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The Caspian Basin, energy reserves and potential conflicts

Five states surround the Caspian Sea in the Caucasus: Iran, Azerbaijan, Russia, Kazakhstan and Turkmenistan. These littoral states – commonly known as the Caspian Basin countries – have interested international policy and energy analysts in recent years, particularly since the demise of the Soviet Union in the early 1990s.

This Paper discusses potential conflicts which might arise in the Caspian Basin as the exploitation of oil and gas resources interrelates with existing geopolitical and domestic tensions. The focus is particularly on the emerging post-Soviet states of Azerbaijan, Kazakhstan and Turkmenistan. Iran and Russia are considered in respect of their Caspian neighbours and wider international affairs.

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Summary of main points

The Caspian Sea is the largest land-locked body of water in the world and is surrounded by Iran, Azerbaijan, Russia, Kazakhstan and Turkmenistan – the Caspian basin countries. (See Maps, Appendix 2) In 2000 the international importance of the Caspian basin was set out in a report by a bipartisan group of influential Americans entitled “America’s National Interests”.

... The most promising new source of world [energy] supplies is the Caspian region, which appears to contain the largest petroleum reserves discovered since the North Sea. This geopolitical crossroad, which includes Iran, Russia, and a number of newly-independent states struggling with post-Soviet modernization and dangers of Islamic extremism, demands more attention by American policymakers.¹

In addition, separatist disputes and more recently nuclear ambitions have emerged as factors of pressing significance at that “geopolitical crossroad”. The conjunction of these elements, it is argued, makes the region susceptible to instability.

The competing interests of the littoral states and the larger international considerations is evident on the Sea itself, which though traditionally dominated by Russia’s Caspian Flotilla, was used for joint US-Azerbaijan exercises involving Azerbaijan patrol boats in 2003 and 2004. As one observer put it, “Russia as the major power broker in the Caspian Sea, clearly sees itself - not the USA - as bearing the security burden. Certainly Iran would prefer a Caspian dominated by Russia to further US encroachment in the region.”²

Azerbaijan, Russia, Kazakhstan and Turkmenistan are all successor states to the Soviet Union and, together with Iran, have a claim to the hydrocarbon (oil and gas) resources under the sea bed as well as to their own ‘on-shore’ reserves.

Iran is the only one of the five with access to the Persian Gulf and Arabian Sea ports, although, since the mid 1990s it has been subject to a US embargo under the Iran and Libya Sanctions Act, which has hindered its development and integration into the global economy, and affected its regional political relations.

¹ “A Report from the Commission on America’s National Interests” (2000). The Commission was organized by the Belfer Center for Science and International Affairs at Harvard University, the Nixon Center and the non-profit making RAND Corporation. The members of the Commission were Graham T Allison, Richard Armitage, Robert Blackwill, Laura Donohue, Jeffrey Eisenach, Robert Ellsworth, Richard Falkenrath, David Gergen, Andrew Goodpaster, Bob Graham, Jerrold Green, Rita Hauser, Arnold Kanter, Geoffrey Kemp, Paul Krugman, John McCain, Sam Nunn, Condoleezza Rice, Pat Roberts, Dimitri K Simes, Paul J Saunders, Brent Scowcroft, James Thomson

² John Donaldson, *Jane’s Intelligence Review*, Vol 16, No.5, May 2004
http://jir.janes.com/docs/jir/search_results.jsp

Azerbaijan on the western coast of the Sea, and its neighbour Georgia, are geographically vital in linking the Caspian Sea to Turkey's Mediterranean coast, without traffic having to pass through Russia.

Russia, bordering the Caspian and the Black Seas, sees its traditional control of export of oil and gas, and other products, being eroded, and its historical sphere of influence weakened.

Kazakhstan is a huge fuel-rich country with a border that touches China; and Turkmenistan, though the least able currently to develop its resources, has strategically important borders with Iran and Afghanistan and a close relationship with the latter.

The new-found independence of the Soviet successor states and the world's future energy needs came together by the mid 1990s to provide the opportunity to renew the exploitation of rich sources of gas and oil in the Caspian basin. However, the energy reserves were some distance from their potential markets and transport infrastructure was poor. The introduction of safe routes to Europe and America would end Russia's monopoly on transport, and reduce dependence on the Bosphorous and Dardanelles waterway; and the fuel needs of Pakistan, India and China with their rapidly growing economies, could be addressed.

Afghanistan was at one point considered by the United States as a promising route for transporting oil south. Kazakhstan, with its eastern border abutting China, is becoming a considerable source for that huge country. Azerbaijan is now host to the largest energy infrastructure project in the world, the BTC pipeline, taking fuel west. The effects of this development potential on Kazakhstan, Azerbaijan and Turkmenistan, vary considerably depending on their historical, geographical and political complexions. Azerbaijan is a Council of Europe member state (as is Russia) and the stability of the regions is becoming of increasing interest to the European Union.³

Then there is the related factor of internal instability, arising from demands for autonomy or self-determination in some states, from human rights abuses and possibly from Islamic fundamentalism. For example Georgia's domestic conflicts with rebels may spill over to its neighbour, Azerbaijan; Azerbaijan itself has its longstanding, devastating and intransigent dispute with Armenia over the enclave of Nagorny-Karabakh, both countries looking for support from the US; and there is the violent Chechnya conflict which Russia has attempted to resolve militarily despite international condemnation. Turkmenistan has close relations with Afghanistan, is the least susceptible to western influences, and has been the subject of the most serious criticism for torture and corruption. Iran, also under scrutiny for human rights abuses, is currently at the centre of international disagreements about its nuclear programme.⁴

³ For example see the Council of Europe Parliamentary Assembly document, 'Europe and the development of energy resources in the Caspian Region' by Bernard Schreiner, No. 9635, 12 December 2002

⁴ For a full discussion of Iran's nuclear programme see Library Standard Note SN/IA/2688

In 2004 a wide-ranging analysis of the Caspian's resources and boundaries, written by John Donaldson, appeared in *Jane's Intelligence Review*.⁵ This Paper draws considerably on this work in discussing the potential conflicts arising in the region as the exploitation of oil and gas resources interrelates with existing geopolitical and domestic tensions. The focus is particularly on the emerging post-Soviet states of Azerbaijan, Kazakhstan and Turkmenistan, but the paper refers to Iran and Russia in respect of their Caspian neighbours and wider international affairs.

⁵ John Donaldson, *Jane's Intelligence Review* Vol 16, No 5 May 2004
http://jir.janes.com/docs/jir/search_results.jsp John Donaldson is research associate with the International Boundaries Research Unit, Department of Geography, University of Durham

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I The Caspian Basin and the Cheney Report

The US government's National Energy Policy report published in May 2001 addressed the future energy needs of the United States, predicting its own and other major energy consumers' needs by 2020. By then, China's import of oil is expected to increase at least fivefold. The scale of the US shortfall in gas and oil is set out starkly:

Over the next twenty years oil consumption will grow by over 6 million barrels per day. If US oil production follows the same historical pattern of the last ten years, it will decline by 1.5 million barrels per day. To meet US oil demand, oil and oil products would have to grow by a combined 7.5 million barrels per day. In 2020 US oil production would supply less than 30 per cent of US oil needs.

Over the next twenty years US gas consumption will grow by over 50 per cent. At the same time US natural gas production will grow by only 14 per cent, if it grows at the rate of the last ten years.⁶

The Cheney Report recommended diversity of types of energy and of sources, in order to maintain continuity of supply in the event of disruption; it expanded on the support to be offered to the Caspian basin countries, begun under the previous American administration. The report's recommendations for the Caspian included:

supporting the Baku-Tibilisi-Ceyhan oil pipeline as it demonstrates its commercial viability

working to establish the commercial conditions that will allow oil companies operating in Kazakhstan the option of exporting their oil via the BTC pipeline.

encouraging Greece and Turkey to link their gas pipeline systems to allow European consumers to diversify their gas supplies by purchasing Caspian gas.

deeper commercial dialogue with Kazakhstan, Azerbaijan, and other Caspian states to provide a strong, transparent, and stable business climate for energy and related infrastructure projects

US policy in the region, particularly in relation to Kazakhstan and Azerbaijan, has advanced the recommendations.

Some commentators question the long term stability of the Caspian:

⁶ <http://www.whitehouse.gov/energy/National-Energy-Policy.pdf> The National Energy Policy Development Group was chaired by the Vice-President, Dick Cheney, formerly chief executive of Halliburton, the oilfield services company. The Report is widely known as the Cheney Report.

Before leaving office, [President Clinton] flew to Turkey to preside at the signing ceremony for a regional agreement permitting construction of the \$3 billion Baku-Tbilisi-Ceyhan (BTC) pipeline.

The White House has high hopes for the development of Caspian Sea energy supplies, but many obstacles remain. Some of these are logistical: ...Other obstacles are political and legal: the authoritarian regimes that predominate in the former Soviet republics are riddled with corruption and reluctant to adopt the legal or tax reforms needed to attract large-scale Western investment. But when all is said and done, the major problem facing the US is that the Caspian basin is no more stable than the Persian Gulf. Any effort to ensure the safety of energy deliveries will require the same sort of military commitments that the US has long made to its principal energy suppliers in the gulf.⁷

II The Division of the Caspian Sea

Quite apart from the legal question of whether the Caspian is a sea or a lake, the division of the Caspian Sea's resources below the sea bed, and the surface area, has been a complicated and drawn out procedure. Attempts at getting multilateral agreements over the years have failed, and a Special Working Group has been meeting periodically to try to reach agreement on the status of the Sea.

However, Russia has taken the lead on forging individual agreements with other states in the absence of progress in multilateral negotiations between the littoral states. Between 1998 and 2003 Russia, Kazakhstan and Azerbaijan have negotiated bilateral agreements of their own and signed up to a division of resources based upon the principle of median delimitation lines of the seabed in the northern Caspian. (A median delimitation line runs "between two coastlines situated either opposite or adjacent one another, every point of which is equal distance from the closest points of the respective coastlines"). Three disputed hydrocarbon fields on the median line are to be divided between Kazakhstan and Russia on an agreed basis.

These agreements apply to the sea bed and do not affect the surface.

The effect of the bilateral arrangements has been to divide the Caspian de facto into two zones – north and south. In the southern zone, Azerbaijan, Turkmenistan and Iran are still in discussion about the seabed boundaries and division of resources. There are disagreements between Azerbaijan and Turkmenistan over three hydrocarbon fields, situated in the middle of the Caspian between the two coastlines. Likewise Turkmenistan has been reluctant to negotiate with Kazakhstan, but it is thought that these obstacles can be overcome and that the median seabed solution will be adopted. Iran has so far opposed any solution along these lines, supporting a division of the Sea into equal parts.

⁷ Michael Klare, "US: Procuring The World's Oil", *Foreign Policy in Focus*, 28 April 2004

The median line principle gives Kazakhstan 29 per cent, Azerbaijan 20 per cent, Russia 16 per cent, Turkmenistan 21 per cent and Iran only 14 per cent of the seabed.

The status of the surface of the Caspian is subject to different principles, on which there is not yet formal unanimous agreement. Russia's position had been that the surface should be held in common, which in practice would have given that country, with the superior military power on the Caspian, effective control. But according to John Donaldson of Durham University "a general consensus has emerged whereby the five states agree that some central portion of the Caspian Sea should be held in common. Each state would have control over what has been termed 'national' or 'coastal' zones extending from their respective shores. The extent of these 'national zones' has become the central topic of debate. Russia advocates a relatively narrow national zone of perhaps 15 nautical miles (nm) while Azerbaijan and Kazakhstan both would prefer the zones to extend up to 40nm. Iran maintains its position that the sea should be held in common, with the sea bed divided evenly." Donaldson argues:

This presents some very interesting security questions. Given that sea bed boundaries are defined along equidistance lines, there is the distinct likelihood that offshore drilling will occur beyond the as yet undefined 'national zones'. This could create a situation, for example, where Russian vessels patrol around an oil platform owned and operated by a US oil company contracted by Azerbaijan within the Azeri sea bed area. Needless to say, such scenarios are fraught with possibilities for conflict.⁸

III Iran

Geographically Iran plays a vital role in linking the Caspian Sea to the Persian Gulf – the only country in the Middle East to do so. It has a population of nearly 70 million, the large majority of whom adhere to Shia Islam, the official religion of Iran. Around 8-10 per cent are Sunni Muslim, with Zoroastrian, Jewish, Christian, and Baha'i communities forming small minorities. There is also a significant Azeri minority in the north-west, where Iran borders Azerbaijan.

Politically, Iran has the most sensitive relationship with the West, but particularly with the United States over the question of support for terrorist groups and the disputed development of its nuclear industry and its compliance with the terms of the Non-Proliferation Treaty. International pressure on Iran has increased following revelations in 2003 that it had failed to disclose the true extent of its nuclear programme. The resulting economic and diplomatic isolation by the United States was intensified by the US Government's *Iran and Libya Sanctions Act* of 1996.

⁸ John Donaldson, *Jane's Intelligence Review* Vol 16, No 5, May 2004

The nuclear programme enjoys broad support across the Iranian political spectrum and has come to be seen as a matter of national pride and a statement of the country's technological prowess.⁹ Support for a nuclear *weapons* programme appears to be more mixed, with advocates arguing that such a capability would help insulate Iran from US pressure and interference in its internal affairs. Critics fear it would lead to the country's international isolation and do little to increase its security.

In March 2004 the US decided to impose sanctions on Iran for a further year. Diplomatic efforts to resolve the dispute continue, led by three European Union countries (UK, France and Germany). In early 2005, the United States government increased its pressure on Iran, Vice-President Cheney declaring that Iran posed a threat to world peace and Middle East stability, accusing Tehran of sponsoring terrorism against Americans and building a "fairly robust new nuclear program."¹⁰ Statements from Dick Cheney and Secretary of State Condoleezza Rice in February 2005 appeared more conciliatory and stressed the diplomatic route to a solution.

Iran is a hugely oil-rich country, but production capacity, says the *International Petroleum Encyclopaedia 2004*, "has reached a plateau and production is on the wane." Oil and gas development in Iran's sector of the Caspian has been stunted, affected in part by the sanctions imposed by the United States. The effect has been to discourage American investment and cause Iran difficulty in attracting funds. Currently the main partners with National Iranian Oil Company are the UK, France, Norway, Malaysia and Tatarstan.¹¹

The Caspian energy potential has been managed in part by Iran developing facilities to 'swap' Caspian area crude coming from other Caspian countries, and exporting equivalent amounts from its Gulf terminals, with income accruing from transit fees and port charges.¹² Iran is extending an existing pipeline from the Caspian Sea to Tehran.

Iran also has substantial gas reserves and plans to export liquefied natural gas to India in 2007-08, as well as targeting Japan, South Korea, China, and Taiwan. It is an ambitious programme of development and progress is likely to be slow.

The country is the only one of the five littoral states not to recognise any of the boundary agreements so far achieved for the Caspian Sea. The country took the view that agreements with the Soviet Union in 1921 and 1935/1940 designated the Caspian Sea as a Soviet and Iranian lake. After the dissolution of the Soviet Union, Iran wanted the Sea to be held in common, and more recently argued that each state be allocated a 20 per cent share of the Sea.

⁹ For example, see Dr Ali Ansari's evidence to the Foreign Affairs Select Committee, 14 December 2004, HC36-ii

¹⁰ Reported in *Washington Post*, 21 January 2005

¹¹ *International Petroleum Encyclopaedia 2004 (IPE 2004)*

¹² *IPE 2004*, above

Despite its political and economic handicaps, Iran continues to promote itself as a transport route to the Persian Gulf for Caspian oil and gas (see below) but while the US sanctions remain in force for Iran, it is unlikely that substantial investment in pipelines will happen.

One of the effects of Iran's international isolation was that oil companies with interests in the burgeoning Caspian energy field began to look in the 1990s at Afghanistan as a route for oil and gas, a plan that was actively discussed during 1997-8 at a time when that country was under the control of the strictly Islamist administration. In December 1997 Taliban representatives were in Texas and Washington for negotiations with the oil consortium Unocal to build a pipeline across Afghanistan to Pakistan.¹³

However subsequent events, the emergence of Al Qaeda, and the instability of Afghanistan, meant that the focus of infrastructure development and transport of energy reserves moved to Azerbaijan, although a route south to supply the fast-growing demand from India and Pakistan would still make geographical sense and has not been ruled out.

IV Turkmenistan

At just over 300,000 square miles of largely subtropical desert, Turkmenistan has a population of approximately five million, predominantly Sunni Muslim people; it borders Kazakhstan and Uzbekistan to the North, Afghanistan to the southeast; and Iran to the south. With Iran it controls the southern end of the Caspian Sea shore.

Turkmenistan's oil production and reserves are modest but its gas reserves are considerable – the fifth-largest known reserves. The country, a republic of the Soviet Union from 1924, had been under the control of Russia since the late 19th century. The Soviet Union thus exploited its raw material resources for many years.¹⁴ Iran, Russia and Ukraine are the main importers of Turkmenistan's gas today. Gas and oil together comprised over 80 percent of exports in 2004 but Turkmenistan is heavily dependent on Russian pipelines to reach markets in Europe and in the post-Soviet years, as a result of obstacles imposed by Russia, and the relatively high cost of exporting natural gas via non-pipeline routes (because the liquefaction required is so capital intensive), its market declined dramatically.

Unlike its neighbour, Kazakhstan, Turkmenistan has found adaptation to post-communist conditions difficult, and has suffered a decline in the economy. Widespread internal poverty, foreign debt, and a command-style economy persist, and Turkmenistan has extensive debts which energy and cotton sales have failed to eliminate. Its economic figures are thought to be unreliable

¹³ Caroline Lees, *Daily Telegraph*, 14 December 1997

¹⁴ <http://www.state.gov/r/pa/ei/bgn/35884.htm>

In the words of the Council of Europe Special Rapporteur, “The oil and gas sector is entirely in state hands. President Saparmurad Nyazov, former Chairman of Turkmenistan’s Supreme Council and the country’s last First Secretary of the Communist Party (he is also called Turkmenbashi, i.e. the father of all Turkmen), is actively involved in the shaping of the national energy policy.”¹⁵ Turkmenistan’s gas options have also been hampered by the United States which has attempted to prevent a Turkmen gas line being built into Iran. The American company Unocal, which was interested in developing a route from Turkmenistan to India via Afghanistan and Pakistan, withdrew from the Central Asian Gas consortium for political reasons in 1998.

The analysis in *Faultlines of Conflict in Central Asia and the South Caucasus* - that “Russian efforts to increase regional economic integration could, if successful, keep these states from many of the potential involvements in the globalised economy...the states of the region will require fundamental – and probably painful – reforms before their economies can truly develop” - is particularly relevant to Turkmenistan.¹⁶ The relatively higher cost of exporting natural gas compared to oil militates against Turkmenistan’s economic progress.

Turkmenistan declared “permanent neutrality” in 1995, a position recognised by the UN. The Foreign and Commonwealth Office says of Turkmenistan that “it has an uneasy relationship with its neighbours, preferring to avoid regional co-operation. There is potential for serious regional disputes over water supplies, environmental issues, drugs trafficking and organised crime... Turkmen participation in international organisations has always been thin.”¹⁷

Prior to 11 September 2001, the Turkmen government worked closely with the Taliban government and was developing a cross-border trade with Afghanistan. President Niyazov refused to allow US forces to use its territory when Afghanistan was attacked in 2002, at a time when US bases were being established in Uzbekistan to the east.

President Niyazov’s presidency is indefinite, a decision which has attracted much discontent from opposition leaders in exile. His party, the Democratic Party of Turkmenistan, is the only party represented in the legislature. As a result of an attack on him in November 2002, potential opposition was thwarted in a ruthless manner. The government has full control of all media and restricts foreign publications. According to the US State Department:

Corruption continues to be pervasive. Power is concentrated in the president; the judiciary is wholly subservient to the regime, with all judges appointed for 5-year

¹⁵ Council of Europe Special Rapporteur, above

¹⁶ ed. Olga Oliker and Thomas S Szayna, *Faultlines of Conflict in Central Asia and the South Caucasus*, United States Army/RAND 2003

¹⁷ Foreign and Commonwealth Office Country Profile on Turkmenistan

terms by the president without legislative review. The president routinely dismisses cabinet members and other government officials on charges of corruption and they are subsequently tried in secret trials and frequently imprisoned or sentenced to internal exile. These dismissals, however, are often politically motivated and have little impact on the culture of corruption.¹⁸

Turkmenistan's lack of openness about its human rights practices, the autocratic nature of its government and essentially unreformed economic structures cause difficulties to the European Union and the United States to be wary. Human Rights Watch say of Turkmenistan that:

The regime of president-for-life Saparmurat Niazov is one of the most repressive in the world. It crushes independent thought, controls virtually all aspects of civic life, and actively isolates the country from the outside world. The perverse cult of personality around President Niazov dominates public life and the education system. Civil society, already on the brink of extinction, this year took another blow with a new law criminalizing involvement in unregistered nongovernmental or religious groups.... the human rights situation in Turkmenistan today is noticeably worse than it was a few years ago.¹⁹

Human Rights Watch criticise the approach of both the United States and the Soviet Union, the former "perhaps due to an unwillingness to jeopardize the corridor to Afghanistan and flyover rights granted by Turkmenistan"; while Russia "which enjoys a great deal of influence over Turkmenistan through economic leverage, softened its criticism of Niazov's regime."²⁰

V Azerbaijan

The state of Azerbaijan is surrounded by Russia, Georgia, Armenia and Iran, with a relatively small Caspian coastline. The country has two anomalous geographical areas: the Nakhichevan Autonomous Republic (population 295,000), which is separated from the bulk of Azerbaijan by southern Armenia giving Azerbaijan a tiny border with Turkey; and the 'enclave' of Nagorny-Karabakh, within the borders of and completely surrounded by Azerbaijan, which is predominantly Armenian-populated. The autonomy of Nagorny-Karabakh was abolished by Azerbaijan shortly after independence in October 1991. (Azerbaijan became the first Soviet republic outside the Baltics to declare its national sovereignty in 1988). This enclave is the subject of a protracted and currently unresolved dispute which has resulted in the closure of the Azerbaijani borders with Armenia, and of the Armenian border with Nakhichevan.

¹⁸ <http://www.state.gov/r/pa/ei/bgn/35884.htm>

¹⁹ Human Rights Watch *World Report 2005* <http://hrw.org/wr2k5/>

²⁰ Human Rights Watch, above

The late President Heydar Aliiev, who was chairman of the Azerbaijani KGB and head of the Azerbaijan Communist Party in the 1960s, transferred power before his death in 2003 to his son Ilham Aliiev by appointing him Prime Minister.²¹ Ilham Aliiev was himself First Vice-President of the State Oil Company of the Azerbaijan Republic in the 1990s. Presidential elections in October 2003 subsequently saw Ilham become President; though the standard of the elections was criticised by an Election Observation Mission of the Organisation for Security and Cooperation in Europe (OSCE) and the Council of Europe for instances of violence and excessive use of force by police, amounting to a pattern of intimidation against opposition supporters, journalists and others.

The Nagorny-Karabakh and Nakhichevan problems

Nagorny-Karabakh is the country's biggest internal political problem, but it has wider implications. Completely within Azerbaijan, the region has historically been a centre of Armenian settlement, but it is also regarded by Azeris as a cradle of their culture. The two peoples have different languages, religion and culture. Following an outbreak of hostilities in 1988 Armenians fled from the cities of Azerbaijan and Azeris from Armenia and the area around Karabakh. The conflict resulted in around 20,000 deaths. A cease-fire came into force in 1994 but the refugee problem which was created and the imposition of an Armenian buffer zone around the enclave are sources of great tension and further potential violence.

An expert on the Caucasus, Thomas de Waal, writes that:

The Armenian-Azerbaijani conflict may not have been one of the worst of modern wars but it has produced one of the worst peaces. In the post-ceasefire situation misery blankets the region. The most miserable people are surely the half a million or so Azerbaijanis expelled from the regions in and around Nagorny-Karabakh in 1992-94. Since then the situation has barely improved... In Armenia perhaps 80 percent of the population lives in poverty on less than twenty-five dollars a month. Emigration rates are catastrophic...²²

The less-publicised Armenian closure of its border with the isolated Azerbaijani province of Nakhichevan in 1991 has been disastrous for that region too, turning it, as de Waal describes, into "the ultimate dead end, as remote as Patagonia. Great rusting trains stand idle...the factories are full of useless Soviet machinery that never found its way to markets."²³

The principal forum for negotiating the dispute has been the "Minsk Group" co-chaired by Russia, the United States and France, under the aegis of the OSCE. In March 1999 the Minsk Group put forward proposals for the establishment of a "common state" with Nagorny-Karabakh and Azerbaijan forming two equal entities. The plan was dismissed by

²¹ See Library Standard Note SN/IA/1745 <http://hcl1.hclibrary.parliament.uk/notes/iads/sn-01745.pdf>

²² Thomas de Waal, *Black Garden: Armenia and Azerbaijan through Peace and War*, New York University Press 2003, p270

²³ above, p271

the Azerbaijan government as being unacceptable. A fresh attempt to push the process forward began in July 1999 with talks in Geneva between the respective presidents (Heydar Aliyev and Robert Kocharian) but this process was disrupted by the assassination in late October 1999 of the Armenian Prime Minister, Vazgan Sarkisian, and other politicians. Although the assassins made no explicit linkage to the talks, some commentators suspected that the intention was to sabotage the negotiations. Talks between July 2000 and October 2002 failed to resolve the problem.

In 2004 a series of meetings in Prague between the Foreign Ministers of Armenia and Azerbaijan initiated the "Prague Process" with US, Russian, and French mediators. The United States supports the territorial integrity of Azerbaijan and "holds that the future status of Nagorno-Karabakh is a matter of negotiation between the parties."²⁴

The Economist commented in October 2003 on the chances for a resolution of the conflict that:

with Armenia's Robert Kocharian safely (if equally dubiously) re-elected in February, and the dynastic succession assured in Azerbaijan, many think an agreement could be revived, giving Karabakh self-government. Ilham Aliev has, however, sounded more belligerent in the past few months, hinting that he is prepared to use force again if need be. That may just be vote-mongering; opposition candidates have taken a similar tough line. But there are fears that he might be driven to war if he cannot broker a peace.

President Aliev has indicated that negotiations have reached stalemate and that the European Union, the Council of Europe and the UN should play a greater role in resolving the conflict. He has also called for a unified approach to separatist problems across the region.

Traditionally the United States has been pro-Armenian. In 1992 the US included in their *Freedom Support Act* a section (907) which prohibited certain types of direct U.S. assistance, including military aid, to Azerbaijan as a result of the dispute over Nagorno-Karabakh.²⁵ However, after 11 September, 2001 the US Congress approved presidential authority to waive Section 907. That waiver has recently been renewed. The influential Armenian lobby in America believes the exercise of this waiver "sends the dangerous signal to Azerbaijan that the U.S. will not respond decisively to renewed aggression against Karabakh or Armenia."²⁶

In recent years, Azerbaijan has benefited economically while Armenia's fortunes have declined. Azerbaijan is the lead country in the Baku-Tbilisi-Ceyhan pipeline route which avoids crossing Armenia (the shorter route to the Mediterranean). Thomas de Waal believes that Armenia faces a "bleak future" if peace is not reached. "It is unlikely to

²⁴ US Dept of State Factsheet, 7 Feb 2005

²⁵ The *Freedom Support Act* was intended to provide help to former communist countries during their transition to a market economy.

²⁶ Armenian National Committee of America www.anca.org/resource_center/position_papers.asp?ppid=6

collapse – its friends in Russia and the United States are too powerful to let than happen. But it risks turning ever more in on itself...War would be catastrophic – and no wars ever end as the men who launch them intend.”

BTC is the linchpin of this renewed interest in Azerbaijan energy. The 1000-mile pipeline will extend from Azerbaijan’s off-shore Caspian oil wells, via Georgia, to Ceyhan on the Turkish Mediterranean coast. BP has invested nearly \$8bn in Azerbaijan, which includes the development of a major field and the BTC pipeline consortium. In addition to US humanitarian and developmental assistance,²⁷ and trade and investment agreements, ChevronTexaco has \$3.2bn invested in oil interests, according to John Donaldson writing for *Jane’s Intelligence Review*, while “more recent estimates suggest that ExxonMobil might have upwards of \$25bn invested in Azerbaijan's offshore fields.”²⁸

The *Guardian* in July 2004 described the US military arrangements with Azerbaijan:

Washington is increasing to 50 the number of military advisers who are training Azerbaijani troops, while doubling its annual military aid package next year to nearly 13m pounds. One European diplomat said the US was developing a "permanent military presence by stealth".

An exchange programme for Azerbaijani troops with the Oklahoma national guard is scheduled for 2005, and the US has built a radar station on the Caspian coast to aid border control.

American planes can be at Azerbaijani bases under a refuelling agreement, and there are persistent reports in the country's media that the US has helped to fund improvements to local airfields, which the embassy denies. The cooperation took on a new openness on June 10, when a squad of elite US navy Seals publicly trained with Azerbaijani special forces in the Caspian, racing powerful speed boats along a stretch of sea that runs between the country's restless neighbours, Russia and Iran.

On the same day, the second most important US general in Europe, Charles Wald, held his second meeting in three months with top Azerbaijani officials. The Pentagon insists this presence is not "permanent" and will not amount to an American base on Azerbaijani soil. Yet Gen Wald said in March that he hoped Azerbaijan could improve some air bases so US craft could "temporarily" use them.

²⁷ The US has also supplied \$140 million of humanitarian assistance to the internally displaced people, refugee, and war-affected populations of Azerbaijan.

²⁸ Donaldson, above

Nato is also increasing its interest in cooperation with Baku, with President Aliyev hovering among senior US officials at the summit in Istanbul this week.²⁹

Azerbaijan's engagement with the west is reflected in its membership of the NATO Partnership for Peace programme, the OSCE, the Euro-Atlantic Partnership, the European Bank for Reconstruction and Development and the Council of Europe. President Aliyev however also needs to preserve a balance between the US and Russia. The *Economist Intelligence Unit* wrote in 2003:

Russia, which supports Iran and is wary of the US presence in the former Soviet Union, will watch these developments closely. Azerbaijan will have to balance relations with the US and Russia, since both countries have similar, albeit sometimes conflicting, interests in the south Caucasus (namely, regarding oil and the possibility of a terrorist presence). Both countries have been competing to gain a stronger foothold in the region. Azerbaijan has already attempted to ensure that it remains on good terms with Russia. In March Mr [Heydar] Aliyev and his Russian counterpart, Vladimir Putin, signed a declaration reaffirming a 1997 Friendship and Co-operation Treaty, as well as the Baku Declaration on Principles of Security and Co-operation in the Caucasus, which was signed in 2001.³⁰

John Donaldson also concludes that President Aliyev may be inclined to move closer to Moscow and Tehran in order to strengthen his role within the state, which is subject to criticism from the west on political and human rights grounds, without jeopardising the vast amount of US investment in his country.³¹

Azerbaijan's human rights record and authoritarian culture was summarised by Human Rights Watch *World Report 2005* thus:

Torture, police abuse, and excessive use of force by security forces are widespread in Azerbaijan. Peaceful protests are frequently met with the use of force and arbitrary arrest. Severe beatings at police stations are routine and torture methods in pre-trial detention include electric shock and threats of rape. In 2004, the government failed to address these problems, perpetuating an environment of almost total impunity for security force abuses surrounding the October 2003 presidential elections. Although international interlocutors repeatedly called on Azerbaijan to investigate allegations of torture by the Organized Crime Unit of the Ministry of Interior, and security forces' use of excessive violence during the protests following the elections, at the time of writing the authorities had not prosecuted any cases.³²

²⁹ Nick Paton Walsh, *Guardian*, 2 July 2004

<http://www.guardian.co.uk/oil/story/0,11319,1252330,00.html>

³⁰ Economist Intelligence Unit Country Profile 2003

³¹ Donaldson, above

³² Human Rights Watch *World Report 2005*

The report also criticised the European Bank for Reconstruction and Development, which had committed more than \$473 million in projects including. \$125 million for the BTC pipeline with no conditions attached regarding democracy, human rights, or rule of law.

In March 2003 a number of organisations³³ wrote to the then International Development Secretary, Clare Short, about their human rights concerns in connection with BTC, particularly “intimidation and threats made to people who raised concerns about the project, its social and environmental impacts and the fair distribution of the project’s benefits to the citizens of Azerbaijan, Georgia and Turkey.” They urged that no public monies be made available to the project.

However, BP, hails the project as an example of good corporate responsibility, pointing out that “the eyes of the world are on us – industry, regulators and NGOs. So we have set out to raise the bar and establish a new international benchmark in human rights and environmental standards. This extends to such diverse areas as leak detection, land acquisition, biodiversity and community investment. In fact, the pipeline is to be buried for its entire route and no-one will be permanently displaced from their home. In drawing up the Environmental and Social Impact Assessment, and the agreements with host governments, we have committed to match the environmental standards applied in the European Union.”³⁴

VI Kazakhstan

Kazakhstan is the ninth largest country in the world and shares a border with both Russia and China, and has considerable oil and gas reserves, which it has developed with mainly American investment, but its relationship with the west and the USA in particular is, unlike Azerbaijan across the Caspian Sea, somewhat equivocal.

Economically, Kazakhstan is one of the most successful of the former Soviet Central Asian states. It has adapted well to a market economy and introduced fiscal and monetary reforms; it was able to repay its debt to the International Monetary Fund ahead of schedule, and is gradually reducing its ratio of foreign debt to its Gross Domestic Product. This success must, in part, be attributable to the considerable assistance from the USA since 1991 when Kazakhstan became independent. In the ten years to 2001 the United States provided “roughly \$874.3 million in technical assistance and investment support in Kazakhstan.”³⁵

³³ Kerim Yildiz, Director, Baku Ceyhan Campaign and Kurdish Human Rights Project; Nicholas Hildyard, Director, Baku Ceyhan Campaign and The Cornerhouse; Nick Rau, Baku Ceyhan Campaign and Friends of the Earth (England, Wales and Northern Ireland); James Marriott, Director, Baku Ceyhan Campaign and Platform Research Ltd.; Mayis Gulaliyev, Causasus NGO Federation

³⁴ ‘Environmental Responsibility in a Global Business’, Greg Coleman, Group Vice President, Health, Safety, Security and Environment, BP, 24 May 2004

³⁵ Donaldson, above

The latest US State Department figures show that \$74.2 million for government assistance programmes was allocated in 2004 roughly as follows:³⁶

Democracy Programs	\$10.6 million
Economic & Social Reform	\$21.5 million
Security & Law Enforcement	\$39.4 million
Humanitarian Assistance	\$0.3 million
Cross-Sectoral Initiatives	\$2.4 million

If expansion of oil production and development of new fields goes ahead as planned, it is estimated by *International Petroleum Encyclopaedia 2004* that Kazakhstan will be among the world's top 10 oil-producing nations. Kazakhstan is connected to the Black Sea by the Caspian Pipeline Consortium(CPC); however the transport of its gas reserves is still relatively undeveloped and the country imports gas from neighbouring countries.

John Donaldson writing in *Jane's Intelligence Review* states that:

Kazakhstan is the biggest recipient of US investment, with US companies holding an estimated 64 per cent of overall investment in its hydrocarbon sector and 37 per cent of participation in actual production. California-based ChevronTexaco has the largest single US interest, holding 50 per cent interest in a 40-year, 20bn dollar relationship with Kazakhstan to develop the massive onshore Tengiz oil field. Started in 1993, the TengizChevrOil consortium also includes Dallas-based ExxonMobil, which has a 25 per cent stake.

ExxonMobil and ConocoPhillips are part of a consortium with Kazakhstan's state-owned KazMunaiGaz to explore the huge Kashagan offshore oil field. The BG (British Gas) Group and Shell from the UK also have interests in the Kashagan field. BG has one of its three largest overseas investments in the Karachaganak gas condensate field.

Kazakhstan was one of the Caspian countries singled out in the Cheney report and indeed U.S. economic and commercial investment has been mirrored by Kazakhstan's cooperation in military and defence issues. Kazakhstan has given up nuclear weapons and weapons grade nuclear material from the Soviet period, and signed a range of arms treaties. It is estimated that the United States contributed \$188 million to Kazakhstan's programme of eliminating weapons of mass destruction and related infrastructure.

In 2003 it was announced that the USA was supplying ships to the Kazakhstan's Caspian sea fleet, and British, US and Kazakh troops engaged in military manoeuvres.

³⁶ <http://www.state.gov/p/eur/rls/fs/35987.htm>

Kazakhstan is a member of the Organization for Security and Cooperation in Europe and participates in the NATO Partnership for Peace programme, while its geographical and strategic position predisposes it to maintain good relations with Russia and its eastern neighbours. In recent years however, Donaldson argues,

...the relationship between Astana and Washington has become increasingly unclear. While Kazakhstan is currently a member of NATO's PfP programme, it has not committed to a permanent US military presence and has shifted its favour back and forth between Russia and the USA on several occasions during the past two years. In February 2004, Donald Rumsfeld, the US Secretary of Defence, met his Kazakhstan counterpart and discussed security issues such as the spread of Al-Qaeda and improving the protection of Kazakhstan's oil fields, but it is unclear if any definite US commitment was made. So far, officially it has only assisted in training Kazakhstan's border troops to address security issues in the Caspian. However, Kazakhstan has recently invested in improving its naval presence in the Caspian Sea, including new vessels and surveillance equipment to address potential threats to offshore facilities. A new digital radar system is now monitoring the Caspian from Kazakhstan's shoreline and a further nine stations are planned. Moscow has been critical of both Kazakhstan's and Azerbaijan's increasing military capacities in the Caspian, suspecting that a permanent US military presence may not be far behind. To quell such fears, Astana has played down any relationship with the USA and prefers to be seen as closer to Russia.³⁷

Politically, Kazakhstan is dominated by President Nazarbayev; his Fatherland party (Otan) won the parliamentary (Majlis) elections in September 2004 and opposition parties are electorally active but the OSCE was critical of the election standards in 1999, when President Nazarbayev was re-elected in for a 7-year term. The Foreign and Commonwealth Office comments:

No opposition groups pose a serious threat to Nazarbayev. A new draft Law on Elections takes into account some of the OSCE recommendations on improvement and transparency of election procedures. There has been some concern in the international community about the democratisation process over the past two years. In November 2001 a group of high-ranking political figures called for greater democracy and established Democratic Choice of Kazakhstan. Two of their leaders, Galymzhan Zhakiyanov and Mukhtar Ablyazov (the latter has now been released) were jailed on corruption charges. In April 2003 an outspoken opposition journalist Sergei Duvanov was jailed on rape charges. The two main new parties to have registered under the new political parties law are Ak-Zhol (a more moderate offshoot of the DCK), and Asar, established by the President's daughter Dariga.³⁸

³⁷ Donaldson, above

³⁸

<http://www.fco.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1007029394365&a=KCountryProfile&aid=1019233907700>

On human rights the Foreign Office says that “although by no means the worst offender in Central Asia, Kazakhstan's performance...since independence has been patchy... Kazakhstan signed two core UN human rights conventions: the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights (yet to be ratified) in November 2003. The President announced a death penalty moratorium in December 2003. Life imprisonment legislation was introduced in January 2004.”

The greatest proportion of the US aid to Kazakhstan in 2004 (nearly \$40 million) went towards security and law enforcement - which included attempts to prevent Afghan opium and heroin crossing Kazakhstan destined for Russia, and for Europe via the Caspian Sea. According to the FCO, drug seizures in Central Asia increased tenfold between 1995 and 1999 and almost tripled between 1999 and 2000 but countries such as Kazakhstan which is a significant transit route have limited means of tackling the problem.³⁹

VII Militarisation of the Caspian Sea

John Donaldson has analysed the effect of the political and energy interests in the Caspian Basin on the militarization of the Sea itself.

Iran, supported by Azerbaijan, has proposed that the whole Caspian Sea be completely demilitarised. Russia has rejected the idea, and will find an unlikely ally in the USA, which has been trying to maximise its influence in the region since the early 1990s.

Events in Afghanistan and Iraq have led Washington to voice concerns that terrorist organisations could be forced into the nearby Caspian region, where they might target oil production facilities. Therefore, runs the argument, in order to counter such threats, the Caspian must not to be demilitarised. Russia agrees with this assessment, but as the major power broker in the Caspian Sea, clearly sees itself - not the USA - as bearing the security burden. Certainly Iran would prefer a Caspian dominated by Russia to further US encroachment in the region.

Russia has criticised Kazakhstan for establishing naval forces, even though the two states participated in joint naval exercises in 2002. Azerbaijan has updated its small naval flotilla and Turkmenistan has recently established a small naval force. Both have faced similar criticism from Russia. All of the new naval forces in the Caspian are generally designed for coastal monitoring rather than offensive capabilities, so their potency at present is more political than military.

³⁹ Foreign and Commonwealth Office Country Profile of Kazakhstan
<http://www.fco.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1007029394365&a=KCountryProfile&aid=1019233907700>

Furthermore, Russia has clearly stated that it does not think outside countries should be involved in securing the Caspian. In March 2004, Viktor Kalyuzhny, presidential envoy for the Caspian, said that the littoral states could reach an agreement on militarisation if it was not for "external influences". When pressed to clarify if he was referring to US influences, Kalyuzhny responded: "By the way, I wanted to say that we have an interest in the US Great Lakes. I will soon ask my government to set up a Russian representative office for these lakes."⁴⁰

The Russian response to creeping militarization of the Caspian cannot be seen in isolation from more general security concerns as a result of US/NATO bases in countries neighbouring the Caspian littoral states, in particular Uzbekistan and Georgia and in Afghanistan. Although Russia had agreed in November 1999 to a series of steps to withdraw four bases maintained in Georgia ⁴¹ by February 2005 Russian-Georgian negotiations were still ongoing to agree the withdrawal from the remaining two, Batumi and Akhalkalaki, and "the use of the infrastructure the Russian troops would leave behind for future counter-terrorist centers."⁴²

VIII Pipelines

A. The Afghanistan option

In 1996-98, plans were advanced for a Caspian pipeline route through Afghanistan to meet the rapidly growing energy demand of Pakistan and India. It was argued that the route and the support for the new Taliban government in Afghanistan were linked.

...pipelines through Afghanistan would allow the US both to pursue its aim of "diversifying energy supply" and to penetrate the world's most lucrative markets. Growth in European oil consumption is slow and competition is intense. In south Asia, by contrast, demand is booming and competitors are scarce. Pumping oil south and selling it in Pakistan and India, in other words, is far more profitable than pumping it west and selling it in Europe.

[Unocal's] scheme required a single administration in Afghanistan, which would guarantee safe passage for its goods. Soon after the Taliban took Kabul in September 1996, the Telegraph reported that "oil industry insiders say the dream of securing a pipeline across Afghanistan is the main reason why Pakistan, a close political ally of America's, has been so supportive of the Taliban, and why America has quietly acquiesced in its conquest of Afghanistan".⁴³

⁴⁰ Donaldson, above

⁴¹ Joint statement between Russia and Georgia agreed at the OSCE Istanbul summit, November 1999

⁴² "Timeframe for Russia's withdrawal from Georgia not set", RIA Novosti, 11 February 2005 <http://www.globalsecurity.org/wmd/library/news/russia/2005/russia-050211-rianovosti03.htm>

⁴³ George Monbiot, 'America's Pipe Dream', *Guardian*, 23 October 2001

Reports about the contract to be signed between representatives of the Taliban government and Unocal appeared in December 1997 but subsequent events culminating in the Al-Qaeda attack on the United States in 2001 forced the abandonment of the plans.⁴⁴

B. From Azerbaijan to the Mediterranean

The greatest single investment project in the Caspian is being made in the Baku-Tbilisi-Ceyhan crude oil pipeline (BTC). It starts at the Caspian Sea port of Baku (capital of Azerbaijan) and passes through Tbilisi (Georgia) to the deep water port of Ceyhan on Turkey's Mediterranean coast, avoiding Russia, the Bosphorous and Dardanelles – and the politically sensitive Nagorno-Karabakh and Armenia. BTC is backed by a consortium of Western oil companies led by BP. It is expected to be complete by June 2005.

Georgia's internal problems with separatist groups could cause disruption to the TBC. The Ajari separatists' successful blockade of the Georgian port of Batumi in March 2004 caused gridlock in the transport of Azerbaijani oil onto the Black Sea and consequent loss of revenues. The security of the pipeline by state forces (Georgian and Azerbaijani) is likely to be supplemented by private contractors, and critics suggest that the BP consortium have effectively been given control over a corridor of territory along the pipeline.

Kazakhstan on the opposite shore of the Caspian would like to join up with the BTC pipeline via a sub-sea pipeline across to Baku; however Kazakh oil and gas currently travels across Russia and Kazakhstan has been reluctant to lose support from the Russian government. Turkmenistan, after much delay, has entered into a Trans-Caspian Gas Pipeline scheme which will carry 1 trillion cubic feet of gas per year between Turkmenistan and Turkey. Around one-half of the natural gas is expected to be consumed in Turkey with the remainder exported to Europe

C. From the Caspian to the Black Sea

One of the major current routes for transporting Caspian oil and gas westward is a network of pipelines ending at the Russian port of Novorossiysk on the Black Sea from where it is shipped via Turkey's congested straits. This Caspian Pipeline Consortium (CPC) network is Kazakhstan's major western outlet for its huge resources, but gives Russia control of the resources crossing its territory. The pipeline from Kazakhstan's Tengiz oilfield to the Black Sea is 1,000 miles long, and Kazakhstan has so far resisted the temptation to develop an alternative route by joining up with the TBC pipeline via the

⁴⁴ Caroline Lees, 'Oil barons court Taliban in Texas', *Daily Telegraph*, 14 Dec 1997

Caspian Sea to Baku and onward to the Mediterranean. Investors in CPC include Chevron (15 per cent); ExxonMobil (7.5 per cent); and Oryx (1.75 per cent).

D. Turkmenistan and Kazakhstan to the Persian Gulf via Iran

Since December 1997 natural gas from Turkmenistan has been transported via pipeline into Northern Iran despite resistance from the US, based on its sanctions against Iran and American companies that invest in such projects. According to the Council of Europe the \$190 million project is to be paid back in kind through Turkmen gas supplies for the Neka power station in Northern Iran. Iran continues to promote a north-south transport corridor to the Persian Gulf and is developing throughput of Caspian oil by increasing the capacity for the Caspian port of Neka to receive oil by ship and pipe it southward. It has also proposed the construction of an oil pipeline meant to link Azeri oil exports with its pipeline network on towards export points in southern Iran and the Gulf. The President of Kazakhstan has indicated to the United States that Kazakhstan also favours a route down to the Persian Gulf, via Turkmenistan and Iran; but the Iran and Libya Sanctions Act militates against any major projects being financed or endorsed by the US.⁴⁵

E. From the Caspian Basin to China

With Kazakhstan's huge potential of oil and enormous space, stretching from the Caspian shore to China, the country has considerable options. A pipeline between the two points would be extremely long, but would be relatively strategically straightforward. *IPE* 2004 reported that work had been "revitalized" on the second stage of a 1,600 mile oil pipeline from western Kazakhstan to the border: the project is financed by a joint Chinese-Kazakh group (Chinese National Petroleum Corporation and Kazmunaigaz) though the proposed 2006 completion date for the project is thought to be ambitious. The pipeline links into the Russian pipeline system.

In December 2004 China expressed an interest in acquiring a stake in Russian oil company Yukos's production unit. These developments introduce into the Caspian situation "a new and powerful player." However, the Council of Europe considers that "difficulties in resolving the immense legal, political and financial complexities involved make the realisation of such projects unlikely in the foreseeable future, and certainly not before the end of the second or third decade of this century."⁴⁶

IX Stability and Threats

The stability of the region and the development of the Caspian oil and gas reserves are interrelated. Clearly a peaceful region is in the interests of the developers and customers of the natural energy resources, and finding routes through which to transport oil and gas

⁴⁵ Council of Europe, above

⁴⁶ Council of Europe, above

which avoid troublespots, can be protected in the event of conflict and are not subject to political interference underlies the planning of the transport infrastructure.

Future threats to the stability of the Caspian region (and thus to security of supplies) are difficult to estimate and, as *Faultlines of Conflict in Central Asia and the South Caucasus* points out “Considering ten years of predictions to the contrary [the area] has seen surprisingly little conflict since independence.”⁴⁷ On the assumption that oil ownership arrangements remain stable there are thought to be two post-Soviet developments which might threaten the status quo – internal disunity, and activity associated with international terrorism.

A. Internal disunity

The end of the Soviet era was accompanied by a parallel rise in internal instability in the successor states, including separatist movements in Georgia (as in Ajara, Abkhazia and South Ossetia), the Russian Federation (Chechnya), and the dispute between Azerbaijan and Armenia over Nagorny-Karabakh. The overall effect of these conflicts has been to produce what one source calls a “confluence of separatist rebellions, border disputes and lawlessness”.⁴⁸

Chechen refugees and some insurgents have sought refuge in Georgia including some foreign militants with possible links to the al-Qaeda network; and the US anti-terrorism response has resulted in a US military presence there. In addition, Russia has a military peace-keeping presence in Abkhazia under a UN Observer Mission, and bases in South Ossetia, a legacy of Soviet military policy.

In mid-February 2005, the UN Under-Secretary-General for Peacekeeping Operations visited Georgia to assess the Georgia-Abkhazia situation and the United Nations Observer Mission there. Talks are planned for the spring in Geneva.

As has been described, Georgia, one of the parties in the BTC pipeline project now approaching completion, plays a crucial role in the Caspian region’s prospects.

As regards the Azerbaijan-Armenian conflict over Nagorny-Karabakh, the consequences of negotiations failing may be a new phase of military escalation. Azerbaijan may seek to regain territory by military force, as Croatia did with Krajina in 1995, with the consequent movement of hundreds of thousands of internally displaced persons, and even, it is argued, a conflict involving Russia on Armenia’s side and Turkey on Azerbaijan’s.⁴⁹

⁴⁷ *Faultlines of Conflict in Central Asia and the South Caucasus* Chapter 2, ‘The Political Evolution of Central Asia and South Caucasus’ by Tanya Charlick-Paley, Phil Williams, Olga Oliker

⁴⁸ ‘Pipeline plans raise fears near Georgian Park’, by Alex Rodriguez, *Chicago Tribune* 29 June, 2003

⁴⁹ According to Thomas de Waal, above

B. Fundamentalism and terrorism

It is suggested that regional and international terrorism poses a threat to the Caspian energy infrastructure, particularly after the terrorist attacks on the United States on 11 September 2001. In January 2003 sabotage of the oil pipeline from Baku to the Georgian Black Sea port of Supsa caused a spill of between 60 and 150 tons, and the Chechen conflict has demonstrated how effective use can be made of pipeline sabotage by insurgent groups. There is a general expectation that the region will attract ideologically motivated violence but from whom the threat might come and the nature of a terrorist network is debatable. Recently, Oliver Miles, former British Ambassador to Libya, gave evidence to a Foreign Affairs Select Committee inquiry, advanced the explanation of what he called “the Bin Laden franchise, if you like, the people who associate themselves as violent Islamic fundamentalists with Bin Laden”.⁵⁰

Energy Bulletin addressed the possibility of Islamic fundamentalist attacks on world oil supplies in an article in February 2005:

Even if it were possible to secure the world's major processing and shipping facilities, there is no way to secure the tens of thousands of miles of aboveground pipelines that traverse every major oil producing country, from the Gulf states to Uzbekistan to Nigeria. The aortic imagery often found in jihadist communiqués about oil—“The artery of the life of the crusader's nation!”—is both a strategic insight for jihad and a physical description of oil's role in the global economy.⁵¹

The scale of the influence of Islamic fundamentalism in this context is difficult to quantify. Hizb ut-Tahrir for example, a successful and relatively moderate Islamic party which seeks the establishment of an Islamic caliphate and an end to corrupt society, appears to be most active in Central Asian states. In *The American Campaign to Suppress Islam* Hizb-ut-Tahrir writes:

As for the American campaign to make Capitalism an ideology for all nations and people of the globe, it meets no resistance except in the Islamic world. This is because the rest of the nations and people of the world either already embrace Capitalism as is the case with the US, Western Europe and their followers such as Canada, Australia and New Zealand or others like Russia and the states of what once were known as the Eastern bloc who have renounced Socialism and started to mould their lives on the basis of Capitalism... .

Other nations and peoples of Latin America, the Far East, South East Asia and some countries and tribes in Africa who continually did not have any ideology, do not perceive Capitalism as a doctrinal rival. The Islamic *Ummah* is the only nation from amongst the non-Capitalist nations which has an ideology which she

⁵⁰ Uncorrected evidence to Foreign Affairs Select Committee inquiry, “Foreign Policy aspects of the War against Terrorism” on 1 February 2005, HC36-iii

⁵¹ Alexander Zaitchik, ‘It’s the pipeline, stupid’ *Energy Bulletin* 3 February 2005

embraces, despite the fact that currently she neither lives according to it nor conveys it to the world ...

This [American] campaign has other motives such as the Capitalist greed, the ambitious desire of America and the West towards the resources of the Muslim lands, the geographic and strategic advantages of these lands, and the fact that they constitute a huge market for the products of the West and are a source for the raw materials necessary for its industries as well as its huge oil reserves vital for its life. Notwithstanding all these motives the principle motive behind this campaign is the potential threat from the Islamic *Ummah* against the interests of the West, and its international influence as well as upon its very existence once the Islamic *Ummah* wakes up, revives, and carries her message to the world.⁵²

The party claims to have a global membership and is of growing concern to established elites, religious and secular, in Central Asia and the South Caucasus. Hizb-ut-Tahrir advocates political and intellectual means of persuasion rather than violence. But the growing support enjoyed by such groups is likely to pose a threat to authoritarian governments where Islamist movements are suppressed and where the party offers a channel of opposition to unpopular governments, whose security rests principally upon the wealth created by the exploitation of their energy resources.

The International Crisis Group warned in 2003 that:

Wider policies of governments in Central Asia have probably contributed to the growth of Hizb ut-Tahrir, particularly in Uzbekistan. Repression by the Uzbek government has given it a certain mystique among some of the population, and the lack of alternative forms of political opposition or expression of discontent has ensured that it has attracted members from the mass of those opposed to the regime for political reasons. Poor economic policies have further undermined support for the government, and induced discontent among traders – a key Hizb ut-Tahrir constituency. Uzbekistan's restrictive border regime has also increased support for a group that advocates a universal Muslim state, with no national distinctions.

For a small but significant group of predominantly young men, Hizb ut-Tahrir gives an easy explanation for their own failure to achieve change in their personal lives, in society or in the state system. It provides young men with some meaning and structured belief in an era of otherwise confusing and difficult social change. It also offers occasional material benefit and social support in states characterised by extreme poverty and social breakdown.

Repression of its members, and often of those merely associated with them, has radicalised the movement, and had an impact on wider societies. Given the radical ideas of the group and the conspiratorial nature of its political struggle, it is understandable that governments are concerned about its impact on stability.

⁵² *The American Campaign to Suppress Islam*, Al-Khalifah Publications, 1996

But too often governments in the region, particularly in Uzbekistan, use Hizb ut-Tahrir as an excuse for their own failure to carry out political and economic reform and for continuing suppression of religious activity outside narrow official structures. Too often the international community has turned a blind eye to this repression. The West, and the U.S. in particular, is in danger of damaging its reputation in the region by close association with Central Asian dictatorships.⁵³

The “Al-Qaeda franchise” groups pose more of a practical threat to energy supplies in the region. An interesting economic analysis has been made by John Robb, an independent analyst, who has focussed on terrorism, markets, and infrastructure. He suggests that the threat of attacks on world energy supplies reflects a growing global guerrilla phenomenon which can exert significant economic power:

One potential target region is Caspian Sea oil -- particularly from Kazakhstan and Azerbaijan. This production is well within the "easy" zone of operations of active GG [Global Guerrilla] groups (particularly Chechen mercenaries). Increased production from the Caspian Sea area is a critical part of the plan to meet the world's ravenous demand for oil. As a result, these pipelines offer extremely attractive targets for global guerrilla operations in central Asia. The potential of millions of barrels a day of production from the region has led to several major pipeline projects (new and upgraded pipelines to the north and west). Unfortunately, complex geopolitical and geographical hurdles make transporting this oil to major markets extremely difficult. For example: pipeline projects to China and through Afghanistan have been put on hold. These considerations have narrowed the list of active targets and simplified the problem for GGs:

Isolate, Control, and Profit Given this sparse and undefendable network, the potential for GG control of oil production from the Caspian region is extremely likely. There is also the potential for cascading failures with the right analysis. Growth in the global demand for oil (particularly from China) and the ongoing disruption of Iraq's oil has reduced excess global production to less than 750,000 barrels a day. This makes even small disruptions in production extremely potent as a means of controlling oil prices. Here's the dominant strategy:

Isolate the Caspian region from the Samara connection to the Russian pipeline grid (Transneft) through continuous attacks (akin to the attacks on the Kirkuk pipelines in Iraq). Given Transneft's limited transportation capacity (only 4 m barrels a day), it is possible that attacks on any major east-west pipeline will bump production from the Caspian.

Control. Conduct regulated attacks against the BTC (Caspian to the Mediterranean) and CPC (Kazakhstan's Tengiz oil field to the Russian Novorossiisk port) to control transport of oil to global markets. The key to maintaining the effectiveness of these attacks is to use them sparingly (a lesson drawn from Lawrence of Arabia's campaign). Extended shutdowns aren't

⁵³ International Crisis Group ‘Radical Islam in Central Asia: Responding to Hizb-ut-Tahrir’, 30 June 2003

necessary to exercise control and increases the potential of the development of alternative pipelines (ie. through Iran). If done correctly, these attacks alone will have the potential to turn participating GG groups into a "shadow" OPEC, with a pricing power akin to Saudi Arabia.⁵⁴

John Robb concludes that the elimination of a proportion of production from global markets can produce price fluctuation which will give Global Guerrillas the “income potential necessary for funding ongoing operations (and expand operations using mercenaries).”

X Other Issues

Two other factors which are not considered in detail here but which are relevant in the future of the area include the expansion of the Shanghai Cooperation Organisation, and the long-term environmental degradation of the Caspian Sea and surrounding region.

A. Shanghai Cooperation Organisation

The Shanghai Cooperation Organisation, which comprises China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, was formed in 1996 as a non-aligned group of five (minus Uzbekistan). Since 2001 it has become a significant influence in the politics of Central Asia, and has concentrated not only on confidence-building measures in the border regions, and combating terrorism (a Convention was agreed in June 2001) but increasing mutual cooperation in the political, security, diplomatic, economic, trade and other areas among the states.

The SCO has inevitably been viewed as a regional power bloc to balance what is seen as the encroachment of western, principally US, economic, political and military influence into the Caspian and Central Asia. Cooperation between SCO and ASEAN (the Association of Southeast Asian Nations) and Iran’s interest in joining the Organisation have strengthened this view of the Shanghai Cooperation Organisation as a developing geopolitical counterweight. *Strategic Survey* 2003/4 reported on “an inaugural anti-terrorism exercise in Central Asia under the auspices of the Shanghai Cooperation Organisation.”⁵⁵ Moscow, it is argued, is responding to its isolation and insecurity in a region where it has traditionally had special interests and influence. For example, David Eisenhower of *People’s Weekly World*:

Despite “sincere assurances” to Russia that the U.S. means no harm — neither in the form of the planned realignment of Washington’s NATO and South Korean-based forces to positions around Russia, nor the new U.S. bases in Iraq,

⁵⁴ John Robb, ‘A shadow Opec’, 19 July 2004

http://globalguerrillas.typepad.com/globalguerrillas/2004/07/long_term_gg_ta.html

⁵⁵ IISS *Strategic Survey* 2003/4

Afghanistan, and Central Asia on Russia's southern flank, nor this "anti-Russian map" in the Caucasus — Russia is unlikely to buy it. Instead, Russia will seek to strengthen its own position in the Caucasus and in Central Asia, chiefly by strengthening the Shanghai Cooperation Organization (Russia, China, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan) and the Collective Treaty Organization, which recently conducted military exercises involving five Central Asian nations, including Russia.⁵⁶

The Chinese General Secretary of the SCO stressed the non-aligned nature of the organisation in August 2004 in order to dispel such concerns:

SCO adheres to one more important principle, namely: non-alignment, non-orientation against other states and regions and openness in front of the external world. That is why we say, that SCO conducts diversified cooperation in internal direction, and establishing multilateral contacts in external directions. Even, when matters of cooperation in the field of security are being discussed, it is not aimed against the USA and the NATO at all, as some people claim. We do not have hypothetical adversaries; our real enemies are terrorism, separatism and extremism, as well as poverty, ignorance and backwardness. Here I would like to solemnly declare once again, that SCO in no case can move towards transformation into a geopolitical military block, and it will never return to the old path of military confrontation.⁵⁷

B. Environmental Challenges

The Council of Europe Assembly Report of December 2002 into the development of energy resources in the Caspian is one of a number in recent years to identify the significance of environmental damage of the Caspian itself, through other activities as well as oil exploration.

The Caspian Sea is a unique ecosystem with a rich aquatic, aerial and terrestrial wildlife. While media and governments have placed much emphasis on the political and economic situation surrounding Caspian developments, little attention has been paid to environmental risks connected with oil extraction and transportation. Past oil ventures have left the inland sea polluted, and since 1978 the Caspian has for reasons not yet fully known risen by almost 3 metres, flooding coastal areas and oil platforms, and further polluting the area. Just as mysteriously, the level of the Caspian has recently started lowering.

27. Environmental issues in the Caspian region are numerous and diverse. The hydrocarbon production includes the establishment of production infrastructure, offshore drilling platforms and pipelines, which easily become a main source of pollution. It is important, however, not to overstate the significance of offshore

⁵⁶ David Eisenhower, 'Oil Rivalry, strife afflict the Caucasus', 9 September 2004
<http://www.pww.org/article/articleview/5757/1/231/>

⁵⁷ Zhang Deguan, Secretary-General of the Shanghai Cooperation Organisation, 17 August 2004

oil activities in the overall environmental picture. Azerbaijan - with extensive offshore oil production facilities as well as onshore oil industry, including a number of refineries on the Apsheron peninsula - is a significant polluter. At the same time, the runoff from the Volga, the Ural and other rivers are heavily polluted with heavy industry wastewater. This seems to account for almost 65 % of the total oil pollution load of the Caspian. However, future large-scale offshore oil developments may end up being major sources of pollution as well. Intense demographic pressure – around ten million people live on the shores – adds to the burden on the environment, especially since it has not been accompanied by the necessary investment in wastewater treatment. Finally, illegal practices such as poaching threaten biodiversity of fish stocks.

28. Against the background of mounting international pressure to curb and possibly reverse the environmental damage in the Caspian, Azerbaijan is defining for its oil and gas sectors new environmental limits comparable to those in the North Sea and the Gulf of Mexico. Its recent Production Sharing Agreements with foreign consortia contain stricter environmental regulations. This is also the case in Kazakhstan, where exploration permits in the shallow north-eastern part of the Caspian (depth averaging 6 metres) and recent oil discoveries have the potential of adding to the heavy pollution of the region.⁵⁸

In November 2003 the five Caspian littoral states signed The Tehran Convention (the Framework Convention for the Protection of the Marine Environment of the Caspian Sea) which was described by environmental observers as “unprecedented regional legislation [which] should ensure effective environmental decision-making and actions, resulting in the development and implementation of much-needed unified standards and regulations for any activity having an impact on the Caspian’s natural resources.”⁵⁹ However, concern has been expressed at the arrangements for monitoring the Convention and the progress since signature has been disappointing. According to Aleksey Knizhnikov,

One year has passed since the signing of the Tehran Convention. Only one country—Turkmenistan—has ratified the Convention; the governments of the Russian Federation and the Islamic Republic of Iran have only recently approved and advanced the Convention for ratification. We are compelled to note that the overall pace of ratification, and therefore the pace of the Convention entering into force, lags far behind the pace of destruction to the Caspian basin’s ecosystems. Moreover, as it now stands, the Tehran Convention will not be a catalyst for creating real mechanisms to ensure environmental safety. Thus, active and immediate efforts must be made to give substance to the Tehran Convention through the development of protocols and provisions.⁶⁰

⁵⁸ <http://assembly.coe.int/Documents/WorkingDocs/doc02/EDOC9635.htm> December 2002

⁵⁹ Aleksey Knizhnikov, “How to make the promises of environmental safety a reality” Crude Accountability, November 2004
http://www.crudeaccountability.org/docs/Caspian%20Ecology%202004_en.pdf

⁶⁰ Crude Accountability, above

In addition to the Caspian pollution issue, Turkmenistan, Kazakhstan, Tajikistan, and Uzbekistan have other problems of connected with the distribution of limited water resources and with regional environmental degradation. The two largest rivers, the Amu Darya and Syr Darya, originate in the mountainous upstream countries of Kyrgyzstan and Tajikistan and flow through the dry plains of the downstream countries of Uzbekistan, Turkmenistan and Kazakhstan towards the Aral Sea. These 'upstream countries' receive 81 per cent of the region's surface water resources and have large-partly developed hydroelectric resources but limited fossil fuel reserves, while the 'downstream countries' are energy-rich, but starved of fresh water. Before independence, these differences were addressed through a centrally managed, integrated water and power system in which fuel and water were shared. Since independence, there has been a sharp decline in the sharing of resources. The current disagreements and potential conflict over water resources particularly affect Kazakhstan which surrounds half of the Aral Sea, poor management of which has caused an ecological catastrophe, and Uzbekistan ⁶¹

USAID describes the consequences of the breakdown as follows:

Joint use of water and energy resources is a key issue among the Central Asian countries. The output of the combined heat and power plants in Kyrgyzstan and Tajikistan is now half of the pre-independence level due to reduced oil, coal and gas imports. Without fossil fuels to provide winter heating, consumers have switched to electricity, increasing the winter demand by over one hundred percent. The countries' economies are so depressed that energy tariffs cannot be raised to financially sound levels to purchase fuel and energy. Both countries also have major losses in their electricity distribution systems. As a result, Tajikistan and Kyrgyzstan experience severe shortages of winter energy.

USAID concludes that the water issue has a significant potential for conflict between the regions. The Framework Agreement between Kazakhstan, Kyrgyzstan and Uzbekistan on the Use of Water and Energy Resources of the Syr Darya Basin in 1998 has had limited success and USAID is working to improve implementation. The World Bank is also working with the government of Kazakhstan on a Natural Resources Management project. ⁶²

⁶¹ 'The causes of water disputes in the Syr Darya River Basin'
http://www.ca-c.org/dataeng/05.chapter_three.shtml

⁶² See
<http://wbln0018.worldbank.org/ECA/ECSSD.nsf/0/2E4BA1F7B4229EA285256B0A004D704D?OpenDocument> and
http://www.usaid.gov/locations/europe_eurasia/car/pdfs/water_mngt_briefer_water_and_energy.pdf

Appendix 1 - Energy resources by country

Estimates of the proven crude oil reserves in the Caspian Sea region vary widely. The US Energy Information Administration estimates that proven oil reserves in the Caspian region range between 17 and 33 billion barrels, comparable with Qatar and the United States respectively.⁶³ In 2003, oil production in the region was estimated at 1.7 million barrels per day (bpd), similar to annual production levels in Brazil, South America's second-largest oil producer. By 2010, analysts expect the countries of the Caspian Sea region to produce between 2.4 and 5.9 million bpd, exceeding the annual production of Venezuela, South America's largest oil producer.

Oil production in the region has risen by approximately 70% since many of the former Soviet states gained independence in the early 1990s. Much of this is attributable to increased production in the Caspian states of Kazakhstan and Azerbaijan. The development of oil production in the region has been led by three major projects: Tengiz and Karachaganak (in Kazakhstan); and Azerbaijan's Azeri, Chirag, and deep-water Gunashli (ACG) field. These projects combined produced about 644,000 bpd in 2004, almost one-half of the region's total. The operating companies expect production levels from these fields to reach 1.7 million bpd by 2010. Following these discoveries, major new finds were also announced in Azerbaijan at Shah Deniz in 1999 where the potential recoverable resources of natural gas were estimated at 14 trillion cubic feet (tcf), and in Kazakhstan at Kashagan in 2000 where recoverable oil reserves were estimated at between 7 and 9 billion barrels with further potential totalling 9 to 13 billion barrels using secondary recovery techniques.

Other countries in the Caspian Sea region have not made similar levels of progress towards developing their hydrocarbon resources. The leading oil projects in Turkmenistan and Uzbekistan are significantly smaller and less well developed than those in Azerbaijan and Kazakhstan. However, Malaysia's Petronas are expected to begin offshore oil production in the Turkmen sector of the Caspian Sea by 2006 or early 2007 while the Turkmen government has also made plans to build a natural gas pipeline and to explore three new oil fields in the Turkmen sector.

Oil and natural gas development in the Russian and Iranian sectors of the Caspian Sea has also been relatively small, although exploration efforts are reportedly underway. The Russian oil company, Lukoil, began exploration of the north Caspian Sea in 1995 and is working on a drilling programme for 2004 to 2010, with initial production of natural gas expected by 2008. Five large fields have been found in the north Caspian since Lukoil began exploring there, at Khvalinskoye, Yuri Korchagin, Rakushechnoye, and Sarmatskoye. Khvalinskoye will be explored by a joint venture between Lukoil and Kazakhstan. In July 2003, Lukoil and Russia's Gazprom established a joint venture with

⁶³ www.eia.doe.gov

Kazakhstan's state oil company, KazMunaiGaz, to develop the Tsentralnaya area on the border of the Russian and Kazakhstani offshore sectors. Tsentralnaya holds recoverable natural gas reserves of approximately 20 tcf and drilling is expected to start in 2007. Russia's natural gas monopoly, Gazprom/Rosneft, is also involved in the offshore Caspian Sea area of Kurmangazy. The Kurmangazy field, which is estimated to contain around 6 to 7 billion barrels of oil, also straddles the border between the Russian and Kazakhstani sectors of the Sea. The field is being developed in conjunction with KazMunaiGaz. Exploratory drilling at Kurmangazy began during 2003 with a total capital investment of \$2.1 billion.

Iran has made relatively little progress towards developing its Caspian Sea resources, although in September 2004 it issued an initial tender to begin drilling in deepwater portions of the Caspian Sea sometime in 2005. Reports indicate that Brazilian company Petrobras has been in talks with Tehran and the National Iranian Oil Company (NIOC) to finalise production sharing agreements.⁶⁴

The Caspian Sea region's natural gas potential is more significant than its oil potential. Regional proven natural gas reserves are estimated at 232 trillion cubic feet (tcf), comparable to proven gas reserves in Saudi Arabia. Natural gas production in 2003 was approximately 4.5 tcf, equivalent to the combined production of the countries of South America, Central America, and Mexico. However, companies and governments in the region have tended to show greater interest in oil than natural gas, owing, in part, to the higher capital expenditure needed to start up new natural gas projects as well as to the region's lack of existing natural gas infrastructure. Consequently, regional natural gas production has increased modestly since many of the states gained independence.

The Caspian region's leading oil producers, Azerbaijan and Kazakhstan, are both net natural gas importers, purchasing natural gas primarily from Uzbekistan and Russia. However, both states plan to increase their own natural gas production significantly by 2010 and to become net exporters. Azerbaijan's major natural gas production increases in the future are expected to originate in the development of the Shah Deniz field. Kazakhstan's natural gas production increases are expected to come primarily from its three largest fields at Tengiz, Karachaganak, and Kashagan.

Although Georgia is not a littoral state, and has limited reserves of hydrocarbons, its position means it has become an important 'corridor' for oil and gas transportation between the Caspian Sea and Western (particularly European) markets.

1. Azerbaijan's Oil and Gas Reserves

Azerbaijan has considerable proven reserves of oil and natural gas. Oil production in Azerbaijan reached 500,000 bpd during the Second World War. In the post-war period, the state never regained its production capacity, and in 2002 oil production in Azerbaijan

⁶⁴ <http://www.iranexpert.com/2004/brazil23september.htm>

was slightly in excess of 300,000 bpd. From 1987 to 1995, Azerbaijan's oil production declined at a rate of 5.4%. The contract signed between Azerbaijan and eleven international companies in 1994 helped to halt this decline, principally by developing the Azeri, Chirag and Gunashli (ACG) fields, and by establishing the Azerbaijan International Oil Company (AIOC). Since 1997, oil production in Azerbaijan has been increasing on average by 10.2% per annum, and the country is expected to exceed oil production of 500,000 bpd by 2007. The ACG fields alone produced 140,000 bpd in early 2004, increasing to 400,000 bpd in 2005 and reach a peak of 1 million bpd in the next decade.

According to the US Energy Information Administration, Azerbaijan's oil production averaged 327,700 bpd in 2003, of which approximately 320,000 bpd was crude oil, building on five consecutive years of growth. During the first half of 2004, oil production increased by almost 2,000 barrels per day to an average of 324,000 bpd compared to the same time period in 2003. Domestic petroleum consumption in Azerbaijan has fallen since independence, resulting in additional opportunities to encourage petroleum exports. Azerbaijan exported approximately 214,000 bpd in 2003, most of which was to Russia, Turkey, and Italy.

Estimates of Azerbaijan's proven crude oil reserves range between 7 and 13 billion barrels. The State Oil Company of the Azerbaijan Republic (SOCAR) estimates proven reserves at 17.5 billion barrels, which may include reserves that are either not viable or not fully proven. The country's largest hydrocarbon structures are located offshore in the Caspian Sea and account for most of the country's current petroleum production. The majority of Azerbaijan's oil output (61% in 2003) originates with SOCAR.

Azerbaijan has proven natural gas reserves of roughly 30 tcf, and there are potentially larger reserves. However, because there is insufficient infrastructure to deliver Azerbaijan's natural gas from offshore fields, the source for the majority of its production, natural gas has tended to be 'flared off' rather than being piped to markets.

Almost all of Azerbaijan's natural gas is produced by SOCAR from offshore fields. The Bakhar oil and gas field, is located off the southern tip of the Absheron Peninsula and currently accounts for slightly over one-half of the country's natural gas output. Recently, output at Bakhar has been declining and, according to press reports, SOCAR has begun efforts to develop a new deposit, known as Bakhar-2 located adjacent to Bakhar. SOCAR reportedly has plans to utilise some of the Bakhar-2 natural gas production for export in the near future. SOCAR recently completed construction of a \$29 million Bakhar-Neftyanıye Kamni pipeline which it anticipates will help double gas transport from the Gunashli field by 2010. Planned capacity is approximately 194 million cubic feet/day (mcf/d). The Gunashli field accounts for approximately 67% of the oil and 50% of the natural gas produced in the country.

Future increases in Azerbaijan's natural gas production are expected to be delivered by the development of the Shah Deniz offshore natural gas field. Shah Deniz is located in the Caspian Sea, approximately 60 miles southeast of Baku, and is being developed by the

Shah Deniz consortium whose members include BP, Statoil, SOCAR, LukAgip, NICO, TotalFinaElf, and TPAO. Some estimates show that Shah Deniz is one of the world's largest natural gas field discoveries in the last 20 years and contains natural gas reserves of between 14 and 35 trillion cubic feet.

Despite the large Shah Deniz natural gas field, Azerbaijan is currently a net natural gas importer. Azerbaijan produced 200 billion cubic feet (bcf) of natural gas in 2003, while it consumed approximately 280 bcf. The majority of Azerbaijan's natural gas imports currently originate in Russia. The Russian company, Gazprom, started to supply gas to Azerbaijan in early 2004 and this will continue until the end of 2008. The contract supplies Azerbaijan with up to 159 bcf of natural gas per year.

2. Kazakhstan's oil and gas reserves

Kazakhstan is the world's largest landlocked country, four times the size of the US state of Texas. It holds the largest recoverable crude oil reserves in the Caspian Sea region. Kazakhstan produces approximately 1 million bpd, around two-thirds of the region's total production. Since the fall of the Soviet Union, Kazakhstan has received US\$20 billion in foreign petroleum investment.⁶⁵

Kazakhstan's combined onshore and offshore proven hydrocarbon reserves have been estimated between 9 and 17 billion barrels, comparable to OPEC members Algeria and Qatar respectively. Kazakhstan produced approximately 1 million bpd of oil in 2003 and consumed just 165,000 bpd, resulting in net exports of 865,000 bpd.

Between 1999 and 2003, Kazakhstan's oil production grew year-on-year by approximately 14%, resulting in a doubling of oil production since independence. Conversely, its other major economic indicators declined markedly during the decade after independence, notably GDP, and the production and consumption of natural gas, coal, and electricity. Increased oil production has been generated through an influx of foreign investment into Kazakhstan's oil sector. International projects have typically taken the form of joint ventures with KazMunaiGaz (formerly Kazakhoil), the national oil company, as well as production-sharing agreements (PSAs) and exploration/field concessions. Independent analysts expect production levels of 4 million bpd, and the Kazakh government estimates production levels of around 8 million bpd by 2020. Most of this growth will be generated from three large oil fields – Tengiz, Karachaganak, and Kashagan.

Despite Kazakhstan's sizeable proven natural gas reserves of 65 to 70 tcf, comparable to Canada and Kuwait respectively, like Azerbaijan the country is currently a net natural gas importer. In 2003, Kazakhstan produced approximately 490 bcf and consumed 560 bcf of natural gas, resulting in net imports of approximately 70 bcf. Gas production in 2005 is

⁶⁵ Reuters, Moscow, 28 December 2003

expected to be approximately 515 bcf. Most of Kazakhstan's natural gas imports originate in Uzbekistan and are destined for the south of the country.

Under a 15-year strategy adopted by the Kazakh Ministry for Energy and Mineral Resources, the Kazakh government plans to increase the country's natural gas production to 1.66 tcf by 2010, and to 1.84 tcf by 2015.

3. Turkmenistan's oil and gas reserves

Oil projects in Turkmenistan are significantly smaller and much less developed than those in Azerbaijan and Kazakhstan. However, the US Energy Information Administration highlight recent press reports that indicate that Malaysia's Petronas oil company will begin offshore oil production in the Turkmen sector of the Caspian Sea by 2006 or early 2007. Turkmenistan has also discussed plans with Petronas to build a natural gas pipeline and to explore three new oil fields in the Turkmen sector.⁶⁶

Since independence, regional natural gas production in Turkmenistan has been characterised by a dramatic collapse then partial recovery. These fluctuations occurred because, after 1991, natural gas from the Caspian Sea region, mostly from Turkmenistan, went into competition with Gazprom, the Russian state natural gas company. Since all the pipelines connecting the region to world markets were owned by Gazprom and routed through Russia, Turkmen natural gas became relatively uncompetitive in market terms and, consequently, Turkmenistan had little incentive for increasing its production of natural gas. The country's output fell throughout the 1990s, from 2.02 tcf in 1992 to only 466 bcf in 1998 when the country was engaged in a pricing dispute with Russia over the export of its natural gas. In 1999, a Turkmen-Russian agreement came into effect, and in 2000 production increased to 1.6 tcf rising to 1.8 tcf in 2003. In April 2003, Turkmenistan signed new agreements with Uzbekistan and Russia to increase its exports to both countries over the next 25 years. After a further pricing dispute which halted Turkmenistan's natural gas exports in late 2004, Turkmenistan re-negotiated the quantities and prices of its natural gas exports to Russia and Ukraine. The recent Turkmen agreement with Russia guarantees initial natural gas exports of 212 bcf in 2005, rising to 2.4 tcf in 2007, and remaining at 2.8 tcf per annum from until 2028. Turkmenistan is also supplying Ukraine with up to 1.2 tcf per annum until 2006 and there are plans to extend the agreement until 2016.

⁶⁶ <http://www.newscentralasia.com/modules.php?name=News&file=article&sid=586>

Proven Oil Reserves (billion barrels)

	Proven Oil Reserves ¹			Total	
	Low	High	Possible ²	Low	High
Azerbaijan	7.0	12.5	32.0	39.0	218.8
Iran	0.1	0.1	15.0	15.1	15.1
Kazakhstan	9.0	17.6	92.0	41.0	49.6
Russia [^]	0.3	0.3	7.0	7.3	7.3
Turkmenistan	0.5	1.7	38.0	32.5	33.7
Uzbekistan	0.3	0.6	2.0	32.3	32.6
Total Caspian Sea Region	17.2	32.8	186.0	167.2	182.8

Oil Production (thousand barrels per day)

	1992	2000	2003	2010	
				Low	High
Azerbaijan	222.2	308.9	328.6	789.0	1,290.0
Iran		<i>no data available</i>			
Kazakhstan	528.6	718.4	1,034.0	748.0	2,400.0
Russia [^]	0.0	0.0	0.0	200.0	200.0
Turkmenistan	110.2	156.6	203.2	475.0	1,000.0
Uzbekistan	66.2	151.9	157.0	225.0	1,000.0
Total Caspian Sea Region ³	927.3	1,335.9	1,722.8	2,437.0	5,890.0

Natural Gas reserves (trillion cubic feet)

	Proven	Possible	Total
Azerbaijan	30	35	65
Iran	0	11	11
Kazakhstan	65	88	153
Russia [^]	<i>no data available</i>		
Turkmenistan	71	159	230
Uzbekistan	66	35	101
Total Caspian Sea Region	232	328	560

Natural Gas production (trillion cubic feet per annum)

	1992	2000	2003	2010
Azerbaijan	0.28	0.20	0.20	0.60
Iran		<i>no data available</i>		
Kazakhstan	0.29	0.31	0.49	1.24
Russia [^]		<i>no data available</i>		
Turkmenistan	2.02	1.89	1.89	4.24
Uzbekistan	1.51	1.99	2.04	3.53
Total Caspian Sea Region	4.10	4.39	4.62	9.61

1. Proven reserves are defined as those volumes of oil and gas that geological and engineering data show with reasonable certainty to be economically recoverable under existing economic and operating conditions

2. Possible reserves are less precisely quantified and are defined here as including other reserves found through extensions, divisions and new discoveries

3. Other estimates: 3.2 billion barrels per day; 3.0 billion bbd

[^] Only Caspian area oil and gas production

Source: US Energy Information Administration

Appendix 2 – Maps: Caspian Basin countries and pipelines

The Caucasus and Central Asia





Courtesy of the US Energy Information Administration, December 2004
<http://www.eia.doe.gov/emeu/cabs/caspian.html>