

# **ENERGY TRANSIT AND SECURITY IMBALANCE IN SOUTH CAUCASUS: THE ROAD BETWEEN RUSSIA AND THE EUROPEAN UNION**

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## **TABLE OF CONTENTS**

<b>1. INTRODUCTION .....</b>	<b>1</b>
<b>2. CHALLENGES TO THE SECURITY OF TRANSIT INFRASTRUCTURE IN SOUTH CAUCASUS .....</b>	<b>2</b>
<b>3. THE EUROPEAN UNION’S ROLE IN REACTING TO THE EXISTING CHALLENGES .....</b>	<b>4</b>
<b>3.1. POLITICAL ASPECTS OF TRANSIT INFRASTRUCTURE .....</b>	<b>6</b>
<b>4. CONCLUSION .....</b>	<b>8</b>

## **1. INTRODUCTION**

The political development of the countries of South Caucasus after the breakup of the Soviet Union is defined by the variety of fissures – the countries’ fragmentation through ethnic and territorial conflicts; the social and economic fragmentation of the societies, a lack of solidarity; the rise of nationalistic ideologies; the wide amplitude of the crises; striving towards and distancing from democracy in a changing frequency; and many others. The complexity of this region is further enhanced by its geographic location in-between the Middle East, Europe and Russia. However, this is not an issue of geography alone, but an issue of struggle between these large energy producing and consuming markets in order to control the energy channels.

As a result of the disruption of the Soviet energy and economic space and infrastructure during the 1990s, energy and economic potential of Azerbaijan, Georgia and Armenia were virtually nullified. Dragged into the Nagorno-Karabakh conflict and a civil war, Azerbaijan found it problematic to utilise its oil resources and make it available to the external market. Armenia, as a result of fight with Azerbaijan and civil wars in Georgia, found itself completely cut off from the vital Russian energy resources. Thus, the 1990s represented the period when the countries of the region had to rebuild their energy infrastructure that was damaged by political instability. At the same time they had to determine which economic and energy spaces they saw themselves as being part of.

The vacuum created by the collapse of the Soviet energy and economic systems was sometimes filled by the growing European market. Even though demands of that market were primarily aimed towards Russia, it also left open the possibility of integration of the South Caucasus countries, especially Azerbaijan as an energy producing country. The cooperation between Turkey, Georgia and Azerbaijan in the field of energy is an indicator for movement in this direction. At the same time, this process exposes regionally significant political problems. There is a very little room left for Armenia’s integration into the European energy space. Armenia is in discriminated position due to its complicated relations with Turkey

and Azerbaijan and entirely relies on technical and infrastructural help and energy resources from Russia. Unlike Georgia, which is also largely a consumer nation, it cannot function as a transit route and become involved in the construction of the great European energy market in this manner. Involvement in this market is particularly attractive for Georgia: in contrast with self-sufficient Azerbaijan and Russian-dependent Armenia, and against the background of deadlocked relations with its northern neighbour, for Georgia this constitutes a natural choice to ensure its energy security.

This complex picture has a political dimension which affords different positions to all three countries of South Caucasus. Involvement in the European energy space, which, on the one hand, is tied with economic integration, and on the other, promises energy security to the countries involved, also implies those countries' democratic political transformation.. Clearly, in view of the aforementioned realities, the response to this thesis of European energy integration is different in each of the three countries of South Caucasus. Oil-rich and self-sufficient Azerbaijan, which has a supplier role in the European energy market, and on whose resources Europe will continue to depend in the near future, is not in a hurry to implement either the EU market regulations, or the democratisation process for its political system. Armenia, which satisfied its 'hunger for energy' by tying itself with the USSR's successor in the Soviet energy space, Russia, and relies entirely on the latter with regards to developing its energy infrastructure, is also less open to sharing European regulations and norms. In this regard, Georgia, whose energy and infrastructure are detached from the Russian energy market and is depended on the transit route between the Caspian and Central Asian energy carriers and the European market, has demonstrated a higher degree of determination to democratise its political system and implement European norms.

Such an imbalance between the countries of South Caucasus with regards to energy dependence and political development poses the question as to how it would be possible to ensure the safety of energy transit and stable political relations between these differing spheres of European and Russian influence. What realities do the countries of the region face today, and what kind of political choices would they have to make if the existing political conjuncture in the energy market was to change?

## **2. CHALLENGES TO THE SECURITY OF TRANSIT INFRASTRUCTURE IN SOUTH CAUCASUS**

On August 5, 2008, in the Turkish section of the Baku-Tbilisi-Ceyhan oil pipeline, a fault within the pipeline's early warning system led to an increase in pressure and an explosion of the pipeline. As a result, the pipeline ceased to supply oil until it was repaired 3 weeks later. The western media based on the investigations claims that the explosion near the Turkish town of Refahiye came about as a result of a cyber-attack by Russian special services.<sup>1</sup> Only a few of days after this event, during the August 2008 war between Georgia and Russia, the Russian military jets dropped several explosive devices in the vicinity of the transit oil pipeline located in Georgia. Fortunately, the pipeline avoided damage during these explosions, but the events of August 2008 exposed the existing risks to the energy corridor that passes through South Caucasus. The fact once again demonstrated the importance of ensuring the security of a pipeline that stretches over thousands of kilometres. This is especially true, if the regional players have such clashing strategic interests, as in South Caucasus. When studying this problem, one must also bear

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<sup>1</sup> Jordan Robertson and Michael Riley, Mysterious '08 Turkey Pipeline Blast Opened New Cyber War, Bloomberg, Dec 10, 2014 <http://www.bloomberg.com/news/2014-12-10/mysterious-08-turkey-pipeline-blast-opened-new-cyberwar.html>

in mind that oil producing and consuming countries have different interests. Therefore, ensuring secure operation of transit infrastructure requires the existence of a multifaceted cooperation format and an agreement regarding the main principles of activity between the energy producing, consuming, and transit countries.

Energy producing countries, such as Russia, use every method in order to maintain their monopoly over the transportation of resources, and to have influence over the main transit routes, which would enable them to control both the production and transport prices, and to maximise their gains. Therefore, it is in Russia's interests to reduce the number of alternative energy routes that bypass Russia as much as possible.

Since the 1990s, Russia has opposed Azerbaijan's decision to invite western companies to the country's Caspian shelf to explore oil and gas reserves, as well as develop new means of transporting them towards the West. Russia has constantly tried, and continues trying to convince the energy consuming countries that the South Caucasus region is unstable and incapable of ensuring safe transportation of gas and oil outside the region over a lengthy period of time.

In order to achieve its goals, Russia has, for example, supported the intensification of other potential threats facing the countries of South Caucasus. In the case of Georgia, this manifests itself in the process of occupation and gradual annexation of the territories of Abkhazia and South Ossetia, which Russia began during the 1990s. There have also been frequent cases of Russia limiting energy supplies to the Georgian population, complicating trade relations, etc.

Furthermore, Russia does not encourage delimitation of the Caspian seabed, which would help launch the Trans-Caspian energy transport route. The Trans-Caspian route would transport additional gas from Turkmenistan and Kazakhstan, via Azerbaijan, towards Europe. However, such projects are not being realised on a large scale, as the Caspian Sea's full transit potential is not being utilised.

Distancing Armenia from regional infrastructural projects further confirms Russia's non-constructive role towards the issue of South Caucasus functioning as a transit route. Armenia has not become part of the South Caucasus transit infrastructure that strengthens the ties between the East and the West. The core reason for this is that Russia foments tensions between Armenia and Azerbaijan around the issue of Nagorno-Karabakh, leaving the conflict between these two neighbouring states unresolved. Armenia also has no diplomatic relations with Turkey, and thus, due to its difficult relations with two of the key players in the transit corridor, it is unable to become involved in the process of transporting the Caspian energy resources.

It is in the interests of the energy consuming countries to protect themselves from the supplier's monopoly, and to encourage diversification of the transit routes. This leads to the establishment of competitive market prices. For the South Caucasus region, the main consuming countries are Turkey and the EU member states. Therefore, the latter are showing great interest in future development of alternative routes. The group of countries which supports the diversification of the transport routes for the Caspian energy resources, and protecting their transit potential from monopoly, also includes the United States.

Significantly, it was precisely with the aid of Turkey, the US and the EU that following the collapse of the USSR, Azerbaijan managed to formalise a so-called 'Contract of the Century' that afforded 10 western

multinational companies (including BP, Amoco, Unocal, Statoil, Ramco, Exxon Mobil, and others) the opportunity to explore and exploit the Caspian energy resources. On the basis of the agreement, Azerbaijan and Georgia became significant transit states for these energy resources. Since 1999, the oil from the Chirag oilfield in Azerbaijan flows to the international market through the Baku-Supsa pipeline that passes through Georgia. Also, in 2006 the Baku-Tbilisi-Ceyhan pipeline became operational and transports oil from Chirag and Guneshli oilfields to the Mediterranean port of Ceyhan, and then onwards to European and other international markets.<sup>2</sup> The same corridor includes the Baku-Tbilisi-Erzurum gas pipeline, which has been transporting gas from Shah Deniz in Azerbaijan to Turkey since 2006. The second phase of obtaining gas from the Shah Deniz gas field is to coincide with the construction of a new gas pipeline, which will supply Greece and Italy, via Turkey, through a Trans-Adriatic pipeline. The construction of the pipeline has already begun, and it is expected to become operational by 2020. Upon completion, this project will establish an energy corridor of Trans-European energy networks.

Aside from the east-to-west pipelines, Georgia also has transit routes running from north to south. The north-south gas pipeline has been transporting gas from Russia to Armenia, via Georgia, since the Soviet times. This infrastructure strengthens Russia's role and interest towards the regional energy projects in South Caucasus, and contains the perspective of future development. However interest of Russia will be the decisive factor in this regard.

Thus, from the 1990s onwards, the transit potential of the Caspian energy resources has been facing challenges created by Russia. It will only be possible for Georgia and Azerbaijan to ensure the development and security of their transit infrastructure through support from, and cooperation with, the West. Since the 2000s, the South Caucasus energy transit corridor has occupied a significant place within the formation of the European Union's energy security system. It starts with Azerbaijan supplying the EU member states with Caspian Sea oil, using both offshore and onshore infrastructures. New gas pipelines are being designed and brought into use. Consequently, the issue of security and sustainability of South Caucasus's transit potential is on the agenda. This can be secured through active cooperation with the EU, which is the main consumer of the Caspian energy resources.

### **3. THE EUROPEAN UNION'S ROLE IN REACTING TO THE EXISTING CHALLENGES**

Azerbaijan's and Georgia's cooperation with the EU in the energy sector has been developing over a period of many years. The formats of cooperation were established within the documents published between 1994 and 2014 by the European Commission. These documents contained both the EU's views about cooperation with energy producing countries, as well as regulations concerning the transportation of resources across borders.

In 1994, the EU member states signed the Energy Charter Treaty, which opened up the possibility of multifaceted cooperation with the EU in the energy sector for numerous countries. The treaty covers all forms of activity, from the producing countries to the consuming ones, and also touches on subjects such as energy use and increased energy efficiency. Fulfilling the terms of the treaty is mandatory, and in the

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<sup>2</sup> It transports 1 million barrels a day, with the potential to transport up to 1.8 million barrel a day with additional, advanced infrastructure.

form of multi-level cooperation, it offers the countries of South Caucasus the chance to respond to the existing challenges and to address the issues regarding energy security at home. The countries of South Caucasus quickly became interested in cooperating with the EU in the energy sector. Georgia joined the Energy Charter Treaty in 1995, and Azerbaijan followed suit in 1998. Armenia also became a member in 1998.

The EU admits that later, during the 2000s, its strategic views regarding the energy sector were affected by one of Europe's main gas suppliers, Russia, pressurising its neighbouring states.<sup>3</sup> Specifically, disruptions to Europe's gas supplies coming from Russia via Ukrainian pipelines occurred in 2006 and 2009, while at around the same time, gas supplies to Georgia were also disrupted. In order to create a common scope of regulations for itself and its neighbours, in 2006 the EU prepared a green paper "Energy Policy for Europe" (officially issued in 2007) on so called 'Europianisation' of the energy market, supporting market development in the energy sector through the involvement of third party states.

Thus, the European Union's energy policy became part of the EU's foreign policy, and reflects the European countries' interest towards establishing a pan-European energy community. The core aim of the EU's energy security strategy is to diversify the supply routes for energy resources, which would protect the European energy market from geopolitical risks. These risks are mainly associated with the possibility of the energy producing countries to use energy resources as a tool for political pressure. Russia has used that possibility many times in the past.<sup>4</sup>

Thus, Azerbaijan and Georgia have the possibility of becoming part of the European corridor. This means that Europe offers the two countries support in enhancing the production and transportation of oil and gas to Europe, and at the same time, to implement EU standards and regulations within their national legislations. However, Europianisation does not imply an immediate and complete overhaul of the existing national regulations to bring them in line with European policies and norms. It provides specific member states of the corridor with the opportunity to choose European norms, which they would be able to fulfil in the near future. In this regard, it will be up to Georgia and Azerbaijan themselves to decide to what extent they wish to become members of the European Energy Community.

At the same time, it is necessary for the energy producing and transporting countries to ensure future development of the democratisation process, if they are to successfully implement the tasks set in the process of cooperating with Europe. Sharing European norms and standards implies transparency in the pricing of production and transportation of resources, and reducing monopolies within the energy sector. This will enhance the level of trust between the energy producing and consuming states, deepen cooperation between them, and unify their interests, which is realistically not possible to achieve in the absence of transparent and responsible governance. On the other hand, if the energy consuming and transit countries were to share common interests, it would naturally increase the security of the transit infrastructure. Therefore, implementing norms of democratic governance in the energy producing and transit countries is absolutely vital.

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<sup>3</sup> Between 2000 and 2013, Russian gas supplies to EU member states fluctuated around the 25% mark, see: Reducing European Dependence on Russian Gas, Oxford Institute for Energy Studies, OIES NG 92, October 2014. <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/NG-92.pdf>

<sup>4</sup> Reducing European Dependence on Russian Gas, Oxford Institute for Energy Studies, OIES NG 92, October 2014.

Practice has shown that at this moment in time, implementing the EU's approach towards energy security runs into difficulties in neighbouring states. These difficulties relate to the EU's problems in supporting to strengthen democracy and increase the level of accessibility of energy resources at the same time, since the majority of the energy producing countries are still governed by authoritarian regimes. That is the reason why the process of integrating the transit infrastructure of South Caucasus within the European networks as its southern corridor has been slowed in recent years.

### **3.1. POLITICAL ASPECTS OF TRANSIT INFRASTRUCTURE**

By 2015, none of the countries of South Caucasus have joined the European Energy Community. These delays were mainly caused by the deficiencies within the countries' democratisation process, as well as the reluctance of their respective governments to implement European policies and regulation standards within their legislations. At the same time, however, it must be pointed out that the EU, as the main consumer, supported the countries of South Caucasus in their efforts to protect the energy market from geopolitical risks, even though the transit countries have not managed to succeed significantly in democratisation, and to bring their national legislative norms closer to European regulations.

In February 2014, the EU began negotiations with regards to Georgia joining its Energy Community. The process is still ongoing, and Georgia still only has the status of a candidate in this process. Today, Georgia's cooperation with the EU in the energy sector takes place in a bilateral form, as part of the Association Agreement which the two parties signed in 2014. The agreement supports the strengthening of Georgia's energy security, which includes bringing its legislation closer to the European model, and developing cooperation in fields of electrical power, renewable energy, energy efficiency, and exploration, extraction and transportation of natural gas and oil. The agreement also supports Georgia's membership in the European Energy Community, which would be a crucial step towards establishing multifaceted forms of cooperation with the EU and other countries with regards to energy. The development of the country's democratisation project will be vital for the success of this process.

In comparison with the other countries of the region, Georgia has been successful in implementing democratic reforms over the past years. Major accomplishments were achieved between 2004 and 2014 with regards to building state institutions and fighting corruption. Equally vital is the development of a Georgian public sector that is strong, independent, and loyal towards democratic values. Even though Georgia's reforms in this field have been recognised, Freedom House still regards it as a partly free country that is still in need of vital reforms on its path towards democratisation. The areas that are most in need of attention from the government include the rule of law, freedom of the judiciary system, reform of the security system, and democratic governance.

The picture of the EU's cooperation with Azerbaijan is relatively different. The EU signed a memorandum of mutual understanding and strategic partnership in the energy sector with Azerbaijan in 2006. Furthermore, Azerbaijan is one of the main energy producing and transporting countries of the Caspian region, and it has often expressed its readiness to fulfil an important role in implementing the EU's energy security strategy.

In 2006-2007, Azerbaijan became a country with one of the fastest growing economies, which is tied with an increase in its energy resources and the price of crude oil. At the same time, international organisations have pointed out the lack of interest from the Azerbaijani government in implementing democratic norms

and basic liberties. Azerbaijan has been criticised both for the absence of free and fair elections in the country, as well as its general practices with regards to universal human rights. From 2007 to 2014, Freedom House has assessed Azerbaijan as an unfree country, particularly with regards to freedom of speech, freedom of press, and its capacity to organise free and fair elections. Between 2012 and 2014, the Azerbaijani government also toughened its approach towards the civil society, virtually banning western donors from supporting the local NGOs that were working on the implementation of democratic reforms in the country.

The Azerbaijani government's most significant recent steps once again came in the energy sector. In this field, members of the government are still cooperating with the non-governmental sector and scientists. A positive role in this process has been played by Azerbaijan's participation in the Extractive Industries Transparency Initiative (EITI), of which it is one of the founding states. The organisation's aim was to improve the standards of governance in resource-rich countries. Initially, Azerbaijan successfully fulfilled the necessary criteria, and became a member in 2009. However, due to the recent developments in the human rights sector, which saw numerous journalists, bloggers and NGO representatives facing judicial charges, the leadership of EITI was forced to criticise the Azerbaijani government's policies. The chairman of EITI has confirmed that additional efforts will be required from Azerbaijan to maintain its membership of the organisation, as new assessment of compliance with the standards will be prepared in early 2015.<sup>5</sup>

Armenia also has its role within the regional energy infrastructure of South Caucasus. It is also recognised as a partly free country by Freedom House. Today, relations between the EU and Armenia are proceeding in a limited form, due to the latter declining to sign the Association Agreement with the EU in September 2013, and prioritising joining the Russian-led Eurasian Union in 2015.

As Russia's strategic partner, Armenia counts on Russian support to satisfy its energy needs. Russia supplies Armenia with gas through Georgia, ensures smooth operation of its nuclear power plants, and manages its nuclear waste. Also, Armenia receives a certain amount of gas from neighbouring Iran through a newly constructed pipeline, although the existing infrastructure does not have the capacity to transit and export gas to other countries. That potential could have been exploited if the international sanctions on Iran were lifted. Russian support for Armenia only takes the form of satisfying its needs, and the latter is unable to function as a transit country on the north-south route. Therefore, the South Caucasus energy corridor is mainly developing in the east-to-west direction.

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<sup>5</sup> <https://eiti.org/news/statement-eiti-chair-clare-short-azerbaijan>

#### 4. CONCLUSION

Thus, taking the existing regional context into account, the transit potential of South Caucasus can play an important role in bringing the Caspian energy resources to the global market. It will be necessary to resolve issues that are vital for its stability and future development, which implies serious reforms. Transit countries must strengthen democratic governance and democratic reforms in general, and obtain support from the important players in the energy market, such as the EU and the US. This will help them deal with internal and external threats, and obtain significant financial support – investments from large financial corporations, banks and energy companies. That would increase the political role of the infrastructure and positively affect on the stability of the region.

As of today, resolving the aforementioned issues remains a distant aim. In spite of the support provided by the EU and the US to the countries of South Caucasus over the past years, there remain serious challenges with regards to the security of these countries, as well as the development of democracy and stability there. Joining the European Energy Community would be an important step for the transit countries of South Caucasus in this regard. However, these prospects will remain unachievable, unless an irreversible democratisation process is implemented in these countries, and unless the countries of South Caucasus that are participating in various energy projects strengthen their cooperation with the other participating members of the corridor, share the common European norms and standards of the energy market, thereby increasing the level of trust and cooperation between the sides, and protecting their national interests from the monopolistic aspirations of the other powerful player that is active in this region.