

MERIA

CYPRUS, A RUSSIAN FOOTHOLD IN THE CHANGING EASTERN MEDITERRANEAN

By Igor Delanoe*

Russian interests in the Eastern Mediterranean have been highlighted both by the country's diplomatic and naval activity related to the Syrian crisis as well as by its stance on economic and energy issues in Cyprus. During the 2000s, Moscow's influence on the island has steadily increased, making Cyprus a new Russian foothold in the Eastern Mediterranean. While Moscow's ties with Nicosia have served Russia's Mediterranean energy interests, they have also revived tensions with Turkey. In the context of the ongoing Syrian crisis, the Kremlin's growing involvement in Cyprus sheds new light on the Russia-Cyprus partnership.

Since 2008, Russia's historical involvement in Mediterranean affairs has once again been demonstrated through the increasing activity of the Russian Navy and Moscow's growing economic interest in the region. Whereas during the Cold War, the USSR had been a key stakeholder on the Mediterranean and Middle Eastern stage, carrying out a pro-Arab policy, Moscow had to unilaterally pull out from the region during the 1990s. Yevgeny Primakov, who served as minister of foreign affairs between 1996 and 1998 under then President Boris Yeltsin, tried to restore Moscow's influence in the Eastern Mediterranean. Yet it only under Vladimir Putin's tenure did Russia eventually succeed in building up its presence in the region. Today, the Kremlin's interests in the Eastern Mediterranean are deeply tied to the Middle East and Russia's national interests. Russia is concerned with securing its southern flank, in light of separatist--and to a certain extent Islamist--tendencies there as well as challenging foreign influences in the Black Sea region. Having concluded arms supply and energy deals with various Mediterranean actors since the early 2000s, Moscow also wishes to protect its economic interests in the region. Finally, the Middle East remains the last area of the globe where the Kremlin still

enjoys influence, which enhances its claimed status of great power.¹

Russian involvement in Cypriot affairs has been highlighted by its assistance to Cyprus with its economic crisis. Moscow's involvement on the Eastern Mediterranean stage has also been underscored by its stance on the ongoing crisis in Syria and the related large-scale naval drills the Kremlin held in the region in January 2013.² The initial purpose of these drills was to deter the West from implementing regime change in Syria. Yet they also took place in the context of rising tensions with Turkey regarding offshore gas reserves. In this regard, Moscow showed its support for Nicosia through use of "gunboat diplomacy."³

Although recent developments have mainly focused on the financial aspects of the Russian-Cypriot relationship, relations between Moscow and Nicosia also rely on a set of political agreements and have cultural roots. Russia has established strong ties with Nicosia since the 2000s, turning the island into both a foothold on the Mediterranean stage, in the European Union (EU), and into an outpost for its influence in the Middle East. This has raised a number of questions regarding those pushing the Russia-Cyprus bilateral partnership.

The USSR and Cyprus established diplomatic relations on August 18, 1960,

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immediately after the announcement of Nicosia's independence. The first trade agreement between the two was signed in December 22, 1962.⁴ During the Cold War, Moscow's relations with Cyprus were ambiguous. The Kremlin backed the Cypriot far-left wing party Akel, and after 1974 and the division of the island, it supported the Greek Cypriot stance against Turkey. At the same time, however, it attempted to maintain decent ties with Ankara due to Moscow's strategic interests in the straits.⁵ The USSR hoped its support for the Greek Cypriot party against the Turks would strain intra-NATO relations, between Athens and Ankara in particular.

Nicosia recognized Moscow as the legal successor of the Former Soviet Union (FSU) on April 7, 1992. Bilateral ties have steadily expanded since then and have included cooperation on economic, political, and cultural matters. Today, Russia and Cyprus have signed some 23 agreements, which have increased rapprochement between the two. In addition, economic ties are supported by the Cypriot-Russian Intergovernmental Committee on Trade and Economic Cooperation.⁶

On November 19, 2008, then President of the Russian Federation Dmitri Medvedev and Demetris Christofias, the Russian-speaking and Soviet-educated then President of the Republic of Cyprus, signed a joint declaration aimed at enhancing bilateral cooperation. The document outlined on both parties' commitment to intensify dialogue--with Nicosia contributing to the understanding between Moscow and the EU, and Moscow backing the reunification of the island within the United Nations Security Council (UNSC) framework. In addition, both stakeholders agreed on addressing new global threats and combatting organized crime.⁷ In 2010, the two countries further enhanced their ties with the signing of additional agreements, including a key accord that abolished double taxation, thus allowing further development in economic cooperation.⁸

The economic crisis has considerably weakened bilateral exchanges, which are

mainly dependent on Russian exports to Cyprus; they decreased from nearly €4.3 billion in 2004 to €1 billion in 2011. Meanwhile, Cypriot exports to Russia, while being marginal, have steadily increased, from €10.6 million in 2004 to €28.8 million in 2011. Russian exports to Cyprus mainly include oil and raw materials such as iron or timber, and Cyprus mostly exports agricultural products and pharmaceuticals to Russia.⁹ Cyprus remains a secondary partner for Russian trade with the Mediterranean, far behind Turkey (€19.3 billion of Russian exports in 2011) and Israel (nearly €1.4 billion of Russian exports in 2011).¹⁰ Without energy exports to Cyprus, Russian-Cypriot trade remains negligible--€47 million in 2011 (far behind Greece, the first Cypriot trading partner, at €1.7 billion; and Israel at €667 million).¹¹

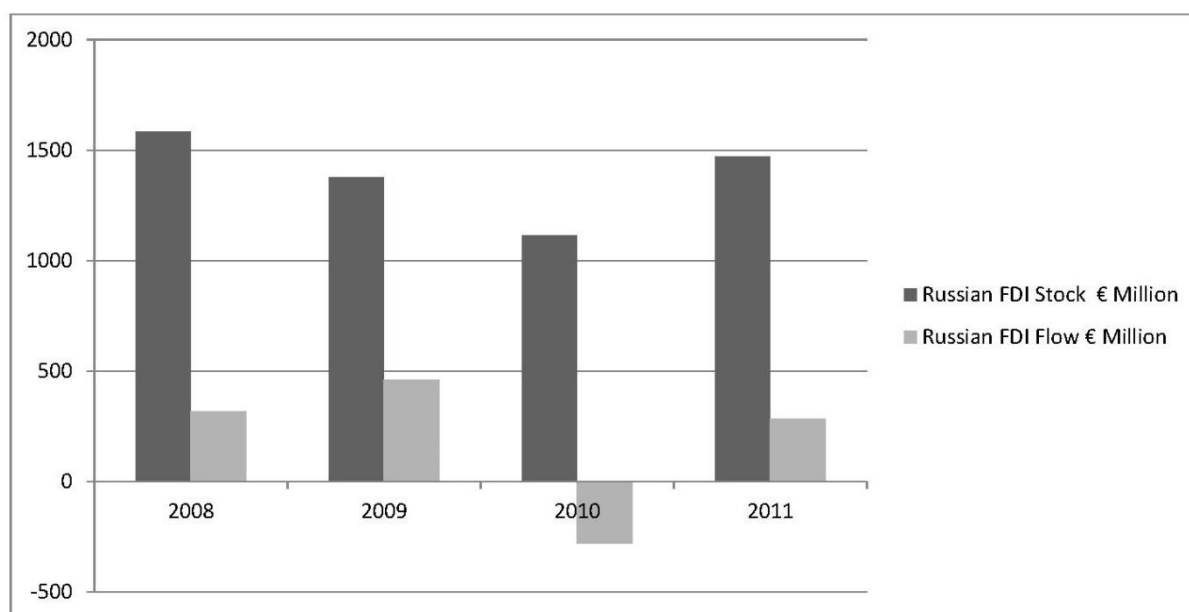
Since the early 2000s, Russian tourism to Cyprus has increased significantly, making the island one of the favorite travel destinations for Russian citizens in the Mediterranean (along with Turkey, Israel, and Egypt). In 1999, 113,500 Russian tourists visited Cyprus compared to 334,000 in 2011, when Russian tourists represented the second largest contingent of foreign travelers after British tourists.¹² Even before the collapse of the USSR and as early as the 1960s, Cyprus--or Famagusta, as it was referred to at the time by Soviet citizens--was a popular Soviet travel destination (with tourists arriving by ship).¹³ Today, due to its attractive mild climate and the cultural affinities with the island, some 50,000 Russians citizens--mainly retirees--are permanent residents in Cyprus (as of 2013). These are mainly "Pontian" Russian of the Black Sea region who grew up in the FSU and migrated to Cyprus in the 1990s. According to some sources, the number of Russian expats living in Cyprus could even be double. With a population of almost 1.1 million, Russian speakers would make up nearly 10 percent of the total population of Cyprus.¹⁴ In Limassol, they have created a "small Russia." There are two Russian schools as well as Russian-language newspapers and radio stations, thus

enhancing cultural ties between the two countries.

During the 2000s, Cyprus and its low ten percent corporate tax rate attracted Russian capital and Russian oligarchs. The flux of cash from Russia to Cyprus and from Cyprus to Russia (see table below) is also heavily sustained by the 1998 bilateral tax treaty, which allows Russians to pay a low five percent rate on dividends.¹⁵ While 30 percent of Russia's foreign direct investment (FDI) was in Cyprus from 2008-2011, Cypriot companies have accounted for 23 percent of FDI in Russia, making Cyprus one of the most important foreign investors for Moscow. Furthermore, at the end of the first trimester of

2013, Russian money accounted for up to €20 billion of the €35 billion of foreign money in Cypriot banks.¹⁶ The Russian money then invested in Cyprus is in turn invested back into Russia, thus taking advantage of the 2010 bilateral agreement which abolished double taxation and bypassing Russian domestic taxation on investments. For Russian oligarchs, the island has served as the backdoor to Europe, since anyone spending a minimum of €300,000 on property is granted permanent residency. This in turn allows one to move freely in the EU. Cyprus has thus become a real fiscal heaven for wealthy Russian businessmen.¹⁷

Russian FDI Flows and Stocks in Cyprus, 2008-2011, € Million



Source: Figures extracted from the Central Bank of Cyprus database, http://www.centralbank.gov.cy/nqcontent.cfm?a_id=10905.

This cycle has raised concerns in Europe about Cyprus becoming an arena for laundering of Russian capital. Some analysts have also highlighted the increasing involvement of Moscow in the Cypriot banking system, pointing to the risks of the island becoming a “Russian protectorate,” plagued by Russian mafia money laundering.¹⁸ In 2011, Cyprus obtained a €2.5 billion loan from Moscow, which will mature in 2016,

with a below-market rate of 4.5 percent. In 2012, Nicosia requested another €5 billion loan from Russia. Moscow denied this request, calling for further EU involvement in the Cyprus bailout. In September 2012, Russian Minister of Finance Anton Siluanov stated that Russia would grant Cyprus a new loan only within the framework of a coordinated action with the EU. President Vladimir Putin repeated this assertion in December 2012.¹⁹

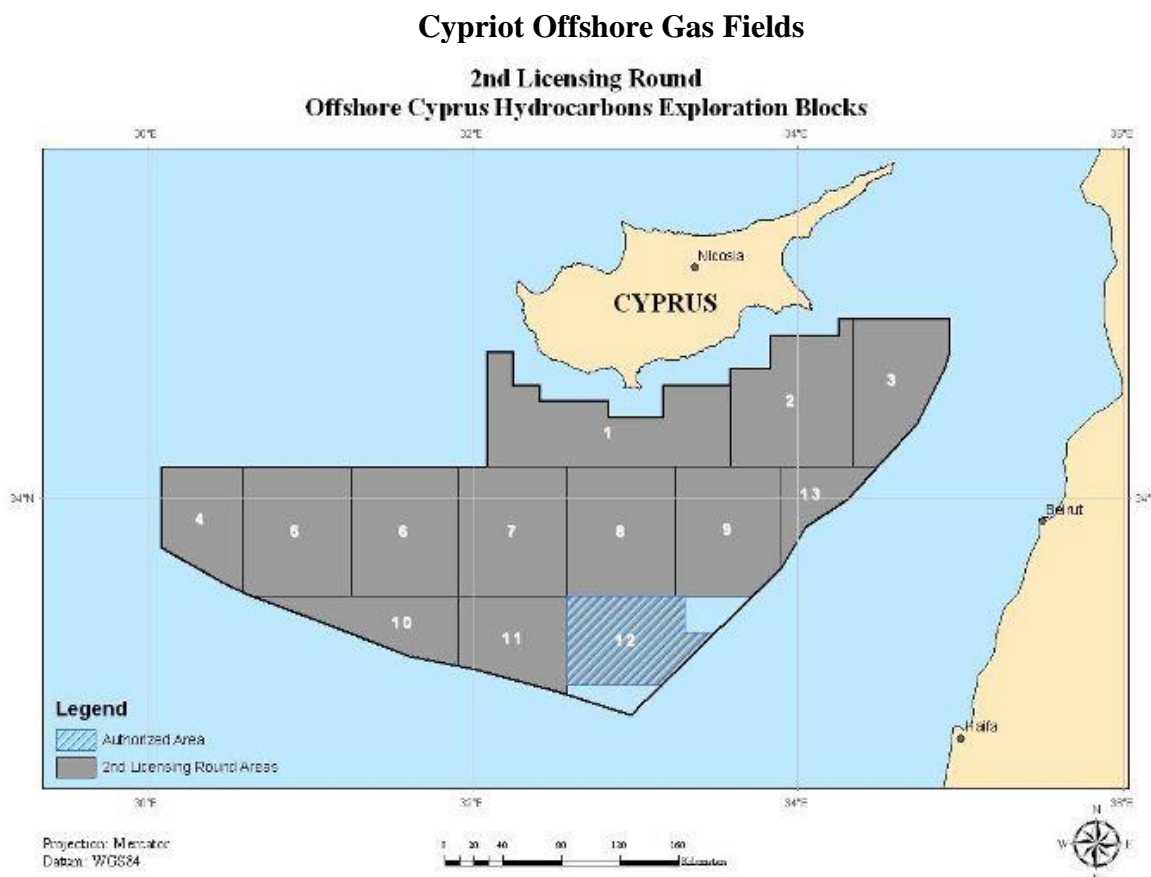
With a public debt assessed at nearly 90 percent of gross domestic product (GDP), anyone accepting to finance the Cypriot debt would be taking serious risk, thus explaining both Russia's cautiousness and European demands for the eventual agreement concluded with Nicosia in March 2013. Cyprus is in need of €17 billion to recapitalize its banking system and keep the government afloat. However, such a bailout would increase Cyprus' debt from 70 percent of GDP to 170 percent, which is unlikely to be sustainable or accepted by any international lenders.²⁰ Despite Berlin's calling in January 2013 to involve Moscow in a Cyprus bailout deal, the EU and Nicosia finally reached a compromise, thus putting aside the Russian option. Within the framework of this €10 billion rescue line from the EU and the International Monetary Fund (IMF), Brussels has demanded Cyprus raise €5.8 billion. Cyprus will thus contribute to its own bailout by taxing bank deposits exceeding €100,000 at a nearly 40 percent rate. As most of these deposits of over €100,000 are Russians, President Vladimir Putin called the plan "unfair, unprofessional and dangerous." Some Russian officials also criticized the plan for "beating up on the Russians."²¹ Although Cyprus only accounts for about 1.2 percent of EU economic activity,²² letting it either sink or be bailed out by Moscow would have been a dubious political move. It could have provided Russia

with greater access to Cypriot offshore gas fields, thus tying Moscow's loan to stakes in Cyprus' gas reserves.

MOSCOW AND CYPRUS OFFSHORE GAS RESERVES

Energy is one of Russia's main strategic interests in the "greater Mediterranean" region, which spans from the Caucasus, through the Middle East, to North Africa. As a key international energy producer and supplier, Russia has steadily developed relations and signed agreements with most of the Mediterranean countries since the early 2000s. The discovery of offshore natural gas fields in the Eastern Mediterranean has boosted Russian activity in the region.

As part of its strategy, Gazprom aims to diversify its supply routes to the European market and to undertake various exploitation projects, thus enhancing its role as a major energy actor. In this regard, Russia has expressed interest in exploring the Cypriot Aphrodite gas field, located on the Mediterranean Sea shelf of Cyprus (see map below). The Aphrodite gas field was discovered in December 2011, and could provide Cyprus with tremendous energy potential. According to a survey conducted by the American company Noble Energy, it could contain from 142 billion to 227 billion cubic meters (bcm) of gas.²³



Source: Ministry of Commerce, Industry and Tourism of Cyprus, http://www.mcit.gov.cy/mcit/mcit.nsf/dmlhcarbon_en/dmlhcarbon_en?OpenDocument.

According to the head of the Energy Department of the Cypriot Minister of Commerce, Solon Kassinis, the reserves contained in Aphrodite Block 12 alone would meet Cyprus domestic needs for the next three centuries.²⁴ Moreover, the exploitation of offshore gas fields and oil could provide Nicosia with more than €800 billion revenue in the decades to come, thus enabling them to return any loans. While the development rights of Block 12 have been granted to a consortium led by the U.S. Company Noble, Russia has expressed interest in developing Block 9. Yet negotiations over the development of Block 9 between a consortium led by the French company Total and the Russian Novatek and GPB Global Resources—the latter belonging to Gazprom—collapsed in December 2012 after the Cypriot authorities were denied their request to upgrade the French-Russian offer.²⁵

While the Kremlin missed out on this opportunity to become involved in Cypriot gas

development, a second opportunity arose in March 2013. Moscow was offered stakes in the exploration and the following exploitation of gas fields during the negotiations for a second loan, but Russia was not sufficiently convinced to proceed with the loan. Due to its refusal to bail Cyprus out, the Kremlin lost access to the Cypriot gas fields.²⁶

Thus the only way for Russia to access the Cypriot gas would be to become involved in its supply. As the ongoing political dispute concerning the division of the island prevents the transit of Cypriot gas to the European market through the Turkish pipeline network, Cyprus will have to explore other options. One alternative would be to build a new pipeline infrastructure to access the export market to Europe through Greece. This would emphasize the importance of Crete, the closest Greek island, where a gas terminal could be built. Nicosia could also build a liquefied natural gas (LNG) terminal to export it through tankers.

Yet another option would be to consider an enhanced Cypriot-Israeli partnership in the energy realm. Russia could then provide expertise in building the pipeline from Cyprus to Israel, or it could also seek to conclude a deal to buy LNG from a plant built either in Cyprus, Crete, or Israel.

However, both solutions would be extremely costly for Nicosia, since the estimated cost for building a LNG plant is €7.6 billion.²⁷ A viable solution might therefore involve a partnership between Israel and Cyprus to export their gas to Europe through an Israeli floating LNG. Israel indeed has a reserve of an estimated 25 trillion cubic feet (tcf) of natural gas, 9.7 tcf of which is located in the Tamar offshore gas field, which could meet nearly a century of domestic needs.²⁸ Moreover, in December 2010, Israel and Cyprus signed an agreement on the delimitation of their respective Exclusive Economic Zone (EEZ), which allowed both stakeholders to conduct seabed exploration.

Although the floating LNG plant is still in the development stage across the globe, Israel's Delek Group and Isramco Negev together with Noble Energy have agreed with the South Korean Daewoo Shipbuilding & Marine Engineering Co. to develop the Israeli gas field Tamar through floating production, storage, and offloading vessels. In addition, in February 2013, Gazprom Marketing & Trading and the Levant LNG Marketing Corporation (the marketing agent for the development of the Tamar project) signed an agreement for exclusive but non-binding talks. The two will hold exclusive talks for six months in hopes of concluding a deal.²⁹ Such a solution would satisfy Israel's desire to maintain full control over its energy sector and also appears to be more affordable and workable for Nicosia to export its gas. Moreover, it would meet Russian efforts to diversify its gas exports in developing Russian LNG, which would strengthen Moscow's role in the growing Asian market, while lessening its dependency upon European customers. Such an agreement would benefit from good relations between Moscow, Jerusalem, and Nicosia, and would pave the way for enhanced

strategic partnership between the three countries in the energy realm in the future. However, this prospect could be affected by tensions between Cyprus and Turkey, and, to some extent, between Moscow and Ankara.

SECURITY PROSPECTS IN THE EASTERN MEDITERRANEAN

On March 21, 1996, the Russian Federation and the Republic of Cyprus signed an agreement on military technical cooperation. During the 1991-2011 period, the two concluded €430.5 million of deals for the purchase of Russian military hardware. With five percent of Russian weapons selling in the Mediterranean, Cyprus is the number five Mediterranean customer--far ahead of Algiers (with some €4.6 billion in arms deals and 57 percent of sales).³⁰ Following the 1996 agreement, Nicosia began to purchase Russian weapons, including 43 BMP-3 and 41 T-80U tanks as well as 6 Tor-M1 surface-to-air missiles (SAM) systems. During the 2000s, Cyprus bought 4 BM-21 Grad self-propelled multi-rockets launchers, 12 Mi-24P combat helicopters, 3 Mi-8MT helicopters, and an additional lot of 41 T-80Us in 2010.³¹

On the international stage, Russia remains a geopolitical ally for Cyprus, since Moscow--as a permanent member of the UNSC--has consistently backed Nicosia in the conflict against Ankara over the island's division. Since the 1990s, Russia and Cyprus have maintained close defense ties. In 1996, Cyprus signed a deal to purchase two Russian SAM S-300 systems. Yet Turkey, backed by the United States, perceived the deployment of these systems as a threat to its interests and both S-300 systems were eventually based in Crete, under Greek control. To offset the deal, Athens purchased six Tor-M1 SAM systems from Russia for Cyprus.³²

During the Russian-Georgian conflict of August 2008, the former Cypriot President was among the few international leaders and was the only European leader to support Russia. Later, he also backed Moscow's demands on the U.S. missile defense system in

Eastern Europe.³³ While visiting the island in October 2010, then President of the Russian Federation Dmitri Medvedev recalled Moscow's support for a reunified Cyprus with a single sovereignty.³⁴ In the context of the Syrian crisis, Nicosia provided Moscow with logistical support, when in January 2012, it allowed a Russian cargo ship carrying 60 tons of ammunition to sail to Syria, bypassing the EU embargo on military supplies to Damascus.³⁵

The Eastern Mediterranean--with its access to the Atlantic via the Strait of Gibraltar and to the Red Sea via the Suez Canal--and Cyprus, in particular--with its strategic location as a lock on maritime routes to the Levant--have long been of strategic importance to Moscow. Cyprus has become even more important to Moscow in light of the situation in Syria. If the Syrian rebels win, the fate of the Russian naval base at Tartus on Syria's Mediterranean coast will be uncertain.³⁶ If the Tartus base were closed, Russia could potentially wish to establish a naval base on the island. Moreover, since Moscow intends to deploy a permanent naval task force of up to ten ships in the Mediterranean by 2015, Russian naval activity in the Eastern Mediterranean and in the Black Sea is expected to increase in the next decade, requiring a sustainable naval facility in the Mediterranean waters for the maintenance and repair of the vessels.³⁷

However, even if Nicosia agreed to the establishment of a Russian naval base, this would raise tremendous concerns from Ankara, which would be likely be backed by Washington. Energy issues have already revived serious tensions between Cypriots and Turks: Ankara has denied Nicosia the right to explore and exploit gas reserves unilaterally without involving Turkish Cypriots. In the naval realm, these tensions turned into "gunboat diplomacy," when in September 2011, Turkey deployed warships and air fighters to escort a seismic vessel for exploration in the Eastern Mediterranean.³⁸ In November 2012, former president of Cyprus, Demetris Christofias, complained about Turkish "gunboat diplomacy" and called on Ankara to desist from such behavior.³⁹ Then in

January 2013, Russian large-scale naval drills in the Eastern Mediterranean were held. The purpose of these drills was both to deter the West from launching a military operation in Syria and to show Moscow's support for Cyprus. In the context of growing tensions between Cyprus and Turkey concerning the gas fields, uncertainty about the situation in Syria, and considering Russia's longstanding interest in the Eastern Mediterranean, it is likely that Moscow would have an interest in establishing a naval base in Cyprus.

Though unlikely, any improvement in Turkish-Cypriot relations could hamper Moscow's interests. In March 2013, in hopes of diffusing tensions with Nicosia, the Turkish foreign minister proposed three alternatives concerning the gas: The two could either form a united Cypriot state and jointly exploit the natural resources around the island, or--in parallel to ongoing peace negotiations--Greek Cypriots and Turkish Cypriots could form a joint committee for natural resources. The final option would be a two-state solution in Cyprus.⁴⁰ If Cyprus makes a deal with Ankara, this would prevent further cooperation with Jerusalem, in light of the deterioration of Turkish-Israeli relations since 2008.

In January 2009, Israel's operation *Cast Lead* in Gaza was met with harsh criticism from Ankara. Bilateral relations further deteriorated after Israeli forces launched a raid on the *Mavi Marmara* on May 31, 2010. The boat, which was carrying humanitarian aid for the Palestinians, was attempting to break the Israeli-Egyptian blockade of Gaza and was thus intercepted by Israeli soldiers. The raid resulted in the deaths of nine Turkish citizens. Following the incident, Turkey recalled its ambassador to Israel and expelled the Israeli ambassador. In addition, Ankara demanded Israel fulfill three conditions in order for relations to be normalized, including official apologies, compensation for the victims, and the lifting of the embargo on Gaza. Since then, Turkish Prime Minister Erdogan has adopted a hostile rhetoric toward Israel. Nonetheless, both parties have attempted to leave the door open to further negotiations and have managed to avoid a complete severance of ties.⁴¹

Acting as a broker, President Obama attempted to put an end to the Turkish-Israeli dispute during his latest visit to Israel in March 2013. Following Obama's trip to Jerusalem, Israeli Prime Minister Benjamin Netanyahu called his Turkish counterpart and expressed his regret for the loss of life following Israel's 2010 raid. Still, after more than three years of low-level relations, this is unlikely to bring any fundamental change to the Israel-Turkey relationship. From Turkish point of view, while Israel's expression of regret was a first step, the three conditions demanded by Prime Minister Erdogan have not been yet been fulfilled, as Erdogan recalled days after Benjamin Netanyahu's phone call.⁴² Moreover, the Turks, especially Erdogan's supporters, are generally supportive of the Palestinians, and Erdogan has reasserted his intentions to visit Gaza.⁴³ Avigdor Lieberman, the former Israeli minister of foreign affairs called Netanyahu's move a "serious mistake,"⁴⁴ and his return to the government after his trial remains highly possible, which could further complicate any improvement in Turkish-Israeli relations.⁴⁵ Nonetheless, Jerusalem has found that losing Turkey "was more damaging psychologically than materially,"⁴⁶ and has since developed its ties with Greece and Cyprus.

In this context, Turkish-Israeli issues concerning energy in the Eastern Mediterranean are unlikely to be solved in the near future. Turkey has indeed already threatened Israel militarily for seeking to exploit its offshore gas field, while at the same time bullying Cyprus.⁴⁷ Israel's ambitions in the energy realm and its potential high level of cooperation with Cyprus are a serious threat to the Turkish position as an energy supplier to Europe. Growing tensions concerning gas fields could then feed into increasing military tensions, and may lead Cyprus to display interest in a potential request from Moscow to establish a Russian naval facility on the island. This would especially be the case if the situation in Syria were to have a negative impact on Moscow. The Jerusalem-Nicosia-Ankara energy partnership thus remains a highly unlikely achievement, especially since

this would first require a settlement of the protracted Cypriot-Turkish conflict and an effective improvement of Turkish-Israeli relations. The Jerusalem-Nicosia-Athens axis, on the other hand, appears as much more viable from a political point of view; from Moscow's point of view, this would likely be more favorable as well.

CONCLUSION

The Russian-Cypriot partnership is primarily based on cultural ties embodied by the nearly ten percent of Russian-speakers who are permanent residents on the island. Cyprus has thus become a small Russia in the Mediterranean. Economic relations remain unbalanced with the bulk of trade relying on Russia's gas exports to Cyprus. From a political standpoint, the Kremlin's support for Nicosia over the island's division has been the driving force behind their bilateral understanding for decades. Despite Moscow's defeat on the bailout issue, the Kremlin is not losing its grip on Cyprus. Due to the discovery of major gas reserves in the Eastern Mediterranean, Cypriot-Russian relations have only grown stronger. A new energy partnership between Jerusalem, Nicosia, and Athens could soon be forged, and Moscow--which enjoys good relations with all stakeholders--could play a key role in this triad by extracting and transporting Israeli and Cypriot gas. However, since it is unlikely to Ankara would allow Cyprus to exploit offshore gas unilaterally, Turkey would have to play a part as well. This would in turn push Nicosia to seek protection from Russia. With Cyprus' security concerns and the potential need for a replacement naval asset for Russia in the Eastern Mediterranean--especially in the case of Syrian President Bashar al-Asad's fall--this could open the door for cooperation between the two. In 2008, Dmitri Trenin wrote about Southeast Europe: "The Russians are re-entering the region as company managers and entrepreneurs."⁴⁸ This assertion could be extended to the Levant as well, where energy seems to remain the Kremlin's best card for maintaining its influence.

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NOTES

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