

## **A NEW WAY FOR THE CASPIAN REGION: COOPERATION AND INTEGRATION**

Azerbaijan is a pivotal state in what is emerging as the new Caspian political order. The region in one way or another connects Asia, the Middle East, Russia and Europe. As such it is the home to many civilizations; it is an energy and trade hub, and a gateway to the Far East countries, Europe, Russia and the Middle East. Caspian energy is of strategic significance for China and Europe. A trans-Caspian component to our energy development is a win-win for all. The Europe dimension is a part of Azerbaijan's orientation. However, we are not knocking on the EU door asking for membership. This is a long-term perspective which should be considered and addressed in due time. Azerbaijan is committed to pursuing a multi-variable approach to regional development. In the end, success will depend on our ability to cooperate.

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## **Introduction**

Energy trends in the global market have brought international attention back into the Caspian region. Following the collapse of the Soviet Union, the Caspian region was marred by conflicts, corruption and state failure. Since then much has changed. The conflicts are protracted, corruption is being dealt with and states are increasing their internal institutional and human know-how. The energy sector is booming with the help of international partners and through domestic reforms on both the east and west coasts of the Caspian Sea. The Caspian region needs a multidimensional international outlook.

Azerbaijan is a pivotal state in what is emerging as the new Caspian political order. Anchored in the trans-Atlantic community with a strong European outlook, we are reaching across to the Central Asian states in an effort to bridge the Caspian Sea and link Eurasian space with Europe. Our dialogue with Iran is progressive and forward looking. Multilateral and genuine cooperation is the only way in which we can progress as a region. The objective is to build a functional regional economic and political order. This will ensure broad stability, which in turn will bring about economic development. Our parameters of regional strategic cooperation will dictate the quality of our relations with the external world.

The region is on a rebound. It is our task to ensure our development has stamina. Therefore sustainable development is a forefront priority for Azerbaijan. Energy outflow and income inflow must be maximized in the short run in order to develop an economic base, which will not only integrate the Caspian region into the global economy, but also ensure a broad and balanced long-term growth. Income inequality continues to persist in our region, which is something to be dealt with systematically. The backbone of a stable society is a strong middle class. How we use our oil revenues is of paramount importance, as energy incomes can easily turn into a burden if the funds are mismanaged. Our plan is to develop strategic non-oil sectors of economy, including infrastructure, tourism, IT, and agro business. Moreover, President Aliyev endorsed a multi-year development program for the country's regions, which has already boosted social and economic life in remote areas.

## **Caspian Energy**

Energy is for the time being the cornerstone of the region's economic revival and for some a key parameter of security. Therefore developing this sector further is a priority for the Azerbaijani government. There are at least two dimensions, which we must keep at the forefront – production and transport. The Caspian Sea is land-locked and the region is situated between two major energy consumers – China and Europe – and energy producers, namely Russia and the Middle East. To maximize the value of our natural wealth and to ensure security of supply the region needs both direct access to external markets and an open energy investment policy that is friendly towards foreign investors. Foreign know-how and technology is still necessary to ensure that we are maximizing our production yields.

For this reason Azerbaijan has preferred an open-door investment policy when it comes to foreign direct investment in our energy market. This open door policy has been balanced with the strengthening of our own domestic energy producer. The latter is slowly being developed into an internationally competitive energy company with assets in third markets.

Caspian energy is of strategic significance also for China and Europe. Their presence on the Caspian market is therefore not surprising. The objective should be to enable European and Chinese engagement on both sides of the Caspian, otherwise we risk dividing the market into the west and east Caspian, which is dangerous as it undermines the logic behind diversity in energy exports for us producers, and it undercuts our efforts to add strategic depth to the notion of regional partnership. The trans-Caspian link is beneficial for both consumers and producers. By connecting Kazakhstan and Turkmenistan with Azerbaijan, Europe would gain strategic access into the east Caspian markets while China could access Azerbaijan's production. A trans-Caspian component to our energy development is a win-win for all.

A link to the West is a key for Azerbaijan. It is a function of our national sovereignty. Even more important is having a diverse energy strategy and market principles. Russia is an important partner in the region in general and in the regional energy sector in particular. However, we are interested in being an equal partner with Russia, which means mutual respect and support for a diversified market approach to energy development. Open energy markets are in the long-run also beneficial for Russia. Market diversity means greater security and a greater net income for the region, which will further drive development and deepen even further our economic cooperation with Russia.

The strategic objective for Azerbaijan is definitely supporting pipeline diversity. This means multiple routes to the West and a connection across the Caspian to the east. Caspian energy can help increase Europe's supply reliability and decrease its market risks. At the same time it is the platform on the basis of which we can cultivate regional cooperation and integration. If we mismanage our energy development the spillover effects will be huge. One clear danger is overdependence on a single market or a single supplier, which puts GDP and economic planning under pressure. It is necessary to support diversified but interoperable infrastructure solutions for Caspian energy in order to avoid, as much as possible, suffering from asymmetric shocks, which are almost always exogenous to any system and difficult to predict therefore one cannot hedge the risks as well.

### **A Trans-Caspian Vibe**

The Caspian Sea is not only rich in energy resources, but it also connects Europe to Asia. It is the meeting point of the Eurasian region. As such it is one of the more relevant geopolitical zones that should be further developed and integrated deeper into the global

economy. Buffered by massive economies like the EU, Turkey, Russia, and China, the case for booming economic growth across the region is more than strong. But for this we need interoperability in our region. Economic trade within the Eurasian space would be seriously enhanced if we manage to build additional infrastructure to support trade across the Caspian Sea.

Infrastructure has been at the core of international economic development. The global economy is based on a modern and integrated infrastructure system that allows easy transfers of goods, people, information and financial derivatives across the world. The priority for the Caspian region is two-fold. First, the infrastructure in the region needs an upgrade in order to better integrate our internal markets. Second, we need varied and secure external connections.

The current regional economic outlook is based mostly on exports of raw materials and imports of refurbished goods and technology. This is an imbalance, which unless corrected will keep our region under the globalization curve, and it can inhibit our ability to build durable economies. We need to plug in at the upper level of the production chain, and grow our economies beyond the raw material phase. Brain drain could become a problem as well without investing in a knowledge-based society and economy. A durable economic platform for the Caspian region is above all a modern and integrated one.

The Caspian region needs to build added value beyond energy. There is a finite horizon on energy production. One day we will be without it. At the same time the profit margins are always higher on the retail and production ends than on extraction. Azerbaijan is therefore rapidly integrating its economy in the regional context, investing in information technology and infrastructure adjustments, and into education. Building a knowledge-based economy should be our second collective priority.

The trans-Caspian dimension is more than just a temporary political fad: It is also about social integration, allowing for closer cooperation of ethnic communities across and beyond regional boundaries.

There are at least three types of infrastructure priorities which will help regional integration. Roads and rail lines should be upgraded in order to allow an increase in cargo transport. New transportation technology would also reduce transportation costs, which would make this region even more interesting in the global context as a major hub. Second and related are logistic parks. We need to construct these on each side of the Caspian Sea in order to facilitate the trans-Caspian transit and trade. In addition to being logistic parks they could also function as free trade zones from where foreign companies could manage and run their regional supply chains. Such modern hybrid parks are a major FDI attraction.

Modern border units and control systems are also required to ensure secure but speedy transfer of passengers and goods. We need to keep our states secure but in doing so we cannot risk undermining the just-in-time delivery systems, which are key to successful and competitive commerce today. Airports need to be expanded and flights added across

the region and between the region and major global economic centers. There is also information exchange system to be built and connected across the region – it will require modern upgrades like wi-max and wi-fi lines. A knowledge-based economy rests on information exchange.

### **The European Dimension**

The Caspian is part of Europe, and the EU is at the heart of our transformation and development. The Europe dimension is a part of Azerbaijan's orientation. However, we are not knocking on the EU door asking for membership. This is a long-term perspective which should be considered and addressed in due time. The European Union is in a transition phase itself and it will take sometime before it is ready to plan its next enlargement.

A clear European perspective, however, is needed. The region should be integrated into the EU's strategic thinking as a partner in security and energy. Further, our markets should also be integrated. This means we need a sustained political dialogue at the highest level on all the outlined topics. Our democracies are still a process in the making. We accept the pointers that more could be done. But this region is in a phase of important transition, where we must ensure a balanced approach between political reforms and the economy. Democracy is a process, which in various degrees we are integrating into the Caspian space. The project, if done organically, will succeed.

Our need to be better integrated into the Euro-Atlantic security space is real. Traditional transnational and asymmetric threats exist in the broader Caspian space, which are best addressed through regional cooperation inside the European and Euro-Atlantic context. In this sense, Azerbaijan is actively implementing IPAP with NATO and ENP Action Plan with the European Union. Regional security threats are specific due to the nature of our geography, internal parameters, and external security conditions, namely in Afghanistan and Iraq. The region in one way or another connects Asia, the Middle East, Russia and Europe. As such it is the home to many civilizations; it is an energy and a trade hub, and a gateway to the Far East countries, Europe, Russia and the Middle East.

Given the differences in textures the concept of openness is perhaps the most relevant for us – openness to ideas, values and norms of others. All exaggerated attempts to exclude one or the other entity are counterproductive and create unnecessary tension that could easily turn violent. The concepts of regional integration and the European perspective are then closely linked with the notion of inclusion and the principle of open societies in the Caspian region. Development in terms of economic stabilization and knowledge revolution are part of this European perspective and openness.

Finally, the process of Europeanization of the Caspian region is not a zero-sum strategy. It is rather a direction that should also be compatible with the region's strong interdependence with Russia and our growing relations with the Asian countries. Europe, Russia and China will be first to benefit in allowing the Caspian region to integrate

organically into a functional and competitive Eurasian political system well integrated into the global economy.

### **Protracted Conflicts**

Territorial integrity and the concept of sovereignty are however indispensable cornerstones of this highly interdependent and interconnected Caspian system. Without having territoriality clearly defined there will be no way of installing into the region modern grid structures and open borders. Open and unresolved border issues stimulate nationalism and narrow political paradigms, which are totally counterproductive to the logic of modern and integrated society and economy.

In this context the protracted conflicts are a major obstacle to progress as they keep us from moving forward at the rate in which we hope to, and at which we need to, in order to catch up with the high-end of global development. The unresolved Nagorno-Karabakh conflict fundamentally impacts Azerbaijan, our security, and our ability to deal with Armenia and the broader Eurasian space through an integrationist frame of mind.

Progress on this issue is long overdue and Azerbaijan cannot wait forever for its resolution, although we remain supportive of a peaceful approach to conflict settlement and the OSCE Minsk process. But the European Union could also be more directly involved in protracted conflict resolution through its neighborhood policy. All three South Caucasus states are partners in the European Neighborhood Program. As this is a major region of strategic interest for Europe, the EU could help not only Azerbaijan and Armenia – through dialogue facilitation and confidence building measures – but also in Georgia and Moldova. The protracted conflicts are predominantly political issues in need of a political solution, which is why the EU can be particularly helpful.

Azerbaijan is not going to negotiate on its territorial integrity and the government stands ready to defend its sovereignty as stated in and supported by the Charter of the United Nations. A military settlement is not our preferred option of resolving the Nagorno-Karabakh conflict nor do we believe it will necessarily lead to a stable end outcome. It will surely undermine our efforts to move towards more regional integration and regional openness. So we need to solve this problem peacefully and now, but Azerbaijan is prepared to defend its territory.

The Nagorno-Karabakh solution can only be set in the broadest autonomy possible for the province. Baku is open to all options and we are ready to negotiate on every aspect of autonomy. What we are not prepared to do is to negotiate on the sovereignty issue. Nagorno-Karabakh is part of Azerbaijan and it would be highly unjust, and also destabilizing for the region and the international system, to ask us to accept an alternative model. The Kosovo status issue currently on the agenda of the international community is not a precedent for Nagorno-Karabakh. The legal, moral and ethnic circumstances, as well as histories of these two cases differ vastly and therefore drawing parallels is extremely counterproductive. Doing so only confuses the situation further.

Azerbaijan and Armenia cannot make a substantial step forward in bilateral relations without first addressing the Nagorno-Karabakh issue. This has a net negative impact on regional development and also on the trans-Caspian project. For Europe, Russia and China this is a major setback in terms of interacting with the region.

Next year is an election year in both Armenia and Azerbaijan. We will soon have new governments in Russia and the U.S. Major shifts are also taking place within the OSCE community. Its structure may change in the year ahead. Therefore, the new political parameters due to emerge after 2008 may provide the opportunity for the grand breakthrough and a permanent resolution of the Nagorno-Karabakh (NK) issue.

This does not mean we have no work to do in 2008. Confidence building and regular diplomatic contacts should continue between the two sides. But most importantly we should in this coming year agree on the parameters for peace and the bottom line principles like territorial integrity and sovereignty. The NK conflict should not feature in the upcoming elections as a political tool for scoring cheap points. Making the conflict a top electoral priority will only make it harder to find a settlement afterwards.

### **Future 2020**

A regional context supported by the European perspective is a precondition to a satisfactory long-term outlook for the Caspian region. Conflict will have to be resolved and economies diversified. But most importantly, the region should be put on the path of integration – internal and external. We need better infrastructure and more local brains to support our regional economic outlook.

The region has the potential to become the hub for Europe and Asia, and a bridge connecting Russia with the Middle East. It is a melting pot, which if managed correctly and in the spirit of cooperation can yield impressive results - economic and strategic - for all concerned. However, and unfortunately, the opposite is true as well. The status of the region may come under severe stress if international powers engage in the region through a zero-sum approach and if regionally we fail to stimulate the spirit of cooperation. Instability from within the Caspian states makes the resolution of the frozen conflicts a first priority. Finally, pursuing political reforms must go hand in hand with economic development.

The push for regional integration is not just a question of cooperation along the energy lines. It is much broader than that, encompassing the wide structures of trade, politics and security. Therefore in 12 years time by 2020, the region as such should be better connected, its frozen conflicts resolved, and servicing as a hub between China, Europe and Russia. This is a vision we should strive to achieve. Our European perspective is as acutely relevant to the Caspian as is the partnership with Russia and China, and Azerbaijan is committed to pursuing a multi-variable approach to regional development. In the end, success will depend on our ability to cooperate.