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**THE IMPLICATIONS FOR EURASIAN ECONOMIC UNION
SOUTH CAUCASUS ENERGY POLICY**

Abstract

The Eurasian Economic Union could change the economic and political landscape in Eurasia and in the South Caucasus. Armenia, with its recent decision to join the Union, is especially sensitive to resulting changes in the South Caucasus. Low oil prices are changing the energy politics in the South Caucasus, which means that the importance of Azerbaijan as an oil-exporting country is decreasing, and this in turn impacts the entire South Caucasus as an oil transit route. Armenia's ambitions to be involved in the process of establishing a "single energy space" are of strategic importance. This, together with its participation in the "North-South high-voltage energy corridor" project - might help Armenia to reinforce its position in the South Caucasus.

Keywords: *Armenia, energy politics, the South Caucasus, the Eurasia Economic Union, Energy transportation infrastructure, Azerbaijan.*

Introduction

Energy politics remains a key factor in the South Caucasus. An East-West energy transportation corridor connecting Azerbaijan, Georgia, and Turkey was established in the region after the collapse of the Soviet Union and became dominant in the South Caucasus in the long-term perspective. In recent years, Armenia, in cooperation with neighboring Iran and strategic partner Russia is building a new electricity corridor – the so-called North-South high voltage power-line, which will connect the energy systems of four countries – Russia, Georgia, Armenia, and Iran¹. Because of this initiative, we can expect a new phase of confrontation in the region, with energy policy a key factor.

This article aims to analyze and show energy policy factors in the South Caucasus and the Eurasian Economic Union as a common pattern particularly in the context of oil price volatility. The low oil

¹Participants of Tender for Construction of Armenia-Georgia Overhead Power Line are known, 09.02.2017, <http://www.minenergy.am/en/article/815>

prices are changing energy politics in the South Caucasus. This has lowered the importance of Azerbaijan as an oil exporting country, which in turn has had an impact on the South Caucasus as an oil transit route. Consequently, this situation would allow other countries to create their energy systems in the region in partnership with contiguous states.

The Eurasian Economic Union's vision to create a single economic and energy space can be a trigger for creating the new energy transit corridor involving Armenia as an EAEU member country, as well as Georgia and Iran as neighbors. The realization of this project can change the perception of the South Caucasus as a region transiting Azerbaijan's gas and oil resources. At the same time, it can give the EAEU an opportunity to increase its influence in the region with the help of Armenia and this new energy project.

The significance of this study is in its analysis of the energy factor as the central motive in the inner workings of the EAEU initiative, and the energy policy – as a factor of pushing it forward. Its findings would help fully understand the mechanisms, methods and metrics for measuring “energy weights” – or the *extent of influence* each participating state would be able to exercise. The basis of this study then will be assessing the possible gains and losses of all players.

The impact of the energy politics on the South Caucasus

Energy politics has a crucial influence on the relations of independent states. All countries - irrespective of whether they are energy exporters or importers - heavily depend on this factor. Energy consumption in the world is constantly increasing, which means that the influence of the factor of energy in the world will grow over time. This was one of the reasons why after the collapse of the Soviet Union the South Caucasus with its small oil and gas resources and transit potential attracted the attention of large consumer countries. The high oil prices in the early 2000s only increased the interest in this region and a number of multinational companies were ready to invest in the Azerbaijan oil deposits and transit infrastructures².

²Walsh. M., A Smell of Oil, The Dublin Review, Issue No. 13 Winter 2003–4.
<https://thedublinreview.com/article/a-smell-of-oil/>

Numerous energy and energy transportation infrastructures – gas and oil pipelines in particular – were developed in the South Caucasus during the post-Soviet period; especially Azerbaijan and Georgia, have engaged in several energy projects over the past 20 years. Due to the Karabakh conflict, Armenia has not been able to participate in these projects and has been forced to create its own energy security system out of regional energy projects.

Since regional dynamics of security heavily depends on energy projects in the South Caucasus, these projects, along with several newly-established pipelines, played a certain deterring role in the regional security environment and provided the region with relative stability and security, but it also greatly enhanced the dependence of relative peace and stability on international oil prices³. Three regional pipelines were built in the region in the post-Soviet period. The Baku-Tbilisi-Ceyhan oil pipeline was commissioned in 2006 and Baku-Erzurum gas pipeline was built in 2006. The oil pipeline Baku-Supsa (Georgia) was built in 1998 but doesn't work now⁴. These developments brought about a significant change in the balance of power in the South Caucasus.

Armenia's absence from the above-mentioned energy projects reduced its role in the regional policy and especially in its energy component. It forced Armenia to look for new ways to create its own energy security system. This provided Russia with an opportunity to strengthen its presence in Armenia's energy sector and gain control of Armenia's gas and electricity industries and infrastructures⁵.

The energy security is a key component of national security of any state, but for Armenia – blockaded by Azerbaijan and Turkey - it is of vital importance. Armenia aimed to create a full-scale energy security system which became possible thanks to its association with an oil-rich ally like Russia. It was one of the reasons why Armenia in 2013 joined the Russia-led Eurasian Economic Union.

³Tsalik. S., Ebel E. R., “Caspian Oil Windfalls: Who Will Benefit?”, ed. by Robert Ebel, 2003, pp. 71-88, New York.

⁴Supsa Terminal and Pipeline, Georgia, <https://www.hydrocarbons-technology.com/projects/supsa/>

⁵Nixey J., “The South Caucasus: Drama on Three Stages”, 2010, pp. 125-142, London.

But in recent years, namely, since 2014, the plunge in oil prices changed the security environment in the South Caucasus. Azerbaijan's role in the region declined, shaking the foundations of the established security system in the region and giving rise to internal economic, political and social problems. The lifting of economic sanctions on Iran allowed this regional power to intensify its participation in regional politics and to attempt to strengthen its influence and position in the region, especially in the sphere of energy projects⁶.

Currently, Iran and Russia are trying to revive the so-called North-South transport corridor program that has an important “energy corridor” component. The aim of this project is to create a high-voltage power line that would tie the electricity systems of Iran and Russia through the South Caucasus - Armenia and Georgia. This will likely increase Russian-Iranian influence in the South Caucasian energy projects and give this alliance a chance to change the balance of power in the region even further⁷.

Consequently, the region is now facing new realities with new problems, risks, and threats to the fragile regional security (and energy security in particular). These realities could potentially turn the so-called frozen conflicts into hot ones; indeed, one of the reasons of the recent war in Karabakh (April 2016) was the change referred to in the regional balance of power – with the low oil prices playing a significant triggering role.

Azerbaijan which has lost its energy power due to the decline in oil prices on the global energy markets faces huge economic and therefore internal political issues⁸. This situation has an impact on the regional energetic system too. Azerbaijan's role and impact as an oil export country are weakening in both the international and markets. Now the so-called East-West energy corridor from Azerbaijan to

⁶Ianchovichina E., Sh. Devarajan, C. Lakatos, Lifting Economic Sanctions on Iran: Global Effects and Strategic Responses, 2016, <http://documents.worldbank.org/curated/en/29868146799709496/pdf/WPS7549.pdf>

⁷Melikyan J. “Foreign Policy of Georgia”, Globus Analytical Bulletin, No. 4, 2016, (in Armenian) http://www.noravank.am/upload/pdf/Globus_4_2016.pdf

⁸De Waal T., Azerbaijan at Twenty-Five: A New Era of Change and Turbulence, Carnegie Europe, 2016, <http://carnegieeurope.eu/2016/09/23/azerbaijan-at-twenty-five-new-era-of-change-and-turbulence-pub-64671>

Turkey through Georgia is not as significant as it was several years ago and it opens up new possibilities to promote the so-called North-South energy system in the South Caucasus with the participation of Iran and Russia.

The low oil prices have forced Azerbaijan to review its energy policy in the region. It has lost its powerful energy card and has turned into a spot of instability in the South Caucasus. This situation, a result of the regional security environment, forces the South Caucasus countries to look for alternative sources of energy and other raw materials.

Against the background of these new realities Armenia must now revise its overall security doctrine and strengthen its own energy security system and actively search for new, perhaps alternative means of power generation to attain self-sufficiency, based on internal resources, and not dependent on external suppliers (an example being renewable energy derived from sunlight and/or wind).

For Armenia – against the background of the ongoing confrontation with Azerbaijan – the so-called North-South high-voltage grid project can be a real alternative. Armenia needs its own energy corridor in the South Caucasus and the North-South corridor can serve as such. The North-South energy high-voltage power-line can be a real alternative because Armenia has a key role in this program as the main player in the ties between Iran and Russia. Armenia has a huge experience in energy cooperation with Russia and Iran. It means that Iran and Russia, in turn, need Armenia as a country for transit and coordination of this project.

Eurasian Economic Union (EAEU) and perspectives of energy policy

Energy geopolitics is a key factor in the foreign policy of resource-rich countries. In the Eurasian continent, the Russian Federation is one of such states, and its energy policy in this region is crucial for the newly established economic union. Free access to energy resources is crucial for countries with scarce resources, and this is one of the reasons why countries short of energy resources are interested in being part of one union.

The newly created the Eurasian Economic Union can change the geopolitical landscape on the Eurasian continent. The Russian Federation - as the founder and the biggest country of EAEU - has a most significant potential in this Union, an important part of which is the energy resources which Russia utilizes to reinforce its position and to make this Union more attractive especially for the former Soviet republics.

Russia's initiative of creating a new economic union with the former Soviet republics – Armenia, Belarus, Kazakhstan, and Kyrgyzstan – is a new possibility for these republics to recover former ties with each other and Russia, and to restore cooperation within the old and familiar markets. The idea of a union appeared attractive to these countries, largely due to familiarity, the experience of a common market along with its standards and demands⁹. This economic union is envisioned as a single market that provides for free movement of people, goods, services, and capital.

The energy factor was at the core of this initiative: all the mentioned states needed a closer cooperation especially in the energy sector; and according to the EAEU treaty, it might be the main locomotive to move this process on and bring the former republics together at the same place¹⁰. This energy attractiveness could play a key role in the creation and reinforcement of this economic union in the future.

The EAEU is one of the most resource-rich organizations in the world; it possesses an estimated 1/5 of the world's gas and about 8% of the world's oil resources. The EAEU produces about 5% of the world electricity, and its energy sector makes up to about 1/6 of its GDP and 1/3 of overall industrial production¹¹.

Members of the EAEU have different energy powers but have close, and high, energy interests, which unite them politically and economically. They all want to create a single energy space that would

⁹Eurasian Economic Integration: Facts and Figures, Moscow, 2015, http://www.eurasiancommission.org/en/Documents/broshura26_ENGL_2014.pdf

¹⁰Treaty on the Eurasian Economic Union, Eurasian Economic Commission, 2015, http://www.un.org/en/ga/sixth/70/docs/treaty_on_eeu.pdf

¹¹Prospects of Energy Cooperation, Eurasian Economic Commission, 2015, http://www.eurasiancommission.org/ru/Documents/_eec_energy_all_150623.pdf

ensure equal opportunities in acquisition, consumption, distribution, and transit. Currently, a so-called energy dialogue is underway among the EAEU members, aiming to reach decisions that will be acceptable for all sides in creating the mentioned single energy market¹².

One of the key issues in this energy dialogue is a phased approach to the formation of a single energy market. Current talks pertain to the formation of a single electricity market on the basis of coordinated power systems operating in parallel. Future talks will cover single gas and oil (primarily petroleum) markets¹³.

The Russian Federation, as one of the energy superpowers, is a key player in the Union and dominates the energy markets of the EAEU. Russian companies control most of the energy corporations and infrastructures in the EAEU countries – hydro or thermal power stations, electricity grids, etc.

Meanwhile, energy interests of EAEU member countries have certain differences as well. For example, for energy consumer countries like Armenia, Belarus, and Kyrgyzstan, a common energy grid and a network are more attractive due to the perspective of access to Russia's internal electricity, oil, and gas networks at more favorable conditions economically and financially. This also creates additional opportunities for energy exports on the part of the member states.

For Kazakhstan, the energy dialogue is interesting because it provides an opportunity to use the Russian pipeline infrastructure for its own gas and oil exports at transit rates that are in line with Russian internal market prices as opposed to the current higher tariffs¹⁴. At the same time, Kazakhstan has an electricity deficit and a common energy market gives it an opportunity to take additional electricity from other members of the EAEU. Unlike Kazakhstan, Armenia has a

¹²Vinokurov E., Eurasian Economic Union: Current state and preliminary results, Russian Journal of Economics 3, 2017, pp. 54–70, [https://ac.els-cdn.com/S2405473917300041/1-s2.0-S2405473917300041-main.pdf?_tid=d316ccea-01e1-11e8-8f91-](https://ac.els-cdn.com/S2405473917300041/1-s2.0-S2405473917300041-main.pdf?_tid=d316ccea-01e1-11e8-8f91-00000aabb0f6c&acdnt=1516893185_2a0660ab4570ca3673bd451ed0f9a74b)

[00000aabb0f6c&acdnt=1516893185_2a0660ab4570ca3673bd451ed0f9a74b](https://ac.els-cdn.com/S2405473917300041/1-s2.0-S2405473917300041-main.pdf?_tid=d316ccea-01e1-11e8-8f91-00000aabb0f6c&acdnt=1516893185_2a0660ab4570ca3673bd451ed0f9a74b)

¹³Strategic Goals and Objectives of EAEU in Energy Field explained by EEC Minister Tair Mansurov, Eurasian Economic Commission, 2015, <http://www.eurasiancommission.org/en/nae/news/Pages/17-11-2015-15.aspx>

¹⁴Oil Export Routes From Kazakhstan, Facts and Details, 2016, http://factsanddetails.com/central-asia/Kazakhstan/sub8_4e/entry-4678.html

surplus of electricity and now it has the opportunity to export it to the EAEU market and make up for the electricity deficit not only in Kazakhstan, but also in Kyrgyzstan.

Energy prices are crucial for the economies of the EAEU member countries, while Russia has an opportunity to play the energy card to strengthen its political influence in the region. On the one hand, a common energy sector/market threatens Russia with some economic loss (Russia would have to sell energy at lower rates and charge less for transit than now), but ,on the other, it provides Russia with additional political leverage in overall regional energy infrastructures and policies and, subsequently, significantly increases its political influence. The significance of this policy is that Russia sees the “Energy dialogue” as a tool for increasing its geopolitical and geostrategic influence on the Eurasian continent.

The analysis shows that Russia is attempting to use the energy strategy as a means of attracting other – not only former-USSR – nations into cooperation with the EAEU¹⁵. This means that energy remains a key factor in this Union.

Conclusion

The EU's future will be dependent of success on the energy industry and the capacity to build common energy markets. The EAEU can be seen as a new energy union because energy is one of the motivating factors for the ex-Soviet nations to join the EAEU.

The Eurasian Economic Union is changing the geopolitical landscape in the South Caucasus, especially in the energy sector. Armenia as a key member of this Union can use it for enhancing its energy influence in the region. The implementation of the North-South energy corridor gives Armenia, as the coordinator of this project, additional leverage for increasing its influence in the South Caucasus. The North-South can be a real alternative for Armenia in

¹⁵Kirkham K., The formation of the Eurasian Economic Union: How successful is the Russian regional hegemony?, Research Paper, The Eurasian Economic Union: Deals, Rules and the Exercise of Power, 2017, <http://www.sciencedirect.com/science/article/pii/S187936651630001X>

the regional confrontation with Azerbaijan's East-West energy corridor.

It can be concluded that the energy component is a vital part of the EAEU. The future and the success of this Union heavily depend on the possibility to create a single energy market with its own energy standards and exchanges. To sum up, of this article, we can state that energy will continue to play a crucial role in EAEU's success or failure politically, energy consumer-states have national interests in this energy policy, an "energy dialogue" idea might become a new format and framework in theoretical energy geopolitics, Russia gains politically but suffers economically.