

Europe's Energy Security and Caspian Oil and Natural Gas

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Abstract

For the countries in the Caspian region, whether they have been endowed with large resources of oil and natural gas or not, the energy politics and energy security has been at the heart of their efforts to build sovereign and prosperous states. To this end, oil and gas producing countries in the region have established arrangements governing the exploration and transportation of their resources to world markets as a central element of their foreign policies, whereas consumer countries carefully crafted their levels of dependence on energy-endowed powers since it is vitally important in determining their ability to formulate their domestic and foreign policies independently. For Europe, on the other hand, the discovery of the importance of energy security has been more recent, and mainly linked to the increasingly assertive policies that the Russian government and its monopolistic subsidiary, Gazprom, have adopted over the past years. As the European Union countries have begun to realize their problem and look for ways to diversify its supply of energy, the potential role of the Caspian region has inevitably emerged on the agenda. However, member countries seem to pursue their own energy policy, which only decrease the overall security of the Union and limit the EU's foreign policy options. Apart from this observation, this project explores several aspects of European energy security particularly its dependence on Russia and the role of Caspian states as a source of alternative supply and argue that European countries must establish a European level energy strategy. Accordingly, this study will unfold in four sections. First section will discuss the paradox of European energy dependency on Russia given that the EU has three and half times as many people, spends seven times as much on its military, and has a GDP fifteen times larger than Russia review Europe's energy vulnerability along with the similarities between European and Caspian states in terms of energy politics. Second section will review Europe's energy vulnerability along with the similarities between European and Caspian states in terms of energy politics. Third section will examine the policy alternatives for the EU in order to gain greater cohesion regarding their external energy policy and upper hand in dealing with Russia. Overall the EU must critically review its approach to energy security and look for ways to develop a more cohesive EU approach towards Caspian countries as well as issues of energy security. Even though certain individual decisions can be made by member states alone, these decisions should be made in accordance with the greater strategy goals set by the European Union.

Keywords: European Union, Caspian Sea, Energy Security, Oil, Natural Gas

Introduction

Up until the early 1990s, due to relatively low prices, energy issues did not receive much attention from the policymakers and the scholars of political science. However two events have changed the outlook of global energy politics. First, the Gulf War alerted policymakers when a significant portion of Middle Eastern energy supplies faced the threats of an Iraqi invasion of Kuwait. Second, the collapse of the Soviet Union was a

welcome development as it suddenly provided the possibility of an alternative source of energy supply to the world.

By the twenty-first century energy studies consolidated its position as high priority when oil and gas prices started to rise in 1999. Over the last decade global oil prices have increased by more than five times from 20USD per barrel in August 1999 to 116USD per barrel in March 2013 (Indexmundi, 2013). The world is facing serious economic security challenges, predominantly determined by the growing population and growing need of resources in developing countries. The world's population will increase to 8 billion by 2030 from the current population of 6.5 billion, and 95 percent of that growth will be in developing countries. If this population growth is supported by growing economic potential and standard of living, more and more resources, and in particular energy resources, will be required. The International Energy Agency predicts a 50% increase in energy demand by 2030, even if efficiency is increased. About 70 percent of this increase is going to be in developing countries, and those countries are relying primarily on fossil fuels because of the very significant cost advantage (IEA, 2010). These numbers indicate the inevitability of increased pressure on the European economy.

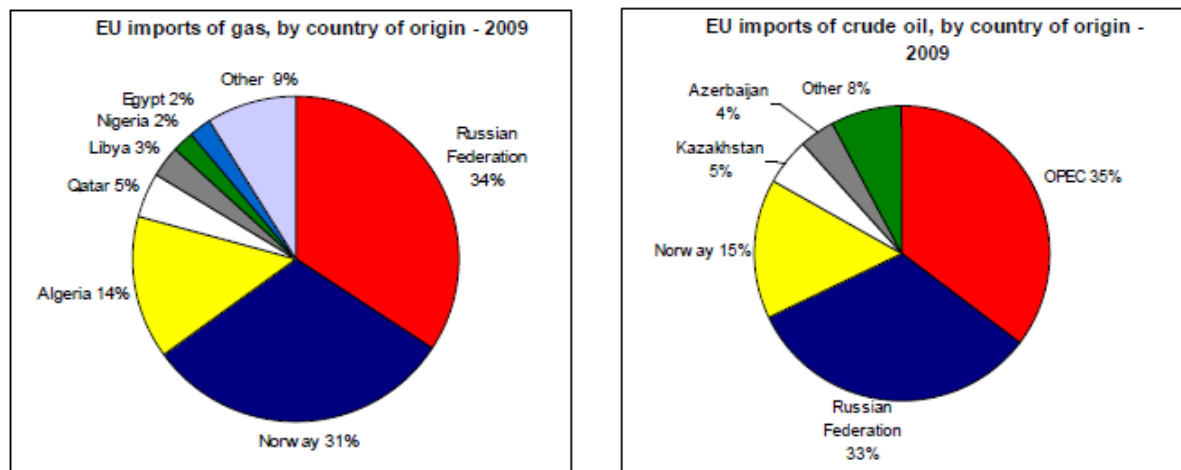
Today, it has become even clearer that energy security has proved to be a significant source of power in foreign policymaking. Accordingly, this paper argues that Europe's high and rising energy demand is highlighting the security problems associated with its dependence on especially Russian gas supplies, and the need for diversifying European energy supply. The EU's vulnerability in this regard is the result of dealing bilaterally with Russia on energy issues and thus granting Russia the capacity to have the upper hand among EU states. Therefore, in order to overcome its energy dependence on Russia, the EU needs to establish a European-level external energy strategy, become more cohesive regarding its external energy policy. In this regard, the strategic location of the Caucasus and Central Asia make it an area of growing importance in the contemporary security environment, particularly given regional instability and the potential threat to Western economic interests because of its energy resources and transport infrastructure. The Caspian region provides the most accessible alternative, provided that the region's resources are transported through the Caucasian corridor, which also requires significant infrastructure investments (Sokolsky&Charlick-Pailey, 1999, p. 10). A more formal framework between the EU and the Caspian region states should be established to streamline EU policies on energy (Dağdemir, 2007, p. 249). European states must realize that working together on issues of energy security, especially when dealing with Russia, will be mutually beneficial in the long term.

The rest of this paper is organized in following sections: First section will discuss the paradox of European energy dependency on Russia given that the EU has three and half times as many people, spends seven times as much on its military, and has a GDP fifteen times larger than Russia review Europe's energy vulnerability along with the similarities between European and Caspian states in terms of energy politics. Second section will review Europe's energy vulnerability along with the similarities between European and Caspian states in terms of energy politics. Third section will examine the policy alternatives for the EU in order to gain greater cohesion regarding their external energy policy and upper hand in dealing with Russia.

The Paradox of European Energy Policy

Recent developments in Europe and Central Eurasia, as well as growing tensions between the EU and Russia over energy issues, have brought new opportunities for alternative suppliers of energy and transit corridors (Baskan&Bac, 2011, p. 361). Table 1 demonstrates that the EU relies on Russia for third of its oil and natural gas and thus diversification of routes and sources is a strategic priority. Moreover the energy disputes of early January 2006, when the disruption in Russian gas supplies to European countries, including Germany and Italy, reaffirmed Europe's vulnerability in its dependence on imported Russian gas (Egerhofer et al., 2006). Russia's political decision to cut off gas supplies to Ukraine, the main transit country for Russian gas headed to Europe, amid a dispute over prices, awakened the EU. The Russian government seemingly replicated this incident in early 2007 when a price and transit fee dispute with Belarus caused another crisis. These incidents have shown the weakness of the European Union and are troubling because, under the leadership of President Vladimir Putin, the Kremlin has pursued a strategy whereby European reliance on Russian energy is leveraged into economic and political gains for Moscow.

Table 1. The EU's Dependence on Few Suppliers for Its Oil and Natural Gas



Source: Eurostat May 2011, Intra- EU trade excluded.

However the assumption that Russia is able to “out-leverage” the EU paradoxical since, after all, by nearly every measure of soft and hard power, Europe would seem to have the upper hand. For instance, the EU has three and half times as many people, spends seven times as much on its military, and has a GDP fifteen times larger than Russia. Even in EU-Russia energy trade, the balance of power appears to favor the European Union. While the gas the EU gets from Russia comprises 25 percent of European consumption, it also represents a full 70 percent of Russia's exports (Leonard and Popescu, 2007). Moreover, due to limitations in export infrastructure to any other region, Moscow currently has limited alternatives to the EU market. In that sense, Russia is more dependent on the European market than Europe is on Russian supplies.

However, so far Russia is successful in maintaining a high level of dependency in Europe. Moreover, the Kremlin has demonstrated that it has few hesitations in manipulating energy supply volumes in an effort to change a state's policies. In July 2006, Russian oil pipeline operator Transneft shut down its pipeline to Lithuania shortly after the Lithuanian government sold its highly profitable MazeikiuNafta oil refinery to a Polish firm instead of

Russia's Lukoil (Egerhofer et al. 2006). Transneft claimed that the shut-down was solely due to technical problems along the route but steadfastly refused all outside offers of assistance in repairing or assessing the damage—and even hinted that the pipeline might remain closed regardless.

The July 2006 incident is hardly the first time that Moscow has shut down pipelines in attempt to influence countries it considers to be in its backyard. Several times in 1990 and 1991, Russia cut supplies to the Baltic states in a blatant attempt to quash—and later exact revenge for—their independence movements. Later, in 2003, Transneft shut down its pipeline into Latvia after the Latvian government did not sell its VentspilsNafta export terminal to the Russian company... Transneft Vice President Sergei Grigorev spelled this out very clearly, saying “Oil can only flow from Russia. [Latvia] can of course sell [the port] to Westerners. But what are they going to do with it? Turn it into a beach?” (Lelyveld, 2003).

Many Western countries chose to interpret the VentspilsNafta debacle as a normal takeover attempt between two economic entities, ignoring the clear political implications. The energy sector, particularly in the former Soviet Union, lies at the intersection of business and politics. Political motivations clearly lie behind Russian gas cut-offs to non-EU countries like Georgia in 2001 and 2006, as well as recent price hikes to Ukraine, Georgia, and Azerbaijan. The dependence of these and other countries on Russia for such a vital commodity gives the Kremlin tremendous leverage. Moscow further increases its leverage in Europe by acquiring ownership (partial or otherwise) of downstream energy assets. Baran (2008, p. 160) states that in the past two years, Gazprom has signed deals with Eni (Italy), Gasunie (the Netherlands), BASF (Germany), E.ON Ruhrgas (Germany), and Gaz de France, supplementing the company's already significant holdings in Eastern European countries. Although Gazprom can often buy a stake in downstream assets outright, its preferred method of acquisition is through a trade for access to Russian oil and gas fields—with the Russian energy company naturally always retaining a controlling stake (Cornell, 2008, p. 149). This type of assets-for-access swap is highly beneficial for Russia, since it gains a presence in downstream European markets without giving up majority control over its own resources (Baran, 2008, p. 160).

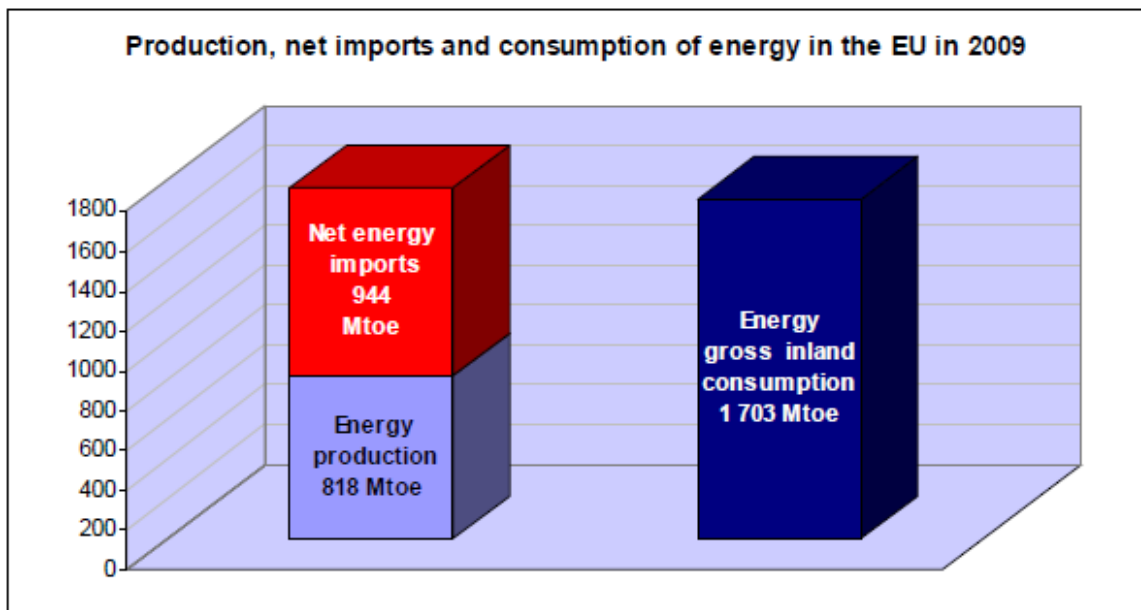
On the other hand Europe's dependency on Russian gas also undermines many of its foreign policy goals. Specifically, EU members are forced to limit their criticisms of Moscow, lest they be given a raw deal at the bargaining table—or become the next victim of a Kremlin-orchestrated supply disruption. Although mere sermonizing is not likely to be productive, Europe would have a freer hand to criticize Russia's increasingly tainted record on transparency, responsible governance, and human rights if it were not so dependent on Russian energy.

As Europe has begun to explore ways to diversify its supply of energy, the potential role of the Caspian region has inevitably emerged on the agenda (Estrada, 2009). Indeed, the Caspian Sea region is the most obvious candidate to serve as a new and relatively untapped source of natural gas and oil for Europe. Geographically, the region is located in Europe's vicinity, and both the states of the region and those that link it to Europe are largely friendly to, and seeking greater integration with, Europe.

The European Energy Needs and Caspian Region Resources

A variety of different products and commodities are vital for the functioning of the European economy, but it is energy resources, notably oil and gas, that are of critical importance for the region in the immediate future. As the Table 1 suggests Europe produces only 48% of its energy needs and is a net importer of energy, and according to a European Commission report, two-thirds of the EU's total energy requirements will be imported by 2020, with natural gas imports estimated to rise to 75% (Tsesereteli, 2008, p. 42). The fact that there is a growing demand for energy resources in the world further adds strain to the issue of access. Unlike the United States, China, or Japan, Europe's geography endows it with a geographic proximity to major sources of energy. Europe currently has three major sources of energy: the Northern Sea region and the potential Norwegian arctic sector from the north, Russia from the east, and the Middle East and North Africa from the south (Larsson, 2008, p. 19). Potential new players to join this list are the Caspian states, which have the potential to help Europe diversify away from its growing dependence on Russian oil and gas. In fact, some of the oil already flows from the Caspian region to European refineries via the Baku-Tbilisi-Ceyhan pipeline and other transportation links.

Table 1. EU energy dependency



Source: Eurostat May 2011. Energy production includes primary energy product and recovered products

Europe faces competition for resources from consumers that are larger and increasingly ambitious. Like in Europe, the United States' internal production share in the consumption of oil is declining rapidly, which means that U.S. dependence on imported oil will rise and, according to different estimates, may reach 68%, with an increased share of imports coming from the Gulf States (Tsesereteli, 2008, p. 45). As the United States began to take pro-active steps toward diversifying its energy supplies in the early 1990s, Central Eurasian resources attracted increasing attention. There is a growing demand for energy in Asia, and in particular in China, and Chinese state-sponsored companies are aggressively pursuing opportunities in Kazakhstan and Turkmenistan at whatever cost. This tactic has worked for them elsewhere in the world, particularly in Africa and Latin America.

On the backdrop of this strategic energy picture, the security of energy supplies has become a dominant issue for European consumers. According to Olcott (2010: 257) the Caspian Sea and Central Asian resources have a substantial role to play in the future oil supplies of the world. It is estimated that the Caspian will provide at least 10 percent of the expected increased production capacity in the next decade. Based on the assumption that current oil prices will remain stable, oil production from the Caspian may reach 6 million bpd by 2020 (Olcott: 2010: 258-259). The problem of the region is that it is land-locked and requires the development of new infrastructure, which would allow the potential of the region to be fully opened for the region itself, as well as for the broader European, and world energy security (Marketos, 2009: 3). Since maritime connections to the region are limited, the pipeline options for access to these markets are of critical importance for the region. Most often used for transcontinental oil movements, pipelines are critical for landlocked areas. They also complement maritime transportation by providing bypasses or shortcuts.

In general, pipelines are the primary option for transcontinental transportation since these are cheaper than railroad, barge, or road alternatives (German, 2008: 65). Pipelines constitute a safe mode of transportation if operating within a nation's borders, or between neighbors such as the United States and Canada, Norway and the EU, or between allied countries such as Azerbaijan, Georgia, and Turkey. On the other hand, pipelines may carry vulnerabilities if crossing politically unstable areas (Estrada, 2009). Moreover, political factors often play significant roles even in relatively stable areas, such as Russia. The political turmoil and price war with Ukraine was an issue of concern for European energy security, as a significant share of Europe's oil and natural gas supplies from Russia arrive via Ukraine.

Previous to the recent crisis over Russian gas, Europe was generally a passive observer of developments in the Central Eurasian region. The Baku-Tbilisi-Ceyhan pipeline (BTC), which connects Azerbaijan's offshore oil fields to the Turkish Mediterranean port of Ceyhan via Georgia, was developed only through strong U.S. support to the project (German, 2008: 68). With the BTC pipeline now in operation, and the development of Caspian natural gas pipeline shipments through Turkey a reality, Europe is acquiring additional supply routes, without major political efforts on its own part. In addition to existing supply routes, Europe now has a Caspian-Caucasus-Turkey-Mediterranean oil pipeline, which can ship light Caspian crude oil directly to the Mediterranean, and then to the refineries in Southern Europe, avoiding the congested chokepoints (Pipinashvili, 2011: 145). The BTC pipeline stands as an example of how strategic planning, coupled with well-designed policies, and effective implementation can help commercially viable projects materialize.

It is obvious that the potential entry of Caspian natural gas to Europe through the South Caucasus and Turkey would help Europe diversify its energy supplies, and to reduce dependence on the state-owned Russian monopoly Gazprom (Kısacık, 2010). Indeed, there appears to be little reason for Europe to access the same resources via Russia, allowing Gazprom as a monopolist to control prices, while making Europe vulnerable to voluntary as well as involuntary supply interruptions. Developing pipelines directly to the Caspian region will perfectly complement major reforms planned in the European gas sector, aiming at the creation of a competitive market of multiple operators with the interest of having different options of delivery routes. Such a competitive market is in the long-term interest of Europe; but it is objectively speaking in Russia's interest, too (Cornell, 2008, p.

154). Diversification of supply routes and gas sector reform in Europe will eventually drive the Russian monopolistic supplier, Gazprom, as well as the Russian gas sector in general, toward much-needed reforms and transparency that will give it sustainability and stability.

European Policy Options

For Europe, the key to overcoming its dependency on Russia lies on its ability to achieve greater cohesion regarding external energy policy. According to Baran (2008, p. 161), Moscow can only extract favorable conditions when it deals with states bilaterally and plays them against each other. Obviously, a collection of twenty-seven independent states, can never hope to be as strongly coordinated as Russia, a self-described “sovereign democracy” whose government increasingly resembles that of the Soviet state from which it descended. Nevertheless, a more formal framework should be established to streamline EU policies on energy. Several European leaders, particularly the EU Energy Commissioner Andris Piebalgs have supported such a position in his speech at the 12th Turkmenistan International Oil and gas Conference (2007). Unfortunately, formalizing a common European energy policy is quite difficult. Member states are far more reluctant to cede sovereignty to Brussels on energy policy than they are on trade tariffs or visa regulations.

At the very least, however, European states must realize that working together on issues of energy security, especially when dealing with Russia, will be mutually beneficial in the long term. For one thing, greater competition in the market will help reduce gas prices; the higher prices that Gazprom recently agreed to pay Turkmenistan and Kazakhstan will inevitably be passed on to European consumers. While many states in the European Union may be wary of “getting tough” with Russia, it should hardly be contentious for them to demand reciprocity in their interactions with Russia (Paillard, 2006, p. 66). This would mean increasing transparency, allowing third-party investment in the energy sector, and respecting the rule of law. For a long time, the only efforts undertaken by the EU to move Russia toward greater reciprocity was to passively insist that the country ratify the Energy Charter Treaty and associated Transit Protocol (Baran, 2008, p. 164). These entreaties were repeatedly brushed aside by Moscow. Now, however, Brussels appears to be taking more robust steps to ensure reciprocity.

The EU also has the legislative tools at its disposal to prosecute companies like Gazprom or Transneft for their monopoly power (Paillard, 2006, p. 46). In fact, the European Commission’s Directorate-General for Competition has already used its antitrust laws to prosecute Microsoft and block a proposed merger between General Electric and Honeywell (Bobelian, 2013). It is well within its authority to do the same to Gazprom, which is not a simple business monopoly, but a state owned strategic one.

It is vital that the EU diversify its energy supply by establishing a Southern Corridor. Thanks to the completion of the Turkey-Greece pipeline, gas can now travel all the way from Azerbaijan to the European Union without traversing Russia. This is an important first step, one that must be supplemented by the Greece-Italy connection, Nabucco, and a trans-Caspian gas pipeline, as well as possibly the White Stream project (Emadi&Nezhad, 2011, p. 29). Building a robust non-Russian-controlled transit route from Central Asia and the Caucasus will break Russia’s leverage, both in Europe and in the Central Asia-Caucasus region. But for this to happen, the EU must demonstrate its firm support for states in that region. After all, these states are much more vulnerable to Russian pressure

than are most European states. Before leaders like Turkmenistan's Gurbanguly Berdimuhamedov or Kazakhstan's Nursultan Nazarbayev will commit to a project such as a trans-Caspian gas pipeline, they must have a firm and steady political commitment from the entire EU.

Conclusion: What to do?

The EU and its member states can do several things for energy development in the region, and by extension for itself. The first would be to strongly support the Nabucco project, understanding that this commercial project is dependent on political support and cannot be left to market forces alone; since all its competitors are politically supported and not market-oriented, and energy issues are by nature political (Cornell, 2008, p. 153).

Second, Europe could invest in supporting the Turkmen-Azerbaijani dialogue, which would be a requirement for a Trans-Caspian linkage. Promising signs of a rapprochement have been observed, but the two states may need some additional incentive to put their differences aside. Supporting joint development fields and ensuring the westward export of its resources would be one such element, which would have the added benefit of de facto building half the Trans-Caspian pipeline (Cornell, 2008, p. 154).

Third, Europe could engage directly with the new Turkmen leadership to a higher degree. While far from a democracy, Turkmenistan is exhibiting rapid progress by regional standards, though it has a long road to travel (Piebalg, 2007). Engaging the country, if the process is conceived of correctly by the EU, would encourage this process.

Finally, it is clear that when dealing with the region, Europe would be well advised to realize that it is in no position to put conditions on energy- or other relationships. Central Asian states are not devoid of options; quite to the contrary, both Russia and China are in a more advantageous position both politically and geographically in the region (Zhengang, 2009, p. 4). Indeed, should Europe not move rapidly to devise a coherent policy and to increase its engagement with the region, the energy resources of Central Asia are likely to reach Chinese and not European consumers.

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