sold gas at this price to its Arme-
nian subsidiary Gazprom Armenia. The latter has sold it to the Armenian households at 330 USD, which is higher than the price of gas sold by Russia to Ukraine and many other European countries. The Armenian government has asked Russian authorities to cut the price of gas. However, the role of the government is not quite clear, as the Russian Gazprom sold its gas on the border to its own subsidiary.

Further, the full control of Armenia’s entire energy system has provided Russia with many fraud and manipulations opportunities. For example, the high price of gas forced almost all Armenian households and many enterprises to cut consumption. However, in 2014, the gas consumption increased unexpectedly by about 10 percent, while in 2015 it grew even further. The explanation is simple; Russia increased the share of electricity generated by the Hrazdan TPP, which is also a Russian asset in Armenia. This, in turn, increased the gas consumption, and (indirectly) raised the price of gas, since electricity generated by the thermal power plants (more than one third of the total) is more expensive than that generated by the nuclear power plant and hydropower power plants. All these manipulations earned extra profit to Russian-owned electricity generating utilities in Armenia, while the share of Armenia-owned utilities fell.

The reasons behind Armenia’s heavy dependence on Russian energy resources are not technical; they are purely political;

1. A large segment of Armenia’s political system lacks internal legitimacy and is trying to secure it from Russia;
2. The most important tasks of the system are linked to corruption schemes, which often prevail over the national interests.

After the disintegration of the former Soviet Union, the hydrocarbon resources of the Caspian Sea gained importance in terms of strengthening the independence of the new states, but they should be transported to seaports, and Armenia would have provided the most convenient and shortest routes for doing so. However, because of the Nagorno-Karabakh conflict, Azerbaijan declined the more economically suitable Armenian route, choosing the more expensive option via Georgia. All pipelines taking the Caspian oil and gas to Europe; the Baku-Tbilisi-Ceyhan oil pipeline, the Baku-Tbilisi-Erzurum gas pipeline, as well as the Trans-Anatolian Natural
Gas Pipelines (TANAP) and the Trans Adriatic Pipeline (TAP), which are under construction, have bypassed Armenia.

The lifting of Western sanctions against Iran, in January 2016, has opened up new possibilities for Armenia to diversify its energy supplies. Iran immediately declared its readiness to increase its gas supplies to Armenia by two to five times. But those plans have been hindered by the capacity of the Iran-Armenian pipeline, as well as by the limited capacity of the Armenia-Iran power transmission lines.

The operation of the pipeline stretching from the Iranian Tabriz to the Turkish Ankara with a capacity of 11 billion cubic meters has been often sabotaged by PKK attacks, and the harsh weather conditions. Iran has become reluctant to expand this route because of these risks, and because it viewed Turkey as a political competitor. Iran is neither enthusiastic about shipping its gas through Azerbaijan because of some political tensions with its northern neighbour. Therefore, Iran would prefer the Armenian route.

Considering Iran as a serious competitor, Russia realized that Iranian gas will eventually reach European markets. To hinder Iranian access to European markets, Moscow is exploiting its infrastructure in the South Caucasus. Thus, Gazprom told Georgia that it wanted to pay in cash instead of 10 percent of the gas transported to Armenia via its territory, as transit fee. If Georgia had agreed, it would not have received enough cash to buy the same amount of gas it was now receiving as a transit fee, and it would have to pay more for the gas bought from Gazprom. Moscow’s plan was to determine Georgia to refuse buying Azerbaijani gas, and buy instead from Iran, through the Iran-Armenia gas pipeline, whose Armenian section, as it was said above, was owned by Gazprom. In case of success, deliveries of the Iranian gas to Georgia would appear under Russian control as well. The problem was that Azerbaijan could not increase its gas supplies to Georgia by 10 percent, as requested by Tbilisi, due to the depletion of its reserves.

The government of Georgia began unprecedented diplomatic activity. After a series of multi-round negotiations, an agreement was reached with Iran on gas supplies and another agreement was reached with Russia to use the Russian-owned pipelines to deliver it to the Armenian-Georgian border. However, Azerbaijan agreed to cut supplies to Turkey, and increased sup-
plies to Georgia, although Turkey paid a higher price than Georgia for Azerbaijani gas. The plans of the Georgian government to buy Russian gas were meantime vehemently opposed by the Georgian opposition that accused it of russophilia.

Concurrently, after several rounds of confidential talks and following the second Southern Gas Corridor (SGC) Advisory Council meeting in Baku on February 29, 2016 Azerbaijan, several South European and Balkan countries, the UK, the US and the EU have signed a joint declaration reaffirming their strategic partnership to build the Trans Adriatic Pipeline (TAP) that will stretch over seven countries to take additional natural gas to Europe and Turkey. The signing ceremony was attended by EU foreign policy head Federica Mogherini. A week later the declaration was approved by the European Commission. It turned out that Phase 2 of the BP-led Shah Deniz deposit in Azerbaijan’s section of the Caspian Sea would provide enough capacity to export, at least, 10 billion cubic meters of gas to Greece, Albania, Bulgaria and Italy from 2020. Russia returned immediately to the old scheme of gas supplies, while Azerbaijan continued to supply gas to Turkey. However, Armenian and Russian pipelines were bypassed again.

It should be noted, though, that the touted volumes of Azerbaijani gas reserves are questionable. This is evidenced by Azerbaijan’s cut of supplies to Turkey in order to secure increased gas supply to Georgia, as well as by Azerbaijan’s intention to start buying gas from Russia. The particular importance of TAP is that a small investment would be sufficient to connect it with the Iranian gas transportation system. If Iran had access to a gas pipeline taking its gas to Europe, Teheran might disregard its political differences with Azerbaijan.

Now let us see what the government of Armenia was doing throughout this time. In fact it was doing nothing! The country’s leadership was preoccupied with constitutional reforms, electoral code, creation of a coalition government, destruction of potential opposition – in a word, it was doing everything to strengthen its hold of power, while the great geopolitical and energy games were outside its attention.

Armenia’s imposed membership of the Eurasian Economic Union provided the monopoly of Russian state-owned energy companies an add-
tional leverage, which has also potentiated further military, information and other components of Russia’s sway on Armenia.

The agreement on Iran’s nuclear program has in fact opened up new political and economic opportunities for Armenia to diversify its energy system. However, in reality, due to the enslaving agreements with the Russian government and the Russian state-owned companies, Armenia has to negotiate with Russians any potential step that can diversify its energy system.

In particular, Tehran has repeatedly stated its intention to sharply increase production and export of hydrocarbons, and it made no secret that the best export routes to the European Union markets lay through the South Caucasus, which among other things is the least politically burdened. This could not be said about the Turkish route because of PKK sabotages and the degrading political situation in that country, or about the routes through the Middle East, which, in the foreseeable future, might be impossible to use.

In addition, through its ambassador to Armenia, Iran said it was ready to offer unprecedented discounts to its neighbouring countries. In a telephone conversation with the Armenian president, Serzh Sargsyan, Iranian president, Hassan Rouhani, spoke about the strategic importance of connecting the Persian Gulf to the Black Sea. The United States and France, represented by their ambassadors in Yerevan, have also spoken about the opportunities opening for Armenia after the lifting of Western sanctions against Iran. But what we see on the Armenian side is “eloquent” silence, forced by Yerevan’s commitments to Russia. Thus, there is a situation where we have almost all the elements that make up the concept of actual occupation.

If prior to Russian intervention in Ukraine, followed by US and EU sanctions against Moscow and the sharp fall in energy prices, Moscow used energy prices’ discounts as means to justify its disproportionate presence in Armenia, now this presence has become not only meaningless, but also a hindrance to the development of Armenia. Moreover, in terms of inefficiency and non-transparency Russian state-owned companies are unmatched. Russian media is rife with stories about how state-owned companies embezzle billions of Rubles.
The former Chief Executive Director of ENA, to whom we “owe” the highest electricity prices across the former Soviet Union, could not even provide an elementary account for ordinary spending items of the company, when asked by Armenian’s Public Services Regulatory Commission, known for its long-time “sympathy” towards Russian companies in Armenia. This prompted an unprecedented wave of protest in Yerevan against the irresponsibility and arbitrariness of ENA.

As it is known, the electricity distribution networks cover the entire territory of the country, employing tens of thousands of people. Naturally, these personnel are used as a kind of political base to secure a comfortable situation for the operation of Russian companies in the country’s political system, and to rule out the adoption of political decisions that might shake the Russian presence in the country in its current form, and at the current scale. Moreover, the military and information components of such a presence also directly or indirectly serve this goal, given that the Russian state is behind it.

Russian companies in Armenia are guided by political, not business, rationality. This is the essence of the current neo-imperialist strategy of the Russian leadership, and was formalized through the so-called integration projects, where Moscow is the absolute hegemon in the post-Soviet space as a zone of privileged interests, as repeatedly stated publicly by Russian leaders.

Today, Russia’s strategy is not aimed at effectively contributing to the stabilization of the situation in the neighbouring countries, but its main goal is to ensure its continued and exclusive control over that instability. The energy levers play a key role in this strategy. By building the “Nord Stream” pipeline, Russia aims to actually bypass Ukraine and some countries of Eastern and Central Europe, and by building the “Turkish Stream” it aims to build leverage on the countries from South-East Europe.

These energy projects have, to a certain extent, strengthened the Russian factor in these regions. But after its interventions in Ukraine and Syria, Moscow might have fallen out with Germany and Turkey. Moreover, against the backdrop of Iran’s efforts to sell its huge hydrocarbon reserves on the world markets, this backward strategy, nurturing an unreformed and
criminal-oligarchic Russian economy based on exporting raw commodities, might experience a serious failure.

Nonetheless, we should note that the energy component of the Russian policy in the South Caucasus is still effective to a certain degree due to the persistent fragmentation of the region, as well as of the lack of understanding that flirting with the Russian factor is unacceptable. As life has shown, in such cases, all parties are losers, but Russia. In addition, the fragmentation of the region has hindered the development of relations with the EU and the US. Thus, against the backdrop of a sharp fall in global energy prices, the emergence of new, historic opportunities for energy diversification, as well as the ongoing energy and information revolutions, Russia’s energy strategy, seeking to revise the European order, is losing its previous advantages.

A need has ripened for the South Caucasus to reach a kind of regional consensus on several important policy issues, which would allow its nations to overcome their fragmentation and isolation, resulting from the unresolved conflicts, while realizing their full economic potential, and providing them with a historical perspective. From this point of view, Armenia should set the task of diversification of its energy supply as early as possible, and remove all legal and political obstacles on that way. First and foremost, the monopoly of Russian Rosneft should be eliminated, while the agreement with Gazprom should be either modified or ignored to enable Iranian gas supply to Armenia. In parallel, a new gas pipeline should be built through Armenia to connect Iran to TANAP on the territory of Georgia in order to cover the potential gas shortages of TANAP.
PART III:

RECONCILING EUROPEAN AND EURASIAN ENERGY SECURITY POLICIES: THE TWILIGHT OF ENERGY GEOPOLITICS?
Turkey’s Energy Strategy and the Challenges of Energy Security in the South Caucasus

Oktay F. Tanrısever

Introduction

This chapter seeks to explore the characteristics and dilemmas of Turkey’s energy strategy. It also hopes to discuss the implications of Turkey’s energy strategy for the challenges of energy security in the South Caucasus. The chapter focuses on the role of Turkey in realizing the European Southern Energy Corridor between Europe and Asia as well as the scale of Turkey’s energy dependence on Russia in the wider context of the European energy security. It also discusses the contributions and limitations of Turkey’s energy strategy to the capacity of the South Caucasian countries to cope with the regional challenges of energy security individually and regionally.

The chapter argues that although Turkey’s energy strategy largely contributes to the regional energy cooperation among the South Caucasian countries due to its role in the realization of the East-West energy corridor as well as the European Southern Energy Corridor, the gap between its ambitious energy strategy objectives and its limited energy resources, as well as its energy overdependence on Russia and the failure to integrate Armenia in Turkey’s regional energy cooperation framework in the South Caucasus region weaken Turkey’s declared strategy of contributing to a sustainable regional energy cooperation in the South Caucasus. The chapter also suggests that Turkey needs to strengthen its regional energy cooperation with all countries in the South Caucasus, the Caspian Sea and the Black Sea regions in order to play a more constructive role in the European energy security. Ankara also needs to develop more innovative solutions to its problems in establishing a sustainable regional energy cooperation framework by working very closely with the NATO allies, European Union partners as well as the South Caucasus countries.

The chapter starts with an examination of the characteristics of Turkey’s energy strategy. Afterwards, it analyzes the performance of Turkey in con-
tributing to the regional energy cooperation in the South Caucasus and the Caspian Sea regions. This will be followed by a discussion of the main weaknesses of Turkey’s energy strategy in coping with the regional energy cooperation in the South Caucasus. The article concludes with a discussion of the main findings of the study for Turkey’s energy security and its implications for the South Caucasus as well as the wider context of the European energy security.

**Characteristics of Turkey’s Energy Strategy**

Turkey is a largely energy-poor country in terms of its hydrocarbon energy resources of crude oil and natural gas. Turkey produces only 8 percent of its total need for crude oil and only 2 percent of its total demand for natural gas. On the other hand it has significant potential for renewable energy resources in hydropower, wind power, solar power as well as geothermal power. Nevertheless, Turkey also faces significant infrastructural, financial and technological limitations in developing its potential in renewable energy, particularly in solar energy, fully. With its relatively high population growth rate and increasing need for all forms of energy for its growing industrial production, Turkey’s energy shortage problem could become even more acute challenge for its economy in the foreseeable future, if it fails to achieve its planned investments in the energy sector soon.¹

Given the limited character of its conventional energy resources as well as the financial and technological difficulties in developing its renewable energy potential, Turkey’s energy supply security has already become very vulnerable to the political and security challenges of its neighbours and the ups and downs in its bilateral relations with the energy rich countries in its close neighbourhood: namely, Russia as well as the countries in the Caspian Sea and the Middle Eastern regions. In fact, Turkey is largely dependent on energy imports from these neighbouring energy-rich countries.

¹ For an updated description of Turkey’s energy profile, see “Turkey”, https://www.eia.gov/beta/international/analysis.cfm?iso=TUR (accessed on 30 March 2016).
Turkey’s main energy trade partners include Russia, Iran, Azerbaijan and Iraq. Turkey has also energy cooperation with Algeria, Nigeria and Venezuela.\(^2\)

As a country with a growing demand for more energy resources for its increasing industrial production, Turkey needs to find sustainable, reliable, affordable and accessible sources of energy supply in order to enjoy energy supply security. Turkey’s official document on energy strategy defines its conception of energy as follows:

The primary aim of Turkey is to realize its own energy security. To this end, Turkey has for objective to diversify its energy supply routes and source countries, increase the share of renewables and include the nuclear in its energy mix, take significant steps to increase energy efficiency, and contribute to Europe’s energy security.\(^3\)

In this sense, Turkey’s conception of energy security resembles to the energy security understanding of the European Union in that both of them emphasize the security of energy supply.\(^4\)

In this respect, the central elements of Turkey’s energy strategy includes the security of supply and the diversity of its energy sources in addition to energy efficiency and a greater use of renewable energy resources. Nevertheless these objectives are easier to be set than to be realized for a country like Turkey with significant energy shortage problems and increasing over-dependence on external sources of energy, mostly in the form of hydrocarbons: crude oil and natural gas.

\(^2\) Ibid.

\(^3\) Turkey’s concern with its own over-dependence on external energy suppliers is visible in its document on energy security which is available online at “Turkey’s Energy Strategy”, http://www.mfa.gov.tr/turkeys-energy-strategy.en.mfa (accessed on 30 March 2016).

Therefore, Turkey’s dependence on external sources of energy undermines its energy security considerably. It is in this context that Ankara considers energy security as a very strategic issue. In order to pursue a sustainable energy strategy, Ankara has been occasionally forced to make a tradeoff between the economic and geopolitical risks and benefits. Hence, the realization of a harmony between the economic and geopolitical dimensions of Turkey’s energy strategy is considered an ideal but very rare situation for Turkey. Besides, Ankara’s pursuit of a sustainable energy strategy is important not only for itself, but also for Turkey’s NATO allies and the European Union partners as well as the countries in the South Caucasus and beyond.5

The geopolitical aspect of Turkey’s energy strategy is characterized mainly by Turkey’s position as a natural bridge between Europe and the Caspian Sea region as well as the Middle East. Ankara seeks to position itself as an energy transit country between the energy rich regions of the Caspian Sea, the Persian Gulf as well as the Eastern Mediterranean and the economically very developed European markets where there is high demand for energy. Nevertheless, Turkey’s diplomatic relations with the energy rich countries in its close neighbourhood in the post-Soviet space and the Middle Eastern regions tend to remain very problematic. In other words, it is very difficult for Ankara to have stable energy cooperation with these energy rich countries in the post-Soviet space and the Middle Eastern regions especially when these energy partners attempt to exploit the vulnerabilities of Turkey’s energy sector and its over-dependence on external sources of energy.6

Turkey’s geopolitics of energy carries in itself some opportunities and risks too. Turkey’s role as a bridge between the energy producers and consumers definitely strengthens its position as a more preferable route for the transportation of energy. Nevertheless, the energy suppliers in the South Caucasus, the Caspian Sea as well as the Middle East regions are also very unstable countries. Turkey’s energy strategy of becoming the main transit route for such energy suppliers located in volatile regions creates extra geopoliti-

6 Ibid.
cal risks for itself. Turkey’s role as energy transit corridor between the East and the West is an integral part of its wider transport strategy of becoming a bridge between Europe and Asia.\(^7\)

Despite the geopolitical risks involved, Turkey intends to construct as many oil and natural gas pipelines as possible in its territory through the realization of the East-West Energy Corridor or the European Southern Energy Corridor. Turkey’s approach to pipelines diplomacy is also compatible with the European Union’s energy security strategy since the European Southern Energy Corridor represents an alternative way of supplying the European markets with energy sources through a route which by-passes Russia. In other words, Turkey’s energy strategy is closely linked to the energy security of the European Union countries as well as the South Caucasus countries. Therefore, the compatibility among the energy security challenges of Turkey, the European Union and the South Caucasus necessitates Turkey to adopt a regionally grounded and European-oriented energy security strategy.\(^8\)

To summarize, Turkey’s energy strategy operates in accordance with the main principles of European energy security policy. It also has a potential of making constructive contribution to the regional energy challenges in the South Caucasus. At the conceptual level, Turkey’s energy strategy serves not only to diversify its own energy supplies but also to diversify the European energy supplies very effectively. Furthermore, Turkey’s geographical position is expected to enable Ankara to serve as a bridge of Europe to both Eurasia and the Middle East. Nevertheless, in order to realize this concept of energy security, Ankara needs to develop sustainable regional energy cooperation with the all countries in the South Caucasus region so that these countries could gain their energy independence from Russia and cooperate among them regionally.


\(^8\) Ibid.
Turkey as Contributor to energy security in the South Caucasus and beyond

The success of Turkey’s ambitious energy security strategy depends to a large extent on its ability to develop closer regional energy cooperation with the countries in the South Caucasus as well as the other neighbouring regions: the Caspian Sea, Middle East and the Eastern Mediterranean regions. Therefore, Turkey’s energy diplomacy towards these regions has been premised on a policy of combining the energy interests of the South Caucasus and the Caspian Sea countries with the European Union in such a way that it could enable Turkey to become a regional energy hub for Europe.

From a geopolitical perspective, the backbone of Turkey’s energy diplomacy towards its neighbourhood consists of the regional energy cooperation in the South Caucasus, the Caspian Sea and the Black Sea regions. The geopolitical interests of Ankara have motivated it to align its regional energy policy with those of Azerbaijan and Georgia, both of which are also oriented towards the European Union. In fact, Azerbaijan and Georgia have serious conflicts with Russia ethno-territorial; namely with respect to Abkhazia, South Ossetia and Nagorno-Karabakh conflicts. This established the geopolitical rationale for Turkey, Azerbaijan and Georgia to resist Russia’s regional hegemony in the Caucasus by developing their energy policies in close cooperation with the United States and the European Union, especially after the deterioration of Russia’s relations with the West over the Kosovo crisis in 1999.9

Turkey’s regional and global alignments have produced their tangible results when they succeeded in bringing Azerbaijan’s crude oil and natural gas to Turkey through the Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline and the Baku-Tbilisi-Erzurum (BTE) natural gas pipeline in the mid-2000s. Consequently, the successful realization of these projects has reduced not only Russia’s geopolitical influence over Azerbaijan and Georgia, but also

Turkey’s energy dependence on Russia since these pipeline projects have enabled Baku to bypass Russia in having access to international energy markets and Turkey to diversify its energy supplies by having access to the Caspian energy resources.10

The synergy among these countries has resulted in the broadening of their regional energy cooperation with a view to have access to the European energy markets in the 2010s. With this regional energy strategy, Turkey and Azerbaijan have sought to supply the European natural gas market with Azerbaijan’s Shah Deniz 2 natural gas field. After a long period of deliberations, Turkey and Azerbaijan agreed to construct the Trans-Anatolian Pipeline (TANAP). This pipeline project is also joined by major energy companies such as BP. It is expected that TANAP will be operational by 2018 at the very latest. The Trans-Adriatic Pipeline (TAP) linking Greece, Albania and Italy is expected to distribute this natural gas from Azerbaijan to the European energy market.11

These successful developments in Turkey’s regional energy diplomacy have also shifted Ankara’s priority to the extension of the existing pipeline networks to the east and south in the 2010s. In the east of the Caspian Sea, the relatively more land-locked countries of Kazakhstan and Turkmenistan have not enjoyed the geographical advantages of Azerbaijan, which has already been able to export its energy resources to Europe via Georgia and Turkey. In fact, Kazakhstan and Turkmenistan, which are geopolitically denied direct access to the European energy markets, have remained largely dependent on Russia for exporting their energy resources. These states have only the option of exporting their energy resources to the Asian markets. Therefore, the main challenge to Turkey’s energy strategy in the Caspian Sea region seems to be the orientation of these countries towards the Chinese and Indian rather than European energy markets.12

10 Ibid.
12 Ibid.
Turkey’s policy of expanding its energy cooperation with Azerbaijan to include Kazakhstan and Turkmenistan has clashed with Russia’s energy interests in the Caspian Sea region. In fact, Moscow intends to keep the Caspian Sea region under its sphere of influence by making these states dependent on Russia for exporting their crude oil and natural gas. Russia’s effectiveness in playing Azerbaijan and Kazakhstan against Turkmenistan and Iran over the status of the Caspian Sea made Moscow a key regional player for the development of the hydrocarbon resources of the Caspian Sea region. So far, Moscow has been able to control the westward energy export pipeline routes of Kazakhstan and Turkmenistan. It is through Russia’s manipulation of the conflict over the status of the Caspian Sea that Moscow has prevented the realization of the Trans-Caspian pipeline networks for transporting the energy resources of Kazakhstan and Turkmenistan to the European energy market. Despite Russia’s opposition, Turkey has contributed to the harmonization of Azerbaijan’s energy policy with those of Kazakhstan and Turkmenistan in recent years considerably.\textsuperscript{13}

Another challenge to Turkey’s policy of developing the East-West energy corridor stems from the energy policies of Iran. Generally speaking, Iran’s policies have largely been in line with Russia’s regional energy policies. Tehran has assisted Moscow in blocking the realization of the East-West energy corridor between the energy producing countries in the Caspian Sea region and the consumers in the European energy market via Turkey. One of the implications of the agreement between Iran and the Group of 5+1 countries concerning the nuclear program of Iran could be a change in Iran’s long-term policy of blocking the East-West energy corridor if the moderates gain the upper hand vis-a-vis the conservatives in the Iranian domestic politics. This may also weaken Russia’s dominance in regional energy diplomacy in the medium term.\textsuperscript{14}

\textsuperscript{13} “Meeting of the Ministers of Foreign Affairs of Turkey, Azerbaijan and Turkmenistan was held in Ashgabat”, http://www.mfa.gov.tr/turkey_azerbaijan_turkmenistan-meeting-of-the-ministers-of-foreign-affairs.en.mfa (accessed on 30 March 2016).

Since Ankara has largely failed to transport adequate amount of natural gas from the Caspian Sea to Europe via Turkey, it needs to find additional natural gas resources from the Middle East and the Eastern Mediterranean. In the Middle East, due to its geographical proximity, only the Iraqi energy resources could have boosted Turkey’s strategy of realizing an East-West energy corridor. The recent agreements between Turkey and Kurdistan Regional Government (KRG) in 2014 have created a significant opportunity not only for regional energy cooperation but also for linking the natural gas resources in Iraq with the European Southern Energy Corridor. In addition to the existing Kirkuk-Yumurtalik oil pipeline, an already operational new oil pipeline and a planned natural gas pipeline between KRG and Turkey are expected to enhance the prospects for the East-West energy corridor considerably.\(^\text{15}\)

Likewise, the Eastern Mediterranean region with its considerable proven natural gas reserves has also become another important region for Turkey to realize its East-West energy corridor. Although the discovery and development of these energy resources have already increased regional rivalries, exporting the natural gas outputs of Israel and Cyprus to Europe via Turkey seems to be the most cost-effective option and a basis for regional energy cooperation. In order to transport these energy resources to Europe via Turkey, Ankara needs to prioritize the normalization of its relations with Israel as well as the peaceful settlement of the Cyprus conflict.\(^\text{16}\)

Overall, Turkey’s performance in contributing to the regional energy security challenges in the South Caucasus and the Caspian Sea regions could be considered partially successful since Ankara has not provided the European energy market with so large amount of natural gas that could make the European Southern Energy Corridor a credible alternative to Russia’s supply of natural gas.


Weaknesses of Turkey’s Energy Strategy

Although Turkey tries to pursue its energy strategy in close cooperation with the European Union and its regional partners in the South Caucasus, the Caspian Sea, and the Middle Eastern regions, Turkey’s regional energy strategy has significant weaknesses. These weaknesses stem mainly from three factors; the gap between Turkey’s expectations and capabilities, Turkey’s overdependence on Russian energy supplies and the exclusion of Armenia from Turkey’s regional energy cooperation framework.

Among these limitations, the gap between Turkey’s expectations and capabilities in its energy security strategy seems to be the most important limitation. Although Turkey seeks to become an energy hub for the European energy market, Ankara has not been able to transport a sufficient amount of natural gas from the other countries in the Caspian Sea and the Middle East regions in order to meet the South East European demand for natural gas. Therefore, given Turkey’s own need for external natural gas, its inability to transport more natural gas from the Caspian Sea and the Middle East regions weakens Turkey’s strategy of contributing to the European Southern energy corridor considerably.

The second important weakness of Turkey’s energy security strategy seems to be its overdependence on Russia’s energy supplies. Just like Turkey, Poland, the Baltic States and the other East European countries have very high levels of dependence on Russian oil and natural gas.17 This overdependence on Russian energy sources seems to be a major source of risk for Turkey as well as other European countries, especially in the aftermath of the ongoing Ukrainian crisis which has its roots in Russia’s strategies of undermining the Ukrainian drive for Europeanization since the Orange Revolution of 2004.18

In fact, Moscow’s use of energy vulnerabilities of the European countries has become a key characteristic of Russian foreign policy since the 2000s. Therefore, immediately after the Ukraine-Russia natural gas crisis of early 2006, the EU started to take the energy security issue very seriously. Brussels also emphasized the need to develop a coordinated and common EU position on the energy trade with Russia. The EU Commission has already published its Green Paper and Strategic Paper on energy security to foster such a coordinated stance on Russia. Likewise, NATO and EU have enhanced their coordination among themselves as the two major institutional frameworks of the European energy security.19

Due to the increasing importance of Turkey’s role in the European Southern Energy Corridor, Russia’s energy policies serve to weaken the energy strategy of Turkey as well as its the European energy security perspective. The potential for competition between Turkey and Russia is evident since the energy strategy of Turkey challenges the Russian hegemony over the energy transportation routes of the other post-Soviet Caspian states; namely Azerbaijan, Kazakhstan and Turkmenistan.20

In this respect, one of the major challenges to Turkey’s energy strategy of creating an East-West energy corridor stems from its increasing dependence on Russia’s energy supplies as well as Russia tendency to manipulate these energy dependencies for extending its regional influence. Russia’s tendency to use energy as a foreign policy tool creates significant security risks for the European energy security too.

The origins of Turkey’s energy trade with Russia go back to the late 1980s when Ankara agreed to import natural gas from the Soviet Union through a


natural gas pipeline known as the “Western route”, passing through Ukraine and Bulgaria. Turkey’s energy cooperation with Russia intensified after the realization of the Blue Stream natural gas pipeline project, which was signed in 1997. The Blue Stream pipeline provides Turkey with Russian natural gas through a direct pipeline constructed under the Black Sea. However, the Blue Stream pipeline has increased Turkey’s dependence on Russian natural gas considerably. Gazprom, Russia’s state-controlled natural gas company and one of the biggest energy companies in the world, seems to be interested in having a considerable share in the natural gas distribution networks inside Turkey as well.21

In addition to Turkey’s energy cooperation in the field of natural gas, Russia is also one of the key crude oil suppliers to Turkey. Turkey’s dependence on Russia’s crude oil increased as Turkey decided to divert its oil imports from Iran to Russia due to the internationally agreed restrictions on importing oil from Iran as part of the sanctions against Iran’s non-compliance with the nuclear non-proliferation regime. Russian oil companies have also shown great interest in Turkey’s dynamic fuel oil sector. One of Russia’s leading oil companies, Lukoil, entered Turkey’s energy market by buying the Akpet fuel retailer company.22

Turkey’s energy dependence on Russia has increased even further with the decision to build a nuclear plant for generating electricity in Mersin Akkuyu. Turkey’s Energy Minister Taner Yıldız and Russia’s Deputy Prime Minister Igor Sechin signed an agreement on the construction of the Akkuyu nuclear power plant on 12 May 2010. This project has been criticized by environmentalists for its possible risks, especially after the Fukushima disaster in Japan in 2011. The environmentalists note, rightly, that Turkey is located in an earthquake zone. Secondly, Turkey does not have expertise in verifying the safety measures in and around the nuclear plant. Finally, Russia’s reputation in nuclear safety is not very high due to the Chernobyl nuclear accident.23 In addition to these environmental concerns, the fact that

23 For a comprehensive analysis of Turkey’s interest in using nuclear power to generate
the Akkuyu nuclear power plant could increase Turkey’s already very high energy dependence on Russia constitutes another important concern with this project.

Needless to say, Turkey’s increasing energy dependence on Russia is not compatible with its overall energy strategy. In fact, Turkey and Russia have serious conflicting interests, and their energy strategies are very competitive and clearly rival to each other. As noted above, Turkey’s energy strategy is based on the creation of an East-West energy corridor between the energy producing countries in the Caspian Sea region and the energy consumers in Europe. This East-West energy corridor is labelled the “Southern Energy Corridor” by the EU as a vital alternative to its dependence on the Russian-controlled Eastern Energy Corridor, which is highly unreliable due to Moscow’s use of energy as a foreign policy tool since Vladimir Putin’s rise to the Russian presidency at the end of 1999. The strategic importance of the “European Southern Energy Corridor” stems from the fact that it could enable the EU to diversify its energy supplies and minimize its dependence on the already very high energy dependence on Russian energy sources.

The differences between the EU and Russia over the supply of natural gas to the South Eastern Europe also put Turkey’s energy strategy to a challenging test in the 2010s. Initially, the planned NABUCCO project which was to be constructed between Turkey and the Austrian natural gas hub in Baumgarten, passing through Bulgaria, Romania and Hungary, was challenged by the Russian natural gas project of the South Stream that follows the same route except that Romania is replaced by Serbia in the South Stream project. Nevertheless, the South Stream project is not endorsed by

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the European Commission due to Gazprom’s violation of the Third Energy Package principles, despite the fact that Russia’s own natural gas reserves are clearly sufficient for the realization of this project.  

In a very surprising move, Turkey’s approval for the planned construction of the South Stream natural gas pipeline under the Turkish Exclusive Economic Zone in the Black Sea on 28 December 2011 strengthened Russia’s position in the politics of pipelines in the Black Sea region. Although Russia was clearly the main beneficiary of this deal, Turkey has some gains and losses. Turkey is believed to benefit from this deal mainly by getting a considerable reduction in the price of Russian natural gas from the Western route, while this reduced price has not yet been publicized.

After the Ukraine crisis, Russia admitted that the South Stream pipeline could not be realized due to the economic sanctions on Russia over its annexation of the Crimea and its role in destabilizing Eastern Ukraine. In order to make Turkey more vulnerable to Russia, Vladimir Putin announced that the South Stream project will be defined as “Turkish Stream” on 1 December 2014. This development is clearly a blow to Ankara’s declared strategy of becoming an energy hub for Europe as an alternative to Russia. It weakens Turkey’s commitment to the Southern Energy Corridor of the EU as well as the TANAP project. In addition, the deal is likely to decrease Russia’s dependence on Ukraine which will be by-passed by the proposed “Turkish Stream” natural gas pipeline. This project could make Turkey more vulnerable to Russian pressures. The “Jet crisis” between Turkey and Russia over the downing of a Russian Su-24M bomber jet after its alleged violation of Turkey’s airspace seems to have led to the suspension of the “Turkish Stream” and the Akkuyu Nuclear Energy projects.

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Last but not least, Turkey’s inability to integrate Armenia to its own regional energy cooperation with Azerbaijan and Georgia is another weakness of Turkey’s energy strategy toward the South Caucasus region. Since the mid-2000s, Turkey has been demonstrating its willingness to realize the normalization of its relations with Armenia and to contribute to the Nagorno-Karabakh peace process. Turkey’s diplomatic initiatives intensified since Turkish President Abdullah Gul’s meeting with the President of Armenia in Yerevan on the occasion of a football match between the Armenian and Turkish national football teams in 2009. Turkish, Armenian and Azeri diplomats increased their contacts for the normalization of their bilateral relations in the aftermath of this ‘football diplomacy’. In this process, Turkey sought to convince Azerbaijan and Armenia about the benefits of diplomatic and peaceful settlement of the conflict. Nevertheless, Turkey’s initiatives turned out to be quite ineffective.

If this ongoing process of normalization between Turkey and Armenia yields concrete results, it is probable that a significant progress could be realized in the peaceful settlement of the Nagorno-Karabakh conflict too. After the successful realization of these dialogue processes, it is very likely that Armenia could be integrated into the existing regional energy cooperation among Turkey, Azerbaijan and Georgia.

**Conclusion**

To conclude, Turkey’s energy security strategy is important for the realization of the European energy security strategy. With its declared strategy of becoming an energy hub for the European energy markets and with its growing demand for energy for its increasing industrial production, Turkey is quite important for the European energy security.

Nevertheless, as this chapter demonstrates, Turkey’s energy diplomacy has been limited by the gap between its expectations and capabilities due to its lack of adequate domestic or imported natural supplies which could help

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Ankara to play this vital role. The chapter shows how Turkey’s overdependence on Russia undermines not only its energy security but also the European energy security as a whole since it makes Turkey, an important NATO ally, vulnerable to Moscow’s manipulations. Last but not least, it is also shown that Turkey needs to integrate Armenia into the existing regional energy cooperation among Turkey, Azerbaijan and Georgia in order to contribute to the regional energy security in the South Caucasus region.

In this context, it is also essential for Ankara to coordinate its own energy security more closely with that of the European Union in developing its energy strategy as well as contributing to the regional energy security of the South Caucasus region. In other words, greater coordination between Turkey and the European Union is important for preventing Russia from exploiting the energy vulnerabilities of Turkey as well as its partners in the South Caucasus region.
The Structure of Energy Politics in the South Caucasus: Grounds for Consolidation or Cooperation?

Alexander Eliseev

Firstly, the European Union (EU) and the Eurasian Economic Union (EAEU) are in the process of elaborating common energy security policies within their respective blocks. Europeans are significantly ahead in this field and have already started the creation of a common energy market, protected from foreign expansion. At the same time the EAEU has barely started elaborating a security policy – a process that could be long and complicated. Member states expect the first results of the common policy in creating a common electricity market by 2019 (and a common oil and gas market by 2025). Until then Russia will remain the main negotiating party of the EU in energy security.

Secondly, it is inevitable that Russia and the EU will continue developing their strategic partnership on energy security cooperation. The necessity is dictated by the interdependence of Russian and European economies on fuel import and export. Half of Russia’s federal budget depends on the trade of energy, while the EU has to import up to 90 percent of its hydrocarbons (and more than 1/3 from Russia).

At the same time Russia and the European Union are trying to limit each other’s influence in the energy sector. Europe has adopted a complex of measures called the Third Energy Package aimed at defending its domestic market from foreign influence, as well as sanctions against the Russian energy sector. Conversely, Russia is shifting from the EU in favour of enlarging the Asian market share of developing countries.

Thirdly, Russia and the EU look at the South Caucasus Region differently. Russia does not consider it important in terms of the country’s energy security policy. The South Caucasus share in the Russia’s export is extremely small and Russia does not use this regional infrastructural system to deliver its oil and gas to European consumers. The only regional exporter – Azerbaijan – cannot compete alone with the Russian energy export potential.
Therefore, the South Caucasus remains a geopolitical subject – Russia has greater concerns about regional conflicts (between Armenia and Azerbaijan; between Georgia, on the one hand, and South Ossetia and Abkhazia, on the other hand) than about its regional energy security.

The EU regards the South Caucasus region (and Azerbaijan, in particular) as a potential energy supplier along with Russia. In addition, the EU aspires to receive natural resources from a wider range of countries via regional infrastructure. Finally, the EU is looking forward to diversify its energy sources away from the Middle East and Central Asia.

**Common Energy policy of the Eurasian Economic Union**

A common energy policy (including energy security policy) of the Eurasian Economic Union has not yet been elaborated or documented. The process risks to be time-consuming and extremely complicated as EAEU leaders will need to take into the account the interests of three major groups of countries: importing countries (Armenia, Belorussia and Kyrgyzstan), exporting countries (Kazakhstan and Russia) and transit countries (Belarus).

The energy security of **importing countries** of the EEU consists in “the uninterrupted availability of energy sources at an affordable price”.¹ This definition of energy security proposed by the International Energy Agency (IEA) and deals with three main factors: reliability, accessibility and affordability. The IEA also pays attention to various time dimensions: “long-term energy security mainly deals with timely investments to supply energy in line with economic developments and sustainable environmental needs”, while “short-term energy security focuses on the ability of the energy system to react promptly to sudden changes within the supply-demand balance”.²

**Exporting countries** pay more attention to the “security of demand”; the sustainable demand for hydrocarbons for reasonable prices on the interna-

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² Ibid.
tional markets. Security of demand becomes crucial when revenues from exporting energy resources form a large part of governmental budget. In theory enormous profits guarantee stable economic growth and development, encouragement of investment and possibilities for further diversification and modernization of the economy.

In the case of the EEU leaders – Russia and Kazakhstan – the export of hydrocarbons is one of the largest income items in the structure of their national budgets. Russia’s export of hydrocarbons to abroad declined to 66.4 percent of total export in 2015 (in comparison with 73.4 percent in 2014). The export structure to the countries of Commonwealth of Independent States (CIS countries) differs, but the major part still belongs to hydrocarbons (39.5 percent in 2015 and 43.6 percent in 2014). The share of oil and gas sector in federal budget income composed 42 percent in 2015 (5.862 billion out of 13.655 billion).

In the export structure of Kazakhstan hydrocarbons play an even greater role than in Russia. According to the data of the National agency on export and investments “Kaznex Invest” the share of primary resources in Kazakhstan export amounted to 78 percent in 2014. The share of oil and gas sector in federal budget income composed 44 percent in 2014.

Transit countries (such as Belarus) play no lesser role in the concept of energy security. Their energy security policy has to take into account the interests of importing and exporting actors, the availability of energy sources, affordable price, and security of demand. At the same time, it is aided by transit predictability, reasonable transit prices and stability of transit infrastructure.

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3 More detailed information on Russian and Kazakh Energy Park can be found in appendix.
5 Ibid.
Russia plays the dominant role in forming the energy security agenda of the EAEU. There are two reasons for this; 1) energy resources of all the other EAEU countries cannot compete with the Russian energy potential in terms of production and export; 2) Russia exercises crucial influence in terms of energy transportation; “Gazprom” took over “Beltransgaz” and “ArmRosGazprom” (key energy companies in Belorussia and Armenia), while Kazakhstan has to use Russian infrastructure to transport energy resources to the EU.

Currently the common energy policy of the EAEU exists as a series of main principles that will lay the ground for coordinate work in a future common energy space. The principles, shared by all the members of the EAEU (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia), are aimed at building a common energy policy as well as common energy space. The principles include:

- Regulating market pricing for energy resources;
- Ensuring the development of competition in the common markets of energy resources;
- The removal of technical, administrative and other barriers to trade in energy resources, equipment, technology and related services;
- Ensuring the development of a transport infrastructure for the common markets of energy resources;
- Ensuring non-discriminatory conditions for economic entities of the Member States in the common markets of energy resources;
- The creation of favourable conditions for attracting investments in the energy sector of the Member States;
- Harmonisation of national rules and regulations for the functioning of the process and business infrastructure of the common markets of energy resources.\(^8\)

These principles will help the EAEU to create conditions for gradually establishing a common energy market (including gas, oil and petroleum...

products) by 2025. Before that Russia is likely to preserve its leading role in the negotiation process with the EU in terms of energy cooperation.

**Russia-EU interdependence**

The EU relies heavily on fuel import, importing 53 percent of the energy it consumes: crude oil (almost 90 percent), natural gas (66 percent), and to a lesser extent solid fuels (42 percent) as well as nuclear fuel (40 percent). The share of Russia in European energy sector is significant – it is Europe’s biggest importer of oil (35 percent), gas (26 percent), coal (30 percent), and uranium (25 percent).

European officials claim that a large proportion of the EU’s energy imports are coming from geopolitically unstable regions and a number of Member States are still dependent on a single external source of supply, which leads to high costs to citizens, enterprises and public budgets, impedes Europe's economic growth and prosperity and endangers national and EU security.

As for Russia there is a common prejudice that the country “uses energy supplies as a political weapon and such actions go against market rationale and seriously increase risks for the EU” uses “oil and natural gas for reasons of foreign policy and for the destabilization of other countries”, and “undermines economic growth and, even more dangerously, democratic stability in Europe and the independence of sovereign states”.

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9 “The EAEU has started the creation of common energy market and coordinate transport policy”. In: Eurasian Economic Union. http://www.eurasiancommission.org/ru/nae/news/Pages/12-03-2015.aspx, 12.03.2015.


13 Ibid.
Therefore, the energy policy of the European Union is aimed at a gradual diversification of fuel import, primarily diminishing oil and gas import from Russia. Official EU documents develop the idea more precisely, indicating that Azerbaijan, Turkmenistan, Iraq and Iran could appear to scale down the dominant position of the Russian Federation. The logic of diversification is supported by the EU’s aspiration to change the European market rules in terms of distribution and transportation of natural gas. The European Union has already limited the possibilities of Russian exports by adopting the Third Energy Security Package (in particular, “Gazprom” had to give up the “South Stream” pipeline and “Nord Stream” could be used only at half of its capacity).

Sanctions imposed on Russia in 2014 pushed European and American energy companies out of joint oil projects. For example, “ExxonMobil” stopped exploiting two pumers; “Universitetskaya-1” and “Tuapse Trough”; “Total” was forced to leave one of the Western Siberia pumers. All the projects have been frozen as Russian companies (Rosneft and Lukoil, respectively) do not have the technology and experience to exploit them alone.

According to a Russian governmental report Western sanctions have not influenced exploitation or export of natural resources. Up until today Russia mostly exploits open-access oil resources. In 10-20 years they will be replaced by stranded oil and Russia may face decline in oil production and export. To overcome these possible difficulties, the government needs to stimulate import substitution in oil and gas engineering, energy engineering, petroleum chemistry and crude oil refining. As a result, sanctions imposed by Western countries have narrowed the window of cooperation possibilities between Russia and the EU in energy security.

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From the Russian point of view, the EU remains the country’s major economic partner in terms of energy export. In 2014 “Gazprom” exported 207 bcm by pipelines. Most of the natural gas (63 percent) was exported to the EU (excluding former Soviet Union Countries (23 percent)). Turkey consumed 27 bcm of Russian gas, or 13 percent of the total.¹⁷

Major trade movements of natural gas in 2014¹⁸


The same situation occurs in the sphere of oil, where the EU dominates in the Russian oil export clientele.

Major trade movements of oil in 2014

Taking into account the resource-driven component of the economy Russian government plans to allocate fuel money to social and economic development. According to the “Energy Strategy of Russia until 2035” – the principal document that outlines Russia’s strategy and actions in the sphere of energy – Russia’s main aim consists in “a structural shift of the energy park of the Russian Federation to a high, qualitatively new level that will boost the country in its dynamic social and economic development”.

Russia faces many challenges in realizing its energy policy:

- Low and volatile global oil prices,
- Stabilization or even reduction of foreign demand,

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Rising extraction costs,
Sanctions and other restrictions on technology export to Russia.

The reduction of foreign demand” is a challenge that presumes that Russian share in the European energy sector will remain at the same level or gradually diminish because of the following factors:

- The EU diversification policy,
- Competition with new oil and gas suppliers (mainly from the US, Iraq, Iran and East Africa),
- Political tensions with the European countries, and
- A more energy efficient and ecologically friendly EU economy.

To overcome existing and future challenges Russia has started shifting its energy focus towards enlarging the Asian (first of all, Chinese) market share of developing countries; the “Energy Strategy of Russia until 2035” requires “to change the production and transportation energy complex taking into account the development of Russian East as well the diversification of hydrocarbons export to the Asia-Pacific Region”.

The need for diversification is common to both the European Union and Russia. While the European Union aspires to diminish the role of Russian imports, Russia wants to be sure that new Asian markets will provide its economic and social development with sufficient amounts of fuel. Both actors are highly dependent on energy resources and put energy security priorities on top of the agenda. Although the EU and Russia are highly interdependent in terms of energy supply, both actors have already started to drift apart from each other as they adjust to internal and external circumstances.

Narrower cooperation in the South Caucasus

Despite heavy interdependence between the EU and Russia, the region of the South Caucasus does not offer many energy cooperation opportunities between the two blocks. It is explained by two main factors: economic imprudence and geopolitical risks.

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21 Ibid.
Economic imprudence

The “Energy Strategy of Russia until 2035” does not mention the South Caucasus region. This fact vividly proves that the Russian Federation does not consider the region as a) a threat to national energy security or b) a possible vehicle for mutual cooperation between Russia and the region.

The absence of threat to Russian energy security is explained by incommensurability of production and export volumes. Azerbaijan – the only regional country exporting energy resources – cannot compete with Russia alone. In 2014 Russia produced 534 million tons of crude oil, which is 12 times more than Azerbaijan (42 million tons). At the same time the country consumed 148 million tons (compared to 4.6 million tons in Azerbaijan). Export of Russian crude oil exceeded the one of Azerbaijan by a factor of ten.\(^\text{22}\)

The situation with natural gas is quite the same. In 2014 the production of natural gas was 34 times greater than that of Azerbaijan (578 bcm and 17 bcm respectively), natural gas consumption is more than 40 times higher (409 bcm and 9 bcm respectively), and exports are more than 24 times greater (187 bcm and 7.7 bcm respectively).\(^\text{23}\) More than that in 2014 only 0.2 bcm of Azeri gas was transported via the Russian pipeline system.\(^\text{24}\)

The European Union is a major consumer of Azeri natural gas and oil, thus making Russia and Azerbaijan competing parties. However incommensurable volumes of production and export between the two countries may be, this cannot make Russia see Azerbaijan as a potential opponent at the European market.


\(^{23}\) Statistics of “Gazprom” natural gas export differs from British Petroleum data. (207 bcm export and 187 bcm export).

The South Caucasus cannot be regarded as a vital oil and gas market for the Russian Federation. Currently Russia provides energy only to Armenia, while Georgia is partly dependent on Azeri imports and Azerbaijan is self-sufficient. Even if Georgia decides to reject Azeri imports in favour of Russia, this will not affect the Russian export ratio.

Russia does not export its natural resources to Europe or Turkey (two most important natural gas importers) via the territory of the South Caucasus region. For fuel transportation Russia mostly relies on the pipeline system of Ukraine and Belarus, or uses pipelines that do not cross other countries (Nord Stream, Blue Stream, and North Stream 2). There are no plans for building new pipelines via the South Caucasus. Therefore, the region has little influence on transit security and reliability of Russian fuel exports.

*Major Gas Pipelines of the Former Soviet Union*[^25]

[^25]: More information on outlet capacity of export pipelines at the FSU border you will find in appendix.

The major threat to the Russian energy security policy consists in declining revenues from exporting natural gas and oil to the European Union. In case of the South Caucasus the threat does not come from Azerbaijan (as the country alone cannot compete with Russia on production and export of natural resources), but from potential suppliers in Asia (Turkmenistan in particular) and the Middle East (Iraq and Iran). The EU considers the Southern Corridor and other similar projects (TAP, TANAP) as “an important element” that “sets the ground for supplies from the Caspian region and beyond”. Official documents stipulate that by 2020 10 bcm/y of natural gas produced in Azerbaijan will reach the European market through the southern Gas Corridor. Moreover, this new pipeline connection is vital in providing a connection to the Middle East. The currently envisaged infrastructure in Turkey could accommodate up to 25 bcm/y for the European market. In the longer term perspective, it could accommodate other countries such as Turkmenistan, Iraq and Iran.

However, long-term projects so far remain only on paper. At the moment the legal status of the Caspian Sea bed remains unresolved. On the one hand, the EU is making efforts to facilitate the process, while Russia is trying to slow it down as it does not correspond with the country’s interests in the sphere of energy security (potential gas suppliers from Central Asia and Middle East could diminish the role of Russia on the European market and cut revenues from fuel energy). On the other hand, the prices for oil and gas that have fallen recently make it practically meaningless for the countries to spend enormous amounts of money on low-performing assets.

Geopolitical risks

Cooperation between the EU and the EAEU in South Caucasus faces many geopolitical challenges and obstacles. Firstly, the region of the South Caucasus remains very unstable because of two frozen conflicts and territorial disputes. The conflict between Armenia and Azerbaijan has worsened over

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28 Ibid.
the last year; in 2015 clashes on borders claimed the lives of 90 Azeri soldiers.²⁹ Both parties violated the existing ceasefire and used heavy weapons first since 1994 when the ceasefire treaty was signed. In the night of April 1, 2016, clashes erupted between Azerbaijan and Armenia in Nagorno-Karabakh, leading to a four-day operation resulting in significant losses on both sides.

Relations between Georgia, on the one hand, and Abkhazia and South Ossetia, on the other hand, seem to be more stable because of the Russian protectorate over two partly-recognized states. Nevertheless, experts still remember the 2008 war and events that preceded the conflict. On August 6, 2008, near the eastern Turkish city of Erzincan the Baku-Tbilisi-Ceyhan (BTC) pipeline exploded. Anonymous hackers “shut down alarms, cut off communications and super-pressurized the crude oil in the line” which led to the blast.³⁰ Moreover, a few days later, after the beginning of 5-day August war between Russia and Georgia, Georgian Prime Minister Nika Gilauri accused Russia of bombing the BTC pipeline near the city of Rustavi. Luckily the bombs missed and the pipeline did not suffer any damage. The events of the last two decades show that the situation in the region can get out of the control in a very short period of time. Unfortunately, the security of pipeline infrastructure and the sustainable transit of hydrocarbons is questionable.

Secondly, countries cannot merge their national interests regarding energy issues in the region due to the numerous political disagreements and deadlocks. Armenia has made its choice and became a full-fledged member of the EEU in 2015. That means that the country will coordinate its energy policy with the members of the organization and first of all Russia. This

²⁹ Evseev, Vladimir: Nagorno-Karabakh Conflict. “Minsk Process as a Path to Settlement”. In: Russian International Affairs Council (8.02.2016). http://russiancouncil.ru/inner/?id_4=7227#top-content. Accessed on 30.03.2016. As for Armenia the official data of soldiers killed during the conflict differs, but the suggestion that the casualties of both sides matches, seems to be reasonable.

thesis is also backed up by the fact that Armenia is relying on energy resources from Russia. Russia dominates in the Armenian gas and energy sector. “Gazprom Armenia”, the leading company in transit and sale of natural gas in Armenia, is a wholly-owned subsidiary of “Gazprom”. At the same time the distribution of electric power is under the control of “Electric Networks of Armenia”, a company that fully belongs to Russian “Inter Raoues”. The strategic cooperation with Russia and the very complicated relationship with Azerbaijan and Turkey leave very little room for future fruitful cooperation with the EU.

Aside from Armenia, Azerbaijan also conducts a more flexible and independent foreign and energy policy. The country is involved in several regional energy projects with Turkey, Georgia and Central Asian states. Azerbaijan purports to become one of the main suppliers of Europe in terms of exporting hydrocarbons (which corresponds with the interests of the EU as well). However, involvement in the European energy space usually goes along with adopting European values and democratic principles. Until now Azerbaijan has not yet shown its aspiration to adopt European norms and regulations as well as democratization process. Nevertheless, the European Union still sees in Azerbaijan an opportunity for diversification.

Georgia presents itself as a transit country. The transport corridor of Azeri (and future Central Asian and Middle East) oil and natural gas via Georgian territory as well as European vector of development make Georgia the most attractive regional actor for energy security integrational process of the EU. The country is heavily interested in sustainable and trouble-free transit of hydrocarbons as it receives money or resources as payment.

Nevertheless, Georgia has difficult relationships with Russia. The recognition of the independence of South Ossetia and Abkhazia has forced Georgia to break off diplomatic relations with Russia. Despite recent positive

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33 Signature of Association Agreement with the EU in 2014 is one of the evidences of the Georgian choice.
events in restoring cooperation between the two countries – for example access of Georgian goods on the Russian market, the re-initiation of regular flights between the two countries, progress on the question of visas for Georgians – Russia continues to treat Georgia as one of the main geopolitical threats to its national interests in the South Caucasus. To a large extent it is explained by the aspiration of Georgia to join NATO and the EU, which contradict the security interests of Russia. As a result, full-scale cooperation between Russia and Georgia (or Russia and EU involving Georgia) on possible and perspective energy projects seems hardly feasible in current circumstances.

Thirdly, different and contradictory interests of foreign countries clash in the South Caucasus. Despite the ending of operations in Syria, Russia and Turkey maintain aggressive rhetoric and contradictions. The Russian jet, shot down by Turkish warplanes, put on hold the realization of joint energy project “Turkish Stream”, and jeopardized the 10 percent discount for Russian gas and made negotiations of future export even more complicated.

More than that Russia is interested in reducing the number of potential alternative energy projects aimed at supplying Europe with energy resources. The country seeks to remain the major supplier of the EU and is ready to defend its interests in the region within the limits of international law. For example, Russia does not foster the process of Caspian seabed delimitation. As a result, it puts obstacles to the realization of Trans-Caspian energy transport route – a project of hydrocarbons transport from Turkmenistan to Europe.

**Possible Scenarios**

Cooperation between the EU and the EAEU can go in three different ways: positive, negative and neutral.

*The positive scenario* assumes that the EU and the EAEU will steadily move towards creation of common energy space (including the South Caucasus). Both integrational blocs will have a sufficient level of trust to start the process of national legal harmonization in favour of creating common oil and gas markets. Both parties will show their willingness to change attitude towards each other, reject prejudices and make a lot of mutual concessions.
Armenia, Azerbaijan and Georgia will have to take necessary steps as well to join a common energy market. Armenia will take up obligations of the EAEU that will have more political force in favour of national legislation. Georgia will have to accept new rules of the game following its path towards EU membership. Both blocs will have to exercise political influence on Azerbaijan (and Turkey) to make them join common energy space and accept common regulations.

This scenario seems unlikely because of the existing political tensions between the members of two blocks, regional conflicts and economic imprudence. However, the period until 2025 is the most appropriate for the comprehensive scenario as the EAEU will be elaborating its energy security policy.

In a negative scenario there is no space for cooperation between the two blocs. Both the EU and the EAEU will vigorously defend their interests in the sphere of energy security, avoiding any chance for mutually beneficial cooperation. The scenario depends on the level of political contradictions between the EU and the EAEU. If the level of the existing political and energy security tensions (mostly between the EU and Russia) grows, the risk of sliding into energy security chaos increases correspondingly.

This scenario will definitely influence the situation in the South Caucasus region. The EU’s efforts to open access to the Central Asian and Middle East natural resources will meet open resistance from the EAEU. Military conflict for the control of regional resources and transit infrastructure is nevertheless excluded. However, both parties have a wide range of hybrid-war methods (including cyberattacks) to defend their interests abroad.

In such circumstances regional conflicts and their prevention move to the forefront. It is extremely important to create or renew the existing mechanisms of control over frozen conflicts. The aggravation of tensions (first of all between Armenia and Azerbaijan), as we have seen over the weekend of 1-4 April 2016, may bring the situation out of control. Therefore, regional security issues dominate over energy cooperation efforts.

If the EU and the EAEU avoid further political escalation then a neutral scenario seems to be highly probable. The scenario assumes that the parties
will take into account and respect the interests of each other in planning their energy strategies. Cooperation will stay at the same level; blocs will not be able to overcome the existing tensions but there will be no escalation of political confrontation.

In the South Caucasus, Russia would not oppose Azeri exports to Turkey and the EU. At the same time, it will not turn a blind eye to the efforts of building transit infrastructure via the region. Russia will defend its interests according to international law, but EU determination will hardly promote mutual cooperation. Therefore, it will be more efficient for the EU to focus on African and US energy export, than trying to finish a new infrastructure project via the South Caucasus region.

**Appendix: Energy Parks**

**Russia**

**Oil.** In 2014 Russia ranked 6th in proved oil reserves with 14.1 billion tons or 6.1 percent of the global share. The country produced 10,838 thousand barrels daily (2nd place after Saudi Arabia) and 534.1 million tons in 2014 (12.7 percent of the total share).

**Natural Gas.** In 2014 Russia ranked 2nd (after Iran) in proved natural gas reserves with 32.6 trillion m³ or 17.4 percent of the global share. The country produced 578.7 billion m³ or 16.7 percent of the total share.

**Coal.** In 2014 Russia ranked 2nd in proved coal reserves with 157,010 million tons or 17.6 percent of the global share. The country produced 170.9 million tons oil equivalent or 4.3 percent of the total share.

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Kazakhstan

Oil. In 2014 Kazakhstan ranked 11th in proved oil reserves with 3.9 thousand million tons or 1.8 percent of the global share. The country produced 1 701 thousand barrels daily and 80.8 million tons of oil in 2014 (1.9 percent of the total share).

Natural Gas. In 2014 Kazakhstan proved reserves of natural gas estimated in 1.5 trillion mi or 0.8 percent of global share of proved natural gas reserves. The country produced 19.3 billion mi or 0.6 percent of total share.

Coal. In 2014 Kazakhstan proved coal reserves were estimated at 33.6 million tons or 3.8 percent of the global share. The country produced 55.3 million tons oil equivalent or 1.4 percent of the total share.

Outlet Capacity of Export Pipelines at the FSU Border, bcm/year35

<table>
<thead>
<tr>
<th>Pipeline</th>
<th>Capacity</th>
<th>Destination of exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Via Ukraine:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Orenburg-Western border (Uzhgorod)</td>
<td>26</td>
<td>Slovakia, Czech Republic, Austria, Germany, France, Switzerland, Slovenia, Italy</td>
</tr>
<tr>
<td>Urengoy-Uzhgorod</td>
<td>28</td>
<td>Slovakia, Czech Republic, Austria, Germany, France, Switzerland, Slovenia, Italy</td>
</tr>
<tr>
<td>Yamburg-Western border (Uzhgorod)</td>
<td>26</td>
<td>Slovakia, Czech Republic, Austria, Germany, France, Switzerland, Slovenia, Italy</td>
</tr>
<tr>
<td>Dolina-Uzhgorod - 2 lines</td>
<td>17</td>
<td>Slovakia, Czech Republic, Austria, Germany, France, Switzerland, Slovenia, Italy</td>
</tr>
<tr>
<td>Komarno-Drozdowichi - 2 lines</td>
<td>5</td>
<td>Poland</td>
</tr>
<tr>
<td>Uzhgorod-Beregovo - 2 lines</td>
<td>13</td>
<td>Hungary, Serbia, Bosnia</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project</th>
<th>Capacity</th>
<th>Destination</th>
</tr>
</thead>
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<tr>
<td>Hust - Satu-Mare</td>
<td>2</td>
<td>Romania</td>
</tr>
<tr>
<td>Ananyev-Tiraspol-Izmail &amp; Shebelinka-Izmail - 3 lines</td>
<td>26</td>
<td>Romania, Bulgaria, Greece, Turkey, Macedonia</td>
</tr>
<tr>
<td><strong>Total via Ukraine:</strong></td>
<td><strong>142</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Via Belarus:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yamal-Europe (Torzhok-Kondratki-Frankfurt/Oder)</td>
<td>33</td>
<td>Poland, Germany, Netherlands, Belgium, UK</td>
</tr>
<tr>
<td>Kobrin-Brest</td>
<td>5</td>
<td>Poland</td>
</tr>
<tr>
<td><strong>Total via Belarus:</strong></td>
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<td></td>
</tr>
<tr>
<td>St. Petersburg-Finland - 2 lines</td>
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<td>Finland</td>
</tr>
<tr>
<td>Blue Stream (design capacity)</td>
<td>16</td>
<td>Turkey (possible to Greece, Macedonia)</td>
</tr>
<tr>
<td>Nord Stream (design capacity)</td>
<td>55</td>
<td>Germany, France, Czech Republic and other</td>
</tr>
<tr>
<td><strong>TOTAL EXISTING EXPORT CAPACITY:</strong></td>
<td><strong>257</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Other New Projects:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nord Stream-2</td>
<td>55</td>
<td>Germany, France, Czech Republic, UK and other</td>
</tr>
<tr>
<td>Yamal-Europe-2</td>
<td>15</td>
<td>Poland, Slovakia, Hungary and other</td>
</tr>
<tr>
<td><strong>Sub-total new capacity:</strong></td>
<td><strong>133</strong></td>
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<tr>
<td><strong>TOTAL PLANNED EXPORT CAPACITY:</strong></td>
<td><strong>390</strong></td>
<td></td>
</tr>
<tr>
<td>Guaranteed contracted exports for 2020-2025</td>
<td>158</td>
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Show me the Monnet: A Workable Model for Separating the Energy Business from Politics

Frederic Labarre

Introduction

In the days of neo-mercantilism, it is not uncommon to think of business ventures as driven by or at any rate connected to political power and intentions.¹ The overall aim of the political sphere is to achieve maximum security for its constituents and/or leadership regime. Very often the two cannot be separated, since regimes that fear violent overthrow depend on a society maintained peaceable preferably through reliable economic growth rather than repression. Therefore, the business elite and political actors of a country will make politics and commerce indistinguishable, as the policies of a company may not be very different from the development aims of the state. To a certain extent, the question that should prevail is; how connected are the two, and can we make a determination as to whether an endeavour is more commercial than political. This contribution suggests a cooperative structure that dissociates energy politics and energy commerce.

Interdependence is the only way

Russia has been repeatedly accused of using its energy resources as a political weapon, or occasionally, seeking the control of external resources or distribution networks as a strategic (national objective). Similarly, many level similar accusations against the United States, claiming that any military adventure, especially in the Middle East, is motivated by the rush for energy resources. Yet, further examination has shown that since the mid-2010s, the United States, like Russia, have become energy independent.² It

would therefore seem that the strategic and political imperatives would take second place behind commercial priorities. Yet strictly speaking, the literature on energy security or energy politics is clear on one point; there is no such thing as energy “independence”.

If independence were feasible, there would be no possibility of speaking of energy “security” and consequently of energy politics. Energy independence is not possible because of the laws of the free market, which constrain all countries and communities equally, if differently. The law of supply and demand imposes conditions of price and availability on both supplier and client. In turn, the distribution of energy, its trade and payments is not the end goal of the transaction between the two actors. We sometimes forget that energy is an enabler; a resource that ensures that ulterior goals – personal, collective or national – can be attained. The attainment of these goals is of course impacted by energy price and availability fluctuations. What is less well understood and examined are the downstream consequences of such fluctuations on socio-economic health, and in consequence, political stability. For commercial endeavours, fluctuations are part of the cost of doing business. Initially, industry required the intervention of the political sphere so as to open up new avenues of oil and gas exploration and exploitation. Inevitably, it seems, the political sphere turned what was merely a commercial endeavour into a question of national security where regime stability and sympathy became the dominant feature. It is true that the role of energy in society looms large; availability and price fluctuations inevitably have an impact on the socio-economic and political health of the community. In fact, “energy security is a precondition to other forms of security. It cannot be divorced from them”.

It is in that sense that the business of energy and politics are intimately linked. For this author, the presumptions that a country would use energy as a “weapon” makes no business or political sense; it violates the profit

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motive of the business concern, and affects the stability motive of the political elite, since delivery interruptions also mean a trickling down of revenue. Like any business venture or political calculation, however, there is always a cost-benefit analysis taking place, whereby questions as to whether it is more or less painful to continue or interrupt trade of a commodity in adverse conditions (for example, when a client is unable to pay) is worth the pain. Although this outlook does not make unanimity in the literature, it is nevertheless taken for granted in this chapter.

The four contradictory dimensions of energy security

Four dimensions define energy security, and eventually, energy politics; 1) availability, 2) affordability, 3) efficiency, and 4) environmental sustainability.

Availability encompasses other aspects of security which inevitably assume a political dimension. These aspects depend on whether a country is resource-rich or resource-poor, or, whether they are beneficiary or supplier. In the former case, the imperative is to ensure continued supply. The onus is therefore on good relations with the supplier, diversification of sources, and the physical security of the methods of delivery. For the supplier, the imperative is to maintain the security of supplies, and this sometimes means the control of geographical areas containing the resources. The disputes we are witnessing over the control of the Caspian Sea Bed is a case in point. In the pursuit of new territories, all means, commercial, legal and military, are available. Some, like Lada Roslycky of Ukraine Today, would argue that the motivation for Russia’s seizure of Crimea is to secure rich hydrocarbon deposits within the 200 nautical mile exclusive exploitation zone afforded by the 1982 Law of the Seas.\(^5\)

Fluctuations in availability have an obvious impact on the second dimension of energy security – affordability. Impacts on the affordability of a resource have second order consequences on the client and suppliers. For the client, an expensive resource means that inflation is always lurking, which in time can trigger a “transfer of insecurity” from fuel to food, for

\(^5\) Conversation with the author held in Ottawa, Canada, February 2014.
instance. In the South Caucasus, insecurity transfer of this sort is a permanent risk, as we have seen with the riots against the high price of electricity in Armenia. Similarly, supplier countries count on high prices to garnish their own coffers, especially in the case of rentier states like Russia and Azerbaijan, whose socio-economic spending is directly related to oil and gas revenue. Affordability vulnerability carries risks of instability common to beneficiary and supplier states alike. There should be a common interest in keeping prices and supplies “adequate”.

In an effort to reduce the vulnerabilities over availability and affordability have led states to embark on programs promoting energy efficiency. Here again, energy efficiency can be understood in two ways. One refers to the consumers’ habits and efficiency of use (using minimal resources for a maximum BTU output). The other refers to the suppliers’ ability to extract, transform and export at lower costs. The literature suggests that the technological sophistication to affect these efficiencies is not yet available widely in the South Caucasus. Efficiency as a dimension of energy security is therefore more the concern of developed and technologically-advanced countries. Efficiency is therefore associated with innovation, and the costs related thereto are insignificant considering the high price of energy, and the mass-market which innovation is designed to serve. In turn, innovation will trigger energy price deflation, never a good result for rentier states.

We have seen the consequences of improved energy efficiency at a moment when in the mid-2000s, surging energy prices catapulted recovering and transitioning economies to the ranks of regional powers. Nations such as Brazil, Venezuela and Russia (with the possible addition of Nigeria) were empowered because a) they controlled their resources, and b) the revenue they got allowed them to turn the curve on the 2008-2009 recession. In late 2007, the United States signed into law the “Energy Independence and Security Act”. The realists among us would be quick to see in this a policy pronouncement aiming at limiting the growth of potential challengers. In reality, market forces would achieve the same results; consumers would

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begin demanding products that are less energy-hungry. Since the price of energy was so high in the mid-2000s, it made sense for industry to invest heavily in research and development (R&D) to satisfy this demand. The current energy price deflation is partly the result of more responsible use of energy in the developed world, and the creation of new forms of alternative energy.

This brings us to the fourth dimension of energy security, which is environmental security. Environmental security has evolved into a stewardship issues which imposes ethical charges on delinquent countries (i.e. countries unable to meet efficiency standards that would reduce carbon emissions). The rationale is that lack of ethical energy use entails environmental and climate degradation which translate into hazards for human health and safety. Therefore the environmental dimension of energy security is solved by the use of more sustainable, environmentally-friendly sources. Those preferences aim to deny a lucrative market to emerging economies that depend on the commerce of hydrocarbons. This tends to also curb their political and socio-economic growth. Developed nations have pushed an environmental agenda on the developing world as if environmental stewardship was a universal norm. In the South Caucasus, the low carbon footprint is not necessarily a sign of good stewardship, but rather a sign of a fragmented energy grid.

In the politics of energy, the four notions of security are contradictory and conflictual. From the four dimensions identified above, only the first three are germane to the South Caucasus context; availability, affordability and efficiency (especially in extraction) determine stability. The salience of this point cannot be emphasized enough; since 2014, resources in Azerbaijan have begun to dwindle. Not having developed sovereign wealth funds (like the United Arab Emirates and Norway have done) to diversify income and mitigate a supply crash, Azerbaijan has to pump ever greater amounts of energy for ever shrinking benefit. In addition, the price of energy makes it prohibitive to develop more efficient extraction methods. Azerbaijan’s reckoning with the consequences of unmet expectations for a rising middle class are being felt as I write. More journalists are imprisoned; more demonstrations are forcibly broken up.
If the aim of this workshop is to find ways to mitigate instability in the South Caucasus (notwithstanding civil society’s calls for greater democracy in the region), then it would seem appropriate that the political elite identify some form of arrangement with regards to the exploitation and transfer of energy. It is in the regimes’ interests; the current economic climate is fertile ground for violent extremism. As such, structural weakness makes states vulnerable to energy scarcity and costs. Energy insecurity can rapidly translate into national, regional and global insecurity.  

It has been alleged that the arrangement in question would much depend on a prior resolution of the conflicts in the region. This position is untenable for two reasons; a) energy transfer issues perpetuate tensions in the region (witness the insistence that Azerbaijani gas should not go through Armenia), and b) the region is ripe for instability. It is therefore urgent that solutions for the future management of energy policy issues be prepared in advance (if not in anticipation of) a negotiated solution to conflict. As the poet said, one does not need to wait for the foundation of the house to be dug to begin planning for the roof.

**What kind of arrangement?**

There are several models already in place which could provide a grounding platform. One is the International Energy Agency in Paris, dedicated to mitigating price variations. Another is described in this book by Patrick Larkin regarding the Energy Charter. Certainly such models can and should be leveraged, but only insofar as they can address the predominant concerns of all the South Caucasus states as expressed in this essay; the promotion of regional stability as dependent on the energy security factors that drive affordability.

Inherent in this mission statement are the outcomes to be achieved; a balance between the various understandings of energy security as dependent on specific countries’ context and identity as client, supplier, or transit partner. This balance would be measurable by the establishment of fair arrangements.

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energy prices, reliable contracting practices and predictable remedies to alleviate imbalances created by supply disruptions, accidents, and market fluctuations.

Particular functions, with corresponding terms of references, would then be stood up within this organization to meet specific outcomes and goals. In this perspective, we would see developing a structure that resembles the solutions adopted in Western Europe after the Second World War. Dr. Elizaveta Egorova’s intervention during this workshop’s discussions elaborated on the prospective organization whereby the South Caucasus states (and partially-recognized political entities) would manage the challenges posed to regional stability by energy security issues.

The establishment of such an organization would have two effects on the perception of the equation of business and politics in the energy industry. First it would consecrate the divorce between the two disciplines by elevating the political aspect to the multilateral and multinational level, leaving industry to focus on the business of energy. Second, it would regionalize energy geopolitics around the shared theme of internal stability – with the avowed hope that, much like the Schumann-Monnet plan of yore, this practice would create spill-over effects into other political and security areas. It is beyond the scope of this contribution to determine whether the theme of regional stability is sufficient by itself to provide the incentives for transnational cooperation. This does not prevent one from suggesting options on which to base the structure of a regional energy security institution. These features – detailed in the conclusion below – should be the object of further discussions at the regional level, or in the format of the PfP Consortium.

**Conclusion or Way Ahead?: Features of a functioning Regional Energy Policy Management Institution**

1. The organization should be presided over by a rotating chair for a duration of no longer than 6 months. This position would be open to representatives of non-recognized political entities as well.

2. The responsibilities of the rotating chair would be to establish an agenda of work for the following 6 months and moderate discus-
sions and debates (not lead them) within the constitutive assembly of the organization (detailed below). The role of the chair is to apply rules of procedures, maintain decorum, and provide an honest broker (or tie-breaker during votes) in mediation.

3. Several functions should be associated with the chair, but be independent nonetheless; an impartial ombudsman function, to manage (if not arbitrate) disputes between members, an industrial relations council, to effect the bridge with industry, and finally an external relations council, to effect the bridge with other regional and international organizations and agencies (such as the IEA, the OSCE, the UN, the WTO, etc.). The leadership of each function should never be of the same nationality.

4. Each function should be staffed multinationally from within the South Caucasus based on a ratio considering national unemployment rates, demographics and population density. The statistics used to effect this determination should be those of the United Nations. The author hereby realizes that this concept is fraught with difficulties, in the context where internally-displaced persons abound. However, if states perceive that it is in their best statistical interest to increase their demographic representation, this could have the effect of facilitating either the return of IDPs, or the abandonment of IDP return as a bargaining factor in peace negotiations.

5. The constitutive assembly of the organization – where most of its business gets done – would be presided by the rotating chair. The objective of this assembly would be to maintain and manage dialogue and decisions on matters of energy supply and demand. The rules of procedure of this body would be established by the assembly itself, and would have no right of veto.

6. An important function (alluded to by George Niculescu) would be the creation of an emergency management trust fund, to which every member would contribute. The purpose of this trust fund would be to provide a financial cushion to alleviate energy price shocks (for suppliers as well as beneficiaries) that could affect the budgetary and development objectives of the members. The ulti-
mate intention is to help members make structural adjustments of a temporary nature (such as subsidies) to prevent internal instability.

7. Finally, and perhaps most importantly, emergency management should not be overlooked. Accidents and acts-of-God in the supply chain will also affect affordability. For example, the sinking of an Liquified Natural Gas (LNG) tanker, or a pipeline rupture can affect pricing as well, especially when demand is high (in winter, for example). The creation of an “Emergency Management Board” is of prime importance in that regard. Its responsibility would be to standardize emergency management practices in the South Caucasus, managing and implementing, where needed, all-hazard contingency plans in the four dimensions of emergency management; prevention, mitigation, response and recovery. This function should be fully inclusive, well-equipped, and ready and able to serve the whole South Caucasus.

8. In addition to these essential functions, a research board should be set up in preparation for moving the South Caucasus into the realm of energy efficiency and innovation.

These are not policy recommendations, but rather the functions of a workable supra-national organization. Supranationality will dissociate nationality from “supply risk” and reintroduce market rationality in the relations between South Caucasus countries as they pertain to energy.

The organization we are proposing in these lines is no different in its intentions that the Commission of Coal and Steel, and later, Euratom, which eventually gave birth to the European Union. The EU was stood up because Western Europe was exhausted by wars caused by strategic resource competition. The only question that begs an answer is whether the South Caucasus is sufficiently exhausted from its conflicts to move towards a cooperative solution – at least in the realm of energy policy management.

It is hoped that future iterations of this Study Group’s workshops will deepen the discussion on this vision, and bring forth the creation of a genuine South Caucasus strategic identity, which neither NATO nor Russia can ignore.
Is a New Energy Transit Regime in the South Caucasus Achievable?

Volkan Özdemir

Introduction

In the search for an energy security regime in a specific region, first of all it is necessary to grasp the geopolitical peculiarities of the energy trade in that specific region. The South Caucasus, as a transit region between two seas, is mainly surrounded by big producers of energy from its North-South and Eastern directions. Those countries like Russia, Iran and the Caspian states including Azerbaijan are net energy exporters. The only possible exit route for this energy rich area is Turkey from the West. However, it is fair to observe that the South Caucasus itself is an important energy transit region regarding the transportation of oil, gas and the electricity. Even as a significant energy producer Azerbaijan is also a transit country for oil and this could be the case for natural gas with the realization of some infrastructure projects in the future. In light of this, a brief discussion on the importance of energy transit is needed in order to define whether it is possible to achieve a new energy transit security regime in the South Caucasus.

Importance of Energy Transit Security

The transit of energy, which frequently covers transport and access issues, constitutes one of the critical components of the energy supply chain. A robust energy trade can only take place with access to a well-connected and well-managed transmission network. Issues such as feasibility of investments, non-discriminatory access to infrastructure and related legal regulations have elevated energy transit security to the top of the energy security agenda. With growing interdependence in global energy, suppliers and consumers alike have become even more concerned about transit security. In fact, the search for a reliable transit of energy goes in parallel with the multi-dimensional, evolving, and highly politicized nature of energy security. Thus, a brief introduction to the concept of transit security and explanation of its importance for the increasingly new interdependent energy order are required.
Energy transit security is by definition highly complex since it requires continuous, consistent and dynamic multilateral cooperation between self-interested actors. Energy importing countries are dependent on foreign resources so they are at first very much interested in uninterrupted flow of energy products to their borders for the well-functioning of their national economies. Once they have made an investment and signed a contract, the importers undertake the risk and they are mainly concerned over regulations that provide stability. On the other hand, energy exporting countries and their enterprises pay more attention to stable markets as the source to reach foreign capital and are highly interested in minimizing the transit risks. The most striking difference in defining energy security is found between energy importers and exporters, resulting from the emphasis on security of supply for the former and security of demand for the latter. However, the third pillar of this concept has become increasingly important recently; transit security. The transit countries have some material and sometimes strategic benefits from the lifeline of energy transportation through their territories.

Within this general framework, what makes the transit security most important among others is the fact that all involved actors should pay special attention to the security of uninterrupted flow of energy at international level. Since all the involved actors in the energy value chain are interested in the well-functioning delivery and transportation of energy commodities, the transit security is now at the heart of all energy debates in a world in which the international energy interdependence is increasing. Transit security as the vital component of broader concept of energy security could be defined as the elimination of risks and disruptions arising from the transit of energy flows that are the basis for a stable functioning of energy trade between producers and consumers. The main pillars for the energy transit regime are access to infrastructure, arrangement of reasonable tariffs and non-discrimination.

**Energy transit regulation in the South Caucasus**

The regulation of transit or cross-border energy transport is a complex task that requires a mix of national, regional and international norms and principles. There have been significant energy infrastructure developments for decades in the South Caucasus. There are numerous international agree-
ments between states, as well as between host countries and private companies, concluded to facilitate individual cross-border energy transport projects. Their terms and conditions vary greatly. As a rule, each project has its own unique legal regime, based on certain principles and rules of general international law, applicable regional instruments, and norms of bilateral pipeline agreements and provisions of commercial contracts between various private parties. Based on the Energy Charter model an Intergovernmental Agreement (IGA) is often signed by the host states of the transport project corridor. The agreement is usually referred to a specific infrastructure, although there are examples of framework agreements of general application (i.e. covering all infrastructure projects between the states concerned). To supplement the IGA, Host Government Agreement (HGA) between an infrastructure owner (pipeline or grid owner) and the host government is signed in practice. Intergovernmental agreements allow for separate treatment with respect to transit and cross-border energy trade in member countries. Each agreement has its own functioning and regulatory system that prevents us to put all those under the category of only transit.

The Trans-Anatolian Pipeline project (TANAP) which aims to bring Azeri gas to Turkish and European markets is unique; although it is designed to serve for cross-border energy transport, it differs from other oil and gas pipelines in the sense that it is not a cross-border pipeline. Rather it is a national transmission line, starting in Turkish-Georgian border and terminates in western boundaries of Turkey. The TANAP also exposes the economic (competition and regulatory policies) and political deficiencies of the existing Eurasian pipelines whose international and cross-border character has blocked the involved countries’ interest-maximization. TANAP will interconnect with a cross border project; Trans-Adriatic pipeline (TAP) at the Greek border and the TAP will end in Italy after passing through Albania under the Southern Gas Corridor concept of the European Union. A possible interconnection of TAP to another project which is called Ionian Adriatic Pipeline (IAP) is also possible. The IAP is projected to cross territories of Albania, Montenegro and Bosnia-Herzegovina, which are all members of both the Energy Community and the Energy Charter Treaty (ECT) before reaching Croatian border.

Furthermore, the electricity trade among the South Caucasus countries takes the form of cross-border transportation whereas natural gas trading
involves transit features. For instance, Georgia and Turkey are simultaneously consumers and transit countries of Azeri gas. The former is a transit country for Turkey through South Caucasus Pipeline and the latter for Europe through the Turkey-Greece Interconnector. In addition to the already existing Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline there is also maritime oil transport between Kazakhstan and Azerbaijan through Caspian. The transportation of Tengiz oil (Kazakhstan) has begun in 2008 and these volumes have been delivered to the Batumi and Kulevi Oil Terminals. With this transportation Azerbaijan has become also an oil transit country. Therefore, observing the already established and various types of energy infrastructure projects in Eurasia, we propose to regulate cross-border energy transport in addition to transit under the agreement.

**Transit community under the Energy Charter Treaty**

After a brief introduction to the concept, it is necessary to discuss history of preparing an internationally binding agreement on energy transit. It is fair to say that as the only multilateral framework that provides legal provisions, the Energy Charter Treaty (ECT) is ideally positioned to become the basis for common transit principles. It is designed to stimulate energy security through the operation of more transparent and competitive energy markets, while respecting the principles of sustainable development and national sovereignty over energy resources. When thinking about the possibility of creating an institutional energy transit regime for the South Caucasus a transit instrument under the ECT could be an achievable option. However taking the previous experience in the negotiations on transit protocol into account, to form an energy transit regime for the region is not easy and could be viable only with a wider integration to Central Asia.

Since the general terms in Article 7 of the ECT are not sufficient enough to regulate the energy transit issues, the parties to the Treaty started to draft a more detailed transit protocol in 1998. The main purpose of the protocol was to delineate rules regarding the implementation of the Charter’s principles on transit and the Treaty’s relevant provisions. The binding nature of obligations resulting from transit agreements; effectiveness of national legislation in ensuring non-discrimination; and prohibition of illegal taking, interruption, reduction or stoppage of established flows of energy materials and products were among the key principles that were agreed upon in the
2003 draft. Technical definitions, such as available capacity and capacity utilization methods, were effectively elaborated, and a general consensus was reached on the underlying principles of transit tariffs. However, in 2003 negotiations were suspended. Three main issues were the subject of consultations between the EU and the Russian Federation and, later on, among all the ECT Contracting Parties during that time. Those were; the long term capacity booking and creation of new transit infrastructure, the cost reflectiveness of tariffs arising from auctions, and a clause introduced by the EU having the effect that the Protocol would not apply to energy flows within the EU (“REIOclause”).

After some setbacks in the process, the issue had been revitalized and again discussions resumed. However, after the withdrawal of the Russian Federation from the ECT in 2009 and unwillingness from the EU, the negotiations on the Transit Protocol were again suspended in 2011, mostly because the draft text was no more accepted as a basis by a large group of states. Nevertheless, the search for a multilateral transit protocol has not totally ended. In November 2011, in view of the possibility to reset negotiations on a new Transit Protocol and develop multilateral rules in order to facilitate cross-border energy transport and transit, the Energy Charter received a mandate from its 53 member states to launch consultations among members, observers and other relevant stakeholders from government and industry. The result of these consultations was discussed at a conference in Warsaw in December 2012. It was concluded that transit negotiations might be reset on the basis of a new document reflecting the common views of the members if an important number of stakeholders expressed a sincere interest in such negotiations and committed to their result. Energy transit mechanisms have also been alluded to in UN General Assembly Resolution 67/263 (2013):

“Reliable and stable transit of energy designed with a multidimensional format in order to tackle the recent economic developments in energy markets. Moreover, the need to address energy transit issues at a multilateral forum energy and its role in ensuring sustainable development and international cooperation”,

actively promoted by Turkmenistan and supported by 72 states.

Taking the withdrawal of Russia from the ECT and EU’s focus on its own energy legislation, there is an increasing need for a new kind of energy tran-
sit regulation especially in a wider region from China to Turkey including the South Caucasus. Those countries around the Caspian basin compose the important part of the ECT constituency and have experience on energy transit regulations through different kinds of international legal mechanisms for years. Moreover, South Caucasus countries are not members of European Energy Community, which aims to externalize the EU energy legislation to the non-EU countries covering the Balkans and Ukraine. Thus, it is fair to target the South Caucasus region and its surrounding countries as the centre of a new energy transit regime under the ECT. In fact, this is compatible with the experience of the region. The significance of the Energy Charter in the development of rules and principles for oil and gas transit especially in the South Caucasus has been publically recognized by decision makers in the region. ECT rules on transit have been largely observed by the governmental actors operating energy systems along the transit corridors: Armenia, Azerbaijan and Georgia (as well as other Caspian and Black Sea states) have all signed and ratified the ECT and actively participate in the Energy Charter Process.

**New geopolitical developments in Eurasia**

There are new geopolitical developments in the region that could accelerate the search for an energy transit regime. Those countries around the Caspian basin try to integrate into the international energy markets through various projects. The emphasis was on the East-West energy corridor in the 1990s whereas recent developments have prioritized the East-East energy corridor as major Asian countries like India and especially China are more and more involved in importing energy from the Caspian basin. The Caspian region and its surrounding countries are at the centre of a new energy order between the big markets in its East and the West. That’s why we need to discuss the main geopolitical developments that might affect the international flow of energy especially in this part of the world. In fact, three main factors have played role in recent years: Chinese involvement in Energy Charter process due to the investments on transit from Central Asia, the lifting of Iranian Sanctions and Turkey’s new role in the Southern gas corridor with TANAP.

Chinese economic development and increasing international presence are important factors that could have political ramifications for the region.
With the creation of the Asian Investment and Infrastructure Bank and the emergence of a grand infrastructure project, “One Belt One Road” (OBOR), China is striving to create a new Silk Road in which energy is the main element. Actually this could be a big catalyst for a transit agreement under the ECT in the future with further Chinese involvement. Main part of OBOR is Silk Road Economic Belt from western China, crossing Central Asia on its way towards Europe through Turkey. While pipelines and accompanying projects have gathered momentum in recent years, potential risks such as threat to critical infrastructure and the allocation of new transit capacity from different counterparts along pipeline routes have become the main issues that China needs to tackle in terms of securing its national energy supply. A more efficient and comprehensive international legal framework, like ECT, is needed to ensure the security of energy flows to China.

China has already showed its interest by adhering to the International Energy Charter in May 2015 and is considering joining the ECT. Regarding transit, the freedom of transit and the principle of non-discrimination which the ECT embraces might enhance the uninterrupted hydrocarbon transit from Central Asia to China. This has meant proliferation of new long-distance energy transport projects, often crossing multiple territories. In the beginning of the Transit Protocol negotiations, the export route in the gas sector was focused on the East-West transport corridor. Nowadays, the focus has shifted to the East-East corridor with Asia’s export potential to Asia. Turkmenistan is now China’s biggest gas supplier and the planned pipeline from Turkmenistan to Afghanistan, Pakistan and India (TAPI), if constructed, could further reinforce dynamics in Asia towards South and East Asia. However, it is important to note that the eastward shift in energy transport routes does not only cover the natural gas sector but also oil and electricity, in line with China’s OBOR initiative.

The lifting of sanctions against Iran and energy export from this country could accelerate the search for a new energy transit regulation as negotiations between Iran and P5+1 countries (US, UK, France, Russia, China + Germany) have resulted in positive outcomes. This further creates the potential to integrate Iran into the global energy markets via new infrastructure projects, for instance, via the TANAP to Europe or through the Iran-Pakistan-China or India pipelines as well as new LNG facilities to be estab-
lished. Iran has adopted the International Energy Charter in May 2015, and could participate as an observer in negotiations of a future legal transit instrument to mitigate these obstacles. Another important result of lifting Iranian sanctions is that possible Iranian participation to the Southern Gas Corridor could also pave the way for energy exports from Turkmenistan to Europe. There have been talks on the construction of the Trans-Caspian Gas Pipeline, under the Caspian Sea for decades but there has not been any progress so far. However, this time there is a window of opportunity for a swap deal between Iran and Turkmenistan. As Iran joins the Southern Gas Corridor Turkmenistan could also bring its gas to Turkey and the EU under a swap deal.

Turkey is a key factor in the fulfillment of the development and expansion of the Eurasian energy projects. This is in keeping with Turkey’s aspirations to become an important energy player with its geographical location between Eastern producers and the Western consumers and also to become the fourth largest gas artery in Europe after Russia, Algeria and Norway with the realization of ambitious TANAP project. Therefore, Turkey’s energy strategy seems to comply with the European Southern Gas Corridor. With Baku-Tblisi-Ceyhan oil (BTC), South Caucasus Pipeline and Turkey-Greece Pipeline are now operational; Turkey can claim to have taken an important step towards achieving this policy. With the political crisis with Russia, now Turkey could become more eager to realize new energy infrastructure projects that are designed to bring Caspian energy to international markets.

**Turkey’s Role in energy transit from the Caspian to Europe**

It is indispensable to discuss the geopolitics of Turkish energy for such kind of an energy transit regime and its relations with the TANAP project. The Turkish territory, which is at the crossroad of several pipeline projects competing against each other along two main axes: East-West and North-South. Turkey, between these two axes, is generally referred to as an energy bridge in the markets. Surrounded by producer countries, big consumption markets, monopolies, and autocratic regimes on the one side, democratic regimes, is squeezed between these different worlds.
Turkey once more is considered as a secondary element of the competition between these two central axes in international energy game. Because Turkey has always been playing an energy role defined by others. Consequently, first of all, it becomes a must to evaluate Turkish foreign energy policy as a role of dilemma between West-Russia axes. Energy corridor, transit and hub represent totally different geopolitical understanding and economic functioning mechanisms from each other. While the position of a country in the energy equation puts it in one of these three categories, it also brings opportunity costs along. Being an energy corridor is the worst option for a passage country since third parties own the transit pipelines and just use the geography of the passage country. In any transit option, although the exporters & importers determine the prices, passage country has the upper hand in comparison with the corridor by owning critical infrastructure and gaining from transport tariffs.

On the other hand, being a hub means the prices are determined in that specific country according to supply/demand dynamics and a sophisticated trade mechanism demanding a liquid market structure, developed infrastructure including storage and sufficient human resource before anything else. Otherwise, even if many pipelines pass under the lands, the country does not become a hub as it is thought in Turkey. With signing TANAP Turkey has given up its claim to be a gas hub but rather accepted to be a transit country for Azeri gas under the Southern Gas Corridor. At the first stage, through TANAP it is projected to carry 16 bcm gas. Commercial contracts were already drawn up. 6 bcm of this number will be consumed in Turkey and 10 bcm of it will be carried to Europe. This project, expected to cost about 10 billion USD, is under control of Azerbaijan’s state oil company SOCAR with 58 percent share. Turkey’s partnership is limited to BOTAŞ with 30 percent and there is also British company BP with 12 percent stake.

**Turkey, Russia and the EU energy triangle**

Although the concept of energy security for the EU and Turkey, as net importers, means the diversification of supply, the same term for Russia is understood as the diversification of supply routes that target the European market in order to minimize the transit risks related mainly to Ukraine. In line with its common energy strategy, the EU has been creating incentives
for alternative sources of gas including renewables and encouraging new infrastructure projects such as LNG terminals, storage facilities and applying exemptions for third party access for some pipeline projects that could bring dynamic competition to the market. Under European pressure Gazprom has been facing serious criticisms centered on price negotiations and even arbitration cases from its biggest clients. Brussels, in its search for reducing its energy dependence on Russia, sees Turkey as a transit country that would be part of the “Southern Gas Corridor” for alternative supplies. However, the EU is not interested in giving a decisive role to Ankara because it basically does not want to deal with a new Russia in its energy arena. On the other hand, as a response to this strategy, Russia has been developing new pipeline projects such as South Stream, Turkish Stream and Nord Stream 2. If one of them could be realized then transit risk stemming from Ukraine would be minimized and politically Moscow would have an important strategic leverage. That is why Moscow is very insistent on marketing these projects for political reasons even if market rationality dictates otherwise. It never gives up proposing new projects when the previous one is getting stuck because of regulatory or political difficulties. The South Stream was dismissed because of regulatory obstacles from the EU’s 3rd Energy Package and priority was shifted to the Turkish Stream. The latter was frozen because of geopolitical tension with Turkey, and now Gazprom is lobbying for a green light from the European Commission to start the construction of North Stream 2. However, Moscow is not eager to give a big role to Ankara because of the possibility of creating a new problematic transit country while it is aiming to neutralize Ukraine.

Turkey shares the aim of the EU of decreasing dependence on Russia but does not desire to lose its general bargaining power against the EU by becoming a cheap transit country. Through competing projects Turkey has already been incorporated into the pipeline game in the European energy arena. Although Turkey wants to become an energy hub at discourse level, Ankara has not been able to follow policies that are compatible with this aim. With Turkish Stream, Moscow has pretended to support Turkey being

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a gas hub though its objective has been to use Turkey only as a corridor and a bargaining tool in its general struggle against Brussels. Ankara was suspicious about Russian intentions for this project from the beginning, which is why Turkey did not let Russia use its territory as a corridor for strategic purposes. Rather it has already opted to become an energy corridor for Azeri gas, by signing the TANAP pipeline agreement.

To complicate things, last year the PKK committed an attack on the Baku-Erzurum gas network and more recently, in February, it attacked the Kirkuk-Ceyhan crude oil pipeline. The autonomous Kurdish Regional Government of Iraq now controls the Iraqi part of this pipeline and sends 700,000 barrels per day of crude oil to international markets through Turkey. In addition, there is continuing political turmoil in Iraq and Syria. This offers opportunities for various actors to use terrorist groups to destabilize the flow of energy by targeting pipelines. In that sense, the PKK might further be used as a proxy to target critical infrastructure in Turkey. As Caspian and Middle East energy resources reach Europe through Turkey, PKK terrorist attacks on critical energy infrastructure in Turkey will have negative repercussions on European energy security.

Within the general energy triangle between the EU, Turkey and Russia, Turkish policy has shifted more towards Brussels, which is an additional burden for Moscow in its struggle in the European energy arena. Changing realities of international gas markets – in particular the European market – in which decreasing prices are occurring due to the LNG glut,\(^2\) abandonment of oil-price indexation and common market regulations, combined with weak demand, will reduce room for new Russian pipeline projects to be realized. In terms of energy security, Brussels seems to benefit from the deteriorating Turkish-Russian relations. Both Russian and Turkish domestic energy markets will be affected by developments in Europe that will likely result in full liberalization of exports for the former and the liberalization of imports for the latter.

Conclusion

To sum up, an energy transit regime could be achievable in the South Caucasus that will contribute to peace and cooperation in the region. Taking into consideration the geopolitics of energy in the South Caucasus, an energy regime should be in form of a transit one. A regional energy transit community under the Energy Charter Treaty is an achievable and best solution for South Caucasus countries. Boundaries of this prospect energy transit community should also cover the Central Asian countries. Both geopolitical developments and market realities make such kind of an energy transit regime more possible in the region. If institutional capacity could be enhanced under the ECT, the energy transit community will not only regulate the energy trade among the South Caucasus countries but also potentially contribute to regional cooperation that is needed in order to avoid armed conflicts.

Nevertheless, such enormous projects like TANAP actually raise questions about critical infrastructure safety in relation with regional conflicts. In case there is no internationally-binding energy transit regime, who will be able to provide security to the region if conflict erupts in the South Caucasus as a result of increased Turkey-Russia tension? Or while the international community is ignoring the Armenian occupation of Karabakh to what extent is the current status quo sustainable in the Azeri-Armenian conflict? Here, the role of an energy transit regime in the region would be very important to lessen the risk of armed conflict. Those questions could be addressed through an institutional energy transit regime in the region. Therefore a new energy transit community should be formed under the ECT that covers all of the South Caucasus states in order to mitigate the potential of conflict by increasing the energy cooperation between the members.
Epilogue

Frederic Labarre

At time of writing these lines and completing the editing of this booklet, sea changes are occurring in the South Caucasus, and those changes are indeed extremely ominous. In the four years since this Study Group has been resurrected, never has the region been under greater stress. The fractures of this stress have emerged in the first six months of 2016. I count four major fractures.

The first is of course the brief resumption of fighting between Azerbaijan and Armenia over Nagorno-Karabakh. It is unclear whether the fighting that occurred between 2 and 5 April – merely days before this workshop – had been pre-planned by either of the parties, or whether it is due to a miscommunication or accident on the contact line. The result has been the death of many hundreds on both sides, and an aggravation of relations between Armenia and Azerbaijan. On the other hand, it could also help reset negotiations on a platform more stable than the Madrid Principles. It is evident that cooler heads have prevailed in April, and that there was no further escalation on the contact line. Whether Armenia or Azerbaijan is the party of that broke the cease-fire matters little; to these editors, the resort to coercive force is ultimately the indicator of a deeper malaise in the societies of the region. Stronger institutions are needed, and although we will not be the advocates of one type of political management over another, the people need to be heard and their grievances addressed without fear. Without fear for the people themselves, and without fear for the regime to become destabilized by protests. The social dimension of the problems of the South Caucasus cannot be ignored. In this sense, it is the same reality of chronic under-development in all countries, of elitism, and of pauperization of the population. In a context of increasingly stable economic recovery in the rest of Europe, the countries of the South Caucasus compare poorly. This is why we have convened a workshop on energy security, because energy security is intimately connected to the economic and commercial well-being of a nation.
The second event of magnitude to rock the region is of course the political meltdown in Turkey. What is more worrisome is the benign neglect of the international community at the blanket purge of thousands of military officers, university academics, the closure of universities and the suspension of the European Convention of Human Rights in the country. As a case study of revolution from above, President Erdogan’s choices are not the concern of this Study Group. However, the impact of those choices on the South Caucasus, and the significance of the international community’s silence is ominous. Mr. Juncker’s admonishment that Turkish membership of the EU could indefinitely be put on hold is a tepid threat considering the affront of rejection in 2004, and also considering the fact that Mr. Juncker could not even promise EU membership even if things were fine. Similarly, State Secretary Kerry’s reckless suggestion that Turkey could lose its NATO membership doesn’t hold water in the current standoff between NATO and Russia over Ukraine. What we are suggesting here is that large powers are themselves overwhelmed by the magnitude and frequency of the events challenging them. That is the real threat to the South Caucasus.

Either by contagion or by coincidence, Armenia is also grappling with a political crisis at the moment when I am writing these lines, bringing in a third factor of unease into the region, and into our Study Group’s work. The hostage crisis that has taken place in Yerevan is a function of a population fed up with official corruption and government abuse. Inevitably there will be accusations that the West is behind these events. However there is no evidence that this is the case. On the contrary, the evidence points to Western governments and international institutions clearly overwhelmed by events. Such events will make the possibility of reaching agreement over the status of Nagorno-Karabakh all the more difficult, because Azerbaijan will likely try to exploit the Armenian government’s momentary weakness. And what is worse is the fourth factor that affects the South Caucasus; the NATO Warsaw Summit Declaration.

The NATO Warsaw Summit Declaration is the fourth event likely to catapult the South Caucasus into the dungeon of history. I cannot stress enough how much of a calamity this Declaration is for the South Caucasus if it is read correctly. Whereas other Summit Declarations were generous of their mention of the South Caucasus, it is clearly not the case this time.
The South Caucasus is mentioned only once in the Warsaw Summit Declaration.

It is worth reproducing what that paragraph says:

"We continue to support the right of all our partners to make independent and sovereign choices on foreign and security policy, free from external pressure and coercion. We remain committed in our support for the territorial integrity, independence, and sovereignty of Armenia, Azerbaijan, Georgia, and the Republic of Moldova. In this context, we continue to support efforts towards a peaceful settlement of the conflicts in the South Caucasus, as well as in the Republic of Moldova, based upon these principles and the norms of international law, the UN Charter, and the Helsinki Final Act. We urge all parties to engage constructively and with reinforced political will in peaceful conflict resolution, within the established negotiation frameworks."\(^1\)

It is difficult to make sense of what this paragraph means for Armenia, Azerbaijan and Georgia especially since the question of territorial integrity is precisely at issue. The point that should not be forgotten is that this paragraph is the result of consensual agreement among all NATO allies. Whereas previous Summit Declarations mentioned all the efforts that NATO was willing to dispense in support of reform, such as Individual Partnership Action Plans, Partnership Action Plan/Defence Institution Building, or even Defence Education Enhancement Program (IPAP, PAP-DIB and DEEP, respectively), there is no mention of that. In fact, there is no mention of Ukraine in relation to eventual NATO membership and Georgia’s conditions for being considered have been increased. All this to say that NATO could be sending a strong signal to Russia that it is perhaps abdicating the whole region.

Therefore, if the region is to survive as a sui generis strategic entity and relatively autonomous partner of either the Euro-Atlantic area or even Russia, its component countries will have to set aside their differences rather quickly. Because the trend is that the West seems no longer interested in shielding the South Caucasus from real or imagined Russian depredations. This could signal the return of a mode of international relations management more reminiscent of the Cold War, where large powers make the

rules and impose them on their neighbourhoods. At worse, the process of fragmentation we seem to be witnessing in Europe could herald the end of large international organizations, or, at any rate, their complete emasculation. For an image of what that could look like, one needs only to cast their eyes back some 15 years, and look on at the fate of the Western European Union, and for the historians among us, to how “imperial” the Holy Roman Emperor really was in the 19th century.

A return to coalition politics would spell disaster for any country of the South Caucasus, because alone, they could fall prey to any large neighbour; Iran, Turkey, or Russia. The last thing that any of these countries’ governments should want is a return to international relations that have led to large-scale wars. Evidently, the Regional Stability in the South Caucasus Study Group’s role is to stimulate regional stability at the grass roots level, and using track-2 diplomacy. Our reach is limited only by the desire of our participants to actively engage with their respective authorities (admittedly this is sometimes difficult), and promote some of the solutions we propose. In the next section, we have listed our policy recommendations in their entirety.

However, we recognize that this is not sufficient, and we have elected to revisit the topic of energy security management and institutionalization at the following workshop in Reichenau in Austria in November 2016. Upon that occasion, we will together draft the outline of a workable institution that could be a mirror of regional cooperation and a significant step forward towards soft power, and the beginning of a retreat from hard power.

Much like the Schumann-Monnet plan that gave birth to the European Union, we hope that the ideas that will spring forth will be the catalyst for meaningful change in the South Caucasus. After decades of frozen conflict, time is no longer on any of the protagonists’ side, and neither is it on the side of large Western powers. Now, the South Caucasus participants should take ownership of their collective destinies, lest they be completely forgotten by the rest of the world. It is the hope of the co-chairs of this Study Group that the creation of an energy security management institution will be a step in that direction.
PART IV:

POLICY RECOMMENDATIONS
Policy Recommendations

Frederic Labarre and George Niculescu

Executive Summary

The following key post-conflict recommendations were the object of significant debate and elaboration, and were agreed to by the Study Group participants:

1. Leverage existing legal and functional frameworks, like the Energy Charter or the Organization of the Black Sea Economic Cooperation (BSEC) to establish and develop a South Caucasus Energy Security Management Organization.

2. Task the putative South Caucasus Energy Security Management Organization with promoting the unimpeded transit of energy, while at the same time stimulating energy diversification, including alternative and renewable sources.

3. Establish and cooperatively manage a regional financial arrangement (i.e. a trust fund) to promote regional energy cooperation, and mitigate energy price fluctuations affecting South Caucasus countries.

4. Prevent, mitigate, respond to and recover from energy-related accidents by the creation and application of common capabilities and policies, such as an Incident Prevention and Response Mechanism (IPRM).

Keynote Speech

Patrick Larkin, Senior Adviser at the Energy Charter Secretariat in Brussels gave the keynote address. He argued that given the three energy blocks currently evolving in Eurasia (European Union’s Energy Union (EEU), the Eurasian Economic Union, and the Silk Road Economic Belt)
there was a danger of developing fault lines. The countries from the South Caucasus were placed on the convergence of those potential fault lines. There was therefore a need to establish a regional forum for energy dialogue, as well as a system of global energy governance, to include all relevant players, if the fragmentation of energy markets in Eurasia was to be avoided. The International Energy Charter, signed in 2015 by a large number of states worldwide, had a significant potential in that regard, and should be used by the countries of the South Caucasus to ensure cooperation at the working level. It might contribute to ensuring compatibility between all, or, at the very least, prevent them from further drifting apart at the technical, commercial and regulation levels. However, for the moment the political will to achieve this was rather scarce.

Panel 1: Understanding the Meanings of Energy Security from the Black Sea to the Caspian

Why have energy security and geopolitics become fundamentally intertwined? One possible explanation viewed energy security as an integral part of geopolitics. That geopolitical picture could not be understood in a realistic manner, unless the energy security pieces of the larger puzzle were properly put together. From this perspective, only a radical change of regional mindsets could really make the difference in separating energy from geopolitics. Regional conflict resolution, incentivizing political elite, and a common vision of the South Caucasus as an energy “aorta” should have economic pragmatism prevail over national security concerns.

Another panelist warned that, in the short to medium term, a thorough securitization of energy relations has emerged in the strategic documents of the Black Sea riparian countries. For instance, in Romania the energy issues were treated in two strategic documents. If regional energy cooperation and geopolitics could ever be divorced from each other, one speaker suggests the establishment of a South Caucasus Joint Energy Group that might: increase and diversify energy imports and exports; enhance, harmonize and inter-connect energy infrastructure; create a unified legal framework that would attract foreign investment; promote strategic and policy dialogue among the stakeholders, while turning the region into an energy hub inter-connecting the European, Eurasian and Middle Eastern energy markets.
Panel 2: Responses to Current Energy Security Challenges in the South Caucasus

This panel offered an opportunity to look at the energy security strategies of the South Caucasian states against the background of the broader geopolitical interests of regional powers, and the ongoing unresolved conflicts in Abkhazia, South Ossetia, and Nagorno-Karabakh (NK).

For Armenia, energy security is one of the pillars of national security. With no oil and gas resources of its own, Armenia has imported natural gas for both domestic consumption and production of electricity. Armenia’s development of renewables may in the longer term lessen Armenia’s dependence on energy imports. Armenia has been excluded so far by Turkey and Azerbaijan from all East-West regional energy projects with the aim to compel Yerevan to make concessions on NK conflict resolution. In addition to not meeting its goals, such isolation both undermined regional energy cooperation, and offered a momentum for Russia to cement its energy (and wider economic) grip on Armenia.

Azerbaijan, as the only major regional energy producer in the South Caucasus, had a quite different perspective on energy security and its relationship with regional security. Azerbaijan would favor developing regional energy cooperation in the South Caucasus, provided significant steps were made on NK conflict resolution. Baku was concerned with the Georgian shift in importing gas from Russia (instead from Azerbaijan), which created increased mistrust in Baku towards the prospects of an emerging Georgian-Russian-Armenian gas deal. Baku remains wary of threats against Azerbaijani energy infrastructure.

According to speakers from the Western South Caucasus, Russia is the most powerful energy actor in the region. However, Georgia maintains certain advantages thanks to its hydroelectric power potential, which is nevertheless in dire need of investment. This is particularly true of the Inguri power dam, jointly administered by Georgia and Abkhazia. The latter does not have the necessary resources to shoulder the burden of upkeep of the power dam. Joint management of the Inguri power station could also be a workable model of non-political and mutually-advantageous cooperation.
Widening the model to other cases of energy cooperation proves problematic in the context of Armenian Azerbaijan tensions. The tensions prevent the consolidation of the energy market region-wide, and decrease the chances of the region becoming a powerful player vis-à-vis Iran, Turkey and Russia, but also the European Union, which alleviates energy dependence through innovation and renewables. The creation of a consolidated energy market, or at any rate of a regional energy security community, could be stimulated by the political awareness raised by certain economic sectors. Tourism is the sector which would require more predictability in energy availability and affordability. Facilities to accommodate such a promising sector are still found wanting in the South Caucasus. Most private investment is generated from Russia, which accentuates the feeling of dependence of Abkhazia. While it is more proper to speak of interdependence, it is still too soon to say that this is not yet another form of external influence in internal affairs.

Panel 3: Reconciling European and Eurasian Energy Security Policies: The Twilight of Energy Geopolitics in the South Caucasus?

With a declared aim to become an energy hub for the European energy markets, and with a growing domestic demand of energy, Turkey has become an important factor in European energy security, aiming at diversifying its own, but also the European energy supply. However, a gap between its ambitious strategic objectives and its limited energy resources as well as the current energy overdependence on Russia has, among other factors, weakened Turkey's ability to contribute to sustainable energy coordination among Turkey and the European Union would be critical to preventing Russia from exploiting energy vulnerabilities in the South Caucasus.

While South Caucasus regional security is not perceived as a threat to Russian energy security, and Moscow doesn't envisage full scale regional energy cooperation, the main challenges facing Russian energy security stem from price volatility, decreasing demand, rising extraction costs, sanctions and embargoes. To mitigate the impact of these energy security challenges, Russia has focused on expanding its Asian energy markets (i.e. new energy deals with China), as well as on defending its share from the European energy market against potential competitors, such as Azerbaijan,
Iran, Iraq, and others. It also aimed at diversifying its energy export routes to Europe away from Ukraine, to allegedly decrease their vulnerability to security and geopolitical risks in the wake of the Crimea and Donbas conflicts. From a Russian perspective, the most likely scenario on reconciling European and Eurasian energy strategies in the South Caucasus would be a “neutral scenario”, thereby mutual respect for each other’s interests, no escalation of regional conflicts, and limited regional energy cooperation prevailed.

Another perspective on divorcing politics from energy is based on balancing the energy security needs of each regional player based on their most acute vulnerability. Russia might be the most powerful player in the energy field in the South Caucasus, yet she is susceptible to price volatility. Elsewhere in the South Caucasus, high energy prices have their benefits such as in Azerbaijan and Iran. On the other hand, the high price of energy is detrimental to energy-poor areas such as Nagorno-Karabakh, Abkhazia and South Ossetia. There, the dependence on larger actors is keenly felt, and not at all to the benefit of the populations and to their socio-economic development. The aim of a regional energy community would be to articulate a policy framework able to balance the needs of affordability, availability and access of the regional countries. Seeing that these factors have a direct impact on economic well-being, the political elite in the region would do well to put their differences aside and exclude the energy market from their political considerations. Therefore, one of the critical abilities of a regional energy community would be to manage a fund that would help cushion energy-induced inflation shocks, so that those shocks do not translate into social upheaval in the South Caucasus, as we have seen in Armenia with the price of electricity, for example.

Policy Recommendations

A) General Recommendations
They were mostly drawn from the discussions in three panels and two Interactive Debates. Unfortunately, it seemed that, in the absence of significant progress in NK conflict resolution, few of these proposals may be implemented at South Caucasus (SC) inter-governmental level, while leaving most of the work to be done within multilateral formats, and by Track II diplomacy:
1. Set up a comprehensive SC energy experts’ dialogue to manage regional energy issues of common interest, such as: increasing and diversifying regional energy trade; developing energy infrastructure; attracting foreign investment; strategic and policy approaches. The Energy Charter Treaty might offer an initial regional framework for starting such a dialogue. This might be subsequently expanded, as appropriate, to link up with other relevant initiatives/international organizations.

2. Consider further opportunities to use joint management of energy/water resources as tools for conflict resolution, in particular in the case of NK, while taking into account the positive experience with Georgian-Abkhaz cooperation at the Inguri hydropower station. The Sarsang Water Reservoir might be considered as a case to the point, provided the appropriate level of interaction among neighboring public administrations was found.

3. Deepen the debate among civil society organizations on, and involve the media in exposing the use of energy security as a geopolitical tool.

4. In a post-conflict setting, establish a South Caucasus. Trust Fund to promote regional cooperation, including energy markets’ integration, and supporting investments in: energy infrastructure; new technologies; and renewable energy sources.

5. Promote the privatization of energy industries in the South Caucasus states as a way to de-incentivize the use of energy security as a geopolitical tool.

6. International organizations, such as the World Bank, should encourage the South Caucasian countries to further liberalize their energy markets, so that they could attract more foreign investments, and function more efficiently.

B) Robert Schumann Group Recommendations
This group focused on Armenia, Azerbaijan and NK and discussed the pros and cons of creating an “energy security regime” in the South Caucasus (understood as an institutional and/or normative governance framework), conditioned upon an effective conflict resolution outcome. In such
circumstances, the following proposals were agreed as priorities for a SC “energy security regime”:

1. Diversify the sources of energy imports of regional actors with a view to reducing dependence from external suppliers, and increasing energy self-sufficiency;

2. Interlink import/export infrastructure;

3. Further develop energy storage facilities;

4. Increase reliance on renewables;

5. Modernize refining infrastructure;

6. Build an energy corridor from Baku through NK, Armenia, to Nakhichevan, and Yerevan. The need for foreign investments, and the involvement of external players were also discussed. Both Armenians and Azerbaijanis stressed on the need to involve Iran in any future regional initiatives. Although some opposition from Russia was possible, future cooperation on making the SC energy self-sufficient wasn’t excluded. The West and China were seen as the main potential investors in meeting the priorities of the SC “energy security regime”. In addition, the following policy recommendations were agreed:

7. The Black Sea Economic Cooperation organization should play a crucial role in developing the SC energy security regime; given its membership, it may also play a critical role in harmonizing EU’s Energy Union with the EU’s nascent common energy policy.

8. More efforts should be invested in research on the sustainability of the SC “energy security regime”, and its wider implications on regional cooperation.
C) Jean Monnet Group Recommendations
The Monnet Group recommended a precise structure to administer the South Caucasus energy market with a view to harmonizing concerns for energy availability, affordability and access. The principles underpinning such an endeavor would be inclusiveness, irrespective of status, and predictability based on commonly-agreed rules, procedures and norms. The following were agreed among the group participants:

1. The legal framework of a regional energy community should be based on that of the Energy Charter as well as those of the World Trade Organization;
2. Sovereignty over the energy market would be divided among the regional participants, but proceeds would also be re-distributed;
3. The energy security principles of environmental sustainability would be preserved by an Incident Prevention and Response Mechanism (IPRM) or an emergency management board;
4. Create a regional trust fund to mitigate the consequences of price fluctuation at national level;
5. Develop adequate and equitable terms of reference for officers serving the organization;
6. Establish functional linkages with industry and downstream partners (i.e. linkages with the European Union, the OSCE, etc.).

Before setting up a concrete structure, political will should be stimulated indirectly through the development of energy-intensive economic sectors, and directly through economic incentives and a media campaign to educate, raise awareness and develop economic sectors. The structure would resemble something like this organization chart:
List of Authors and Editors

Elizaveta EGOROVA, Political Profile, Washington, DC

ALEXANDER ELISEEV, Russian International Affairs Council, Moscow

Frederic LABARRE, Co-Chair RSSC SG and Peace for Partnership Consortium (Pfp) of Defense Academies and Security Studies Institutes, Garmisch-Partenkirchen

Vusal GASIMLI, Centre for Strategic Studies, Baku

Patrick LARKIN, Energy Charter Secretariat, Brussels

George NICULESCU, RSSC SG Co-chair, European Geopolitical Forum, Brussels

Jeyhun NOVRUZOV, Loughborough University, London

Dmitry MUSHBA, Cabinet of the President of the Republic of Abkhazia, Sukhum

Volkan ÖZDEMİR, Institute for Energy Markets and Policies, Ankara

Benyamin POGHOSYAN, Institute for National Security Studies, Yerevan

David SHAHNAZARYAN, Regional Studies Centre, Yerevan

Oktay F. TANRISEVER, Middle East University, Ankara
The South Caucasus is a region of strategic importance for Europe’s energy supply. This is why energy security is so high on the agenda of both the EU’s bilateral relations with regional states, and of the Eastern Partnership. However, the current political instability of the South Caucasus represents a threat to future European energy security and to the security of the region itself. The 13th RSSC SG publication offers an insight into the current situation and provides an overview of the energy framework and its potential for the future. Furthermore, the behaviour of important regional actors is disclosed to see how they cope with the current instabilities and if their aim to establish a regional energy community would balance the needs of affordability, availability, and access of the regional countries.