

## Energy Security Aftermath of Russo-Georgian War: Implications for South Caucasus

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*Since the collapse of the Soviet Union, the Caspian Sea and South Caucasus has become the focus of considerable international attention, primary because it is one of the oldest and potentially richest oil and gas producing areas in the world. The August 2008 Russian invasion of Georgia and the unilateral recognition of the independence of Abkhazia and South Ossetia fundamentally changed the situation in the region. The war has created a new strategic situation.*

*And the question is now how to handle this delicate situation in a strategically and geopolitically important region. So by controlling Georgia (in case Russia reaches abovementioned aims), Russia actually will be able to cut off Central Asia and Caspian resources. It means Russia would be able to isolate and cut off Azerbaijan and Central Asian countries and it will significantly strengthen its energy monopoly over Europe with all results out coming from that fact. So it's about a major shift in the energy policy and a major shift in geopolitics based on this energy policy and Russian energy monopoly. The August war in Georgia demonstrated some risks associated with the functioning of the transit energy corridor in the southern Caucasus. It also demonstrated the need for broader security guarantees for a region that is vital to European and global energy security. This paper deals with economic damage inflicted by the Russo-Georgian war in South Caucasus and its implications for regional security.*

## ენერგო უსაფრთხოების საკითხები რუსულ-ქართული ომის შემდეგ და მისი მნიშვნელობა სამხრეთ კავკასიის რეგიონალური სტაბილურობისთვის

კორნელი კაკაჩია

პოლიტიკის მეცნიერებათა დოქტორი

**ს**აბჭოთა კავშირის დაშლის შემდეგ კასპიის ზღვა და სამხრეთ კავკასია საერთაშორისო საზოგადოების ყურადღების ცენტრში მოექცა. ამ ყურადღების ერთ-ერთი ძირითადი მიზეზი კი ისაა, რომ რეგიონი გლობალური მასშტაბებით უმდიდრესი ნავთობისა და გაზის მოპოვების წყაროა. 2008 წელს რუსეთის აგრესიამ საქართველოში და აფხაზეთისა და სამხრეთ ოსეთის დამოუკიდებლობის ცალმხრივად აღარებამ რეგიონის მდგომარეობა ძირფესვიანად შეცვალა უარესობისკენ. ომმა შექმნა ახალი სტრატეგიული სიტუაცია, რომელიც მოითხოვს დროულ გადაწყვეტას. საქართველოს დასუსტებით (იმ შემთხვევაში თუკი რუსეთი მიაღწევს ზემოთხსენებულ მიზნებს) რუსეთი ფაქტობრივად შეძლებს ცენტრალური აზიისა და კასპიის რესურსების მონიპოლიზირებას. ეს კი თავისთავად იმის ნიშანია, რომ რუსეთი იზოლაციაში მოაქცევს აზერბაიჯანსა და ცენტრალური აზიის ქვეყნებს და ამით შეძლებს ევროპაში თავისი ენერგო მონოპოლიის მნიშვნელოვან გაძლიერებას. 2008 წლის აგვისტოს ომმა საქართველოში გამოააშკარაა ის საფრთხეები, რომლებიც სამხრეთ კავკასიაში ტრანზიტული ენერგო კორიდორის არსებობას უკავშირდება. ომმა ასევე ცხადყო უფრო ძლიერი უსაფრთხოების გარანტიების აუცილებლობა რეგიონისათვის, რომელიც სასიცოცხლო მნიშვნელობისაა ევროპისა და გლობალური ენერგო უსაფრთხოებისათვის. ნაშრომში ასევე განხილულია ის ეკონომიკური ზიანი, რომელიც რუსეთ-საქართველოს ომმა სამხრეთ კავკასიას მიაყენა და გაანალიზირებულია ამ ომის შედეგად გამოწვეული რეგიონული უსაფრთხოების პრობლემები.

Since the industrial revolution the geopolitics of energy – who supplies it, and securing reliable access to those supplies – have been a driving factor in global prosperity and security. Over the coming decades, energy politics will determine the survival of the planet. The political nature of energy, linked to the sources of supply and demand, comes to public attention at moments of crisis, particularly when unstable oil markets drive up prices and politicians hear constituent protests (Pascual, 2008).

Since the collapse of the Soviet Union, the Caspian Sea and South Caucasus region has become the focus of considerable international attention, primarily because it is one of the oldest and potentially richest oil and gas producing areas in the world. Surrounded by the three regional powers - Iran, Russia, and Turkey - and located on the crossroads of Europe and Asia, the South Caucasus has also been at the center of post-cold war geopolitical rivalries.

To a considerable extent, the significant oil and gas reserves in the Caspian Sea, specifically in the Azerbaijani sector, have also amplified regional rivalries for political and economic influence in the region. Despite physical isolation, the region sits at the very heart of one of the world's geopolitically most significant and sensitive areas. Thus, a large number of world powers see the resources as important, making the South Caucasus the subject of a second "great game."

The August 2008 Russian invasion of Georgia and the unilateral recognition of the independence of Abkhazia and South Ossetia fundamentally changed the situation in the region. The war has created a new strategic situation. By sending forces over its borders for the first time since the 1979–89 Soviet–Afghan War and forcibly redefining the border with Georgia, Moscow has aroused concern among other newly independent countries about its future intentions.

Whereas invasion of Georgia was justly seen as part of Moscow's plan to reassemble its former empire or at least exert enough control of its border to deny Western access to critical energy supplies without the Kremlin's approval, the invasion was in part a reaction to the expansion of NATO to the borders of Russia proper along with consideration for membership of both Georgia and Ukraine. One of the Russian targets in Georgia was the pipeline carrying oil from the Caspian Sea to the West

### *Economic Damage of Russo- Georgian War*

The five-day clash between Russian and Georgian forces in August inflicted serious damage on Georgia's economy both in casualties and in wors-

ening the prospects for development and investment. The material damage has initially been estimated at some 1 billion dollars or about 8% of forecast 2008 GDP. The damage was mainly confined to military targets — bases, military airfields, anti-aircraft systems. There was no great damage to civilian targets, including industrial or agricultural assets, with the factory producing military aircraft in Tbilisi a rare exception.

Major communications routes have remained mostly intact. The only exception here was the blowing up by Russian soldiers of a railway bridge 40 kilometers east of Tbilisi on August 16, after the ceasefire. This disrupted rail communication between eastern and western parts of the country, causing problems not only for Georgia, but also for Azerbaijan and Armenia, for which this railway is an important route. Georgia suffered lost revenue from the confrontation: In 2007 Baku-Tbilisi-Cheihan fees generated \$25.4 million in transit revenues, and before hostilities erupted Saakashvili's government had estimated BTC transit payments for 2008 at about \$45 million.

In addition seeking an alternative route, British Petroleum switched to the recently reopened 550-mile, 140,000-bpd Western Route Export Pipeline, better known as the Baku-Supsa line, which opened in 1999 and was running at about 90,000 british pound. Because of the worsening military conflict, on August 12 BP announced that it was suspending shipments through Baku-Supsa, as well as the South Caucasus Pipeline, which transports natural gas from Baku to Turkey via Tbilisi.

Completing the lock-in of Azeri oil exports, the fighting caused authorities to suspend seaborne shipments from Georgia's Black Sea ports of Batumi (200,000 bpd) and Poti (100,000 bpd), both supplied by rail. Poti was closed Aug. 8 following reported Russian airstrikes. Adding to the grim picture, authorities also ceased exports from Kulevi, Georgia's third Black Sea oil terminus, which opened in 2007 and is capable of shipping 200,000 bpd.

But probably the most painful loss for Georgia was the damage to its reputation as a safe venue for investment and a secure corridor for fuel transportation. As early as May, 2008 Standard and Poor's lowered its outlook for the sovereign credit rating of the government of Georgia from 'positive' to 'stable', explaining it by the deterioration in relations with Russia and the reinforcement of Russian forces in the separatist regions of Abkhazia and South Ossetia ("S&p revises georgia's," 2008). During the August war, the agency expressed concern that investors may become even more cautious in making investment decisions in Georgia ("Georgia: war costs," 2008). In particular, the future of the EU's Nabucco gas pipeline project for supplying EU member states with gas from Azerbaijan and Central Asia may have been endangered.

Added to these concerns is the growing risk associated ~~to~~ with infrastructure investments in Southern Caucasus in the aftermath of the war. Al-

though Russian bombers did not target any energy facilities, the coincidence of an explosion in the Turkish section of the BTC close to the Georgian border a few days prior to the military operations raised some concern about the possible targeting of the pipelines (Coskun , & Yevgrashina, 2008). The war also demonstrated that the Western guarantees for Georgia lacked substance, and the integrity of the oil and gas corridor depended simply on Russian good will (Blagov , 2008).

A clear sign of this came from the BP decision to temporarily stop the oil flows through Georgia to divert part of them through the Russian facilities, while Kazakh Prime Minister Karim Masimov ordered KazMunajGaz to study whether the domestic market could absorb the exports envisaged for transit via Georgia. Even the Azerbaijani company SOCAR re-directed a portion of its exports, normally sent through the Georgian terminal of Kulevi, towards the Iranian port of Neka during August and September 2008 (IEA, 2008).

The military confrontation inflicted significant fiscal “collateral damage” on Azeri oil exports, as all its westward export routes were closed. The war did not spill across the border into Azerbaijan, but its economic repercussions have. Foreign investment has been imperiled by the geopolitical instability laid bare by the brief war and the continuing uncertainty about the present peace (Ismailzade, 2008). For Azerbaijan the conflict was an unmitigated financial disaster, as the country’s oil sector receipts account for almost half of all government revenues, with oil exports generating around 90 percent of total export revenues. Between the BTC explosion and the military clash, Azerbaijan had been blocked from shipping approximately 17 million barrels of crude, while the U.S. Department of Energy estimated that Azerbaijan’s final cost for the lost shipments surpassed \$1 billion.

The Baku-Tbilisi-Ceyhan and Baku-Supsa oil pipelines and Baku-Tbilisi-Erzurum gas pipeline, as well as the Azeri state oil company’s recent purchase of the Kulevi oil terminal on the Black Sea, had begun to enhance the importance of the region as a major East-West energy corridor. Azerbaijan and Georgia have agreed, in partnership with Turkey, to build the Baku-Akhalkalaki-Kars railway, connecting the rail systems of the three countries. The project would create a much shorter and faster rail corridor between Europe and Asia than the current one through Russia, making Georgia and Azerbaijan the key hubs for the Eurasian transport network. However, the war has shrouded the future of these achievements in doubt and undermined the Azeri grand vision of turning the south Caucasus into the primary transit hub to central Asia. The conflict froze the operations of the East-West energy corridor.

On Aug. 5, 2008, two days before the outbreak of hostilities between Georgia and Russia, there was an as yet unexplained explosion on the BTC segment at Yurtbasi village in eastern Turkey. The cause of the explosion re-

mains unclear, although Ankara initially suspected that it might have been a terrorist attack by the Kurdish separatist Partiya Karkeren Kurdistan, or Kurdistan Workers' Party. BTC operator BP declared force majeure, and the pipeline only resumed operations on August. 25.

Following this unrelated attack on the Baku-Tbilisi-Ceyhan pipeline in Turkey, the violence brought air and rail traffic to a sudden halt, closed the Kulevi port of Georgia and forced the evacuation of Azeri personnel. As a result, Azerbaijan and its Western oil company partners were forced to suspend operations in the Caspian oil and gas fields and energy contracts had to be re-negotiated. Kazakhstan has backed off the plan to build a \$1 billion oil refinery in Batumi, a \$10 million grain terminal in Poti, and to export oil products and other goods through the territory of Georgia. The export of Turkmen gas through the south Caucasus has been similarly affected.

The Georgia-Russia war has placed Armenia, which is hemmed in on all sides by closed borders with Azerbaijan and Turkey, in a bind as well. The war, and its complicated aftermath, has thus inflicted a considerable amount of damage on the Armenian economy. One of the consequences of this action was that some 107 train cars of wheat, 10 fuel containers and 50 additional train cars with miscellaneous goods were left in limbo. The unloading of ships with goods meant for Armenia reportedly resumed only on September 1, according to the information of Armenian government ("Translations from Yerevan Newspapers", 2008).

The delays were stoking concern about a possible wheat shortage in Yerevan. Armenian companies were attempting to import the wheat via Iran. Gasoline has been another problem. Until late August, many gas stations country-wide posted "No gas" notices. Although the government declared that gas reserves were sufficient to withstand a temporary shortfall, drivers who were forced to wait in long lines to buy gas scoffed at the assurances.

The stand-off has reminded Armenians that their country's economy is too dependent on Georgia for its own good. Only in August last year, when the war interrupted Armenia's export trade, the country lost 600-700 million US dollars ("Russia-georgia tensions harm," 2009). At the moment, 70-80 per cent of Armenian exports travel to Russia, leaving the Georgian port of Poti for Bulgaria, then shipped to Novorossiisk on Russia's southern coast. The whole journey can take eight or ten days, whereas the road through the mountains and Upper Lars is relatively quick. This quickly drove Yerevan to intensify its dialogue with Turkey over prospects for opening their common border that has been closed for decades, and, like Belarus, to join the EU's Eastern Partnership.

While the consequences of the conflict will be felt for a long time throughout the region, the balance of power in the Caucasus has shifted.

Relations between Armenia and Azerbaijan have been influenced and the conflict might also have an impact on the Nagorno-Karabakh conflict. Armenia was left with no military ground transit from Russia, and the country is now essentially cut off from any possibility of obtaining effective help from its ally and has decided to respond quickly to Turkey's proposal to normalize relations and open the border. The very idea that Turkey would go through with the border talks without attaching any conditions on Karabakh has provoked anger in Azerbaijan, especially since Turkey sealed the border in 1993 in response to the Armenian occupation of the regions, a reality which has clearly not changed.

Due to this delicate issues significant challenge for regional security issues is ongoing Armenian-Turkish rapprochement, which could considerably change security environment in South Caucasus. On October 10, 2009 the Foreign Ministers of Turkey and Armenia met in Zurich and signed accords aimed at establishing diplomatic relations and opening their closed border. They also agreed to a series of consultations and confidence-building measures to resolve longstanding disputes and foster closer cooperation. These protocols still need to be ratified in Ankara and Yerevan, and implementation is very far from certain. But these new accords - finalized after some critical last-minute diplomacy by U.S. Secretary of State Hillary Clinton - could prove transforming for regional stability around the South Caucasus and beyond.

#### *Geopolitical interest of Regional players and balance of Power*

The European Union has long sought alternate supply routes, including the prospective Nabucco pipeline that would carry Caspian and Central Asian gas to Europe but skirt Russia. The EU also risks continued energy dependency on Russia and a sharp rise in natural gas prices unless it backs alternative non-Russian projects similar to White Stream. The White Stream Pipeline aims to bring Caspian gas through Azerbaijan and Georgia and across the Black Sea to Ukraine and Romania, from where it will travel farther into Europe. The pipeline would reduce the impact on the EU of any future Russian gas cut-offs and complicate Russian plans to put gas prices on a higher footing for the long-term.

Having seen that BTC (Baku-Tbilisi-Cheihan) and BTE (Baku-Tbilisi-Erzurum) are aiding its efforts toward energy diversification, the European Union representatives are debating various new energy-import projects. This in turn is leading potential supplier and transit countries to line up to get in on what promise to be very lucrative deals (Pannier, 2009). But by diversification, Europe also means finding routes that do not go through Russia.

In order to meet this challenge this summer (2009), EU backed consortium of energy companies from Turkey, Bulgaria, Romania, Hungary, and Austria that have joined together to build the \$11 billion Nabucco natural gas pipeline. Such an energy strategy, pundits say, is urgently needed to stop Moscow's "divide-and-conquer politics." Nabucco would bring gas from Middle Eastern and Caspian fields across Turkey's Anatolian plateau, and north into Europe. The pipeline is backed and partly funded by the EU and is strongly supported by the United States. Perhaps most importantly, Nabucco would completely bypass Russia. But the real question that will determine Nabucco's future — a question vividly on display in every country the pipeline will touch — is whether Europe has the stomach to fight as hard for its interests as Russia does for its own (Freifeld, 2009).

However, Russia's aggressive behavior versus Russia's neighbors and outright aggression against Georgia, that led to effective annexation of two Georgian territories- Abkhazia and South Ossetia, creation of the Russian military bases and deployment of regular Russian forces makes the role and security of current or future pipelines running through that country an issue that weighs heavily on the minds of many in the EU.

Similarly, whilst Russia sees the economic value of the energy security issues, this is secondary to its geopolitical value as a means of maintaining control over it's so called "near abroad" and ensuring only nominal independence for the countries of the region. This policy is most clearly evidenced in their intervention in the internal affairs of these countries. Moreover, Russia seems unable to control the political development in the region and has moved to dominate region including through military means.

Though officially Russia does not object to the construction of the Nabucco gas pipeline and as Russian Prime Minister Vladimir Putin said after the signing of South Stream documents with European partners "will not create any impediments", it has attempted to block alternative energy routes other than its own encouraging crisis between Azerbaijan and Armenia over Nagorno Karabakh and destabilizing and publicly invading Georgia. Moreover, like Iran Russia envisages resources of the Caspian Sea into the energy hub of non-Western energy zone (Sinker, 2001. p. 54).

Moscow has sought to gain control of the energy transport and distribution networks in neighboring states for long-term economic gain and leverage over their policies, and to ensure that the energy producers among them export through Russia. Russia has also aggressively pursued blocking potential natural gas export competitors from entering the European market, such as Iran, Azerbaijan and producers in Central Asia, and works assertively to retain control over Central Asian export. Iran is the only country that has the vol-



umes of natural gas and the location to pose any major threat to Russia's supply dominance in Europe. In the spring of 2007, Moscow spent a considerable amount of money to buy out Iran's potential access to the European gas market through Armenia (Shaffer, 2009).

If Russia can be seen as the current leader in the competition for influence in the South Caucasus, Iran can be considered an outsider for now. Iran's policy in the Caucasus is based primarily on its own security and economic considerations. Domestic inputs and constraints—primarily the presence of a significant Azerbaijani minority in Iran—and its interests and confrontations beyond the region, including that with the United States, also influence Iran's policies toward the region. However, the major Iranian concern in the region is not economic but strategic and its main objective is to expand its influence, for historic, economic and political reasons. In recent years, Iran also sees the role in energy security issues in the region and stands a good chance of being a future contributor to existing and planned pipelines through the Caucasus.

As for Turkey, Istanbul would prefer to see the European Union-backed Nabucco pipeline built <sup>1</sup>, since it would transit Turkish territory and thus provide both a new source of gas for the country and a new source of revenue. But Turkish participation in Nabucco also comes at a price. From Europe, the Turkish government seeks guarantees of eventual Turkish membership in the European Union. From Azerbaijan, the Turkish government wants a DAF (Delivery At Frontier) agreement, meaning Azerbaijani gas becomes Turkish gas as soon as it enters Turkish territory (from which Turkey will sell it on to Europe).

### *Conclusion*

Once considered a "crossroads of civilization," the South Caucasus has emerged as a crossroads of energy-export routes — spurring renewed competition in the region. The August war radically transformed the geopolitical pattern in the South Caucasus in several ways. First, Georgia lost its previous central role in the region, which may endanger many investment programs (including energy) previously linked to that country. Second, due to the break in relations between Georgia and Russia, Moscow lost part of its influence on the whole region, with the European Union and Turkey striving to fill that gap. Third, the five-day war showed everybody how fragile south Caucasus stability is and how dangerous an armed conflict may be in this region.

As the competition continues, only one thing is certain — there is no formula for energy-export routes through the Caucasus that can satisfy all the in-

interested parties inside and outside the region. The West's failure to intervene credibly in Georgia reduces the prospects of strong Western action to strengthen and broaden the east-west energy transportation corridor across the South Caucasus.

Although Russia may seem to be a common enemy, the policies Moscow follows often make sharp different South Caucasian states. And Russian policymakers frequently choose to play one against another. The recent visit of US President Obama to Turkey was far more significant than the President's speech would suggest. For Washington Turkey today has become a geopolitical "pivot state" which is in the position to tilt the Eurasian power equation towards Washington or significantly away from it depending on how Turkey develops its ties with Moscow and its role regarding key energy pipelines.

Its clear, that if Ankara decides to collaborate more closely with Russia, Georgia's position is precarious. As a result Azerbaijan's natural gas pipeline route to Europe, the so-called Nabucco Pipeline, could be blocked as well. If it cooperates with the United States and manages to reach a stable treaty with Armenia under US auspices, the Russian position in the Caucasus is weakened and an alternative route for natural gas to Europe opens up, decreasing Russian leverage against Europe<sup>2</sup>.

Moreover, for the Turkey and South Caucasian countries (remaining members of the Commonwealth of Independent States (C.I. S) the choices are stark - continue relations with Georgia after the August war as before, thereby tacitly approving Tbilisi's confrontational posture vis-a-vis Moscow and risking Russia's wrath, or pay heed to Medvedev's "privileged interests" in the Caucasus<sup>3</sup>. While little is clear in this respect yet, last year's military clash has given former Soviet states significant food for thought about what happens to former Soviet republics that ignore Moscow's concerns and stray too far westwards.

The global economic recession, decline of European demand and the lack of available investment are among the key factors making westbound pipelines from Eurasia largely a pipedream. Add to that the increasing geopolitical "pull" of China, an increase in Russian clout in its so-called "near abroad" after the Georgian war and the possibility of a future Iranian route - if rapprochement with the US succeeds - and these uncertainties make the future pipeline policy in South Caucasus a forecaster's nightmare<sup>4</sup>.

In addition if the combined effect of the financial crisis and the August war is likely to weaken the political support for investments in South Caucasus aimed at freeing the Caspian resources from the Russian control, it is even more likely to undermine the economic viability of these investments that has already been questioned because of the insecurity of the supply of gas<sup>5</sup>.

And the question is now how to handle this delicate situation in a strategically and geopolitically important region. So by controlling Georgia (in case Russia reaches abovementioned aims), Russia actually will be able to cut off Central Asia and Caspian resources. It means Russia would be able to isolate and cut off Azerbaijan and Central Asian countries and it will significantly strengthen its energy monopoly over Europe with all results out coming from that fact. So it's about major shift in the energy policy and major shift in geopolitics based on this energy policy and Russian energy monopoly.

The August war in Georgia demonstrated some risks associated with the functioning of the transit energy corridor in the southern Caucasus. It also demonstrated the need for broader security guarantees for a region that is vital to European and global energy security.

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### Footnotes

<sup>1</sup> At the time of the project's inception, it was envisaged that the pipeline would be filled primarily with Iranian gas. However, the complex geopolitical situation around Iran, coupled with the current under-investment in the Iranian hydrocarbons infrastructure that has turned this country with colossal reserves into a net importer of gas, has led to a shift of focus. Attention now centres far more on Azerbaijan; specifically, on its offshore field of Shah Deniz. Gas for Nabucco is expected to come from Phase II of the project, which could provide the base load for the pipeline.

<sup>2</sup> William Engdahl, War, Oil And Gas Pipelines, <http://www.rense.com/general85/fth.htm>

<sup>3</sup> John C.K. Daly, UPI, Analysis: Implications of Georgia leaving C.I.S. [http://www.upi.com/Energy\\_Resources/2009/06/09/Analysis-Implications-of-Georgia-leaving-CIS/UPI-90981244588248/](http://www.upi.com/Energy_Resources/2009/06/09/Analysis-Implications-of-Georgia-leaving-CIS/UPI-90981244588248/)

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