

# DGAPanalyse

Prof. Dr. Eberhard Sandschneider (Hrsg.)

Otto Wolff-Direktor des Forschungsinstituts der DGAP e.V.

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## Recalibrating Germany's and EU's Policy in the South Caucasus

by Stefan Meister



## Foreword

by Prof. Dr. Eberhard Sandschneider

The South Caucasus, and the broader Caspian region, is becoming increasingly more important for European energy, security and economic interests. Europe's Southern energy corridor depends on Europe's access to the energy resources in the Caspian Sea. Stability in the South Caucasus has a direct impact on security along the EU Black Sea flank, while EU-Russia, EU-US, and EU-Turkey relations are being shaped by and are shaping the trends in the broader Caspian region.

The changes in the region are overwhelming, and yet, the EU has not made the necessary adjustments. Part of the problem has been the lack of German focus in this region, which ironically has become increasingly interesting for the German private sector, most notably Azerbaijan, which is the 6th major oil supplier to Germany today, and also the biggest recipient of German FDI that flows into the South Caucasus.

Further, Azerbaijan through its balanced foreign policy and steady domestic development has become the regional leader. It not only is the biggest economy in the South Caucasus region, but it has become a major energy supplier to Turkey, Georgia and Southern Europe. It is a connecting point for Europe to Turkmenistan, and a key player in broadening regional security. Azerbaijan has the highest military budget in the region in nominal figures and over 20 percent of its territory is under Armenia's control. The Nagorno-Karabakh frozen conflict is an obstacle that stands in the way of unhindered regional cooperation and integration, and is a security threat to European energy projects in the Caspian and to European investments in this region. For this reason, Germany should increase the political push within the EU to bring a lasting solution to the Nagorno-Karabakh issue.

This paper is a timely endeavor, with appropriate key messages for the German and European decision-makers. Not only is this an opportunity to engage in the region more proactively, but Berlin also has an inherent interest in recalibrating its regional policy to fit better the current regional realities. Germany has always had a special relationship with Russia, but as this paper argues, it thus should also take the unique responsibility and shape a value added and independent European policy towards the South Caucasus.



## Zusammenfassung

# Neuaustrichtung deutscher und EU-Politik im Südkaukasus

von Stefan Meister

Die Politik der Europäischen Union gegenüber dem Südkaukasus ist ein typisches Beispiel für das Unvermögen ihrer Mitgliedsstaaten, eine gemeinsame Politik gegenüber dem postsowjetischen Raum zu entwickeln. Gleichzeitig ist die EU nur relativ langsam dazu in der Lage, auf Veränderungen in der Region zu reagieren. Dies betrifft insbesondere den Einfluss- und Bedeutungszuwachs von Aserbaidschan im Südkaukasus. Das Scheitern von Konfliktlösung im Südkaukasus hat auch seine Ursachen im begrenzten Engagement der EU in der Region und in den unterschiedlichen Interessen ihrer Mitgliedsstaaten, was die EU-Politik in der Region wenn überhaupt dann reaktiv macht. Erstens, der Südkaukasus ist Ausdruck für die interne Debatte in der EU, wie die Politik gegenüber Russland und dem Südkaukasus entwickelt werden soll. Zweitens, die zum Teil ideologisch geführte Diskussion über die Diversifikation der Energieversorgung in Europa hat die Debatte über die Erschließung und den Zugang zu den kaspischen Energieressourcen ohne konkrete Erfolge beeinflusst. Drittens, die Region zeigt das Fehlen einer gemeinsamen »westlichen« Strategie, d.h. der EU und den USA, gegenüber dem postsowjetischen Raum.

Als Ergebnis war die europäische Konfliktlösung in der fragmentierten Region in den letzten 20 Jahren wenig erfolgreich. Gleichzeitig nutzte Russland, welches ebenfalls ohne Entwicklungsstrategie für die Region ist, die Abwesenheit der EU, um den Status quo zu erhalten und die Region in seinem Interesse zu beeinflussen. Die drei südkaukasischen Staaten sind deshalb frustriert mit der relativ schwachen und gegensätzlichen Politik der EU in der Region. Es war ein Fehler, die EU-Politik im Südkaukasus auf Georgien zu konzentrieren, insbesondere als deutlich wurde, dass die georgische Führung ihr Land nicht demokratisieren und eine nationale Versöhnung suchen würde.

Deshalb sollte die EU-Politik gegenüber dem Südkaukasus neu ausgerichtet werden. Deutschland kann eine zentrale Rolle für die Neugestaltung der EU-Politik gegenüber der Region spielen, ist jedoch im Moment ein wenig aktiver Akteur in der EU-Ostpolitik-Debatte. Wenn Deutschland nicht dazu bereit ist, die Östliche Partnerschaft der EU aktiver zu unterstützen, dann wird die EU insgesamt darin scheitern, zu einem relevanten Akteur im Südkaukasus und Kaspischen Raum zu werden. Fehlender Einfluss bedeutet begrenzten europäischen Zugang zu den kaspischen Ressourcen, dem zentralasiatischen Markt sowie das Scheitern der Demokratisierungspolitik in der gesamten Region. Deutschland und die EU sollten das »window of opportunity« nutzen, welches sich nach dem russisch-georgischen Krieg im August 2008 geöffnet hatte, um eine umfassende Strategie für den Südkaukasus zu entwickeln.

## Summary

# Recalibrating Germany's and EU's Policy in the South Caucasus

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The European Union's policy towards the South Caucasus is a typical example of the inability of its member states to develop a common policy towards the post-Soviet space. Furthermore, the EU has been slow to adapt to changes in the region, such as, most notably, the rise in power and relevance of Azerbaijan in the South Caucasus region. The failure of conflict resolution in the South Caucasus is also due to diverging interests between the member states and EU's limited engagement in its neighborhood, which makes the EU policy towards the South Caucasus at the most reactive. First, the South Caucasus fuels internal European disputes on how one should develop a policy towards Russia, and its post-Soviet neighbors. Second, an ideologically charged debate about diversification of energy supply has unfolded in the Europe-Caspian discourse, without tangible results. Third, the region exemplifies a lack of a common Western – that is US and EU strategy – towards the post-Soviet space.

As a result, conflict resolution in this fragmented region has not yielded results in the last 20 years, and Russia, lacking its own strategy for the development of the region, uses the absence of a serious EU involvement in conflict resolution to prolong the status quo and control over the region. The three South Caucasian states are highly frustrated with EU's weak and contradictory policy in the region. From the beginning it was a mistake to concentrate EU's regional approach on Georgia, especially when it became obvious that the Georgian leadership failed in transforming the country's strong western support into a clear political democratization, economic transformation, and national reconciliation.

There is an urgent need for recalibrating EU's policy towards the South Caucasus. Germany can play a crucial role in setting in motion a new policy approach towards the region, but it is currently a weak link in the EU's eastern policy debate. If Germany is unwilling to actively promote Eastern Partnership (EaP) policy the EU as a whole will fail to be a relevant player in the South Caucasus and the broader Caspian region. By default, a lack of influence means limited European access to Caspian energy resources, and the broader Central Asia market and consequentially the failure of democratization policy in the region. Germany has traditionally played a key role in all EU initiatives in the region, but has thus far been unable to consolidate its vision for the wider trans-Caspian region into a comprehensive strategy. The EU and specifically Germany should use the window of opportunity that opened after the Russian-Georgian war in August 2008 to develop a comprehensive strategy concerning the South Caucasus

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# Recalibrating Germany's and EU's Policy in the South Caucasus

by Stefan Meister

## Why the South Caucasus?

There are numerous reasons why the EU, and especially Germany, should recalibrate its activities in the South Caucasus. Capitalizing on its last enlargement to Bulgaria and Romania, the EU has now become a direct actor in the Black Sea region, which borders the South Caucasus. Furthermore, the South Caucasus, in particular Azerbaijan and Georgia, form a land bridge to the energy resources of the Caspian Sea and the gateway to Central Asia and China. The frozen conflicts that have for decades undermined regional progress and cooperation negatively impact broader European security. Weak borders, proliferation and trafficking are soft security threats, which the EU can no longer ignore.

At the same time, the instability in Afghanistan is directly impacting the stability of the South Caucasus political systems, and in this way influencing the security of Europe. Conflict resolution is deeply connected with bringing comprehensive stability to the broader Caspian region and instigating future economic development in the three South Caucasus countries, and can stimulate flow of foreign investments into the region. Without a solid presence and position in the South Caucasus, Europe's role in Central Asia will continue to be very limited – most recently this lack of EU influence in the political process in Central Asia became apparent during the crisis in Kyrgyzstan, where the political management was reserved for Russia, Kazakhstan and to an extent the US. Furthermore Armenia, Azerbaijan, and Georgia are the southern part of the Caucasus which cannot be separated from the North Caucasus as a part of the Russian Federation. This makes Russia a key player in the South Caucasus because conflict solution and economic development must be seen within the context of developments in the Northern Caucasus.

The political trends in the region favor a new strategy of EU engagement. Not only has the balance of power in the region shifted in favor of Azerbaijan, but also the politics of enlargement and European integration have changed in the last few years, making the prospect of EU membership for the South Caucasus countries unlikely. Energy and investments have become the primary drivers of engagement between Europe and the broader Caspian region. Currently, Azerbaijan is Europe's key energy partner in the South Caucasus, as well as Europe's connection to the gas riches of Turkmenistan and Uzbekistan.

Rather than focusing first and foremost on Georgia, the EU should work with all states and taken into consideration the various levels of development, their different conflicts as well as different interests in the rapprochement with the EU. Furthermore the EU should foster a special relationship with Azerbaijan, which because of geographic location and economic potential has become the most important economic partner for Europe in the region. The Azerbaijanian record on human rights and democracy is a work in progress, but economic development and to some degree political stability are for the South Caucasus important outcomes of the current leadership's policies. As membership in the EU is not really on offer for the South Caucasus states, the EU's ability to impact change in this region will come mainly from engagement in economic and energy issues, as opposed to democracy and human rights policy. A state like Azerbaijan, which has a multi-vector foreign and energy policy, needs Europe's strategic support in order to promote regional development, and enhance stability.

Azerbaijan is also Europe's natural connection to Central Asia, and trade, energy and political links between Azerbaijan and east Caspian states are already established. Therefore, working with Azer-

baijan to develop a comprehensive Central Asian policy, as well as emphasizing EU's relations with Azerbaijan in the South Caucasus context, can yield a double win for Berlin and Brussels. By focusing on relations with Azerbaijan, Europe could increase its relevance in both the South Caucasus and in Central Asia, as well as become a more competitive economic player within these markets, which cumulatively represent more than 100 million consumers.

## Frozen conflicts in the South Caucasus after the Russian-Georgian War

The Georgian-Russian war in August 2008 and Russia's unsupported recognition of South Ossetia and Abkhazia have changed the geopolitical situation in the South Caucasus. Countries in the region are desperately searching for alternative allies and links in order to avoid a dependence on Russia. No serious external power, not even Belarus or China, has recognized the independence of the two separatist territories.<sup>1</sup> This lack of recognition weakens Russia's position in the South Caucasus and in the post-Soviet space and challenges its alliance policy. Today Russia alone is responsible for the economic development and political stability of South Ossetia and Abkhazia. The track record in the North Caucasus shows that Russia has no strategy to pacify and develop ethnically tense regions. While Abkhazia has the potential to be independent from Russia, South Ossetia has become a de facto subject of the Russian Federation. These developments are both unsustainable and contrary to the broader security and strategic interests of the EU in the region.

The Turkish-Armenian rapprochement, which started in 2006 was accelerated by the August 2008 war. For the Armenian decision-makers it became strikingly clear how isolated their country had become and how risky their dependence on Russia is. The Armenian leadership was thus keen to restart negotiations with Turkey. Turkey, urged by the US, and looking for greater regional influence, initially embraced the rapprochement policy, but has subsequently abandoned this policy.

For Azerbaijan the results of the Georgian war are problematic in two ways: first, the recognition of South Ossetia and Abkhazia's independence by Russia sets a dangerous precedent and could have a negative effect on the resolution of the Nagorno-Karabakh frozen conflict. Second, the bulk of Azerbaijan's energy exports pass through Georgia. The security of this supply route was challenge by the war; a problem that also affects Turkey as it tries to define itself as a reliable energy hub, delivering to the market gas and oil from the Caspian region and Russia. Thus, Turkey also has an underlying motivation to bring lasting stability to the region, which helps explain Ankara's initiative to create a new platform for Stability and Development in the Caucasus. The Turkish initiative has been received with a degree of skepticism by the countries in the region, while Baku has been especially critical of Ankara's rapprochement with Armenia.

In fact, Azerbaijan has subsequently strengthened its energy cooperation with Russia, signing an agreement with Russia's gas monopolist Gazprom for the sale of 500 million m<sup>3</sup> of gas in 2010 – this volume can be increased to 1 billion m<sup>3</sup> by the end of this year.<sup>2</sup> Furthermore Baku will export 500 million m<sup>3</sup> of gas to Iran in 2010 and Azerbaijanian officials are exploring possibilities to sell natural gas to China and India. For Turkey, Azerbaijan is not only an important political ally but also an indispensable alternative supplier for oil and gas, which Turkey needs to balance out its overdependence on Russia. All in all, Azerbaijan and the Trans-Caspian connection are key components in Turkey's strategy to become an energy hub.

Georgia has lost its reputation in the West: The majority of the EU member states assess the current Georgian leadership as unpredictable, and the Obama Administration is showing serious reservations in backing Tbilisi unequivocally. During the course of the war Georgia lost its rebellious regions, which has put an indefinite end to the policy of re-integration. Tbilisi's second important goal, a NATO-membership, is no longer on the table. Despite increased criticism of the regime in Tbilisi, the West gave Georgia an unprecedented aid to deal with the economic consequences of the war – \$4.55 billion to meet its post-conflict needs.<sup>3</sup>

It is in nobody's interest to further destabilizing Georgia, and offering Georgia aid right after the war key to help strengthen regional stability. But as long as the Georgian President leads his country without efficient checks and balances, Georgia will struggle to contribute effectively to conflict resolution in the region. Neither the parliament, the constitutional court, the opposition, nor the public were able to control the executive to start a war after having been provoked by Russia.

After the August war, the negotiations over the Nagorno-Karabakh conflict intensified. Russia launched a series of high-level meetings, which culminated in a joint Russian-Armenian-Azerbaijani declaration on the non-use of force signed by the Presidents of the three states, Ilham Aliyev, Serzh Sargsyan and Dmitri Medvedev on the 2 November 2008. Yet, neither the Minsk group nor the Russian initiative has achieved a breakthrough in the Karabakh conflict. On the contrary, Baku has grown increasingly frustrated with the Turkish-Armenian rapprochement and subsequent Armenian refusal to agree to a full withdrawal from the occupied territories in Azerbaijan. More recently, the Armenian President suspended the ratification of the protocols with Turkey, in light of Turkish Premier Erdogan's refusal to commit to the border opening between Turkey and Armenia as long as Armenian troops remain in Azerbaijan.

As a result of the August war and the change in leadership in Washington, the US engagement in the region has decreased. Because the US Government is dealing with a difficult conflict in Afghanistan, and Iran's nuclear challenge, the South Caucasus is falling in rank on the Washington's priority list. At the same time the Obama administration is emphasizing good relations with Russia, which means it will strive to avoid conflict with Moscow in the post-Soviet space. However, it is unlikely and unreasonable for Washington to abandon the South Caucasus altogether, as this region is also the gateway to Central Asia and thus is important for securing the transit for the International Security Assistance Force (ISAF) to Afghanistan and access to energy resources.

Having been a bystander in the South Caucasus for almost two decades, the EU is assuming a

more proactive and direct role in the region. After mediating a ceasefire between Russia and Georgia, Europe established a monitoring mission (EUMM) in Georgia. The EU has strengthened its presence in the region, which raises expectations in the South Caucasian states of the future role of Brussels in the region. On the one hand, Russia has accepted the EU's role in monitoring the situation. On the other hand, it expects the EU to recognize the current status quo of South Ossetia and Abkhazia. This is a challenge that the EU has to manage and which will determine the future of Europe's role in that region. However, still missing is a long-term EU strategy for the region and the willingness to assume responsibility for conflict resolution and development in the South Caucasus.<sup>4</sup>

The Eastern partnership and the Southern Energy Corridor might be the tools necessary for increasing the ties between the EU and the South Caucasus countries, but they are no strategy. However the key challenge for a credible EU policy in the region is resolving the Nagorno-Karabakh frozen conflict, as the key conflict of the South Caucasus. Nagorno-Karabakh and the seven occupied regions surrounding it constitute close to 20 percent of Azerbaijan's territory. Armenian occupation of these areas has persisted since a cease-fire was negotiated between the two sides in the early 1990s. This occupation goes against international law, and contradicts recognized norms and principles of sovereignty, and its resolution should be the main focus of the EU. Above all, the EU should be consistent in its approach to conflict resolution in the South Caucasus. If in the case of Georgia, Brussels clearly backs the principle of territorial integrity of the Georgian state, the same principle must apply in the case of Azerbaijan.

Armenia's occupation of Azerbaijan not only is a major security challenge to regional integration and cooperation, but a serious economic impediment, which keeps the regional market artificially and unnecessarily fragmented. Resolving this conflict will do more to unlock Armenia's isolation and integrate the South Caucasus market with Turkey, more than any other regional initiative. Hence, the focus of German and EU's policy in the region should be on conflict resolution and economic development rather than on given development aid.

## Balance of economic power in the region

The states in the south Caucasus differ greatly in status of economic development. While Azerbaijan produces more than 60 percent of its GDP through the export of oil and gas, and therefore has a much higher GDP than Georgia and Armenia, the economies of the latter two depend primarily on the construction sector, services and agriculture. The two have suffered more than Azerbaijan in the latest economic downturn, but their economies are also less vulnerable to fluctuation in energy prices. The Armenian economy is heavily subsidized with money transfers from the Armenian Diaspora. The amount of money sent home by migrant workers in 2008 was more than \$2.1 billion, which equaled more than half of the domestic retail turnover.<sup>5</sup> Georgia on the other hand, earns a great deal on transit fees from energy and trade moving from the Caspian Region to Turkey and across the Black Sea to Europe, and on fees it collects from trade passing between Armenia and Russia. Approximately 70 percent of Armenian trade transits via Georgia.<sup>6</sup> Because of Armenia's economic and energy dependency from Russia and its transit dependency on Georgia, the recent conflicts between Russia and Georgia have hurt the Armenian economy severely.

Azerbaijan is the main energy supplier for Georgia, as well as a key energy partner for Turkey. Today, the Azerbaijan oil and gas company SOCAR owns significant parts of the Georgian gas distribution network.<sup>7</sup> It supplies Turkey with close to 8 billion cubic meters of gas per year, and it is a key partner in the US-backed BTC (Baku-Tbilisi-Ceyhan oil pipeline) project, designed to bring Caspian oil to the global market.

Despite the high potential for conflict the South Caucasus countries demonstrated impressive economic growth and have made significant progress in reforms since the mid-2000's. Economic growth combined with market reforms has stimulated European private sector interest in the region. Azerbaijan had one of the highest real GDP growth rate worldwide (between 10 and 30 percent from 2002 to 2008), reaching 30.5 percent growth

in real GDP in 2006. In spite of the financial crisis Azerbaijan managed to retain a GDP growth of 9.3 percent in 2009 and the IMF forecasts for 2010 is of 2.7 percent.<sup>8</sup> From 2003 to 2008 Armenia and Georgia recorded a less impressive but compared to Europe still high GDP growth cycle; both managed a growth rate close to 10 percent.<sup>9</sup> But unlike Azerbaijan, Georgia, and especially Armenia, were hit by the global economic downturn, and saw their economies shrink in the last few years. Thanks to the large financial injection of international aid in 2008, Georgia managed to offset somewhat the negative impact of the global economic recession.

Georgia is a regional leader in economic reforms and market liberalization. After Mikhail Saakashvili became president in 2004 he started comprehensive economic reforms which led to a high level of foreign direct investment and impressive economic growth. The government simplified the tax code, overhauled the custom code and is tackling corruption head-on. The number of taxes applicable to the business sector was reduced from 21 to 7 and the government introduced a flat tax of 12 percent. The World Bank recognized Georgia as one of the fastest reforming countries in the world in 2008. During the peak of economic growth – between 2006 and 2008 – foreign direct investment quarterly inflows into Georgia averaged half a billion Dollar.<sup>10</sup> FDI has slowed since the war with Russia and due to the global financial crisis.

Azerbaijan's creation of a state oil fund (SOFAZ) contributes to making the country more credible as an economic and as a trade partner in spite of enduring problems with corruption, comparable to those in Armenia. Azerbaijan's oil production is largely responsible for the high growth rates between 2005 and 2007 as the oil and gas sector accounted for 52.8 percent of the GDP in 2007 and even more than 50 percent in 2008.<sup>11</sup> More than 40 percent of state revenues will be provided by transfer from the SOFAZ in 2009.<sup>12</sup> Azerbaijan made some efforts to modernize its economy, which means first of all simplifying domestic regulatory requirements for investments and transparency.

However, some limitations remain across the region, most notable impediments to foreign direct

investment being inefficient administrations and corruption. Like in Armenia but in a contrast to Georgia, the state still plays a dominant role in the economy of Azerbaijan. Armenia remains an isolated economy, with no real access or potential to compete on external markets.

## EU's transport and energy projects in the South Caucasus

The South Caucasus touches a number of European key energy routes, and is integrated in several Eastern policy initiatives including the European Neighborhood policy, the Eastern Partnership, and the European Black Sea Synergy. It is part of the Southern Energy Corridor and the Trans-Caspian strategy. The Southern Corridor has become a priority energy project for Brussels, and is outlined in the Second Strategic Energy Review published in November 2008.<sup>13</sup> The Review calls for a new degree of energy interdependence, especially with Russia and the Caspian countries. After the Georgian-Russian war in the summer of 2008 and the gas supply interruptions resulting from the Russian-Ukrainian crisis in January 2009 the Southern Energy Corridor and its key project, the Nabucco pipeline has become a priority in the European diversification debate.

The Southern Energy Corridor relies on two supply regions – the Caspian basin, where the key gas suppliers are Azerbaijan, Turkmenistan and potentially Uzbekistan, and the Middle East, where the gas would be supplied from Iran and Iraq via Turkey to Europe. The estimated total volume of gas transiting through the Southern Corridor is between 30 and 40 billion cubic meters, and the infrastructure under consideration includes pipeline projects like the White Stream (Azerbaijan-Georgia-Ukraine-EU), Nabucco, and Turkey-Greece-Italy Interconnector.

Because of its geographic location, established relations with western energy companies, and a finalized transit agreement with Turkey, Azerbaijan is Europe's key partner for the Southern energy corridor.<sup>14</sup> So far Azerbaijan has been the only Caspian

country committed to fill in the Nabucco pipeline from the beginning of the project, but this is not enough for the full capacity. Due to the exploration of the second phase of the major offshore Shah Deniz gas field in the Caspian Sea Azerbaijan will be able to export up to 30 billion m<sup>3</sup> in long run. The country is also a connector to Turkmenistan and Uzbekistan. Kazakhstan, Turkmenistan and Uzbekistan have a long-term potential (starting from 2020) for gas exports of around 150 to 200 billion m<sup>3</sup>, but it is still unclear, how to transport their gas through the Caspian Sea.<sup>15</sup> Turkmenistan sits on the third biggest global natural gas reserve and Europe's access to Turkmen gas will only be possible with the help of Azerbaijan.

Although the EU member states are the main potential consumers of Caspian energy, and European energy companies like BP, ENI and Statoil play an important role in the extraction of Caspian gas and oil, the EU has failed to politically back a key strategic project connecting it to the region. As the principal energy consumer, Europe should prioritize Caspian gas. First, Europe needs to ensure a transparent transit regime that satisfies both, Turkey's interest in position and political weight of being a hub-nation, and the interests of the end-users of the gas transiting in continental Europe. At the same time, EU must keep in mind the long-term relevance of the Azerbaijan-Turkmenistan Interconnector, in order to ensure access not only to Azerbaijanian's, but also Turkmenistan's gas. Direct access to Caspian gas resources is the only way for the EU to ensure that the Southern Energy Corridor contributes net value to European energy security.

The South Caucasus has also been thought as a transit route connecting EU trade with Central Asia, China, and India crossing the Black Sea, Georgia, Azerbaijan and the Caspian Sea. The goal of this visionary TRACECA (Transport Corridor Europe Caucasus Asia signed in 1998)<sup>16</sup> project was to develop integrated transport strategies and infrastructure between Europe and the South Caucasus and Central Asia states, bypassing Moscow-centric routes from the Soviet times. A second project, INOGATE (Interstate Oil and Gas Transport to Europe) was also developed in the mid-90's and was aimed at integrating oil and gas pipeline routes

between the region and Europe to increase the security of supply. Both projects failed to fulfill their objectives and expectations, due to underfunding and lack of political support.

The lessons from these failures are applicable to the existing Southern energy corridor. First and foremost the EU needs to back major infrastructure projects between Europe and the Caspian region with high-level political support from the capitals. This support can attract the east Caspian states into the project, as well as overcome any attempts at revising the transit conditions agreed by Turkey. The member states support will pacify possible Russian objections and help Azerbaijan resolve its outstanding dispute with Armenia over Nagorno-Karabakh.

## Germany as the advocate for an EU South Caucasus strategy

What the South Caucasus needs is a strong political advocate inside of the European Union comparable with France's role in the Union of the Mediterranean Sea. The EaP was important in focusing the EU on the Eastern Neighborhood, however the Polish-Swedish initiative lacks the active support of countries that are key shapers of EU's eastern policy. Here, the role of Germany, and an increased presence of German political actors in the South Caucasus are critical. The division in the EU between countries that perceive Russia as a key partner for EU's Eastern policy (Germany, Italy and France) and those, that see the big neighbor as the main obstacle (Baltic States, Poland, Sweden) is a main hindrance in developing a competitive and functional EU policy towards the South Caucasus. A clear policy position from Germany can help overcome this division. Furthermore, the opportunity to forge a common EU policy towards the region is now more realistic, especially as both Poland and Sweden took on cooperative positions vis-à-vis Russia, and Moscow has done the same vis-à-vis Poland and the Baltic States.

Following the collapse of the Soviet Union, the main focus of German eastern policy has been its

relations with Russia. The German "Russia first approach" can be explained in a historic-economic context, namely the Russian support for the German unification, German economic and energy interests in Russia, and the German perception that security of Europe is only possible in cooperation with Russia. Germany's interest in Russia and its support for Eastern enlargement of the EU became the key components of EU's eastern policy. Hence, Germany is not only critical to an invigorated EU South Caucasus policy, but also essential to its implementation. Without Berlin's leadership, there can be no changes to the current EU position in the region because there will be no clear support from the EU member states on how to manage the Russia factor.

With changes in the post-Soviet space and with the accession of the Central-Eastern European states to the EU Germany's role as the main player on EU's Eastern policy decreased. While the post-Soviet countries diverge from Russia, Germany's foreign policy still is focused first and foremost on Russia. Beside its special relationship with Moscow, the German leadership was not able to develop a two-track policy, which, on the one hand, involves Russia and on the other hand, establishes bilateral relations without Russia in the post-Soviet space. Moreover, Germany's predominant interest in Russia hinders its initiatives towards Central Asia and the South Caucasus. The absence of Russia was an important reason why the former Minister of Foreign Affairs Frank-Walter Steinmeier refused to introduce the important EaP initiative in the EU together with Poland.

## Germany's policy towards the South Caucasus and the wider Caspian region

In 2008 Germany's trade volume with Azerbaijan reached €2.4 billion, €358 million with Georgia, and only €237 million with Armenia.<sup>17</sup> For Germany, Azerbaijan is clearly the main trading partner in the South Caucasus. It is increasingly relevant for Germany's big industry and the energy sector. In 2008, Germany purchased 3.5 million tons of oil from Azerbaijan, making Azerbaijan the 6th

most important oil supplier for Germany. Since 2001, a Caucasus initiative of the Federal Ministry for Economic Cooperation and Development has increased efforts to improve the cooperation between the three states, to support the political and economic transformation of the region and contribute to conflict resolution.<sup>18</sup>

In addition to Azerbaijan's growing relevance for EU-member states as trade partner, Azerbaijan is also increasingly important to the EU and Germany for energy security (access to primary energy resources in the Caspian Sea and access to gas in Central Asia). Furthermore, the South Caucasus is also relevant for global security (sharing a border with Russia and Iran), and transit security (Central Asia-China). In 2007, the German government introduced the Central Asia strategy and Black Sea Synergy during its EU Presidency. But the German government did not pursue a sustainable policy to foster the relations with Central Asia and the Black Sea/South Caucasus states in the long-term.

Within the European Union, Germany is a key player in policy regarding the South Caucasus, and has introduced important initiatives for this region. It was a German initiative to organize a fact-finding mission after the August war 2008. Furthermore Germany placed Hansjörg Haber as the head of the EUMM, and sends the highest number of members to the monitoring mission.<sup>19</sup> Moreover, the appointment of an EU special representative for the South Caucasus in July 2003 was based on a proposal by the German government. Mediation in the conflicts concerning South Ossetia and Abkhazia, the concept of a Caucasus Stability Pact, and the support of integration of the three states into the EU comprise Germany's initiatives in the region in the past years. But they did not help to solve the conflicts in the region. Germany never took the initiative to bring the EU as a relevant player into the South Caucasus and Trans-Caspian region. Berlin's consideration of Russia's interests in the region inhibited the German government to get more involved in conflict resolution and to push EU policy towards the region.

Related to the Partnership and Cooperation Agreements with the three South Caucasian states in

1999, there was, especially among the German political elite, a debate on the significance and risks in the South Caucasus. With regard to the Balkan Stability Pact, originally a German concept, a Stability Pact for the South Caucasus was discussed in 1999/2000. This concept included not only the South Caucasus but also the Caspian region and Central Asia. Beside the goal to prevent a crisis in the region and to contribute to a conflict solution, the main goal was to create a secure environment for European investment in the region. "European market interests demand political stability as a prerequisite."<sup>20</sup> This project never became reality because neither the EU-member states nor the states of the region were ready for a comprehensive initiative. The lack of a regional will for cooperation and absence of an EU consensus on the region in the EU hindered the implementation of this project. Now, the situation has changed; after the Russian-Georgian war the geopolitical situation in the region is different, and the EU seems to be more willing to act in the South Caucasus and Caspian region.

Former German Minister of Foreign Affairs Frank-Walter Steinmeier traveled to Georgia, Abkhazia, and Russia in July 2008 to cool down the increasing tensions between Abkhazia and Georgia and to distribute a peace plan.<sup>21</sup> Steinmeier's trip came too late and was not embedded in a functioning negotiation process; it could not prevent the war. All these important initiatives will always have just a limited success as long as they are not embedded in a comprehensive strategic and much more focused EU-policy towards the entire region. After the Georgian-Russian war, the Green party as well as the leading coalition of CDU/CSU (Christian Democrats) and SPD (Social Democrats) called on the German government to increase its direct involvement in the South Caucasus region. The governing coalition demanded a clear German contribution to regional development and peace.<sup>22</sup>

## A new German approach towards the South Caucasus

Summary of key points on how the German policy, and in turn the EU policy towards the South Caucasus should change:

1. Germany should act as an advocate for more European engagement in the South Caucasus and the Trans-Caspian region within the EU. It should use its authority, economic power, and conceptual spadework to advance a platform to promote broader Trans-Caspian cooperation. The South Caucasus is the bridge between the Black Sea and Central Asia; it is the connection for Europe to the Caspian resources. This approach should favor economic cooperation, the support of good governance, and active work on conflict resolution in the South Caucasus. This multidimensional and multilateral approach could act as a counter model to unilateral and hegemonic interests in the region and can be a precondition for conflict resolution and cross-border cooperation. Both Germany and the EU-member states would gain a better framework for investment and economic cooperation with Central Asia and the wider Caspian region and a safer transit route to China if it does more to broker a deal between Azerbaijan and Armenia on the Nagorno-Karabakh frozen conflict.
2. Germany should rethink its eastern policy and develop a two-track approach. On the one hand, relations with Russia are important and have to be deepened in the context of EU-Russia relations with a modernization partnership, energy cooperation, and support of good governance. On the other hand, Germany must develop a policy towards the post-Soviet space without Russia on bilateral and multilateral tracks. This approach is a precondition for a more successful and strategic EU-policy in the South Caucasus. Russia should be involved in specific policy platforms and confidence-building measures, but simultaneously it should have no influence on German and EU decision-making concerning the post-Soviet space and the South Caucasus.
3. Germany should recalibrate its policy in the region by moving away from Georgia to a more balanced approach towards all three states of the region, lead by a closer partnership with Azerbaijan on energy, economic cooperation and development, and conflict resolution. This also means that Berlin should take a more proactive stance in bringing about a resolution to the Nagorno-Karabakh frozen conflict, which is the main obstacle to regional cooperation and growth. Berlin should insist the EU take over from France the position of the Co-Chair in the Minsk Group. With its role as one of the main aid donors to Armenia, Berlin and the EU have the ability to influence Yerevan, and they can leverage on this influence.
4. In addition to promoting conflict resolution and working closely with Azerbaijan on developing the EU-Caspian energy links, Germany can also lead the EU in supporting further integration between the region and the EU. Furthermore, Germany should not abolish the idea of offering this region a clear EU representative, even if membership in the EU club may not be a realistic option for the South Caucasus countries.
5. Germany should actively support the Southern Energy Corridor project, which means increasing the level of relations and interactions between Berlin and Baku and Berlin and Ashgabat. This support must include the Southern Energy Corridor and the Trans-Caspian pipeline system, and be based on sound economics and politics. Increasing the stability and diversity of energy supplies to Europe is ultimately in the interest of Germany, who with its massive economy can only benefit by an increase in the number of routes and suppliers to Europe.
6. Berlin should increase its outreach to Turkey in order to better coordinate EU's conflict resolution in the South Caucasus, and EU's Caspian energy policy. Turkey is a key country shaping the trends in the South Caucasus, Black Sea, and the broader Caspian region. Concerning relations with Ankara, concentration on the discussion about Turkey's potential EU membership hinders a broader cooperation with the country regarding energy and conflict resolution. Together with France, Germany still plays an inhibitory role in this discussion and must rethink its approach. The EU and its member

states should better calibrate its policy with Ankara and push the EU accession of the country as an important strategic decision.

7. Without Russia a competitive EU-South Caucasus policy is impossible, and Germany should convey this message in Brussels clearly. Moscow is a partner in the conflict resolution process in the South Caucasus, but cannot be allowed to inhibit promoting progress and change. This means that the EU will have to develop a South Caucasus policy independent of Moscow, even if closely coordinated with Moscow. Germany with its special relations should facilitate good cooperation with Russia in the region, but not sacrifice EU's strategic interests for the sake of maintaining a no-conflict relationship with Russia.
8. An indispensable partner for the EU in the region is also the US. Here too, the role of Berlin can be instrumental in terms of leveraging

its good relations with the US to bring Brussels and Washington closer together in their policy approach towards the South Caucasus and the broader Caspian region. The Obama Administration's less confrontational policy towards Russia and its special relations with Turkey offers a good basis for a more coordinated approach between the EU and the US in managing transition in the South Caucasus. The EU and its member states have to be aware that the US does not have the same interests in the region, and that its current Russia policy is made with regard to other international crises. Europe should accept the reality of a limited US involvement in the region in order to push its own agenda in coordination with Washington.

Dr. Stefan Meister, Program Officer Russia/Eurasia, Research Institute, DGAP e.V.

## Notes

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