EXPERT OPINION

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SOUTH CAUCASUS ENERGY CORRIDOR: PERSPECTIVES AND CHALLENGES

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Foreword

The region of the South Caucasus started appearing on the global energy policy map in the 19th century. Since then, the South Caucasus energy corridor has been within the constant focus of energy resource importing countries as well as energy companies themselves. The importance of this region in supplying the world with energy resources was much greater in the second half of the 19th century and the beginning of the 20th century than it is now. The South Caucasus energy corridor, however, continues to retain its place in modern global energy policy.

Period of the Russian Empire: Oil Boom and the First Pipeline

In the 19th century, the Russian Empire was the main player in world energy policy, obtaining and transporting energy resources on the territories now belonging to Azerbaijan and Georgia which were under the control of the Russian Empire at that time. The Russian Empire started producing oil in 1879 when the famous Swedish entrepreneur brothers, Robert and Ludwig Nobel, built nine oil wells and refineries in Baku. At the initial stage, oil was being transported to the port of Astrakhan, through the Caspian Sea, using tankers.¹

At the end of the 19th century, transporting energy resources from the landlocked Caspian Sea to consumers was as much of an issue as it was at the end of the 20th century. The process of looking for new transport routes in order to overcome the existing geographic barriers ended in 1883 with the building of the first Caucasus rail line between Baku and Batumi with the funding of famous entrepreneurs, the Rothschild family. In 1906, the first pipeline with a length of 883 km, the so-called Kerosene Pipeline, was built parallel to the railway.²

During the period of the First World War and in its aftermath, the South Caucasus turned into a place of international confrontation aimed at obtaining influence over the production and transportation of oil. In 1918, a German military official, Erich Von Ludendorff, believed that the main reason for his country’s interest in gaining ground in the South Caucasus was to establish control over Azerbaijani oil and its transportation routes running through Georgia. At the end of the First World War, Great
Britain managed to get control of Baku. In 1919, the Foreign Secretary of Great Britain, Arthur Balfour, believed that establishing control over the production and exports of oil was a priority for British foreign policy. After the British left Baku, however, the Bolsheviks occupied it in April 1920.³

Soviet Period: Weakening of the Role of Azerbaijan

In 1941, Baku, which produced three-quarters of all Soviet oil, occupied a vital role in Stalin’s anti-German undertakings. After Hitler’s invasion of the Soviet Union’s territory, Baku once again became an important target for the Germans; however, Hitler failed to advance his army into the South Caucasus. Taking into account the danger facing Baku, Stalin moved the oil production industry and its specialists to the newly discovered Volga and Ural oilfields.⁴ As a result, at the period of declaring its independence, Azerbaijan used to produce just twelve million tons of oil per year which could not even ensure the full operation of the oil refineries situated in Azerbaijan.⁵

Post-Soviet Period: Weakening of Russian Influence

Contract of the Century

After the dissolution of the Soviet Union, Azerbaijan became a resource-rich state which greeted its first years of independence with a war over Nagorno-Karabakh with the also newly independent Armenia. The war was having a catastrophic influence on the economy of Azerbaijan and the country’s political elite believed that the only way for reviving the economy would be to develop oil production. The main precondition for this development, however, was stopping the war and attracting investments, mainly from Western countries. The three off shore oil fields (Azeri-Chirag-Gunashli) on Azerbaijani territory, discovered by Soviet researchers back in the day, had a deposit of about five billion barrels of oil.⁶

The initial attempts of the leaders of Post-Soviet Azerbaijan to turn the development of Caspian Sea resources into a significant source of income for the country met with resistance from Russia. The second President of independent Azerbaijan, Abulfaz Elchibey, became the victim of a coup d’état just 12 days after signing a declaration with a consortium of
foreign oil companies. Elchibey was replaced by the former First Secretary of the Communist Party of Azerbaijan, Heydar Aliyev. On 20 September 1994, Aliyev’s government signed a contract for the development of Azeri-Chirag-Gunashli oil fields, calling it the “contract of the century.”

The oil strategy formulated during Aliyev’s power consisted of several directions: attracting foreign investments, turning Azerbaijan into the main oil-exporting country in the region as well as a strategically important natural gas supplier for neighboring countries and for the whole of Europe in a longer-term perspective and becoming an important transit country for Central Asian natural resources in an also longer-term perspective. Aliyev’s strategy also aimed to turn Azerbaijan into an energy self-sufficient country.

Aliyev’s energy policy got significant support from the United States of America. In October 1995, the President of the United States, Bill Clinton, sent a letter to Aliyev which was personally delivered to Baku by the former Secretary of the National Security Council, Zbigniew Brzezinski. In the letter, Washington expressed the US government’s support towards the issue of building the Baku-Supsa pipeline.

*Early Oil Transportation*

At the end of the 20th century, much like its beginning, the issue of transporting Azerbaijani oil to Western markets became relevant once again, fueling a new wave of confrontation in the region. Transportation by railway would be slow and expensive. In this case, using pipelines as a means of transportation would have no real alternative. Part of the shareholders of the newly created Azerbaijan International Operating Company (AIOC) and Russia demanded the transportation of Azerbaijani oil to the port of Novorossiysk through the territory of the Russian Federation. The United States only agreed that the so-called early oil would pass through Russian territory. In September 1995, the AIOC consortium and the government of Azerbaijan agreed on two various pipelines: the Northern Route Export Pipeline (Baku-Novorossiysk Pipeline) opened in 1997 and the 830 km Western Route Export Pipeline (Baku-Supsa Pipeline) which was finished in 1998. Despite the fact that the transport capacity of both of these pipelines is quite low (about 100 thousand barrels per day in the case of the Baku-Supsa Pipeline and 150 thousand barrels per day for the Baku-
Novorossiysk Pipeline), their construction was still a sensible decision for exporting Azerbaijan’s so-called early oil before the exploitation of larger Azerbaijani oilfields and the exports of much higher volumes of oil started.\textsuperscript{11}

\textit{Main Oil Transportation}

In 1998, after determining the routes for the early transportation, the main decision that the Western consortium needed to make was which would be the main route for the transportation and exports of larger quantities of oil from the main Azeri-Chirag-Gunashli oilfield. This is where the government of the United States became more actively involved. The importance of the Caspian region in United States foreign policy was underlined by the creation of a specialized position – Special Advisor to the President and Secretary of State for Caspian Basin Energy Diplomacy. The Advisor was tasked with mobilizing the Western actors involved in producing Caspian energy resources in order to support Washington’s position. An experienced diplomat, Richard Morningstar, was selected for the position of the Advisor. Morningstar took to his new job energetically, supporting the construction of the Baku-Tbilisi-Ceyhan export pipeline with the backing from Washington. This idea was first voiced by the Turkish side which was opposed to the idea of oil-loaded tankers passing through the Bosporus due to ecological considerations.\textsuperscript{12} In 1994, about 1.5 million barrels of oil per day used to pass through the Bosporus, carried by tankers. This number had further increased by 2003 and reached 2.8 million barrels per day. This was a direct threat to Istanbul, overlooking the Bosporus and home to millions of people. Several alarming events had already taken place due to the narrowness of the strait and incorrect maneuvers of the tankers.\textsuperscript{13}

Apart from the Clinton administration’s declared support to the alternative pipeline system, the cornerstone of Washington’s new Caspian basin policy was to exclude the participation of Russia and Iran in the transportation of Caspian energy resources. Washington believed that removing these two countries from regional pipeline politics would be the main pre-condition for reducing their influence on the newly independent states (Azerbaijan and Georgia).\textsuperscript{14}

Not only economic factors were dominant while selecting the Baku-Tbilisi-Ceyhan route but the political context was taken into account as
well. Making the decision using economic considerations only would have reduced the chances of Georgia and Turkey becoming transit states. Based upon an already existing extensive pipeline network and its access to the European market, the Russian route was considered to be the cheapest option. Apart from Russia, the Iranian route was also considered as economically satisfactory while the Georgia-Turkey route was the most expensive option. Despite the fact that using the Russian route would make the most sense economically, constructing another pipeline going to Western Europe through Russia would have given Russia too much control, having serious influence on the security of supply. The Iranian route was excluded due to the bad relations between the United States and Iran. As a result, the best remaining option for the Baku-Ceyhan project was the Georgia-Turkey route.\textsuperscript{15}

Russia considered any pipeline project bypassing Russian territory as a direct threat to its own pipeline system. The Kremlin considered this to be an issue of national security, given that according to Moscow’s assessment, the new pipeline, going to Turkey’s Mediterranean port of Ceyhan through Georgia, would undermine Russia’s monopoly on the exports of Caspian resources to Western markets. In 2002, Russia claimed that the Baku-Tbilisi-Ceyhan pipeline would be commercially unprofitable as Azerbaijan did not have sufficient oil reserves and would be unable to fully load the pipeline. According to Moscow, the aim of the project was “Russia’s expulsion from the region where it had historical and legitimate interests.”\textsuperscript{16}

At the initial stage, the Baku-Tbilisi-Ceyhan project also met resistance from the companies participating in the consortium due to the relatively high costs of the project. Despite Washington’s position, the companies were skeptical towards the implementation of the proposed project and during one of the meetings at the White House during the Clinton administration, they refused to participate in the project. In 1998, due to the low prices of oil and the high costs of the project, increasing the capacity of the Baku-Supsa Pipeline was also being considered as an alternative option. However, the situation changed in 1999 when the main player of Azerbaijan’s oil politics, British Petroleum (BP), merged with the US oil company, Amoco. In October 1999, the newly merged company not only supported the implementation of the Baku-Tbilisi-Ceyhan pipeline project but started taking on the leading role as well. The representative
of the company stated that they had arrived at the conclusion that the Baku-Tbilisi-Ceyhan pipeline was a strategically important transport route whose building would be vitally important.\textsuperscript{17}

Owing to Washington’s active energy diplomacy, the construction of the pipeline started in September 2002 with a ceremony held at the Baku Sangachal Terminal where President Aliyev pointed out that the implementation of the project would ensure the peace, security and stability of the region, further uniting the three countries and nations participating in it.\textsuperscript{18} The inauguration of the 1,768 km pipeline\textsuperscript{19} took place in July 2006 at the Turkish port of Ceyhan. Despite the fact that the Baku-Supsa Pipeline had already been functioning before, Azerbaijan firmly regained its place on the world energy resources map with the inauguration of this new pipeline.\textsuperscript{20}

The implementation of successful oil pipeline projects in the South Caucasus energy corridor also predetermined the export route for Azerbaijan’s Shah Deniz natural gas field. A new 692 km gas pipeline, the South Caucasus Pipeline (Baku-Tbilisi-Erzurum),\textsuperscript{21} was built alongside the Baku-Tbilisi-Ceyhan Pipeline. The exploitation of the pipeline started in 2006. The selection of the Turkish route for the gas pipeline was due to Turkey’s internal market and its ability to adequately pay for the received gas as well as to the support from Georgia and its willingness to become a transit country. Other options for this project (Russia, Iran and Armenia) were unacceptable due to either economic or political reasons.\textsuperscript{22}

**Development of the Southern Gas Corridor**

The South Caucasus energy corridor perspective is mainly determined by the position of the European states on the development of alternative sources and routes. The idea of constructing alternative pipelines, which envisaged the transportation of natural gas from the Caspian basin and parts of the Middle East through Turkey towards Europe, appeared in Europe in the 1990s. The most probable suppliers of natural gas from the Caspian basin would be Azerbaijan and Turkmenistan while this role would be assumed by Iraqi Kurdistan territory from the Middle East. The discussions became more active in 2008 and the term ‘Southern Gas Corridor’ appeared. This term is used by the European Commission to describe the planned
infrastructural projects which will ensure the transportation of Caspian and Middle Eastern gas resources to Europe, thereby increasing energy supply security.

An agreement about the transportation of natural gas resources from Turkmenistan could not be reached. At the same time, the issue of constructing the Trans-Caspian Pipeline was also left unresolved due to the uncertainties generated by the political and legal status of the Caspian Sea. In addition, the 2008-2009 economic crisis put the necessity of a new energy corridor under question. However, ultimately it was still decided to enact a more toned-down version of the corridor, ensuring the transportation of gas towards Europe from the second stage of development of the Shah Deniz gas field.²³

After several years of negotiations involving Western companies, it was decided to build a new natural gas exporting pipeline in order to transport gas from the second stage of the Shah Deniz gas field development. It was also decided that this pipeline would pass through the Southern Gas Corridor. The new pipeline project consists of three important components: South Caucasus Pipeline expansion project (SCPx), the Trans-Anatolian Pipeline (TANAP)²⁴ and the Trans-Adriatic Pipeline (TAP).²⁵ The new pipelines will run through Turkey and Greece, delivering Azerbaijani gas straight to Europe (Italy). The new project will expand the existing capacity of the South Caucasus Pipeline performance system which is currently at about seven billion cubic meters per year, increasing it to enable the exports of an additional 16 billion cubic meters per year to the Georgia-Turkey border.²⁶

**Profitability of the South Caucasus Energy Corridor for Georgia**

The construction of transit pipelines on the territory of Georgia gave it an additional political weight in international energy politics and had a decisive influence on the country’s energy-independence. The most important development here is that Georgia’s dependence on Russian natural gas ended from 2007.

In the case of the Baku-Supsa and Baku-Tbilisi-Ceyhan pipelines, Georgia only plays the role of a transit state and obtains revenues from the transit during the periods of the operation of the pipelines. The revenues from
operating oil pipelines, consisting of profit tax and tariff taxes, reached USD 36.4 million in 2014. In addition, Georgia also profits from this indirectly, more specifically owing to the fact that Georgian citizens are employed in the project as well as the fact that the pipeline operating company has millions of dollars of operating and capital expenses, employing numerous local companies for the provision of various services.\textsuperscript{27}

In the case of the South Caucasus Pipeline, Georgia gets 5\% of the transported gas as a transit payment and can buy an additional 0.5 billion cubic meters for a discounted price. The profit for Georgia from the South Caucasus Pipeline expansion project is quite impressive as well. About USD 2 billion will be invested in the country in terms of this project, up to 20\% of the planned investments (USD 400 million) will be spent on purchasing goods and services from local suppliers, about 2,000 workplaces will be created at the peak of the construction process and, finally, according to the agreement with the government of the country owning the territory, Georgia will receive 5\% of the natural gas passing through the expanded pipeline.\textsuperscript{28}

\textbf{Perspectives for Development of the South Caucasus Energy Corridor}

The development of the energy corridor in the South Caucasus can be facilitated by both economic as well as political factors.

\textit{Export of Azerbaijani Oil Resources}

There was a great deal of hopes for Caspian energy resources in the 1990s and the region was sometimes called the ‘second Persian Gulf’ or the ‘new Texas.’ The Caspian energy resource deposit\textsuperscript{29} cannot directly compete with other energy resource-rich regions and is not in the position to have decisive influence on the world market; however, it should be pointed out that Azerbaijani oil is of an especially high quality and hence it can have certain influence on oil prices. Despite the fact that the Caspian basin resources cannot compare (in quantities) with those of the Middle East and also being more expensive to produce than the Middle Eastern resources, Caspian resources are quite enough for the companies to develop profit and the countries of the region to have a stable income.\textsuperscript{30}
Export of Azerbaijani Gas Resources

For the development of the energy corridor in the South Caucasus, it is vital to transport enough amounts of natural gas. At this stage, the production of natural gas in Azerbaijan depends on one gigantic gas field, Shah Deniz, which, as of today, produces over nine billion cubic meters of natural gas per year. In the second stage of production, it will produce an additional 16 billion cubic meters per year. In the future, apart from the Shah Deniz Stage Two project, the Southern Gas Corridor could also be supplied from other projects currently being developed in Azerbaijan. In 2020, the production of natural gas in Azerbaijan could be expanded even further through additional gas resources from several off shore gas fields. In Azerbaijan, they believe that they will be able to produce a total of 40-45 billion cubic meters of natural gas per year by 2025 whose consumers will be Azerbaijan itself, Georgia and other European countries.\(^{31}\)

Export of Caspian Basin Resources

Apart from the Azerbaijani gas resources, the development of the Southern Gas Corridor as well as that of the more general South Caucasus energy corridor will also depend on the transportation of Turkmen gas resources. Talks about transporting Turkmen gas resources to Europe through the Trans-Caspian Pipeline have been going on for a long time. However, the uncertain status of the Caspian Sea and the resistance from Russia and Iran hinder the implementation of this project. Negotiations on the transportation of Turkmen natural gas resources to Europe through the South Caucasus were also held during the visit of the President of Turkmenistan to Georgia.\(^{32}\) The implementation of the project in the short-term perspective is unlikely; however, in a longer-term perspective and in the case of a changing political environment, the implementation could become more plausible.

Russia-Ukraine Confrontation

The confrontation between Russia and Ukraine is an additional facilitating factor for the development of the South Caucasus energy corridor. The so-called energy wars between Russia and Ukraine in 2006 and 2009 further hastened the plans for developing alternative supply routes to Europe. The confrontation between the two countries endangered the transportation
of Russian gas through Ukraine to Europe. Given the unreliability of the Ukrainian route and the desire to reduce dependency on the Russian Federation, the development of the Southern Gas Corridor became one of the top priorities for Europe.

**Challenges to the Development of the South Caucasus Energy Corridor**

The possible barriers to the development of an energy corridor in the South Caucasus are closely linked with economic as well as security issues.

*Amount and Price of Azerbaijani Gas*

The lack of production of the amount of natural gas necessary for adequate exports from Azerbaijan (without exploiting additional gas fields) and the low competitiveness of Azerbaijani gas given the current prices could become a challenge for the development of the South Caucasus energy corridor. The price of Azerbaijani natural gas, which is determined by the costs of production in off-shore areas and transportation over long distances, will be in constant competition with the natural gas resources of lower net worth produced by other countries.\(^{33}\)

*Alternative Routes for Turkmen Gas*

A decisive factor for the further development of the South Caucasus energy corridor will be the transportation of Turkmen natural gas apart from natural gas from Azerbaijan. In this sense, Turkmenistan’s export policies, given the insufficient support from the West towards the Trans-Caspian route project and the confrontation from Russia and Iran, has been oriented more on China which makes the possibility of Turkmen natural gas exports towards Europe unlikely in the nearest future. Turkmenistan also plans the implementation of an ambitious Trans-Afghanistan Pipeline (TAPI) project whose construction started on the territory of Turkmenistan in 2015.\(^{34}\)

*Threat of Terrorism*

Another challenge for the proper functioning of the South Caucasus energy corridor is the threat of terrorism in the transit states. In this sense, the Turkish part is the most vulnerable. As a result of the explosion at
the locking station in the country’s Erzincan province on 6 August 2008, the operation of the Baku-Tbilisi-Ceyhan Pipeline was halted for 19 days. Bloomberg provided interesting insights about the explosion in 2014, basing its presumption on the conversations with former and acting US intelligence workers, saying that the explosion was operated from a distance and that the organizers were connected to Russia.\textsuperscript{35} Explosions on the Turkish part of the South Caucasus Pipeline in the Karsi province also took place on 4 August and 25 August 2015. According to the Turkish government, the explosions were organized by the Kurdistan Workers’ Party (PKK) and were not caused by mere technical reasons.\textsuperscript{36}

\textit{Russian Aggression}

During the August 2008 war between Russia and Georgia, several bombs fell in the Kvemo Kartli region of Georgia, near the pipeline. The Baku-Supsa Pipeline was shut down on 12 August 2008. The Baku-Tbilisi-Ceyhan Pipeline, on the other hand, had already been shut down due to the explosion in Turkey on 6 August 2008.\textsuperscript{37} As a result of the Russia-Georgia war, a small part of the Baku-Supsa Pipeline (1,605 meters) ended up on the territory of de facto South Ossetia. To date, there have been no problems with the operation of the pipeline and it continues working in a normal regime. According to a representative of the Government of Georgia, Georgia has an alternative plan for bypassing this part of the pipeline altogether which will be implemented immediately should any problems occur with the operation of the pipeline.\textsuperscript{38}

\textit{Nagorno-Karabakh Conflict}

The closest the Nagorno-Karabakh conflict ceasefire line comes to the pipeline is 13 kilometers. Even though this has not yet happened, it is possible that in the case of the reinvigoration of the conflict, Armenia will target the block valve station which is above the ground or attack other energy infrastructure objects. Despite the fact that such a step would be politically devastating for Armenia itself, they still could use this as an instrument of war in the case of an extreme level of confrontation.\textsuperscript{39} Recently, during the so-called 4-day War (2-5 April 2016), Armenia directed its threats towards the pipelines as well. More specifically, the de facto Minister of Defense of Nagorno-Karabakh stated that they would attack Azerbaijan’s energy infrastructure.
Conclusion

• In terms of worldwide energy resource transportation, the South Caucasus energy corridor assumes a modest place. However, the geopolitical factors formed over the past couple of years have earned the region a measure of political support in the West. The reduction of the dependence on Russian energy resources and the Ukraine transit route have become top priorities for Europe’s energy policy. The ongoing construction of the pipeline in the South Caucasus in terms of the development of the Southern Gas Corridor is the result of the implementation of this specific policy, creating the opportunity for transporting Caspian basin resources directly to Europe for the first time in history. Despite the fact that the share of Azerbaijan in supplying Europe with energy resources will be low for the upcoming years, the imports of Azerbaijani resources and the general issue of the South Caucasus energy corridor will maintain importance for the West given that they ensure the reduction of the level of dependence on Russia.

• Western energy policy is a contributing factor towards the development of the South Caucasus energy corridor which, in its own right, ensures the energy independence and stability of Azerbaijan and Georgia. The political decision made by the United States of America back in the 1990s to develop a transit route through Azerbaijan, Georgia and Turkey, completely bypassing Russia and Iran, has already brought positive results for these three countries. Primarily, it has strengthened the energy independence of these post-Soviet countries (Azerbaijan and Georgia), lowering the level of political and economic dependence on Russia. Despite the security risks existing in the region, the South Caucasus energy corridor has been successfully transporting energy resources towards the West for years. This creates further perspectives for the implementation of new projects and future development for the energy corridor. For the realization of this perspective, however, it will be of vital importance for the Trans-Caspian pipeline projects to have active political and financial support from the United States, the European Union and some of its member states as well.

**Keywords:** Azerbaijan, Georgia, Russia, Turkey, USA, Western Route Export Pipeline (WREP), Baku-Tbilisi-Ceyhan Pipeline (BTC), South Caucasus Pipeline (SCP), South Caucasus Pipeline expansion project (SCPx), Southern Gas Corridor, South Caucasus energy corridor.
7. Rafael Kandiyoti, *Pipelines: Flowing Oil and Crude Politics* ... pp. 158-159.
10. Detailed information about the project may be found here: www.on.bp.com/2mc2H2e.
19. Detailed information about the project may be found here: www.on.bp.com/2mXUr65.
20. Rafael Kandiyoti, *Pipelines: Flowing Oil and Crude Politics* ... p. 171.
21. Detailed information about the project may be found here: www.on.bp.com/2n6XKqz.
22. Ekpen James Omonbude, *Cross-Border Oil and Gas Pipelines and the Role of the Transit Country: Economic, Challenge and Solutions* ... pp. 81-82.

24. Detailed information about the Trans-Anatolian Pipeline Project may be found here: www.tanap.com.

25. Detailed information about the Trans-Adriatic Pipeline Project may be found here: www.tap-ag.com.


28. BP Georgia website: www.on.bp.com/2n6XKqz.

29. According to the existing data, the share of the Azerbaijani oil and gas resources in the overall resources in the world is less than 1%. In this sense, Turkmenistan’s natural gas deposits are more interesting as they make up about 9.4% of the overall world natural gas resource deposits. “BP Statistical Review of World Energy,” June 2016, 6, 20, www.on.bp.com/2bSW4Mf (Accessed 19 March 2017).

30. Rafael Kandiyoti, *Pipelines: Flowing Oil and Crude Politics* ... pp. 166-168.


