GEOPOLITICS OF CASPIAN OIL AND GAS

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─Abstract ─

This paper provides an analysis of increasing geopolitical competition over energy rich Central Asia and Caucasus by key actors such as the U.S.A., Russia and China. In addition to an evaluation of the region's future as an energy hub both for East and West, this paper examines how the regional conflicts such as the August 2008 war between Russia and Georgia might affect prospects for Caspian energy development and export. Even though both Russia and China have a common goal of countering Western, particularly U.S., influence in the region, they both have their own agenda and distinct relationships with Western countries. In terms of oil and natural gas, only Kazakhstan and Turkmenistan have the potential to play significant roles in the future. However the entire region will continue to be major area of conflict or cooperation for global powers.

Key Words: *Energy, Central Asia, Caucasus, Russia, China, U.S.A.*

JEL Classification: Y80, Y90, Z00

1. INTRODUCTION

Up until the early 1990s, due to relatively low prices, energy issues did not receive much attention from the policymakers and the scholars of political science. However two events have changed the outlook of global energy politics. First, the Gulf War alerted policymakers when a significant portion of Middle Eastern energy supplies faced the threats of an Iraqi invasion of Kuwait. Second, the collapse of the Soviet Union was a welcome development as it suddenly provided the possibility of an alternative source of energy supply to the world.

By the twenty-first century energy studies consolidated its position as high priority when oil and gas prices started to rise in 1999. Over the last decade global oil prices have increased by more than five times from 20USD per barrel in

August 1999 to 114USD per barrel in August 2012 (Indexmundi, 2012). In addition, developing economies such as China and India demand more energy and cause a potential source of tension in international relations. Recently it has become even clearer that energy security has proved to be a significant source of power in foreign policymaking. The strategic location of the Caucasus and Central Asia make it an area of growing importance in the contemporary security environment, particularly given regional instability and the potential threat to Western economic interests because of its energy resources and transport infrastructure. Energy represents one of the most important aspects of the growing international significance of the region, and states like the USA, Russia, China and organizations such as the European Union (EU) have an interest in the development of stability and security in the Caucasus and Central Asia (Tannock, 2005: 10).

The Caspian is at the historic crossroads between Europe and Asia, and this paper provides perspectives on the region's future as an energy hub both for East and West. To do that this paper is organized in following ways. Section 2 provides a brief background of the history of the region and presents vital data on the energy sources in the region. Section 3 examines the impact of the Russian-Georgian War, in addition to other sources of instability, which are significant for the future of the region. Section 4 presents an overview of the policies of the U.S., Russia and China toward the Caucasus and Central Asia.

2. CASPIAN OIL AND GAS

2.1. Brief History

During the nineteenth-century, the 'Great Game' between Imperial Russia and Britain was based on competition for wider power and influence to assert control over Central Asia. From the late nineteenth century to the Second World War, oil emerged as a strategic raw material to be monopolized by the great powers and major actors were engaged in intense competition for influence over the oil-producing areas of region (Hussain, 2010:3). In the contemporary era, Russia, China, India, the EU and the US and to a lesser extent Turkey and Iran are engaged in the Caucasus and Central Asia. For instance, Russia regards the South Caucasus and former Soviet republics as its traditional backyard of influence whereas the United States engaged in the region due to its heavy military involvement in Iraq and Afghanistan (via NATO), even though withdrawal of its troops is underway.

The region's importance has also peaked since Western markets will be confronted with various risks in the next twenty years in the field of energy. Most notably Paillard states (2010: 65) that there is no clear alternative to fossil energy on a large scale with the possible exception of nuclear energy; yet few countries are able to pay for the large investment required by a nuclear industry. According to the International Energy Agency (IEA) natural gas will constitute 22 to 29 percent of all energy supplies in 2030 in the world (2008) and natural gas is estimated to be the second most important energy source in Europe (2009). However, the region is prone to instability and armed conflicts due to historical (e.g. Armenia- Azerbaijan), ethnic and separatist (e.g. Chechnya), religious (e.g. armed radical Islamic groups in the region such as Al- Qaida and Caucasus Emirate) and political (Russia- Georgia) reasons. One or more of these things may result in armed conflict and could easily develop into instability on a larger scale (Aydın 1999: 119). This would not only affect both the political and energy security situations of the actors involved but also other states not directly involved. Therefore, the security and energy situation in the region is a matter of concern for local, regional and even global actors.

2.2. Energy Data

The oil and gas landscape of the Caspian region has been transformed in the years since 1991 (Emadi and Nezhad: 2011: 23). In the last two decades the Caspian resource-owner states of Azerbaijan, Turkmenistan and Kazakhstan have become autonomous actors, asserting national authority over management of their resources and creating new links with export markets.

The process of market consolidation has been quicker for oil than for natural gas due to its relative ease and flexibility of transportation to multiple destinations. (Fontevecchia, 2012). By contrast, natural gas exports were characterized by non-cash and barter payments below the international value of the gas. It was only after 2005 that Gazprom, the major purchaser of Central Asian gas, was ready to concede cash payments and higher export prices, which according to Emadi and Nezhad (2011: 24) reflects the importance that Central Asian supplies had come to assume in the Russian gas balance as well as increased competition for Caspian gas resources from China and also from other potential consumers in Europe and southern Asia.

Table 1. Reserves, Production, Exports and Consumption of Oil

	Reserves (Thousand barrels per day 2007)	Production (Thou.Br./d. 2007)	Exports (Thou.Br./d. 2006)	Production/consumption (2007)
Azerbaijan	7,000.0	865.4	550.0	7.21
Georgia	35.0	1.1		0.06
Kazakhstan	30,000.0	1,384.4	1,1160.3	9.50
Kyrgyzstan	40.0	1.2	3.4	0.08
Tajikistan	12.0	0.3	0.3	0.01
Turkmenistan	600.0	188.4	79.1	2.00
Uzbekistan	594.0	104.9	5.7	0.85
5 “stans”	31,246.0	1,679.2	1,248.8	
Central Asia	38,281.0	2,545.7	1,798.8	
World Total	1,166,322	83,125	63,057	
1st in CA	KZ (9)	KZ (19)	KZ (19)	
% 5 “stans”	2.60%	2.00%	1.90%	
% world’s 1st 5	68.8%	42.8%	35.59%	
% world’s 1st 10	83.73%	61.4%	54.34%	

Source: ENI (2008), *World Oil and Gas Review*

Table 2. Reserves, Production, Exports and Consumption of Natural Gas

	Reserves (Billion cubic metres 2008)	Production (Bcm 2007)	Exports (Bcm 2005)	Production/consumption (2006)
Armenia	176.0		0..0	
Azerbaijan	1,350.0	6.2		0.59
Georgia	50.0	0.0		0.01
Kazakhstan	1,900.0	25.7	15.4	1.18
Kyrgyzstan	10.0	0.0		0.03
Tajikistan	10.0	0.0		0.05
Turkmenistan	2,860.0	64.8	46.6	3.89
Uzbekistan	1,870.0	56.2	12.0	1.26
5 “stans”	6,650.0	146.7	74.0	
Central Asia	8,226.0	152.9	74.1	
World Total	181,945.5	2.929.1	853.7	
1st in CA	TKM (13)	TKM (10)	TKM (5)	
% 5 “stans”	3.60%	5.00%	8.70%	
% world’s first 5	62.50%	52.19%	59.92%	
% world’s 1st 10	76.07%	65.53%	76.41%	

Source: ENI (2008), *World Oil and Gas Review*

Tables 1 and 2 give us a comparative outlook on Central Asian oil and natural gas with those of the world's top five and top 10 producers. Two conclusions could be drawn out from these figures. First, comparatively Central Asian countries will not be the world's biggest hydrocarbon producers in the future and their influence will be limited. In order to increase their affect on the world energy market they must find ways to strike alliances with larger producers (Estrada, 2009). Second, Azerbaijan, Turkmenistan and Kazakhstan are the only countries with the capacity to ensure future exports. Overall, it would be wrong to downgrade the importance of energy sources of Central Asia and significance of Caucasus as an energy transit corridor to the West. Kazakhstan will be a medium sized producer in the global oil industry and Turkmenistan could play the same role in the natural gas industry (Olcott, 2010: 269). The downside of this picture is twofold: first, energy resources of these countries are not up to par with that of Russia and second, these countries must rely on transit countries to deliver their assets. None of these countries are powerful enough to dominate the transit marketplace, therefore they have to rely on the balance of power in the region including both more powerful transit states such as Russia and Turkey and less powerful ones such as Georgia.

3. REGIONAL INSTABILITY AND RESOURCE VULNERABILITY

3.1. Russia-Georgia conflict and Central Asian-Trans-Caspian energy routes

The main interruption to energy flows pre-dates the Russia-Georgia conflict and consisted of explosions which damaged the pipelines to Georgia on Russian soil in 2006 (Haas et. al., 2006: 17). Media have blamed Russia for these explosions and reported it as a show of force against Georgia's efforts for Western integration (RFL/ RL, 2006). Moreover, in 2008 another explosion and fire on 5 August at a block valve on the Turkish section of the Baku-Tbilisi-Ceyhan (BTC) pipeline stopped the flow of gas (IEA, 2008: 46). Media have reported that the PKK claimed responsibility for the explosion, although sabotage has not been confirmed (Milliyet, 2008).

The main short-term effect of the Russia- Georgia conflict was to limit the options for re-directing BTC oil along other routes. For a period from mid to late August, the only operational route across the South Caucasus was the Baku-Novorossiysk (Tsereteli, 2009: 12). The conflict in Georgia was not fought over energy and even though there were reports of Russian bombs landing close to pipeline routes, there are few indications that energy infrastructure was systematically targeted. Nonetheless, Tomberg (2008) argues by increasing perceptions of risk in the

South Caucasus and the perceived cost of disagreement with Russia, the conflict could influence the strategic calculations of Caspian resource-owners and the development of export routes for Caspian oil and gas. This effect would be amplified in case of lasting instability in Georgia or if another frozen conflict in the region, for instance between Azerbaijan and Armenia over Nagorno-Karabakh, were to be rekindled.

Obviously energy transit projects will boost the relations between countries, improve regional security and help develop regional cooperation. However there are many unresolved issues, which may be detrimental to stability in the region. For instance separatist conflicts in Chechnya, Nagorno-Karabakh, Abkhazia and South Ossetia, as well as rising popularity of militantly religious groups in Central Asia have implications for Europe, the U.S., South Asia and the wider international community. Although these unresolved conflicts are unlikely to physically impact upon energy infrastructure such as pipelines, as it did not happen during the Russian-Georgian War, continued instability in the region could deter future investment (German, 2008: 69). Therefore, the inability to solve, or at least control inter-state (Azerbaijan- Armenia) and non-state (El-Qaida, Caucasus Emirate) conflicts will undermine efforts to boost regional co-operation, hamper economic development and further destabilize the region.

4. U.S., RUSSIAN AND CHINESE INTEREST IN THE REGION

4.1. The U.S.

In regard to the Caspian energy resources transportation, the US policy can be characterized as a ‘multiple pipelines’ strategy, the purpose of which is to diversify the sources of energy carriers and to bypass competing routes through Russia and Iran in their transit (Cornell et. al, 2005: 19). From an American point of view, the landlocked dimension of Central Asia and the dependence on Russian-controlled supply routes has been a major problem.

The remedy for this problem was the BTC oil pipeline. Inaugurated in 2005, it runs through Azerbaijan and Georgia passing nearby ongoing and potential conflict zones, before ending at the Turkish port of Ceyhan. From the beginning, the BTC pipeline was designed to challenge Russian hegemony over energy in the Black Sea-Caspian Sea region. For that reason, the ‘Baku-Tbilisi-Ceyhan’ is a perfect example of where the line between economics, security and geopolitics begin to blur in Central Asia and South Caucasus. The US policy with respect to

Central Asia and South Caucasus is not limited only to the above-mentioned spheres and involves a wide spectrum of interests, including the formation of a civil society, assistance in democratic management, etc., which represents, according to Joseph Nice (2005), a 'soft power' phenomenon in the US policy.

4.2. Russian Federation

The strategic goal of Russia was to maintain Central Asia and South Caucasus under its political, economic and military influence. Russia does not wish to lose its position in Central Asia and South Caucasus region, which it labels its 'near abroad', considering it to be a zone of vital interests (Haas, 2006: 12). Russia has institutionalized its relations with Central Asia and South Caucasus through several regional organizations such as the Commonwealth of Independent States (CIS), the Collective Security Treaty Organization (CSTO), the Shanghai Cooperation Organization (SCO) and Eurasian Economic Community (EurAsEC)

Russia has a negative attitude towards the 'Baku-Tbilisi-Ceyhan' oil and 'Baku-Tbilisi-Erzurum' gas pipelines, since these pipelines break Russia's monopoly over gas and oil resources. The Russia-Georgian war of August 2008 was a strong counter attack made by Moscow, which intensified the US-Russia conflict (Ma Zhengang, 2009: 7-8). So far, Russia has taken various initiatives aimed at settling the Azerbaijani-Armenian conflict over Nagorno-Karabakh. However, the foreign policy strategy of Russia appears to be one of the main factors of instability in the whole Black Sea-Caspian Sea Region. Therefore, it is very difficult in the foreseeable future to establish a reliable Eurasian security system and promote integration processes in Central Asia and the Caucasus.

4.3. China

In regard to the South Caucasian dimension of China's foreign policy strategy, the reality is that while maintaining the vital strategic interest in Central Asia, China at the same time does not express a similar high interest towards South Caucasus. In contrast to Russia and the US, China pays a less attention to the states of South Caucasus and prefers to concentrate its efforts on strengthening cooperation with Central Asian Republics (Pipinashvili, 2001: 145). The Central Asian region is of great strategic significance to China since it is a buffer zone between China and Russia and between China and regional powers such as Turkey and Iran.

According to Zhuanghi (2007: 52), Chinese strategy towards Central Asia is mainly aimed at three key goals: 1) to guarantee and reinforce national security and regional stability; 2) to develop political and economic relations with Central Asian republics as a kind of geo-economic strategy; 3) to ensure the control of Caspian oil and gas in order to strengthen its energy security. China has developed energy cooperation with oil and gas rich Kazakhstan and Turkmenistan and Chinese national companies have begun to invest in Central Asian oil and gas fields, with the clear strategic aim to realize new pipelines in order to transport Caspian energy resources to China, thus allowing diversification of its energy imports. China is rapidly replacing Russia as the main Asian power. While the role of China has grown dramatically in the 21st century, Russia seems to have reached the limit of its economic and security power in the region. The competition between Russia and China in the Central Asian energy sector represents the most evident element of potential tension in their relations. Following the implementation of the Sino-Kazakh oil pipeline and the realization of the Sino-Turkmen gas pipeline (so-called 'China-Central Asia gas pipeline') which also involves Kazakhstan and Uzbekistan, Russian monopolistic control over Central Asian energy exports has been seriously damaged (Marketos, 2009: 14).

4. CONCLUSION

The existing volumes of shipments of energy and other resources already make the East-West transportation infrastructure a vital element of European economic security. The more resources become available in the region, the more the stability of the transit infrastructure will be crucial in determining the ultimate direction in which these resources will flow. The need for alternatives has been recognized and certain policy prescriptions have been planned, but the security of those alternative lines cannot be taken for granted. The Russian military incursion into Georgia and subsequent increase of the Russian military presence challenge strategic interests of both Europe and United States in the region.

Overall, these stakes provide enough incentives for Western interests in this pivotal region to take a more proactive security position and balance the pressure from Russia. Georgia or Azerbaijan independently cannot guarantee the security of the transit lines. Only a strong European and American presence would prevent disruptive actions that sabotage the transit infrastructure and would ensure the status of the region as a future energy hub.

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