

# THE GEOPOLITICS OF ENERGY IN THE SOUTH CAUCASUS: TOWARDS A REGIONAL ENERGY COMMUNITY

## Policy Recommendations<sup>1</sup>

### Study Group Regional Stability in the South Caucasus



PFP Consortium of Defense Academies and  
Security Studies Institutes

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#### 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).



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.

#### 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

#### 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 weary 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-Azerbaijani 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

regional energy cooperation in the South Caucasus. Greater 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 EEU'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

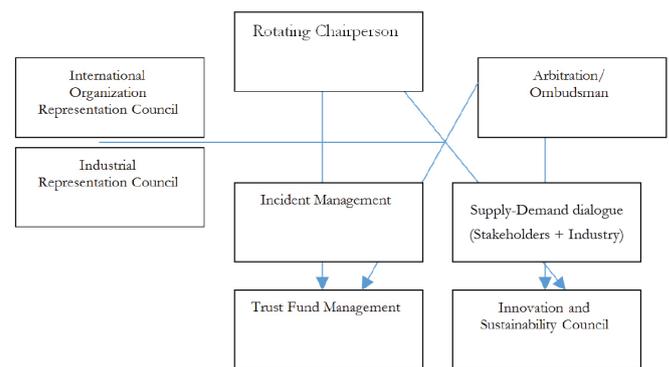
The Monnet Group recommended a precise structure to administer the South Caucasus energy market with a view to harmonizing concerns for energy availability, affordability and access. The principles underpinning such an endeavor would be inclusiveness, irrespective of status, and predictability based on commonly-agreed rules, pro-

cedures 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:



<sup>1</sup> These Policy Recommendations reflect the findings of the 13<sup>th</sup> RSSC workshop “THE GEOPOLITICS OF ENERGY IN THE SOUTH CAUCASUS: TOWARDS A REGIONAL ENERGY COMMUNITY”, convened by the PFP Consortium Study Group “Regional Stability in the South Caucasus” in CHISINAU from 7-9 APRIL 2016. Compiled by George Niculescu and Frederic Labarre, RSSC SG Co-chairs, with inputs from Patrick Larkin, Benyamin Poghosyan, and Oktay Tanrisever.