

Patterns of Regionalism and Security:  
Energy as a Transformational Influence in the Black Sea Region

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ABSTRACT

One of the more significant regional groupings to have emerged since the collapse of the Soviet Union is the wider Black Sea. Located at the jagged confluence of the Western, Orthodox and Muslim worlds, the region was quite frequently a violent meeting place, and thus instead of a bridge between civilizations, it has been a barrier. Even more compelling is how the presence of oil and gas has thrust the Black Sea into the world's view and contributed to the rush of external interest, and how this has helped develop a unique regional entity. Today, in an interconnected global economy, the region's position as a producer and conduit for fossil fuels makes it impossible to consider in isolation. More importantly, to succinctly define this dissertation's research question, it can be asked *how does energy act as a transformational agent in the emergence of a Black Sea region?*

A main component of this analysis is the presence of 'drivers,' those phenomenon which move the regional transformation process forward, notably externally and internally driven change. The externally driven change component is the European Union (EU) and its demand for stability, primarily on its eastern periphery, and energy security. The internally driven change is initiated by the Black Sea Economic Cooperation (BSEC), a regional political and economic organization loosely based on the EU. Indeed, for the purposes of this analysis, the BSEC is portrayed as an analogous entity with the EU.

What becomes evident is that fossil fuels play an inordinately large role in the Black Sea regional development and transformation process. This is attributable to the realities of basic supply and demand; European demand being met by suppliers (Russia and Azerbaijan), and the remaining regional states sandwiched in between. Ultimately, when harnessed to a coherent, planned and well-funded public-private agenda, energy, notably oil, gas and power, is without peer as a transformational agent, a fact currently being established in the Black Sea RSC. This dissertation determines the EU will be *the* deciding factor, more so than any other, of how the Black Sea RSC will align itself in the future. As the European political, economic and administrative center of gravity continues shifting to the east under Germany's initiative, this continues to work in Berlin's long-term favor.

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GENERAL AUDIENCE ABSTRACT PAGE

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## Introduction

“Like the Pontic sea, whose icy current and compulsive course ne’er feels retiring ebb, even so my bloody thoughts, with violent pace, shall ne’er look back...” (Shakespeare, Othello, Act 3, Scene 3).

“...in many ways the wider Black Sea region has been the Bermuda Triangle of Western strategic studies” (Asmus and Jackson 2004: 2).

“The Black Sea has a personality which is not caught by some adjective like “unpredictable” or phrase like ‘friendly to strangers’ and which—because it is not made up of traits or epithets but of the interplay of circumstances—cannot be described in detail at all. These circumstances, adding up to an identity, include fish and water, wind and grass, cliffs and forests, migrating birds and human beings” (Neal Ascherson 1995: 11).

One of the more significant regional groupings to have emerged in the post-Soviet era is the wider Black Sea. With a combined population of over 330 million people, slightly more than the United States, the Black Sea basin occupies a territory of 834,719 square kilometers. Its estimated GDP is around \$3.6 trillion, producing 4.3 percent of the world’s total GDP in 2012. It is enclosed on all sides by major land masses; Eastern Europe, the Caucasus, and Anatolia, the Black Sea flows to the Aegean and the Mediterranean seas via the Bosphorus Strait and the Sea of Marmara. It is fed by some of the Continent’s great rivers; reaching from the heart of Europe, the Danube is one the most important, as well as the Dnieper and Don Rivers, all of which flow to the Black Sea (Manoli 2014: 4).

It is a geographic space with plentiful natural resources, as well as industrial and agricultural capacity, yet with all this tremendous economic potential, it maintains volatile and seemingly intractable political, ethnic and religious conflicts. Few geographic areas in the world have such a long, contentious and consequential history. The region’s location at the jagged confluence of the Western, Orthodox and Muslim worlds was quite frequently a violent meeting place, and thus instead of a bridge between civilizations, it has acted as a barrier. During the Cold War, the Black Sea states were hidden for decades behind the Iron Curtain, resulting in an enigmatic existence, and only since 1991 has this region been exposed to serious scrutiny from the outside.

Changing headlines in the Black Sea region have been a real-time demonstration of the region’s short term evolution. In 2008 Georgia was effectively dismembered at the hands of the Kremlin, and Ukraine is sharing a similar fate. Moldova is also suffering from Russian-inspired territorial disputes, rendering it politically off balance and inert. Bulgaria and Romania were admitted into the EU in 2007, though with unremarkable consequences, as both countries became mired in political and economic turmoil. Greece sank to near political and economic collapse, only to be propped up by a German-led banking union. Armenia is becoming a defacto Russian oblast, while the Aliyev dynasty is solidifying its power in Azerbaijan, reinforced by (until recently) solid energy revenues.

The two primary regional powers, Russia and Turkey, enjoyed fairly positive relations over the last decade, much of which was predicated on the mutual need for energy trade. The two countries now find themselves in an awkward position; both dependent on the other, though now becoming increasingly at odds over the Syrian question. As natural regional competitors for centuries, this is not an unprecedented outcome as both sides have gained from the other's misfortune. Finally, the emergence of Islamic State and other destabilizing influences in the Middle East once again demonstrate the Black Sea's place as a rickety gateway to Europe; whereby political or economic weakness simply attracts destabilizing forces, which in turn, invites great power intervention, and the cycle perpetuates itself.

Even more compelling is how the presence of oil and gas has thrust the Black Sea into the world's view and contributed to the rush of external interest. This not a new phenomenon; in the mid-19<sup>th</sup> Century the discovery of oil in the South Caucasus created the first rush of prospectors, entrepreneurs and adventure seekers. Today, in an interconnected global economy, the region's position as a producer and conduit for fossil fuels makes it impossible to consider in isolation. Therefore, the political and economic stability of the wider Black Sea must be viewed as a broader regional security issue, and not simply a localized one. Indeed, the dynamics shaping the area can be attributed to a combination of external and internal drivers which demonstrate an evolution in patterns of regionalism and security. For these reasons, the wider Black Sea area as a coherent group demands closer inspection, and serves as the primary intellectual motivation behind this dissertation project.

## **The Drivers of Change**

This dissertation is about political, economic and social change, specifically that transformation which occurs within a distinct regional entity. Within the context of this analysis, it is instructive to consider the ground level transactions which enable or propel this transformation and take an objective view of the economic factors that contribute most to changing regional dynamics. These activities, or drivers, cross inter- and intra-regional boundaries, as well as transcend the public and private sectors, forcing the states to reach across geographic and geopolitical boundaries. It can be argued these ground-level interactions are key to the regional transformations underway. Though change is a constant phenomenon, what is attempted in this dissertation is to isolate a specific place and time where this change occurs and, in a sense, 'freeze' it in place to look deeper at its characteristics, and understand these drivers and how they impact regional change.

Even before it is possible to consider the drivers, it is important to study the Black Sea and its broader impact and relationships. As such, a rigorous intellectual foundation is necessary; one that establishes the Black Sea as a unique analytic unit, suitable for deeper and rigorous discovery. Such an analytic foundation will provide an inter-disciplinary structure to study the Black Sea's economic, political and social construct, as well as its relationship in the broader European family of nations where there is a broad affinity (Ozveren 2001: 62). Yet, with such a tumultuous background and its current state of affairs, can the Black Sea be considered a distinct geo-political region with its own unique identity? Can these widely disparate nations with such varied political and economic systems, as well as ethnic, religious and cultural roots be so easily identified?

Furthermore, a Black Sea “region” is not a clearly defined entity with a commonly recognized border or territory, but is an otherwise amorphous area. Therefore, it can be argued the use of the term “region” is a cerebral exercise, denoting a popular vision of a Black Sea area which has ebbed and flowed over time. The term “Black Sea” is usually referenced in vague abstractions with little understanding of the people and their realities, much as one would mention “North America” or the “Pacific Rim,” in a similarly vague and uninformed context. It exists at a level of consciousness between both inhabitants and outsiders, or the collusion of the collective mindsets that create the basic spatial structure (King 2004: 7-8).

Even residents of the littoral states are ambiguous about their own existence within a Black Sea region. In 2002 a study was conducted by academics from Bulgaria, Romania and Ukraine to determine popular perceptions of a Black Sea regional identity, or “regionness.” The organizers, leading subject matter experts in Black Sea history and regional security, interviewed a variety of sources ranging from fellow academics to random street poll participants. The study found that the notion of “regionness” in the Black Sea area was “very little in evidence.” This lack of a Black Sea regional cohesion was most prevalent in Bulgaria, which identifies itself with the Balkans; the strongest sense was in the Crimea (Pop 2004: 77).

More specifically, the study concluded that there was little commonality between Black Sea neighbors regarding security cooperation. Reasons cited were the region’s heterogeneous nature, growing nationalism, economic rivalry and the lack of regionally-based projects. There was also the claim that Black Sea “regionness” is an identity imposed by the West, apparently for exploitative purposes and reinforcing the notion of the neo-imperialist commercial fantasy. Many of the respondents in this group noted that economic cooperation was the highest priority from a regional development perspective. Interestingly, the polls indicate that economists more than any other professional group were open to the notion of a Black Sea region (Pop 2004: 77-78).

More than a decade later, Mariana Semenushyn in her paper, “The Black Sea Region in the Media,” looks at traditional media coverage in Russia, Turkey and Ukraine, and whether this coverage supported the notion of Black Sea cohesion or identity. Ultimately, she determined with few exceptions, “the concept of the Black Sea as a region was largely ignored” by these media outlets, further indicating that a Black Sea region bears a questionable existence (Semenushyn 2014). So, what should be made of this prevailing attitude from the inhabitants themselves that question the viability of a Black Sea region? Is it possible to view the region in any other way than as a simple sum of its parts? Additionally, what about the arguments that are made in favor of the existence of such a region? It is hard to deny that a uniquely shared existence is in play; derived by the benefit of geography and mutual experience of the inhabitants. A point succinctly noted by then-Turkish Foreign Minister Ahmet Davutoglu regarding the “common historical, cultural and social values” at play in the wider Black Sea region (Black Sea News, December 2012: 1).

It must also be acknowledged that interstate activity, commercial, diplomatic and cultural interactions are underway daily, indicating these states do not operate in isolation, but exist in an increasingly interrelated space. From that standpoint, it can be argued that since the end of the Cold War, the emergence of a Black Sea region has been evident. There is also the fact that

numerous organizations exist which attempt to embody the Black Sea states in some form of broader regional entity; perhaps not in a neat, tidy and satisfying package, but in a more haphazard and uncoordinated manner, which mirrors the Black Sea's own disjointed existence. These transactions indicate that relations do exist which detract from this inductivist notion, therefore, coupled with its unique position within the broader European context, a deeper analysis of a Black Sea unit should be considered (Ozveren 2001: 61).

Additionally, this analytic structure must allow the evaluation of energy's influence in the region; energy as defined for the purpose of this dissertation is fossil fuels, primarily crude oil and natural gas, but also the generally overlooked electric power, which is quite often the product of coal-fired thermal plants. These energy sources combine to collectively propel regional economic growth, so can it be argued that this regional growth is creating its own deep-seated change? There may not be a strong Black Sea cultural identity as evidenced in the EU or even the Mediterranean; however, this dissertation will argue that a "brittle" regional identity is emerging. A cohesion, forged of intrastate friction and interaction, external pressure as well as the embodiment of internal mutual goals and fears. Coming back to the notion of regional change, what are the drivers that push this Post-Cold War political and economic transformation? Additionally, which drivers in particular are most responsible for this transformation?

As noted earlier, energy, specifically oil, gas and electric power, has taken a prominent position within the wider Black Sea region, and since this paper centers on the political, economic and social power of energy, it must be asked how does energy contribute to the overall regionalist concept? More importantly, to narrow the research question more succinctly, it can be asked *how does energy act as a transformational agent in the emergence of a Black Sea region?* It is the contention of this dissertation that as a critical component to everyday life, as well as economic and social stability, energy must be seriously considered as a transformational commodity.

## **Georgh Bratianu: The Geo-political Crossroads Model**

It is the region's violent interaction that underscores much of its historical legacy. The persistent contestation prevented the littoral states from developing cohesion and effectively stunted their social, political and economic growth. In addition to, or because of this, the wider Black Sea area was viewed as an appendage in a broader geopolitical construct, usually explained away as an extension of some other competing region's 'back yard.' In contrast, after contesting its own strategic space throughout history, the Mediterranean has managed to maintain a unique identity as home to a variety of social, religious and ethnic groups. This unique identity is multilateral, manifest in numerous institutions, the most recent being former French President Nicholas Sarkozy's concept of a Mediterranean Union (Lesser 2007: 12).

One way to understand the dynamics of contestation and power at play in the wider Black Sea region is to apply the 'Bratianu Model.' Gheorg I. Bratianu, born into a prominent Romanian family, was an academic and politician of the mid-20th Century, who envisioned an imaginary road intersection bisecting the Black Sea basin (Bratianu 1969: 48). In his "La Mer Noir, des origins a la conquête ottoman" (The Black Sea, from its Origins to the Ottoman Conquest), Bratianu became the first historian to write of the Black Sea as its own entity. In the work he makes the argument for the existence of a distinct Black Sea region through an in-depth and

richly portrayed geographic foundation in an almost lyrical presentation. Imprisoned and executed by the communist government, Bratianu's legacy exists as a respected member of Romania's intellectual class.

It is Bratianu's virtual road intersection superimposed across the Black Sea basin which has embodied the region's broader social and political power trajectory throughout history. This model serves as a simple yet effective way to visually portray the manifestations of regional power and change. It is possible to utilize his model to describe long-term geopolitical shifts, specifically on the intersection's North-South axis, which since ancient times, Bratianu notes, has been dominated by the southern pole. Specifically, Byzantium, later Constantinople, and finally, Istanbul, was the Black Sea's geopolitical center of gravity in the North-South power dynamic, and it was from there that power and the motivations for change originated (Bratianu 1969: 48; Ozveren 2001: 73-74).

From Bratianu's viewpoint, by the end of the Byzantine era the Ottoman and Russian empires were the dominant forces and would continue to hold this position well into the future, thereby perpetuating this North-South focus (Bratianu 1969: 49). In the early 20th Century, the balance between the poles decisively changed in favor of the North when the Ottoman Empire collapsed and the Soviet Union emerged from the ruins of Tsarist Russia. The USSR, under various dictators gamely hung on, consolidated its power, and continued many of the Imperialist policies designed to expand Moscow's influence to the south. Much of the second half of the Century that came to be identified with the Cold War meant, for the Black Sea states, a continuation of the political and economic isolation and stasis.

Yet, a major change in the geo-political landscape, unforeseen by Bratianu, was the emergence of a consolidated Europe under the European Union (EU) as a political and economic force with growing influence over the Black Sea states. This coupled with the end of hegemonic control over the Sea after 1991 allowed the littoral populations more freedom to choose their political and economic destinies. This emphasis on good governance, economic liberalization and respect for human rights are powerful incentives for a region which has historically lacked these attributes, though are quite anxious to develop them. These affiliations are, by and large, orienting toward the West, as the short-lived northern dominance of the 20th Century is shifting on Bratianu's intersection with a newfound gaze. What is evident is a long term alteration in the traditional power dynamics, as the Westward pull from a consolidating Europe begins to challenge this traditional North-South power dynamic.

This phenomenon has a name; Europeanization, attributed to Robert Ladrech in his 1994, "Europeanization of Domestic Politics and Institutions: The Case of France," as a demonstration of shared European values and norms throughout the Union. Ladrech noted Europeanization as an "incremental process reorienting the direction and shape of politics to the degree that [EU] political and economic dynamics become part of the organizational logic of national politics and policy-making" (Ladrech 1994: 17). Europeanization is derived primarily from "conditionality," whereby EU benefits are bestowed on the Member States on the *condition* of implementing various legislative components. The idea being that the more the Member States adhere to these common values, or core norms, the more the shared benefits can be dispensed among those states (Manners 2002: 242).

The notion of Europeanization was originally intended for EU members, though it is now being applied to non-members. Indeed, such states are accepting and implementing EU *acquis communautaire*, its cumulative legal structure, comprising the Union's policies and rules, and which acts as a regulatory 'shaping' mechanism for the members, within their own legal infrastructure as a means of moving closer to Brussels. This constitutes a blending of members and non-members and provides a much broader expansion of what can be considered as EU influence than one would imagine by simply looking at the geo-political borders on a map.

The opening of communist Eastern Europe in the late 1980s allowed long shut out Western media and intellectuals to peer into a mysterious and opaque system. The subsequent volume of work written on the region over the last 25 years demands that any serious analysis of this depth and complexity requires the imposition of academic discipline, notably how the data will be gathered, organized, analyzed and presented. More broadly, this considers the intricacies of political, economic and social life in the wider Black Sea, as well as the energy industry and the various analytic lenses applied. To address and make sense of these complexities, this dissertation is organized into three main fields of study; 1) theoretical, 2) substantive and 3) methodological, each field with its own unique set of sources and structures to draw upon.

## The Theoretical Field

As the research question centers on the notion of a newly emerging regional "space" called the wider Black Sea area, how should this space be categorized? At the center of this discussion is the concept of regionalism as a theoretical construct with which to frame this analysis. To establish the geopolitical foundation it is necessary to delve into regionalism as a theoretical field, now with a broad body of knowledge to draw upon. Therefore, early on in the analytic process, there will be concentration on the theoretical principles as the intellectual baseline for the dissertation.

One of the residual impacts of the collapse of the Cold War was the new era's changing geopolitical order and the emergence of strong regional entities, as evidenced by the host of resurrected political, economic and social issues found in the region. More specifically, this paper emphasizes the theoretical concepts of regionalism as developed by Barry Buzan and Ole Wæver of the so-called 'Copenhagen School' of international relations. What distinguishes Buzan and Wæver from the other regionalist theorists highlighted in this dissertation is their focus on security and territoriality and the ability to bridge the neo-realist and normative ideological divide in a logical and systematic manner, in contrast to those who consider culture or social aspects in isolation or in competition with security.

Following the Buzan and Wæver definition of a region; "...where states or other units link together sufficiently closely that their securities cannot be considered separate from each other," it is possible to better understand the authors' perspective. Regions consist of states which exist within an environment of what the authors call 'amity and enmity,' a precarious mixture of friendship and contention, that which creates such durable interactions and which links the competing elements into a recognized entity, roughly the equivalent to the precept "opposites attract."

This constant interplay of interstate hostility and/or friendship creates these long-standing relational patterns (drivers) at play in the regional development process (Buzan and Wæver 2003: 43). It is through this analytic process the authors have developed a theoretical model which identifies these structures as regional security complexes, or RSCs. As will be demonstrated, the Regional Security Complex Theory (RSCT) is a crude but effective model that categorizes the Black Sea region's composition and makes the case for a Black Sea RSC and the theoretical structure from which to complete the analysis. The classification criteria of what actually constitutes an RSC were found too stringent for this dissertation, requiring a revision to the methodology; this revision will be addressed in the next chapter.

## **The Substantive Field**

It can be said that the substantive field provides the intellectual fodder, or building blocks, of the dissertation's structure. It presents the raw materials that answer the research question; essentially the processes which portray specific events, or actions which have facilitated the drivers' trajectories. The difficulty with taking on such an economically, politically and ethnically diverse region as the Black Sea is the equally broad and diverse range of sources required for analysis. These are sources that range from periodicals, blogs, conferences, books and interviews. For this reason it is the most voluminous and diverse of the disciplines which were gathered, relying on the majority of sources.

The substantive field is broken down into two broad sections from which to allow better organization and provides the framework for the case studies; the concentration on the region's external and internal drivers. For instance, external drivers are those political, economic and social forces which emanate from outside the Black Sea region, notably from the EU, which are forcing transformation. Internal drivers are those which are generated from within the regional grouping; from within the Black Sea states themselves. It is the constant friction, or contestation, between and among these drivers which establish the intellectual foundation for this dissertation.

Focusing more closely on these individual drivers, it is possible to address the transformational activities within the wider Black Sea area into its broader economic milieu. The oil and gas pipeline infrastructure (both planned, in operation and abandoned) that transits the region represents varying levels of government and private sector collaboration. Additionally, there is a focus on pipeline politics and the regional energy dynamics, as well as corporate and official governmental documents. A main component is the presence of drivers, which moves the transformation process forward through external and internal stimuli. These are described in more detail below.

### **1) Externally Driven Change: The European Union (EU) and the Demand for Stability and Energy Security**

This line of analysis examines the outside influence on the Black Sea region and in doing so demonstrates an appreciation for Europe's post-war development and the impetus which enabled it to reach its current state as a political and economic power. Furthermore, this EU-centricity considers the initiatives as externally driven efforts at economic interdependence within the region, and highlights the notion of Europeanization. It is here where the impact of the EU and, more specifically, the European Commission, plays a considerable, and generally unrecognized, role in this phenomenon. Additionally, this driver looks at the EU's own domestic energy program, an effort which falls broadly under the European Commission's Directorate for Energy and Environment, and which has identified three pillars as a focal point for EU policy; efficiency, competition and security of supply. It is these pillars which provides the basis for much of the EU energy policies in Black Sea region.

The EU has a handful of initiatives which reinforce the importance of stability on its borders via regional interaction. For instance, the European Neighborhood Policy (ENP), aims to more closely interact with the nations on the EU's periphery.<sup>1</sup> More specifically, this engagement was to be conducted through the Black Sea Synergy (BSS) and the Eastern Partnership (EaP), two of the more recent initiatives dedicated to furthering relations with nations on the EU's eastern border. While this analysis concentrates on external drivers, notably the full range of EU energy programs, there is also a review of the EU-Russian energy relations, which are central to the EU's quest for energy security. In fact, this unique, contentious and frequently divisive relationship proves to be an enduring theme throughout this dissertation.

The EU's interest in the region is evident, though Brussels has yet to produce a viable and coherent strategy; BSS and EaP are widely regarded as failures or marginally successful. This is a serious gap, considering the inherent instability present in a region that abuts the EU and which is vital for long-term European energy security. The current migrant crisis demonstrates the negative impact of this proximity to unstable elements on the EU's borders. Nevertheless, the EU benefits from its position of relative economic and political strength, which are proving to have normative qualities and which are in themselves a potentially stabilizing influence on its more restive neighbors. Interestingly, it is the role of energy trade which provides much of this potential stability over the long term, and which is the basis of this dissertation's research question.

## **2) Internally Driven Change: The Black Sea Economic Cooperation (BSEC)**

For purposes of comparison with the EU, the BSEC is portrayed as an analogous entity. The BSEC was devised in 1992 by Turkey as an EU alternative and to take advantage of the power vacuum created by the USSR's collapse. It has since evolved into a loosely structured political and economic organization which encompasses the wider Black Sea states as the primary regional entity. Therefore, when considering BSEC as the internal driver, it is with the notion that regional change is determined from within this regional structure. Similar to the EU, BSEC

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<sup>1</sup> The ENP is designed to engage with the countries on the Union's southern and eastern periphery, though not necessarily with concrete membership offers. See Europa (1) European Neighbourhood Policy (ENP), date accessed March 13, 2016.



has attempted to develop a coherent internal energy platform which stresses member cooperation, and for a variety of reasons, it will be demonstrated that BSEC has been unable to overcome its funding deficit and lack of internal unity to satisfactorily advance this initiative. To be fair, the EU's energy policies have been less than effective, though Brussels has achieved certain success, notably in the energy liberalization effort, mostly attributable to the legislative force and freedom of action which has been bestowed upon the Commission.

Indeed, the EU overshadows the BSEC states in virtually every economic category, and for this reason it assumes the de facto role of senior partner in this relationship. BSEC suffers from limited funding and is rendered inert by strong-willed members (Russia and Turkey), which are unwilling to give up any elements of sovereignty to a regional governing body. Despite its weakness, BSEC has attempted to carve out "Areas of Cooperation" from which to structure and promote economic, political or social issues unique to the Black Sea region. Energy and its peripheral sectors, such as transportation and manufacturing, is perhaps the most important of the Areas of Cooperation, receiving much of the organization's interest and attention.

In this paper emphasis is placed on BSEC's energy environment, notably its relationships with the EU and Russia, and Turkey's position as the BSEC's founding member and most active participant. Russia has a unique relationship inside and outside the Black Sea region, both as a BSEC member and a great power, and this relationship is evident in the organization's activities. However, because of the organization's loose structure and contentious internal relations, it has largely failed in its attempt to develop this energy structure. In fact, this organizational inertia has forced BSEC to try to align itself with an EU that is politically, economically and culturally encroaching on the Black Sea region; an area that has typically fallen within Russia and Turkey's sphere of influence.

## **The Methodological Field**

Compared to the other two fields of study, methodology is 'cross-functional,' whereby its effects and benefits are dispersed throughout the analysis. While theory provides the lens, and the substantive data provides the building blocks, the methodological field considers the *design* of the intellectual structure, or how the information will be gathered, analyzed and presented. For this reason the methodological component holds an important place within these fields by bringing clarity and focus to the research question. Looking at the more practical means of performing this analysis, the portrayal of *how* the methods will be analyzed is instructive and requires further discussions.

As this dissertation is a study in international relations (IR), it attempts to bring order and structure to complex human events, those which are sometimes incoherent and frequently unpredictable or illogical. For this reason a qualitative approach, which emphasizes textual solutions, is the best means of analysis. Moreover, it is a qualitative analysis, as opposed to the data-centric quantitative approach, which tells a story via textual material, and how to make sense of the vast data which has been gathered. In fact, an analysis of the Black Sea, which encapsulates multiple variables over time and space is best done in a qualitative environment and supplemented by a variety of quantitative data.

When discussing the practical aspects of research methodology, there are several types of data collection techniques to choose from when conducting qualitative research. These entail the task of actually gathering the data in a manner that best supports the goal of answering the research question:

- Interviews (face to face, telephone or email)
- Observations, interpretation of events
- Document analysis (Dipeolu 2010)

For the purpose of this dissertation, emphasis will center on the three types listed above. By looking more closely at qualitative research, it is composed of three ‘commitments’ which entail;

1. Understanding the subject and the actors through the interaction and interpretation of the actions; and these human interactions determine how the players’ perceptions are addressed. For instance, international relations are about human interactions, the perspectives of which are no more tumultuous than in the wider Black Sea region.
2. Data are collected in an “open” environment in real-world settings as opposed to the confined space of a laboratory. Such an open environment allows the analyst to review the source material in a holistic and natural setting.
3. There is an emphasis on inductive research methods, to include developing theories from observation in their natural settings, and synthesizing the volumes of data into recognizable themes (Sullivan and Brockington 2004: 5).

This brings the discussion back to the research question. If the analysis is determined to answer how energy is the transformational agent in the wider Black Sea, this sets the foundation for the types of sources to be consulted. The research question presents a unique challenge, to prove or disprove the notion that energy is the transformational catalyst behind the Black Sea RSC. In this regard, the research question forms the intellectual cornerstone, and exists as the point of reference for the paper. In other words, all research is conducted to support this one statement. As the research questions threads its way through the paper, it will provide guidance and oversight of the paper’s progress. Therefore, the research question is also evaluative in that the analyst provides data and context to validate it. As attempts are made throughout the text to provide evaluation and context that supports the research question, it (the research question) becomes the ‘Holy Grail’ or the main focus of this intellectual journey.

The other element to be discussed within the methodological field is the case study. This entails intensive analysis of a single or small sample of a ‘unit’ from which to generalize within larger sets of similarly constructed units. Case studies allow similarly identified material to be deconstructed, isolated, consolidated and analyzed, and permits the evaluation process and evaluates the efficacy of the research question. Finally, within the context of this analysis, case studies provide a detailed measure of the Black Sea Region’s complexity and validation toward answering the research question. In this instance, three unique cases are analyzed with a Black Sea transformational focus.

A form of case study, and one that will be utilized in this dissertation, is process tracing. This lays out the historical and sequential context, all of which are critical to understanding the wider

Black Sea area and its changing dynamics. This ability to ‘trace’ events over time helps define themes and patterns, which identifies a time continuum or a timeline of events. The analyst traces the sequential events that generate the outcome at each stage and event in the process (Van Evera 1997: 64-66, 70). In the Black Sea context, process tracing is particularly valuable as a methodological tool by addressing the region’s rich political, economic and social heritage over space and time and in a phased and structured format.

### *A Note on Sources*

As the research question is the focal point of the paper, all sources were consulted with this central concept in mind. This dissertation relies on a combination of primary and secondary sources, to include interviews, memoirs, archives, news accounts, official government and corporate documents to develop a thorough analysis of the evidence. Starting with the theoretical category, notably when outlining the regionalist discussions, there are sources which provide a range of perspectives on regionalism and security communities. For instance, some sources concentrate on traditional and new regionalism, particularly with a consideration of the EU’s structural prototype, arguably the most successful regional security organization in the world.

Karl Deutsch and Ernst Haas were dominant figures in the field of post-war European political theory, and much of the intellectual underpinnings of contemporary European security theory are traced to their works. Deutsch’s “Political Community and the North Atlantic Area,” and “Analysis of International Relations,” focused on creating pluralistic “security communities,” or clusters of states with similar views of peaceful co-existence. Ernst Haas’s “The Uniting of Europe,” concentrated on the Franco-German rivalry and the effort to transform this intense hostility into economic and, to a lesser extent, political cooperation via the European Coal and Steel Community (ECSC) of 1952. Indeed, Ladrech’s 1994 “Europeanization” paper can be traced to Haas’s ‘spillover’ concepts or, to a lesser extent, Deutsche’s ‘intellectual traditions.’ Europeanization is paired with Ian Manners’ outline of the ‘5 core norms,’ notably: 1) the centrality of peace, 2) personal liberty, 3) democracy, 4) the rule of law and 5) human rights. Therefore, the combination of Europeanization and the 5 core norms position Europe as a normative power and a highly attractive mechanism with which to explain Brussels’ coercive influence (Manners 2012: 242). Deutche and Haas offer much to regionalism’s early intellectual foundation, and with the benefit of 60 years of experience in the post-War’s European experiment, it is safe to say that Haas emerged as the most influential.

Though the theoretical field centers on “Regions and Powers,” there are numerous other works that are included to augment as well as contrast Buzan and Wæver. Alexander Wendt’s 1999 “Social Theory of International Politics,” was a direct response to Kenneth N. Waltz’s seminal 1979 work, “Theory of International Politics,” in which he (Waltz) introduced neo-realism as an alternative to classical realism. In his book, Wendt established the constructivist school of thought by breaking out of the pervasive determinism of realism. As will be demonstrated, Wendt’s constructivist theories will prove influential to Buzan and Wæver in their own work on regionalism.

Other perspectives were considered as central theoretical tenets, but were eventually discarded. For instance, the neo-realist approach of Kenneth Waltz, (Theory of International Politics), and

Robert Keohane and Joseph Nye's institutionalism (Power and Interdependence), are theoretical counterweights to the Buzan and Wæver regionalism argument. However, Buzan and Wæver's perspectives most closely identify with the post-Cold War version of regionalism and the wider Black Sea area's transformation. It is within the context of 'new' regionalism that the concepts of Buzan and Wæver's "Regions and Powers" is the theoretical cornerstone of this work.

Turning to the substantive field, there are many historical accounts, to include two of the more significant recent histories; Neal Ascherson's "Black Sea: The Birthplace of Civilisation and Barbarism," and Charles King's "The Black Sea: A History." These two works provide unparalleled insight in the wider Black Sea's historical, cultural and societal background, and are particularly enlightening for a Western audience. However, while Ascherson and King are an excellent historical foundation, most of the research centers on late-Cold War and post-Cold War material, as a means of demonstrating the rise of regionalism which has emerged since the collapse of the Soviet Union, and how this is a direct contributor to the emergence of a Black Sea region. It is for this reason that the bulk of the sources need to provide a level of currency, particularly as the region's political setting is so volatile, and that periodicals are so highly valued.

Despite the vast amounts written on contemporary Russian energy issues, there were relatively few unclassified works on Soviet energy published before 1991. The CIA devoted considerable effort to analyze the Soviet energy industry during the Cold War, though this was unavailable to the general public. Robert W. Campbell, Marshall I. Goldman and Melvin Conant were prominent Western analysts who published on this subject and their works were consulted to provide the basis for the Soviet era's discussion. These authors provide valuable input to this work as Russia's current energy environment is understandably traced back to its Soviet era precedents.

Pre-1991 news or periodical material existed, though the opaque nature of the Soviet Bloc news organs provided little in the way of solid or objective information. Under Perestroika and Glasnost reporting and the relative freedoms afforded Western news agencies brought much needed attention to events and conditions in communist Eastern Europe and the USSR. The period after the collapse saw an unprecedented openness to Russian journalism, though this was short-lived and the recent murder and prosecution of prominent Russian journalists has created an environment of fear and self-censorship. Most of the Putin-era news sources come under the Kremlin's control, making their objectivity and reliability suspect. For that reason contemporary Russian-based news sources, notably Russia Today and Sputnik, are rarely if ever used in this work. There are still bits of light and freedom in policy analysis; the post-Cold War intellectual environment in Russia has produced a host of analysts and writers generally free to publish their work. Lilia Shevstova, of the Carnegie Endowment for International Peace, is a highly influential and prolific writer on Russia's domestic and international politics who has the relative freedom to write openly about the government.

Additionally, there is a new generation of regional analysts emerging from both sides of the Cold War's ideological divide who are looking at the Black Sea as its own entity, following Bratianu's example of breaking away from the 'back yard' notion so often found to describe the region. One such group of Greek and Turkish thought leaders: Panagiota Manoli, Dimitrios Triantaphyllou,

Tunc Aybak and Mustafa Aydin, to name a few, have come forward over the last two decades to consider this unique phenomenon. Like Bratianu before them, these intellectuals identify a unique Black Sea region, but also acknowledge the growing European dimensions; a notion that figures prominently in this analysis. A Romanian academic, Adrian Pop, though perhaps more skeptical of a Black Sea region, has also written extensively on the Black Sea's political and security dynamics. Georgian academic, Tedo Japaradize, is a frequent and lucid commentator on Russia's relations with its Black Sea neighbors. The late Ron Asmus, an American diplomat and regional expert, was a leading security analyst, having contributed mightily to the body of works in the post-1991 environment. His death in 2011 has left a gap in the overall body of knowledge, particularly from the US perspective.

Many of the official documents are derived from the European Commission; texts which highlight the EU's singular contribution to the development of Eastern Europe in general, and the wider Black Sea area in particular. Much of these official documentation contribute to the 'acquis communautaire,' or the EU's comprehensive legislative record. Also referred to as simply the 'acquis,' this is a term which will figure prominently the Black Sea's transformation, particularly regarding EU relations. Another resource is the myriad of official sources from BSEC. This is particularly the case in the latter's internal documents which outline the structure and organization of the BSEC and its influence in the regional dynamics. It should be noted, the European Commission is a prolific organization, particularly on energy-related issues; the BSEC, as it was determined, not so much.

Numerous periodicals were consulted, of which the Economist, Financial Times and the Wall Street Journal are the most noteworthy. Other web-based news sources have provided much material; Natural Gas Europe is a weekly compilation of articles, interviews and conference reviews on European natural gas issues; a valuable outlet with the pulse of the regional energy environment. Also, the works of the International Centre for Black Sea Studies (ICBSS), the BSEC's dedicated research institute, produces a variety of documentation concentrating on regional integration, economics and security. Several of these works will figure prominently which emphasize the internal dynamics of these initiatives and identify processes that constitute drivers of change. The center produces solid research, though budget cuts have forced it to abandon several valuable products, and it is questionable whether it can continue under current funding constraints. Finally, there were numerous interviews of subject matter experts both in the United States, Europe and the Black Sea RSC.

### *Chapter Breakdown*

This paper is roughly divided into two parts. To set the foundation to answer the research question, Part One comprises a positive intellectual environment and develops the theme which explores the foundational construct of a Black Sea region, hence the title, "Thoughts on the Creation of a Black Sea Region." A challenge with such a complex topic is the effort to establish the intellectual basis for the existence of a Black Sea region, upon which the remainder of the dissertation rests, essentially a building block approach in which each successive level develops and expands upon the previous one. The establishment of this intellectual baseline takes shape in the early chapters, which address the notion of a Black Sea Regional Security Community

(RSC), and then expands on this notion by cementing a foundation, filling in the historical gaps and geopolitical dynamics at play in this diverse region.

Chapter 1, entitled, “Thoughts on the Creation of a Black Sea Region: A Regionalist View of the Wider Black Sea,” establishes the theoretical foundation as espoused by Buzan and Wæver in “Regions and Powers.” Indeed, Chapter 1 answers the critical question, “What is regionalism,” thereby creating this paper’s intellectual and theoretical foundation. The central goal of the chapter is to establish the definition of regionalism within the Buzan and Wæver context, though this theoretical construct will be compared and contrasted to other regionalist theoreticians of the 20<sup>th</sup> and 21<sup>st</sup> Centuries. Moreover, as the Buzan and Wæver RSCT is introduced and applied, it becomes the main theoretical model used in the dissertation.

The latter part of the chapter is dedicated to the Black Sea states and how they are categorized as a unique region. In establishing the basis of the research question, the first chapter makes the case for the existence of a discernable though weak RSC in the wider Black Sea area, supported by a growing energy infrastructure and fueled by an incessant European demand. Yet, beneath the surface is a complex and volatile mix of energy insecurity, economic disparity and political and social tensions.

Chapter 2 exemplifies and details the region’s inter-generational causes of such volatility and tension. For this reason it is called “Thoughts on the creation of a Black Sea Region: A History of Contestation.” As the chapter’s subtitle suggests, the region’s violent history is discussed, as well as the Cold War and post-Cold War events, all of which were forged in the crucible of time, space and ideology. It is also the most expansive of the chapters, covering the region’s geology, geography, economics and history, albeit in very general terms. While this chapter provides a historical overview of the region, most of the emphasis is on contemporary events, to include economic and energy-related conditions within each Black Sea nation. This analysis is performed looking at the unique historical, economic and energy contexts of the member of the research pool; an essential task to understand the broader transformational dynamics at play.

In this respect, Chapter 2 is transitional in that it delivers the work from the theoretical to substantive realms. It is also by far the longest chapter, and goes to great length to establish this geo-political and geo-economic foundation. In the chapter’s concluding section, four distinct themes are identified which point to 25 years of post-Cold War experience. In the concluding section entitled, ‘The Lessons from 1991 – 2016,’ these four themes are: 1) The Russia-Western Geopolitical and Economic Divide, 2) EU Political and Economic Integration, 3) Energy Disparity and Interdependence, and 4) US Geo-political Disengagement. These four themes are interwoven throughout the text and help address the research question.

Finally, the last of the foundational chapters, Chapter 3 addresses the energy dynamics of the Black Sea region. Entitled, “Thoughts on the creation of a Black Sea Region: The Dominance of Energy,” there is background on the global energy industry and an in-depth analysis of the Black Sea’s oil and gas sectors. This includes a review of the regional energy entities which include trans-national distribution networks, notably in the forms of oil and gas pipelines. This chapter also looks in more detail at the contractual vehicles and the energy sectors’ interplay between the states, which entails a review of the pipelines and other transmission projects; those which

physically interconnect the region. Concluding thoughts tie the three chapters into a coherent foundational unit from which more specific regional analysis can be conducted.

The goal in the latter half of the dissertation is to isolate and analyze these occurrences further and ‘fine tune’ them. Therefore, the next three chapters under Part Two consider in more detail the external and internal cases in the development of a Black Sea RSC. By portraying and constructing the substantive data, the final three chapters build on and complete the foundation erected in Chapters 1 through 3. Chapters 4-6 shed light on the transformations under way and how these examples will be identified, isolated and analyzed further. These latter chapters look in more depth at the drivers of change in the Black Sea region, and the importance of investigating more thoroughly the two primary drivers and considering the influence of energy in the transformation process.

Chapter 4 addresses the EU’s influence as the external driver; not only as defined by Brussels’ elaborate and hierarchical structure, but the ways these energy efforts have permeated the Black Sea RSC. There is particular focus on the Western European influence. Entitled, “Externally Driven Change: The European Union and the Demand for Energy,” there is emphasis on the EU’s efforts to implement its own energy markets and regulating bodies. Here the magnitude of EU energy demand which is influencing the development of a Black Sea region is portrayed through Brussels’ energy acquis as a model for the Black Sea states’ transition. Finally, this chapter highlights the EU’s growing influence as an economic and political power within the Black Sea region, with the direct implication that energy is the driving force behind this phenomenon.

Chapter 5 considers the BSEC as an analogous organization to the EU through which the region’s internal dynamics are analyzed. Entitled “Internally Driven Change: The Black Sea Economic Cooperation (BSEC),” the chapter considers the region’s premiere economic and political body. Initially created as ‘a region of peace,’ BSEC has had some successes in developing its niche in the region, particularly with the challenges of having Russia and Turkey as members, but also, being neighbors with the EU and the difficulty of the organization to escape Brussels’ and Moscow’s dominance. The result is BSEC is a much looser and scaled-back organization than the EU and lacks the unity of purpose and funding stream available to its Western rival. As will be demonstrated, this will hinder BSEC’s ability to wield regional influence.

Chapter 6 contains the case studies and for this reason it is the most impactful of the chapters. Entitled “Public-Private Partnerships and the Grass Roots Dynamics of Energy,” the chapter is the dissertation’s culminating work and builds on the sequential foundation provided by Chapters 1-5. Embedded within the chapter are case studies which represent each of the two primary drivers, but also a composite case study, designed to look more closely at a unique public-private partnership on display in the region. It is here the foundational material is brought into full context, and from the intellectual platforms developed in the external and internal discussion, the case studies continue this trajectory by delving deeper into the drivers’ makeup and to more clearly identify the transformational elements. More specifically, the case studies look at the research question in its natural environment and highlights the impact of spillover and creeping Europeanization within the Black Sea region. A key element is the studies’ ability to enhance

cross-border interaction, a notion which considers such key aspects as the impact of the growing public-private partnerships and their influence on the region's political economy.

The case studies' topics mirror the contingencies identified within the external and internal drivers. For instance, under the external theme, the first case study concentrates on the Energy Community, an organization established by the European Commission to create energy markets in South East Europe and draw the non-member Eastern European states into the EU's legal and economic structure. This is accomplished using the energy sector's *acquis communautaire*, the intricate legal web spun out of Brussels. The second case study centers on the Black Sea Trade and Development Bank (BSTDB) as a generally well-managed lending institution which focuses on small to medium enterprises (SME) within the BSEC member states. It is a small player and is forced to partner with larger International Financial Institutions (IFI). Additionally, this case study considers how these enterprises are financed and the broader regional impacts of its activities, principally in the energy sector.

The final case study addresses BP's influence on Azerbaijani economic, political and social growth over the last 20 years and how this often stormy relationship is emblematic of the broader transformational process under way in the Black Sea. As the major Western oil and gas company operating in the region, BP has played a unique role in the region's development. For this reason, BP's relationship with Azerbaijan will be analyzed as an example of Western management processes as implemented in the region, though primarily in its purported role as a contributor of regional transformation. In this capacity, the last case study is a form of hybrid, which considers how a large multinational corporation, BP, exerts influence on the broader Black Sea. This entails BP's role as the region's main private sector oil and gas producer, but also as a major player in the region's 'pipeline politics.'

Within the context of this analysis, it is instructive to consider the transactions that enable or propel these drivers, and which require an objective analysis of the political, economic and social conditions; those factors which contribute most to the changing regional dynamics. Notably, sectors which cross inter- and intra-regional boundaries, as well as transcend public and private sectors; those which force the states' to reach across geographic and geopolitical boundaries and focus on the ground level dynamics. Therefore, the key to answering the research question, as will be demonstrated, is provided in cross-border interactions, enhanced by the flow of energy.

Finally, there are broader and inevitable geo-political issues which must be addressed when dealing with large-scale energy flows. For instance, what is the US influence? Are changes within the Black Sea RSC, contributing to larger powers shifts? An increasingly dominant Berlin, which is quite often taking a hesitant lead in Eastern Europe, finds itself in its traditional role opposite Moscow. What this research does in particular is portray a peripheral and more subtle dynamic; the continuing influence of classical great power rivalry and their ability to exert influence. Indeed, this great power rivalry exists as a more potent component than might be imagined. In fact, many of the 19<sup>th</sup> Century geo-political machinations are still quite relevant in the early 21<sup>st</sup> Century.

The goal of this dissertation is to critically examine the influences or sources of these drivers. Secondly, there will be analysis of the broader regional impact of energy on other sectors,



such as the transportation and manufacturing sectors. In fact, in some cases the two are inextricably linked. More specifically, this dissertation will consider the three case studies which describe these emerging patterns; a combination of external, internal and hybrid drivers changing the regional dynamics. Though these cases appear unrelated, this paper contends that there is a clear connection and underlying theme between them—the role of energy.

Regarding this paper's attention to the variety and types of place and name spellings. As might be expected in such a contested region, great symbology is attached to geographic names and places. Charles King noted that among Black Sea inhabitants, "a spelling bee can be a political event," from which to inflame national, ethnic or religious passions. Where someone is born and lives, and how that location is represented on a map or document, defines and categorizes that individual. The author is very aware of this fact, and was careful not to show undue bias, however, for the sake of convenience and expediency, standardized spellings had to be maintained. Usually, this was based on the most prevalent spelling in the resource literature.

This attempt at standardization also applied to monetary demonination and units of measure. For instance, monetary denominations, notably Euros and Rubles, were converted to US dollars. Conversely, because it is the predominant system in use in Europe and the Black Sea states, the metric system is used throughout the dissertation. This is particularly the case in measuring oil and gas quantities, where it was necessary to convert cubic feet to cubic meters.

## Chapter 1. Thoughts on the Existence of a Black Sea Region: A Regionalist View of the Wider Black Sea

“The region...refers to the level where states or other units link together sufficiently closely that their securities cannot be considered separate from each other. The regional level is where the extremes of national and global security interplay, and where most of the action occurs” (Buzan and Wæver 2003: 43).

“Necessity, and sometimes fear, binds such communities together. But within that binding-strap they remain a bundle of disparate groups—not a helpful model for the ‘multi-ethnic society’ of our hopes and dreams” (Ascherson 1995: 9).

“At various points in history, the lands around the Black Sea have been frontiers...: the locus of distinct communities defined by their position between empires or states, and a foil against which the cultural and political identities of outsiders have been built” (King 2004: 9).

### What is Regionalism?

From the closing years of the 20<sup>th</sup> Century to the present day there has been a clear geopolitical drift toward regionalism. That is, formal or informal groupings of states into identifiable and distinct clusters, invariably for the purpose of security. At its most basic configuration, a region is comprised of sovereign states occupying a geographic space, yet, as with any IR topic, it is much more intricate with multiple variants and causal factors. Region-building is an evolutionary process; complex, dynamic and shaped by endogenous and exogenous forces. Though security is the common denominator and primary motivator, a region can be dually based on common political institutions, streamlined economic activity or social and cultural characteristics, resulting in a region being “polysemous,” or having multiple or even contradictory interpretations (Van Langenhove 2011: 63).

As these composite states interact, they frame a unique identity based on the members’ respective histories as well as their political, ethnic and religious backgrounds. It is through these regionally-based interactions that members develop policies which address common threats or opportunities (Manoli 2012: 323). Shifting alliances, changing economic fortunes and intermittent conflicts ensure that regional structures are fluid entities, and constantly evolving over time. Therefore, a region is more than simply a geographic expression but a time-based one as well, in which a region exists depending equally on when it exists in addition to where it exists (King 2004: 7-8). And perhaps more importantly, how that region is *perceived* by its organic members and neighbors.

One point that should be stressed is that not all regions are comprised of friendly states intent on benign cooperation. The EU is perhaps the best example of a cooperative regional entity, but it should be remembered that up until the middle of the last century, its Member States were frequently locked in devastating internecine wars. Even today, the Union is wracked by competing sovereign agendas and national political and economic goals; hardly the perception of positive regional relations. A high level of cooperation is more often the exception than the rule,

so it is possible for a heterogeneous composition of widely varying political, ethnic and religious groups to be classified as a region. As will be demonstrated, regions can exist absent any formalized or deliberate integration plans. Indeed, regions can form in spite of the members' best attempts to prevent it, so regionalization, the process of regionalism, can be marked by great cooperative efforts or intense confrontation.

While hyperactive nationalism was succeeded by globally-based collective security mechanisms to establish the hallmarks of 20<sup>th</sup> Century IR, it is too soon to tell whether the 21<sup>st</sup> Century will settle into a middle ground based on regional formations. Nevertheless, much has been written about the ascent of regions over the last 20 years, and there is a growing body of work which provides intellectual support to this phenomenon. Peter Katzenstein's "A World of Regions," foretells of a global order dominated by regional entities (Katzenstein 2005: 21, 41-42). David Lake and Robert Morgan predict that most future conflicts will be caused by "regional concerns" (Lake and Morgan 1997: 5). Luk Van Langenhove claims that because of globalization, states will form regional structures to "cope with today's problems and challenges" (Van Langenhove 2011: 63). Though a regionalist skeptic, Amitav Acharya concedes that regionalist study is "vital to our understanding" of the broader IR field (Acharya 2007: 636).

Barry Buzan and Ole Wæver take this line of thought a step further and divide the world into a patchwork of mutually exclusive regional security complexes (RSCs). They claim that recent regionalist trends are merely examples of the global order falling into its natural, pre-ordained configuration of localized security structure based on geographical proximity. Buzan and Wæver identify 1500 AD as the beginning of the regionalist movement, brought about the advent of the contemporary sovereign state coupled with the "global scale international system," initiated by the period of wide scale European colonization. These conditions, reinforced by the Westphalian concept of sovereignty created the environment from which modern regionalism could emerge (Buzan and Wæver, 2003: 14-15). This is but a small sample of the literature that has emerged to describe this predominantly post-Cold War phenomenon, and which has embellished a once small and generally obscure field.

There is a central theme to this modern regionalist phenomenon; the legacy of the Cold War weighs heavily on the current state of IR, most notably in Europe, and it is proving difficult to escape its shadow. The Cold War's end is the demarcation point for how regionalism is viewed, and pre-1991 versions of regionalism, called *traditional regionalism* for the purpose of this paper, was strongly embedded in the bi-polar order. Though Cold War-era regional entities developed, most notably two Western-based organizations, the EU and NATO, they formed within the era's ideological confines, which discouraged deviation outside of this formation. Traditional regionalism was exclusive to the military and political realms, and even regions with economic foundations, such as the ECSC and, subsequently, the European Community (EC), developed within this narrow ideological environment.

The current regionalist trend, *new regionalism*, is more than simply a post-Cold War event as the EU and NATO trace their beginning to the height of this era and the intra-regional tensions in Europe. Nevertheless, the proliferation of regionalist activity since 1991 is difficult to ignore, and the underlying motivating factors have changed, notably the diminution of the formidable East-West tensions and ideological divide which formed during the Cold War. As will be

discussed in more detail, post-Cold War regions are developing outside of the exclusive military and politically themed environment, and are now also influenced by such normative aspects as society, culture and environmental issues.

What is evident is the Cold War's bi-polar order had a significant impact in preventing regional organizations from developing outside of the ideological template, leading to a post-1991 migration of power away from the state or global institutions to regional clusters. This migration precipitated a shift in the global balance of power, toward the middle, or regional, level which exists between the state and the global levels. For instance, the Doha round of the World Trade Organization (WTO) has made little progress over the last 15 years, yet regional free trade agreements, such as NAFTA, EU expansion and APEC, strengthen and proliferate. Does this mean that Buzan and Wæver are correct, that IR is inexorably moving to regionally-based entities? If so, what will be the impact on state sovereignty and global institutions? These are questions which can only be answered with the passage of time and are outside the scope of this analysis.

This dissertation looks at regionalism in a more succinct and defined context, particularly in the 'new' or post-Cold War era; drawing attention to the wider Black Sea, where it can be observed that a hesitant coalescing of regionalist activity exists among the littoral states. The Black Sea littoral states maintain a special significance as few geographic areas overlap three of the world's great geopolitical and ethnic entities; Europe, Asia and the Middle East, and for this reason they are home to ancient animosities carefully fed and nurtured by successive generations to this day. Moreover, the modern iteration of these animosities presents broader security and stability considerations that cannot be ignored.

Nowhere are these dynamics of Black Sea geopolitical tensions more evident than in the production and transport of energy products. As a region blessed with abundant natural resources, notably fossil fuels, it has been only recently that the large scale and coordinated exploitation of this commodity has been attempted. This activity in the energy field, coupled with the upheavals derived from the end of the Cold War, has begun to profoundly transform the political, economic and social structures of these states. Not only is this transformation impacting the internal Black Sea regional dynamic, it is also affecting conditions on the outside of it as well, notably how the Black Sea states interact with neighboring regions, such as Europe, Asia and the Middle East.

Therefore, the impact of energy in this regionalist trend in the Black Sea requires further investigation and serves as the primary intellectual theme behind this paper. Moreover, central to this investigation is the knowledge that fossil fuels, their by-products and peripheral economic sectors are vital elements to 21<sup>st</sup> Century life; social and economic vitality, not to mention national security, are fully dependent on these commodities. These factors can be translated into a cogent research question, "*How does energy act as a transformational agent in the emergence of a wider Black Sea region?*"

To be certain, no other economic sector has the ability to generate such broad and lasting social and economic change, so the impact is profound. Additionally, to better understand the impact of energy as a transformational force, it is important to know the genesis of this phenomenon, or the

*drivers* behind this transformation. Because of its location and ethnic/religious composition, the Black Sea region has been unduly influenced by outside factors, a condition which persists today. Coupled with this external influence, as well as its own inherent internal dynamics are pushing the region into new and uncharted ground. Finally, there is a particular driver which should be considered; the newly established blend of public and private sector representation which is making inroads in the economic environment. Therefore, the research question will frame this analysis from multiple perspectives; from that of the external actors along with internal Black Sea members,' as well as through the confluence of the public and private sectors.

In this foundational chapter, three goals will be accomplished: 1) It will establish the theoretical foundation of regionalism, both traditional and new, paying particular attention to the notion that theory creates the lens to view and understand problems. In that regard, this chapter will trace four theories which demonstrate pre- and post-Cold War regionalist progression and the manner in which sovereign states create regional entities. Furthermore, discussion will center on how regional evolution may not always be the deliberate and generally benign activity as seen in post-war Western Europe, but a natural occurrence with varying military, political and social outcomes. This is particularly evident with the Black Sea states which were so thoroughly steeped in the Cold War ideological divide; a divide which is proving difficult to bridge, 2) Another goal is to provide a geographical framework from which to support the analysis, notably which states actually comprise a Black Sea region and why such unique and diverse states deserve to be called a region, 3) Finally, in support of the paper's research question, the premise that energy plays a key role in the Black Sea's regional development will be broached, setting the stage for a more detailed analysis throughout this paper.

### David Mitrany: Functionalism

To adequately study the evolution of contemporary regionalism, it is necessary to track its origins to a short-lived and fanciful theory of the interwar years, a period noted for its economic deprivation and social unrest throughout much of the world. David Mitrany was a highly idealistic British academic who, like many of his generation, clamored for solutions to these endemic political, social and economic problems. In 1933 he wrote "The Progress of International Government," which outlines the concepts of functionalism, a theory framed in the post-World War I and Great Depression eras under the notion that unchecked state power and *laissez-faire* economics were the cause of disastrous wars and endemic human suffering<sup>2</sup> (Mitrany 1933: 39, 98-99, 101).

Mitrany noted that the state in its modern Westphalian condition is an obstacle to civilizational progress. To move away from the "state fixation" and its inability to effectively govern for the common good, states have to be restructured on functional necessities as opposed to "territorial lines." To accomplish this, states could integrate based on economic conditions, social programs, and administrative oversight among other functions, thereby creating a supranational structure that would make the nation state irrelevant. Functionalism would be propelled by a "material interdependence," creating ever more integrative dynamics which would over time peacefully bind societies together. This would be a global undertaking, not unique to any one region or

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<sup>2</sup> "The Progress of International Government" was based on a series of lectures Mitrany delivered at Yale in 1932.

geographic entity. Indeed, Mitrany dismissed what he called “continental unions” or regional integration schemes as half-steps toward a stateless structure (Mitrany 1933: 118).

World War II stymied Mitrany’s efforts, and while he continued to advocate for a post-war functionalist environment, his concepts were never seriously implemented as they lacked empirical rigor, flexibility and a workable course of action.<sup>3</sup> Functionalism was poorly suited to the changing dynamics of the early Cold War era, particularly within the UN, which actually preserved and reinforced the state system. Though Mitrany’s concepts were perhaps naïve at best, he did help establish some of the intellectual groundwork for the practical integrationist efforts later in the century. In that capacity, functionalism can be considered a precursor to contemporary globalization theory.

In the early postwar years, it was the notion of a global collective security entity, principally the UN, which was considered the best situated to achieve national and/or economic security. Yet, shortly after its creation, dissatisfaction emerged with the international body. This was caused by the ideological divide which pitted the permanent members of the Security Council against each other, and demonstrated the UN’s inability to stop the Korean War and other conflicts that emerged in the post-war landscape (Fawcett 2009). Though the Cold War was a global phenomenon, there were distinct regional dynamics at play concurrent with the UN’s early development, for instance the East-West confrontation, which was most visibly manifested in a divided Europe. This geo-political environment was instrumental in creating regional structures, most notably NATO in 1949 and the ECSC in 1952.

#### Karl Deutsch: Security Communities

It was in the early Cold War’s political and intellectual setting that a group of academics led by Karl Deutsch considered regional solutions to security threats. In 1957, Deutsch and his colleagues published “Political Community and the North Atlantic Region,” which approached regional integration via the notion of “security communities.” Deutsch advocated for like-minded states to develop patterns of predictability and familiarity, leading to a security community, where there is an assurance that the members of that community will peacefully settle disputes. It was through long-term and repetitive “transactions” or interstate communications and interactions which strengthened these patterns (Deutsch 1957: 5).

More specifically, Deutsch identified two types of security communities; one was an amalgamated security community in which the region’s member states subordinate themselves to a larger government, such as the United States following the Constitutional Convention of 1787. The second was a pluralistic security community in which the states retained considerable sovereignty, but were still able to achieve high levels of trust and familiarity; similar to the current state of US-Canadian relations (Deutsch 1957: 5, 6). Deutsch loosely equated Mitrany’s functionalism with amalgamation, referring to the latter as an “assembly line process.”

Moreover, he felt these concepts were wasteful and time consuming bureaucratic machinations which sap the momentum from the broader integration effort, and detract from the overall goal of creating a security community. Though Deutsch did not dismiss amalgamation altogether, he was

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<sup>3</sup> A contemporary reviewer described Mitrany as a “misguided seel” (The Harvard Crimson 1933).

more favorable toward maintaining state sovereignty under the pluralist structure (Deutsch 1957: 79-80).

By contrast, pluralistic security communities were derived from “intellectual movements and traditions.” Deutsch acknowledged the North Atlantic area was increasingly becoming a pluralistic security community, comparing it to the shared Anglo-Saxon heritage which brought about the US-British rapprochement following the War of 1812. Furthermore, pluralism’s model of “consultation, communication and cooperation” was proven necessary for peaceful coexistence. Such integration is easier to attain and preserve, and equally as effective as amalgamation in preventing war within the integrated area. In fact, his research showed that amalgamation as a vehicle for successful integration was inconclusive (Deutsch 1957: 81-82, 116, 199-20; Breslin et al. 2002: 2).

### Ernst Haas: Neo-Functionalism

Another prominent regional theorist of the early post-war period, Ernst Haas, refined Mitrany’s work in his 1958 book, “The Uniting of Europe.” Haas’s neo-functionalism differed from functionalism by being empirically grounded and non-normative, but, ironically, focused on state integration from a regional perspective as opposed to a global one espoused by Mitrany. Haas was influenced by “Political Communities in the North Atlantic,” however, contrary to Deutsch, he noted that states integrate in functional or economic areas, which increase the momentum for further integration. Neo-functionalism was predicated on what Haas called “spillover,” whereby integration would take root in one functional area and “spill over” into another, through an endless progression in which the state would eventually be subordinated to an overarching power center.

There are two types of spillover; a functional spillover, calling for economic integration, and political spillover, which advocates a strong supranational entity from which to transcend state power. Haas noted that as integration begins, “political actors” are forced to shift allegiance to this new central power with jurisdiction over the state and nullifying its ability to wage war (Haas 1958: 16). Haas believed that integration was an inevitable process, rather than a desirable state of affairs that can be introduced by the political or bureaucratic elites. Successful spillover is demonstrated by the transition of the ECSC to the European Economic Community (EEC), to the EC, and ultimately the EU. Considering the spillover and the creation of a supranational structure in the form of the EU; it is possible to see with each successive generation, as the region became further integrated and more complex, it would appear that Haas’s concepts were more readily accepted, and that Europe in this period was coalescing into a regional entity along both political and economic lines (Breslin 2002: 2).

Yet, when looking at the EU’s regional development, it was not a smooth transition, but one of fits and starts. At the height of success, in the latter half of the 1960s, the integrationist movement ran aground. This is partly attributed to the “Empty Chair Crisis,” but also because of a general fatigue in the process by pushing too far too fast, ultimately creating a backlash from the anti-integrationists.<sup>4</sup> Opponents argued that integrationism was a temporary and ill-conceived

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<sup>4</sup> The crisis centered on French concerns with the European Commission’s attempt to act as a supranational entity to fund the Common Agriculture Program, normally a state responsibility. Following several months of dispute, in

over-reaction to World War II, and that the global security order would eventually revert back to its traditional (realist) posture. Strangely, while the integrationist movement was at its weakest and most vulnerable, Haas himself instigated what amounted to an internal assault on the very fabric of regionalism. His 1975 paper, “The Obsolescence of Regional Integration Theory,” declared that regional integration in Western Europe had “disappointed everyone,” while the proponents themselves acknowledged that predictions of the end of the state system were premature<sup>5</sup> (Haas 1975: 6; Breslin et al 2001: 3).

Early Cold War regionalism’s post-mortem can be summed up in that integrationism was defeated by the resilience and power of the state, coupled with the unyielding and inflexible dynamics of the bi-polar system. Moreover, critics claimed that integrationists overestimated the strength and popularity of their movement. However, it was De Gaulle who demonstrated the most glaring weakness with the “Empty Chair Crisis,” and how a single, determined state can derail the integrationist process. Ultimately, notions of Europe coalescing in a linear progression were dashed by Gaullism and the Luxemburg Compromise, with clearly established limits (up to that time) to which regionalism would not be allowed to erode national sovereignty.

### Deutsch and Haas

Deutsch and Haas perhaps epitomized regionalist thinking in the early Cold War era. Both were Euro-centric in perspective and their theories were created within the confines of the bi-polar order. The work of both men proved popular in this period, and was replicated in other parts of the world with varying degrees of success. Yet, it was in Western Europe where regionalism was most successful, notably with the relatively rapid development of the supranational system under the EU. Since Deutsch privileged pluralistic security communities as opposed to outright amalgamation and the state centric model, he saw the state as retaining a more influential role. In this regard, Deutsch was somewhat vindicated by De Gaulle’s actions in 1965 and 1966. However, in most other respects, such as the creation of supra-national bodies, with the passage of time, it would appear that Haas’s neo-functionalism emerged more prominently and durable in the European postwar integration experiment.

### Regionalism’s Renaissance: Constructivism, New Regionalism and the Post-Cold War IR Environment

For the 10 years following Haas’s “obsolescence” article, integrationists appeared to wander the intellectual and political wilderness. It was during this period the term “Eurosclerosis” was coined to describe the economic distress and sense of political inertia that beset the EC. However, looking back, Eurosclerosis was perhaps a misnomer, as the integrationists were actively working behind the scenes, biding their time and waiting for the political winds to shift in their favor. Patience paid off leading to a burst of energy in the waning days of the Cold War.

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June 1965, French President Charles De Gaulle recalled his representative in Brussels in protest. The French seat remained vacant until January 1966, hence the ‘empty chair.’ The Luxembourg Compromise was reached which allowed a state to veto any legislation it deemed contrary to its national interests. For a more detailed description, see Ludlow 2006.

<sup>5</sup> Haas felt there was more opportunity for regional integration outside of Europe, notably in Asia and Latin America (Haas 1975: 1).



For instance, the mid-1980s saw renewed integrationist activity with the 1985 White Paper on the Internal Market and the Single European Act of 1986. These led to the Treaty on European Union of 1992, more commonly known as the Maastricht Treaty, and ultimately to the formation of the EU. Once again Haas and neo-functionalism were in vogue, as the reinvigorated integrationists attempted to create, via Maastricht, a more robust European political entity.

Yet it was the collapse of the Soviet Union which broke loose the rigid structure of the bi-polar order in Europe and opened up a more fluid geopolitical environment. This also exposed the demand for self-determination, whereby cultural, ethnic and religious issues, long suppressed under communism, emerged into a regionally driven focus on security. Moreover, it was a perspective that took into account not only security and political issues, but also economic, cultural and normative aspects that were relegated to the sidelines in the Cold War. It became clear this post-Cold War regionalist environment no longer fit within the rationalist, Wesphalian-based neo-realist/neo-liberal framework forwarded by Deutsch and Haas. It was this post-Cold War realization which set the stage for the transition from traditional to new perceptions of regionalism.

Moreover, it was this intellectual foundation established by Deutsch and Haas which allowed the post-Cold War generation of theorists to flourish in their new geopolitical environment. This is particularly the case with European-centric theorists, such as Ladrech and Manners, who built on Haas's spillover concept to develop their Europeanization and 'core norms' theories, respectively. And while Ladrech's and Manners' concept were perhaps not genuinely unique, changes in the regional landscape after 1991 allowed them the intellectual freedom to view European development outside of the Cold War era confines. In this capacity Ladrech, Manners and other post-Cold War theoreticians have become the intellectual heirs to Deutsche and Haas. The next section looks deeper into these geopolitical changes and how they shaped a new concept of regional development.

IR theorists noticed these dramatic changes in the days leading up to and beyond the end of the Cold War and tried to make sense of it. Alexander Wendt's 1992 work, "Anarchy is What States Make of It," articulated these post-1991 changes, notably how rationalists continued to adhere to a materialist foundation and ignored human agency and social construction (Wendt 1992: 392-397). Whereas anarchy is deterministic and lacks any overriding authority, it reinforces the "self-help" concept that one state must gain advantage over another. The result is a system by which all sovereign states, regardless of size, population or military strength, are technically equal, exercising control over their own territory.

Wendt's 1999 follow-on work, "Social Theory of International Politics," was a direct response to Kenneth N. Waltz's seminal 1979 work, "Theory of International Politics," in which he (Waltz) introduced neo-realism. In his book Wendt established the constructivist school of thought by breaking out of the determinism of anarchic realism and embraced "cultures of anarchy," which supposes a Hobbesian, Lockean and Kantian perspective. Under the cultures of anarchy template, a Hobbesian sees other states as threats, while a Lockean sees them as rivals, and to a Kantian they are friends (Wendt 1999: 43, 246-311). The constructivist model as defined by Wendt became a popular means of framing the post-Cold War world as an alternative to the rationalist school of thought. Wendt's contribution to IR studies is considerable and as will be

demonstrated, his notions of constructivism and human agency, particularly in a regionalist context, proved highly influential.

### Barry Buzan and Ole Wæver

One of the more important theorists to come out of the new regionalism field is Barry Buzan of the “Copenhagen School” of IR.<sup>6</sup> In his 1983 work, “People, States and Fear,” Buzan sought to widen the prevailing security discourse. To accomplish this he devised the notion of “securitization,” whereby an otherwise innocuous political or social event could escalate via “speech acts” to one of existential importance justifying extreme measures to mitigate that threat. In 1998, Buzan and co-authors, Ole Weaver and Jaape de Wilde, completed “Security: A New Framework for Analysis,” which expanded this line of thinking by outlining his securitization concept embedded in a neo-realist foundation (Buzan 1983; Buzan et al. 1998).

In “People, States and Fear,” the genesis of Buzan’s regionalist predilection comes to light where he first makes reference to RSC, though this was thinly developed and embedded in the work’s broader securitization context. In the ensuing twenty year period, and the considerable global changes therein, he acknowledged the growing regionalist trend within IR. In 2003, with the publication of “Regions and Powers,” Buzan and Ole Wæver looked deeper into RSCs with a more developed theoretical construct. Furthermore, the authors shifted from a decidedly neo-realist privilege to a blended constructivist perspective, an indication of Wendt’s influence. This shift caused them to elevate regionalism from a peripheral position to a central one, altering the theoretical focal point from the micro level, with an emphasis on social identity and the state, to the meso/macro level and considerably broadening the regional perspective.

Buzan and Wæver claimed that most states see their own security from a regional perspective, as opposed to a purely state-to-state or a global one. This is because threats travel more readily over short distances or are cross-border in nature, thereby emphasizing the localized nature of security. This also explains why states mesh together in “regionally based clusters” to form distinct units or RSCs which can be identified apart from other regional units (Buzan and Wæver, 2003: 5, 43). With this new dynamic at play, it is important to determine how regionalism fits within the larger IR context. This is particularly relevant as Buzan and Wæver elevate regionalism to parity with the Waltzian “systems” of neo-realism and neo-liberalism. These three main theories (neo-realism, neo-liberalism and regionalism), and their interrelations, will now be examined in greater detail (Buzan and Wæver 2003: 6).

### Buzan and Wæver: Neo-Realism

Classical realism, and later neo-realism, has been the dominant IR theory throughout modern history. Under the precepts of classical realism, conflict is inevitable, or as merely human nature; something to be understood and contained, but never tamed. In the latter half of the 20th Century, the neo-realist school emerged, led primarily by Henry Kissinger and Kenneth N. Waltz. It was Waltz, in particular, who noted that IR’s anarchic nature, lacking any overarching

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<sup>6</sup> The term Copenhagen School was coined by Bill McSweeney in his 1996 critique, “Identity and Security: Buzan and the Copenhagen School.” Barry Buzan and his colleagues, Ole Wæver and Jaap de Wilde, were at the Copenhagen Peace Research Institute during the school’s formative years.

authority, is comprised of units or states, determined to protect their sovereignty or engage in “self-help” policies. In his 1959 book, “Man, the State, and War: A Theoretical Analysis,” Waltz discusses the interrelation of the three “images,” 1) human behavior, 2) the internal structure of states and 3) international conflict and international anarchy (Waltz 1959/2001: 12). The confluence of these images resulted in the power of the state as solely able to ensure peaceful co-existence.

Twenty years later, in his “Theory of International Politics,” Waltz abandoned his images for “systems,” though ultimately comes to the same conclusion; the primacy of the state and balance of power combine to ensure security (Waltz 1979: 209-210). Though still predicated on a state-centric model, whereby security in the form of raw military or political strength are its primary tenets, neo-realism is based on power polarity with economy and society or culture, falling in behind. This results in a structured and systemic approach to address man’s frequently violent interactions, rather than simply relying on human nature to explain its characteristics. Arguably, it was Waltz’s neo-realism which became the predominant theory in the final years of the Cold War.

Buzan and Wæver favorably view the neo-realist position, particularly Waltz’s work as outlined in “Theory of International Politics,” however they admit that Waltz’s “system” is monolithic, ambiguous, and inherently inflexible. It is this inflexibility which overlooks the territorial clustering prevalent in regionalism. Furthermore, Waltz is unable to explain the normative aspects of international relations that have emerged in the post-Cold War period, notably the influence of culture and non-governmental organizations (NGOs) that skirt or even subvert state power (Buzan and Wæver 2003: 28). Referencing back to Wendt, it is the fluidity of constructivism which provided filler for the gaps left open by post-Cold War neo-realism; a point which Buzan and Wæver pick up and develop further.

#### Buzan and Wæver: Globalism (Neo-liberalism)

The second theory discussed in “Regions and Powers” is globalism, which is based on “cultural, transnational and international political economy” existing as the antithesis of neo-realism (Buzan and Wæver 2003: 7). In outlining this theory within a regionalist context, Buzan and Wæver make an important distinction; instead of referring to this structure as liberalism or neo-liberalism, which it would otherwise be identified, they opt to use the term globalism.<sup>7</sup> The authors claim that neo-liberalism in its purest form is akin to Marxism, which rejects all vestiges of the state and adheres to a deterritorialist platform. The milder form of neo-liberalism, globalism, according to the authors, does acknowledge some value of the state system and for this reason Buzan and Wæver felt the term globalism was a more acceptable alternative (Buzan and Wæver 2003: 7-8).

Following the authors’ rationale, because it adheres to variations of “deterritorialization,” globalism impoverishes the value of national sovereignty and directly challenges state-centrism and the neo-realists. Globalism, through the process of globalization, privileges the international

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<sup>7</sup> The preference of this author would be to leave the terminology as “neo-liberalism,” primarily as a means of offering a contrast with neo-realism. However, to maintain fidelity with Buzan and Wæver’s framework, “globalism” will be used.

political economy, transnational exchanges and cultural activities over the implementation of security and coercion. Additionally, globalism acknowledges the role of non-traditional and independent structures, such as transnational entities, NGOs and inter-governmental regimes, and though the state is often a player within these entities, it usually does not control them (Buzan and Wæver 2003: 7).

Robert Keohane and Joseph Nye, two recognized theorists in the globalist field, outline their concepts in “Power and Interdependence: World Politics in Transition” and other writings. As proponents of globalism, or institutionalism as they term it, the notion of “complex interdependence” places interconnected political and social ties over security and military relationships (Keohane and Nye, September/October 1998). Furthermore, it should be noted that Keohane and Nye advocate a more nuanced approach, pulling back from a functionalist world order. They do recognize the value of sovereignty, though seeing international interdependence as tools of the state to achieve their goals, they retain confidence in institutions, particularly from a security standpoint<sup>8</sup> (Keohane, Nye and Hoffman 1993: 383).

It is Keohane and Nye’s inability to acknowledge the primacy of security, which elicits the most criticism from Buzan and Wæver. Because globalism, they contend, lacks a tangible grounding, it operates in the abstract and/or academic realms, prompting them to note, “...we are less interested in the academic debate about globalisation than in the real world responses to it” (Buzan and Wæver 2003: 8). As globalists start from an assumption of deterritorialization with emphasis on non-state structures as opposed to a security infrastructure, the authors reject this as unrealistic in the international security environment. More specifically, Buzan and Wæver challenge the globalists’ inability to address security in a meaningful way, or provide viable alternatives to neo-realism. The authors share some of their sharpest comments for globalism, stating;

“...our regional focus and even more our use of a constructivist understanding of security place us outside the neorealist project. Our relationship with the globalist perspective is, on the face of it, necessarily less close” (Buzan and Wæver 2003: 11).

As neo-realism and globalism occupy either end of the theoretical spectrum, they lack representation in the middle, or regional, level. Moreover, as rationalist theories, both neo-realism and globalism fail to adequately explain the post-Cold War environment, and their weaknesses stem from the emphasis on the systemic or global levels at the expense of the regional. Furthermore, both theories impose a single monolithic perspective (systems versus complex interdependence) over the broader IR structure, thereby perpetuating the inflexibility of the Cold War IR system<sup>9</sup> (Buzan and Wæver 2003: 20, 26).

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<sup>8</sup> Interestingly, in his 1975 “obsolescence” article, Haas praised Keohane and Nye’s early work on interdependence and institutionalism, believing integrationism as a subset of interdependence (Haas 1975: 1, 86-89).

<sup>9</sup> There is indication of a split within the new regionalism camp. This “newer regionalism” is a product of the “new security,” which challenges Western or Euro-centrism and attempts to distance itself from the rationalist elements of new regionalism by concentrating on the so-called “grey areas” of security, such as diasporas, narcotics, gangs, migrations and conflicts over water and minerals (Shaw et al. 2011: 8-9).

## Buzan and Wæver: Regionalism and the Regional Security Complex Theory (RSCT)

It is regionalism where the authors stake their position, and which serves as the primary theoretical platform of this dissertation. Regionalism as explained in “Regions and Powers” is a *mutually exclusive grouping of states*, “socially delineated in which the member states are impacted by the security actions of each other.” A central premise of regionalism is territoriality and the paramount importance of a security footing. There is also a strong historical component, as Buzan and Wæver argue that regionalism is the natural state of IR, and the Cold War atrophy was merely an aberration imposed by the superpowers in what is essentially a brief interruption of a 450 year cycle. So it can be claimed, with some justification, that post-Cold War intellectuals, such as Buzan, Wæver and Wendt, as well as Ladrech and Manners, have ushered in the new regionalist structure.

RSCs are subordinate structures within the international system, noted for their high levels of security, as well as political, cultural and economic interdependence. A RSC must also be mutually exclusive, or clearly sit apart from other regions; to do otherwise will make effective comparison or analysis impossible. Fundamentally, it is at the regional level where states link together sufficiently closely to construct their unique regional identities (Buzan and Wæver 2003: 14-15, 48, 51, 64-65). According to the authors:

“The regional level is where the extremes of national and global security interplay, and where most of the action occurs. The general picture is about the conjunction of two levels: the interplay of the global powers at the system level, and clusters of close security interdependence at the regional level” (Buzan and Wæver 2003: 43-44).

Buzan and Wæver contend that a regionalist security perspective is based on the interdependence and interactions of the states within the complex. As states are usually threatened (whether real or imagined) by their neighbors, their security is foremost centered on a territorial posture. Therefore, each RSC comprises the collective fears and aspirations of the members, and is structured on a security foundation in which the non-security elements, such as economics, culture and history are secondary. In fact, to consider non-security elements first, the author’s claim, allows such arguments to easily degenerate to normative-political in nature (Buzan and Wæver 2003: 46).

What are the specific criteria that make up a region, and what geographical and geopolitical factors are involved? Few theorists have actually addressed this with any degree of satisfaction. To answer this challenge, the authors develop a rudimentary theoretical model, the Regional Security Complex Theory (RSCT). The model is predicated on a neo-realist foundation of territoriality, state centrality and a balance of power calculation, blended with a constructivist appendage based on geography, history, culture and religion called “amity and enmity” (Buzan and Wæver 2003: 50). In this way, Buzan and Wæver move beyond a purely neo-realist interpretation and provide a tool to address the constructivist tendencies in post-Cold War IR. The RSCT considers four key criteria when identifying a region: 1) a clearly defined boundary, 2) an anarchic system of two or more states, 3) power polarity, or a recognizable balance of power within the region, and 4) a social construction, or the presence of amity and enmity (Buzan and Wæver 2003: 53).

The types of RSC as provided by the authors are: 1) a conflict formation, 2) security regime or 3) security community. As the internal dynamics within each region vary between violent competition and benevolent cooperation, Buzan and Wæver try to reflect these dichotomies. The authors refer to a Wendtian-influenced cultures of anarchy, though instead of Hobbesian, Lockean or Kantian perspectives, Buzan and Wæver label them, “conflict formations, security regimes or security communities” respectively (Buzan and Wæver 2003: 53-54, 489, 491).

The three are described further:

- 1) Conflict Formation: “a pattern of security interdependence shaped by fear of war and expectations of the use of violence in political relations;”
- 2) Security Regime: “a pattern of security interdependence still shaped by fear of war and expectations of the use of violence in political relations, but where those fears and expectation are restrained by agreed sets of rules and conduct, and expectation that those rules will be observed;”
- 3) Security Community: “a pattern of security interdependence in which the units do not expect or prepare for the use of force in their political relations with each other” (Buzan and Wæver 2003: 53-54, 489, 491).

A further variation of RSC is the delineation between a standard complex and a centered one. A standard RSC is based on a simple Westphalian model of power polarity, comprised of two or more states driven by security concerns and intra-regional relationships among the members. Standard RSCs do not contain a global power, and in such regions power distinctions are drawn between internal regional dynamics and competition between member states. A centered RSC is noted by the existence of at least one superpower, great power or an institutional power, such as the EU.<sup>10</sup>

The authors also define how new or developing regions are designated. For instance, a “proto-RSC” exists in an environment containing some elements of security inter-dependence, and to the extent that a region can be identified, but is otherwise too underdeveloped to be a true RSC.<sup>11</sup> When considering external influence, the impact of great powers is found in two categories; overlay and penetration. Overlay exists when a power has such influence that it can significantly alter the domestic politics of the region, a notion which will figure prominently in later discussion. Penetration is where a power exerts influence, though lacks the strength or desire to sustain that influence (Buzan and Wæver 2003: 55-56, 62-64).

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<sup>10</sup> The EU, as the institutional power, exists as a highly developed RSC, and holds great power status capable of operating at the global level (Buzan and Wæver 2003: 62).

<sup>11</sup> The authors provide a helpful example in their description of West Africa as a proto-RSC with Economic Community Of West African States (ECOWAS) as an analogous organization to BSEC (Buzan and Wæver 2003: 238-241).

## Comparisons, Weaknesses, Criticisms and the Development of a ‘Provisional’ Buzan and Wæver Theory

As might be expected with an IR theory which attempts to challenge the status quo, the RSCT is controversial and contested within the broader community. Moreover, any theory will have strengths and weaknesses and openings for criticism from other theorists with their own vested interests. Focusing on these varying perspectives from competing theories or authors, allows a deeper understanding of the RSCT, whether alternative explanations are possible and how the Buzan and Wæver model might be applied in a real-world setting.

Comparing and contrasting RSCT with other regional theories is a useful exercise to validate the theory and identify its strengths and weaknesses. Buzan and Wæver specifically address Samuel Huntington’s “Clash of Civilizations,” challenging his notion of how large civilizations like Islam, the West, and Asia violently interact along the fault lines of these culturally based units. In the Buzan and Wæver framework, cultural and civilization issues emerge at the global level where they transcend regional, as well as state boundaries. Therefore, these issues of identity are uniquely globalist and fail to acknowledge the importance of security and territoriality. This is not to say that civilization aspects are irrelevant in a RSC, but they can only influence regional dynamics and not dictate them. It is under this model that the primacy of security and territoriality, as well as other considerations, such as cultural or civilizational topics, are addressed subsequently within this security structure (Buzan and Wæver 2003: 43-44).

Lake and Morgan’s “regional orders,” which are actually based on the RSC concept, concentrate on externalities in regional development, or the impact of outside influence at the expense of the internal regional dynamics which puts them at odds with Buzan and Wæver. Strangely, the authors place the United States within European, East Asian and Middle Eastern regions (Lake and Morgan 1997: 12). From an obvious geographical standpoint this claim is hard to justify and proves the Buzan and Wæver penetration/overlay concept more intellectually satisfying<sup>12</sup> (Buzan and Wæver 2003: 78-82; Oskanian 2012: 3). More significantly, Lake and Morgan ignore the importance of mutual exclusivity, a key component to the RSCT, in constructing their regional orders, notably by acknowledging overlapping regions or “gray areas” (Lake and Morgan 1997: 30, 50-51).

Yet, in doing so, Lake and Morgan attempt to address a troubling aspect of the RSCT which has never been satisfactorily addressed; its mutual exclusivity in the regional construct, notably the inability of one state to exist in dual regions. In other words, a critically important country, such as Russia, can only belong to one RSC. According to Buzan and Wæver, Russia falls within a ‘Weak European Supercomplex,’ and can only exist in this configuration without the possibility of overlapping with other complexes. Buzan and Wæver have a good reason to create such a

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<sup>12</sup> Buzan and Wæver address this lack of regional discipline on the part of Lake and Morgan: “Although the United States may be ‘in’ Europe and East Asia and the Middle East in a seemingly durable way, it makes a big difference that it always has the option to withdraw from (or be thrown out of) these regions. China and Japan are in East Asia whether they want to or not. By collapsing this distinction, Lake and Morgan risk repeating the analytical policy errors of the Cold War in which superpower dynamics were given far too much weight, and regional ones far too little...” (Buzan and Wæver 2003: 81-82).

hard and fast rule; if a country can exist in multiple RSCs, then it is impossible to conduct any meaningful inter-regional analyses.

However, this strict adherence to mutual exclusivity does not work in the development of a Black Sea RSC, whereby excluding Russia (and Turkey for that matter), and the other European states, makes any regional analysis impossible. Mutual exclusivity, while important for region-to-region comparison, hampers the ability to construct and analyze a unique or developing region. Therefore, it is time to make an important deviation in this analysis; to revise the RSCT and relax Buzan and Wæver's model enough to create a provisional tool which will allow the analysis to proceed within a uniquely Black Sea context. This Provisional RSCT provides the flexibility needed to create a unique regional entity that can be analyzed. These will be put into practice on page 34 (Buzan and Wæver 2003: 351).

There is criticism of the Copenhagen School in general and RSCT in particular, which should be addressed. Ken Booth, in "Beyond Critical Security Studies," claims that the Copenhagen School is "state-centric and elite-centric" (Booth 2005: 271 as referenced in Buzan and Hansen 2009: 215). From a broadly theoretical standpoint the most severe criticism comes from Bill McSweeney in his 1996 article "Identity and Security: Buzan and the Copenhagen School." McSweeney takes issue with the Copenhagen School's hallmark blending of neo-realist and constructivist tenets first identified in "People, States and Fear" and carried forward by "Security: A New Framework for Analysis." McSweeney classifies this theoretical blending as the desire to have a "foot in both camps" (McSweeney 1996: 82). Yet, it is the securitization of the societal sector that creates the basis of McSweeney's criticism.

McSweeney states Buzan's emphasis on the popularly appealing "identity" frames the debate on such sensitive subjective issues which effectively shuts down debate and makes it impervious to criticism. McSweeney notes that identity,

"...makes everyone an expert. Its fundamental character as an inalienable human property blocks all criticism and makes its secure possession a matter of elementary justice. We are who we think we are; no one else can judge us...In effect they (Copenhagen School) have an objectivist theory with relativist consequences"<sup>13</sup> (McSweeney 1996: 86-87).

McSweeney also notes that we are required to acknowledge and accept the identity of every state or community without the ability to critically analyze or pass judgment, essentially forced to conclude, "We may not like who they are, but if they think that way, so be it" (McSweeney 1996: 86-87). Moreover, from a methodological standpoint, McSweeney claims that Buzan and the Copenhagen School treat identity as static without taking into account its inherent flexibility. By operating with a fixed variable (referent object, as identified by McSweeney), it impoverishes the very principle of constructivism which is supposed to negate such rigid formulations (Critical Approaches to Security in Europe (CASE) 2006: 453).

In a pointed criticism of the RSCT, Rodrigo Tavares in his 2005 paper "Understanding Regional Peace and Security: A Framework for Analysis," questions the ability of the RSCT to

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<sup>13</sup> McSweeney's article touched off a spirited debate with Buzan and Wæver. See Buzan and Wæver, "Slippery? Contradictory? Sociologically Untenable? The Copenhagen School Replies," 1997.



satisfactorily explain international terrorism in a post-911 world (Tavares 2005: 15). Reading the passage in “Regions and Powers” on international terrorism and RSCT, in many ways it is similar to the authors’ critique of Huntington noted earlier in this chapter; international terrorism by nature is deterritorialized and transnational, and necessarily relegated to operating at the global level. Therefore, according to Buzan and Wæver, terrorism can only *alter* the intra-regional dynamics not *transform* them (Buzan and Wæver 2003: 44, 466-467; Buzan and Hansen 2009: 254-255).

However, Tavares makes an interesting point which must be considered further. The Buzan and Wæver position does not adequately respond to the international terrorist threat, particularly when organized and well-funded organizations such as Hezbollah, Al Qaeda, and more recently, Islamic State, which has destabilized portions of Iraq and Syria, can transform the internal structure of a weak or failed state, thereby altering the intra and extra-regional dynamics. This, in effect, shifts the frame of reference from a deterritorialized foundation to a territorialized one. Examples of Afghanistan, Iraq and Syria show how state structures can be eroded to the point of collapse, thereby allowing destabilization to spread within and beyond the respective regional structures. This can be explained that Buzan and Wæver’s pre-9/11 frame of reference is perhaps anachronistic in regard to the potential impact of non-state actors on national sovereignty.

Another weakness of Buzan and Wæver is their reliance on the internal dynamics of regional development. In this capacity, it can be argued that Buzan and Wæver do not place enough emphasis on external influence in the creation RSCs. The authors’ note the driving force behind regional development is disproportionately dependent on the internal, or intra-regional, composition the member states, which impoverishes the influence of the neighboring or non-regional states. This may be so in the development of some regions, but it is a critical component to a Black Sea RSC, which, as will be demonstrated, is so heavily influenced by outside players.

From the perspective of this analysis, it is amity and enmity which presents the biggest intellectual benefit as well as challenge. It is an inelegant and awkward attachment to an essentially neo-realist theoretical structure which makes it the subject of criticism, as noted earlier by McSweeney.<sup>14</sup> As it lacks a strong empirical basis, a more clearly defined explanation and application would be an improvement, for example a means of measuring degrees of amity and enmity and their impact on regional development. Lake and Morgan address the amity and enmity puzzle by imposing a systems approach, yet this attempt to provide a positivist perspective bogs down in confusing detail about regional and global systems structures with little value added analytical benefit (Lake and Morgan 1997: 45-67).

As noted earlier, there is an attempt to classify types of RSCs roughly based on the Wendtian “cultures of anarchy.” Buzan and Wæver do not explore this concept in any appreciable detail and their types of RSC provide no additional insight to what Wendt has already put forward in his 1992 and 1999 works (Buzan and Wæver 2003: 50). Amity and enmity then becomes a double-edged sword in that it provides a needed constructivist element to the neo-realist framework, though lacks any appreciable quantifiable measures. While quantified analysis is not

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<sup>14</sup> Acharya makes an interesting if not amusing comment. Referring to the RSCT, he mentions how the “The Wæverian constructivist façade of R&P (Regions and Powers) sits uneasily atop its Buzantine neorealist foundation” (Acharya 2007:636).

necessarily vital within a broadly qualitative work, the ability to provide metrics would be a beneficial attribute toward addressing the research question.

A former student of Buzan's, Kevork Oskanian, takes the challenge and applies what he calls a "Wendtian soft constructivist" approach. Oskanian thoughtfully applies a richer construct to amity and enmity; instead of a Hobbesian, Lockean and Kantian perspective he embeds "enmity, rivalry and friendship." Therefore, Oskanian effectively condenses Wendt's constructivist model within the amity and enmity realm and further embellishes the concept with an "Amity and Enmity Spectrum," essentially a sliding scale with a representation of "Cultures of Anarchy"<sup>15</sup> (Oskanian 2012: 14, 20-22). Moreover, this ability to insert different sub-models within the RSCT, as Oskanian has done, indicates the theory's overall flexibility.

Though other theories researched for this dissertation provide valuable insight into regionalism, it is impossible to effectively divorce regionalism from territorialization and the security dynamics. The other theories handicap themselves by discounting the state's role in regional security, and by focusing so heavily on economic cooperation and interdependence, at the expense of security, it significantly detracts from the suitability of these theories (Buzan and Wæver, 2003: 43-44). No theory can perfectly model the incongruities and changing nature of IR, so the analyst must rely on one that provides appropriate rigor and flexibility. Whatever its flaws and ambiguities, the RSCT is a relatively flexible and comprehensive framework for studying regionalism.

For this dissertation, it was determined that the benefits of amity and enmity outweigh its detractions, and despite criticism from McSweeney and other purists, it is precisely the ability to blend these different theoretical concepts that make the RSCT so useful. The RSCT forces the analyst to critically examine and categorize the elements which comprise a region, in this case the greater Black Sea region. This is particularly important when analyzing a region so politically, socially and historically diverse as the wider Black Sea area. It was for its inherent flexibility, simplicity and comprehensiveness that RSCT is the theoretical template chosen to explain the construct of a Black Sea region.

#### A Wider Black Sea Region within the RSCT Framework

Having established the principles and types of RSCs as defined by the Provisional RSCT, the Buzan and Wæver model is applied to the Black Sea region. The goal is to test its applicability and determine what constitutes a Black Sea RSC, as well as test the model's flexibility in adapting it to a complex Black Sea environment. As a reminder, the four criteria are:

- 1) Defined boundaries
- 2) An anarchic system with two or more members
- 3) Power polarity
- 4) Amity and Enmity (Social structure, or constructivism).

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<sup>15</sup> Oskanian email to the author, July 20, 2014. See Table 1, Page 22 of Oskanian "Friends and Enemies: Expanding the Amity/Enmity Variable within Regional Security Complex Theory."

Items One and Two: Defined boundaries/An anarchic system.

As Items One and Two center on territoriality and sovereignty, they are mutually supportive and interdependent, and for this reason they are combined into one category for analysis. Implied within Items One and Two is to clearly identify the member states of the Black Sea RSC. This component is vital as it frames the context of the research question and sets the analytic stage for the balance of this paper. What comprises the Black Sea region's component parts must be geographically reasonable and also permit the unique regional dynamics to reveal themselves.

Yet, there are multiple constructions of a Black Sea RSC quite often depending on the nationality or perspectives of the analyst, hence the confusion and susceptibility to misinterpretation. These range from a purely littoral definition, as noted from Bratianu, which strictly applies to Bulgaria, Georgia, Romania, Russia, Turkey and Ukraine. Such a narrow interpretation of only the littoral states is not helpful, particularly within the context of energy where key players, such as Azerbaijan and Greece are omitted simply because of their geographic locations as non-littoral states.

Others consider a much more liberal interpretation which encompasses the extensive river tributaries. For instance, such a perspective would find a wider Black Sea area following the Danube River into Central Europe (Mee from Aybak 2001: 133). This broader interpretation, as noted in the International Commission for Protection of the Danube River (ICPDR) and the Danube-Black Sea (DABLAS) Task Force, is perhaps relevant for riparian states to maintain oversight of trade and environmental issues. However, from a geopolitical standpoint such an expansive and holistic interpretation is unwieldy and not useful, making any analysis cumbersome (International Commission for Protection of Danube River (ICPDR) website, date accessed October 12, 2013; The Danube-Black Sea (DABLAS) Task Force website, date accessed October 12, 2013).

A generally accepted regional construct is provided by BSEC's membership of 12 sovereign states.<sup>16</sup> As noted in the Introduction, BSEC is a loosely structured organization of states designed to address regional trade and cooperation issues. This analysis is generally in agreement with the BSEC membership criteria, with the exceptions of Albania and Serbia, countries usually recognized as Balkan rather than Black Sea states. Including these two as BSEC members is difficult to explain other than as a political expediency to rehabilitate them by integrating them into an established organization. Secondly, both states are valuable as energy transit (pipeline) states, notably Albania's port city of Vlore on the Adriatic coast, so this can be viewed as a thinly-veiled *quid pro quo*. Finally, in the case of Albania, Turkey wanted another Moslem-majority state in BSEC, and pushed for Tirana's inclusion (Valinakis 1999: 25).

Therefore, this paper challenges a Black Sea region as defined by Bratianu, BSEC or the ICPDR/DABLAS, either as too limiting or expansive and not faithful representatives of a Black Sea RSC capable of being analyzed in any meaningful capacity. Instead, this dissertation

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<sup>16</sup> The BSEC member states are Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Turkey and Ukraine. A more in-depth analysis of BSEC will be conducted in Chapter 5.

presents a more narrowly configured entity of ten states comprising the six littoral nations of Bulgaria, Georgia, Romania, Russia, Turkey and Ukraine plus the non-littoral states of Armenia, Azerbaijan, Greece and Moldova. The two non-littoral south Caucasus states are included because of their historical ties to each other (and Georgia) and to Russia. Indeed, it is difficult to discuss any one of the South Caucasus states without making even a cursory reference to the other two; let alone Russia. Additionally, Azerbaijan is a major component to the Black Sea RSC's development, notably because of its position as a critical source of oil and gas within the region.

As the ancient colonial power for over a millennium, Greek culture and influence run deep, and for this analysis it is considered a member of the Black Sea RSC. This is mainly because of historical, economic and political ties, as well as geographic proximity to the littoral states, which places it in such a unique position. Moldova, though not technically a littoral state, is included because of the direct access via the Dniestr and Prut Rivers, and indirect access via the Danube. Other considerations include Moldova's cultural links to Romania and Turkey, and its difficult and binding relations with Ukraine and Russia.

This configuration of ten states is emblematic of the Buzan and Wæver model, and it also identifies a more realistic analytic base, which creates a tangible structure capable of being identified, analyzed and documented. Moreover, it is an analytic unit that is equally representative of the region's political and ethnic composition without veering too far into other competing regional structures, such as the Balkans, Central Europe or Central Asia or the Middle East. It should be noted that the Black Sea RSC configuration as captured in this paper is not arbitrary, lacking any intellectual precedent; the European Commission acknowledges these 10 states as the core of the Black Sea Region in the 2007 Black Sea Synergy Communication. Finally, this configuration is corroborated by such regional experts as Panagiota Manoli, Dimitris Tryantaphallou and Dmitry Tsantoulis (European Commission, (1) 2007: 2).

Item Three: Power polarity.

Item Three is perhaps the embodiment of the neo-realist element in the RSCT, that which considers raw military or political power as the manifestation of national viability. In this context it becomes a testament to the composite members' ability to deliver and deter hard power when and where desired. The goal here is not to analyze the region's respective militaries and orders of battle, but to draw some general assumptions on power distribution among the ten states. Moreover, hard power varies widely among the Black Sea "Ten," with differing perspectives and conditions on its use. Focusing on the region's two military and political powers, possessors and users of hard power, Russia and Turkey, provides an interesting contrast. The traditional north-south power rivalry still exists, though perhaps in a more benign state than from a century ago, when both were locked in a brutal conflict in the Caucasus and eastern Turkey. A conflict which led to the Armenian Genocide and other atrocities of the war, emblematic of the deep political, ethnic religious animosities of the region, and which are present to this day.

In fact, relations between Russia and Turkey have warmed considerably since 1991, with the immediate-term effect of keeping large power tensions in check, with the benefit of relative regional stability. Nevertheless, this balance of power falls decidedly in Russia's favor, though

the ratio is counterbalanced somewhat by Turkey's membership in NATO. Turkey lacks the coercive influence that Russia enjoys in the Black Sea RSC, and while Ankara under Erdogan is distancing itself from its traditional Western-oriented posture, it is doubtful Turkey will make a dramatic break from the West any time soon. To be sure, attempts to permanently change the balance of power by Ankara would be highly provocative to Moscow, as well as Brussels, Washington and Tehran.

The implications of the two Western regional security entities, the EU and NATO, must also be considered. The EU is relegated to its role as a soft power for the foreseeable future, leaving the application (or threat) of hard power to a US-dominated NATO. The Alliance's position as a Black Sea military power began with Turkey's admittance in 1952, while the accession of Romania and Bulgaria in 2004 further anchored NATO on the western and southern littoral. This condition is complicated by the US, a highly divisive force in the region. Furthermore, as NATO's primary power, it is too soon to tell the implications of the Alliance's presence, particularly in its relations with Russia, as demonstrated by Moscow's ability and willingness to wield political and military force in its sphere of influence. For the time being, hard power resides on the northern axis, and any long-term power polarity analyses which deviate from this fact are fraught with risks.

#### Item Four: Amity and Enmity as a Component of a Black Sea RSC

The Buzan and Wæver model assumes a neo-realist foundation of territoriality, state centrality and a balance of power calculation, meshed with "amity and enmity," a constructivist element based on geography, history, culture and religion (Buzan and Wæver 2003: 50). As such, Buzan and Wæver have transcended a purely neo-realist perspective and demonstrate a combined tool to address the constructivist tendencies in post-Cold War IR. So, while RSCT Items One through Three exist within the neo-realist realm of the state-level organization, notably sovereign borders and balance of power alignment, a key task is to look beyond this rigidly-defined construct and focus on culture, civil society and economic interaction. In other words, concentrating on normative aspects, whereby through eroding interstate barriers, constructivism acts as a counterbalance to neo-realism. This distinction becomes even more relevant when discussing cross-border energy projects, where borders and state-imposed restrictions are overcome to derive broader regional benefits. In fact, it is in the Black Sea RSC's economic and social structures, which exist outside the neo-realist framework, where we see most of the activity and transformational potential, and which act as underpinnings and the focal point of this paper.

As noted earlier in this chapter, amity and enmity exemplify what can be described as an amplifier of a soft power attitude, that which embodies the normative or constructivist aspects of the RSCT, as opposed to the hard power dictates identified in Item Three. The presence of amity and enmity adds a unique perspective to a Black Sea RSC, which is normally associated with a neo-realist posture. Yet, few regions in the world offer such an array of possibilities for constructivist analysis, all of which falls squarely within the amity and enmity realm. The most prominent example of constructivism at play is the revised role of energy in the region, a phenomenon which will be examined further in this chapter. It is this preponderance of constructivist perspectives within the substantive discipline which dictates that the majority of this dissertation concentrates on the Black Sea RSC's economic and societal topics.

As one of the world's main purveyors of soft power, as well as a regional neighbor, it is necessary to consider the EU as a component to the Black Sea's RSC construct. The presence of Bulgaria and Romania, as well as long-term member Greece, as both EU states and components of the RSC, demonstrate the Union's ability to straddle both organizations and thereby wield influence. What is becoming clear is the manner in which EU soft power is altering the traditional power flow within the Black Sea RSC. This political and economic influence emanating from Brussels will prove to be a contributing factor to answering the research question. Moreover, it demonstrates how soft power acts as an asymmetrical counterweight to neo-realism, and it is here where the true dynamics of the interplay between constructivism and neo-realism are visible.

There are other elements of the RSCT which offer insight into a Black Sea region. Looking at great powers within the Black Sea RSC, it is possible to identify Russian overlay of the South Caucasus, Moldova or Ukraine, overlay is again identified as the most dominant form of influence a state can exercise within the RSCT. The other (lesser) example is penetration, which exists when an externally-based power is strong enough to make its presence felt in a region, and has the ability to penetrate the Black Sea, such as the United States, though chooses not to, or only in a limited capacity (Buzan and Wæver 2003: 46).

Perhaps the greatest test of the RSCT's efficacy in the Black Sea environment is an analysis of its final outcome. When applying RSCT's four elements, it is possible to see a weak, though recognizable security regime, where each of the four items are developed and considered as a unique entity. Looking deeper at the Black Sea Ten, what is also present is a "centered proto-RSC," centered on Russia's great power status and a "proto" in which a basic structure exists, though it lacks the intra-regional dynamics that would allow it to form a more established RSC (Buzan and Wæver 2003: 64). For the purposes of this paper, the region encompassing the wider Black Sea will be referred to as an RSC.

#### Examples of the RSCT Applied to a Black Sea Environment: Ryabstev, Eyvazez, Coppieters, and Makaryechev

Having established the Black Sea in a RSCT context, it is necessary to consider if or how the model has been utilized for similar purposes. Research has found analysts who have applied certain aspects of the RSCT or Buzan and Wæver theorems to a Black Sea regional template, however the results are spotty. Some authors freely borrow terminology from Buzan and Wæver, but ultimately do not employ the model in its entirety or misunderstand its application. This misapplication portrays an array of perspectives, most of which are firmly embedded in a traditional regionalist understanding of the changing post-Cold War geopolitical landscape.

This residual Cold War mindset is best exemplified by Vladimir Ryabstev, in his "Why is there not a 'Security Complex' in the Black Sea-Caucasus Region?" As the title implies, Ryabstev argues that a Black Sea security complex does not exist. He notes the lack of a "security discourse" in the region and identifies the "Black Sea-Caucasus," unlike that of the Balkans of the 1990s, is responsible for failure to generate positive results. Curiously, he then undermines his premise:

“To be fair, it should be mentioned that since 1999 this question [the lack of discursive organizations] – in respect of the Caucasus – has been raised in the South Caucasus, in the EU, and in Russia. The idea of such a pact has received support in the European Parliament. Finally, it should not be forgotten that in January 2000, Süleyman Demirel, the Turkish President, also made a similar proposal. This proposal, however, has not resulted in any concrete action” (Ryabstev 2009: 98).

Several other organizations dedicated to Caucasus security were omitted by the author, to include the Organization for Security Cooperation in Europe’s (OSCE) Minsk Group and BSEC’s Parliamentary Assembly. Therefore, it would appear not so much a *lack* of discursive security organizations, but a lack of *effective* security organizations, not to mention an earnest desire by both parties to engage in such dialogue; such earnestness appears to be lacking equally in both camps. The author does touch on a critical element by acknowledging the need for confidence-building measures within the states and to “interweave” a security complex via a range of bilateral agreements or treaties. As an example, he cites the 1992 Principles of Relations between Russia and Turkey, which permitted Russian gas to be exported to Turkey via the Blue Stream project. Unfortunately, this analysis is incomplete as the author does not elaborate on the impact of commercial relations as a means of establishing a security foundation (Ryabstev 2009: 99).

Ryabstev then outlines the four reasons why a regional security complex does not exist in the BSC:

1. The lack of a common regional identity
2. Lack of co-operation
3. Interference of major powers
4. Centrifugal tendencies and heterogeneity

(Ryabstev 2009: 99-107)

All four examples demonstrate a generic and one dimensional consideration of regionalism, more in common with a Cold War interpretation, without acknowledging the constructivist elements in play. However, it is Ryabstev’s claim of “centrifugal tendencies and heterogeneity,” that impede a BSC which appear the most contradictory and must be challenged. The notion of centrifugal tendencies can be disputed by the existence of centripetal tendencies, or pressure and interference from external powers as noted in his third example. It is the clear presence of these countervailing centripetal forces which, in fact, further define and make the case for a distinct Black Sea RSC.

Another analyst who refers to a Caucasus “Security Complex,” Bruno Coppetiers, does a credible job outlining the existence of a Caucasus security complex, particularly Russia’s post-Cold War influence. Coppetiers references Buzan’s “People States and Fear,” as opposed to the more recent and definitive “Regions and Powers,” and for this reason omits the constructivist elements of regionalism (Coppetiers 2004). This proves to be a critical omission, one that hobbles his analysis, relegating it to a purely neo-realist condition. Jannatkhon Eyvazov has a firm grasp of the first three components of the RSCT; for instance, he believes the post-Soviet space is still too unstable to be adequately classified as an RSC, yet this indicates another

distinctly neo-realist perspective on regionalism, which adds little to the discussion (Eyvazov 2011).

A generally faithful application of the RSCT to the Black Sea littoral space is by Andrey Makarychev. The author claims the prospect of securitization within the former Soviet Black Sea states, caused by Russian domination, will force the creation of a ‘conflict formation,’ the most unstable and conflict prone of RSC outlined by Buzan and Wæver. Makarychev notes the existence of “fuzzy borders,” as well as the securitized nature of relations within the former Soviet Union would indicate a serious potential for conflict (Makaryev 2008: 1-2). According to Makarychev, Russian ‘overlay’ (a uniquely Buzan and Wæver term) of the frozen conflicts ensures these conflicts will remain localized for the foreseeable future. It is hard to argue with Makarychev’s view that the conflicts will remain localized, though it is equally difficult to imagine the Black Sea RSC existing as a conflict formation, primarily because of the external pressures capable of being implemented by the West that would deescalate such intra-regional tensions.

Though each of the four analysts represented invoke Buzan and Wæver, the RSCT or ‘Regional Security Complexes’ in some form, with the exception of Makarychev, none appears to fully understand the main premise of Buzan and Wæver’s concept of blending neo-realist with constructivist thought. Even so, Makarychev’s work is narrowly defined to a purely Russian context without looking at the broader Black Sea RSC and its external (EU) influences. What becomes evident is that many IR analysts have relegated the Black Sea RSC to a Cold War interpretation of regionalism, which is both inaccurate and limiting in scope and perspective. This fixation on a traditional regionalist interpretation indicates there is still broad-based resistance to the geopolitical changes underway in the world’s regional entities, let alone the wider Black Sea.

## **Energy and Regionalism: The Cold War and Post-Cold War Perspectives**

Because of the securitized nature of energy, with its position as an enhancer of state power and social and economic advancement, it can be viewed as a transitional commodity, transitional in the sense that it carries weight in both the neo-realist and constructivist elements of the RSCT. This provides an ability to compare and contrast not only energy’s changing status, but also its ability to bridge the range of theoretical postures as noted by Buzan and Wæver. In this respect it highlights the ‘double-edged sword’ analogy that was applied to amity and enmity earlier in this chapter; notably that energy can be both an enhancer of hard power dynamics, as well as a source of cross-border cooperation.

This section begins the discussion that is central to his paper’s research question, notably *the interaction and mutual influence of regionalist theory and energy as a transformational agent, particularly as it applies to the Black Sea RSC*. In many respects the Cold War acts as a convenient demarcation point from which to analyze the effects of new regionalism and the energy dynamic. When framed in a Cold War/post-Cold War context, it is helpful to consider these effects of energy on regional development from a traditional and new regionalist



perspective.<sup>17</sup> In other words, how has the end of the Cold War and the relatively recent and widespread availability of FSU oil and gas on a global scale affected the creation of the Black Sea RSC?

This discussion must first start with a look at how changing perspectives of regionalism and sovereignty have impacted the energy sector, or the manner in which energy has transcended the Cold War eras. Moreover, this section resurrects the regionalist theories explored earlier in this chapter, but now reviewing them with an energy-centric lens, which further entails considering energy as a facilitator in the creation of regional security complexes. Also, considering energy's influence in a Cold War and post-Cold War environments helps set the regional foundation for later analysis, in particular the neo-realist versus constructivist divide.

### Traditional Regionalism and Energy

When applying the RSCT format, traditional regionalism with its basis in neo-realism sits squarely within items One through Three of the Buzan and Wæver framework. Considering energy within this structure, it was predicated on a notion of state centrality and balance of power, whereby the control and manipulation of energy was a function of state viability and prowess. For instance, fossil fuels were a means of enhancing state power; such as for military operations or readiness and generating economic growth. Moreover, energy is an enhancer of state power, and by extension regional power, something to be exploited, protected and denied to all rivals.

There is also a coercive element, which allows energy-rich states to influence those which are energy deficient. In this capacity subsidized energy has a strong controlling element in the Cold War era, notably for domestic political expediency, but also for influence purposes. Indeed, both superpowers supplied subsidized energy to client states during the Cold War, primarily as a means of ensuring loyalty and compliance. The Soviets were particularly astute in this tactic, using cheap oil and gas to placate energy hungry internal republics and Eastern European allies alike (Campbell 1976: 80-81). For these reasons a traditional regionalist energy perspective fits neatly within the Cold War's stark theoretical framework.

At the height of the Cold War a unique event took place; the creation of the ECSC, which was the deliberate attempt by the Western European nations to pool economic resources. This union would have repercussions during the Cold War and after as it evolved into a broader and extensive political and economic entity. From the ECSC's preamble, the organizers, "Resolved to substitute for age-old rivalries the merging of their essential interests" (Office for Official Publications of the European Communities 1989). This was, in effect, a supra-national attempt to provide oversight of coal and steel, two key elements of state power and war making potential in the mid-20<sup>th</sup> Century. Besides trying to hobble state (read German) power, it was also to achieve efficiencies and economies of scale, so there were legitimate economic motivations behind the ECSC as well.

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<sup>17</sup> When talking about energy in this context, it is referencing primary energy sources, notably fossil fuels. Secondary energy is classified as electricity.

As the ECSC evolved into the EU, developing ever stronger political and economic control centrally located in Brussels, it became perhaps the epitome of the neo-functionalist entity, with a direct correlation between energy and regionalism, a relationship which continues to this day. Therefore, the genesis of today's EU was energy security and it is still a primary consideration, with notable interests from the highest levels of power in Brussels. The ECSC proves that energy was a *logic* of regional integration and demonstrates the dispersive power of energy, capable of breaking down the rationalist confines of the Cold War and allowing greater input from the private sector in a cross-border capacity.

On the surface it would appear that the superpower divide was strictly enforced; such as the US and USSR and their constellation states closely aligned behind them. However, in reality such an interpretation of the pre-1991 energy environment is somewhat flawed; despite the hostile rhetoric and actions, there was more energy-related cooperation between blocs than might be imagined, particularly in the later Cold War years. It should be noted the Soviet Union was exporting oil and gas to Western Europe well before 1991, brought about by European demand for these commodities and the USSR's need for hard currency (Gustafson 2012; 149-150). This East-West trade was under strict control of the Soviet authorities and was frowned upon by the US, and despite the general mistrust, the Soviet Union proved to be a reliable business partner.

Despite the aforementioned benefits to state power, there are limits to fossil fuels as the source of neo-realist (state) or traditional regional power. In fact, it is possible to show it as quite fluid, ebbing and flowing with a range of both external and internal dynamics. In the 2000s, as the price of oil rose to unforeseen heights on international markets, Russia's global standing was greatly enhanced by its ability to harness its energy wealth as an engine of state power. By 2016, Russia, has lost much of the power it wielded even four years prior, mostly caused by the global economic crisis and the drop in oil and natural gas prices. Russia's economy is also further destabilized by capital flight and currency devaluation caused by Western sanctions in response to Moscow's Ukraine ventures.

Another example of the limits to the regionalist energy dynamic is how Azerbaijan's power has been enhanced by its energy wealth, leading to a rapid military buildup funded by its energy revenue windfall, primarily to confront Armenia over Nagorno-Karabakh. Azerbaijan is expanding its regional soft power via strategic investments, though it is no closer to wresting physical control of this enclave than it was 20 years ago. Azerbaijan may have enhanced its economic, political and cultural power within the RSC, but this has not translated in any meaningful way in the military realm or its ability to project raw power. The implication being that while energy is proving instrumental in creating a Black Sea RSC, there are numerous external and internal factor which can limit the application of a traditional (neo-realist) regional model.

## New Regionalism and Energy

Shifting from the Cold War era and the traditional regionalism model, there is now a move to a constructivist foundation in regionalism, previously identified as 'new' regionalism. It is in this context that a post-Cold War global realignment is more clearly identified in regional entities noted by Buzan and Wæver. Additionally, it can be said that new regionalism, with its focus on

constructivist attributes, has enhanced the regional impact of energy as compared to the high-level and atrophied strategies of the Cold War era. Indeed, this new geopolitical environment, with an emphasis on transcending barriers and cross-border interaction, can be credited with opening previously closed markets to FSU energy concerns. More specifically, it was the end of the bi-polar system which opened up the former Soviet republics to new, previously unavailable capital, technologies and management practices. This constructivist focus also permitted more diffusion outside the Soviet era pipeline infrastructure and allowed greater freedoms from which market forces could prevail. In this capacity amity and enmity, via constructivism, becomes a critical component in generating the inter and intra-regional friction inherent in the competition that drives the energy industry.

When considering new regionalism and energy within the confines of the RSCT, it is Item Four that will have the most impact; the area which embodies the normative political, economic and social environment embedded within constructivism. Such examples are the liberalization of the EU's energy markets, notably in the gas and electric sectors, and how this is creating transborder markets; a condition that would have been impossible during the Cold War. What becomes clear is that energy provides a key component to both traditional and new regionalism. Furthermore, it can be stated this dissertation is a study in new regionalism viewed primarily from a political, economic and social perspective. With the Black Sea as a regional testing ground, the basic theoretical principles noted in this chapter will be examined.

It can also be stated that the Cold War era's ideological discipline no longer exists in an era of liberal trade and free markets. What is interesting is how global free trade agreements have been extended to include most former Eastern Bloc countries since 1991, while there has also been a parallel move toward regionalism. Furthermore, this transformation is steeped in contradictions; Russia is a recent signatory to the WTO, while also engaged in a variety of regional trade and security organizations, notably the Eurasian Economic Union (EEU) and the Shanghai Cooperation Organization. Finally, this transition process to new regionalism is far from a linear progression, instead regressing back to elements of traditional regionalism, depending on the geopolitical trajectory of the member states.

### Final Thoughts on a Black Sea RSC

Regions are dynamic entities, constantly changing and evolving, influenced by the external and internal attributes, hence the research question which attempts to identify the drivers of this transformation within the Black Sea RSC. It should be noted that regions are comprised of humans with their own unique fears, prejudices and predilections, one of which is to band together in familiar groupings, to the (often times violent) exclusions of others. It is in this regard that Neal Ascherson noted:

“Peoples who live in communion with other peoples, for hundred or a thousand years, do not always like them – may, in fact, have always disliked them. As individuals, ‘the other’ are not strangers but neighbors, often friends. But my sense of Black Sea life, a sad one, is that latent mistrust between different cultures is immortal” (Ascherson 1995: 9).

It is this “immortal” mistrust which creates the churning mélange with such disparate and diverse states that ultimately defines a Black Sea RSC, and which emphasizes that benign, cooperative relations may be desired, but are not necessarily guarantees of a regional entity. One simply has to look at South Asia, which is widely considered a unique region despite the fact that it houses one of the world’s most contentious and potentially explosive power balances. It would reason an equally diverse grouping of states could forge a broad regional entity, further influenced by the insertion of oil and gas into the geo-political mix. If the Black Sea RSC is a legitimate entity, as is argued in this chapter, it is imperative to understand the external and internal factors which have gone into this transformational process.

In fact, the Black Sea RSC, with its unique location and disruptive internal political and ethnic dynamics, makes it even more susceptible to external influences than most other regional entities. For example, there is the presence of two great powers (Russia and the EU) with varying degrees of overlay and perspectives on how the Black Sea RSC should look and orient itself. There is the United States with its penetrating ability in the region, though reticence to do so, while Iran and Turkey clearly desire overlay power, but currently lack this ability in any appreciable sense. For this reason external power dynamics will feature prominently in how this dissertation answers the research question, and it is ultimately the strength of such forces which are pushing regional transformation.

**Figure 1: Black Sea RSC Political Map**



## Chapter 2: Thoughts on the Existence of a Black Sea Region: A History of Contestation

“The historical interest aroused by a geographical region is a benefit which pays dearly” (Bratianu 1969).

“This (Black Sea) is not just a place but a pattern of relationships which could not have been the same in any other place, and this is why Black Sea history is first of all the history of the Black Sea” (Ascherson 1995: 11).

“At last, Russia has returned to the world arena as a strong state - a country that others heed and that can stand up for itself” (Vladimir Putin 2008, from the Economist, (1) February 1, 2014).

Having established the general theoretical framework of regionalism and explained the existence and rationale behind a Black Sea RSC, the next step is to delve deeper into the historical and political background of the composite states and explore their unique characteristics. While Chapter 1 addressed the theoretical aspects of the research question through a Buzan and Wæver lens, Chapter 2 begins the process of establishing the substantive credentials; again, substantive being the core research material used to answer the research question. The purpose is to identify the threads of contestation and follow them to today’s environment, and the intra-regional tensions which have set the stage for the current transformational dynamics.

### Geographical and Historical Background

The Black Sea is a relatively young body of water. The circumstances surrounding its creation are debated, though the most plausible is the “Black Sea Deluge Theory” put forward by William Ryan and Walter Pitman in their 1998 “Noah’s Flood.” In a somewhat controversial though thought-provoking premise, the authors postulate that a freshwater lake already existed in the current Black Sea basin under the shadow of the Pontic Mountains of modern Turkey. This New Euxine Lake, as named by Ryan and Pitman, was home to Neolithic hunter-gathers and farmers who lived on its shore, and would have a tremendous impact on the development of Europe and the Middle East (Baker from Yanko-Hombach et al. 2009: xii).

Approximately 14,000 years ago, the Eurasian Ice Sheet began to melt raising global sea levels and pushing meltwater south, carving out the great rivers Danube, Dniester, Dnieper, Don and the smaller Kuban, all of which emptied into the New Euxine Lake (Ryan and Pitman 1998: 156-157). Meanwhile, the rising sea levels in the Mediterranean Sea pushed saltwater northward through a narrow causeway what is now the Bosphorous Strait. This cataclysmic flood emanating from both north and south caused water levels in the New Euxine Lake to rise approximately 15 centimeters per day and within a year had inundated over 100,000 square kilometers. The result was to push the lake’s boundaries in line with the modern Black Sea, though now with a brackish composition (Ryan and Pitman 1998: 158; Baker from Yanko-Hombach et al. 2009: xii, xx). Moreover, the humans living in the area quickly scattered, taking with them and passing down

through the generations the story of the great flood, which, the authors claim, was the basis for the Book of Genesis<sup>18</sup> (Ryan and Pitman 1998: 50-51).

Another long term effect of the flood resulted in the Sea's great depths and one of its more unsavory attributes; its position as the world's greatest repository of anoxic, or oxygen deprived, water. This is a phenomenon whereby the heavier Mediterranean sea water rested at the bottom of New Euxine Lake, while fresh water, carried by the numerous rivers that emptied into it from the north, deposited on top. Over the centuries sediment from these rivers also settled on the sea floor, and mixing with the saltwater created a toxic brew of hydrogen sulfide (Mee from Aybak 2001: 134; Ascherson 1995: 4-5).

In a fascinating hydrological balance, the Sea in its current state is split in three horizontal layers, with an upper, middle and lower portion. The lower or sulfidic zone exists in a dead, oxygen deprived state, so hazardous to life that few creatures can survive.<sup>19</sup> The middle, or suboxic layer, is where the top and bottom layers blend in a "transition zone." The top or oxic zone is the most conducive to supporting life. It acts as a security blanket, containing the bottom two layers and preventing an escape of hydrogen sulfide; the cloud from such a release, should it ever occur, could prove deadly to countless littoral inhabitants (Murray from Yanko-Hombach et al. 2009: 3; King 2004: 17). The threat of such a catastrophe has many local health officials and leaders worried about the condition of the oxic zone which has suffered from centuries of pollution and neglect.

The Black Sea is virtually landlocked; its only means of access to external seas is through the Bosphorous Strait located at the Sea's southwestern edge. At its most narrow the Bosphorous is under a kilometer, and slightly over 3.5 kilometers at its widest. It is also shallow; ranging between 30 to 100 meters deep. Coupled with the strong currents, winds and fog prevalent during certain times of year, it presents navigation hazards to even the most experienced sea captains. The Bosphorous is actually the northernmost passage in a more complex waterway. Moving north to south, the Bosphorous connects to the Sea of Marmara, which in turn adjoins another narrow passageway, the Dardanelles. The Dardanelles then open to the Mediterranean via the Aegean Sea. These three unique waterways, the Bosphorous, Sea of Marmara and the Dardanelles will be referred to as the Turkish Straits (Murray from Yanko-Hombach et al. 2009: 1-2).

In many respects, the Black Sea is at odds with itself with each layer outlined in contrast, though unable to overwhelm the others, existing in an ecological stalemate. The Sea's upper layer supports a rich variety of marine life, ranging from the Mediterranean monk seal, to anchovies, sturgeons and carp. However, man's presence on the sea pushed the monk seals into near extinction, and the once seemingly endless fish populations were culled to dangerously low levels. Foreign species, either accidentally or deliberately introduced, such as the comb jelly (*Mnemiopsis leidyi*), which feeds on plankton and fish larvae, have devastated the indigenous sea life (Mee from Aybak 2001: 135-136; Kamburska et al. 2006). This delicate natural balance

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<sup>18</sup> Also see Chapter 2 of Shalva Jaoshvili's "The Rivers of the Black Sea," European Environmental Agency, Technical report No. 71, 2002.

<sup>19</sup> Ancient shipwrecks have been recovered in remarkably good condition after centuries underwater, due to the preservative effect of the anoxic environment (King 2004: 18-19).

exists in much the same way in the human sphere as the population on the Sea's littorals has endured in a state of near perpetual conflict. In fact, man's relations with his fellow humans have been equally destructive, the scene of horrific tragedies and of self-inflicted hardships, testament to his willingness to brutalize his neighbors.

Throughout much of its history, control of the Black Sea and the littoral areas has been bitterly contested between advancing and receding empires. Even during periods of relative calm or local hegemony, such as the Byzantine or Ottoman periods, access to the Sea was jealously guarded by the dominant powers, limiting trade and intercultural contacts. The successive waves of invaders, nomads and immigrants have left a rigidly compartmentalized and fragmented society with deep ethnic and cultural barriers. Despite examples of diverse peoples living in peace, suspicion lurks beneath the surface, capable of exploding into violence at a moment's notice. Ultimately, this contestation prevented the littoral states from developing cohesion and effectively stunted their long-term political, economic and social growth.

There is a certain hazard with trying to encapsulate nearly two millennia of human experience in a handful of pages, however the intent is not to present a history for its own sake, but to provide a background and reinforce the concept that the wider Black Sea area's legacy of contestation has forged its modern identity. The ancient historical foundation of the Black Sea is a compelling story, though it will only be touched upon briefly; the primary focus is on the 19<sup>th</sup>, 20<sup>th</sup> and 21<sup>st</sup> Centuries as the period most relevant to this analysis.

Records exist of Phoenicians and Assyrians exploring the Black Sea as early as 1200 BC, though the most consistent and reliable history of human settlement dates to the beginning of the 8<sup>th</sup> Century BC, when Ionian Greeks established settlements along the coast (Herrmann 1954: 98). The early Greek inhabitants were following the massive anchovy schools on their counterclockwise migration around the sea, but later settled permanently to exploit the rich soil and mineral resources (Ascherson 1995: 5). This Greek colonization would create the region's commercial, administrative and cultural framework for centuries, and this residual influence is present today.

The ancient Greeks frequently came into violent contact with the Scythians, an ethnically Persian nomadic people from the steppes of Central Asia. This early division of cultures defined the East-West confrontation accentuating the landed versus nomad, civilized versus barbarian; a theme of the dangerous "other" which has played out countless times in history and with tragic consequences. According to Strabo, the ancient Greek geographer, the earliest name given the Sea was Pontos Axeinos, "inhospitable sea," for the violent storms that seemed to spontaneously appear, forcing sailors to hug the coastline (Ascherson 1995: 1). However, once Greek civilization was firmly entrenched and maritime activity became more or less routine, the name changed to Euxine Pontos, "hospitable sea," or simply, "ho pontos;" "the sea." It is unclear when it started being referred to as the Black Sea, though it is possible to describe the water's dark color or, more likely, a reference to the sea's fearful reputation as a graveyard for innumerable ancient mariners (Herrmann 1954: 98, King 2004: xi-xii).

Greek cultural and economic dominance waned in the latter decades BC, as Roman military power supplanted Hellenic influence. Rome's control of the Sea was fleeting; naval forces

engaged primarily in sporadic counter-piracy operations, but never maintained full control. Roman power ultimately gave way to the Byzantines which became the dominant regime for nearly one thousand years. Byzantine control was more pervasive than the Romans and extended to the northern shore for much of their hegemony. The Byzantines saw the Sea as a sovereign body of water, and were determined to control foreign access while ensuring that Constantinople, the “paradise of monopoly, privilege and protectionism,” and the center of Byzantine political, cultural and social life, was supplied with necessities. Successive hegemonies followed the Byzantines, notably the Ottoman Turks and the Soviet Union, both of which adhered to the “closed sea” policy (Langer 1968: 186, 107-108; Diehl 1957: 89).

From roughly 1200 to 1400 AD, the Mongols controlled much of the area to the north and east of the Black Sea. Though capable of great violence and destruction in pursuit of conquest, once firmly in control they realized the benefit of stability and the rule of law in their acquired territories, which specifically applied to the value of trade as a source of tax revenue. The Mongols encouraged Italian merchants to establish trade links, and it was through this collusion that Venetian and Genoese merchantmen solidified their operations in the region via the Silk Road, a vast network of land and sea routes extending from Europe to Asia. The Silk Road brought inter-cultural contact and great wealth, but also tremendous human suffering through devastating disease and a steady supply of slaves<sup>20</sup> (Ascherson 1995: 17-18 and 92-96; Onacewicz 1985: 22; Ozveren 2001: 74-76).

This 200 year period of domination was unusual in its relative stability and prosperity, particularly on the Sea’s northern littorals. At the close of the Mongol period, the Ottoman Turks emerged as a leading contender for regional power. Turkish power grew throughout the 15<sup>th</sup> Century, mostly at Constantinople’s expense, and by 1461 the last vestiges of the Byzantine Empire had been eradicated, leaving the Ottoman Empire firmly in place on the Black Sea’s southern shore (Dupuy 1994: 327, 366-380, 421, 424). Over the next several centuries, while the Ottoman’s were consolidating their control over Anatolia, South East Europe and North Africa, the Persian empire was also pushing into the Caucasus and the Caspian Basin. Moreover, a growing Russian Empire was slowly moving southward, overwhelming everything before it.

It was in the 1870s that the Russian Caucasus, notably Baku, Azerbaijan, was propelled to the world stage as a repository of oil which, when refined, produced kerosene, then becoming prominent as an illuminant. The local inhabitants had known for centuries about the mysterious, thick liquid that seeped out of the ground, and used this for a variety of purposes to include health care remedies, lighting and crude incendiary devices, but it had never been exploited on a large-scale. Drawn by the promise of tremendous fortunes to be made in the new and exciting industry, this period saw an influx of foreign financiers, engineers and laborers which placed Baku at the forefront of the global oil industry.

This feverish activity centered on Baku and the wells of the Apsheron Peninsula, a hook-shaped body of land that juts into the Caspian Sea. The Rothschilds and Nobels made their way to Baku to establish global companies centered on the oil industry, directly competing with John D.

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<sup>20</sup> Strabo, as noted in Riasanovsky’s “A History of Russia,” referred to east-west trade routes through the south Russian steppes well before the Mongols arrived, indicating the Silk Road merely replaced and enhanced these existing routes (Riasanovsky 1984: 41-43).



Rockefeller's Standard Oil (Yergin 1991: 60-61; Levine 2007: 5, 14-25). In 1883 Baron Alphonse Rothschild financed a railroad line from Baku to Batumi, a port on the Black Sea in what is now Ajaria province of Georgia, which introduced Russian oil to the global market and began the long and storied tradition of that country's global influence (Goldman 1980: 16-17).

To support the fledgling kerosene industry, high tariffs kept Rockefeller at bay while the Russian commercial foundation was able to develop and flourish. Oil production peaked in 1901 just as the shallow wells around Baku were becoming depleted; early 20<sup>th</sup> Century drilling technology was unable to go below 750 meters. Though new fields were found near Grozny, Chechnya, production levels dropped when a series of strikes and civil and labor unrest, partly instigated by Joseph Stalin, erupted in Batumi and later Baku between 1901 and 1907. These events and the 1905 revolution had a devastating effect on the oil industry in the Caucasus, all leading precipitously to the slow and painful collapse of the Romanov's caused by World War I and the Russian Civil War (Goldman 1980: 16-17, 20; Grace 2005: 7-8, 10-12).

The war proved disastrous for all the European belligerents, but no less so for the Ottomans. As allies of Imperial Germany, the Ottomans would suffer for this partnership; a chaotic post-World War I Turkey became embroiled in conflict with Greece supported by the Allied powers. After suffering early reverses, Turkey, led by Mustafa Kemal (Ataturk), was able to stabilize the military situation and concluded an end to hostilities. Peace came at a high price for the Ottomans under the Treaty of Lausanne (1923); their empire was dismembered and its vast territory picked apart by the victorious European powers, leaving a weakened and vulnerable Turkish rump in Anatolia. A further diminution of Turkish power was in the Aegean Sea where most of this vital waterway fell under Greek control, a course of events which would have ramifications to the current day. The treaty provided that the Turkish Straits would remain neutral, though in 1935, Turkey petitioned for, and the next year received, controlling rights to the Straits in the Treaty of Montreux (Langer 1968: 1085-1088).

Tsarist Russia was also thrown into turmoil and bloodshed in the post-World War I era. Tsar Nicholas II was deposed and murdered, precipitating a civil war which raged from 1917 through 1922, and resulting in a reconstituted Russia as the Soviet Union. In the ensuing chaos, the empire did not fully disintegrate, in fact the Bolsheviks were as aggressive in their territorial ambitions as the Tsarists; newly independent republics in Armenia, Azerbaijan and Georgia were snuffed out, and, in the 1930s, Ukraine was deliberately and literally starved into submission. In 1918 Bessarabia, much of what is now Moldova, was occupied by Romanian troops and remained under Bucharest's control until 1940.

After the civil war, the new Soviet government initially kept foreign investors and petroleum experts out, but Moscow soon realized it could not compete without external capital and technical assistance. The foreigners with their new technologies, such as the rotary drill in use in the United States, which allowed greater production levels, were invited back. Before long the Caucasus wells were producing and contributing to the Bolshevik hold on power. By the late 1920s, when production had recovered to pre-War levels, many of the Western concessions were revoked (Grace 2005: 8-10; Goldman 1980: 24).

During World War II, the Black Sea region gained prominence as a strategic objective; specifically, the Baku and North Caucasus oilfields were a main target of German military ambitions, and a significant portion of the Black Sea's littoral area fell under Axis control. Germany was never able to secure Baku's oil deposits, and, ironically, Azerbaijan's oil contributed mightily to Hitler's defeat. World War II was the last time the Sea and its littoral areas held such significant geopolitical interest. The Black Sea's isolation was reinforced in the decades following the war, when these states existed as hostages to an ideological divide superimposed by Cold War realities. Though Turkey, as a NATO member, continued to exercise sovereignty over the Straits via the Montreux Treaty, the Black Sea fell into the Soviet orbit, a victim of the East-West schism. The Soviets and their Warsaw Pact allies, Bulgaria and Romania, closely controlled access to the Sea, effectively replicating the same policies of previous hegemony, and contributing to the region's deeper isolation (Ozvdren 2001:78).

The collapse of the Soviet Union precipitated a flurry of post-Cold War political and economic activity. It awakened multiple long-dormant ethnic and religious conflicts, as well as renewed self-determination movements and intra-regional wars. This phenomenon also created a host of 'new' or non-traditional security threats ranging from human trafficking, nuclear proliferation, environmental degradation, growing terrorist threats and entrenched organized crime. Finally, it is impossible to overlook the impact of energy; a high value commodity superimposed on an already fractious political, religious and ethnic environment. Moreover, Caspian and Central Asian oil and gas deposits, as well as new discoveries in the Sea itself, have pushed the region into the global economy and public awareness. This is further reinforced by the admission of Bulgaria and Romania to the EU and NATO, and with these organizations now solidly situated on the Black Sea's western shore, the Euro-Atlantic powers have a stake in the region's security and development.

Bratianu's comment about the perpetuity of the Russian-Turkish power struggle is now coming into question. A major change in the European geo-political landscape since Bratianu was the emergence of the EU, its presence as an economic force and the growing interdependence with the Black Sea states. This is particularly relevant with the former Soviet republics anxious to benefit from European markets and distance themselves from Russian domination through the relative stability and security of the EU. In light of such additional concerns as global energy security and reinvigorated nationalist and secessionist tensions, it can be argued that the Black Sea RSC occupies attention far beyond its regional boundaries; in other words it is now a "global space."

## Setting the Geo-Political Stage

Having established a rough historical context, the next step in developing this regional foundation is to look at the individual players and their contribution to answering the research question. This section identifies the unique characteristics of the Black Sea RSC's ten component states, touching on the recent history and economic foundation, mostly concentrating on the post-Soviet era. Finally, each state narrative will contain a brief historical and economic background followed by an overview of its energy sector, with the goal of providing a deeper understanding of the Black Sea Ten and how they fit within the RSC. As the largest and dominant state, Russia is analyzed first, with the remaining states listed in alphabetical order.

## Russia

Russia holds a unique position as both a littoral state and great power, and from this dual vantage point it operates relatively freely both inside and outside the Black Sea RSC while it performs on the global stage. Moreover, one of the world's top energy producers and possessing a formidable conventional military and nuclear force, Russia's ability to wield power and influence beyond its borders far outclasses its Black Sea neighbors. Bolstered by energy revenues, Russia under Putin is determined to regain its status as a global power, a position it had humiliatingly lost in the turmoil following the collapse of the Soviet Union. For these reasons, Russia is *the* consequential regional player within the Black Sea RSC.

Throughout history, the Black Sea was a central feature of Russia's territorial expansion, accentuated by Moscow's keen sense of vulnerability and its demand for security, which created an obsessive need to push its borders outward to distance itself from potential enemies. Russia's relationship with the Black Sea's littoral inhabitants has been difficult and emotional, culminating in a centuries-long struggle of conquest and subjugation. To this day the Caucasus holds a romanticized place in Russia's cultural and literary heritage. The southern territories are particularly important; Ukraine roughly translated means "borderland" and the term "little Russia" is a common reference to this part of the traditional Russian empire.

The current Russian foreign minister, Sergei Lavrov, summed up his country's historical perspective on this relationship noting, "...the whole heritage of the Russian history is connected with this region (Black Sea) where my country has always been a main player in various fields. This is even truer regarding the present and future" (Lavrov, June 1, 2006). Aside from a manifestation of national pride and accomplishment, control of the Sea was also a vital geopolitical asset; a warm water gateway to the world, as well as a source for fishing, agricultural industries and mineral wealth.

Moving forward to the early 21st Century, Russians bitterly resent the loss of their southern empire; Ukraine and the southern Caucasus republics, which took the better part of three centuries and untold loss of life and treasure to subdue and integrate, were granted independence with the stroke of Mikhail Gorbachev's pen. From a Western perspective it is difficult to understand the anger and frustration felt by many Russians by the loss of prestige and world standing in the early 1990s. As Russia was the nucleus of the USSR, the Soviet collapse seemed to strike at the heart of national identity as a powerful and respected state, leaving many disillusioned and fearful of the future. Accompanying this disintegration was sharply reduced geographic borders including many resource-rich republics in the Caucasus and Central Asia. Independence also narrowed Russian access to the Black Sea as the common coastal area was divided between Russia and the newly independent littoral states of Ukraine and Georgia. A notable loss was the Ukrainian port cities of Odessa and Sevastopol, the latter being the location of Russia's Black Sea fleet.<sup>21</sup>

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<sup>21</sup> Russia lost more than half of its original Black Sea coastline though retained Novorossysk, its only modern port, and the smaller port of Tuapse (Kovalsky from Aybak 2001: 163). The Black Sea fleet was split between Russia and

After independence, Russia tried to maintain influence over its former empire by creating the Commonwealth of Independent States (CIS) and providing subsidized oil and gas and other economic incentives. As these new countries were experiencing economic turmoil in the transition economy, this was a very welcome benefit, though, as will be demonstrated, these subsidies also created a dependency which has proven difficult to break (Grace 2005: 68). In 2010 the EEU, comprising Russia, Armenia, Belarus, and Kazakhstan was launched, seen as a first step towards a broader economic alliance of FSU states and as an alternative to the EU.<sup>22</sup>

When Russia achieved independence on August 24, 1991, President Boris Yeltsin was instrumental in implementing democratic and economic reforms in a country with no history of true representative government or a market economy. A post-1991 welter of taxes levied from federal and local jurisdictions feasted on oil and gas revenues and deprived that sector of investment capital. Perhaps most pernicious was the “exploration tax” which had the direct effect of stifling new discoveries (Grace 2005: 41-42). In 1992, with the help of Western advisors, an embryonic legal structure was established which provided for a market economy and foreign investments within the emerging private sector. Central to the 1992 legal foundation was the attempt to reform the oil and gas sectors through privatization, though this proved to be inadequately conceived, as well as imperfectly implemented and enforced (University of Texas-Austin 2001: 4; Victor 2008: 47-48).

The post-communist transition was a period of political and economic instability with endemic corruption, lawlessness, and a shocking military defeat in Chechnya, all of which contributed to a sense of hopelessness and despair for the average Russian. Furthermore, many of the post-communist era reforms under Yeltsin failed to improve conditions, while privatization efforts allowed a small group of politically connected businessmen, the “Oligarchs,” to exploit their position and amass tremendous wealth. At the height of this period of national distress the 1997 Asian financial crisis spread to Russia the following year, brought about by the country’s large debt and unstable currency. This was exacerbated by OPEC’s 1996 decision to increase production which, by 1998 had forced the price of crude to drop from \$20 per barrel to \$13.<sup>23</sup> Russia’s oil companies were crippled, losing a cumulative 70 percent of their valuation (Grace 2005: 81-83).

With artificially high, fixed exchange rates, the ruble further destabilized dragging down the economy as Moscow spent its limited hard currency trying to defend it. By August 1998, as capital flight took hold, the banking system was on the verge of collapse, forcing the IMF and World Bank to intervene under the mantra that Russia was “too big and too nuclear to fail,” though this effort was too little too late. Russia was forced to devalue the ruble and defaulted on its short term obligations, leading to a difficulty in assuming further risk and capitalizing the bonds<sup>24</sup> (Blustein 2003: 237-238).

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Ukraine; the Russian portion of the fleet is docked in Sevastopol on a long-term lease arrangement. Russia’s March 2014 annexation of Crimea has not been recognized by the larger global community.

<sup>22</sup> Kyrgyzstan is set to join, though a formal date has not been announced.

<sup>23</sup> In 1998 denomination.

<sup>24</sup> By May 1998, government bond yields increased to 47 percent with inflation at 10 percent. Though Russian banks would normally have taken the government paper, there was a lack of confidence in the ability to repay the bonds, so investors became increasingly cautious of risk (Victor in email to the author, February 15, 2014).

Perhaps the most noticeable phenomenon during the crisis was the lack of Russian leadership. Yeltsin was ill and in seclusion, and the newly installed prime minister, Sergei Kiriyenko was hopelessly overwhelmed<sup>25</sup> (Shevstova 2005: 10-14). The crisis produced considerable resentment of the IMF and the West in general, but this was also seen as another failure of national leadership and cause for humiliation. By 2000, the combination of the free floating ruble and the subsequent doubling of the price of crude allowed Russia to make a rapid recovery. Within 18 months there was a \$29 billion surplus and the crisis was all but forgotten<sup>26</sup> (University of Texas-Austin 2001: 2).

As the 1990s came to a close, Yeltsin became increasingly unpopular, while his inner circle of friends and family members shielded him from the public (Shevstova 1999: 16; Shevstova 2007: 27). Succumbing to poor health and the stress of public life, Yeltsin resigned the presidency effective December 31, 1999. Though Yeltsin is credited with overseeing the peaceful demise of the USSR and introducing democratic principles, he and the post-Soviet leaders failed to nurture true economic and political reform. In the end, these structural reforms were too shallow and imperfectly planted and subsequently easily uprooted. Yeltsin died in 2007, and it can be claimed his legacy is viewed more favorably by non-Russians, as many of his countrymen associate him with economic hardship, national decline and global humiliation.

On January 1, 2000, Vladimir Putin, Yeltsin's prime minister and hand-picked successor, became president. Putin, a former KGB colonel and senior member of St. Petersburg mayor Anatoly Sobchak's staff, made a name for himself in the early 1990s as a bright and ambitious political operative. Upon assuming the presidency, Putin began the process of reestablishing internal stability and international respect for Russia, primarily by imposing stronger state control over the economy and political activity. The centralization of power and Putin's ascent came with an implied bargain; the Russian people would give him power in return for stability and a renewed position of respect for the country (The Economist, (2) Eastern Approaches, November 1, 2012).

Putin succeeded during his early years in office; by conducting a particularly brutal counterinsurgency campaign he concluded the Chechnya war on Russia's terms and initiated much needed military and economic reforms. It was in the economic and political realms where he reasserted government control, most notably over the energy sector. Renationalization of energy coincided with a spike in oil and gas prices, and by the summer of 2008 the price of Urals blend, the Russian export crude, reached an unprecedented \$145.29 per barrel, creating a windfall in government revenues<sup>27</sup> (Top Oil News, July 3, 2008; Gustafson 2012: 363).

Riding the wave of high oil and gas prices of the mid-2000s, Russia was "awash with cash," putting Putin and the state at the height of political and economic power (Gustafson 2012: 363). In fact, the period of 1999-2008, the so-called "Growth Decade," saw poverty drop from 29 to 13

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<sup>25</sup> Earlier in 1998 Yeltsin replaced Viktor Chernomyrdin, the popular and pragmatic prime minister, with the younger, inexperienced Kiriyenko, who took responsibility for the crisis and resigned on August 23, 1998.

<sup>26</sup> This led to an 86 percent inflation rate in 1999, compared to 28 percent in the previous year (University of Texas-Austin 2001: 1).

<sup>27</sup> By comparison, the Brent benchmark was \$147.27 during this period (Gustafson 2012: 363).

percent, while opinion polls showed new highs in public satisfaction (Aslund 2010: 10-12). Under Putin, Russia strode with renewed confidence on the world stage, for which he was rewarded in 2004 with a “managed” reelection. With GDP growth at 7 percent, it ranked second to China among the BRICs, and this growth permitted increased military spending which translated directly into renewed geo-political power, particularly in Russia’s near abroad.<sup>28</sup> In his second term, Putin reinforced the “power vertical” that was introduced in 2000 by further strengthening the top-down, authoritarian role of the presidency, and rolling back hard won democratic reforms of the Yeltsin era (Shevstova 2005: 6, 302-304).

It would be easy to ascribe the Russian renewal solely to the oil and gas price spike of the mid-2000s, but that is not the full story. Liberalization policies enacted in the early 2000s, highlighted by the 2001 tax reform and reinforced by reduced interest rates, helped small businesses and entrepreneurs, which, in turn, spurred consumer spending (Aslund 2010: 10-12; Grace 2005: 41, 78-79; Victor 2008: 54). Moreover, as Russian companies began to compete among themselves and in the international arena, they were forced to implement new technologies and universal best practices which increased overall efficiencies (University of Texas Austin 2001: 4).

Much of the credit for “Putinomics” can be given to the popular and unassuming finance minister of this period, Aleksei Kudrin, one of Putin’s St. Petersburg colleagues. It was for his competence and professional reputation that Kudrin was given considerable autonomy and additional responsibilities in handling state finances<sup>29</sup> (The Economist, (3) October 1, 2011: 54; Kommersant, May 13, 2008). By 2008, under Kudrin’s guidance, Russia had amassed sovereign wealth funds in excess of \$700 billion and is credited with helping Russia weather the 2008-2009 crisis through government stimulus efforts (Gustafson 2012: 360-361).

Russia joined the World Trade Organization in 2012, which allows greater market access for its goods and services, and providing it greater credibility in international trading circles. In recent years Russia has had difficulty attracting foreign direct investment (FDI) and has seen capital outflows, much of this caused by nervous investors responding to Russia’s activities in Georgia and Ukraine and the Western sanctions that followed. This has also prompted state-supported efforts to enhance the country’s rankings for its investment and business environment. In 2007, in an effort to diversify from its dependence on commodities, the Kremlin initiated a program to develop the country’s high technology industry (CIA, (1) Russia date accessed March 16, 2016).

The global economic contraction beginning in 2008 did have an impact on Russia. According to the World Bank the government’s anti-crisis package in 2008-09 amounted to roughly 6.7 percent of GDP. The economic decline bottomed out in mid-2009 and the economy began to grow again in the third quarter of 2009. The recession also contributed to heavy deficit spending; in 2010 there were \$264 billion in state revenues against expenditures of \$321 billion. High oil prices boosted growth in 2011-12 and helped Russia reduce the budget deficit inherited from 2008-09 (CIA, (2) Russia, date accessed March 16, 2016). More recently, generally weak

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<sup>28</sup> In 2001 Goldman Sachs economist Jim O’Neill coined the term “BRIC” in his paper “The World Needs Better Economic BRICs,” to account for the (at that time) four largest developing countries of Brazil, Russia, India and China.

<sup>29</sup> Kudrin was dismissed in 2011 for engaging in a well-publicized policy disagreement with then-President Medvedev.

European demand, Russian's primary market, has impacted long-term growth. Putin's goal of 5 percent growth for 2013 was wildly optimistic, more realistically it was between 1.6 to 1.8 percent for that year (Hille, November 7, 2013). Russia's GDP growth has steadily diminished, with a -3.8 percent for 2015 (The Economist, (4) December 19, 2015).

In the immediate aftermath of the Crimean and Ukrainian crises, the US and the Western allies began imposing ever-stronger sanctions on Russia, mostly directed against the country's leadership, but also impacting its financial and energy producing players. Indications are that the sanctions are having an effect; diminished GDP growth while capital flight in the first quarter of 2014 was between \$60-70 billion (The Economist, (5) April 19, 2014: 56-57). Continued capital flight and the fall of the ruble in late 2014 point to further weakening economic indicators. In late 2015 the Russian inflation rate was 15 percent, while unemployment held at 5.5 percent (The Economist, (6) December 19, 2015). The 50 percent drop in the price of oil beginning in late 2014 is also having a significant impact on the Russian budget. Russian finance minister Anton Siluanov, noted that 2015 revenues will be \$180 billion less than anticipated, which will impact the country's military reforms and other efforts, such as badly needed domestic spending (Qiu March 15, 2015).

It is impossible to discuss Russian domestic politics without considering its close relationship with the energy sector, which is responsible for filling the state coffers and seen as a source of wealth and a stepping stone to national leadership and influence. Surrounding Putin in his inner circle is the siloviki, a clutch of ex-KGB officers in whom Putin has placed considerable trust. In addition to the intelligence contingent are Putin's former St. Petersburg colleagues, which combined with the siloviki create a tight knit group holding key public and private sector management positions. These Putin associates predominate in Russian energy companies, for example, Dmitry Medvedev, Russia's former president and current prime minister, was Gazprom's chairman before being elevated to national leadership. Igor Sechin, a former intelligence officer and Putin's chief of staff before he was put at the head of Rosneft, is considered to be one of the most influential men in Russia. Alexei Miller, Gazprom's president, was subordinate to Putin while both were in the St. Petersburg mayor's office (Shevstova 2005: 86; Smith 2004: 24-26; Gustafson 2012: 247-248).

In 2003 Putin's plan to re-nationalize the energy industry started in earnest when he began replacing oil and gas executives with siloviki or other political allies (Fredholm 2005: 3; Smith 2004: 24-25). The Kremlin also began to bring the Oligarchs and the various energy corporations under tighter central control (Aalto 2008: 168). In August of that year, the then-Ministry of Industry and Energy released the "Russian Energy Strategy to the Year 2020," which outlined this policy shift.<sup>30</sup> The report proved to be one of the more insightful documents, as it defines the state's role in creating the market infrastructure as a regulator of market interaction and efficient management of the state energy assets. This would be accomplished through efforts to regulate and develop an efficient market system through coordinated tax, tariff, customs, and broad-based institutional reforms (Energy Charter, (1) Russian Federation 2007).

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<sup>30</sup> The Russian state energy policy, also released in 2003 and developed in concert with, but subordinate to, the strategy, states its primary goal to effectively use natural resources "for economic growth and improvement of life quality" (Russian Federation 2003: 2).

The strategy confirmed what had been evident since early 2000; Putin's desire to renationalize the energy industry, and foreshadowing a more aggressive role of the government in the energy sector, announcing the extent to which Russian energy would influence foreign policy:

The strategy called for a "... common energy...and transport infrastructure in the regions of Europe and Asia, [and the] development of the international energy and transport systems, providing of (sic) the ... transit of energy [to] *answer the strategic interests of Russia*. In order to reach these aims, the state will foster the participation of Russian joint-stock companies in development and realization of the great international projects of transport of gas, oil and energy both in western and eastern lines" [italics added] (Russian Federation, Ministry of Energy 2003: 12).

The Ministry of Energy, with oversight of Russia's primary revenue creator, holds a key position within the government by providing oversight of the energy sector and working closely with the state-run firms.<sup>31</sup> Under Alexander Novak, a key Putin lieutenant, the Ministry develops and implements national energy priorities and intergovernmental agreements. It also provides guidance to Russian companies operating outside the country to facilitate access to world energy markets. Finally, the ministry promotes stable relations with consumers and negotiates multilateral and bilateral energy agreements (Kommersant, May 13, 2008; Russian Ministry of Energy website, date accessed January 18, 2014).

The ministry's board of governors comprises an elite cross-section of industry leaders and government officials, and establishes long-term strategic direction for Russia's energy sector (Russian Ministry of Energy website, date accessed November 11, 2013). At the May 21, 2013 meeting, the board acknowledged the need for a vast modernization effort within the energy sector. This addressed a host of new technologies, more specifically in pipeline operations, enhanced extraction techniques, offshore exploration and production and exploiting unconventional oil and gas resources. It was in this capacity the board noted the "shale revolution" and the need to develop LNG markets, to offset reduced European energy demand; the implication being to find new markets in Asia and develop the supporting infrastructure. Additional reference was made to enhance Russia's renewable energy capabilities. The report concluded: "To solve these problems without rapid modernization, increased...investment...and reduced energy intensity of fuel...is not possible" (Russian Ministry of Energy, College of Energy website, date accessed November 12, 2013).

The board optimistically anticipates the cost for this modernization effort at "about" \$ 1 trillion USD, over an unspecified time frame and with a surprising lack of specificity and formalized courses of action. Nevertheless, this proved to be a very revealing document in that it telegraphs Russia's acknowledged technological shortcomings and areas where future investment will be made. By analyzing the strategy, six key technology clusters can be identified:

- Pipeline technologies
- Well recovery and enhanced extraction techniques
- Offshore exploration and production

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<sup>31</sup> Until 2008 it was the Ministry of Energy and Industry.



- Unconventional sources (Shale, tight oil, oil sands)
- LNG terminals and infrastructure
- Renewable energy sources

According to the IEA, Russia's proven oil reserves total 80 billion barrels, considerably below Saudi Arabia's 300 billion barrels, though the two nations are at near parity in production capacity with approximately 11 million b/d (EIA, (1) Russian Country Analysis, 2014: 2). Of the roughly 7 million b/d of oil exported in 2011, Germany and the Netherlands received the majority (80 percent), while Asia imported 12 percent and the remaining 6 percent went to the Western Hemisphere<sup>32</sup> (EIA, (2) Russian Country Analysis 2014: 2).

The dominant oil company, state-run Rosneft, produced 2.5 million b/d in 2012 (EIA, (3) Russian Country Analysis 2014: 7). Founded in 1993, Rosneft struggled as the larger private firms, Yukos and Lukoil, garnered the most productive fields and foreign investment capital. By the mid-2000s this changed as the Kremlin began to dismantle much of the private sector competition, notably Yukos, and fed the best pieces to Rosneft.<sup>33</sup> Competition from other state-owned firms is limited; the example being TNK-BP, which was bought in its entirety by Rosneft in late 2012 (Torello March 8, 2013). Independent oil companies do exist, such as Novatek and Lukoil, whereby the latter company produced 1.7 million b/d in 2010, a distant second behind Rosneft (EIA, (4) Russian Country Analysis 2014: 7). Though Lukoil is technically a private company, some of its past and current leaders are former KGB members and hold close ties to the Kremlin, so its independence is questionable (Smith 2004: 41-42).

Russia's other main private sector company provides an interesting contrast. Novatek, Russia's largest independent natural gas producer, is arguably the most aggressive and independent of the public and private sector companies by actively seeking niche markets and foreign partners. In this regard it behaves more like a Western company than a Russian one (Victor email to the author, March 21, 2014). Created in 1994 as "Novafininvest," the name was changed in 2003 to the simpler Novatek (Russian Oil Companies, date accessed November 30, 2013). In comparison to Lukoil, the company's chairman, Alexander Y. Natalenko, is a geologist by training, while the CEO, Leonid Mikhelson, started out as a construction foreman and worked his way up as a civil engineer (Novatek website, date accessed November 30, 2013).

Considering the vast distances between Russian oil sources and the end consumer, oil pipelines play a critical role in Russia's export and domestic markets. Rosneft does not run the oil pipeline infrastructure in Russia, a function performed by Transneft, the state-run operator. Transneft maintains 50,000 kilometers of pipelines, much of which was inherited from its Soviet predecessor, Glavstransneft<sup>34</sup> (Gustafson 2012: 80). The most notable of Russia's oil pipelines is

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<sup>32</sup> According to Victor, the energy services and analysis company, DeGolyer & MacNaughton, determined Russia's recoverable reserves at between 150 to 200 billion barrels (Victor 2008: 17).

<sup>33</sup> Yukos prospered under Mikhail Khodorovsky, yet it was his very success which made him a threat to Putin. When Khodorovsky began to publicly challenge Putin's authority, he was convicted on flimsy tax evasion charges and imprisoned. Yukos was broken up and sold to Kremlin insiders, much of it going to Rosneft (Grace 2005: 124-128). Khodorovsky was pardoned by Putin in December 2013.

<sup>34</sup> An exception to the Transneft monopoly is the Tengiz-Novorossiysk oil pipeline which is owned and operated by the Caspian Pipeline Consortium (CPC); See Chapter 3 for more detail. It was officially ruled in 2003 that the state, via Transneft, would control oil export pipelines (Gustafson 2012: 269).

the massive (5,327 kilometers) Druzhba, or Friendship, pipeline built in the early 1960s to supply the western USSR and Eastern European satellite states. Transneft's president and chairman, Nikolay Tokarev, a former KGB officer, was appointed to the position by Putin in 2007 (Transneft web page, date accessed November 12, 2013; Pipelines International September 2009).

Cross-border oil transit is conducted through the Transneft pipeline system, based on inter-governmental agreements or protocols. The Transneft subsidiary, Chernomortransneft, delivers oil to refineries in the Krasnodar area of southern Russia as well as the Black Sea ports of Novorossiysk and Tuapse with respective capacities of 960,000 b/d and 100,000 b/d (Energy Charter, (2) (Oil) 2012: 23, 71). Russian and some Kazakh crude transported by Transneft is blended to create the Urals grade.<sup>35</sup> Druzhba carries the Urals blend, which is either piped to Eastern and Central Europe, shipped by tanker from the Baltic Sea ports to Northwest Europe, or shipped from Novorossiysk to mainly Mediterranean customers. The small customer base, high sulfur content and heavier weight causes Urals blend to be sold at lower prices compared to other global brands. A high grade crude, Siberian Light, is transported to Tuapse (Energy Charter, (3) (Oil) 2012: 65; Top Oil News, date accessed December 28, 2013; Uniforex, date accessed January 11, 2011).

It is natural gas where Russia wields considerable geo-political power and holds a decisive competitive advantage. This is partly attributed to the growing popularity of gas in world markets for environmental considerations as well as its relative low cost and increased functionality, ranging from heating, electricity generation and transport. With nearly 50 tcm, Russia holds approximately one quarter of the world's proven reserves, 95 percent of which is located in Siberia or northern Russia. In 2009 Russia was the world's second-largest natural gas producer at 665 bcm, falling behind the US, which was starting to benefit from large scale exploitation of unconventional sources. In 2013, Russia produced 622 bcm of gas. Russia was the world's largest exporter at 203.9 bcm of natural gas in 2009, of which 142 bcm or 70 percent is exported to Europe<sup>36</sup> (EIA, (5) Russian Country Analysis 2012: 10-12; EIA, (6) International Energy Statistics, Russia, date accessed January 10, 2016).

The main player in Russia's gas industry is Gazprom, which began in 1965 as the Soviet Gas Ministry<sup>37</sup> (Victor 2008: 46). The company in its current iteration was created in 1989 by Victor Chernomyrdin, a former prime minister, and it was his influence which permitted Gazprom to gain its favored position. With 330,000 employees and 80 percent of the country's total natural gas output; the company by itself accounts for 10 percent of GDP and a quarter of state revenues (EIA, (7) Russian Country Analysis 2012: 10-11; Aslund 2010: 152-153). This dominance is

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<sup>35</sup> The exported Urals crude is a high-sulfuric blend of heavy and high-grade oil with some light oil. It is comprised of product provided by Rosneft, Lukoil, Surgutneftegaz, Gazprom Neft, TNK-BP and Tatneft (Top Oil News, "Oil Prices-Urals, Brent," Date accessed December 28, 2013).

<sup>36</sup> Russian export figures include Central Asian gas imports. Russia imports gas from Turkmenistan to meet occasional supply shortages. These purchases are heavily discounted and range between 70-80 bcm a year, though declining production and Turkmenistan's domestic problems indicate long-term reliance may not be possible (Victor 2008: 15).

<sup>37</sup> Gazprom traces its roots to wartime USSR (1943), when Glavgazprom built a gas pipeline from Saratov to Moscow (Victor 2008: 46).

codified through a legally sanctioned state monopoly which allows it to control the gas sector more completely than Rosneft, its closest parallel in the oil sector.<sup>38</sup>

A difference from the Russian oil sector is that Rosneft must rely on Transneft to export its product, while Gazprom's pipeline arm is organic. With an imposing position in both upstream and downstream markets, to include control of the domestic pipelines, Gazprom has unique influence in the Kremlin which translates into unrivalled political and economic power. Riding the energy price spike of the mid-2000s, Gazprom reached a market capitalization of \$362 billion in 2008, and this strong financial position allowed the company to initiate several expensive and technically challenging projects, notably North Stream, South Stream, Yamal and Shtokman<sup>39</sup> (Global Security 2013; The Economist, (7) November 4, 2010).

Yet despite its market dominance and impressive cash flow, Gazprom is a company facing tremendous challenges and, by extension, a potential negative impact on Russia's economic future. Gazprom amassed large debt in the 2000s, and by 2005, this had risen to \$28.5 billion, the highest corporate debt in Russia.<sup>40</sup> This did not go unnoticed by the Kremlin, which pressured the company to lighten its exposure (Victor 2008: 39). Gazprom has struggled in its concurrent production efforts, events coupled with the 2008-2009 crisis which have shaken the company's position atop Russia's corporate field. Indeed, 2011 and 2012 were difficult years for Gazprom.

In 2012, a one percent drop in global gas demand caused a 15 percent loss on its 2013 profits (Marson, February 8, 2013). In August 2012, Gazprom backed out of the Shtockman project and in September of that year the European Commission announced it was investigating Gazprom for unfair business practices (The Economist, (8) September 15, 2012: 52). In December 2014, it was announced that Gazprom was canceling the South Stream project, a large pipeline across the Black Sea, in favor of an ill-defined and now politically questionable Turkish route.

A concern among global energy experts is the marked depletion of the West Siberian gas fields, as well as the lack of a strategy for locating and financing new sources. The pending crisis finds Russia struggling to meet foreign and domestic obligations; it should be noted that Russian electricity demand is growing between 5 to 10 percent a year, and the government gives no indication of stopping the subsidies which deny Gazprom needed investment capital. Moreover, the new fields are found in distant and inhospitable locations, far from the consumer base, which makes access to capital and technology imperative, both of which are limited under Western sanctions (Victor 2008: 11, 14, 17).

Actions within Europe, both planned and unplanned, have also created problems for Gazprom; the combinations of the economic downturn, conservation efforts and market efficiencies have contributed to reduced demand. This includes sourcing non-Russian gas, notably from Norway's Statoil, which is luring European customers with better prices and flexible contract terms based on the spot market (Hoyt 2014: 18). Additional pressure is generated by Rosneft and Novatek,

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<sup>38</sup> Gazprom's monopoly status was legislated in 2005.

<sup>39</sup> As of March 28, 2015, Gazprom's market capitalization was \$55.26 billion (Wall Street Journal, March 28, 2015).

<sup>40</sup> This included a debt-to-asset ratio of 22, well above the industry average of 11 (Victor 2008: 39).

both of which have fledgling gas arms and are anxious to compete in the gas export market.<sup>41</sup> In 2013 legislation was passed, taking effect in 2014, which allows competing companies to export LNG, whereby Novatek hopes to directly challenge Gazprom's monopoly (Stratfor 2012: 3; Marson, November 14, 2013; Victor 2009: 17).

Finally, the burgeoning North American shale gas industry is impacting Gazprom's revenues. As the US exploits its own unconventional resources, LNG initially destined for North America, is being redirected to Europe or Asia. Cheaper US coal has found an eager market in Europe, primarily for electricity generation, also contributing to the drop in gas demand, raising stockpiles and pushing down prices. This activity has pressured Gazprom's business model which is dependent on long-term gas contracts tied to the crude oil index, as opposed to gas in the US or UK which is traded on the spot markets at lower, though fluctuating, prices (The Economist, (9) June 29, 2013: 63; Hoyt 2014: 18).

These external conditions are creating internal pressure within the Russian domestic gas market, threatening Gazprom's privileged position. Weak European demand has forced Gazprom to lower prices, provide rebates or both. Gazprom paid \$2.7 billion in rebates in 2012, and allocated \$4.7 billion for 2013, though these were not needed (Buckley, February 8, 2013). The culmination of Gazprom's troubles have generated debate in the Kremlin with calls to repeal the 2005 monopoly law and allow greater competition by spinning off its pipeline division (Stratfor 2012: 2; The Economist, (10) March 23, 2013).

Though weakened in the face of these internal and external challenges, Gazprom is fighting back. With strong upstream and downstream positions, it is still capable of investing in long-term projects, albeit with more difficulty in light of the Western sanctions. Initially, Russian energy leaders saw the emergence of shale gas as a threat to their commanding hold on conventional gas exports; Alexei Miller regularly demonized shale as being unsafe or having negligible impact. By mid-2013 it was impossible to ignore the changes underway in the global gas sector, and the company, under Putin's prodding, appears to have embraced this technique.

The same can be said with LNG; Russia resisted investing in LNG technology, though it is now actively pursuing this option with foreign partners. Finally, the company is looking eastward for markets. In late 2013, Russia agreed to ship China 38 bcm per year by 2018, 3 bcm more than it exports to Germany (Marson, March 22, 2013). In early January 2014, Russia and China agreed on a price of \$11 per MBTU for gas piped to the Chinese border (Hille, January 5, 2014). The infrastructure costs associated with this eastward shift are expected to be significant, though the Kremlin believes the long-term benefits are worth the investment.

The reforms of the early 21<sup>st</sup> Century revitalized the Russian economy, but has done little to reduce Moscow's precarious dependence on oil and gas exports. Indeed, oil and gas receipts provide the state with more than 45 percent of tax revenues, and are responsible for 60 percent of foreign exchange earnings (Russian Ministry of Energy website, date accessed November 11, 2013). This dependence is problematic in the long term, as it leaves the economy vulnerable to a

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<sup>41</sup> In 2013 Novatek produced 62.2 bcm, an 8.5 percent increase. Most of its gas fields are situated in the northwestern Siberian Yamalo-Nenets Autonomous Region with a total estimated reserve of 1.5 Tcm (Natural Gas Europe, (1) January 13, 2014).

volatile and cyclical commodity, the results of which we are now witnessing in early 2016 with reduced demand and lower prices compounded by sanctions.

Looking at the long-term trends, the oil and gas fields of Western Siberia are more than 40 years old and will require capital and modern technologies to meet current levels of production. Eventually, new fields must be developed, though Gazprom's current debt load, coupled with the impact of sanctions, makes that an unlikely prospect without external investment (Victor 2008: 20-21). Hence there exists an insoluble gap in which investors are reluctant to commit in an untrustworthy climate, and Russia is unable to meet its full economic potential and contractual obligations without foreign capital.

Finally, as has been repeatedly demonstrated in the post-Cold War era is Russia's willingness to use energy as a blunt foreign policy tool. Continued exploitation of its neighbors' energy weaknesses will perpetuate instability in its near-abroad, forcing states to either align closer to the West, enhance their own security postures, or reach an unfavorable accommodation with Moscow. This strategy demonstrates the lack of diplomatic depth available to Russia, whereby Moscow's most potent coercive mechanisms are its energy arm or military intervention. And while this policy bolsters Russia's short term geopolitical standing, it maintains an unhealthy dependence by the state on oil and gas revenues, manifest by resentment and counterproductive over the long-term.

Domestic instability and political machinations are perhaps the most significant challenges to Russia's long-term growth. An egregious case came in September 2011 when Dmitri Medvedev announced that Putin would run for president in the March 2012 elections, ending speculation about his candidacy and confirming that the "power sharing" arrangement was a cynical end-run around the Russian constitution (The Economist, (11) October 1, 2011: 53-54). In late 2011 and early 2012, amid the "power sharing" revelation, the persistent corruption, opaque government and creeping authoritarianism, a populist backlash erupted with protests and civil unrest, though there has never been a serious challenge to Putin's hold on power, and by 2015 Putin is the undisputed leader in Russia.<sup>42</sup>

Putin's authoritarianism has always been buttressed by the high price of oil and gas which masks deep-seated social and economic problems, and removes the impetus for long-term reform and allows power consolidation in the Kremlin's top echelon. Most Russians appear to accept such activity as the price of stability and global prestige that has been credited to Putin (Shevstova 2007: 25). In fact, the vast majority of Russians condone Putin's actions as he basks in 80 percent approval ratings (The Economist, (12) July 26, 2014: 9). Staffed with political allies, this 'trifecta' which is the Russian energy realm encompassing the state, the corporate and the personal, demonstrates there is little doubt that control of the energy sector is firmly held in Vladimir Putin's hands (Balmaceda from Aalto 2012: 144-145). The impact of Putin's control of Russian energy policy ensures his presence will be felt long after he leaves office.

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<sup>42</sup> Putin was constitutionally ineligible to run for a third term as president, so a "power sharing" arrangement was made with his prime minister, Dmitri Medvedev. The arrangement equaled a swap, whereby Putin moved to the prime minister position and Medvedev would assume the presidency for a single four year term, at the end of which Putin would again be eligible for the presidency. Additionally, before he left the presidency in 2008, Putin pushed through a constitutional change which extended a presidential term from four to six years, taking effect in 2012.

Russian resentment of the West, brought to light during Putin's 2007 speech, indicates there continues to be a strong sentiment of victimhood and revenge emanating from the Kremlin and which finds a receptive audience among the populace.<sup>43</sup> Subsequent claims by Putin that US or Western actors are behind the Ukrainian crisis, as well as the exploitation of unconventional plays, such as fracking, which have driven down the price of oil and gas, reinforce the theme of the Russian victim. This phenomenon whereby Russia's actions under Putin seem determined to settle old scores and make right real or perceived slights at the hands of Russia's enemies falls on sympathetic ears (Smith, Hanna from Aalto 2012: 126-127). This notion is further reinforced by the general perception that the Crimean annexation and civil war in Ukraine are being touted as a victory for Moscow in a geopolitical tug-of-war reminiscent of the Cold War. Putin still has a firm grip on power, though it remains to be seen if this continues as low oil and gas prices induce greater economic hardship.

## **Armenia**

Armenia's post-Soviet experience is highlighted by its conflict with Azerbaijan which lingers unresolved to this day. At the center of the dispute is the disposition of Nagorno-Karabakh, the ethnic Armenian enclave located within Azerbaijan's borders. Armenian calls for Nagorno-Karabakh to secede from Azerbaijan began before the Soviet Union's collapse and were met with resistance from Baku. Hostilities lasted from 1990 to 1994, in which Armenia, with Russian military assistance, occupied the disputed region as well as large swathes of Azerbaijani territory. Yerevan, now firmly in control and supported by Moscow, is unwilling to countenance UN declarations to return Nagorno-Karabakh (Pourchot 2008: 65-66). Moreover, the OSCE's Minsk Group, headed by the US, France and Russia to resolve the ongoing crisis, has failed to make serious progress.

Armenia declared independence on August 23, 1990, and enjoyed relative domestic stability, by regional standards, until 1998 when President Levon Ter-Petrossian resigned under pressure for rumored concessions with Azerbaijan on Nagorno-Karabakh. A year later, several members of the government were assassinated, to include the speaker, though new elections were held without incident. Robert Kocharyan was elected president in 1998 and re-elected in 2003 in a disputed outcome which sparked protests in early 2004. Serze Sargasyan, the current president, was elected in 2008, upon which the opposition claimed fraud; again demonstrations erupted which were forcibly suppressed.

Following the contentious 2008 election, the national leaders felt it was important that the 2012 elections be conducted without incident, primarily to demonstrate stability to the international community and aid generating institutions. On May 6, 2012, Armenia held parliamentary elections deemed peaceful and fair by independent observers. One of the more insightful results of this election was the indication of Armenia's political evolution, as relations with Turkey and

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<sup>43</sup> Speaking at the 43<sup>rd</sup> Munich Conference on Security Policy on February 10, 2007, Putin gave a blunt speech blaming the West, and the United States in particular, for destabilizing global security by its missteps in the Middle East, expanding NATO and continuing its missile defense program. It was a watershed event in that it signaled a more forceful and confrontational posture from the Kremlin (Putin 2007).

Azerbaijan were not major factors in the political campaign. Instead the focus was on corruption and the economy, indicating Armenia is confident in its long-term ability to hold Nagorno-Karabakh, allowing it to concentrate on domestic development and civil society (Zolyan 2012: 7). The same cannot be said about the February 2013 presidential elections in which there were allegations of ballot stuffing and bribery leading to Sargasyan's reelection (The Economist (13) Eastern Approaches, November 14, 2013).

The key to Armenia's survival is Russia's continued military and economic support and, to a lesser extent, good relations with Iran. Therefore, it is no coincidence that Moscow's influence is extensive as much of the Armenian infrastructure is owned or managed by Russian firms, particularly its energy sector. Ankara recognized Yerevan's independence in 1991 but closed the border in 1993 and has balked at formal ties while Azerbaijani territory is still occupied. Attempts at an Armenian-Turkish rapprochement in 2009, with the goal of reopening the border, were scuttled under strong Azerbaijani objections.

After the August 2008 war between Russia and Georgia, President Sargasyan maneuvered to retain good relations with the belligerents, as land-locked Armenia is dependent on Tblisi's acquiescence to ensure external trade links remain open (Nichol 2009: 23). To this end, Armenia skillfully played a balance between Russia and the West called "complementarism," a term coined by a former foreign minister, Vardan Oskanian (Zolyan 2012: 7). This policy worked well, whereby Armenia relied on Russia for protection and trade, and the West for technology and investment, however events came to a head in mid-2013 when Moscow forced Yerevan to decide on a definitive posture.

In 2000 Yerevan asked NATO to expand its Partnership for Peace (PfP) activities which, in addition to enhancing professional development and readiness, helps it stay informed of Azerbaijani activities, another PfP member. In late 2005 Yerevan adopted an Individual Partnership Action Plan, which streamlines closer cooperation with the Alliance, despite then-President Kocharyan's insistence that Armenia would not seek NATO membership. Negotiations to sign an association agreement (AA) with an accompanying Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU were criticized by Russia which wanted Yerevan to join the EEU.<sup>44</sup> This resulted in Moscow warning Yerevan not to drift too far from Russia's sphere; pressure which included a 67 percent increase in the price of gas (BBC, May 21, 2013). In July 2013 the European Commission had completed four years of negotiations with Yerevan on the association agreement, when abruptly, in early September, Yerevan succumbed to Kremlin pressure and signed on to the Russian-led EEU, which took effect on January 1, 2015 (Bendavid, September 4, 2013).

The synergy between Iran and Armenia bears further discussion. As both countries are diplomatically and geographically isolated, they have become natural allies and trading partners. In December 2008 the Iranian-Armenian gas pipeline was completed and Armenia is supplying electricity to northwest Iran (Shareshenidze 2011). Iranian gas deliveries increased after the April 2010 completion of a new power plant in Yerevan (CIA, (3) Armenia, date accessed

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<sup>44</sup> The Deep and Comprehensive Free Trade Agreement (DCFTA) is a provision which calls for highly favorable trade relations between the non-member state and the EU. It is frequently embedded with the broader Association Agreement.

December 28, 2013). Both countries gain political advantage through this alliance; Armenia gets an alternative energy supply and pressures Baku, while Iran challenges a secular Shiite majority country (Azerbaijan) on its border and thwarts Turkey's regional ambitions.

In the Soviet era, Armenia traded machine tools, textiles, and various manufactured goods for raw materials and energy supplies, and therefore enjoyed a fairly strong economy. This eroded considerably in the recession following independence. The post-independence military success in Nagorno-Karabakh has translated into economic hardship as Azerbaijan and Turkey closed their borders depriving Armenia of trade revenues. Moreover, Yerevan's isolation and weak economic base have made it vulnerable to the 2008-2009 global economic downturn. To compensate for this, Armenia's state revenues are enhanced by international aid, diaspora remittances and FDI. The soft Russian economy has led to a cutback in remittances which has sparked economic hardships and unrest in Armenia (Grove June 23, 2015).

In the post-1991 period some improvements were made in tax and customs administration, as well as privatization efforts. In January 2003, Armenia joined the WTO, and enjoyed several years of solid economic growth. The recession caused GDP to decline by 14 percent in 2009, made more difficult by the drop in domestic construction and remittances from Armenian workers based in Russia. There was 2.1 percent growth in 2010, followed by 4.6 percent and 3.8 percent in 2011 and 2012 respectively. A 2011 amendment to the state tax law was made to stimulate economic growth and employment, with little success. Since August 2011, the Armenian dram depreciated 15 percent, while the 2012 unemployment rate reached as high as 17.3 percent. Anti-corruption efforts have been ineffective and the economic downturn resulted in a drop in tax revenues, forcing the government to accept loans from Russia and the IMF (CIA, (4) Armenia, date accessed December 28, 2013).

Domestic oil and gas exploration began shortly after World War II with some success, though in the mid-1970s the Soviet Ministry of Geology halted explorations to concentrate on more productive fields in Siberia. After independence, Yerevan requested US assistance, which estimated Armenia's total hydrocarbon potential to be nearly 6.4 billion barrels of oil and 175 bcm of gas. This is a sizeable amount, though difficult geology, limited infrastructure and a lack of capital have stymied large-scale exploitation. In 2005, the Russian electricity company, RAO-UES assumed management control of the Metsamor nuclear power plant and Armenia's electric power network<sup>45</sup> (Energy Charter, (4) Armenia 2008: 7, 67, 70-71).

In the 1990s, the gas pipeline through Georgia was repeatedly sabotaged, this coupled with the Turkish-Azerbaijani border closure, added to Armenia's economic challenges (Sarkissian, October 31, 1995). Though oil and gas reserves have been identified, there are no producing fields or refineries, and for this reason Armenia is further dependent on Russian and Iranian energy imports. Much of Armenian oil imports originate in Georgia at the ports of Batumi or Poti, from where a rail link brings it across the border. Other means of transit include trans-Georgian pipelines and small quantities of oil which make the mountainous crossing from Iran, transported by Iranian trucks.

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<sup>45</sup> Fuel rods and other components are imported for the Metsamor nuclear power plant (Energy Charter, (5) Armenia: 2008:7).



Armenian gas consumption peaked at 6.5 bcm in 1989, though since being subjected to real-world economic conditions, this has shrunk to under 2 bcm/year (Energy Charter, (6) Armenia 2008: 77). In May 2006, Russia increased the gas price for all three south Caucasus states. Unable to pay the higher rate, Armenia was forced to turn over much of its gas infrastructure to Russian companies, notably Gazprom<sup>46</sup> (Nichol 2009: 23). This resulted in ArmRosGazprom, a joint venture between Gazprom and the Armenian State (Energy Charter, (7) Armenia 2008: 7, 71-72). In December 2013 the Armenian National Assembly authorized the sale of the remaining 20 percent of the company owned by the government to Gazprom. The sale terms stipulate that Armenia will be unable to import from non-Russian sources or change the contract until 2043. The news brought street protests by those claiming the sale was unconstitutional<sup>47</sup> (News.AM (Armenia), December 23, 2013; Armenian Ministry of Energy and Natural Resources, date accessed February 17, 2014).

The Armenian energy strategy is to continue importing fuel from Russia and Iran, but to also develop domestic and renewable resources. However, it is unclear how Yerevan's shift away from the EU toward Moscow, which includes the energy sector's continued domination by Russian companies, will allow it to develop domestic energy resources and enact any serious reform (Energy Charter, (8) Armenia 2008). All indicators show that Armenia's isolation and dependence on Russia will drag on as attempts at complementarity in its East-West relations may be stifled as pro-Moscow elements in Yerevan become stronger. Furthermore, the EU, having been jilted once by Armenia, is reluctant to engage in any further discussions (Boonstra and Delcour, January 2015: 3). Indeed, the 2013 elections may be a harbinger for future Armenian conduct, whereby Yerevan is now so integrated in the Kremlin's web that such undemocratic behavior will become the norm.

## **Azerbaijan**

Azerbaijan holds a unique place within the Black Sea RSC. In the short-term its conditions are generally favorable, enjoying significant rents from its energy exports, a windfall which has placed Azerbaijan in a position of influence well above what its size and population would normally dictate. Though increased oil and gas revenues have improved the living standards of the average citizen, Azerbaijan suffers from a history of corruption, rigged elections and an intimidated press, all of which has earned the government Western criticism. Long-known as an oil producer going back to the mid-19<sup>th</sup> Century, these wells are rapidly depleting, forcing Baku to rely on its new-found gas formations.

In the late 19<sup>th</sup> Century, Baku's oil industry was one of the world's most innovative and productive. One hundred years later Soviet neglect and mismanagement turned Azerbaijan's oil fields into dilapidated wrecks; so much so that the newly independent state lacked the capital and expertise to exploit its own natural resources. Following independence in 1991, Azerbaijan endured a variety of crises, many of which are reflected in its current state of affairs. Military reverses in Nagorno-Karabakh and a deteriorating economy prompted a June 1993 rebellion

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<sup>46</sup> Azerbaijan, with its own domestic gas sources coming on line, rejected Russia's demands and refused to purchase Russian gas until 2010 (Nichol 2009: 23).

<sup>47</sup> The company was renamed Gazprom Armenia on January 17, 2014.

against Abulfaz Elchibey, the country's first post-Soviet president. Heydar Aliyev, a former Soviet Politburo member, emerged as an opposition candidate and convincingly won the presidency in October 1993. A failed military coup left him in such firm control that by 1996 he wielded near dictatorial power.

Aliyev's greatest accomplishment was steering the country out of conflict and resurrecting Azerbaijan's oil industry. Shortly after assuming the presidency, Aliyev negotiated the so-called "Contract of the Century," in 1994 which placed its oil and gas operations in the hands of foreign IOCs, BP in particular, and increasing oil revenues and dramatically boosting the economy. Aliyev was overwhelmingly re-elected in 1998, though the results were tainted by evidence of voter fraud (Library of Congress 2012). He was hospitalized in April 2003 and subsequently forced to retire; the "Father of the Republic" died on December 12, 2003, after his son Ilham was elected president in October 2003. The younger Aliyev's election experienced violence and claims of irregularities, though there was little international condemnation. In 2008, opposition parties boycotted the elections, which allowed Aliyev to win re-election with 87 percent of the vote. The following year a constitutional referendum was held which removed term limits on presidential candidates during times of war, thereby allowing Aliyev to run again, and win, in 2013<sup>48</sup> (Matsaberidze: 2005).

Azerbaijan's foreign policy has undergone significant change since independence. The Elchibey administration emphasized Baku's Western relations, and the elder Aliyev maintained this orientation by seeking European integration and international recognition by joining NATO's PfP and the Council of Europe. Under Ilham Aliyev the importance of European institutions has waned; caused by Western criticism of his governance practices and human rights abuses (Shirinov 2012). The Nagorno-Karabakh issue continues to fester 20 years after the cease fire, a conflict in which Armenia, with direct Russian support, gained control of this Armenia-majority enclave from Azerbaijan. There is also growing concern in Baku with insurgencies in Russia's North Caucasus. Despite popular support for their fellow Muslims, Baku realizes that Moscow plays a valuable stabilizing role in the Caucasus, and Russian setbacks in Chechnya and Dagestan, two Russian republics undergoing considerable unrest, would potentially create greater ethnic unrest which could spill over into Azerbaijan (Valiyev 2011).

Aside from the Armenian question, Baku faces security challenges from a variety of other ethnic groups; the Lezgins in the north have strong ethnic and cultural affiliation with Dagestan. In the south, the Talysh demand more political freedom and autonomy. Baku is in a broader dispute with Iran over the demarcation of the Caspian Sea and Azerbaijan's siding with Russia and Kazakhstan over oilfield delineation there is aimed at countering Iranian border claims (Nichol 2009: 58-59). Azerbaijan relies on Turkey and Georgia to help export its products, so the incentive exists to ensure smooth relations. Moreover, because of shared ethnic background, Azerbaijan maintains particularly good relations with Turkey, to the point where during the Nagorno-Karabakh war, in solidarity with Azerbaijan, Turkey closed its border with Armenia. Finally, as Azerbaijan and Georgia suffered at the hands of Russia and Persia throughout recent history, these shared experiences have translated into solid relations today.

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<sup>48</sup> This referendum was based on the assumption that the Nagorno-Karabakh issue was unresolved, which technically means the country is still at war.

Attempts to undermine Baku's secular regime, as well as Tehran's repression of its Azeri minority have damaged relations between Azerbaijan and Iran, further complicated by Azerbaijan's good relations with the US and Israel. Additionally, Iran is alarmed by separatist agitation within its own Azeri population. It is Nagorno-Karabakh which exemplifies Tehran's realist approach to the South Caucasus; by supporting Armenia instead the Shia-majority Azerbaijan, Iran is countering its traditional rival, Turkey. Because of its open disdain for Azerbaijan's Western orientation, Tehran is introducing Islamic fundamentalism via diplomatic, religious and cultural exchanges. The effort to weaken Western influence has so far failed as the secular Azerbaijani's enjoy unprecedented economic growth and relative personal freedom thanks to oil and gas revenues which make the government largely immune to outside political pressure (Shareshenidze 2011).

Brussels and Baku have developed a relatively good relationship based on mutual needs and combined efforts with Washington have been vital in developing Azerbaijan's energy resources and finding markets for its products. Under the EU's Azerbaijan Action Plan, an element of the ENP, Azerbaijan will continue to cooperate with the Union on a range of Black Sea RSC and Caspian energy issues<sup>49</sup> (Energy Charter, (9) Azerbaijan 2013: 86). The increase in Azerbaijan's regional status, principally its position as a reliable energy exporter to Europe, has allowed it to operate on near-equal footing with the EU.

Nevertheless, relations with the West have often experienced strain. A long-term point of contention between Baku and Washington is Section 907 of the Freedom Support Act of 1992, a provision which denies US non-humanitarian aid to Azerbaijan without yearly presidential authorization.<sup>50</sup> Section 907 was implemented to punish Azerbaijan for its role in Nagorno-Karabakh and attempts to rescind this provision have been unsuccessful. This has created strained relations at times, whereby Washington supports Azerbaijan's autonomy and energy sector development, though harbors concerns about an attempt by Baku to take Nagorno-Karabakh by force.

In 1995 Azerbaijan experienced an economic collapse, caused by weak domestic and global energy demand coupled with the post-independence economic contraction and the protracted conflict with Armenia. Beginning in 1999 energy production stabilized and expanded rapidly, posting a growth rate of 12 percent over the next 14 years, while energy exports over the same period rose from 13.5 Mboe to 370 Mboe. This dramatic expansion in energy production mirrors a similar GDP growth rate of 13 percent between 1995-2009. By 2008 Azerbaijan enjoyed a current account surplus of \$16.5 billion, though during these periods of high growth, the economy achieved inflation rates as high as 20 percent (Energy Charter, (10) Azerbaijan 2013: 23-26, 33).

Baku has been synonymous with Russian and Central Asian oil production for over a century and a half. The Soviet experience is a powerful factor in Azerbaijan's energy industry, notably from Moscow's long-term neglect which undermined Baku's development in that sector and put Azerbaijan at a considerable technological deficit. After independence, Baku began to search for foreign, primarily Western, assistance. Enter BP and the 'contract of the century' which

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<sup>49</sup> See Chapter 4 for more on the European Neighbourhood Policy.

<sup>50</sup> The Freedom Support Act of 1992 provided financial support and other forms of aid to former Soviet states.

positioned Azerbaijan as a leading exporter to Europe.<sup>51</sup> Though the oil fields are in decline, Azerbaijan holds 7 billion barrels of known reserves making it the largest regional energy producer behind Russia. Oil production in Azerbaijan was 1.1 million b/d by 2010, with exports of 777,000 b/d, an 8 percent drop from 2009. Azerbaijan's oil production was 881,000 b/d in 2013. In addition to its oil production, in 2007, Azerbaijan became a gas exporter thanks to the offshore Shah Deniz fields (EIA, (8) 2012 Azerbaijan Country Analysis: 2).

The Ministry of Industry and Energy (MIE), is the sector's lead oversight entity, supported by the Ministry of Economic Development, the State Oil Company of the Azerbaijan Republic (SOCAR) and Azerenerji JSC (the state-owned electricity company), charged with formulating national industry and energy sector policies. The MIE works in particularly close cooperation with SOCAR, the dominant figure in Baku's operational energy sector, to negotiate, implement and oversee Production Sharing Agreements (PSAs) or other contracts (Energy Charter, (11) Azerbaijan 2013: 47-50, 64, 86).

Born from the 1992 merger of the Soviet-era Azerneft and Azneftkimiya, the respective oil and petrochemical enterprises, SOCAR has oversight of the country's oil and gas production, as well as refining and pipelines. Furthermore, it acts as the state energy revenue collector, giving it unprecedented control over the country's upstream and downstream sectors. SOCAR is the primary interface between the state and the International Oil Companies (IOCs) in all PSAs concluded between Azerbaijan and foreign partners. It was SOCAR, under Heydar Aliyev's oversight, which acted as the government interface for international partners in 'the contract of the century' (EIA, (9) Azerbaijan Country Analysis 2012).

As an arm of the Baku government, the company's political affiliations are undeniable. Azerbaijan's president has full control over all aspects of SOCAR to include PSA negotiations as well as the ability to reorganize the company (Kjaernet 2011: 12). Ilham Aliyev was SOCAR's vice-president from 1994 to 2003 when he was elevated to the country's prime ministership before winning the presidency. With 80,000 employees on its payroll, SOCAR frequently fulfills the role of "cash cow" by supporting non-energy related, though politically popular, projects, such as schools, sporting events, scholarships and health care (Cornell 2012: 238).

Aware that the energy sector's long-term prospects are limited, SOCAR is looking for investment opportunities outside of Azerbaijan, the goal being to tap into downstream energy consumers to maximize rents on its national resources. A prime example is the SOCAR-funded Trans-Anatolian Pipeline (TANAP), designed to ship Azerbaijani gas across the length of Turkey, where it will tie into the European gas network. Additionally, SOCAR has invested in key regional markets, such as the Georgian port facilities at Supsa and, more recently, in some of the Balkan states, principally in gas stations (MacDowall, May 3, 2013).

Operational since 1997, the Sangachal oil and gas terminal south of Baku serves as the start point for some of the region's major pipelines, notably the Baku-Tblisi-Ceyhan (BTC) and the South Caucasus Pipeline (SCP), oil and gas pipelines respectively. Sangachal receives, stores, processes and distributes product from Azerbaijan's oil and gas fields (also from Kazakhstan and

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<sup>51</sup> Initial estimates of Azerbaijan's profit were projected to be \$81 billion over 30 years, in 1994 dollars (Sagheb and Javadi 1994).

Turkmenistan), which is then distributed through the transportation network, including road and rail, making it one of the world's largest integrated oil and gas terminals and placing Baku as a critical hub in the Black Sea RSC's energy environment. The terminal can handle 1 mb/d of crude, has eight storage tanks, and is equipped with modern metering devices and pumping units (Energy Charter, (12) Azerbaijan Energy Efficiency 2013: 55-56).

Located 100 kilometers east of Baku and holding 5 billion barrels, over 80 percent of the country's known oil reserves, the combined offshore Azeri–Chirag–Gunashli (ACG) fields are a main source of state revenue.<sup>52</sup> The ACG's primary administrator is the Azerbaijan International Operating Company (AIOC), of which BP is the lead<sup>53</sup> (EIA, (10) Azerbaijan Country Analysis 2012: 1). As an indication of Azerbaijan's declining capacity, oil production from the ACG fields fell to 664,400 b/d in 2012, down from 823,000 b/d in 2010 (Oil & Gas Journal, (1) November 5, 2012; BP (1) Azerbaijan Sustainability Report 2012: 9). However, much of the drop in production can also be blamed on reduced investment, as much of the revenues have been diverted within the Aliyev government for “patronage purposes” (Kjaernet 2011: 27).

Azerbaijan now finds itself in a fairly new position; that of a gas exporter at the opportune time when its oil reserves are falling. The 1999 discovery of the offshore Shah-Deniz gas fields, with roughly 850 bcm of proven natural gas reserves, further enhances Azerbaijan's position as a regional energy power. In 2010, Azerbaijan produced 16.7 bcm and exported 6.8 bcm (EIA, (11) Azerbaijan Country Analysis 2012: 3). As with ACG, BP is the primary operator of Shah Deniz, and, along with Statoil, is the largest shareholder in the Shah Deniz Consortium, each holding 25.5 percent.<sup>54</sup> Shah Deniz Phase I began producing in 2006, and is expected to peak at 8.9 bcm per year. The Shah Deniz Full Field Development (FFD), or Phase II, will peak at 15.8 bcm per year, including the 8.9 bcm from Phase I. FDD is expected to begin production in 2017 with the majority of the product destined for Europe. In 2010, Azerbaijan exported approximately 6.4 bcm to Turkey, 300 mcm to Georgia, 1 bcm to Russia and 100 mcm to Iran (EIA, (12) Azerbaijan Country Analysis 2012: 4).

As one of the largest gas development projects in the world, upon completion, Shah Deniz Phase II will include two bridge-linked production platforms, 26 subsea wells, 500 kilometers of subsea pipelines in up to 550-meters-deep water, a 16 bcm upgrade for the SCP, and an expansion of Sangachal terminal. Since Shah Deniz came on stream in late 2006 to the end of 2012, it has exported 37.6 bcm and 80 million barrels of condensate to local and international customers (BP (2) Azerbaijan Sustainability Report 2012: 9-10).

Azerbaijan's gas exploration efforts continue to achieve success. In October 2010 a PSA was announced between BP and SOCAR to jointly explore and develop the Shafag-Asiman deepwater field. The PSA will be in force for 30 years, with BP as the operator and 50 percent shareholder, while SOCAR maintains the other 50 percent. The PSA was ratified by the

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<sup>52</sup> Production began in 1997 from the Chirag section, which now includes the Central, West and East Azeri and Deepwater Gunashli sections.

<sup>53</sup> AIOC comprises 10 petroleum companies, notably BP, ExxonMobil, Chevron, Statoil, TPAO (Türkiye Petrolleri Anonim Ortaklığı) and SOCAR.

<sup>54</sup> The other shareholders include SOCAR, Total, LUKoil, and Iran's OIEC, each at 10 percent, while Turkish TPAO holds 9 percent (EIA, (13) Azerbaijan Country Analysis 2012: 4).

Azerbaijani parliament in May 2011 (Oil & Gas Journal, (2) May 16, 2011: 7). In November 2010, SOCAR announced work on the second largest gas field, Umid, which contains between 200 to 250 bcm. These finds put Azerbaijan's proven gas reserves at around 2.5 tcm (Energy Charter, (13) Azerbaijan Energy Efficiency 2013: 28).

Even more so than Russia, Azerbaijan is highly dependent on oil and gas revenues to meet its budgetary obligations. As the driving force behind several large oil and gas projects, Azerbaijan will continue to wield influence over the Black Sea RSC's energy sector. SOCAR for its part, continues to be insular, opaque and heavily influenced by politics, indicating the prospects for reform are limited (Kjaernet 2011: 3). This could be consequential in the future, as SOCAR will preside over diminishing oil and gas production, and will find it difficult to enact necessary change for which to derive market efficiencies. On paper Azerbaijan has implemented an energy sector privatization effort via the State Program on Poverty Reduction and Sustainable Development 2008–2015. However, according to the Energy Charter “no noticeable activities have taken place” and state energy officials “confirmed that there are no immediate plans to proceed” with the sector's privatization (Energy Charter, (14) Azerbaijan Energy Efficiency 2013: 48).

One point in Baku's favor is Azerbaijan's generous PSA terms and stable business climate, which has made the country attractive for investment. Whereas Russia and Kazakhstan have renegotiated contracts with foreign companies to extract greater rents, notably the Sakhalin II and Kashagan projects, respectively, Azerbaijan has refrained from such tactics so as to maintain positive relations with BP and the other consortium members (Ciarreta and Nasirov 2011: 20–21). Moreover, despite the political corruption and dodgy human rights record, foreign business entities are generally comfortable working in Azerbaijan and are reluctant to jeopardize this relationship by criticizing the government. The result is an acceptable balance between the state and foreign business concerns.

BP's presence in Azerbaijan spans nearly 20 years and its influence is noteworthy; BP, through the AIOC, produces about 80 percent of Azerbaijan's energy (EIA, (14) Azerbaijan Country Analysis 2012: 1). The BP-Azerbaijan relationship has been rocky lately, primarily from oil production shortfalls at the ACG field. At the center of this dispute is the reduced ACG production volume, which at 664,400 b/d in 2012, was well below the 1 million b/d anticipated at this stage.<sup>55</sup> The Aliyev administration has complained about the estimated \$ 8.1 billion of lost revenue, noting that ‘serious action’ will be taken. Yet, BP is unable to overcome the geological cards it has been dealt, and according to Mathew Hulbert, the “ACG consortium is already spending around \$2 billion a year to keep production at current levels,” indicating that further capital outlays will jeopardize BP's profit margin (Hulbert October 12, 2012). Though much of this is politically motivated and outside of BP's control, in recent years BP, SOCAR and the other partners have been working to manage ACG production challenges (BP (3) Azerbaijan Sustainability Report 2012: 7).

For a country of such limited territory and population, Azerbaijan holds considerable clout, and BTC is perhaps Azerbaijan's key foreign policy success since independence. Though it was a political and financial challenge to build, its presence has derived considerable benefits for

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<sup>55</sup> The national production forecast for 2012 was 940,000b/d (Hulbert October 12, 2012).

Baku.<sup>56</sup> Azerbaijan was able to leverage Western support, coupled with Turkish demands for a bypass, to ensure a political and economic coup (Cornell and Ismailzade 2004: 63-67). In January 2011, European Commission President José Manuel Barroso and Ilham Aliyev signed the “Joint Declaration on the Establishment of the Southern Corridor,” whereby Azerbaijan committed over the long-term to supply “substantial volumes” of gas to the EU in return for favorable market access (European Commission, (2) January 13, 2011). It is also a function of its size that, as time progresses, it will have gradually diminishing oil and gas reserves to exploit, leaving it vulnerable to regional power plays.

Finally, there is a perceptible shift in the relations between the region’s oil and gas powers. In 2014 Russia and Azerbaijan signed trade deals to circumvent Western sanctions, though this can probably be viewed more as a case of mutual opportunism than a long-term rapprochement between Moscow and Baku (de Waal 2014). It should also be noted that Washington’s attitude to Baku cooled following the flawed 2003 elections and has barely recovered since then. The completion of the BTC/SCP pipeline seems to have altered little in this relationship, particularly when U.S. policy distanced itself from Azerbaijan and focused on a post-Rose Revolution Georgia<sup>57</sup>(Cornell and Ismailzade 2004: 63-67).

Yet, what to make of Azerbaijan? A secular and educated society with little experience in Western democracy, it has been placated by a generous, though overbearing state. A visit to Baku in the spring of 2008, noted the city’s numerous high profile construction projects which ostentatiously demonstrated the new-found wealth. This included state of the art German fire trucks and other Western equipment and expertise to help secure this infrastructure. However, ventures away from the city center displayed crumbling infrastructure and rows of dilapidated and overcrowded Soviet era housing projects made worse by Nagorno-Karabakh refugees. Even the most casual observer could not help to notice that Azerbaijan had a long way to go to raise the quality of life for its citizens. Whether this complacency will remain during lean years remains to be seen.

Surrounded by great powers, Azerbaijan’s small population and size would ordinarily relegate it to the role of a minor power dominated by the larger regional states. Indeed, most states in the Caucasus and Central Asia have often found themselves either under the dominant influence of one larger power, or forced to play off regional powers against one another to maximize their own independence and freedom of action. While Azerbaijan is no match for Russia’s overwhelming overlay capability, or Iran for that matter, Baku’s oil wealth has given it considerably more independence, both domestically and regionally, than its South Caucasus neighbors, let alone in the Black Sea RSC. Lower oil and gas prices in recent years have given cause for concern in Baku as the potential for maintaining popular social programs weakens. There is now the fear in regional capitals that a weakened Aliyev regime could precipitate civil unrest or induce an effort to retake Nagorno-Karabakh to cement domestic support.

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<sup>56</sup> According to Cornell and Ismailzade, “As late as 2000, western, Russian, and Iranian analysts alike could still be caught on record arguing that the chances of the pipeline being built were close to nil.”

<sup>57</sup> This is in “spite of the strong strategic interests that the U.S. has in the country, best illustrated by Defense Secretary Donald Rumsfeld’s three visits to Baku in as many years” (Cornell and Ismailzade 2005: 63-67).

## **Bulgaria**

As fellow Slavs and possessing an enduring gratitude for having freed them from Ottoman rule in 1878, Bulgarians generally feel a strong kinship with Russia. During the Cold War, Sofia was one of Moscow's strongest Warsaw Pact allies. Yet, after 1991, Bulgaria was anxious to relieve its economic dependence on Russia, and placed strong emphasis on European integration. The early 1990s economic crisis triggered social unrest, however this turmoil precipitated a series of reforms that began in 1997 and helped stabilize the country's economy. Bulgaria was admitted into NATO in March 2004 and became a member of the EU in January 2007.

In the 2000s, Western FDI steadily flowed into the country improving the overall economic health, though this inflow has faltered in recent years. Evidence of corruption caused the EU to block badly needed cohesion funding, whereby the Socialist-led government was voted out of office in the July 2009 general elections. Boyko Borissov, a former mayor of Sofia and leader of the center-right Citizens for the European Development of Bulgaria (GERB), took 116 of 240 seats in parliament, but in February 2013, anti-austerity protests forced his resignation (US Department of State 2010, accessed March 2, 2013; MacDowall, February 20, 2013). Plamen Oresharski, of the Bulgarian Socialist Party, was elected prime minister in June of 2013, though resigned in August 2014, also because of political pressure brought about by poor economic conditions. The October 2014 elections brought Borisov back to power, who has been trying to repair damaged relations with Brussels, and steer his country to solid economic growth.

Bulgaria is the poorest of the EU states with 2008 per capita income estimated at 40 percent of the EU-28 average (Energy Charter, (15) Bulgaria Investment Climate 2011: 25). A weakness in the Bulgarian labor market is long-term unemployment and shortages in critical skills, while the resulting skills to labor mismatch is pushing up wages and creating inflationary pressures. A long-term concern is the changing demographics which is shrinking the labor force, primarily through emigration of younger and skilled workers. Paradoxically, despite a reduced pool of workers, unemployment was 12.7 percent in 2012 with little improvement expected in 2013 and 2014. Another indication of broad systemic, rather than cyclical, problems with the labor market (European Commission, (3) European Economic Forecast (EEF) 2012: 52-53).

Manufacturing and construction were heavily impacted by the recession, dragging 2008 GDP growth of 6 percent to 4.2 percent in the first half of 2009. Exports also fell by 18 percent in the first half of 2009. The good news is that through strong fiscal discipline, Bulgaria positioned itself relatively well for the downturn, with large foreign exchange reserves and a fiscal reserve account which reached 12 percent of GDP in July 2009. Bulgaria also has one of the EU's lowest tax burdens, with a 10 percent corporate tax and a 10 percent flat tax rate on individual income (Energy Charter, (16) Bulgaria 2011: 35; Invest Bulgaria Agency, date accessed December 29, 2013). Bulgaria has actually maintained steady, if not robust growth in recent years; 0.5 percent in 2012, 1.1 percent in 2013, and 1.7 percent in 2014 (CIA, (5) Bulgaria, date accessed December 29, 2015). The indicators point to a slow recovery from the 2008-2009 recession and the political unrest that followed.



Political and economic reforms were undertaken to facilitate EU membership, and there is a strong political commitment to liberalization. The energy sector, with an emphasis on attracting FDI, is key to the country's economic development. Established in 1999, the State Energy and Water Regulatory Commission (SEWRC) is an independent oversight body which monitors the Bulgarian energy market and which prompted the 2011 Energy Strategy to concentrate on improved competition through privatization, procurement and transparency reform (Energy Charter, (17) Bulgaria 2011: 9-10, 59; Bulgarian Government, June 2011).

Bulgarian energy policy is defined by the Council of Ministers, roughly the equivalent of a cabinet, and implemented by the Ministry of Economy, Energy and Tourism (MEET). The Energy Strategy of 2002 addressed Sofia's transition to the EU by implementing a market-oriented and financially stable energy sector (Energy Charter, (18) Bulgaria 2011: 9-10, 35, 59; Bulgarian Government, June 2011). The 2011 Energy Strategy more closely encompasses EU energy priorities found in the 'New Energy Policy for Europe,' notably the "20-20-20" plan. For instance, the new strategy addresses energy security through diversified sources and transit routes to reduce emissions, increase renewables and improve efficiency<sup>58</sup> (Energy Charter, (19) Bulgaria 2011: 60).

The Oil and Gas Exploration and Production Plc (OGEP), privatized in 2004, performs exploration and development of oil and gas fields, as well as refining activity. Exploration and production occurs primarily in the northern part of the country and in the Black Sea, and is dominated by external players, such as Lukoil, Petrol, OMV, Shell, Hellenic Petroleum and Rompetrol. Oil refining is a major economic contributor; most of the crude is imported from Russia, Romania, Croatia, Italy and Greece (Energy Charter, (20) Bulgaria 2011: 62-63).

Bulgarian domestic natural gas production began in 1963 with the discovery of the now-abandoned field near the town of Chiren. On December 30, 1973, the state oil and gas company was registered, which later became Bulgargaz. To meet EU accession requirements, in January 2008, Bulgargaz was unbundled, transformed into Bulgargaz Holding EAD, and split into three separate companies; Bulgartransgaz EAD (transit) Bulgargaz EAD (service provider) and Bulgartel EAD (telecommunications) (Energy Charter, (21) Bulgaria 2011: 61). Bulgaria has promising shale formations, though a fracking ban prevents any exploitation.<sup>59</sup>

This vulnerability may change following the discovery of the Khan Aspurah offshore gas field, estimated at 40 to 80 bcm, and which could meet Bulgaria's domestic demand for the next 15-20 years (Petroleum Intelligence Weekly July 9, 2012). Bulgarian domestic gas production has fallen dramatically from 511 mcm in 2006 to 217.5 mcm in 2008. Most domestic gas production comes from the Galata field, on the Black Sea's continental shelf. Bulgaria imports between 3.2 to 3.5 bcm of gas from Russia under long-term contracts, and virtually all of this product is imported via Ukraine and carried across the border gas by Bulgartransgaz (Energy Charter, (22) Bulgaria 2011: 67).

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<sup>58</sup> The EU 20-20-20 directive sets three key objectives; a 20 percent reduction (from 1990 levels) in CO2 emissions, increasing the proportion of energy from the share of EU energy consumption produced from renewable resources to 20 percent, and a general 20 percent improvement in the EU's energy efficiency by 2020 (European Commission, (4) website, date accessed September 30, 2013).

<sup>59</sup> Some suggest the Kremlin is behind this movement (Yardley and Becker 2014)

The Russia-Ukraine gas crises and the civil war in the Donbass provide a compelling need to diversify the sources and routes of natural gas. Considering that it imports from Russia more than 85 percent of its gas and 95 percent of its oil, Bulgaria finds itself in an extremely exposed position. Bulgaria was keen to have the now-abandoned South Stream come ashore at Burgas with the prospects of turning the country into an energy hub. Russia and Bulgaria signed a cooperation agreement on January 18, 2008, which was ratified by the Bulgarian Parliament in July of that year. In May 2009, a multilateral agreement between the major gas companies of Russia, Italy, Bulgaria, Serbia and Greece was signed to build the South Stream pipeline. Bulgarian Energy Holding EAD, a joint Bulgarian-Russian venture was registered specifically to manage the Bulgarian portion of the pipeline. Sofia has also begun the construction of interconnections with its neighbors, importing LNG or compressed natural gas (CNG), reversing the flow of certain pipelines and exploring new fields on land and offshore (Energy Charter, (23) Bulgaria 2011: 71).

In 2014 Bulgaria emerged as a flashpoint in East-West relations, primarily from its cooperation with Russia on South Stream which generated agitation in Brussels with claims that it violated EU energy competition laws. In early June, Brussels suspended cohesion payments to Sofia for its failure to halt South Stream, and later that month a group of US Senators led by John McCain visited Sofia to voice their displeasure. In early July 2014, Bulgarian Prime Minister Oresharski succumbed to the pressure and ordered work to stop. A growing banking crisis forced Oresharski to resign on July 23, 2014, which put Borrisov back in the prime minister's position (Carney July 23, 2014; Yardley and Becker, December 30, 2014).

## **Georgia**

While the Soviet Union was still intact, Georgia's internal republics of Abkhazia and South Ossetia began agitating for greater autonomy from Tbilisi. Sporadic bloodshed occurred in the lead up to Georgian independence in April 1991, and in the following month Zviad Gamsakhurdia, a Soviet-era official, was elected president on a wave of crude and virulent populism. Gamsakhurdia was determined to assert control over Abkhazia and South Ossetia, and launched militia forces into the breakaway republics shortly after taking power (De Waal 2011: 152).

The Gamsakhurdia administration was particularly amateurish, and coupled with a singular economic incompetence, it polarized and impoverished the population in a remarkably short period of time. Within a year the president was removed in a coup, and the country fell into a civil war between pro-Gamsakhurdia forces and opposition factions (Jones 2012: 60-62, 84). Meanwhile, the Georgian militia forces did not acquit themselves well; ill-disciplined and poorly trained and equipped, they were routed by Abkazan and South Ossetian forces, who were themselves heavily supported by overt Russian military assistance. By 1994, aside from scattered, isolated civilian enclaves and some military outposts, Tbilisi effectively lost control of both republics<sup>60</sup> (Jones 2012: 60-62, 84, 97).

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<sup>60</sup> Both sides were accused of human rights violations, though the Gamsakhurdia administration is blamed for committing the majority of abuse (Jones 2012: 97).

The last serving Soviet foreign minister, Eduard Shevardnadze returned home to Georgia in 1992 and joined the opposition. Elected president in 1996, Shevardnadze concluded humiliating cease fires in Abkhazia and South Ossetia which effectively gave both republics de facto independence; he was reelected in 2000, and credited with reestablishing stability to the country (Jones 2012: 97). However, it was the revelation of electoral fraud in the November 2003 parliamentary elections that touched off the so-called Rose Revolution, led by a US-educated member of Shevardnadze's ruling party, Mikhail Saakashvili. Shevardnadze was ousted in late 2003 and Saakashvili was elected president in 2004.

The Rose Revolution culminated in closer US-Georgia ties and a diminished Russian presence resulting in the most pro-Western of the three South Caucasus states. At the NATO Riga Summit in September 2006, Georgia felt confident to ask for "Intensified Dialogue," a preliminary step to a Membership Action Plan (MAP) and eventual Alliance membership, thus setting the stage for the contentious summit at Bucharest in April 2008. In Bucharest, the Bush administration pushed for a Georgia MAP invitation, though Germany, fearful of jeopardizing its relationship with Russia, much of which centers on its sizeable gas imports, vetoed the offer (Nichol 2009: 28; Asmus 2010: 137, 141).

In early August 2008, open warfare broke out again between Georgia and South Ossetia; Russia intervened with a massive influx of personnel and equipment, and within a matter of days had defeated the US-trained and equipped Georgian forces. Following the war, Tblisi fostered anti-Russian sentiment in the north Caucasus republics, which did little to ease bilateral tensions (Zakareishvili 2011). Moreover, Saakashvili sustained political damage for what many Georgians perceived as his culpability for the August 2008 war, and his heavy handed dealings with the political opposition. In the run up to the October 2012 parliamentary elections, Georgian Dream candidate, Bidzina Ivanishvili, promised better relations with Moscow and went on to defeat Saakashvili.<sup>61</sup> The new president, Georgy Margvelashvili, an Ivanishvili ally, was elected in October 2013.

With the noted exception of Russia, Georgia has solid relations with its Black Sea neighbors. Tblisi has taken care to balance its relations with the other South Caucasus states to avoid accusations of favoritism regarding Nagorno-Karabakh. Additionally, Georgia and Azerbaijan share common interests which have led to some cooperation, particularly in the energy sector. For instance, both are pro-Western (Azerbaijan now less so), face separatist movements, and derive revenues from energy exports; Azerbaijan as a producer, Georgia for its transit role. However, the greatest common denominator is the mutual fear of Russia's assertiveness, forcing both states to actively seek external support. Despite European ambivalence before and after the 2008 war, Georgia under the Saakashvili administration worked to cultivate its relations with the West. Tblisi has had considerable success attracting foreign investment by liberalizing its economy, attacking corruption and increasing governmental transparency<sup>62</sup> (Jones 2012: 68).

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<sup>61</sup> In 2012 Georgia transitioned to a parliamentary system with political power residing in the prime minister's office. Saakashvili remained in office until November 2013 when the new president took power.

<sup>62</sup> This business friendly environment has seen Iran investing in Georgia, mostly as a means of avoiding sanctions in response to Tehran's nuclear program, though this may be winding down from the negative publicity (Faucon June 20, 2013).

The post-independence economic collapse forced approximately 1.5 million Georgians to emigrate, mostly to Russia. Subsequent legal, tax and regulatory reform, and privatization efforts designed to integrate into the EU economy took hold. Beginning in the mid-2000s, Tbilisi's GDP doubled to \$12.5 billion in 2008, though in that same year Georgia suffered the combined shocks of the Russian war and the global financial crisis, which caused a nearly 4 percent contraction in GDP. Nevertheless, the economy has performed comparatively well in recent years, aided by foreign capital inflows and government stimulus programs. Real GDP growth was a projected 6.4 percent in 2010 after an economic contraction of 3.9 percent in 2009 and economists predict strong growth through 2014 and 2015 (Energy Charter, (24) Georgia 2012: 26, 28). On June 27, 2014 Georgia, along with Moldova and Ukraine signed AA and DCFTA's with the EU. Each country has its own frozen conflict within its borders, so it is difficult to imagine them being invited to join the EU or NATO. These agreements were offered to provide some level of political and economic support in light of Russian pressure.

Georgia has three oil and gas pipelines which provide access to global markets, and maintains rail lines to Black Sea ports such as Batumi, Poti and Kulevi. Transit payments are made in kind as a hedge against price volatility. As a link in both the BTC and SCP pipelines, to include the Baku-funded port of Supsa, Georgia is an important oil and gas transit point for Azerbaijan, and this activity is a welcome source of income (Jones 2012: 192; World Ports Source, date accessed November 30, 2013). In late 2006 Georgia was singled out by Gazprom for a 100 percent price increase, leaving Tbilisi's only options to surrender control of its gas infrastructure to the Russians or expect a cessation of gas supply by the end of the year. Georgia later negotiated to receive Azerbaijani gas through the newly opened SCP (Nichol 2009: 23). Following the 2008 war, Gazprom continues to supply gas to Georgia, as Russia has an incentive to maintain this relationship with Tbilisi because of Armenia's own reliance on Russian gas transit via Georgian territory (Nichol 2009: 23-24; Natural Gas Europe, (2) December 28, 2016).

The Ministry of Energy generates energy policy, while the Georgian Oil and Gas Regulatory Agency, works to bring these policies in line with the EU's energy *acquis communautaire*. Two state organizations, the Ministry of Energy and the National Energy Regulatory Commission, are responsible for the development and operation of the electricity and gas markets. Oil exploration and production is conducted by Georgian and foreign IOCs. In 2010 Georgia produced 360,000 barrels of oil and 7.8 mcm of natural gas, which together accounts for approximately 25 percent of its energy requirements. Georgian land-based oil reserves are estimated at about 59 million barrels with an additional offshore oil potential of 70 million to 1.3 billion barrels. Hydropower meets more than 90 percent of the electricity demand. In late 2003, Russian UES acquired a majority interest in Tbilisi's electrical infrastructure, as well as hydro and thermal facilities (Energy Charter, (25) Georgia 2012: 13-20, 31, 33, 46; Nichol 2009: 23-24).

## **Greece**

Much of Greece's recent history has been overshadowed by its deep economic malaise, the seeds of which were sown early in the new millennium. Greece was already a NATO member when, in 1981, it joined the EC. It then commenced a period of strong economic growth brought about by

cohesion funds and revenues from tourism, shipping and manufacturing. The country adopted the euro in 2001 and benefited greatly from this affiliation, whereby the perennially high inflation and currency devaluations disappeared overnight. Lower interest rates allowed the government to refinance debt and borrow on favorable terms, pushing annual GDP growth by an average of 4 percent, one of the highest in the EU. The improved economic conditions contributed to a higher standard of living, though with a considerable public and private debt load (The Economist, (14) February 4, 2010).

By December 2009, the global recession laid bare Greece's true financial picture brought about by uncontrolled government spending and weak tax collection, compounded by inaccurate or misleading reporting. To avoid a default, in May 2010, the Eurozone countries and the IMF agreed to loan Greece an immediate \$58 billion followed by another \$142 billion later that year. In return, Greece had to enact harsh austerity measures to control its deficit, to be accomplished through reduced spending, the sale of government assets, stronger tax collection policies, revised entitlement programs, reformed labor laws and liberalized commercial markets (CIA, (6) Greece, accessed October 6, 2012).

The Greek economy contracted 10 percent between 2009 and 2011, while unemployment is having a devastating impact (CIA, (7) Greece, date accessed October 6, 2012). The high unemployment and difficult economic conditions have resulted in episodes of civil unrest since 2008 with a rise in radical activity from both left and right wing extremists. The impact of the austerity program showed some improvement; in December 2013 Greece announced a \$3.6 billion surplus and the labor market was expected to experience a slow recovery by 2014 with unemployment at around 22 percent<sup>63</sup> (European Commission, (5) EEF 2012: 65-66; Stamouli, December 12, 2013).

Nevertheless, the austerity measures were very painful and the cause of great dissatisfaction with the voters, leading to the January 2015 election of the leftist Syriza party, which promised to roll back austerity and renegotiate the loans. This has created uncertainty with Greece's recovery; Greek GDP growth was expected to reach 2.3 percent in 2015, though it fell back into recession in early 2015 and only managed to eke out 0.5 percent at year's end (The Economist, (15) November 2014: 114; The Economist, (16) December 19, 2015). Attempts to renegotiate the loans failed, resulting in Greece remaining in the Eurozone, but not before Athens was forced to make painful and embarrassing concessions as conditions for a third bailout.

Greece's perpetually difficult relations with Turkey have improved somewhat in recent decades. This is particularly the case since 1999 when earthquakes hit both nations leading to cooperative relief efforts causing Athens to rescind its threatened veto of Turkey's EU accession (Grigoriadis 2008: 155). In 2007, the 285 kilometer Turkey-Greek Interconnection (TGI) was completed which fulfilled the long-term goal of directly supplying Azerbaijani gas to Europe.

However, in late February 2013, tensions increased over Greece's determination to conduct oil exploration in the Aegean Sea (Natural Gas Europe, (3) February 28, 2013). Greek control of the Aegean, a result of the 1923 Lausanne Treaty, is a contentious issue with Turkey, which has

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<sup>63</sup> The tourism industry remains a major source of foreign exchange earnings and revenue, employing, directly or indirectly, 16.5 percent of the total workforce (CIA (8) Factbook accessed October 6, 2012).

threatened military action should Athens attempt to exploit these reserves. The estimated \$130 billion of oil and gas reserves under the Aegean would greatly benefit Greece's economy and establish it as another European energy source. As a 1994 signatory to the U.N.'s Law of the Sea treaty, Greece is entitled to 12 nautical miles (21.6 kilometers) and a 200 nautical mile (360 kilometers) "exclusive economic zone" (EEZ). Athens has refrained from pursuing this for fear of Turkish reprisals, and to counter potential military or political actions, Greece it is looking for international support for recognition of its EEZ<sup>64</sup> (Granitsas, March 7, 2013).

Moving from the Aegean to the Eastern Mediterranean, the Greco-Turkish animosity also remains close to the surface. Discoveries of significant natural gas deposits in the Levantine Basin have created a host of opportunities and problems, much of them around Cyprus.<sup>65</sup> Central to the dispute is Turkey's refusal to acknowledge the ethnic-Greek controlled Republic of Cyprus, which it claims was illegally created following a 1974 coup. Statements from Greek Cypriots leaders indicate a willingness to share revenues with the Turkish side of the island, so far this has been 'rhetorical,' with little in the way of advancing concrete steps to make this a reality (Stetter Interview, December 16, 2014). Moreover, Ankara says it will not allow Cyprus to export gas from the island, and in October 2014 Turkish naval vessels were dispatched into Cypriot waters.

Within Greek Cyprus's disputed EEZ is the Block 12 offshore concession, also known as the Aphrodite field. There are varying estimates to the quantities of Aphrodite; the U.S. Geological Survey claims 280 bcm, while Delek Energy, the Israeli company working in the area, claims it is only 116 bcm. There is interest in building a LNG terminal at Vasiliko, Cyprus, though, according to Constantine Levoyannis and Mathieu Labrèche, a LNG facility requires a minimum 155 bcm per year to be viable, which questions whether Aphrodite alone can justify such an expenditure (Levoyannis and Labrèche, December 13, 2013). Possible solutions are to direct gas from other Eastern Mediterranean sources through Vasiliko. For instance, Israel has developed its own offshore Leviathan field and in 2014 Greece will start exploration in the Ionian Sea and southeast of Crete in the Herodotus Basin, estimated to hold 1.5 to 2 tcm (Foscolos, November 2011). Finally, Egypt is developing its own gas resources which could potentially support this play.<sup>66</sup> In fact, this effort is apparently bearing fruit as Eni in August 2015 announced the discovery of a major offshore gas field off Egypt's Mediterranean coast.

These developments to the south of the Black Sea RSC have created talk of a "second Southern Gas Corridor," yet the logistical and political challenges are perhaps even more daunting than the first corridor. At the December 2013 Frankfurt Gas Forum, former US Ambassador to Azerbaijan, Mathew Bryza, claimed that the potential gas wealth in the Eastern Mediterranean could be the incentive for long-term dispute resolution. Bryza noted the need to "line up" the political environment in which to facilitate a potential Israeli-Turkish natural gas alliance or even the possibility of a satisfactory resolution to the Cyprus issue, and feels the possibility of energy

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<sup>64</sup> In 1995 Greece ratified the Law of the Sea treaty; Turkey is not a signatory, which has put it at a legal and diplomatic disadvantage in the negotiations (Granitsas, March 7, 2013).

<sup>65</sup> A U.S. Geological Survey report estimates approximately 3.4 tcm of gas in the Eastern Mediterranean, making it one of the world's largest gas fields (Levoyannis and Labrèche 2013).

<sup>66</sup> Maria Kottari's "Energy Fact Sheets: Cyprus," provides additional insight. Kottari, Maria, December 2014.

investment will “catalyze” a political breakthrough.<sup>67</sup> Finally, Bryza referenced the importance of US involvement, citing Washington’s influence in the Eurasian corridor development in the 1990s, but cautioned that any deals between these parties will require considerable external (US and EU) patience (Natural Gas Europe, (4) December 12, 2013).

Greek hydrocarbon exploration dates back to the early 20th century, carried out by both domestic and foreign companies. In 1960 the former Ministry of Industry, with foreign assistance, conducted geological surveys which identified offshore oil and gas fields. In 1975 DEP SA was founded, and in 1985, DEP-EKY SA began upstream operations as a DEP SA subsidiary.<sup>68</sup> In the mid-1990s DEP SA and DEP-EKY SA conducted seismic explorations, which located the offshore oil field in Katakolo western Greece and the gas field in Epanomi, Thessalonica (Greek Ministry of Environment, Energy and Climate Change, date accessed January 12, 2014). With known domestic oil and gas reserves of just 6 million bbl and 900 mcm respectively, Greece is highly dependent on imports to meet its basic energy needs, so these Eastern Mediterranean plays are very interesting to Athens. Like its neighbors, Greece is hoping to facilitate energy transit to Western Europe while securing its own supply, thus garnering badly needed revenues. In this capacity, Athens has been anxious to develop a regional energy network within the Southern Gas Corridor (Watkins, November 20, 2007). The TAP will potentially give Greece some much-needed good news as the gas pipeline will connect with TGI, providing jobs and long-term transit fees.

In the initial bailout provisions, Greece needed to generate over \$2.0 billion from the sale of government assets. In March 2013, attempts by the Greek government to auction off state assets, such as the Public Petroleum Corporation (DEPA SA), the state-owned gas company, were unsuccessful; Gazprom was considered the most likely buyer but did not submit a bid<sup>69</sup> (Kottari 2014: 6; Financial Times, Beyond BRICS, March 16, 2013). DEFA SA, or the Hellenic Gas Transmission System Operator, the Greek state-owned gas transmission company, and a subsidiary of DEPA SA, was purchased by SOCAR, though the EU energy directorate made it clear that the transaction must comply with liberalization efforts and is subject to parliamentary approval (Natural Gas Europe, (5) December 12, 2013). As of December 2015, Brussels had not approved the deal. The Syriza government stated there will be no further auctions of state assets, though it remains to be seen if this can be sustained under the new bailout regime agreed to in July 2015.

Greek energy policy is developed by the Ministry of Environment, Energy and Climate Change, which comprises three main objectives; uninterrupted and reliable supply, ensure emergency supply, and provide sustainable development and production.<sup>70</sup> The strategy is based on gaining access to a diversity of oil and gas sources, pipelines, developing domestic and renewable energy

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<sup>67</sup> Amos Hochstein, Special Envoy at the State Department’s Bureau of Energy Resources, makes almost the exact comments as Bryza, also stressing the US taking a more active role (Hochstein, January 8, 2015). Israel and Turkey had generally solid relations for decades, though this took a decided downturn during the Erdogan years. This was further exacerbated when Israeli special forces killed 8 Turks in May 2010 on a flotilla trying to break the Israeli-imposed Gaza blockade.

<sup>68</sup> (DEP-EKY SA) Public Petroleum Corporation - Hydrocarbons Exploration and Exploitation

<sup>69</sup> DEPA-Dimosia Epichirisi Paroxis Aeriou.

<sup>70</sup> On October 7, 2009 the Ministry of Environment, Physical Planning and Public Works name was changed to the Ministry of Environment, Energy and Climate Change.

sources, market liberalization and a healthy investment climate. Moreover, Greece is bound by the provisions of the “20-20-20” as obligated in the National Action Plan reports to the European Commission. Greece follows an “open door” policy which permits open invitations for bidders on concessions (Greek Ministry of Environment, Energy and Climate Change, date accessed January 12, 2014).

## **Moldova**

To understand Moldova’s modern history one must first acknowledge its unique cultural and linguistic background. Moldovan heritage is traced to Romania, which makes it predominantly non-Slavic.<sup>71</sup> This divide is manifest in two distinct regions within the country; the bulk of the population lives in the western, or Bessarabian, portion of Moldova. The Slavic element, comprising ethnic Ukrainian and Russians, live in a thin piece of territory on the eastern edge of the Dneistr River, or Transnistria (King 1997: 22). Transdnistria is densely populated and holds significant parts of Moldova’s industrial and energy producing facilities. It is this ethnic divide which has defined Moldova’s post-Cold War existence.

In the aftermath of World War II, Molodva was incorporated into the Soviet Union, whereupon Moscow attempted to eradicate its Romanian, or Latin, ancestry by imposing the Cyrillic alphabet and forcing the use of Russian language in all official capacities.<sup>72</sup> The communists also stressed Moldova’s unique linguistic and cultural heritage to weaken the links to Romania, primarily to dissuade any future effort at unification. This attempt to drive a wedge between Moldova and Romania was generally unsuccessful, as the Moldovans closely guarded their Romanian ties while under Soviet rule.<sup>73</sup>

As Glasnost and Perestroika were implemented in the USSR, mass demonstrations in Chişinău in 1989 pressured the authorities of the Moldavian SSR to officially recognize Latin script as the state language. Parliamentary elections were held in early 1990 and in June the new parliament adopted the Declaration of Sovereignty of the Soviet Socialist Republic of Moldova, which placed supremacy of Moldovan laws over Soviet ones; a defacto declaration of independence. Moldova’s formal independence was granted on August 27, 1991, with Romania being the first state to recognize it (Musteată, 2014).

During this period the Slavic population of Transdnistria became concerned with the rise of Moldovan nationalism and the possibility of reunification with Romania. This Slavic majority in the east broke away from the Moldovan Republic to create a separate Transnistrian state under

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<sup>71</sup> Between 1538 through 1812, Moldova lived under Turkish rule, though from 1812 through 1918 it fell under Russian control. In 1918, Romanian troops occupied Moldova until 1940 when Soviet military pressure forced a withdrawal. This was a little known provision of the non-aggression pact between Nazi Germany and the USSR, whereby Hitler agreed to Russian annexation of Bessarabia.

<sup>72</sup> In 1860, after many years of being forced to use the Cyrillic alphabet, Moldovans were allowed to use the Latin script.

<sup>73</sup> Moldovan nationalism and cultural identity are more complex than simply an extension of Romania. Despite the strong linguistic and cultural links, there is little interest to unite into a “Greater Romania,” and such attempts have been defeated at the ballot box, indicating Moldovans are content with maintaining their unique identity apart from Romania (King 2000: 224).



Russian protection (Pourchot 2008: 72-73). In the winter of 1991-1992 clashes occurred between the Moldovan police and Transnistrian separatist forces, supported by elements of the Russian Army. The Moldovans were unsuccessful in reuniting the country and a “frozen conflict” ensued. The lack of governing oversight has allowed the breakaway state to take on an increasingly lawless nature, existing as a convenient and unmolested transit point for organized crime.

In early January 1992, Moldova introduced economic reforms and liberalized prices, which resulted in rapid inflation and a severe economic downturn. The introduction of real world oil prices in 1991 meant a 40-fold increase in energy prices, which further shocked the economy, but also forced a 50 percent decrease in energy utilization, primarily from reduced industrial production and conservation efforts, but also limited financial means to purchase the resources.<sup>74</sup> For nearly ten years an economic crisis gripped the country, impoverishing much of the population and forcing many to emigrate. In 1997 Moldova enacted energy reforms, to include full liberalization of its energy supply. The reforms were supported by the World Bank and European Bank of Reconstruction and Development (EBRD). These post-independence reforms showed some positive developments; financial and banking reform was undertaken and the legislative and institutional basis resulting in a market economy in which economic stabilization eventually ensued (Energy Charter, (26) Moldova 2004: 13-14).

As the economy began to recover Moldova enjoyed annual growth rates of between 5-10 percent, and in 1994 joined the PfP and became a member of the Council of Europe the following year. In April 2001, Vladimir Voronin, of the communist party was elected prime minister. In 2009 the communists won only 49.5 percent of the vote, which precipitated a three year political crisis between the communists and a coalition of moderate parties. It was only in March 2012 that the independent, Marian Lupu, was able to cobble together a working coalition government (CIA, (9), Moldova, date accessed October 6, 2012).

There is concern that the effects of the Ukrainian crisis is impacting Moldova and its own potentially explosive domestic issues, while the corruption and political infighting has allowed the emergence of populist candidates. On November 17, 2014 German Chancellor Angela Merkel “warned” Moscow against any adventurism in post-Soviet states, to include Moldova. Leading up to the November 30, 2014 parliamentary elections, the country’s election commission barred the pro-Russian candidate from participating after allegations surfaced of his close relations to Russia’s security apparatus, the FSB (Parkinson November 28, 2014).

Moldova has virtually no oil and gas fields in production and imports its domestic requirements from Russia on Gazprom-owned pipelines. As a transit country for Russian gas, exports to the Balkans are an important source of energy and revenues. Moldova was negatively impacted by the Russia-Ukraine gas crises, and has since attempted to diversify its energy sources. In 2010, much to the Kremlin’s annoyance, Moldova joined the Energy Community, an EU-sponsored organization that promotes energy market liberalization in Eastern Europe. Moldova now finds itself involved in a public dispute with Russia over gas prices; Chişinău has asked for a price reduction and debt relief from the \$4 billion owed Gazprom, however, Russia's energy minister,

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<sup>74</sup> During this period 34 percent of Moldova’s import budget is spent on energy resources (Energy Charter (27) Moldova 2004: 13-14).

Alexander Novak, indicated that any discussions on price reduction and debt relief would be predicated on Moldova's withdrawal from the Energy Community. Günther Oettinger, the European Commissioner for Energy at that time, called the Russian ultimatum "blackmail" (Keating 2012).

The Ministry of Energy is the responsible executive authority for energy policy, and in 2000 a 10-year energy strategy was released, designed to increase energy efficiency, diversity and utilize local resources, and renewables.<sup>75</sup> There is also a priority to import more natural gas over the next 20 years, which include plans to build new gas pipelines and distribution networks. In August 2013, a gas pipeline linking Moldova with Romania was opened, the significance being that gas from non-Gazprom owned pipelines is now available to the country (Energy Charter, (28) Moldova 2004: 9; Ceban, March 2, 2012; Natural Gas Europe, (6) August 27, 2013). Though Moldova may benefit from eastward-bound gas, it is very likely this is re-directed Russian gas from other sources.

In 1997 the National Agency for Energy Regulation (ANRE) began as an independent body to introduce market reforms in the energy sector, primarily gas and electricity. A year later, additional reforms were passed designed to further liberalize the energy sector through unbundling state-owned entities which allowed private ownership and a nascent energy trading capability<sup>76</sup> (Energy Charter, (29) Moldova 2004: 20). In January 2013 a new strategy was released which outlined security of the energy supplies, the development of competitive markets and their regional and European integration. The government has allocated \$325 million to accomplish the strategy, a sizeable sum and an indication of the government's seriousness to enact reform (AllMoldova, January 16, 2013; Moldova, January 2013). The new strategy also identified a 2 percent annual reduction in energy intensity, though this will require doubling GDP without increasing energy consumption (Energy Charter, (30) Moldova 2004: 20).

Moldovagas is responsible for the import and distribution of natural gas. The company was privatized in 1999 with Gazprom taking majority ownership (50 percent plus one share) and operational responsibility. The Moldovan government retains 36 percent and Transdnistria the remaining 14 percent (Energy Charter, (31) Moldova 2004: 16). With a total annual capacity of 34.6 bcm, Moldova is a vital transit country for Russian gas. It is this route which supplies Romania, Bulgaria and Turkey, to include feeder lines to Greece and Macedonia. Moldova has no domestic storage facilities, and must rely on Ukraine for this function. Moldovan gas consumption recovered after 2008 to about 3 bcm per year, of which 1 bcm per year is consumed in Transdnistria. The remaining consumption is concentrated in Chişinău (Energy Community, (1) Annual Implementation Report 2013: 112-113).

## **Romania**

Romania is a mid-sized power within the Black Sea RSC with a tradition of industrial and agricultural strength commensurate to its size. Though Romania fell within the Eastern Bloc, it

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<sup>75</sup> From 1991 to 2001 this was Department of Energy and Fuel-and-Power Resources.

<sup>76</sup> Unbundling is the process of instilling greater competition by legally breaking the link between producer and service provider.

was far from an enthusiastic member. In 1965 Nicolae Ceausescu took power and was initially regarded by the West as a leader willing to challenge Moscow, notably over economic policy and ideology. For this reason Romania was afforded generally positive Western attention and press coverage. Over time his government became more autocratic and his social and economic policies more broadly harmful. These oppressive conditions lasted through the 1980s when Ceausescu was overthrown and executed in December 1989.

Similar to Bulgaria, post-independence Romania has placed emphasis on closer ties with Western Europe and the United States, a policy which proved successful as Romania joined NATO in 2004 and the EU in 2007. Yet, Romania is also plagued by governmental corruption, putting it at odds with Brussels which (similar to Bulgaria) has delayed disbursing cohesion funds (The Economist, (17) June 5, 2012). Political in-fighting, notably between the president and prime minister in recent years has also elicited criticism from Brussels, and has negatively affected the government's efficiency.

Romania emerged from the 1989 revolution with weak growth caused by a decrepit and obsolete industrial base. This experience prompted a campaign to address these weaknesses, and by 2000 the Romanian economy had experienced a turnaround, with high growth, low unemployment and declining inflation. For 2008, GDP growth was 7.1 percent, one of the highest rates in Europe, however, the global recession shook the Romania economy, contracting over eight percent in the following two years (European Commission, (6) EEF 2012: 99-100). Romanian GDP growth in 2012 was a weak 0.8 percent, though labor and market reforms implemented before the recession helped it recover to 3.4 percent in 2013 and 2.9 percent in 2014 (European Commission, (7) EEF 2012: 99-100; CIA, (10) Romania, date accessed September 7, 2015).

Romania has benefited greatly from the Carpathian-Balkan Basin on its territory, currently estimated to hold 5.9 billion barrels of oil, 255 bcm of natural gas, and 100 million barrels of natural gas liquids<sup>77</sup> (Pawlewicz 2007: 1). For over a century Romania was one of Europe's foremost oil and gas producers, a fact which attracted the attention of both Axis and Allied powers during World War II. This attention proved detrimental for its contribution to the German war effort and as a target for Allied bombers. As war reparations, the Soviets confiscated much of the undamaged Romanian energy infrastructure and relocated it within the USSR to help with the post-war reconstruction<sup>78</sup> (Goldman 1980: 57-58). The existing oil and gas network, has a refining capacity of 500,000 b/d and an extensive pipeline infrastructure managed by an experienced workforce, which makes Romania attractive for investment (Popovici 2009)

Petrom is the predominant energy producer in Romania.<sup>79</sup> It is the former state-owned oil and gas company, and was established as the flag-ship of the Romanian oil industry in 1997. It is a vertically integrated oil and gas company, with primary operations in Romania, and external involvement in Kazakhstan, Hungary and Moldova. To meet EU accession requirements and

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<sup>77</sup> It should be noted that part of the Carpathian-Balkan Basin lies on Bulgarian territory. The figures cited are estimates and not necessarily recoverable quantities.

<sup>78</sup> Romania was allied with Nazi Germany in World War II.

<sup>79</sup> Petrom is majority controlled by OMV of Austria. It is sometimes referred to as OMV-Petrom.

implement stronger oversight mechanisms, Romania opened up its energy sector; Petrom was privatized in 2004 allowing foreign investment (Petrom website, accessed July 30, 2014).

Anxious to bring in FDI and diversify from a reliance on Russian energy sources, in October 2009 Romania agreed to buy 7.3 bcm per year of Azerbaijani gas. Bucharest has also allowed Caspian basin producers access to EU markets via its own infrastructure. In 2007, Kazakh state-owned oil and gas company, KazMunaiGaz, began investing in Romania (Popovici 2009). Azerbaijan's SOCAR is another foreign company interested in Romania's energy assets, with 2013 investments expected to total \$66 million, primarily in SOCAR-brand gas stations (Black Sea News April 9, 2013).

Romanian oil production peaked in 1976 at 308,000 b/d, and by 1979 imports exceeded domestic production. By 1986 production had fallen to 227,000 b/d. With known oil reserves at 600 million bls, Romania produced 94,000 b/d of oil in 2011, meeting less than half of national requirements, and forcing the country to import, mainly from Russia, to make up the shortfall (CIA, (11) Romania, date accessed May 19, 2013; European Commission, (8) Directorate for Energy and Transportation 2008). The Black Sea port of Constanta holds an important position by receiving and supplying crude oil to the cluster of refineries located in southern Romania, notably the Arpechim, Pitesti and Ploesti facilities, serviced by a 1,200 kilometer pipeline with a 360,000 mb/d capacity. The Romanian pipeline network is operated by majority state-owned Conpet S. A. (Energy Charter, (32) (Oil) 2012: 75; SeeNews, January 2011: 5).

The Romanian natural gas industry is also experiencing decline from its mid-1970s high of 34.7 bcm, falling to 26.8 bcm in 1986, and forcing Bucharest to import product from the Soviets (Geographic.com; accessed May 19, 2013; CIA (12) Romania, date accessed May 19, 2013). The primary gas producer, Petrom, delivers 5 to 6 bcm/year, which meets less than half of domestic gas requirements (Petrom website, accessed May 19, 2013). With 60 bcm of recoverable natural gas reserves, production is now 11.5 bcm per year, against consumption approximating 14 bcm per year (Popovici 2009). In February 2012, Petrom announced the discovery of the Neptun gas fields off Romania's coast, with an estimated 42 to 84 bcm, or a potential 6.5 bcm per year.<sup>80</sup> This find has the potential to eliminate Romania's gas production shortfall for the foreseeable future (Petroleum Intelligence Weekly, July 9, 2012; Natural Gas Europe, (7) April 13, 2013).

In 2003, two documents were released; the 'National Strategy for Energy Sector' and the 'National Strategy for Energy Efficiency for 2004 – 2015,' both with goals to harmonize Romanian energy legislation as prescribed by the EU acquis. Of note was the admission that crude oil and natural gas represented over 80 percent of Romania's total imports, necessitating a diversification of energy sources. Also included in the latter strategy is the goal to attain 3 percent yearly reduction in energy intensity (Energy Charter, (33) Romania 2006: 8-9, 59-60). Though Romania (and Bulgaria) are in legislative lockstep with the EU regarding their energy policies, how well these are implemented in the face of powerful and vested interests remains to be seen.

The energy strategies emphasize unconventional and renewable resources, as well as offshore reserves, which have been relatively small. Romania's leaders are preparing for the inevitable

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<sup>80</sup> Petrom is developing the Neptun field in cooperation with ExxonMobil and OMV.

time when its fields are depleted at which point it may have no alternative but to exploit its shale reserves. Romania is also trying to develop its shale gas, though this has raised opposition from farming and environmental organizations concerned over its impact. Additionally, there is a well-developed hydro power infrastructure, aided by Romania's vast river networks, which have helped diversify the country's electricity generation sources (Karasz, April 22, 2012; Reuters, October 12, 2013).

## Turkey

After Russia, Turkey is the dominant military, political and economic power in the Black Sea RSC, also with a long history of attempting to influence events in the region. In the early 1990's, Turkey tried to exploit the post-Soviet power vacuum by positioning itself as the nominal leader of the Turkic speaking people with the "Greater Turkey" or the "Cooperative Hegemony" movement. Motivated by a combination of fraternalism, ethnic pride and an interest in the oil and gas wealth present in their Turkic neighbors, this newfound assertiveness was a departure from Ankara's generally low-key foreign policy of previous decades (Rittenburg 1998: 116, 158). This attempt at a pan-Turkic entity lacked the political and financial credibility to sustain itself in the face of Russian and Iranian regional ambitions, let alone US and EU interests. Additionally, the former Soviet-Turkic populations, despite cultural and ethnic similarities and Ankara's generally benign intentions, were not enthusiastic to submit to another regional master (Aybak 2001: 4).

Recep Tayyip Erdogan, the current prime minister and leader of the Islamic-leaning Justice and Development Party (AKP),<sup>81</sup> was first elected to the office in 2003. Under Erdogan there has been the imposition of 'Neo-Ottomanism,' a mild-authoritarianism, as well as a gradual relaxation of the strict secularism that has been Turkey's traditional domestic policy since Ataturk. Erdogan has also weakened the Turkish general staff, the enforcers of secularism, and prosecuted journalists for criticizing the government. Neo-Ottomanism has been vigorously rejected by secular Turks and Erdogan's political opponents; the June 2013 unrest in Turkey was seen as a reaction to Erdogan's authoritarianism and drift from the secularism that was the foundation of the modern Turkish republic. The 2014 regional elections saw gains from the AKP candidates indicating Erdogan's overall political strength, yet this was balanced by significant political setbacks by the AKP in 2015.

Furthermore, Turkey's accession talks with the EU have gone badly in recent years, partly from this authoritarian drift, as well as human rights abuses committed in the conduct of counterinsurgency operations against the Kurdish People's Party (PKK) (Sarokhanian and Stivachtis 2008: 179). In response Turkey claims an anti-Muslim bias within the EU, leading to signs that Ankara's reflexive pro-Westernism may be ending. This partly stems from the perceptions of Western political and economic failures, such as the 2003 Iraq War and the 2008-2009 financial crisis, which have negatively affected the country and forced Turkey to shift from its predominantly Western focus to a neutral or Middle Eastern one (Goksal 2011).

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<sup>81</sup> Adalet ve Kalkinma Partisi.

Moreover, it is argued, because of Turkey's staunch Westernism throughout much of the 20<sup>th</sup> Century, and the neglect of its non-Western neighbors, it has been unable to reach its full economic, political and cultural potential (Goksal 2011). This traditional Western orientation has brought Turkey into conflict with the USSR and Iran, whereby these latter countries have actively challenged Ankara's regional role for decades, a condition which drained resources and prevented Turkey from operating independently in its sphere of influence. It can be said that Turkey's effort in the late 1990s and early 2000s to adhere to the Copenhagen Criteria for EU accession was exemplary, arguably making better progress than Bulgaria and Romania.<sup>82</sup> However, the dispute over Cyprus forced a suspension of talks in December 2008 and Ankara's accession prospects have diminished considerably since then (Sarokhanian and Stivachtis 2008, 280-282).

These circumstances led the Turkish foreign minister at the time, Ahmet Dovutoglu to promote the "Zero Problems" policy, which attempts to remove neighbors' incentives to counter Turkish interests (Goksal 2011). This foreign policy shift is attributed to the AKP's Islamic foundation, and the desire to expand its influence through soft power, ultimately to position itself as a regional political and economic powerhouse (The Economist, (18) June 12, 2010: 55-56; Turkish Ministry of Foreign Affairs website, accessed October 26, 2013). The intent was to "complement" the neighbors' foreign policy initiatives in what the minister calls "rhythmic diplomacy," or moving with the natural ebb and flow of regional relations (Vorotnuyk 2007).

Zero Problems is perhaps easier said than done. As "a country surrounded by reality," Turkey is squarely in the middle of external forces beyond its control, forcing it to endure a "curse or blessing" of history and geography (Vorotnuyk 2007). It was this policy which drove the exploration of normalizing ties with Armenia, but as Baku is anxious to maintain pressure on Yerevan, this initiative was not well received by the Azerbaijanis. After rising tensions with Azerbaijan and negative public reaction in Turkey, Ankara backed down, but not before damaging its credibility in both Yerevan and Baku (Goksal 2011). The Russia-Georgia War of 2008 further demonstrated Ankara's difficulty maintaining this policy in the wake of Moscow's prowess. For this reason Turkey has been reluctant to challenge Russia, leading to Ankara's opposition to NATO's Operation Active Endeavor, a Mediterranean counter-terror and anti-narcotic interdiction effort, from operating in the Black Sea (Goksal 2011).

When looking at relations between the Black Sea RSC's two largest powers, there is a strong historical background of confrontation which carries on to this day. Though still regional rivals, the relations between Russia and Turkey have improved considerably in the last 20 years, notably in the economic and political sectors. The centerpiece of this new era is the "Treaty on the Principles of Relations between the Republic of Turkey and the Russian Federation," signed in May 1992 and the "Joint Action Plan for Cooperation in Eurasia" of November 2001, which ushered in a level of cooperation that would surprise Bratianu (and Ataturk)<sup>83</sup> (Turkish Ministry of Foreign Affairs website, accessed on Oct 26, 2013). In fact, as Ankara's EU accession talks

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<sup>82</sup> This criteria was developed in Copenhagen in June 1993. For more information see the Copenhagen Criteria of 1993. (See Europa, (2) Economic Accession Criteria: The Copenhagen Criteria, date accessed March 12 2016).

<sup>83</sup> In 2010 Moscow and Ankara initiated the High Level Cooperation Council to further coordinate economic and diplomatic relations between the states; the December 2015 meeting was canceled in light of the rapidly deteriorating relations (Gurel and Tzimitras 2015: 28).

continue to stagnate, Russia tries to exploit this divide by dangling an invitation to the EEU at Turkey to draw it even further from its Western bearings (Cohen 2015: 2).

In fact, it should be noted that the USSR and Turkey had economic contact during the Cold War, primarily in technical and economic assistance which paved the way to today's commercial relationship.<sup>84</sup> In 2008 Turkey bypassed Germany as Russia's largest trading partner with \$38 billion in annual trade volume, and in May 2010, the two nations agreed to build Turkey's first nuclear power plant, estimated at \$20 billion. In particular, the cooperation in the energy sector between the countries should be noted; Blue Stream is a significant point in Russia-Turkish political and economic relations, as was Turkey's permission to allow South Stream to pass through its EEZ (Markedonov 2011). With South Stream now defunct, its replacement, Turk Stream, could lead to greater Turkish-Russian cooperation in the regional energy sector.

However, in the political sphere there are still numerous contentious issues, most recently Russia's deployment of military personnel and equipment to Syria's Bashar Assad, Turkey's Arab nemesis in the Middle East. Additionally, there is Moscow's fear that Pan-Turkism will foment agitation in Russia's Islamic population, while Ankara's solidarity with Azerbaijan in Nagorno-Karabakh has drawn criticism from the Kremlin. Furthermore, there is the Kremlin's annoyance at Turkey's support of Georgian territorial integrity, as well as improved relations between Ankara and Kiev. For its part, Turkey chafes at Russia's militarization of the Black Sea following the annexation of Crimea. There is also Moscow's vigorous counterinsurgency operations in the North Caucasus and the military presence in Armenia, and Ankara views Russian-Iranian cooperation as a challenge to its regional ambitions (Markedonov 2011). Nevertheless, these wide-ranging and potentially inflammatory issues have so far been successfully compartmentalized and managed by Ankara and Moscow.

Turkey has set its sights on being the region's transformational force, and the long-term focus on stability has created unprecedented growth and improved its regional standing. In the early 1980s, after decades of political and economic drift in the form of chronic inflation and periodic booms and busts, Turkey underwent an economic revitalization which addressed the public deficit, banking sector reform, privatization, and persistent inflation. The author of the liberalization plan was Turgut Ozal, the finance minister and later prime minister. Ozal and the Motherland Party began to shift the Turkish economy from import substitution to an export based model, resulting in relative economic and political stability.

In essence, integrating Turkey into the global economy was the final act of the country's Westernization process, and, according to Ozal, the intervening half-century of inactivity was an "enormous loss of time." The Turkish constitution, as well as numerous laws and regulations were amended to meet EU acquis, and in 2005, the EU recognized Turkey's improved market economy, and elevated it to candidate status<sup>85</sup> (Ozal 1991: 306-308; Onis 2010: 46, 61). Turkey under Erdogan will continue its authoritarian Islamic drift, which has the potential for future

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<sup>84</sup> In 1987 Russia began supplying natural gas to Turkey via the existing trans-Balkan pipeline (Markedonov 2011).

<sup>85</sup> Turgut Ozal was one of the more consequential Turkish leaders of the late 20<sup>th</sup> Century. In the early 1980s he was deputy prime minister under Suleyman Demirel where he began to implement economic liberalization reform. Subsequently, he was Turkish prime minister from 1983 through 1989, followed by a term as president from 1989 to 1993 (Encyclopedia Britannica).

unrest, and which will increase as the Middle East becomes more unstable. This endemic instability will likely sabotage any hopes of EU accession, while this authoritarianism by the Black Sea RSC's two main powers highlight the internal friction at play with the region.

Ankara avoided the worst of the 2008-2009 crisis which originated from outside the country and was largely beyond its own control. Though the Turkish economy suffered, it did not require IMF assistance to meet balance of payment obligations as had been the case during previous downturns. Turkey's response was to implement tax cuts to stimulate consumption, which helped it to weather the economic storm (Onis 2010: 58). In the 2011 election, Erdogan and AKP won reelection primarily because the opposition, the Republican People's Party (CHP), could not exploit economic issues. In August 2014, Erdogan was elected president, a relatively ceremonial position, so there is now a shift in power to that office from the prime minister. Despite constitutional limits to the president, that office's power has expanded under Erdogan's forceful and active leadership. However, Erdogan's attempt to change the constitution to formally grant the president more power was defeated at the ballot box in June 2015.<sup>86</sup>

Though Ankara's long-term economic forecast is fairly positive, there are definite areas of weakness. Having survived the worst of the global crisis, tepid GDP growth in the EU has diminished demand for Turkish goods and services. Turkish real GDP growth slowed from an impressive 8.5 percent in 2011 to 3 percent in 2012. GDP growth is forecast to fall to 2.9 percent in 2013, before rising to 3.7 percent in 2014; effectively a "soft landing" in economic parlance. GDP growth for 2015 is anticipated at 4 percent (The Economist, (19) November 2014: 114). Moreover, Turkey still finds itself hampered in that 3-4 percent annual growth rates cannot meet long-term employment demand (Onis 2010: 60). Unemployment decreased from 8.8 percent in 2011 to 7.5 percent in 2012, and is expected to drop to about 6-7 percent in 2013-2014 (European Commission, (9) EEF 2012: 126-127). Finally, the recent emergence of high-level corruption in Erdogan's cabinet and the Turkish lira devaluation in early 2014 has shaken the government, though these scandals had limited impact on Erdogan's election to the presidency.

It is possible to see the influence of Turkey's EU accession bid in which it has implemented oversight bodies, checks and balances and a liberalized energy sector. The Turkish oil and gas sectors, as well as electricity and LNG markets, are overseen by the Energy Markets Regulatory Authority (EMRA). Established in 2001, the EMRA is the independent market regulator for petroleum, natural gas, electricity and LNG, entrusted to ensure competitive domestic energy markets. EMRA works in conjunction with the Ministry of Energy and Natural Resources (MENR), which reports directly to the Prime Minister, and has responsibility for developing and implementing energy policies. In this capacity, MENR coordinates public and private sector entities, and provides oversight of exploration, production and distribution (Gunay 2006; Energy Charter, (34) (Oil) 2012: 78).

Turkey's economic growth since the 1980s has far outstripped its domestic capacity to meet energy requirements. Prior to the global recession, Turkish energy demand's rate of increase was one of the world's highest, particularly for heating and electricity generation (EIA, (15) Turkey Country Analysis 2011: 5). At 270 million barrels in known reserves, Turkey is far below Azerbaijani or even Romanian capacity (CIA, (13) Turkey, date accessed January 15, 2013). In

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<sup>86</sup> Dovutaglu, the former foreign minister, is now the Turkish prime minister.



1991 Turkey's oil production peaked at 85 thousand b/d, and has since leveled off to approximately 40 thousand b/d. With oil consumption over 650 thousand b/d, Turkey imports the vast majority of its oil requirements to make up for this shortfall (EIA, (16) Turkey Country Analysis 2011: 2; Popovici 2009).

The government-owned TPAO produces most of Turkey's oil output, and though the company has preferential rights on Turkish projects, in 2010 ExxonMobil and Chevron were invited to conduct Black Sea exploration and production. Preliminary exploratory results estimate as much as 10 billion barrels of oil, which, if accurate, could significantly alter Turkey's role in the region by transforming it into both a hub and producer (EIA, (17) Turkish Country Analysis 2011: 2). The oil and gas pipelines are built and operated by BOTAS, the state-owned concern, which dominates the sector, though most of the domestic market is now open to competition.<sup>87</sup>

In 2015 Turkey consumed approximately 50 bcm of natural gas per year, a 17 percent increase over 2009, and a quantity which is expected to rise to 75 bcm in 2025<sup>88</sup> (Turkish Weekly, September 18, 2012). Turkish natural gas reserves, estimated at 6.2 bcm, are predominantly derived from the offshore field in the Sea of Marmara, resulting in only 710 mcm produced in 2009 (EIA, (18) Turkey Country Analysis 2011: 2-5; Popovici 2009). Production is mainly carried out by three companies, of which only one (TPAO) is a domestic firm; the others being BP and Shell. To diversify its sources, Turkey relies on imports from Russia, which provides 55 percent of total gas consumed, as well as Iran, Iraq and Azerbaijan, as well as LNG shipments, much of it from Algeria and Nigeria, to its terminal at Marmara Ereğlisi in western Anatolia (EIA, (19) Turkey Country Analysis: 4; Ellinas December 18, 2015).

Despite Turkey's relative weakness as a producer, its most valuable asset in the broader energy realm, indeed, its economic and geopolitical asset as well, is its strategic location. The geography of the Anatolian peninsula creates a concentrated, channeling effect whereby energy transit is forced into a relatively narrow and confined perimeter, and this concentration has allowed Turkey to enjoy logistical command and control benefits. In many respects, TANAP exemplifies Turkey's importance as a transit state; Ankara recognizes its role and is determined to pursue its energy goals as well as its energy mix while increasing its domestic oil and gas production. Turkey has been cooperating closely with SOCAR on the TANAP, and in October 2011, SOCAR and BOTAS signed several gas export agreements, including the transit of Azerbaijani gas to Europe through Turkey (Oil & Gas Journal, (3) July 16, 2012: 13).

## **Ukraine**

Arguably, Ukraine is the Black Sea RSC member with the most unrealized potential. A country of 46 million with considerable industrial capacity and natural resources, it has been characterized by a weak and unpredictable economic environment with public agitation for better governance, and persistent intervention by Russia. Ukraine's security is further undermined by its energy dependence and its linguistic and ethnic schism, manifest in a starkly divided country; the western part oriented toward Europe, while the eastern portion looks toward Moscow. The

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<sup>87</sup> Boru Hatlari ile Petrol Tasima

<sup>88</sup> For comparison purposes, in 1999 Turkey consumed 12.5 bcm (EIA (20) Turkish Country Analysis 2011: 4).

results of this divide are now being played out in today's headlines and the current state of flux makes it difficult to project long-term trends.

Ukraine's foreign policy is arrayed in what Tor Bukkval calls the "three vectors"; 1) the Black Sea, 2) Eurasia (which includes Russia) and 3) the West. Under President Leonid Kravchuk, Ukraine attempted to develop the Black Sea "vector," the approach with the most freedom of action and potential for success, through a Kiev-Ankara-Baku axis. This effort was highlighted by the creation of Georgia-Ukraine-Uzbekistan-Azerbaijan-Moldova (GUUAM), later GUAM-Organization for Democracy and Economic Development (ODED), organized primarily as a means to secure the members' sovereignty and counterbalance Moscow's regional dominance<sup>89</sup> (Bukkvol from Aybak: 85, 90). Nevertheless, despite support from the US and the EU, GUAM-ODED is a marginal player in the regional power calculus.

During the Soviet era Ukraine was the union's second largest economy after Russia, and its industrial and agricultural sectors contributed to Moscow's post-war economy. It was Nikita Khrushchev, a Ukrainian, who "gave" the Crimea to Ukraine, as a goodwill gesture and a token compensation for Stalin's deprivations there. This was despite the fact that ethnic Russians comprise over 50 percent of the Crimean population; it was a gift with long-term and nefarious consequences (Pourchot 2008: 93; Bukkvol from Aybak 2001: 103). In one respect Ukraine benefited from the Soviet collapse by its accumulation of sea ports; Odessa, Sevastopol, Mykolayiv and Kherson were Soviet ports, and all of which transitioned to Ukraine in 1991-1992. Kiev lost control of Sevastopol, by far the most important from a geopolitical standpoint, in early 2014 when Russia annexed Crimea.

As the USSR broke apart, Russia continued to offer Ukraine and the former Soviet republics subsidized gas, but by mid-1993 Ukraine found itself in arrears to the point where Gazprom cut back on deliveries.<sup>90</sup> Later that year Russian energy authorities offered to erase the gas debt if Ukraine renounced its claim to the Black Sea Fleet, the status of which was under dispute, and gave Moscow full control of Ukraine's nuclear missile arsenal.<sup>91</sup> Kravchuk agreed to this offer, but later rescinded it as he became engulfed in a political firestorm. The so-called Massandra Incident was concluded with Gazprom taking majority control of Ukraine's gas pipeline network<sup>92</sup> (Smith 2004: 47).

Following independence in 1991, the country hap hazardously transitioned from a planned to a market economy, but did not effectively implement structural reforms. For instance, though the government established a legal template for privatization, many of the state-owned companies were exempt from the process. Furthermore, as the government liberalized some prices, it continued to subsidize state-run industries and agriculture, creating broad imbalances and

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<sup>89</sup> Uzbekistan left the organization in 2005.

<sup>90</sup> Russian oil imports to Ukraine were priced at world market rates (Popovici 2009).

<sup>91</sup> The Black Sea fleet was a point of contention between Russia and Ukraine in the early 1990s. The 1997 Partition Treaty split the fleet between the states, while giving Russia a 20 year lease to maintain the fleet in Sevastopol. The Budapest Memorandum of 1994, signed between Ukraine, Russia, US and UK, stipulated that Ukraine's sovereignty and territorial integrity would be respected in return for Kiev giving up its Soviet legacy nuclear weapons. In 1994 Ukraine signed the Nuclear Non-Proliferation Treaty and turned over its full nuclear arsenal for disarmament. For more information see the Nuclear Threat Initiative website.

<sup>92</sup> Named after the Crimean town where the negotiations were held.

inefficiencies in the economy. Finally, the Russian gas subsidies created a dependency which is only now being addressed (Popovici 2009).

At the end of the Leonid Kuchma administration in 2004, the government was increasingly under public pressure for corruption, voter fraud, diminishing civil liberties and power concentration in the presidency (Pourchot 2008: 76; *The Economist*, (20) January 23, 2010: 47-48). In 2004, Kuchma's (and Putin's) hand-picked successor, Viktor Yanukovich, claimed victory over Viktor Yushchenko, in what was ruled a fraudulent election by the Ukrainian courts and foreign observers. Massive public demonstrations, dubbed the 'Orange Revolution,' nullified the Yanukovich election, bringing Yushchenko to power. During the Yushchenko era, Ukraine attempted to integrate further into the Western economic and political environment by flirting with EU and NATO membership and joining the Energy Charter and the Energy Community, all of which infuriated Moscow.

What ensued after independence and the botched privatization was a deep recession, high unemployment and a rise in violent crime and corruption, leading to a general public mistrust in the government. Beginning in 2000, Ukraine experienced a turnaround with peak annual growth of 7 percent in 2006 and 2007 (CIA, (14) Ukraine, date accessed September 7, 2013). Ukraine joined the WTO in February 2008 and worked with the EU to frame the 1998 Partnership and Cooperation Agreement (PCA), though this did not save Kiev from Western criticism of its economic performance and gross failures in governance. The Ukrainian economy has withered under Russian military, political and economic pressure since the 2014 Maidan Revolution; GDP contracted 6.8 percent in 2015 and dropped 14.7 percent in the second quarter of 2015 (CIA, (15) Ukraine, date accessed September 7, 2015; *Trading Economics*, date accessed, September 7, 2015).

Ukraine's dependence on Russian gas caused considerable uncertainty during this period, and the subsequent arrears in payment prompted service shutdowns in 2006, 2009, 2014 and 2015, whereby downstream customers in Central and Eastern Europe were impacted. These shutdowns were as much politically motivated, primarily to express Moscow's displeasure with Yushchenko's Western overtures, as they were financially motivated. The deepening economic problems and the inability of the Orange Revolution to deliver lasting results left many Ukrainians disillusioned with the political process. The Fatherland party, under Yulia Tymoshenko, was defeated by Yanukovich in the 2010 presidential election and she was then tried and sentenced in 2011 to seven years in prison for alleged abuse of power (*The Economist*, (21) July 30, 2011: 49). She was released in early 2014 for health reasons.

By late 2012, economic indicators pointed to Ukraine heading into its second recession in four years with falling public and investor confidence. Prior to Ukraine's October 28, 2012 parliamentary election, polls show that the majority of Ukrainians were dissatisfied with the Yanukovich regime and wanted change (Olearchyk, October 19, 2012). Yanukovich's Party of the Regions won the October 2012 election amid opposition claims of vote rigging. Indeed, the OSCE declared the poll flawed, noting "the abuse of power and excessive role of money," which further soured public sentiment and set the stage for the Maidan Revolution a year later (*The Economist*, (22) October 29, 2012).

In an attempt to placate Russia, Ukraine backed away from its interest in NATO, though there was still consideration of future EU accession, particularly an Association Agreement which permitted closer relations and trade benefits between Brussels and Kiev (The Economist, (23) February 13, 2011:53-54; The Economist, (24) February 26, 2011: 58). The EU's Association Agreement negotiations were temporarily put on hold and following the 2012 election, and the IMF withheld \$15 billion in loans to demonstrate its displeasure with Kiev over Tymoshenko and the 2012 elections (Wilson, November 7, 2012).

Three years into the Yanukovich administration, domestic conditions became strained, and despite polls indicating support for stronger European ties, Yanukovich suspended further discussions with the EU in November 2013, setting off massive demonstrations reminiscent of the Orange Revolution. On December 17, 2013, following Kiev's initial rejection of the Association Agreement, Putin and Yanukovich met in which the former agreed to lend Ukraine \$15 billion and reduce the price of gas from \$400 to \$268 per 1000 m<sup>3</sup> (The Economist, (25) December 21, 2013: 81). The anti-Yanukovich protests intensified in 2014 in what became known as the Maidan Revolution, named after the Maidan Square in Kiev where much of the protests took place. As the protests grew and governmental attempts to quash is failed, Yanukovich was forced to flee to Russia resulting in the election of a pro-Western government. Upon Yanukovich's departure, the provisional government began to make renewed overtures to the West. In the spring of 2014, Moscow undertook a series of bold measures to punish Ukraine and undermine its economy by invading and annexing Crimea and fomenting unrest in the Russian-dominated portion of Eastern Ukraine, which erupted in civil war later that year.<sup>93</sup>

Addressing this complex and emotional relationship between Kiev and Moscow has been the major component of Ukrainian foreign policy. This also explains the intense pressure from Moscow to thwart Ukraine's Western trajectory, which could also place Belarus and Moldova as future east-west battlegrounds or possibly alter Kiev's burgeoning relations with Ankara (The Economist, (26) October 5, 2013: 13-14). Much of the touchy post-Soviet relations between Russia and Ukraine centers on energy, notably the price of gas and its transit. As it sits squarely between Russian oil and gas fields and the western markets, Ukraine has a unique and influential position in both the EU-Russia and Black Sea RSC energy dynamic (Watkins, May 24, 2010). Moreover, Russia provides roughly 30 percent of the EU's gas requirements; much of which must traverse Ukrainian pipelines en route to its destination.

Considering Ukraine's domestic production meets only 25 percent of its gas requirements, the Russian subsidies covered a substantial gap but also reduced Kiev's incentive to produce more domestic energy or source non-Russian supplies (Popovici 2009). These subsidies are no longer available, and Ukraine must pay the going rate, which brings additional hardship on an already weak economy. Similar to Russia, Ukraine's energy production and transport is highly centralized under the country's oil and gas company Naftogaz Ukrainy, or Naftogaz.<sup>94</sup> Another state-owned entity, Ukrtransnafta, the Ukrainian Oil Transportation Company, operates

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<sup>93</sup> Henry Kissinger commented that Russia's annexation of Crimea was "...incompatible with the rules of the existing world order..." (Kissinger 2014).

<sup>94</sup> Naftogaz is in the process of restructuring itself to conform with EU competition regulations, which entails splitting into three separate companies, dedicated to natural sales, transportation and storage (Natural Gas Europe, (8) June 4, 2014).

Ukraine's aged pipeline system. Through the venerable Druzhba trunk pipeline, Ukrtransnafta transports Russian oil 680 kilometers to the western border where it splits between Slovakia and Hungary (Energy Charter (35) (Oil) 2012: 69).

The Orange Revolution caused a change of policy in the Kremlin toward Ukraine, which quickly became evident in the energy sector. Moscow, now confronted with what it considered an unfriendly regime, was unwilling to continue subsidizing Kiev's gas imports (Romanova interview, October 11, 2013). In early 2005 negotiations for 2006 gas prices began with Gazprom insisting on a new price of \$160 per 1,000 m<sup>3</sup>, a significant increase from the subsidized price of \$50 per 1,000 m<sup>3</sup> (Oil & Gas Journal, (4) January 16, 2006). Negotiations broke down in late 2005 with Naftogaz refusing to pay the new rate. On January 1, 2006 Gazprom reduced the volume of gas through the pipeline by approximately 100 mcm, the amount commensurate with Ukraine's now-expired contract requirements. Naftogaz continued to draw its regularly allotted quantities, which created shortages for recipients further down the pipeline. Later on January 1, when Eastern European customers complained about the depleted gas volume, Gazprom accused Ukraine of "stealing" the gas (Oil & Gas Journal, (5) January 9, 2006).

The disruption in gas service prompted an outcry from European customers, forcing Gazprom and Naftogaz back to the negotiating table, and on January 4, the parties signed a new contract (Oil & Gas Journal, (6) January 16, 2006). The broader impact proved costly to both countries in terms of lost revenues, but much more so in damaged reputations. The episode created a stronger impetus within Brussels to diversify its energy sources, with the EU's Energy Commissioner at that time, Andris Piebalgs, calling for "clearer...collective and cohesive policy on security of energy supply" (Oil & Gas Journal, (7) January 9, 2006). Though there was additional sparring between Moscow and Kiev over the next two years, relations generally stabilized and the gas flowed unhindered. When time came to renegotiate the contract in 2008, Naftogaz was \$2.4 billion in arrears to Gazprom (Izunda, January 12, 2009).

Relations were tense throughout 2008 as Gazprom and Naftogaz renegotiated the price and supply contract for 2009. Gazprom demanded payment of the \$2.4 billion plus \$450 million in fines before a new supply contract took effect. As the crisis deepened without resolution, Gazprom hired a Western public relations firm to reach out to the EU on the pending impasse, though this fell on deaf ears in Brussels (Romanova interview, October 11, 2013). In December 2008 Ukraine repaid more than \$1 billion of this debt, however, on January 7, 2009, Gazprom cut Ukraine's allotment.

This time the EU was prepared, and to mitigate the impact European energy suppliers redirected Russian gas from other pipelines, and sourced additional product from the UK, Norway, and the Netherlands. Following the 2006 dispute, Eastern European providers had amassed larger stockpiles and enacted emergency plans. In events similar to 2006, Naftogaz diverted its regular volume of gas, thereby impacting downstream customers, notably Turkey, Greece, and Macedonia. Bulgaria, which relies almost solely on Russian gas, ran dangerously low and Slovakia declared a state of emergency. France, Germany and Italy also suffered reductions. Naftogaz blamed Gazprom for the disruption, while Gazprom again alleged the gas was stolen (Izunda, January 12, 2009).

In spite of these mitigation efforts, Eastern European customers continued to suffer because of the long-standing dependence on Russian gas and a reliance on the Soviet-era infrastructure which was configured in an east to west flow. The two parties met in mid-January, in which Ukraine's prime minister, Yulia Tymoshenko, negotiated a deal which required Ukraine to purchase a minimum 52 bcm per year (National Radio Company of Ukraine, April 19, 2013). It was later claimed that these negotiations were conducted "without government review," and which prompted the Yanukovich regime to later prosecute Tymoshenko for abuse of power (The Economist, (27) July 30, 2011: 49).

The 2009 election of Viktor Yanukovich provided Moscow with what it initially believed to be a friendly administration in Kiev. On April 21, 2010, Presidents Medvedev and Yanukovich met in Kharkov, Russia whereby the parties negotiated a 30 percent reduction in the price of gas sold to Ukraine. This was essentially a debt swap which allowed Ukraine to purchase gas at a reduced price, saving \$40 billion over 10 years.<sup>95</sup> In exchange, Russia's lease of the Sevastopol naval base was extended for 25 years, with an additional five-year renewal option. Despite vigorous protests from the opposition, the Ukrainian Rada (Parliament) ratified the Karkhov Agreement on April 27, 2010. Yanukovich defended the action as a way to help stabilize the state budget, though opponents described the agreement as an affront to national sovereignty<sup>96</sup> (The Economist, (28) April 29, 2010).

The lack of incentives to develop alternative sources were caused by state ownership and central planners who wanted to maintain the status quo, as well as an abundance of cheap energy and the prevalence of nuclear energy for electricity generation (Energy Community, (2) 2013: 72). Despite the close relations with the Kremlin, Ukraine's leadership was aware that continued dependence on Moscow was unsustainable, and began in earnest to diversify its energy sources. As outlined in its 2030 energy strategy, the goal was to increase its domestic production and concentrate on renewable and nuclear energy. This includes a push into unconventional (shale) gas reserves, estimated at 5 tcm, a significant, though still largely unsubstantiated amount (Natural Gas Europe, (9) April 15, 2013).

These early efforts to reduce Russian gas imports have been generally successful; since 2009, Ukraine has seen a drop in gas purchases from Russia. In an April 2013 radio interview, then-Ukrainian Prime Minister Mykola Azarov attributed "...conserving energy, increasing domestic production, and finding cheaper alternative sources of gas in Europe" to why Ukraine purchased only 33 bcm from Russia in 2012, 12 bcm less than in 2011. Azarov did not attribute this to Ukraine's poor economic conditions as the cause for reduced demand, though he did criticize Tymoshenko's 2009 deal with Gazprom (National Radio Company of Ukraine, April 19, 2013). By late 2013, purchases from Russia were another 30 percent lower than 2012, or between 20 to 25 bcm (Olearchyk, October 22, 2013). This is again attributable to improved industrial and housing efficiencies, and that Ukraine is now importing quantities from Western sourced pipelines (Olearchyk, October 14, 2013).

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<sup>95</sup> There were also intense efforts on the part of Gazprom to absorb the Ukrainian state gas company, Naftogaz, but this was rejected by Kiev.

<sup>96</sup> The yearly rent was to increase to \$100 million after 2017 from the then-current \$93 million per year (Watkins, May 3, 2010).

In early 2013 the government approved new PSA laws which permit greater FDI in the country's energy sector, leading to a January 2013 agreement with Shell to explore shale gas deposits in the Black Sea (Paliashvili, January 18, 2013). Soon thereafter, Naftogaz was presented by Gazprom with a \$7 billion bill for failure to meet the minimum purchase requirements, based on the 'take or pay' provisions in the contracts (Butler, January 30, 2013; Olearchyk, January 25, 2013). This amount was later revised to \$882 million (Ria Novosti November 26, 2013). Combined EU/Ukraine efforts to renegotiate new terms for Gazprom's imports were unsuccessful, which prompted another gas shut off on July 1, 2015.

Because of its size, strategic position, natural resources, and economic potential, the development of Ukraine will have long-term consequences for the Black Sea RSC. The importance of public and private FDI for economic renewal is vital, yet without a stable security environment, let alone predictable energy policy and independent regulatory regime, most investors will look elsewhere (Energy Charter, (36) Ukraine, 2013). The August 2014 imposition of an ill-advised 55 percent 'royalty tax' on energy exploration was designed to increase revenues, but has instead created further reticence among foreign investors (Vorobyov 2015).

Ukrtransgaz is the gas transmission system operator in Ukraine, which includes cross-border transmission through Ukraine. The Ukrainian gas transit system is in need of modernization to increase its reliability and capacity to transport the gas needed for both Ukraine and the European Union. Unconventional plays, notably shale gas, has attracted IOCs such as Shell and Chevron to Ukraine. By the end of 2014 both Shell and Chevron had exited Ukraine on account of the civil war and the general instability (Nanay, June 2015: 8).

In 2011 the transited volume of gas dropped to 84.2 bcm in 2012 (from 104.2 bcm in 2011), as a consequence of declining demand in Europe and the fact that Russian gas exports have partly shifted to the Nord Stream pipeline (Energy Community, (3) 2013: 122-123). To comply with EU liberalization requirements, Kiev broke the Naftogaz monopoly on gas imports, allowing other suppliers to import gas. Secondly, Naftogaz and the other suppliers are diversifying their portfolios by purchasing gas from non-Gazprom sources from European companies such as RWE, via Hungary and Poland (Energy Community, (4) 2013: 122-124). In June 2015 a plan for Nord Stream II was put forward by Alexei Miller at the St. Petersburg International Economic Forum to expand the existing Nord Stream pipeline to 55 bcm, which combined with Turk Stream, would effectively isolate Ukraine, Belarus, Poland and the Baltic States, while denying them of considerable transit fees.<sup>97</sup>

Relations between Kiev and Moscow since Yanukovych's departure have been complicated by separatist activity on Ukraine's eastern and southern periphery, marked by direct support from Putin. This resulted in Russia's annexation of Crimea and destabilization of the eastern portion of the country via military action, which turned the situation irrevocably hostile. Tensions are now too strong to be resolved through a market-based relationship between Gazprom and Naftogaz; in other words without a political resolution blessed from Moscow or Kiev. By early

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<sup>97</sup> See Alan Riley's, "Nordstream 2: Too Many Obstacles, Legal, Economic, and Political to be Delivered?" Issue Brief, Atlantic Council, November 2015.

2016, the war in Ukraine's eastern Donbass region, comprising Donetsk and Luhansk Oblasts, is looking like another Kremlin-controlled frozen conflict.

Zbigniew Brzezinski in "The Grand Chessboard" makes an interesting observation, placing Ukraine as the eastern anchor to a European power core that includes France, Germany and Poland (Brzezinski 1997: 85). This is an intriguing notion of a strong and self-confident Ukraine bridging the EU-Black Sea divide. But this notion has proven illusory. Writing in 1997, Brzezinski believed Ukraine would have put itself on a path toward growth and stability to assume this role in the 2005-2010 timeframe. His timetable was off by at least a generation, as he did not factor in Putin's determination to thwart these plans or Ukraine's own political malfeasance and inability to overcome its internal divisions. By early 2016, Ukraine is as far away than ever from accepting any type of regional leadership role, let alone integrate into a larger European power structure.

### **The Lessons from 1991 – 2016**

That the Black Sea Ten have had a violent and stressful relationship is evident by their histories going back the last two millennia. Yet, the same can be said of virtually any other regional group. What makes the Black Sea RSC unique is the depth of its historical reach and how this influences today's events. Moreover, the fragmented nature of the members' borders and the often contorted ethnic and religious intra-regional groupings leads to a complicated understanding of their modern-day realities. What becomes clear is the competing intra-regional tensions that were so prominent in the 19<sup>th</sup> and early 20<sup>th</sup> Centuries, and which were kept in relative check for nearly 75 years, have reemerged, caused by the collapse of the political and economic forces which kept them confined for so long.

As noted earlier in this chapter, the Black Sea RSC's recent history is most relevant to the discussion of the region's transformation, notably the 25 years following the end of the Cold War. Moreover, the elapsed quarter century has provided a glimpse into developing themes within the Black Sea RSC. This is a combination of dramatic successes and heartbreaking setbacks against a backdrop of growing external influences. It is possible to summarize this period as the mixed realization of long-cherished goals, such as national independence, economic liberalization and personal freedoms. By 2016, there is a new generation of Black Sea RSC residents with no direct knowledge of the communist era or the Cold War. Though they have certainly experienced the post-Cold War era booms and busts, the unprecedented personal freedoms and the ability to emigrate have created demands for better opportunities and responsible government.

The post-1991 euphoria that gripped Eastern Europe brought with it many unforeseen misperceptions and challenges. For instance, the belief that Russia would be a friendly partner to the West was a popular notion shortly after the end of the Cold War which has turned out badly. Additionally, the notion that Eastern Europe would uniformly embrace liberal reforms, and begin an orderly and systemic transition into a Western-dominated EU has also proven spotty. Though most of the former communist states did enact Western-influenced economic reforms, some of which proved successful, the long-term results have been disappointing. This is partly from the



unexpected difficulty of shifting from a command to a market-based economy, as well as still under-developed governance and social structures. Nevertheless, the post-Cold War era shows a Westward orientation by many Black Sea states, facilitated by geographic proximity, cultural familiarity and the promise of political and economic security via the Western European markets and their demand for energy and raw materials.

As the consequential regional state, Russia influences virtually all the inter and intra-regional events. The first decade of post-Soviet Russia saw the most significant advances in political and economic liberalization, yet this was also a time of lawlessness, poverty and a general despondency among the populace. With hindsight, it was perhaps inevitable that a leader such as Putin would emerge to force stability upon the country. Moreover, it is Putin's determination to redraw the map of Eastern Europe and Central Asia along the old imperial borders which has caused the most consternation in the West and FSU, all the while using his dominant energy position as a coercive tool. It is safe to say that Russia has regressed the most on its early post-Cold War liberalizing trajectory, pushing back on what it sees is encroaching Western political, economic and social spillover.

None of the Black Sea Ten were spared the 2008-2009 recession. Some states; Russia, Azerbaijan and Turkey were able to weather the storm relatively well, though Russia and Turkey have faltered in the post-recession period. Azerbaijan, though hurt by the drop in oil and gas prices, is enjoying its relative energy wealth. Other states, notably Greece, teetered on the brink of economic collapse in 2009/2010 and once again found itself on the precipice in 2015. It remains to be seen whether Athens can rise to the occasion and enact true economic reform. It can be argued that Georgia emerged in a stronger economic position than before the downturn or the 2008 war; according to the IEA, Tblisi's economic liberalization effort has been "outstanding," which has helped it attract FDI (IEA 2014: 20).

The remaining states, Armenia, Bulgaria, Moldova and Romania have experienced slow, uneven economic progress with recent domestic political setbacks. Since independence, Ukraine has underperformed in virtually every category, suffering from a combination of misfortune, malicious intent or gross incompetence on behalf of its leaders. The results of Maidan may have set Kiev on the road to lasting political reform, though it will be a long, hard road, much of which depends on Ukraine's relationship with Russia.

When looking at the geopolitical and economic landscape within the Black Sea RSC over the last 25 years, several themes and commonalities are evident, having risen above the turbulence, and which have contributed to the current regional state of affairs. These are based on great power influence and contestation, both externally and internally derived and implemented. Some themes are more impactful than others, though all contribute to the development of the Black Sea RSC. By considering the Buzan and Wæver concepts of overlay and penetration, what is being demonstrated is continued East-West tensions, EU expansion, US inattention and the closely related issue of energy trade.

As these affiliations align themselves toward the West, what is evident is a fundamental alteration of the traditional North-South power dynamics; notably the short-lived northern dominance of the 20th Century shifts on Bratianu's intersection with a newfound gaze. Indeed,

this geopolitical realignment on a grand scale is moving from a Russian-centric regional configuration to a European-centered one, with control emanating from Brussels. These new dynamics are also working to alter the region's political and economic status quo which has been in place for centuries; the traditional north-south power relationship.

This phenomenon can be traced to the emergence of the EU as a political and economic force, coupled with the end of hegemonic control over the Sea post-1991, which has allowed the region's population centers to choose their political and economic futures with growing influence vis-a-vis the Black Sea states. It is this emphasis on five core norms embodied in the *acquis*, which create powerful incentives for change within a region which has historically lacked these attributes. These five core norms are 1) the centrality of peace, 2) personal liberty, 3) democracy, 4) the rule of law and 5) human rights (Manners, 2002: 242).

Europeanization's hallmark is its emphasis on these core norms are embodied in an exclusive region, where benefits are bestowed upon the members on the condition of implementing various legislative components. In this regard, it is possible to view Ladrech and Manners as the intellectual heirs to Haas and neo-Functionalism. Furthermore, Ladrech's notion of Europeanization, was originally intended for EU members states fully integrated within the EU's social and political environment. Moreover, it is the attraction of these norms which is aiding this neo-functionalist spillover. Now these benefits, or variations of them, are being offered to non-members, whereby such states are accepting and implementing the EU *acquis communautaire*, which tries to 'shape' the geopolitical and economic disposition of non-members, within their own legal infrastructure primarily as a means of moving closer to Brussels.

### The Russia-Western Geopolitical and Economic Divide

The first of the post-Cold War themes to be addressed is the perennial East-West divide that continues to this day. Shortly into the post-Cold War era, Russia-Western relations, though never warm, did benefit from cooperation on a variety of geo-political issues, notably arms control. Indeed, Yeltsin and Clinton appear to have developed a true personal friendship during this time which certainly facilitated bi-lateral relations. The Kremlin views expanding Western influence on its borders as intolerable, coupled with its determination to retrieve and maintain its great power status lost after independence which has been central to Putin's tenure. Much of this is seen as Russia re-exerting influence after the humiliation it suffered following the Cold War, fueled by Moscow's sense of victimhood at the hands of the West. Moreover, there is Western interest in countering Moscow's actions in the Black Sea and ensuring there is equal opportunity to bring oil and gas products to market without external (Russian) interference. The result is that East-West relations are more strained now than at any time in the post-Cold War era, so closing this political and economic divide is daunting.

Additionally, there is the East-West manifestation of amity and enmity, which is evident in the friction and cooperation seen in inter and intra-regional relations. Most evident in this geopolitical divide is the use of energy as a Russian foreign policy tool. With this fact in mind, it is important to view South Eastern European energy relations through the lenses of the 2006-2009 crises, the 2008 war and the current standoff in Ukraine, which combined demonstrate the growing divide between Putin's Russia and the West. Indeed, there is no end in sight to the

downward trend in relations, which has dashed the hopes of many on both sides of the divide anxious for normalized relations.

As the world's only nuclear armed petro-state, Russia will continue to wield considerable geopolitical power while creating consternation among its neighbors. However, it should be kept in mind that Russia is operating from a position of growing weakness, and without political and economic reform the long term trends are not in its favor. As Moscow's stability is dependent on oil and gas revenues, its relative technological backwardness in this sector and limited investment capital is hampering Russia's ability to fully exploit these reserves.

In the Cold War there was concern with a strong Soviet Union, though there is now fear that a weak Russia is more dangerous. Indeed, a humiliated and paranoid Kremlin, coupled with diminishing state revenues it is feared, will lash out unpredictably and countenance further pressure on its near abroad or its internal political foes. These conditions lead to a sense of foreboding and unpredictable circumstances for the future among Russia's neighbors, hardly conducive for long-term economic stability and social development.

### EU Political and Economic Integration

Another theme is depicted by the EU's own overlay of the Black Sea RSC; the pull from Brussels as an irresistible economic and political force. Indeed, all ten RSC members have enacted legislation or implemented policies to converge with EU standards or directives; the *acquis communautaire*, which acts as a blueprint for standardized legal and cohesive framework binding the EU states. Even Russia has been forced to adopt EU standards, most notably its abandonment of South Stream, which was caused (primarily) by opposition from Brussels on anti-competition grounds. The result has been a Westward orientation by most Black Sea RSC states, anxious to exploit this source of capital and security.

The EU is enduring its own set of economic and demographic challenges, also brought about by declining birth rates and an inability to enact reform within some member states. This is further evidenced by the growing north-south economic divide within the Union. However, Brussels is buttressed by the German economy which has demonstrated considerable strength and stamina, coupled with Berlin's relatively newfound political confidence. Though many Germans, as well as its neighbors, are wary of a politically assertive Berlin, it is generally expected that Germany will ultimately assume a role commensurate with its economic standing. This would include Berlin's ability to coax its EU partner states into enacting economic and labor reforms which will ensure greater economic stability. A by-product of Germany as Europe's economic engine ensures the EU's center of gravity continues to shift to the east, thereby drawing in Eastern Europe, to include the Black Sea RSC, into Brussels' economic and political sphere.

As will be clarified later in this work, access to capital and technology are critical components to developing a Black Sea RSC energy infrastructure. Yet, there is another component which ties into the requirements of capital and technology; that is the need for human capital. The large scale emigration to the Western power centers is depleting the region of its best and brightest, thereby impacting long-term growth and stability. This vicious cycle appears permanent as long

as these states are unable or unwilling to provide good governance and responsible economic and social policies with which to attract and retain qualified people.

Referring to Bratianu's intersection, by virtue of geography, culture and economics, the wider Black Sea states will continue their westward shift, but considering the diversity in the region the depth of this shift and its accompanying interdependence is far from certain. These states will undoubtedly undergo change as time goes forward; the notion that essentially forms the basis of this dissertation. However, much of this change depends on Russia's posture in the coming years, not to mention the strength of the EU's presence and, as is discussed below, the willingness of the United States to remain engaged.

### Energy Disparity and Interdependence

A cross-cutting theme that has been highlighted in the course of this analysis, is that of regional energy disparity and the accompanying interdependence. Energy is cross-cutting in that it is not directly influenced by overlay or penetrating dynamics of great powers, but by its own unique power attributes which serve as an influencing mechanism. This is notably expressed by the example of Azerbaijan, which despite its small territory and population, has been able to extend its economic influence far beyond its borders. Russia, considering its size, population and industrial capacity is a great power in its own right, which is markedly enhanced by the presence of fossil fuels.

By looking at the individual states and their unique dynamics, there are widely varying political, economic and social perspectives. There is also the impact of energy disparity within the Black Sea RSC member states, most notably between producers and consumers. For instance, the energy 'haves' (Russia and Azerbaijan) hold considerable sway over the 'have nots' (the rest of the Black Sea RSC). It is this disparity which creates the general conditions (amity and enmity) present in the region which allow for the formation of a regional security complex.

There is an additional East-West divergence embedded within the Black Sea RSC which overshadows Bratianu's visions, and these conditions combine to create the regional friction noted by Buzan and Wæver. This divergence has exacerbated Russian geopolitical and economic tensions in its near abroad. The surge in North American shale gas production has also dampened some of the enthusiasm for Caspian oil and gas. This will be particularly acute if European states produce enough non-conventional gas to offset the cost of Caspian product, or if the spot price drops to where it is unprofitable. What will also be demonstrated is the value of energy, but more than just hydrocarbons, but electricity, particularly in under-served regions.

### US Geopolitical Disengagement

In the years immediately after the USSR's collapse, the US was perhaps the strongest advocate for self-determination and economic liberalization in the newly independent or former Eastern Bloc states. These policies were carried through generally faithfully in both Republican or Democratic administrations, and it is highly unlikely the relative successes seen in the Black Sea RSC could have been achieved without Washington's guidance. Beginning in 2009, there has been a marked period of US indifference brought about by global economic hardship, changing

regional priorities and the US “pivot” to Asia. The relative US withdrawal from the Middle East, hastened by military drawdown in Iraq and Afghanistan, has added to this loss of interest and engagement, which relegated Eastern Europe and the Black Sea to a lower priority in Washington. Continued instability in the Middle East and Eastern Europe, particularly in Ukraine in 2014-15, has redirected US attention (reluctantly) back to the Black Sea RSC.

It is impossible to determine whether this is a long-term condition or aberration caused by the vagaries of the US electoral process. So, the US continues to act as a major, though occasionally lukewarm behind the scenes, player, and barring any serious destabilizing events, such as an escalation of the Ukraine conflict, it will most likely continue this approach, regardless of the party in the White House. However, the main question is whether the US will continue to act as the lead hard power counterweight to Russia, or allow that role to fall to the EU; and EU that has so far proven unable or unwilling to accept such responsibility. The comments of Ambassador Bryza give clear indication that the US has an indispensable position in the region, particularly when it comes to broader energy security. In other words, the results of the 2016 presidential elections will give better insight into the US future role in the region.

While the US was instrumental in the early post-Cold War energy projects, Washington’s overall penetration is generally inconsistent, and it is not reflective of the full 25-year period. It is welcomed by most of the smaller Black Sea RSC states, particularly those which were former members of the USSR. This perceived US disinterest on the part of the regional states most threatened by an aggressive Russian, particularly those non-NATO members without the Article 5 security guarantee is a perpetual worry. Some would argue that even Article 5 is not a guarantee that NATO will come to their aid. Hence, the US (via NATO) efforts to shore up confidence by conducting joint exercises and committing to prepositioned military hardware at key locations in Eastern Europe.

The US, though a vital component, enjoys the benefits of distance and its relative energy independence, which puts it in marked contrast with the EU. US engagement depends on the changing priorities of each administration, notably the Obama Administration which has downplayed the importance of the region. An example is the elimination of the Special Envoy of the United States Secretary of State for Eurasian Energy, initially under veteran diplomat, Richard Morningstar, replacing it with a more generic Special Envoy and Coordinator for International Energy Affairs. After three years, the Special Envoy, Carlos Pascual, an experienced diplomat and former Ambassador to Ukraine, was replaced in July 2014 by a competent though relatively junior State Department official, Amos Hochstein. Finally, there is the lack of coordination between Departments of State, Defense and Energy and the US intelligence community, let alone with NATO and the EU (Cohen 2015: 3-4). These events have not gone unnoticed by the more vulnerable Black Sea RSC states

All four themes follow a trajectory of energy-centric contestation, so there is notable synergy between them. The greatest contribution from the dynamics emanating from the flow of oil and gas will be explored further in the following chapter. Finally, the themes demonstrate the inherent intra-regional frictions as defined by the RSCT. In particular, this is the manifestation of amity and enmity and the consequences of new regionalism’s blend of power politics and

constructivist notions. There are also clear elements of neo-functionalist spillover, notably through the EU's normative expansion outside of its existing member base. This spillover, which is facilitated by the growing energy interdependence within the Black Sea RSC, will be detailed further in the follow chapters.

## **Chapter 3: Thoughts on the Existence of a Black Sea Region: The Dominance of Energy.**

“...there will remain exceedingly important considerations affecting energy supply which warrant further and specific mention--these are embedded in ‘location’ and ‘control’,” (Melvin A. Conant, “Geopolitics of Energy,” Volume II, 1976: 8).

“Geopolitics of the 20<sup>th</sup> Century was shaped by energy issues, and in particular the appropriation or ownership of resources, since without plentiful energy, it is impossible to develop economically, much less exercise hegemony” (Samuele Furfari, unpublished manuscript: 70).

“Time after time in years past, the fortunes of Russian oil have had significant global impact...” (Daniel Yergin, *The Prize* 1992: 773).

In establishing this dissertation’s foundation, Chapters 1 and 2 identified the Black Sea RSC and developed the members’ geopolitical and economic placement within the region, to include the general composition of each states’ energy sector. In this chapter the fundamentals of the geology and the global energy industry will be addressed in broad terms. Specifically, this chapter centers on the fossil fuels industry and its unique role in history over the last 150 years. Additionally, the focus will shift to the Black Sea RSC’s energy sectors which are developed further as economic bases and drivers of regional change. This is in line with the research question, such as how they help shape its position in the broader geopolitical dynamic, particularly as a component of new regionalism.

Finally, this chapter will analyze the pipeline networks and their broader implications, thereby setting the foundation for a description of the drivers and the case studies. In this capacity, it acts as a bridge between the two foundational chapters and the structural chapters in the latter part of this analysis. Moreover, Chapter 3 is not designed as an in-depth analysis of the petro-chemical industry, but more of a necessarily broad overview and background to give the reader a better context.

### Introduction

The earth’s crust holds unknown quantities of hydrocarbons; prehistoric organic matter, usually zooplankton or algae, buried under layers of sedimentary rock and subjected to millions of years of heat and pressure. Under such conditions, this matter has been transformed into a solid, liquid or gaseous state, respectively coal, crude oil and natural gas. These fossil fuels are usually found in underground reservoirs or in saturated rock or sand formations, which frequently push to the surface, where, in the case of coal and oil, such deposits can be relatively easily collected. These resources were discovered by the local inhabitants to have lighting and heating properties and were gathered with rags or crude drilling or mining efforts. By the 19<sup>th</sup> Century technology allowed more efficient means to extract and transport them and which has transformed the global economy and human existence. Indeed, carbon-based fossil fuels are amazingly versatile, serving as the feedstock to a huge array of consumer goods to the point where modern-day life would be unimaginable without them.

Crude oil is a liquid that must be brought to the surface, removed of gases, water, and impurities, and then transported to refineries where finished products are created. Petroleum products derived from crude oil include gasoline, aviation fuel, diesel fuel, heating oil, lubricants, and liquefied petroleum gas as well as a number of petrochemical stocks. Similar to crude oil, natural gas is removed of impurities and then transported, usually via pipeline, to gas processing facilities that separate heavier gas components, leaving a product composed almost entirely of methane. The methane is shipped as clean natural gas to bulk storage, industrial consumers or individual homes.

The gas liquefaction process has only recently been cost-effective allowing its use on a truly global basis. The gas is frozen to where it produces a dense concentrate and enables this liquefied natural gas (LNG) to be transported economically by oceangoing tankers instead of pipelines. Additionally, the LNG process is proving to be a technology with far-reaching geopolitical, as well as economic, ramifications into the future. Coal, the most abundant of the three, must be mined by deep underground excavations; a dangerous process resulting in hundreds, if not thousands, of deaths each year around the world. More recently surface mining is used, where practical, which requires carving out massive open air pits, instead of the hazardous subsurface technique. Because of its environmental impact, coal is falling out of favor as an energy source, frequently replaced by cleaner natural gas or renewable sources.

Fossil fuels by their very nature are fungible commodities, capable of mutual substitution or replacement based on the prevailing market conditions. Therefore, a fungible commodity in an open trading regime will always follow the path of least resistance and find favorable pricing and transit conditions. With universal demand in modern society, these energy sources benefit from Adam Smith's proverbial "invisible hand" which transcends international boundaries and political bottlenecks. For this reason free markets will almost always trump natural or state imposed restrictions to the flow of energy, the result being that these products are in theory available to a wider consumer group at the cheapest cost.

Why have fossil fuels, and more specifically, oil and gas, been elevated to such importance in the international economy? Furthermore, why have such large fortunes been accumulated and lost and why have such violent conflicts erupted because of them? This can be explained that hydrocarbon-generated energy has permeated virtually all levels of modern society, and the control and manipulation of these commodities has become increasingly important to societal stability and national security. To date, no other source of energy matches oil and gas's (oil in particular) overall versatility, transportability, cost and combustible power. Furthermore, no other commodity generates the most revenues and the concomitant wealth which manifests itself into raw political and economic power. Since the possession of energy wields so much military, political, and economic power, its ability to transform societies is evident and worthy of further analysis.

Yet, to answer the research question, what are the catalysts at the grass roots level that put such regional transformations in motion, and how does it impact regional development, in particular the Black Sea RSC? This chapter begins the process of answering the research question from a practical and operational standpoint. Emphasis is placed on oil and natural gas, the primary fuels



in the Black Sea RSC with the greatest flexibility and overall economic impact. Additionally, it is difficult to ignore electricity, particularly as a by-product of fossil fuels, so this sector will be addressed in more detail later in this analysis. Finally, there will be peripheral discussions of coal, nuclear and renewable resources, though primarily in subordinate roles to oil and gas.

Furthermore, distinction will be made between oil and natural gas pipelines, more specifically those Black Sea RSC pipelines which are operational, in planning, under construction, delayed or abandoned. Based on revenues and its inherent political and economic power, oil may still be king, but it is the relatively recent popularity of gas which has experts at the International Energy Agency (IEA) asking if we are in a “Golden Age of Gas” (IEA 2011). Though it may be premature to make such a proclamation, for cost and environmental reasons, the current trend has natural gas rising in popularity around the world.

### Oil and its Associated Fuels

Liquid fuels, referred to as conventional petroleum and heavy oils, exist in pockets at varying depths, and, as natural petroleum springs are rare, best extracted by drilling. The composition of crude oil varies in viscosity and impurities which must be removed in the refining process before final sale to the consumer. Heavy oils are by far the most plentiful liquid fuels and exist as a subordinate category to petroleum, requiring some form of thermal treatment, such as steam, to be extracted (Speight 2011: 20-22, 25-26; Alboudwarej 2006: 35).

Tar sand bitumen or oil sand is an unconventional heavy oil which exists in dense clay or sand formations. Such deposits are found in large quantities throughout the world, and it should also be noted that because of their solid compositions, oil sands are mined, not drilled and for this reason they have been bypassed until recently because of the expense and environmental impact in their extraction. The wide varieties in the composition of these deposits and the cost in their extraction indicate why some formations are exploited while others are not. Another variation, oil shale, is an immature formation which could not convert into crude, usually because it never reached adequate subsurface depth and temperatures. It contains kerogen, a mixture of organic chemical compounds, the soluble part of which is bitumen. Oil shale is usually located in shallow deposits and must be either heated in the ground to be extracted or it must be mined, very much like tar sands (Speight 2011: 26-27, 255-259; Hyne 2001: 164-165).

Sedimentary rock formations of low porosity and permeability produce a form of light oil called “tight oil,” and should not be confused with oil shale. In this state, as the oil is trapped in the rock, it does not flow as normal liquid crude, and must be coaxed out using a variety of methods, thus the basis for the term “tight” oil. Oil in these fields requires stimulation, such as hydraulic fracturing, or “fracking.” This procedure involves drilling into the shale, first vertically then horizontally, and injecting highly pressurized water, sand and chemicals to break open the rock which will allow extraction (Natural Resources Canada, date accessed January 19, 2014; Hyne 2001: 423-426). A process which has transformed the global oil and gas industry in the last decade and catapulted the US to dominance again in a remarkably short time.

For the first 150 years of the petroleum era, the producers benefited from easily accessible crude reservoirs. What is evident in the last 20-30 years is the most accessible oil has already been

extracted leaving only remote, poor quality or technically challenging reservoirs available for exploitation. The result of this phenomenon is the quality of crude has dropped during this period with greater sulfur content requiring higher boiling temperatures and greater cost during the refining process. This has impacted downstream prices, particularly gasoline which needs considerable refining to meet performance and environmental requirements (Speight 2011: 20-22, 25-26; Alboudwarej 2006: 35). This was certainly the case until roughly 2014 when the combination of North American unconventional plays and reduced worldwide demand began impacting the global supply.

### Natural Gas

Natural gas is often found in conjunction with subsurface crude producing formations. It generally has high quantities of methane and smaller amounts of other gaseous elements, such as ethane, propane and butane. As with crude, natural gas has many uses and benefits to society at large, ranging from combustibles to consumer goods. There are two forms of gas product; associated and dissolved. Associated gas is that found within an oil well, often as the gas cap sitting atop the oil reservoir, and which is trapped and separated during the extraction process. The other form, dissolved gas, is removed from crude during the refining process and stored separately (Speight 2011: 23, 25).

Shale gas, similar to oil shale, is comprised of product trapped in shale formations that is unable to be extracted using conventional methods. Until recently, these formations were bypassed, but in the last 5-10 years fracking has been cost effective for large-scale exploitation. On the whole, fracking has been instrumental in increasing North American natural gas production, and reducing the spot price to approximately \$2.67 per million BTUs in 2015 from \$6.13 in December, 2003 (EIA, (21) Henry Hub Spot Price, date accessed April 14, 2015). As will be discussed in more detail, the world is just beginning to see the long-term impact of this phenomenon and the broader geo-political implications.

For decades gas was the least desirable of the fossil fuels. Its composition made it difficult to transport by the traditional means of sea, road or rail, and relegated its consumption to close proximity or via pipeline directly from its source. Associated gas that could not be transported long distances was used for fertilizer, and was (and still is) flared to access the more valuable crude.<sup>98</sup> For these reasons gas has traditionally been of lesser commercial and strategic importance than oil or coal, though recent improvements in extraction and transportation, coupled with its increased popularity over the other fossil fuels, have led to growing demand. This is particularly the case for unconventional (shale) gas, the impact of which is only now being felt in the global market (Conaway 1999: 221).

Another consideration is the change underway in market pricing, particularly in gas. The ability to liquefy gas, albeit an expensive procedure, has provided more flexibility, allowing gas to be shipped long distances and thereby breaking the direct links to crude and its point of extraction. As gas was seen as an adjunct to crude its price was also tied to that of oil, which kept the price unnaturally high because of the inability to break the association with crude. This pricing model

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<sup>98</sup> Gas flaring, because of the inherent waste and environmental concerns, is coming under increasing criticism and scrutiny.

has begun to erode in the face of technological changes, particularly with the growing popularity and availability of LNG. Gas's independence now allows the price to be based on its own unique market fundamentals as opposed to the price of crude. Essentially, gas has matured to the point where it can hold its own in the broader energy market place alongside the other fossil fuels. This is the case in the US, UK and parts of Europe and Asia, where a spot market allows for considerably cheaper prices for gas contracts than those inflexibly tied to the price of crude.

This divergence is quite relevant in the energy dynamic between Russia and its European customers; a dynamic that is currently being played out in the media with broad geopolitical impact. Russia prefers long-term, take or pay contracts with the price of gas tied to that of crude, as well as destination clauses which limit the resale of Russian gas to third parties.<sup>99</sup> The benefits, it is claimed, is a fixed, long-term price of gas that will not change because of price fluctuations. However, this model is increasingly difficult to justify, as lower spot prices have created a widening gap with the oil-based price structure. Much of this can be attributed to the upsurge in shale gas, the availability of which has forced this price disparity.

## **Oil and Gas Technologies: A Geopolitical Force Multiplier**

Despite fossil fuels being considered a “dirty” commodity, there is a strong technological element to the industry. Indeed, the impact of energy technologies and their transformational effect on geopolitics over the last decade has been immense. Furthermore, these technologies have valuable spinoff capabilities, generating follow-on or dual-use applications; one example being seismology which has application in both the petroleum industry and civil security realms, notably for earthquake analysis. The acquisition and deployment of advanced technologies allow engineers and crews to locate subsurface deposits more accurately, to exploit previously inaccessible reserves, or give new life to depleted wells.

Energy exploration and production is capital and technology intensive, requiring a combination of brute mechanical force and sensitive, sophisticated equipment. Additionally, intricately detailed pricing methodologies are needed for a variety of products, such as telecommunications and software which are equally important to the sale and transit of hydrocarbons. Far from being a dirty commodity, the global energy sector is a blend of engineering skill and high technology to meet a critical societal need, and benefits derived from the energy sector permeate multiple peripheral economic sectors and the base technologies are applied throughout society.

Shortly after widespread land-based exploitation commenced in the mid-19<sup>th</sup> Century, offshore exploration and production began. As the technologies have matured over the last century, and as land-based reservoirs have been depleted, offshore activities have become more prevalent. Production rigs are now venturing from deep-water (300 to 1,500 meters) to ultra deep-water (1,500-3,000 meters). Furthermore, equipment operating at such depths face environmental challenges not found on land or in shallow water, notably extreme pressures and low temperatures which induce greater wear and more frequent maintenance and replacement

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<sup>99</sup> These allow the seller to control how the product is distributed once it has already been sold, thereby permitting gas to be sold to different customers at variable prices. The argument is made, accurately, that Russia can pressure recipient states by manipulating the gas price.

schedules. For these reasons, deep and ultra-deep water production can be 3 to 4 times more expensive than land or shallow water production (Speight 2011: 222).

As noted earlier, another important technology with use outside the energy industry is reflected seismology. This is a technique used in petroleum exploration which allows controlled seismic sources, such as elastic sound waves, emitted from an energy source to determine the existence of subsurface hydrocarbons. These waves can be delivered via vibrosis or controlled explosion, and are directed into the subsurface where the reflected waves are recorded and analyzed. This is a specialized technology that has evolved over time, to where three and four-dimensional seismic readings are possible allowing petroleum engineers greater accuracy in locating hydrocarbons both on land and under water resulting in fewer dry holes and better labor and capital management (Conaway 1999: 48-50; Hyne 2001: 229-231).

Pipelines are one of the earliest examples of technological achievement in the petroleum industry, and their overall value has increased immeasurably since then. Each pipeline exists within a unique set of circumstances and requirements, designed to address one or more commercial or engineering problem. Moving large quantities of valuable liquids is not new; Romans transported water to population centers by aqueducts. Large-scale commercial oil pipelines trace their origin back to the mid-1800s where rudimentary wooden structures, using the same basic principle as the Romans, were built to transport Pennsylvania crude to New York-based refineries (Yergin 1991: 33). Over the last century and a half, pipelines became more functional and sophisticated, capable of traversing difficult terrain with higher throughput capacity.

This also transcended to gas, particularly as the ability to capture and transport it has improved, so has its value as a commodity. Modern oil and gas pipelines are detailed systems comprised of monitoring and maintenance facilities, or “pigging” stations, pumping stations (for oil) and compressor stations (for gas) and valve points, designed to maintain and monitor safety and functions along the route. Moreover, with crude as the lifeblood of the modern global economy, so have pipelines’ geo-political importance. As the political, financial, and societal value of oil and gas has increased, pipelines became more than simply energy transit mechanisms, but manifestations of state and corporate power. Indeed, pipelines can even be described as symbols of wealth and stability, which translate into political legitimacy, to where a country can derive strategic or commercial advantage over its neighbors.

The majority of crude oil is transported by ship; tankers provide the greatest flexibility over other forms of transport, notably in the diversity of routes, quantities shipped and distance traversed. Yet, for moving landlocked oil and gas long distances, pipelines constitute a permanent fixture providing economical, year-round supply, independent of road, rail or sea. When properly constructed and maintained they are impervious to the most extreme weather and natural conditions, making them generally inexpensive to operate. This coupled with advanced monitoring and communications capabilities, such as SCADA (Supervisory for Control and Data Acquisition), remotely piloted aircraft, satellite surveillance and a range of security measures can be emplaced, thereby reducing costs as well as the environmental risks.

The negative aspects of pipelines are sunk costs, potential environmental impact and their static nature which makes them generally inflexible for any specialized consumer demands. Additionally, they are frequently dedicated to a single production location, consumer base, refinery or port, again hindering their ability to respond to changing market requirements. The meticulous planning involved in their construction, ranging from multilateral political negotiations at the national and local levels, to funding sources and engineering challenges, ensures this is an extremely costly and time consuming venture well before work has even started.

When compared to ships, pipelines provide fewer options for delivering varieties of grades of crude to consumers and are often limited by throughput capacity. Also, with this highly visible manifestation of power and wealth they are excellent targets for forces anxious to challenge that status or intent on disrupting service. Moreover, there is always the threat of natural disaster or theft by cutting into the pipe and siphoning off the product. Nevertheless, oil pipelines do play a vital role, as they allow the exploration and production of remote fields, and are cheaper and convenient to transport as opposed to road or railway. This is particularly true with the end of the Cold War where a host of new suppliers in the Caucasus and Central Asia emerged, for which pipelines have been critical in facilitating oil and gas transport to global consumers.

Many of the same benefits and limitation with oil pipelines are found in gas pipelines. For instance, when compared to coal, the composition of natural gas makes it generally well-suited to pipeline transport. The vast majority of gas transit, roughly 70 percent, is performed by pipeline, indicating there is more room for LNG to grow as the technology matures and economies of scale prevail. There are also evident geopolitical implications to the growth of LNG, particularly in the Black Sea RSC. For instance, 84 percent of the EU-Russia and FSU gas trade is via pipeline traffic, which, arguably makes Ukraine the most influential gas transit state and consequential to European energy security (Energy Charter, (37) (Gas) 2012: 9).

Finally, there is perhaps the most important technological innovation in recent years—fracking, which has opened up oil and gas plays which were considered unprofitable. This in turn has driven down the price of both oil and gas; the combination of hydraulic fracturing and horizontal drilling, and possibly permanently altered the energy sector’s geopolitical landscape. Most notably, within the last several years, the US has shifted from a potential gas importer to an exporter. Moreover, fracking has in a remarkably short time changed the global geo-political energy dynamics, mostly by eroding Russia’s economic position and challenging Moscow’s long-term ambitions in its near abroad. It also has the potential to allow the EU and many Black Sea RSC states considerable freedom of action, particularly regarding gas imports and their relations with Russia.<sup>100</sup>

## **Energy and the Black Sea Regional Security Complex (RSC)**

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<sup>100</sup> In 1948 US petroleum engineers developed the technique of hydraulic fracturing ‘fracking’ as a replacement for explosive fracturing. It was the more recent ability to combine the benefits of horizontal drilling with fracking that have allowed this unprecedented activity.

The Black Sea itself does not hold significant quantities of oil or gas, particularly when compared to the Caspian basin. In recent years modest offshore reserves have been discovered, though it is too soon to determine their full potential. In the immediate-term, it is the Caspian-based oil and gas fields which have shown the most potential, and which have generated so much interest, notably in European markets. When considering the Black Sea RSC's geographic and political attributes, one of the critical questions which comes to the fore is how to produce and transport Central Asian energy in an economical manner. It is in this capacity that it is possible to address the combined geological and geopolitical dynamics in place which answer the research question.

The regional states have also shown initiative as the promise of energy riches force them to jockey for position to solidify their respective roles as producers, transport hubs or both. Cross-border cooperation is necessary to move these resources to market, as does the need to plan, build and maintain this energy network present a host of challenges related to the Black Sea RSC's geography, geology and politics. All of which require countless inter and intra-regional transactions, as well as capital and technologies to keep this network functioning. Therefore, it is possible to observe the Black Sea energy corridor as fungibility in its most basic element, and as a driver of change in the broader region.

In the confluence of geography, geology and politics, none is more relevant than the Turkish Straits which, for centuries, has acted as the traditional boundary between Europe and the East, and is the only feasible access for large scale shipping in the Black Sea. Alternative shipping routes exist, notably via the numerous rivers that access the Sea, the most prominent being the Danube River, as an inland waterway, allows shipping traffic into the heart of Europe. However, these Continental options are limited, usually relegated to smaller vessels and environmental restrictions limit the type and quantities of certain cargoes.<sup>101</sup> The result being there are no alternate routes for shipping from the Black Sea, thereby placing pressure on the Turkish Straits to support this growing regional trade volume (Tempera, November 2010).

The passage holds many risks to shipping traffic as well as to local population centers. The Bosphorus cuts through Istanbul with over 13 million inhabitants and presents immense environmental and public safety concerns (Turkstat accessed May 16, 2013). Furthermore, the Straits are subject to strong currents and winds, as well as rain and dense fog, particularly during spring and autumn. Though the Montreux Treaty guarantees free and unhindered passage for commercial shipping, Turkey can impose safety regulations. In October 2002, Turkish maritime authorities scaled back tanker traffic through the Bosphorus, also placing restrictions on nighttime transit for ships greater than 200 meters in length (Bosphorus Straits News, date accessed March 17, 2013). These restrictions effectively singled out petroleum product traffic, however, all shipping suffered and the inevitable backlog caused millions in demurrage charges as penalty for delayed cargo deliveries.<sup>102</sup> By early 2004, conditions had deteriorated to the point where Russia

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<sup>101</sup> According to Dejan Radojicic, of the University of Belgrade, the Danube's traffic levels are less than 10 percent of full capacity, primarily from political and economic factors, "as well as unfavourable navigational conditions on the waterway itself" (Radojicic 2012).

<sup>102</sup> During this period a round trip between the Black Sea and the Mediterranean was 15 days and by late 2003, 65 ships had clustered off the Bosphorus awaiting clearance to proceed. A round trip for a Suezmax tanker of 130,000-140,000 dwt (285 meters) had reached 29 days, incurring over \$1.5 million in demurrage costs (Petroleum Intelligence Weekly February 19, 2004: 2).

threatened legal action, claiming Turkey to be in breach of Montreux (Petroleum Intelligence Weekly, February 19, 2004).

The threat of environmental accident or terrorist attack created the impetus for a bypass pipeline as an economic and logistically feasible means of transporting Central Asian oil and gas. In fact, a Turkish oil bypass pipeline had long been considered as a desirable solution to overcrowding in the Bosphorus, and by the late 1990s discussions were under way between national and local governments, as well as commercial stakeholders to build such pipelines. Interestingly, this represents a reversal of the Black Sea's traditional geopolitical and economic configuration, whereas the Turkish Straits for centuries conveniently restricted entry *into* the Black Sea, they are now hindering traffic *out* of the Sea.<sup>103</sup> Again, what is evident is the influence of fossil fuels in changing the configuration of the traditional geopolitical posture, accentuated by the external and internal dynamics.

## The Soviet-Era Oil and Gas Industry

As the long-term regional energy power, any analysis of the Black Sea RSC's energy environment must consider the Imperial/Soviet period, whereby it played the dominant role and provides insight and historical context to today's regional energy dynamic. When the Bolsheviks took over the Caucasus oil fields, Imperial production had been decimated by 15 years of labor strife, revolution, civil war and capital and intellectual flight. In 1918 the fields were nationalized, but there were few indigenous engineers qualified to run them, while a Western (anti-communist) embargo only compounded the Bolshevik's problems. Production bottomed out in 1920 with 32 million barrels versus 100 million barrels in 1901, and it was not until 1928 that the USSR, with considerable foreign assistance, was able to surpass that quantity (Goldman 1980: 14-15, 22-25).

In the 1930s, major discoveries in the Ural-Volga basin and West Siberia overshadowed the Caucasus, but it was not until after World War II that these fields were seriously exploited; initially the Ural-Volga basin, then the Western Siberian fields as the former became depleted. The Soviets were aware of the potential in the Caspian basin, though lacked the expertise to exploit it. And though they were able to rebuild their Caucasus oil fields into a marginally productive industry, it was the Siberian fields which pushed the USSR from a coal-based economy into a petroleum-based one at the long-term expense of Baku (Grace 2005: 14-15; Goldman 1980: 34-35).

Throughout the Cold War these two massive reservoirs in the Ural-Volga and Western Siberia sustained the post-World War II economic recovery, the Soviet military machine and the Eastern Block with subsidized fuel. Moreover, this surplus of oil made its way to the global market which drove down the price of crude, reducing royalties to the Middle East kingdoms and providing the impetus behind OPEC's formation in 1960 (Victor 2008: Appendix A, 71). In the gas sector, as these formations in the Western part of the Union were depleted, by the 1960s the Soviets were forced to venture deeper into Siberia and Central Asia. Today, the largest Russian

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<sup>103</sup> See Appendix A for the results of an IHS-CERA study which challenges the necessity of a Bosphorous bypass.

gas fields in production are in the Arctic, Siberia or the Far East (Grace 2005: 213-214; Campbell 1975: 52-53).

Soviet oil production peaked in 1987-88 at 11.4 mbd, which placed it as the world's largest producer and second largest exporter behind Saudi Arabia. Additionally, in 1990 the Soviet Union was the world's leading natural gas producer at 822 bcm per year, versus the United States at 502 bcm. The Russian Republic accounted for nearly 80 percent of Soviet gas production. The Soviet Union was a major oil and gas consumer in its own right, and generous subsidies kept the Soviet republics and client states dependent on plentiful oil and gas, rendering them pliant and docile<sup>104</sup> (University of Texas-Austin 2001: 2).

This push to achieve ever higher production goals was encouraged by rising prices, a need for hard currency, and the Soviet leaders' own innate insecurity which propelled them to produce more than anyone else as a sign of national prowess and to guarantee their hold on power. However, this production rate was unsustainable, motivated by unrealistic goals handed down by state planners with no concept of the technical challenges faced on the ground. This pace of production required considerable state financial support at the expense of other sectors, and the inability to maintain equipment led to mechanical breakdowns, well damage, worker injuries and environmental accidents. The long-term reliance on subsidies fomented waste and poor management policies which helped devastate the industry. The collapse of global oil prices in the 1980s and the inevitable domestic oil industry downturn contributed to the Soviet collapse in 1991 (Grace 2005: 65, 70-75).

One of the greatest flaws of the Soviet system, and the energy sector in particular, was the lack of competition and profit incentive; the basic elements which drive effective capital allocation and innovation were glaringly absent in the USSR. Disassociated from basic market principles, production goals were derived from quantity-based targets with little regard to cost, profitability, sustainability or environmental concerns. Oil and gas revenue collection was hap hazard and unreliable, and funds were redistributed in accordance with political priorities, notably defense, without consideration for resource conservation, technological innovation or improvement of management practices (Grace 2005: 11; University of Texas-Austin 2001: 3).

Cold War-era trade restrictions resulted in primitive technologies and decreased production efficiencies, an irrational use of resources, and rapid depletion of reservoirs. Moreover, thousands of kilometers of pipelines were laid without adequate leak detection and tracking mechanisms, leading to poorly maintained networks, inefficient management, product theft and frequent environmental degradation. Multiple layers of bureaucracies required production companies to obtain a variety of permits, resulting in a corrupt, redundant and counterproductive system. Additionally, the Soviet energy sector was a convenient source of tax revenues, while overlapping federal, regional and municipal taxes were imposed which inhibited exploration and production. By 1991 a wide divergence in exploration and production technology had opened between East and West, brought about by such systemic inefficiencies within the Soviet system (Goldman 1980: 178-179; University of Texas, Austin 2001: 4-5).

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<sup>104</sup> In 1988 the Soviet Union consumed 7.7 million bpd, approximately one-half of that consumed by the United States and 80 percent of Western Europe (University of Texas-Austin 2001: 2).



The collapse of the Soviet Union and the ensuing economic contraction meant the end of the most generous subsidies, though Moscow still provided below cost oil and gas in Russia, the former Soviet states and Eastern Bloc countries. As the FSU economies were so closely interrelated, being forced to buy oil and gas at elevated (though still subsidized) prices, intensified the economic downturn, but also instilled greater efficiencies leading to reduced demand. For instance, between 1990 to 1997 Russian gas consumption fell more than 16 percent (420 bcm to 350 bcm) while gas exports to the FSU declined by 31 percent (from 110 bcm in 1990 to 75.6 bcm in 1998). Yet as domestic consumption dropped during this period, gas production declined by only 8 percent, compensated by new export opportunities which had been closed during the Cold War. This was not the case with Russian oil production, which fell by 23 percent during this time but recovered slowly, principally because OPEC was able to fill this void and reduce Russian market share (Victor 2008: 10).

As noted in Chapter 2, in the industry's formative years Baku was a leading center of innovation and advanced technology in the petroleum field, spurred by foreign capital and expertise which congregated there. By 1920 revolution and civil war had all but destroyed the sector, and though it was rebuilt, by the end of the Soviet era, the Caucasus energy sector was lacking advanced equipment and processes, and suffering from gross inefficiency and waste (Grace 2005: 14-15; Goldman 1980: 34-35). A problem which plagued the Soviets and now the Russian Federation was the technological disparities with their Western counterparts, and the twenty-five years since independence and the shock of competition, have allowed Russian companies to make some gains on their Western competitors or fail trying (Goldman 1980: 178-179; University of Texas, Austin 2001: 4-5).

Soviet-era engineers proved resourceful, but were never able to overcome these systemic limitations and inefficiencies. (See Appendix B for a description of the development of the turbo-drill). As noted in the May 2013 Energy Ministry's board meeting, these weaknesses carried over into the post-Communist era, where there is now a concerted effort to narrow this technological gap. These key technologies are of great interest to the Russians and are focusing on acquisitions, joint ventures or targeted purchases to obtain them. In the wake of the Crimean and Ukrainian crises, the impact of Western sanctions, many of which are directed against Russian energy or banking concerns, have hurt Moscow's long-term competitiveness in the sector.

### The Soviet Legacy and the Russian Pipeline Network

Pipelines are not new to the Black Sea RSC. In 1873, at perhaps the height of Russia's dominance of the global oil industry, the Rothschilds and Nobels built a pipeline to deliver Azerbaijani oil to Black Sea-based ships in Batumi of what is now Georgian Adjara (LeVine 2007: 217). Over the following century the Russians and later Soviets developed an impressive network to send oil and gas from Caucasus, Siberian or northern Russian fields to the Union's western consumption centers. The result being an extensive east-west pipeline infrastructure was in place long before 1991, and as the USSR splintered into multiple sovereign states, the pipelines, which now transcend newly imposed international boundaries, have taken on decidedly geopolitical overtones. Indeed, this legacy Soviet pipeline network is much at the heart of the current East-West tensions.

With the onset of independence, the oil and gas sectors of Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan were already well-integrated within this predominantly westward running infrastructure configured in Russia's favor, whereby Moscow controlled virtually all access to foreign markets. Under this template, the former Soviet states had no choice but to feed into the dominant architecture of the Russian system. This also was true with the Russian seaport of Novorossiysk as the main oil export facility on the Black Sea, and which left Moscow in a strong logistical, and ultimately political and economic position vis-à-vis the newly independent states (Elkins 2005).

## The Eurasian Energy Corridor

Europe has always had relatively plentiful coal resources, though it has been a net oil and gas importer since the beginning of the Petroleum Age. For this reason, a crucial element to Europe's economic vitality is maintaining a secure and predictable supply of energy, notably oil and gas. Yet, the genesis of the Eurasian Energy Corridor concept is traced to Washington, which wanted the Central Asian and the Caucasus states the ability to transmit oil and gas to the West outside of the Russian pipeline network, thereby giving these newly liberated states economic and political independence (LeVine 2014). In fact, US Secretary of State, Madeleine Albright, highlighted the US position:

“The US does not recognize Moscow's rights to spread the sphere of its interests outside of Russia's borders. We openly declare that the US does not recognize Russia's or somebody else's right to have special commissions or spheres of influence outside of its borders” (Turan News Agency, October 27, 1994).

Another consideration when establishing the corridor was to operate outside of Iranian territory. Isolating Iran was justified because of its sponsorship of terrorism and overt hostility to the West, not to mention the 2002 revelation that it had a covert nuclear development program. It is doubtful if the recent and supposed Iranian rapprochement with the West will alter this fundamental policy. The result is a narrow corridor traversing a fractious and violent region, fraught with geopolitical, geological and financial challenges, all of which demanded a safe energy transit route.

As the Soviet Union began to open up in the early 1990s an exciting prospect emerged for Western governments and energy companies which eagerly looked at the Caspian basin; notably Azerbaijan, Kazakhstan and Turkmenistan. Azerbaijan, because of its existing infrastructure and friendly disposition toward the West, was the centerpiece of the Caspian energy strategy (Pfluger 2012: 2). However, at the time it was believed that Azerbaijan's aging oil fields had limited lifespan and, over the long-term, more productive areas existed further east. This notion was reinforced by a 1997 US Department of State report based on a US Geological Survey analysis which estimated considerable oil and gas reserves in the eastern Caspian basin. More specifically, the report helped spur interest in Kazakhstan and Turkmenistan, creating the

impetus for a Trans-Caspian pipeline which would allow the oil and gas to reach global markets outside of Russian and Iranian territory<sup>105</sup> (Cornell 2012: 229; Klett, et al. 1997).

The great distances between the Caspian basin's oil and gas fields and the European markets make pipelines the most feasible solution, reducing the reliance on poor road or rail networks and the inefficiency or corruption of the local governments. By breaking out of the traditional Soviet-era network, the non-Russian Caspian basin energy producers were given political economic freedom, albeit at considerable financial cost (Elkins 2005). The emergence of the Eurasian Energy Corridor gave these former Soviet states options outside of the Russian network, so it was considered a threat to Russian domination and has been actively challenged by the Kremlin. These initiatives touched off a new form of geo-economic competition known as "pipeline politics."

It is the relatively recent popularity of natural gas that has altered the Black Sea RSC energy dynamic, and changed the petroleum-centricity of the initial considerations. Because its transportability via marine tanker allows oil and its peripheral products to be delivered to European markets from a variety of global sources, the main concern has been natural gas which lacks this capability. As LNG still provides only a small amount of Europe's yearly gas consumption, estimated at 47 bcm or 10-15 percent in 2009, the vast majority is produced domestically or is piped in from external sources (Kavalov 2009: 6). To address this weakness, European leaders sought to diversify their gas sources by establishing energy corridors roughly based on the four Cardinal directions. For instance, a Northwest corridor is supplied by the North Sea's gas fields, a Southwestern one from Algeria, and a Northeast corridor from Russia. The one missing direction, from the Southeast, has only been recently addressed in the form of the Southern Gas Corridor. It is the Southern Gas Corridor which is the most challenging, notably because of the difficult terrain, numerous international boundaries and the generally contested relations nested in the region.

The 1999 discovery of the Shah-Deniz gas fields, approximately 100 kilometers east of Baku, set a host of new regional dynamics in motion. This new discovery by Azerbaijan, coupled with the realization that the Central Asian states were unwilling to annoy Moscow at that time by circumventing the Russian pipeline system, was instrumental in shifting Washington's focus back to Azerbaijan and set in motion what would be the Nabucco Pipeline. Additionally, the goal would be expanded to include a greater emphasis on European access, particularly in light of the 2006 gas dispute, therefore the Southern Gas Corridor was not only a vehicle for Central Asian independence, but a venue for European energy security. Finally it lessened the importance of an expensive and politically and legally contentious underwater pipeline across the Caspian<sup>106</sup> (Cornell 2011: 229; LeVine 2014).

## **Black Sea RSC Oil and Gas Pipelines**

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<sup>105</sup> A US Geologic Survey report in 2010 estimated 196 billion barrels, 7 tcm of gas and another 9.3 billion barrels of gas liquids, such as methane, butane or propane, existed in the Caspian basin (US Geologic Survey, 2010: 1).

<sup>106</sup> The disputed legal status of the Caspian Sea's littoral state's claims remains a stumbling block; the littoral states have carved out economic zones, though their legal status is questionable. For more information, see Diba 2006.

It has already been established that pipelines embody cutting edge technological innovation and exist as sinews of inter and intra-regional economic development and geopolitical change. There is also the interest to further develop and investigate the impact of the pipeline network within the Black Sea RSC and how they shape and answer the research question. This next section provides the textual background to the pipeline network and lays out the basis of their roles as not only economic but also geopolitical assets as well. Moreover, it breaks down the oil and gas pipelines into operational, planned or delayed or abandoned projects. With the help of maps, it is possible to get a perspective on the extent of oil and gas pipelines within the region, notably by evaluating their density of coverage, throughput capacity and overall ability to affect geopolitical change. This section will review the region's main pipelines, their historical and geopolitical background, as well as their general relevance to the region's transformation.

## Operational Oil Pipelines

### The Early Oil Project: Baku-Novorossiysk and Baku-Supsa Pipelines

The “Early Oil Project” (EOP) was designed to quickly resurrect wells with the most production potential in the Chirag fields to provide Azerbaijan revenue before tackling the more challenging Azeri and Gunlesh fields and before a larger, dedicated export pipeline could be built. The EOP was the first large-scale post-Cold War oil project in the Caspian basin, and was made possible with a \$200 million startup loan from the World Bank's International Finance Corporation (IFC) and the EBRD. In addition to the Chirag refurbishment was the construction of the Sangachal terminal and its underwater pipeline network, and an enhanced oil export facility in Supsa, Georgia. Equally notable under the EOP was new or refurbished pipelines and facilities in Azerbaijan and Georgia; the Baku-Novorossiysk and Baku-Supsa pipelines respectively (Azerbaijan website, date accessed November 23, 2013).

In 1991, the Baku-Novorossiysk pipeline was already in existence, though configured as a north-south running oil link. In February 1996 a contract signed between AIOC, SOCAR and Transneft began the process of reversing the oil flow and allowing Chirag crude to be exported to Novorossiysk.<sup>107</sup> The pipeline was rerouted around Chechnya, on account of the insurgency there. In February 2008, SOCAR, bought out the other members and became the sole owner and operator on the Azerbaijani side (Trend, February 6, 2008). The pipeline is 1330 kilometers long; 231 kilometers within Azerbaijani territory, with a 100,000 b/d capacity (Energy Charter, (38) (Oil) 2012: 23).

In March 1996, a month after the Baku-Novorossiysk contract, Heydar Aliyev and Eduard Shevarnadze agreed to establish the 829 kilometer Baku-Supsa pipeline. The first oil was transported in April 1999, and it is still in operation, managed by BP on behalf of the AIOC, with

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<sup>107</sup> There is a portion of this pipeline, the Makhachkala-Novorossiysk section used to transit Turkmen and Kazakh oil to the Caspian port of Makhachkala (Energy Charter (39) (Oil) 2012: 71).

an estimated capacity of 145,000 b/d<sup>108</sup> (Cornell 2012: 226-228; EIA, (22) Azerbaijan Country Analysis 2012: 3). Stakeholders have priority access, though non-members are permitted to transport oil on the pipeline.<sup>109</sup> The Supsa terminal improvements include a new 13 kilometer branch line extended from the existing Samgori-Batumi pipeline and four reservoirs each with a 1.8-million barrel capacity (Energy Charter, (40) (Oil) 2012: 26, 66-67).

## **Baku Tblisi Ceyhan (BTC) Pipeline**

In the 1990s BTC became the centerpiece of a combined US-EU energy strategy in the Black Sea RSC, acquiring tremendous political and symbolic importance. BTC was initiated under the George H.W. Bush administration, and its construction carried into the Clinton and George W. Bush administrations. The stakeholder concerns had considerable influence; for instance, the most direct route, through Armenia, was impossible because of the unresolved Nagorno-Karabakh conflict, while Turkey demanded that the pipeline terminate at the Mediterranean port of Ceyhan so as to bypass the Turkish Straits. The November 1999 “Istanbul Protocol,” which committed to the construction of the BTC oil pipeline was, in effect, the first Black Sea RSC bypass effort. It was signed in Istanbul by Azerbaijan, Georgia, Turkey, and Kazakhstan, with President Clinton in attendance (Nichol 2009: 34; Fredholm 2005: 23).

The financial, political and engineering challenges of BTC were immense, and it faced strong Russian and Iranian opposition who felt, correctly, they were deliberately excluded from Western markets (Cornell 2011: 230-231). The pipeline was completed in 2005 and first oil reached Ceyhan in May 2006. BTC carries high quality Azeri Light crude from the ACG fields, and stretches 1,790 kilometers with a capacity of 1.2 million b/d.<sup>110</sup> An incorporated joint venture, the Baku-Tbilisi-Ceyhan Pipeline Company, built and operates the pipeline, which comprises 11 shareholders and is managed by BP, the largest shareholder<sup>111</sup> (BP (4) website, date accessed March 19, 2016). BOTAS was awarded the contract to build and operate the Turkish portion. Additionally, the shareholders have access quotas, and non-member third parties have access with shareholder consent (Energy Charter, (41) (Oil) 2012: 26, 67). In 2012, BTC exported 245.8 million barrels of crude, while capital spending was \$64 million, and planned expenditures in 2013 was about \$97 million (BP (5) Azerbaijan Sustainability Review: 15-18).

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<sup>108</sup> The Baku-Supsa pipeline is also called the Western Route Export Pipeline (WREP). (See BP (6) website, date accessed March 12, 2016).

<sup>109</sup> Participants are: Amoco Caspian Petroleum Limited, BP Exploration (Caspian Sea), Delta Nimir Khazar Limited, Den Norske Stats Ojeselskap a.s., Exxon Azerbaijan Limited, LukOil, McDermott Azerbaijan Inc., Pennzoil Caspian Corporation, Ramco Khazar Energy Limited, SOCAR, TPAO and Unocal Khazar Ltd. (Energy Charter (42) (Oil) 2012: 66-67).

<sup>110</sup> The pipeline comprises Azerbaijan (449 km), Georgia (235 km), and Turkey (1,092 km.). BTC handles 80 percent of Azerbaijan’s oil exports, mostly delivered to European markets; since it began operation, Baku’s oil exports have nearly tripled (EIA (23) Azerbaijan Country Analysis: 3). Since October 2008, BTC has exported Kazakh and Turkmen oil shipped across the Caspian Sea (Guliyev 2008).

<sup>111</sup> The BTC pipeline consortium and its respective shares is made up of BP (30.1 percent) and project operator, SOCAR (25 percent), the US companies Unocal (8.9 percent), Amerada Hess (2.35 percent), Statoil (8.7 percent), TPAO (6.5 percent), Italy’s Eni (5 percent), Total (5 percent), and the Japanese-based Itochu and Inpex with 3.4 percent and 2.5 percent interests respectively, and Indian ONG-Videsh (2.5 percent) (Trend, June 10, 2013; BP (7) website, date accessed January 17, 2016).

## **Caspian Pipeline Consortium (CPC) or the Atyrau-Novorossysk Pipeline**

This 1,500 kilometer oil link originates at Atyrau, in western Kazakhstan, near the Tengiz oil field. Privately owned and operated by the Caspian Pipeline Corporation (CPC), its main stakeholders include Chevron, Shell, ExxonMobil, Italy's Eni, and Rosneft and Lukoil.<sup>112</sup> Construction on the pipeline began in May 1999 and it became operational in 2001. By 2010 the pipeline's volume had reached 250 million barrels per year of its own CPC blend, and was expanded to a yearly volume of 500 million barrels in 2015 (CPC website, date accessed March 30, 2013; Energy Charter, (43) (Oil) 2012: 65). The pipeline is expected to increase its throughput considerably when Kashagan oil begins to flow again.<sup>113</sup>

In the early 1990s, the CPC was supported by Yeltsin and Chernomyrdin, who at the time were anxious to tap Western expertise and capital. The pipeline opened in 2001, early in the Putin era, and has since been "under siege", with pressure growing stronger over time as Moscow's control of the energy sector increased. The subsequent opposition and threats of nationalization indicate the pipeline is a challenge to Moscow's ability to maintain full control of its energy sector (Dellecker 2008: 6-7, 17). In reality, the Kremlin is also aware that these actions (nationalization) may intimidate potential investors, so, for the time being, Moscow appears resigned to accept the presence of the CPC.

The pipeline's shareholder agreement establishes the rules of access and tariffs, and for this reason the CPC is exempt from the myriad of Russian and Kazakhstan tariffs and access regulations. The shareholders have priority use of the pipeline, though non-members are allowed access with shareholder approval. The pipeline's base load is met by Tengizchevroil<sup>114</sup> (a Chevron subsidiary) and Karachaganak Petroleum Operating B.V. (Energy Charter, (44) (Oil) 2012: 25).

## **Odessa-Brody Pipeline**

The Ukrainian government initiated the Odessa-Brody pipeline to diversify its oil sources through a bypass effort designed to transmit Caspian oil to Central Europe via the Black Sea port of Odessa. The first stage (Odessa-Brody) was a 674 kilometer pipeline with a 280,000 b/d

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<sup>112</sup> BP was an initial investor in the Tengiz field and the CPC, but sold its shares to Lukoil in 2009 for \$1.6 billion in cash (Swint, December 11, 2009).

<sup>113</sup> After numerous delays, the field began production in September 2013 but was shut down in November 2013 because of safety concerns. As of early 2016 the field is still not operational (Menas, November 2013).

<sup>114</sup> The governments of Russia and Kazakhstan own 50 percent of the consortium: RFFI, 24 percent plus 7 percent through CPC Co and KazakhOil, 19 percent plus 1.75 percent through Kazakhstan Pipeline Ventures LLC. The second half is divided up between private companies. These companies are: Chevron Caspian Pipeline Consortium Co. (15 percent), LUKARCO (12 percent), Mobile Caspian Pipeline Co. (7.5 percent), Rosneft-Shell Caspian Ventures Ltd (7.5 percent), Agip International (2 percent), BG Overseas Holdings Ltd (2 percent) and Oryx Caspian Pipeline LLC (1.75 percent) (Energy Charter, (45) (Oil) 2012: 66).

capacity. The plan was to implement a second stage from Brody to Płock, where it was intended to tie in with Druzhba's western branch. A third and final stage would take the pipeline to the Baltic port of Gdansk (Energy Charter, (46) (Oil) 2012: 91). To date, stages 2 and 3 have not been implemented.

In August 2001 the Odessa-Brody portion was completed, but generated no interest from potential customers. TNK-BP agreed to transit Urals blend crude to the Odessa refineries, in reversed mode from Brody to Odessa. The pipeline operated under these conditions for several years, at only 18,000 b/d. Beginning in late 2011 quantities of Azeri Light were introduced to the pipeline running from Odessa to Brody, where it was shipped via rail to Belarus's Mozyr refinery (Energy Charter, (47) (Oil) 2012: 73). There is no official record of the cost to build the pipeline, but it almost certainly has been a money losing effort for Ukraine.

## **Kirkuk-Ceyhan Pipeline**

The Ceyhan terminal receives oil from the Kirkuk pipeline, which originates in northern Iraq's semi-autonomous Kurdistan Regional Government (KRG). The Kirkuk-Ceyhan pipeline, at 970 kilometers, is comprised of two parallel pipelines with a total capacity of 500,000 bbl/d. The first of the two pipelines was commissioned in 1977, the second pipeline, built in 1987, was to circumvent Iranian counter-shipping efforts in the Persian Gulf during the Iran-Iraq War (Roberts 2009). In 1990, UN sanctions forced its closure, and by 1996 only limited quantities of crude oil were shipped. Operations were again suspended during the 2003 Iraq War, though volumes have grown in post-Saddam Hussein Iraq (Energy Charter, (48) (Oil) 2012: 75). The pipeline is jointly operated by Iraq and Turkey's pipeline companies; the State Company for Oil Projects (SCOP) and BOTAS (Clancy March 2010; Iraq State Company for Oil Projects website, date accessed December 4, 2013).

A separate Kurdish pipeline, under construction by Norwegian oil company DNO International, ties into the Kirkuk-Ceyhan pipeline, with the goal of carrying crude oil from the Kurdish Tawke oilfield to Ceyhan.<sup>115</sup> These unilateral activities have caused irritation in Baghdad, which is trying to rein-in the KRG and implement a revenue sharing mechanism (Asharq Al-Awsat August 22, 2013). The disintegration of Iraq in 2014 has left the KRG a defacto self-governing petro state, which enjoys relative stability and prosperity compared to the rest of the country and attempts by Baghdad to reinstate control will be difficult, if not impossible (Swint, June 13, 2014).

## **Abandoned or Delayed Projects**

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<sup>115</sup> According to DNO, the Tawke field is capable of producing 113,000 barrels per day (Asharq Al-Awsat August 22, 2013).

## **Samsun-Ceyhan Pipeline**

The Samsun-Ceyhan Pipeline was another bypass project running the breadth of Turkey from the Black Sea port of Samsun to the Ceyhan facility. Though a dead project for now, it provides insight into the frequently opaque and murky political-energy machinations in what was a vast *quid pro quo* between Russia and Turkey. Ankara wanted another bypass in addition to the BTC, though Moscow saw the project as an attempt to circumvent its own pipeline network and opposed it, promoting the Burgas-Alexandropolous bypass as an alternative.

The effort was initially developed in 2006 by Calik Holding and Eni to build a 550 kilometer, \$2.5 billion (2008 estimate) pipeline capable of moving 1 million bpd, with the potential to increase to 1.5 million bpd. Moscow gradually warmed to the idea following Putin's August 2008 visit to Turkey where it was proposed that Ankara would support South Stream if Russia joined Samsun-Ceyhan. In October 2008 Turkey, Italy and Russia signed a MOU to build the pipeline, and the Trans-Anatolian Pipeline Company (TAPCO) was created as a joint venture between Calik Energy and ENI, each with a 50 percent stake. Ankara subsequently authorized Russian geological exploration in its economic zone in preparation for South Stream (Kardas 2008). Transneft and Rosneft agreed to supply the crude and build a refinery in Ceyhan (Popovici 2009).

Charges of contract irregularities were quickly leveled by the Turkish political opposition. The Republican People's Party requested an official investigation into the business dealings of Erdogan's son-in-law, Berat Albayrak, Calik's CEO. It was claimed the 2006 contract award was improperly let as sole-sourced, and allegations were made that Calik would unfairly benefit from pending economic stimulus legislation designed to support private sector contracts for infrastructure development<sup>116</sup> (Kardas 2008). However, it was the fallout between Turkey and Eni that ultimately decided the project's fate, which stemmed from Eni's cooperation with Greek Cyprus to develop its offshore gas field.<sup>117</sup> Ankara has consistently protested attempts by Cyprus to develop these reserves, and in early 2013 Turkey ejected Eni from the project (Turkish Weekly, March 29, 2013). Efforts to find a replacement for Eni were unsuccessful. When Russian Energy Minister Novak told the Turkish paper, "Today's Zaman" it would be 40 percent cheaper to send oil through the Turkish straits, Ankara closed down the project (UPI, April 23, 2013).

## **Burgas-Alexandroupolis Oil Pipeline Project**

A prospective bypass project, Burgas-Alexandroupolis Oil Pipeline Project would bring oil by tanker from Novorosiysk to Burgas, from where it would be carried through a 280 kilometer pipeline to Alexandroupolis. A tri-governmental MOU was signed in Athens on March 15, 2007

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<sup>116</sup> The Calik group responded to these charges by claiming it only required a license rather than a formal public tender. The company also noted other pipelines were built under similar licensing practices (Kardas 2008).

<sup>117</sup> Prime Minister Erdogan vowed that Turkey would support Northern Cyprus's attempt to exploit oil and gas in its own EEZ (Kardas 2008).



establishing the project outlines, and another agreement was signed in Moscow on December 18, 2007, which formed the international project company; Trans-Balkan Pipeline B.V.<sup>118</sup> Russia held a 50 percent plus one share equity in the company, and Greece and Bulgaria each held a 24.5 percent share. The expected quantity was 250 mbl per year, with the potential to increase capacity to 360 mbl per year (Energy Charter, (49) Bulgaria 2011: 90-92)

It would also require reconstruction of the Burgas and Alexandroupolis terminals, to include new oil tanks with 4.2 million barrel capacity in Burgas, and 8.5 million barrels in Alexandroupolis. The pipeline was expected to cost \$1.35 billion in 2008 prices and would be built and owned by Trans-Balkan Pipeline B.V. (Energy Charter, (50) Bulgaria 2011: 90-92). In early 2013, Sofia, citing financial concerns, abandoned the project (UPI March 13, 2013). This decision was a blow to Turkey as it scuttled a viable bypass project and to Russia as it killed another export route for its oil. Additionally, both Bulgarian and Greek lost out on badly needed economic stimulus.

**Figure 2: Map of Black Sea RSC and Caspian Basin Oil Pipelines**



## Operational Gas Pipelines: The Southern Gas Corridor

### South Caucasus Pipeline (SCP)

Westbound gas originating from Shah Deniz is transported via the South Caucasus Pipeline (SCP), also called Baku-Tbilisi-Erzurum (BTE), which runs alongside the BTC before terminating in Erzurum, Turkey. The pipeline was constructed parallel to the BTC pipeline, using the same integrated project team to leverage costs and minimize the environmental and

<sup>118</sup> The Trans-Balkan Pipeline B.V. was incorporated in the Netherlands on February 6, 2008. Russia's 50 percent plus one share is further subdivided into the Burgas-Alexandroupolis Pipeline Consortium, a Russian joint venture between Transneft, Rosneft and Gazprom Neft. Bulgarian Burgas –Alexandroupolis oil pipeline Project Company-BG owns 24.5 percent of the shares.

social impact. SCP began supplying gas in 2007 (BP (8) website, date accessed September 2, 2013; EIA, (24) Azerbaijan Country Analysis 2012: 5). This was, in effect, the first substantive gas pipeline which permitted Azerbaijan to export Shah Deniz gas.

The South Caucasus Pipeline Company (SCPC) is responsible for the construction and operation of the pipeline. It is an incorporated joint venture company made up of 7 shareholders and operated by BP and Statoil, its largest shareholders (BP (9) website, date accessed November 12, 2013). To meet the anticipated influx of Shad Deniz II gas, the Shah Deniz consortium announced SCP Expansion, or SCPX to 23 bcm per year by 2017<sup>119</sup> (Interfax, BP Georgia, May 2012; BP (10) website, date accessed January 17, 2016). SCP has operated at 7 bcm per year, or slightly below its potential annual capacity of 8 bcm. The pipeline is 692 kilometers long (443 kilometers in Azerbaijan, 250 kilometers in Georgia), and will hand off to the forthcoming TANAP, which will take it across the length of Turkey to the Greek border (BP (11) website, date accessed March 19, 2016). The pipeline's average daily throughput exceeded 11.1 mcm in 2012. Capital expenditure for that year reached \$11 million, while estimates for 2013 is more than \$13 million<sup>120</sup> (BP (12) Azerbaijan Sustainability Report 2013: 13-18).

## **Blue Stream**

Blue Stream is a manifestation of the post-Cold War Russia-Turkey cooperation brought about by mutual economic needs of the region's two largest powers. Though it exists outside the technical definition of the Southern Gas Corridor, Blue Stream is an important part of the Black Sea RSC's energy and geopolitical environment for which it deserves cursory attention. In December 1997, Gazprom and BOTAS signed an intergovernmental agreement to ship 365 bcm of gas to Turkey over a 25 year period. In February 1999 Gazprom and Eni signed an MOU on the joint construction of the pipeline, with the intent to export gas from Beregovaya, Russia across the Black Sea to Samsun.

The system is owned and operated by Blue Stream Pipeline Company BV (BSPC), a Gazprom-Eni joint venture. The underwater design and construction requirements were awarded to the Italian firm Saipem under an engineering, procurement, construction and installation (EPCI) contract<sup>121</sup> (Offshore-technology.com; date accessed November 12, 2013). The offshore work started in mid-2001, and it was officially inaugurated in November 2005, with a capacity of 16 bcm per year, of which 8 bcm is allocated to BOTAS. At a cost of \$3.4 billion, the pipeline configuration includes a pair of opposite running pipelines; E1 designating the eastward route, and W2 the westward route. The full length of the pipeline is 1,213 kilometers, of which nearly 400 kilometers is under water (Gazprom website, date accessed May 13, 2013; Eni website, accessed November 12, 2013). In 2007, it supplied 9.5 bcm (Eni website, date accessed November 12, 2013).

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<sup>119</sup> Though separate entities, the Shah Deniz consortium and the SCP pipeline consortium have identical shareholders; BP and Norway's Statoil with 28.8 percent each; AzSCP (10.0 per cent), TPAO (19 per cent), Petronas (15.5 per cent), Lukoil (10 per cent), NICO (10 per cent) and SGC Midstream (6.7 per cent). (BP (13) website, date accessed January 17, 2016).

<sup>120</sup> Norway's Statoil handles the SCP's administration and business development.

<sup>121</sup> Saipem is an Eni subsidiary (Saipem website, date accessed December 8, 2013).

BSPC experienced “unprecedented difficulties” in constructing the dual underwater pipelines on account of the steep dropoff, deep water (2,150 meters) and the toxic environment at the Sea’s deeper levels. Additionally, the project included the construction of a gas feeder system from the Krasnodar region in southern Russia to deliver the product to Beregovaya, where a gas compressor station propels the product to its destination across the Sea (Eni website, date accessed November 12, 2013). Blue Stream Two was announced in 2002 as a means to compete with Nabucco, and early planning ensued with the concept to expand Blue Stream to South East Europe. In 2007 Blue Stream Two was abandoned, and the South Stream project was announced as the alternative (Offshore-technology.com; date accessed November 12, 2013).

### **Interconnector Turkey-Greece-Italy (ITGI)**

The Interconnector Turkey-Greece-Italy (ITGI) was initially supposed to take gas from Turkey across the Aegean Sea to Italy. The intergovernmental agreement for the first stage, connecting Turkey and Greece, was signed in Thessaloniki, Greece on February 23, 2003 by the MENR and the Greek Ministry of Development. In November 2007 the pipeline was completed allowing up to 11.5 bcm per year of Shah Deniz gas to move 300 kilometers from the western Turkish city of Karacabey to the Greek city of Komotini (Watkins, November 20, 2007). The line includes a 17 kilometer-long offshore section beneath the Marmara Sea.

The significance of ITGI is that Caspian basin gas is for the first time exported directly via pipeline to the European market and becoming the Continent’s fourth energy corridor, and fulfilling Turkey’s long-time goal of acting as an east-west energy bridge (EIA, (25) Turkish Country Survey 2011: 4). The Greece-Italy leg of the project, which includes the 200 kilometer undersea “Poseiden” pipeline was subsumed within the TAP (Edison SPA (Italy) website, date accessed May 5, 2013; Energy Charter, (51) (Gas) 2012, Annex: 79). There is a more in-depth description of TAP further in this chapter.

### **Planned or Under Construction**

#### **Trans Anatolian Pipeline (TANAP)**

On December 26, 2011 a MOU was signed between Ankara and Baku to build the 16 bcm per year TANAP as a non-European gas pipeline, and the largest component of the Southern Gas Corridor. Currently gas is transported across Anatolia through the existing Turkish pipeline network, which proves to be a less than efficient solution. TANAP will be a dedicated pipeline for Azerbaijani gas exports (and potentially other Caspian basin gas transit). The new pipeline calls for Shah Deniz gas to be picked up at the Turkish-Georgian border and carried directly to the Turkish-Greek border, where it will continue westward via the European-only TAP. Turkey will receive 6 bcm per year of product; the remaining 10 bcm will continue to Western markets.

TANAP is majority-owned (80 percent) and operated by SOCAR in partnership with BOTAS. The initial estimate was \$5-10 billion, though this has increased to \$20 billion and the cost will most likely surpass the latter estimate (Petersen, February 6, 2012).

Construction of the TANAP extension of the existing SCP pipeline began on September 20, 2014. Perhaps less obvious is the demonstration of SOCAR's growing influence beyond Azerbaijan's borders, and by funding TANAP, Azerbaijan is demonstrating its long-term strategy and regional power, as well as the level of cooperation between Baku and Ankara. What remains to be seen; since there is no direct Western involvement, this brings into question whether the project can be completed in an open and cost effective manner (Jarosiewicz 2014).

### **Trans Adriatic Pipeline (TAP)**

As Nabucco's problems and questionable viability became more evident with time, a new competing consortium emerged which would take the final leg of the Southern Gas Corridor on a European-only pipeline across the Adriatic; this took the name Trans Adriatic Pipeline (TAP). TAP is comprised of Statoil (42.5 percent), Switzerland's Axpo (formerly EGL) (42.5 percent) and Germany's E.ON (15 percent) (TAP website, date accessed, August 2, 2014). In late June 2013, the Shah Deniz consortium formally announced its decision, giving the nod to TAP over the Nabucco proposal.

When completed, TAP will transport Caspian basin gas from the Turkish western border and carry it to Italy under the Adriatic Sea via Greece and Albania (Kusznir 2013: 3). The TAP proposal called for a shorter, less expensive pipeline than Nabucco and its technical concept received positive reviews from evaluators and subject matter experts. Statoil, TAP's primary stakeholder, also sits on the board of directors of the Shah Deniz Consortium, so the speculation is this worked in the project's favor (Socor March 27, 2013).

TAP's cost is estimated at \$2 billion with throughput capacity at 10 bcm per year and with the possibility of expansion to 20 bcm or more. It will be 870 kilometers in length, which, broken down by national contribution will comprise; Greece 550 kilometers, Albania 210 kilometers, offshore Adriatic Sea 105 kilometers; Italy 5 kilometers. The design includes two compressor stations, one near Kipoi, in Greece and another on the Albanian coast near Fier (TAP website, date accessed, November 8, 2014).

There are several interconnector pipelines planned as offshoots from TAP, designed to diversify the sources of Balkan states dependent on Russian gas. The European Commission offered a \$61.5 million grant for Interconnection Bulgaria-Greece, of which the full cost is estimated at \$220 million. The planned capacity of the pipeline is 3-5 bcm per year. The Interconnection Bulgaria-Romania plans to link these countries over a 25 kilometer pipeline, at an estimated cost of \$38 million. It is a joint development project by Bulgartransgaz and Transgaz, for which the European Commission approved a \$12 million grant. The Interconnection Bulgaria-Serbia will be about 170 kilometers, with an estimated capacity of 2 bcm per year. The Interconnection Turkey-Bulgaria will ship 2.4 mcm per day in reverse flow from the existing Balkan pipeline.

The project will be funded internally by BEH at an estimated \$410,000. Bulgargaz plans to expand the existing underground gas storage facility in Chiren and build new underground gas storage in Galata once the field is depleted. These facilities will eventually hold 250 and 400 mcm respectively. The cost of the Chiren project is expected to be between \$125-250 million, and \$150-300 million for Galata (Energy Charter, (52) Bulgaria 2011: 92-94).

## **Turkish Stream**

Turkish Stream is the newly proposed pipeline in the wake of South Stream's cancellation in early December 2014. A primary goal of Turkish Stream is to avoid EU territory, notably by terminating in Turkish Europe, thereby evading Brussels' competition directives. The full details have not been released, but the pipeline will be large, capable of transmitting 63 bcm per year, and it will follow a roughly similar route to Blue Stream across the Black Sea. The pipeline will be completed in 2019 or 2020, and will provide 13 bcm to the Turkish market, and the remaining 50 bcm to a gas hub on the Turkey-Greece border from where it will carry on to European consumers (de Waal, December 15, 2014). As of early December 2015, the project was put on hold as a response to Turkey's downing of a Russian aircraft operating in Syria (Natural Gas Europe, (10) "Russia's Novak Says Turkish Stream Project Has Been Halted" December 3, 2015).

## **Abandoned Projects**

### **Nabucco**

Though Nabucco is effectively shuttered, it is important to consider its background and the geopolitical environment it created in its wake. Supported by the US and EU since its inception in 2002, the project was to be the centerpiece of the Eurasian Energy Corridor.<sup>122</sup> The six original shareholders were BOTAS, Bulgargaz, Transgaz, Hungary's MOL, Austria's OMV, and Germany's RWE. There was always a strong underlying political component to Nabucco, most importantly to supply gas to Central and Eastern European states to reduce their dependence on Russia. This pipeline project, though no ground was ever broken in its construction, would be a central geopolitical component to the Black Sea RSC's internal and external relations. This was particularly so regarding the years-long sparring contest with Russia's South Stream, in which these pipelines in many ways became emblematic of the increasingly contentious East-West energy relations.

The initial plan was to move 31 bcm of gas per year from Baku across Anatolia and the Balkans to the central European hub of Baumgarten, Austria from where it would be distributed further within Europe. The pipeline was anticipated to be nearly 4,000 kilometers long at a cost \$11

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<sup>122</sup> The story is that while in Vienna, the negotiators saw a performance of Verdi's "Nabucco;" it was then decided to use the opera's name for the pipeline project.

billion. Yet, the mathematics were questionable from the beginning. Shah Deniz alone could never have supported this quantity, so the difference had to be found outside of Russian or Iranian sources, an impossible feat considering Kazakhstan and Turkmenistan also lacked the ability to meet this demand, let alone a trans-Caspian pipeline to move this gas (Smith, Hanna 2012: 110).

Nabucco was beset with delays, primarily from a lack of funding as well as the inability to source an adequate supply to make it viable. The project received a major setback in November 2011, when Azerbaijan reached an agreement with Turkey for the TANAP (Smith, Hanna 2012: 110). TANAP effectively scuttled the original Nabucco concept, which then became a smaller European-only effort called Nabucco West. The Nabucco West project had a diminished 16 bcm capacity and ran 1,300 kilometers from the Turkish-Bulgarian border to Baumgarten (Kuszniir 2013: 2). Problems plagued the project up to the end; in December 2012 RWE pulled out claiming too much “uncertainty” and questioning the overall viability of the effort<sup>123</sup> (Petroleum Intelligence Weekly, December 17, 2012).

Dramatic changes in the global gas market continued to undermine Nabucco West’s position. North American shale was being extracted in record quantities, which, in tandem with Qatari LNG now delivered to Europe, drove the price down (LeVine 2014). Nabucco West’s very existence came into question as it tried to compete with TAP for the privilege of transporting Azerbaijani gas to Europe. Both pipeline consortia delivered proposals to the Shah Deniz Consortium, and the final decision was made in June 2013 in TAP’s favor which effectively laid Nabucco to rest. Though Brussels took a neutral position on Nabucco, mostly because of the pipeline’s tenuous position, behind the scenes it was the EU’s favored pipeline effort and Brussels (and Washington) lobbied hard for its success (Jackson, May 2, 2013; Patnaude, June 26, 2013). What started out as a shining example of EU cooperation on energy security collapsed under the weight of overoptimistic projections, political inertia and relentless Russian pressure. It also damaged European credibility with Turkey and Azerbaijan, who were both forced to sit idle while the project drifted further into irrelevance.

## **South Stream**

Another casualty of the Western-Russia energy friction is South Stream, which was officially canceled by Putin on December 1, 2014. Similar to Blue Stream, South Stream fell outside the Southern Gas Corridor definition, though it is much too important to omit from any Black Sea RSC energy analysis. The reason cited for its cancellation was continuing opposition from the Commission, primarily for anti-competitive practices, though there is slightly more to the story. Gazprom had spent \$9.4 billion in the seven years and was unwilling to continue its fight with a now-united and steeled EU (LeVine 2014).

The pipeline was named as the southern counterpart to the North Stream which currently delivers Russian gas directly to Germany via a Baltic Sea pipeline. The concept began to emerge as a possibility in June 2006, designed to circumvent Ukrainian territory and compete with Nabucco.

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<sup>123</sup> In March 2013, OMV announced it had acquired RWE’s shares (Natural Gas Europe, (11) April 15, 2013).

In December 2007 Gazprom and Eni teamed to propose the construction of a 900 kilometer 63 bcm per year undersea pipeline from Beregovaya, Russia to Burgas, Bulgaria. From Burgas, South Stream would cross the Balkans and terminate in Baumgarten (Smith, Hanna 2012:110; Gazprom website: accessed May 18, 2013; Energy Charter, (53) Bulgaria 2011: 90-92). The operating company was South Stream AG, a joint venture between Gazprom and Eni.<sup>124</sup> In early 2008, under Putin's direct leadership and with attractive partnership terms, Russia began to aggressively negotiate bi-lateral transit agreements with Bulgaria, Serbia, Hungary, Greece, Slovenia, and Austria. The German conglomerate BASF joined South Stream, as well as France's EDF (LeVine 2014). In December 2011, Gazprom was granted permission to lay pipe through Turkey's Black Sea EEZ (Smith, Hanna 2012: 110). Work formally began in December 2012, a year ahead of schedule, with a pipe welding ceremony attended by Putin and other heads of state involved in the project.

In June 2013 South Stream was successful in the Kremlin's contribution to derailing a disunited EU and ultimately (with TANAP's help) finished off Nabucco. One would think that with Nabucco dead and the weak European demand, there was little need to continue with South Stream. However, Moscow pressed ahead with its long-term view that demand and product availability would make the venture profitable. The Kremlin also saw South Stream as a means of pressuring Ukraine as well as providing jobs and infrastructure development on Russia's Black Sea coast (Romanova Interview October 11, 2013).

Complaints were leveled from Brussels stating that South Stream was not compliant with EU competition law, particularly with the effort to unbundle energy services within Gazprom. Discussions were held to address this issue, though Foreign Minister Lavrov noted that the existing agreement between Russia and the Eastern European transit states could not revise the *acquis communautaire* (Natural Gas Europe, (12) December 5, 2013; iFocus, February 1, 2014). Finally there was the rift underway between the EU, Bulgaria and other importers. These states believed that with Nabucco's diminishing expectations for success, it was necessary to hedge their bets and cooperate with Russia, which became all the more imperative with Nabucco's end.

Even as the European Commission's pressure mounted on South Stream the partners gamely carried on, and as recently as mid-November 2014, Hungary indicated construction on its piece of the line would begin in 2015; within schedule for a 2017 completion. Quite simply, the turning point for the EU was the Ukraine civil war and Russia's annexation of Crimea, which stiffened EU resolve, and Brussels demanded its members stop supporting South Stream. On December 1, 2014, after \$9.4 billion in expenditures, Putin, canceled the project. The undersea portion alone would have been a major engineering feat and the project's full cost estimate was \$40 billion<sup>125</sup> (The Economist, (29) March 23, 2013). Perhaps the main point from the Nabucco-South Stream episode is how the EU cobbled together a resistance, though it remains to be seen whether this unity will stand the test of time.

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<sup>124</sup> The company registered in Switzerland on January 18, 2008.

<sup>125</sup> Comment by Jean-Arnold Vinois, former Acting Director for the Internal Energy Market at the European Commission at the Black Sea Oil and Gas Forum in Sofia, Bulgaria, March 3, 2013, as reported in Natural Gas Europe. Russian estimates are \$27 billion (Gabuev December 6, 2012).

Turkey is in a position to make political and commercial gains with South Stream’s demise, and its ambitions to become an international gas hub are enhanced as even greater volumes of gas will support its growing demand allowing it to acquire transit revenues from supplying southeast European markets. This position would be reinforced with new gas supplies from Russia, the Caspian Sea, Northern Iraq, and Iran (de Waal 2014). However, this does place Turkey in an even greater position of dependence on Russia. Moreover, it has not been decided what TANAP’s disposition will be; whether this 63 bcm, on top of the 12 bcm from Blue Stream, will tie into TANAP. Despite the potential for unprecedented cooperation between Moscow and Ankara, Russia and Turkey are natural competitors in the Black Sea RSC, so it is not impossible to see a falling out sometime in the future with unknown consequences of their energy relations (de Waal December 15, 2014).

Putin is determined to stop this Western realignment, claw back lost territory and assert Moscow’s domination over its former empire by controlled energy access and manipulation. South Stream’s demise was clearly a blow to Putin’s prestige as it was a high profile project at the center of Russia’s southern gas strategy. With South Stream’s demise, the EU gained a geopolitical victory, and Brussels’ hard-line strategy against Russia showed that the EU can prevail in the ‘gas war’ if motivated, properly led and supported by the US. It proved to be the correct strategy in the long-term.

Like Nabucco, South Stream had primarily a geopolitical logic, with little commercial viability or real-world applicability. Despite the setback, Russia’s influence cannot be ignored, and the attempt to diversify the EU’s energy supply has been a key element in the East-West dispute. South Stream’s death altered the geopolitical energy dynamics of the Black Sea RSC. It also demonstrated energy’s fungibility; Russian gas will get to market, though perhaps not in the quantity or the route initially envisioned. Amos Hochstein, the Special Envoy and Coordinator for International Energy Affairs at the State Department, noted after the South Stream decision; “Russia understood it had to play by EU’s rules at least for the time being” (Hochstein January 8, 2015).

**Figure 3: Map of Russian and Soviet Legacy Gas Pipelines**





## Alternative Transport Projects

### **Azerbaijan-Georgia-Romania Interchange (AGRI)**

The Azerbaijan-Georgia-Romania Interconnector (AGRI) is a highly speculative project to transport between 2 to 8 bcm of LNG to Europe by pipeline and ship from Sangachal to Constanta, Romania via Supsa, Georgia. The idea being that increased European demand for gas would make it a viable effort. Discussions have involved SOCAR, Georgian Oil and Gas Corporation, Romania's ROMGAZ, as well as Hungary's MVM, with the possibility of having the route operational by 2018. The downward trajectory of the price of gas and the high cost of the requisite LNG infrastructure makes this a very unlikely proposition (Natural Gas Europe, (13) April 22, 2013; Black Sea Monitor, October 2012).

### **Baku-Tblisi-Kars (BTK) Railway**

When Turkey closed its western rail link with Armenia in 1994, it was another variable in Armenia's political and economic isolation. This isolation is reinforced with the pending Baku-Tblisi-Kars (BTK) Railway which allows direct rail access from Baku to Istanbul, via Tblisi. This is a rail version of the BTC pipeline, and in effect, an Armenian bypass, and though the project will facilitate transportation of passengers and goods, it is mainly seen as a supplement to BTC. The US and EU refused to support the project, claiming it is a deliberate attempt to isolate Armenia, leaving BTK as a wholly intra-regional effort. On May 25, 2005, Azerbaijan, Georgia and Turkey authorized the BTK, and construction began in November 2007; it is expected to be operational by 2015. Despite Armenia's legal challenges to halt it, the project moved forward; Turkey and Azerbaijan will fund their portions, while Georgia received soft loans from Azerbaijan. A total of 105 kilometers of new railway line will need to be constructed (Railway-Technology.com, November 8, 2013).

Once completed, BTK is expected to transport a million passengers and 6.5 million tons of cargo, increasing by 2030 to an estimated three million passengers and 17 million tons of cargo. This broader east-west rail network will be facilitated by the completion of the Marmaray project under Istanbul which will allow the uninterrupted passage of goods and passengers from Europe to China, at which point it becomes an entrenched component to the Eurasian Energy Corridor (Railway-Technology.com, November 8, 2013).

## **The Dominance of Energy and the Eurasian Energy Corridor**

The presence of nearby oil and gas, as well as deposits in the Sea itself, has made the Black Sea and its littoral states vital links in the global economy and unwitting players in the foreign policies of larger regional powers. Caspian Basin energy and its transit to global markets has captivated political and commercial leaders for over two decades. Despite wars, insurgencies,

innumerable political disputes and escalating costs, the projects are moving forward, albeit slowly. Perhaps the notion that the Black Sea states are actors in a new “Great Game” is overly dramatic, though it is clear that the dynamics of global energy security and supply, with its inherent benefits and problems, are present in the region and are becoming stronger.

Energy’s broader influence in the Black Sea RSC is significant, though it presents a complicated set of circumstances. Once again, the region’s geopolitical contestations come to the fore, creating an environment which has helped shape the Black Sea RSC. This dissertation’s research question postulates that actual and projected energy flows via the EEC are largely responsible for the regional transformation under way in the Black Sea RSC, and this chapter begins the process of portraying energy as a transformative force.

Ultimately, what is at play is more than a purely academic or one dimensional geo-political or even geographic analysis. It is an example of hydrocarbons’ fungibility and their broader geopolitical influence; that is the ability to reach global markets irrespective of natural or manmade roadblocks. Yet, this is also an example of new regionalism at work, a phenomenon which led to vast new markets for energy producers, but set off a chain reaction of new alliances and cooperation, as well as alterations in long-standing state alignments. The prevalence of free market forces has also provided the competitive environment that lead to pipeline politics, a phenomenon which has injected external political and commercial activity into the Black Sea RSC, and which would have been impossible under Soviet rule.

A point that should be made is that while pipelines have a generally positive view as an inclusionary mechanism and are considered a main component to the Black Sea RSC’s transformation, they also have an exclusionary element. Most notably, the basic premise behind the EEC was to exclude both Russia and Iran from EU-bound oil and gas from Azerbaijan and points eastward. Furthermore, Armenia has effectively been shut out of the pipeline network emanating from Azerbaijan’s Sangachal facility. The motivation behind South Stream/Turk Stream (or North Stream, for that matter), was to circumvent Ukrainian territory on Russia’s gas exports to Europe. Therefore, pipelines can be configured by the initiator as either a reward or punishment depending on the regional contingencies.

Finally, there are also some basic mathematics at play which should be considered as it pertains to the Southern Gas Corridor. The EU consumes approximately 400-500 bcm per year, and despite impressive conservation and renewable efforts, it can reasonably be expected this number will rise in the future. By the time Azerbaijan’s Shah Deniz II becomes operational in 2017, initial throughput from the SCP will be 16 to 23 bcm per year, of which 6 bcm will be allocated to Turkey. The relatively small amounts of gas currently flowing through the Southern Gas Corridor will *possibly* increase over time, particularly as pipeline capacities are expanded and new sources brought online. So, is the emphasis on the new corridor for only 1-2 percent of current EU demand justified? In 2013 EU Energy Commissioner Oettinger noted, “...the Southern Gas Corridor is a real breakthrough. Through its further enlargement, the corridor will have the potential to meet up to 20 per cent of the EU’s gas needs in the long term” (European Commission, (10) Press Release, December 17, 2013).

However, assuming EU demand remains in the 400-500 bcm per year range, a 20 percent contribution will require 100 to 120 bcm per year; an impossible task based on Shah Deniz II alone. This will clearly require product from the Persian Gulf, the Eastern Mediterranean or even Iran, though these prospects are well into the future.<sup>126</sup> These external oil and gas plays, through pipelines and ship-borne transport, have the potential to enhance the capacity of the EEC considerably, and strengthen Europe's southeastern energy source, albeit from a highly unstable region.

The basic principles of energy supply and demand, housed in a persistent Europeanization drive, facilitated by technology in the form of pipelines and LNG infrastructure, are creating many of the regional transformational drivers; in other words, neo-functionalism spillover. Yet, what is taking place is more than a purely Haasian neo-functionalism phenomenon enhanced by the imposition of Europeanization and Euro Norms. There is clearly a much broader regionalization underway, that which is influenced by great power penetration and overlay, which is espoused in the works of Buzan and Wæver. Indeed, the genesis of this energy-derived regionalism in the Black Sea RSC can be traced to the Western powers.

Without the political and financial capital expended by the West, the Caspian-basin hydrocarbons would still be untouched in the ground. More specifically, considerable credit for this political and economic realignment underway in the wider Black Sea region must go to US and EU determination and diplomatic resolve over the long-term to ensure the existence of the Eurasian Energy Corridor. In particular, early bi-partisan interest from Washington which centered on establishing regional stability in the wake of the disruption that followed the USSR's collapse. In 2009, Ambassador Richard Morningstar, the US special envoy for Eurasian energy affairs at the time, perhaps best summed up Russia's value in the Black Sea and Caspian region, "Russia will continue to be a major player in this region for the foreseeable future," however, "The West is comfortable with Russia as 'a' supplier, though not as 'the' supplier" (Watkins, October 12, 2009).

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<sup>126</sup> There must be a better, localized perspective of this energy security calculus, whereby the regional dimension comes into play; the 16 to 23 bcm from Shah Deniz is very important to the Balkan states, many of which are wholly dependent on Russian gas, so it becomes more of a question of proximity of source to consumer as opposed to a holistic, or EU-wide, calculation.

**Figure 4: Map of The Eurasian Energy Corridor: Regional Oil and Gas Pipelines**



- Refineries
- Main oil fields
- Main existing oil and gas pipelines

- Oil and gas pipelines projects supported by:**
- Russia
  - Turkey and Russia
  - Europe

## Chapter 4. Externally Driven Change: The European Union and the Demand for Energy Security

“The EU’s energy efficiency has greatly improved over the last 30 years from the combined effects of structural change in the economy, more efficient technologies and better energy savings measures” (Samuele Furfari 2009: 9).

“It is the European Commission, which in cases of cartels, abuse of dominant positions and long-term contracts guides the way” (Energy Community, (5) Implementation Report 2013: 80).

“The EU can be judged by how others respond to it. If others treat it as a great power, then it qualifies as such regardless of its ambiguous *sui generis* political status” (Buzan and Wæver, 2003: 33).

### Introduction

This chapter looks deeper at energy’s transformational qualities, notably its political, economic and social impact across a variety of nations and how it contributes to the development of a regional structure in the greater Black Sea region. This is initiated by looking at the EU as a driver of change exerted from outside the Black Sea RSC. Moreover, this chapter also begins to address how the region and its composite member states have reacted to these EU efforts. Emphasis will be placed on Brussels’ relations with key regional actors, notably Russia and Turkey, and the recent events which have occurred generally in the geopolitical field, more specifically in the energy field relative to these states. What will be demonstrated is the profound influence the EU has on the Black Sea RSC and the manner in which it addresses the research question.

With 500 million consumers and a \$13 trillion economy, the EU is the world’s largest trading block, so its global economic impact is considerable, even more so on the smaller, poorer Black Sea RSC (Egenhofer et al., 2011: 1). This influence is more than purely economic; it encompasses the political and social aspects as well. With the EU’s structured organization, legal foundation and support for human rights, many inhabitants of the Black Sea states view the EU as the embodiment of Western liberalism, guarantor of national sovereignty as well as political and personal freedoms. This is perhaps a valid sentiment for those nations which suffered under Soviet domination in the 20<sup>th</sup> Century and are made uneasy by current Russian behavior.

For its part, the EU sees the Black Sea RSC as more than an energy source; it is also a market for value added products and services and cheap labor. Western commercial interests, quite often automobile manufacturers, have moved into the region over the last 20 years for cost incentives and proximity to the local customer base. By and large, this effort has created competitive advantages for Western companies that would have otherwise been unavailable during the Cold War. However, Western Europeans also view their neighbors with apprehension, fearful that political and economic weakness in the East will impact the Continent and create a flood of low-wage workers and foment instability by permitting entry for illegal immigration and organized crime. These EU concerns center on the porous borders and the overall threats emanating from the Black Sea RSC and beyond. It is this apprehension which has prompted the EU to try to

stabilize its eastern neighbors through liberal trade relations while instilling principles of good governance. This presents Brussels with a clear incentive to integrate these economies into the broader Union's economic base and exploit these advantages.

Brussels' attempt to influence its periphery and create peaceful, stable and economically compatible neighbors has proven to be a powerful dynamic. The Europeanization process implies the EU's institutional, social and political attributes are solidly and irrevocably imposed on its members (Economides 2009). Such assimilation is brought about by conditionality, where the members meet basic conditions of peaceful existence, liberty, democracy, human rights, rule of law. According to Ian Manners, these norms are dispersed via *contagion*, a concept very similar to those espoused by Deutsche and Haas. It was the "unintentional" dispersion of ideas, customs and laws from the EU to others, that which occurs in the everyday conduct of affairs, or via *transference*, such as the exchange of goods and services, trade or technical assistance through substantive or financial means tied to explicit policy change within the recipient nation (Manners 2012: 244-245).

The end state occurs when the state has formally adopted the EU's *acquis communautaire*, which acts as a regulatory 'shaping' mechanism for the members, as laid out in Copenhagen in June 1993. Europeanization being the process when EU laws have been effectively transposed and implemented within the "institutions, politics and practices" of another state. Such shaping takes effect when a country has accepted Brussels' normative provisions, manifest in a variety of rules and behavior, or an EU "mindset," rather than simply the technocratic aspects of the *acquis* (Economides 2009; Manners 2012: 242).

It is now possible to see a variation to the traditional Europeanization process brought about by Brussels' attempt to limit new members and slow down the accession process, a change in attitude attributed to a less than enthusiastic view from within the Union about new entrants. The newest members, mostly from the former Soviet Bloc, have demonstrated mixed results with Europeanization, and were inadequately prepared for membership, as their political, social and economic structures had not fully transitioned from the Cold War extremes. Coupled with a general wariness and the financial burden of accepting new entrants, the Union has cooled the desire for expansion, at least at the rapid rate of 2004 and 2007.<sup>127</sup> This 'accession fatigue' becomes an important concept in the early 21st Century notion of EU expansion, whereby states may not formally receive accession invitations, but are able to derive some benefit of Brussels' largess and soft power without enjoying full membership. As Spyros Economides notes:

"The remit of this [accession] process has now had to be expanded to incorporate not only those states which are members of the Union, but also those which are prospective members—those in accession talks—and, more interestingly, all those states which have *entered into contractual relations* with the EU" (Economides 2009).

This notion of quasi-membership is unappealing to many EU aspirants as it relegates prospective member states to a sort of accession limbo; Turkey is the most notable example, making it clear it will only accept full membership, as opposed to some form of watered down "special

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<sup>127</sup> In 2004 the "Big Bang" included new entrants Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. Bulgaria and Romania formally joined in 2007.

relationship,” though the political mood in Brussels does not appear to be changing, particularly in light of the current migrant/refugee crisis gripping Europe.

When discussing Europeanization, there is a strong relationship to the regionalist theories noted earlier, mainly defined as a neo-functionalist-type spillover coupled with a constructivist element. In other words, Europeanization is synonymous with aspects of both traditional and new regionalism, whereby we see hints of Haas and Deutsche, as well as Buzan and Wæver. Indeed, there are clear portrayals of amity and enmity as evidenced by the emphasis on social and cultural identification, with neo-realist displays of sovereignty and power balance. This leads to a discussion of how Deutschian ‘transactions’ or Haasian ‘spillover,’ are enabled through the energy field, which propels the regional transformation process, and where theoretical notions become real-world attributes.

Therefore, the Europeanization process and the implementation of the EU’s *acquis* becomes as much a foreign policy effort as a domestic one, where the lines are blurred between official and unofficial activities designed to promote regional interaction. The EU’s foreign policy, the Common Foreign and Security Policy (CFSP) is conducted through the High Representative for Foreign Affairs and Security Policy, a position designed to enhance interstate interaction and promote EU soft power (Europa website, (3) “Foreign and Security Policy,” date accessed October 25, 2014). Moreover, the EU promotes (or tries to) conditionality on virtually every aspect of its relations with its neighbors, primarily via the ENP and its subordinate programs. This interaction proves to be a powerful incentive mechanism for the neighboring states and it is through this venue that Brussels is able to reinforce European norms to its neighbors in the forms of peaceful coexistence, personal liberties, democratic representation, the rule of law and respect for human rights (Manners, 2002: 242).

Picking up the mantle of EU foreign policy as a commercial and region-building tool, there are other mechanisms in place which promote such efforts, in particular the manner in which Brussels interacts with its Eastern neighbors. While the ENP provides the general guidance for Brussels’ engagement with the border states for the Black Sea RSC’s energy coordination, there are two initiatives to consider; Black Sea Synergy (BSS) and the Eastern Partnership (EaP). Founded in 2007 and 2008, respectively, both efforts are dedicated to furthering relations with nations on the EU’s eastern and southeastern border (European Commission, (11) “Communication from the Commission to the European Parliament and the Council - Eastern Partnership,” 2008; European Commission, (12) “Communication from the Commission to the Council and the European Parliament: Black Sea Synergy – A New Regional Cooperation Initiative,” April 11, 2007).

BSS was initiated as a response to a December 2006 report by the Commission critical of the ENP and its inability to engage effectively with the Black Sea states. The program was subsequently proposed by the European Commission to aid the accession of Bulgaria and Romania, as well as ameliorate Brussels’ weakness vis-à-vis the region’s broader challenges, notably the Black Sea RSC’s democratic deficit and economic imbalances (Delcour and Manoli 2010: 6). By design, BSS is multilateral in structure, with the intent of approaching the Black Sea states as a regional entity, focusing on democratic and economic reforms and taking a

“bottom up” approach to the region’s issues (Europa, (4) BSS website, date accessed March 7, 2015).

The EaP is designed to take both a bilateral and multilateral approach to EU-Black Sea relations, specifically concentrating on the three South Caucasus states, as well as Moldova and Ukraine. The EaP was proposed by the foreign ministers of Poland and Sweden, respectively Radislaw Sikorski and Carl Bildt. As with BSS, its primary focus is to enhance regional stability via democratic and economic reforms. The framers also wanted to strike a balance with the newly formed Mediterranean Union, whereby any southern proposals were met with a similarly structured venture to the EaP states. The EaP took on added importance following the August 2008 war, mostly as a means of reassuring the nervous FSU states (Averre 2009: 169; Nasshoven, July 2008; Europa, (5) EaP website, date accessed March 7, 2015).

On the surface these programs attempt to address the perceived deficit in EU-Black Sea relations. Yet, there are also complicating factors which have impacted their effectiveness, such as inter-program rivalry. For instance, there is similar language to describe the two programs, notably the reference to “concrete” ideas or deliverables. Additionally, BSS and EaP share many of the same domains, such as agriculture, energy, transportation and good governance, and so must compete for resources and attention. BSS and EaP were supposed to complement each other, but within a year after its inception, the EaP was overshadowing its competitor program. This can be explained by the EaP’s bilateral focus and effective leadership which generated more interest within the EU and the member states.

The appeal of BSS, is its multilateral or regional emphasis on unity and shared norms. However, it was slow to identify and implement projects and suffered from dwindling resources, a direct impact of its competition with EaP and its general lack of effectiveness (Delacour and Manoli 2010: 13). By early 2016 it would appear that for all intents and purposes, BSS is a dying organization, however, the Economist’s Charlemagne referred to EaP as “ultimately doomed.” This author does not agree that the EaP’s demise is imminent, but it would also appear that there are limitations to the effectiveness of any organization that does not lead to eventual membership (The Economist, (30) December 6, 2014: 39).

## **Regionalism (Europeanization) via Energy Policy**

It has been established that the EU’s interest in promoting commerce and stability on its borders and its demand for energy, more specifically, oil and gas, sets the stage for regional transformation; in effect establishing Brussels’ conditionality through energy trade. A natural next step is to see how this process has taken place within the Black Sea RSC and contributed to the Europeanization process outside the EU’s borders. But first it is important to look within the EU itself, to determine how its own energy acquis evolved, which, in turn directly relates to the development of its energy policy. Only by understanding the motivating factors in the external drivers can the influence on its Eastern neighbors be demonstrated.

### **The Early Years: Energy and EU integration**



The EU's quest for a uniform energy strategy can be traced to the Rome Treaty of 1952 and the creation of the ECSC, therefore, it can be argued that supra-national energy management was *the* core unifying element of the EU.<sup>128</sup> This was to be accomplished by controlling coal and steel resources, the primary war-making elements of the mid-20<sup>th</sup> century. In this period, European economies were predominantly coal-driven, which explains the importance of the ECSC and its impact. Moreover, coal and steel, because of their place as the foundation of state viability, acted as catalysts for bilateral and multilateral interaction. In other words, by controlling access to commodities of such vital importance to national livelihood, the member states were forced to cooperate at the highest political and economic levels. In 1957 the European Atomic Energy Community (Euratom) was founded to consolidate atomic trade and safety regulations while addressing non-proliferation issues<sup>129</sup> (European Information Association, 2007; Furfari 2012: 47-48, 288).

This reliance on coal diminished later in the post-war years when Europe turned to oil as the primary energy resource, and as the European post-war recovery began to accelerate in the 1950s and 60s, this principle of energy cohesion was largely forgotten (Aalto 2008: 24). Post-war reconstruction required increasing quantities of energy (oil and coal, initially) to feed the expanding economies, but there was no coherent energy policy at the European level; energy policies continued to be a competitive function between the sovereign Member States. Additionally, national oil, gas and electricity entities held considerable economic and political power, erecting entry barriers and ultimately distorting economic influence, resulting in uncompetitive and unrealistic consumer prices coupled with shoddy services.

The oil shocks of the 1970s highlighted the EU's sense of vulnerability and European leaders began to consider more seriously conservation measures and source diversity. The UK and the Netherlands exploited oil and gas reserves under the North Sea, and in 1973 West Germany began importing Soviet gas via newly installed pipelines. The USSR was a reliable partner, and in the 1980's other Western European countries, as well as Greece and Turkey, began taking deliveries<sup>130</sup> (Westphal in Aalto 2008: 94; US Library of Congress, May 1989).

The Soviet breakup presented Western political and commercial leaders with an unexpected geopolitical and economic gift, notably in the form of reduced East-West tensions and an untapped consumer base craving high quality goods. There was also the realization that vast oil and gas resources were now open to Western markets. Yet with this gift came many challenges, such as how to extract and transport these hydrocarbons at competitive prices. There was also the belief that a friendly, Western-oriented Russia would satisfy Europe's energy appetite, and the West was willing to overlook Moscow's more unsavory behavior in the forms of corruption, instability, the harsh counterinsurgency in Chechnya and the propensity to engage in resource

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<sup>128</sup> The ECSC Treaty was formally disbanded in 2002.

<sup>129</sup> The ECSC did not apply to oil and gas, or secondary energy sources. The Messina Declaration of 1955 was an attempt to standardize trade in other commodities, electricity and atomic power among them, with the knowledge that cheap and abundant energy was vital for future economic growth (Belin, Hughes, Interview with Samuele Furfari, "If Russia cuts the gas tap, it can forget its dream of selling gas to China one day," (Energy Post, April 30, 2014).

<sup>130</sup> These included Austria, France, Italy and Switzerland.

nationalism. Indeed, it was the West's reaction to this behavior that highlighted a new era of Russian-European, or East-West tensions in the post-Soviet environment.

Russia's opening coincided neatly with Brussels' push for a coherent strategy and a secure and stable source of energy. And though coincidental, it was clearly mutually supporting and beneficial, however as time progressed this relationship has come under stress, primarily from energy disputes and Russia's military adventures in Georgia and Ukraine. Furthermore, while a liberalized energy market has been the goal of European integrationists for generations, until recently the motivations and mechanisms for achieving this goal have always been missing. In the early 1990s this began to change, prompted by price fluctuations, the growing presence of Russia as an energy power as well as the EU's own transformation to a stronger Federalist entity (Aalto 2008: 7-11, 64-65). What follows is a progression of pan-European initiatives designed to impose a supra-national structure to the EU's energy sector.

### **The Energy Charter Treaty<sup>131</sup>**

By the early 1990s the EU realized that more robust provisions than those found in the ECSC and its successor organizations were needed. At the June 1990 European Council summit in Dublin, discussion touched on broad-based liberalization and energy cooperation motivated by the swift political and economic changes in Eastern Europe attributable to the unraveling Soviet Union.<sup>132</sup> The Council tasked the Commission to support such interaction, and in December 1991 the European Energy Charter was proposed. Explicit in the Charter's objectives was the promotion of market-led pricing via sector competition which would in turn create energy efficiencies and sustainable development (Europa, (6) "Summaries of EU Legislation; European Energy Charter," date accessed January 13, 2013).

The Charter's goal was a mechanism for cooperation via common principles of energy trade in products, services and investment. The underlying framework of such cooperation was a regime open to any qualified country, based on reciprocity, transparency and free access to energy markets. The intent was to follow the basic principles of the GATT's Article 29IIa, dedicated to equal treatment and reciprocal market access (Aalto 2008: 11). The charter was codified as the Energy Charter Treaty which formalized into a legally binding mechanism between the member states. The Treaty was signed in Lisbon in December 1994 and went into effect in 1998. The Energy Charter has since been a tireless advocate for liberalized energy markets through lobbying, analyses and position papers.

The Energy Charter is not without its controversies and criticism. Most notably, there is the adherence to third party pipeline access to promote competition, a key provision to drive down prices and improve service. Known as the Transit Protocol, it requires member states to;

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<sup>131</sup> In May 2015 the International Energy Charter was adopted in The Hague, with the goal of expanding the same principles of mitigating energy investment risks to a global membership as opposed to a purely European one. The European Energy Charter is still in effect (See International Energy Charter, date accessed March 12, 2016).

<sup>132</sup> Ruud Lubbers, Prime Minister of the Netherlands at the time, was the driving force behind the initiative.

“permit passage of all goods...unhindered transit of energy materials and products without distinction made on the origin, destination or ownership of such energy materials or products, nor discriminatory pricing on the basis of these distinctions, and without imposing delays, restrictions or unreasonable taxation” (Energy Charter (54) from Europa, date accessed March 19, 2016).

It is the Transit Protocol which elicited the strongest opposition from Moscow, which was (and still is) unwilling to allow unrestricted use of its pipelines by non-Russian entities. Though Moscow signed the Treaty, it has not been ratified and Russia has only implemented the provisions with which it is in agreement. These opposing philosophies demonstrate a clear distinction between Moscow’s desire to retain central control over its energy infrastructure and Brussels’ free market focus, which forms the crux of the dispute.

## **EU Policies**

As the EU’s executive and enforcement body, the European Commission was best placed to craft and negotiate the Union’s energy strategy. More specifically, the Commission functions to initiate action and legislation, implement Union policies, and act as the decision-making authority on competition. Thus the Commission has considerable power and leeway in energy-related activity, and through the Directorate General of Energy (DG ENER), acts as the primary force behind the EU’s push in energy competition and integration (Egenhofer et al. 2011:34-42).

Arguably, the Commission’s depth of intervention and influence is unmatched in any other economic sector. Less than a year after the Energy Charter’s birth, the Commission launched the first in a series of “Green Papers,” which established the foundation for a coherent energy policy. In January 1995, ‘For a European Union Energy Policy’ was issued, which focused on consolidating energy markets and creating “a sound and coherent energy policy framework.” The paper announced a 5 year program to address three pillars of energy security; *competitiveness, conservation (to include sustainable development) and security of supply* (European Commission, (13) ‘For a European Union Energy Policy’ 1994. In November 2000, the Commission published a follow-on Green Paper, ‘Towards a European Strategy for the Security of Energy Supply.’ This was produced in the wake of a dramatic increase in oil prices over the previous 5 years which underlined the Union’s challenge of energy security, and reinforced the notion that the EU would never escape its energy dependence without a comprehensive policy (European Commission, (14) ‘Towards a European Strategy for the Security of Energy Supply,’ 2000.

In March 2006, the Commission published a third and culminating Green Paper entitled, ‘A European Strategy for Sustainable, Competitive and Secure Energy,’ which outlined the three pillars in a more coherent manner. The paper addressed the need for a common external energy policy which would allow the EU to speak as a single entity, as well as implementing provisions of the Energy Charter Treaty within a free and open energy market. Furthermore, it promised to establish European technological leadership in the energy field, and develop renewable energy emphasizing alternative transport fuels to reduce CO2 emissions. Solutions were also presented

to stimulate investment, and develop new infrastructure necessary to enhance energy access for consumers (European Commission, (15) Green Paper 2006).

### The Athens Memorandum of 2002/The Energy Community 2005

In the Athens Memorandum of 2002 the European Commission outlined principles for a Southeast European electricity market. It was designed to extend the EU's own energy liberalization effort, notably unbundling, transparency and third party transit, with the intention of forcing competition into the Southeast European power sector. It is intended to create a legal and economic foundation for cross-border energy trade, eliminate entry barriers and improve service to promote long-term regional integration and energy market development. It also highlights a "common framework of activities" designed to create energy markets in the BSEC Region and the Balkans.

An important quality of Athens is to enhance stability and attract investment to Southeast Europe, a vital goal considering the World Bank and the EBRD estimate that in excess of \$30 billion (in 2008 USD) will be needed to bring the region's gas and electricity sectors up to EU standards (Roberts 2007: 26; European Commission, (16) 2011: 6). Revisions in 2003 and 2008 added natural gas and oil into the framework, making it a fully comprehensive energy structure (European Commission, (17) "The Athens Memorandum of 2002," November 15, 2002). This became the "Athens Process," formally known as the Southeast Europe Energy Community, or simply the Energy Community. The treaty was signed by the Commission and the member states, or Contracting Parties, on October 25, 2005 in Athens, and it entered into force on July 1, 2006<sup>133</sup> (The Energy Community, (6) "Facts and Figures About the Energy Community," February 2013).

Considering the Contracting Parties are energy importers, membership is a welcome chance to reduce dependence on Russia and integrate into the EU's economic structure; viewed by the parties as a step on the road to closer relations or membership at some future date (BSEC (1), Istanbul Energy Working Group, June 2004, as found in Roberts, Annex 9; The Energy Community, (7) website, date accessed September 5, 2013). One reason for its attractiveness is its rigor, essentially forcing the Contracting Parties to enact reform they know is needed but might not otherwise do without such external pressure. There is also relative fluidity among the members; Bulgaria and Romania transitioned out when they entered the EU in 2007, as did Croatia in 2013. Ukraine and Moldova joined in 2010 and 2011 respectively, while Georgia joined in early 2015 (Energy Community, (8) website, date accessed September 5, 2013; European Commission, (18) 2011: 5).

Russia has treated the Energy Community with either hostility or disdain, seeing it as a challenge to its dominant position in South Eastern Europe and the Black Sea region. As with the Energy Charter, the Kremlin stated it will comply with only certain aspects, indicating Moscow wants to participate on a certain level while retaining de facto veto power<sup>134</sup> (Roberts 2007: 26-27). This

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<sup>133</sup>The charter members were Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Republic of Macedonia, Republic of Montenegro, Serbia, Romania, Turkey and UNMIK (Kosovo). Armenia has applied for observer status.

<sup>134</sup>Turkey played a prominent role in creating Community, but did not become a party out of concerns over certain binding provisions within the Treaty. Turkey is an observer, though negotiations were reopened in 2009.

tension continues to demonstrate the growing geopolitical rivalry between the EU and Russia, and the impact this will have on regional transformation. It is a rivalry which will become increasingly intense as Russia sees Western political and commercial incursions into what has traditionally been its zone of influence.

Though both the Energy Charter and the Energy Community seek very similar objectives--energy sector liberalization, there are differences between the organizations which should not be confused. Whereas the Energy Charter is a quasi-private sector entity created by an EU initiative, the Energy Community is a direct function of the Commission, and has the full force of that body behind it. In the Energy Community the Europeanization process is evident in its most basic form, utilizing conditionality as a binding mechanism to develop a viable market, stabilize the region and lay the groundwork for eventual membership. This memorandum has proven to be important from a transformational standpoint, seen as a mechanism to draw the Black Sea RSC into the EU political and economic order and coalesce the fractious states using energy as the unifying force.

#### Baku Initiative 2004<sup>135</sup>

The 1st Energy Ministerial Conference was held in Baku on November 13, 2004, dedicated to organizing the stakeholders and streamlining existing efforts to transport oil and gas to European markets. The conference fell within the ENP under the Commission's "Silk Road of the 21st Century" project, an early regional trade promotion and infrastructure development effort. The Baku participants agreed to develop regional energy markets in the Caspian Basin and the neighboring countries with which to enhance investment and develop policies and programs leading towards better integration within the energy markets (European Commission, (19) "The Baku Initiative," August 10, 2014). A key element to Baku was the Interstate Oil and Gas Transportation to Europe (INOGATE) program, designed to address Europe's oil and gas requirements via the former Soviet states. As the newly independent FSU states had little experience in basic statecraft and interstate commerce, INOGATE was to perform this function and allow these countries to create their own internal energy infrastructures<sup>136</sup> (International Energy Agency, 2014; Interstate Oil and Gas Transfer to Europe (INOGATE), 2009).

There are two other closely related efforts discussed in Baku; one is Transport Corridor Europe-Caucasus-Asia (TRACECA), designed to stimulate inter- and intra-regional trade through an enhanced sea, air and land transportation network. Established in 1993, TRACECA is sponsored by the EU and IFIs, and is tasked to identify and overcome trade roadblocks (TRACECA, 2010). The Trans-European Network-Energy (TEN-E) also falls within the Baku Initiative, and is dedicated to strengthening cohesion and interoperability in the gas and electricity sectors. Though it is intended for EU states and, perhaps most importantly for this paper, it also applies to non-members<sup>137</sup> (Europa, (7) Trans-European Energy Network, date accessed August 10, 2014). What Baku demonstrates is an early attempt by Brussels to harness the region's disjointed energy transportation infrastructure with a broader structural overview. Moreover, by controlling

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<sup>135</sup>Not to be confused with the Baky Summit of September 2003, a BSEC initiative to be discussed in Chapter 5.

<sup>136</sup>It was initiated in 1996 and is headquartered in Kiev.

<sup>137</sup> The EU has recognized TAP as a "Project of Common Interest," making it eligible for funding under TEN-E. (TAP website; date accessed, November 8, 2013).

the mechanisms which force cross-border interaction, notably transportation, it is possible to directly identify spillover mechanisms at play; instigated by the EU, though carried out by the states.

### Electricity and Gas Sector Liberalization: The Energy Packages

Since the mid-1990s, and operating in parallel to the Green Papers and the other energy initiatives, is a series of legislative “packages” enacted to liberalize the EU’s energy sectors. The European Commission submitted the packages to the European Parliament for legislative review and approval by the Council. The main emphasis has been on the member states’ electricity and gas sectors, which are often uncompetitive, opaque and unaccountable, and inject transparency into the market. A total of three packages have been approved, each successively more stringent and demanding than the previous.

The first package was implemented in 1996 to establish “common rules” for liberalization via separate electricity and gas markets (European Parliament, (1) Directive 96/92/EC 1996; Furfari 2012: 260, 369). The EU’s wholesale electricity market is a main focus of the package which has proven extremely difficult to crack open and which has carried over till today. The 2003 directives, or Second Package, sought to close the gaps found in the 1996 document. This included unbundling supplier and transmission activities, removing the regulatory gaps (in particular for cross-border transactions), improving transparency and allowing third-party access to the gas infrastructure<sup>138</sup> (European Parliament, (2) Directive 2003/54/EC 2003). Following the passage of the Second Package, the Commission continued to encounter opposition within the members states’ proving the difficulty in dismantling the national champions and entrenched interests.

In the face of this opposition, the Commission began implementing stronger oversight regimes and by early 2006, the Electricity Regional Initiative (ERI) was launched to accelerate the process of integrating the national gas and electricity markets. This was seen as an interim step in the process by creating seven regional gas and electricity markets to force liberalization and efficiencies in the markets. Operating within this framework and guided by similar goals is the Council of European Energy Regulators (CEER) and the Agency for Cooperation of Energy Regulators (ACER). CEER is comprised of the national regulators and acts as a forum for discussion and sharing best practices. On the other hand, ACER is a creation of the Commission with legal authority to implement market liberalization guidelines (CEER website, date accessed March 14, 2015; ACER website, date accessed March 14, 2015).

The creation of these entities again demonstrate Brussels’ willingness and ability to reach across national boundaries and erode the impact of these state-level commercial energy players. These neo-functionalist designs were originally intended for EU Member States, but are now being applied to non-members which have signed up for EU oversight and management, most notably as found in the Energy Community. Additionally, the aspects that give these agencies more influence than, say those within the Baku Initiative, is the ability to bring EU political and legal pressure on the national governments to force compliance.

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<sup>138</sup> 2003/54/EC was dedicated to electricity while 2003/55/EC focused on gas.

In September 2007 the Commission began work on the ‘Third Energy Legislative Package,’ designed to address flaws in the previous two packages and further open the gas and electricity markets (European Commission, (20) “Questions and Answers,” September 19, 2007). The Third Package was adopted by the European Parliament and the European Council in July 2009, and became effective on September 3, 2009. Thanks to a stronger enforcement regime across the industry, powers provided by Lisbon, the new enforcement tools include the ACER and the Energy Networks of Transmission System Operators for Electricity (ENTSO-E) and a similar one for Gas and Energy Networks of Transmission System Operators for Electricity (ENTSO-G). Essentially, these tools allow more effective oversight, such as better sector coordination and the ability to levy fines for non-compliance<sup>139</sup> (European Commission, (21) “Directive 2009/72/EC of the European Parliament,” Geamens Energy Consulting Services, Geamens website, date accessed September 29, 2013; Furfari 2012: 371).

## The Lisbon Treaty Era

### Lisbon Treaty, September 2007

While the Green Papers and the Energy Charter established the theoretical structure and organizational principles for a comprehensive energy strategy, it was the September 2007 Lisbon Treaty which enshrined these principles in the EU’s political and legal environments. Lisbon highlighted the three pillars, though there were several additional elements. For instance, the value of pipelines were noted to “...promote the interconnection of energy networks” but also road and rail, as well as market-based interactions.<sup>140</sup> The Treaty also introduced climate change as a major policy platform following the Commission’s “20-20-20” directive.<sup>141</sup> Finally, Lisbon gave the Commission unprecedented power to liberalize the European energy industry, particularly gas and electricity, which has been useful in Brussels’ attempt to impose market discipline<sup>142</sup> (Furfari 2012: 50-51; Information Network for Sustainable Europe (INFORSE), The Lisbon Treaty and Sustainable Energy, date accessed September 30, 2013). Perhaps Lisbon’s most important contribution is its attempt to consolidate the wide-ranging and disparate energy initiatives under the Commission’s control. Indeed, the EU’s post-Lisbon energy policies have been marked by a series of aggressive policy efforts by Brussels which will be discussed further.

### European Energy Strategy to 2020 and The European Energy Roadmap 2050

In 2010, the Commission published two ‘over the horizon’ strategies; an indication of the Commission’s long-term perspective in the energy sector. Released in November 2010 was the ‘European Energy Strategy (EES) 2020,’ which highlighted the Commission’s approach to ‘decarbonisation,’ a principle firmly grounded in the Lisbon treaty and earlier environmental

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<sup>139</sup> Because the global oil market is already liberalized, the packages concentrate primarily on electricity and gas. The packages do address certain aspect of crude and petroleum storage, particularly requiring the member states to have 90 days of supply on hand. This is covered in more detail in Chapter 6.

<sup>140</sup> As found in the Lisbon Treaty’s Article 176A. (See INFORSE)

<sup>141</sup> The 20-20-20 figures were targets and each member state has individual goals which are established and are monitored every other year for progress (Furfari 2012: 315-316). These have since been superseded by the 2030 provisions of October 2014.

<sup>142</sup> Articles 122.1 and 194 of the Lisbon Treaty. (See INFORSE)

directives. Such a long-term strategy was necessary, as it is estimated that \$1.1 trillion in investments will be required over the following ten years to upgrade equipment and infrastructure to implement the strategy (European Commission, (22) “Europe 2020” 2010: 2). In December 2011, as a compendium to the EES 2020, the Commission released the ‘European Energy Roadmap 2050,’ which reinforced the EU’s long-term demand for diversified sources of oil and gas, as well as interest in sustainable energy development. In this strategy, the EU committed to reduce 2050 levels of CO2 emissions to 80-95 percent below 1990 levels (European Commission, (23) “Background paper: Energy Roadmap 2050 – State of Play,” May 3, 2011). These back-to-back publication acted as a proverbial stake in the ground, indicating the Commission’s policy directions and priorities following Lisbon.

### The May 2014 Summit: A New Energy Strategy and Climate Package

With the unfolding Ukraine crisis and the South Stream pipeline tensions as a backdrop, on May 28, 2014, the Commission released a new energy strategy which superseded the EES 2020 of 2010. For the short term it proposes stress tests to simulate a gas supply disruption with the goal of determining how the member states would respond to such an event. The intent was to formulate emergency plans which require increased gas stocks and reverse flow pipelines to reduce short-term demand. Medium to long-term challenges were also presented, which include increased energy efficiency toward reaching climate goals, effective negotiations with export partners, notably Russia, Norway, Saudi Arabia and Caspian Basin states, and “speaking with one voice” regarding EU energy policy. With South Stream in mind, the Member States were asked to inform the Commission about “third country” agreements which may impact Brussels’ freedom of action (European Commission, (24) “Energy: Security of Energy Supply,” date accessed August 10, 2014).

Additionally, new climate and energy targets to 2030 were released in Brussels on October 23, 2014, which were even more ambitious than the 20-20-20 provisions. The new targets require reduced emissions of 40 percent, as well as 27 percent renewables and 27 percent energy efficiency. Poland and several Central and Eastern European countries received financial concessions for their support of the package. Environmentalists accused the Commission of backing away from more stringent directives, while industry groups were equally dissatisfied with claims that further regulations would drive up energy costs and make them less competitive with foreign economic sectors (van Renssen 2014). The 2014 directives build on the post-Lisbon documents of 2010 and 2011, and attempt to further consolidate the various energy and environmental efforts underway, all pointing to a culminating event in Riga in early 2015.

### The Riga Summit of February 2015: The European Energy Union

Rounding out the 2014 energy strategy and 2030 climate package is the European Energy Union (EEU), which was outlined at the Riga energy summit in February 2015. The Commission was determined to conclude far-reaching directives across the energy sector, particularly in the electricity market. In fact, Riga was hailed by European Commission’s Vice President for the Energy Union, Maroš Šefčovič, as “...the most ambitious European project since the formation



of the coal and steel community.”<sup>143</sup> Though at this point the EEU is merely a compilation of guidelines with no legal authority, it is clear that the Energy Union, if implemented as intended, has the potential to extend Brussels’ influence over the European energy sector. Attempts to impose stricter unbundling provisions are essentially extensions of the Third Package, however, there is interest in negotiating a single EU price, particularly in gas, to break Russian price manipulation.

Additionally, there are provisions to allow Brussels the right to countermand any energy contract signed by a Member State with a third party. This is a deliberate attempt to rein in states, such as Bulgaria, which signed unilateral agreements with Russia to accommodate South Stream. Though the details have yet to be released, there is concern the Energy Union infringes on national sovereignty (van Renssen 2014). Currently, such concerns appear to be overblown as the “... Lisbon Treaty states explicitly that member-states have the exclusive right to deal with their energy mix and exploitation of their energy sources” (Kottari email to the author, March 13, 2015). Such a loophole has also brought up questions on how to “rebalance” political power in favor of Brussels. In other words, demanding further concessions on sovereignty by the Member States to give the Commission a stronger hand to implement energy liberalization (Van Renssen, February 24, 2015).

## The EU-Russia Energy Dialogue

As noted earlier, a central theme in the paper is the importance of the rivalry between two of the world’s largest energy players; the EU and Russia, and the impact of this relationship on the Black Sea RSC’s transformation. It is a rivalry based on geostrategic positioning, culture and ideology, and culminating in elevated political, economic and, to a lesser extent, military tensions. East-West rivalry has always existed, so these current tensions are a modern manifestation of this age old tradition, yet it is arguably the first time that energy has been the centerpiece of such tensions. Attempts to manage this energy-centric relationship, particularly in light of heightened tensions between the parties, is proving difficult.

The EU-Russia Energy Dialogue was an attempt by both sides to create a framework for formalized discussions on energy-related subjects. Over the years the dialogue has covered Russia’s regulatory framework, energy efficiency, technology transfer and investments. Its roots in the post-Soviet era are traced to June 2000 with the Feira European Council Summit, the significance of which committed the EU to support Russia in its energy development and, in effect, gave Moscow a relative free hand within its sphere of influence (Romanova from Aalto 2008).

More specifically:

“The Union stands ready to assist Russia in meeting these aspirations, objectives and commitments, and to develop cooperation with it on the basis of its Common Strategy and the

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<sup>143</sup> In 2015 the Commission’s Energy Directorate position was expanded to include a higher level, Vice President for Energy Union under Maroš Šefčovič. Miguel Aria Canete is the commissioner for the newly formed Climate Action and Energy directorate.

Partnership and Cooperation Agreement. To this end, the European Council invites the Council and the Commission to review the situation in July and to take the necessary decisions about TACIS and other instruments” (European Parliament, (3) “Santa Maria Da Feira European Council, 2000).

In other words, the EU would relax its opposition to Russian policies in return for enhanced energy trade. This acknowledged Russia’s position as the Union’s dominant energy supplier, and telegraphed the importance of this relationship for future economic growth.<sup>144</sup> Moreover, it also made clear that a key tenet of the EU, human rights, was negotiable.

In October of that year the venue which propelled the dialogue forward was actually a side-event at the 6<sup>th</sup> EU-Russia Summit in Paris. During the summit Putin and then-European Commission President Romano Prodi met privately to discuss mutual concerns about the energy trade. At the center was the dynamics of energy supply and demand (European Commission, (25) 2000; Roberts 2007: 11). On the demand side of the equation, the “Prodi Plan” committed the EU to doubling its Russian gas imports to 240 bcm by 2020.<sup>145</sup> Through the plan, Russia was guaranteed long-term revenues to justify the considerable investment required to extract and transport hydrocarbons from Western Siberia and North Russia. Both sides were subject to penalties for breach of contract. However, from the supply standpoint, by agreeing to export 240 bcm, well above its capacity to do so, Russia placed itself in an untenable position<sup>146</sup> (Roberts 2007: 13, 28-29; Romanova in Aalto 2008: 64-65, 98; European Commission, (26) “EU-Russia Energy Dialogue,” date accessed January 13, 2013; Furfari 2012: 391, 398).

The summit not only solidified the broader EU-Russia energy dialogue, but also set the stage for further energy cooperation. For example, following the gas dispute of 2009, it was through the formalized Dialogue that the EU and Russia developed an early warning mechanism to ensure communication in the event of future disputes or supply interruptions. Another product of the Dialogue was the EU-Russia Gas Council, also created after the 2009 dispute to address and mitigate any future occurrences (Furfari 2012: 399). On March 22, 2011, Oettinger and Novak signed the “Roadmap EU-Russia Energy Cooperation Until 2050,” which, as the name implies, attempts to establish a long-term framework for bilateral energy cooperation (European Commission, (27) “Roadmap EU-Russia Energy Cooperation until 2050,” March 2013).

Despite the Dialogue and other cooperative mechanisms, the two sides share fundamentally opposite perspectives on the energy trade, and there is little hope of reconciling these differences in the near term. For the EU the impetus is on competition and free trade utilizing the Commission to break down barriers to entry and unbundle the energy markets for the purpose of providing low-cost and best value to the consumer. This is in contrast to Russia’s desire to implement firm state control and monopolistic conditions, and use the power of the state to close off competition. Furthermore, it can be argued from the Russian standpoint, the Russian consumer benefits from cheap, subsidized gas. These competing models demonstrates an

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<sup>144</sup> Reference to Christian Cleutinx of the EU’s DG TREN (Romanova in Aalto 2008: 64-65).

<sup>145</sup> The Prodi Plan was devised in September 2000 and presented the following month in Paris. Other discussions centered on energy investment, information sharing and technology transfer (Romanova from Aalto 2008: 64-65).

<sup>146</sup> Russia’s 2000 exports to the EU were approximately 125 bcm. In 2013, Russian gas exports amounted to 160 bcm. Stern’s data includes some non-EU states (Stern, “The Importance of Russia,” Centrex Undated: 9).

interesting example of executive power at play to create opposite goals; the EU notion that liberalized markets create the best options for consumers and promote transparency which, in turn, generate capital flows, whereas the Russian goal of central control, though inefficient and prone to opaque management practices, permits the best opportunities for state control of the markets.

A main component to the liberalization process is demonstrated by the EU's demand for third party access to the pipeline and transmission infrastructure to introduce competition and reduce prices. By contrast, Russia feels it is within its right to restrict use of its pipelines and maintain greater control of its gas when it enters the EU, accomplished via destination clauses which limit the ability of a buyer to resell Russian gas to a third party. These divergent models were most evident during the development of South Stream, whereby Brussels mounted an effective blocking campaign of the project. Russia's refusal to accept the EU's energy acquis, while aggressively pursuing customers among the Member States, further angered Brussels<sup>147</sup> (Romanova in Aalto, 2008: 68).

Another visible manifestation of the EU-Russia energy conflict is Gazprom's protected status and monopolistic structure. Attempts to have Russia accept aspects of the energy acquis, notably by breaking Gazprom up, have been unsuccessful. The Russian goal of maximizing rents allows them to recoup their infrastructure investments, which also reinforces the long-term "take or pay" contract model. Russia notes that without such guarantees of a revenue stream, the ability to extract and transport gas would be impossible. Finally, the EU feels it should be recognized as a single energy market, while Gazprom claims that under these conditions it will lose control over its product and curtail its revenues (Roberts 2007: 30; European Commission, (28) "Energy from abroad: EU-Russia Energy Dialogue," European Commission website, date accessed September 30, 2013).

There had long been unease in Brussels over its growing dependence on Russian energy, though, until recently, it was impossible to get Union-wide consensus on how to address it. The gas disputes of 2006 and 2009 caused trepidation within the EU about how reliable a partner Russia would be. There was (and still is) resentment on the part of the EU that Russia did not recalculate the gas prices which were indexed to the price of oil during the 2008 price spike which saw ever increasing revenues flowing to Gazprom's coffers.<sup>148</sup> Nevertheless, and with Russia's continued unfair trade practices, the EU was still willing to compromise with Russia. The key event was Crimea, which was considered "too much" and which forced a reconsideration of the EU's relationship with Putin's Russia (Furfari interview 2015).

Indeed, EU's sanctions imposed on Russian government officials and business concerns as a result of the Kremlin's bellicose actions in its near abroad are having an impact. The result is that Brussels is now pursuing energy diversification by looking more seriously at North African and Central Asian gas, as well as LNG sources outside of the Russian pipeline network. Russia, because of its conflicts and contracting demand in the West, is also anxious to diversify its client

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<sup>147</sup> Russian opposition to third party transit led to its December 2003 rejection of the Energy Charter Treaty and the announcement that it will not be ratified unless the Transit Protocol is changed (Aalto 2008: 169).

<sup>148</sup> Though Gazprom did provide rebates, it was only after EU complaints of Russia's excessive rent-seeking. It was later claimed, "This is not how partners are supposed to behave towards each other" (Furfari: 2015).

base. Asian demand is shifting the global economic focus, though it will be some time and considerable expense before Russia has developed an Eastward-oriented infrastructure. Despite Moscow's desire to redirect its resources to non-EU markets, it is difficult to imagine Europe being toppled as Russia's primary oil and gas recipient any time soon (Bradshaw 2014).

What is evident in 2016 are conditions in some ways reminiscent of the Cold War era's ideological rift between East and West. The reoccurrence of a new Cold War is not evident, as the divisions and rhetoric are not so stark as before 1991; the volume of trade and cooperation is much higher, though there is a distinct differentiation nonetheless between East and West and a more heightened level of tension than any time since the Soviet Union's collapse. On its current trajectory, the EU-Russian rivalry, particularly in energy and the Black Sea RSC, will continue and intensify following traditional patterns of East-West tensions that will require continued dialogue and interaction.

### EU-Turkey Energy Relations

Another Black Sea great power rivalry that is emerging is the one between Brussels and Ankara. Like Russia, because of its size and relative influence, Turkey can be assessed as a separate entity from the broader Black Sea RSC. It is fair to say that current EU-Turkish energy relations mirror the general deterioration between Brussels and Ankara, perhaps understandably considering the vital role that energy plays in this bilateral relationship. This tension is relatively new, and can be identified by Turkey's growing economic power and concomitant demand for energy.

In the initial stages, there was cooperation on Nabucco and the Southern Gas Corridor; Turkey was anxious to portray itself as a worthy European partner and regional leader. Yet, as time passed, cost estimates mounted and organizational problems surfaced, most notably how the pipeline was to be filled, gave way to frustration in Ankara at the slow pace of progress. Meanwhile, further upstream, Azerbaijan was becoming equally frustrated at the delays in moving Shah Deniz gas. Ankara and Baku began discussion of a trans-Anatolian pipeline, or TANAP project, built and managed outside of European control. As noted in Chapter 3, Turkey and Baku delivered the expected death blow to Nabucco in June 2013. Turkish resentment with the EU over lost time, money and goodwill is palpable and further demonstrates Ankara's desire to 'go it alone' and forge its own path outside of Western influence, a divergence that has been introduced under Erdogan and is at odds with Turkish foreign policy dating back to Ataturk.

Despite these diverging paths and cooling relations, Turkey's role in the EU's energy security strategy is significant and will most likely grow over time. There is the potential for as much as 30 bcm of natural gas per year passing through TANAP into EU-based pipelines; this includes not only Azerbaijani, but also Iraqi, Persian Gulf and, possibly, Iranian gas. This eventuality places Turkey in a position of considerable strength, a position which Erdogan clearly relishes given his desire for a greater political and economic role in the region (Tagliapietra 2014: 6-7, 16; Marketos 2014). This is facilitated in the case of the Ukraine crisis and souring relations between the EU and Russia, whereby Turkey becomes an attractive alternative for Moscow. Indeed, the announcement of Turkish Stream in December 2014 indicated a growing Moscow-Ankara nexus at the expense of European energy security.

What is clear is that the “No Problems” policy is in tatters, if it ever truly was a coherent program. Turkey must contend with shaky relations with Greece, Cyprus and Israel, three prospective gas exporters from the Eastern Mediterranean. Additionally, considering the traditional Turkish-Russian rivalry, any gas projects may not stand the test of time. It is possible that if Turkey continues with its geopolitical realignment away from Europe, it will become a gas rival to the West, defeating the purpose of the Southern Gas Corridor and setting back the EU’s effort at source diversity. Ultimately, this power trifecta of EU-Russia-Turkey could devolve into a tense, though functional relationship based on mutual needs.

The Turkey and Azerbaijan dynamic also bears discussion; the two states often operate in tandem, as demonstrated by strong cultural ties, and despite that Turkey is predominantly Sunni and Azerbaijan is Shia. Though Turkey and Azerbaijan are on generally friendly terms with the EU, there is concern that the former is realigning itself as a neutral or even Middle East-centric state which could jeopardize long-term relations with the latter two. In light of TANAP, it must also be asked whether too much dependence is being placed on Azerbaijan’s Shah Deniz fields. Furthermore, Erdogan’s thinly veiled threat to hinder Nabucco’s progress unless Turkey’s EU accession talks are resumed, has not helped assuage the European sense of vulnerability (Euractiv January 20, 2009). More specifically, what are the consequences of this influence being held in the hands of a few producer and transit states, and will Europe once again be vulnerable to a handful of energy producers or transit countries; the very conditions it was trying to avoid, and which prompted Nabucco in the first place?

### EU-Black Sea Relations

So far the results of Europeanization in the Black Sea RSC are mixed if not poor.<sup>149</sup> In the early post-Soviet period, the lack of experience in democratic governance and liberal economic structures hindered the process. This was particularly so regarding the multigenerational changes needed to reverse deep-seated cultural and societal norms which taken root in the communist era. For instance, newer members Romania and Bulgaria, appear to be backsliding into corruption, governmental malfeasance and political manipulation, indicating the conditionality process had not fully taken root and that perhaps their accession was premature.

A powerful tool available to the EU in coercing regional transformation is the AA coupled with a DCFTA, which gives the recipient country certain trade and aid benefits from Brussels. Viewed as a critical step toward eventual membership, the AA is coveted by most Black Sea RSC members as it conveys a certain sovereign credibility and legitimacy. Turkey has an AA dating back to 1963 and initial accession discussions with EEC, which have since then dragged on in fits and starts. Since 1963 Ankara has made progress in streamlining its legislative *acquis* to conform with Brussels’ requirements, however EU member status has eluded it, mostly because of Turkey’s troubled domestic politics, as well as EU reticence in bringing a large and relatively poor Muslim state into the fold. Post 1991, Ankara has watched with frustration as former Soviet or Eastern Bloc states were welcomed in the Union, while its own accession appears permanently stalled.

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<sup>149</sup> Russia did not want to be lumped into a ‘neighborhood’ and demanded direct interaction with the EU, hence the Common Spaces program.

Azerbaijan is anxious to establish closer ties with West, however Baku's own problems with corruption and election fraud has resulted in criticism from Brussels. Moreover, the unresolved issues with Armenia over Nagorno Karabakh and Baku's recent friendly overtures with Russia and Iran, have created concern in Brussels. These facts notwithstanding, Azerbaijan's AA is under negotiation. Georgia has had success against corruption, and improving its overall business climate, though the domestic political machinations have also proven unpalatable to the EU. Nevertheless, in June 2014, Georgia, along with Moldova and Ukraine, countries with their own domestic and foreign political problems, signed AAs with Brussels. As noted in Chapter 3, Armenia was on the verge of an AA, but backed out under intense Russian pressure. If anything, this demonstrates Moscow's nervousness and determination to keep its former empire firmly in its grasp. Russia is wary of Western expansion on its borders and has forcefully pushed back in Georgia and Ukraine in recent years. The EU was anxious to demonstrate its support to these four non-Russian states, though full membership is unlikely while they maintain unresolved conflicts within their borders, let alone the parlous state of their domestic affairs.

What this also demonstrates is the multidimensional state of relations between the EU and the individual members, indicating a much more difficult task to evaluate the overall state of relations between a fractious Black Sea RSC and Brussels. As each state has unique issues to contend with, this also highlights the inherent difficulty of multilateral agreements, as found in BSS, which overlooks such conditions present in the member states (EaP website, date accessed, March 7, 2015). This also indicates the challenges posed by a highly contentious state of affairs on the EU's southeastern border and the difficulties to be faced in the future. Ultimately, a complicated set of circumstances appears on the surface as overlapping rivalries and geopolitical goals clash. This is portrayed by the regional trifecta of EU-Russia-Turkey with the other, smaller states, uncomfortably perched in the middle.

The perception of a benign European master showing the way to its backwards neighbors is not always shared nor appreciated in the Black Sea RSC. Bulgaria, and non-Black Sea RSC states Hungary and Serbia were furious over Brussels' interference in South Stream, claiming this denied them a ready and stable supply of gas. There are other concerns about Brussels' heavy-handed approach to its eastern neighbors, amid charges of European neo-imperialism at play on its periphery. Notably, the sentiment that conditionality is a condescending attitude that perpetuates Western European economic, political and cultural superiority. There were complaints that the Green Papers, as well as the Lisbon Treaty, the energy packages and now the Energy Union, were too aggressive and usurped member sovereignty for the purpose of energy security policy<sup>150</sup> (Aalto 2008: 64-65).

It is these attempts to weaken state sovereignty for the purpose of energy policy coherency which has created pushback in many member states in the form of anti-EU political movements, notably the Front National in France, the UK Independence Party and Golden Dawn in Greece. The mishandling of the migrant/refugee crisis has strengthened these nationalist entities. These "Eurosceptic" parties have gained considerable ground in recent years, mostly on anti-EU and anti-immigration platforms, to where they are gaining seats in national assemblies, as well in the

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<sup>150</sup>Charges of neo-colonialism also come from EU Member States, particularly within the context of the Greek financial crisis. "Greece is standing up to EU Neocolonialism" (Douzinas and Papaconstantinou 2011).

European Parliament. It would not be inconceivable that in the near future the EU experiences a period of inertia to the extent last seen in the “Eurosclerosis” era of the late 60s and 1970s.

The EU-Russia Energy Dialogue reinforces how Brussels’s development and its interaction with Moscow have influenced much of the global energy dynamics. Indeed, a major exception to the EU’s economic and political dominance over its Black Sea neighbors is Russia, which, because of its size, preponderance of energy and therefore, influence, has been able to resist this pressure and exploit the Union’s internal divisions. For this reason, much of Brussels’ Black Sea RSC energy policy centers on its relationship with Moscow, which is frequently trying to split the EU and engage bilaterally with the Member States. Additionally, there has been disagreement among the EU members, as Eastern states were willing to pressure Russia while most Western countries were reluctant to damage their relations with the Kremlin. The Ukraine crisis has set back EU-Russian dialogue to the point that it may be that East-West relations are so frayed no serious energy dialogue can continue in the foreseeable future.

Finally, there is Russia’s influence superimposed on the region’s geopolitical and economic landscape; a counterweight which factors prominently in the equation. The impact of the Black Sea RSC’s Europeanization process creates at least two possible scenarios going forward: 1) there is some economic spillover into Russia in which Moscow is forced to accept certain Western standards or practices to protect its market share, or 2) a status quo Russia under Putin or similarly nationalistic leader continues to aggressively confront Western influence.

## **The EU as a Driver of Regional Transformation**

Since the early 1990s the EU has made considerable progress consolidating its internal energy sector with a balance between fossil fuels and environmental protection. This has been through a liberalization policy aimed to ensure that the three pillars are intact and produce market solutions while maintaining equilibrium between supply and demand. By drawing on the EU’s economic, organizational and legislative strengths, the *acquis* facilitates market access for energy suppliers and competition and transparency for consumers. There are other variables involved, most prominently environmental considerations which impact the use of fossil fuels and creates the demand for renewable sources. In effect, Brussels, via the Commission, is transforming Europe’s internal energy market, which is proving the unifying force, overriding disparate practices and national standards to force alignment on the *acquis*. As the catalyst of the common European energy strategy, the Commission promotes interconnections through a legislative and regulatory framework (the *acquis*) while enforcing established competition rules.

By extension, the Commission, through its numerous efforts, spearheads the Europeanization process in the Black Sea RSC, via a combination of mechanisms pushed from above or below, orchestrated to promote energy-centric interaction among the parties. Additionally, by intersecting the region’s energy supply routes into the EU from the Caspian basin and Middle East, it will increase competition and reduce dependence on a single (Read: Russian) source of gas. This is also an indication that the Southern Gas Corridor, assuming it expands beyond transporting only Shah Deniz gas, will become an important integrating vehicle for Black Sea RSC energy transport. More recently there is the Commission’s “Union for Mediterranean Gas Platform,” which attempts to coordinate the efforts of the gas players throughout the

Mediterranean, though the Eastern Mediterranean will certainly be a factor (Natural Gas Europe, (14) June 11, 2015).

It is also possible to see the limits of high-level initiatives pushed down from Brussels in favor of ground level interaction in achieving geopolitical goals. By ground-level interaction, it is meant those discreet initiatives which help catalyze cross-border transaction. Therefore, it can be argued *the most effective EU program dedicated to the Black Sea RSC is the Energy Community, which has contributed to fusing the EU with the Black Sea RSC from an economic and geopolitical perspective using energy as the implementation vehicle.* The Energy Community highlights the strategic role that many Black Sea states play vis-à-vis Brussels' own security posture, particularly as a means of enabling the Southern Gas Corridor and stabilizing the EU's south eastern flank. The Energy Community will be highlighted as a case study in Chapter 6.

This push into EU-wide energy solidarity is not without its critics, and despite its success, there are still significant failings in Brussels' attempt to liberalize its electricity and gas sectors. Despite the ground-breaking activity in this regard, most recently in Riga, the notion of a functioning European-wide electricity grid or gas network is still years away from realization. As will be demonstrated in more detail in Chapter 6, most of the state-run energy firms have been privatized, but are still intact as national monopolies, unable or unwilling to coordinate outside their respective borders.

There are other gaps and weaknesses in the Commission's energy policy efforts. For instance, what to make of the myriad of programs to streamline energy flow to Europe? Though they have had some impact by channeling Brussels' funding and cohesion projects, in the final analysis, INOGATE and TRACECA are questionable players in the broader EU-Black Sea dynamic; a senior BP official noted that "Neither of these entities are particularly relevant" (Greg Saunders email to the author, August 18, 2011). Furthermore, it also calls into question the overall impact of multilateral infrastructure projects of this nature, where such unproductive efforts have been abandoned in favor of bilateral MOUs (Furfari interview, February 12, 2013)

Despite Russia's best efforts, it is hard to dispute the EU's growing economic and political influence moving eastward into the Black Sea RSC. Both sides are seeking economic and political stability, which has pushed them together in an inexorable, though in a clearly staggered, haphazard and inefficient manner. It comes down to meeting mutual economic and stability needs, and it is these needs of the EU-Black Sea RSC that have unleashed market forces which have pushed the two regional entities together, and it is within these dichotomies where it is possible to consider the political, social and economic interplay between the two regional entities.

Carrying the theme further, the dominant EU is subsuming a non-Russian Black Sea RSC which has barely developed itself in the post-Cold War era. In effect it is the EU's own neo-functional and political cohesive qualities spilling over into its neighboring regions and creating the transformative conditions at work. Europeanization and the embodiment of its core norms via the Black Sea RSC energy infrastructure, permits this spillover to occur, which has, in effect, answered an element of the research question, via an external driver mechanism. *Through the*



*combination of its economic posture and demand for energy, the EU exerts considerable influence, pushing outward and engulfing the Black Sea states in its normative web.*

## Chapter 5: Internal Drivers of Change. The Black Sea Economic Cooperation (BSEC)

“As far as the Black Sea countries are concerned, energy is potentially the most important sector, one that will generate functional regional interdependence and cooperation in the Black Sea. Therefore, the management of energy resources remains a critical issue for the Black Sea countries” (Tunc Aybak 2001: 42).

“The deterioration of Turkey's relations with the European Union, and the worsening outlook for full membership has spurred an "agonizing reappraisal" of Turkey's interests in relation to the West” (Ian Lesser 1999).

“Aim to ensure that the Black Sea becomes a sea of peace, stability and prosperity, striving to promote friendly and good-neighbourly relations“ (BSEC (2), The Summit Declaration on the Black Sea Economic Cooperation, the Istanbul Declaration, Article 8, June 1992).

Brussels' economic foundation, its organizational and diplomatic strength, coupled with the legislative structure provided by its *acquis*, allows it to overshadow the Black Sea RSC in almost every measurable category. And while the EU is challenged by a host of economic and demographic issues, it will continue to dominate its eastern neighbors. Yet, despite these weaknesses there are unmistakable internal drivers within the Black Sea RSC helping to transform it through discrete and persistent cross-border interaction, a manifestation of the push and pull inherent in region building.

Moreover, this internal focus is an indication of the Black Sea players assuming responsibility and initiative, and setting a distinct course of action to control their respective and regional destinies. This is consequential since the local governments and institutions are best positioned to articulate the intra-regional details, as true solutions can only be derived and implemented from them, and as they will ultimately have to live with the consequences. In recognition of the results of inaction, most of the members of the Black Sea RSC have thrown in with the EU. This chapter will consider how the Black Sea RSC's internal drivers, via the impact of energy, complements and supports this regional transformation.

The EU, with its deep institutional and organization framework, legislative traditions and rule of law, embodies the role of the external driver, so it is important to locate a similarly structured entity for the Black Sea RSC if only for the purposes of comparison and analysis. For instance, what is the best analytical *vehicle* for framing a review of the Black Sea RSC's internal drivers? Such comparisons allow greater ability to analyze and apply structure and discipline to the discussion from which to further address the research question. Ideally, this would be in the form of an existing regional structure representing as closely as possible the four elements of the RSCT foundation; a defined boundary, an anarchic system, power polarity and the existence of amity and enmity. It must also be inclusive and diverse enough to address political, security and economic sectors. In the case of the Black Sea there are numerous standing regional organizations which incorporate varying degrees of the Black Sea RSC criteria, however the vast majority of these are defined by a specific focus and membership pool with limited

organizational trappings and influence. Also, virtually all these regional organizations lack any type of legal recognition outside of its membership base.

This chapter looks more closely at a handful of examples, notably GUAM-ODED, Black Sea Naval Cooperation Task Force (BLACKSEAFOR) and EuroNest Parliamentary Assembly. Each of these organizations maintains a select membership and is dedicated to a specific mission or goal. Additionally, they attempt to reach across national boundaries to promote intra-regional cooperation. As noted in Chapter 2, GUAM-ODED is comprised of Georgia, Ukraine, Azerbaijan and Moldova. It is dedicated to counterbalancing Russian influence through democracy promotion and enhancing member security, and because of this position it has generated support from the United States and the EU.

Created in 2001, BLACKSEAFOR is made up of the Black Sea's littoral states; Bulgaria, Georgia, Romania, Russia, Turkey and Ukraine. It was created as a regional security cooperative entity, primarily to address maritime search and rescue, but also counterterrorism and counternarcotics in the region. EuroNest, with members Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine promotes inter-parliamentary cooperation between the EU and the EaP nations. Committees are dedicated to human rights and democracy, EU convergence, energy security and education and civil society (GUAM-ODED website, date accessed September 29, 2013; BLACKSEAFOR website, date accessed November 14, 2014; EuroNest website, date accessed February 17, 2014; Akiner 2004: 306-307).

Looking further at these organizations, there are significant flaws or shortcomings which should be noted; primarily, all are narrowly defined around a specific agenda, or comprise a small membership base. GUAM-ODED and BLACKSEAFOR are security-centric; the former is decidedly anti-Russian in outlook, while the former is a cooperative naval entity with a narrow mandate. EuroNest, with a small membership base, is not fully representative of the Black Sea region<sup>151</sup> (Roberts 2007: 27-35; BLACKSEAFOR website, date accessed September 28, 2013; GUAM website, date accessed December 13, 2014; EuroNest website, data accessed February 17, 2014).

When applying the RSCT, these three organizations maintain distinct, though hardly inclusive, boundaries representing an anarchic system of sovereign states. Furthermore, because of the limited membership base, the ability to gauge power polarity is non-existent in GUAM-ODED and EuroNest. Moreover, as noted earlier about the inherent problems with the EaP, EuroNest has a limited effectiveness and perhaps limited lifespan. It appears to have little value added from other parliamentary organizations which foster inter and intra-regional cooperation. BLACKSEAFOR can be considered as a complementary security element to the Black Sea RSC, however, the scope and membership is so narrow as to limit its usefulness for the type of analysis envisioned by this dissertation.<sup>152</sup> Yet, the question is whether these institutions are broad or

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<sup>151</sup> The OSCE is another multinational organization with a prominent regional role, though its membership base is too broad to be considered here.

<sup>152</sup> BLACKSEAFOR was originally broached within the BSEC in 1998 and was subsequently established in 2001.

robust enough in scope to be evaluated as a regional organization?<sup>153</sup> In the end, each of the examples are either unsatisfactory or are outclassed by BSEC.

## BSEC as the Primary Regional Analytic Vehicle

Of the previously noted regional organizations, BSEC is the oldest, most inclusive and organized, with broad cross-functional oversight encompassing economic, environmental, social and parliamentary aspects. Furthermore, BSEC is the only regional organization to have legal and diplomatic status which allows it relative parity with the EU. This position gives it a certain credibility the other organizations lack. It must be asked, can BSEC be considered for more than simply analytical purposes, but as a regional entity in its own right, capable of functioning as a force for change? Does it have the organizational capacity and geopolitical standing to act as a variable in addressing the research question? These questions will be answered in the course of this chapter.

Despite the faults noted in Chapter 2 regarding its membership composition, the organization most closely embodies the RSCT principles in its inclusiveness, power balance and internal frictions, or amity and enmity. Admittedly, BSEC's security focus is limited, and this role is filled to some extent by BLACKSEAFOR. Moreover, the organization does address security in a peripheral capacity, notably through conflict resolution, and the central tenets of peaceful cooperation through trade and cross-border interaction. By process of elimination, the BSEC is the most suitable organization capable of comparison with the EU to analyze the internal transformational drivers, and for this analysis becomes the representative of the Black Sea RSC.

BSEC was first proposed in 1990 by the widely respected Turkish diplomat, Sukru Elekdat, and enthusiastically supported by then-Prime Minister Ozal. More than a manifestation of the "Greater Turkey" initiative, it was seen as an *alternative* to the EU, "...should Turkey's designs for eventual membership not work out as planned"<sup>154</sup> (Aydin 2009: 278). It was Ozal's belief that peaceful interaction at the state level could be achieved through economic liberalization as opposed to protectionism and import substitution. BSEC was inaugurated in June 1992 at the Istanbul Summit under the "Declaration on the Black Sea Economic Cooperation," also known as the Bosphorus Statement (Black Sea Economic Cooperation, June 25, 1992). Its foundational text borrows heavily from the UN Charter and the Committee for Security Cooperation in Europe (CSCE), the precursor to the OSCE (Sayan 2005). Finally, BSEC's founding principles and its organization demonstrate a clear influence from the EU, notably its structure on functional or economic sectors, its rotating leadership mechanism as well as its goal to eliminate economic and political barriers. Though the EU was an inspirational model for BSEC, it was never mentioned in the Bosphorus Statement, an indication of this desired independence.

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<sup>153</sup> The Commission on the Black Sea has a fairly comprehensive list of regional organizations (See Bertelsmann, Annex I, May 2010)

<sup>154</sup> Turkey has had a long and difficult journey in its quest for EU membership. The 1959 Ankara Agreement gave Turkey an AA, to take effect in 1963. However, future enlargement over the following half century have eluded Turkey. The 1980 military coup effectively killed any possibilities for a generation, while Turkey's current foray into Islamism will most likely prevent any accession into the foreseeable future.

During BSEC's formation, Ozal acknowledged the inherent regional tensions would prevent the creation of a Black Sea entity similarly as cohesive as the EU. Moreover, if there were too many binding requirements that inhibited sovereign freedom of action, the whole notion would never get off the ground. Therefore, he proposed a loose formation, with the goal of integrating the BSEC with the global economy and transforming it into a region of "peace, freedom, stability and prosperity." This was to be achieved through an inclusive membership base, the creation of a free-trade zone and a secondary role of peace missions and dialogue for dispute settlement<sup>155</sup> (Sayan and Osman from Rittenberg 1998: 117-118; Black Sea Economic Cooperation, Summit Declaration, Article 5, June 25, 1992). This cooperation also takes into account the "unique interests and concerns of the countries involved," notably the states undergoing post-Soviet transition (BSEC (3) Summit Declaration, Article 10, June 25, 1992). Within this framework, the participating states agreed to trade in goods and services and reduce or progressively eliminate obstacles (Sayan 2005: 337).

Headquartered in Istanbul, BSEC is generally a well-structured and process-driven organization with oversight over all the main economic and societal sectors. Day-to-day activities are managed by a dedicated and experienced professional staff. The chairmanship is held on a six month rotating basis among the members with succession in alphabetical order. At the highest levels are the "decision making and executive bodies," which provide general organizational direction: The Council of Ministers of Foreign Affairs (CMFA) meets every six months and is presided over by the Chairmanship in Office (CiO), usually the foreign minister of the state holding the BSEC presidency. The CiO is assisted by the Troika, which consists of the previous, current and succeeding chairmen. The Committee of Senior Officials (CSO) is comprised of appointed senior representatives of the member states and the chairmen of the Related Bodies (see below) to support the activities of the Permanent Secretariat (PERMIS) and the CMFA. The BSEC PERMIS handles the daily administrative and coordination tasks of the organization (BSEC (4), ICBSS, 2007: 5-6).

At the next level from the decision making and executive bodies is the BSEC Related Bodies or Affiliated Institutions, which represent legislative, political, commercial, financial and academic functions within the organization. They maintain separate budgets and have relative autonomy from the decision making bodies. The Parliamentary Assembly (PABSEC) comprises the parliamentary chambers of the twelve member states and provides the BSEC with legislative support to the PERMIS. PABSEC meets twice a year in plenary session and maintains close contact with the European Parliament as well as the parliamentary organs of the Council of Europe and the OSCE. Intra-regional commerce is supported by the BSEC Business Council (BSEC BC). Housed in Istanbul, it is the body responsible for coordinating private sector commercial interaction and strives to improve the business climate and competitiveness of the member states.

Operating within the PERMIS are the "Areas of Cooperation," intended to promote collaboration on a range of economic and social topics from energy, transport, agriculture, crime, tourism and science and technology.<sup>156</sup> By promoting multilateral and bilateral interaction, BSEC plays the role of consultation board and conflict resolution arbiter. It is transparent; the working groups

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<sup>155</sup> A Black Sea free trade organization has never materialized.

<sup>156</sup> The full list of Areas of Cooperation is found on the BSEC website. (BSEC (5) Areas of Cooperation, website).

and other functions and declarations are open to public scrutiny with the documents posted online. Finally, BSEC has an active agenda and since its inception has been host to numerous summits, conferences and working group meetings.<sup>157</sup>

Despite this relatively solid organizational structure, BSEC languished as a moribund talk shop with little to show for its efforts, and by the mid-1990s Ozal's attempt to establish an alternative to the EU in the Black Sea was clearly not working. What was needed was a more robust and dynamic organization with legal standing in the international arena. Russia's post-2000 reemergence as an aggressive regional power caused many of the BSEC's smaller states to seek relative protection within the EU's soft power regime. This pressure from member states anxious for closer ties with Brussels, forced BSEC to rethink its posture. It also confirmed that, given its relative weaknesses, its political and economic future was aligned with the West. Finally, this Westward shift can be viewed in part as a maturation process, whereby the organization recognized its limits and saw itself more as an enabler rather than as a regional entity in its own right. Debate ensued as to the organization's future and it became evident BSEC had to embrace the EU to survive. In June 1998 the BSEC Charter was produced, ratified by the parliaments of the then-eleven member states, and went into effect on May 1, 1999.<sup>158</sup>

The Charter transformed BSEC into a true regional economic organization with legal and diplomatic status (Black Sea Economic Cooperation, June 5, 1998). With a new lease on life, BSEC kicked off a range of political and economic initiatives, many in the energy and transportation sectors. Additionally, it was this year (1998) when the organization expanded to include the Black Sea Trade and Development Bank (BSTDB) and the International Center for Black Sea Studies (ICBSS). The BSTDB began operations in March 1998 and is headquartered in Thessaloniki, Greece. It serves as a regional development bank supporting local projects, frequently partnered with extra-regional lending institutions such as the EBRD or IFC.<sup>159</sup> Located in Athens, the ICBSS is the independent research and analysis arm of the BSEC. It produces analytic support through a variety of studies, reports and newsletters (Sayan 2005: 338-339; BSEC (6), ICBSS 2007: 7).

## BSEC-EU Relations/Influence

Despite any lingering Turkish resentment, BSEC's most important relationship is with the EU; the effort to establish formal ties with Brussels began at the October 1996 Moscow Summit which initiated the era of EU-centricity, a policy that has continued to this day (BSEC (7), October 25, 1996). In December 1997 the European Commission reciprocated by acknowledging BSEC and promising cooperation. Nevertheless, the Commission has been uncertain about its relationship with BSEC, mostly stemming from the unstable political, economic and social

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<sup>157</sup> GUAM also has "Working Organs," which are roughly analogous to BSEC's "Areas of Cooperation." For instance there is a Working Group on Energy, coordinated by Azerbaijan and a "Working Group on Transport" with Georgia as the country-coordinator. Additionally, there are attempts to reduce tariffs and promote what is intended to be a free-trade zone. The website provides little additional information on these activities, so it is difficult to determine their effectiveness (GUAM-ODED website, date accessed December 13, 2014).

<sup>158</sup> A combined Serbia and Montenegro became the 12th member in 2004.

<sup>159</sup> The BSTDB will be analyzed further in Chapter 6.

conditions among the member states, as well as BSEC's own limited track record of accomplishments (Japaridze et al. 2010: 6).

In fact, the EU has contributed to the Black Sea RSC outside of the BSEC venue; most from the legacy Technical Assistance to the Commonwealth of Independent States (TACIS), of which \$785 million was disbursed between 2000-2006 for cross-border cooperation projects in Moldova, Ukraine, Russia, Georgia, Armenia and Azerbaijan. When the ENPI program began in 2007, an estimated \$21.2 million was set aside for cross-border cooperation between 2007-2013; recipient nations were Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Russia, Turkey and Ukraine (Chrysanthopolous 2006: 4). These include transportation projects, such as the Motorways of the Seas and the Ring Highway. The Motorways of the Seas is an EU attempt to promote enhanced sea transport, while the Ring Highway is a concept to build a road around the Black Sea, thereby linking the member states.

Formal cooperation between the EU and BSEC was codified in a December 2007 MOU called the Intergovernmental Commission TRACECA (IGC TRACECA), to develop a "highly efficient regional transport system," and "multilateral regional cooperation" (BSEC, (8) September 8, 1998). This BSEC-EU interaction has resulted in a fairly one-sided relationship, described as "limited and rather ambivalent," with Brussels firmly established as the mildly disinterested senior partner (Japaridze et al., January 2010: 3). EU-BSEC relations are further complicated by overlapping and conflicting initiatives from Brussels, notably INOGATE, TRACECA and TEN-E.

As noted in Chapter 4, these divergent approaches present a challenge for BSEC to coordinate activities which develop long-term, consistent regional policies and relationships. Furthermore, most members aspire to EU membership as their ultimate geo-political and economic objective, whereby BSEC is referred to as a "preparation ground" for European integration. Yet, these aspirations are at BSEC's expense, and places the organization as merely a stepping stone toward eventual EU membership, thereby further weakening its effectiveness. For instance, Bulgaria and Romania, as new EU states, have been forced to distance themselves from their former BSEC colleagues; EU membership requires the emplacement of political and economic barriers to non-members (Tsardinidis 2005: 389; Aydin 2005: 72, 77).

Though the relationship may be ambiguous, BSEC accurately presents itself as Brussels' only legitimate regional partner, and cooperation has been achieved, particularly in the energy, transportation and electricity sectors. This progress is enhanced by the changes underway in Europe's own internal market and the EU-Russia energy dynamic, which has pushed many Black Sea RSC states closer to the EU. Central to this interaction is the realization of the region's potential; and that BSEC is motivated to influence the flow of energy within the Black Sea RSC, notably by championing various projects for its members. That said, BSEC's energy plans are ambitious, if not aggressive or groundbreaking, and all the steps taken by the organization point toward a legal framework to propel economic development in the free-market economies. Yet there is a lack of consensus within both the EU and BSEC on whether they can or should work towards a more integrated market (Tsardinidis 2005: 376). To further define this interaction, there is an evaluation of the legal and political framework progression which enables internal interaction within an energy context.

## BSEC-Russian Relations

The Russian Federation's ability to operate both inside and outside of BSEC creates a unique and complicating set of dynamics. Moscow has always had a divided focus regarding BSEC, viewing the organization as a lower priority venue, and this attitude has hardened in recent years. With the acknowledgement that most of its revenues are derived from European trade, the Kremlin is primarily interested in its bilateral relationship with Brussels. Notably, the EU-Russia Energy Dialogue, NATO interaction and the Common Spaces initiative all demonstrate that Russia's primary interests are outside of its BSEC responsibilities.<sup>160</sup>

Despite its external focus, Moscow sees political and economic value in maintaining a BSEC presence on its southern border and open commercial relationships with its Black Sea neighbors, many of which were former Soviet or Eastern Bloc states (Alexandrov-Arbatov 2008: 36). Additionally, BSEC provides Moscow a venue to explain its policies and keep an eye on its rivals. In March 1996 the Russian National Committee to BSEC (RNCBSEC) was established to support Russian business interests within the organization by working with the BSEC Business Council. Moscow was also in favor of expanding BSEC's charter in 1998, as a means of elevating itself and interacting on a level plain with Brussels (Kovalsky from Aybak 2001: 173-174).

Even as late as 2006, well into Putin's tenure, Russia viewed BSEC as a useful diplomatic tool. At the opening ceremony launching Russia's 2006 BSEC presidential rotation, Foreign Secretary Sergei Lavrov noted,

“Russia considers the BSEC to be a viable regional international organisation which possesses necessary mechanisms for cooperation”

He continued,

“The priority... is dialogue in the energy sector. ...without exception the reliability of energy supply, energy efficiency and conservation have become integral parts of national strategies for energy sector development”<sup>161</sup> (Lavrov, June 1, 2006).

A year later, Putin attended the 15th anniversary of BSEC and asked for greater cooperation in the energy sector with the desire to strengthen the energy markets in the Black Sea, to include the value of long-term contracts. He hoped to “...diversify the energy supply routes, to create new insurance systems and to distribute the financial risks among partners by an exchange of assets” (Acturca, July 2, 2007; Russia Today, June 25, 2007).

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<sup>160</sup> Common Spaces was conceived at the May 2003 St. Petersburg Summit, whereby additional engagement would be held in areas of shared or 'common' interest, such as economic cooperation, judicial matters, security, research and development and education.

<sup>161</sup> Additionally, the minister called for “Stronger joint activities...to promote...the Black Sea electricity ring to synchronize power systems in the region” (Lavrov, October 19, 2011).



As time passed and Russia's power increased, and as the East-West divide sharpened, the Kremlin under Putin has seen less value for BSEC. In 2012, Putin refused to attend the 20th anniversary celebrations because of disagreements with Ankara over Syria and its embattled leader, Hafiz al Assad (Today's Zaman, June 26, 2012). A visit to the BSEC website will find no references to the Russia-Ukrainian crisis or any other contentious issues, and speculation is that the organization is unwilling to broach the subject for fear of offending Moscow.<sup>162</sup> This indicates the politically tenuous conditions of the BSEC's international relations, whereby dissent is not tolerated.

With this last point in mind, it is opportune to resurrect GUAM-ODED and its value as an outlet for certain Black Sea RSC members to address issues that would be impossible under BSEC. Therefore, it exists as a parallel anti-Russian organization, and the fact that all four members states harbor frozen conflicts controlled or instigated by the Kremlin, and have been subjected to various levels of Moscow's resource nationalism, should not be lost. Each of the four members suffer from a variety of problems relating to sovereignty, corruption, and domestic political challenges. Though GUAM is smaller in size and scope than BSEC, it has backing from the US and the EU which allows it to stay relevant in the face of Russian pressure.

The Kremlin views GUAM-ODED as a challenge to its interests and Russian media emphasizes the name "Guam," the US territory and military base in the Pacific, in an attempt to portray GUAM-ODED as a Western front group (Blagov 2007). For this reason, GUAM-ODED has come under considerable pressure, notably Georgia, Ukraine and Moldova, though Azerbaijan has been able to effectively balance its relations between Russia and the West, resulting in less attention from Moscow. On December 5, 2014, as a side event to the OSCE Ministerial meeting in Basel, members of GUAM-ODED and the US delegation met and issued a joint statement calling for Russia to respect the national sovereignty of the GUAM-ODED members (GUAM-ODED website, date accessed December 13, 2014). Nevertheless, GUAM-ODED has a difficult challenge to maintain effectiveness in the future, even with nominal US and EU support.

## **BSEC Energy Initiatives**

The 1998 Charter permitted BSEC to adopt a more pronounced extra-regional role, notably by moving closer to the EU. Nowhere is this more evident than in the energy sector which benefited from this enhanced legal status. BSEC's energy portfolio exists within the PERMIS's "Areas of Cooperation," and therefore, operates primarily at the working group level. This progress has been achieved through a persistent attempt to burnish the organization's credentials and develop its own unique energy acquis, particularly in transit and other cross-border transportation projects. Looking at the historical record, it is possible to determine BSEC's progression to pursue internal energy integration, while also positioning itself as an EU enabler, resulting in an incremental process that builds on existing precedent. What follows is a sequential trace of the significant energy initiatives which highlight BSEC's goal of ensuring an emerging Black Sea regional identity and as a major energy provider.

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<sup>162</sup> References are found regarding the Nagorno-Karabakh and other Armenia-Azerbaijan issues

Led by Turkey, it was in this post-1998 environment that the Organization began to take a coherent approach to energy. It is in this context that the potential importance of the energy summits and the value derived by the host nation becomes evident, which dictates the agenda and the summit's overall trajectory. Therefore, the summits are not only national showcases of pomp and ceremony, but are also venues where the host nation can influence the topics of discussion in the hope of deriving future gain. Through the summit process we can see the interplay and behind the scenes interaction is clear, as well as the individual preferences of the member state hosting the event. This is particularly so with the energy summits in which high stakes discussions lead to potential state revenues and regional influence.

#### The Moscow Summit of Foreign Ministers, April 27, 2001

The April 2001 BSEC foreign ministers' summit in Moscow was the first since 1998 to address in a coherent manner an agenda which emphasized deeper economic interaction, notably in the science and technology fields. The summit laid out a broad foundation to permit economic initiatives, which set the stage for future BSEC energy dialogue, and allowed the working groups and Areas of Cooperation to proceed with their own unique agendas (BSEC (9), April 27, 2001). The summit title, "BSEC Economic Agenda For The Future: Towards A More Consolidated, Effective and Viable Partnership" demonstrated the intent of this newfound cooperation. The summit was hosted by Russia, though curiously there was no statements on oil and gas, other than through peripheral sectors such as transportation and electricity. As the summit was relatively early in Putin's tenure, the full intent of the Kremlin's consolidation of the energy sector was not apparent.

#### Baky Summit Declaration, September 19, 2003<sup>163</sup>

Two years after the Moscow foreign minister's summit, the BSEC energy ministers met in Baku in September 2003 to establish the precedent for future cooperation. Azerbaijan was the driving force behind this and had the most to gain from deeper and comprehensive coordination, particularly with the growing interest and demand from Europe. Hence Baky emphasized the Black Sea's strategic location and BSEC's inherent responsibility as a "bridging role" between Europe, Asia and the Middle East, in support of European energy demands, notably the "interconnecting oil and gas pipeline networks"<sup>164</sup> (BSEC (10), Baky Declaration 2003). Finally, there was the goal of electricity integration and the desire of some member states to join the European standard Union for the Co-ordination of Transmission of Electricity (UCTE) as an alternative to the Soviet era Unified Power System (UPS) and Integrated Power System (IPS) or UPS/IPS electricity standard still in use in the FSU. UCTE co-ordinates the activities of 22 European TSOs, servicing about 450 million people with an annual consumption of 2,300 TWh. Its objective is to ensure the synchronous operational security of the interconnected power system. UCTE has created rules which provide the basis for a reliable power system, and member cooperation is vital to allow efficient interconnected operation.

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<sup>163</sup> The declaration uses the Azeri spelling for Baku.

<sup>164</sup> Other goals discussed within the Baky framework were energy information exchange by involving BSEC-related institutions and sharing energy sector best practices (BSEC (12), Baky Declaration 2003).

This was an early demonstration of Azerbaijan's growing regional clout. The post-summit declaration referenced the importance of energy in developing "cooperation and integration" in the Black Sea RSC, and the significant role of energy in member states' development. The declaration also affirmed the role of the Energy Charter as a means to "strengthen the rule of law on energy-related issues" through free market principles and diversified sources and transit (BSEC, (11) Baky Declaration 2003). On paper the Baky Declaration was impressive in scope and ambitions; perhaps too ambitious, considering the organizational challenges and limited chance that these efforts would come to fruition any time soon. Nevertheless, Baky was the template for future BSEC dialogue, and it did lay out the organization's comprehensive and long-term goals to support the integration of the region's energy sector.

#### Istanbul Energy Working Group Meeting of June 1-2, 2004

Less than a year after Baky, the BSEC energy working group met in Istanbul where it developed a list of strategic objectives, primarily focusing on the regional harmonization of the oil, gas and electricity markets. The summit was influenced by the Athens Process already underway to create coherent electricity and gas markets in South East Europe. Istanbul-2004 demonstrated Turkish influence in the agenda, notably the bypass issue which figured prominently in Ankara's energy posture. The Istanbul Summit, in particular, also addressed the environmental and public safety risks from shipping "oil and other hazardous cargo" through the Turkish Straits. What resulted was a list of proposed bypasses; Bourgas-Alexandroupolis, Bourgas-Vlore, Constanta-Trieste, Kiyikoy-Ibrikbaba,<sup>165</sup> Odessa-Brody and Samsun-Ceyhan (BSEC (13), As found in Roberts 2007: 48, 105-106). BSEC was not in a position to choose a bypass location, though it did have the capacity to influence cooperation on the legal, regulatory and technical issues.

Roberts claimed there was "considerable room for cooperation" between the BSEC states regarding a bypass, however:

"...so long as some tanker operators continue to dispatch their vessels through the Straits for free, whilst others rely on a bypass, those using the Straits will have a significant price advantage of perhaps 50 cents per barrel on a year-round basis" (Roberts 2007: 49).

Roberts also noted this competitive disadvantage can be overcome by governments simply directing oil companies to use particular lines, or for operators to split their cargoes between the Straits or another route, as suggested by the Turkish government in its proposed 'voluntary principles' of 2004 (Roberts 2007: 49). Yet the question still remains, and Roberts does not address it; if utilizing the Turkish Straits, BTC or Russia's Eastern European network is a voluntary process, how can or should this be mandated when the bypass puts the user at a competitive disadvantage to non-users?

Istanbul, like Baky before it, was broad in scope and ambitious in its goals. And though it provided a forum to discuss these issues, it ultimately fell flat, as the political hurdles were far too high and numerous. Of potential by-pass routes, only the troubled Odessa-Brody ever

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<sup>165</sup> The little-known Kiyikoy-Ibrikbaba oil pipeline was to be an all-Turkish pipeline from Kiyikoy on the Black Sea coast to Ibrikbaba on the Saronac Gulf near the Greek border. As this pipeline was to traverse a Turkish national park and threaten a coral reef, it was vigorously opposed by environmentalists. This opposition prompted the prime contractor, Transneft, to pull out of the project in 2005 (Oil and Gas Articles.com, January 9, 2006).

materialized. BTC, which was not under consideration at Istanbul, is in effect the only true regional bypass.

#### The Alexandropolous Energy Summit, March 4, 2005

In March 2004 at the Alexandropolous energy summit, Greece promoted itself as a regional hub, particularly with its influence as the only EU member in the prospect of a newly forming energy market. The Athens Process was already widely discussed within BSEC, and was formally referenced at Alexandropolous. In fact, the most notable event of the summit was the signal that BSEC was adopting the provisions of the Energy Community, whereby the members agreed to implement the EU's energy acquis and liberalize the gas and electricity sectors. In 2002 the BSEC created a working group dedicated to the Athens Process and the implementation of its provisions (Roberts 2007: 24-26). Again, BSEC had no real authority to sign the Energy Community, a right reserved for the sovereign member states, however, it did provide a venue for discussion and possible coordination (BSEC (14), "Alexandroupolis Declaration," March 4, 2005).

#### BSEC: Sochi Energy Summit, September 27, 2006

The year 2006 proved to be a decisive one for Putin, and by extension, Russia's energy sector. Gazprom's power and influence was on the ascent, and in January of that year, the first of the gas crises with Ukraine broke. The 2006 crisis was seen as a Russian geopolitical victory and demonstrated Moscow's hold over the West, which was manifest at the June 2006 G-8 Summit in St. Petersburg, Russia. Russia was able to control the summit's agenda and pursued an energy-centric retinue of issues. The summit was concluded with an Energy Action Plan which acknowledged the rights of energy consumers as well as producers. As Roberts noted the G-8 Energy Action Plan derived from St. Petersburg was a firm, yet "non-contentious" framework for energy cooperation (Roberts 2007: 53).

Several months later at Sochi, Russia was hoping to push further on the heels of St. Petersburg. Indeed, Russia, via BSEC, saw the G-8 plan as a focal point and a clearly defined course of action which could be applied to its own acquis. The BSEC members took consideration of the Action Plan and explored the means of implementing it. Specifically, the Action Plan provided BSEC with several substantive areas on which to focus, such as cooperation in energy regulatory regimes, as well as reducing barriers to investment and trade and workforce training (BSEC (15), Sochi 2006; G-8 Declaration 2006, paragraphs 9, 13, 14, 17). The progress of St. Petersburg and Sochi were soon dashed by continued displays of Russian resource nationalism, notably the 2008 war, the 2009 gas crisis and the realization that the EU and Russia were progressing down opposite paths.

#### "Declaration on Cooperation with the EU in the Field of Energy," Kiev, Ukraine, April 9, 2008.

The April 2008 summit in Kiev was dedicated exclusively to EU-BSEC energy cooperation, in which the declaration noted Brussels' "significant role" as a regional stakeholder. To support the BSEC efforts, the declaration advocated harmonization with the EU energy acquis to include information exchanges, sharing best practices, and joint training programs. There was

acknowledgement of the value of NGOs, international organizations and the private sector, such as the UN Economic Commission on Europe (UNECE), the Energy Charter, and the IEA. There was also reference to exploring “A Joint BSEC-EU Action Plan” which would establish closer energy relations between the EU and BSEC, though this has never materialized (BSEC (16), April 9, 2008). In the case of the Kiev Summit, Ukraine pushed for enhanced EU relations in the post-2006 crisis environment, however, much of the opposition, or lack of enthusiasm, came from the EU, which was reticent in getting too heavily involved in a friendly, though unstable, Yushenko regime.

#### Rhodes Energy Summit October 7, 2010.

In 2010 Turkey joined Greece to jointly promote the Green Energy Task Force, whereby in October of that year, in Rhodes, there was discussion of a “Joint Action Plan on Regional Energy Security,” with emphasis on “Green Energy” cooperation. In recent summits BSEC has placed an emphasis on developing a regional energy market, as well as shifting toward an environmentally focused agenda (BSEC (17), October 7, 2010). It is these two themes which predominate contemporary BSEC energy discourse. Focusing on BSEC’s niche in environment and renewable projects, in 2012 a Green Energy Task Force was initiated under Turkey’s Presidency. This emphasis on environmental efforts appears to be an attempt to join the green bandwagon as a means of maintaining legitimacy and staying in favor with the EU and its own ambitious efforts in the field. To support this focus, the ICBSS also began producing more reports and analyses addressing environmental topics.

#### Black Sea Electricity Integration

Electricity is rightly seen as an enabler of national stability and prosperity, and the Black Sea Electricity Ring is a project gaining interest in the region. Though BSEC is not directly involved in determining the best route, standards or tariffs, the Ring has been a topic of discussion at recent energy summits. Also, of note is the ability of the FSU and client states to migrate to the UCTE from the IPS/UPS; a transition viewed as shedding their communist past and embracing the new possibilities available under Western alignment. A 2008 feasibility study noted that while large-scale synchronous interconnection between standards was technically possible, it would be a challenging proposition requiring additional study and coordination (ENTSO-E, “Feasibility Study: Synchronous Interconnection of the Power Systems of IPS/UPS with UCTE,” April 2008).

Much of the concern centered on intra-regional coordination in the event of a large-scale emergency. BSEC has helped develop a framework within which utility companies and governments can meet, though it remains to be seen how successful this effort will be going forward in light of the East-West standoff over Ukraine and Crimea. This is an important issue to the Black Sea RSC members, though BSEC appears to be standing on the sidelines while the Energy Community and the member states address this issue bi-laterally or multi-laterally outside the Organization.

#### The Turkish BSEC Chairmanship July-December 2012

As the founding state and primary advocate, Turkey plays the most aggressive role in the organization. It was during the 2012 Turkish Chairmanship that Ankara, via BSEC, pushed a range of ambitious projects, designed for closer relations with the EU. This was to be an important period both for Turkey and BSEC; the 20<sup>th</sup> anniversary fell during this chairmanship, and Ankara was anxious to demonstrate its, and the organization's, relevancy. The theme was entitled, "From Regional Cooperation to a Zone of Prosperity in the Black Sea Area." Turkey was behind the November 2012 conference on tax harmonization, as well as efforts to push the Motorway of the Seas initiative. These two efforts would have long-term benefits of enhancing transportation and harmonizing commercial activity within the Black Sea RSC, with direct impact on trade in hydrocarbons. However, these are complex and politically contentious issues, and while Turkey should be commended for broaching these topics, they fell flat without any appreciable progress. Subsequent chairs have lacked similar levels of enthusiasm; Ukraine was preoccupied with its existential crises with Russia, while the others, Armenia and Azerbaijan, lacked the relative weight or interest to keep up the momentum (Black Sea News, No. 26, December 2012; Uluslararası Politika Akademisi 2013).

Quite naturally, the member states will emphasize policies which promote their best interests; the most impactful addressing energy or related projects. Considering these energy summits in context, it is possible to see the broader regional dynamics at play. Turkey is, and has always been, the organizational leader within BSEC and it has been able to coerce the other members. Moreover, Turkey sees itself as the state fulfilling a long-denied role as regional leader and will continue in this role. Russia, which early on, felt it could shape the dialogue and agendas, particularly between 1998 and 2008, has backed away and lost interest. Now that Russia and Turkey have reached a tentative agreement on future energy cooperation via Turk Stream, there may be renewed interest from Moscow. Azerbaijan and its newfound influence as a regional bankroll continues to punch above its weight at the summits. This will continue as Baku attempts to diversify its economy in anticipation of the inevitable time when its wells run dry.

BSEC has been an open and transparent forum for discussion as well as a venue for ground-level interaction, providing small, discrete, and clearly identified projects. Moreover, despite long-term animosities and ongoing regional conflicts, the Organization expanded in membership and scope (Aydin 2009: 278). Early in its existence, BSEC proved valuable in bridging many of the Cold War-era barriers allowing EU and NATO states to interact with former Soviet republics and Warsaw Pact members in a neutral setting (Sayan: 2005: 335). This geopolitical discourse has been invaluable, and though there are other regionally-based organizations which facilitate this interaction, none has the relative breadth and organizational structure. Therefore, it can be claimed its main contribution has been to help solidify the Black Sea RSC's position as a regional entity with potential global impact.

There are specific areas where BSEC has contributed:

- 1) Its established structures and procedures allow it to address regional issues in a multilateral format, while recent improvements in transparency and accountability, have enhanced the effectiveness of events and activities. For instance, over the years;

"The bureaucratic routines are well established, meetings are held, for the most part, on schedule, reports are delivered, the archives are in order" (Celac, November 2011).

2. It is inclusive, comprising countries with traditional cultural and social links to the Black Sea. to include varying degrees of military power, levels of socio-economic development, systems of governance, maturity of democratic institutions, and sophistication of business culture or civil society

3. BSEC incorporates a diverse agenda; its organs include parliamentary, business, academic, science and technology initiatives and non-governmental dimensions, addressing a range of networks, partnerships and membership base (Celac, November 2011).

This was clearly noted as early as 2005 when Mustafa Aydin referred to BSEC as a “side-effect of European integration” (Aydin 2005: 59). It can be stated the Black Sea RSC exerts a much weaker and inward focus that is overshadowed by the EU. It also becomes clear the internal drivers are merely extensions of the external (EU) drivers which permit a dispersal of power to the Black Sea states. For instance, each energy initiative pursued within the BSEC are traced to an external origin, notably the EU. Therefore, the source of transitional change emanates primarily from outside via Brussels, so it can be said that, in RSCT parlance, the EU clearly penetrates the Black Sea RSC. This merely reaffirms BSEC’s position as an organizing element and a facilitator, but not a driving force; underscoring its inability to lead events but react to them.

It is also important to consider the organization’s internal fissures. Because of its strength as an oil and gas supplier, Russia is able to manipulate the BSEC energy agenda, and by extension, the organization itself. Furthermore, Azerbaijan is also positioning itself as a regional energy power, and most of this posturing is conducted outside the BSEC, as noted by the Azerbaijan-EU Declaration of January 13, 2011, which recognized Azerbaijan as the product source of the Southern Gas Corridor (Europa, (8) “Joint Declaration on the Southern Gas Corridor,” January 13, 2011). As Turkey shifts to the east and becomes even more distant from the EU’s basic governing principles, it is possible that this role as the defacto BSEC leader could make Ankara and BSEC less relevant.

By reviewing the website and the various reports contained within, it is hard not to see an organization adrift; there are old or broken links and many pages are out of date, indicating a breakdown in organizational structure and reduced operating revenues. The members do not have the economic base of the EU, resulting in funding shortfalls necessary to maintain forward momentum. The Commission on the Black Sea makes some sharp points:

“In spite of permanent structures such as a secretariat, a development bank, a parliamentary assembly, a business council, a think tank and thematic working groups, it [BSEC] suffers from a number of deficiencies such as slow decision-making, a shortage of funds, a lack of qualified expert staff and the limited participation of private sector and civil society actors” (Bertelsmann Stiftung, Commission of the Black Sea, 2010: 36).

BSEC exists uneasily under Brussels’ and Moscow’s shadow, and its long-term future is unclear. Perhaps most importantly, BSEC has never exploited its strengths, notably its geography, to position itself as an indispensable partner to the EU. Ultimately, it is a product of its political,

economic and social environment, suffering from mistrust, fragmentation and widely varying goals and capabilities of its members.

Mariana Semenyshyn notes:

“...the strictly intergovernmental nature of the Organization leaves no room for the development of the ‘Black Sea civil society’ and bottom-up initiatives within the BSEC which could smooth an uneasy process of mutual understanding and contribute to the fostering of the Black Sea’s ‘regionness’ (Semenyshyn 2014: 19).

It is precisely these missing bottom-up initiatives which prevent serious cohesion at the regional level. Moreover, this Turkic-centricity may be a problem in coming years as Ankara drifts further away and the other members demonstrate unease in this transition.

Because of its fragmented structure, trying to determine BSECs’ impact as a transformational force is difficult. The BSEC states lack the institutional background or experience in transparent government and accepted standards of accountability. Additionally, it is the internal disunion, stemming from endemic insecurity, combined with unclear EU regional policy, that has resulted in limited efficiency and effectiveness. BSEC has been unable to define and implement its long-term plans, resulting in the organization’s difficulty looking beyond its immediate horizon of 5-10 years. In August 2008, when two member states, Russian and Georgia, became belligerents, BSEC was powerless, and had to rely on external (US and EU) intervention. The same currently holds true for Crimea and eastern Ukraine.

Finally, there is the theme of energy as a transformational force. BSEC’s interest in oil and gas production and transportation, as well as its role in the electricity and environmental sectors, has motivated it to marshal political support in these fields. These can be identified as: 1) energy transit, such as pipelines and electricity interconnection, to include the Bosphorous bypass, 2) support to the Energy Community in market liberalization, and 3) general organizational discussions, such as multilateral coordination. Yet, two of the more significant initiatives, the G-8 Energy Plan of Action and the Energy Community, did not originate within BSEC, though the organization has been able to craft its support around them.

It is safe to say that but for Europe’s energy demand, BSEC would not exist, except perhaps as a loosely based trade organization. One way of considering the external influence on the Black Sea RSC is the BSEC states enacted energy *acquis communautaire* to accommodate EU regulations, which point to a long-term European influence. Through a combination of bilateral and multilateral engagement with the Black Sea RSC, the most important being the bilateral relationship with EU. It is through these networks which foster regional commercial cooperation to attract EU and other foreign investment (European Commission, (29) November 14, 1997; Tsardanidis 2005: 383-385).

The BSEC has been criticized for its failure to live up to initial expectations, and its demise is often claimed as imminent (Jenkins 2008). Whether these accusations of ineffectiveness are accurate is not fully relevant; what is most instructive about the organization, given the lack of any regional precedent and the area’s storied history of violent conflict, is the BSEC’s very



existence can be viewed as a geopolitical and diplomatic triumph. Yet, when looking at BSEC's ability to answer the research questions, the results are negligible; as the defacto Black Sea RSC, BSEC is finding it impossible to affect change from purely internal means. This also demonstrates the limits to institutional regionalism when clear mandate is lacking from the members. Despite the organizational improvements of the late 1990s, the mechanisms are still weak and underdeveloped. Even when allied with EU efforts, the BSEC is a marginal player. Looking deeper into the EU-BSEC energy dynamic, notably the Kiev Summit, the EU is viewed as BSEC's reluctant partner; on one hand anxious for the region's energy and stability, though unwilling to be too closely intertwined within the BSEC apparatus. In the final analysis, BSEC fills two role; a weak defacto Black Sea RSC structure and Ankara's proxy. Both points explain Brussels' reluctance to engage too closely.

## **Chapter 6. The Case Studies: Public Private Partnerships and the Grass Roots Dynamics of Energy in the Black Sea Regional Security Complex**

This chapter closes the circle which began with the initial discussion of Buzan and Wæver's regional security complexes outlined in "Regions and Powers," whereby the post-Cold War global order is in the process of being defined by regional entities. Moreover, these regions are identified by their internal and external interactions which present these unique geographic entities. While the Buzan and Wæver model has provided the primary theoretical foundation of this paper, a secondary theme that was also introduced earlier, that of Haasian neo-functionalism, has been woven throughout this text. Again, neo-functionalism is identified by spillover, which demonstrates how regional integration can be affected by gradually overlapping functional and political areas.

These blended functional areas are further embellished by the more modern integration theories espoused by Ladrech and Manners, Europeanization and the Euro Norms respectively. This is where uniquely European political, cultural and social norms are shared and act as binding mechanisms for the member states. Moreover, while Ladrech and Manners may have become the heirs to Haas in the European regional analysis realm, they are also mutually complementary. In fact, these theories, Buzan and Wæver included, come together to provide a powerful and comprehensive lens with which to view the Black Sea RSC and offer feasible explanations for the transformational process underway.

While these models operate in conjunction to establish the rich theoretical framework as noted in the early parts of this work, Chapter 6, through the case studies, will apply the substantive material in its natural environment. Moreover, this theoretical framework, much like a building or other physical structure, provides the foundation upon which the remaining portion of this structure is developed; in this case with the help of the substantive material. Up to now this paper has centered on the broad-based organizational and geopolitical structures which enable energy interaction within the Black Sea RSC. Though these structures have created a legal and commercial environment for interaction, there has been little analysis of the actual mechanisms, particularly in how they shape the discussion of the research question. The purpose behind the case studies is to identify and analyze the transformational sparks within the discrete public-private initiatives that engender cross-border cooperation with an energy sector context.

The case studies are a culmination of Chapters 1 through 5, and build on this progressively expanding foundation. As the argument for the existence of a unique Black Sea RSC was made in the course of this work, it in effect validates the Buzan and Wæver blend of neo-realism and constructivism via the presence of amity and enmity. The other theoreticians identified earlier, notably beginning with the discussion of regionalism, the state narratives, the regional energy environment and the drivers of change, fill out the first five chapters and provide their unique structure. What is evident in Chapter 6 is the research question displayed in its most basic form; as a ground-level manifestation of energy's transformational dynamics.

The first two of the three case studies mirror and expand upon on the already identified drivers. Focusing first on the external drivers, the Energy Community is an EU-centric example of legislative interaction, paramount in its ability to transcend boundaries of EU and non-EU

members alike. Secondly, the internal drivers concentrate on the financial perspective, notably the BSEC's BSTDB and targeted investment in energy-based small to medium enterprises (SME). Finally, in the third case study there is the example of BP's experience in Azerbaijan, which requires closer examination of a Western private sector play and its potential geographical and social influence in the region at large.

The case studies are perhaps a manifestation of East-West soft power interaction underway today in the Black Sea RSC, whereby the inherent influence of energy as a transformational force is crafted as broader policy initiatives. Moreover, they provide a real-world laboratory to analyze the transformational drivers, in which their value is to identify clear themes and trends which address the research question. Europeanization and the transposition of Euro Norms to the Black Sea RSC via the energy sector is a dominant component of the research question, and in all three cases, as will be demonstrated, public-private partnerships are key facilitators of transformation at the ground level. Additionally, the case studies will point to a relatively new phenomenon in the Black Sea RSC, the role of the private sector in the regional development process, whereby the case studies exemplify the free market energy environment; or quasi-free market in the case of Azerbaijan.

A point that has only recently been touched upon is the value of secondary energy; more specifically electric power as a commodity capable of creating "coherent and convergent" regional market forces and cross-border interaction. In fact, secondary energy is an important aspect of the EU's energy acquis, as well as BSEC's effort to derive a unified energy market in the Black Sea RSC. This emphasis on electricity is relevant to the discussion of the Energy Community as this sector figures prominently in its creation.

The BTSD also concentrates some of its activities in the power sector, therefore, electricity harmonization becomes another element in the energy-centric laboratory which analyzes cross-border relations and Europeanization spillover outside the EU Member States. This also demonstrates the ability of public-private partnerships and cross-border institutions to engender transformational change via the electricity sector. Whether derived from nuclear, hydro or renewable sources, secondary energy, when combined with hydrocarbons, completes the full energy picture of the Black Sea RSC. Therefore, it is in Chapter 6 where all these energy attributes are pulled together via the case studies.

### **Case Study Number 1: The Energy Community and Market Liberalization**

As a reminder, the Energy Community was a European Commission effort to promote energy liberalization in South East Europe through service unbundling, market transparency and third party transit. It comprises Albania, Bosnia and Herzegovina, Georgia, Kosovo, Macedonia, Montenegro, Serbia and Ukraine. The Energy Community was chosen for deeper analysis because it exemplifies the EU's conditionality in action against a highly centralized, uncompetitive and opaque energy environment, exacerbated by traditionally poor and inefficient inter-state connections. Though designed for South East Europe (or predominantly Balkan), the Energy Community is equally relevant for a Black Sea RSC. Particularly, as an EU accession tool, it directly impacts non-EU states within the RSC, such as Georgia, Moldova and Ukraine.

Under the Athens Treaty, the Contracting Parties are legally bound to enact the relevant aspects of the EU's energy *acquis communautaire*. This establishes regulatory structures, and liberalized energy markets, with the goal of creating a balance between energy supply and demand as the foundation of a functioning market. Such a foundation is based on the Contracting Parties' adapting "legislation and regulation to EU norms and practices" to attract investments and ensure market harmonization and liquidity (Energy Community, (9) website, date accessed June 8, 2014; Energy Community, (10) 2013: 3, 16-18).

The Energy Community primarily addresses the electricity and gas sectors, the highest priorities for market liberalization, and the sectors with the greatest potential impact. Perhaps most importantly, it was conceived as a "pre-accession instrument," a pathway to membership for South East Europe, and in doing so, it has arguably become one of the more successful elements of the ENP. The unique aspects of the Energy Community is that membership is contingent on applying the EU's energy *acquis* within the Contracting Parties' own legislative record, despite the fact that none are EU members and few have a chance of acceding any time soon, if ever. As will be demonstrated, there are challenges with the process, compounded by the lack of democratic and free market experience in these countries, as well as the EU's own poor example of implementing the energy *acquis* within their own sectors, factors which have reduced the Energy Community's own effectiveness.

The Energy Community is headed by a Ministerial Council, which functions as the executive and primary decision-making organ. It meets once a year and consists of a representative of each Contracting Party and two representatives of the European Commission. Additionally, the Council's duties include casting votes to implement specific *acquis*, create a task force, or approve the organization's budget. The Council also decides on the accession of new members or observer states. The Ministerial Council's presidency drives the agenda, and which is rotated on a 12-month term on an alphabetical basis (Energy Community, (11) website, date accessed May 12, 2014).

The Permanent High Level Group (PHLG) prepares the work of the Ministerial Council, interacts with donor organizations and reports to the Council on progress implementing Treaty objectives. It meets four times a year and comprises one member from each of the Contracting Parties and two representatives from the European Commission. The Secretariat is the Energy Community's permanent body managed by a full-time professional staff. Seated in Vienna, it provides administrative support to the Ministerial Council, the PHLG, and other Community organizations. It also produces the Community's budget and submits annual progress reports to the Council.<sup>166</sup> Furthermore, it coordinates with the European Commission, and performs other Treaty-related tasks handed down by the Ministerial Council (Energy Community, (12) website, date accessed May 12, 2014; European Commission, (30) Report to Parliament and the Council 2011: 4).

The Energy Community Regulatory Board (ECRB) provides the ground-level coordination and cross-border codes or rules adjudication. The ECRB interfaces with the national regulatory bodies to develop a regional energy environment, via competitive electricity and gas markets and

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<sup>166</sup> The Energy Community's 2013 budget was 3.3 million Euro, of which 95.4 percent was provided by the EU. The next largest contributor was Ukraine with 3.9 percent of the total (KPMG Austria AG, Annex 1/14, 2014).

regional integration. The Board concentrates on three components; an independent regulatory vehicle, sharing best practices within the Community and harmonizing regulations through the elimination of internal barriers. At the start of each calendar year it produces an annual work program, which identifies key efforts to be accomplished and is then concluded with an annual report. One of the more interesting documents is the yearly Implementation Report which tracks progress in the Community's rollout of the *acquis* and other goals for the preceding year. The Energy Community Forum, chaired by a member of the European Commission, brings together industry representatives, academia and consumer groups dedicated to electricity, gas, oil and social issues. Forum conclusions are adopted by consensus and are forwarded to the PHLG (Energy Community, (13) Regulatory Board, April 2015; Energy Community, (14) website, date accessed May 12, 2014).

In recent years, the Energy Community's evolution has advanced in parallel with the EU's own energy *acquis*. For instance, EU legislation, notably the Third Energy Package and the Renewables and Emergency Oil Stocks Directives, were subsequently incorporated by the Ministerial Council into the Energy Community's own *acquis*.<sup>167</sup> This also applies to the provisions of the EEU which was launched earlier in 2015. Other legislation still under consideration within the EU, will eventually be adopted by the Energy Community. Without these guidelines and their implementation, the Secretariat states, "...the commitments made amount to little more than lip service" (Energy Community, (15) 2013: 10).

### The Electricity Sector

The generally disjointed and heterogeneous electricity market in South East Europe and the Black Sea RSC, is emblematic of extreme inefficiencies and poor intra-national coordination, all exacerbated by entrenched state-level central planning. This lack of cross-border electricity trading is the result of multiple international borders, opaque management, weak transmission interconnection capacity compounded by fragmented or non-existent trans-border wholesale auction mechanisms. As the Energy Community was created to organize South East Europe's electricity market, this sector is the benchmark for regional market development against which all the other economic sectors are measured (Energy Community, (16) 2013: 3, 11-12, 16-18).

To better integrate in the EU's electricity markets, the 8th Electricity Region was created.<sup>168</sup> This region, which encompasses the Contracting Parties and several South East European EU member states, was named in numerical succession with the EU's existing seven electricity regions. The goal is to harmonize EU activities and incorporate non-EU members with differing standards into a coordinated market<sup>169</sup> (Energy Community, (17) Regulatory Board, "8<sup>th</sup> Region Report, Q4/2014-Q1/2015," April 2015; Energy Community, (18) 2013: 179; Energy Community, (19)

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<sup>167</sup> The Emergency Oil Stocks Directives (2009/119/EC) stipulates the quantities each Member State should hold in emergency stocks (Energy Community, (20) 2013: 10).

<sup>168</sup> The South East European Regional Action Plan (SEE-RAP) details the process for market integration within the 8th Region, which is based on the European electricity model of four cross-regional goals: 1) capacity calculation, 2) long term capacity allocation, 3) day ahead capacity allocation, 4) and mechanisms for cross border intraday trading (Energy Community, (21) Regional Action Plan 2011; 4-5; Energy Community, (22) Annual Implementation Report 2013: 4).

<sup>169</sup> The EU's Regional Initiatives is a template which establishes the seven European electricity regions into a single market.

website, date accessed May 26, 2014). The decision to incorporate the Third Energy Package's electricity acquis was made by the Ministerial Council on October 2011, with a transposition deadline of January 1, 2015. Moreover, EU regulatory mechanisms integral to the broader European electricity system are also being implemented by the ECRB, with oversight falling to the ENTSO-E regime.<sup>170</sup>

Within the Contracting Parties, there is the existence of vertically integrated state-owned companies, which most national oversight bodies are unwilling to challenge. This results in a cozy relationship between supplier and trader, all of which stifles competition and entrepreneurial incentives. The Contracting Parties, less new members Moldova and Ukraine, are required to open their markets by 2015, however this has failed to materialize as many electricity wholesalers are still subsidized, impacting regional integration and widening the gap between the Energy Community and the EU wholesale markets. Going forward, the continued failure to break these subsidies will have negative consequences for prices, investments and the security of supply in the Energy Community, let alone the implications to the region's broader political, social and economic development (Energy Community, (23) 2013: 10-11).

Finally, there is the interconnection between UCTE and IPS/UPS standards. As the EU standard, UCTE is viewed as promoting closer integration with Brussels, whereby new members are encouraged to convert to UCTE, a challenging and expensive process that is difficult to accomplish without direct support from Brussels. This is particularly so considering the technical and operational standards which faces compatibility issues, notably load balancing as well as legal and regulatory challenges.

### The Natural Gas Sector

Within the Energy Community the natural gas acquis applies only to transportation and downstream markets, excluding exploration and production. As with electricity, the gas market operates in a complex and frequently counterproductive environment of excessive subsidization and state interference, compounded by the reliance on a single primary source of imports (Russia) which limits market competition and consumer choice. There is some source diversification on the horizon, notably from TAP which will spawn connector links, such as the Gas Ring, into South East Europe and theoretically weaken dependence on Russia. Also, the recent trend in Ukraine to source gas imports through reverse flow projects indicates an attempt at diversification. This is being done via Slovakia and Poland, though not enough to meet all of Ukraine's needs. In September 2014, Russia claimed these deliveries were redirected Russian gas which violated the contracts' destination clauses. Gazprom then cut gas deliveries to Poland and Slovakia, effectively ratcheting up the pressure on these countries, as well as Ukraine and the EU (Carney October 1, 2014).

Similar to the electricity sector, the gas acquis outlines improved access to the natural gas network, third-party access, transparency, balancing rules, and guidelines for capacity allocation and congestion management<sup>171</sup> (Energy Community, (24) 2013: 7, 11; Stafford, *Europolitics*,

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<sup>170</sup> The newest members, Moldova and Ukraine, are in the initial stages of integration.

<sup>171</sup> A function of the spot market, balancing is an important element to creating a fluid and competitive market. It is the apportion and management of gas sales by multiple providers over shared or third-party natural gas facilities. A

May 13, 2014). As gas will play an increased role in meeting long-term electricity demand, its security of supply and the equitable distribution depends largely on market reforms, infrastructure investment and access to reliable and diverse sources. The Secretariat participates in the EU's Gas Coordination Group, thus acting as a bridge between the Commission and the Energy Community. Moreover, the ENTSO-G, as with its electricity counterpart ENTSO-E, is a stakeholder in the Energy Community's regulatory regime, dedicated to implementing a regional gas market under the Third Package's provisions.

The Gas Ring concept is an example of a Community supported regional effort. When completed, it will connect the seven current Contracting Parties via regional pipelines, LNG terminals and storage facilities, as well as tying in former Contracting members, Bulgaria and Romania (Energy Community, (25) website, date accessed May 26, 2014). It is anticipated the Gas Ring will enhance competition, market development and strengthen security of supply, aided by TAP's ability to transport Shah Deniz gas via the Southern Gas Corridor (Energy Community, (26) 2013: 11; Giamouridis, Anastasios and Spiros Paleoyannis, July 2011: 85; Thomadakis, Michael 2010:5). Yet, the full success of the Gas Ring and other connector pipelines is dependent on the ability to source gas from suppliers in addition to Azerbaijan, as Shah Deniz gas will not be sufficient.

The fragmented infrastructure and poor interconnections between the Contracting Parties is an obstacle to the creation of a regional market. With the missed January 1, 2015 deadline for transposing and implementing the Third Package, the status of the gas sector's unbundling effort "remains critical," while some Contracting Parties "achieved no progress in this respect" (Energy Community, (27) 2013: 89). As with electricity, there has been difficulty liberalizing the wholesale gas markets, which is hampered by preferential pipeline access and state interference, notably state-owned companies which deny consumer choice and market fluidity (Energy Community, (28) 2013: 11; Frisch 2003). The indication being there is no real consequence for missed deadlines and failure to unbundle energy infrastructure other than to 'name and shame.'

### The Oil Sector

Unlike the electricity and gas sectors, the global petroleum market is already integrated and largely liberalized, so needed legislative reforms are minimal. In fact, the Community's oil markets are relatively open and new suppliers can enter the market and access transmission networks and storage facilities. There is a high dependency on oil imports within the Energy Community, compounded by limited interconnections between members and insufficient storage facilities, inhibiting market stability and emergency response (Energy Community, (29) 2013: 11, 130).

It is oil and petroleum storage with the most potential for implementing market efficiencies and energy security among the Contracting Parties, issues which are addressed in the oil acquis. In October 2012 the Energy Community adopted European Commission Directive 2009/119/EC and IEA oil storage standards with an implementation deadline of January 1, 2023. The Commission directive requires a 90-day stock of crude oil and/or petroleum products, which

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gas-balancing agreement addresses production imbalances from a gas well or field, which is reconciled through cash reimbursement or in-kind payment (USLegal.com, date accessed August 10, 2014).

amounts to 13 mbls within the Energy Charter states, of which the current storage capacity is 5 mbls, much of which is operational storage at refineries; far short needed for compliance. To build this capacity for another 8 mbls will cost an estimated \$3.9 billion and another \$6.4 billion to purchase the oil and petroleum at 2013 prices (Energy Community, (30) 2013: 11). Moreover, the Contracting Parties do not have contingency plans in the event of a significant supply disruption, while some have failed to fully transpose the Directive into law.

The Secretariat suggests that each Contracting Party establish an oversight entity responsible for national oil stocks and to liaise with the Secretariat on oil supply emergency issues. In fact, one solution under discussion is a regional approach to pooling oil and refined products in such cases. Finally, the Secretariat has produced guidelines to transpose Directive 2009/119/EC, to include legislation for emergency response systems, an oil stockholding strategy, and the creation of regional central stockholding entity. The Secretariat will help organize and manage this framework, which include cooperation efforts for a regional approach to joint stock holding agreements and coordinated stock draw (Energy Community, (31) Implementation Report 2013: 11).

### Renewable Energy

As one of the components of the EU's energy policy, renewable energy has also been embraced by the Energy Community with the 2012 adoption of the "20-20-20" guidelines.<sup>172</sup> The Energy Community is actually in position to achieve some of these goals with the greatest potential from biomass and hydro projects, the latter a benefit derived from the numerous rivers in the region. Also, by accepting the European Commission's 2020 targets the Contracting Parties are allowed to participate in collaborative efforts with the EU, such as electricity transfers or other schemes to meet broader renewable goals. Energy audits are conducted every two years to ensure progress is being made (Energy Community, (32) 2013: 11, 138).

The secretariat is now grappling with the EEU provisions and how these are to be implemented among the contracting parties. Problems still exist establishing a coherent regional renewable energy program, as most of the Contracting Parties failed to submit National Renewable Action Plans (NREAP) to the Secretariat by the June 30, 2013 deadline. The NREAP outlines the policies establishing the framework to the consumers, investors and other stakeholders to encourage investment in renewable energy market. Though all Contracting Parties have established legal and regulatory frameworks for renewables, few projects have become operational, attributable to a weak enforcement framework (Energy Community, (33) 2013: 140).

### The Horizontal Policies

The Energy Community's so-called 'horizontal' policies are those which fall outside the management of direct energy production, such as energy efficiency, competition and state aid, as well as statistics and social issues. Though perhaps not as compelling or interesting when

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<sup>172</sup> Decision 2012/04/MC-EnC. "Renewable Energy Directive: On the Promotion of the Use of Energy from Renewable Sources." In April 2009, the Commission released Directive 2009/28/EC, which codified the "20-20-20" provisions.



compared to sector-specific reform obligations of electricity, gas or petroleum, these policies and their implementation are vital to reform the regional energy market (Energy Community, (34) 2013: 12). The value of the horizontal policies is that taken within the full context of the electricity, gas, oil and renewable policies, it demonstrates the breadth and scope of the Energy Community and its mandate to enact change.

### *State Aid and Competition*

Theoretically, competition authorities can impose fines and “behavioral or structural remedies,” to pry open markets to new investors, dismantle monopolies and weaken state intervention. The reality is that stifled competition exists despite the Energy Community’s competitive provisions, and lack of enforcement has resulted in ineffective and inconsistent application of competition and state aid laws. Without any investigative or adjudicative mechanisms, the Secretariat is limited to merely an oversight role which addresses legislative loopholes and monitoring the transposition of the acquis. The Treaty provides no equivalent enforcement or monitoring body similar to the European Commission, so it is up to each Contracting Party to ensure effective state aid control and oversight. Few Contracting Parties have performed sector inquiries or specific investigations of the electricity and/or gas markets, and few of the priorities noted in the Secretariat’s 2011 Implementation Report regarding competition and state aid have been addressed<sup>173</sup> (Energy Community, (35) 2013: 11).

It was the lack of progress in the Community’s competition goals which prompted the Secretariat to initiate the Competition Network in November 2012. This network, which also includes non-members Armenia, Austria and Georgia, meets on an ad hoc basis, and cooperates on competition and enforcement issues. It accumulates best practices and works to implement legislation and enforcement of EU competition acquis within the Energy Community. In addition to the ad hoc meetings, an online platform exists to exchange information and consult among the competition authorities (Energy Community, (36) 2013: 11).

### Projects of Energy Community Interest (PECI)s

In October 2012, the Ministerial Council noted that at least \$44 billion in investments were needed between 2012 and 2020 to meet energy demand. These investments will facilitate:

- 1) A competitive and integrated energy market
  - 2) Attracting energy investments in energy
  - 3) Providing customers with a secure and sustainable energy supply
- (Energy Community, (37) website, date accessed August 8, 2015).

With the exception of Ukraine, the individual Contracting Parties are relatively small making it cost prohibitive for each state to develop its own market infrastructure. To promote economies of scale, initiatives have been identified with the greatest regional impact via Projects of Energy Community Interest (PECI). A PECI is assessed on several criteria; cost-benefits, its support for competition, regional market development and whether it enhances broader renewable energy goals. To support a PECI’s chances of success, the Energy Community attempts to eliminate

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<sup>173</sup> Interestingly, only the Moldovan and Ukrainian competition authorities have taken enforcement actions, resulting in penalties against uncompetitive companies.

cross-border investment barriers and encourage cooperation between national regulatory authorities. Indeed, the focus on PECIs emphasize cross border projects and financial instruments. Those PECIs proposed at the October 2013 Council meeting and which are most relevant to the Black Sea RSC are:

The construction of a new 800 megawatt (MW) coal fired thermal power plant (TPP) within the existing Burshtyn, Ukraine site, to be built by DTEK Zakhidenergo PJSC.<sup>174</sup> This project will enhance cross-border service with bi-directional capacity, contribute to regional market integration and increase electricity supply from Western Ukraine to Hungary. Its estimated cost is \$1.5 billion with a 2019 completion date (Energy Community, (38) website, 2012, date accessed May 9, 2015).

The construction of a new 660 MW coal fired energy unit at the existing site of Dobrotvir TPP in Dobrotvir, Ukraine. It is also constructed by DTEK Zakhidenergo PJSC. It will ensure enhanced bi-directional, cross-border capacity and provide sustainability and increase electricity supply from Western Ukraine to Poland. The project will cost \$1.2 billion, and will be completed in 2019 (Energy Community, (39) website 2012, date accessed May 9, 2015).

There are plans for a cross-border high voltage direct current (HVDC) interconnector between Poland and Ukraine, built by DTEK Zakhidenergo PJSC. This is to adjust the existing Khmelnytsk nuclear power plant (KhNPP)-Rzeszów line, connecting to the Dobrotvir TPP. The results will increase exports flows to Poland by 265 MW, and ensure energy exchanges in both directions. The total increase in cross-border capacity between Poland and Ukraine resulting from the project is 865 MW. The cost is \$218 million to be completed by 2016 (Energy Community, (40) website, 2012, date accessed May 9, 2015).

A new cross-border HVDC interconnector between Hungary and Ukraine, to be constructed by DTEK Zakhidenergo PJSC. This project entails rehabilitating the existing Soviet-era Zakhidnoukrainskaya-Albertirsa line and the installation of the HVDC interconnector with 600 MW capacity. The project will increase energy supply to a needy region in Hungary, enable the supply of energy in two directions and facilitate system flexibility. The project is estimated to be completed in 2017 at a cost of \$218 million (Energy Community, (41) website, 2012, date accessed May 9, 2015).

In the gas sector, TAP interconnection projects will allow the modernization of the Urengoy-Pomary-Uzhgorod pipeline, also known as the Trans-Siberian Pipeline operated by Gazprom and Ukrtransgaz, a Naftogaz affiliate. The project is designed to improve the reliability of gas transportation to Ukrainian consumers and transit to Europe by replacing older sections of pipe. It is expected to be completed by 2016 at a cost of \$327 million (Energy Community, (42) website, 2012, date accessed May 9, 2015).

Moldova's Cazaclia Underground Gas Storage (UGS) project is under construction by JSC Moldovagaz with the goal for Moldova, Romania and other Balkan states to access gas through

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<sup>174</sup> Many of the Ukrainian electricity projects are to be managed by DTEK Zakhidenergo PJSC, a subsidiary of DTEK, a large integrated energy company with a presence in the Donbass region. It is unclear whether these projects are underway considering the tenuous conditions on the ground.

the existing network. The UGS project will be available during periods of peak demand in cold season and supply interruptions. This project is estimated at \$850 million (Energy Community, (43) website, 2012, date accessed May 13, 2015).

There are plans for an unidentified LNG terminal in Ukraine to diversify the country's gas supply sources and strengthen regional energy security. By accessing non-Russian gas supplies, it is expected to create business synergies with Ukraine's gas transmission system and underground storage facilities. The estimated cost is \$1.1 billion with an unknown completion date (Energy Community, (44) website, 2012, date accessed May 9, 2015).

The Community's primary oil pipeline project is the extension of the Brody pipeline to Poland and Lithuania, called the Brody-Adamowo oil pipeline. This will be constructed by MPR Sarmatia Sp z.o.o, an Azerbaijani, Georgian, Ukrainian, Polish and Lithuanian joint venture. The first phase of the project has been completed at a cost of \$517 million, with implementation of another \$630 million, to be completed by the end of 2015 (Energy Community, (45) website, date accessed May 9, 2015; Energy Community, (46) 2013: 11; Energy Community, (47) November 2013).

These PECCI's are outlined because of their relevance to the Black Sea RSC within an energy context. Moreover, as the other Black Sea RSC states are not members, by default the majority of projects will impact either Ukraine or Moldova and their neighbors. What this list does demonstrate is a focus on basic infrastructure development and modernization, notably in the gas and power generation and transmission sectors. Additionally, it will be noticed that all the Ukrainian-based projects were given to Donetsk-based DTEK Zakhidenergo PJSC, headed by Rinat Akhmetov, a Ukrainian oligarch with strong ties to the Yanukovich government and with an interest in maintaining the status quo.

On the surface this would indicate a surprising lack of contractual diversity, in direct contravention to the Energy Community's liberalization mission. Yet, there needs to be some further explanation for this phenomenon. These contracts were let in 2013, while the Yanukovich regime was still in power, so there were no other permissible alternatives to DTEK Zakhidenergo PJSC. Moreover, considering DTEK's dominant position in Ukraine's energy services sector, it is unlikely any competitors could have performed the work had they been allowed to bid. Therefore, it can be claimed these contracts were expedient methods initiated to begin the process of infrastructure modernization. Finally, as much of DTEK's operating area, the Donbas, is under rebel control, it is unclear how these projects are faring.

### *Social Dimension*

The Energy Community has been criticized for the lack of a social dimension, that is considering worker and consumer protection and relief for underprivileged consumers. Though the original treaty does not provide a defined set of social acquis, there are references to social stability as being vital for creating a viable energy market. To clarify this, a MOU on "social issues" was signed in October 2007 which outlines the intent of the Contracting Parties to address the treaty's social consequences.<sup>175</sup> The MOU stipulates the need for consumer protection, notably those

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<sup>175</sup> Moldova and Ukraine signed the social dimension MOU in October 2011.

considered most vulnerable, and improving energy sector employees' living and working conditions (Energy Community, (48) 2013: 11, 216-217).

In December 2007, the Council initiated an annual Social Forum, requiring each Contracting Party to create a Social Action Plan and to chart the progress of the October 2007 MOU. The EU's Third Package also covers vulnerable consumers, thereby giving incentive for the Council to address the issue. In April 2013 the Secretariat submitted a Social Strategy, which proposed the definition of a "vulnerable" consumer in line with the EU directive. In the Social Strategy, the Secretariat acknowledged that vulnerable consumers must be addressed as a national social policy rather than energy policy, while additional focus should be placed on non-economic support, such as protection from outages or supply disruptions (Energy Community, (49) 2013: 11; 216-217).

Criticism of the lack of "instruments" to achieve its objectives, prompted the Secretariat in 2012 to analyze the Treaty's weaknesses in a report to the PHLG. It noted the inadequate enforcement mechanism, lax environmental standards, and "limited harmonization measures" which undermine organizational structures and pricing regimes (Energy Community, (50) 2013: 12). In the report, the Secretariat recommended that the Energy Community initiate discussion on ways to improve institutional efficiency and legal framework. The PHLG, in June 2013, supported extending the treaty beyond 2016, and recommended to the Council the formation of a High Level Reflection Group (HLRG) to evaluate the Treaty and propose amendments to improve its function.<sup>176</sup> Chaired by Jerzy Buzek, a former Polish Prime Minister, the recommendations of the HLRG ranged from financial incentives for states that implemented the *acquis* to stronger enforcement options, such as financial penalties and disputes heard in a court of justice or in local jurisdictions. There was also the recommendation of opening up Community membership to potential members in Eastern Europe and the Mediterranean (Energy Community, (51) "Annual Report on the Activities of the Energy Community 2014," September 2014: 2; Energy Community, (52) 2013: 11-12).

As noted earlier in this case study, there are disparities between members' capabilities to implement the *acquis*, mostly from ineffective legislative leadership or deliberate 'foot dragging' by parliamentarians to avoid upsetting important constituents. A recommendation from the HLRG included a two-tiered membership, whereby all Contracting Parties committed to a set of core EU principles, with the option of "opting in" for additional rules. This concept has not been detailed, but on the surface it would appear that such an approach would undermine one of the main purposes of the Community, that of a uniform and coherent liberalization strategy (Energy Community, (53) "Annual Report on the Activities of the Energy Community 2014," September 2014: 2).

In a sense, the Energy Community spearheads the EU's CFSP to integrate the newly independent South Eastern European and overlapping Black Sea RSC states within the EU's normative environment. It should also be pointed out that deliberately transposing and implementing EU energy law within their own legal structures, indicates a desire to reform their economies and blend deeper within Brussels' political and economic fold (Furfari interview 2015; European

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<sup>176</sup> Article 97 of the original Treaty stipulates a 10-year life span from the date of implementation.

Commission (31) 2011: 3). The European Commission's report on the Energy Community offers a good description:

“The Energy Community is about investments, economic development, security of energy supply and social stability; but – more than this – the Energy Community is also about *solidarity, mutual trust and peace* [italics added]. The very existence of the Energy Community, only ten years after the end of the Balkan conflict, is a success in itself, as it stands as the first common institutional project undertaken by the non-European Union countries of South East Europe” (European Commission, (32) 2011: 3).

It is clear that the Energy Community openly advocates for Europeanization of a critical economic sector of South East Europe and the Black Sea RSC, with the full support of the Contracting Parties. Indeed, the Europeanization effects are clearly detailed in the way the Energy Community is constructed as an overt spillover enhancer, particularly by the very nature of cross-border projects which it promotes. In this way it exists as enabling neo-functionalism and embellishing the Europeanization process. Therefore, with respect to Ian Manners, this is hardly an “unintentional” effort to instill core norms, but a very contrived and concerted plan to accomplish this.

It is too soon to determine ultimate success or failure, though the ability to graft the EU's energy agenda to the Energy Community is, in the initial stages, proving to be an effective vehicle for creating a liberalized regional market. This is an energy market still dominated by state institutions intent on exerting control of utilities through subsidies and regulated energy prices, all of which have been analyzed and criticized in the Secretariat's 2013 annual report on the *acquis*' implementation. The 2013 report further notes the implementation gap which results from lack of enforcement, the inability to enact market reforms and the need for change to the Treaty's institutional and procedural makeup.

The HLRG in its May 2014 report noted that the Energy Community's goals are unachievable “without reforming the organization's legal, procedural and institutional set-up.” (Energy Community, (54) “An Energy Community for The Future: Report by the High Level Reflection Group of the Energy Community,” May 2014). This means that in the current environment, the sovereign status quo is too strong to permit the necessary liberalization, the implication being that a further surrender of sovereignty is necessary to better implement the *acquis*. This is a difficult sell in the current political climate, which demonstrates an increase in Euroscepticism and general unease with the growing power in Brussels.

It should be noted that the Energy Community's activities force the “solidarity, mutual trust and peace” in a region that for the last several centuries has known any but these attributes. It is precisely these Horizontal Policies and PEICs that enable the market-based solutions which permit the business-to-business interactions and foster the profit incentive. Moreover, each of the PEICs, whether deliberately or by necessity, are designed to intersect multiple borders and force interaction between the various public and private sector entities. These broad-based confidence building measures provide the basis for the Community's existence and relative success going forward. In effect, this creates a powerful argument for the Energy Community's *raison d'être*; market liberalization.

It is the PECIs, in particular, which cross a variety of industry sectors; electricity generation and transmission, as well as gas pipelines and storage. Interestingly, it should be noted that two of the PEI's involve construction of coal-fired thermal power plants, in what would appear to be in opposition of the stated emphasis on renewable energy sources or low-carbon solutions. However, these projects will provide more modern and efficient technology to existing plants at both Burshtyn and Dobrovtyr in Western Ukraine, where immediate consumer need necessitated a reevaluation of the Community's stated mandate. Therefore, the Energy Community's social dimension superseded its long term regional and environmental vision, demonstrating a certain pragmatism to attain long-term socio-economic goals.

A point that has also been highlighted in the Energy Community's analysis is the long-term corrosive effects of energy subsidies, which hinders the ability to realize full cost recovery for the stakeholders, and creates consumer resistance to price reform. Furthermore, with costs disassociated from market forces, energy efficiency will lag behind its market potential. These conditions conspire to deprive working capital to the energy suppliers and reduce their operational effectiveness. This nefarious collusion of government and business is counterproductive and hinders effective resource allocation and influences decision making in favor of political patronage, rather than sound business practices.

Similar complaints were (and still are) lodged against current EU members, many of which are loath to unbundle their own national energy champions. It is difficult to expect the Contracting Parties to take liberalization seriously when the same directives are openly flouted by the EU Member States. However, when asked about this apparent double standard, frustration does not seem to have permeated to the grass roots within the Contracting Parties (Lorenc Gordani, November 22, 2014 email to the author). The conditionalities are clearly established, and despite imperfections in the *acquis'* implementation, the Contracting Parties understand the criteria for acceptance and the longer term benefit.

## **Case Study Number 2: The Black Sea Trade and Development Bank and the Emphasis on Small, Medium Enterprises**

Chapter 5 depicts the BSEC as a well-intentioned though generally ineffective organization, hamstrung by internal dissent and a weak economic base; circumstances which inhibit its ability to drive regional transformation without external (read EU) support. Under the current political environment there is little prospect for change. Arguably, where the BSEC has been unsuccessful in the diplomatic arena, the BSTDB has bridged these divides through carefully planned and targeted financial disbursements across a range of economic sectors. The bank acknowledges the regionalist trend in the Black Sea RSC, and the goal of market liberalization "through the public and private sectors" (BSTDB (1) 2000: 7-8). The case study will note the direct impact the bank has on energy-related development projects in the Black Sea RSC.

The bank was conceived in 1994; its emergence in 1998 coincided with the BSEC's post-charter burst of activity, and arguably at the height of its influence in the region. Its mandate is to promote "economic growth and regional cooperation" by providing loans and credit in one or

more of eleven member states.<sup>177</sup> It prioritizes activities through national or sectoral plans, by leveraging capital in commercially viable regional projects where it has a strong geographical or technical stake.

Once again, the basic spillover tenets are visible in a case study, as the BSTDB promotes investment which are designed to spread the transaction benefits across the BSEC member states. Investment projects must have positive development impact and enhance regional cooperation, with the potential to transfer technology and know-how, and whereby, the benefits to accrue to more than one member state. The Bank does not try to maximize profit, but lends at market rates. However, there is no concessional lending or soft loans (Christakis, September 2013).

As an IFI, the BSTDB is capable of mobilizing capital and providing long term financing in markets which traditionally lack such access. It can cover risks the private market is unable to bear, notably country risk mitigation, which allows it to support projects that otherwise never see the light of day. On the negative side, the Bank is unable to provide globally competitive funding packages, suffers from a lack of experienced staff and is slow to process the loans. Generally speaking, IFI's in general and the BSTDB in particular, have difficulty in assuming the role of the private sector, such as predicting market innovations and trends and participating in risky or speculative investments which are more suitable for venture capital lenders (Christakis, September 2013).

The BSTDB sets aside 28.1 percent of its disbursements on SME projects, the traditional engines of economic growth and regional development, and quite frequently the most vulnerable to economic downturns. The bank projects focus primarily on cross-border trade, job creation and technology transfer (BSTDB, (2) April 21, 2007; BSTDB (3) website, date accessed November 23, 2014; BSTDB, (4) December 2013). This targeted sectoral approach is aimed at the region's grass roots beneficiaries and those most sensitive to social change.

Every four years a "Medium-Term Strategy and Business Plan" is submitted, the current iteration covering the years 2015 to 2018. Additionally, a ten-year plan is produced, the "Long-Term Strategic Framework" (LTSF) which communicates over-the-horizon strategies and objectives. The current LTSF encompasses 2010 to 2020, and concentrates on the changing economic structure in the Black Sea RSC, such as the deindustrialization of some members, the general decline in agriculture and the increase in the services sector (BSTDB, (5) 2009).

In the 'Medium Term Strategy and Business Plan,' the bank acknowledges the imbalance between sector disbursements with the balance heavily in favor of the financial sector. The emphasis on financial institutions is more an expediency, as most of these firms are already structured to receive and disburse funds, whereby businesses which operate outside the financial sector, often lack the experience and acceptance criteria to successfully apply for loans. In other words, there are relatively few prospective recipients that meet the minimum risk criteria which would permit their quick dispensation. However, this emphasis on the financial sector has its own inherent risks and increases the overall exposure by a lack of a diversified sectoral portfolio. According to the 2015-2018 plan, the banks will attempt to shift resources to energy and

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<sup>177</sup> Serbia is not a member of the BSTDB, though it is included in the bank's regional economic analyses.

telecommunications. To address this imbalance, the bank will analyze underserved states or economic sectors during the current four year period (BSTDB, (6) February 21, 2015: 19).

As noted in the LTSF, the bank hopes to achieve an outstanding operating portfolio between \$2.5 to \$3.25 billion, however continued economic weakness in the EU and the Black Sea RSC has delayed this goal (BSTDB, (7) May 25, 2009: 11). As of late 2014, the bank's operating portfolio was approximately \$1.2 billion (BSTDB, (8) February 21, 2015: 10). To alleviate this gap, the bank intends to implement a plan over the next four years to sign an average of 25 new projects per year at approximately \$400 million of new loans. This translates into an average loan disbursement growth rate of 7.5 percent per annum; an achievable goal, according to the bank's leaders (BSTDB, (9) February 21, 2015: 18). Moreover, as energy, transportation and utilities comprise 16 percent of the bank's current portfolio, this growth rate equals roughly 5 energy projects per year averaging \$12 million per project, well within bank precedent on such disbursements. This is still ambitious as any expansion depends on numerous variables outside the bank's control, such as broad based economic growth and the availability of qualified recipients.

The total of signed loans from all economic sectors between 2011 to 2014 was \$1.01 billion. Disbursements by economic sector for the same period (2011 to 2014) places energy at \$106.2 million or 10.5 percent of the total; coming after financial institutions \$593.2 million (58.5 percent) and manufacturing at \$118.5 million or 11.7 percent. When combined with energy-heavy transportation and utilities sectors, the bank's full energy portfolio is \$224.7 million or 16.7 percent of total portfolio disbursements.<sup>178</sup>

When looking at total project distribution by state, Russia is by far the largest recipient with \$234 million or 23 percent between 2011 and 2014. Next is Romania with \$135 million (13 percent) followed by Azerbaijan with \$134.7 million (13 percent). Turkey at \$123.4 million (12 percent) is followed by Ukraine with \$85.2 million or approximately 8.5 percent in signed loans (BSTDB, (10) February 21, 2015: 13). Moreover, each state has unique sectoral requirements and priorities. For instance, Ukraine prioritizes transport infrastructure projects to increase competitiveness and integration into European networks, as well as developing its domestic oil and gas production. Russian projects stress the reduction of congestion, while in the cases of Armenia, Azerbaijan, Greece, and Romania, BSTDB focuses on cross-border transport projects, such as railways and port facilities (Luică, May 18, 2012). Bulgaria is anxious to develop its energy infrastructure as well as locate new sources of oil and gas, particularly offshore reserves (Matkiwsky, "BSTDB: The Black Sea Trade and Development Bank," March 2013).

The bank has placed emphasis on improving its credit rating, noting the lack of a AAA rating hinders its ability to raise money at competitive rates and invest in consequential projects. In October 2014 its rating was lowered to A-/A-2 by Standard and Poor and remained steady with an A2/P1 rating by Moody's, demonstrating a solid, though perhaps unspectacular long-term outlook<sup>179</sup> (BSTDB, (11) Investor Relations, website date accessed March 12, 2015). On March 15, 2015, Moody's Investor Service affirmed BSTDB's A2/P-1 ratings but downgraded its

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<sup>178</sup> For the full breakdown of BSTDB projects by state, see page 29 of the 2012 Annual Report. The full list of BSTDB energy projects is found at (BSTDB (12), Projects Financed, date accessed February 15, 2014).

<sup>179</sup> A- is an indication of long-term rating and A-2 is short-term.



outlook on the A2 rating to negative from stable. Moody's justification was the higher risks to BSTDB's portfolio quality, because of "deteriorating operating environment in Russia and the CIS," and its (Moody's) own downgrade of Russia's sovereign bond rating from Baa3 to Ba1, which puts it in the low credit-quality (non-investment grade), or "junk" category (Moody's Investor Service, March 19, 2015).

To minimize risk, cooperative financing on capital intensive projects with the other larger IFIs are preferred. As a relatively new institution, BSTDB hopes to develop its in-house expertise, and to eventually lead its own projects and attract other IFIs and commercial sources. It takes into account the member countries' political environment but must remain neutral, and does not impose conditions on its investment such as demanding restructuring or reform of national energy companies or markets. This provides a competitive advantage over other IFIs, which often link investment money to specific political, social or economic reforms (BSTDB (13) 2000: 4).

The bank finances up to 35 percent of the project cost with loan guarantees or co-financing transactions with other financial institutions and/or commercial banks. It frequently partners with larger IFIs, such as the EBRD. The minimum loan amount is \$4.1 million, the maximum limit is \$52 million, with no ceiling for sovereign loans. Maturity or tenor for corporate loans is 5 to 7 years, while energy and infrastructure projects can be carried out to 15 years. A 3 year grace period is also offered in certain cases (Yeremyan, June 15-17, 2011; BSTDB (14) Annual Report 2012). Loan conditions depend on the project's operating requirements, on the interest rate (fixed or variable), or the convertibility of the national currency (Luică, May 18, 2012).

Finally, borrowers must be established entities with an existing track record of success. For instance, they are expected to have a solid financial foundation, with proven ability to service current and forecasted debt. Additionally, borrowers must show commitment to the project by allocating a portion of their own human and financial resources. The recipient will also demonstrate the ability to manage the project and determine project "maturity," such as technical feasibility studies, market analyses, and environmental impact studies (Yeremyan, June 15-17, 2011). The loan recipient must undergo in-progress reviews of how the funds are being spent and whether the project is moving in a satisfactory direction.<sup>180</sup>

### The Energy Sector

As regional energy consumption is inefficient, BSTDB promotes less energy intensive industrial growth, an objective which reflects the common concerns of the member countries. This also includes encouraging supply diversity, which permits energy interdependence, increased energy efficiency, market liberalization and infrastructure development, and the "environmentally sensitive" production, transport and consumption of fossil fuels (BSTDB (16) 2000: 15-26).

The key point stressed by the bank is not energy independence, but *energy interdependence*, a notable similarity with the Energy Community. Energy sector investment projects are

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<sup>180</sup> An interesting case study provides insight into the banks evaluation process as well as Focused Mid-Term Evaluations. See BSTDB (15) "Enhancing The Performance of a Major Environmental Project in Bulgaria Financed by BSTDB," January 2005.

characterized by cross-border cooperation, complex negotiations, compounded by numerous domestic and international political considerations. The bank seeks energy projects which enable trade and investment among the members; essentially those which facilitate intra-regional trade and investment. The energy sector plan acknowledges the role of regional development and by targeting small scale projects, it contributes towards the region's overall economic development by allowing consumers to access the most efficient sources of energy. There is emphasis on projects that enhance strategic objectives and increase intra-regional cooperation, as opposed to politically motivated project that reinforce energy independence. These targeted investments are "niche" energy production in both traditional and non-traditional plays (BSTDB (17) 2000: 3).

The bank's leaders select a range of energy projects within the broader BSEC energy guideline. The bank prefers local sponsors for energy sector projects which facilitate the bureaucratic approval processes, improve public relations, promote corporate awareness and minimize the chance of default (BSTDB (18) 2000: 21). BSTDB can assume some political and country risk that deter most private investors. Products are tailored to the needs of clients and partners, and technical assistance available for project preparation, such as business plans, audit support, etc. (Yeremyan June 15-17, 2011).

The bank does not promote any one energy sector over another, though it approaches "with extreme caution," politically motivated projects, as well as nuclear power or those with an internationally controversial outcome. Additionally, it avoids exploration or large upstream operations which are capital intensive and dominated by the majors, preferring small and specialized projects which contribute to "inherent flexibility and low overhead financial profile." The projects must be financially viable, with limited requirements for state subsidies, and which promote progress towards open markets, and pricing transparency. Projects must also be technically feasible and provide opportunities that promote growth in line with the Bank's strategic objectives (BSTDB (19) 2000: 3, 7, 9).

#### *Oil and Gas Pipelines and Port Terminals*

The BSTDB's leadership recognizes the shortcomings in the regional energy transportation infrastructure which limit the development of an integrated regional energy market. Therefore, it invests in oil and gas pipelines and associated equipment, to include pumping and compression stations and electricity transmission project. The bank acknowledges the existing gas pipeline network is counterproductive to intra-regional trade, and though the new transit pipeline construction projects will fall outside the bank's scope, such as TANAP and TAP, it does plan to support peripheral pipeline projects, notably the TAP interconnectors and portions of the Gas Ring.

There is interest in connecting the existing oil and gas pipeline network and ports on the Caspian, Black, Mediterranean and Adriatic Seas into a broader regional infrastructure. This has resulted in a focus on projects which alleviate bottle-necks and facilitate inter and intra-regional trade. Additionally, increased energy demand throughout the region, particularly in Turkey, enables the EU market liberalization effort and environmental concerns that shift focus towards gas as a cleaner fuel. Much of this is affiliated with the larger Commission-sponsored 'Motorway of the Seas' concept, which looks at improving seaborne logistics throughout the EU's maritime

members (Europa, (9) “Mobility and Transport: Motorway of the Seas,” date accessed September 20, 2015).

### Electricity Sector

The BSEC’s electricity sector is considered a growth area with privatization as a key strategic goal. It is favorably disposed to electricity systems of member countries that meet UCTE technical requirements, however, state control of transmission network does not necessarily prevent BSTDB investment in these infrastructure projects. There is emphasis on joint venture projects between national electricity companies and private sector operators, with a need to upgrade generating capacity, which will increase as energy demand accelerates. Additionally, emphasis is placed on cross-border transmission and inter-connections for the development of a regional electricity market.

### Energy Efficiency

BSTDB follows the precept that it is easier and cheaper to solve capacity issues from a demand rather than a supply management perspective, or reduce consumer demand rather than spend to develop infrastructure. As energy intensity is on average higher in the BSEC states than elsewhere in Europe, focus is placed on renewable sources, such as hydroelectric, solar and wind. This emphasis on efficiency and renewables, provides the opportunity to improve regional industrial competitiveness through reduced consumption of fossil fuels. Consideration is also given to renewable energy projects with a local development benefit notably for employees, or the potential for knowledge or technology transfers.

As noted earlier, the BSTDB focuses its loan disbursement in the energy sector across a range of technologies and member states, all designed to foster cross-border interaction. It will be noted that many of the active loans are weighted toward renewable energy projects, very much in line with the BSEC’s more recent focus. The older loans were directed towards traditional fossil fuel plays, such as pipelines and retail outlets, with emphasis on Romanian and Ukrainian borrowers. The BSTDB portfolio of active and completed loans in energy and utilities is listed below:

#### Active Loans

##### Bulgaria: AIS Maritza East

The BSTDB has a commitment of \$20.1 million to finance a 600 MW lignite TPP, the largest new power generation investment in Bulgaria. It will be constructed by Alstom, the French engineering company which specializes in electricity generation, and operated by AES-3C Maritza East I, the company created to manage the project. The loan’s tenor is for a period of 16.5 years, with a total cost of about \$1.2 billion. It is designed to support the electricity sector privatization and restructuring process under the Third Energy Package, and it will replace older and inefficient Cold War-era systems. Other lenders include EBRD, Calyon (Credit Agricole Group), ING and BNP Paribas, with loan guarantees provided by Germany’s HERMES and COFACE of France (BSTDB (20) website, AIS Maritza East (Bulgaria), date accessed May 2, 2015).

### Bulgaria: Suvorovo Wind Farm

In 2009 EBRD and BSTDB partnered to finance the construction and operation of a 60 MW wind farm near the eastern Bulgarian town of Suvorovo. The full package calls for BSTDB to fund \$15 million of an overall \$99 million package over a 16 year lifespan (Yeremyan, June 15-17, 2011; BSTDB (21) website, Suvorovo Wind Farm (Bulgaria), date accessed May 2, 2015; Christakis 2013).

### Greece: Terna S.A. I and II

BSTDB provided a general purpose loan of \$13 million to Terna S.A to build wind parks in Greece. The Greek firm Terna Energy S.A. is dedicated to the development of renewable energy turnkey operations, as well as the construction, ownership and operation of similar energy projects. A follow-on project, Terna Energy II, received a \$9 million loan over 6 years to finance 8 bio gas plants, also in Greece. Electricity generated from these effort will be used for local agriculture or transmitted to the electricity grid (BSTDB (22) website, Terna S.A. I and II (Greece), date accessed May 2, 2015).

### Romania: EDPR Photovoltaic (PV)

The bank loaned EDP Renovaveis SA (EDPR) \$11 million for the construction and operation of a 50.4 MW solar park in southwestern Romania. The project consists of six plants which will allow Romania to meet its 2020 target of 38 percent of electricity consumed from renewable sources (BSTDB (23) website, EDPR PV (Romania), date accessed May 2, 2015).

### Turkey: Koprubasi Hydropower Plant

This \$15.6 million loan will help finance the construction and operation of the 74 MW Koprubasi hydroelectric power plant in Bolu Province, Turkey. The plant's water source is derived from Devrek Creek. The effort is expected to have a high developmental impact; in addition to renewable power generation, the project will also provide flood protection and create employment opportunities in the region. The borrower, Yuksel Enerji Elektrik Uretim ve Ticaret A.S., was incorporated in 2006 with the purpose to build and operate the plant (BSTDB (24) Koprubasi Hydropower Plant (Turkey), date accessed May 2, 2015; Christakis).

### Ukraine: Galnaftogaz III

Galnaftogaz is an independent petroleum products distribution company in Ukraine, and it is the third largest network of gas stations operating under the OKKO brand. Galnaftogaz provides a variety of consumer products and services, to include petroleum wholesale "logistics services." The Galnaftogaz expansion program will increase the company's existing 320 gas stations by another 75, as well as provide working capital for general operations to strengthen Ukraine's downstream energy market and generate employment in the sector (BSTDB (25) website, Galnaftogaz III (Ukraine), date accessed May 2, 2015).

## Abandoned or Completed Projects:

### Turkey: Star Refinery

In June 2013, the BSTDB announced it would lend \$58 million to SOCAR, the largest loan package in its history, to build the Star Refinery.<sup>181</sup> According to Andrei Kondakov, the bank's director at the time, the bank usually disburses loans for up to 10 years, which are generally underwritten with sovereign guarantees. However, in this case, regular procedures were waived as SOCAR was a "very serious and reliable partner" (Jafarova, June 24, 2013). Considering the size and recipient of the loan, this proved to be a significant change in policy, however BSTDB backed out of the project, concerned over its exposure.

### Ukraine: Chornomornaftogas

One of the bank's goals is to finance the development of Ukraine's oil and gas reserves, to allow it more diversity of sources and reduce its dependence on Russian imports. Chornomornaftogaz was established in 1998 as a public subsidiary of Naftogaz to exploit hydrocarbons off the Crimean Peninsula. BSTDB made two corporate loans of \$20 million and \$21 million in 2004 and 2007, with a tenor of 7 years (Yeremyan, June 15-17, 2011; BSTDB (26) website, Chornomornaftogas (Ukraine), date accessed May 2, 2015). Russia's annexation of Crimea meant the loss of the Chornomornaftogaz offshore fields, which was expected to produce 3 bcm of natural gas by 2015 (Dabrowski August 3, 2015).

### Galata (Bulgaria)

BSTDB contributed \$17 million to develop proven offshore gas resources near Varna, Bulgaria. The project, completed by UK's Melrose Resources, delivered satisfactory results, though it is unclear if there are any follow-on efforts (BSTDB (27) website, Galata (Bulgaria) date accessed May 2, 2015).

### Romania: Petrom Environmental Loan

Romania's Petrom received funding for an environmental enhancement program to include pollution clean-up, pipeline replacement, health and safety measures and energy efficiency projects. Petrom received \$34 million from BSTDB with EBRD providing the remaining \$379 million loan package. The life of the project's loan is 5 years (BSTDB (28) website, Petrom Environmental Loan (Romania), date accessed May 2, 2015).

### Romania: Rompetrol Financing

The Rompetrol Group, NV (TRG) is a Netherlands-based, integrated oil and gas company with the bulk of its operations and assets in Romania. After state-owned SNP Petrom, it is the largest private operator in the Romanian refining and marketing sector. Rompetrol also owns the subsidiary companies Petromidia (Navodari) and Vega (Ploesti) with a combined refining capacity of 110,000 bld; a national wholesale business including four tank farms, a retail station

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<sup>181</sup> The Star refinery will be located in western Turkey on the Petkim Peninsula near Izmir.

business of 127 gas stations, and a maintenance, logistics, and environmental services companies. The project supported the bank's mandate to finance projects with strong development impact and contributed to cooperation among BSEC Member Countries. The loan was for \$18 million (BSTDB (29) website, Rompetrol Financing (Romania), date accessed May 2 2015).

#### Romania: SNP Petrom SA I

The operation involved a \$10 million loan to support Petrom's restructuring and pre-privatization process. BSTDB's loan was for an 8 year term, while additional financing of \$140 million was provided by the EBRD and other banks. The project also had a strong environmental impact within EU standards and practices (BSTDB (30) website, SNP Petrom SA I (Romania), date accessed May 2, 2015).

#### Romania: Termoelectrica

This project provided capital for purchase of raw materials to meet Romania's electricity and thermal heat requirements. The loan's purpose was to finance imports of energy inputs from BSTDB member countries while the Romanian government restructured the energy sector. The Romanian government created Termoelectrica S.A. in 2000, as the state-owned monopoly producer of thermal electricity and heat. The company produces 7 percent of Romania's electric power and 60 percent of the thermal energy. Moreover, 80 percent of the electricity produced by Termoelectrica is for the industrial sector, while the remaining 20 percent is for household use. The energy inputs used by Termoelectrica are coal, of which 19 percent is imported, fuel oil (65 percent imported) and natural gas (70 percent imported) (BSTDB (31) website, Termoelectrica (Romania), date accessed May 2, 2015).

#### Romania: Transgaz Equity Financing

This investment in Transgaz S.A. was to rehabilitate and modernize its transmission system, to address technical weaknesses and improve environmental management. As Romania is a key transit point for natural gas from Russia to the Balkan area and Turkey, regional cooperation played a large role by providing improved efficiency of the gas network activity "through the rehabilitation of the national gas transmission system links with the neighboring countries." This project supported the modernization of the Romanian gas transmission company and the operational efficiency by reducing pipelines leaks, and increasing overall system reliability (BSTDB (32) website, Transgaz Equity Financing (Romania), date accessed May 2, 2015).

#### Ukraine: Transbalkan I and II

The Transbalkan I project entailed the construction of a new compressor on the existing Ananyev-Izmail gas pipeline at Tarutino, Ukraine, enhancing throughput capacity in the existing pipeline crossing Romania and Bulgaria. It was the first phase of a larger program to increase the delivery of Russian gas to Southeast Europe, or Transbalkan II. It is managed by Gastransit, a limited liability company established by Gazprom, Naftogas, Turusgas (Turkey) and Transbalkan (Turkey). The full loan was structured by the EBRD, which issued a \$ 51 million loan to

Gaztransit to modernize and increase the throughput capacity of Ukraine's gas transit network. The project has already received funding from the BSTDB (\$ 6 million), Germany's HypoVereinsbank (\$ 40 million) and Greece's Agriotiki Trapeza (\$ 20 million). Naftogaz and Gazprom each own 37 percent of Gaztransit, and the balance belongs to private Turkish companies (BSTDB (33) website, Transbalkan I and II (Ukraine), date accessed May 2, 2015; Neftegazovaya vertikal via NewsBase,” November 22, 2001, date accessed 3 May 2015).

After a successful completion of Transbalkan I, BSTDB participated in phase II , financing the engineering, procurement, construction and commissioning of an approximately 75 kilometer natural gas pipeline on the southern Ukrainian section of the Trans-Balkan Gas Pipeline. As a result of the project, Russia will have increased gas transit capacity through Ukraine, Turkey, Romania and Bulgaria. Upon completion of the two phases, increase in the net gas supply to Turkey will be around 1.6 -2 bcm per year, with increased transit fee and tax revenues for Ukraine, Romania and Bulgaria. In the current political environment, it is unclear whether this pipeline is still in use (BSTDB (34) website, Transbalkan I and II (Ukraine), date accessed May 2, 2015).

#### Ukraine: Galnaftogas I

To meet EU safety and emission standards and improve distribution in the local market, BSTDB extended a \$23 million loan to Galnaftogaz to modernize its gas stations. Established in 1995, Galnaftogaz is a petroleum distribution company. The BSTDB portion of the financing will support the company's investment program, which includes network expansion. The total cost was \$93 million, the balance of which came from bank loans, bond and equity issue, and operational revenues outside of the BSTDB. BSTDB's loan is for a tenor of 7 years. (BSTDB (35) website, Galnaftogas I (Ukraine), date accessed May 2, 2015).

#### Ukraine: Alfa Nafta Petroleum

The BSTDB loan to Alfa Nafta Petroleum (ANP) was designed to support the company's retail network expansion program, to include the construction or purchase of new gas stations and consumer oil products. The operation was designed to consolidate ANP's position as a local fuel supplier and by servicing cross-border transportation flows (BSTDB (36) website, Alfa Nafta Petroleum (Ukraine), date accessed May 2, 2015).

In many respects the BSTDB's energy portfolio acts in much the same way as the Energy Community's PECIs. Both promote narrowly defined projects designed to enhance cross-border cooperation while addressing regional energy security. While both attempt to harness private and public sector support, the BSTDB is less-politically aligned than the Energy Community. Though political support is certainly a key component to the bank's project makeup, there is not the overarching political oversight that can be leveraged at the trans-regional level, notably via Brussels. Put another way, the BSTDB must rely more heavily on the relative influence of the sovereign member states to generate support for a project.

When looking at the active and completed loans as a consolidated energy-centric list, there are two clear trend lines in play over differing periods of time. The active loans, roughly from 2009

to the present, demonstrate the bank is following BSEC's lead in pursuing renewable resources, notably the wind farms and hydroelectric power. This is a departure from earlier in the bank's history when it maintained a more varied portfolio aimed at a traditional basket of projects, to include highly polluting lignite burning thermal power plants. Additionally, these earlier projects were heavily weighted toward efforts in Romania and Ukraine, and many were coupled with larger EBRD or other big lender contributions, so this fact helped influence the Bank's decision-making process.

The bank's more recent activity is following a slightly different trajectory. Though still partnered with larger institutions, it follows BSEC's new emphasis on renewable energy sources. However, it may be premature to write off conventional energy sources when the Black Sea RSC economies are still so vulnerable. Additionally, the current group of loans are more evenly spread out among the member states, thereby distributing the risks. Yet, this also demonstrates the bank's inability to establish a long-term focus caused by the shifting priorities of its BSEC masters, thereby jeopardizing broader strategic focus and continuity.

According to the former Azerbaijani Finance Minister, Samir Sharifov, the BSTDB played a role in the post-2009 regional recovery and Eurozone crisis, claiming its value to the region "cannot go unnoticed." However, according to Sharifov, the bank has not achieved its full potential, noting its average credit rating and relatively small loan portfolio (under \$ 2 billion) for an institution with such high political profile and member support. This would, he claims, justify a more aggressive approach to regional lending. Finally, the minister hinted the focus is weighted too heavily on the financial sector, a point noted by the BSTDB leadership and which is supposedly being corrected (Jafarova 2013).

There is now an effort to spread capital risks within the bank portfolio through alliances to promote a diversified range of loans and gain access to broader financial networks. In line with the Bank's focus on SME, the Small Enterprise Assistance Fund (SEAF) Caucasus Growth Fund was developed in 2012 in conjunction with the IFC, EBRD and the Netherlands Development Bank. The goal is to create a \$70 million fund allocated to small businesses in Armenia, Azerbaijan and Georgia, across the economic spectrum and with a focus on discrete projects with cross-border goals. The BSTDB's portion is \$10 million (BSTDB, (37) Annual Report 2012: 34). By focusing on limited and impactful projects, quite often ones that private lenders refuse, the bank enhances SME projects with potential for success which would otherwise be overlooked because of political risk. This also demonstrates a commitment to the Black Sea RSC's south Caucasus states, which are arguably the most geopolitically vulnerable of the region.

In 2014 the bank's management conducted an internal assessment to determine future strategic planning. A questionnaire was distributed and the results pointed to a series of key indicators of internal management challenges. Most telling was the litany of bank weaknesses, which ranged from slow decision-making, no prioritized strategic objectives, poor internal communications, and understaffing of core functions; all topped off with 'declining staff motivation.' In the spirit of fairness, this lack of motivation can perhaps be attributable to the long-term sluggishness in the global financial sector, not to mention the Ukraine-Russia war, and the persistent European banking malaise; all of which contributed to a diminished or secondary role for the bank.



Therefore, this harsh internal assessment is more than simply acknowledging systemic problems within the bank's operating infrastructure but also a function of global economic conditions. Another point noted in the Medium-Term Strategy and Business Plan is the need to address declining staff morale at the BSTDB. This also explains the bank's new 'culture of listening' it has embarked upon in the new medium term strategic cycle; that is listening to the needs of the regional loan recipients (BSTDB, (38) 2015: 38-39). This brings up the question whether these staff problems can be so easily resolved without dramatic leadership change and strategic redirection within the bank.

The benefits of a lending institution with such strong grass roots and a sensitivity to local needs are clear, and the BSTDB fills an important role. Nevertheless, the impact is limited in scale and any transformational benefits in the energy sector are negligible, as it lacks the capital and influence to be anything more than a contributing element to a small number of regional projects. Considering the BSTDB's contribution to answering the research question, *what becomes clear is that energy and its peripheral sectors are a priority, but not the priority* (BSTDB, (39) Annual Report, April 2014). Therefore, it can be considered a yardstick of success, though a marginal one, lacking the political and financial fortitude to engender solid transformational change.

### **Case Study Number 3: BP in Azerbaijan and the Influence of Western Management Practices (Expanding the Boundaries of Regional Influence).**

This last case study will focus in-depth on BP, a foreign commercial player which is heavily integrated within the Azerbaijani state apparatus and economy. As a transplanted Western commercial entity embedded within the FSU borders, BP is an example of how large multinational corporations can wield political, economic and social influence. With the emphasis on cross-border projects, human resource development and training programs, this case study considers a predominantly private sector contribution to the research question. Therefore, what is on display is a demonstration of Western capital and knowhow infused within the Black Sea RSC. This is a presence which began early in the post-Cold War era, and is still firmly in place today, and though it is too soon to know the extent of the impact on deep-seated political, economic and social environments, it is possible to view the last 20 years as a rough indicator of future trends.

Western companies operating in the Black Sea RSC are quite common in 2015. Yet, in 1994 BP was one of the first to cross the East-West barrier in such a lucrative and high-profile industrial sector. Moreover, the scope and breadth of BP's PSA was (and still is) unprecedented at the time, allowing the company tremendous freedom of action and influence in a sovereign state. Additionally, in this capacity, BP provides a unique perspective on addressing the research question. Similar to the other case studies, BP literally operates at the grass roots, or upstream level, physically extracting and transporting product. However, unlike the other two case studies, BP does not have the full benefit of sovereign power behind it, a point that will be discussed later on this analysis.

While this theme follows that of grass roots level transformation in an energy context, the question is whether BP has the stamina and force to directly impose conditions via its corporate

activities. Will these corporate institutions form the work ethic and attention to standards that need to be inculcated within the Azerbaijani social and economic fabric to develop to allow these attributes to be passed on to future generations? Or is this simply a superficial and temporary imposition which will gradually erode once BP leaves? With regard to this specific case study, a partial revision of the research question asks; “can a corporation, albeit a large and influential one, affect transformation?” Moreover, and most importantly from this dissertation’s perspective, is this influence demonstrated beyond Azerbaijan? These are questions which will be answered in the course of this research.

BP is a large IOC which operates in 80 countries with 80,000 employees and enjoys a market capitalization of \$112.84 billion (BP (14) website, date accessed March 19, 2016 The Wall Street Journal, date accessed August 2, 2015).<sup>182</sup> BP has a dense and well-developed presence in Azerbaijan; at the end of 2013, the company had 81 oil wells in production there. In 2013, BP delivered around 6 mcm per day of ACG associated gas to SOCAR, or 2.19 bcm for the year (Oil and Gas Eurasia February 14, 2014). BP also produced over 239 million barrels of oil in Azerbaijan in 2013. The company’s yearly investment in operations and upkeep of ACG is not insignificant; in 2014 its operational and capital expenditures within the field alone was \$1.05 billion in operating expenditures, and \$2.07 billion in capital expenditures. Also in 2013, the Shah Deniz gas condensate field produced 9.8 bcm of gas and 19.6 million barrels of condensate, which translates to 47.3 bcm of gas and 99.5 million barrels over the life of the project. For Shah Deniz activities in 2014, BP is estimated to have spent approximately \$200 million on operating expenditure and \$4.0 billion on capital expenditure (Oil and Gas Eurasia February 14, 2014; BP (15) Azerbaijan Sustainability Report 2013: 9).

Central to BP’s tenure in Azerbaijan has been its sense of corporate social responsibility (CSR) in the FSU, that is to integrate corporate self-regulation and oversight into business practices which take into account ethical and transparent operations. In the case of BP, the idea is to soften its image in public perception, a common sentiment among Western IOCs, which have collectively suffered in public perception over the last several decades. The 1994 Contract of the Century provided BP with a financial boost and a public relations coup, placing it at the forefront of the post-Soviet energy industry. To win the contract, BP put considerable effort in local outreach, emphasizing its credentials in community engagement, workforce education and training and environmental protection. In this regard, there was much riding on the Azerbaijan project as BP was anxious to reinforce its reputation as an energy services company sensitive to local needs (BP (16) Azerbaijan Sustainability Report 2012: 9; BP (17) Azerbaijan Sustainability Report 2013: 9).<sup>183</sup>

The two main pipeline projects, BTC and SCP offer a glimpse into BP’s effort to expand its operations and prove itself as a valuable local partner. The dual pipelines pass through more than a dozen predominantly rural municipalities in Azerbaijan, and it can be stated these communities

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<sup>182</sup> In July 2015, BP agreed to settle U.S. federal and state charges over the 2010 Deepwater Horizon accident, the result of an accident which killed 11 workers and spilled oil into the Gulf. The final amount is \$18.7 billion to be paid out over 18 years; this is in addition to the previous five years, in which BP has taken charges for more than \$40 billion in legal and cleanup fees (Gilbert and Kent, July 2, 2015).

<sup>183</sup>At the contract signing ceremony, John Browne, BP’s CEO at the time, presented \$5 million to President Aliyev to be used upon Parliament’s ratification of the Contract to refurbish a Baku hospital (Sagheb and Javadi, Winter 1994).

have been affected both positively and negatively by the pipelines. An early BP effort, the Community Investment Program (CIP) was created to develop local infrastructure, health care and educational services (Cornell and Ismailzade 2004: 63). Co-funded by the EBRD and the BTC Consortium, the CIP was designed to empower the communities and give them a sense of ownership and responsibility for the pipelines.<sup>184</sup>

The results have been mixed. In 2004 an independent assessment sponsored by the Open Society Institute-Assistance Foundation (OSI-AF) was hired to poll the local Azerbaijani residents on the construction project. The BTC consortium's CIP was specifically mentioned in the report, whereby workers noted "unfair labor practices and poor or non-existent medical treatment." There were also charges that local inhabitants were not adequately represented in the negotiations and during the construction process, lending to the view that Baku and BP were "too powerful" to address their concerns (Guliyeva 2005: 1-7).

The report also noted poor coordination between community groups and the project organizers, whereby community group leaders did not relay information down to the town members. Moreover, BP and the government overlooked some smaller communities along the pipeline route. Finally, there were no provisions for maintenance and upkeep once a project had been completed, so that many roads quickly fell into disrepair because of the heavy volume of truck traffic associated with the pipelines. There were also allegations that house damage was caused by this traffic (Guliyeva 2005: 1-7).

Another area of concern is environmental protection. BTC's Environmental Investment Program (EIP) was established to address such issues along the pipelines' route. The concern was (and still is) most acute in Georgia, where the pipelines pass near the Borjomi Gorge, known for its mineral water spring and an important source of export revenues. In Azerbaijan, local NGOs raised opposition to BTC/SCP passing through the Gobustan area, which includes the Gobustan National Park, a UNESCO World Heritage Site, yet SOCAR and the Ministry of Ecology and Natural Resources, minimized these concerns and pushed forward with the project (Cornell and Ismailzade 2004: 66). The implication is that SOCAR, because of its position as a powerful governmental entity, was able to override any environmental concerns, and whereby BP and the Baku government exploited the lack of social and political organization of the rural inhabitants. The OSI-AF report addressed some important findings, yet the notion that this was a grand collusion of government and corporate, creating a behemoth which tramples on the rights of the individual is not truthful; the reality is probably somewhere in between.

### BP's Operating Management Practices

The oil and gas industry is known for its intense competition, high capital expenditures and engineering complexities, all of which require meticulous planning and management practices via codified processes and procedures. Operations management practices are designed to

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<sup>184</sup> BTC Co. developed a "Resettlement Action Plan" to compensate for the land use during the pipeline's construction, with further plans to return the land for agriculture and grazing once the pipeline has been completed (Cornell and Ismailzade 2004: 63).

wring efficiencies and mitigate operational risk which might lead to accident or costly production delays, and maximize return on investment resulting in a relentless pursuit of cost savings through efficiencies and best practices. This emphasis on operations management focuses on careful oversight of the processes to produce and distribute products and services, such as inventory and quality control, storage, logistics and process evaluations. A great deal of focus is on efficiency and effectiveness of processes, which often includes substantial measurement and analysis of internal processes from sophisticated computer models. In addition to operating in a challenging competitive environment, few sectors are so highly scrutinized by both governmental and private sector groups.

The value of introducing the local workforce to Western management practices is another point of consideration. BP's management practices have been honed in the highly competitive international energy industry where there is little tolerance for failure or mismanagement. This emphasis on efficiency and process improvement has forced the companies to develop a keen awareness of corporate competitive advantage. Moreover, these efficiencies and the emphasis on process improvement are weak in most of the national oil corporations (NOCs) which, because of limited competition, lack this stringent oversight and subservience to the scrutiny of shareholders and government regulators.<sup>185</sup>

Therefore, BP's operating management system (OMS) is a systemic, corporate-wide framework which instills safety and quality control into its operations. There is also a performance improvement cycle embedded in OMS which promotes greater levels of worker empowerment and participation. This program of continuous improvement is designed to eliminate defects and address opportunities to ensure safety, reduce cost and enhanced quality of service. Approximately 350 of these projects were implemented by BP in Azerbaijan during 2013. These combined processes embody standard Western management practices in use for the last two decades in BP's Caspian basin projects, practices which were unfamiliar to those brought up in the Soviet era where such concepts of cost and quality control were unheard of (BP (18) Azerbaijan Sustainability Report 2013: 18).

BP also has programs to strengthen its human capital by promoting from within and developing a pool of candidates for current and future engineering positions. The 'Transition to Engineering' program is intended for local employees already familiar with BP's operating practices, who wish to pursue an engineering career within the company. It is a selective process which considers the individual's experience and growth potential. In 2012, 60 technicians applied for the program, 29 were interviewed, resulting in seven individuals selected for advanced training and promotion (BP (19) Azerbaijan Sustainability Report 2012: 24).

Additionally, BP in Azerbaijan implements ISO 14001: 2004, an environmental management system which ensures that operations are in compliance with local and international laws. The process involves internal and external inspections, as well as formal and ad hoc ones. The environmental monitoring program focuses on two activities; 'operations monitoring,' which evaluates outputs such as CO2 emissions and liquid discharges; and 'ambient monitoring' which

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<sup>185</sup> The main exception is Norway's Statoil, which, unlike most NOCs, has developed a well-deserved reputation as a highly efficient producer.

quantifies the impacts of emissions and discharges on humans, animals, air, plants, soil and water. The results are submitted via an environmental impact assessments (EIA), which are shared with the MENR and SOCAR, as well as the ACG and Shah Deniz Consortiums and the Azerbaijan National Academy of Sciences, an indication that BP's reporting efforts are integrated within the government machinery (BP (20) Azerbaijan Sustainability Report 2013: 34).

Another area where BP has implemented global technical standards is through the Extractive Industries Transparency Initiative (EITI), a process that promotes transparent reporting of company payments and government revenues in the extractive industries. Azerbaijan first joined in 2003 and became compliant in 2009. In Azerbaijan, BP has been working with government, civil society and other extractive industry firms within the framework of this initiative. Notable goals are to provide incentives, validation methods and improved governance methods within the EITI framework (BP (21) Azerbaijan Sustainability Report 2012: 43; Iskender 2006).

Azerbaijan's activities under EITI have come under criticism, with claims that it is a well-planned deception scheme in place via the Azerbaijani authorities. Jonas Moberg, the head of the EITI secretariat, noted that if the Initiative determines Azerbaijan is in violation of the rules, a suspension would be considered (Human Rights Watch September 24, 2014). Yet, there are also those who have questioned EITI's credibility as an industry watchdog. According to Julia Gouseva in her article, "EITI: a new global standard for lying," the EITI model is flawed in that it is not fully transparent and "only checks the data which have been provided," and is not privy to opaque agreements made between the government and SOCAR (Gouseva 2008). The implication that IETI operates in a closed system that is easily manipulated and which functions in BP's and SOCAR's interests.

To identify and develop businesses to meet its strategic goals, BP forges partnerships with local companies, preferably SMEs where possible. In 2007 BP created the enterprise development and training program (EDTP) to identify local energy sector companies capable of achieving international standards. In 2013, the company contracted with 28 local companies worth about \$93.5 million. Since its inception, 149 companies, including 28 in 2013, have completed the program. The EDTP has helped secure contracts with local and international companies, \$181 million with BP in Azerbaijan alone (BP (22) Azerbaijan Sustainability Report 2013: 47). In 2013 BP spent \$1.98 billion in Azerbaijan-based operations and projects, a 26 percent increase over 2012. Operations-only expenditure with local suppliers rose to about \$1.2 billion, reflecting increased links between enterprise development efforts and demand planning (BP (23) Azerbaijan Sustainability Report 2012: 44-45).

To be certain, the goal of this case study is not to provide BP with free publicity, but to highlight its activities which address the research question. While BP has placed emphasis on local engagement and workforce development, there are other, less altruistic reasons for BP's effort to develop the local work force; that is the preference to use local human resources where possible, as these workers are frequently cheaper to train and retain than are expatriate specialists. Hence the motivation to train future generations of engineers and skilled workers for its regional energy operations, as well as shore up Azerbaijan's weak infrastructure and skills deficit. Ultimately these efforts are designed to enhance productivity and the company's bottom line. Though

Azerbaijan inherited the USSR's strong educational legacy, at the time there were gaps (there still are) in petroleum engineering and management techniques, Western business practices and English language skills. The question is whether these skills will be carried forward and developed in future generations once BP leaves.

When looking at the broader impact of BP's activities in Azerbaijan, one of the salient considerations is the company's footprint, manifest in its business operations' impact on democracy and governance. For instance, has BP's combined efforts, and the wealth derived from them, enhanced Azerbaijan's democratic principles and governance and by extension, more broadly in the Black Sea RSC? Generally speaking, there are two schools of thought on energy's influence; a pessimistic or optimistic perspective:

On the pessimistic side, energy wealth is blamed for poor governance and lack of accountability which is felt throughout the Azerbaijani governmental and social spheres. Chapter 2 outlines many of the political and electoral improprieties within the Baku government, and the fear is that continued energy wealth will merely reinforce this activity. For instance, the conduct of presidential, parliamentary or municipal elections, have raised questions as to the influence of energy, and the money affiliated with it, as negatively impacting political competition. This is symbolic of the 'resource curse' that afflicts many countries' which are overly dependent on commodities to fund generous social programs with which to placate restive populations.

Speaking optimistically, supporters claim that Azerbaijan's proximity to Europe and its intersection with the European economy will result in gradual political and economic integration of the country into Western institutions and values. This will lead to improvements in democratic principles, good governance and respect for human rights. As an example, in 2001, Azerbaijan joined the Council of Europe, which prompted anti-poverty and anti-corruption measures, the establishment of a public media, the release of political prisoners, and amendments to the constitution, including opening the means for citizens to petition the Constitutional Court. The Council of Europe has also pressured Baku to strengthen the country's electoral law, and transfer power to the municipalities (Cornell and Ismailzade 2004: 67).

Additionally, Baku has taken steps to promote political and governmental transparency, especially in the energy sector. One example is Azerbaijan's state oil fund (SOFAR), where the IMF worked with the government to establish an annual reporting system, and whereby the executive branch coordinates more closely with the national parliament, and giving control to elected representatives. This includes transferring SOFAR's day-to-day operations from the President to the Parliament. Additionally, Western governments, international NGOs and aid agencies, such as USAID, the World Bank, and the OSCE, work with local NGOs and independent media to influence the decision-making and governance process (Cornell and Ismailzade 2004: 68).

Another area is poverty and unemployment, which were persistent problems throughout the country's history in the Soviet era and after. In 2004, 42 percent of the population lived below the poverty line, and over a million Azerbaijanis emigrated in search of economic opportunity; by 2012 this has dropped to 6 percent. Inefficient and potentially corrupting as it is, the impact of oil and gas wealth on public health and well-being is demonstrable (Cornell and Ismailzade

2004: 67; World Bank, Azerbaijan, date accessed August 9, 2014). Yet, this dramatic decrease in poverty is based on government subsidies, which are most likely unsustainable over the long-term.

The Azerbaijan Social Review Commission (ASRC) was established in 2007 as an independent advisory group to help the company recognize and address challenges to transparency, dialogue and public engagement of BP's Azerbaijan activities. The commission was active for five-years and produced five annual reports. It was not renewed at the end of its tenure in 2011. The ASRC talks of BP's 'boundaries,' or "...*what a foreign commercial company can or should address*" while operating in a host nation. The Commission holds the view that BP has a constructive and appropriate part to play in Azerbaijan in improving good governance, high levels of transparency, low levels of corruption, effective institutions and respect for the rule of law. For example, implementing stronger anti-corruption processes up and down the supply chain (ASRC Report 2011 4).

In 2010 the percentage of Azerbaijani professionals in the BP workforce was 87 percent. By most accounts this is a positive development, however the ARSC makes an interesting point, noting:

"...there may be certain positions in the company that might be appropriately filled by expatriate staff who, because of their separateness from Azerbaijani society, might be better able to make objective decisions or, for example, resist external pressures or present BP in the public sphere as more independent and hence build trust" (ASRC Report 2011 9).

Moreover, while BP must meet the PSA requirements regarding the proportion of national staff on its payroll, the Commission acknowledged BP's meritocratic approach, with the caveat that "... an expatriate may be the right person for a particular job, and a degree of heterogeneity is good for identifying and managing risks" (ASRC Report 2011 9). By being 'anchored' in Azerbaijan, and operating within the civil society, supporting fundamental freedoms and implementing anti-corruption efforts, BP is "... playing a positive role in Azerbaijan society" (ASRC Report 2011 19).<sup>186</sup>

After the 2003 presidential elections, opposition parties and NGO's accused the West and the oil companies of ignoring electoral fraud and supporting the Aliyev government for the sake of stability and EU energy security. This raises the claim that foreign governments and energy companies (read BP) are only interested in ensuring the viability of its oil and gas projects over the imposition of true reform. Moreover, these energy companies have no incentive to change this relationship, particularly if the implementation of reform impacts corporate profits (Cornell and Ismailzade 2004: 68).

In 2014, former US ambassador to Azerbaijan, Richard Kauzlarich, co-authored an opinion piece noting the extreme measures the Baku government was taking against both internal and external critics. Indicating it was "Time for Sanctions on Baku," the authors noted that Baku's smear

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<sup>186</sup> BP's responses to the 2011 ASRC Report can be found at (BP, (24) "Response: Azerbaijan Social Review Commission 2011).

campaign included recently departed U.S. Ambassador Morningstar, who had been critical of the government, “was subjected to various personal attacks by Azerbaijani government representatives...” (Kramer and Kauzlarich 2014). The question is, whether it is rightly or wrongly accused, how long BP can continue in the face of this criticism, and are these reforms legitimate or merely marking time while the gas is still flowing (Kauzlarich interview, December 29, 2014). BP has, so far, weathered the storm of global public opinion and the anger from the Baku government over diminishing oil production, though it can be reasoned this will be a convenient mechanism with which the Aliyev regime can pressure BP in the future.

It is without question that hydrocarbons have helped Azerbaijan’s development, and BP is a critical component to this rise. Indirectly, the company has helped establish a functioning state with governmental institutions that work considerably better than its neighbors. The importance of BTC/SCP for Azerbaijan’s sovereignty, as well as for its relations with the Euro-Atlantic community has been vital in helping create a modern, wealthy, albeit undiversified, economy. The pipelines ensure that Azerbaijan’s major economic assets are not in the hands of regional powers (Russian and Iran) that would be inclined to use this asset to influence or control Azerbaijan’s foreign and domestic affairs. It should be noted that Azerbaijan has also contributed to Europe’s energy security, an important geo-strategic consideration with Russia’s dominance of the energy market. How long will this last once the oil and gas fields run dry? Once Azerbaijan loses its status as a regional soft power, admittedly this could be several generations in the future, it may be susceptible to external pressures from Russia, Turkey and Iran.

How much is BP responsible for Azerbaijan’s progress or failure? BP’s presence in Azerbaijan has clearly contributed to the country’s GDP and helped elevate it into a maturing soft power in the Black Sea RSC. However, as noted by Cornell and Ismailzade, these relative political reforms have no direct correlation to BP and its projects, and would most likely have occurred in the general course of events. This research generally corroborates this view, though perhaps acknowledging that through its presence, BP helped accelerate these reforms.

Ultimately, unless true political reform is enacted, over the long-term there will be little indication of BP’s presence in the country. The possibility of exposing enough of the middle class, the sector which traditionally wields the most political, economic and social power, to Western practices, which will in turn force the Baku government to acquiesce. This is perhaps wishful thinking in a system which operates as a soft dictatorship and which has such strong control over the media and other civil institutions. Finally, BP is not the indispensable entity; the company could have easily been replaced by another Western IOC, where CSR is an accepted part of business.

Azerbaijan’s ability or even willingness to emulate the “Norwegian Model” and improve governance has disappointed many. Similar to Azerbaijan, most of Norway’s energy industry is under nominal government control. This includes its sovereign wealth fund of nearly \$870 billion (Norges Bank Investment Management, date accessed August 2, 2015). Norway manages its hydrocarbons with three government bodies: a national oil company (Statoil), a government ministry which implements policy; and a regulatory body for oversight and technical expertise. The Norwegian government applies a relatively light touch, providing the oversight structure, then giving a free rein to these entities. Furthermore, Norway benefits from the combination of



an ethical and efficient government and a robust and competitive political environment, i.e., checks and balances (Thurber 2011). Therefore, when considering the successes of the Norwegian model of separation of powers, transparency and political competition, all three are lacking in Azerbaijan (and most other Black Sea RSC states), and there is little BP, or any external entity, can or should do to change this in the immediate term.

The notion of using BP as a cudgel to open up Azerbaijan's (or the Black Sea RSC, for that matter) civil society is appealing to many who support CSR as a means of 'giving back' to the community. As noted earlier in Chapter 2, Azerbaijan's PSA's are generally flexible and unrestrictive; certainly more so than what is found in Russia or Ukraine, and this permissive environment allows BP to establish these CSR efforts. Moreover, BP's CSR programs are in place with Baku's encouragement, notably because it alleviates the government from performing these functions itself. So it can be stated these programs are important to both BP and the Aliyev regime, though perhaps for different reasons.

Hence the ASRC's question about 'boundaries,' however to advocate for a deeper social role against the will of the host nation may be ill-advised. BP will clearly walk a fine line as it continues in its capacity as Azerbaijan's primary generator of revenue. CSR may be a legitimate effort to improve its public image and minimize potential lawsuits via socially responsible programs, but ultimately, BP is not in the social engineering or government reform business; it is expected to make a profit and the corporate leaders are answerable to the shareholders. BP would find itself in an awkward, if not untenable, position if it made overt attempts to push the boundaries of Azerbaijan's cultural and political configuration.

While BP has had an impact on Azerbaijan, this is only part of the story. To fully address the research question within the BP context, it is necessary to look at the Black Sea RSC as a whole, and not simply as a purely Azerbaijani issue. Indeed, it is imperative to do so, as this dissertation addresses the Black Sea as a unique region instead of focusing on one specific state. If Azerbaijan can be viewed as a microcosm of the broader Black Sea RSC, what, if any, correlations can be made with the broader Black Sea region? What lessons can be learned from BP's experience that can be effectively translated within the region?

It can be argued that BP's relative success in Azerbaijan is partly attributable to the permissive operating environment guaranteed by the Baku government. It should also be recognized that Azerbaijan is not bound by the levels of public opinion and environmental concerns as found in the EU countries, and for similar agreements are not available within most of the other Black Sea RSC states. Yet even in this environment the ability to operate freely is somewhat illusory, as the ever-present reality of state control is visible in the form of SOCAR, SOFAR and other manifestations of Azerbaijani state power. Therefore, varying levels of state intervention, as well as domestic political realities, hinders any replication of BP's transformational model in the region.

Prior to the start of this analysis, it was believed that BP had a much stronger political and social impact over the last 20 years in the region, primarily from its activities in Baku. This perspective was also attributed to the company's dominant position in the region's pipeline infrastructure. To the casual observer, it would appear that BP exerts undue influence in Azerbaijani political and

societal affairs. This preconceived notion has proven to be untrue, though some explanation is required. Viewed through the lens of regional history, BP's relationship is exceedingly short, narrow and confined to a relative elite section of society, and it is questionable whether any transformational impact has filtered throughout Azerbaijan's broader civil society in any appreciable way.

When compared to the other entities highlighted in the case studies, BP certainly lacks the influence of the Energy Community, which is specifically designed and managed as a spillover enhancer, or the BSTDB with its ability to fund important niche projects which would otherwise never be realized. As an example, the Energy Community's PEI's range primarily in the hundreds of million to low billions per project. The BSTDB's contributions, while relatively small, are often partnered with much larger projects with well-capitalized lending institutions, notably the EBRD, which finances multiple projects throughout the region. Even a highly capitalized multi-national such as BP would be hard-pressed to match this kind of investment across the Black Sea RSC.

Finally, the Baku government has become more authoritarian during BP's tenure in the country, undermining the premise of Western norms somehow 'rubbing off' on the host nation via commercial activity. These activities by Western governmental organizations and NGOs may give the impression of governmental reform in Azerbaijan, though there should be little doubt that ultimate power lies with Aliyev. So it is difficult, if not impossible, to transpose the short-term experiences of one country across a range of dissimilar ones. What becomes clear is that BP's influence is as localized as it is limited, and it would be highly unlikely to see this influence spilling over in a significant way outside of Azerbaijan's borders.

Looking at the case studies in a broader context, the Black Sea RSC exemplifies the East-West soft power calculus at play, notably the evident position of energy as a transformational policy tool. The case studies were earlier described as real-world laboratories from which the transformational drivers can be analyzed, primarily the impact of energy on the political, economic and social spheres of the Black Sea RSC states. Moreover, they can be summed up succinctly in the following way; the Energy Community with its goal of market creation and streamlining the energy sector, the BSTDB with its targeted investments and BP with its mandate to extract and transport hydrocarbons.

All three cases demonstrate elements of Haasian neo-functional and political spillover, enhanced by Euro Norms and cross-border interaction manifest within the Buzan and Weaver regionalist model. Of the three case studies, the Energy Community exhibits the most spillover potential and BP with the least. Yet, this spillover is achieved in very different ways, and approaches the research question from two different perspectives. What is evident is the case studies highlight a combination of *top-down* and *bottom-up* driven change within the Black Sea RSC. In either case, whether top-down or bottom-up, both methods are powerful ways to instill change.

The top-down method denotes the transformational impetus, strategic direction and funding streams are derived from a higher organizational vantage point and pushed down to the

lowest levels. This configuration affords the most centralized control, but more specifically, top-down indicates the changes are deliberate policy efforts from the governing elite. The bottom-up approach indicates transformational change is manifest from the grass roots level and pushed up the social and governing hierarchy. Bottom-up cases are denoted by limited amounts of centralized control, whereby oversight and direction are provided by the local or municipal governments. Moreover, this can be considered as a less intentional, or stealthy, transformation process instigated from organized social or cultural entities among the population.

What is evident with the Energy Community is its demonstration of new regionalism in a top-down manifestation as a transformation tool. It is the most structured and focused of the case studies, where strategic direction emanates from the European Commission, and for this reason *it validates the research question with the most fidelity*. From a regional and energy-related perspective, it provides a template of the EU's energy acquis overlaid on a smaller, more fractious region, and though the case study notes the problems involved with such a complex effort, momentum appears to be in its favor. Similar to the Energy Community, BSTDB is the other top-down driven catalyst, enhancing neo-functionalist spillover. BSTDB receives this impetus from the BSEC and ultimately from the member states themselves, however in a less effective and disjointed approach than the Energy Community. And while the bank lacks the political and financial strength at Brussels's disposal, it has elevated BSEC's energy portfolio beyond the purely discussion phase.

Staying focused on the top-down examples, there are similarities between the Energy Community and the BSTDB, both of which concentrate on the cross-border interdependencies. For instance that the PECIs and the BSTDB's portfolios have broadly similar short-term goals, yet a telling shortfall noticed within these case studies is the lack of coordination between the Energy Community and the BSTDB's energy sector portfolio. Both entities partner with the EBRD or other IFIs, rely on free market solutions, albeit with differing perceptions and modus operandi. Despite the similarities between the organizations to foster cross-border interaction, this missing collaboration toward a broad goal can only be seen as a detriment to efficient cooperation, the ultimate impact is their lack of respective effectiveness. Another important dissimilarity between the two top down driven entities is that BSTDB lacks the legislative imprimatur, and the concomitant credibility that is afforded the Energy Community.

In the bottom-up example provided by BP, relative change is driven upward through the company's daily oil and gas exploitation as a by-product of its conduct of business. The BP case study is the least impactful of the three, whereby the company has a limited overall spillover effect within the Black Sea RSC. As noted earlier, BP lacks the incentives, strength and mandate to be a geo-political player, or to be anything more than an accidental or peripheral influence in the Europeanization process. Real power and influence, both domestically and inter-regionally, is exerted by Baku. This is a condition that will not change any time soon, unless instigated internally, via domestic unrest, to include a Baku-initiated play for Nagorno-Karabakh, or externally, most likely from Russia or Iran. Of course, any destabilizing event in one South Caucasus state is unlikely to be contained there for very long, a factor which must weigh heavily on decision makers in Baku, Moscow and Tehran.

Pushing deeper into the case studies, a consequential and central theme is identified, that of the free market at work creating this Westward shift. Indeed, the determination to extract and transport Caspian Basin hydrocarbons to Europe via a Black Sea infrastructure has created a new and relatively unfamiliar phenomenon in the region: blending state and private sector efforts. The energy liberalization effort underway, most notably via the Energy Community, has injected external commercial and business activity and, by extension, influence into the Black Sea's political and economic landscapes. The case studies successfully portray the value of public-private partnerships in the transformational process, notably how Europeanization and the spillover of Euro Norms to the Black Sea RSC is facilitated through the energy sector. This, in fact, demonstrates a critical component of the research question, whereby the public-private partnerships are highlighted in all three cases studies as key facilitators of the Black Sea RSC's transformation.

The Energy Community and BSTDB are compelled by a geo-political logic to force such cross-border and intra-regional interaction, therefore, it is possible to consider these as either deliberate or co-incidental transformational efforts. In this case, top down driven change appears the most effective; government sanctioned initiatives, which are targeted, concentrated and well-funded have proven most effective in driving change. While the Energy Community and the BSTDB are both top-down driven efforts, these are also tied to private sector entities to actually perform the work. For this reason it can be stated that of the top down, or government-led cases, spillover has proven to be the dominant phenomenon in the Europeanization process. A fact evident from the earliest days of the European Coal and Steel Union is this transformation is manifest in the drivers (external and internal) which promote functional spillover.

The idea of government-generated influence ranging across economic sectors to affect broader social change is not a new phenomenon within the course of human history. What is unique, and what has been identified in the process of answering the research question, is how this transformation activity is being planned, funded and executed *from outside the impacted region*. What is equally unique is that the sovereign non-member states are willing participants surrendering a degree of sovereignty for greater political and economic gain, with no real guarantee of future accession. The case studies merely reinforce the notion of neo-functional spillover, whereby the public and private sectors are capable of operating relatively freely across borders and economic sectors in an environment facilitated by the energy trade.

In "The Uniting of Europe" Haas mentions the "inevitability" of spillover, yet this is only partly correct; spillover can only be inevitable with state buy-in and a committed capitalization effort. Moreover, if contemplating a uniquely Black Sea RSC context; there is a blend of public and private cooperation in the region's energy sector which meets public policy goals with appropriate levels of competition and transparency. Looking further at a top-down driven free market, it is actually intuitive, whereby market forces, propelled by a critical economic sector (energy), create the condition for political, economic and social change in the Black Sea RSC. Having shaken off the strictures imposed by conflict and decades of ideological isolation, the Black Sea RSC, though still contested and poorly formed, is enjoying enough stability to transform itself and follow its natural trajectory, even if that trajectory is into the arms of a fickle EU organizational power.

This leads to another important point concerning the place of great power politics and its influence on regional dynamics. Neo-functionalist spillover and the Europeanization process encompassed by the five core Euro norms demonstrates how energy acts as an enabler of new regionalism, pushing beyond borders and ideological divides.<sup>187</sup> What it provides is an example of the complex intra-regional dynamics at play which also impact regional development. Yet, interestingly, it is also possible to picture a microcosm of the East-West divide, broadly manifest across traditional political, social and cultural lines. This becomes evident whereby the eastern energy exporting states, notably Russia and, to a lesser extent, Azerbaijan, are pitted against the western energy importing states. Perhaps a somewhat simplistic interpretation, but with some validity, particularly when determining the impact of the larger or great powers on Black Sea RSC development.

Behind each of the case studies exists a larger public policy goal; the Energy Community's ability to incorporate South East Europe within the broader EU's legal environment, the BSTDP to engender cross-border cooperation and economic development. Even BP, though not a policy-making arm in its own right, is a function of the Baku government's desire to modernize and integrate into the Western political and economic sphere, as well as perpetuate its hold on power. What can be determined in all three cases is the subtle blending of the private sector and policy goals. In fact, the theme of economic liberalization is highlighted throughout this paper, whereby governments see the value in fostering competition and open economic systems to derive efficiencies and revenues. This is particularly relevant with such a high value and relatively abundant commodity as energy.

When revisiting the research question first posed in the Introduction; *how does energy act as a transformational agent in the emergence of a Black Sea region*, it can be confirmed the basic premise of the research question is answered in the affirmative; energy is helping create a unique region comprised of the ten Black Sea states. What becomes evident, in the case of the Black Sea region, is that fossil fuels play an inordinately large role in the regional development and transformation process. This is attributable to the realities of basic supply and demand; European demand being met by suppliers (Russia and Azerbaijan), and the remaining regional states sandwiched in between. Additionally, coupled with the value of secondary energy as a transformational tool, it provides a powerful mechanism for regional change. Ultimately, when harnessed to a coherent, planned and well-funded public-private agenda, energy is without peer as a transformational agent, a fact currently being established in the Black Sea RSC.

Yet, there is more to answering the research question than simply affirming that energy is a transformational catalyst within the Black Sea RSC; energy has been transforming human society there (and around the world) since the mid-19<sup>th</sup> Century. A dynamic that has been implied through this dissertation, though not seriously addressed until now, is that of a classic great power rivalry superimposed on the region. Though the EU and US hold relatively similar perspectives as the Western partners, there are clear differences in goals and the means of achieving those goals. For instance, both states seek a free market solution, and are not shy about promoting Western political and cultural values; though the EU relies solely on soft power, while the US is willing to use a mixture of hard and soft power. Russia, on the other hand, is

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<sup>187</sup> As a reminder, these are: 1) the centrality of peace, 2) personal liberty, 3) democracy, 4) the rule of law and 5) human rights (Manners, 2002: 242)

determined to pursue the central economic control model, and demonstrates no reluctance to use military might to achieve its goals. With such diverse perspectives working in close proximities, future ideological clashes are to be expected.

Turkey, as the other regional great power, albeit with limited intra and extra-regional reach, had nominally folded loosely under Europe in previous decades, may opt for a Neo-Ottomanist future outside of any overt external attempts to dominate it. Finally, two other distant great powers with relative influence, India and China, factor into this discussion, if only on a peripheral level. This influence will take the form of a demand for energy products and services to meet these two countries' growing economies, though it will not manifest itself into a direct rivalry in the foreseeable future.

What is visible is a 21<sup>st</sup> Century version of great power rivalry taking shape, but with a new regionalist context. In other words, a blend of neo-realism and constructivist aspects in line with the Buzan and Wæver theorem, however, it is a regionalism still heavily influenced by great powers. In fact, this great power influence will persist well into the future and despite the inevitable rise of the region writ large. Moreover, the overlapping great power influence as evidenced in the Black Sea RSC can be considered a work in progress and moving along a non-linear progression; that is in hap hazard fits and starts of contestation, notably between the EU and Russia, as well as, to a lesser extent, Turkey.

Looking at Bratianu's 'intersection' it is possible to observe both external and internal great power dynamics at play. As the distant power, the US wields considerable penetration capacity vis-a-vis the Black Sea RSC, however, penetration is the weaker of the external influencing attributes as defined by Buzan and Wæver. The stronger and most influential external power attribute, overlay, is present with both Russia and the EU, with a fairly clear demarcation between the eastern and western member states. In other words, Bulgaria, Greece and Romania are aligning (perhaps not smoothly) under Brussels and the south Caucasus states falling under Russian overlay. Armenia, Georgia, Ukraine and Moldova are currently being contested, with the possibility of a permanent schism provided by a great power brokered solution. What becomes clear, even in a transformed Black Sea RSC, the smaller or weaker powers will inevitably be forced to choose sides among the region's larger powers.

## Conclusion

“...whenever economic life around the Black Sea flourished, it was done so in connection with increased exchanges with global markets” (Manoli 2014: 4-5).

“In an ideal world, Russia and the European Union would be partners in achieving mutual energy security,” (Roberts 2015: 16)

Work on this PhD began in the fall of 2007, shortly after Vladimir Putin’s Munich speech, and approximately 18 months after the 2006 gas crisis. While East-West tensions were high, they were manageable, generally operating under the belief that each side needed the other. While arguably true, this has not stopped a deterioration in relation in the ensuing 9 years. Putin’s speech proved to be an abrupt departure from precedent, causing many observers to question whether this hard line from the Kremlin was heralding a new Cold War, or at least an extended period of difficult relations, not least exacerbated by confrontations on energy policy, as well as Georgia, Ukraine and Syria (Shanker, February 11, 2007). These observations have been generally proven correct; while not precipitating a new Cold War, relations between Russia and the West have clearly worsened with little possibility of improving in the immediate term.

The course of this research has highlighted and reinforced the research question’s basic premise; the growing influence of fossil fuels and their means of delivery have effectively transformed the Black Sea RSC. Yet, it must also be reiterated that this transformation would have been impossible without the demand signal emanating from the West. It is also more than purely a dispassionate analysis of supply and demand; Europe provides an attractive role model to those in Eastern Europe living under corrupt or incompetent government and limited opportunities. Therefore, the trade in oil and gas, as well as electric power, perform the role as initially described in the introduction; as drivers of change. Moreover, the EU, and more suitably, Europeanization, clearly stands out as the primary driver of the Black Sea RSC’s transformation.

Returning to the earlier statement of Russia as the consequential Black Sea state. This period of research has witnessed Russia’s dramatic rise and relative decline as an energy power and its concurrent drift to authoritarianism. Indeed, Russian economic weakness will become more apparent as time passes, particularly as sanctions and investor reticence deprives Moscow of FDI needed to exploit its energy riches. Russia will settle into a position as a regional power with diminished geo-political capabilities, unable to meet its ambitions as a global power. It is possible that China will fill this investment shortfall, though it is more likely the age-old Russia-Sino rivalry will scuttle this relationship sooner rather than later (The Economist, (31) January 2, 2016: 39). In the end, the last nine years have proven to be a fascinating foray into a geo-political and cultural laboratory, where great power machinations to gain advantage at the expense of their rivals were witnessed and documented firsthand.

### Preconceived Notions, Misinterpretations and Revelations

There were many preconceived notions or misinterpretations held at the beginning of this academic journey, beliefs based on preliminary or faulty assessments before adequate research

had been conducted. Most notable was the belief that a structured and coherent region was developing among the ten Black Sea states; admittedly not to the extent of a European Union, but the beginnings of a pronounced regional structure. It was the RSCT analysis in Chapter 1 which demonstrated a weak regional entity, though with limited capacity to act in unison, and with even more inability to develop into a stronger regional unit under current geo-political conditions. This altered notion was affirmed throughout the course of this research.

Equally important and interrelated was the misinterpretation of the impact of the two primary transformational drivers; the EU and BSEC. The BSEC's influence on the research question was overestimated in the belief that the organization was a true catalyst for change, particularly through its energy portfolio. In fact, early hypotheses viewed BSEC as pushing the internal drivers as autonomously motivated through undefined social, political and economic forces. This was based on the belief that the Black Sea RSC was progressing in linear trajectory, directly commensurate with its growing influence as an energy conduit. This was also based on the assumption that Russia and Azerbaijan were both members and capable of wielding influence as regional energy producers.

Consequently, it was believed that transformation was a result of equally balanced external and internal drivers, whereby Russia and Azerbaijan's energy power negated the EU's economic and political power, in other words, a relatively even balance of supply and demand. In this capacity, it was believed, that BSEC acted as a countervailing force to the EU's economic and political heft. By the same token, while BSEC's power as a driver was overestimated, the EU's influence was underestimated, notably the impact of the energy acquis and its ability to force change. It was during the course of the research of the external drivers that the European Commission proved to be the primary driver of regional transformation, more specifically, the economic and political weight of Germany as the engine behind this transformational driver.

BP proved to be an interesting case study. As a major IOC with unprecedented operational control of a small country's oil and gas sector, it was expected the BP would wield exceptional influence not only in Azerbaijan, but, by extension, within the Black Sea RSC. This was primarily through the company's ability to provide cash infusions or other key and targeted investments to win the 'hearts and minds' of the local population. In fact, BP's influence was found to be much less than originally expected, not only at the governmental level but within Azerbaijani civil society.

This raises interesting questions about the effectiveness of regional private sector plays without significant government backing, notably "Can the private sector survive in the region without some form of enduring government affiliation?" The answer is most likely not, or not for very long, primarily because of the legacy of strong governmental control which stifles the nascent private sector. This is particularly so in the energy sector which contributes so much to state revenues, whereby the temptation is such that national governments will raid corporate profits for their own use.

Another significant underestimation was the impact of secondary energy in the region's development and its position as a natural transformational tool. The power sector is highly regulated and structured, and is an influential component to the regional transformation equation,



though still lesser than fossil fuels, and lacking their overt political power. Again it was the impact of the European Commission and its regional agent, the Energy Community via the *acquis*, which pushes this effort. Additionally, electricity standardization provides a powerful economic benefit for consumers as well as an integration and cooperation tool, and similar to oil and gas pipelines, cross-border electricity transmission lines force bilateral interaction.

There was also a misunderstanding of the role of the great powers in the region. With Russia's dual duty of Black Sea RSC member state and resurgent great power, it was envisioned that the other powers (US and to a lesser extent, China) would be relegated to that of interested observer. This notion was found lacking, particularly when it was revealed the US exerted considerable diplomatic and economic influence to establish the European Energy Corridor in the early 1990s. Moreover, it was also determined that the EU was, in fact, a great power, (or institutional power, as Buzan and Wæver identify it), and exerted considerably more political and economic influence than was originally expected.

Staying with the great power theme, EU-Russian relations, in particular, will continue to ebb and flow, noting the inter and intra-regional amity and enmity which provides the regional transformational friction that is so evident in the Black Sea RSC. In his article, "The European Union and the Black Sea Region in Search of a Narrative or a New Paradigm," Dimitrios Triantaphyllou outlines the 'alphabet soup' of failed EU initiatives toward the FSU over the last 25 years. Furthermore, in the article Triantaphyllou references Ian Manners by noting the limits to European normative power, particularly under Russia's effort to derail this effort (Triantaphyllou 2014: 286).<sup>188</sup>

This is clearly the case in the immediate and near-term, though a failure by the Kremlin to change course and institute political and economic reform over the long-term, could result in further Western political, economic and cultural encroachment. Continued state inhibitions of personal freedoms and failure to provide financial security for its citizens will be challenging enough, particularly when a successful alternative is in plain view across the border. Finally, there is a sobering fact which should be mentioned and which also puts much of the great power rivalry discussion in perspective; that Russia's GDP is approximately that of Italy's, so without significant economic reform, there is a limit to what it can achieve outside of its immediate 'near abroad.' Moreover, even a concerted effort by Russia to exert stronger influence in the Black Sea RSC would require a relative Western retreat and acquiescence, which does not seem imminent even under current leadership in Brussels and Washington.

That being said, the best way for the EU to keep Russia at bay and engender Black Sea RSC transformation is to reform its members' economies and expand economic growth. Brussels has its own problems which need to be addressed, primarily through its own economic and political reform, which appears to be making little headway in light of the recovery from the recent recession and banking crisis. This does demonstrate the continuing challenge integrationists have with imposing regional or extra-sovereign control over nation states unwilling to accept it. The key to enacting these reforms within the EU is a vigilant and self-confident Germany, capable of leading such an effort. To date, that vigilant and self-confident Germany is nowhere to be found.

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<sup>188</sup> Triantaphyllou provides a comprehensive list of this 'alphabet soup' on page 289.

One of the most significant phenomena to emerge in the global energy industry since 2007 was the commercialization and widespread application of hydraulic fracturing. Daniel Yergin heralded the beginning of large-scale fracking with his 2009 Wall Street Journal opinion piece referring to a pending gas ‘revolution’ (Yergin 2009). The results have been tremendous over the ensuing half decade, notably in the realm of geo-politics; the fracking ‘revolution’ has initiated North America’s reemergence as a global energy producing power. In the US alone, fracking is behind the near doubling of daily output from 5 million b/d in 2008 to over 9 million b/d in 2015 (The Economist, (31) January 23, 2016: 9).

This recent activity from North America, combined with reduced demand from Asia, has resulted in dramatically lower oil prices and put economic and political pressure on traditional global energy powers. In the Black Sea RSC, these traditional energy powers, Russia and Azerbaijan, are also increasingly under pressure to maintain spending levels on social programs vital to keeping the populace content. Therefore, a host of newly introduced factors are undermining the status quo throughout the global energy industry, whereby traditional energy powers are coming under increasing pressure. For instance, it is possible that Saudi Arabia will lose its position as the world’s swing producer, stepping in to meet unmet demand on short notice to stabilize prices, whereby this vital and influential function may have already (or soon will) shifted to the North American frackers.

#### The Black Sea RSC: Looking Forward

That the presence of oil and gas has changed regional dynamics is clear, yet the extent and depth of this change is too soon to tell. Reverting back to the earlier discussion of the post-Soviet “space,” and by extension the research question, how has the potential for energy wealth helped shape this space which has been identified as the Black Sea RSC? If energy is the primary driver, invariably economic and commercial issues will revolve around the flow of capital and wealth creation. *Thus it is possible that a Black Sea RSC is in fact as much a ‘commercial fantasy’ as it is a geopolitical one, created in the minds of politicians and oil executives for the purpose of exploitation.*

It is likely that as the levels of commercial interaction grow, intertwine and become stronger, relationships will continue to thrive, both intra- and extra-regionally; though much depends on Russia’s posture in the coming years, as well as the EU’s willingness to stabilize its eastern border and the willingness of the United States to remain engaged. The presence of so many regional and global powers vying for influence contribute to a high level of tension and instability at the state and regional levels. This premise reinforces the role of finance and trade, whereby forces of change are derived from the flow of capital, which creates the spark of interaction and transformation. It is the need for investment capital and the lure of anticipated wealth and influence which is driving both the commercial and geopolitical interests. These are the ground level funding mechanisms which forces the interactions and which ultimately address the research question.

Transformation has not and will not occur in any cataclysmic flash, but in slow, incremental changes. Whether initiated by top down or bottom up efforts, such changes occur at the grassroots level which influences culture and civil society, and where the genesis of change

begins. Richard Ladrech noted Europeanization as an “incremental process reorienting the direction and shape of politics” to where political and economic norms and actions are integrated within the state’s structural framework (Ladrech 1994: 17).

To understand the Black Sea RSC’s transformation, one must first recognize the European role in the process, predicated on a viable EU as a political and economic entity, and which has managed to coalesce as a larger and regional entity in its own right. The notion of a consolidated Europe as a lasting entity enjoying sustained political and economic coherence and stability is a rarity; arguably unseen since the time of Charlemagne. The current prolonged peace and prosperity in the second half of the 20<sup>th</sup> Century is certainly unprecedented, yet, it is this very peace and stability, and the related economic growth, that has allowed the EU to be such an influential entity over the last 50 years.

The EU’s economic and political influence is undoubtedly moving eastward into the Black Sea RSC. Moreover, it is the mutual needs of economic and political stability that have pushed the two entities together on a slow motion collision course, with the expected contestation and inter and intra-regional clashes. It is through such an inter-regional collision that a politically and economically dominant EU is incorporating much of the non-Russian Black Sea RSC within its normative zone of influence. What is evident is the EU’s own spillover qualities are creating this transformative environment among its eastern neighbors. This manifestation of Europeanization and with it the embodiment of its core norms via the Black Sea RSC energy infrastructure, enables spillover, a fact which satisfactorily addresses the research question. Moreover, the EU’s soft power, backed up by US hard power versus Russian hard power will prove dominant over the long term.

Panagiota Manoli notes there is an “inclusive, innovative, and integrated Black Sea region,” and on a certain level, this dissertation is in agreement (Manoli 2014: 1). Yet, is the Black Sea RSC a valid notion and is it capable of being transformed through energy trade? The answer is yes, though not to the extent that was initially envisioned. Moreover, this regional development is subordinate to a much stronger European dynamic taking shape. While energy is the motivating factor in the Black Sea RSC’s transformation, it is the capacity of wealth creation which provides the spark behind this motivation, and without the potential for wealth, the region’s development would be much different.

Nevertheless, the EU will be *the* deciding factor, more so than any other, of how the Black Sea RSC will align itself in the future. As the European center of gravity continues shifting to the east, this continues to work in Germany’s long-term favor. This also gives further indication of the EU’s political, economic and administrative shift to the east, for example the presence of Moldova, Ukraine, and most recently, Georgia in the Energy Community are in the vanguard of this eastward movement of westward standards and practices. Furthermore, it is also possible to see a growing influence on the eastern end of the east-west axis, particularly as China and India seek energy for their growing economies. Great power politics is still influencing regional dynamics, and outside of warfare or the application of coercive hard power, this is outcome is unavoidable.

Another phenomenon is the relatively recent emergence of the Eastern Mediterranean as an area in play. This has created an interesting side effect which is the widening of the Eurasian Energy Corridor's traditional footprint, and which now encompasses the Eastern Mediterranean, as well as Iranian and Persian Gulf states. The newly discovered gas fields in Israeli, Cypriot and Egyptian waters present a new range of geopolitical possibilities which will impact the Black Sea RSC, and its position as a gateway to European markets. Indeed, this could lead to a diminishing impact of the Black Sea RSC, particularly as the Shah Deniz gas is diluted with other sources ranging from Central Asia, the Persian Gulf and the Eastern Mediterranean. Such an eventuality simply reinforces the notion of an even more brittle and fragmented Black Sea RSC. This is an interesting phenomenon worth watching in the future.

Finally, there are openings for a series of speculative questions and seemingly endless possibilities. Could it be that a modern-day version of mercantilism is now emerging, whereby great power rivalry disguised as public-private partnerships is manifest? Are carefully crafted beggar-thy-neighbor policies enacted by Brussels and Moscow, and to a lesser extent Washington and Beijing being put in place? Policies designed to further great power influence via energy trade, but are becoming regionally derived? Perhaps the age-old notion of "commerce following the flag" is now reversed.

There have been many destabilizing events in the region during this period of 2007 to 2016, which merely highlight the perpetual contestation present in the region. The geo-political realignment underway on the Bratianu intersection can be likened to tectonic plates shifting under intense pressure, such pressure applied by inter and intra-regional amity and enmity. Once again, the wisdom and foresight of Bratianu's Black Sea intersection model is on display.

The Black Sea RSC will continue to be a brittle region; uneasy and contested, subject to the whims of great powers which exist both within and outside the region. This great power rivalry, driven by the energy trade, will persist into the future along this most pervasive and consequential of geo-political fault lines. Therefore, a smaller, fractious contingent of Black Sea states will eventually be subsumed within this great power rivalry, much as they are now and have always been. Ultimately, there are too many variables with inherent complexities of technology, markets and geopolitics which will deny any sort of neat package or clear visions into the future. It is a messy, frequently disappointing and somewhat dissatisfying result, but one based on Black Sea RSC realities.

## Appendix A: IHS-CERA Study on the Feasibility of a Turkish Straits Bypass

It should be noted there is debate on the economic and security necessity for a Turkish Straits bypass. A 2012 study by IHS-CERA makes this case, stating that crude oil alone accounts for only 3.2 percent of traffic in 2010, whereby combined crude and refined products comprised 5.4 percent of the total shipping. In 2010, 69,338 vessels made the passage, a 5 percent increase over the previous year. Of this number, 10,226 were tankers shipping crude oil, refined products, chemicals and gas, a 13 percent *decrease* from 2009 (IHS-CERA 2012: 5-6).

Furthermore, the emphasis on ship safety, aided by technological and procedural improvements, particularly for tanker traffic, ensures additional scrutiny and oversight making the possibility of an accident even more remote. In fact, the report notes the greatest risk comes from non-tanker traffic, which comprised 85 percent of the total passages in 2010, a 9 percent increase over 2009. Additionally, IHS-CERA estimates the number of oil tanker passages will drop from 9,000 in 2010 to about 5,900 by 2025, a 34 percent decline, primarily due to the larger and modern Suezmax oil tankers.

In terms of volumes, the total oil quantities in 2025 are expected to approximate those of 2010. Finally, the 2001 modification to the Russian tax code makes it less advantageous to export refined products, further reducing the quantity of fossil fuel through the Straits. Given these estimates, the argument exists that the sunk and transit costs associated with pipelines do not outweigh the benefits of speed and volume that tanker transport provides (IHS-CERA 2012: 3, 25-27). If the IHS-CERA study is accurate, it is not the economics equation but the political risk that creates the impetus for a bypass.

As is often the case, political imperatives trump economic realities, and Turkey, with strong backing from the regional stakeholders and the West, has already embarked on a bypass policy and is unlikely to reverse this initiative. The IHS-CERA analysis notwithstanding, pipelines are destined to play a significant role far into the Black Sea RSC's future and the prospect of backing off from this policy is a decision the Turkish authorities do not want to take.

## Appendix B: Soviet Turbo Drill Technology

In the mid-20<sup>th</sup> Century, the East-West technological divide was presented in stark reality in the energy sector. This was exemplified in the poor quality of Soviet drill bits and pipe which necessitated frequent replacement or resulted in accidents and frequent and expensive work stoppages.

Early drilling techniques used manual or automatic boring procedures which relied on brute force and gravity to punch a hole into the reservoir from where the crude could be extracted. This method was inefficient and time consuming, and by the late 19<sup>th</sup> Century rotary drills were more commonly used on a worldwide basis. In the 1940s and mid-1950s, as the requirement for deeper wells increased, Soviet engineers reached their limit because of poor quality steel in the pipe string and tool joints could not withstand the additional pressure at those depths (Campbell 1975: 20-21). Furthermore, the drill bits would wear out after only short periods of use, necessitating continual replacement, a time-consuming process.

In the 1950s Soviet engineers were able to find a solution with the turbo-drill which placed the pressure on the water-activated bits, thereby alleviating pressure on the pipe (Goldman 1980: 38-42). By mid-1950s the majority of Soviet drilling (85 percent) shifted from rotary to turbo drilling, (Campbell 1975: 21). However, this was only part of the solution as the drill bits still wore out at much faster rates than Western-made bits, and Soviet crews were limited to depths of 3,000-3,500 meters (Goldman 1980: 40-41).

The Soviets realized that their only hope of acquiring the technology was through Western companies, either by equipment purchases or joint ventures (or theft), but these options were highly restricted by both Western or Eastern governments (Goldman 1980: 40, 128). This demonstrated Soviet innovation to address systemic failures with only marginal by successful long-term improvement. Ultimately, the Soviets were never able to overcome the systemic quality problems in its steel industry.

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