

The Political Economy of Caspian Oil

After the collapse of the Soviet Union, the Caspian region emerged as an area of contestation among the major regional powers. First of all, Russia wanted soon after to reassert its power in the former Soviet republics. The so-called 'near abroad' policy adopted by the Russian government emphasized Russia's vital political, economic, and military interests in these areas. In addition, Moscow was disturbed by what it perceived to be an encroachment by outside powers in the Caucasus and Central Asia.

On the other hand, Iran also regarded this area to its north as strategically important. Tehran, a historically important player in the Caspian region, once again wanted to emerge as a key actor in the post-Soviet era. It was hoped that developing commercial, cultural and political ties with these newly-established states could help Iran in escaping its international isolation due to the US government's 'dual containment policy' and the embargo. Furthermore, similar to Russia, Iran was also disturbed by the increasing involvement of the outside powers, especially the US, in the region. Within this context, Turkish interest in the area was also disturbing for Iran, not only because of the perceived so-called 'Pan-Turkist aims' of Turkey, but also, and may be more important, because Turkey was an ally of the US.

Finally, Turkey also saw an opportunity in the region and hoped that common linguistic, ethnic, and religious ties with these states would provide a ground from which the relations could flourish. Ankara wanted to help these countries to consolidate their political independence. Among other things, that would also create a friendly buffer zone between Turkey and Russia and provide Turkey with a new opportunity to play an important role in regional affairs and thus increase its strategic and political importance in the post-Cold War era. In addition to Turkey's own strategic, political and economic interests, the US also started to promote Turkey as a 'model' for these countries, which was perceived as a counterweight to the Iranian 'model'.

Therefore, with the emergence of newly independent states in Central Asia and the Caucasus, three major regional actors found themselves in a competition for influence: Iran and Turkey were trying to reestablish their ties with a region with which they were unnaturally cut off during the Soviet era. Russia, on the other hand, was struggling to continue, as much as possible, its hegemony in these areas.

Pipeline Politics

This rivalry between the regional major powers was most evident over the issues surrounding the Caspian oil, since it combined political, economic and strategic concerns. In fact, soon after the disintegration of the Soviet Union a major area of interest that emerged was the vast oil and gas resources located in three of the countries of the region, namely Azerbaijan, Kazakstan, and Turkmenistan. Although the initial declarations that the region would be 'another Persian Gulf' had to be reevaluated over time, it became obvious that there was a significant amount of oil in Eurasia. The estimates just for the oil resources of the region have ranged from 50 to 200 billion barrels.¹ This amount was important as it was regarded as the biggest oil exploration effort since the discovery of the North Sea oil about 25 years ago. Moreover, 'the Caspian Basin is the only region open for foreign investment, free

¹ Proven gas reserves in the region are estimated at 236-337 trillion cubic feet, comparable to North America reserves.

of US or other multilateral sanctions, which offers companies the scale of new opportunities for investment that could allow them to create new core producing areas.² Finally, Caspian oil also presented an opportunity especially for the Western countries to diversify their oil supplies and to decrease their dependence on Persian Gulf oil.

As a result, soon major international oil companies began to take part in the exploration and the exploitation of the region's oil resources. They were followed by their home countries and other interested states. The first important deal was signed between an American oil major Chevron and Kazakhstan for the development of the on shore Tengiz oil field. This was followed by the signing of the so-called 'deal of the century' for three off-shore fields in Azerbaijan.

One major issue that emerged was about the transportation of this oil and natural gas. The countries concerned were landlocked and pipelines were needed to bring these resources to the world market. The possible route for the marketing of especially Eurasian oil became a subject of intense diplomatic and legal battles. Three major regional powers, Iran, Russia, and Turkey, wanted the oil to pass through their own territory. Initially, there was a fierce competition between Russia and Turkey, when both countries presented alternative routes as the most viable ones and engaged in a bitter struggle to convince other parties. At that time Iran had to stay on the sidelines, because of US government's insistence to exclude Iran from both production and transportation of Eurasian oil. However, that did not mean that in these early stages Tehran waited without doing anything. In fact, a most interesting development was a rapprochement between Iran and Russia during this period. These two countries with similar interests, aimed to prevent the involvement of outside powers in the development of Caspian oil. Within this context, they brought forward the issue of the legal status of the Caspian, and argued that it was a lake, not a sea, and as such there should be joint possession of the Caspian, including its mineral resources. Later, Iran emerged in 1997 as an important actor of pipeline politics, when, getting the support of some of international oil companies, started to advertise the Iranian option as the most viable one.

Stage One: Russia Vs Turkey

The Russian Federation was very much disturbed by the developments in Eurasian oil. By then Moscow was trying to reassert itself in the former Soviet republics. The developments in Eurasian oil were analyzed and interpreted within that context. From the beginning two positions emerged in Moscow. On the one hand, there was especially the newly privatized Russian oil company, LUKoil, which was also supported by the Ministry of Fuel and Energy. They argued that Russia should participate in the Caspian oil deals and thus acquire benefits from the oil bonanza. On the other hand, the Russian Foreign Ministry adopted a hard line position and made it clear that Russia was against any foreign investment in Caspian oil. These views were openly stated in 'Directive No. 396 'On Protecting the Interests of the Russian Federation in the Caspian Sea, which made the standard realist case for a Russian sphere of influence.'³ Furthermore, in order to prevent any outside encroachment and to consolidate its control and influence in the area, the Kremlin also raised the issue of the legal status of the Caspian Sea. Russia also brought forward environmental concerns as regards the Caspian. However, at the same time Moscow wanted the Eurasian oil to pass through its own

² For instance, Iran and Iraq a two important country with similar opportunities face US and UN sanctions respectively. Julia Nanay, in 'Symposium: Pipelines and Politics', *Middle East Policy*, 5, No. 4 (1998): 32.

³ Robert V. Barylski, 'Russia, the West, and the Caspian Energy Hub', *Middle East Journal*, 49, No. 2, (1995): 223.

territory, to use the existing pipeline system with minor repairs. While promoting the 'northern route', Moscow opposed the building of any other pipelines.

This was unacceptable for Ankara. Therefore, Turkey came up with a plan to carry the Eurasian oil to the world market and started to argue that this was the ideal route to carry the oil. Therefore, the Russian and Turkish proposals became the main contenders. Ankara was first involved in the issue in 1992. At that time BOTAS, the State Pipeline Company, prepared a proposal to partly use the existing Kerkuk-Yumurtalik pipeline, which was built to carry the Iraqi oil. However, some international oil companies objected to this on the grounds that the line followed an area where there had recently been an increased PKK activity.⁴ As a response in December 1994 the Turkish government put forward a proposal called the 'Caspian-Mediterranean Oil Pipeline Project' which required the building of a completely new pipeline. It aimed to carry Kazak and Azeri oil through two interconnected pipelines from Tengiz and Baku overland and from Turkey to the Ceyhan export terminal on the Mediterranean. This was a major terminal with 2.5 million b/d surplus capacity even if Iraq resumed exports. Since the 1990 Gulf War the terminal has virtually been idle and Turkey has suffered billions of dollar losses for that reason. Ankara, therefore, saw this project also as a way to make the Ceyhan terminal operational once again. After intense diplomatic efforts the Turkish government, in January 1995 got the US support for a 'pipeline through Turkey' in the general framework of the US policy that supported the idea of 'multiple pipelines'. The US government at that time did not want to alienate Russia altogether. On the other hand, for economic and political reasons Washington did not want only one country to control the tap. This became the cornerstone of the US policy at that early stage.

The Turkish government, while continuing to promote the Baku-Ceyhan route, made several arguments against the Russian proposal, which aimed to bring the oil to the terminal at Novorossiysk, a Russian port on the Black Sea coast, and then carry it with tankers via the Turkish Straits. First of all, Turkey made it clear that it would oppose the use of the Straits for transporting the Caspian oil. It was stated that if all Caspian oil passes through the Bosphorus, this would mean that each year 100 million tons of oil would pass instead of the current 32 million tons. This would put an additional strain on the traffic in this already overloaded, narrow waterway, and create environmental problems, presenting an increased health risk to Istanbul's 12 million inhabitants. To prevent this from happening the Turkish government hastily adopted some new regulations on 1 July 1994 concerning the passage of oil tankers through the Straits. The timing of these actions by Ankara gave the impression that, like Russian ecological concerns for the Caspian, Turkey had political reasons behind this decision. However, the threat to the Bosphorus and Istanbul was so real that eventually the Turkish arguments received at least an understanding from different circles. Turkey also pointed out the limitations of the port of Novorossiysk. Since the current capacity of the port would be inadequate to handle the export of the Caspian oil, either an expansion or the building of a new port was needed, and both would add to the expenses. In addition, it was noted that the Black Sea port was closed at least one third of the year because of weather conditions. Finally, as long as the Chechnian problem continued, there was the issue of the security of the Russian pipeline that crossed Chechnya.⁵

On the other hand, Russia also tried to convince the oil companies and the related governments that the Turkish proposal was much less attractive. First of all, it would cost

⁴ Interview with the then-General Manager of BOTAS, Mete Göknel, *artiPolitika* (Istanbul), 23, 23-29 May 1998: 50-53.

⁵ For more on the arguments of the Turkish government see, Temel Iskit, 'Turkey: A new Actor in the Field of Energy Politics?' *Perceptions* (Ankara), 1, No. 1 (1996): 58-82.

more than the Russian proposal. Moreover, several Russian officials brought the Kurdish problem to the discussion and argued that the Turkish route was unsafe. Thus, the issue of the security became an important part of the debate about pipelines and both sides accused each other of fanning the flames in their problem areas and the Kurdish question and the problems in Chechnya were used by both sides to support their arguments.

In 1995 to meet the immediate needs of Azerbaijan the Azeri International Consortium, AIOC, decided to produce about 5 tons of oil per year maximum, totaling 20 tons over a 10-year period. Again the selection of the export route for this relatively small amount of oil, the so-called 'early oil', to be produced by the Consortium became an issue. The most likely possibility was to use the 'northern route' through Russia, since that route required very little investment to become operational. Yet as the route passed through Chechnya there was a political problem and the Kremlin tried to solve that as soon as possible. In the meantime, the Turkish government, in cooperation with Georgia, submitted a proposal to transport this early oil through a 'western route' across Azerbaijan and Georgia to the Black Sea port of Soupsa. In order to make this proposal competitive Ankara offered several things. If the AIOC decided to build the pipeline Turkey would guarantee attractive tariff levels and concessionary financing. If not, Ankara offered to create a company with participants from Azerbaijan and Georgia to build and to operate the pipeline. Russia was also invited to participate as an equity partner. In addition, Ankara offered to buy all of this early oil at market rates.

The Turkish government's support of the Soupsa route was based on the argument that if that route was chosen by the Consortium, that would end the domination by Moscow of the transportation infrastructure of the region. This support, however, led to divisions among several government actors in Ankara that had been involved in pipeline politics. The government's support for the Soupsa route was criticized especially by BOTAS on the grounds that Turkey should concentrate its efforts on the main route and try to win support for its own proposal as soon as possible. The general Manager of BOTAS claimed that by supporting the Georgian option Turkey would be supporting a rival project.

On 9 October 1995 the AIOC announced its decision to use two pipeline routes to export the early production oil from the Azeri oil fields to the world markets: both the northern and the western routes. Several factors, mostly political, seemed to play a role in this decision. The most important one was the attitude of the US government. The Clinton administration had adopted a policy that called for the building of 'multiple pipelines' for the transportation of the main oil. At the last minute they adopted the same approach as regards to the 'early oil'. In this, diplomatic efforts of the Turkish government played some role. The US government made its policy openly known when the US ambassador to Baku gave a press conference a few days before the Consortium was to make public the route for the transportation of early oil. He reiterated the US support for multiple lines since the US government believed that the more pipeline routes there were, the greater the chances to ensure the safety of oil transportation and investments. In addition, President Clinton called President Aliyev of Azerbaijan and restated Washington's desire for multiple pipelines. The Turkish support for the western route and the proposal that was submitted by the Turkish government were also decisive in the decision of the Consortium. In fact, after the announcement of the decision, the vice president of the AIOC said that they initially preferred the Russian route but then, when Turkey said that it would finance the Georgian route and decrease the transportation rate considerably, the western route also became economical. He also added that, in addition to economic considerations, the Consortium did not want to rely on one route for the reason of political risks.⁶

⁶ Yeni Yuzyil , 19 November 1995.

The Turkish government declared the decision of the AOIC as a victory for Turkey. They argued that the decision signaled the realization of the Baku-Ceyhan route. It was true that Turkey's support for the Georgian route had played a major role in the decision of the Consortium. Yet the question remained as to whether or not this decision was really a signal for the Baku-Ceyhan route. In fact, it was soon apparent that Turkey was in square one in terms of the realization of this pipeline.

Recent Developments

Since mid-1997 the diplomatic efforts on the issue of the transportation of Eurasian oil intensified. One of the most important reason for this was a change in the attitude of the US government toward the region. The US government had started to show an interest in the region after the disintegration of the Soviet Union. However, up until 1997 this interest was rather limited. One reason for that was the influence of those within the US administration that aimed to put 'Russia first'. In addition, mostly as a result of the pressures from the Armenian lobby in Washington, the US administration had little contact with Azerbaijan. Under these circumstances the US government's room for maneuver was rather limited. Washington's efforts during this period concentrated in supporting its oil companies and preventing Iran's participation in Eurasian oil in any way. A related policy was to support the Turkish route, yet this was not then as open and clear as it was going to become in the last year.

During 1997 the US government made its intention to involve itself in the security issues of the area much more explicit. It became clear that the region itself had become important in the eyes of the policy makers in Washington. The US under-secretary of State Strobe Talbott on 21 July 1997 delivered a speech at Johns Hopkins University and declared the Caspian region to be of vital importance for the US. He also stated that this energy hub could not be left under the hegemony of Russia. Furthermore, it seemed that the Armenian lobby's influence was also decreasing. The government officials started to talk about resuming aid to Azerbaijan. In July 1997 Azerbaijani President Aliyev received a very warm welcome in Washington. President Clinton promised him to work for the lifting of the embargo that was based on Clause 907 of the Freedom Support Act, passed in October 1992. Finally, Washington started more openly to support the Turkish route. Strobe Talbott stated in the above mentioned speech that the US especially supported the Turkish route. This open support was reiterated by US Secretary of Energy Frederic Pena when he was on a presidential tour to the Caspian region on 18 November 1997. As one of the key players in this game, the support of Washington increased hopes in Ankara about the possibility of this route.

There were other encouraging developments for Turkey. In a speech at a ceremony to mark the flowing of the first oil from the Chirag-1 off-shore deposit Aliyev said that the main pipeline to export Azerbaijani oil should flow to the Turkish port of Ceyhan. This was important in that, maybe for the first time, Aliyev expressed his support of the Mediterranean route in such a strong manner. Besides Aliyev, Ankara also got the support of Georgia for its proposal. Finally, the Turkish government started to emphasize that Turkey, being a net importer of oil and natural gas, would not represent a conflict of interest with the Eurasian oil producers. Unlike Russia and Iran which themselves are major oil and gas producers, Ankara would be more than willing to allow as much oil as possible from the pipeline.⁷

⁷ The importance of this issue became obvious when Russia's gas company Gazprom refused to transport Turkmenistan's natural gas to the West to reduce the competition.

On the other hand, it seems that Russia has been recently losing influence in the region. That general disengagement has also been reflected in the issues surrounding the Eurasian oil. A parallel development is the increasing influence of economic interests in Russian foreign policy. A recent bilateral deal between Russia and Kazakstan to delimit the Caspian, a move very much criticized by Iran as well as the hard-liners in Moscow, was a clear sign of this influence. Yet the resentment in Russia continues. Recently a group of foreign policy analysts signed a declaration which said that 'Russia must not stand by as the energy resources of the Caspian are carved up in the interests of the US and Europe'.⁸

The most curious, however, is the question of Iran. On the one hand, the US government continues to be as adamant as ever to prevent Iranian participation in Eurasian oil. One of the main elements of the US policy towards the Middle East after the Gulf War has been the 'dual containment policy', which aimed to contain both Iraq and Iran. An important instrument of this policy has been embargoes. On 15 March 1995 President Clinton issued an administrative directive banning US firms from participating in Iranian oil development projects. In April 1995 this time the administration announced a total ban on trade with and investment in Iran. A more important move came in August 1996, when President Clinton signed the Act for Reinforcing Sanctions Against Iran and Libya passed by the Congress. This so-called D'Amato Law stipulated that companies from third countries investing 40 million dollars or more a year in Iran would be subject to US sanctions. Within this context the Clinton administration prevented Iran from benefiting from the developments in Eurasian oil. As late as November 1998 the US Minister of Energy in his tour of the region mentioned above once again argued that 'we do not support conducting ordinary business with a country that funds, trains, and supports terrorists or seeks to acquire weapons of mass destruction.'⁹ The opposition to any Iranian involvement seems to be a major continuity in US policy.¹⁰ However, one can detect some new developments even there. First of all, some influential figures close to the US administration, such as former National Security Advisor Zbigniew Brzezinski, started to question the success of the dual containment policy and argued instead for inducing Iran into cooperation rather than alienating it. These arguments intensified especially after the election victory in May 1997 of Muhammad Khatami, who was regarded as one of the moderates in Iran. In the meantime, the attitude of the Gulf states toward Iran has undergone significant change. Most important, a 'rapprochement' was initiated between Iran and Saudi Arabia. This was a serious blow to the US' 'dual containment policy'. In addition some US oil companies also started to push for the Iranian route for the transportation of Eurasian oil, which they argued was the most economical option. In fact, in recent months one could even see signs of a slow rapprochement between Iran and the US. Nevertheless, so far there has not been a drastic change in the situation and the US government, at least on the surface, continues its opposition to an Iranian participation in Eurasian oil.

Parallel to these developments, after the election of President Khatami the Iranian government seemed to have increased its efforts to push for an Iranian route. Getting the support of some of the oil companies, the Iranian government started to argue that Iran was the easiest and the cheapest route since most of the infrastructure was already there. Therefore, Tehran argued, the decision should be made according to economic rather than

⁸ Time, 29 June 1998: 25.

⁹ United States Information Service, 'Pena Wins Support for Oil Transport Corridor,' 18 November 1997, <http://www.mtholyoke.edu/acad/itrel/oilcauc.html>.

¹⁰ This continuity is generally explained by the influence of the Israeli lobby in the US. However, it seems clear that the US government is disturbed by Iranian policies in the Middle East and regarded the Iranian regime as a threat to its hegemony in the region as well as to its allies, not just Israel but also Saudi Arabia.

political criteria. However, a new study by the French oil company Total, which has been a supporter of the Iranian route, showed that a 'north-south pipeline through Iran to the Gulf would in fact cost about \$4 billion and would not be operational until 2004' which meant that 'the line through Iran would cost as much and take at least as long to build as the east-west system that would run through Turkey.'¹¹ The most obvious advantage of the Iranian option, on the other hand, is that from the Persian Gulf the oil could go to the Asian markets, where it seems that most of the demand growth will be happening.

If not postponed once again, especially amidst declining oil prices, the decision for the main route is expected to be taken in October 1998. It is clear that companies and governments that establish exploration rights and export routes will gain influence for decades and the participant actors are aware of this. Therefore, each is pushing hard for the acceptance of its proposal. Yet another thing which is obvious is that when compared, each proposal has its advantages and disadvantages. Given the complexity of interests and the intensity of power politics that surrounded the issue from the beginning, it is hard to predict what the decision on the main route will be. However, it seems that there is room for more than one pipeline for the Eurasian oil and the resources of the area could be used as a vehicle for cooperation among the regional actors, something which has not really been tried in recent years.

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¹¹ Time, 29 June 1998: 29.