

A GREAT GAME NO MORE: OIL, GAS AND STABILITY IN THE CASPIAN SEA REGION

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Annex:

REGION OF THE FUTURE: THE CASPIAN SEA German Interests and European Politics in the Trans- Caucasian and Central Asian Republics

**Policy Paper of the SPD Parliamentary Group in the German
Bundestag**

**Presented by Gernot Erler
in cooperation with
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REGION OF THE FUTURE: THE CASPIAN SEA

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Dieter Dettke
Washington, DC
December 1999

Introduction

Dieter Dettke

Energy resources in the Caspian Sea area are bound to attract the attention of many powers and players. The U.S., Europe, Russia, Turkey, Iran as well as China, India, Pakistan and Japan will have an interest in economic and political developments in the area and the focus of their attention will be on the future market dynamics of energy supplies. The region has to offer a substantial share of world energy resources, estimated at up to almost 10% of current world oil reserves or 3 to 4% of total Western energy supplies. Additional new oil reserves are being probed in Western Kazakhstan. However, the interplay of the interests of Caspian Sea powers and external pressures is extremely delicate. Not only does the old – and new – rivalry of the Cold War powers persist, the European Union is also attempting to establish itself as a new entity in the region with a new quality of relationships based on partnership as well as more traditional economic, political and cultural ties. Above all, the war in Chechnya threatens to destabilize the entire region.

At the OSCE summit meeting in Istanbul in November 1999 an agreement was reached between Turkey and Caspian Sea powers for the transportation of oil from Baku, Azerbaijan to Ceyhan, Turkey. In addition to that, a pipeline will be built to transport gas from Turkmenistan to Turkey through the Caspian Sea. In the past, Turkey received most of its gas from Russia. The Istanbul Declaration, signed by the presidents of Turkey, Azerbaijan and Georgia as well as the presidents of Turkmenistan and Kazakhstan has the strong backing of the United States in spite of continuing doubts over the commercial viability of the proposed oil pipeline route. The costs of the Baku-Ceyhan pipeline are estimated at 2.7 billion dollars at the low end and as much as 3.7 billion dollars at the high end. To expand the capacity of existing pipelines such as the one from Baku to the Georgian port of Supsa would be much cheaper. Russia – for obvious reasons – would prefer to expand the old Soviet pipeline from Baku to the port of Novorossiysk. However, these three oil routes do not have to be mutually exclusive. Multiple pipelines could be the best solution and might indeed be the final outcome. Even less costly and potentially the most economical way of getting Caspian oil to

European markets would be so-called “swaps” with Iran. However, any inclusion of Iran in major Western energy access routes seems to be out of the question in the near future. Until today, all efforts to improve relations between Iran and the West have failed. As a result, Iran for now will not be part of the emerging economic and security system in the Caspian Sea area.

Furthermore, a serious concern for the West must be Russia’s role in future stability efforts. The present economic and political dynamics in the Caucasus and the Caspian Sea regions mostly contravene Russia’s interests and expectations. Its role in the past as the only major player in the region is in decline, also a result of the ethnic conflict in Chechnya and the strong independence movement there. Political instability – internal as well as external – will characterize the relationship between Russia and Chechnya for years to come, and for the West to rely on energy supplies through Chechnya would be extremely risky. Russia is also losing power as a force of regional stability. The best economic prospects for the Caspian region are with the West, with Western oil companies as well as Western markets. This powerful trend, however, undermines the ties of the Caspian states with Russia, reinforcing their independence and forging new relationships with the United States and Europe.

These new political and economic dynamics changed the “Great Game” of yesterday in a fundamental way. The key issue for the region is stability, but there is still a long way to go before a more peaceful environment in the region can emerge and the Caspian powers will be able to develop their full economic potential.

This publication is based on presentations at an international conference of the Washington office of the Friedrich Ebert Foundation held in Washington in the spring of 1998. Papers have been revised and edited for and oral presentations adjusted for publication in the form of this conference report.

Washington, DC
December 1999

Oil and Gas in the Caspian Sea Region

Gernot Erler

Seven years ago the political map of Europe changed dramatically. The Soviet Union and the Warsaw Pact were dissolved. Up until 1991, Eastern and Southeastern Europe had consisted of the relatively manageable number of eight separate countries. Alongside the enormous Soviet Union, which acted as a single political unit, despite the existence of its fifteen republics, there were Poland, Czechoslovakia, Hungary, Bulgaria, Romania, Yugoslavia and Albania. After the collapse of communism, however, a system was created made up of twenty-seven countries, fifteen of them within the territory of the former Soviet Union. This unusually large number was confusing at first. For the sake of clarity, an attempt was made to create country categories, something that might perhaps be described as a “federalization” of political geography. This political geography divided the Newly Independent States into two groups:

- a) the Baltic States (Estonia, Latvia, Lithuania) and
- b) the twelve Newly Independent States (NIS).

Various divisions can be made within the group of Newly Independent States. Seen from the perspective of Moscow, three concentric rings have been formed:

1. The union between the Russian Federation and Belarus;
2. The community constituted by the four countries of Russia, Belarus, Ukraine, and Kazakhstan;
3. The NIS with all twelve members.

From its own perspective, the West divides these countries up differently. It distinguishes the following units:

1. The Russian Federation with Belarus as its (current) appendix;
2. The Ukraine as an important independent country, which is still strongly dependent on Moscow in economic terms but moving in the direction of greater independence (the small country of Moldova is seen as a minor partner for the Ukraine);
3. The three Transcaucasian republics of Georgia, Armenia and Azerbaijan;
4. The five Central Asian republics of Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and Kyrgyzstan.

The dividing line between the three Transcaucasian and five Central Asian countries does not make sense. As a country bordering on the Caspian Sea, Azerbaijan, for instance, in many ways has more in common with Kazakhstan and Turkmenistan than it does with Armenia and Georgia. A binding definition of the Caspian Sea Region does not exist, given that Georgia and Armenia are sometimes counted among the countries in this group alongside the five countries that actually border on the Caspian Sea (Russia, Kazakhstan, Azerbaijan, Turkmenistan and Iran). This is due to the fact that the oil pipeline problem plays such an important role. The term “Former Soviet South” is broader geographically, including all the Transcaucasian and Central Asian republics in one group, but not including either Russia or Iran.

In recent years there has been a political rediscovery of this region, regardless of whether the reference is to the “Caspian Sea Region” or to the “Former Soviet South”. Needless to say, information about newly discovered, as well as potential oil and gas deposits has contributed greatly toward the growing interest in this region seen throughout the world. We can distinguish economic, political and strategic interests in this context. We can also distinguish various players. Both governments as well as private corporations (especially transnational oil and gas companies) are carrying out parallel activities in the region.

Comparing these activities in categories based on place of origin, we discover that there are differences in the priorities set. There is one phenomenon that is particularly striking. Surprisingly, after the end of the Cold War we are experiencing a “renaissance of geopolitical thinking”. It would be very interesting to investigate the question of why the end of East-West confrontation has once again given geopolitical issues a prominent place on political agendas. This is not the appropriate forum to address this interesting phenomenon. But, it can be said for certain that with the exception of the Gulf Region there is no other region in the world that is the source of as much intensive discussion of conflicting geopolitical and geostrategic interests as the “Caspian Sea Region”.

My purpose here is to elaborate on German and European interests in the Caspian Region. For Germany, at least, it can be said that its interests are not geopolitical in

nature. Germany's focus is on classical economic interests. This situation specific to Germany derives from the fact that it does not have any important and internationally active oil companies. There are no German firms among the world's 100 largest oil companies. Germany is involved in only five cases of the direct oil business in the Caspian Region. The largest such business interest is a 10% share owned by Germany's Deminix in Lenkoran-Deniz, the fifth Azeri consortium. The situation is very different for other European countries. Britain, France, Italy and the Netherlands have transnational oil companies with strong activities in the Caspian Region.

However, Germany's modest share of the direct oil and gas business does not rule out other kinds of cooperation. German economic interests are concentrated on projects in the mining sector, the energy sector, telecommunications, air transport, agricultural engineering and the textile industry, though the present volume of these activities must be viewed as extremely modest. There was significant increase in trade with Azerbaijan and Turkmenistan in 1997, but the volume of German trade with the countries of Eastern Europe for the same year amounted to \$94 billion.

With a bit of a time lag, the German government and the German economy have discovered the Former Soviet South as a growth market and they are competing for an appropriate share of these future markets. Last year three different federal ministers (foreign, economic and development) led large delegations to this region to support these objectives. Needless to say, no way has been found thus far to overcome the structural disadvantage that exists as a result of Germany's incapability to conclude supplementary contracts in the context of the direct oil and gas business.

In addition to economic interests, there is for Germany and for all of Europe an interest in stable development in this region, Russia being included in this context. Germany currently satisfies around 30% of its energy needs with Russian supplies. In the case of oil, some 50% of Germany's requirement is covered by North Sea sources, the production levels of which are expected to drop to about half the current level by the year 2010. As such, Berlin is interested in preserving a reliable supply of Russian energy and at the same time will have to be looking for a way to replace the weakening flow of North

Sea oil. Seen from this perspective, a long-term and stability-based solution for the overall complex of resource development in the Caspian Sea Region and the route to be established for the pipelines are matters of interest to Germany. The Berlin government feels that it is appropriate and possible to resolve these problems without excluding Moscow in any way.

From a European perspective, a long-term circumvention of the interests of other “regional players” would have a negative effect on the objective of stable development for the region. Special reference needs to be made here to the involvement of Turkey and Iran. An analysis of global energy requirement forecasts shows that the current requirement in Europe and the United States will increase only slowly up to the year 2015 and will not go beyond an additional 15 million barrels a day. Other forecasts have been made for the energy requirements of the Asia-Pacific countries, where a doubling of the current level of energy consumption by the year 2015 appears probable. It would be logical to want to make the oil resources in the Caspian Region available to cover this demand, and a stringent containment of Iran would make this very difficult and expensive. It is a well-known fact that a change is currently taking place in the United States’ policy on Iran, a change that can only be welcomed from a European standpoint.

For the European countries that receive a large part of their energy supply from the Russian Federation for energy security, this has led to the carrying out of a certain number of measures and activities. Experiences with the Soviet Union as a supplier country were positive. The collapse of the Soviet Union has of course raised numerous questions. Among the key instruments for achieving energy security under the conditions of a changed political geography are the European Energy Charter of 1991 and the Energy Charter Treaty. Viewed from a European perspective, the Energy Charter process can place the entire energy sector, particularly in such sensitive regions as the Caspian Sea, on an international law footing. European interest in a solid legal foundation, including investment protection and arbitration, is congruent with the interests of transnational oil companies. In the European view, the problems of the Caspian Region

can best be solved on the basis of two fundamental principles: regional cooperation and international law.

Conversely, it is true that any political actions on the part of countries in the region or any outside political influence directed against the development of regional cooperation and the implementation of international law are not compatible with European interests. The following phenomena are necessarily viewed as negative in this context:

1. When ethnic conflicts are intentionally perpetuated or fomented for the purpose of maintaining political influence or of controlling key functions, e.g. in Abkhazia, South Ossetia or Nagorno-Karabakh;
2. When, in the matter of planning the pipelines, criteria are brought to bear other than those dictated by economic rationale, and in this context there is a failure to give due consideration to the interests of all the regional powers involved;
3. When global interests of powers that exert outside influence on the situation in the Caspian Region create disturbances for regional cooperation such as containment measures directed against individual regional powers.

Here again it is thought that the development of regional cooperation and the implementation of international law – two desirable trends from a European perspective – will most likely accommodate the interests of the private sector and transnational oil companies. The same is true regarding the following tenets of a policy formulated for the Central Asian/Caspian Sea Region, on which there is a consensus from the European standpoint:

- The transformation of the countries of this region in the direction of democracy, market economy systems, and administrative efficiency is to be supported on the basis of political independence;
- A contribution is to be made toward achieving a lasting solution of the – for the most part – ethnically motivated conflicts or latent conflicts in the region;
- The regional powers are to be integrated to the extent possible into multilateral organizations. It is important in this context that these multilateral institutions renounce methods aimed at the exclusion of any one or more of the countries in question;
- The objectives of energy security, the guaranteed pipeline-based transport of energy resources, the protection of investments, as well as the settlement of disputes can only be achieved by implementing rules of international law and here, in particular, the European Energy Treaty;

- Fair conditions for market access must be created for this growth region which must not be monopolized on the basis of a linkage with investments made on the part of the major oil companies.

What is involved here in the final analysis is the question as to whether or not the West will be able, on the basis of the experience gathered in the course of the past century, to arrive at a more constructive and rational policy concept for this important region which serves as a bridge between Europe and Asia. At the beginning of this century the ideology of the “heartland” and the dominance of strategic power policy thinking proved to be costly and fateful for everyone concerned. A reversion to this kind of thinking must be avoided now, seven years after the end of the East-West conflict. It is only then that it will be possible to use the wealth of the Caspian Region in such a way that the maximum number of people will benefit from it and that it will be possible to avoid new and dangerous conflicts.

Policy Options in the Caspian Sea Region

Friedemann Müller

This presentation is divided into a first part describing briefly the energy resource situation in the Caspian Region as well as the production outlooks and its contribution to world energy demand and supply while the second part offers seven theses dealing with policy options based on the resource situation.

I. Oil and Natural Gas Resources

Different from regions where large quantities of oil and natural gas are produced over decades like the Persian Gulf, Alaska or the North Sea, the Caspian resources are not well explored, although the first oil was found there far more than a hundred years ago. The Soviet Union concentrated its efforts during the 1970s and 1980s on Western Siberia. The effect was a decline in Caspian oil production lasting to the mid 1990s, although during the 1980s some new investments were drawn mainly to the Kazakh share of the Caspian region. Estimates on oil resources show therefore a wide range between proven and possible. The often – preferably by elder statesmen – quoted figure of 200 billion barrels is a product of fantasy not based on careful research. “Possible,” however, is a term without a definite upper limit, so it permits to include some fantasy. It seems, however, to be reasonable to follow the U.S. government study (table 1), which expresses in its wide range of a lower (16 billion barrels) and an upper limit (178 billion barrels) the main stream estimates.

Table 1

	Proven Oil Billion Barrels	Possible Oil	Total	Proven Gas Trillion Cubic Meters	Possible Gas***	Total
Azerbaijan	3.6	27.0	31.0	0.3	1.0	1.3
Kazakhstan	10.0	85.0	95.0	1.5	2.5	4.0
Turkmenistan	1.5	32.0	33.5	4.4	4.5	8.9
Uzbekistan	0.2	1.0	1.0	2.1	1.0	3.1
Russia*	0.2	5.0	5.0	NA	NA	NA
Iran**	0	12.0	12.0	0	0.3	0.3
TOTAL	15.6	163	178	8.3	9.3	17.6

* Only regions in Russia near the Caspian and the Russian "sector" of the Caspian are considered

** Only the regions of Iran near the Caspian and the Iranian "sector" of the Caspian are considered

*** In most new petroleum regions, undiscovered, recoverable gas resources are extremely difficult to estimate, and few sources are available; thus spotty, often single sources are used here

Source: U.S. Department of State, Caspian Region Energy Development Report, April 1997, p. 4.

Many analysts assume that the highest probability of actual *oil resources* lies in the range of 90 billion barrels.¹ It would, if proven, contribute 9% to currently proven world reserves. This puts the region's resources into the same order of magnitude as Iran's (93 billion barrels), Kuwait's (94 bb), and Iraq's (112 bb) proven reserves. Thus, the Caspian region is not comparable with the Persian Gulf (600 bb), it is, however, "the greatest unexplored and undeveloped oil province in the world" as John Browne, BP's chief executive, puts it.²

The natural gas resources of the region were less neglected during the Soviet era. As table 1 shows, the proven and possible reserves are much closer together. 8.3 trillion cubic meters (tr cu m) of proven reserves mean a 5% share in world reserves. It might be twice as much if further exploration turn out to be successful.

¹ See, for instance, Geoffrey Kemp, Robert E. Harkavy, Strategic Geography and the Challenging Middle East. Carnegie Endowment for International Peace in Cooperation with Brookings Institution Press, Washington, DC, 1997, p. 131.

² Turkistan News, February 26, 1998.

Oil production of the three Newly Independent States (3NIS) Azerbaijan, Kazakhstan and Turkmenistan together decreased between 1989 and 1996 from 0.9 to 0.8 million barrel per day (mbd), which is now 1.2% of world production. Natural gas production of the 3NIS decreased in the same period from 107 billion cu m to 47 billion cu m and further to approximately 30 billion cu m in 1997. The 1996 figure means 2% of world production. The oil production in 1996 showed, however, little increase over the previous year for the first time in more than ten years and further growth is almost inevitable. The estimates on oil production of the 3NIS for the year 2010 vary between 2.1 and 4 mbd (3% to 6% of today's world production, it might be 2-2.5% to 4-5% of world production at the time).

Future natural gas production of the region cannot equally be estimated. It depends much less on production capacities and far more on the then existing transportation facilities to the market, where the demand is located. The natural gas market is much less flexible than the oil market, due to the limited numbers of states that demand natural gas and to the fact that natural gas transportation by liquefied natural gas (LNG) is complicated, and therefore, extensive infrastructural measures of even several thousand kilometer long pipelines are preferred. Today, with the exception of a small pipeline from Turkmenistan to Iran, in operation since December 1997, only the post-Soviet network is available. Russia's Gazprom, however, admits only a reduced throughput that forced Turkmenistan, the main natural gas producer in the region, to reduce its production drastically. There are principally three options where pipelines have to be constructed to reach a potential significant demand; firstly, through Iran to Turkey and Europe; secondly, through Afghanistan (or Iran) to Pakistan and the Indian sub-continent; and thirdly, to China and the Pacific Ocean. None of these options is easily realized. If such a construction could be completed and the demand would be there (which is uncertain in the case of a pipeline to Europe) depending on the price, Turkmenistan alone might produce 200 billion cu m, which could make this country with its four million inhabitants rather rich.

For Europe's natural gas demand, an additional supplier on the natural gas market would be welcome in addition to the considerable resources located mainly in Norway, the Netherlands and Great Britain and the traditional suppliers, Russia and Algeria. In the

year 2000 the European Union (EU) has already covered its demand of 406 billion cu m by indigenous production and contracted imports. In 2010 a not yet contracted supply of 43 billion cu m (out of an estimated demand of 474 billion cu m) is to be met. In 2020 this uncovered share amounts to 154 billion cu m (estimated demand 510 billion cu m).³ There are, however, other options for Europe's supply, like additional contracts with Russia and Norway, LNG from Nigeria or from natural gas rich Middle East countries. Japan might prefer to get natural gas from geographically close Sakhalin. For China and the Indian sub-continent, Caspian natural gas might, however, be of great interest.

The *demand* side of the world oil market will certainly welcome the Caspian oil. It is difficult to say, though, whether the world market really depends on it. The International Energy Agency calculates with a global demand of 97 mbd in 2010, which would be balanced by a supply including an increase of production in the post-Soviet countries by 3.2 mbd in comparison to 1995.⁴ This seems to be a realistic assumption, since Russia probably will increase its production by 1 mbd until 2010, while the Caspian region could cover the remaining growth. Deviations from the estimated supply might, however, be influenced particularly by Iraq, which can contribute roughly 5 mbd. The demand side has its uncertainty especially in East Asian economic growth, but also in global measures linked with the climate change process. It is obvious that the availability of Caspian petroleum will influence the world market price. It is, however, unclear whether those who dispose of the region's petroleum wealth will be in a powerful position due to an otherwise structural demand surplus over supply. Until 2010 and beyond it any long-term trend of a growing scarcity in the world oil or natural gas market cannot be predicted.⁵

The importance of Caspian oil and natural gas might, however, be underlined by comparing this wealth with the economic capacity of the 3NIS. According to table 2 the combined GDP of the 3NIS was \$23 billion in 1996. Oil resources of 90 bb would mean a treasure of \$1.35 trillion (at a price of \$15 per barrel). Natural gas resources might

³ European Parliament, Directorate General for Research, Esther-News No. 3, Natural Gas in the European Union, July 3, 1996, p. 3.

⁴ International Energy Agency, World Energy Outlook 1996, Paris.

⁵ John v. Mitchell, The New Geopolitics of Energy, The Royal Institute of International Affairs, 1996.

reach a similar magnitude, which means that the total petroleum wealth would be above \$2 trillion or close to 100 times the current 3NIS GDP. Such a relation between recoverable probable resources and GDP is absolutely unique worldwide. It opens a great opportunity but also a chance to fail, as it is commonly expressed by the alternative “Norway or Nigeria.”

Table 2: GDP of Central Asian States in Billion US Dollars and % Growth

	1995	1996	1997*
Azerbaijan	3.47	3.70	5.5%
Kazakhstan	15.77	15.93	2.0%
Kyrgyzstan	3.03	3.20	6.9%
Uzbekistan	21.60	21.94	2.0%
Tajikistan	1.90	1.77	-5.3%
Turkmenistan	3.90	3.78	1.7%
TOTAL	49.67	50.32	

* Estimated growth in 1997 over 1996

Source: IMF, World Economic Outlook, May 1997 p. 32
World Bank, Global Development Finance 1997

II. Seven Theses

The following theses exploit the presented data for offering some policy options.

First thesis, on supply security: The amount of petroleum resources in the Caspian region is significant, but not necessarily decisive for the supply security of the Western world. In contrast to the 1970s, today’s world oil market is a true market observing the law of demand and supply and not the one of zones of influence. Oil goes to whoever pays the price, not to whomever dominates a region. There is, of course, a major bottleneck, namely the Strait of Hormuz, which potentially can put the working market out of order. If this bottleneck were to be closed, it would have a disastrous impact on the world oil

supply, hampering first of all East Asia, including more and more China, and secondly Europe. Thus far, there is a common interest that the major share of Caspian oil need not be transported through this bottleneck. It does not make sense to claim the Caspian region as a zone of influence for any major power. If Russia or China were to do so, they would have a hard time getting real benefits from it, since excluding the region from the working world oil market would exclude them from more important markets in a globalizing world.

Second thesis on oil production: The Caspian region's estimated share in world oil production of 3.5% (plus/minus 1.5%) in the year 2010 amounts to a size about which it cannot be definitely said whether it will be essential to meet the world demand. Other uncertainties like the integration or non-integration of Iraq into the oil market, the long-term growth of East Asia, or a global climate change regime, including an intensified substitution of oil by natural gas, might have a stronger impact on the demand/supply balance. It must be, however, in the interest of the Western world to integrate the Caspian market as a reliable partner into a competitive world market. This would be the best guarantee for a stable supply in the twenty-first century.

The third thesis is on the relation of petroleum wealth and economic potential: The concentration of public attention on the question of "energy and geopolitics" prevents us from concentrating much more on the development options of the region. The relation between the petroleum wealth of the 3NIS, which can be materialized if an adequate policy is applied, and the current economic potential of the region, is absolutely unique worldwide. The choice lies not just between two options that might be described with "Nigeria or Norway" – there are many options in between like Libya or Kuwait. The Caspian region, however, is different. As a former geographic and cultural part of the Silk Road, and as former member of the industrialized Soviet Union with its high educational standard, and of the OSCE, it might be more accessible to the political system and norms of an open, competitive, and rule of law respecting society and political system than other oil producing countries. Its location between two difficult neighbor regions, Russia and the Middle East, and its proximity to conflict constellations

in Nagorno-Karabakh, Chechnya, Dagestan, Tajikistan and Afghanistan should raise in the West a particular interest in the region's long term stability on the basis of democracy, a market economy under rules of fair competition, and human rights. The very fact that the region is rich enough to pay for its development, but needs guidelines to optimize this option, should inspire Western policies to give the right assistance.

The fourth thesis is on shaping the new infrastructure: If the Caspian region is to be integrated into a global market its infrastructure is essential. Infrastructure means, first of all, pipelines to transport the petroleum. It is quite obvious that there is a competition between different powers to shape this infrastructure according to their own benefit. This happens now and within the next five years. Will the main oil pipeline be Baku-Ceyhan or Baku-Novorossiysk? Will there be an oil pipeline from Tengiz to Baku crossing the Caspian Sea as an alternative route to the Tengiz–Novorossiysk pipeline? Will the major natural gas pipeline from Turkmenistan to the Indian sub-continent be going through Afghanistan or through Iran? Is a pipeline from Turkmenistan through Iran to Turkey and further to Europe viable, or not? All these are questions of vital interest to some regions and they are decisive for the integration into the world market. They are, however, not primarily decisive for the political dominance of the region through a power like Russia. Infrastructure has to be financed and financing today even in Russia is possible only if the investment is profitable. Profitability will be measured by investors, not only in terms of investment costs and expected economic benefit, but also by the political risk. If this is too high, the investment will not take place. Russia's Gazprom decided to construct a natural gas pipeline to Turkey crossing the Black Sea, although it is more expensive than going around the Sea, explicitly due to the too-high political risk included in the land option. Even if Russia wanted to dominate the transportation of the region by investing against economic rationality into an appropriate infrastructure, it could not prevent the construction of a competing system outside of its borders. Therefore, it is quite probable that the new infrastructure will be shaped by profitability considerations. Nevertheless, if a major pipeline is constructed it will be followed by other investment measures and finally, the whole system gets a form and a direction,

from which some will benefit and others will not. Thus, it makes a lot of sense to support the initial infrastructure decisions.

The fifth thesis is on political systems in the region: Many experiences have shown that long term investments built on a coalition with politically unreliable partners can be very risky and damaging to their own reputation. Therefore, it is not less important to invest in the long term reliability of political partners not just with sticks and carrots, but by supporting the build-up of a civil society and the acceptance of the rule of law, including the principle that international competitiveness can be reached only by those who observe the rules of transparent and fair competition. Those who follow the rules of a zero-sum-game (like the Great Game) will not be integrated into the sophisticated network of international cooperation and competition. Russia, for instance, has shown several times that it is on the way to understanding this new rule of the game, for instance by not intervening physically against the Baku deal of 1994 and the follow-up deals, although the legal status of the Caspian Sea is still unclear today. Instead, the Lukoil demand to behave like a normal multinational oil company dominated over old thinking in Russian politics.

The sixth thesis deals with American and European interests and strategies. There is an obviously far-reaching congruency between American and European goals and strategies towards the region. Among them are:

- Supporting the independence of the 3NIS;
- Opposing any monopoly structure for petroleum production and transportation;
- Supporting principally an East-West transport corridor.

There are also some differences. The U.S. government is concretely engaged in influencing decisions of investors, particularly by:

- Supporting the Baku-Ceyhan pipeline as the main export route for Azerbaijani or even Kazakh oil;
- Isolating Iran as a possible transit country (Iran-Libya Sanction act of 1996).

Europeans are much more engaged in programs supporting the build up of economies in the region that are prepared to cooperate internationally. This refers among other initiatives to:

- The European Energy Charter (initiated in 1990, signed in 1991) and the legally binding Treaty of the Charter (signed in 1994, among others by all post-Soviet states, Turkey, Japan, and all European states, it will enter into force after the thirtieth ratification next month), which regulates protection of investment, of transit, of trade and dispute settlement;
- The TACIS aid program, which is better endowed than the U.S. equivalent and which supports many projects such as building up a civil society, or the INOGATE program (Interstate Oil and Gas Transport to Europe), which is the European equivalent to the East-West corridor;
- The Partnership and Cooperation Agreements with the CIS as an initiative of integrating post-Soviet states into Europe.

The differences in the approaches are visible on two levels: First, the U.S. government influences the policies in the region directly, by applying strong instruments to isolate Iran and promote Turkey as the favorite transit country, while Europeans prefer to influence the political structure. This includes the preference of investment direction for infrastructure to those who accept the common rules (like the Treaty of the Charter). It could favor Turkey as well as Russia, theoretically even Iran, which, however, was not invited yet to sign the Energy Charter Treaty (ECT). It also could be China, which showed interest in the ECT, however, not as a substitute to the East-West corridor, but as a supplement. The second level of difference is the public attention. While any phone call from the White House to President Aliyev, or any announcement of U.S. non-intervention against a pipeline creates attention in the international media, the structure of EU policy does not allow it to compete with this effective policy of a superpower. There is no doubt that American policy in the region has much more influence in concrete measures to be taken now, like decisions on pipeline routes, than the EU can have.

The final thesis deals with combining European and American strategies. There cannot be any doubt that we need both a *realpolitik* which takes care of preventing wrong decisions when a new infrastructure for the next decades or centuries is shaped, and a build up of political structures that allow the integration of the region into a competitive

world of common rules. A U.S.-European dialogue on the priorities of developing this region would be helpful. Its agenda should include:

- The East-West corridor;
- The support of stable political structures (civil society, democracy, market economy, human rights);
- The reduction of political risks for investors (Energy Charter Treaty).

It should be tested whether the EU is able to take the burden of an equal share of responsibility in this process. An American contribution to a closer cooperation with Europe in this sphere could be to give the Energy Charter Treaty more weight by signing it.

The Caspian Energy Resources and the World's Energy Needs

Laurent Ruseckas

First, I am going to outline the position of Caspian energy resources relative to global reserves and global supply. I argue that global energy security is not at the core of what is important to the west about the Caspian region, which is a contrary view. Second, I will look at the pipeline question and offer a few observations about what the market wants to happen with Caspian oil flows.

It has become conventional wisdom that Caspian oil and gas will be crucial to world energy supplies in the next decade and beyond. The corollary of this that is held by a lot of policy makers in the foreign policy community – in the U.S. and Europe and elsewhere – is that energy security offers a very important reason, perhaps the main reason, for policy makers and think tank people to be concerned about the Caspian region. I would like to challenge both of these assumptions.

First of all: gas. There is a great deal of gas in the Caspian: 8 trillion cubic meters. However, the Caspian region has the problem that it is stuck between number one and number two in the world in terms of gas reserves. Russia has about 6 times the reserves proven of the entire Caspian, and Iran comes in second with about 2.5 times Caspian reserves.

When talking about gas, of course, we have to look at specific markets more closely since there is no global market for gas the way there is for oil. There are basically three markets here: China, South Asia and Turkey.

For China, I would just like to point out that Central Asia is a long way away from China. There is a tremendous amount of gas there, but in the coastal regions it can be met at this point more economically by imports of liquefied natural gas, LNG. And in the northeast, where demand is also growing strongly, it is much closer to Russian gas fields. A gas pipeline from Central Asia to China will probably happen, not at all soon, but rather in the very long run.

Pakistan and India are also growing markets and many people are familiar with the plan being put forth by UNOCAL to build a pipeline from Turkmenistan to those markets. This project has not moved ahead quickly so far because of the political situation in Afghanistan. Even if we were to set that issue aside, the project could work, but it is not crucial to meeting the gas needs of Pakistan or India. Iran, Qatar, which has gas reserves on the scale of the entire Caspian, and Oman are closer to South Asia and they have their own substantial gas reserves and their own pipeline plans.

Turkey has ambitious plans to substantially increase its consumption of gas. For Turkey, there are four potential sources of supply: Russia, Iran, the Caspian and LNG, which can come from a variety of sources. For now, though, most of Turkey's gas comes from Russia and right now Turkey's main motivation is to diversify its gas supplies. The Caspian can and will play some role in this.

So far I have not mentioned Europe. My perspective on the European gas market and the relevance of Caspian gas is based on the research done by the European gas practice at Cambridge Energy Research Associates, which is based in Paris.

It has been said that there are a lot of countries hoping to push a lot more gas into the European market. Growth is strong, but it is a mature market. This is not anything like Turkish growth, where they want to quadruple gas consumption in the next twelve years.

Thus, Caspian gas is of marginal importance for the European market. In general, one cannot say that on the gas side the Caspian is crucial to global supplies, or even to supplies in any critical market. If we imagine the Caspian's basin as having just enough gas to meet its own needs and was unable to export, it would not make a tremendous difference to gas supply.

For Turkey, it would make it more difficult to diversify, particularly if the political problems of importing Iranian gas are to continue. For China, in the long term, it would also be marginally harmful.

But, what about oil, for which there is a global market and where one normally thinks more about security of supply? The amount of proven reserves is not entirely clear and there are a variety of different definitions, but I would estimate currently proven reserves of the Caspian are about 20 to 25 billion barrels. If that is compared to 1 trillion barrels for the world or about 100 billion for Iran and Iraq, or 300 billion for Saudi Arabia, it is not that much.

Of course, in the Caspian, the focus is on the possible, the undiscovered reserves. And this number of 200 billion barrels that was used in the report delivered to Congress, has, unfortunately, become the number one sees most often. The number that is frequently cited in the press is 200 billion barrels of oil reserves in the Caspian basin.

There are two problems with this. One, it is somewhat fantastical. 200 billion barrels is a very optimistic guess based on talking to a lot of geologists. The estimates there for how much oil could be discovered, especially offshore in the Kazakh sector, are overwhelmingly high, much higher than what any geologist at an oil company would feel comfortable quoting.

I would put forth a somewhat lower estimate than the 90 billion barrels based on the internal studies done by various clients that work with Cambridge Energy. The range of total Caspian reserves at 50 to 75 is more the conventional wisdom. One can expect the oil companies to have the best geologists and the least political motivation for changing around those numbers.

Incidentally, the first two data points we have, which come from exploration wells that have been drilled in Azerbaijan in the past four or five months, support a more pessimistic outlook for reserves. Two of the consortia there have drilled wells where they thought they were going to find sizable oil fields. What they found is, in one case, a gas field and, in another case, a mostly gas field. Neither with anything like the oil reserves for which they had hoped.

The real test is going to come, however, when the offshore Kazakhstan consortia operated by Shell and Mobil and many European companies drill their first exploration well this summer in offshore Kazakhstan. They could find another Tengiz, in which case offshore Kazakhstan will be a major oil zone, or they could find something less, and that is certainly possible. Exploration risk is something that a lot of people have forgotten about in the Caspian, but it is certainly there. In the North Sea, 1 in 6 is the probability of finding oil in a structure that has been identified, in the volumes that had been hoped for.

So, ultimately, the cited figure that the Caspian will contribute by 2010 3.5% of world oil supply fits in with our view. We might go a little bit higher than that. Ultimately, Caspian oil is going to be important at the margin. It is going to help make up for North Sea decline after 2002 or 2003, and it is going to slow the rate at which Persian Gulf oil increases as a share of total world consumption.

Of course, it is possible that there will be tremendous exploration success – that all of these structures in the north and south Caspian will hold, in fact, a lot of oil. In that case, one could imagine it becoming a more significant oil province. Still, it would be nothing on the scale of the Middle East under any circumstances.

That is an outlying scenario. The potential is equal to two North Seas in terms of reserves. It may replace the North Sea in terms of world oil supply. Thus, it is important, but not that important.

What, then, is all the excitement about? Well, there is a different answer according to which of the three different players one asks: the companies, the host government or the external governments, including the West.

For the host governments, it is obvious; they see their oil and gas reserves as their ticket to wealth and prosperity. It is not going to be that easy, but it is clear what they want out of their oil reserves and why it is important to them. For the oil companies, the reason for all the excitement is that Caspian reserves are accessible. The vast majority of the world's oil reserves are closed to investment from private oil companies. Saudi Arabia,

Kuwait, Iran and Iraq are not places where western companies can go in and invest. The Caspian is. And right now the Caspian and Venezuela are the two boom areas for oil companies to invest in the upstream.

One should note also that oil companies are not only driven to find new oil reserves and to produce new oil just because that is what oil companies do. There is also the reason that stock is undervalued and those share prices tend to rise. Thus, there is an important structural reason having to do with financial markets. Why are oil companies driven to add reserves? What a lot of oil people will tell you is actually rational in terms of profits and rates of return.

Why is the Caspian significant for external states, for the players in the so-called Great Game? Caspian energy is important because it sits at the center of Central Asia and the Caucasus, a region that is very important to the world. Its political and economic future is critical across a huge stretch of territory from the Middle East into Asia.

With the Soviet collapse, this area became a huge geopolitical no man's land. Future balance of power in the region is still uncertain. The future economic links that this region will have are undetermined. The neighboring states (primarily Russia, China, Iran and Turkey) cannot help but be interested in what happens in this region. These states have in varying degrees economic ties, cultural, ethnic or religious links, and historical political relationships with the region.

All of these states, and other surrounding states not mentioned, will be affected by what happens in Central Asia and the Caucasus. They all have a stake in seeing the situation there evolve in a way that reflects their interests as they perceive them. Energy and its export, of course, are central to the future of these states. Which way the pipelines run, how quickly the oil and gas is exported and how that revenue is used is clearly going to have a strong effect on the regional balance of power, and it will help define the region's position with regard to the world economy.

What about those countries external to the region? The U.S. would fall into this category. The national interest of the United States is clearly engaged in the Caspian for a number of reasons that have nothing to do with energy security. Of these reasons, three are more important than energy security from the U.S. perspective.

First, Iran could possibly use the Caspian as an area where it undermines U.S. efforts to contain it by making inroads into the Caspian region and into Caspian energy. Number two is the fear of an aggressive reassertion of Russian hegemony over the region. Something that compromises the sovereignty of the states in Central Asia and the Caucasus would clearly have negative implications for U.S./Russian relations and – as the U.S. perceives – for the situation in the Middle East.

Third is support for Turkey, where the U.S. policy community consensus maintains that Turkey is a crucial country at the border of Europe and Asia. Turkey is a secular, democratic, Muslim state, which is very important. It is a country that has been going through a rough patch politically. It is also a country that sees itself as having been recently rejected again by Europe. Thus, it is seen in the U.S. as ever more important that we support Turkey and one good way to do that is to endorse Turkey's ambitions in the Caspian.

These are the three main U.S. interests in the region. Energy security and support for the interests of U.S. companies are on a lower plane. There is, to some extent, support for the interest of U.S. companies and that has been clear in a variety of circumstances, but it only goes to a point.

Working with some of these oil companies, one can see clearly that once it gets to a certain point, the interests of the United States government, the perceived national interest, win every time against the interests of the oil companies.

How then can the fact that energy security is regularly cited as one of the primary motivations every time you have a U.S. official making a statement about Caspian energy

be explained? One, they probably see it as more important than I do. Number two, if one is speaking publicly, it is a very convenient thing to say.

Every single one of the U.S. interests in the region is controversial in some way. Containing Iran is controversial internationally in the age of the Iran/Libya Sanctions Act. It is also becoming controversial in the United States in the business community.

Russia would certainly take issue with the United States thinking it has a legitimate role in trying to guard against any sort of Russian resurgence in the region. Support for Turkey and even more so, support for Azerbaijan is very controversial in the United States within a certain constituency. Even support for U.S. business is attacked now by some in Congress as being corporate welfare.

So all of these are controversial. And who is going to attack energy security, particularly with the 1970s, albeit a long time ago, still weighing heavily in people's minds?

There are three different groups with three different goals. The companies, of course, have one very strong goal, which is to maximize profits. More specifically, they want to maximize the net back value of the crude they produce in the Caspian at the well head.

What this means is, corporations would like to maximize the price they are paid for their crude in whatever market they deliver it to, minus the transportation costs it takes to get to that market. That is how oil companies look at different pipeline routes. They do the math and they come up with what works best for them. Of course, political risk plays a serious role and they also have the goal of minimizing political risks associated with the production and export of the oil in the region.

The host governments' perspectives on the pipelines show remarkable alignment with the interests of the oil companies. They might put the political risks or the politics of the pipelines a little bit higher. Host governments see the pipelines as a way to export their oil, and to cement their sovereignty and their independence. They would certainly like to avoid any monopoly control of their exports by any single country. Something that has

plagued all of these states in the recent past is Russia's monopoly control over exports. This is something, of course, that the companies share fully. The host governments also certainly want to maximize the value of the crude.

Over the long run, much more of the crude sent through these pipelines is going to belong to the host governments than to the oil companies. This fact is not lost on the governments in the region. What is more, the contracts that have been signed explicitly try to give the governments incentives to worry as much as they possibly can about the value of their crude. The Azerbaijan International Operating Company (AIOC) contract in particular was written so that it would put Azerbaijan's interests in alignment with AIOC's interests in terms of the commercially optimal export options.

Then, of course, there are the external states. Certainly, their involvement is growing. When you look at the situation from the perspective of oil companies, they have been working to a considerable extent in a political vacuum so far in this area. That is now changing.

From the oil companies' perspective, they have a lot less flexibility, a lot less room for maneuver than they did in 1993, 1994, and in 1995, as all the states in the region and near the region take a greater interest in what happens to this oil.

I will conclude by making four points by way of answering the question of what does the market want to happen, or what do the companies want to see happen in the Caspian pipeline derby for oil. There is no specific answer yet. One simply cannot answer the question today of what is the best pipeline route because there is too much uncertainty.

First of all, what various producers do in the Caspian affects the situation of other producers. So what AIOC does affects the perspective of someone producing oil in Kazakhstan. How that is all going to work out is going to be very complex and cannot be predicted.

Furthermore, until all of the tariffs and the terms associated with various pipeline alternatives have been negotiated, at least preliminarily, it is very hard to say whether Baku-Ceyhan is the best way out, or whether Baku-Ceyhan is much too expensive and thus will never work.

There are four broader points about what the market does want. Number one, the market wants flexibility. It wants to keep options open for as long as possible. Foremost, no commitments should be made to major new export pipelines, multi-billion dollar pipelines, that might not be optimal, or that changing circumstances are going to render as non-optimal.

There are going to be a lot of changing circumstances. There is a tremendous amount of geological uncertainty. No one has any idea, at this point, whether the oil that needs to flow out of Azerbaijan is going to be AIOC's production and a little bit more, or AIOC's production and a lot more. We will not know the answer to that question until the year 2000, or late 1999, after many more exploration wells have been drilled.

This is why, in my opinion, there will not be a commitment to Baku-Ceyhan in 1998. It would be crazy for the AIOC to commit themselves firmly to Baku-Ceyhan that soon, with so much uncertainty. That is not to say it is not, in the long run, going to be the optimal route. It may well be, but flexibility in keeping options open must be a priority if they are going to do what the shareholders want them to do. Which, as was mentioned before, is what companies are all about.

Number two: the market wants inclusiveness. This is related to political risks. The best way to reduce political risk in the Caspian area is to give all of the countries around there a stake in seeing production and export of the oil and gas go forward. This means giving them all a stake in a tangible way. This includes Iran and this includes Russia. Were it up to the companies, just for reasons of political risk, they would want to be including Iran and Russia much more than politics is driving them to include these two countries in the current situation.

Number three and number four are related. They are the two ends, the question of maximizing net back value. First of all, the companies want the lowest transportation costs. Second, they want the strongest possible markets at the other end of those pipelines and tankers.

For the first, low transportation cost, this is largely a function of the capital costs of various pipelines. Not totally, but to a considerable extent, a 3 billion dollar pipeline is going to cost you more than a 2 billion dollar pipeline in terms of tariffs. The best way to reduce transportation costs, at least for some portion of your production, is to go from nearby markets. These markets can be accessed through much shorter pipelines or even through existing infrastructure. For Kazakhstan, this is Russia. For Azerbaijan and Turkmenistan, this is Iran.

Looking a little bit further down the road, all of the states are going to be sending oil to the Black Sea. This means demand around the Black Sea and Ukraine, Romania, Bulgaria and potentially Turkey, if it could build infrastructure to import on its Black Sea coast.

Right now there are problems with all of these. Politics is preventing Azerbaijan and Turkmenistan from sending oil to Iran. Here I am referring to a main pipeline through Iran, which I think is something that has not been explored and it is not entirely clear that that would be the optimal route. In some corners of the oil industry, there is a perception that if Iran were possible, all the oil would flow through Iran. It would make tremendous commercial sense, and that would be that.

What is clear, though, is that to send – if the Iranians were going to be at all constructive, and at all desirous of this – some portion from Turkmenistan and Azerbaijan, something around 600,000 barrels a day, to the refineries in northern Iran in a swap arrangement by which one could take crude from Iran on the Persian Gulf would be a very low cost alternative to building major new export pipelines.

For Kazakhstan, the issue is the Russian market where so far one cannot receive full value for crude. Over the last few years, the price paid for crude oil in Russia has fluctuated, but it is been around 70% of the world oil market price. Of course, transportation costs are lower, so that the differentials in fact are smaller than that.

Today, with world oil prices being so low, it is competitive, but no one expects oil prices to be at \$14 a barrel for a sustained period of time. So these low cost export alternatives certainly cannot accommodate all the Caspian oil that is going to be produced, but they can accommodate some, if the political barriers are removed in Iran. Out of trying to meet the interests of the shareholders, companies have to watch that, and if and when it becomes possible to do that, that option will be investigated.

Second, watch the Russian market. There are a lot of changes you can see with the structure of Transneft, the Russian pipeline company, and with the refining industry in Russia that might push up the domestic price of crude in Russia and make these alternatives of using existing infrastructure to take oil from Kazakhstan to the Russian market competitive with export routes. This would certainly be more commercially sensible than building billions of dollars worth of new pipelines.

That is for part of the oil. I am not arguing there is no need to build any major new oil pipelines out of the region. Sooner or later, it will have to be done. Here, the question is what is the best market for a couple of million barrels a day of new oil production. The headline is that Asia is the market one wants to reach and the Mediterranean is not the market one wants to reach.

This may not be true for AIOC. AIOC has said from the beginning that the market for its oil is the Mediterranean. That is what they have decided makes sense for them. But when one starts adding on increments of crude and imagines it all flowing to the Mediterranean, one loses value by delivering that crude to a market that is already saturated, as opposed to delivering it closer to an Asian market, which is where demand growth is, despite the economic crisis in Asia.

This is particularly an issue for Trans-Caspian oil pipeline options that are now discussed and promoted by the U.S. government. If one imagines Azerbaijani oil going to the Mediterranean, whether to Ceyhan or to the Black Sea, and then the Caspian pipeline consortium; one sees a project that seemed to be in trouble for a while and now it is back on track.

For oil going from Kazakhstan to the Mediterranean – particularly if there is the possibility of Iraq coming back on line and putting some significant portion of its oil, as it has in the past, onto the Mediterranean – the last place to put the next tranche out of Kazakhstan is in the Mediterranean.

What oil companies will do is try to project patterns of supply and demand, which is very complicated. Then, they will try to figure out what the differential is going to be in this market scenario between the Mediterranean and Asia in, for example, 2005. If one goes through a scenario where all the first couple of waves of Caspian oil are flowing to the Mediterranean, the differential between the Mediterranean and Asian markets is tremendous, whether it is Gujranwala, in Pakistan, as the port, or straight to China, or the Port of Jask, in Iran. So there is an overwhelming economic interest to send later tranches of Caspian oil south and east rather than west.

The Great Gamble

Geoffrey Kemp

Regarding the Caspian region, there are two points to keep in mind. One, that this is not a Great Game. This is a Great Gamble. Nobody knows whether these projects are ever going to come to fruition, in part because of the unique geography and politics of the region. Two, no one really knows how important they are going to be in their right, except for the local countries, who clearly will gain a lot of money if they start producing two to four million barrels of oil a day some time in the next century.

The first thing that I want to emphasize is that a lot of the issues under discussion are future projects, and there is something of a gamble about it. One of the reasons they are such a gamble is because the geopolitics of the Caspian, in which the United States is now getting itself embroiled in many different ways, are very different from other areas where the United States has taken firm and demonstratively assertive positions over the years.

Very different, for instance, from the Gulf, where there was, for years, massive American economic investment that is now backed up by massive military power. In the case of the Caspian, it is not clear that either of those ingredients is present or ever will be present. Therefore, a great deal is going to depend upon the regional rivalries that exist and that could become worse, as the case may be.

In particular, as long as the United States policy towards the Caspian deliberately excludes the participation of one of the key Caspian players, namely Iran, a lot more pressure is clearly going to be put on the other countries who have to live with Iran and who are also being asked to become the roots for oil and gas that cannot, as of this moment, according to American policy, go through Iran.

Of course, this relates to the other strategic reality that although our formal policy is to encourage multiple routes out of the Caspian, including routes through Russia, there is a distinct impression in Moscow that our policy is a little less generous than that. In fact, if

you read Congressional hearings and look at what is said about this region, you hear many statements to the effect that one of the reasons we want to play such an active role in establishing this east/west corridor, from Central Asia across the Caspian, into the Caucasus is so that routes do not go through Russia.

Thus, the first ingredient is that neither the Russians nor the Iranians regard our policy as particularly friendly at this moment in time. Now these things can, of course, change.

First, let us look at the sort of strategic picture as it is today. Clearly the number of disputes that are unresolved, that have, at this moment, nothing to do with oil have causes that go back many, many years.

In this area, the Caspian basin, we have seen some of the most violent and bloody conflicts to have taken place in recent years. Whether it is Chechnya or Nagorno-Karabakh or Afghanistan, or the Kurdish crisis in eastern Antalya; all these are major unresolved conflicts that are taking place exactly in the regions where there are dreams of building pipelines and establishing communication routes.

To the south, of course, you have the Gulf. And one cannot de-couple the politics and the strategy of the Gulf from what is happening in the Caspian. Particularly since Iran is a member of both and Iraq is next door and we recently nearly got into a war over Iraq. This is certainly a troubled neighborhood with many unresolved conflicts.

When one overlays into a troubled neighborhood the issue of energy, some clearly difficult problems emerge. Of course, the uniqueness of the Caspian (it is unlike any other major oil development that I can think of in history) is the geography of access; that none of the three major producing small states, Azerbaijan, Turkmenistan and Kazakhstan can get their products to market without going through someone else's territory.

We all know that by now, but think of another case where this applies in as great a magnitude. Virtually all other oil producers get their products to market directly through the open seas and do not have to go through this situation.

The second point to note is that one of the most important elements of this region is the growing demand for energy within the region itself. Whether we are talking about Turkey, with its extraordinary deficit on energy and its need for gas from all directions, or Eastern Europe, the Ukraine, and Romania, with growing needs for energy, or whether we are talking about Iran, India or Pakistan; all of these countries will have huge energy needs in the future. Therefore, one could make the argument that a lot of the energy that may come out of the Caspian will be destined for local markets rather than Japan or Europe or North America.

The fact of the matter is, you only have to spend an hour in Iran these days to know that aside from their own political problems and the United States, their maximum four million barrels a day in the twenty-first century are still important. It will mean that if this pans out, Baku becomes one of those points on the map that we all know has great strategic importance, just like anyone familiar with the strategy of the Gulf knows about the Straits of Hormuz, knows about Ra's Tannurah, knows about Khark Island and why countries go to great lengths to protect these assets.

The problem with the Baku strategy is that, at the moment, there is no American economic or military component. The U.S. government has said quite clearly that this is going to have to be funded by people other than the U.S. taxpayer. Maybe some concessions can be made on insurance for people who wish to invest there, but no vast amounts of American money are going to be put into this system.

Furthermore, as of this moment, there is not, to my knowledge, any comprehensive plan to protect the asset in the event of a crisis. Now, obviously, one hopes it will not be necessary. Obviously, one hopes that what will happen is that as the east/west corridor booms, the nascent Newly Independent States will find their feet and establish democratic institutions, and that they will all be friendly with each other, they will all

share in the wealth and there will not be any need to consider unpleasant scenarios like what if the Russians and the Iranians do not like it, or what if they argue amongst themselves at some point in time. If this were the Mediterranean, it might be possible to come up with a rosy scenario like that. But, even then, it would have to be the west Mediterranean rather than the east Mediterranean.

Realistically, though, that type of picture is, to say the least, a little over-optimistic. Therefore, if the United States is serious about its strategy, then it better make sure it has the means to implement it. That inevitably leads to questions about extending the role, or mandate, of the United States into the Caspian. Presumably it would be an issue into which the NATO partners would be drawn. There is an increasing amount of discussion about NATO's out-of-area missions and roles. A role in the Caspian and the Caucuses is not as absurd as it might seem these days, particularly if the strategy compels one to think in these terms.

The beginnings of such a policy are going to put enormous premium on the stability of one little country, Azerbaijan, that has not yet a proven record for stability, without any real sense of what happens if things get nasty—and things do get nasty.

Until the problems with Iran are resolved, American policy is going to be out on a limb. Since May 1997, the U.S. government, in its public and private statements, has taken a much less strident, a much more diplomatic, formal posture towards the Islamic Republic. And every time Khatami has said something conceivably pleasant about the U.S., we have reciprocated.

There have been some very interesting developments. The appointments made by Mr. Khatami to his cabinet surprised a lot of people. It was felt that perhaps he couldn't get them through the parliament. He did. The incredible success of the Islamic summit, which they hosted in December, surprised a lot of people. It came, of course, right after the very unsuccessful American led economic summit, or conference as it was called.

Then, of course, Khatami made these very public utterances, most famously, in the presence of Ms. Amanpour, calling for a public dialogue with American scholars, writers, tourists, artists; but not with the American government. The United States replied that it has always been in favor of an informal dialogue with Iran. We would like to go to serious conversations with the Iranian government, but the Iranians will not agree to this at this time.

Their reasoning is as follows: They argue that Iran has such a demonized image in this country, due primarily to the fact that most Americans see Iran through the eyes of the hostage crisis in 1979 and 1980, see Iran through the image of flags being burned, America being denounced and America's closest ally in the region, Israel, being not only vilified, but denied even the right to exist. They see Iran behind many terrorist incidents around the world and they believe that Iran, despite its utterances to the contrary, has indeed embarked on military programs that could, in the long run, threaten the region. The Iranians argue they know Americans much better than Americans know Iranians because, after all, just go anywhere in Iran and anyone will tell you about America, whereas Americans do not know about Iran. In fact, they argue, half the time Americans mistake Iranians for Arabs, which is true.

Iranians argue that this imagery has to change, because if they go into an official dialogue now with an American diplomat, they say the Americans will come in, they will sit them down and they will pull out a list (terrorism, weapons of mass destruction, Salman Rushdie, peace process etc.,) and they will shake hands and go away.

It is not going to work that way because, of course, the Iranians also have a list. And theirs is a list that goes back a little longer than the American list. One of the fascinating nuances now of Iranian policy is that, one of the issues they are most bitter about, (not just the government buy everyday citizens) is the Gingrich 20 million dollar contingency fund to set up a covert program to destabilize the regime.

For most Iranians, that immediately reminds them of 1953, Roosevelt and the overthrow of Mossadegh and the return of the Shah. Thus, Gingrich's 20 million dollars is a topic of hot conversation on the diplomatic circuit there.

It turns out that at the recent World Economic Forum meeting in Davos, two individuals were seen locked in very close animated conversation. They appeared to be getting on like a house on fire. Those two people were none other than Newt Gingrich and Kamal Kharrazi, the new Iranian Foreign Minister. So something is in the wind.

The Khatami people are different. He has surrounded himself with some very able people in the Foreign Ministry, many of who were educated here (not that that means much since most of the bad guys were educated here, too). But they do seem eager to talk to us. First, indirectly and then, presumably, directly at some point.

The prevailing conventional wisdom is that Mr. Khatami is in a very strong position legally. He has legitimacy. The problem is that the people who oppose him are going to find ways to undermine him, to threaten him and to make things nasty for Khatami and Israel and the U.S. and others. There is a German businessman awaiting a sentence of death for having a relationship with a Muslim woman. This is how they are going to undermine Khatami, rather than with tanks. It is not going to be the Prague summer, after the Prague spring.

Those who want to develop their energy sector, those that want to play a role in the Caspian, those that want to cooperate with the United States, know that the key to solving their problem with us is part psychological, but it also has a lot to do with Israel.

Therefore, unless the Israeli concerns are addressed, very effectively, it is unlikely that there will be a fundamental change in the mood of the U.S. Congress and sanctions will not be lifted. Changing Iranian-Israeli relations is feasible if the Khatami people survive and increasingly establish their power throughout the country. That is a big if, but it is not impossible.

All of the uncertainties in the Caspian, and all the reasons why it is a Great Gamble rather than a Great Game, the one area where the United States can make some positive progress, (if it has cooperation from the Iranians) is on the Iranian front.

If that were resolved, it would not only remove the problem of investment, it would, of course, remove a huge obstacle in relations between Iran and Israel. It would make this whole question of dealing with weapons of mass destruction more manageable, and would, of course, then open up Iran to be part of the multiple root options scheme.

The Political Risks of Various Pipeline Routes in the Caspian Basin

Hooshang Amirahmadi

To assess the political risks associated with various pipeline routes from Central Asia and the Caucasus to markets in Europe, Asia and other world regions one must account for a multiple of often paradoxical factors at national, regional and global levels. Yet the current positions held by the major players involved often ignore this complexity in favor of narrowly defined strategic and economic interests largely informed by shortsighted political animosity, rivalry or alliances. To advocate for particular routes on the basis of a policy that excludes some players and includes others in the so-called great game that has ensued in the wake of the oil and gas rush in the Caspian basin is haphazard at best. The current approach is equally dangerous, for it remains oblivious to internal political and economic developments of the countries involved.

In what follows, I shall first provide a description of various routes and their advocates and then give an outline of the major risk factors involved including the extent they are ignored or accounted for in the positions held by the regional players. I shall conclude by proposing that decisions concerning oil and gas pipelines should recognize the need for multiple routes as dictated by political, economic, technical and strategic realities, and that a grand cooperative and win-win strategy is preferred over the current alliance-making and win-lose games. Yet, the most important preconditions for a sustainable transport of Caspian energy are national political and economic developments. The proposed framework is based on the assumption that the long-term prospect for every player is much richer than what it can achieve by maximizing its short-term gains.

I. Pipeline Routes and Their Advocates

Currently, five pipeline routes are available, proposed or contemplated. They include northern routes, southern routes, western routes, eastern routes, and southeastern routes. As we shall shortly see, some are extensions of existing pipelines while others are altogether new and have to pass through untested and contested geographies. Rough terrain, ethnic violence, bureaucratic infighting and individual ambitions need to be accounted for along the way. They are also distinguished in terms of their strategic

significance, economic feasibility and technical complexity. More importantly, these routes involve uneven political and environmental risks, as explained in the subsequent sections of this lecture, and are viewed within a framework of win-lose and alliance-making strategy.

Yet the real difficulty with pipeline politics is that it must find a solution to often opposing business and strategic interests. For example, while Iran provides the most economical routes, the U.S. opposes the alternative in an attempt to curb its future regional influence. The fact is pipelines offer more than economic benefits and trade possibilities; they would form strategic cores of power along which communications, transportation and other infrastructure corridors will develop. The nation or alliance that controls such corridors would supposedly hold sway over the region. The U.S. policy is set for an East-West axis, the so-called New Silk Road, which excludes Iran and Russia. As this U.S. policy goes against economic logic of the companies involved, it has become a stumbling block to pipelines construction; meanwhile other countries have used the U.S.-Iran tension to push for less than optimal routes through their territories with a view to gain business and strategic advantages.

Northern Routes

Advocated by the Russians, both Kazakhstan and Azerbaijan could join existing Russian pipelines by building extensions or new pipelines that would take their oil to Novorossiysk on the Black Sea. The Caspian Pipeline Consortium (CPC) is already busy developing the line. For the Kazakh oil, the pipeline will be built as it encounters no rival or opposition at present. For the Azeri oil, however, the routes will have to pass through the insecure Chechnya territory or near it, a rather unpleasant possibility for prospective investors. Chechnya has a ruined economy with no real prospect for future growth and is seeking political independence from Russia. These conditions combined with elite rivalry and a growing drug trade calls for continued political violence there. Besides, both Azeris and Kazakhs remained concern about Russia's continued dominance of their political life; for the Azeris, the concern is elevated to fear by their Turkish, Israeli and American allies. The real problem is this: Russia, as the holder of the world's largest reserves of

natural gas can hardly be excluded from the growing world gas market, thus making the northern route a real option.

Western Routes

Preferred by the U.S., Turkey, Azerbaijan and Georgia, these routes are intent to bypass the Russian territories and Iran. The less expensive alternative is to build an upgraded pipeline to the Georgian port of Supsa on the Black Sea; from there oil will have to be taken by tankers through the Bosphorus to Europe. One immediate problem is the current political instability in Georgia: the Abkhazia separatists would have to be suppressed or co-opted first. Even then there is the problem with the rebellious South Ossetia. According to one report, the people living in the vicinity of the pipeline going to Supsa made some 800 holes in the line, forcing Azerbaijan International Operating Company (AIOC) to build a wholly new line for its early oil. The other problem is environmental. Turkey claims, rightly, that the Bosphorus is already too congested and further tanker traffic will endanger Istanbul's safety. Despite these problems, this route seems to be on schedule for construction given a lack of a better or more politically acceptable alternative. The Bosphorus problem could be addressed in a number of ways including a bypass from Bulgaria to Greece or pipeline from Baku to Ceyhan.

Turkey instead has pushed, with U.S. and Israeli support, for another pipeline from Baku to its Mediterranean port of Ceyhan, a direct one. A Trans-Caspian pipeline will then feed Kazakh oil and Turkmen gas to these routes. The U.S. is currently lobbying the Kazakh and Turkmen governments to support the pipeline. The U.S.' attraction to the Ceyhan route and the Trans-Caspian line emanates from its desire to build an East-West axis of influence and commerce in the Eurasia region. But this alternative is too expensive and passes through the Kurdish-dominated territories. The proposed Trans-Caspian pipeline poses additional environmental hazards to the sea. No wonder that despite serious U.S. effort, the Ceyhan alternative is resisted by the companies. Even AIOC have argued against it. The companies had asked for American subsidies at a substantive level. The U.S. originally resisted but after it became clear that the line may not be built by the companies, the U.S. offered to assist with \$823,000 toward a projected

cost of \$2.8-\$4.0 billion (*New York Times*, October 22, 1998). Turkey, which originally did not come up with the promised incentive package, was also forced to bow but its offer remains as yet vague and unattractive. Financial difficulty aside, companies also complain that “the instability of Turkey’s government has made it a difficult partner”(*New York Times*, October 11, 1998).

Southern Routes

Favored by Iran and oil companies, the southern routes make economic and commercial sense. They are cheaper to build, pass relatively safer territories, and pose no serious environmental hazard. Significant pipeline and port infrastructure also exists. A gas pipeline extends from Turkmenistan to Iran, which they hope to extend to Turkey via a new pipeline to be constructed by Shell. Extensive oil pipelines to south of Iran also exist as do port facilities in the Persian Gulf from where both Europe and big Asian markets could be efficiently served. Most notably, the southern routes also offer the Swap option, something no other routes have offered as yet. Oil companies and governments worry that the Southern option increases the world’s reliance on the Strait of Hormuz, a concern that can be addressed by linking the pipelines to the port of Jask on the Gulf of Oman. Certain geologists have also argued against the line because of possible seismic problems in Iran. Yet, in the last several decades earthquakes have not posed problems for the pipelines in Iran. The U.S. is opposed to the southern routes for obvious political reasons and has made it a policy to prevent its realization. Opposed to the routes is also Azerbaijan who remains wary of Iran’s intention, a fear largely instigated by its allies, the U.S., Israel and Turkey. Yet, the U.S. and others may find it hard to advocate exclusion of Iran, which holds the world’s second largest gas reserves and is its fourth largest oil producer.

Eastern Routes

China is increasingly energy-hungry and needs to seek new markets. The Kazakh option is attractive because it is comparatively speaking the most accessible. Thus, China signed a contract with the Kazakhs in September of 1977 to build a 2000-mile long and extremely expensive pipeline from two fields in Kazakhstan that China has proposed to

purchase, to its western territories. The deal, commercially unattractive, can only go if China was to continue viewing Kazakh's option as a new strategic necessity. All indications to date point to China's commitment to the proposed pipeline. However, financing the project could prove much harder than Chinese had originally anticipated. This is the only route that seems to have no rival or enemy despite the fact that it can cause China's influence to rapidly grow in the Caspian region.

Southeastern Routes

Favored by Pakistan and Afghanistan, UNOCAL, an American oil company, along with the Saudi Arabian Delta Oil, has been promoting a pipeline to transport oil and gas from Turkmenistan and possibly Kazakhstan, through Afghanistan, to Pakistan and eventually India. The line has also had the tacit approval of the U.S. government until last summer when, following the bombing of American embassies in Africa, Washington had to bomb Osama bin Laden's terrorist camp inside Afghanistan. The Taliban's identification with bin Laden has also forced UNOCAL to withdraw its proposal for the time being. The Afghan geography presents some difficulty and costs, though reasonable, could make fund-raising a bit too difficult. Yet, the real obstacle is a political one. As long as the Afghan civil war is not fully ended and the Iran-Afghanistan crisis continues, any attempt to build the line will prove futile.

II. Major Political Risk Factors

Alternative pipeline routes are exposed and vulnerable to uneven political risks and involve risk factors of national, regional, and global origins and significance. It must be noted that these risk factors are interdependent given that national and regional borders are increasingly at the mercy of global forces. The risk factors are also dynamic due to the fact that the region as a whole is in a state of transition to a new political-economic future. Clearly, the transient character of the region makes any short-term strategic alliances unstable as political changes will make loyalties shift and national interests change. For example, Russia, whom Americans thought would become a strategic partner of the U.S. in the wake of the Soviet collapse, has already become a strategic rival to it. Another case in point is Afghanistan. Iran thought encouraging Islamic movements there

will help its cause but the Taliban victory can jeopardize Iran's national interest. Indeed, the Taliban will not serve even the strategic interest of Pakistan and Saudi Arabia, the group's main political patron and cash register, respectively.

III. National-Level Risks

As *The Economist* (February 7, 1998, p. 6) noted: "Oil companies take a more relaxed attitude to political risk than many other firms. They are used to dealing with violent or unstable countries. Because oil is simply pumped out of the ground and can be speedily exported, they can tolerate economic mismanagement, civil disobedience and even isolated violence in the host country more easily than other industries." Nevertheless, political independence, stability and certainty concern them to a great extent. Pipeline security will particularly depend on the political stability in countries of origin and transverse. These include Azerbaijan, Turkmenistan and Kazakhstan as countries of origin, and Russia, Iran, Afghanistan, Georgia, Armenia, and Turkey as countries of possible transverse.

The fact that proposed pipelines would have to pass through two or more countries makes the situation even more complicated. Additional political sensitivity arises due to the multi-ethnic and socially polarized characters of the countries involved. Another risk-contributing factor is the undemocratic nature of the ruling elite in most of these states, and in the countries of origin in particular. Political independence is not fully assured given the harsh political-economic conditions in the countries of origin and due to the growing Russian interventionism in its near abroad. The explosive population growth is generating increasing and urgent needs for jobs and economic growth. Meanwhile, the new generation is demanding more and has higher expectations than its predecessor generation. They will hardly accept the continuation of current political repression and backwardness for long. They will demand democracy and development.

Equally unacceptable will be the current social inequalities in income and wealth distribution and in geographic distribution of national expenditures leading to extreme territorial imbalance. Such inequalities generate abject poverty and lead to environmental degradation and unsustainable growth. In the case of Persian Gulf states, oil economies in

the Caspian region tend to overestimate the role that oil revenue can play in sustainable growth of their economies. Any undue over-reliance will result in unstable economic policies and unwise spending.

Finally, ethnic disparity and the unresolved nationalities' question are additional sources of national cleavage in the Caspian states. The desire of ethnic elite to gain from pipelines economically and politically adds to the volatility of the political situation.

IV. Regional-Level Risks

The Caspian pipelines face a series of risks that originate from regional and inter-state conflicts. Ethnic movements are quite prevalent in the region. The Kurds in Turkey dominate the eastern mountains of the country and are a major source of worry for Ankara, which wishes to promote the Ceyhan route. The current crisis between Turkey and Syria is an indication of Ankara's deep concern with its Kurdish question. The Lezgins are struggling for national unity and independence. At present, they are divided into two parts in the Russian Federation and Azerbaijan. The Abkhazia separatist movement has destabilized the government in Georgia and continues to remain a source of national cleavage in that country. Chechnya and Dagestan continue to remain potential violent spots on the Russian Caspian frontier. The Chechens are particularly adamant about their independence and possible gains from future pipelines through their territories. Conflict among more than a dozen other ethnic groups in the Caucasus can flare up if their political and economic demands are not met.

The conflict between Armenia and Azerbaijan over Nagorno-Karabakh is on hold and could lead to renewed fighting in the future. Presently, twenty five percent of Azeri territory is occupied by the Armenians and this makes pipelines from Baku less than safe. In Afghanistan, while the Taliban seem to have secured its position as the dominant force, the end game remains less than certain there given the crisis with Iran. Other regional or international crises can develop given the alliance-making policy that some states follow. Meanwhile two other important source of tension remain: dispute over the legal regime of the Caspian Sea and a possible environmental conflict that can follow from the unwise utilization of resources in the Caspian by the oil producing states,

Azerbaijan in particular. Iran and Russia have little oil and gas resources around the Sea; instead, they depend on its clean environment for fishery and caviar. In addition, agriculture, forestry and tourism are vital for the people on the Iranian side of the Sea. Any degree of pollution can harm Iran's interests and become a cause for political conflict.

V. Global-Level Risks

Another set of political risks that face a rational decision regarding pipeline routes emanates from global games for strategic gains. The East-West axis strategy followed by the U.S. proposes to exclude Russia and Iran while including Turkey along with states in the Caucasus and Central Asia. The rivalry this strategy generates can prove unproductive for the independent and democratic development of the very states the U.S. wishes to promote. Both Iran and Russia are central to the coherence and wellbeing of the larger region. Their cooperation can help while their antagonism is sure to hurt. To view the Caspian solely as a linchpin of American global game for strategic gains is unwarranted. The current power game and alliance-making policy goes against the need for cooperation in building, utilizing and safeguarding the pipelines.

As part of its global and regional games, the U.S. has tried to cripple Iran economically and isolate it politically. The economic impact of the containment policy has been simply devastating for the Iranian people who continue to suffer from declining income and employment opportunities. Politically too the U.S. policy has hurt Iran by making it enemies to its otherwise natural allies. At present, three sets of regional alliances are organized around and against Iran: Turkey-Azerbaijan-Israeli alliance in the northwestern and western borders, Iraq-Mojahedin-UAE alliance in the western and southwestern borders, and Pakistan-Taliban-Saudi Arabia alliance in the southern and southeastern borders. These destructive attempts notwithstanding, the U.S. has not been able and will not be able to bring Iran to its knees as the country benefits from a rich history of national dignity and regional role.

Aside from destructive rivalry between the states, the present policy discourse in the Caspian region will increase the tendency toward anti-externalism, reviving the largely

outmoded anti-imperialist political culture so embedded in the minds of the Caspian people. If current outside intervention lead to failure of the states to develop their respective societies, alternative social systems and ideologies will come to challenge the current drive for establishing liberal political and economic systems. Extremism and national fascism are candidates for such an eventuality. From this perspective, pipeline routes needs to be decided with a view to regional development not as a tool to serve strategic interests of particular states or groups of states. The key to altering the present discourse is a change in U.S. policy toward Tehran and a good starting point will be for the U.S. to free the Iranian asset in a symbolic gesture and to drop its opposition to pipelines going through Iran.

VI. Toward a Cooperative and Win-Win Strategy

The above analysis indicates, among other considerations, that the best solution to the current stalemate may be found within a cooperative framework that emphasizes four principles: a win-win strategy, a multiple-pipelines approach, political reform and sustainable economic development. A win-win strategy will de-politicize decisions with regard to pipeline routes, seeks a balance of national interests, and includes existing and prospective investors in determining the optimal routes. Meanwhile, the states with high stakes in the region, namely the U.S., Russia, Iran and Turkey, must realize that their current rivalry or hostility serves no one in the longer term and that a more amicable solution to outstanding claims will serve all parties involved. In this regard, a solution to the current standoff between the U.S. and Iran is the most critical. Here as in the case of other rivalries, visionary leadership is called for in which sensationalism is subordinated to rationalism and long-term gains.

A multiple-pipelines approach is another component of the optimal and logical solution to the current stalemate. First, a multiple-pipelines approach will reduce dependency on a few countries and avoids concentration of world energy in a few hubs such as Baku, the Strait of Hormuz in the Persian Gulf and Novorossiysk or Ceyhan and Supsa on the Black Sea.

Second, the multiple-pipelines approach is economically logical. For example, while Iran offers a cheaper alternative than Russia or Turkey for pipelines from both Central Asia and the Caucasus, its comparative advantage lies in providing swap arrangements and easier access to fields in Turkmenistan and Kazakhstan. Turkey and Russia could have offered attractive routes for pipelines originating from points in Azerbaijan but, cost aside, feasibility is seriously constrained by political and environmental difficulties. Third, the political logic of multiple-pipelines is equally attractive as it reduces sensitivity to political instability in a given country or countries along a given route. The current largely political logic applied to pipeline routes not only goes against economic logic but is counterproductive because of its superficial treatment of regional politics. For example, while bilateral political and strategic alliances are emphasized, internal political development is ignored.

Fourth, the technical feasibility of various routes also increases with a multiple-pipelines approach. This is due to the varying geographic and environmental difficulties that certain proposed routes pose. Within a cooperative framework, pipeline routes can be modified to avoid country-fixed solutions and possible inter-state environmental conflicts. Finally, the multiple-pipelines approach lessens possible strategic losses while increasing potential strategic gains. Pipelines are long-term commitments to a nation and countries that lose will do so strategically. While there is no guarantee that the people who gain will remember the favor, the losing people will surely develop a structural animosity toward countries it considers as the culprits. Given the deep-rooted anti-imperialist political culture or nationalistic tendencies in most of these nations, such a structural anti-externalism can lead to social upheavals. Needless to say that in that case, the domestic and international players in the pipeline and energy games of the Caspian region will encounter a lose-lose situation.

Political reform is key to political stability in the Caspian region and as such is the most important precondition for the safe operations of the pipelines in the long run. The reform must be genuine and lead to political participation, elite circulation and the rule of law. It must also end corruption, create discipline within the state and increase its

accountability. Current personality-based and exclusionary politics will not last for long. The new generation expects freedom, participation and development. The new global community is too transparent concerning what has been achieved by developed nations and represents models for emulation and potentials. The future leaders of the Caspian states will have difficulty to justify underdevelopment and dictatorship in an increasingly developing and democratizing world. As a basic requirement of political reform, the states must prepare the ground for expansion of civil society institutions and alternative discourses in all spheres of national life.

Political development is a precondition for sustainable economic development. Yet, the states in the region cannot afford to postpone the latter until the former has been achieved. Here lies the challenge facing the emerging economies in the Caspian region: They must develop as they democratize. The one and only possible alternative in this direction is a balanced development strategy: one that allows for economic growth and diversification, provision of basic needs, expansion of civil institutions and circulation of the elite. As states promote political liberalism and free-market principles, they must also devise visions for re-inventing the government, expanding social networks and promoting political competition. In short, political and economic pluralism along with a complementary social policy is the key to state-building and national development in the region. Unless and until these conditions are met, pipelines will continue to remain vulnerable to domestic violence and inter-state conflicts.

In closing, I wish to invite attention to the consequences of the Iraqi invasion of Kuwait for the pipelines that used to take millions of barrels of Iraqi oil to international markets. Those who promoted the pipelines on the basis of economic, technical or strategic criteria never thought that Saddam Hussein's dictatorship and undemocratic approach to the states in the region would become a cause for their closure. Had the Iraqi people and the states involved insisted in a balanced political-economic development of the country, Iraq would not have lost billions in oil revenue investment, and the pipelines would have been carrying more oil to the world energy markets for the benefit of all involved (except for the Caspian states!). As it is rightly said, democracies do not fight, internally or

externally; but dictatorships do! I am only hoping that this and similar other examples will make current decision-makers think deeply about the multiple conditions that need to be satisfied for a sustainable Caspian energy transport.

The Interests of Russia and the Caspian Successor States of the Soviet Union

Uwe Stehr

It is not difficult to determine both the economic and the political interests of the states situated at the Caspian Sea. Their economic interest is to earn money. All of them are aware of the fact that they cannot acquire and exploit the oil and gas resources alone, but have to share and that they therefore depend on cooperation with their neighbors. They also know that the time has not yet come to earn a lot of money and that they have to wait some six to eight years before this situation will change. It is of particular relevance for the future development of this region to observe how these states use the six to eight years to find solutions to their regional instabilities and how they prepare their legal systems and their infrastructures for the expected big business.

The political interests of Azerbaijan, Kazakhstan and Turkmenistan are to stabilize and to strengthen the national independence they achieved seven years ago. They implement this policy by inviting as many investors from different countries as possible, thereby diversifying their dependencies on foreign capital.

Another interest of today's ruling elite is to stabilize their dominant position in their societies with the help of gas and oil. The more money they can distribute or make available to competing clans, the fewer the challenges they face for their own power. Here again the ruling elite will have to make provisions for the years from 1998 to 2005.

To determine the Russian interests in the region is more complicated. At first glance, Russia wants to pursue two objectives, apart from earning money: Russia wants to provide political stability at its southern flank and it wants to be acknowledged as a leading power in this post-Soviet era. Russia's leverages to implement these objectives are security offers, and offers for conflict resolution on the one side, Lukoil and pipelines on the other side. In the Caspian region as well as in the West, there is a lot of speculation about decisions concerning the future routes of big pipelines. The facts of today are that there is certainty only about the northern route to Novorossiysk through

which the early oil is being transported with sufficient reliability. Also relatively certain is the small pipeline through Georgia which is expected to be ready by the end of 1998. Decisions on the other, larger pipelines will require a substantial increase in the exploitation of new oilfields and will therefore be taken at a later time. It is this big oil in the years to come which fuels discussions today.

For Azerbaijan, Kazakhstan, Georgia and Turkmenistan, as well as for the western oil companies, the relationship toward Russia is a crucial issue. Business interests and interests in the solution of the various conflicts of the Caucasus region focus on the role Russia will play.

In Georgia, the criticism with respect to Russia has grown since the attack on President Shevardnadze and the hostage taking of four soldiers of the United Nation's mission. Georgia is disappointed about the lack of Russian engagement in the solution of the Abkhazian conflict and is again interpreting Russian politics in terms of hegemony. Azerbaijan, which, in the commercial field, supports cooperation with Russian companies, at the same time, perceives Russia as a power that backs Armenia in the Nagorno-Karabakh conflict. The Karabakh conflict prevents a consolidation of Azerbaijan as the Abkhazian conflict prevents a consolidation of Georgia. A Russia that declares a vital interest in the stability of not only the Northern Caucasus, but also the Transcaucasus should – this is the expectation – pursue a different policy with respect to Karabakh and Abkhazia and should try to settle instead of prolong the conflicts.

Since Primakov took over the foreign ministry, many have had the impression that Moscow wants to regain influence in the former Soviet republics and is actively trying to implement this policy. In reality, there is a big gap between Primakov's rhetoric and the capabilities of Russian politics. Russia today is not capable of realizing initiatives to solve Transcaucasian conflicts comparable to those the U.S. undertook in Dayton to solve the conflicts in Bosnia.

It is probably correct to say there will be no conflict resolution in the Transcaucasus without the participation of Russia. But this does not mean the reverse – that an inclusion

of Russia will most likely lead to a positive solution. The policy of the Russian state – not the policy of Gazprom or Lukoil, but of the state – is weak. Its budget is full of illusions and deficits and incapable of giving positive economic incentives for de-escalating conflicts and for exerting influence in a modern way, for example through preventing arms trade and corruption instead of organizing it, and through mediation by their stationed forces in cases of shootings between different parts of the population, etc.

The three Caucasian states will not find stability as long as a substantial part of the many refugees have not returned to their homes. This is an urgent issue that should be dealt with before oil and gas will become a dominant economic factor in the Caspian region. The refugee issue will – the longer it is postponed – create a momentum of its own and generate more and more violence and instability, which in the end might effect the prospects for a diversified multinational investment in the future of the region.

Oil and gas are interesting subjects not only because a few people can get rich through the exploitation and the selling of this raw material. Oil and gas constitute the hope to put an end to the economic and social decline of at least some of the post-Soviet states. While the former COMECON members in Eastern Europe, (in particular Hungary, Poland, the Baltic Republics and the Czech Republic) developed into dynamic regions of economic growth by pursuing a consistent reform policy and by Western support which resulted into a level higher than that of the year 1989, Russia and the other successor states were less successful. They lack domestic investments and they still have not reached the turning point for a stable, reliable, comprehensive recovery. The question of where the dynamic factors are that are capable of principally reversing the negative trends, is unanswered yet in Russia. The successor states around the Caspian Sea hope that oil and gas are dynamic factors which will give their societies a new and modern basis for sustained development and for success the same as the Eastern European countries achieved not because of oil, but because of hard work. It is too early to know whether they will succeed.

American Commercial Interests, Commitments and Strategies in the Caspian Area

Sheila Heslin

Without getting into the specific strategies of individual companies, who really need to speak for themselves, there is a broad convergence, at the overall level, between U.S. government policy and American commercial interests at this time, with the possible exception of U.S. policy toward Iran.

I will outline what the broad themes are that frame this issue. First of all, in terms of what U.S. commercial interests are, the U.S. government is looking at this more broadly than simply, “can we have a few more oil suppliers in the market”.

There is a great interest in diversifying western energy supplies, reducing to the greatest extent possible dependence on Middle Eastern sources of energy. And, what a lot of people will tell you, is that the Caspian may only produce 3-4 % of what we will eventually need – or will buy. But it is important to keep in mind that it was exactly a 3-4 % shortfall in the 1970s that caused the great oil price shocks we had in the West. So, 3-4 % is an important incremental addition to world energy supply.

In addition, something that is not often noted, but turns out to be very important, is that the U.S. (and the West in general) has a great interest in encouraging Caspian development because it nudges along the Russians and the Gulf states, in terms of competition, access to production sharing agreements (PSAs) and investment.

There are three potential producing regions: Russia, the Caspian and the Gulf. The Russians and the Gulf states actually have more in terms of reserves. But, they have been very reluctant to do things like grant PSAs. They have been pretty tough on all western companies. And, what we have seen is both the Russians and the Gulf States responding to a development that they did not think would happen. This development is western companies investing large amounts of money in the Caspian. More than in the entire former Soviet Union energy sector at this stage is in the ground in the Caspian. While the

Gulf states have their whole energy industry up and running, they are still facing the second round of investment requirements. This introduces needed competition.

Third, American commercial interest is in rapid Caspian energy development and its transport, via multiple pipelines that are competitive, reliable and secure. I would say that the most likely bets in the first generation of pipeline development (and by first generation I mean between now and 2010) are the Black Sea ports of Novorossiysk, Supsa and Batumi. Here, regional governments in the south Caucasus and Central Asia have made clear that is their preference. American companies, and actually many European companies, are also interested in this option. The U.S. government has expressed strong support. But, there are still some important outstanding problems, which may mitigate how quickly that will come to fruition.

Routes for American companies to keep an eye on in terms of second generation include Afghanistan, Pakistan, China and Iran. Depending on how the U.S./Iran relationship evolves. There is a lot of synergy between our broad interests, which is encompassed in those three or four points.

In terms of strategies and commitments, the companies will tell you that this is a commerce-led development. And that, above all, commercial principles have to reign. Basically, for all the regional powers, this means that if you want a stake you have to pay. This is an important principle, and it has given a certain level of sanity to an otherwise very complicated region. It has created both a floor and a ceiling for what is possible as these lucrative field and pipeline developments take place.

A second broad theme that we have seen emerge is that all the consortia that have been put together have tended to be broad based and multinational. The reason for this is to protect against political risk, which is still very significant in the region not simply because of regional conflicts, but really because of all the regional power interests involved. For example, AIOC, which was one of the front runners, had fifteen companies with eight countries involved, including Russian, Turkish, Saudi, U.K., and U.S. companies. What people will say is that we have purposefully wanted to ensure we had a

U.N. security council of countries involved in our consortium because political risks are high.

So, one sees, in particular, quite a bit of company to company competition in terms of what their field of concentration is. But, there is an enormous amount of cooperation between U.S., European and, increasingly, Japanese companies, too. In each field cooperation is moving forward. The same applies to Turkmenistan, where UNOCAL – together with others – is involved with the Saudis, and the South Koreans. That is the main principle and strategy for companies.

Another important element in the overall strategy for how to deal with the Caspian is that companies have basically agreed to rapid development. I am not convinced, given world price levels that they would have necessarily agreed to that themselves, but the countries in the region basically see rapid development as directly linked to their future prospects for independence.

Most of these companies have signed on to timelines in terms of how long they are going to explore and when they are going to produce. Most of these are in the six to eight year timeframe.

So, we will see this region coming online despite the nay-sayers. Or, companies will find themselves in difficulty. That is why one sees that the other sort of element, in terms of strategies for companies, is to very directly field development and transportation. There isn't one without the other. Further, governments in the region are now linking these two together.

Tengiz is linked up with the CPC pipeline. AIOC is progressing; they have multiple early oil pipelines that are coming online and then they are looking at a main oil pipeline. That is because, overall, all companies are looking for an overlapping web of fields, pipelines and shipping contracts. With American companies now, one sees that almost all are involved in all three energy rich countries. And, if they are not involved in all three, they are working very hard to become involved in all three. They are trying to

figure out how to link up the volumes across on the two sides of the Caspian so they can drive these pipelines where they need to go. They need enough volume to be able to negotiate a route to take them where they want to go.

There is much discussion about how one gets regional governments on board, et cetera, but almost every American major player is now on at least two sides of the Caspian pursuing multiple pipeline development. Regarding pipelines, companies are seeking to gain experience through small-scale pipelines first. Before they invest billions, and before they get to construction or commitments on main export pipelines, they want to form partnerships with key players while the risks are still relatively low.

They are trying to resolve intractable problems before they end up in a situation like we saw in the Tengiz field where Chevron had a billion dollars invested in the ground and Russia refused to let them ship through their pipeline network. This is shut-in production and it is very costly for American companies. Almost everybody has taken a lesson from this in the Caspian region.

So the small-scale projects that are now under way go through the Russian pipeline system. From Azerbaijan to the Russian port of Novorossiysk, about 20,000 barrels flow per day. They are hoping they can get it up to about 150,000 barrels a day coming out of AIOC. The pipeline has been recently shut down, apparently, and it is not clear whether it is for maintenance, or if there is a tariff problem again between the Russians and the Chechnyans. So, it is not a reliable pipeline.

There is oil coming out of Tengiz through the Russian system, up to the Baltic, and, also, by barge through the Volga-Don Canal and there is a little bit going out in Novorossiysk. It is going out of all places, but not in large amounts.

In Georgia, the AIOC has committed to build the Baku-Supsa pipeline. I suspect they initially were thinking that they would have that up and running by this fall, but that may slip a little bit to next spring. In any case, that is moving forward and there is also oil being shipped from Kazakhstan, across the Caspian and then by rail across Azerbaijan

and Georgia – again, by the folks at Tengiz. They have also picked up extra pipeline, so you will see oil coming through Georgia, both out of Supsa port and out of the Batumi port; some of it from across the Caspian.

Further, there are small-scale exports coming out of Kazakhstan by rail to China. And, there is oil coming out of Kazakhstan through swaps with Iran. U.S. companies are not directly involved due to our sanctions law. And, there is a small-scale gas pipeline that is also moving very small amounts of gas into Iran out Turkmenistan.

All of the routes that are being discussed in terms of potential main export pipelines are actually being tested in small volume. All of these routes are commercially viable. There will be timing and sequencing issues in terms of which ones get built first, what impact that has on the region and what impact that has on American and other companies.

This brings me to the development or strategies for development of main oil and gas pipelines. In the first generation, you will see some expansion into Novorossiysk, – out of Kazakhstan; the CPC pipeline will eventually be built. There are some problems between the Russian Federation and the regional government regarding conflicts over how much each is going to get and what the line is going to look like. Commercially, that has to be overcome, but eventually that will be surmounted and it will be built.

You will see, as a result, some minor expansion coming into Novorossiysk out of Baku, but not a big main oil export pipeline. At this stage even the Russians have said Novorossiysk can only take so much and it can't take a whole lot more. You will also see an expansion in the Supsa direction. Maybe as much as up to 350,000 barrels a day if there is another pipeline added on.

My prediction is movement of this first tranche of oil toward Baku – toward the Ceyhan land route, simply, and not only because the Bosphorus is, in some ways, a ticking bomb. Maybe you can get ten years of oil shipments – increase oil shipments through the Bosphorus, but one day there will be an accident. When the accident occurs near Istanbul,

if other routes have not been developed, there are going to be big problems. And, that is when oil production is going to be a lot higher than it is today.

Thus, American companies, for now, really cannot look to Iran for the first generation. There are two things that are at play. Number one, it is actually more profitable to go to Ceyhan than to go to Khark for oil. It is more expensive to build the line, but more profitable.

The other issue is that if you look at most American sanctions, they take a long time to remove once they get put on the books. Jackson-Vanik is still on the books, and that is a Soviet sanction. The Soviet Union dissolved a long time ago. Until U.S./Iran relations evolve, sanctions will be a problem.

Because American companies tend to be bundled in with the other companies for broader geopolitical reasons, in consortia, this will tend to slow down an Iran route. It will eventually emerge, but not in the first generation.

What you will see is a significant expansion of small-scale kinds of pipeline developments and swaps through Iran. On the gas side, a lot depends on what happens in terms of the legal status of the Caspian Sea. There has been some movement recently on the part of Russia in terms of how to address the legal dispute, and how to manage resources, subsidy resources, and the water column. That may have some bearing in whether cross Caspian pipelines can be driven.

China is a route to watch, again, for a second generation. It may be that China will move forward, in the first stage, in terms of financing pipelines down to Iran out of Kazakhstan and Turkmenistan, but China and the rest of Asia right now have quite a few problems of their own.

There is significant interest on the part of China for broader geopolitical reasons, to reach into the Caspian region and across the Caspian region, into the Middle East directly. This

is a very good way for them to begin to do that, though it may take them some time to actually move forward.

With regard to Turkmenistan, in a second generation the absolutely best option for them is to pursue a route to the Arabian Sea. It would bring them close to Asia. They would be able to supply their markets in Pakistan and India. The Afghan war is a clear problem, and probably will remain one for some time.

It is interesting that during the entire Soviet occupation of Afghanistan, pipelines tended not to be blown up. Various regional warlords were basically bought off by the Russians. There is, then, a trading culture in the region which might allow pipelines to be laid, but financing will be an obstacle to moving that forward until there is some government that is recognized to be in control of the region.

Where does that leave us? Where we stand right now, American companies, European companies and Asian companies, in particular the Japanese, are in the Caspian region to stay. There's already four to five billion dollars in the ground, if not more. Another 60 billion or so in semi-concrete commitments are also out there. Estimates of as much as 200 billion dollars in infrastructure that people think over the next 20 to 30 years will be required.

Whether that will be put in the ground, who's to say. In the first generation of Caspian development there is a great deal on convergence between U.S. and European companies. Obviously, Iran is an issue again, but when you get down into the details, from a purely commercial standpoint on oil, it is not as much as an obstacle on gas. It depends very much on how the legal status issue plays out.

At a broader geopolitical level, U.S. policy toward Iran is certainly a flash point and one that is going to have to slowly, but surely, be addressed.

European Union Policy and Action Toward Central Asia and the Caspian Sea Countries

René Leray

The EU policy toward the Newly Independent States (NIS) is mainly articulated around four complementary pillars:

- EU partnership and cooperation agreements (PCA) with each of the Newly Independent States (NIS): These are comprehensive frameworks covering economic issues and political dialogue and democratic institution building.
- EU TACIS programs (technical assistance programs), which constitute the world's largest donor grant finance to the New Independent States.

These first two pillars cover the whole spectrum of the necessary economic and political modernization of these countries

- The European Energy Charter and its Treaty, which is legally binding and which will enter into force in November 1998.
- INOGATE (Interstate Oil and Gas Transport to Europe), a specific technical assistance program.

Both the Energy Charter and the INOGATE program are designed to create opportunities for these countries to exploit and export energy resources as a concrete basis for their economic development and their political independence.

Since 1991 TACIS allocated more than 2.3 billion ECU for grants to the NIS of which a significant share went to the Caucasus and Central Asia countries.

Energy – not including nuclear safety – represented more than 300 million ECU, the other important sectors of assistance being the reform of the public administration, the restructuring of state enterprise and private sector development, the modernization of agriculture as well as transport and telecommunication infrastructures.

The Energy Charter is a multilateral framework initiated by the European Community as early as February 1991 which settles a full set of guidelines and principles for investment

protection. These principles include equal treatment of domestic and foreign investors, protection against politically motivated disruptions, trade relations similar to the World Trade Organization (WTO) agreement and a dispute resolution procedure. It was negotiated in 1991 and completed three years later by a legally binding instrument called the Energy Charter Treaty in 1994. Forty-nine states, including all the post-Soviet countries – but not the United States and Canada – signed the Energy Charter Treaty in December 1994. This treaty will enter into force in November 1998 when the needed number of thirty ratifications has been reached.

Concerning the EU INOGATE program, its origins go back to 1992, but it was only in 1994-1995 that it acquired a strategic importance for the NIS, and especially the Caspian Sea countries. That was when it became perfectly clear that without free and permanent access to international markets and to hard currency, customers there could not have any kind of sustainable political independence and economic prosperity.

This was very flagrant, for instance, in the Ukraine's case when Moscow decided in 1994 to openly link the issue of Kiev's arrears on payments to Gazprom with the dispute over the Black Sea Fleet. Or, in Georgia's case, where after the victory of the Abkhazian secessionists, Moscow sought to use gas supplies as a means of coercing the Shevardnadze government in the face of a wave of popular hostility against Russia and against the Russian military in particular. Or, when Moscow refused to allot Central Asian gas producers capacity on pipelines for export to Europe. Or, when Moscow imposed very high transit fees for Central Asian products, namely on Kazakh metals and Uzbek cotton to be exported to Europe via the Russian railway system.

All these facts combined with, for instance, the strong pressure exercised by Moscow on Georgia, Armenia, Uzbekistan and Azerbaijan to press them to join a "Customs Union" (Russia, Belarus, Kazakhstan and Kyrgyzstan) were perceived as a way of controlling from Moscow the foreign economic relations of the Caucasus/Central Asian countries or even blocking them into a kind of *chasse gardée* within which these countries would be obliged to trade their raw materials and energy resources for second-rate Russian industrial products. They definitely convinced those in the NIS who saw a direct link

between the independence of their country and their ability to get permanent and free access to the international markets.

More or less at the same time (mid 1995) the European Union defined more precisely its strategic interests in both the Caucasus and in Central Asia and decided on reinforcement of its action especially in the field of energy and energy infrastructure.

As a follow-up, the European Commission organized a first Conference in Brussels, which was attended at ministerial level by all NIS and created a working group that founded the INOGATE program.

Fifty million ECU were allocated to this program for the period 1996-1999. In that time, many concrete projects have been implemented, including:

- The rehabilitation, expansion and modernization of regional gas transmission systems and of supply systems for oil and oil products;
- The assessment of the prospects for enhancing the transport of hydrocarbons from the Caspian Basin and Central Asia to European markets;
- The transfer of “know-how” needed to ensure conformity with international standards;
- The feasibility of alternative routes, notably, new routes across the Caspian Sea.

The beneficiaries of the first set of projects are all the republics of Central Asia and the Caucasus plus the Ukraine, Belarus and Moldova. Russia, which until now voluntarily limited its participation to the level of observer, has recently expressed its desire to become a full member of the working group. Intensive negotiations are presently taking place between the European Union and the United States.

There are a number of issues under discussion on a “policy planing” level. The first concerns the perspective of a concerted approach not only for the energy aspects of this region, but also for the consolidation and progressive democratization of states. This concerted approach could be aimed at better coordination of what is now done separately in the OSCE framework, or with the NATO Partnership for Peace, as well as with the EU and United States policies. It could contribute to avoiding a repetition of the Great Game

(or Great Gamble). That is to say, the development of a bad balance between the necessary rationality of the energy projects – including pipelines – on one side, and a too “geopolitically minded” approach on the other side. It could also efficiently support a more active and confident regional cooperation as well as a full extension of the Energy Charter and its treaty to countries like Russia and the United States, but also Turkey, China, Iran, and even Japan.

These policy recommendations should be discussed first between Europe and the United States. It would have the added effect of being a good way to enrich the so-called “renewed” transatlantic dialogue.

U.S. Policies in the Caspian Sea Region: Implementation Issues

Nancy Lubin

JNA Associates is currently working on two studies that address some of these issues from two different angles. The first study, undertaken at the request of five private foundations here in the U.S., is to assess the U.S. assistance program throughout the former Soviet Union to explore the kinds of things that work, and the kinds of things that do not work. Simultaneously, we have begun directing a Council on Foreign Relations Task Force, under the Chairmanship of Senator Nunn, to take a look at the potential for conflict in Central Asia and how one can begin to address it before it gets out of hand.

What I will do today is simply outline some of the broad findings from these and other studies that seem to complement the kinds of issues we have been discussing here. We have found that while often Western strategies themselves might be clear and sensible, carefully balancing all of our different objectives in the region; in practice, once they begin to be implemented on the ground, the tactics can become unclear and often undermine the very overall objectives that we are trying to attain.

This is true in terms of western assistance policies and projects on the ground as well as overall foreign policy. Regarding assistance, on the one hand, the commitment that donor organizations have made to encourage fundamental change – to help stimulate democratic change, help create market-based economies, and the like – has been laudable. The amount of support, overall, that has been sent to these countries is high and rising. For Central Asia alone, the U.S. administration is currently requesting about \$200 million this year in assistance for the southern tier – a huge jump from what it has requested before. This funding is requested for a wide array of programs that hit questions of democratic and economic change as well as broader commercial and foreign policy issues. Some of these programs have been remarkable, including an army of non-governmental organizations who are working with groups on the ground to start to create a constituency that can lobby these otherwise often entirely authoritarian governments under which they must operate.

Humanitarian assistance is also extensive, as are the number of groups trying to help reshape laws and create societies based on the rule of these laws. Even in Azerbaijan where the level of U.S. activity has been low due to 907, which prohibits government-to-government assistance, an army of small non-governmental organizations (NGOs) have been able to work around the law's restrictions. Assistance funding is still small, and should be expanded in this part of the world.

That said, however, a major challenge is to provide this assistance more effectively. Once on the ground, far too many assistance programs seem to be hampered by a number of factors that even the assistance community has acknowledged are major impediments to encouraging any fundamental change.

One of the first problems we came across is that once the strategies start getting broken down into action, western assistance efforts become far too piecemeal to be effective. Each individual portion starts to focus – and is rewarded for focusing – on its own tiny mandate that ignores the bigger picture under which it is supposed to be operating. The net effect is that often we address one small part of the picture but step on our own toes as we make the overall picture worse.

When we have asked the heads of various economic reform programs on the ground, for example, how they factor into their projects broader political and social issues – issues such as how what they are doing might impact on the political situation in these countries, how it might exacerbate a gap between rich and poor (which is one of the biggest sources of conflict currently) rather than to mitigate it, etc. – all of them uniformly answered that they do not assess or address those questions because it is not part of their mandate. This was also a major criticism that came out in the European evaluation of the EU TACIS where, in July 1997, this independent evaluation criticized TACIS for focusing too much on the economic side and not on the broader political context, in this case, questions of democratic reform. As a page from that report here puts it, “the evaluators consider that the consent of the TACIS program has so far not reflected the fact that reinforcing democracy is one of their two program objectives.”

In the absence of a comprehensive policy that integrates these different objectives, this piecemeal approach to reform often addresses the small questions, but might inadvertently exacerbate the bigger ones.

A second problem highlighted in our work that may fit our discussion here is the generally weak coordination both within assistance agencies, among them, and between the assistance community and the expatriate business community in this region. We found that often, many different groups are on the ground begin to work at cross-purposes. For example, the European Bank for Reconstruction and Development recently announced its decision to provide a hundred million dollar credit line to Uzbekistan at precisely the same time that the International Monetary Fund (IMF) announced its decision to suspend its \$135 million loan because the Uzbekistani government was not living up to its obligations.

What we often give with one hand we end up taking back with the other. This allows the countries of the region to play us off against one another. The business community is commonly quite skeptical, if not hostile, towards the assistance community for not only failing to pursue programs that could open the way and assist business in its efforts to expand commercial activity on the ground, but for sometimes directly impeding their efforts. Many say that too often, our assistance programs erect new impediments rather than assisting to open up commercial doors, and projects often work at cross-purposes. Some assistance providers agree with this assessment – but place the blame for lack of coordination at the feet of the entrepreneurs and business community.

A third problem is a paucity of real regional projects. We have been discussing regional problems a great deal at this conference, but for the most part, our assistance programs are set up bilaterally. A number of small NGO type regional conflict resolution or prevention programs, for example, in the Caucasus have been terrific. But for the most part, it is rare to see larger projects structured that way.

A fourth concern is the absence of effective follow-up. We hear a good deal about agreements that are signed, and for the most part, mark very important first steps. But

these agreements do not mean much unless they are enforced. An army of Western specialists have been working on the ground helping to re-write various types of legislation; but rarely is it part of their mandate to continue to provide oversight to ensure, or even assess, whether this legislation is being enforced. Many of these countries have long boasted an array of beautiful laws and agreements on the books – but also an array of laws that have rarely been enforced over the past seventy years. Greater follow up should be a key component of all efforts in the region, and is far too often pushed to the side as donors push ahead with new programs.

A fifth problem may be the most serious of all. There seems to be a sense, at least as assistance programs are designed, that we all share the same objectives. It is assumed – indeed, assistance is often predicated on the notion – that these governments are seeking democratic and market reforms, and our role is mainly to show them the way.

But this is not the case. These governments do not necessarily want the same things that TACIS, USAID or other western donors are striving to create in their countries; their vision is often quite different from our own. While these differences should not put a brake on aid, they should be explored, understood, and incorporated into our own approach and project design. Our greatest challenge may be to shape our programs so that local goals are taken into account – or avoided where they may be counterproductive – but so that we do not lose sight of our own goals. Programs should be approached ultimately to help reshape countries in a way that is productive for local inhabitants and for western commercial, foreign policy and geostrategic interests.

A final challenge is that so many of these problems stem from the fact that there are so few people on the ground who have had prior experience in the region. Without understanding the informal workings of these economies, the widely varying sets of interests and the nuances of how all of this fits together, western designed projects at best will be distorted, co-opted – and perhaps, ultimately, destructive. The number of poorly designed projects has been wonderful for JNA's business, because we tend to be called by many organizations that realize the mismatch between their projects and Central Asian political, social and economic realities – but it can be terribly destructive for the region.

I would end by suggesting, then, that as we discuss Western strategy in this region, part of our mission be not only to shape the strategies themselves, but to have better insight, and oversight, into how these are implemented on the ground. This is not an easy challenge, and requires pooling the thinking of policymakers, practitioners, independent experts and local observers to match strategy and programs with local realities. And it requires a greater degree of public involvement as well. I hope conferences such as these are able not only to inform policymakers and practitioners, but also to better educate all of our respective publics, perhaps particularly in conveying a sense that this region is not only a twentieth century “Great Game” over competition for oil and gas, but a region of enormous potential and possibility, yet danger and intrigue, that is likely to affect us all in the years to come.

U.S. Policy and Action Toward Central Asia and the Caspian Sea Countries

John Lichtblau

This paper will focus on the oil aspects of the Caspian Sea projects and developments. There is obviously a very significant interest on the part of the U.S. from the oil point of view. It is well known that the U.S. is the world's largest oil importer and as a super power we are interested strategically in that area. About 50% of our oil is imported and all projections show that our oil imports will rise perhaps 60% ten years from now. I think the administration has accepted that fact.

There is still talk at Congressional hearings that we have to do something about our oil import level, that we have to cut it in some way. But this gets to be less and less convincing. After all, 50% import dependency is a lot less than Germany's 95% or Japan's 100% and these countries are not exactly suffering. It is thus tolerable, but it requires government planning and strategy and this is where the Caspian Sea comes in, because it is an important new supply source.

If one has to depend on foreign oil, the best way of making the dependency less risky is by continuous diversification of supply sources and not just for oneself, but on a global basis. The U.S. actually has substantially reduced its import dependency from the Middle East and increased its imports from Western Hemisphere sources significantly.

That is logistically meaningful, but strategically it is not, because if there is any disruption in the Middle East, we would be just as much affected by it even though our imports from that area are very small. Also affected would be Japan or Germany or any country that is totally dependent on the Middle East. There is a single world oil market and anything that affects that market, affects all customers.

So diversification of supply sources has been one of the U.S. basic policies in our import program and our import policy over the years. This was discussed at a recent Department

of Energy planning hearing here in Washington. There were some comments made that we have to do something about reducing our dependency, but it was basically just talk.

The really important question was how do we distribute the risk by having more supply sources, and the Caspian Sea is potentially a very important new supply source. It is true that very current oil exports from the Caspian region are very small. It has not been developed, the oil has not been developed, even though Caspian Sea oil production started at the beginning of the century.

But, it has not been developed anywhere near its potential under Russian control. The oil is there; it is just a matter of investing and bringing it out. There has been some talk that it might be another Middle East. I think that is not really possible. We're talking about currently 15 to 30 billion barrels of crude oil reserves in the Caspian region area versus about 650 billion currently in the Persian Gulf.

Of course, part of the reason why the Caspian Sea is only 15 to 30 billion is because there was relatively little drilling done in the region. That is supposed to be changed now. The potential, according to the U.S. government, may be total recoverable reserves of possibly as much as 150-200 billion barrels. Which is, indeed, a lot, but, on the other hand, the total potential reserves in the Middle East are well over a trillion barrels.

So it does not come anywhere close to the Middle East. The Middle East's share of world oil exports is likely to rise even in ten or fifteen years from now. But prices, as is well known, are made at the margin, so the possibility that perhaps by 2010 the region might be able to export perhaps as much as three, three and a half million barrels a day is a very significant factor of interest to the U.S. economy.

This is one reason why the U.S. is interested. Another reason is that American companies, with their technology, are in a position to develop these resources and it is good for American business to be in there. So from the commercial point of view, the U.S. State Department and other U.S. agencies have been very active in encouraging both American companies to go in there and the governments of these countries of Kazakhstan

and Azerbaijan and others to accept these companies. They have done this so that there is a very real presence of American companies in the Caspian region now.

The problem is all of this oil is land-locked. And the problem with land-locked oil is, the only way you can get it out is through pipelines. That means that the transit countries play a very important role. Once the pipeline is built and operating, the transit country almost has an monopoly position. They can raise the fee, they can ask for something else. It cannot be stopped.

This is not a problem only in the Caspian Sea region, it happens in many other places in the world. Usually one is able to cope, but one of the ways of coping is to have multiple supplies, meaning multiple pipeline outlets, so that if something happens in one, you can shift to another, especially if each one of them has some spare capacity.

There is, therefore, a real interest on the part of the United States to see that a number of pipelines will be developed to transport that oil to world markets. The first big pipeline will be the one through Novorossiysk, which is on the Russian Black Sea port. The U.S. is not opposed to that. It is likely to be built, but it does not want this to be the only line. It is undesirable because politically it would give Russia unusual leverage over the economy and the politics of these countries.

The other pipeline that is being discussed as the most likely runs through Ceyhan in Turkey. That is much further, and it is more expensive, but it would diversify the exit of oil from the Caspian region. It does cost more money, though, and so there is some reluctance. And there may be some other pipelines.

One of these possible pipelines (and this is where we get into the sensitive political area) is through Iran. In fact, it is the shortest alternative. It goes straight down to the Persian Gulf, and in terms of capital investment, costs substantially less than the one through Ceyhan, in Turkey. It might even be less than the one through Novorossiysk, although there is no question that the one through Novorossiysk is being built.

But, the U.S. is, of course, opposed to any kind of investment from any source in Iran. At the same time, costs will be less and it would mean that oil from the Caspian Sea could be transported to the east, instead of the west.

Now the growth market of the world is Asia, even though there is a crisis there right now. Both in recent years and in the future you will still see substantial growth rates there. The oil demand in Europe and the U.S. is leveling off or increasing at a very slow rate so that logically a pipeline that goes through Iran to the Persian Gulf, where oil could then be shipped either east or west, would be the first choice. But, at the moment it is not even a second choice. It may be built eventually.

We know that a pipeline, a gas pipeline, from Turkmenistan to Turkey, via Iran is under serious consideration. It is very likely it will be built even though the U.S. is not happy about it.

One might have thought that with the changing government in Iran there might be a change in attitude in the U.S. government. But, in a recent statement an Assistant Secretary of Energy said quite bluntly “forget about a pipeline through Iran. We do not want them and there will not be any.”

Now I do not know if that was an official line, or off the record. He was at a Congressional hearing, but being a Deputy Assistant Secretary of Energy is not necessarily a policy position. It may not have been the official policy, but it was nevertheless a very strong statement at a Congressional hearing.

So our policy towards Iran here is in conflict with most other industrial countries and most other potential actual oil importers who would like to see a diversification of supply sources, just as we do. They would like to see part of this pipeline go through Iran. It is possible that if a pipeline is built, the U.S. may not object to the oil from U.S. companies going through there as long as the U.S. is not involved in building the pipeline itself.

But, that is only a possibility. It is also possible that at one point somebody in the Senate may say this is, in a way, benefiting Iran and our policy is not to benefit Iran, therefore these exports would have to cease. So, in a way, it puts U.S. companies at some additional risk in the area, vis-a-vis non-U.S. companies.

It does not mean that they have not gone in there. There is a substantial U.S. region. But, the Caspian region without Iran is unthinkable. It is the biggest country in the area. Even though Iran, itself, has almost no offshore production off the Caspian Sea, it is now considering developing some. But most of its oil is offshore in the Persian Gulf region, not in the Caspian Sea. However, this could possibly change.

Another thing is that Iranian companies may be involved as partners in some of the developments. Under current legislation an American company cannot participate in any joint venture where there is an Iranian partner. So this is also potentially a problem.

There is another possibility to include Iran and that is to ship Iran oil from Kazakhstan or Azerbaijan to these northern refineries and then exchange it for equal volumes of oil exports from Iran through the Persian Gulf. In fact, on a very small scale, this is done now with Kazakhstan and it is permitted by the U.S. administration. But the potential of that could be as much as maybe 350,000 barrels a day. Right now it is 40,000 barrels a day. So here is a possibility without any significant investment to bring some oil, at least as much as several hundred thousand barrels a day, through the Persian Gulf from the Caspian Sea exporting areas.

Whether the U.S. government will permit this or whether they will at that time say, “No, this is a circumvention of our legislation and American companies cannot be involved,” one doesn’t know. But there is a conflict. How it affects American companies in that region is definitely to some extent negative – not enough to keep them out, but to have a handicap, vis-à-vis other companies.

German Policy Towards the Caspian Sea Region

Michael Schmunk

I.

The view that Germany has up to now revealed no *strategic* interest in the Caspian Sea region, is often expressed. However, that is not the case. The German Government is indeed very much aware of the geostrategic significance of the Trans-Caucasus as a *bridge and crossroads* between Europe in the west and Central Asia in the east, Russia in the north and Turkey and Iran in the south. A power vacuum in this area would be an open invitation to regional powers with hegemonic designs in the Caspian Sea. It is therefore the aim of German foreign policy to prevent the emergence of new spheres of influence in the region by bolstering the independence of Azerbaijan, Georgia and Armenia. A vacuum here would undermine stability not only in the Caucasus-Caspian Sea region but in the wider area extending as far as Europe, which as a result of the European Union's eastern enlargement is moving ever closer to Transcaucasia and the Caspian Sea. It is precisely for this reason that the German Government is involved in efforts to find a political solution to the Nagorno-Karabakh conflict, for instance.

Stability is definitely a *strategic* objective, which Germany is pursuing with a whole series of national measures and projects, as well as other measures together with its partners in the European Union:

- Political measures:
the promotion of democratization; election assistance; a political and social system based on the rule of law; the promotion of free media; and the introduction of modern laws;
- Economic measures:
the development of a free market system; creation of medium and small sized businesses; an efficient agricultural system; advice on the modernizing of old "Soviet" industries in branches with potential; as well as energy and water supply for households;

- Regional measures:
establishing a West-East transport and communications corridor within the EU framework: TRACECA/INOGATE (including the transport of oil and gas from the region towards Europe); promotion of cooperation among the Transcaucasian states themselves.

Immediately after the three Transcaucasian (and five Central Asian) republics became independent, Germany opened embassies in all of their capitals and began promoting their sovereignty – which at that time was not unchallenged – as well as their political and economic development, which has been appreciated on all sides.

Thus Germany was in a good position when the time came to pick up the old cultural threads. In Azerbaijan, for instance, Germans began to settle in 1819; they were known as the "Danube Swabians". And in 1864, Siemens began producing various metals (especially copper) and successfully continued this activity for about 50 years. Germany also has very close and long-standing cultural relations with Georgia.

The German Government has not identified itself with the "Great Game" slogan which is used to describe the geopolitical and geo-economic (oil resources!) tensions and disputes in the region. On the contrary, it has from the very outset sought cooperation with the new states in the Transcaucasian/Caspian Sea region in an effort to de-escalate conflict situations.

A major part of this strategy is to include, not exclude, all three major powers in the region, Turkey, Iran and Russia, for all of them are directly or indirectly affected, politically, militarily, but also economically, by the formation of these new states on their borders. But Germany, along with its European partners and here too largely in agreement with our American partners, is helping to maintain a balance of interests and stability in the region in spite of the new geopolitical constellation.

II.

However, Germany has considerable economic and, though to a less instant, energy policy interests in the region. Today, for example, some 50 German firms are engaged in trade with Azerbaijan. Indeed, a number of them have established production facilities there. They include world-famous corporations, but also medium-sized companies.

Germany's involvement in off-shore oil production in the Caspian Sea is, admittedly, fairly modest compared with that of the United States and EU partners Great Britain, Norway, France and Italy. German DEMINEX, joint operator in the international oil business on behalf of the energy corporations VEBA, RWE/DEA as well as BASF/WINTERSHALL, only began offshore activities in July 1997 with a 10 % holding in the fifth international consortium "Lenkoran-Denis"/"Talish-Denis" (and is now seeking a 35 % share and thus leadership of the consortium in another field). Up to now there has been only an onshore joint venture with AZGERNEFT near Baku through the Hamburg oil firm of GRÜNEWALD. At any rate, German companies such as DEUTAG (seabed drilling) or GABEG (underground tanks) are carrying out assignments for other consortia.

Many participants have asked why, where oil and gas are concerned, Germany is a consumption giant but a production dwarf. The reasons are mainly practical.

- Unlike the United States or Great Britain, for instance, Germany has no comparable national corporations, which are organized and operate internationally.
- Germany does not have any experience with offshore production. In contrast to the United States (e.g. Gulf of Mexico) and the North Sea countries, United Kingdom and Norway, Germany has no oil or gas resources of note.
- Germany has secured long-term supplies of crude oil (and natural gas) by means of a dense network of contractual relationships.

The German government naturally wants to diversify imports of oil and gas so as not to depend too heavily on specific suppliers and at the same time to ensure that as deposits are exhausted new suppliers of oil of the same quality are available (stocks in the North Sea, for instance, from where Germany obtains about 33 % of its crude oil, will start to

diminish in about 2010). Both factors are increasingly important for reasons of foreign, security, economic and energy policy. Oil is finite, and this, according to present estimates, will be particularly noticeable from the year 2040 on. But as early as 2010 the growing demand for oil will deplete major deposits with the result that fewer and fewer suppliers will be left, most of them in the Middle East, including Iran and Iraq.

The present low oil price is deceptive: various experts expect the end of cheap oil by 2010 at the latest. How far science and research can open up alternative sources of energy, which would ensure a smooth transition to a post-oil economy, is uncertain.

Germany is following these developments and projections. The energy industry in Germany is organized along private lines, however. Thus it is ultimately private companies who decide whether and to what extent they should become involved in foreign exploration and production, as well as the development of transport routes (pipelines) to ensure diversification. However desirable it may be for Germany to be involved in oil exploration and production in the Caspian Sea on grounds of foreign and energy policy, the government can only provide advice and a favorable environment. It is management themselves who make the ultimate decisions.

Our American friends have impatiently asked the Germans and the Europeans what route they prefer for pipelines for Caspian (and possibly Kazakhstan and Turkmenistan) oil. This question has an economic and a strategic element. First, pipeline routes are a question of economics: private consortia have to pay for construction and operation and therefore base their decisions on cost and profit factors. Since German companies are only marginally involved in production, their influence will be correspondingly small. There are also political and security implications. Hence, various routes are being considered under this aspect: the northern route via Russia to Novorossiysk, the western route via Georgia with bridgeheads in Supsa and, via Turkey, Ceyhan, as well as several possibilities through Iranian or Armenian territory ("peace pipeline").

Apart from the cost and capacity question, one has to ask how far these routes would be safe from attack or disruption for political reasons. It would be politically unwise to rule

out one of the above options from the outset. How far the private consortia are willing to take political arguments into consideration remains to be seen. The German Government would not be able or want to interfere in such decision-making processes. However, it will continue to be involved in the EU's more general discussion on pipeline concepts as part of the wider project for a Euro-Transcaucasian-Central Asian transport corridor.

Germany is in any case not last in line where oil dealing in Baku is concerned. Through BENCKENDORF & Co. (Hamburg) it was involved in the Azeri onshore oil production as early as 1888/1889. In 1906 the company produced about 530,000 barrels a year and by 1912 was using 74 pumps operated by 600 workers. This continued until the Soviets nationalized the company in 1920.

The Caspian Sea Littoral States: The Object of a New “Great Game?”

William Odom

The most I can do in addressing the Great Game and Regional Security is to offer some elementary ideas about how to view them. My remarks, therefore, are intended as a modest contribution to clarification of the topic, and particularly, of why the United States is ill positioned to deal with the regional security problems of the Caucasus and Central Asia.

I. Why the Great Game Image is Misleading

It has become popular to see a new Great Game shaping up in this region, one in the tradition of what Rudyard Kipling called the Great Game between Russia and Great Britain over this same region during the nineteenth century. This image is misleading because it obscures at least four major differences.

First, the nineteenth century Great Game was between two imperial powers, Russia and Britain. Today, Russia is up against many players. Nearby outside regional players include, at a minimum, Turkey, Iran, Pakistan, and China. Western Europe and the United States are not yet players although their big oil companies are dragging them into the game. Finally, inside the region several Newly Independent States are players; three in the Caucasus and at least three of the Central Asian countries, perhaps all five.

Second, the old Great Game was one of competing imperialism. Today, imperialism is found only on the Russian side, and there it is a seriously weakened and could either disappear entirely or revive in a limited way. The jury is still out over which course Russia will follow.

Third, the character of the regimes within the contested areas is quite different from the nineteenth century. These former Soviet republics have high literacy rates, experience with industrialization and urbanization, and an active intelligentsia. The intelligentsias are attempting to articulate indigenous identities – religious, cultural, and ethnic –

sometimes with state support, sometimes against the local rulers. At most, such developments in these countries were only inchoate a century ago.

Fourth, pay-off in the Great Game was territorial gains, and the costs normally exceeded potential gains. Today, the pay-offs are several, including national independence, profits from oil and gas production, an Islamic cultural revival, and many lesser ones.

In sum, there is utility in the historical analogy, but it is in the dramatic differences, not the similarities. The mere exercise of defining the differences improves our understanding of the forces at work both within and from outside Central Asia and the Caucasus.

II. Threats to the Region

If we are concerned with the security of this region, we must properly identify and distinguish between threats and vulnerabilities, not confusing the latter for the former. Much talk about threats to the region has clearly been off the mark precisely because it has confused conditions or dispositions with causes. Let me elaborate this problem in principle.

Let us suppose that I throw a rock through a window and the window shatters. Then suppose an observer says, “the glass broke because it was brittle.” The implication seems to be that brittleness broke the glass. At first we nod in agreement, but consider it for a moment. Did brittleness actually break the glass? Not at all. It was brittle before I threw the rock, and it did not break earlier. Obviously not! The rock broke the glass. Brittleness is a disposition or condition, not a cause. In military security language, “threats” are potential causes, and “vulnerability” is the proper label for a disposition that threats may attack or exploit.

Diversity in ethnicity is mistakenly but often viewed as a “threat” throughout much of the region although it is really a “disposition” that can become a “vulnerability.” The so-called danger of radical Islam in Central Asia also is more properly labeled a “disposition” than a “threat,” giving it the status of a “cause.”

With these distinctions in mind, let me suggest two major security threats and two vulnerabilities in Caspian Sea region. If we understood them fully and could deal with them, we would be well advanced toward a solution to the region's security challenges.

III. Russia

First, Russia remains a threat. Yet, it has proven far less effective in asserting its grip on Central Asia and the Caucasus than many observers, including myself, would have believed only a few years ago. The reasons are twofold. First, the Russian reformers, especially economic reformers, recognized that maintaining political control of these regions would seriously impede a transition to a market economy in Russia. Neo-imperialists in the Ministry of Defense and some of the old economic central planning bureaucrats and firm managers want to reclaim control of both Central Asia and the Caucasus. Until the summer and fall of 1993, the liberal reformers seemed to be winning, and then the tide seemed to shift as Russia pushed its way into the Tajik civil war and into Georgia and Azerbaijan. Still, the liberal reformers occasionally succeed in blocking the neo-imperialists. For example, they simply do not provide funds to the army even when they had been appropriated, and the cost of keeping troops on the Afghan border, in Dushanbe, and in Georgia and Armenia is not small.

The second reason is that the Russian regime has proven far weaker than most observers expected. It has demonstrated its capacity to make trouble inside states in both regions, but it has not been able to reassert full control. Part of this weakness is attributable to lack of interest; numerous Russian elites would like to reassert control, but the public at large seems either disinterested or against it. Even the plight of Russian minorities in both regions stirs little sympathy, and Moscow's policies toward those returning to the Russian Federation range from cool to downright hostile.

Still, I would not yet write off Russian imperialism because of Russia's proximity to the region. Russia is big and close by. Europe, the United States, and China are far away. Over a long period of time, the West may lose interest; Russia is so close that it probably will not. Nor will China lose interest in Central Asia.

IV. Two Types of Weak States

Next let me describe a major vulnerability in the region: the weak state syndrome. It is conspicuous throughout the region. To understand what constitutes a weak state, of course, requires knowing what constitutes a strong state. I am using the term as it has been developed in American comparative politics literature, such as Samuel Huntington's book, Political Order in Changing Societies, Joel Migdal's Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World, Brian Downing's The Military Revolution and Political Change: Origins of Democracy and Autocracy in Early Modern Europe, and others, including my own book, On Internal War: American and Soviet Approaches to Third World Clients and Insurgents. As Huntington puts it, the "degree of government" is more important than the "kind of government" when we are concerned with stability and state strength, and as several scholars have demonstrated empirically, the single best indicator of the strength of a state is its capacity to collect income taxes, i.e. direct taxes, because that requires effective local government, police, courts, communications, etc. A state that can assert such invasiveness at the local and individual levels certainly has a high "degree of government." Huntington also emphasizes that most dictatorships – praetorian regimes – are weak regimes, although the popular view is normally that they are strong. And Migdal explains why the popular view is wrong. Such dictatorships leave many autonomous social enclaves not integrated into the state. Dictators repress them and try to contain them precisely because they do not have the institutional capacities to integrate them within their political system.

Applying these concepts to the states of the Caspian Sea littoral, we can see that all of them are weak, very weak, similar to many of the Third World states, former colonies, newly independent since WW II, most of which are still weak and likely to remain weak for a long time. The "weak state" syndrome in fact seems to be the international norm. Yet from a policy viewpoint, Western observers tend to see it as temporary, abnormal, a situation that must rectify itself. Weak states do not actually "cause" disorder, violence, and war. Rather they are vulnerable to the actors that cause such things.

We find two types of weak states in Central Asia and the Caucasus. The first is the struggling democracy, or those states that tried to follow the democracy path in the last years of *perestroika* and immediately after the collapse of the Soviet Union. They are Georgia, Armenia, Azerbaijan, Tajikistan, and Kyrgyzstan. In all of these cases but Kyrgyzstan, the Russians took advantage of the open political processes there to create chaos, applying a divide-and-rule strategy to retain Moscow's influence. Kyrgyzstan has been an exception, probably because Kazakhstan and Uzbekistan did not want a civil war there and nipped the KGB's mischief in the bud in the Fergana disorders in 1990.

The second type of weak state is found in the dictatorships – Kazakhstan, Uzbekistan, and Turkmenistan. In these cases, the local communist party leaders changed their labels, became nationalists, kept control, and therefore were able to prevent the Russians from stirring up conflicts, which they could then pretend to manage through so-called “peacekeeping” endeavors, the pattern in Tajikistan, Georgia, and for a time in Azerbaijan. Aliyev has moved Azerbaijan toward this type, just as Akayev has done in Kyrgyzstan. Strongman rule allows them to keep the Russians out, but it brings a host of other problems.

The dictatorships may survive for quite some time because they are not precisely what Huntington defines as praetorian systems. From the Soviet polity they inherited fairly strong institutions for social and economic mobilization, that is, a high “degree of government.” The Uzbek, Turkmen, and to lesser degrees, Kazakh and Azerbaijani governments look very much like the regimes in Syria and Iraq, with Baathist parties and institutions which were copies from the Leninist model. The latter two, however, could easily fall into disorder. Kazakhstan's large Russian ethnic minority region makes it particularly vulnerable. Aliyev's Azerbaijan has a large number of refugees, the lingering Nagorno-Karabakh conflict, and weaker residual institutions from Soviet times than Karimov's Uzbekistan and Niyazov's Turkmenistan.

V. Is the Islamic World a Source of Instability?

Next, as the third factor, is Islam a “threat” to the region or a “vulnerability”? Much was made in the first couple of years after the collapse of the Soviet Union about the probable ascendancy of radical Islamic influences in both Central Asia and Azerbaijan. A lasting judgment on this problem is impossible, but thus far, Islamic radicals have not done well in the region, not even in Tajikistan. Iran has behaved with considerable circumspect, not pushing radical Islamic in the region. Saudi Arabia, however, is covertly spending large sums of money throughout the region to revive Muslim clergy and to construct mosques. What their politics will be is not yet clear.

As a tentative judgment, I suggest that Islam is a cultural “disposition,” not a “threat,” but possibly a “vulnerability.” The seven decades of secularization in Central Asia and Azerbaijan will retard but probably not permanently preclude a revival of Islam. Whether its politics will be radical is likely to be determined by how the dictators treat it. If they treat it as a threat and repress it brutally, it will turn radical. Thus, we may want to call Islam a vulnerability, but we should not see it as a threat to the region.

VI. The Threat of Oil Revenues

A fourth factor falls into the threat category because of the deleterious effects it will almost inexorably have on several regimes. As some of these states succeed in exporting significant amounts of oil or gas, large revenues will pour in. Anyone familiar with the history of Peru knows what a state’s dependency on commodity exports for revenues does to the strength of the regime. It keeps it weak. The regime has no incentive to penetrate the social, economic, and political enclaves that resist political integration. This is true because the rulers have such large revenues from other sources that they do not have to tax individuals and businesses at the local level.

Oil exports are particularly dangerous in this respect. Nigeria’s history over the past two decades and the recent developments in Venezuela are cases in point. So is Algeria. The Shah’s fall in Iran was in no small part abetted by dependency on oil revenues for state income. The fragility of all the Persian Gulf oil producing regimes is conspicuous, and

the oil price boom in the 1970s weakened Saudi Arabia's internal tax system noticeably, imposing serious problems when the price bust came in the 1980s.

In the Caspian Sea littoral states, pouring wealth into the hands of weak governments could destroy them, or at least prevent them from making significant progress in state-building. This threat is far more serious for these regimes than Russian imperialism. Yet it is most difficult and the threat least likely to be addressed by effective Western strategies.

VII. Strategies for Providing Regional Security

Against this assessment of the "threats" and "vulnerabilities," let me turn to strategies for achieving regional security.

First, dealing with the Russian threat has to be part of our overall strategy toward Moscow, not separate and limited to the Caspian Sea region. Contributing effectively to Russian economic reforms is likely to dampen neo-imperial aspirations, but effective contributions may no longer be big IMF loans and other direct monetary transfers to the Russian state. Such transfers are beginning to have a negative impact, allowing the postponement of economic reforms. The former finance minister, Boris Fedorov, argued here in Washington in 1996 that an \$11 billion IMF loan made no economic sense what so ever. It could only be justified as buying Yeltsin's re-election. His clear-eyed candor took his listeners by surprise as Congressional staff aides insisted that Russia needed the IMF loan and perhaps more!

Second, building alternate pipelines to those running from the region through Russia is absolutely essential if the worst kind of Russian influence is to be avoided. Multiple routes will encourage competition and a desirable kind of Russian influence – cooperative, private sector, business participation.

Third, if the United States is to play more than a trivial role in the region, it has to break out of the constraints it has placed on itself with its double containment policy toward Iran and Iraq. It may not be easy, and many American political leaders may oppose it.

We should be clear, however, that the price will be to exclude the United States from playing much of a role. And the price will also be to facilitate the reassertion of Russian neo-imperialism at the very time we have a chance to transform the Russian role into a positive one.

Fourth, within the CIS structure, an alliance of presidents – Kuchma of Ukraine, Shevardnadze of Georgia, and Karimov of Uzbekistan – has been acting together to constrain Russian use of the CIS to re-impose its hegemony. President Aliyev of Azerbaijan and President Niyazov of Turkmenistan have also come to participate. In the near term, this may be the most important development for regional security. These men, especially Shevardnadze, are seasoned leaders with a record for effective political judgment. Conceivably, they will succeed in improving the prospects for regional peace and stability while we in the West quarrel amongst ourselves and clash over policies toward particular countries, leaving us more or less out of the picture.

The Great Game – Then and Now

Michael Mandelbaum

To refer to the politics and economics of Caspian Basin energy as the new Great Game is to deploy an historical analogy. It is to compare what is happening in the Caspian Basin region now with the imperial rivalry between Russia and British India in the Caucasus and Central and Southwest Asia in the nineteenth century. The deployment of analogies in this way is familiar, useful, and perhaps even necessary. After all, the past is our only real guide to the future, and historical analogies are instruments for distilling and organizing the past and converting it to a map by which we can navigate. During the Cold War, American diplomats were perpetually concerned to avoid another Munich and American military officials strove to prevent another Pearl Harbor. Lately, we have been warned about the need to avoid, in Kosovo, another Bosnia.

The appeal of this particular analogy, moreover, is plain. There are striking parallels between the events to which it refers that were important in the last century and those to which it also refers that promise to be important in the next. The region in question is the same. In both cases, high stakes were involved – in the nineteenth century the control of territory and the security of what were then the two largest empires on the planet, in the twenty-first the enormous wealth that flows from the exploitation of energy resources. Conflict is a feature of both cases. Then, two great European powers were rivals. Now, although there are many players in this new Great Game, they often have different interests. And lurking beneath the surface of current events, at least in the eyes of some, is the specter of the revival of the great antagonism of global politics in the second half of the twentieth century, the one between the United States and the Soviet Union.

While analogies are useful, however, they can also be misleading. They smuggle in assumptions that can be wrong. That, I believe, is the case here. The differences between the Anglo-Russian rivalry in the nineteenth century and the politics and economics of Caspian Basin energy in the twenty-first are more important than the similarities.

The first difference is captured by the term itself. The Great Game has a romantic overtone. The romanticism associated with this great imperial rivalry was typical of the nineteenth century, or at least of the twentieth century's retrospective view of it. This was a game played by brave, eccentric, often lone adventurers, who journeyed into hostile, unknown territory, sometimes dying tragically, or heroically. In Britain in the nineteenth century the names of the players of the Great Game were well-known: Conolly, beheaded by the Emir of Bukhoro; Burnes, martyred in the first Afghan war; Younghusband, the last in the line of great explorers of Chinese Turkestan. There were also Russian equivalents who were known in Russia in the nineteenth century but whose names were blotted out by a Bolshevik regime that had no use for them. These individuals played the same role in the culture as the great explorers of the nineteenth century and the early twentieth: Stanley, Sir Richard Burton, Lewis and Clark, the polar explorers Scott and Amundsen. They were especially appealing figures because their histories exalted the individual in an age that was already beginning to be dominated by machines and organizations.

A hundred years later the exploitation of Caspian Basin energy is pre-eminently, quintessentially, the work of powerful machines and vast organizations. The participants are teams of executives, geologists, engineers and bankers. The contrast with the lone heroes of yesteryear could not be starker.

Where the metaphor of the game is concerned, the differences are also stark. The players of today are different than the players of the nineteenth century. Then there were two more or less equal contestants, both present in full force in the stretch of Asia that they contested. They were like prizefighters glowering at each other from opposite corners of the ring: Russia from the northwest, British India in the southeast. The players in the game of Caspian Basin energy are different. There are many sovereign states, not just two. There are many private interests. Russia, of course, is still important for reasons of geography, but the United States cannot substitute for British India because it is not and will not be physically present. There will be no American expeditionary force to Central Asia. If the politics and economics of the Caspian Basin turn into a military contest the

United States will not wage it directly. But it is not a military contest. The rules now are different.

The Great Game of the nineteenth century took place in the age of empire. It was a contest for direct control of territory and its inhabitants. Today, we live in the age of national, or at least local, sovereignty. Imperial control is difficult to impose and costly to sustain. Nineteenth century Britain sometimes assumed control of distant territory, despite the fact that no one in London wished to do so. Today, by contrast, while neo-imperial impulses may live on in Russia, the obstacles to acting on these impulses are formidable.

In fact, the stakes are different now than they were then. The nineteenth century Great Game was in essence a contest for power. Such contests are zero-sum games: one player's gain is another's loss. That is why the logic of international politics is the logic of conflict. Where Caspian Basin energy is concerned, the stake is economic gain; consequently, the logic is one of cooperation. There was, to be sure, a measure of cooperation between the antagonists in the old Great Game. Afghanistan was tacitly left as a buffer state between the two; at the end of the nineteenth century Persia was divided into spheres of influence in anticipation of the larger conflict that began in 1914. And it is also true, of course, that conflict – or at least disagreement – is involved in the division of the energy resources of the Caspian region, above all over how to apportion the riches of the Caspian Sea itself.

In the new Great Game relative gains do matter. But absolute gains are more important. Every player would like to have a larger share of the pie than the others do; but every one of them wants, above all, to get *something*, and that requires cooperation. So the essence of Caspian energy politics is cooperation, and of that there has been a great deal. Cooperation has occurred in the form of multinational consortia, agreements among governments, and cooperation between and among different firms from different countries for the sake of energy exploration and retrieval and the building and refurbishment of pipelines, and this cooperation includes Russia. The appropriate metaphor for the politics of Caspian energy is therefore not imperial rivalry; the

illuminating comparison is not with the Anglo-Russian Great Game of the nineteenth century or the scramble for Africa at the end of that century. The late-twentieth century scramble for oil wealth bears a far closer resemblance to a large business deal put together by lawyers, executives and bankers. All wish to maximize their own individual shares, but all need a deal of some kind or nobody gets anything. And, in fact, the exploitation of Caspian Basin energy riches requires, and involves, a series of just such deals.

The business deal is one analogy that captures some features of Caspian energy that a comparison with the nineteenth century Great Game leaves out. Three others are also instructive.

The first of these is with Bosnia. Bosnia stands for conflicts arising from the lack of fit between political borders and the geographic distribution of ethnic and national groups. It is relevant because both deposits of energy and actual and proposed pipeline routes are located in just such geopolitical seismic zones. The relevant place names are familiar: Karabakh, Chechnya, Georgia. With their ethnic and national conflicts, these areas resemble Bosnia but with the added complication that, unlike in the Balkans, tangible western interests are at stake. Pipeline routes are potentially hostage to warring national and ethnic groups.

The second relevant analogy has to do with a particular threat not to outside powers but to the local countries. The analogy is to Nigeria, which stands for the danger that oil wealth will lead to corruption, political disintegration and, in the long term, even economic debilitation. The windfall of great riches can, if mismanaged, make things worse, not better, for the recipients.

The third and final analogy is to the position of Britain in the Arab Middle East after World War I. The British inherited responsibility for much of the Ottoman Arab provinces and for the Arabian peninsula after the defeat of the Turks in 1918. But that responsibility turned out to involve thankless and expensive tasks, which London attempted to shrug off almost from the beginning. Managing the Middle East competed

with more important political and military responsibilities, first in India then in Europe. The American relationship to the Caspian Basin is relevant here. From the point of view of the United States, the Caspian Basin is considerably less important than the Persian Gulf, for the simple reason that it has considerably less energy. It is the Gulf that matters in economic and therefore in strategic terms. The Gulf is where the United States, willy-nilly, has serious responsibilities. It is not particularly illuminating to describe the task of shouldering those responsibilities as a game. That task is frustrating and dangerous. But it cannot be abandoned, except at great cost. The Persian Gulf is too important, because of its energy reserves, and too unstable, because of its culture and politics, to be left to local forces. Happily, that is not true of the Caspian Basin.

Part II

Region of the Future: The Caspian Sea

German Interests and European Politics in the Trans-Caucasian and Central Asian Republics

Policy Paper of the SPD Parliamentary Group in the German Bundestag

**Presented by Gernot Erler
in cooperation with
Friedemann Müller**

I. Central Asia and the Caspian Region: The Political Challenge After the Dissolution of the Soviet Union

When the Soviet Union dissolved in 1991, it left standing fifteen independent states. The Central Asian Republics of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, as well as the Trans-Caucasian Republics of Armenia, Azerbaijan, and Georgia began their independent political existence. These nations all belong to the "Commonwealth of Independent States" (CIS), with the Russian Federation as their most powerful partner. The political developments since 1991 have shown that these eight member countries of CIS (the remaining members are the Ukraine, Belarus, and Moldova) create a geopolitical unity which is characterized by constantly shifting loyalties among one another.

The discovery of rich raw material mineral deposits, mainly in Azerbaijan, Kazakhstan and Turkmenistan, has strengthened the sense of unity in the Caspian Region. The potential wealth of the region has awoken worldwide interest. The interest today picks up where it left off at the turn of the century, when the world had turned its attentions to Central Asia. Geopolitical experts such as the German Karl Haushofer and Halford Mackinder from Britain used their "Turkestan" and "Heartland" theories to expound on the idea that political control of this bridge between Europe and Asia provides the key to world domination.

Today, when the Central Asian region is again a main topic of geostrategical discussion, the memory of these theories is revived. The central question is whether the new oil and gas discoveries could lead to a "second Gulf Region", which several powerful countries would like to have an interest in.

Characteristic of the Caspian Region, there is a large spectrum of gray area between the potential of, and the proven presence of, reserves of raw minerals. The presence of approximately three billion tons of oil is confirmed. This represents roughly two percent of the world's reserves, approximately as much as is produced from the North Sea. The forecasts are for a presence of up to twenty-eight billion tons (in comparison: Saudi

Arabia alone has an assured presence of thirty-five billion tons of crude oil). Of this, up to ten billion tons (seven percent of the world reserves) are thought to be accessible.

With natural gas, the difference between discovered and suspected reserves is narrower. Six billion cubic meters of gas (six percent of world reserves) are certain, while there is a suspected total presence of eighteen billion cubic meters. These figures do not justify talk of a "second Gulf Region". The worldwide interest in accessibility to or control over these reserves is nevertheless understandable. With a steady rate of production, the North Sea oils will suffice for Norway for fourteen years, while Great Britain's reserves will last closer to ten years. Thereafter, the Western dependence on oil from the Middle East will be renewed. Using current rates, in 2010 ten percent of Europe's total demand for natural gas will remain unmet. In 2020 that rate is expected to reach thirty percent. In addition, an increase in the demand for energy is expected for South and Southeast Asia. Because of these expected developments, any chance for diversification of energy suppliers is seen as attractive. The differing interests in the Caspian Region therefore intersect. The situation becomes even more complicated due to the fact that a natural accessway to the open sea, and thus to the customer, is lacking. The mineral resources first become valuable to the producing countries, the oil companies, and the end user when the appropriate transport systems (pipelines) are installed. Every decision made over the management or building of the pipeline network helps one involved party, but hinders another.

The political challenge is that this above-described clash of interests takes place in a region in which, after the dissolving of the Soviet Union, there is still no political stability. The eight Trans-Caucasian and Central Asian countries, still searching for their identity, are struggling with their independence, and are to a great extent still at the beginning of a transition towards democracy and a market economy. They see themselves as standing in the middle of a precarious and menacing vacuum of political security, set off by the numerous and highly variable influence from abroad. The prospects appear to be completely open. The Central Asian-Caspian Region could minimize the problems and conflicts, and even become a model region for preventative

international balance-of-interests. This could be achieved through a co-operative effort by responsible parties which takes into consideration both the politics of the region and the international community, and through the co-operative use of the available wealth. There could also be the creation of a second Gulf Region; not in the sense of the Gulf Regions' energy reserves, but in the reproduction of strains and conflict of interests that in the Gulf has already resulted many times in bloody war.

II. German and European Interests in the Caspian Region

The Federal Republic of Germany and the member countries of the European Union pursue both political and economic goals and interests in the Caspian Region. Desire for political stability in the whole post-Soviet realm as the groundwork for the transformation process towards democracy and a market economy is strong. The European view is that a stable and conflict free development of the Caspian Region will only be successful when a balance is struck not only between the eight countries of the Caspian Region, but also between the Caspian Region and other affected regional as well as great world powers. These affected countries include Russia, China, and the USA, as well as Turkey and Iran and, due to the laying of pipelines, Afghanistan, Pakistan and the nations on the rim of the Black Sea. A monopolistic model for the accessibility to the oil and gas and its transport to the customer markets would damage the worthwhile desire for a balance of interests, as would the exclusion from participation and/or damage to the interests of any one or more of the above-mentioned countries.

European market interests demand political stability as a prerequisite. Taking their cue from their own prospective energy demand, the Europeans plan for direct participation in the large Caspian oil and gas syndicates. Trans-national European oil companies such as Agip, British Gas, BP, Royal Dutch Shell, Statoil and Total are taking part in the upstream activities and the pipeline projects. They do not, however, come close to approaching the interests of the large American companies, which in the most important syndicates in Kazakhstan and Azerbaijan have between a forty and fifty percent share hold.

In the Federal Republic of Germany, which is not represented among the 100 most important oil companies, there are smaller investments, out of which the ten percent share held by DEMINEX of Essen in the Fifth Azeri Syndicate in Lenkoran-Deniz is the most important. Apart from that, German businesses are oriented heavily towards infrastructure contracts, especially in road creation, the building of transportation systems and communal infrastructure, telecommunication, radio and television, and the production and distribution of electricity, to name but a few.

Until now, German foreign trade with the eight Trans-Caucasian and Central Asian republics has been modest. Imports in 1996 stood at a worth of 473 million Deutschmarks (DM), with exports worth 1,681 million DM. The amount of German direct investment has up until now been marginal. However, indications of a high level of increase are present. The total worth of trade with the region in 1998 will surpass 2.5 billion DM, and alone with Kazakhstan the volume of import/export climbed from 546 million DM in 1996 to 1.1 billion DM in 1997.

German industry judges the possibilities for the future as positive and points to a generally positive image of Germany, which leads back to the wave of industrialization in the beginning of the 19th century, to which names such as Siemens and Rothschild, among others, made unforgettable contributions. A financially successful strategy by German investors was the decision not to restrict business to oil and gas. This creates the opportunity to expand and diversify their interests in the Caspian Region. Finally, German businesses do not bind any of their business projects with the geopolitical and geostrategical interests of Germany, which is also registered as a plus by the countries of the Caspian Region.

Political stability, advancement in the transformation of state and society, contributions to Europe's secure supply of energy, fair terms for investment and development of trade relations – this list of goals is shared by all European countries. As far as a common European policy for the Central Asian-Caspian Region is concerned, though, although there are optimal conditions present, there is hardly even a hazy outline of any such policy at this time.

III. Obstacles and Risks

Certain conditions in the eight countries of the region are impeding a faster rate of development in economic relations. For example, German investors have gathered that the trans-national corporations of the mineral oil branch often use their investments for the creation of favorable conditions for other bidders coming from their own home countries. The business done with raw energy materials paves the way for further contracts in infrastructure. German policy must in this case make great efforts to demand fair trade conditions, and a balancing out of the present competitive distortions.

Many businesses fail due to financial problems. Even the countries with large oil and gas deposits do not have much purchasing power at their disposal, due to the fact that these resources will generate an increase in revenue sometime in the future. The reliance on private risk capital or guaranteed loans causes further problems. The German Hermesbürgschaften, for example, is tied to government guaranteed loans, for which the partner countries involved continually refuse to guarantee. Lines of credit, which are modest anyway, are yet to be taken advantage of. The Bank for Reconstruction's credit program for small and medium sized operators in the region will not take effect until the medium term. As an alternative, barter goods require that western markets are opened up to as yet unknown products. This is a next to impossible task for many of the European trade partners.

Business activity in the Caspian Region is also confronted with problems that lay in the backlog of the transformation process. There are complaints about a lack of clearly defined rights, and administrative hurdles that are hard to overcome. In addition, responsibilities and competencies are in a state of constant change, there is inadequate compliance to contracts, payment adherence is weak, and there is widespread corruption. It is essential in bilateral contacts that the government representatives of the partner countries strive constantly to minimize these obstacles to productive co-operation.

In the countries of the Caspian Region, business has yet to emancipate itself from political influence. There are strong ties and close personal relationships between the

leaders of government and the leaders of private and public companies; some that even create intertwining, clan-like structures. Important business decisions as a rule require the direct personal approval of the ruling President. As long as these patrimonial structures reign, one must take them into consideration. Without the establishment of contacts to political personalities, there will be no advancement in economic relations.

The political stability and the development of economic relations depend to an even larger extent on the continual solving of the many regional problems, which constantly threaten to become virulent again. The conflict between Azerbaijan and Armenia over Nagorno-Karabakh could flame up at any time. The government in Baku will not put up with the occupation of twenty percent of the Azeri territory or with the social burdens of 800,000 refugees forever. Without a clarification of the situation in Abkhazia and South Ossetia, Georgia will not settle down. The scars from the bloody war in Chechnya have yet to heal, and problems with ethnic minorities are a destabilizing factor in almost every society in the region, when they do not take an overall dimension, as in Kazakhstan, where Kazakhstani Russians make up thirty-one percent of the total population and there are over 260,000 ethnic Germans.

The latent ethnic conflicts and minority conflicts create an atmosphere where every state, along with its political and other interests, is vulnerable. It is, therefore, the state's task to ensure the goodwill of and balance with its neighbors. A few characteristic examples illustrate the region-wide situation:

- If Azerbaijan does not pay proper attention to Russian interests, Moscow can exercise its influence in Armenia over Nagorno-Karabakh, or choose to support the Lezgian minority to increase pressure on Baku. There are similar possibilities for Moscow against Georgia by taking advantage of the Abkhazia and South Ossetia conflicts. An anti-Russian position on Kazakhstan's part could also be answered by the Kremlin with encouragement of agitation by Kazakhstani Russians.
- Conversely, too much pressure from Russia on the Azerbaijani and Kazakhstani governments could result in an organization of transit for oil and gas that bypasses

Russian soil, and a boycott of the existing Russian pipeline network. The "Chechnian Card" is also always available for play. The most important Russian pipeline runs for 147 kilometers straight through the middle of Chechnya. The planned circumvention of this pipeline is practically defenseless against Chechnian acts of sabotage.

The more power brought into the Caspian Region from foreign elements to pursue their own interests, which in turn conflict with other interests and other competitors, the faster the political risks grow. The following shows an outline, though not an all-encompassing, overview:

- The United States has an interest in seeing the creation of a second Gulf Region that stands independent from the Gulf area, and includes an extraction zone with international access. It, therefore, supports the extensive engagement of American oil companies in the region. The United States will, at any cost, impair attempts by Russia to exercise influence over the former Soviet Caspian Region, or to reinstate the Imperium that collapsed in 1991. Any bit of influence Iran might have in the region is also anathema.
- The Russian Federation does not want to give up its traditional political and economic influence in the region. It views the United States' role, and the tied-in role of Turkey, skeptically and wants to ensure profit and control through the transit of Caspian raw materials through Russian pipelines.
- Through a giant pipeline out of Kazakhstan (contract worth: U.S. \$ 9.5 billion) China gains some of the energy materials it will need in the future for industry, and advances its competitive position with Russia and the western trans-national corporations.
- Iran, itself positioned on the Caspian rim, views itself as the natural hegemonic Islamic power in the region. It offers a well-developed pipeline network as an ideal transport means for the Caspian raw goods to the open seas and the Asian markets. This plan comes up against a veto from Washington.

- Turkey offers itself as the political alternative to Tehran with U.S. backing behind it. It would like to win for itself the lion's share of transport profits through the mammoth pipeline from Baku to Ceyhan that stand to be gained from the Caspian energy raw materials. Through this strategy, the pipelines would also be pulled away from Russian control.

The implications of the participating powers and the witches brew of diverging political and economic interests remind one of the general conditions that created the "Great Game" of the early part of this century, which is why this comparison is often made. The parallels are, however, limited in that today, the great trans-national oil and gas corporations constitute a new global player in the game. The new players often pursue completely different goals from their governments. Thus, the Russian oil multi-conglomerates do not in any way support Moscow's tactic of using the disagreement over the status of the Caspian Sea as a tool to inflame insecurity and to stall explorations. Likewise, the eight large U.S. oil companies, who have billions of dollars worth in contracts in the region, criticize and fight against Washington's Containment policy regarding Russia, and especially Iran, which stands in the way of a practical solution to the pipeline question.

The signs of growing tension and of the attempt to use existing conflicts for egotistical political goals are not lacking in the Caspian Region. Much depends on whether the European states can make up their minds to develop a single strategic policy towards the region.

IV. The Future of the Caspian Region: A Political Strategy

The Caspian Region will not develop into an area of peace, prosperity and political stability all on its own. The engagement of western countries and western multinational corporations in the region lends itself to a degree of responsibility. A common European strategy for the Trans-Caucasian and Central Asian countries does not exist at this time, but it is needed. The following points outline what this common European political strategy should comprise.

1. Transformation to Democracy and a Market Economy as a Prerequisite for Peace

The doctrine of American President Woodrow Wilson, which states that democracies do not go to war with one another and settle differences of interest non-militarily, has to this point remained intact. This fact alone justifies every measure of support for the democratic transformation of the eight Caspian Region countries.

There are, moreover, several regional-specific arguments. In the countries, which have a new wealth at their disposal, we witness today a completely one-sided appropriation of this wealth to families, clans or oligarchies. Use of the resources to expand the prosperity of the masses does not occur. On the contrary, the difference between conspicuous luxury on the one side, and extreme poverty on the other, is growing. The instruments of oppression, which are necessary for the perpetuation of these proportions, continuously produce human rights abuses. If the distribution of wealth remains in its current form, the protests of those groups discriminated against will be unstoppable. The above-mentioned conditions could be used from the outside as an instrument by the competing interests and bring about a crisis situation of destabilization and tensions throughout the entire region.

Those oligarchies that cash in profits from raw material excavation are, as a rule, not eco-conscious. The horizontal insolidarity in the form of an elite appropriation of wealth finds its counterpart in a vertical lack of solidarity against future generations. A successful transformation will first be necessary before a majority of people is going to demand ecologically protective uses of the valuable natural commodities. In contrast, a continuation of the ruthless exploitation of natural resources will damage not just the environment, but will multiply the security risks for the entire region. The ecological balance of the Caspian Sea is on the edge. The countries bordering the Caspian Sea face huge problems alone due to a rising of the water level by a possible fourteen centimeters a year through the year 2010 or 2020, not to mention the presence of rusting old drill structures, a plenitude of off shore extraction, and a sea floor pipeline project. Yet, more people make their livelihoods through fishing and caviar production than from oil excavations which so far also provides a higher economic revenue. The region could not

cope with a new ecological disaster. It still has no answer to the drying up and poisoning of the Aral Sea due to the cotton mono-culture of its two most important tributaries, the Amu Darya and the Syr Darya, nor for how the effects of nuclear contamination in the area Semipalatinsk, a former nuclear testing ground of the Soviet Union, should be brought under control. Given these circumstances, and the knowledge that authoritarian regimes will continue to push the politics of exploitation that during the Soviet era brought about these horrific environmental catastrophes, the political goal of the transformation to democracy can justifiably be called a matter of survival.

Therefore, it cannot be European policy to turn a blind eye to human rights abuses, or to an apparent refusal by a regional regime to democratize, simply in order to gain the advantageous business of the oil, gas, and natural resources sectors. Such presently comfortable and profitable agreements will prove in the future extremely costly, when the price is the abetting through silence of those regional rulers who would delay or even refuse to institute reforms.

2. Regional Co-operation vs. "Strategic Alliances"

The reasons that lend themselves to the organization of regional co-operation with the goal of a common Trans-Caucasian-Central Asian market are straightforward economic; foreign investors, especially those who want to construct production plants in the region, run up against the hindrances of a too-small, splintered market. A common market of the whole region would encompass a population of seventy million, and thus constitute a highly attractive order of magnitude.

Another argument for regional co-operation is the fact that the entirety of the region is land-locked and has no access to the open seas. The achieving of prosperity through raw materials will remain a dream so long as there are no transport routes. The three paramount preconditions are decision-making, construction and safeguarding. The above described mutual applicability and dependence practically force an amicable solution to the pipeline problem that takes all sides into consideration. The voices of the large oil

companies concerning the pipeline questions are loud and clear; they stand for a co-operative solution and emphatically reject (for whatever reason) political tutelage.

Regarding mutual dependence, further region-specific co-operation is absolutely necessary, mainly due to the fact that the mineral rich, lower elevated republics of Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan have little water at their disposal. The higher elevated countries of Kyrgyzstan and Tajikistan have plenty of water, but little of other riches. There would be no need for a battle for life-sustaining water if a regional distribution and coherence system could bring about a balanced redistribution of unequally distributed goods and resources.

Unfortunately, political developments are moving in an antagonistic, fatal direction. Under the influence of powers from outside the region, there are two camps emerging. These opposing groups, the line of division for which runs straight through the middle of the Caspian Sea, refer to themselves as "strategic alliances". The one group aligns Azerbaijan and Georgia with foreign powers Turkey and the United States. The other includes Iran, Armenia, the Russian Federation, and (with reservations) Turkmenistan. The antagonism between these "alliances" reminds one of the ill-fated geopolitical developments of the last century, which ended in a high death toll for Europe. A common European policy must attempt to retard the repetition of another such development. Europe supports and encourages regional co-operation in the Baltic (customs union), in East-Central Europe (CEFTA) and in the Balkans, because such co-operative undertakings bring the possibility of conflict resolution and preparedness for integration that would be needed for an expansion of the EU. The EU should support political concepts in the Caspian Region similar to those it supports in Eastern and Southeastern Europe and thereby take early steps against dangerous "block building".

3. Integration into European Decision-Making Processes:

The OSCE and the Energy Charter

All eight countries of the Caspian Region belong to the CIS, but after the dissolving of the Soviet Union they are faced with a security policy vacuum. There are no great expectations held by the Caspian Region that either the Russian Federation (which, with the exception of Azerbaijan has garrisons throughout the entire region) or the CIS will fill this vacuum. Thus, their gaze falls upon the OSCE, which through its missions in Tajikistan, Georgia, Chechnya, and Nagorno-Karabakh (Minsk Conference) has acquired an amount of trust. This lone competent and active security organization in Central Asia has the advantage that, on the one hand, it does not encompass a one-sided representation of major powers' interests, but on the other hand, does not leave Russia out of the equation. Russia cannot hold a strengthening of the OSCE's role in the region as provocative, because Russia itself long ago called for a reevaluation of the organization.

Lately, the countries of the Caspian Region have heightened their expectations vis-a-vis the OSCE. This was emphasized by the visit of its presiding chairman Geremek to five Central Asian republics in April 1998. Until then, the OSCE operated from a modest regional office (Central Asia Liaison Office) in Tashkent. Several of the countries visited are contending for additional liaison offices, out of which Bishkek (Kyrgyzstan) has the best chance. While the activities of the Office for Democratic Institutions and Human Rights (ODIHR) have been met with little enthusiasm, the presidents and governments of Central Asia nevertheless desire a stronger consideration of security interests and a more active role in the OSCE for the solving of economic and ecological problems.

The Federal Republic of Germany and the European countries should grab onto the opportunity offered by this enquiry, and give the OSCE the competence to take over these additional responsibilities in the Caspian Region. The democratization and human rights goals must not be shoved into the background. The OSCE orientation towards human rights includes important principles and messages that need to be adopted in the Trans-Caucasian and Central Asian republics. The OSCE can contribute to the relaxing of tensions through its dialogue-oriented crisis prevention instruments, and as a non

partisan advocate constructively fill the political and security vacuum without the setting of geopolitical goals. The Central Asian communities need international help to cope with the environmental catastrophes, and every bit of regional economic co-operation deserves support. It goes without saying that the OSCE should implement these undertakings that are the expressed wishes of the region. To that purpose, the OSCE, which in comparison to other international institutions enjoys an impressive record of achievements and effort, still requires additional tools.

A great opportunity for the Caspian Region is held in the Energy Charter Treaty (ECT), which came into effect on April 16, 1998, and has been ratified by thirty-two nations, including all eight republics of the region. The ECT creates dependable and equal conditions for investments in exploration, upstream projects and pipeline network projects. It includes instruments to guarantee the fulfillment of contracts, secures the free flow of oil and gas, and offers an effective arbitration procedure for disagreements. It can act as a bulwark against the threatening politicization of the exploitation and promotion of raw materials and the transit of energy sources in the region. In addition, it can prepare the way for an economical and rational decision about the variants in question. The global investors have an interest that their engagements are set within the framework of international law and not in a tangle of competing special interest groups. The Energy Charter Treaty, which now receives worldwide support, could do much good in this area. Europe should make great efforts to strongly anchor their own energy security and all their oil and gas companies in this legal groundwork. To such efforts Europe must add both a lobbying of the United States to join the ECT, and of Iran and the Russian Federation to ratify the treaty.

V. The Prospects for the Caspian Region

The Caspian Region will definitely play an important role in producing raw energy materials for the world. What remains unclear is, in precise numbers, how large a role. A comparison with the Gulf Region is easy enough to make, and parallels are constantly drawn between the two. The Gulf Region has been many times over the venue for wars that resulted in heavy losses. The Gulf is characterized by opposing ethnic and religious

groups and by an overwhelming domination by undemocratic and authoritarian regimes. The elitist acquisition of profits from energy raw materials (oil and gas) has not resulted in any popular rise in the standard of living, nor has it created stability and prosperity for the region. The strategic significance of the Gulf Region for the maintenance of the western energy supply forces constant and costly stabilization-input from abroad. The United States alone during peacetime invests annually more than U.S. \$ 30 billion for the military security of the Middle East.

In the Caspian Region we find all the elements and conditions for a reproduction of a "Second Gulf Region" in the sense of all of the above-described "Chronic Crisis Syndromes". Without special effort, without a farsighted policy of prevention, the Caspian will adopt a similar course to that of the Gulf Region. It is not especially encouraging that after the massive systemic failure in 1989-1990 and the end of the Cold War, little more was expected world-wide than a return to classic power politics and geostrategic thinking. A new round of the "Great Game" with a regression to the political mindset of the nineteenth century, and the metamorphosis of the Caspian countries into a battlefield of geopolitics; that would be the worst that could happen to this sensitive region, and it would be a political defeat for the whole of Europe.

There are possibilities and instruments with which to build a different future for the Central Asian and Trans-Caucasian countries. There is realism in a strategy to not repeat the mistakes that would result in a second "*hotzone à la Gulf*". It is worthwhile to take advantage of the seldom-offered opportunity to bring regional and extra-regional economic interests together with the goal of a rational, preventative and peace-oriented policy. Europe must use this chance. The Federal Republic of Germany has the possibility, through the EU Presidency in the first half of 1999, to give important impetus and make contributions to a common European policy, and thereby take advantage of the opportunity that presents itself.

Notes on Contributors to Part I

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Dieter Dettke is the Executive Director of the Washington Office of the Friedrich Ebert Foundation. He studied political science at the Universities of Bonn, Berlin and Strasbourg (France). Prior to his tenure in Washington, Dr. Dettke served as Political Counselor to the SPD Parliamentary Group of the German Bundestag from 1974 to 1984, and as Staff Director at the Office of the State Minister of the German Foreign Ministry in 1982. He is the author of *Allianz im Wandel* and has published numerous articles and papers on security issues, East-West relations and U.S. foreign and domestic policy.

Gernot Erler is a Member of the German Parliament for the Social Democratic Party (SPD) representing the city of Freiburg. He is Deputy Chairman of the SPD parliamentary group and is the group's coordinator for international affairs. As Deputy Chairman, Mr. Erler's responsibilities and areas of expertise include foreign affairs, security, human rights and development policy. Mr. Erler serves on the committees for foreign affairs, defense, economic cooperation and development, human rights and humanitarian aid and European Union affairs.

Sheila Heslin served as Director for Russian, Ukrainian and Eurasian Affairs at the National Security Council in 1995 and 1996, where she had principal responsibility for coordinating U.S. policy toward the states of the South Caucasus and Central Asia as well as former Soviet Union energy issues. Ms. Heslin has written a number of papers on the status and prospects for Caspian energy and pipeline development. She began government service in 1988, completing assignments at the State Department's Policy Planning Staff, the Office of the Secretary of Defense and the Congressional Research Service. In each case, primary responsibilities were related to U.S. policy toward the former Soviet Union. Ms. Heslin graduated Magna Cum Laude from Cornell University

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Geoffrey Kemp, Director of Regional Strategic Programs at The Nixon Center, focuses on the geopolitics of energy in the Caspian Basin and Persian Gulf and U.S. relations in the Middle East, especially with Iran. He received his Ph.D. in political science at M.I.T. and his M.A. and B.A. degrees from Oxford University. Prior to his current position, he held positions with the White House during the first Reagan administration, the Carnegie Endowment for International Peace and the Committee on Foreign Relations in the U.S. Senate. From 1970 to 1980, Dr. Kemp was on the faculty of the Fletcher School of Law and Diplomacy, Tufts University. He is the author or co-author of several books on the Middle East including, *Strategic Geography and the Changing Middle East* (1997), and *Point of No Return: The Deadly Struggle for Middle East Peace* (1997).

René Leray is currently foreign policy advisor in the Central Policy Planning Department for External Relations in the European Commission, DG.IA. Dr. Leray joined the European Commission in 1973 as an administrator in Directorate General II (economic and financial affairs) where he analyzed the effects of the oil crisis. During his tenure at Directorate General II, Leray was rapporteur for a high-level expert group on Community social and economic cohesion chaired by Jacques Delors. He was appointed to the President's Advisory Group in 1983 and served under Presidents Thorn and Delors until 1988. As a member of the Advisory Group, he concentrated on EC regional policy reform, budgetary discipline, and defense and security issues. He was transferred to Directorate F of the Secretariat General, where he remained until 1990, when he became Deputy Head of Unit of Energy Policy in the Directorate General for Energy. At the same time, he became a member of the Task Force on the Middle East Peace Process, concentrating specifically on the region's water problems. In 1993, Dr. Leray joined the newly created DG.IA. There he became the rapporteur of a High Level Expert Group on CFSP, chaired by Mr. J. Durieux. Dr. Leray has a Ph.D. in economic science, and is a professor at the European Institute of the Catholic University of Louvain-la-Neuve.

John Lichtblau, a leading international expert on petroleum economics, has been Head of the Petroleum Industry Research Foundation, Inc. (PIRINC) since 1961, when he became Executive Director. His title was shifted to President in 1980, and to Chairman and CEO in 1990. He joined PIRINC, a not-for-profit research organization that provides analysis of public policy matters affecting the U.S. petroleum industry, in 1956. From 1954 to 1955 he was an analyst with the petroleum-consulting firm, Walter J. Levy Consultants Corp. Mr. Lichtblau has written many articles on petroleum economics and has been a frequent witness at Congressional hearings on energy policy as well as a keynote speaker and lecturer at conferences and seminars in the U.S. and abroad, including the World Petroleum Congress. He has served on the National Petroleum Council and is a member of the Council on Foreign Relations. In 1986 he received the International Association for Energy Economics annual award for outstanding contribution to the field of energy economics. Mr. Lichtblau is also Chairman of PIRA Energy Group; a private consulting firm, founded in 1976, which currently has over 200

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