

The Geo-politics of Oil: Russia and Central Asia

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Recently Lukoil, Russia's largest private oil company, announced the discovery of a major oil and gas field in the Russian sector of the Caspian Sea. The total probable and possible reserves of the new field, called Filanovsky, are 600 million barrels of oil and 1.2 trillion cubic feet of gas. Thus, the discovery marks a significant victory for Lukoil, which has been exploring the shallow, stormy and sometimes ice-clogged waters of the north Caspian for a decade. The discovery also sheds light on the growing efforts to re-assess the Caspian's hydrocarbon resources and potential.

The high expectations of the early 1990s had been proven unrealistic by the turn of the century. Four geological and strategic developments have contributed to this new assessment – modest reserves, high cost of production, environmentally challenging fields, and regional rivalries. Shortly after the collapse of the Soviet Union some observers thought the Caspian region could replace the Middle East as the major oil producer in the world. Indeed, some analysts thought Azerbaijan would become a "new Kuwait". However, although the countries in the region continue to sign exploration deals with major companies, many experts believe the new discoveries will not match the huge deposits such as the offshore Azeri-Chirag-Guneshli oil fields and Shah Deniz gas field in Azerbaijan or the onshore Tengiz and Karachaganak blocks, and the Kashagan offshore fields in Kazakhstan. Accordingly, major oil companies have admitted their inability to find commercial reserves.

In addition, as prospects in the region diminish, oil companies are finding that the costs of exploration and production (E&P) keep rising. In February 2005, Lukoil and Azerbaijan's state-owned oil company, Socar, terminated a deal to develop Govsany-Zykh oil deposit because of an extra \$100 million due in environmental costs, which would have made the project uneconomic. A few months later (July 2005) British Petroleum (BP)

said total costs for its various oil and gas projects in Azerbaijan would be approximately \$500 million higher than previously thought because of higher costs for contractors and project management.¹

These rising costs of exploration and production are partially a result of harsh environmental conditions. In addition, domestic politics, particularly corruption and authoritarianism, as well as international rivalries have further complicated the efforts to utilize the Caspian Sea/Central Asia's hydrocarbon resources.

This essay examines American, European, Russian, and Chinese energy interests in the Caspian Sea and Central Asia. In recent years this rivalry over hydrocarbon resources has been reinforced by the drive to increase political and security influence. In the following section American, European, and Chinese energy outlooks will be examined, followed by an analysis of the political rivalry between Washington, Moscow, and Beijing. The argument is two-folds: A) The Caspian's hydrocarbon resources will contribute to global energy security, but it should not be seen as a substitute or replacement to the Middle East; B) The rivalry between global powers in the region is likely to continue to intensify in the foreseeable future. This rivalry will further fuel economic and political instability in the Caucasus and Central Asia.

United States Energy Outlook: The United States of American is the world's largest energy producer, consumer, and net importer. It currently depends on oil for about 40 percent of its total primary energy requirements followed by natural gas (approximately 24 percent). Despite this overwhelming dependence on these hydrocarbon resources the nation has limited proven reserves of both fuels. The United States has 30.7 billion barrels of oil (2.7 percent of world's total proven oil reserves) and 5.23 trillion cubic meters (3.0 percent of world's total proven gas reserves). These limited reserves have

¹ Watson N.J., "Caspian Region: To Boldly Go," *Petroleum Economist*, Vol.72, No.10, October 2005, pp.21-22, p.21.

not restrained production. The United States is the world's third largest oil producer (after Saudi Arabia and Russia) and the world's second natural gas producer (after Russia). These huge levels of production mean that oil and natural gas reservoirs are rapidly depleting. To complicate things further, consumption of the two fuels is rising at an alarming rate. Thus the growing gap between production and consumption has been increasingly filled by imports from other oil and gas producing countries. In early 2005 the United States imported approximately 58 percent and 17 percent of its oil and natural gas consumption respectively. Most of the oil is imported from Canada, Mexico, Saudi Arabia, and Venezuela while most of the gas is imported overwhelmingly from Canada and to a far lesser extent from Trinidad, Algeria, and Qatar.

Faced with a steady growing dependence on imported oil and natural gas supplies to meet its expanding energy needs, the United States has failed to articulate a coherent long-term national energy policy. Both Democrat and Republican administrations have not been able to reach a consensus on an appropriate means to address energy insecurity. After long negotiations the Congress passed an energy bill, which President Bush signed into law in August 2005. The thrust of this energy policy is to diversify the nation's energy mix and sources.

The European energy outlook: On November 29, 2000 the European Commission adopted the Green Paper, Towards a European Strategy for the Security of Energy Supply (GP). The main goal of this important document was to initiate a debate

on possible solutions to the energy question and to reach a consensus on the necessary strategies to ensure Europe's energy security. The thrust of the problem is that Europe's indigenous energy production is declining while its demand is rising. This growing gap has been increasingly filled by foreign supplies. As a result, the EU's energy import dependence is projected to rise from 50 percent in 2000 to 68 percent by 2030.²

Europe's energy mix is heavily dominated by fossil fuels. In 2000 oil constituted approximately 41 percent of the EU's energy consumption, natural gas 22 percent, coal 16 percent, nuclear power 15 percent and renewables 6 percent.³ By 2030 the EU is projected to be 90 percent dependent on imported oil and 80 percent dependent on imported natural gas.⁴ Most of the oil comes from the Middle East while most of the gas originates in Russia.

The underlying reason for this large and growing dependence on foreign supplies is Europe's limited indigenous energy production capacity. The EU members possess only approximately 0.6 percent of the world's proven oil reserves and 2.0 percent of proven natural gas reserves.⁵ These limited reserves are largely concentrated in the North Sea.

Restrained by this combination of limited indigenous hydrocarbon resources and rising demand most European policymakers have reached the conclusion that energy self-sufficiency is not a realistic option. Instead, strategists have focused on a twofold policy – containing demand and diversifying sources of energy.

China's energy outlook: The People's Republic of China (China) is the world's second largest energy consumer (after the United States). Two factors have contributed to this rise in energy consumption. With more than 1.2 billion people, China is the most populous country in the world. In late 1978 the Chinese leadership began moving the economy from a sluggish inefficient, Soviet-style centrally planned economy to a more market-oriented system. The result has been a quadrupling of gross domestic product (GDP) since 1978. Measured on a purchasing power parity (PPP) basis,⁶ China since 2003 has stood as the second-largest economy in the world (after the United States), although in per capita terms the country is still poor.

In order to maintain its impressive economic performance and satisfy its fast-growing demand for energy, China has pursued a variety of strategies. The core of these strategies is to diversify both the energy mix and the energy sources.

Historically, natural gas has not been a major fuel in China. It was used largely as a feedstock for fertilizer plants, with little use for electricity generation. In 2004 it accounted for only about 3 percent of total energy consumption.⁷ However, the need to reduce the country's heavy dependence on coal and because of the environmental benefits, China has taken aggressive steps to develop indigenous natural gas production, transportation,

² European Commission, European Energy and Transport Trends to 2030, p.15, January 2003 on line at http://Europa.eu.int/comm/energy/index_en.html

³ European Commission, Green Paper: Towards a European Strategy for the Security of Energy Supply, p.4, November 2000, on line at http://Europea.edu.int/comm/energy/index_en.html

⁴ Commission of the European Communities, Green Paper on Energy Efficiency or Doing More with Less, p.5, June 2005, on line at http://Europa.eu.int/comm/energy/index_en.html

⁵ Energy Information Administration, Regional Indicators: European Union, January 2005, on line at www.eia.doe.gov

⁶ Purchasing Power Parities (PPPs) are circumvented conversion rates that both convert to a common currency and equalize the purchasing power of different currencies. In other words, they eliminate the difference in price levels between countries in the process of conversion.

⁷ Energy Information Administration, Country Profile: China, July 2004. On line at www.eia.doe.gov.

and import capacity. Three LNG import facilities are currently either under construction or have been approved. They are led by China National Offshore Oil Corporation (CNOOC) and are located in Guangdong, Fujian, and Zhejiang provinces, along the south and southeast coastline.⁸

Certainly the most dramatic change in China's energy outlook is the skyrocketing of its oil demand and consumption. In the first four years of this decade China has increased its imports of oil by 400 percent.⁹ Throughout the 1970s and 1980s, China had the luxury of neutrality toward dramatic events in world oil markets. Internal supplies were fairly evenly matched with domestic requirements.¹⁰ This self-sufficiency came to a dramatic end in the early 1990s as the country's oil demand soared and its production declined. China became a net importer of oil in 1993, and surpassed Japan in 2003 to become the world's second largest oil importer (after the United States). In other words, in one decade China has become a major player in the global oil market.

The rapid rise of China's oil and natural gas demand reflects the country's impressive economic performance and its lack of domestic proven reserves. China holds only about 2.1 and 1.0 percent of world's proven reserves of oil and natural gas respectively.¹¹ Not surprisingly Chinese oil companies are almost everywhere in the world negotiating oil and natural gas deals, competing with their Western and Russian counterparts. China National Petroleum Corp. has been involved in exploration and production operations in Africa, particularly in Angola and Sudan.¹² In late 2004 it was reported that delegations of senior executives from China's largest oil companies had been in talks with Canadian oil executives on ventures that would send oil extracted from oil sands in the northern reaches of the energy-rich province of Alberta to new ports in western Canada and onward by tanker to China.¹³

The Caspian Sea/Central Asia energy outlook:

The 700-mile long Caspian Sea is located in northwest Asia. Five countries – Azerbaijan, Iran, Kazakhstan, Russia, and Turkmenistan share the Caspian Basin. Their policies on the exploration and development of the region's hydrocarbon resources since the collapse of the former Soviet Union in late 1991 have been of great interest to energy officials from all over the world. The region is important to the United States and other energy consuming countries because it can contribute significantly to the world's oil and gas production and, equally important, to the diversifica-

tion of global hydrocarbon resources and consequently reduce heavy dependence on the Middle East. In short, the Caspian Sea has the potential to substantially enhance global energy security.

The region is not new to the petroleum and natural gas industry. It is worth remembering that commercial energy output began in the Caspian basin in the mid-19th century, making it one of the world's first energy provinces. By 1900 the Baku region produced about half the world's total crude oil. Since the early 1950s, however, several developments contributed to a substantial reduction of Caspian oil production. Concern over Baku's vulnerability to attacks during the Second World War, along with the discovery of oil in the Volga-Urals region of Russia and later in western Siberia, led to a switch in the former Soviet Union's investment priorities. This new policy resulted in decreased exploration and production in the Caspian for most of the second half of the 20th century. Since the late 1980s, however, Azerbaijan, Kazakhstan, and Turkmenistan have gradually occupied center stage in the global energy markets. The three countries have succeeded in attracting massive foreign investment to their oil and gas sectors.

Since the collapse of the Soviet Union several international oil companies have negotiated and signed agreements with Caspian states, particularly Kazakhstan and Azerbaijan. These agreements suggest that the geological potential of the Caspian region as a major source of oil and gas is not in doubt. The rate of investment, however, is (and will continue to be) determined by the perceived risk in the region, or what industry experts call "above-the-ground risk." In other words, the risk is not in finding the oil and gas, but in juggling the multitude of risks associated with operating in very difficult host country environments. This section will examine two of these risks; the lack of consensus on the legal status of the Caspian Sea and the disagreement over the most cost effective pipeline routes.

The Legal Status of the Caspian Sea:

In the twentieth century the former Soviet Union and Iran

⁸ Martin Clark, "LNG: China – Fools Rush In," *Petroleum Economist*, Vol.71, No.7, pp.24-25, p.24.

⁹ John Browne, "The Outlook for the World Oil Market," *Middle East Economic Survey*, Vol.47, No. 51/52, December 20/27, 2004, on line at www.mees.com.

¹⁰ Amy Myers Jaffe and Steven W. Lewis, "Beijing's Oil Diplomacy," *Survival*, Vol.44, No.1, Spring 2002, pp.115-134, p.117.

¹¹ British Petroleum, *BP Statistical Review of World Energy*, 2004, pp.4 & 20.

¹² China National Petroleum Corp. owns 40 percent – the largest single share – of the Greater Nile Petroleum Operating Co., a consortium that dominates Sudan's oil fields in partnership with the national energy company and firms from Malaysia and India.

¹³ Simon Romero, "China Emerging as U.S. Rival for Canada's Oil," *New York Times*, December 23, 2004.

signed several agreements to govern their relationship with respect to the Caspian Sea, most notably the Friendship Treaty of 1921 and the Treaty of Commerce and Navigation of 1940. Moscow and Tehran agreed that the Caspian was only open to their own vessels and was closed to the rest of the world. They also reserved a twelve-mile zone along their respective coasts for exclusive fishing rights. However, no attempt was made to delimit any official sea boundary between them and the treaties said nothing about the development of mineral deposits under the seabed. Thus, many analysts and policymakers have questioned the applicability of these two documents to the new, post-Soviet situation in the Caspian. Indeed, Russia, Iran, and the three former Soviet Republics have intensely disagreed on how to define the Caspian as a body of water.

A fundamental question in this debate on the legal status of the Caspian is whether it is a “sea” or a “lake.” According to the United Nations Convention on the Law of the Sea, nations bordering a sea may claim twelve miles from shore as their territorial waters and beyond that a two-hundred mile Exclusive Economic Zone (EEZ). If the law of the Sea convention were applied to the Caspian, full maritime boundaries of the five littoral states bordering it would be established based upon an equidistant division of the sea and undersea resources into national sectors. If the Law were not applied, the Caspian and its resources would be developed jointly – a division referred to as the condominium approach. After more than a decade since the break-up of the Soviet Union, the five littoral states have not agreed on whether to characterize the Caspian as a sea or a lake. The main point of contention centers on the uneven distribution of potential oil and natural gas riches in the basin.

The Russian position has varied over time. Initially, Moscow argued that the Law of the Sea did not apply to the Caspian because it was an enclosed body of water, and that regional treaties signed in 1921 and 1940 between Iran and the former Soviet Union remain valid. However, the signing of several agreements between the other three littoral states and international oil companies to explore and develop hydrocarbon resources beneath the Caspian’s water prompted Russia to change its position. Thus, in 1996 Moscow proposed that within a forty-five-mile coastal zone each country could exercise exclusive and sovereign rights over the seabed mineral resources. Since the late 1990s, the Russian leaders have advocated the principle of dividing the seabed and

its resources between neighboring states. In line with this approach, Russia signed agreements with Kazakhstan (1998) and Azerbaijan (2001) dividing the northern Caspian seabed.

Unlike Russia, Iran has been more consistent in rejecting any bilateral agreement to divide the Caspian. Tehran’s preference is for all five littoral states to adopt a collective approach in developing the mineral resources beneath the Caspian. Indeed, for the last several years, Iran has increasingly become the lone voice in the debate over the legal status of the basin. The reason is simple – Iranian shores on the Caspian seem to hold less oil and natural gas reserves than the other four littoral states.

Since the break-up of the Soviet Union in 1991, the evolving positions of Azerbaijan, Kazakhstan, and Turkmenistan regarding the legal status of the Caspian have been driven by three interrelated developments. First, the coastal areas of each of the three countries are believed to hold more oil and gas reserves than those of Russia and Iran. Second, developing available hydrocarbon resources is considered crucial to the economic survival of these newly independent states, which have very few other economic assets. Third, the substantial international investments in the energy sectors of these three countries have incited them to be more assertive in their demands to divide the Caspian Sea into national sectors.

To sum up, the five littoral states have yet to agree on the legal status of the Caspian Sea. Despite this lack of consensus, a de-facto regime is emerging. Several international oil and gas companies have decided not to wait for an agreement and started developing the Caspian offshore fields. These ambitious and very expensive deals between international companies and littoral governments, however, face another serious hurdle – the lack of an adequate export system to ship the region’s oil and gas to global markets.

Pipeline Diplomacy: Given that Azerbaijan, Kazakhstan, and Turkmenistan are landlocked, they have to ship their oil and natural gas by pipelines, which cross multiple international boundaries. The issue of potential routes through neighboring countries has become a priority for both regional and international powers, as well as for oil and gas companies. The construction of a pipeline would provide the transit states with several financial and political benefits, including access to oil or natural gas for their domestic needs, foreign investment and jobs, substantial transit fees, and

political leverage over the flow of oil and gas. Thus, the process of choosing and constructing pipeline routes is complicated and requires delicate negotiations with many parties. Until recently, the existing pipelines in the Caspian region were designed to link the former Soviet Union internally and were routed through Russia. Therefore, most of the Caspian's oil and gas shipments terminated in the Russian Black Sea port of Novorosiisk. Since independence political and security concerns have arisen as to whether these Caspian states should remain as dependent on Russia as their sole export outlet.

For several years a number of proposed routes have been under consideration. These include a pipeline to the north to Novorosiisk (completed in 2000), a second one to the east from Kazakhstan to China, a third one to the southwest through Afghanistan to Pakistan, a fourth one to the south across Iran, and finally, a pipeline to the west from Baku to Azerbaijan to the Georgian port of Supsa on the Black Sea (became operational in April 1999), or the Turkish port of Ceyhan on the Mediterranean (became operational in 2005). For several years international companies and the concerned governments have been engaged in serious negotiations to determine the priority of each pipeline. Both strategic considerations and financial interests have shaped the outcome of these negotiations.

Since the late 1990s, the United States has promoted the pipeline from Baku to Tbilisi to Turkey's eastern Mediterranean oil terminal at Ceyhan (BTC) as the main export pipeline (MEP). Most of the oil comes from the Azeri-Chirag and Gunashli field complex in the Azeri sector of the Caspian Sea, but Kazakhstan intends to export some of its oil through this scheme. The BTC pipeline is expected to be coupled later with a natural gas pipeline linking Baku and Tbilisi to Erzurum in Turkey's eastern Anatolia region. In addition, in February 2003 Greece and Turkey agreed to construct a pipeline linking natural gas producers from the Caspian Sea region with the European market. Initially, the Russian government had strongly opposed the BTC. However, by mid-2001 Moscow had dropped its opposition and focused on finishing the construction of the Caspian Pipeline Consortium (CPC), which connects the Tengiz oil field in Kazakhstan to the Russian Black Sea port Novorosiisk. This project reflects cooperation between Russian and American oil companies. Tengiz is one of the world's largest oil fields with substantial high-quality proven reserves. The American oil giant Chevron, now Chevron-Texaco, be-

gan negotiating a deal to develop the field in 1990 before the demise of the Soviet Union. Tengizchevroil, a joint venture between Chevron, Exxon-Mobil, and Kazakhstan, became operational in 1993. The pipeline was officially opened in November 2001.

Europe's interest in energy cooperation with the Caspian and central Asian states has been institutionalized since 1995 in what is known as Interstate Oil and Gas Transport to Europe (INOGATE). This program is, to a large extent, similar to the EU-Russia Energy Dialogue. It aims at promoting European investment in Caspian Sea/Central Asia states in return for their energy cooperation with the EU member states. Another important step in the same direction was taken in February 2001 when the INOGATE Umbrella Agreement officially came into force. This Agreement sets out an institutional and legal system designed to rationalize and facilitate the development of interstate oil and gas transportation systems and to attract the investments necessary for their construction and operation. This European enthusiasm to strengthen energy cooperation with the Caspian Sea region faces many hurdles, particularly the lack of consensus on how to divide the Caspian and the disagreements over the most cost-effective pipeline routes.

China has special interest in Kazakhstan's hydrocarbon resources. The two countries share a long border and Kazakhstan has the Caspian Sea region's largest recoverable oil reserves. In addition, Kazakhstan produces more than double that of Azerbaijan and Turkmenistan together. Furthermore, with substantial assistance from international oil companies, Kazakhstan's President, Nursultan Nazarbaev, has ambitious plans to double his country's oil production several fold. This crucial role of foreign investment, however, cannot be taken for granted. The Kazakh government's stand on the role of international oil companies in exploration and development operations is uncertain. Since the early 2000s the government has introduced new restrictions to new oil deals with foreign investors. In January 2004 a new tax structure was introduced that included a so-called "rent tax" on exports – a progressive tax that increases as oil prices grow.¹⁴ The new amendment to Kazakhstan's tax law has raised the government's share of oil income to a range of 65 to 85 percent, and it has removed a clause guaranteeing investors a static tax rate throughout the duration of the contract.¹⁵

¹⁴ Energy Information Administration, Country Profile: Kazakhstan, November 2004, on line at www.eia.doe.gov.

¹⁵ Ibid.

Despite the uncertainty surrounding Kazakhstan's business environment China has sought to increase its oil imports from Kazakhstan. This Chinese policy reflects both Beijing's fast growing need for foreign oil supplies and dissatisfaction with Russia's lack of commitment on a pipeline to ship Russian oil to China. Thus, On May 17, 2004, during a state visit to Beijing, Kazakhstan President Nursultan Nazarbayev signed a joint declaration with Chinese President Hu Jintao on the construction by the China National Petroleum Corporation (CNPC) of what was termed the "second section" of the two countries' long-planned Kazakhstan-China oil pipeline project. The underlying rationale for this pipeline project is obvious. Kazakhstan intends to increase its oil production and ship it through multiple routes (i.e. not only via Russia's pipeline system). Meanwhile China needs to import large volume of oil to maintain its impressive economic performance. Construction of this 613-mile long pipeline began in late September 2004 and is expected to be completed in December 2005. Initially it will have capacity of around 200,000 b/d, which will eventually be expanded to 400,000 b/d.

Three conclusions can be drawn from this discussion of pipeline diplomacy in the Caspian Sea. First, given the domestic, regional, and international rivalries surrounding oil and gas fields in the Caspian, there is no doubt that multiple export routes would increase the energy security for consumers, producers, and the global energy markets by making deliveries less vulnerable to technical or political disruptions on any individual route. Still, energy security will have to be balanced by economic feasibility, since a larger number of pipelines would mean smaller economies of scale. Second, the decision to choose the most appropriate route reflects a competition between strategic concerns and economic interests. Most pipelines are built by companies, not by governments. Ultimately, projects must stand on their own commercial merit and the economics of a project will dictate its success. In the long term, pipelines that make economic sense are more likely to be built than those that do not. Third, pipeline' capacity and availability will, to a large extent, influence the timing of oil and gas development in the Caspian region.

In summary, the lack of consensus on how to divide the Caspian Sea and the disagreement on choosing the most cost-effective pipeline routes, as well as other serious challenges such as the absence of both political transparency and an entrepreneurial culture and ethnic divisions, have all negatively affected the investment climate and the development of the region's hydrocarbon resources.

Geo-strategic competition

Russian/Soviet domination of Central Asia and the Caucasus region lasted for more than one hundred years. The break-up of the Soviet Union in December 1991 created a "power vacuum" and triggered jockeying for influence by both neighboring states and a distant superpower. Thus, some analysts describe the geopolitical rivalry in the region as a "neo-Cold War" or "neo-Great Game."

The experience of regional and international rivalry in Central Asia and the Caucasus since the early 1990s suggests several factors that need to be taken into consideration in any analysis of the region. First, militarily, Central Asia and the Caucasian states are surrounded by four nations with nuclear capability (Russia, China, India, and Pakistan). Another neighbor – Turkey – is a NATO member and Iran – another bordering state – has an active nuclear program and is accused by the United States of trying to acquire nuclear weapon capability. Furthermore, the instability in Afghanistan that led to the September 11th terrorist attacks and the subsequent war has been a constant challenge to overall regional stability. In short, the military and strategic balance of power in the region is very fragile. Second, United States' war on terrorism in Afghanistan has substantially increased the strategic significance of several Central Asian states. Washington needed military bases in the region to fight al-Qaeda and the Taliban. Third, this growing American military presence in Russia's, China's, and Iran's backyard is not welcomed by the three nations. Despite initial understanding of the need to cooperate in the war against terrorism, Moscow, Beijing, and Tehran have increasingly grown suspicious of Washington's intentions in what they perceive as their neighborhood.

Fourth, the United States, Russia, and China as well as several Central Asia and Caucasus states face a common challenge – militant Islam. This mutual enemy has prompted and facilitated cooperation between these strategic rivals. Still, their perceptions of the threat and the methods to contain militant Islam are not identical. Fifth, the Caspian's hydrocarbon wealth is at the heart of the rivalry between regional and international powers. The United States is the world's largest oil importer, Russia is the world's largest natural gas producer and exporter, and the second largest oil exporter (after Saudi Arabia), and China is the second largest oil importer. Every contender wants a piece of the potentially large energy pie in the Caspian. Sixth, ironically, the speedy and full development of the region's energy resources has been slowed down by the uncertainty of fiery competition between regional and international powers. Gradually most contenders came to realize that their rivalry over the Caspian's

energy resources should not be put in zero-sum terms. Rather, increasingly the Russians and Americans, and the Iranians and Turks, have found common ground and are working together on several schemes to develop the region's oil and gas fields and pipelines. Finally, in addition to the rivalry among the United States, Russia, China, Iran, Turkey, and other regional states, there is an internal competition between strategic and economic interests within each state. In other words, there is no monolithic American or Russian policy toward Central Asia. Instead, foreign policy goals and strategic considerations compete with commercial ones in formulating and determining where each of these players stands.

Taken all these factors into consideration, this analysis briefly examines the main guidelines of American, Russian, and Chinese policies in the Caspian region since the early 1990s.

The United States: The emergence of independent states in Central Asia and the Caucasus following the collapse of the Soviet Union was a surprise to the United States. Initially, the region was seen as peripheral to U.S. interests. Since the early 1990s several parameters have shaped American policy toward these states. First, United States was concerned about the proliferation of weapons of mass destruction in Central Asia. Kazakhstan inherited some of the Soviet nuclear weapons that were deployed on its territory. Financial incentives and political pressure were used successfully to rid the region of these unconventional capabilities. Second, the Caspian Sea's proven record of hydrocarbon wealth presented Washington with an important opportunity to diversify its energy sources and reduce its dependence on the Middle East. Several major American oil companies signed lucrative deals to explore and develop oil and natural gas deposits in Azerbaijan and Kazakhstan. Meanwhile, the Clinton administration took the lead in supporting the construction of pipeline routes to transport oil and gas shipments from the region to the international markets. Third, the war on terrorism following the September 11th terrorist attacks added significant strategic value to Central Asia. Washington forged cooperation with several states in the region for at least two purposes: A) to fight the Taliban and al-Qaeda in Afghanistan; and B) to contain home-grown militant Islam such as Hizb ut-Tahri (HT) (the name translates from Arabic as "Party of Islamic Liberation"), and the Islamic Movement of Uzbekistan (IMU).¹⁶

Fourth, the United States' growing penetration of Central Asia and the Caucasus reflects Washington's strategic relations with Iran and Russia. The U.S. has had hostile relations with the Islamic Republic of Iran since the revolution in Tehran in 1979. An important goal for American diplomacy in

Central Asia is to prevent the expansion of Iranian influence in the region. In the early 1990s the United States did not wish to antagonize Russia in what Moscow perceives as its sphere of influence or "near abroad". However, the growing American commercial and strategic interests in Central Asia and the Caucasus added more incentives for a strong U.S. economic, diplomatic, and military role in the region.

In order to strengthen its position in the region, the United States employed several unilateral and multilateral methods. These include close military cooperation with Azerbaijan, Kazakhstan, and Uzbekistan. The Bush administration initiated a series of joint military exercises in the Caspian Sea designed to train Azerbaijan's naval fleet to protect the oil-rich nation's offshore drilling platforms.¹⁷ In the mid-2000s the United States government set up special troops called the "Caspian guard", whose aim is to establish mutual control of air, sea, and land borders for Azerbaijan and Kazakhstan. The mission of these special troops is to swiftly react to emergencies, including terror attacks on oil fields and pipelines. Another example of this military cooperation is the creation of the Partnership for Peace, a military assistance program with a mandate in conflict management and peacekeeping.¹⁸

In addition to growing military cooperation between Washington and several Central Asian states, the United States has supported the creation of GUUAM, an informal regional grouping of countries that includes Georgia, Ukraine, Uzbekistan, Azerbaijan, and Moldova. These member states wish to strengthen their cooperation independently from Russia's influence. Finally, in the mid-2000s the US has given important political support to promoting democracy in Central Asia and the Caucasus as the developments in Ukraine (so-called Orange Revolution), Georgia (so-called Rose Revolution), and Kyrgyzstan have demonstrated.

Russia: Despite the dissolution of the Soviet Union several powerful members in Russia's military and

¹⁶ The HT was founded in the early 1950s by Palestinians in Jordan and is currently active in many countries including Western Europe. It arrived in Central Asia in the mid-1990s and is now active in Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan. The organization's stated goals are the restoration of the caliphate and the establishment of strict Islamic law. Although there is no confirmed evidence of HT's involvement in violent actions as an organization, HT propaganda has praised martyrdom and called for attacks against coalition forces in Iraq. The HT has claimed that the United States and the United Kingdom are at war with Islam, and called for all Muslims to defend the faith and engage in Jihad against the two countries. The HT was officially banned in Britain following the July 2005 terrorist attacks. Meanwhile, the IMU was formed around 1997 with the expressed goal of overthrowing the government of President Islam Karimov and establishing an Islamic state in Uzbekistan. Eventually, it extended its mandate to overthrow all regional governments. The organization founders established close relations with the Taliban and Osama bin Laden. IMU's main area of operations includes the countries of Afghanistan, Iran, Kyrgyzstan, Pakistan, Tajikistan, and Uzbekistan.

¹⁷ Ilan Berman, "The New Battleground: Central Asia and the Caucasus," *Washington Quarterly*, Vol.28, No.1, Winter 2004-05, pp.59-69, p.62.

¹⁸ S. Neil Macfarlane, "The United States and Regionalism in Central Asia," *International Affairs*, Vol.80, No.3, May 2004, pp.447-461, p.452

political establishment have maintained their strategic thinking of a Great Russia with strong ties to former Soviet republics. Thus, Moscow has robust strategic and economic interests in Central Asia and the Caspian Sea, which it considers its backyard or "near abroad." U.S. growing penetration of Russia's "sphere of influence" is viewed with a great deal of suspicion and resentment. In the aftermath of September 11, Russia accepted the U.S. military presence and use of air bases in Uzbekistan, Kyrgyzstan and Tajikistan, but opposition by top officials in Russia's security services, which are traditionally anti-America, is strong. Moscow's suspicions of Washington's intentions and policies were further reinforced by recent support given by the U.S. to the democratic movements in several former Soviet republics mentioned above.

In order to contain American penetration in Central Asia, Russia has created several regional organizations to foster its cooperation and strengthen its ties with these former Soviet republics, including the Commonwealth of Independent States and Collective Security Treaty Organization. In addition, Russia has conducted several military and naval exercises in the Caspian Sea to demonstrate that it has the political will and military capability to defend its strategic and commercial interests in the region.

Russia is not quite as dependent on hydrocarbon resources as those countries of the Persian Gulf. Still, oil and gas play a significant role in Russia's economy. Accordingly, Moscow has shown great sensitivity and interest in the development of the Caspian Sea's hydrocarbon resources. The Russian government and Russian companies have employed different methods to promote their interests. Gazprom, Russia's gas monopoly, buys almost all of Turkmenistan's natural gas. Several Russian oil companies are actively involved in exploration and development schemes in cooperation with their Western counterparts. Furthermore, most of the Caspian's oil and gas is still exported through Russian ports.

China: Like the other contenders, China has significant strategic and commercial interests in Central Asia and the Caspian Sea. The region represents Beijing's direct contact with the Islamic world (i.e., Afghanistan, Kazakhstan, Kyrgyzstan, Pakistan, and Tajikistan). China has a large Muslim population and for many years has fought against the Uighur separatist movement. Indeed, the Mus-

lim countries of Central Asia, Afghanistan and Pakistan constitute the southern flank of Russia and the western flank of China. The interests of the two great powers coincide there,

as both seek to contain the threat of Islamic radicalism.¹⁹ In part due to these shared concerns, the two nations, along with Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan, have established the Shanghai Cooperation Organization (SCO). Originally the goal of SCO was to resolve border disputes among the signatories, but since its establishment in 1996 the goal has evolved into combating Islamic extremism.

To sum up, the rivalry between the United States, Russia, China, and other regional powers since the early 1990s has focused on two dimensions – strategic considerations and hydrocarbon interests. To a great extent the former has been pursued in zero-sum terms with little room for compromise. Meanwhile, there has been some cooperation in the competition over energy resources. Most contenders (governments and companies) have realized that they have a common interest in developing the region's hydrocarbon wealth.

Concluding Remarks: The Caspian – An Assessment

In 1994, Azerbaijan signed a \$7 billion contract with a Western consortium to develop some of its vast Caspian oil reserves. Dubbed the "deal of the century" this much-publicized contract marked the beginning of what was then expected to become a new "Great Game", pitting U.S., Russian, European and many more national interests against one another. Attracted by the prospects of huge returns on investments, energy majors from all around the world started injecting hundreds millions of dollars into the area, mainly in Kazakhstan and Azerbaijan. The high expectations, however, proved to be unrealistic. The Caspian Sea's hydrocarbon deposits are significant but are no match to those of the Middle East. Within this context, three conclusions need to be highlighted.

First, In addition to the lack of consensus on how to divide the Caspian Sea and on the construction of pipelines, the region faces many other serious challenges including domestic corruption and ethnic divisions. These hurdles have negatively affected the investment climate and the development of energy resources. Second, the Caspian Sea should be seen as a supplement, not a replacement to the Persian Gulf. By the year 2025 oil production from the Caspian Sea is projected to reach 6.0 million barrel per day (b/d),²⁰ while production from the Persian Gulf will reach 45.2 million (b/d).²¹ Third, Central Asia/Caspian Sea states are bound to see continued Western strategic engagement in their region. This engagement is driven by interest in the area's hydrocarbon resources and its role in the war against extremist Islamist movements. □

¹⁹ Boris Rumer, "The Powers in Central Asia," *Survival*, Vol.44, No.3, Fall 2002, pp.57-68, p.62

²⁰ Energy Information Administration, *Annual Energy Outlook*, Washington, DC: United States Government Printing Office, 2004, p.3.

²¹ Energy Information Administration, *International Energy Outlook*, Washington, DC: United States Government Printing Office, 2003, p.235.