

Geopolitics of Energy in the Caspian Sea Region

Azerbaijan's Challenges

Master of Arts Thesis

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Dedication

To my wife Pari whose love, trust and devotion is a source of my inspiration

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Abstract

In the age of rapid economic development and uneven allocation of hydrocarbon resources around the world, acute need for their transportation and amplified energy dependency world politics is and will in the coming years be increasingly dominated if not determined by the energy. Contest to gain access to the Caspian energy and rivalry about transportation routes should be viewed within this context. In addition to their own merit the hydrocarbon resources of the Caspian Sea are used by external players for broader objectives of dominance and influence, while the local actors brought them into play for economic development, social welfare, political consolidation, creation of forthcoming and stable regional environment and integrating into world economy. International players making use of their financial potential and political influence, sometimes even military strength, and the Caspian countries proceeding from their complex political surrounding and taking advantage of their resources and favorable geographic location resorted to geopolitics in pursuit of their ends. Turkic-Mongol empires dominated Eurasia during the centuries promoted and facilitated extensive trade, economic, cultural, religious, scientific exchanges across continent along the trade routes known as Great Silk Road. These connections in huge landmasses of Eurasia were possible in addition to such values as tolerance and mutual respect due to perfect communications means. XXI century presents another opportunity for such exchanges, this time through energy links. The Caspian Sea should be region uniting, not dividing Eurasia through co-operation and partnership, not rivalry and opposition. The Caspian is pivot of Heartland. Who co-operates in the Caspian commands Eurasia.

Introduction

The research revealed the complexity of the issues related to the geopolitics of energy. Contrary to the expectations, it exposed many variables; legal, technological, economic, financial, geopolitical and strategic each of them with their own different and complex dimensions.

Research Focus and Objectives

Since the signing of the oil contract in 1994 between Azerbaijan and oil companies the Caspian Sea region turned out to be site for co-operation on, but also for competition for energy resources. What were Azerbaijan's energy policy purposes? Was energy policy a part of wider policy objectives? How the energy policy was pursued and how did it contribute to Azerbaijan's energy security, to its overall security? How Azerbaijan viewed its energy security or how it could be defined and how energy security contributed to its security as a whole? How this policy met internal expectations and was adequate to the concerns of the external actors. What kind of challenges did or could Azerbaijan face and what was or could be policy responses? What is or may be the role of such countries as Azerbaijan in the present contest, whether they do or should encourage competition or partnership, and whether they are capable of doing so at all? What were the policy objectives of outside players towards the region? Is this contest all about energy only or energy is used for other, broader strategic gains?

Proceeding from the research objectives and questions to be tackled geopolitics was chosen as a conceptual framework and methodological approach of the thesis. Applying the concept of geopolitics I would argue that in the era of heightened energy need world politics is and will be increasingly dominated if not determined by the energy. The Caspian energy and its transportation routes are used by external players not for sake

of hydrocarbon resources only, but for broader geopolitical objectives. Whereas the Caspian Sea countries tried to make use of energy for economic and social development, political consolidation, building stable regional environment and integrating into world economy. To this end both of them resorted to geopolitics employing their own advantages. The Caspian Sea countries ultimate aim in this geopolitics should be to reach co-operation and partnership, rather than competition and rivalry.

The geopolitics of the Caspian is very broad theme in term of geography, players involved and issues to deal with. Based on the above-mentioned conceptual approach, also given the thesis limitations and the relevance of the issues, I narrowed the scope of the research to those identified in the context. Our geography is limited with the core of the Caspian, Azerbaijan being as a case study whose location in the region is very significant and its study attribute very interesting case for the Caspian Sea region as it defined in this research. Politics is restricted to the energy, e.g. oil and gas. The US and Russia in addition to others are considered as main players. Chronological frame in general encompasses period of 1994 up to now with the emphasis on the present geopolitical encounter.

The thesis could conditionally be divided into three parts. The first part is devoted to the concept and methodology of the research (chapter I). The second part deals with the pure facts. Global energy trends, the share and role of the Caspian hydrocarbon reserves (chapter II), including Azerbaijan's oil and gas resources' role and place in world energy, their exploitation (chapter III) provide background and very relevant information and context. The third part covers main objectives of Azerbaijan's energy policy (chapter IV), and broader picture of geopolitics in the Caspian Sea region and in

Eurasia (chapter V), where presently oil and gas become major policy tools for domination over energy resources and geostrategic influence.

Review of Literature

The degree of study of the issues related to the subject in the literature is different. The revival of geopolitics at the end of XX century caused the renewed interest in the subject, on our part required to evaluate H. Mackinder.¹ After the collapse of the USSR power vacuum in the heartland of Eurasia, core of which for the purposes of this research is the Caspian, draw the attention of military strategists and political theorists who laid down their vision of state of play of great game and future of geopolitics.² The Caspian Sea and its resources became the subject of interest of authors who studied different aspects of the problem, such as: history of oil development in the Caspian, role of oil and gas, pipelines, status of the Caspian Sea, regional conflicts, and politics of regional states.³

Most commentators study geopolitics in the context of transportation of resources.⁴ Azerbaijan was present in those studies; however, there are also few

¹ Halford J. Mackinder, *Democratic Ideals and Reality: A Study in the Politics of Reconstruction* (New York: Henry Holt and Company, 1942); Halford J. Mackinder, *Britain and the British Seas* (Westport: Greenwood Press Publishers, 1969); Francis P. Sempa, *Geopolitics: From the Cold War to the 21st Century* (New Brunswick: Transaction Publishers, 2002); John Agnew, *Geopolitics: Re-visioning World Politics*, 2nd ed. (London and New York: Routledge, 2003); Geopolitics. (2009). Encyclopedia Britannica. *Ultimate Reference Suite*. Chicago: Encyclopedia Britannica.

² Henry Kissinger, *Diplomacy* (New York: Published by Simon & Schuster, 1994); Zbigniew Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives* (New York: BasicBooks, 1997); Michael Mandelbaum, "The Caspian Region in the Twenty-first Century," in *Energy and Conflict in Central Asia and the Caucasus*, ed. Robert Ebel and Rajan Menon (Lanham: Rowman & Littlefield Publishers, Inc., 2000); Lutz Kleveman, *The New Great Game. Blood and Oil in Central Asia* (New York: Grove Press, 2003); Steve LeVine, *The Oil and the Glory: The Pursuit of Empire and Fortune on the Caspian Sea* (New York: Random House, 2007); Andrew C. Hess, "Eurasia and Geopolitics of Gas," *The Fletcher Forum of World Affairs*, Winter 2008, Vol. 32:1.

³ Moshe Gammer, ed., *The Caspian Region: Re-emerging Region*, vol. I (London-New York: Routledge. Taylor & Francis Group, 2004); Michael Croissant and Bulent Aras, ed., *Oil and Geopolitics in the Caspian Sea Region* (Westport-London: Praeger, 1999).

⁴ Svante E. Cornell and Niklas Nilsson, ed., "Europe's Energy Security: Gazprom's Dominance and Caspian Supply Alternatives," *Central Asia-Caucasus Institute, Silk Road Studies Program*, February, 2008 (accessed February 23, 2009); available from <http://www.isdp.eu/files/publications/scornell/sc08europesenergy.pdf>; Svante E. Cornell, Anna Johnson, Niklas Nilsson and Per Haggstrom, "The Wider Black Sea Region: An Emerging Hub in European

researches devoted to Azerbaijan particularly.¹ Surprisingly energy security is not only defined well yet, but very few attempted to do so. Merely agencies and officials dealing with energy tried to explain the term.² Internal challenges the oil revenues may impose are very purely researched.³

Some authors present really controversial propositions alleging that in the Caspian region “the United States has no overriding security interests and which is chock full of ethnic conflicts, contested borders, and shifting power balances, the wiser is to walk softly and carry small stick”⁴ not availing themselves to explain what in terms of policy “soft walk” and “small stick” mean.

The general trend is that all commentators view the Caspian Sea as a source of energy, how it may contribute to energy security of consumers, exporters. Commentators

Security,” *Central Asia – Caucasus Institute, Silk Road Studies Program, Silk Road Paper*, December 2006 (accessed February 23, 2009); available from <http://www.isdp.eu/files/publications/srp/06/sc06widerblack.pdf>; Svante E. Cornell, “Pipeline Power: The War in Georgia and the Future of the Caucasian Energy Corridor,” *Georgetown Journal of International Affairs*, vol. 10 no. 1, Winter 2009, *Johns Hopkins University, Central Asia – Caucasus Institute, Silk Road Studies Program* (accessed February 23, 2009); available from <http://www.isdp.eu/files/publications/scornell/GJIA-2009.pdf>; Thrassy Marketos, “Eastern Caspian Sea Energy Geopolitics: A Litmus Test for the U.S. – Russia – China Struggle for the Geostrategic Control of Eurasia,” *Caucasian Review of International Affairs*, vol. 3 (1) – Winter 2009 (accessed February 12, 2009); available from http://cria-online.org/Journal/6/Done_%20Eastern%20Caspian%20Sea%20Energy%20Geopolitics_Marketos.pdf

¹ David Hoffman, “Azerbaijan: The Politicization of Oil,” in *Energy and Conflict in Central Asia and Caucasus*, ed., Robert Ebel and Rajan Menon (New York-Oxford: Rowman & Littlefield Publishers, Inc., 2000); Nasib Nassibli, “Azerbaijan: Oil Politics in the Country’s Future,” in *Oil and Geopolitics in the Caspian Sea Region*, ed., Michael Croissant and Bulent Aras (Westport-London: Praeger, 1999); Cynthia Croissant, *Azerbaijan, Oil and Geopolitics* (Commack: Nova Science Publishers, Inc., 1998).

² *Emerging Global Energy Security Risks*, ECE Energy Series No. 36 (Geneva: United Nations, 2007); International Energy Agency, *Energy Security* (accessed March 14, 2009); available from http://www.iea.org/Textbase/subjectqueries/keyresult.asp?KEYWORD_ID=4103; Hugo McPherson and Duncan W. Wood, ed., *Emerging Threats to Energy Security and Stability; Proceedings of the NATO Advanced Workshop, London, 23-25 January 2004* (Dordrecht: Springer, 2005).

³ Michael Cohen, “The Effect of Oil Revenues on Transition Economics: The Case of Azerbaijan,” *Geopolitics of Energy*, vol. 28, no. 6 (June 2006).

⁴ Robert Ebel and Rajan Menon, “Introduction: Energy, Conflict, and Development in the Caspian Sea Region,” in Robert Ebel and Rajan Menon, ed., *Energy and Conflict in Central Asia and the Caucasus* (Lanham: Rowman & Littlefield Publishers, Inc., 2000), 3-4.

and analysts consider Caspian hydrocarbons from the standpoint of outsiders, whereas my view come from inside the region and reflect region's vision and preoccupations.

The literature also doesn't examine the strategy and policy of the Caspian countries. In fact these policies are critical in shaping the geopolitics of the region. Azerbaijan as well as other Caspian oil producing countries is regarded as passive actors which is not true since their policy influences the outcomes and we will see how. Azerbaijan is not the only energy player in the Caspian region and interplay of different players determines the certain outcomes of energy policy not only in the Caspian, but in Eurasia as a whole. Important question is what dynamics of geopolitics of energy in Eurasia are.

Review of Sources

Information related to the global oil and gas was obtained from the web-site of the Energy Information Administration (EIA). In particular we extensively used the data containing in *The International Energy Outlook 2008 (IEO2008)*.¹ This report presents an assessment by the EIA of international energy projections and outlooks for major energy fuels. This paper focused on liquid fuels and natural gas based on reference case. In using this data we aimed at depicting continues rise of consumption and need for supply of liquid fuels and natural gas. This data was important to place the Caspian region in the context of global energy picture and to show its role and importance. The time frame for historical data begins with 1980 and extends to 2005, and the projections expand to 2030.

EIA in its web-site provides several sources (BP Statistical Review, Oil & Gas Journal, World Oil and CEDIGAZ) of a data concerning the world proved reserves of oil and natural gas. The data of each of these sources in relation to the same country and

¹ Energy Information Administration, *International Energy Outlook, 2008* (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

fuels sometimes is different. Information about Caspian region's reserves is not reported to World Oil. In *IEO2008* on world proved reserves of oil and natural gas EIA uses the data provided by Oil & Gas Journal. On the same subject for the consistency we also applied the figures provided by Oil & Gas Journal. Tables containing information about world oil and gas trends were compiled based on our research requirement, that is to say only countries related or close to the Caspian were included.

Web-site of International Energy Agency (IEA), in particular its working paper on Perspectives on Caspian Oil and Gas Development of December 2008¹ was very helpful in obtaining information regarding oil and gas pipelines, as well as maps. International Monetary Fund's country information was important in terms of assessing Azerbaijan's accomplishments.

Data related to Azerbaijan's oil and gas, policy statements and information on managing oil revenues were obtained from web-sites of Azerbaijan's late and current presidents, as well as governmental agencies, i.e., SOCAR, SOFAZ. Speeches by the head of state are the only source for policy formulation. In some instances texts in English obtained from these web-sites have been refined.

The US sources such as web-site of EIA, Senate and others were very useful. We also extensively used web-sites of some international institutions, e.g. European Commission, IMF, INOGATE, and SCO.

¹ International Energy Agency, *Perspectives on Caspian Oil and Gas Development, December 2008* (accessed February 20, 2009); available from http://www.ica.org/textbase/papers/2008/caspian_perspectives.pdf

I. Defining Geopolitics, Caspian Sea Region and Energy Security

Geopolitics was chosen as a conceptual framework and methodological approach of the research which in its turn necessitated a definition of the terms of “geopolitics”, “Caspian Sea Region” and “energy security”.

1. Geopolitics

F. Sempa defines geopolitics as “interaction among states and empires in a particular geographical setting” and discusses population, economics, technology, military power, and character of government, drawing attention to the size and specifically to the geographic position of a country.¹ In accordance to other definition geopolitics is “the study of the impact of the geographical distributions and divisions on the conduct of world politics.”²

Encyclopedia Britannica provides that geopolitics is about analysis of the geographic influences on power relationships in international relations. The word geopolitics was originally coined by the Swedish political scientist Rudolf Kjellen about the turn of the 20th century, and its use spread throughout Europe in the period between World Wars I and II and came into worldwide use during the latter.

Geopoliticians sought to understand how the new industrial capabilities of transportation, communication, and destruction - most notably railroads, steamships, airplanes, telegraphy, and explosives - interacting with the largest-scale geographic features of the Earth would shape the character, number, and location of viable security units in the emerging global international system. During World War II some even

¹ Francis P. Sempa, *Geopolitics: From the Cold War to the 21st Century* (New Brunswick: Transaction Publishers, 2002), 5-6.

² John Agnew, *Geopolitics: Re-visioning World Politics*, 2nd ed. (London and New York: Routledge, 2003), 135.

predicted that technological developments would render naval power obsolete. With the advent of the railroad, others posited that land power would trump sea power. The emergence of the airplane led some geopoliticians to downplay the role of both naval and land power in favour of air superiority.

The popularity of geopolitical theory declined after World War II, because the emergence of nuclear ballistic missiles reduced the significance of geographical factors in the global strategic balance of power. However, geopolitics continued to influence international politics, serving as the basis for the United States' Cold War strategy of containment as a geopolitical strategy to limit the expansion of the Soviet Union. Political geographers also began to expand geopolitics to include economic as well as military factors.¹ Presently they go as far as to include outer space and discuss “astropolitics.”

The most prominent geopolitician whose studies inspired and continues up to present to inspire many military strategist and political planners is widely considered to be the British political geographer Halford Mackinder (1861-1943). Among Mackinder’s “insular” and “peninsular” powers, relative advantage of “land power” over “sea power” and “Midland Ocean” concepts his “heartland” theory presents the most important and extremely useful case for our research.

Mackinder named Eurasia and Africa as World Island surrounded by islands of Americas, Australia, Britain and Japan in “outer crescent” and all located in one ocean. The vast interior regions of Eurasia Mackinder called Heartland of the Continent which he put in “a great inner crescent,” or “Eurasian Rimland” as another geopolitician N. Spykman called it, of the former. This great area of Heartland embraces the basins of the Lena, Yenisei and Obi rivers steaming northward through Siberia to the northern

¹ Geopolitics. (2009). Encyclopedia Britannica. *Ultimate Reference Suite*. Chicago: Encyclopedia Britannica.

inaccessible edge of Asia and for that reason they were detached from ocean and river navigation. The region also comprises the basins of the Volga and Ural rivers flowing to the Caspian Sea, and the Oxus and Jaxartes to the Sea of Aral. For the strategic reasons he also included in the Heartland Baltic and Black seas, middle and lower Danube, Asia Minor, Persia, Tibet and Mongolia.¹ Based on his consideration finally Mackinder comes to his famous conclusion and remarkable advice given to European statesmen in Versailles in 1919: “Who rules the East Europe commands Heartland; who rules Heartland commands the World-Island. Who rules the World-Island commands the World.”²

But the most stunning was his proposed settlement to the problem of Eastern Europe where after the fall of Austria-Hungarian and Ottoman Empires, and withdrawal of Bolshevik Russia from Europe power vacuum emerged. Mackinder suggested forming a “tier of independent states between Germany and Russia,” which would establish “a broad wedge of independence, extending from the Adriatic and Black Seas to the Baltic” and constitute “territorial buffer between Germany and Russia.”³ We will come back to this idea later.

Heartland is almost coincide with D. Christian (though he doesn't accept geopolitical significance of the region) definition of “Inner Eurasia” which includes Russia, Ukraine, Belarus, Moldova, Baltic states, Central Asia, China's Central Asian empire within its modern provinces of Sinkiang and Kansu, Mongolia, including parts within modern China, Caucasus and Tibet. “Outer Eurasia” includes several well-watered

¹ Halford J. Mackinder, *Democratic Ideals and Reality. A Study in the Politics of Reconstruction* (New York: Henry Holt and Company, 1942) 73-115.

² Ibid., 150.

³ Ibid., 158-165.

coastal sub-continents that lie a great arc from Europe, to the Middle East, to India, and to South and East Asia.¹

Eurasia as a cradle for earliest human civilizations from the times immemorial was at forefront of world history, world politics and world power. From III century BC up to XV century Eurasia was dominated by Hun, Blue Türk, Mongol and Seljuk empires which facilitated and upheld trade, economic, cultural, religious, scientific exchanges across continent along the trade routes known as Great Silk Road. These connections in huge landmasses of Eurasia were possible among other things due to perfect communications means. Highly mobile army consisting entirely of cavalry, traveling without supply train other than reserve of horses, with self-sufficient warrior, carrying strips of dried meat and milk – yogurt, leather of flask water, using traditional methods of communications, such as use of torches, whistling arrows, smoke, flares and flags, arm signals, all of which had no analogy in any army of the time was part of that system. Together with newly established, but very efficient postal service, consolidation of steppe customs and traditions as a law, firmly enforced across the huge territory, this geopolitics promoted co-operation and exchanges, as well as ethnic and religious tolerance among the peoples of Eurasia. This policy which provided stability and prosperity was in fact internal strength of these empires. This politics enforced by force if necessary was also instrumental in managing the balance of interests with powerful neighbors, China, Rome, Byzantine, Iran, Caliphate, representing different civilizations, religious, cultures and traditions.

¹ David Christian, *A History of Russia, Central Asia and Mongolia*, vol. I: *Inner Eurasia from Prehistory to the Mongol Empire* (Singapore: Blackwell Publishing, 2006), xv.

Continuation of this policy by the Ottoman Empire provided its domination of the outlet of the Silk Road to Europe. Revenues and ideas generated by trade coming all the way from the East and firmly protected by the Ottoman land army stimulated and also forced backward at that time Western Europeans locked between Arctic North and desert South to search for maritime routes from the West to the East and its wealth, but instead they discovered America which became the source of prosperity for Western Europe as was the Silk Road trade for the peoples of Eurasia.

The fall of Kazan and Astrakhan khanates in the XVI century marked the division of Eurasia. From that time on Heartland or Inner Eurasia was shared by rising Rus, and splitting and declining Turkic empires. Trade and exchanges along the Great Silk Road contracted gradually paving the way to isolationism. In XIX century the Russian Empire was the only power in command of Heartland thus replacing centuries long Turkic-Mongol supremacy with its cultural, religious tolerance and openness. In the XIX century attempt by Britain though being “of Europe, yet not in Europe”¹ by advancing northwards to contain Russia which in its turn trying to expand further south was the first instance of playing “great game” in Eurasia between non-Eurasian sea power and Eurasian land power. The Tsarist Russia’s policy was consistently followed by the USSR in the XX century.

Geopolitics is about analysis of the influence of geographic factors on state’s policy and its interaction with other states. Not undermining such determinants as population, economics, technology and military strength, which may change over time, however size, location, natural resources and communications of a country have to be

¹ Halford J. Mackinder, *Britain and the British Seas* (Westport: Greenwood Press Publishers, 1969), 12.

underlined. Size, natural resources, communications also may alter, but, location of the country seems to be the only constant variable to be taken into account in geopolitics.

After the ‘Cold War’ and short period of high idealistic expectations of a new world order interest to geopolitics renewed. The dissolution of the Soviet Union created new dynamics and focus shifted towards Heartland/Inner Eurasia this time mainly due to its energy resources and power vacuum which emerged here. Energy became the main tool for geopolitics in Eurasia and the Caspian Sea region – its pivot.

2. The Caspian Sea Region

Caspian Sea is world's largest inland body of water, lying to the east of the Caucasus Mountains and to the west of the vast steppe of Central Asia. Its name derives from the ancient Kaspi peoples, who once lived in Transcaucasia to the west; among its other historical names, Khazarsk and Khvalynsk derive from former peoples of the region, while Girkansk stems from Girkanos, “Country of the Wolves.” The elongated sea sprawls for nearly 750 miles (1,200 km) from north to south, although its average width is only 200 miles (320 km). It covers an area of about 149,200 square miles (386,400 square km)—larger than Japan—and its surface lies some 90 feet (27 metres) below sea level. The maximum depth, toward the south, is 3,360 feet (1,025 metres) below the sea's surface. The drainage basin of the sea covers some 1,400,000 square miles (3,625,000 square km). The sea contains some 63.4 billion acre-feet or 18,800 cubic miles (78,200 cubic km) of water—about one-third of the Earth's inland surface water (Annex, Map 1).

The Caspian is the largest salt lake in the world, but this has not always been true. Scientific studies have shown that until geologically quite recent times, approximately 11 million years ago, it was linked, via the Sea of Azov, the Black Sea, and the Mediterranean Sea, to the world ocean. The Caspian is of exceptional scientific interest,

because its history—particularly former fluctuations in both area and depth—offers clues to the complex geologic and climatic evolution of the region. Human-made changes, notably those resulting from the construction of dams, reservoirs, and canals on the immense Volga River system (which drains into the Caspian from the north), have affected the contemporary hydrologic balance. Caspian shipping and fisheries play an important role in the region's economy, as does the production of petroleum and natural gas in the Caspian basin. The sea's splendid sandy beaches also serve as health and recreation resorts.¹

The Caspian Sea is bordered in the northeast by Kazakhstan, in the southeast by Turkmenistan, in the south by Iran, in the southwest by Azerbaijan, and in the northwest by Russia. Through these countries it is connected to wider regions; the South Caucasus on the west, the Central Asia on the east, the Middle East in the south and Eurasia on the north.

The Southern Caucasus and the Central Asia started to attract the attention and the interest of the international community at the first half of the 90ths of the XX century. Not known much during the Soviet rule, these regions after the break-up of the USSR began to frequently appear in the Western newspapers. Eager to get rid of the Soviet heritage their names have quickly been changed. The Soviet “Transcaucasia” and “Middle Asia” restored their true names, Southern Caucasus and Central Asia respectively. In addition, the new term “The Caspian Region” never existed before was introduced. But most importantly politicians, diplomats, scholars and commentators started to talk about old continent of Eurasia, but with renewed interest. All these name alterations, beside the fact

¹ Caspian Sea. (2009). Encyclopedia Britannica. *Ultimate Reference Suite*. Chicago: Encyclopedia Britannica.

that they more precisely reflected geographic names and realities, as well as political interest in geography, certainly bear a geopolitical connotation.

Some scholars using the term “Caspian Sea Region”, “Caspian Region” or simply “Caspian” attempted to provide its definition. One usage implies a geopolitics determined by peculiarities of geology, which has led to the formation of a region defined by oil and gas.¹ Mustafa Aydın gives broader description. He proceeds from “the interplay of economic, political and strategic interests of various actors”, identifies “energy resources, interacting with many regional conflicts surrounding the area and with the international efforts to solve peacefully these conflicts” and “foregoing the simplistic version of geopolitical classification” refers “to a vast region stretching from the Black Sea to western China and Mongolia.”²

There were also metaphoric definitions according to which “[t]he Caspian region is crossroads, a meeting point of different people, different cultures, and different political, social, and economic forces... For the region is the site of the convergence – and sometimes the collision... The region’s future will be determined by the interplay of these time-traveling historical forces.”³

Before going to definition we need to consider the factors, which since the 90th of XX century made the region valuable and accordingly raised its importance, brought it to the attention of the international community and evoked its interest towards the region. There are several of them: (1) the emergence of the independent states after the

¹ Manaba Shimisu ed., *IDE Spot Survey: The Caspian Basin Oil and its Impact on Eurasian Power Games* (Tokyo: Institute of Developing Economics, 1998), 8; Graham Fuller, “Geopolitical Dynamics of the Caspian Region,” in *Caspian Crossroads*, vol. 3, no. 2 (1997): 1.

² Mustafa Aydın, “Oil, Pipelines and Security: The Geopolitics of the Caspian Region,” in: *The Caspian Region: A Re-emerging Region*, vol. I, ed., Moshe Gammer (London and New York: Routledge, 2004), 6.

³ Michael Mandelbaum, “The Caspian Region in the Twenty-first Century,” in *Energy and Conflict in Central Asia and the Caucasus*, ed., Robert Ebel and Rajan Menon (Lanham: Rowman & Littlefield Publishers, Inc., 2000), 21.

dissolution of the Soviet Union; (2) the presence of rich resources of oil and natural gas; (3) countries' favorable geographic location; (4) the foreign policy conducted by these states.

During the Soviet period the Caspian Sea has been exploited mainly by the USSR and was closed for external involvement. Whereas the break-up of the Soviet Union and the emergence of the independent states around the Caspian Sea, presented chances and opportunities for external actors to establish co-operation with these countries.

Rich oil and natural gas resources in the Caspian Sea actually made the region important, attracted the interest of external actors and provided prospects for co-operation. The region occupies central position in the Eurasian continent, in its Heartland. This geographic location is important due to being: (1) the crossroad of the traditional trade routes connecting North and South, as well as East and West, Asia and Europe, known as the Great Silk Road, and (2) proximity of the Middle East and South Asia, in particular Iraq and Afghanistan, the main battlefields in the fight against terrorism.

However, it was not geology and geography per se, but the policy of openness towards the West conducted firstly by Azerbaijan, which actually opened the Caspian Sea region to the West. Without that policy the West, mainly the USA could have not been in the Caspian in its search for energy and in its fight against terrorism, as well as in its quest for geopolitical influence, and the region would have not gained its present significance.

Though Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan are geographically littoral countries and all of them have oil and gas resources, however, role and importance of each of them are not equal due first of all to their energy policy. Azerbaijan and Kazakhstan made the first steps to open the Caspian Sea's hydrocarbon

resources and transport them to world market. Turkmenistan is also or rather may be a crucial player in the transportation of gas to the West.

Georgia and Turkey serve as transit countries for transportation of the Caspian hydrocarbons to Europe. Oil is delivered by pipeline from Kazakhstan and Turkmenistan (through Uzbekistan and Kazakhstan) to China. There are also proposed gas pipelines connecting Turkmenistan via Uzbekistan and Kazakhstan with China and with India through Afghanistan and Pakistan.

Proceeding from the above-mentioned reflections the Caspian Sea region may be described as several overlapping spheres or circles. The main one or heart is made up of Azerbaijan, Kazakhstan and Turkmenistan as major hydrocarbon exporters. The second circle comprises Georgia, Turkey, Russia, Uzbekistan, Afghanistan and Pakistan as transit countries. Europe, US, China and India are importers and connected to the region. Though Iran does not participate presently in any project, it may change over time and in any event is very relevant to the Caspian Sea. Russia's role is probably unique, though it is presented here as a transit country, but it is also exporter and even importer. Russia has key stakes in the Caspian and unlike other littoral states may significantly influence the state of affairs.

The region's security is fragile and volatile and is threatened by a number of risks and challenges. The conflicts in the South Caucasus, status of the Caspian Sea, Iranian nuclear program and policy in the Middle East, war in Afghanistan, nontraditional threats, such as terrorism, illicit arms delivery, drug trafficking, illegal migration, trafficking in human beings, difficulties related to nation and state building are the issue to be dealt with. There is plenty of work for international community and local actors to accomplish.

Proceeding from the above-mentioned we may come to the conclusion that the region's security is based on two fundamental concepts. Security is comprehensive on one side and multilevel, on the other side. Comprehensiveness means that security has political-military, economic and humanitarian dimensions. Risks and challenges come from national, regional and global levels. Complexity lies with the reality that challenges could be, purely humanitarian in their dimension and rigidly national in their origin or they may be multidimensional and pose a threat simultaneously at the global, regional and national level. Depending on the dimension and the level of challenges one should choose the appropriate mean to deal with and respond nationally, regionally or globally, politically and economically, peacefully or otherwise.

The Caspian Sea region's geography is very wide, security is comprehensive and multilevel, and politics is tremendously complex. Obviously the region is understood as a geo-political term. The appearance of the term is mainly related to the presence of hydrocarbons deposits in the Caspian Sea. Ensuring energy security was viewed in the region as a tool for safeguarding broader security and even independence altogether.

3. Energy Security

Though the term is widely used generally accepted definition is still lacking. The term is used by diverse authors for dissimilar purposes in various contexts with different meanings which make the common definition even harder. Perhaps it is unnecessary given that each actor view it differently.

Energy Safety Forum (ESF) launched in 2003 by the United Nations Economic Commission for Europe (UNECE) while acknowledging that energy security is not easy to define because it is multifaceted concept, identifies four dimensions of particular relevance: (a) physical disruption of supplies due to infrastructure breakdown, natural

disasters, social unrest, political action or acts of terrorism; (b) long-term physical availability of energy supplies to meet growing demand in the future; (c) deleterious effects of economic activity and peoples due to energy shortages, widely fluctuating prices or price shocks; and (d) collateral damage from acts of terrorism resulting in human casualties, serious health consequences or extensive property damage. Taking into consideration these four dimensions, ESF defines energy security as “the availability of usable energy supplies, at the point of final consumption, at economic price levels and in sufficient quantities and timeliness so that, given due regard to encouraging energy efficiency, the economic and social development of a country is not materially constrained”. ESF admits that this is but one of a number of possible definitions that could be put forward, however it does have the merit of capturing the multidimensional nature of energy security.¹ This concept puts emphasis on availability and safety of supply at an adequate price.

International Energy Agency (IEA) suggests somewhat broader definition. IEA describes energy security as “the uninterrupted physical availability at a price which is affordable, while respecting environment concerns”. IEA’s concept provides that energy security has many aspects: long-term energy security is mainly linked to timely investments to supply energy in line with economic developments and environmental needs. On the other hand, short-term energy security is the ability of the energy system to react promptly to sudden changes in supply and demand. Another way to look at energy security is to study the different energy sources (coal, oil, gas, and renewables), intermediate means (electricity, refineries) and transportation modes (grids, pipelines, ports, ships). All of these have risks of supply interruptions or failures, challenging the

¹ *Emerging Global Energy Security Risks*, ECE Energy Series No. 36 (Geneva: United Nations, 2007), 8.

security of undisturbed energy supply.¹ Environment, different energy sources and transportation types are issues IEA draws attention to.

Dr. Andrei Konoplyanik, Deputy Director of the Energy Charter Secretariat believes that "...energy security is best understood as the continuing assurance and maintenance of adequate, reliable supply of energy at a reasonable cost in the short, medium and long term. This persistence of adequate and reliable supply can only be assured in the context of the right investment decisions. There are many facets to energy security...".² Dr. Konoplyanik adds new elements: time perspective and investments in securing supply.

Arne Walther, Secretary General of the International Energy Forum (Riyadh) provides more extensive notion. According to him energy security is broad based issue and is no longer focused purely on oil. Energy efficiency, stock-holding, fuel-switching, substitution options, diversification of resources and spare capacity are, along with emergency responses, key concepts in traditional security of supply thinking. He emphasize that there are two sides of the energy security coin: security of supply and security of demand. Energy importing countries want security of supply from energy-exporting countries. Energy-exporting countries in turn want security of energy demand in energy importing countries. They may in addition need investments from abroad to develop infrastructure necessary to produce and export their energy resources.

He states furthermore that for both consumers and producers this implies dependency. Some would argue that dependency on others is so important and strategic an area as energy constitutes a political and economic risk that should be reduced to a

¹ International Energy Agency, *Energy Security* (accessed March 14, 2009); available from http://www.iea.org/Textbase/subjectqueries/keyresult.asp?KEYWORD_ID=4103

² Hugo McPherson and Duncan W. Wood, ed., *Emerging Threats to Energy Security and Stability; Proceedings of the NATO Advanced Workshop, London, 23-25 January 2004* (Springer: Dordrecht, 2005), 79.

minimum if it cannot be avoided altogether. Others would argue the more positive vision: such dependency can serve as a drive to improve relations between countries and to stabilize the geopolitical climate overall. He concludes by saying that energy security should not be regarded as an issue of technical arrangements and infrastructure alone. It has also to do with economics, politics and the environment in both short and long-term perspective.”¹

A.Walther’s definition is more comprehensive. He draws attention to stock holding, fuel substitution and resource diversification. He doesn’t focus on supply exclusively which is vital for consumers. He brings the issue of demand that is suppliers’ interests. This leads him to the concept of mutual dependency which is not necessarily bad. Finally he views energy security not in technical terms only, but involving politics, economics and environment.

As we have seen the proposed definitions of the concept are wide in scope, still not inclusive however and embrace such elements as disruption, availability, reliability and diversification of supplies, adequate price, short, medium and long term period, investments, availability of demand, consumer and producer dependency, economic, political and the environmental dimensions. All of them may work for Azerbaijan but to various degree and they are not equally applicable. Diverse definition is probably justifiable, given that different players proceed from dissimilar circumstances.

What may determine Azerbaijan’s approach to its energy security? Several factors have to be mentioned. Azerbaijan is oil and gas producing country. As such it is interested in demand, which is obviously not in short supply. Oil is extracted from the Caspian Sea and environmental consideration is very important. Azerbaijan lacks direct

¹ Hugo McPherson and Duncan W. Wood, 77.

access to world markets and some of its neighbors are also oil producing countries. The implication is that Azerbaijan needs to transport not only its own resources, but those of other oil suppliers. So it is also transit country. Under these circumstances transportation of hydrocarbons comes into the agenda. At a time when Azerbaijan signed the oil contract its oil and gas industry was in decline, in need of new technology and investment. Investments on other side require reliable legal environment. The regional conflicts in the South Caucasus, as well as proximity to the unstable and unpredictable Middle East may pose physical threat to the transportation infrastructure. Energy security was considered as crucial element of Azerbaijan's overall security. This in turn required attracting and selecting of large number of countries and companies for investment under the calculation that investing countries will have not only economic but also political interest in the stability of the region, as well as sovereignty and independence of the region's countries.

All previous definitions of energy security were mainly supply oriented so to say, foremost preoccupied with how to provide and secure uninterrupted supply. Azerbaijan's position requires new additional elements, namely diversification of transportation, reliable legal safety for investments and environmental protection.

Another important factor is that Azerbaijan's energy security was not constant equation; it changed over time at different stages of oil exploitation. The first period starts in 1994 when oil contract was signed and continues up to 2006/2007 when Baku-Tbilisi-Ceyhan (BTC) and South Caucasus Pipeline (SCP) became operational. At this stage Azerbaijan focused on attracting investments, protecting its legal rights in the Caspian Sea and securing political and financial support for BTC project. Azerbaijan was mainly security consumer. At the second period when pipelines started to deliver

hydrocarbons to the world market emphasis changed, diversification not of oil only, but also gas supplies, security (in political and security terms) of infrastructure, tackling of internal challenges came to the forefront. At this phase Azerbaijan became more security provider.

The following elements could make up energy security of Azerbaijan: increasing demand, multiple transportation routes to deliver oil and gas, protection of environment, investments in exploitation and transportation infrastructure, political will of energy importers for high investments, investment friendly environment, securing transportation, mutual dependency of energy importing and exporting countries leading not to geopolitical confrontation, but to stability and cooperation.

In sum, Azerbaijan's energy security could be defined as "to meet increasing demand secure transportation of oil and natural gas, extracted with due regard to environmental protection, through multiple pipeline networks requiring investments, protected by country's law, backed by strong political will on the part of investing and consuming countries leading to the security and mutual dependency of exporting, transit and importing countries resulting not in contest, but in geopolitical cooperation and stability."

II. Global Trends

The *IEO2008* reference case projects world consumption of marketed energy to increase from all fuel sources over the 2005 to 2030 period. Fossil fuels (liquid fuels and other petroleum, natural gas, and coal) are expected to continue supplying much of the energy used worldwide. Liquids supply the largest share of world energy consumption over the projection period.

1. Liquid Fuels

Liquids are expected to remain the world's dominant energy source. Liquids make up the largest share of world energy consumption over the projection period, though their share falls a bit from 37 percent in 2005 to 33 percent in 2030, as other fuels replace liquids where possible.¹

1.1. World Liquid Consumption

The demand for liquid fuels and other petroleum continue to increase robustly. Liquid consumption increases at an average annual rate of 1.2 percent from 2005 to 2030. World use of liquids and other petroleum grows from 83.6 million barrels oil equivalent per day in 2005 to 95.7 million barrels per day in 2015 and 112.5 million barrels per day in 2030 due to strong economic growth primarily in the emerging economies of the world.²

Liquids consumption increase in all regions. But the strongest regional increase in liquids consumption is estimated for non-OECD Asia and the Middle East (Annexes, Table 1).³ Among the nations of non-OECD Asia, China and India account for much of the growth in liquids demand, and together they account for 11.5 million barrels per day

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.1 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Ibid., 23.

³ Ibid., 24-25, 108. Table in the source includes several other countries. Countries presented in this table have been chosen for their relevance to our subject.

(74 percent) of the regional increment in liquids use. Liquids consumption in non-OECD Asia is projected to surpass that in the United States (currently the world's largest liquids-consuming nation) by 2020, and in 2030 it is projected to exceed U.S. consumption by nearly 40 percent.¹

1.2. World Liquids Production

To meet the increment in world liquids demand total supply in 2030 is projected to be 28.2 million barrels per day higher than the 2005 level of 84.3 million barrels per day (Annexes, Table 2).²

About 47 percent of the total world increase in liquids supplies is expected to come from OPEC member states. It is assumed that OPEC producers will choose to maintain their market share of world liquids supply, and that OPEC member states will invest in incremental production capacity so that their conventional oil production represents approximately 40 percent of total global liquids production throughout the period.³

In 2030 65 percent of OPEC's total liquids production increase per day will come from the Middle East. The largest increase in the individual OPEC countries' liquids production is projected for Saudi Arabia: from 11.1 million barrels per day in 2005 to 13.7 million barrels per day in 2030.⁴

As for Europe significant decline is projected for the North Sea, which includes offshore production from Norway, the United Kingdom, the Netherlands, and Germany. However there are positive indications of future prospects for both Norway (with the

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.25 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Ibid., 23-24, 207. Table in the source includes several other countries. Countries presented in this table have been chosen for their relevance to our subject.

³ Ibid., 27.

⁴ Ibid., 30.

opening of the Barents Sea for exploration) and the United Kingdom (with the development of Buzzard field).¹ In the United States, total liquids production increases from 8.2 million barrels per day in 2005 to 10.3 million barrels per day in 2022, but falls to 9.8 million barrels per day in 2030.²

More than one-half of increase from non-OECD Europe and Eurasian producers is attributed to the liquids production increases in Russia, which is the country with the largest projected increase (by volume) in non-OPEC liquids production at 4.0 million barrels per day from 2005 to 2030.³

Significant portion in conventional liquids production is projected for the Caspian area. Overall, production from the Caspian Basin is expected to grow at an average rate of 3.6 percent per year, resulting in an increment of 3.0 million barrels per day over the 2005-2030 period. Kazakhstan alone accounts for 2.3 million barrels per day of the projected increase, primarily as a result of the development of its Kashagan field and the expansion of gas reinjection at Tengiz. Undiscovered yet fields in its Caspian territory are also expected to be developed before 2030. The growth of Kazakhstan's production will depend not only on resource availability and extractability, but also, because of its geographical position, on the opening of export routes—a task that will require regional cooperation.

Other Caspian producers Azerbaijan and Turkmenistan are also expected to increase their production. Turkmenistan's production is projected to grow by more than 6 percent per year in the mid-term and somewhat more slowly in the long term. Azerbaijan's production is projected to grow rapidly, to a peak production of 1.3 million

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.28-29. (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

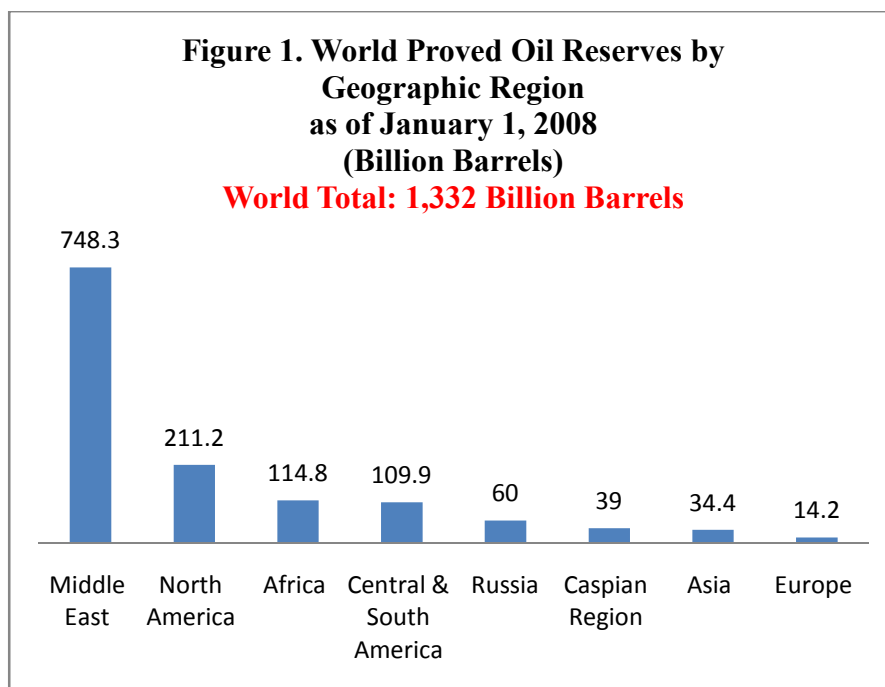
² Ibid., 29.

³ Ibid.

barrels per day in the next decade, followed by a decline to 1.0 million barrels per day in 2030.¹

1.3. World Oil Reserves and Resources

As of January 1, 2008, proved world oil reserves were estimated at 1,332 billion barrels, 56 percent of which are located in the Middle East (Figure 1)². Among the top 20 reserve holders in 2008, 11 are OPEC member countries that, together, account for 69 percent of the world's total reserves.³



IEO2008 includes into the Caspian region Kazakhstan with 30 billion and Azerbaijan with 7 billion barrels of oil reserves. Turkmenistan accounts for 0.600 billion, Uzbekistan - 0.594 billion barrels of oil reserves.⁴ Caspian region's oil reserves exceed

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.28-29 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Caspian Region singled out by us based on the data presented in *IEO2008*.

³ Energy Information Administration, *International Energy Outlook, 2008*, p.32 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

⁴ Ibid., *World Proved Reserves of Oil and Natural Gas, Posted August 27, 2008* (accessed January 16, 2009); available from <http://www.eia.doe.gov/emeu/international/reserves.html>

those of Asia and Europe, both neighboring regions where consumption goes beyond production.

2. Natural Gas

Worldwide natural gas consumption increases by 1.7 percent per year on average, from 104 trillion cubic feet in 2005 to 158 trillion cubic feet in 2030. Natural gas is expected to replace oil wherever possible.¹

2.1. World Natural Gas Demand

In OECD Europe, natural gas consumption is projected to rise by an average of 1.4 percent per year—from 19.3 trillion cubic feet in 2005 to 22.8 trillion cubic feet in 2015 and 27.2 trillion cubic feet in 2030 (Annexes, Table 3).²

The countries of non-OECD Europe and Eurasia rely on natural gas for 51 percent of their energy needs—a larger share than for any other country grouping in the *IEO2008* projections. Russia is second only to the United States in total natural gas consumption, with demand totaling 16.2 trillion cubic feet in 2005 and representing 55 percent of Russia's total energy consumption. The other countries of non-OECD Europe and Eurasia met 46 percent of their combined total energy needs with natural gas in 2005. The increase in natural gas consumption accounts for 45 percent of the total increase in energy consumption in non-OECD Europe and Eurasia from 2005 to 2030.³

Non-OECD Asia, which accounted for only 9.0 percent of the world's total consumption of natural gas in 2005, shows the most rapid growth in natural gas use and accounts for 33 percent of the total increase in world natural gas consumption from 2005 to 2030. Both China and India's natural gas consumption expected to rise rapidly,

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.37 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Ibid., 38.

³ Ibid., 39.

growing by 5.5 percent per year in China and 4.6 percent per year in India on average from 2005 to 2030, as LNG imports and new domestic production help the two countries meet continued demand growth.¹

2.2. World Natural Gas Supply

Non-OECD countries account for more than 90 percent of the world's total growth in production from 2005 to 2030 (Annexes, Table 4).²

The Middle East and Africa are at the forefront of the trend to develop export projects—particularly, LNG, which is expected to account for a significant portion of exports. For the two regions combined, natural gas production increases by 21.0 trillion cubic feet from 2005 to 2030, while their combined demand for natural gas increases by only 9.9 trillion cubic feet. The increase in exports from Qatar alone from 1 trillion cubic feet to 3.6 trillion cubic feet of natural gas would account for 14 percent of the total projected increase in production from 2005 to 2015 for the non-OECD countries, excluding non-OECD Europe and Eurasia.³

China and India are projected to almost double their production volumes from 2005 to 2015, bringing production from India's Krishna Godavari Basin and China's Sichuan province, as well as from smaller projects, to market. Some new export projects are expected to be brought on line in non-OECD Asia by 2015—most notably, the Tangguh LNG project in Indonesia—but production increases are aimed primarily at meeting rapid demand growth in the region. As rapid increases in production continue to

¹ Energy Information Administration, *International Energy Outlook, 2008*, p.39-40 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Ibid., 40-41.

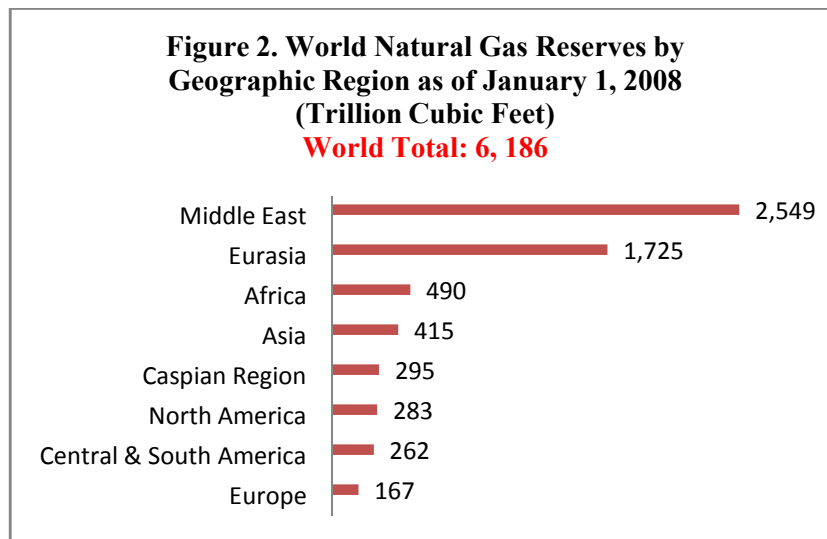
³ Ibid., 40.

be outpaced by consumption growth, non-OECD Asia is projected to become a net importer of natural gas after 2015.¹

In non-OECD Europe and Eurasia, natural gas production is projected to grow from 29.3 trillion cubic feet in 2005 to 36.1 trillion cubic feet in 2015 and 43.0 trillion cubic feet in 2030. Production increases are projected to outpace growth in natural gas demand in non-OECD Europe and Eurasia, and it is anticipated that Eurasian producers will remain important suppliers for their neighbors, especially in OECD Europe.

2.3. World Natural Gas Reserves

As of January 1, 2008, proved world natural gas reserves, as reported by *Oil & Gas Journal*, were estimated at 6,186 trillion cubic feet. Almost three-quarters of the world's natural gas reserves are located in the Middle East and Eurasia. Russia, Iran, and Qatar together accounted for about 57 percent of the world's natural gas reserves as of January 1, 2008 (Figure 2).²



¹ Energy Information Administration, *International Energy Outlook, 2008*, p.40-41 (accessed January 4, 2009); available from [http://www.eia.doe.gov/oiaf/ieo/pdf/0484\(2008\).pdf](http://www.eia.doe.gov/oiaf/ieo/pdf/0484(2008).pdf)

² Ibid., 43-44 (Caspian Region included by us based on EIA's data on *World Proved Reserves of Oil and Natural Gas*).

In the Caspian region Turkmenistan and Kazakhstan each accounts for 100, Uzbekistan - 65 and Azerbaijan – 30 billion cubic feet natural gas reserves.¹ The Caspian region' reserves exceed those of North America, Central and South America, as well as Europe. In adjacent to Caspian region Europe and Asia (both OECD and non-OECD) in 2005-2030 gas consumption is expected to exceed production.

During the period of 2005-2030 energy consumption will increase steadily mainly in non-OECD member states. China and India' aggregate share in energy consumption will rise and reach the level of 25 percent in 2030. Though US share will fall to 17 percent in 2030, but this is the highest share for a single country.

As far as liquids are concerned, they will continue to be the dominant fuel and to have the largest share in energy consumption. Demand for liquids increases worldwide, in every region. However the main demand will come from non-OECD, in particular Asia, where India and China account for almost two thirds.

Liquids production expected also to grow to meet the demand. More than half - 56 percent - of the oil reserves is located in the Middle East. During 2005-2030 OPEC and Gulf countries will remain the main (70-72 percent) producers and their share in world production will be 43-44 and 27-28 percent respectively. In the years of 2010-2030 US, OECD Europe, Japan, China and India' share will be about 57-59 percent of world consumption and most of the oil they need will have to be imported.

Though US is expected to reduce its dependence on oil imports from 61.6 percent to 56.1 percent in the projected period, however still more than half of its oil consumption will be covered by imports. OECD Europe will be even more dependant

¹ Energy Information Administration, *International, Petroleum (Oil) Reserves and Resources, World Proved Reserves of Oil and Natural Gas, Posted August 27, 2008* (Accessed January 16, 2009); available from <http://www.eia.doe.gov/emeu/international/reserves.html>

from the imports and share of its imports in its overall consumption will increase from 61.9 percent in 2005 to 78.7 percent in 2030. The share of imports in China's consumption will persistently rise from 43.8 percent in 2005 to 73.9 percent in 2030. The share of India's imports will also climb from 66.7 to 73.5 percent in the same years.

As for natural gas its considerable increase is also projected for non-OECD Asia, but these boosts are expected to be used largely for consumption. As rapid increases in production continue to be outpaced by consumption growth, non-OECD Asia is projected to become a net importer of natural gas after 2015. Production increases are projected to outpace growth in natural gas demand in non-OECD Europe and Eurasia, and it is anticipated that Eurasian producers will remain important suppliers for their neighbors, especially for OECD Europe.

US would need to export 15-17 percent of its gas demand. Europe's dependence on gas imports will increase from 43.5 in 2005 to 62.1 percent in 2030. In contrast to US and OECD Europe most of China and India's demand will be covered by their own production. However, share of China and India's import will increase: China's - from 7.4 percent in 2010 to 32.8 in 2030 and India's – from 15.4 percent in 2005 to 25.6 in 2030.

As far as the Caspian region is concerned both oil and natural gas reserves are significant. Region's oil reserves constitute almost 3 percent, and gas reserves amount to 5 percent of world reserves. Caspian region's oil reserves surpass those of Europe and Asia. In addition to Europe, Caspian region's gas reserves also exceed reserves of North America, as well as Central and South America. In adjacent to the Caspian region Europe and Asia (both OECD and non-OECD) in 2005-2030 oil, as well as gas consumption is expected to go beyond production. It goes without saying that the Caspian region plays an important role in providing hydrocarbons to Europe and also Asia.

Hydrocarbon reserves generally considered to be sufficient to meet world demand. However there are several points of concern. First, these reserves are distributed unequally in a few countries. Second, demand and supply countries/regions are different, which makes the transportation necessary and important. Third, supply regions are considered generally to be politically unstable. “Overall, a conservative estimate is that by 2020 half the world’s oil and gas come from politically unreliable sources.”¹ Fourth, reserves are located in developing countries and their exploitation requires huge investments. However, “there are real concerns about political stability and barriers to investment in the non-OECD countries that will provide a growing share of the world’s energy.”² Fifth, the investments in their turn necessitate appropriate legal, regulatory, fiscal framework and protection given that in some cases environment is not investment friendly. Sixth, some individual countries such as Russia, Saudi Arabia, Iran, account for a significant amount of reserves and they do use energy to promote their political agenda. “Russia (9.0 mbd this year), which has overtaken Saudi Arabia and the USA (each about 7.8 mbd this year) as the leader in oil production in this regard is most prominent.”³

¹ Hugo McPherson and Duncan W. Wood, ed., *Emerging Threats to Energy Security and Stability: Proceedings of the NATO Advanced Workshop, London, 23-25 January 2004* (Dordrecht: Springer, 2005), 16.

² Ibid., 23.

³ Ibid., 4.

III. Oil and Natural Gas Production in Azerbaijan

1. Brief History

Crude oil and natural gas was known in Absheron peninsula (where Baku, as well as its oil and gas rich suburbs located) since times immemorial. Followers of Zoroastrian religion dating back to around 1000 BC used to visit the sacred places in Absheron to warship “Holy Fire” that bursts forth from the soil. Temple “Atəşgah” (Fire Temple) with its eternal fire in the vicinity of Baku is one reminder of such places.

The first written record of oil dates back to IX and X centuries to the Arabian travelers and historians who mentioned black and white oil (kerosene) on Absheron and described how residents of Baku used soil soaked in oil as fuel.¹ The Venetian traveler Marco Polo (1254-1324) in his way through Anatolia describes “... a spring from which gushes a stream of oil, in such abundance that a hundred ships (camels) may load there at once. This oil is not good to eat; but it is good for burning and as a salve for men and camels affected with itch or scab. Men come from a long distance to fetch this oil, and in all the neighbourhood no other oil is burnt but this.”² The very fact that M. Polo observed oil far from Baku implicated that Baku’s oil had a far reach.

The first ever drilling of oil wells by applying boring technique in Bibi-Heybat in 1847 and later in Balakhani, suburbs of Baku more than decade before the Drake Well was drilled in Pennsylvania in 1859 was the turning point in the world oil production.

In 1873 exploration and drilling on Ramany, Balakhany, Sabunchu and Bibi-Heybat fields begun and 26,000 tons of oil was extracted. The same year Robert Nobel

¹ Mir Yusif Mir-Babayev, “Azerbaijan's Oil History. A Chronology Leading up to the Soviet Era,” *Azerbaijan International*, Summer (2002): 34-40.

² *The Travels of Marco Polo*, Translated and with Introduction by R.E. Latham (London: Penguin Books, 1958), 17-18.

arrived at Caucasus with the task to purchase walnut wood for rifles butts to be produced by his brothers, but instead he purchased refinery in Baku and brothers established Nobel Brothers Petroleum Producing Company. Soon this company replaced David Rockefeller's America's Standard Oil as world's leading oil supplier. In 1878 *Zoroaster* the world's first oil tanker shipped the first oil in the Caspian. Oil initially was transported across the Caspian Sea upstream the Volga river and the by train which was complicated, long way and expensive. In 1883 direct railway line was built from Baku to the Black Sea port Batumi recently seized by Russia from the Ottoman Empire. By the end of the XIX century the Nobel Brothers and Rothschilds controlled more than 40 percent of the oil market.

Foreign capital was not the only one operating in Baku's oil fields. Oil boom produced the local oil barons such as Haji Zeynalabdin Taghiyev, Agha Musa Naghiyev, Murtuz Mukhtarov, and Isabay Hajinsky who spent great deal of their profits to charity by financing the education of young Azerbaijanis in the European universities, building mansions, theatres, schools, hospitals and other public buildings. While preserving the architecture of "İçəri Şəhər" - *Inner City* (oldest part of Baku inside fortress walls) this huge construction dramatically changed appearance of the city. Outside the medieval Inner City European downtown arose. This new dualism is intellectually yet to be absorbed. Characteristic in this regard is the dialog in Kurban Said's timeless masterpiece between Ali Khan Shirvanshir and his father the latter arguing that "Asia is not dead. Its borders only have changed... Baku is now Europe. ...There were no Asiatics left in Baku any longer."¹ Oil moved Baku from Asia to Europe. Baku became important regional city. The borderland location between Asia and Europe, East and West, together with the

¹ Kurban Said, *Ali and Nino. A Love Story* (New York: Anchor Books, 2000), 194.

mixture of traditionalism and modernism has become the main feature of Baku and Azerbaijan for the years to come.

With ancient oil extraction traditions Baku became a world center of oil production. In 1901 Azerbaijan produced 11.5 mln. tons of oil (in the same year 9.1 mln. tons of oil was produced in USA), more than half of the world oil production and 95 percent of oil produced in Russia. Oil exported through Baku-Batumi pipeline constructed in 1906 with the capacity of one million tons of processed oil per year. This huge output and direct delivery aggravated competition between the Nobels, the Rothschilds and the Rockefellers over world's oil markets, that as L. Kleveman put it "in retrospect, almost appear quaint compared to today's geopolitical struggle for Caspian oil."¹

Years of the Soviet power marked the second period of oil production and in 1943 it reached the highest level - 23 mln. tons (75 percent of oil produced in the former USSR). Three quarters of Soviet Army's demand during the World War II was met by Baku oil. In 1949 the first offshore oil field was discovered. For its operation the unique city on piles "Neft Daşları" (Oil Rocks) 40 km from the shore was constructed. It was the first experience of offshore oil production in the world.

Since the start of industrial production 1 billion and 325 million tons of oil has been produced in Azerbaijan. In the Azerbaijani section of the Caspian Sea 400 million tons of oil and up to 400 billion cubic meter of gas have been extracted. Alongside with the development of oil and gas industry, research institutes and higher education schools have been created. Institute which is called now Oil Academy was established to prepare qualified experts for oil industry. Azerbaijani oilmen, experts, engineers, scientists

¹ Lutz Kleveman, *The New Great Game. Blood and Oil in Central Asia* (New York: Grove Press, 2003), 16.

discovered new oil fields in Siberia, Tumen, which became “Second Baku”, “Third Baku” and etc. This highly qualified and experienced human potential became very instrumental for independent Azerbaijan’s oil production.

2. Oil

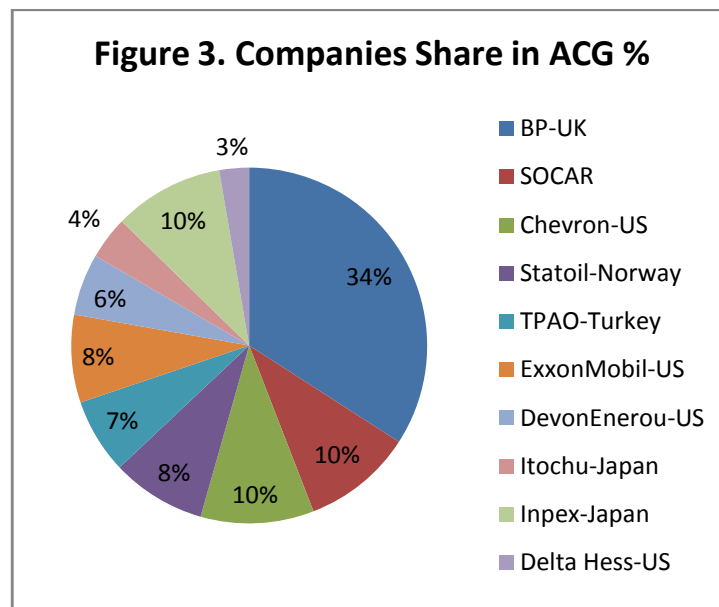
In 1991 when Azerbaijan regained its independence the oil and gas industry was in decline. New technology and investment required. Azerbaijan managed to attract significant international interest in its hydrocarbon reserves. After 3 years of intense negotiations in 20 September 1994 the agreement on joint development of Azəri, Chirag and Gunashli (ACG) oil fields and production sharing with twelve oil companies later known as "Contract of the Century" was signed which marked the beginning of the third oil boom. Contract was signed for 30 years. To date, Azerbaijan has signed 25 major field agreements with 35 companies from 15 countries with a total investment estimated at over US\$ 70 billion. In early 1995 the Azerbaijan International Operation Company (AIOC) was created to coordinate the consortium's joint operations.

2.1. Reserves

Based on the information as of January 1, 2008, estimates of Azerbaijan’s proven crude oil reserves range between 7 and 17.5 billion barrels according to different sources. *BP Statistical Review* and *Oil & Gas Journal’s* estimate is 7 billion barrels. The State Oil Company of the Azerbaijan Republic (SOCAR) estimates proven reserves at 17.5 billion barrels. Even with 7 billion barrels Azerbaijan is among the top 20 oil producing countries of the world ranking as number 19. The largest hydrocarbon structures are located offshore in the Caspian Sea and account for most of the country's current petroleum production.

2.2. Production

Foreign investments have revitalized the oil sector through the development of large-scale new projects and the refurbishment of existing facilities. Increase in oil production came mainly from the AIOC's ACG field, which in 2007 represented over 80 percent of Azerbaijan's total oil exports and is estimated to contain proven crude oil reserves of 5.4 billion barrels according to BP, the field's operator and largest stakeholder (Figure 3).¹



In 2005 SOCAR raised its assessment of the field's recoverable reserves from 5.4 billion barrels to 6.9 billion barrels. Up to now more than 74 million tons of oil has been produced from the operating fields. It is intended to raise oil production to 58 million tons by 2010 year. Oil production has risen significantly (Table 5).²

¹ State Oil Company of the Azerbaijan Republic (SOCAR), *Projects and Partners. BTC-Shah-Daniz-ACG-SCP* (accessed February 11, 2009); available from <http://socar.az/acg-en.html>

² Data collected from: State Oil Company of the Azerbaijan Republic (SOCAR), *Statistics. Oil and Gas Output* (accessed February 15, 2009); available from <http://socar.az/oilgas-az.html>

Table 5. Oil Output, 2004 - 2008**Million tons**

2004	2005	2006	2007	2008
8976.4	8967.4	8993.77	8800.88	9337.10

Azerbaijan became the largest contributor to non-OPEC supply growth during 2006 and 2007. Azerbaijan's most net exports were routed to Russia, Italy, Turkey, and Germany. The United States import from Azerbaijan increased considerably and amounted at around 50,000 bbl/d during 2007 (Table 6).¹

Table 6. The US Oil Imports from Azerbaijan, 1998 – 2007**Thousand barrels**

1998	2002	2004	2005	2006	2007
4,2	7	484	563	10,091	22,809

2.3. Exports

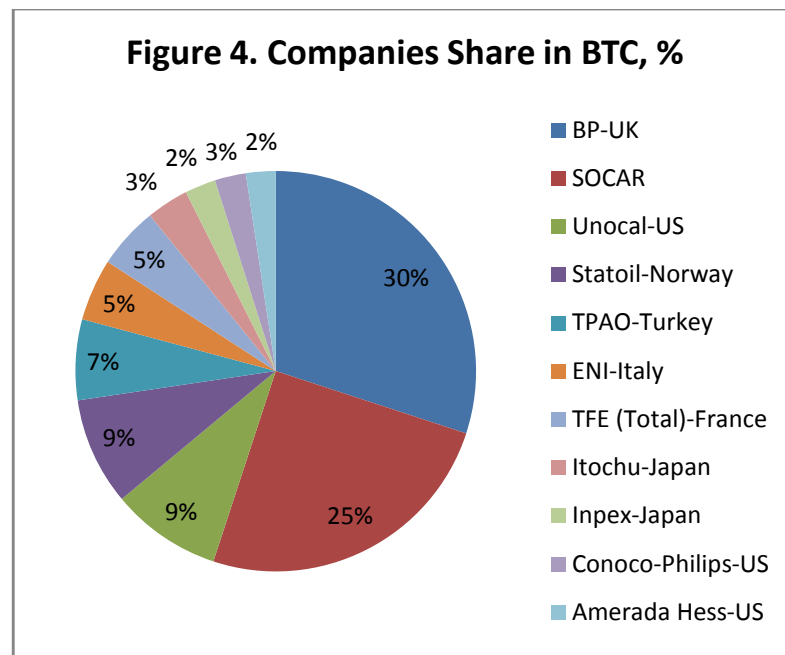
Early in June 2006, a small pipeline was completed to allow ExxonMobil's share of ACG production to be pumped directly from Azerbaijan's Sangachal terminal to the nearby AzPetrol rail tank-car terminal. The ExxonMobil and AzPetrol rail links to Batumi have 120,000 bb/d of transport capacity.

The first delivery of oil to world market took place on 25 October 1997 when Baku-Novorossiysk pipeline ("Northern Route") was commissioned. This pipeline is 1400 km length with annual capacity of 6 million ton exports roughly 40,000 bbl/d of

¹ Energy Information Administration, *US Imports by Country of Origin* (accessed January 15, 2009); available from http://tonto.eia.doe.gov/dnav/pet/pet_move_impcus_a2_nus_ep00_im0_mbb1_a.htm

SOCAR oil to the Russian Black Sea port. The Baku-Novorossiysk pipeline closed briefly in late June 2004 after oil thieves set off an explosion when they attempted to steal oil from the pipeline. The next step in exporting of oil was the construction of 850 km long Baku-Supsa oil pipeline (also called the Western early oil pipeline) commissioned in April 1999. The Baku-Supsa line has an estimated yearly capacity more than 6 million ton or 155,000 bbl/d.

Almost all Azerbaijan's oil is exported via Baku-Tbilisi-Ceyhan (BTC) pipeline, thereby bypassing Russia. Agreement on construction of the Baku-Tbilisi-Ceyhan main export pipeline was signed on November 18, 1999 in Istanbul by the presidents of Azerbaijan, Turkey, Georgia and Kazakhstan with the participation of the US president. BTC is an international project designed for the transportation of crude oil, produced in the Azerbaijani sector of the Caspian Sea, to the international markets (figure 4).¹



¹ State Oil Company of the Azerbaijan Republic (SOCAR). *Projects and Partners. BTC-Shah-Daniz-ACG-SCP* (accessed February 11, 2009); available from <http://socar.az/acg-en.html>

The construction started in 2002. In June 4, 2006 the first tanker was filled with the Caspian oil dispatched from the port of Ceyhan to Europe. The pipeline runs from Baku via Georgia to the Turkish Mediterranean port Ceyhan. The length of the BTC pipeline route is 1,767 km, of which 443 km are in Azerbaijan, 248 km in Georgia and 1,076 km in Turkey. The design life of the pipeline is 40 years, while the capacity is 1 billion barrels (50 mln. tones) of oil per annum or 1 million barrels per day. Constructed at the cost of almost \$4 billion the BTC pipeline allows oil to bypass the crowded Bosphorus and Dardanelles Straits. The pipeline provides delivery of the ACG-produced oil to the Mediterranean and passes the territory of 3 states – Azerbaijan, Georgia and Turkey. Oil flows from ACG via subsea pipelines to the Sangachal terminal near Baku where it is pumped to the pipeline. In July 2007, the 42-46 inch diameter pipeline reached a peak flow of 905,000 bbl/d. In October 2007 the BTC line exported roughly 650,000 bbl/d of crude. Up to now more than 13 million tons of oil was transported via BTC pipeline.

3. Natural Gas

With the addition of the Shah Daniz natural gas and condensate field and the South Caucasus Pipeline (SCP), Azerbaijan will become a large natural gas provider to Turkey and to Europe in the upcoming decade.

3.1. Reserves

There are different estimates about Azerbaijan's natural gas reserves. The latest figures are based on the information as of January 1, 2008. According to *Oil & Gas Journal*, Azerbaijan has roughly 30 trillion cubic feet (Tcf) proven natural gas reserves. *BP Statistical Review* estimates the country's reserves at 45.132 cubic feet, CEDIGAZ slightly raises this figure up to 45.380 cubic feet. IHS Energy estimates that ultimate

recoverable resources are approximately 67 Tcf. With the 30 Tcf reserves Azerbaijan is still among the top 25 gas richest countries of the world. President I. Aliyev stated that gas reserves of Azerbaijan are at least 2 trillion cubic metres, which is sufficient for the next decades, one hundred year.¹

3.2. Production

Virtually all of Azerbaijan's natural gas is produced from offshore fields. The leading Bahar and Bahar-2 natural gas field and the Shallow Water Gunashli field currently accounts for almost half of the country's natural gas output. Increases in production from the Shah Daniz gas and condensate field in 2007 allowed raising production considerably (Table 7).²

Table 7. Natural Gas Output, 2004 – 2008

Mln. cubic m.

2004	2005	2006	2007	2008
5006,2	5818,3	6829,9	9977,3	8236,7

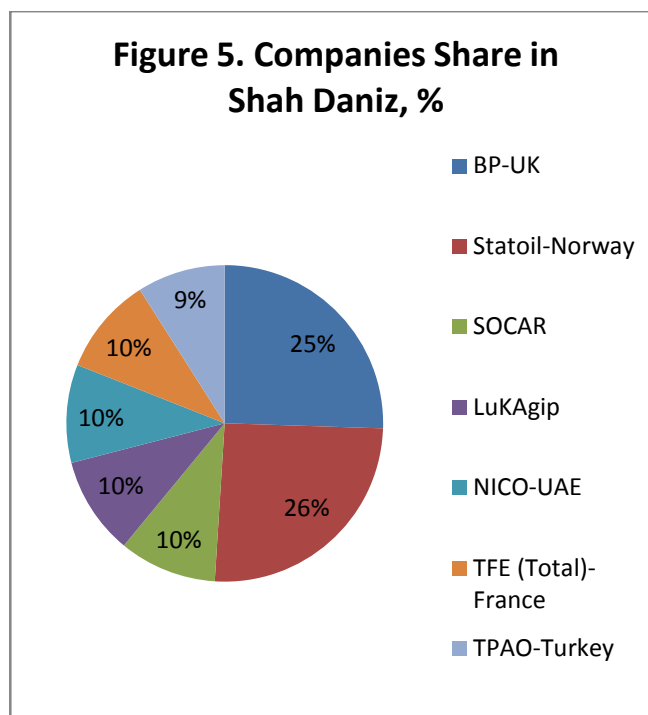
Azerbaijan's major natural gas production increases are expected to come from the development of the Shah Daniz offshore natural gas and condensate field. Industry analysts estimate that Shah Daniz is one of the world's largest natural gas field discoveries of the last 20 years. According to the project's operator, BP, the field contains "potential recoverable resources" of roughly 15 Tcf of natural gas and 600 million barrels of condensate. However, other industry and trade sources, employing widely different

¹ President of Azerbaijan, Activity, *Speech at the Summit on Nabucco Project on 27 January 2009* (accessed 22 February 2009); available from

http://www.president.az/articles.php?item_id=20090129102004996&sec_id=11

² Data collected from: State Oil Company of the Azerbaijan Republic (SOCAR). *Statistics. Oil and Gas Output* (accessed February 15, 2009); available from <http://socar.az/oilgas-az.html>

definitions of "reserves", estimate the field's size to be as high as 35 Tcf. The first phase of the Shah Daniz field's development was officially approved on February 27, 2003. Shah Daniz consortium began producing natural gas for export during spring of 2007. By now about 280 billion cubic m. gas was produced from the field. Shah Daniz is located offshore, approximately 60 miles southeast of Baku and is being developed by the Shah Daniz consortium. The Shah Daniz production sharing agreement was signed in 1996 (figure 5).¹



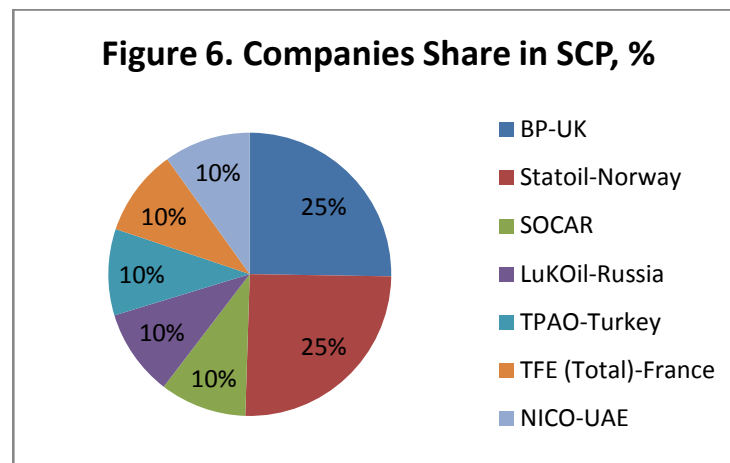
With the confirmation of a major new natural gas discovery below the existing reservoir, BP now says there is enough gas to justify Phase 2 development. Phase 2 of the Shah Daniz project has the potential to produce roughly 700 Bcf, but not until as early as 2013. The cost of developing phase 2 of Shah Daniz will probably be "at least \$10

¹ State Oil Company of the Azerbaijan Republic (SOCAR). *Projects and Partners. BTC-Shah-Daniz-ACG-SCP* (accessed February 11, 2009); available from <http://socar.az/acg-en.html>

billion", according to Jan Heiberg, vice-president of Statoil Azerbaijan, which holds a 25 percent stake in the consortium.

3.3. Exports

Azerbaijan began exporting Shah Daniz gas in March 2007 to Georgia. In July 2007, the first natural gas began to flow into Turkey's natural gas system via the South Caucasus Pipeline. The main conduit for Azerbaijan's natural gas exports is the "South Caucasus Pipeline," (SCP) also known as "Baku-Tbilisi-Erzurum," (BTE) which is 970 km length, has 280 bln. m³ capacity and runs parallel to the BTC pipeline for most of its route before connecting to the Turkish gas pipeline. BP is technical operator for construction and operation, and Norway's Statoil is responsible for business development and administration (figure 6).¹



The \$1.3 billion pipeline's capacity is expected to carry 233 Bcf per year initially and can be increased later up to 700 Bcf with the future addition of compression stations. Construction process started in 2004 and completed at the end of 2006.

Turkey will purchase 91.0 billion cubic m. gas over 15 years. On March 12, 2001, Azerbaijan signed its first major natural gas export deal when it concluded an agreement

¹ State Oil Company of the Azerbaijan Republic (SOCAR). *Projects and Partners. BTC-Shah-Daniz-ACG-SCP* (accessed February 11, 2009); available from <http://socar.az/acg-en.html>

to supply Turkey with natural gas beginning in 2004. In February 2003 the deal was renegotiated, intended for exports to begin in 2006. In March 2002, Greece and Turkey signed an intergovernmental agreement on a construction of a pipeline from Ankara to Komotini which would enable the export of the Azerbaijani gas through Turkey to Greece, Italy, Balkans and other European countries. Turkey began re-exporting Azerbaijani gas to Greece after a new pipeline connecting Turkey and Greece opened in November 2007.

Due to conflict between Azerbaijan and Armenia, as a result of which communications with Azerbaijan's Nakhchivan enclave have been disrupted Azerbaijan began implementing a swap deal that provides natural gas to Nakhchivan. Azerbaijan sends natural gas into Iran via the Baku Astara pipeline, and Iran delivers the gas via a new 30 mile pipeline into the enclave. Iran receives a 15 percent commission on transit fees.

IV. Azerbaijan's Energy Policy

Right after the signing of the oil contract Azerbaijan faced number of challenges, status of the Caspian Sea, pipeline politics, and managing oil revenues were among them. To meet these challenges very careful policy was required.

1. Objectives

Azerbaijan's late president Heydar Aliyev was the architect of this policy. In the opening speech in the I International Oil-Gas Production in the Caspian Sea Exhibition held in Baku on 24 May 1994 president Aliyev stated that cooperation with the western oil companies would ensure further development of the Azerbaijan's oil industry and would lead to mutual partnership with the western countries. Steps taken by Azerbaijan towards cooperation with western oil companies have both economic and political substance.¹ Azerbaijan's objectives were further elaborated by H. Aliyev at the signing ceremony of the "Contract of the Century" on 20 September 1994:

By taking such a step we show that Azerbaijan is open for world and for world economy. By signing this contract we demonstrate that Azerbaijan is fully independent state. By signing this contract we build relations with developed countries of the world, ensure integration of Azerbaijani economy to the world economy. By signing this contract we confirm once again that independent Azerbaijan is democratic and rule of law state. Azerbaijan is intended to go in the way of market economy. This contract is first big step for the establishment of market economy in Azerbaijan. By signing this contract we open the way for foreign investments and create the basis for activity of companies in other spheres in Azerbaijan. By signing this contract we hope for consolidation of friendly relations in all fields and economic cooperation with countries that companies participating in contract represent - United States of America, Russia, England, Turkey, and Norway. The most important is that this contract

¹ Heydar Aliyev – National Leader of Azerbaijani Nation, *Speeches* (accessed February 22, 2009); available from <http://www.heydar-aliyev.org/jsp/PShowArt.jsp?lang=en&id=112>

will bring great benefits to present and future of Azerbaijani people, create base for elevation of its prosperity.¹

Since 1994 Azerbaijan made significant progress. Despite the difficulties related to the status of the Caspian Sea and obstacles on the way of pipeline route for major oil, contacts worked, oil extracted, BTC oil pipeline and BTE gas pipeline constructed and become operational. Azerbaijan turned into world hydrocarbon provider and tries to further expand its supply.

By no means had the above-mentioned achievements affected energy policy and the current president Ilham Aliyev expanded its scope. On 27 January 2009 at Nabucco Summit in Budapest I. Aliyev underlined the importance of and adherence to the principle of diversification of energy transportation links, which assure Azerbaijan's economic and social requirements on one side and contributes to the energy security of Europe on the other side. Azerbaijan is adherent to the policy of diversification, close partnership with European Union and Euro-Atlantic institutions. The philosophy of Azerbaijan's energy policy is that energy should unite, but not divide peoples.²

The National security concept of Azerbaijan approved by president on 23 May 2007 among potential threats lists attempts to undermine energy industry (both production and transportation) generating revenues, which are a valuable asset for the economy of Azerbaijan, through political means or by inflicting physical damage to the infrastructure. Advancement and utilization of the oil and gas reserves, and ensuring

¹ Heydar Aliyev – National Leader of Azerbaijani Nation, *Speeches* (accessed February 22, 2009); available from <http://www.heydar-aliyev.org/jsp/PShowArt.jsp?lang=en&id=110>

² President of Azerbaijan, *Speech at the Summit on Nabucco Project on 27 January 2009* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20090129102004996&sec_id=11

the security of energy transportation networks have been determined as energy and transportation security policy objectives.

Azerbaijan's energy policy objectives include wide range of issues, encompass economic, social, political, geostrategic dimensions and could be summarized as comprising the following elements:

- Economic: (1) further development of Azerbaijan's oil industry; (2) openness to world economy; (3) integration of Azerbaijan's economy to the world economy; (4) first step for implementation of market economy reforms in Azerbaijan; (5) openness to foreign investments; (6) cooperation in and development of non-oil sector;
- Social: (1) prosperity of present and future generation of the people of Azerbaijan;
- Political: (1) as fully independent state Azerbaijan pursues its own interests; (2) partnership with the countries represented in contracts; (3) close partnership with European and Euro-Atlantic institutions; (4) energy as a mean to unite, but not divide peoples;
- Geopolitical: (1) diversification of energy transportation; (2) contribution to the energy security of Europe;
- Rule of law (1) Azerbaijan is democracy; (2) and rule of law state;

Based on the above-mentioned objectives Azerbaijan's energy policy had to tackle three practical issues: the status of the Caspian Sea; pipelines routes, their financing and filling with fuel; and how to manage the oil revenues.

2. Status of the Caspian Sea

Right after the signing the contract of the century Azerbaijan became the subject of heavy criticism and political pressure under the pretext that the status of the Caspian

Sea is not defined. Russia raised the issue of the status of the Caspian Sea and claimed that the contracts and explorations are illegal.

Previously, the relations between the Soviet Union and Iran concerning the Caspian Sea had been determined by the agreements of 26 February 1921 and 25 March 1940. But these treaties dealt with navigation and fishing, leaving the natural resources of the seabed open. Sectorial division of the Caspian was determined in 1970 by the Ministry of oil industry of the former USSR. Based on that division Azerbaijan developed its sector of the Caspian Sea. After the collapse of the Soviet Union in late 1991 the littoral states initiated discussions to determine the status of the Caspian Sea. Azerbaijan was the only country advocating the sectorial division of the Caspian.

On 5 October 1994 the Russian Federation distributed paper in the United Nations which reflected its view regarding the legal regime of the Caspian Sea. Russia proceeded from the position that the Caspian Sea lacks a natural link to the world's oceans and seas and is thus a land-locked body of water. The norms of international maritime law, particularly those pertaining to the territorial sea, the exclusive economic zone and the continental shelf, are not applicable to it. There is thus no basis for unilateral claims relating to the establishment of zones of this type in the Caspian or for the introduction of elements of their regimes.

Russia claimed that all utilization of the Caspian Sea, in particular the development of the mineral resources of the Caspian seabed must be the subject of concerted action on the part of all States bordering the Caspian. This task can only be addressed through strict respect for the legal regime of the Caspian Sea and the prevention of any unilateral action, given that the Caspian Sea, by virtue of its legal nature, is subject to joint utilization; any questions relating to exploitation of its

resources, must be decided jointly by all the countries bordering its coast. National claims made by any Caspian Sea State in connection with the Sea and its resources inevitably affect the rights and interests of the other Caspian States and cannot be considered legitimate.

Russia believed that the legal regime of the Caspian Sea provided for in the Soviet-Iranian agreements of 1921 and 1940 has not as yet undergone any change. This regime provides for free navigation in the Caspian Sea by vessels flying the flag of its coastal States, national regimes for vessels of other coastal States in their home ports and unimpeded fishing in its waters, with the exception of the 10-mile coastal zone, in which fishing is reserved for vessels of the corresponding coastal State.

The document further stated that in accordance with the principles and norms of international law, all coastal states are bound by the provisions of the 1921 and 1940 agreements. The legal regime of the Caspian Sea set out in these agreements however needs to be updated, taking into account changing circumstances, including those resulting from the emergence of new coastal States. However, this can only be done through the conclusion of new agreements among all the Caspian Sea States.

The document was concluded on a forceful warn that unilateral action in respect of the Caspian Sea is unlawful and will not be recognized by the Russian Federation, which reserves the right to take such measures as it deems necessary and whenever it deems appropriate, to restore the legal order and overcome the consequences of unilateral actions.¹

The gist of the paper was that the Caspian Sea, in particular its natural resources in the seabed are subject to joint sovereignty and have to be commonly used.

¹ The UN Document, A/49/475, 5 October 1994.

Azerbaijan holds the position that since the Caspian Sea has no natural connection to the World Ocean it is a boundary lake. After the 1970 decision by the Ministry of oil industry the Caspian Sea was divided into sectors and hydrocarbons were utilized based on that practice. Generally accepted norms of international law, establishment of the median line and the local practice should be used as a basis for the division of the Caspian Sea into the national sectors and determination of the Caspian Sea legal status (Annexes, Map 2). Kazakhstan supported this position.

Azerbaijan initiated the idea on demilitarization of the Caspian Sea. In order to use the Caspian Sea only for peaceful purposes, Azerbaijan proposed to include in the legal framework the principles of demilitarization and security, as well as free transit opportunities in the framework of general arrangements for the vessels of the littoral states which have no access to other seas and world ocean.¹

Turkmenistan presently also supports the idea of dividing the Caspian into national sectors. But Azerbaijan and Turkmenistan suggested a different method of determining the median line which would divide the national sectors of two countries. Presently the median line overlaps some oil fields. Azerbaijan and Turkmenistan are still working out these differences. Although this controversy affects Azerbaijan and Turkmenistan in relation to Kəpəz (Azerbaijani version) / Sərdar (Turkmen version) deposit, such potential problems may arise in the future between other Caspian states as well.² After the visit of newly elected president of Turkmenistan Gurbanguly Berdimuhamedov to Baku in May 2008 the relations between two countries began

¹ President of Azerbaijan, *Speech at the second Summit of Caspian littoral states in Tehran, 16 October 2007* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20071017105701589&sec_id=11

² Khoshbakht B. Yusifzade, "The Status of the Caspian Sea; Dividing Natural Resources Between Five Countries," *Azerbaijan International*, Autumn 2000 (8.3): 93.

improving. The differences are not so serious that they cannot be resolved in the foreseeable future.

The Russian position however changed over time, not least due to Azerbaijan's principal position, as well as oil discovery and the necessity to explore the large "Khvalyn" oil field in the Russian sector of the Caspian Sea. As a result of exploration work from 1995 to 2006, LUKOil discovered 6 major fields, most notably the V. Filanovsky field in 2005 with proven reserves of 1.6 billion barrels.¹ Russia suggested dividing the Caspian seabed according to a modified median line, while the water surface would remain for general use. In other words, the seabed and the water surface should be considered as objects with separate sets of regulations. Kazakhstan, Turkmenistan and Azerbaijan already proceeding from principled position regarding the division of the Caspian Sea into national sectors, also advocated for the similar bimodal schemes: the water area and seabed must be considered as separate objects and are subject to independent regulations whereby seabed is divided into national sectors; water layer is subject to further consultations.

Today all littoral Caspian states proceeding from this principle have agreed with the division of the Caspian Sea via the median line method, with the exception of Iran. The Russian Federation and Kazakhstan in 1998 reached an agreement identifying sovereign rights regarding the exploitation of the Caspian resources. Four years later, in May 2002, they reached an agreement on the division of the sea bottom and signed a Protocol to the agreement establishing the geographical position of the median line. In a month that year, the presidents of the Russian Federation and Azerbaijan also signed an agreement on the division of the contiguous Caspian seabed, which identified the median

¹ Perspectives on Caspian Oil and Gas Developments, IEA Working Paper Series, December 2008, p.16.

line. In 2003, a similar agreement was signed between Kazakhstan and Azerbaijan. On September 23, 2002 a trilateral agreement identifying the junction point of all the median lines was signed by the Russian Federation, Kazakhstan and Azerbaijan, which specified that the northern 64 per cent of the sub-surface boundaries are to be divided, giving 19 per cent to the Russian Federation, 18 per cent to Azerbaijan and 27 per cent to Kazakhstan.¹

By reaching an agreement on the division of the seabed Azerbaijan, Kazakhstan and Russia thus made a significant step towards the resolution of the problem. Though Russia was the first who raised the status issue, ironically it became the only Caspian country that delimited its sea borders with all neighbors. Azerbaijan is the only country which borders all other littoral countries and still has to reach agreement with two countries. Turkmenistan and Azerbaijan can come to an agreement, while Iran is unlikely to make any compromise.

Azerbaijan has based its sea boundaries with Iran on the Astara - Hasangulu line, which was accepted as the boundary line separating the former Soviet Union and Iran. After the break-up of the Soviet Union, Iran did not accept this borderline and set forth various proposals, especially as it relates to the exploration of the hydrocarbon resources of the Caspian Sea. One such proposal was that any exploration that takes place anywhere in the Caspian Sea should be jointly owned by all five littoral states. In other words, Iran proposed to establish a condominium regime. When this proposal was not accepted, Iran suggested that the territory be equally divided so that each state would receive 20 percent of the sea territory regardless of the size of the cost line and actual

¹ Oksana Kim, "The Caspian Sea Still Undefined," *UN Chronicle Online Edition* (accessed March 20, 2009; available from http://www.un.org/Pubs/chronicle/2004/webArticles/081304_CaspianSea.asp

share in the sea.¹ However, this rigid position did not prevent Iran from seeking a stake at AIOC consortium in Azerbaijan, though blocked by other parties. Iran did emerge in 1996 with a share in the Shah Daniz gas field.² Iran did not recognize the trilateral agreement between Russia, Kazakhstan and Azerbaijan.

These and some other discontents made negotiations complicated, sometimes even leading to serious incidents. A research vessel explored the seabed in the south of the Azerbaijani sector of the Caspian Sea at the “Araz”, “Alov” and “Sharg” deposits. On July 23, 2001 the Iranian battleship prevented the research works by threatening to use a force which was the first ever threat to use the force in the Caspian Sea, and forced the Azerbaijani boat to leave that part of the sea. The explorations of the deposits have not been yet resumed.

The Caspian Sea plays an important role in the political and economic development of the littoral states. In November 2003 littoral states concluded a Framework Convention for the Protection of the Marine Environment of the Caspian Sea, which entered into force in 2006. As for differences between the littoral states they are being negotiated with a view to reconcile them. The working group on the Convention on the legal status of the Caspian Sea discusses the matter and its recent the 23rd meeting was held on 4-5 September 2008 in Baku.

Peace, stability and security in the region, economic prosperity and cooperation between all states of the region, non use of force should be guiding principles of policy. To this end an agreement of the status of the Caspian is important. Without an agreement on the maritime borders in the Caspian Sea, Araz, Alov, and Sharg group of fields and the Kəpəz/Sərdar field have been left untapped due to the lack of clarity on ownership.

¹ Yusifzade, 93.

² Perspectives on Caspian Oil and Gas Developments, 16.

Finally agreement on the status will facilitate the expansion of transportation routes from Kazakhstan and Turkmenistan through Caspian to Azerbaijan to join Nabucco project. On the other side, Russian and Iran have interest in the transportation of the Caspian gas for the export to Europe. Their own transportation networks may discourage them from taking flexible position on the status, resolution of which may pave the way for a pipeline from Central Asia across the Caspian to Azerbaijan. Russia and Iran would view Trans-Caspian pipeline as undermining their chances to deliver gas to Europe, Russia via South Stream and Iran through Turkey. Iran argues that legal status for the Caspian Sea is prerequisite for the construction of pipelines across the Caspian.

3. Pipeline Politics

The status of the Caspian Sea appeared to be the first, but not the only challenge. In addition Azerbaijan choice about the route of a pipeline for major oil faced considerable difficulties and obstacles.

Caspian Sea is landlocked lake with no outlet to open sea. Hydrocarbons' extraction is just part of the task. Oil and gas have to be transported to world market; otherwise its extraction alone doesn't mean much. Exporting and transporting countries get investments, employment, revenues, transit fee, economic and geopolitical interest and involvement of those who invest, sell and purchase. Pipeline is a big deal and stakes are high. Determination of route of a pipeline becomes not only economic, but rather geopolitical issue. Exporters and investors are main decision makers, however, attractiveness of transit countries, as well as policies and interests of neighboring countries are important to take into account. This is really place for geography, politics and strategy.

3.1. Oil Pipelines

After the extraction of oil the question how to deliver it to world market becomes the issue to tackle. There was only one existing and viable route from Baku to Novorossiysk. Russia didn't avail itself with delayed proposal. Surprisingly this option was supported by Terry Adams, BP's CEO in Baku.¹ The Iranian option was excluded because of the 1996 Iran-Libya Sanctions Act (it was renamed the Iran Sanctions Act ("ISA") after the law's Libya sanctions were removed in 2006) which requires the US president to impose sanctions against any foreign or domestic companies making any investment of more than \$20 million that directly and significantly contributes to the development of Iran's petroleum resources. There was another proposal to build pipeline through the territory of Armenia to encourage Armenia to take flexible position on Nagorno-Karabakh conflict, to reconcile Armenia and Azerbaijan and promote regional co-operation which would have broader implications. Armenia accepted the proposal, but stated that this has nothing to do with the resolution of the conflict, pipeline and conflict settlement are two different issues. That left Georgia as the only feasible option for the main pipeline (Annexes Map 3).

From the very beginning Azerbaijan made no secret that it prefers multiplicity of transport routes. The first oil was pumped to Novorossiysk in 1997. Baku – Supsa was constructed and became operational in 1999. BTC as main pipeline for major oil was commissioned in 2006. By taking strategic decision on these pipelines Azerbaijan proceeded from its own broader security interests in general and energy security in particular, the latter determining the former. The northern route took into account the Russian interests. The western route provided opportunity to deliver oil to the Black Sea.

¹ Steve LeVine, *The Oil and the Glory. The Pursuit of Empire and Fortune on the Caspian Sea* (New York: Random House, 2007), 218.

The BTC as a strategic route delivering the major oil took into account the Western interest. Thus, Baku not being dependent on any single route and transit country had some geopolitical options.

This pipeline, however, on its way to reality faced enormous geopolitical, environmental and financial difficulties. It made its pathway due to Azerbaijan's strategic vision, political will and determination, and certainly with the US unequivocal political support and financial lobbying.

Ambassador Richard Morningstar, Special Advisor to President Clinton for Caspian Basin Energy Diplomacy unfolding the U.S. energy policy toward the Caspian Basin not only depicted the Baku-Ceyhan pipeline as a commercially viable way of carrying Caspian oil to the Mediterranean, but also outlined much broader vision thereby it would create a robust economic linkage between Central Asia, Caucasus, and Turkey. Baku-Ceyhan not only would avoid the commercial, environmental and safety risks posed by a significant increase in oil shipments through the Bosphorus, but moreover, it would ensure that Turkey remains an integral player in the development of Caspian energy resources and play a stabilizing role in the volatile regions of the Caucasus and Central Asia. After all of the relevant companies getting understanding of these political realities the US government's primary focus was to encourage the companies to get down to business in order to make Baku-Ceyhan a reality.¹

But importance of BTC had other dimension. It was constructed with capacity to deliver also the Kazakh oil to the world market. Kazakhstan in addition to its Russian and Chinese routes may acquire choice to transport its oil to the Mediterranean. In June 16,

¹ Richard Morningstar, *Address to CERA Conference, Washington, DC, December 7, 1998* (accessed March 21, 2009); available from <http://www.mtholyoke.edu/acad/intrel/morning.htm>

2006 president I. Aliyev of Azerbaijan and president N. Nazarbayev of Kazakhstan met in Astana to sign an agreement on the Kazakh oil to be delivered from Kazakhstan through the Caspian Sea to Azerbaijan, and through BTC main export pipeline to the world market.

3.2. Gas Pipelines

In 2006 BTC become operational. In the same year BTE/SCP was commissioned and in 2007 gas started to be exported from Shah Daniz. Having completed two pipelines, one for oil and another for gas, both delivering hydrocarbons from the Caspian to the Mediterranean from now on Azerbaijan's main focus shifted to other gas pipeline projects to transport Caspian gas to Europe (Annexes Map 4).¹

These efforts date back to the Energy Ministerial Conference held in Baku on 13 November 2004 with the participation of the European Commission and the Black Sea and the Caspian Sea littoral states and their neighbors, namely Azerbaijan, Armenia, Bulgaria, Georgia, Iran (observer), Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation (observer), Romania, Tajikistan, Turkey, Ukraine and Uzbekistan. The conference launched "Baku Initiative" which was aimed to facilitate the progressive integration of the energy markets of this region into the EU market as well as the transportation of the extensive Caspian oil and gas resources towards Europe, be it transiting through Russia or via other routes such as Iran and Turkey. Secure and safe export routes for Caspian oil and gas will be important for the EU's energy security by increasing the geographical diversification of the EU's energy supplies. Supplying the

¹ International Energy Agency, *Perspectives on Caspian Oil and Gas Development, December 2008* (accessed February 20, 2009); available from http://www.iea.org/textbase/papers/2008/caspian_perspectives.pdf

EU market at competitive prices will also be crucial for facilitating the economic, social and political development of countries of the Caspian region. INOGATE Technical Secretariat serves as a coordination mechanism for supporting the energy cooperation under the Baku Initiative.¹ A road map to achieve these objectives was adopted at the Astana Ministerial Conference 30 November 2006.

Presently there are several projects with two major transit routes to deliver Caspian gas to Europe. One route envisages Russia as a transit country either through upgrading of the Central Asia-Centre pipeline system which connects Turkmenistan/Uzbekistan, Kazakhstan and Russia or by building Caspian Coastal pipeline in Turkmenistan, Kazakhstan and Russia. In May 2007 heads of state of Russia, Kazakhstan, Turkmenistan and Uzbekistan signed relevant declarations. The second route is called “Southern Corridor” pipelines through Azerbaijan, Georgia and Turkey and further on. There are several proposals for this route: Trans-Caspian options, Nabucco, Greece-Italy Interconnector and Trans-Adriatic Pipeline. The second route starts with SCP and runs via Turkey.

Proposals for trans-Caspian gas trade date back to the end of 1990s. In May 1999 Turkey and Turkmenistan signed a 30-year agreement for deliveries of 30 bcm/y to Turkey, and later the same year an intergovernmental declaration was signed by Azerbaijan, Georgia, Turkey and Turkmenistan supporting a trans-Caspian pipeline. However, the project ran into difficulties over payment and price issues. Legal status of the Caspian Sea also complicated situation.

¹ European Commission, Directorate-General, Energy and Transport, *Baku Initiative* (accessed March 24, 2009); available from http://ec.europa.eu/dgs/energy_transport/international/regional/caspian/energy_en.htm

Attention to trans-Caspian options revived since 2006 in response to Europe's energy concerns and the need for diversification of gas supply, following the Russia-Ukraine gas dispute. The new president of Turkmenistan demonstrated interest in trans-Caspian gas export as part of the strategic goal to multiply export routes. Azerbaijan and Turkey have also expressed support. Presently both the EU and the US conduct feasibility studies of trans-Caspian options.

SCP hopefully with Turkmen gas through trans-Caspian pipeline supposed to be linked to Nabucco which is the title of Verdi's opera composed in 1842. Its emotional "Chorus of the Hebrew Slaves" is said to have hardened the spirit of Italians to get rid of Austria's occupation. But by irony of history Nabucco Gas Pipeline International was initiated exactly by Austria's OMV Gas & Power, the country's largest industrial firm with commanding influence over Central and Southeastern Europe's oil and gas business. "Consortium partners (Nabucco) have a combined equity interest of 30 percent. This means that 70 percent of the project's well-over \$10 billion construction costs will have to be covered by subscriptions from the international capital market."¹

The Nabucco Pipeline Company, established in 2004, in addition to OMV has six equal shareholders, MOL (Hungary), Transgaz (Romania), Bulgargaz (Bulgaria), BOTAS (Turkey), and since February 2008 RWE (Germany). The pipeline has been designed to transport a maximum amount of 31 bcm/y. Following a development phase until the end of 2009, construction is envisaged in two stages from 2010, with the pipeline becoming operational in its first stage from 2013. The second stage, which will take the pipeline to full capacity, is expected to come on stream by 2019. To expand into

¹ Peter Pogany, "Budapest "Nabucco Summit" to turn pipedream into reality," *Energy Bulletin*, Published on 18 November 2008 (accessed March 20, 2009); available from <http://www.energybulletin.net/node/47243>

the second stage, it will be necessary to access new supplies. Azerbaijan, Egypt, Russia, Iran and even Iraq at a later point in time, as well as Turkmenistan and Kazakhstan are considered as potential supply sources for the pipeline.

The pipeline length is foreseen to reach approximately 3300 km, starting at Turkey through Azerbaijan-Georgia and/or through Turkmenistan-Iran with 2000 km crossing Turkey, and then Hungary, Bulgaria and Romania. The pipeline will end in Austria, whence gas will be entering the European grid to be further transported to the central and western European markets. An intergovernmental agreement between the five Nabucco countries is under negotiation (map 5).

Map 5. Nabucco Project



Nabucco project was the key subject of the Baku Energy Summit held in 14 November 2008 and attended by high-ranking officials from Azerbaijan, Bulgaria, Estonia, Georgia, Greece, Hungary, Italy, Kazakhstan, Latvia, Lithuania, Poland, Romania, Switzerland, Turkmenistan, Turkey, Ukraine, USA and European Commission. Russia was invited, but declined the offer, given that the summit was intended to look at energy supplies to Europe bypassing Russia.

This summit was held almost at the same time of the EU-Russia summit at Nice. Although the EU-Russia discussion was intended to re-affirm the role of Russian gas supplies to Europe, the Union's Energy Commissioner Andris Piebalgs was actually in Baku to push forward the Nabucco pipeline, which is supposed to be a major step in breaking Russia's domination of the European gas market.

The summit's main focus was to consider the ways to diversify the routes of oil and natural gas transportation from the Caspian basin to the global and European markets. The Summit Declaration underlined the importance of the Caspian region as one of the largest centers of production of the hydrocarbon resources and transportation of energy to international markets and representing the significant element in the system of the Euro-Asian Oil Transport Corridor. In the context of the diversification policy summit expressed support for transportation and transit of the Azerbaijani natural gas to the European markets. In this regard summit noted the positive experience of Baku-Tbilisi-Ceyhan, Baku-Novorossiysk, Baku-Supsa oil pipelines, Baku-Tbilisi-Erzurum and Turkey-Greece gas pipelines. Declaration endorsed the creation of the system on transportation of the Kazakhstan oil via Caspian Sea and the territory of Azerbaijan to the European and global markets. Interestingly enough there was just one loose reference to Nabucco among other projects. Participants agreed to continue the efforts for coordination of activities in realization of the joint projects directed to the strengthening of energy security of Europe, especially gas transit projects, including those across the territories of Georgia and Turkey, ITGI (Interconnector Turkey-Greece-Italy), Nabucco, and others.

But worrying was the fact that the declaration was not joined by Kazakhstan and Turkmenistan, whose input will be vital for Nabucco's feasibility. This fact, as well as

the absence of a clear commitment to Nabucco at the Baku summit is therefore disturbing for the feasibility of the project.

Nabucco summit meeting held in Budapest on 27 January 2009 didn't produce much answer either and brought little resolution to the problems that have overwhelmed the proposed pipeline since its initiation in 2002. Most participants at the meeting were seeking answers to two questions: whether there is money and whether there is a gas for the project?

Although some limited amounts of EU money were offered at the summit, a political consensus however remains elusive. The European Commission plans to spend around €3.5 billion (\$4.5 billion) on a wider energy package that also includes Nabucco. Commission energy spokesman Ferran Tarradellas made it quite clear the EU is planning to make no direct contributions to Nabucco, saying the money "is not to be given to Nabucco," but rather that it will "be given to the European Investment Bank to generate funds, to give loans to Nabucco afterwards."¹ The €3.5 billion still has yet to be approved by the European Parliament.

In order to attract loans for the pipeline, the European Commission will provide €250 million (\$323.7 million) to the European Investment Bank. Philipp Maystatt, president of the European Investment Bank, told the meeting his institution could underwrite about a quarter of the Nabucco's estimated €7.9 billion (\$10.2 billion) cost. Thomas Mirow, president of the European Bank for Reconstruction and Development,

¹ Ahto Lobjakas, "Despite Nabucco Funding Plan, EU's Intentions Remain Muddled," *Radio Free Europe/Radio Liberty* (accessed March 21, 2009); available from http://www.rferl.org/content/Despite_Nabucco_Funding_Plan_EUs_Intentions_Remain_Muddled_/1376046.html

said his bank was "ready to examine the case for a financial contribution to the pipeline."¹ The Nabucco consortium will still need to secure the remaining funding. The Reuters news agency cited the Philipp Maystatt, president of the European Investment Bank as saying the bank was ready to finance a "substantial share" of the project, but only if the project is viable. "We'll need more information to see if this project would meet the criteria for financing," he said.²

In addition to vague financial commitments meeting has suffered from political disagreements between the countries involved. At the summit, Hungarian Prime Minister Ferenc Gyurcsany called Nabucco "a strategic project crucial for the economic prosperity and political independence of the whole of Europe" and urged the EU to provide direct funding. Commission president José Manuel Barroso urged Europe to "learn the lessons of the recent gas crisis and invest heavily in energy." Nabucco is partially sidelined by Germany's support for the planned Nord Stream pipeline that would supply Russian gas directly to the country via the Baltic Sea. The proposed South Stream project linking Russia to South-East Europe by a pipeline through the Black Sea still garners support as well. Nord Stream and South Stream would be controlled by the Russian Gazprom.³

Turkey's position is also very important to the Nabucco project. The Turkish government has already asked for reduced rates on the gas that transits over its territory. Prime Minister Recep Tayyip Erdogan did not attend the Budapest summit, hinting that

¹ Pablo Gorondi, "Support grows for non-Russian gas pipeline," *International Herald Tribune*, January 27, 2009 (accessed March 20, 2009); available from

<http://www.ihf.com/articles/ap/2009/01/27/business/Europe-Pipeline-Summit.php>

² Bruce Pannier, "Nabucco Summits Opens Amid the Questions of Funding, Supply," *Radio Free Europe Radio Liberty* (accessed March 20, 2009); available from

http://www.rferl.org/content/Nabucco_Pipeline_Conference_Opens_Amid_Questions_Of_Funding_Supply/1375273.html

³ Peter Cassata, "Nabucco Summit Exposes Differences," *Atlantic Council of the United States* (accessed on March 20, 2009); available from

http://www.acus.org/new_atlanticist/nabucco-summit-exposes-differences

the EU needs to open the energy chapter of Turkey's EU accession talks before Turkish progress on Nabucco will be seen.¹

Nabucco will initially supply gas only from Azerbaijan, but other suppliers will be needed later because the nation on the southwestern Caspian Sea may not have enough gas reserves to justify the pipeline's financing costs, analysts and corporate officials involved in the project say.²

Azerbaijan has shown increasing interest in Nabucco. President I. Aliyev in Budapest summit clearly stated that Azerbaijan has always been supporting Nabucco project. As for Azerbaijan's participation in Nabucco project as a self-sufficient country it is not in need of financial support.³ Later I. Aliyev proposed that such projects as Nabucco, TGI (Turkey-Greece-Italy) and TAP (Trans Adriatic Pipeline) should be implemented regardless of gas volumes hinting to possible insufficiency of gas supplies at the initial stage. Referring to BTC he mentioned that BTC was operational in 2006, Kazakhstan oil however started to be transported in 2008 only.⁴

But Turkmenistan, which recently confirmed the presence of an enormous gas field (South Yolotan-Osman), has offered only vague commitments. Kazakhstan has rarely commented on being in Nabucco at all.⁵ Kazakhstan and Turkmenistan risk rebuke from Russia if they enter the project. A lack of European political unity, and the support

¹ Fulya Özerkan, "Erdoğan will not Attend Nabucco Pipeline Meeting," *Hürriyet Daily news.com* (accessed March 21, 2009); available from <http://www.hurriyet.com.tr/english/domestic/10818773.asp>

² Margit Feher, "EU to Support Nabucco pipeline," *WSJ*, 27 January 2009 (accessed March 21, 2009); available from <http://online.wsj.com/article/SB123310095047721959.html>

³ President of Azerbaijan, *Speech at the Summit on Nabucco Project on 27 January 2009* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20090129102004996&sec_id=11

⁴ Ibid., *Speech at the Forum of the Group of Mutual Business Relations on Azerbaijan, Davos, January 30, 2009* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20090204103907006&sec_id=11

⁵ Pannier.

that comes with it, may very well result in these countries being more hesitant about entering the Nabucco project.

4. Managing Energy Revenues

During the recent years about \$ 40 billion have been invested in Azerbaijan. Azerbaijan's financial reserves make up around \$ 20 billion, whilst state debt is roughly \$2,5 billion.¹ Several years to come will also produce huge oil and gas revenues for Azerbaijan. Hydrocarbon resources bring to Azerbaijan not only revenues, but challenges as well. Though Azerbaijan has long history of energy production, it has never owned and managed its income. Based on the experience of some other oil producing countries some authors cautioned that in those countries "energy revenues have not been used to build the foundations of economies with divers' types of production and sources of income..."²

Dutch disease, fiscal effects, income inequality are usually listed among major challenges the oil producing countries face. Dutch disease occurs when large inflows of oil revenues appreciates a country's exchange rate, causing a loss of competitiveness in the non-oil sector; and making economic policy management even more difficult.³

In 2003-2007 as a result of hydrocarbon production Azerbaijan's gross domestic product (GDP) increased significantly. So did the share of oil and gas sector in GDP. In 2007 more than half GDP came from oil and gas sector (table 8).⁴

¹ President of Azerbaijan, *Speech at the Forum of the Group of Mutual Business Relations on Azerbaijan, Davos, January 30, 2009* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20090204103907006&sec_id=11

² Michael Cohen, "The Effect of Oil Revenues on Transition Economics: The Case of Azerbaijan," *Geopolitics of Energy*, vol. 28, No. 6, June 2006, 13.

³ Ibid., 19.

⁴ International Monetary Fund, *Republic of Azerbaijan: Statistical Appendix, Published July 3, 2008*, IMF Country Report No. 08/216, p. 2-3 (accessed March 13, 2009); available from <http://www.imf.org/external/pubs/ft/scr/2008/cr08216.pdf>

Table 8. GDP and Share of Oil and Gas in GDP, 2003 – 2007

	2003	2004	2005	2006	2007
GDP at current market prices, mln. AzM	7,147	8,530	12,523	18,746	26,884
Real GDP % change	10.5	10.4	24.3	30.5	23.4
Oil and gas sector share, %	30.1	31.3	44.1	53.8	58.6

In order to manage vast revenues pursuant to the decree of the country's president of December 29, 1999 the State Oil Fund of the Republic of Azerbaijan (SOFAZ) was established. The Oil Fund is assigned to manage effectively oil revenues and to achieve the following objectives: (1) preservation of macroeconomic stability, ensuring fiscal-tax discipline, decreasing dependence on oil revenues and stimulating development of the non-oil sector; (2) accumulate and preserve oil revenues for future generations; (3) Financing major national scale projects to support socio-economic progress.

SOFAZ's activities are overseen by a Supervisory Board. The board reviews draft annual budget, annual report and financial statements along with auditor's opinion, and provide its comments. Members of the board are appointed by the president. In accordance with the presidential decree of November 27, 2008 prime-minister, vice-chairman of the parliament, president's economic advisor, ministers of finance and economic development, chairman of national bank and president of national academy were appointed as members of the board.

Executive director appointed by and accountable to the president is a chief executive officer. He represents the fund, manages daily business, disbursement of the assets of the fund in conformity with the rules and regulations approved by the president. Executive director is responsible for the preparation of the annual budget of SOFAZ,

incorporating an annual program of fund's assets utilization, and its submission for the approval of the president.

The Fund financed number of projects. In the years of 2001 – 2008 the Fund allocated AZM 523, 0 mln. for building housing and the improvement of socio-economic conditions of refugees and internally displaced persons who were forced to flee their native lands as a result of the Armenian-Azerbaijani conflict. Housing, social facilities and infrastructure were constructed for refugees and IDPs in 11 districts and 3 cities of Azerbaijan.

In accordance with presidential decree dated July 30, 2002 SOFAZ financed Azerbaijan's equity share in the BTC oil pipeline project and invested AZM 298 million.¹ In 2006 SOFAZ allocated AZM 427, 5 mln. to the construction of a water pipeline from Oghuz-Gabala region to Baku. The project is designed to provide 24 hours uninterrupted water supply to Baku city.²

In 2006 the State Oil Fund allocated AZN 90 mln. to form up the statutory capital of the Azerbaijan Investment Company established under the presidential decree dated March 30, 2006. The ultimate objective of the company's investment activity is to ensure long-term investment of resources by acquiring equity investments as well as shares in joint-stock companies and other commercial entities operating in the non-oil sectors of the country's economy. According to the Fund's philosophy the investment company's newly launched operations enabled environment for applying an advanced, state-of-the-art investment mechanism. Implementation of this new mechanism will enable the government, on one hand, to stimulate the operations of enterprises it will acquire equity

¹ State Oil Fund of the Republic of Azerbaijan, *Activities, Projects, Heydar Aliyev Baku-Tbilisi-Ceyhan Main Export Pipeline* (accessed February 22, 2009); available from <http://www.oilfund.az/en/content/10/95>

² Ibid., *Financing of the project of constructing a water pipeline from Oghuz-Gabala region to Baku city* (accessed February 22, 2009); available from <http://www.oilfund.az/en/content/10/84>

investments in, wherefore the investment policy designed to promote development of non-oil sectors will be perfectly realized, and, on the other hand, will preserve and maintain the proportionality and equitability between the public and private sector ownership. The company's equity and bond issuance activities will help promote the domestic securities market as well as support development of corporate governance forms. Dividends to be gained on the company's shares in enterprise equities will be transferable to the government that is the Oil Fund's account, which means an additional source of income and expanded resource base of the Fund.¹

Another project financed by the Oil Fund is "State Program on education of Azerbaijan youth abroad in the years 2007-2015" approved by the president on October 19, 2006. Implementation of the program is realized by the Ministry of Education of Azerbaijan. Supervision on execution of the program has been entrusted to the Commission on Education under the President of Azerbaijan. As of 31 December 2008, total AZM 3,11 million, including 2,3 million from SOFAZ and 0,81 million from Reserve Fond of the President of Azerbaijan were allocated for financing of this program and up to this date the number of students studying abroad under the State program is 164 persons.²

Baku-Tbilisi-Kars railway project is among important projects financed by the Oil Fund. Agreement "On Baku-Tbilisi-Kars New Railway", as well as some other related agreements between Azerbaijan, Georgia and Turkey was signed in Tbilisi on February 7, 2007. Total length of Kars-Akhalkalaki railway line is 105 kilometer. Construction of 76 km-long Kars and Akhalkalaki railway line running via Turkey will be implemented at

¹ State Oil Fund of the Republic of Azerbaijan, *Activities, Projects, Formation of the statutory capital of Azerbaijan Investment Company* (accessed February 22, 2009); available from <http://www.oilfund.az/en/content/10/82>

² Ibid., *Financing of the "State Program on education of Azerbaijan youth abroad in the years 2007-2015"* (accessed February 22, 2009); available from <http://www.oilfund.az/en/content/10/92>

the expense of Turkey. Rehabilitation – reconstruction of 29 km –long railway line from Kars to Akhalkalaki as well as 160 km long existing railway line of Akhalkalaki-Marabda section is financed by Azerbaijan in the amount of 200 million USD allocated for 25 years. Pursuant to Decree of President of Azerbaijan dated February 21, 2007 funding of “Baku-Tbilisi-Kars new railway line” project is assigned to State Oil Fund which allocated 88 682, 0 thousand manats.¹

Implementation of international project of Baku-Tbilisi-Kars railway line and construction of railway line tunnel in Bosphorus will connect Trans-European and Trans-Asian railway networks. Transportation of goods and passengers through the territories of Azerbaijan, Georgia and Turkey will increase the transit potential of these countries, accelerate the regional cooperation and integration into the European networks, and contribute to the European Neighborhood policy.

Azerbaijan’s long-term strategy on the management of oil and gas revenues for the period of 2005-2025 was released on 27 September 2004. President in his decree fixed annual limit for expenditures based on the ‘constant real expenditures’ principle. When income from oil and gas revenues peaks, at least 25 percent shall be saved. The strategy for use of revenues aimed at retaining macroeconomic stability, developing the non-oil sector and infrastructure, reducing poverty, developing “human capital”. The strategy also envisaged consolidation the defense capabilities of the country and reconstruction in the liberated territories to provide the return of internally displaced persons to their native

¹ State Oil Fund of the Republic of Azerbaijan, *Activities, Projects, Financing of “Baku-Tbilisi-Kars New Railway” Project* (accessed February 22, 2009); available from <http://www.oilfund.az/en/content/10/86>

lands.¹ Share of defense expenditures in GDP steadily increased from 1.9 percent in 2003 to 3.4 percent in 2006, but decreased to 3.0 percent in 2007.²

President I. Aliyev recently outlined the future plans to move forward country's economy. He proceeded from the clear understanding that at some point oil and gas will be exhausted. Government already takes this into account and will pay close attention to knowledge, technology and education which are the only means to promote economy and condition for success of developed countries. In 2009 the government plans to invest \$ 5 billion, in particular in renewable sources of energy. The government plans to utilize the potential of rivers and to build hydro plants on the artificial lakes. Information technology (IT) is another promising sphere and after energy sector it could be the leading sphere in the economy. Presently IT is increasingly applied in various spheres. To expand the use of IT government intends to allocate big investments in health and education. Creation of the space industry is also among the government's plans.³

In addition to social spending such as for refugees and water pipeline, Fund financed Azerbaijani share of BTC, Baku-Tbilisi-Kars railway line and education which should be considered as long and mid-term investments of strategic importance. As of January 1, 2009 Fund's assets are in the amount of 8 987 mln. manats (USD 11 219 mln.) Establishment of the Oil Fund, as well as government plans to invest in other sectors of economy or even establish new ones shows that Azerbaijan is aware of the possible challenges and problems and tries to deal with them. Fund is successfully deals with its

¹ State Oil Fund of the Republic of Azerbaijan, *Acts on Fund's activity, Long-term strategy on the management of oil and gas revenues* (accessed March 23, 2009); available from <http://www.oilfund.az/en/content/25/157>

² International Monetary Fund, *Republic of Azerbaijan: Statistical Appendix, Published July 3, 2008*, IMF Country Report No. 08/216, p. 15 (accessed March 13, 2009); available from <http://www.imf.org/external/pubs/ft/scr/2008/cr08216.pdf>

³ President of Azerbaijan, *Speech at the Forum of the Group of Mutual Business Relations on Azerbaijan, Davos, January 30, 2009* (accessed February 22, 2009); available from http://www.president.az/articles.php?item_id=20090204103907006&sec_id=11

objectives as preservation of macroeconomic stability; accumulation oil revenues; and financing national projects. On the other side, projects aimed at improving internal infrastructure, creating new spheres of industry could be expanded.

IMF highly appreciates Azerbaijan's reform efforts. IMF mission team which visited Azerbaijan on December 10-17, 2008 in its report stated "that recently implemented and planned structural reforms would help support non-oil activity in Azerbaijan. However, if the global recession turns out to be deeper and domestic non-oil growth decelerates quicker than expected during the first half of 2009, the mission believes that, in contrast to other countries in the region, the solid foreign asset position of Azerbaijan and the expected overall fiscal position provide sufficient room to withstand a possibly severe economic slowdown."¹

The key objective, as they were proclaimed, of Azerbaijan's energy policy is to provide prosperity of the people of Azerbaijan, to develop oil sector and other sectors of industry, as well as to attract investments. Last, but not least, cooperation with countries, as well as diversification of supplies and contribution to energy security was also among important objectives.

¹ International Monetary Fund, *Republic of Azerbaijan: December 16, 2008 – Azerbaijan: Aide Memoire for the 2008 IMF Staff Visit Discussions* (accessed March 13, 2009); available from <http://www.imf.org/external/np/ms/2008/121608b.htm>

V. Geopolitics of Energy

The present geopolitics of energy in the Caspian Sea revived the memories of ‘Great Game’ played in the remote and rarely accessible areas of Eurasia in the XIX century and reminded the studies of the political scientists in the turn of the XX century about geopolitical importance of the region. Many modern analysts and commentators think that “... the struggle in the Caspian was also about geopolitical power and national pride. Now that it had won the Cold War, Washington was determined to establish an American preserve in the region and dismantle the expansionist Russian empire for good. After the breakup of the Soviet Union, Russia was desperate to retain its old imperial influence. ... And so “pipeline politics” became modern-day version of the nineteenth century Great Game” which “was played once again across the harsh environs of the Caspian Sea.”¹

But commentators distinguish the differences in to-day’s Great Game, which are the spoils. Presently “the new Great Game focuses on the Caspian energy reserves, principally oil and gas.”² Other differences have also been acknowledged in Great Game: “Then there were two more-or-less equal contestants... In today’s game of Caspian energy there are many sovereign states ...and private interests.”³ Professor A. Hess looks at the issue in a much broader context. He argues “that this old-fashioned thinking does not adequately recognize the globalizing effects of post-World War II paradigm shifts; the industrial expansion of the 1970s, the information revolution, and the privatization of the world economy.” In the case of the Russia he rightly concludes that, “the Great Game explanation does not acknowledge the complexities of Russian pipeline policies, its

¹ Steve LeVine, *The Oil and the Glory. The Pursuit of Empire and Fortune on the Caspian Sea* (New York: Random House, 2007), xiv.

² Lutz Kleveman, *The New Great Game. Blood and Oil in Central Asia* (New York: Grove Press, 2003), 3.

³ Michael Mandelbaum, “The Caspian Region in the Twenty-first Century,” in *Energy and Conflict in Central Asia and the Caucasus*, ed. Robert Ebel and Rajan Menon (Lanham: Rowman & Littlefield Publishers, Inc., 2000), 23-24.

interaction with large and small international organizations, its penetration of markets on a global scale, and its acquisition of complex modern petroleum technologies.”¹ It is true that in the present Great Game there are more players and new players, and they are active rather passive. Russia remained the only actor played in old and new game. But there are also outside players. It is also true that prize is oil and gas, but in fact it is more than that, it is geopolitical domination.

1. The US stakes

After the dissolution of the Soviet Union the power vacuum emerged in the Inner Eurasia draw the attention of strategic analysts and planners who saw the stakes for the United States. Former State secretary H. Kissinger was credited for reviving the concept of geopolitics for the US strategy according to which “[t]he domination by a single power of either of Eurasia’s two principal spheres – Europe or Asia – remains a good definition of strategic danger for America... . For such a grouping would have the capacity to outstrip America economically and, in the end, militarily. That danger would have to be resisted even were the dominant power apparently benevolent....”²

Later former National security advisor Z. Brzezinski provided even more thorough explanation and proposed detailed and elaborate geostrategy. Acquaintance with his analysis confirms that he was inspired by H. Mackinder’s concept. After the World War II the next fifty years were dominated by bipolar American-Soviet contest for global supremacy, world’s leading maritime power, dominant over both the Atlantic and Pacific Oceans, against the world’s leading land power, paramount on the Eurasian heartland. After the defeat and collapse of the Soviet Union for the United States as the

¹ Andrew C. Hess, “Eurasia and Geopolitics of Gas,” *The Fletcher Forum of World Affairs*, vol. 32:1 (Winter 2008): 83-84.

² Henry Kissinger, *Diplomacy* (New York: Published by Simon & Schuster, 1994), 813.

first truly global power Eurasia become chief geopolitical prize. Eurasia retains its geopolitical importance: it is globe's largest continent and geopolitically axial; accommodates 75 percent of the world's population; contains most of the world's physical wealth; accounts about 60 percent of the world's known energy resources; is location of most of the world's politically assertive, economically dynamic and militarily powerful states (after the US the next six largest economies and the next six biggest military spenders); site all but one of the world's overt nuclear powers; place of the world's two most populous aspirants to regional hegemony and global influence. A power that dominates Eurasia would control two of the world's three most advanced and economically productive regions, which would almost automatically entail Africa's subordination, rendering the Western Hemisphere and Oceania geopolitically peripheral to the world's central continent. Eurasia is the center of the world and who controls Eurasia controls world. Eurasia is thus chessboard on which the struggle for global primacy continues to be played.¹ Finally in order to achieve two goals – averting global anarchy and impeding the emergence of a power rival Z. Brzezinski offers the following geostrategy for the US:

In the short run (the next five or so years), it is in America's interest to consolidate and perpetuate the prevailing geopolitical pluralism on the map of Eurasia. That puts a premium on maneuver and manipulation in order to prevent the emergence of a hostile coalition that could eventually seek to challenge America's primacy, not to mention the remote possibility of any one particular state seeking to do so. By the middle term (up to twenty or so years), the foregoing should gradually yield to a greater emphasis on the emergence of the increasingly important but strategically compatible partners who, prompted by American leadership, might help to

¹ Zbigniew Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives* (New York: BasicBooks, 1997), xiv, 1, 5-6, 30-31.

shape a more cooperative trans-Eurasian security system. Eventually, in the much longer run (beyond twenty years) still, the foregoing could phase into a global core of genuinely shaped political responsibility.¹

What role did Brzezinski assign for the Caspian Sea region in his strategy? To specify the US policy he divides Eurasian chessboard into four regional spaces and states into two groups based on their geostrategic capacity and geopolitical importance. Out of four spaces the south is a politically anarchic, but energy-rich region of potentially great importance to both the western and eastern Eurasian states, including to the southernmost area a highly populated aspirant to regional hegemony. If the middle space (Russia) can be drawn increasingly into the American predominant West (Europe), if the southern region (South Caucasus, Central Asia, Middle East, region stretching from Turkey up to India, this is almost Caspian Sea region) is not subjected to domination by a single power, and if the East (China, Japan, both Koreas) is not united, America can then be said to prevail.²

He identifies also two groups of states in Eurasia: active geostrategic players and geopolitical pivots. The former are the states that have the capacity and the national will to exercise power or influence beyond their borders in order to alter the existing geopolitical state of affairs. The latter are the states whose importance is derived not from their power and motivation but rather from their sensitive location and from consequences of their potentially vulnerable condition for the behavior of geostrategic players. According to Brzezinski protection of geopolitical pivots is a crucial aspect of America's global geostrategy.³

¹ Brzezinski, 198, 214.

² Ibid., 34-35.

³ Ibid., 40-41.

Among the core Caspian Sea states (based on our description) Azerbaijan is the only country named as playing “the role of critically important geopolitical pivots.”¹ Azerbaijan with its vast energy resources is the cork in the bottle containing the riches of the Caspian Sea basin and Central Asia. The independence of the Central Asian states can be rendered nearly meaningless if Azerbaijan becomes fully subordinated to Moscow’s control. An independent Azerbaijan, linked to Western markets by pipelines running through ethnically related and politically supportive Turkey that do not pass through Russian-controlled territory, also becomes a major avenue of access from the advanced and energy-consuming economies to the energy rich Central Asian republics. Yet Azerbaijan is very vulnerable to pressure from powerful Russia and Iran and has become the object of their pressures to restrict its dealings with the West.²

In addition to America’s goals and subjects Brzezinski identifies also the tools of the game played in the chessboard of Eurasia. Particular focus of the geopolitical contest is on access. Whoever either controls or dominates access to the region is the one most likely to win the geopolitical and economic prize. It is this consideration that has made the pipeline issue so central to the future of the Caspian Sea basin and Central Asia. If the main pipeline continues to pass through Russia to its Black Sea Novorossiysk port the region will remain politically dependant on Russia. If another pipeline crosses the Caspian Sea to Azerbaijan and thence to the Mediterranean through Turkey and if one more goes to the Arabian Sea through Afghanistan, no single power will have monopoly over access.³

¹ Brzezinski, 41.

² Ibid., 46-47, 129.

³ Ibid., 139-140.

Later we will come back to Brzezinski's conclusions while discussing Azerbaijan's policy options, dilemmas and choices. But what is essential is the importance of the region, including Azerbaijan's place, as well as US strategy there and role assigned by Brzezinski to Azerbaijan. Brzezinski also suggests establishing of trans-Eurasia security system based on political pluralism and responsibility, idea which seems remained unnoticed.

The US administrations shared the approaches identified above and followed the policy based on the appreciation of the importance of the region for US interests and security. The Clinton administration was very vocal in this regard. United States/European Union Joint Statement on Caspian Energy recognized the importance of Caspian Basin oil and gas resources in contributing to the economic prosperity, energy security, and stability of the region. These resources have been recognized as an important addition to world oil and gas supplies, and would require secure access routes to world markets. Essential to this development would be the early availability of multiple pipelines. Major export pipelines from the Caspian would accordingly contribute to the secure delivery of an important new source of world energy supplies. The United States strongly endorsed commercially and environmentally sound projects to develop Caspian energy resources and their transport to international markets. The United States underscored that the Caspian Pipeline Consortium project is a critical component of a commercially driven multiple pipeline system for the entire region. Commercial considerations will first and foremost determine decisions on the development of energy projects and export routes. They must also meet the highest environmental standards. The United States and the European Union welcomed the progress made by the littoral states

towards formulating legal regime for the Caspian that would enhance rapid developments of the region's energy resources.¹

Ambassador Richard Morningstar, Special Advisor to President Clinton for Caspian Basin Energy Diplomacy describing the U.S. energy policy toward the Caspian Basin identified four strategic objectives in the Caspian region that the US supported Caspian pipelines served: (1) Strengthening the independence and prosperity of the new Caspian states and encouraging political and economic reform; (2) Mitigating regional conflicts by building economic linkages between the new states of the region; (3) Enhancing commercial opportunities for U.S. and other companies; and (4) Bolstering the energy security of the U.S. and its allies and the energy independence of the Caspian region by ensuring the free flow of oil and gas to the world market. The fundamental objective of the U.S. policy in the Caspian was not simply to build oil and gas pipelines. Rather, it was to use those pipelines as tools for establishing a political and economic framework that will strengthen regional cooperation and stability and encourage reform for the next several decades.

Morningstar underlined Turkey's critical role in this effort, serving as the geographic, commercial, and cultural bridge between the Caspian region and Europe. Russia is also central to this vision. The US aimed to work with Russia as a partner in the development of Caspian energy resources. These strategic objectives explain the US endorsement of five particular pipelines to build cooperation with Russia and create a robust economic linkage between Central Asia, the Caucasus, and Turkey.

¹ The American Presidency Project, William J. Clinton, XLII President of the United States: 1993-2001, *United States/European Union Statement on Caspian Energy, May 18, 1998* (accessed March 22, 2009; available from <http://www.presidency.ucsb.edu/ws/index.php?pid=55986&st=Caspian&st1=>

In addition to its political support the U.S. Government played crucial role with respect to Caspian pipelines as a catalyst on financing through its trade finance and investment agencies. In May 1998 the US announced Caspian Sea Initiative, an unprecedented effort by the U.S. Government's three finance and investment agencies, the Trade and Development Agency (TDA), the Overseas Private Investment Corporation (OPIC), and EXIM Bank, to coordinate their efforts to promote investment in energy projects throughout the Caspian region. The U.S. therefore attempted to strike a balance between commercial and political objectives.¹

The US applied these principles vis-à-vis its policy towards Azerbaijan. During the meeting between the presidents Clinton and Aliyev held on August 1, 1997 in Washington president Clinton reaffirmed U.S. support for the independence, sovereignty, territorial integrity, and democratic development of Azerbaijan, noting that close U.S.-Azerbaijan relations are important in promoting regional peace, stability and prosperity. The two presidents noted the importance of rapid development of Caspian energy resources and welcomed the establishment of an official dialogue on energy policy. They also agreed on the vital importance of the Eurasian transport corridor to the economic future of Azerbaijan and the entire region.²

The Clinton administration policy was continued by Bush administration. On 16 May 2001 the National Energy Policy Report prepared by the National Energy Policy Development Group was submitted to president Bush. The members of this group

¹ Richard Morningstar, *Address to CERA Conference, Washington, DC, December 7, 1998* (accessed March 21, 2009); available from <http://www.mtholyoke.edu/acad/intrel/morning.htm>

² The American Presidency Project, William J. Clinton, XLII President of the United States: 1993-2001, *Joint Statement on Azerbaijan-United States Relations, August 1, 1997* (accessed March 22, 2009); available from <http://www.presidency.ucsb.edu/ws/index.php?pid=54495&st=Caspian&st1=>

included vice-president D. Cheney, state secretary C. Powell, energy secretary and many other prominent officials.

Though the report underlined the centrality of the Middle East oil producers to world oil security and the Gulf as a primary focus of U.S. energy policy, however in the context of encouraging greater diversity of oil production and transportation the report valued importance of the Caspian Sea as rapidly growing new area of supply that can lessen the impact of a supply disruption on the U.S. and world economies.¹

The group recommended to support the BTC oil pipeline and to export the Kazakhstani oil via the BTC pipeline. The group suggested to develop the Shah Daniz gas pipeline as a way to help Turkey and Georgia diversify their natural gas supplies and help Azerbaijan export its gas via a pipeline that will continue diversification of secure energy supply routes. Another recommendation given by the report was to encourage Greece and Turkey to link their gas pipeline systems to allow European consumers to diversify their gas supplies by purchasing Caspian gas. The group advised to deepen commercial dialogue with Kazakhstan, Azerbaijan, and other Caspian states to provide a strong, transparent, and stable business climate for energy and related infrastructure projects.² Critical point was that the group recommended the president to make energy security a priority of the US trade and foreign policy.³

Guided by the recommendations of the group the National Security Strategy of the USA suggested America to strengthen energy security by working with energy

¹ US Department of Energy, *National Energy Policy, Report of the National Energy Policy Development Group, May 2001*, p. 8-5 – 8-7 (accessed February 18, 2009); available from <http://www.ne.doe.gov/pdfFiles/nationalEnergyPolicy.pdf>

² Ibid., 8-13.

³ Ibid., 8-18.

producers to expand the sources and types of global energy supplied and the Caspian region was listed alongside with other regions.¹

During the review of implementation of the National Energy Policy Development Group's specific recommendations related to the Caspian Sea it was mentioned that OPIC has approved up to \$125 million in political risk insurance for the BTC project and the Export-Import Bank approved financing for up to \$160 million.² Among other activities National energy policy status report pointed out that the United States facilitated discussions between Azerbaijan and Kazakhstan to move Kazakh oil through the BTC system, encouraged Georgia, Azerbaijan and Turkey to ratify an agreement to construct "South Caucasus" gas pipeline³, and persuaded Greece and Turkey to sign an agreement in December 2003 to build a natural gas pipeline connecting the two countries.⁴

The strengthening of independence and sovereignty of the Caspian states, promoting regional co-operation, boosting commercial interests of the US companies, reinforcing the US energy security broadly understood should be viewed in a wider context of the America's international strategy "to promote a balance of power that favors freedom" by using its "unprecedented – and unequalled – strength and influence in the world."⁵

2. The Russian Interests

After the dissolution of the Soviet Union Russia embraced the concept of "Westernism" which implied that Russia is part of Europe and adhered to the European values of free

¹ *The National Security Strategy of the United States of America*, September 2002, 19-20.

² US Department of Energy, *National Energy Policy Status Report on Implementation of NEP Recommendations, Submitted by the US Department of Energy, January 2005*, p. 30 (accessed April 6, 2009); available from http://www.energy.gov/media/NEP_Implementation_Report.pdf

³ *Ibid.*, 31.

⁴ *Ibid.*, 32.

⁵ *The National Security Strategy of the United States of America*, 1.

market and democracy. The history of Russia is closely connected to that of Europe. In foreign policy it was assumed that Russia, provided that it accepts and applies the European values, would be included into the community of the European nations. This Western drive was associated with then foreign minister A. Kozyrev.

Rejection of CIS model by former Soviet republics, NATO enlargement, disagreements in the Balkans, involvement of the US and western oil companies in the Caspian, the US withdrawal from ABM treaty was viewed as encirclement, didn't meet the expectations and caused the review of the policy priorities. In 1996 the foreign policy under E. Primakov, orientalist by background took another course defined as "Asiatic" or "Oriental" as a doctrine, multi-polarity as a concept and multilateralism as a tool with the drive to the South and the East.

However, in both approaches the South Caucasus and Central Asia as a part of broader CIS or "Near Abroad" (as component of the West in the first doctrine and of the east in second doctrine) was among policy priorities. The Foreign Policy Concept of the Russian Federation adopted by president B. Yeltsin on April 23, 1993 underlined that "[t]he foundations are being laid for equal partnership with our neighbors and with the leading democratic and economically developed nations."¹ Though the concept emphasized that "building fundamentally new, equal, and mutually beneficial relations between Russia, CIS states, and other countries of the near abroad" is foreign policy priority,² however it did not separately mention the Caspian Sea, its status or energy issues.

¹ Andrei Melville and Tatiana Shackleina, ed., *Russian Foreign Policy. Concepts and Realities* (Budapest-New York: CEU Press, 2005), 28.

² Ibid., 32.

The status of the Caspian Sea did not appear until the contract of the century was signed in 1994. As the Russian foreign policy doctrine changed so did its Caspian strategy though regardless of the former. Russia was against any foreign involvement in the Caspian believing that this area is its sphere of interest and influence. Any foreign, especially the US investment in the region will produce economic interest which in turn will bring geopolitical engagement. The US presence in the region will oust or expel Russia from the region. Later acquisition by some Russian oil companies' shares in the Caspian projects, discovery and exploration of oil fields in its own section of the Caspian, participation in the transportation of the Caspian oil to world market and 1998 agreement with Kazakhstan were indications of the change of the Russian policy. In November 1998 Russia approved the final two right-of-way permits required to allow construction to begin on the Caspian Pipeline Consortium (CPC) pipeline. Prime Minister Primakov hosted a ceremony in Moscow on November 24, 1998 marking this event. During that ceremony, the prime minister hailed the CPC pipeline as a vehicle for deepening Russia's involvement on Caspian energy projects and providing jobs and revenues for Russian workers and companies.¹ Faced with the determination displayed first of all by Azerbaijan backed by the US, Russia had nothing but to adjust its policy.

The nomination of V. Putin as prime-minister in 1999 and his subsequent election as a president marks new era in Russian politics in general and energy politics in particular. It was during his office that Eurasianism started to gain ground. Eurasianism as an intellectual thinking and political doctrine emerged in 1921 among the Russian émigrés. By the end of World War II it became known in the USSR with Lev Gumilev as its major representative. In new Russia it became a major ideological concept of the

¹ Morningstar.

opposition to Yeltsin. In 2002 during V. Putin's presidency two Eurasian parties were established.

The Eurasianists proceed from the assumption that Russia-Eurasia is a distinct civilizational unit, different from both Asia and Europe. Eurasia includes Europe and good part of Asia proper. Some Eurasianists, such as Georgi Vernadski, regarded the Mongol drive to dominate the center of this geographic area as healthy urge.¹ L. Gumilev believed that the Tatar yoke was a military union of Russians (eastern Slavs to be precise) and Tatars against their enemies; he admired Chingiz Khan; similarity of interests of nomads and Russians; peaceful disposition of the nomadic people and rebuttal of the "black myth" about their aggressive and wild temper.²

In fact National Security Conception of the Russian Federation of 2000 proceeded from this approach and qualified "...other states' attempts to ...undermine its position in Europe, the Middle East, Transcaucasia, Central Asia, and the Asia-Pacific region" (these areas are nothing else but Eurasia) as "threats to the national security of the Russian Federation."³

The Concept of the Foreign Policy of the Russian Federation of 2000 was more specific regarding the CIS policy and the Caspian Sea basin first time appeared as a separate region. Russia sought to elaborate such status of the Caspian Sea which would allow littoral states to unfold mutually beneficial co-operation on the exploitation of the region's resources on the equitable basis taking into account the legitimate interests of each other.⁴

¹ Dmitry Shlapentokh, ed., *Russia between East and West, Scholarly Debates on Eurasianism*, (Leiden-Boston: Brill, 2007), 14.

² Ibid., 121.

³ Andrei Melville and Tatiana Shakleina, ed., *Russian Foreign Policy. Concepts and Realities* (Budapest-New York: CEU Press, 2005), 134.

⁴ Igor Ivanov, *Vneshnyaya Politika Rossii na Sovremennom Etape* (Moskva: MID RF, 2000), 51.

V. Putin redefined Russian national priorities in favor of internal social-economic and political modernization which only may lead to reemergence of Russia as great power. He was mainly preoccupied with the Russia's declining economy and lost superpower status. Putin's concerns date back to late 90s before he was appointed as prime-minister. In the dissertation submitted in June 1997 to the St. Petersburg Mining Institute and in a subsequent article "Mineral'no-syr'evye resursy v strategii razvitiia Rossiyskoi ekonomiki" published in *Zapiski Gornogo Instituta* in 1999 he outlined plan for Russia's recovery and return to economic and political influence. In his study Putin called on the Russian government to reassure its control over the country's abundant natural resources and raw materials. "The process of restructuring the national economy must have the goal of creating the most effective and competitive companies on both the domestic and world markets." He viewed this as probably the best way to reestablish Russia's status as a superpower, an energy superpower. Instead of allowing the country's oligarch-controlled corporations to focus exclusively on making a profit, Putin proposed that they should be used instead to advance the country's national interests. In Putin's words, "Regardless of who is the legal owner of the country's natural resources and in particular the mineral resources, the state has the right to regulate the process of their development and use. The state should act in the interest of society as a whole and of individual property owners...."¹

Putin was in full compliance with his vision and when he took the office in 2000 the state's share of total crude oil production was 16 percent; by late 2007, it had increased to about 50 percent.²

¹ Marshall Goldman, *Petrostate. Putin, Power, and the New Russia* (New York: Oxford, 2008), 97-98.

² Ibid., 99.

Presently Russia actively uses gas pipelines in pursuit of its energy policy. South Stream is advanced and promoted to counter Nabucco project. Nabucco is feasible if Kazakhstan and Turkmenistan join it and for that purpose a pipeline should be build under the Caspian Sea. Russia opposes the construction of any pipelines in the Caspian under the pretext that legal status of the Caspian Sea has not yet been determined. But real reason is that this pipeline would link Kazakhstan with Azerbaijan encouraging also Turkmenistan to join and connect all of them further with Turkey and Greece challenging thus Russia's backed Southern stream.

Putin rightly understood that country's energy resources are main assets to be used to regain economic revival and restore great power status. Under Yeltsin oligarchs and private companies used energy resources to advance their personal interests and profits, whereas Putin supporting privatization turned the whole enterprise to advance also government's interests. Russia learned the lessons on market economy and began using the rules of market economy with all power of the government. Russia started to employ economic tools or give preference to them instead of military (war with Georgia we will discuss in subsequent chapter) in a competitive market. But it brings into play economic tools not for economic purposes only but also for political and geopolitical ones.

3. Europe's Position

EU's first entanglement with the region dates back to 1993 when in order to use the its favorable geographic location for trade purposes the EU initiated TRACECA project dealing with transport. INOGATE was the next programme created in 1995. Programme's mandate is to support the development of energy co-operation between the European Union, the littoral states of the Black and Caspian Seas and their neighbouring

countries. The co-operation framework covers the areas of oil and gas, electricity, renewable energy and energy efficiency. INOGATE is also concerned with the broad energy security strategies of both the Partner Countries and the EU. INOGATE Programme used to stand for "Interstate Oil and Gas Transport to Europe". The enlargement of INOGATE's scope of activities was a two-year process that began on 13 November 2004 with an Energy Ministerial Conference held in Baku, known as the "Baku Initiative". On 30 November 2006, this initiative culminated in the signing of the Astana Energy Ministerial Declaration through which the INOGATE Programme's expanded scope and objectives were formally adopted by all the countries involved.¹ In 2004-2007 INOGATE realized number of logistical and feasibility projects and presently continues to implement others.

Presently Europe is very dependent on oil and gas imports, in particular from Russia and this dependency will increase. In the last ten years OECD Europe's reliance on Russian crude exports has grown from around 12 percent of total crude imports to around 29 percent in 2007. Russia exports crude oil via the Druzhba pipeline to Belarus, Ukraine, Germany, Poland, and other destinations in Central and Eastern Europe, including Hungary, Slovakia, and the Czech Republic. Another outlet is the Baltic Pipeline System (BPS) which came online in December 2001 carrying crude oil from Russia's West Siberian and Timan-Pechora oil provinces westward to the newly completed port of Primorsk near St. Petersburg in the Russian Gulf of Finland. The BPS gives Russia a direct outlet to northern European markets, allowing the country to reduce its dependence on transit routes through Estonia, Latvia, and Lithuania. Russia also exports oil through the Black Sea.

¹ INOGATE, (accessed April 7, 2009); available from http://www.inogate.org/inogate_programme/about_inogate/inogate-expanded-mandate

Europe dependence on gas is even greater. Russia almost became Europe's only gas supplier. Russian Gazprom has shifted much of its natural gas exports to serve the rising demand in countries of the EU, as well as Turkey. To this end the Yamal-Europe I pipeline, which carries natural gas from Russia to Poland and Germany via Belarus, would be expanded. Recently Russia significantly expanded its gas pipeline to Europe or plans to do so. One of them, northern pipeline extending over 2,000 miles from Russia to Finland and the United Kingdom via the Baltic Sea, was proposed in June 2003 by Russia and the UK, and was renamed Nord Stream by the stakeholders in 2006. About 700 miles of the pipeline will pass under the Baltic Sea. In November 2006, Gazprom (51 percent shareholder), and Germany's BASF and E.ON (24.5 percent each) submitted project information to Baltic Sea countries for the start of an environmental impact assessment. Another is the Blue Stream natural gas pipeline which connects the Russian system to Turkey through a 750-mile pipeline, 246 miles of which extends underneath the Black Sea. Natural gas began flowing through the pipeline in December 2002. In June of 2007 Italy's Eni and Gazprom signed a memorandum of understanding on a feasibility study for the underground and first component of the South Stream project. The first component of the South Stream project plans to send natural gas from the same starting point as the Blue Stream pipeline at Beregovaya for 560 miles under the Black Sea, achieving a maximum water depth of over 6,500 feet. The second, onshore component will cross Bulgaria with two alternatives: one directed towards the northwest, crossing Serbia and Hungary and linking with existing gas pipelines from Russia; and the other directed to the southwest through Greece and Albania, linking directly to the Italian

network. Russia and Bulgaria signed an intergovernmental agreement on the pipeline in January 2008. Gazprom expects the project to be completed in 2013.¹

In order to diversify supplies Europe is searching for alternatives and Nabucco is such an alternative. But there are number of questions. The strategic question is whether by implementing South Stream project Russia would have full access to the Caspian gas and be the only gas supplier to Europe or realization of Nabucco project would diversify Europe's supply.

Implementation of Nabucco project depends on a number of factors. To begin with, expectation is that Kazakh and Turkmen gas would be pumped in a Trans-Caspian Pipeline (TCP) across the Caspian Sea to Azerbaijan. But this pipeline is still need to be built. TCP makes the status of the Caspian Sea viable again. Its construction requires agreement between Azerbaijan and Turkmenistan on determination of a middle line dividing their national sectors in the Caspian. Russia and Iran oppose the construction of any pipelines in the Caspian under the pretext that legal status of the Caspian Sea has not yet been determined. Reason this position is that this pipeline would link Kazakhstan and Turkmenistan with Azerbaijan and further with Turkey challenging thus Russia's backed Southern Stream. Due to the Russian objection to TCP and very dependence on Russia it is not clear whether Kazakhstan and Turkmenistan would be willing to face Russian disapproval and resist possible pressure. Russia's position makes the likelihood of the construction of TCP pipeline uncertain.

There is no unified EU position on Nabucco; it is inconsistent and unreliable, partly because some influential EU members would rather engage Russia than exclude it. This approach prevents EU from committing financial resources to Nabucco. European

¹ Energy Information Agency, *Country Analysis Briefs, Russia, Last updated May, 2008* (accessed April 7, 2009); available from <http://www.eia.doe.gov/emeu/cabs/Russia/pdf.pdf>

position will be critical and unified unequivocal political and financial support for Nabucco may influence Kazakhstan and Turkmenistan decision. The US can also play its role in persuading Europeans and mediating Azerbaijani-Turkmen negotiations.

4. Iran's Ambitions

Iran from the outset rejected contract of the century and joined Russia in challenging Azerbaijan under the pretext of the non-resolution of the status of the Caspian Sea. Later obtained the share in Şah Dəniz field however did not change its position. Moreover, Iran threatened the use of force in 2001 against Azerbaijani vessel conducting research in the Azerbaijani sector of the Caspian. The reason for Iranian position is geopolitics: Iran is against American involvement in the Caspian which would strengthen Azerbaijani independence and fears 30 million Azerbaijani population residing in Iran. For that matter Iran favors Armenia in its conflict with Azerbaijan.

1996 Iran-Libya Sanctions imposed by the US prevented Iran from being considered among possible main pipeline options, although it is not clear whether Azerbaijan, who proceeded from economic profitability or rather from geopolitical considerations, would have been willing to opt for this alternative.

EU considers Iran as a potential supply source and transit country for Nabucco project. We already mentioned that Kazakhstan and specially Turkmenistan are also among possible suppliers. However for that matter the construction of TCP closely related to status of the Caspian Sea. Iran would prefer the construction of TCP not to happen rather transiting Turkmen gas through its own territory, thus becoming both transit and supply country. Although it is not clear whether this option may or may not incur disapproval in Washington. To which extend the new approach of the US

administration towards Iran which manifested itself in March 2009 talks with Iranians in Moscow will affect outcome is not clear.

Currently, alongside with Russia Iran also has shown willingness to use oil as a political tool. Iran has threatened the use of the oil weapon to retaliate against efforts to constrain its nuclear program. Russian relations with Iran complicate U.S. foreign policy efforts to stop Iran from developing nuclear weapons. China, with its rapidly growing dependence on foreign oil also blocks U.S. diplomatic initiatives in an effort to strengthen its own ties with oil exporters, including Iran. In addition Iran is observer in SCO and whether it will full-fledged member or not is not clear.

Conclusions

Today's interest in the Caspian Sea hydrocarbon resources is not novelty. The first interest was generated by the need in fuel on the part of the German army by the end of World War I on the one side, and exploiting it by V. Lenin towards his political ends on the other side. During the negotiations in Brest-Litovsk in early March 1918 V. Lenin in exchange for the cease-fire which would withdraw Soviet Russia from World War I among other things promised Germans Baku oil. Lenin's order was conveyed to Baku Commune backed by Armenian military units deserted from the Russian-Ottoman front which collapsed under the Ottomans offence, and joint Bolshevik/Menshevik/Eser militia of Baku Commune. These forces "liberated" Baku oil fields from "bourgeois exploiters" and while doing so they also murdered 30.000 "nationalists".

Interest in the Caspian, rather in Baku oil was renewed during the World War II. In early 1942 Nazi planners chose the Caucasus as a main battlefield for offence operations. The target was Baku with its oil fields. Only when the Nazi forces were stuck in the Caucasus, Stalingrad became the main front line in the fall of 1942 – winter of

1943. Capture of Baku would have allowed to cut Soviet Army's fuel supplies and to lead to ultimate fall of Stalingrad, strategically key city on Volga River, capitulation of which would have allowed the German army to move upstream the Volga River and strike Moscow from behind. Seizure of oil would have also let the Wehrmacht's highly motorized units to advance into the Middle East to deprive Britain from its colonies. Obviously Baku's strategic location and its hydrocarbon resources was recognized and played important role in Hitler's strategic calculations.

After the collapse of the Soviet Union the interest towards the region renewed. This interest coincided with the increased worldwide demand for energy. In forthcoming 20 years the US, OECD Europe, Japan, China and India' share expected to be almost about 60 percent of world consumption and most of the oil they need will have to be imported. More than 70 percent of the increase in oil demand will come from developing countries, particularly from China and India due to their fast economic growth. Though supply can still meet the demand, but oil supply is increasingly dominated by a small number of major producers, most of them in the Middle East which accounts for more than half of proved world oil reserves. Among the top 20 reserve holders, 11 are OPEC member countries that, together, account for 69 percent of the world's total reserves. Iran and Iraq have significant potential to expand their production, but Saudi Arabia remains by far the largest producer. The top 20 countries account for 90 percent of world gas reserves. Russia and Iran together boast more than 40 percent of world gas reserves. The oil industry needs investment a total of \$4.3 trillion (in year-2005 dollars) over the period of 2005-2030, or \$164 billion per year. A critical uncertainty is whether the substantial investments needed in the oil production sector in key Middle East countries will, in fact, be forthcoming.

The continued energy demand increase, location of energy in few, but large and mainly unstable regions, domination of small number of energy rich countries with unpredictable policies and individual agenda, necessity of transportation of energy exacerbated competition for energy and turned energy into a policy tool. This change has already been recognized by some commentators, in particular M. Klare comes to a very important conclusion that “[i]n the emerging international power system, we can expect the struggle over energy to override all other considerations, national leaders to go to extreme lengths to ensure energy sufficiency for their countries, and state authority over both domestic and foreign energy affairs to expand.” New system – Klare names it as a new international energy order – opens new chapter in the history of international politics, “one in which the pursuit and control of energy resources would be the central dynamic of world affairs, and governments – rather than private corporations in interests – would assume commanding roles.”¹

There are several points in Klare’s conclusion that has to be mentioned: (1) new international system is emerging; (2) this system is dominated and determined by energy; (3) governments rather than private corporations will play commanding roles. It is important to note that in the new system the force is not among major policy tools that can bring decisive result or success. After 9/11 there was impression that unchallenged military force can still be used to reach political ends. But that turned to be debatable.

General Charles Wald, the retired U.S. Air Force, former Deputy Commander, U.S. European Command and member of Energy Security Leadership Council in hearing before the US Senate Committee on Energy and Natural Resources on January 10, 2007 stated that due to successful fulfillment by the US armed forces of energy security

¹ Michael Klare, *Rising Powers, Shrinking Planet. The New Geopolitics of Energy* (New York: Metropolitan Books. Henry Holt and Company, 2008), 6-7.

mission many have come to believe that energy security can be achieved solely by military means. This paradigm has to be changed, because the U.S. military is not the best instrument for confronting all the strategic dangers emanating from oil dependence.¹

It was the US unparalleled military strength and most importantly its use without the Security Council authorization in 2003 against Iraq that may have provoked some states to search for other power tools alternatives. Energy situation provided such an opportunity. In an oil-dependent world facing increasingly tight supplies from unstable regions energy became powerful device.

Against this background the Caspian Sea region entered the world energy politics. Here there were all ingredients of perfect geopolitics: hydrocarbon resources, the land locked region, huge geography, need for transportation networks, demand, producers eager to export, consumers keen to import, influential powers competing for geopolitical influence.

The importance of the Caspian hydrocarbon reserves for the energy security lies not with the size of the reserves, though they are large enough, but with the fact that the Caspian energy lets firstly diversify the energy supply to world market, secondly, comes from investment friendly countries, thirdly, exported from countries capable and willing to diversify supplies, fourthly, comes from countries ready to invest in transportation with a view to diversify. But main significance is that Caspian hydrocarbons allow Russia, China and the USA to use geopolitics of energy as a part of a broader Eurasian geopolitics to ensure their domination and/or influence in Eurasia.

¹ Congress, Senate, Committee on Energy and Natural Resources, *Geopolitics of Oil: Hearing before the Committee on Energy and Natural Resources*, 110th Cong., 1st sess., to receive testimony on the geopolitics of oil and its implications for U.S. economic and national security, January 10, 2007, p. 33 (accessed March 16, 2009); available from http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_senate_hearings&docid=f:33869.pdf

The Caspian Sea region's geopolitical position is right in the middle of Eurasia and it borders Europe in the West (Turkey is here), Russia in the North, China in the East, and Middle East in the South (Iran is here). Although the US doesn't geographically border the Caspian Sea it is obviously one of the main players in the Caspian. The Caspian Sea region's neighbors constitute "geo", whereas the US represents "politics" and they all part of geopolitics in the region.

During the recent (we will go back to more remote history too) almost 200 years Russia was the only dominant power in the Caspian Sea. After the dissolution of the Soviet Union, Russia continued to view the Caspian Sea as sphere of its interest. Among other things this approach found its reflection in the "Near Abroad" concept. Emerged economically weak and politically not attractive Russia under the Yeltsin administration resorted mainly to military tools to keep former republics in check. This policy manifested itself in instigating conflicts and subsequently offering mediation to deploy peacekeeping forces and open military bases. The policy of pressure and confrontation continued after the contract of the century. But it was apparent that this policy was destined to fail. Co-operation with western companies continued, relations with the US became meaningful, decision on main pipeline (which was litmus paper) was taken.

At the end of 1990s Russia started to accommodate itself and joined the development of energy resources well underway by that time in the Caspian. The policy of accommodation under Putin's administration turned to policy of more energy co-operation under market terms rather than political confrontation. Tremendous change in Putin's policy was not that he altered the Russian objectives and ambitions; he somewhat even raised the bar, but instead of continued reliance on regional instability (conflicts already were in place with Russia as mediator) and political-military pressure (to

Georgian-Russian war we will still come back later) only he mainly started to resort to, or added to his policy apparatus new, economic and energy tools.

NATO enlargement squeezed Russia from the Eastern Europe. Having lost this part of Europe which is path to Europe for Russia it tries to equalize by asserting its influence and domination in the Caspian Sea energy and tries to return to Europe through gas pipelines. What powerful geopolitical tool energy may become.

The wider Caspian Sea region is one of the world's most energy-rich areas. According to BP's 2008 Statistical Review of World Energy, the five littoral countries and Uzbekistan hold roughly 21.4 percent of the world's proven oil reserves and 45 percent of the world's proven natural gas reserves.¹ Stakes are really high. Russia almost secured the Central Asian gas, became Europe's the only gas supplier and exports energy to China. In securing its influence in the Central Asia Russia expressed readiness to co-operate with China, in particular through the Shanghai Cooperation Organization (SCO) which was founded in Shanghai on 15 June 2001 by China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan (Annexes, Map 6). Its primary concern is security issues, but organization also deals with economic and cultural co-operation. History of this organization dates back to 1996 when Shanghai Five (without Uzbekistan) was created to protect borders from terrorist groups, drug smugglers, illicit arms trade and etc. Its member states cover an area of over 30 million km², or about three fifths of Eurasia, with a population of 1.455 billion, about a quarter of the world's total. The US request for membership was denied.

¹ BP Statistical Review of World Energy, June 2008 (accessed March 29, 2009); available from http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/downloads/pdf/statistical_review_of_world_energy_full_review_2008.pdf

SCO's 2005 Moscow Summit announced joint energy projects and the exploration of new hydrocarbon as priority. At the 2007 Summit V. Putin called for an "energy dialogue, integration of our national energy concepts, and the creation of an energy club", and member states agreed to establish a "unified energy market" for oil and gas exports, while also promoting regional development through preferential energy agreements.¹

Some experts are concerned that a potential SCO energy cartel would pose a significant threat, especially if Iran attained full membership. Though, the competing efforts of Russia and China to secure influence in the region seem to may have been a potential obstacle to extensive SCO energy cooperation. However, SCO appears managed to keep the US out of Central Asia. Russia views the U.S. financial and especially military presence in post-Soviet states with suspicion, while Beijing sees U.S. forces along its western border in Central Asia as part of Washington's strategy to contain China. The closure of the US air base in Uzbekistan in 2006 and February 2009 decision of Kyrgyzstan to close the US base in Manas were very welcome events for Russia and China.²

The consolidation of Russian, Central Asian and Chinese co-operation was acknowledged by Flynt Leverett, Senior Fellow and Director of Geopolitics of Energy Initiative of New America Foundation who described SCO as a "new axis of oil", bolstering Sino-Russian cooperation on a whole host of strategic issues and emerging as the principle counterweight to American hegemony in global affairs. As an example he mentioned that it has been quite successful over the last 2 to 3 years in essentially rolling

¹Eurasianet.org , *Central Asia: SCO Leaders Focus on Energy, Security and Co-operation, August 16, 2007* (accessed April 2, 2009); available from

<http://www.eurasianet.org/departments/insight/articles/pp081607.shtml>

² Elisabeth Bumiller and Ellen Barry, "Facing Loss of Crucial Air Base in Kyrgyzstan, U.S. Scrambles to Replace Conduit," *The New York Times*, February 5, 2009, A1, A12.

back the projection of U.S. influence into Central Asia following the September 11 terrorist attacks. Working together in the Shanghai Cooperation Organization, Russia and China have basically been able to lock the US out of Central Asia. Iranian nuclear issue was another example Leverett brought that the axis of oil is working against American influence.¹

Was establishment of Shanghai organization response to NATO enlargement from the Russian side? Was that Chinese attempt to oppose American policy of containing China? Was SCO a reply by both Russia and China to secure their interests in Central Asia from the American influence and counter the US in Eurasia altogether? What about the Central Asian? Central Asian countries have been cautioning about the threat of terrorism since the second half 1990s after Taliban came to power in Afghanistan, but instead they have been offered to tackle water resources management in Central Asia to use Middle Eastern example. Fight against terrorism after 9/11 was viewed in Central Asia as a chance finally to end terrorist intrusions. It was this context that the US obtained air bases. However, lack of tangible success in Afghanistan and the Russian pressure resulted in closure of the basis. Central Asian countries probably view the SCO as framework where Russia and China balance each other or/and they together set off the US. Until recently Heartland was not dominated by a single power and pluralism looks like the better option.

The United States entered the Caspian Sea region with aim to develop energy resources to provide business opportunities for American firms and energy security for the US and its allies. Investments and diversification policy served the purpose.

¹ Congress, Senate, Committee on Energy and Natural Resources, *Geopolitics of Oil: Hearing before the Committee on Energy and Natural Resources*, 110th Cong., 1st sess., to receive testimony on the geopolitics of oil and its implications for U.S. economic and national security, January 10, 2007, p. 40 (accessed March 16, 2009); available from http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_senate_hearings&docid=f:33869.pdf

Development of energy also strengthened countries' independence and sovereignty, stimulated region's economic growth and prosperity, bolstered economic and political reforms, energy security, regional co-operation and stability. By doing so the US was promoting wider agenda to secure its influence in the region to be stable, predictable, adhered to the principles of free market and democracy. The last proposition was exactly what Russia perceived as challenge to its influence and interest.

The Russian and American geopolitics of energy in the Caspian was part of their broader Eurasian agenda and geopolitics. Energy was the tool in pursuit of policy objectives. Though economic feasibility and financial attractiveness were important market rules, however both the US and Russia employed government influence and asserts to affect and determine the outcomes. Russian – US competition in the Caspian for resources and influence marked new stage in international relations dominated by energy.

It would probably fair to state that Azerbaijan caused the interest and to certain extend stimulated geopolitical contest in the Caspian without probably intending doing so. From the very beginning Azerbaijan faced the power of geopolitics and the first challenge to deal with was the status of the Caspian Sea. Unsettled status however did not prevent from development of hydrocarbon resources. Next step was to determine the route of main oil pipeline. Azerbaijan's strategic objective was to diversify its export routes in order not to be dependent on a single country and increase its options. In this Azerbaijan's interest coincided with that of the US, but contradicted to the Russian, as well as Iranian interest. Azerbaijan faced a dilemma and made a choice: oil will flow in two directions, to the North and to the West. Confronted with US sanction against Iran Azerbaijan however also accommodated Iran which gained shares in Şah Dəniz. Talks

between the US and Iran held in Moscow on March 28 under the auspices of the SCO¹ could mean reconciliation attempt hopefully not at the expense of the Iranian neighbors.

Exporting oil via Northern route to Russia and having completed two – oil and gas - pipelines connecting South Caucasus and Caspian Sea with the West through Turkey Azerbaijan shifted its focus to other gas pipeline projects, in particular to Nabucco to transport Caspian gas to Europe. This was new stage in Azerbaijan's geopolitics and marked another chapter in Azerbaijan's energy policy with the aim to diversify gas supplies. Azerbaijan entered the game with its own oil and gas deposits, transportation networks, investment potential and vision. It was already full-fledged player completely equipped.

Azerbaijan supported Nabucco, but the European, Iranian and Central Asian positions are a bit ambiguous. Notwithstanding this Azerbaijan is in a winning situation any way. Moscow in an attempt to boost South Stream offered last year to buy all Azerbaijani gas (designed for export to Europe) at market prices. Azerbaijan has options, though expressed its preference to Nabucco, to utilize this offer for other concessions or flexibilities from Russia. After all Azerbaijan in addition to South Caucasus Pipeline would gain additional route and diversify its exports. It looks like that by accepting this deal Azerbaijan clearly may be capable to kill Nabucco once and for all. Having succeeded in Central Asia Russia would gain upper hand also in the West of the Caspian. Given Europe's hesitation and Central Asia's reluctance Russia may become Europe's only supplier and complete its energy domination in the Caspian.

As we see Azerbaijan was not a passive actor in all these endeavors. Nonetheless this fact remained unnoticed in the literature. Independence regained in 1991 allowed to

¹ Christina Lamb, "US, Iran Officials Meet in Moscow," *The Australian*, March 30, 2009 (accessed March 29, 2009); available from <http://www.theaustralian.news.com.au/story/0,25197,25260110-2703,00.html>

conduct sovereign policy. However, it was exactly the policy of openness towards the West conducted firstly by Azerbaijan, which actually opened the Caspian Sea region for the West. Without that policy the West could have not been in the Caspian to utilize the advantages of the region on such issues as security, energy, revival of the Great Silk Road and fight against terrorism and the region would have not gained its present significance. Azerbaijan stood up to the pressure from two powerful littoral states on legal status issue and continued its co-operation with oil companies, as well as it was firm in its choice favoring the Western option for the main oil pipeline in addition to existing pipelines. Azerbaijan was subject to power politics when the Iranian battleship threatened to use a force against Azerbaijani boat conducting research in the Azerbaijani sector of the Caspian Sea on July 23, 2001. This was the first ever threat to use the force in the Caspian Sea. Azerbaijan literally brought Georgia and Kazakhstan to BTC project and extended the scope of cooperation to the Eastern Caspian.

As a result of energy policy Azerbaijan became regional leader and its capital city Baku turned into global city. S. Sassen explains that “[s]ince 1980s major transformations in the composition of the world economy ... have renewed the importance major cities as sites for producing strategic global inputs.” Sassen calls them “...*global cities*,...covering a broad variety of specialized roles in today’s global economy”. Some of these cities have been centers for world trade and banking. Others, Sassen continues are command points in the organization of the world economy, key locations and marketplace for the leading industry and major sites of production.¹ Baku with its world important oil and gas industry completely falls under this definition of global cities.

¹ Saskia Sassen, *Cities in a World Economy*, 3rd ed. (Thousand Oaks: Pine Forge Press, 2006), 7.

Azerbaijan in pursuit of energy policy proceeded from its own interests to develop country's economy, ensure well-being of people, to establish friendly relations with Neighbors and the Western countries. Azerbaijan tried to utilize its advantages. Azerbaijan's main tool was its energy resources, geographic location and strategic vision. Just quick look at the map reveals the simple but telling geostrategic truth; Azerbaijan is literally located at the crossroads. Azerbaijan's geographic position allows connecting Europe and Central Asia, as well as Eurasia and Middle East. Similarly Azerbaijan may separate these parts of Eurasia. Azerbaijan has always been supportive for diversification initially for its own sake, but over time for the Caspian and later Europe's energy security. Azerbaijan is also conduit for Central Asian energy and this enhances Central Asian options and security. In fact premise was that energy security of supplier meant also energy security of consumer. Azerbaijan's energy policy aimed at providing energy security is part of ensuring broader security, in fact its independence and survival. Azerbaijan is land locked hydrocarbon rich country with favorable geographic location literally sandwiched by two powerful states and surrounded by neighbors with some whom there are unsettled issues. This complex geopolitical surrounding posed challenges and dilemmas to Azerbaijan with difficult choices to make.

The key to the stability in and geopolitical future of the South Caucasus is the resolution of the conflicts in Georgia and the Armenian-Azerbaijani conflict. Neither Georgia nor Armenia and Azerbaijan are capable militarily or even politically resolve the conflicts alone. The US, as well as Russia is one of "friends of Georgia". They are also co-chairs of the OSCE Minsk group. Participation in either group did not lead to the settlement of the conflicts, which is considered in the region as blow to US credibility. Georgia and Azerbaijan in fact to certain extent sacrificed and made their secessionist

regions hostage in pursuit of their pro-western policy of openness and co-operation on variety of issues.

The US relations with Russia for the foreseeable future will remain the most difficult and challenging. Russia views US presence in the Caspian in addition to NATO enlargement as extension of sphere of American domination. Having accepted that Russia has lost its domination in Europe, and faced with tough and decisive US position in Europe Russia tries to assert its influence in Eurasia. More the US is pushing in Eastern Europe more Russia affirms in the Caspian Sea region. Russian military operation against Georgia in August 2008 and subsequent recognition of independence of South Osetia, as well as Abkhazia viewed by Russia as symmetric actions similar to those conducted by NATO in Bosnia in 1995 and in Kosovo in 1999 and recognition of Kosovo in 2008. Most importantly that was clear indication who is master in the region. The fact that Georgia was the subject of attack by its powerful neighbor was not the first one of this kind. The first incident occurred when Iran threatened the use of force against the Azerbaijani research vessel in the Caspian Sea in 2001.

The American reaction was very soft, as it is perceived in the region. The relations may cool only on the global items which are generally beyond the region's immediate concern. As far as the issues directly related to the region are concerned not much happens. On the one side, the US encourages Caspian Sea countries to diversify supply routes at the expense of their relations with Russia or even security, but on the other side, when it comes to counter Russia on energy or on separatist regions these countries face Russia alone. After the Russian operation in Georgia the pre-war status-quo was restored, it was exactly what Georgia desperately tried to change. NATO only

suspended the conduct of business as usual with Russia. As for Azerbaijan in 2001 the reaction was also very modest.

In the Caspian Sea region the US faces very difficult dilemma. The United States may have two geopolitical choices. First, the US may be tough with Russia; particularly this relates to conflicts in the South Caucasus. The Russian reaction would be more pressure and consequently more US-Russian tension. Question is whether this is priority given other engagements. Second, the US may continue the present policy of being engaged in the Caspian Sea region, but not to the extent that irritate Russia or pose threat to Russian geopolitical interests in the region as it perceives them. It looks like the second option is prevailing. President B. Obama of the US and president D. Medvedev of Russia in their first meeting in London on April 1, 2009 release joint statement which promised “fresh start in relations between our two nations” and expressed readiness to move beyond cold war mentalities.”¹

What are the geopolitical options for Caspian Sea countries? The most difficult choice is the Caspian Sea region’s geopolitical place, not least because its South Caucasus and Central Asian components have different geopolitical dilemmas, choices, and possible priorities. Central Asia is already part of SCO. South Caucasus is in much more ambiguous situation. CIS is not attractive, doesn’t work and in fact has almost been disabled. EU enlargement is stocked in “enlargement fatigue”. The Caspian ended up in the neighborhood. NATO enlargement among other things is subject to the Russian grievances and anxiety. For this reason is the US able to provide security guarantees? Is elaboration of its own identity and engagement in mutually reinforcing co-operation with all players what remains? Should the region be in European multilateral institution, stick

¹ Helene Cooper, “Promises of a “Fresh Start” For U.S.-Russia Relations,” *The New York Times*, April 2, 2009, A13.

to Eurasia employing bilateralism with Russia and multilateralism in CIS, prefer to bilateralism with the US or to choose mutually reinforcing options. Should the Caspian Sea region be under European/American domain, in Russian/Eurasian realm or be separate identity? Consolidation as states in the short-term, regional co-operation, elaboration of regional identity and equal, mutually beneficial co-operation with the US, Russia and China in the mid-term could be the option, while leaving the long-term alternatives open depending on the US assertiveness and Russian flexibility.

The Caspian Sea during the centuries was a part of Turkic/Mongol empires. D. Christian observed that “[t]he emergence of the first extensive steppe empires coincided with the first appearance of a flourishing trade route across inner Eurasia, dominated by the power of ... the pastoral nomadic Suing-nu (Huns). ...The Türk Empire of the sixth century CE created political links across Eurasia for a second time, while the Mongol empire of the thirteenth century created a third economic, cultural and epidemiological system embracing much of the Eurasian land mass. The exchanges made possible by the creation of the Mongol empire stimulated economic and cultural development throughout Eurasia, and may have contributed significantly to the rise of European capitalism.”¹

The fourth opportunity presents itself at the end of the XX century at a time of acute demand for energy. Azerbaijan having opted for openness, co-operation and multiplicity paved the way for connecting the Caspian to the West. Kazakhstan on the other side linked the Caspian with the East. The missing link in the chain is ironically the Caspian Sea itself. What is vital is to overcome tiny disagreements on the delimitation of the Caspian for the sake of bigger geopolitical gains. To complete the long chain from East to West, from China to Europe, to restore Great Silk Road in its new dimension

¹ David Christian, *A History of Russia, Central Asia and Mongolia*, vol. I, *Inner Eurasia from Prehistory to the Mongol Empire* (Singapore: Blackwell Publishing, 2006), 9.

“sons of the conquerors”, “descendants of the nomad armies who once conquered China and the Byzantine Empire” need to achieve political unanimity so that “Turkic regimes began adjusting their strategic balance towards powers like China, Europe and Russia” with the United States “setting the pace in the Turkic world” not to allow “a return to the old situation of one great power having exclusive control of Central Asia”.¹ This is their real chance for future of co-operation and partnership, true trans-Eurasian security, as oppose to rivalry in the Caspian Sea. The Caspian is pivot of Heartland. Who co-operates in the Caspian commands Eurasia.

¹ Hugh Pope, *Sons of the Conquerors. The Rise of the Turkic World* (New York-Woodstock-London: Overlook Duckworth, 2005), 383, 385.

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Map 1. Caspian Sea¹

¹ http://www.lindsayfincher.com/news/caspian_sea_map.png

Table 1. World Liquid Consumption by Region/Country, 2005 – 2030

(Million Barrels Oil Equivalent per Day)

Region / Country	2005	2010	2015	2020	2025	2030	Average Annual Percent Change
North America	25.2	25.3	26.2	26.7	27.2	28.0	0.4
United States	20.8	20.7	21.4	21.6	21.8	22.3	0.3
OECD Europe	15.5	15.4	15.9	16.0	16.0	16.0	0.1
OECD Asia	8.6	8.4	8.8	9.0	9.1	9.2	0.3
Japan	5.4	5.0	5.0	5.0	5.0	4.9	-0.4
South Korea	2.2	2.4	2.6	2.7	2.9	3.0	1.3
Non-OECD Europe and Eurasia	4.8	5.5	5.9	6.3	6.6	6.9	1.4
Russia	2.8	3.0	3.2	3.3	3.4	3.5	0.9
Non-OECD Asia	15.3	18.1	21.2	24.3	27.4	30.8	2.9
China	6.7	8.8	10.0	11.7	13.6	15.7	3.4
India	2.4	2.7	3.3	3.8	4.3	4.9	2.8
Middle East	5.9	6.8	7.5	8.2	8.9	9.5	2.0
Africa	2.9	3.4	3.7	4.0	4.1	4.3	1.6
Central & South America	5.5	6.3	6.6	7.0	7.3	7.8	1.4
Total World	83.6	89.2	95.7	101.3	106.5	112.5	1.2

**Table 2. World Total Liquid Fuels Production by
Region/Country, 2005 – 2030**
(Million Barrels Oil Equivalent per Day)

Region/ Country	2005	2010	2015	2020	2025	2030	Average Annual Percent Change
OPEC	36.1	37.4	40.9	44.4	46.7	49.3	1.3
Asia (Indonesia)	1.1	0.9	0.9	0.9	1.0	1.0	-0.7
Middle East	23.8	23.7	26.2	28.8	30.2	31.8	1.2
Non-OPEC	48.2	51.8	54.7	57.0	59.8	63.2	1.1
North America	15.1	16.2	17.0	17.2	17.7	18.0	0.7
United States	8.2	9.4	9.9	10.2	10.2	9.8	0.7
OECD Europe	5.9	4.5	3.9	3.5	3.4	3.4	-2.1
OECD Asia	0.7	0.8	0.8	0.8	0.9	0.9	0.8
Japan	0.1	0.1	0.1	0.2	0.2	0.2	1.4
South Korea	0.0	0.0	0.0	0.0	0.0	0.1	5.8
Non-OECD Europe & Eurasia	11.9	14.0	15.9	16.8	17.5	18.9	1.8
Russia	9.5	10.2	11.4	12.1	12.6	13.5	1.4
Caspian Area	2.1	3.5	4.2	4.5	4.7	5.1	3.6
Non-OECD Asia	6.5	6.9	7.1	7.4	7.6	7.7	0.7
China	3.7	3.8	3.9	4.0	4.0	4.1	0.4
India	0.8	1.1	1.1	1.2	1.4	1.3	1.8
Middle East	1.7	1.5	1.5	1.5	1.6	1.6	-0.2
Africa	2.6	3.0	3.3	3.7	4.1	4.5	2.3
Central & South America	3.8	4.9	5.2	6.0	7.0	8.2	3.1
World	84.3	89.2	95.7	101.3	106.5	112.5	1.2
OPEC Share	43%	42%	43%	44%	44%	44%	
Gulf Share	28%	27%	27%	28%	28%	28%	

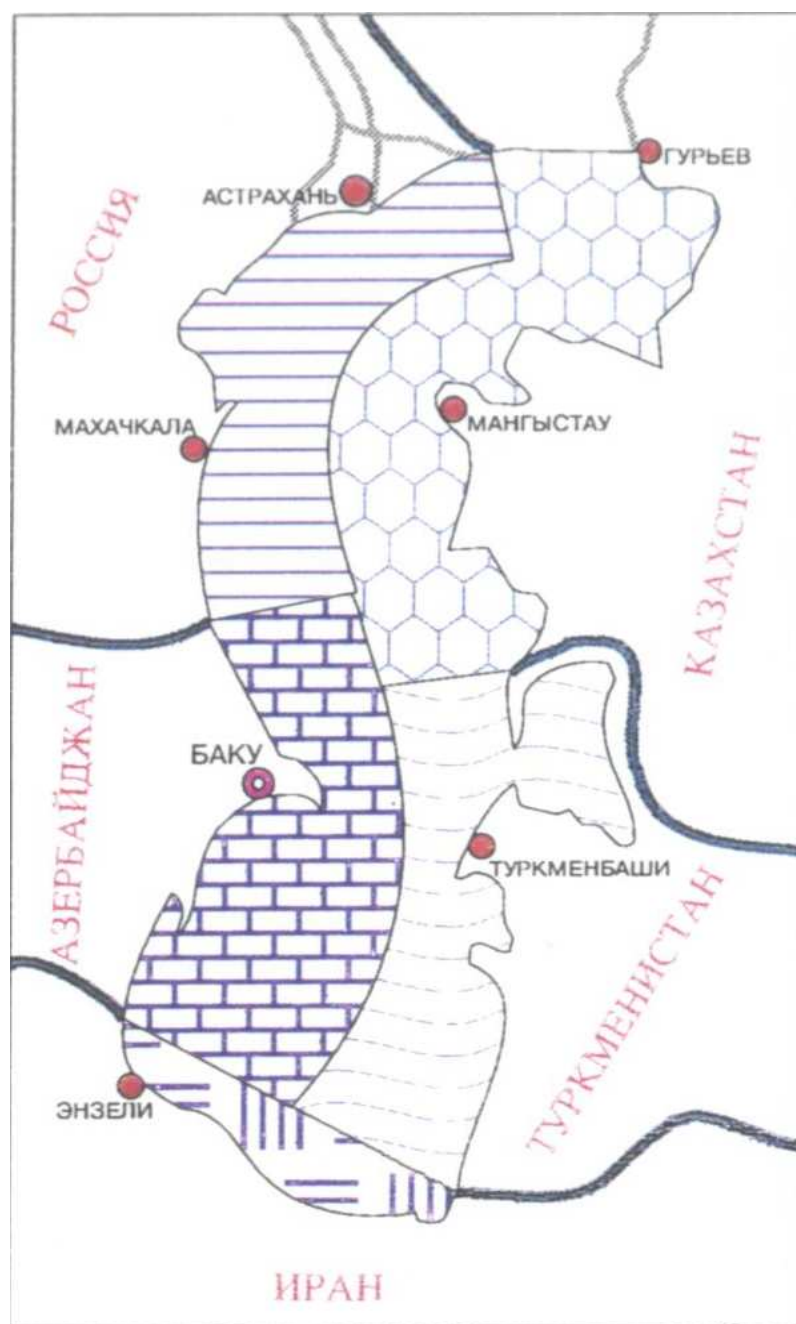
**Table 3. World Natural Gas Consumption by Region/Country
2005 – 2030**

(Trillion Cubic Feet)

Region/ Country	2005	2010	2015	2020	2025	2030	Average Annual Percent Change
North America	27.4	28.9	30.0	30.6	31.1	31.7	0.6
United States	22.2	23.2	23.7	23.3	23.0	22.7	0.1
OECD Europe	19.3	20.7	22.8	24.7	26.0	27.2	1.4
OECD Asia	5.2	5.8	6.4	6.6	6.9	7.0	1.2
Japan	3.1	3.3	3.5	3.6	3.7	3.7	0.7
South Korea	1.1	1.3	1.6	1.7	1.8	1.8	2.2
Non-OECD Europe & Eurasia	25.3	27.3	29.2	30.9	31.9	33.4	1.1
Russia	16.2	17.3	18.4	19.1	19.7	20.5	1.0
Non-OECD Asia	9.3	12.6	16.8	21.2	24.4	27.4	4.4
China	1.7	2.7	3.9	5.0	5.7	6.4	5.5
India	1.3	1.8	2.4	2.9	3.5	3.9	4.6
Middle East	9.8	11.2	12.8	14.2	14.9	15.7	1.9
Africa	3.0	3.6	4.5	5.6	6.3	7.0	3.5
Central & South America	4.4	5.6	6.7	7.4	8.1	8.7	2.8
World	103.7	115.	129.	141.1	149.5	158.0	1.7
		7	2				

Table 4. World Natural Gas Production by Region/Country, 2005 - 2030
(Trillion Cubic Feet)

Region / Country	2005	Projections					Average Annual
		2010	2015	2020	2025	2030	Percent Change
OECD	26,5	27,2	27,1	27,1	27,3	27,6	0,2
North America							
United States	18.4	19.4	19.6	19.8	19.7	19.5	0.2
OECD Europe	10,9	11,3	11,2	10,7	10,5	10,3	-0,3
OECD Asia	1,8	2,2	2,9	3,7	4,0	4,3	3,7
Japan	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total OECD	39,2	40,8	41,2	41,5	41,8	42,2	0,3
Non-OECD Europe & Eurasia	29,3	33,1	36,1	38,4	40,4	43,0	1,6
Russia	22.6	24.9	26.9	28.7	30.6	33.0	1.5
Non-OECD Asia	11,2	13,7	17,2	20,6	23,5	25,6	3,3
China	1.8	2.5	3.2	3.8	4.2	4.3	3.6
India	1.1	1.5	2.0	2.4	2.7	2.9	4.1
Middle East	11,2	14,6	16,9	19,3	20,7	22,5	2,8
Africa	6,1	7,9	10,7	13,5	14,8	15,8	3,9
Central & South America	4,9	6,2	7,3	7,9	8,8	9,5	2,7
Total Non-OECD	62,7	75,5	88,3	99,7	108,1	116,4	2,5
Total World	101,9	116,2	129,5	141,2	149,9	158,6	1,8

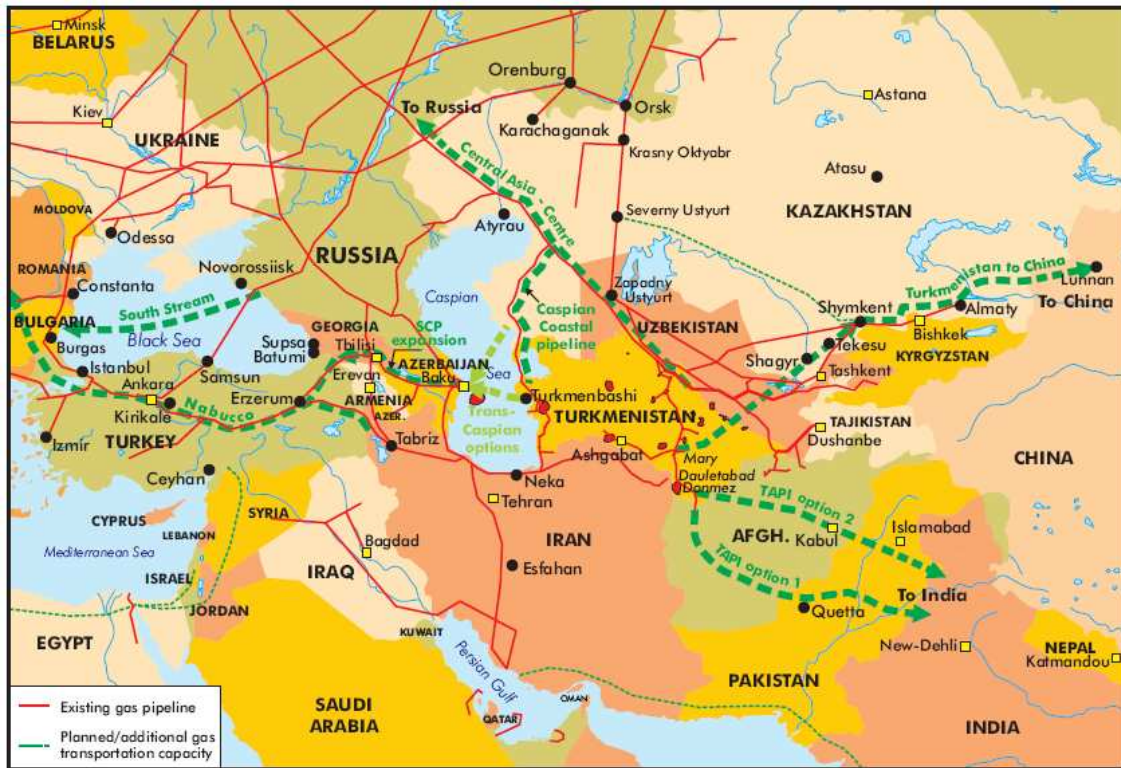
Map 2. Division of the Caspian Sea into the National Sectors

Map 3. Main Oil Transportation Routes in the Caspian¹



¹ International Energy Agency, *Perspectives on Caspian Oil and Gas Development*, December 2008 (accessed February 20, 2009); available from http://www.ica.org/textbase/papers/2008/caspian_perspectives.pdf

Map 4. Main Natural Gas Transportation Routes in the Caspian



Map 6. Shanghai Co-operation Organization**Members**

-  China
-  Kazakhstan
-  Kyrgyzstan
-  Russia
-  Tajikistan
-  Uzbekistan

Observers

-  India
-  Iran
-  Mongolia
-  Pakistan

Guest Attendance

-  Afghanistan
-  ASEAN
-  CIS

Abbreviations

ABM	Anti-Ballistic Missile
ACG	Azari, Chirag and Gunashli
AIOC	Azerbaijan International Operation Company
AZM	Azerbaijani Manat
Bbl/d	Billion Barrels per Day
Bcf	Billion Cubic Feet
BTC	Baku-Tbilisi-Ceyhan
BTE	Baku-Tbilisi-Erzurum
BP	British Petroleum
BPS	Baltic Pipeline System
CEDIGAZ	Centre International d'information sur le Gaz Naturel et tous Hydrocarbures Gazeux
CIS	Commonwealth of Independent States
CPS	Caspian Pipeline Consortium
EIA	Energy Information Administration
ESF	Energy Safety Forum
EU	European Union
GDP	Gross Domestic Product
IDP	Internally Displaced Persons
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas Transport to Europe
IT	Information Technology

IEO	International Energy Outlook
IEA	International Energy Agency
LNG	Liquid Natural Gas
NATO	North Atlantic Treaty Organization
Mbd	Million Barrels per Day
Mln	Million
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
OSCE	Organization for Security and Co-operation in Europe
SCP	South Caucasus Pipeline
SOCAR	State Oil Company of the Azerbaijan Republic
SOFAZ	State Oil Fund of the Republic of Azerbaijan
TAP	Trans Adriatic Pipeline
Tcf	Trillion Cubic Feet
TCP	Trans-Caspian Pipeline
TGI	Turkey-Greece-Italy
TDA	Trade and Development Agency
TRACECA	Transport Corridor Europe Caucasus Asia
SCO	Shanghai Co-operation Organization
UN	United Nations
UNECE	United Nations Economic Commission for Europe
USSR	Union of Soviet Socialist Republics

