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Iran and Energy Cooperation in the South Caucasus: Prospects for the Post-Sanctions Era

By Hamed Kazemzadeh, Warsaw

Abstract

The collapse of the Soviet Union and its replacement by independent republics had a significant effect on the geopolitics of Iran, especially on its northern borders. Within these new geopolitics, Iran functions as a land bridge connecting the two major energy-producing regions of the world, i.e., the Caspian Sea and the Persian Gulf. This new situation has had a profound impact on Iran's security and foreign policy, as have the Iran nuclear deal and the lifting of related international sanctions on Iran, which—for years—had obstructed the expansion of international economic relations and energy cooperation between Iran and the Caucasus. Thus, it can be argued that the prospect of cooperation between Iran and the South Caucasian countries will change in the post-sanctions era, especially regarding investment expansion policies and the joining of potential regional pipelines for the purpose of supplying energy resources.

Background

The void created by the dissolution of the Soviet Union in 1991, combined with the rich energy resources of the Caspian Sea and the South Caucasus, directed the attention of the regional and transregional powers to this geopolitical area. Furthermore, the transformation of the previous two Caspian-littoral countries into five countries, four of which are former Soviet Republics, marked the beginning of serious competition at different regional and international levels.

After the dissolution of the Soviet Union, the Islamic Republic of Iran achieved a unique geopolitical position in the region. Iran has consistently tried to play a decisive role in the region's energy equation. However, due to political restrictions and international sanctions, it has so far failed to satisfy its own needs and to achieve its goals, especially in areas such as energy transfer and energy investment (oil and gas). On the one hand, Russia has tried to retain its traditional influence and control over the Newly Independent States by establishing a monopoly over all export routes. On the other hand, the United States, a new and serious competitor in the region, favors routes that, in line with its long-term goals and geopolitical interests, can limit Iran's role in the region.

It should be noted that the Caspian Sea and the South Caucasus are among those regions that have long-standing historical ties, as well as geographical proximity, to Iran. Because of this proximity, Iran considers them potentially important.

Iran's Position in the Geopolitics of Energy Transfer through the South Caucasus

Iran's geographical and strategic position in the region has provided it with immense potential for cargo and

energy transfer and also made it a viable choice as the pipeline route for Caspian oil and gas exports. Although it will require modification, investment, improvement and completion if it is to meet global and regional demands, the Iranian domestic infrastructure for oil and gas transfer is, in its current condition, relatively developed. Now that sanctions have been lifted, Iran can potentially act as a bridge, connecting the Caucasian countries' energy to the global economy.

The change in the world order following the disintegration of the Soviet Union, concurrent with the increasing importance of the Persian Gulf and the Caspian Sea as the world's great energy repositories, have all led to an increase in the geopolitical significance of Iran as an intermediary between these two energy reservoirs. While 70% of the world's reserves of oil and gas lie in this region, Iran is the only bridge between the Caspian Sea and the Persian Gulf.

With regard to energy transfer, Iran's operation is twofold: it includes both oil swap and the gas pipeline between Iran–Armenia, Iran–Nakhchivan, and Iran–Azerbaijan. Oil swap is a three-step operation in which Iran receives crude oil from its neighboring countries via oil tankers to the Iranian port of Neka at the Caspian Sea, transfers this oil to its northern refineries—currently located in Tabriz and Tehran—through the Neka–Rey oil pipeline, and then refines it. In return, Iran exports oil, equal to the amount received in its northern port, from its southern ports at the Persian Gulf on behalf of the countries supplying the northern refineries. At the moment, Iran is more focused on importing oil from other oil-exporting countries, where the three Caspian ports of Anzali, Noshahr, and Neka receive oil by-products from the Caspian Sea countries.

Energy Transfer Challenges for Iran

Iran faces regional challenges and obstacles concerning the potential benefits of the transfer of energy from the Caspian Sea to global markets. These obstacles include economic-political weakness and the instability and independence of energy-producing countries in decision-making; the strategies of the U.S., Europe, and Israel on Iran; the serious competition between Turkey and Russia for dominance over the region's export routes; and finally, Iran's weak foreign policy in the face of such challenges. Regardless of the different commercial and trade benefits, Iran's ability to transfer Caspian Sea energy is one of the issues that is emphasized by its economic competitors and political opponents.

One of the significant consequences of the new geopolitical competition between Russia and the U.S. for control over and access to energy resources and transfer routes was that energy became the first priority of the European Union's foreign policy toward neighboring countries and regions. Despite the considerable energy transfer challenges faced by Iran, especially those posed by the United States, Iran does currently have some opportunities and capabilities, many of which are due to the beginning of a new era of tension between Russia and the West resulting from the events in Ukraine.

Iran's Strategy for South Caucasus Energy

As mentioned earlier, energy is one of the most important elements contributing to Iran's achievement of its participatory goals in the region. Large oil and gas reserves, a strategic geographical location, and proximity to major energy-producing and energy-consuming countries have contributed to Iran's special situation in the region. Taking advantage of this proximity and considering potential economic benefits, Iran conducts its energy trades through export, import, swap, and transit. With over two thousand miles of coastline in the south, Iran makes it possible for the northern landlocked countries to have convenient and secure access to global markets. At the same time, Iran's ports, refineries, and oil and gas pipeline networks offer considerable logistical and technological advantages to the oil and gas exporting countries of the Caspian Sea. In this regard, the 3+3+1 Model Framework for Regional Cooperation guarantees regional cooperation among the three Caucasian countries, the three regional powers (Russia, Turkey, and Iran), and the European Union. Energy connects the countries that produce, transfer, and consume it. Thus, it is quite obvious that energy can play a central role in furthering their collective interests, contributing to the promotion of regional cooperation by creating links among producing countries, transferor countries, and consuming countries.

Iranian Prospects for the Post-Sanctions Era

The nuclear deal that was reached on 14 July 2015 between Iran and the P5+1 (US, Russia, China, UK, France, and Germany), combined with the lifting of sanctions against the Iranian economy in January 2016, offer the potential for the implementation of a major energy model with long-term, large-scale financing and investment contracts in pipeline infrastructure. Accordingly, attention was drawn to the prospect of international companies' return to Iran, which has the potential to increase investment in various sectors of the Iranian market and to facilitate Iran's entry into the international arena as an active player. In addition, Iran's rich energy resources, along with the country's willingness to recapture its previously owned markets and its potential entry into new markets, have given the energy sector great potential to develop in the post-sanctions period.

The Iranian gas exports model adopted during the post-sanctions era will, in turn, influence the EU's Eastern Neighborhood Policy (ENP). Under the post-sanctions conditions, the EU will have the opportunity to strengthen the security of its natural gas supply by building up stability across its eastern neighbors through integrated cooperation in energy transfer with Turkey, Azerbaijan, Georgia and Turkmenistan. It seems that Turkey and Azerbaijan prefer to have Iran contribute to the Southern Gas Corridor and expand to Turkmenistan through the proposed Trans-Caspian Gas Pipeline. It should be noted that Turkey, as a gas hub, is trying to establish itself as a transit route for all of the region's energy resources. So, the Turkish policy of inviting Iran (Tabriz-Erzurum) and Russia (Blue Stream, Turkish Stream) to contribute to all projects stems from Turkey's being a gas hub for the EU.

Shortly after the enforcement of JCPOA, there were serious discussions of the possibility that Iran could supply natural gas to Georgia. Based on the proposals outlined so far, Iran has announced its willingness to transport natural gas through Armenia to Georgia. Although it was declared that such a measure only served to supply Georgia's domestic needs, further realization and development could pave the way for bringing Iranian gas to European markets via the Black Sea. Moreover, the implementation of this project could have a significant impact on the geopolitics of energy across the region, further diversify energy sources in Georgia, and engage Armenia in Caucasian energy transmission projects.

Georgia, as a transit country, can obtain a share of any Iranian gas flowing through the Southern Gas Corridor or other potential pipelines toward the EU. According to the official announcement of the managing director of the National Iranian Gas Export Co. in 2016, after

the sanctions were lifted, Georgia imported more than 24 million cubic meters of Iranian gas through Armenia. No gas export contract was signed between Iran and the Georgian government, but a private company named GIEC imported gas from Iran. One of Iran's other goals is to join the Azerbaijan–Georgia–Romania Interconnector joint gas project and the South Caucasus Pipeline in the region.

Accordingly, cooperation in energy exports is high on Iran's agenda in its relations with Azerbaijan and Armenia. Concerning Azerbaijan, "During President Aliyev's visit to Tehran on February 2016, another important agreement was signed on the construction and operation of hydroelectric power plants. However, in public, the emphasis was placed on the other aspect of energy cooperation, namely the agreement to develop a bilateral 'oil swap' mechanism."¹ At the same time, "Iran is Armenia's fourth-largest trade partner and the only alternative to Russia for natural gas supplies. Armenia and Iran have been swapping gas for electricity. An existing, 1.1-billion-cubic-meter-capacity pipeline owned by the Armenian branch of Gazprom links the two countries and, if upgraded, could supply most or all of the roughly 2.5 billion cubic meters of gas that Armenia needs annually."²

Conclusion

In summary, Iranian prospects for the post-sanctions era include the following:

- a. A policy that emphasizes—in all diplomatic talks—having the ability to export energy to all international markets due to having one of the world's largest energy reserves.
- b. Supplying some of Europe's energy by joining regional export pipeline projects such as the Southern Gas Corridor, TANAP, and the Trans-Caspian Gas pipeline.
- c. Energy imports from the region to reduce other countries' ability to export, allowing Iran to transform itself into an energy hub of Central Asia, the Caucasus and the Caspian Sea region.

About the Author

Hamed Kazemzadeh holds a doctoral degree from the University of Warsaw (Poland), where he is a senior researcher at the Center for East European Studies. His research and teaching expertise focus on Iran–Caucasus ties, identity and the social development of the Caucasus.

See overleaf for further reading.

- d. Strengthening and increasing oil swaps in Caspian Sea ports.
- e. Creating alternative energy routes through Armenia and Georgia to Europe instead of Turkey.
- f. Increasing regional energy cooperation, particularly with the Republic of Azerbaijan.

If Iran were to gain the attention of Caucasus and EU countries by removing diplomatic obstacles, then we would witness the advent of an Iranian–Russian geopolitical rivalry over the corridor connecting the Caspian Sea and the South Caucasus' energy to the world market. As a general conclusion, one can argue that Iran, despite all the difficulties and challenges in its way, would remain part of the bigger picture of the future of energy supplies for the EU. At the same time, it would be impossible to envision the future of the European energy supply without Iran. As a leading actor on the geopolitical energy scene of the Caspian Sea and the Caucasus, Iran is moving in a direction that would force all players to acknowledge it as the connecting factor between the Caspian Sea and the Persian Gulf.

Finally, some comments are in order regarding the probable invitation for Iran to participate in TAP, TANAP, or Southern Gas Corridor Projects. The memorandums of understanding signed between Iran and Austria, Italy, Bulgaria, Greece, and Hungary following the removal of sanctions signify an interest on the part of these energy-consuming countries in Iran's participation in the final plans of the project intended to transport energy from the Caspian Sea and the Caucasus to Europe. It should be noted that in determining the route for the Southern Gas Corridor, political and security considerations are of greater importance than are economic and technical ones. In attempting to participate in the energy routes from the South Caucasus, Iran aims to be the main buyer of Caspian Sea energy at the initial stages and then, using this policy, to become a supplier of energy for Georgia and Armenia.

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2 Quoted in: Lomsadze, Giorgi. "Gazprom to Take Over Iranian–Armenian Pipeline", Eurasianet, June 2015, <<http://www.eurasianet.org/node/73731>>

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Connecting Iran and the South Caucasus: Competing Visions of the North–South Corridor

By Yana Zabanova, Berlin

Abstract

Due to its geographic location, the South Caucasus could provide alternative trade routes between Iran and Europe as part of a larger vision of an international North–South Transport Corridor. Potential benefits to Iran include having an alternative to its overland route to Europe via Turkey, which has been a source of major problems in recent years, and—in the longer term—becoming a transit country for cargo traffic between South Asia and Europe. Armenia and Azerbaijan, which share a common border with Iran, have been promoting competing rail routes. Azerbaijan’s projected rail link to Iran along the Caspian Sea coast has gained momentum since the nuclear deal thanks to the availability of funding and Russia’s interest. In contrast, the rival Southern Armenian Railway project, which would connect Iran to Georgia’s Black Sea ports via Armenia, was more attractive to Iran during the sanctions era, when it had fewer options at its disposal. This 3.2 billion USD project has failed to secure external funding, making its implementation increasingly unlikely. However, the ongoing large-scale road rehabilitation and construction program in Armenia, financed by international donors, can still improve Armenia’s attractiveness as a transit country. While Iran has expressed interest in all these initiatives, it has adopted a cautious approach, as it is also exploring transport corridor options in other regions, including Central Asia.

Introduction

On 16 January 2016, the EU and the UN announced the lifting of all international nuclear-related sanctions on Iran as part of the so-called “nuclear deal.” This landmark agreement has important economic implications for Iran: it unfreezes some 100 billion USD worth of Iranian assets abroad, allows Iran to sell oil to Europe

and to use the SWIFT global transaction system, and it lifts US secondary sanctions on entities conducting business with Iran. In the South Caucasus, Armenia, Azerbaijan and Georgia have all welcomed the nuclear deal, hoping that an economically stronger and more Western-oriented Iran will scale up its trade and investment activities in the region. Although Iran is the only