



ANALYSIS

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TREACHEROUS TERRAIN: THE POLITICAL AND SECURITY DIMENSIONS OF ENERGY DEVELOPMENT IN THE CASPIAN SEA ZONE

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FOREWORD

The collapse of the Soviet order has led to a new and remarkable era of international competition for access to the vast oil and gas resources of the Caspian Sea region. Corporations from all corners of the globe—supported by governments seeking to diversify energy supply—are investing billions of dollars to develop the resources of Azerbaijan, Kazakstan, and Turkmenistan. The evolution of the energy sector is closely tied to efforts by these former Soviet republics to establish viable states independent of Russian control. Yet in the post-Cold War transition, political and security problems—domestic and regional as well as international—have greatly hampered efforts to develop the resources of the Caucasus and Central Asia.

In this issue of the *NBR Analysis*, Dr. Rajan Menon, professor of international relations at Lehigh University and adjunct professor at Columbia University's Harriman Institute, analyzes the complex interplay between political and security issues and the development of the region's resources. Dr. Menon details the numerous areas of tension in the volatile Caucasus region and addresses their impact on the energy sector. He points out that the resumption of armed conflict between Armenia and Azerbaijan, or between ethnic minorities and ruling governments, cannot be ruled out. A recurring theme throughout the essay is the role of Russia, which remains the predominant regional power. The author asserts that Moscow has made a concerted effort to use its control of the export pipelines, capacity to destabilize neighboring regimes, and involvement in regional conflicts to obtain for its companies significant shares in most of the production and pipeline consortia formed to date. As Russian companies become more involved in these consortia, Moscow's arguments for joint development of the Caspian's resources by all littoral states are relegated to "ritualistic symbolism."

Dr. Menon also examines the ways in which pipelines that pass through Russia are susceptible to demands by regional governments for a share of transit revenues, and would be vulnerable in the event of ethnic conflict or renewed civil war in the North Caucasus. Meanwhile, pipelines that would avoid Russia are also fraught with difficulties. On top of the potential for armed conflict in the Caucasus, pipelines to the south are effectively blocked by civil war in Afghanistan and U.S. sanctions against Iran.

Dr. Menon concludes that while the United States should not maintain a Moscow-centered policy, policymakers must also recognize that Russia will continue to be a critical player in regional energy developments. The U.S. government should assist the countries of Central Asia and the Caucasus to broaden their economic and political contacts but not raise expectations that it can counter Russian influence at every stage. Sanctions against Azerbaijan should be recon-

sidered, efforts to resolve regional ethnic and territorial disputes strengthened, and assistance programs to the Caspian states continued so that oil revenues are used to enhance economic development, democratization, and prospects for regional stability.

This paper is a product of NBR's ongoing research program on the politics and economics of energy in the former Soviet Union. Lead funding for the project is provided by the Henry M. Jackson Foundation and The International Research and Exchanges Board (IREX). In the coming months, this research series will continue with studies examining Japan's and China's interests in the energy resources of the former Soviet republics and the geopolitics of pipeline development.

Richard J. Ellings
Executive Director
The National Bureau of Asian Research

Existing and Potential Oil and Gas Export Routes From the Caspian Basin



TREACHEROUS TERRAIN: THE POLITICAL AND SECURITY DIMENSIONS OF ENERGY DEVELOPMENT IN THE CASPIAN SEA ZONE

Rajan Menon

Introduction

The Caspian Sea's energy resources are sometimes described with breathless wonderment.¹ Yet the region is expected to account for only 4 to 7 percent of global oil production at its peak, and its reserves are currently estimated to be a third of Kuwait's or Iraq's. While this is a substantial amount, it is hardly comparable to the holdings of the Persian Gulf region, which contains two-thirds of the world's oil reserves.² Thus the energy wealth and strategic significance of the Caspian Sea should be put in perspective. Hyperbole will make for policies that are ineffective and unsustainable at a time when Americans, in the aftermath of the Cold War, seek clear and sound foreign policy priorities so that resources can be channeled to long-neglected domestic problems.

That said, the importance of the Caspian region for the United States will undoubtedly increase. America's multifaceted presence there is expanding just when the area is undergoing historic change that is accompanied by the possibility of instability. A fundamental shift is underway in the regional balance of economic and political power. Russia, long the uncontested hegemon, is in decline. Meanwhile the role of other states (Turkey, Iran, China, Japan, the United States, and Western European countries) as well as international organizations like the United Nations, NATO, the Organization for Security and Cooperation in Europe, and the World Bank is increasing rapidly. Multinational oil companies have also entered the region. This alone has increased the attention it receives in, and the importance it is assigned by, the major powers. America's foreign policy is not, of course, simply a function of the interests of its corporations. Yet there is no question that the inflow of billions of dollars in American investment into the Caspian Sea zone, and the area's growing importance for global energy supply, will increase its salience in Washington.

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¹ A case in point is Anthony Sampson's contention that the "center of gravity" of global energy is shifting to the Caspian Sea. Sampson, "Russia: New Oil Czar in Asia," *Impact 21*, October 1996, p. 12.

² "Pipe Dreams Come Closer to Reality," *Middle East Economic Digest*, March 28, 1997, internet edition.

Growing American involvement in the Caspian region will occur amidst changes that will be unsettling—even tumultuous. Inherently complex processes that took generations to unfold in the West are being compressed there into decades. New political institutions, ground rules, and legitimating principles are being fashioned. Markets and private property are emerging—albeit slowly and unevenly—against the backdrop of state-managed economies and administered prices and are creating new social divisions. New national identities are being formed in a context rife with separatist and irredentist conflict.

Burgeoning oil and gas wealth along the Caspian littoral and the influx of foreign investment are creating unprecedented economic opportunities for the people of the area. But the dangers that accompany energy booms should not be overlooked.

Burgeoning oil and gas wealth along the Caspian littoral and the influx of foreign investment are creating unprecedented economic opportunities for the people of the area. But the dangers that accompany energy booms should not be overlooked. The societies of the Caspian zone could experience the dicey combination of increasing economic inequality and surging popular expectations. In Azerbaijan, Kazakstan, and Turkmenistan leaders proclaim that energy revenues will bring profound and beneficial economic changes. This message is heard by the common people and has raised their hope that a better life will be at hand. Such expectations can be fulfilled. But local leaders must ensure that conspicuous consumption and the jet-set lifestyles of a small, deracinated local elite, its foreign partners from the international oil industry and consulting firms, and a plethora of showcase projects are not the main consequences of rising oil and gas exports.

The energy boom could create vast opportunities to improve health care, education, housing and other basic needs. But, if badly handled, it could also have pernicious consequences in the form of corruption, nepotism, capital flight, and crime. And increasing contact with the global marketplace could make for a torrent of fads and fashions that fail to coopt because they remain tantalizingly beyond the reach of the common man or woman but breed resentment by challenging indigenous customs, mores, and culture. This combination of unrequited hopes, glaring inequality, and anomie created by an assault on the familiar could provide fertile soil for extremist movements. And these movements could well have an anti-Western edge precisely because the West—through its banks, consultants, corporations, products, and advertisements—becomes so closely identified with the oil boom and its legacy.

Energy wealth could also create pernicious power transitions in the Caspian area—particularly in the south Caucasus where the Nagorno-Karabakh issue festers in an untenable neither-peace-nor-war mode. Azeri leaders will undoubtedly use part of their oil revenue to increase their military capability if a diplomatic solution acceptable to Azerbaijan proves elusive. They may at some point feel that they are in a position to retake the secessionist region by force. But Armenia and Nagorno-Karabakh, sensing the impending shift in power, may feel compelled to take preemptive action. At the very least they will react by beefing up their own military might, exacerbating the conflict spiral. Either way, the energy boom will have contributed to a more unstable environment.

Thus American involvement in the Caspian Sea zone amounts to an entry into uncharted waters with shifting currents. This is why the level and modality of involvement must be debated and defined. This will increase the likelihood that the assumptions behind our diplomacy are tenable,

that the scenarios it anticipates are appropriate, and that the resources supporting it are adequate. As part of the debate, the sometimes parochial, reflexive, and ideological bases of American policy (exemplified by our policy toward Nagorno-Karabakh, the preoccupation with a generally ill-defined Islamic fundamentalism, and a lingering Russocentrism) must be challenged so that our enduring interests come to light. This debate has already begun in the executive and legislative branches and in the intelligence and foreign policy communities, and it has made several matters pertinent to American policy in the Caspian region topics of controversy.

The wisdom of adhering to the Section 907 restriction, which prohibits U.S. aid to Azerbaijan until it allows the flow of goods into and out of Armenia through its territory, is now being questioned.³ Opponents of Section 907 argue that it is detrimental both to the competitiveness of American companies in what could be the premier economic power in the south Caucasus and to the goal of strengthening U.S.-Azerbaijani relations.⁴ The growing role of U.S. oil companies in Azerbaijan has begun to make members of Congress receptive to this view, and it has prompted prominent Americans who have served in high-level governmental positions to weigh in against Section 907.⁵ The policy of isolating Iran and banning investment in its energy sector is also being questioned.⁶ Critics maintain that it denies the United States an array of means to encourage change in that country, while also preventing Azerbaijan, Kazakstan, and Turkmenistan from reducing their dependence on Russia as a conduit for their energy exports.

Russia also figures in the discussions on American policy toward the Caspian. The controversy centers on how best to balance engagement and the construction of an enduring relationship based on trust with Moscow with the development of a multifaceted American presence in the Caspian Sea zone—an area in which most Russians think they should be dominant. Whatever the intentions of the United States, a Russia in decline is bound to feel that it is under challenge in a vital periphery and that America's expanding role in the former Soviet republics along the Caspian littoral will erode Russian influence. American foreign policy experts disagree about the balance between—indeed, compatibility of—acknowledging Russia's geostrategic interests in the Caspian region and helping Azerbaijan, Kazakstan, and Turkmenistan reduce their dependence on Russia.

Oil and gas companies operating in the Caspian Sea region cannot bypass political and security issues—on the grounds that they are best left to political leaders—and focus solely on economic and technical challenges. Politics and security will determine the conditions under which energy is sought, extracted, and transported. The states of the Caspian Sea and their immediate neighbors inhabit a volatile region which, since the unraveling and collapse of the Soviet Union, has experienced conflicts and civil wars that are directly relevant to the work of oil companies. The Nagorno-Karabakh war—a hybrid of civil and inter-state war—has ended,

³ Herbert Ellison and Bruce Acker discuss the debate on Section 907 in "Azerbaijan: U.S. Policy Options," *NBR Briefing*, no. 2 (June 1997). On the Clinton Administration's policy toward the Caspian Sea region in general and Section 907 in particular, see the statement of Stuart Eizenstat, undersecretary of state for Economic and Business Affairs, before the Senate Foreign Relations Committee, Federal News Service, July 22, 1997, internet edition.

⁴ See, for example, S. Rob Sobhani, "The Great Game in Play in Azerbaijan," *The Washington Times*, February 20, 1997; George Zarycky, "Unfair Punishment for Azerbaijan," *The Washington Times*, July 26, 1997.

⁵ George Melloan, "Who's Winning, and Losing, the New 'Great Game'," *The Wall Street Journal*, March 31, 1997. One news report listed Lloyd Bentsen, Dick Cheney, John Sununu, Brent Scowcroft, Zbigniew Brzezinski, Richard Armitage, and former Congressman Charles Wilson among those who have argued for a change in U.S. policy toward Azerbaijan and who have business or consulting interests in the Caspian zone. "Caspian Caviar," *The Washington Times*, July 28, 1997; "Inside America: U.S. Aides Seek The Caspian's Black Gold," *The Guardian* (London), July 1997.

⁶ A call to rethink U.S. policy toward Iran is made by Robert D. Kaplan, "Why the U.S. and Iran Will be Friends Again," *The Wall Street Journal*, February 10, 1997. An even more explicit argument, which relates what the authors regard as an ill-considered American policy of isolating Iran to American interests in the Caucasus, is contained in Paul B. Henze and S. Enders Wimbush, "A New Policy for the Middle East," *The Wall Street Journal*, January 31, 1997.

but the peace is punctuated by clashes and no viable solution has emerged.⁷ The Karabakh Armenians insist on retaining their independence; the Azeris are equally adamant that the region be reincorporated into Azerbaijan. In Georgia's South Ossetia region, where separatists once fought the central government, the prospects for lasting peace are relatively promising. But in strategically important Abkhazia, with its Black Sea coast and a border with Russia's volatile north Caucasus zone, the breakaway regime is determined to retain the independence that it won from Georgia in the war of 1992–94. The Georgian government is equally committed to ending what it regards as an illegal secession and, under great pressure from Georgian nationalists groups and refugees who fled Abkhazia, may try to retake the lost territory. The possibility of strife in Kazakstan between Kazaks and Russians, who form the majority in the provinces that adjoin Russia, is by no means foreordained. But neither can it be excluded. The war between Russia and Chechnya ended in 1995, but it could break out anew, or war could erupt between the embryonic Chechen central government and assorted private military formations. Fighting between the Kurdistan Workers' Party and the Turkish government in the country's southeastern regions continues with no end in sight. The civil war in Afghanistan ensures that plans to build pipelines through that unfortunate country to convey Turkmenistan's natural gas to Pakistan and beyond will stay on the drawing board. As I shall show, each of these actual or potential conflicts are relevant to the tapping and transportation of Caspian energy. Turmoil would shake the confidence of investors, whose willingness to commit the necessary funds to support prospecting, drilling, and the building of pipelines and other infrastructure is essential. Regional instability—whether because of wars within or among states—could hamper the construction of pipelines and the security of those that are built.

Russia fears that its traditional dominance in Central Asia and the Caucasus could be imperiled as Western, Turkish, Japanese, and Chinese companies move in to tap the oil and gas wealth of Kazakstan, Azerbaijan, and Turkmenistan.

The shifting regional balance of power will also affect the economic climate. [Russia fears that its traditional dominance in Central Asia and the Caucasus could be imperiled as Western, Turkish, Japanese, and Chinese companies move in to tap the oil and gas wealth of Kazakstan, Azerbaijan, and Turkmenistan.] Russia is beset by problems and its economic leverage on these states is in decline. But it is not a paper tiger. To get their energy riches to hard currency markets, the Kazaks, Azeris, and Turkmen depend on pipelines that are either owned by Russia or go through its territory.⁸ The former Soviet Union is a unipolar region: all of the newly independent states are weak, but power is relative, and Russia is the least weak. Once Russia recovers economically, it will play a more active role in the region, drawing on a reserve of power far greater than that available to the other states of the former Soviet Union. In the meantime, post-Soviet Caspian Sea states remain dependent on Russia (albeit unevenly so) for trade, energy supplies, military hardware and training, and internal and external security. As I shall show, by contesting the Caspian Sea's legal status, stoking or fomenting domestic unrest in the region, and successfully lobbying for the inclusion of its firms in energy and pipeline consortia, Russia has demonstrated that it may be down but is by no means out. Thus the nature of its internal evolution and external orientation will shape the environment in which the energy resources of the Caspian are developed.

⁷ In a confidential interview with the author in Baku in June, a senior executive of one of the Western oil consortia in Azerbaijan identified the resumption of war between Azerbaijan and Armenia as the problem that posed the greatest danger to the prospects for regional energy development.

⁸ See Sarah Lloyd, "Pipelines to Prosperity," *International Spectator*, vol. XXXII, no. 1 (January–March 1997), pp. 53–70.

The interplay in the Caspian Sea area between politics and security on the one hand and energy development and transportation on the other constitutes the focus of this paper. To set the stage for analysis, the essay first summarizes the energy riches of the Caspian Sea zone and the international ventures currently underway. [The Appendix provides a more detailed picture.] The national strategies of the littoral states related to energy development and their positions on the controversy over the legal status of the Caspian Sea are discussed in the next section. The analysis then turns to the political and security problems affecting present and proposed pipeline routes. The conclusion examines the implications posed by my analysis for American policy toward the Caspian region.

Energy Stocks, Consortia, and Contracts: A Snapshot

As Table 1 demonstrates, the hydrocarbon wealth of the Caspian is substantial. With 15 to 29 billion barrels in proven oil reserves and 162 to 249 trillion cubic feet (tcf) of natural gas, the energy wealth of the Caspian Sea region is on par with that of the North Sea:

Table 1: Caspian Oil and Gas Resources⁹

	Proven oil	Possible Oil (billion barrels)	Total Oil	Proven gas	Possible Gas (trillion cubic feet)	Total Gas
Azerbaijan	3.6–11.0	27.0	31–38	11	35	46
Kazakstan	10–16	85.0	95–101	53–83	88	141–171
Russia	0.2	5.0	5.2	N/A	N/A	N/A
Turkmenistan	1.5	32.0	33.5	98–155	159	257–314
Iran	0	12.0	12.0	0	11	11
Uzbekistan	0.2–0.3	1.0	1.2–1.3	74–88	35	109–123
TOTAL	15.3–28.7	162	177–190	162–249	293	455–542

Despite the political and security problems noted earlier, international corporations have moved rapidly into the Caspian Sea zone. As a result, a number of oil and gas consortia and agreements on pipeline construction have emerged within a relatively short span of time.¹⁰ In Kazakstan, the Tengizchevroil (TCO) consortium was established in 1993 to exploit the giant Tengiz oil field. The partners are the government of Kazakstan, Chevron, Mobil, Kazak Oil, and Russia's LUKoil. To provide Kazakstan an export channel for Tengiz oil other than Russia's Atyrau-Samara¹¹ pipeline, the Caspian Pipeline Consortium (CPC) was established to build a line—now scheduled to be completed in late 1999 or even as late as 2000—that will originate in Kazakstan but then run largely through Russia and terminate at a port to be built north of

⁹ The energy wealth of Russia and Iran depicted in the table covers only their Caspian Sea zones. The energy resources of Uzbekistan and Georgia, which do not border the Caspian Sea, are omitted. United States Energy Administration's *Country Analysis Brief: Caspian Sea Region*, October 1997.

¹⁰ I have assembled the information on energy ventures underway in Kazakstan, Azerbaijan, and Turkmenistan from: *Caspian Region Energy Development Report (As Required by HR 3610)*, pp. 21–23, hereafter *CREDR*; Rosemary Forsythe, *The Politics of Oil in the Caucasus and Central Asia*, Adelphi Paper No. 300, London: International Institute for Strategic Studies, 1996, pp. 37–43; Economist Intelligence Unit (EIU), *Country Profile: Georgia, Armenia, Azerbaijan, 1996–97*, London: EIU, 1997, pp. 55–57; EIU, *Country Profile: Kazakstan, 1996–97*, pp. 27–34; EIU, *Country Profile: Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan, 1996–97*, pp. 72–75; the country profiles of the U.S. Department of Energy's *Oil, Natural Gas, Coal, Electricity Profile* (Internet site: <http://www.eia.doe.gov/emeu/cabs>); Richard Hildahl and Laurent Ruseckas, "The New 'CPC': What It Means for The Politics of Caspian Oil," Cambridge Energy Research Associates, *Decision Brief*, July 1996; and various press reports.

¹¹ Samara is a major pipeline junction from which oil heads to markets through several routes.

Novorossiisk.¹² The Russian government and two Russian firms, LUKoil and Rosneft, together control 44 percent of CPC's equity. The rest is held by Kazak state firms, the Kazak government, Oman, and several Western firms, including Chevron, which has a 15 percent share. Kazakstan has also concluded a number of deals with Western companies to survey Kazakstan's Caspian reserves through the KazCaspianShelf (KCS) consortium established in 1993. Kazakstan sold China National Petroleum Company (CNPC) a majority stake in state-owned companies and signed agreements on prospecting, drilling, and the construction of pipelines to China from the Aktyubinsk and Uzen fields.¹³ It also formed the Kazakstan-British Gas-Agip partnership (which Texaco later joined and which LUKoil will enter) to exploit the large gas field at Karachaganak.

Investment in Azerbaijan has also been robust. The Azerbaijan International Operating Company (AIOC) was formed in 1994 to tap the Azeri and Chirag offshore sites and the deep-water portions of the Guneshli site. British Petroleum (BP) holds a 17.1 percent share, AMOCO 17 percent, SOCAR (the Azeri state oil company) 10 percent, and LUKoil 10 percent. The rest of the equity is held by Western, Turkish, Japanese, and Saudi Arabian firms. The Caspian International Operating Company (CIOC) emerged in 1995 to develop the Karabakh offshore field. It is a partnership between Pennzoil (30 percent), LUKoil (12.5 percent), a LUKoil-Agip partnership (45.5 percent), and SOCAR. Agip is reportedly carrying LUKoil in recognition of Russia's geostrategic importance. A third consortium was established in 1996 to develop the Shah-Deniz offshore field with BP, Statoil of Norway, Turkish Petroleum Limited (TPAO), SOCAR, LUKoil, Elf, and the National Iranian Oil Company as shareholders.

In December 1996 the Northern Apsheron Operating Company (NAOC) was formed to exploit the Ashrafi and Dan Uludzu offshore field with AMOCO (30 percent), Unocal (25.5 percent), Itochu (20 percent), SOCAR (20 percent), and Delta-Nimir of Saudi Arabia (4.5 percent) as the partners. SOCAR and LUKoil signed an agreement in 1997 to develop the Yalama field in the North Caspian, with the latter holding a 60-percent share. In the same year, SOCAR, LUKoil, and Rosneft combined to develop the Kyapaz field located midway between Azerbaijan and Turkmenistan in the Caspian. The latest flurry of deal-making occurred during Azerbaijani president Heidar Aliev's visit to Washington in July 1997. Aliev signed four new agreements—valued at between \$8 and \$10 billion—with American oil companies. SOCAR serves as a major shareholder in each consortium. The agreements covered the Inam field (with AMOCO), the Apsheron field (with Chevron), the Nakhchivan field (with Exxon), and the Oguz site (with Mobil).¹⁴

The amount of foreign investment in Turkmenistan's oil, and substantially bigger natural gas, sector has been smaller. Turkmenistan's economic environment features a contracting GNP, an unstable currency, and high rates of inflation. Investors have been deterred by government officials who make and break contracts capriciously. The higher costs of transporting gas relative to oil have also reduced the attractiveness of Turkmenistan because of its total reliance on the Rus-

¹² Pending the completion of the Caspian Pipeline Consortium (CPC), Kazakstan has, in addition to using the Atyrau-Samara line, worked out a swap arrangement with Iran. It was reached in 1996 and took effect in May 1997. Kazak oil will be shipped across the Caspian Sea to Iran. Iran in turn will export an equivalent amount of its oil from its Karg island terminal and transfer the proceeds to Kazakstan. The agreement provided that the exchange would begin at 40,000 barrels per day (b/d) and rise to 120,000 b/d over two years. The presence of mercaptans (sulphurous contaminants) in Kazakstan's oil had made for delays. "Iran to Deliver Oil Under Kazakh Swap Deal," *Reuters European Business Report*, May 10, 1997.

¹³ "The Lure of the East," *The Financial Times* (London), July 23, 1997; *Pipeline News* internet publication, no. 70, part I (August 1997); "China's Strike," *The Economist*, August 16, 1997, pp. 32-33; "Chinese Corporation Wins Another Kazakh Oil Tender," *RFE/RL Newslines*, August 5, 1997.

¹⁴ Details from *Pipeline News*, no. 70, part II (August 1997). Additional deals may be in the works. One possibility is an agreement between Azerbaijan and Frontera (and its partner, Baker Hughes Solutions) to develop the onshore fields of Kyursangi and Karabagly in the Azeri portion of the Kura river basin. These fields have been exploited since the 1960s and are estimated to contain 150 million metric tons of oil. The agreement could be expanded to include Unocal and its partner, Delta-Nimir of Saudi Arabia, by reducing the shares of SOCAR and Frontera.

sian pipeline system and its consequent vulnerability to assorted conditions imposed by the Russian natural gas monopoly, Gazprom, on the volume, destination, and price of gas exports.

Nevertheless these constraints have not prevented foreign investment in Turkmenistan's energy sector. Bidas (an Argentine company that was summarily deprived of its export license in December 1995), Lamarg Energy Associates (a Dutch firm), and Dragon Oil (registered in Ireland) have sought to develop oil in the Keimir, Ekpatlaukh, Chishlyar, Cheleken, and other sites. Turkmenistan's gas deposits are far more substantial, and are the world's third largest after Russia's and Iran's. The largest fields are Dauletabad-Donmez in the Amu Darya basin along the border with Uzbekistan and Yashlar in the Murgab basin in the south. Unocal, Delta, and Gazprom plan to work Dauletabad-Donmez, and Bidas has been developing Yashlar since 1991.¹⁵ But total gas production fell from 84 billion cubic meters in 1991 to 32 billion cubic meters in 1996. Exports dropped by 50 percent to 25 billion cubic meters in 1996, and because of the dependence on Russian pipelines, they have been largely restricted to markets in the former Soviet Union, whose customers owe \$1 billion in arrears.

The forces of global capitalism have moved with vigor and dispatch into a region that was a closed-off periphery of the Soviet empire for almost 75 years.

This context-setting synopsis highlights several points that will be amplified in the analysis that follows. Considering that the post-Soviet Caspian states became fully independent only in December 1991, the volume of foreign investment is remarkable.¹⁶ The forces of global capitalism have moved with vigor and dispatch into a region that was a closed-off periphery of the Soviet empire for almost 75 years. As a consequence, Russia's leverage over these states is being contested as never before. While Russia remains an important participant in the competition for the Caspian's energy wealth, it is too deficient in what has come to be known as soft power to wage an effective competition with the West.

However, it would be a mistake to write Russia's obituary. The Caspian Sea zone has a geopolitical salience for Russia's security that it will never have for the West, and Russia has the motive to act forcefully to defend its interests. Russia has abundant opportunity as well, by virtue of its proximity, role in the regional and ethnic conflicts, capacity to destabilize regimes, and control of pipeline routes that convey Caspian energy to the markets. For a declining power Russia has not done badly in parlaying this leverage to ensure that Russian companies are represented in the energy and pipeline consortia that have sprouted. Indeed, the Caspian states have sought to include Russian firms precisely because they understand that Russia remains a strong player and must be coopted. To reduce their dependence upon Russia and to increase their strategic significance for the West, the Caspian states, especially Azerbaijan and Kazakhstan, have made a point of attracting non-Russian investment.

¹⁵ It should be emphasized that much of the activity in Turkmenistan's energy sector remains in the planning stage, Dauletabad-Donmez being a case in point.

¹⁶ Yet, the amount of investment is small compared to East Asia and other parts of the world such as East Asia and most of it is confined to Azerbaijan and Kazakhstan, where it is largely in the energy sector.

Legal Disputes and National Strategies

Russia and the Collective Model

The dispute over the Caspian Sea's legal status has received extensive coverage and will be discussed only briefly here. The Russian position is that Caspian energy should be exploited only with the agreement of all littoral states, that each should receive a share of the proceeds, and that the sea should not be divided into exclusive national sectors beyond a limited territorial zone. In essence, Russia bases its position on the Russo-Iranian treaties of 1921 and 1940 that it maintains have not been superseded. But Russia's position is driven ultimately by strategic calculations, not legal sensibilities. It wants to exercise as much control as possible over the inflow of Western capital and technology into the region and realizes that unfettered investment will reduce Russian economic influence, increase that of the West, and lay the groundwork for strengthening the West's strategic stake in the Caspian Zone.

The ex-Soviet states located off the Caspian Sea basin have been within Russia's strategic orbit since at least the mid-19th century, and Russia fears that an open door policy, especially given its own economic weakness, would inexorably change this state of affairs. Moreover, a collective approach to profit sharing would enable Russia to stake a claim to proceeds from oil and gas regardless of where in the Caspian they are located. The detailed seismic surveys of the Caspian now underway indicate that most of its energy resources are located within the sectors claimed by Azerbaijan, Kazakstan, and Turkmenistan.

Yet while Russia has consistently declared a preference for the collectivist model, it has been unwilling to push aggressively for it. Russian companies have participated in the various agreements that Azerbaijan has signed with Western, Japanese, and Turkish energy companies in areas of the Caspian over which Baku asserts exclusive ownership. The government in Moscow has not sought to block their participation. Nor has it made support for CPC dependent on Kazakstan's acceptance of the Russian position on the Caspian or seriously turned up the heat on Kazakstan in the many ways that are conceivable given Kazakstan's location, demographic composition, and economic dependence upon Russia. Moreover, not only has Moscow not tried to block the participation of Russian companies in Caspian projects, it has been their advocate and promoter. The standard, but rather questionable, explanation for this apparent contradiction is that bureaucratic infighting in Russia's fragmented state makes coherent policy on the Caspian well-nigh impossible.

In Azerbaijan, Russia is widely seen as patron of Armenia—a view that is not unjustified given the historical record, Russia's position during the Karabakh war, its arms supplies to Armenia, and its December 1991 and August 1997 security treaties. The latter (the "Treaty on Friendship, Cooperation, and Mutual Assistance") is described by Yeltsin as a "qualitatively new stage" in bilateral relations and the basis for a "strategic partnership" and by Armenian president Levon Ter-Petrossian as a document that would make Armenia's integration with Russia closer than that of Belarus. The treaty also calls for mutual aid in the event of an attack by a third party and expanded military cooperation.¹⁷

Yet Moscow recognizes the emerging economic and strategic importance of Azerbaijan and has not placed all its eggs in the Armenian basket. It understands that tacking completely to-

¹⁷ On the Russian-Armenian treaty of August 1997 and the statements of Yeltsin and Ter-Petrossian, see "Russian, Armenian Presidents Sign New Cooperation Agreement," *RFE/RL Newswire*, September 1, 1997. On Azerbaijan's criticism of the accord, especially the provision for mutual assistance in the event of war, see "Azerbaijan 'Concerned' About Russian-Armenian Treaty," *RFE/RL Newswire*, September 2, 1997; and "Azerbaijan Concerned About Russian-Armenian Treaty," *RFE/RL Newswire*, September 4, 1997.

ward Armenia would be counterproductive given its desire to have Russian oil companies included in Azeri consortia and to counter Azeri efforts to expand economic relations with Turkey and the West, and strategic ties with the United States and NATO. Russia has, therefore, sought to build ties with Azerbaijan and steered clear of endorsing the Armenian-Karabakh position that Nagorno-Karabakh should be forever outside Azerbaijan's jurisdiction.

Russia and the Caspian: Coherence or Chaos?

The standard explanation for the contradictory Russian policy that rejects the idea of national jurisdictions for the Caspian Sea while encouraging its firms to take part in deals based on its national division is that the Russian-state-in-formation is fragmented. Policy—to the extent that it exists—is the product of rivalry among various bureaucratic and private lobbies.¹⁸ On the Caspian Sea dispute, the Foreign Ministry and the national security bureaucracies are seen as proponents of *Machtspolitik*: advocates of the collective model on the grounds that it alone would ensure that Russia's strategic influence remains paramount and would keep Western influence then within tolerable bounds.

Russia's private or partly state-owned energy companies and those segments of the state bureaucracy preoccupied with economic policy and reform are viewed as holding a different perspective. The energy companies are supported, the argument goes, by Prime Minister Viktor Chernomyrdin, a long-time official in the Soviet gas industry who engineered the creation of Gazprom out of the Soviet gas industry. He and other top officials who see the world through commercial lenses are said to be driven by the logic of investments and profit and to oppose a ham-handed pursuit of collectivism for fear that it could exclude Russian companies from the action in the Caspian. The coexistence and rivalry of these two approaches is said to explain the contradictory nature of Russian policy. This is not an altogether unreasonable rendition. There has certainly been confusion and contradiction in Russian policy. As in any government, there have also been squabbles aplenty on policy among segments of the bureaucracy, and the Caspian issue is no exception. These differences are taken to connote disarray because the inference jibes with the prevailing intellectual paradigm that Russia is a colossus engulfed by chaos.

Yet this plausible explanation fails to account for why the Russian state has not, so far as we know, really attempted to block the participation of Russian economic interests in the Caspian consortia. More importantly, it fails to explain why Moscow has worked to ensure that they are included in the various consortia and that their share is increased. The bureaucratic tug-of-war explanation focuses on the fragmentation of Russia's policy process and in effect denies the existence of behavior guided by state and national interests. Keeping the Caspian Sea controversy alive may well be a way for Russia to remind Azerbaijan, Kazakstan, foreign oil companies, and Western governments that Russia is not a spent force whose interests can be overlooked and that energy deals have a much better chance of going forward with Russia on board than with Russia as a spoiler. After all, Russia's strategic importance and the lobbying of the Russian government, rather than the compelling technical and financial contributions of Russian energy companies, explain why companies such as LUKoil and Rosneft have gained prominent places in the Caspian consortia. In short, the Caspian Sea controversy can be used as an evocative issue to assert Russia's interests and demonstrate its capacity to be the fly in the ointment. As such, it is a lever for squeezing Russian economic interests into the consortia.

¹⁸ See, for example, Igor Khirpunov and Mary M. Matthews, "Russia's Oil and Gas Interest Group and Its Foreign Policy Agenda," *Problems of Post-Communism*, vol. 43, no. 3 (May/June 1996), pp. 38–47.

Despite Russia's campaign on behalf of the collectivist model [for developing Caspian resources], the major international energy companies are in the Caspian Sea in strength and have signed multi-billion dollar contracts with Azerbaijan and Kazakstan.

It can hardly have escaped the Russian government that wrangling over the legal status of the Caspian Sea has so far made little difference to the imperatives of global capitalism. Despite Russia's campaign on behalf of the collectivist model, the major international energy companies are in the Caspian Sea in strength and have signed multi-billion dollar contracts with Azerbaijan and Kazakstan. Indeed, the significance of the legal dispute over the Caspian Sea has been exaggerated. But keeping the controversy alive has been effective in gaining Russian economic interests entree—especially because Western companies and governments believe that geostrategic imperatives recommend a strategy of coopting Russia by including it in energy deals. Moscow's calculation may be that, should Russia recover economically and reemerge as a great power, the collective model could, if need be, be pursued with bite and not just bark.¹⁹

The other, and increasingly less salient, facet of Russia's strategy has been to isolate Azerbaijan, the most vociferous foe of the collectivist formula. Russia's partnership with Iran has been one means to do that. Another has been to prevent a coalition among Azerbaijan, Turkmenistan, and Kazakstan. There are two examples of the latter approach. In order to demonstrate to Turkmenistan that signing on to the Azeri model would prove costly and risky, Russia threatened at one point to withdraw Russian officers (vital for the Turkmen military that is under joint Russian-Turkmen command) from the Turkmen armed forces and Russian border guards who patrol Turkmenistan's borders with Iran. This was reinforced by a reminder that Russia could block the access of Turkmen shipping to the Volga River.²⁰ Turkmenistan's backtracking from the Azeri model and its confusing approach to the Caspian dispute indicates that the message was received.

The shift in the Russian position on the Caspian Sea's legal status is the second example. In November 1996 Russia proposed that 45-mile national jurisdictions be established for oil and gas extraction and 10-mile boundaries for fishing, with joint ownership as the governing principle elsewhere.²¹ A added provision allowed energy sites beyond that limit and already under development to be treated as special cases. This was generally seen as a fresh approach by the new Foreign Minister, Yevgeni Primakov, a wily strategist who had realized that Russia had failed in its efforts to insist on the undiluted common ownership model. But it may well have been an effort to split Kazakstan and Turkmenistan from Azerbaijan. Russia may have reasoned that its new solution would appeal to them because it offered limited national jurisdictions while not requiring them to get embroiled in disputes with Russia. The gain to Russia would have been that the collective model would have acquired widespread support among the littoral states with Azerbaijan being cast in the role of isolated contrarian.

Yet Russia's efforts to establish a joint regime for the Caspian have become noticeably less strenuous since late 1995. There are two reasons for this change. First, the effort to use the col-

¹⁹ That Russia's legal position on the Caspian could be reactivated with force at some point in the future when Russia's bargaining position is stronger was suggested to me by a senior official of SOCAR under the government of former president Elçibey. Interview, Baku, June 1997.

²⁰ Interview with a senior official of the Turkmenistan foreign ministry, Ashgabat, June 1995.

²¹ On Russia's more flexible conditions, see EIU, *Country Report: Kazakstan*, 1st Quarter, 1997, London: EIU, 1997, p. 36. Azerbaijan rejected the Russian proposal. I am grateful to Laurent Ruseckas for discussions on this issue.

lective model as a means to gain what would in effect be a veto over Caspian energy development has manifestly failed. Second, if indeed Russia's real goal has been to use the legal dispute as a means to have its companies included in energy deals by creating an incentive for Azerbaijan and Kazakhstan to coopt them, the outcome has been remarkably successful. But this of course makes harping on the unresolved legal status of the Caspian purely symbolic and in fact downright contradictory. This seems increasingly apparent to Moscow. Thus if the Russian foreign ministry publicly questioned the legality of the AIOC deal—even as representatives of the energy ministry appeared at the signing ceremony—President Boris Yeltsin joined Aliiev to witness the signing in Moscow of the July 1997 agreement between LUKoil and SOCAR on the Yalama offshore field. Russian officials—including First Deputy Prime Minister Boris Nemtsov, who attended the signing—also welcomed the agreement reached in the same month among SOCAR, LUKoil, and Rosneft on the Kyapaz field.²² It follows that, with time, Russia's preference for collectivism will be relegated to symbolism.

Iran and the Collectivist Model

Iran has supported the Russian approach on the Caspian. Its position is that the Soviet-Iranian treaties of 1921 and 1940 should serve as the basis for the Caspian's legal regime until the coastal states work out a final solution. That solution, in Iran's view, should allow for national zones of up to 20 miles, with the areas beyond treated as "common holdings" with "all of the development . . . based on the agreement of the littoral states."²³ The regime favored by Russia would give Iran a far greater share of Caspian energy revenues and a much more prominent voice in the development of the region's energy wealth than would an arrangement based on exclusive national sectors. Once the Soviet Union collapsed and Central Asia and the Transcaucasus opened up to the outside world, Iran and Russia were seen as putative rivals in these regions. But rivalry has been overridden by convergent interests stemming from common fears of a unipolar world dominated by the United States, concerns over Turkish ambitions in the southern states of the NIS, the shared apprehension over irredentist or separatist ethnonationalism, and substantial economic and military transactions. This convergence is also apparent in the legal squabble over the Caspian status.

Iran has studiously avoided bellicose tactics in advocating the joint management of the Caspian. Indeed, it has entered joint ventures in Azerbaijan, the leading critic of the collectivist model. Iran was eager to join the AIOC deal and was incensed when Azerbaijan shut it out in response to American pressure. It subsequently joined the consortium formed to develop Azerbaijan's Shah-Deniz field and also participated in those established to exploit the Talysh-Deniz and Lenkoran-Deniz sites. Iran has also been willing to participate in the bidding for offshore tenders solicited by Turkmenistan.

Iran's approach is what psychologists might call "conflicted." On the one hand, it recognizes that the Caspian dispute offers an opportunity to make common cause with Russia, thereby strengthening a relationship that it values for strategic, economic, and military reasons.²⁴ Like Russia, Iran realizes that the collective model would be economically more beneficial for it if most of the energy wealth of the Caspian turned out to be in the sectors claimed by Azerbaijan, Kazakhstan, and Turkmenistan. On the other hand—without endorsing the sectoral model—it has sought participation in the deals that Azerbaijan has signed because it does not want to be

²² "LUKoil, SOCAR Sign Deal for Yalama Field," *Pipeline News*, no. 66, part III (July 1997).

²³ Seyed Kazem Sajjadpour, "The Caspian Sea Region: Iranian Policy Position," *Analysis of Currents Events*, vol. 9, no. 6 (June 1997), p. 7. Sajjadpour is an Iranian scholar currently working at Iran's UN mission.

²⁴ A succinct account of the considerations shaping Iranian attitudes towards the Caspian Sea dispute is offered by Laurent Ruseckas and James Placke, "The United States and Iran: Implications for Azerbaijani Oil," Cambridge Energy Research Associates, *Decision Brief*, April 1995.

shut out of the action and sees involvement in Caspian energy projects as a way to counter American-imposed isolation. While Iran has a number of convergent interests with Russia in Central Asia and the South Caucasus, it also wants to increase its economic presence in these regions and to attenuate their dependence on Russia. In particular, it has been keen to emerge as a conduit for pipelines carrying oil and gas from Central Asia and Azerbaijan to world markets. A strategy of non-involvement in Caspian energy deals based on a doctrinaire fealty to the collective model would defeat these goals.

Azerbaijan: Arch Foe of Collectivism

Azerbaijan has been the most forceful in insisting on an alternative model that divides the Caspian into exclusive national jurisdictions and provides littoral states full freedom to develop energy resources within their zones. Baku has steadfastly refused to acknowledge the validity of the Russian position or even to accept the variant of 45-mile national zones that Russia proposed as a compromise. The insistence on the right to exploit what is seen as Azerbaijan's sector of the Caspian marked the policy of the Elcibey government, and it has been continued under Aliev.

Former president Elcibey was quite nationalistic and open about ending what he saw as a quasi-imperial relationship with Russia. Aliev—a former head of the Azerbaijan KGB, First Secretary of the republic's communist party, and member of the Soviet Communist Party's Politburo—has been less strident and more willing to accommodate Moscow on key issues such as membership in the Commonwealth of Independent States (CIS), which Elcibey had rejected. Aliev appreciates keenly the extent of Russia's strategic influence, which Moscow has displayed in a number of ways: its arms sales to Armenia; its apparent role (which has wide credence within Azerbaijan) in Surat Husseinov's attempted coups against both Elcibey and Aliev; its closing of the border with Azerbaijan from December 1994 to early 1997, and the intermittent restrictions, even after the opening of the border, on Azeribut not Georgian or Armenian—motor vehicle traffic into Russia from Georgia.²⁵

*While bringing Russian oil companies into the consortia,
[Azerbaijan's President] Aliev has also sought to take advantage
of the competition among them.*

Aliev has dealt with Russia through a judicious amalgam of resistance and cooptation. Like Elcibey, he has stood firm on the Caspian dispute. In contrast to Elcibey, he has welcomed the participation of Russian oil companies in the deals signed to exploit the Azeri sector, while implying that a policy of non-participation would result in Russia's exclusion from lucrative contracts. This strategy of implied threat and substantial inducement has been remarkably effective. The increasing role of Russian companies has had the effect of coopting Moscow by increasing its stake in Azerbaijan's energy sector. This in turn has sparked discussions in Russia about the wisdom of a pro-Armenia policy and increasingly relegated Russian legal arguments about the Caspian's status to the domain of ritualistic symbolism. While bringing Russian oil companies into the consortia, Aliev has also sought to take advantage of the competition among them. In July 1997, he signed the deals covering the Yalama and Kyapaz fields with LUKoil and Rosneft, but also met with representatives of two other major Russian oil companies, Sidanko and Yukos—and he made a point of letting it be known that he had done so.

²⁵ On the closing of the Russian-Azeri border, see the report on the visit of the chairman of the Russian Duma's Defense Committee, Lev Rokhlin, to Azerbaijan in *Nezavisimaia gazeta*, October 2, 1996, pp. 1, 3, trans. in *Current Digest of the Post-Soviet Press* (CDPSP), vol. XLVIII, no. 40 (October 30, 1996).

While eliciting Russia's cooperation by increasing its stake in oil and pipeline deals, Aliiev has also courted major Western oil companies aggressively. He has done so for three reasons. First, they have the technology and capital—or ability to raise capital—and are thus the best bets to ensure that Azerbaijan enjoys the benefits of substantial and reliable oil revenues. Second, like Elcibey, Aliiev wants to diversify Azerbaijan's economic relations to reduce the heavy dependence upon Russia. The many deals signed with non-Russian oil companies are meant to further that objective. Third—and this explains Azerbaijan's distinct preference for the "majors"—he believes that the Western oil giants have far more political influence in their home countries than smaller companies.²⁶ He hopes that this influence, in combination with their growing investment, will raise Azerbaijan's strategic significance in the eyes of Western powers.²⁷ Aliiev calculates that this, in turn, will offset Russia's strategic dominance and alter what is seen widely in Azerbaijan as the West's general pro-Armenian policy on the Nagorno-Karabakh conflict and its specific manifestations such as the Section 907 restrictions on U.S. aid to Azerbaijan.

In Aliiev's mind the problems in Azerbaijan's relations with the United States are not the mere result of the effectiveness of Armenian lobbies but also of Azerbaijan's failure to articulate and demonstrate its strategic significance. The most vivid recent example of an effort to do this was Aliiev's August 1997 state visit to Washington, during which, with Vice President Gore in attendance, he signed major deals with AMOCO, Chevron, Exxon, and Mobil. The event was calculated to increase significantly the stake of U.S. oil companies in Azerbaijan and to allow maximum publicity for a country that, until recently, has received relatively little attention in the American media and foreign policy circles. In sum, the Azeri approach to the Caspian Sea goes beyond the (admittedly important) matter of generating revenue for economic development. It is also part of a post-imperial policy toward Russia, a strategy related to the dispute with Armenia, and a plan for forging strategically significant links to the West.

Kazakstan: Quiet Rebel

Like Azerbaijan, Kazakstan has also asserted the right to develop its national sector of the Caspian Sea. But Kazakstan is far more vulnerable to Russian pressure than Azerbaijan: it has a 3,000-mile border with Russia (the validity of which Russian hypernationalists periodically call into question); Russians constitute about a third of the overall population and almost twice that in many of the northern provinces adjoining Russia; and Kazakstan depends on Russia far more heavily than Azerbaijan for trade, arms, military training, and border defense along the frontier with China.²⁸ Consequently, it has been more circumspect in challenging the Russian position. Kazakstan supports the idea of national sectors in the Caspian, but advocates a negotiated solution involving all parties and favors a collective approach to environmental protection and fishing.

²⁶ Aliiev's gambit may be a shrewd one. As part of their efforts to make U.S. policy more suited to their economic interests in Azerbaijan, the American oil companies—while not acting as official lobbyists for Azerbaijan—have pressed for changes in policy that would benefit Azerbaijan. They have also made the Azeri perspective more visible by explaining the Azeri position on Nagorno-Karabakh, opposing Section 907, and rallying support against the Porter amendment, which specifies that one-seventh of private U.S. humanitarian aid (allowed to non-state Azeri entities under section 907) must be allocated by the Azeri government to Nagorno-Karabakh. See "Oil Industry Largely Backing Azerbaijan in Armenia Tiff," *The Houston Chronicle*, September 26, 1996; and the letter to the editor by Frank Verrasto, Senior Vice President, Pennzoil, in *The Washington Post*, July 19, 1997, which lays out the Azeri case against Section 907 and on Nagorno-Karabakh.

²⁷ As Ilham Aliiev, Vice President of SOCAR and son of Azerbaijan's president, remarked at a February 1997 Washington, D.C. conference on the Caspian Sea, while noting Azerbaijan's preference for investments by the major Western oil companies, "Azerbaijan's political and economic strength will get us heard." "Azerbaijan Investors Show Interest, Backing at Big Washington Conference," *Russia and Commonwealth Business Law Report*, vol. 7, no. 21 (March 12, 1997), internet edition.

²⁸ Rajan Menon, "In the Shadow of the Bear: Security in Post-Soviet Central Asia," *International Security*, vol. 20, no. 1 (Summer 1995), pp. 149-181.

Turkmenistan: Twists and Turns

Turkmenistan's position is more difficult to fathom. In the early post-Soviet period, it favored dividing the Caspian, but was exposed to intense Russian pressure not to collude with Azerbaijan and Kazakstan. By mid-1995, Turkmenistan appeared to have moved close to the Russian-Iranian position. It embraced the idea of combining limited national jurisdictions for fishing and oil and gas development and proposed that joint management should prevail elsewhere. While Turkmenistan ceased publicly to espouse the Azeri model, it has not explicitly advocated the Russian-Iranian variant either. Turkmenistan's official position now is that the status of the Caspian is unresolved and that there is a need for an "international legal order in the Caspian basin proceeding from the new political reality, with the aim of civilized development of its resources and in the interests of all the littoral states," who are asked to show "restraint as far as practical operations in the Caspian Sea are concerned until its new legal status is finalized."²⁹ This appears to say a lot; but as with most please-all protean formulations, means very little.

Turkmenistan claims the Azeri offshore field and part of the Chirag field (which were included in Azerbaijan's deal with AIOC) on the ground that they are within its sector of the Caspian. But this makes its position not just vague but curious. So does its condemnation in July 1997 of the agreement among SOCAR, LUKoil, and Rosneft on the Kyapaz field ("Serdar" in Turkmenistan's nomenclature) on the grounds that Turkmenistan is the rightful owner. The protest caused Russia to announce that it would not recognize the contract and led Rosneft to withdraw.³⁰ LUKoil stayed in, citing guarantees from the Azeri government, but later said that it would not proceed with the implementation of the agreement. Azerbaijan rejected the Turkmen claim on the ground that Kyapaz had been discovered by Azeri geologists in 1989 and it had made the subsequent investments to develop the site.³¹ President Niyazov upped the ante by saying that Turkmenistan would entertain bids from Russian oil firms and the National Iranian Oil Company on Kyapaz/Serdar.³² (So much for Turkmenistan's official position that unilateral action on Caspian Sea development be avoided.)

It is unclear whether this brinkmanship is designed to bolster Niyazov's position in a negotiated compromise with Azerbaijan or portends a confrontation between the two Caspian States.³³ But, by challenging Azerbaijan over Kyapaz/Serdar, Turkmenistan has in effect endorsed the Azeri model on the Caspian; its only quibble would appear to involve where precisely the demarcation lines ought to be.

The Northern and Western Routes

The Azerbaijan International Operating Company (AIOC) announced in November 1995 that there would be two pipeline routes for the export of early oil: the Baku-Grozny-Novorossiisk

²⁹ July 5, 1997 Turkmenistan Foreign Ministry statement in "Turkmenistan Disputes Russian and Azeri Rights to Caspian Oilfield," British Broadcasting Corporation (BBC), *Summary of World Broadcasts*, SU/WO494/WF (July 11, 1997).

³⁰ At the same time, Russia's Ministry of Fuels and Energy and Ministry of Foreign Affairs refused to be drawn into the dispute between Azerbaijan and Turkmenistan, saying that the Kyapaz agreement was a commercial transaction between private Russian and Azeri companies. (Yet SOCAR and Rosneft are state-owned and the Russian government has a stake in LUKoil.) "Russia Plays Down Turkmen Protest over Caspian Oil Deal," BBC, *Summary of World Broadcasts*, July 11, 1997, citing Interfax, July 8, 1997.

³¹ On the Azeri response to Turkmenistan's claim on Kyapaz, see *Ibid.*

³² *Pipeline News*, no. 66, part III (July 1997); *Pipeline News*, no. 70, part II (August 1997); "Russia Annuls Kyapaz Contract," *RFE/RL Newslines*, August 4, 1997; "Turkmenistan Contests Russia-Azerbaijan Oil Deal in Caspian Sea," TASS, July 6, 1997; "Russian Delegation Leaves for Turkmenistan," ITAR-TASS, July 27, 1997; "Turkmenistan, Iran, Russia to Develop Kyapaz?" ITAR-TASS, August 26, 1997.

³³ Niyazov has gone beyond protesting what he takes to be Azeri violations of Turkmenistan's Caspian zone. In an apparent effort to back up his claims, he is reported to have approached Pakistan and Iran for help in strengthening Turkmenistan's naval capabilities. "Neighbor States in the Caspian Area May Be Divided by a Border," *Nezavisimaia gazeta*, July 22, 1997.

line through Russia (the “northern route”) and the Baku-Supsa line through Georgia (the “western route”). While technical and financial considerations were obviously weighed, politics was very much part of the equation. The Russian state and Russian oil and pipeline companies had pressed persistently for making Russian territory the sole export corridor, and there was little doubt that there would be a Russian route. The existence of the Soviet era Baku-Novorossiisk pipeline made it the cheapest option. The real question was whether it would be the only one.

Western oil companies operating in the Caspian have learned quickly, if they did not know this before setting up shop locally, that the legacy of the Soviet era gives Russia powerful leverage. Despite its foibles, Russia is far and away the most powerful of the former Soviet states and the one most likely to recover and reemerge as a major power. Because of the political economy of the Soviet Union—central planning, communication networks binding center and periphery, and a division of labor wherein the southern republics provided food and raw materials in exchange for industrial goods—the Caspian region’s non-Russian, post-Soviet states are heavily dependent on Russia for markets, trade routes, energy pipelines, and military supplies.

Azerbaijan, Turkey, and the United States do not want only one export outlet running through Russia. This would reinforce Azerbaijan’s economic dependence on Russia and work at cross purposes with the Azeri policy of reducing economic reliance on Russia.

Political calculations and pressures were also responsible for bringing the western route into being. Azerbaijan, Turkey, and the United States do not want only one export outlet running through Russia. This would reinforce Azerbaijan’s economic dependence on Russia and work at cross purposes with the Azeri policy of reducing economic reliance on Russia. Turkey has a more specific reason to push for the western route, which it sees as the foundation for an export pipeline for long-term Caspian oil from Georgia to the Turkish port of Ceyhan in the northeast Mediterranean. This consideration led Turkey to lobby the United States government for a western route—through Georgia or Armenia. Turkey went so far as to offer to finance a western route and to purchase its oil if AIOC committed itself to the Ceyhan option for late oil. AIOC refused: it did not want to jump the gun and alienate Russia; it was not clear that Turkey’s terms would prove better than those available on the open market; and a feasibility and financial study of the Ceyhan line had yet to be undertaken.

The 700 km western route through Georgia, scheduled to be completed by the end of 1998, will ultimately have a capacity of 200,000 barrels per day (b/d). It will require some \$250 million for repairs to existing lines and for new construction: 39 km of pipeline from the border with Azerbaijan to tie in with the existing pipeline in Georgia; another 3.5 km at Supsa and out to the loading point; and an oil terminal at Supsa.³⁴ When pipeline construction, drilling, and production are taken into account, the total investment required for the western route is estimated at \$1.1 billion.³⁵

³⁴ *East European Energy Report*, May 28, 1997.

³⁵ Paul Sampson, “Central Asia: The Next Energy Source,” *Impact 21*, October 1996, p. 16; Turan News Agency, February 21, 1997; “Caspian Pipeline Plan,” *Hart’s Daily Petroleum Monitor*, March 24, 1997, internet publication. AIOC decided to increase the ultimate capacity of the pipeline to reduce dependence on the northern route. The overall cost for the Baku-Supsa line is based on a statement of Gregory Rich, an AIOC vice president, as quoted in “Crude Oil to Take Three Routes,” *Nezavisimaia gazeta*, June 17, 1997.

The export channel through Georgia materialized for several reasons. Azeri opposition to the Armenian conduit was strong, and there was the compelling danger that renewed war would imperil oil flows: what better way for Armenia to reduce the Azeri capacity for protracted war than by cutting off oil revenues? Thus, although some had advocated the Armenian route as a way to increase Azeri-Armenian economic interdependence to improve the prospects for defusing the ticking Nagorno-Karabakh time-bomb, their proposals withered on the vine. That left Georgia as the most likely choice, and political considerations improved the prospects.

Georgia and Azerbaijan have common strategic interests inasmuch as both have faced ethnic conflicts in which secessionist forces (the Abkhaz in Georgia; the Karabakh Armenians in Azerbaijan) have received direct or indirect Russian help. Both also face the problem of Armenian ethnonationalism, albeit to different degrees. Azerbaijan has lost control of Karabakh and a number of surrounding districts. Georgia has not lost territory, but there is rising concern about the political loyalties of the 200,000 Armenians in Georgia's southern Javakheti region that abuts Armenia.³⁶

Azerbaijan and Georgia have also faced Russian pressure to grant military basing rights and to strengthen strategic ties. Azerbaijan has parried the quest for bases, but Aliiev reversed the Elcibey policy and joined the CIS in 1993. As a way to gain Russian cooperation on the conflicts in Abkhazia and South Ossetia, Georgian president Eduard Shevardnadze also joined the CIS in 1993. But he went further and gave Russia a 25-year lease on a network of bases. This recent history with Russia made for a convergence of strategic perspectives between Georgia and Azerbaijan, increasing the likelihood of a Georgian pipeline. Shevardnadze's restoration of stability in Georgia was crucial to enabling the western route to emerge as viable possibility. His ability to end the chaos of the Gamsakhurdia phase, to stop the war in Abkhazia, and bring paramilitary forces to heel allayed fears that would have been created by a Georgia in turbulence.³⁷

An Armenian Route: Catalyst for Peace?

It remains to be seen whether Armenia will yet become a corridor for the shipment of late oil through Turkey to the Mediterranean. The hope remains that the established pattern of suspicion and zero-sum competition between Armenia and Azerbaijan can be altered by giving each a stake in cooperation on Caspian Sea energy. Yet, for at least two reasons, Azerbaijan will be wary of proposals that present a pipeline through Armenia as a way to displace animosity with cooperation. First, it will balk at pipelines through Armenia unless there is tangible evidence that Yerevan and Stepanakert (the capital of Nagorno-Karabakh) are willing to accept Azeri sovereignty over Karabakh in exchange for extensive autonomy, the return of Azeri refugees to Karabakh, and the return of areas outside Karabakh along the Azerbaijan-Armenian border that were wrested from Azerbaijan. Second, without a change in the tenor of Azeri-Armenian relations, any Azeri government will be reluctant to have a portion of its oil source of export earnings flowing to export markets through the land of an adversary.

Nevertheless, an arrangement in which oil greases the wheels of diplomacy on the Karabakh conflict is not beyond the realm of possibility. Neither the Armenian nor the Karabakh authorities are as yet willing to return to the status quo ante bellum even with guarantees of significant autonomy for Karabakh. But there is increasing pressure on Yerevan and Stepanakert to become flexible. Within Russia, there is a much greater awareness that Azerbaijan could be the emerg-

³⁶ Interviews with Georgian officials and academic specialists, Tbilisi, Georgia, June, 1997.

³⁷ See Jonathan Aves, *Georgia: From Chaos to Stability?* London: Royal Institute of International Affairs, 1996.

ing economic and strategic power in the South Caucasus and that a Russian policy that is pro-Armenian through and through will diminish the opportunities for Russian energy companies in Azerbaijan's oil sector and the effectiveness of Russian diplomacy in Azerbaijan.³⁸ Despite its traditionally pro-Armenian policy, including indirect aid to Armenia and the Karabakh fighters during the war over Nagorno-Karabakh, Russia has never endorsed Karabakh's permanent severance from Azerbaijan. And its backing—at the 1996 OSCE Lisbon meeting and the G-8 meeting in Denver in 1997—of a solution based on autonomy for Karabakh within Azerbaijan must surely indicate to the Armenians that Russia has not given them *carte blanche* and that its support is neither unconditional nor open-ended. Calls for a reassessment of Russian policy toward the Nagorno-Karabakh dispute have been made in recent years by influential figures within Russia, particularly the former minister for CIS affairs Aman Tuleev and the chairman of the Duma's Defense Committee, retired general Lev Rokhlin.

There are also signs, albeit small, of a shift in American policy. Until 1997, Section 907 of the U.S. Freedom Support Act prohibited non-humanitarian American aid to the government of Azerbaijan except for humanitarian reasons until Azerbaijan lifts all restrictions on the flow of goods into and out of Armenia. But there is an unprecedented level of discussion within Congress and the American foreign policy community about the prudence of a policy that singles out Azerbaijan as the villain in a complex ethnic dispute and ignores the fact that the Karabakh Armenians began a movement to secede from Azerbaijan, that some 750,000 Azeris have been evicted from Karabakh and the surrounding districts, and that the war fought by the Karabakh Armenians was directly supported by Armenia and indirectly by Russia. Calls by prominent members of the Senate to annul Section 907 have been supported by the Clinton Administration, which, like its predecessor, has opposed the measure. In the foreign operations appropriation bill for 1998, Section 907 was revised to allow U.S. support for democratic institution building, as well as limited support for U.S. commercial entities through the Trade and Development Agency and other organizations. These changes in American policy, small though they might be, have not gone unnoticed in Armenia and may, like the change in Russia's approach, lead Yerevan and Stepanakert to rethink their rejection of a solution based on Azeri sovereignty.

Given its fervent desire to scuttle Section 907, to regain Nagorno-Karabakh and the other territories, to increase ties with the West, and to change what it perceives as a longstanding Russian and Western policy that is pro-Armenian, Azerbaijan will be under pressure to offer an autonomy package to the Karabakh Armenians that is as attractive as possible. While it does not seem likely at present, it is not inconceivable that Azerbaijan may decide that an oil pipeline through Armenia would constitute additional proof (beyond the offer of extensive autonomy to Karabakh) of its reasonableness, while also providing an inducement for economically troubled Armenia to give ground. Indeed, Azerbaijan has in the past floated ideas of a *quid pro quo* involving an oil pipeline through Armenia in exchange for the return of Nagorno-Karabakh and adjacent territories.³⁹ Thus the pressure on Armenia to be flexible, together with the pressure on Azerbaijan to be generous, could well alter the established pattern wherein Armenia rejects an oil-for-land deal and Azerbaijan treats the pipeline as a stick and not as a carrot.

³⁸ On the changes in Russian and U.S. policy toward the Karabakh conflict and the role played by Caspian Sea oil, see Sanobar Shermatova, "Oil: A Powerful Factor in Karabakh Politics," *Moscow News*, July 17–23, 1997, p. 4.

³⁹ See Ara Tatevosyan, "Oil Deal Possible in Nagorny Karabakh," *Moscow News*, December 11–17, 1996; Paul Goble, "Putting Pipelines into Play," *RFE/RL Newslines*, May 6, 1997. In May 1997, Aliiev suggested explicitly that Azerbaijan would support a pipeline through Armenia in exchange for an acceptable settlement on Karabakh. Armenia rejected the idea.

. . . the existing northern and western pipeline routes . . . are susceptible to a host of security threats because of longstanding political problems in the north and south Caucasus.

Securing the Northern Route

If political and security considerations played a significant role in bringing about the existing northern and western pipeline routes, they will prove equally important for their viability. Both export channels are susceptible to a host of security threats because of longstanding political problems in the north and south Caucasus. The outlook for the Baku-Novorossiisk line is better than it has been since Russia launched its war against Chechnya in December 1994. The realization that the war could not be won and was detested at home led Yeltsin to pursue peace, particularly with the onset of the presidential election. The result was the August 1996 Khasavyurt cease-fire agreement negotiated by Alexander Lebed (then chairman of Russia's Security Council) and Chechen leader Aslan Maskhadov. This was followed by the May 1997 agreement, "On Peace and the Principles of Relations between the Russian Federation and the Chechen republic of Ichkeria." Without saying so explicitly, this document comes close to recognizing that Chechnya will eventually become independent: the principles of international law are invoked, and the implication is that the signatories are states.⁴⁰

Without the end of the war in Chechnya, the Baku-Novorossiisk line would never have been secure for reasons that are obvious. Following the May 1997 agreement on general state-to-state relations, Azerbaijan, Chechnya, and Russia sought an accord dealing specifically with pipeline issues.⁴¹ As the summer progressed, reports suggested that the thorny issues—Chechnya's share of the transit revenues, Russian funds for repairing the Chechen leg of the pipeline, and pipeline security—would be settled. Even though only 150 km of the northern route crosses Chechen territory, Chechnya was supposedly assigned four to five U.S. dollars for every ton of oil that crossed its territory, or about 25.5 to 31.9 percent of the total transit fee set for each metric ton of oil sent through the entire 1,500 km Baku-Grozny-Novorossiisk pipeline.

The Chechens also agreed to create a special security force dedicated to protecting their sector of the route.⁴² But no sooner did reports appear on the outlines of the deal than Chechen authorities stated that they could not implement it so long as Russia continued economic pressure on Chechnya, ranging from a continued freeze on the Russia-based assets of Yunko, the Chechen oil company, and restrictions on rail traffic into Chechnya.⁴³ By the end of August, the likelihood of an agreement seemed bleak. The Chechen leadership rejected Russia's offer to pay \$0.43 per metric ton in fees from the \$15.67 that Russia is to receive according to the SOCAR-

⁴⁰ See Sergei Kovalev, "Russia after Chechnya," *The New York Review of Books*, June 17, 1997, pp. 27–31; *The Boston Globe*, May 13, 1997.

⁴¹ The negotiations proved complex for a number of reasons. Russia was opposed to a tripartite accord under which Chechnya would have been given co-equal status. (This was finessed by labeling the agreement a commercial one—signed by the president of SOCAR, the Russian First Deputy Prime Minister Boris Nemtsov, and the head of the Chechen state oil company, Yunko). Azerbaijan, while traditionally sympathetic toward Chechnya's struggle against Russia, had signed a January 1996 agreement with Russia for shipping oil through the northern route and did not want to pay additional and separate transit revenues to Chechnya. (Russia undertook to provide Chechnya a share of transit fees.) And Chechnya sought to link the agreement on the northern line to a banking and customs agreement. (A compromise was reached on these issues.) Agence France Press, July 1, 1997; BBC, *Summary of World Broadcasts*, SU/WO494/WF (July 11, 1994), citing Interfax, July 2, 1997; Xinhua News Agency, July 12, 1997; "Grozny Sets Down Its Own Terms," *Nezavisimaia gazeta*, July 9, 1997.

⁴² *Pipeline News*, no. 69, part I (July–August 1997).

⁴³ *Ibid.*

Transneft agreement of February 1996. They also insisted that the \$12 million given by Moscow to the pro-Russian Chechen government of Doku Zavgayev in 1995 be transferred to them.⁴⁴

On September 3, 1997, a compromise was reached that required Transneft to make up the difference between the Russian government's offer (\$0.43) and the rate sought by the Chechens, \$2.20.⁴⁵ An accord covering the allocation of transit fees that also provided for \$845,000 in Russian funds to repair the Chechen portion of the pipeline was finally signed on September 9, but its future became uncertain almost immediately. That very day, a Russian truck carrying workers to repair the pipeline was blown up in Chechnya and First Deputy Prime Minister Nemtsov stated that Russia would not carry out repairs unless the safety of its construction personnel could be ensured. In response, Russian officials were again raising the possibility of a new pipeline segment to bypass Chechnya. Chechen leaders countered by demanding ten times more in transit revenues. But the Chechen-Russian negotiations have always been about much more than a pipeline, and this became apparent quickly as the war of words heated up.⁴⁶

What all of this makes clear is that the northern route is hostage to the future relationship between Russia and Chechnya and the political order within Chechnya. These are matters that individuals who deal in the economic and technical aspects of energy cannot influence. Moreover, these problems make for considerable uncertainty about the security of the pipeline through Chechnya. In ascending order of severity, the most serious potential problems are:

- 1) Future disputes over the sharing of pipeline transit revenues between Moscow and the Chechen authorities that are not resolved and that override their interest in benefiting economically from the northern route;
- 2) Attacks against the Chechen sector of the pipeline and repair crews working on it by radical Chechen forces aimed at forcing Russia to recognize Chechen independence. The most famous of such radicals, Salman Raduyev, has explicitly threatened such action;⁴⁷
- 3) Civil war in Chechnya between the elected government of Aslan Maskhadov and paramilitary forces who resist central authority;
- 4) Military operations against Russia that include sabotage and terror and provoke military countermeasures;⁴⁸
- 5) An economic and political crisis in Russia that culminates in the advent of ultra-nationalist leaders who use force to block Chechnya's move from de facto to de jure independence, thus reigniting full-blown war.

The disputes between Russia and Chechnya over the pipeline had to be solved so that AIOC could start pumping oil as scheduled in the latter part of 1997. The need for a solution was all the more urgent because the repairs and construction needed to make the western route through Georgia operational were not scheduled to be completed until late 1998. (Pending the readiness of the northern route, Azerbaijan has been shipping oil by rail across Georgia to the Black Sea port

⁴⁴ Details from "Russia, Chechnya Fail to Reach Pipeline Agreement," *RFE/RL Newslines*, September 2, 1997; "Yeltsin, Chernomyrdin Also At Odds Over Pipeline," *RFE/RL Newslines*, September 2, 1997.

⁴⁵ "Russia, Chechnya Reach Compromise on Oil Transport Tariffs," *RFE/RL Newslines*, September 4, 1997.

⁴⁶ Russian officials declared as unconstitutional the death penalties handed down by Chechen Islamic courts. Chechnya's Vice President responded that Chechnya was an independent state and implied that such verdicts might be appropriate against Russian leaders who had waged a genocidal war against Chechens. "Russian-Chechen Agreement on Rebuilding a Major Oil Pipeline is Beginning to Unravel," *The New York Times*, September 13, 1997, p. 6; "Russia, Chechnya Threaten to Abrogate Oil Transit Accord," *RFE/RL Newslines*, September 11, 1997.

⁴⁷ "Moscow-Chechen Oil Transit Talks Again Postponed," *RFE/RL Newslines*, September 8, 1997.

⁴⁸ On Raduyev as a source for instability within Chechnya, see Liz Fuller, "Overcoming the Final Barriers to a Chechen Peace Agreement," *RFE/RL Newslines*, May 7, 1997.

of Batumi.) The priority that Russia and Azerbaijan accorded this task, and the economic benefits to Chechnya, led to a settlement of the dispute over transit revenues. But in the turbulent post-Soviet environment there is no guarantee that they will not reappear—or be displaced by new ones. There are ways to ensure that oil headed from Baku to Novorossiisk skirts Chechnya. One is to build a bypass line from Baku to Komsomolsk and on to Tikhoretsk. Another, which Russian leaders are already pursuing despite the accord with Chechnya, is a 283 km line from Khasavyurt in Dagestan to Terskaia in north Ossetia that would enable the northern route to avoid Chechnya.⁴⁹ But neither diversion is a perfect solution inasmuch as new construction would mean added costs, and Chechen fighters could make the new lines vulnerable by widening a future war.

The future of Chechnya is the biggest question mark hovering over the northern route. But three others are worth considering. One is the uncertain balance of power between the center and the provinces in post-Soviet Russia. The regions insist that they must have a say on land rights and be given a share of the transit fees when pipelines cross their territory. For example, Ingushetia's president Ruslan Aushev asserted these rights because 18 km of the pipeline and the largest pumping station are within his republic.⁵⁰ Ingushetia and Transneft appear to have reached an agreement on this issue, but whether and to what extent localism affects the construction and security of pipelines depends on the emergence of a Russian political order based on a predictable relationship between Moscow and regional governments.

The assertiveness of Russia's provincial governments may make for complex negotiations over pipeline transit rights and revenues, but it will not imperil the security of the northern route.

The assertiveness of Russia's provincial governments may make for complex negotiations over pipeline transit rights and revenues, but it will not imperil the security of the northern route. Conflict between the Azeri government and its Lezgin-populated northern regions is potentially a much more serious potential problem.⁵¹ Disputes over autonomy or the outbreak of irredentist war (the Lezgin people are divided by the Russia-Azerbaijan boundary) waged by radical Lezgin groups cannot be ruled out. Whether violent disputes materialize and persist depends on the nature of Azeri nationalism. If, as in Georgia under former president Gamsakhurdia, nationalism is exclusive and the titular nationality remains privileged, alienated minorities will be drawn to the aggressive counternationalism championed by radical elites. The capacity of the Azeri government to accommodate diversity by offering political and economic autonomy, rather than quashing it through repressive hypercentralism will be decisive in determining the balance of power and popular appeal between Lezgin organizations that seek autonomy within Azerbaijan and those that seek independence and do not rule out violent means.⁵² Lastly, the degree to which Armenia, Iran, and Russia seek to exploit ethnic disputes within Azerbaijan for their own ends will matter.

The possibility of a new cycle of war between Armenia and Azerbaijan over the simmering Karabakh dispute will be an even graver threat. The periodic flare-ups in fighting—such as occurred in the spring and summer of 1997 in Azerbaijan's Qazak and Tausz regions—suggest that renewed war is an ever-present possibility so long as the Nagorno-Karabakh cauldron sim-

⁴⁹ "Russia to Build Oil Pipeline Bypassing Chechnya," *RFE/RL Newswire*, September 15, 1997.

⁵⁰ "Ingushetia to Have Dividends for Caspian Oil Transit," TASS, July 16, 1997.

⁵¹ On Lezgin nationalism, its manifestations, and the Azeri government's response, both under Elcibey and Aliiev, see Arif Yunusov, "Contested Ground," *War Report*, no. 48 (January-February 1997), pp. 26-27. I am also indebted to Azeri scholars for lengthy discussions (in June 1997 in Baku) on the nationality issue in Azerbaijan.

⁵² Samur, for example, wants greater autonomy for Lezgins within Azerbaijan, while Sadal seeks independence for the Lezgins.

mers. True, the Baku-Novorossiisk pipeline does not bump up against the border with Armenia. But, in the event of war, one analyst goes so far as to argue that Armenia could attack the pipeline or even oil facilities in and around Baku—through commando raids, air strikes, or missile attacks with the *Scud-Bs* received from Russia—to cripple Azerbaijan's ability to wage a protracted campaign.⁵³ Even if this scenario is exaggerated, one can imagine a number of ways in which the northern route could be put at risk should a protracted and full-scale war break out between Azerbaijan and Armenia.

How Secure is the Western Route?

The western route from Baku through Georgia to Supsa is exposed to security risks as well. It has been barely two years since Georgia emerged from near collapse—with Tbilisi engulfed by anarchy and separatist Abkhazia and South Ossetia enveloped in civil war. An oil pipeline through Georgia could not have been built, or even considered seriously, had stability not returned. The question is how long it will last. A settlement based on autonomy looks feasible in South Ossetia; peace has returned to Tbilisi; and the central government has, on the strength of Shevardnadze's appeal and overwhelming victory in the 1995 elections, asserted control over private armies. Yet not all of the roots of upheaval in Georgia have been severed.

Abkhazia in particular remains volatile. The Abkhaz are determined to hold fast to the gains made in the 1992–94 war, to continue expanding the administrative strength of their statelet, and to move toward independence. Georgian refugees evicted from Abkhazia are determined to return and, by their visible presence in Tbilisi (and ties with nationalists in the Georgian parliament), constitute an evocative symbol of what Georgians regard as a national humiliation. A diplomatic solution acceptable to Georgia and Abkhazia remains elusive, especially as hard-line nationalists on both sides equate compromise with treachery. These conditions in tandem make the resumption of war a real possibility.

Although the pipeline to Supsa does not go through Abkhazia, given Georgia's small size the renewal of war could make it a target. This is particularly likely if war breaks out again both in Abkhazia and in South Ossetia and collaboration occurs between the two regions, as it did during the 1992–94 war in Abkhazia. Under these circumstances, the pipeline through Georgia, which does run close to South Ossetia, would be vulnerable.⁵⁴

If the outbreak of war between Azerbaijan and Armenia over Nagorno-Karabakh could imperil the northern route, it is an even greater danger for the Baku-Supsa pipeline. En route to the Georgian border, the pipeline comes within 30 km of Nagorno-Karabakh. Cooperative links with Armenia, Russia, and Iran have enabled the Nagorno-Karabakh authorities (who are keenly aware that Azeri oil could alter the regional balance of forces) to build a 10,000-man army, acquire training and weapons, and construct infrastructure to improve force mobility. All of these assets could be deployed against the southern line.⁵⁵

Western oil companies operating in the Caspian region are aware of these dangers. The problems are not unique, and their mere possibility has not prevented the business of extracting and transporting oil and will not do so. Nor should the vulnerability of oil pipelines be exaggerated. Sabotaged or damaged pipelines can be repaired, pumping stations can be shut off to compartmentalize damage and curb the loss of oil and environmental damage, and oil can be made to

⁵³ See Glen E. Howard, "Oil and Missiles in the Caucasus," *The Wall Street Journal*, May 14, 1997.

⁵⁴ "Another Mine Under Georgia's Oil Mains," *Segodnya*, June 5, 1997.

⁵⁵ See Laurent Ruseckas, "The Unfinished Business of Nagorno-Karabakh: How Will It Affect Azerbaijani Oil Development?" Cambridge Energy Research Associates, *Decision Brief*, December 1996. Arkadii Ghukasyan, the former foreign minister of Nagorno-Karabakh, who was elected president in September 1997, has ruled out a settlement based on autonomy within Azerbaijan. Soon after his election he announced that he would seek to build up the region's military strength.

flow again without prolonged interruptions.⁵⁶ Nevertheless, any normal operation of pipelines—defined as reliability at tolerable cost from the standpoint of Azerbaijan, the oil companies, and customers—would be jeopardized if disruptions became widespread and regular. Moreover, the construction or overhaul, as opposed to maintenance, of pipelines in conditions of war and conflict poses larger problems, among them the safety of civilian personnel, secure routes for transporting equipment, and retaining the confidence of investors.

The Ceyhan Option: Cure or Chimera?

Thus the two routes for early oil are subject to a variety of political and security problems. But so is the proposed 1,900 km pipeline from Georgia to Turkey's Mediterranean port of Ceyhan that is widely discussed as a leading contender for the export of long-term production from Azerbaijan. A major drawback with the Ceyhan route is that it is far more expensive than the northern and western routes for early oil because it is longer and will require construction in mountainous terrain. The estimated cost is over \$3 billion.⁵⁷ Turkey has nevertheless lobbied intensively for this project, worked hard to get American and Azeri support, and even sought to woo Georgia—where the line to Ceyhan would begin—with promises of support in Abkhazia, where the Georgian government believes that Turkey has been among the sources of arms for the separatists.⁵⁸

Turkey favors the Ceyhan option for political, economic, and ecological reasons. Politically, Turkey realizes that its emergence as the major outlet for Caspian Sea energy would complement its efforts to increase its economic and strategic presence in culturally kindred regions of the South Caucasus and Central Asia that were closed off once they became part of the Russian and later Soviet imperial system. A pipeline to Ceyhan via Georgia would draw Azerbaijan (and Georgia) closer to Turkey and reduce Russian influence in Azerbaijan. A similar outcome would occur in Kazakstan were oil to be brought to Baku from Kazakhstan's fields—by ship or a pipeline under the Caspian Sea—and sent to export markets via a pipeline through Turkey. The same calculation applies to possible exports of Turkmenistan's gas through Iran to Turkey and beyond. Economically, Turkey stands to gain from transit revenue, jobs, contracts for Turkish engineering firms, and oil for eastern Anatolia. Ecologically, the Ceyhan route would bypass the Turkish Straits. Turkey worries that the long-term export of Caspian oil across the Black Sea and through the Bosphorus—17 miles long, with three 45 degree turns and, at one point, a width of only 700 meters—would increase tanker traffic significantly. The roughly 300 million barrels of oil that now go through the Turkish Straits yearly could increase three-fold if the Black Sea and the Bosphorus become the principal thoroughfare for Caspian oil. The number of ships using the passage—up from 115 a year in 1936 to 50,000 today—would increase as well.⁵⁹ Turkey fears that the net result would be an increase in the chances of accidents and oil spills.⁶⁰ And it uses its environmental concerns to bolster its lobbying strategy for the Ceyhan pipeline.⁶¹

⁵⁶ Interview, senior oil executive, Baku, Azerbaijan, June 1997.

⁵⁷ Statement of Gregory Rich "Crude Oil," *op. cit.*

⁵⁸ Turkish president Suleiman Demirel visited Georgia in mid-July 1997, just before Shevardnadze's trip to the United States, and reportedly offered support on Abkhazia. "Turkey Persuades Georgia to Bypass Russia," *Kommersant Daily* (Russia), July 14, 1997.

⁵⁹ *CREDR*, p. 11, 37, and map details the volume of oil through, and navigational constraints in, the Bosphorus.

⁶⁰ Turkey is even concerned about the increased flow of oil through the straits resulting from the shipments of early oil. It has proposed to Russia that early oil be shipped from Novorossiisk to the Turkish port of Samson on the southern Black Sea coast and thence to Ceyhan by pipeline so as to bypass the Straits. This proposal is almost certainly also meant to increase the chances for the Ceyhan export option for late oil. "Turkey Wants Early Oil Shipped to Samson," *RFE/RL Newslines*, August 25, 1997.

⁶¹ To counter these concerns while advancing its campaign to be the conduit for long-term Caspian oil, Russia has proposed routes that would take oil from Novorossiisk to global markets without going through the Bosphorus. The plan for a route from Novorossiisk to Burgas in Bulgaria to Alexandroupolis in Greece and out to markets via the Aegean Sea is one example, and it includes two states that have strong cultural ties to Russia and a history of conflict with Turkey.

These considerations made Turkey an ardent champion of an oil pipeline to Ceyhan to export Caspian production—and a rival of Russia, which would like such a pipeline to cross its territory.

These considerations made Turkey an ardent champion of an oil pipeline to Ceyhan to export Caspian production—and a rival of Russia, which would like such a pipeline to cross its territory. In addition to the costs and technical challenges of constructing a long pipeline in a rugged setting, other impediments exist. The Turkish segment of the pipeline to Ceyhan would traverse Kurdish-populated areas in which fighting between the Turkish armed forces and the PKK, could increase in the future. Again, as with security threats to the northern and western lines, the issue is not whether pipelines can be protected from acts of war and sabotage, or repaired once they are damaged; they can. The real issue is how frequent and serious any disruptions will be and what the implications are as regards costs to operators and reliability for customers.

There are ways to avoid areas that have been the principal venues for war and where the proportion of Kurds in the population is high. One is to build a new line that runs from Georgia to Sivas north of Ceyhan and then due south to the port.⁶² But this alternative would entail higher costs stemming from additional construction and the inability to use the existing Iraqi-Turkish pipeline system that runs west from Turkey's border with Iraq through the Turkish city of Midyat to Ceyhan. Moreover, Turkey's Kurdish problem has been resilient and could well spread to new regions.⁶³ If it does, a pipeline to Ceyhan that is routed to avoid the zones in which fighting has traditionally been the most intense could still be an attractive target for Kurdish fighters. The bottom line is that Ceyhan remains a live option despite the challenges posed by distance, terrain, costs, and war. By no means, however, is it a foregone conclusion.

The Quest for Non-Russian Routes

The disruption of export routes on account of conflict is one way in which politics and security affect pipelines. Another is the fear that exporting countries have of depending on one country as a pipeline corridor or as the owner of the pipeline network itself. Caspian Sea energy producers find themselves in this position vis-à-vis Russia to varying degrees. I have already discussed the extent to which Azerbaijan's early oil exports can be influenced by Russia because they are carried in pipelines that go through Russia or through states subject to Russian influence. But Kazakhstan and Turkmenistan are even more dependent on Russian routes, and both have experienced the disadvantages of this dependence. Kazakhstan relies on Russia's Atyrau-Samara pipeline for exporting production from Tengiz.

The prevailing view among scholars is that the fragmented Russian state does not have a unified policy aimed at squeezing the energy producing states of the Caspian littoral by exploiting their dependence on Russia's energy transportation network. The terms that Russia demands for the use of its pipelines are seen as the consequences of the parochial and pecuniary interests of bureaucratic cliques within the Russian state. One analyst has noted that although Kazakhstan has been allowed to export only half the capacity (220,000 barrels per day) of the Atyrau-Samara

⁶² John Roberts, *Caspian Pipelines*, London: Royal Institute of International Affairs, 1996, pp. 32, 42–43.

⁶³ For a thorough analysis of Turkey's Kurdish problem and its prospects, see Henri J. Barkey and Graham Fuller, *Turkey's Kurdish Question*, Latham, MD: Rowman and Littlefield, 1998, forthcoming.

pipeline to customers outside the CIS because bureaucrats in Russia have to be bribed, Russian oil producing companies from Siberia have faced even more severe restrictions at the hands of such officials.⁶⁴ But, as Russia's ability to regulate and set conditions on exports from Tengiz shows, so long as Russia remains the sole export corridor, Kazakhstan faces a problem. That unreliable access to Russian pipelines is probably caused by bureaucratic pathologies within Russia and not neo-imperial designs will provide but cold comfort to Kazaks. What will matter to them is that unpredictability, whatever its etiology, can jeopardize their oil production, revenues, and plans for economic development.

The completion of the CPC pipelines from western Kazakhstan—with initial capacity of 564,000 b/d, expected to increase to 1.5 million b/d by 2012—will certainly improve Kazakhstan's ability to export oil. But it will not lessen the dependence on Russia because most of that pipeline runs through Russian territory and terminates at a Russian port. Moreover, CPC has encountered problems. The project originated in 1992 and was supposed to have been completed by 1996, but work had only begun by the end of that year and is not expected to be completed until the end of 1999.⁶⁵ Owing to changes made in the original plan, construction costs have risen from the original estimate of \$1.2 billion to \$2 billion—a sum that covers only the initial phase.⁶⁶

The phenomenon of localism and divided authority in post-Soviet Russia has been another source of delay. Agreements have had to be negotiated with regional authorities in Kalmykia, Stavropol, and Krasnodar to secure land rights, and they have used the occasion to demand that CPC contribute to various economic projects. These negotiations have also delayed the completion of the pipeline and increased its costs.⁶⁷ Until the CPC is complete, Russia will have considerable leverage over Kazakstani oil production and exports because Kazakhstan—while it can rely to an extent on exports through Georgia and swap arrangements with Iran—will have to depend primarily on the Atyrau-Samara channel.

There is no doubt whatever that Kazak leaders are worried about a future in which, even with the CPC, their ability to export oil hinges on the nature and disposition of Russia's government and the murky process (featuring bargaining, clientilism, and not a little corruption among Transneft, the Ministry of Fuel and Energy, and private and state oil companies) of allocating export quotas in the Russian pipeline system. Because the Atyrau-Samara line and CPC do not entirely free them from this predicament, the Kazaks have actively explored export options that evade Russia.

One option is the use of Georgia as a conduit. Chevron has been sending oil from Tengiz to Baku by barge and then by rail to the Georgian port of Batumi, and all three countries see additional pipeline capacity through Georgia as a long-term export route for Tengiz oil. The presidents of Azerbaijan and Kazakhstan have also discussed the idea of a pipeline under the Caspian that would bring Kazakhstan oil to Baku and transport it overland to Georgian ports for export.⁶⁹

A second option is China, which has been drawn into Kazakhstan's oil sector in part because Kazakhstan's leaders see it as a future export corridor and market for oil. To test the possibilities,

⁶⁴ Laurent Ruseckas, "Caspian Oil: Beyond the 'Great Game'," *Analysis of Current Events*, vol. 9, no. 2 (February 1997), pp. 4–5.

⁶⁵ "Urgent Accord Reached on Kazakhstan-Russia Pipeline," Agence France Press, May 16, 1997.

⁶⁶ I am grateful to Laurent Ruseckas for sharing his expertise on CPC with me.

⁶⁷ *Pipeline News*, no. 69, Part I (July–August 1997), pp. 8–9.

⁶⁸ See the comments of Richard Matzke, president of the Chevron Overseas Corporation, in "Chevron Supports Construction of Georgian Oil Pipeline," BBC, *Summary of World Broadcasts*, SU/WO492/WF (June 27, 1997), citing Interfax, June 19, 1997; interview with Eduard Shevardnadze, Georgian Radio, 0715 GMT, June 30, 1997, BBC, *Summary of World Broadcasts*, SU/D2960/F (July 2, 1997). Shevardnadze said that 0.5 million tons of Tengiz oil had been sent to Batumi so far, that the 1997 level would reach 1.2 million tons, and "double or even treble next year."

⁶⁹ Umirserik Kasenov, "The Caspian Sea: Legal Status, Oil, and International Security," *Delovaia nedelia* (Almaty), August 1, 8, 15, 22, and 29, 1997, trans. in *FBIS-SOV*, October 2, 1997.

Chevron has begun sending Tengiz crude to the refinery at Urumqi, in China's Xinjiang region, by rail. Chinese investment in the Aktyubinsk and Uzen fields in western Kazakhstan is supposed to lay the groundwork for a pipeline to China and—this is the long-range hope—out to the Yellow Sea to reach the Asia-Pacific market.⁷⁰ The anticipated benefit is a pipeline system which, unlike CPC or Atyrau-Samara, runs largely through Kazakhstan (assuming the trans-China line proves unfeasible given the expense) rather than Russia. The problem with a Kazakhstan-China pipeline—which would cover some 6,000 km from the oil fields of western Kazakhstan to China's east coast—is, of course, money. There are serious doubts whether China can raise the capital and whether the giant pipeline will be commercially viable absent the long-term exploitation of the oil deposits in China's Tarim River basin.

Likewise, Turkmenistan's dreams of a bonanza from gas exports cannot be realized unless alternatives to Russian pipeline routes are found. For the moment, even though the subsidized Soviet-era price has increased to 60 percent of Europe's benchmark price, virtually all of Turkmenistan's gas is sold to the ex-Soviet republics through the Gazprom pipeline system. Because of the lack of pipelines that avoid Russia, 75 percent of the 40 billion cubic meters of gas produced by Turkmenistan in 1996 was sold to Ukraine, Georgia, and other states. These countries have been chronically unable to pay and have amassed debts.⁷¹ In 1994 Gazprom terminated the arrangement under which a proportion of its exports to Europe (in 1993 it was equivalent to some 19 percent of Turkmenistan's production) was considered Turkmen gas, with Turkmenistan receiving payment in hard currency. Even though the economic consequences for Turkmenistan were dire, Gazprom evidently had little incentive to assist a competitor.⁷²

In 1995, the intervention of Yeltsin produced a deal between Gazprom and Turkmenistan under which Gazprom—although it insisted on a purchase price less than half that sought by Turkmenistan—agreed to purchase 20 billion cubic meters of Turkmen gas.

In 1995, the intervention of Yeltsin produced a deal between Gazprom and Turkmenistan under which Gazprom—although it insisted on a purchase price less than half that sought by Turkmenistan—agreed to purchase 20 billion cubic meters of Turkmen gas. Half the amount was to be sold within the former Soviet Union and half in Western Europe.⁷³ But the accord was never implemented. Instead, Turkmenistan and Gazprom reached the following agreement: Turkmenistan's gas exports are sold to Gazprom. Most of the gas is paid for with Gazprom maintenance and technical services for Turkmenistan's gas pipelines. Turkmenistan receives payment for the rest of the gas in cash. Gazprom then exports the gas to Ukraine, Georgia, and Armenia. Thus Turkmenistan's complete dependence on Gazprom for pipeline and technical expertise prevents it from exporting to hard currency markets. To make matters worse, Russian gas from Siberia is being sent to southern Kazakhstan, limiting Turkmenistan's possibilities in

⁷⁰ "Lure of the East," *op. cit.*

⁷¹ EIU, *Country Profile: The Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan*, 1996–97, p. 73.

⁷² EIU, *Country Profile: Georgia, Armenia, Azerbaijan, Kazakhstan and Central Asian Republics*, London: Economist Intelligence Unit, 1995, pp. 130, 136.

⁷³ EIU, *Country Profile: The Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan*, 1996–97, pp. 72–73; "Turkmens to Boost Gas Output, Attract Investments," *Reuters European Business Report*, March 11, 1997, internet edition.

that market as well. To create a stable relationship with Gazprom, in 1995 Niyazov created a joint venture with Gazprom called Turkmenrosgaz. But he terminated it in 1997 because of unspecified misgivings about its operation. This led to a rift with Gazprom, with potentially serious consequences for Turkmenistan's gas infrastructure and exports.⁷⁴ These examples show the extent to which reliance on the pipelines and expertise of Russia, a competitor in the natural gas export market, limits Turkmenistan's options.⁷⁵

Such problems explain why the Caspian Sea energy-producing nations want to build pipelines that bypass Russia. Like Azerbaijan and Kazakhstan, Turkmenistan has been trying to develop pipeline routes that would ease its predicament, but a mix of political and financial factors make the outlook uncertain.⁷⁶ One possibility is a pipeline from Turkmenistan through Afghanistan to Pakistan and on to India. Planning meetings and memoranda of understanding led to the formation in October 1997 of the Central Asia Gas Pipeline Ltd (Centgas). Unocal, Delta of Saudi Arabia, the Turkmen government, and various South Korean, Pakistani, and Japanese companies formed a consortium—led by Unocal—to get the project underway, and Gazprom is expected to join.⁷⁷ The plan is to commence construction in December 1998 and to complete a 1,271 km pipeline to Multan in Pakistan by 2001. An additional leg of 640 km to India is envisaged as well. The cost is estimated at \$1.9 billion for the section from the Dauletabad gas fields in southeastern Turkmenistan to Multan and an additional \$600 million for the segment to India. But, so long as Afghanistan remains convulsed by civil war, as it has since 1978, these plans for a pipeline amount to a pipedream. Widespread expectations that the Taliban juggernaut would crush its opponents and unify Afghanistan had proven premature by the summer of 1997, and a protracted civil war seems more likely.⁷⁸

Turkmen leaders have also spoken about a pipeline through Uzbekistan, Kyrgyzstan, and China to Japan.⁷⁹ But it would be over 5,000 km long, and given the much higher costs of transporting gas relative to oil, it is unlikely to be cost effective. At best it is a very long-term solution to an immediate problem. Another possible export route—apparently the most promising—is through Iran and on to Turkey. It has been moving forward ever since the agreement signed among Iran, Turkey, and Turkmenistan in April 1995. Iran agreed to fund a 287 km pipeline from the Korpedzhe fields in western Turkmenistan to Kord-Kuy in northern Iran and to link it with the existing 1,000 km line running west across northern Iran to the Turkish border. From there, a second new pipeline is to take the gas into Turkey. In April 1997, under another trilateral agreement, Turkey agreed to purchase 28 billion cubic meters of Turkmen gas a year via the Iranian pipeline.⁸⁰

⁷⁴ I am indebted to Laurent Ruseckas for information on Turkmenistan's relationship with Gazprom. After Niyazov ended Turkmenrosgaz, the head of Gazprom was quoted as saying that Gazprom had decided "to give up on Turkmenistan entirely." At stake are Turkmenistan gas exports to the newly independent states and to hard currency markets, as well as the upkeep of its facilities. "Gazprom Ready to Give Up on Turkmenistan," *RFE/RL Newswire*, August 1, 1997.

⁷⁵ In August 1997 Gazprom and Turkey signed an agreement providing for the construction of a pipeline under the Black Sea to transport Russian natural gas to Turkey. This suggests that Gazprom has little interest in contributing to the growth of Turkmenistan as a competitor in the global natural gas market. "Russia, Turkey Sign Gas Pipeline Accord," *RFE/RL Newswire*, September 1, 1997.

⁷⁶ Turkmenistan's quests for pipelines that bypass Russia are described in Ahmed Rashid's excellent articles, "Power Play" and "Pipe Dreams," *Far Eastern Economic Review*, April 10, 1997, pp. 22–24, 27–28.

⁷⁷ The shares in the consortium are divided as follows: Turkmenistan (7 percent), Unocal (46.5 percent), Delta-Nimir (15 percent), Gazprom (10 percent). The remaining shares (28.5 percent) will be divided among the South Korean, Pakistani, and Japanese companies. "Consortium Formed to Build Central Asia Gas Pipeline," *PRNewswire*, October 27, 1997; "New Consortium to Build Turkmen Gas Pipeline," *RFE/RL Newswire*, October 27, 1997.

⁷⁸ By mid-1997, the Taliban's drive northward had stalled. Its logistical supply lines were overextended and the resulting inability to concentrate forces set the stage for effective counterattacks from Rabanni's chief commander, Ahmed Shah Massoud. "Afghanistan: The Volley from the Valley," *The Economist*, August 2–8, 1997, pp. 33–34. But by September, its drive north had resumed again.

⁷⁹ Interviews with senior Turkmen economic officials, Ashgabat, June 1995.

⁸⁰ "Turkey and Iran: It Will Burn Nicely Anyway," *The Economist*, August 2, 1997, p. 30.

But experts are skeptical that a pipeline from Turkey that will send Turkmen gas on to Western Europe will materialize.⁸¹ Moreover, although the United States government did not criticize the plan for a Turkmenistan-Iran-Turkey pipeline when it was first announced, it has since voiced strong opposition. While Washington supports Turkmenistan's efforts to diversify its export routes, it maintains that this should be achieved by a trans-Caspian pipeline that takes Turkmenistan's gas to Azerbaijan and then onward to hard currency markets. But there are at least three problems with this alternative. First, Turkmenistan's problems are immediate, while the trans-Caspian pipeline is a long-term solution. Second, financing such an expensive project will prove complicated. Third, given the difficult relationship between Turkmenistan and Azerbaijan, Turkmenistan's leaders may hesitate to rely on Azerbaijan as a corridor for its gas exports.

Implications for American Policy

As I noted at the outset, the Caspian Sea region is sometimes heralded as a new Persian Gulf; but its energy output, and thus its strategic significance for the West, will not approach that of the Gulf. Pressing domestic needs, tight budgets, and the end of the Cold War have created a context in the United States that will require hard choices among foreign policy commitments, and the Caspian Sea zone is not likely to become a vital area for American national security. Nevertheless, its importance will increase for several reasons: the growing stake of large American oil companies; the decline of the traditional hegemon, Russia; and the potential for conflicts within and among states.

The United States should fashion its policy toward the Caspian based on the following general guidelines:

1) *Remove restrictions on U.S. support for Azerbaijan.* Section 907 of the Freedom Support Act should be eliminated. It is based on a skewed and simplistic understanding of the complexities of the Nagorno-Karabakh conflict and it makes U.S. companies less competitive in Azerbaijan. More importantly, it restricts the diplomatic tools that Washington has to promote democracy, economic reform, and conflict resolution in Azerbaijan and the region. A comparison of American aid policy toward Armenia and Azerbaijan illustrates an imbalance that should be corrected. In Azerbaijan, Section 907, which is attached to all foreign aid legislation dealing with the former Soviet Union, has to date effectively prevented U.S. aid by forbidding assistance to state-owned entities (in a country in which the role of the government is pervasive). By contrast, “[o]ver \$600 million dollars in American assistance has been granted to Armenia since independence. . . . On a per capita basis, Armenia has received more aid than any of the other NIS [newly-independent states of the former Soviet Union]; indeed, only Israel received more per capita assistance from the U.S. in FY 1996.” Georgia has received \$420 million in aid since its independence; Azerbaijan only \$80 million.⁸² This distribution of aid across the south Caucasus hardly squares with the relative strategic and economic significance of these three countries to the United States. A balanced policy will enable the United States to play a more effective role in stabilizing Azeri-Armenian relations, thereby creating a setting conducive to energy development and economic growth in the region. Recent changes to the legislation are welcome, but Section 907 still weakens the potential of the United States to encourage change in the country.

⁸¹ *Pipeline News*, no. 69, part I (July–August-1997).

⁸² Statement of John E. Herbst, deputy coordinator for the Newly Independent States, before the House International Relations Committee, Federal News Service, July 30, 1996.

The repeal of Section 907 will help eliminate the widespread belief in Azerbaijan that the United States, like Russia, instinctively supports Armenia and cannot therefore act as an honest broker.

2) *Maintain U.S. support for Armenia.* A new policy toward Azerbaijan must not entail the abandonment of Armenia. The repeal of Section 907 will help eliminate the widespread belief in Azerbaijan that the United States, like Russia, instinctively supports Armenia and cannot therefore act as an honest broker. But the United States must counter the impression that this constitutes a rejection of Armenia.⁸³ An isolated Armenia will, in all likelihood, tack even more toward Russia strategically and shy away from imaginative and flexible solutions to the Karabakh problem. Moreover, a sudden shift in U.S. policy that conveys the impression that Armenia is isolated may actually increase the risk of war in the region—especially if the balance of forces changes in favor of Azerbaijan as its oil exports increase. The United States should encourage Azerbaijan to include Armenia in energy projects so as to increase mutual trust and dissipate the aura of suspicion and zero-sum thinking in both Baku and Yerevan.

3) *Strengthen conflict resolution efforts in the Caucasus.* The United States should redouble its efforts to facilitate a settlement of the Nagorno-Karabakh conflict based on maximum autonomy for Karabakh within Azerbaijan, with specific guarantees of minority economic, cultural, and political rights. Washington must declare that it is willing to contribute to collective peacekeeping operations while a settlement on this basis is pursued. Neither the diplomatic nor the peacekeeping field should be conceded by default to Russia. A similar approach—Georgian territorial integrity alongside autonomy for minority nationalities—should be adopted toward Abkhazia. The rationale for this approach to conflict resolution is that stability in the Caucasus, the building of pipelines that diversify the export options of Caspian oil and gas producers, and the prospects for regional economic cooperation that could gradually erode the memories of recent conflicts will all be harmed should war resume over Nagorno-Karabakh and within Georgia.

4) *Encourage policies that will bring economic benefits to the average citizen.* The United States should consistently remind the leaders of Azerbaijan, Kazakstan, and Turkmenistan that it is vital to ensure that the energy sector benefits all citizens, not simply a stratum of wealthy local and foreign elites. American aid policy should be crafted to help prevent an economically unjust and politically pernicious gulf between haves and have-nots. Such a policy needs to be devised with care to avoid the appearance of overzealous intervention, and it must be realized that the American contribution to equitable development can hardly be decisive. But it should be possible in principle for American non-governmental organizations (NGOs) and official aid-giving agencies to devise initiatives that promote basic human needs. Should oil wealth be seen as something that enriches foreigners and a small domestic minority (my visits to the region suggest that this is indeed a danger), the stage could be set for extremist religious and ultranationalist movements.

5) *Maintain commitments to energy-sector investment and environmental protection.* The United States should support and facilitate investment designed to tap the Caspian's natural resources and to build a diversified energy transportation infrastructure. But such efforts should be accompanied—in American policy in both the official and non-governmental sphere—by a com-

⁸³ A British news report cited an unnamed diplomat as saying that after the Lisbon OSCE meeting of December 1996 Armenia feels that “the world is ganging up on them” and “a change of mentality” has led to a “hunkering down.” “How Armenia Won the War But Lost the Oil,” *The Independent* (London), July 25, 1997.

mitment to do so with a keen eye on the environmental side-effects. Aside from the general “spaceship earth argument,” which views environmental problems as global and not local, there are others. Opportunities for creating jobs in the sphere of environmental protection for the people of the region and for Americans should not be missed. And the danger of a nationalist backlash that could result from narrow commercialism—should there be an unholy combination of resource extraction by foreign companies, a lack of tangible advances in living standards for the average citizen, and severe environmental degradation—should not be overlooked. Economic aid and educational assistance programs in the Caspian Sea area should seek to raise environmental consciousness, support environmental research, and make environmental effects an intrinsic part of project assessment.

6) *Reevaluate U.S. policy toward Iran.* The current American policy of changing Iran’s conduct by containment and exclusion should be subjected to a searching evaluation by our policymakers. This should be done for several reasons. The 1997 presidential election in Iran suggests that there are elite constituencies that support reform and a widespread popular yearning for it. The establishment’s candidate was defeated by Mohammed Khatami, a man identified in the minds of voters as a proponent of reform. This suggests that there are internal sources of change that can be strengthened and encouraged. The United States seeks to prevent a strategic convergence between Russia and Iran, and a policy of isolating Iran is hardly effective to achieve that goal. And Iran, by providing an export route for Caspian energy producers, can help reduce their dependence on Russia in a crucial sphere. Any sudden change in existing American policy toward Iran is premature. But several questions concerning our relationship with that country need to be examined in an imaginative and dispassionate manner: How effective has the existing American strategy of containing and isolating Iran been in promoting changes in its domestic and foreign policy? What is the range of alternative approaches and what are the relevant trade-offs? What would a policy of conditional engagement toward Iran look like, and how would it be initiated and conducted? What changes in Iranian conduct do we seek, and what incentives can be offered to bring them about? If a policy of engagement is unwise or premature, why exactly is that the case?

7) *Accurately assess the extent and limits of Russian power.* American policy toward Russia should avoid the Manichaeism wherein Russia is either an unreconstructed predator or a reeling giant. Analysts who dwell on Russian neo-imperialism are stuck in the past. They are imprisoned by analytical categories developed during the Cold War and have not come to terms with the internal and external constraints on post-Soviet Russia and the vast changes that it has undergone since its independence. At the other extreme, scholars and policymakers in the United States are now wont to dwell on the fragmentation of the Russian state and the chaos of its policy in what has become the new orthodoxy. During the Cold War, the Russians were coming; now they are crumbling. Russia, in this view, is a strategic has-been.

But in the Caspian Sea zone, Russian policy has not been a failure by the standards of what other states have been able to achieve in regions that they consider important. Despite its weaknesses, Russia remains by far the most powerful state in the former Soviet Union. In the south Caucasus and Central Asia, Russia faces states that are smaller and weaker and that have economic problems far more severe than its own. The most likely scenario is that the gap between Russia’s power and theirs will grow. Moreover, many of these states face an array of internal problems. Russia has emerged as the decisive external party in the conflicts in Tajikistan, Georgia, Azerbaijan, and Armenia. And, by virtue of its geography and demography, Kazakstan’s security and internal stability is heavily dependent on Russia. While the economic dependence of some states, notably Azerbaijan and Georgia, upon Russia has declined significantly, others, especially Kazakstan and Turkmenistan, remain heavily dependent. Because it remains a vital conduit for present or future pipelines and has carved out a place for itself in Caspian

energy and pipeline deals, Russia will continue to be a critical participant in energy development in the region. In a word, Russia has many opportunities and much room for maneuver in the Caspian region.

American policy must rest upon a clear-headed appreciation of the extent and limits of Russian influence and power. The anxieties that Russia feels about its security and its influence in strategically important regions—such as the Caspian zone—must be taken into account. But the weakness and ineptness of Russia should not be overdrawn or considered a permanent state of affairs. Given existing commitments in other—strategically more consequential—parts of the world, Washington should be careful not to raise expectations in the non-Russian, ex-Soviet Caspian states that America's interests in the region are so important that it can be counted upon to offer reliable security guarantees against Russia. This would amount to promising what we cannot deliver. Raising false hopes will not merely breed disillusionment; it could be downright destabilizing if it encourages Russia's neighbors to take steps based on an understanding of American policy that turns out to be incorrect. It does not follow, however, that the United States should adopt a Moscow-centered policy toward the Caspian. To the contrary, helping the states of the region to broaden their economic and political contacts and thus reduce their dependence upon Russia should be a long-range American goal.

APPENDIX: CASPIAN OIL, GAS, AND PIPELINE CONSORTIA AND CONTRACTS

Kazakstan

1) *Tengizchevroil*

In April 1993, five years of negotiations over a venture to tap the giant Tengiz oil field in western Kazakstan were concluded. The Tengizchevroil (TCO) consortium was established with Chevron and Tengizmunaigaz, a subsidiary of the state energy company Kazakmunaigaz, as the major partners. Chevron agreed to invest \$20 billion over 40 years (\$1.5 billion before 1997), and Kazakstan was allotted 80.4 percent of the anticipated profit. Production was to peak in 2010 at 700,000 b/d. The deal was reconfigured exactly three years later when Kazakstan sold half its equity in TCO (50 percent) to Mobil and reduced its share of the profit to 72 percent. In January 1997, the Russian oil company LUKoil acquired a 5 percent stake by paying Chevron \$200 million to reduce its share to 45 percent. The January 1997 deal distributed the percentage of shares as follows: Chevron (45); Tengizmunaigaz (25); Mobil (25); and LUKoil (5). LUKoil's late entry into TCO could be the beginning of an effort to carve out a larger role, given reports that it is seeking to acquire an additional 5 percent at the expense of Tengizmunaigaz.⁸⁴ TCO's production rose from 23,000 b/d in 1993 to 160,000 b/d at the end of 1996, accounting for 32 percent of Kazakstan's total oil output.

A major problem for Kazakstan, which hopes that energy revenues will propel economic growth, is getting the oil from Tengiz and future fields to hard currency markets.

2) *The Caspian Pipeline Consortium*

A major problem for Kazakstan, which hopes that energy revenues will propel economic growth, is getting the oil from Tengiz and future fields to hard currency markets. Without a pipeline network of its own, Kazakstan depends entirely on the Russian pipeline system, aside from some limited swap agreements with Iran. The desire to develop alternative export routes led Kazakstan to consider various options: via Russia to Novorossiisk; through Iran; through

⁸⁴ EIU, *Country Report: Kazakstan, 1st Quarter 1997*, London: EIU, 1997, pp. 33–34. The swap agreement with Iran was reached in 1996 and took effect in May 1997. Kazak oil will be shipped across the Caspian Sea to Iran. Iran in turn will export an equivalent amount of its oil from its Karg island terminal and transfer the proceeds to Kazakstan. The agreement provided that the exchange would begin at 40,000 b/d and rise to 120,000 b/d over two years. The presence of mercaptans (sulphurous contaminants) in Kazakstan's oil had made for delays. "Iran to Deliver Oil Under Kazakh Swap Deal," *Reuters European Business Report*, May 10, 1997.

Iran and Turkey; across Afghanistan and Pakistan; and via China. For a mix of financial, technical, and political reasons, it decided that the Russian route was the most immediately feasible.

The need to transform an additional Russian export channel from concept to reality led to the formation of the Caspian Pipeline Consortium (CPC) to finance and construct a 1,500 km pipeline with a 72 million metric ton per year capacity that would use existing lines running from Tengiz to Atyrau and on to Astrakhan and Komsomolsk in Russia. From Komsomolsk a new line would be built west to Tikhoretsk and from there southwest to Novorossiisk, parallel to the existing Tikhoretsk-Novorossiisk line so as to increase the amount of oil that can be cleared from Novorossiisk.

The original CPC deal signed in June 1992 divided the equity equally among Kazakstan, Russia, and Oman (brought in by the Kazakstani government both as a source of financial and technical expertise and to prevent the power asymmetries that would accompany a solely Russia-Kazakstan venture). That agreement had to be restructured because Chevron disliked the terms. As a nonstate participant in CPC, Chevron was not allocated the Class A shares reserved for states. It was allotted Class B shares while being obligated to come up with financing for the project. There was a clear imbalance between equity and possible financial risk. Chevron balked at making future investments and began to explore alternative export routes. As a result, CPC was refashioned in April 1996 and the final agreement signed in December 1996 and January 1997. In essence, the equity of state participants was reduced, the Class A-Class B distinction erased, and a host of private oil companies, who are responsible for financing the pipeline project, were brought in. The new deal had several striking characteristics. Kazakstan's equity share was reduced, and Oman's was cut even more radically. Russia's, on the other hand, was reduced only from one-third to 24 percent. While Chevron's complaints were heeded by allotting it 15 percent, Russian firms received 20 percent. Table 2 depicts the composition of CPC as of mid-1996.

The net result of these changes is that Russia has a commanding voice in Kazakstan's main new export channel for long-term Tengiz production. The Russian government and the Russian oil companies, LUKoil and Rosneft, together control 44 percent of CPC equity. This allocation was hardly unrelated to Russia's determination to ensure a dominant role in the emerging Caspian Sea energy complex and its political and military influence as the former Soviet Union's premier power. More specifically, the dominant role of Russia within CPC cannot be divorced from Kazakstan's asymmetric dependence upon Russia. Aside from the critical role of the Atyrau-Samara line in getting Tengiz oil to market, Kazakstan's refinery at Pavlodar, which supplies oil to the eastern regions of the country, relies totally on Russian crude oil from Siberia, and the Chimkent refinery, which supplies the south, is heavily dependent upon Siberian crude. Both the volume of oil that Kazakstan has been allowed to send through the Atyrau-Samara line (vital for Tengiz production pending the completion of CPC) and the deliveries to Pavlodar and Chimkent have proven erratic.⁸⁵ Whatever the cause of these fluctuations, they drove home to Kazakstan the need to placate and coopt Russia. Kazakstan's dependence upon Russian pipelines and crude oil, alongside the demographic, economic, and geographical circumstances of the country, were undoubtedly important in the dominant role that Russia acquired in CPC by virtue of shares allocated to the state and to LUKoil and Rosneft, which remains state-owned.

⁸⁵ Russian crude oil exports to Kazakstan fell from 14 million tons in 1991 to 4.5 million tons in 1994, and in October 1995 deliveries to the Pavlodar refineries were suspended for a time. As for access to the Atyrau-Samara line, the quota assigned to Kazakstan moved from 70,000 b/d in early 1995 to 30,000 b/d in September to 83,000 b/d in February 1996, and 100,000 b/d in April. See Sarah Lloyd, "Pipelines to Prosperity," *op. cit.*, pp. 53-57.

Table 2: CPC's Restructured Equity Distribution: June 1996
(in percentages)

A. States	
Russia	24.0
Kazakstan	19.0
Oman	7.0
B. Kazak Firms	
Kazakoil	1.75
C. Russian and Western Firms	
Chevron	15.0
LUKoil-ARCO ⁸⁶	12.5
Rosneft-Shell	7.5
Mobil	7.5
Agip (Italy)	2.0
British Gas	2.0
Oryx	1.75

Source: *Economist Intelligence Unit (EIU), Country Profile: Kazakstan, 1996-1997*, London: EIU, 1996, p. 33; Richard Hildahl and Laurent Ruseckas, "The New 'CPC': What It Means for The Politics of Caspian Oil," Cambridge Energy Research Associates, *Decision Brief*, July 1996, p.5; discussions with Laurent Ruseckas.

3) KCS and Other Oil Ventures

The KazCaspian Shelf Consortium (KCS) was established in December 1993 to carry out prospecting in Kazakstan's sector of the Caspian. KCS consists of Mobil, Agip (Italy), British Gas, a British Petroleum-Statoil (Norway) partnership, Royal Dutch Shell, and Total (France). Each participant was given the chance to select two sites for development once the survey is finished and prior to opening up the entire area to international bidders. The survey stage reached a conclusion in June 1997, and the initial contracts were expected to be signed in November.⁸⁷ In addition, Exxon and Oryx (the original sole investor) are sharing in the development of the Metvyi Kultuk field located just south of Tengiz, and Oryx is also developing the Arman field, located off the Buzachi Peninsula some 75 miles southeast of Tengiz. Production is expected to rise to a peak of 20,000 b/d from a mix of existing and fresh oil wells.

Kazakstan has also signed major oil agreements with China, even though (or perhaps because) it evokes considerable apprehension in the country owing to its size, increasing Chinese immigration, and fears of irredentism. The logic of coopting China while using it to reduce the reliance on Russia seems to have prevailed. In June 1997 the China National Petroleum Corporation (CNPC) received a 60-percent share in the Aktyubinsk field in exchange for \$325 million and a commitment to invest \$4 billion over the next two decades.⁸⁸ In the following month, CNPC was selected over American and Malaysian competitors to receive the right to be the sole outside party in contract negotiations for a joint venture with Kazakstan to develop the onshore Uzen oil field, which, with an estimated 130 to 200 million tons of oil reserves, is second in size only to Tengiz. CNPC will invest \$1 billion to modernize Uzen and also plans to build a 1,300-mile pipeline to transport oil to China.⁸⁹

⁸⁶ Under the LUKoil-ARCO partnership. ARCO will provide all the capital until CPC earns a profit. Thereafter, the division of equity will be 54 percent in favor of LUKoil.

⁸⁷ *Pipeline News*, no. 76, part II (October 1997).

⁸⁸ "The Lure of the East," *op. cit.*

⁸⁹ *Pipeline News*, no. 70, part I (August 1997); "China's Strike," *The Economist*, August 16, 1997, pp. 32-33.

4) *Karachaganak*

In June 1992 Kazakhstan, British Gas, and Agip signed an agreement to modernize the oil and gas sites at Karachaganak through \$10 billion in investment over 40 years, with each company assuming a 50-percent stake. The Karachaganak site was discovered in 1979 and is located 300 km north of Kazakhstan's northern Caspian Sea coast at the confluence of the Volga and Zhayq rivers. Geologically connected to Russia's Orenburg field, Karachaganak is two-thirds the size of Tengiz. It is estimated to contain 46 tcf of natural gas—more than half of Kazakhstan's total natural gas reserves—and accounts for 70 percent of Kazakstani gas production.

Despite its promise, Karachaganak has been beset by start-up problems. In February 1995, Gazprom, the Russian natural gas company, entered the deal, acquiring a 15-percent stake, which came at the expense of British Gas and Agip. Wrangling soon began among the partners over the terms of the Russian firm's entry, but the need to include it was apparent to all. Gazprom had considerable leverage over the future of Karachaganak. Moscow made it clear that the purchase price of Karachaganak gas and access to export pipelines would be affected were Gazprom excluded. Karachaganak's reliance on the Russian processing plants at Orenburg, Novo-Ufimsky, and Salavat underscored the extent of Russian leverage.⁹⁰

If Kazakhstan could build a robust pipeline system to bring gas from its northwest to the south and west, the country's dependence on gas from Uzbekistan and Turkmenistan for domestic use could also be eliminated.

Owing to unresolved disputes among the new and old partners about the terms of Gazprom's participation, continuing restrictions on access to the Orenburg processing plant, and various longstanding financial and bureaucratic hindrances, production at Karachaganak remains sluggish. A significant increase would not only provide export earnings: If Kazakhstan could build a robust pipeline system to bring gas from its northwest to the south and west, the country's dependence on gas from Uzbekistan and Turkmenistan for domestic use could also be eliminated.⁹¹

Azerbaijan

1) *Azerbaijan International Operating Company (AIOC)*

Negotiations between Azerbaijan and American, British, Turkish, and Norwegian oil companies began as soon as it was clear that the country would become independent. The government of Abulfaz Elcibey reached an agreement in June 1993 for a consortium in which the Azeri state oil company, SOCAR, would retain 30 percent of the equity. With the fall of Elcibey and the advent of a new leadership headed by Haider Aliev, negotiations began anew. An agreement was signed in September 1994, resulting in the establishment of the first international oil consortium, AIOC, to tap the Azeri and Chirag offshore fields and the deep-water portions of the Guneshli site.

⁹⁰ Sarah Lloyd, "Pipelines to Prosperity," *op. cit.*, pp. 56–57.

⁹¹ On Karachaganak, see U.S. Department of Energy, Energy Information Administration, *Oil, Natural Gas, Coal, Electricity Profile: Kazakhstan*, July 11, 1997, internet publication.

These fields, which lie on a northwest to southeast trajectory beginning about 55 km off the tip of the Apsheron peninsula, are to be developed with an investment of \$8 billion over 30 years. They are estimated to hold nearly 4 billion barrels of oil. Production is estimated to rise from 80,000 b/d in 1998 and peak at 700,000 b/d in 2010, accounting for 60 percent of total Azeri production. Azerbaijan will receive bonus payments totalling \$300 million as well as 70 percent of all profits. Table 3 shows the distribution of shares in AIOC, which is led by British Petroleum and AMOCO.

Table 3: AIOC Share Distribution
(in percentages)

British Petroleum	17.1
AMOCO	17.0
SOCAR	10.0
LUKoil	10.0
Unocal	10.0
Statoil	8.6
Exxon	8.0
TPAO	6.8
Pennzoil	4.8
Itochu	4.0
Ramco (UK)	2.1
Delta-Nimir (Saudi Arabia)	1.6

Source: U.S. Department of Energy, Energy Information Administration, *Country Analysis Brief: Azerbaijan (CAB: AZ)*, November 10, 1997.

2) CIOC

The Caspian International Operating Company (CIOC), Azerbaijan's second joint venture, emerged in November 1995. CIOC's goal is to exploit the Karabakh field that is located 120 km offshore about 10 km north of Guneshli. Drilling was to begin in June 1997. Unlike the fields allocated to AIOC, Karabakh is more of a gamble. While it has been surveyed and is estimated to contain 900 million barrels of oil and 14 billion cubic meters of natural gas, actual yields could fall far short. CIOC's venture will require a \$3 billion investment, and the shares in the consortium are allocated as follows:

Table 4: CIOC Share Distribution
(in percentages)

LUKAgip	50.0
Pennzoil	30.0
LUKoil	7.5
SOCAR	7.5
Agip	5.0

Source: CAB: AZ (November 10, 1997), p. 3; *Caspian Region Energy Development Report (As Required by HR 3610)*, p. 21.

The prominence of Russian oil interests is even more noteworthy in CIOC, particularly the Agip-LUKoil partnership under which Agip is reportedly carrying LUKoil in what, one must conclude, is an acknowledgment of the value of the Russian connection for reasons that have little to do with technical expertise or financial resources.

3) *Shah-Deniz*

The third Azerbaijani consortium was established in June 1996 to develop the Shah-Deniz site located some 25 km south of the Apsheron peninsula and reckoned to have 700 million barrels of oil. The consortium allocated 60 percent of the shares to a group of Western oil companies: BP and Statoil control 25.5 percent each; SOCAR, LUKoil, Elf (France), the National Iranian Oil Company (NIOC) each have a 10-percent share; and TPAO has 9 percent. The shares of LUKoil and NIOC were ceded from SOCAR's portion after the initial agreement creating the consortium was signed. The decision to include Russia and Iran was in all likelihood a political move intended to coopt Azerbaijan's two principal adversaries.

4) *Yalama and Kyapaz/Serdar*

In July 1997, Azerbaijan and LUKoil signed an agreement to develop the Yalama field in the North Caspian, which is estimated to contain between 50 and 100 million metric tons of oil. LUKoil will hold a 60-percent share and SOCAR the rest. The total investment will be \$2 billion. In the same month an agreement was reached over the Kyapaz offshore field located midway between the coasts of Azerbaijan and Turkmenistan east of the Azeri, Chirag, and Guneshli sites. (Turkmenistan, which contests Azerbaijan's claim to the field refers to it as "Serdar.") The partners are SOCAR (50 percent), LUKoil (30 percent), and Rosneft (20 percent).

Kyapaz is said to have 50 million metric tons of oil and will require \$1 billion to exploit.⁹² The oil from both Yalama and Kyapaz will be transported through the northern route. This will simultaneously increase Russia's transit revenues, potential leverage over Azerbaijan's oil exports, and stake in the profitability of the Azeri oil industry. Because of the dispute between Azerbaijan and Turkmenistan over Kyapaz/Serdar, Rosneft withdrew from the partnership soon after the agreement, while LUKoil temporized. In the fall of 1997, the Russian government officially informed Turkmenistan that neither company would participate in the Kyapaz/Serdar venture.

5) *NAOC and the August 1997 Deals*

The Northern Apsheron Operating Company (NAOC) was established in December 1996 to explore and develop the Ashrafi-Dan Uludzu offshore fields. Dan Uludzu is estimated to have reserves of 35–40 million tons of oil and 20–25 billion cubic meters of gas. Ashrafi's reserves are estimated at 50–60 million tons of oil and 10–15 cubic meters of gas.⁹³ The percentage distribution of shares in the consortium is: AMOCO (30), Unocal (25.5), Itochu-Japan (20), SOCAR (20), Delta-Saudi Arabia (4.5 percent). The oil fields that are to be worked by the NAOC lie roughly 30 km northeast of the Apsheron Peninsula and are expected to require a total investment of \$2 billion. Production is projected to commence in 2003 and output will be between 7 and 9 million tons within five years of that date.

If the involvement of U.S. oil companies in the AIOC, CIOC, and NAOC agreements had already made for substantial investment in Azerbaijan's oil sector, Aliev's late July and early August 1997 visit to the United States made it bigger still. On August 1, amid much fanfare, he signed four new agreements with American companies valued at between \$8 and \$10 billion.⁹⁴ The agreement with AMOCO concerns the Inam field, located offshore 120 km south of Baku,

⁹² *Pipeline News*, no. 66, part III (July 1997).

⁹³ Turan News Agency, February 25 and 26, 1997; ANS, February 24, 1997, as cited in U.S. Embassy, Azerbaijan, "Baku's Black Gold: February Oil Highlights," February 1997.

⁹⁴ Details from *Pipeline News*, no. 70, part II (August 1997).

which SOCAR estimates to contain 200 million metric tons of oil, although AMOCO has not made a final estimate because its seismic surveys are incomplete. Fifty percent of the shares are to be held by AMOCO and the rest by SOCAR, which may invite other participants to join. The agreement with Chevron covers the Apsheron field, a 400 square kilometer segment just south of the Azeri, Chirag, and Guneshli fields being developed by AIOC. Chevron will hold a 30-percent share, with SOCAR taking the rest. The third agreement was signed with Exxon on the Nakhchivan offshore field 100 km south of Baku. The final agreement, with Mobil, covered the 227 square kilometer deep-water Oguz field, which is 100 km from Baku off Guneshli. The shares are to be divided equally between SOCAR and Mobil.⁹⁵

Turkmenistan

Turkmenistan has not experienced the tempo of Western investment found in Kazakstan and Azerbaijan. There are several reasons for this. The inflation rate is among the highest in the newly independent states, and the manat (the national currency) has failed to hold its value. More importantly from the standpoint of would-be investors, Turkmen president Saparmurad Niyazov's economic policies have been capricious. Foreign energy companies (such as the Argentine firm Bidas) have had their export licenses revoked, unreliable contracts impose onerous terms on foreign companies while giving an exorbitant share of profits to the government, and the ill-developed pipeline network makes exporting to hard currency markets (most of Turkmenistan's natural gas exports now go to cash-strapped NIS customers) problematic.⁹⁶

While Turkmenistan's key natural resource is gas, the country also has some 1.5 billion barrels of proven oil reserves. Two foreign companies have been active in the development of Turkmen oil fields. Bidas has invested some \$400 million since 1991 to develop three sites—Keimir, Ekpatlaukh, and Chikshlyar—but the company was deprived of its export license in December 1995 and is now involved in a legal dispute with the Turkmen government. Larmag Energy Assets, a Dutch firm, has a joint venture to tap the Cheleken field and has invested some \$90 million. But it too has been weighed down by the burdens of exporting oil and unpredictable government policies. Dragon Oil, a firm registered in Ireland, has also been developing oil fields in Turkmenistan and is reported to have reached a production level of 6,600 b/d at its Block II location in mid-1997.⁹⁷ Peak oil production is estimated to reach 50,000 b/d at the Bidas sites, 85,000 b/d at the fields being worked by Larmag, and 75,000 b/d at Dragon's Block II site.

Turkmenistan's gas reserves are far more substantial, indeed the third largest in the world following those of Russia at 1,750 trillion cubic feet (tcf) and Iran at 742 tcf. They are estimated at 98 tcf, with the largest fields being Dauletabad-Donmez in the basin of the Amu Darya river to the east along the border with Uzbekistan and Yashlar in the Murgab river basin in the south. Bidas has been working the Yashlar field since 1991 and Unocal, Delta (Saudi Arabia), and Gazprom have combined to work Dauletabad-Donmez. Total production in 1994 was 1.3 tcf, exports 0.9 tcf. The principal challenge is increasing the level of production and exports. Production fell from 84 billion cubic meters in 1991 to 32 billion cubic meters in 1996. Exports amounted to 25 billion cubic meters in 1996, a fall of 50 percent over 1993 levels.⁹⁸

⁹⁵ See footnote 13.

⁹⁶ Details on Turkmenistan's energy sector are from U.S. Department of Energy's *Oil, Natural Gas, Coal, Electricity Profile: Turkmenistan*, *op. cit.*; and EIU, *Country Profile: Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan*, pp. 72–75.

⁹⁷ *Pipeline News*, no. 70, part I (August 1997).

⁹⁸ "Turkmens Urge Speedy Investment in Gas Pipelines," *Reuters Financial Services*, March 13, 1997, internet publication.

Turning natural gas exports into hard currency earnings that can spur economic development may be an even bigger challenge. Turkmenistan, which depends on the Russian pipeline network for its exports, has been restricted largely to the non-lucrative NIS market, whose customers owe it \$1 billion in arrears. The chances for alternative pipelines to wealthier customers remain slim in the near-term, despite the confidence of Turkmen officials about routes through Iran and Turkey, across China to the Pacific, and via Afghanistan and Pakistan to the Indian Ocean.⁹⁹

⁹⁹ Interviews with senior Turkmen officials and representatives of international financial organizations in Ashgabat, Turkmenistan, June 1995. On the proposed pipeline through Afghanistan, see page 31.