

Azerbaijan and U.S. interests in the South Caucasus twenty years after independence

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Abstract

The author evaluates U.S. interests in the South Caucasus, via three broad and interrelated categories: security, energy, and democracy. These strategic interests shape U.S. foreign policy toward the region. Despite numerous strategic concerns, the South Caucasus is generally perceived as a secondary consideration for U.S. interests.

The author argues that today, strong, independent, pro-Western states in the South Caucasus serve to contain the expansionary anti-American regimes in Russia and Iran, enable the secure passage of energy resources from the Caspian to the Black Sea and the Mediterranean via Turkey, and encourage the expansion of democratic and free-market principles and institutions across Eurasia. Furthermore, the author presents his concerns, namely the “neo-realism” of the Obama administration. It will take time, he argues, before the White House recognizes that this policy does not bear the desired fruit; in this matter the paper includes a number of recommendations to the U.S. government for the protection of U.S. interests regarding security, energy, and democracy in the South Caucasus.

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Since the fall of the Soviet Union, the South Caucasus has become an area of key strategic concern for both regional and global powers. After the collapse of the Soviet Union in 1992, the United States was quick to cultivate ties with the new independent states. Within months, the first Bush administration had opened embassies in all 11 non-Russian New Independent States, including the three countries of the South Caucasus – Armenia, Azerbaijan, and Georgia. The first Bush administration clearly recognized the energy wealth of the Caspian Sea and the geopolitical importance of the land bridge between the Middle East, Turkey, and Russia, which also connected Europe with Central Asia along the ancient Silk Road. U.S. involvement in the region has intensified since, under the Clinton and second Bush administrations through military cooperation, economic exchange and the development of energy infrastructure.

Washington put a particular emphasis on developing relations with Azerbaijan – a fast growing, energy-rich economy in a strategic nexus between Russian, Iran, and Turkey. The Rus-

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sian Federation has also demonstrated a continued interest in the South Caucasus, the USSR's "soft underbelly". Today, Russia, a hydrocarbon producer, retains its power thanks to the region's energy exports. Under President Obama, efforts to resuscitate a friendly relationship with Russia have compelled the United States to move away from such close engagement with the South Caucasus states. It would be mutually beneficial for Azerbaijan and the Euro-Atlantic community to rekindle these close ties.

U.S. interests in the South Caucasus are a function of the region's strategic location at the crossroads of Europe, Russia, the Middle East, and Central Asia. Strong, independent, pro-Western states in the South Caucasus contain the expansionary anti-American regimes ruling in Russia and Iran; enable the secure passage of energy resources from the Caspian to the Black Sea and the Mediterranean via Turkey; and encourage the expansion of democratic and free-market principles and institutions in Eurasia.

Despite numerous strategic concerns, the South Caucasus is generally perceived as a secondary consideration for U.S. interests, in comparison with the region's larger, more important neighbors such as Russia, Turkey and Iran. As a result, the policy toward the South Caucasus risks taking a backseat to other U.S. priorities. For example, critics blamed the Clinton

administration, especially during its first term, for following a “Russia first” policy, allegedly pursued under Strobe Talbott (special advisor to the secretary of State on the former Soviet states and later deputy secretary of State), rather than engaging with interests in the South Caucasus.¹ Greater emphasis on the region, particularly the promotion of a strategic East-West energy corridor, was seen during Clinton’s second term and intensified under George W. Bush’s administration, which developed close relations with all of the South Caucasus countries, particularly Georgia. However, U.S. policy toward the South Caucasus has shifted under the Obama administration, which has prioritized “resetting” frayed relations with Russia in order to gain its help and cooperation on such issues as Afghanistan, Iran, and arms control. This policy has led to fears that the Obama administration may be diminishing ties with allies in the South Caucasus in favor of strengthening relations with Moscow.

Vice President Joe Biden’s July 2009 trip to war-ravaged Georgia did little to reassure the region of American support. Although Biden correctly rejected Russia’s claims of what President Dmitry Medvedev has called an “exclusive sphere of interests,”²

he fell short of offering the nation a “physical security guarantee” from America; nor did he offer any concrete road map for the restoration of Georgian sovereignty over Abkhazia and South Ossetia, or for holding Moscow to its commitments in the Medvedev-Sarkozy peace accord of August 2008, which requires Russia to pull back to its pre-war positions.³ These two breakaway regions have since remained unrecognized by the West, and are sustained by their patrons in the Kremlin.

The absence of a developed and engaged U.S. foreign policy in the South Caucasus puts U.S. security and commercial interests, along with the sovereignty and independence of U.S. regional allies, at risk. Weakened ties between the South Caucasus and the U.S., NATO, EU, and other principal trans-Atlantic institutions, embolden Russia and Iran to extend their influence, jeopardizes the reliability of energy transit and new pipeline projects, and threatens the development of democratic and free market institutions. The Turkish-Armenian rapprochement, which has taken place against the background of increasing Turkish-Russian security and energy cooperation, alongside the simmering security conflicts in the South Caucasus - the breakaway Georgian provinces of Abkhazia and

1 Hill, Fiona, “A Not-So-Grand Strategy: U.S. Policy in the Caucasus and Central Asia Since 1991,” *Foreign Policy, Asia*, February 2001, http://www.brookings.edu/articles/2001/02/foreignpolicy_hill.aspx (October 27, 2009).

2 “Interview given by Dmitry Medvedev to Television Channel One, Russia, NTV,” Sochi, August 31, 2008, at [\[un.int/russia/new/MainRoot/docs/warfare/statement310808en.htm\]\(http://www.un.int/russia/new/MainRoot/docs/warfare/statement310808en.htm\) \(October 27, 2009\).](http://www.</p></div><div data-bbox=)

3 “Biden pledges support for Georgia,” *BBC News*, July 22, 2009, <http://news.bbc.co.uk/2/hi/8163876.stm> (October 27, 2009).

South Ossetia and the Nagorno-Karabakh dispute, for instance - make strong U.S. engagement in the region essential. The Obama administration needs to understand the strategic importance of the South Caucasus and to provide its allies with the same firm support as its predecessors did.

Azerbaijan and U.S. interests in the South Caucasus

U.S. interests in the South Caucasus can be divided into three broad and interrelated categories: security, energy, and democracy. These strategic interests shape U.S. foreign policy toward the region. The coordination and integration of these occasionally conflicting priorities is the main challenge facing the U.S. policy in the region.

International Security Priorities

Security in the South Caucasus is of great importance to the United States in that it affects the balance of power in Eurasia and the Middle East. Central to this concern is the desire to check the power of the increasingly anti-American regimes in Russia and Iran. Strong, independent states in the South Caucasus can prevent Moscow and Tehran from running roughshod over the region, provide access to the Caspian and Central Asian energy resources, and create opportunities for electronic and other intelligence gathering capabilities.

Azerbaijan has also been a vital trading and strategic partner for Israel, an important American ally. After the Soviet collapse, Israel developed close ties with the post-Soviet states, and particularly with Azerbaijan, a secular Islamic country with substantial oil riches but initially weak economic and military capabilities.

The relationship is based on military and economic foundations, with Israel investing in Azerbaijani infrastructure and markets and importing Azerbaijani oil. Israel and Azerbaijan also share strategic objectives, including their mutual mistrust and fear of Iran. Israel has been a significant weapons supplier for the Azerbaijani army, starting with arms sales during the Nagorno-Karabakh war.⁴ In September 2008, a major weapons deal was signed between Israel and Azerbaijan.⁵ Azad Systems, a UAV manufacturer that will make Azerbaijan an important arms producer, is a joint venture between Azerbaijan and the Israeli defense industry.⁶

Israel and Azerbaijan also have close security relations. For example, Israeli diplomats publicly stated their

4 Cagaptay, Soner, and Murinson, Alexander; *Good Relations between Azerbaijan and Israel: A model for Other Muslim States in Eurasia?*; Washington Institute for Near East Policy, Policywatch section, March 30, 2005 (April 10, 2011)

5 "Azeri-Israel ties 'discreet but close'": WIKILEAKS; *Azernews.az*, February 23, 2011, http://www.azernews.az/en/Nation/30104-Azeri-Israeli_ties_%60discreet_but_close%60:_WikiLeaks (April 15, 2011)

6 "Azerbaijan starts production of Israeli drones" *News.Az*, 10 March 2011, <http://www.news.az/articles/politics/32639> (April 15, 2011)

support for Azerbaijan's position in the Nagorno-Karabakh conflict. Israel and Azerbaijan also share intelligence about Iran, with Soner Cagaptay⁷ even suggesting that Israel has listening posts on the Azerbaijani-Iranian border.⁸ While Baku is suspicious of Iran's support of Armenia, Jerusalem fears Iran's confrontational rhetoric towards Israel and Tehran's deep involvement with and sponsorship of global terrorist networks.

From the perspective of the Russian Federation, the South Caucasus remained a priority for Moscow even after the collapse of the Soviet Union disabled or weakened Russian influence elsewhere along the Russian periphery. Political leadership, senior experts, and military top brass laid down plans to reintegrate parts of the former USSR as early as 1993, when Moscow supported Abkhaz separatists, and even allowed Chechen separatists to fight on the side of Sukhumi secessionists against Georgia.

The expansion of Russian power and influence in the South Caucasus is a major security concern for the U.S. Since the mid-1990s, Russia has endorsed a "multi-polar" world view, as articulated by the then-Foreign Minister and Prime Minister Yevgeny Primakov, and has launched a

thinly veiled attempt to dilute American influence in international affairs since the Iraq war. Under the banner of multi-polarity, Moscow seeks to legitimize its efforts to restore its "privileged sphere of influence" in the post-Soviet space. To this end, a resurgent Russia is actively seeking to reverse the Western shift of its former satellite states by influencing their domestic political processes and threatening their security and territorial integrity. These actions run counter to U.S. interests, which seek independent and sovereign countries along Russia's borders, combining Western orientation with good relations with Moscow, if possible. This conflict between U.S. and Russian interests was brought to the forefront of international relations during the August 2008 war.

Despite the Obama administration's attempt to "reset" frayed U.S.-Russian relations, the security interests of the two powers are likely to continue to clash in the South Caucasus. Observing the lack of a forceful U.S. response to the Georgia conflict, Russia has been emboldened to exercise its strength in that the area it considers its backyard. Future U.S.-Russian conflicts in the South Caucasus may involve Georgia's breakaway republics and the status of Nagorno-Karabakh, which is officially part of Azerbaijan but under Armenian occupation. The U.S., preoccupied with Afghanistan, Pakistan, Iran, Iraq, and the Arab revolutions, in addition to

7 Director of the Turkish Research Program at The Washington Institute for Near East Policy

8 Cagaptay, Soner, and Murinson, Alexander; Good Relations between Azerbaijan and Israel: A model for Other Muslim States in Eurasia?; Washington Institute for Near East Policy, Policywatch section, March 30, 2005 (April 10, 2011)

the global war on terrorism, has neither the attention span nor resources to deploy sufficient diplomatic power and foreign assistance to counter aggressive moves by Moscow in the South Caucasus, or to prevent proxy conflicts. Instead, the Obama administration will employ diplomatic measures, and seek help from European allies and Turkey to resolve

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future conflicts. Kremlin strategists, who view geopolitics as a zero-sum game, will read a lukewarm U.S. response to Russian encroachment and aggression as a sign of weakness, and push harder to expand its power in the post-Soviet space. Moreover, the Turkish-Russian rapprochement, based on growing energy trade and construction contracts, is evolving into a strategic relationship, and both countries are maintaining good relations with Teheran, America's arch-rival.⁹

9 "Interview with Ariel Cohen, Карабах должен оставаться под суверенитетом Азербайджана" ["Karabakh must remain under Azerbaijani sovereignty"]; AzeriToday.com, December 2, 2009, <http://azeritoday.com/archives/9317> (April 25, 2011)

Iran's Rising Power

America's second security concern in the South Caucasus is Iran. For decades, Iran vied for power in the Middle East against Saddam Hussein's tyrannical regime in Iraq. In the 1980s, Tehran sought Moscow's support against U.S.-allied Iraq. In the 1990s, Iran's priority for its relationship with Russia was obtaining technical assistance for its missile and nuclear sectors, and arms deals. The latter included modern fighter aircraft and missile systems, including the S-300 long range anti-aircraft missiles. Iran has suggested that it has deployed S-300s¹⁰; however, Russia promised not to sell them to Iran in 2010 in response to the START talks with the United States,¹¹ and Tehran was not interested in upsetting the apple cart and meddling in either Central Asia or the Caucasus in conflict with Russian interests – even when hundreds of thousands of Muslim Chechens were killed during two wars (1994-1996 and 2000-2004).

This balance was upset by the U.S.-led Operation Iraqi Freedom in 2003, which is now in its concluding stages. The eventual withdrawal of U.S. troops from Iraq and the somewhat fragile Iraqi government that remains

10 Kreuger, Nicholas; "Iran Announces Acquisition of S-300 Air Defense Systems", *The Foundry*, Heritage Foundation, August 5, 2010, <http://blog.heritage.org/2010/08/05/iran-announces-acquisition-of-s-300-air-defense-systems/> (April 6, 2011)

11 "Kremlin bans sale of S-300 missile systems to Iran"; *BBC World News, Europe Section*, 22 September 2010 (April 4, 2011)

in place, as well as the strength of the Shia in Iraq, provides Iran with a strategic opening to increase its influence in the Middle East. Iran already has a considerable military advantage over its neighbors in the Gulf, and its intelligence services have an active presence in Shia areas of Lebanon, Saudi Arabia's Eastern Province, Iraq, and Azerbaijan. If Iran manages to develop nuclear weapons, it could emerge as a regional hegemony in the Middle East, with the capacity to threaten U.S. allies as far away as Israel, Egypt, and southern Europe. Iran can already threaten the world economy by shutting off oil tanker traffic in the Strait of Hormuz. Were the U.S. to contemplate military action against Iran, the countries of the South Caucasus, particularly Azerbaijan, would be needed as a staging ground for U.S. intelligence gathering, military pressure, or contingencies (centers from which US military and civil operations can observe Iran's activities), in order to contain Iran or implement nuclear disarmament.

The U.S. can help contain the threat posed by Iran by promoting peace in the disputed territory of Nagorno-Karabakh. Officially, Iran holds a neutral position on the Nagorno-Karabakh conflict between Armenia and Azerbaijan, its two Caucasian neighbors to the north. Unofficially, however, Iran is keen for Azerbaijan to remain embroiled in the dispute, thus making the nation less attractive

to Iran's Azerbaijani minority and diverting resources from a campaign for South Azerbaijan's autonomy or even independence, which could cause the Azerbaijani-populated territory in northwest Iran to demand independence.¹² By helping Azerbaijan and Armenia reach a peaceful settlement in the Nagorno-Karabakh conflict, the U.S. could help both Azerbaijan and Armenia, and weaken the anti-American regime in Tehran.

A final security consideration for the United States is the threat of Islamist terrorism in the South Caucasus. Since the attacks on September 11th, 2001, the U.S. has prioritized intervention in activities of terrorist groups that could endanger the United States and its allies. The risk of Islamic radicals gaining a foothold in the South Caucasus is less acute than in the North Caucasus, where *jama'ats* are active throughout the region, especially in Dagestan and Ingushetia, or in Central Asia. The only predominantly Muslim nation among the South Caucasus is Azerbaijan, and the country's traditionally tolerant population makes it an unlikely breeding ground for Islamic radicalism, for now at least. Nonetheless, some Muslim activists in the Sunni north of Azerbaijan belong to the Salafi (also known as Wahhabi) sect

12 Schaffer, Brenda, "Iran's Role in the South Caucasus and Caspian Region: Diverging Views of the U.S. and Europe," *Iran and Its Neighbors: Diverging Views on a Strategic Region*, Eugene Whitlock (Ed.), Stiftung Wissenschaft und Politik/German Institute for International and Security Affairs, Berlin, July 2003, p. 19, http://belfercenter.ksg.harvard.edu/files/tfpd_divergingviews_whitlock.pdf (October 1, 2009).

of Islam, one of the strictest forms of the faith, whose adherents include Al-Qaeda and the 9/11 attackers. Iranian-controlled Shia groups in southern Azerbaijan are also a growing concern. Russia shares this particular anxiety, and the Global War on Terror (or “Overseas Contingency Operations” as the Obama administration has renamed it) can provide a platform for the convergence of U.S. and Russian interests, facilitating cooperation between the two powers and the regional states in the South Caucasus.

Oil and Gas Priorities

Energy is a critical U.S. interest in the South Caucasus because of the region’s role as a strategic transit corridor for energy from Azerbaijan and Central Asia (Kazakhstan and Turkmenistan in particular) to Western markets. Non-OPEC oil supply has been flat-lining in recent years and many, including Fatih Birol, the chief economist at the International Energy Agency (IEA), believe that conventional non-OPEC oil production will peak in the next few years if it has not already.¹³ As a result, world oil markets are expected to become increasingly dependent on OPEC oil supply (found primarily in the Middle East) to meet growing demand. Greater dependence on OPEC is risky for the U.S. and its allies; in the past, OPEC

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has used its oil exports as a political and economic weapon. Moreover, OPEC is a cartel that sets production quotas in order to maintain high prices, thereby harming Western consumers.

The non-Russian, non-Iranian Caspian region, which includes Azerbaijan and the Central Asian nations of Kazakhstan and Turkmenistan, has moderate proven oil reserves of about 38 billion barrels. Azerbaijan, by EIA’s 2010 estimates, has reserves of 7 billion barrels.¹⁴ However, estimates of this region’s possible reserves—a less precise measure of in-ground resources that includes reserves found through new discoveries—indicate that the Caspian could hold as much as 162 billion barrels of crude oil, making it a potential energy superpower (See Table 1).

In addition to oil, the Caspian region also holds significant proven and possible natural gas reserves, which can be tapped to diversify Europe’s

13 “IEA Warns Non-OPEC Oil Could Peak in Two Years,” *The Times*, July 21, 2008, http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article4368523.ece# (October 1, 2009).

14 Azerbaijan; *Country Analysis Brief*, Energy Information Agency, U.S. Department of Energy, November 2010, <http://www.eia.gov/countries/cab.cfm?fips=AJ> (April 17, 2011)

Table 1. Proven and Possible Crude Oil Reserves (billion barrels)¹⁵

	Proven Reserves	Possible Reserves
Azerbaijan	7.00	32.00
Kazakhstan	30.00	92.00
Turkmenistan	0.60	38.00
Caspian 3	37.60	162.00
Russia	60.00	

natural gas supply sources (See Table 2). Dependence on Russian natural gas is a key energy security concern for U.S. allies in Europe. Russia is Europe's single largest source of natural gas, supplying more than 40 percent of total EU natural gas imports in 2006, or about 25 percent of total EU gas consumption.¹⁶ Russia's state-controlled Gazprom is the monopoly supplier to many Eastern, Central, and Southern European countries. Many Western European countries rely on Russia for a substantial proportion of their net natural gas requirements, and their dependence is growing.

Russian gas pipelines already reach deep into Europe via Ukraine and

¹⁵ Proved Reserves as of 2009 from "International Energy Statistics," U.S. Energy Information Administration, <http://tonto.eia.doe.gov/cfapps/ipdbproject/IEDIndex3.cfm?tid=5&pid=57&aid=6> (November 3, 2009). Possible Reserves as of 2005 from "Caspian Sea Region: Survey of Key Oil and Gas Statistics and Forecasts," U.S. Energy Information Administration, July 2005, http://www.eia.doe.gov/emeu/cabs/caspian_balances.htm (November 3, 2009).

¹⁶ "EU Energy in Figures 2009," Directorate-General for Energy and Transport, European Commission, http://ec.europa.eu/energy/publications/doc/statistics/part_2_energy_pocket_book_2009.pdf (October 27, 2009).

with additional large pipeline projects such as the North Stream, Russia hopes to consolidate its hold on the European gas market. This dependence on Russian natural gas is worrisome, not only because of the magnitude of this dependence, but also because of Moscow's deployment of energy exports as a foreign policy tool. New natural gas exports from the Caspian region have the potential to diversify Europe's natural gas supply away from Russia and enhance the continent's energy security.

Table 2. Proved Natural Gas Reserves (billion cubic meters)

Azerbaijan	850
Kazakhstan	2,408
Turkmenistan	2,663
Caspian 3	5,921

The U.S. has a strategic interest in developing the Caspian region's oil and gas resources and bringing those resources to Western markets without traversing Russian or Iranian territory. The key export route for these resources is a path through friendly countries – Azerbaijan, Georgia and Turkey – which can bring the Caspian gas supply to Europe and the Mediterranean Sea. This route, known as the "Southern Corridor," already has two key pipeline systems: the Baku-Tbilisi-Ceyhan (BTC) pipeline, which can carry up to 1 million barrels per day of oil to the Turkish port of Ceyhan on the Mediterranean Sea, and the South Caucasus Pipeline,

which can deliver up to 8.8 billion cubic meters per year of natural gas to the Turkish pipeline system at Erzurum.¹⁷ Begun in November 2007, an extension of the South Caucasus Pipeline is now operational, transporting natural gas from Turkey to Greece.¹⁸ The U.S. and its European allies hope to expand exports along the Southern Corridor to bring more Caspian energy to Western markets. Integral to this goal is the proposed 7.9 billion Euro (US\$11.5 billion) Nabucco gas pipeline that would expand and extend the South Caucasus Pipeline and transport up to 31 billion cubic meters of natural gas from the Caspian to Europe.¹⁹

The Nabucco project has progressed extremely slowly, with pricing disputes involving Turkey, disorganization among the European consumer states, a lack of commitment from suppliers, and strong competition from the Gazprom-managed South Stream pipeline. For years, Nabucco's future has been uncertain. However, in 2010, Azerbaijan, Romania, and Georgia signed a memorandum on the implementation of the Azerbaijan-Georgia-Romania intercon-

ductor (AGRI), which would move liquefied natural gas (LNG) from the Caucasus to the Southeastern Europe through pipelines and tankers.²⁰ Other important projects include the proposed Trans-Caspian oil and gas pipelines that would bring energy resources from Turkmenistan and Kazakhstan to the BTC and Nabucco through pipelines running beneath the Caspian Sea.

Russia allowed the BTC pipeline to break up its monopoly on Caspian oil resources, and does not want to see Nabucco do the same for natural gas - despite the statements to the contrary by captains of the Russian gas industry. Russia is aggressively contracting Caspian gas; recent measures include agreements to export Azerbaijani gas along Russian pipeline systems, in order to starve the Nabucco project of needed volumes.²¹ Turkey's demands for higher transit tariffs and lower gas prices have forced Azerbaijan to look for alternative routes.

By increasing presence in the Caucasus, Russia has managed to acquire gas export agreements with Azerbaijan: in 2009, Gazprom leadership signed a contract with Azerbaijan to import 500 million

17 "Azerbaijan Country Analysis Brief," U.S. Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/Azerbaijan/Background.html> (October 1, 2009).

18 "Turkey-Greece Pipeline Delivering Azerbaijani Gas to Europe Inaugurated," APA News Agency, UNDP Azerbaijan Development Bulletin, November 19, 2007, <http://www.un-az.org/undp/bulnews54/rg1.php> (October 1, 2009).

19 "Project Description / Pipeline Route," Nabucco Gas Pipeline Project, Nabucco Gas Pipeline International GmbH, <http://www.nabucco-pipeline.com/project/project-description-pipeline-route/project-description.html> (October 1, 2009).

20 Cohen, Ariel and Rzaeva, Gulmira; "The Baku Summit Launches a Breakthrough LNG Project"; CACI Analyst, September 17, 2010, <http://www.cacianalyst.org/?q=node/5407> (April 20, 2011)

21 Erkan Oz, "Azerbaijan Looks For Gas Routes To Europe Bypassing Turkey", *The Wall Street Journal*, October 17, 2009., <http://online.wsj.com/article/BT-CO-20091017-701339.html>

cubic meters,²² which will be increased to 2 billion cubic meters in 2011, according to bilateral agreements.²³

Moscow has also proposed a competing project – the South Stream pipeline – which would supply gas to Europe from essentially the same sources (plus Russian gas) and along the same route as Nabucco. U.S. and EU energy security interests will continue to clash with Russia’s desire to control energy flows in Eurasia. The energy “chess game” that has played out between Russia and the West will continue to intensify over the next decade.

Supporting Freedom

The promotion of democracy and free market principles in the South Caucasus is an important component of U.S. policy in the South Caucasus. There was a long-standing belief in U.S. foreign policy circles during the Clinton and George W. Bush administrations that democracy and free trade bring stability and economic growth. There is less commitment to democracy promotion under the prevailing “neo-realism” of the Obama administration.

22 Socor, Vladimir; “Azerbaijan-Russia Gas Agreement: Implications for Nabucco Project; Eurasia Daily Monitor Volume:6, Iss.: 189, October 15, 2009, [http://www.jamestown.org/programs/edm/single/?tx_ttnews\[tt_news\]=35615&tx_ttnews\[backPid\]=27&cHash=efe96da8f4](http://www.jamestown.org/programs/edm/single/?tx_ttnews[tt_news]=35615&tx_ttnews[backPid]=27&cHash=efe96da8f4) (April 27, 2011)

23 “Russia’s Gazprom CEO makes number of company announcements”; RIA Novosti, 2010 ST. Petersburg International Economic Forum, June 19, 2010

Empirical evidence shows that democracies go to war with each other considerably less often and are internally more stable than brittle autocratic regimes.²⁴ Liberal theory also predicts that trade creates common interests for countries, thus raising the costs of going to war and reducing its frequency.²⁵ Furthermore, strong, independent democracies in the South Caucasus would help to ward off external attempts to influence and control relatively new and weak states. Strong democracies in the South Caucasus would also bolster America’s broader strategy to bring peace and stability to the turbulent Greater Middle East.

The U.S. strongly supported Georgia’s 2003 “Rose Revolution” that replaced President Eduard Shevardnadze with a government led by President Mikheil Saakashvili. During the 2008 Georgia War, Russia sought not only to create conditions to the Abkhaz and South Ossetian independence, which is likely to lead to an *Anschluss* by Russia in the future, but also to undermine the Rose Revolution by forcing out President Saakashvili. This conflict over democracy (and independence) in the South Caucasus will continue to be a source of tension between the U.S. and Russia. The U.S. was particularly pleased with Baku’s decision in

24 Rummel, R.J., “Democracies Don’t Fight Democracies,” *Peace Magazine*, May-June 1999, <http://archive.peacemagazine.org/v15n3p10.htm> (October 27, 2009).

25 Friedman, Thomas L., “The Lexus and the Olive Tree,” *Farrar, Straus and Giroux*, 1999, p.240

Furthermore, strong, independent democracies in the South Caucasus would help to ward off external attempts to influence and control relatively new and weak states

late 2010 to release Adnan Hajizade, a youth activist and blogger critical of the Aliyev administration. Hajizade and his associate Emin Milli were imprisoned on charges of hooliganism and sentenced to two years imprisonment until the Baku Court of Appeals overturned the decision and released both Hajizade and Milli from prison.²⁶ The U.S. will likely show even more support to Azerbaijan if its leadership further liberalizes its political system.

U.S. security challenges in the South Caucasus

U.S. interests in the South Caucasus are threatened by the region's simmering insecurity, including the conflict between Russia and Georgia over the latter's breakaway provinces, the ongoing dispute between Armenia and Azerbaijan over Nagorno-Karabakh and the occupation of Azerbaijani territories, and the worrying emergence of Islamic fundamentalism in Azerbaijan.

The August War

Who started the war between Russia and Georgia in August 2008 is subject to debate between the parties directly involved in the conflict as well as experts around the globe. It seems clear that Russia had been preparing for this war for years, and deliberately provoked Georgia through the shooting and shelling of Georgian-controlled villages in South Ossetia. There is no question that the brief but intense events that unfolded in the summer of 2008 damaged U.S. interests regarding security, energy, and democracy in the South Caucasus. Although the conflict was formally ended by the peace plan brokered by French President Nicolas Sarkozy, Russia failed to implement many of the fundamental components of the plan, and the debate over the self-proclaimed "independence" of the Georgian provinces of South Ossetia and Abkhazia remains unresolved. At the time of the writing, only Russia, Nicaragua and Venezuela recognize the secessionist territories, with Belarus promising to follow suit. The simmering conflict is liable to flare up again, and there is a high probability that the issue will further impact U.S. interests in the region.

During the August War, Moscow's response went beyond the fighting in South Ossetia when Russian forces destroyed key military and civilian infrastructure in Georgia, and caused thousands of casualties. Russia's

26 Ismayilova, Khadija; Azerbaijan: Blogger Adnan Hajizade Released from Prison; EurasiaNet, November 18, 2010, <http://www.eurasianet.org/node/62401> (Accessed May 20, 2011)

systematic attacks on Georgia's military bases and capabilities have weakened the country's ability to defend itself in future conflicts. More importantly, the obliteration of Georgia's nascent military power and the heightened insecurity of its borders have made some NATO member countries – particularly those in Western Europe – less willing to extend a Membership Action Plan (MAP) to Georgia, and have also raised questions about NATO membership for Ukraine.²⁷ MAP is the last formal step on the path to possible future membership in NATO. By keeping NATO out of the South Caucasus, Russia reserves the right to military intervention in the region without fear of a treaty-obligated allied response under Article 5 of the NATO Charter. In a recapitulation of the principle of collective defense, NATO announced that

Article 5 is at the basis of a fundamental principle of the North Atlantic Treaty Organization. It provides that if a NATO Ally is the victim of an armed attack, each and every other member of the Alliance will consider this act of violence as an armed attack against all members and will take the actions it deems necessary to assist the Ally attacked.²⁸

27 Kucera, Joshua. "Georgia: No Discussion of MAP for Tbilisi during NATO Meeting," *Eurasia Insight*, December 4, 2008, <http://www.eurasianet.org/departments/insightb/articles/eav120408c.shtml> (October 1, 2009).

28 "What is Article 5?" NATO website, <http://www.nato.int/terrorism/five.htm> (October 27, 2009)

For now, this principle will not apply to Georgia. As Vice President Joe Biden stated during his visit in July 2009, the U.S. will not provide a "physical security guarantee" to Tbilisi.²⁹ Future instability in Georgia's breakaway provinces or another war could further strengthen Russia's hand in the region at the direct expense of Georgia's sovereignty and the interests of the U.S. and its Western allies.

Security and energy in the Caucasus are inextricably linked. The August War between Russia and Georgia was ostensibly fought over the breakaway province of South Ossetia. However, it also affected the security of Armenia and Azerbaijan. Many speculate that Russia's disproportionate use of force in Georgia was designed to cast doubt on the security of the strategic pipeline corridor linking the energy resources of the Caspian with Western markets. The BTC oil pipeline, which runs from Azerbaijan through Georgia to Ceyhan, a Turkish port on the Mediterranean Sea, was shut prior to the start of the August War due to an explosion at a pump station in eastern Turkey. However, this did not stop Russian forces from targeting the pipeline. Media sources reported that Russian jets dropped more than 50 bombs in the vicinity

29 Cohen, Ariel, "Biden Should Treat Poland with Respect," *The Foundry*, The Heritage Foundation, October 21, 2009, <http://blog.heritage.org/2009/10/21/biden-should-treat-poland-with-respect/> (October 27, 2009)

of the BTC pipeline but failed to damage the buried line.³⁰

Overall, the BTC shutdown had a minimal effect on world oil markets. Despite the restriction of oil flows from Azerbaijan during the August War, oil prices continued to fall due to the bursting of the financial bubble, the drop in energy prices and a steadily worsening global economic outlook. The real long-term effect of the August War has been to cast doubt on the security of future energy projects in the South Caucasus, particularly the proposed Nabucco gas pipeline, which the U.S. and EU see as a necessity for meeting Europe's growing demand for natural gas, and for diversifying gas supply sources away from Russia. By causing instability in the South Caucasus, Russia has effectively increased Nabucco's security risk, making the project less appealing to investors and giving an advantage to Gazprom's competing South Stream pipeline.

The August War also threatened democracy in the South Caucasus. Russia's leadership has publicly expressed its disdain for pro-Western Georgian President Mikhail Saakashvili, who came to power during the "Rose Revolution" of 2003. Toward the end of the August War, Russia's U.N. ambassador reportedly

told then U.S. Secretary of State Condoleezza Rice that Saakashvili "must go."³¹ Russia's heavy-handed response to the relatively low-level dispute between Georgia and South Ossetia was partly designed to embarrass Saakashvili and force a change in the country's leadership. Russia would like nothing more than to replace Saakashvili's pro-Western government with a more Russian-leaning leadership.

In January 2009, the out-going Bush administration showed strong support for Georgia by signing the "U.S.-Georgia Charter on Strategic Partnership," which states that "our two countries share a vital interest in a strong, independent, sovereign, unified, and democratic Georgia."³² The charter, among other things, emphasized cooperation on defense and security matters to defeat threats and to "promote peace and stability" in the South Caucasus and to increase "the physical security of energy transit through Georgia to European markets." The Obama administration's support for Georgia has been more muted and Obama's push to "reset" relations with Moscow has raised fears in some quarters that the U.S. is abandoning its Georgian ally.³³

31 "U.S.: Russia Trying to Topple Georgian Government," CNN.com, August 11, 2008, <http://www.cnn.com/2008/WORLD/europe/08/10/un.georgia/> (October 1, 2009).

32 "United States-Georgia Charter on Strategic Partnership," U.S. State Department, America.gov, January 9, 2009.

33 "Diplomacy 'reset' worries some U.S. allies," Wall Street Journal, March 9, 2009, <http://online.wsj.com/article/SB123655154931965237.html> (October 27, 2009)

30 "Georgia: Russia Targets Key Oil Pipeline With Over 50 Missiles," U.K. Telegraph, August 10, 2008, <http://www.telegraph.co.uk/news/worldnews/europe/georgia/2534767/Georgia-Russia-targets-key-oil-pipeline-with-over-50-missiles.html> (October 1, 2009).

Nagorno-Karabakh Conflict

The Armenian-occupied disputed territory of Nagorno-Karabakh is another potential issue in the South Caucasus that could threaten U.S. interests. Azerbaijan and Armenia are still technically at war over Nagorno-Karabakh and the seven adjacent regions, but a ceasefire has kept the region under Armenian control since 1994. In the short-term, the risk of the conflict resuming is low. Armenia, which has been heavily armed with Russia's help, still has a significant military advantage over Azerbaijan, despite Baku's significant increases in its military spending, which has been fueled by surging oil and gas income over the past several years.³⁴

Nevertheless, violations of the 1994 ceasefire increased in 2008-2009, and the departure of the U.S. and Russian envoys from the OSCE Minsk Group – the Organization for Security and Cooperation in Europe, the body responsible for Nagorno-Karabakh negotiations in 2009 – has further

clouded the prospects for peace.³⁵ The reopening of the conflict between Azerbaijan and Armenia would affect U.S. interests in the Caucasus.

In the meantime, both the Turkish-Armenian and Azerbaijani-Russian rapprochement open new grounds for the Karabakh settlement. In October 2009, Turkey and Armenia signed a protocol to establish diplomatic relations, reopen their shared border (which has been shut since the Armenian occupation of Nagorno-Karabakh in 1994), and establish a joint historical commission to investigate the massacre of Armenians by Ottoman Turks during the First World War. The accords were supported by both Washington and Moscow, but under pressure from domestic public opinion and Azerbaijan, Turkey and Armenia froze the rapprochement. Turkey has returned to its prior position, under which Armenian rapprochement can proceed only after the resolution of the Karabakh conflict.³⁶ In Armenia, the rapprochement faces vehement opposition from nationalists at home and from the Armenian diaspora abroad, while Turkey is facing pressure from Azerbaijan to make the

34 Daly, John C. K., "Growing Azeri Defense Budget Buildup—In Earnest or for Show?" *Eurasia Daily Monitor*, Vol. 5, Issue 209, October 31, 2008, http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=34069 (October 1, 2009) and Giragosian R., "The Military Balance of Power in the South Caucasus," *ACNIS Policy Brief Number Two*, April 2009, <http://www.acnis.am/publications/2009/THE%20MILITARY%20BALANCE%20OF%20POWER%20IN%20THE%20SOUTH%20CAUCASUS.pdf> (October 30, 2009).

35 Abbasov, Shahin, "Azerbaijan: With Departure of Two Karabakh Mediators, Future of Talks Unclear", *Eurasianet.org Eurasia Insight*, August 6, 2009, <http://www.eurasianet.org/departments/insight/articles/eav080609a.shtml> (October 1, 2009).

36 Avetisyan, Tigran, Musayelyan; *One Year On, Turkey-Armenia Rapprochement Stalled*; *Radio Free Europe/Radio Liberty*, October 10, 2010, <http://www.rferl.org/content/One-Year-On-Turkey-Armenia-Rapprochement-Stalled/2186246.html> (April 24, 2011)

deal conditional on the withdrawal of Armenian troops from the occupied territories and the return of displaced Azerbaijanis.³⁷ Though some in Baku felt betrayed by Ankara, many international analysts saw the Turkish-Armenian rapprochement as a positive factor that could finally lead to a breakthrough in the Nagorno-Karabakh dispute.³⁸

Moscow's support of the Turkish-Armenian agreement is curious, and there is doubt concerning to what extent Moscow actually supports the rapprochement. A resumed conflict

leverage and influence in the region.³⁹ Moscow already enjoys powerful influence in Armenia due to the latter's political and economic isolation from its neighbors. In 1995, Armenia and Russia signed an agreement allowing Russian military presence at Gyumri for 25 years, until 2020. In 2010, Yerevan agreed with Moscow to extend this to 49 years, meaning that they will not withdraw until 2044.⁴⁰ Russia not only dominates Armenia's political and military infrastructures, but actually have its own troops stationed in Armenia for the next 33 years. Similarly, Russia controls Armenia's nuclear and hydrocarbon energy infrastructure.

In the meantime, both the Turkish-Armenian and Azerbaijani-Russian rapprochement open new grounds for the Karabakh settlement

between Azerbaijan and Armenia would benefit both Russia and Iran at the expense of the U.S. Russia would benefit if Russian "peacekeepers" are called in to mediate a ceasefire between Baku and Yerevan, and an increased Russian military presence would further increase Moscow's

Meanwhile, Iran stands to gain if Azerbaijan remains preoccupied with Nagorno-Karabakh - as opposed to turning its attention towards Iran's Azerbaijani minority, which reportedly numbers 25 million and has complained of rights abuses.⁴¹

Much like a second Georgian war, a resumed conflict between Azerbaijan and Armenia would cast doubt upon the ability of the U.S. to protect its allies, in addition to jeopardizing

37 "Statement of the Ministry of Foreign Affairs of the Republic of Azerbaijan," Republic of Azerbaijan, Ministry of Foreign Affairs, October 10, 2009, http://mfa.gov.az/eng/index.php?option=com_content&task=view&id=580&Itemid=1 (October 29, 2009) and "Turkey-Armenia rapprochement far from guaranteed," Reuters, October 12, 2009, <http://www.reuters.com/article/vcCandidateFeed1/idUSTRE59B3GY20091012> (October 29, 2009)

38 "Turkish-Armenian rapprochement might cause breakthrough in Nagorno-Karabakh," Sunday's Zaman, October 29, 2009, <http://www.sundayszaman.com/sunday/detaylar.do?load=detay&link=182043> (October 29, 2009)

39 "Russia Steps Up Efforts on Nagorno-Karabakh," Radio Free Europe Radio Liberty, October 29, 2008, http://www.rferl.org/content/Russia_Steps_Up_Efforts_On_NagornoKarabakh/1336149.html (October 1, 2009).

40 "Armenia to extend Gyumri base lease for 49 years"; Voice of Russia, August 18, 2010, <http://english.ruvr.ru/2010/08/18/16224474.html> (Accessed: May 20, 2011)

41 Vatanka, Alex, "Azerbaijan-Iran Tensions Create Obstacle to Caspian ResoSlution", Eurasianet.org Eurasia Insight, January 29, 2003, <http://www.eurasianet.org/departments/business/articles/eav012903.shtml> (October 1, 2009).

the security of U.S. and EU-backed energy projects in the South Caucasus. If the conflict were to resume, and Armenia were to attack Azerbaijan, it would likely target the BTC pipeline or Azerbaijan's Sangachal Terminal – where oil and gas from Azerbaijan's offshore fields are stored and processed before export.⁴² A successful attack on the processing plants at Sangachal would shut down Azerbaijani exports for much longer than a direct attack on the pipeline would, putting billions of dollars of Western investments at risk. An attack on the BTC or Sangachal would also increase the political risk of the proposed Nabucco gas pipeline and other future energy projects in the region. If the Nagorno-Karabakh conflict were to erupt into all-out war between Azerbaijan and Armenia, Azerbaijan's energy exports (its source of currency revenues) would become a strategic target for Armenia.⁴³ Thus, The U.S. would rather see Armenia and Azerbaijan reach a peaceful compromise over Nagorno-Karabakh, limiting Moscow and Tehran's leverage in the region and allowing the countries of the South Caucasus to integrate economically with the West.

Terrorist Threats

Controlling the spread of Islamic

42 "BP Caspian - Sangachal Terminal," BP website, <http://www.bp.com/sectiongenericarticle.do?categoryId=9006674&contentId=7015100> (October 1, 2009).

43 Emmanuel Karagiannis, *Energy and Security in the Caucasus*, (New York: RoutledgeCurzon, 2002), p. 45.

terrorism in the South Caucasus is another important foreign policy concern for the U.S. To date, there has been some evidence of international terrorist groups operating in the South Caucasus. Azerbaijan is the only country in the region with a majority Islamic population, but its traditionally secular government and elites make it less prone to radicalism. Nevertheless, Islamist ideology has gained ground in recent years due to internal factors, such as disillusionment with the current government and increased levels of poverty despite booming oil and gas revenues, as well as external factors, such as the penetration of Hezbollah and sponsorship of Islamic schools by Middle East donors and foundations connected with radical Sunni circles, which also support Al Qaeda and other terrorist organizations.

Radical Shia groups sponsored by Iran and Hezbollah are an addition source of concern for Azerbaijan, particularly in the south, along the Iranian border. Baku has repeatedly accused Teheran of interfering in its internal affairs. In 2002, the Azerbaijani authorities shut down several Iranian-sponsored extremist Shia madrasas (religious schools), whose curriculums glorify the theocratic regime in Tehran, but a large number of schools reportedly remain in operation.⁴⁴ In 2008, surveillance uncovered links between local militants and

44 Geybullayeva, p. 114.

Hezbollah operatives, which enabled Azerbaijani security forces to foil a plot to blow up the Israeli Embassy in Azerbaijan. The plot was reportedly designed by Hezbollah and the Iranian intelligence as revenge for the alleged Israeli assassination of Imad Mughniyeh, chief operations officer of Hezbollah, who died in a car bomb in Damascus.⁴⁵ Due to strong Iranian pressure, the two arrested Hezbollah operatives were released after only a year and a half in Azerbaijani prison, despite their fifteen year sentences.⁴⁶

The rise of the violent variety of the Salafi branch of Islam among the country's Sunnis is a worrying phenomenon. In a country where the majority of the Muslim population is Shi'ite, Salafis face some wariness from Azerbaijani society.⁴⁷ Of particular concern is the radical Wahhabi movement that has taken hold among the ethnic Lezgin minority in northern Azerbaijan, sponsored by wealthy Saudis, Kuwaitis, and natives of other Gulf States.⁴⁸ The Wahhabi movement has been active in the North Caucasus – including Chechnya and

Dagestan – for over a decade and has grown in Azerbaijan alongside Lezgin nationalist sentiments.⁴⁹ In 2007, Azerbaijani security forces detained a group of Wahhabi militants armed with grenade launchers and automatic weapons. They had been planning to launch an attack on the U.S. and British embassies in Baku, as well as the Baku offices of several major oil companies.⁵⁰

The rise of Wahhabi radicalism in Azerbaijan could endanger the region's energy infrastructure, particularly if violence is involved. Energy assets have become a popular target for Islamic terrorists in the Middle East because they are high-value Western investments with world-wide repercussions. In February 2006, Saudi forces foiled an Al Qaeda attack on the Abqaiq oil collection and processing plant, which handles two-thirds of the country's oil output.⁵¹ More recently, in July 2009, Egyptian authorities arrested 26 men with Al Qaeda links, suspected of planning to attack oil pipelines and tankers transiting the

45 "Azerbaijan Seen as a New Front in Mideast Conflict," *Los Angeles Times*, May 30, 2009, <http://articles.latimes.com/2009/may/30/world/jg-shadow30> (October 29, 2009)

46 *Azerbaijan releases 2 Hizbullah members from prison*; *Jerusalem Post*, August 15, 2010, <http://www.jpost.com/Headlines/Article.aspx?id=184782> (Accessed May 20, 2011)

47 Sultanova, Shahla, *Azerbaijan: Sunni Groups Viewed with Suspicion*; *Institute for War and Peace Reporting*, April 8, 2011, <http://www.unhcr.org/refworld/country,,,AZE,,4da3f66a2c,0.html> (May 1, 2011)

48 Geybullayeva, Arzu, "Is Azerbaijan Becoming a Hub of Radical Islam?", *Turkish Policy Quarterly*, Spring 2007, p. 109, <http://www.turkishpolicy.com/images/stories/2007-03-caucasus/TPQ2007-3-geybullayeva.pdf> (October 1, 2009).

49 Kotchikian, Asbed, "Secular Nationalism Versus Political Islam in Azerbaijan," *Jamestown Foundation Terrorism Monitor*, Vol. 3, Issue 3, February 9, 2005. http://www.jamestown.org/single/?no_cache=1&tx_tnews%5Btt_news%5D=27525 (October 1, 2009).

50 Yevgrashina, Lada, "Analysis: Azerbaijan Plot Shows Radicals' Threat Has Teeth," *Reuters*, November 8, 2007, <http://www.reuters.com/article/latestCrisis/idUSL08191665> (October 1, 2009) and Cohen, A. and Kushnir, K., "Azerbaijan," *World Almanac of Islamism* (2010, forthcoming).

51 "Saudi Arabia: Explosion Near Oil Refinery," *Stratfor*, February 24, 2006, http://www.stratfor.com/saudi_arabia_explosion_near_oil_refinery (October 1, 2009).

Suez Canal with remote-controlled detonators and explosives.⁵² In 2010, even Interpol got involved: four Azerbaijanis were listed as wanted for their links to terrorist organizations including Al-Qaeda.⁵³ If Al Qaeda gains a foothold in Azerbaijan, oil and gas assets, such as the BTC pipeline and the Sangachal oil and gas terminal, could become potential targets.

Developing Caspian Energy Exports

The South Caucasus region is of great importance to the U.S. and its Western allies because it provides a corridor free of hostile influence for the export of oil and gas from the Caspian Basin – a region that includes Azerbaijan, Kazakhstan, and Turkmenistan. Historically, all energy exports from this landlocked region have flowed through the Russian Empire to markets in Europe, or, after the 1917 Bolshevik Revolution, into the Soviet Union. This arrangement has benefited Russia in two ways. First, as the sole export route for Caspian energy until the mid-2000s, Russia has wielded significant economic and political leverage over the Caspian Basin countries. Secondly, Russia has been able to increase the total volume of energy resources under its control,

52 "Egypt Arrests 26 Over Suspected Suez Canal Plot," *Al Arabiya*, July 9, 2009, <http://www.alarabiya.net/articles/2009/07/09/78285.html#> (October 1, 2009).

53 *Interpol declares four Azerbaijani citizens wanted for links with Al Qaeda*; *Panorama Armenian News*, March 11, 2010, <http://www.panorama.am/en/law/2010/03/11/az-interpol/> (April 27, 2011)

allowing it to secure a monopoly over gas supply, consolidate its political leverage in Eastern and Southeastern Europe, and expand its market share and political clout in Western Europe.

Azerbaijan's energy resources and location became of particular importance as Russia's control over Caspian energy began to weaken with the opening of the Southern Corridor's BTC oil pipeline in 2005 and the South Caucasus Pipeline (SCP) gas line in 2006. The BTC pipeline in particular was heavily supported by the Clinton and Bush administrations (1993-2008). These projects allowed Azerbaijani oil and gas exports to bypass Russia on the way to consumer markets in the West. Other Caspian producers remain dependent on Russian oil and gas export routes, although this dynamic may change with the proposed Trans-Caspian oil and gas pipelines, which would run beneath the Caspian Sea, linking up with the BTC oil pipeline and the South Caucasus/Nabucco gas pipeline in Azerbaijan.

Russia has forcefully opposed the U.S. and EU-backed Nabucco gas pipeline. In recent years, Russia has offered to buy natural gas from Caspian producers, especially the key supplier Turkmenistan, and has proposed a competing project – the South Stream pipeline – designed to obviate the need for Nabucco.⁵⁴

54 "Russia to Increase Purchase Prices for Central Asian Gas: Outlook and Implications," *Eurasia Daily Monitor*,

Given the limited number of potential suppliers in the Caspian region, it is unlikely that there is enough gas to supply both Nabucco and Russian-proposed South Stream. Even Azerbaijan, though it remains committed to the Nabucco project, has begun to sell gas to the Russians and is pursuing other European export projects, such as AGRI, which would follow Early Oil pipeline route via Georgia to the Black Sea, as opposed to a trans-Turkey route. Azerbaijan and Turkmenistan are the primary potential suppliers for the Nabucco project, and although supplies from Iraq and Iran could conceivably contribute to the pipeline, political and security concerns make their participation extremely tentative. Iran is under U.S. sanctions, whereby foreign investment into the Iran's energy industry is seriously limited.⁵⁵ The security situation in Iraq, including relations between the Kurdistan Regional Government and the central government in Baghdad, are far from stable. Turkey is likely to oppose Iraqi gas for Nabucco.

Russia has acted assertively in order to ensure that its South Stream project, which would go from Russia across the length of the Black Sea to

Volume 5, Issue 50, March 16, 2008, [http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=33464](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=33464) (October 27, 2009)

55 Cohen, Ariel, Phillips, James, Graham, Owen; Iran's Energy Sector: A Target Vulnerable to Sanctions; The Heritage Foundation, Backgrounder #2508, February 14, 2011, <http://www.heritage.org/research/reports/2011/02/irans-energy-sector-a-target-vulnerable-to-sanctions> (Accessed in May 20, 2011)

Bulgaria and on to Serbia, Hungary and Austria, has the upper hand over Nabucco. In 2007, Gazprom agreed to buy up new supplies of Kazakh and Turkmen gas at near European prices beginning in 2009 – a move that effectively doubled the price that Gazprom paid in 2008.⁵⁶ Likewise, 2009 marked the beginning of Azerbaijani gas exports to Russia, as mentioned above. In this way, Russia plans to eliminate the southern Corridor pipelines by pulling supplier states away from European-designed transit projects.

Russia, Turkmenistan, and Kazakhstan have also agreed to expand the existing northbound Caspian coastal gas pipeline, the Prikaspiisky pipeline, which will increase its capacity to accommodate 10 billion cubic meters (bcm) per year of Turkmen gas and equivalent quantities of Kazakh gas. This move mean that there is not enough Central Asian gas available to sustain the Western-backed Nabucco pipeline, and will set up the framework for greater cooperation between Russia and Caspian producers to fulfill the South Stream project.⁵⁷ Gazprom's willingness to pay higher prices for Central Asian gas despite the resulting reduction in its profit margins on re-exports

56 "Russia to Increase Purchase Prices for Central Asian Gas: Outlook and Implications," Eurasia Daily Monitor, [http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=33464](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=33464)

57 "Turkmenistan to Launch Russia Gas Pipeline in 2010," Reuters, July 15, 2008. <http://uk.reuters.com/article/oilRpt/idUKL1563346520080715> (October 1, 2009).

to Europe highlights the company's willingness to sacrifice short-term profits for long-term control of the Central Asian gas supply and its European market share, and its central goal of limiting the options of pipeline projects that avoid Russian territory.

Despite the financial crisis and the decline in energy prices, in May 2009, Gazprom announced with its Italian project partner Eni SPA that it was planning to double the capacity of the South Stream pipeline to 63 bcm per year, up from the original capacity of 31 bcm per year.⁵⁸ Shortly before the plans were announced, Russian Energy Minister Sergei Shmatko told reporters that he thought that the South Stream project, currently slated to launch in 2015, would be realized before the 31 bcm per year Nabucco project, which has an in-service date of 2014.⁵⁹ The South Stream project scored a major victory in October 2009 when Russia announced that Turkey had granted all of the permits necessary for Gazprom to construct South Stream along the Turkish-controlled seabed beneath the Black Sea.⁶⁰ The agreement, which allows Gazprom to redirect the South Stream through Turkish rather than Ukrainian waters

(at higher cost), follows recent deals signed with Italy, Bulgaria, Greece, Serbia and Slovenia to start building the onshore European segments of the pipeline and gives the project a clear leg up over the Nabucco project. The agreement also caused speculation, fueled largely by Russian media outlets, that Moscow was planning to bypass Bulgaria and run the pipeline onshore in Turkey. The rumors may have been designed to put pressure on Bulgaria, regarding both the pipeline and a Russian-built nuclear reactor.⁶¹

Russia is also seeking to poach potential Nabucco supply from Azerbaijan. In June 2009, Gazprom signed an agreement to import 500 million cubic meters per year of natural gas from Azerbaijan and transport it by pipeline to Europe starting in 2010.⁶² Although the contracted amount is relatively small, Alexei Miller, Gazprom's CEO, said that Azerbaijan had also promised the company priority in buying gas during the second phase of Azerbaijan's Shah Deniz gas field – which the EU is hoping will be the main supply source for the Nabucco pipeline.⁶³ As mentioned before, this amount will quadruple to two billion cubic meters per year by the end of 2011. Setting the framework for future

58 "South Stream Pipeline Capacity to be Doubled," *Oil & Gas Journal*, May 21, 2009.

59 *Ibid.*

60 "Russian Pipelines Win Key Approvals," *Wall Street Journal*, October 21, 2009, <http://online.wsj.com/article/SB125605250259596613.html> (November 3, 2009).

61 "Ivan Kostov: The publications in Russian media about South Stream is a tactic to put pressure on Bulgaria," *Focus Information Agency*, October 21, 2009, <http://www.focus-fen.net/index.php?id=n197893> (November 3, 2009).

62 "Gazprom Seeks to Rattle EU with Azerbaijan Gas Agreement," *Oil & Gas Journal*, June 30, 2009.

63 *Ibid.*

Russian purchases from Shah Deniz II, the sale and purchase agreement for the Azerbaijani gas deal, signed in October 2009, indicated that initial purchase volumes would increase in proportion with increases in Azerbaijan's production.⁶⁴

The U.S. and EU have not responded to Russia's assertive actions in the Caspian, although both have continued to give strong support for the Nabucco project, which has struggled to move forward amid numerous challenges. For Nabucco to succeed, a large number of actors need to be brought fully onboard, including multiple suppliers, transit nations, and customers across several regions, including Central Asia, the South Caucasus, and Europe. In September 2009, Joschka Fischer, a political communication adviser to Nabucco and a former German vice chancellor and foreign minister, said the project had not yet received the necessary political backing to move forward.⁶⁵ While the EU as a whole supports Nabucco, some European countries and companies have acted opportunistically, choosing to support both Nabucco and Gazprom's South Stream project. Turkey has also raised questions over pricing, and at one point hinted that Nabucco's

success is related to its accession to the European Union. Nonetheless, there has been progress. In 2010, European and Turkish governments ratified the intergovernmental agreement commissioning the Nabucco pipeline. Turkey was last to ratify the agreement, although there are still serious concerns about suppliers.

European concerns were partially assuaged in July 2009, when Azerbaijan, along with Turkmenistan, confirmed that they had enough gas available to fill Nabucco, although neither has signed a supply agreement with the project to date.⁶⁶ A few days later, the governments of participating EU countries signed an intergovernmental agreement with Turkey authorizing the Nabucco project. Following the agreement, Russian state television echoed earlier statements from Prime Minister Vladimir Putin that questioned the feasibility of the project. In May 2009, Putin derided the Nabucco initiative, saying: "Before putting millions of dollars into a pipeline and burying it in the ground, you have to know where the gas for this pipeline is going to come from."⁶⁷ Gazprom's head Alexei Miller voiced a similar sentiment at the meeting with the members of the Valdai Club in September 2009.

64 "Gazprom and SOCAR sign purchase and sale contract for Azerbaijani gas," *Gazprom Press Release*, October 14, 2009, <http://www.gazprom.com/press/news/2009/october/article69312/> (October 27, 2009).

65 "Nabucco Needs More Support, Fischer Says," *Hurriyet Daily News*, September 8, 2009, <http://www.hurriyetdailynews.com/n.php?n=nabucco-needs-more-support-fischer-says-2009-09-08#> (October 1, 2009).

66 "Caspian Gas Producers Affirm Supplies for Nabucco," *Oil & Gas Journal*, July 10, 2009.

67 "EU Nations, Turkey Sign Nabucco Gas Line Treaty," *Oil & Gas Journal*, July 14, 2009.

The U.S. and EU have not responded to Russia's assertive actions in the Caspian, although both have continued to give strong support for the Nabucco project, which has struggled to move forward amid numerous challenges

Russia's moves in the Caspian energy game constitute a direct challenge to U.S. energy interests in the South Caucasus. If Gazprom's South Stream project succeeds at the expense of Nabucco, Russia could consolidate its grasp on Caspian gas for decades to come and provide Moscow with enhanced energy clout and bargaining power vis-à-vis European capitals and Brussels. Given the strategic economic and political benefits at stake, Russia will continue to push South Stream regardless of the cost, which many experts expect to be at least double that of Nabucco. Russia will also continue to offer potential Nabucco suppliers, transit countries, and customers better terms than what the non-Russian routes are providing. The U.S. and EU are likely to stand firm in their support of Nabucco, but will have difficulty managing the myriad diplomatic and financial prerequisites necessary for its launch, particularly in the face of Russia's determination to kill the project.

If Russia is unable to derail the Nabucco and Trans-Caspian pipelines

economically and politically, it may resort to violence – by stirring up the simmering territorial conflicts in Georgia, Nagorno-Karabakh, or even the Caspian Sea – as a means of increasing the security risk in the Southern Corridor. Iran, another Caspian littoral state, is Moscow's ally in this regard. In July 2009, Russia and Iran held a joint military exercise in the Caspian Sea involving some 30 vessels, a signal that the two nations' Caspian interests are beginning to align. Iran wants a greater stake in the Caspian's energy riches – up to 20 percent if the Caspian Sea is legally classified as a lake – while Russia would like to block the Trans-Caspian pipelines designed to bypass Russian territory.⁶⁸

A more fundamental threat exists, too: the fragile political situation in Middle Eastern and African states devalue their natural gas supplies, because the pipelines are less secure.

Policy recommendations for the U.S. Administration

Since the fall of the Soviet Union, the South Caucasus has been a region of great economic and strategic value. The U.S. has had significant strategic and economic interests in the South Caucasus, including the containment of revisionist anti-American regimes in Russia and Iran, securing the

68 Afrasiabi, Kaveh L., "Russia and Iran Join Hands," *Asia Times Online*, July 30, 2009, http://www.atimes.com/atimes/Middle_East/KG30Ak01.html (October 1, 2009).

transit of oil and gas exports from the Caspian, and promoting democratic principles, transparency, good governance and markets based on property rights and the rule of law in Eurasia. These interests are threatened by region-wide security concerns, including Russia's actions – direct and indirect – against states perceived to be U.S.-friendly, such as Georgia and Azerbaijan. The August 2008 conflict between Russia and Georgia over Georgia's breakaway provinces and the conflict between Armenia and Azerbaijan over Nagorno-Karabakh should be viewed in terms of their individual merits, as well as through the prism of the Russian-American competition in the region.

President Barack Obama's "reset" policy with Russia has not changed the basic geopolitical facts, or U.S. interests in the region. U.S. energy interests are threatened by Moscow's determination to dominate the Caspian's oil and gas resources and to control key energy routes to European oil and gas markets. A careful approach is required in examining the roles of Iran and Turkey in the region, especially as Turkish society, government, and policy assume a more pronounced Islamic character and the country distances itself from the U.S., and as Iran teeters between religious dictatorship and popular revolution.

President Barack Obama's "reset" policy with Russia has not changed the basic geopolitical facts, or U.S. interests in the region

The rise of Islamic fundamentalism in Azerbaijan should be seen through the prism of the global rise of radicalism and the Sunni-Shia confrontation. In the aftermath of the predominantly Sunni "Arab Spring", Iranian and Sunni interests are likely to clash in the Greater Middle East and around the world, and Azerbaijan, the South Caucasus, and the Russian North Caucasus are no exception.

Energy security is another crucial point: Azerbaijan is a vital player in developing the potentially gigantic reserves of the Caspian Basin. Equally important is Baku's role in maintaining a clear line of energy production and transit for Europe. Through current pipelines like the BTC as well as future projects, Azerbaijan will be critical in maintaining Europe's energy security by providing an alternate supplier from the Russians, for whom energy trade and geopolitics are so closely linked. Azerbaijan is also a valued energy provider for U.S. ally Israel, which needs to import all of its oil from abroad, and generally gets its energy from the former Soviet Union. Despite these strategic concerns, the Obama administration has reduced U.S. support for allies in the South Caucasus,

seeking instead to prioritize relations with Russia. This is the “neorealism” of the Obama administration, and it will take time before the White House recognizes that this policy does not bear the desired fruit – or, perhaps, until it is a success. Nevertheless, this divergence from previous foreign policies is putting significant regional U.S. interests at risk. In order to defend U.S. interests regarding security, energy, and democracy in the South Caucasus, the Obama administration should:

Apply pressure for a fair conclusion of the Nagorno-Karabakh Peace Process

Settlement of the dispute over Nagorno-Karabakh would help bring stability to the South Caucasus, defuse the “frozen conflict” between Armenia and Azerbaijan, and reduce political risk in the strategic Southern Corridor. Provided Azerbaijani sovereignty over occupied lands is restored, Armenia and Azerbaijan would be able to forge closer relations with the West and eventually join NATO and/or the EU. The Obama administration should work inside and outside of the OSCE’s Minsk Group to negotiate a peace settlement between Baku and Yerevan. The Turkish-Armenian rapprochement and the September 2009 appointment of Robert Bradtke as envoy to the Minsk Group are a good start.⁶⁹ So

69 “Armenia and Azerbaijan: Appointment of U.S. OSCE Minsk Group Co-Chair,” U.S. Department of State, September 7, 2009, <http://www.state.gov/r/pa/prs/ps/2009/sept/128680.htm> (October 1, 2009).

is the appointment of Matthew J. Bryza as the U.S. ambassador to Baku. The United States will have to recognize that Russia has used its significant influence in the region to undermine the Minsk Group at times, hoping to make itself, rather than the international community, the pivotal player in resolving the frozen conflict. Russia has used its military capabilities to develop such a position, not only in the August War but also with its right-of-troops agreement at the Gyumri military base in Armenia.

Re-think the “Reset” Policy

The Obama administration should reassess its policy of “resetting” relations with Russia. Maintaining a working relationship with a country that still has enough nuclear weapons to destroy the world several times over should continue to be an important goal of the U.S. However, this goal should not come at the expense of U.S. allies in the South Caucasus or elsewhere in the former Soviet Union. Although the Cold War has long been over, strategists in the Kremlin still view the “near abroad” as Russia’s “zone of privileged interests”, and international politics as a zero-sum game. The post-Soviet *siloviki*⁷⁰ who direct Russia’s foreign policy will undoubtedly see friendly overtures and unilateral concessions by the U.S. (such as the cancellation of the missile defense program in

70 Largely made up of former KGB. men and military officers

Poland and the Czech Republic) as a sign of weakness, if not naïveté, and a signal that the U.S. may not seek to contain a resurgent Russia in the post-Soviet space. Georgia and, to a lesser degree, Ukraine have already felt the heavy hand of Moscow. The losers in this equation are the countries that belong in what Moscow considers its “sphere of interests,” including those in the Southern Caucasus. The Obama administration should show firm support for the nations of the South Caucasus, including by boosting political-military relations, and send a clear signal to Moscow that attacks on the integrity and independence of friendly nations will come at a price.

Cooperate on Anti-Terror measures with Azerbaijan

The Obama administration should continue to support bilateral and multilateral cooperation with Azerbaijan to combat the rise of Islamic fundamentalism and terrorism. Intelligence sharing between U.S. and Azerbaijan should be expanded, while Azerbaijan should further undertake financial measures to uncover and intercept terrorist financing. Azerbaijan’s close ties with Israel, and that country’s expertise in tracking terrorists, could be particularly useful in this venture. Although Azerbaijan is making progress in this realm, the Council of Europe, through its Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the

Financing of Terrorism mechanism, issued a negative assessment of Azerbaijan’s anti-money laundering reform effort in January 2009.⁷¹

Permanently waive Section 907 of the Freedom Support Act

In view of the Turkish-Armenian rapprochement and in order to continue anti-terror support that began under the Bush administration, the Obama administration must permanently waive the sanctions, i.e. “Section 907 of the Freedom Support Act of 1992”, levied against Azerbaijan in response to its blockade of Armenia. Section 907 bans any kind of direct U.S. aid to the Azerbaijani government. In October 2001, the Senate gave the president the ability to waive Section 907, and President Bush used this authority to provide counterterrorism support to Azerbaijan.

Secure Azerbaijan as transit state for Northern Distribution Network

Ensuring that a Georgia-Azerbaijan-Turkmenistan “leg” of the Northern Distribution Network is established is critical to the American war effort in Afghanistan. This route is important to sustain and expand, given that the Pakistani route is at risk, particularly in the aftermath of the elimination of Osama bin Laden; dependence on the Russia-Kazakhstan-Uzbekistan route alone is ill-advised.

71 “MONEYVAL publishes its second report on Azerbaijan,” Council of Europe, <http://www.coe.az/Latest-News/123.html> (November 2, 2009).

Help Europe to rake a leadership role on Nabucco

The U.S. should help Europe push forward the Nabucco pipeline project, which will diversify Europe's natural gas supplies away from Russia. The U.S., perhaps more than the EU, has a unified and coherent policy toward Nabucco, as well as the political leverage to bring all the necessary actors together. Nonetheless, it is a European project and should be run by and for European companies, consumers and governments. Without sidetracking European actors, the Obama administration should boost U.S. involvement in Nabucco, encouraging all actors to cooperate in getting the project from the negotiating room onto the ground.

Conclusion

The South Caucasus will remain a crucial geopolitical area, where East-West and North-South interests intersect. The U.S. is involved in Iraq, Afghanistan, Pakistan, and the global war on terrorism. Washington is trying, with great care, to push the "reset button" in its relations with Moscow and has a confrontational and highly problematic relationship with the Islamic Republic of Iran. The South Caucasus will continue to play sensitive and important roles in all these areas. In managing US interests in the region, diplomatic, defense, energy and intelligence establishments will

play an important role. As Russia, Iran, and Turkey increase their involvement in the South Caucasus, U.S. policy toward the region will also require appropriate resource allocation and ample executive time, understanding, compassion, and toughness at the highest level.