

IRAN AND THE SOUTH CAUCASUS AFTER THE NUCLEAR DEAL

Special Editors: Andrea Weiss and Yana Zabanova, Berlin

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Introduction by the Special Editors

Research on regional powers in the area of the Caucasus, especially from a Western perspective, largely tends to ignore Iran, as it does not fit neatly into the usual narrative of Russia's competition with the West (potentially with Turkey in the background). With the nuclear agreement and the lifting of sanctions in 2016, Iran's role in the South Caucasus, however, has become more prominent. While the election of Donald Trump in the US casts a shadow of uncertainty over the future of the Iran deal, the lifting of the sanctions has already had implications for the prospects of several major infrastructure projects in the region, providing a boost to some while hindering others. Some of these projects serve broader geostrategic goals, such as Iran's quest for a stable region to its North, in a sea of (perceived) instability around the Islamic Republic. Consequently, Iran views economic engagement with the region primarily as a tool to promote stability. Hence its preference for a focus on large projects as opposed to trade relations of medium-size enterprises or even small scale trade. Aside from this goal, Iran's underlying vision of the South Caucasus is similar to that of the other two regional powers—Russia and Turkey—in one respect: Iran itself looks towards the Caucasus through the prism of its own history and perceives the region mostly as a part of its own historical territory, which it lost in the traumatic Treaties of Gulistan (1813) and Turkmenchay (1828).

This collection of articles represents, to some extent, what Iran does and does not do or see in the Caucasus: while Hamed Kazemzadeh and Yana Zabanova focus on two issues that Iran assesses as potentially promising—its energy cooperation with the South Caucasus and its participation in regional transportation corridor projects—Andrea Weiss and David Jijelava detail factors that limit Iran's economic engagement in the region.

Kazemzadeh elucidates one of the main issues underlying some of Iran's geostrategic interests: the country perceives itself as a land-bridge between the Caspian Sea and the Persian Gulf. Within this vision, the reinvigoration of energy cooperation in the post-sanctions era links Iran to the Caucasus, as well as to the wider world beyond (e.g., to the European Union). The roles of the production, transfer and consumption of energy offer prospects for regional cooperation.

In her analysis of Azerbaijan's and Armenia's competition for alternative transportation routes connecting Iran, the South Caucasus, and Europe, Zabanova argues that the impetus behind existing projects, such as the North–South Corridor through Azerbaijan and the Southern Armenian Railway, largely comes from these two countries rather than from Iran. In fact, with a wider range of options at its disposal, including participation in China's Silk Road Economic Belt initiative, Iran has been cautious about exclusive commitments to major transportation projects in the Caucasus.

Weiss explains that economic relations are the least important reason why the South Caucasus matters to Iran. In terms of size of these national economies as potential markets, as well as for the type of goods they produce, on a larger scale they have little to offer to Iran. Logically, as economic relations rank low on Iran's priority list, and due to their status in Iran, Iranian Armenians, Iranian Georgians and Iranian Azeris did not assert their comparative advantage by serving as a bridge and forging economic ties to the South Caucasus.

Jijelava concludes this CAD issue by detailing why, even after the sanctions, Georgian–Iranian economic relations are unlikely to offer the potential for significant growth or large mutual material benefits in the near future. He exemplifies this assessment by discussing gas imports from Iran, the import and export of goods and services, and foreign direct investment in pistachios.

Disclaimer:

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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

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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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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

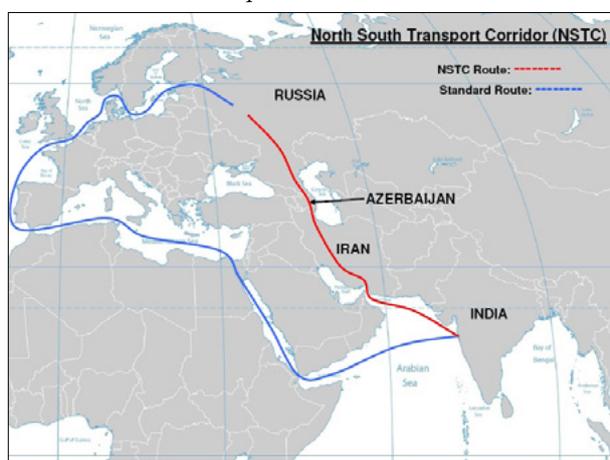
On 16 January 2016, the EU and the UN announced the lifting of all international nuclear-related sanctions on Iran as part of the so-called “nuclear deal.” This landmark agreement has important economic implications for Iran: it unfreezes some 100 billion USD worth of Iranian assets abroad, allows Iran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

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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>>

The Role of Iranian Azeris, Armenians and Georgians in Iran's Economic Relations with the Countries of the South Caucasus

By Andrea Weiss, Berlin

Abstract

This contribution examines Iran's economic relations with the South Caucasus through the (admittedly marginal) roles of Iranian Azeris, Armenians and Georgians. In quantitative terms, such as the movement of goods, economic interdependency between Iran and the South Caucasus is rather low and the ties are weak. Because the prevailing understanding of nationality in Iran is primarily of a civic nature, and not least due to their low numbers, these Iranian minority populations do not form the strong links to the Caucasus that one might expect.

Iran's Civic Understanding of Nationality and the Status of Minorities in Iran

Iran is not only a direct neighbor of Armenia (with a common border of 35 km) and Azerbaijan (with a common border of 611 km, including 179 km with the Azerbaijani Nakhchivan exclave)¹, Persia has been a major regional power in the South Caucasus for two millennia. Consider the early role of Iranian civilizations such as the Parthians and all the civilizations that developed in Persia, with all their high and lows. Only in the 18th century did Russia enter the scene, waging war with Iran while the Ottoman Empire, the third regional force in the last three hundred years of Caucasian history, finally lost the area north of the Arax river with the Treaty of Turkmenchay in 1828. It is through this prism—its long-standing historical and civilizational role as a regional power—that Iran has regarded the South Caucasus as a part of its own history.

Over the course of this historical relationship, Caucasian populations found their way into the contemporary territory of Iran. Shah Abbas in the 17th century (forcefully) re-settled Georgians from Eastern Georgia to various areas in Iran, predominantly in the Fereydunshahr area, east of Isfahan; Armenians from Julfa (Jolfa) were resettled to Northern Iran. The historical settlement area of Azeri-Turkic speakers extends on both sides of the Arax river into the Republic of Azerbaijan and Northern Iran, well into Eastern Turkey. The estimated number of Azeris in Iran ranges from conservative estimates of 12 million to 27 million people², while in comparison, Iran's northern neighbor, the Republic of Azerbaijan, has only approximately 8 million inhabitants, the majority of whom are Azeris. The Georgian

community totals some 60 000 people³, although the Armenian community is perceived to be larger due to attributions of craftsmanship and industriousness. In the past decades, the population has shrunk, through emigration, from approximately 200 000 to 45 000⁴.

The Georgian, Armenian, and Azeri communities not only exemplify completely different dimensions in terms of numbers but also in terms of perception, "classification" and status. Iran is an ethnically diverse country that perpetuates its self-understanding through a civic notion of nationality and not an ethnic focus. Therefore, Azeris are perceived as less of a separate community than as Iranian citizens—as Shia Muslims with a different second mother tongue. Particularly towards outsiders and in public, Azeri identity is entirely subordinated to the national Iranian identity. Given that a population of at least 12 million in a country with a total population of approximately 80 million is sizeable, and given Iran's historical experience and fear of destabilization by outside powers, a public emphasis on Azeri identity carries not only a strange but also at times a threatening connotation. For instance, the Soviet Union attempted to use minorities in neighboring countries as a vehicle to gain influence in domestic politics; at the end of World War Two it supported the short-lived People's Republic of Azerbaijan in Northern Iran. In the context of the prominent civic definition of Iranian identity, tacit fears and images of outside interference that potentially ignite separatism or irredentism make the question of Azeri identity a vulnerable soft spot. This fear of potential instability and the desire for stability together form one of the most important key concepts for understanding Iran's approach to the South Caucasus more generally.

Historically, Azeris have populated Iran's Northwest along with other groups, but, similarly to people from

1 <<http://www.nationmaster.com/country-info/stats/Geography/Land-boundaries/Border-countries>>

2 See Shaffer, Brenda. *Borders and brethren: Iran and the challenge of Azerbaijani identity*. MIT Press, 2002.

3 See Rezvani, B. "The islamisation and ethnogenesis of Fereydani Georgians." *Nationalities Papers* 36.4 (2008): 593–623.

4 Personal communication of the Floor Institute, Teheran

other regions, a considerable number have moved to Teheran, which is the country's major hub. Due to the sheer number of Azeris, Azeri ethnicity does not confer any accentuated class or social status, except, perhaps, for very subtle notions of provinciality. Among Azeris, a spectrum of all social classes is represented, mirroring the larger population.

Despite a huge difference in population size and subsequently in threat potential, Georgians are not considered a minority in Iran. Although they are—more so than Azeris—inclined to regard themselves as a minority, they would not be eligible for official minority status in the Islamic Republic of Iran because they are Shia Muslims. The Georgian community has preserved some of its distinct identity mainly because of its remote settlement away from major transit routes in the mountainous Fereyduhshahr area, West of Isfahan, while Georgians in other regions of Iran were mostly assimilated. Fereyduhshahr is an area in which the predominant source of income derives from agriculture, so the general income level—and also the educational status—of Iranian Georgians can be considered middle class; they may even be considered to be of lower socio-economic status.

In contrast to Iranian Azeris and Georgians, who are both (Shia) Muslims, Armenians—as Christians—have minority status. This status entails representation by two members in the Iranian parliament. Other religious minorities, such as the Zoroastrians, are also represented through a fixed number of MPs in the parliament. Despite their small number, which has also been diminished by accelerated emigration since the Islamic Revolution, the role and influence of Armenians in economic life is exaggerated in popular stereotypes. This is due to the success and industriousness attributed to Armenians, as well as to their overrepresentation in the middle class professions that use technical skills, such as mechanics. In general, although Armenians on average tend to be wealthier than average Iranians and are significantly overrepresented in the middle class, all social and income classes are represented among Iranian Armenians.

Economic Ties to the South Caucasus—a Priority?

From the perspectives of both ordinary citizens and state institutions, economic relations are seen through the prism of historical ties and the historical importance of the South Caucasus to Iran. Consequently, Iran has emphasized the geo-strategic importance of the South Caucasus as a stable neighborhood, as reflected in its economic status. This has led to the prioritization of pipelines, energy and transit routes rather than an emphasis on bilateral economic relations. Some of these pipelines

and routes serve the purpose of connecting Iran through but beyond the Caucasus, e.g., to Europe, rather than to the Caucasus itself.

However, this orientation is also a result of the fact that the South Caucasus is a small market compared with the needs of a country of Iran's size. Iran was quick to assert itself as a supplier of essential goods to blockaded Armenia during the Karabakh conflict. Today, Turkish goods have flooded the South Caucasus; ironically, they far outnumber Iranian goods even in Armenia, which in theory is under Turkish blockade. Several factors seem to be causing Iran's weakness: Iran produces few consumer goods that are competitive and can meet the needs of the South Caucasus countries. At the time of the collapse of the Soviet Union in the 1980s, Iran and its economy were still tainted by the effects of the Iran–Iraq war. Furthermore, Iran never saw the South Caucasus countries as a market to expand to and, last but not least, international sanctions later hampered Iran's economic relationships.

However, the sanctions are double-edged: on the one hand, they impeded Iran's economic development, while at the same time, Iran's relationships with Armenia and Azerbaijan also helped to subvert economic sanctions. This, for example, developed through the use of Armenian banks for international monetary transactions or by making use of informal practices in Azerbaijan that are a vital part of doing business and served as a proxy to hide the Iranian origin or destination of goods.

Furthermore, Iran engages in a balancing act between Azerbaijan and Armenia—the two parties to the Karabakh conflict; this also affects Iran's economic role in both. Iran has the best and most intense relationship with Armenia out of all countries in the South Caucasus, but Armenia is a small market. Armenia can only trade with and through its Northern neighbor Georgia and its Southern neighbor Iran. However, this relationship is not only vital for blockaded Armenia but for Iran. Armenia, as Iran's only Christian neighbor, constitutes a crucial ally because of this very fact.

In economic terms, Azerbaijan is a bigger market than Armenia, but mutually beneficial trade is hampered because both are petroleum-exporters and their economies compete and overlap instead of complementing each other. Further, Iranians complain about the rampant corruption in Azerbaijan. On the one hand, corruption facilitates and provides economic opportunities that are hindered by a stricter application of laws and a need for clean papers elsewhere; but corruption also means that actors incur more costs as consequences of bribery. In general, the long-strained relationship between Azerbaijan, which has stressed its secular orientation, and Iran, which has tended to see majority Shia Azerbaijan

as a space in which to project its religious authority, has gradually improved over the years. Although Iran has unilaterally lifted the visa regime for Azerbaijani citizens, this has not been reciprocated and—albeit merely theoretically—provides Azerbaijani shuttle traders who travel to Iran with a comparative advantage in the border area.

Georgia is not only geographically removed from Iran but also the only one of the three South Caucasian countries that is part of a Western orbit. This not only means that, before the 2011 sanctions, (liberal) business-minded Iranians used Tbilisi as their base but also that under US pressure Georgia implemented the sanctions in the banking sector with more fervor and abandoned the visa-free regime with Iran, only to reintroduce it in 2016. Armenia has also served as a door to the West in terms of shopping for Western or Russian consumer goods and as a vacation destination where Islamic law does not apply. Now that Turkey is increasingly experiencing unstable political conditions, the role of Armenia in this respect has increased, and the same is true for once again visa-free Georgia.

Iran's Northern border mirrors the complexity of the Karabakh conflict, which requires Iran to balance between its two neighbors Armenia and Azerbaijan. Armenia has to rely on Iran, as its border with Iran is one of its only two open state borders; it is an only 35 km long stretch along the Arax river with one single border crossing point. Azerbaijan needs Iran as a transit area between mainland Azerbaijan and the enclave of Nakhchivan. The lack of attention to cross-border trade with the South Caucasus in Iran mirrors the low priority of economic relations on Iran's agenda. Nevertheless, this trade has obviously been vital for the economic development of Iran's border zone. More than two decades of open borders have changed the economic situation there and led to (modest) flourishing in border towns such as Rasht and Julfa.

The Marginal Role of Iranian Armenians, Georgians and Azeris

Given the overall low priority in Iran of economic relations with the South Caucasus, the low level of minority involvement does not come as a surprise. In general, economic relations are more prominent in the minds of state officials, researchers and the interested public in the form of macro-economic relations, although shuttle trade has played a non-negligible role in the development of the border areas, economic development in the periphery and social cross-border ties.

A classical picture of ethnic entrepreneurs does not emerge in Iranian–South Caucasus economic relations. Neither Iranian Armenians nor Iranian Geor-

gians are numerous nor do any of them form a significantly wealthy small community; therefore, they cannot capitalize on any comparative advantages that their language skills might have granted them. Consequently, due to their lack of capital, Iranian Georgians have served as intermediaries for Iranian companies, helping them enter the Georgian market instead of being investors themselves. In general, the trade turnover between Georgia and Iran has been so low that even the activities of a few medium-sized companies visibly impact statistics. Although, on average, they are better educated than Iranian Georgians, Iranian Armenians also tend to be intermediaries rather than entrepreneurs. Though some are quite successful in the construction business in Armenia, mostly in housing and also in hotel construction. However, the housing sector in particular reached its peak for profit-making by the late 2000s.

Iranian Azeris fit the picture of ethnic entrepreneurs who forge ties to their imaginary “homeland” even less than Iranian Armenians or Iranian Georgians. As the majority of Azeris live in Iran, most do not relate to the Republic of Azerbaijan as an imaginary homeland, not the least because of its prevalent secular orientation. For Iranian Armenians and Iranian Georgians, culture shock is one element to reckon with in the face of an alleged home society that turns out to be “Sovietized” and therefore slightly different than expected. This is especially true for Iranian Azeris who, having grown up in a Persian-Azeri Shia environment, are confronted with a society that to them might seem “Soviet,” with such widespread bribery that tourists, not to speak of businessmen, are easily confronted with it. As knowledge of Azeri-Turkish is very widespread in Iran, Azeris do not possess any comparative advantage in language terms. While virtually almost no Armenians live in Iran's Northern border area, many Iranian Azeris do. They travel to Armenia to such a large extent that they become visible in public spaces, and Azeri can be heard on the streets of Yerevan. Using Armenia as a transit country, they have also forged (business) ties with Azeris living in Kvemo Kartli/Georgia and practice shuttle trade via Armenia.

Conclusion

Although economic relations between Iran and the South Caucasus are far less important than strategic and infrastructural concerns in terms of volume and government priority, and although they are overshadowed by the historical narrative about Iran's importance in the region, they should not be underestimated as a vehicle to ameliorate and intensify Iran's impact on and relations with the South Caucasus. Either the political circumstances (in the case of the Azeris) or

the small size of the community and its relative lack of economic leverage (the Georgian and to a certain extent the Armenian case) have prevented these communities themselves, entrepreneurs and the Iranian state from taking full advantage of the linguistic compara-

tive advantage that these communities possess and that could help foster economic ties. Geographic proximity trumps alleged cultural proximity in the case of Iranian Azeris and Armenians.

About the Author

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The Unfreezing of Iran: Economic Opportunities for Georgia

By David Jijelava, Tbilisi

Abstract

In the aftermath of the Iran deal, there has been considerable speculation about the likely impact of the deal on the Caucasus. In Georgia, there has been speculation about the degree to which Iran could drive economic growth through development of the energy sector by providing a new market for Georgian exports or by becoming a source of FDI or tourists. This article looks at each of these areas and concludes that none of them are likely to be major drivers of growth in the short to medium term.

Introduction

Since the collapse of the Soviet Union, Georgia has engaged relatively little with Iran. Instead, it has focused its aspirations on the West and its worries on Russia. In recent years, even modest engagement has been made challenging by the increasingly stringent sanctions put into force by the international community. However, in July of 2015, the Joint Comprehensive Plan of Action (hereafter, 'the Iran Deal') was signed, and nuclear-related sanctions were suspended 6 months later.

This has led to a resurgence of discussions about Iran's potential role in the region. With a population of approximately 80 million and the 18th largest economy in the world (in PPP terms), as well as large oil reserves and the world's second largest proven stocks of natural gas, Iran certainly seems like a potential source of economic opportunity. Iran has been discussed as a means of diversifying Georgia's energy supply, a market for Georgian exports and a source of tourists and foreign investment.¹

This paper will consider each of these options within the broader geopolitical context. In general, it concludes that while there may be short-term opportunities in tourism, other areas are unlikely to see significant opportunity until the deal has been in place for at least a few years, as the Iranians know that, based on previous experience, if sanctions are re-applied, Georgia will not choose its relationship with Iran over its relationship with the West.

Oil and Gas

Georgia might benefit from Iranian oil and gas resources, from diversifying its own supply of oil and gas, from acting as a transit hub or from serving as a location to produce value-added exports. At the beginning of 2016, Georgian Minister of Energy Kakha Kaladze created a media storm by suggesting that it might be possible for Georgia to diversify its gas supplies and buy some gas from Iran. This built on previous suggestions by Iranian state officials that Iran might develop its gas supplies to Armenia as a transit route to Georgia. Georgia is overwhelmingly dependent on Azerbaijan for its gas supply, with a small percentage coming from Russia. Most of

1 See, for example, Economic and Policy Research Center (April 2016), Georgia and Iran: Opportunities for "Finding Keys to the Door", and Tbilisi and Charles Johnson and Lasha Lentava (Sept 2015), "Un-Muzzling the Persian Panther: Where Geor-

gia Stands to Gain from an Iran without Sanctions." ISET Policy Institute Blog.

the following discussion surrounded whether it was wise to make new deals with Gazprom, but in the process, Iranian gas transited through Armenia was also suggested as a possibility.

Georgia could also benefit as a transit country for Iranian gas heading for Europe. The South Corridor Pipeline is currently being upgraded by BP in a consortium that includes Azerbaijan's SOCAR. The upgraded pipeline, SCPX, is intended to increase the capacity of gas transited across Azerbaijan and Georgia to three times its current level, with the ultimate intent of supplying Europe through the Azeri/Turkish-owned TANAP pipeline. This pipeline was originally planned to transport Azeri gas from the Caspian Sea, but it will have far more capacity for transit than Azerbaijan can supply. Its two most likely sources for supplementing that gas are Iran and Turkmenistan.²

Finally, Georgia could gain from Iranian oil and gas sources if it chooses to pipe oil and/or gas across Georgia (via Azerbaijan or Turkey) for processing on the Black Sea coast, allowing easier access to Europe.

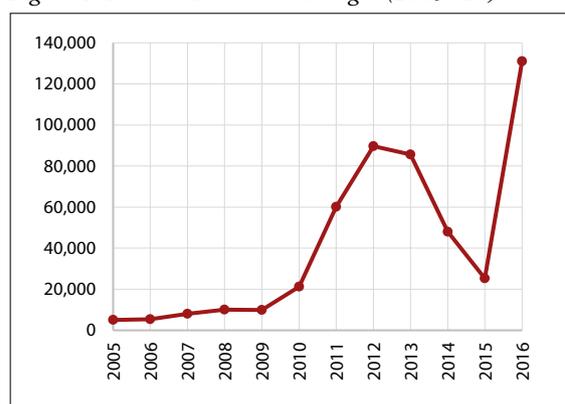
None of these options seem likely in the short to medium-term. In gas terms, Iran is unlikely to supply across Armenia for export to Europe, as the pipeline it would have to use is owned by Gazprom. Iran is also unlikely to export gas to Europe across Georgia using SCPX, as their stated preference is exports to Asia, and even if they did want to connect to TANAP, there is a more direct route that avoids Azerbaijan and Georgia and connects at Erzurum. However, this is by no means certain. There was some subsequent softening of the 'Asia first' policy, but in May 2015, Petroleum Minister Zanganeh's public statements strongly suggested an 'Asia-First' Policy for the Export of Iranian Gas. Similarly, the Erzurum route may be extremely difficult to upgrade.³ Finally, value-added activity in Georgia (such as LNG or a refinery) may happen in the future, but Iran has currently signalled that they want to first build up their local capacity in both areas.

Export of Goods and Services

After oil and gas, the next focal point for discussion of the opportunities presented by Iran is tourism. Following the removal of the need for visas to travel from Iran to Georgia in November 2010, the number of visitors increased significantly. This dropped off dramatically, once the need for visas was reintroduced in 2013, but

it quickly returned when visa-free travel was reintroduced in the aftermath of the Iran Deal in early 2016, as Figure 1 indicates.

Figure 1: Iranian Tourists to Georgia (2005–16)



Source: Georgian National Tourism Administration (reviewed December 2016)

Iranians are attracted to Georgia for a range of reasons. As Stuart Nelson, the General Manager of the Hilton Batumi says, 'Iranians like the fact that there is no visa, it's close, that it is safe, the countryside is green and they can behave more Western'. To keep or expand on this growth, Georgia will have to upgrade its service provisions. As Michael Kerschbaumer, General Manager of Tbilisi Marriott Hotels said, 'Now we need to make sure that the quality of service and infrastructure outside of the hotels is as good as it is inside the hotels'.

The sector will also have to cater to specific cultural needs, particularly culinary and linguistic. This should be possible—Iran has a Consulate in Batumi, which should help, and thanks to a strong tradition of philology, Georgia has a fair number of Farsi speakers.

However, it is important to keep in mind that while this growth is dramatic, it only represents approximately 2% of the visitors to Georgia in a given year. Therefore, it has quite a long way to go before Iranian tourists will really start to be a driver of growth in the sector as a whole.

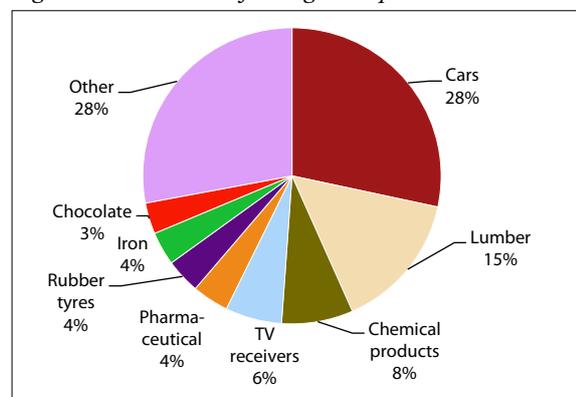
Outside of tourism, current exports to Iran from Georgia are slim across the board. While 2016 was a fairly good year, export to Iran is still only approximately 2% of total exports. Moreover, the categories of goods exported do not reveal much consistency in terms of opportunity or comparative advantage, as Figure 2 overleaf indicates.

Given this variety, instead of looking to current exports to see opportunity, one could look to the economic fundamentals. Georgia has three very obvious advantages that could make it a producer of exports to

2 Micha'el Tanchum (Sept 2015), A Post Sanction Iran and the Eurasian Energy Architecture: Challenges and Opportunities for the Euro-Atlantic Community, Atlantic Council, p. 8.

3 Micha'el Tanchum (Sept 2015), A Post Sanction Iran and the Eurasian Energy Architecture: Challenges and Opportunities for the Euro-Atlantic Community, Atlantic Council, p. 8.

Figure 2: Breakdown of Georgia's Exports to Iran 2015



Source: United Nations Conference on Trade and Development (reviewed December 2016)

Iran and a potential recipient of FDI: climate, business environment and geographic location.

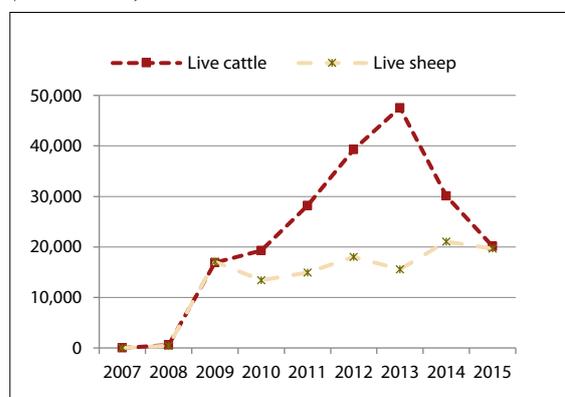
These different benefits combine in a range of ways. The most obvious opportunity would seem to be in agriculture. Georgia has approximately five times the rainfall of Iran, so one might think that Iran would be a large importer of agricultural products. However, opportunities for agricultural export to Iran seem rare. While opportunities may exist for agricultural exports to the rest of the Middle East, despite its limited water supply, Iran continues to be a large agricultural exporter, with exports in fruits and vegetables of \$2.2 billion in 2015, the country's largest non-oil export. This included export to Georgia of \$4 million in wheat, \$3.8 million in fruits and nuts and \$1.3 million in vegetables.

However, Georgia has benefited from increasing demand for live animals in the Middle East, particularly for sacrifice at the end of Ramadan and the Hajj. This has been driven by increasing demand for and the increasing challenges of transporting live animals internationally for animal welfare reasons. As a result, in 2007 Georgia went from having more or less no recorded live animal exports to over \$1 million in 2008 and \$34 million in 2009, as Figure 3 shows.

This sudden increase in exports of live animals was great for farmers. Georgia also managed to continue supplying itself with meat by importing cheaper frozen products, thereby mitigating some of the potential negative social consequences of this trade.

However, further increases are limited by the availability of grazing and undeveloped meat production processes. This partially explains why, despite higher prices, exports in sheep have not increased dramatically since 2009. Also, Georgian animals have a number of endemic diseases, and while a 24-day quarantine is used to ensure that diseased animals are not exported, failures in this

Figure 3: Live Cattle and Sheep Exports from Georgia (2007–2015), thousand USD



Source: GeoStat (reviewed December 2016)

system have led to sporadic bans on the export of live animals from Georgia to the Middle East. This, therefore, also seems an unlikely driver of economic growth.

Foreign Investment

The final obvious option for Iranian impact on Georgia is FDI. The reported amount of Iran's frozen assets varies from \$30 to \$100 billion. Whatever the number, these sums are significant, particularly since Iranians have experience dealing with Georgia and might be well placed to help develop products and services, based on regional skill sets, that are targeted at the Middle Eastern population.

However, the numbers so far do not give much reason for optimism. The official FDI has never been more than 2 million USD, and it was only approximately 0.5 million USD in 2015, which is more or less irrelevant in FDI terms. However, these figures provide a distorted picture. According to our discussion with the Georgian National Investment Agency and with one large Iranian investor, it seems as though Iranian FDI is coming from ethnic Iranians who left Iran after 1979 and are now located in other places, particularly Iraq.

These Iranians may offer opportunities for Georgia as business people experienced with working in the region, particularly as the world becomes less nervous about Iranian investment generally. One example that could offer a model for future ethnic Iranian investment in Georgia is the investment in pistachio production currently underway by Aric LLC. Aric is owned by an ethnic Iranian who has ties with the US and the UK.

This investment is built on Georgia's comparative water advantage. Pistachio production is hugely water intensive, consuming as much as 3 litres of water per nut. Its production is dominated by California and Iran, two places that are rapidly running out of water, so global production is currently hitting supply constraints. There-

fore, exporting Iranian expertise to produce pistachio nuts in Georgia makes sense. This also plays to existing strengths in the country. Nuts have overtaken wine as Georgia's largest agricultural export category, with \$176 million, or 8% of total exports, in 2015.

Beyond that, it is difficult to predict where opportunities may emerge. The holy grail for Georgian FDI and economic development growth is generally considered to lie in Georgia's access to the EU. When Georgia signed the EU Association Agreement two years ago, it was not clear exactly how they would benefit from it. While the agreement opens the EU market for Georgian goods and services, looking around the country, there do not seem to be many areas where Georgia has the productive capacity to take advantage of this opportunity.

However, the hope is that large industrial manufacturers operating outside of the EU might see Georgia as a low-cost, predictable environment with access to the EU's developed market. In the first instance, China is usually discussed in these terms. The true value of the much-discussed Silk Road is not transit, which yields only modest returns to the economy, but it would be if China decided to engage value-adding activities to secure tariff-free imports to the EU. A similar effect occurred in the UK in the 1980s when Japanese car manufacturers set up production facilities in the relatively libertarian UK labour market to gain access to the EU market. Similar shifts happened when new Eastern states entered the EU.

Iran might offer similar opportunities. Although Iran is not an industrial powerhouse on the scale of China, for an oil-rich state, it does have a fairly diversified economy, producing large quantities of gas and oil-based, or energy-intensive, industrial products, including plastics, iron, fertilizers and even automotive products. Any one of these might present an opportunity for value added in the Georgian market.

What, then, are the hurdles to Iranian FDI-led growth? The greatest challenge probably remains the uncertainty of the geopolitical environment. Georgia has shown on numerous occasions that while it appreciates positive engagement with Iran, its Western relationships, particularly its relationship with the United States, take clear and unqualified precedence. Kornely Kakachia has suggested that 'Iranian officials perceive

Tbilisi as a "Westoxicated" regime, subservient to the national interests of the United States'.⁴

This has been made clear several times in recent years. In 2008, Georgia–Iran relations were frozen for a year when Georgia agreed to extradite an Iranian citizen to the United States. Similarly, in 2013, after a negative Wall Street Journal article suggested that Iranians were investing in Georgia to avoid sanctions, the Georgian Government cancelled its visa-free regime (allegedly under pressure from the US Government). This created considerable consternation for investors and students who had settled in the country.

This will certainly create concerns for any investment coming from Iran proper. According to Serhan Unal, who wrote a report on Iran for the Turkish Energy Foundation, Iran is still driven by an 'economy of resistance', and as a result, its short-term investment policy will be driven by a desire to use this opportunity to help itself prepare for 'the next crisis'.⁵ This makes large-scale investment in Georgia unlikely because, in the event of the 'next crisis' (presumably some kind of re-application of sanctions), Georgia is likely to align itself with the West, the US in particular.

This will affect both actual Iranian investment and the likelihood of ethnic Iranian investment. The ethnic Iranian investor behind the pistachio investment explained that one of the greatest impediments to ethnic Iranian investment in Georgia is anti-Iranian feeling. This probably results from long-standing cultural biases, and it has been reinforced by concerns about the Iran sanctions.

Outlook

The situation has been made even more confusing with the election of Donald Trump as US President, as this has opened the real possibility that the United States may try to rescind the deal, push for a harsh interpretation of it, or impose new non-nuclear sanctions. It is difficult to know what the EU will do in such a situation or what a country like Georgia could do. However, the increased prospect of this policy shift may ensure that Iran remains fairly insular for the time being, focusing its resources on developing internally. This could limit the benefits that Georgia can gain, at least in the short-term.

About the Author

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4 Kornely Kakachia (Sept 2011), *Iran and Georgia: Genuine Partnership or Marriage of Convenience?*, PONARS Eurasia.

5 Serhan Unal (Feb 2016), *Post Sanctions Iran and Regional Energy Geopolitics*, Turkish Energy Foundation, Ankara.

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