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Russian National Interests and the Caspian Sea

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Introduction

The Caspian Sea, located on Iran's northern border, surrounded by Azerbaijan, Kazakhstan, and Turkmenistan, and sharing a border with the south-west corner of Russian territory, is the epicenter of a collision of regional, national and business issues. These include questions among the littoral countries over demarcating the Sea, route diversification for oil pipelines, state interests, investor concern over political and ethnic stability, and the role of international agreements.

From a Russian point of view, the Caspian Sea area is of particular concern due to a host of interests that must be protected. Among the most important are:

- Geo-strategic interests: Russia wants to remain strong in the area and wield power within and control over the Commonwealth of Independent States (CIS), thereby ensuring the security of its southern flank. States of concern here are those CIS members noted above plus Georgia and Armenia. Russia sees as its greatest danger the potential expansion of Chechen authority into Dagestan at Russia's expense, thereby severely restricting Russia's direct access to the Sea (only Astrakhan remains).
- Geo-political interests: the retention of Russian influence within the space of the former Soviet Union directly determines the future of Russian statehood, according to many analysts. Caspian oil, despite all its economic significance, is merely the external manifestation of the global political task of the present day-the restoration of Russia's might.¹ Evolving problems in the North Caucasus among the autonomous Russian republics (not only Chechnya, but also Karachay-Cherkessia, Kabardino-Balkaria, North Ossetia, Ingushetia, etc.) and growing religious pressures (from the Wahhabis, among other groups) make this area as or perhaps more important to Russia than the CIS in terms of interests and stability.

- Economic interests: Russia wants to ensure that cash flows in the form of Western capital will continue from Central Asian and Siberian oil fields, and that cash flows are not be redirected out of Russia and into the Caspian region. Russia can compete on a level playing field with Kazakhstan and other Caspian oil investors with the proper Production Sharing Agreement (PSA) legislation in place. Another economic concern (which is also a geo-strategic, geo-political and ecological concern) is sovereignty rights to the body of water itself. The bottom and outer edges of the Caspian is divided one way, the column of water over these divisions in another.
- Ecological interests: developing safe ecological norms for the exploitation of both hydrocarbons and fishing resources (especially the protection of the Caspian sturgeon stock that produces 80-90 per cent of the world's finest caviar) are paramount concerns. This feeling is especially acute due to the severe meteorological conditions (extremely strong and unpredictable storms) that occur in the North Caspian Sea region.

Thus, from a Russian viewpoint, the Caspian Sea is the focus of many vital concerns that will affect not only regional and world stability but also investor confidence in Russia if not handled properly. The line up of players in the area from Russia and the region underscores this point. Russian involvement includes the Ministry of Foreign Affairs, the oil lobby and the Ministry for Fuel and Energy, the Internal Troops (MVD), the Ministry of Defense and General Staff, and the Federal Security Service. Also present are regional authorities (and opposition elements), ethnic lobbies (Armenian, Abkhaz, etc.) in Moscow, various shadowy interests (Mafia, etc.), the organized Chechen diaspora, and so on.

Unfortunately for Moscow, the debate over the fate of this area is occurring at a time when Russia is weak both militarily and politically. The impotent response of Russia's military leadership to NATO's two month long bombing campaign in Yugoslavia, and the appointment of a third government in the space of a year and two months, are cases in point. Russia cannot impose its will on any state in the region (in fact, Russia is slowly withdrawing from the area), and sees only Kazakhstan and Armenia as potential allies.

A Complicated Region

As long ago as the 1870s the Caspian Sea began to attract potential investors and geologists. At that time, geological finds in Baku drew such notables to the region as the Rockefellers, Nobels and Rothschilds. The tsars sent agents to the region as well, with Russia's involvement in the area stretching back over 300 years. For centuries, the area has formed a portion of the disputed frontiers between the Russian, Turkish and Persian empires.²

The Caspian area has remained very important into this century. At the beginning of the twentieth century, the Caspian Sea region reminded one of the gold rush in California, as people flocked to the region to try to find oil. In World War II, Germany made the Caspian area one of its strategic goals. After the fall of the USSR, the region began opening to the outside world when three new states (Azerbaijan, Kazakhstan and Turkmenistan) began to exploit significant onshore and offshore holdings. American companies as early as 1989 joined the rush to exploit Caspian oil and are today enmeshed in the economic development of the region.

Political and economic blocs eventually evolved to vie for influence in the Caspian Sea region. On the one side, there is a loose and unofficial alliance between the US, Turkey and Azerbaijan. This bloc's role, particularly that of the US, is viewed by some Russians as designed to weaken Russia's influence in the area and to reorient the economic interests of members of the CIS toward American and other Western investments. On the other side, there is an understanding or mutual interest pact among Russia, Armenia and Iran. This triangle, for a variety of political, ethnic, and historical reasons, is aligned against Azerbaijan. This understanding is being tested as Russia and Iran continue to drift apart. Players not part of these blocs, but influencing the situation in the region, are Britain, France, Italy, China, Spain and Japan. Russian-Georgian relations are also exceptionally important and complicated by both countries' policies regarding the Caspian. Georgia hopes to capitalize on pipeline revenues and would like to greatly limit Russian access to its lines and ports. Any arrangement between Georgia and the US or Azerbaijan that omits Russia is beneficial in Georgian eyes. Russia also believes that the creation of the GUUAM alliance (Georgia, Uzbekistan, Ukraine, Armenia, Moldova) is an anti-Russian, US-backed alliance designed to split the CIS. This was particularly noticeable once exercises concerning pipeline protection began.³

Both Iran and Russia view Washington and the West with suspicion, which has mounted since NATO's involvement in the Balkans. Both hope to serve as a counterbalance to Azerbaijan. Iran has improved its relations with Armenia, which has helped counterbalance not only Azerbaijani influence but that of Turkey as well. There is also a pan-Turkic trend in Azerbaijan and Turkmenistan that Turkey has tried to exploit.

It is also possible to layer the nations in the region by function. The littoral states surrounding the Caspian are in charge of exploitation and protection of resources and are the initial staging point for oil flowing through the pipelines. Located in the second tier are those states across which the oil will traverse until it reaches a port facility. The final tier is the states with port facilities for shipping the oil to the rest of the world. Some nations, like Iran and Russia, can address all three functions. The producing countries, Azerbaijan, Kazakhstan and Turkmenistan, are literally at the mercy of transportation solutions, complicated by Russia's control over all currently functioning exit pipelines for both oil and gas, with the exception of a small line across Georgia to Supsa, newly reopened this year.

The growing complexity of political-economic interests in the region has forced Russia to change its position on the Caspian's status on more than one occasion. Not only are the Caspian's resources at stake, but also transportation networks, commercial operations, the status of the Sea itself and the issue of military control over the region. China's interests and desire to access oil reserves for its growing population have further exacerbated the battle over transportation issues, such as pipeline developments and demarcation problems. The military issue has developed into an area of intense concern of late. First, Russia created a regional air defence command in Armenia for the Caspian region. In early January 1999, Russia announced that it intended to deploy S-300 surface-to-air missiles in Armenia. Second, in February 1999, Azerbaijan asked for the deployment of US or NATO (specifically Turkish) forces on its soil. Such an arrangement would greatly heighten tensions in the Caspian region and could lead to war. Russia has stressed that America already has a Theatre Commander in Chief monitoring the region. Other reports indicate that the mission of guarding the oil pipelines will be assigned to the US Air Force base

at Incirlik, Turkey.⁴ This increased US and NATO attention toward the region prompted one Russian General to claim that the greatest threat to Russia is not China or Islamists but the possibility of Desert Storm II starting on the shores of the Caspian over economic issues.

In addition to traditional motives, the oil and gas treasures lying under and around the Caspian Sea have generated a host of unusual foreign geo-strategic military and investor moves that have fueled Russian suspicions. One of the most bizarre stories postulated that Princess Diana was planning to marry Arab Dodi al-Fayed as part of a long-term British investment plan for the region. She would convert to Islam after the marriage and, through her public image, be exploited to raise money. The Princess would support a Chechen plan to lease an oil line to the British in exchange for an investment fund to help restore Chechnya's badly damaged economy. British Secret Services got whiff of the plan, as this preposterous story goes, and helped to arrange Princess Diana's death.⁵

Yet another oddity demonstrating the complexities of the region is the policies of the US Congress and the current administration. The 105th Congress moved to ease the provisions of Amendment 907 of the Freedom Support Act of 1992, which allows aid to all of the 15 former Soviet republics except Azerbaijan. The 105th sought to allow the government of Azerbaijan to deal directly with the Export-Import Bank, the Overseas Private Investment Corporation and the Trade and Development Agency. As one analyst noted, "Washington has two foreign policies toward the region, one pro-Azeri, the other anti-Azeri. The pro-Azeri policy belongs to the administration, which listens to the oil companies. The anti-Azeri policy belongs to Congress, which listens to the Armenian lobby."⁶ Perhaps, however, the situation is more ambiguous than this statement implies. As but one example, oil companies, regardless of administration policy and investment potential, are not excited at the moment over the cost of pipelines and associated political and security issues.

For the current US administration, the problem is not Azerbaijan but how to deal with Iran. The Iran-Libya Sanctions Act (ILSA) places Iran's oil and gas sector off limits to US companies, but the US government cannot impose the same sanctions on Russian or European dealings with Iran. Such acts as the ILSA can thus: limit the effectiveness of US policies, harm US interests and ability to isolate such problem states, and directly harm US business interests.

Finally, there is the question of the status of the Sea itself. Is the Caspian Sea a lake or a sea? The Russian Ministry of Foreign Affairs (MFA) sought to prevent the Sea from being divided into national sectors as proscribed by the United Nations Law of the Sea Convention because some of the Sea's richest deposits did not lie in its sector. To achieve this end, the MFA initially argued that the Caspian is a lake and not a sea in order to gain access to the richer oil deposits (since the Caspian basin would be treated as common economic property to its littoral states if it was considered a lake and not a sea). Russia battled with the international community over this issue. This position changed in November 1996 when Russia proposed a 45-mile coastal zone, beyond which there would be a condominium approach to the problem.⁷ Of course, this line of reasoning has several different implications for pipeline developments. Russia has since changed its position again. It signed a bilateral agreement with Kazakhstan in which the sides decided jointly to divide up the sea bottom but not the column of water above the bottom.⁸ The current volume of offshore investment and exploration by Azerbaijan, Turkmenistan and Kazakhstan testifies to

the defacto resolution of this matter in favour of the national sector community. Iran is the only remaining dissenter in any serious way in this regard and, like Russia, has the least prospective offshore holdings.

Russia's Objectives in the Caspian-Caucasus Region

Russian policy must take into consideration the new realities of the situation in the Caspian. Leaders recognize that Russian influence has declined precipitously and Russian oil and gas firms need Western technology to get to both Caspian and Siberian resources. Russia also recognizes that the Caspian grows in importance as the Siberian fields decline in importance, especially since gas and oil account for 40-45 per cent of Russian export earnings. However, it also must be remembered that the majority of Russia's reserves lie not in these two areas but on the shelves of the Barents and Karelian Seas.

Russian leaders recognize that US and Turkish influence has increased greatly and that these countries now threaten Russian interests in the Caspian. Some of the littoral states not only want Western technology and investments but also a Western presence as a counterbalance to any potential Russian interference. Strangely, however, there appears to be no singular, coordinated Russian policy pursued in this region. Rather, different ministries are pursuing different policies. The Ministry of Defence and Ministry of Foreign Affairs are focusing on security interests in the area while the Ministry of Fuel and Energy is evaluating economic interests that include foreign investment and trade opportunities.⁹

Generalizing, however, it is possible to identify several overarching objectives that appear to support the positions of all the ministries: first, secure a friendly buffer zone to ensure Russia's security and geopolitical interests; second, ensure stability in the region to avoid ethnic tensions from spilling over into Russia or causing border tensions (for example, the Lezgins of Dagestan have indicated a desire to unite with Azerbaijan); third, maximize the economic benefits from Azerbaijan's substantial oil and gas deposits if possible; fourth, dismantle US power in the region; fifth, weaken the re-emergence of OPEC; and finally, strengthen ties with Iran and join the Caspian via a pipeline with the Persian Gulf.¹⁰ The policies and actions of former CIS economic tsar and long-time Yeltsin supporter, Boris Berezovskiy, have further reinforced these objectives. Berezovskiy has tried to support both his personal and Russian ministerial interests in the region.

Possible strategies to attain these objectives include treating the Caspian Sea area as a zone of Russian interest or influence (in the psychological or ideological sense); penetrating the littoral states from the inside (using the Russian private firm Lukoil or another firm to negotiate favorable agreements with a littoral that the Russian government cannot achieve); using local conflicts to their advantage; or producing legal and other obstacles to prevent new competitors from participating in foreign investments in the Caspian region. For example, Russia could attempt to block any pipeline linking Azerbaijan with Kazakhstan or Turkmenistan, or a Baku-Ceyhan (Turkey) pipeline. Another obstacle would be the effective blocking of the Volga-Don canal. This system is a low volume seasonal link between the Caspian and Black Sea leading into the internal European waterway system. This is literally the only ingress for over-sized offshore drilling rigs and other support equipment for the Caspian. One Russian analyst theorized that

blocking this system would provide a military response to problems not solved to Russia's satisfaction in the Caspian region. During the 1995-96 war with Chechnya, the Russian government closed the Volga-Don canal to ships sailing under the Azerbaijani flag. Russia now limits transit to Azeri vessels citing the unresolved status of the Caspian. Russia has indicated a willingness to sign documents with Azerbaijan over the "question of maintaining joint use of the Caspian Sea's water surface and water mass for purposes of ensuring freedom of navigation and compliance with uniform standards of fishing and environmental protection."¹¹

Russia has entered into various alliances with the new states of the region to accomplish these goals. Some have proven to be much more useful than others. Armenia, for example, willingly invited Russian military forces into its territory in 1993. These forces, which include T-72 tanks, armored personnel carriers and artillery and antiaircraft systems, are viewed as Armenian trump cards in relations with Turkey and Azerbaijan, Armenia's external threats. Azerbaijan President Haydar Aliyev promised to co-operate closer with Russia than had his predecessor, and even approved Lukoil's 10 per cent stake in the Azeri-Chirag-Guneshli project (lately, however, tension has increased as Russia has supported opponents to Aliyev. Rumors suggest that on two occasions Russia tried to have Aliyev killed).¹²

Unfortunately, Russia's war with Chechnya did little to further Russia's goals in the region. The prestige of its military plummeted, as did its control of the pipeline that passes through Chechen territory. With its military policy marginalized, however, Russia's energy policy gained more and more influence within the Chechen government, a policy pursued by media and oil magnate Berezovskiy. Thus, even in this dark period a glimmer of light appeared, but to the credit of big business and not the military.

The military has, however, remained active in the area. The headquarters for a joint Ministry of Defence force was formed in Kaspiysk, Dagestan in December 1998. It consists of the 136th Motorized Rifle Brigade (garrisoned in Buynaksk), ships of the Caspian Flotilla, Army aviation and airborne sub-units. Future plans are to build a naval base that consists of small air-cushion vessels and marine infantry sub-units in addition to coastal units. This joint force is reinforcing the main Russian naval base located at Astrakhan.¹³ Russia looks at the military factor as a potential trump card in protecting vital economic interests in the region. Providing security for Dagestan and the Caucasus helps insure that some oil will flow through Russian territory,¹⁴ but this will remain a difficult task. For example, in June 1999, Russia's Fuel and Power Minister, Viktor Kalyuzhny, noted that the Baku-Novorossiysk pipeline must be closed due to the constant interruptions in the Chechen stretch of the pipeline. Some twenty illegal taps were reported in the section managed by Chechentransneft (the Chechen Petroleum Transportation net). Russian authorities have recommended building a separate pipeline through Dagestan to get around Chechnya or to move oil by rail through Dagestan.¹⁵ For this reason, the recent fighting in Dagestan against Chechen rebels may even put this policy on hold.

There are, of course, several risks associated with any policy involving oil and this region in particular. Pipeline breaks and intelligence bluffs over the true nature of oil, gas and even water reserves are but two of the oil risks. Paradoxically, Russia cannot afford to leave the region due to its geo-strategic and economic importance yet has dwindling means to keep itself there. If it does leave, its influence in the Islamic world would suffer; Russian exports of oil and natural gas

(and subsequent cash flows) may go elsewhere; and Russia's ability to hold onto Dagestan could be strained. Russian claims of US interference in the construction of a Turkish-Russian gas line between Ankara and the southern Russian gas plant of Izobilnoy exacerbate these strains even further.

Extraction and Ecological Difficulties

For Russia to be a player in the region, it must be able to exploit the oil and gas resources that lie beneath the earth's crust. The extraction of these deposits in the Caspian Sea basin has always been very difficult. There are three frequently cited Russian reasons that underscore the difficulty of extracting oil from the Caspian. First, there are qualitative difficulties with the oil itself. It is reported to have a high sulphur content which "requires additional financing for expensive corrosion-resistant pipes for transport."¹⁶ This particularly applies to Kazakh oil, with Azeri oil being sweeter and requiring less cleanup. Second, the Caspian is an enclosed sea that is located far from the centers of its consumption. Long transport distances affect the final price of the oil. Pumping one ton of Persian Gulf oil costs an average of \$2-\$5, North Sea oil costs \$10 while Azerbaijani oil cost \$17. It costs \$35-\$45 a metric ton to get oil out of Siberia. Thus, Caspian markets are twice as cheap as Siberian markets, so it is clear why Russia fears the loss of cash revenues if both are exporting to the same markets. Finally, the Caspian Sea sits in an area beset by severe weather and climatic conditions, where some of the most severe storms on the continent occur. Russians claim that this area is second only to Siberia for difficulty in extraction.¹⁷

It is difficult to determine the energy reserves of each state located on the shores of the Caspian. One reason for this is the different ways countries apply the factor of geological and technical risk to assessing the potential yield of categories of petroleum reserves. According to one late 1998 Russian article, Turkmenistan has 6.5 billion tons of oil and 5.5 trillion cubic meters of gas (fourth in the world in terms of explored gas reserves), Kazakhstan has 6 billion tons of oil and 2 trillion cubic meters of gas, and Azerbaijan has 3.5-5.0 billion tons of oil and 600 billion cubic meters of gas. Russia's oil reserves amount to 1 billion tons, not counting a January 1998 discovery of a field with the potential to yield some 600 million tons.¹⁸ Before the fall of the USSR, all of these resources belonged to Russia. Now it is the poorest client among the littoral states.

The Caspian Sea, in addition to its rich oil and gas deposits, is the breeding ground and home of the Beluga sturgeon, which produces the world's most valuable caviar. It comes as no surprise that Russia and Iran are the countries most often trading in caviar since they have been the Caspian's proprietors for the past century. The sturgeon is a prehistoric fish (having evolved over 250 million years ago) that reportedly can live to be 150 years old, and weigh up to 2,500 pounds. The Russian-Kazakhstani agreement signed in July 1998 to divide resources in the oil-rich Caspian had a hidden agenda to help sturgeon fishermen. The agreement divided the seabed between Russia and Kazakhstan but kept the waters above the seabed open for fishing and free navigation. This was an important concession for the sturgeon trade of both nations. Before the agreement, poachers had illegally fished approximately 90 per cent of the sturgeon catch.

Supply can not keep up with demand, however, as the stocks of sturgeon are declining for reasons other than poaching. These reasons include the damming of rivers that reduce vital spawning grounds, pollution from industry, oil production, the destruction of natural waterways and habitats, and the new role played by organized crime in the sturgeon market.¹⁹ It is estimated that the sturgeon population has plummeted by some 50-70 per cent. This creates a serious threat to the world's supply of caviar, since some 90 per cent of supplies to the caviar market comes from the Caspian Sea from just three species of sturgeon: the Giant Sturgeon (beluga), the Russian Sturgeon (*Acipenser Gueldenstaedti*) and the Stellate Sturgeon (*A. Stellatus*).²⁰ The Laboratory on Ecology of Anadromous Fish of the Caspian described the state of sturgeon breeding as "catastrophic." At the traditional spawning grounds near the Volga water basin, they did not find a single spawn of roe as very few breeder fish were able to make the journey from the Caspian to the Volga due to dams, poachers and so on.²¹ The disappearance of the sturgeon will also cause the disappearance of traditional fishing villages. According to one sad report, local fishermen are forced to poach since the government is not paying current or back wages. Even law enforcement agencies, the report adds, are turning a blind eye.²²

Russian View of the Littoral States

Turkmenistan

Russia has formulated three objectives in dealing with Turkmenistan. First, it must protect the interests of the 400,000 Russians living there. Second, it wants to secure Turkmenistan's 2,472-kilometer border with Iran and Afghanistan, and maintain military facilities there. Finally, Russia wants to control Turkmenistan's export routes and profit from the domestic energy industry. President Niyazov has taken steps to try to improve relations between his country and Russia, which were somewhat strained over economic policy differences. In 1994, Russia and Turkmenistan negotiated an agreement on dual citizenship (the only one in the CIS) but this issue has remained dormant ever since the agreement. There are now some 15,000 Russian troops on the Turkmenistan border with Afghanistan and Iran to combat drug smugglers and to counter the flow of refugee and Islamic fundamentalists into the country. The Russian military controls borders and some air defence facilities. The earlier agreement on a joint Turkmen-Russian military command was abrogated in 1994. Technically, there are no Russian forces left, just some ethnic Russian officers in the Turkmen pay.²³ Finally, in 1995, Russia's Gazprom and the Turkmen government formed the Turkmenrosgaz Joint Venture (JV) to develop, market and export gas reserves from the Republic.²⁴ Gazprom would not ship Turkmen gas, however, due to differences over transit fees and Turkmen exports in the late 1990s dropped to a trickle. In late 1998, Gazprom forced Turkmenistan to accept its terms to transport gas to Ukraine.

Russia does maintain some interest in Turkmenistan's ethnic Russian community, but this policy appears to be more declaratory than many would care to believe. Recently, Turkmenistan became the first CIS country to impose visa requirements on citizens of other CIS countries.

Kazakhstan

Kazakhstan has a developed economic and industrial infrastructure most of which lies adjacent to Russia's borders. Its population is also some 35 per cent Russian, with the majority of

Russians living in the north and Kazakhs in the south (more than 500,000 Russians left the country between 1989-1995 and Kazakhstan does not allow dual citizenship). These factors have kept the two countries relying on each other for years. Its centralized pipeline system has made it dependent on Russian goodwill for the Caspian Pipeline Consortium (CPC) project but not over other projects. Russia has utilized a quota system to maintain control over both Turkmenistan and Kazakhstan. In 1995, for example, Russia allowed Kazakhstan to export only 70,000 barrels of oil per day through its national pipeline system, Transneft. This was a major constraint on the Tengizchevroil JV (composed at the time of Chevron, US and Tengizmunaigaz), since the field potential is 90,000 barrels a day (a US estimate is that it exceeds 700,000 barrels a day). In 1996, the CPC gave an increased share of the consortium to Russia. Russia then allowed some 100,000 barrels of oil a day in the pipeline since it was now highly profitable for Moscow.²⁵

Azerbaijan

The political battle over the Caspian began with a confrontation in April 1994 among Azerbaijan, Britain and Russia. Russia viewed a pending agreement between the UK and Azerbaijan as infringing on its national interests. This situation was exacerbated in November 1994 when the Azerbaijan International Operating Company's (AIOC) plan to develop three oil fields located near the center of the Caspian (the Azeri, Chirag and Guneshli fields) was ratified by the Azeri parliament. However, in spite of subsequent concessions made to Lukoil, the relationship is far from perfect. Recent arms shipments by Moscow to Armenia have made the Azeris uneasy.²⁶ Opinions differ on whether the US wants Russia in or out of any arrangement between Baku and Ceyhan. Moscow will look in the same fashion on the statement of Azerbaijan's presidential adviser for foreign policy, Vafa Guluzade, on 18 January 1999, in which he called for expanded security co-operation with the west (and even proposed a military base in Azerbaijan for the US, Turkey or NATO).²⁷

Pipeline Decisions

Initially, there were at least nine routes under consideration to move Caspian oil out of the area. These-were:

1. Kazakhstan to the Russian Black Sea port of Novorossiysk (two branches, one avoiding Chechnya and one including it, the CPC route)
2. Baku (Azerbaijan) to the Turkish Mediterranean port of Ceyhan
3. Baku to the Georgian Black Sea port of Supsa
4. Baku to the Georgian Black Sea port of Batumi
5. Kazakhstan to Baku (one route directly across the Caspian and one through Turkmenistan)
6. Kazakhstan to the Persian Gulf
7. Turkmenistan to Afghanistan to the Persian Gulf (Central Asian route)
8. Baku to Novorossiysk (through Chechnya).
9. Kazakhstan to China.

A Turkmenistan-Ceyhan route is also under discussion, either trans-Caspian or via Iran.

The Caspian Pipeline Consortium's favorite route appears to be moving toward implementation, to Russia's delight. This is acceptable to Russia for a host of reasons. First, all CPC members have agreed to pay Russian transit fees whether oil is shipped or not, acting as an incentive to members to use the route. Second, during the initial operation of the route, Russia is allowed to ship eight million tons of oil a year (of a total capacity of 28 million tons) through the pipeline, and if they lack enough Kazakh crude, they can substitute oil produced in Russia. Finally, Russian companies hold 44 per cent of CPC, ensuring a large cash return on their investment. When operating at full capacity, this should mean some 20 million tons of oil are pumped per year (out of a total capacity of 67 million tons) to Russia's Novorossiysk port. The existing portion of the CPC pipeline, which will feed into new construction, is only ten years old, a fact which should help investor confidence in the project. However, the shaky financial situation in Russia, and the potential for unrest during the upcoming presidential elections, have Kazakhstani officials looking for alternate routes for their crude to loosen their reliance on Russia as its sole outlet.

The other pipeline option that continues to demonstrate its resiliency is the Baku-Ceyhan route. Richard Morningstar, the US Ambassador to the Caspian Basin, noted in late December 1998 that the pipeline will be built but it is not clear when, 2002, 2004 or 2006. It took a long time, however, to determine just oil availability, commercial incentives, and even construction subsidies offered by the pipeline's transit governments. Turkey and Azerbaijan finally signed an intergovernmental agreement in support of a Baku-Tbilisi-Ceyhan route in November 1999. Those states must now work out an agreement with Georgia. Kazakhstan and Turkmenistan are also working on an agreement to allow oil to flow across the Caspian and into the Baku-Ceyhan pipeline.

At the present time, in addition to the CPC arrangement, Lukoil's share in the oil contracts in the area- are:

- 'Contract of the Century' agreement in 1994 left Lukoil with 10 per cent in the deep water part of Guneshli
- Karabakh arrangement in 1995 left Lukoil with 7.5 per cent, Lukoil-Agip with 50 per cent
- Shahdeniz arrangement in 1996 left Lukoil with 10 per cent

US Views of the Russian Position

Russia does not have significant hydrocarbon resources in the Caspian region in comparison to the three Caspian littoral states actively producing and exporting oil from the region:

Kazakhstan, Azerbaijan, and Turkmenistan. The issues for Russia are competition and control over transportation of oil and gas to market. The Caspian has been compared to the North Sea in size of petroleum holdings. It is credited with 20 to 40 billion barrels of proven oil reserves with up to 70-150 billion barrels possible (approximately four per cent of total world reserves). This pales in comparison to Russia's massive Siberian reserves bordering on 200 billion proven barrels. However, with the development of transportation solutions to extraction of high quality Caspian oil, Russia will no longer hold a monopoly on oil flow from Central Asia. The CPC is issuing permits and will begin construction in 1999 to transport oil from the giant Tengiz fields

in Western Kazakhstan. Other routes are being completed or planned from Baku for Azeri offshore oil into Georgia and western markets. Hence, Russia's concern is for controlling the competition for petroleum to the West.

Russia has tried several approaches to controlling competition. Russia has successfully used economic collaboration as a tool. For example, the inclusion of Lukoil into the AIOC signalled Russia's willingness to join the commercial exploitation of offshore Azeri resources. Russia is an essential partner in the CPC, contributing existing pipeline and communications infrastructure and work force to the proposed 1500-kilometer pipeline from Tengiz to Novorossiysk on the Black Sea. At the same time, Russia has applied coercive tactics within the region to achieve her objectives. Russia has dragged her feet on acquiring transit permits for the CPC, acceding to demands for higher regional taxes on the pipeline and trying to pass these costs on to the consortium. In addition, Russia continues to compete with alternative routes out of Baku for Azeri offshore oil and to deal with issues of stability in Georgia/Abkhazia, Nagorno-Karabakh and Chechnya. Each requires a different approach, depending on the impact on Russian economic objectives and political hegemony.

There are larger issues for Russian energy and geo-political policy beyond the Caspian. Russian oil production has been falling for ten years and some Russian policy representatives, such as former Deputy Prime Minister Yuri Maslyukov, forecast that Russia could become a net importer of oil. Russia should take a page from Kazakhstan's book on developing hydrocarbon resources. Kazakhstan began to work with Chevron in the late 1980s, before the demise of the Soviet Union. They set up the foundation for a collaborative enterprise that has led to colossal expenditures on the part of Western commercial oil companies to rebuild and create infrastructure for the extraction and transport of oil out of Western Kazakhstan. Russia fears Western exploitation and control of her energy sector. The New Production Sharing Agreement (PSA) legislation was written in 1995 but it was still so constrictive that not a single PSA was signed since that revision. The Yeltsin administration has finally recognized the dire straits that Russia's energy industry finds itself in and has re-written the PSA legislation again, in January 1999, with the hopes of attracting desperately needed capital to this critical industry. The Caspian region will not be significant if Russia cannot solve the critical modernization and technological problems of this evolving area. There are other issues related to restructuring public-private energy firms and modernizing transportation facilities. Fully 40 per cent of the pipe in Russia's national oil pipeline company, Transneft, has exceeded its planned service life and the system currently is only operating at 50-60 per cent capacity. Government ownership of oil companies is a huge issue with complex ramifications for modernization and export capacity.

Recommendations and Conclusions

For Russia, the Caspian Sea region offers the government a unique challenge. In an area that once was totally under its influence, Russia now finds itself marginalized and unable to employ the brand of power politics and party brokering to keep its leadership intact. Yet in spite of this situation, Russia cannot abandon the area for a mixture of geo-strategic, political, economic and ecological reasons. Particular focus remains on Chechnya, as any attempt by Chechen rebels to expand their area of influence into neighboring Dagestan will greatly limit Russian access to the Caspian Sea and weaken the security of its south-western flank. Others agree with this

assessment. For example, US former Secretary of State James Baker noted that the Caspian is not an economic or geological or engineering problem, but a geopolitical problem of the first magnitude.

Some Russian analysts believe that workable options to meet the challenges presented above include:

- Ensure access of the region's energy resources to the world market: force the construction of the Tengiz-Novorossiysk CPC main pipeline; step up construction of a pipeline that bypasses Chechnya; and declare the Baku-Ceyhan projects for access to Caspian energy unacceptable. Use all means to remove the Turkish route: political-economic pressure on neighbors, diplomatic maneuvers, stepping up information-psychological influence on ethnic Russians outside the boundaries of Russia, support of national-liberation movements in the Transcaucasus and in the near East, closure of traffic along the Volga-Don waterway system; exploit age-old and irrefutable antagonisms between certain western participants in the Caspian Pipeline Consortium, which present the Russian Federation with a very broad field for maneuvering.²⁸
- Address and resolve foreign political problems: Russia must develop a unified strategy for its numerous power ministries and infrastructures with big business; support international organizations and groups in the Commonwealth of Independent States (CIS) that have a pro-Russian sentiment, and support the 'enemies of our enemies' in the Near and Middle East and in South Asia; establish an alliance or relationship with Iran, India, Iraq and China to counterbalance Western organizations; and re-channel efforts aimed at CIS integration (excluding Azerbaijan at the present time).
- Redefine the critical geo-strategic aspects of Russian's national security: establish a limit on what Russia will or will not permit on Russia's southern boundaries and pay more attention to this area; develop a system to oppose threats and establish a method to measure degrees of risk from the south; and put the nation's 'southern policy' in the country's national security concept.²⁹

Historically, more wars have been fought on Russia's southwestern axis than on any other two axes combined. Therefore, the outbreak of a new conflict here would not be surprising. However, Russia can ill afford even a limited conflict. Its prestige is already at an all-time low in the region. What it needs is enlightened diplomacy and some far-sighted politicians who can visualize the region 25 years in the future and construct policy today to meet that vision. This is particularly important since up front money put into oil extraction procedures will only yield a return on investments after 35-40 years. Long-term strategy and stability thus remain essential components. Without them, Russian influence in the region may fall too far behind to be of any concern to the other littoral states in the coming years.

End notes

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