

AMERICAN UNIVERSITY OF ARMENIA

ENERGY POLICY OF THE EUROPEAN UNION TOWARDS THE SOUTH CAUCASUS  
THROUGH THE LENSES OF INTERDEPENDENCE THEORY

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## **Abstract**

The objective of this Master's thesis is to examine EU-South Caucasus energy relations putting emphasis on relations with Azerbaijan and trying to reveal what is the major energy policy priority of the EU in the South Caucasus and whether there is interdependence between the EU and Azerbaijan. Throughout the thesis their energy relations are analyzed, major pipelines are introduced and the EU's official documents related to energy are analyzed to do discourse analysis. Then interdependence theory is presented with the EU-Azerbaijani case. Afterwards conclusions are drawn based on each chapter and final concluding remarks about the EU-Azerbaijani interdependence are presented.

## **Introduction**

After the collapse of the Soviet Union in 1991 the South Caucasus countries (Armenia, Georgia and Azerbaijan) became unstable with deteriorated economy. The conflicts (the Nagorno-Karabakh conflict between Armenia and Azerbaijan, the South Ossetian and Abkhazian conflicts between Russia and Georgia) made the region instable and foreign actors did not manifest willingness to get involved and cooperate with the South Caucasus countries. After the collapse of the Soviet Union the European Union got involved in the region and tried to provide financial and technical assistance to the newly independent states. The EU's policy towards the South Caucasus is aimed at promoting cooperation, justice, stability, good governance and prosperity throughout the region (Manvelyan 2011).

Currently the main policies addressing political and economic issues as well as regional cooperation are the ENP and the EaP. The EU is the major promoter of regional cooperation and is even considered a unique actor in this regard.

Unlike other post-Soviet countries the South Caucasian states were not at the centre of attention of the EU. The EU launched its policy towards the region later than the other EU member states. Partnership and cooperation agreements (PCA) with the South Caucasus countries were signed in 1996 and entered into force in 1999. Five years later in 2001 the EU wanted to carry out closer cooperation with the region for the resolution of conflicts and their prevention. This proposal was accepted by the South Caucasus governments in 2003. The region became closer to the EU after 2004 because of the eastern enlargement. The EU included previously weak South Caucasus in the eastern programs.

The region borders other international actors such as: Russia, Turkey and Iran. All of them try to get involved in the region and use it for their own interests. The EU is not an

exception and tries to get closer to the region by promoting stability and peace and at the same time competing with the regional powers.

The South Caucasus is important for the EU because of its economy, i. e. import of energy resources by building of the East-West transportation corridor. This corridor is mostly used for oil and gas pipelines carrying larger significance. In the last decade the South Caucasus was viewed as the major transit route connecting Europe with Central Asia, China and India via the Black Sea, Georgia, Azerbaijan and the Black Sea. Currently, Georgia and Azerbaijan are the main bridge countries for trade development. The significance of the corridor was recognized by the EU's TRACECA program, under which two projects were realized INOGATE (Interstate Oil and Gas Transportation to Europe) and TACIS (Technical Assistance to the Community of Independent States). The development of the Caucasian energy corridor had a prior importance for the EU, particularly, Baku-Tbilisi-Ceyhan and Baku-Tbilisi-Erzurum pipelines. It was followed by the construction of South Caucasus Gas Pipeline (SCP) and Nabucco. In this sense, Azerbaijan has become not only a producer but made the South Caucasus a transit region.

The Azerbaijani energy resources are of major importance for the European Union. Oil and gas rich Azerbaijan uses its energy leverage to be closer to the European Union. At the same time the European Union wants energy diversification; it wants to reduce its dependence on Russia. Though the major pipelines (TAP, TANAP) are still under construction and have not been initiated yet, there is a belief that they will ensure energy diversification for Europe and will decrease its energy dependence.

The thesis consists of three chapters. In the first chapter the EU-South Caucasus relations are described with an emphasis put on energy relations. The major pipelines are introduced and the shares of oil and gas of the EU are presented afterwards. The second chapter is the EU's document analysis related to energy. The last-third chapter introduces

interdependence theory, and tries to show find out whether there is interdependence between the EU and Azerbaijan.

## **Literature review**

A group of authors support the view that interdependence fosters cooperative political relations. Montesquieu claimed that “the natural effect of commerce is to lead to peace. Two nations that trade with each other become mutually dependent. If one has an interest in buying the other has an interest in selling; and all unions are based on mutual needs” (Baldwin, p. 17). In international relations interdependence has two meanings. Firstly, a group of countries is considered interdependent if economic conditions in one are contingent on those found in the others. Second, countries are considered interdependent if it would be costly for them to rupture and forego their relationship. The first one is the **sensitivity** interdependence, the second one is the **vulnerability** interdependence. The major difference between the two is related to the costs that countries would bear if the relations are disrupted. The measure of interdependence focuses on the following components: openness, vulnerability and gain (Tetreault 2001, Baldwin n.d.).

According Keohane and Nye dependence means being affected by other actors, whereas interdependence means mutual dependence. They define vulnerability as ‘measure of government’s inability to insulate itself from effects of the transmission of events originating elsewhere’ and ‘*sensitivity*’ as ‘mutual responsiveness of one nation occurring in the other’ (Keohane and Nye 1977, p. 7).

Keohane and Nye (1977) state that interdependence exists when there are transactions, otherwise there is simply interconnectedness between the actors. As opposed to this, Baldwin distinguishes ‘interdependence’ and ‘mutual responsiveness’ instead of interconnectedness. ‘Mutual responsiveness’ means that the actors are not dependent on each other. Moreover, they are able to do without each others’ aid (Baldwin n.d.).



As opposed to Keohane and Nye, Tetreault states that when interdependence is measured by transactions it is horizontal interdependence, which is not actually interdependence, but transactions are means to reach interdependence (Tetreault 2001).

Tibold, Cillessen (2006) and Gogberashvili (2010) state that EU largely depends on foreign energy imports. The EU currently imports 50% of its energy resources and this figure is going to reach 70% by 2030. It should be stressed that 25% imports are from Russia and this number will become 40% by 2030 (Gogberashvili 2010). These authors state that the EU taking into consideration its increasing demand for energy resources and at the same time willingness for energy diversification wants to use Azerbaijani energy resources for these purposes. Besides, dependence on Russia strongly affects the energy security of the EU. Russia may use its energy leverage against the EU to reach its major political goals. Energy diversification has become a priority for the EU since 2006 when the EU member states experienced energy crisis because of Russia starting from 2006. Russia knew that the EU had no alternative then and could use its energy leverage whenever it wanted. These are the reasons that make the EU dependent on the Azerbaijani energy resources (Tibold and Cillessen 2006, Gogberashvili 2010, Manvelyan 2011).

The above mentioned facts became a stimulus for the EU to start implementing new pipeline projects for the purpose of ensuring its energy diversification relying on Azerbaijani energy resources. Currently Baku-Tbilisi-Ceyhan and Baku-Tbilisi Erzurum pipelines are the major energy security guarantees for the EU. The Southern Gas Corridor plan was launched specifically for the EU energy diversification purposes. The plan includes the Nabucco gas pipeline project, Turkey-Greece-Italy, Trans-Adriatic Pipeline project (TAP), Trans-Anatolian gas pipeline. The construction of the Nabucco gas pipeline was initiated in 2011. The pipeline is designed to provide 31 billion cubic meters gas to Europe. TANAP is designed to transport Azerbaijani gas from Shah Deniz 2 gas field to Europe through Turkey (Badalyan 2012).

Only Armenia of three South Caucasus countries does not have either oil or gas markets. It depends on foreign imports; oil from Georgia and Iran and gas from Russia. As for Georgia, the Oil and Gas Corporation is (GOGC) the major player in Georgia's oil and gas market. The State Oil Company of Azerbaijan (SOCAR) is responsible for its own oil and gas resources. After the construction of the Shah Deniz gas field Azerbaijan has become a net gas exporter, whereas in the past it imported gas from Russia. The Azerbaijani dependence of energy resources on Russia decreased significantly after the discovery of the Shah Deniz gas field, moreover, it started to export its own natural gas. The Shah Deniz gas field made Azerbaijan become significant exporter for the European Union, which initiated the construction of new pipelines (INOGATE 2014).

The domestic oil production of the EU has decreased by 43% within ten years (1998-2008), and along with this the demand has increased respectively. The same is with the natural gas. Gas demand has increased significantly and the production has decreased respectively (Kubicek 2013). The EU's main partners in this regard are Russia, Norway, the countries of the Caspian basin, Middle East and Algeria from North Africa. If the EU reduces its dependence on Russia then the only alternative is Azerbaijan. Not only the EU as a whole wants diversification, but the Member States separately want to be less dependent on Russia. (Kubicek 2013, Muradkhanli 2013, European Commission 2013).

The EU has taken steps for the acceleration of the process of energy diversification. The Trans-Adriatic gas Pipeline (TAP) and Interconnector Greece-Bulgaria (ICGB) signed an agreement to jointly bring the Azerbaijani gas to Bulgaria, which is highly dependent on Russian gas.

As opposed to the authors mentioned above, several authors state that though the construction of new pipelines may be an alternative route to avoid using Russian energy resources, TAP and TANAP will be able to export only about 10% per year of the whole energy

Europe consumes. TAP is expected to deliver only 2% and TANAP only 6% accordingly (Valiyev 2012). Moreover, the realization of TAP largely depends on Russia. If Azerbaijan ignores the Russian role and ignores its pressure the TAP pipeline will be realized, otherwise it is not likely to. So, the prospects with these pipelines to ensure energy diversification for the whole Europe are not promising (Valiyev 2012, Badalyan 2012).

In the literature review firstly, the interdependence theory was discussed viewed from different perspectives, i.e. the definition of interdependence varied among different authors. Then the focus was put on the Azerbaijani energy resources, whether it can provide Europe with such amount of energy resources it actually needs. The views differ, i.e. some authors state that Azerbaijan can become one of the major energy suppliers of Europe in the future, whereas, others disagree with this point, stating that Azerbaijan will not provide the whole Europe with its energy resources and become a major supplier even after the construction of pipelines the Southern Gas field.

## **Methodology**

The following research questions are addressed in the current thesis:

***Research Question N1:** How does the EU promote energy cooperation in the South Caucasus region?*

***Research Question N2:** Why does the EU promote energy cooperation in the South Caucasus?*

***Research question N3:** How can the EU-Azerbaijani energy relations be explained through the interdependence theory?*

***Research question N4:** What is the EU's energy policy priority in the South Caucasus?*

***Research question N5:** Can Azerbaijan become the major energy supplier of the European Union?*

***H1:** The EU's energy policy priority in the South Caucasus region is energy security.*

***H2:** There is energy interdependence between the EU and Azerbaijan.*

The method chosen for this research is qualitative. One of the instruments of the qualitative research is document analysis. Both primary and secondary sources have been used in the current study. The primary sources comprise the EU official documents, EP resolutions, progress reports of the Commission. On the other hand, as the secondary sources journal articles, working papers, books, academic research papers have been used.

## Chapter 1: EU's energy policy towards the South Caucasus

The South Caucasus has been a transit region for transportation of energy between East and West, North and South. The South Caucasus is becoming more and more significant for the EU. One of the EU's geostrategic priorities is to establish good relations with countries outside the EU. The EU-South Caucasus relations are important for both actors in the field of energy, trade, security and transport. Besides, the EU promotes democratic values, human rights, cooperation and stability, tries to boost regional economic relations with the South Caucasus countries and establish peace through the resolution of regional conflicts. The EU provides financial and technical assistance to the three states (Haydar 2012).

There are number of reasons why the EU considers the South Caucasus as a region of special importance. First of all, EU's willingness of having diversification in energy suppliers brings it closer to the South Caucasus. The geographical location of the region, i.e. at the crossroads of East-West transportation area makes the region attractive either in trade or communication and in military terms. Georgia and Azerbaijan connect the exits of Caspian and Black Sea at the same time providing a transit route of oil and gas from Central Asia (Kazakhstan, Turkmenistan) to Europe (Alieva, 2006).

For about 15 years there were not stable energy relations between the EU and the South Caucasus countries. In 1990s the European Commission launched the program Technical Assistance to the Community of Independent States (TACIS) to ensure the development of post-Soviet states. Two projects within this program covered assistance among other states to Armenia, Georgia and Azerbaijan: i.e. TRACECA (Transport Corridor Europe-Caucasus-Asia) and INOGATE (**I**nterstate **O**il and **G**As Transformation to **E**urope), which aimed at improving the energy transportation routes, ensuring energy supply and guiding the investments for the pipeline projects. In this sense, the EU has supported the South Caucasus countries in the development of Baku-Tbilisi-Ceyhan oil pipeline, South Caucasus gas pipeline and Baku-Supsa

oil pipeline. Along with technical support, the EU was a mediator in making agreements between Azerbaijan, Kazakhstan and Georgia in 1990s. Armenia was paid to less attention in this regard. This was because of Armenia's dependence on Russian Gazprom and scarcity of its energy resources. The situation started to change at the beginning of 2000 because of EU's increasing demand for energy resources. By 2030 the EU's dependency of gas supply on Russian is estimated to become twice more, which means that Russia will become dominant in supplying energy to Europe (Caucasus Analytical Digest 2011).

The *INOGATE* program is an international energy cooperation program. The mandate of *INOGATE* program is to support energy cooperation among the European Union, countries of the Caspian and Black Seas, particularly, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kirgizstan, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. The framework of cooperation is limited by electricity, oil and gas, energy efficiency and renewable energy. *INOGATE* is concerned with the energy security strategies of the EU as well as the partner countries. Initially *INOGATE* implied "Interstate Oil and Gas Transport to Europe" which has derived from the previous project called "Interstate Oil and Gas Pipeline Management" completed in 1997. Enlargement of the *INOGATE* program was launched in 2004 during the Energy Ministerial Conference held in Baku, known as the "Baku Initiative". In November 2006 the Initiative came to an end when the Astana Energy Ministerial Declaration was signed, which stated that *INOGATE* would expand its scope. The objectives of the program were adopted by all member countries. They agreed to reach the following objectives:

1. Converge energy markets based on the EU's energy market principles, taking into consideration the energy markets of specific countries
2. Enhance energy security paying attention to such issues as: energy exports/imports, energy transit, supply diversification and energy demand
3. Support regular energy development, specifically, renewable energy, energy efficiency, demand side management

4. Attract investments for common and regional energy projects

Some of the objectives have been achieved, others are still under realization. Particularly, much efforts are taken to enhance energy security and thus ensure energy diversification for Europe.

The program is represented by the respective minister of member countries and the coordinating mechanism of the *INOGATE* program is the *INOGATE* Technical Secretariat in Kiev. The program supports the partner countries to advance in energy cooperation. The activities taken by the *INOGATE* program and the Technical Secretariat accordingly, include:

1. Information, Communication, Promotion and Networking between the EU and Partner countries
2. Technical support for the member countries by
  - Implementing EU's technical assistance projects in energy market convergence, energy security, energy efficiency, investment attraction, and renewable energy sector
  - Enhancing capacity building (e.g. based on the principle of energy regulation, sustainable development)
  - Permitting supporting desk studies
  - Supporting the partner countries to find out major objectives and priorities
  - Providing links for other financial assistance instruments

Till 2006 the *INOGATE* program was funded by the EU's Technical Aid to the Commonwealth of Independent States program (TACIS). In 2007 the program was funded by the European Neighborhood and Partnership Instrument (ENPI). Though the Central Asia is not included in the ENPI the three Central Asian countries also benefit from the funding (*INOGATE* n.d.).

The following table shows currently active INOGATE and INOGATE-related projects.

<b>Title</b>	<b>Project Period</b>	<b>Energy themes</b>	<b>Countries</b>
Supporting Participation of Eastern European and Central Asian countries in the 'Covenant of Mayors'(INOGATE-related project)	20/09/2011-20/07/2015	Energy efficiency, renewable energy	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
INOGATE Technical Secretariat and Integrated Program in support of the Baku Initiative and the Eastern Partnership energy objectives	01/02/2012-31/01/2015	Oil, Gas, Electricity, Energy Efficiency, Renewable Energy, Climate Change, Convergence of Energy Markets, Energy Security, Sustainable Energy Development, Investment Attraction	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Sustainable Energy Program for Central Asia: Renewable Energy Sources- Energy Efficiency	01/02/2013-31/06/2016	Energy Efficiency, Renewable Energy	Kazakhstan, Kirgizstan, Tajikistan, Turkmenistan, Uzbekistan

Source: (INOGATE n.d.)



After the collapse of the Soviet Union EU's involvement in the region took place only in 1996 when it signed Partnership and Cooperation Agreements (PCAs) with each country. These agreements went into force only in 1999 (Alieva 2006).

There have been three phases of economic transformation and development (1991-95, 1996-2002, 2003-till present) since the collapse of the Soviet Union. In Azerbaijan two periods coincided with Heydar Aliyev's presidency, whereas the third one started with Ilham Aliyev's time of governance in 2003. The first period was characterized by economic chaos. The period after 1996 is characterized by dynamic economic development. The third phase was the period of stable economic development as Azerbaijan had already financial resources for making investments in its economy. Before that in the first phase in 1994 the Azerbaijani government signed the Production Sharing Agreement (PSA) with all oil companies for the purpose of exploiting oil and gas deposits to the Caspian Sea. This agreement was known as "The Contract of the Century", which supposed that the foreign companies would make investments in three oilfields, and in the end 80% of the profits would remain to Azerbaijan, the other 20% would be divided among these companies. The construction of Baku-Tbilisi-Ceyhan (BTC) pipeline and South Caucasus gas pipeline was in the plans of those foreign companies. These pipelines would aim at the transportation of oil and gas. The contract also permitted to gain other investments from different companies (Valiyev 2012).

After enlargement in 2004 the South Caucasus countries have become a priority for the EU. The role of the European Union in the region has become crucial. The South Caucasus countries were included in the European Neighborhood Policy (ENP) launched in 2004, Black Sea Synergy (BSS) launched in 2007 and the Eastern Partnership (EaP) initiated in 2009. Both the regional projects of the EU and bilateral and multilateral cooperation is continuously increasing (Haydar 2012). The ENP promotes EU values in the neighboring countries, such as: human rights and democracy, good governance, rule of law, market economy principles and sustainable development" (Liargovas 2013, p. 2).

The Black Sea Synergy was launched in 2007 by the European Commission to intensify cooperation with the countries around the Black Sea region. The main domains of Black Sea Synergy are democracy and human rights, regional conflicts, trade, energy, regional development, fisheries, environment (European Parliament 2010).

The Eastern Partnership was launched in Prague (2009). It (EaP) aimed at bringing the eastern neighbors of the EU closer to the Union by strengthening political association and economic integration between the two parties. The EU supports both democratic and economic reforms in the eastern neighborhood, which accordingly ensures stability and prosperity. It also aims at struggling against certain challenges such as regional conflicts, poverty and social inequalities. The EaP also addresses cross-border challenges such as, irregular migration, trafficking and pollution. For supporting the Neighborhood Policy and financing related programs a special financial instrument was applied called the European Neighborhood and Partnership Instrument (ENPI) (European Commission, 2012).

Due to oil resources overall FDI (Foreign Direct Investment) increased for Azerbaijan from EUR 825 million in 2001 to EUR 5.890 billion in 2010 (The State Statistical Committee of Republic of Azerbaijan 2010). In 1999 the State Oil Fund of Azerbaijan was created the mission of which was to accumulate funds and assets from the exploitation of oil fields. The major incentive for the prosperity of Azerbaijani economy was the oil factor. The production of oil and gas increased the GDP per-capita to EUR 3.411 in 2009 (The State Statistical Committee of Republic of Azerbaijan 2010). The oil GDP was higher from the non-oil GDP. Actually, the Azerbaijani economy became dependence on oil and its price (Valiyev 2012).

As already mentioned, the South Caucasus is a vital region for hegemonic powers as the region was a means for them to influence the neighboring countries. In the past this kind of approach was applied by the Ottoman and Persian powers. At present this strategy is carried out by the US and Russia. Russia considers the South Caucasus as its backyard and relying on its

energy resources is competing with the West to increase its involvement in the region. Along with this, the geopolitical importance of the South Caucasus region is conditioned by the valuable oil and gas resources in Azerbaijan, Central Asian states, Turkmenistan and Kazakhstan. The western states became interested in the energy resources of the region starting from 2002, as they wanted to decrease their dependence on Russia and the Middle East. As a result, the oil and gas prices rose in 2000s and the region became more important for the West. Stability and security in the region are required conditions for the transportation of oil and gas. The Caspian region contains 3-4% of global oil reserves and 4-6% of world gas reserves (Tibold and Cillessen 2006).

In the South Caucasus not only the security concerns of the three countries are interconnected but also the security of the whole region and each country separately is affected by the intervention of either regional or global powers. If this or that actor becomes dominant in the region or in one of the countries it tries to use the region for its own goals. E.g. Turkey wants to use Azerbaijani energy resources and become an energy hub and energy transit country. Pipelines of the Caspian region traversing the region have significant impact on the security of the whole region. The location of the region between Russia and the EU, Middle East and Central Asia the Caucasus is the transit route between the Caspian basin and the West. Now two pipelines are of major importance for the region: the BTC running from Baku via Tbilisi to Ceyhan is the main oil exporting pipeline and the BTE running from Baku via Tbilisi to Erzurum is the main gas export pipeline. Among other important export pipelines are from Baku to Novorossiisk and to Supsa both constructed for exporting Azerbaijani oil resources. Along with this, there are two important pipelines importing gas, namely the North-South Pipeline, originated in Russia and the Iran-Armenia pipeline (Badalyan 2012).

In 1996 Azerbaijan signed an agreement with Russia for building the Baku-Novorossiisk pipeline to transport Azerbaijani oil from Baku to Novorossiisk. The pipeline has 1347 km long,

the operations started in 1997 and the total capacity per day was 100.000 barrels. Soon there was a need for an alternative pipeline, as because of the Chechen War terrorist activities still continued in the North Caucasus region. In spite of Russia's unwillingness towards the construction of the second pipeline in 1995 the second pipeline called Baku-Supsa was initiated by the Azerbaijan International Oil Company (AIOC). Having 917km length it runs from Baku via Georgia's Black Sea coast goes to Supsa. The pipeline started its operations in 1999 exactly when the Baku-Novorossiisk pipeline was closed because of tensions in Chechnya (Badalyan 2012).

The Iran-Armenia gas pipeline which was initially designed to reduce Armenia's dependence on Russian gas, started to operate under the control of Russian Gazprom. The agreement on the construction was signed in 1997 but the first section was opened in 2007 running from Tavriz (Iran) via the Iran-Armenian border Meghri to Kajaran. The Iranian gas is used for firing the Hrazdan power station and the Armenian electricity is exported to Iran accordingly. Initially this pipeline was planned to be built with double capacities. Thus, it would have a significant importance not only for the region but for the European markets, as well. Under the Russian pressure the pipeline was kept small. Russia was actively involved in the construction process investing \$200mln in the project (Badalyan 2012).

The BTC is the second longest (1768 km) and one of the most expensive pipelines (\$4.6 billion). The operations started in 2006 with one million barrels per day. It starts from Azeri-Chirag-Guneshli oil field and connects Ceyhan via Tbilisi. Along with BTC, the BTE pipeline gas pipeline carries gas from Shah Deniz field to Erzurum via Tbilisi. It also became operational in 2006. Diversification in energy suppliers and alternative routes for transportation are the EU's main priorities and incentives for its energy security (Badalyan 2012).

The South Caucasus is a part of a pipeline project called Nabucco, launched in 2002 by Austrian Gas Company. The construction was initiated in 2011 and only in 2014 gas flow will take place. This project is favored both by the US and the EU as it gives an opportunity to decrease the EU's dependence on Russian gas. As an alternative Russia offered to use the Blue Stream pipeline for transporting Azerbaijani and Iranian gas to Europe (Gogberashvili 2010). However, this suggestion was rejected, as it did not meet the EU's objective, i.e. to have diversification in energy suppliers - a part of Blue Stream runs through Russian territory. The Nabucco project, in its turn, is aimed at delivering Iranian and Azerbaijani gas from Turkey to Austria via Bulgaria, Romania and Hungary, passing the South Caucasus and bypassing Russia (Gogberashvili 2010, p. 32). Russia's reaction was harsh towards the decision of the European Council, i.e. to permit the European Commission to act as a mediator between Azerbaijan and Turkmenistan for the purpose of immediate construction of the Nabucco gas pipeline. Iran is also against the construction of Nabucco pipeline (Manvelyan 2011), because it will prevent to transport Iranian gas to the European market. Along with regional conflicts, energy competition and these kinds of issues create extra-problems and tensions in the Caspian basin as well as in the South Caucasus (Manvelyan 2011). The Nabucco Gas Pipeline is designed to provide 31 billion cubic meters gas to Europe by 2020.

“Currently the Nabucco consortium is made up of Austria's OMV, Bulgaria's Energy Holding Bulgargaz, German's RWE, Hungary's MOL, Romania's Transgaz and Turkey's Botas, each of which holds 16.67% stake. The project plans to receive about 20 bcm of gas per year from the Azerbaijani Shah Deniz gas field 2 and initially 10bcm from Turkmenistan. In the long run gas will come from Iraq, as well. Other supplier countries such as Kazakhstan and Egypt will also be included in the gas supply negotiations” (Caucasus Analytical Digest 2011, p.10).

The European Commission has supported Nabucco in many ways. Firstly, it mediated in the negotiation process between the Nabucco consortium and supplier countries. In July 2009 an

agreement was signed and ratified by the national governments of EU member states involved in the Nabucco project and by including Azerbaijan and Turkey accordingly. The European banks invested 4 billion Euros in the consortium (1.2 billion from the European Bank for Reconstruction and Development and 2 billion from the European Investment Bank) (Caucasus Analytical Digest 2011).

The EU has shown its willingness to finance the Nabucco project though there is no guarantee that the project will succeed, because of new alternative pipelines. In 2009 at the Budapest meeting German Chancellor Angela Merkel with the vice president Silvio Berlusconi expressed against the project. Both leaders were sure that the project was not likely to be launched in the near future. That is why, they refused any proposal of financing energy diversification projects (European Commission 2009). At the same summit Hungarian prime-minister Ferenc Gyurcsány said that Nabucco was an issue of national security and was in favor of the project. Czech Prime Minister Mirek Topolánek said in his speech: “The Nabucco gas pipeline is not a matter involving just a few companies or a handful of countries. It is a strategic project crucial for the economic prosperity and political independence of the whole of Europe”. Romania being another Nabucco transit country is in favor of the South Stream pipeline. Along with this, Romania wants Nabucco to be built first and then only South Stream. The president of Romania Traian Basescu said in Budapest “As soon as we finish Nabucco, we are in favor of the South Stream coming across our country”. Bulgaria and Hungary are also in favor of the EU’s funding of the Nabucco project. Azerbaijani president Ilham Aliyev stated in his speech: “Azerbaijan has always been supportive to this project and today once again we would like to declare that we continue to support the project” (Euroactive 2009). The president of the *European Investment Bank* Philippe Maystadt stated that the bank was ready to finance the project up to 25% of the Nabucco’s cost (EuroActiv 2009).

The preferences about Nabucco's realization were turned to be right to some extent. The Eastern section (from Azerbaijan to Bulgaria) of the Nabucco pipeline was abandoned in 2013 and instead the Trans-Anatolian Pipeline (TANAP) financed by Turkey and Azerbaijan came to the front. Only the Western- Nabucco (from Turkey to Austria) remained from the original pipeline. Though TANAP will somehow decrease the dependence on Russia it can provide only 2% of Europe's demand. The Austrian firm **OMV**, Bulgaria's **BEH** Romania's **Transgaz** and Hungarian firm **FTSZ** will be affected by this decision, whereas the German firm **RWE** had withdrawn from the project earlier (Barysch, 2010).

Currently the EU countries import 50% of their energy resources and this figure is going to increase reaching 70% by 2030 (Tibold and Cillessen 2006). Moreover, 25% of their energy resources the EU member countries import from Russia and this figure is going to reach 40% by 2030 (Tibold and Cillessen 2006). Concerned with energy security (specifically with the fact that the Middle East where it imports its energy resources in a rather unstable region) and energy dependency on Russia, the EU tries to have diversification in its energy resources trying to use energy reserves located in the South Caucasus (Tibold and Cillessen 2006).

Dependence on the Russian energy resources creates challenges for the EU's energy security. The need for energy diversification became urgent after the Ukrainian-Russian gas crisis in 2006. It can be supposed that Russia tries to achieve its political goals by using its energy leverage against the EU. This makes the EU more dependent on the South Caucasus energy resources (Gogberashvili 2010). The EU's Green Paper of November 2000 called "Towards a European strategy for the security of energy supply" emphasized the EU objectives in securing the energy supply and also the diversification of energy suppliers for the purpose of minimizing the dependence on one source. As a result, Russia's dominance over energy, new energy resources over the Caspian region and the EU's competition with non-EU states in terms of energy were the factors that made the energy supply priority for the Union. Another factor that made the EU seriously deal with energy supply was that Russia refused to ratify the Energy

Charter Treaty of the EU in 2006, which would permit the EU to import oil and gas from Kazakhstan and Turkmenistan via Russia (Tibold and Cillessen 2006).

In 2005 the EU policy-makers developed the EU security and Solidarity Action Plan, aimed at the liberalization of energy market of the Union, enhancement of energy efficiency and diversification of energy supply. The main priority of the Action Plan was gas transportation from the Caspian region and Middle East, specifically from Azerbaijan, Turkmenistan, Iran and Iraq by promoting the Southern Gas Corridor. The Southern Corridor plan included: the Interconnection Turkey-Greece-Italy pipeline project (ITGI), the Nabucco Pipeline Project and the Trans-Adriatic Pipeline Project (TAP). In this Action Plan the Nabucco pipeline was perceived as the flagship of the EU. The Nabucco project was treated from two perspectives by the European Commission: 1) a project which would provide diversification in gas supply and 2) means of connecting the Caspian region and the South Caucasus in one network project. In this project Azerbaijan was the major actor for energy supply (Caucasus Analytical Digest 2011).

In 2006 the EU identified the main objectives related to energy policy. The major factor touched upon was that the EU could have new energy suppliers other than Russia, i.e. Middle East. This fact resulted in the EU's willingness to sign contracts with Turkmenistan and Kazakhstan and also work out strategies to import Caspian and Central Asian energy resources via Turkey and Azerbaijan (Tibold and Cillessen 2006).

Due to the EU's interest in the energy diversification the BTC (Baku-Tbilisi-Ceyhan) oil pipeline was opened in 2006 and the South Caucasus (or Baku-Tbilisi-Erzurum) gas pipeline (SCP) in 2007. The latter is the only route not being under Russian dominance which brings the Caspian energy to the European market (Gogberashvili 2010).

Energy diversification policy has been the EU's major priority starting from 2005 when the EU member states experienced an energy crisis because of the Russian gas deliveries. In March 2006 Russian Gazprom cut the gas flow because of the pipeline crossing the



Ukraine's territory. This became the reason for a drop in supply to seven EU states: France, Austria, Germany, Italy, Hungary, Poland and Slovakia. Though the crisis ended after the Russian-Ukrainian agreement, the EU representatives were concerned that there would be another crisis. The High Representative for the EU's Common Foreign and Security Policy addressed to the European Council: "A secure energy supply requires a combination of internal and external policies" (Wisniewski 2011). In addition to this, Solana stated: "the development of a coherent and focused external EU energy policy would enhance the collective external energy security of the Union. One of the proposals of Solana was to search for energy resources in the Caspian Sea basin (Wisniewski 2011).

Four main characteristics are identified in the energy policy of the EU:

Access the Central Asian energy resources

Bypass Russian pipeline system

Decrease the prices

More influence of the EU on the former USSR countries

In 2008 an agreement was signed with Azerbaijan as another gas supplier along with Turkmenistan. After this Turkey signed an agreement with Russia for the South Stream-a rival pipeline with the EU-sponsored Nabucco. Nabucco links the former USSR states (e.g. Azerbaijan) to the EU countries. Bypassing Russia the Central Asian resources can be transported to Europe only through the South Caucasus. Another alternative route is Iran, which is not trustful because of its nuclear program (Wisniewski 2011).

Turkey has a significant importance in the South Caucasus. It has established diplomatic relations with Georgia and Azerbaijan. Turkey and Georgia have close economic ties, whereas in the case of Azerbaijan, besides trade energy is the key factor in their relations. As for Armenia, since 1993 Armenia-Turkey border is closed, there are no diplomatic relations between the two countries. Turkey's involvement in the region is also explained by the fact that it wants to secure

energy for its own consumption and become an energy hub for the resources coming from Azerbaijan to Europe. Ankara is concerned that increasing tensions between Russia and Georgia will endanger its prospects to become an energy hub (Kubicek 2013). Free from political issues, Georgia and Turkey have bilateral diplomatic relations: there is a visa-free regime and besides, Turkey is Georgia's first trading partner. For Turkey Georgia also has a significant role in energy security of the region. Its transportation lines are important for Turkey's aspirations in becoming an energy hub. BTC and BTE are important pipelines for both countries. Russia has been trying to prevent Azerbaijan's access to Europe via Turkey. On the other hand, it is not beneficial for Azerbaijan that Iran has close ties with Russia and Armenia (Batalla 2013). Due to BTC Turkey is connected to the Caspian region, but most of its needs are satisfied from the Russian pipelines including the "Blue Stream" (Kubicek, 2013).

Iran has also an important role in the South Caucasus region. Iranian –Armenian relations are based on four major areas of cooperation; trade and industry, gas and electricity, the m major field of cooperation being Iranian gas exports to Armenia. This cooperation is strategically important for both actors. Armenia may become a transit route for the transportation of Iranian gas to Europe. A twenty-year agreement was signed between Armenia and Iran according to which Armenia should deliver 3kWh of energy to Iran for each cubic meter of Iranian gas. This makes Armenia energy exporter in the region. The leaders of the countries are planning to build hydroelectric plant on the Arax river for the purpose of increasing their annual trade volume. Iran-Azerbaijani relations are not as good as Iran –Armenia relations. This is because Iran and Azerbaijan are competitors in oil and gas markets. Along with disagreements, there were several agreements signed between the two countries; one for implementing electricity projects signed in 2004, another one for a building hydroelectric dam on Arax river in 2006. Unlike Armenia and Azerbaijan, Iran does not have borders with Georgia. However, there were several agreements signed between the countries. When because of conflicts Russia cut off its gas exports to Georgia Iran exported 30 cubic meters of gas top Georgia. One of Iran's primary goals is to become an

influential actor in the South Caucasus. If it manages to do so, it will become a transit route for the East and the West (Gasparyan, 2014).

## **Chapter 2: Analysis of the EU Official Documents Related to Energy**

The EU's official documents will be analyzed to find out the priorities of the EU's energy policy. In March 2007 the Heads of State and Government of 27 EU states adopted a binding target of 20% energy consumption from renewable energy by 2020 in the Renewable Energy Source Directive (RES Directive, 2007). After 2007 the European Commission made the proposal for Renewable Energy Directive in 2008. Both the European Parliament and the Council were making amendments to the directive and within a year they came to an agreement. The 2009 EU Renewable Energy Directive is a breakthrough which enables the wind power and other renewable to overcome past barriers. Along with this, the directive confirms that Europe will carry out the energy revolution the world needs. To make sure that 2020 target will be met all the EU member states had to submit National Renewable Energy Action Plan to the European Commission by June 2010. National Action Plans (NAPs) define how to reach its national target including all shares for renewable energy (The European Wind Energy Association 2008).

On October 2, 2012 the European Commission made a decision related to the contracts of energy policy. The principal objectives were to set up a progressive European policy which would assure continuous energy supply security, smooth running of internal energy market and access to transport networks for energy, the observation of the energy market, analysis of modeling, particularly, scenarios on the impact of policies being considered, the strengthening of the rights and protection of energy users, based on the information on European and global energy markets for all energy types (European Commission 2012).

In 2010 many states reached the 2011/2012 target mentioned in the Directive. Every two years the European Commission publishes a Renewable Energy Progress Report. These reports assess the member states' progress towards the 2020 targets. It also describes overall energy developments in each member state. On March 27, 2013 the European Commission published its first Renewable Energy Progress Report based on the framework of 2009 Renewable Energy

Directive. After the adoption of the directive most EU member states experienced growth in their renewable energy consumption. The 2020 figures illustrate that the EU is on the trajectory of the 2020 targets with its renewable energy shares of 12.7 % (European Commission 2013).

In November 2013 the European Commission report on the implementation of the European Energy Program for Recovery (EEPR) stated that the EEPR would provide financial support for the implementation of energy projects related to security and diversification of energy supply, smooth operation of internal energy market and also reduction of greenhouse gas emissions (European Commission 2013).

In February of 2014 the European Commission adopted a decision on the work program in the field of energy. It aims at constituting the financing decision based on the financial regulation. The maximum contribution for financing the 2014 work program is EUR 4.900.000 from the EU budget (European Commission 2014).

According to the European Commission Action Plan on Energy Security and Solidarity, both security and solidarity are important components of the EU's energy policy. The aim is to reduce energy consumption by 20% and energy imports by 26 % till 2020. The Energy Security and Solidarity Action Plan is set out around five major points:

### **1. Infrastructure needs and the diversification of energy suppliers**

In this regard, six priority actions should be taken into consideration:

Connecting the remaining isolated energy markets in Europe

Developing a southern gas corridor for the supply of gas from Caspian region and Middle Eastern sources

Making use of liquefied natural gas to ensure the liquidity and diversity of the European Union markets

Linking Europe with the Southern Mediterranean through electricity and gas interconnections

Developing gas and electricity interconnections crossing Central and South-East Europe along a north-south axis

Developing interconnections between the electric networks of the North-West of Europe and so as to optimize wind energy in the North Sea (European Commission 2013).

### **External energy relations**

The ‘interdependence’ between the EU states tends to increase. That is why, energy supply is important in international relations. The energy community is building integrated energy community in Southern Europe. As Russia is an important energy partner for the EU it is important to establish a stable partnership with it (European Commission 2013).

### **Oil and gas stocks and crisis response mechanisms**

The Commission plans to revise the legislation on the Emergency Strategic Oil Stocks and the directive on the Security of Supply of Natural Gas.

### **Energy efficiency**

As already mentioned, the EU tries to achieve 20% improvement in energy efficiency. The following initiatives will help to reach all the objectives.

A revision of the Energy Performance of Buildings Directive

A revision of the Energy Labeling Directive

An intensification of the implementation of the Ecodesign Directive

Promotion of cogeneration

Increase of Cohesion Policy funds

## **Making the best use of the European Union's indigenous energy resources**

The EU produces 46% of total energy consumption, 9% of the energy is consumed within the EU from renewable resources. The Commission works with the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and other institutions for setting up sustainable energy initiative (European Commission 2014).

The objective of the European Commission's Strategy for Competitive, Sustainable and Secure energy (2014) is to make changes in a way in which Europe produces and consumes energy, while building on what has already been achieved in the area of energy policy. The priorities in achieving this objective are:

- Achieving 20% energy savings by 2020
- Ensuring free movement of energy using the internal market
- Providing secure, affordable and safe energy
- Developing innovative energy technologies
- Strengthening external links (participation of neighboring countries) (A strategy for competitive, sustainable and secure energy, 2014). (European Commission 2014).

### ***European Parliament Resolutions***

<b>Date</b>	<b>Resolution</b>	<b>Major topics</b>
<b>November 2010, Strasbourg</b>	The European Parliament Resolution towards a new energy strategy for Europe	1. A strategy to ensure full implementation of the Lisbon Treaty 2. Ensure the functioning of energy market 3. Support modern integrated grids 4. Finance the energy policy 5. Exploit better the EU's energy efficiency and renewable energy potential 6. Ensure security of energy supply 7. Promote energy research and development and innovation 8. Put the benefits of consumers and citizens at the centre of the EU's energy

		policy
<b>December 2010, Strasbourg</b>	The European Parliament Resolution on revision of the Energy Efficiency Action Plan	<ol style="list-style-type: none"> <li>1.Compliance with and implementation of existing legislation</li> <li>2.Energy Efficiency Action Plan should focus on the full energy supply chain</li> <li>3.The EP calls on critical assessment of National Energy Efficiency Action Plans and their implementation</li> <li>4.Multi-level approach to energy efficiency</li> <li>5.Likely combination of the Eco-Design Directive and the Energy Labeling Directive</li> <li>6.Analysis of the consequences of energy efficiency standards</li> <li>7.Stresses the need to improve the use of existing EU funds.</li> </ol>
<b>September 2009, Strasbourg</b>	The European Parliament resolution on energy security	<ol style="list-style-type: none"> <li>1.The EP calls on the EU and member states to reduce greenhouse gas emissions by 60 to 80 % by 2050 and also reducing energy consumption by at least 20 %</li> <li>2. Reaffirms energy diversification and improvement of the EU's energy security</li> <li>3. Rejects EU's foreign policy aimed at controlling world's energy resources, to make energy efficiency worldwide priority, support for the idea of solidarity and cooperation between states</li> </ol>
<b>June 2012, Strasbourg</b>	European Parliament resolution on Engaging in energy policy cooperation with partners beyond our borders. A strategic approach to secure, sustainable and competitive energy supply	<ol style="list-style-type: none"> <li>1.Internal energy market-better coordination at EU level</li> <li>2.Diversification-enhanced security of European energy supply</li> <li>3.Sustainability-strengthened partnership with supplier countries and international organizations with their sub points.</li> <li>4. the European Parliament stresses the need for strong coordination between Member States' policies and for joint action and solidarity in the field of external energy policy and energy security</li> </ol>
<b>October 2013,</b>	European Parliament	1.Cooperation and interaction between



<b>Strasbourg</b>	resolution of 23 October 2013 on the European Neighbourhood Policy: towards a strengthening of the partnership.	Member States at the EU level 2. Boost energy security 3. Establish energy interdependence between Member States 4. Full implementation of internal energy market legislation
<b>February 2014, Strasbourg</b>	EP resolution on the 2030 framework for climate and energy policies	1. The EP welcomes the 2030 energy policies 2. Set a binding EU 2030 energy efficiency target of 40% 3. Reduce greenhouse gas emissions of the EU 4. Promote renewable energy production 5. The EP highlights the importance of resource efficiency in achieving the EU energy policy objectives 6. Emphasizes the security of energy supply to be crucial

#### **Press Releases of the European Council related to energy**

<b>Date</b>	<b>Heading</b>	<b>Objective/outcome</b>
Brussels, 22 February 2013	Transport, Telecommunications and Energy	Focus on the main obstacles to the achievement of the Europe 2020 energy objectives, i. e. increasing the share of renewable in final energy consumption to 20% and moving towards 20% increase in energy efficiency
Brussels, 27 February 2013	Informal agreement on safety of offshore oil and gas operations	The Council and the European Parliament reach informal agreement on safety of offshore oil and gas operations

Brussels, 11 March 2013	Transport, Telecommunications and Energy	To break the oil dependence of transport and reduce greenhouse gas emissions from transport by accelerating the market uptake of alternative fuels and vehicles adapted to their use. The initiative consists of a strategy for the promotion of alternative fuels and a proposal aimed at building up a minimum infrastructure for alternative fuels within the EU
Brussels, 21 March 2013	The Council adopts energy infrastructure regulation	To expand Europe's energy infrastructure in order to allow the EU to meet its energy policy objectives of competitiveness, sustainability and security of supply. It states that no member state should remain isolated from the gas and electricity networks after 2015.
Luxembourg, 6-7/10 June 2013	Council conclusions on the Commission Communication "Making the internal energy market work"	Internal market should be completed so that no member state would be isolated from European gas and electricity after 2015, it also emphasizes the contribution of Internal Energy Market for the three pillars of the EU energy policy: sustainability, competitiveness and security of supply, promotes different energy policies, i. e. renewable energy, energy efficiency, etc.
Luxembourg, 10 June 2013	Council adopts directive on safety of offshore oil and gas operations	Reduce the occurrence of major accidents related to offshore oil and gas operations and limit their consequences
Brussels, 10 October 2013	Transport,	The Council adopted a decision

	Telecommunications and Energy	authorizing the Commission to negotiate amendments to the Energy Community Treaty on behalf of the European Union
Brussels, 23 October 2013	Informal agreement on notification of investment projects in energy infrastructure	Increase investments in energy infrastructure for the development of European Energy Policy
Brussels, 12 December 2013	Transport, Telecommunications and Energy	To complete EU energy internal market, develop external dimension of EU energy policy, to amend the fuel quality and renewable energy directive

Source; (European Council 2013).

<b>Date</b>	<b>Heading</b>	<b>Objectives/results</b>
Luxembourg, September 2012	Transport, Telecommunications and Energy	Focus on the draft resolution on trans-European energy infrastructure, on two aspects of the proposal: regional groups and regulatory measures

Luxembourg, October 4 2012	The Council adopts energy efficiency directive	The Council adopted the energy efficiency directive, which establishes a common framework of measures for the promotion of energy efficiency within the Union in order to achieve its 2020 20 % headline target on energy efficiency and to pave the way for further energy efficiency improvements beyond that date. The directive should result in a 17 % improvement in energy efficiency by 2020 Compared to the 20 % target
Luxembourg, 4 October 2012	The Council adopts new rules on the exchange of information on energy agreements with third countries	Council adopted a decision establishing a mechanism for the exchange of information between member states and the Commission on intergovernmental agreements in the field of energy, in order to optimize the functioning of the internal energy market
Brussels, 30 November 2012	The Council and the European Parliament reach informal agreement on energy infrastructure regulation	Modernize and expand Europe's energy infrastructure in order to allow the EU to meet its core energy policy objectives of competitiveness, sustainability and security of supply
Brussels, 3 December 2012	Council conclusions on Renewable Energy	To achieve a share of 20% of renewable energy sources (RES) in the Union's energy consumption, to increase renewable energy in the EU, Full implementation of the internal energy

		market legislation, the removal of deficits in market liberalization
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(European Council 2012).

Based on the analysis of the EU official documents a discourse analysis will be provided for the purpose of accepting or rejecting one of the hypothesis of the research. The table below shows the intensity of indicators in the EU official documents. From each column 20 documents starting from 2010 are analyzed documents. It is obvious that ‘Energy Security’ is the major priority of the EU’s energy policy in all documents. Afterwards come ‘Energy Efficiency’ and others.

<b>Descriptors</b>	<b>EC Directives</b>	<b>EP Resolutions</b>	<b>EC Press Releases</b>
<b>Diversification</b>	27	165	31
<b>Solidarity</b>	15	100	15
<b>Interdependence</b>	4	38	11
<b>Energy Security</b>	47	420	53
<b>Energy Efficiency</b>	15	220	44
<b>Sustainability</b>	14	205	24

The EU’s external energy dependence is increasing and 50% of the EU’s energy demand is met through the imports and if nothing changes this figure will reach to 70 % by 2020 or 2030 (European Commission 2010). The external dependence on energy creates social, ecological, economic and physical risks for the EU. Energy imports are only 6% of the total imports: 45% of oil imports come from the Middle East and 40% of natural gas from Russia (European Commission 2010). The current Green Paper recommends that in order to tackle this problem the EU should work out a strategy for security of energy supply in order to reduce the risks related to energy dependence. The EU will face the following challenges while tackling those problems:

Environmental concerns that influence energy choices

The development of the internal market

According to the Green Paper, the main objective of the energy strategy is “to ensure the uninterrupted physical availability of energy products in the market at an affordable price for all consumers, whilst respecting the environmental concerns and looking towards sustainable development” (European Commission 2010). It aims at reducing the external dependence.

According to the energy strategy of the current Green Paper, the EU must:

Rebalance its supply policy by taking a clear action in favor of demand policy, which is currently envisaged

Assess the contribution to be made by nuclear energy in the medium term

Provide a stronger mechanism to build up strategic stocks and to secure new import routes for increasing amounts of oil and gas, though specific plans for this purpose are still in process (European Commission 2010).

Through this Green Paper the European Commission tries to initiate a public consultation for developing a new strategic approach to achieve energy objectives of the EU. Within this framework the main priority is to develop the energy networks of the Member States and enhance operation in the internal energy market. Energy transportation networks are crucial for the realization of energy policy objectives. That is why, the Trans-European Energy Networks have to correspond to the requirements of energy policy along with sustainability, competitiveness and supply. The external dimension and energy network development are also important for the development of energy market (European Commission, 2013)

### **Energy Community**

Energy Community is an international organization which deals with energy policy. The organization was established in 2005 in Greece and entered into force in 2006. The parties are

the EU and nine contracting parties from the Black Sea region and South East Europe. The secretariat is located in Vienna. The eight *contracting parties* are: Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Moldova, Montenegro, Serbia, Ukraine and Kosovo (Energy Community 2014).

The contracting parties have the following responsibilities under the treaty:

- Extension of the *acquis communautaire*
- Mechanism for operation of Network Energy Markets
- Creation of a single energy market

The *acquis communautaire* of the Energy Community consists of twenty legal acts. The latter encompasses all the acts related to electricity, oil and gas, renewable energy resources, energy efficiency and statistics (Energy Community, 2014).

The goal of the treaty is to create a stable regulatory and market framework for the purpose of:

- Attracting investment in power generation and networks to ensure ongoing and stable energy supply
- Creating an integrated energy market and ensure integration with the EU market
- Ensuring the security of energy supply
- Improving the environmental conditions related to the energy supply
- Enhancing competition at regional level (Energy Community 2014).

The European Commission statement about the Energy Community: “Energy Community is about investments, economic development, security of energy supply and social stability; but more than this-the Energy Community is also about solidarity, mutual trust and peace. The very existence of Energy Community, only ten years after the Balkan conflict, is a success in itself, as it stands as the first common institutional project undertaken by the non-European Union countries of South-East Europe.” Currently the so called leitmotiv of the Energy Community is

to import the EU energy policy to the non-EU states (Energy Community, 2014). Armenia, Georgia, Turkey and Norway are observers of the Energy Community. Moreover, Georgia is in the process of joining the Energy Community.

### **The Energy market of Armenia**

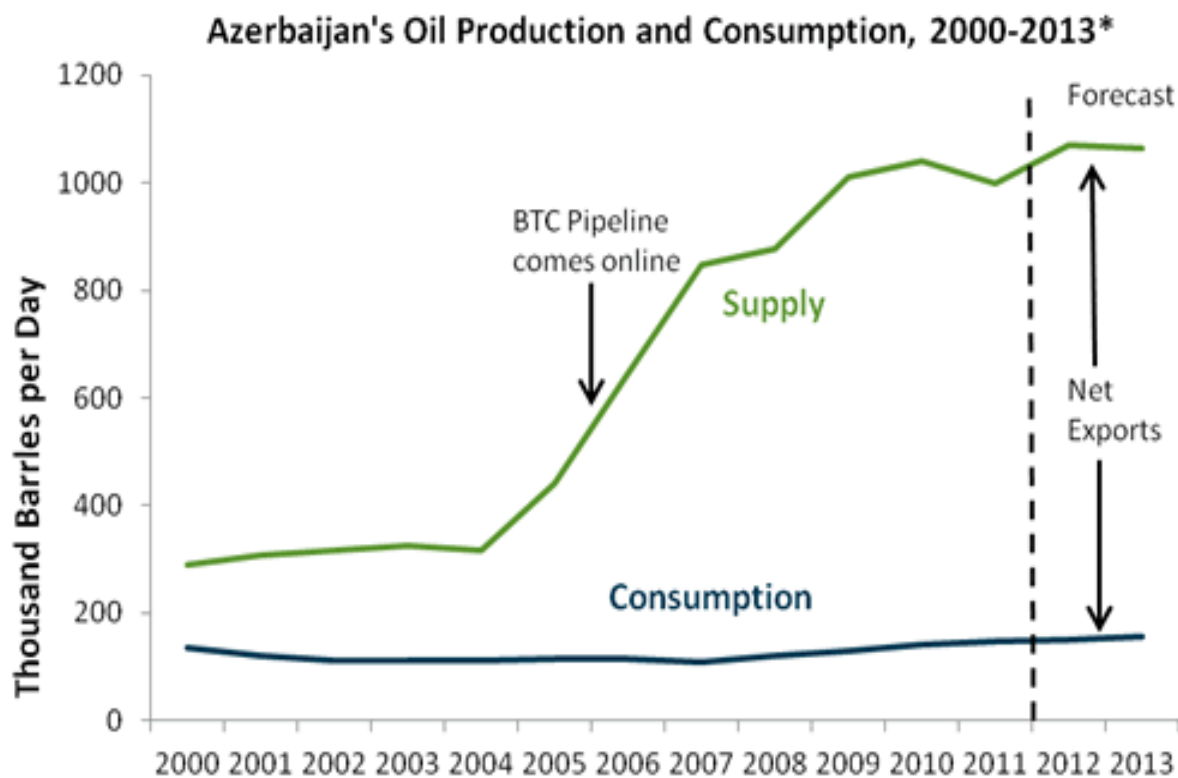
**Oil market** - Armenia has neither oil nor gas production. That is why it depends on foreign imports, mainly from Russia and Iran. It has the capacity to store up to 1.2 m. tones of light products and 0.9 m. tones of fuel oil. In 2008 oil imports amounted 47.000 bpd. The most parts of oil imports comes from Georgia's Batumi refinery. Because of the close borders with Turkey and Azerbaijan another alternative for oil imports is Iran (INOGATE 2014).

**Gas market** - Armenia has no gas production and entirely depends on the foreign imports of natural gas. The natural gas is imported from two companies: "ArmRosGasProm" CJCT and "Transgas" LLC, which belong to Russia. Natural gas imports amounted 2.254mcm in 2008 (INOGATE 2014).

### **The Energy market of Azerbaijan**

**Oil market** – The State Oil Company of Azerbaijan Republic (SOCAR) is Azerbaijan's State own company which is responsible for both oil and gas production and management of the country's oil and gas imports and exports. The Azerbaijan International Operating Company (AIOC) is a consortium including ten petroleum companies that have contracts with Azerbaijan (BP as the biggest one). The graph below shows Azerbaijani oil production, consumption and net exports from 2000-2013. It is obvious that Azerbaijan exports about 1000 barrels oil per day.



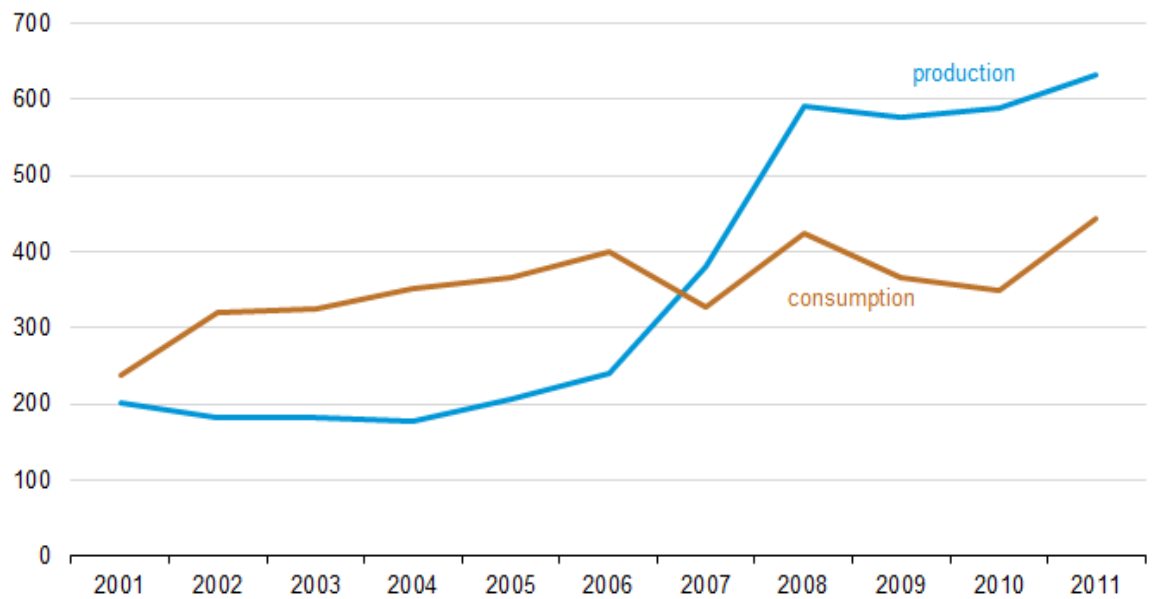


Source: U.S. Energy Information Administration, Short-Term Energy Outlook  
 \* 2012-2013 data are EIA forecasts

**Gas market** – Azerigas is a SOCAR subsidiary responsible for natural gas processing, transportation and distribution. Azneft is another subsidiary of SOCAR responsible for exploration, development and production of natural gas. AIOC is involved in the development of gas field of Shah Deniz gas field. Shareholders of Shah Deniz Gas field are: BP (Great Britain) (25.5%), StatoilHydro (25.5%), Lukoil (Russia), SOCAR (Azerbaijan), Total (France), Naftiran (Iran) each hold 10% and TPAO (9%) (INOGATE 2014). Only in 2007 after the construction of Shah Deniz Azerbaijan became a net gas exporter, before it imported gas from Russia. The graph below shows Azerbaijani gas consumption, production and net exports from 2001-2011.

## Azerbaijan's dry natural gas production and consumption, 2001-2011

billion cubic feet



Source: U.S. Energy Information Administration

### The Energy market of Georgia

**Oil market** – The Georgian Oil and Gas Corporation is (GOGC) is the major player in Georgia's oil market. The following companies are involved in the oil production in Georgia: Can Argo, Frontera, Global Oil and Energy and Aksai BMC. The two major transportation projects are operated by the BP (West Route Export Pipeline and Baku-Tbilisi-Ceyhan).

**Gas market** – GOGS is also responsible for natural gas imports in Georgia. The South Caucasus gas pipeline operated by the BP carries gas from Shah Deniz Gas field to Azerbaijan, Georgia and Turkey. Georgia has no gas market (INOGATE, 2014).

**Oil** made up 36% of the EU's energy consumption in 2006-2010. The increase in oil prices implies that the global market is in the period of increase scarcity. The EU-27 average oil dependence currently is 83% (73% in 1999). This can be explained by the fact that EU domestic oil production decreased by 43% within ten years (1999-2009). 20 member states import 95% of their oil needs, whereas the UK's dependency is only 8% and Denmark exports its oil resources

rather than imports them. Germany, France and Poland depend on oil imports to the highest degree (97%, 95% and 98% respectively). Germany and Poland largely depend on Russian imports, whereas, France depends on several sources, such as; Middle East and North Africa, North Sea and Russia. 45% of its oil imports comes from the Middle East (European Commission, 2013).

**Natural gas** made up 25% of the EU energy consumption in 2006-2013. In the last 15 years gas demand has increased largely (from 20% in 1995 to 25% in 2010). Overall, the EU imported 62% of its energy needs in gas in 2006-2013. As in case of oil EU gas dependence has increased since 1999 (42%). This is explained that the EU reduced its gas production by 25% within the last decade and at the same time the overall EU gas consumption increased by 10%. The same picture is with gas supply. Germany, France and Poland are the major importers respectively, 80%, 70% and 95 from the Middle East, Algeria, Norway, etc. (European Commission, 2013).

In 2009 20 EU member countries reported gas shares of different suppliers; I.e. 34% from Russia, 30% from Norway, 14% from Algeria 5% from Qatar and remaining 17% from other countries. Fossil fuels (gas, oil and coal) represent 80% of Total Primary Energy Supply (TPES) of the EU (European Commission 2013).

The EU imports its energy resources from Russia, Norway, Caspian basin, Middle East and North Africa. The EU states and the European firms have been major investors in the pipeline projects in the Caspian basin. E.g. British Petroleum was the leading investor in many projects including BTC and Shah Deniz fields in Azerbaijan and also other companies, namely, Royal Dutch Shell, British Gas, Total (France), Agip and Eni (Italy) made huge investments in Azerbaijani oil and gas projects. Geo-strategically EU member states are willing to make diversification in their energy imports. They want to decrease Russian dominance over them (Kubicek 2013).

The Caspian region is one of the major sources of global oil and gas supply. The proven natural gas resources of Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan are estimated 1.000 trillion cubic feet among the largest in the world. The International Energy Agency estimates that the Caspian region's natural reserves are 7% of the world's reserves (Muradkhanli 2013).

***Natural gas data***

*(units = trillion cubic feet (tcf))*

Country	Reserve	Production
Azerbaijan	44.9	0.5
Kazakhstan	66.4	0.7
Turkmenistan	858.8	2.1
Uzbekistan	56.6	2.0
Total	1,026.7	5.3

Source: *Statistical Review of World Energy 2012*

Crude oil									
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Russia	29.2	31.1	32.2	32.5	33.4	33.2	31.4	33.1	34.5
Norway	19.4	19.2	18.8	16.9	15.5	15.1	15.1	15.2	13.8
Libya	7.5	8.4	8.8	8.8	9.2	9.8	9.9	9.0	10.2
Saudi Arabia	10.1	11.3	11.3	10.6	9.1	7.2	6.9	5.7	5.9
Iran	4.9	6.4	6.3	6.1	6.2	6.2	5.4	4.7	5.7
Kazakhstan	2.4	2.7	3.4	4.5	4.6	4.6	4.8	5.4	5.5
Nigeria	3.5	4.3	2.6	3.2	3.6	2.7	4.0	4.5	4.2
Azerbaijan	1.0	1.0	0.9	1.3	2.2	3.0	3.2	4.0	4.2
Iraq	3.0	1.6	2.2	2.1	2.9	3.4	3.3	3.8	3.3
Others	18.8	14.2	13.4	14.0	13.2	14.7	16.1	14.6	12.8
Natural gas									
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Russia	45.0	45.1	43.8	40.6	39.3	38.4	37.6	34.3	31.8
Norway	26.2	25.5	24.9	24.4	25.5	28.2	28.9	30.7	28.2
Algeria	21.2	20.0	18.2	18.0	16.4	15.4	14.7	14.2	14.4
Qatar	0.9	0.7	1.4	1.6	1.8	2.2	2.2	4.6	8.6
Nigeria	2.2	3.1	3.7	3.5	4.3	4.7	4.0	2.4	3.6
Libya	0.3	0.3	0.4	1.7	2.5	3.0	2.9	2.9	2.8
Trinidad and Tobago	0.2	0.0	0.0	0.2	1.3	0.8	1.6	2.2	1.5
Egypt	0.0	0.0	0.0	1.6	2.5	1.8	1.7	2.1	1.3
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.2
Others	4.1	5.3	7.5	8.4	6.4	5.5	6.2	6.5	7.7

The table above shows the EU's oil and gas dependence on foreign actors. It is obvious that the biggest imports both for oil and gas are from Russia and Norway. As for Azerbaijan, currently the EU imports about 5% of its overall demand. As for natural gas, it is about 3% currently. So, overall the EU imports almost 8% energy resources from Azerbaijan.

After the discovery of Shah Deniz field in Azerbaijan it became an important energy partner for the European Union. The country has established cooperation with Europe and with major companies and institutions. Currently Azerbaijan's oil and oil products are exported to 33 countries via different routes. In terms of energy security Azerbaijan occupies an important position due to Azeri-Chirag-Guneshli (ACG) and Shah Deniz (SD) projects, Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the South Caucasus gas pipeline (SCP). Currently the country exports natural gas to Russia, Iran, Georgia, Turkey, Greece, etc. Shah Deniz field is the major source of the planned gas transportation projects. Shah Deniz gas field reserves totally 1.2 trillion cubic meters, the expected gas extraction is 16 billion cubic meters. Through opening the Second Gas Corridor 6 bcm natural gas will go to Turkey and 10bcm to Europe by 2020 (Muradkhanli 2013).

The Trans-Anatolian Natural Gas Pipeline (TANAP) Project will realize natural gas transportation from the SD2 and other fields of Azerbaijan through Turkey to Europe. In 2003 Azerbaijan and Turkey signed a Memorandum of Understanding for the construction of TANAP, where Azerbaijani SOCAR is the main stakeholder (80%). TANAP actually was replacing Nabucco's eastern wing in the Turkish territory and made Nabucco shorter known as Western Nabucco (Turkey-Bugaria-Austria) (Gurbanov 2013).

The Trans Adriatic Pipeline (TAP), on the other hand, is aimed at transporting natural gas from the SD2 field in Azerbaijan, via Greece and Albania, and across the Adriatic Sea to Southern Italy, and then to Western Europe, particularly, Switzerland, Germany, France and Great Britain. The initial pipeline capacity will be 10 bcm per year with possibility of further expansion to 20 bcm per year (Gurbanov 2013). The TAP route is designed to be almost 870 km in length (Muradkhanli, 2013). The primary shareholders of TAP were Switzerland's Axpo (42%), Norway's Statoil (42.5%) and Germany's E.ON Ruhrgas (15%). SOCAR, BP and Total entered the TAP pipeline consortium. SOCAR and BP owned 20% each and Total 10% of TAP's shares. Another shareholder is Fluxys (Belgium-based operator of gas transmission) which took 16% of stake. Norwegian Statoil and German E.ON reduced their stakes of the TAP project. The current stakeholders of the project are SOCAR, BP and Statoil each 20%, Fluxys 16%, Total 10%, E.ON 9%, and Axpo 5 % (Gurbanov 2013).

### **Chapter 3: EU-Azerbaijani relations through the lenses of interdependence theory**

The concept of dependency-either mutual or otherwise-has become controversial in the last decade. Generally it means ‘mutual benefits’, which may be defined in terms of the ‘values of the parties and the likely effects on those values of breaking the relationship. If there is little or no effect or if the parties would actually be better off, the relationships would not be described as interdependent. It is in this sense only that interdependence involves mutual benefits’ (Baldwin, p. 483).

The world currently has become interdependent to such a degree that without the world government the realization of many values such as economic well-being and peace, will not be possible. Keohane and Nye state that interdependence cannot be defined as a condition in which events in one part of the world covary with other events in another part of the world (Baldwin p. 484).

‘Dependence is translated into policy most directly when certain policies which a government might otherwise follow become prohibitively costly’ (Keohane and Nye 1977, p. 8). Dealing with dependence and interdependence certain problems arise for large states. Small and weak states will be able to make decisions only by considering their own costs and benefits at the same time taking into consideration probable reactions from other states, as well. More powerful states also should take into consideration the impact of their decisions on the other states. As soon as states become dependent on one another, some of them possess new means for making influence on others (Keohane and Nye 1977).

“Dependence means a state of being determined or affected by the external forces, whereas interdependence means mutual dependence. It is referred to situations characterized by reciprocal effects and among countries or among actors in different countries” (Keohane and Nye 1977, p. 7). Keohane and Nye define interdependence in two ways: in terms of

*'vulnerability'* which refers to the 'measure of government's inability to insulate itself from effects of the transmission of events originating elsewhere' and *'sensitivity'* which 'refers to mutual responsiveness of one nation occurring in the other' (Keohane and Nye 1977, p. 9).

Interdependence exists when there are transactions, in the absence of transactions there is simply interconnectedness. Interdependence also restricts autonomy. Interdependence does not ensure existence of mutual benefits; it depends on the nature of relationships. Less dependent actors may use the interdependence as a source of power in bargaining over an issue. Power is conceived as a control over outcomes. It is the ability of an actor to do something they otherwise would not do (Ibid, p.7).

“Interdependence affects world politics and the behavior of states: along with this governmental actions also influence the patterns of interdependence. It is considered as a natural necessity to which a certain policy should adjust, not as a situation created by the policy itself. There is an argument that interdependence reduces the likelihood of conflicts (Ibid, p. 6). “Interdependence rhetoric and national security coexist. Interdependence rhetoric suggests that conflicts of interest are passed, whereas national security confirms that there are conflicts which will remain potentially violent. The politics of interdependence encompasses domestic, transnational and governmental interests” (Ibid, p. 7).

International relations scholars have discussed the dependence and interdependence referring to self-sufficiency and vulnerability of the state towards alternations in international relations, particularly trade (Baldwin, p.485).

Deutsch distinguished 'interdependence' and 'mutual responsiveness' that states might not be dependent upon each other, i.e. might be able to do without each other's aid. Cooper sometimes uses the terms 'interdependence' and 'integration' interchangeably, while in other cases he uses the term 'interdependence' to refer to relationships that are costly to forego (Baldwin, p. 485).



Theoretically interdependence is multinational and systematic as a relationship among states rather than an international pattern of behavior among an entire set of countries. A novel approach to interdependence emerged in 1977 by Richard Rosecrans and his colleagues (Tetreault 2001). They focused on the ‘sensitivity’ component of interdependence. As a result, two types of interdependence were distinguished; when interdependence is measured by transactions it is *horizontal* interdependence. *Vertical* interdependence is measured “by the responses of one economy to the other in terms of changes in factor prices. In 1980s true interdependence was considered only vertical interdependence, whereas, transactions were treated as means of assisting to develop interdependence. Besides, Rosecrance group state that horizontal interdependence implies simply connectedness, nothing more (Tetreault 2001, p. 430).

The Rosecrance group suggests two measures for the sensitivity component of interdependence. First ‘a correlation of the movement of factor price indices between two societies and second, a correlation of the changes in such movements’ (Tetreault 2001, p. 431). They stated that correlation indicated a high level of interdependence between developed countries (Tetreault 2001, p. 430).

The highest degree of convergence of Azerbaijan with the EU norms for liberalizing its energy market, transportation and distribution of energy was realized from 2006-2009. In this situation the EU suggested its norms to Azerbaijan for convergence. Azerbaijani bargaining power was increasing with the EU and this was due to the EU’s external energy policies. In 2000s the EU launched governance networks both with private and public sectors on regional and bilateral level. Joint projects in the bilateral level ensured substantial convergence. EU external energy policy became much more important. Moreover, after signing the Memorandum of Understanding (MoU), the European Commission singled out Azerbaijan as the major energy partner in the Southern Gas Corridor. Along with this, Azerbaijan was included in the co-

development of regulatory governance of several sectors of the Southern corridor (Weber, 2014).

The visit of Ilham Aliyev to Brussels in June 2013 was important in the future relations of the sides. The president met with the president of the European Council, Herman Van Rompuy and the president of the European Commission Jose Manuel Barroso. At the core of the discussion were the EU- Azerbaijani future relations, issues in cooperation concerning particularly energy. *President Barroso also highlighted the role of energy in their relations referring to the new gas pipeline he stated; “The Southern Gas Corridor is what we were looking for. It will bring 10 billion cubic meters to Europe by 2019. The corridor could in the medium term cover more than 10% of our annual needs in Europe and thus contribute to our energy security, price stability, growth and jobs. This is our common vision as president Aliyev and I agreed in 2011. We believe it is the best interest of Europe and Azerbaijan”* (Commonspace, 2013).

The higher is the share of imported energy the **more vulnerable** a state is to foreign decisions, price increases, etc. In 2006-2013 54% of the EU’s consumed energy came from imports and this number is quite high compared with 1999 (43%). This is because the EU has reduced the production of primary energy, especially oil and hard coal and on the other hand its demand for energy resources has increased by 10% (European Commission 2013).

Keohane and Nye state that in the absence of transactions there is simply interconnectedness between the actors. This is the case with the EU and Azerbaijan. Though Azerbaijan with its energy resources is important for Europe to decrease its dependence on Russia there is no interdependence between the two. Though the newly-designed pipeline projects (TAP and TANAP) are supposed to deliver Azerbaijani gas to Europe it does not still imply that there is interdependence because the percentage of energy resources delivered is too small. TAP and TANAP will deliver 10bcm gas to Europe annually starting from 2020.

Whereas, the EU's overall demand annually is 500bcm. This means that Azerbaijan will deliver only 5% of the EU's overall demand. This figure does not mean that the EU cannot do without Azerbaijani energy resources. It can otherwise import more energy resources from the Middle East. In this case Azerbaijan is willing to sell its energy resources to the European market and the EU also wants to buy those resources so that to decrease its dependence on Russia. So, there is interconnectedness which can be considered as a component of interdependence but not interdependence itself. The discovery of the Shah Deniz gas field made Azerbaijan more important for the EU due to energy resources and it was found useful to carry out energy cooperation. Cooperation-which creates interconnectedness rather than interdependence.

## **Conclusion**

Having examined the EU-South Caucasus energy relations, conclusions will be drawn from each of the three chapters and afterwards final concluding remarks will be presented which will address the research questions of the study and will test the hypothesis.

In the first chapter the EU-South Caucasus relations were analyzed starting from 1991 after the collapse of the Soviet Union. The European Union launched TACIS and INOGATE programs for ensuring technical and financial assistance to the post-Soviet states. Partnership and cooperation agreements (PCA) were signed in 1996 and entered into force in 1999 in three South Caucasian countries. Afterwards, the South Caucasus countries became involved in the European Neighborhood Policy and Eastern Partnership. Located between Russia and the EU, Middle East and Central Asia makes the Caucasus region a transit route between the Caspian basin and the West. Currently Baku-Tbilisi-Ceyhan oil pipeline and Baku-Tbilisi-Erzurum gas pipeline are the major pipelines in the region, which have a strategic importance for it. Baku-Novorossiysk and Baku-Supsa pipelines are designed to transport Azerbaijani oil resources. As Europe seeks diversification of its energy resources Nabucco, TAP and TANAP were designed aimed at transporting Azerbaijani gas to Europe. Purposes and challenges of the projects have been analyzed. Afterwards the role of Iran and Turkey in the energy-related issues were discussed. After the discussion it became clear that the former tries to become a transit route between Europe and the East and the latter wants to become an energy hub using Azerbaijani energy resources. Though Europe wants to diminish its dependence on Russia, Russia is trying to prevent the access of European Union in the South Caucasus countries.

The second chapter is mainly document analysis, EP resolutions, European Council, European Commission Directives and Progress Reports related to energy, Green Papers on the Security of energy supply, etc. The analysis of these documents revealed that energy-related issues are of prior importance for the European Union. It tries to work out plans and strategies to

ensure diversification of its energy resources. The discourse analysis revealed that the EU's energy policy priority is *energy security*, which is related to *diversification* (though frequency of the word 'diversification' was low in comparison with other indicators). Afterwards, it became clear that currently the EU imports 40% of its energy resources from Russia, and this number is going to reach 70% by 2030 if Europe does not find other alternative solutions. Energy markets (gas and oil) of the South Caucasus states are discussed to show how much capacity does the oil and gas rich Azerbaijan have to provide Europe with energy resources and decrease Europe's dependence on Russia. Apart from Russia, the EU imports energy resources from Norway, Caspian basin, Middle East and North Africa, as well. However, the percentage of these imports is not so high so that to meet the energy demand of the EU.

The third chapter discusses firstly the interdependence theory and its main points. Afterwards, combined analysis of the EU-Azerbaijani energy relations with the interdependence theory is analyzed, also based on the speeches of the heads of EU institutions and Azerbaijani president Ilham Aliyev. The EU-Azerbaijani relations are perceived as relations seeking "mutual benefits".

After Russia-Ukraine crisis the EU's external energy policy became more important. Moreover, after signing the Memorandum of Understanding (MoU), the European Commission singled out Azerbaijan as an energy partner in the Southern Gas Corridor. Along with this, Azerbaijan was included in the co-development of regulatory governance of several sectors of the corridor.

The overall analysis shows that the European Union is highly dependent on Russian energy resources and at the same time it wants diversification of the energy resources because the EU does not want Russia to use its energy leverage over it for accomplishing its political goals. Though the EU imports energy from Norway, Middle East and Algeria, as well, if not Russia, they all together will not meet the EU energy demands. The most appropriate alternative

in this regard is Azerbaijan. The Southern gas corridor and construction of new pipelines are aimed at ensuring the transportation of Azerbaijani gas to Europe. So, it becomes clear after the analysis that in case the European Union decreases its energy dependence on Russia another alternative is Azerbaijani energy resources. But at the same time another question arises. It is a fact that the EU wants diversification, but the issue should be tackled from another perspective: whether Azerbaijan will be able to substitute Russia and provide as much energy resources to Europe as Russia or not. The tables analyzed before revealed that TAP and TANAP pipelines will provide only 5% of the EU's annual demand. This figure is too small to consider that the EU depends on Azerbaijan. If not Azerbaijan the EU can import more resources from the Middle East or North Africa. So, there is interconnectedness between the EU and Azerbaijan rather than interdependence.

The first hypothesis of the research will be accepted based on the document analysis and discourse analysis. It was obvious after the analysis that the EU's energy policy priority in the South Caucasus was energy security. As for the second hypothesis, it will be partially accepted because there is interconnectedness between the EU and Azerbaijan.

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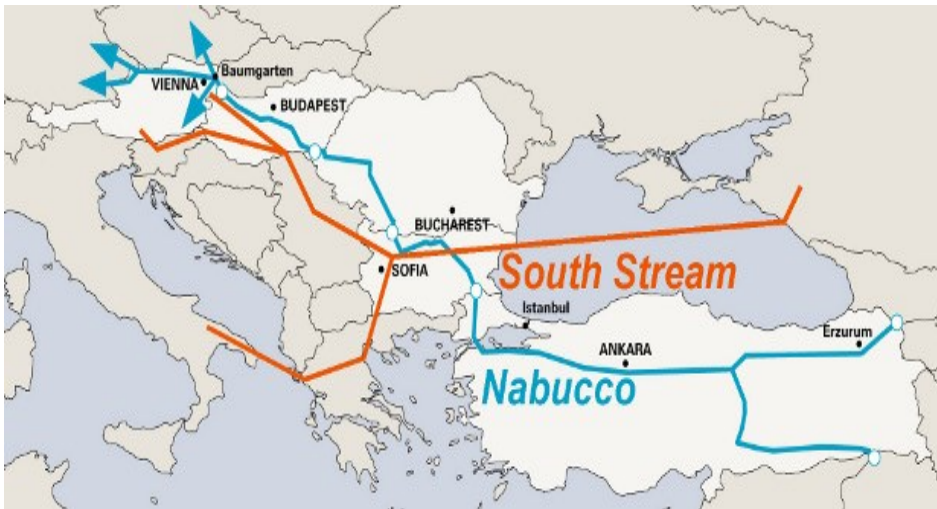
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## Appendix



South Stream and Nabucco Pipelines



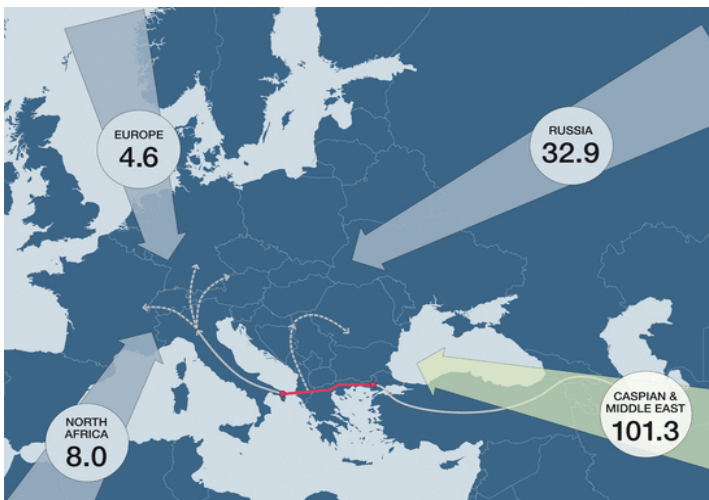
Baku-Tbilisi-Ceyhan, Baku-Novorossiysk, Baku-Tbilisi-Erzurum pipelines



TAP (Trans Adriatic Pipeline)



South Stream Pipeline



Natural gas reserves (in trillion cubic meters). Source: BP World Energy Statistical Review 2012



TAP and TANAP gas pipelines



The EU's major energy suppliers

