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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

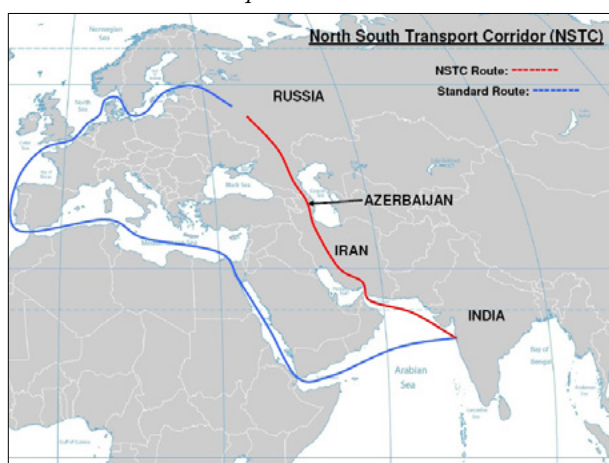
On 16 January 2016, the EU and the UN announced the lifting of all international nuclear-related sanctions on Iran as part of the so-called “nuclear deal.” This landmark agreement has important economic implications for Iran: it unfreezes some 100 billion USD worth of Iranian assets abroad, allows Iran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

regional power to maintain working relationships with all three South Caucasus states, its economic presence in the region has lagged far behind that of Turkey or Russia. The transportation sector is one potential area that could boost economic cooperation between Iran and the South Caucasus.

New Momentum for the North–South Corridor?

The North–South Transport Corridor



Source: Wikimedia Commons <[https://commons.wikimedia.org/wiki/File:North_South_Transport_Corridor_\(NSTC\).jpg](https://commons.wikimedia.org/wiki/File:North_South_Transport_Corridor_(NSTC).jpg)>

Because they share direct borders with Iran, both Armenia and Azerbaijan attach major importance to improving connectivity with their southern neighbor. During Soviet times, a direct train ran between Moscow and Tehran, passing through Georgia, Armenia, Azerbaijan's Autonomous Republic of Nakhichevan, and through Jolfa and Tabriz in Iran. Today, there are no direct rail connections between Iran and the South Caucasus, and, due to closed borders, no new route could cross Armenia and Azerbaijan at the same time. Despite their limited trade volumes with Iran, Armenia and Azerbaijan have been trying to position themselves as transit countries for cargo flows among Europe, Iran and South Asia. Most of this trade currently takes place via a lengthy maritime route through the Suez Canal and the Mediterranean. A much shorter overland corridor, from Iran's Persian Gulf Port of Bandar Abbas, could significantly reduce the time and costs of transportation.

This ambitious vision lies at the core of the idea for the 7200 km-long multimodal "International North–South Transport Corridor" (INSTC), first announced in 2000 at a trilateral summit of Iran, India, and Russia in St Petersburg. The INSTC envisions connecting northern Europe and the Persian Gulf through Central

Asia, the Caspian Sea, or the Caucasus. A 2008 feasibility study by the International Union of Railways identified the Caucasus route as the most economically attractive option, featuring only one break of gauge (between Azerbaijan and Iran) and the fewest border crossings.

Although this project lay dormant for many years, there has been a recent revival of interest, and Azerbaijan has been particularly active in pushing for the implementation of the new route. With its oil production having slowly declined since 2009, Azerbaijan is prioritizing the development of its non-oil sector and transforming into a major transport hub. In addition to pursuing a direct rail link with Iran, Azerbaijan has invested in the construction of the Baku–Tbilisi–Kars railway, in modernizing its highways and transport facilities, as well as in the construction of a new international port at Alat on the Caspian coast.

Armenia, which has no direct access to Russia, has advocated its own vision of the "Persian Gulf–Black Sea Corridor," which would connect Iran to Georgia's Black Sea ports via Armenia by rail or road. All of Armenia's cargo traffic passes through Georgia and/or Iran, but the condition of the roads is poor, which limits their capacity and reduces Armenia's attractiveness as a transit country. As a landlocked country with closed borders to the East with Azerbaijan and to the West with Turkey, Armenia attaches the utmost strategic importance—importance that goes beyond purely economic considerations—to a modernized North–South transport link to Iran.

Iran has voiced support for Armenia and Azerbaijan's initiatives but has been cautious about making an exclusive commitment to either. While Armenia remains Iran's closest ally in the Caucasus, Iran's strained relationship with Azerbaijan has improved since 2013, when President Rouhani came to power, although tensions remain. Iran is thus treading cautiously, in order to avoid antagonizing either country. Generally, Iran is interested in improving its access to European markets and would benefit from acquiring transit country status for South Asian goods. In addition, both the Armenia and Azerbaijan routes offer some advantages compared to Iran's main overland transportation route to Europe, which passes through Turkey.

In recent years, this route has been a source of many problems, including a major drawn-out dispute with Turkey over transit fees, long queues at the Bazargan–Doğubeyazıt border crossing (with waiting times reaching several days), recurring border closures, and a series of attacks on Iranian truck drivers—allegedly carried out by Kurdish insurgents.¹ In fact, in 2015, Iran rec-

¹ Maysam Bizaer, "Can Iran Go Around Turkey to Reach Europe?", *Al-Monitor*, 9 August 2016. <<http://www.al-monitor.com/pulse/originals/2016/08/iran-persian-gulf-black-sea-corridor-azerbaijan-georgia.html>>

ommended that its truck drivers use alternative routes—either through Armenia, Georgia and Romania or Bulgaria, or through Azerbaijan, Russia and Belarus. The route through Armenia would give Iran access to the Black Sea and southern Europe while avoiding Turkey altogether. The route through Azerbaijan would not only connect Iran with northern Europe but, through the Baku–Tbilisi–Kars railway, provide a safer route through Turkey and eliminate the need to use the Lake Van ferry.

On the other hand, the North–South Corridor transport projects are costly undertakings requiring massive investments worth hundreds of millions of dollars. Despite the unfreezing of its assets abroad, Iran is not in a position to easily finance large infrastructure projects and is, in fact, looking for external funding. It will take years before its economy fully recovers from the damage inflicted by the sanctions—a process that is being hindered by low oil prices. Additionally, the small size of the South Caucasus economies means that the bulk of cargo traffic would come from outside, which makes it essential to obtain realistic estimates of expected trade flows along the projected routes in order to assess potential returns. Finally, with the international sanctions lifted, Iran now has several options at its disposal and has been actively pursuing participation in China’s Silk Road Economic Belt project. Thus, Iran needs to be strategic in its choices and decide how different projects can be optimally integrated.

The Azerbaijan route: Qazvin–Rasht–Astara railway

The lack of a rail connection between Azerbaijan and Iran is a critical missing link in the proposed Caucasus route of the North–South Corridor. In October 2010, Iran and Azerbaijan signed agreements on the construction of a 375 km railway that would link Qazvin, a regional capital in northern Iran, to the Caspian city of Rasht and then to Iranian Astara at the border with Azerbaijan. From there, a railway bridge will be built over the Astarachay River and a connection to Azerbaijani Astara will be established. Most of the construction (367 km) would take place in Iran, with only an 8 km section to be completed in Azerbaijan.² An additional section would also connect Rasht with the Iranian Caspian port of Anzali to provide access to cross-Caspian maritime routes.

There has been a noticeable proliferation of high-level contacts between Azerbaijan and Iran since the lifting of the sanctions. In February 2016, President Aliyev visited Tehran, signing an agreement on the construction

of the railway bridge at the Azerbaijani–Iranian border; the groundbreaking ceremony promptly followed two months later. In April 2016, the Azerbaijani, Iranian and Russian foreign ministers discussed issues related to the North–South Corridor in Baku. In August 2016, Azerbaijani President Ilham Aliyev welcomed his Russian and Iranian counterparts, Vladimir Putin and Hassan Rouhani, to Baku for the first-ever trilateral summit. In Azerbaijan, the meeting was mainly viewed as kickstarting the North–South Corridor project.³

The Qazvin–Rasht section, which is part of Iran’s overall strategy of developing its domestic rail network, is nearly finished as of February 2017. Now, all attention is on the crucial 175 km Rasht–Astara link, which would cost ca. 1 billion USD and take some five years to complete. To date, funding has not been fully secured, delaying the beginning of construction. Azerbaijan has offered Iran a loan of 500 million USD to finance this project; the Russian state-owned Russian Railways (RZD) company is also looking at possible options to participate in the construction and funding of this section.⁴ At the 1520 Forum in November 2016 in Baku, a representative of the EBRD said the Bank might provide a loan to cover some of the costs. The Iranian Deputy Minister for Roads visited Astara in January 2017, promising that construction works would start within 12 months. If this happens, it would be a strong sign that the North–South Corridor between Iran and Azerbaijan is indeed becoming a reality. However, much depends on future developments in their bilateral relations. Iran has been highly critical of Azerbaijan’s growing military cooperation with Israel, while Azerbaijan has suspected Iran of trying to influence Shi’a groups within the country. A new wave of tensions between Iran and Azerbaijan could slow down the project’s implementation.

Southern Armenian Railway

Armenia’s counterproposal, the so-called “Southern Armenian Railway,” envisions a 470 km rail connection with Iran, crossing Armenia from Meghri in the south to Yeraskh in the north and connecting to the Georgian rail network and the Black Sea ports of Batumi and Poti. The bulk of the construction work (410 km)

2 Ziyadov, Taleh: Azerbaijan as a regional hub in Central Eurasia, Baku (ADA) 2012 p. 107.

3 Fariz Ismailzade, “The ‘North–South’ transport corridor finally kicks off”, *CACI Analyst*, 27 September 2016. <<https://www.cacianalyst.org/publications/analytical-articles/item/13395-the-%E2%80%9Cnorth-south%E2%80%9D-transport-corridor-finally-kicks-off.html>>

4 Sputnik, “Rossiya gotova prinyar’ uchastie v stroitel’stve uchastka Resht–Astara v Irane” (Russia is ready to participate in the construction of the Rasht–Astara section in Iran), 25 November 2016. <<https://ru.sputnik.az/azerbaijan/20161125/407861176/jeleznie-doroqi-rf-i-ar-inteqrirovani-v-edinuyu-set.html>>

would have to take place in Armenia, while Iran would only need to build a 60 km section. The railway, which is supposed to become the shortest transportation route between the Persian Gulf and the Black Sea⁵, was first advocated in 2008 by Armenian President Serzh Sargsyan in his annual address to the National Assembly.⁶ In 2009, the Transport Ministers of Iran and Armenia signed a memorandum of understanding on the project. In 2012, a Dubai-based investment company, Razia FZE, was granted a 50-year concession to construct and operate this railway, and a tripartite agreement was signed in 2013 between Razia FZE, the Armenian Transport Ministry, and the South Caucasus Railway (a full subsidiary of Russian Railways). According to Razia FZE's 2013 feasibility study, the costs of construction would be 3.2 billion USD.⁷

The Armenian leadership has consistently described the project as a top geopolitical priority, and for a while, there was much enthusiasm in the Armenian media about its potential benefits. Compared to the rival Azerbaijani project, however, the Southern Armenian Railway has a number of serious disadvantages. Due to Armenia's difficult terrain (as compared to the route along the Caspian Coast), construction would be much costlier and technically more difficult, requiring multiple tunnels and bridges. While Iran expressed the willingness to construct the Iranian section of the railway if the project takes off, Armenia has been left scrambling to find investors for its much longer section of the railway. Hopes for a Chinese investor have not materialized, and Russian Railways, whose full subsidiary took control of Armenian Railways in 2008, expressed interest in managing the railway if built but made no commitments regarding funding. Russia's limited interest in the project is understandable, as it would not connect Russia to Iran (this could only happen if Georgia agreed to allow rail transport to Russia through Abkhazia, which is highly unlikely). In an interview in 2015, RZD Head Vladimir Yakunin bluntly stated that the railway project

lacked an economic rationale, comparing it to making a window that looks at the wall of a neighboring house.⁸

With the Iran–Azerbaijani railway project progressing, and given Armenia's failure to secure external funding, project implementation is becoming increasingly unlikely. At the recent meeting of the Armenian and Iranian Presidents in Yerevan in December 2016, Rouhani avoided commenting on the Southern Armenian Railway, only saying that it was “possible” to create rail or road connections between the Persian Gulf and the Black Sea.⁹ On 12 January 2017, the Armenian government announced that it was liquidating the Railway Construction Directorate, an entity set up by the Transport Ministry to oversee the design of the projected railway.¹⁰

Armenia's North–South Road Corridor Program

Map of the projected North–South Road Corridor in Armenia.



Source: *northsouth.am* (used with permission)

5 Arka News Agency, “Armenia tries to attract private investors into construction of Armenia–Iran railway link”, 7 November 2016. <http://arka.am/en/news/business/armenia_tries_to_attract_private_investors_into_construction_of_armenia_iran_railway_link/>

6 Armen Grigoryan, “Iran–Armenia Railway Project and Russian Geopolitics”, *Eurasia Daily Monitor*, vol. 12, issue 20, 2 February 2015. <<https://jamestown.org/program/iran-armenia-railway-project-and-russian-geopolitics/>>

7 Arka News Agency, “Armenian government to come out with statement on Armenia Iran railway link, minister says”, 22 June 2015. <http://arka.am/en/news/economy/armenian_government_to_come_out_with_statement_on_armenia_iran_railway_link_minister_says/>

8 EurAsia Daily, “Glava RZhD: Zheleznaya doroga Iran–Armenia – okno v nikuda” (RZD Head: The Iran–Armenia Railway is a window to nowhere), 8 June 2015. <<https://eadaily.com/ru/news/2015/06/08/glava-rzhd-okno-v-nikuda-ili-zheleznaya-doroga-iran-armeniya>>

9 President of the Republic of Armenia, Press Release, “Presidents of Armenia and Iran Recapped the Results of the Meeting”, 21 December 2016. <<http://www.president.am/en/press-release/item/2016/12/21/President-Serzh-Sargsyan-Iran-President-Hassan-Rouain-announcements-for-Mass-Media/>>

10 Nelly Babayan, “Armenia's south railway construction project all up in the air?”, *Aravot.am*, 12 January 2017. <<http://en.aravot.am/2017/01/12/187318/>>

The moribund railway project does not mean that Armenia has to abandon its plans to serve as a transit country for cargo traffic between Iran and Europe. In 2012, Armenia launched a major road construction and rehabilitation program called the North South Road Corridor Investment Program. The five-tranche project aims at creating a modern 463 km highway passing through Bavra, Gyumri, Ashtarak, Yerevan, Goris, Kapan, and Meghri, thus connecting Armenia's north and south regions. In Soviet times, major highway and rail links in Armenia crossed the Nakhichevan territory of Azerbaijan. After the border closing, the southern provinces of Armenia became far more isolated. The new highway would replace the existing 556 km route and is expected to nearly halve the transit time from the Georgian to the Iranian border, from 9 or 10 to ca. 5 hours.

The project's estimated cost is 2.3 billion USD, with the Asian Development Bank providing a 500 million USD loan as the largest donor. Other donors include the Eurasian Development Bank and the European Investment Bank; however, one-third of total funding has not yet been secured. Importantly, the North-South Corridor would also improve Armenia's connections to Georgia and Iran, increasing its potential to serve as a transit country. Tranche IV envisions a highway link between Artashat, located 30 km southeast of Yerevan, and Agarak at the Armenian-Iranian border, cutting the current travel distance by 91 km. Construction on this section has not yet begun.¹¹ The tender for the technically challenging 36 km road and tunnel connection between Qajaran and Agarak was announced in 2016; it will be mainly funded by the Eurasian Fund for Stabilization and Development.¹²

The Road Corridor project has faced its share of problems, including allegations of corruption, construction delays, and complaints about the poor quality of new roads. As with all other projects, there is also the question of expected volumes of cargo traffic. Still, the project stands a good chance of being successfully completed and can co-exist alongside the Iranian-Azerbaijani railway. In November 2016, a test shipment of two containers from Germany arrived in Iran by ship, rail and

truck, passing through Romania, Georgia, and Armenia. If Armenia succeeds in constructing the new highway, thereby reducing the duration and costs of transit, it could provide a viable alternative to Iran's route through Turkey.

Conclusion

In recent years, Armenia and Azerbaijan have been competing for transit country status within the projected North-South Transport Corridor that would connect Iran with Europe. Intent on becoming a major regional hub, Azerbaijan has been actively pursuing a rail connection with Iran that would pass along the Caspian Sea coast and connect to Russia in the North. Armenia's rival project is a 3.2 billion USD railway between Iran and Armenia, connecting to Georgia's Black Sea ports. While Iran has shown interest in both initiatives, it has not been a driving force behind them, nor has the lifting of the sanctions translated into large Iranian financial contributions to either project.

The Azerbaijan-Iran railway has gained momentum since the nuclear deal thanks to its strategic importance to Azerbaijan, the availability of funding and Russia's support. As for the Southern Armenian railway, the idea may have been more attractive to Iran during the sanctions era, when the Islamic Republic had fewer options at its disposal. Having failed to secure funding from international donors, and facing competition from the Azerbaijan-Iran railway and a lack of interest on the part of Russia, the Southern Armenian Railway is unlikely to be implemented.

However, Armenia's ongoing large-scale road construction and rehabilitation program is expected to improve its road connections to Iran and Georgia, increasing Armenia's attractiveness as a transit country. In the end, however, given the wide range of options at Iran's disposal and its modest economic presence in the region, Iran's interest in transport routes through the South Caucasus depends, to a large extent, on its participation in major infrastructure projects in other regions, most prominently China's Silk Road Economic Belt initiative.

About the Author

Yana Zabanova is a South Caucasus analyst who worked as a research fellow at the German Institute for International and Security Affairs (Stiftung Wissenschaft und Politik, SWP) in Berlin from August 2014 until December 2016. At SWP, she conducted research within the framework of the EC-funded project "Inter- and Intrasocietal Sources of Instability in the Caucasus and EU Opportunities to Respond", focusing on the role and influence of Turkey and Iran in the South Caucasus.

11 "North South Corridor Road Investment Program—Republic of Armenia", Power Point presentation. <https://www.unece.org/fileadmin/DAM/trans/doc/2016/wp5-eatl/WP5_GE2_14th_session_Mr_Jeyranyan_Armenia.pdf>

12 North South Road Corridor Investment Program, General Procurement Notice—Tranche IV, Deadline: 31 December 2016. <<http://northsouth.am/en/procurement/show/40>>