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THE ENERGY DIMENSION IN RUSSIAN GLOBAL STRATEGY

RUSSIA'S CASPIAN ENERGY POLICY AND ITS IMPACT ON THE
U.S.-RUSSIAN RELATIONSHIP

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Introduction

In recent years, the Caspian Sea region, with its abundant energy, biological, and other natural resources, has become a zone of very intensive political, military, and economic activities for Russia and the United States. In the process, a complex and highly controversial relationship has developed between both nations. This is sometimes described as “the new Great Game”—a clear allusion to the fierce struggle between Russia and Great Britain over spheres of influence in the same region in the nineteenth century.¹ Indeed, both Russia and the United States are now, as Russia and Britain were in the past, the two principal actors in Caspian political, security, and economic affairs, and both declare the Caspian region to be a zone vital to their national interests. Their respective interests vary from being parallel and even complementary on some issues to highly competitive, sometimes nearly confrontational, on others. Although there are other regional and extra-regional countries with strong interests in the Caspian region, it is Russia and the United States that possess the greatest political, economic, and military capabilities to pursue and actively defend actively their interests in the region.

With the breakup of the Soviet Union and emergence of new sovereign states in the Caspian Sea region, the geopolitical and geoeconomic situation has undergone fundamental changes. One such change is connected with challenges and threats to regional political and economic security and stability generated by forces of international terrorism, religious extremism, local separatism, and organized crime, whose activities strongly escalated in the Caspian region over the last decade and a half. Another group of changes is linked to the crisis of the legal regime for the Caspian Sea, established by the 1921 and 1940 Soviet–Iranian Treaties. In the absence of new, mutually accepted legal norms, exploitation of Caspian natural resources has become severely complicated, while relations between Caspian littoral states over territorial and economic rights are progressively under strain—especially between Azerbaijan, Turkmenistan, and Iran. Furthermore, disputes are mounting in the region—with extraregional countries (the United States in particular) playing an active role in choosing oil and gas export routes.

¹ See, for instance, Zonn I., Zhiltsov S. “Bol’shaya igra-2. Strategiya SshA v Kaspiyskom regione” (“The Great Game-2. USA Strategy in the Caspian region), Moscow. OOO Edel’-M.2002; Cohen A. “The New ‘Great Game’: Pipeline Politics in Eurasia.” *Eurasian Studies*. Ankara. Vol.3, No. 1. Spring 1996.

This paper analyzes Russian policy in the region on energy and energy-related issues under President Vladimir Putin's administration. It also explores the main challenges that Russia's Caspian policy faces, including those coming from within as well as those from outside the region. Finally, the paper draws conclusions about how this policy influences the overall relationship between Russia and the United States.

Basic principles of the Russian Caspian policy

Revenues from production and exportation of oil and natural gas account for about 40 percent of the post-Soviet Russia's gross national product, and maintaining stable hydrocarbon production levels is among the most important of national economic priorities. Although the principal energy resources in Russia are located in Siberia and the Russian Far East, those next in importance to them (accounting for 8 to 10 percent of the total national proven recoverable energy reserves)² are oil and gas reserves to the north and northwest of the Caspian Sea, located in both onshore and offshore territories. In the late 1990s, new discoveries of oil and gas deposits were made in the northern part of the Caspian Sea and off the Dagestan coast, helping to upgrade significantly—by at least 500 million tons in oil equivalent—the previous estimates of recoverable energy reserves in this part of Russia. What makes these resources even more attractive for exploitation is that their production and export are significantly more cost-effective than those in distant parts of Siberia, due to lower overhead expenses and availability of pipelines, refineries, storage facilities, and other required infrastructure.

The strategic interests of Moscow in the Caspian region are by no means limited to the use of oil and gas resources. Moscow's interests extend to the need to establish and maintain close coordination with other Caspian littoral states (Kazakhstan, Turkmenistan, Azerbaijan, and Iran) and with the gas-rich Uzbekistan located next to them on issues of regional security, as well as on problems of energy transportation to the outside world.

The role of the Caspian policy in the Russian global strategy goes well beyond Moscow's relations with its Caspian neighbors. It is motivated by the need (a) to develop a constructive, cooperative relationship with outside powers, whose involvement in Caspian affairs has lately

² "Neft' Rossii." Moscow. 2002. No.3. p. 35.

become quite substantial, and (b) to prevent these outside powers from establishing political, economic, and possibly military control over the region, which possesses combined recoverable reserves of at least 60 billion barrels of oil and 15 trillion cubic meters of natural gas³—making it one of the most energy-rich areas in the world. In light of these developments, the Caspian dimension of Russian foreign policy has grown in significance, especially compared to the first post-Soviet decade.

It has been correctly noted that after the collapse of the Soviet Union and during almost all of the 1990s, Russia's policy in the Caspian region was mainly reactive to turbulent political, security, and economic developments, rather than proactive.⁴ That policy also stood in need of clearly formulated national strategic objectives. The weak and indecisive Russian policy at that time came largely as a result of a deep national political and economic crisis. Ambiguities and contradictions of the policy were also reflected in the absence of sufficient coordination among different government institutions and private business interests, and by the inability of President Boris Yeltsin to carry out a consistent foreign policy to defend Russian national interests. It came as no big surprise, therefore, that Russia in the 1990s was mostly on the retreat from the Caspian region, in spite of tough rhetoric to the contrary. This weak and disoriented policy allowed Russia's rivals and competitors to build up their own power base in regional economics and politics. Only at the very end of the 1990s, and especially after Vladimir Putin became the new president of Russia, did Moscow move to work out a relatively consistent long-term policy in the Caspian region.

This fundamental shift in Russia's policy was reflected in decisions taken by the national Security Council in April 2000, as well as in the text of the "Foreign Policy Concept of the Russian Federation" adopted the same year. Among Russia's main strategic goals in the Caspian region, as listed in this document, was the need to maintain an atmosphere of peace, stability, and good neighborly relations among regional countries. In practical terms, the new policy meant that Russia intended to act as a mediator in possible disputes among regional countries and as a principal guarantor of regional security. Achievement of this role for Russia would help promote Russia's economic interests in the region, including those

³ Roberts J. "Energy Reserves, Pipeline Routes and the Legal Regime in the Caspian Sea" in *The Security of the Caspian Sea Region*, ed. by Gennady Chufirin. Oxford University Press. 2001. p. 34.

⁴ Malysheva D. "Rossiyskaya karta v kaspiskom pas'yanse" (Russian Card in the Caspian Puzzle). *Mirovaya ekonomika i mezhdunarodnye otnosheniya*. Moscow. 2002. No.7. p. 53.

connected with the choice of main energy export routes.⁵ To centralize and coordinate Russian foreign policy in the region, the post of Special Representative of the Russian President in the Caspian region was created. A former Minister of Energy, Victor Kalyuzhny, was appointed to this post.

As a direct consequence of these political and administrative decisions, Russian activities in the Caspian region became more coherent and focused. The most important actions taken by Russia afterwards included:

- a) reaching an agreement with Azerbaijan in 2001 on the legal regime for the Caspian Sea, similar to what Russia and Kazakhstan had signed in 1998;
- b) holding intensive negotiations with Kazakhstan and Turkmenistan on their use of oil and gas pipelines across the Russian territory as the main outlet to export their energy resources to the world market;
- c) intensifying consultations with the former Soviet republics in the larger Caspian region—including Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan in Central Asia and Azerbaijan and Armenia in the South Caucasus—as well as with Iran on issues of bilateral and multilateral security cooperation; and
- d) establishing a new regional security body, the Shanghai Cooperation Organization, in June 2001 at a summit meeting of Russia, China, Kazakhstan, Uzbekistan, Kyrgyzstan, and Tajikistan.

With these steps taken, it looked as if Russia were on the way to recovering its strategic losses in the region and strengthening its positions there in the new geopolitical and geoeconomic environment. These initial policy gains, however, appeared to be rather short-lived, as they were seriously challenged by the geopolitical consequences of events that occurred thousands of kilometers away from the Caspian region—Washington, D.C., and New York—on September 11, 2001.

Changing security model in the Caspian region

There are few regions of the world that experienced such a profound and lasting impact of the September 11 events as the Caspian region. As a result of the U.S.-led anti-terrorist operation

⁵ “Kontsepsiya vneshney politiki Rossiyskoy Federatsii,” (Foreign Policy Concept of the Russian Federation). “Diplomaticheskii vestnik.” Moscow. 2000. No.8. p.10.

in the wake of these events by a military campaign directed against the Taliban regime and Al Qaeda network in neighboring Afghanistan, the Caspian states were deeply influenced by these developments, each of them to a different degree.

Not only did these states declare their complete political backing of the U.S.-led anti-terrorist operation in Afghanistan, but most of them—with the notable exception of Iran—also allowed U.S. transport and military aircraft access to their airspace. In addition, Uzbekistan and Kyrgyzstan agreed to lease to the United States and its NATO allies airport facilities in Khanabad and Manas, respectively, to be used against Taliban forces in Afghanistan.

Initially, these dramatic decisions made with Russia's acquiescence looked like short-term contingency plans under the emergency situation, but only a few months later they appeared to have become an integral part of a new security strategy of the Caspian states. No state showed any intent to reduce security and military cooperation with the United States and its NATO allies.

For its part, the United States stepped up considerably its military assistance to the Caspian states after September 11. In FY 2002 alone, these states received over \$74 million in U.S. military assistance, the largest beneficiary among them being Georgia (\$32 million), followed by Uzbekistan (\$12 million) and Kyrgyzstan (\$11.6 million).⁶ In the same year, the United States also waived Section 907 of the 1992 Freedom Support Act, which banned U.S. military aid to another Caspian state, Azerbaijan, on account of the Nagorno-Karabakh dispute.⁷ On the list of beneficiaries of U.S. military assistance in the Caspian region was also Turkmenistan, in spite of condemnation by Washington of the country's continuing violations of human rights. As part of this assistance, the United States has already donated two high-speed patrol boats to Ashkhabad and now intends help Turkmenistan modernize its armed forces.⁸

Local political elites openly demonstrate their interest in enhancing this cooperation. Their stand is motivated by their high regard for the U.S./ NATO military deployments—already

⁶ Alyson J.K. Bailes, Bjorn Hagelin, Zdzislav Lachowski, Sam Perlo-Freeman, Petter Stalenheim and Dmitri Trofimov, "Armament and Disarmament in the Caucasus and Central Asia." SIPRI. Stockholm. July 2003. p.10.

⁷ Ibid., p.11.

⁸ Mukhin V., "Oruzhiye dlya Turkmenii," (Arms for Turkmenia) "Nezavisimaya gazeta," Moscow. Nov. 12, 2003.

existing in Central Asia and likely to be established in the South Caucasus—as an effective stabilizing force in a highly confused regional political and security situation, challenged by forces of international terrorism and local separatism. Consequently, a new security model began to emerge in the larger Caspian region—one that is focused on cooperation with the United States and its NATO allies and replaces a previous orientation toward the CIS Collective Security Treaty (CST) as the core institution.

Moscow's attitude toward the latest security changes in the region remains ambivalent. On the one hand, Moscow refrained from formal criticism of the U.S./NATO plans to extend their military presence indefinitely in Central Asia and played down local concerns when Georgia allowed the U.S. military on its soil. This appeared to be a logical continuation of Russia's earlier policy of extending support to the international anti-terrorist campaign. On the other hand, critical appraisals of the United States and its allies' intentions to consolidate their military presence in Central Asia and to extend that presence to at least some post-Soviet states in South Caucasus became more prominent in parliamentary debate, in public statements of several well-known politicians, and in mass media. In the opinion of those critics of the latest developments in the Caspian security situation, the Russian national interests in regional and global security affairs were bound to suffer irreparable damage that would put Russia at a strategic disadvantage.

These arguments were increasingly vocalized by proponents who targeted their criticisms, not only against U.S. activities in Central Asia (and for that matter in the South Caucasus too), but also—albeit indirectly—against a pro-Western shift in the Russian foreign and security policy initiated by President Putin in the wake of the events of September 11. As these views gained ground among wider sections of Russian society, President Putin had to appease his hardliners.

As a result, it was decided in May 2002 to transform the CIS Collective Security Treaty into a better-structured military-political alliance—a move to upgrade the level of military cooperation among its members.⁹ A little earlier, with the aim of increasing the role of the CST in Caspian security affairs, it was decided to step up military-technical cooperation with

⁹ “Sessiya Soveta Kollektivnoy Bezopasnosti gosudarstv-uchastnikov Dogovora o Kollektivnoy Bezopasnosti” (“Session of the Council of Collective Security of states Participating in the Agreement on Collective Security”). *Diplomaticheskij vestnik*, 2002, No. 6, pp. 76-78.

the regional states and to increase deliveries of Russian armaments to them at reduced prices.¹⁰

The largest-ever naval exercises by Russia in the northern part of the Caspian Sea at the beginning of August 2002 were an even stronger reminder to the outside world of Russia's intention to maintain an important role in the region's security.¹¹ More than ten thousand Russian servicemen, sixty warships, and over thirty combat aircraft and helicopters took part in the exercises. Although troops from Kazakhstan and Azerbaijan also participated, the exercises were a clear show of Russia's military power and its determination to use that power in a crisis situation. This show of force was also directed at Russia's neighbors in the region, reassuring them about Russia's capability to act firmly and decisively as a guarantor of regional stability.

During the past few years, Russia has upgraded its naval force in the Caspian Sea. In 2002, a large patrol vessel, *Tatarstan*, was put on active service, and another is expected to join it in 2004.¹² The border guard forces operating in the Caspian Sea region received three high-speed boats and three Mirage-type guard boats.

Another important step was taken in October 2003, when President Putin inaugurated a Russian military air base in Kant (Kyrgyzstan) that was formally declared to be part of the CIS rapid deployment force (RDF).¹³ Even though Russia flatly denied that this base was to act as a counterbalance to the air base in Manas used by the U.S./NATO forces, the symbolic significance of establishing Russia's own military presence nearby was not lost on either Moscow's friends or its rivals. In doing this, Russia sent a clear signal that it is prepared to defend resolutely its national interests in this part of the world.

Following the reinforcement of the United States and its NATO allies' strategic positions in Central Asia and the larger Caspian region, Moscow also took active steps to upgrade the role of the Shanghai Cooperation Organization (SCO) in regional security affairs and to facilitate an early start of that organization's concrete activities. A Moscow initiative, the SCO summit

¹⁰ Sokut S. "Reanimatsiya SNG na voennyi lad" (Reanimation of the CIS in a Military Way). *Nezavisimaya gazeta*. February 28, 2002.

¹¹ "Nezavisimoye voennoe obozrenie." Moscow. August 16, 2002. No. 27.

¹² "Krasnaya zvezda." Moscow. May 27, 2003.

¹³ *Nezavisimaya gazeta*. Oct. 24, 2003.

meetings were held in St. Petersburg (June 2002) and Moscow (May 2003). These sessions adopted the SCO Charter, the basic legal document of the organization, and established the SCO Secretariat with headquarters in Beijing and a Regional Anti-Terrorist Center (RATC) with headquarters in Bishkek.¹⁴ These decisions were necessary to enable the SCO to implement the goals incorporated in its charter.

The primary concern of the SCO was to strengthen security and stability in Central Asia. Member states reiterated that the basic threat to regional security was international terrorism, separatism and extremism, organized crime, and illegal trafficking of narcotics and weapons.¹⁵ It was also stated that the SCO was potentially capable of making an important contribution to the cause of peace and stability throughout the Caspian region.

At the same time, it is important to underscore that the steps taken by the SCO member-states did not envisage a transformation of the SCO into a military alliance. Leaders of these countries repeatedly stated that the SCO did not present a bloc or a closed alliance, and its activity was not directed against any state or group of states. The Central Asian members of the SCO did not want the organization to be seen as a counterweight to U.S. security policy in the region.

Their stand proved that in spite of all recent efforts by Russia, its erstwhile dominance in the Caspian security affairs was on the decline. The United States had not only become a permanent actor in regional security, but its role continued to increase. The significance of these developments goes well beyond mere military security and makes a lasting impact on all aspects of political and economic situations in the Caspian region and on the bilateral U.S.–Russian relationship.

Russian policy on the Caspian Sea legal regime

Transformation of the Caspian Sea legal regime in accordance with the new geopolitical realities and adoption of new legal documents by all Caspian littoral states has become one of the stated goals of Russian foreign policy in the region. From the Russian point of view, the

¹⁴ “Diplomaticheskii vestnik.” 2003. No. 6. pp.45-48.

¹⁵ Press Department of the Russian Ministry of Foreign Affairs. Information Bulletin. February 26, 2003; *Diplomaticheskii vestnik*, 2002. No.9. p.17.

current, highly confused legal situation in the Caspian Sea impedes the littoral states from regulating their conflicting commercial interests—from exploration of energy resources to fisheries—in a nonadversarial way.¹⁶ As a result, political and security tensions are growing in the region, tensions that may lead to open conflicts between the Caspian littoral states themselves and serve as a pretext for outside interference in regional affairs.

Initially, Russia opted for a “condominium principle” under which a 45-nautical mile coastal zone would fall under the jurisdiction of the respective littoral states and the rest of the Caspian Sea would be shared jointly. Later, however, taking into account conflicting claims of the littoral states to Caspian natural resources, both mineral and biological, Russia changed its position in favor of demarcation of Caspian seabed resources between the littoral countries by a median line (i.e., a line running at an equal distance from the acknowledged coastal baselines of these countries). At the same time, Russia retained its position on joint use of the waters of the Caspian Sea for free navigation and for common use of biological resources.¹⁷

These principles were first upheld in the Russia–Kazakhstan “Agreement on Division of the Northern Caspian Seabed,” concluded in July 1998. Later, in January 2001, a similar agreement was reached between Russia and Azerbaijan. These agreements created a needed legal basis for investments in exploration of mineral resources in the Caspian seabed and helped Russia, Kazakhstan, and Azerbaijan proceed with their production plans.¹⁸

But the two remaining Caspian littoral states—Iran and Turkmenistan—continued to raise serious objections to these agreements, questioning their legality and claiming that the accords violated their individual sovereign rights.

Iran's position was that the Caspian seabed and sea surface should be divided into five equal sectors or, applying the “condominium principle,” that all littoral states should enjoy common use of Caspian biological and mineral resources. Neither of these proposals, however, was acceptable to other Caspian states. Littoral countries argued that the “condominium principle”

¹⁶ Kalyuzhny V. “Medlit's opredeleniem Kaspiya opasno” (It's dangerous to delay resolution of the Caspian status) “Nezavisimaya gazeta.” Oct. 2, 2001.

¹⁷ Silayev N. “Rossiya kardinal'no pomenyala pozitsiyu v otnoshenii razdela Kaspiyskogo morya” (“Russia Changed Radically its Position on the Division of the Caspian Sea). *Expert*. Moscow. Aug. 21. 2000.

¹⁸ Thus the 1998 Russia-Kazakhstan Agreement served a positive role in resolving a dispute between Moscow and Astana regarding new oil deposits discovered in the northern part of the Caspian Sea. In May 2002 the conflicting parties reached a settlement that allowed them to jointly explore these deposits.

was irrevocably outdated. The other suggestion—dividing the Caspian Sea into five equal sectors—was even less acceptable. Both Iranian schemes would have resulted in an increase in the share of Iranian control of the sea shelf from 13 to 14 percent now, which is proportionate to the length of its coastline, to 20 percent. All other Caspian littoral states voiced strong opposition to this proposal. Moreover, they warned Iran that they considered this nothing less than a barely concealed attempt to revise the common territorial legacy inherited from the Soviet Union.

Joining other post-Soviet Caspian states in rejecting the Iranian proposals, Turkmenistan was highly reluctant to support and conclude any agreement similar to those signed by Russia with Kazakhstan and Azerbaijan. The reason behind its uncompromising stand was rooted in the pending territorial dispute with Azerbaijan over the oil-rich Kyapaz and Chirag offshore fields.

To resolve the deadlock on establishing a mutually acceptable Caspian Sea legal regime, the littoral states have held regular consultations at the level of deputy foreign ministers since 1996. In April 2002, they held the first high-level Caspian summit meeting in Ashkhabad, but failed to reach an agreement. The repeated failures of such talks have created some distrust within the region, in particular over sovereignty of the southern part of the Caspian Sea, where mounting territorial claims and counterclaims between Azerbaijan, Turkmenistan, and Iran have become increasingly difficult to reconcile.

The tense atmosphere is impeding normal investment and production activities in the disputed areas. It also hinders attempts to implement a coordinated environmental policy in the Caspian Sea. In fact, several crisis situations have almost ended in open conflict. In July 2001, for instance, Iranian armed forces intruded into an economic zone claimed (unilaterally) by Azerbaijan. That incident brought the two Caspian neighbors to the brink of an armed clash, which, fortunately, was avoided at the last moment through diplomacy. Another crisis developed in March 2002, when an Iranian patrol boat intruded into what Azerbaijan claimed to be its territorial waters.¹⁹ Another clash among the Caspian states over territorial rights—although this time verbal—occurred even during the first Caspian summit

¹⁹ “Kommersant.” Moscow, March 12, 2002.

(April 2002) when its host, President Saparmurat Niazov of Turkmenistan, threatened to use military force in the territorial dispute with Azerbaijan.²⁰

Given that such conflicts are provoking militarization in the region, the dispute over the legal status of the Caspian Sea presents a serious threat to regional peace and stability. Responding to anticipated security threats to their oil and gas interests in the Caspian Sea, the littoral countries have started modernizing their armed forces. These efforts include creating rapid-deployment units and building up naval capabilities. In turn, this militarization is creating a long-sought pretext for outside powers to assume a more-active role in regional security affairs. Since the mid-1990s, the United States and its NATO allies (notably Turkey) have assisted the post-Soviet Caspian states in training their armed forces and in carrying out their arms-modernization programs. As part of these programs, Turkey supplied the Azerbaijan navy with a patrol boat in 2000. U.S./NATO military assistance continues to play a critical role in building up the naval strength of Azerbaijan, already reported to possess the second-largest naval force in the Caspian Sea, after Russia. Another Caspian littoral state, Kazakhstan, was reported to have received, as recently as 2003, up to \$35 million from the NATO countries for creating its naval infrastructure in the Caspian Sea.²¹ The United States promised Kazakhstan the delivery of several armored personnel carriers, four Hughes helicopters, and a C-130 Hercules transport aircraft in 2004.²²

There is little doubt but that outside involvement into regional security affairs is likely to increase, as long as the legal regime of the Caspian Sea remains unresolved and intraregional tensions among the littoral states continue to escalate.²³ Moreover, this involvement may escalate beyond military assistance to establishing a direct military presence by third countries in the Caspian littoral states.

Russia will try to do its utmost to prevent this worst-case scenario from developing. With this purpose in mind, Russia is already trying to facilitate negotiations on the Caspian legal

²⁰ Panfilova V. and Khanbabayan A. "Dolgiye razgovory u morya" ("Long Talks at the Seacoast"). *Nezavisimaya gazeta*. Aug. 1, 2002.

²¹ Belov P. "Astana tam pravit bal" (Astana orders music there) "Kommersant." Jan. 9, 2004

²² Mukhin V. "Voennyye vyzovy Kaspiyskogo regiona." (Military challenges in the Caspian region) "Nezavisimaya gazeta" Jan.16, 2004.

²³ Thus responding to Azerbaijan's naval build up Iran is reported to plan redeployment part of its naval forces from the Persian Gulf to the Caspian Sea. (Mukhin V. "Voennyye vyzovy Kaspiyskogo regiona" "Nezavisimaya gazeta" Jan.16, 2004).

regime and to drive participants to an early conclusion of formal multilateral agreements in the form of a joint convention on the legal status of the Caspian. Russia believes this convention will introduce mutually accepted legal norms and regulations between the littoral states and reduce the possibility of new conflicts among them to a minimum. This convention will meet the vital interests of all Caspian states—in particular, those of Azerbaijan, Iran, and Turkmenistan, whose energy development plans are seriously affected by unresolved issues of property rights over disputed oil and gas fields.²⁴

In addition, the convention will set clear legal norms in relations between the Caspian littoral states and third countries. On the one hand, it will help create and maintain a favorable investment climate in the region, protecting interests of international investors, including those from the United States. On the other, it will protect exclusive rights of the Caspian states themselves over regional natural resources.

This last provision has already received full backing from members of a special working group formed by the Caspian littoral states at the level of deputy foreign ministers. Although major differences remained among members of the working group on many other issues, they reached complete consensus on the text of the first clause of the convention, which stated that “only the Caspian littoral states possess sovereign rights on the use of the Caspian Sea and its resources.”²⁵

Russia has also proposed to supplement this clause (which basically addresses economic rights of the Caspian states) with another one that declares foreign military presence on sovereign territories to be totally unacceptable, but this proposal still awaits approval by other Caspian littoral states.

Another important initiative related to the Caspian legal regime was launched by Russia during the first Caspian summit meeting in Ashkhabad. Trying to bridge the existing differences among the Caspian states on zones of their exclusive rights, Russia proposed to

²⁴ There appeared initial signs that Iran being afraid of international isolation at the time of growing tensions with the USA softened its position on the Caspian legal status. Mehdi Safari, a high level official of the Iranian Ministry of Foreign Affairs, while on a visit to Moscow, indicated that Iran's stand on this issue “becomes closer to that of Moscow.” (http://di.julia.net/press/nez_gaz/2003/07/240703-5_Kaspiy.htm).

²⁵ “10-e zasedaniye Spetsial'noy rabochey gruppy po razrabotke Konventsii o pravovom statuse Kaspiyskogo morya” (The 10th Special Working Group meeting on the development of Convention on the legal status of the Caspian Sea”) “Diplomateskiy vestnik” 2003, No. 8, p. 46.

establish 15-mile-wide zones of national control off their coasts. Within these zones, each Caspian littoral state would exercise its border, customs, and other forms of control and have exclusive fishing rights. If accepted, a 15-mile-wide zone would replace the 10-mile-wide national fishing zones established by the 1921 and 1940 Soviet–Iranian Treaties. Speaking on this proposal, Victor Kalyuzhny, Deputy Minister of Foreign Affairs and Special Representative of the Russian President in the Caspian region, stated that in Russia's opinion, establishment of 15-mile-wide zones of national control would help resolve conflicting claims to fishing rights among the Caspian states and would streamline and coordinate their policies aimed at preserving the environment and fighting poachers of sturgeon and caviar. Russia insisted, however, that establishing such zones should not violate the principle of common waters applied beyond them.²⁶

Russia's policy on transportation of Caspian energy resources

While the new Caspian legal regime remains an internal regional diplomatic matter for the Caspian littoral countries, the problem of transporting Caspian energy resources has been an international one. Export of energy resources remains one of the central points in the economic strategies of the Caspian countries. Starting immediately after the collapse of the Soviet Union, these countries began to explore actively options for cooperation with the outside world on energy transportation. Establishment of multi-directional energy routes was the clearly preferred objective. These policies received strong backing from major international energy companies. Moreover, the U.S. government declared a multi-route energy transport strategy to be an integral part of its policy in the Caspian region. Also, from the U.S. perspective, U.S. interests in a diversified oil supply would best be served if multiple transit routes avoided Russia and Iran.²⁷

Because the search for multi-directional energy routes amounted to reducing dependence of the post-Soviet Caspian states on oil and gas pipelines running across the Russian territory, Moscow was not happy with such developments, even though it refrained from openly

²⁶ “Briefing zamestitelya ministra inostrannykh del Rossii V. Kalyuzhnogo dlya rossiyskih i inostrannykh SMI” (Briefing by Victor Kalyuzhny, Deputy Minister of Foreign Affairs of Russia, for Russian and foreign media) May 19, 2003. “Diplomaticheskii vestnik” 2003, No.6, p.118.

²⁷ On this subject see, for instance, Barnes J. “U.S. national interests: getting beyond the hype” in “Energy in the Caspian Region: Present and Future” Ed. by Yelena Kalyuzhnova, Amy Myers Jaffe, Dov Lynch and Robin C. Sickles. N.Y. Palgrave Publishers Ltd. 2002.

opposing the proposed routes. Nevertheless, for some time, there was no need for active opposition. Moscow even graciously accepted commissioning of small pipelines such as the Korpedze (Turkmenistan)–Kurt Kui (Iran) natural gas pipeline (which became operational in 1997) and the Baku (Azerbaijan)–Supsa (Georgia) oil pipeline (which became operational in 1999), as they could not challenge in any substantial way the preeminence of Russian control over transportation of Caspian oil and gas to the world market.

Addressing the first Caspian summit meeting, President Vladimir Putin tried to dispel fears and suspicions among other leaders of the Caspian littoral states by saying that “a multi-route energy-export concept does not cause any allergy in Russia.” But he added that “the choice of routes for new pipelines should not be based on political considerations but made after taking into account economic as well as environmental factors.”²⁸

Russia strongly challenged major projects that would bypass its own lines when the U.S. and Turkey began to lobby for trans-Caspian underwater oil and gas pipelines. Russia succeeded in postponing construction of these bypasses by arguing that seismological and water pollution dangers might harm the Caspian's unique biological resources.

Russia maintained, in this regard, that, “construction of trans-Caspian underwater pipelines in undesirable in principle, as their operation, irrespective of their routes, presents high environmental hazards to the whole Caspian water body and to all the littoral states without any exception.”²⁹ The need for ecological protection of the Caspian Sea was shared by other Caspian states too. As a result, on November 4, 2003, official representatives of four Caspian littoral states signed, in Tehran, the “Framework Convention on Protection of the Caspian Sea Environment.”³⁰ Four days later, the fifth Caspian country, Turkmenistan, joined them in signing this Convention, thus making it the first intergovernmental document approved by all the Caspian littoral states.

Moscow was less successful, however, in opposing another Western-backed energy transport project—an oil pipeline across the Georgian territory, from Azerbaijan to Turkey. This 1760-

²⁸ Press Department of the Russian Ministry of Foreign Affairs. Information Bulletin. April 24, 2002.

²⁹ Press Department of the Russian Ministry of Foreign Affairs. Information Bulletin. Dec. 4, 2003.

³⁰ “On Signing of the Framework Convention on Protection of the Caspian Sea Environment.” Press Department of the Russian Ministry of Foreign Affairs. Information Bulletin. Nov. 11, 2003.

kilometer pipeline with an initial estimated cost of \$2.9 billion (other estimates put its actual cost much higher, up to \$4.3 billion)³¹ was originally aimed to help Azerbaijan transport oil from the Azeri-Chirag-Guneshli oil field near Baku to the Ceyhan oil terminal on the Mediterranean coast of Turkey. The so-called Baku-Ceyhan oil pipeline, with a rated capacity of approximately 1 million barrels a day (b/d), will come on line in the second half of 2005, carrying 500,000 b/d of Azeri crude. The line is projected to some day carry oil from other Caspian states, such as Kazakhstan, but no commitments of line fill have been forthcoming so far.

In August 2002, an international company for construction of the Baku-Ceyhan pipeline was set up in London. Among its shareholders were the state oil company of Azerbaijan (SOCAR) and such well-known international oil companies as BP, Statoil, Unocal, TPAO, Itochu, and Delta Hess (a joint venture of Amerada Hess and Delta Oil). At the end of September 2002, presidents of Azerbaijan, Turkey, and Georgia, while meeting at the Azeri's Sanchagal oil terminal on the Caspian Sea, formally started construction of the Baku-Ceyhan pipeline. The World Bank and the European Bank of Reconstruction and Development each allotted \$250 million to the project. The rest has been raised from private sources.

These steps notwithstanding, it became clear, soon enough, that they were insufficient to ensure an efficient operation of the pipeline. Among the fundamental challenges to the Baku-Ceyhan project, the most important appeared to be an acute shortage of oil available for transportation. Indeed, while, as mentioned above, the annual rated capacity of the pipeline was to be approximately 1 million barrels a day, the total amount of oil produced in Azerbaijan in 2002 was less than 320,000 barrels a day.³² True, Azerbaijan is expected to increase its oil production up to 400,000 to 500,000 barrels a day in the next few years, but that will be still well below the minimum required amount for a commercially normal operation of the pipeline. Besides, Azerbaijan is expected to use part of this volume for domestic needs, as well as for meeting its earlier commitments of exporting oil via the northern route to the Russian terminal in Novorossiysk, and via the western route to Supsa in Georgia. The problem is further complicated by the yet-unresolved dispute between

³¹ Orlov D. "Bol'shaya truba dlya dyadi Sema" (Big pipe for Uncle Sam). "Nezavisimaya gazeta." Dec. 26, 2003.

³² Alexandrov Y. and Orlov D. "Baku-Tbilisi-Ceyhan: gde neft'?" ("Baku-Tbilisi-Ceyhan: Where is Oil?") *Nezavisimaya gazeta*. Nov 4, 2002; "Caspian.ru." December 23, 2002.

Azerbaijan and Turkmenistan over the property rights on the main Chirag oilfield, which accounts for almost half of Azerbaijan's total oil production. All this means that, unless Kazakhstan becomes firmly committed to use the Baku-Ceyhan pipeline on a sufficiently large scale,³³ the cost of maintaining this pipeline will be prohibitive. It came as no surprise therefore, that private Western oil companies had been slow to commit to make the large, long-term investments in the construction of the pipeline.

For its part, Russia preferred to avoid making any formal statements on the future of the Baku-Ceyhan pipeline, even though it never concealed its highly critical attitude toward this project.³⁴ Instead of being drawn into polemics on comparative merits and demerits of this project, Moscow concentrated on the conclusion of long-term agreements on transportation of Kazakh, Turkmen, and Azeri oil across the Russian territory on sufficiently attractive commercial terms, as well as quietly advising Russian private oil companies to stay away from participation in the Baku-Ceyhan project.³⁵

Concrete steps were taken in commissioning of an alternative, 1500-kilometer pipeline, with an annual capacity of up to 560,000 barrels a day of oil linking the Tengiz deposit in Kazakhstan with the oil terminal in Novorossiysk on the Russian Black Sea coast. Also in 2002, Russia concluded a long-term agreement with Kazakhstan on the annual transit of 300,000 barrels a day of oil. In December 2003, a bilateral protocol was signed supplementing this agreement and increasing the amount of oil for transit up to 500,000 barrels a day.³⁶ The implementation of these agreements is likely to channel all of the Kazakh oil surplus currently available for export and direct it across the Russian territory.

This situation, however, may not be sustainable in the future when Kazakhstan intends to step up considerably its oil production – from 950,000 barrels a day in 2002 to 3.0 million barrels a day to 3.5 million barrels a day by 2015.³⁷ One of the possible new export routes could run

³³ According to existing estimates, the annual amount of Kazakh oil needed for transportation through the Baku-Ceyhan pipeline to make it commercially viable should be around 20 million tons. *Panorama*. Moscow. June 6, 2003.

³⁴ See, for instance, interview with Victor Kalyuzhny, Special Representative of the Russian President in the Caspian Region. <http://di.julia.net/press/vremya/2002/09/42326.htm>. Sept. 27, 2002.

³⁵ As a possible consequence to that, in early 2003 one of the largest Russian private oil companies, Lukoil, announced that it would no longer plan to take part in the Baku-Ceyhan project. *Nezavisimaya gazeta*. April 2, 2003.

³⁶ <http://di.julia.net/press/caspian/2004/01/16574.htm>. January 12, 2004.

³⁷ "Caspian.ru." Oct. 8, 2003. *Panorama*. July 6, 2003.

to China, where Kazakhstan plans to export up to 1 million barrels a day via an oil pipeline to be constructed by 2006.³⁸ The other one could be from the Kazkh oil terminal in Aktau to Baku across the Caspian Sea, either by oil tankers or via an underwater pipeline (to be constructed after all with a foreign assistance against Russia's objections). If Kazakhstan decides to use this route, the first oil shipments to the Baku-Ceyhan pipeline may begin as early as 2008.³⁹

The future of the Baku-Ceyhan project may also be heavily influenced by the situation developing in the Turkish straits of Bosphorus and Dardanelles, through which a bulk of oil arriving from the Caspian Sea to Black Sea oil terminals is then transported by tankers. Even though a free passage through the Straits is formally guaranteed by the 1936 Montreux Convention, in actual practice, Turkey tried recently to limit the traffic of tankers there on ecological grounds. Turkey's arguments, however, were only partly true, as they were used mostly to persuade the outside world of the necessity of diverting the bulk of the Caspian oil flow to the Baku-Ceyhan pipeline now under construction.⁴⁰ Whether this actually is going to happen remains to be seen. Turkey's strategy is evidence that from its very start, the Baku-Ceyhan project was initiated as a rival scheme to the Russian-controlled oil network. There is no doubt, therefore, that contradictions around the Baku-Ceyhan project will continue to mount between Russia and Western sponsors of this project.

In addition to its serious efforts to influence the policy of Caspian oil transportation, Russia takes a no-less active attitude to transportation of natural gas from the region to international consumers. In January 2002, during the meeting in Moscow with President of Turkmenistan, Saparmurat Niazov, President Vladimir Putin floated an idea of forming a "gas alliance" with post-Soviet gas producing countries as its participants.⁴¹ The next step in this direction was made in March 2002, when again on Russia's initiative, the Joint Declaration was signed in Alma-Aty (Kazakhstan) by Presidents of Russia, Turkmenistan, Kazakhstan and Uzbekistan. According to the main provisions of this Declaration, its co-signatories pledged to develop cooperation among their countries on bilateral, as well as on multilateral levels, with a view

³⁸ http://di.julia.net/press/tass_mir/2004/01/2004.01.06.00-10.htm. January 9, 2004.

³⁹ *Panorama*. June 6, 2003.

⁴⁰ Aliev Y. and Gordienko A. "Bosforskiye kozyri" ("Bosphorus Trumps"). *Nezavisimaya gazeta*. January 16, 2004.

⁴¹ Telegina Ye. "Mirovoy energeticheskiy rynek i geopoliticheskiye interesy Rossii" ("World Energy Market and Russia's Geopolitical Interests"). *Mirovaya ekonomika i mezhdunarodnye otnosheniya*. 2003. No.5. p.62.

to develop their natural gas resources, promote construction of gas pipelines and to coordinate their policies on export and import of gas.

Russia's interests in promoting the formation of this "gas alliance" were largely (though not exclusively) motivated by the need to preserve Russia's position in the European market. Russia fears that its position could be seriously threatened by competing gas from Algeria and/or from Norway, especially since the domestic production of gas at main deposits in western Siberia recently are declining. To compensate for the fall in production, Russia needs to explore new gas deposits, but that, in turn, takes time and substantial new investments. In the meantime, incremental volumes of gas could be re-exported from Central Asia to Europe, across the Russian territory, holding Russia's market share until it can develop new Russian sourced supply. Such a scheme could be in the interests of the central Asian gas producing countries too, but only on the condition that they would be assured by Russia of sufficiently attractive prices for their gas sales. This position was clearly formulated by President Saparmurat Niazov during the first Caspian summit.⁴²

Taking this into account, Russia conducted intensive negotiations with its potential partners in the "gas alliance" from Central Asia and by the beginning of 2003, reached a number of agreements on gas prices, volumes of gas sales to Russia and terms of Russia's assistance to Central Asian gas exploration and production, as well as in modernization of gas pipelines. Special agreements were reached on new terms of Kazakh, Uzbek and Turkmen gas transit across Russia to consumers in third countries. For all practical purposes, it meant that the "gas alliance," consisting of Russian and post-Soviet central Asian producers, consumers and transporters of gas, began functioning.⁴³

Turkmenistan, the richest Caspian country in natural gas reserves, has repeatedly stated that it favors multi-routed export of its resources. In practice, however, its main gas export routes continue to run across Russian territory. The larger of the two pipelines (former Central Asia–Center 1 pipeline) runs from Deryalyk in Turkmen territory to Eastern Europe. The second line (former Central Asia–Center 3 pipeline) goes to Europe from Bekdash (Turkmenistan). Both pipelines were constructed in the 1960–1970s, when Turkmenistan was a constituent Soviet republic, and both are in serious need of modernization. Responding to

⁴² <http://di.julia.net/press/caspian/2002/07/11268.htm>. July 23.2002.

⁴³ Yevplanov A., Chichkin A. "Gazovyi kulak" (Gas fist) "Rosiyskaya gazeta." Moscow. April 22, 2003.

these needs, Moscow offered its assistance to Ashkhabad and in April 2003 signed a 25-year cooperation agreement under which Russia will not only help modernize the existing pipelines, but will also assist in exploration for new gas deposits. After 2008, Russia also intends to buy 70 to 80 billion cubic meters of gas annually from Turkmenistan (with a possible increase up to 100 billion cubic meters in 2010), thus replacing Ukraine as Turkmenistan's largest export market.⁴⁴

The signing of this agreement did not mean, of course, that Turkmenistan had completely abandoned its plans to explore alternative gas routes to link it with other potential markets—Iran, Pakistan, China, Japan, or South Korea. In May 2002, a preliminary agreement was signed in Islamabad by leaders of Turkmenistan, Pakistan, and Afghanistan on construction of a 1460-kilometer international natural gas pipeline between Dovletabad (Turkmenistan) and Multan (Pakistan) via the Afghan territory. But this project, the initial cost of which was estimated at \$2 billion, ran into serious difficulties from the start and was postponed indefinitely, due to the political situation in Afghanistan, which remains highly unstable. Political considerations—vis-à-vis the relationship with the United States—may also prevent Turkmenistan from seriously expanding gas exports to Iran.

Russia also pays close attention to Uzbekistan's plans to increase gas production and exports. Tashkent began to develop its gas resources actively in 2000, after world prices on its other main export commodity, cotton, started to decline. Tashkent was also encouraged to shift its export emphasis in favor of natural gas after a new discovery made Uzbekistan the second-richest country in gas resources in Central Asia, after Turkmenistan.

To make its export strategy succeed, Uzbekistan not only stepped up its domestic output of natural gas, which reached 60 billion cubic meters/annum, but also announced plans to radically upgrade its gas transportation system. Traditionally, some of Uzbekistan's gas is exported to neighboring Kazakhstan and Kyrgyzstan, but most of the volume is exported through the former Central Asia–Center pipeline, constructed during the Soviet era. The cost of modernizing this export route is estimated at about \$2 billion and will involve expansion of new pipeline networks, reconstruction of existing compressor plants, and construction of a new compressor plant at the Gazli underground gas storage facility. The main Russian state

⁴⁴ Kozhushko M. "Gazovyi brachnyi soyuz" (Gas matrimonial alliance) "Nezavisimaya gazeta" April 11, 2003.

gas company, Gazprom, has announced plans to participate in this modernization program and to acquire up to a 44-percent interest in the Uzbek gas transportation system.⁴⁵ Another Russian company, privately owned Lukoil Overseas, decided to join Uzbekneftegaz Company in a consortium to invest up to \$1 billion in production from new fields in Khauzak and Shady.⁴⁶ With the realization of these projects, cooperation in gas production and export may become the principal area of Russian-Uzbek business cooperation for the foreseeable future.

Equally encouraging is the prospect of Russia's cooperation on natural gas with another Central Asian state, Kazakhstan. In 2002 and 2003, annual sales of Kazakh gas to Russia totaled more than 6 billion cubic meters and are expected to grow. A gas trade deal was reached during an official visit by President Putin to Kazakhstan in January 2004.⁴⁷ To facilitate their bilateral cooperation, Russia and Kazakhstan also formed a joint company, Kazrosgaz, to produce and export Kazakh natural gas to the world, mainly European, market (0.8-1.0 billion cubic meters annually) and to transport gas from Turkmenistan and Uzbekistan across the territory of Kazakhstan. In addition, under the intergovernmental agreement signed in 2001, gas produced from the Karachaganak gas deposit will be processed at the Orenburg gas plant in Russia. Russian-Kazakh relations are not without problems, however, since—on suggestion of Western contractors operating at the Karachaganak gas deposit—Kazakhstan also intends to construct a gas processing plant there. If the local plant is built, the Orenburg plant will experience severe shortages of gas for processing.⁴⁸

These problems notwithstanding, Russia's cooperation with Central Asian states on natural gas is progressing, and formation of the "gas alliance" may help Russia considerably to strengthen its position in the Central Asian economy, where lately it has experienced growing competition from other countries.

⁴⁵ "Vremya novostey." Moscow. September 25, 2003.

⁴⁶ "Kommersant." September 23, 2003.

⁴⁷ <http://di.julia.net/press/caspian/2004/01/16574.htm>.

⁴⁸ Belov P. "Astana tam pravit bal." *Kommersant*. Jan. 9, 2004.

Summary

As this analysis of the latest developments in Russia's Caspian policy indicates, Moscow has been struggling to stay its strategic retreat from the Caspian region, which began in early 1990s, and to preserve its still-considerable role in regional political and economic affairs. For that purpose, a wide range of political, legal, economic, and security measures have been undertaken during the last few years.

Among the most notable policy steps taken by Moscow is its efforts to streamline the Caspian legal regime and to prevent existing disputes among the littoral states over possession of Caspian natural resources from escalating into open conflicts.

Russia has also tried to retain a maximum degree of control over transportation of Caspian energy resources to the world market by modernizing existing pipelines, laying new oil and gas pipelines across its territory, and concluding long-term trade agreements with a number of Caspian states on procurement of large volumes of their energy resources for export. Further, energetic steps have been taken to create a "gas alliance" with a number of Central Asian states.

In security affairs, Russia has attempted to present itself as a principal guarantor of regional stability by developing bilateral and multilateral security cooperation with the Caspian states and by building its own military capability in the region.

The effectiveness of these measures is rather mixed, however, not least because—in trying to achieve its objectives—Moscow has been increasingly confronted by the United States, its main competitor for leadership in Caspian regional affairs.

Before September 11, 2001, U.S.–Russian competition in the Caspian region concentrated largely (although never exclusively) on economic issues—the most important being exploration of Caspian energy resources and their transportation to the world market. As the largest consumer of energy in the world, the United States has a special interest in diversifying sources of energy production and in guaranteeing access to them. An integral part of that policy is U.S. support for the principle of multiple export routes for Caspian oil- and gas-export pipelines, with special support for the Baku–Ceyhan project. Even though this

U.S. policy conflicted with Russia's own objectives, the divergence of interests between the U.S. and Russia for many years resulted only in a low-key competition.

The situation started to change rapidly and radically with the escalation of the U.S. role in Caspian regional security affairs after September 11 and the military action in Afghanistan. U.S. policy in the Caspian region was no longer limited to pursuing economic goals as its main objective, but now focused on changing the whole strategic situation in the region commensurate with the U.S. global interests, both political and economic. Establishing, then expanding, its military presence in Central Asia and building patron-client relations with post-Shevardnadze Georgia are, from the Russian perspective, the most notable landmarks of this new U.S. policy.

This does not mean that U.S. economic interests in the Caspian region are now diminishing. Not only do they remain intact, but they also continue to grow stronger. Taken by itself, this would not cause much concern in Russia. What worries Moscow is the possibility that U.S. economic strategy in the Caspian region will become closely linked to a growing U.S. involvement in regional political and security affairs. This explosive combination may, as a result, have a strong negative impact on Russia's strategic interests in the Caspian region, located on its national borders. As these developments will most likely lead to a progressive restriction of Russia's influence in the region, a progressive straining of the U.S.–Russian relations in the region appears to be imminent. Taking into account the critical importance of the Caspian region for its economy and military security, Russia may have no other alternative but to start defending its national interests in the region in a more resolute way, one that will put Russia and the United States on a collision course. Needless to say, this conflict will have a negative impact on the overall state of U.S.–Russian relations.

To avoid this worst-case scenario, Moscow and Washington need to hold intensive bilateral consultations on a wide range of Caspian political, economic, and security issues at an early date and try to work out clear rules and set red lines to govern their future relationship in the Caspian region.