

Pipeline Politics; The struggle for control of the Eurasian energy resources

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CONTENTS

LIST OF TABLES, FIGURES AND MAPS	II
LIST OF ABBREVIATIONS	III
CHAPTER 1: INTRODUCTION	1
1.1 Pipeline Politics	3
1.2 Formulation of the problem to be analyzed in this paper:	5
CHAPTER 2: GLOBALIZATION AND OIL	7
2.1 International Political Economy and Globalization.....	7
2.2 Geostrategic importance of oil.....	10
2.3 World and Eurasian oil reserves and the oil industry in recent years	14
2.4 The Oil Industry in Eurasia in recent years	18
2.5 Geostrategic importance of natural gas, and Eurasian production	20
CHAPTER 3: BACKGROUNDS OF THE POLITICAL SITUATION IN EURASIA..	23
3.1 An overview of the recent history of Eurasia	23
3.2 State-society relations in the newly independent republics	27
3.2.1 The War on Terrorism and the State-society relations.....	30
3.3 The uncertain legal status of the Caspian Sea.....	31
CHAPTER 4: THE POLITICAL SITUATION IN EURASIA	35
4.1 The Central Asian Republics and Russia	35
4.1.1 Russia.....	35
4.1.2 The Newly Independent Republics.....	39
4.2 External powers: the US, China, Iran and Turkey.....	42
4.2.1 The United States of America	42
4.2.2 China	44
4.2.3 Iran and Turkey.....	46
4.3 Non-state actors	49
4.3.1 Transnational Oil Companies.....	49
4.3.2 Islamic Movements in Eurasia	50
4.3.3 Intergovernmental Organizations and NGOs.....	51
CHAPTER 5: EXPLOITATION AND EXPORT OF THE RESOURCES.....	55
5.1 Transnational Oil Companies and their states of origin	55
5.2 The political importance of export pipelines.....	57
5.3 The Baku-Tblisi-Ceyhan Main Export Pipeline	58
5.4 Potential role for Eurasian oil in the world oil market.....	61
CHAPTER 6: CONCLUSION.....	65
BIBLIOGRAPHY	71

Lists of Tables, Figures and Maps

Table 2.1	Proven World Crude Oil Reserves, 2001	14
Table 2.2	Crude Oil Reserves in Eurasia	16
Table 2.3	Crude Oil Production Development in Eurasia	19
Table 2.4	Natural Gas Reserves and Production in Eurasia	20
Figure 2.1	‘Western’ oil production and consumption	11
Figure 2.2	World Primary Energy Sources	12
Figure 2.3	World Oil Production: History and Projections.....	15
Figure 2.4	Average Crude Oil Price Development 1997-2002	17
Figure 5.1	Eurasian oil Production and Export Estimates	62
Map 1.1	The BTC Pipeline and other export pipelines	4
Map 3.1	Political Map of Western Eurasia	23
Map 3.2	Trouble Spots in the Caucasus	26
Map 3.3	Kazakhstan’s new and old capital	29
Map 3.4	Proposed Borders on the Caspian Sea	33
Map 4.1	New US military bases in Central Asia.....	45
Map 4.2	Turkey’s linguistic links with Eurasia.....	48
Map 5.1	Future and Operational Export Routes	58

List of abbreviations

AIOC	Azerbaijan International Operating Company
BBL	Billion barrels
BCF	Billion cubic feet
BTC	Baku-Tblisi-Ceyhan
Centrazbat	Central Asian Battalion
CIS	Commonwealth of Independent States
CPC	Caspian Pipeline Consortium
EIA	Energy Information Administration
FSU	Former Soviet Union
G-8	Group of Eight
GDP	Gross Domestic Product
GUUAM	Georgia, Ukraine, Uzbekistan, Azerbaijan, Moldova
IEA	International Energy Agency
ILSA	Iran-Libya Sanctions Act
IMF	International Monetary Fund
IMU	Islamic Movement of Uzbekistan
IPE	International Political Economy
IRP	Islamic Resurgence Party
LPG	Liquefied Petroleum Gas
MEP	Main Export Pipeline
MNC	Multinational Corporation
MTOE	Million tonnes of oil equivalent
NATO	North Atlantic Treaty Organization
NGO	Non-Governmental Organization
OP. CIT.	Opere Citato
SCO	Shanghai Cooperation Organisation
SOCAR	State Oil Company of the Azeri Republic
TCF	Trillion cubic feet
TNOC	Transnational Oil Company
UN	United Nations
US	United States of America
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

Chapter 1: Introduction¹

For several reasons Eurasia, consisting of Central Asia and the Caspian Region, has been receiving world attention. With the demise of the Soviet Union in 1991, new states, who had no prior experience with independence², have come into being in this region. The collapse of the Soviet Union resulted in a local power vacuum. Regional powers consider Eurasia vital to their interests. These countries include Iran, China, Russia (who sees this region as its regional sphere of influence) and Turkey. Also, the United States, the world's only remaining superpower, are actively promoting their interests in the region. The region's location, between Asia and Europe, Russia and the Middle East, China and Iran, and its proximity to four of the world's nuclear powers³ contribute to its geostrategic importance. There is also an important economic reason for regional and external powers to become entangled: the presence of substantial hydrocarbon reserves. Western states are dependent on energy-imports to fuel their economies. They see Eurasia as a potentially new, non-OPEC source of oil and natural gas.

In the current world situation, oil and natural gas have become of preponderant importance. The supply of hydrocarbon resources is of strategic importance. A clear example of this was the second Gulf War of 1991. Because of their economic dependency on oil, especially Middle Eastern oil, a US-led coalition waged a war to liberate Kuwait. Leaving a hostile regime in charge of both Iraq's and Kuwait's energy resources would have constituted a grave risk for Western, energy-importing states. They sought to secure a free flow of oil from this region to world oil markets. Also, these states have been looking for ways to diversify this dependence on oil coming from the Middle East. Production in other regions, such as the North Sea, is starting to decline, thereby increasing the market share and importance of Middle Eastern oil. For this reason energy-importing states ardently support the development of new sources, such as those of Eurasia. The development of hydrocarbon resources is not carried out by the states themselves, but is the work of transnational oil companies. Only these companies possess the necessary technology and capital to exploit and export the natural resources of Eurasia.

Export of the energy resources could pose a problem as well. Eurasia is a land-locked region, and there is only a small local demand for oil and gas. There is therefore a need to bring the oil and gas to distant markets. This requires the construction of long distance pipelines to markets or to seaports where tankers can transship the oil further. Because these pipelines are being built by profit-seeking transnational oil companies, one would expect the most economic options to be employed. However, when looking at the Baku-Tblisi-Ceyhan (BTC) pipeline, right across the Caucasus from Azerbaijan to Turkey's Mediterranean coast, this doesn't seem to be the case. Construction of this pipeline has just started and this route cannot be explained using only economic arguments⁴. A much cheaper route, leading straight through Iran directly to the Persian Gulf, has clearly been ignored. An Iranian export route

¹ The author would like to thank Prof. dr. A. Van Staden, Prof. dr. C. van der Linde, and Dr. Mehdi Amineh for their suggestions and comments. Also, he would like to thank Mr. Van Bruinse for his editing work.

² Azerbaijan, Georgia, Armenia, Turkmenistan, Uzbekistan, Tajikistan, Kirgizstan and Kazakhstan.

³ Russia, Pakistan, India and China

⁴ PEIMANI, H., *The Caspian Pipeline Dilemma, Political Games and Economic Losses*, Westport: Praeger, 2001, p. 77.

would not only have been cheaper, but it would also bring the newly available Eurasian oil closer to what will probably become its most important export market, Asia. Oil demand is expected to rise most buoyantly in Asia in the near future⁵, creating a high demand for new sources of oil. To complicate matters further, the BTC pipeline will run through some politically volatile regions, such as Georgia. Clearly, there must have been other reasons to justify this particular choice. The BTC pipeline will be a Main Export Pipeline, that is to say that a large part of Eurasian oil must take this route to reach the world oil market. The capacity of the pipeline will be 1 million barrels a day⁶. The importance of the BTC pipeline must therefore not be underestimated and the particular choice of its route cannot be disregarded by saying that this is just one of the export options. The BTC pipeline, while only carrying a third of the planned export capacity of the region, will have a profound influence on the political situation in the whole region. Other pipelines have a similar political component.

The construction of this pipeline is a clear example of the changing nature of international relations and more specifically, the international political economy. Globalization has resulted in an increasing interdependence between countries, and a growing economic role and political influence for non-state actors such as multi-national corporations. International relations are no longer the exclusive field of competence of government officials and they are well aware of this development.

As mentioned above, the political situation in the whole region is definitely unstable. This is a direct result of the fragility of the newly independent republics and the strategies the external powers are employing when dealing with these weak countries. The relations between countries in the region and external powers are intricate. Even though they became *de jure* independent when the Soviet Union ceased to exist in the early 1990's, the Eurasian republics are still trying to establish their political independence from Russia. Each does so with a different degree of success, and not every country feels the need to do so with the same urgency. Nevertheless, Russia remains for all these countries of extreme importance, especially from an economic point of view. Russia is very aware of its dominant position, and for a long time tried to limit the role played by Western countries in the region. It did so because it feared that any form of Western presence in the region would diminish Russian influence over the newly independent republics.

Despite this policy of keeping the newly independent republics in Russia's sphere of influence, its dominance over the region has gradually declined. There are several reasons for this phenomenon, such as the Russian inability to maintain a high-posture presence in political, economic and military matters. During the 1990's Russia faced huge economic as well as political hardships, and was unable to conduct a coherent foreign policy towards Central Asian and the Caspian region. It simply didn't have the money and was internally divided. The inability of the Russian army to ensure a quick military victory against the Chechens during the first Chechen War⁷ convinced the governments of the newly independent republics of the decline in Russian

⁵ See below, Chapter 2.

⁶ Petroleum Economist, "Azerbaijan", June 2002, <http://www.petroleum-economist.com/contents/publications/petec/>

⁷ 1994-1996

power. The gradual development of the countries in the region, and the ever-growing presence of regional and external powers also contributed to the reduction of Russian dominance. Since the 11 September 2001 attacks on the World Trade Center in New York and the Pentagon in Washington, D.C., and the subsequent start of the 'War on Terrorism', the United States have developed strong ties with most of the local governments and are actively promoting their interests in the region. To counter its declining influence, Russia is increasingly trying to use the economic leverage it enjoys over local governments as a foreign policy tool.

An even bigger problem seems to be instability within the countries themselves. There have been examples of ethnic conflicts as well as civil wars in the past decade in Tajikistan, Georgia and Azerbaijan. Clearly not every state enjoys a large degree of control over its territory and population. In a bid to maintain their positions, the local governments are becoming more and more authoritarian. This causes resentment with the local population, and secessionist movements as well as other political organizations are using this public grievance to gain support for their actions. The most dreaded of such political groups are the different radical Islamic groups that are active in different parts of Eurasia. Some of these, such as the Islamic Movement of Uzbekistan, have gained influence in the region, inevitably to the detriment of the different state authorities. The local governments are actively trying to eradicate these Islamic organizations. Some non-governmental organizations are also trying to influence the local situation. They want to improve the human rights situations in the newly independent republics. However, because the governments of the Eurasian republics are notorious for their human rights violations, the influence of non-governmental organizations is minimal. All these different actors, local or external, state or non-state, are vying for influence, and pursuing different agendas. Even though not all of these different organizations or movements are actively pursuing policies focused solely on oil or natural gas matters, it appears that hydrocarbon issues form the single most important subject of Eurasian political and economic relations. This all leads to Pipeline Politics.

1.1 Pipeline Politics

What constitutes Pipeline Politics? It consists of two different, but interconnected problems. First of all, there is the struggle for control of the hydrocarbon resources of Eurasia. This is a complicated matter, because of the uncertain legal status of the Caspian Sea. The Caspian Sea contains large oil deposits, but there are no internationally recognized borders dividing the sea shelf among the littoral states⁸. In the 1920's and 1940's the Soviet Union and Iran did work out a limited legal framework for utilization of the Caspian Sea but it was not devised to cater for the current situation and does not provide any certainty with regards to the geographical boundaries of the Sea's shelf. In a worst-case scenario this could even develop into a source of conflict. Since the littoral states have not yet decided what kind of new legal regime should apply to the Caspian Sea, conflicts could arise when states try to solve border disputes by resorting to the use of force to impose their opinion on the other states and to ensure their title over the rich hydrocarbon deposits underneath the Caspian Sea.

⁸ These states are Kazakhstan, Russia, Azerbaijan, Iran and Turkmenistan.

Secondly, pipeline politics comprises problems regarding the exploitation and export of these resources. These two problems are closely connected. The countries that possess hydrocarbon deposits do not have the technology and financial capability necessary to start the exploitation without outside help. They are dependent on the cooperation of usually Western transnational oil companies. These firms are only willing to do business with the local governments as long as their investments promise to be profitable, and therefore they are reluctant to do business in an unstable political environment. The local governments, which are desperately looking forward to energy revenues as a cure for all their ailments, must try to provide a safe and predictable business environment. The economic importance of the multinational companies is also a source of influence for the governments of their countries of origin. These external powers may also use other ways to try to influence the exploitation of the Eurasian hydrocarbon resources. Finally, export of the oil and gas to the world markets poses a big problem. Since Eurasia is a land-locked region, this is a difficult and costly matter. Because of the importance of the future exports of oil and natural gas from this region, this is where international politics and international economics come together.

Map 1.1 Multiple export pipeline propositions⁹



⁹ Source: Energy Information Agency, <http://www.eia.doe.gov/emeu/cabs/caspsfull.html>, June 2000.

With the help of map 1.1 a brief overview of the different hindrances surrounding possible export routes can be given. Possible export routes southward, through Iran, are for the moment effectively blocked by US legislation. Export routes through Afghanistan towards Pakistan suffer from the continuing political instability in Afghanistan. A possible export route from Kazakhstan to China is unlikely because of the huge distances involved. Political instability could threaten export routes passing through Azerbaijan, Georgia and Turkey. Congestion hampers Black Sea export routes, also giving rise to environmental concerns. The capacity of the existing Russian export system is insufficient, and both regional and external states want to prevent a Russian export monopoly.

1.2 *Formulation of the problem to be analyzed in this paper*

To make a proper analysis of pipeline politics, the following questions must be answered:

What is the importance of gaining control over the Caspian energy resources and how does this influence the world energy markets?

Oil is much easier and safer to handle than natural gas. Crude oil can be transported by using pipelines, trains or other means, without great difficulty and at a low cost. Because it is easy to transport, oil has enabled industries to develop in places where there is only a rudimentary infrastructure, for example in Third World countries. These industries and the transportation sector remain dependent on the availability of crude oil, adding to the strategic importance of oil. Natural gas is more difficult to transport from Eurasia to markets outside the region. Natural gas can be converted into LPG, liquefied petroleum gas. Either way, transportation and transfer onto tankers, necessary for further transport, is more costly and hazardous than is the case with crude oil.

The chapters of this study are organized as follows. Chapter two gives a framework of analysis, in order to properly understand the issue of pipeline politics. The international economy of oil and gas will also be discussed in this chapter. This outline will help us to gain a better understanding of the geostrategic importance of hydrocarbon resources in general, and the amount of oil and natural gas that Eurasia is likely to produce in comparison with global oil and gas reserves and consumption. Chapter three gives an analysis of the background of Eurasia's political situation, by looking at the recent history of the region, the state-society relations and the impact of the so-called War on Terrorism. A very important factor in interstate relationships of the region is the uncertain legal status of the Caspian Sea. Chapter four will take a closer look at the different actors, both state and non-state. For an external power such as the United States and for Russia Eurasian politics constitutes only a part of their foreign policy. It is beyond the scope of this paper to investigate American or Russian policy objectives in a bigger perspective. Only their actions and policies that are related with Eurasian pipeline politics will be examined. Chapter five will then explore the political significance of pipelines, including the BTC pipeline. The potential role of Eurasian oil, and natural gas, in the world energy markets will also be discussed. Finally, in this paper's conclusion I will try to answer the questions that I posed in the beginning.

Chapter 2: Globalization and Oil

The focus of this paper, pipeline politics, is a typical subject in which economics and politics meet. Politics and the economy are not two separate issues but stand in close connection to each other. For that reason, the relations between the international economy of oil and the geopolitical struggle over the Eurasian hydrocarbon resources must be examined.

The interconnectedness of politics and the economy is visible on a national and international level. States regulate their national economies by means of legislation. On an international scale states try to regulate market forces through international economic organizations such as the International Monetary Fund (IMF), the World Bank and the World Trade Organization (WTO). Strange calls this the 'politics of international economic relations'¹⁰. But such an exclusive focus on states is inadequate to come to a proper analysis of the international oil market. This market is shaped by political concerns as well as economic aspects, and therefore the focus of our attention in this paper will be both the international economy and international politics¹¹, a field of study called the International Political Economy, or IPE. In fact, IPE is a generic term for several theories on international relations, all stressing the interconnectedness of politics and the economy at an international level.

The process of globalization that is taking place is further expanding the interconnectedness of the state and the economy, by increasing the numbers and forms of transnational relations, and must therefore be examined properly. Globalization has eroded some of the state's powers, and non-state actors now are capable of wielding important economic or political power on the world stage, thus influencing international politics as well as the international economy. In today's globalized world gaining access to new markets is a legitimate foreign policy goal. Even though interstate relations extend beyond military relations, the military power of a state remains of great importance. Only a few states possess the military capabilities to support their foreign policies effectively¹². On a general level, powerful states are capable of arranging the structure of the international system. On a smaller level, military presence in a region could enhance local influence. Military power may translate into economic power, and vice versa. Russian and American presence in Eurasia must be seen in this light. Then, to get a better understanding of the geostrategic importance of oil and natural gas, I will discuss the international oil economy. But first the different aspects of globalization deserve our attention. Ever-expanding transnational social and economic relations have an impact on international relations and the role of the state. Looking at the characteristics of globalization could help to gain a better understanding of the positions of the newly independent republics in Eurasia.

2.1 International Political Economy and Globalization

Economics and politics are intertwined, not only at the national level, but also internationally. This basic assumption lies at the heart of the International

¹⁰ STRANGE, S, *States and Markets*, London: Pinter, 1994, p. 12.

¹¹ LINDE, C. VAN DER, *Bakkeleien om Olie*, The Hague: Clingendael, 2001, p. 4. (in Dutch)

¹² BALDWIN, D.A., "Power and International Relations", in: CARLSNAES, W., RISSE, T., SIMMONS, B.A. (eds), *Handbook of International Relations*, London: Sage Publications, 2002, p. 177.

Political Economy. Pearson and Payaslian define IPE as ‘the relationship between political and economic changes and their impact on global and domestic political, market, and production activities’¹³. The international economy is political in nature because it involves the process of ‘who gets what, when and how’, and this is politics¹⁴. The interconnection of politics and economics also stems from the observation that the distinction between what is ‘international’ and what is ‘national’ is blurring. As Baylis and Smith put it: ‘The extent and depth of interdependence - created through transnational economic processes that cut across state boundaries, increased trade, membership of regional economic groupings, and the process of globalization - has effectively joined national societies and economies together to the extent that no national policy can be purely ‘domestic’ anymore’¹⁵.

Since the 1960’s internationalization of production and capital has reached ever-higher levels. International economic relations and also transnational social relations have always existed, but in the last 40 years their numbers have grown significantly¹⁶. New types of relations have come into being and the significance of these ties has increased and spread across the globe dramatically. This process, called globalization, has caused a significant change in contemporary international relations. Globalization is the result of the expansion of economic transactions and the organization of economic activities across political boundaries of sovereign states, but it is not limited to the economy only¹⁷. Globalization refers to processes whereby social relations acquire relatively distanceless and borderless qualities, so that human lives are increasingly played out in the world as a highly integrated place¹⁸. In other words, the world has become a single place.

As noted above, globalization is not just an economic phenomenon, but changes in the international economy constitute one of the major pillars of globalization. Dodds asserts that ‘globalization is probably best considered as an intensification of interaction between national and transnational social formations operating through the interstate system’¹⁹, encompassing the movement of people, information, goods, services and ideas. It consists of the following five phenomena²⁰:

- The concentration of economic activities within the ‘Triad’ of North America, the European Union and Japan/Asia. Global trade, although not a new phenomenon, has increased significantly since the end of the Second World War. This trade is dominated by these three groups of countries, and global trade has grown much quicker than global production figures;
- The vast increase in capital flows in the world economy. This is a combination of global investments and the transnationalization of

¹³ PEARSON, F.S., PAYASLIAN, S., *International Political Economy: Conflict and Cooperation in the Global System*, Boston: McGraw-Hill College, 1999, p. 5

¹⁴ Definition by H. LASSWELL, quoted by BAYLIS, J., SMITH, S. (eds), *The Globalization of World Politics*, Oxford: Oxford University Press, 1999, SMITH, *Op. cit.*, 1999, p. 215.

¹⁵ BAYLIS, SMITH, *Op. cit.*, 1999, p. 215.

¹⁶ SMOUTS, M.-C., *Les Nouvelles Relations Internationales*, Paris: Presses de Sciences Po, 1998, p. 50.

¹⁷ AMINEH, M.P., *Towards the Control of Oil Resources in the Caspian Basin*, New York: St. Martin’s Press, 1999, p. 4.

¹⁸ BAYLIS, SMITH, *Op. cit.*, 1999, p. 14.

¹⁹ DODDS, K., *Geopolitics in a Changing World*, Harlow: Prentice Hall, 2000, p. 50.

²⁰ BAYLIS, SMITH, *Op. cit.*, 1999, p. 223.

finance. Global investments usually occur in the shape of foreign direct investments. Foreign direct investments are the result of the emergence of transnational networks of production. These secure profitability through the most advantageous labor procurement, combining dimensions of political security and predictability²¹. The transnationalization of finance is the result of the growing importance of foreign exchange, bank lending, financial assets and government bonds. These financial practices have grown incredibly and are traded internationally. The enormous growth of international financial flows has resulted in the development of global capital markets from a set of loosely linked national markets to a single global entity²²;

- The growth in importance of non-state actors. Some of these have gained such an amount of influence, that they have become even more powerful than some states. Also, they now wield significant influence on the decision-making process within state governments and between states. These actors include multi-national corporations (MNCs), non-governmental organizations (NGOs) and other international movements. In fact, the whole process of globalization is spearheaded by MNCs. They are engaged in foreign direct investment;
- The blurring of boundaries between domestic and international realms. Because of external influences, the state has lost some capacity to regulate a national economy through deregulation, exchange and interest rates, and fiscal policy²³. Especially developing countries are therefore unable to fully control the effects of their national economic policies. Not every country is in a position to fully benefit from its integration into the world economy as a result of globalization. It has been suggested that states are only capable to profit from this integration if they have laid the requisite foundations for industrialization and development. This includes the creation of a physical infrastructure, development of human resources, an increase in agricultural production and working government institutions to regulate the functioning of their internal markets²⁴;
- The changing institutional and ideological basis of international economic relations. To counter the diminishing effectiveness of states to control their economic performance, and to better face international threats, such as environmental pollution, governments are willingly engaging in processes of regional integration. This results in a process of internationalization of the functions of the state, whereby some formerly exclusive state functions are now organized in larger political units. Examples of this process are offered by the European Union and international organizations, such as the World Trade Organization²⁵. The ideological basis of the world economy is without a doubt modern capitalism. The end of the Cold War and the implosion of most of the centrally planned economies have led to the self-proclaimed 'triumph' of modern capitalism²⁶. There is no alternative for countries who want to open their borders or who are forced by market developments to do so.

²¹ AMINEH, *Op. cit.*, 1999, p. 6.

²² AMINEH, *Op. cit.*, 1999, p. 8.

²³ DODDS, *Op. cit.*, 2000, p. 50.

²⁴ AMINEH, *Op. cit.*, 1999, p. 12.

²⁵ AMINEH, *Op. cit.*, 1999, p. 13.

²⁶ BAYLIS, SMITH, *Op. cit.*, 1999, p. 226.

This presents the current world system with a structural problem: a system of political units, or states, is now overlaid by a global economy that takes power away from individual states and groups of states²⁷. This explains why we have to look further than just the immediate surroundings of the oil producing regions and countries in Eurasia if we want to make a proper analysis of the issues that make up pipeline politics. In the globalized world, the development of the oil industry in Eurasia is influenced by a number of internal and external factors that could have a profound impact on different global issues, and vice versa.

States pursue foreign policy goals based on their national interest. The physical environment of a state greatly influences its foreign policy, this is called geopolitics. Geopolitics is a term first coined by the Swedish journalist Rudolf Kjellen in 1899. In his opinion it signified a general concern with geography and politics and the relationship between the two. Al-Sati defines geopolitics as 'a dynamic relationship between a geographical setting and political behavior, as manifested in the quest for power and influence among states'²⁸. A state has the following means to serve its national interest: its own armed forces, market regulations, trade relations, production technology and the flow of capital²⁹.

The interstate system is anarchical in nature. The national security of a state can be considered as the ultimate goal of all geopolitics. Today, no longer do only other states or outlaw groups threaten this security. The world is much more complicated than that. As Pearson and Payaslian state: '[...] rapid globalization and related transformations in the international political economy inevitably cause conflict but also create opportunities for cooperation among countries'³⁰. States themselves form part of international economic and political structures, and transnational social forces are challenging the authority of the state. But threats to the national security of all states also takes on new forms, such as environmental pollution. Therefore, national security has become globalized³¹.

2.2 *Geostrategic importance of oil*

Since the Second World War, and especially since the 1960s, oil has become the world's dominant energy source. Because of its liquid form oil is easy to produce, transport and use. The immense oil reserves discovered in the Middle East and its low cost has added to the popularity of this energy source. Huge amounts of oil found their way to the American and European markets, where because of oil's widespread availability the development of the automotive industry was made possible. Mass fabrication of plastics and synthetics also started and oil gradually substituted coal as a heat source. Next to its practicality, the popularity of oil is a direct result of its low price. It is a cheap source of energy to transport and its extraction cost is relatively low, ranging

²⁷ BAYLIS, SMITH, *Op. cit.*, 1999, p. 212.

²⁸ AL-SATI, S.M., *Oil and the Geopolitics of Central Asia: a "New 'Great Game'"?*, (dissertation) University of Southern California, 1998, pp. 9, 39.

²⁹ AMINEH, M.P., "Geopolitiek van Energiebronnen in de Kaspische Regio", *Internationale Spectator*, LVI no. 2, Februari 2002, p. 82. (in Dutch)

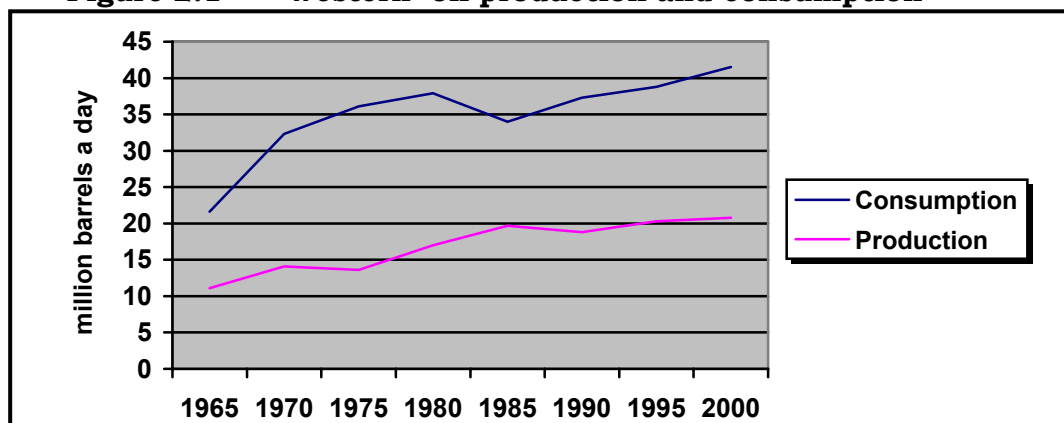
³⁰ PEARSON, PAYASLIAN, *Op. cit.*, 1999, p. 5.

³¹ AMINEH, M.P., "Eurasia in Transition: Conflict, Security and Development", *Development ISSues*, Vol. 4, no. 2, 2002, p. 10.

from about \$2 per barrel³² in the Middle East to \$10-12 in the offshore oil exploitation areas in the North Sea or the Caspian.

Only in a few countries can oil be found in large quantities, mostly in countries surrounding the Persian Gulf. The growing Western thirst for oil, taken together with its geographically limited availability, gave oil geostrategic importance. The oil-consuming states were obliged to rely on oil imports because their production levels were insufficient to meet demand. In 1960, the major oil-producing countries created a forum to coordinate of their export policies, the Organization of the Petroleum Exporting Countries (OPEC), primarily to strengthen their position towards the oil companies³³. By setting production ceilings for its members and curbing the total output of oil, OPEC proved capable of influencing world oil prices. In a sense, OPEC had become a cartel³⁴. As Van der Linde puts it, 'based on its market behavior OPEC must be defined as a cartel, while the feasibility, operation, and durability of the cartel must and can be explained by more than economic factors'³⁵. After a while OPEC used its leverage over world oil prices for political reasons. It did so for the first time successfully by imposing an embargo on the Western nations that supported Israel during the Israeli-Arab Yom Kippur war of 1973³⁶, disrupting the flow of OPEC oil to Western markets. The oil crises of the 1970's exposed Western dependency, when the oil-producing countries discovered the leverage their oil production gave them in their relations with the oil-importing states³⁷. In short, the oil weapon was born.

Figure 2.1 'Western' oil production and consumption³⁸



³² 1 barrel equals 159 liters of oil. These extraction cost printed here represent the costs in an ideal-type situation. The actual extraction costs could therefore differ from these figures, according to circumstances. All prices in this paper are in US\$.

³³ The role of oil companies will be explained below, in section 4.3.1.

³⁴ In another sense, it hadn't. The motives of the participants of a cartel are important when trying to explain its success. OPEC member states aren't corporations, their motives (or policy objectives) aren't based solely on profit maximisation, but are also political in nature. Opinions diverge on the importance of this difference. For a thorough explanation of this issue, refer to LINDE, C. VAN DER, *Dynamic International Oil Markets*, (dissertation) Amsterdam: Universiteit van Amsterdam, 1991, pp. 24-28.

³⁵ LINDE, C. VAN DER, *Op. cit.*, 1991, p. 28.

³⁶ Also called the October War or the Ramadan War. A first attempt during the Arab-Israeli Six-day war of 1967 failed.

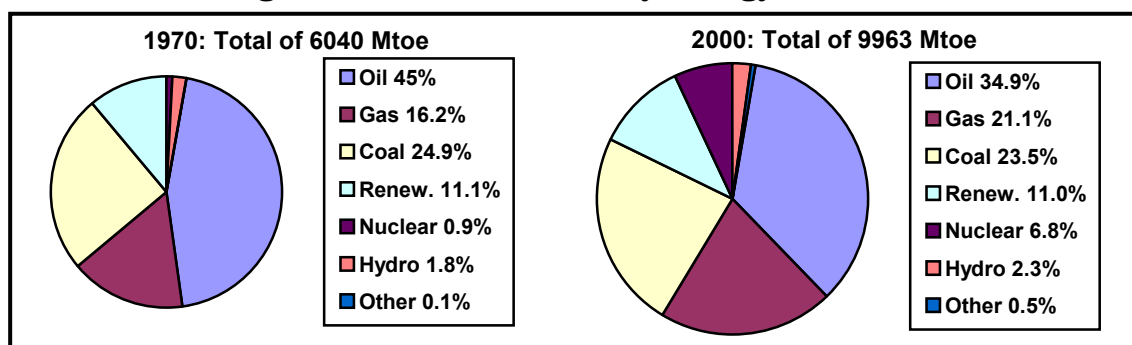
³⁷ Including Japan.

³⁸ Source: British Petroleum, *Statistical Review of World Energy*, June 2002, <http://www.bp.com>. To get these figures, oil production and consumption of the US, Japan and Europe are taken together. The difference between consumption and production has to be imported.

In response to their apparent dependency on oil imports, Western states started developing some alternative fuels. Particularly for electricity generation they switched from fuel oil to coal and nuclear. They also actively pursued the development of other sources of oil, such as the oil fields of Alaska and the North Sea. Because of geophysical factors, the exploitation of oil in these two regions is more expensive than in the Middle East. Their exploitation was made viable because of high, OPEC-induced market prices for crude oil.

As the Second Gulf War³⁹ has proven, there can be no misunderstanding of the importance of oil as a geostrategic commodity. This war acted as a reminder that as long as oil remains fundamental to economic growth and as long as there are governments who want to assure access to hydrocarbon supplies, there will be a commitment to use force to prevent any single government from controlling the market⁴⁰. Nowadays, the bulk of all oil is produced for less than \$8 per barrel, and sold for prices ranging between \$10 and \$30⁴¹. Even today oil remains the world's major energy source⁴².

Figure 2.2 World Primary Energy Sources⁴³



All importing states are trying to achieve energy security: availability of energy at all times in various forms, in sufficient quantity and at affordable prices⁴⁴. Energy-importing countries are economically vulnerable to a rise in the price of energy. A sudden disruption of their energy supplies likewise renders them strategically vulnerable. When one of these events occur, the energy-importing country may face difficult economic consequences, such as reduced industrial output, resulting in higher unemployment figures and lower living standards. Political consequences could be a weak bargaining position with respect to the exporting states and a loss in flexibility in the formulation of foreign policy

³⁹ In 1991. The First Gulf War was fought between Iraq and Iran in the 1980's.

⁴⁰ MORSE, E.L., "A New Political Economy of Oil?", *Journal of International Affairs*, Vol. 53, no. 1, 1999, p. 16.

⁴¹ FAVENNEC, J.-P., "Géopolitique du pétrole au début du XXI^e siècle", *Commentaire*, Vol. 99, 2002, p. 537. See also below, figure 2.1.

⁴² FAVENNEC, *Op. cit.*, 2002, p. 537. This excludes non-commercially traded fuels such as wood, peat and animal waste, which are very important in many countries. See also below, figure 2.2.

⁴³ Source: International Energy Agency, *Key World Energy Statistics 2002*, <http://www.iea.org>. Mtoe stands for Million tonnes of oil equivalent, this standard is used to enable a comparison between different sources of energy; applying the conversion factor of 7.33, 6040 Mtoe equals 44 billion barrels of 'oil', 9963 Mtoe equals 73 billion barrels of 'oil'. 'Renew.' stands for renewable fuel sources. The official term is Combustible Renewables and Waste, these are fuels such as wood and animal waste. 'Other' includes geothermal, solar, wind and heat energy sources.

⁴⁴ United Nations Development Programme, *World Energy Assessment*, New York: UNDP, 2000, as quoted in: ANDREWS-SPEED, P., LIAO, X., DANNREUTHER, R., "The Strategic Implications of China's Energy Needs", *Adelphi Paper*, Vol. 346, 2002, p. 13.

objectives. This might induce conflicts between exporting and importing states⁴⁵.

Disruptions could be global or local, and the result of either political or market conditions. Political reasons could be physical disruptions as a direct result of a war or serious threats of war, or a decision by oil exporting countries to either cut back on production or on exports. They could also choose to impose an embargo on a specific importing state. Local threats to energy supply may be just as harmful. These threats might be the result of a disruption in local markets, caused by government mismanagement or monopolistic behavior.

To counter these threats, an energy-importing state may choose to diversify its energy supplies to secure its energy security or it may try to improve existing energy supply relations. There are two methods of diversification. The government can follow a strategy of diversifying its energy supplies according to the origin or according to the type of energy. For the oil-importing countries, diversification with regard to the origin of their imports means obtaining supplies from both OPEC and non-OPEC sources, such as Norway or Russia, thus alleviating dependency on a single supplier or a bloc of suppliers. Another option is to vary the type of energy, relying less on potentially insecure oil imports and switching to coal or nuclear energy production.

Improving relationships with suppliers may be an attractive tactic to enhance energy security. A state could do so by combining state-sponsored economic measures with political initiatives, for example by forging close political links with energy-exporting states. Another approach is the market approach. This approach relies on the national and international energy markets and would seek to reduce the risk of disruption by improving the efficiency of these markets. Even though the market approach is supported by several energy-importing states, the continued importance of OPEC in determining the direction of oil price changes adds an unpredictable political element to oil markets⁴⁶. Energy-importing states will continue to look for ways to minimize this unpredictability.

Next to the dependency of the energy-importing countries stands the battle for survival of the transnational oil companies. These companies are dependent on a constant flow of oil to fulfill their contractual obligations and secure their income. They therefore benefit from an undisrupted world oil market. As private companies, TNOCs are constantly looking for new investment opportunities. The successful oil companies of the last few decades have grown very large. They want to remain large, so they have to remain being successful⁴⁷. In the last few years we have witnessed a lot of mergers and acquisitions, such as the merger between Exxon and Mobil into ExxonMobil⁴⁸. Some other TNOCs, such as Royal Dutch/Shell, have managed to expand through exploration or development deals. The recent consolidation of the TNOCs provides these companies with an advantageous position to face the

⁴⁵ Ibid.

⁴⁶ ANDREWS-SPEED, LIAO, DANNREUTHER, *Op. cit.*, 2002, pp. 18, 19, 20.

⁴⁷ NANAY, J., "The Industry's Race for Caspian Oil Reserves", in: THE EMIRATES CENTER FOR STRATEGIC STUDIES AND RESEARCH, *Caspian Energy Resources, Implications for the Arab Gulf*, Abu Dhabi, 2000, p. 111.

⁴⁸ Merger concluded on November 30, 1999.

coming challenges in the world oil industry⁴⁹. The interest expressed by the leading TNOs in Eurasia is partly the result of the basic requirement of these firms to constantly find new locations to invest. Continuing investment is the only way to ensure their survival.

2.3 World and Eurasian oil reserves and the oil industry in recent years

Oil played an important part in the vast increases in international trade we have witnessed during the last few decades. Because oil is a liquid, it is very easy to transport. New applications of oil technologies in light industrial sectors and process technology have increased the efficiency of production processes, and ended the requirement for corporations to position themselves on locations near fuel supply centers, or transport corridors, as is still more or less the case with gas and coal industries. This new flexibility resulting from the use of oil as energy source combined with better communication methods and transnational capital flows enabled the internationalization of production, such as the relocation of production plants to developing countries which reduces labor costs.

The world will not run out of oil in the near future. In the last few years proven oil reserves have remained stable, even though there have not been a lot of major new discoveries of oil deposits. Proven reserves are defined as oil deposits that are considered 90% probable. Another definition that is used in oil (or natural gas) exploration activities is that of possible reserves. Possible reserves are defined as deposits that are considered 50% probable. Even though only half of the amount extracted in recent years has been newly discovered, re-evaluation of older deposits has resulted in the opinion that current proven reserve estimates remain the same. Current estimates tell us that proven oil reserves amount to just over 1000 billion barrels.

Table 2.1 Proven World Crude Oil Reserves, 2001⁵⁰

Source:	Amount (billions of barrels)
British Petroleum (BP)	1050,0
Oil and Gas Journal	1028,1
World Oil	1004,1

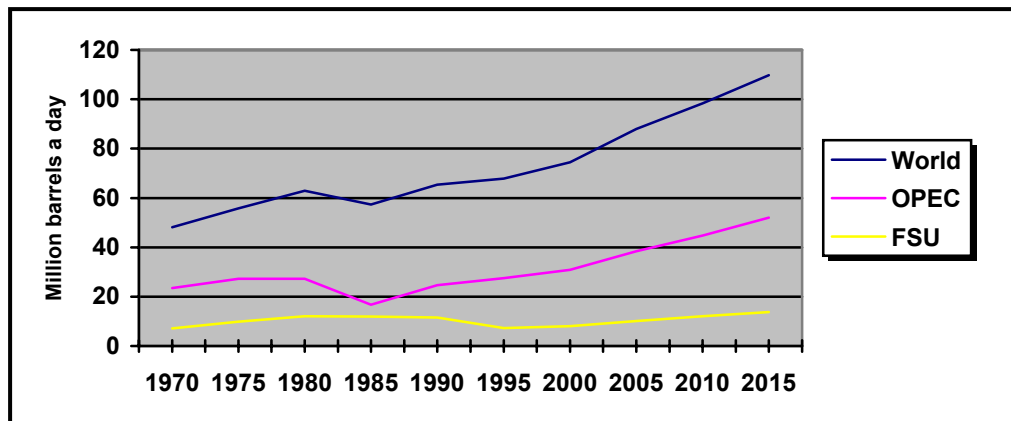
In 2001, world oil production amounted to 74,5 million barrels a day⁵¹. Oil consumption will most probably continue to rise worldwide over the next few decades. In Western countries oil demand is expected to increase only slightly, as car ownership numbers are likely to remain stable. In the industrialized countries the oil market is saturated, and in some cases oil is gradually being replaced by other fuels, such as natural gas in electricity production. However oil demand is projected to grow considerably in China and India because of their economic development accompanied by an expected rise in car ownership figures. This is based on the expectation that there will be no economically viable alternatives for oil as a transportation fuel⁵².

⁴⁹ LINDE, C. VAN DER, *De Europese voorzieningszekerheid van olie en gas in de komende jaren: economische en geopolitieke risico's*, The Hague: Clingendael International Energy Programme, 2001, p. 10. (in Dutch)

⁵⁰ British Petroleum, *Statistical Review of World Energy*, June 2002, figures for end of 2001, <http://www.bp.com>; Oil and Gas Journal and World Oil as quoted on US Energy Information Administration website: <http://www.eia.doe.gov>, figures for January 1st, 2001.

⁵¹ BP, *Statistical Review of World Energy*, June 2002. See also figure 2.2.

⁵² EIA, *World Energy Outlook 2002*, pp. 27, 29, 30.

Figure 2.3 World Oil Production: Recent History and Future Projections⁵³

With current world oil consumption exceeding new deposit discoveries, and oil extraction from some oil provinces, like the North Sea and Alaska, starting to decline, OPEC's position in the world oil market will become more dominant over the years. OPEC member states own 60% of all proven crude oil reserves, but currently account for only about 40% of world production⁵⁴. Oil-importing countries are looking for ways to diversify their oil imports, especially by promoting the exploitation of oil fields in countries outside OPEC⁵⁵. Besides, oil output in the Middle East has stagnated for the last 20 years⁵⁶.

In the early 1990's the oil export from the former Soviet Union member states collapsed, because of the dire economic situation in those countries. In the years that followed, oil producers in the Middle East started promoting their own energy resources as a cheaper alternative than the development of Central Asian oil⁵⁷. They feared renewed competition with Eurasian oil producers. Ever since the Soviet Union collapsed in the early 1990's, Eurasia has been portrayed as a new and possibly important source of crude oil. It was thought that oil production levels in the Former Soviet Union could easily climb back to former high levels, if appropriate investments were made. Several countries in Eurasia possess over large oil and natural gas deposits, but the specific amounts have been a source of controversy over the last ten years. It is therefore desirable to give an overview of the reserves in the region to determine its importance for energy-importing countries. Eurasian countries not included in tables 2.2 and 2.4 do not possess large hydrocarbon deposits.

⁵³ Data from 1970 until 2000: BP, *Statistical Review of World Energy*, June 2002. Future projections data from EIA's *World Energy Outlook 2002*, p. 251. Remarkably, the data for 2000 provided by the EIA differs from BP's figures. BP's data for 2000 is inserted in the figure. For visual aspects in this graph the difference, never more than 2%, is negligible. FSU stands for Former Soviet Union: figures are for the combined production of Russia and all the (other) newly independent republics. Note that the projection figures are only one possible projection given by the US government Energy Information Agency (EIA). These figures are very dependent on future oil prices.

⁵⁴ SALAMEH, M.G., "A Third Oil Crisis?", *Survival*, Vol. 43, no. 3, 2001, p. 135. See also below, table 2.3. Alaskan and North Sea oil extraction will start to decline because the deposits are nearing depletion.

⁵⁵ OPEC member states are: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela. The major non-OPEC producers are the United States, Mexico, Russia, Norway and The United Kingdom.

⁵⁶ MORSE, E.L., RICHARD, J., "The Battle for Energy Dominance", *Foreign Affairs*, Vol. 81, no. 2, 2002, p. 22.

⁵⁷ MORSE, RICHARD, *Op. cit.*, 2002, p. 22.

Table 2.2 Crude Oil Reserves in Eurasia⁵⁸

Country	Proven oil reserves (bbl)	Possible oil reserves (bbl)
Azerbaijan	1,2	32
Iran (Caspian)	0,1	15
Kazakhstan	5,4	92
Russia (Caspian)	2,7	14
Turkmenistan	0,6	80
Uzbekistan	0,6	N/A
Total	10	231

The collapse of the Soviet Union has had a profound influence on the international oil economy. This economy is now characterized by open access to resources, with the clearest example being the introduction of the Caspian Basin into the world oil economy. The oil markets are no longer under government control and there has been a shift towards government and industry cooperation⁵⁹. The influence of transnational oil companies has also increased significantly. There are two reasons for this increase in importance of TNOCs.

First of all, governments of oil-producing countries are re-opening their borders to foreign investments because of their need for capital, caused by the decline in real terms of crude oil prices since the 1970's. The oil producing countries of OPEC have not implemented any economic or political reforms, and are very dependent on oil revenues. The OPEC countries face budgetary problems if the oil price falls below a certain level. OPEC tries to raise the price of crude oil by reducing production in these instances. Because OPEC is using its state-owned oil companies for political, economic and social purposes, these companies are unable to compete on the international markets⁶⁰. Western TNOCs are not subject to the same level of government control. Their governments regulate the legal working environment for enterprises, but have no decisive sway over the company decision-making process. These governments however try to influence TNOC behavior by lobbying or offering financial advantages if these companies follow government policies.

Secondly, technological innovation has revolutionized the oil industry by making it easier, cheaper and faster to find and develop hydrocarbon resources. Only TNOCs have this technology plus the necessary skilled personnel acquainted with this latest technology⁶¹. Low oil prices in the late 1990's have prompted a series of giant mergers between TNOCs⁶², which in turn has led to a greater concentration of knowledge in just a few companies. In the same period several Russian oil companies succeeded in finding their place on the international oil market. These companies were created during

⁵⁸ Source: EIA, *Caspian Sea Region: Reserves and Pipelines Tables*, July 2002, <http://www.eia.doe.gov>. Figures for Iran and Russia only represent the reserves of the Eurasian parts of these countries, Iran's total proven reserves are 89.7 bbl (billion barrels), Russia's proven reserves total is 48.6 bbl. Other sources however may publish different figures. BP publishes figures that vary considerably with the figures in this table. For example, BP puts Azerbaijan's proven reserves at 7.0 bbl, and Kazakhstan's proven reserves at 8.0 bbl. As a comparison, Saudi Arabia possesses the largest proven crude oil reserves in the world: just over 260 bbl (source: EIA)

⁵⁹ MORSE, *Op. cit.*, 1999, p. 1.

⁶⁰ LINDE, C. VAN DER, *Bakkeleien om Olie*, The Hague: Clingendael, 2001, p. 4.

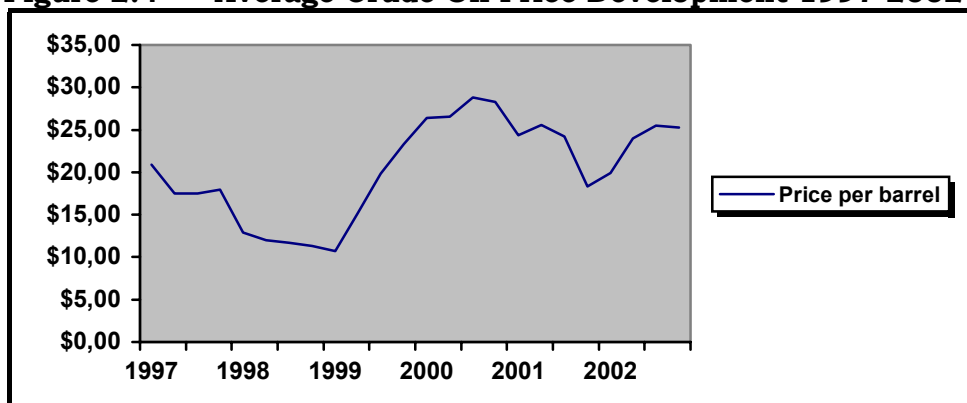
⁶¹ MORSE, *Op. cit.*, 1999, p. 18.

⁶² LINDE, *Op. cit.*, 2001, p. 16.

the Russian privatization of its oil sector in the Yeltsin years. Even though these newly created companies possessed huge reserves, it took them several years to adapt themselves to operate in a free-market economy. They were only able to present themselves internationally after the devaluation of the Russian rouble in 1998 and the increase in the oil price in 1999. These events helped the Russian oil industry out of a decade of crisis⁶³. The firm establishment of the rule of law in Russia also helped these companies to reinvest their earnings, thereby enlarging their production potential⁶⁴. In 1999 Russia's oil revenues increased significantly. But the reason for this revenue increase lies outside Russia.

This 1999 rise in the price of oil came after some years of relatively low oil prices. These low prices were the result of high levels of OPEC production, together with a falling demand as a result of the Asian financial crisis of 1997⁶⁵. Low oil prices achieved one goal of OPEC's policy: to minimize oil exploitation in new areas such as Eurasia. It caused new exploitation efforts in these areas to be unprofitable at the time. But it came with grave repercussions for the oil exporting countries' balance sheets, as their oil revenues dropped dramatically. In 1999 OPEC, spearheaded by its most important member Saudi Arabia, itself facing budget deficits since the early 1980's, decided to cut back significantly on production⁶⁶. The OPEC output decrease turned out to be successful, seeing that oil prices rose to levels acceptable to its member states. This was a very fortunate development for the Russian oil industry, which saw both its revenues and its market share grow without any effort on its side. Russian reinvestments of its oil revenues resulted in a spectacular rise in production of more than 500,000 barrels per day in the year 2000-2001⁶⁷. High market prices provided Russia with increased revenues⁶⁸.

Figure 2.4 Average Crude Oil Price Development 1997-2002⁶⁹



But there was also a structural reason for this price development. Oil prices remained low in the 1980's and early 90's, and the major oil producing

⁶³ FAVENNEC, *Op. cit*, 2002, p. 546.

⁶⁴ MORSE, RICHARD, *Op. cit*, 2002, p. 17.

⁶⁵ MANNING, R.A., "The Asian Energy Predicament", *Survival*, Vol. 42, no. 3, 2000, p. 75.

⁶⁶ LINDE, *Op. cit*, 2001, p. 11.

⁶⁷ MORSE, RICHARD, *Op. cit*, 2002, p. 16.

⁶⁸ Taxes on the earnings of Russian oil companies are a major source of income for the Russian government. See also chapter 4.

⁶⁹ This table shows the average price per season, thereby eliminating highs and lows. During this period the maximum price was \$32,86 on September 8, 2000, and the lowest price was \$9,32 on December 11, 1998. Source: psw12vxall.xls, EIA.

countries saw no reason to invest in their oil production infrastructure. As a result, spare capacity, to be used in cases of emergency, is today very limited and only available in Saudi-Arabia⁷⁰. The lack of spare capacity poses a potential risk to the global energy security. The oil producing countries would not be capable of securing the same level of production if, for some reason, the oil supply of one of them is disrupted. Because of this risk of acute shortage, oil prices rose sharply in 1999. An increase in production in 2001, followed by falling oil prices, again created severe balance of payment problems for several OPEC members. OPEC decided to cut back on production again on January 1st, 2002, by 1,5 million barrels a day. It had deliberately refrained from doing so in the wake of the September 11th attacks, but a decrease in world oil demands provided the logic for such a measure. Norway and Mexico followed suit, but OPEC political pressure resulted in only the slightest cutback on Russian production. Russia enjoyed a higher market share and increasing oil revenues as a result of OPEC policy⁷¹.

2.4 The Oil Industry in Eurasia in recent years

During the 1990's, the oil industry in Eurasia did not develop in the way some commentators thought it would. An oil bonanza was predicted, with a country like Azerbaijan developing into a new Kuwait. No exact data was available on the hydrocarbon deposits of Eurasia, but estimates ranging up to 200 billion barrels for the entire region were published⁷². During Soviet days some of the oil and natural gas resources of Azerbaijan, Kazakhstan and Turkmenistan were already exploited, but a lack of investments, out-dated technology and a deteriorating infrastructure resulted in a declining rate of production in these countries during the early 1990's⁷³. Due to political instability in the region and the uncertain legal regime of the Caspian Sea, there has been no massive influx of foreign investments as predicted.

Until recently proven hydrocarbon reserves for both Turkmenistan and Kazakhstan were insufficient to attract the large investments needed for transportation pipelines⁷⁴. The breakthrough for Kazakhstan came in April 1993, when Chevron (now ChevronTexaco) signed a deal with the Kazakh government, forming the Tengizchevroil joint venture to develop the Tengiz oil field. Current production is 250,000 barrels a day. This volume could increase to a possible peak of 750,000 barrels a day in 2010 if adequate transport facilities are built. The Kazakh republic founded the state oil company Kazmunaigaz, to ensure a single state policy on using the country's hydrocarbon resources. ChevronTexaco operates in a joint venture with this company⁷⁵. Oil production in Turkmenistan is hampered by layers of state regulation, that form restrictions on foreign investments and impedes the TNOCs expansion activities in Turkmenistan. Consequently oil production

⁷⁰ MORSE, E.L., JAFFE, A.M., *Strategic Energy Policy Challenges for the 21st Century*, New York: Council on Foreign Relations, 2001, pp. 10, 23.

⁷¹ MORSE, RICHARD, *Op. cit.*, 2002, p. 16.

⁷² KUNIHOLM, B., "The Geopolitics of the Region", in: ASCHER, W., MIROVITSKAYA, N. (eds), *The Caspian Sea: A Quest for Environmental Security*, Dordrecht: Kluwer Academic Publishers, 2000, p. 93.

⁷³ Energy Information Administration, <http://www.eia.doe.gov/emeu/international/contents.html>.

⁷⁴ HILL, F., SPECTOR, R., "The Caspian Basin and Asian Energy Markets", *Brookings Conference Report*, No. 8, 2001, p. 1.

⁷⁵ EIA, *Kazakhstan Country Analysis Brief*, July 2002, <http://www.eia.doe.gov/emeu/international/contents.html>.

figures in Turkmenistan remain lower than necessary, with Turkmenistan's state oil company producing 90% of total output⁷⁶.

Foreign investments have been pouring into Azerbaijan ever since September 1994, when the so-called 'deal of the century' was concluded between the State Oil Company of the Azeri Republic (SOCAR) and several Western firms, creating the Azerbaijan International Operating Company (AIOC) joint venture. AIOC will develop three oil deposits in the Caspian Sea, and is now producing 120,000 barrels a day; this figure could reach 800,000 in 2010⁷⁷. SOCAR is closely linked with the Azeri government. SOCAR's president, Natick Aliev, is the son of Azerbaijan's president Heidar Aliev.

Table 2.3 Crude Oil Production Development in Eurasia⁷⁸

Country	Production in 1995 in 1000 b/d	Production in 2001 in 1000 b/d	Percentage of Total World Production in 2001
Azerbaijan	185	300	0.4%
Iran (Caspian)	0	N/A	N/A
Kazakhstan	434	828	1.1%
Russia (Caspian)	144	300	0.4%
Turkmenistan	84	162	0.2%
Uzbekistan	172	172	0.2%

In comparison, total world production in 1995 amounted to 67,9 million barrels a day. In 2001 this figure was 74,5 million barrels a day. OPEC's market share (including Iran) in 2001 was 40.7%, with a production of 30.2 million barrels a day⁷⁹.

A third major investment in the region expected to boost Eurasian oil production figures in the near future is the development of Kazakhstan's offshore Kashagan block, in the Northern part of the Caspian Sea. Exploration and preliminary drilling in the Kashagan block has produced impressive results. This oil field may prove to be more lucrative than the Tengiz deposit. As for now, at the first stage of development, output estimates for 2005 are 100,000 barrels a day⁸⁰. As with the Tengiz exploitation, further successful development of this field depends on the availability of adequate export facilities.

These expected rises in oil production in Eurasia could be matched by rises in production in the Middle East. US-led sanctions against Libya and Iran are becoming less effective. Iran is trying to attract foreign direct investment in its oil industry to boost production, and increase its earnings as well as its

⁷⁶ EIA, *Turkmenistan Country Analysis Brief*, May 2002.

⁷⁷ EIA, *Azerbaijan Country Analysis Brief*, June 2002.

⁷⁸ British Petroleum, *Statistical Review of World Energy*, 2002, and EIA, *Caspian Sea Region: Reserves and Pipelines Tables*, July 2002. Figures for Iran and Russia are for 1990 in stead of 1995, and refer only to their production in the Caspian region. Total Russian production in 1995 was 6,2 mb/d, in 2001 7,1 mb/d, 9.7% of world production. Total Iranian production in 1995 and 2001 was 3,7 mb/d, equalling 5.1% of world production.

⁷⁹ British Petroleum, *Op. cit.*, 2002. See also above, figure 2.2.

⁸⁰ EIA, *Kazakhstan Country Analysis Brief*, July 2002, <http://www.eia.doe.gov/emeu/international/contents.html>.

diplomatic clout⁸¹. This could lead to a prolonged oil surplus accompanied by low oil prices. Additionally, a possible war between the US and Iraq is a major uncertainty and a disruption of Iraq's oil supplies would probably provoke a significant rise in the market price of crude oil.

2.5 Geostrategic importance of natural gas, and Eurasian production

The economic importance of natural gas is starting to equal that of oil. World gas consumption has risen only 0.3% worldwide between 2000 and 2001, but gas is gaining popularity especially in the growing energy markets of South and East Asia. During this period gas consumption in China rose 12.9% and in Pakistan 6.1%⁸². Also Turkey's consumption is growing quickly. Eurasia could be an important provider of natural gas for these emerging markets, but major investments and adequate export facilities are required. There are several initiatives to get Eurasian natural gas to the world market, but for now most of the produced gas is consumed locally.

Table 2.4 Natural Gas Reserves and Production in Eurasia⁸³

Country	Proven gas reserves (tcf) (source: EIA)	Possible gas reserves (tcf) (source: EIA)	Production in 2001 (bcf/d) (source: BP)
Azerbaijan	4	35	0,5
Iran (Caspian)	N/A	11	5,9 *
Kazakhstan	65	88	1,1
Russia	1700 *	N/A	55,4 *
Turkmenistan	101	159	9,1
Uzbekistan	66	N/A	5,5
Total	1936	293	77,5

World gas demands are expected to rise, partly as a consequence of the Kyoto Protocol⁸⁴. Natural gas is a less polluting form of energy than either coal or oil, partly because of lower carbon dioxide emissions in its utilization process. China is stepping up its gas consumption to reduce its dependency on coal. Coal has caused major environmental pollution in China. Turkmenistan has good credentials to become an important player in the world gas market, except for its geographical location. To reach world markets, gas from Turkmenistan has to pass through Russia or Iran, the two countries with the biggest proven natural gas reserves in the world and Turkmenistan's main competitors. Because local consumption is minimal, Turkmenistan exports the bulk of the natural gas it produces. Before the launch of a pipeline towards Iran in 1997, all exports went through the Russian natural gas pipeline system. Gazprom, the Russian gas company, was able to limit the amount of gas Turkmenistan could export, thus curbing Turkmenistan's revenues. The

⁸¹ JAFFE, A.M., MANNING, R.A., "The Shocks of a World of Cheap Oil", *Foreign Affairs*, Vol. 79, no. 1, 2000, p. 21.

⁸² Source: British Petroleum, *Op. cit.*, 2002.

⁸³ Source: EIA, *Caspian Sea Region: Reserves and Pipelines Tables*, July 2002. Figures marked with an asterisk (*) are for the entire country, not just its Eurasian region. Again, BP publishes different figures. According to BP, Azerbaijan's proven gas reserves are 30,0 tcf. Everybody agrees that Russia has the world's largest natural gas reserves. Tcf stands for trillion cubic feet; bcf/d signifies billion cubic feet a day. World production in 2001 was 241,9 billion cubic feet a day.

⁸⁴ LINDE, *Op. cit.*, 2001, p. 15.

main customers for Turkmen gas are other former Soviet republics, who have difficulties paying in hard cash for the deliveries. Azerbaijan, Kazakhstan and the Ukraine are indebted to Turkmenistan for natural gas supplies⁸⁵.

Russia can be said to be to natural gas what Saudi Arabia is to oil⁸⁶. Russian gas reserves are huge, and the Eurasian countries are linked to Russia's gas industry by their gas infrastructures. In general, Russia is likely to retain a dominant position in the Eurasian natural gas industry, both in exploration and exploitation activities. The Eurasian gas fields, especially in Turkmenistan, are located far away from the European and East Asian markets, and most export routes run through Russian territory. The bigger of the two export pipelines operating in the region, runs from Turkmenistan to Russia. The second runs from Turkmenistan to Iran, but has only one tenth of the capacity of the aforementioned⁸⁷. There have been no investment deals by Western gas companies in the region of the same scale as the AIOC or Tengizchevroil oil deals⁸⁸. An ambitious plan to construct a natural gas pipeline from Turkmenistan through Afghanistan to Pakistan is ardently supported by their respective governments. A deal to construct this \$3,2 billion pipeline has been signed by these countries, but continuing instability in Afghanistan deters investors⁸⁹. Even if the necessary capital can be found, the viability of this plan remains doubtful. Pakistan is not big enough as a market for natural gas to justify the construction of this pipeline. India is another emerging market for natural gas. Mutual mistrust between India and Pakistan however prevent India from joining this project. Political instability in Tajikistan and China's Xinjiang province preclude the construction of export pipelines for Turkmenistan's natural gas to the east.

⁸⁵ EIA, *Turkmenistan Country Analysis Brief*, May 2002.

⁸⁶ HILL, F., FEE, F., "Fueling the Future: The Prospects for Russian Oil and Gas", *Demokratizatsiya*, Vol. 10, no. 3, 2002, p. 3.

⁸⁷ EIA, *Caspian Sea Region: Natural Gas Export Options*, July 2002. Capacities are 3,5 tcf and 0,35 tcf a year.

⁸⁸ HILL, FEE, *Op. cit.*, 2002, p. 14.

⁸⁹ The Economist, "Afghanistan: the rebirth of a nation", January 11, 2003, pp. 47, 48.

Chapter 3: Backgrounds of the Political Situation in Eurasia

In this chapter we will try to analyze the backgrounds to the current political situation in the region. To gain a better understanding of the relations between the different actors, an overview of the recent history of Eurasia is given. To better understand the constraints under which the governments of the newly independent republics are operating, an analysis of the State-Society relations in Eurasia is given in section 3.2. After that attention is paid to a problem that gravely affects the oil industry and the interstate relations in the region, i.e. the uncertain legal status of the Caspian Sea.

Map 3.1 Political Map of Western Eurasia⁹⁰



3.1 An overview of the recent history of Eurasia

To gain a better understanding of the current political landscape, it is desirable to give a brief overview of the recent history of the region. There has been an extensive debate about what actually caused the Soviet empire to collapse. It is not within the scope of this paper to try to answer such a question. But a loss in oil revenues, one of the most important sources of its foreign currency earnings, certainly contributed to the downfall of this huge empire. Soviet military expenditure, rising in a desperate bid to keep up with US military spending, became too high for the USSR to maintain. There were no sources of income to support this rise in spending. On top of this all, Saudi Arabia increased its crude oil output significantly in the mid-1980's. This caused an oil price collapse, which decimated Soviet oil export earnings⁹¹.

The disintegration of the Soviet Union resulted in the *de jure* independence of the Central Asian Republics. The end of the Cold War was heralded as the final victory of the Western, capitalist state system over the socialist system of nationhood. The international community took for granted that the Central Asian Republics would develop quickly into independent, market-oriented states⁹². But the organizational structure of the Soviet Union had been devised

⁹⁰ Source: <http://www.caspiantimes.com/html/info.html>.

⁹¹ MORSE, RICHARD, *Op. cit.*, 2002, p. 29.

⁹² PFAFF, W., "La Politique Étrangère Américaine", *Commentaire*, No. 98, 2002, p. 293.

in such a way, that Moscow was the center of all economic activities of the Soviet Union. Therefore, the newly independent republics quickly discovered that their political autonomy was largely cancelled out by an enduring economic dependence on Russia. Tsygankov notes that the newly independent republics 'were unable to exercise their national autonomy fully over at least some critical issues due to their economic dependency on the ex-metropole'⁹³. A gradual transition to a market economy, if that is what the governments of these republics wanted, had to be accompanied by a redirection of their economies away from Russia. The last decade has witnessed attempts by the Eurasian governments to free their political and economic future from Russia. Nevertheless, when they found themselves in dire circumstances, Russia was one of the first places to which they turned to for help. The difficulties that fell upon them consisted of both economic hardship and internal strife.

Eurasia witnessed one international conflict, between Armenia and Azerbaijan, who struggled over control of the autonomous region of Nagorno-Karabach, and several internal conflicts, most notably in Georgia, Russia and Tajikistan. The Eurasian republics as they exist today, are the result of the redrawing of the map by Soviet command in the 1920's-1930's for internal administrative reasons. It was Soviet policy to disregard historically grown and more *natural* social borders so as to ensure a political division in which Russia's dominant position could not be challenged. Consequently most of the Central Asian Republics consist of different ethnic groupings, sometimes without one of them making up the majority of the population. This is a cause for uncertainty for the governments, who more often than not represent only a certain part of the population. On several occasions neighboring countries, especially Russia, have used the presence of minorities as a pretext to get involved in another country's internal affairs.

The Soviet redrawing of the map has resulted in a situation where both Armenia and Azerbaijan now have an enclave within each other's borders. Fighting broke out between both countries over the control of the Armenian enclave of Nagorno-Karabach in Azerbaijan. Russia was able to influence the development of the conflict to a large extent. Up until 1992 Russia supported Azerbaijan, because of Russia's belief in the sanctity of existing borders⁹⁴. But when Azerbaijan sought to improve its ties with Turkey, which Russia perceives as a local rival, Russian support for Azerbaijan declined, and eventually Russia supported Armenia. It did so by sending arms shipments to Armenia and Karabach rebels, as a lever to put pressure on Azerbaijan. Azerbaijan also raised Russia's wrath by promoting an oil export route through Turkey, threatening to end the Russian oil transport monopoly in this region⁹⁵. Russia implied to Azerbaijan that if it allowed a Russian oil company to share in the development of Azerbaijan's hydrocarbon resources and if Azerbaijan chose an existing Russian pipeline as its main export route, Russia would put

⁹³ TSYGANKOV, A.P., "The Culture of Economic Security: National Identity and Political-Economic Ideas in the Post-Soviet World", *International Politics*, Vol. 39, 2002, p. 155. Tsyganlov calls this an economic security dilemma.

⁹⁴ Known as the principle of *uti possidetis juris*. This became part of international practice at the time of South American and later African decolonization. For further reading on this issue, see M.N. SHAW, *International Law*, Cambridge: Cambridge University Press, 1999, pp. 356-360. Besides noble thoughts on the development of international law there were other, more political reasons for Russia to support this principle. The Russian government fears a disintegration of the Russian Federation.

⁹⁵ This route is the Baku-Tblisi-Ceyhan route. See Chapter 5.

pressure on the Karabach Armenians to put down their arms⁹⁶. Armenia was the *de facto* victor of this war and it still controls large parts of Azerbaijan's territory. A cease-fire, declared in 1994 and mediated by Russia, has largely held until now, despite a few serious clashes in 1997 and 1999. A change in the local balance of power or the mere conviction by the warring factions that such a change is forthcoming could easily rekindle the hostilities⁹⁷.

Georgia has been confronted with two separatist movements aspiring sovereignty⁹⁸, which resorted to the use of force to present their cases. The mountainous region of South Ossetia, about 100 kilometers North-West from Georgia's capital Tblisi, wanted to break free from Georgia in order to align itself with Russian North Ossetia, on the opposite side of the Russian-Georgian border. A cease-fire was brokered in 1992, but a situation of 'no peace, no war' persists⁹⁹, with an ever-threatening danger of renewed hostilities. The other breakaway region in Georgia is Abkhazia. The main fighting in the Abkhazian conflict happened in 1992 and 1993. Abkhazia wanted to restore its independence from Georgia, in a bid to emulate its own history as a separate Soviet republic in the 1920's. Abkhazia is of major importance to Georgia, because it houses Georgia's main rail and road links to Russia, half of Georgia's Black Sea coastline and rich agricultural and mineral resources. Even though ethnic Abkhazians only represent 1.8% of Georgia's entire population¹⁰⁰, the Georgian army was unable to resist the Abkhaz army. The Abkhazians received support from Russia, who wanted to protect the Russian minority in Georgia, even though the official Russian policy was one of neutrality in the conflict. Allegedly, the Russian decision to support the Abkhaz side was motivated by a desire to weaken Georgia. It wanted to make Georgia less safe as a possible transit region for Azerbaijani oil, thereby raising world crude oil prices¹⁰¹. A cease-fire was concluded under UN and Russian supervision. The Georgian president Shevardnadze was obliged to ask for Russian help to suppress this rebellion, at the cost of significant military and political concessions. As a reward for its efforts in concluding the cease-fire Russia now has several military bases as well as border guards in Georgia¹⁰². Besides causing a loss of political independence and prestige for the Shevardnadze regime, both conflicts also resulted in the economic downfall of Georgia.

Tajikistan is located on the Eastern side of Eurasia; it has no major hydrocarbon deposits and therefore is of little importance to the pipeline politics of Eurasia. Even so, Tajikistan's internal conflict was of great importance to the other States in the region, who feared a horizontal escalation of the conflict. The civil war that raged in Tajikistan from 1992 to 1997 was a consequence of the Tajik neo-communist regime's unwillingness to share

⁹⁶ KARAGIANNIS, E., *Energy and Security in the Caucasus*, London: RoutledgeCurzon, 2002, pp. 40, 41.

⁹⁷ KARAGIANNIS, *Op. cit.*, 2002, p. 47.

⁹⁸ LYNCH, D., "Separatist States and post-Soviet Conflicts", *International Affairs*, Vol. 78, no. 4, 2002, p. 836.

⁹⁹ MINASSIAN, G., "Caucase du Sud: les enjeux de la coopération régionale", *Politique Étrangère*, no. 3, 2002, p. 724.

¹⁰⁰ HERZIG, E., *The New Caucasus. Armenia, Azerbaijan and Georgia*, London: The Royal Institute of International Affairs, 1999, p. 76. A census in 1989 showed that there were 93.000 Abkhazians in Georgia.

¹⁰¹ KARAGIANNIS, *Op. cit.*, 2002, pp. 81, 83.

¹⁰² HERZIG, *Op. cit.*, 1999, p. 19.

power and its efforts to deny the rise of the Islamic Resurgence Party (IRP)¹⁰³. The opposition to the Tajik army in the civil war was composed of several groups, of which the IRP was the most influential. The IRP was founded as a political party in 1991. The goals of the IRP were to promote the spiritual revival of Tajikistan, and the achievement of economic and political independence of the country¹⁰⁴, unlike the Abkhazian and Karabach rebellions, which wanted to secede. Acceptance of the legitimacy of the Tajik state contributed to the popularity and legitimacy of the IRP¹⁰⁵ in the eyes of the Tajik population¹⁰⁶. The governments of the other Central Asian Republics saw the rise in power and importance of the IRP as an indication of the danger of political Islam and as a warning of things to come. Consequently they have seized the occasion to stiffen their stance towards religious groupings in their own countries. In the end both sides opted for negotiations to end the conflict. The peace agreement that ended the Tajik civil war awarded the IRP posts at all levels of government by means of a quota, and its fighters were incorporated in the Tajik army. But because the IRP has been unable to offer any cohesive political doctrine or economic program, public support is waning¹⁰⁷.



Within Russian borders a violent conflict has been raging for years. The Chechen autonomous region, already enjoying a large degree of self-control, declared its independence from Russia in the early 1990's. Russia decided to settle the matter by force. It attributed great strategic value to this military

¹⁰³ ALAOLMOLKI, N., *Life after the Soviet Union. The Newly Independent Republics of the Transcaucasus and Central Asia*, Albany: State University of New York, 2001, p. 41. The IRP is also known as the Hezib-e Nehzat-e Islami.

¹⁰⁴ SAGDEEV, R., EISENHOWER, S. (eds), *Islam and Central Asia: an Enduring Legacy or an Evolving Threat?*, Washington D.C.: Center for Political and Strategic Studies, 2000, p. 66.

¹⁰⁵ LYNCH, *Op. cit.*, 2002, p. 834.

¹⁰⁶ RASHID, A., *Jihad: The Rise of Militant Islam in Central Asia*, New Haven: Yale University Press, 2002, p. 95.

¹⁰⁷ SAGDEEV, EISENHOWER, *Op. cit.*, 2000, p. 68.

¹⁰⁸ Source: <http://www.rferl.org/caucasus-report/maps.html>, changes by author.

campaign, fearing that if Chechnya would be allowed to break away from the Russian federation, other regions would try to follow suit. Also Grozny, Chechnya's capital, is a major hub in the old Soviet transport network of Caspian oil, giving this conflict great economic importance as well. Chechnya was stealing large amounts of oil flowing through Grozny and effectively controlling the pipeline. Therefore Russian policy makers decided that Chechnya had to be brought back under control¹⁰⁹. Thus the first Chechen war broke out in 1994, a brutal conflict in which the Russian army was incapable of finding an answer to the Chechen guerilla tactics. The Eurasian republics learned two lessons from this military quagmire. Firstly, the failure of the Russian armed forces to quickly bring the situation back under control seriously weakened the image of Russia as the local powerhouse in the eyes of the Central Asian Republics¹¹⁰. Secondly however, even though Russia is no longer a superpower, Russian willingness to fight if its vital interests are at stake, as it proved and still is proving in the second Chechen war, convinced the Eurasian republics that it is very unwise to cross Russia.

In general, the last decade of the 20th Century was marked by the economic downfall and political instability of Eurasia. Russia has tried different ways to exert influence over the region. One of these was on a multilateral basis, for example by means of the Commonwealth of Independent States (CIS). Russia hoped that by playing a leading role in the CIS it could induce the Central Asian Republics to more or less follow Russian policy decisions. Russia wanted to form the CIS into a security structure for the region. Some progress has been made, but not to the extent that Russia wanted¹¹¹. Russia has also sought to enhance its southern borders by concluding bilateral security treaties with some of the newly independent republics¹¹².

3.2 *State-society relations in the newly independent republics*

Together with independence came the responsibility for the affairs of state for the new governments. In the 1990's the process of state building in the Central Asian Republics took form on two different levels: orientated towards the outside and towards the inside of their republics. Firstly, the new governments attempted to define and consolidate their political communities, and create and maintain meaningful relations with other political communities, in order to become a member of the society of states. Secondly, in order to secure the sources of power of government, they had to establish viable government institutions, capable of controlling and administrating key resources, such as territory, coercive force and wealth. This had to be done so that the institutions of government could be sustained beyond the political lives of individual office-holders¹¹³. The Eurasian governments, trying to secure the internal side of their power, took such drastic action, that these governments can now be described as authoritarian. This is both a consequence of and an influential factor in the state-society relations in the newly independent republics.

Eurasia is located as the crossroads between East and West, and between Russia and the Middle East. The region is an important trafficking area for

¹⁰⁹ KARAGIANNIS, *Op. cit.*, 2002, p. 62.

¹¹⁰ HERZIG, *Op. cit.*, 1999, p. 49.

¹¹¹ GLEASON, G., "Inter-State Cooperation in Central Asia from the CIS to the Shanghai Forum", *Europe-Asia Studies*, Vol. 53, no. 7, 2001, p. 1086.

¹¹² HERZIG, *Op. cit.*, 1999, p. 48.

¹¹³ HERZIG, *Op. cit.*, 1999, p. 6.

weapons, narcotics, and even terrorists¹¹⁴. Trafficking is made possible by the weakness of state governments, most of which are unable to fully exercise control over their territories. Besides being a consequence of the weakness of the Eurasian governments, the trafficking industry also contributes to this weakness by running a black market economy outside the reach of government tax collectors. The weakness of the local governments is expressed in their corruptness, their political repression, and sometimes the virtual absence of the rule of law in these countries¹¹⁵. Slaughter states that the situation in the newly independent republics resembles the former European colonies in Africa, because the rule of law hasn't taken hold¹¹⁶. The human rights record of most of these countries is grim.

The local governments face a lack of resources to build strong economic and political institutions. The dire economic conditions of these countries have resulted in massive levels of unemployment. In most cases living standards as well as industrial output levels are lower now than they were before the collapse of the Soviet Union in 1991¹¹⁷. With their independence the Eurasian republics inherited the Soviet system of an economy whose visible parts are owned and directed by the state. This system handed the new governments the capability to direct and control the economy, and to appoint protégés on key functions, without paying attention to market conditions. A system of nepotism and corruption developed. War or the threat of war and political instability further enhanced the governments' grip on economic affairs¹¹⁸. Unemployment is a great problem for the quickly growing populations of these republics. The Central Asian countries are pursuing different strategies to revitalize their economies. Kazakhstan and Kirgizstan are to a certain extent carrying out reforms in a neo-liberal fashion, while Uzbekistan and Turkmenistan want to keep the state in charge of the economy. Throughout Eurasia agriculture remains the dominant sector of the economy, employing most people, accounting for approximately 10% of Kazakhstan's or Turkmenistan's GDP, and more than 30% of Uzbekistan's GDP¹¹⁹.

The political repression these governments exert to secure their privileged positions could backfire. One of the reasons for the instability of the Eurasian republics is domestic political repression. It could foster radicalization of Islamic movements and galvanize popular support for these movements as the only credible political alternative and the only way to get public grievances under attention¹²⁰. The local governments are very aware of the possible dangers of radical political Islam and focus their attention on combating this possible enemy¹²¹. Hereby they tend to neglect the other problems facing their countries, such as the inflow of drugs, problems of water management¹²², the

¹¹⁴ KALICKI, J.H., "Caspian Energy at the Crossroads", *Foreign Affairs*, Vol. 80, no. 5, 2001, p. 121.

¹¹⁵ KALICKI, *Op. cit.*, 2001, p. 121.

¹¹⁶ SLAUGHTER, R., "Poor Kyrgyzstan", *The National Interest*, No. 68, 2002, p. 56.

¹¹⁷ CORNELL, S.E., SPECTOR, R., "Central Asia: More than Islamic Extremists", *The Washington Quarterly*, Vol. 25, no. 1, 2002, p. 199.

¹¹⁸ HERZIG, *Op. cit.*, 1999, p. 22.

¹¹⁹ GLEASON, G., "Foreign policy and domestic reform in Central Asia", *Central Asian Survey*, Vol. 20, no. 2, 2001, pp. 168, 169.

¹²⁰ LUONG, P.J., WEINTHAL, E., "New Friends, New Fears in Central Asia", *Foreign Affairs*, Vol. 81, no. 2, 2002, p. 63.

¹²¹ RASIZADE, A., "Na Afghanistan het nieuwe Grote Spel in Centraal-Azië", *Internationale Spectator*, Vol. 66, no. 10, 2002, p. 496. (in Dutch)

¹²² The two main rivers in Eastern Eurasia are the Syr Darya and the Amu Darya, in ancient times known as the Jaxartes and Oxus rivers. Upstream and downstream countries are quarreling about the

widespread availability of weapons, and the presence of refugees from the different conflicts that have pervaded the region in recent years. The ‘no peace, no war’ outcome of some local conflicts, especially in the Caucasus, makes it impossible for the refugees to return home¹²³.

Political repression is widespread in the newly independent republics. Elimination of all forms of political opposition since 1992 has left Islam as the only available vehicle for channeling political grievances¹²⁴. In the case of presidential or parliamentary elections, the existing powers ensure that there is no viable political opposition. For example, Tajikistan’s president Emomali Rahmonov was re-elected in 1997 with 95% of the vote, and the Uzbek president Islam Karimov with 99.6% of all votes cast in 1995¹²⁵. In both cases there was no serious opposition candidate. The weaknesses in state building and in the development of state-society relations leave citizens exposed to threats to their property and political rights¹²⁶, resulting in growing tensions between government and society.

As noted above, the Soviet-fabricated country borders do not represent clear lines of division between the different ethnic groupings. All countries host considerable ethnic minorities¹²⁷. The lack of access to political offices for minorities exacerbates ethnic tensions between the different peoples of Eurasia. Usually minorities are kept out of the higher public offices, and accordingly cannot benefit from the widespread corruption that pervades these jobs¹²⁸. Most of the times governments take a different stance toward Russian minorities. Even though many ethnic Russians emigrated to Russia after the breakup of the Soviet Union, Russians remain of great importance to the governments, because of their high level of education and elevated position in

Map 3.3 Kazakhstan’s new and old capital



society. Not minding the huge costs of the operation, Kazakhstan even switched its capital from Southeastern Almaty to the more centrally located Astana¹²⁹ in a bid to appease the very large Russian minority in Kazakhstan. Ethnic Russians, who dominate Kazakhstan’s oil and gas industries, constitute the largest majority in the Northern parts of Kazakhstan and the national government fears secessionist activities¹³⁰.

amount of water that each country is allowed to utilize. See RASIZADE, A., “Na Afghanistan het nieuwe Grote Spel in Centraal-Azië”, *Internationale Spectator*, Vol. 66, no. 10, 2002, p. 494. (in Dutch)

¹²³ ALAOLMOLKI, *Op. cit.*, 2001, p. 54.

¹²⁴ LUONG, WEINTHAL, *Op. cit.*, 2002, p. 65.

¹²⁵ BACEVICH, A.J., “Steppes to Empire”, *The National Interest*, No. 68, 2002, p. 45.

¹²⁶ HERZIG, *Op. cit.*, 1999, p. 45.

¹²⁷ KARAGIANNIS, *Op. cit.*, 2002, p. 34.

¹²⁸ SLAUGHTER, *Op. cit.*, 2002, p. 59.

¹²⁹ Source: *The Economist*, “Don’t know, don’t care in Kazakhstan”, June 7, 2001.

¹³⁰ ALAOLMOLKI, *Op. cit.*, 2001, p. 64.

In the Caucasus, economic blockades, imposed as a consequence of armed hostilities, such as the one imposed on Armenia by Azerbaijan, have wrecked the local economies. Another consequence of these blockades is the impossibility of contact between the two populations, and no restoration of former social relations or economic ties has been possible. Blockades do have a side effect, they form incentives for smuggling¹³¹. Georgia also imposed blockades on Abkhazia and South Ossetia, with similar consequences.

3.2.1 *The War on Terrorism and the State-society relations*

To gain support for their War on Terrorism following the September 11th, 2001 attacks on the New York World Trade Center and the Pentagon, the United States have greatly increased their political and military ties with the governments of the Eurasian republics. Their objective was to facilitate the military attack on the Taliban regime in Afghanistan. US support is welcomed enthusiastically by the Eurasian ruling elites. The financial aid given by the US enhances the corrupt tendencies of these governments, and they use their relations with the US as leverage in regional rivalries¹³². The US military presence and pledge of economic assistance is helping the Central Asian regimes with their internal consolidation of power. Invitations to visit Washington D.C. for Uzbek president Karimov and Kazakh president Nazarbaev served as a huge boost for these unpopular authoritarian rulers. They can now legitimize their hold on power by pointing at the American support they are enjoying. Prospects of a long-term US military presence in their countries also enable some of the Eurasian rulers to extract maximum political and financial benefits from their relations with the United States¹³³. This may turn out to be a vital factor in the struggle for political survival.

Military aid given by the United States to the armies of the Eurasian republics is welcomed very warmly indeed. These armies were based on conscription, and low wages and high levels of corruption resulted in low morale. The military capacity of the Eurasian countries declined as a direct result of their economic downfall of the 1990's¹³⁴. With outside help, mostly from the US, China and Russia these states can now modernize their armies¹³⁵. By doing so, the Central Asian Republics will pose security threats to one another, a notion already incorporated in the Kazakh military doctrine¹³⁶.

Since the outbreak of the hostilities between the United States¹³⁷ and the Taliban in Afghanistan, the Central Asian governments have stiffened their stance towards ethnic minorities¹³⁸. Visitors from neighboring countries have been expelled, and especially Uzbekistan is tightening controls at the Tajik and Kirgiz borders¹³⁹.

¹³¹ HERZIG, *Op. cit.*, 1999, p. 65.

¹³² FAIRBANKS, C., "Being There", *The National Interest*, No 68, 2002, p. 41.

¹³³ RUMER, B., "The Powers in Central Asia", *Survival*, Vol. 44, no. 3, 2002, p. 57.

¹³⁴ RASHID, *Op. cit.*, 2002, p. 223.

¹³⁵ Eurasianet, "Central Asia: Militarization could come at cost of Regional Stability", 19 September 2002, <http://www.eurasianet.org>.

¹³⁶ ZARDYKHAN, Z., "Kazakhstan and Central Asian: regional perspectives", *Central Asian Survey*, Vol. 21, no. 2, 2002, p. 173.

¹³⁷ In close cooperation with the Afghani Northern Alliance, and with the United Kingdom.

¹³⁸ HEUVEL, M. VAN DER, "Onrust in Kirgizstan", *Internationale Spectator*, Vol. 66, no. 10, 2002, p. 493. (in Dutch)

¹³⁹ RASIZADE, *Op. cit.*, 2002, p. 494.

3.3 *The uncertain legal status of the Caspian Sea*

Ever since the Soviet Union was dismantled the five states bordering the Caspian Sea have been arguing about the legal status of this largest land-locked body of water in the world. Czarist Russia/the Soviet Union and Persia/Iran had concluded several bilateral treaties, which formed a reflection of the local balance of power of those times, with Russia more or less imposing its will on Persia. These treaties, the first of which was drafted in 1753, created a legal regime, albeit of a limited scope. Freedom of navigation was emphasized and the treaties of 1921 and 1940 provided for the creation of a 10-mile exclusive fishing zone and stipulated the idea on common use of the Caspian and its resources¹⁴⁰. The Caspian Sea was declared to be a ‘Soviet and Iranian Sea’¹⁴¹.

Since the moment of their independence the three new littoral states, Kazakhstan, Azerbaijan and Turkmenistan, have stressed that the old legal regime is no longer applicable in the current situation because did not participate in the drafting of these treaties. All parties agree that the old treaties can no longer provide for the maritime regime of a body of water now surrounded by five coastal states¹⁴². No such regime has been established yet, and as a result the legal status of the Caspian Sea remains undetermined.

This uncertainty is a potential source of conflict between the regional states because the legal title to some of the hydrocarbon deposits in the Caspian Sea could be challenged. The absence of legal clarity has a detrimental impact on the development of oil deposits located in disputed areas of the Sea, deterring investments by TNOCs. Nobody doubts the claims of states on deposits that are located unambiguously nearer to their shores than to those of any other state. No state denies that clarification of the legal status of the Caspian Sea will help the development of the hydrocarbon resources. All states have something to gain by agreeing on a new legal regime for the Caspian. The problem is however, that the spoils appear to be distributed in an uneven way, raising a feeling of anxiety among some states. Without any major deposit discovery in its coastal area, especially Iran is afraid of being sidelined when the rewards are distributed. From a legal point of view the dispute involves the following issues:

- Whether the old treaties are still in force and thereby regulate the legal regime of the Caspian Sea, as Iran claimed until recently¹⁴³. However, these treaties do not provide clear boundary lines on the Sea, they only provide rules concerning navigational and fishing rights on the Caspian Sea, dividing these between the USSR and Iran, excluding others¹⁴⁴.
- Whether the Caspian Sea is a real *sea* and therefore subject to the 1982 Law of the Sea Convention, or whether it is an inland *lake*, giving each state full jurisdiction over their part of the water after a division has been agreed upon. Alternatively, the littoral states can

¹⁴⁰ PEIMANI, *Op. cit.*, 2001, p. 41.

¹⁴¹ BUNDY, R.R., “Legal Aspects of Protecting the Environment of the Caspian Sea”, *Review of European Community & International Environmental Law*, Vol. 5, no. 2, 1996, p. 125.

¹⁴² MIRFENDERESKI, G., *A Diplomatic History of the Caspian Sea*, New York: Palgrave, 2001, p. 187.

¹⁴³ Iranmania, “Russia hails Iran’s stance regarding Caspian Issues”, September 22, 2002, <http://www.iranmania.com>.

¹⁴⁴ At that time a rather hypothetical issue, since the Caspian Sea was surrounded by these two States, and the only way to reach the waters of the Caspian Sea was by passing through one of them.

come up with other legal systems as well, such as a condominium, as long as they all agree to do so and bind themselves by means of a multilateral treaty. Before any meaningful cooperation between the littoral states, such as the construction of trans-Caspian pipelines, can take place, the legal regime must be clarified.

To reach a break-through of this diplomatic deadlock, different initiatives have been undertaken. During most of the 1990's, the majority of the hydrocarbon finds were situated in parts of the Caspian located near the Azeri, Turkmen and Kazakh coasts. Especially Azerbaijan advocates a full division of the Caspian Sea in national sectors along median lines. Iran remains opposed to this idea, mainly because the 'Iranian' sector of the Caspian Sea doesn't contain large hydrocarbon deposits. A working group of representatives from each country was set up to create a joint declaration on the new legal status of the Caspian Sea, but this multilateral initiative hasn't produced any tangible results yet. Various bilateral initiatives have been undertaken.

Several bilateral agreements have been concluded to strengthen and clarify the positions of the littoral states. Kazakhstan reached an agreement with Azerbaijan in 1997. In this instance both countries did not address the legal status of the Caspian Sea, but agreed to divide their sectors along the median line until a convention on the legal status is signed¹⁴⁵. In the same year Turkmenistan and Kazakhstan agreed to divide their sectors by following old Soviet administrative borders. In 1998 Kazakhstan and Russia decided to divide the seabed along median lines, leaving the waters under joint ownership. Both countries agreed to do so when they decided to develop deposits located on the median line together. Companies from each country are therefore allowed to join in the development of deposits located just on the other side of the border¹⁴⁶. Cooperation in exploration issues removed a potential source of conflict between the two countries. Kazakhstan had been very anxious about Russian activity in this particular area¹⁴⁷. In May 2002 Russia and Kazakhstan concluded a protocol in which they defined their offshore boundary. It is their hope that this agreement will serve as a blueprint for the other littoral states to come to a division of the entire seabed¹⁴⁸.

Until 1999 Russia had been opposed to a complete delimitation of this body of water, and championed the principle of a condominium to maximize Russian influence on the entire Caspian Sea. But the discovery of more substantial reserves than anticipated in the 'Russian' sector of the Northern Caspian, together with the rise in crude oil prices since 1999 persuaded Russia to alter its stance. Russia is now more amenable to the carving up of the Caspian Sea to secure the title to its own assets¹⁴⁹. Russia and Azerbaijan reached an agreement to this purpose in September 2002¹⁵⁰.

¹⁴⁵ EIA, Caspian Sea Region: Legal Issues, <http://www.eia.doe.gov/emeu/cabs/casplaw.html>.

¹⁴⁶ Russian companies are allowed to take part in the development of Kazakhstan's Kurmangazy structure, and Kazakh companies are allowed to participate in the development of Russia's Khvalynskaya field, owned by LUKoil. EIA, *Caspian Sea Region: Legal Issues*, July 2002.

¹⁴⁷ ZARDYKHAN, *Op. cit.*, 2002, p. 174.

¹⁴⁸ Petroleum Economist, "Caspian Sea", June 2002.

¹⁴⁹ HILL, FEE, *Op. cit.*, 2002, p. 13.

¹⁵⁰ Iranmania, "Iran renews opposition to bilateral deals on Caspian", September 23, 2002.

Map 3.4 Proposed Borders on the Caspian Sea¹⁵¹

Apparently all littoral states except Iran are denouncing the continuing validity of the old legal regime. Indeed there is one specific agreement between the Soviet Union and Persia that even Iran considers to be void. In 1962 the Aram-Pegov memorandum established a boundary between Persia and the USSR across the Caspian, in a straight line from Astara, on what is now the border between Iran and Azerbaijan, to Esenguli¹⁵² on the current border between Iran and Turkmenistan¹⁵³. As a result Iran controlled only a small part of the Caspian Sea, even smaller than the 12-13% fraction it would administer if a new division of the Sea is made according to the method of equidistance. Even though this agreement was never published, both governments consented to it and acted

accordingly. Mirfendereski argues that state practice, along with the belief by both parties that this practice is the expression of the law constitutes customary international law¹⁵⁴, thereby binding the parties and successor states on this issue. However, Russia and Iran disavowed this agreement in 1993, effectively ending all discussion between the littoral states on the subject of the Aram-Pegov memorandum¹⁵⁵.

Iran creatively interpreted its own historical record with the Soviet Union and stated that since both states had labeled the Caspian Sea as a 'Soviet and Iranian Sea', giving the states joint ownership, this implied that Iran has historically been entitled to 50% of the entire Caspian Sea, leaving the other half to the four successor states of the Soviet Union. However, there is no international custom or law that support such an interpretation of the treaties, and Iranian acquiescence of Soviet dominance of the Caspian, together with the Aram-Pegov memorandum demonstrates flaws in Iran's reasoning¹⁵⁶. Iran probably used this harsh, but ultimately untenable position as a bargaining chip in negotiations with the other littoral states. Having no major oil deposits near its Caspian coast, Iran is in no hurry to conclude an arrangement and patiently tries to achieve the best result possible. Recent bilateral initiatives between the other states have however forced an Iranian response. Iran stated that it would settle for a full division, provided it receives jurisdiction over one

¹⁵¹ Source: The Economist, "Storm in a precious teacup", August 2, 2001. Changes by author.

¹⁵² Also called Hassan Koli or Hassangoli.

¹⁵³ MIRFENDERESKI, G., *A Diplomatic History of the Caspian Sea*, New York: Palgrave, 2001, p. 169.

¹⁵⁴ MIRFENDERESKI, *Op. cit.*, 2001, p. 178.

¹⁵⁵ MIRFENDERESKI, G., "Equal but undivided?", *The Iranian*, March 12, 2001, <http://www.iranian.com/GuiveMirfendereski/2001/March/Russia/index.html>.

¹⁵⁶ MIRFENDERESKI, *Op. cit.*, 2001, p. 190.

fifth of the Caspian Sea¹⁵⁷. The other states promote a division based on the meridian or equidistance line.

Iran hasn't been persuaded into accepting a division of the Caspian seabed along the method of equidistance or median line. Iran insists that the old treaties of 1921 and 1940 are still in place and rejects the validity of any unilateral or bilateral agreements on this issue. Iran states that either the sea should be used in common, by means of a condominium, or the Sea should be divided into equal shares, meaning that each country should control 20% of the sea floor and surface. The median line method, as applied by Azerbaijan, Kazakhstan and Russia when drawing their division lines, gives Iran control over a mere 12-13% of the Caspian¹⁵⁸. When a condominium according to Iran's idea is established, all offshore developments must be sanctioned by every littoral state until a new legal regime is created. In this way the Iranian role in the Caspian oil industry would be maximized, effectively giving Iran veto right over offshore activities by the other countries. For this reason the other littoral states ardently oppose this plan. Iran is thus blocking any efforts to come to an agreement for the creation of a new regime, and voicing strong opposition to any bilateral agreement concluded between the other littoral states.

A summit of the heads of state in April 2002 in Ashgabat, Turkmenistan, failed to produce an agreement on the legal status of the Caspian Sea. Because of the Iranian stance on the issue, and because of uncertainty how cross-border deposits should be divided, there is still a possibility that conflicts among the littoral states will arise. There have been two examples of states willing to resort to other means to get their message heard. In the first incident Iranian gunboats chased two Azerbaijani research vessels from a contested oil field in July 2001. These ships were on a BP exploration mission and the incident seriously damaged relations between Azerbaijan and Iran¹⁵⁹. The second incident occurred in August 2002 when Russia held large fleet exercises on the Caspian Sea during two weeks¹⁶⁰. It is unclear what exactly Russia tried to prove by this operation, but in any case Russia flexed its muscles¹⁶¹, maybe to convince the other littoral states of the high priority Russia gives to Caspian matters. Until a convention succeeds in creating a new legal regime for the Caspian Sea, there will always be a risk of militarization of the region, or an escalation in a dispute about the control of the resources among the littoral states. A new summit will probably take place in 2003.

¹⁵⁷ Iranmania, "Iran renews opposition to bilateral deals on Caspian", September 23, 2002; MIRFENDERESKI, *Op. cit.*, 2001, p. 213.

¹⁵⁸ Iranmania, "Iran renews opposition to bilateral deals on Caspian", September 23, 2002.

¹⁵⁹ The Economist, "Storm in a precious teacup", August 2, 2001.

¹⁶⁰ Eurasianet, "Caspian: Results of Russian Wargames still a mystery", August 24, 2002.

¹⁶¹ BLANK, S.J., "Putin's Twelve-Step Program", *The Washington Quarterly*, Vol. 25, no. 1, 2002, p. 155.

Chapter 4: The Political Situation in Eurasia

To gain a better understanding of the political situation, we have to look at the Eurasian policies of the different actors, and the impediments their situation imposes on them. These are the newly independent Central Asian Republics and Russia, external powers such as Iran, Turkey, China and the United States, Transnational Oil Companies (TNOCs), and other transnational movements, such as radical Islamic political forces, intergovernmental organizations such as the GUUAM group¹⁶², financial institutions, and finally, non-governmental organizations (NGOs).

The arrival of the United States in the region as a result of their War on Terrorism has a vast impact on the local political situation. It offers opportunities for the Eurasian Republics to enhance their security and economic situation, it seems a mixed blessing for Russia and isn't welcomed warmly by either China or Iran. This mix of conflict and cooperation, in which coalitions between countries can give rise to counter-coalitions by others, constitutes the geopolitical situation of the politics of oil in Eurasia.

4.1 *The Central Asian Republics and Russia*

The relations between the newly independent republics and Russia remains of pivotal importance for the whole region. As the most influential actor in the shaping of the international relations in Eurasia over the past decade, Russia is the logical starting point when making an assessment of the Eurasian political situation, even though its influence is no longer what it used to be.

4.1.1 *Russia*

As noted above, Russia perceives Central Asia and the Caucasus as part of its 'near abroad', i.e. Russia's vulnerable underbelly. Throughout the 1990's it therefore maintained that Eurasia is part of Russia's sphere of influence, and that others, especially Western countries, had no business there. With the economic dependency of the newly independent republics on Russia and with the large military presence in the region, a legacy of Soviet days, Russia's dominant position in the region seemed incontestable¹⁶³. But Russia's steady political and economic decline in the 1990's have weakened its grip on the situation and internal disagreements within Russia's government prohibited the formulation of a clear policy towards Eurasia. However, Russia quickly gave its relations with the Eurasian states greater priority after Azerbaijan and Georgia concluded an agreement on the BTC pipeline in 1999, which was seen as a blow to Russian interests in the region. Russia wanted to prevent other agreements like this one in Central Asia¹⁶⁴. Russia is well aware of its waning influence and has altered its stance accordingly, trying different methods to achieve its newly prioritized Eurasian policy goals, with emphasis on military and economic matters.

The Central Asian Republics are willing to accommodate the Russian influence to a certain extent in exchange for Russian security efforts in their behalf. Russia and the republics share an interest in preventing radical Islamic

¹⁶² The acronym GUUAM is derived from the first letters of the member countries Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova.

¹⁶³ RUMER, *Op. cit.*, 2002, p. 57.

¹⁶⁴ CUMMINGS, S., "Happier Bedfellows? Russia and Central Asia under Putin", *Asian Affairs*, Vol. 32, no. 2, 2001, p. 148.

threats, but Russia uses this threat as justification for its extensive presence in the region¹⁶⁵. Russia is not capable of securing this whole region by itself and doesn't want to do so. The memory of the Afghan-Soviet war in the 1980's and the continuing fighting within its borders in Chechnya weighs heavily on Russia's mind and there is a real fear that harsh military action in Eurasia will provoke terrorist responses on Russian targets, such as the bomb attacks in Moscow in 1999¹⁶⁶. Ever since that time Russia has been obsessed with its internal security and what it labels as pervasive threats, fearing that the country may disintegrate¹⁶⁷ and especially fearing secession by its predominantly Muslim territories. This is why Russia's policy makers refuse to accept anything else than victory in their struggle with breakaway Chechnya. The military aid that Russia is giving the Eurasian republics, e.g. by providing border guards at the Tajik-Afghan border, is prompted as much by economic as geopolitical motives. By providing this aid and selling military hardware below cost-price to the Eurasian governments, Russia effectively subsidizes its own defense industry, and tries to re-establish a unified defense-industrial sector throughout the former Soviet Union¹⁶⁸.

In the wake of the terrorist attacks on the US in 2001, the outbreak of fighting in Afghanistan between the United States and the Taliban seemed inevitable. Russia quickly decided that it had more to gain by approving American military presence in Central Asia than by opposing it. The War on Terrorism promotes Russian policy goals as well. This is why Russia didn't see any problems when Uzbekistan announced its alignment with the US and the imminent placement of American troops on Uzbek soil¹⁶⁹. The enemy that the United States are fighting in Afghanistan is also an enemy feared by Russia. Russia however is very anxious about the possibility of the US succeeding in bringing the energy resources of Central Asia under their control. This fear was evoked by a speech US Secretary of State Colin Powell gave in Tashkent, Uzbekistan, in December 2001, stating that US interests in Central Asia exceed Afghanistan alone¹⁷⁰.

Furthermore, Russia has succeeded in obtaining a high price for its cooperative spirit: American and Western endorsement of its internal war in Chechnya¹⁷¹. The Kosovo war of 1999 served as a frightening example for Russia of Western willingness to intervene in a internal conflict, a danger now removed. Russia has always stressed the relationship between the War on Terrorism and its struggle in Chechnya, although no proof of such a link has ever been presented¹⁷². As a result of Russian-American concordance on the War on Terrorism, Russia now has much better ties with NATO, formalized in the creation of the NATO-Russia council in May 2002¹⁷³. Besides, Russia, with a GDP smaller than that of the Netherlands, is now considered a true market

¹⁶⁵ RUMER, *Op. cit.*, 2002, p. 61.

¹⁶⁶ RUMER, *Ibid.* Actually, no proof has ever been presented that these bomb attacks were terrorist attacks.

¹⁶⁷ BLANK, *Op. cit.*, 2002, p. 152.

¹⁶⁸ Eurasianet, "Central Asia: Militarization could come at cost of Regional Stability", September 19, 2002.

¹⁶⁹ RUMER, *Op. cit.*, 2002, p. 64.

¹⁷⁰ RUMER, *Op. cit.*, 2002, p. 58.

¹⁷¹ BLANK, *Op. cit.*, 2002, p. 147.

¹⁷² LEVADA, Y., MENDRAS, M., "L'alliance opportuniste de Vladimir Poutine et George W. Bush", *Esprit*, Vol. 287, 2002, p. 43.

¹⁷³ DELPECH, T., "Quatre regards sur le 11 septembre: Etats-Unis, Europe, Russie, Chine", *Esprit*, Vol. 287, 2002, p. 26.

economy and admitted in the G-8¹⁷⁴. Finally, at a treaty concluded on May 24th, with the US, Russia is allowed to withdraw itself from earlier made START-II agreements on arms reduction and retain a larger number of nuclear warheads, thus making the world believe it is still a major power¹⁷⁵. This treaty effectively ended the agreement by Russia and the United States to not threaten non-nuclear states with their nuclear arsenals¹⁷⁶. As the Russian fleet maneuvers of last August show, Russia is using the military more and more as one of its principal tools in international relations, and its good relations with other regional powers such as China and even to a certain degree Turkey, allow Russia to continue to do so¹⁷⁷. It has been suggested that the Russian fleet exercises on the Caspian Sea last August were intended to show Iran, the country effectively blocking an agreement on full division of the seabed of the Sea, that Russia means business¹⁷⁸.

When pursuing its policy goals in Eurasia, Russia is making sure that it will not alienate itself from the United States. It is profiting indirectly from the War on Terrorism and would not have been able to wage such a military campaign by itself. This is a consequence of Russia's economic breakdown. Russia also needs the United States and Europe as important sources of foreign direct investments. The weakened Russian economy is in dire need of large amounts of foreign direct investments¹⁷⁹; Russian industrial equipment is very obsolete. Especially the Russian ruling elites are well aware of Russian dependency on foreign investments. Russia feels the need to be accepted as a fully 'European' country¹⁸⁰, and wants to be seen as a country of great importance.

One of the alternative methods of exerting influence over the newly independent republics that Russia tried was to use intergovernmental organizations as tools of their foreign policy. Most of these initiatives concerned structures for economic cooperation, such as the Economic Union, the Eurasian Economic Community, and a plan to establish a free trade zone. Because the newly independent republics quickly realized that Russia wanted to use these structures as economic levers to reassert its influence, these initiatives failed¹⁸¹. Russia also wanted to increase the security role of the Commonwealth of Independent States (CIS)¹⁸². Russia hoped that a strong military presence in Eurasia would help to make the CIS function as a security structure. So far this hasn't happened, and Russian military bases continue to represent Russian influence on foreign soil. Local resistance to these bases in the other Eurasian countries is not very profound because they also recruit local personnel and in this way lose some of their 'Russian' character¹⁸³.

Russia is using the energy that it supplies to most of the republics as levers. It wants to obtain a similar power over the local governments by providing the

¹⁷⁴ Russia was participant of the G-8 conference in May 1998 in Birmingham, England. PEARSON, PAYASLIAN, *Op. cit.*, 1999, p. 3. Russia's GDP is \$251 billion, that of the Netherlands \$365 billion (figures for 2001).

¹⁷⁵ DELPECH, *Op. cit.*, 2002, pp. 27, 28.

¹⁷⁶ BUSSIERE, R., "Après le 11 Septembre", *Commentaire*, No. 98, 2002, p. 303. Treaty concluded in May 2002.

¹⁷⁷ BLANK, *Op. cit.*, 2002, p. 157.

¹⁷⁸ Eurasianet, "Caspian: Results of Russian Wargames still a mystery", August 24, 2002.

¹⁷⁹ AMINEH, *Op. cit.*, 1999, p. 89.

¹⁸⁰ LIEVEN, A., "The Secret Policemen's Ball", *International Affairs*, Vol. 78, no. 2, 2002, p. 254.

¹⁸¹ RUMER, *Op. cit.*, 2002, p. 60.

¹⁸² CUMMINGS, *Op. cit.*, 2001, p. 146.

¹⁸³ HERZIG, *Op. cit.*, 1999, p. 48.

majority of future energy exports to the world market through Russian territory. This would provide Russian control over the amount of oil and gas these countries can sell, thereby directly influencing the export earnings of these countries. For now, the energy-producing countries around the Caspian depend heavily on Russia for transport. Until AIOC's Baku-Supsa oil pipeline became operative in April 1999, with a capacity of slightly more than 110,000 barrels/day, Russia had a monopoly on oil exports from this region. This gave Russia the power to unilaterally raise tariffs and effectively constrain Caspian exports according to its whims¹⁸⁴.

Russia has proved on multiple occasions that it is willing to use its dominant position in energy transport for political reasons. For example, if Georgia wanted to continue to import Russian gas, it was made clear to the Georgian government that it should take a less positive stance towards the BTC pipeline, close its borders to Chechen rebels, allow Russian border guards to cross the Georgian border whenever they are in hot pursuit of Chechen rebels, join the Eurasian Economic Community and allow Russian troops to remain on the bases they now occupy in Georgia¹⁸⁵. Minassian states that Russia could try to rekindle the Abkhaz-Georgian conflict in a bid to make Georgia seem unfit as part of any oil export route and simultaneously strengthen Russian influence in Georgia. But that seems rather far-fetched because the United States now have troops in Georgia as part of their War on Terrorism¹⁸⁶, Russia will not risk a confrontation or even a deterioration of its valuable relations with the US at the moment. A decision on the BTC pipeline has been taken and construction has already started, so it is too late for Georgia to miraculously change its mind. Nevertheless, Russian presence in Georgia is very real and there are Russian military bases very near to the route of the BTC pipeline¹⁸⁷.

The rise of the Russian TNOCs on the international oil market in the last two years has altered the Russian stance on export pipelines in Eurasia. Russia understands that it is most probably fighting a losing battle by continuing to oppose every pipeline that doesn't pass through Russian territory. The newfound strength of the Russian TNOCs, who as a result of the establishment of the rule of law in Russia are now fully capable of joining in international tenders, enables Russia to take a more cooperative position on the issue of non-Russian export pipelines¹⁸⁸. Russian companies are very likely to take an active part in their construction and exploitation. Apparently the transnationalists in the government have succeeded in getting their voices heard and promote Russian TNOCs to participate in Eurasian oil development projects, thus ensuring access to capital and advanced technology for Russia¹⁸⁹.

In general, Russia has pursued four different paths in its attempt to retain influence over the development of the oil industry in the Caspian Sea area. Firstly, Russia is trying to maximize the role of Russian TNOCs in oil development initiatives in the area. Secondly, Russia has tried for years to remain the only oil export transit country, and still wants to ensure a majority share of all Caspian export transits. Thirdly, until recently Russia used the

¹⁸⁴ KALICKI, *Op. cit.*, 2001, p. 123. This pipeline is recently upgraded to 145.000 barrels a day.

¹⁸⁵ BLANK, *Op. cit.*, 2002, p. 155.

¹⁸⁶ MINASSIAN, *Op. cit.*, 2002, p. 719.

¹⁸⁷ KARAGIANNIS, *Op. cit.*, 2002, p. 125.

¹⁸⁸ MORSE, RICHARD, *Op. cit.*, 2002, p. 26.

¹⁸⁹ AMINEH, *Op. cit.*, 1999, p. 87.

uncertain legal status of the Caspian Sea to try and diminish confidence in unilateral offshore development projects by claiming that these projects are unacceptable unless they are sanctioned by all littoral states¹⁹⁰. This is no longer a viable policy for Russia because it now tries to secure the title to deposits in the 'Russian' sector of the Sea. And finally, Russia remains a competitor of the Caspian oil producing countries and a market in its own right¹⁹¹.

4.1.2 The Newly Independent Republics

The Eurasian republics have faced a difficult decade during which they tried to secure their independence. The states that possess considerable hydrocarbon deposits look at future oil and gas revenues as miracle cures for all their ailments. The different options and the difficulties for the Eurasian states in their struggle for control, exploitation and export of their hydrocarbon resources are the result of several intra- and inter-state factors that strongly influence their behavior. Even if these states are capable of overcoming the problems that accompany the exploitation of their hydrocarbon resources, they will have to rely on regional cooperation in order to secure export routes to the world market¹⁹². As one would expect, the countries take different paths in implementing their policy objectives in different circumstances. For our research it is not necessary to thoroughly investigate such dissimilarities and a more general picture is presented.

The globalization of world politics strongly influences Eurasian efforts to develop a true nation-state. Weak states like the Eurasian republics experience in their process of nation-building the consequences of policy decision of external powers that either want to support or obstruct these processes¹⁹³. To ensure a peaceful resolution of border disputes, a legacy of the Soviet period, all states want regional cooperation¹⁹⁴. However, mutual mistrust and regional rivalry have prevented the establishment of regional cooperation on an elaborate scale¹⁹⁵.

At first sight there appear to be several exceptions to this statement, such as the GUUAM group, the Shanghai Cooperation Organization, and Centrazbat, all described in detail later on. But these forums for intergovernmental policy coordination do not aspire to create enhanced levels of regional cooperation, or any form of integration such as the European Union. A new cooperation initiative was started with a declaration on October 29th, 2001 between Armenia, Azerbaijan and Georgia in a response to the terrorist attacks on the US and the outbreak of the so-called War on Terrorism. These Caucasian states are no longer avoiding contact with each other; the integration of these states in the world society has evoked an urge to engage in a certain level of regional *rapprochement*. Regional cooperation is used here as a way to support the consolidation of the states¹⁹⁶.

¹⁹⁰ KARAGIANNIS, *Op. cit.*, 2002, p. 117

¹⁹¹ BAHGAT, G., "Pipeline Diplomacy: The Geopolitics of the Caspian Region", *International Studies Perspectives*, Vol. 3, 2002, p. 316.

¹⁹² AMINEH, M.P., *Op. cit.*, 1999, p. 85.

¹⁹³ TOLIPOV, F., "Nationalism as a geopolitical phenomenon: the Central Asian case", *Central Asian Survey*, Vol. 20, no. 2, 2001, p. 184.

¹⁹⁴ ZARDYKHAN, *Op. cit.*, 2002, p. 169.

¹⁹⁵ See, for example, AYOUB, M., "South-west Asia after the Taliban", *Survival*, Vol. 44, no. 1, 2002, p. 54.

¹⁹⁶ MINASSIAN, *Op. cit.*, 2002, pp. 715, 716, 723.

The Eurasian governments are aware of the problems in their state-society relations, but stress that the bulk of these problems originate from the subversive role acclaimed to radical Islamic movements. The authoritarian regimes of Eurasia do not allow any questioning of their legitimacy or their hold on power. In their bids to enhance the process of nation-building, while preventing social or ethnic conflicts, these governments are pursuing policies focused on the following points, either oriented inwardly, or outwardly towards the relations with other states¹⁹⁷:

- The internal government policies focus on restructuring society while preserving internal coherence, in particular between the rural and urbanized areas, and coming to terms with the role of religion in society;
- The policy goals concerning the relations between the newly independent republics and the international society are focused on the ever-important relations with Russia, and on ways to find foreign support in the struggle for regime survival.

The inwardly oriented government policies focus on state-society relations, cohesion of the state and government control. The Eurasian governments are trying to construct a nation-state while at the same time preserving their society's multi-ethnic character. When doing so, as Amineh states, they have to dismantle the old Soviet power structure 'while having to deal with social upheavals', consisting of the rising differences between rural and urbanized areas, and the increasing role of Islam in society¹⁹⁸. The government leaders are trying to hold on to their privileged positions, by effectively banning all kinds of political opposition. Their focus on radical Islamic movements, constantly portrayed as the main security threat to their countries, prevents them from acknowledging that a bigger danger stems from within the countries themselves in the form of social upheaval.

As noted above, the weakness of the local governments to control large tracts of their territories combined with the high penetrability of their borders contributes to large-scale smuggling of narcotics. In the cases of Kirgizstan and Tajikistan this low level of government control could result in the degeneration of the state into a failed state¹⁹⁹. Nearby Afghanistan is the world's largest poppy producing country, cultivating 72% of the total world production in 2000. A large quantity of these drugs passes through Eurasia on its way to Moscow and Europe²⁰⁰. The drug trafficking industry has led to increased smuggling activities and corruption of state officials, especially border guards of the Eurasian republics. The governments of Turkmenistan and Tajikistan are accused of profiting directly from the drug trade²⁰¹. These

¹⁹⁷ AMINEH, *Op. cit.*, 1999, p. 72. Amineh states five internal transformational problems that the governments of the Central Asian Republics have to address, however these can be re-categorized in two groups: the first group focusses on aspects that are orientated internally, the second group focuses on external relations, especially relations with Russia.

¹⁹⁸ Ibid.

¹⁹⁹ FAIRBANKS, *Op. cit.*, 2002, p. 47. Failed states are 'states that have collapsed into civil war and disorder, and where the government of the state has ceased to exist inside the territorial borders of the state', BAYLIS and SMITH, *Op. cit.*, 1999, p. 397.

²⁰⁰ AHMED, S., "The United States and Terrorism in Southwest Asia", *International Security*, Vol. 26, no. 3, 2001, p. 81.

²⁰¹ OLCOTT, M.B., "Drugs, Terrorism, and Regional Security: The Risks from Afghanistan", March 13, 2002, Carnegie Endowment for International Peace, <http://www.ceip.org>.

circumstances make it very difficult for the governments to create a situation of order throughout their entire countries²⁰².

The international counterpart of this policy of nation-building focuses on Russia and, more generally speaking, the rounding up of international support for the current regimes. Government policies concerning the relations with other states share the desire to diminish Eurasian political and economic dependence on Russia, even though Russian support in most cases was essential for the local elites to acquire power. These elites often come from a communist apparatchik background. To reduce dependency on Russia, the states will have to improve their debt record. Current payment arrears provide Russia with extended leverage over the republics, enabling Russia to threaten disruption of energy supplies²⁰³. Russia has wielded this weapon to pressurize Georgia, brandishing Russia's reputation as a supplier of oil or, in this particular case, gas²⁰⁴.

Internal factors, such as cultural heritage, can play a determining role in the formulation of the government's policy between the different Republics and Russia. These attitudes are the result of each country's perception of its historical experience with Russia²⁰⁵. For instance the bias that the Azeri's thought Russia showed against them during the Nagorno-Karabach conflict²⁰⁶ and Russia's ruthless behavior in the Chechen wars. The devastation of Grozny and brutal treatment of Chechen civilians by the Russian military evoked a sense of mistrust towards Russian presence in Central Asia among the Central Asian populations, who sympathize with the Chechens. After a period of seemingly Russian military decline²⁰⁷, the Eurasian governments became aware of Russia's enduring military power and understood that they might once have to rely on this power to secure their own survival²⁰⁸. The military balance in some of the slumbering conflict appears to be changing. Azeri oil revenues are used to strengthen the Azeri military, causing a gradual erosion of the military advantage enjoyed by the Karabach secessionist²⁰⁹. Armenian support remains critical to the Karabach region, and Armenia might turn to Russia if needed. The balance between Georgia and Abkhazia is slowly shifting in Georgian favor as well. Georgia is now gaining strength, but if the Georgian government chooses to re-capture Abkhazia by force, Russian acquiescence will be essential because of the Russian military presence between the two camps²¹⁰. The unsurpassed Russian intelligence services in Eurasia, together with the Russian cooperation against the perceived radical Islamic threat to the situation in Central Asia makes Russia indispensable to any regional security measure in the eyes of the Eurasian governments²¹¹.

Securing independence and regime survival is the ultimate goal of the different presidencies. Outside help is of great importance, especially when this support also strengthens the country's position vis-à-vis Russia. The uncritical support

²⁰² LUONG, WEINTHAL, *Op. cit.*, 2002, p. 66.

²⁰³ MINASSIAN, *Op. cit.*, 2002, p. 721.

²⁰⁴ KALICKI, *Op. cit.*, 2001, p. 129.

²⁰⁵ TSYGANKOV, *Op. cit.*, 2002, p. 154.

²⁰⁶ HERZIG, *Op. cit.*, 1999, p. 68.

²⁰⁷ HERZIG, *Op. cit.*, 1999, p. 103.

²⁰⁸ RASHID, *Op. cit.*, 2002, p. 195.

²⁰⁹ HERZIG, *Op. cit.*, 1999, p. 63.

²¹⁰ KARAGIANNIS, *Op. cit.*, 2002, p. 88.

²¹¹ CUMMINGS, *Op. cit.*, 2001, p. 149.

the US has been giving to the Uzbek regime is welcomed by this repressive government and has as a consequence that the other countries in the region have an impression of being sidelined²¹². Because of their economic and military weakness, these countries have very limited options regarding their foreign policy, and are more or less obliged to follow their allies' stance. For example, Georgia abandoned the idea of improving its ties with nearby Iran due to Western pressure²¹³. The Eurasian republics are dependent on their Western allies because only they can provide them with much-needed financial resources, directly with foreign direct investments and indirectly because of Western control of international financial organizations and the technology needed for development.

4.2 External powers: the US, China, Iran and Turkey

The external powers that have a direct influence on the pipeline politics of Eurasia are two countries in the vicinity, Turkey and Iran, and two countries located further away, namely China and the United States of America. The close geographical locations of Iran and Turkey reverberate in historical, linguistic and cultural ties with the Eurasian countries. After the demise of the Soviet Union both countries were willing to assign great diplomatic efforts to improve their ties with the newly independent republics out of respect for these historical ties. Economic and geopolitical interests, influenced by oil politics but larger in scope, have nevertheless acquired a high priority in Iran's and Turkey's policy towards Eurasia. The American and Chinese policies towards the region are also the result of their geopolitical and economic interests, strongly influenced by their thirst for oil. Armed conflicts between states, such the one between Armenia and Azerbaijan, between ethnical or religious forces and the state, such as the conflicts in Chechnya and religion-inspired clashes in Uzbekistan and civil war, such as in Tajikistan, force external powers to intervene and actively secure their interests²¹⁴.

4.2.1 The United States of America

The United States, the only remaining superpower, wield an ever-larger influence on Eurasian politics and the Eurasian economy. The US have no historical ties with the region that would justify an increased American presence here. The recent opening up of Central Asia offered ample geostrategic opportunities for the United States due to the geographical location of the region. American presence in the region, in particular direct military presence, helps to contain China, whose increasing interests in Eurasia are likely to clash with American interests in the **near** future²¹⁵. It also serves as a check on Iran, a country mistrusted by the US. US' feelings towards Iran are best exemplified by US president Bush's classification of Iran as part of an 'axis of evil', during his January 2002 State of the Union speech²¹⁶. American military presence in the region was made possible as part of the War on Terrorism.

²¹² LUONG, WEINTHAL, *Op. cit.*, 2002, p. 69. The US government have voiced concerns regarding human rights in Uzbekistan on several occasions, but no consequences were ever allotted to these concerns.

²¹³ EFEGIL, E., STONE, L.A., "Iran's interest in Central Asia: a contemporary assessment", *Central Asian Survey*, Vol. 20, no. 3, 2001, pp. 354, 355.

²¹⁴ AMINEH, M.P., "Geopolitiek van Energiebronnen in de Kaspische Regio", *Internationale Spectator*, Vol. 66, no. 2, 2002, p. 81.

²¹⁵ AYOUB, M., "South-west Asia after the Taliban", *Survival*, Vol. 44, no. 1, 2002, p. 60.

²¹⁶ TAKEYH, R., "Re-imagining US-Iranian Relations", *Survival*, Vol. 44, no. 3, 2002, p. 23. Other 'axis of evil' states are Iraq and the Democratic People's Republic of Korea (North Korea).

Before the September 11th, 2001 attacks on the US and the commencement of the War on Terrorism, American economic policy objectives for Eurasia focused on two issues. The US wanted to encourage Russia to better protect US corporate investment in the Russian energy sector, and the US wanted to play a part in the development of the Eurasian hydrocarbon industry, while avoiding a Russian export monopoly²¹⁷ and any form of Iranian influence²¹⁸. The United States are trying to minimize Western direct investment in the Iranian oil industry. The Iran-Libya Sanctions Act (ILSA) of 1996 prohibits American companies and their foreign subsidiaries from conducting business with these countries²¹⁹. Without Western investments Iran is incapable of playing an important role in the development of the Eurasian oil and gas resources. The United States government encourages American economic activity in the region by promoting joint investments between American and Russian companies in the Eurasian energy sector, thus providing economic incentives for Russian cooperation. This policy also ensures access to foreign direct investments for the Eurasian republics, while securing an active American corporate presence in the region²²⁰.

Before the War on Terrorism and the resultant American military presence in Eurasia, US geostrategic interests were best served with stability in the region. This would enable the local hydrocarbon economy to develop. Before 2001 this could be done without large-scale American military presence, which would have provoked strong Russian, Chinese and Iranian opposition. The US tried to ensure stability by fostering regional cooperation in the shape of multilateral institutions, such as NATO's Partnership for Peace-program²²¹. The geostrategic policy goals of the US consisted of three points. Firstly, the US government wanted to prevent the spreading of Islamic fundamentalism, that it believes Iran is sponsoring. The ILSA act aims to do so by depriving Iran of the financial resources it needs to sponsor terrorism²²². Secondly, it wants to prevent the export of nuclear technology from the former Soviet states. Lastly, the US government wants to impede Russian domination of Eurasia²²³.

The outbreak of the War on Terrorism and the subsequent entering into bilateral military relations with several Eurasian states changed the role of the US in Central Asian politics as a whole. The American ability to defeat the Taliban regime in a short time was a striking demonstration of their military superiority²²⁴. The US government, responding to the threat the Al-Qaeda network poses to the US, prioritized the elimination of such terrorist networks²²⁵ and increased its support of the Eurasian governments. The

²¹⁷ MORSE, RICHARD, *Op. cit.*, 2002, p. 26.

²¹⁸ HILL, F., "Une Stratégie Incertaine: la Politique des Etats-Unis dans le Caucase et en Asie Centrale depuis 1991", *Politique Étrangère*, Vol. 66, no. 1, 2001, p. 101.

²¹⁹ AMINEH, *Op. cit.*, 1999, p. 99. This act, also known as the D'Amato Act, prohibits companies to invest more than \$20 million in Iran. Iranian sponsorship for terrorist organisations in the Middle East forms one of the reasons for the US to impose these sanctions.

²²⁰ KALICKI, *Op. cit.*, 2001, p. 130.

²²¹ LUONG, WEINTHAL, *Op. cit.*, 2002, p. 61.

²²² BAHGAT, G., "US-Iranian Relations: Sanctions and the Caspian Sea", *Security Dialogue*, Vol. 32, no. 2, 2001, p. 232.

²²³ AMINEH, *Op. cit.*, 1999, p. 146. Clearly, these geostrategic objectives would certainly benefit the economic objectives of the US.

²²⁴ COX, M., "American Power before and after 11 September: Dizzy with Success?", *International Affairs*, Vol. 78, no. 2, 2002, p. 263. Taliban forces remain active in Afghanistan until this day, but the political role of the Taliban has been curbed significantly due to the American military offensive.

²²⁵ BACEVICH, A.J., "Steppes to Empire", *The National Interest*, No. 68, 2002, p. 40.

United States remain dedicated to the preservation of existing states. The US government realizes that Russian acquiescence to its aggressive stance in Eurasia is essential. Without Russia, the only US ally in the region would be Uzbekistan, a country feared by its neighbors for its hegemonic tendencies²²⁶. The United States increased its aid to most of the Central Asian republics, but refrained from giving explicit security guarantees in exchange for access to Central Asia²²⁷. By keeping troops on foreign soil and creating a battlefield far away from American soil, the US military is trying to achieve full spectrum dominance to any possible adversary around the globe²²⁸.

It has been argued that US military presence in Eurasia serves more than just geostrategic purposes in the War on Terrorism. Bacevich argues that the US want to make sure no hostile power will succeed in bringing the Eurasian energy resources under its control²²⁹. Examples can be found in the American policies towards Georgia and Azerbaijan. The Russian army is guarding the cease-fire in Georgia between the Georgian army and the Abkhazia, whilst the US conducted a military operation in Georgia in Spring 2002 as part of their War on Terrorism. Azeri support for this War has resulted in the suspension of American sanctions on Azerbaijan, dating back to the Nagorno-Karabach fighting²³⁰. Good relations with both Georgia and Azerbaijan are important for the US, because they are the main proponents of the BTC pipeline that will run through these two states.

Before the outbreak of the War on Terrorism the US government promoted American corporate activity in Eurasia, on the basis that the economic activity of these corporations would stimulate economic liberalization in the region and speed up the integration of the local economies into the world economy²³¹. This desire also led to extensive American support of international financial organizations' activity in the region²³². The United States are actively pursuing their geostrategic and economic goals in Eurasia and their influence is growing strongly because of their military presence and the increasing economic value that American companies, especially TNOCs, represent to the local governments.

4.2.2 China

As an external power, China's influence is small in comparison with that of the US. China is neither a military powerhouse nor a financial giant of the same category. Nevertheless, the Chinese government is well aware of the interests that China has in Eurasia. In 1993 China became a net oil importer. Chinese oil import dependency is expected to grow significantly in the coming decades. Domestic production is not expected to rise spectacularly in the near future. There are some oil deposits in Western China, but these are too far away from the Eastern Chinese markets and too small to be exploited economically²³³.

²²⁶ LIEVEN, *Op. cit.*, 2002, p. 255.

²²⁷ FAIRBANKS, *Op. cit.*, 2002, p. 40.

²²⁸ PFAFF, W., "La Politique Étrangère Américaine", *Commentaire*, No. 98, 2002, p. 294.

²²⁹ BACEVICH, A.J., "Steppes to Empire", *The National Interest*, No. 68, 2002, p. 48.

²³⁰ MINASSIAN, *Op. cit.*, 2002, p. 719. In 1992, the US government enacted Section 907 of the Freedom Support Act, imposing sanctions on Azerbaijan as a punishment for its behavior towards Nagorno-Karabach.

²³¹ AMINEH, *Op. cit.*, 1999, p. 94.

²³² *Ibid.*, p. 96.

²³³ XU, X., "The Oil and Gas Links between Central Asia and China: a Geopolitical Perspective", *OPEC Review*, Vol. 23, no. 1, 1999, p. 43; MANNING, *Op. cit.*, 2000, 78. In 2001, Chinese oil production

That is why China wants to enhance its energy security by securing future imports of Eurasian oil.

American military presence in that region evokes a fear in Chinese policy makers that future oil supplies might be in danger²³⁴. China relies on the forging of bilateral ties with the Eurasian republics to secure future energy supplies. Growing imports by oil tankers, present a strategic vulnerability so China has been considering inland alternatives²³⁵. Plans to build a mammoth oil pipeline from Kazakhstan to China however have been shelved due to high costs²³⁶. Also political instability in its Xinjiang province hampers the development of plans to build such a pipeline, or a natural gas pipeline from Turkmenistan to China. China's main objectives in its energy policy are the diversification of its energy imports, stepping up domestic crude oil production and securing imports through long-term sale arrangements, rather than buying it on the international spot market²³⁷.

Map 4.1 New US military bases in Central Asia²³⁸



Next to this economic interest, the Chinese government perceives a geostrategic necessity to defend its interests in Eurasia. Beijing fears encirclement by its main geostrategic competitor, the US²³⁹. With the arrival of the US military in Central Asia and the recent *rapprochement* between the US and India, a long-time regional competitor of China²⁴⁰, this encirclement, enabling an effective containment, is nearing completion. Other strategic interests of China in its relationship with Eurasia are the Chinese fear of secessionist movements among its Uighur population and tensions on its

amounted to 3.3 million barrels a day, while consumption stood at 5.0 million barrels a day (Source: BP *Statistical Review of World Energy*) (excludes Hong Kong).

²³⁴ JAFFE, A.M., LEWIS, S.W., "Beijing's Oil Diplomacy", *Survival*, Vol. 44, no. 1, 2002, p. 124.

²³⁵ JAFFE, LEWIS, *Op. cit.*, 2002, p. 125.

²³⁶ EIA, *China Country Analysis Brief*, June 2002.

²³⁷ ANDREWS-SPEED, LIAO, DANNREUTHER, *Op. cit.*, 2002, p. 38.

²³⁸ Source: CNN, <http://www.cnn.com/SPECIALS/2001/trade.center/military.map.html>. Changes by author.

²³⁹ FAIRBANKS, *Op. cit.*, 2002, p. 42.

²⁴⁰ BUSSIÈRE, R., *Op. cit.*, 2002, p. 304. China and India fought a war in 1962 and Chinese forces still occupy part of India's territory today.

Russian borders²⁴¹. The Uighurs are a Muslim minority that live in Xinjiang, in the Northwestern part of China. Among the Uighur minority there is a secessionist group operating in this huge Chinese province. The Chinese government wanted to take advantage of the War on Terrorism to have this movement included on the American list of terrorist organizations, effectively giving Beijing *carte blanche* in dealing with them. The United States government recently has done so²⁴². Tensions between Russia and China on their border, dating back to Cold War days, are putting a great strain on the Chinese army, a strain that China aims to reduce by improving its relations with the Russian government.

China has been nourishing its economic and political ties with the Eurasian republics, while making sure not to cross Russia²⁴³. These ties could be investments in the Eurasian oil industry by Chinese state oil companies, for example in Kazakhstan²⁴⁴, the selling of military hardware, including the sale of missile technology to Iran²⁴⁵ and offers to help suppress insurgencies. An example of this was the Chinese offer to help Uzbekistan in the struggle against the Islamic Movement of Uzbekistan (IMU). The IMU staged an armed resistance to the Uzbek government in 1999 and 2000²⁴⁶. In its dealings with Eurasia, China makes sure that it does not cross Russia because it sees Russia as the pivotal force in the region.

4.2.3 Iran and Turkey

Because of its geographic proximity, its cultural and historic ties and its natural resources, Iran wants to play an important part in the regional politics of Eurasia²⁴⁷. Because of the international isolation that the US have imposed on the country, Iran is trying to use its ties with the Eurasian republics to break free from this deadlock²⁴⁸. It wants to become a, if not the, major transport corridor of Central Asia. American government measures are often successful in preventing large Iranian participation in Eurasian oil development projects. Iran is nevertheless investing in oil fields located in the Caspian Sea off the coasts of Azerbaijan and Turkmenistan²⁴⁹. Iranian proposals to construct an export pipeline through Iranian territory towards the Persian Gulf receive no international backing.

The enmity between the US and Iran has resulted in an adverse situation for Iran. Iran needs foreign direct investments to upgrade its ageing oil industry, and ended its old legal prohibition on direct foreign investments in that industry. The US government, through its direct influence over international financial institutions and indirect influence over American TNOCs by means of the ILSA act, is capable of barring Iran from access to international capital. Iran also wants to establish economic ties with the US without having to engage in diplomatic relations²⁵⁰. There are some minor examples of American-

²⁴¹ RASHID, *Op. cit.*, 2002, p. 202.

²⁴² HOOGHE, I. D', "Gevolgen van '11 september' voor China's Centraal-Aziëbeleid", *Internationale Spectator*, Vol. 66, no. 10, 2002, p. 485. (in Dutch). This movement is called the East Turkestan Islamic Movement.

²⁴³ RUMER, *Op. cit.*, p. 57.

²⁴⁴ AMINEH, *Op. cit.*, 1999, p. 128.

²⁴⁵ AYOUB, *Op. cit.*, 2002, p. 60.

²⁴⁶ CUMMINGS, *Op. cit.*, 2001, p. 150. See below, section 4.3.2.

²⁴⁷ AMINEH, *Op. cit.*, 1999, p. 109.

²⁴⁸ SAGDEEV, EISENHOWER, *Op. cit.*, 2000, p. 179.

²⁴⁹ KALICKI, *Op. cit.*, 2001, p. 125.

²⁵⁰ TAKEYH, *Op. cit.*, 2002, p. 26.

Iranian cooperation, such as naval cooperation in the international embargos on Iraq²⁵¹. The American military presence in Afghanistan, on Iran's Eastern border, which appears to be a long-term engagement, is raising concerns in Iran. Tehran fears that the US might use their presence in Afghanistan to support the construction of oil or gas pipelines from Central Asia through Afghanistan to the world market, thus finding another route to bypass Iran²⁵². But in general the current situation concerns Iran for two reasons. Iran is being marginalized in the development of the Caspian Sea resources, and Iran is incapable of preventing hostile foreign penetration in the region²⁵³.

Iran is a Shiite Islamic state. Because the majority of the population of Eurasia is Sunni, Iran refrains from proselytizing its brand of Islam. Iran fears that if it engages in promoting its form of Islam, it will cause resentment among the Eurasian governments and thus lead to a deterioration of Iranian ties with these states²⁵⁴. Only Uzbekistan has openly accused Iran of trying to export its religion to Central Asia. Most Eurasian states do not join in the American policy towards Iran, and are willing to engage in economic ties with Iran. Turkmenistan exports gas through Iran and Kazakhstan and Iran have arranged an oil swap: Iran imports Kazakh oil at its Caspian coast, and exports an equal amount of oil on its Persian shore²⁵⁵. Tehran wants to use swap deals as a way of circumventing US sanctions. Iran claims that since no direct investments by a TNOC are required to engage in such a deal, they fall outside the scope of the ILSA act. Iran plans to improve its facilities to accommodate future oil swaps by upgrading the pipeline between Tehran and its Caspian Sea port of Neka. However, only 20,000 barrels a day of Turkmen oil are swapped at present²⁵⁶. Iran remains at odds with its neighbor Azerbaijan about the legal status of the Caspian Sea.

Turkey also feels a strong historical and cultural connection with most of the Eurasian countries. The relations with Armenia remain difficult as Turkey denounces the 1915 Armenian genocide. Turkey has improved its ties with Georgia and Azerbaijan²⁵⁷, becoming an important trade partner for Georgia. The Turkish government has been a strong supporter of the Baku-Tbilisi-Ceyhan oil pipeline. At present nearly all Caspian oil has to be shipped through the Bosphorus straits to reach the world markets. Due to the Montreux Treaty of 1936, the Bosphorus is considered an international waterway, effectively eliminating all Turkish control over the traffic in this narrow and crowded waterway²⁵⁸. The Turkish government is very concerned about the potential risk that the increase in oil shipping poses. Construction of the BTC pipeline is expected to alleviate the shipping lanes through the Bosphorus. This pipeline can also be seen as a symbol of Turkish aspirations to be recognized as a regional power²⁵⁹.

²⁵¹ TAKEYH, *Op. cit.*, 2002, p. 30.

²⁵² TAKEYH, *Op. cit.*, 2002, p. 32. The discussion is about the Turkmenistan-Afghanistan-Pakistan pipeline, proposed by these countries to transport natural gas from Turkmenistan towards South Asia.

²⁵³ BAHGAT, *Op. cit.*, 2002, p. 317.

²⁵⁴ RASHID, *Op. cit.*, 2002, p. 220.

²⁵⁵ EFEGIL, STONE, *Op. cit.*, 2001, p. 356.

²⁵⁶ EIA, *Iran Country Analysis Brief*, May 2002. The upgrading is done by a consortium led by China's CNPC and Sinopec oil companies. As part of the swap deal, the Turkmen oil is consumed in Iran, and an equal amount of oil is made available for export on Iran's Kharg Island in the Persian Gulf.

²⁵⁷ MINASSIAN, *Op. cit.*, 2002, p. 720.

²⁵⁸ KARAGIANNIS, *Op. cit.*, 2002, p. 131.

²⁵⁹ KARAGIANNIS, *Op. cit.*, 2002, p. 92.

Map 4.2 Turkey's linguistic links with Eurasia²⁶⁰



Turkey is a large consumer of natural gas, and domestic production is insufficient. Ankara wants to increase its gas imports from Azerbaijan. Recently a natural gas pipeline has been constructed, running from Russia to Turkey, which will fulfill a large part of Turkey's energy needs. This 'Blue Stream' pipeline will deliver 565 billion cubic feet of gas to Turkey each year and operations started in October 2002²⁶¹. Turkey also imports gas from Iran, and in May 2001 a deal was signed with Azerbaijan. Starting in 2005, Turkey will import large amounts of natural gas from that country as well²⁶².

Turkey has experienced considerable ethnical difficulties within its borders, with its Kurdish minority. Government refusal to accept the existence of a Kurdish minority within Turkey, together with a Kurdish secessionist movement, resulted in a situation bordering on civil war in Eastern Turkey. For decades, Kurdish activists have been struggling for an independent Kurdistan as a way to escape the Turkish government's policy of assimilation. For years the conflict was a violent one²⁶³. Diplomatic efforts have resulted in significant concessions by both parties and hostilities have subsided. However, there remains an ever-present threat of future aggression²⁶⁴. The Kurds are dissatisfied with the status quo in Turkey. If a war in Iraq results in the creation of an autonomous Kurdish region in Northern Iraq, Kurds in Turkey may claim a similar status.

Turkey fears an emerging geostrategic competition between two blocks in the Caucasus or even the whole of Eurasia. The balance of power in the region remains unsettled. Azerbaijan and Georgia, wary of Russian intentions, aligned themselves with Turkey and the US. Russia has deepened its relations with Iran and Armenia, in an attempt to increase its influence over the

²⁶⁰ Source: The Economist, "A Turkish Move into Central Asia", November 23, 2000.

²⁶¹ This figure roughly amounts to the total Turkish natural gas consumption of 2001 (Source: BP, *Statistical review of World Energy*, 2002). However, Turkish natural gas consumption is expected to rise to nearly 1000 billion cubic feet in 2004 (Source: EIA).

²⁶² EIA, *Turkey Country Analysis Brief*, November 2002.

²⁶³ KARAGIANNIS, *Op. cit.*, 2002, p. 96. Fighting resulting from the Kurdish insurgency, led by the Kurdish Worker Party or PKK, had claimed over 21.000 lives by May 1997.

²⁶⁴ AMINEH, *Op. cit.*, 1999, p. 198.

Caucasus²⁶⁵. The Russian military campaign in nearby Chechnya serves as a reminder for the states in the Caucasus of Russian power. The plan to construct the BTC oil pipeline has augmented US presence in this area, providing the US government with a direct influence on the shaping of future political as well as economic initiatives²⁶⁶. These two blocks may grow into regional geopolitical rivals.

4.3 *Non-state actors*

The internationalization of economic and social relations, and the blurring of boundaries between domestic and international realms have contributed considerably to the growing importance of non-state actors in the international political economy. To complete our analysis of the current political situation in Eurasia it is imperative that we deal with the role of non-state actors. There are different types of non-state actors. The most influential are the transnational oil companies, radical Islamic groupings, intergovernmental organizations and also to a certain extent, non-governmental organizations.

4.3.1 *Transnational Oil Companies*

Being the forerunners of globalization, American oil companies entered Eurasia before the US government opened its first embassies in the region²⁶⁷. The opening up of the former Soviet Union has greatly improved the competitive position of TNOCs in the international oil economy²⁶⁸. Since direct investments by these companies are now in high demand by a growing number of oil producing countries, the oil companies have regained a dominant position in the oil markets. They held this position before OPEC gained cartel control over the oil markets. It was by bringing down the cost of frontier oil-field development, in predominantly offshore or hostile environments, that the TNOCs gained a competitive advantage over OPEC's national oil companies²⁶⁹. The key element that enabled the companies to do so successfully was their strategy of exploitation research and development²⁷⁰.

Even though the transnational oil companies are actively pursuing investment opportunities in Eurasia, they remain concerned about the potential risks. Firstly, the fragile political situation could be disturbed by an international or sub-national conflict, making exploitation and export of the hydrocarbon deposits impossible. To improve the security of the development deals, most investments are made in the form of joint ventures with state-owned local oil companies²⁷¹. Secondly, the international sanctions against Iraq or the US sanctions against Iran could be lifted, opening their oil industry to foreign investments²⁷². Most Middle Eastern states have a ban on foreign direct investments²⁷³. Oil companies that have committed themselves to long-term investment obligations in Eurasia would have to compete with a large amount of cheaper oil, endangering their profitability. TNOCs are looking for ways to

²⁶⁵ RUSECKAS, L. "Turkey and Eurasia: Opportunities and Risks in the Caspian Pipeline Derby", *Journal of International Affairs*, Vol. 54, no. 1, 2001, p. 218.

²⁶⁶ STRANGE, *Op. cit.*, 1994, p. 19.

²⁶⁷ RASHID, *Op. cit.*, 2002, p. 189.

²⁶⁸ LINDE, C. VAN DER, *The State and the International Oil Market, Competition and the Changing Ownership of Crude Oil Assets*, Boston/Dordrecht/London: Kluwer Academic Publishers, 2000, p. 8.

²⁶⁹ LINDE, C. VAN DER, *Op. cit.*, 2000, pp. 18, 127.

²⁷⁰ *Ibid.*

²⁷¹ AMINEH, *Op. cit.*, 1999, p. 134.

²⁷² LINDE, C. VAN DER, *Bakkeleien om Olie*, The Hague: Clingendael, 2001, p. 16. (in Dutch)

²⁷³ BAGHAT, *Op. cit.*, 2002, p. 311.

diversify their income. Some companies are expanding activities in the more lucrative gas sector, assuming that world gas consumption will probably rise in the near future²⁷⁴.

By improving the position of international minority shareholders and by changing their management structure²⁷⁵, Russian oil companies are completing their transformation into true TNOCs²⁷⁶ and are taking an active stance in the development of Eurasian oil. Their investment capacity however does not match that of the bigger Western firms. Russian TNOCs may even turn to their Western counterparts as sources of capital²⁷⁷ and after a period of hesitation, Western companies seem more willing to invest in their Russian counterparts²⁷⁸. This process is likely to increase the willingness of Russian companies to cooperate with the larger, Western TNOCs. Since oil extraction in Russia exceeds new oil discoveries, the Russian TNOCs have to find new investment opportunities to secure their survival²⁷⁹, this explains their willingness to invest in Eurasia.

The presence of TNOCs provides the Eurasian governments with considerable sums of money from foreign direct investments or in the form of revenues. These new sources of capital the oil companies provide increase the corrupt tendencies of the ruling elites²⁸⁰. Because of the revenues they generate for their host countries, the oil companies carry a considerable clout in Eurasian oil politics.

4.3.2 Islamic Movements in Eurasia

Radical Islamic movements have been portrayed as the biggest threat to Eurasian security and on a number of occasions this danger seems to have been realized. There is no doubt that Islam has an appeal to the frustrated populations of Eurasia²⁸¹, who see their living standards decrease, see no possibility to do anything about this, and have no confidence in the government's ability or willingness to offer any improvement²⁸².

During Soviet days religion was suppressed and Islam survived chiefly in its traditional, folkloric form. There was no great knowledge of the basic doctrine of Islam. After the demise of the Soviet Union, religious leaders started to educate the people, thus contributing to the creation of feelings of identity, and cultural heritage. 98% of the population of Central Asia is follower of the Sunni branch of Islam with a particular interpretation, called Sufism. Sufism is a mystical form of Sunni Islam that is very tolerant to other religions and focuses on rituals and tradition, not on politics²⁸³. Political Islam (Islam as a guide for political action) is often depicted as 'fundamentalist' by the Eurasian governments. Even so, these governments accept and support a role for Islam

²⁷⁴ HILL, FEE, *Op. cit.*, 2002, p. 9.

²⁷⁵ HILL, FEE, *Op. cit.*, 2002, p. 6.

²⁷⁶ MORSE, RICHARD, *Op. cit.*, 2002, p. 25.

²⁷⁷ LIEVEN, *Op. cit.*, 2002, p. 255.

²⁷⁸ The Economist, "OPEC", April 25, 2002.

²⁷⁹ Petroleum Economist, "The Search for New Russian Oil", May 2002.

²⁸⁰ RASHID, *Op. cit.*, 2002, p. 64.

²⁸¹ WARE, R.B., KISRIV, E., "The Islamic factor in Dagestan", *Central Asian Survey*, Vol. 19, no. 2, 2000, p. 238.

²⁸² KEPPEL, G., *Jihad. The Trail of Political Islam*, London: I.B. Tauris Publishers, 2002, p. 6.

²⁸³ TAZMINI, G., "The Islamic revival in Central Asia: a potent force or a misconception?", *Central Asian Survey*, Vol. 20, no. 1, 2001, pp. 67, 68. See also AMINEH, *Op. cit.*, 1999, p. 77.

in everyday life. They want to use Islam as a unifying force for their countries²⁸⁴.

The civil war in Tajikistan caused anxiety among other Central Asian governments, who feared similar uprisings. They quickly outlawed most opposition parties, including Islamic parties²⁸⁵. A new threat, stemming from Islam, surfaced in Uzbekistan, where the Islamic Movement of Uzbekistan (IMU) staged several armed attacks in 1999 and 2000. The IMU wants to establish an Islamic state in Uzbekistan. After kidnapping a few Americans in 2000, the IMU was included on the US list of terrorist groupings²⁸⁶. The military threat posed by the IMU to the Uzbek government has largely been eliminated by the American campaign against the Taliban, IMU's main supporter²⁸⁷. The IMU is heavily involved in drug trafficking from Afghanistan to Central Asia²⁸⁸. Another Islamic group in Central Asia is the Hizb ut-Tahrir al-Islami. This is a transnational movement, operating throughout Central Asia. Its goal is the spread of Sunni Islam, without the influence of Sufism. It claims to be a peaceful movement but is persecuted in Uzbekistan²⁸⁹.

The influence of Islamic movements on the political situation in Eurasia remains rather limited and Russia and the Eurasian governments have profited from its existence. Russia appealed to the dangers of Islamic movements to justify its pro-active role in the region and the local governments took advantage of the perceived threat of Islam by increasing the suppression of opposition groups²⁹⁰. Limited as its role may be for the moment, radical Islamic movements will gain support among the regional populations as long as it remains the only platform for political opposition.

4.3.3 Intergovernmental Organizations and NGOs

There are several intergovernmental organizations operating in Eurasia, each with different member states and different fields of action. Intergovernmental organizations are only successful in achieving their objectives if the member states are convinced that cooperation is in their national interest.

The GUUAM group was set up in 1996, with Uzbekistan joining in 1999. Its main purpose is to enhance regional economic cooperation, and to provide a forum for discussion of security problems²⁹¹ without having to rely on Russia²⁹². Internal conflict in Georgia made GUUAM decide to set up a joint peacekeeping force to protect oil export pipelines in the GUUAM countries²⁹³ without having to include Azerbaijan's regional rival Armenia²⁹⁴. Such a force has not been established as yet.

²⁸⁴ AKBARZADEH, S., "Political Islam in Kyrgyzstan and Turkmenistan", *Central Asian Survey*, Vol. 20, no. 4, 2001, pp. 451, 456.

²⁸⁵ CORNELL, SPECTOR, *Op. cit.*, 2002, p. 195.

²⁸⁶ RASHID, *Op. cit.*, 2002, p. 171.

²⁸⁷ SLAUGHTER, *Op. cit.*, 2002, p. 64. Nevertheless, in the summer of 2001 the IMU announced that it had renamed itself the Islamic Party of Turkestan. See CORNELL, SPECTOR, *Op. cit.*, 2002, p. 205.

²⁸⁸ CORNELL, SPECTOR, *Op. cit.*, 2002, p. 197.

²⁸⁹ RASHID, *Op. cit.*, 2002, pp. 115, 124.

²⁹⁰ CUMMINGS, *Op. cit.*, 2001, p. 149.

²⁹¹ GUUAM, *The GUUAM Group: History and Principles*, November 2000, <http://www.guuam.org>.

²⁹² RASHID, *Op. cit.*, 2002, p. 197.

²⁹³ Energy Information Administration, "Caspian Sea Region: Regional Conflicts", <http://www.eia.doe.gov>.

²⁹⁴ MINASSIAN, *Op. cit.*, 2002, p. 723.

NATO is also involved in Eurasia with its Partnership for Peace programme. Centrazbat, an acronym for Central Asian Battalion, is a regional peacekeeping unit, created in 1995²⁹⁵, which held exercises in 2000. Several Central Asian states participated, together with Mongolia, Russia, Turkey, The United Kingdom and the US²⁹⁶. Even though the Partnership for Peace programme does not provide specific security guarantees for the Eurasian republics, it is considered a welcome vehicle for these countries to diversify their security network away from dependency on Russia²⁹⁷. In an attempt to reassert Russian influence in Eurasia, the Commonwealth of Independent States, a body dominated by Russia, held military exercises in Kirgizstan in April 2002. In spite of this, CIS influence in the region remains limited²⁹⁸.

To improve its ties with Russia, and with other Central Asian states, China was the driving force behind the establishment of the Shanghai Cooperation Organization (SCO), in June 2001. The SCO is a forum in which its members, China, Russia, Kazakhstan, Kirgizstan, Tajikistan and Uzbekistan, discuss matters such as border demarcation, and economic cooperation²⁹⁹. China's objective was the restriction of American influence in the region by promoting regional cooperation. China also hoped that the SCO could be a vehicle for Beijing to gradually replace Russia as the most influential power in Central Asia³⁰⁰. The outbreak of the War on Terrorism however was a setback for the Chinese. All the other SCO member states concluded agreements with the US without consulting each other³⁰¹. This development, and the fact that Uzbekistan has taken a very passive stance in SCO dealings, has caused the SCO to gradually fall apart³⁰².

The importance of international financial institutions in Eurasia is growing, as most of these countries are still involved in the process of reforming their economy. The attempts by these institutions to finance institution-building and infrastructure policies are supported by the US, who have a large influence over the decision-making processes in them³⁰³. Decision making power in these institutions is weighted to reflect contributions, which gives the US and other Western states a dominant voice³⁰⁴. The IMF and the World Bank are willing to provide loans if a country's economy is diverse enough to secure different sources of income. This was the case with Kazakhstan in the 1990's because of its wheat production and mineral reserves³⁰⁵. Uzbekistan secured itself World Bank support by participating in the War on Terrorism³⁰⁶. New IMF and World Bank aid is related to the economic reforms that the governments have conducted. However, these reforms, necessary to end the economic isolation of Eurasia, have a detrimental effect on the living standard

²⁹⁵ LUONG, WEINTHAL, *Op. cit.*, 2002, p. 70.

²⁹⁶ Monterey Institute for International Studies, "U.S. Military Cooperation with the Central Asian States", 17 September 2001, <http://cns.miis.edu/research/wtc01/uscamil.htm>.

²⁹⁷ HERZIG, *Op. cit.*, 1999, p. 52.

²⁹⁸ Eurasianet, "Russia seeks elusive 'Big Brother' role in upcoming conferences", October 5, 2002.

²⁹⁹ HOOGHE, D', *Op. cit.*, 2002, p. 488.

³⁰⁰ RUMER, *Op. cit.*, 2002, p. 63.

³⁰¹ DELPECH, *Op. cit.*, 2002, p. 29.

³⁰² RUMER, *Op. cit.*, 2002, p. 64.

³⁰³ AMINEH, *Op. cit.*, 1999, p. 96.

³⁰⁴ MACFARLANE, N., *Western Engagement in the Caucasus and Central Asia*, London: The Royal Institute of International Affairs, 1999, p. 7.

³⁰⁵ RASHID, *Op. cit.*, 2002, p. 63.

³⁰⁶ *Ibid.*, p. 184.

of the populations and governments aren't keen to proceed in a hasty manner. Such a policy would only add to their unpopularity.

The growing importance of international economic organizations such as the IMF and the World Bank in Eurasia is a consequence of the structural power Western states wield. Strange defines structural power as '[...] the power to shape and determine the structures of the global political economy within which other states, [...], their economic enterprises and [...] other(s) have to operate'³⁰⁷. The Eurasian states, if they want to benefit from these institutions, have to accept and adopt Western, mainly American, trade regulations.

Non-governmental organizations (NGOs) play a minor role in the political situation of Eurasia. In some cases they provide basic help to local populations when the local governments are unable to do so. Generally speaking though, they are incapable of influencing the decision-making process of the other actors in this region. They focus mainly on small-scale conflict resolution efforts. As McFarlane explains, 'NGO activities supplement the intergovernmental and inter-party efforts of intergovernmental organizations and Western states with attention to local micro-level sources of conflict'³⁰⁸

³⁰⁷ Strange, *Op. cit.*, 1994, pp. 24, 25.

³⁰⁸ MACFARLANE, *Op. cit.*, 1999, p. 18.

Chapter 5: Exploitation and Exportation of the Resources

Despite a decade of low oil prices and political disagreements, a regional oil export network is gradually starting to develop. This enables deposit development schemes in Eurasia to proceed. Exploitation is carried out by transnational oil or gas companies and in some cases state-owned companies and is dependent on a secure working environment. However, if unspoken security concerns persist in a country, host nations tend to look at the presence of Western transnational oil companies in their country as a stabilizing force. They hope that the presence of these companies equals a commitment to their security by the TNOCs' countries of origin. Investments in the hydrocarbon sector have a long time horizon and form a much-needed source of income for the newly independent republics. The relations between transnational oil companies and host nations are complicated. The heritage of Soviet equipment, technology, exploitation methods and infrastructure compels these states to cooperate with Western TNOCs. In addition, the lack of commercial, legal and financial expertise of the newly independent republics adds to this dependency and leaves considerable room for manipulation by the companies³⁰⁹. In most cases, joint ventures are established between the TNOCs and national oil companies. Joint ventures provide host states with a controlling voice in the exploitation activities, while securing active cooperation by Western TNOCs. Another often-used form of collaboration is the product-sharing agreement.

5.1 *Transnational Oil Companies and their states of origin*

Most TNOCs are of Western origin and only in the last couple of years have a few Russian firms established themselves on the world market. All TNOCs are private enterprises. This implies that in theory they are able to operate without any interference by the governments of their country of origin. In some cases the state is a minority shareholder³¹⁰ and as a whole the links between these companies and their state of origin remain of some significance. The home countries sometimes actively support 'their' companies abroad by pursuing profitable deals with the Eurasian governments³¹¹, effectively acting as an extension of these companies.

Home states also try to influence behavior of the decision making process inside the companies. An example can be found in the American Iran-Libya Sanction Act (ILSA) of 1996, which penalizes American companies who make substantial investments in either Iran or Libya. This act also aims to prevent non-American companies who have economic ties with the US, to invest in Iran or Libya. US-based firm Conoco was forced to withdraw from a 550 million dollar investment deal in Iran. The deal was later taken over by France's Total (now TotalFinaElf), together with Malaysia's Petronas³¹². Non-US companies have seized the opportunity presented to them by the absence of American competitors and entered into investment and exploitation contracts with Iran in the last few years. These companies include TotalFinaElf, Shell, and ENI/Agip. American allies, such as most European countries, do not support this American policy and want to improve their ties with Iran, whom

³⁰⁹ AMINEH, *Op. cit.*, 1999, p. 182.

³¹⁰ For example in Russian firms LUKoil and Yukos, and the British government in BP.

³¹¹ AMINEH, *Op. cit.*, 1999, p. 132.

³¹² EIA, *Iran Country Analysis Brief*, May 2002.

they see as a crucial partner in the development of Caspian oil deposits³¹³. Consequently, American TNOCs object to the continuation of this policy. They consider Iran to be a good investment opportunity as well as the easiest, fastest and cheapest export route for Eurasian oil and would like to see American sanctions lifted³¹⁴.

Russia tries to re-establish some form of state influence over Russian TNOCs. The biggest Russian oil companies are Yukos and LUKoil. Even though Russian oil companies were fully state-owned companies only a decade ago and the government customarily remains one of the shareholders, state influence over them has diminished considerably. As Morse and Richard explain, 'the Russian government has extremely limited powers over how Russian firms allocate their sales or investments. Moscow can encourage or limit access to pipelines under government control³¹⁵, but it cannot control what companies do', making the Russian oil industry significantly more autonomous than its counterparts in OPEC countries, or even in Norway³¹⁶. This explains why Norway could decide to join OPEC production cuts in 2001, while Russia, officially agreeing with OPEC, only made the slightest cutback³¹⁷. The Russian government couldn't compel Russian companies, who wanted to increase their market share, to decrease production levels³¹⁸.

Russian oil companies account for roughly 30% of Russia's hard currency export revenues. Tax revenues from the oil and gas industry account for more than half of Russia's tax revenues³¹⁹. High taxes render the industry short on cash to reinvest and expand production. Another consequence is the fact that the companies are trying to maximize their earnings. International oil and gas prices are much higher than Russian domestic prices. To secure supplies within its borders, the government has resorted to the use of quotas³²⁰. Russia now sees its hydrocarbon industry as a strategic asset and an important way to give it a voice on the international scene. For that reason the Russian government is improving its ties with and influence over the Russian oil companies, for example by holding onto its 14% stake in LUKoil³²¹.

The Russian natural gas industry has not seen the same surge of privatizations that the oil industry has experienced. State-controlled Gazprom dominates Russia's natural gas industry. Even though the state has a stake of only 38% in the company, there is an intimate relationship between Gazprom and the government³²². In a ten-year deal between Russia and Kazakhstan, to jointly upgrade the old Soviet natural gas pipeline grid, Gazprom actually represents the Russian state³²³. This pipeline system is the only existing grid to transport natural gas from Kazakhstan to Europe and other markets. The Russian export pipeline monopoly and the fact that Western gas companies

³¹³ RAHR, A., "L'Europe et L'Asie Centrale", *Commentaire*, No. 94, 2001, p. 292.

³¹⁴ BAHGAT, *Op. cit.*, 2002, p. 315.

³¹⁵ State ownership of the oil pipeline grid is a key medium to influence Russian oil company behavior. See also Petroleum Economist, "More Oil to more Destinations", August 2002.

³¹⁶ MORSE, RICHARD, *Op. cit.*, 2002, p. 28.

³¹⁷ The Economist, "Oilman's bluff", December 6, 2001.

³¹⁸ FAVENNEC, *Op. cit.*, 2002, p. 546. See also Chapter 2.3.

³¹⁹ CONSIDINE, J.I., KERR, W.A., *The Russian Oil Economy*, Celtenham, Northampton: Edward Elgar, 2002, p. 11.

³²⁰ *Ibid.*

³²¹ HILL, FEE, *Op. cit.*, 2002, pp. 4, 17.

³²² *Ibid.*

³²³ Petroleum Economist, "Former Soviet Union", January 2002.

haven't made the same entry into Eurasian gas development as they have in the region's oil development, ensures its continuing influence on this section of the local economies. Russia aims to further enhance its prominent position in the Eurasian gas market by promoting a Eurasian gas alliance³²⁴.

The oil-producing countries are trying to use the presence of foreign oil companies on their soil as a political tool. The Eurasian republics found out that the economic leverage that Russia wields over them has a counterpart. Russian business objectives are vying with the government's geopolitical objectives in the relations with Eurasia. Russian opposition to foreign investments in Azeri oil deposits in the Caspian Sea was put aside when Russian oil company LUKoil joined in the development, arousing protests by Russian government officials who disagreed with LUKoil's behavior³²⁵.

5.2 *The political importance of export pipelines.*

Eurasia is a land-locked region and because local consumption levels are low, the main markets for its hydrocarbon resources are located thousands of kilometers away. To reach these markets, a secure method of transportation must be found. This is done by means of pipelines that are built and operated by TNOCs. There are already several pipelines in the region, most of which were built during Soviet times and are still under control of the Russian government, given that they are completely owned by state company Transneft. This old grid was not designed to transport the large amounts of crude oil that will be available in the next few years and parts of it are falling in a state of disrepair. Local and external countries have expressed their wish for new export routes, bypassing Russia. Especially the US want an export route that bypasses Russia and Iran so that the US can maximize their own influence in the region. Several pipelines have been proposed and both the proposed and operational pipelines make Azerbaijan the regional hub in oil transport. In the last decade, Russia has redirected its exports away from the region, towards Europe, where oil and natural gas prices are higher³²⁶.

The end of Russian opposition to any export pipeline bypassing Russian territory resulted in an apparent convergence of opinions between the United States and Russia regarding future oil exports³²⁷. Now that several pipelines will be needed to transport the oil and gas out of the region, it is acceptable to both parties that some will pass through Russian territory, albeit not all. Neither country has anything to gain by the construction of a pipeline through Iran, strongly promoted by the Iranian government and several TNOCs. Both countries are also keen on nourishing their bilateral relations while keeping some sort of check on each other's regional ambitions³²⁸.

Karagiannis offers a comprehensive explanation of the political significance of pipelines. As he explains, 'pipelines can and have become points of leverage in times of political disagreements and hostage in times of armed conflicts'³²⁹. In the past, Chechen rebels have succeeded in blocking the flow of Russian oil through Grozny and Kurdish rebels have in the past jammed Iraqi oil exports

³²⁴ HILL, FEE, *Op. cit.*, pp. 14, 17.

³²⁵ KARAGIANNIS, *Op. cit.*, 2002, p. 117. Internal Russian disagreement on foreign policy issues is common.

³²⁶ CONSIDINE, KERR, *Op. cit.*, 2002, p. 10.

³²⁷ MORSE, RICHARD, *Op. cit.*, 2002, p. 26.

³²⁸ LINDE, C. VAN DER, *Bakkeleien om Olie*, The Hague: Clingendael, 2001, p. 14. (in Dutch)

³²⁹ KARAGIANNIS, *Op. cit.*, 2002, p. 4.

through an Iraq-Turkey pipeline. Karagiannis goes on to explain what he says are separately distinguishable patterns of security implications for regional pipeline development in Eurasia. First of all, pipeline routes have developed into basic features of the region's instability, linking internal conflicts over territory with conflicts over transit revenues. These transit revenues, or even the possibility of future revenues, influences the relationship between Georgia and Abkhazia, and Nagorno-Karabach and Azerbaijan. Secondly, security interests connected to pipeline development influence relations between states in the region, also because pipelines can be used as a tool for economic competition. Disallowing third countries access to the pipeline, limiting export capabilities and thus revenues can do this³³⁰.

5.3 The Baku-Tblisi-Ceyhan Main Export Pipeline

The biggest subject of debate in the pipeline politics of Eurasia in the last few years has been the eventual construction of an oil pipeline right across the Caucasus from Azerbaijan to Turkey, the BTC pipeline, mentioned above. With a planned capacity of 1 million barrels a day, it will become a Main Export Pipeline, or MEP, securing the necessary export capacity for the development projects of Azerbaijan and Kazakhstan and their profitably. Construction has started and exports are due to start in February 2005.



When operational, the bulk of the oil transported through this new pipeline will be AIOC oil. Part of the trajectory of the BTC pipeline runs parallel to that of the Baku-Supsa pipeline, also operated by AIOC, with a capacity recently upgraded to approximately 145,000 barrels a day. This pipeline, called the “western route”, mainly carries AIOC’s “early oil”, i.e. oil produced in the first stage of development of AIOC’s offshore Caspian deposits. Georgia receives \$0,17 per barrel as transit fee, which is relatively little³³². Georgian officials

³³⁰ KARAGIANNIS, *Op. cit.*, 2002, p. 9.

³³¹ Source: The Economist, “Caspian Pipedreams no longer”, March 8, 2001.

³³² KARAGIANNIS, *Op. cit.*, 2002, p. 28. The exact figure is \$1,24 per tonne. In 2001, Supsa exports stood at 130.000 barrels a day, thus providing the Georgian government with \$8 million in transit fees in the whole year. (source: EIA)

have proposed to expand the capacity of this pipeline to 300,000 or 600,000 barrels a day. AIOC however has chosen to use the BTC pipeline for future exports and is not interested in a capacity expansion of the Baku-Supsa pipeline³³³.

Another pipeline running from Baku to the Black Sea coastline is the “northern route”, the Baku-Novorossiisk pipeline, operated by the Russian state company Transneft. This route, with a capacity of 100,000 barrels a day, opened in 1997. It consists mainly of upgraded sections of older Soviet pipelines. This pipeline passes through Grozny, the Chechen capital. Persisting instability in Chechnya compelled Transneft to build a bypass around Chechnya. Transneft receives \$2,14 per barrel as transit fee, making it an expensive export pipeline and not very popular with oil companies operating in Azerbaijan³³⁴. Another reason for this unpopularity is that high-quality Azeri oil is mixed with lower quality oil, decreasing its value³³⁵.

In March 2001 a new pipeline between Tengiz in Kazakhstan and Novorossiisk was commissioned. It has been constructed by the Caspian Pipeline Consortium (CPC). The CPC is half state-owned. Russia holds 24%, Kazakhstan 19%, and the state of Oman 7%. Oil companies own the other half. ChevronTexaco owns 15%, LukArco (Russian-American company linked to LUKoil) 12.5%, Rosneft-Shell (Russian-Dutch/English) 7.5%, ExxonMobil 7.5% and there are a few smaller shareholders³³⁶. This pipeline has a capacity of 565,000 barrels a day and will be upgraded to a capacity of 1.34 million barrels a day by 2015. The regions along the pipeline route will receive 50% of the revenues of the pipeline and taxes³³⁷. The majority of the oil is provided by the Tengizchevroil joint venture. Development of the Kashagan oil field in the Northern Caspian will add another source of oil for this pipeline. With the contract signed in 1997, the Agip Kazakhstan North Caspian Operating Company, a joint venture between Italy’s Agip and a Kazakh state-owned oil company, is developing the Kashagan block. Other participants in the development are ExxonMobil, TotalFinaElf, Shell and Britain’s BG, all with a 16.67% interest. Oil shipped from Kazakhstan by barge to Baku is another export route already in use. Finally, nearly 100,000 barrels of Kazakh oil is exported through the Russian ‘Baltic Pipeline System’ with oil being loaded at the Primorsk oil terminal on the Gulf of Finland³³⁸.

Concerns have been raised in the past over the economic viability of the BTC pipeline, as well as regional security risks threatening future oil transports on this particular route. The economic viability of the pipeline is being questioned because of its huge construction costs, estimated at \$2,8 billion. Estimated transportation costs amount to \$3.00 a barrel, before the oil is available for transshipping by tanker from Ceyhan. These high costs threaten the project’s

³³³ EIA, *Azerbaijan Oil and Natural Gas Export Options*, June 2002.

³³⁴ KARAGIANNIS, *Op. cit.*, 2002, p. 27. In a 1997 deal, Chechnya received approximately 6 cents per barrel passing through Grozny, and had to guarantee the safety of the pipeline.

³³⁵ EIA, *Azerbaijan: Oil and Natural Gas Export Options*, June 2002.

³³⁶ EIA, *Kazakhstan: Major Oil and Natural Gas Projects*, July 2002; AMINEH, *Op. cit.*, 1999, p. 192.

³³⁷ Petroleum Economist, “Russia goes to Market”, February 2002. In total, over 40 years, Russia is expected to earn \$23,3 billion in taxes and revenues, and Kazakhstan \$8,2 billion.

³³⁸ *Ibid.* This pipeline system has been upgraded to a capacity of 310,000 barrels a day. The majority of the capacity is reserved for Russian oil.

viability because of possible cheaper alternatives, through Iran or Russia³³⁹. No major new oil finds have been made in Azerbaijan or its offshore part of the Caspian Sea in recent years, giving further rise to concerns about the profitability of the new pipeline. It is unsure if AIOC oil output will be sufficient to operate the pipeline at full capacity. Low oil prices in the late 1990's caused doubts about the pipeline among top American oil executives³⁴⁰. Nevertheless, the recent discovery of the giant Kashagan oil field in Kazakhstan's part of the Caspian, offers a new, potential source of crude oil for the pipeline, increasing its economic viability. The American government, strong supporters of construction of the BTC pipeline, encouraged the Kazakh government to commit itself to send oil through this new pipeline³⁴¹. The Kazakh government prefers to keep all options open, including a possible future export pipeline through Iran.

Seven members of the AIOC consortium are contributors to the construction costs of the BTC pipeline. These are BP, which holds 38.2% of the so-called sponsor group, SOCAR with 20%, Unocal with 9.6%, Norway's Statoil 8.9%, TPAO 7.5%, TotalFinaElf 7%, ENI 5%, Itochu 3.4% and Delta Hess 2.4%. Non-participating members of AIOC are LUKoil, ExxonMobil and Devon Energy. LUKoil wanted to join the sponsor group, but eventually didn't³⁴². BP, the operator of the AIOC consortium, doubted the economic viability of the project at first, but changed its mind when its estimates showed that the pipeline will make a profit if 4 to 4.5 billion barrels of oil is pumped through. BP considers this to be a realistic figure. The sponsor group will provide 30% of the construction costs, with the remainder coming from credits from international financial organizations³⁴³. Turkey has guaranteed to cover construction costs exceeding \$1,4 billion on its part³⁴⁴. A detailed engineering study was completed in May 2002, and construction has begun.

Next to the economic insecurities surrounding the BTC pipeline there are serious political risks connected to its geographic location. Its Turkish trajectory leads it through Eastern Turkish, the part of the country with a predominantly Kurdish population. After a period of social unrest and political violence, the situation appears to have become much more stable. This part of Turkey however could experience future difficulties if this conflict is rekindled, transforming the BTC pipeline into a political target. During the conflict in the 1990's, the Kurds received some backing from Russia. They hoped that the conflict would destabilize Turkey enough to make it unfit for hosting a major export pipeline such as the BTC pipeline³⁴⁵. As Weisbrode argues convincingly, the BTC pipeline must be seen as a deliberate attempt to enhance Turkish prestige in the region. The project encompasses an effort to satisfy the hopes of regional states for an American commitment to safeguard their independence and a bid to steer the region away from excessive Iranian or Russian influence³⁴⁶.

³³⁹ KALICKI, *Op. cit.*, 2001, p. 131. Russia could easily lower the tariff on the Baku-Novorossiisk pipeline.

³⁴⁰ PEIMANI, *Op. cit.*, 2001, p. 99.

³⁴¹ Petroleum Economist, *Azerbaijan*, June 2002.

³⁴² HILL, FEE, *Op. cit.*, 2002, p. 14. Interestingly, they claim that LUKoil didn't proceed because it hadn't received backing from the Russian government. However, no evidence in support is presented.

³⁴³ EIA, *Caspian Sea Region: Oil Export Options*, July 2002.

³⁴⁴ KALICKI, *Op. cit.*, 2001, p. 131.

³⁴⁵ KARAGIANNIS, *Op. cit.*, 2002, p. 102.

³⁴⁶ WEISBRODE, K., "Central Eurasia: Prize or Quicksand?", *Adelphi Paper*, Vol. 338, 2001, p. 24.

There are also security concerns in Azerbaijan. There has been a history of mutinies on army bases in Azerbaijan during the 1990's. The dismal economic situation of the country causes dissatisfaction among the population, which also has serious reservations on the current political system of the country. Corruption, inefficiency and human rights violations are widespread. A system of nepotism has developed. The president's son is the chairman of SOCAR, and vice-chairman of AIOC³⁴⁷. Armenia may also put at risk Azeri oil exports. The balance of power between these two countries is slowly shifting in Azerbaijan's favor as a result of Azeri oil revenues. As Karagiannis argues, this may convince Armenia, the *de facto* victor in the struggle over Nagorno-Karabach, to strike pre-emptively³⁴⁸.

The BTC pipeline is not the only export route facing possible security threats. The kidnapping of UN employees in Abkhazia in June 2000 serves as confirmation of the fragility of the political situation in Georgia³⁴⁹. Supsa, the terminal of the "western route" lies only 19 kilometers (12 miles) from the Abkhaz-Georgian buffer zone. Abkhaz rebels have threatened to disrupt oil transits through this pipeline. If the conflict remains unresolved, normal operations of the Baku-Supsa pipeline may face a constant risk of disruption.

5.4 *Potential role for Eurasian oil in the world oil market*

Now that the availability of Eurasian oil is poised to increase over the next few years, it is interesting to speculate what influence this new source of oil will have on the world oil markets. World oil production is expected to peak around 2020, at a level of approximately 119 million barrels a day³⁵⁰. Most of the production increase is expected to come from OPEC countries.

As oil supplies from the North Sea and Alaska are decreasing and destined to decrease even further in the near future, the Eurasian oil industry, as a new, non-OPEC source of oil, may be able to influence oil markets on a global scale if sufficient quantities become available to affect crude oil prices as well as the flow of oil in different directions. In order to buttress this hypothesis with plausible arguments, the quantity of Eurasian oil that will become available must be examined. It is difficult to make an estimate of future Eurasian oil exports. What lies at the heart of this insecurity is the fact that future oil exports are influenced by different factors that cannot be predicted with any degree of certainty. The Eurasian oil industry will only reach its full potential if the following conditions are met:

- The political situation is stable enough for development schemes to proceed according to plan. This includes a settlement of the different conflicts in the Caucasus that could threaten oil exports through the Baku-Supsa, Baku-Novorossiisk and Baku-Tblisi-Ceyhan pipelines. Also the littoral states must come to a decision on the legal regime of the Caspian Sea that is acceptable to all;
- The current assessments of the different hydrocarbon deposits in Eurasia turn out to be realistic, thus enabling the different exploitation projects to proceed;

³⁴⁷ PEIMANI, *Op. cit.*, 2001, p. 82.

³⁴⁸ KARAGIANNIS, *Op. cit.*, 2002, p. 45.

³⁴⁹ PEIMANI, *Op. cit.*, 2001, p. 88.

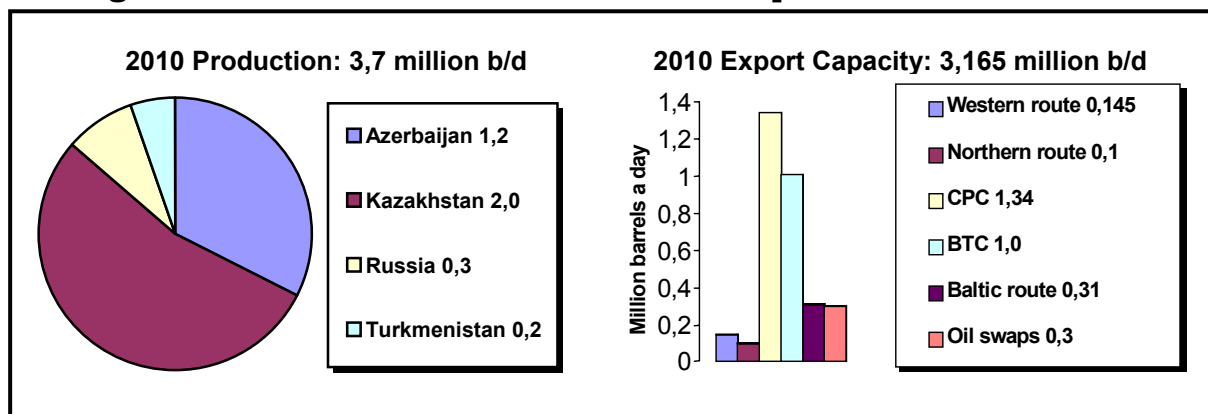
³⁵⁰ EIA, *International Energy Outlook 2002*, Washinton D.C.: U.S. Department of Energy, 2002, p. 24.

- Crude oil prices remain high enough in the foreseeable future for the transnational oil companies to justify their investments in the region.

If these conditions are met, and local consumption remains comparatively low, export capability of the region will be considerable. Exploration and development of oil deposits in the Russian part of the Caspian Sea are expected because production in Western Siberia will start to decline soon, compelling the Russian oil companies to commence new development projects. Consequently exploration activities in the Northern Caspian by Russian oil companies are increasing³⁵¹.

The Eurasian oil potential is not in doubt. Commentators expect reserve estimates to increase in the coming years³⁵². With an export capacity exceeding 3 million b/d in 2010, the region is no new Middle East and is more likely to resemble the North Sea in its production levels and influence on world oil markets³⁵³. Eurasian oil now fulfills 1.7% of world oil demand. If development proceeds as planned, this figure grows to 4.1% of world production³⁵⁴. A new, relatively secure source of oil will temper future oil price volatility on the spot market³⁵⁵.

Figure 5.1 Eurasian Oil Production and Export Estimates for 2010³⁵⁶



Decreasing market share and a growing need for investment have lessened OPEC's control over world oil markets, but the organization remains of some importance. Being dependent on high oil prices to keep their state budgets balanced, the OPEC countries have to adapt their output levels to market conditions. In most cases this means cutting back on production to support crude oil prices. OPEC fears that the arrival of Eurasian oil on the world oil market will compel OPEC to continue to act in such a manner, even though

³⁵¹ EIA, *Russia Country Analysis Brief*, November 2002.

³⁵² See for example MORSE, RICHARD, *Op. cit.*, 2002, p. 23; HILL, FEE, *Op. cit.*, 2002, p. 8.

³⁵³ BAHGAT, *Op. cit.*, 2002, p. 313.

³⁵⁴ Using the same figures as in figure 5.1 and table 2.3.

³⁵⁵ EMERSON, S.E., "The Relevance of Caspian Oil for the World Market", in: THE EMIRATES CENTER FOR STRATEGIC STUDIES AND RESEARCH, *Caspian Energy Resources, Implications for the Arab Gulf*, Abu Dhabi, 2000, p. 182.

³⁵⁶ Source: EIA, *Caspian Region: Reserves and Pipelines Tables*, July 2002. Only Russia's production in the Caspian region is included. The current production level in the region is 1,3 million barrels a day, of which 0,9 million barrels are exported. Total world production in 2010 is expected to surpass 90 million barrels a day. Eventual export pipelines passing through China, Iran or Afghanistan are excluded from the figure because construction of any of these oil pipelines seems very unlikely at the moment.

the supply of oil from other non-OPEC sources is declining³⁵⁷. This would mean that non-OPEC producers could continue to profit from OPEC output control policies. However, OPEC's sway on the oil economy would increase if some of the Eurasian producing countries decide to join the organization. Kazakhstan holds an observer status since 2001³⁵⁸, but there are no signs that it wants to become a full member in the near future.

Van der Linde explains the possible effect of Eurasian oil on world oil markets:

“A concentration of oil reserves in a few exporting countries doesn't necessarily lead to a concentration of the market if the number of suppliers (in our case oil companies) remains large enough. The significance of Eurasian oil reserves [...] stems from the fact that these countries have opened their oil industries to transnational oil companies. [...] The significance of North Sea oil exceeds the importance of just its volume. Because competition is taking place at the margin of the world oil economy, relatively small amounts of oil can influence world oil prices considerably. [...] A similar function is predicted for Eurasian oil. Support for this proposition can be found in the fact that the exploitation in the region is done by TNOCs. In the past oil companies have continued to operate normally no matter what market situation, and OPEC countries have always been compelled to reduce production to support the oil price.”³⁵⁹

TNOCs consider the market price of oil a given fact; only OPEC has the capability to cause an increase in crude oil prices³⁶⁰. For oil consuming countries the strategic importance of Eurasian oil lies in its price-shaping ability, its economic interests, including spill-over³⁶¹, resulting from Western TNOc investments, the geostrategic location of the sources³⁶² and in the prospect of a new, less easily interrupted, source of crude oil supplies of high quality³⁶³. This all reduces OPEC control over world oil markets or any form of state control in general. It makes it ever more costly for OPEC member countries to implement production cutbacks, which encourages cheating on quotas by its members. Still, OPEC has committed itself to a system of market interventions to support stable crude oil prices. It is OPEC policy to intervene by either increasing or reducing production levels if crude oil prices exceed \$28 or when they fall below \$22³⁶⁴. These guaranteed OPEC interventions, out of self-interest, provide a market environment that allows Eurasian oil exploitation to proceed³⁶⁵.

³⁵⁷ LINDE, C. VAN DER, *De Europese voorzieningszekerheid van olie en gas in de komende jaren: economische en geopolitieke risico's*, The Hague: Clingendael International Energy Programme, 2001, p. 18. (in Dutch)

³⁵⁸ EIA, *Kazakhstan: Oil and Natural Gas Exports*, July 2002.

³⁵⁹ LINDE, C. VAN DER, *De Europese voorzieningszekerheid van olie en gas in de komende jaren: economische en geopolitieke risico's*, The Hague: Clingendael International Energy Programme, 2001, p. 31. (in Dutch). Translation by author.

³⁶⁰ The Economist, “The Next Shock?”, March 4, 1999.

³⁶¹ KALICKI, *Op. cit.*, 2001, p. 121.

³⁶² LINDE, C. VAN DER, *De Europese voorzieningszekerheid van olie en gas in de komende jaren: economische en geopolitieke risico's*, The Hague: Clingendael International Energy Programme, 2001, p. 40. (in Dutch)

³⁶³ KARAGIANNIS, *Op. cit.*, 2002, p. 3.

³⁶⁴ LINDE, C. VAN DER, “Strijd om het Zwarte Goud”, *Safe*, Vol. 21, no. 3, 2002, p. 1. (in Dutch)

³⁶⁵ LINDE, C. VAN DER, *Bakkeleien om Olie*, The Hague: Clingendael, 2001, p. 15. (in Dutch)

Alliances between Western oil importing states are another reason why OPEC influence over world oil markets has declined. Western cooperation on energy security has taken shape in the formal alliance of the International Energy Agency, or IEA. The IEA aims to prevent policy decisions by the oil-exporting countries that are detrimental to the oil-consuming countries. This happens when the exporting countries try to use the leverage they enjoy over the world oil market through their exports as a tool for political blackmail. By threatening a joint release of consumer country oil stocks any oil withheld from the market could be replaced, thus rendering an oil embargo ineffective³⁶⁶. However, all this does not make OPEC powerless or redundant. With three-quarters of the world's proven oil reserves and 40.7% of world crude oil production, OPEC remains an important platform for discussion among oil-exporting countries, still capable of influencing, if no longer controlling, world oil markets³⁶⁷.

³⁶⁶ JAFFE, LEWIS, *Op. cit.*, 2002, p. 116.

³⁶⁷ LINDE, *Op. cit.*, 2000, p. 151.

Chapter 6: Conclusion

In the 19th century Russia and Great Britain went head to head in a struggle for control of Central Asia, a contest largely ignored by the other powers of the day. Rudyard Kipling called this competition for control of the trade routes to India the 'Great Game'³⁶⁸. By reference to this old rivalry the current power struggle for control over the Eurasian hydrocarbon resources has been named the New Great Game. This time there are more actors involved and the prize for grabs are Eurasia's hydrocarbon riches. According to some commentators, the New Great Game consists of an old-fashioned *zero-sum* competition between different states, in which direct, physical control over the resources is the policy goal of the states involved. In the preceding chapters I have tried to argue that such an approach does not provide an accurate analysis of the concept of pipeline politics in the Eurasian region.

So what is the importance of gaining control over the Caspian energy resources and how does this influence the world energy markets? To answer these questions, we had to look at the regional and international settings in which the different actors are operating. The regional setting is defined by the interaction between the newly independent republics and a few external powers, as well as the specifics of the state-society relations in these republics, defining the power of each state. Military presence in the region is an important tool for external powers to enlarge their influence in the region.

When looking at the struggle for control over the Eurasian resources, the impact of different aspects or elements of globalization can easily be identified. Historically isolated economies, such as Kazakhstan and Azerbaijan³⁶⁹, are finding their place in the world economy due to the development of their oil industries. This process is accompanied by large capital flows entering these countries in the form of foreign direct investments. Transnational oil companies, mostly of Western origin, make these investments. The financial weight of these corporations provides them with a dominant role in Eurasian politics, with the local governments becoming more and more dependent on revenues generated by these companies. Local governments have difficulties distinguishing between TNOCs and their states of origin, or prefer not to make a distinction between the two. Hydrocarbon exploitation and exportation schemes confront the Eurasian republics with blurring between domestic and international realms. A single country cannot make decision concerning hydrocarbon export routes single-handedly. It is essential to gather international support, not only from neighboring states, but also from TNOCs, international financial institutions and external powers.

Economics and politics are intertwined, not only at the national level, but also internationally. The international economy is political in nature because it concerns the process of 'who gets what, when and how', and this is politics. Transnational oil companies play an important role in the development of the Eurasian energy resources. The growing importance of international economic organizations such as the IMF and the World Bank in Eurasia is a consequence of the structural power Western states wield. The Eurasian

³⁶⁸ KARAGIANNIS, *Op. cit.*, 2002, p. 2.

³⁶⁹ LOONEY, R., "Oil Price Movements and Globalisation: is there a Connection?", *OPEC Review*, Vol. 26, no. 3, 2002, p. 238.

states, if they want to benefit from these institutions, have to accept and adopt Western, mainly American, trade regulations.

A complicating factor in Eurasian pipeline politics is the continuing uncertainty surrounding the legal status of the Caspian Sea. The five littoral states of the Caspian Sea have not been able to agree on the creation of a new legal regime for this body of water. As a result, there are no mutually recognized borders. The Sea contains considerable hydrocarbon deposits and the lack of legal clarity may give rise to conflicts between the littoral states. There appears to be an agreement on the idea of a division of the Sea shelf, but opinions diverge on how this division should be made. Most states prefer a division according to the method of equidistance or median. Iran insists that each littoral state should obtain an even 20%. Without a multilateral agreement, several states have concluded bilateral treaties. But unless all states agree on a new framework, the legal status of the Caspian Sea will remain a source of uncertainty and could provoke a local arms race. This seriously hampers the development of the Caspian Sea resources.

The region has seen several armed conflicts over the past ten years. Secessionist conflicts in Georgia and Azerbaijan seem to have subsided, but no lasting peace agreements between the warring factions have been concluded. Real or perceived changes in the local balance of power could rekindle these conflicts. Armenia still occupies part of Azerbaijan's territory and unrest continues in Chechnya, as the Melnikova Street Theater hostage case in Moscow in October 2002 showed. Because of Azerbaijan's and Georgia's role as oil export countries, other countries have a direct interest in the internal situation of these states, while Russia emphasizes the internal character of its conflict with the Chechens.

Political instability may also arise from within the countries. The newly independent republics have developed into authoritarian regimes. Lack of political freedom, economic hardship and decreasing living standards cause grievances under the local populations. Because most types of political opposition are banned, political Islam forms a credible alternative for disenchanted parts of the local populations. Pervasive corruption adds to public dissatisfaction. Radical Islamic movements have failed to make the impact on the political situation in Eurasia as commentators predicted a few years ago. Limited as its role may be for the moment, radical Islamic movements will gain support among the regional populations as long as it remains the only platform for political opposition. In the mean time it serves as a pretext for continuing Russian presence in the region, and increasing American activity as part of their 'War on Terrorism'. China also emphasizes Islamic threats in its relations with the newly independent republics.

Income generated by the hydrocarbon industry carries a potential risk with it for the newly independent republics if these new funds aren't managed properly. If this happens and the governments of these countries pursue short-term gains instead of implementing long-term policies to develop other, vital parts of their economies such as agriculture, they are destined for the so called 'Dutch disease'³⁷⁰. The effects of 'Dutch Disease' are threefold: a positive

³⁷⁰ CANTLEY, S.E., "Black Gold or the Devil's Excrement? Hydrocarbons, Geopolitics and the Law in the Caspian Basin. A Review Article", *Europe-Asia Studies*, Vol. 54, no. 3, 2002, p. 479. The phenomenon

balance of payments, resulting in an exchange rate that is too strong for the rest of the economy, wage increases in the oil industry that cause marginalization of other economic activities and a bloated government that makes investment decisions that are not necessarily in the best interest of the country. Only a small elite is involved in the distribution of the benefits of oil and natural gas revenues. This encourages corruption and funds mismanagement³⁷¹.

Russia has long been the dominant force in Eurasia. Russian dominance has been declining over the years but it is trying different means to reassert its influence. Russia is pre-occupied with its own safety and territorial integrity and offers military assistance to the Eurasian republics. However, as the case of Georgia shows, Russian military presence quickly translates in a lever on the policy formation of another country. Generally, the Central Asian Republics are willing to accommodate to the Russian influence to a certain extent in exchange for Russian security efforts in their behalf.

Together with their TNOCs, the advanced industrialized countries of the West wield a big political clout in Eurasia today. These countries, the US, but also the United Kingdom, France, Italy and Japan, want a stable Eurasia, with market-orientated economies³⁷². If American TNOCs had not done so already, the American-led 'War on Terrorism' with direct military presence in the region has given the United States an increasingly commanding voice over Eurasian affairs. Until their military arrival, US interests in the region were mainly economic in nature. While wanting stability in the region, American policy goals consisted of support for the development of the Eurasian resources by American corporations, prevention of a Russian export monopoly and avoiding growing Iranian influence in the region. Direct military presence offers great geostrategic awards for the US. It helps contain China, an expected future rival of the US in the region, and it serves as a check on Iranian objectives. The United States hold a deep mistrust towards Iran and Iran mistrust the US. The industrialized countries of the West also have a determining voice in the decision making process of international financial institutions, another source of capital for the Eurasian republics.

Transnational oil companies have become important actors in the international political economy. The oil markets are no longer under government control; there has been a shift towards government and industry cooperation. Technological innovation has revolutionized the oil industry, making it easier, cheaper and faster to find and develop hydrocarbon resources. Only TNOCs have this technology as well as the necessary skilled personnel acquainted with the latest technology. The Eurasian governments are very dependent on oil or natural gas revenues. Most TNOCs are of Western origin; only in the last couple of years have a few Russian firms established themselves on the world market. These companies are not under control of their respective governments, but often the links between these companies and their states of origin remain of some significance. Non-governmental organizations, *par excellence* ways to achieve new social frameworks and a good indication of the

got its name in the 1970s, when the Dutch economy became increasingly disbalanced as a result of high natural gas export revenues.

³⁷¹ LINDE, *Op. cit.*, 2000, p. 88.

³⁷² AMINEH, *Op. cit.*, 1999, p. 132.

importance of social spaces outside the state, are of little significance in Eurasia.

All conflicts in the region, irrespective of their legal, intra-state, or inter-state character, have one thing in common: they hamper quick development of the region's deposits. It is the presence of these considerable resources that gave rise to the international attention for Eurasia. Large investments are required and political instability for a long time deterred companies and institutions to commit themselves. After a slow start exploitation and export projects are now proceeding, promising large revenues to the local governments.

Eurasian oil has to be transported by means of pipelines to reach world markets. The political significance of pipelines can be appreciated when one recognizes that pipelines can and have become points of leverage in times of political disagreements, and hostage in times of armed conflicts. The overlap between economics and politics are clearly visible when looking at the decision to start construction of the Baku-Tblisi-Ceyhan Main Export Pipeline. Instead of taking the shortest export route to open water, which would traverse Iran, a new, expensive pipeline is being constructed from Azerbaijan, across the Caucasus to Turkey's Mediterranean coast, defying economic arguments. There are three possible conflict zones in the vicinity of its trajectory, threatening safe operations of the pipeline. Only strong American support could enable this project. The United States want this particular export route, because it bypasses both Russia and Iran, and enhances the regional role of their ally Turkey. It also enhances American corporate activity in the region. The geopolitical factor seems to be of overriding importance.

Turkey fears an emerging geostrategic competition between two blocks in the Caucasus or even the whole of Eurasia. The balance of power in the region remains unsettled. Azerbaijan and Georgia, wary of Russian intentions, aligned themselves with Turkey and the US. Russia has deepened its relations with Iran and Armenia, in an attempt to increase its influence over the Caucasus. The Russian military campaign in nearby Chechnya serves as a reminder for the states in the Caucasus of Russian power. The plan to construct the BTC oil pipeline has augmented US presence in this area, providing the US government with a direct influence on the shaping of future political as well as economic initiatives. These two blocks may grow into regional geopolitical rivals.

Political instability remains the biggest threat to future oil and natural gas exports from the region. Unsettled disputes in Georgia, Azerbaijan, Turkey and Russia could develop into violent conflicts, transforming oil or natural gas pipelines into potential targets. The Eurasian republics are subjected to the structural power of Western countries. Western influence in the region is the result of commercial and political activities. TNOCs and their 'home' governments are influenced by each other's behavior, and try to influence one another.

The Eurasian oil potential is beyond dispute. With an expected export capacity exceeding 3 million barrels a day within a decade, the region is no new Middle East and is more likely to resemble the North Sea in its production levels and influence on world oil markets. Eurasian oil now fulfills 1.7% of world crude oil demand. If development proceeds as planned, this figure will grow to 4.1% of total world production. OPEC fears that the arrival of Eurasian oil on the world

oil market will compel OPEC to continue to act as a “swing producer”, adapting its output levels to market conditions. This would mean that non-OPEC producers, such as Azerbaijan, Russia and Kazakhstan could continue to profit from OPEC output control policies.

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