



საქართველოს სტრატეგიისა და საერთაშორისო ურთიერთობათა კვლევის ფონდი
GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

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**REGIONAL COOPERATION AND
THE FUTURE OF THE CASPIAN REGION**

GIORGI BADRIDZE

EXPERT OPINION



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The opportunities presented by the Caspian region¹ for European energy security have been underutilised since the South Caucasus and Central Asian countries gained independence in the early 1990s. One of the reasons was the existence of the Soviet era pipeline infrastructure that ensured that Central Asian gas could only be exported to Russia. Russia then would resell the gas to European consumers at its own price and with many political strings attached. Kazakh oil has also been exported almost exclusively through Russian pipelines and oil terminals.

Azerbaijan is so far the only country in the region that has managed to break the Russian monopoly and exports both oil and gas to Western markets through a direct route – the South Caucasus Energy Corridor. As a result, Azerbaijan can claim a much greater degree of political independence than any other Caspian nation.

As the European nations have finally come to the realisation that they cannot afford the dependence upon the Russian energy supplies and seek to diversify their imports, a new window of opportunity has opened for the energy-rich countries of the Caspian region.

This paper will argue that the Caspian region should play a significant role in the diversification of energy as well as transport routes on the continent and could contribute significantly to its energy security and economic growth. By doing so, the nations of the region would consolidate their own independence and security.

However, there is a precondition for this to materialise: the countries of the region must engage in economic and political cooperation. They must realise that they have a common interest in breaking out from the Russian dependency. The concerted efforts of regional players will ensure the political and economic benefits for all concerned. Otherwise, Central Asia and the Caspian Sea will slide back into what it was during the Soviet years – an isolated Russian backwater. It will be one of the greatest missed opportunities of the 21st century.

Background

For many centuries the Caspian region connected Eastern and Western civilisations by means of the Silk Road but faded as the Silk Road itself slid into history. Much later when oil and, later, natural gas started to fuel the world economy, the region's strategic importance started to make a dramatic comeback.

¹ Caspian region: the Central Asian countries in the east the Caspian Sea and the South Caucasus countries in the west.

Since the dawn of history the great powers have fought for domination over the wider Caspian region, an area at the very heart of the Eurasian continent and one of the largest crossroads in history. The Silk Road, which passed through the region, helped to develop interactions between Oriental and Western civilisations through the exchange of goods, ideas and technologies. As a result, both the East and the West changed in many certain ways.

The strategic geographic location of the Caspian region and, particularly, that of the South Caucasus as its Western gateway, turned it into a major battlefield between the regional powers. In the 19th century, the region was conquered by Russia, leaving the southern tip of the Caspian Sea to Iran. Soon after the Russian conquest, the dominant Western power of the time – Britain –needing to protect the Indian subcontinent from Russian ambitions, developed interests in Central Asia and the Caspian region, resulting in what became known as the Great Game.

By the end of the 19th century, technological progress gave the Caspian Sea a new dimension: oil products started to replace coal and acquired significant strategic importance. From the very first phase of oil exploration in Azerbaijan, oil was considered in the context of exports to the Western markets via the Georgian Black Sea coast.

In the 1870s, the Baku-Tbilisi-Batumi railway connected the Caspian region to the Black Sea, thereby securing more efficient access to the Western world. In 1896, construction of the world's longest pipeline between Baku and Batumi began and, once operational, this route delivered the first Azerbaijani oil products (kerosene to be precise) to international markets. The project was a result of multinational cooperation from the outset with the Nobels and the Rothchilds playing a significant role.

The First World War dramatically changed the geopolitical outlook of the region: the Russian Empire collapsed and the three South Caucasus countries on the western side of the Caspian region (Georgia, Azerbaijan and Armenia) declared their independence in May 1918 (after a brief experiment with confederation). The German expeditionary forces were placed by the British and for a short time it seemed as if the West had won direct access to the Caspian resources.

However, the independence of the three Caucasian states was short-lived: in 1920, the Red Army invaded Azerbaijan and Armenia. The following year, the Georgian Democratic Republic was also captured by the Russians and soon all three were annexed by the new reincarnation of the Russian Empire – the Soviet Union. The next 70 years turned the Caucasus, the Cas-

pian Sea and Central Asia into an isolated Soviet periphery. However, the Soviets continued to develop the Caspian oilfields and before long, natural gas exploration was also initiated. In the 1920s, a new oil pipeline was built between Baku and Batumi, this time serving the Batumi oil refinery as well as seeking to export to the international market.

Recent Past and Current Realities

After the dissolution of the Soviet Union, national borders and geopolitical fault lines shifted once again. The three Caucasian republics of Georgia, Armenia and Azerbaijan re-emerged as independent states, opening the Caspian region to the West.

However, the new era presented not only great opportunities but also huge challenges: Azerbaijan and Armenia clashed in the dispute over Karabakh. Georgia, the only non-Baltic republic which refused to join the CIS, was soon punished by Russia. Georgia's first democratically elected government was ousted after an armed coup while Moscow-friendly separatists in Abkhazia and South Ossetia received full Russian support. Russia sought to fuel regional conflicts in order to maintain its influence and expand its footprint in ways that presaged the current conflict in Ukraine.

While Russia's "divide and rule" approach significantly affected the region, the Russian-built road blocks failed to completely halt the region's cooperation with the West. While conflict with Azerbaijan left Armenia isolated from regional cooperation, with US leadership, Azerbaijan and Georgia collaborated to advance the infrastructure for delivering the Caspian energy to western markets. At the first stage, the Baku-Supsa early oil pipeline was built which served as a pilot project for what became known as the "Project of the Century" – the Baku-Tbilisi-Ceyhan (TBC) main oil pipeline. The Baku-Tbilisi-Erzurum natural gas pipeline soon followed.

It is difficult to overestimate the importance of these projects for the region. Not only did they jump-start Azerbaijan's economic development but, more importantly, they became a defining factor in reinforcing Azerbaijani and Georgian political independence.

The West has made multibillion investments in developing the Caspian oil and gas fields and with that has come huge political investments. Anyone involved in the process of multinational negotiations over the BTC pipeline knows all too well that without the hands-on political involvement of the US administration in the 1990s and throughout the entire planning and implementation process, the pipeline would never have been constructed. This is perhaps the most important (although not the only) reason behind

Russia's hostility. Russia still believes in its exclusive sphere of influence over the Caspian region, its self-declared 'near-abroad.' Apart from geopolitical motives, Russia is also driven by purely commercial interests; notably, in the hydrocarbon sector.

Moscow considers every barrel of oil and every thousand cubic meters of natural gas that bypasses the Russian pipeline system in its journey from the Caspian region to Western markets as lost revenue as well as lost political leverage to further manipulate the European energy market. The future of the entire region was seriously threatened in 2008 when Russian tanks rolled into Georgia in a blatant act of intimidation and aggression.

Under international pressure they were forced to retreat, but 20% of the country's territory remains occupied and consolidated under Russian control while the Kremlin continues to exert political and economic pressure upon Georgia. At this stage, Russia directs its efforts at creating obstacles to the region's economic and political cooperation with the West. In the recent past Russia objected only to its neighbours' aspirations for NATO membership; however, Russian leaders have already made it very clear that Eastern Partnership countries will be made to pay a hefty price for closer integration with the European Union.

While Ukraine resisted Russian pressures, Armenia recently succumbed to and joined the Russian-led Customs Union, scrapping the EU Association Agreement (along with the Deep and Comprehensive Free Trade Agreement).

Once Russia stops pursuing a zero sum game and reconciles itself to the independence of the former Soviet republics, (which seems highly unlikely under President Putin's leadership) it will realise that the benefits of having stable and prosperous neighbours will outweigh any gains made by undermining their security. Russia can still play a positive role in the Caspian energy projects. Russian companies have already been invited to join the international consortium that operates oil and gas fields in Azerbaijan. There is a possibility that Russia's own oil could be transported via the BTC if, as discussed by Russian and Azerbaijani officials, the Baku-Novorossiysk pipeline could be used for reverse flow, which is technically possible.

The Silk Road has never been a single channel for regional trade and within the Silk Road there have been many different routes. The modern role of the Caspian region will be to diversify, rather than replace, the existing transport and energy arteries. While Russia has no right to claim a monopoly over transportation of Caspian oil and gas to Western markets, a cooperative Russia should not be excluded from the benefits which such cooperation could generate.

In order to fully utilise their existing potential, the countries of the Caspian region must cooperate more closely. At this stage only Azerbaijan and Georgia (in conjunction with Turkey) can be described as strategic partners in the region. The other countries around the Caspian Sea have closer ties with Russia than with one another. If unaddressed, this lack of cooperation will prevent the development of the infrastructure that is required if the region is to maximise its geostrategic potential, located as it is between the world's economic giants, Europe and China. It also will forgo maximising the value of its hydrocarbon resources through proper access to European and global markets. The same problem will mean that all regional countries remain vulnerable to security threats and Russian pressure.

By joining the Russian-led Customs Union and putting up artificial barriers for trade with more developed partners, these countries have made a step toward self-isolation and a step backwards in their potential economic and social development.

Future Prospects

The region is strategically positioned to play an increasingly significant role in the globalising world through its natural resources and potentially through future transport infrastructure. But to realise this potential, it must change.

There are two fundamental realities that will determine the role and future prospects of the Caspian region: first, effectively harnessing its enormous energy resources and, second, its location half-way between two major drivers of the world economy – Europe and China. Energy demand will continue to grow both east and west of the Caspian. Thus, if the necessary infrastructure is developed, the region could attract a considerable share of the enormous volume of cargo transit generated by the trade between the Caspian region's eastern and western neighbours.

Energy Supplies

Disunity and dithering among the EU countries may have delayed the Nabucco project, which was meant to channel Middle Eastern and Caspian gas supplies to Europe through Turkey, but there has been a significant and very promising recent development: the Trans-Anatolian Pipeline (TANAP), delivering Azerbaijani natural gas to the South European countries when it joins with the Trans-Adriatic Pipeline (TAP). In the initial phase the project has relatively modest ambitions: only 10 bcm will be supplied to Italy (to put this in context, Russia annually supplies around 150 bcm to the EU).

According to some experts, the selection of the TAP as a partner project to the TANAP has sounded the death knell for Nabucco, but this may not necessarily be the case. Once the infrastructure is ready to carry large volumes of Caspian gas directly to the European market, the eastern Caspian states and, particularly, Turkmenistan will have to give much more serious consideration to the proposed Trans-Caspian Gas Pipeline (TCP) project which has fallen off the negotiating table. Turkmen gas has been supplying the European market for years via Russian pipelines and on Russian terms. With the TANAP, the prospect of Turkmen participation in the TCP project becomes more plausible.

Turkmen gas supplies via the TANAP could bring Nabucco back to life as the second phase of the project. Of course, if Europe remains passive, Turkmenistan will direct the larger share of its 17.7trillion cubic meters of proven gas reserves towards China or reach a new deal with Russia. Kazakhstan has been the most cautious of all the Central Asian countries in order not to irritate Russia through involvement in energy projects which do not have Moscow's approval.

However, there is a precedent for the transport of Kazakh oil via the Southern Energy Corridor. Since the 1990s, Chevron has sent modest amounts of oil from Kazakhstan over the Caspian Sea and then to the Georgian Black Sea coast by railway. Given the right political climate, there is a solid commercial rationale for Kazakh participation in the future trans-Caspian energy supplies. The same can be said about the "sleeping energy giant"—Uzbekistan, although this is probably a more remote prospect.

Road and Railway Transportation

As mentioned above, it is difficult to imagine a world that will not require a more advanced transport infrastructure. In the future, the Caspian region can regain its historic significance in connecting the East and the West. Of course, land transportation (road and railway) is no longer dominant but its importance should not be underestimated.

In terms of costs, lorries and even trains cannot compete with the giant container ships that carry the majority of goods between Europe and Asia. They are also slower than air transit but land transportation will always retain an important niche in the international transport system and its role will only increase with economic growth.

In the last decade, Turkey has notably developed its transport infrastructure and has created new opportunities for the closer integration of the South Caucasus and Caspian regions into European road and railway net-

works. It is expected that the project connecting the Turkish and Georgian railway systems will be completed by the end of 2014. The project will potentially enable rail transportation of goods between Western Europe and China via a shorter route than the Trans-Siberian railway. Again, this project does not have global ambitions and is not in any way an alternative to the “Trans-Sib.” What it could do, however – apart from giving Azerbaijan much needed rail access to Turkey and vice versa – is provide a new capacity for additional volumes of cargo and thus quite literally pave the way for economic growth both within the Caspian region and on the continent.

In addition to road and railway infrastructure, Azerbaijan is committed to creating an air transportation hub near Baku. The strategic location and unlimited supply of local fuel will significantly contribute to the success of the project.

Conclusion

The strategic geographic location and mineral wealth of the Caspian region has historically been both a blessing and a curse. While the existence of the vast energy resources and demand for the region’s transport infrastructure presents great opportunities, the lack of cooperation among the Caspian states leaves them vulnerable to outside manipulation and pressure.

The strategic cooperation by Azerbaijan and Georgia with their Western partners (and with each other) has provided the Caspian region with the shortest and the most reliable access to the West; in particular, the Turkish and European markets.

Europe’s need to cut its dependence upon Russia and diversify its energy supplies creates a historic opportunity for the countries of the Caspian region and this opportunity must be grasped with both hands because this window of opportunity will not be there for much longer. The competition is great and if the Central Asian nations do not act now, they will not only miss a chance to get a share in the world’s most prized European energy market but a prospect of insuring their real independence.

There is no simple way of doing this without angering Russia but if these countries care about their independence, this is their chance.

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