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## U.S. Policy in the South Caucasus

*Martha Brill Olcott*<sup>1</sup>

The three tiny countries of the South Caucasus have each gotten far more attention from U.S. policy-makers than one would have initially expected, given their size and their geographic isolation. The explanation for this lies in Azerbaijan's oil, Armenia's powerful international diaspora, and Georgian president Eduard Shevardnadze's popularity in the West.

### **Azerbaijan**

Since the mid-1990s, the Azerbaijanis have been working hard to get more direct U.S. engagement in their country, hoping that Washington would serve as a buffer between them and Moscow. But despite Azerbaijan's considerable oil reserves,<sup>2</sup> Washington's initial tilt in the dispute between Azerbaijan and Armenia over the status of the contested Karabakh region was toward Armenia. Section 907 of the Freedom Support Act, passed in October 1992, was probably the greatest manifestation of this. It sharply restricted U.S. assistance to Azerbaijan until that state took "demonstrable steps to cease all blockades and other offensive uses of force against Armenia and Nagorno-Karabakh." Moreover, it proved very difficult for the Azerbaijanis to demonstrate that they were desisting from the use of offensive force against the Armenians (and that the Armenians were behaving aggressively to Azerbaijan as well).

Azerbaijan's oil, though, became an increasingly attractive magnet for the Americans. Several U.S. firms are involved in the oil consortia active in Azerbaijan; Chevron, ExxonMobil, Unocal, and Amerada Hess all have stakes in one or more projects. Since the merger of BP and Amoco, the U.S. has also become a greater stakeholder in Azerbaijan's largest oil project—the development of Azeri, Chirag and the deepwater portions of Gunashli, which BP agreed to develop in a 30-year contract signed in September 1994, which created the Azerbaijan International Oil Operating Company (AIOC). BP holds 34.1 percent of the shares in AIOC and is the project operator. Unocal holds 10.2 percent of the shares, and ExxonMobil another 8 percent.

Heydar Aliyev seems to have fully understood the value of the "oil card" as, under his leadership, the Azerbaijani government has proven quite savvy in the assembly of these projects in order to ensure that the major global powers were

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<sup>1</sup> Martha Brill Olcott is a Senior Associate at the Carnegie Endowment for International Peace, Washington, DC.

<sup>2</sup> Estimates of Azerbaijan's proven oil reserves vary from 3.6 to 12.5 billion barrels, according to the U.S. Department of Energy, Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/caspian.html>.

all represented. The AIOC project also includes LUKoil (Russia) with a 10.0 percent share, Statoil (Norway) with an 8.6 percent share, Itochu (Japan) with a 3.9 percent share, and Delta (Saudi Arabia) with a 1.7 percent share. Shah Deniz, Azerbaijan's second largest project, is also operated by BP (with a 25.5 percent share), and has Russian, Italian, French, Norwegian, and Iranian participation as well.

But the development of Azerbaijan's oil has been far from problem-free. The problem of the main export route is still not fully resolved, although after years of U.S. pressure, the AIOC is expected to irrevocably lock in the decision to use the Baku-Ceyhan route as the main export route for its oil by summer 2002. However, the legal status of the Caspian Sea is still unresolved, with each nation effectively carving out their own national zones for development. This has left Azerbaijan with three major contested deposits—two with Iran and a third with Turkmenistan—and in July 2001, Iranian military gunboats confronted a BP-owned research vessel that was exploring the Araz-Alov-Sharq structure, ordering it out of what it claimed to be Iranian territorial waters.<sup>3</sup> The Iranians claimed that if BP continued work on this project, they would be barred from bidding on new projects in Iran, and the incident led to a serious deterioration in the already strained Azerbaijani-Iranian relationship.

However, without U.S. engagement, the Azerbaijanis would likely have found it far more difficult to develop their oil wealth and could, like Turkmenistan, have found themselves fully dependent upon Russia for transport. This is precisely what the U.S. feared, since oil, unlike gas, is driven by the price structure of a global market, transit states have a lot of discretionary power. It was to keep the Russians from having a similar stranglehold on Azerbaijan that the Clinton administration pushed hard for Azerbaijani oil to be shipped via Turkey, along the Baku-Ceyhan route, instead of north to Novorossisk and then out along the main Russian export pipeline.

This policy had the additional advantage of rewarding Turkey, which had been a close ally to the U.S. throughout the Cold War but had not really reaped the kind of benefits for this support with the collapse of Communism that many in Ankara and Istanbul had hoped for. The Baku-Ceyhan route would provide the Turks with substantial transit fees, and had the additional advantage of not adding tanker traffic to the Turkish straits.

For all the U.S. administration's prodding, though, the AIOC was unwilling to commit to this route if it did not prove to be economically feasible, for Washington was unwilling to provide subsidies for its construction. As the Clinton Administration began lobbying the oil companies doing business in Azerbaijan, the Azerbaijanis began lobbying the Clinton Administration. As U.S. oil firms became more active in Azerbaijan, pressure to remove or seriously modify these

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<sup>3</sup> Caspian Sea Regional Country Analysis Brief, <http://www.eia.doe.gov/emeu/cabs/caspian.html>.

sanctions mounted considerably, and in October 1998 modifying legislation was passed that provided some important exceptions, allowing the U.S. Export-Import Bank, the Overseas Private Investment Corporation (OPIC), and the Trade and Development Agency to engage in projects in the country. All of this was designed to spur further U.S. investment in Azerbaijan's oil industry. Azerbaijani non-government organizations also became eligible to receive U.S. funding, and in 2000 the U.S. government spent \$32.18 million in Freedom Support Act activities. US AID-funded programs have also been developed for working with independent political groups and the Azerbaijani media.

Until the late 1990s, just about all U.S. foreign aid to Azerbaijan was restricted to humanitarian assistance, mostly earmarked for the country's refugee population.

Azerbaijan has about eight hundred thousand refugees, if one counts the more than half a million internally displaced people in that category (people forced from the parts of Azerbaijan that were occupied by the Armenians during the fighting of the early 1990s). The rest of the refugees come from Armenia proper.<sup>4</sup>

The Azerbaijani government was determined to have the Freedom Support Act sanctions lifted largely as a matter of prestige. While corruption has been a constant and growing problem in Azerbaijan, the rising price of oil globally has made the Azerbaijani government the least dependent upon international assistance of any of the states in the region, although the IMF and World Bank are both engaged in the country, trying to speed up the process of macroeconomic reform.

President Aliyev and his key advisors have hoped that the tragic events of September 11 would mark a new beginning for U.S.–Azerbaijani relations, and that this would take the form of increased security cooperation. The hated Section 907 of the Freedom Support Act of 1992 was lifted by Congressional resolution in October 2001, and affirmed by Presidential decree in January 2002.

Some Azerbaijani politicians had long been pressing for Azerbaijan to grant NATO a base, a request that seemed highly implausible prior to September 11, but since then there have been reports that U.S. planes have used the Baku airport for stopovers en route to Afghanistan.<sup>5</sup> Many in the Azerbaijani elite hope for even greater U.S. military engagement, and the decision by the U.S. administration to introduce military trainers and U.S. combat helicopters into Georgia has sparked hopes in Azerbaijan that the U.S. military presence in their country might be increased as well, especially if the U.S. winds up engaging in combat in the Persian Gulf. The repeal of Section 907 of the Freedom Support Act is likely to lead to

<sup>4</sup> At the end of 1999, Azerbaijan had 791,550 "persons of concern to UNHCR, including 221,600 refugees and 569,600 internally displaced persons." See <http://www.unhcr.ch/statist/main.htm>.

<sup>5</sup> Tim Wall, "Bush Administration Uses Economic Levers to Encourage Anti-terrorism Cooperation", *Eurasia Insight*, October 22, 2001, <http://www.eurasianet.org/departments/insight/articles/eav102201c.shtml>.

the creation of wide-ranging new contacts between the U.S. and Azerbaijani militaries.

The first bilateral U.S.–Azerbaijani military consultations took place in Baku in late March 2002, and focused on naval defense in the Caspian Sea, on standardization of air controls, and on questions of military training. There has also been a lifting of the ban on U.S. arms exports to both Azerbaijan and to Armenia, which creates further opportunities for solidifying ties between the U.S. and Azerbaijan.<sup>6</sup>

The repeal of Section 907 is a real milestone in U.S.–Azerbaijani relations, and opens the possibility of much greater U.S. engagement with Azerbaijan, and with 78-year-old President Heydar Aliyev. It also in turn increases the potential U.S. role in a succession crisis, which could occur at any time, given the Azerbaijani president's fragile health.

### **Georgia**

Ever since Eduard Shevardnadze came to power in Georgia in late 1992, the U.S. has tried to strengthen the cause of Georgian independence, which has been seriously compromised by the fighting over the status of the autonomous republic of Abkhazia, and the area of South Ossetia around Tskhinvali, neither of which are under the control of the Georgian government. In fact, Russia's key role in helping sustain these conflicts, at least until they became frozen through Russian negotiated cease-fires in 1994, was a major reason for a hardening of U.S. attitudes toward Russia. In the first year or so of its existence, the Clinton Administration was willing to grant Russia a relatively free hand in the newly independent states on its borders. But Moscow's behavior in Georgia (and, to a lesser extent, in Azerbaijan and Moldova) convinced even the most pro-Russian of Clinton's advisors that the Russians had to be closely monitored.

The U.S. was less concerned with Russia's early tilt toward Armenia in the war over Karabakh, and Washington even came to believe that Moscow could be an honest broker in this dispute. But first the Clinton and now the Bush Administration remains fearful of Russia's capacity to undermine Georgian statehood. The U.S. has tried to be a close friend to the Shevardnadze government, even as the latter's democratic credentials have begun to tarnish.

For the Americans, Shevardnadze still remains someone of important symbolic value. He is well remembered in Washington for his role in ending the Soviet occupation of Eastern Europe while serving as foreign minister, for breaking with Soviet President Mikhail Gorbachev because of the latter's turn toward Moscow's hard-liners, and for his visible support of Yeltsin at the time of the failed Communist Party putsch in August 1991.

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<sup>6</sup> Stephen Blank, "U.S. Military in Azerbaijan, to Counter Iranian Threat", *Central Asia-Caucasus Analyst*, April 10, 2002, 5–6.

Washington's support for Georgia has taken many forms, and not least among them is Washington's willingness to give Tbilisi a disproportionate share of foreign assistance targeted for the Soviet successor states. In FY 2000 the U.S. government provided an estimated \$149.6 million in assistance to Georgia, including \$108.64 in Freedom Support Act Funds. The U.S. has also been instrumental in helping Georgia obtain substantial funding from the IMF and World Bank.

Georgia has really needed this assistance, although it has not always put it to good use. Lacking Azerbaijan's oil and gas wealth, Georgia was even more vulnerable to pressure from Russia, and Russia has always been ready to use a heavy hand in Georgia, even before the war in Chechnya, when Georgia could not be considered to pose any sort of direct security threat to the Russian state. Shevardnadze came to power during the war in the breakaway region of Abkhazia, which remains a frozen conflict. The unresolved nature of this conflict is one of the defining features of Georgian statehood, as well as being an economic burden to the Georgian government, which has assumed responsibility for the nearly three hundred thousand internally displaced people it produced.<sup>7</sup>

The international community's helping hand has been a mixed blessing. Georgia's external debts are high—\$1.6 billion, or 53 percent of the country's GDP at the end of 2000, much of which was owed to bilateral creditors. The Paris Club nations have been willing to reschedule Georgia's debt, in part to reward Georgia for its commitment to macroeconomic reform and the liberalizing of trade, which led to Georgia's invitation to join the WTO in June 2000.<sup>8</sup> But the country's creditors closer to home (China, Russia, Ukraine, and Turkmenistan) have generally been much less accommodating which, among other consequences, has fueled Georgia's energy shortages, which have in turn complicated the process of economic recovery. This situation has also made the Georgians relatively beholden to whoever is willing to invest in the reorganization of their energy industries, with the strong preference of Tbilisi being to bring in U.S. firms wherever possible, so that they might serve as a buffer to the Russians.

This is why the transport of energy has taken on such enormous importance to the Georgians, for it represents a source of income that seems to ensure its existence as well as a means of economic livelihood (although many industry insiders say that the Georgians have been willing to take too low a price for the transit of oil and gas across their territory). For, although the Georgian government has repeatedly vowed to assume the responsibility for safeguarding current and future oil and gas pipelines across their territory, at the same time there is the expectation that the West will not allow the alternative pipeline routes to come under Russian control.

<sup>7</sup> According to the UNHCR, there were 279,200 internally displaced persons in Georgia in late 1999; see <http://www.unhcr.ch/statist/main/htm>.

<sup>8</sup> "Georgia: Recent Economic Developments and Selected Issues", *IMF Country Report*, November 2001, no. 211, 12–13.

A portion of both “early” oil from the AIOC in Azerbaijan and Tengiz-Chevroil oil (from Kazakhstan) currently go through Georgia. The former goes through the Black Sea port of Supsa, and the latter was shipped across the Caspian Sea and then across Azerbaijan and Georgia to the port at Batumi until the opening of the CPC pipeline in 2001–2002.

The creation of Georgia as an energy corridor for the Caspian Basin is one important element of U.S. policy in the region, but it is coupled with a U.S. concern for Georgia’s security. U.S. military assistance to Georgia predates the decision of the Bush Administration to declare Georgia an outpost in the war against terrorism in February 2002, when Washington announced the decision to send 150 military instructors to the country, and 10 military transport helicopters which the Georgians had asked for as early as 1997, but which the Clinton Administration had been reluctant to deliver. This should enable the Georgian government to dispatch troops to the Pankisi Gorge, near the border with the breakaway republic of Chechnya, where the government has been unable to maintain order.

The decision of the Bush Administration builds on a history of growing U.S.–Georgian military cooperation. Of all three South Caucasian states, Georgia has played the most active role in the NATO Partnership for Peace program. U.S. bilateral military assistance to Georgia has also been steadily increasing, in part responding to the lobbying pressure of anti-Russian groups in Washington. In FY 2000, the U.S. government provided Georgia with \$20 million in funding for Border Security and Law Enforcement Training, and committed an additional \$10 million to help meet the cost of the relocation of the Russian army from their military bases within Georgia. Georgia also received \$3 million for military education as well.

U.S. military assistance to Georgia is likely to increase in the coming year, in part because the war on terrorism provides a convenient cover for Washington to respond favorably to requests for military assistance that might have previously been seen as inconvenient. But it is also coming at a time of increasing cooperation between Moscow and Washington, and is unlikely to lead to a dramatic redefinition of Georgia’s relationship with Russia.

### **Armenia**

The Armenians are a very effective lobbying group in the U.S., and successfully use donations and the threat of bloc voting to keep the pressure on a number of key members in the U.S. Congress. Every April, the Armenian Genocide of 1915 is commemorated by a congressional resolution.

Armenia was also one of five Soviet successor states that the U.S. Department of State decided merited a U.S. embassy to be opened in the first days after independence was granted. Three of the other four states (Belarus, Ukraine, and Kazakhstan) had nuclear weapons that U.S. policy-makers wanted removed,

while Kyrgyzstan was rewarded for the seemingly more democratic behavior of their president.

The Armenian lobby had pressed for U.S. engagement in Armenia even before independence, and the U.S. mounted a major relief effort in Armenia in the aftermath of the December 1988 earthquake that killed about 25,000 people. This was the first major U.S. relief effort in the USSR since World War II.<sup>9</sup>

Armenian lobbyists also closely monitor the work of oil lobbyists, as well as the much more recently-developed Azerbaijani lobby, redoubling their efforts every time that it seemed that Congress would vote to lift the restrictions of Section 907 of the Freedom Support Act.

These same lobbying groups were also very effective at getting U.S. foreign assistance money allocated to Armenia, which received \$124.18 million in U.S. assistance in FY 2000, including \$102.46 million in Freedom Support Act funds.

Armenia has been able to balance its close ties with the U.S. with a very close relationship with Russia, and a close Iranian–Armenian relationship as well. The Armenians are also very active diplomatically in Europe, and have particularly close ties with France, which also has a large Armenian diaspora community. One result of this is that Armenia has been a major beneficiary of international assistance. There has also been a downside to the country’s diplomatic success, which is that the country has a very large external debt burden;<sup>10</sup> this, coupled with the country’s slow increase in GDP, has made poverty reduction the focus of current World Bank assistance.

But there is reason for pessimism that World Bank, U.S., and other forms of international engagement can redress the demographic trends that are sapping Armenia’s economic potential. Armenia also has a considerable refugee population, estimated by UNHCR at just fewer than three hundred thousand people in July 2000<sup>11</sup>.

Russia is an important source of employment for Armenians (as it is for Georgians and Azerbaijanis). Armenia is going through a slow depopulation. According to the preliminary results from Armenia’s census, done in October 2001, some 950,000 people have left the country since the USSR collapsed in 1991. In fact, according to the UN’s International Organization for Migration, Armenia has had the highest rate of outflow of any former Soviet republic.<sup>12</sup>

<sup>9</sup> Richard D. Kauzlarich, *Time for Change? A Century Foundation Report* (New York, 2002), 15.

<sup>10</sup> At the end of 2000, Armenia’s external debt was 45 percent of the national GDP. “Republic of Armenia: Recent Economic Developments and Selected Issues,” *IMF Country Report*, May 2001, No. 01/78, 19.

<sup>11</sup> According to the UNHCR, Armenia had 296,220 refugees at the end of 1999; see <http://www.unhcr.ch/statist/main/htm>.

<sup>12</sup> Jeffrey Swedberg, “Armenian Census Numbers Spark Debate But are Good News for President,” *Central Asia-Caucasus Analyst*, March 27, 2002, 9.

Few believe that Armenia will be able to end this trend and seriously address its economic problems as long as the country continues to have to meet the disproportionate military obligations that are created by the unresolved conflict with Azerbaijan. In recent years, the U.S. has been playing a very active role in trying to help mediate this conflict, as part of the effort of the OSCE.

The OSCE has been engaged in trying to mediate a settlement to the Nagorno-Karabakh crisis since March 1992 (when the organization was still known as the CSCE), just months after Azerbaijan and Armenia became independent. The initial intent of the OSCE was to sponsor a peace conference at Minsk, which was never held, but an eleven-nation committee (plus Armenia and Azerbaijan) known as the Minsk group serves as an on-going forum for negotiations in this conflict, which has had a cease-fire in place since May 1994 (although there have been many violations of it). The group is co-chaired by the Russian Federation, France, and the U.S.

Initially, there was great optimism after President George W. Bush took office that there might be a resolution to the Nagorno-Karabakh conflict, especially after he took a personal interest in it, inviting the leaders of both Azerbaijan and Armenia to Key West in April 2001. The presidents of Armenia and Azerbaijan had been in regular direct dialogue since 1999, and the Key West meeting was designed to capitalize on gains that were said to have been made in a March 2001 session that had been hosted by French President Jacques Chirac. But that meeting seemed to expose the limitations of the Minsk group-sponsored peace process as much as its successes, when the two leaders came away from the meeting convinced that the terms on offer for a negotiated peace would be unacceptable to their respective populations.

### **The Future of U.S. Engagement**

The war on terrorism is likely to involve increased U.S. engagement in the South Caucasus, and more acquiescence on the part of Russia than would have otherwise been forthcoming. The Bush Administration strongly believes in the need for the U.S. to seek out new friends and strengthen existing friendships with states that give the U.S. greater flexibility in dealing with potential security threats.

When one's geopolitical focus is one of containing threats from the Middle East, the Persian Gulf, and Afghanistan, the states of the South Caucasus seem less remote than would otherwise be the case. Similarly, access to assets that are relatively small, such as Azerbaijan's oil supply, becomes all the more critical when larger sources of oil seem ever less dependable.

All this said, the U.S. is unlikely to view the South Caucasus as a region of primary security concern. So, while bilateral assistance to these states is likely to increase, the U.S. is also unlikely to invest vastly increased sums of money in foreign assistance in this part of the world, or to make changing the nature of these systems a priority.